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Business and Enterprise Committee

The Insolvency Service

Sixth Report of Session 2008–09

Report, together with formal minutes, oral and written evidence

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The Business & Enterprise Committee

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Contents

Report

Page

Summary 3

1 Introduction 5

2 The Insolvency Service 6

3 Confidence in the Insolvency Regime 10

Pre-pack administrations 10

Insolvency practitioners fees 14

4 Funding arrangements 16

Redundancy payments 17

Investigation and enforcement 18

Future funding 20

5 Regulation 22

6 Conclusion 24

Conclusions and recommendations 25

Appendix: Funding arrangements 28

Formal Minutes 29

Witnesses 30

List of written evidence 30

List of Reports from the Committee during the current Parliament 31

Summary

Throughout this year our focus has been on the challenges facing businesses and individuals caused by the economic downturn. Each year we examine one of the Department's agencies; this year we decided it would be timely to look at the Insolvency Service; rarely in its history has there been a greater need for its functions to be performed with efficiency and effectiveness.

We commend the Insolvency Service and its staff for the generally effective and efficient way in which its functions are discharged. We urge, however, a redoubling of efforts to ensure that high levels of service are maintained throughout the economic downturn. This must include action to address concerns about the insolvency regime that have been raised during this inquiry.

In particular, public confidence in the insolvency regime will be damaged unless prompt, robust and effective action is taken to ensure that pre-pack administrations (when a company's business and assets are sold on terms that were negotiated between the buyer and the administrator before the company formally entered administration) are transparent and free from abuse. Unsecured creditors tend to be kept in the dark and recover even less than they would in a normal administration. This causes particular outrage where the existing management buy back the business and continue to trade clear of the original debts ("Phoenix pre-packs"). Pre-packs of this kind fuel understandable concerns about illegitimate, self-serving alliances between directors and insolvency practitioners. The interests of unsecured trade creditors must take a higher priority, especially in "phoenix" pre-pack administrations. The insolvency system, the Insolvency Service and the insolvency profession all risk real reputational damage if the situation is not addressed. More worryingly, many SMEs appear to be suffering unreasonable financial harm with no corresponding benefits to the wider economy. Where there are good reasons for an insolvency practitioner agreeing to a pre-pack, which there can often be, this must be explained clearly and fully. Where there are no good reasons for entering a pre-pack, this must be exposed before the damage is done.

In view of this, we welcome the introduction of the new practice statement, Statement of Insolvency Practice 16, which aims to increase the transparency of pre-packs. We also welcome the Insolvency Service's commitment to monitor its implementation. This is a responsible first step, but the recession makes this a matter of considerable urgency. There must be systematic monitoring of the situation by the Insolvency Service and the Department. If the new practice statement does not prove effective then it will be necessary to take more radical action, possibly by giving stronger powers to the creditors or the court.

In the meantime, we encourage anyone who suspects the abuse of pre-packs to contact either the Insolvency Service or the body that licenses the insolvency practitioner concerned. We also encourage large creditors, particularly Her Majesty's Revenue and Customs, to take an active role in rooting out abuse.

It may be inevitable that insolvency practitioners' remuneration is perceived as unduly

high by many creditors. There must, however, be sufficient opportunity and information to allow creditors to ensure that fees are reduced where that perception is justified. We therefore welcome the Insolvency Service's commitment to monitor whether insolvency practitioners are complying with the current practice statement governing the approval of their fees. We urge the Insolvency Service to make its findings publicly available. We also urge the Government to respond to these findings and to consider the case for strengthening control of insolvency practitioners remuneration beyond the limited powers currently exercised by creditors.

More generally, the Department for Business, Enterprise and Regulatory Reform must work with the Insolvency Service to ensure that its funding arrangements are sufficiently robust to handle the very high levels of insolvency that are almost inevitable at a time of steep economic decline. Appropriate funding is needed to ensure that we all benefit from a world-leading insolvency regime, both now and in the future. In particular, the Department for Business, Enterprise and Regulatory Reform must provide the Service with sufficient funding to meet any increase in demand for its investigation and enforcement activities, and to ensure those activities are effectively publicised. We recognise the heavy demands on public expenditure, but maintaining confidence in the market is a central task of the Department and, in the light of regulatory failures elsewhere, we are surprised by the lack of commitment shown by the Department in this crucial area. The sums involved are, after all, very modest.

1 Introduction

1. Each year we conduct an inquiry into one of the executive agencies and associated public bodies of the Department for Business, Enterprise and Regulatory Reform (BERR). Throughout this year our focus has been on the challenges facing businesses and individuals caused by the economic downturn. There has been an alarming increase in the number of companies entering liquidation and unprecedented numbers of people are being made bankrupt.[1] In light of this we decided to review the work of the Insolvency Service; rarely in its history has there been a greater need for its functions to be performed with efficiency and effectiveness.

2. We decided to hold an oral evidence session with the Insolvency Service and in preparation we invited interested parties to submit written evidence on the way in which it is performing its duties. We are grateful to all those who took the time to respond by offering us the benefit of their detailed and thoughtful comments. We are also grateful to Mr Stephen Speed, Inspector General and Agency Chief Executive at the Insolvency Service together with his deputy, Mr Grahame Horne, for giving oral evidence and responding to our further inquiries.

1 Insolvency statistics for the third and fourth quarters of 2008, available at http://www.insolvency.gov.uk/otherinformation/statistics/insolv.htm

2 The Insolvency Service

3. The Insolvency Service is an executive agency of BERR which employs around 3,000 people and has an annual turnover of approximately £200 million, primarily funded by fees for its services. It describes its core functions as to:

- administer and investigate the affairs of bankrupts, of companies and partnerships wound up by the court, and establish why they became insolvent;
- act as trustee/liquidator where no private sector insolvency practitioner is appointed;
- act as nominee and supervisor in fast-track individual voluntary arrangements;
- take forward reports of bankrupts' and directors' misconduct;
- deal with the disqualification of unfit directors in all corporate failures;
- deal with bankruptcy restrictions orders and undertakings;
- authorise and regulate the insolvency profession;
- assess and pay statutory entitlement to redundancy payments when an employer cannot or will not pay its employees;
- provide banking and investment services for bankruptcy and liquidation estate funds;
- advise BERR ministers and other government departments and agencies on insolvency, redundancy and related issues;
- provide information to the public on insolvency and redundancy matters via our website, leaflets, Insolvency Enquiry Line and Redundancy Payments Helpline; and
- conduct confidential fact-finding investigations into companies where it is in the public interest to do so. These enquiries are carried out by Companies Investigation Branch.

4. An individual who is insolvent can be made bankrupt either on their own petition or on the petition of a creditor. The individual will then ordinarily be discharged from bankruptcy, and clear of their debts, after a period of one year. As an alternative to bankruptcy, a debtor can enter an individual voluntary arrangement (IVA), which in broad terms releases the individual from their debts provided its terms are approved by a specified majority of creditors and then implemented. This routinely involves the individual making a fixed number of payments from their income. Debt Relief Orders will also be available from April 2009 for individuals with few assets, a low income and unsecured debts of less than £15,000. This will give the Official Receiver, who is employed

by the Insolvency Service, a new power to sanction a debt relief scheme without the need for creditor or court approval.

5. A company struggling to pay its debts may be able to enter administration. Where this happens control over the company passes from its directors to an insolvency practitioner, known as an administrator. The administrator must act according to the statutory purposes set out in the Insolvency Act 1986 including, where possible, to rescue the company as a going concern. Alternatively a company can enter a company voluntary arrangement (CVA) or a scheme of arrangement, which are also aimed at achieving a rescue. Where this is not possible or appropriate, a company can enter liquidation (either voluntarily or compulsorily by court order) during which its assets will be realised and the net proceeds (if any) distributed to its creditors. The company will then be dissolved.

6. The UK was recently rated as joint eighth out of 155 countries for the speed with which it deals with troubled businesses and ninth out of 155 countries for the amount recovered for creditors.[2] The Service is justifiably proud of this achievement. It continues to press for changes to the insolvency regime in England and Wales. This includes a long planned reform of the insolvency rules and two Legislative Reform Orders addressing matters such as the advertising regime applicable to certain types of liquidation and the removal of unnecessary requirements to report to court.

7. We have received positive feedback about the overall performance of the Insolvency Service. For instance, the Institute of Chartered Accountants stated that it generally "carries out its functions efficiently and with expertise and professionalism."[3] The Insolvency Practitioners Association noted that it has effectively managed fluctuating levels of insolvency cases in recent years, while the body that represents the majority of insolvency practitioners, R3, formally known as the Association of Business Recovery Professionals, stated: "the Insolvency Service provides a valuable service to the UK. The professionalism and commitment of the staff and its management in discharging their obligations should be recognised."[4]

8. The Insolvency Service achieved nearly all of the targets set by the Secretary of State for 2007–08 (see below).[5] A notable exception concerned the failure to increase the number of successful enforcement proceedings relating to misconduct by directors and others. This followed cuts to the funding provided by BERR to the Service in the previous year, 2006–07.[6] We return to this issue, below.

2 The World Bank, *Doing Business Report 2009,* available at http://www.doingbusiness.org/

3 Ev 46, para 6 (The Institute of Chartered Accountants in England and Wales)

4 Ev 36, para 1 (Insolvency Practioners Association); Ev 27, summary (Association of Business Recovery Professionals)

5 Annual Report 2007-08, 28 July 2008, page 7, available at http://www.official-documents.gov.uk/document/hc0708/hc08/0800/0800.asp

6 Ev 21, para 38 (The Insolvency Service)

2007–08 Published Targets	Achieved
Maintain satisfaction levels of bankrupts and directors at 91%	92.1%
Increase satisfaction level of insolvent creditors to 84%	80.3%
Increase the level of public confidence in The Service's enforcement regime to 65%	65.3%
Reduce the average time from insolvency order to the instigation of disqualification proceedings in appropriate cases to 22 months	18.5 months
Increase the quantity of enforcement outputs in 2007-08 from 2006-07 baseline of 7%	0.1%
Complete consideration of 90% of vetting complaints cases within 2 months	92.6%
Complete 90% of internal section 447 investigations within 6 months	95.7%
Action redundancy payment claims 78% within 3 weeks 92% within 6 weeks	 78.7% 93.7
Maintain the cost of redundancy payment processing at the 2006-07 baseline	96.6% of 2006-07 costs
Increase the satisfaction levels of redundant employees to 78%	75.2%

Source: The Insolvency Service Annual Report and Accounts 2007–08, Table 1, p7

9. The recession may have a significant impact on the work of the Insolvency Service. For instance, the Service's Corporate Plan for 2008–11 accepts that uncertainties about the volume of insolvencies poses a "big challenge" and that maintaining current levels of performance will be difficult.[7] In particular, the Service has recently had to increase its estimate of the cases that it expects to administer this year by an additional 5.5%, while the number of redundancy payments that it will be required to process is expected to more than double compared to last year.[8] The demand for investigations into misconduct by directors and others is also expected to rise.[9]

10. While the Service considers that it is well placed to handle these challenges, a number of discrete concerns have been raised in relation to the insolvency regime. These include widespread fears about the abuse of pre-pack administrations, misgivings about the Insolvency Service's powers and role as regulator of the insolvency profession, and ongoing doubts about its funding arrangements, particularly in relation to its investigation and enforcement activities.

11. **We commend the Insolvency Service and its staff for the generally effective and efficient way in which its functions are discharged. We urge, however, a redoubling of efforts to ensure that high levels of service are maintained throughout the economic**

7 The Insolvency Service, Corporate Plan 2008-11, pp3 to 4, available at http://www.insolvency.gov.uk/aboutus/CorporatePlan.pdf

8 Q31 (Mr Speed); Q41 (Mr Horne)

9 Ev 17, para 9 (The Insolvency Service)

downturn. This must include action to address concerns about the insolvency regime that have been raised during this inquiry.

3 Confidence in the Insolvency Regime

Pre-pack administrations

12. Administration has become the main insolvency procedure aimed at rescuing a company's business. During an administration the company is controlled by a private sector insolvency practitioner, known as the administrator, whose powers and responsibilities are set out in the Insolvency Act 1986, Schedule B1. A pre-pack administration describes the situation where a company's business and assets are sold on terms that were negotiated between the buyer and the administrator before the company formally entered administration. The sale is often then carried out privately and rapidly by the administrator with limited disclosure or control available to creditors. Pre-packs are not new and have been used commonly where commercial pressures require urgent action in order to save the value of a company's business.[10] There is, however, a growing body of evidence that the number of pre-packs has increased since the Enterprise Act 2002 made it simpler for companies to enter administration.[11] Recent high profile examples include the sale of The Officers Club, Whittard of Chelsea, and MFI.

13. There is controversy over the balance between the benefits and the drawbacks of pre-packs, including their susceptibility to abuse. While research is still continuing, the Insolvency Service states that: "A pre-pack may offer the best chance for a business rescue, preserve goodwill and employment, maximise realisations and generally speed up the insolvency process."[12] This view is shared by many other witnesses, including the Recognised Public Bodies (RPBs) that license insolvency practitioners and even some of those who have lost money as creditors of a failed business.[13] For instance, R3 state that pre-packs are a frequently misunderstood tool and their potential benefits must not be "lost in the debate over their perceived impact on creditors".[14]

14. We accept the logic that more value will be recovered from the sale of a company's business and assets where it continues to trade than where it is broken up. Research by academics such as Dr Sandra Frisby of the University of Nottingham indicates that secured creditors do particularly well, recovering an average of 42% of debts as part of a pre-pack compared to 28% in a business sale.[15] Although a full understanding of pre-packs is some time away, early signs also indicate that higher numbers of staff are transferred to the new

10 Association of Business Recovery Professionals, Pre-packaged sales briefing notes, available at https://www.r3.org.uk/uploads/documents/Pre-packs%20briefing.pdf

11 Ibid

12 Enterprise Act 2002 – Corporate Insolvency Provisions: Evaluation Report, January 2008, at p147, available at http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/EA02CorporateInsolvencyReport.pdf (hereafter referred to as"Evaluation Report")

13 Further information on RPB's is available at Ev 19, paras 22 to 23 (The Insolvency Service)

14 Association of Business Recovery Professionals, Pre-packaged sales briefing notes, available at https://www.r3.org.uk/uploads/documents/Pre-packs%20briefing.pdf

15 Ibid

company than would happen otherwise.[16] This appears to be especially true in the case of larger pre-packs resulting from negotiated agreements with creditors.

15. There is, however, evidence that unsecured creditors fare worse during a pre-pack, recovering 1% of their debts on average compared to 3% as part of a standard business sale.[17] Moreover, there are suggestions that pre-pack administrations adversely affect competitors, who will continue to carry costs which the phoenix company has shed.[18] **Criticisms of pre-packs are at their sharpest where existing management buy back the business following private negotiations with an insolvency practitioner and then continue to trade clear of the original debts through a new "phoenix" company. This means that unsecured creditors are initially kept in the dark and then left empty handed. The phoenix company may also have some advantage over competitors who honour their financial obligations. The anecdotal evidence in media reports and confidential letters to the Committee suggest that "phoenix" pre-packs affecting smaller companies with high levels of unsecured trade creditors cause particular concern and are more likely to damage the supplier base without corresponding broader benefits to the overall economy.**

16. The views of many unsecured creditors are reflected by one individual who stated: "Of course it is good news that many jobs have been saved but it seems to be at our expense. We are unable to borrow on those bad debts so are facing grave difficulties in trading as a direct result of the rescue of our client company… this pirate's charter will surely make this particular downturn even more painful for the small business".[19] John Moulton, the head of a private equity firm, Alchemy Partners, is also reported as saying "Pre-packs could be very easily abused. Bad management can plan for a pre-pack months in advance, line up an administrator — and then be back running the business immediately."[20] The Association of British Insurers is particularly concerned that a lack of transparency and notification to unsecured creditors is causing an increasingly serious problem for both small and medium-sized enterprises (SMEs) and credit insurers.[21]

17. These general concerns have not gone unnoticed by the Insolvency Service. It is responsible for regulating the insolvency profession and for advising the Government about any changes that need to be made to the insolvency regime. It has acknowledged that pre-packs can be carried out without sufficient market exposure, that creditors can be denied the opportunity to participate in negotiations, that there can be a lack of transparency and accountability, and that the "phoenix" phenomenon can cause utter

16 Association of Business Recovery Professionals, Pre-packaged sales briefing notes, available at https://www.r3.org.uk/uploads/documents/Pre-packs%20briefing.pdf

17 Association of Business Recovery Professionals, Pre-packaged sales briefing notes, available at https://www.r3.org.uk/uploads/documents/Pre-packs%20briefing.pdf

18 Ev 52 (Jonathan Williams)

19 Q52

20 Daily Mail Online, Pre-pack deals risk cheating creditors, 5 January 2009, available at http://www.dailymail.co.uk/money/

21 Ev 27, para 2 (Association of British Insurers)

disbelief among those who lose out: "consumer and small trade creditors can find it particularly baffling that this is allowed or at least not barred by the legislation."[22]

18. This led to the Insolvency Service (and other RPBs that license insolvency practitioners) introducing a practice statement, known as Statement of Insolvency Practice 16 (SIP 16). Mr Horne explained that for the first time it will require insolvency practitioners "to give details of how they were introduced to the company, what work they did prior to their appointment, what marketing they did at the company, what valuations they took of the business, really to explain to creditors why they felt that a pre-pack was the best thing for them".[23]

19. SIP 16 has been welcomed by some, but there is general agreement that its impact must be monitored closely. The Insolvency Service has committed to doing so as a matter of priority.[24] In particular, the Service has committed to check each pre-pack administration to ensure compliance with both the letter and spirit of the new rules. The British Printing Industries Federation (BPIF) argue that if monitoring uncovers ongoing problems then tougher legislative alternatives should be considered.[25] Further, the Insolvency Practitioners Association has called for the Insolvency Service to clarify that transparency takes priority over any duty of confidentiality owed by the administrator to the pre-pack purchaser.[26]

20. Others believe that SIP 16 will not prove sufficient and favour immediate changes to the law. For instance, the Association of British Insurers (ABI) argues that it is "a step in the right direction, but only deals with the situation after the pre-pack. The Government should act to address these problems by, for example, imposing minimum disclosure and transparency requirements."[27] Another alternative has been suggested: "explanations after the event are little help to suppliers. And when a business is saved, critical partners such as lenders and suppliers should share the benefits… The rules must be changed to give at least the biggest creditors a say".[28] Some unsecured creditors have gone so far as to call for pre-packs to be banned outright.

21. In some jurisdictions it would not be possible for pre-packs to operate behind closed doors. For instance, Chapter 11 proceedings in the United States require proposals to be approved by the court before being implemented. While the Insolvency Service has committed to learning lessons from elsewhere, it has argued against this kind of restriction because of its concerns that it may prevent businesses from being rescued:[29]

22 Evaluation Report p147

23 Q59

24 Q60 (Mr Horne)

25 Ev 36, para 10 (British Printing Industries Federation)

26 Ev 40, para 5.11 (Insolvency Practitioners Association)

27 Ev 27, para 4 (Association of British Insurers)

28 Financial times, The Lex Column, 11 February 2009

29 Q72 (Mr Horne)

> the administrator needs to be left alone to get on with the urgent restructuring actions that are necessary with minimum cost and delay; this is the best way to ensure that jobs are saved and value is not lost. Imposing additional requirements to seek court approval is likely to jeopardise a rescue by diverting the administrator from that critical restructuring activity. It may also create unnecessary and lengthy delays and will certainly dissipate what limited funds there may be on legal and professional fees.[30]

22. The former head of Woolworths, Sir Geoff Mulcahy, has questioned whether the existing regime does, in fact, ensure that profitable parts of a struggling company are restructured with a view to retaining jobs and promoting the rescue culture. In relation to the example of Woolworths he stated:

> I am sure the Board, the Banks, the credit insurers, and the administrator would all have acted within the necessary rules, regulations and applicable laws, which raises the issue as to whether these processes have worked in the overall public interest… Whilst each case is unique, there is a pattern of events from the apparent failure of corporate governance to the eventual liquidation of the business which deserves examination to see if lessons could be learnt.[31]

23. Mr Speed has highlighted that administrators act in accordance with strict statutory duties, including to rescue the company wherever possible.[32] More generally: "the jury is still out as to whether [the regime introduced by the Enterprise Act 2002] is in fact increasing rescue rates and increasing returns to creditors, and we will certainly need to carry on evaluating it."[33] But the Insolvency Service is optimistic for the future: "Protections already exist to deal with misconduct on the part of both directors and administrators and the recent introduction of SIP 16, whereby the Government has put in place arrangements to improve transparency where a pre-pack sale has been effected, will help further."[34]

24. Mr Horne accepted that small creditors find it difficult to protect their interests by challenging pre-packs at court. However, he added: "they can raise it with the administrator, they can raise it with the administrator's professional body, they can raise it with us. Government is often approached in these cases as well. HMRC are often a creditor and I think they can have a proactive role to play in this."[35] The Service has provided details of its hotline which can be used to report instances of suspected abuse: enforcement.hotline@insolvency.gsi.gov.uk or 0845 601 3546.

25. **Public confidence in the insolvency regime is being and will be further damaged. Prompt, robust and effective action is needed to ensure that pre-pack administrations**

30 Ev 24, para 6A (The Insolvency Service)

31 Ev 48 (Sir Geoff Mulcahy)

32 Q55

33 Q74 (Mr Horne)

34 Ev 24, para 6A (The Insolvency Service)

35 Q63

are transparent and free from abuse. Unsecured creditors tend to be kept in the dark and recover even less than they would in a normal administration. This causes particular outrage where the existing management buy back the business and continue to trade clear of the original debts. Pre-packs of this kind fuel understandable concerns about illegitimate, self-serving alliances between directors and insolvency practitioners. The interests of unsecured trade creditors must take a higher priority, especially in "phoenix" pre-pack administrations. The insolvency system, the Insolvency Service and the insolvency profession all risk real reputational damage if the situation is not addressed. More worryingly, many SMEs appear to be suffering unreasonable financial harm with no corresponding benefits to the wider economy. Where there are good reasons for an insolvency practitioner agreeing to a pre-pack, which there can often be, this must be explained clearly and fully. Where there are no good reasons for entering a pre-pack, this must be exposed before the damage is done.

26. **In view of this, we welcome the introduction of the new practice statement, Statement of Insolvency Practice 16, which aims to increase the transparency of pre-packs. We also welcome the Insolvency Service's commitment to monitor its implementation. This is a responsible first step, but the recession makes this a matter of considerable urgency. There must be systematic monitoring of the situation by the Insolvency Service and the Department. If the new practice statement does not prove effective then it will be necessary to take more radical action, possibly by giving stronger powers to the creditors or the court. In the meantime, we urge anyone who suspects the abuse of pre-packs to contact either the Insolvency Service or the body that licenses the insolvency practitioner concerned. We also encourage large creditors, in particular Her Majesty's Revenue and Customs, to take an active role in rooting out abuse.**

Insolvency practitioners fees

27. There is a general and enduring perception that insolvency practitioners charge unduly high and occasionally opportunistic fees for administering the estates of insolvent individuals and companies. Mr Speed explained that the Insolvency Service does not have direct responsibility for professional fees and stated his belief that they are generally in alignment with the legal and accountancy professions.[36] He emphasised that the onus rests on creditors to take action whenever they are concerned that fees are excessive:

> Once the relationship has been established the people who need to take control of what is happening in relation to fees are the creditors. We do not live in a society in which we regulate prices; we have to rely to some extent on competition, but creditors do have powers, for example, to object to fees that administrators are proposing and they can and sometimes do get the administrators changed.[37]

36 Q77

37 Q76

28. Mr Speed accepted, however, that more could be done: “creditors need to be better educated and better facilitated to use the opportunities that they already have in law to get together and decide what it is that they want to pay for in the administration.”[38] His deputy, Mr Horne, made a constructive commitment to monitor the current practice statement on remuneration:

> The point about fees is that they have to be approved by creditors. There is a SIP [Statement of Insolvency Practice]… which says the insolvency practitioner must explain to the creditors why the fees are how they are. I think what we also need to do, in the light of the current circumstances, is check that that is being adhered to by insolvency practitioners as well; that they are giving the creditors enough information for the creditors to make an informed view as to whether or not they will approve these fees.”[39]

29. **It may be inevitable that insolvency practitioners’ remuneration is perceived as unduly high by many creditors. There must, however, be sufficient opportunity and information to allow creditors to ensure that fees are reduced where that perception is justified. We therefore welcome the Insolvency Service’s commitment to monitor whether insolvency practitioners are complying with the current practice statement governing the approval of their fees. We urge the Insolvency Service to make its findings publicly available. We also urge the government to respond to these findings and to consider the case for strengthening control – possibly through independent arbitration – of insolvency practitioners’ remuneration beyond the limited power to do so currently exercised by creditors.**

38 Q77

39 Q77

4 Funding arrangements

30. The Insolvency Service's operations are funded from various sources, including charges that are levied against the services that it provides, programme budgets funded by BERR, and the recovery of fees in the course of legal proceedings. Further information is provided in the Appendix, below. Before 2004 almost all of the funding was set in advance and paid by BERR each year.[40] The current arrangements are intended to take away some of the financial risk that BERR would have to pay more if case loads unexpectedly increased. It is vitally important to ensure that the arrangements adequately support the work of the Insolvency Service both in the turbulence of the present economic climate and beyond.

31. More than two thirds of the Service's expenditure relates to the administration of insolvent estates, including companies that have been wound up by the court and individuals who have been made bankrupt. A private insolvency practitioner may be appointed in relation to those cases that raise complex issues or involve substantial assets, but the majority are handled by Official Receivers and other staff employed by the Service.[41]

32. Case administration is funded by fees that are set on the basis of key planning assumptions about the expected number of cases for each year. The Service's Corporate Plan states: "To the extent that our planning assumptions prove inaccurate, The Service has to manage the consequences in-year and, where appropriate, adjust fee levels and resource allocation in future years."[42] The Service is subject to an efficiency savings target to reduce case administration fees by 15% before 31 March 2011. It is confident that this can be achieved without sacrificing quality. The savings will primarily depend on IT-led investment which is due to achieve net savings of £67 million up to the year 2012–13.[43] Mr Horne allayed our concerns, based on the track record of many IT projects, by confirming that the project is due to conclude this summer both to time and budget.[44]

33. More generally, Mr Speed confirmed that it is "incredibly difficult" to predict the number of cases that will fall to be administered by the Service in any one year. For instance, the Service recently increased its estimate for this year by just over 5%.[45] Mr Speed played down the risk of needing to make further large increases, but stated the Service could cope even if levels rose by up to 35% to 40%.[46] In particular, the Service has stated that each extra case is broadly self-funding:

40 Q16 (Mr Speed)

41 Q9 (Mr Speed)

42 Corporate Plan 2008-11, p11

43 Corporate Plan 2008-11, pp9, 12 and 41

44 Q15

45 Q31

46 Q31; Q45

> when case numbers increase, fee income increases… through the deposit we receive in all cases and then from assets realised in cases. Cases with few or no assets are cross subsidised by cases with assets.[47]

34. There is an inevitable time lag between the onset of new cases and the income that is derived from realising assets in those cases, which the Service manages by receiving working cash from BERR.[48] While extra cases will call for extra staff, Mr Speed stated that the service is able to recruit qualified lawyers and accountants on short term contracts: "there is a pretty active market in these people…so we are able to draw on that market to act as a buffer for our work".[49]

35. A quirk of this system is that as fees go up so do bad debts; this is because the Service estimates that 12% of fees will never be recovered.[50] This led to BERR's Supplementary Estimate for 2008–09 increasing its bad debt provision by a further £14 million based on its upward revision of the expected number of insolvency cases this year. We accept the Service's assurance that there is "no practical implication" associated with this revision and that it will not lead to more money being required from BERR.[51]

36. **The Insolvency Service's Chief Executive, Mr Speed, assured us that arrangements for funding its case administration work are sufficiently robust to handle a dramatic increase in insolvencies if this were to happen. While we hope that this assurance is not tested, at this stage we can only hope that he is correct. Both he and his staff will understand the serious consequences if he is not.**

Redundancy payments

37. Aside from case administration, a redundancy payments scheme is operated by the Service. This involves processing claims made by employees who have been unable to recover redundancy (among other) payments from their employers. The payments, and the costs of administering them, are paid out of the National Insurance Fund.[52] Each year Her Majesty's Revenue and Customs agree to provide a set amount of funding to the Service to meet its costs of administering the scheme. The funding for this year has been cut due to expected efficiency gains arising from a new IT based procedure. However, the number of claims is set to more than double from less than 80,000 last year to more than 160,000 this year.[53] The Citizens Advice Bureau has warned:

> If the Insolvency Service is not able to cope, and processing of claims becomes delayed, then individuals will be left without money that might for example prevent

47 Ev 23, para 3 (The Insolvency Service)

48 Ev 23, para 3 (The Insolvency Service)

49 Q39

50 Ev 22, para 2 (The Insolvency Service)

51 Ev 22, para 2 (The Insolvency Service)

52 Ev 20, para 28 (The Insolvency Service)

53 Q41 (Mr Horne)

> them losing their home. There is no evidence of this happening yet, but it is still early days.[54]

Fortunately, the Service is managing to meet its targets for processing claims within the prescribed period of time, but doing so will cost it more than was budgeted.[55] HMRC is content to increase its funding in view of the extra demand, but it need not have done so. The Service's Annual Report highlighted: "Unless additional funding can be secured from HMRC, deficits not covered by surpluses must be met by BERR."[56] **The Insolvency Service must consider changing its agreement to operate a redundancy payments scheme on behalf of Her Majesty's Revenue and Customs by ensuring that in future years there is an entitlement to recover extra funding based on a higher workload. We welcome the fact that this year any interdepartmental wrangling over funding has been set aside to give priority to ensuring victims of the recession get the payments to which they are legally entitled. This should become permanent.**

Investigation and enforcement

38. The investigation and enforcement activities of the Service are also coming under increasing pressure. The Service's Corporate Plan for 2009–12 estimates that the overall number of complaints and reports alleging misconduct will increase from 9,250 in 2008–09 to somewhere between 10,150 and 10,850 in 2009–10.[57] This is the equivalent of an increase of between 10% and 17%. While positive steps have been taken over the previous 12 months to restructure and unify this part of the Service's operations, it has been acknowledged that: "as insolvencies increase and incidences of director misconduct grow (as usually happens in an economic downturn), the Service will need to maintain rigorous processes to ensure that the instances of misconduct which most merit action in the public interest continue to be targeted."[58]

39. We are concerned that this extra pressure comes at a time when many insolvency practitioners already consider that too few investigations are being carried out. For instance, R3 stated its belief that:

> given the limited resources within the Service, not all of the reports submitted by IPs [i.e. insolvency practitioners] are pursued (for reasons such as a lack of evidence to exact a disqualification). A number of IPs assert that it is due to the lack of resources that not all reports meriting action are investigated, leading to fewer, justified disqualifications; and there is a fear that 'easy cases' are taken on in order to meet targets.[59]

54 Background briefing to the Committee

55 Q41 (Mr Horne)

56 Annual Report for 2007-08, p24; Q42 (Mr Horne)

57 Page 8

58 Ev 21, para 39 (The Insolvency Service); Qq 4 to 6

59 Ev 31, para 3.2 (Association of Business Recovery Professionals)

40. R3, among others, have therefore recommended that the Service receives greater resources to fund this part of its activities.[60] At the moment, investigations are primarily funded by a programme budget set by BERR. The Service's Corporate Plan for 2009–12 states that funding was £42.4 million in 2008–09 and projects that this will reduce to £40.5 million in 2009-10 and £40 million in 2010–11.

