THE ENTERPRISE ACT

INSOLVENCY PROVISIONS – REGULATORY IMPACT ASSESSMENT

1. INTRODUCTION

1.1 This Regulatory Impact Assessment (RIA) supports the Insolvency provisions contained in the Enterprise Act. It accompanies the RIAs on the competition and consumer measures in the Act. Detailed commentary on all the measures in the Act can be found in the explanatory notes published alongside the Act.

1.2 Proposals to reform insolvency law were set out in the White Paper "*Productivity and Enterprise – Insolvency: A Second Chance*". Further information about insolvency policy and the Enterprise Act is available on The Insolvency Service web-site (www.insolvency.gov.uk/reform.htm).

1.3 The provisions in the Act relating to insolvency can be separated into four general groups, and these have been mirrored in the RIA. The groups are:

- **Individual** – dealing with the reforms to bankruptcy and individual voluntary arrangements;
- **Company** – dealing with the reforms to corporate insolvency law;
- **Crown Preference** – dealing with the Government's intention to abolish the Crown's preferential status; and
- **Financial Regime** – dealing with the reforms to the financial structures of The Insolvency Service.

However, the provisions are intended to be viewed as a package, and many of the provisions that have a particular impact will be balanced by others that impact in the same area in the opposite direction.

1.4 Implementation of the Enterprise Act will require secondary legislation to be put in place. We expect the Act's provisions and secondary legislation on corporate insolvency and the abolition of Crown preference to be commenced early in the 2003 financial year. The individual insolvency provisions and secondary legislation and those reforming the financial regime of The Insolvency Service are expected to come into force early in the 2004 financial year once the necessary staff training and infrastructure have been put in place.

1.5 The Insolvency Act 1986 sets out the regime for dealing with the affairs of both insolvent companies and individuals. The Enterprise Act amends the Insolvency Act 1986. However, the previous regime under the 1986 Act will apply until the relevant provisions of the Enterprise Act are commenced. Therefore, for the purposes of this RIA, references to the current regime and/or existing legislation refer to the regime as it stands, prior to commencement of the Enterprise Act. Many of the issues in the RIA use particular technical terms, and a glossary of these terms can be found at Annex A.

Table 1: IVAs commenced

Year	IVAs
1996	3,983
1997	4,211
1998	4,620
1999	7,086
2000	7,909
2001	6,286

Source: The Insolvency Service

2. THE ISSUES AND OBJECTIVES

ISSUES

Individual

2.1 At present, insolvency legislation subjects all bankrupts to substantially the same process and

restrictions irrespective of the facts of their individual case or whether they are in any way culpable. Furthermore, the restrictions, prohibitions and disqualifications that currently automatically attach to all bankrupts on the making of a bankruptcy order act as a real barrier to enterprise by discouraging business start-ups and restarts.

2.2 Individual voluntary arrangements (IVAs) were intended as an alternative to bankruptcy. The numbers of IVAs commenced over the last 5 years are set out in table 1. The level of fees charged by insolvency practitioners and the returns to creditors have been subject to criticism. Paragraph 5.18, below, gives details of research into this point undertaken by The Insolvency Service.

Company

2.3 For the last twenty-five years or so, the focus of insolvency law reform in the United Kingdom has increasingly been on the promotion of a rescue culture, a trend which started with the work of the Cork Committee, chaired by Sir Kenneth Cork. The Cork Report recommended, wherever possible, the continuation of a debtor's business or its disposal as a going concern. In its response to the Report, the Government introduced new mechanisms to facilitate these objectives – administration and Company Voluntary Arrangement (CVA) procedures in the Insolvency Act 1986. However the take-up of those procedures since 1986, whilst on an increasing trend, has been seen by many as disappointingly low. There was also widespread concern that the large number of administrative receivership appointments in the early 1990s may have represented precipitate behaviour on the part of lenders, causing companies to fail unnecessarily. Table 2 sets out the take-up of administration in comparison with administrative receivership.

