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Business, Innovation and Skills Committee

The Insolvency Service

Sixth Report of Session 2012–13

Report, together with formal minutes, oral and written evidence

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Business, Innovation and Skills Committee

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/bis. A list of Reports of the Committee in the present Parliament is at the back of this volume.

The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and some or all written evidence are available in a printed volume. Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee are James Davies (Clerk), Amelia Aspden (Second Clerk), Peter Stam (Committee Specialist), Josephine Willows (Committee Specialist), Ian Hook (Senior Committee Assistant), Pam Morris (Committee Assistant), Henry Ayi-Hyde (Committee Support Assistant).

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1 Introduction

1. Insolvency is the inability to pay debts to debtors, resulting in companies going into liquidation or individuals being declared bankrupt. Companies going into liquidation has the inevitable consequence of job losses, whilst creditors such as suppliers and subcontractors are also hit particularly hard. The impact of this has been thrown into stark relief by the number of large high street chains entering administration with the loss of many jobs. The insolvency service and the insolvency profession have a key role to play in managing not just the financial bankruptcy but also the human cost that comes with business failure.

The Insolvency Service

2. The Insolvency Service (the Service) is an executive agency of the Department for Business, Innovation and Skills. The Service exists to provide the framework and the means for dealing with financial failure in the economy and with the misconduct that is often associated with it. It operates under a statutory framework—mainly the Insolvency Acts 1986 and 2000, the Company Directors Disqualifications Act 1986 and the Employment Rights Act 1996 and the Companies Acts 1985 and 2006, as well as from a range of secondary legislation relating to these acts. The role of the Service is to:

- administer and investigate the affairs of bankrupts, individuals subject to debt relief orders, 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', individuals subject to debt relief orders, and directors' misconduct;
- deal with the disqualification of unfit directors in all corporate failures;
- deal with bankruptcy and debt relief 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 estate accounting and investment services for bankruptcy and liquidation estate funds;
- conduct confidential fact-finding investigations into companies where it is in the public interest to do so;
- advise BIS ministers and other government departments and agencies on insolvency, redundancy and related issues; and

- provide information to the public on insolvency and redundancy matters via its website, leaflets, Insolvency Enquiry Line and Redundancy Payments Helpline.[1]

Our inquiry

3. Our predecessor Committee inquired into the Insolvency Service in 2009, when it held a one-off evidence session with the Inspector General and Agency Chief Executive, and the Deputy Chief Executive.[2] In its Report, the Committee raised three key questions:

- Was there a case for strengthening the control of the remuneration of insolvency practitioners?
- Would the Insolvency Service and the Department be nimble enough to reshape policy if necessary to address concerns about pre-pack administrations and other issues emerging from the downturn in the economy?
- Would the funding model be robust enough to deal with any increase in case workload as well as maintaining effective enforcement?

4. We decided to return to these issues to assess progress against these challenges and also to judge how the Insolvency Service had risen to the challenges of operating in the current economic climate. We invited interested parties to submit written evidence on the role and functions of the Insolvency Service, including:

- Pre-pack administrations (issues of transparency, their link to 'phoenix' companies);
- the possible regulation and sanction of licensed insolvency practitioners;
- the creation of an Insolvency Ombudsman;
- the strengthening of the control of IP's remuneration; and
- the effects of the reductions in the Insolvency Service's staff and budget.

We are grateful to all those who took the time to respond by offering us the benefit of their detailed and thoughtful comments.

5. In early 2012, we held two oral evidence sessions; one with representatives of the Recognised Professional Bodies (RPBs) and a representative of Prospect (Insolvency Branch); and another with the then Inspector General and Chief Executive of the Insolvency Service, Mr Stephen Speed, together with his deputy, Mr Grahame Horne.

6. In May 2012, it was announced that Dr Richard Judge would be replacing Stephen Speed as Inspector General and Chief Executive of the Insolvency Service.[3] In October 2012, we decided to hold a further evidence session with the Insolvency Service to get an update on

1 http://www.bis.gov.uk/insolvency/About-us

2 *The Insolvency Service*, Sixth Report of Session 2008–09 (HC 198), published on 6 May 2009

3 Insolvency Service Press Release, *New Chief Executive for The Insolvency Service*, 29 May 2012

issues from the new Chief Executive, as well as hearing his plans for the future of the Service.

7. While the Service considers that it is well placed to handle the challenges facing it, a number of specific discrete concerns have been raised in relation to the insolvency regime. These include continuing public mistrust of the use 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.

2 The Insolvency Service

A challenging period for the Insolvency Service

8. The lifespan of this inquiry has encompassed the publication of two Annual Reports from the Insolvency Service. In its Annual Report for 2010–11, the then Agency Chief Executive, Stephen Speed, described the previous 12 months as "the most challenging in the Service's 21-year history",[4] while the 2011–12 Annual Report claimed that "the 12 months covered by this report have come close to that bar if not exceeded it".[5]

9. Over the past decade, the Insolvency Service has experienced a significant expansion in its workload. The number of bankruptcy cases going through the Service rose from around 30,000 in 2001–02, to 78,000 new cases in 2008–09. In the last three years, however, there has been a sharp downturn in casework. While there have been some high profile corporate insolvencies on the High Street, the overall scale of business failure has remained low compared to the aftermath of previous recessions.[6] Commenting on this reduction, industry experts have coined the phrase 'zombie businesses', claiming that official figures may be masking the true debt problems faced by companies in the UK. With asset values currently so low, creditors have been reluctant to instigate insolvency proceedings. In the meantime, personal insolvencies have also continued to fall, with bankruptcies now accounting for approximately a third of all personal insolvencies. Individuals have instead turned to less costly debt resolutions, such as Debt Relief Orders (DRO).[7] This reduction in casework has a direct impact on the Service since it relies on casework for its funding. The fall in bankruptcy casework and the diminishing returns on assets therefore represent a significant challenge for the Insolvency Service and the way that it operates.

A new delivery strategy?

10. The Insolvency Service's Annual Report and Accounts for 2010–11 set out the full extent of the budgetary and staffing cuts experienced by the Service in the last two years. In the year ending March 2011, the Service faced a budget cut of 11 per cent, and while 470 staff—18 per cent of the workforce—left the agency under a voluntary exit scheme. It had also cut approximately 40 of its freelance investigators in November 2010.[8] In total, the Insolvency Service had cut its expenditure by around £60m since December 2009.[9]

11. In early 2010, the Insolvency Service's Directing Board decided to look closely at how it might deliver services more flexibly in the future, by exploring a number of options for restructuring the organisation, including the potential closure of a number of offices. In its written submission to us the Service stated that:

4 The Insolvency Service Annual Report and Accounts 2010–11, p.1

5 The Insolvency Service Annual Report and Accounts 2011–12, p.1

6 BBC News, *Company insolvencies at five-year low*, 2 November 2012

7 Financial Times, *Corporate insolvencies edge up*, 4 November 2011

8 Ev 59

9 The Insolvency Service Annual Report and Accounts 2010-–11

> The scale and pace of change, along with a decline in the value and volume of assets in bankruptcy estates, has demonstrated the relative inflexibility of the Service's current organisational and geographical structures in reducing direct and indirect costs in line with falling case numbers and fee income.[10]

12. From June to August 2011, the Service consulted its staff on the future Delivery Strategy. In that consultation, the Board set out its preferred option of separating the front and back facing functions undertaken by the Service and centralising the latter in fewer locations.

13. Following the conclusion of the consultation, and having considered all the responses carefully, the Board announced to staff in September 2011 its intention to :

- adopt a new Delivery Strategy, with back-office work focused in fewer locations and the maintenance of a network of local offices across the country for necessary face-to-face customer work;
- put a case to BIS for funding support to allow the Service, subject to full public consultation, to close its offices in Medway and Bournemouth in 2012 and Stockton in 2013;
- review the funding regime for Official Receiver Services case administration work; and
- review the corporate centre, in order to ensure it has sized and structured appropriately for the current and future size of the organisation. [11]

14. In February 2012, Atkins Consultants were appointed to work with the Service and BIS, over a four month period, to assist in introducing the new delivery strategy. The work was underpinned by three work streams:

- Reform of the Official Receivers Services funding model to provide a more sustainable income stream;
- Development of a costed investment plan for the implementation of the Delivery Strategy; and
- A review of the size and function of the corporate centre to ensure that the costs not directly under the control of the front line businesses were set at an affordable level and consistent with the size and scale of the Service in future.[12]

15. This work was followed by the appointment of Dr Richard Judge as the new Chief Executive in May 2012. When he came before us, he stressed that he was keen to take stock of all of the accumulated evidence:

10 Ev 64–65

11 *Ibid*

12 The Insolvency Service Annual Report and Accounts 2011–12, p.8

> I hesitate to say it is almost a rolling strategy. The approach we are taking is one of being very clear on the high-level direction, so we are very clear what we are working towards over the three to five year horizon.[13]

He added:

> One of the early bits of work that I was keen to do was to take the Atkins results, which were very helpful input, but also take a step back from that and say, "What is it as a service we want to be achieving? Where do we think we are going over the next three to five year horizon?" then go into some of the helpful evidence and support that came out from Atkins in specific areas, and build on the back of it. That is the stage we are at currently. We have outlined to our people a high-level direction of travel: this is what we are setting out to achieve; these are the areas and things you might expect to change. We will now be able to go back to the detail and pick up on the advice of Atkins.[14]

16. **The Insolvency Service has now been considering a new Delivery Strategy since early 2010, which has created uncertainty for staff and added to the delay in delivering much needed improvements to the Service. We understand that the new Chief Executive will want to put his own stamp on the new strategy, but it is important that the Service moves swiftly to the delivery stage of that strategy. In its response to our Report we will expect to receive a clear timetable for the implementation of the new strategy for the Insolvency Service.**

Reductions in the workforce

17. In October and November 2010, it became clear that the reduction in case numbers handled by the Insolvency Service was both significant and likely to continue. As a consequence, the Service introduced a range of cost reduction measures, including a reduction in staffing levels.[15]

18. When we took evidence from Tony Butcher, President of Prospect (Insolvency Branch) in early 2012, he told us:

> As you can tell from the figures that the Insolvency Service has provided, we will be losing a third of our workforce in just over a year. By the very nature of exits, they are likely to be of experienced staff in quite senior positions—the sort of people who are relied upon to pass their wisdom on to the generations of new entrants, which has meant that this year there has been a very big impact.[16]

13 Q 187

14 Q 186

15 See para 9

16 Q 59

He added:

> The business planning they have done for the next year is predicated on a certain level of cases coming in. If those cases do not come in, they have to deal with it and go through the same thing again, probably.[17]

19. In October 2012, Dr Judge, the new Chief Executive of the Insolvency Service told us that he expected another small voluntary exit scheme by the end of the financial year, but that due to the uncertainty of future case levels, further staffing cuts in the future could not be ruled out:

> For the short term, by which I mean this financial year or next, I take you back to the delivery strategy that highlighted overcapacity in some of our grades. Lower examiner grades are a specific example; these are the grades that are specifically associated with the debtors' petition cases that have fallen rapidly. We have overcapacity there. The expectation, if you like, rather than the formality announced and everything else, is that there would be some action taken in that area. We are talking probably this year. In talking to staff, I am asked the number, and I give a figure around 50, which reflects overcapacity rather than anything else.
>
> If you look further ahead, which is the other part of the question, it depends on whether or not the efficiencies we think are there are genuinely there and can be realised, but also what our expectations are in case numbers. If case numbers continue to fall, there is less demand; if there is less demand, we have overcapacity.[18]

20. Dr Richard Judge went on to highlight the continuing high performance of staff during this period of upheaval:

> Despite almost 1,000 people having left the organisation over an 18-month period, we still see a strong commitment to delivery and investigations, and people doing a fantastic job.[19]

This view was echoed by a number of our other witnesses. R3, the body that represents the majority of insolvency practitioners, stated that overall, the Insolvency Service performed much of its role "very well".[20] The Institute of Chartered Accountants stated that it valued "the experience and expertise of the Insolvency Service staff with whom we interact and recognise that the agency is facing challenging times".[21] It is also worth noting that the United Kingdom is rated eighth overall in the World Bank report on *Doing Business*, for the efficiency of insolvency procedures.[22]

21. **We applaud the fact that the staff of the Insolvency Service have maintained their high levels of service throughout the difficult period of staff reductions and budget**

17 Q 61

18 Q 200

19 Q 184

20 Ev 79

21 Ev 69

22 *Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises*, International Bank for Reconstruction and Development/The World Bank, 23 October 2012, p.203

cuts. However, there is a risk that further reductions in annual running costs and staff may put undue pressure on its ability to deliver. In particular, the Insolvency Service will have to prove to us that it is sufficiently robust to deal with any potential substantial increase in insolvency casework.

Reorganisation of office locations

22. When the Insolvency Service first began its consultations on a new Delivery Strategy in 2010, it raised the issue of the inflexibility its structure and its geographical organisation. The Service recommended concentrating its back-office work in fewer locations while maintaining a network of local offices across the country for necessary face-to-face customer work. The consultation proposed reducing the number of offices from 35 to 25.

23. The Service told us that the business case for this reduction was based on "reducing the amount of management you need, because you would have larger groups of people in fewer locations, and making better use of accommodation so you are not paying for accommodation you are not using".[23]

24. Tony Butcher, representing Prospect (Insolvency Branch), questioned this approach in terms of both cost and efficiency:

> We do not feel that taking away—I am not going to say work—functions from a locale will have any long-term benefit. You lose the local knowledge, and you lose flexibility.[24]

He went on to argue that:

> The Insolvency Service has put forward a costing for the delivery strategy, essentially for closing and rationalising offices and moving individuals, of £33.5 million. That is what is known as a big-bang cost, that is, if everything happened on the same day and went smoothly. The Insolvency Service management has conceded that the reality is that it will not be a big bang, because there cannot be a big bang. There will be double-running. Therefore the £33.5 million costing must be incorrect. We cannot see any long- or short-term benefit.[25]

25. In March 2012, the Insolvency Service launched three further public consultations on its proposals to rationalise its estate. They covered:

- The closure of the Bournemouth Office and subsequent merger with the Southampton Office;
- The closure of the Medway Office and subsequent merger with the Canterbury Office; and
- The closure of the Stockton Office and subsequent merger with the Newcastle Office

23 Q 144

24 Q 57

25 *Ibid*

The consultations closed on 22 June 2012.

26. In July 2012, the then Minister, Norman Lamb MP, announced that after further consideration, the Insolvency Service had communicated to staff in the 3 affected offices that, before taking a firm decision on the future of individual offices, they needed to take stock. In particular, he stated that the Service wanted to consider the proposals in light of the Atkins Consultancy report and to make decisions alongside, and as part of, the development of its restructuring Plan. As a consequence, decisions regarding these three offices were deferred until the Autumn.[26]

27. In his evidence, Dr Judge told us that a decision on the three sites would be made "in this calendar year". He explained how the Service would come to a decision:

> On the back of what we view as the appropriate estate strategy for the Service, we need to make very clear decisions for the three sites being considered for closure. In terms of where I am currently, we have got two sites in an area with a level of activity such that you would expect those sites to be managed together. That was the case; that is the case. How we achieve that is an open question, and what we benefit from is helpful feedback through the consultation process earlier in the summer.[27]

28. **We are concerned that the continued uncertainty over the future of the Insolvency Service estate could have a detrimental effect on the performance of the Service. If the estate is to be rationalised, decisions on office closures cannot be continually deferred. Any rationalisation of the estate will need to demonstrate the ability to maintain existing levels of service and delivery.**

26 http://markreckless.files.wordpress.com/2012/07/norman-lamb-mp-to-mark-reckless-mp-regarding-the-possible-closure-of-insolvency-service-offices.pdf

27 Q 203

3 Budgetary pressures

Funding arrangements

Income streams

30. The Insolvency Service's costs are met from a mixture of funding provided by the Department for Business, Innovation and Skills (BIS) from general taxation, HM Revenue and Customs (HMRC) and income from fees that the Service charges for services that it delivers (see table below).

Insolvency Service costs and how they are recovered

	Recovered from
Insolvency Case Administration and Official Receiver Investigations	Fee income
Debt Relief Orders	Fee income
Estate Accounting	Fee income
Insolvency Practitioner Regulation	Fee income
Investigation & Enforcement Services	Programme funding from BIS and costs recovered from successful litigation
Redundancy Payments	National Insurance Fund supported by Service Level Agreement with HMRC
Policy	Administration funding from BIS
Other	Various e.g. rent recoveries from sublet accommodation

Funding pressures

31. In 2009, our predecessor Committee raised concerns about the robustness of future funding arrangements for the Insolvency Service. The recession and the rapid decline in the number of cases dealt with by the Service have brought the funding issue into stark relief. Case fee income in 2010–11 fell to £141m, from just over £152m the previous year, while the Annual Report and Accounts from financial year 2011–12 have shown a further fall to just a little over £84.6m.[28] Casework numbers have also fallen, with official receivers dealing with 43,594 new cases in 2011–12, as compared to 77,898 cases received in 2009–10. This is a fall of approximately 56 per cent. Furthermore, the Official Receivers arm of the Insolvency Service has dealt with an increasing number of cases where there are no assets or only minimal assets, which do not contribute to the administration fee that the Insolvency Service is supposed to charge and recover. There has also been a steady decline in the number of bankruptcy cases with an increasing number of individuals choosing

28 The Service, in accordance with IAS18, does not recognise income on the basis of actual fee recoveries. Income is based on the average cost of work undertaken and recognised over a period of 36 months in relation to the work effort expended, regardless of when cash receipts are banked.

debtor petitions.[29] A further challenge facing the Service is that asset realisations take a number of years to conclude.

32. Graham Horne, the Deputy Inspector General of The Insolvency Service, neatly summed up the funding challenge facing the Service:

> The unsustainability bit is probably about rapid fluctuations and what model would be able to cope with case numbers going from 30,000 to 78,000 and coming back down again.[30]

33. Dr Richard Judge clearly recognised the funding challenge for the Service, but acknowledged that "there is no silver bullet we can spot".[31]

The funding model of the Official Receivers' Office

34. The Official Receiver deals with 3 types of cases:

- **Debtor petition bankruptcy cases** (in which the debtor petitions for their own bankruptcy). To do so they pay a court fee of £175 and a deposit of £525. The deposit fee was raised in June 2011 from £450 to £525, having been £345 in April 2008.
- **Creditor petition bankruptcy cases** (in which a creditor petitions in respect of monies owing to them). The deposit paid is currently £700.
- **Compulsory liquidations**. The deposit paid, currently £1,165, is used to fund the administrative cost of the case and the investigation into the company's affairs and the directors' conduct up to the point of the Secretary of State authorising the issuing of proceedings.

35. A notional fee of £1,625 is charged to each bankruptcy estate to cover the costs of administration but where, as in the majority of cases, no assets are realised there are insufficient funds to recoup this fee from the petition deposit alone.

36. The funding model allows for cross-subsidisation between cases where there are asset realisations. That said, given the falling bankruptcy case numbers and the lack of assets available for realisation, means that there is now a significant gap between fees and income.

37. In evidence to us, the then R3 President, Frances Coulson said of the funding model for the Official Receiver:

> Its funding model is predicated on being funded by the fees that are paid in terms of bankruptcy and winding up. Strangely, that works when there is a lot of formal insolvency, but when there is not, self-funding does not work.[32]

29 The Insolvency Service Annual Report and Accounts 2011–12, p.15

30 Q 194

31 Q 189

32 Q 8

38. Tony Butcher, President of Prospect (Insolvency Branch), supported Ms Coulson's assertions, stating that in a large number of cases "there are no assets or only minimal assets, which will not contribute to paying the administration fee that we are supposed to charge and recover".[33] He added:

> Effectively, we have to recognise that the very nature of the Insolvency Service is that it is going to be unable to recover its costs, because it is dealing with insolvent businesses. […] In the present economic cycle, if case numbers go up and asset values do not, then the notional loss increases even though there is a need to have more resources to process and investigate more cases. That is built in to that funding model. It is thoroughly illogical.[34]

39. In its written evidence to us, Prospect argued that the Service should be paid for from the public purse "with realisations and fees providing a contribution to mitigate the costs of carrying out the statutory functions". It went on to state that

> The creditor and debtor should not bear the entire cost, much like a burglar and their victim are not expected to pay for the police investigation.[35]

40. **Funding for the Official Receiver Service relies on a fee-generated income model. It is clear from the evidence we received that this model is unreliable in the current economic climate. We recommend that the Insolvency Service work together with the Department for Business, Innovation and Skills to look at alternative funding models that are sustainable and not wholly reliant on unpredictable levels of casework and asset values.**

Bankruptcy case administration fees – altering the balance

41. When we took evidence from the Insolvency Service in early 2012, we were told that the most detrimental impact on the funding arrangements of the Official Receivers' Office was the level of recoverable fees from debtor petition bankruptcy cases. Graham Horne, the Deputy Inspector General, told us that the Service was starting to look at the balance of fees in bankruptcy cases between debtor, creditor and taxpayer:

> What we would want to do is look at our funding regime to see whether that balance needs to be altered. It could involve saying to the bankrupt themselves that perhaps they should pay more for the cost of administrating their bankruptcy, bearing in mind they get debt relief. If you are getting debt relief of over £30,000, maybe it is not unreasonable for you to pay slightly more than £500.[36]

However, he recognised that paying more might prove a barrier to bankruptcy for some:

33 Q 68

34 Q 70

35 Ev 78

36 Q 102

> Equally, if you want more cash up front, you would not want to make the debtor pay more money to seek debt relief, because that would be driving away their access to debt relief.[37]

42. One of the issues that the Service appeared to be considering was whether the administration fee the debtor pays needed to be paid up front, or whether to move to a system similar to debt management companies:

> The advantage that debt management companies have is that you can pay by instalments, whereas ours you have to pay up front. That is one thing we would want to look at.[38]

43. **At present, individual debtor bankrupts have to pay an upfront fee of £525. Given the level of debt relief they can receive we agree with the Insolvency Service that it would not be unreasonable to increase that fee, possibly on a sliding scale. We also agree that the fee should not be automatically required to be paid up front but could be staggered along similar lines as payments to debt management companies. We will expect the Insolvency Service to set out progress in both of these areas in its response to this Report.**

37 Q 194

38 Q 104

4 Impact of budgetary and staffing cuts on the Investigations Unit

Published targets for the Service

44. The Investigations Unit of the Insolvency Service carries out a range of investigation and enforcement activities aimed at supporting fair and open markets and, where necessary, taking steps to safeguard those markets from companies and individuals whose conduct is not conducive to the public interest. These include:

- the investigation, following complaints or other intelligence, into corporate abuse where there is suspicion of misconduct including the investigation of live companies;
- the investigation of reports of misconduct by company directors from insolvency practitioners acting under appointments;
- the investigation of misconduct by company directors, bankrupts or individuals subject to debt relief orders by official receivers in compulsory insolvencies;
- securing remedies, including the institution of civil proceedings, where this is in the public interest; and
- reporting allegations of criminality to prosecuting authorities.

45. Each year BIS Ministers announce to Parliament a set of targets for the Insolvency Service. While the Service achieved nearly all of the targets set by the Secretary of State for 2010–11 and 2011–12, a notable exception each year was stakeholder confidence in the enforcement regime, which fell below the 68 per cent target on each occasion.[39] This was highlighted by Prospect (Insolvency Branch) which noted that "the Service is unable to meet its internal target for the progression of disqualification investigations".[40]

46. Dr Judge argued that that a key factor in the Service's failure to meet its enforcement regime targets was a tension between activity and public perception:

> If a perception of the Service, a perception of the activity we are doing, is that there are resourcing issues, you almost get a self fulfilling prophecy. If someone says, rightly or wrongly, "There is a resourcing issue in the Service, therefore we are not that confident in it," and that is articulated repeatedly, almost inevitably you are going to find it quite hard to up the levels of confidence. That is something that clearly we have got to work on.[41]

47. When we pressed him further on whether a level of 68 per cent stakeholder confidence in the enforcement regime was a challenging target, he told us:

39 64 per cent in 2010–11 and 65 per cent on 2011–12

40 Ev 77

41 Q 185

> It is a challenging target. The question is whether it is the right target. If it was not a challenging target we would be walking it; we are not. If you look at it from that perspective, it is clearly something that is demanding, despite a lot of good work by people across the organisation. What I am not clear about, and the point is a fair one, is: should it be 75%; should it be 85%? What is an appropriate target for a world where many of the people involved in being asked for opinions do not want to be where they are?[42]

48. **The target of 68 per cent for stakeholder confidence in the enforcement regime has clearly proved a challenge for the Insolvency Service. Public perception of resource pressures may dampen stakeholder confidence but we do not accept that this is the prime reason for the Service to miss its targets in this area. Confidence in the enforcement regime is a key factor in the success of the Insolvency Service. In its response to this Report the Service must demonstrate that it has a strategy for promoting the successes of the investigatory and enforcement regime so that confidence in it can be better measured.**

Investigation and enforcement activity

49. During 2011–12, the Service secured 1,151 disqualification orders or undertakings against directors of failed companies, compared to 1,437 in 2010–11. Eighty percent (920) were achieved by way of an undertaking made by directors, the same proportion as in 2010–11. The average length of disqualification undertakings and orders secured against directors during 2011–12, was 5.9 years.[43]

50. In December 2010, the Service introduced a new policy for recording complaints.[44] Rather than record and report all complaints received the Service has switched to recording only those complaints which passed an initial sift to determine whether there was merit in considering the complaint further. This change was implemented in order to exclude those complaints which were not about an identifiable corporate entity or were otherwise outside its jurisdiction. As a result, it is not possible to compare post-2010 figures with previous years. The change may go some way to explain the significant reduction in complaints recorded in 2011–12 (3,523) when compared to the previous years' levels (4,852 complaints received during 2010–11 and 5,989 during 2009–10).[45]

51. Out of the 3,523 complaints received in 2011–12, 165 investigations were commenced, an 8 per cent decrease on the 180 investigations commenced during 2010–11, and a 56 per cent decrease on the 295 investigations carried out in 2009–10.[46] During 2011–12, 149 company investigations were concluded (compared with 205 in 2010–11), 355 winding up orders were obtained against limited companies compared with the 181 winding up orders secured in 2010–11.[47]

42 Q 205

43 The Insolvency Service Annual Report and Accounts 2011–12, p.30

44 The Insolvency Service Annual Report and Accounts 2011–12, p.32

45 *Ibid*

46 *Ibid*

47 The Insolvency Service Annual Report and Accounts 2011–12, p.31-32

Investigation and enforcement costs

52. The majority of investigation and enforcement activity is funded through a BIS programme budget, with a small amount funded from costs recovered from disqualified directors. In the 3 years, from 2008–09 to 2010–11, the Service's budget for investigation and enforcement fell by £6.6 million or 11 per cent.[48] However, this decline was reversed in 2011–12, when the Department increased the budget for investigation and enforcement by approximately £5 million, as shown by the table below.

Investigation and enforcement costs and recoveries

Costs and recoveries	2007–08 £'000	2008–09 £'000	2009–10 £'000	2010–11 £'000	2011–12 £'000
BIS funding	37,489	40,228	37,583	33,558	38,372
Cost recovery from disqualified directors	2,138	3,022	2,506	2,731	2,269
Investigation and enforcement costs	39,627	43,250	39,969	36,289	40,641

Source: The Insolvency Service Annual Report and Accounts 2011–12, page 38

53. In its 2010–11 Annual Report, the Service acknowledged that the 11 per cent reduction in the budget for investigation, together with its voluntary exit scheme had been a factor in the reduction in the number of cases commenced in 2010–11.[49] However, in its evidence to us, the Insolvency Service was confident that the current level of funding was "sufficient to enable enforcement activity to be undertaken across a broad spectrum of cases." It added that the Service had a vigorous vetting process, which prioritised cases in the public interest:

> At the vetting stage, cases accepted for investigation for both insolvent cases from IPs and live company cases are prioritised in terms of the Public Interest and other factors. At present the Service is able to investigate all insolvent cases which pass vetting, though this position can change, for example, if the volume of cases passing vetting rises or if two or three especially complex cases arise. [...] Cases are rigorously prioritised. Where they are not immediately allocated for investigation they are reviewed after two months and then again each month until six months. If a case has not been allocated for investigation at month six, it is usually discontinued. As a result of this rigorous and repeated assessment, the Service ensures that it gets the best value for money in terms of targeting the cases whose investigation is most strongly in the Public Interest.[50]

54. The trade union, Prospect (Insolvency Branch), submitted evidence to us that challenged the Insolvency Service's claim. It argued that the 11 per cent budget cut in June 2010, together with the voluntary exit scheme had resulted in the Insolvency Service being "unable to meet its internal target for the progression of disqualification investigations".[51] It

48 The Insolvency Service Annual Report and Accounts 2011–12, p.38

49 The Insolvency Service Annual Report and Accounts 2010–11, HC 1388, published on 18 July 2011. See also Insolvency News ,*Cuts see Insolvency Service probes plummet by 40%*,12 October 2011

50 Ev 65–66

51 Ev 77

also asserted that there had been a significant decrease in live company investigations, with some cases abandoned for lack of resource.[52]

55. The following table was provided by Prospect to demonstrate its case:

Disqualification timeliness of investigation	Expected 2011–12	Actual YTD
OR Cases - % within 15 months of order	80%	50%
OR Cases - % within 19 months of order	100%	83%
IP Cases - % within 10 months of allocation	90%	unavailable
IP Cases - % within 19 months of insolvency	100%	40%

Data source: November 2011 IED internal performance report

56. In evidence to us, Tony Butcher, the President of Prospect Insolvency Branch, reiterated the Union's view that budgetary and staffing cuts had severely affected the Service's investigatory and enforcement work:

> The important thing to look at is how fast we are able to do our work. What we submitted was that there has been a significant impact on the ability of The Insolvency Service to progress work that was in progress. The reality of the way that staff—the disqualification investigation teams especially—had to deal with this loss of staff was that, with staff who were lost, their cases got transferred to the people who were already there or who had come in. Those cases were done or were work in progress. The cases in progress have progressed, but the cases behind lagged, and have not been done. This means that this year and next year will be when the overall impact will be noticed.[53]

57. We also received evidence from the industry expressing concerns about the impact of budgetary reductions on the investigative functions of the Service. The Insolvency Practitioners Association claimed that "our IPs often tell us that the returns they make to the disqualification unit are not acted upon, and they attribute this in part to resource constraints".[54] The Institute of Credit Management summarised the concerns of many of those who submitted evidence to us when they commented:

> We would be greatly concerned if the reductions in budget resulted in a degradation or reduction of Disqualification Unit activity. We believe any such dilution of activity would send entirely the wrong message to delinquent directors at a time when corporate insolvencies are likely to increase.[55]

58. During the evidence session on 24 January 2012, R3 raised with us the industry's concerns about current levels of enforcement by the Insolvency Service:

52 Ev 76–77

53 Q 59

54 Ev 57

55 Ev 68

> Disqualifications have halved over the last couple of years. Practitioners make reports to the Insolvency Service in terms of director behaviour. If they put in a report saying that directors have behaved badly, they obviously want to see that taken forward to disqualification. Very low numbers—only 20 %—of reports are being taken forward to disqualification. This is partially because we have seen a dip in funding. That is something that we are concerned about because it affects other businesses where directors are perhaps behaving better.[56]

59. Since the evidence sessions in early 2012, R3 have continued to raise concerns about the directors' disqualification regime. They have claimed that whilst the number of directors disqualified each year by the Insolvency Service has remained relatively stable over the last decade (approximately 1,200 a year), the number of cases of misconduct identified by Insolvency Practitioners (via D1 forms) in the same period has risen from 3,539 to 5,401. As such, the disqualification rate has dropped from 45 per cent in 2002–03 to just 21 per cent in 2011–12.[57]

60. When we questioned the Insolvency Service in October 2012, they said that the level of 1,200 disqualifications per year was in the public interest and questioned whether an arbitrarily chosen bigger number would necessarily act as a further deterrent.[58] R3 have since refuted this statement and fully believe that the number of disqualifications should increase as the level of errant behaviour rises. They have argued that "the increase in the number of misconduct cases submitted to the Service disproves the theory that this figure acts as a deterrent".[59]

61. **Both the insolvency industry and the Insolvency Service have recognised that resource constraints, both in terms of funding and staffing, have had an impact on the investigatory and enforcement regime. While we welcome additional funding from the Department for Business, Innovation and Skills, we remain concerned that this area of activity remains under-resourced.**

62. **We are strongly of the opinion that the levels of disqualification of errant directors should not be determined by an arbitrary level set in what the Insolvency Service describes as the public interest. We believe that any dilution of enforcement activity would send entirely the wrong message to delinquent directors and recommend that the Department provides the Insolvency Service with sufficient, and if necessary, additional funding to disqualify or sanction all directors who have been found guilty of misconduct.**

56 Q 5

57 Ev 82–83

58 Q 208

59 Ev 83

5 Pre-pack administrations

Introduction

63. A pre-pack administration involves the sale of an insolvent company's business and assets, at a price which is agreed, before the company goes into administration. The sale is then carried out immediately after the administrator is appointed. In 2011, the Insolvency Service estimated that 25 per cent of the 2,808 companies that entered administration in 2011 used the pre-pack procedure; and that nearly 80 per cent of pre-pack sales were to connected parties.[60]

Reform of pre-packs

64. Pre-packs have attracted criticism because it can appear that an insolvent company has reformed without any redress to its creditors—a concept known commonly as 'phoenixism'. The Solicitors' Regulation Authority's (SRA) Statement of Insolvency Practice 16 (SIP 16), introduced in January 2009 aimed to make the process more transparent for creditors and ensure that a fair value was obtained for the assets. SIP 16 also provides professional guidance on how pre-pack sales should be conducted, with the administrator sharing with the creditors the reasoning and justification for the initiation of the pre-pack process. (We discuss SIP 16 in more detail later in this Report.)

65. On 31 March 2011, the then Minister for Employment Relations, Consumer and Postal Affairs, Ed Davey, announced measures intended to further improve transparency and confidence in pre-pack administrations.[61] These reforms included:

- a requirement on insolvency practitioners to announce their intentions to sell in advance to creditors where there is no opening market of the assets or business; and
- a requirement for three business days' notice before the sale could be completed.[62]

The rationale was that these changes would enable creditors to consider and make representations, possibly make higher offers and, if necessary, apply for an injunction to restrain the proposed sale taking place.

66. Despite concerns about the fairness of pre-pack administrations, the Institute of Chartered Accountants for England and Wales (ICAEW) believed that there was very little wrong with the process:

> Although there is a lot of negative perception around pre-packs, there is no real evidence to suggest there is a real flaw in the process. The Insolvency Service's own reports into the operation of statement of insolvency practice 16 (the standard

60 The Insolvency Service, Annual Report on the Operation of Statement of Insolvency Practice 16, January to December 2011

61 31 Mar 2011: Column 30WS and The Insolvency Service Press Release, *Edward Davey, BIS Minister with responsibility for the insolvency regime announces new proposals for dealing with pre-pack administrations*, 31 March 2011

62 *Ibid*

> introduced by the RPBs which requires IPs to provide an explanation of their actions to creditors) have not identified any evidence that there are different levels of director misconduct in a pre-pack than any other corporate failure. Similarly, a sale back to existing management is not in itself indicative of misconduct or malpractice.

67. The Institute went on to argue that in order to "encourage entrepreneurial activity" it was important to "enable those who have failed to try again and that should include being able to purchase a business if they have made the best offer whether that is done via a pre pack or some other form of business sale".[63]

68. John Milsom, chairman of the Joint Insolvency Committee, also argued that pre-pack administrations also helped to maintain business activity and jobs in a very difficult trading environment.[64]

> Removing our ability to do pre-packs would be bad for the economy, because it would lead to more job losses. Again, you have to look at what you are trying to achieve with your insolvency policy. If you are looking for effective economic recycling of assets and the preservation of jobs, pre-packs are generally a good thing.[65]

69. However, the Institute of Credit Management argued that pre-pack administrations were "simply used as a vehicle to allow the rise of a phoenix company that has absolved itself of debts and continues to trade as if it were the former business to the detriment of unpaid creditors".[66]

70. The Association of British Insurers (ABI) also questioned the value of pre-pack administrations and claimed that that they were "open to abuse," and risked "preserving large companies at the expense of their smaller suppliers, potentially leading to more jobs lost than saved".[67] It went on to argue that:

> The heart of the problem lies in the serious conflict of interest inherent in an Insolvency Practitioner devising a pre-pack sale in secret in conjunction with the directors and secured lenders of a failing company, and then immediately implementing that transaction as administrator with a duty to act in the best interests of all creditors. Despite the professional and legal rules designed to prevent abuse, it is inevitable that a large proportion of pre-pack transactions will be structured so as to favour the owners of the business and their secured finance providers, who initially engage the Insolvency Practitioner and are privy to the design of the scheme, at the expense of unsecured creditors who have no opportunity to comment or intervene.[68]

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63 Ev 69

64 See research undertaken by Dr Sandra Frisby, *A preliminary analysis of pre-packaged administrations*, August 2007

65 Q 37

66 Ev 68

67 Ev 51

68 *Ibid*

71. However, Frances Coulson, the then president of trade body R3, insisted research showed pre-packs produced a better return for creditors than a normal business sale, while preserving jobs:

> Pre-packs are one tool in the panoply of tools that a practitioner has in terms of business rescue. Research undertaken by Dr Sandra Frisby shows that pre-packs produce a slightly better return for unsecured creditors than an ordinary business sale. A pre-pack is a tool that is available. It does work well in a large number of cases. As with any system, there are areas where there may be some abuse. I think it is a useful tool for business rescue and job rescue, particularly where the value in the business is its people.[69]

72. Proponents of pre-pack administrations argue that they preserve jobs and provide for the effective economic recycling of assets. However, that is disputed by a range of organisations. An objective assessment of pre-pack administrations is not easy and the only research carried out in this area was in 2007 by Dr Sandra Frisby, a lecturer at the University of Nottingham. For the public and creditors to have confidence in pre-pack administrations there needs to be a reliable body of evidence on how they have worked. **We therefore recommend that together, the Department and the Insolvency Service commission research to renew the evidential basis for pre-pack administrations.**

SIP 16 compliance

73. All Insolvency Practitioners are required to follow and maintain the guidance set out in Statements of Insolvency Practice (SIP). The purpose of SIP 16 is to ensure that creditors are given sufficient information to understand the circumstances surrounding the decision to opt for a pre-pack sale and the reasons why the particular course of action was adopted by the practitioner. However, its introduction has not stopped criticism of the process. For example, the Association of British Insurers argued that the current guidance on pre-pack administrations (SIP 16) had "failed to achieve its aim" and was "ignored by many Insolvency Practitioners".[70] In January 2012, the Government set up an urgent review on the effectiveness of the existing controls on pre-packs. The review focussed on the SIP 16, and whether more could be done within the existing regulatory framework to improve confidence and transparency.

74. In May 2012, the Insolvency Service published its *Annual Report on the Operation of Statement of Insolvency Practice 16*. According to the Report, 32 per cent of cases reviewed during 2011 were not fully compliant with SIP 16 disclosure requirements. 29 cases—7 per cent of the sample—were referred to the relevant authorising body for being substantially deficient. Cases were reported if they failed to provide enough detail or justification to support the pre-pack process or were "not sufficiently timely". As a result, the Insolvency Service reported 21 insolvency practitioners, related to 29 companies, to their regulators.[71] The Report also stated that "some SIP 16s are failing to fully comply with requirements to

69 Q 33

70 Ev 51

71 The Insolvency Service, Annual Report on the Operation of Statement of Insolvency Practice 16, January to December 2011

provide information on pre-appointment costs and expenses, and to obtain the approval for them".[72] The Insolvency Service stated that it hoped to publish further guidance on how to meet the requirements in SIP 16 by the end of 2012. This will be the second time the Insolvency Service has had publish guidance since January 2009.

75. Lee Manning, President of R3, was concerned that the Insolvency Service had focussed on the 'technicalities' of compliance, rather than addressing the serious concerns raised by creditors on the need for transparency in pre-packs. He argued strongly that rather than concentrating on "whether a report was filled out with every 't' crossed" the focus should be on "catching directors who are taking advantage and need to be pulled out of the system".[73]

76. When we questioned the Deputy Inspector General, Graham Horne, in October 2012 he expressed his disappointment that the insolvency industry had been unable to raise its compliance levels above 68 per cent. He did agree, however, that non-compliance was a "slightly technical" area:

> That is why, again, as part of the reforms, we were looking at strengthening the rules and regulations relating to the supply of information, to really put it on a statutory footing rather than the footing it is on with the SIP. [74]

When we pressed him on why this had not yet been done he explained following the consultation, Ministers had rejected the need for legislation. In his words, the Department's rationale was as follows:

> On the balance that we do not want to legislate if we can do things via voluntary means, and we are legislating on small businesses—because a lot of these firms are, indeed, small businesses themselves. At the moment the balance has been decidedly against legislation.[75]

Penalties for non-compliance

77. Insolvency practitioners can be subject to fines for non-compliance. However, a number of witnesses argued that the level of fines were inadequate to act as a deterrent.[76] Graham Horne, the Deputy Chief Executive of the Insolvency Service, appeared to agree:

> My disappointment is that those penalties have not had the impact of improving compliance levels, and I think what we are trying to do with the RPBs is urge them to up the game to say, "You need to do more to make sure they do reach acceptable levels of compliance".[77]

72 Accountancy Age, *21 IPs reported for pre-pack non-compliance in 2011*, 15 May 2012

73 Accountancy Age, *R3: Regulator failing to address pre-pack concerns*, 16 May 2012

74 Q 221

75 Q 222

76 Ev 83

77 Q 223

78. To put this into context, in supplementary evidence to us the Insolvency Service gave us figures on the number and the level of fines that had been levied for SIP 16 non-compliance:

> Since January 2010 there have been a total of 6 fines given to insolvency practitioners by their authorising bodies for breaches of SIP 16. The fines ranged from £250 to £2,500 with costs attached ranging from £250 to £2,167. In 26 other cases, the authorising bodies took regulatory action resulting in 5 consent orders without financial penalty and 21 formal warnings. There are 10 SIP16 referrals currently with the authorising bodies for consideration.[78]

79. R3 have highlighted to us that "of the 32 per cent of reports labelled by the Insolvency Service as non-compliant, just 7 per cent were actually referred to the Insolvency Practitioners' regulator", and that "in recent years, just a small fraction of the reports referred to the regulators have led to disciplinary proceedings".[79] They also aired concerns with the way the Insolvency Service judged reports to be non-compliant, arguing that insolvency practitioners were "not made aware of the criteria on which they are being judged by the IS, or indeed given any feedback on their reports".[80]

80. **In May 2009, our predecessor Committee expressed concerns about the lack of transparency, resultant abuse of pre-pack administrations and their link to 'phoenix companies'. Despite the introduction of Statement of Insolvency Practice Note 16 and additional guidance, pre-pack administrations remain a controversial practice. The Insolvency Service is committed to continue to monitor SIP 16 compliance, but to make this effective, non-compliance needs to be followed through with stronger penalties by way of larger fines and stronger measures of enforcement.**

81. We have some sympathy with the concerns of the regulator R3, which argues that non-compliant insolvency practitioners are not made aware of the criteria on which they are being judged by The Insolvency Service, or given any feedback on their reports. **We recommend that the Insolvency Service amend its monitoring processes to include feedback to each insolvency practitioner and their regulatory body where SIP 16 reports have been judged to be non-compliant. We further recommend that the criteria by which SIP 16 reports are judged should be published alongside the guidance.**

Other measures to increase confidence in the insolvency regime

Continuation of supply

82. R3 launched a campaign called *Holding Rescue to Ransom* in March 2011, which called for the Insolvency Rules to be amended to prevent suppliers demanding "extortionate ransom payments", by increasing their prices or ceasing to supply as a company goes into formal insolvency. Research from R3 suggests that if suppliers were obliged to continue to supply on insolvency, over 2,000 additional businesses could be saved each year, rather

78 Ev 67

79 Ev 83

80 *Ibid*

than being put into liquidation. In addition, the number of pre-packs administrations could decrease, as Insolvency Practitioners argue that more than one in five of the administrations they work on have to be pre-packed due to fear of unreasonable actions by suppliers.[81]

83. On launching the campaign, R3's former President, Steven Law, commented:

> When a supplier demands a ransom payment it puts a further strain on a business's already stretched resources. This prevents an insolvency practitioner from trading a business out of insolvency and reduces the amount that can be returned to the body of creditors as a whole. In these cases a supplier is not recouping money lost; the supplier is 'taking advantage' to the detriment of other creditors. It is unnecessary for suppliers to take this action as those who continue to supply during insolvency have the security of being paid as an administration expense—ahead of all other payments.
>
> Traditionally a practitioner would be able to rescue the business following a period of successful trading. Unfortunately our members are now handling cases where utility companies and other suppliers have more than doubled their tariffs when the business was trying to trade through an administration. Insolvency need not be the death knell for a business, but often a supplier's actions reduce the options available to an insolvency practitioner. In many cases the only options left are to sell the business as quickly as possible or simply shut it down.[82]

84. When we questioned the Insolvency Service, Graham Horne told us that continuation of supply was a "tricky area" but one which was under consideration by the Insolvency Service:

> When you start looking at these contractual arrangements, there is a danger of unforeseen consequences, unless you get it right. When you interfere between two contracting parties, the price of credit could go up if you start to say to people, "You have to supply at a certain rate, regardless of the risk", because clearly risk is an element in price. If you are dealing with a company that is insolvent or is about to become insolvent, your risks might be increasing, and that might be reflected in your price.
>
> That is not to say there is not a genuine point here. Where you are talking about regulated industries, we should do and are doing something about it. It is not right that a regulated industry should seek to profit because a company is going insolvent. Where there is a contracting party it is trickier; we are aware of the issues and we are discussing them with insolvency practitioners and others. It would require legislation, and it is a question of those unforeseen consequences: if you pull a lever over here, you are not totally sure what the consequences are over there at the moment.[83]

81 Ev 84

82 R3 Press Release, *R3: Change insolvency law to reduce pre-packs*, 15 March 2011

83 Q 201

85. Despite this and statements from the Government saying that they are looking into the issue, a formal consultation has yet to be issued.[84]

86. We recommend that the Department undertake a consultation as a matter of urgency on the rules relating to the continuation of supply to businesses on insolvency in order to assess whether a greater number of liquidations or further damage to businesses could be avoided if that supply was better protected.

84 8 Nov 2011 : Column 304W

6 Reforms to the regulation of insolvency practitioners

Complaints against Insolvency Practitioners

87. There are currently eight regulators of insolvency practitioners:

- the Association of Certified Chartered Accountants (ACCA);
- the Institute of Chartered Accountants in England and Wales (ICAEW);
- the Institute of Chartered Accountants in Ireland–CARB (ICAI);
- the Institute of Chartered Accountants in Scotland (ICAS);
- the Insolvency Practitioners Association (IPA);
- the Solicitors Regulation Authority–SRA (Law Society);
- the Law Society of Scotland (LSS); and
- the Insolvency Practitioner Unit of the Insolvency Service.

Each regulator has the power to issue fines and reprimands although practices differ from to one another.

88. The 2011 *Annual Review of Insolvency Practitioner Regulation* showed that complaints against insolvency practitioners (IPs) dropped by 16 per cent over the past two years.[85] Overall complaints for 2011 were 517, down from 531 in 2010 and 618 in 2009. However, the number of IPs sanctioned and fined rose from four in 2010 to 19 last year. The Review shows that in total, 80 IPs were subject to regulatory or disciplinary sanctions, including fines, warnings and reprimands—representing 4.6 per cent of all practitioners.[86]

89. In 2011, the Office of Fair Trading investigated the corporate insolvency profession and made several suggestions including the introduction of a single complaints body.[87] A Ministerial statement issued in December 2011 made clear that the Government felt more could be done to improve the effectiveness of the regulatory regime. [88] A key element of the proposed reforms related to the complaint handling processes, focusing on improving the ability of creditors to complain when they feel excessive fees have been charged. However, the statement stopped short of recommending a single regulatory body for the insolvency industry. The Statement also confirmed that the Secretary of State (SoS) proposed to withdraw from the direct authorisation of Insolvency Practitioners; to reform his powers as

85 *2011 Annual Review of Insolvency Practitioner Regulation*, The Insolvency Service, May 2012

86 *Ibid*

87 *The market for corporate insolvency practitioners: a market study*, The Office for Fair Trading, June 2010 and *Consultation on reforms to the regulation of insolvency practitioners*, The Insolvency Service, February 2011

88 Written Ministerial Statement, *Reforms to the Regulation of Insolvency Practitioners*, 20 December 2011

oversight regulator to make them more effective; and to introduce regulatory objectives to the regime.

90. Stephen Speed, the former Inspector General and Chief Executive of the Insolvency Service, said: "I believe that the regulatory regime works reasonably well and that the vast majority of IPs do a first-class job in what are usually very challenging circumstances." However, he acknowledged the need to provide greater transparency, consistency and independence for complaints-handling processes.[89]

91. Lee Manning, President of the trade body R3, also agreed that further work was needed to improve the complaints-handling process stating that the vast majority of his members "would be happier with fewer regulators than the current seven bodies." He was also in favour of "guidance on common sanctions to ensure wrongdoing is punished in the same way by differing regulators".[90]

92. In evidence to us, the Recognised Professional Bodies supported the view that the regulatory system need to be improved in terms of transparency, consistency and effectiveness. R3 told us that they would "welcome a reduction in the number of regulators to address these concerns".[91]

93. The insolvency industry has however been united in their view that the establishment of such a body was not required. The ICAEW told us:

> We do not believe the case has been made that there is a fatal lack of confidence in the existing complaints systems which would require such a major overhaul of the existing systems.[92]

The ICAEW's executive director of professional standards, Vernon Soare, added: "we believe that this is best achieved by effective oversight of the existing regulators. In the current climate, we don't believe the time and cost associated with establishing a new single regulator is feasible".[93]

94. When we questioned the Insolvency Service in October 2012, Graham Horne told us that Ministers had ruled out legislating to establish a single independent regulator at the current time, and that the Insolvency Service and the insolvency profession were looking to achieve the same results with a voluntary set of measures:

> Neither we nor Ministers have ruled out a single independent regulator. It needs Parliamentary time and they need to think about that, but what we are trying to achieve for this voluntary set of measures is some of the advantages that would give us—a single gateway for complaints, common standards and a common appeal process—so that people do not need to work how it works. The public do not need to

89 Insolvency News, *IP complaints drop by 16% over two years*, 16 May 2012

90 *Ibid*

91 Ev 81

92 Ev 70–71

93 Q 11

> work their way through it. You want the public to be able to go to one place, and that is the idea of our gateway.[94]

95. The Joint Insolvency Committee[95] has drafted the Common Sanctions Guidance which they hope will bring greater clarity and transparency to disciplinary measures, reinforce consistency of disciplinary outcomes across the profession, and could increase confidence from the creditor community. David Kerr, Chief Executive Officer of the Insolvency Practitioners Association and the draft's author, has said:

> A published common sanctions guidance will be an important part of the new complaints regime. It will help to ensure that decisions on complaints are demonstrably consistent, and it will go a long way to improving transparency and building greater confidence in the regulation processes.[96]

96. On 20 December, Jo Swinson announced a series of reforms to the way complaints against insolvency practitioners are handled by industry regulators. The main elements of the reforms are:

- A complaints gateway operated by the Insolvency Service providing visibility to the complaints system for creditors, debtors and others
- Published common sanctions guidance to provide transparency and consistency to the sanctions system, and which the regulators will refer when deciding upon a sanction
- The Insolvency Service hosting a single web page to publicise sanctions given out by the regulators. All sanctions will be published for a period of at least a year.
- Common decision makers for appeals by complainants and IPs—regulators will, where their rules permit, use the same independent individuals for key roles in their appeal processes to aid consistency.

The reforms are expected to be in place in Spring.[97]

97. **We welcome the news that the insolvency industry and the regulators have been working together to create common regulatory standards across the profession. The creation of a single gateway for complaints, common standards and a common appeals process would be an important step in this regard. We agree that the Insolvency Service, in regulating the recognised professional bodies (RPBs), should have a wider range of powers, very much akin to those that the RPBs themselves have in disciplining their members.**

94 *Ibid*

95 The Joint Insolvency Committee is a major forum for discussion of issues of concern to the profession and has representatives from each of the insolvency Recognised Professional Bodies and from The Insolvency Service. The Association of Business Recovery Professionals and The Insolvency Service, Northern Ireland have observer status. The Committee, which first met in December 1999, presently meets four times a year

96 Accountancy Age, *Insolvency profession to unite on disciplinary measures*, 1 May 2012

97 Credit Today, *Business minister confirms insolvency review*, 20 December 2012

98. **Many insolvency complaints are about the legal framework or a creditor's financial loss rather than a failing in the insolvency practitioner's conduct. Often complainants are simply dissatisfied with an insolvency and the financial loss they have suffered. A simplified complaints system, which included greater publicity about the operation and scope of the current system, signposting of disciplinary outcomes and expectation management of potential complainants, could go some way to providing a clearer picture of the work of insolvency practitioners. We expect the industry, as a matter of good practice, to publish an annual report detailing complaints and progress in this area.**

Insolvency Practitioners fees

Remuneration of IPs

99. The fees of insolvency practitioners can vary from one practitioner to another, and can depend on the complexity of the cases they work on, the geographical area they are based in, and the kinds of firms they work for. When a company goes into administration or liquidation the costs of the proceedings are paid out of its assets. The creditors, who hope eventually to recover some of their debts out of the assets, therefore have a direct interest in the level of costs, and in particular the remuneration of the insolvency practitioner appointed to act as an administrator or liquidator.