41. We struggle to understand how the Service will respond to increasing demand whilst facing reducing levels of funding. With this in mind, we note the decision by the Secretary of State to scrap the Service's target of increasing the number of successful enforcement outcomes by 7% each year. Instead, the target for 2009–10 is to maintain enforcement outputs at the same level that was achieved in 2008–09.[61] The Service has stated that instead of targeting a higher number of enforcement outputs it will take an extremely rigorous approach to prioritising cases in the public interest.

42. This is insufficiently ambitious at a time when the number of complaints is expected to increase. Targeting the same number of enforcement outputs means that a lower proportion of wrongdoers face sanctions for what they have done. The Service has agreed this target on the grounds that "prioritisation of cases will consume proportionately more resources than in the past as the volumes of misconduct increase"[62] and maintains

> The Service will take care to ensure that proper attention is paid to the full range of different types of cases that we see, so that no area of corporate or personal misconduct falls below the enforcement radar.[63]

43. It will be little comfort to insolvency practitioners and creditors that their reports and complaints are rigorously prioritised, if investigation does not follow. From their perspective, it may appear that that the Service is lowering its sights at the very time when more than ever must be done to combat misconduct. Understandably, Mr Speed was keen to emphasise the Service's enforcement achievements: "on an average working day in this country round about five directors will be disqualified as a result of the work that we do, round about six or seven bankrupts will have bankruptcy restrictions placed upon them as a result of what we do, and somewhere in the country, again on average, one person per working day will be convicted of committing an offence on the basis of evidence that we have brought to a prosecuting authority".[64] He did not call on BERR to provide additional funding for investigation and enforcement, but felt that what was missing was a small amount of additional funding to highlight the number of successful cases as a deterrent effect: "we do not do enough of this and we do not do it well enough".[65] This aligned with R3's belief that the industry as a whole suffered from a low profile and while everyone

60 Ev 31, paras 3.2 to 3.3 (The Association of British Recovery Professionals); Ev 37, para 3.5 (Insolvency Practitioners Association)

61 Corporate Plan 2009-12, page 23

62 Corporate Plan 2009-12, para 6.1.1

63 ibid

64 Q50

65 Q47; Q48

concerned was in part responsible, the Service insufficiently promoted its activities.[66] R3 called for the Service to be awarded more money to enable it to publicise its work.[67]

44. **It is surprising and disappointing that the Secretary of State has reduced the funding for investigation and enforcement activities for 2009–10, despite the expectation that there will be an increase in the number of cases referred to the Insolvency Service. It is unacceptable that the Service's new target requires it to achieve no more than the same number of successful enforcement outcomes than was achieved for 2008–09. This would mean that as the recession bites there will be proportionately fewer wrongdoers facing sanctions for their misconduct. This is unlikely to inspire confidence among the insolvency practitioners and creditors who report wrongdoing but see no sign of it being investigated or penalised. The Department for Business, Enterprise and Regulatory Reform must provide the Service with sufficient funding to meet an increase in demand for its investigation and enforcement activities and it should amend the target to ensure that the number of successful outcomes the Service is expected to achieve in 2009–10 is increased to ensure it is proportionately equivalent to the target in 2008–09.**

45. **While the Service is securing sanctions against a considerable numbers of individuals at present, there is a need for additional funding to promote this more widely in order to create the best possible deterrent effect. We recognise the heavy demands on public expenditure, but maintaining confidence in the market is a central task of the Department and, in the light of regulatory failures elsewhere, we are surprised by the lack of commitment shown by the Department in this crucial area. The sums involved are, after all, very modest.**

Future funding

46. Recently the Service changed the way that it projects the demand for its services by replacing a precise estimate with figures based on a lower and upper range.[68] For instance, bankruptcies for 2009–10 are estimated to be 77,400 to 83,300 for 2009–10.[69] This is in recognition of the unpredictability of demand caused by the current economic climate.[70] We can see the sense in this. However, the funding arrangements and target for 2009–10 onwards are each based on figures at the very bottom of the range.[71] The Service has stated that any shortfall in funding will be managed in-year and, where appropriate, adjustments will be made to fee levels and resource allocation in future years.[72]

66 Ev 29, para 1.11 (Association of Business Recovery Professionals)

67 Ev 29, para 1.13 (Association of Business Recovery Professionals)

68 Corporate Plan 2009-12, page 7

69 Corporate Plan 2009-12, page 8

70 Corporate Plan 2009-12, page 7

71 Corporate Plan 2009-12, page 7

72 Corporate Plan 2009-12, page 7

47. The Department for Business, Enterprise and Regulatory Reform must work with the Insolvency Service to ensure that its funding arrangements are sufficiently robust to handle the very high levels of insolvency that are almost inevitable at a time of steep economic decline. We welcome the Service's shift to projecting demand for its services based on a lower and upper range, but we believe that its funding and targets should be based on the expectation that activity will be at the mid-range, rather than the bottom end, of the scale.

5 Regulation

48. There are approximately 1,680 licensed insolvency practitioners. A licence can either be obtained from the Insolvency Service or from one of seven Recognised Public Bodies (RPBs). It is by far more common for private sector insolvency practitioners to be licensed by one of the RPBs than through the Service. Each of those RPBs are in turn regulated by the Service, which has led to concerns that it suffers from a conflict of interest due to being both a regulator and licensing body.[73] This was denied by Mr Speed on the basis that the Service does not actively promote its power to license insolvency practitioners and, in practice, only does so in relation to a small number of individuals, currently totalling 92:

> we do not compete with the regulated professional bodies. We do not go out and market our regulation as something we would like people to sign up to. It happens to be there in statute, and if somebody approaches the Service to be directly licensed by the Secretary of State then that is a service we are statutorily required to deliver. I do not think it gets in the way at all of the work that we do in overseeing the seven Recognised Professional Bodies who oversee the vast majority of insolvency practitioners.[74]

49. The Service does, however, accept criticisms that it fails adequately to explain the work that it carries out as regulator. For instance, the Insolvency Practitioners' Association stated: "The Service should take a more outward-looking role in assuring the integrity and robustness of the regulatory framework."[75] Mr Speed stated that more needs to be done:

> Let me take that one on the chin… We are now looking to see how we can make a step-change in the level of disclosure that we might put, for example, in our annual report and accounts, and I think there are three parts to this: firstly, about what the regulatory bodies themselves have done during each year in relation to their population of insolvency practitioners; secondly, about what we have done as a direct licensor in relation to it - our population of about 92 IPs; and, thirdly, about the way in which the Service has sat at the top of the pyramid and overseen the work of the regulator bodies.[76]

50. More generally, some witnesses raised the unusual contrast between the relatively large number of licensing bodies, eight in total, against the comparatively small number of insolvency practitioners. Mr Speed explained that this was due to the way in which the regulation of the insolvency profession has evolved.[77] He argued that the real issue was whether the regulation was consistent, which he believed it to be.[78] This was supported by the Insolvency Practitioners Association who highlighted the Memorandum of

73 Conflicted role weakens Insolvency Service, Accountancy Age, 31 July 2008, available at http://www.accountancyage.com/accountancyage/news/2222914/conflicted-role-weakens-agency

74 Q89; 92

75 Ev 42, para 6.7 (Insolvency Practitioners Association)

76 Q91

77 Q94

78 Q94

Understanding entered between the Service and each of the RPBs, the bringing together of the various licensing bodies through the Joint Insolvency Committee which issues practice statements applying to all members of the profession, the process for inspecting and reporting upon the licensing bodies, and a 2006 study that revealed the licensing bodies were each exercising their disciplinary powers in a broadly comparable way.[79]

51. We are, however, concerned that the Insolvency Service has a narrower range of powers with which to discipline its licensed members than are available to other RPBs. The Insolvency Practitioners Association stated: "If The Service is to continue to licence insolvency practitioners, then it should have the full range of sanctions to deal with transgressions and misconduct."[80] Mr Speed accepted that in an ideal world this would be the case, although he stated that the Service manages to take action where necessary by increasing inspection of the individual concerned, agreeing an action plan and where necessary restricting or revoking their license.[81]

52. A more recent report commissioned by the Insolvency Practices Council also considered issues surrounding complaints and professional discipline. It concluded that, in the prevailing economic climate, the insolvency profession and its regulators should consider the case for introducing an insolvency ombudsman responsible for handling all complaints against insolvency practitioners.[82] The report considered the case for this proposal, including the usefulness of a full, independent review and the prospect that this would increase public confidence. It also considered the case against, including the expense and prospect for vexatious complaints. In its most recent annual report, the Insolvency Practices Council called for personal debtors to be able to take their complaints to the Financial Ombudsman service and for there to be a complaints procedure dealing with complaints falling short of the threshold for disciplinary action, including the possibility of an appeal to an independent external reviewer, with power to award appropriate redress. The issue was raised too late for us to examine it properly and come to a conclusion but we recognise its importance.

53. The Insolvency Service must increase the transparency of its regulatory activities as a matter of priority. More generally, the Department for Business, Enterprise and Regulatory Reform should take the earliest available opportunity to provide the Service with the same range of powers to discipline its licensed members as are available to the other Recognised Professional Bodies. We recommend that the Department and the Insolvency Service should undertake a cost benefit analysis of the case for establishing an insolvency ombudsman.

79 Ev 41, para 6.3 (Insolvency Practitioners Association)

80 Ev 41, para 6.6 (Insolvency Practitioners Association)

81 Q92; 94 (Mr Speed)

82 Complaints Handling by The Regulators of Insolvency Practitioners: A Comparative Study, Professors Seneviratne and Walters, Nottingham Trent University, January 2009, available at http://ssrn.com/abstract=1310791.

6 Conclusion

54. The Minister for Employment Relations recently announced new targets for the Service for the year 2009–10.[83] As in previous years, this included a target for overall user satisfaction. This was set at 92% for 2008–09 but has been reduced to 90% for 2009–10. In evidence to us and throughout its recently published Corporate Plan, the Service has emphasised its goal of maintaining standards throughout the challenges of the economic downturn. We question whether now is right time for the Service's targets to lower its aims in relation to the experience of its users.

55. **Current economic conditions face the Insolvency Service with considerable challenges. The Service itself recognises this, and has some plans in place to meet them. However, we have three concerns. Is there a case for strengthening control of insolvency practitioners' remuneration? Will the Service and the Department be nimble enough to reshape policy if necessary to address concerns about prepack administration and other policy issues which may emerge as a result of the recession? And is the service's funding model sufficiently robust to deal with the expected increase in workload, and, in particular, to maintain an appropriate level of enforcement activity?**

83 Written Statement, Minister for Employment Relations and Postal Affairs (Mr Pat McFadden MP), available at http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm090331/wmstext/90331m0001.htm

Conclusions and recommendations

The Insolvency Service

1. We commend the Insolvency Service and its staff for the generally effective and efficient way in which its functions are discharged. We urge, however, a redoubling of efforts to ensure that high levels of service are maintained throughout the economic downturn. This must include action to address concerns about the insolvency regime that have been raised during this inquiry. (Paragraph 11)

Pre-pack administration

2. Criticisms of pre-packs are at their sharpest where existing management buy back the business following private negotiations with an insolvency practitioner and then continue to trade clear of the original debts through a new “phoenix” company. This means that unsecured creditors are initially kept in the dark and then left empty handed. The phoenix company may also have some advantage over competitors who honour their financial obligations. The anecdotal evidence in media reports and confidential letters to the Committee suggest that “phoenix” pre-packs affecting smaller companies with high levels of unsecured trade creditors cause particular concern and are more likely to damage the supplier base without corresponding broader benefits to the overall economy. (Paragraph 15)

3. Public confidence in the insolvency regime is being and will be further damaged. Prompt, robust and effective action is needed to ensure that pre-pack administrations are transparent and free from abuse. Unsecured creditors tend to be kept in the dark and recover even less than they would in a normal administration. This causes particular outrage where the existing management buy back the business and continue to trade clear of the original debts. Pre-packs of this kind fuel understandable concerns about illegitimate, self-serving alliances between directors and insolvency practitioners. The interests of unsecured trade creditors must take a higher priority, especially in “phoenix” pre-pack administrations. The insolvency system, the Insolvency Service and the insolvency profession all risk real reputational damage if the situation is not addressed. More worryingly, many SMEs appear to be suffering unreasonable financial harm with no corresponding benefits to the wider economy. Where there are good reasons for an insolvency practitioner agreeing to a pre-pack, which there can often be, this must be explained clearly and fully. Where there are no good reasons for entering a pre-pack, this must be exposed before the damage is done. (Paragraph 25)

4. In view of this, we welcome the introduction of the new practice statement, Statement of Insolvency Practice 16, which aims to increase the transparency of pre-packs. We also welcome the Insolvency Service’s commitment to monitor its implementation. This is a responsible first step, but the recession makes this a matter of considerable urgency. There must be systematic monitoring of the situation by the Insolvency Service and the Department. If the new practice statement does not prove effective then it will be necessary to take more radical action, possibly by giving

stronger powers to the creditors or the court. In the meantime, we urge anyone who suspects the abuse of pre-packs to contact either the Insolvency Service or the body that licenses the insolvency practitioner concerned. We also encourage large creditors, in particular Her Majesty's Revenue and Customs, to take an active role in rooting out abuse. (Paragraph 26)

Insolvency practitioners' fees

5. It may be inevitable that insolvency practitioners' remuneration is perceived as unduly high by many creditors. There must, however, be sufficient opportunity and information to allow creditors to ensure that fees are reduced where that perception is justified. We therefore welcome the Insolvency Service's commitment to monitor whether insolvency practitioners are complying with the current practice statement governing the approval of their fees. We urge the Insolvency Service to make its findings publicly available. We also urge the government to respond to these findings and to consider the case for strengthening control – possibly through independent arbitration – of insolvency practitioners' remuneration beyond the limited power to do so currently exercised by creditors. (Paragraph 29)

Funding arrangements

6. The Insolvency Service's Chief Executive, Mr Speed, assured us that arrangements for funding its case administration work are sufficiently robust to handle a dramatic increase in insolvencies if this were to happen. While we hope that this assurance is not tested, at this stage we can only hope that he is correct. Both he and his staff will understand the serious consequences if he is not. (Paragraph 36)

Redundancy payments

7. The Insolvency Service must consider changing its agreement to operate a redundancy payments scheme on behalf of Her Majesty's Revenue and Customs by ensuring that in future years there is an entitlement to recover extra funding based on a higher workload. We welcome the fact that this year any interdepartmental wrangling over funding has been set aside to give priority to ensuring victims of the recession get the payments to which they are legally entitled. This should become permanent. (Paragraph 37)

Investigations and enforcement

8. It is surprising and disappointing that the Secretary of State has reduced the funding for investigation and enforcement activities for 2009–10, despite the expectation that there will be an increase in the number of cases referred to the Insolvency Service. It is unacceptable that the Service's new target requires it to achieve no more than the same number of successful enforcement outcomes than was achieved for 2008–09. This would mean that as the recession bites there will be proportionately fewer wrongdoers facing sanctions for their misconduct. This is unlikely to inspire confidence among the insolvency practitioners and creditors who report wrongdoing but see no sign of it being investigated or penalised. The Department for Business,

Enterprise and Regulatory Reform must provide the Service with sufficient funding to meet an increase in demand for its investigation and enforcement activities and it should amend the target to ensure that the number of successful outcomes the Service is expected to achieve in 2009–10 is increased to ensure it is proportionately equivalent to the target in 2008–09. (Paragraph 44)

9. While the Service is securing sanctions against a considerable numbers of individuals at present, there is a need for additional funding to promote this more widely in order to create the best possible deterrent effect. We recognise the heavy demands on public expenditure, but maintaining confidence in the market is a central task of the Department and, in the light of regulatory failures elsewhere, we are surprised by the lack of commitment shown by the Department in this crucial area. The sums involved are, after all, very modest. (Paragraph 45)

10. The Department for Business, Enterprise and Regulatory Reform must work with the Insolvency Service to ensure that its funding arrangements are sufficiently robust to handle the very high levels of insolvency that are almost inevitable at a time of steep economic decline. We welcome the Service's shift to projecting demand for its services based on a lower and upper range, but we believe that its funding and targets should be based on the expectation that activity will be at the mid-range, rather than the bottom end, of the scale. (Paragraph 47)

11. The Insolvency Service must increase the transparency of its regulatory activities as a matter of priority. More generally, the Department for Business, Enterprise and Regulatory Reform should take the earliest available opportunity to provide the Service with the same range of powers to discipline its licensed members as are available to the other Recognised Professional Bodies. We recommend that the Department and the Insolvency Service should undertake a cost benefit analysis of the case for establishing an insolvency ombudsman. (Paragraph 53)

12. Current economic conditions face the Insolvency Service with considerable challenges. The Service itself recognises this, and has some plans in place to meet them. However, we have three concerns. Is there a case for strengthening control of insolvency practitioners' remuneration? Will the Service and the Department be nimble enough to reshape policy if necessary to address concerns about prepack administration and other policy issues which may emerge as a result of the recession? And is the service's funding model sufficiently robust to deal with the expected increase in workload, and, in particular, to maintain an appropriate level of enforcement activity? (Paragraph 55)

Appendix: Funding arrangements

	2008-09 £m	2009-10 £m	2010-11 £m	Recovered from
Insolvency Case Administration	141.2	135.3	131.1	Fee income
Estate Accounting	2.5	2.5	2.5	Fee income
IP Regulation	0.9	0.9	0.9	Fee income
Redundancy Payments	9.7	8.2	7.7	Service Level Agreement with HMRC plus £1.5m carried forward from 2007-08
Investigation & Enforcement	41.9	39.5	39.5	Programme funding from BERR and costs recovered from disqualified directors
Policy	2.0	1.9	1.8	Administration funding from BERR
Other	1.4	1.9	2.0	Various e.g. rent recoveries from sublet accommodation
Total Costs	**199.6**	**190.2**	**185.5**	

Source:The Insolvency Service Corporate Plan for 2008–11

Formal Minutes

Tuesday 21 April 2009

Members present:

Peter Luff, in the Chair

Mr Adrian Bailey
Roger Berry
Michael Clapham
Miss Julie Kirkbride
Anne Moffat
Mark Oaten
Lembit Öpik
Mr Anthony Wright

1. The Insolvency Service

Draft Report (*The Insolvency Service*), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraph 1 to 55 read and agreed to.

Summary agreed to.

A Paper was appended to the Report.

Resolved, That the Report be the Sixth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned until Tuesday 12 May at 10.15 am

Witnesses

Tuesday 27 January 2009 *Page*

Mr Stephen Speed, Inspector General and Agency Chief Executive, Insolvency Service and **Mr Graham Horne,** Deputy Executive, Insolvency Service Ev 1

List of written evidence

1	The Insolvency Service	Ev 16, 22
2	Mrs Melanie Andrews	Ev 25
3	Association of British Insurers	Ev 26
4	Association of Business Recovery Professionals	Ev 27
5	British Printing Industries Federation	Ev 34
6	Insolvency Practitioners Association	Ev 36
7	Institute of Chartered Accountants in England and Wales	Ev 45
8	Sir Geoff Mulcahy	Ev 48
9	Pension Corporation	Ev 49
10	Mark Skingley	Ev 51
11	UK Shareholders Association	Ev 52
12	Jonathan Williams	Ev 52

List of Reports from the Committee during the current Parliament

Session 2008–09

First Report	Energy policy: future challenges	HC 32
Second Report*	Pre-appointment hearing with the Chairman-elect of Ofcom, Dr Colette Bowe	HC 119
Third Report	Work of the Committee in 2007-08	HC 175
Fourth Report	Regional development agencies and the Local Democracy, Economic Development and Construction Bill	HC 89
Fifth Report	The Postal Services Bill	HC 172

Session 2007–08

First Report	The work of the Committee in 2007	HC 233
Second Report	Jobs for the Girls: Two Years On	HC 291
Third Report	Post Office Closure Programme	HC 292
Fourth Report	Funding the Nuclear Decommissioning Authority	HC 394
Fifth Report	Waking up to India: Developments in UK-India economic relations	HC 209
Sixth Report	After the Network Change Programme: the future of the post office network	HC 577
Seventh Report	Keeping the door wide open: Turkey and EU accession	HC 367
Eighth Report **	Scrutiny of Arms Export Controls (2008): UK Strategic Export Controls Annual Report 2006, Quarterly Reports for 2007, licensing policy and review of export control legislation	HC 254
Ninth Report	Construction matters	HC 127
Tenth Report	Post Office finance: matters arising from evidence taken on 10 June 2008	HC 662
Eleventh Report	Energy prices, fuel poverty and Ofgem	HC 293
Twelfth Report	Post Office Card Account: successor arrangements	HC 1052
Thirteenth Report	Companies House	HC 456
Fourteenth Report	Departmental Annual Report and Scrutiny of the Department for Business, Enterprise and Regulatory Reform	HC 1116

* First Joint Report with Culture, Media and Sport Committee

** First Joint Report of Committee’s on Arms Export Controls

Oral evidence

Taken before the Business and Enterprise Committee

on Tuesday 27 January 2009

Members present

Peter Luff, in the Chair

Mr Michael Clapham
Lembit Öpik
Mr Anthony Wright

Witnesses: **Mr Stephen Speed**, Inspector General and Agency Chief Executive, and **Mr Graham Horne**, Deputy Chief Executive, The Insolvency Service, gave evidence.

Q1 Chairman: Gentlemen, I am sorry to have kept you waiting for a few minutes; we had some other business today. I am also sorry we are slightly light on the Committee today. We have got some colleagues on Bill committees which does sometimes happen. Can I say how grateful I am to you for coming and for the memorandum you provided the Committee with before this evidence session, and ask you, as I always do, to introduce yourselves?
Mr Speed: Certainly, Chairman. I am Stephen Speed, Inspector General and Chief Executive of The Insolvency Service.
Mr Horne: I am Graham Horne, Deputy Chief Executive.
Chairman: As I think you understand, this is a session about two things, our general scrutiny work of the non-departmental public bodies which come under the Department for Business, Enterprise and Regulatory Reform aegis, and we will be asking you questions about that initially, but we also want to ask you questions about insolvency practice and policy, particularly in the light of the current recession, and pre-pack administrations which we will be asking you questions about a little later on in the evidence. We will begin if we may with some questions on the routine scrutiny of your organisation.

Q2 Lembit Öpik: You have been in the job now about six months; is that right?
Mr Speed: About 15 months.

Q3 Lembit Öpik: Sorry; I was a year out. In that time presumably you have had a strategic look at the Grant Thornton recommendations.
Mr Speed: Yes.

Q4 Lembit Öpik: To be quite specific about those, they recommend improving vetting procedures, increasing career development opportunities for the workforce and also introducing a new regional or national management structure for all investigative staff. How do you feel about those recommendations? There would obviously be quite a bit of structural and strategic change if you were to take on board those recommendations.
Mr Speed: I feel very positive about those recommendations. You are right: as a newcomer coming into the Service I felt the need to get a little bit of help to look at the picture from the strategic level, particularly in relation to the way we carry out our investigations and enforcement work. We worked, as you say, with Grant Thornton to do that and I felt that their recommendations were very positive. I would just draw attention to the fact that, of course, Grant Thornton were quite impressed with the quality of the work that we do, but on top of that had a number of suggestions for how we might improve it further, particularly in regard to our effectiveness and efficiency. We have taken a number of steps already since that report was delivered to us. I think the most obvious one is that on 1 January this year we did indeed make the structural change that they had recommended, so we have brought together into a single organisation within The Insolvency Service three rather major components of our investigation work. We have brought together the Companies Investigations Branch, which looks into the affairs of live companies, our disqualification investigations teams, who are the people who investigate allegations brought to our attention by insolvency practitioners, and also a team we call the enforcement team. They carry out a range of functions which in the legislation are secretary of state powers. There is a separation of duties that we have had for some time. We have brought all those together, and you were right to draw attention to the fact that one of the things I am very interested in achieving as a result of that is that our examiners, who are very highly qualified and well-trained people, have a broader career prospect ahead of them. There was a tendency, I think, in the past for people to arrive in the Service and tend to stay in the stove pipe in which they arrived and I would like to see that broken down; I would like to see people starting to use their skills in different parts of the organisation.

Q5 Lembit Öpik: So you feel that you are achieving a better connection between the three silos that you are describing?
Mr Speed: Absolutely. In a sense one of the unintended but nevertheless extremely good by-products of having Grant Thornton in was that it catalysed a whole range of discussions within the Service which have really borne fruit in the last 12 months. It has now become a matter of routine that

all the different enforcement and investigation parts of the Service do not just talk to each other but do business together and think carefully about how they can share their learning with each other, so yes, it has been very positive.

Q6 Lembit Öpik: In essence do you feel you are achieving the career development opportunity target, which was a recommendation set for you, by bringing those together?
Mr Speed: You do not achieve something like that overnight, but I am very confident that we will. There are structural issues to overcome and also cultural issues. In organisations as big as the Service you tend to find that there are cultures in different places. I do not think it is going to be a particularly difficult job but it will take a little bit of time. Certainly in the discussions I have had with our professional investigators in all the different parts of the Service they have been very positive about this and are quite looking forward to seeing them come to fruition.

Q7 Lembit Öpik: Moving on from though still slightly connected to that, is it your intention to handle more insolvency cases through official receivers rather than contracting them out, if you like, to private practitioners?
Mr Speed: That is quite a complicated question and I know it is a matter of some controversy with some of our stakeholders, so let me explain the underlying philosophy. The vast majority of the cases that our official receivers deal with are bankruptcies in which there is no real value, and our view is that even if we wanted to invite other people to take those cases on we probably would not be able to because there is no value in them. In a sense the official receiver has a position of appointee of last resort. There is, I think, a degree of questioning in the public mind about some cases we do where there are considerable assets, and what I would like to say about that is that we will only do cases with assets in them where the realisation of the assets is entirely straightforward and we can do it quickly and cheaply, and we will do those because the underlying objective of what we are trying to do is to return as much money as we can to creditors. Where we come across cases where the realisations are going to be too complicated and our staff are not sufficiently trained, and we do come across 1,000 or so cases a year where we have been the initial appointee, we will usually seek a secretary of state appointment of a private sector insolvency practitioner.

Q8 Lembit Öpik: Do you have any strategic intention to develop that in-house capacity to handle more complicated cases or are you saying that you do not think that is good use of the Service's time?
Mr Speed: We are satisfied with the policy that we have at the moment. We recognise that some of our stakeholders have some reservations about it and on that basis I am very pleased to be able to say that we have agreed with the trade association for insolvency practitioners, R3, that later in the year we will do some joint research with them about the costs of doing this sort of work in different scenarios. We always like to keep an open mind but it seems to me that the underlying public policy objective which we must focus on is trying to return as much money as we can to creditors.

Q9 Lembit Öpik: Obviously, how much you do has an impact on the profession as a whole. Have you given any consideration to the potential impact on the quality and viability of the profession as a whole, it being dependent on how much you do yourselves?
Mr Speed: It is perhaps helpful to remember that the profession does a great deal of the work itself already. Certainly on the corporate side our estimate is that insolvency practitioners will be doing about three-quarters of corporate cases, plus, as I mentioned a moment ago, we seek secretary of state appointments in more complicated company winding-up cases. The most recent figures I have got are around 1,000 in the year. On the personal side, of course, insolvency practitioners do individual voluntary arrangements (IVAs). In addition, we would seek secretary of state appointments where bankruptcy cases are complicated, and I think in the last year we have done about 5,500 of those, so even in that area where we do seem predominant we reckon that something like 44% of the work is being done by the profession.

Q10 Lembit Öpik: Finally, I want to ask you the degree to which you might be hampered by a lack of understanding by businesses and also by the general public in terms of the insolvency services which are available. Obviously, very few people go through it at all, and no business wants to, so is there a barrier to the effectiveness of applying the Service's, and indeed the sector's, skills effectively?
Mr Speed: I think you have to start from the proposition, do you not, that, like it or not, insolvency is a pretty complicated subject? That is what I have found, certainly in the last 15 months, and for an individual who has managed to get themselves into some form of financial distress there is quite a lot of choice out there, and, of course, if you are in distress choice can mean difficult decisions. We would certainly support any measures across government or the voluntary sector, or indeed anywhere else, to make sure that people get the best advice they can. The contribution we make to that is not so much in providing individual advice, which we really believe we cannot do, but nevertheless in making sure that the channels people use have access to the best and most authoritative guidance that we can give them. We have a very proactive approach to providing information. If I can give you some examples, we hold the national statutory database for bankruptcies and IVAs and we get about seven hits a minute on that database, about 3.5 million a year, so a lot of people are interested in that sort of thing. We have about 40 information leaflets available as hard copy, download, even MP3 format for some of them, and you will find most of those in any citizen's advice bureau you go to and lots of other help offices that you might need to use. Indeed, one of our leaflets that is very popular is entitled

Alternatives to Bankruptcy and that is designed to first of all make people recognise that there are alternatives and try to give them some information about what those alternatives may be. I think I am trying to give you the message that we take very seriously the responsibility we have as custodians of the system to try to give people the best information we can about it.

Q11 Lembit Öpik: If a business is about to go insolvent is there any guaranteed methodology for advice from, say, their own accountants which makes sure that that business knows the procedures?
Mr Speed: Certainly an accountant would be expected to be extremely familiar with the corporate insolvency provisions. Indeed, most of the insolvency practitioners we deal with are accountants or lawyers, so I would expect that to be the case. I think I will use the opportunity of your question to stress that the most important thing that a company or an individual can do is to take advice and act early. A lot of the most difficult cases that we see, and I am sure that insolvency practitioners see, are where people have not recognised their problems early enough and have allowed them to become overwhelming.

Q12 Mr Wright: Is the request by the department to reduce your case administration fees by 15% over the next couple of years going to affect the service quality that you can provide?
Mr Speed: I will ask Graham to say a word about the detail of that in a moment, but our view is that it is not. Our view is that, like any other part of government, we should be subjected to pressures on our efficiency, pressures to do the job we do better on a continuous basis, and that target was agreed with our parent department a year and a half ago on that basis. I would like Graham to explain, but we are fairly confident that we are going to be able to deliver that without difficulty.