Table 2: Comparison between Administrations and Administrative Receiverships

	Administrations	**Administrative Receiverships**
1998	338	1145
1999	440	1212
2000	438	1106
2001	698	1266
2002	327 *(1st/2nd Quarter)*	407 *(to 10 May)*

Sources: Administrations: DTI
Administrative Receiverships: London & Edinburgh Gazette

Crown Preference

2.4 Under existing legislation, the Crown is able to claim preferential status in relation to certain debts. This is mainly in respect of debts owed in relation to VAT, Income Tax and National Insurance contributions. Full details of preferential debts are found in Schedule 6 to the Insolvency Act 1986. In liquidations and bankruptcy the order of payment out of the estate is set down in legislation. In broad terms, the order of payment is:

- The costs and expenses of the insolvency;
- Fixed charges;
- Preferential creditors;
- Floating charge-holders;
- Unsecured creditors.

Financial Regime

2.5 The Insolvency Service is an Executive Agency of the DTI subject to gross running cost control. The cost of its operations is defrayed in part from realisations from a complex set of 15 fees covering case administration and a Secretary of State (SoS) Fee, none of which reflects full cost recovery. In addition the net income from estate balances invested in the Insolvency Services Investment Account, some £43 million in 2000-01, is paid to the Consolidated Fund.

OBJECTIVES

2.6 The Government has announced its intention to make enterprise and productivity the cornerstone of economic reform for this Parliament. The goal is an enterprising economy that makes the UK the best place in the world to do business.

2.7 The insolvency provisions in the Enterprise Act will help achieve this goal by modernising the framework for individual and company insolvency. They will encourage responsible risk taking, addressing the fear of failure and reducing the stigma of bankruptcy. They will encourage those who have failed honestly to try again while providing a robust and effective remedy against the small minority who abuse their creditors. They will facilitate the rescue of viable companies, and provide certainty and fairness to creditors and other stakeholders. To achieve these objectives the Act will:

Individual

(a) Reduce the number of restrictions that are automatically imposed on undischarged bankrupts and provide for the automatic discharge of nearly all bankrupts after a maximum of 12 months.

(b) Introduce Bankruptcy Restrictions Orders (BROs) to protect the public and the commercial community from bankrupts whose conduct before and during bankruptcy has been found to be culpable.

(c) Introduce of Income Payment Agreements (IPA) as an administrative alternative to court-based Income Payment Orders (IPO). IPAs will carry the same conditions as IPOs and both will be able to run for a period of up to three years.

(d) Enable the Official Receiver (OR) to act as nominee and supervisor of IVAs commenced after the making of a bankruptcy order.

(e) Require the Official Receiver to investigate the cause of failure of all bankrupts only where he thinks that this is necessary.

(f) Limit the period in which a trustee may deal with his/her interest in a bankrupt's home prior to that interest reverting to the individual.

Company

(g) Streamline the procedure of administration to make it more efficient and accessible in order to facilitate the rescue of viable companies, and, if this is not reasonably practicable, a better return to creditors.

(h) Restrict the ability of lenders to appoint an administrative receiver to the holders of pre-existing floating charges and certain capital market and other transactions where the ability to appoint an administrative receiver is fundamental to the effective operation of the market.

(i) Introduce powers to extend certain insolvency proceedings, with modifications, to foreign companies, Industrial and Provident Societies and Friendly Societies.

Crown Preference

(j) Remove the Crown's preferential rights in all insolvencies and make provision to ensure unsecured creditors are major beneficiaries.

Financial Regime

(k) Reform the financial regime of The Insolvency Service, making it simpler, fairer to creditors and more transparent.

3. RISK ASSESSMENT

3.1 The Government is committed to making the United Kingdom the best place to do business. In order to achieve this, people from all walks of life need the opportunity to realise their creativity, innovative ability and entrepreneurial potential. If the measures in the Act had not been adopted then the existing provisions would continue to act as a barrier to achieving this goal.