100. In April 2010, substantial amendments were made to the Insolvency Rules 1986. In particular, there were changes to the basis on which an insolvency practitioner's remuneration may be approved. New provisions were also introduced that enabled creditors (in certain circumstances) to seek information on, and challenge the level of, that remuneration. There were also parallel provisions enabling creditors to seek information on, and challenge the expenses of, an insolvency practitioner.

101. On 8 November 2011, Ed Davey, gave the following written reply to a Parliamentary Question on whether he intended to bring forward proposals to set a cap on the fees charged by IPs:

> I confirm that I have no plans to bring forward proposals to cap the fees charged by insolvency practitioners, which are properly a matter for the creditors or the court.
>
> However, the Government believe that it is important for creditors and others affected by insolvency to have confidence that the fees charged by insolvency practitioners are fair. For this reason, earlier this year the Government issued a consultation on a set of reforms, which included a proposal to introduce a non-court based mechanism for creditors to complain about the level of fees charged by insolvency practitioners.[98]

102. In its response to our inquiry, the Association of British Insurers commented:

> We would support a strengthening of the control of IPs' remuneration, such as an agreed hourly rate or maximum amount, as it would improve transparency. It should

98 HC Deb 8 November 2011 c304W

> include an obligation to inform creditors from the outset that any changes or meetings to renegotiate fees would still result in a cost to the estate.[99]

103. Three of our witnesses—the Institute for Chartered Accountants for England and Wales (ICAEW), the Insolvency Practitioners Association and the Joint Insolvency Committee—believed that the statutory remedies in this area already provided protection for creditors. The ICAEW suggested that:

> More should be done to encourage creditor engagement in the fee approval process. For creditors who only have limited experience of insolvency procedures this may be difficult to achieve initially, but repeat creditors should be encouraged to participate and The Insolvency Service has a role to play in educating creditors.[100]

R3 commented on the frustrations felt by unsecured creditors in the fee setting process:

> "R3 [...] supports a number of proposals from the IS to give unsecured creditors greater influence (for example, we support IS proposals which state that IPs' hourly rates should be agreed by creditors at the time of resolution and IPs should have to go back to creditors with a new resolution if their rates change at any point during the case).
>
> We also propose that the Government departments who are major, repeat unsecured creditors better exert their considerable market power. Under existing legislation, unsecured creditors have a range of effective mechanisms open to them to engage in the insolvency process, especially following changes introduced in April 2010. Yet sadly these mechanisms often go under-used. We can understand that certain unsecured creditors may find it difficult to engage in insolvency - due to lack of experience, size of debt or unfamiliarity with the process - but it is hard to believe that Government departments cannot do so.
>
> HMRC and the IS itself through the Redundancy Payments Service account for more than a quarter of unsecured debt and therefore have considerable market power, if only they would exercise it. We suggest that HMRC set up their own fee review teams to consider IP fees, based on their existing and effective Voluntary Arrangements Service (VAS). This non-regulatory solution would be self-funding and would see unsecured creditors playing a much more active role in fee-setting".[101]

104. Stephen Speed, the Inspector General and Chief Executive of the Insolvency Service, acknowledged that fees for insolvency practitioners continue to be a vexatious issue and that "if you are an insolvent person or creditor and you have lost a lot of money, you will start from a pretty sore place, and that is perfectly right and understandable." He agreed with R3 and the views of many of the RPBs about encouraging greater creditor engagement in the process, when he told us:

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99 Ev 52

100 Ev 71

101 Ev 82

> We need to educate creditors more generally about the process and the rights of action they have in corporate insolvencies, but it is not easy because, if you are in business and you are lucky, you go through life with this never happening to you, and if you are unlucky, it may happen once or twice. I think there are about 4.2 million registered companies in this country. The question is how you educate an extraordinarily large population of potential unsecured creditors about an event that they may experience if they are unlucky only once or twice in their working lives. But that is something we need to think harder about with the profession and also the creditor community.

However, he also added that the Statement of Insolvency Practice Note No. 9 did provide "a very good, straightforward statement of creditors' rights to action".[102]

105. When we questioned the Insolvency Service in October 2012, it acknowledged that it had not made as much progress as it would have liked on the issue of fee complaints. Graham Horne told us that the common gateway would be the avenue for people to raise complaints regarding fees:

> They will be able to raise complaints about fees, and RPBs will look at those where the circumstances surrounding the fees amount to misconduct, so where an IP does not have proper authorisation for fees, where an IP cannot support the calculation for the fees, or where the fee levels are very egregious. They will, then, look at those, and that will give creditors some avenues to complain.
>
> The position is still that, in most cases, the recourse is to court if you are not happy with the way practitioners have handled fees. Most fees are approved by creditors, so, in most cases, the creditors will have approved the way in which the insolvency practitioner gets their fees.

He also added that the Service recognised that this was a voluntary measure. They would monitor it very closely and had not ruled out legislation if it was deemed to be necessary:

> Again, we are looking at whether we can push this voluntary measure a little further, because the recourse, again, would come back to legislation, and we would want to look at secondary legislation to give RPBs the right to examine the quantum of fees, and have not ruled that out.[103]

106. On 20 December 2012, Jo Swinson announced a review, led by Professor Elaine Kempson from the University of Bristol which will look at the concerns expressed by creditors that fees charged by insolvency practitioners do not represent value for money. The review will build upon the earlier study conducted by the Office of Fair Trading. A report is expected in summer 2013.[104]

107. **Insolvency practitioner fees continue to be a vexatious issue and more needs to be done to educate the public and creditors about the fee-setting regime. We welcome the**

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102 Q 180

103 Q 234

104 Credit Today, *Business minister confirms insolvency review*, 20 December 2012

announcement of the review led by Professor Kempson and expect an update on progress on this issue in the response to this Report.

108. **We welcome the Insolvency Service's continued monitoring of compliance by insolvency practitioners with the Statement of Insolvency Practice Note 9. Whilst we recognise that unsecured creditors will not be comforted by this alone, more needs to be done to advertise the process of creditors committees. We also believe it is important for the Insolvency Service to encourage unsecured creditors such as the HMRC, Government Departments, and the Redundancy Payments Service to actively participate in creditor committees.**

7 Conclusion

109. **The Insolvency Service is confident that it has emerged in good shape after a challenging period of budget cuts and staff reductions. The Service believes that further efficiencies will be found through the implementation of its much delayed delivery strategy. However, this is not a foregone conclusion. Concerns remain about the funding arrangements for the Service, in particular the Official Receivers Service. Its funding model, based on a static level of casework and the value of assets, is in need of urgent reform.**

110. **The Insolvency Service also has to address as a priority, staffing reductions and budgetary constraints in its enforcement and investigations unit. Without an increase in resources it will be unable to increase the number of cases it can prosecute which will further undermine stakeholder confidence.**

111. **The insolvency profession plays a key role in a difficult and often emotional environment. Overall it does a good job but it faces a number of challenges. The on-going reform of regulations and standards needs greater impetus, and responsibility for that lies with the profession.**

112. **There remain a number of concerns about pre-pack administrations which need to be addressed. Greater transparency, higher levels of compliance with SIP 16 and a stricter regime of sanctions are needed. Equally, more attention needs to be given to educating creditors of their rights.**

113. **If the Insolvency Service and profession is to have a more stable and sustainable future, these are issues which will need to be resolved.**

Conclusions and recommendations

A new delivery strategy?

1. **The Insolvency Service has now been considering a new Delivery Strategy since early 2010, which has created uncertainty for staff and added to the delay in delivering much needed improvements to the Service. We understand that the new Chief Executive will want to put his own stamp on the new strategy, but it is important that the Service moves swiftly to the delivery stage of that strategy. In its response to our Report we will expect to receive a clear timetable for the implementation of the new strategy for the Insolvency Service.** (Paragraph 16)

Reductions in the workforce

2. **We applaud the fact that the staff of the Insolvency Service have maintained their high levels of service throughout the difficult period of staff reductions and budget cuts. However, there is a risk that further reductions in annual running costs and staff may put undue pressure on its ability to deliver. In particular, the Insolvency Service will have to prove to us that it is sufficiently robust to deal with any potential substantial increase in insolvency casework.** (Paragraph 21)

Reorganisation of office locations

3. **We are concerned that the continued uncertainty over the future of the Insolvency Service estate could have a detrimental effect on the performance of the Service. If the estate is to be rationalised, decisions on office closures cannot be continually deferred. Any rationalisation of the estate will need to demonstrate the ability to maintain existing levels of service and delivery.** (Paragraph 28)

The funding model of the Official Receivers' Office

4. **Funding for the Official Receiver Service relies on a fee-generated income model. It is clear from the evidence we received that this model is unreliable in the current economic climate. We recommend that the Insolvency Service work together with the Department for Business, Innovation and Skills to look at alternative funding models that are sustainable and not wholly reliant on unpredictable levels of casework and asset values.** (Paragraph 40)

Bankruptcy case administration fees-altering the balance

5. **At present, individual debtor bankrupts have to pay an upfront fee of £525. Given the level of debt relief they can receive we agree with the Insolvency Service that it would not be unreasonable to increase that fee, possibly on a sliding scale. We also agree that the fee should not be automatically required to be paid up front but could be staggered along similar lines as payments to debt management companies. We will expect the Insolvency Service to set out progress in both of these areas in its response to this Report.** (Paragraph 43)

Published targets for the Service

6. The target of 68 per cent for stakeholder confidence in the enforcement regime has clearly proved a challenge for the Insolvency Service. Public perception of resource pressures may dampen stakeholder confidence but we do not accept that this is the prime reason for the Service to miss its targets in this area. Confidence in the enforcement regime is a key factor in the success of the Insolvency Service. In its response to this Report the Service must demonstrate that it has a strategy for promoting the successes of the investigatory and enforcement regime so that confidence in it can be better measured. (Paragraph 48)

Investigation and enforcement costs

7. Both the insolvency industry and the Insolvency Service have recognised that resource constraints, both in terms of funding and staffing, have had an impact on the investigatory and enforcement regime. While we welcome additional funding from the Department for Business, Innovation and Skills, we remain concerned that this area of activity remains under-resourced. (Paragraph 61)

8. We are strongly of the opinion that the levels of disqualification of errant directors should not be determined by an arbitrary level set in what the Insolvency Service describes as the public interest. We believe that any dilution of enforcement activity would send entirely the wrong message to delinquent directors and recommend that the Department provides the Insolvency Service with sufficient, and if necessary, additional funding to disqualify or sanction all directors who have been found guilty of misconduct. (Paragraph 62)

Reform of pre-packs

9. We therefore recommend that together, the Department and the Insolvency Service commission research to renew the evidential basis for pre-pack administrations. (Paragraph 72)

Penalties for non-compliance

10. In May 2009, our predecessor Committee expressed concerns about the lack of transparency, resultant abuse of pre-pack administrations and their link to 'phoenix companies'. Despite the introduction of Statement of Insolvency Practice Note 16 and additional guidance, pre-pack administrations remain a controversial practice. The Insolvency Service is committed to continue to monitor SIP 16 compliance, but to make this effective, non-compliance needs to be followed through with stronger penalties by way of larger fines and stronger measures of enforcement. (Paragraph 80)

11. We recommend that the Insolvency Service amend its monitoring processes to include feedback to each insolvency practitioner and their regulatory body where SIP 16 reports have been judged to be non-compliant. We further recommend that the criteria by which SIP 16 reports are judged should be published alongside the guidance. (Paragraph 81)

Continuation of supply

12. We recommend that the Department undertake a consultation as a matter of urgency on the rules relating to the continuation of supply to businesses on insolvency in order to assess whether a greater number of liquidations or further damage to businesses could be avoided if that supply was better protected. (Paragraph 86)

Complaints against Insolvency Practitioners

13. We welcome the news that the insolvency industry and the regulators have been working together to create common regulatory standards across the profession. The creation of a single gateway for complaints, common standards and a common appeals process would be an important step in this regard. We agree that the Insolvency Service, in regulating the recognised professional bodies (RPBs), should have a wider range of powers, very much akin to those that the RPBs themselves have in disciplining their members. (Paragraph 97)

14. Many insolvency complaints are about the legal framework or a creditor's financial loss rather than a failing in the insolvency practitioner's conduct. Often complainants are simply dissatisfied with an insolvency and the financial loss they have suffered. A simplified complaints system, which included greater publicity about the operation and scope of the current system, signposting of disciplinary outcomes and expectation management of potential complainants, could go some way to providing a clearer picture of the work of insolvency practitioners. We expect the industry, as a matter of good practice, to publish an annual report detailing complaints and progress in this area. (Paragraph 98)

Remuneration of IPs

15. Insolvency practitioner fees continue to be a vexatious issue and more needs to be done to educate the public and creditors about the fee-setting regime. We welcome the announcement of the review led by Professor Kempson and expect an update on progress on this issue in the response to this Report. (Paragraph 107)

16. We welcome the Insolvency Service's continued monitoring of compliance by insolvency practitioners with the Statement of Insolvency Practice Note 9. Whilst we recognise that unsecured creditors will not be comforted by this alone, more needs to be done to advertise the process of creditors committees. We also believe it is important for the Insolvency Service to encourage unsecured creditors such as the HMRC, Government Departments, and the Redundancy Payments Service to actively participate in creditor committees.(Paragraph 108)

Conclusions

17. The Insolvency Service is confident that it has emerged in good shape after a challenging period of budget cuts and staff reductions. The Service believes that further efficiencies will be found through the implementation of its much delayed delivery strategy. However, this is not a foregone conclusion. Concerns remain about

the funding arrangements for the Service, in particular the Official Receivers Service. Its funding model, based on a static level of casework and the value of assets, is in need of urgent reform. (Paragraph 109)

18. The Insolvency Service also has to address as a priority, staffing reductions and budgetary constraints in its enforcement and investigations unit. Without an increase in resources it will be unable to increase the number of cases it can prosecute which will further undermine stakeholder confidence. (Paragraph 110)

19. The insolvency profession plays a key role in a difficult and often emotional environment. Overall it does a good job but it faces a number of challenges. The on-going reform of regulations and standards needs greater impetus, and responsibility for that lies with the profession. (Paragraph 111)

20. There remain a number of concerns about pre-pack administrations which need to be addressed. Greater transparency, higher levels of compliance with SIP 16 and a stricter regime of sanctions are needed. Equally, more attention needs to be given to educating creditors of their rights. (Paragraph 112)

21. If the Insolvency Service and profession is to have a more stable and sustainable future, these are issues which will need to be resolved. (Paragraph 113)

Formal Minutes

Tuesday 29 January 2013

Members present:

Mr Adrian Bailey, in the Chair

Paul Blomfield	Ann McKechin
Caroline Dinenage	Mr Robin Walker
Rebecca Harris	Nadhim Zahawi

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

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

Paragraphs 1 to 113 read and agreed to.

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

Ordered, That the Chair 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 in addition to that ordered to be reported for publishing on 17 and 31 January 2012.

[Adjourned till Tuesday 5 February at 9.00 am

Witnesses

Tuesday 24 January 2012 *Page*

Frances Coulson, President, R3, **David Kerr**, Chief Executive, Insolvency Practitioners Association, **Vernon Soare**, Executive Director, Institute of Chartered Accountants in England and Wales, and **John Milsom**, Chairman, Joint Insolvency Committee — Ev 1

Tony Butcher, President, Prospect (Insolvency Branch) — Ev 13

Tuesday 7 February 2012

Stephen Speed, Inspector General and Chief Executive, and **Graham Horne**, Deputy Inspector General, The Insolvency Service — Ev 20

Tuesday 23 October 2012

Dr Richard Judge, Inspector General and Chief Executive, and **Graham Horne**, Deputy Inspector General and Deputy Chief Executive, the Insolvency Service — Ev 36

List of printed written evidence

1	Association of British Insurers	Ev 51
2	British and Irish Ombudsman Association	Ev 52
3	British Property Federation	Ev 52
4	David N Clough	Ev 54
5	John Hancox	Ev 55
6	Insolvency Practitioners Association	Ev 56
7	Insolvency Service	Ev 58; Ev 66
8	Institute of Credit Management	Ev 67
9	Institute of Chartered Accountants in England and Wales	Ev 68
10	Joint Insolvency Committee	Ev 72
11	Legal Ombudsman	Ev 75
12	Prospect (Insolvency Branch)	Ev 76
13	R3	Ev 79; Ev 82
14	ShareSoc (UK Individual Shareholders Society Ltd)	Ev 84
15	Professor Mark Watson-Gandy	Ev 86

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2012–13

First Report	The Hargreaves Review of Intellectual Property: Where Next?	HC 367-I/II (HC 579)
Second Report/First Joint Report	Scrutiny of Arms Export Controls (2012): UK Strategic Export Controls Annual Report 2010, Quarterly Reports for 2010 and January to September 2011, the Government's review of arms exports to the Middle East and North Africa, and wider arms control issues	HC 419
Third Report	Post Office Network Transformation	HC 84 (HC 678)
Fourth Report	Overseas Students and Net Migration	HC 425
Fifth Report	Apprenticeships	HC 83-I/II/III (HC 899)

Session 2010–12

First Report	The New Local Enterprise Partnerships: An Initial Assessment	HC 434 (HC 809)
Second Report	Sheffield Forgemasters	HC 484 (HC 843)
Third Report	Government Assistance to Industry	HC 561
Fourth Report / First Joint Report	Scrutiny of Arms Export Controls (2011): UK Strategic Export Controls Annual Report 2009, Quarterly Reports for 2010, licensing policy and review of export control legislation	HC 686
Fifth Report	Government Assistance to Industry: Government Response to the Committee's Third Report of Session 2010–11	HC 1038
Sixth Report	Is Kraft working for Cadbury?	HC 871
Seventh Report	Rebalancing the Economy: Trade and Investment	HC 735 (HC 1545)
Eighth Report	Trade and Investment: China	HC 1421 (HC 1568)
Ninth Report	Time to bring on the referee? The Government's proposed Adjudicator for the Groceries Code	HC 1224-I
Tenth Report	Pub Companies	HC 1369-I/II *(Cm 8222)*
Eleventh Report	Time to bring on the referee? The Government's proposed Adjudicator for the Groceries Code: Government Response to the Committee's Ninth Report of Session 2011–12	HC 1546
Twelfth Report	Government reform of Higher Education	HC 885-I/II/III (HC 286)
Thirteenth Report	Pre-Appointment Hearing: Appointment of Director of the Office for Fair Access	HC 1811
Fourteenth Report	Debt Management	HC 1649 (HC 301)
Fifteenth Report	Stamp Prices	HC 1841-I/II

Oral evidence

Taken before the Business, Innovation and Skills Committee

on Tuesday 24 January 2012

Members present:

Mr Adrian Bailey (Chair)

Katy Clark
Julie Elliott
Margot James
Simon Kirby
Ann McKechin
Nadhim Zahawi

Examination of Witnesses

Witnesses: **Frances Coulson**, President, R3, **David Kerr**, Chief Executive, Insolvency Practitioners Association, **Vernon Soare**, Executive Director, Institute of Chartered Accountants in England and Wales, and **John Milsom**, Chairman, Joint Insolvency Committee, gave evidence.

Q1 Chair: Good morning and welcome. Thank you for agreeing to be interviewed by us. We are not actually scheduled to start until 10.30 am, but given that we have a lot of questions to get through, it would be helpful if we could just go through the preliminaries now. First of all, just for voice transcription purposes, could you introduce yourselves, starting with Vernon on my left?

Vernon Soare: Thank you, Chairman. My name is Vernon Soare, and I am the executive director with the Institute of Chartered Accountants in England and Wales, or ICAEW. We are the largest regulator of insolvency practitioners in the UK. We also have 140,000 members who advise and work in businesses or in audit practice.

Frances Coulson: Thank you, Mr Chairman. I am Frances Coulson. I am president of R3, which is the trade body for insolvency practitioners. We have 97% of insolvency practitioners as our members, and also specialist lawyers and others—students and so forth.

David Kerr: I am David Kerr, chief executive of the Insolvency Practitioners Association. We are the recognised professional body specialising in insolvency, monitoring about a third of the UK's licensed practitioners.

John Milsom: Good morning. My name is John Milsom. I am chairman of the Joint Insolvency Committee, which is a standard-setting body, comprising of members of each of the RPBs. I am also a licensed insolvency practitioner and a partner in KPMG.

Q2 Chair: Thank you very much. Just before we start, we have a lot of questions to ask you. I am conscious that, with four experts here, if all four of you talk at great length on every question, we could be here for a very long time, so perhaps one person answering and others adding or objecting to any comments that that person has made would be the easiest way to do this. Please do not feel obliged to contribute on every question if it just means repeating something that somebody else has said. We will not think ill of you if you do not wish to comment on something, unless we specifically demand that you comment on it.

May I just start with a fairly general question? How would you describe the latest insolvency figures? I suspect, Frances, that you are perhaps the best placed to lead on that.

Frances Coulson: Yes. I think that for a long time people have expected a surge in insolvency figures. We are not seeing that in formal insolvency. We are seeing a large number of what we have termed "zombie businesses"—businesses that are limping along and not going into formal insolvency. That is, I think, because traditionally there is a lag between a recovery in the economy and an upturn in insolvencies. Because the recovery, if there is one, is so slow, we are not seeing an increase in the insolvency figures. This is perhaps surprising to many, but we are not particularly expecting an upsurge in formal insolvency for quite some time.

Q3 Chair: Would it be fair to say that, while the perhaps surprisingly low level of insolvencies, given the general economic situation, is welcome, ironically, as the economy improves and presumably the asset base of some of those companies improves, they would be more vulnerable to going under than they are at the moment, as creditors move in? Is that a reasonable observation?

Frances Coulson: That is a reasonable observation. We have seen, for instance, an increase of 19% in company dissolutions, because there are no assets so companies are just falling off the register rather than restructuring, perhaps because there is not enough there to rescue. As creditors see more of an asset base, they may feel that they can recover their security. That may also have a benefit in clearing out and giving a little bit more competition in the market, where, as I say, if businesses are limping along without much competitive benefit, that is not necessarily a good thing. Where interest rates are low, there is not a great incentive for lenders to tip companies over if interest is being serviced.

Q4 Chair: Anybody else wish to add or object to anything there?

David Kerr: I would make the observation that this is not perhaps a typically shaped recession. The pattern

we are talking about is the one we have seen before, but is not the one we are seeing this time.

Q5 Chair: Moving on, what would you describe as the prime purpose of the Insolvency Service?
Frances Coulson: From our point of view, the Insolvency Service is primarily there, as a Government agency, to deal with the administration of estates and the passing on of asset—based estates to private practice. On the one hand, there are a large number of companies, as we have seen, that go into insolvency with no assets and need an administration structure to deal with the closing down of the structure—obviously, on the personal side, this is similarly the case in bankruptcy.
The other side is in terms of the disqualification of directors—the investigation of poor behaviour by directors, moving on to the disqualification of those directors. That is something that we feel is a very important part of the service's role. It is something that we are a little concerned has perhaps dipped over the past few years. Disqualifications have halved[1] over the last couple of years. Practitioners make reports to the Insolvency Service in terms of director behaviour. If they put in a report saying that directors have behaved badly, they obviously want to see that taken forward to disqualification. Very low numbers—only 20%[2]—of reports are being taken forward to disqualification. This is partially because we have seen a dip in funding. That is something that we are concerned about because it affects other businesses where directors are perhaps behaving better.[3]
Vernon Soare: A secondary purpose of the Insolvency Service is to act as the oversight body to oversee the work of the recognised professional bodies, the RPBs, like ourselves. That is an important function. They cannot carry out the detailed regulation—that it delegated to us under legislation—but they are the oversight body to review what we do.

Q6 Chair: I was going to ask what service it provides that cannot be delivered by the industry. Do you think that, realistically, the industry could provide such an oversight service itself?
Vernon Soare: I do not think that the industry itself should—often professional bodies are accused of being self-regulated, with all the pejorative overtones of that phrase. It is necessary and right that Government Departments, in this case BIS and the Insolvency Service, actually have an oversight role. They can be seen to be independent of the profession, as they are not reliant on the profession in that sense and can stand back and be objective about what we do.

David Kerr: I think all of us and the service acknowledge that it is doing some things that perhaps it ought not to be doing, which muddies the waters in terms of that oversight function, for example directly authorising insolvency practitioners where it does not have the mechanisms in place to discipline them and do so on in the same way that the RPBs do. So removing itself from that function will enable it to enhance its oversight role.

Q7 Chair: Could you tell us what RPBs are?
David Kerr: Recognised professional bodies: the Institute, the IPA and the others that are licensed to regulate practitioners directly.

Q8 Chair: How would you assess the performance of the Insolvency Service in the last year or so?
Frances Coulson: I think that the service has had to work under very difficult circumstances. It has had two large voluntary exit schemes. Obviously it has had difficulties. Its funding model is predicated on being funded by the fees that are paid in terms of bankruptcy and winding up. Strangely, that works when there is a lot of formal insolvency, but when there is not, self-funding does not work. The service is having to work in quite difficult circumstances. Where you have voluntary exit schemes, you then get reallocation of staff and retraining issues, and so on and so forth.

Q9 Chair: Coming back to the original question I asked, as you say, ironically, a low level of insolvencies presents greater difficulty. If there is a sudden upsurge, given the reduction in staff that they had, do you anticipate difficulties there?
Frances Coulson: I think that given the large numbers of staff who have left the service, it could cause problems. What is needed is an efficient system for an initial taking on of cases and then a rapid transfer of cases that are appropriate out to the private sector, where they can be dealt with quickly. That is down to computer systems and an appropriate system.
John Milsom: It is a difficult period for the service, a period of change, not just in its funding and structure, but also, as David and Frances have both said, in the economy. I think that it will be well-served to be clear in setting its objectives, and the policy it wishes to achieve and its agenda during the year, working with the RPBs to achieve those goals. It is sometimes quite difficult—certainly it has been during the past 12 months—to see what the service has been trying to achieve. It has been slightly reluctant, in a period of change, to bring forward what it is seeking to achieve.

Q10 Julie Elliott: Moving on to the reform of insolvency practitioner regulations, are the Government's priorities—with a general move towards more self-regulation—appropriate for the industry?
Vernon Soare: I am not sure actually that we are being subjected to that, or asked to be more self-regulating. The discussions that we have had with the

[1] Note by witness: The percentage of reports taken forward by the Insolvency Service has reduced from 45% in 2002–3 to 27% in 2010–11

[2] Note by witness: This should read only 20% in 2009–10 and just 27% in 2010–11

[3] Note by witness: The Insolvency Service estimates a net benefit of £88,000 to the market for every company director disqualified (in terms of potential economic damage that they would otherwise cause). Therefore, the total potential savings to creditors from disqualifying unfit directors is estimated at £143.2 million in 2009–10. Should disqualification rates return to 2002–03 levels, the benefit to the economy would be an estimated £247.4 million in 2009–10.

Insolvency Service following the Insolvency Service consultation about the future of regulation had not indicated to us that we are essentially being left to our own devices. We will still be overseen, and indeed there are some proposals on the table to rationalise some of the regulation that currently takes place from eight recognised professional bodies, perhaps into a smaller number, or at least in some way to give a more consistent line from the regulatory bodies. As far as we are concerned, we will still be overseen by the Insolvency Service, and inspected, as it does at regular intervals.

David Kerr: It is a process of delegated statutory regulation. As Vernon says, it is subject to oversight by the Insolvency Service. I think most observers have recorded positively the great benefit that comes from having professionals involved in the regulation process and the expertise that they bring. We have increased lay input into the process. They are on most of the RPBs. Recently we had lay members introduced for the first time to the Joint Insolvency Committee that John chairs. There is more external scrutiny going on, even though primarily, it is, as you say, a self-regulation system.

Q11 Julie Elliott: The Government have announced the creation of a single independent regulator. Do you all support that?

John Milsom: It is very difficult to support that when we have got different legislation governing Northern Ireland, Scotland and England and Wales, so it would be quite difficult to implement. One can see some value in having a smaller number of regulators to get better consistency and transparency. I wonder whether the legislative changes that would be required would actually be of benefit in the longer term, because one would hope that the attraction that insolvency practitioners are getting at the moment reflects the economy and one would hope that the economy improves. In the longer term, a smaller number of regulators and the Insolvency Service not being a regulator has to be a good thing for consistency and transparency.

David Kerr: The Minister's statement was interesting as I read it because, although there was reference to seeing merit in the benefits of a single regulator, potentially, the Minister was keen to engage with the profession through officials at the Insolvency Service to see whether the objectives—greater consistency and so on—could be achieved through other means. We are actively engaged with the service at the moment in a package of measures, particularly on the complaints side, with a view to doing just that. We think that we can probably achieve the objectives that the service is looking for, and the OFT raised, short of that step.

Frances Coulson: Certainly, in R3, we cannot make too much of the consistency for our members and also for the general public. It is good for reputation of the profession. But we are very concerned that changes that are made are proportionate. At the end of the day, cost comes out of the creditor's pocket. You are always starting off with less than 100% of the money. Some of it is about communication, making it easier for people to complain, making the sanctions common, and generally making what is being done visible to the public.

Vernon Soare: I would just add that, as with David, my reading of the Minister's statement was, while he was still potentially minded to move to one regulatory body, that is not the current intention. Indeed, as David mentioned, we are working with officials to see how the current system can be improved. Obviously we all have the goal of making sure that the regulatory process commands public confidence and that the complaints system is seen to be fair and effective. We believe it is already, but there is always more you can do to educate creditors and complainants to make it more accessible. That is what we are currently working on with the Insolvency Service staff.

Q12 Julie Elliott: Why do you think that there are so many representative organisations and regulatory authorities? It does seem a lot.

Vernon Soare: I am often asked this question—also, in the wider accountancy profession—and normally my answer is: history and geography. That is not quite a detailed answer but I think it is a reflection of the fact that, over time, there have been historical differences. Different professions had obviously had an interest in insolvency and been licensing their members. That is really the genesis of why there are so many bodies. Probably you would not start from there.

Q13 Julie Elliott: Do you think they are all needed now?

Vernon Soare: My view is that we probably do not need as many. I have to declare an interest as my organisation is the largest. Our view is that we probably do not need that many. Some are very, very small, and you have to wonder about the economies of scale. You also have to wonder about the effectiveness of very small bodies, and their ability to bring all the necessary resources into the regulatory framework. That is obviously an issue for the Insolvency Service itself, to look at the effectiveness of individual bodies. Generally speaking, our view would be that there should probably be a reduction, but not a reduction to one. Even though we are the largest, we do not want to see one. We do no think that one is a good idea. A little bit of competition, in the best sense, among regulators keeps us all on our toes.

Q14 Julie Elliott: A couple of you have touched on this question: would the creation of a single regulator remove the need for the Insolvency Service?

Frances Coulson: It is difficult, as Vernon says, to go to a single regulator. For instance, in the legal profession—I am a solicitor—accountants are being authorised to undertake certain legal work and therefore they will be regulated by the ICAEW, not the Solicitors Regulation Authority. There are different streams. For example, some practitioners are chartered accountants and others are insolvency practitioners who have come through a different route.

If you are a very large firm and you have a multidisciplinary practice, with some accountants and insolvency practitioners, you may choose to have one regulator that can deal with both, from cost and consistency purposes. But you might not be a chartered accountant; you might be in a firm that solely consists of insolvency practitioners. We have a large number of small businesses, micro-businesses and sole practitioners, so we are concerned that they are not forced unnecessarily into the wrong box or the wrong circumstances.

David Kerr: If I may, coming back to the Chairman's opening comments about the purpose of the Insolvency Service, if, going forward, that includes setting regulatory objectives for the system, oversight and policy-making, then arguably those things would still be separate from a regulator that is dealing with the operational functions of the regulatory system.

Q15 Julie Elliott: This question is for John. If the Government was to recommend a single independent regulator, who would be responsible for standard-setting in the industry? Would creating a single regulator make transparency and consistency easier?

John Milsom: I think a single regulator may well make transparency and consistency easier to see, but I think we can get there in a more cost-effective manner. I think it would be difficult to achieve in the near-term because of the legislative changes that would be required. Even with a single regulator, because you have different legislation, you are still going to have to deal with the inconsistencies between those regulations and laws. It is not a panacea, unfortunately.

Q16 Julie Elliott: Finally, David, what is the current status of the Commons Sanctions Guidance? Is it still the intention to publish the guidance early this year?

David Kerr: Yes, it is very much on the agenda of the Joint Insolvency Committee. I have been doing some work on that with colleagues in the other regulators. It will be back on the agenda for the next meeting. We are trying to get it to the position where we can tidy up the loose ends and agree it between us and then publish it.

Q17 Ann McKechin: Let me first declare my interest as a member of the Law Society of Scotland, which I know is one of the regulatory bodies within this combination today that we are examining. I just want to press the panel a little more about the issue of complaints. What is the current level of complaints in the industry? Do you think that there are sufficient safeguards at the moment for vexatious and frivolous complaints? Obviously, insolvency practitioners are not necessarily the most popular people when they come into a new case.

Frances Coulson: Unfortunately, we come into an unhappy situation, as a rule. It is partially a question of education. The system that we have been working on with the Insolvency Service envisages a single portal for complaints, something that is easy, perhaps on the Insolvency Service website, which could also assist with education. For example, you could have FAQs so that people understand the role an insolvency practitioner has. Partially owing to legislation, creditors get large amounts of paper, going into some detail, but often that is information that they cannot necessarily cope with, particularly smaller creditors. It would be helpful to have bullet-point FAQs and an easy point of entry, so that you filter that out. Then the service could filter the complaints to whichever is the relevant RPB for that practitioner, and those complaints would then be dealt with quickly and efficiently.

David Kerr: Our experience of dealing with complaints tells us that, as Frances hinted, complainants are quite often complaining because they are unhappy, inevitably. On investigation, quite often it turns out that they are complaining about lack of understanding of the process, understandably, or their concern about the outcome. On investigation, quite often the nub of the problem is not the conduct of the practitioner, but of course the practitioner is in the firing line. We do get a lot of complaints that we end up having to filter out of the system. That quite often involves providing explanations to complainants, at which point maybe they go away less unhappy than they were. That is just part of the process that we have to absorb within the regulatory system, to deal with those and deal with them properly.

Vernon Soare: Can I just add our experience of numbers of complaints? Interestingly, our complaints over the whole of ICAEW number about 2,000 a year. Of those, about 10% relate to insolvency practitioners, so actually the number of complaints that we get is above the norm for the generality of our members, but, as Frances said, it is partly a result of the fact that in administration and liquidation there will always be parties who feel that they have lost out. Therefore there is a sense in which you would expect insolvency to generate more complaints, because it is inevitable that, when businesses fail, there are going to be dissatisfied people.

On the point you asked about vexatious and frivolous complaints, I think we have to start, as regulatory bodies, from the point of view that we have to deal with each complaint on its merits. I think that it is all too easy for a regulatory body to be accused of not taking complaints seriously. So in a sense we try very hard to go to the other extreme. How we handle complaints is part of the review that the Insolvency Services carries out on us from time to time.

Q18 Ann McKechin: You have obviously made your points clear as to what you think about having one regulator. The Government have been consulting about an independent complaints body. Some of you are regulated already in your professional capacity by independent regulators. That is the case for the Law Society of Scotland. But that is not the case for all of you, and is not the case for those who are regulated by the Insolvency Service. Would you consider that a complaints body that is independent would go some way to addressing the problems people feel about it being an inside job and not getting a fair deal?

John Milsom: If I answered your previous question slightly differently, part of the problem here is that—we have talked very much about process so far—you

have an individual who is unhappy with another individual. It is very difficult for a first individual to go to the second individual to say, "I am unhappy with what you did". That is part of the problem we have. Rather than somebody complaining directly to an IP, or, as Vernon and the other members have said, seeking to understand the process, there is a visceral reaction, saying, "I am going to complain about this person to somebody who can make a difference". As Frances said, we need to manage their expectation. If we have a common portal, using the Insolvency Service to improve general understanding, I do not think we need a common complaints process, because we have a very effective process. What we need to ensure is that the RPBs are consistent and transparent in how they deal with the IPs and make sure that when people complain they get a human reaction—a little bit of sympathy, perhaps—while trying to improve their understanding.

Q19 Ann McKechin: I take your point, but the issue is that, unlike other professional relationships, it very often is not a direct service provider/client relationship, where the norm in complaints services is to say to the client, "Go and have a meeting face-to-face with the company concerned to discuss the case", which very often saves a lot of cases turning up at the complaints level in the way that is recorded through your various organisations. In this case, many of the people concerned are not your client but they have a direct interest. I could put to you the alternative, that, actually, the need for independence, given that fact that they do not have that direct client relationship, is even greater than in normal professional relationships.
John Milsom: The difficulty with that suggestion is that if they do not go through the first steps of communicating with me, even though I am not their direct provider of the service—with an unsecured creditor, for instance—I am still obliged, as an IP, to provide them with information, and I would be foolish, as an IP, to ignore the simple questions that can be easily answered. There is a line between the frivolous and the vexatious. One person's vexatious comment is another person's perfectly reasonable request for additional information; there is a balance there. So I, as an IP, do have to interchange with these people and need to communicate with them. I think that there should more communication at that level. One of the changes that happened in April 2010 is that we are now encouraged to communicate more. That is going to take some time to filter through our systems. But that is going to improve things. I do not think that an independent body, which will then immediately become an arbiter of what was and was not, with the benefit of hindsight, reasonable, will improve things.
David Kerr: I agree with John largely. We said in our response to the Insolvency Service consultation last year that we could see some merit in an independent body, provided it was a decision-making body and that it was proportionate from a cost point of view. Coming back to John's comments about the portal and the rest of it, we can achieve a great deal of independence and consistency through this package of measures that we are talking about with the service at the moment. In addition to that first entry point though the service, which increases accessibility for complainants, coupled with the Common Sanctions Guidance and with some joint activity at review and appeal level, which we are talking about with the Institute, along with a common place where the adverse decisions are published, so that that is more open and transparent as well, and along with the Insolvency Service potentially acting as the gatekeeper at the front part of the process, thereby enhancing its oversight of the RPBs and the way it handles complaints, we will have a package of measures that will increase accessibility, consistency, and independence as well.
Vernon Soare: Can I just add one comment? If the outcome for unsecured creditors of putting together an independent complaints body was a better outcome at the end of the day, then there would be a strong argument for moving to an independent regulator. However, I do not think that there is evidence currently that the current system is failing. In fact, I think that it is working better than is perceived. One of the problems with complaints systems generally is that, in terns of trying to get to the right outcome, there is a lot of expectations management needed. I wonder whether the creation of a new independent complaints body, which will be launched with a lot of expectation, would actually disappoint in the end, because it would have to go through basically the same process as the RPBs currently go through. If it could be demonstrated that there would be better outcomes then there is obviously a policy argument there, but I do not think that the evidence is there currently.
Frances Coulson: Practitioners are obviously regulated and if there is a complaint against them they are investigated by their RPB and may be disciplined. The Insolvency Service has indicated that it is giving up its direct regulatory role and going back to being just an overseer of the others. Our principal concern with having a separate body is the cost of that, because at the end of the day that has to be funded in some way.

Q20 Ann McKechin: I will come back to that point. If a single complaints body was to be established, which of the four models put forward in the consultation paper would you prefer and why? Which, very quickly, is the most preferable?
Frances Coulson: We have opted for model two, to have an independent joint appeals process, so that any error in law or regulation can be dealt with. We are in favour of rationalisation of the number of regulators, that is fair to say.

Q21 Ann McKechin: You would accept the argument for consistency in judgments?
David Kerr: I think that comes from the Common Sanctions Guidance. Even if you have one body making decisions, they still have to be consistent in their decision making from one hearing to the next. The guidance will be a big factor in that.

Q22 Ann McKechin: If you favour the creation of an appeals complaints body, where should this be

based and how should the body be funded? That is a point you have made, Frances—where would the money come from?
Frances Coulson: RPBs are funded by licence fees.
Vernon Soare: But ultimately the money would come from the creditors because the charges would filter down through the recognised professional bodies from insolvency practitioners and creditors.
David Kerr: The model we suggested was effectively putting in a complaints decision-making body that was probably no more expensive than the Insolvency Practices Council, which is about to be disbanded, for which there is a levy of £50 a year charged to insolvency practitioners. One could argue that it is a one-in, one-out basis that would allow you to fund it without a huge increase.

Q23 Chair: Fees, the vexatious issue. Has the SIP 9 note—the amendment in April 2010—remedied any of the frustrations felt by creditors in fee-setting for insolvency practitioners?
David Kerr: Can I just make one point on that before we get into the substance of the question? There is a new SIP 9, that came out at the beginning of November last year, approved by all the bodies, which goes a bit further than the short-term fix that was issued at the time of the 2010 rule changes and introduces some new restatements of key principles about reasonableness and costs being commensurate with work needing to be done. That is a relatively new standard which was issued subsequent to the 2010 rule changes.
Vernon Soare: In terms of proportion, of the 200 to 250 complaints that the ICAEW received about solvency last year, only 15 were to do with fees.

Q24 Chair: Is this a relatively insignificant problem?
Vernon Soare: I do not think that it is insignificant, because obviously if a set of creditors are concerned, they are concerned. But I think that, in terms of the issues around fees, which we understand can be very emotive—we are not trying to deny that—again, we come back to this issue of what creditors understand and what the public understand about how fees are charged. We go back to the Insolvency Service, and maybe the RPBs, to do some more education. There is a lot in the newspapers about fees currently being charged in the Farepak case, et cetera. What probably many people will not know is that there is a creditors' committee, or liquidation committee, made up of interested creditors, including HMRC, who will monitor the fees being incurred by the insolvency practitioner. There is a big education issue here—not to minimise the angst that fees generate.
David Kerr: Just to add a point about the 2010 rules: it is too early to know whether the changes that were introduced then have made a big difference to creditors. I do not think that any assessment has been made of the impact of those rule changes.

Q25 Chair: I think Vernon touched on this. I was going to specifically ask this to Frances. How do you propose to give unsecured creditors, including HMRC and the Redundancy Payments Service, greater influence in the fee review process?
Frances Coulson: We would certainly encourage more participation and we do encourage it, but it is difficult. In a large number of cases, creditors have obviously already lost money, and they make the decision that they are not going to invest time in dealing with the post-insolvency process. It is a bit like getting shareholders to engage in controlling directors' remuneration; it is quite difficult to get people to participate. Certainly where there is a creditors' committee it is much easier, because they are much more directly involved in discussing what work is being done and what fees are being charged. But in a lot of cases, it is difficult to get people. You only have to have three people for a creditors' committee, but you cannot even get three volunteers. We think that the Revenue having a greater involvement, because it is an unsecured creditor in a quarter of the cases, could make a big difference, but that is obviously a resource issue for it as well.[4] We can do better in terms of fee estimation. You go in to a job at a crisis point, when you are not necessarily aware of all of the circumstances, so it can be difficult to give fee estimates, but we can do a bit better with that. Experienced practitioners will know that, in certain circumstances, a job ought to cost around X much, and we should tell creditors that.
John Milsom: Our problem is getting creditors to participate.

Q26 Chair: How widespread is the practice of having creditors' committees with insolvencies?
John Milsom: In an insolvency, as a working practitioner, you want creditors involved, but, as Frances says, getting them to participate is very difficult.

Q27 Chair: Have you any idea of what proportion of total insolvencies result in a creditors' committee being formed?
John Milsom: No.
Frances Coulson: I expect it is low.
John Milsom: It is going to be low. The difficulty then is—and this is one of the changes that were brought about in April 2010 and will actually filter through—beforehand, at the outset, for instance in an administration, the administrator could get the basis for his fees approved for the length of the assignment. Now, you can have rest periods and you can re-engage with the creditors. The purpose of this has to be that the person who is paying for the service should decide how much the service is worth, which is why you want creditors' committees to be formed. But getting them to do it is very, very tough. They do not want to, for the simple reasons that, if they are not seeing any return and it is going to take their time, then why, economically, would they do it? It is simple economics for them. I have a lot of sympathy with them. The difficulty that then arises is that under some of the other models it has been suggested that we could start paying to go on committees. That would

[4] Note by witness: We suggest that HMRC set up their own fee review teams to consider IP fees, based on their existing and effective Voluntary Arrangements Service (VAS). This non-regulatory solution would be self-funding and would see unsecured creditors playing a much more active role in fee-setting.

be wrong, because then you would have a professional group of people going on committees. I do not think that that would improve the lot of the unsecured creditor. So what you then have to say is, "OK, is there a general educational step that could be taken?" I think that that is something that the Insolvency Service needs to encourage creditors to participate in the process. We can do some of that education, but it has to be a more general education from the Insolvency Service as well.

Frances Coulson: I also think that a greater use of online engagement, as things move on, becomes cheaper and easier for people to engage. At the moment, people have to come to a meeting, have to read voluminous papers, and it may become easier and we may be able to find more ways of trying to get people to participate.

Q28 Chair: Would it be possible effectively to devise a model of creditor engagement and, if so, which body would really be entrusted with developing it?

David Kerr: The Institute of Credit Management might have some interest in pushing that. Following John's point about creditors not having a financial interest at all, , even where creditors do have a financial interest but it is small, there is a difficulty in getting them to engage and spend time and effort when they are more interested in moving on to make the next sale. The ICM certainly might have a part to play.

Q29 Chair: If an online model could be devised then obviously the level of physical engagement is that much easier, isn't it?

John Milsom: Once you have a committee there is an awful lot of interaction that goes on. We would still come back to the same point about getting a committee or a representative group to actually respond. Even with email, if we had a 10% barrier to approve our fees, we would then be scrabbling around to get over 10% and would probably spend half our life on the phone, calling people up and saying, "Can you press the button and say yes or no?". After a while, you lose interest in whether it is yes or no; you just want an answer.

Q30 Chair: Okay, I think we have covered that issue. Moving on, and referring back to the previous discussion on an independent complaints body, should such a proposed body have the power to review the fees and remuneration charged by IPs?

Frances Coulson: Fees are quite a difficult area, because obviously it is a collective process. There are mechanisms for creditors to challenge fees if they consider that they are excessive, and for them to be looked at by the courts. If practitioners' fees are challenged, they will invariably give detailed breakdowns. It is in their interests to do that. They do not want a complaint to go further and they certainly do not want to be in court because of the attendant cost that goes with that.

If we are talking about creditor engagement, the difficulty is that, if a creditor has not engaged throughout the process and has had no say at all, and then suddenly, at the end, says, "I am unhappy with those fees" and makes a complaint, that may very well be an unrepresentative complainant. If 90% of the creditors have said, "Yes, we have agreed those fees", what do you do with the one complainant who is unhappy? It is quite difficult to do something with a mechanism. As Vernon says, we have been working with the Insolvency Service, looking at how we can bring fees into the complaints procedures. They are dealt with by the RPBs now, but we are looking at making that more transparent and more engaged so that if fees are excessive, we are trying to find a mechanism for looking at that as a conduct issue and a disciplinary issue. There are procedures for solicitors, for example, in terms of dealing with fees, but that is a one-on-one situation—you contract with your solicitor, they provide a service, you have agreed what the service is and what the fees are. Creditors are a collective body and so it is difficult: you might have 90% agreeing and 10% not agreeing, who can then challenge the fees in court.

Q31 Chair: Would an independent complaints body potentially act as a sift to prevent cases having to go to court?

Frances Coulson: It is still very difficult. If you took a larger case, for example, and the amount of work and knowledge in terms of the case that would need to be undertaken—such as a court would undertake, and even a court sometimes has to engage independent reviewers and experts to look at the fees—it is difficult to see how a complaints body, unless it was quite heavily funded, could look at such large cases. If someone had challenged the fees in the Lehman Brothers case, for example, the work that would be necessary to review each and every step taken in such a case—whether the commercial decisions taken by the practitioner were correct at the time, the amount of work was correct at the time—with hindsight would be very difficult.

David Kerr: I think that the two things are separate. There is a valid question about whether the complaints system—the present one or something different in future—should embrace complaints about fees. We are actively engaged with the service on that. We have a meeting scheduled next week with the other regulators as well to talk about that and other aspects of the complaints system. It is being looked at very actively. But the question is, whether the complaints system, whichever body it is that is making decisions, should be able to deal with complaints, especially one where the complainant might be a minority creditor, not on a committee, outside of the eight-week window provided in the 2010 rule changes, and in what circumstances then the regulator would be expected to deal with that complaint and do something about it.

John Milsom: We do want an efficient system as well. It would be wrong for an IP to have his fees approved, either through a meeting of the general body of creditors or a committee or even going to court, and then have somebody be able to stymie that system by being able to say, "Hold on a second, I do not like this, I want to go to the independent complaints body". That would not be in the best interests of the other group of creditors, because the IP is going to have essentially to put the case into a sort of limbo.

Q32 Chair: How do you think that costs for a fee-related complaint should be paid where, first of all, the IP is found to have overcharged and, secondly, when they have not overcharged?
David Kerr: If it was in the complaints system as now, then if a case is found against the practitioner, the practitioner will ordinarily pay costs to the body that has taken the action. Presumably, if a case was not found then the costs would be borne by the regulator.

Q33 Margot James: I have a general question to start with: how effective are pre-pack administrations in your view?
Frances Coulson: Pre-packs are one tool in the panoply of tools that a practitioner has in terms of business rescue. Research undertaken by Dr Sandra Frisby shows that pre-packs produce a slightly better return for unsecured creditors than an ordinary business sale. A pre-pack is a tool that is available. It does work well in a large number of cases. As with any system, there are areas where there may be some abuse. I think it is a useful tool for business rescue and job rescue, particularly where the value in the business is its people.

Q34 Margot James: I noticed in your submission that you mentioned this research by Dr Frisby. Has anyone else done any research on the effect of pre-packs on unsecured creditors or is it just the one study?
Frances Coulson: She is the only study that I am aware of.
Vernon Soare: She has cornered the market, as far as I am aware.

Q35 Margot James: So with just one study, we perhaps should not set too much store by it.
Vernon Soare: One study is not definitive, but a lot of this is the view of the effectiveness. You can judge the effectiveness of a pre-pack from different perspectives. It depends who you are looking at. From the employees' perspective, pre-packs, on the evidence we have to date, assist greatly in maintaining employment. From the creditors' point of view, that may not be their desired first outcome. Interestingly, there is a lot of press focus on pre-packs, for the reasons such as the idea that maybe the directors of the former company are getting off lightly, et cetera. As a proportion, they are still running at approximately 25% of administrations. As Frances has mentioned, they are but a tool. It is not as if virtually all administrations are pre-packs. It is up to the judgment of the individual insolvency practitioner. Of course, they do have to give their reasons for using a pre-pack tool in the statement to creditors.

Q36 Margot James: What confidence have you got that they are only being used in appropriate circumstances and with a reasonable degree of transparency?
Frances Coulson: The practitioners are putting their reputation and regulatory position on the line. They are taking commercial decisions quickly in what is usually quite a distressed situation. Certainly in, for example, small family-run businesses there is quite often no other interest. The misconception arises in that people think that the directors have got away with it, have just walked away and got their business back, and the creditors are left high and dry. The practitioner has a duty to do the best for the creditors, which is what he or she is doing, but sometimes the creditors do not appreciate it. What is forgotten about is the second stage of the process. Simply because the business has been sold back to the directors does not mean that the directors, further down the line, perhaps in a liquidation exit—and we propose that in a sale to a connected party there should be a liquidation exit, probably with a secondary practitioner—that the directors' behaviour will not be reviewed and that they will not have action taken against them personally to recover money for the creditors under some of the antecedent insolvency actions that can be taken. Because the pre-pack happens at the primary point, that is what everybody is concerned about and that is what upsets the creditors. Sometimes there is a little less interest in the secondary process, which requires a bit more forensic examination of what the directors did before the insolvency, looking at the accounts, inappropriate credit raised and so forth. Actions are taken against directors for recovery in those circumstances.
John Milsom: Pre-packs are not a new tool. They have been around for many years—20 or 25 years, probably more. I remember doing my first one over 25 years ago. They have been around for that length of time. You have to ask yourself why they are more prevalent now. They are more prevalent now because of the changes that were made in the 2003, in the Enterprise Act, which shifted the weight of interests of the various parties.
It now means that it is very difficult for me as an IP. If, on day one, I am faced with borrowing with £1 million—I am personally liable for that £1 million—am I going to trade it, or sell the business in the very near term to protect the jobs and make a similar, if not better, return to the creditors? That is why there are more around. It is a complex set of factors that have changed over the last 20 years that have led to more pre-packs. They are not a panacea and IPs should assess the alternatives and explain those alternatives. SIP 16 is very clear on what IPs should give to creditors. It is pretty effective, albeit that that there is a level of poor disclosure by a group of IPs that the regulators need to work with.
David Kerr: Your point about transparency is central to it. We can check that up, as we do, on monitoring visits to practitioners. We have some measure of the degree of non-compliance through the monitoring that the Insolvency Service does. It gets all the copies of the SIP 16 statements from practitioners and, where appropriate, refers complaints to the RPBs. Compliance has gone up, the number of complaints has gone down, and we are in a much better place now than we were two years ago.
Frances Coulson: We also think that there are couple of changes that could be made that could reduce the use of pre-packs. One is more certainty in the range of expenses in administration that are administration expenses, which have been extended by the courts on an ongoing basis. If administrators knew, going in, as

a certainty, what was going to be an administration expense, they would be more able to trade a business. The other change that we have been calling for relates to this: where a business goes into administration, certain suppliers have to continue to supply, but some suppliers will also change the terms of supply, so that you go in thinking that you are going to be able to have your supply at X price and the prices have changed simply because you are going into an insolvency procedure, which makes it impossible to estimate effectively, to run your management accounts and estimate whether you should trade that business. We think that, provided that the supplier is going to get paid, there should be a change to say that they must continue to supply on the same terms, to enable that business to be traded through into rescue. The suppliers are getting paid—they are not suffering a detrimental change in terms. We think those are two quite simple changes that our members say could save 2,000 more businesses a year.