Q13 Mr Wright: You said that was with agreement with the department. Was that a figure that you put forward that you could achieve or was it through negotiation or compromise?
Mr Speed: We would not want to put forward a figure we could not achieve. It was a figure we put forward on the basis that it seemed to us to be reasonably consistent with the pressure that the department generally was under to reduce its costs across the piece. I think you will find that most departments are facing the prospect of having to do their work with 5% year-on-year administration cost reductions, and we felt that we needed to be kept to the same discipline, provided, as your question implies, that we can continue to offer the level of service which we have offered in the past.
Mr Horne: The principal way in which we are going to achieve it, which, as you said, is challenging but we think achievable, is through an IT-led programme of change. We are investing some £70 million in IT systems which we think should bring about a net benefit of between £30 million and £40 million and it is that which we think is going to be the main way in which we will achieve those efficiency savings. As well as achieving efficiency savings the IT will also help us improve our service to customers through such things as increasing the speed of processing, improving the quality of the output and also making services accessible online.

Q14 Mr Wright: I am in a difficulty when we start talking about IT and improved services. There is always slippage in the cost. You mentioned, was it, £75 million?
Mr Horne: It is £72 million.

Q15 Mr Wright: Is that a realistic figure? Are we going to see slippage in terms of the time for implementation? Are there going to be difficulties and errors within the system? That is where I find it is difficult when you rely on savings in the Service of up to 15% and you can deliver those, but—and there is always a "but"—it is all to do with the fact that you need to modernise your IT and that all the timescales generally slip.
Mr Horne: The programme is now sufficiently developed for me to have a degree of confidence that we will deliver it in the summer, so it is not as though this is a way away. We have had some issues over the last few months, like every IT programme does. I am pleased to say we have kept within the £72 million budget and we are quite close to delivery. I am confident the £72 million budget will still be sufficient to deliver the changes. We are quite well advanced with the development of the systems. We expect them, as I say, to go live in the summer and then we will start reaping the benefits from those systems, which will be productivity and efficiency savings which will then feed through into case administration.

Q16 Mr Wright: Of course, the other part of the equation is the fact that you rely quite heavily on a number of incomes from various sources which are really outside your control. There is funding from BERR and the recovery of legal costs in court proceedings. Does that make it difficult to predict what level of service you can provide and would it not perhaps be far better for you to know exactly what your budget is going to be rather than relying on an unknown quantity?
Mr Speed: That was the way that the Service was run up until 2004. The problem with that is that it puts a huge amount of risk on the department because the department, having to fund in particular the case administration work, then bears the risk of having to deal with significant changes in the caseload, such as we have seen in some parts of our organisation recently, without having the funds to back that up. The great advantage to the Service of the net funded regime which came in in 2004 is that where we are delivering public services we are able to collect fees to cover the costs of what we do.

Q17 Mr Wright: So you do not find that a difficulty, predicting the level of service that you can provide, because you obviously assume that you are going to get recovery of legal costs?

Mr Speed: Predicting the volume of demand that is put upon, for example, the official receivers or the redundancy payment service, is incredibly difficult so I would not want to pretend that that is easy, but in the official receivers' area the point is in a sense that every case we do brings in the income that we need to cover the costs of doing it.

Q18 Mr Wright: You have said that you can deliver the service at the level that you have done before, but you did approach the department for a supplementary estimate in 2008-09 for £14 million in relation to case administration. What was the reason for that?
Mr Horne: What happens is that on our fee funded side we get fee income and the fee income equals costs, so as part of the parliamentary approval process we have to ask for a supplementary estimate when say our costs have increased, but it is a net zero because our fee income has also increased. The reason it has gone up by £14 million is that we have more cases. On the case administration side, more cases equal more fees and therefore it zeroes off, which is not true on those parts of the business which are funded from a programme budget.

Q19 Mr Wright: I am sure somebody with an accountancy degree will be able to understand but an engineer would not be able to do that perhaps.
Mr Horne: I suppose the point is that we were not asking for more money from Parliament. It is the accounting side of the transaction which balanced off to zero.

Q20 Mr Wright: So at the end of the day it is just a paper transaction?
Mr Horne: On the case administration side more cases equal more fees, and therefore the fee should cover the cost of carrying out that administration.

Q21 Mr Wright: And this is an annual event, that you call for a supplement if there are more cases?
Mr Speed: Whenever the case volume is different from the projections that we have made, clearly we have to adjust our books as we go through the year.

Q22 Chairman: Just to be absolutely clear that I have understood that correctly, the BERR winter supplementary estimate said that £14 million was a "bad debt provision for case administration fees", £14 million in relation to case administration fees that the Service no longer expects to recover. I am probably just not understanding. You say that it nets out and yet there is a £14 million bad debt provision.
Mr Horne: But our fee structure is based around the fact that we predict a 12% bad debt rate.

Q23 Chairman: 12%?
Mr Horne: Yes, but that is built into our fee structure, so in asking for that estimate I think it is something to do with the way the accounts have to be approved by Parliament. What we were not asking for was £14 million worth of public money to write off bad debts because that had already been covered by the fees we were collecting.

Q24 Chairman: So this is just a bookkeeping exercise?
Mr Horne: It is a bookkeeping entry, yes.
Chairman: I think we might seek some greater clarification subsequently just to make sure we have got that right, but we will not linger on the point today.

Q25 Mr Clapham: Looking at the current economic challenges, if I can just refer to my own town, in Barnsley over the last year we have seen unemployment increase by 82%. Given the severity of the downturn, is it more severe than you expected or less severe, and do you feel that you have the resources to be able to deal with the situation as we move forward?
Mr Speed: Would you forgive me if I do not indulge in economic punditry because it is not really something I am skilled to do? What I am happy to talk about is the extent to which the change in economic circumstances has affected the Service. It is clear that we have seen—

Q26 Chairman: Just a second. It is a key planning assumption, is it not?
Mr Speed: We certainly make planning assumptions but we have to—

Q27 Chairman: So what is your planning assumption about the numbers this year?
Mr Speed: This year we said that we would see 74,200 cases going through the official receivers' offices.

Q28 Chairman: Compared to, for last year?
Mr Speed: I think it was round about 70,000. I would need to check that for you.

Q29 Chairman: So a very modest increase, is what you are saying?
Mr Speed: Yes. If I could just put a bit of colour on that, bankruptcy numbers actually fell flat about 18 months ago—a little longer ago than that, actually—and until as recently as summer they have remained flat. At this time last year, when we were writing our corporate plan, you can see that we were in very different circumstances.
Chairman: I will not steal Mr Clapham's questions from him, but thank you.

Q30 Mr Clapham: The key assumptions, of course, need to be adjusted. We have seen, as you say, the increase in insolvencies from 70,000 to 74,000.
Mr Speed: That was last year compared to this year.

Q31 Mr Clapham: So quite a modest increase, and, given the indication that that is going to continue to increase, there must be some need for you to adjust your planning assumptions.
Mr Speed: We have adjusted our planning assumptions during the course of the year, yes. We are now having this year round about 78,000 cases instead of the 74,000 that we originally thought.

Q32 Mr Clapham: But you feel that you have got the resources to cover that?
Mr Speed: Oh, certainly, for that sort of increase, yes. We will not have any difficulty coping with that.

Q33 Mr Clapham: You have quite obviously set the targets that you feel you have the resource to meet. Given that situation, which of your targets is likely to come under the most stress as we move into a situation where the economic scene becomes more severe?
Mr Speed: Obviously, it is a question of degree, but the target that will come under most stress most quickly is likely to be the target for enforcement.

Q34 Mr Clapham: Given that, and enforcement being a major part of the work that you do, do you feel that you can still deal adequately with that with the staff that you have, or will you be needing to call on staff from outside to come in and assist?
Mr Speed: Enforcement is one of the areas which is not fee funded; it is funded by the taxpayer, and therefore we have a budget from the department to carry out that work, so it is not in our gift to flex, as it were, the size of the organisation. This is the point I was making to Mr Wright earlier in relation to the move forward, that we made fees in April 2004, but that does not affect this part of the business. If we were to see a sharp increase in complaints about the conduct of company directors, or indeed about live companies, then we would have to deal with that against the background of discussions with the department, I suppose, about the resources available to us.

Q35 Mr Clapham: One of the things that we do know about an economic downturn is that the statistics indicate that there is an increase in wrongdoing. Given that situation and what you have said about enforcement, is it more likely that you are going to have to call for extra resource, particularly bearing in mind the budget? Is the budget going to be sufficient to underpin the enforcement work that is required?
Mr Speed: We do not have a budget for next year yet. That is something we are talking to the department about.

Q36 Chairman: You do not have a budget for 2009–10?
Mr Speed: We were given an indicative budget, as everyone was at the beginning of the comprehensive spending review period, but we do not have a specific agreed budget for next year yet.

Q37 Chairman: When will that be agreed?
Mr Speed: We are working with the department on that at the moment.

Q38 Chairman: But it is only two months away.
Mr Speed: The same goes for the whole of the department. We are in it with everybody else.

Q39 Mr Clapham: I heard what your reply was to Mr Öpik. Given that we are likely to see this increase, do you have sufficient numbers of official receivers to mean that you can deal with it, or do you see yourselves being much more reliant, for example, on agency staff, and do you feel the agency staff are sufficiently qualified to be able to deal with a lot of the work that is going to come forward?
Mr Speed: In relation to the official receivers' work, the short answer to that is yes. We have a policy, and have had for some time, of bringing into the organisation what we call short-term appointees. It is a rather unhelpful term. What it actually means is people who are fully qualified either in law or accountancy. There is a pretty active market in these people outside, I am pleased to say, so we are able to draw on that market to act as a buffer for our work, and we already have a number of those people working in the official receivers' offices because, of course, apart from the blip that I mentioned a moment ago, bankruptcy cases in particular have been rising quite steadily since about 2003.

Q40 Mr Clapham: Given what we said at the beginning of the questioning session about changes in structure, have you put any measures in place that would, for example, mean that there is going to be more regional engagement than there has previously been, or is that something that is likely to develop over the next two or three years?
Mr Speed: One of the things that I think The Insolvency Service is very proud of is the fact that it is not just a regionally but a very locally based organisation. We have 36 buildings around the country, we have 42 official receivers around the country. We have an office, as you may know, in Sheffield and we have two offices in Leeds. The reason we are disposed that way around the country is that some of the work that the official receivers do, particularly the investigations work they do into potential misconduct of bankruptcy company directors, requires from time to time that we do face-to-face interviews with people, so we think it is quite important to be present in the community and we have specially designed offices to allow our customers to come in and see us. In terms of other parts of our work, the redundancy payments offices, for example, we have those in Watford, Birmingham and Edinburgh, and they divide the country up according to where the headquarters of companies whose ex-employees that they are dealing with are, and, as I said earlier, in relation to most of the rest of what we do, we have three concentrations of staff. I think it would be helpful to point out that one of the biggest concentrations of staff we have is in Birmingham and there is also a pretty big group of people in Manchester. We have bits of most parts of The Insolvency Service both in Birmingham and in Manchester.

Q41 Mr Clapham: On the redundancies issue, this is a very important one. Do you feel that your funding is fit for purpose in the current situation? I will tell you why I raise that. A little earlier today in the tea room, and all the chaps go off in the tea room, I was

talking to a colleague about his particular situation in his constituency and he was referring me to companies that went insolvent or shed labour rather than going completely out of business and yet the people who were waiting for their redundancy pay have been waiting since October and some of them still had not received it. Given that situation, does it not indicate that possibly your funding may not be fit for purpose in a situation where the recession is increasing in severity?
Mr Speed: I think we have got a very good story to tell on that, and I would like just to make the point that the only redundancies that we deal with are those which arise from corporate insolvencies, so they may not include the case that you are talking about, but Graham is very close to this area and perhaps he would like to comment on it.
Mr Horne: We have seen a large increase in the number of redundancy claims we have to process. We processed less than 80,000 last year. This year we think it will be over 160,000. Despite that we are still meeting our target of processing 78% of claims within three weeks, so the case you are referring to I am certain is not one that we are handling because we are processing our claims very quickly. There are circumstances where employees are made redundant and their employer does not pay the redundancy they are due but they are not formally insolvent, so therefore it is not in our system because the company is not formally insolvent. What they can do, however, is go to an employment tribunal and get an order that the company pay and then we will pay out and seek to recover it from the company. There is this state buffer that if the company either cannot pay because it is insolvent or will not pay, provided a tribunal makes an order, we will then be able to process the claim.

Q42 Mr Clapham: So you do not see a situation arising where, for example, the Service is likely to be out of pocket as a result of redundancy arrangements? I mean out of pocket with, for example, the relationship with HMRC in the funding that you receive?
Mr Horne: No. The HMRC, as you say, fund us for administering the redundancy payment scheme. We have had a large increase in the cases we have had to administer. We have had discussions with them and they have said that they have no difficulty in giving us more money so that we are able to cope with the higher volume of claims, so we are confident that next year we will be able to cope with the volume of claims that we think we will have to deal with.

Q43 Mr Clapham: If things do get worse, and the indication is that they are likely to get worse before they get better, do you feel that you have sufficient resource to be able to bring in the qualified people from the private sector who are going to be able to assist in an appropriate way?
Mr Horne: On the redundancy payment side it is processing work. It is done by comparatively junior staff. How we have coped so far is by using our experienced staff to manage groups of temporary staff, and that is what we would expect to do in the following year, taking the dedicated and committed workforce we have got who are there processing claims at the moment and using them to lead teams of people we bring in. We have seen a 100% increase and we are still hitting our targets. We could easily cope with quite a large increase next year through this use of our dedicated staff to manage temporary staff.

Q44 Mr Clapham: And that will generally apply to, shall we say, the general case administration as well?
Mr Speed: Broadly speaking, yes, it would. We have got, I think, a considerable way to go before we would face serious difficulties in coping with an upturn in demand in that sort of work.

Q45 Lembit Öpik: I understand that you feel that you are covered. What happens if there is a 40,000 increase? I do not think that is going to happen, but what do you do? What is the mechanism? Do you go to the Government to get private practitioners out to try and deal with that backlog?
Mr Speed: One of the things the Committee may want to note is that we will be putting our corporate plan before Parliament in about two months' time, so if this inquiry is still ongoing you will be able to have a look at what we have concluded we should do. We are, obviously, in a position where we are thinking about what we should do should there be an increase? Should cases increase by 10% or 20% or 30%, or maybe even 35% or 40%,—and I am talking now about the official receivers' work, not the redundancy payments work that Graham was talking about—we could cope. At the top end of that it would get more and more difficult but we could cope. My own feeling is that that is unlikely to happen despite the economic climate outside, not least because the level of bankruptcy which we are dealing with is already at a historic high. You might have seen our quarterly statistics at the end of September, that on a seasonally adjusted basis that was the highest level of bankruptcies on record. Beyond that we have to start thinking quite differently, as your question implies. We would certainly be wanting to have discussions with the insolvency profession outside to see how we might cope.

Q46 Lembit Öpik: Is there a mechanism through which you can ensure that Government and ministers are cognisant of what you think are the trends as you see them?
Mr Speed: Oh, yes. Very simply, I write a quarterly report about the state of play across the whole of the Service to my minister and we talk pretty frequently. He is pretty well appraised of what is going on.

Q47 Chairman: I just want to test this question of director misconduct during the recession in a bit more detail before we turn to pre-packs. One of the obvious ways in which directors can misbehave during a recession is to trade when knowingly insolvent, for example. They place large orders with suppliers, knowing they are unlikely to be able to afford them. There have not been very many

prosecutions for trading when knowingly insolvent over the last few years. This is an area that is likely to increase, it seems, during a recession. It is a natural defensive response. I think it is evil but the intention quite often is probably to keep the business going. Sometimes it is built on assets which can be sold in a pre-pack administration, and we will come to that later, but this question of funding for director misconduct does concern me. What are you asking for for the financial year? It is £37.9 million this year, 0.5% higher than the previous year. What increase are you looking for in the New Year?
Mr Speed: I would rather wait to see what the department says it is able to help us with. One thing I have said to the department is that I think it would be helpful for the confidence of the market generally if, instead of investing all the money that we get into front-line activities, we were to invest a very small top slice of that money in putting more effort and more resource into publicising the work that we do with a view to creating a better deterrent effect. We do do some of that but my own feeling is that we do not do enough of this and we do not do it well enough.

Q48 Chairman: Publicity?
Mr Speed: Publicity, yes. I think knowledge of the types of sanctions which are available and of the consequences of misconduct probably is not as good as it should be, so, almost in a perverse way, you are suggesting we need more money and I suggest what we need is a little bit of money to do something different.

Q49 Chairman: That is in the evidence and people in the profession have said to us that they think you should. They take part of the responsibility for the low profile of insolvency work and they say The Insolvency Service itself could also do more.
Mr Speed: I agree with that. I do not want to words in other people's mouths but I suspect the department would be fairly comfortable with that.

Q50 Chairman: A truly well-functioning capitalist economy demands the stiffest punishments for abuse.
Mr Speed: Yes. You talked about a specific type of director misconduct. If I could give you a flavour of what we do actually do, in terms of director misconduct? On an average working day in this country round about five directors will be disqualified as a result of work that we do around about six or seven bankrupts will have bankruptcy restrictions placed upon them as a result of what we do, and somewhere in the country, again on average, one person per working day will be convicted of committing an offence on the basis of evidence that we have brought to a prosecuting authority. It is probably worth also pointing out that, in relation to director disqualification, at the moment we are achieving an average disqualification period of round about six years. If you are somebody whose business is running businesses that is a pretty serious sanction to have put upon you.

Q51 Chairman: As long as Companies House monitors it properly and makes sure that new companies are not being formed with disqualified directors.
Mr Speed: I have read the transcripts and we do talk to Gareth pretty frequently.

Q52 Chairman: I note and welcome what you said about publicising your work more. Let us look at this thorny question of pre-pack. I have had a copy of an email to you yesterday which said, talking about the Radio 4 programme *File on Four*, "Growing numbers of unsecured creditors are being short-changed by chief executive officers who move liabilities and debts to a beleaguered company within their organisation and then call in the administrators to that company. This practice is perfectly legal and is performed in the name of preserving jobs, but at what cost?". I have a lengthy one here which I received this morning just before I came to the Committee, and I think this summarises the situation rather well. I will not name the person; I will happily show it to you afterwards. "It seems inconceivable that the law allows small companies to be put into jeopardy whilst the administrators collect huge fees. The banks and the Revenue"—the Inland Revenue—"are preferred when they already have help from the Government and the buyout teams can usually trade these invaluable assets and goods which have been supplied, and supplied at no cost to them, by the unsecured small businesses. We are currently suffering as a result of a pre-pack administration which left us with a considerable bad debt. As this was billed during the VAT quarter ending November 2008 we have had to pay the VAT on this at $17\frac{1}{2}$% against no income and we will be unable to claim against the bad debt until the end of the next VAT quarter." That is a policy question that I had not previously considered. "Of course it is good news that many jobs have been saved but it seems to be at our expense. We are unable to borrow on those bad debts so are facing grave difficulties in trading as a direct result of the rescue of our client company. This is our 37th year of trading,"—so this is an established business—"so we are old campaigners and have been through recessions before, but this pirate's charter will surely make this particular downturn even more painful for the small business". "Pirate's charter" is the phrase that you and I heard on Radio 4 as well. I could take you through the series of questions. Is there anything you want to say first before I do that?
Mr Speed: I will just correct one point in that, if I may, which is that it is no longer the case that the Crown has preference in insolvency. That was removed in the Enterprise Act. I could talk to you about our thoughts about pre-packs and all that if you wish or I can answer your questions.

Q53 Chairman: Let us see how we go on the questions. I think it is fair to say that the balance of evidence we have received about The Insolvency Service, and I do not want to pre-judge our report, has been pretty favourable to the Service. There are concerns of detail here and there but we have not

really heard a litany of complaints against the Insolvency Service, so you can congratulate yourselves on that. We have got quite a lot of complaints about insolvency practitioners and I suppose that is inevitable because no-one likes insolvency practitioners because they are doing an unpleasant job, but I think some of those complaints might be legitimate. I want to move on to policy work here. A good company can have a bad balance sheet; that is possible, and a going concern is always preferable to liquidation because that gives as much overall value to the company as possible. Also, I am coming to the view that pre-pack is a problem for smaller businesses and not the bigger businesses. Most big companies will differentiate between financial and trade creditors and try to look after trade creditors in administration. Is that fair comment?

Mr Speed: I do not think I can answer that question. One of the interesting characteristics of pre-packs is that we are still learning about them. You have, I dare say, had information from Sandra Frisby, who is one of the leading academics in this area, who indeed has been working very closely with R3, and to some extent with us as well, so we need more and better particulars on that sort of thing. One point that struck me while you were reading out the email that you had had—and you are right: we did have a copy of the other one yesterday—is that it seems to me there is a considerable amount of confusion in the quite extensive dialogue that has been going on recently in the press and elsewhere about the position of unsecured creditors. There seems to be an inference being drawn by a great many people that somehow a pre-pack is uniquely prejudicial to unsecured creditors when I think the real position is that unsecured creditors are going to lose anyway, and therefore in the round the sum of things is that the evidence suggests that pre-packs do preserve jobs, economic value and goodwill in a business that has become insolvent or got into difficulty, and therefore, from a public policy perspective, there is an argument, I think, that greater value can be preserved through that route.

Q54 Chairman: I have some sympathy with that but I have got to drill down to the detail. Generalised comments about all pre-packs being bad is not helpful. Let us look at what formal insolvency actually does. It destroys all value in the company effectively, does it not?

Mr Speed: Yes.

Q55 Chairman: And also—and this is perhaps more controversial—when the big accountancy companies like Deloittes and PWC get into a business, and I have no particular cases in mind here, they make huge money in fees for collection, and also the administrator takes on effectively personal responsibility for getting cash for the business, so actually there is direct pressure on the administrator to have a fire sale of assets and get the thing off his books as quickly as possible.

Mr Speed: I would argue that the greater pressure on the administrator is to fulfil his statutory objectives, which are set out very clearly in the Enterprise Act and amendments to the Insolvency Act, and those are very clear and the centrepiece of what the Government was trying to achieve in the Enterprise Act, which was the better development of a culture of rescue for businesses before they completely fail. An administrator is bound by the Enterprise Act amendments to act first of all, in the interests of all the creditors, whether they be secured or unsecured, to try to rescue the company itself that is in difficulty, failing that to try to preserve as much of the business as possible, and that would include a pre-pack, it would include a business sale, a trading on, whatever, and only—failing all of those avenues—to liquidate the business and distribute the assets to the creditors. I think the difficulty with pre-packs is, as I said earlier, that they are one technique that is available to insolvency practitioners. They are unregulated but they are a technique that is available, but I do not think they cause the effects that people worry about uniquely differently from, for example, trading a business on or selling a business on after administration has begun.

Q56 Chairman: I think there is a difference. The view I am coming to provisionally, and it is only anecdotal evidence so far, is that the promise of pre-packs is all right particularly for smaller companies that go into administration, which typically rely more on their trade credit to finance the operation than the more sophisticated business might, so having long periods of payments to your suppliers is the way you keep going in business quite often. You use trade credit to finance your business, and some big companies do too. Some of the supermarkets one thinks of do, and the fact is they are not being particularly noble, but it is particularly true of small businesses. They rely on trade credit and so there are large numbers of unsecured trade creditors, and do not forget that 99% of all businesses in the UK employ fewer than 50 people so it is a huge issue in terms of employment in the UK. Another test also is where the company is effectively a phoenix company with the existing ownership and management. Often it is good to have the same ownership and management because they are the best placed to run the company and give it a fresh start, but often this combination of factors—smaller companies with a large amount of trade credit and a phoenix company emerging, which is effectively the same business all over again with just the trade creditors dumped rather painfully—seems to be where the issue arises. In macroeconomic terms this may not be of huge significance but good pre-packs of big companies might deliver macroeconomic benefits, but the impact on a lot of small businesses in a recession can be very serious.

Mr Speed: And we heard some excellent examples of that on the *File on Four* programme.

Q57 Chairman: Including from my own constituency.

Mr Speed: Yes, indeed, and clearly when that happens to you that is not a nice thing. I am still struggling though to understand why it is that we draw a distinction between what would happen in a pre-pack in a given situation to those people and what would happen where the administrator cannot sell the business and effectively has to liquidate it. Those unsecured creditors are going to be pretty much in the same position either way. What I struggle with is trying to see what specific evil pre-packs bring. One of the things that people talk about a great deal is this phoenix business, that is to say, where a connected party, which is a polite way of saying the same person in many ways, ends up with the business again, and I would draw a little bit again on some of the research that Dr Frisby has done, which shows that, to the extent that connected party sales fail a second time down the line, that second failure is very rarely connected with the first. That suggests that these connected party transactions on the whole are innocent, ie, they are people who have run into innocent failure, want to start again, and where they fail the second time the failure is not connected with what happened to them the first time.

Q58 Chairman: This Committee believes in failure. We believe failure is very important, the principles underlying it. There is nothing wrong with that at all because it happens that some people fail and sometimes we have heard evidence that people who have failed have gone on to be better business people the second time around; we can understand that, but there are a lot of anecdotes, particularly in the printing industry, for example, about individuals behaving in a predatory manner.
Mr Speed: Perhaps we need to look at this from a slightly different angle, and I would like to invite Graham to comment on some work that he has been doing, which is that we have to use all the tools at our disposal. We have talked already about the enforcement regime that we have. We have regimes which I mentioned earlier which allow us to disqualify directors. We also, of course, oversee the Insolvency Practitioner Regulation Framework and I think it is very important to get on the record—

Q59 Chairman: Regulation we want to talk about at the end of our session.
Mr Speed: Yes, sure, but it is germane to this as well because the parties who are concerned with this are the company directors, their financiers and the insolvency practitioners. I have talked about the duties that insolvency practitioners are under. Directors have their own duties under company law. What we have is a suite of powers which enable us to test whether those duties have been adhered to, and Graham might like to say a bit about SIP 16 and the extent to which we think that is quite a big step forward but also what the Insolvency Service is doing in parallel with the introduction of SIP 16 to try to get a better handle on this question.
Mr Horne: As you may know, SIP 16 came into force on 1 January. It imposes duties upon administrators to disclose certain things to creditors in relation to the actions they took prior to their appointment. They have to give details of how they were introduced to the company, what work they did prior to their appointment, what marketing they did at the company, what valuations they took of the business, really to explain to creditors why they felt that a pre-pack was the best thing for them, and it is really down to the administrator's judgment as to, in this case, whether the best thing was a pre-pack. What the SIP 16 statement does is put on record the insolvency practitioner's explanation of why he or she came to that decision. What we are going to be doing is proactively policing those SIP 16 statements. We are going to be getting every SIP 16 statement into our office and we are going to be looking at them to see two things: one, that the administrator has followed not just the letter but the spirit of SIP 16, and we will be asking more questions of administrators about whether they did take the right decision in those cases, not second-guessing their commercial judgment but trying to say, "Have you really explained to creditors why you chose this particular route?", so we are looking at how the insolvency practitioner has behaved but also how the directors have behaved. Clearly, for there to be an abuse there probably has to be negligence (at best) on the part of the insolvency practitioner and abuse on the part of the director. We will be able to use the regulatory and enforcement sanctions available to us to approach it on both fronts.

Q60 Chairman: If you have the resources to do it.
Mr Horne: We are going to prioritise this. With the resources we have got we will certainly be putting this as one of our priority activities.

Q61 Chairman: My political experience is that when issues climb up the agenda they usually do so for a reason, not by accident. There is never smoke without some fire. I was going to ask you what steps you will take to monitor the new guidance. I think you have answered that question.
Mr Speed: I just wonder for the transcript whether we should say that SIP 16 stands for Statement of Insolvency Practice 16.

Q62 Chairman: Can I ask as a matter of fact in pre-pack administration what role the court has, what role you have, what happens?
Mr Horne: There is no role for the court in the sense that what the administrator does is that he or she decides that that is the best thing to do for the creditors. The sale is effected on the same day as the appointment or shortly thereafter. The administrator then has to put a proposal to the creditors which explains to the creditors what he or she has done in their interests, and the creditors can vote, if they are going to receive some money, on whether or not they agree with the administrator's proposals. It depends whether the creditors are going to be getting a dividend but there is a proposal that he has to put to creditors. He has already sold

the business and you might say, "What are the creditors voting on?", but they will be given the information as to why that has already happened, and if they do not like what the administrator has done they will be able to go back to the administrator and ultimately back to the court if they really think that the actions of the administrator have not been in the best interests of the creditors.

Q63 Chairman: You see, we are dealing with some quite disadvantaged people, are we not? My constituent on the programme lost £54,000 in a pre-pack and then lost more money with the following company. That is his pension fund gone, effectively. He had no redress at all, did he?
Mr Horne: It is difficult for small creditors to take court action but they can raise it with the administrator, they can raise it with the administrator's professional body, they can raise it with us. Government is often a creditor in these cases as well. HMRC are often a creditor and I think they can have a proactive role to play in this.

Q64 Chairman: I suspect we will see more and more of these unsecured small business creditors coming to us and saying, "We have had our fingers burned". What advice should we give them? What should we tell them to do?
Mr Speed: I am not one to give business advice. It does seem to me though, just as a matter of common sense, and I saw this in one of the press articles recently—I think it was in the *Financial Times*—that this is a time in the economic cycle when all businesses have to be looking very hard at whether they have priced their own risk properly, and that sounds a slightly sophisticated term, but whether they have covered their base properly.

Q65 Chairman: The trouble is here that the bigger problem is getting credit insurance. In fact, it has been put to me that credit insurers are not treated properly as stakeholders in insolvency, and that is one of the reasons why they are having problems with credit insurance now. Do not answer that point now but it is an observation. Absent credit insurance there is a huge problem out there.
Mr Speed: I will not answer the question substantively but we have had a very useful discussion with the Association of British Insurers a mere matter of months ago, so we are engaged with them.

Q66 Chairman: Yes, but it has got worse recently. The Government, to be fair, is looking at what it can do here with some urgency.
Mr Speed: We have got anecdotal stories out there, we have all heard them. The difficulty is getting some systematic evidence that there is—

Q67 Chairman: The whole business class cannot get access to credit insurance where they used to.
Mr Horne: But if creditors wish to raise concerns they have about how the administration has been handled we have a hotline, we have an enforcement email address. We would certainly want them to email us.

Q68 Chairman: We should put aggrieved creditors in touch with you. That is the answer to my question.
Mr Horne: Indeed.
Mr Speed: It is a very helpful hook for me to say that we would like our hotlines—we have hotlines for all the different types of misconduct that we investigate—to be used more. As I said earlier, we would like to get some more publicity out of all these avenues, yes.

Q69 Chairman: I just want to test a few other things before I move on. One of the claims made for pre-pack administrations is that they preserve jobs but it has been put to me that it is TUPE that does that, the Transfer of Undertakings Regulations. It is not actually the pre-pack; it is the legal requirements. Actually, with pre-pack administrations quite often the jobs are shed subsequently over a period of time and the protection is the protection of TUPE.
Mr Speed: That is difficult to comment on. Again I go back to Dr Frisby, who is the expert in this area, and her research seems to prove reasonably conclusively that pre-packs do preserve jobs. I cannot comment on what happens afterwards because I do not know.