Individual

3.2 The Official Receiver has a statutory duty to investigate the cause of failure in most bankruptcy cases. The figures for bankruptcies in the years 1989-2000 over the past four financial years are set out in Table 3. The majority of cases lead to no further action against the bankrupt and little administrative activity beyond the first few months. Most bankrupts are not discharged until three years after the bankruptcy order and therefore are denied the opportunity of prompt rehabilitation in relation to their financial affairs.

Table 3: Numbers of Bankruptcies

Year	Number
1989	8.138
1990	12,058
1991	22,632
1992	32,106
1993	31,016
1994	25,634
1995	21,933
1996	21,803
1997	19,892
1998	19,647
1999	21,611
2000	21,550
2001	23,477

Source: The Insolvency Service

3.3 The only sanctions currently available to address misconduct or dishonesty by bankrupts are criminal ones. The high evidential requirements of the current criminal sanctions mean that few bankrupts are convicted (about 3 per cent of all cases in the last year resulted in convictions). A civil BRO regime, with its lower standard of proof (i.e. the balance of probabilities rather than beyond reasonable doubt) will allow for greater protection of the public and commercial community. That protection will not be present if the proposals are not brought into force. The BRO regime will require additional resource from the courts by way of court time, but this should be offset against a reduction in case numbers taken through the criminal system.

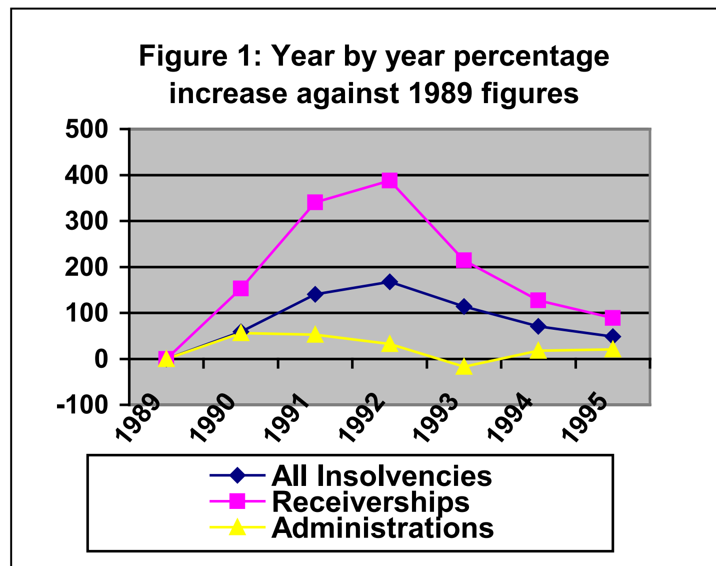
3.4 Currently, a bankrupt's interest in the family home is part of the estate and vests in the trustee, and this remains so regardless of the bankrupt's discharge. Where there is any equity, this will be available to creditors if and when it is realised. There has been concern that trustees are subject to no time limits as to when they realise the bankrupt's interest. This has led to cases where trustees have taken action many years after discharge.

Company

3.5 There has been concern that the large number of administrative receivership appointments in the early 1990s may have represented precipitate behaviour on the part of lenders, causing companies to fail unnecessarily. Figure 1 (next page) shows the percentage

increase in total insolvencies, administrative receiverships and administrations during the period 1989-1995. It shows the number of administrative receiverships increasing at a greater rate than the increase of all insolvencies, while the rate of increase in administrations dropped.

3.6 Concerns have been expressed that administrative receivership provides little incentive to maximise economic value. There has also been concern about whether it provides an acceptable level of transparency and accountability to the range of stakeholders with an interest in a company's affairs, in particular other creditors.



3.7 There may be concern that restrictions on administrative receivership will adversely affect the cost of secured lending, for SMEs in particular. The new streamlined administration procedure should, however, reassure such lenders and is intended to match the flexibility and cost effectiveness of administrative receivership.

3.8 These reforms should ensure better alignment of incentives, encourage survival of viable companies, provide better returns to creditors, and preserve value in the economy as a whole.