Q37 Margot James: You started that answer by saying, "If we wanted to reduce the number of pre-packs"; is that because you think it is too high and should be reduced?

Frances Coulson: No. There is a lot of adverse press about pre-packs. They are a tool that is available to practitioners and they will use their judgment as to what is most appropriate in the circumstances. It is a matter for Parliament to decide as to whether you do or do not make them available. We have to work with what there is. In whichever circumstance, the practitioner will decide what is best for that circumstance.

John Milsom: Removing our ability to do pre-packs would be bad for the economy, because it would lead to more job losses. Again, you have to look at what you are trying to achieve with your insolvency policy. If you are looking for effective economic recycling of assets and the preservation of jobs, pre-packs are generally a good thing. If you have some other aim, maybe you want to get rid of pre-packs, but I think it would lead to job losses.

Vernon Soare: The Insolvency Service itself over the past couple of years has been reviewing the SIP 16—the Statements of Insolvency Practice 16—statements issued by insolvency practitioners. Its latest figure is from 2010. It is doing a review for 2011. In its view, about 80% to 84 % of the statements issued complied with the SIP 16 requirements. Now, that instance does not answer questions necessarily as to whether it was the right tool at the right time but it gives an indication that, in general, the usage of pre-packs and the explanations to creditors are improving. There is always more that can be done.

Q38 Margot James: What do you say to the accusation that pre-packs can create job losses further back in the supply chain by allowing companies to get rid of or dump debts, and the effect that has on suppliers and the people that they employ?

Frances Coulson: If the company does not have a pre-pack sale, it does not mean that it will not go into some sort of insolvency, and therefore that the supplier will not suffer a loss anyway. The principal complaint that is made is that the directors get the company back and lose the debt. But, as I said, that is not to say that they will not be pursued for that later down the line. Just because it is not a pre-pack does not mean that there will not be an insolvency. Again, we go back to education, looking at suppliers and their risk assessments and credit checks and so forth. I know that the ICM have been working on getting more education out there about that.

Q39 Margot James: To what extent do you think that any economic value preserved by a pre-pack sale would otherwise transfer to alternative ventures if a pre-pack was not undertaken?

Frances Coulson: I know we have been called a nation of shopkeepers, but I think it is fair to say that, as I understand it, 30% GDP in this country is from small family-run businesses. In a large number of cases, nobody else would give the business a go. It is fair to say that it is a valuable tool, particularly in the SME sector. If you want people to try and then try again, then you have to have some sort of mechanism whereby they can do that. That is not a policy decision for us to make, but I think that it would have an effect if that tool were taken away, particularly on the SME sector.

Q40 Margot James: What about the concerns of these unsecured creditors about the abuses of pre-packs? Do you feel that there is validity in them? What do you think of the proposal that was made last year of introducing the three-day rule?

Frances Coulson: We have lobbied hard for a fourth alternative. I can understand the concern about a sale to a connected party and why creditors would feel disgruntled about that. Again, transparency and so forth are important, but, we think, after the event. It goes back to what I said about the secondary set of processes in pursuing the directors for any wrongdoing, and indeed looking at what the administrator has done. We have proposed something else if you have a sale to a connected party, apart from the three options that the Minister has proposed. Dealing with those, there is the three-day notice, which is working days so is effectively a week: this would make funding and keeping staff very difficult. It is a very useful tool in people-based businesses, as I said. You may lose your key staff, and I am not sure how you would continue with funding. Another option of the Minister's was conditional sale, but again it is difficult to get somebody to enter into a conditional sale, because of the expense of that and so they may then lose the business. There was also an application to court; again, going back to the smaller businesses, an application to court is expensive and may preclude the sale happening at all.

We proposed as a fourth option, that, if there was a sale to a connected party, there should be a compulsory liquidation exit—because you can dissolve a company out of administration if there is going to be no dividend to unsecured creditors—with a second IP, perhaps with a small pot of money from the sale proceeds reserved. It may be the Official Receiver or the Insolvency Service that takes that secondary role. This would mean that the actions of

the directors were looked at, action could be taken to pursue the directors for any wrongdoing and the actions of the administrator were looked at. If you want to stop abuse, we think that that is the correct way to do it, without taking a tool away from business rescue.

John Milsom: The difficulty with the proposals is that the first set of proposals was introduced and there are clearly some difficulties with the statutory instrument. We are all interested to see if it is going to be reissued with those matters dealt with. The devil is definitely in the detail. Insolvency is a very technical area. There are acres of legislation to get to grips with. Having another piece of legislation that does not fit in with everything else is going to make our lives much harder. You go back to the issue of whether you really want to take away a tool that can rescue jobs or whether you want to limit that tool in some way. It is a question of balance, between taking a tool away and making sure that you curb the excesses of its use.

David Kerr: Pat of that is deciding what weight you give to creditors who complain about abuse when what they mean is that the abuse is that someone has been allowed to start up again, using the same assets and the same premises and so on. Their concern is that they have lost money, and they say that they have lost that money because of a pre-pack. As Frances says, they have not lost money because of the pre-pack, they have lost money because the company was insolvent, and whether it went into an administration, pre-pack or otherwise, or it went into liquidation, they have lost their money at the point when the insolvency practitioner comes in. There is an issue about their perception of the process.

Q41 Margot James: How prevalent do you think that the practice of creating phoenix companies is? From a reading of the press, you might think it was quite widespread. In your experience, how frequent is this process of phoenix companies?

Frances Coulson: It has always happened and it will always happen in a certain small percentage of cases.

Q42 Margot James: You said earlier that the number of director disqualifications has lowered. Is this not a factor in the encouragement of more people to proceed down this rather cavalier path with suppliers' money?

Frances Coulson: Yes. The two tools that would tackle the abuse, whether it is in pre-pack or liquidation or anything else—phoenixes have always happened in liquidations—are first, to have an effective disqualification regime and to have an effective prosecution of directors who ignore the disqualification order, which also happens. Prosecutions are relatively limited because of resource issues. Second, to make sure that practitioners are enabled in bringing actions against directors to hit them in the pocket and take the money that they may have gained from going through the phoenix process. You have to make those two areas effective. Disqualification has to be funded to enable that to happen effectively. Disqualifications have reduced by over half since 2009.[5]

Vernon Soare: The Insolvency Service itself in its report in 2010 estimated that about 70% of pre-pack sales were to parties connected with the insolvent company. That is quite an interesting statistic. Of course, it does not necessarily mean that the directors or connected parties were at fault. There is a big difference between poor management leading to the folding of a company and economic circumstances being right against it. However, that is the most recent statistic that the Insolvency Service itself has put out. It begs the question as to the circumstances in which the pre-pack administration is sold on to those with a previous connection to the business.

David Kerr: That may not be entirely the same management. One case I was looking at yesterday involved new investors, but one of the directors from the previous company was involved in the new one. That would be in the 70%. I think that Sandra Frisby's research did cover the proportion of the cases that she looked at with a connected sale so there is that information available.

John Milsom: I would not stake too much on Sandra's very good work. It could reflect the world some years ago now. We have a fast-moving economy—perhaps not as fast as we might like, but it has changed—and pre-packs are being used slightly differently now, in part because you have large concerns with very complex financial instruments and complex financial structures. Where you have an operating group of people who have a knowledge of the business you want to retain them, because they are people who can actually keep the employment going. The fact that they may not be the CFO and the designer of the financial instruments that the company used might be a good thing. There is a balance there, again.

Frances Coulson: Our members have been working with the Insolvency Service to improve the "D" forms that our members have to submit—they have to report on directors when a company fails. A very high proportion—almost 80%[6]—of practitioners putting in an adverse report felt that they were not being taken forward appropriately. We have been trying to make the process easier, both for the practitioner and for the service when it is looking at them. At the end of the day, it is sort of "for want of a nail": it has to be funded so that disqualifications can happen. Although that is a down-the-road benefit, it is a benefit to the economy to do that.

Q43 Nadhim Zahawi: Do you believe that an insolvency practitioner providing advice to a company on the potential for a pre-pack has an inherent conflict of interest when accepting a formal appointment as an administrator with a view to subsequently executing a pre-pack sale? If so, do you believe that such a conflict extends to circumstances where the insolvency practitioner has had an ongoing prior

[5] Note by witness: This figure is in error and should read "the percentage of reports taken forward by the Insolvency Service has reduced from 45% in 2002–03 to 27% in 2010–11".

[6] Note by witness: This should read 75% of practitioners, putting in an adverse report, felt that they were not being taken forward appropriately.

relationship with that company in the context, say, of undertaking review work for a lender?

John Milsom: If you have undertaken that review work, first of all, management do not welcome you with open arms, because you are there for a particular reason, so there is a natural tension between you and management. You are doing a critical review of their work. If you do that job well, you gain an understanding of what their business objectives are and the value of that business. To then have you replaced and a new IP coming on the day that you are appointed, and imagine that they can then gain the knowledge that you may have accrued over three or four months, is not reality. It would not work very well, and you would probably see businesses being sold for a smaller value or, even worse, being sold back to the management who you have challenged very hard over a 16-week period, who can then just buy the business back from the new guy who does not perhaps have the benefit of your knowledge.

There is a conflict-of-interest issue. I completely accept that. There are very stringent ethical requirements. In fact, in the last 12 months we have brought in a new statement of insolvency practice, SIP 1, to codify the code of ethics as well, because we recognise that, if I have had a significant professional relationship with a business, it would be inappropriate for me to become the insolvency practitioner. That is what the code of ethics says. There will be examples. I work for a large firm; if my firm had done £50,000 worth of VAT work three years ago, I do not personally regard that as being a significant professional relationship, but I do recognise that somebody else may say that £50,000 is a great deal of money.

Frances Coulson: I think that, as John says, there is a difference between going in to do a review—perhaps at the instigation of a lender—and doing work to look objectively at the management and finances of the business and then being appointed, as opposed to having a relationship over a longer period, having been engaged by the board to advise them on things going forward. That latter is a different type of relationship and may well give rise to a conflict. Those are things which practitioners take very seriously, again, in terms of their regulators, which would look at them very closely in those circumstances.

David Kerr: The ethics code does cover it to a large extent. Perhaps the other area of potential conflict, which I am sure that most practitioners are keen to avoid, is getting involved in advising the directors personally in that prior period where, again, there could be difficulties because of director reporting duties.

Vernon Soare: From the ethical point of view and the way that regulators look at it, there is a code of ethics, there is SIP 1. I think that sometimes this needs to be viewed in the long term. If an insolvency practitioner is knowingly going into a job where they are conflicted, facing the potential of complaints by creditors, regulatory action by their regulator and their firm being put up in lights as having dabbled in that, then, unless they are going to make their fortune on that one administration and retire, they have a career to consider. You need to consider that that is a very heavy professional consideration to take into account. Interestingly, we get very few complaints about independence issues coming through. We get quite a lot of complaints, but they are not independence-based complaints.

Q44 Nadhim Zahawi: Do you believe that a requirement for a different insolvency practitioner to accept appointment as administrator would improve confidence that pre-packs are only used in appropriate circumstances?

Frances Coulson: No, I actually do not think that that would make a difference. The difference comes in, as I said before, a liquidation exit, when you are at the stage of post-mortem and antecedent transaction. Of course there is a certain amount of engagement that has to take place with a company before formal insolvency and you have to try to understand the business quite rapidly, but I do not think that that would improve the confidence in pre-packs. I think that it is an education process. It is quite difficult, because pre-packs now have a bad name and there has been a lot of press about them.

John Milsom: I think that pre-packs have got a better name over the last 12 months because they have been seen to work very effectively in protecting jobs. The East London Bus Company, La Senza, Blacks: there is a whole series of cases where they have been very well used. I think that if you were to introduce a new IP to do a pre-pack, all you would do is change the nature of the problem. People work with people. If I was asked to replace some guy who had done the work a couple of weeks before and I did not like him, I would maybe not say why I cannot do that transaction. Eventually there will be accusations of a cabal: "You always work with that guy". That cannot be right either. All you do is change the nature of the problem. I do not think that there is a problem there. IPs, in the vast majority of cases, use pre-packs appropriately. I am not saying that there is not occasional abuse or poorly explained pre-packs—I completely accept that—but I think that, in the vast majority of cases they are appropriately used.

Frances Coulson: Of course there is the overlay of secondary cost.

Q45 Nadhim Zahawi: I was about to say that none of you mentioned costs.

Frances Coulson: We have to come back to the issue that there is never enough money to pay creditors in circumstances in which we go in. Anything that duplicates cost or adds cost unnecessarily is something that we obviously need to avoid.

David Kerr: Critically, as well, would it make a big impact on creditors' perception of the pre-pack process? If you had a second IP coming in, and assuming that most of the transactions you are undertaking now would still be undertaken but by a different practitioner, the creditors still will not find out until after the event, and they may not be any happier about it than they would have been had it been the same IP, so you may not solve the problem

John Milsom: I think if the main lenders thought they could get a better return and it would give them

greater clarity, they would have already pushed us to this. They are pretty forceful with us in any event around fees and their expectations of us. I think that if it was going to work we would have got there in any event.

Q46 Nadhim Zahawi: In your experience, are there more effective alternatives to pre-packs, either here or internationally? Have you seen anything more effective than that?
John Milsom: I have worked in the States quite extensively. Chapter 11 has a very good press and is quite a useful system. It has lots of attractions. However, it is cripplingly expensive. The company has to pay for a plethora of advisers who are very often value-destructive because they spend more time squabbling over the assets than they do trying to protect the jobs. I think that we have a very good system in the UK. It is effective, and the fact that other people want to come to the UK and use it demonstrates that. I do not think that there is a better system for our economy.

Q47 Nadhim Zahawi: It is interesting that you mentioned that. Anecdotally, and we would have to test this, I would say that Chapter 11 has a better brand halo around it—that is, the company can protect itself—than pre-packs. With pre-packs, there is the perception that they can get away without paying their suppliers and just start all over again, easily.
John Milsom: I am not quite sure. I recognise that it does have a better perception. Having worked with it extensively, it is fascinating that it has got that, because, essentially, the directors who crashed the car get given the keys again to take the car round the track one more time. That is what debtor-in-possession must mean. The fact that they have a group of lawyers in the back, saying, "left", or, "right", "change gear" or "stop", or "brake", makes life much harder for them. It gives a limit to it. But equally, there are a number of—I mean, the joke is that it is the 22 now. It was 11 and it has gone down again.

Q48 Nadhim Zahawi: From a suppliers' perspective, there is value destruction on both sides, either to you guys or to a bunch of lawyers.
John Milsom: It is not necessarily Chapter 11, but some of the parts of Chapter 11 that are actually appealing, such as cure payments, which mean that you have to make whole a particular creditor if you decide that you want to trade with that person over a longer period of time, i.e. through the Chapter 11. You do not want businesses trading in that limbo, zombie sense, being traded by people like me. It does not make sense. You would have to change the whole regime in the UK and remove an IP, who is very often a ringmaster and can bring sense to a very difficult situation, and stop the petty squabbling over whether somebody gets 1.1p or 1.15p. We have a very good system. If you talk to people in the US they are always surprised how effective IPs in the UK can be in complex restructurings.
Chair: Can I just leave that now as we are moving on. Ann has a question on the R3 Holding Rescue to Ransom campaign.

Q49 Ann McKechin: A very quick question to Frances. You launched this campaign in March last year. I think I am right in saying that you estimated that if the campaign was successful, you could potentially reduce the number of pre-packs by about a fifth. Would that be right?
Frances Coulson: Yes.[7]

Q50 Ann McKechin: What success have you had and what legislation would need to be changed if you cannot get voluntary agreement?
Frances Coulson: We get a sympathetic hearing and we are trying to keep it high up the agenda. If change was to happen, now would be good, because now is when the economy is suffering. In terms of a change, it would be to Section 233 of the Insolvency Act. It is not a very large change that is needed. The legislation needs updating a little anyway, in terms of who can and who has to continue supply, for example. But it would be better if you had a pay-as-you-use system when you are in administration, rather than a supplier being able to say, "Well, we are just going to cut off the supply", or, "We are going to supply, but the price has gone up by three times", as that makes it very difficult for the practitioner to take a decision to trade that business, because he or she does not know at what overhead they are going to be trading that business.

Q51 Ann McKechin: Are there any international equivalents? In other parts of Europe, for example, are these schemes standard or do they operate a different system?
Frances Coulson: I am not aware of any.[8]

Q52 Simon Kirby: If it is all working so well, why is there need for change to insolvency rules? If there is a need for change, what would you like to see changed?
Frances Coulson: In the main, the insolvency legislation in this country works well. The Insolvency Act has lasted a very long time, and the Enterprise Act brought in changes to help with the rescue culture. The changes that we have pressed for are: no change to trading terms in administration; and fixing in legislation what is an administration expense because of the uncertainty that arises out of cases such as Nortel, and so forth, in expanding the range of things that are administration expenses. Practitioners need certainty in order to be able to make their decisions.
John Milsom: The rules are quite old—1985 or 1986—and the way we operate and the way that the general economy operates are very different now. The ability to communicate with people electronically would be really useful. To have that in the legislation quite clearly would be very useful. To take away some of the duplication and make it a more streamlined set

[7] Note by witness: R3's research estimates that if the campaign were successful there would also be an additional 2,000 businesses saved each year.

[8] Note by witness: The US's Chapter 11 has some similarities to R3's campaign and obliges continued supply. This 'automatic stay' prevents suppliers terminating their contracts with a company on the grounds of insolvency alone and we understand that it works well (please note, we would not recommend introducing Chapter 11 in its entirety to the UK).

of rules would be very useful as well. It is quite easy now to get a copy of the insolvency rules, to google a particular section. The difficulty as a layperson is that it is incredible complex. Having some simplification in the rules would be useful not just for IPs, but for the general public.
David Kerr: There have been a number of changes in the rules since 1986. There is a consolidation exercise underway at the moment with the service, and that is probably needed, just to bring it all back together into one place again.
Frances Coulson: Some of it is updating. Some people cannot cut off supplies to a business in administration, so you cannot lose your electricity, but you might lose you software licences. In this day and age, IT is perhaps almost as important, so updating in some cases is helpful.

Q53 Simon Kirby: Can I press you on that? Is there a need for anything other than updating and simplification?
Frances Coulson: It is tweaks, really. Those are the two principal tweaks that we would have said are necessary. The system does work well, and when we have spoken to various people, in Opposition and in Government, that is what our consistent line has been. It is good for rescue. All of the tools are there in terms of pursuing poor directors or rescuing businesses. In some cases, the key is having the budget and the will to do it.
David Kerr: The answer is that there probably are not any single major issues that need to be amended, but there are a series of smaller things that could be tidied up. The service has consulted on those and has a list, and they will be factored into the consolidated rule changes.
Frances Coulson: We do not disagree on any of them. It is just getting a window to do it.
Vernon Soare: Can I just make one comment about whether the system needs to change? I think that we would say that any changes must be evidence-based. We see, not just here, but in the audit profession as well, a lot of calls for change without having a good look at the evidence. I would give one cautionary note. We talked a lot about a single complaints body. As I said, if it gives better policy outcomes, well, fine. But it is interesting to note that when the Office of Fair Trading did their original review of insolvency—and a lot of that was used for the Insolvency Service's own report—the criticisms they made about complaints, for example, were based without coming to visit any of the regulators to look at what they were doing. Yes, let there be change, if there is an evidence base for it.
On the positive side, we have spoken about better engagement by creditors, particularly, where possible, HMRC, which is a big player, and also, better creditor education. I do not know how you do that, but, I think, a better understanding of things—not just pre-packs, but the whole system—is needed. We have responsibility as regulators and trade bodies to educate the media, apart from anything else, who have a lot of preconceptions. At the end of the day, the other key thing is that prevention is better than cure. If we can, we should advise businesses so that they do not get themselves into positions where they go into administration. The ICAEW has a business advisory service. We advise about 1.5 million small businesses. While I obviously do not wish to take business away from my colleagues at this table, if we can do that, and get back behind the cause, that is probably better than getting into these situations in the first place.
David Kerr: One final plea on the rules changes, any of them, including the one potentially coming in in spring on pre-packs, is to make sure that the service gets the information out so that the profession can respond to them and be consulted on them before they are set in stone.
Chair: Thank you. That concludes our questions to this panel. Thank you. I shall just say what I say to all panels: if by any chance you realise in retrospect that there is an answer to a question that you would have liked to have given but did not, please submit it in writing. Similarly, if you feel that there is an answer to a question that we did not ask but should have, feel free to do so. If we feel that there was a question that should have been asked but we did not ask it, we may well do the same to you. Thank you very much.

Examination of Witness

Witness: **Tony Butcher**, President, Prospect (Insolvency Branch), gave evidence.

Q54 Chair: Good morning, Tony and thank you very much coming to speak to us today. For voice transcription purposes, could you just introduce yourself?
Tony Butcher: My name is Tony Butcher. I am the president of the insolvency branch of Prospect. We represent what might be called the professional examining staff and directors—up to director level—in the Insolvency Service.

Q55 Chair: I shall start with a fairly general question—well, perhaps it is not that general. Has Prospect been consulted on the service's delivery strategy?
Tony Butcher: In some respects, there are two answers to this, a quantitative and a qualitative answer. In quantity terms, yes, definitely. We have no objection or complaints as a trade union, and the staff cannot have any either, to the engagement, as it was put in the submission by the Insolvency Service, which started at about this time last year and was rolled through until November, which was post the date upon which the service made a decision on what it called the delivery strategy. It started in meetings with both trade unions, including PCS, before the directing board had come to any conclusions, when it was constructing its report and doing its analysis. It showed us the results of it and told us what it intended doing. It did it. It then took on board the

recommendations from the trade unions that the service personally take ownership of it and not hide on the fifth floor of our headquarters, but go to each office to explain it and themselves, not only while the consultation period was going on, but also after the decision had been made. On those terms, the service has engaged and consulted with not only the trade unions but also all members of staff.

In qualitative terms, that is where there may be a difference of opinion between the trade unions and our senior management. One of the things that is drummed into you when you enter the Insolvency Service is "never assume", and always to test assertions that are made. When the delivery strategy was in its consultation stage and all the options were laid before trade unions and staff, in a roadshow of office visits, the staff then put on their professional heads and asked the directors the same sort of questions that they would ask directors of failed companies, that is, testing the assertions made on the basis of the options. What rather sticks in the throats of members of staff and members of the trade unions is that we do not feel that, to coin a phrase from 10 minutes ago, change has been based on evidence. When questioned, a lot of the basis of the options, and then the decisions, was founded on assumptions. We challenged those assumptions and we still do not feel that we have got satisfactory answers.

In the original terms of reference, there is no reference at all to delivery strategy so we did not concentrate on that in our submissions. There is quite a lot of literature and analysis that has been done. Can I suggest that, if the Committee wishes to see this, we can provide it to you very quickly, by email? It goes into the detail that I have just been referring to.

Q56 Chair: That would be helpful. My next question was: how do you think that the Insolvency Service has managed this period of change, but I think that, to a certain extent, you have pre-answered that. Could you summarise what you think have been the flaws in the consulting?

Tony Butcher: For the delivery strategy? Essentially, it is not evidence-based. A lot of assumptions were made on individual office requirements. The most obvious one that people noticed was that a blanket assumption was made on the number of face-to-face interviews that each office would be required to do. It did not take into account local variances. It also did not take account of the reality of the number of face-to-face interviews that had occurred over the preceding decade, or certainly in the last two or three years. It was based on a coefficient, based on expected inputs of bankruptcies and company liquidations.

Q57 Julie Elliott: In your view, what will be the impact of reducing local offices and focusing on a more regional call centre type of operation? In particular, representing, as I do, a northern constituency, there only one seems to be one office in the north of England and none in the north-east and Cumbria.

Tony Butcher: The Insolvency Service's decision to reduce its estate, which is effectively what it is, and effectively centralise certain functions, is something that we fundamentally disagree with. The Insolvency Service has, over the past 20 years—I have been in it for over 20 years—changed vastly from the monolithic entity of 20 years ago. It has reacted to all the pressures that have come on all Government services to reduce cost, such that it has streamlined its operations within the local offices. We do not feel that taking away—I am not going to say work—functions from a locale will have any long-term benefit. You lose the local knowledge, and you lose flexibility. The one reason why the Insolvency Service has put forward the delivery strategy as it has is that it is saying that it needs flexibility to deal with the fluctuations in case numbers. We have done that locally in the past. In the individual local offices, it allows the office manager—effectively the Official Receiver—to use their resources in the way that they see fit at that office.

The Insolvency Service has rather undermined itself in the delivery strategy, because in moving towards the end product—how it will be in four or five years' time, which is something we cannot see because we do not know where things will be, we just know what they believe the organisational structure should look like—it has stated that it will not be moving people. It has stated that the work can be done where people are now. Our view is that, if it can be done where people are now, why do you need to move them? That has a very large cost and a very large impact on the efficiency of the service and its ability to perform its functions. The Insolvency Service has put forward a costing for the delivery strategy, essentially for closing and rationalising offices and moving individuals, of £33.5 million. That is what is known as a big-bang cost, that is, if everything happened on the same day and went smoothly. The Insolvency Service management has conceded that the reality is that it will not be a big bang, because there cannot be a big bang. There will be double-running. Therefore the £33.5 million costing must be incorrect. We cannot see any long- or short-term benefit.

Q58 Julie Elliott: How will it work, moving into these regional hubs? What practical problems do you think will arise?

Tony Butcher: There will be an internal problem in the sense that the staff who will be moved and corralled into certain functions in a centralised location will be expected to form the core of the examining staff who do the investigation, because of the career structure. They will be corralled into at most eight places, whereas the investigations will be in another 17 places in addition to those eight. The insolvency-examiner role is a very complex one. It takes a long time to learn it because, if you think about it, you are dealing with everything. We deal with the whole social and economic interaction. The Insolvency Service has broken down the examining role into three levels, which we think is a false dichotomy—well, it is a trichotomy—in that, if you are investigating a failure or bankruptcy or a big company, you cannot know one third or two thirds of an offence, allegation or technical matter. You have to know everything. So you learn from your colleagues around you and from doing cases. There is a benefit

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for the whole, which includes what is classed as the administration of a case, to be in the same locale as the investigation of the case. Almost by osmosis, you will find things and note things. It is also an informal audit check.

Q59 Julie Elliott: There have been some significant redundancies in the past few years. What has been the impact of those redundancies and voluntary exits on the staff working for the service?
Tony Butcher: We have not had redundancies, we have had voluntary exits. We lost 474 posts in April last year. There are another 108 offers at this point, so we are likely to lose another 100. As you can tell from the figures that the Insolvency Service has provided, we will be losing a third of our workforce in just over a year. By the very nature of exits, they are likely to be of experienced staff in quite senior positions—the sort of people who are relied upon to pass their wisdom on to the generations of new entrants, which has meant that this year there has been a very big impact.
In our submission, we pointed out that the Insolvency Service may look as though it has produced the same amount of work as it had done in the past, in terms of the output being measured by disqualifications or bankruptcy restrictions, but that is a lagging indicator, because when an investigation occurs for a bankruptcy, it takes a year, and for a company it can take two years, or maybe even longer, before you get the outcome—the order or the undertaking, or the hearing of the case. The important thing to look at is how fast we are able to do our work. What we submitted was that there has been a significant impact on the ability of the Insolvency Service to progress work that was in progress. The reality of the way that staff—the disqualification investigation teams especially—had to deal with this loss of staff was that, with staff who were lost, their cases got transferred to the people who were already there or who had come in. Those cases were done or were work in progress. The cases in progress have progressed, but the cases behind lagged, and have not been done. This means that this year and next year will be when the overall impact will be noticed.

Q60 Julie Elliott: What impact has it had on staff morale? How is staff morale at the moment?
Tony Butcher: I think it is fair to say that they are all uncomfortably numb. They have been buffeted by many events. We touched on the delivery strategy that comes from a problem with the funding model for the Insolvency Service. We can go back and back, and there have been a lot of pressures on the Insolvency Service generally in the past two or three years, which have resulted in short-term decisions having to be made very quickly by the management. This has of course impacted on the staff morale, if morale is a word that we can use. The innate professionalism of the staff has resulted in the work still being carried out to a high level. But it cannot carry on that way. We can all pass on anecdotes of individuals. I do note from my contacts around, and especially at relatively senior levels on the investigation side, that the pressure is telling. They have had to assimilate not only one set of new investigators but a second set, with possibly a third set coming along, in various places where they did not have people before. Rather than managing people in one place, they are now managing new people in three, four or five places. It has put a lot of pressure on a lot of senior people. Individually, they are just about coping.

Q61 Julie Elliott: Finally, you mentioned 100 people waiting to exit the service. Are you expecting any more redundancies after that, or do you think that that is the end of this restructure?
Tony Butcher: What happens next is for management to answer. The business planning they have done for the next year is predicated on a certain level of cases coming in. If those cases do not come in, they have to deal with it and go through the same thing again, probably.

Q62 Margot James: The 11% cash cut in the investigations budget—how has that affected services?
Tony Butcher: What happened was that we immediately lost 40 short-term appointees. I was about to say, traditionally—in effect, it is traditionally—but since 1992, when the Public Accounts Committee criticised the Insolvency Service for a lack of investigatory effort, 20 years ago, we were given resources by the previous Government to investigate properly. The Insolvency Service brought in some contractors, mainly Antipodean and South African solicitors. So we brought in that talent. They have an innate knowledge and capability, but they do not have the technical knowledge so we relied on our internal managers, of whom I ended up being one, as an example, to produce work. Since then, which is 20 years ago, the investigatory effort was mainly staffed in the disqualification unit by short-term contractors. There has always been a long-term plan to reduce that and have our own staff do it, which is a good thing. We are now at that point, and it has been forced and rather rushed by events, of which that was the major catalyst or starting gun. The impact of this was that some very experienced staff, who were dealing with some quite difficult cases, had to go.

Q63 Margot James: When was that?
Tony Butcher: That was in June 2010. It was quickly followed by the VES or exit scheme. That was predicated, not on the budget cuts in 2010, but on the problems in the Official Receivers, with their income streams. It had an impact on the investigatory effort, as we submitted in our written submission.

Q64 Margot James: The investigations unit has been accused of targeting the easy-win cases. How true is that?
Tony Butcher: The investigatory effort of the Insolvency Service starts with its case-targeting, in that the parameters determine what cases are looked at. If there would be any change of the scoping of what the Insolvency Service regards as worthy cases for investigation, it would be at that point. What happened with case-targeting was that a change in directorates and management coincided with many

other events. The director, I understand, drew up what is called a public interest grid, so that they could target cases that were appropriate. I do not have specific knowledge myself of that, but I am sure that if the Committee wishes to know more details of it they can ask the Insolvency Service for it. It is a public interest grid and it scores cases. If there were to be any changing of the parameters it would be there.
Do we perceive it? In my job, I am at the other end, where the cases have been investigated and it is about to be decided whether we should disqualify someone. I see the end point and the fruits of it. The case mix is no different from what I have seen before, so I cannot honestly say that we have seen a different case mix. That is not quite the answer to your question, but if there were to be a change in the scoping, it would be at the case-targeting stage—once it has passed for investigation, it is investigated thoroughly, or as thoroughly as it can be.

Q65 Nadhim Zahawi: We have received evidence that the staff making the decision to refer complaints for further investigation are of junior grades. Is this true, and if so, do these staff have adequate training?
Tony Butcher: As a branch and as members of the Insolvency Service, we would hold to the Carltona and Philips principles of differentiating between investigators and prosecutors, and also of the right people making the decisions at the right grades. When the change in that case-targeting occurred, we did make inquiries about the appropriate people making the decisions. I cannot tell you that I have got a definitive answer to give you. I cannot give you that because we did not get a definitive answer. We do know that the change in case-targeting resulted in a change of processing, which I understand included the idea that now when "D" returns or complaints come in, they are measured against the grid to which I referred. So the actual mechanics of that is something that I would suggest that you can ask in detail from the Insolvency Service management team themselves. The perception of staff is that, because there was such a large set of changes, especially in that area, that gave rise to suspicion. There was a perception that there was an introduction of people at a lower grade to do some part of the work. As to whether that was simply to do with bureaucracy and not a qualitative decision—I am sure that that is something that you would wish to ask the Insolvency Service itself.
I think that you might be referring to Mr Clough's submission. He used to work for what was called the Companies Investigation Branch. I have made some specific inquiries about that, in terms of how that section has been rearranged. In effect, it is different labelling of what already existed. The critical point for us in relation to how the Insolvency Service has been able to perform is that it coincided with the budget cuts I referred to, plus the VES scheme that resulted from the Official Receivers having to cut the number of staff. It is to do with people leaving and new people coming in and needing to be trained. It is part of the lagging indicator that I referred to and the lagging problems. It is because we have had to move so many people around to do so many new things, all at the same time.

Q66 Nadhim Zahawi: So, could it be that the levels of complaints have also decreased because of a perceived lack of confidence in the process?
Tony Butcher: I do not know why there is a lower number of complaints. The Insolvency Service, within the relevant directorates, is making inquiries and has put people on to specific reporting to find that out. They have not reported yet as far as I know. Specifically in regard to the number of criminal referrals, I know that that has been noted and is being investigated. It is ongoing, so I do not know what the answer to that is.

Q67 Nadhim Zahawi: Do you think the service could do more to explain how it prioritises the cases which are targeted for enforcement action?
Tony Butcher: If the insolvency practitioners who input on company disqualifications—if we are talking about that—are not aware of what our prioritisation is, that would suggest that there is a need for it.

Q68 Ann McKechin: Tony, your union has expressed concern about the current funding model for the Official Receiver Services. Could you quickly outline what your main concerns are?
Tony Butcher: Seven or eight years ago—within the last decade—the way in which the Official Receivers were funded changed. Before then, in essence, the Insolvency Service went to its parent department and said, "This is how much money we need to do what we need to do", and it got it, or thereabouts. But then it was changed. Now, Official Receivers have to effectively break even and get in as much as they spend, which is why there is a so-called notional loss. We think that that is fundamentally flawed. It is completely irrational. The clue is there in what we are called: we are called the Insolvency Service. We are dealing businesses and individuals who have not got any money or assets. We are going to deal with a lot of cases where there are no assets or only minimal assets, which will not contribute to paying the administration fee that we are supposed to charge and recover. The reality is that, in the simplest terms, in the present funding model the Insolvency Service is given an amount of money for the Official Receivers, and then has to give it back. It gets it back by charging fees, which means that over a three-year cycle we are supposed to break even. We think it is thoroughly irrational. We also think that it is unfair on creditors. We do not think the creditors should be funding absolutely everything. The Insolvency Service and Official Receivers exist for a reason. We are dealing with failure and performing a court function and a function of the state.

Q69 Ann McKechin: Your proposal is that there should be further Government funding of the service. If I could put the contrary argument: given that this involves, in effect, people who enter into private commercial contracts and take a risk that the person that they supply the service to may not have enough money to pay the bill at the end of the day, why do you think that the taxpayer should be taking an increased share of the cost, given that there are,

frankly speaking, likely to be more of these types of cases?

Tony Butcher: I would not like to sidestep this, but I was thinking about this on the way down, and I remembered that the Insolvency Service, with all that it does—and it does a lot of things—had running costs of £203 million. They were reduced to £143 million. Now, that figure is going to reduce even more. I have a simple proposition: why don't we give the Insolvency Service £143 million and ask Mr Speed, who is the chief executive, "What can you do with that?", because we will not be spending any more money then, will we?

Q70 Chair: I think by the silence—you say, "We will not be spending any more money", but surely they are supposed to get it back. How would they get it back? We have heard one half there. We would like the other half.

Tony Butcher: Our contention is that the Official Receivers section should not be expected to break even. It should be expected to make recoveries that contribute to reducing or mitigating the cost of running that side of the business. The consequence of the suggestion I made, which brought silence in the room, is that, if we follow that logic towards the investigation side—and I am sure we are going to come on to how to fund that—there is a block on utilising the resources of the Insolvency Service, which is people. You cannot send investigation cases to the Official Receiver to do. You cannot send the people in the Official Receivers to do the investigation, because if that happens, it comes out of the cost of IES, the £32 million that is given to investigate.

So, if the Insolvency Service was told, "Here is the money, here is £143 million—do it", it could use that money, that is effectively in the Official Receivers' offices at the moment as an untapped resource, to do that extra work. It is not extra money in terms of the Government giving us extra money. It is producers being allowed to produce more with the money that we are being given.

Effectively, we have to recognise that the very nature of the Insolvency Service is that it is going to be unable to recover its costs, because it is dealing with insolvent businesses. The present funding model is thoroughly illogical. Not only does it produce the effects that I heard you describe earlier, in the present economic cycle, if case numbers go up and asset values do not, then the notional loss increases even though there is a need to have more resources to process and investigate more cases. That is built in to that funding model. It is thoroughly illogical.

Q71 Simon Kirby: I want to ask a hypothetical question. What would you say to a small business in my constituency that might welcome the savings of £60 million, say that you are being very selfish, and would welcome the money to cut corporation tax, VAT and red tape and try to remain solvent? That is, at the end of the day, what we want—jobs and employment. As a hypothetical supplementary question, that same business might ask how and who pays for the 500 union members that are employed by your union?

Tony Butcher: I will leave that matter aside, about who pays for the 500 members.

Simon Kirby: I was just wondering.

Chair: I do think that that is part of rather a different issue and we need to focus on the purpose of the inquiry.

Tony Butcher: Why does the Insolvency Service exist? That is my starting point. Why does the Official Receiver exist? The Official Receiver came along as a statutory officer of the court in the 1880s because of scandals in the private sector in Victorian times, which was not administering insolvent estates in an appropriate way. The Insolvency Service and the Official Receivers have a basis in fact and reality about what can happen when a market goes wrong. That is what we do. The present Minister of State has often been quoted as describing us as the plumbers of the economy. If you do not get the plumbing right, the whole house falls down. It is a value judgment that Government will have to make, and the Committee can make a recommendation in terms of what is it right to do in terms of policing the market and ensuring that rogue and incompetent business entities are removed.

Q72 Simon Kirby: I accept all of that but my question is, in a climate of limited funds, how do you justify arguing for increased spending? Every other part of Government is having to make these difficult savings.

Tony Butcher: We have already had £60 million of savings in a year, which is a huge amount to lose. It is just under a third of a relatively large organisation. To reduce it further may render the organisation incapable of performing its statutory functions. It will come to a point where it has to make a decision as to what its priorities are within its statutory obligations, and some of those may not get done. If they are not being done, that will impact ultimately on small businesses—small businesses are the ones that get hit most, we can see that—and the taxpayer, ultimately through HMRC. If people are allowed to remain hiding behind limited liability, they cause an imbalance in the local market. The worst thing that can happen to a local business is another local business taking them for a ride. You can say, "Something must be done about it"—well, we are the something-must-be-done people. The Insolvency Service is the backstop. If we do not do it, no one will. If you want something done, we are the people to do it.

Q73 Ann McKechin: On this element about the fee level, I take your point about how we have debtor petition bankruptcy cases, and if people do not have any money, then how much can we reasonably ask them to pay as a fee? If it is too high then presumably your argument is that people will not present themselves for bankruptcy.

Tony Butcher: Sorry, I misunderstood. That is a slightly separate issue. That is about the bankruptcy fee, to make yourself bankrupt or be made bankrupt. That is different from the administrative fee that feeds

into the funding model. There is a school of thought within the Insolvency Service that we are effectively pricing ourselves out of a market. We do not like to refer to it as a market, because we do not think it is a market, but if we think of it in those terms, we are making it too expensive to go bankrupt. If you look at the alternatives, they are cheaper, in the sense that there is no immediate cost to individuals. The consequence of that is that people in dire financial straits are more likely to go down another route. Whether that is the right route or not is a moot point. It is certainly noticeable, and has been reported back by members in each Official Receiver's office, that the reason why we are getting a lot of cases where people have no assets is that we are getting a sizeable number of cases where the assets have gone because they have gone down another route.

Q74 Ann McKechin: The more profitable ones are going to the debt management companies?
Tony Butcher: Yes, you can say that. There is nothing left. We are just left with an eviscerated husk, which is another reason why we have financial problems. It is also another reason why we are there—we are performing a function of public good.

Q75 Katy Clark: The figure of a cut in the budget of a third in a year is absolutely massive. Could you outline very briefly how that has affected the service in terms of the amount of work that has been carried out and the quality of the service?
Tony Butcher: Briefly? The impact, as I have alluded to and described earlier, is internal change on a huge scale. The consequence of that is that things get delayed, essentially. I shall concentrate on the enforcement side, because that is what the terms of reference were—unless you want to talk about something else, like the Official Receivers. On the enforcement side, because of the internal chaos—I would use the word "chaos", but I am sure that senior managers would not be happy with that; I am sure she is smiling behind me—things are not done quickly. If things are not done quickly, then insolvency practitioners are effectively saying, "What are you doing about something? I sent this six, eight, nine or 10 months ago, and have heard nothing about it". They have heard nothing about it because we have no one to give it to at that point.

Q76 Katy Clark: So you are saying that there are bigger backlogs?
Tony Butcher: There is a backlog.
Chair: I will move on to the bad debts write off. In the context of this, I believe something like £81 million was written off in 2010–11. Can I just bring in Katy on the last annual report?

Q77 Katy Clark: The last annual report from the Insolvency Service stated that £15.7 million, I think, of bad debt had been written off to the cost of the taxpayer. What do you think are the reasons for that and in your opinion is that acceptable?
Tony Butcher: This really flows from the flawed funding model and the nature of insolvency. What it refers to is the funding model being that we charge a fee and try to get the money back. If we do not get the money back, it goes down as a bad debt. That is all that it is. In previous times, that was regarded as just being the cost of dealing with insolvency—that there are cases where there are no assets, and there is insufficient income, so you write them off as a bad debt, because they are and that is just the way it is. The question within the accounts—if is just an accounting matter and whether the Insolvency Service was correct in deciding that a figure of 12% was right for bad debt write-offs or if it should have been higher—is, to be fair to management, in a sense looking at things in hindsight. The economic cycle is an unusual one. We have had a big recession. Whether they would have the ability to guess that it would be greater than 12% is something that I would not like to criticise them on. I think that is was unforeseeable. I would not say this area is a red herring, but I think that it is a recognition of the impact of the funding model. It creates a notional loss. You are basically creating a balance sheet on which the Insolvency Service looks insolvent.

Q78 Chair: I can see the basic problem with the model insofar as if you have a statutory obligation and, in order to fulfil that obligation, it costs so much money, and you are supposed to compensate by fees from the organisations you are dealing with, if they cannot contribute those fees, then obviously you are caught between a rock and a hard place. It comes back to the prioritisation issue. Is there an argument, given your limited resources and the funding issue, for prioritising those cases on which you can actually get a return?
Tony Butcher: Can I ask you to be more specific? The Insolvency Service is a very big organisation and it works in very different ways. Are you talking about the Official Receivers here?
Chair: Yes.
Tony Butcher: We have a statutory obligation. We have to do what we have to do under the Act.

Q79 Chair: So is it simpler, with a company where there is absolutely nothing there, and there are no assets—
Tony Butcher: If there are no assets, there are no assets. There is nothing to retrieve, so therefore there is a notional loss. It is the same with bankruptcies.

Q80 Chair: What I am trying to say is could you have, if you like, one model of service delivery for such a company, where there are no assets, and another for a company where there were assets?
Tony Butcher: That appears to have intellectual coherence, but the reality is you do not know what the asset position is until you investigate it. You rely to a large degree, at the very first instant, on the director or the bankrupt providing you with information. Accuracy of that information depends on many factors, which could include the honesty of that individual. It could also be that they are not recognising what they are being asked to provide. It is only after you have done an initial investigation or perusal—whichever phrase you wish to use—that you

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can assess whether there may be further assets. Especially in bankruptcy, there are a lot of referrals to the Official Receiver for matters which they could not possibly know at the time. So, it is post-event that they get told that somebody has got something or had something at the time. So if you decided to separate out cases at an early stage, saying, "This is a NINA—no income, no assets—and this one is something else", another acronym that I cannot think of at the moment, then you have to have the mechanism to move it from one place to another. You are creating essentially unnecessary bureaucracy within the system. If you treat every case the same, you will find things or not find things. With the ones where you do not find things, you just have a notional loss.

Q81 Chair: Have you just created a new word for the Insolvency Service or did it exist before?
Tony Butcher: What one is that?
Chair: NINA?
Tony Butcher: I have stolen it from the Insolvency Service. I will not claim that.

Q82 Chair: I think that you have explained that last point very lucidly. Thank you for your evidence. I will repeat what I said to the previous panel: if you think that there is anything else that should be added, please feel free to submit it.
Tony Butcher: I will submit to you by email the thing that I referred to earlier.
Chair: Thanks very much.

Tuesday 7 February 2012

Members present:

Mr Adrian Bailey (Chair)

Paul Blomfield
Katy Clark
Julie Elliott
Rebecca Harris
Margot James
Simon Kirby
Ann McKechin
Mr David Ward
Nadhim Zahawi

Examination of Witnesses

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

Q83 Chair: Good morning, and thank you for agreeing to come before the Committee. Could you just introduce yourselves for voice transcription purposes, to make sure we have the right levels and everything?
Stephen Speed: Good morning. My name is Stephen Speed; I am the Chief Executive of The Insolvency Service.
Graham Horne: I am Graham Horne, Deputy Inspector General in charge of the Official Receivers business.

Q84 Chair: We have a lot of questions; obviously, you do not both have to speak on every question but equally, if there is something you want to add to or disagree with—I am sure you will not—then feel free to do so. It seems odd on the surface: the economy shrank in the last quarter of last year, but there actually seems to be a drop in insolvencies. Can you explain why?
Stephen Speed: I am not an economist, so it is very difficult to explain. There was a drop in personal insolvency; there was an increase in corporate insolvency. I can speculate. It seems to me that there was a huge increase, as you know, in bankruptcies and other sorts of personal insolvency throughout the last decade, which was probably a product of easy credit, easy lending and easy borrowing. My own view is that we are seeing that unwinding. What the recession did on top of that was change behaviours. It has restricted people's appetite for borrowing and it has restricted lenders' appetite for lending. So it is not entirely surprising that we have seen levels of personal insolvency level off, and in the case of bankruptcy fall rather dramatically, because the whole cycle of lending and borrowing has changed quite dramatically since 2008–09.

Q85 Chair: Could you say that people are behaving themselves a bit better?
Stephen Speed: That is not really for me to say. One of the indexes that we track when we look at what is happening in bankruptcy, as well as GDP, is the average level of household debt. I cannot tell you exactly when, but that peaked a little while ago and, if anything, I think it is declining slightly. Something has changed quite fundamentally, in that people's appetite for credit is not the same as it was a few years ago, and clearly nor is lenders' appetite for lending.

Q86 Chair: You make the point that corporate insolvencies are on the increase.
Stephen Speed: Corporate insolvencies rose across the board by about 5% last year compared with the year before. The only major type of corporate insolvency that broke that trend was administration, which was ever so slightly down on the year before.

Q87 Chair: Frances Coulson, the President of R3, said, "We are seeing a large number of what we have termed 'zombie businesses'—businesses that are limping along and not going into formal insolvency," presumably because it is not worth their creditors actually taking action to put them into insolvency. Do you think that, as the economy improves, it may perversely lead to an increase in corporate insolvencies?
Stephen Speed: I would not want to speculate on what may happen in the future. Frances and her colleagues in the profession are probably closer to the dynamics of that than we would be. We do not deal with a great deal of corporate insolvency ourselves in the Insolvency Service. On the basis of the experience of previous recessions, it would be fair to say that there does tend to be a significant lag, beyond the end of a recession and into recovery, of businesses having difficulties and becoming insolvent.
Chair: You have developed a future service delivery strategy, and I want to bring in Nadhim Zahawi to ask some questions on that.

Q88 Nadhim Zahawi: How challenging has it been to reduce the Service's annual costs by 30%?
Stephen Speed: It has been extremely challenging. We have reduced costs by about 30% in around 18 months. Unfortunately, the biggest part of that cost reduction has had to be saying goodbye to a lot of really valuable people in the Service. That is both people who have been working for us on a temporary basis—we had hired quite a number of temporary staff as case numbers rose during the last few years—but regrettably in April we had to release about 18% to 19% of our permanent work force in one go. That was incredibly difficult and has had some operational consequences for us during the course of the last financial year.

Q89 Nadhim Zahawi: Would you say that 19% reduction in staff has been disproportionately amongst

high-quality investigative staff? Where has that come from?
Stephen Speed: We are very lucky in the Insolvency Service in that we have a very high quality of really professional staff at all levels right across the country. The changes we needed to make last April were really targeted across most of the grades we have. We are very lucky in the sense that we have a wonderful group of people still working for us, and we have been able to recover from the shock of losing those people reasonably quickly.

Q90 Nadhim Zahawi: How many cases do you deal with a month at the moment?
Stephen Speed: Insolvency cases? We are going to have about 43,000 cases this year. So if you divide that by 12, it is about 3,500 a month. Is that right, Graham?
Graham Horne: Yes, it is on a slightly downward trend, so at the start of the year it may have been nearer 4,000, but it is now about 3,200 a month.

Q91 Nadhim Zahawi: Do you think that is partly because of the reduction of the resource—i.e. the staff are stretched and are therefore investigating less?
Graham Horne: No, it is purely a function of the fact that fewer people are making themselves bankrupt. Of all the various types of insolvencies that we deal with, the one that is falling is what is called a debtor's petition bankruptcy, where someone makes themselves bankrupt. Those are the types of cases that are falling, and because we have fewer cases to administer, we need fewer people to do that. That is why we ran the two voluntary exit schemes: to match our staffing resource with the number of cases we have to administer. It is not related to the amount of investigation work that we have to do.

Q92 Nadhim Zahawi: We have had some anonymous evidence—and I must caveat that—saying that the fall in complaints has been due to staff redundancies and, therefore, not having sufficiently experienced staff to register those complaints. It suggested that the figures are adjusted by you, Mr Speed, using an unknown formula. Can you share with us what formula you use?
Stephen Speed: There are a number of issues built into that. We started the conversation talking about the work the Official Receivers do. I think that allegation is actually aimed at the investigative enforcement work that we do in the Service as a whole, so that is a slightly different part of our work programme. I am very happy to refute that completely: there is no formula and there is no changing of the figures.

Q93 Nadhim Zahawi: So the figures are the figures?
Stephen Speed: The amount of people who work in our investigation enforcement area, which we may be talking about later, is actually slightly more now than it was this time last year. The Insolvency Service is a federation of five separately funded businesses. Graham's business is by far the largest, but it is not the only one.
The area your question was about is actually a taxpayer-funded part of the organisation, which does investigation and enforcement. That is not the part of the funding problem we have had to fix in the last 12 months. The funding for that has been relatively stable, certainly in this financial year. So in that area, the consequences have been more to do with staff turnover than with the loss of staff. That is because we had a significant number of temporary staff working in that area, and we were able to release those staff and take across staff from the Official Receiver's office who had become surplus in that area. So in that way we have managed to save some jobs, but we have also moved people across from one type of investigation work to another, where the skill sets are really very similar. There is no formula.

Q94 Nadhim Zahawi: You touched upon it just now, but can you just articulate what the current priorities are for the Insolvency Service and whether you have enough resources to fulfil those priorities?
Stephen Speed: We have some big challenges ahead of us, so let me try to articulate what those are. First of all, we need to work with the Department to resolve some of the short-term funding problems that we now have as a result of losing not far short of about half of our debtor's petition bankruptcy cases. As you may have seen, our case numbers in total have fallen from about 78,000 to about 43,000 this year. So that would be the first one.
The second one would be that we have articulated a future vision for the Service and a delivery strategy aligned to that. It is very important now that we press on and turn that into an implementation plan. Again that is something we will need to do in partnership with the Department, because it will probably need some financial support.
The third priority for us as managers in the Insolvency Service is really to do what we can to reengage with our work force. Our work force has had a very difficult 12 months: a lot of them have had to leave; others have been given news, because of the shrinkage of the Service, that is not welcome to them, and they are understandably unhappy about that. So we need to work with the whole issue of staff engagement. One of the keys to that is about giving people certainty about what is going to happen to them at an individual level, which we have not yet really been able to do to the level they would want. So even if it is difficult news for individuals, they would like to know what it is.
The fourth point—and these are not in order of priority—is that we have to maintain the levels of service we have had in the past; this is fundamental. We have been able to maintain this fairly well through the difficult period we have had over the last 12 months, so being able to maintain that going forward has to be a priority for us.

Q95 Nadhim Zahawi: And you think you can do that?
Stephen Speed: Yes I do.

Q96 Nadhim Zahawi: You mentioned the future investment. Can you just say a little bit more about where you are in terms of your consultations with the Department and the trade unions on that?

Stephen Speed: Yes, I can. I would like to say that we have had an excellent working relationship with both the Department and our trade unions—I understand that one of the trade unions provided you with evidence during your session two weeks ago—and we have been working very closely with the trade unions. We did a full consultation with our staff over the course of last summer about how we would like the future of the Insolvency Service to look. We set some options out in that, but we were clear that we thought there was a preferred option for the future. That was built primarily around the idea that we need to start to separate out the front-office and back-office processes to bring greater efficiency and flexibility.