Q70 Chairman: I have not seen Dr Frisby's research. My suspicion is that it deals with the whole range of pre-pack administrations, and statistically in the bigger administrations it is done often consensually with creditors, so her conclusions could be valid, but for smaller administrations which are not done consensually, they are imposed on trade creditors, they would not be valid. That is my amateur hunch on this, and in a recession we must protect the smaller businesses too. Let us go on to Chapter 11. It has been put to me that a lot of Chapter 11 administrations are actually the American version of pre-pack.
Mr Horne: The first thing to say about Chapter 11 is that I do not think the experts agree amongst themselves as to whether or not it would be good or bad for this country. One thing that Chapter 11 does is that, because it has got an indefinite moratorium and leaves the directors in charge, it means that the company carries on almost *ad infinitum*, sometimes even when that was not the best thing to do. You said earlier on that you believe in failure and I think one point about Chapter 11 is that it almost tries to get rid of failure. At one point I think 50% of the airline seats of American airlines were from airlines in Chapter 11, and I think there is a point there about competition in the market place and whether Chapter 11 is anti-competitive. Chapter 11 is just an insolvency process. It does not stop companies going into insolvency. The question I have asked myself is, is it better for returning value to creditors and for preserving jobs than what we already have? One

observation I would make is that it is very debtor-friendly whereas we have had historically quite a creditor-friendly system.

Q71 Chairman: All that you are dealing with is issues of balance; it is a balance of interests, the balance of the ongoing business against the creditors, and here I think you have a different question of balance. I put to you earlier on that at present the balance of pressures on the administrator is to have a fire sale to get rid of the business, to move it on very quickly, not necessarily in the best interests of the wider economy, the company or the creditors; it is a process that has to be gone through, whereas in Chapter 11 with safe havens and debtor-in-possession arrangements it is possible for the company to take some time to think about what is the best model in the interests of the company. With the best will in the world, an accountant coming in knows nothing about how to run a business. He only knows how to get the value of assets.
Mr Speed: An administrator has 12 months, and indeed, if he or she should find 12 months is not sufficient, he or she can go to the court to have that administration extended, so I am not sure that the time itself is a barrier to similar achievements in administration. I would also go back to the point I think I made earlier, which is that the principal objective of administration is rescue. We must not lose sight of that. That is really what an insolvency administrator is bound by law to try to achieve in the interests of all of the creditors.

Q72 Chairman: Have you looked at the new French "safeguard measures", I think they are called? I will not use the French. Have you looked at what their implications are, because that is something closer to the debtor-in-possession arrangements in the US, is it not?
Mr Horne: Yes. We have spent some time looking at other systems round the world. We have taken a lot from New Zealand and Australia. The French have recently done some interesting work which we are looking at and seeing whether there are things we can import, because we are always keen to see if there are things we can, quite frankly, steal from other regimes that would work in the UK economy. Going back to Chapter 11, one of the issues we raised earlier was TUPE. One of the advantages of the American Chapter 11 system is that you can break contracts, which is very good to keep the company going but perhaps not so good for employees whose contracts are broken or creditors who get their contracts broken, so again there is a balance in all these systems.
Mr Speed: And, of course, TUPE derives from European law which the Americans are not yet bound by.

Q73 Chairman: I am just wondering if some of the benefits claimed for pre-pack are over-claimed; that is all I am putting forward. I have a concern about whether the Enterprise Act was good for the good times but has not been quite so good for the bad times, with in particular smaller suppliers facing real challenges. Do you think that the position of unsecured creditors has got worse or better since the Enterprise Act?
Mr Speed: I think from one perspective it has got better. We have moved away from—and the statistics report this—administrative receivership where one person would go in, sort themselves out and leave everybody else hanging out to dry. The amount of administrative receiverships has fallen very steadily since that came in, and indeed has been substituted by administration where the purpose is rescue, so I would argue that the policy framework was designed to help businesses in that position in a more effective way than it would have done before. In practice, of course, what is happening now is something we have not seen for 15 years or so, and, of course, if you look at the panorama of business failure, if I can put it like that, it would be very difficult to de-convolute the outright effect of recession as opposed to the effects of the change in the law which took place six years ago.

Q74 Chairman: Have you learned the lessons from post-legislative review of the Enterprise Act?
Mr Speed: I will ask Graham to comment in a moment but, as you may know, we published a rather hefty set of tomes round about this time last year. We can point to specific things in there where a lot of work went into that, and that was indeed in fulfilment of the pledge we made during the passage of the Act itself. It is worth pointing out that we were not in the same economic times as we are now when we wrote that and, as some famous person in history said, it was a little bit early to draw any firm conclusions. I think it was Deng Xiaoping.
Mr Horne: I think that is really what the evaluation we carried out said, that it was a bit early to say and we need some really hard data as to how well it is doing, bearing in mind the transitional arrangements it will take some time before it starts impacting. The information we have so far is that it is achieving what we set out to achieve. The jury is still out as to whether it is in fact increasing rescue rates and increasing returns to creditors, and we will certainly need to carry on evaluating it.
Mr Speed: One thing I think it did show was that the average speed of administration has fallen quite substantially since the Act came in. I think it has fallen from about 17 months to about 12. I hear what you said earlier about an indefinite moratorium for Chapter 11, but in practice I think the faster you can do these things effectively the better it is for all the people concerned.
Chairman: I just leave you with the thought that phoenix pre-packs in SMEs might be the focus of political concern. That may be wrong but that is the view I am coming to. Shall we move on to other aspects of insolvency law and policy?
Lembit Öpik: My biggest single concern is what look like extortionate fees which are charged in a position where those who can challenge them are usually economically vulnerable. Do you have a particular view on that, or do you think this should be covered under licensing, Chairman?

Chairman: No, it is part of what I said at the beginning about our last section of questions—the unpopularity of insolvency practitioners. Fees are seen to be very large. It is a question I am not happy about.

Q75 Lembit Öpik: It seems to me that the client is basically in a really vulnerable position and therefore the fees can pretty much be set in what amounts to a monopoly situation.
Mr Speed: I do not think it is a monopoly situation. As you would expect, I think, The Insolvency Service talks to insolvency practitioners and their representatives quite frequently and I often hear anecdotes of people scrapping quite hard to get particular appointments, so I would not say that.

Q76 Lembit Öpik: What would you say once the relationship has been established? I could be wrong about this. It seems very—
Mr Speed: Once the relationship has been established the people who need to take control of what is happening in relation to fees are the creditors. We do not live in a society in which we regulate prices; we have to rely to some extent on competition, but creditors do have powers, for example, to object to fees that administrators are proposing and they can and sometimes do get the administrators changed. Therefore, perhaps one of the cultural lessons we need to draw from this is that creditors need to be better educated and better facilitated to use the opportunities that they already have in law to get together and decide what it is that they want to pay for in the administration.

Q77 Lembit Öpik: The issue for me though is that the creditors are in a vulnerable position. As the Chairman has already pointed out, often they are in vulnerable financial circumstances themselves. I think every MP has probably been in the situation where one has ended up brokering between creditors and somebody who is trying to decide who gets what. You have said that there is a facility for creditors to work that out. Is there any way that we can make that more robust to give creditors more influence, or certainly a feeling of more potency, when it comes to the setting of fees, some of which, I have to tell you, sometimes have looked rather gratuitous and opportunistic?
Mr Speed: Can I deal with the "gratuitous and opportunistic" first? I think it is helpful to remember that insolvency practitioners are very highly qualified, highly trained, regulated professional people, most of whom are either accountants or lawyers. I suspect you will find that the sorts of fees they are charging are concomitant with what you would expect to pay an accountant or a lawyer. I think part of the difficulty is going to be a perceptual difficulty, that when you are in distress and do not have any money that is going to sound like a lot of money. I think we need to be a bit careful about using words like "extortionate". It may well feel extortionate but whether it is or not is a different question. As I say, we do not regulate prices: we are not a competition regulator either so, in that sense, fees are not something that we directly take a view on.
Mr Horne: Just talking about the Statement of Insolvency Practice which we talked about, SIP 16, there is one about fees as well. The point about fees is that they have to be approved by creditors. There is a SIP, I think it is 9, which says the insolvency practitioner must explain to the creditors why the fees are how they are. I think what we also need to do, in the light of the current circumstances, is check that that is being adhered to by insolvency practitioners as well; that they are giving the creditors enough information for the creditors to make an informed view as to whether or not they will approve these fees. Of course if he does not get his fees approved he will have to go to court to get them approved and there will be some court supervision. There is a process there but I think we have to see that SIP 9 is working and make sure that insolvency practices are explaining themselves effectively.

Q78 Mr Clapham: Before we leave the scene, particularly in relation to chapter 11, which can be enormously difficult—particularly where you have got a company in the UK that is taken over by an American company and then consequently where the insolvency issues are heard in the American courts; again, particularly in relation to long-term liabilities, for example, where there may be asbestos; and I am thinking here in terms of the Turner and Newall issue—do you have a list where you would have your expert administrators, receivers et cetera that you would recommend actually be the people who are associated with a given company, given the complexities?
Mr Speed: I think there may be a slight misunderstanding here: we do not get involved at all in administration work; we do not do that whatsoever. The only type of company work that we get involved in is where a company has been compulsorily wound-up by the courts—and the Official Receivers would deal with that as a matter of course. We do not do any of the other forms of insolvency.

Q79 Chairman: Could I just ask you a question about how law and policy is actually shaped. We have heard criticism, not necessarily of you but of the system, that you are overseeing a piecemeal development of personal insolvency laws which risks undermining its effectiveness; we know with the Debt Relief Orders it is unclear how that fits into the existing regime; and we have also heard about an awful lot of proposals from the Department which have been dropped, and consultations on more than 15 other proposals including the use of electronic communication and repealing or otherwise restructuring parts of the insolvency legislation. It seems that we could do more to perhaps look at the way the law is actually shaped in this area?
Mr Speed: The law is shaped broadly by periodically looking at it strategically in the round. The last time we did that was in relation to the Enterprise Act, where I think we started by issuing a White Paper in

1999 which led to the passage of the personal and corporate insolvency provisions in that Act. Periodically the insolvency world lifts itself up and has a good hard look at itself; and prior to the Enterprise Act that would have happened by means of *The Cork Report* in the 1980s which led to the Insolvency Act. In between, as it were, those big upheavals, what the Service tries to do is a sort of care and maintenance job, if you like: it is to make sure—because the world does not stand still and because also, as Graham hinted earlier, we do learn lessons from some overseas jurisdictions as we go round and talk to them—the system remains fit for purpose, and also really remains as good a system as we can make it for all of its users. It is at two levels really: it is an occasional huge strategic drains-up, if you like; and then the job we do in between that is to make sure if something is not working quite right that we can fix it.

Q80 Chairman: It does not feel "strategic" to me, certainly. Here is the evidence we have had from the Association of Business Recovery Professionals, paragraph 4.4: "There are a large number of legislative initiatives which are about to be introduced to deal with personal debt. Those in the process of being introduced include: Debt Relief Orders, Enforcement Restriction Orders and changes to the Administration Orders scheme, all of which deal with differing levels and kinds of debts. R3 is concerned that these measures are being introduced in a piecemeal and disjointed fashion by differing parts of Government. There does not appear to be a discernable coherent policy to tackle the underlying problem of personal debt".
Mr Speed: You are referring there to two pieces of work I think the Ministry of Justice are doing.

Q81 Chairman: They want you to oversee all this?
Mr Speed: Yes, I am aware of that and could not possibly comment.

Q82 Chairman: That normally means, yes!
Mr Speed: What I would say is I would not want the Committee to have the impression that we are not working extremely closely with our colleagues in the Ministry of Justice, because we are. There is also a consultation going on at the moment that they are working on in relation to debt management plans; and we have been working with them extremely closely for many months now. It may be confusing, I suppose, to the outside observer looking at the fact that different bits of Government appear to hold different parts of the system, but I would like to assure the Committee that we worked in a very joined up way—in particular with the Ministry of Justice, and of course with the Court Service who we work very closely with on the bankruptcies and compulsory winding-up orders that we deal with anyway which come to us from the courts.
Mr Horne: If I could just say about Debt Relief Orders, we certainly think there is a strategic fit there because the reason we are going to introduce Debt Relief Orders is to cater for really, as I characterise it, the people who are too poor to go bankrupt, because there are people with low levels of debt who cannot afford the deposit you need to be able to go bankrupt; and so the Debt Relief Order scheme is aimed at the financially excluded with low levels of debt and no income so they can get debt relief, which they cannot currently get through the bankruptcy process.
Mr Speed: Can I just take a step back to your broad and more strategic question, and just advertise the fact, if I may, one of the things we look at is international comparisons of how insolvency regimes work around the world; and you may be aware that the World Bank has done some work on this recently. I do not want to blow our trumpet too hard but, when we are under fire about whether we should do this, that or the other, it is worth remembering that according to the World Bank's own data we rank about eighth out of 155 companies for the speed with which we deal with insolvency in business in this country, and ninth for the amount that we recover for creditors, which is of course the point we started this discussion with earlier. In all of those cases we actually do considerably better than some of the other countries we have talked about during the course of this hearing. I think it is very important we just remember that that is where we are. We are not in a place where things are fundamentally broken.

Q83 Chairman: It is just interesting to me that we have had two legislative reform orders: one of which has been dropped in relation to IVAs because it is considered primary legislation is a better way of dealing with that now; and the advertising requirements which are nugatory, to say the least, but actually at the margin I thought were unhelpful in a recession to small businesses and I wrote to object to that particular order—and I believe that is not being proceeded with now or is being sent back for further consideration anyhow. There are an awful lot of proposals floating around which do seem to get dropped which is rather strange?
Mr Speed: One of the recommendations that was made to the Insolvency Service, certainly two, three or four years ago, and I think it was the House of Lords that made the recommendation to us, was that the body of insolvency rules, as opposed to primary legislation, had become almost unusably complicated, disparate and so on; and so we undertook a very major piece of work, really to try both to consolidate that but, to do more than that, to modernise the rules. The rules do not allow, for example at the moment, for electronic transmission of documents; they do not allow the use of websites for the posting of documents; all the sorts of things we are used to dealing with; a pretty mammoth exercise. Our law consolidation textbook that we use in the office has something like 450 pages worth of rules; and we are working with the Insolvency Rules Committee, which is a committee of very learned people who work with the Lord Chancellor, to

promote that. Some of the measures you have been talking about have come out of that work. I would not say that we are simply picking things out because we fancy it, but those things came out of a determined and consistent approach to try to modernise the rules.

Q84 Chairman: Why are so many of them being delayed or withdrawn?
Mr Speed: In relation to simple IVAs what I would say is that our underlying policy objective remains where it is. Graham might wish to comment a bit more on that in a moment, if we may. In relation to advertising, we only found out that one yesterday.

Q85 Chairman: They are two small ones, but there were 15 other proposals which have been dropped as well I am told?
Mr Speed: We have not dropped those.

Q86 Chairman: You have not?
Mr Speed: No.

Q87 Chairman: "Increasing the use of electronic communication and repealing or otherwise restructuring parts of the insolvency legislation", this is not true?
Mr Speed: We have not actually tabled the Instruments for those yet.

Q88 Chairman: You might just correspond about the details. I have not got a list of the 15 in front of me and I do not want to mislead you.
Mr Speed: Yes, and they are part of the bigger programme which is coming.

Q89 Chairman: Let us just turn quickly to regulation finally. Is there a conflict of interest between the Service's role as a regulator and actually competing as a licensing authority against the other licensing bodies it regulates? Are you a conflicted regulator?
Mr Speed: I could see why people might reach that view. What I would say is, I do not think there is because we do not compete with the regulated professional bodies. We do not go out and market our regulation as something we would like people to sign up to. It happens to be there in statute, and if somebody approaches the Service to be directly licensed by the Secretary of State then that is a service we are statutorily required to deliver. I do not think it gets in the way at all of the work that we do in overseeing the seven Recognised Professional Bodies who oversee the vast majority of insolvency practitioners.

Q90 Chairman: On this question of seven bodies—seven bodies to license 1,618 insolvency practitioners—that seems a bit strange to me. Consistency seems a bit difficult to achieve with such a plethora of bodies?
Mr Speed: There are two points there: there is the consistency point; and the "it looks a bit odd" point. On the latter, that was my view too when I took the post but you always have to work out what the history of this is. The history of this, I suppose, is simply, as I mentioned earlier, insolvency practitioners are either, on the whole, accountants or lawyers; and I think somebody in the past presumably must have taken the view that since there was already a self-regulatory regime for both of those professions, there was no point in inventing something new and different for what is actually a relatively small number of people, about 1,600 or 1,700 people. Consistency comes down to how we do our job—both directly with the recognised professionals and also through the Joint Insolvency Committee, which is a committee of the eight of us who get together to work these things through. I think there has been some criticism of the fact that perhaps we are not as transparent about the way we do this.

Q91 Chairman: That was exactly my next question.
Mr Speed: Let me take that one on the chin. I would be prepared to accept that as what I might call "a helpful bit of feedback". We are now looking to see how we can make a step- change in the level of disclosure that we might put, for example, in our annual report and accounts, and I think there are three parts to this: firstly, about what the regulatory bodies themselves have done during each year in relation to their population of insolvency practitioners; secondly, about what we have done as a direct licensor in relation to it—our population of about 92 IPs; and, thirdly, about the way in which the Service has sat at the top of the pyramid and overseen the work of the regulator bodies. I would agree, I think, that we need to do more to shine a light on that. It goes back to the related point I made earlier: one of the most important things the Insolvency Service is able to deliver is confidence in the market. I think the more information we can put out the more helpful it is going to be.

Q92 Chairman: Do you need more powers to discipline the individuals you license?
Mr Speed: It is certainly true that we do not have the gradation of sanctions that is available to the Recognised Professional Bodies, and I suppose it would be fair to say that it would be good if we did. I think we are pretty effective: we can disqualify or revoke licences. We have the power actually also to restrict the terms of licences that we offer; normally we would offer three years but we can reduce that down to six months, which has a slightly penal effect of requiring an IP to be licensed twice in 12 months, which is quite expensive. Where we do find things amongst the IPs that we license directly, we will have some pretty robust conversations with them, and we will agree plans; and we will agree our visit programme to the IPs on a risk basis—so the ones we are most worried about we will visit most often; and, where there is an action plan in place, if we found that action plan was being disregarded I think we would start to look at the stiffer powers that we have.

Q93 Chairman: In an ideal world you would have a greater range of powers, but you are coping?

Mr Speed: In an ideal world all eight regulators would have the same powers, yes.

Q94 Lembit Öpik: On the question of the seven bodies, I understand from what you have said how that has come about. Forgive my ignorance, but is there a common code which you would agree with those seven bodies so everybody is working to the same hymn sheet?

Mr Speed: To start with, we have a Memorandum of Understanding with each of the regulatory bodies. I am going to take a punt here but I think it would be fair to say they are all pretty much the same. That is the starting point. The second thing is the Statements of Insolvency Practice, which we have referred to a couple of times during the hearing, and there are something like 13 of these statements. These apply to all our insolvency practitioners by whomever they are regulated, and they are mandatory and have regulatory force. In addition, on 1st January, along with all the other regulators, we published a Code of Ethics, again agreed through the process of using the Joint Insolvency Committee, which is the forum where we do this sort of stuff together. That is the long answer: the short answer is, yes, I think!

Q95 Chairman: I have got to the end of my questions. Is there anything you would like to say that you have not had an opportunity to say during the questions you have been asked?

Mr Speed: I would like to take the opportunity since we can, and put it on the record, just to pay tribute to the staff of the Insolvency Service who, as some of you will have observed during the discussion, are under a lot of pressure at the moment but are continuing to deliver really what I regard as very high quality services to our customers. Around about nine out of ten bankrupts that we deal with tell us they were giving them a good or very good service; and many of these people are people who are in quite serious financial distress themselves, and personal distress. I would like to pay tribute to our staff. I would also observe, Chairman, that the Insolvency Service is quite a complicated, complex thing to try to understand. If it would be of any help to the Committee, you would be very welcome to come and visit us and see what we do, because I think that would give you a more concrete flavour about some of the things we have been talking about today. If that is of help to you, please let us know.

Chairman: Particularly if our worst fears come to pass about what is going to happen this year that might be helpful—I hope they do not. Gentlemen, thank you very much indeed for your evidence, we appreciate it.

Written evidence

Memorandum submitted by The Insolvency Service

Introduction

1. This memorandum briefly describes the work of The Insolvency Service ("The Service") as well as highlighting some current issues and future challenges that The Service faces.

2. The Service's role is to provide an effective and efficient insolvency regime for citizens and businesses. It operates under a statutory framework mainly comprising:

— the Insolvency Acts 1986 and 2000;

— the Company Directors Disqualification Act 1986; and

— the Employment Rights Act 1996 and the Companies Act 1985.

3. BERR Ministers determine the policy framework within which The Service operates, drawing on the knowledge of our specialist staff. The Chief Executive is responsible for the day to day running of The Service, and reports to Ministers on the execution of policy, progress towards targets, and proposals for future developments.

Overview

4. The Service became an executive agency of the Department of Trade and Industry in 1990 and is now an agency of the Department for Business, Enterprise and Regulatory Reform (BERR). For the greater proportion of its work, The Service's costs are covered by fees charged for its services.

5. The Service employs some 3,000 staff (of whom around 2,500 are permanent and 500 are agency staff). It operates out of 36 locations across Great Britain, most of which are official receiver's offices working with local county courts. The head office is in London, but a substantial proportion of The Service's corporate services are delivered from its offices in Birmingham.

6. The Service has six main areas of work:

Policy

The Service combines its operational responsibilities with the role of leading on insolvency matters for government generally on behalf of BERR Ministers. The Service maintains the complex framework of legislation as well as developing policy to ensure that the insolvency framework remains world-class and fit for purpose. This work is funded by an administration budget from BERR, which is £2.1 million in 2008–09.

Regulation of Insolvency Practitioners

On behalf of the Secretary of State, The Service is responsible for the oversight of the system of regulation of insolvency practitioners (IPs). Most IPs are authorised by one of seven professional bodies. The remainder, fewer than 100, are authorised directly by the Secretary of State. This activity is funded by fee income, which in 2007–08 was £0.9 million.

Insolvency Case Administration

The Service's official receivers (ORs) administer the compulsory winding up of incorporated businesses and the bankruptcies of individuals upon appointment by the courts as liquidators or trustees. This work is carried out by 42 ORs (supported by some 1,800 permanent and 300 agency staff) located throughout England and Wales. Insolvency case administration is funded by fees that are set at a level to recover costs from a combination of petition deposits and asset realisations. In 2007–08, the costs were £14.9 million for companies and £110.7 million for bankruptcies. The ORs are answerable to the courts for the conduct of individual case administrations.

Estate Accountin The Insolvency Services Account (ISA) provides banking facilities to ORs and IPs in relation to the estates of bankruptcies and compulsory liquidations. This activity together with the associated estate accounting is funded by fees and the total cost in 2007–08 was £3.9 million.

Investigation and Enforcement

The Service's investigation and enforcement activities aim to ensure that dishonest, reckless or irresponsible bankrupts and company directors are identified and dealt with in a timely manner. There are three main strands to this work:

- ORs investigate the causes of failure in the cases they administer. Where they find misconduct, they prepare reports with a view to obtaining either bankruptcy restrictions or director disqualifications and, where appropriate, they refer cases to prosecutors for criminal investigation. Bankruptcy restrictions, introduced in 2004, have the effect of extending the time during which individuals are subject to the restrictions of bankruptcy.
- In addition, The Service is responsible for investigating and then taking forward proceedings against directors of companies that are subject to administration, administrative receivership and voluntary liquidation, where the IP office holder has formed the view that there is unfit conduct.
- Using Companies Act powers, The Service's Companies Investigations Branch (CIB) carries out fact-finding investigations into live companies.

With the exception of the bulk of investigation work carried out by the ORs, The Service's investigation and enforcement work is funded by means of a BERR programme budget. In 2008–09, this budget is £37.7 million.

Redundancy payments

The Service is responsible for the payment of claims from the National Insurance Fund made to people whose employers have either become insolvent or who have refused to honour an employment tribunal award. Some 120 staff are engaged in this activity and in 2007-08 they handled 76,416 claims. This work is funded from an administration budget from HM Revenue and Customs (HMRC), created from a transfer out of the National Insurance Fund and agreed with The Service via a service level agreement. In 2008–09, the cost of this is expected to be £8.3 million.

7. The Service is committed to delivering excellent service to all of its customers, many of whom are in considerable financial distress. Our customer service approach across all our business areas has been independently recognised by the award of Charter Mark accreditation, which The Service has held continuously since 1998.

8. Insolvency work is complex and our ability to deliver high quality customer service depends critically on the professional abilities of our staff. The Service makes substantial investments in training and developing its staff to the necessary professional levels and this, and our work more generally in learning and development, has been recognised by the award of the Investors in People standard, which the Service has now held for nine years.

The Insolvency Framework

Personal

9. The personal insolvency framework recognises the importance of getting the balance right between the needs of the indebted and those of their creditors. A portfolio of existing or planned statutory procedures ensures that, whatever an individual's circumstances, a suitable remedy is available, as follows:

- Bankruptcy provides debt relief and rehabilitation for those who cannot pay their debts and ensures that any assets are shared out fairly amongst creditors;
- Debt Relief Orders (DROs) which will be available from April 2009 to those who find themselves currently financially excluded from other procedures. DROs will provide cheap and easy access to debt relief for those on low incomes, with no assets of value, who are overwhelmed by relatively low levels of debt;
- Individual Voluntary Arrangements (IVAs) allow people with unmanageable debt but steady incomes and/or assets to reach a formal compromise with their creditors, thus avoiding bankruptcy;
- Enforcement Restrictions Orders, which are expected to be available from late 2010, will provide short term assistance via enforcement relief to those who encounter a sudden and unforeseen change to their financial circumstances; and
- County Court Administration Orders (CCAOs) are a court-based procedure and provide for regular payments to be made towards creditors. Total debts must not be more than £5,000 and the procedure requires regular income. The Ministry of Justice have plans to reform CCAOs and increase the total debt level to £15,000.

Policy responsibility for the last two of these procedures rests with the Ministry of Justice.

10. In addition to these statutory procedures, it is possible to reach informal agreement with creditors. The principal means by which this is done is Debt Management Plans (DMPs). DMPs are not regulated and they are not legally binding.

Corporate

11. The corporate insolvency framework exists to facilitate the orderly and effective handling of the affairs and assets of companies that have become insolvent. The regime has two key distinguishing features:

— it aims to protect, as far as is reasonable, the interests of creditors; and

— a high priority is given to the rescue of existing companies and businesses, where possible.

The framework gives confidence to investors, businesses and other stakeholders by providing a range of appropriate and proportionate procedures.

12. The UK system provides routes to rescue and is both highly regarded by external commentators and ranks well internationally. The World Bank "Doing Business Report 2009" ranks the UK joint 8th out of 155 countries for the speed with which it deals with troubled businesses; and 9th out of 155 countries for the amount recovered for creditors. This compares with joint 23rd and 15th for the USA, joint 37th and 40th for France and 20th and 33rd for Germany. The routes to rescue are administration and company voluntary arrangements (CVAs).

13. In *administration*, the management of an insolvent company is handed over to an IP whose primary duty is to effect a rescue subject to acting in the wider interests of the creditors. Substantial reforms introduced in the Enterprise Act 2002 made the process faster, fairer and focussed on rescue. It achieved this by making the process easier to enter and giving companies a one year period to come up with a plan or for the business to be rescued, during which time creditors cannot take action (a moratorium).

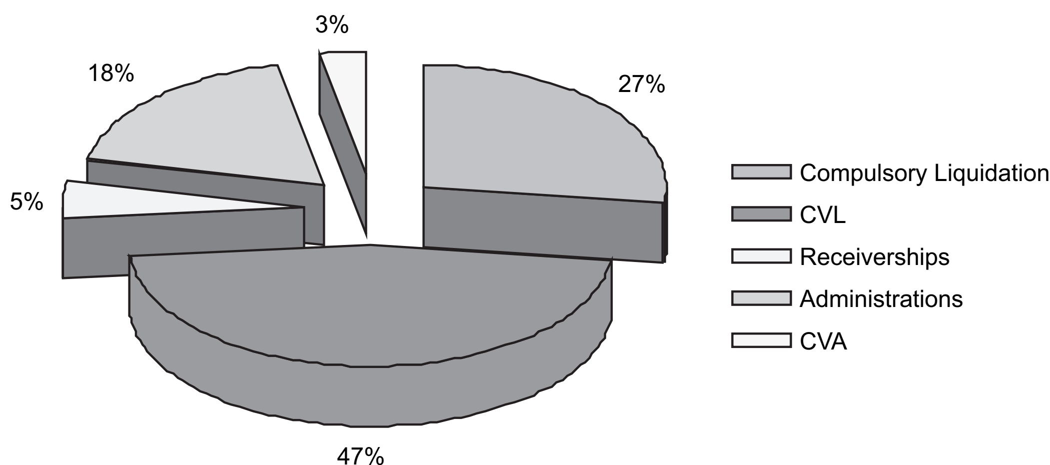
14. The term "pre-pack administration" refers to a deal for the sale of an insolvent company's business or assets, which is put in place before the company formally goes into administration. The sale is then executed immediately following the appointment of the IP.

15. The Government's view is that pre-pack administrations have a useful role to play in preserving jobs and economic value and activity. However, the Government also believes that the interests of creditors must be protected and therefore welcomes the adoption, on 1 January 2009, of the Statement of Insolvency Practice 16. This requires detailed disclosure to creditors of the reasons for the use of the pre-pack approach and an explanation of why this represented the best interests of creditors.

16. A *CVA* enables directors of a viable company to reach a legally binding agreement with creditors for repayment of all or some debts over a period of time in full and final settlement. This procedure provides a light-touch alternative to administration in which the existing management stays in place. A short moratorium stops individual creditors taking action whilst a rescue plan is put together.

17. Where a business cannot be rescued, the insolvency framework provides *liquidation* procedures (either *creditors' voluntary liquidation* or *compulsory liquidation*) to ensure the winding up of a company's affairs and the orderly distribution amongst creditors of any assets. In addition, administrative receivership allows the holder of a floating charge to appoint an insolvency practitioner to deal with assets subject to that charge, which can include the whole of the company's business.

Breakdown of Corporate Insolvencies 1 April - 30 September 2008



Policy Development and Regulation

Development

18. The Service works to maintain and develop the insolvency regime to make sure that it remains world-class and fit for purpose. Policy developments currently in train include the following.