Crown Preference

3.9 Crown preference can lead to distortion of commercial decisions, and disadvantage creditors and disrupt the effectiveness of insolvency procedures. In other jurisdictions, such as Australia and Germany, the trend has been towards the restriction or abolition of State preference. To retain Crown Preference would run the risk of the UK's insolvency procedures becoming less effective and disadvantaging creditors, in particular unsecured creditors, including SMEs for whom there is often little or no money available after other creditors have been paid.

3.10 Without specific provision in corporate cases, the benefits of the abolition of Crown preference might accrue solely to floating charge holders rather than unsecured creditors whom this change is intended to benefit. It is therefore intended to provide for a percentage of funds available for distribution to be ring fenced for the benefit of unsecured creditors.

Financial Regime

3.11 The Insolvency Service's existing financial regime does not support the achievements of its objectives of efficient case administration and investigation, nor is it fair to creditors. Whilst an increase in the number of insolvencies may increase the level of fee income that money is not available to defray the additional cost of dealing with those cases. A clear example of unfairness to creditors is the payment to the Consolidated Fund of the net income from the Insolvency Services Investment Account which defrays the cost not only of case administration but also investigation, enforcement and policy work, clear public interest functions. In addition, the obligation for voluntary company liquidations to deposit funds in the Insolvency Services Account is out of line with the fact that voluntary liquidations are dealt with wholly by Insolvency Practitioners, who have been licensed and bonded for many years. The current system means that creditors rather than the profession pay for the cost of

Insolvency Practitioner (IP) regulation. Finally the fee structure lacks clarity, with none of the fees representing full cost recovery.

ISSUES OF EQUITY OR FAIRNESS

Individual

3.12 No change would mean that the majority of bankrupts remain undischarged for three years and subject to the large number of outdated restrictions. It would be inconsistent with the goal of increasing enterprise through providing those who fail through no fault of their own with an opportunity to start again.

3.13 Reducing the period of bankruptcy will substantially shorten the time during which a trustee can exercise his power under section 307 of the Insolvency Act 1986, to claim property that vests in the bankrupt after the bankruptcy order, thus potentially reducing the assets available to creditors. However, trustees do not often use the current powers.

3.14 Reducing the restrictions placed on bankrupts could result in those whose conduct is on the margins of acceptability not having their conduct addressed.

3.15 Whether culpable and non-culpable bankrupts are treated the same or differently is unlikely to have much effect on returns to creditors, but it will allow lenders to make better informed decisions when considering the provision of credit to bankrupts post-discharge.

3.16 The Insolvency Service has for some years operated a low-cost scheme to enable the trustee to transfer the debtor's interest in a property to another person for a nominal fee in negative equity cases. While this has helped to alleviate the problem, it does not occur in all cases.

Company

3.17 Retention of the current arrangements would, in the majority of cases, deny companies, creditors and other stakeholders the benefits of the new rescue-oriented, collectively-based regime described above, to the detriment of the economy.

3.18 The current regime contains aspects, which are perceived to be unfair and inequitable, particularly the treatment of unsecured creditors, and the administration procedure is less accessible than it might be. Reliance on a voluntary code would not provide a statutory means of addressing departures from its terms.

3.19 The provisions in the Enterprise Act seek to put in place a more equitable system to ensure that the interests of all those who stand most to lose when a company fails are taken into account and they are given an opportunity to influence the outcome.

Crown Preference

3.20 It is unfair for the Crown to be paid in full before claims of other creditors are considered. The abolition of Crown preference will affect money currently owed to the Exchequer. The focus on company rescue should ensure that losses to the Crown through the abolition of preferential status are offset by increased tax received from the continued trading of the survivors.

Financial Regime

3.21 A new regime will provide simplicity and transparency and help The Insolvency Service to better respond to changing workloads. It will also, rightly, ensure that creditors do not pay for enforcement work. Finally, there will be a much fairer rate of return to the insolvent estates from which creditors will be expected to benefit.

3.22 Without change the system would continue to be unfair and inflexible. The Government would continue to claim a large proportion of the income earned through the Insolvency Service Investment Account. In addition, the inherent cross-function subsidy in the system is not equitable.