Through the late autumn and into the current period, we have been talking to the Department about getting confidence around the strategy. We are now about to go into a process with the Department that I hope will lead to a fully costed set of plans for how we will implement all of this. I would like to see that in place by the summer so that we can crack on with that. It is quite a big job; we are talking about a fairly major restructuring of the way we work.

Q97 Nadhim Zahawi: That begs the obvious question: if morale is low because of the uncertainty, how certain are you that you are going to be able to deliver on this big job? It is hard enough doing it when morale is stable.

Stephen Speed: Do you want to talk about the last year?

Graham Horne: One thing we do is try to make sure the changes we introduce are not "big bang". So they do not happen all at once, which would be very disruptive. We would try to set out a programme of events, so that people realise there will be a period of time and so that the agency could react to that. At the moment, we are trying to introduce the delivery strategy in what we call a virtual way, without moving people around, so we can get used to the structures we want to put in place. This is a way of de-risking the eventual delivery strategy, so we can get used to new ways of working and can see what the problems are with those new ways of working before we go to a physical implementation.

It is really just about talking to staff on a regular basis, talking to the trade unions, explaining why we have to do things and seeking their input. They are the people at the front line, they know what they are doing, they know the job and we need to get their input into what we do so we can design it in the best possible way. It is not going to be easy; that is certainly true.

Stephen Speed: I would just add that, as a Board, we have a huge amount of experience in insolvency. What we may be lacking is specific expertise in big change management, both the hard-nosed programme side of it and also the softer skills as well. Over the next couple of months, providing we can agree a way forward with the Department, we will be looking to strengthen the Board a little bit in that area.

Q98 Nadhim Zahawi: That is crucial.

Stephen Speed: Yes, that is probably one capacity we do not have enough of at the moment.

Q99 Nadhim Zahawi: My last question is about the current case prediction model. Models have proved fallible in the past, particularly in predicting changes of direction. Are they really sufficiently reliable tools for you to base a delivery strategy on?

Stephen Speed: The answer to that is that they are a guide. They have predictive value at some points in the business cycle and less predictive value when the gradient of the curve is steep, as it is at the moment. It is probably best if I say a few words about how we do this. I do not know anybody—either in the profession, in the City or in the banks—who actually has a strongly predictive model for bankruptcies in particular; remember, we are trying to isolate bankruptcies from the rest of personal insolvency remedies that exist. We have our own statistical model, which, as I said earlier, is based on GDP, average debt per household and so on, and we run that model. I ask Graham's Official Receivers around the country to use their local knowledge and intelligence about what is going on in their parts of the country as well, and we get some data from that side.

Then, about two or three times a year, we gather together a group of people to talk this through. That group of people includes economists from big banks in the City, insolvency practitioners—we usually invite Frances Coulson or whoever is in her position—debt advisers—people who work in the debt advice sector and who see that sort of thing first hand—some of our own non-executive directors, economists from the Department and statisticians. We sit together in a room, look at all the data we have and come to a view. There is not a science but we take the best view that we can.

Q100 Nadhim Zahawi: So, basically you have some quantitative data and then there is a bit of qualitative data and a bit of thumbing to come up with what the view is.

Stephen Speed: Yes, and I would say openly that it is never going to be a perfect science. It has been difficult in the past and I do not think it is going to get any easier. One thing that is interesting is that the rate of decline of bankruptcy at the moment is unprecedented. The gradient of the curve is very steep. It has taken us by surprise, I have to say; it is not the way bankruptcy usually behaves after a recession. But because it is so steep, it is going to have to level off at some point, and that point is going to be sooner than it might otherwise have been. So although we are going through a period of terribly difficult instability at the moment, we can foresee a point in maybe a couple of years' time where we will have started to level out again.

Q101 Ann McKechin: I wonder if we can look in particular at the issue of funding and the Official Receivers, Mr Horne. When we interviewed the trade union representative, he said, "We are going to deal with a lot of cases where there are no assets or only minimal assets, which will not contribute to paying the administration fee that we are supposed to charge and recover." Does relying solely on a fee-generated income make it difficult to predict what level of service you can provide?

Could you also comment on one other question we asked the trade union side? There is an increasing use of debt management companies by many private individuals these days, and they sell their services exceptionally hard. Some people might say they are actually creaming off the more profitable side in terms of recovery, and that you are left, more and more, with the cases where there are absolutely no assets to recover. Would that be true?

Graham Horne: We have always said that bankruptcy is a very serious last step for people; it is something they should not enter into lightly. So it is not something that we would want to go out and market, saying, "Why don't you go bankrupt and get some debt relief?" It is a very serious step for people to take. We have to take all the cases; we cannot choose not to take cases, so we have to take all the cases where the court makes orders. Approximately half of them do not have any assets, but we do get the deposit the debtor has to pay to make themselves bankrupt, so we do get a contribution to our costs.

The whole system is designed around cross-subsidy, where cases with assets pay for those without assets. That model is fine in times when case numbers are fairly static and when asset values are static. What has happened recently is case numbers have fallen far more quickly than we expected and asset values have also come under strain as the recession has bitten. That has put that funding model under some strain, and that is why we had the deficit we had last year. It is a model that can work in good times and is proving difficult in these particular times.

In 2010 we made some changes to the funding model to try to improve our cash flow. Essentially, someone has to pay for debt relief; if you want to give people debt relief, someone has to pay for it. That can only be the taxpayer, the creditors or the person themselves. Striking the balance between those three is what Ministers have to do to decide who should pay.

Q102 Ann McKechin: If we have a situation where there are more and more cases where there are in fact no assets, and if these people are trading anyway and are not made insolvent, it presents a danger in the commercial world that these people are allowed to continue and accrue debts. It is a danger to people who are doing business with them potentially. So I would say there is an issue of public good and also the balance of to what extent you think it is fair for the creditors to take on the entire onus of the fees in cross-subsidisation in the model you currently have to implement.

Graham Horne: The cases that cause difficulties are not the trading cases. Trading cases tend to have some assets in them. The trading cases where people have been in business, such as a small grocer's shop or whatever, are not the ones that cause us difficulties. The ones that are causing us difficulties are what we call consumer bankrupts, where they have credit card debt and make themselves bankrupt but do not have any other assets. What we would want to do is look at our funding regime to see whether that balance needs to be altered. It could involve saying to the bankrupt themselves that perhaps they should pay more for the cost of administrating their bankruptcy, bearing in mind they get debt relief. If you are getting debt relief of over £30,000, maybe it is not unreasonable for you to pay slightly more than £500.

Q103 Ann McKechin: Am I right in thinking that in your Service they have to pay an upfront fee?

Graham Horne: You have to pay a deposit at the moment. To be bankrupt you have to pay an upfront fee of £525 already.

Q104 Ann McKechin: If you go to a debt management company, they take the fee over a certain period of time, so they have an advantage.

Graham Horne: The advantage that debt management companies have is that you can pay that by instalments, whereas ours you have to pay up front. That is one thing we would want to look at.

Q105 Ann McKechin: So that is one of the things you might be examining?

Graham Horne: Absolutely: whether the fact people have to pay it all in one go is a barrier to bankruptcy.

Q106 Ann McKechin: Obviously there is a pretty long timeline between the date when someone actually declares themselves bankrupt and goes into liquidation and the time when you recover assets and, presumably, your fees. As you have pointed out, you have this very steep downward curve, which means—if you look at the figures from last year—it potentially could be another two years before the full impact falls on to your Service. Some people suggested that you are trying to keep too many of the complex cases in-house and that you might do better to try to outsource some of those complex cases, because you are never going to make real money out of them. Would you like to comment on that?

Graham Horne: It does not really matter to our finances whether we do the case or an outside practitioner does the case, because our fee has to be paid whoever does the case. We are not resourced to do complex realisations and asset recoveries, and we do not tend to keep those cases. If it is more than a simple, straightforward asset recovery case, we will seek to get an insolvency practitioner involved, because we are not resourced to do it and we are not skilled to do it. The only cases we keep are cases with low asset values and comparatively simple realisations where we think the creditors will possibly get a better return than if we also had an IP's remuneration on top.

Q107 Ann McKechin: Would it be fair to say the Service may require further restructuring if the figures are going to change?

Stephen Speed: My view is that the Service does require restructuring. We were talking about that earlier. It is for that reason that we went through the process during 2011, and indeed a little earlier, in 2010, of starting to look at what that restructuring needs to look like.

Q108 Ann McKechin: Would that potentially involve reducing your staffing numbers in the Service further?

Stephen Speed: The restructuring itself is not linked to staff numbers. We want to make the Service operate differently from the way it does at the moment. The thing that is driving staff members is going to be the volume of cases. Clearly the volume of cases is falling rapidly. We are running a second voluntary exit scheme for staff at the moment, and unfortunately I cannot rule out the possibility we might have to do that again in the future.

Q109 Ann McKechin: The danger is if there is a sudden upturn in cases. For example, if the interest rate increases, so will mortgage repossessions, which very often ends up in bankruptcy cases, or if there is a recovery in the economy, as insolvency practitioners have suggested, you will see an increase in cases. To what extent do you believe you will have sufficient staff, resources and capacity to deal with any increase in cases as and when that arises?
Stephen Speed: That is a very good question. We dealt with rising case numbers very successfully throughout the last decade. From about 2003 right up to 2009, cases were rising quite steeply. The way we did that was to use temporary staff. Temporary staff have become a bit more expensive because of the Agency Workers Directive but that possibility still exists. It is also the case that, as we make the business smaller, we are doing it slightly behind the curve. You have to do that, because you still have a stock of cases to run. So we can probably afford for cases to go up a modest amount without having to worry too much. After that we would probably need to think about in-sourcing some of the flexibility we would need, as we have done in the past.

Q110 Mr Ward: I have a question at this point because it does not fit in anywhere else. I am just interested in getting your feel about this. We are obviously spending a lot of time looking at the support the banks are giving in terms of lending to businesses. How have the banks been behaving? Is it the Mark Twain idea of taking the umbrella back when it starts to rain? What has the general support been from the banking sector towards businesses in distress?
Stephen Speed: I regret to say that I do not feel very well equipped to answer that question. We focus mostly on personal insolvency in the Service.

Q111 Mr Ward: Personal insolvencies have gone down but corporates have gone up.
Stephen Speed: Yes, corporates have gone up. In particular compulsory winding-ups have gone up by about 15% year on year. That is due to the actions of creditors. They may be banks or it may be the Crown.
Mr Ward: The unsecured ones are probably the banks themselves.
Stephen Speed: The banks and the Crown would probably be the two largest groups, yes.

Q112 Chair: On this issue of staffing, I was looking at the graph provided concerning the number of insolvency cases. Going back to 2001–02 there appeared to be about 28,000. That obviously peaked in 2008, 2009 and 2010. Now we are running at around 50,000, which is a substantial reduction. What are your relative levels of staffing now as opposed to in 2001–02?
Stephen Speed: Graham, it is probably best if you answer that for the Official Receivers.
Graham Horne: Since 2001–02 we have undoubtedly become more efficient, so I suspect we are probably back at the same staffing levels now, with 40,000 to 50,000 cases, as we had in 2001–02 with 26,000 cases. Over that period of time various changes to processes and various improvements within IT have made us more efficient. So on the Official Receivers side, we are about 1,300 people, which I suspect is about the level we were when dealing with fewer cases in 2001–02.

Q113 Chair: So you are doing probably 80% more with the same level of staff now.
Graham Horne: I do not think it is quite at that level. This is from memory—I do not have the figures in front of me—but we probably had 1,400 people in total, of which some 1,100 were in Official Receiver Services. We are more efficient, but not 80% more efficient.

Q114 Paul Blomfield: I wanted to explore a similar thing about the impact of reductions you have had to make in relation to the investigations unit. Only one in four cases of "adverse" director conduct ends in disqualification, and there is a lag of 18 months for investigations. Do you think that is a result of the 11% cuts and has that been a cut too far?
Stephen Speed: We took an 11% cut along with most of the BIS family in June 2010. That cut has certainly had some impact, but my own feeling is that the organisational change we have been going through this year, which I described earlier, and will continue to go through a little bit next year, has probably had an effect as well. Overall the number of directors we were disqualifying had actually increased year on year until last year, when we did about 1,437. So I do not think there is any direct evidence that you can point to yet.
The problem with this, as you said yourself, is that the cases take quite a long time. That is because the insolvency practitioner or the Official Receiver is doing their job in asset realisation, and then reports are submitted to the Secretary of State after six months or so. These investigations require a decent quality of evidence before we can start proceedings against directors or against bankrupts. In the case of bankrupts, we have to do them within a year, and in the case of company directors, we have to have issued proceedings within two years. We try to issue proceedings within 19 months, so there is a five-month window where we can operate beyond that. It has been difficult in the last couple of years, but we have managed to keep the show on the road reasonably well.

Q115 Paul Blomfield: I just want to pursue the point you are making about the timeliness of progressing investigations. Is it fair to say that you have been falling significantly below your own targets for progressing cases within a 19-month timeline?

Stephen Speed: No, I do not think it is. We met that target last year. We published it in our annual report and accounts, and I am pretty sure we met that target. The current position this year is that we think we are going to meet the 19-month target, as far as I know.
Graham Horne: You may be referring to some of the evidence from the trade union side, where they are referring to internal targets we set ourselves for stages of the process. We do set challenging targets to try to encourage our staff to move things on as quickly as they can, but the overarching target is to launch proceedings within 19 months. That is the one we are achieving. It is very important that, if you are going to disqualify someone, you do it at the earliest possible opportunity.

Q116 Paul Blomfield: Within 19 months?
Graham Horne: The target is to launch disqualification proceedings within 19 months of the insolvency.

Q117 Paul Blomfield: But on your own internal targets, as of an internal performance report in November 2011, on Official Receiver cases you were at 83% and your target was 100%.
Stephen Speed: By the end of this year, which is only about six or seven weeks away, the indications are that we will meet the 19-month target across the totality of cases that go through that route—director disqualification cases.

Q118 Paul Blomfield: But if those figures are right, as of November, you were substantially behind.
Stephen Speed: Yes, we were behind that target earlier in the year.

Q119 Paul Blomfield: The target for 19 months?
Stephen Speed: We were behind the 19-month target earlier in the year, but we have recovered, and that was due to some of the disruption I have talked about. It might be worth me saying—and I may be repeating this, for which I apologise—that that part of the Insolvency Service has had a 30% staff turnover as a result of the disruption we had when staff left in April. So one in three of our investigators working on that type of work is new. We were certainly not meeting the target earlier in the year but, as I said to you, the indications are that by the end of the year we will have met the target for the year as a whole. That emphasises the point I was trying to make earlier, which is that I absolutely accept that we suffered a bit of a setback earlier in the year but we have done quite well to recover the position overall. I pay tribute to our staff, who have been the principal reason why that has been able to happen.

Q120 Paul Blomfield: I would like to probe on another area: live company investigations. In your annual report for 2010–11, you stated that there has been a 39% decrease. Now, is that because of changing patterns of work or is that as a consequence of the savings and the impact on the Service?
Stephen Speed: Can you pick that one up, Graham?
Graham Horne: These numbers change from time to time. These are comparatively small numbers; it depends on how many complaints you have had and whether you are dealing with groups of companies or individual companies. We have a prioritisation model, and what we try to do is put all our insolvent cases we need to investigate and all our live cases through a model and try to work out which is the best set of cases to use our resources on.
With complaints about live cases, you often have very little information about the company apart from someone saying, "We do not think this is quite right; we do not think we are being treated properly." Whereas, in an insolvency, you have a failure; creditors have lost money, and you really should have some investigation as to why creditors have lost money. So in allocating the resource, we try to make sure we allocate it in the way that best addresses the interest of the public and the people who have lost money. So there is often a mixing between live company investigations and insolvent investigations, and it may be that we shifted some resource into the insolvent side rather than the live company side, which is why the numbers varied slightly last year from previous years.
Stephen Speed: I would just add to that to say the live company area was one of the areas where we did lose a significant number of staff in April.
Paul Blomfield: That is precisely the area I am trying to probe.
Stephen Speed: Those are staff who had been working on that area for some time. We have replaced them all with internal people who were doing similar work but on a different type of case. It has taken a while for them to be trained up, but my understanding is that is going pretty well.

Q121 Paul Blomfield: I just want to probe Mr Horne's point a little more. You were talking about these numbers coming and going. Is a 39% decrease within the normal cyclical pattern or is that more substantial?
Graham Horne: In 2007–08 we only did 193. In 2008–09 we did 240. So it varies a bit. 205 is probably fewer than we would have liked to have done, but it is not totally out of kilter with the level of activity you have in this area. As I said, we did lose some experienced members of staff. We did take decisions to prioritise the insolvent cases, as creditors had actually lost money. So there may have been a few more cases we would have liked to have done had we been in a different position.
Stephen Speed: Whatever actually happens, I can absolutely give the Committee assurance that the most serious, important cases—with a public interest, harm or whatever—get done. It is not a question of really difficult cases not being done. We have a very sophisticated, useful and accurate way of prioritising cases, which has got us through this period of disruption and will settle us down again quite soon I am sure.

Q122 Paul Blomfield: On the question of enforcement and the importance it plays, do you think you can still deal adequately with your enforcement work with the staff you have, or do you think you are going to need to hire in staff from outside?

Stephen Speed: We have no current plans to hire in staff from outside. We have about 12 or 13 more headcount or FTE than we had this time last year. That workforce is now stable because, as I mentioned earlier, previously quite a few of those people had been employed by us on a temporary basis. We do not really have very many temporary staff in that area now. We have a good, stable workforce, which is settling down, I think it's fair to say; a lot of them are new. So I do not think that is an issue, no.

When we come across cases that are a little bit beyond our own capability—really seriously difficult, big cases—we have some capacity to outsource those to solicitors' firms. We have call-off contracts with some solicitors' firms. So we also have the scope to flex at the margin as well.

Q123 Paul Blomfield: I have one final question on a slightly different strand. Do you think the rebranding of the Companies Investigation Branch in April 2006 caused confusion among the general public about where to make a complaint about a fraudulent company?

Stephen Speed: We did not rebrand it in 2006; it was moved from the Department into the Insolvency Service in 2006. We brought it into company investigations more widely about a year ago.

I hope not. I saw the evidence from a former colleague of ours who thought that was the case. I do not think there is any direct evidence of that in terms of the number of complaints we see. If anything, we have streamlined our complaints process. We now have a single hotline number; we used to have a panoply of different numbers that people could phone. We have the number much more clearly and prominently advertised on our webpage; in the past you had to click a couple of times to find it. I really hope that is not the case, and I do not see any evidence that it is.

Graham Horne: What we have done is put a lot of effort into intelligence and networking with other agencies to make sure that those people who might want to make use of our powers are aware of our existence and can come to us if they think we can help them. So we put a lot of effort into intelligence and surveillance to make sure that people who have some decent information that we can use to start doing some investigations know about us and know about our existence.

Stephen Speed: I am glad you raised that; that is a very important point. We used to be fairly reactive and we decided about a year and a half or two years ago that we needed to turn that around. So we now do a lot of intelligence sharing with other enforcement agencies. We are looking for ways in which they can use our evidence and we can use theirs. We do not just sit and wait for people to come and lay complaints at our door.

Q124 Margot James: We have received evidence that some investigator posts have been replaced by lower grade admin staff who have not had sufficient training. To a certain extent you have covered this in your previous answers, but could you just recap?

Stephen Speed: I do not think that is the case. There is an allegation that decisions are being taken at too junior a level in some cases. We train people, from the most junior right up to the most senior level in their job, very carefully. What the witness or the person submitting evidence was talking about was the very early stage vetting of disqualification cases. The people who do that work know exactly what they are doing. They are trained very carefully in doing it. In order to give ourselves assurance that it is being done well, we have a fairly robust audit process, which checks that is being done properly. I do not have a concern, and I think the allegation is a little bit unfair on the people who are doing the job.

Q125 Margot James: As well as cutting staff you have also had to take on less experienced staff—or rather, let more experienced staff go—to save money, and perhaps train up the less experienced staff. Is that how you have handled it?

Stephen Speed: We had a voluntary scheme last year that released 470 staff. As you have to with these schemes, we had a very clear and objective set of criteria for scoring people for release. Clearly, what we tried to do was make sure that priority was given to retaining the best people where possible, but you cannot retain all the best people where possible when you are letting one-fifth of your workforce leave. So we did lose some valuable experience.

Q126 Margot James: Among the 470, of course you are going to lose some experienced people, but you cannot make serious cost reductions by letting go of the junior people. So there is a strong temptation, which we are seeing in other areas, of letting go of the more expensive people—because that is where you can save the money—but of course they are the more experienced people as well. Is that not a fair criticism?

Stephen Speed: The point I would like to make—and I think Graham would like to make a point as well—is that we did not do this randomly; we actually set up a target number for each of the grades we have. So it was not just "we need 470 people"; it was "we need so many at this level, so many at this level" and so on.

Q127 Margot James: What I am probing is: to make the financial reductions, it is easier to trim off the top, because that is where you make the main savings and still have some decent headcount left.

Graham Horne: The grade we actually let fewest go of, or protected the most, is the investigator grade, the L3 grade. That is not a grade where we have surpluses; it is not a grade where we wanted to let people go. We have let managers go. Because staff numbers were reducing, we had too many managers, and they can be quite expensive. So we have tried to readdress our management headcount span so that managers are not managing only two or three people. So it is managers we have tried to reduce, but skilled investigators is the one grade we have tried to retain; in fact I am just about to do a recruitment exercise to promote some more people into that grade. We have preserved, as far as possible, that investigator grade.

Stephen Speed: There is a nice little point buried in what Graham just said. The Service has been in a degree of stasis for members of staff for a few years,

because there have not been promotion opportunities. One of the things this scheme has allowed us to do, and maybe the new scheme will allow us to do as well, is to offer a limited number of promotional opportunities to staff, which would not have been possible otherwise.

Q128 Margot James: My last question is about the consequences of these staff cuts on the level of disqualifications and the level of investigations. Is it not the case that one reason for the alarming drop in the number of investigations, as pointed out by my colleague, is that, because of the amount of change you have had and the loss of some experienced people, potentially a decision might have been made by those people remaining to put difficult cases on the back burner, and that might have resulted in such a dramatic loss of disqualifications.
Stephen Speed: I genuinely do not think so. First of all, Graham talked about our prioritisation model earlier on. There is an allegation out there in the press that we try to take the low-hanging fruit because it is easy and we can do lots of them. We do not do that; I want to be very clear about that. We do the cases that most need doing. On any given day, when we are looking at what we have in front of us, we will do the cases that most need doing.
I accept that we went through some disruption earlier in the year, but we are recovering from it reasonably quickly. If you examine the figures we put in our corporate plan for this year, you will see that in a sense we admitted at the beginning of the year that we would not be able to do quite as well this year as in previous years. What I am saying to you now is that is the case, but we are on the road to recovering our general performance a little faster than I expected. I do not want to sound complacent, but I am very pleased with that.
Chair: You have rather anticipated Rebecca Harris's next question. Do you want to add anything to that?

Q129 Rebecca Harris: Perhaps I may go into it in a bit more detail. Can you give the Committee some understanding about how you prioritise cases? We heard about case targeting in a previous evidence session, and that you may have a public interest grid or parameter for working out which cases to deal with. In relation to the allegation that you pick low-hanging fruit, can you give us an idea what you do?
Graham Horne: We have quite a lot of experience of this; we have been doing it for a long time. We can spot things when they come through from the Official Receiver or insolvency practitioner side of the business. We look at the case on the insolvent side and see who has lost money. Are they institutional creditors? Are they members of the public? What is the nature of the losses? Have members of the public lost money because of an investment fraud, or something like that? We try to categorise the nature of the losers and how many complaints we have received.
Is there a risk of continuing activity? Is the business continuing, or are the directors continuing with another business? Have they had previous failures? Is it something we have seen before from these people? All of those factors are put into our prioritisation model, along with such issues as whether it kept proper accounting records. Is there any evidence of assets being misappropriated? Is it possibly being run by someone who has been disqualified? Are there indications of misconduct or criminal activity?
All of these are put into a grid and people use their experience and knowledge to assign values to them. That gives a score for the public interest. In deciding the allocation of resources for the investigation, obviously those cases with the biggest score will be taken out first. Those with the lowest score might be the ones that do not get done, because they just do not have the factors that indicate the public interest means we should spend resources on them.

Q130 Rebecca Harris: Presumably, there is not necessarily a relationship between a high public interest and it being an expensive case.
Graham Horne: Absolutely not. The score is based purely on whether the case should be investigated in the public interest, and the people taking those decisions do not think about whether they have the resources or how much it will cost. They look simply at the facts of the case and give it a score, and it goes in. Those cases with high scores are done first. If it is a case that involves a lot of resource, we might want to outsource it to a firm of solicitors or get specialist help, but those are the ones that are taken first.

Q131 Mr Ward: I cannot understand where the dividing line is. You said earlier that you do not deal with corporate failure.
Stephen Speed: In terms of case administration, in Graham's business we deal with three types: personal bankruptcy where you have made yourself bankrupt; personal bankruptcy where a creditor has made you bankrupt; and cases where the courts have compulsorily wound up a company.

Q132 Mr Ward: Can that be a public or private limited company? Is it any form of company?
Stephen Speed: Any Companies Act company.
Graham Horne: They tend to be smaller companies.

Q133 Mr Ward: Generally family businesses?
Graham Horne: Yes. You will not necessarily find a big high street name going into compulsory liquidation. They tend to be smaller one-man-type companies.
Stephen Speed: In terms of the investigation work we do, essentially that covers all companies that go into insolvency, and the routes are through either the Official Receiver who does investigations or the profession that might be managing an administration or liquidation, which is required by law to report to the Secretary of State within six months on the conduct of the directors. Those are the main sources of allegations we would receive on which we would then take a view on whether or not to take proceedings.
Graham Horne: We are not dealing with the administration of Peacocks, but the administrator must report to us on the conduct of Peacocks. Those

conduct reports are the ones we look at to see whether or not we should take investigatory action.

Q134 Mr Ward: Yet that does not pick up the role of the banks, because they, along with the Crown, will often be the ones who force the issue into administration?
Stephen Speed: The banks will be secured creditors in many cases; they will have a charge on the floating assets of the company. The banks will be taking a view about the extent to which they wish to stay involved in a company that might be in distress, but that does not necessarily go to the issue of whether or not the directors have been involved in any misconduct. That will often emerge afterwards, once either the Official Receiver or the insolvency practitioner is looking at the company.

Q135 Chair: Before we move on, in your annual report there is a rigorous vetting procedure to determine the priorities of investigation. What concerns me is the line: "If a case has not been allocated for investigation at month six, it is usually discontinued." What reassurance can you give us that, in the event of some very staff-intensive investigations, shall we say, precluding the examination of potential investigations lower on the priority list but still important, they will not just be abandoned after six months?
Stephen Speed: In our submission we were talking here about live cases. For the record, for some time we have felt able to do all the insolvency cases that have come our way that merit taking forward to investigation. I want to talk just about the live companies. Our procedure is that, if we are not able to allocate an investigation immediately, we will set it aside.
At the end of two months we will review all of the cases, and one of the things we will be looking for is whether further information has come to light from any source, whether it be a complainant, insolvency practitioner or whoever. That case is then reviewed at the end of each month up to the end of six months, and it is only after that fifth review that we would take a difficult view that probably we cannot, at the moment anyway, afford to give resource to that case. It is not simply abandoned at day one; it would be looked at five more times. One of the issues we would be looking for is whether further evidence has come to light since we took the initial decision not to proceed immediately. If you like, it is a six-month process rather than an immediate one.

Q136 Chair: I quite understand that. I am just wondering what safeguards there are that some potentially significant investigations will not be abandoned prematurely because no further evidence has turned up—by definition you tend not to get evidence unless you investigate it.
Stephen Speed: That is a difficult question, because in a sense we are getting thousands of complaints a year, most of which are not evidenced. That is the way it is.
Chair: I understand.
Stephen Speed: I see where you are coming from. This may go back to the point that we have tried very hard over the last year, I think with some success, to develop the intelligence and surveillance side of what we do. Certainly on the live companies side we are very well clued in to how we can use our powers to deal with particular types of scams going on in the economy.
We have had runs of cases on issues like land banking, boiler room scams, carousel fraud and charity publishing, which has been particularly predominant in the north-west of England for some reason. We are working with the police, the Serious Fraud Office, SOCA and other organisations in intelligence sharing. If we have a case in the stack that is going through its monthly review, it is perfectly possible that we will get further intelligence from one of those sources that will help us with it. If that is the case, it is perfectly possible that we will lift it out of the stack and allocate it to somebody to investigate.

Q137 Chair: Looking at your outputs, it is interesting that the number of disqualifications has risen despite your staffing issues. The number of live company investigations has dropped significantly, certainly from the 2008–09 and 2009–10 figures. How many of those disqualifications arise from live company investigations or other investigations?
Graham Horne: Very few of the disqualifications come from live company investigations. If we investigate a live trading company using our powers and we do not like what it is doing—we think it is trading against the public interest—we will put it into liquidation. If a fraud or scam is going on, the measure we take is to stop it by putting it into liquidation. The disqualifications flow from the insolvencies and liquidations we deal with, so that is our major power on live company investigations.
Stephen Speed: As a general comment, these figures are quite difficult even for us to interpret because of the 19-month point we talked about earlier. There is not a one-to-one correlation between the early and late-stage figures in a given year. A two-year time lag is built into these numbers.

Q138 Rebecca Harris: Mr Speed, in evidence to our predecessor Committee in 2009 you said you were proud of your very good and locally based service. Can you comment on that in view of the fact that you are moving to a much more regional call centre base under the current model?
Stephen Speed: I remain very proud of everybody in the Insolvency Service. They are a constant wonder to me. This takes us back to the earlier discussion about the delivery strategy on which we have been working. What we have said in the delivery strategy is that we need to separate out our customer-facing work in the front office from the back-office work, because we need to concentrate the back-office work in fewer locations than we have at the moment if we are to get further efficiencies and if we are to have the flexibility we need to cope with future ups and downs of the sort we have seen recently. At the moment we are stuck with the predicament of trying to shrink our complement in 35 different places. In the future we

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would like to design a Service where the ups and downs can be managed in a much smaller number of places. It will make the whole thing a lot easier to do. But what we have said in the delivery strategy and remain absolutely committed to is that we need a local presence across the country. As we have said in the strategy document, in the long run we envisage a network of about 25 offices staffed by people whose job it will be to do all the face-to-face work we currently do. We are not planning to cut back on the face-to-face work; we want to continue that; it is very important. The key part of that face-to-face work is the need—which in a sense is more our need than the customers'—to interview bankrupts or company directors where we have some concern about their behaviour in the run-up to the insolvency. For the purposes of that face-to-face work, we want to remain local.

At the moment, if you are made bankrupt on your own petition in the courts, we will interview only about 15% of those cases face to face, because that is our estimate of what we need to do. For some years the other 85% we have been interviewing over the telephone, so to that extent it is not necessary for that service to be localised.

Q139 Julie Elliott: To put a supplementary before I go to my question, you say that you are slimming down to 25 face-to-face offices. Will any of those be in the north-east of England?

Stephen Speed: There will be one in the north-east of England.

Q140 Julie Elliott: I am slightly concerned about a regional structure where the furthest north is Leeds, which has no link to my region.

Stephen Speed: We will absolutely need to have a presence in the north-east of England, and our plans certainly include that.

Q141 Julie Elliott: Good. As to the regional call centre system you have proposed, what analytical work has been done on the benefits and efficiency savings of the policy, and was the decision evidence based?

Stephen Speed: I think it was evidence based. If I may put the record straight, you have used the expression "call centres". We have not used that expression; they are not really call centres but offices where more of our staff will work than work in our average office at the moment. They will be Graham's people to some extent who do the telephone interviewing, so these are people who are calling out, not taking calls that come in, which is not quite what the call centres are for.

Q142 Julie Elliott: Call centres can be outward- or inward-facing.

Stephen Speed: It is a job we already do around the country in all our offices, and we just want to bring it together. The work itself is not new, and we would not want to create something from scratch. The investigation work where we have not had to do a face-to-face interview would be in those offices as well. There are other aspects of the Insolvency Service's work. We have looked also at redundancy payments work, where there is scope for separating out the job that is done in terms of actual claims processing, which is the important part of the job—it is how you get the money to the redundancy claimant as fast as possible—and dealing with people who have made claims on the telephone. It is not necessarily the best thing to have the same person try to do both.

Q143 Julie Elliott: What was the evidence base that you used for moving to this structure?

Graham Horne: We have loads and loads of spreadsheets, analyses and masses of data. As Stephen says, we are not changing the way we do things. We still want to interview face to face because you have to. If people have lost money, you need to be able to see the whites of their eyes and what they have done with the money. We are still going to telephone people, as we telephone them now.

The case is based on having 35 increasingly small offices that can be quite inefficient to run because you need a manager in that office and yet there will be only six or seven people in it. We are trying to get efficiencies through the use of our accommodation and maximising the use of our managers, but for the people doing the key day job, the examiners, they are still doing the same job they were doing and still need the same skill sets. It is really about making better use of our management and accommodation, and we have pages and pages of spreadsheets with detailed analysis.

Q144 Julie Elliott: You have put forward a cost saving of £33.5 million for the closing and rationalising of offices and moving of staff. How realistic is that costing, given that there will be a period of double running at the offices?

Graham Horne: That is a business case based on the assumption—you have to do business cases on this basis—that on day one you move to this structure, and you calculate what the cost would be of moving to the structure in a big bang approach. In reality you would not do that, because you would want to do it over a period of time. You could not put the organisation through that degree of stress. So, the business case is based on reducing the amount of management you need, because you would have larger groups of people in fewer locations, and making better use of accommodation so you are not paying for accommodation you are not using. It is very hard to flex buildings up and down when you have 35 of them. On the plus side, you have efficiencies through fewer managers and better use of accommodation, but there are costs in moving to that system, and the business case model enables you to do various scenarios.

Q145 Julie Elliott: In coming to the decision to adopt this model, did you look at the possibility of using cheaper accommodation to keep a more locally based service?

Graham Horne: We will be locally based, so we will still need 25 local offices, and we will be looking for accommodation increasingly on the Government estate. It makes more sense for us to share with other

Government Departments than to try to have our own particular building, so again some of the accommodation savings will come from our renting part of another Government Department's building in the local presence. We will then have fewer but larger administration centres, and they are the ones that might flex up and down a bit, so we will be trying to find some flexible cheap accommodation that means we can grow and shrink as case numbers grow and shrink.

Stephen Speed: As Graham said, we have 35 locations at the moment, about half of which have a lease break or lease end that will come up in the next two or two-and-a-half years, so that is a significant opportunity for us to grasp. We have already taken the bull by the horns in deciding that in a couple of months' time we will be moving ourselves in London from a quite big and expensive building that we can no longer populate properly into a smaller building on the Department's estate and with the help of our Department. We are getting on with that now.

Q146 Julie Elliott: If you have these local units, or whatever they are to be called, the staff in them will still be managed, because you have made great play of the cost of management. Will they be managed at arm's length?

Graham Horne: No. The delivery strategy envisages that the local offices where you have local examiners doing the local cases will have local management. It is in the regional centres where, if you like, there will be management as well. In the process of moving, there is an element of remote management, but that is an interim stage until we can go to the physical implementation of the delivery strategy.

Q147 Julie Elliott: Moving to the information systems that you use, more than £80 million has been spent on the Service's Enabling the Future IT system over the past two years. This is more than one-third of the annual budget of the Service. Is this an efficient use of public money?

Stephen Speed: Let me give you a top-line answer and then pass it to Graham, who was the main instigator and did quite a lot of this work. That was a programme of work that took about four or five years. A big component of it was simply changing the contract we had with our desktop ICT supplier, which was originally Fujitsu and is now IBM. That has already paid back quite considerably. The second component in terms of the systems is our case administration system, which was introduced in October 2010. For both that and the claims handling system that we use in redundancy payments, the technology we were using up until then was such that it was becoming very risky to keep it going. The systems were quite elderly, and we increasingly found it difficult to find anybody in the market to support them, so replacing those systems was something we would have had to do, regardless of what the business case looked like, just to keep the business running. We took that opportunity to bring all of those things together.

As to the case management system, in particular in Graham's business, we built it on the technology platform supplied by IBM, and it is now in such a state that we will be able to use it to drive forward the changes in the delivery strategy that we talked about earlier. Had we not done any of that work, we would be a bit stuck with the kind of estate and type of geographical spread that we have at the moment, so it has been very much an enabling piece of work for us, and it will pay back in about 2013–14.

Graham Horne: The cost is £82 million. However, the benefits on the other side of the equation are estimated to be £124 million by March 2015, so it is a net benefit of £42 million. We have already realised benefits of £68 million, so it is very nearly at break even, and will be by May of next year. Purely on the financial side, it is due to break even but, as Stephen said, it is a great enabler.

For example, another part of the programme of which we are very proud is the debt relief order system. It will enable us to do the debt relief order systems, which is a low-cost debt relief mechanism for those who cannot afford bankruptcy. That was part of the project that came in on time and on budget and is part of the £82 million. The benefits are not great for us, but the benefits for the people who make use of the debt relief order process are very important.

Q148 Julie Elliott: We have been told that the new case management system is slower and less productive than the former one. What would you say to that?

Graham Horne: This may be because what we have asked for is more data capture than previously. Like all businesses, I suppose we want management information and to be able to capture information so we can better run the business. The former system, which was very old, just did not contain certain bits of data, so when we introduced it we took the opportunity to capture more data. People probably have to do a little more inputting, but at the same time it enables us to get efficiencies further down the line with the way we manage the business, and managers will get more information. If you like, it helps with efficiency in terms of the number of managers we need, but overall we think it will improve productivity.

Stephen Speed: Perhaps I may link this to the question Mr Zahawi asked at the beginning. You made the point about the need for change capability. One of the groups of people who will be watching the proceedings today is our own staff. When that system was rolled out in October 2010, it did not go very well. The difficulties for our staff that that roll-out created persisted for some months. Having recognised that we did not do that particularly well—the system worked but not as well as it should have—we have made some very significant improvements and it is now working well, and we have learnt quite important lessons from that difficult episode that we need to take forward into the wider changes that we now need to make.

Q149 Julie Elliott: Do you plan any further major investments in IT systems?

Graham Horne: Not major ones. We will look constantly to improve the ones we have got and see how they can be made better for both customers and

our staff. We have aspirations to create a portal for our customers to interact with us electronically. That will not be anything like on the same scale of investment we had with the Enabling the Future programme. We still need to work through the business case on that, but we are not planning investments on quite the same scale as the Enabling the Future programme.

Q150 Julie Elliott: We have heard that you are planning to introduce another new IT project called WISDOM, which will mean that manual bankruptcy case files across the Service will become purely electronic files. How much will the system cost, and what are the perceived benefits in efficiency and productivity?
Graham Horne: We already have that in place; we already have areas of the business where there are electronic files. All we are doing is turning on more scanning; in other words, paper that arrives in some parts of our business is already scanned in and turned into images, so it can be used without having paper. All we are doing is rolling that out, so there is no significant investment; it is merely extending something that happens in some areas across the whole of the business. Once that is done, people will be able to work remotely because they will not need a paper file in front of them; the paper file will be on the computer. That means people can work flexibly from home and we can move cases around the country without having physically to ship files around the country. It is nothing significantly new; it is something we already do and we are just extending its range.
Stephen Speed: It will also reduce the costs of storage over the next few years. All of our cases are in storage and we will not need to store new cases in our own offices. If you go into our offices, in most of them you will see a big rack of paper cases. We want to start to get rid of that so we can use our space more effectively.

Q151 Julie Elliott: You said that people would be able to work remotely from home. Is that common practice within the organisation?
Graham Horne: Yes. Currently, we have about 500 people who work partly from home. We like a pattern that means that maybe they work two days at home and three days in the office. There are some who work at home full time, although they can get a little bit isolated and some of our work does not necessarily lend itself to full-time home working, but we want to extend, as part of making better use of our accommodation, a working pattern where, if people want to, they can work at home two or three days a week and two or three days in the office. It is good for their work/life balance and good for us.
Stephen Speed: The context is that the Government have essentially made it mandatory over the last couple of years to have an eight to 10 hot-desking ratio. We are driven that way anyway, but that is the way we want to go. In terms of the delivery strategy, we shall be asking people to make difficult choices about where they will work in future, moving work from one office to another. What I have said to staff, which I fully intend to follow through, is that where we can give them flexible working to make that transition easier we will certainly try to do that if the business can afford it.

Q152 Mr Ward: There seemed to be an intent by the former Minister in a statement in March of last year to respond to the concerns of some people about pre-pack administrations, but, within the last couple of weeks—you are nodding your heads so you know what I am going to say—has there been a change of mind?
Stephen Speed: As to where the Government are coming from, first I make the point that pre-packs are an important part of the armoury available to insolvency practitioners, but they recognise the concerns that in particular creditor groups often have about the way they work. The Government have thought fairly extensively about this, but have reached the view that, in the light of higher level policy decisions that have been taken about the way the coalition want to do regulation—and effectively to step away from it particularly for micro-business until 2014—the benefits of the things we had been thinking about do not outweigh the wider benefits of the micro-business exemption.

Q153 Mr Ward: That is not a view shared by the Federation of Small Businesses.
Stephen Speed: I appreciate that. I know there are people who do not agree with it, but that is the position the Government have reached having thought about this quite carefully.

Q154 Mr Ward: In place of that, the argument is that there are a number of other measures that can be taken, in particular SIP 16. What is your interpretation of the success with which that particular SIP is being implemented?
Stephen Speed: SIP 16 was introduced on 1 January 2009, a couple of weeks before we came before this Committee three years ago. It was a pretty big step forward for the profession. It codifies the general principle that there must be high levels of disclosure very quickly by the insolvency practitioner to the body of creditors. It goes on to set out 17 different specific types of disclosure that are required, most importantly in our view about the extent to which valuations of the business have been made, or it has been marketed and so on. To that extent it has been a new and useful tool in the regulatory armoury.
We have had concerns over the last couple of years about whether, in specific individual cases, insolvency practitioners always meet the SIP and tick every single box. There is some evidence that that is not happening, but I think it would be wrong to draw a conclusion that linked that fact directly to an allegation that abuse in pre-packs themselves is widespread. I do not think those two things are necessarily related at all.

Q155 Mr Ward: Even with the recently increased level of compliance, your evidence suggests that 25% still do not comply fully with SIP 16.
Stephen Speed: Yes, when we find more serious cases, we refer them to the recognised professional

bodies, the people who regulate insolvency practitioners themselves, and we expect them to take firm and appropriate action.

Q156 Mr Ward: The big issue is the suspicion of unsecured creditors, because the secured creditors will be part of the negotiations and the agreement. Is there protection there? Do you still have concerns about the unsecured creditors in these situations?
Stephen Speed: There are always concerns about the power of unsecured creditors in an insolvency. For example, in many cases quite a lot of unsecured creditors have a relatively low individual economic interest in the outcome. Unfortunately, unsecured creditors tend not to be as well organised as secured creditors, and often there are lots more of them. There are probably questions about the extent to which they understand the system into which they have found themselves pitched by the insolvency.
Probably the most important point to remind ourselves about is that, unfortunately, when a company goes insolvent, by and large unsecured creditors lose. What we have seen in the past is some evidence that they do not do much worse whether or not a pre-pack is done, so to the extent unsecured creditors lose in an insolvency, it does not seem to me that the presence or absence of the pre-pack itself is a determining factor. Clearly, what it does do is heighten the perception among those unsecured creditors that they have been unfairly treated.

Q157 Mr Ward: Just for my benefit, what is the difference between that and a CVA?
Stephen Speed: In a CVA the creditors sit round the table.

Q158 Mr Ward: It is a voluntary agreement?
Stephen Speed: Yes. Normally, in a pre-insolvency situation they negotiate; in other words, the company being advised will come to the table with a proposition to the creditors.

Q159 Mr Ward: One of the protections was the three days' notice. Three days is not a long period of time, is it?
Stephen Speed: The three days' notice protection was interesting because it produced some very polarised views among our stakeholders. Creditors took the view that it was a useful step forward but would have liked it to be longer; insolvency practitioners tended to take the view that it would make the whole process impracticable unless there were further refinements to that idea. One of the difficulties with pre-packs is that you get very polarised views. Insolvency practitioners are very keen, with good reason, that we should not lose the idea of a pre-pack, because in their view—I think there is evidence to support it—when used appropriately pre-packs are reasonably effective in safeguarding economic value and also jobs that would otherwise be lost.

Q160 Mr Ward: How many pre-packs would you support before you became suspicious if it involved one family firm?
Stephen Speed: I cannot give you a specific number but, in the context of our matrix that Graham talked about earlier, one of the behaviours we would be looking for as an indicator for taking on an investigation would be serial phoenixism; in other words, a repeat failure normally with similar reasons behind it.

Q161 Mr Ward: Is a time built into that? Obviously, many people have very long business lives.
Stephen Speed: No. We would look at our records as necessary. Obviously, if there had been a series of repeat phoenixes that happened quite quickly, it would be a very serious issue, but we would look back at our own records to see what intelligence we had about an individual going back into previous times.

Q162 Mr Ward: Would you then look at the separation of the business wealth from the personal wealth in those cases?
Graham Horne: That is one of the things we look at—the misappropriation of assets. We are looking to see whether or not there is any evidence that the company's assets are no longer in the company and have somehow found their way to a company controlled by the director or the director personally. Everybody is entitled to fail. The economy is all about people seeing if they can make a go of business. What we are saying is, "Okay, but have you learnt from that failure?" For those people who do not learn and carry on with the same failed business model, we come in and say, "I'm sorry; this is not working, so you need to be disqualified." We look to see whether the second company is in some ways a mere repeat of the first, or shows some differences in the way it operated.
Mr Ward: All Bradford City supporters are experts in this field.

Q163 Chair: Probably an increasing number of football fans of other clubs have also become experts. You mentioned earlier that, in the context of the 25% of IPs who basically were not compliant with SIP 16, that fact was reported to their RPBs. What steps are the RPBs taking?
Stephen Speed: Just to clarify it, the 25% relates to the cases we see that we regard as sufficiently serious. We see some very minor breaches, and it would not be worth taking a lot of time to pursue those. The bodies have a range of powers available to them. At one extreme they can simply take away the licence and livelihood of the insolvency practitioner.

Q164 Chair: Has that happened?
Stephen Speed: Yes, that does happen. I do not know whether that has happened specifically in relation to a pre-pack, but as a general rule, looking across the whole of practitioner regulation, I think that in 2010 six individuals had their licences taken away, and we know of at least three who had their licences taken away last year. As oversight regulator once a year we publish a statement of the regulatory activity in which the bodies have been engaged over the last 12 months. We will probably be publishing that next month.

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Q165 Chair: I want to move on to the issue of a single regulator. To the layperson it seems absurd that there are so many regulators on this. What is the idea behind the Government's proposal to reduce the current nine to one? I can see broadly what the idea is; it is obvious, but how practicable do you think this is?
Stephen Speed: The previous Minister, who was in post until Friday, took the view, which he expressed publicly on a number of occasions, that if he was starting from scratch there would be a single regulator, but he accepted that there is not a single regulator but in fact eight. For historical reasons, one of them happens to be the Insolvency Service itself. I can say a bit about that in a moment.
He accepted that it would be better in the short term to try to find a solution to some of the problems faced by the regulatory system by working with the eight bodies as they are to try to increase the level of transparency, accessibility, independence, consistency and so on of the system rather than take up expensive legislative and regulatory time reforming the system root and branch. The Government have a pretty heavy legislative timetable going forward.

Q166 Chair: If I may intervene at this point, the issue has not been Government time, quite honestly. They have plenty of time. I realise that is not your Department, but I will not labour the point.
Stephen Speed: At the moment we are talking to the larger regulatory bodies, the creditor community and so on and looking at a process that will lead to a single complaints system that is far more accessible and easy to use by people who want to complain about the conduct of practitioners. We and Ministers have been very clear that we want that complaints system to be capable for the first time of looking at the quantum of insolvency practitioner fees, which at the moment is pretty much the sole remit of the courts. As a statement of Government policy, we want to remove the Secretary of State from direct regulation of insolvency practitioners.
Chair: We will not go down that particular avenue today.
Stephen Speed: We wish to remove the Secretary of State from being an authoriser of individual practitioners. That is a hangover from the 1986 Act, which we now believe to be unnecessary and complicates the landscape. So, as well as being the oversight regulator, we are looking after at an individual level about 66 insolvency practitioners. We do not see the need to do that any more.
There is a question mark certainly in our minds about whether, as oversight regulator, we have the breadth of powers we need to bring to bear on the regulatory system as a whole. I mentioned a moment ago that the individual regulators have a wide range of powers that they could bring to bear. When we look at the regulatory system from above, essentially we have either a nuclear button, which means we can de-authorise one of the regulatory bodies, or we have to have a private conversation with them if we are not happy with what we find. There is nothing in between for us. It seemed to me at least, as someone charged with this, that it might make more sense to have a similar suite of powers and sanctions as they have themselves over insolvency practitioners. That is what we are trying to achieve. We have made it very clear that we want to achieve that with the profession and its regulated bodies with the interests of creditors and other interested parties at the table. That was not a big feature of the system in the past, and we want to get on with that quite quickly.

Q167 Chair: In that context, do you not think there is a conflict of interest between the role of your service as a regulator and competing as a licensing authority against the other licensing bodies it regulates? It is a bit like having a referee who is free to pick up the ball whenever he wants.
Stephen Speed: I do not think that is right. The Official Receivers work in one part of the business and have nothing to do with the way we carry out the regulatory part of it. There is a very clear Chinese wall there. A couple of years ago one thing I did was to separate the individual licensing operation from the oversight regulator. They were being done in the same place, and I pushed those to separate parts of the organisation so that that perceived conflict of interest is also dealt with, I hope. I do not see that as an issue for us.

Q168 Chair: I do not expect you to answer on behalf of the former Minister, but one of the arguments was about the time and cost involved in setting up a new body. Have you researched it? As a layman it seems logical to have one body, and even if in the short term it would take a bit of time and money to sort it out, the long-term savings would be quite considerable. Have you done any cost benefit of this?
Stephen Speed: I think the honest answer is that I do not think we have, but it is quite important to remember that the Government have said that they support self-regulation by the profession. This sits alongside the self-regulation of other professions. One of the reasons we have a number of regulators other than the Secretary of State is that almost every insolvency practitioner I have ever come across before authorisation is sought is already an authorised accountant or lawyer, or in some cases both. In a sense, whether or not you think it is neat, the current situation has taken advantage of the fact that there is already a series of regulatory bodies looking after the legal and accountancy professions.
I suppose a counter argument to a single regulator would be that you are creating something outside that framework. Only one of the seven recognised professional bodies, the Insolvency Practitioners Association, does not do that; it is unique in that. All of the others regulate both insolvency practitioners and lawyers or accountants.

Q169 Ann McKechin: Mr Speed, you mentioned that you had a very limited range of powers with the regulators. You could either authorise them or remove authorisation.
Stephen Speed: We can either de-authorise them or have a private conversation behind closed doors.

Q170 Ann McKechin: Does that apply simply to the regulatory bodies in England or the regulatory bodies in Scotland and Northern Ireland?
Stephen Speed: We regulate in Great Britain but not Northern Ireland, so it is the same for England, Wales and Scotland.

Q171 Ann McKechin: In terms of the consultation, have you had any contact with the Scottish Government or the Scottish courts about the potential of moving to one regulator?
Stephen Speed: I talk to my opposite number in Scotland regularly; I was in her office about 10 days ago. But they do not have legislative locus in regulating insolvency practitioners at the moment. In Great Britain that is a reserved issue for Westminster; it is devolved in Northern Ireland.

Q172 Chair: To go back to the number of professional bodies, seven license 1,600-plus insolvency practitioners. It still seems an incredible number. It would seem to me that if you are licensed by one as opposed to others, you would be able to do certain things that others licensed by another body would not be able to. How do you get consistency?
Stephen Speed: The perception of inconsistency is one of the things that has driven the whole issue. The matter arose from a report by the Office of Fair Trading in 2010 and a feeling that there must be an issue if you have seven bodies exactly as you have stated. There is a body called the Joint Insolvency Committee, where we get together with the seven bodies and look at the way the system works, in particular regulatory standards. It was that committee that worked up SIP 16, which we talked about earlier. One of the things we are working on with them at the moment is whether we can institute a common tariff for sanctions across all the bodies so they are effectively working to the same system, which they do not do at the moment. It would be quite a big step forward if we can achieve it, and I am confident that we will.

Q173 Chair: Logically, if you have a joint committee working on that and it achieves it, what is the problem with having just one organisation?
Stephen Speed: I think the problem is simply the cost and upheaval. First, it would require primary legislation; second, there would be cost and upheaval in moving everybody from place A to place B. The view taken by Ministers is that would be something they would want to do as a later resort if we cannot come up between us in non-legislative mode with a better solution than the one we have at the moment. My feeling from the conversations we are having with the bodies is that we will be able to come up with something that is significantly better than the system we have at the moment in terms of the experience that the user will have of it.

Q174 Chair: I find it odd that should be a major obstacle, given the number of reorganisations that Government Departments and other bodies, including you, have had to go through. I would not have thought that parliamentary time was a problem, given the fact that for the last three or four months probably fewer Bills have gone through the Commons than I have known since I have been here. However, I recognise that you are not responsible for the Government's legislative timetable. Do you feel you need any more powers to sanction IPs and RPBs?
Stephen Speed: The Secretary of State as the licenser of insolvency practitioners has the same problem as I alluded to earlier in relation to his power of oversight. Essentially, we have either a nuclear button or the hope that they will be compliant when we talk to them in firm tones. I think that in both cases it would be better for confidence in the system as a whole if we had a wider range of powers, very much akin to those that the recognised professional bodies themselves have in disciplining their members.