- A revised advertising regime across all insolvency proceedings comes into force on 6 April 2009 (subject to Parliamentary approval). Whereas current legislation requires all key insolvency events to be advertised in both *The London Gazette* and a newspaper, in future the latter will no longer be required. This will save creditors around £17 million per year and help further to reduce some of the stigma associated with bankruptcy.
- DROs, which (subject to Parliamentary approval) come into force in April 2009 (see paragraph 9).
- From October 2009 (subject to Parliamentary approval), measures aimed at modernising insolvency proceedings to reduce costs and improve the returns to creditors will take effect. The changes include provisions allowing electronic communication between insolvency office-holders and consenting creditors as well as the use of websites to "deliver" documents in insolvency proceedings. Estimated annual savings are £25 million.

19. In response to academic research which indicated that the IVA remedy introduced in 1986 needed to be updated, The Service set up a number of stakeholder working groups in 2007. One of the recommendations of those groups was that the efficient handling of straightforward consumer IVAs could be improved by stakeholders agreeing a number of best practice methods. A number of possible changes to the IVA procedure were also identified, principally aimed at streamlining the regime and making it cheaper, quicker and more transparent for simple cases. Such cases would be known as Simplified Individual Voluntary Arrangements (SIVAs). To implement SIVAs legislative change would be required and we originally considered a Legislative Reform Order (LRO) to be the appropriate vehicle.

20. Further consideration of best practice methods resulted in the launch of a protocol on 1 February 2008, which is voluntary and applies to both IVA providers and creditors. The protocol sets out a standardised approach to the format for presenting an IVA proposal to creditors as well as to what constitutes a debtor's income and expenditure. It also contains an agreed set of standard terms and conditions for use in straightforward consumer IVAs, which covers matters such as: the start, duration and effect of such an arrangement; a debtor's duties and obligations; and the supervisor's functions and powers.

21. The Service decided in November 2008 to withdraw its proposals to introduce a SIVA by means of a Legislative Reform Order. This decision reflected both our developing experience of the operation of the protocol as well as concerns about (a) whether the desired policy outcome could be achieved by non-legislative means, (b) whether it removed burdens and (c) whether it was clear that it would not add new burdens. The Service will, later this year, undertake an evaluation of the operation of the protocol to determine whether it is meeting the legitimate needs of debtors, creditors and IPs. The IVA Standing Committee, chaired by The Service and including organisations representing debtors, creditors and IPs and their regulatory bodies will oversee this evaluation.

Insolvency Practitioner Regulatory Framework

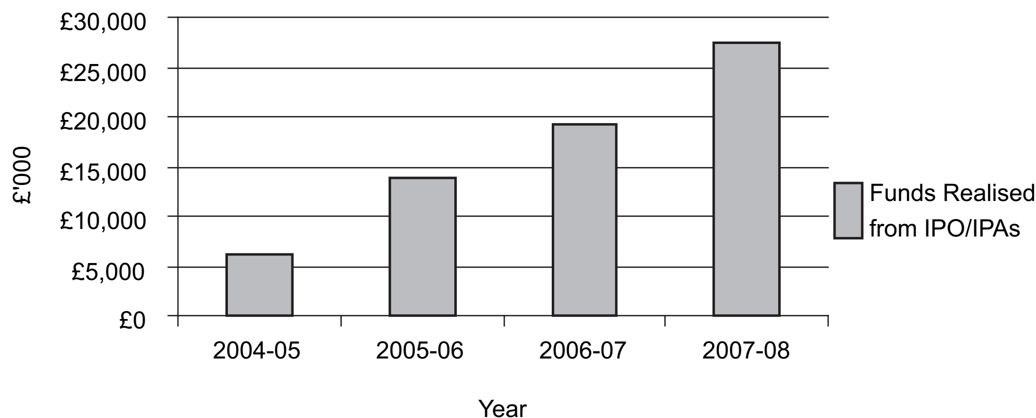
22. The Secretary of State regulates and monitors seven "recognised professional bodies" (RPBs) to authorise the majority of insolvency practitioners, numbering around 1,600; and directly authorises around 100 insolvency practitioners. A key part of The Service's role is to provide guidance and disseminate required practice to ensure that those bodies regulate their practitioners effectively and to an appropriate standard.

23. The Service works closely with the RPBs, both directly and through the Joint Insolvency Committee, to set and assure standards of professional practice and it monitors the regulation of IPs undertaken by the RPBs. In order to achieve consistency in regulation, we have a memorandum of understanding with each RPB which sets out the standards that the RPBs need to meet in order to retain recognition and to satisfy The Service that they are complying with that standard. We also carry out monitoring visits to RPBs and, as part of those visits, attend an investigation or disciplinary committee meeting to ensure that their procedures are effective in practice. To ensure consistency in regulation, The Service complies with the memorandum in respect of the IPs who are licensed directly by the Secretary of State.

Insolvency Case Administration

24. The main objectives of the work of the OR administering bankruptcies and compulsory liquidations are:

- To maximise returns to creditors. In addition to the realisation of bankrupts' assets, ORs also use their powers to ensure that bankrupts who have surplus income contribute further to repaying their debts through income payments orders (IPOs) and income payments agreements (IPAs).



- To administer bankruptcy to relieve debtors of overwhelming debts and enable creditors to write off irrecoverable debts earlier. Bankruptcy orders are made by the courts on either the petition of a debtor or creditor and ORs act (in the first instance) as trustees of the bankruptcy estate for the benefit of creditors.
- To administer the winding up of companies where the court has ordered a compulsory winding up. In this case, the OR is appointed liquidator, unless the creditors have decided that that role should be taken on by an IP.
- To investigate the conduct of bankrupts and directors whose cases they administer and take action where appropriate (see paragraph 6).

25. In 2007–08, ORs had 67,218 new cases to administer. In the period 1 April to 30 September 2008 36,487 cases were received, 1,765 more than in the same period last year.

26. A key issue for The Service in times when insolvency case loads change quickly is planning the capacity needed to ensure that we can maintain levels of service. To achieve this, The Service relies on its ability to recruit agency staff at both administrative and professional levels while maintaining a permanent staffing level appropriate to the longer-term level of underlying case load.

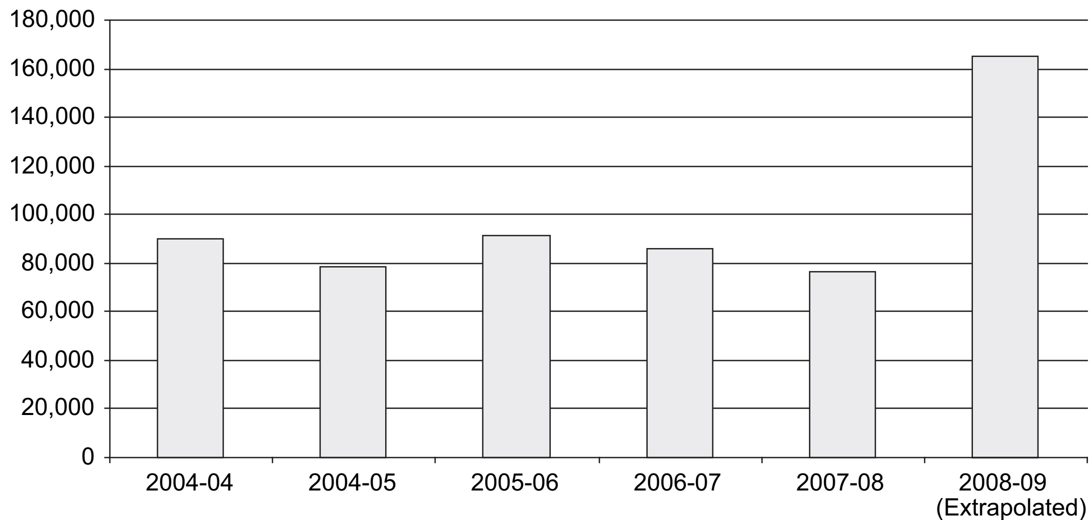
27. Because of the specialist nature of its work, The Service needs to recruit and develop staff that can combine excellent administrative, investigative and interpersonal skills. The Service's Examiner Development Programme offers a suite of mandatory qualifications up to degree level to all professional examiner staff, which are externally accredited by Nottingham Trent University, with whom The Service has enjoyed a long and fruitful partnership.

Redundancy Payments

28. The Redundancy Payments Service, based in Watford, Birmingham and Edinburgh processes and pays claims for statutory redundancy and other payments from former employees of insolvent companies which the insolvent company has not paid. Payments, and the costs of administering them, are paid out of the National Insurance Fund.

29. The current economic climate has had a significant impact on the number of claims The Service is receiving. It is expected that this financial year the number of claims will be substantially higher than last year. By the end of December around 129,000 claims had been received in this financial year, a 60% increase over the number of claims handled in the whole of the last financial year.

30. The Service aims for 92% of claims to be paid within 6 weeks, and 78% paid within three weeks.



Estate Accounting

31. Although IPs acting as liquidators in voluntary liquidations can now choose their provider of banking services, many still use The Service's Estate Accounts Services because they are tailored specifically to insolvency estate account management and offer a competitive rate of interest.

Investigation and Enforcement

32. The Service's various activities in this area are summarised at paragraph 6.

33. The objective of The Service's investigation and enforcement work is to remove from markets those who are deemed unfit, by virtue of their conduct, to be market participants. The removal of bankrupts from credit markets and the disqualification of unfit directors is aimed at protecting those whose interests may be put at risk. As a consequence, general confidence in the proper functioning of credit markets and the corporate world increases.

34. The ability to seek resolution of disqualification proceedings by way of a legally binding undertaking was introduced in 2001. Prior to that date disqualifications required an order of court. Corresponding provisions for bankruptcy were introduced in 2004 with the advent of bankruptcy restrictions.

35. Currently some 80% of disqualification proceedings are settled by the acceptance of an undertaking from directors, most of which are offered before court proceedings are commenced. The corresponding figure is around 90% for bankruptcy restrictions. The high undertaking rate makes the process very cost effective as early resolution saves vital public resources.

36. The Service operates a hotline to enable members of the public, insolvency practitioners and creditors to "blow the whistle" on apparent misconduct, particularly by bankrupts and directors who are ostensibly contravening bankruptcy restrictions or disqualifications. Valid complaints are sent to BERR prosecuting lawyers for criminal investigation or passed to our ORs or CIB for further investigation. This facility provides an excellent way of ensuring that those instances of abuse that are of most concern to the public are addressed.

37. Until recently, the cost of all enforcement and investigation work was funded by means of a programme budget allocation from BERR.

38. During 2006–07 BERR's budgets came under pressure and this led to a 7.5% (or £3.3 million) reduction in the budget for that year. As pressure on BERR budgets was expected to continue in subsequent years a review was undertaken of the work carried out by ORs in enquiring into the causes of failures, the disposition of assets and the conduct of directors and insolvents. As a result some of costs of the work carried out by ORs were moved from taxpayer funding to fee funding. This switch allowed the funding level originally agreed for 2006–07 to be restored in 2007–08. In total some £10 million of the funds used to finance investigation and enforcement activity is now drawn from fee income.

39. Looking to the future, as insolvencies increase and incidences of director misconduct grow (as usually happens in an economic downturn), The Service will need to maintain rigorous processes to ensure that the instances of misconduct which most merit action in the public interest continue to be targeted.

"Enabling the Future"

40. This is a £72.2 million strategic investment programme of IT-led change which is designed to enable The Service to develop as a modern, fit-for-purpose organisation that is ready to face the future with confidence; to improve further its services and to meet increasing and rapidly changing customer expectations by providing electronic delivery channels. It also enables The Service to continue to attract and retain the people of the high calibre that it needs.

41. The provision of a refreshed underlying infrastructure had been delayed due to problems encountered by the supplier. While this has impacted on the timing of the delivery of other projects within the programme, the programme as a whole remains within budget.

42. One legacy project, CAMEO, was halted in late 2004, resulting in a write off of £7.65 million in the accounts for 2006–07. It has been replaced by the Estate Accounting System (EAS) project, which is ready for deployment in June 2009.

43. Losses totalling £1.32 million have also been written off in respect of two ongoing IT projects (ISCIS and CHAMP) in the 2007–08 accounts. These are not IT failures. In these instances, early decisions have been taken to move to an alternative underlying product to meet business requirements. These decisions have already produced further identifiable benefits, such as enabling the consolidation of different IT applications into one, with the consequential benefits of improving information flow and accountability. As a result, the cost of ISCIS is expected to be within the original business case forecast including the loss written off. A new tender is being undertaken for CHAMP and should result in a contract being awarded in March 2009.

9 January 2009

Supplementary memorandum submitted by the Insolvency Service

Thank you for your letter of 9 February 2009 in which you sent a number of follow-up questions on behalf of the Committee. Please find below The Service's responses to the those questions.

Hopefully, the answers below will answer the Committee's questions, however, if you require any further clarification, please do not hesitate to contact me again.

I would also like to take this opportunity to re-state my invitation to the Committee to visit The Service if they feel that this would be of benefit.

1. *You referred to structural and cultural issues that still need to be overcome within The Insolvency Service (Q6). What issues remain and how are the being resolved?*

The structural issues mentioned at the Select Committee hearing have largely been overcome with the creation of Investigations and Enforcement Services (IES) in January this year, which brought together Companies Investigation Branch, Investigations Directorate and Enforcement Directorate. The vision going forward is of a new business within The Service which will deliver a proportionate and responsive Investigation and Enforcement capability through professional, flexible and motivated staff, engaging with stakeholders and achieving high-impact outcomes that reflect the public interest and BERR objectives. We recognise that simply creating a new structure is not enough, and we have already held events bringing together all the constituent parts of the new business area giving colleagues the opportunity to learn more about the different areas within IES and to reinforce the message that we are all working to common goals. Other communications are planned with the intention of enhancing cohesion.

Underpinning the national structure will be the development of a single investigator career stream for the whole Service, both in terms of recruitment and professional qualification. This is aimed at delivering an appropriate grade and skill mix across the IES (and the wider Service). It is intended that this will enhance the flexibility of IES to focus on particular areas of concern as required. A collaborative approach is being taken to this work and participation in both the development and contribution to the resources required for training and associated activities will be made by all the IES businesses.

2. *Why has the increase in cases been neglected in supplementary estimates by a "bad debt provision for case administration fees" for the sum of £14 million Winter Supplementary Estimate for 2008-09 of the Department for Business, Enterprise and Regulatory Reform (Q18)? Does this have any practical implications?*

Budgeting within Government includes the concept of non-cash expenditure. This includes the costs of making a provision for possible future bad debts. Treasury's intention when introducing the concept of non-cash was to ensure that all costs of Departments (eg depreciation, cost of capital charges etc) were captured. Where a Department charges for its services, it must also include any "non-cash" costs.

For The Service this means that income covers both the near-cash and non-cash costs. Our policy is to make a (non-cash) provision for bad debt write-off, currently at 12%, for unrecovered fees.

The year-on-year changes in the provision are based on assumptions about case levels. These are subject to periodic adjustment, particularly in the current financial climate where our caseload is increasing. We re-forecast through the year as appropriate and use the Supplementary Estimates process to ensure that our budget reflects essential changes.

The figures in the Main Estimate reflect the CSR07 Settlement which was agreed in 2007. In reality, the position by the beginning of any financial year seldom mirrors the situation envisaged at the time of a settlement, particularly in the case of provisions. The amount of non-cash included in the CSR07 Settlement has proved to be insufficient for The Service's needs. Overall, there is no practical implication as the receipt and expenditure estimates offset each other and the overall effect on the Department's budgets is zero.

3. *You have stated that the funding regime for case administration work is sufficiently flexible to deal with a significant increase in demand (Q45). To what extent does the delay or time lag between carrying out case work and the receipt of case fees create problems for The Insolvency Service?*

The case administration activities carried out by The Service are funded through fees. This provides flexibility as when case numbers increase, fee income increases and enables The Service to employ additional resources. The fees we charge for case administration are recovered in the first instance through the deposit we receive in all cases and then from assets realised in cases. Cases with few or no assets are cross subsidised by cases with assets although The Service makes an overall assumption (a bad debt provision) that it will not recover some of the fees it charges, currently 12%. The time lag referred to is in relation to recovering the fees from asset realisations and this presents cash flow problems for The Service. This cash flow is managed with BERR who provide The Service with working cash.

4. *You stated that on an average working day around 5 directors are disqualified and five or six individuals are made subject to bankruptcy restrictions (Q50):*
(a) *How does this compare to the total number of requests that are received by The Insolvency Service to begin an investigation on an average working day?*

Insolvency Practitioners (IPs) appointed to non-compulsory insolvent companies have to make a report on the directors' conduct to the Secretary of State (in practice, The Service). The number of unfitted conduct reports received from IPs this financial year at the end of January 2009 was 3,842 and our expectation for the year is to receive in the region of 4,600. Official receivers' also contribute to the total of unfitted director cases taken forward through the responsibility to investigate the affairs of companies that are compulsorily wound up by the court. The Committee may also recall that The Service's Companies Investigation Branch also receive requests for investigation of live companies. As for Bankruptcy Restriction Orders, these do not usually begin with requests for an investigation but arise from the official receiver's duty to investigate the affairs of people subject to bankruptcy orders.

(b) *What are you doing to address concerns held by insolvency practitioners that not all cases which merit investigation are being followed-up by The Insolvency Service?*

Since September 2008, The Service has applied more resource to the provision of feedback to IPs on cases that are not targeted for investigation. This takes the form of a letter that addresses the key points of the case and the reasoning that resulted in the conclusion not to proceed with the case. Those reasons may include that the IP report is of poor quality, that the case would be too small/not in the public interest or that there are serious doubts about the potential evidence to support the allegations being made. This gives the IP the opportunity to resubmit the report, to submit further and better supporting information or to accept the explanation and to learn from it. Positive responses have been received from IPs who have said that they welcome the change.

Feedback is also given on a case by case basis whenever an investigation is concluded without any sanction being sought.

In parallel to the detailed feedback The Service is offering the opportunity of visits to IP offices to talk to managers and staff about their reporting responsibilities, the quality expected of reports and evidence etc. There has been some up take of this, with positive feedback, which appears to be increasing.

We are also taking up opportunities to talk to groups of IPs at the many regional or national conferences organised by the recognised professional bodies.

5. *Could you provide the details of the hotline and enforcement e-mail address that you would like aggrieved creditors to use to register potential abuse of pre-pack administrations and other wrongdoing?*

— Hotline telephone 0845 6013546
— Email enforcement.hotline@insolvency.gsi.gov.uk
— Post to The Insolvency Service, Conduct and Complaints Team Hotline, 3rd Floor, Cannon House, 18 Priory Queensway, Birmingham, B46FD

6. *What measures will The Insolvency Service use to determine whether Statement of Insolvency Practice (SIP) 16 is successfully resolving problems associated with pre-pack administrations?*

In order to ensure that the new SIP 16 is being adhered to, The Insolvency Service is working closely with the recognised professional bodies that regulate the majority of insolvency practitioners to ensure that creditors are provided with the appropriate information as soon as possible. We will be examining all SIP 16 statements to ensure that they comply with the spirit and letter of the new disclosure requirements with a view to improving the transparency of the pre-pack process. In due course we will evaluate the effectiveness of SIP 16 and make recommendations for any necessary changes to be made.

However, it is important to note that The Insolvency Service is not empowered to interfere with the commercial decisions taken by administrators, and that the commercial reality is often such that unsecured creditors are unlikely to receive a significant proportion of any debt due to them, whether assets are realised through a pre-pack administration or any other insolvency process.

In addition to monitoring SIP 16 statements, we will also be using our enforcement powers to clamp down on any directors who intentionally misuse the administration process to disadvantage creditors or who seek to gain benefit for themselves.

(a) *Has any consideration been given to requiring court approval (similar to Chapter 11 proceedings in the United States) in all cases where an administrator is proposing to sell the company's business to a connected party?*

The Service has in recent few years undertaken an extensive evaluation of our legislative changes and is committed to review the insolvency framework on an ongoing basis to ensure it remains "fit for purpose". Elements of the US chapter 11 model were considered when we were reviewing how best to streamline the administration process as part of significant changes which were made by the Enterprise Act 2002, but for sound policy reasons we opted for a different approach.

We are aware that there remain those who would advocate a more court-driven chapter 11-type process, but that is not a universally held view even amongst insolvency lawyers. The interests of creditors, employees and other stakeholders are best served by a rescue of the company or, if that is not possible, any parts of the business which remain viable. For that to be achieved the administrator needs to be left to get on with the urgent restructuring actions that are necessary with minimum cost and delay; this is the best way to ensure that jobs are saved and value is not lost. Imposing additional requirements to seek court approval is likely to jeopardise a rescue by diverting the administrator from that critical restructuring activity. It may also create unnecessary and lengthy delay and will certainly dissipate what limited funds there may be on legal and professional fees.

Protections already exist to deal with misconduct on the part of both directors and administrators and the recent introduction of SIP 16, whereby the Government has put in place arrangements to improve transparency where a pre-pack sale has been effected, will help further.

7. *You said that creditors need to be "better educated and better facilitated" to use existing means of challenging the fees of insolvency practitioners (Q76). What can The Insolvency Service do to make sure this happens?*

The mechanism by which remuneration and expenses of IPs is fixed and reported to creditors is currently being reviewed within a project that The Service is undertaking to modernise the insolvency legislation. Those changes, which are likely to come into force in April 2010, will provide greater flexibility to creditors' committees (or if there is no committee, to the general body of creditors) as to the basis by which remuneration may be fixed. They will also include measures to give greater transparency to creditors over amounts of remuneration charged and expenses incurred, with clearer rights to request fuller particulars of those amounts and to challenge them at court in appropriate cases.

SIIP 9, sets out detailed rules that IPs must follow when seeking approval for their fees. It indicates that they should be mindful at all times of the rights accorded to creditors in relation to fees under insolvency legislation, and that when acting in an advisory capacity or as insolvency office holder should ensure that adequate steps are taken to bring those rights to their attention. IPs are required to ensure that explanatory notes detailing how office holders' remuneration is fixed (including reference to the relevant statutory provisions) is made available to creditors before any resolution is passed to fix or approve remuneration.

Guidance will be placed on our website in April 2009 giving details of the recourse available to creditors if they are unhappy with an office-holder's remuneration, along with a link to SIP 9 and the related information concerning the approval of fees that IPs are required to make available to creditors. In addition, we will look to identify further ways of engaging with creditors, for example, by contributing to trade journals and other publications.

8. *At Questions 83 to 88 the Committee discussed your plans for changes to Insolvency Law. Please could you list:*
(a) *Proposals that have been dropped*

The Legislative Reform Order (LRO) that was intended to introduce Simplified Individual Voluntary Arrangements (SIVAs) was withdrawn by the Minister of State once it became apparent that an LRO was not a suitable vehicle for these changes. One of the reasons for this is that progress is being made under the IVA Protocol, a voluntary code for straightforward IVAs agreed by all sides of the IVA industry. Further time is now being given to see whether the Protocol can fully deliver the policy intentions behind the SIVA proposals, and early indications are very positive. The policy objectives remain the same, it is simply the means of introducing it that have varied.

Other proposals contained in the SIVA LRO are still being taken forward by other legislative vehicles.

(b) *Proposals still to come before Parliament*

— better targeted advertising regime amendments to the Insolvency Act (by an LRO that is likely to come before Parliament for a full debate next month) and Insolvency Rules (by an amending instrument, subject to the negative resolution procedure) to deliver a better targeted regime for advertising key insolvency events, with effect from April 2009;

— an LRO to amend the Insolvency Act to modernise insolvency processes by removing unnecessary administrative burdens, thereby improving the efficiency by which insolvencies may be administered. This LRO is likely to be laid before the parliamentary scrutiny committees during April 2009 and the proposals, if approved, are expected to be implemented in early 2010. One of these proposals is one of three proposals that was taken forward in the earlier LRO, which was withdrawn. That proposal deals with the removal of unnecessary requirements to report to court with respect to certain individual voluntary arrangements(IVAs);

— Insolvency Rules—modernisation and consolidation of the Insolvency Rules expected in 2010–11(by two separate instruments, both subject to the negative resolution procedure); and

— there are five statutory instruments (subject to the negative resolution procedure) which are due to be laid in parliament in March 2009 to give effect to Debt Relief Orders (DROs). The instruments concerned are:

  The Tribunals, Courts and Enforcement Act 2007 (Transitional Provision) Order 2009;

  The Insolvency (Amendment) Rules 2009;

  The Debt Relief Orders (Designation of Competent Authorities) Regulations 2009;

  The Insolvency Proceedings (Fees) (Amendment) Order 2009 (as well as setting the fee for DROs this order will bring effect to other fee changes including increasing by inflation deposits payable on the presentation of a bankruptcy petition and on the presentation of a petition to wind up a company; and

  The Insolvency Proceedings (Monetary Limits) (Amendment) Order 2009.

  Finally:

— There are two further statutory instruments (subject to the negative resolution procedure) which are due to be laid in parliament in March 2009;The Insolvency Practitioners and Insolvency Services Account (Fees) (Amendment) Order 2009 which raises fees payable by insolvency practitioners and The Insolvency (Amendment) Regulations 2009 which increases fees charged by The Insolvency Service in respect of its services for case administration.

(c) *Changes which will be made by other means*

We have no plans to make any changes of this nature.

2 March 2009

Memorandum submitted by Mrs Melanie Andrews

I am writing to outline my objections to the proposed change to Insolvency Rules anticipated to start April 2009.

My understanding is that it will mean that Insolvencies no longer need to be advertised in the local or national press but will just appear in *The London Gazette*. Whilst this publication is certainly "the bible" for the industry it not known by the lay person and as such would not be an easy source of information to persons having claims against the insolvent company.

The comment by the person instigating the changes is that there is little response to the notices but surely that is the point. It simply proves that the Insolvency Practitioner has openly and professionally carried out his obligations. I feel very strongly that were this safeguard to be disposed of that there would be companies more than willing to take advantage of this loophole. As this advertising has always been deemed a "Public Notice" surely it should remain public.

I appreciate that Creditors are supposed to be advised by Insolvency Practitioners with regard to making claims but this supposes that Insolvent Companies disclose all relevant information and are able to provide accurate and comprehensive business records—not always the case.

Legal advertising is a safeguard for small companies and sole traders since it can advise them of companies who may "Phoenix" serially, and enable them to make an informed decision as to whether they wish to give credit to such companies. Without this information being readily available these small companies can be forced into liquidation themselves by unscrupulous persons.

There is a suggestion that advertising would be left to the discretion of the Insolvency Practitioner and can be placed in any media. How could this be centrally accessed by individuals? How would they know where to look? What penalties to the Insolvency Practitioner for failure to disclose?

On line placement of notices that may be suggested to take the place of traditional advertising seems to me to be fundamentally flawed, since it necessitates having prior knowledge, and actively searching for information on the relevant company. The current practice ensures that the information is freely available in the trading area, and, is visible to all persons who may have a financial interest in profitability of companies ie staff as well as bosses.

It appears that once again the interests of small businesses have been sidelined. Rather than be able to take five minutes to read the public notice sections of local newspapers they will now be expected to search on line for each individual customer, another onerous time consuming and uncost-effective job for already hard pressed small businesses.

In view of current economic projections it appears that Governments will be come increasingly dependent on "small businesses" to take up the slack in the employment market. Surely these companies should be allowed full access to information that enables them to make the proper and sensible credit decisions in running their business.

Costs involved in statutory advertising are negligible against fees the amounts saved by cutting advertising would have no or very little impact on payments to creditors.

In recent years changes to legislation have caused problems in some ways due to a lack of common sense aforethought. The Licensing Act 2003 has not had the predicted effect on personal drinking and the Government now have to issue more warnings against excessive alcohol consumption. On-Line gambling is encouraging more debt amongst those who can least afford it. Please do not let unnecessary changes to Insolvency Rules impact negatively in this turbulent economic situation.

Bankruptcies have escalated in the last few years. It appears that people are choosing to simply write off their debts rather than pay them back. Since it appears there are no penalties for failure to pay back what they owe, how many will be repeat bankrupts in future? Hiding the problem does not make it disappear but just disguises the underlying statistics and will Insolvencies follow the same pattern if not curtailed?

Whilst I applaud any effort to assist small businesses there is a fine line to be drawn. In order to help good businesses it goes not necessarily make sense to protect bad businesses, as often badly run business will have a domino effect on other companies.

At the present time of economic stringency it appears to me to be incumbent upon those persons in authority to ensure that small companies be protected and one of those ways is to inform them openly and comprehensively. Again I repeat information is key to the financial well being of all small companies, in order that they may continue to make an enormous contribution to the financial well being of this country.

19 December 2008

Memorandum submitted by the Association of British Insurers

The ABI is the voice of the insurance and investment industry. Its members constitute over 90% of the insurance market in the UK and 20% across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

SUMMARY

— Pre-packaged administrations ("pre-packs") are deals for the sale of an insolvent company's assets that are put in place before the company goes into a formal insolvency process.

— This process is normally negotiated behind closed doors and often before the administration order is made. Unsecured creditors and trade credit insurers remain unaware that the process is happening. This lack of transparency and notification can cause the collapse of the unsecured creditors (including SMEs).

— This is becoming an increasingly serious problem. The Government must act to address these problems by, for example, imposing transparency and minimum disclosure requirements before the pre-pack takes place.

THE CONSEQUENCES OF PRE-PACKS FOR SMEs AND TRADE CREDIT INSURERS

1. Pre-packs are negotiated behind closed doors and often before the administration order is made, which means that unsecured creditors and trade credit insurers are kept in the dark.

2. Unsecured creditors often experience that the money they have outstanding is never repaid as all the debtor's assets have been stripped away before the creditor is even made aware that a pre-pack has taken place. This is to the detriment of small and medium-sized enterprises (SMEs), and also of credit insurers, who are faced with claims from SMEs resulting from the unpaid debts. Only around 20% of SMEs have trade credit insurance, so those who do not are left to cover the losses on their own.

3. There has been an increase in the number of pre-packs. The ABI estimates that 50% of administrations are now pre-packs. With the increase in businesses going into administration due to the economic downturn, the lack of transparency and notification to unsecured creditors in pre-packs is becoming an increasingly serious problem both for SMEs and for insurers.

4. Pre-packs can keep a business going and avoid redundancies. However, the lack of transparency and lack of notification can cause the collapse of the unsecured creditors. The recent Statement of Insolvency Practice 16 by the Accredited Licensed Insolvency Practitioners is a step in the right direction, but only deals with the situation after the pre-pack. The Government should act to address these problems by, for example, imposing minimum disclosure and transparency requirements.

January 2009

Memorandum submitted by the Association of Business Recovery Professionals

EXECUTIVE SUMMARY

R3 believes that the Insolvency Service provides a valuable service to the UK. The professionalism and commitment of the staff and its management in discharging their obligations should be recognised. R3 and the Insolvency Service, along with the subordinate regulators, inhabit shared space in the open system that is the insolvency industry; and share many of the challenges and satisfactions available to those who act in the service of the debtor and creditor communities, and the country as a whole overlain by the current insolvency legislation.