4. OPTIONS CONSIDERED

Individual

4.1 **Option 1**: Continue to rely on the provisions of the Insolvency Act 1986.

4.2 **Option 2**: Accept the need to reduce the stigma of bankruptcy in the long term but seek to do this by way of education rather than legislative change.

4.3 **Option 3**: Legislate to reduce the stigma of bankruptcy by removing unnecessary restrictions, allowing for an earlier discharge for the majority of bankrupts whilst at the same time providing a tougher regime for culpable bankrupts.

4.4 Provide more choice for creditors and debtors by allowing the Official Receiver to act in post-bankruptcy IVAs.

4.5 Introduce IPAs as a less bureaucratic alternative to IPOs and ensure a fairer deal for creditors by providing that both Orders and Agreements can extend after discharge from bankruptcy but will last no longer than 3 years from the date of their commencement.

4.6 Amend the Insolvency Act to include a time limit by which a trustee must act in relation to a bankrupt's interest in his/her home.

Company

4.7 **Option 1**: Rely on the existing legislation. The current insolvency regime in the UK is prescribed principally by the Insolvency Act 1986 and Insolvency Rules 1986.

4.8 **Option 2**: Introduce a voluntary code of practice for floating charge-holders. A code of practice would aim to encourage creditors with the ability to appoint an administrative receiver to allow a company to put together a rescue proposal, before enforcing their security.

4.9 **Option 3:** Legislate to streamline administration, and restrict the use of administrative receivership to certain capital market and other transactions where the ability to appoint an administrative receiver is fundamental to the effective operation of the market.

Crown Preference

4.10 **Option 1**: No change. The Crown will retain preferential status.

4.11 **Option 2**: Abolish Crown preference, and ensure unsecured creditors benefit.

Financial Regime

4.12 **Option 1**: Retain the existing system.

4.13 **Option 2**: Introduce new legislation to reform the financial regime of The Insolvency Service. Creditors should pay for the full cost of Official Receiver case administration. Investment income earned on insolvent estates should as far as possible be returned to creditors. The cost of investigation and enforcement will be met by the Government. Insolvency Practitioners (IPs) and the recognised professional bodies should pay for regulation, mirroring the system currently used by the Financial Services Authority.

5. BENEFITS OF EACH OPTION CONSIDERED

IDENTIFY THE BENEFITS

Individual

5.1 **Option 1** (no change): There will be no benefits other than that it will impose no additional costs on businesses.

5.2 **Option 2** (non-legislative change): The benefits of an economy strengthened by increased entrepreneurial activity might be achieved in the long term. Entrepreneurs may have increased awareness of the pitfalls of business and the stigma of bankruptcy may gradually be reduced through a programme of education. This option would not require legislative change.

5.3 **Option 3** (provisions in the Enterprise Act): The early discharge provisions will mean prompt rehabilitation of non-culpable bankrupts. The removal of the automatic application of the various unnecessary restrictions, disqualifications and prohibitions that currently attach to bankrupts will reduce the stigma attached to bankruptcy and increase both business start-ups and restarts by encouraging responsible risk takers back into business and thereby contributing to the economy. Rogues will have greater restrictions placed on them so protecting the public and business community. Where such restrictions are agreed through binding undertakings there will be a reduction in both administrative and court costs.

5.4 The provisions for Official Receivers to act as nominees and supervisors of IVAs, linked to increased contributions by bankrupts through Income Payment Orders and Income Payments Agreements, will generate greater dividends for creditors and allow greater number of bankrupts to have their bankruptcy annulled.

5.5 Legislating to allow the Official Receiver to supervise post-bankruptcy IVAs and to make Income Payments Agreements will enable more people to make out-of court arrangements.

5.6 The interest in the home of a bankrupt or former bankrupt will generally revert to the former bankrupt three years after the date of the bankruptcy order if the trustee has not disposed of that interest in the meantime or has taken steps to secure a charging order over the bankrupt's interest. The value of that interest will be fixed at the value as at the date of the charging order.

Company

5.7 **Option 1** (no change): There will be no additional costs placed on business.