Q175 Mr Ward: Many of the IPs are dual-qualified or more in terms of other professions: taxation, accountancy or law.
Stephen Speed: As I think I said earlier, almost all IPs will be either accountants or lawyers before they qualify as insolvency practitioners. I think the average age of qualification for insolvency practitioners is the early 30s.

Q176 Mr Ward: So, it is a second one?
Stephen Speed: Yes.

Q177 Simon Kirby: What are your views on the proposal to establish an independent complaints body?
Stephen Speed: This goes back to the same line of questioning we have just been on. I think it is to do with the question of the ombudsman raised in some of the evidence. We have been looking at that. As I think the evidence from the Legal Services Ombudsman said, we have been talking to them about their experiences in doing this and looking round generally. We are trying to achieve a system that has the characteristics of an ombudsman but does not necessarily require us to set up something new. The Government have been involved in reforming the landscape of public bodies for the last year or so, and there is a high-level presumption against the creation of new bodies, particularly new regulatory ones. As part of the process I was talking about, we are trying to create appeals processes at later stages that will have the characteristics of an ombudsman without having to set up something new.

Q178 Simon Kirby: Is one of the arguments for not setting up something new the conflict over the power to adjudicate on fee complaints, and whether that should be left to courts or an independent complaints body? Is that an argument for not changing things?
Stephen Speed: Bringing in fees at all is a difficult and quite big step for the profession, whether it is in the appeals process or at the beginning. That is quite tricky, but we are determined to press on with it. I do not think that goes specifically to whether or not we set up an ombudsman. In very large cases, fees will probably end up being determined by the courts where there is a big dispute. It is not really that sort of case we are looking at but cases where in the past there

has been a lower level of dissatisfaction that has not been taken to the courts. I do not think that issue is necessarily linked directly to whether or not we have an ombudsman. We want to bring consideration of excessive fees into the process from start to finish.

Q179 Simon Kirby: If you accept there is a fair amount of frustration felt by creditors about fee setting for insolvency practitioners, has the revised SIP 9 note gone some way to relieving and remedying that frustration?
Stephen Speed: I cannot answer for creditors and the way they feel. We did some work two or three years ago to look at compliance with SIP 9. We found that in general compliance levels were very high. From our systematic review of those cases—Graham was involved in this—we did not find a systemic problem. It is also important to make a general point on IP fees themselves. Of course, if you are an insolvent person or creditor and you have lost a lot of money, you will start from a pretty sore place, and that is perfectly right and understandable. But what needs to be said is that insolvency practitioners are extremely highly qualified, able people. The barriers to entry to the profession are extremely high. They are very highly regulated, and they do incredibly difficult jobs in difficult circumstances. It therefore does not seem to me necessarily wrong that the premium they command in the market should be particularly different from the premium commanded by highly qualified accountants and lawyers, which is broadly what we are talking about.

Q180 Simon Kirby: Let us suppose for one moment that is correct and you have a reasonable argument. What more can you do than you are currently doing to educate creditors that the fees being charged are reasonable?
Stephen Speed: We need to educate creditors more generally about the process and the rights of action they have in corporate insolvencies, but it is not easy because, if you are in business and you are lucky, you go through life with this never happening to you, and if you are unlucky, it may happen once or twice. I think there are about 4.2 million registered companies in this country. The question is how you educate an extraordinarily large population of potential unsecured creditors about an event that they may experience if they are unlucky only once or twice in their working lives. But that is something we need to think harder about with the profession and also the creditor community. In preparation for today I re-read SIP 9, to which you referred a moment ago. Annex C has a very good, straightforward statement of creditors' rights to action. Maybe that is something we need to push a bit harder to people who are in that sort of situation.
Chair: I think that concludes our questions. Thank you for your contribution. I state, as I always do, that if by any chance retrospectively you feel there is a question you would have liked to answer but it was not posed, feel free to submit your response in writing. Equally, if we feel there is a question we should have asked but did not, we may do the same and require an answer. On that, thank you very much.

Tuesday 23 October 2012

Members present:

Mr Adrian Bailey (Chair)

Mr Brian Binley
Paul Blomfield
Katy Clark
Mike Crockart
Rebecca Harris
Ann McKechin

Examination of Witnesses

Witnesses: **Dr Richard Judge**, Inspector General and Chief Executive, and **Graham Horne**, Deputy Inspector General and Deputy Chief Executive, the Insolvency Service, gave evidence.

Q181 Chair: Good morning and welcome. Thank you for agreeing to assist us with our inquiry. Would you like to introduce yourselves for voice transcription purposes?
Dr Judge: I am Richard Judge, Chief Executive and Inspector General of the Insolvency Service.
Graham Horne: Graham Horne, Deputy Chief Executive.

Q182 Chair: Thank you very much. Can I convey the Committee's congratulations on becoming the new Chief Executive? I think we are just about on time, so I will start with a couple of pretty general questions. What are your main priorities for the future of the service?
Dr Judge: We can take priorities at two levels. First, the long-term priorities are where I have been focusing, and there are probably three things there. One is to make sure that the service continues to do the really good job that it is doing already and that we absolutely sustain a high degree of service. Perhaps in a later question I will get the opportunity to explain and give examples of some of the fine work that is going on with our people. The second one is bringing the service together in a more integrated way. My predecessor described the service as almost a collection of federated businesses. There is greater power for the service to be working together, and therefore integration is an important part of the future. The third leg is retaining a very strong external focus. We play an important part in the sector, and I am keen we should play that role to the full.

Q183 Chair: Looking at your professional history, what elements of it do you think are particularly relevant to your new role?
Dr Judge: That is an interesting question—almost the same question as I had at interview for the role. By way of background, I have been a chief executive for the past 12 years; I have been running professional service organisations of one form or another for that time and beyond. Professionally I am chartered as an engineer; I am also a chartered director; and I have worked in both the private and the public sector.
The common characteristic in all of that is going into organisations where a degree of change is needed or there are some particular challenges, and helping the organisations get to grips with those challenges and take them forward. That is the specific experience. The other point I would remark on in passing is a degree of versatility that comes from having worked in quite different sectors: I started life in nuclear; I have been in rail; I have been in environment; I have been in marine science recently; and now I am in insolvency. That brings a breadth of experience and maybe some fresh perspectives that can help.

Q184 Katy Clark: According to the latest Annual Report, user satisfaction levels and stakeholder confidence in the insolvency regime were two targets that were missed. How do you account for this and what is being done to improve on this performance?
Dr Judge: Is that the 90% customer satisfaction, which was down to 87%—just to make sure I have got the same number—and the stakeholder one? There are two things going on, and it is probably worthwhile putting it into the context of where the service has been for the last three years. It had gone through a massive expansion in its role: if you take the cases going through the service, from 30,000 or thereabouts a decade ago it went up to 78,000 new cases every year four years ago, and then there was a sharp downturn, and it had to deal with that. That has made it very difficult for the service, and we are seeing some legacy issues on the back of that. At the heart of it, though, despite almost 1,000 people having left the organisation over an 18-month period, we still see a strong commitment to delivery and investigations, and people doing a fantastic job.
I will come on to the specific question of what we are doing about it, but I will just give you a quotation that came in from one of our customers: "I have never dealt with anyone quite so remarkably and reassuringly efficient. It made me feel as though I was her only customer. She is a wonderful asset to the service." That is not an unusual comment. We are seeing our staff working incredibly hard with people who are going through very distressing circumstances. We should all be very proud of that and the work they do.
Regarding the 90% figure, this year we are seeing higher figures than that; we are a touch above that, in fact, so I am confident we should be up there, or thereabouts. If you take the other figure you were asking me about, which was the stakeholder confidence in the investigation and enforcement regime, again, that has been bouncing around for four or five years at about 64% to 65% or thereabouts. Anybody who has tried to deal with changing perceptions knows what a hard job it is to change perceptions over a period of time. Again, I would expect that to be bouncing around at that sort of level.

As for the specifics, what we are doing, building on the feedback of the previous surveys, is in part trying to take action around communications—making sure that people are more aware of the good work we are doing. There are some great cases. We are dealing with scams such as people targeting OAPs; we are dealing with scams on solar energy companies—somebody was effectively turning over £50 million fraudulently. We are dealing with those things. We did a great publicity campaign in June or July raising awareness of some of the scams affecting OAPs. There is good work going on, and in part our role is to make sure that is more visible—there is a visibility issue on both of those—which will help us to increase it. But the underlying work and the contribution being made by our people, in what have been very difficult circumstances, is excellent.

Q185 Chair: On the general level of approval and confidence in the regime, the confidence in the service's enforcement regime seems considerably lower than other elements of the regime. Your target is 68%, and 65% was achieved. Why do you think that is?

Dr Judge: In part it is the difficulty of shifting perceptions over time. That is a notoriously difficult thing to do, so there is an element of that. There are very specific concerns that were flagged during the year around resourcing; we might come back to that later on. If a perception of the service, a perception of the activity we are doing, is that there are resourcing issues, you almost get a self-fulfilling prophecy. If someone says, rightly or wrongly, "There is a resourcing issue in the service, therefore we are not that confident in it," and that is articulated repeatedly, almost inevitably you are going to find it quite hard to up the levels of confidence. That is something that clearly we have got to work on.

Q186 Ann McKechin: Moving on to the delivery strategy, you appointed Atkins consultants in February this year to assist you with introducing a new strategy. Could you update the Committee as to whether they have concluded their investigations and whether or not they have come to any conclusions about what changes are required?

Dr Judge: Yes, Atkins have concluded their work—they did so in June or thereabouts. They were looking at three things. One was the funding regime and the sustainability or otherwise thereof. The second was our Official Receiver work, and particularly some of the responses that could be made in an area where we are expecting less demand for our services. The third one was our corporate centre—whether we had resized the corporate centre, the back office-type services, in the light of reducing demand elsewhere—and the proportionality and balance of the organisation.

What they did not look at, which is quite important, is the service in the whole. They did not look at the investigation and enforcement part of the organisation; they did not look at redundancy payments. One of the early bits of work that I was keen to do was to take the Atkins results, which were very helpful input, but also take a step back from that and say, "What is it as a service we want to be achieving? Where do we think we are going over the next three to five year horizon?" then go into some of the helpful evidence and support that came out from Atkins in specific areas, and build on the back of it. That is the stage we are at currently. We have outlined to our people a high-level direction of travel: this is what we are setting out to achieve; these are the areas and things you might expect to change. We will now be able to go back to the detail and pick up on the advice of Atkins.

Q187 Ann McKechin: In terms of timeline, when do you anticipate that you will have a new, more detailed delivery strategy?

Dr Judge: I hesitate to say it is almost a rolling strategy. The approach we are taking is one of being very clear on the high-level direction, so we are very clear what we are working towards over the three to five year horizon. There are clear things we have got to be tackling; again, I can expand on those if people are interested. Then, within each of those areas, we will develop the detail. For example, one of the comments from Atkins was that there was scope to improve some of our internal processes. That is not an unusual thing to see when you bring in people who are experienced in looking at operations.

If you follow that through, what does that mean? It means that on the face of it there is a prize, which is 10–15% or thereabouts, for doing things such as looking carefully at where the handoffs are and how we standardise processes. That work was done with 14 workshops, using a range of people from within the service to look at a level of detail. Now, taking that forward, clearly there is something we need to look at in more detail to articulate and understand. Where that would go is: if you revise your processes, then to implement it you would probably be seeing some downstream changes you would want to do around some of our IT systems; you would be looking at how we arrange ourselves at a level of detail.

When I say the detail will follow, what I am saying is we are pretty clear that we think there is a prize for getting better at processes. We think that prize is in the region of 10–15%, but the detail of it, exactly how we do it, is best achieved by working with our people who are at the front line, who understand the day-to-day pressures and processes, and getting a degree of consistency across all services. We are operating on 35 sites currently, and trying to get those to work as one is important as well.

When I say we have a high-level picture now, and detail to follow, that is what I mean. Obviously, the bits we pick up will vary, and there are things we will do first and things we do later, because there is a natural sequencing of events.

Q188 Ann McKechin: Do you think that that message has been clearly communicated to staff in the Insolvency Service? Are they aware of what kinds of changes are likely to happen?

Dr Judge: The best test of that is to go out and ask staff, and that is something I try to do. In terms of the overall direction of travel, that is something we have only recently settled. As you are probably aware, I

have been at the service for 10 or 11 weeks. It was important for me to take a step back. It has been going through a huge amount of change recently, and rather than rush headlong to the next initiative, it was much better to take stock and say, "Okay, let's see what we are doing overall. Let's take the inputs from Atkins. Let's also get an understanding of what we are seeing elsewhere in the organisation, and be clear what we are trying to achieve". That is what I have been doing over the last few weeks. In doing that, I have been out to the offices—I have visited half our sites so far; I have got half still to do. I will pick up through engagement, through the conversations, on the level of detail. Would I expect everybody to be aware now, in detail, if you went out there and did a test tomorrow? No, I would not. It is early days, and there is a lot of work to do to bring it to life, to make the examples real. That is clearly one of the challenges for us.

Q189 Paul Blomfield: I wonder if I can ask a question about a strand of Atkins' work that you just touched on, which is the sustainability of your income. We raised concerns with your predecessor that your current model was not sustainable, given the reduction in asset-rich casework. Where are you now with that? What has come out of Atkins and where are you going?

Dr Judge: I might get Graham to come and help me on this one in a minute, but I will try and summarise where we are. That was absolutely one of the concerns; it is a valid concern. Look at the history over recent years of the types of cases we have had coming in: the spike I described earlier on, going from 30,000 cases to 78,000 and dropping again. Much of that spike was linked to debtors' petition cases; many of those debtors' petition cases had no assets, which then left fairly significant financial issues for us. That was recognised some years ago, with my predecessor and the team, which is why I say I may turn to Graham in a minute, but, in terms of the team, they understood this was happening. In 2010, the balance of the deposits and the Secretary of State fee, which we also charge in the assets, were modified. Those changes seem to be bearing fruit in terms of beginning to stabilise the position for us. In effect, the action we took two years ago, as we look at things now, seems to be helping.

If you go forward, which I guess is the question, Atkins almost confirmed the position as we knew it: that it is a very tricky challenge. How do you balance what are three clearly competing interests? On the one hand you want to make the bankruptcy regime as accessible as possible; you want to try and maximise returns for creditors; and you want to do it at best value to the taxpayer. Those three things do not always sit comfortably together, and there is a balance between those three.

The bit of work that we are doing and looking at next is saying, "Okay, there is no silver bullet we can spot; we have to do some more work around this area". That is a bit of work we will kick off early as part of the enforcement regime. I do not think the position has changed radically from when you were discussing it in January or whenever.

Graham Horne: As Richard has already said, it is that balance between the taxpayer, the person seeking debt relief paying, and the creditors. Because we are now down at a lower level of cases, the funding model is more sustainable than when we had 78,000 cases, many of whom did not have assets. Management information is key to this, but if we know the types of cases we are getting, if we have a richer level of knowledge about those cases, then we can try and match the resources we apply to a case to the income that that case is giving us. What we do not have yet, but we are going to be working on, is better quality management information to be able to take decisions on how we handle cases.

Q190 Mr Binley: You mentioned the three legs of those interested bodies in the Insolvency Service, and I am particularly concerned about many small businesses that should be in receipt of some return for a sizeable build-up in debt. That build-up occurs because they dare not be too heavy, because business has been fragile for five years or so, and yet insolvency agents sell off at 10% irrespective. They feel very badly let down. Have you looked at that area of the activity of insolvency agents in selling off assets that many people think will be sizeably undervalued by the agents handling the case?

Graham Horne: It is an age-old problem; you would not want to sell anything out of an insolvency—

Q191 Mr Binley: Forgive me, that is why it should be solved: because it is an age-old problem. I wonder what you are going to do about it.

Graham Horne: The issue is, when you know that something is insolvent, you know that there is a forced sale: the person who is selling the asset cannot not sell it, because the company is in liquidation, and it has to be sold. There is an element of someone saying, "I am going to hold out here, because I know that the liquidator at some stage will have to sell that asset, because his duty is to realise the assets and pay the creditors." It is a forced sale; it is a fire sale. They are obliged by law to get the best possible price for assets, and they use qualified valuers and agents in selling it. It is very difficult, when you have a forced fire sale, to do something that increases the value. Ironically—we may come on to this later on—pre-packs are a way in which value is maintained, because it is done prior—

Mr Binley: We are coming there.

Graham Horne: That is one answer to the question.

Q192 Mr Binley: Having been in business for a very long time, and considering myself a reasonable businessman and not a very good politician, I know a little bit about the receiving end of this particular problem. I do know how angry it makes people, particularly people running small businesses, when they know the value is sizeably higher, but where, because of the fire sale that you talk about, there is a culture of, "Get rid of it; 10% will do".

Graham Horne: Insolvency practitioners are often incentivised to get the best possible price, because their fees are often based on a percentage of the asset realisations. That is a way in which one does

incentivise a good value: if you have a fee regime that says the amount of remuneration an insolvency practitioner can get will be a percentage of the realisations.

Q193 Mr Binley: Not if they work on a 10% basis; they think they have achieved their objective. Can I ask you seriously to look into this matter, and can I ask you to come back to me? I am not satisfied with your answers; I think they have been sizeably complacent. A consideration of SMEs, where hopefully the growth is going to come from, needs to be higher up your list of priorities than it appears to be.

Q194 Paul Blomfield: That was a very helpful intervention Brian, but I will continue on the theme I was pursuing. What you seemed to describe to me was the predicament you face with your funding model, and that things were not as bad as they might be because, through external circumstances, your business base had changed at the current time. You did not seem to say anything that indicated how you were addressing the fundamental unsustainability of the funding model, which I think we agreed with your predecessor, and certainly we have had a lot of comments on. I am interested to know what Atkins said specifically on that and in what direction you might be going.

Dr Judge: Graham can correct me if I am wrong. My recollection is that a fee-based system for the short term seems to be the option for the way forward. I recall there were comments in there about being clearer in our views about what the options were and what the impacts would be. An important element of that was clearly around better management information, as Graham mentioned, because if we have a better understanding of exactly where our costs lie and how they materialise, it would help to do that. They also mentioned in passing the wider benefit and that, if we can get efficiencies elsewhere, we do not need to recover as much fee to balance our books. Again, that comes through. In essence, the recommendation from Atkins was, "Look at this area in greater depth"—a policy project, for want of a better description—"review it further," which is what we intend to do. Graham, is there anything specific I have missed in there?

Graham Horne: The unsustainable point of it was its ability to cope with very large fluctuations of cases and the fact that income comes in over a number of years, because asset realisations take a number of years to realise. The unsustainability bit is probably about rapid fluctuations and what model would be able to cope with case numbers going from 30,000 to 78,000 and coming back down again.

Currently the model is working reasonably well, but we have to look at that balance between what the debtor pays, what the creditor pays and what the taxpayer pays. The sustainability point comes to cash flow and how you can protect the income that you need at the start of a case, rather than waiting for the income to come in. Clearly in any business, if you are waiting for up to six years to get paid, that impacts upon the stability of your funding level. Equally, if you want more cash up front, you would not want to make the debtor pay more money to seek debt relief, because that would be driving away their access to debt relief.

That is the balance you need to strike. Lowering the costs and efficiencies are certainly a part of that, because if the cost is lower then you can get more of what you need on day one.

Q195 Paul Blomfield: In terms of the further work you described you are doing on that, what is the timeline for completion?

Dr Judge: We have yet to start the exact project, though the early actions we are taking are part of the direction of travel. The hope is to look at all our income streams, not just this one; we are talking specifically around the Official Receiver work, which is where the most material change has been. For that, the sooner we do it, the better; but beyond that we have not got a fixed plan with a fixed programme that I could show you to be definitive, but I am keen to get clear as to what could be done. I recognise that ultimately, when we are talking about fees, it is a matter for Ministers, Treasury and others to get involved in as well, so we have got wider views to take.

Q196 Paul Blomfield: Moving on to a related issue, clearly your current models for case prediction have proved flawed in the past. Can you tell us more about what you are doing on case forecasting and the role of the Consensus Group, which you mentioned in your Annual Report?

Dr Judge: I am not sure that historic forecasts have been flawed—

Paul Blomfield: Well, fallible.

Dr Judge:—just as an opening comment on that. Had we formed a view of the future? In running any business, that is one of the hardest and most important things to do: to look ahead, to forecast. In terms of the case numbers, we look across the piece, but I am looking very specifically at new cases coming through our Official Receiver work. There are three different strands coming together. You begin with an element of the past—relatively straightforward econometric models that build on GDP, household debt, some of the main parameters we see across the sector, which might be seen as drivers of future demand. That is one element.

Overlaying that is the frontline experience. One of the advantages of having 35 offices in different parts of the country is we have official receivers who understand what is really happening on the ground, what they are seeing. They are talking to other people in the sector, and that gives us some frontline experience. Graham collates and brings that together, and says, "Okay, well, the model may be saying this, within this range". A typical answer from a model might say we are looking ahead to 30,000, plus or minus 5,000 cases, over a one to two year period—whatever the numbers are. Graham then comes in and says, "Is that consistent with what we are seeing on the front line?" to bring it all the way through.

We overlay that again with what I would describe as experts from the field: people from the credit agencies,

the trade bodies, banks, HMRC, and others. We take what I suppose is beginning to give you an indication for a model, and then apply the qualitative test, and say, "Does this make sense? Is this consistent with what people are saying?" On the back of that, we form the view as to what we should be planning for.

We recognise the aim of the forecast is not to be absolute; it is to tell us roughly what we should be thinking about what we plan. That is the way forward; that is the way we have been working. So that is the Consensus Group and how it works in terms of getting the numbers through. The ranges we are looking at: we are looking at 34,000, 35,000 or thereabouts new cases to the end of this year; six months in, we are reasonably confident the numbers will be there, plus or minus 1,000 or 2,000. It is trying to bring those two elements together.

Q197 Paul Blomfield: To be clear, the Consensus Group is bringing together technical expertise and field experience?
Dr Judge: Yes.

Q198 Paul Blomfield: How regularly has that been meeting?
Dr Judge: Twice a year.

Q199 Paul Blomfield: It was in your report in July, so it has met a couple of times.
Dr Judge: It met a couple of weeks ago, because I was at it. One of the interesting things—if I make an observation from that committee as a newcomer coming in—is that people look at economic statistics and assume X will happen because this is happening to GDP, or because growth is happening, or whatever it is going to be. Ultimately, it has all the dynamics of a market: if you are in financial distress you have different options available to you, and you would go out and use whichever you felt was most appropriate to you at the time.

One of the really interesting bits is the behavioural insights, because the behaviours of individuals or companies in distress will vary, as will the behaviour of creditors in terms of their appetite for taking action at a given time, depending on broader circumstances, resources, likely returns, all of those things. The approach of using economic data as a basis for it, sense-checking against local experience and then taking the view from experts of some of the behaviours we are seeing out there, is probably as good as we are likely to get. Then recognise that when you are planning it is a number, and you are not going to plan on a number; you have got to view what is a likely range, and on the back of that start doing scenario models, or whatever you do, to make sure you have got enough flexibility.

Q200 Paul Blomfield: A final question from me is about staffing levels. You have had two voluntary exit schemes over the last couple of years. Are levels about right now, or are you planning further schemes?
Dr Judge: For the short-term, by which I mean this financial year or next, I take you back to the delivery strategy that highlighted overcapacity in some of our grades. Lower examiner grades are a specific example; these are the grades that are specifically associated with the debtors' petition cases that have fallen rapidly. We have overcapacity there. The expectation, if you like, rather than the formality announced and everything else, is that there would be some action taken in that area. We are talking probably this year. In talking to staff, I am asked the number, and I give a figure around 50, which reflects overcapacity rather than anything else.

If you look further ahead, which is the other part of the question, it depends on whether or not the efficiencies we think are there are genuinely there and can be realised, but also what our expectations are in case numbers. If case numbers continue to fall, there is less demand; if there is less demand, we have overcapacity.

The driver for staffing levels is starting with market demand; it is driven by what the need for our service is, and that is where we start. Looking ahead, would it get smaller? Yes, if you believe case numbers will reduce down to 30,000, you can imagine it would get smaller.

Q201 Mike Crockart: If I could come in on something that you said in the last answer, you talked about the interesting part being the difference in behaviour of companies, of creditors. One of the issues that has been brought up to me is in relation to the behaviour of creditors, and whether that is helping enhance the culture of trying to save businesses, particularly in continuation of supply. If a company goes into insolvency, its creditors can act to change the levels they are charging them, to look for quicker payment. Insolvency practitioners have estimated that, if that could be changed, it would potentially be saving over 2,000 companies from failing. Do you think that there is a need to change the regulations around continuation of supply to ensure that businesses that find themselves in difficult circumstances are given the breathing space to be able to sort out their problems?
Dr Judge: I am not familiar with the data.
Graham Horne: I am aware of the comments made. Currently there is a fair amount of forbearance around in the market; we see a lot of people not pushing people or companies into insolvency, so levels of insolvency are quite low or quite static. The point about continuation of supply is a topic that has been raised with us, and it is a serious one we need to look at. When you start looking at these contractual arrangements, there is a danger of unforeseen consequences, unless you get it right. When you interfere between two contracting parties, the price of credit could go up if you start to say to people, "You have to supply at a certain rate, regardless of the risk", because clearly risk is an element in price. If you are dealing with a company that is insolvent or is about to become insolvent, your risks might be increasing, and that might be reflected in your price.

That is not to say there is not a genuine point here. Where you are talking about regulated industries, we should do and are doing something about it. It is not right that a regulated industry should seek to profit because a company is going insolvent. Where there is a contracting party it is trickier; we are aware of the

issues and we are discussing them with insolvency practitioners and others. It would require legislation, and it is a question of those unforeseen consequences: if you pull a lever over here, you are not totally sure what the consequences are over there at the moment. Certainly there is a fair amount of forbearance currently.

Q202 Mike Crockart: You talk about an increase in risk, but suppliers would be paid as a priority. Therefore, there may be an increase in risk, but it is surely a marginal one.
Graham Horne: It depends on the suppliers. We are aware of cases where there is effectively an attempt to blackmail a company that has gone into some form of insolvency; the supplier has a particular thing that they supply that the company desperately needs, and they seek then to try and increase the price. We do not think that is right, but it comes down to how you would legislate to prevent that sort of thing. Are there codes of practice that you can have with trade industries? Regulated industries are an easy way of doing it; we have taken some action on the regulated industries. It is a tricky area and one we are working on. You are absolutely right: if you are going to have a proper rescue culture you would want to make sure that no artificial barriers were put in the way to prevent rescue.

Q203 Rebecca Harris: Back to the staffing and the shape of the service, you are still working from 35 sites. I was wondering if you could update us on the proposed closures of Official Receiver's offices in Stockton, Bournemouth and Medway.
Dr Judge: Linking back to what I have been doing over the last not quite three months, I was very keen to take a step back on everything that was going on and take the opportunity to consider what we are doing as an organisation, to be very clear what our long-term priorities are, and therefore what we need to be doing in the short term. Part of that is trying to form a view. There is one fundamental point we needed to be clear about in terms of how we deliver in the future, and that was a model which was described in the Delivery Strategy as centralisation.
What centralisation did—it is a term that I was less familiar with when I arrived, but have since learned about—was basically say there is logic in economies of scale, which you recognise. It makes sense, particularly in the context of a high level of debtors' petition cases, which tend to be administrative-rich—our heaviest resource level is there—to bring those types of capabilities together. That allows you to split off some of the professional examination work from the case clerk administration-type activities, and consolidate those in centres.
Where we are going to, in reflection, and reflecting the different mix of cases that we have, is a slightly different model. That is consistent with some of the findings coming out from the Atkins review of our work, which says that there is a lot of value in bringing case teams together—a slightly different approach. Rather than separating the team with examiners in one place and administrators in another, its critical mass remains important, but can we achieve that by bringing people together with clearer accountability around the case, rather than separating it out?
With that approach, what we now have to do is to say, "Fine, what are the implications for the estate strategy as a whole?" That is for every site, not just the three being considered. On the back of what we view as the appropriate estate strategy for the service, we need to make very clear decisions for the three sites being considered for closure. In terms of where I am currently, we have got two sites in an area with a level of activity such that you would expect those sites to be managed together. That was the case; that is the case. How we achieve that is an open question, and what we benefit from is helpful feedback through the consultation process earlier in the summer.
The timeline for decisions, which is often a question, is: having now done the overall strategy and being very clear what we are doing at the high level, we are working on the estate strategy, so we are very clear about the principles we would apply, and we are seeking to take decisions on the three sites this calendar year.

Q204 Rebecca Harris: You were talking about your percentage satisfaction ratings in the investigatory and enforcement regime. You said that, to some extent, those figures can be skewed by people thinking that there are staff cuts, and just hearing things. Also, you are not selling cupcakes, so this is not a service that everyone is going to naturally enjoy being involved in, in terms of your stakeholders. Is your 68% target still a target for satisfaction and is that still achievable?
Dr Judge: I would be surprised if it was radically different from a year ago, which was 65%. It is once a year, so it is quite a hard metric to forecast; it depends on mood at the time. As I mentioned before, it has been bouncing around 64% or 65% for four or five years.

Q205 Rebecca Harris: It is not a very high percentage and it is not a terribly ambitious target, although I accept you are not selling a universally enjoyable product. I still do not think it is a very challenging target, though.
Dr Judge: It is a challenging target. The question is whether it is the right target. If it was not a challenging target we would be walking it; we are not. If you look at it from that perspective, it is clearly something that is demanding, despite a lot of good work by people across the organisation. What I am not clear about, and the point is a fair one, is: should it be 75%; should it be 85%? What is an appropriate target for a world where many of the people involved in being asked for opinions do not want to be where they are? What would we feel is an appropriate level? I have not got benchmarks for that yet; it is a question I am quite interested in, so if people have got benchmarks then clearly I am interested. However, I have not got a specific answer for that.

Q206 Rebecca Harris: Might there be some better way of judging how well you are doing, rather than satisfaction?

Dr Judge: There may well be a better way. The thing that I think brings value to it is that ultimately, if you are thinking about an effective enforcement regime, one of the elements of that is perception. Is it going to change behaviours? Is it going to persuade people not to abuse the system? That tends to be quite a soft driver, and therefore to pick up perceptions through some sort of survey is certainly part of the answer; I do not think it is the only answer. The question is what you put it alongside.

Q207 Rebecca Harris: It might be worth looking at some other measurements.

Dr Judge: That may be one of the things we could look at.

Chair: We are coming on to issues about director disqualification and company investigation.

Q208 Mike Crockart: Over the last few years, the number of reports coming in to you has been rising fairly regularly. The question is whether there is an issue about capacity in dealing with those, because broadly the number of disqualifications has stayed fairly flat, which has meant that of the 5,401 reports passed to the Insolvency Service in the year to March 2012, only 1,151, which is just 21%, resulted in director disqualification. That has gone down—it was 27% last year and 45% 10 years ago. I realise that that is because of the numbers that have been reported to you, but you say it is about perception; the perception is that you are dealing with director disqualifications in a less effective way, leaving directors who have been guilty of alleged misconduct able to start new companies, and putting people at risk. There is, then, a particular perception there.

Dr Judge: I accept the perception. I do not necessarily agree with the figures, but I accept the perception. It is a figure that has been reported in the media. The 45% figure quoted is not a figure that is familiar to me.

Mike Crockart: From 10 years ago?

Dr Judge: Yes, from 10 years ago. What is familiar to me is that we are disqualifying roughly 1,200 directors a year; that is roughly five every working day. That has been fairly consistent now for a number of years, over which the level of company insolvencies has also been broadly consistent. In terms of the relative amount of disqualifications—this does not quite answer your question—that has been fairly clear, and I do not think that is always recognised. In discussions and meetings that I have had with stakeholders there has been some element of surprise that we are doing 1,200 a year. The message that people are picking up, bringing us back to my point about perceptions, is that 1,200 feels like quite a big number, as opposed to a small number.

The other part of it is recognising we continue to target the proportion of more serious cases. We clearly prioritise things: 10% of those 1,200 are between 11 and 15 years of disqualification, which is a significant number, where we think cases are serious, and it is good to see that coming through. The broader issue that is coming back is twofold. If we went from 1,200 to a random number—3,000, just to take a big number—would we really be adding considerable public value? Would it really act as a deterrent?

If we look at the cases and the reports coming in from the insolvency practitioners, which is where the number of 5,000 or thereabouts is—the D1 Forms coming through—then it is right that IPs are doing their job. They see potential misconduct—it is an indication of misconduct, I emphasise that, as opposed to definitive, proved misconduct—and then there is a view to be formed about how that gets pursued.

There are a number of things that come through; one is if there are cases with very low monetary values, they might not get pursued. You have to take account of what the court judgments would be; is there evidence there to take it through? For a number of reasons, cases may not be taken forward. One of the things we probably have not done well enough is to communicate back to the insolvency practitioners why cases are not going forward. That is one of the bits of work we will look to do with the trade associations.

The other part of the question mark around 1,200 is whether or not there have been sufficient resources in the service. We have as many people investigating now as we did last year, or thereabouts; it is slightly up.

Q209 Mike Crockart: I will stop you there, because I am going to come on to that in my next question. You seem to be handing it back to insolvency practitioners and saying, "You are sending too many."

Dr Judge: No, I am not; not at all.

Q210 Mike Crockart: The proportion that you are dealing with is falling year on year. Insolvency practitioners see something there that they believe you should be dealing with, because the numbers are going up, but you seem to be quite satisfied with the number that you are dealing with year on year; you feel that that is a reasonable number and the right number. What discussions are you having with insolvency practitioners to say, "You are sending through stuff that we do not feel we should be acting upon"? That is ultimately the setup that you are describing: you are happy with the 1,200 you are doing. But there are 5,000 coming through. What are you saying about the 3,500 that you are not taking forward?

Dr Judge: I will get Graham to come in on some of the detail in a minute. Specifically, to be clear about what I said, there are 5,000 indications of misconduct. I say indications, because I think that is an important point; not every one is going to be severe. There are people who are innocent amongst that. Every case is looked at; every case is assessed on a public interest basis: is this a case where it is a good use of public money, there is sufficient evidence, and we believe we would secure a conviction? We form a view as to which we investigate in further depth, which ultimately may well end up in a disqualification.

That goes on, and the level at which that has been going on is broadly where it has always been. The question is: have we communicated well enough with the practitioners on our rationale? That is an area where we can probably do more work, so there is a common understanding. Every bit of potential misconduct is very valuable intelligence anyway, because if we see the same people again two years later that will help us.

There is value in understanding the indications of their concerns. We tackle it by assessing public interest and we prioritise, but we make sure we get the most significant cases. Hence, I have been pleased to see the 11 to 15 year disqualifications. We work our way through that, and at the moment those 1,200 feel an appropriate level to secure an effective enforcement regime, which ultimately is what we are trying to achieve. We believe at that level it is, but there is a discussion certainly ahead of us.

Graham Horne: Insolvency practitioners have got a statutory duty to report, so they are obliged to report. If I can use a speeding analogy, they are obliged to report someone doing 31 in a 30 mile zone; that is what they have to do. Clearly, we are not going to take a lot of those things forward, because it just is not in the public interest. As part of the Red Tape Challenge, we are looking at the way in which they report, and looking at that whole area of disqualification reporting, to see if there is a smarter, better way we can attack that particular problem. It is a burden upon them; they have to report, because there is a statutory obligation. They are reporting, and they are correct to report; it is useful intelligence. But is there a smarter way we can target those cases that deserve public resources being spent on them? That is part of the Red Tape Challenge and the projects we are setting up to look at that.

Q211 Mike Crockart: We will be returning to that later on. Coming back to the resources that you started talking about, the Committee were concerned that last year's Annual Report had shown that BIS had reduced the budget for investigation and enforcement by £6.6 million since 2008–09. This year's Annual Report shows an increase of nearly £5 million. Can you outline how that will assist in investigation and enforcement work at the service?

Dr Judge: Can we just make sure we are talking about the same numbers? What is the number you see for last year?

Q212 Mike Crockart: We have £33.5 million in 2010–11 and £38.3 million in 2011–12.

Dr Judge: I am trying to think whether I recognise those numbers; there are a variety of numbers that are floating around, which always makes it complicated. I will do the generics and Graham can sort out the detail of the actual numbers. In terms of the level of resourcing we are getting around the investigation and enforcement area, broadly speaking there was a decline three years ago, in 2010, which was noted by the Committee in January.

In terms of the overall resourcing, there has been an impact in terms of the numbers of people we have got doing the work and everything else. The implied criticism that we have not done as much as we should have is fair, but it is less a resourcing issue in a sense of absolute budgets. For me, the observation coming in is one where the investigation and enforcement area has gone through massive change. We have swapped about 30% or 40% of the people investigating; those are people who have left and other people who have come in from elsewhere in the organisation. That turnover has a bigger impact than absolute resource levels.

In terms of performance and some of the question marks about whether we are at the levels we want to be, if you look back to last year and the early part of this year, we are not quite back at the full level. Looking ahead, we are confident we can be. The point is it is probably less an absolute resourcing issue, and much more an organisational change issue, where you are turning over 30% of the staff, and having to retrain and develop. People have got the innate skills and an understanding of the area, but need to work their way through that. That is what we are seeing, and have seen. We are comfortable and confident that we can deliver an effective regime within the resources and budgets we are allocated.

Q213 Chair: Earlier you mentioned pre-packs, and I want to come on to those now. There is widespread dissatisfaction with pre-packs and proposals that had been mooted were shelved early on this year. How do you see the Government's perspective on pre-pack administrations? Do you think there is scope for further reform?

Dr Judge: I will bring Graham in on some of the details of the policy side; he is more familiar with it, particularly on the history. I will make some general points on pre-packs. As I understand it, about 25% of all administrations are now pre-packs. They are a useful tool as part of a rescue culture; they have saved jobs, and we have not come across widespread evidence of abuse.

Having said that, we recognise that almost 80% of pre-packs are to connected parties, and that would be an underlying factor in phoenix-type issues. This is not a new issue. One of the written witness statements to this Committee reflected that, over 100 years ago, phoenix companies were something of concern. Picking this up specifically, I recognise there are creditor concerns, one of which was around transparency, which the Statement of Insolvency Practice 16 tried to address. There was also some slight concern about distortion in the markets through changing competitive behaviours if someone goes through a pre-pack and deals with their debts in that way.

There are concerns out there. Clearly, they are also a useful tool, so it is quite a complicated world, and on that complicated world, I will pass over to Graham to answer.

Graham Horne: We did consult on some specific reforms, which try to address the issue of sales to connected parties. This is the real heart of people's complaints: a company director fails a company, goes into administration, buys back the assets, and carries on as if nothing had changed the next day. What the reform has tried to say is, where there is a sale to a connected party, the creditors should be given three days' notice of that sale so they can intervene. We were suggesting strengthening some of the regulatory obligations on insolvency practitioners.

In consultation, there was not universal support for the proposals; there were different views. There is a general Government view that legislation should not be passed on to small businesses, because that is not

what we are trying to do. Insolvency practitioners and the companies involved are often small businesses. On balance, Ministers decided not to pursue legislation at this stage, although it has not, I do not think, been ruled out.

The previous Minister had a round table with various trade bodies to try to make them more aware of the position and to make them aware that there are avenues for them to complain and of how to formulate complaints. We have also put factsheets on our website so that people can complain. We get comparatively few complaints about pre-packs. We get about 20 a year, and those are actively looked at with the various powers available to us, and we will report IPs to their recognised professional body if we do not think that they have been following the best practice as far as transparency is concerned.

There are, then, mechanisms out there where people can complain if they think something has happened, and this is where the disqualification regime does come in. Last year, we disqualified 161 directors who entered into transactions which were to the detriment of creditors, 56 directors who misappropriated assets, and 102 directors whose conduct was quasi-criminal. Where we are coming across directors who are misappropriating assets, doing transactions which really just defraud creditors, we will report them to a prosecuting authority, and criminal sanctions might flow, but we will also take disqualification action against them.

Q214 Chair: Just arising from that, have you any idea how many directors were actually prosecuted?

Graham Horne: I do not have the figure in front of me. We do not prosecute; we refer them to a prosecuting authority and I think we probably report about 400 possible offences to prosecuting authorities a year. Some of those will be individual insolvencies; some will be corporate ones. Certainly, our parent Department gets a couple of hundred prosecutions a year from the reports.

Q215 Chair: Earlier, you mentioned that you had a round table. Can I just quote from the service's Annual Report? The "Minister recently hosted a meeting of stakeholders, and ideas for improvement were suggested which are now being considered". Is that the meeting you referred to and, if not, what I am looking for is whether you could share with us any suggestions for improving the service, other than those you may have covered already?

Graham Horne: Ultimately, it comes back to the balance between trying to not fetter something which is a useful tool in preserving jobs and value, and giving greater confidence to creditors. There are various suggestions which are made from time to time, but, whatever suggestion is made, one party does not think it will work whereas the other party thinks it will work. Transparency is one thing we are continuing to work on, and we are not satisfied that insolvency practitioners are doing enough to persuade creditors that they have done a good job in the way they have handled the pre-packs. We do not see evidence that the pre-pack was not the right thing to do, or it was not the best option in the circumstances. What I do not think practitioners are doing enough of is explaining to people why they chose that option and giving the circumstances surrounding it.

Q216 Chair: Were there any specific suggestions at that meeting which are being looked at?

Graham Horne: Other than the ones I have mentioned, no, I do not think so.

Q217 Mr Binley: I cannot set your number of directors being delisted, as it were, into context. The figures were vague. I did not understand the size of the potential marketplace, to use a term I would use in my business. Could you come back to us with 200 out of how many, and what is the exact figure? We really do need to know that to be able to make a judgment as to the relevance of what you are telling us.

I have a question regarding SMEs in pre-packs—small businesses who often think the whole deal is done above their heads. They do not get any information whatsoever and they feel either the Inland Revenue or the banks or the big companies have wrapped it up, without any recognition of the relative size of the hit to a small business. To a bank, £50,000 is not a great deal of money; to a small business, it is very often the difference between survival and going under. In terms of pre-packs, it is often the SME—the very small business—that is totally left out of any consideration. Is that fair? If there is a hint of concern there, what are you doing about it to find out how great that concern is?

Graham Horne: There is obvious concern, and it is SMEs who suffer through any insolvency, because they are the ones who can least afford the debt that they lose. Insolvency is going to hit them. The real issue there is that the company they have been dealing with has become insolvent, and they are going to become a creditor, and that is clearly going to affect SMEs. I think this is where the forbearance that we are seeing at the moment on the part of banks and, to some extent, the HMRC, is helping, because there is, at the moment, a general belief that companies are not being pushed into insolvency precipitously. I know the HMRC are certainly looking at the way they approach their debt collection at the moment to see if they can do more to turn people to payment rather than push them into insolvency, so there is forbearance. SMEs will suffer in insolvency.

The added injury/insult, if you like, that they will get in a pre-pack is lack of knowledge of what is going on. They will be dealing with a company one day; the next day, it will be announced it has gone into administration, and the company has reformed. I think this is where we have not ruled out going back to that idea that people should give notice. As part of the practice, we do encourage IPs to market the company's assets, because I think one answer here would be to say to people, "What is anyone prepared to pay for these assets?" This is what it is all about, going to your earlier point: a fair, open market to say, "What is anyone prepared to pay?" I think the issue on pre-packs is, often, that it is done behind closed doors. The SIP is supposed to be telling IPs to give information about what marketing they have done,

and this is where we pull them up. Their compliance, I am afraid, is disappointing with the SIP. It is, then, the light of transparency that would go some way to helping SMEs, I believe.

Q218 Chair: One of the most vocal critics of this has been the British Property Federation and the Association of British Insurers, maintaining that the conditions of pre-packs are quite deliberately kept vague in order to favour potential buyers over the unsecured creditors. How would you respond to those criticisms?
Graham Horne: Again, what I would stress is administrators have a duty to try to rescue the company and rescue the business. They have a statutory obligation to try to do the best they can, so that business is preserved. If they cannot do that, their duty is to get the possible value for assets, so creditors get the best deal. That is their obligation; we look at their conduct to see if they are achieving those aims.
I think the issue here is, when you have a retail business, the preserving of the business may well be all about how many sites that company should be on, what its profitable sites and least profitable sites are. The judgment that the insolvency practitioner will have to make is how he would structure a deal so as many jobs and as much of the business can be preserved going forward. That, unfortunately, often means jettisoning unprofitable shops, or shops with onerous lease provisions.
We are looking at the relationship between what is payable as an expense to the administration as against what is a claim in the administration, because you do not want to do something that will drive behaviour in the wrong way. You do not want people to take decisions based upon trying to game the system, but what you have to try to do is give the insolvency practitioner enough tools to be able to rescue the business, because that, really, is what we are all about. We are trying to make sure that businesses that have some element of them which is worth preserving are preserved so they can carry on. That is a lot of what we are looking to try to do and work with the practitioners on.

Q219 Chair: You touched on this in terms of selling of shops, but why do you think the British Property Federation and the ABI are particularly critical? Is there anything in this process that you think particularly affects them over and above what you have said already?
Graham Horne: Clearly, at the moment, the high street is under real threat. The business models are changing. People are struggling to make profits trading out of the high street, which is leading to a high level of insolvencies in the retail sector. As I said, inevitably, when an administrator is looking to see what he can preserve out of a company, that will all be about, “Can I lower the cost of renting premises? Can I get rid of unprofitable shops?” I think a lot of the onus that we have seen through CVAs and administrators has been restructuring to reduce the burden arising out of rental properties, so I can understand the British Property Federation’s concerns in that area.

Q220 Chair: What about the ABI? Like you, I can see the British Property Federation having a particular concern; I am less clear about the ABI.
Graham Horne: They provide trade-indemnity insurance to suppliers, so they would be providing insurance for a supplier to a retail outlet. If the retail outlet goes into insolvency, they often have to pick up the debt. The creditor, in fact, will not lose out; it will be the insurance company that will lose out. They are clearly keen to see this transparency point and whether the debt that they are insuring has been ditched in an appropriate way and whether they have been left holding the baby. They are keen, again on this transparency point, to make sure that things do not go into insolvency as a device, but it is a proper recourse for the circumstances of that particular company.

Q221 Ann McKechin: Regarding the issue of SIP 16 compliance, in your Annual Report this year you stated that 32% of the cases reviewed were not fully compliant, and some 7% of the sample were substantially deficient. That is quite a high percentage, I would suggest to you, in terms of problems. Are you satisfied with the levels of compliance at the moment, and when do you expect to publish further guidance to ensure that we get a higher compliance rate?
Graham Horne: No, I am not at all satisfied with that. It is disappointing that the industry has been unable to get that level up to where I would expect it to be. They are professional people. It is a complicated SIP and it has quite a lot of elements to it, but one would expect them to be able to comply with that to a far higher level than 68%. I would say that non-compliance is slightly technical, so it is not as though, in those cases, the pre-pack was in any way wrong or was the wrong thing to do or there was abuse; it is simply the point that they are not giving enough information to creditors. That is why, again, as part of the reforms, we were looking at strengthening the rules and regulations relating to the supply of information, to really put it on a statutory footing rather than the footing it is on with the SIP. So it is disappointing, and we do complain where we think there is abuse.

Q222 Ann McKechin: The SIP, at the moment, is a sort of voluntary guidance provided by your Department, and you would prefer, personally, for that to be on a statutory footing of some kind?
Graham Horne: I am not sure my personal opinion carries much weight, but it is something that Ministers would want to look at. This was part of the consultation we went out on: in instilling confidence in people, is that something that we should be looking at to try to strengthen the obligations?
Ann McKechin: But Ministers have rejected this proposal at this point.
Graham Horne: On the balance that we do not want to legislate if we can do things via voluntary means, and we are legislating on small businesses—because a lot of these firms are, indeed, small businesses themselves. At the moment the balance has been decidedly against legislation.

Ann McKechin: Insolvency practitioners are not always small businesses.
Graham Horne: There is a range.

Q223 Ann McKechin: They are used to statutory regulation or, often, their professional regulations. Have any of the professional regulators involved adopted the SIP 16 guidance into their own regulatory environment, so that, in fact, there are penalties for those who do not comply?
Graham Horne: There are penalties for non-compliance, yes. When we complain, penalties are imposed, fines are imposed and undertakings are given, so there are some regulatory consequences of the failure to comply. My disappointment is that those penalties have not had the impact of improving compliance levels, and I think what we are trying to do with the RPBs is urge them to up the game to say, "You need to do more to make sure they do reach acceptable levels of compliance".

Q224 Ann McKechin: Is it the level of penalty that is faced? Do you think that is a reasonable one they face at the current time? Would it be better if they actually had a strengthening of the penalties?
Graham Horne: I think our view is that the penalties imposed so far have not really been of the level we would have liked to have seen in some cases. We think that perhaps the RPBs could have taken a little bit of a firmer line with some of the non-compliance cases.

Q225 Ann McKechin: Thank you very much. If I could turn to this issue about the complaints against IPs, the number of complaints against insolvency practitioners has decreased by 16% in the last few years. Is this due to the difference in the volume of cases that are currently going through the system or is it an indication of increasing confidence in the insolvency profession?
Graham Horne: Interesting. If you read the OFT report, you might think it was possibly because of a lack of awareness of how to complain, and maybe there is a little bit of an issue there about the mechanisms by which you complain, the way in which you complain. Levels of insolvency are fairly static at the moment, so I would not want to expect increasing levels of complaints. Insolvency practitioners, in fairness, do a difficult job and do it well in the main, and the level of complaints is comparatively small compared to the sorts of cases they deal with. What we are doing is trying to work with the recognised professional bodies on a measure to have a single gateway for compliance, and we are, hopefully, pretty close to announcing a basket of measures there, where we will host a gateway for complaints, so people will be able to see the way in which they can complain and will not need to work out which body is licensing which insolvency practitioner.

Q226 Ann McKechin: Is this the alternative to having a single complaints body, which had been originally considered as one option?
Graham Horne: Yes. It is a voluntary package of measures. We are working on them and, hopefully, close to getting ministerial agreement to launch shortly.

Q227 Ann McKechin: Is it one telephone number, one email, one web account which one can access?
Graham Horne: Yes, there will be one gateway for complaints, which we will host. We are also working on common sanctions, so it will not matter which body you are complaining to; there will be a consistent approach to the misconduct and a common appeal process as well. You get many of the advantages of a single regulator but by bringing it together with a single front end and a single approach to complaints.

Q228 Mr Binley: I am concerned about what seems to be a bit of an anarchic market with regard to regulation in this respect, and the impression is given that some practitioners fall between seven stools. Has the suggestion of a single complaints body for the insolvency profession now been taken off the agenda? It did appear that there was a merging of these seven regulatory bodies that has come to an end. What is your response to that concern?
Graham Horne: We consulted on the question of a single independent regulator, and I think there was quite a lot of strong support for that. Perhaps I am going to sound like a broken record here, but again Ministers have ruled out, at this stage, legislation—because that would require legislation. What the previous Minister said was that he would want to explore the question of trying to achieve the same aims through voluntary means, which is this package of measures that I have just been talking about. No one falls between two stools because, to be an insolvency practitioner, you have to be licensed by one of the bodies, so you have to choose and you get licensed by the ICAW for an accountant or whatever, so you have to be licensed. The issue is this lack of transparency about who to complain to. You can have joint administrators in a company: one would be licensed by one body and one by another body.

Q229 Mr Binley: That is clear.
Graham Horne: Neither we nor Ministers have ruled out a single independent regulator. It needs Parliamentary time and they need to think about that, but what we are trying to achieve for this voluntary set of measures is some of the advantages that would give us—a single gateway for complaints, common standards and a common appeal process—so that people do not need to work how it works. The public do not need to work their way through it. You want the public to be able to go to one place, and that is the idea of our gateway.

Q230 Mr Binley: There is quite a support and demand for it in the industry, isn't there? Lee Manning, President of the trade body R3, who said, "The vast majority of our members would be happier with fewer regulators than the current seven bodies", suggests that there is a requirement. One of the great frustrations of business is that it feels that, in terms of how Government bodies move, a snail's pace is quick,

quite frankly. How quickly are you moving on this? Because you do have great influence.

Graham Horne: This is ultimately a matter for Ministers. We can propose, we can say there is support for this measure, and we can advise how easy or difficult it would be to bring that measure forward, but ultimately Ministers would have to decide where that fitted in the Parliamentary schedule and in the priorities for legislation. So far, Ministers have not pushed that far enough up the chain.

Dr Judge: I will just add two things: one, just in terms of the numbers, I think I picked up some numbers, which I might subsequently be corrected on. Creditors and debtors had a strong feeling that a single regulatory body or a single place would be sensible and would give them greater confidence. Of the insolvency practitioners, I think the figure was about 39%, so just under half, but still a substantial proportion, so reinforcing your point.

In terms of where we are at the moment, what I am picking up coming in is that almost nobody would start from where we are, but we are where we are. The question then becomes one of: is it worth, if you like, the added value coming from the energies put in to try to bring fewer numbers of regulators; would that add value? The message I am picking up in a number of places is that, if we can achieve the same aims, so you can get consistency, you can get effective regulation and you can build confidence, then, ultimately, that is a goal. I think the message I am picking up is the first step is, "Let's try to make that work". If we cannot make that work, then clearly the other options exist, such as legislation.