ABOUT R3

R3—The Insolvency Trade Body—represents 97% of all licensed Insolvency Practitioners (IPs) who help individuals and businesses in financial trouble. There are approximately 1,700 IPs in the UK, who are licensed and regulated to give best advice and apply statutory, licensed procedures. Whether as accountants or lawyers, IPs deal with personal and business insolvencies, from large to small businesses; and help from "turnaround" to formal insolvency procedures. 89% of IPs state that that they give their first hour of advice for free.

MAIN RECOMMENDATIONS

R3 believes that the Insolvency Service should:

— report more fully on how it regulates the multiple regulators, so demonstrating that standards are applied consistently across the industry;

— provide fuller details of its operations as a direct regulator of Insolvency Practitioners (IPs), in order to demonstrate equal treatment of all IPs across the industry;

— be awarded greater resources to promote the industry within Government, parliament and the general public;

— be allowed to "punch at and above its weight" within Government on issues which have an impact on insolvency in the UK;
— support R3's goal to protect the title "Insolvency Practitioner" thereby offering greater protection to the public and R3 members;
— relinquish Crown immunity;
— ensure that creditors' legitimate calls for creditors' meeting and "Secretary of State" (IP) appointments should not be frustrated by the Official Receivers (ORs);
— evaluate ORs work as a free-standing area of activity to establish the true cost and benefits;
— be resourced fully to ensure that the projected increase in the number of Directors meriting disqualification, can be investigated appropriately;
— further investigate, adapt and introduce into the existing UK regime compulsory financial education for Directors' of failed businesses and personal bankrupts;
— require the Regulators to fully ensure the application of SIP 16 to ensure Pre-packs are processed correctly;
— have the lead role in protecting public policy on insolvency issues;
— manage/oversee all insolvent debt solutions to ensure consistency and coherence;
— review its plans and find either time to introduce SIVAs as originally planned or reflect on how the planned procedure can be accommodated under the current insolvency regime;
— collect figures on Debt Management Plans (DMPs) to build a more meaningful picture of the number of insolvent people in the UK; and
— take the lead have sole responsibility for the regulation of DMPs, so that these "missing debtors" are brought within the formal insolvency regime.

1. The Insolvency Regime

1.1 *The value of the industry to the UK economy*

R3 believes that the UK's insolvency industry requires no fundamental changes—it is largely fit for purpose. The centre for economics and business research (cebr) in "The value of the insolvency industry"[1] conducted an independent study into the economic significance of the insolvency sector and its potential future contribution to UK prosperity. Some of the key findings are that the UK insolvency industry:

— saved 910,000 jobs in 2006 in businesses suffering financial problems;
— ranked ninth out of 127 countries for speed with which it deals with troubled businesses; and tenth out of 175 countries for the amount recovered for creditors (above the USA in both areas);
— employs 12,700 people directly; and makes a direct contribution to GDP of £780 million; and
— plays a vital role in maintaining a business environment in which entrepreneurship is encouraged and the economy can flourish.

1.2 *Recommendation*

R3 believes that UK's insolvency regime does not require an overhaul, "managed evolution" is sufficient.

1.3 *R3 projections on the growing number of insolvencies*

R3 members surveyed in October 2008 (18% response rate) predicted a significant increase in the numbers of business and personal insolvencies in 2009—a 41% increase in the number of business insolvencies (13,091 in 2007, 15,693 for 2008 and 18,440 for 2009) and an increase in the number of personal insolvencies (121,796 in 2007, 132,700 for 2008 and 148,352 for 2009), a predicted 22% increase from 2007-2009. In addition, members expect more complex cases.

1.4 *Recommendation*

R3 believes that the private sector part of the insolvency industry uniquely has the skill and experience to deal with the volume and complex nature of expected insolvencies; and that moves to increase the Official Receivers' (ORs) activities be curtailed.

[1] "The value of the insolvency industry", centre for economics and business research (cebr) July 2008 www.r3.org.uk

1.5 *Multiple regulators*

Insolvency Practitioners are individually licensed by one of nine regulatory bodies.[2] The Insolvency Service as a "regulator of the regulators" must ensure that appropriate standards are applied consistently across the industry. This is challenging for an industry where the multiplicity of regulators cover differing fields (accountants and lawyers) and jurisdictions (England & Wales, Scotland and Northern Ireland). Key aspects of the regulators' work, which includes the adoption of new regulations, disciplinary procedures and monitoring, are not reported or recorded on an insolvency-industry wide basis and there is no public evidence (as in its annual report) of the detail of the Insolvency Service's regulation of the regulators.

1.6 *Recommendation*

The Insolvency Service should report more fully on how it regulates the multiple regulators, so demonstrating that standards are applied consistently across the industry.

1.7 *The Insolvency Service as a Regulator and the "Regulator of Regulators"*

The professional bodies derive their power to regulate IPs from the Insolvency Act 1986 (section 391). They carry out this function under terms agreed with the Insolvency Service which are set out in a Memorandum of Understanding. The Insolvency Service also has powers to regulate insolvency practitioners directly, but this is conferred by a different section of the Act (section 392).

1.8 The Service therefore acts both as supervisor of the regulators, and as a direct regulator itself (of some 90 IPs). However, because of the nature of the legislation, there is a difference in the powers available to the professional regulators and the powers available to the Insolvency Service. The professional regulators employ a wide range of sanctions which they apply depending on the transgression. The Service does not have this range of sanctions; only the removal of a person's licence, or a limitation. This means that there is unequal treatment, depending on whether a practitioner is licensed by a professional regulator or by the Service. This may be seen as providing an incentive for some to choose to be licensed by the Insolvency Service, because they are subject to a less punitive system than applied to those regulated by the professional bodies.

1.9 The Service also has its own operational "managers" in the shape of Official Receivers, who are not licensed insolvency practitioners. We comment on this further below.

1.10 *Recommendation*

The Insolvency Service should provide fuller details of its operations as a direct regulator of Insolvency Practitioners, in order to demonstrate equal treatment of all IPs across the industry.

1.11 *The profile of the Insolvency Industry*

Despite the contribution the insolvency industry makes to the UK economy, the industry's profile is low as compared with other sectors and industries. Through our own activities, R3 is aware that the economic and social importance of insolvency is insufficiently understood within Government and Parliament as a whole. Whilst those within the Industry accept some responsibility for the lack of understanding (R3's parliamentary activities, including establishing an APPG on Insolvency is aimed at addressing this issue), this may also be attributed to the Service insufficiently projecting what it does. Whilst the Service undertakes activities such as research (staging a third annual research seminar in 2008, in conjunction with R3), its limited PR output, and a lack of public circulation of any forecasting work means its efforts are sub-optimal.

1.12 The IS's position within Government means that as an Agency it is "one step removed"; which raises questions about levels of understanding within the Department for Business, Enterprise and Regulatory Reform and beyond. Succeeding BERR Ministers have had large portfolios of other responsibilities, so the degree to which "insolvency" is addressed is inevitably limited. Indeed, the BERR Select Committee's limited interest to date evidences a low ranking of importance.

1.13 Recommendation: The Insolvency Service should be awarded greater resources to promote the industry within Government, parliament and the general public.

[2] Institute of Chartered Accountants in England & Wales (ICAEW); Insolvency Practitioners Association (IPA); Association of Chartered Certified Accountants (ACCA); Solicitors Regulation Authority on behalf of the Law Society of England and Wales (LS); Institute of Chartered Accountants of Scotland (ICAS); Insolvency Service on behalf of the Secretary of State (SS); Institute of Chartered Accountants in Ireland (ICAI); Law Society of Scotland (LSS) and the Law Society of Northern Ireland (LSNI).

1.14 *The Insolvency Service's Interaction with other parts of Government*

There are examples where "joined up Government" by the Service within its own and other Departments could be improved, which includes the Ministry of Justice, Department of Work and Pensions, Department for Education and Skills (as was) and the Financial Services Authority.

1.15 We give some examples of instances where cooperation between the Insolvency Service and other departments have been helpful, and others where they have been less successful:

1.16 *A good result—Empty property rates in administrations*

Problems were caused for companies in administration by the *Trident Fashions* case, in which it was held that companies in administration had to pay empty property rates as a priority expense, even though this brought no benefit to the administration. The Service was instrumental in persuading the Department for Communities and Local Government to recommend a change in the law to remove this problem.

1.18 *A less good result—Transfer of Undertakings Protection of Employment regulations (TUPE)*

The TUPE Regulations 2006 are the primary policy responsibility of the Department for Work and Pensions. They give effect to EC Directive 23/2001, containing important provisions regarding the transfer of employees in insolvency proceedings, and are therefore of policy interest to the Service. The insolvency-related part of the Regulations were defectively drafted, and were not capable of giving proper effect to the Directive. We understand that this was pointed out to the DWP by the Insolvency service, but was ignored. The Service tried to mitigate the acknowledged problem by issuing guidance on how they thought the regulations should be applied. However, a recent EAT case, *Oakland v Wellswood (Yorkshire) Ltd* shows both that the regulations are defectively drafted, and that the guidance issued by the Service was incorrect.

1.20 *Recommendation*

The Insolvency Service should be allowed to "punch at and above its weight" within Government on issues which have an impact on insolvency in the UK.

1.21 *Protecting the title*

Insolvency work is highly skilled, requiring experience and extensive training. We believe the interests of those who we serve is damaged by the activities of those who purport to be qualified, using mimicking terms like "licensed insolvency consultant" or simply "insolvency practitioner". We seek the Service's support to have the word "insolvency practitioner" designated "words cognate", thereby affording greater protection to the public and our members. Alternatively, we call upon them (and other branches of government, eg the OFT) to act quickly and decisively to counter misleading and damaging behaviour by such unlicensed "experts" (sic).

1.22 *Recommendation*

The Insolvency Service should support R3's goal to protect the title "Insolvency Practitioner" thereby offering greater protection to the public and R3 members.

2. Competition Issues

2.1 The Service competes directly with professional insolvency practitioners in some areas, but the standards which apply to them are less rigorous than those which apply to the private sector. This is mainly in the area of small liquidations and bankruptcies; the Insolvency service is not equipped to deal with large or complex cases.

2.2 Historically, IPs were appointed in most small bankruptcy and compulsory liquidation cases where there are assets. By law, cases start off with the Official Receiver (OR), but a private sector IP may be appointed in one of two ways: a meeting of creditors convened for the purpose by the OR, or by direct appointment by the OR (acting on behalf of the Secretary of State) on a rota basis.

2.3 In recent years, ORs have kept more of this work in-house in regional trustee and liquidator units. This was a policy decision, and a deliberate change from the earlier policy that cases should go out to the private sector whenever possible. This has caused hardship to some small IPs practices, which have relied on this work and we are unconvinced that the benefits claimed are justified.

2.4 ORs are meant only to keep straightforward cases, with difficult cases going to IPs. The Service claims that by doing more cases themselves they get a better deal for the creditors because they can do the work more cheaply. There are two points to note regarding this:

2.4.1 (i) On quality of work/return to creditors, many R3 members report that ORs only do the minimum necessary to realise assets, without taking any extra steps to try to add value by increasing receipts into the estate "pot". It should be noted that one of the major recipients of this estate pot is often Government itself through HMRC. So, whilst ORs base costs are less, it may be questioned whether they represent the best value for creditors when viewed alongside realisations.

2.4.2 (ii) There are frequent complaints from IPs that the Service disregards the wishes of creditors by refusing to hold a creditors' meeting. Where 25% by value of creditors requisition a meeting, the OR must hold one (sections 136 and 294), but are frequently reported as refusing to hold one. Similarly, even when the necessary 50% of creditors vote in favour of a Secretary of State appointment, this is often frustrated by some ORs.

2.5 As regards the differing standards, it should be noted that ORs do not have to comply with all the rules and regulations applicable to IPs (SIPs); are not required to pass the JIEB[3] exam, are not subject to the same regulatory regime, do not have to be bonded; and, following the decision in *Mond v Hyde*, are immune from suit for negligence. In view of all these factors, it can be seen that ORs have a considerable advantage with regard to costs.

2.6 Recommendations: The Service should relinquish Crown immunity; ensure that creditors' legitimate calls for a creditors' meeting or a Secretary of State IP appointment are not frustrated by the ORs; and should evaluate OR area's work as a free-standing activity to establish the true cost/benefit of that division.

3. Corporate Insolvency

3.1 *Directors' Disqualification*

By law, when a business fails, a report is made by the IP on the conduct of the Director/s of that business during the last three years of trading. Should any of the behaviour of the Director/s be identified as "dishonest" or "blameworthy", the IP is required by law to submit a report to the Service, outlining the areas of concern. Depending on the level of seriousness, the report could lead to a period of disqualification for the Director/s (between 2–15 years). This process acts as a protection for the general public and other businesses, preventing Directors who are "dishonest" or "blameworthy" from setting up another business. Approximately 1,200 directors are disqualified on an annual basis.

3.2 R3 understands that given the limited resources within the Service, not all of the reports submitted by IPs are pursued (for reasons such as a lack of evidence to exact a disqualification). A number of IPs assert that it is due to the lack of resources that not all reports meriting action are investigated, leading to fewer, justified disqualifications; and there is a fear that "easy cases" are taken on in order to meet targets. The current economic climate is such that that fraud/dishonest/blameworthy behaviour will increase. Therefore, the already tight resources the Service has at its disposal must be increased to cope with the expected increased number of cases.

3.3 *Recommendation*

R3 calls on the Government to provide extra resource to the Insolvency Service to ensure that they can act on the expected increased number of cases for disqualification.

3.4 *Canadian post-bankruptcy rehabilitation scheme*

There are no requirements for a Director of a UK company to undertake any training or qualifications to be a Director. Compulsory financial education for Directors of failed companies could help more future businesses survive. R3 believes that a scheme adopted in Canada[4] could be usefully adapted and deployed for individuals and Directors who have faced financial difficulty.

3.5 *Recommendation*

R3 believes that the Insolvency Service should further investigate, adapt and introduce into the existing UK regime compulsory financial education for Directors' of failed businesses and individual bankrupts.

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[3] JIEB—Joint Insolvency Examinations Board Exams. It is a requirement to pass the JIEB exams to become a licensed Insolvency Practitioner. For further information see http://www.bppprofessionaldevelopment.com/insolvency/jie/

[4] (see the Services own publication: Bankruptcy—A Fresh Start. Insolvency Service, DTI publication, April 2000, at paragraphs 7.19–7.21, (paragraph 4.8).

3.6 *Pre-packs*

A pre-pack is a deal for the sale of an insolvent company's assets which is put into place before the company goes into a formal insolvency process. Pre-packs have been the cause of much controversy, as it can seem as though a business, from one day to the next, has kept almost the same name, staff and owner/ managers or directors, but because it has been "pre-packed", has "shrugged off" its unsecured debts. Pre-packs are deployed successfully when a business' principle assets are the employees, forward contracts or intellectual property, as in all service businesses. "Trading on" such a business when it is almost certain to enter insolvency is virtually impossible as staff, suppliers and customers abandon the company, leaving effectively, no business.

3.7 There is clear evidence that pre-packs perform better than business sales in preserving employment (although this is not a statutory purpose of the legislation). Research commissioned by R3[5] demonstrates that the entire workforce is transferred to the purchaser in 90% of pre-pack cases. The corresponding figure for business sales is just 62% of cases. Ongoing research suggests that creditor returns for pre-packs are largely similar as in traditional administration cases. Unsecured creditors of large companies receive around 27% on average, although this plunges to only 5% of 6% for small firm cases.

3.8 Pre-pack sales are increasing sharply in number, most notably in administrations. In terms of going concern sales, by May 2005 the majority (53%) were effected through the use of a pre-pack, and this tendency has continued into 2006. Insolvency Practitioners predict that the number will continue to rise in 2009 and 2010 given the economic downturn. The main areas for their use are the professional services sector and the construction industry.

3.9 R3 has helped to draft best-practice guidance on pre-packs for Insolvency Practitioners, in order to address the reporting and "transparency" issue. The best practice guidance—"SIP 16", was introduced in November 2008.[6]

3.10 *Recommendation*

R3 believes that the number of Pre-pack cases will increase in 2009 and 2010 and, rather than curtailing their use, the Insolvency Service with its subsidiary Regulators should fully and quickly apply SIP 16's provisions.

4. Personal Insolvency

4.1 *Individual Voluntary Arrangements (IVAs)*

Individual Voluntary Arrangements (IVAs) were introduced under the Insolvency Act 1986 as an alternative to bankruptcy for businessmen in excessive debt. However, increasing levels of consumer debt resulted in a huge increase in the number of non-business individuals seeking IVAs, rising from 400 in 1987 to a peak of 44,000 in 2006. Despite the current economic climate and increasing levels of personal debt, the number of IVAs fell to 42,000 in 2007 and our estimate for the number in 2008 does not exceed 38,000. This is counterintuitive, and reflects (mainly) banks counter-measures to restrict IVA numbers.

4.2 During 2006, banks began to tighten their criteria for approving IVAs (NB 75% of creditors by value must approve an IVA) and many imposed so-called "hurdle rates", the most well known is HSBC's "40p in the £" requirement. A number of informed commentators, including R3, believe IVAs in 2007 could have reached 65,000, but for bank intervention. The underlying demand and need for IVAs has not reduced. R3 believes that excessive blocking of IVA approvals is a frustration of public policy. Insolvent debtors have three choices if an IVA is not approved: bankruptcy, a Debt Management Plan (DMP) or "hanging on as best they can".

4.3 *Recommendation*

The Insolvency Service has a role in protecting public policy on insolvency issues, which includes campaigning/ highlighting the IVA issue and so should more fully use or enlist powers as necessary to achieve this.

[5] "A preliminary analysis of pre-packaged administrations—a summary", Dr Sandra Frisby, The University of Nottingham, August 2007.

[6] https://www.r3.org.uk/members/default.asp?dir=r3library&pag=statementsofinsolvencypractice&i=342

4.4 *Proposed changes to personal insolvency*

There are a large number of legislative initiatives which are about to be introduced to deal with personal debt. Those in the process of being introduced include: Debt Relief Orders (DROs), Enforcement Restriction Orders (EROs) and changes to the Administration Orders (AOs) scheme, all of which deal with differing levels and kinds of debts. R3 is concerned that these measures are being introduced in a piecemeal and disjointed fashion by differing parts of Government. There does not appear to be a discernable coherent policy to tackle the underlying problem of personal debt.

4.5 *Recommendation*

R3 believes that the Insolvency Service should manage/oversee all insolvency debt solutions to ensure consistency and coherence.

4.6 *Simplified Individual Voluntary Agreements (SIVAs)*

SIVAs were proposed by The Insolvency Service as a "third option" to bankruptcy and "normal" IVAs, aimed at debtors of less than £75,000 (a group one might call "the indebted poor"). With a proposed 51% of creditors needed to agree a SIVA (75% of creditors approve an IVA), and with reduced costs, this was a solution designed very much with the debtor in mind, but also with benefits to creditors.

4.7 The Service suddenly announced in November 2008, after three years of work, the withdrawal of their SIVA idea apparently finding only at the eleventh hour that after three years of work, the Legislative Reform Order (LRO) solution was "inappropriate". R3 believes that abandoning SIVAs leaves a whole swathe of personal debtors with fewer options; and the faith they place in banks to allow a "market solution" to be unjustified and misplaced.

4.8 Recommendation: R3 calls on the Insolvency Service to review its plans and find either time to introduce the SIVAs as originally planned or reflect on how the planned procedure can be accommodated under the current insolvency regime.

4.9 *Debt Management Plans (DMPs)*

A DMP is an unofficial, but formalised agreement between an individual who is in financial difficulty and their creditors. Such people are technically insolvent. DMPs can be appropriate for some individuals, providing a structured way to repay debt. However, they are unregulated, meaning that some plans can become "debt slavery", as there is no guaranteed debt write off; freeze in interest or charges; and they can run for decades (R3 has heard of a 70 year plan).

4.10 There are no official records of the number of DMPs currently in place in the UK. Whilst this data is very difficult to collect, this situation is clearly unacceptable. R3, working with YouGov,[7] found that 600,000 UK residents state that they are currently in a DMP. This number dwarfs the number of UK residents who are in current formal insolvency arrangements—approximately 150,000 people in an IVA (Individual Voluntary Arrangement) and 300,000 people who have been or are currently declared bankrupt.

4.11 R3/YouGov research also found that 19% of those in a DMP state that the plan is due to last over 10 years, with 29% of those stating that they did not know how long the plan was due to last. By comparison, an IVA usually lasts five years; and bankrupts are discharged after one year.

4.12 There is concern amongst many IPs that banks are deliberately refusing to approve IVAs to force debtors into DMPs. R3 believes this preference for DMPs may be due to the fact that accounting and current banking regulation allow lenders to disguise or mask these "impaired" lendings, thus presenting an inaccurate picture in their balance sheets. Banks, we believe, can categorize DMP debt as "rescheduled and performing" and so are not required to raise bad or doubtful provision against it as with IVA debt.

4.13 Her Majesty's Court Service (HMCS) is currently looking at proposals for statutory Debt Management Plans. The proposals are in an early stage and currently do not contain any finalised detail. There are many unanswered questions: who would be eligible for the DMPs; will the same structures such as professional advice and legal protections that surround bankruptcy and IVAs be available to people looking who enter into DMPs; will bonding be required; and, most importantly, who would manage the regulatory regime (HMCS has stated it wouldn't want to)?

[7] R3/YouGov "debt tracker"—surveyed 3,329 participants in 31 July to 5 August 2008.

4.14 *Recommendations*

R3 calls on The Insolvency Service to collect figures on DMPs to build a more meaningful picture of the number of insolvent people in the UK; and take the lead/have sole responsibility for the regulation of DMPs, so that these "missing debtors" are brought within the formal insolvency regime.

Memorandum submitted by the British Printing Industries Federation (BPIF)

PRE-PACKS AND THEIR IMPACT ON THE UK PRINTING INDUSTRY—A SUBMISSION BY THE BPIF TO THE BERR SELECT COMMITTEE ENQUIRY INTO THE INSOLVENCY SERVICE

1. Introduction

The British Printing Industries Federation (BPIF) is the trade association for the UK printing industry. It has 1,915 member companies with 77,000 employees, covering approximately 55% of the industry by turnover. We provide a wide range of business services critical to developing and growing healthy, sustainable businesses. Through our team of around 50 advisors and consultants, all industry experts, we deliver high quality, bespoke advice and support to printing companies, where, when and how they need it.

The UK printing industry has a turnover of £15.3 billion and employs approximately 150,000 employees in around 11,500 companies across the UK. It is a vital manufacturing sector, which is of strategic importance to the UK economy. It has harnessed technological innovation to make an increasingly positive contribution to the UK balance of trade, and it supplies every sector of the UK economy. It is an industry comprising predominantly small companies—only 60 printing companies in the UK employ over 250 people. In many segments of the printing industry, for example jobbing and promotional print, the cost of entry is relatively low compared with much of manufacturing industry. It is an industry where entrepreneurs can get started—and fail—relatively easily. Overcapacity is very much a feature of the industry and not surprisingly therefore, consolidation—through closures, rationalisation, mergers and acquisitions—has been taking place in the sector for many years. This trend is set to continue apace in the years ahead. Price pressures are intense, with many customers buying on a purely commodity basis and exploiting the fierce competition that overcapacity inevitably creates. The purchase and sale of companies—often through pre-pack deals—is common, usually where companies have become distressed as they fail to keep pace with the competition.

2. What is a "Pre-pack"?

The term "pre-pack" refers to an arrangement where a deal is struck to sell an insolvent company's assets to another party before it enters insolvency.

Insolvency practioners (IPs) have argued that these preserve more jobs: a recent research report by R3 found that 92% of pre-packs resulted in a 100% transfer rate of employees to new owners, compared with 65% in other types of sale following insolvency. It has also been argued that where small businesses, which trade on their reputation, are concerned, a quick administration is essential.

However pre-packs are also often criticised for being a "stitch-up". Businesses can write off debts owed to creditors through the arrangements, with the new owners sometimes the same as the old owners, as in the recent DSR case where DSR Print Management's business and assets were bought by the company's owners in a pre-pack deal following the Northampton-based print manager's fall into administration (see below).

3. Impact of the Enterprise Act 2002

There is no doubt that pre-packs have been used more frequently by IPs since the introduction of the Enterprise Act 2002, which includes measures to encourage the rescue of more businesses. However there have been cases where the pre-pack facility has been abused, for example where IPs help sell a business back to its original owners free of debts without considering marketing the business, or where they proactively target failing businesses - offering the owners an easy way out of debt through a pre-pack sale to a newly-formed phoenix company that allows them to hold on to the original company's assets.

4. Reaction of the Insolvency Profession

There is evidence that the IPs professional body is sensitive to the adverse publicity such cases bring. The rules governing pre-packs are to be tightened up by a new code of ethics on company wind-ups, published in October 2008 by the Insolvency Practioners Association. Statement of Insolvency Practice 16 calls for IPs to make disclosures on topics such as valuations when reporting to creditors after the sale of a company has

been completed. There is a disciplinary element to the new code, which would mean IPs could find themselves open to disciplinary action from their governing body if they could not explain a deviation from the rules.The aim is to put creditors' minds at rest that IPs are getting the best value for companies out of a pre-pack and also to ensure best practice in the insolvency community. Many of our members are sceptical about the effectiveness of SIP 16, given their experiences to date. Accordingly we believe that the impact of this should be carefully monitored, with consideration being given to the introduction of statutory measures if it is found wanting.

5. Recent Events

A number of members have recently expressed their concerns about prepacks, following the recent developments concerning the sale of DSR Print Management to new owners DSR Group. DSR Print Management, which recorded a turnover of £18.7m in 2005, failed because of the collapse of its largest client, furniture retailer MFI, which left it with a substantial bad debt. DSR Group announced that they would be based at DSR Print Management's site in Northampton and that all DSR Print Management employees would be transferred to DSR Group.

6. Impact on Printing Companies

Not all prepacks necessarily involve malpractice. Some involve a new management team coming in, with fresh capital and a clear plan of action for the business geared to turning it around. Even where the existing management team buy the business, it may be that they have been trading responsibly previously but have been hit by loss of contracts, bad debts etc and forced to close: in such cases it may be a case of bad luck, or it may be down to poor management of course. However the difficulty facing member companies is that regardless of the "virtues" (or otherwise) of any particular case, they still end up being faced with a competitor who has a clear trading advantage over them, especially if they themselves are heavily laden with debt.

7. Political Considerations

The Government's philosophy is to encourage new business start-ups and of course the Enterprise Act 2002 makes it much easier for businesses to get started, and for those involved in failed ventures to start again. All indications are that the Government is unlikely to wish to reverse these provisions, although we believe that both Government and Opposition should be aware of, and should seelk to address, the adverse consequences of the current legislation that are now impacting on industries such as print.

8. Marketing Companies to Other Purchasers

In an overcapacity industry such as print, prepacks can often be the only way that an unprofitable business can be sold intact. With fellow printers hungry for new contracts and customers jumpy at the prospect of loss of supply (especially in sectors with short publication deadlines), the interests of employees, shareholders and customers alike may be best served by keeping the sale under wraps until the deal is concluded. This is little comfort to competitors of course.

However it may be that more can be done to ensure that vendors are required to make discrete enquiries into who else is in the market for purchasing the type of business concerned, so that at least other purchasers have the opportunity to bid. It would also prevent an IP being able to hide behind a claim that they had to pre-pack the sale to a given purchaser (or back to the original owners) because no-one else was interested in buying. We are exploring whether the BPIF can play a role in this in relation to the printing industry, by establishing a confidential list of companies interested in purchasing others. However it may be that the Association of Busness Recovery Professionals (R3), as the trade body for the insolvency profession, could also play a role here across the wider business sector, with support from Government.

9. The Need for Action by Suppliers

The position of suppliers is crucially important. It is in their clear interest to withold credit facilities to prepacks until the new owners have at least demonstrated some willingness to pay off past debts. That isn't necessarily to say they shouldn't supply them at all, but rather that they should insist on payment up front (which would go some way to redressing the competitive balance with other printers). However there are some notorious cases where suppliers should consider not supplying them at all.

10. Summary

We submit that the following actions should be considered in response to our members' concerns regarding pre-packs:

(i) Government should evaluate the adverse consequences of the current enterprise legislation that are now impacting on our industry through pre-packs.

(ii) The effectiveness of SIP 16 should be carefully monitored, with consideration given to the introduction of statutory measures if it is found wanting.

(iii) Government should support initiatives to establish a confidential list of companies interested in purchasing others, providing scope for other purchasers to have the opportunity to bid and denying IPs the ability to argue that no-one else was interested in buying.

(iv) Suppliers should be encouraged to refuse credit facilities to prepacks until the new owners have at least demonstrated some willingness to pay off past debts. Normally this would involve continuing to supply but insisting on payment up front, although in some cases suppliers should consider not supplying at all.

January 2009

Memorandum submitted by the Insolvency Practitioners Association (IPA)

1. Summary

The IPA is of the view that The Insolvency Service has generally discharged its wide ranging insolvency functions efficiently and effectively, and has shown itself capable of managing the marked increases in bankruptcies in the last five years. However, with the likelihood of significant further increases in bankruptcies and also now in companies, it would be appropriate to look at a number of issues which need, or will soon need, to be addressed—

— Para 3.3: The Service should make more use of the Secretary of State's powers to appoint insolvency practitioners as trustees and liquidators to ensure that its official receivers continue to be able to deal with the essential protection of assets and the investigation of conduct of bankrupts and directors of failed companies.

— Para 3.5: It is important that The Service's investigation and enforcement activities are maintained, and not arbitrarily restricted by reductions in its budget.

— Para 4.3: Advice organisations and others providing debt advice should be required to provide debtors with information and appropriate advice across the range of statutory and non-statutory debt relief and repayment solutions, as is currently required of insolvency practitioners.

— Paras 4.4 and 4.5: Officials receivers, in the event that it is decided that they should accept petitions for bankruptcy, should establish whether debtors have received professional advice, particularly in cases where they file their petitions on-line.

— Paras 4.5, 4.6 and 4.7: Bankruptcy should be a last resort; and debtors who can pay should be directed to alternative solutions likely to have less impact on their credit rating and improve their access to financial markets, and enhance returns to creditors.

— Para 4.6: The Government should ensure that debtors are not being unreasonably denied access to debt relief and repayment procedures.

— Para 4.8: The Service should have responsibility for the proposed approval of debt management scheme providers to ensure coherence and consistency with the authorisation and regulation of insolvency practitioners and approval of debt relief order intermediaries, and with other debt repayment procedures.

— Paras 5.10 and 5.11: Transparency in pre-packaged administration sales of companies should not be overshadowed by particular interests' preferences for confidentiality.

— Para 6.6: If The Service is to continue to license insolvency practitioners, then it should have the full range of sanctions to deal with transgressions and misconduct.

— Para 6.7: The Service should take a more outward-looking role in assuring the integrity and robustness of the regulatory framework.

2. About the IPA

The IPA is a membership body for those in insolvency practice, those engaged in insolvency related work and those with an interest in insolvency.