Coming back to your point about what else we could be doing, one of my senses is that our oversight function—and we do have an important part to play with oversight of regulators—is one we can probably reinforce. I think our predecessor to this Committee explained there are, basically, two buttons you can press: one fairly nuclear and the other one is a quiet word. I think, at the moment, we are limited in the actions we can take. However, that does not stop us being pretty clear about our views on particular bodies' approaches and being a bit more overt, more explicit, on our oversight regulatory role. That is a role I will be looking at to see how we might explore.

Q231 Mr Binley: I am encouraged by your words. Let me be more robust: when did you last have the seven heads of these seven bodies—almost like the Seven Dwarves, aren't they? "We're off to work" or not to work, as the case may be—together to knock their heads together and see that you can get a more compliant and sensible situation?

Dr Judge: We had a complaints committee fairly recently. We are trying to do that. But I do not have—

Q232 Mr Binley: Can you let us know and can you keep us in touch with the progress you make?

Dr Judge: Specifically on complaints, yes.

Q233 Mr Binley: I am very grateful. I wanted to ask about the announcement that the IPA recently made that it had reached agreement with the Solicitors Regulation Authority to handle all complaints made against solicitor insolvency practitioners. That is a surprisingly good response from a body which tends to be rather autocratic and sees themselves as the masters of all they survey; I am talking, of course, of the Law Society. I wonder, again, what the current progress is on common sanctions guidance; there is no sense in answering, other than to include that too in your response to us, so we have the written evidence to allow us just to monitor the situation. Thank you.

Q234 Rebecca Harris: Similar questions, really: what progress has been made in enabling creditors to challenge and look at excessive fees?

Dr Judge: I will pass that one over to Graham again, in terms of the details.

Graham Horne: This is an area where we have made some progress but, I think, I have to say, not as much progress as we would have liked with our dealings with the recognised professional bodies. We talked about the common gateway and the question that people will be able to raise complaints. They will be able to raise complaints about fees, and RPBs will look at those where the circumstances surrounding the fees amount to misconduct, so where an IP does not have proper authorisation for fees, where an IP cannot support the calculation for the fees, or where the fee levels are very egregious. They will, then, look at those, and that will give creditors some avenues to complain.

The position is still that, in most cases, the recourse is to court if you are not happy with the way practitioners have handled fees. Most fees are approved by creditors, so, in most cases, the creditors will have approved the way in which the insolvency practitioner gets their fees. Again, we are looking at whether we can push this voluntary measure a little further, because the recourse, again, would come back to legislation, and we would want to look at looking at secondary legislation to give RPBs the right to examine the quantum of fees, and have not ruled that out. I think the natural concern is getting into a commercial discussion/debate about whether that was the appropriate fee in that particular case. We think it is right that there should be some mechanism where someone looks at that and decides whether, not down to last pence—

Q235 Rebecca Harris: That is the formal appeals process.

Graham Horne: Yes. We would want to see whether that is something that would be facilitated in some way, other than the way at the moment, which involves going to court. I think our common complaints process, which we will hopefully be launching shortly, will help, and it will enable people to complain. We are doing all we can in our role as a creditor, albeit we become a creditor after the event, to use our power as a creditor to look at IPs' conduct and raise issues. HMRC do quite a lot as well, although they have to take it on a resource basis. They cannot do every case, because they are a creditor in every case.

Q236 Rebecca Harris: That was what I was coming on to, because it was made clear to us that about a quarter of all debts are due to the HMRC or even yourselves in terms of the Redundancy Payment Service. How much is actively being done to deal with that? You said there was a resource issue at HMRC. I would have thought that they would have an interest in that and they would get something back for their investment in working harder on that. You have the clout, which often these smaller creditors do not have, and the knowledge of dealing with it.

Graham Horne: They take a commercial view: if they think there is some merit in putting their resources into it, they will put resources into it and they will get involved in overseeing the liquidation and administration, and challenging what the IP is doing. They will take it on a case-by-case basis. In some cases, they just do not think it is worth their while, because they do not see any return for them in doing it. They are, then, making commercial decisions. Our position is that, since the Committee raised this last time around, we have put more resources into our role as a creditor. We are a creditor by default: once an insolvency practitioner has made an employee redundant, we have to pay the redundancy pay and then become a creditor. So we are a creditor after the event, not at the time of the insolvency. Nonetheless, we are a significant creditor and we have put some of our resources into a team that looks at the cases, looks to see what has happened, raises issues with the insolvency practitioner and raises points where we do not think that what has gone on is quite the way we would want to see things being handled. That is something that we have put more resources into and will continue to look at.

Q237 Rebecca Harris: It is interesting that you say that the HMRC look at it on a case-by-case basis. You would have thought, if they were throwing their weight around, they would be setting an example, at the end of the day. By looking at it on a case-by-case basis, it may not be worth their while, but by using their clout more generally it might drive down and drive out sharp practice or excessive fees in the long term. It would be worth putting more work into that, don't you think?

Graham Horne: I would have to say these are matters for them, and you would have to ask them rather than me and doing it third-hand. From our discussions with them, however, they are fully aware of the position and they say they put their efforts in where they think there is some reward for the taxpayer in putting their efforts in. They clearly do not have unlimited resources, and they try to apply them in what they think is the appropriate way.

Q238 Rebecca Harris: Do you take my point, though, that, if they made a more general effort in that direction, it might be that the problem does not occur in the first place?

Graham Horne: I note the point.

Q239 Mike Crockart: I will start with a fairly general question: what do you hope to achieve from the Red Tape Challenge? In particular, have you been in contact with any stakeholders with any interesting or creative ideas in identifying any particular regulations which can be simplified, merged or, indeed, scrapped?

Dr Judge: I will give you the general position as to what we are doing and, then, if there is anything specific, maybe Graham can pick that up. The general position that the Red Tape Challenge is something which is running across a number of industries. I came across it whilst I was working in the marine area. It makes absolute sense if a regulation that is no longer needed, out of date or overly demanding, to get rid of it. Indeed, one of the points around IP fees is, if we can simplify some of the processes, then the costs which are being incurred on a time-and-materials basis also go down, and that has a wider benefit. Absolutely, then, there is huge value in that to try to strip out costs. There is also a huge value for us operationally, because, if we can lose bits of activity we have to do again, it will simplify some of the efficiencies we are aiming for.

In terms of the process and the timings, it was launched in early or mid September for a period of six weeks, and ideas came through. We are fortunate to have Philip King, Chief Executive of the Institute of Credit Management, chairing Red Tape Challenge, so it is being done by an independent party. He has held meetings with stakeholders and there have been ideas coming in. My understanding is that those meetings have been productive and a number of ideas have flown in, including some from us, where we see opportunities for doing things, but they are currently being assessed, as far as I understand it. As they are assessed, there is the test of whether it is credible, whether it is going to achieve what people are trying to achieve and whether it is a sensible thing to move forward. However, I think the overall ambition to try to simplify matters is clearly one which most people would subscribe to.

Linked to that is the tidying-up of some our Insolvency Rules, because, as you simplify some of the regulatory approaches, it also makes sense to take the opportunity to do some, I guess, slightly overdue tidying-up of the rules which are slightly complex and have not caught up with recent amendment, so there is also work in that area.

Q240 Mike Crockart: That was going to be my next question. If we do that first, then we can look at specifics. When do you hope to start the consultation on a set of draft Insolvency Rules?

Dr Judge: Have you got a date for that, Graham?

Graham Horne: They will not come into force until October 2014. We are hoping, some time next year, to have a set of rules which will be able to go to a focus group. We know this is quite a big thing. It is a big document and people will need time to respond. We do not have a specific time, but early in 2013, I think, we will be going to a focus group. We want to leave those rules in place for six months, so people can comment on them. We are, then, really taking quite a measured process all through the way until October 2014, because we appreciate that people have systems in place that they need to amend. Between now and

October 2014, then, with at least a six-month period of time for people to look at those rules.

Q241 Mike Crockart: A focus group rather than a wider consultation?
Graham Horne: There will be a wider consultation but a lot of these are quite technical rules, so there will be a stakeholder focus group to get into the nitty-gritty of the detail. However, they will be on our website for six months and we will make them publicly available for people.

Q242 Mike Crockart: Can we go back to the Red Tape Challenge and try to get into any specifics that you are looking at?
Dr Judge: I have not seen specifics come through to me yet, because it is still being discussed.
Graham Horne: There is an interesting thing, because we have had some responses that say, "This is an industry where people handle other people's money and we would quite like some regulation there," so we do not want to throw the baby out with the bathwater. I mentioned the disqualification area, which is a big area we are looking at in terms of reporting disqualifications and the whole D form issue. I think the rest really relate to the processes of insolvency and some of the issues relating to how meetings with creditors are held and whether we are facilitating modern means of communication. There are little rules in there about things having to be sent by first-class post. That alone would save £280,000 if we removed that requirement to send by first-class post. It is a lot of little things. I cannot really tell you that there is a big idea, because we have not received a big idea that would sweep away a load of it. It is, however, incremental things which, taken in the whole, will amount to a serious pruning of—how was it described?—the impenetrable thicket of insolvency legislation. We are taking the pruning shears to it.

Q243 Mike Crockart: I take your point about regulation being there for a reason, but there is process that can be dealt with as well, such as the D1 forms that you are talking about. There is a feeling amongst insolvency practitioners that that has been shelved; that there was a move towards an electronic form, but that is now not happening. It was caught up in the moratorium on new regulation. Is that the case? The moratorium was there to stop extra regulations being built on top and making it more difficult, but, ultimately, this is wanted by 80% of the people who are going to be affected.
Dr Judge: I will let Graham pick up on the moratorium aspect specifically. I think, more generally, one of the things we will be looking at as a service is how we make better use of digital channels generally. One of the early areas of focus—redundancy payments—is how we can transfer information very easily. We are slightly cautious in going with a big bang with IT projects—I think people have seen some of the challenges of big bang IT projects—so we are being quite focused in our ambitions. We are going to get a portal going and working. We will start with redundancy payments in one area, make sure that works, and then look to adopt the wider approaches of digital channels for all of our customers, because it adds a huge amount of value for them more generally as we go downstream. I am keen, where we can, to make use of that; it makes sense. I take your point that you can do these forms electronically. It helps everybody.
Graham Horne: We certainly have not shelved it. We have had some discussions, and we had a meeting with insolvency practitioners. We have hit certain barriers in terms of legislation, but we are kicking off another project to see, to the very point you make, whether we can make a good case out for reform. What I am keen to do is take it away from the narrow focus of, "Should we put the form onto the web? Why don't we look at the way in which reporting is done in the first place? What is the point of the D2 form, which is a no return?" That is a classic Red Tape Challenge-type thing we can look at and ask, "Do we need a D2?" We can just have the D1. Should we have a reporting requirement that is different to merely filling in a form, which can involve an element of doing it by rote without necessarily thinking about the longer-term reasons why you are doing it? What we have just initiated is, hopefully, a short, sharp project to see how we get through this impasse we seem to have reached on the D form, and try to break out of it. It is an important area we should try to break out of, using the Red Tape Challenge maybe as the lever or the mechanism to get that time in before Parliament if needed.

Q244 Chair: We come to the last issue, and that is the perceived cosy relationship between insolvency practitioners and asset-based lenders.

Q245 Mr Binley: Many small businesses would know asset-based lending as factoring, as you know, and it is that particular area I wish to concentrate on. I understand you are to meet, with officials from the BIS Department and the Treasury, a group called Campaign for Regulation of Asset-Based Finance. I think that meeting is due to take place this week. They quote a case of a sizeable bakery in, I think, the north, called Tindale & Stanton, who had factoring with Bibby Financial Services. They were given two and a half working days around the Jubilee Bank Holiday to find new funding, when a deadline for an investment round was missed. They got other funders. Bibby wanted a £92,000 termination fee before they would allow the whole thing to go to other funders, and the business was put into administration. Fortunately, it was saved, and it was saved because, clearly, other people saw it as a very good business.
I wonder whether you think the power—and, seemingly, the unfair power—that some factorers have in this respect is right and proper. I want to link that with the fact that some factoring companies put companies into administration and appoint a friendly insolvency firm. Some go even further; they pass leads to lenders who are owned by the insolvency practice firm themselves. This is pretty much an unacceptable mess, isn't it? Can I ask, this week, whether you are going to really pull the stops out to put this right when you meet with this group, and could you keep us in

touch with the outcomes of that meeting, which seems to me to be very important in this area?
Dr Judge: I absolutely recognise the concern with the story you describe. I can understand why you raise that here and why it is important. It is a relatively recent concern. As you say, we are meeting with Treasury and with BIS.

Q246 Mr Binley: It is not a relatively recent concern. It is relatively recent in that it has been brought to your attention recently, but as a businessman, I can tell you it has been going on for a very long time.
Dr Judge: It is a concern we are relatively recently aware of.
Mr Binley: Thank you. That's better.
Dr Judge: I think what is important is that, yes, we do speak with the relevant players—we understand that—to understand the issue. Clearly, our interest in that is largely around the behaviour of administrators or around the insolvency aspects of it, and other parts of Government will have other interests within that as a whole. What is important for us is to really get a feel for the size of the problem and the issues. Where there are specific issues and evidence, that is very helpful to have, and I would encourage people to provide that to us.
Graham Horne: I think the regulatory framework is there in place, and we do not need even more tools. If people have taken out charges late on prior to the insolvency, those charges can be rendered invalid. These sorts of things can be looked at in terms of the way the company's behaviour was structured just before insolvency. This is stuff that we can do with our current powers, so what we need to do is to get complaints to us. We have powerful powers to investigate companies, using our statutory powers there, and we are more than happy to receive any instances where people think it does not look right. If people tell us, "This does not look right; this looks wrong", then we will look at those cases.

Q247 Mr Binley: How would you get those instances when you meet? I think it is this week that you are meeting, isn't it?
Graham Horne: It is an ongoing dialogue. I think there has been a meeting already and we will be having more meetings.

Q248 Mr Binley: If you would keep us in touch with process, because it seems to me that some of the time limits being laid down are especially harsh, and I might say Barclays Bank did exactly the same sort of thing with overdrafts. If that helps small businesses by my stating that, I am delighted, and I am equally delighted if you can come back and tell us that you are looking into this and what progress you are making.
Graham Horne: One issue we are looking at is the way in which insolvency practitioners get introduced to business, because they have a code of ethics. They should look at where their business is coming from to make sure that they are approaching new business with clean hands, and that is, certainly, one focus of our investigations.

Q249 Mr Binley: You do recognise that the banks have an important role to play in this particular area.
Graham Horne: Yes.

Q250 Mr Binley: Because it is the banks that almost stipulate—and I use the word "almost"—that some of their small businesses use an associated factoring company. The whole loop has a smell about it which is not overly savoury.

Q251 Chair: Just picking up one previous issue, which was the SIP 16 compliance issues, it would be helpful to know the number and the level of fines that have been levied for non-compliance. I think, to help you and us, I will ask my officials to go through the transcript, single out those issues that we have asked you to come back with written evidence on, tabulate them and send them to you, which, hopefully, will help you as well as us. Equally, of course, I can say, if there is anything further that you would like to say, please put that in further evidence to us. It may well be that, in hindsight, you feel that there is a response either to a question that we did ask or one that we did not ask but you would have liked to have asked, that you would like to give us. That would be very helpful. Could I just conclude by saying thank you very much? It was very helpful indeed. On receipt of your written evidence, we will be issuing a report and we will publish it in due course. Thanks very much.

Written evidence

Written evidence submitted by the Association of British Insurers

1 Introduction

1.1 The ABI is the voice of insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

2 Overview

2.1 We support developments in UK law that enhance the market power of unsecured creditors to play a role in the insolvency process and improves the way our existing regulatory system handles complaints. This must include measures to reduce the complexity of the current system to make it more accessible for unsecured creditors, rationalise the number of Recognised Professional Bodies and improve consistency in decision making across the regulatory framework.

3 Pre-Pack Administrations

3.1 The ABI has long expressed concern about the increased use of pre-packaged ("pre-pack") administrations. The ABI is not opposed to pre-packs in principle, but they are not always a fair solution, and are open to abuse. While a pre-pack deal means that a company is bought out and can continue with business as usual, in most cases its unsecured creditors are left exposed. These are often SMEs who, in most cases, will never be repaid the money owed to them and are themselves therefore at serious risk of collapse. Only around 20% of SMEs have trade credit insurance, so those who do not are left to cover the losses on their own. In many cases, these unsecured creditors will have been trading with the company, unaware that it is about to enter a pre-pack, right up to the time the deal is done. The current system risks preserving large companies at the expense of their smaller suppliers, potentially leading to more jobs lost than saved.

3.2 The lack of transparency and notification of unsecured creditors in pre-pack situations is a serious problem both for SMEs and for insurers. We are disappointed that there has been no progress on this matter considering there was a consultation on proposals for a restructuring moratorium last year—which we responded to.

3.3 Statement of Insolvency Practice (SIP) 16 was intended to reduce the incidence of abuse of pre-pack sales, by compelling Insolvency Practitioners to disclose—albeit after the event—certain information concerning each transaction. It has failed to achieve its aim. It is being ignored by many Insolvency Practitioners, apparently with little consequence. Tighter regulation is required.

3.4 Pre-packs are being actively marketed by restructuring advisers as a convenient way in which to "dump debt" and start afresh free of troublesome creditors. The potential abuse of pre-packs is in danger of becoming institutionalised. We think that the heart of the problem lies in the serious conflict of interest inherent in an Insolvency Practitioner devising a pre-pack sale in secret in conjunction with the directors and secured lenders of a failing company, and then immediately implementing that transaction as administrator with a duty to act in the best interests of *all* creditors. Despite the professional and legal rules designed to prevent abuse, it is inevitable that a large proportion of pre-pack transactions will be structured so as to favour the owners of the business and their secured finance providers, who initially engage the Insolvency Practitioner and are privy to the design of the scheme, at the expense of unsecured creditors who have no opportunity to comment or intervene. We therefore favour greater transparency for unsecured creditors and support the Insolvency Service's proposal for legislation requiring a three-day notice period.

4. Regulation and Sanction of Licensed Insolvency Practitioners

4.1 We support any development in the UK regulatory system that restores trust among unsecured creditors. The current structure does not protect their interests sufficiently and a lack of transparency and accessibility has undermined confidence in the process. This has contributed to a perception that RPBs are not consistent when handling after-the-event complaints and the oversight regulator has insufficient powers to correct market failure.

4.2 We support the creation of an independent complaints body alongside measures to rationalise the number of regulators, introduce a single and coherent regulatory framework and a single complaints portal to reduce complexity for creditors. Such a body must incorporate lay membership as a feature to improve confidence in the handling of complaints. If such a body is given the powers to review fees and remuneration charged by IPs these responsibilities should reflect their duty to act for the body of creditors as a whole.

5. Creation of an Insolvency Ombudsman

5.1 We believe that creation of an Insolvency Ombudsmen should be a matter of last resort if self-regulation through RPBs fails to correct market failure consistently.

6 Strengthening Control of IP's Remuneration

6.1 We would welcome greater transparency in the remuneration of IP's. We would support a strengthening of the control of IP's remuneration, such an agreed hourly rate or maximum amount, as it would improve transparency. It should include an obligation to inform creditors from the outset that any changes or meetings to renegotiate fees would still result in a cost to the estate.

21 December 2011

Written evidence submitted by the British and Irish Ombudsman Association (BIOA) (IS 08)

This submission is made on behalf of the Chair and Executive Committee of the Association which was established in 1991 and includes as members all major ombudsman schemes and complaint handling bodies in the United Kingdom and Republic of Ireland. The Association's objectives include:

— encouraging, developing and safeguarding the role and title of Ombudsmen in both the public and private sectors;

— setting criteria for the recognition of Ombudsman offices by the Association;

— formally recognising those persons or offices who satisfy the criteria; and

— facilitating mutual learning and providing services to members designed to develop best practice working to raise the profile of Ombudsmen and the understanding of their work.

The Association welcomes this opportunity to comment and give evidence to the Committee, primarily about the possible creation of an "Insolvency Ombudsman" which is contained in the Terms of Reference of the Inquiry.

BIOA would ask the committee to bear in mind that the most effective ombudsman schemes are "BIOA compliant", which means that they must meet the following five key criteria:

— Independence

— Fairness

— Effectiveness

— Openness and transparency

— Accountability.

Indeed, these criteria are recognised by the Cabinet Office in its guidance to departments on setting up ombudsman schemes.

The development of the current ombudsman landscape has been, to an extent, fragmented and piecemeal and can sometimes cause confusion and result in unintended underlaps and overlaps. Before proposing the creation of a new ombudsman scheme, BIOA urges the committee to consider whether insolvency practitioners could be incorporated within an existing scheme—but if it is felt that a new ombudsman scheme is required, such a scheme should be fully integrated within the wider ombudsman landscape.

30 December 2011

Written evidence submitted by British Property Federation

The British Property Federation (BPF)

1. The BPF is the trade association for the property investment sector. In that context our members include most of the larger companies and institutions investing in the commercial property sector, sector specialists and smaller commercial landlords, as well as fund managers and investment banks.

Introduction

2. In this submission we have focused on our areas of specialism and interest, specifically pre-packed administrations and Notices of Intention to Appoint an Administrator (NoIAA). This means we have not covered the range of issues the Committee is seeking to explore.

Pre-Pack Sales

3. Whilst we are mindful of the role that pre-pack sales have to play in rescuing businesses, we have highlighted our concerns to the Insolvency Service that, in some instances, the communication between the restructuring company and the creditors to that business is poor resulting in creditors being presented with a pre-pack situation that they are unable to influence or highlight foul play. We have, therefore, been supportive of the intentions to give unsecured creditors a greater say in the pre-pack process especially where there has been no marketing of the business assets and a subsequent sale to parties connected with the insolvent business, to ensure greater transparency in the overall process.

4. In seeking to resolve this, the Insolvency Service has been thorough in consulting with all stakeholders affected, sometimes involving us solely with other creditor representatives, and sometimes with a broader range of stakeholders, including insolvency professionals. There is a delicate balance that officials are trying to strike, on the one hand providing greater protection for creditors, whilst on the other hand not undermining the pre-pack process.

5. In pursuit of that policy objective the Insolvency Service has proposed a three day notice period for pre-pack sales. Such a short period would only be of practical use to creditors if the lodging of any concerns was a relatively easy process. We believe that is what is planned.

6. For the administrator, a three-day notice period could be damaging to the rescue and so we also support the compromise that allows for the insolvency practitioner to ask the Court to set aside the three day notice period if the Court's judgment feels it would prejudice the conduct of the administration.

7. Policy has evolved on this issue during the course of the recession from reliance on self regulation via Statement of Insolvency Practice (SIP)16 and the lodging of SIP16 notices with the Insolvency Service, to the most recent announcements on pre-packs. One in four SIP16 notices were not lodged with the Insolvency Service in 2010, despite this being a require on insolvency practitioners, and having had one false start on a statutory instrument to tighten up regulation in this area, creditors are hopeful that legislative change will now be delivered expeditiously, so that their interests are properly protected.

THE MISUSE AND TACTICAL USE OF STATUTORY NOTICES OF INTENTION TO APPOINT AN ADMINISTRATOR

8. The Insolvency Act 1986 outlines the key mechanisms as to how a notice of intention to appoint an administrator (NoIAA) should operate. At the point where a notice is filed, a 10 day moratorium is triggered preventing creditors from taking action to recover the debts due to them. Whilst we support a notice period in allowing a window free of action with which to appoint an administrator, we feel that there are certain abuses taking place where a notice is filed consecutively in order to prolong the moratorium period. This can be hugely beneficial especially if the period includes quarterly rent payment. Also, there is a far broader issue about the tactical timing of use of notices of intention, where the notice is served in the days leading up to a rental payment.

9. Most existing commercial leases require rentspayable quarterly in advance. However, if a notice of intention is served shortly before the quarter day, landlords cannot enforce rental payments as a result of the interim moratorium. Once an administrator is appointed, the entire quarter's rent will be classed as an unsecured pre-appointment debt under the *Goldacre (Offices) Limited v Nortel Networks UK Limited (in administration) [2009]* judgement and therefore not paid as an expense of the administration.

10. We have highlighted cases of abuse to the Insolvency Service, including the case of a jewellery chain, where a notice was served purely to get the benefit of the interim moratorium. A memorandum from the company's administrators expressly stated: "*In order to further consider the restructuring options available to them and to provide an opportunity to explore both a sale and restructuring of* [the retailer], *and with the next rent quarter day due on the 23 December 2010, the directors of the Companies took the decision to issue a notice of intention to appoint administrators… on 23 December 2010 in order to protect the Companies' assets in the short term via an interim moratorium*". We have calculated that over £1 million in rent was denied to its landlords across 78 stores as a result of this action.

11. This is not a situation where a company serves notice and then does not go into administration, as the rent will still be payable once that notice expires, but where the notice is filed tactically before the rental due date in order to prevent the landlord from distraining or threatening to forfeit to recover the rent. Losing a quarter's rent on a commercial property has a significant impact and can lead to financial problems for the landlord.

12. Furthermore, particularly in a "pre-pack" administration, it is in the interests of the company to delay the appointment of the administrator and sale until after the rent payment day, as rent payable by the administrator for using the property, which he will seek to recover from the purchaser under a licence to occupy, will only start from the appointment date. Anything due prior to this is an unsecured claim, will remain unpaid and will be of no concern to the purchaser and its directors, despite the fact that the business has benefitted from trading from the property throughout. The longer the moratorium period goes on; the longer the purchaser gets the benefit of the company having traded "rent free".

13. We have engaged with the Insolvency Service on this matter and have found them constructive. Limiting notices to a specific number such as two would address the problem of multiple serving of them, but not the underlying tactical issue, and we would agree there will be situations where serving more than one notice in succession is wholly legitimate.

14. We believe that a better solution all-round, is to address the situation of the landlord during a moratorium period. One possible solution would be to treat landlords differently from other creditors given that they are unable to terminate supply of a service. It has been suggested that under the *Goldacre* judgement, where the rent be paid as an expense of the administration, that this be extended to cover the interim moratorium period requiring rent to be paid in full. A further solution would be for the administrator to treat the landlord as a secured creditor in the administration for rents accruing during the interim moratorium.

15. Such policy solutions could only be pursued via legislation. The Insolvency Service may have to consider legislative change as a result of *Goldacre* more generally and if so, we will be pushing for this issue to be considered. In the meantime, we would like to see a Statement of Insolvency Practice (SIP) on notices of intention, so that there is greater clarity on what is professional practice in this area.

23 January 2012

Written evidence submitted by David N Clough

It has been my privilege to work within The Service or BIS (in its various incarnations) for 28 years and for CIB for the last 17 of those, an experience which I found thoroughly rewarding and through which I have met many fantastic people.

There are a few matters concerning recent changes within the live company side of Investigation & Enforcement Services (IES) that you would wish to be brought to your attention. I would just add that I have considerable respect for Robert Burns (the head of IES), who has always had CIB's interests at heart.

The Service as a whole is currently going through a turbulent time but certain developments within IES give me grave cause for concern, firstly as a professional but now as a tax-payer.

IES Branding

In the private sector, a well-known and respected brand is seen as an asset. The CIB brand was well known within the enforcement community and covered all aspects of live company investigation—complaint vetting, investigation and follow-up action leading to winding up and disqualification. The "troops" within (what was) CIB, still cannot understand why this respected brand was discarded. Not only is there now no snappy alternative (Company Investigations, Manchester, Company Investigations, London, Corporate Intelligence and Authorisations Team being among the alternatives), a strong silo management ethos has built up to separate, what used to be, a homogenous business area, where all stages of the process worked closely together.

"Fly-Tipping" of Complaints

You may be aware that the disqualification side of IES does very little high profile work and, indeed, has gained a reputation externally for tackling "low hanging fruit". This seems incongruous given the high profile failures which have been in the press over the last couple of years. I have been told by colleagues dealing with that area of work that part of the disqualification vetting function is engaged in trying to "head off" cases where targeted directors might put up a fight, the preference being for "easy" wins which look good statistically. I will follow with interest whether anything comes of the rumour of a referral by the FSA to The Service, covering the conduct of top officers within Royal Bank of Scotland.

The low hanging fruit tag was never applied to CIB. In fact, the landmark court case on land banking was achieved by CIB, not the FSA, despite the latter being the lead regulator in this area.

Until the end of 2010, the CIB vetting function was carried out by staff with relevant specialist qualification or experience, including decisions on whether to take a complaint forward for detailed consideration. Now the initial sifting of complaints is performed by staff at A2 (junior administration) grade on a formulaic basis and with no understanding of deeper issues that might lie with the complaint correspondence.

Let me elucidate just one example of the impact this has had. During the pre-winding-up of a company, which targeted vulnerable people, the Manchester Live Investigations team became aware that the directors were already trading in the same way via a phoenix. The new company details were sent for vetting and the matter refused by an A2 grade *in less than 60 seconds*. When the investigators protested, the A2's decision was reviewed by higher, specialist grade staff and a new investigation sanctioned *with a Medium risk priority*! My point is that decision-making on live company complaints is being made at too junior a grade by staff following a process but without understanding the issues. If a complaint falls at this hurdle, it is lost to CIB. Could the decisions made by A2 grade staff provide an explanation for the number of live company vetting files being opened having slumped from when the work was transferred to them?

The Live Companies statistics for incoming complaints from sources external to The Service and the number of cases accepted for investigation, year-on-year, should be called for from The Service. Since the changes to procedures in 2010 referred to above, volumes have fallen most markedly. Has this happened because:

- The public is disinclined to complain;
- There is a policy of choking off complaints at vetting stage (due to internal politics) to a volume roughly equal to what Vetting judge the investigators can handle, with no consideration for case quality (the low hanging fruit issue again).

Finally, I would just say my concerns are for the reputation, effectiveness and efficiency of live company investigations as carried out within IES. I have worked hard to play a part in the long-term success of "CIB" and do not want to see a respected brand devalued and the object of critical public comment, as appertains to the IES insolvent disqualification work. Do not be fooled by smooth management speak; it's the results that

count. Change is continual—I have left The Service—but change needs to be positive and too much of the change I have seen lately is neither positive nor offers any benefit in terms of efficiency or economy.

29 December 2011

Written evidence submitted by John Hancox

A recent article in the newspaper said that the "Association of British Insurers" had made a submission to your committee concerning the use of "pre pack administration" orders.

I can only add to their concerns my knowledge of a particular instance. I was involved until autumn 2008 with a company which, having traded for a dozen years, because of both difficulty with the bank and trading pressure, went into a pre pack arrangement. My involvement ceased.

Two years later in September 2010 the one remaining director of that company went into a further pre pack arrangement, leaving behind further debts including unpaid amounts to the Inland Revenue. My complaints briefly concerned:

> Misleading information reluctantly provided by the accountant insolvency specialists to put off outside purchasers by inflating the TUPE obligations; and
>
> Assets that were omitted from the statement of the company and vehicles that were removed just prior to the date.

I contacted the Insolvency practice who would not respond.

I contacted at the time the Institute of Chartered Accountants who confirmed my views and suggested that I contact the Insolvency Service (I.S.).

Their initial response—October 2010—was to say that the matter was not to do with disqualified directors or bankrupts, and therefore irrelevant.

I wrote as suggested to the Insolvency practice and received no response. On returning to the I.S. in mid November I received a letter (26 November 2010) to the effect that they were "not responsible for monitoring the actions of insolvency practitioners whilst carrying out their duties". They considered that this was the responsibility of the Secretary of State. This was counter to the advice of the Institute of Chartered Accountants who had referred me to them in the first instance. In relation to the conduct of the directors concerning the assets of the company that were withheld from the insolvency or passed outside the company just before its pre pack, they considered that a six monthly report from the liquidator would confirm or otherwise.

I received a response from the Insolvency practice—7 December 2010—promising to "look into" some aspects and covering (over) others. The I.S. immediately—8 December 2010—asked if I was satisfied and if not to explain.

14 December 2010—I reminded the lady at the I.S. that I had provided all the necessary information that I had to them and that they were the representative of the practitioners unit giving guidance and control. A month (14/01/11) later a response said that they were satisfied that the only aspect of my complaint that could be upheld was a delay in the response from the Insolvency Accountant.

20 January 2011—I emailed the three people from the I.S. concerned and explained the unanswered aspects of the matter. They had already made me "aware that I would not be able to be privy to the answers or details". I explained that I did feel that they had a need to show that the "proper investigation had been made and acted upon".

21 January 2011—The I.S. response was that I should await the Corporate Conduct team of the I.S.'s six monthly report.

21 April 2011—The Intelligence team of the Intelligence and Enforcement Directorate of the I.S. contacted me to say that based on the six monthly report "it would be appropriate for this section to recommend that further enquiries and investigation be undertaken in this case". I spoke to the person concerned who said that an investigator would be appointed because of the number of anomalies in the case.

26 June 2011—I contacted the person in the Company Investigations section of the I.S. who was looking at the case. I wrote—29 July 2011 to say that my MP had said that I "may wish to ask the Corporate Conduct team to provide me with a report following the liquidators return". I received responses which I have not kept, the essence of which was to stress that due to varying reasons I should not be able to see any results as they might contain information of detriment to individuals.

I wrote once more—6 October 2011—to the investigator to say that I wished confirmation that action where appropriate had been taken. I received no response.

In summary, I am far from convinced that the I.S. in this instance has investigated this instance where it would appear that matters were not conducted appropriately by either the directors concerned or by the Insolvency Practice concerned. Their actions give me no comfort that they considered this other than to fend

off outside interest. Their lack of response can only encourage inappropriate actions from both practitioners and directors.

Ob dict I was aided (as always) by my M.P. who was responsive and helpful but even he cannot make them act other than by shaking unhelpful response from the I.S.

I also contacted both the I.S. and HMRC to see what actions were in place to ensure that non payments by pre pack companies were followed up in the new company to ensure that default was not endemic. No response from either.

I think that it is unlikely that you will wish to contact me but should you wish details and information, I am of course willing to provide them.

3 February 2012

Written evidence submitted by the Insolvency Practitioners Association

The IPA is a Recognised Professional Body under the Insolvency Act 1986 and is the only one of the RPBs specialising in insolvency. The IPA currently regulates 515 Insolvency Practitioners. It also runs insolvency examinations and is committed to the development and maintenance of high standards in the insolvency profession.

On the matters that we understand to be the subject of the inquiry, we comment as follows.

The Role and Functions of the Insolvency Service

Generally with respect to the role of the Service, the main points we wish to make concern (a) the Service as a direct regulator of Insolvency Practitioners; (b) the Service as Official Receiver in bankruptcy cases; and (c) the Service and the reform agenda.

By way of opening remarks, we would like to place on record our appreciation of the positive and constructive way in which the Service and its senior personnel undertake their roles and engage with the profession. For the most part the points we wish to raise are those which we have had an opportunity to raise with the Service direct during the course of the last year or so.

(a) *Regulator of IPs*

The Service has a number of different roles, one of which is as direct authorising agent (as a competent authority) of IPs on behalf of the Secretary of State. The Office of Fair Trading raised this matter in its report on its study into the insolvency market and concluded that the Service should ideally cease to authorise IPs directly, and we understand that the Service intends to accept this recommendation. We encourage that move for two main reasons:-

(i) it removes a conflict between the Service's role as regulator of IPs and its more pivotal role as regulator of regulators; and

(ii) it ensures that there will be a more level playing field in the arena of regulatory and disciplinary sanctions, as the Service does not have the powers under current legislation to take effective measures against its directly authorised IPs in the same way that it requires RPBs to do.

(b) *Official Receiver*

The OR's role as trustee in bankruptcy cases causes some concern because of the current fee structure. Whilst it is understood that in the current economic climate it is undesirable for the Service to be making call on the Treasury for funding, nevertheless there is something fundamentally inequitable about a system which penalises some creditors (in cases where there are estate funds—assets or income) by overcharging in those cases to cover the costs of administering others in which there are no assets/income. Appendix I illustrates how creditors in an income-based case would invariably be better off if the same income payments were made through an Individual Voluntary Arrangement rather than a bankruptcy. We understand the Service is looking at the fee structure and we urge that work to continue with a view to implementing change as soon as possible.

We have made separate representations to the Service on the OR's current approach to dealing with family property. The Service is a party to joint regulatory initiatives through the Joint Insolvency Committee, and as part of that arrangement has approved an Insolvency Guidance Paper issued to IPs setting out how such property should be realised—essentially guiding IPs to deal with any equity early in the bankruptcy process, avoiding speculation on property prices and providing clarity, a degree of certainty and fairness to the bankrupt and any spouse/other person residing in the property. Unilaterally, the Service has now instructed ORs to ignore this guidance and delay dealing with property until around 2½ years after the commencement of the bankruptcy (by which time the bankrupt will ordinarily have been discharged). That presents IPs with a problem, if they are then appointed to realise the property equity, given the three-year use it or lose it rule, but it is also illustrative of a lack of joined up thinking in policy terms, because it contradicts the previous guidance and creates inconsistency in the way these matters are dealt with across the profession.

(c) *Reform agenda*

The Service is engaged in dialogue and policy making in a number of different areas—perhaps too many at the same time. There is an open consultation on reform of the petition process, where we have some concerns about the role of the proposed adjudicator and more generally about the narrowness of the issues being consulted upon. There is a real danger of missing an opportunity here to take creditors' rights into account. We do not think it is appropriate for a bankruptcy order to be obtained by a debtor (rather too easily, one might argue) under the proposed new streamlined electronic procedures without due consideration being given to alternative insolvency mechanisms that could produce better outcomes for creditors.

On regulation, the Service does not appear to have defended the system it has overseen for the last 25 years as robustly as it might have done in the face of criticism by the OFT, particularly given that some of the OFT's evidence was anecdotal. Notwithstanding that, the Service is now engaged in dialogue with the profession to explore non-legislative solutions to achieve the greater consistency desired in the way in which complaints against IPs are dealt with by the RPBs. We very much welcome this and trust that sufficient time will be given to consider fully the changes that we believe can be made to improve the present system.

Those changes have to be cost effective and workable, and they should represent a proportionate response to the issues identified by the OFT. We believe the proposals we and others have put forward to the Service will achieve those aims, and deliver results more quickly than could be brought about through legislation.

Pre-pack Administrations (Issues of Transparency, their Link to "Phoenix" Companies)

This is one of the areas in which reform is under discussion. The Service has indicated how it plans to address the phoenix issue, and creditors' concerns around this process are well understood. We are worried that the detailed reforms (the draft new Rules) will not be published in sufficient time ahead of implementation for the Service to be able to consider any potential problems in drafting. We are also concerned that in the drive to eradicate scope for abuse there is a real danger that a valuable rescue mechanism may be lost, and that creditors will gain little in participation and information but will almost certainly lose out if businesses are closed instead of saved. There is also likely to be an adverse impact on jobs.

Possible Regulation and Sanction of Licensed Insolvency Practitioners

Of course, IPs are already regulated and have been for the last 25 years. Other than in respect of those authorised by the Service, all the RPBs have (as they are required to do under the Memorandum of Understanding with the Service) procedures for disciplining their licensed IPs when the need arises. The current discussion around sanctions is really about consistency, and on this subject we have submitted proposals to the JIC with a view to implementing and publishing a common sanctions guide. This will drive consistency in decision-making and publicity. Other related proposals involve increasing accessibility and accountability, use of common review and appeal mechanism where possible, all with the aim of increasing levels of trust in the system. Again, though, proportionality is a factor. There were only around 100 complaints against IPs last year where some sanction was required—a remarkably small number given that there were approximately 100,000 insolvency cases and numerous creditors, employees and directors in each one. Insolvency by its very nature will involve people who have lost money or jobs, and so the existence of complaints should not be a surprise. Not always are those complaints about the conduct of the IP; they are often about little-understood procedures and about dissatisfaction with outcomes for unsecured creditors. They may also be about the conduct of directors and frustration with the IP's perceived inability to bring them to account (see comment below regarding effects of reductions in staff and budget).

Creation of an Insolvency Ombudsman

The Financial Ombudsman Service deals with redress for consumers. We do not believe that an insolvency ombudsman with a wider or more general role would be appropriate. Insolvency is a collective process. Remedies are available through the courts, as specified in the Insolvency Act and Rules, and redress should be for creditors or certain classes of creditor as a whole, not to individual complainants.

Strengthening of the Control of IP's Remuneration

We are in discussion with the Service about ways in which the complaints system can deal with complaints about fees, but again the statutory remedies in this area already provide protection for creditors. Indeed, the Rules were amended as recently as April 2010 to give creditors enhanced rights and remedies. Fees can more easily be challenged. It is too early to know how effective those measures have been, and the Service has not carried out a review of the impact of that new legislation. It is therefore premature to contemplate further change in this area.

The Effects of the Reductions in the Service's Staff and Budget

The main area of concern here is the resourcing of the director disqualification unit. In a recessionary period, this is the one department that should be receiving additional funding. Our IPs often tell us that the returns they make to the disqualification unit are not acted upon, and they attribute this in part to resource constraints.

We are grateful for the opportunity to submit comments for consideration by the committee, and stand ready to offer any further assistance the committee may require.

David A Kerr MIPA
Chief Executive

6 January 2012

APPENDIX I

Bankruptcy (debtor petition) three yrs' Income Payments	*£*	*IVA based on comparable three yrs' Contributions*	*£*
Surplus Income		**Surplus Income**	
36 x £250 a month	**9,000**	36 x £250 a month	**9,000**
Fees		**Fees**	
Case Administration Fee—(net of debtor's deposit)	**1,190**	Nominee Fee: typically limited to 5 x contributions	**1,250**
Collection Agents Fee @ 5%	**450**		**–**
VAT	**90**		
		Bond, Registration Fee and other allowable expenses (estimated)	**125**
Secretary of State Fee @		Supervisor Fee	
0% on first £2,000	**–**	15% of Surplus Income	
100% on next £1,700	**1,700**	(36–5) x 250 @ 15%	**1,162**
75% on next £1,500	**1,125**		
15% on remainder of £3,800	**570**		
Distribution Fee (average based on time/rate)	**160**	Distribution Fee—included in Supervisor Fee	**–**
VAT	**32**		
Total Fees + VAT	**5,317**	**Total Fees**	**2,537**
Available for Creditors	**3,683**	**Available for Creditors**	**6,403**

Written evidence 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;
— the Employment Rights Act 1996; and
— the Companies Act 1985.

3. BIS Ministers determine the policy framework within which The Service operates, drawing on the knowledge of its 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.

4. The Service is committed to delivering excellent service to all of its customers, many of whom are in considerable financial distress. The Service's customer service approach, across all its business areas, has been independently recognised by the award of Charter Mark accreditation, now rebranded as Customer Service Excellence, which The Service has held continuously since 1998.

5. Insolvency work is complex and The Service's ability to deliver high quality customer service depends critically on the professional abilities of its staff. In line with its organisational values of People, Pride and Professionalism, The Service makes significant investments in training and developing its staff to the necessary professional levels. This, and its work more generally in learning and development, has been recognised by the award of the Investors in People standard, which The Service has now been held for 12 years.

OVERVIEW

6. 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, Innovation and Skills (BIS).

7. The Service employs some 2,135 staff (of whom around 2,020 are permanent and 115 are agency staff) and operates out of 35 locations across Great Britain, most of which are official receiver's (ORs) 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.

8. The Service has six main areas of work:

Policy. The Service combines its operational responsibilities with the role of advising Ministers on insolvency matters. The Service provides advice on the complex framework of legislation as well as developing policy to ensure that the insolvency framework remains world-class and fit for purpose, contributing to BIS's wider growth agenda. This work is funded by a budget from BIS, which was £1.7 million in 2010–11.

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 remaining 66 IPs are authorised directly by the Secretary of State. This activity is funded by fee income, which in 2010–11 was £1.5 million.

Insolvency Case Administration. The Service's 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 29 ORs (supported by some 1200 staff) located throughout England and Wales. The ORs are answerable to the courts for the conduct of individual case administrations. Insolvency case administration is funded by administration fees that are set at levels intended to recover costs from a combination of petition deposits and asset realisations. The petition deposit charged recovers only part of the relevant case administration fee and in many cases there are insufficient assets to recover the remaining element of the fee. The Service also delivers, in partnership with approved intermediaries, Debt Relief Orders (DROs) which provide relief for those overwhelmed by relatively low levels of debt and without surplus income or assets.

Estate Accounting. The Insolvency Services Account (ISA) provides banking facilities to ORs and IPs in relation to the estates of bankrupts and compulsory liquidations. This activity, together with the associated estate accounting, is funded by fees and the total cost in 2010–11 was £4.3 million, of which £2.15 million is charged to OR administration and covered by the administration fee. £2.15 million is charged to IP cases and recovered through fees charged to the estates administered by them.

Investigation and Enforcement. The Service's investigation and enforcement activities aim to promote confidence in markets by ensuring that dishonest, reckless or irresponsible bankrupts and company directors are identified and dealt with in a professional and proportionate manner, in the public interest. 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. Official receivers can also apply to have the bankrupt's period of discharge suspended in cases where the bankrupt fails to co-operate. It is also possible to obtain a Debt Relief Restrictions Order against individuals who abuse the Debt Relief Order process.
- 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 Directorates carry out fact-finding investigations into live companies and may petition the court for the winding up of companies in the public interest.

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 BIS budget. In the current financial year 2011–12, the budget provided by BIS is £33.5 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 150 staff are engaged in this activity and in 2010–11 they handled 116,972 claims. This work is funded by an administration budget from HM Revenue and Customs, created by a transfer out of the National Insurance Fund and agreed with The Service via a service level agreement. In 2011–12, the cost of this activity is expected to be £8.6 million.

9. During the last two years, The Service has experienced a substantial reduction in income associated with an unexpected and steep fall in bankruptcy. This, combined with a fall in asset values in insolvency cases, which has adversely affected The Service's ability to recover its fee from insolvent estates, has put The Service under severe financial strain. The effects of this have been felt across The Service and are referred to later in this memorandum. The Service has already taken substantial steps to address this issue. For example, since 1 April 2010 it has reduced its headcount by 28%, including running a major voluntary exit scheme for some 470 permanent staff in 2011. As a result of this and other measures, The Service has reduced its total annual costs by around 30% from £203 million in 2009–10 to a projected £143 million in the current year.

10. Continuing falls in case numbers and the absence of any recovery in asset values means that The Service needs to do more if it is to avoid rising deficits in the years ahead. The Service is therefore working closely with BIS and in consultation with its trade unions, on the development of a soundly based investment plan to restore it to a sustainable financial position over the medium term.

Policy

11. The Service works to maintain and develop the insolvency regime to make sure that it remains world-class and fit for purpose. It does so in close consultation with interested parties.

The Personal Insolvency Framework

12. 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 different procedures ensures that, whatever an individual's circumstances, a suitable remedy is available. These are:

- *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)* provide access to debt relief for those on low incomes, with no assets of value, who are overwhelmed by relatively low levels of debt; and
- *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.

13. In addition to these statutory procedures, it is possible to reach informal agreement with creditors. The principal means by which this is done is through a Debt Management Plan.

The Corporate Insolvency Framework

14. The corporate insolvency framework facilitates the orderly and effective handling of the affairs of companies that become insolvent or that need to restructure to avoid liquidation. It is designed to promote economic stability and growth by enabling viable businesses to be restructured and to close non-viable businesses efficiently. The regime provides for an efficient resolution of the insolvency and seeks to protect, as far as possible, the interests of creditors by safeguarding their security, ensuring the equitable treatment of similarly ranked creditors, and providing protection to all creditors through claw back of preference and under-value transactions.

15. The UK system is well regarded internationally for its corporate rescue procedures: *administration* and *Company Voluntary Arrangements (CVAs)*. The World Bank's annual "Doing Business" report published in October 2011, includes a section on "resolving insolvency" (formerly "closing down a business"). In this latest report, the UK is ranked sixth out of 183 countries based on the time, cost and rates of return to creditors from corporate rescue procedures. This compares favourably with The Service's main competitors: the USA is ranked at 15, Germany is at 36 and France at 46.

16. 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 focused on rescue. It achieves this by making the process easier to enter and by giving companies a one year period to produce a plan for the business to be rescued, during which time creditors cannot take action (a moratorium). Administration is now the main procedure used for dealing with troubled businesses where there is some prospect of rescue or part trading on of the business.

17. The term *"pre-pack administration"* refers to an arrangement under which the sale of all or part of the company's business or assets is negotiated with a purchaser prior to the appointment of an IP as administrator. The sale is then effected shortly after the IP is appointed (often on the same day). A pre-pack will normally be used where commercial pressures require urgent action. In 2010, pre-packs accounted for approximately 27% of all administrations.

18. It is the Government's view that the existence of pre-pack administrations can make a valuable contribution to preserving jobs and economic value of ailing businesses. It is however important that the process is not abused. In 2009, a new Statement of Insolvency Practice *(SIP16)* was introduced to provide greater transparency. Under SIP16, IPs are required within 14 days to provide creditors with certain information regarding the pre-pack sale. This includes the reasons for the use of the pre-pack approach and an explanation of why this represented the best interests of creditors. The SIP16 disclosure is also sent to The Service for compliance monitoring purposes, and The Service reports on the outcome of this monitoring. The most recent report, for the period 1 January to 31 December 2010, showed that full compliance by IPs with the provisions of the SIP had increased to 75%, from 62% in 2009.

19. In light of continuing concern regarding the pre-pack process, in March 2010 the previous Government launched a consultation inviting views on improving the transparency of, and confidence in, pre-packaged sales in administrations.

20. The current Government reviewed and considered the responses to the consultation, engaging with interested parties in the process. Unsecured creditors have argued for some time that they are presented with little chance to influence events and insufficient information with which to determine if the pre-packaged sale was in their best interests. As many sales are to the owners or directors of the insolvent company, there is a perceived lack of transparency resulting in allegations of "phoenixism". "Phoenixism" describes the practice where directors or owners carry on essentially the same business successively through a series of failures, leaving unpaid debts each time.

21. In March 2011 the Government published the results of the consultation. The responses made it clear that the greatest cause for concern was where the business and assets are sold back to the current management or a connected party. In order to address these concerns and inject greater transparency into the process, the Government put forward plans for the following measures:

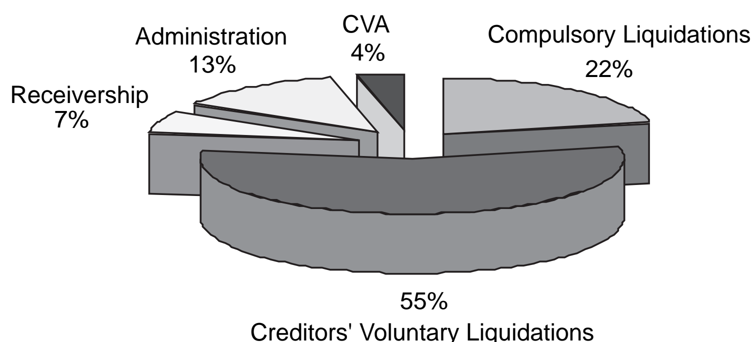
- administrators to give notice to creditors where they propose to sell a significant proportion of the assets of a company or its business to a connected party, in circumstances where there has been no open marketing of the assets;
- the detailed explanation of why a pre-pack sale was undertaken (already a SIP16 requirement) to be included in the administration proposals which are lodged at Companies House, making the information available to business as a whole, including credit reference agencies; and
- administrators to confirm in their consent to act that the sale represents, in their view, best value for the creditors.

22. Following detailed discussion with a broad spectrum of interested parties on these measures, Ministers are now considering the way forward and expect to make a public announcement early in the new year.

23. A CVA enables directors of a viable company to reach a legally binding agreement with creditors, for repayment in full and final settlement of all or some debts, over a period of time. This procedure provides a light-touch alternative to administration in which the existing management stays in place.

24. 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 IP to deal with assets subject to that charge, which can include the whole of the company's business.

Breakdown of Corporate Insolvencies 1 January - 30 September 2011



Proposed reform of petitioning for compulsory insolvency

25. In November 2011, the Government launched a consultation on proposals to reform the application process for bankruptcy and the compulsory winding up of companies. The aim is to provide the most appropriate route into bankruptcy and winding up, in order to provide an efficient service and better outcomes for both creditors and debtors. The proposals suggest the creation of a new office of the Adjudicator, based within The Service, to handle applications. The Adjudicator would decide the outcome of each application where there is no disagreement between the parties, and the courts would deal with more complex matters that require judicial expertise. The consultation closes on 31 January 2012 and the Government will consider the way forward in the light of responses to consultation.

REGULATION OF INSOLVENCY PRACTITIONERS

The Framework

26. In England and Wales only IPs in the private sector and ORs can legally act as office holders in insolvency proceedings. This includes acting as trustees in bankruptcy; liquidators; administrators and administrative receivers of companies; and supervisors of IVAs and CVAs. IP regulation in Great Britain is reserved to Westminster, and IPs are able to act as office-holder in equivalent Scottish insolvency procedures.

27. The Secretary of State—through The Service—regulates and monitors seven recognised professional bodies (RPBs) who authorise the majority of IPs, and also acts as an eighth authorising body. As at the start of 2011 the total number of IPs was 1,733, although only 1,341of those took insolvency appointments. There are currently 66 IPs directly authorised by the Secretary of State—around 4% of the total.

28. The RPBs are independent bodies that make their own membership rules and regulations, but are required to have in place rules to ensure their IPs are fit and proper people to carry out their duties and meet requirements as to education, practical training and experience. For IPs authorised by the Secretary of State, legislation sets out the framework under which they operate.

29. For all IPs, one of the main requirements is that they must pass an examination—the Joint Insolvency Examination—to qualify as an IP. The law also requires them to have in place a "bond", a form of insurance, against which a claim could be made if the IP acts fraudulently or dishonestly. Additionally, all IPs are subject to monitoring visits (at least once every six years, and earlier if considered necessary) from their authorising bodies. Monitors seek to establish that IPs are adhering to the legislation, and to accepted standards such as Statements of Insolvency Practice, the Insolvency Code of Ethics, and the relevant rules and regulations of the authorising bodies.

30. In its oversight role, the Secretary of State has agreed a set of principles with the RPBs in a Memorandum of Understanding, for the purposes of achieving consistency in the authorisation and regulation of IPs. In support of this, staff from The Service visit each RPB to monitor them, usually at least once in three years. This is to ensure that the RPB is complying with the Memorandum of Understanding. If any RPB fails to meet the requirements the matter may be referred to the Secretary of State, which could result in its status as a recognised professional body being revoked.

31. The Joint Insolvency Committee is made up of The Service together with representatives of the seven RPBs, and sets mandatory professional standards for IPs. The Service also disseminates information about the law and practice of insolvency to IPs by way of an electronic newsletter, Dear IP.

Insolvency Practitioner Regulation Reform

32. In 2010 The Office of Fair Trading published a market study, "The market for corporate insolvency practitioners". The results of the study found that whilst the market often functions well, unsecured creditors suffer losses as the regulatory framework does not effectively protect their interests, whilst shortcomings and inconsistencies in the regulation of IPs contribute to undermining confidence in the profession. In response to the study, in February 2011, the Government launched a consultation to consider a number of proposed reforms to the current regulatory system, principally:

- the establishment of regulatory objectives to increase accountability and better target regulatory activity;
- the establishment of a transparent, independent, consistent and robust complaints system to include challenges on the level of an IPs fees;
- the withdrawal of the Secretary of State from direct authorisation;
- to increase the range of sanctioning powers of the oversight body to make them more proportionate;
- to improve standard setting; and
- to make changes to particular regulations to increase the ability of unsecured creditors to influence insolvency procedures.

33. On the 20 December the Government published its response to the consultation on reforming the market for IP regulation. The successful operation of this market is important as it plays a vital role in enabling all markets to operate fairly and efficiently, by ensuring that in the event of insolvency as much as possible is fairly returned to those extending credit.

34. The present regulatory regime is a complex one involving a number of different regulators. The Government's assessment of the regime is that it works reasonably well, and that the vast majority of insolvency practitioners do a good job in difficult circumstances. The Government also recognises the benefits self-regulation provides, including its utilisation of the expertise of the profession.

35. However the Government considers that improvements need to be made to the system to increase returns to unsecured creditors and to deliver the vision of having a regulatory regime that is transparent, consistent, accessible, independent and accountable.

36. Responses to the consultation, along with subsequent discussions the Minister has held with stakeholders, have indicated strong support for an independent single regulator, as an effective and efficient way of achieving this vision. Although the Government is supportive of such a move and has not ruled out moving to this, it wishes to work with the profession and interested parties to see if there is a way to reform the system so that it delivers its objectives without such significant change.

37. The Government has therefore announced that it will:

— explore with interested parties how best to strengthen and simplify processes for handling complaints, including on excessive fee charging, and how best to achieve consistent and transparent sanctions where wrong doing has occurred;

— when Parliamentary time allows, introduce legislation to remove the Secretary of State from the direct authorisation of IPs, to ensure that the powers of the Secretary of State as oversight regulator are appropriate, and to ensure that the objectives of the regulatory regime are clear;

— consider the charging structure for oversight regulation, to ensure that it apportions the costs of this more fairly between the different regulators; and

— in light of any new regime for complaints, consider further the changes proposed in the consultation to insolvency secondary legislation, in order to improve the disclosure and transparency of fee charging, to modify court processes on challenges to fees and to allow unsecured creditors to exercise greater influence over insolvency proceedings.

38. A copy of the full statement can be found at http://www.bis.gov.uk/insolvency/Consultations/IPConsultation?cat=closedwithresponse.

Insolvency Case Administration

39. The main objectives of the work of the OR in 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);

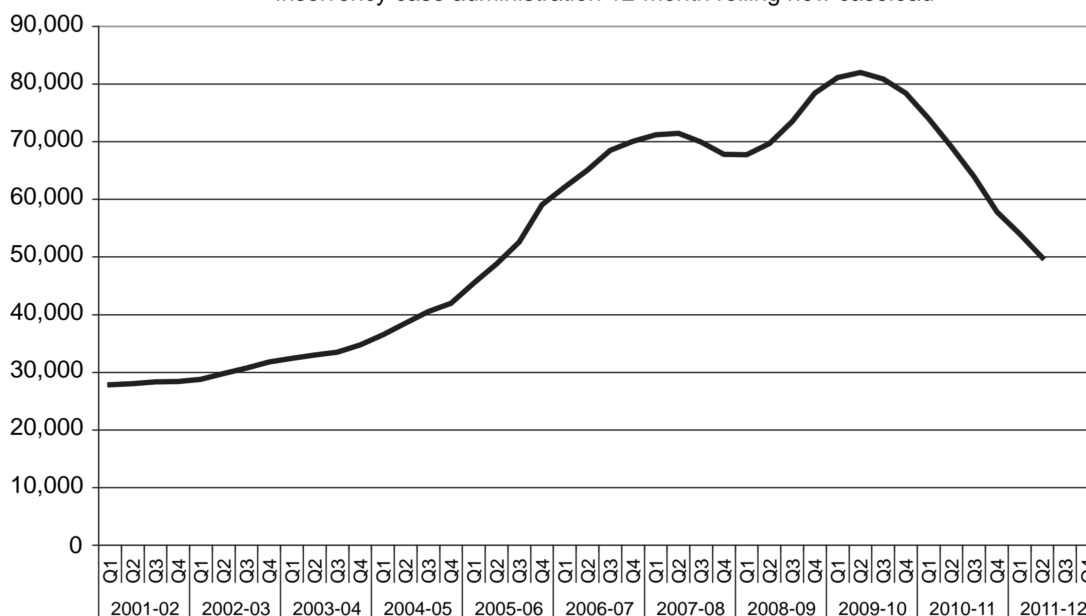
— administer bankruptcy to relieve debtors of overwhelming debts. Bankruptcy orders are made by the courts on either the petition of a debtor or creditor and ORs act (in the first instance) as trustees of the bankruptcy estate for the benefit of creditors;

— 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; and

— investigate the conduct of bankrupts and directors, whose cases they administer, and take action where appropriate.

40. This work is funded by a combination of case administration fees charged directly to each insolvent estate, and a Secretary of State fee on asset realisations. Income for the business is therefore directly dependent upon the number of new cases made each year and the assets available within those cases.

41. In 2009–10, ORs had *77,898* new cases to administer. This reduced to *58,029* in 2010–11, and in the first six months of 2011–12, *23,142* cases were received, *8,014* fewer than in the same period last year. This reduction in casework is mainly attributable to a rapid fall in the number of debtor petition bankruptcies.



42. Current projections for bankruptcies and compulsory liquidations for 2011–12 suggest a drop in the region of 45% from 2009–10 levels, in response to stabilising aggregate levels of consumer debt, increased reluctance in part as people move towards other debt relief solutions.

43. As a result of this steep decline in casework, income has dropped from £144.3 million in 2009–10 to £113.5 million in 2010–11. In October and November 2010, when it became clear that the reduction in case numbers was both significant and likely to continue, The Service introduced a range of cost reduction measures, including releasing approximately 100 temporary and agency staff, retaining only those in business-critical roles. From December 2010 to April 2011 around 360 of OR Services' 1,700 permanent staff exited under a voluntary scheme, reducing the permanent workforce by over 20%. Another 70 specialist staff were transferred into other business areas and following the continued drop in case numbers, a second voluntary exit scheme has recently been launched to deal with a projected surplus of 100 staff.

44. The significant fall in new cases in the current year, and the disruption inherent in such a large number of staff exits have impacted upon ORs' investigation of insolvents' conduct. As a result the number of bankruptcy restrictions has fallen from 1,796 (or 3.3% of total bankruptcy cases) in 2010–11 to around 800 currently projected for this year, which is above the lower range planning assumption, which was set at between 700–1,000. The ORs' contribution to The Service's output of director disqualifications has also reduced from 609 in 2010–11 to an anticipated 250 in 2011–12. It is anticipated that OR Services contribution to enforcement outputs will return to normal levels (3% bankruptcies and 5% compulsory liquidations) next year.

Insolvency Service bad debt write off

45. The Service receives income for the ORs administration and investigation of compulsory insolvency cases from fees charged to each insolvency case. However, as some insolvency cases do not have sufficient assets to cover the cost of administering the case, the case administration fee includes the cost of an expected bad-debt write off, which represents fees charged that The Service is unable to collect. Since 2004 The Service has estimated the bad-debt write off, based on an asset recovery model, to amount to around 12% of the case administration fee charged.

46. The case administration fee is recovered from a deposit collected at the outset of a case and from assets in insolvent estates. Where cases have few or no assets the recovery of the case administration fee relies on a second fee, the Secretary of State fee, being applied and collected on cases where there are assets.

47. There are many different types of assets in cases and while some may be realised at the outset of an insolvency case, some may not be realised for many years after the insolvency commences. As a consequence, the balance sheet in The Service's Annual Report and Accounts, reflects an outstanding debtor for those fees not yet collected, after providing for the expected write off of 12%.

48. As case numbers increased over the period from 2004–05 to 2009–10 the amount of the outstanding debtor for fees increased. The recession has reduced the proportion of new cases containing sufficient assets to cover the fee as well as reducing the value of unrealised assets in older cases. Fee changes made in April 2010 and June 2011 have addressed this issue in new cases, but fee changes cannot be applied retrospectively. Given this it was necessary to make a one-off adjustment in The Service's accounts in 2010–11 of £81.3 million, reflecting fees that The Service no longer expects to be able to recover, as a result of the accumulated effects of the credit crunch and recession. The Service's Annual Report and Accounts set out the net cost to the taxpayer of this write off since 2004, which is £15.7 million.

Insolvency Service Delivery Strategy

49. The scale and pace of change, along with a decline in the value and volume of assets in bankruptcy estates, has demonstrated the relative inflexibility of The Service's current organisational and geographical structures in reducing direct and indirect costs in line with falling case numbers and fee income.

50. In recognition of this inherent inflexibility, in early 2010 The Service's Directing Board (the Board) decided to look closely at how The Service might deliver services more flexibly in the future, by exploring a number of options for restructuring the organisation, including the potential closure of a number of offices. Throughout this process the Board engaged closely with the Agency Trade Union Side. From June to August 2011,The Service consulted its staff on the future Delivery Strategy. In that consultation, the Board expressed its preferred option of separating out front and back facing functions undertaken by The Service and centralising the former in fewer locations. The consultation document issued to staff can be seen at http://www.bis.gov.uk/assets/bispartners/insolvency/docs/publication-pdfs/deliverystrategy-consultationdoc.pdf. During this period the views of a number of key external stakeholders were also sought.

51. Following the conclusion of the consultation, and having considered all the responses carefully, the Board announced to staff in September 2011 its intention to:

- adopt a new Delivery Strategy, with back-office work focused in fewer locations and the maintenance of a network of local offices across the country for necessary face-to-face customer work;

— put a case to BIS for funding support to allow The Service, subject to full public consultation, to close its offices in Medway and Bournemouth in 2012 and Stockton in 2013;

— review the funding regime for OR Services case administration work; and

— review the corporate centre, in order to ensure it is sized and structured appropriately for the current and future size of the organisation.

52. The new Delivery Strategy proposes the creation of centres to deal with the back office administration of insolvency case work, and the non face to face interactions with insolvents. Over 80% of debtor petition bankruptcies, the more volatile workload, are currently dealt with without the need for face to face contact, at least in the first instance, although much of this is currently based locally. By centralising this activity The Service will increase process efficiency and more importantly limit the impact of any future caseload volatility on its network.

53. In contrast, a network of smaller local offices will focus on the necessary face-to-face interactions with bankrupts and company directors, including any relevant investigations.

Estate Accounting

54. IPs acting as liquidators in voluntary liquidations have been able to choose their provider of banking services and some still use The Service's Estate Accounts Services. However, following a consultation in late 2010 this option has been withdrawn for all new voluntary accounts from 1 October 2011. Accounts in operation at 1 October 2011 can either be continued until they are closed or withdrawn and placed in a commercial account.

Investigation and Enforcement

55. The Service's various activities in this area are summarised at paragraph 8.

56. The objective of The Service's investigation and enforcement work is to enhance the confidence of market actors by removing from markets those who are deemed unfit, by virtue of their conduct, to be market participants. The removal of bankrupts from credit markets, the disqualification of unfit directors and the compulsory winding up of disreputable companies, are all aimed at protecting those whose interests may otherwise be put at risk.

57. 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.

58. 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 83% for bankruptcy restrictions. The high undertaking rate makes the process very cost effective as early resolution saves the cost of a formal court procedure.

59. The Service operates a hotline to enable members of the public, IPs and creditors to "blow the whistle" on apparent misconduct, particularly by bankrupts and directors who are ostensibly contravening bankruptcy restrictions or disqualifications. Substantive and valid complaints are passed to ORs or Company Investigations Teams for further investigation or, where there is evidence of potential criminal activity, such as fraud or theft, to BIS prosecuting lawyers for investigation with a view to possible prosecution. The hotline therefore ensures that instances of misconduct or abuse that are of most concern to the public, are properly addressed.

60. During 2010–11, The Service conducted an evaluation of the impact of its enforcement activities, which was validated by BIS economists. The evaluation concluded that the financial and other impact of The Service's investigation and enforcement activities support the integrity of the insolvency and corporate regimes and continue to be both substantial and integral to the maintenance of market confidence.

61. In the last four years (from 2008–09) The Service's budget for investigation and enforcement has fallen by £6.6 million. Reported incidences of director misconduct have remained relatively stable, although incidences of debtor misconduct have decreased as bankruptcy numbers have fallen (see paragraph 44).

62. The funding The Service receives is currently sufficient to enable enforcement activity to be undertaken across a broad spectrum of cases. At the vetting stage, cases accepted for investigation for both insolvent cases from IPs and live company cases are prioritised in terms of the Public Interest and other factors. At present The Service is able to investigate all insolvent cases which pass vetting, though this position can change, for example, if the volume of cases passing vetting rises or if two or three especially complex cases arise. However, in respect of live company cases, in recent years The Service has not been able to investigate all cases which pass vetting. This is because of both resource constraints and more recently because of the effects of significant staff movement across The Service (see paragraph 43). Cases are rigorously prioritised. Where they are not immediately allocated for investigation they are reviewed after two months and then again each month until six months. If a case has not been allocated for investigation at month six, it is usually discontinued. As a result of this rigorous and repeated assessment, The Service ensures that it gets the best value for money in terms of targeting the cases whose investigation is most strongly in the Public Interest.

63. In 2010, the average length of director disqualification undertakings and orders was 6.1 years. The number of key enforcement outputs for The Service for the period from 2006–07 to 2010–11 was:

Outputs	*2006–07*	*2007–08*	*2008–09*	*2009–10*	*2010–11*
Disqualifications	1,223	1,173	1,281	1,388	1,437
Bankruptcy restriction orders and undertakings	1,867	1,827	1,781	1,948	1,796
Live Company Investigations	174	193	240	268	205

Redundancy Payments

64. 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 employer has not paid. Payments, and the costs of administering them, are paid out of the National Insurance Fund.

65. The current economic climate has had a significant impact on the number of claims The Service is receiving. While not at its peak (in 2008–09 165,000 claims were received) claim numbers are still running at over 50% more than the pre-recession level of 76,000 claims.

66. The Service aims for 93% of claims to be paid within six weeks, and 80% paid within three weeks.

Devolution

67. The Insolvency Service's jurisdictions within the UK, in summary, are as follows:

Personal insolvency, including enforcement	England and Wales
Corporate insolvency	Mixed: some Great Britain (including civil enforcement) and aspects England and Wales only
Companies Act investigations and inspections	UK
IP Regulation	Great Britain
Redundancy Payments	Great Britain

23 December 2011

Supplementary written evidence submitted by The Insolvency Service

Thank you for your letter dated 26 October in which you detailed action points for The Insolvency Service following the oral evidence session on 23 October. The action points together with the responses are set out below.

1. *Dr Judge to send the Committee a note on The Service's oversight of the seven regulatory bodies, particularity on the issue of complaints*

The Service carries out the Secretary of State's function in monitoring the effectiveness of the seven recognised professional bodies and publishes an annual report on the regulatory system. A copy of the latest published report is attached for information. Monitoring visits and any recommendations made are taken very seriously by the recognised professional bodies and recent visits demonstrate continuous improvement. The Secretary of State only has power to derecognise a recognised professional body (RPB) as an authoriser.

The Secretary of State is not an appeals body for complaints sent to the RPBs, however we can consider complaints where the RPBs have not followed their published processes in dealing with a complaint. This does not preclude us from having a dialogue with the RPBs where we do not feel they are dealing effectively with any aspects of regulation.

Our then Minister Edward Davey announced in December 2011 that his vision was to have a regulatory regime that is transparent, consistent, accessible, independent and accountable. Responses to a consultation on the insolvency regime and subsequent discussions the Minister held with stakeholders, indicated strong support for an independent single regulator for insolvency practitioners as an effective and efficient way of achieving these aims. The Minister saw the merits of this but wished to work with the profession and interested parties to see if there is a way to reform the system so that it delivers better against our objectives without such significant change. He went on to say that we will explore with interested parties how best to strengthen and simplify processes for handling complaints, including on excessive fee charging, and achieving consistent and transparent sanctions.

Government policy remains that it intends to bring forward proposals, when legislative time permits, to remove the Secretary of State from the direct authorisation of insolvency practitioners. This would ensure that the powers of the Secretary of State as oversight regulator are appropriate, and that the objectives of the regulatory regime are clear.

2. *Dr Judge to send the Committee a note on the current progress towards common sanctions guidance*

As mentioned in answer to action point 1, above, we have been working with the recognised professional bodies on measures which are aimed at improving confidence in and transparency of insolvency regulation. Good progress is being made. The measures include the introduction of a common complaints portal to improve accessibility for creditors, a common independent appeals process, and working towards commons sanctions guidance. The proposed measures will deal with complaints about insolvency practitioner fees to the extent that they represent misconduct on the part of the practitioner.

3. *Dr Judge to send the Committee a note on asset-based lending and update the Committee on meetings held with officials from the BIS Department and the Treasury, as well as the Campaign for Regulation of Asset-Based Finance*

An asset based lender, or invoice factoring company, is one which lends money to a business in return most frequently for receiving the payments of the firm's book debts. In doing so the factoring company takes a charge (security) over the firm's book debts.

Invoice financiers are a valid alternative source of finance. Invoice factoring, like lending to businesses more broadly, is not a regulated activity, and provides around £15 billion of credit to SMEs. The industry currently however has no clear independent process for responding to complaints.

Government officials in BIS and HM Treasury met with various stakeholders during the first week of October. This included the Campaign for the regulation of Asset based Finance, which has been leading the call for regulation in this area, and the Asset Based Finance Association (ABFA), the trade body for the industry.

ABFA is proposing to increase the level of self regulation in the industry by establishing a complaints panel that will be managed by ABFA, but will have a majority of independent members. ABFA is also developing a new and tighter Code of Conduct. Both appear robust and further Government action will depend on how well they work in practice.

A campaign group has called for the industry to be regulated, but currently neither factoring, nor business lending more generally are regulated activities. The Financial Secretary to the Treasury has written to the campaign group to confirm that HMT are not considering legislation. We have received some complaints regarding asset based lenders which we are currently considering. We have indicated that we are happy to receive any additional evidence of misconduct or abuse in this area.

4. *Dr Judge to send the Committee a note on the number and the level of fines that have been levied for SIP 16 non-compliance*

Since January 2010 there have been a total of six fines given to insolvency practitioners by their authorising bodies for breaches of SIP 16. The fines ranged from £250 to £2,500 with costs attached ranging from £250 to £2,167. In 26 other cases, the authorising bodies took regulatory action resulting in five consent orders without financial penalty and 21 formal warnings. There are 10 SIP16 referrals currently with the authorising bodies for consideration.

Richard Judge
Inspector General and Agency Chief Executive

9 November 2012

Written evidence submitted by the Institute of Credit Management

The Institute of Credit Management is the largest professional credit management organisation in Europe. Its members hold important, credit-related appointments throughout industry and commerce, and are key stakeholders in every form of insolvency as creditors, often unsecured. We therefore feel it appropriate to submit evidence to the inquiry.

Pre-Pack Administrations

The institute has engaged actively with the Insolvency Service in the recent consultation relating to pre-pack sales and the introduction of a notice period. We recognise the conflicting views and interests involved but believe the opportunity for creditors, who may have detailed and local knowledge, to provide information to the insolvency practitioner is vital. We believe the intention to allow the notice to be waived, with the Court's

permission to be sensible and would only urge that adequate consultation takes place before the detailed changes are implemented to avoid the risk of unintended consequences.

We recognise the value of pre-pack sales in rescuing businesses and maintaining employment and believe, in the right circumstances, they are appropriate and useful. We are however concerned when the process is simply used as a vehicle to allow the rise of a phoenix company that has absolved itself of debts and continues to trade as if it were the former business to the detriment of unpaid creditors. Indeed, on occasions, the knock-on effect of such an administration can be the failure of other businesses.

Possible Regulation and Sanction of Licensed Insolvency Practitioners

We would point out that licensed insolvency practitioners have always been regulated by their RPBs and sanctions already exist. The Joint Insolvency Committee, on which the Institute of Credit Management now sits as a lay member, has been working towards common sanctions guidance and progress is well underway.

We also believe the work towards a strengthened and simplified complaints process, highlighted by Ed Davey in his December 2011 statement, will be of benefit in creating an environment in which complaints are seen as being treated more consistently and seriously.

Creation of an Insolvency Ombudsman

The Insolvency Service should be the regulator of regulators, and the decision to remove the Secretary of State from the direct authorisation of insolvency practitioners is helpful. The proposal for a strengthened and simplified process for handling complaints (mentioned above) is welcomed by the Institute and the creation of an Ombudsman would, in our view, add little value and be likely to add a further layer of bureaucracy that we could not support.

Strengthening of the Control of IP's Remuneration

We believe the complaints proposal, the remit of which would include excessive fee charging will enhance control, as will measures to encourage the engagement of creditors through, for example, Creditor Committees. Anything that encourages transparency is to be encouraged but not if it adds significantly to costs and we would suggest that the revised complaints regime should be introduced and tested prior to further steps. We would also suggest that the impact of the changes to the Insolvency Rules introduced in 2010 need to be fully established, and their impact assessed, before further action is instigated.

The Effects of the Reductions in the Service's Staff and Budget

We would be greatly concerned if the reductions in budget resulted in a degradation or reduction of Disqualification Unit activity. We believe any such dilution of activity would send entirely the wrong message to delinquent directors at a time when corporate insolvencies are likely to increase.

There are occasions where the return to creditors in an insolvency in which funds are available is reduced because of the need to fund non-asset insolvencies and this inequity should be considered alongside the broader funding issues.

22 December 2011

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

Introduction

1. We are writing to provide evidence in response to the call for evidence by the Business, Innovation and Skills Committee on the Insolvency Service. ICAEW would be pleased to provide oral evidence on any aspect of its submission.

Who We Are

2. ICAEW is a world leading professional accountancy body supporting over 136,000 Chartered Accountants in more than 160 countries. We are the largest single insolvency regulator in the UK, regulating 700 out of 1,700 Insolvency Practitioners (IPs). Our IPs work in firms of all sizes, but around 45% of ICAEW's appointment-taking licence holders are based in national practices with several ICAEW licensed IPs.

3. Although we offer insolvency licences to non-members the majority of our licence holders are also chartered accountants. As a regulator of IPs, ICAEW's aim is to ensure that those IPs we license meet the appropriate legislative and regulatory standards.

4. As a Recognised Professional Body (RPB) our primary contact with the Insolvency Service is with its policy teams, although our IPs have contact with Official Receivers and their staff. Our aim in all these interactions is to assist the Insolvency Service in achieving its policy objectives, and challenge their views if

we believe a policy is unworkable or unrealistic. We value the experience and expertise of the Insolvency Service staff with whom we interact and recognise that the agency is facing challenging times.

5. With a Royal Charter, we work in the public interest with governments, regulators and industry to maintain the highest business and ethical standards

Executive Summary

6.

- — We welcome the government's commitment to work with the profession to reform the insolvency system so that it delivers its objectives without the need for significant change.
- — We are concerned that the insolvency profession will not be ready for the pre-pack administration changes (in April this year) which will affect liquidations and administrations.
- — If we are to encourage entrepreneurial activity we need to enable those who have failed to try again.
- — The key to consistent regulation is effective oversight of the RPBs.
- — We do not believe there is a strong case for the establishment of an Insolvency Ombudsman.
- — The Insolvency Service should play a greater role in educating creditors about IPs' remuneration and how they may participate in setting fees.
- — As the Insolvency Service sees its budget reduced, it could do more to explain to IPs its approach to the enforcement regime and allocation of resource.

Context

7. In difficult economic times there is an expectation that the insolvency profession will be overwhelmed with work. So far, the current difficult conditions have not had much of impact on the numbers of formal insolvency appointments but that is not to say that an IP's caseload will not be increasing.

8. It has been a time of extreme uncertainty for the insolvency profession and the RPBs. A government consultation published in February 2011 proposed a number of fundamental changes to the regulatory regime, including the creation of an independent complaints body and a move towards a single regulator for insolvency. We are pleased that this uncertainty is now at an end with the publication of the government's response to that consultation on 20 December 2011 and are encouraged by the Minister's (Edward Davey MP) statement that he wishes to work with the profession to see if there is a way to reform the system so that it delivers better against the government's objectives without the need for significant change.

9. The profession has faced other challenges during the last 12 months, including the possible changes proposed in the Legal Aid Bill (currently at Committee Stage in the House of Lords) to prevent the recovery of success fees for claimants' lawyers under Conditional Fee Arrangements (CFAs). In its current form, the Bill will have a negative impact on litigation undertaken by insolvency practitioners and ultimately affect returns to creditors (businesses and HMRC).

Pre-pack Administrations

10. The issue that causes many to question the use of pre packs is that creditors are often unaware that the sale has taken place until they receive notification from the administrator. A pre-pack is one of a number of tools available to an insolvency practitioner to facilitate business rescue. Pre-packs are used when a prompt sale of the business is necessary—this could be because of the nature of the business or if no funding is available to trade the business in administration. They have also been used to facilitate some large scale corporate restructurings, for example EMI.

11. An unfortunate consequence of any insolvency procedure is that creditors will not be repaid the full amount they are owed. This is not unique to pre packs and it is not the pre-pack itself that causes those losses but the failure of the business. Research conducted by Dr Sandra Frisby suggests that pre-packs achieve greater returns to creditors than a break up sale. And feedback from R3 members also suggests that pre-packs preserve employment.

12. Although there is a lot of negative perception around pre-packs, there is no real evidence to suggest there is a real flaw in the process. The Insolvency Service's own reports into the operation of statement of insolvency practice 16 (the standard introduced by the RPBs which requires IPs to provide an explanation of their actions to creditors) have not identified any evidence that there are different levels of director misconduct in a pre-pack than any other corporate failure. Similarly, a sale back to existing management is not in itself indicative of misconduct or malpractice.

13. If we are to encourage entrepreneurial activity we need to enable those who have failed to try again and that should include being able to purchase a business if they have made the best offer whether that is done via a pre pack or some other form of business sale.

14. Before steps are taken to make a pre-pack so difficult as to be unfeasible, more should be done to educate users of insolvency processes so they understand how the process works. The Insolvency Service is progressing policy proposals aimed at improving confidence in and the transparency of the pre-pack process.

15. We first expressed disquiet at the proposal to give three days notice (effectively six days when service requirements are factored into the process) of the transaction to creditors when this was included in the draft statutory instrument published by the Insolvency Service during the summer. For SMEs, it is unlikely that there will be funds available to trade the business for that six day period, value will be destroyed by the associated publicity and it is likely that suppliers will take the opportunity to cease supply. This requirement will essentially make a pre-pack unviable and so lead to business closure. In the case of large corporate restructurings, a lack of publicity preserves value—something that would be destroyed if notice had to be given to creditors. We understand this notice period (though possibly with a route available to waive the notice period) will still be included in the next revision of the statutory instrument, which could be introduced as early as April 2012. Our reservations over this remain, but as worrying is that there is to be no further publication of the draft statutory instrument before implementation and that it will not be available for scrutiny by the profession. We are concerned that the profession will not be ready for the changes which will affect liquidations as well as administrations which could lead to delays in the process and impact on business rescue.

Possible Regulation and Sanction of Licensed Insolvency Practitioners

16. There are eight RPBs which licence IPs. Those RPBs are subject to oversight by the Insolvency Service. The Insolvency Service itself directly authorises insolvency practitioners. What may have been a suitable model in 1986 (when the current structure came into place) may not necessarily be one that would be designed now but it is not immediately obvious that the current model is so flawed as to require fundamental change.

17. In the February 2011 consultation, the government's underlying message was that they preferred the creation of a single regulator in place of the current eight. We do not consider that such change was necessary, and responded to the consultation to that effect. We are therefore pleased to see that the Minister (Edward Davey MP) recently announce his intention to work with the profession to see if there is a way to reform the system so that it delivers better against the government's objectives without such a significant change as the introduction of a single regulator.

18. Outside mainstream financial services, there are few professions where there is a single regulator. There are multiple regulators in audit, legal services and "non mainstream" financial services. The structure for legal services regulation is a new model having become fully operational on 1 January 2010. The adoption of this structure was subject to extensive consultation and review. Multiple regulators should not necessarily lead to inconsistency—the key is effective oversight of those bodies, in this case by the Insolvency Service.

19. Most of the inconsistency in the regulation of IPs, arises from the significant differences between the powers available to the RPBs and the Secretary of State. In the survey of IPs conducted in May 2010 as part of the OFT's study, which asked for their views of insolvency regulation the Insolvency Service was considered to be the most lenient of the regulators.The Secretary of State has only the power to remove authorisation and no lesser powers of sanction—the RPBs have a range of penalties available to them to control the behaviour of their licensed IPs. We were therefore pleased to note that the government has confirmed its intention to bring forward proposals, when legislative time permits, to remove the Secretary of State from the direct authorisation of insolvency practitioners. This step will remove an obvious inconsistency in the approach to the regulation of insolvency practitioners.

20. As most of the RPBs will now issue insolvency licences to non-members there seems to be no reason for a regulator of last resort. Given the commonality of entry requirements between the RPBs, which form part of the memorandum of understanding between the RPBs and the Insolvency Service, it seems reasonable to suggest that if no RPB is willing to offer an applicant an insolvency licence then they are probably not suitable to be licensed.

21. One issue which may be outside the scope of this enquiry, but valid nonetheless, is the differing legislative frameworks for insolvency across the UK. Although rule changes in England and Wales are generally adopted in Scotland and Northern Ireland, there is usually a time lag which leads to inconsistency across the jurisdictions. For example, the changes to the Insolvency Rules introduced in England and Wales in 2010, have yet to be adopted in Scotland and Northern Ireland. An obvious way of achieving greater consistency would be to more closely align the legislation across England and Wales, Northern Ireland and Scotland.

Creation of an Insolvency Ombudsman?

22. In the February 2011 consultation, the government consulted on a proposal to create an independent complaints body for insolvency, although the consultation did not go as far as suggesting that this body be some kind of ombudsman. Their proposals included a number of suggested models for dealing with complaints ranging from a single independent complaints body to an independent appeal body.

23. We do not believe the case has been made that there is a fatal lack of confidence in the existing complaints systems which would require such a major overhaul of the existing systems. In the Insolvency Service's annual report for 2009, ICAEW's complaints handling is referred to as "accessible, effective, fair and

transparent." We are therefore pleased to note that the government has announced that it now wishes to explore with interested parties how best to strengthen and simplify processes for handling complaints, without it appears creating a new complaints body.

24. There is a general consensus that many existing insolvency complaints are about the legal framework or a creditor's financial loss rather than a failing in the IP's conduct. Many complainants are simply dissatisfied with an insolvency and the financial loss that has caused them. Personal debtors may be unhappy at the effect the process is having on their lives—loss of income or their home and other assets. There are other means for improving confidence which could be achieved at a significantly reduced cost. These could include greater publicity about the operation and efficacy of the current system, signposting of disciplinary outcomes and expectation management of potential complainants.

25. In these difficult economic times, it would be prudent to try and use these other means before committing to the creation of an independent complaints body, and we are working with the Insolvency Service and the other RPBs to look at ways we can work together.

Strengthening of the Control of IP's Remuneration?

26. Adequate mechanisms already exist within insolvency legislation for creditors to approve and review IPs' fees. The approval mechanism for an IP's fees allowed for by law allows creditors to have influence over fees. It would be inappropriate for a creditor who had not participated in this approval process to be enabled to challenge fees properly approved under the statutory mechanisms.

27. Rules introduced in 2010 aim to benefit creditors by providing greater transparency in respect of IP's fees. Creditors now have the right to request further information and more detailed explanations of anything contained in the office-holder's report, and greater rights to challenge fees and expenses. There has been little opportunity to assess the impact of these changes and it is unclear whether there will be any evaluation of these changes by the Insolvency Service. If these changes have proved ineffective in increasing creditor engagement then that should be evidenced before any further changes are proposed.

28. More should be done to encourage creditor engagement in the fee approval process. For creditors who only have limited experience of insolvency procedures this may be difficult to achieve initially, but repeat creditors should be encouraged to participate and the Insolvency Service has a role to play in educating creditors.

29. Creditor education is also important so that they understand how an IPs fee is calculated and the work involved in a particular insolvency. There are many actions taken by the IP that are prescribed by law and follow a detailed administrative process which is again prescribed in the rules. IPs are also required by law to fulfil functions in the wider public interest such as Company Directors Disqualification Act 1986 and money laundering reporting which may have no direct benefit for the creditors in a particular insolvency. For compulsory liquidations and bankruptcies there is also the impact of the Secretary of State fee to be taken in account, something which many creditors will be unaware of. In addition, a new statement of insolvency practice 9, was introduced by all the RPBs on 1 November 2011. This requires an IP to provide information sufficient to enable creditors and other interested parties to exercise properly their rights under the insolvency legislation, a move we support.

30. A major step would be for those government departments who are creditors in an insolvency to actively participate in the approval of fees. It would be interesting to see in how many cases currently HMRC or the Redundancy Payments Service exercise their voting power. Though we appreciate there would be resourcing implications for both these departments in taking such steps, we believe that wherever possible the government should lead by example and participate in the insolvency proceedings where they are a creditor.

31. An extreme example of where creditor participation is at its most effective is the creditor agent voting system in the consumer Individual Voluntary Arrangement (IVA) market. Whilst voting behaviour in IVAs has been criticised in some quarters and may have had unforeseen outcomes, the creditor agents exert significant downward pressure on nominee and supervisor fees in consumer IVAs using the means available to them under the Act and Rules. These creditors, some of whom will have purchased the debt from the original creditor at much less than its face value, have obviously taken a commercial decision to participate in the process which would appear to suggest that the existing mechanisms for creditor control of fees are effective.

The Effects of the Reductions in the Service's Staff and Budget

32. We welcome the Insolvency Service's robust and innovative approach to the spending constraints it faces, whilst aiming to deliver high quality public services.

33. ICAEW's licensed IPs have raised concerns about their recent interactions with the Insolvency Service (although have not said that this is as a direct result of reductions in the Service's budget), in particular:

— Secretary of State appointments being sought close to expiration of the statutory three year period for dealing with the family home, leaving the IP with little time to realise the interest in the property—in one case there was only two months remaining, before that three year period expired.

— Delays in handing over cases to IPs.
— Inadequate information being supplied on handover, with often no action having been taken to protect assets or collect in accounting records.

34. More could also be done to explain to IPs the Insolvency Service's approach to the enforcement regime and allocation of resource. IPs often feel that the cases where they have reported serious misconduct are not pursued. Perhaps the Service could do more to explain how they prioritise the cases which are targeted for enforcement action.

6 January 2012

Written evidence submitted by the Joint Insolvency Committee

The members of the Joint Insolvency Committee represent the bodies that regulate the practice of insolvency in Great Britain: The Association of Chartered Certified Accountants; The Insolvency Service; Insolvency Practitioners Association; The Institute of Chartered Accountants in England and Wales; The Institute of Chartered Accountants in Ireland; The Institute of Chartered Accountants of Scotland; The Law Society of Scotland; Solicitors Regulation Authority.

The Joint Insolvency Committee (JIC) welcomes the opportunity to submit evidence to the select committee. This submission is made on behalf of the Recognised Professional Body (RPB) members of the JIC. Our evidence is restricted to those matters within the scope of the JIC, primarily consistency and standard setting, where the JIC interacts with the Insolvency Service (IS).

Set out at annex A to this submission is a brief history of the JIC and its objectives, putting the interaction between the JIC and IS into context.

The JIC meets four times each year but works through the year and with sub-groups between meetings. Each RPB is represented on the JIC, usually by an insolvency practitioner (IP) supported, where appropriate, by staff from the RPB they represent. The JIC also welcomes a number of observers who play a valuable role in updating JIC on issues from within their remit. Details of the RPBs, other JIC members and observers are detailed at annex B to this response.

The IS attends this meeting in two contexts, the first as a competent authority for the purpose of authorising IPs, and secondly as the oversight regulator of the RPBs. These roles are fulfilled by two people.

Although, there is a full public consultation involved in the development of all new standards, the JIC believes that inviting lay members to join the committee will further increase transparency and involve other interested parties in JIC's discussions from the outset. JIC contacted a number of organisations identified by the IS as having a particular interest in insolvency and as a result of that process we are delighted that the Association of British Insurers, HMRC and the Institute of Credit Management have accepted invitations to join the JIC. At its meeting in November 2011, the JIC welcomed these three new lay members to the committee.

Given the role of the JIC, and the desire of the IS to work with the JIC, it would be helpful if the IS could share its objectives, policies and agenda such that the JIC can prioritise its work and better achieve both the goals of the JIC and objectives of the IS. We hope that this will change now that the Government response to the consultation on reform of the regulation of IPs has been published.

Pre-Pack Administrations

The JIC developed a new Statement of Insolvency Practice (SIP) for pre-pack administrations—SIP 16, which was introduced in January 2009. The overriding aim of the SIP was to increase transparency regarding pre-packs and to ensure that creditors were provided with information on a timely basis. The SIP requires the administrator to provide creditors with a detailed explanation and justification of why a pre-packaged sale was undertaken, so that they can be satisfied that the administrator has acted with due regard for their interests (see paragraph 8 of the SIP).

It had always been the JIC's intention to keep SIP 16 under review and to assess its effectiveness. In 2010, the JIC consulted with users of insolvency proceedings and the profession to establish how SIP 16 was working. The feedback received was that there were few requests from creditors for further information after having seen SIP 16 information, and this feedback would suggest that SIP 16 is achieving its objective.

The JIC has not however progressed its review of SIP 16 as the Government has plans to legislate in this area. A first draft of the proposed statutory instrument was published during the summer of 2011, and members of the JIC and other interested parties made extensive comments and suggestions. It is expected that a revised statutory instrument will be in force by April 2012. It is of concern to the JIC that the profession may not see and be able to comment on the detail of the statutory instrument before it comes into force, as it will have a direct impact on SIP 16. There could be no need for the SIP going forward, but without the opportunity to scrutinise the statutory instrument, or have some further explanation from the IS, the JIC will struggle to have an appropriate standard in place. This will obviously have an impact on the profession (which will have to

deal with a period of uncertainty) but in relation to other interested parties, in particular creditors, there will be no opportunity to manage expectations on the level of information they may or may not expect to receive.

Furthermore the JIC has met with the IS and other RPBs to discuss the consistency and adequacy of disclosure around SIP16, and the need for IPs to ensure that the principles outlined in paragraph 8 of the SIP are being followed, as opposed to merely providing data with no explanation. This informal working group concluded with the IS that the approaches of the RPBs in assessing submissions by their members are consistent.

Possible Regulation and Sanction of Licensed Insolvency Practitioners

IPs are of course already regulated and have been since the introduction of the Insolvency Act, 25 years ago. The JIC is actively looking at common sanctions guidance for its RPBs' committees and tribunals involved in making decisions on complaints, and also common principles for the publication of disciplinary findings. These are important ingredients in the drive towards greater consistency in complaints handling and in transparency of outcomes. At its most recent meeting, JIC was able to agree many of the fundamental points of principle. Further detailed work is now underway with a view to finalising draft common sanctions guidance for the bodies.

Whilst each of the RPBs has a series of sanctions that can be applied to licensed IPs (ranging from an unpublicised caution to removal of an IP's authorisation to act), the IS as a regulator is disadvantaged in that it only has a single sanction against those IPs that it directly authorises (approximately 5% of the total IP population), which is the removal of authorisation. For that reason alone the decision of the IS to stop being a direct regulator of IPs is welcomed. The other RPBs can then ensure that there is transparency, consistency and appropriate sanctions that the IS can review as oversight regulator.

Strengthening of the Control of IP's Remuneration

The JIC's primary interest in remuneration is through SIP 9, which deals with payments to insolvency office holders and their associates. This SIP reflects the enhanced creditor rights introduced by the Insolvency Rules 2010, and also reinforces the need for information to be provided that is comprehensible and transparent. This an area which shows SIPs at their most effective. The law will never be able to reflect fully the nature of the relationship between the insolvency profession and the users of insolvency processes—standards enable us to build a framework that goes beyond time scales and bald facts, and requires IPs to provide information that explains why they are seeking payment of a particular sum.

The IS played an active part within the working group in developing the recent revisions to SIP9. SIP9 (England and Wales) came into force on 1 November 2011 and SIP9 (Scotland) is close to being issued.

The SIP needs to be placed into context with insolvency legislation that guides and determines the remuneration that an IP can seek. However, each of the RPBs (and indeed individual IPs) recognise that active participation of all creditors (both secured, preferential and unsecured) in the setting of insolvency fees is to be encouraged. This need for inclusion of all creditors has been made to the IS, and should be part of the general education of the wider stakeholder community—a role that falls to the IS. Discussions at the JIC have often centred around the lack of participation to date by government bodies (such as HRMC and the Redundancy Payments Service) in many cases.

The JIC believes that existing mechanisms within insolvency legislation for creditors to approve and review IPs' fees, when linked together with SIP9, are adequate and enable creditors both to influence, and ultimately approve or reject, fees in an appropriate manner, particularly given the enhanced rights for creditors introduced in the 2010 Rule changes (the full impact of which has yet to be assessed). However, as part of our ongoing review of the adequacy of existing systems and in response to the latest Government announcements, we will be giving further consideration to the extent to which complaints about the remuneration of IPs can be accommodated within the RPBs' complaints systems.

The Effects of the Reductions in the Service's Staff and Budget

The JIC operates as a standard setting body without any formal budget and relies on the members of the JIC to fund the expenses of their representatives and the costs of hosting meetings. The working groups which review SIPs are made up entirely of volunteers. Secretariat services, including the consultation processes for new standards, are provided to the JIC without charge.

The JIC's engagement with the IS is primarily with staff within the policy functions of the IS, rather than with the Official Receivers' operational staff. We may not be seeing first-hand the effects of reductions in budgets and staff, but we are conscious that those staff we primarily deal with are funded by a levy paid by every insolvency practitioner. The insolvency profession is diverse, ranging from sole practitioners to multi partner global operations, and the IS should not assume that the profession can bear increasing levy costs.

5 January 2012

Annex A

ABOUT THE JIC

The JIC was formed in 1999 and provides a forum for discussion and promotes consistency of approach across bodies which authorise insolvency practitioners in Great Britain. Its mission statement is to:

— *Consider, maintain, improve, develop and promote insolvency standards and guidance of a regulatory, ethical, or best practice nature by means of debate and agreement within the Committee.*

— *Discuss any such matters with any other appropriate bodies.*

— *Facilitate discussion between authorising bodies in order to ensure that, as far as possible, insolvency practitioners are dealt with uniformly by such authorising bodies.*

The JIC has three primary regulatory tools by which it can fulfil its mission statement—the insolvency code of ethics, statements of insolvency practice, and insolvency guidance papers.

Statements of Insolvency Practice (SIPs) are a series of guidance notes issued to licensed insolvency practitioners with a view to maintaining standards by setting out required practice and harmonising practitioners' approach to particular aspects of insolvency. All insolvency practitioners are therefore working to common standards.

SIPs are issued under procedures agreed between the insolvency regulatory authorities acting through the JIC. Where appropriate, when changes are made to SIPs affecting England and Wales, equivalent changes are made to those affecting Scotland and Northern Ireland.

The purpose of SIPs is to set out basic principles and essential procedures with which insolvency practitioners are required to comply. Departure from the standards set out in the SIPs is a matter that may be considered by a practitioner's regulatory authority for the purposes of possible disciplinary or regulatory action.

Insolvency Guidance Papers (IGPs) are issued to insolvency practitioners to provide guidance on matters that may require consideration in the conduct of insolvency work or in an insolvency practitioner's practice. Unlike Statements of Insolvency Practice, which set out required practice, IGPs are purely guidance and practitioners may develop different approaches to the areas covered by the IGPs.

Annex B

MEMBERS OF THE JIC

The Association of Chartered Certified Accountants

Insolvency Practitioners Association

The Institute of Chartered Accountants in England & Wales

Chartered Accountants Regulatory Board
(Chartered Accountants Ireland)

The Institute of Chartered Accountants of Scotland

The Law Society of Scotland

Solicitors Regulation Authority

The Insolvency Service

Association of British Insurers

Institute of Credit Management

HMRC

OBSERVERS OF JIC

Representatives of
- The monitors of the authorising bodies
- R3
- The Accountant in Bankruptcy
- The IS Northern Ireland
- Law Society Northern Ireland

Written evidence submitted by the Legal Ombudsman

Introduction

The Legal Ombudsman was set up following the Legal Services Act 2007 to deal with service complaints in the legal sector. We have now been in existence for more than a year. Our remit is to resolve disputes in a cost effective, fair and transparent manner, providing a straightforward path to redress for consumers of legal services. Our secondary purpose is to feed back information to consumers and the legal profession to help drive up standards and improve consumer confidence in this sector.

We use technology to ensure complaints are dealt with quickly and at less cost than the previous arrangements; operating within a budget of £19.9 million compared to the old system which cost £32.5 million, according to independent analysis commissioned by the Ministry of Justice. The other key change from the previous arrangements is that we are an independent body, a crucial element to resolving complaints in any sector. The creation of the Legal Ombudsman was a deliberate move away from self-regulation by the legal profession, designed to improve consumer confidence in the system.

We have had a positive response from our first customer satisfaction survey, with 67% of respondents saying that they were satisfied with the professional service provided by the Legal Ombudsman. This is comparable to satisfaction with other more established bodies such as the Financial Ombudsman Services, an encouraging result for our first period of operation.

Our early learning from legal complaints is that the legal and consumer landscape is constantly changing and that our service needs to adapt to developments and provide access to redress for all consumers using legal services. As such we wished to share our experiences and expertise to assist the Insolvency Service in reforming their complaints handling structure.

We welcome the BIS Select Committee's inquiry into the Insolvency Service. The terms of reference of the inquiry can be split into three sections: the first looks at the effectiveness of pre-pack administrations and proposed changes to pre-packs announced in March 2011; the second looks at the effects of the reductions in the Service's staff and budget; and the third section looks at the possible creation of an independent complaints body. In our submission we will comment on the first and third sections.

Pre-pack Administrations (Issues of Transparency, their Link to "Phoenix" Companies)

We welcome proposals to increase transparency within pre-pack administrations. To date, we have investigated and closed 209 cases where the company has been a successor firm. This is around 3% of our cases.

The Legal Services Act 2007 (the Act), ensures that when we order a law firm to pay compensation to a complainant; successor firms, including "phoenix" firms, are liable to provide the redress, if appropriate. The Act states that:

"(1) The ability of a person to make a complaint about an act or omission of a partnership or other unincorporated body is not affected by any change in the membership of the partnership or body.

(2) Scheme rules must make provision determining the circumstances in which, for the purposes of the ombudsman scheme, an act or omission of a person ("A") is, where A ceases to exist and another person ("B") succeeds to the whole or substantially the whole of the business of A, to be treated as an act or omission of B.

(3) Rules under subsection (2) must, in relation to cases where an act or omission of A is treated as an act or omission of B, make provision about the treatment of complaints under the ombudsman scheme which are outstanding against A at the time A ceases to exist."

Due to the provisions made in the Act, ordinarily, pursuing redress for complainants from successor firms is relatively straight forward. However, it can become more complicated if the firm disagrees about their status as a successor firm or if the firm has reopened under a new regulator. Take this case study:

> Firm A operated for less than a year in 2009–10. In 2010, the firm was replaced by another company with the same solicitors and partners, the same premises and many of the same customers. We considered this firm to be a successor firm of Firm A and we ordered redress for the complainants who had received poor service. The case was, however, complicated by the firm's denial that they were a successor firm and the fact that they had reopened under a new regulator. Neither of the regulators involved could tell us whether they were prepared to treat the firm as a successor of firm A. It was clear that the complainants were not going to be successful in claiming their compensation on their own, so we worked with them to access it. Once the legal proceedings had been triggered, the firm unexpectedly accepted responsibility for the complaints under its previous name. So, the members of the public who have been seeking redress will now receive the compensation they are entitled to.

We are keen that any changes to the Insolvency Service should consider the needs of consumers as well as creditors. This not only creates positive outcomes for members of the public, but can also improve consumer confidence in the profession. Part of the role of an independent Ombudsman is to feed back to the legal profession to improve the standard of legal services.

Any new arrangements should also take into account regulatory conflicts and conflicts between Ombudsman schemes. For example, if a new independent complaints handler were to be established for insolvency practitioners, there could be a situation where a successor firm reopens not just under a new regulator, but under a new Ombudsman, as many insolvency practitioners are also solicitors.

As well as making sure that any changes to the regulation of insolvency practitioners fit in with other current mechanisms of consumer redress, it is also important to make sure that they are sympathetic to likely changes in the wider regulatory landscape. We feel that it is particularly important to consider the direction of developments within the European community. The European Commission recently published their proposed directive on alternative dispute resolution (ADR) and their proposed regulation on online dispute resolution (ODR). If the proposals are adopted, this would mean that ADR mechanisms, such as Ombudsman schemes, will cover all sectors, where contractual transactions take place, including the insolvency sector.

Reforms to the Regulation of Insolvency Practitioners

In May 2011, we responded to the Insolvency Service's consultation on the regulation of insolvency practitioners, we commented on the proposals from our perspective as an independent complaints body. We stated that we saw no reason why an Ombudsman scheme would not be successful in the insolvency sector. This view has been strengthened in light of the European Commission's ADR and ODR proposals. Indeed, there are many similarities between regulation and complaints handling in the legal sector before 2010, when the Legal Ombudsman was created, and the current arrangements in the insolvency sector. Currently, there are more than 10 overlapping organisations regulating 1,800 insolvency practitioners. The Legal Ombudsman also oversees many of the agencies who regulate insolvency practitioners.

One solution which has been touted is the possibility of creating an Ombudsman scheme to cover Insolvency Practitioners. The Office of Fair Trading (OFT) report, "The market for corporate insolvency practitioners" June 2010, suggested:

> *"Establishing an independent complaints body to increase the efficacy and consistency of after-the-event complaint and review, restore creditor trust in the regulatory regime, and allow a cost-effective route of fee assessment*
>
> *"Setting clear objectives for the regulatory regime, and changing some of the regulatory processes and responsibilities, to increase its ability to meet those objectives, and*
>
> *"Amending some of the detailed regulations to better align the interests of the IP with the interests of the wider creditor group."*

The OFT report also pointed out that many insolvency practitioners come from a legal or a financial background. So, if it was decided that an Ombudsman scheme or independent complaints handler would be most appropriate, it would be worth considering the possibility of extending an existing scheme's purview to cover the insolvency sector. We would be happy to explore this model further with partners at the Insolvency Service and the Department for Business Innovation and Skills, if it was decided that an extension of the Legal Ombudsman's jurisdiction may be appropriate.

The Government recently announced that, although they understood that there was a lot of support for a single insolvency regulator, they are currently looking at improving the existing arrangements and making them work better. We would be very happy to share our experiences and knowledge, gained from our own set up, with interested parties to assist in the development of any new arrangements, whether they are in the form of an Ombudsman scheme, or if the decision is made to make the existing arrangements work more effectively.

3 January 2012

Written evidence submitted by the Insolvency Branch of Prospect

Introduction

1. Prospect is a trade union representing 569 staff employed by The Insolvency Service ("The Service"). Our members are the specialist staff within The Service comprising examiners, managers, office holders and directors.

2. We do not provide an overview of The Insolvency Service's operations, as this has been done by The Service itself, nor do we comment directly on the role of Insolvency Practitioners ("IPs") and their regulation.

3. IES is funded directly by BIS to investigate all misconduct referred to it.

4. Prospect do not accept that The Service's Delivery Strategy, of reducing local offices and clustering the initial investigations of bankruptcies into "call centre" type operations, is the most cost effective way to provide the full service expected by the business community and general public . This Delivery Strategy is without the published terms of reference of this Committee.

Executive Summary

5. In this memorandum Prospect highlight:

- the adverse affects of the 11% cash cut to the investigation budget in 2010;
- the impact of income reduction in Official Receiver Services ("ORS") on investigation work carried out by The Service; and
- flawed funding model for ORS.