- It has some 1,700 individual and firm members and students.
- It is the second largest of the professional bodies recognised for the purpose of authorising and regulating insolvency practitioners (IPs) under the Insolvency Act 1986.
- As the only recognised body solely involved in insolvency, it has been at the forefront in developing professional and ethical standards; widening access to insolvency knowledge and understanding; and promoting the principles of better regulation.
- It introduced what has become the Joint Insolvency Examination which is the required qualification for IPs; and has developed an intermediate Certificate of Proficiency in Insolvency and Certificate of Proficiency in Personal Insolvency Examinations, primarily for those involved in case administration.
- It jointly administers a voluntary scheme for the registration and regulation of those specialising in fixed charge receiverships which fall outside the statutory framework.
- It has been instrumental in establishing the Debt Resolution Forum which will set, monitor and regulate standards for those involved in providing non-statutory debt solutions.

3. Insolvency Service Case Loads

3.1 The announcement of the Committee's scrutiny refers to "insolvencies increasing at an alarming rate and the appropriateness of looking at The Insolvency Service's efficiency". Such an increase has yet to be fully reflected in the latest published statistics to 30 September 2008. However, there remains a broad consensus amongst commentators, re-enforced by reports of more large, medium and small businesses facing falling sales and tighter provision of finance, along with some high profile companies entering into administration, that numbers of insolvencies will increase significantly over the coming months.

3.2 The Service's financial regime gives it flexibility to deal with fluctuations in case administration workloads from one year to another by adjusting resources in line with cases and the fees that they generate. But it is acknowledged in the Corporate Plan 2008–11, published in April 2008, that the effort needed to be put into training and development of new staff to handle the expected increase in case numbers from 67,200 in 2007–08 to a then projected 74,200 in 2008–09 would mean that The Service would be stretched very hard to maintain its performance. The numbers of bankruptcies can expect to be affected when the provisions of the Tribunals Courts & Enforcement Act 2007 relating to debt relief orders are brought into operation in April 2009—it is estimated in the Corporate Plan that some 8,000 debtors who might otherwise have been expected to present their own petition for bankruptcy would qualify for a debt relief order on the basis that their liabilities do not exceed £15,000 and they have minimal assets and limited surplus income. But rising unemployment may result in debtors defaulting on individual voluntary arrangements (IVAs) and resorting to bankruptcy; and there could be fewer IVAs proposed as alternatives to bankruptcy without some changes to the approach to IVAs—see Personal Insolvency at paras 4.6 and 4.7.

3.3 With the likely rise in insolvencies and the question about The Service's ability and capacity to recruit and train sufficient numbers of additional staff, the IPA considers that it should look again at the use it makes, and considers making more use, of the powers of the Secretary of State to appoint IPs as trustees and liquidators to ensure that the role of its official receivers and their staff in the essential protection of assets and the investigation of conduct is not adversely affected by the need to themselves also undertake the trustee and liquidator functions where there are assets—currently IPs are appointed in some 9% of bankruptcies and 21% of compulsory liquidations. Otherwise, there is a distinct risk that case administrations standards will fall and/or investigations will be curtailed, undermining the credibility of the framework for dealing with financial failure.

3.4 Would the private sector be able to cope any better? While large and medium firms are heavily committed to some major failures, they are generally in a position to re-allocate resources from other departments whose workloads have historically reduced as the economy has shrunk. The number of smaller firms across the country would offer more flexibility to spread case work.

3.5 There would be a further concern if, as a consequence of pressures on government spending, The Service's investigation and enforcement functions, which are funded by the Department of Business Enterprise & Regulatory Reform under a programme budget, were to be arbitrarily restricted by reductions in that budget: it might be reasonably predicted that if the number of insolvencies do rise, then there will be a need for an increase in investigation and enforcement—in actual numbers if not necessarily proportionately. It would be damaging to the integrity of the insolvency system if bankrupts and directors who had acted irresponsibly, recklessly or dishonestly in bringing about their own or their company's insolvency were to escape detailed scrutiny, and appropriate sanctions.

3.6 The Committee should be aware that in December 2006 The Service had to announce that, as a result of the then Department of Trade & Industry having suffered some unforeseen demands on its budgets in 2006–07 and being required to cut expenditure on some of its activities, its enforcement budget had been reduced by 7.5%: in consequence it was unable to investigate as many cases as it had originally planned. It is understood that the budget was re-instated for 2007–08, but a shorter term impact seems to have been that The Service fell short of its target for increasing its enforcement outcomes in 2007–08.

4. Personal Insolvency

4.1 The Government, principally through The Insolvency Service and the Ministry of Justice, is taking forward proposals to provide individuals facing financial difficulties with a wider range of statutory debt relief and repayment solutions, alongside the many non-statutory solutions—see Appendix I.

4.2 The concepts behind the statutory proposals are straightforward, depending very largely on the ability of debtors to pay (and their readiness to do so) and how much they owe—see Appendix II. Bankruptcy should be the last resort, essentially for those whose affairs should be investigated by the official receiver: other debtors should be channelled into one of the other relief/repayment solutions.

4.3 From the perspective of most debtors however, the statutory and non-statutory options and the impact on them are likely to seem somewhat bewildering: independent, authoritative advice is essential. There is an existing requirement on IPs consulted by debtors to ensure that they receive information and appropriate advice across the range of statutory and non-statutory solutions; and to record the conclusions. While it appears from responses to surveys conducted for or by The Service in 2005 and 2007 that the majority of debtors who presented their own petition for bankruptcy had considered other solutions and sought advice, the extent of that consideration and the validity of the advice are unclear. The IPA considers that the requirement placed on IPs should also be extended to advice organisations and others providing debt advice. Such a requirement would be supported by the publication of a Debtor's Guide which is being finalised by a Standing Committee, chaired by The Service and including representatives of the insolvency profession and regulatory bodies, creditors, Citizens Advice and other advice organisations, the Office of Fair Trading and the Insolvency Practices Council which represents the public interest in insolvency profession standards: the Guide outlines the debt solutions available to debtors and identifies the criteria for them and their effect on debtors.

4.4 In October 2007, The Service published a proposal under which debtors would file their petition for bankruptcy with its official receivers, rather than as now with the courts. The proposal would present an opportunity for The Service to take a more proactive and innovative role in steering debtors to the appropriate solution. For example:

- There already exists a provision by which, in relation to a debtor presenting his own petition and who has assets and/or income, the court can refer him to an IP with a view to proposing an IVA. The procedure has fallen into disuse in the hands of the court; and in consequence, debtors are being made bankrupt when a more appropriate solution might have been more fully considered.
- While in 2007–08 some 13,000 bankrupts (out of 62,000) were subject to agreements/orders to make payments out of their surplus income for periods of up to three years, only 13 attempted a post-bankruptcy fast track voluntary arrangement (FTVA) under the aegis of official receivers—something which would immediately lead to the annulment of their bankruptcy; should have less impact on their credit rating and improve their access to financial markets; and should enhance returns to creditors.

4.5 The Service response to comments on the consultation, published in July 2008, suggests that it might see itself more as "a safety net" rather than a primary source of advice. That is probably right. But the IPA considers that official receivers should establish whether debtors petitioning for their own bankruptcy have had information about the options available to them and have received professional advice—particularly in cases where the debtor files his petition on-line; and in appropriate cases, refer debtors to an insolvency practitioner or to a recognised advice organisation for that advice and further consideration of the options, including an IVA.

4.6 A debtor cannot be compelled to put forward a proposal for an IVA; nor can creditors be compelled to accept. That suggests:

- Consideration might be given to introducing a scheme with elements of the US Chapter13 procedure by which a debtor who has surplus income can only proceed under protection of the Bankruptcy Code through a repayment plan, usually for five years—around 40% of US Bankruptcy Code filings proceed under Chapter 13.
- Alternatively or additionally, the period of income payments orders/agreements entered into by bankrupts should be extended from three years to five years to align the procedure with (i) the proposed payment period for county court administration orders and (ii) the usual payment period for IVAs; and provide more incentive to "can pay" debtors to come to some arrangement with their creditors outside bankruptcy, and improve returns to creditors.

— It would be appropriate to revive the proposal contained in the recently withdrawn draft Legislative Reform Order by which a voluntary arrangement proposal could be approved by a simple majority in value of creditors (rather than as now, 75%), thereby reducing the risk of a minority creditor owed as little as 25% of the amount due to creditors who vote (and perhaps even a smaller percentage of the total amount owed) being able to defeat a proposal which would benefit the vast majority.

— Given the difficulties which debtors have encountered with creditors, particularly banks, putting forward unnecessary or inconsistent modifications to proposals for IVAs and imposing restrictive pre-conditions, the Government should ensure that debtors are not being unreasonably denied access to debt relief and repayment procedures.

4.7 The IPA considers that to deliver its objective of supporting a fresh start for bankrupts by providing an accessible alternative to bankruptcy, The Service gives early attention to:

— removing unnecessary internal restrictions to FTVAs which seem largely to be matters of its administrative convenience rather than reflecting the interests of bankrupts and creditors;

— exploring mechanisms by which IPs with experience of handling more complex IVAs could be appointed as supervisors of FTVAs, or alternatively encouraging such bankrupts to proceed under a non-FTVA post-bankruptcy proposal with an IP; and

— pursuing the recommendation in the Enterprise Act Personal Insolvency Evaluation Report, published in November 2007, that it work with credit reference agencies and lenders to ensure that FTVAs and post-bankruptcy IVAs are appropriately reflected in lender policies, and are therefore more attractive to "can pay" debtors.

4.8 It is noted that the Ministry of Justice has formulated proposals for approval of debt management scheme providers under powers in the Tribunals Courts & Enforcement Act 2007. So far as it is possible to establish, the intention is that scheme providers would be able to offer debt repayment plans which would mirror county court administration orders—that is, based wholly on income without any recourse to the debtor's assets; imposed on creditors with a limit on payments of five years, and therefore invariably involving write-off of part of their debts; and with fixed percentage fees—but would be administered by the private sector. It is unclear how the proposals sit alongside IVAs; or indeed, whether there is yet established a need for such schemes. While, as noted, the origins lie in the county court administration order procedure administered by the courts, the IPA submits that the proposals should be taken forward with The Service in the lead to ensure coherence and consistency with the requirements for authorisation and regulation of IPs and approval of intermediaries appointed to assist debtors submitting applications for debt relief orders; and with other debt repayment procedures for which it is responsible.

5. Company Insolvency—Administration

5.1 The administration procedure was introduced by the Insolvency Act 1986 to provide companies (and by addition in 1994, partnerships) facing financial difficulties with a breathing space to re-structure their business and funding.

5.2 Amendments introduced by the Enterprise Act 2002, covering administrations and administrative receiverships and aimed at creating a fairer system for creditors generally, re-stated the administration objectives as first rescuing the company as a going concern; or if that was not reasonably practicable, achieving a better result for the company's creditors as a whole; or if that was not reasonably practicable, realising property to make a distribution to one or more secured or preferential creditors. At the same time, the requirement to apply to the court for an administrator was removed, thereby reducing the costs and delay involved in obtaining an appointment and making the procedure more accessible to smaller companies.

5.3 Since the amendments made by the Enterprise Act 2002, the numbers of administrations (England & Wales) have increased significantly—from 643 in 2002 to 2,512 in 2007 and 2,804 in the first nine months of 2008, representing some 19% of company insolvencies.

5.4 Research undertaken for The Insolvency Service and reproduced in its Enterprise Act 2002 Corporate Insolvency Provisions Evaluation Report, published in January 2008, shows that within a sample of administrations commenced in 2001–04, 41% resulted in the rescue of the whole or part of the company or a going concern sale of the whole or part of the business; while 56% resulted in the sale of the company's assets on a break-up basis (and 3% were ongoing at the time of the research)—reflecting, it would seem, the range of objectives for which administration was designed. What has to be recognised however is that there has been a very significant shift in the economic climate since those companies went into administration; and that would suggest that it would be appropriate to put in place procedures to more immediately track the outcomes of new administrations.

5.5 It is also appropriate to make the point here that many company rescues are achieved without recourse to statutory procedures, involving re-structuring of share capital, re-financing of day to day operations and/or re-scheduling supply and delivery arrangements and debts. Indeed, it is likely that they exceed the number/value of formal rescues through administration (or company voluntary arrangements). Thus those companies, or certainly the larger ones, resorting to administration are frequently those where informal negotiations have been unsuccessful and they cannot (or should not) continue trading outside a

formal insolvency mechanism; but where it is nevertheless worthwhile exploring further the possibility of securing a sale of all or part of the company or its business, rather than automatically resorting to liquidation and break-up sale. It might be added that the vast majority of companies which go into liquidation are not rescuable because of loss of market or of underlying unprofitability, and generally directors act too late to save them. Greater use of administration and publicity surrounding it might increase awareness and provide encouragement to directors to seek advice at an earlier stage when their company's business, or parts of it, might be capable of being turned round to solvency and profitability.

Pre-Packaged Administrations

5.6 There has been considerable discussion recently about the appropriateness and propriety of "pre-pack" administration whereby arrangements for the sale of the company or all or parts of its business are put in place immediately before the appointment of an administrator who then completes the sale on or shortly after his formal appointment. A "pre-pack" may offer the best chance for a business rescue, preserving goodwill and jobs and retaining key staff, maintaining profitable contracts and avoiding the worst effects of adverse publicity; or simply it may be that the company has run out of cash and cannot continue trading to wait on possible offers from third parties. But the "pre-pack" practice has attracted criticism where the sale is made to some or all of the directors even though, and particularly in the current economic climate and market conditions, they may be the only parties prepared to offer better than break-up value.

5.7 The legislation contains a number of provisions to safeguard the interests of creditors—see Appendix III. But perhaps of at least as much importance is the provision of information about dealings with a company's business and assets, particularly where they involve the directors or connected or associated individuals or companies.

5.8 The licensing bodies have recently adopted a mandatory Statement of Insolvency Practice on "pre-packs" (SIP16—November 2008). The SIP requires that IPs should keep a detailed record of the reasoning behind a decision to proceed to disposal of the company and its assets through a "pre-pack" sale; and that creditors are provided with a detailed explanation and justification of why a "pre-pack" sale was undertaken—see Appendix IV.

5.9 Additionally, the new Code of Ethics, which came into force on 1 January 2009 and applies to all IPs, re-iterates their obligations to comply with principles of integrity; objectivity; professional competence and due care; and professional behaviour.

5.10 The IPA itself has placed particular emphasis on transparency in additional guidance which it has given its licence holders on the Code provisions, and which it believes to be of fundamental importance: "It is imperative that all members ensure that, except where to do so would conflict with any legal or professional obligation, their acts, dealings and decision making processes are transparent, understandable and readily identifiable . . . particularly . . . where the assets and business of an insolvent company are sold shortly after appointment on pre-agreed terms. . . [and where] . . . creditors at large are not given the opportunity to consider the sale of the business or assets before it takes place".

5.11 The IPA was concerned that the need for transparency, not least in relation to "pre-packs", should not be overshadowed by any duty of confidentiality to the parties to the transaction. The additional guidance therefore makes clear the distinction between a member acting as adviser to a company or its directors, where the principle of confidentiality may arise; and acting as a statutory office holder, where a client/professional relationship will not arise. It believes that that does need to be re-enforced with the profession as a whole by the RPBs and by The Service.

Rescuing Businesses—UK Administration v US Chapter 11

5.12 There has been some discussion in the media and elsewhere whether the UK should move its administration procedure more towards the United States Chapter 11 for the purpose of rescuing businesses.

5.13 UK administration is distinguishable from US Chapter 11 in one important aspect—in the UK an IP is appointed to take control of the company, the powers of the directors cease and it is for the IP to formulate the detailed proposals for the rescue of the company; whereas in the US the directors invariably remain in office whilst a plan is formulated and negotiated with the various creditor and stockholder groups for presentation to the court: indeed, the court may have to consider competing plans submitted by creditors.

5.14 While the US process would seem to ensure the involvement of creditors and shareholders, frequently through committees separately of unsecured creditors, secured creditors, employees, bondholders and stockholders, that is inclined in larger cases to result in legal actions which may be complex, lengthy and costly and have to be borne from the assets which might otherwise be available for creditors generally; and, unless there is ready unanimity, means that Chapter 11 is impractical for many small and medium size companies.

5.15 Chapter 11 also recognises the priority rights of those who fund the company's business under a re-organisation plan—something which may facilitate a continuation of the business, but which may be at the expense of the unsecured creditors.

5.16 The most recent statistics show that there were 5,900 Chapter 11 filings in the US fiscal year 2007, representing some 20% of total business filings—comparable with the usage of the administration procedure here of 19%. It has not been possible to identify any recent research into outcomes; but a study by the Executive Office of the US Trustees some years ago suggested that re-organisation plans were confirmed in around 30% of filings. Without more recent data, it is not possible to say whether Chapter 11 does work and whether it or parts of it might, with advantage, be imported into UK legislation.

6. Regulation

6.1 Licensing of insolvency practitioners (IPs) was introduced by the Insolvency Act 1986. IPs may be licensed by The Insolvency Service on behalf of the Secretary of State or by professional bodies recognised by the Secretary of State. There are seven such recognised professional bodies (RPBs), including the IPA which licenses 465 IPs (out of a total of 1,680).

6.2 The statutory basis of recognition is that the body enforces rules for ensuring that its members who are licensed are fit and proper persons to act as IPs and meet acceptable requirements as to education and practical training and experience.

6.3 Why have seven RPBs, together with The Service, regulating 1,680 IPs? That mirrors what was in place at the time in relation to auditors under the Companies Acts 1948 & 1976 which provided for authorisation by four accounting bodies or by the Secretary of State; and it reflected, and continues to reflect, the fact that many of those who are licensed as IPs also undertake other work which is subject to oversight and regulation by their professional body.

6.4 How can consistency in the regulation of IPs be assured through eight regulators?

- The RPBs are subject to agreement entered into with The Service as a condition of recognition in the form of recently reviewed and updated Memorandum of Understanding and Principles of Monitoring which set out detailed provisions relating to granting licences, ethics and professional standards, monitoring and inspecting IPs, dealing with complaints and disciplinary matters.
- The RPBs, with The Service, agree common Statements of Insolvency Practice, a Code of Ethics and Insolvency Guidance Papers through their Joint Insolvency Committee.
- The Service requires annual reports from the RPBs in relation to monitoring and inspection and disciplinary action taken.
- The Service conducts its own inspections of RPBs' systems and procedures at least once every three years, and can call for information and documentation relating to individual IPs and individual cases at any time.
- The Service has carried out a detailed comparative study of disciplinary measures taken by the RPBs in relation to IPs' transgressions and misconduct, published in October 2006, and found them to be broadly consistent.

It should be added that no evidence has been submitted by critics of the framework of any adverse impact—for creditors or insolvents or others—arising from having eight regulators.

6.5 Is there an incompatibility in The Service's role as regulator of regulators and in itself licensing IPs? The provision by which The Service has power to grant licences was originally envisaged to be limited to "grandfathering in" those individuals who had acted for some years as IPs but were not, and did not wish to become, members of one of the RPBs. It has continued to exercise the power in relation to new entrants to the insolvency profession who choose to be licensed by it. An advantage of it doing so might be said to be that it thereby has direct experience of IP procedures and practices and of their monitoring, inspection and regulation which it can bring to bear to more effect in discussions with the RPBs about standards. There is left at large a question raised in the context of Better Regulation Executive Review of The Service's Regulatory Performance as to whether The Service might press forward improvements in standards and expedition of implementation as regulator of regulators to the extent only that they suit it as regulator of IPs and how it goes about regulating them: the Review might elaborate on that (or dismiss it) when it is published.

6.6 One other aspect which does give rise to concern is The Service's sanctions against the IPs which it licenses—limited to removal of the licence and only where the IP is found to be no longer be fit and proper. All the RPBs have a range of sanctions from warnings/reprimands through fines (with costs) to restrictions where an IP's transgressions fall short of making him no longer fit and proper; and have provisions for publishing their findings. Doubtless The Service is able to impose conditions and restrictions administratively; but none are published on an individual case basis or reported in its Annual Report. That there are differences between the RPBs and The Service may in practice be more a matter of perception than reality—except to the extent that its IPs are not liable to fines and costs, and publicity (although there is no evidence of regulatory arbitrage: that is, no evidence that IPs have sought to move to The Service to avoid the risk of fines and costs, and publicity). But at least a perception remains that IPs licensed by The Service are not as rigorously regulated; and that can undermine confidence in the regulatory framework and The Service's role in it. The IPA considers that if The Service is to retain its power to license IPs, then it should have the full range of sanctions to deal with, and to be seen to deal with, transgressions and misconduct.

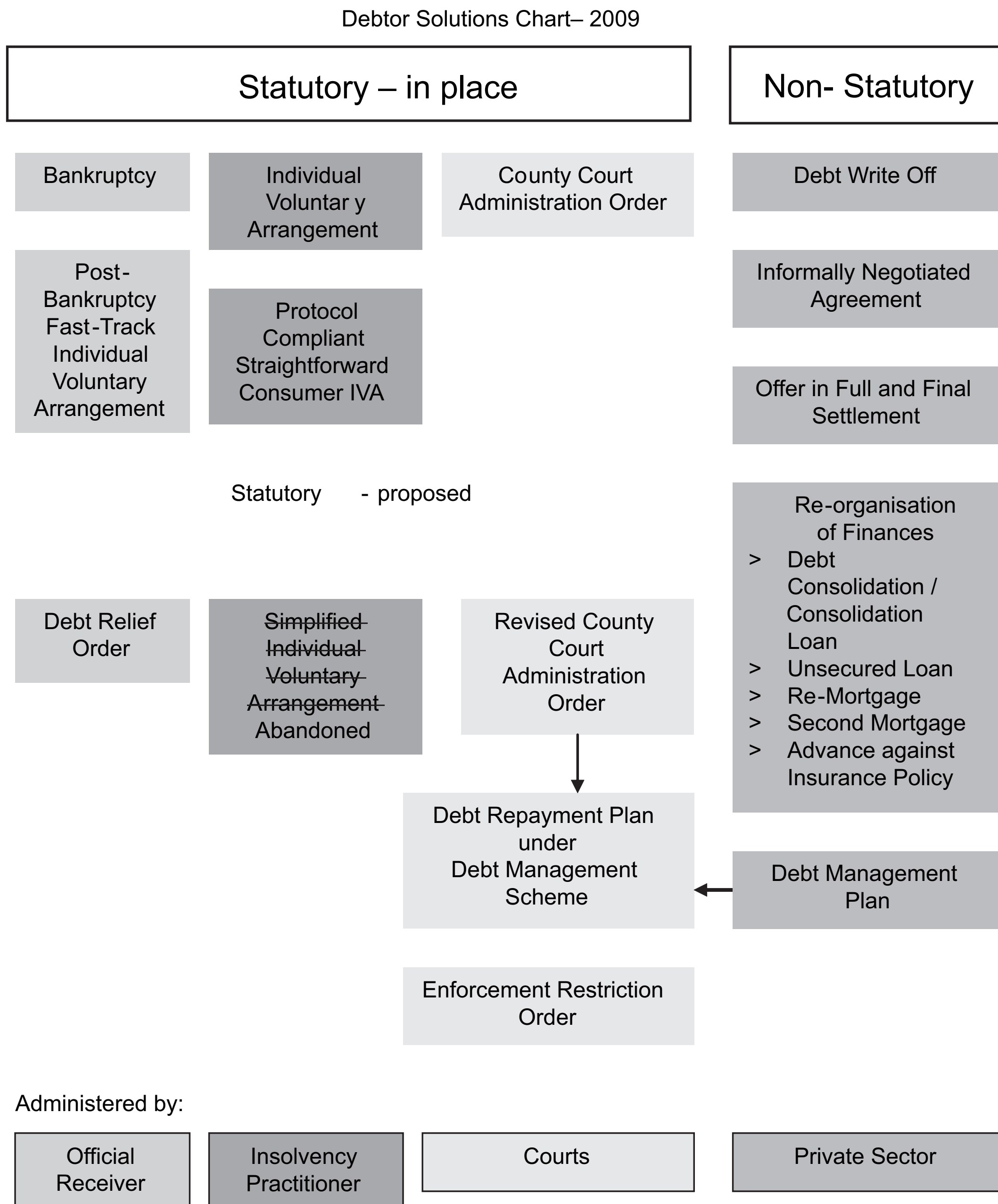
6.7 It is important that what goes on in relation to the regulation of IPs is not internalised and that regulators are seen to respond positively and quickly to emerging issues; otherwise, there may be misunderstanding, misconception and misapprehension about how regulation works, and whether regulation works. The IPA considers that The Service should take a more outward-looking role in assuring the integrity and robustness of the regulatory framework and its responsiveness, for example:

— provide fuller reports of the discharge of its functions as both regulator of regulators and as regulator of IPs—its Annual Reports are descriptive of activities but not of outcomes;

— look to further improve the working of regulation by discussions with the RPBs and with other stakeholders about its findings from RPB inspections and complaints referred to it;

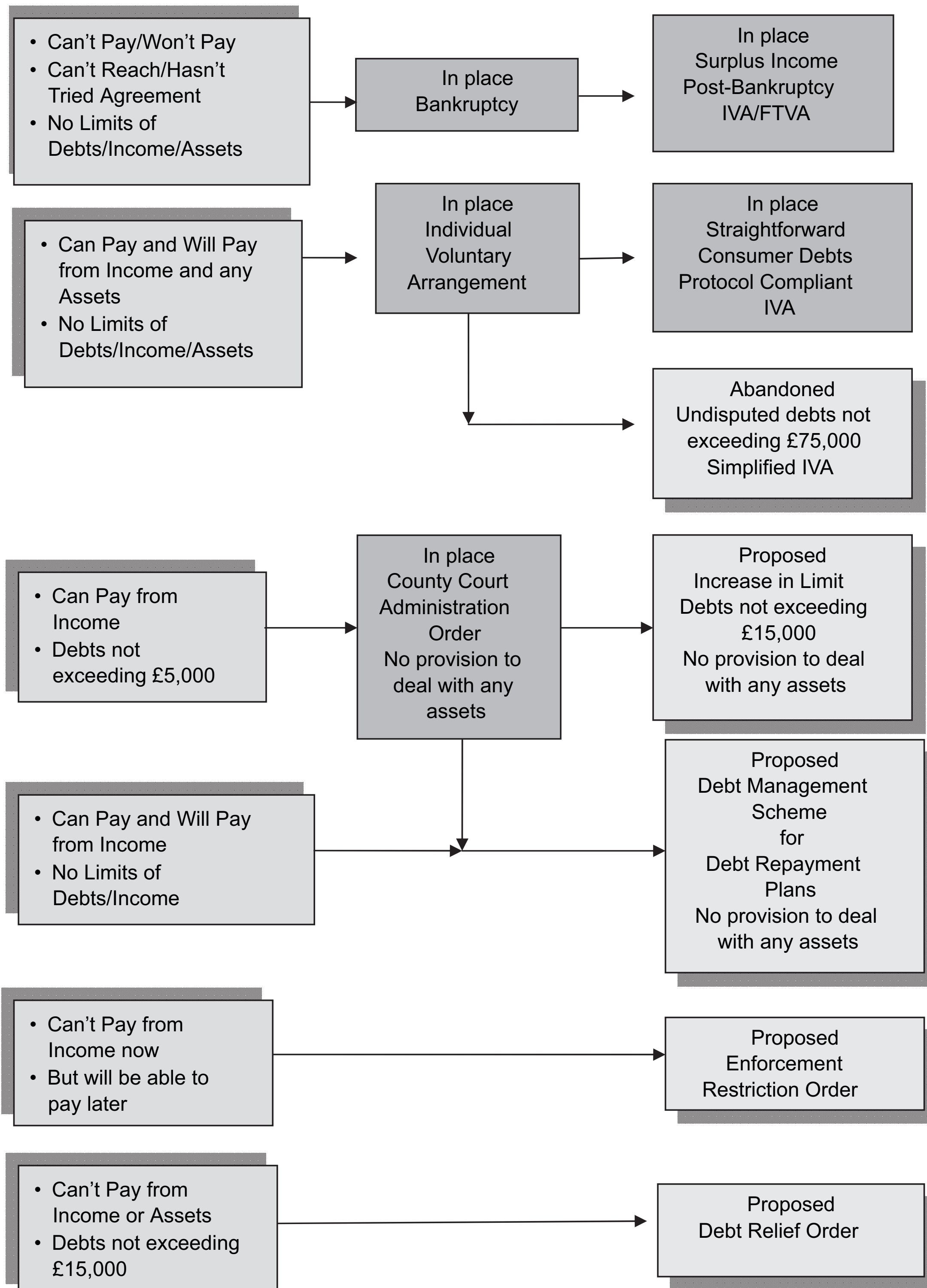
— generally inform and provide a more transparent view of how regulation works, and demonstrate the coherence, consistency and effectiveness of the framework across the insolvency profession.

APPENDIX 1



APPENDIX 2

Debtor Statutory Solutions Chart – 2009



APPENDIX 3

COMPANY ADMINISTRATION: "PRE-PACK" LEGISLATIVE SAFEGUARDS

1. First, the administrator's powers include the power to sell or otherwise dispose of the property of the company by public auction or private auction or private contract; and where the circumstances warrant it, he may do so without the prior approval of the creditors. But he is required to do so "in the interests of the company's creditors as a whole" or otherwise avoid "unnecessary harm [to] the interests of the creditors of the company as a whole"

2. Secondly, an administrator is an officer of the court for the purpose of carrying out his functions; is bound by case law to act honourably and fairly; and is accountable to the court for the performance of his functions.

3. Thirdly, the company or its directors are required to give at least five business days' notice of the intention to appoint an administrator to the company's bank or other lender which holds what is termed a fixed and floating charge on the company's assets; and the bank or other lender, if not content with the administration to proceed under the control of the insolvency practitioner nominated by the company or its directors, can appoint an insolvency practitioner of its own choice or apply to the court to restrain proceeding with the administration if it is of the view that it is inappropriate or for an improper purpose.

4. Fourthly, the administrator is required as soon as reasonably practicable to advertise his appointment and send notice of his appointment to the company's creditors; to hold a meeting of creditors—unless the company has sufficient assets to pay its creditors in full, or it has insufficient assets to enable any payment to be made to unsecured creditors, or the objective is to realise property to make a distribution to one or more secured or preferential creditors; and where a meeting of creditors is required to be held, to obtain creditors' approval of his proposals—failing which the court may amongst other things end his appointment.

5. Finally, any creditor can apply to the court where it considers that the administrator has acted or is proposing to act so as unfairly to harm its interests; and the court may amongst other things regulate the administrator's exercise of his functions and/or require him to do or not do specified things and/or examine his conduct which may result in an order that he repay, restore or account for the company's assets and/or contribute to the company's assets by way of compensation for breach of duty or misfeasance.

6. SIP16 also picks up concerns where for example a supplier has delivered goods after the insolvency practitioner has been engaged by the company to review its financial position but before his formal appointment, and remains unpaid at the time the company enters administration. It makes it clear that insolvency practitioners have to be mindful of the potential liability attaching to those who are a party to a decision to cause the company to incur credit when they knew or should have known that there was no reason to believe that it would be repaid.