6. Prospect propose that:

- the funding arrangements of ORS be amended so that there is no *requirement* to be self-funding;
- that BIS resolve to restore by 2014 the moneys cut from the Investigation and Enforcement Service ("IES") budget in 2010;
- BIS accept that any difference between income and expenditure is the proper price to pay for the administration and investigation of insolvent estates and live companies; and
- that The Service does not further reduce its examining and specialist manpower.

7. This financial comfort will provide a stable platform to enable The Service to have the experienced, trained and professional in-house resource to investigate all misconduct identified or referred to it.

Investigations and Enforcement Services

8. Investigations of insolvent estates, and IES activities in particular, cannot be viewed as separate and distinct from the rest of The Service, especially ORS. Significant structural change in ORS has had an impact upon the ability of IES to investigate misconduct due to the movement of staff. These changes were necessitated by the reduction in ORS income due to the funding model applicable to ORS.

9. The Service identified in June 2010 that the savings required by the incoming government's emergency budget would "*visibly affect the delivery of front line services*". Among the main impacts identified were that the number of director disqualifications, bankruptcy restrictions and criminal allegation referrals would significantly decrease, and that this would limit the ability to handle more complex/high profile cases. Alternatively, if a complex case were investigated, then fewer *"normal"* cases would be investigated. The budget allocated for investigation and enforcement was reduced by 11%, resulting in the immediate termination of non-permanent investigators (around 40).

10. These posts were eventually filled, between June and December 2010, with permanent staff transferred from ORS, with many remaining in their existing locations, resulting in investigators being based in at least 23 offices.

11. In December 2010 The Service launched a voluntary exit scheme resulting in 470 staff leaving in April 2011, of which 45 were from within IES. The consequence of these two events was a significant organisational upheaval lasting nearly a year, with new staff arriving as experienced and senior staff in IES prepared to leave. This had a material impact on the ability of IES to progress investigations.

12. As a direct result of the 11% budget cut in June 2010, together with the voluntary exit scheme denuding sections of significant numbers of experienced staff, The Service is unable to meet its internal target for the progression of disqualification investigations as shown below: (source November 2011 IED internal performance report).

Disqualification timeliness of investigation	*Expected 2011–12*	*Actual YTD*
OR Cases—% within 15 months of order	80%	50%
OR Cases—% within 19 months of order	100%	83%
IP Cases—% within 10 months of allocation	90%	unavailable
IP Cases—% within 19 months of insolvency	100%	40%

13. The Secretary of State has two years from the date of a corporate insolvency to decide whether to bring proceedings (it is one year for Bankruptcy Restrictions). Disqualification orders and undertakings obtained in 2011 are therefore mainly a result of cases investigated in 2010.

14. At November 2011 referrals from IPs were being assessed within two months of receipt in 79.6% of cases, which is 10.4% below target. In April 2011, The Service had completed 65.5% of cases within two months. This shows that recovery from staff and structural change is not yet complete. The longer that it takes to assess the referral, the less time an investigator has available, and the further away are the events being investigated. This increases the risk that the necessary evidence cannot be obtained and/or there are inhibitors to progressing to the point of proceedings being issued.

15. The number of cases referred for criminal investigation has dropped by a material amount, being presently 18% below the planning expectation for 2011–12.

16. There has been a significant decrease in live company investigations, with some cases abandoned for lack of resource. The Service's 2010–11 Annual Report stated at page 33 "*As a result of those complaints 180*

investigations were commenced, a 39% decrease on the 295 investigations commenced during 2009–10. This decrease is as a consequence of the 11% cuts which reduced the amount available to outsource some investigation work, and replacing experienced non-permanent workers with permanent staff from other areas of The Service last autumn". So far in 2011–12 cases referred for live investigation have not materially increased.

Official Receiver Services

17. Official Receivers' activities are described as administration and investigation. This is a false dichotomy as included within the activities described by The Service as administration are interviews with insolvents and enquiries that are fundamental to any investigatory activity. "Administration" and "investigation" are inappropriate and inaccurate cost labels, akin to classifying all police activity prior to a suspect being charged as administration.

18. The Service has provided Prospect with the following information in respect of cases identified by Official Receivers for further investigation ("FI"):

Year	*Total Insolvencies*	*FI*	*%*
2007–08	69,227	7,970	11.51
2008–09	74,163	7,484	10.09
2009–10	79,498	5,518	6.94
2010–11	57,385	4,158	7.25
To Nov 2011	28,036	2,179	7.77

19. The Official Receivers do not have sufficient resources to investigate every bankruptcy and liquidation identified by them for further investigation. The Service records these by way of placing them within an "investigation pool" .The Service removes cases from this "pool" to either investigate or formally abandon the investigation. Prospect does not have access to this data, but members report their unhappiness that cases they have identified for further investigation do not get investigated for lack of examining resource.

Statutory Funding Model of ORS

20. The Official Receiver deals with three types of cases:

- *Debtor petition bankruptcy* cases (in which the debtor petitions for their own bankruptcy). To do so they pay a court fee of £175 and a deposit of £525. The deposit fee was raised in June 2011 from £450 to £525, having been £335 in April 2008.
- *Creditor petition bankruptcy* cases (in which a creditor petitions in respect of monies owing to them). The deposit paid is currently £700.
- *Compulsory liquidations*. The deposit paid, currently £1,165, is used to fund the administrative cost of the case and the investigation into the company's affairs and the directors' conduct up to the point of the Secretary of State authorising the issuing of proceedings.

21. A notional fee of £1,625 is charged to each bankruptcy estate to cover the costs of administration but where, as in the majority of cases, no assets are realised there are insufficient funds to recoup this fee from the petition deposit alone.

22. The funding model allows for cross-subsidisation by cases where there are asset realisations but, given the falling bankruptcy case numbers and the lack of assets available for realisation, there is now a significant gap between fees and income.

23. This has produced the perverse effect of causing the operation of Official Receivers (a statutory office) to be "insolvent". The same result would occur if case numbers increased but asset values didn't.

24. The decline in insolvencies administered by The Service is almost entirely due to a reduction in debtor petition bankruptcies. The amount at which the deposit on the petition is set is a significant factor in a debtor's decision as this is a front-loaded cost for people who are insolvent—they have to pay for it out of their pocket, there and then.

25. In contrast an Individual Voluntary Arrangement (administered by an IP) or a debt management plan (unregulated and administered by the private sector as a business), is usually funded by a percentage of realisations made. In other words, the debtor isn't paying a lump sum up front.

26. It is the contention of Prospect that ORS should return to its former model of being funded by the taxpayer to administer and investigate, with realisations and fees providing a contribution to mitigate the costs of carrying out the statutory functions. The creditor and debtor should not bear the entire cost, much like a burglar and their victim are not expected to pay for the police investigation.

SUMMARY

27. Despite all the pressures placed and upheaval forced upon The Service by the withdrawal of over £3 million from the investigation budget in June 2010 and a notional "income deficit" with ORS, the staff throughout The Service have continued to perform professionally and meet the revised expectations. The fact remains that less is being done overall by less people with less money.

30 December 2011

Written evidence submitted by R3

R3 represents 97% of UK Insolvency Practitioners—the only professionals authorised to take insolvency cases. From senior partners at the "Big Four" accountancy firms to practitioners who run their own micro-businesses, our members have first-hand experience of insolvency practice and regulation, and interact closely with The Insolvency Service.

I can speak from experience on topics such as pre-pack administrations and insolvency remuneration, as well as articulating the profession's concerns about the insolvency regime. For example,

— The Insolvency Service's record in investigating unfit directors: in 2002–03, 45% of cases reported to the Service were taken forward to investigation; this fell to just 20% in 2009–10.

— Harm caused by suppliers demanding "ransom payments" following insolvency—thereby reducing creditor returns, damaging the UK business rescue culture, and artificially increasing the number of pre-packs.

Frances Coulson
R3 President

21 December 2011

EXECUTIVE SUMMARY

The IS performs much of its role very well. We have highlighted in our response certain areas in which we believe there is room for improvement:

— The IS's investigation and enforcement regime, which is designed to protect the public from unfit directors, is suffering from a lack of funding. This leaves culpable directors free to start up other companies—putting other businesses, investors, suppliers and members of the public at risk. We urge the Committee to recommend that the Minister introduce a new reporting process to improve disqualification efforts as soon as possible; and to consider recommending increased funding for the IS's disqualification work.

— The IS proposals to stamp out "phoenix" pre-packs will not eliminate this practice but drive it further "upstream." If the IS's objective is to address concerns about pre-packs, they should tackle the obstacles that currently stand in the way of more traditional business rescues using the administration procedure—ransom payments and expenses in administration.

— The key criticism of the regulatory system among creditors is that there are too many regulators—8 for around 1,700 IPs. The IS has not identified rationalisation of regulators as an immediate priority, but the Minster, profession and regulators are working together to deliver reforms to the regulatory system to improve consistency and increase independence.

— Unsecured creditors have expressed concern about IP fees. We encourage the Committee to support IS proposals to empower unsecured creditors and to help Government departments, who are unsecured creditors themselves, to exercise their market power over IP fees more effectively.

— One of the key roles the IS performs is "bankruptcy case administration" which mainly involves investigating the causes of bankruptcy. The funding model for this function has come under increasing pressure due to a decrease in bankruptcy numbers and an increased proportion of cases with few or no assets. It is now running a deficit—a problem we believe must be addressed.

DETAILED RESPONSE

Role of the IS: disqualifying "unfit" directors

1. One of the IS's four main goals is to "*to deliver and promote an effective investigation and enforcement regime.*" A key part of this function is the investigation and disqualification of "unfit" directors. R3 is concerned that the IS investigates too few cases of alleged misconduct, which leaves culpable directors free to start up other companies—putting other businesses, investors, suppliers and members of the public at risk. The IS estimates a net benefit of £88,000 to the market for every company director disqualified (in terms of potential economic damage that they would otherwise cause).

2. An IP is required to report to the IS if they believe a director of an insolvent company has been dishonest, blameworthy or is otherwise unfit to be concerned in the management of a company. The IS decide whether to take forward the case in question to investigation stage, which can result in the director being disqualified.

3. The proportion of adverse conduct reports by IPs that result in disqualification by the IS declined from 45% in 2002–03 to just 20% in 2009–10. The total potential savings to creditors from disqualifying unfit directors is estimated at £143.2 million in 2009–10. Should disqualification rates return to 2002–03 levels, the benefit to the economy would be an estimated £247.4 million in 2009–10.

In May last year a survey of 300 R3 members found that 75% had submitted an adverse report on a director to the IS during the last year; of these, 79% believe that the IS's decision not to proceed with further investigations was wrong and/or that the director should have been disqualified. Case studies were also collected:

4. *Case study 1*: A joinery manufacturer based in the Midlands, employing around 30 people pre-insolvency. Aspects of the director's conduct which the IP believed warranted a report to the IS: non payment of Crown debts to finance trading, personal benefits obtained by directors and appropriation of assets to other companies. The IP stated that the director was: "*A serial phoenixer….[who] subsequently left the country…. [the] IS view was that pursuing him was not in the public interest*".

5. *Case study 2*: A financial services company in the South East. Aspects of the director's conduct which the IP believed warranted a report to the IS: attempted concealment of assets, phoenix operations, appropriation of assets to other companies, personal benefits obtained by directors, overvaluing assets in accounts for the purpose of obtaining loans, or other financial accommodation, or to mislead creditors, and use of delaying tactics. The IP said: "*In 20 years I have never seen such a clear cut case for disqualification and I remain bemused by the decision*".

6. A press article on 5 November 2011 entitled *"Insolvency Service lets "serious" cases go"* contained comments from Robert Burns, head of investigations at the IS. The article states that he "*admitted two rounds of staff cuts have "taken [their] toll" and warned of a "longer term impact"…Mr Burns said the Insolvency Service has been forced to reduce investigations. "[The cuts] will have an impact on investigations, there's no getting around that."*

7. To ensure the public is protected from errant directors, R3 would welcome budgetary increases for the IS to fund their disqualification work, given the significant economic benefit to the economy of disqualified directors. This could be achieved at least in part by levying fines on disqualified directors (the proceeds of which could fund work on disqualification). Appreciating that budgetary increases may not be possible, we have been working with the IS on streamlining the reporting process (the "D1 forms")—enabling the profession and IS to identify which cases should be treated as high priority. We understand the Minister will shortly decide whether this new reporting process will be introduced—we urge the Committee to recommend that it is brought in as soon as possible.

Concerns around "Pre-pack Administrations" and a Return to Traditional Administrations

8. We understand MPs' and creditors' concerns about pre-packs, especially sales to connected parties (often known as "phoenixes"). Though we understand the political will to reform pre-packs, we should highlight that pre-packs—even to connected parties—can have real advantages. Academic research finds that these kinds of administrations are successful in preserving businesses and saving jobs, as well as delivering higher returns to secured and unsecured creditors.[1] They are best used in businesses where the key asset is the workforce (eg advertising agencies, software consultancies and recruitment firms), where open ended administration would result in staff being poached by competitors, destroying the business overnight.

9. The IS intend to address concerns about pre-packs by requiring IPs to give three days notice to creditors if they propose a connected party pre-pack. This will not succeed in eliminating "phoenixes"—instead it will give rise to *"pre" pre-packs*. At the moment, directors are able to purchase their own business or its key assets through a pre-pack sale facilitated by an IP; under the new proposals, directors will simply purchase their own business or its assets through a deal either carried out themselves or facilitated by an adviser pre-insolvency. "Phoenixing" will not be eliminated by the IS proposals, the practice will simply happen further "upstream" instead.

10. R3 believes that the IS's efforts would be better focused on improving the "administration" rescue regime which would in turn reduce the need for pre-packs. Administration and pre-packs are both procedures that can be used to rescue businesses. The use of trading administrations has become stunted because of two key problems—ransom payments and increasing expenses (outlined below). As a result of these impediments to trading a company in administration, pre-packs have stepped into in their place.

11. If the following two issues were addressed, the number of pre -packs would reduce:

12. *Ransom payments*: Ransom payments demanded by suppliers on insolvency as a condition of supply can crush attempts to rescue a business through administration. R3 has been calling for a change to the Insolvency

[1] Frisby, Dr S, A Preliminary Analysis of Pre-Packaged Administrations, 2007. Frisby, Dr S, A The pre-pack promise: signs of fulfilment? RECOVERY magazine, Spring 2010.

Act 1986 to end ransom payments and ensure continuity of supply at the same rate (with the proviso that suppliers are paid in full for new supply). We estimate that this change would result in a 22% decline in pre-packs because businesses that would have gone into a pre-pack could be rescued through administration instead.

13. *Administration expenses regime:* When an IP is advising a company in trouble, they weigh up the pros and cons of various courses of action. Administration is a key option to rescue a business, but in order for it to be a feasible choice the costs of trading the business through administration must be reasonable. Recent case law has made trading in administration vastly more expensive than the law ever intended, as the costs that are classed as expenses rather than claims in the insolvency have dramatically increased. The Judge in the most recent case (Mr Justice Briggs in 2010) admitted that the situation is a "*legislative mess"*. Evidence from our members indicates that more than half of "typical" administration cases are now going into a pre-pack or liquidation instead. A return to the equitable "pay for what you use" principle could be achieved by legislative amendment. Clearly defining and reducing the expenses of administration in this way would make administrations viable in many more cases and consequently reduce the use of pre-packs.

14. One of the IS's key responsibilities is insolvency policy and legislation. If their objective is to address concerns over pre-packs, ransom payments and the administration expenses regime should be their top priority. We urge the Committee to recommend this course of action. This would have the added benefit of enabling more businesses to be saved during these fragile economic times.

Reform to the Regulation of IPs

15. The key criticism of the regulatory system among the creditor community is that there are too many regulators (eight for around 1,700 IPs) which they believe breeds inconsistency and confusion. R3 would welcome a reduction in the number of regulators to address these concerns.

16. We understand the IS does not intend to pursue this as an immediate priority, other than to remove the Secretary of State from direct authorisation of IPs. In the absence of an imminent reduction of regulators, it is clearly important that the complaints system is easily accessible to potential complainants; delivers transparent and consistent outcomes; and is sufficiently independent to cultivate external confidence.

17. The Minister has asked the profession to deliver reforms to the regulatory system to achieve these goals. R3 is working with the Government and the two main insolvency regulators (covering 68% of IPs) on reforms which would deliver a single entry and exit point for complaints, see all regulators working to a common framework for processing, investigating and adjudicating on complaints, and include greater involvement of independent lay members in the complaints process. We hope these reforms will be delivered in 2012.

Remuneration of IPs

18. The fees of IPs sometimes spark criticism, with particularly large cases dominating headlines. We would encourage the Committee to view IP fees in the context of each particular case—ie in view of the role the IP performs, the amount returned to creditors, the size and type of business, and the complexity of the case.

19. When an IP is appointed to a case they essentially have to "pick up" the business from scratch and decide what to do with it. There is no universal approach—a careful commercial judgement must be made in each case. Faced with a struggling company, an IP may either take over the company's reins, reverse its decline and restructure it; sell the business on; continue trading to increase returns to creditors; or, in cases where the company is extremely weak, close it down. In view of the complex role they perform, it is right that IPs are highly qualified professionals with significant skills and expertise. As such, their input carries a cost, and IP rates are comparable to those of similarly qualified professionals (lawyers, accountants, high level medical professionals). The benefit of this expertise is perhaps best put into context by looking at the number of businesses and jobs saved through insolvency work. According to the Centre for Economics & Business Research, 67% of insolvency firms are involved in restructuring or turnaround, and research by ComRes finds that the work of IPs saves close to 2 million jobs each year. World Bank data June 2011 states that the UK's recovery rate is the sixth best in the world—better than the US, France and Germany's recovery rates.[2]

20. High profile cases tend to come in for the most criticism over fee levels. But huge cases like Lehmans or Woolworths require a considerable range of resources and skills. The Zavvi case, for example, required the administrative staff from Ernst and Young to go to each of the 114 stores on the day the administration was announced; and in Woolworths, Deloitte was dealing with over 800 stores and 30,000 employees. The sheer manpower needed to deal with these cases leads inevitably to high costs, but they are necessary to ensure the job is done well.

21. It is also the case that many of the costs covered by an IP's fees come from legal requirements on formal and procedural matters designed to maintain the integrity of the insolvency regime. For example, one of an IP's duties is to report on the conduct of the directors—a cost which increases their fees (as it cannot be done for free).

22. It should also be understood that despite the headlines, more than 90% of insolvency firms are small—they tend to work on smaller cases where costs are much lower.

[2] http://www.doingbusiness.org/data/exploretopics/resolving-insolvency

23. Although it is creditors who set IP fees, it is often unsecured creditors who express frustration with the fee setting process. R3 therefore supports a number of proposals from the IS to give unsecured creditors greater influence (for example, we support IS proposals which state that IPs' hourly rates should be agreed by creditors at the time of resolution and IPs should have to go back to creditors with a new resolution if their rates change at any point during the case).

24. We also propose that the Government departments who are major, repeat unsecured creditors better exert their considerable market power. Under existing legislation, unsecured creditors have a range of effective mechanisms open to them to engage in the insolvency process, especially following changes introduced in April 2010. Yet sadly these mechanisms often go under-used. We can understand that certain unsecured creditors may find it difficult to engage in insolvency—due to lack of experience, size of debt or unfamiliarity with the process—but it is hard to believe that Government departments cannot do so.

25. HMRC and the IS itself through the Redundancy Payments Service account for more than a quarter of unsecured debt and therefore have considerable market power, if only they would exercise it. We suggest that HMRC set up their own fee review teams to consider IP fees, based on their existing and effective Voluntary Arrangements Service (VAS). This non-regulatory solution would be self-funding and would see unsecured creditors playing a much more active role in fee-setting.

Funding Difficulties within the IS

26. One of the key roles the IS performs is "bankruptcy case administration" which mainly involves investigating the causes of bankruptcy. The funding for this important role has come under increasing pressure due to a decrease in bankruptcy numbers and an increased proportion of cases without assets. It is now running at a deficit.

27. The cost of the IS's bankruptcy case administration work is covered in part by a case administration fee (£1,715 per bankruptcy). This is recovered in part by the deposit paid by a debtor (£525) or a creditor (£700) when applying for bankruptcy. The rest is largely covered by the assets realised in bankruptcy cases.

28. The funding structure for this case administration work depends on there being a certain number of bankruptcies and, more importantly, sufficient assets in bankruptcy cases to cover the cost of the work. However, bankruptcy numbers declined by 27% in 2010–11 and a growing proportion of cases have few or no assets.[3] In 2010–11, the IS received an income from case administration fees of just over £141 million, compared to £195 million spent administering cases—causing a funding deficit of £53 million.[4]

29. The IS has undertaken considerable cost cutting measures over the last year, but the fundamental difficulty with the funding model remains unresolved. R3 would be pleased to discuss our concerns and our initial suggestions for potential reform with the Committee.

Recommendations

30. The IS's investigation and enforcement operations should be given increased funding to protect the public from "unfit" directors. This could be achieved, at last in part, by levying fines on disqualified directors (the proceeds of which could fund work on disqualification).

31. The Minister should introduce the proposed new reporting process to improve disqualification efforts as soon as possible.

32. The IS should address the obstacles that currently stand in the way of traditional business rescues using trading administrations—ransom payments and the administration expenses regime.

33. The Government departments that are unsecured creditors should exercise their market power over IP fees more effectively.

34. The deficit run by the IS on bankruptcy case administration must be addressed.

21 December 2011

Supplementary written evidence submitted by R3

As President of R3, the insolvency trade body, I would like to raise some concerns we have regarding the recent Select Committee evidence session attended by the Insolvency Service (IS).

By way of background, R3 is the leading professional association for insolvency, business recovery and turnaround specialists, representing 97% of all Insolvency Practitioners. Our members work with financially distressed individuals and businesses across the UK on turnaround and preventing insolvency, as well as formal insolvency procedures. They work on cases of a range of sizes—from the "giants" such as Woolworths and Lehmans, to small businesses and individual insolvencies.

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[3] The Insolvency Service Annual Report and Accounts 2010–2011

[4] *Ibid*

Since January 2012, when the inquiry first began and R3 gave evidence, several key issues have developed and legislative vehicles have emerged, which may provide solutions to some of the points raised in the Committee. With this in mind, I have enclosed for your attention supplementary information on these areas, which I would welcome the opportunity to discuss with you in more detail.

Issues we have focused on include: the latest figures for SIP16 reporting, which were announced in May this year; the Government announcement in January on the "three-day rule" for pre-packs; concerns with the current directors' disqualification regime; and the behaviour of suppliers in insolvency cases, which we believe could be resolved via the Enterprise and Regulatory Reform Bill.

Lee Manning
R3 President

SIP16 Compliance

R3 have some concerns regarding the evidence presented to the Select Committee on SIP 16 compliance in pre-packs. The Insolvency Service (IS) referred to 32% of SIP16 reports received in 2011–12 that they judged to be non-compliant.

To put SIP16 compliance into perspective, of the 32% of reports labelled by the IS as non-compliant, just 7% were actually referred to the Insolvency Practitioners' (IPs) regulator. Furthermore, in recent years, just a small fraction of the reports referred to the regulators have led to disciplinary proceedings. R3 believe this a more accurate indication of the conduct of IPs' who use pre-packs.

R3 have concerns with the way the Insolvency Service judge reports to be non-compliant. By way of illustration, our members give examples of cases where they marketed a business and explained this, but did not use the word "marketing" in the SIP16 report which, as a result, was subsequently deemed non-compliant. Unfortunately, IPs' are not made aware of the criteria on which they are being judged by the IS, or indeed given any feedback on their reports.

R3 believe that IPs should be made aware of what precisely the IS expects to see included in SIP16 reports and when they deem a breach is significant enough to be referred to the regulator. It is also important that IPs are given feedback on any non-compliant reports, so they do not repeat similar mistakes. This would cut down on the number of reports being considered non-compliant due to technicalities and would allow the IS to focus their attention on genuine cases of misconduct. R3 would also like to see the introduction of a "traffic light system" to identify IPs whose reports consistently do not include information that the creditor community would like, but individually do not warrant investigation by the regulator.

Pre-packs

R3 recognise creditors' concerns with the pre-pack process and believe that important changes can be made to improve confidence in what is an effective business rescue tool, which can preserve businesses, save jobs and increase returns creditors. R3 have called for creditors to have the option of appointing an independent liquidator to investigate pre-pack sales to connected parties. It is envisaged that a sum would be set aside for the appointment of an independent liquidator, nominated by the creditors, to investigate the transaction.

Unlike a notice period for creditors, or other "before the event" protections being pursued by the IS earlier this year, R3 believe that appointing an independent liquidator would empower creditors and increase transparency in the process, but at the same time ensure that pre-packs can still be used to rescue businesses and save jobs.

Directors' Disqualification

R3 continue to raise concerns about the directors' disqualification regime. Whilst the number of directors disqualified each year by the Insolvency Service has remained relatively stable over the last decade (approximately 1,200), the number of cases of misconduct identified by Insolvency Practitioners (via D1 forms) in the same period has risen from 3,539 to 5,401. As such, the disqualification rate has dropped from 45% in 2002–03 to just 21% in 2011–12.

In the evidence session, it was suggested by the IS that approximately 1,200 disqualifications per year is in the public interest and any more would not necessarily act as a further deterrent. R3 refute this statement and fully believe that the number of disqualifications should increase as the level of errant behaviour, detected by Insolvency Practitioners, rises. Indeed, the fact that errant behaviour has increased in recent years disproves the theory that this figure acts as a deterrent.

Insolvency Practitioners do not submit D1 forms lightly, only in cases where there is a strong prima faci suggestion of unfit conduct. We appreciate that not all D1 forms should necessarily result in disqualification, however, R3 members consistently see clear cases of misconduct, not taken forward by the Service. See below for an example of this:

> An IT company based in Yorkshire went into insolvency and the IP reported on the conduct of the director. Aspects of the director's conducted which the IP believe warranted a report to the IS

included: non-payment of crown debts to finance trading, personal benefits obtained by the director, preferences and phoenix operations. The IP said: *"The sole director is now running his second phoenix company in three years. The companies were grossly insolvent and yet the director has managed to retain the benefits of running the businesses."*

Since R3 submitted evidence to the BIS Select Committee, we have been looking at ways in which the IS' disqualification income can be boosted. One option concerns "uneconomic dividends": the situation where in almost every insolvency where a dividend is paid, extremely small dividends are processed and paid to unsecured creditors (eg cheques for sums as small as 12p). Almost inevitably, the costs of doing this (and hence the fees of the IP) are grossly in excess of the benefit derived to those creditors.

R3 believes that there is merit in introducing a minimum payment level (monetary and/or percentage return), below which agreeing the claim and issuing a dividend cheque need not be undertaken, thereby saving unwanted dividends and unnecessary professional fees. This money could potentially provide significant sums of additional funding for directors' disqualification.

Continuation of Supply

Mike Crockart MP questioned the Insolvency Service about the behaviour of suppliers in insolvency situations, particularly where key suppliers, such as IT and software suppliers, terminate supply or ask for extortionate ransom payments before continuing to supply.

This behaviour can mean the difference between business rescue and liquidation. Research suggests that if suppliers were obliged to continue to supply on insolvency, over 2,000 additional businesses would be saved each year, rather than being put into liquidation. In addition, the number of pre-packs is likely to decrease, as Insolvency Practitioners say that more than one in five of the administrations they work on have to be pre-packed due to fear of unreasonable actions by suppliers.

R3 first raised this issue with the Insolvency Service in 2010. Since then, the changes suggested have been supported by business organisations, including the British Chambers of Commerce, and the Federation of Small Businesses. Despite this and statements from the Government saying that they are looking into the issue, a formal consultation is yet to be issued.

R3 believes the Enterprise and Regulatory Reform Bill provides a timely opportunity to address this issue, which could make a real difference to the UK rescue culture—preventing unnecessary liquidations and their attendant job losses.

Written evidence submitted by ShareSoc (UK Individual Shareholders Society Ltd)

Insolvency Service and Pre-pack Administrations

As an organisation that represents shareholders in public companies, we are very concerned about such Administrations and have previously made a strong case to the Insolvency Service for urgent reform. But since a meeting in early 2011, nothing has been done, and the Insolvency Service have not even had the courtesy to respond to a letter I sent them in November asking about the progress on this matter.

This is what we originally said when it was proposed to introduce a three day notice period for creditors to stop the abuses—a change which in our view would have had little impact:

1. A three day notice period is hardly sufficient to allow time for creditors to put forward alternative proposals. In addition it totally ignores the rights of shareholders in such companies to be consulted on the matter.

There have been numerous cases where pre-packs have been arranged primarily to benefit former insiders in the business. Indeed the FT reports that research by the University of Nottingham showed that in 58% of cases of prepack administration, the sale was to a connected parties—typically to the former part owners or managers. In other words these are typical "phoenix" company situations where the company escapes its former creditors one day and starts up in business anew with the same assets, the same managers, and sometimes the same owners, the next day.

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 had personal 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, I 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.

Another example was covered by Alistair Blair in the Investors Chronicle—namely of Axeon. This was an AIM company that was put into administration via a "pre-pack" arrangement at the behest of its main lender who was also a shareholder (Ironshield). The company was sold to AG Holding, a new company specially set up for the purpose by Ironshield about one hour after it entered administration. In effect, as with all pre-packs, the whole deal had been arranged some time before. In this case it seems even more outrageous than normal as the company's press release said that "creditors would be unaffected", so only the shareholders were deprived of their interest in the business.

There have no doubt been many other cases of small companies that are listed on AIM suffering the same fate (SCS Upholstery is another one that springs to mind). This system is pernicious and the only real beneficiaries are the insolvency practitioners. It needs full scale reform, not the putting of a sticking plaster on a failed system.

2. After the very inconclusive meeting held at the Insolvency Service—which was mainly attended by banks and insolvency practitioners who are the main beneficiaries of the system, but few others, I made these additional comments:

It was said at the meeting that [the three days notice] would give time for "representations" to be made to the administrator, but in my view the administrators would simply ignore those representations. The above examples were of course public companies where you might expect some higher level of standard, or at least more oversight of the process. But most pre-packs are of course in unlisted and probably smaller companies where the oversight is likely to be much less. I am simply not convinced that a three day "hiatus" will make much difference to the abuses that have taken place with pre-packs since they were introduced.

In essence the proposed regulations are a damp squib which will not be effective in reforming the practice of pre-packs, which is their prime intent.

I am also not convinced that the "review process" as indicated in the regulations will actually provide any proper oversight of pre-packs in terms of the level of abuse that is taking place. As I said at the recent meeting, the terms are much too wishy-washy and need to be tightened up as to exactly what is being reviewed and the objectives of those reviews.

It was apparent from the meeting that the insolvency practitioners were also not happy with the proposed regulation changes, although for different reasons. They were alleging that the changes would preclude the use of pre-packs in future, but it was not clear why.

I suspect it was more a case of not wanting to have any restrictions on the use of prepacks which at present enable practitioners to act in the interests of major creditors (such as the banks who were also present at the meeting) and ignore minor creditors, or other stakeholders such as shareholders.

The pre-pack system it seems to me was devised by insolvency practitioners, for the benefit of insolvency practitioners, in that it enables them to deal with complex and difficult circumstances easily and quickly. Whether that is appropriate and in the interests of the wider financial world is altogether another matter.

Whatever the reasons for the opposition of others to the proposed changes, it does seem to me that the Insolvency Service, and the Minister who is setting policy on this matter, needs to totally rethink what should be done.

If no better system can be devised, that meets the concerns of insolvency practitioners, and of other interested parties such as ourselves, then pre-packs should be simply scrapped.

It is in principle 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.

Neither is it in the interest of the commercial world that a company can escape its creditors and resume business to the prejudice of its competitors. Phoenix companies should be absolutely discouraged, and pre-packs are the obvious route to create them.

We even have the situation lately of companies going through more than one pre-pack administration (eg Allied Carpets, or Moben/Dolphin).

It was mentioned at the meeting that banks might have problems with major "debt restructurings" (where other creditors might not be involved), if pre-packs were made more difficult. But perhaps they should be examined in more detail as to how such restructurings can be accommodated.

In summary, I hope the Select Committee will tackle the Insolvency Service on these issues and encourage substantial reform.

Roger W Lawson
Chairman
ShareSoc (UK Individual Shareholders Society Ltd)

23 January 2012

ABOUT THE UK INDIVIDUAL SHAREHOLDERS SOCIETY (SHARESOC)

ShareSoc represents and supports individual investors who invest in the UK stock markets. We are a mutual association controlled by the members with "not-for-profit" articles and incorporated as a company limited by guarantee. The organisation is financed by member subscriptions, donations from supporters and by the provision of services to members. More information on ShareSoc can be obtained from our web site at www.sharesoc.org (our objects are fully defined on this page: www.sharesoc.org/objects.html).

Written evidence submitted by Professor Mark Watson-Gandy

INTRODUCTION

1. This is my personal evidence in my capacity as a barrister and academic to the inquiry into the working of the insolvency system in the United Kingdom.

2. My experience derives from advising and acting in personal and corporate insolvency cases both for office holders and for those facing their attentions and for creditors both within this country and in other jurisdictions.

3. A fuller profile is set out in Schedule to this document.

THE INSOLVENCY REGIME IN THE UK

4. Insolvency, whether personal or corporate, in the UK is in essence a court regulated regime. It is governed primarily by the Insolvency Act 1986 and the Insolvency Rules 1986.

5. The importance of the court's control, besides the self-evident human rights issue,[5] is to allow an otherwise draconian regime to be tempered by judicial discretion and to ensure that there is always the possibility of recourse to a check by a higher authority when decisions by office holders cause unfairness or injustice.

6. The word "draconian" is not lightly used. For example, in the context of personal insolvency, a bankruptcy order:

(a) deprives the bankrupt of virtually all his property, which vests in his trustee,[6] including any legal cause of action;[7]

(b) it imposes on the bankrupt (and others) a wide range of obligations to provide information and documents;[8]

(c) it invalidates his dealings and payments from the date the petition was presented;[9]

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[5] Article 6 of Schedule 1 Part I Human Rights Act 1998 provides for the right to a fair trial "In the determination of his civil rights and obligations…, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly […]".

[6] Section 306 Insolvency Act 1986. As to the estate, see section 283.

[7] *Heath v Tang* [1993] 4 All ER 694.

[8] See, for example, sections 312(1), 333 Insolvency Act 1986.

[9] Section 284 Insolvency Act 1986

(d) it restricts the bankrupt's ability to raise credit;[10]

(e) it makes him susceptible to a postal re-direction order[11] which interferes with a fundamental right otherwise recognized by the law;

(f) it makes him susceptible to an income payments order;[12]

(g) it makes him susceptible to a bankruptcy restrictions order;[13]

(h) it makes him potentially liable for certain criminal offences;[14]

(i) it renders the bankrupt and others liable to a range of legal remedies, the purpose of which is to undo certain antecedent transactions; in certain circumstances, it renders not only the bankrupt but his family and others residing with him liable to be made homeless if the trustee decides to realize property in which the bankrupt has an interest for the benefit of creditors;

(j) it means that the bankrupt cannot, without the permission of the court, be a director of a limited company or carry out a range of other functions including holding certain public offices;[15] and

(k) Finally, there is the stigma which attaches to bankruptcy itself which may affect the standing of the bankrupt during the period of the bankruptcy, which may be extended beyond the generally applicable one year period on the application of the official receiver or trustee.[16]

A Few Words of Context

7. A few words of context should be given to any examination of the insolvency regime.

(a) The first factor is that it would be wrong to look at our national regime in isolation and in so doing to fail to appreciate the importance of our retaining a court based control. Our insolvency regime has to interlock on a daily basis with other insolvency regimes. This arises not merely in terms of our treaty obligations,[17] jurisdiction,[18] court assistance to foreign courts[19] but on a more basic level; ready access to foreign travel and the internet have made it easier for people and their businesses to enter into foreign contracts and acquire foreign assets and this requires a need to accommodate international aspects.

(b) The second factor is that (whatever flaws the system may have[20]) we do have a highly efficient[21] and internationally envied insolvency regime in the United Kingdom. This can be seen in things as diverse as forum hopping by German nationals so that they can be bankrupted in the UK[22] to the fact that recently in major foreign insolvencies[23] it is English lawyers and insolvency practitioners who have been deployed. This is no bad thing. Legal and professional services are an important generator of invisible earnings for the UK economy.

(c) The third factor is that insolvency is never a rarely a happy process. Inevitably any insolvency carries with it hardship, anger and a sense of betrayal. Insolvency practitioners necessarily need to have a thick skin as they are likely to face the brunt of the resentment from all sides.[24] In that context and with usually limited and fast dwindling resources, they may need to make fast commercial decisions.

(d) The fourth factor is that it is a specialist regime. It is necessarily different from other court processes in that a petitioner acquires a class remedy for all creditors rather than a remedy just for himself. In 1982 Sir Kenneth Cork's committee on insolvency said this about the need for specialization, the

[10] Section 360 Insolvency Act 1986.

[11] Section 371 Insolvency Act 1986.

[12] Section 310 Insolvency Act 1986.

[13] Schedule 4A Insolvency Act 1986.

[14] Chapter VI of Part IX Insolvency Act 1986.

[15] See for example section 11 Company Directors Disqualification Act 1986.

[16] See sections 278–280 Insolvency Act 1986.

[17] For example EC Regulation on Insolvency Proceedings 2000 and the UNCITRAL Model Law on Cross Border Insolvency as adopted by the Cross Border Insolvency Regulations 2006

[18] under the EC Regulation on Insolvency Proceedings and section 265 Insolvency Act 1986 See, for example, *Shierson v Vlieland-Boddy* [2005] EWCA Civ 974 but also the many recent cases arising out of the phenomenon of German insolvency tourism.

[19] Section 426 Insolvency Act 1986

[20] Flaws undoubtedly exist in the present system (for example the absence of a power to cure procedural defects on paper—as opposed to court—appointments of administrators). However there is an existing mechanism to allow for the correction of the Insolvency Rules 1986 as and when problems are identified through the Insolvency Rules Committee, a specialist panel of lawyers and judges.

[21] Winding up petitions are dealt with in an astonishingly efficient and cost effective manner. The High Court in London hears them once a week, disposing of 250 odd petitions in a single morning, yet providing each company with a hearing at which companies do appear or are represented.

[22] There has been press comment about Germans moving to the UK to fall within the jurisdiction of the UK's bankruptcy laws. The most conspicuous example has been with Schefenacker AG which moved its company's base of operations to the UK. See article at http://www.telegraph.co.uk/finance/2950351/German-bankruptcy-laws-drive-car-mirror-firm-to-UK.html

[23] Most graphically in relation to the collapse of foreign banks such as the Icelandic bank, Kaupthing.

[24] The insolvency practitioner will face pressure from many quarters. The bankrupt or director of the insolvent company and his family will face reduced circumstances. Employees will lose their jobs. Suppliers may have their business crippled when they find that goods they have supplied in good faith will never be paid for. Her Majesty's Revenue and Customs will have claims for unpaid duty and taxes.

nature of insolvency work and the desirability of keeping personal and corporate insolvency in line with one another.[25]

> "The exercise [of the insolvency jurisdiction] must almost invariably be concerned with commercial matters and frequently with the analysis of business accounts, culminating in the making, by the court itself, of decisions or judgments of an essentially commercial nature. Its philosophical orientation in this respect is akin to that of the Commercial Court of the Queen's Bench Division."
>
> "Insolvency law is frequently complex and technical, and may require the analysis of transactions displaying elements of commercial sharp practice and dishonesty. It is almost always concerned with the breakdown of commercial contracts and with accountancy problems and often requires important decisions to be taken."
>
> "[T]he exercise of the newly-conferred discretions can only receive acceptance if there is consistency shown in their exercise. It is therefore desirable to concentrate insolvency court business, so far as practicable, for hearing before the minimum number of judicial officers consistent with its effective and expeditious discharge…"
>
> "The harmonisation of corporate and personal insolvency will, we are convinced be more effective if the same judicial officer deals with both types of administration. We therefore recommend that whoever is appointed to hear insolvency matters should deal with all types of insolvency.[26]"

8. The Cork Committee recognized the importance of insolvency work, its commercial nature and the need for specialist skill in dealing with it. The insolvency work undertaken now is largely the same as that done then.[27] It also underscored the importance of keeping insolvency proceedings in the hands of a limited group of judicial officers.

9. The present system functions well, with petitions being dealt with by existing structures, namely the High Court and the county courts. There are judges in place, therefore, who are already dealing with these petitions which are absorbed efficiently and satisfactorily in an existing system of justice.

Phoenix Companies

10. Phoenix companies have inflamed the public imagination. Typically, the "phoenix syndrome" or "phoenixism" involves a person trading through successive companies with similar names, leaving creditors behind as each company becomes insolvent.

11. As Mr. Gabriel Moss QC described:[28]

> "Honest creditors have been plagued by the phenomenon of phoenix companies for over 100 years. The position was eloquently satirized in the 19th century in Utopia Ltd, a Gilbert and Sullivan operetta which contains the following:
>
> > "You merely file a winding-up petition,
> > and start another company at once!
> > Though a Rothschild you may be
> > in your own capacity,
> > As a Company you've come to utter sorrow—
> > but the liquidators say "never mind—you needn't pay",
> > So you start another Company tomorrow!"[29]

12. Yet to suggest that this can be done today with impunity and without consequence is simply wrong.

13. Section 216 of the Insolvency Act 1986 creates civil and criminal restrictions on the re-use of company names where a company has gone into insolvent liquidation. It only applies to a person who was a director or shadow director of the liquidating company within the period of 12 months immediately prior to liquidation, and only to names by which the liquidating company was known within that period of 12 months or a name so similar as to suggest an association with the liquidating company. Section 216(3) of the Insolvency Act 1986 effectively imposes a five-year bar on the director of the liquidating company from reusing the liquidating company's actual or trading name without the court's permission.

14. Moreover phoenix operations have been held to ground an order being made disqualifying a director from acting in the management of a company under section 6 Company Directors Disqualification Act 1986. Indeed it has been held to fall within the most serious bracket of misconduct and therefore justify the longest period of disqualification.[30]

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[25] *Report of the Review Committee, Insolvency Law and Practice*, 1982 (Cmnd. 8558).
[26] Paragraphs 972 and 994–996.
[27] Although until the Insolvency Act 1986 came into force winding up petitions were dealt with by a High Court judge.
[28] sitting as a Judge of the High Court in *Official Receiver v Zwirn [2002] BCC 760, [2001] All ER (D) 375 (Jul) at [10]*
[29] (W.S. Gilbert Complete Operas, Dorset Press 1932, page 622—quoted in the Law of Reinsurance by O'Neill and Woloniecki, 1998)
[30] *Official Receiver v Zwirn [2002] BCC 760, [2001] All ER (D) 375 (Jul)*

15. The real objectionable aspect of the reincarnated phoenix is that it may seek to utilize the name, goodwill and intellectual property rights of the old company without any payment to the old company for the benefit of its creditors. Yet even then liquidators have powers to seek relief from the court to reverse transactions at an undervalue or preferential arrangements.[31] Victims can apply for relief from the court to reverse any transaction where assets have been transferred off or sold at an undervalue to defeat creditors[32] and creditors can sue the directors for breach of duty.[33]

Pre-packs and Phoenixism

16. As I have indicated the real objectionable aspect of the reincarnated phoenix is that it may seek to utilize the name, goodwill and intellectual property rights of the old company without any payment to the old company for the benefit of its creditors.

17. Yet that the old business should be sold is not of itself a bad thing.

18. The business of a failing company may represent a valuable asset which could be sold for the benefit of the creditors. Such a sale would be likely to operate to transfer the jobs of employees of the failing company to the new owners[34] of the business which would spare the creditors a further dilution of their dividend.

19. Nor is the fact that the proposed purchaser is the present management, of itself, objectionable given that they are often (whether through optimism, hope or affection) prepared to pay more for the business than a third party.

20. In the cited case, even the judge recognized that the shades of grey were very real:

> "Although "phoenix" companies are often a menace to the public, I would introduce one note of caution. There are also honest phoenix companies where a failure has occurred through no fault of the management and the business has been rescued into a successor company in the interests of creditors and the public. The "bad" phoenix company is by contrast characterized by the selfish and dishonest behaviour of the management in looking after their own interests and ignoring those of the creditors and/or the public."

21. It is desirable that such a sale of the assets of an insolvent company to a new company controlled by the directors of the insolvent company be through an office holder as the transaction is at arm's length. In another case Mr. Justice Harman recognized:[35]

> "Advice … which is wholly beyond reproach or criticism [would be] that if it proved impossible … to keep Douglas going the sensible thing would be to have a company available to take over the business of Douglas, to urge the bank which had a debenture to appoint a receiver, and to arrange to purchase from the receiver at a proper arm's length sale on a full price the assets of Douglas which were desirable to keep the business going."

22. Since the sale of the business as a going concern is made possible by the statutory moratorium in administration, it is unsurprising that administrators find themselves in this position.

23. Controversy arises in respect of "pre-pack" sales to the existing management because the administrator completes the sale[36] before it can be placed before the creditors meeting for their approval.

24. This might attract the unattractive perception that the administrator is somehow "in bed" with the directors and trying to "stitch up" the creditors. However, more often than not, a pre-pack will however result in a better deal for the creditors. It eliminates uncertainty as to the outcome of the administration (you have a buyer on day one), it pares out ongoing trading risk/cost (the longer the sale is delayed, the greater burn rate to the company as it will be, by definition, insolvent) and pares the professional costs to the bone (no need to trade the business and no advertising costs).

25. The introduction of Statement of Insolvency Practice 16 has set out a code of conduct for administrators to ensure that this process is not abused and creditors are kept informed. It provides a way to trying to ensure that the administrators do still get the best available price for the business assets even though the deal is undertaken at speed.[37]

[31] Section 339, 340 and 423 Insolvency Act 1986
[32] section 423 Insolvency Act 1986
[33] Under the summary remedy under *section 212, Insolvency Act 1986* they can sue to recover damages and assets for the company where the director has been negligent or acted in breach of fiduciary duty. Directors, at common law, will owe a duty to the general body of creditors where the company is insolvent or the creditors are at risk: *Yukong Line v Rensburg* and *Re MDA Investment*.
[34] Transfer of Undertakings (Protection of Employment) Regulations 2006
[35] *Re Douglas Construction Services Ltd [1998] BCLC 397 at 400*
[36] para 67, Schedule B1 Insolvency Act 1986
[37] My personal experience on court appointment of administrators is that the judges do now examine SIP 16 compliance as part of their considerations.

26. Moreover it is important to remember that, if the circumstances that relate to the transaction create any cause for suspicion about its genuineness or give any cause for concern about its appropriateness, the fact that it is entered into by an office-holder will not make it free from scrutiny by the court.[38]

27. Indeed it is not beyond the Court's powers to intervene in a sale, for example in *Re Ulva*[39] where the court compelled the administrator to unscramble a sale.[40] There the application was brought under *paragraph 74, Schedule B1 Insolvency Act 1986* which gives the court discretion to make orders if the administrator has been acting or threatens to act in a way which will unfairly harm the applicant.

28. Nor should it be forgotten that when an insolvency practitioner holds office as administrator he acts as an officer of the court (whether or not he was in fact appointed by the court). This places him under the supervision of the Court itself and places upon him duties

(a) To be candid with the court

(b) To exercise reasonable care and skill

(c) To act speedily and efficiently

(d) To select the purpose of the administration

(e) To act with good faith, independence impartiality and loyalty (to the company)

(f) Not to act dishonourably

(g) To act within powers

(h) To act for a proper purpose and not a collateral one

(i) To seek information which is necessary

(j) To make his decisions rationally.

29. The principle in *ex parte James*[41] moreover creates an obligation upon him to temper his strict adherence to the rules with a respect for honest dealing and justice. Thus he must not take advantage of creditors without giving credit for their debts nor insist on taking windfalls from another's mistake.[42]

30. Moreover an administrator can be sued by creditors or subsequent office holders if it is found that he has misapplied or retained money or other property of the company, has become accountable for money or other property of the company, has breached a fiduciary or other duty in relation to the company or has been guilty of misfeasance.[43]

Insolvency Ombudsmen and the Regulation of Insolvency Practitioners

31. It is mooted whether an insolvency ombudsman should be appointed. I have serious reservations as to whether this is either necessary or desirable.

32. There are already three distinct levels of regulation and control already in play.

(a) Firstly the insolvency practitioner is answerable to his professional body as regards his professional conduct much as any other professional might be. If he breaks the rules of his profession, he may be disciplined and his livelihood may be taken away. The professional bodies have risen to that challenge and have done much to enforce increased professionalism in the industry.[44]

(b) Secondly the insolvency practitioner when acting as an officer of the court (such as when acting as a liquidator, trustee in bankruptcy or administrator) is answerable to the Court and expected to deploy a higher standard of propriety and fairness.[45]

(c) Thirdly those affected by the acts or decisions of the insolvency practitioner have remedies in the courts for damages[46] or to reopen or reverse their decisions.[47]

33. It might be said that having to have recourse to the courts in the last two contexts may act as a deterrent for a complainant.

34. This is no bad thing.

35. Insolvency is a collective remedy. What suits some may well not suit others. The office holder has the unpopular role of trying to achieve a fair result for all.

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[38] *Re Keypak Homecare Ltd (No 2) [1990] BCLC 440*

[39] Sub nom. Coyne v DRC [2008] EWCA Civ 488

[40] The application was brought under *paragraph 74, Schedule B1 Insolvency Act 1986* which gives the court discretion to make orders if the administrator has been acting or threatens to act in a way which will unfairly harm a creditor.

[41] *Re Condon ex parte James* [1874–80] All ER Rep 388

[42] *Re T & N Ltd* [2004] EWHC 2361

[43] *para 75, Schedule B1 Insolvency Act 1986*

[44] The only criticism I have is that there is presently considered to be a disparity of sentencing between the regulators however this is a matter which is best sorted between themselves.

[45] The principle in *ex parte James* see above.

[46] For example under section 212 Insolvency Act 1986 and paragraph 75 Schedule B1 Insolvency Act 1986

[47] For example sections 108(2), 112, 303 and paragraph 74, Schedule B1 Insolvency Act 1986

36. In a context of limited resources and time, forcing complainants to seek their remedy before the courts provides a natural filter of commercial common sense. The complainant should know he runs a personal costs risk if he is to divert the office holder's time and limited resources by minor or meritless gripes.

37. There are a number of reasons why an ombudsman is an unattractive addition to these existing remedies:

(a) There is a risk that without these commercial restraints that the floodgates will open to a deluge of unhappy creditors who see this as a chance to voice complaints that they would not have considered serious enough to trouble a court with.

(b) An ombudsman still might be seen as an alternative source for recovery when the pot for division in the insolvency is otherwise empty.

(c) It might be considered to act as a brake on the insolvency practitioner's commercial judgment and willingness to take calculated risks. The Court has, with good reason, been particularly cautious about intervening to second guess an office holder's decision making. Experience teaches that allowing the office holder to provide a rough and ready solution in the face of the facts that present themselves to him or her on the ground usually lead to a better result for creditors.[48]

29 December 2011

MARK WATSON-GANDY

Professor Mark Watson-Gandy was called to the Bar in 1990 and was made a Junior Counsel to the Crown in 2000. In 2004 he joined the Bar Council's panel of Young Spokesmen for the Bar.

He is a tenant at Thirteen Old Square Chambers.13 Old Square is a specialist chancery/commercial barristers' chambers in Lincoln's Inn founded by leading chancery silk, John McDonnell QC. Mark's work is primarily in the areas of insolvency and company law. He was a finalist in Credit Today magazine's Insolvency & Rescue Awards 2009 and 2010 as "*Barrister of the Year*".

He is a Visiting Professor at the University of Westminster (teaching on their Corporate Finance Law LLM) and a Visiting Lecturer at Cass Business School (teaching the business law elective on their Executive MBA). He holds the Institute of Chartered Accountant's Corporate Finance qualification. He is the author of "*Watson-Gandy on Accountants*", "*Corporate Insolvency Practice: Litigation Practice and Procedure*" and the ICAEW Guide "*Tax Advocacy*". He is one of the Editors of the Company Law volume of the "*Butterworths Corporate Law Service"*. He is Head of Professional Standards for the Institute of Certified Bookkeepers. He has acted for three of the UK's accountancy institutes and two of its second tier bodies and drafted the legislation on auditors for Dubai.

Cases include: *DTI v Daniel* (2002) *The Times* 8 April (instructed for the Secretary of State for Trade and Industry both at first instance and before the Court of Appeal in this human rights test case on the reverse burden of proof in bankruptcy prosecutions), *Society of Lloyds v Levy* [2004] 3 CMLR 56 (Lloyds Names challenge to premium claims under the Audit Directive) and *Feetum v Levy* (2005) *The Times* 28 February (the first case on the £50 million project finance exception to the bar on administrative receivers under the Enterprise Act 2002), *Khan v Nallamothu* [2005] All ER D (Oct) 60 (company hi-jack), *Watersheds v Da Costa* [2010] Bus LR 1 (FSMA implications when raising corporate finance for clients), *Kaupthing Capital Partners* [2010] Lawtel (validity of the administration of the investment fund of Iceland's largest Bank) and *Re Marrache* [2010] (specially admitted to the Gibraltar Bar to appear as leading counsel in this high profile bankruptcy case before the Gibraltar Court of Appeal).

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[48] A graphic contrast is seen when one compares this to Law of Property Act receivers where one sees notoriously high fees and little recovery for either creditor or debtor in the context of an overly cautious approach to the management of the property they are appointed over.

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