APPENDIX IV

COMPANY ADMINISTRATIONS—"PRE-PACKS"
EXTRACT FORM STATEMENT OF INSOLVENCY PRACTICE 16—NOVEMBER 2008

The following information should be disclosed to creditors in all cases where there is a pre-packaged sale, as far as the administrator is aware after making appropriate enquiries:

- The source of the administrator's initial introduction.
- The extent of the administrator's involvement prior to appointment.
- Any marketing activities conducted by the company and/or the administrator.
- Any valuations obtained of the business or the underlying assets.
- The alternative courses of action that were considered by the administrator, with an explanation of possible financial outcomes.
- Why it was not appropriate to trade the business, and offer it for sale as a going concern, during the administration.
- Details of requests made to potential funders to fund working capital requirements.
- Whether efforts were made to consult with major creditors.
- The date of the transaction.
- Details of the assets involved and the nature of the transaction.
- The consideration for the transaction, terms of payment, and any condition of the contract that could materially affect the consideration.
- If the sale is part of a wider transaction, a description of the other aspects of the transaction.
- The identity of the purchaser.
- Any connection between the purchaser and the directors, shareholders or secured creditors of the company.

— The names of any directors, or former directors, of the company who are involved in the management or ownership of the purchaser, or of any other entity into which any of the assets are transferred.

— Whether any directors had given guarantees for amounts due from the company to a prior financier, and whether that financier is financing the new business.

— Any options, buy-back arrangements or similar conditions attached to the contract of sale.

This information should be provided in all cases unless there are exceptional circumstances, and if this is the case, the reason why the information is not provided should be stated. If the sale is to a connected party it is unlikely that considerations of commercial confidentiality would outweigh the need for creditors to be provided with this information.

Unless it is impracticable to do so, this information should be provided with the first notification to creditors. In any case where a pre-packaged sale has been undertaken, the administrator should hold the initial creditors' meeting as soon as possible after his appointment. Where no initial creditors' meeting is to be held and it is impracticable to provide the information in the first notification to creditors it should be provided in the statement of proposals of the administrator which should be sent as soon as practicable after his appointment.

December 2008

Memorandum submitted by The Institute of Chartered Accountants in England and Wales (ICAEW)

Executive Summary

1. The main points in this submission are that:

(i) the Insolvency Service should take steps to enable regulators of voluntary arrangement practitioners to be recognised as soon as is reasonably possible, ideally by non-legislative means;

(ii) the Insolvency Service should reconsider its decision not to proceed with proposals for simplified voluntary arrangements as a matter of urgency;

(iii) the Insolvency Service should improve the means by which it engages with key stakeholders, particularly when communicating difficult or unpopular messages; and

(iv) consideration should be given to the removal of the Secretary of State's ability to authorise insolvency practitioners.

Introduction

2. The Institute of Chartered Accountants in England and Wales (ICAEW) operates under a Royal Charter, working in the public interest. Regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world-leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance which has over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

4. The Institute is a Recognised Professional Body under section 391 of the Insolvency Act 1986 and can license suitable individuals as insolvency practitioners. The Institute licenses a larger number of insolvency practitioners than any other licensing body. At 31 December 2007, the Institute licensed 719 insolvency practitioners out of a UK total of around 1,700. In order to comply with the requirements of the Act and to maintain professional standards, the Institute monitors insolvency practitioners and operates disciplinary and regulatory systems. These ensure that insolvency practitioners licensed by the Institute meet acceptable standards in education, practical training and experience, and are "fit and proper".

5. The Institute's approach to insolvency regulation reflects its determination to ensure that the public interest is taken fully into account. Key features of the Institute's systems and processes include:

— complying with the "Principles for Monitoring" agreed with the Insolvency Service;

— participating in arrangements for independent input into the ethical and professional standards of the insolvency profession via the IPC;

— including members who are neither insolvency practitioners nor chartered accountants on the committees that license, monitor and, if necessary, discipline insolvency practitioners;

— cooperating with the other authorising bodies through the JIC;
— cooperating—through regular meetings of those involved in monitoring—to ensure common monitoring standards;
— monitoring the work of insolvency practitioners, using individuals who are independent of the practitioners and who have an appropriate level of training and experience to assess the work undertaken by insolvency practitioners;
— requiring insolvency practitioners to comply with Statements of Insolvency Practice that are adopted as common standards across all the licensing bodies;
— requiring insolvency practitioners to follow the Code of Ethics, which is the common insolvency ethical guidance applied by all the authorising bodies;
— communicating with insolvency practitioners and providing information via the Institute's website and in Insolvency News;
— making public our annual report to the Insolvency Service (and the DETI in Northern Ireland); and
— requiring insolvency practitioners to monitor their own compliance with the Insolvency Regulations.

Together, these measures are designed to ensure accountability, transparency, consistency and independence.

INFORMATION

6. Generally, we believe that the Insolvency Service carries out its functions efficiently and with expertise and professionalism. The evaluation of the Enterprise Act is a prime example of evidence based policy making—it has produced extensive and useful data on many aspects of both corporate and personal insolvency. Their initiative which brought together creditors and the insolvency profession to discuss the IVA market is to be applauded. They worked hard to find common ground between the parties which lead to the creation of the IVA protocol. The matters detailed below are the only concerns we would wish to draw to the committee's attention.

SECTION 389A INSOLVENCY ACT 1986

7. In 2005 the ICAEW commenced discussions with the Insolvency Service to become a regulator for voluntary arrangement practitioners (later described as approved persons) under section 389A of the Insolvency Act 1986 (as inserted by the Insolvency Act 2000). We communicated to the insolvency practitioners we license our intention to apply to become a regulator of voluntary arrangement practitioners; a similar announcement was made in the Insolvency Service's own publication *Dear IP*. We also produced draft changes to our internal insolvency regulations to implement the proposed changes and took those amended regulations through our own internal approval processes.

8. In 2007 the Insolvency Service received legal advice that a change would have to be made to the law before any body could be recognised because, in its current form, section 389A would enable all members of the body recognised to act as voluntary arrangement practitioners. This difficulty with the legislation had been identified earlier but the Insolvency Service had believed that the internal rules of the applicant body could be amended to restrict recognition to those members with relevant insolvency experience which our draft rules would have achieved. Further legal advice was that the only option now available would be to await legislative change using a legislative reform order.

9. On 17 November 2008, we were invited by the Insolvency Service to attend a meeting at which it was announced that they would be postponing making the changes necessary to section 389A of the Insolvency Act 1986 to enable the licensing of voluntary arrangement practitioners. This was because they were unable to use a legislative reform order to make the changes. Instead they would bring forward these changes when a suitable bill became available—although they could not say when that would be.

10. It is extremely disappointing that our application to become a regulator of voluntary arrangement practitioners could not be progressed. The initial flawed drafting of section 389A has been compounded by the delays experienced during the application process, culminating in the announcement by the Insolvency Service that a change using primary legislation is now the only option available, with no timescale being set for that change. It is also disappointing that we were not given the opportunity to provide evidence to the parliamentary committee to support the need for change. Even if this had not affected the outcome, we believe it would have been appropriate for us to have been given that opportunity rather than simply being informed once the decision had been made.

11. We feel that in a time of economic downturn, every opportunity should be taken to facilitate an adequate supply of suitably qualified professionals to offer a solution to over-indebted individuals. In recent years, the population of insolvency practitioners has remained relatively static at around 1,700. In our view, the introduction of voluntary arrangement practitioners would have contributed to that supply, and the opportunity to do so has now been missed.

Simplified Voluntary Arrangements

12. In July 2005 the Insolvency Service first published its proposals for the introduction of a simplified voluntary arrangement. The consultation document also included recommendations for the adoption of industry best practice to streamline the voluntary arrangement process in areas where legislative change was not appropriate. The proposals for legislative change were refined during consultation and, in May 2007, a further consultation document proposed the introduction of the simplified voluntary arrangement using a legislative reform order. We were broadly supportive of the introduction of simplified voluntary arrangements.

13. During this period, a series of meetings were held with interested parties within the field of insolvency which resulted in the creation of the IVA protocol. The aim of the protocol was to establish a framework to be adopted by both insolvency practitioners and creditors to facilitate the efficient handling of straightforward consumer IVAs. We played a major role in the development of the protocol and it was formally launched at our offices in Moorgate on 1 February 2008. We are also represented on the IVA standing committee which was set up to monitor the effectiveness of the protocol. Nevertheless, we always saw the protocol as the response to those initial proposals for industry best practice that accompanied the recommendations for legislative change to the IVA regime. We are sure that many insolvency practitioners saw the introduction of the protocol as part of a package of measures which included legislative change and accepted the protocol on that basis.

14. At the meeting with the Insolvency Service on 17 November 2008 (paragraph 8), we were informed that their plans to introduce a simplified voluntary arrangement would not now be taken forward due to the success of the IVA protocol. It appears that these proposals have now been completely dropped.

15. It is again most disappointing that we were not given the opportunity to inform the opinions of those who decided that the success of the protocol had made simplified voluntary arrangements unnecessary, particularly given our role on the IVA standing committee. It is much too early to say whether the protocol has been successful and it was never, in our view, a substitute for legislative change. It is also disappointing to note that, unlike the changes to section 389A, there appear to be no plans to take these changes forward using another legislative vehicle. In the current climate, a mechanism that would have offered over-indebted individuals an alternative to bankruptcy and creditors greater returns than would have been received in bankruptcy would only have been a good thing. A simplified voluntary arrangement would have offered such an alternative.

16. We would also question the way in which the announcement was made. We were only informed in the sidelines of the meeting about section 389A (as were the other applicants for recognition), and other stakeholders were left to find out via a small announcement on the Insolvency Service's website. The members of the IVA standing committee were notified by email, but at around the same time of the announcement on the website. We feel that the whole matter was particularly badly handled and that this was compounded by the way in which the announcement was made and has caused a great deal of bad feeling in the insolvency profession.

Role of the Insolvency Service as an Authorising Body

17. The Institute is a Recognised Professional Body under section 391 of the Insolvency Act 1986 and can license suitable individuals as insolvency practitioners. A body may be recognised if:

> "it regulates the practice of a profession and maintains and enforces rules for securing that such of its members as are permitted by or under the rules to act as insolvency practitioners:
>
> (a) are fit and proper persons so to act, and
>
> (b) meet acceptable requirements as to education and practical training and experience".

18. Insolvency practitioners may also be directly authorised by the Secretary of State acting through the Insolvency Service.

19. In common with the other Recognised Professional Bodies, we have a disciplinary process with a range of sanctions that could be imposed on an insolvency practitioner. These include ordering a targeted insolvency monitoring visit, restricting or removing an individual's licence, fines and removal from membership of the Institute. We are also able to impose obligations on the insolvency practitioners we license using our own internal regulations.

20. The Insolvency Service can take no formal disciplinary action against the insolvency practitioners it authorises except for withdrawal of their authorisation (which we are not aware as ever happened). Neither does the Insolvency Service have internal rules for its insolvency practitioners. Any obligations the Insolvency Service wishes to impose (such as requirements for continuing professional development) must be introduced using secondary legislation or using a Statement of Insolvency Practice and would affect all insolvency practitioners.

21. This has the potential to cause difficulties. There is the potential for regulatory arbitrage between the bodies: a body that can impose a limited range of sanctions could be seen as a more "attractive" option than one that can apply a range of penalties. It also appears inherently unfair that behaviour that could lead to

a financial and/or reputational penalty being made against an insolvency practitioner authorised by one of the recognised professional bodies would result in no action being taken against the same practitioner were he/she authorised by the Secretary of State.

22. Additionally, the Insolvency Service's lack of any form of internal regulations (short of legislation) can cause problems when considering making changes that affect the regulation of the whole population of insolvency practitioners. To give a practical example, a sub-group of the Joint Insolvency Committee was considering requiring insolvency practitioners to apply their body's clients' money rules when operating certain types of bank account for estate funds. This was not considered possible, as the Insolvency Service has no such rules.

23. There is also the matter of the Insolvency Service's role as the regulator of regulators, acting on behalf of the Secretary of State, to decide whether a body is suitable to license insolvency practitioners. We are subject to inspection by the Insolvency Service and are required by the Memorandum of Understanding to submit a report on insolvency regulation annually. Although we are not in any way opposed to such oversight, it seems somewhat bizarre that the inspection is carried out by a body that is essentially competing in the same market place. We would also question how the Insolvency Service's own monitoring and regulation of insolvency practitioners is inspected. It appears that the Insolvency Service does not produce, or at least does not make publicly available, information about the regulation of its insolvency practitioners to the same level of detail as the Recognised Professional Bodies are required to produce.

24. In many ways, the direct authorisation of insolvency practitioners by the Secretary of State is an accident of history. Nevertheless, there is now no reason for direct authorisation to continue. Many of the Recognised Professional Bodies can issue insolvency licences to individuals who are not members of their body, and an accounting or legal qualification is not a requirement for them to hold a licence. There is no longer a need for a regulator "of last resort".

9 January 2009

Memorandum submitted by Sir Geoff Mulcahy

I understand that your Committee is looking at the Insolvency Service. I suggest that you should examine the collapse of Woolworths as a case study which in my opinion raises a number of questions about whether current practice is acting in the public interest.

As current Chairman of the British Retail Consortium and, until seven years ago having had responsibility for Woolworths, I have taken a particular interest in the Woolworths collapse. I should stress though that I am writing to you in a purely personal capacity. I believe that there are a number of issues which deserve investigation and would be of interest to you to see if lessons can be learnt to help a better outcome in future cases.

Woolworths had been a profitable business that had been in decline for a number of years. Management had failed to evolve the business to meet the evolving needs of the customer but it was still a trusted brand with around 5 million customers a week. Current market conditions should, with the Woolworths' brand reputation for value for the home and family, have enabled it to trade successfully. However, along with some other businesses, credit insurance was withdrawn, banks refused further credit and then put the business into administration, and the administrator proceeded to rapidly liquidate the business.

Whereas the banks have probably recovered most of their money plus additional default fees, and the administrator and his agent are reported to have earned up to £40 million, other creditors and shareholders will receive little or anything. More importantly, the human cost is that some 27,000 people have lost their jobs, with the Government having to pay the costs of redundancy, unemployment, and the pension deficit, whilst many communities have lost a key part of their High Street.

I am not in favour of Government intervening to preserve businesses which are failing as a consequence of not meeting their customers' needs. In recent years much attention has been given to corporate governance, risk assessment and financial rules and regulation. However, in this case I think that one can identify a number of failures in the processes, which contributed to this unfortunate series of events and which started before the business went into administration.

1. The business had been in decline for a number of years, and arguably the Board, who take prime responsibility for the failure, and shareholders should have taken action much sooner. However, a new Chairman and Chief Executive had been appointed who had publically recognised that a turnaround was necessary and possible.
2. Credit insurance was withdrawn just as the business was gearing up for Christmas, its most important trading season, and the banks refused to extend extra credit. Traditionally, the business has made around £100 million profit over the Christmas period and if it had been allowed to trade over this period, would probably have not only done so profitably but also significantly reduced its stocks and thus been able to repay a significant part of its debts to the banks.
3. Once appointed, the administrator proceeded rapidly to liquidate the business by making people redundant, and liquidating the stocks. I believe that it would have been possible to restructure the

business, which would probably have necessitated reducing the size of the chain to around 600 stores, but would have resulted in a profitable retail business employing around 15,000 people and maintaining profitable EUK and two entertainment businesses. The timetable to which the administrator worked did not allow any time for the consideration of serious restructuring alternatives.

I am sure that the Board, the banks, the credit insurers, and the administrator would all have acted within the necessary rules, regulations, and applicable laws, which raises the issue as to whether these processes have worked in the overall public interest. For example, and accepting that the Board must take prime respnsibility:

— In spite of the Board following the principles of corporate governance, why was the business, as has happened in some other business, allowed to decline before action was taken?

— Should the banks be allowed to put a business into administration without regard to the interests of other stakeholders such as other creditors and employees? It is reported that the Banks received multi-million pound additional fees by taking this course of action in addition to amounts owed.

— Did the administrator, who was also adviser to the banks, have a conflict of interest? It has been reported that the administrator and their agent Hilco would earn up to £40 million in fees for successfully recovering the banks' money out of administration, compared with maybe a few hundred thousand pounds if they had only acted as an adviser.

— Should the redundancy and pension obligations be the responsibility of the administrator and rank ahead of the banks before falling on the Exchequer? As the administrator has no liability for these costs, as indeed he has no liability for the ongoing rental and other supplier costs, it is much simpler and less risky for him to realise as much cash as possible as quickly as possible and walk away from other liabilities.

— Is an administrator qualified to determine whether viable restructuring options exist or is there a role for independent experts? The administrators have an essentially financial background, and whilst they might not have confidence in a failed management, an independent view might produce alternatives to the liquidation or fire sale of the business.

— Should not the process allow time for proper alternatives to be considered, as can occur in the US Chapter 11 procedure? In this case, the process of winding up the business started within days, which for a large complicated situation, gave no time for the proper consideration of alternates.

Whilst each case is unqiue, there is a pattern of events from the apparent failure of corporate governance to the eventual liquidation of the business which deserves examination to see if lessons could be learnt. In particular, should not the administrator be obligated to take account of the wider interests of other stakeholders including employees and not just those of preferred creditors? Whilst this might put up the cost of borrowing, if my assessment of this situation is correct, then the public interest would have been better served by keeping several thousand people in jobs, producing a better outcome for other stakeholders, and reducing the cost to the Government. The outcome of this case would seem to be neither socially, morally, or economically justifiable.

For your information I have written separately to the Secretary of State and Mr John McFall MP.

28 January 2009

Memorandum submitted by the Pension Corporation

Overview

1. In the current economic environment we are seeing an increasing number of insolvencies and as a result of this, the increasing number of cases of pre-packaged administration.

2. An increasing number of insolvencies inevitably leads to a rise in the number and size of the pension schemes going into the Pension Protection Fund's assessment period, without necessarily going into the fund at the end of this process.

3. This is an uncertain period for scheme members during which they receive lower pensions than those to which they may be entitled, depending on the funding levels in the scheme.

4. It is vital to protect what is usually the largest unsecured creditor and consider whether the pension scheme debt can be secured above the PPF level, protecting members and reducing the cost for other levy payers.

Pension Corporation and the Market

5. Pension Corporation is a major participant in the UK pension insurance industry, specialising in pension risk transfer solutions for defined benefit pension funds in the UK. Since its inception, Pension Corporation has developed innovative, affordable solutions for pension schemes and had a 22% market share in 2008.

6. Pension Corporation underwrites pension risk management solutions for defined benefit pension funds including: Pension insurance buy-outs, Longevity risk insurance, Pension fund stewardship, Asset and Liability Management.

7. The pension insurance market is a large, fast growing and dynamic market, which exceeded £8 billion in 2008, more than double the business written in 2007. This figure is less than 1% of the potential market of DB pension schemes, which is estimated at £1 trillion.

8. The market is being driven by increasing numbers of sponsors looking to remove risk from their balance sheets, and Trustees looking to secure their members' benefits for the very long-term.

Defined Benefit Pensions

9. Defined benefit pension funds remain a live and worryingly important issue for many companies.

10. From a corporate perspective, being a scheme sponsor means maintaining an open-ended commitment for a very long period. This can have dramatic effects on its share price, limit strategic options including refinancing and debt restructuring, and ultimately damage the very security of the commitments it is pledged to maintain.

11. The security which the members are seeking, by paying into a pension fund, can in some cases act as a corporate straightjacket when companies are looking at takeovers, mergers or other re-structuring.

12. This can have immediate consequences for the survival of a company. It can also impact adversely the security and level of retirement benefits available to members.

13. In a recent survey by PWC, 90% of Finance Directors stated that they are concerned about the risks their pension scheme poses to the business; 30% intend to use contingent assets to offer trustees security, while enabling the company to limit cash contributions.

14. Given the level of concern with which pensions are viewed by many companies, it is not surprising that an insolvency event, with the ability to "dump" the scheme on the PPF, is often seen by struggling companies and their advisors as the only option.

15. This results in members receiving lower benefits—even if the scheme is funded above the PPF level, during the PPF assessment period only PPF level benefits are paid. It also has a knock-on impact for all other companies with a DB scheme, in that the PPF levy increases.

16. The PPF levels, for pension scheme members who have not yet reached normal pension age will, on reaching it, receive 90% of their pension, capped at around £28,000.

Pre-packaged Administration and Defined Benefit Pensions

17. In insolvency, pension schemes are usually the largest unsecured creditors. Unsecured creditors rarely make any recoveries from the business. Members are often shocked and frightened by the insolvency of the scheme sponsor and the resultant reduction in their pension.

18. This was recognised in the Pensions Act 2004, which established the PPF and gave them the ability to take on the creditors' rights the scheme has, in order to best protect members and levy payers. However, by the time an insolvency event occurs it is usually too late for the unsecured creditors to make any significant recoveries.

19. The increasingly used pre-packaged administration, which allows companies to be sold on quickly, gives the insolvency practitioner and the directors of the company time to pre-arrange the value and terms of any sale.

20. Whilst this complies with the Enterprise Act requirement to achieve the best possible results for creditors, whilst keeping the business as a going concern, the result is often the dumping of the pension scheme on the PPF.

21. Consideration should be given to making it a statutory requirement that before any insolvency event, consideration should be given to ways to secure the PPF level of benefits other than via sending the scheme to the PPF. For example, if the scheme does not have sufficient assets, equity or debt in the new business (sometimes given to the scheme but only when the scheme enters the PPF assessment period eg Heath Lambert) could be given to the scheme prior to an insolvency event.

22. The scheme's assets may then be sufficient to allow the scheme to compromise its debt above the PPF level and purchase an annuity for members.

23. This would have a number of advantages:

1. There would be no additional calls on the PPF and no resultant levy increases.
2. would not enter the PPF assessment period, members' benefits would not have to be reduced and the costs associated with this would not fall on the scheme.
3. Members would receive benefits from an FSA regulated insurance company, at least and usually above the PPF level of benefits.

24. The PPF's own figures show that 30 schemes which had previously entered into the PPF's assessment period have now come out of it due, in the main, to their funding levels allowing for greater benefits than those which would be paid under the PPF. The PPF currently has 291 schemes in the assessment period, with a total of 122,622 members.

25. The PPF assessment process lasts for around two years, during which, irrespective of the actual level of funding in the pension fund, the scheme members have their benefits cut to the levels of the PPF. During this process there is a great deal of anxiety placed on the scheme members as they wait to find out what their levels of benefits are. The administration burden and cost of reducing benefits is also high.

26. In volatile market conditions when asset valuations are constantly changing, this two year period could mean the scheme missing out on options to secure the members' benefits for the long term.

27. The level of attention given to pension schemes during the pre-pack insolvency should be raised and a statutory duty to consider securing benefits above the PPF level before an insolvency event should be imposed.

16 February 2009

Memorandum submitted by Mark Skingley

I saw the piece on *Newsnight* about pre-packs and felt compelled to write. I have thought long and hard about whether to write but feel you should understand exactly how pre-packs are abused.

The murky business of pre-packs is being abused by IPs and Directors to their mutual benefit and to the obvious detriment of creditors and shareholders. It is a practice that is used to take out shareholders and allows Directors to take a business and restart with a new board, new rshareholders and no creditors. And all this is done with the protection of the courts. It is argued that the business survives and jobs are saved. This is undoubtedly true in some circumstances but in my view the minority and the scale of abuse and the devastation it reaps is a cost that needs to be addressed.

I have been on thereceiving end of a pre-pack and as a result I have no capital, no job and my shares are worthless but I am still standing. In brief, I started a business in 2003 with two other people and it grew to 18 people and we had customers such as BT, O2, T-Mobile, Orange, KPMG, Rexam etc. We had a good team and were self funded; I had funded the business but split the equity equally with the other Directors and put the money in as a Directors loan. In 2007 we sought some outside equity to broaden the base and appoint some non-execs. After a short time we had some non-execs and a couple of potential investors, one who was interested in being more involved on a part time basis. However, after some time it became apparent that he had other ideas and co-opted the other two directors.

I returned from a weekend visiting my father who had just been diagnosed with an aggressive cancer to be told I had been suspended and no reason was given. It was April 2007 and 4.5 years work later and I was suspended from a company I had founded, was the largest shareholder (38%) and the largest creditor. I was shell shocked and what ensued was a legal nightmare when they refused to reply to letters and I was put through a completely farcical "internal disciplinary process" that was described as as such by the Employment Tribunal. I was suspended on full pay and was not paid a thing. After one of the Directors faked an illness to avoid the Tribunal in November, it was adjourned and again in January 2008 with a date set finally for July 2008. I had prepared a case for unfair and wrongful dismissal and illegal deduction of salary and a High Court case to recover my debt (£196k). Then in April 2008 I got a call from Simon Thomas at RSM Bentley Jennison who informed me that the company was to be put into administration and did I want to buy back the assets; assets that I had already paid for once. I explained in great detail that he should not take this on and my solicitors explained the context but he persisted and they bought back the assets and continue to trade to this day.

I won at the Employment Tribunal, it was held I was wrongly and unfairly dismissed and their conduct was torn apart. I was awarded £96k but have not received a penny. When RSM Bentley Jennison was appointed Simon Thomas made the point of explaining that once the company went into administration he would be working for the creditors. I now find myself seriously questioning his conduct. I have had the case reviewed by another IP and he has made a catalogue of errors, the first was not inviting me to the creditors meeting and thereby denying me any input into the appointment process and level of fees. The result is I have been unfairly prejudiced as a creditor. At the same time they have billed 46 days or £76k as fees (in addition they charged a pre-appointment fee of £22k) and as a result there is no money left to distribute to creditors. The conduct of the Directors has not been investigated despite ample evidence that they ripped

cash out immediately prior to the administration, paid key suppliers in preference and invoiced services provided by the old company in the new company. I am vigorously pursuing these issues and intend to write to their professional bodies should I get no satisfactory answers.

I am happy to accept that public policy must put in place legislation to allow companies to re-group and re-organise in some situations and that saving jobs is a valid reason. However, there appears to be a lack of balance and very little policing of abuse and abuse is rife.

I hope this has not been too lengthy or tedious but it is an example of the sharp practice that seems to be prevalent amongst IPs and the abuse of a process that is necessary but in diar need of reform. I have included my contact details below and would be happy to discuss any of the above should it be of help in understanding the issues. As for me I am hopeful for the future and not too down trodden but I am concerned that Directors can use the system to manipulate circumstance and take out shareholders and creditors with no apparent recourse but significant personal gain.

February 2009

Memorandum submitted by the UK Shareholders Association

I understand from an article in the *Daily Telegraph* that you are taking up the issue of Pre-Pack Administrations and I think this is very timely. In my personal view Pre-Pack Administrations are an abomination and should be made illegal.

It is totally wrong for an Administrator to act in advance of his appointment as Administrator which is what happens in practice at present. Often arrangements are made with the connivance of the company's directors or bankers which are not in the interests of creditors or shareholders. These arrangements are often made in secret with no public knowledge and then put into place in a matter of a few hours after formal appointment of the administrator.

I have experience of this process not long ago in the case of Torex Retail Plc. This was a company that got into financial difficulty after an alleged fraud and claims of false accounting. The directors arranged to sell the business via a Pre-Pack Administration to some private equity investors—this mainly was to the advantage of the bankers who protected their loans to the company but also obtained a stake in the on-going business. This meant that shareholders were left with nothing, and creditors were presented with a fait-accompli.

Torex was in essence a sound business that could have traded out of its problems given a short period of stability and some protection from short term creditors.

Before the Administrator was officially appointed, we tried to arrange an alternative refinancing which would have protected shareholders and other stakeholders' interests, but the directors ignored our approach. We then requisitioned an EGM to remove the directors and replace them, but the Administration was pushed through that pre-empted this move.

In essence there was no approach by the Administrators to the open market, no consideration by them of alternative offers, and the whole deal was stitched up behind closed doors before most people knew anything about it.

This was surely not how Administration was conceived as working when it was put in place by the original legislation. Regrettably legal precedent has been established that seems to condone this practice, and now companies left, right and centre are using it to evade their debts and create new "phoenix" businesses from the ashes of companies in financial difficulties. The directors or parent/related companies often being the beneficiaries of these arrangements.

I hope therefore that you will try and get some changes to the legislation to outlaw this practice.

13 January 2009

Memorandum submitted by Jonathan Williams

I was given your details by Chris Kelly last week and I understand that you have taken a keen interest in pre-pack administrations. I wanted to give you details of a recent case which may be of help. I have previously written to Mr Fitzpatrick and to Lord Mandelson about pre-pack and received a very inadequate response from both.

For your information, I am the owner and Managing Director of Maritime Transport Ltd., the largest private container transport company in the UK, based at Felixstowe in Suffolk.

The facts of the case were as follows: At the end of January a company called Bulmers Logistics went into pre-pack administration and re-emerged the following day, with the same management team, trading as Bulmers Transport.

Whilst no one wishes to see the demise of any transport organisation, there are always fundamental, underlying reasons and regrettably employees, suppliers, funders and HMRC can lose out in the process. In Bulmer's case, this was a company we and many others in the transport industry had been predicting would fail for a very long time. The current recession was not the reason this company failed, it was simply the final straw that broke the camel's back.

Pre-pack administration has prevented other transport operators benefiting from Bulmers' demise, to help them in difficult market conditions, but most concerning, it has propped up a failed business and actually placed it in a more advantageous position to compete against other operators, which is not what pre-packaged administration is designed to do.

I find it incredible that the directors have been allowed to set up overnight and recommence trading as if nothing had happened at all. Given these circumstances, how is it that a failed business and management team is able to effectively continue to operate without first a rigorous assessment of its viability and assurances that the same management team will not leave a further trail of liabilities in its wake?

Whilst I have a great deal of sympathy for the employees in such situations and share the desire to protect against job losses as much as possible, especially in the current climate, in my experience if the work genuinely exists at sustainable rate levels, other companies will always fill the void created and the workforce will naturally migrate to new service providers. But what about the survival of suppliers and their employees affected by the pre-pack? These companies are conveniently forgotten and left to hang out to dry. When an insolvent company is wound up, at least creditors have some chance of being paid and their workforce holding on to their jobs.

In a case like Bulmers, pre-pack sends out absolutely the wrong message. It makes a mockery of professionally run companies who work exceptionally hard to create sustainable businesses only to find they are competing with organisations that can potentially behave recklessly, walk away from their obligations to creditors and make a comeback with no obvious restrictions or changes in management. This is a practice that should only be available to companies that pass the most stringent viability tests, otherwise we're opening the floodgates for all to jump on this bandwagon.

I have no axe to grind with Bulmer Logistics and my company would not have directly benefited from their demise. However, I know I'm not alone in reaching the conclusion that for the owner to state in his press release that he is leading a management buyout and to purchase his business for £1, leaving behind £10m debts, is an offence to any company trying to succeed in these very difficult times and pre-pack has enabled him to do it.

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