5.8 **Option 2** (non-legislative change): While a Code of Practice might contribute to the objectives above, since it would not be mandatory there is no certainty it would lead to a reduction in the number of administrative receiverships and wider use of the administration procedure.

5.9 **Option 3** (provisions in the Enterprise Act): The streamlined administration procedure will be cheaper and easier to access for companies and their creditors. The company, its directors and floating charge holders will be able to appoint an administrator out-of-court, and changes to the current insolvency rules will remove the requirement for a Rule 2.2 report, reducing the cost of entry into administration. Simplified purposes, new and shortened timescales and clear deadlines for ending the procedure will provide greater speed and certainty to creditors. This should improve the prospects for survival of viable companies and provide better returns for creditors. New powers to extend provisions of the Insolvency Act 1986 to foreign companies and to apply company arrangement and administration procedures to Industrial and Provident Societies and Friendly Societies.

Crown Preference

5.10 Option 1 (no change): The Crown would continue to exercise preferential status in insolvencies and there would be no benefits to creditors.

5.11 Option 2 (provisions in the Enterprise Act): The benefits accruing to creditors through the removal of Crown preference are likely to be significant. In personal insolvencies, where there are no floating charges, benefits will flow to unsecured creditors; in company insolvencies, the beneficiaries will be the holders of pre-existing floating charges and increasingly over time the unsecured creditors. Many of these unsecured creditors are small businesses. Removal of the Government's right to be paid in priority to any preferential claims lodged in insolvency proceedings by former employees will benefit those employees.

Financial Regime

5.12 Option 1 (no change): There will be no additional costs or benefits placed on business.

5.13 Option 2 (provisions in the Enterprise Act): There will be the following benefits from reform of the financial regime, which will be done partly through the Enterprise Act and partly through secondary legislation using existing powers:

- The proposed fee structure in the new regime should be simpler for both debtors and creditors to understand.
- The fee structure will enable The Insolvency Service to deal better with sudden caseload surges.
- Creditors will also benefit as insolvency estates will receive the investment returns which currently flow from the Insolvency Service Investment Account into the Consolidated Fund.
- It will eliminate all cross-function subsidy, and clearly link fees to costs. It will also bring the financial regime into line with HM Treasury guidelines on fees and charges.
- It will better underpin the other reforms in insolvency law, such as IVAs.

QUANTIFYING AND VALUING THE BENEFITS OF OPTIONS CONSIDERED

Individual

5.14 Option 1 (no change): There will be no additional monetary benefit to the public or business.

5.15 Option 2 (non-legislative change): It is very difficult to quantify the impact that education would have in changing attitudes to bankruptcy and the extent to which this might influence the climate for entrepreneurial activity.

5.16 Option 3 (provisions in the Enterprise Act): Administrative overheads will be reduced in all bankruptcies through the early discharge provisions. The Insolvency Service currently deals with about 22,500 bankruptcies a year. The vast majority of these involve no substantive input after the Official Receiver has completed his enquiries.

5.17 The public and businesses will be protected from those culpable bankrupts who are the subject of BROs. At present some 3% of all Official Receivers' cases lead to a conviction. Based on current Official Receivers' investigations, it is estimated that between 7% and 12% of bankruptcy cases could result in a BRO and restrictions will run for up to fifteen years, rather than the current three.

5.18 IVAs are flexible but debtors are deterred by the entry costs. The Official Receiver will already have access to most of the required information and will be able to draw up proposals at minimum cost, including offering lower entry fees for the lower end of the market. This will make IVAs more accessible and increase numbers of post-bankruptcy IVAs in the section of the market where debtors are frequently prevented by costs from being removed from the bankruptcy system. Creditors will get a higher return from the anticipated increased number of post-bankruptcy IVAs.

5.19 Most IVA proposals are prepared by insolvency practitioners and presented to creditors in return for a "nominee's fee". If the IVA is accepted it will be administered by a supervisor who will charge fees over the term of the IVA. The Insolvency Service has researched IVAs either completed or abandoned in the period 1 August 2000 to 31 October 2000. The number of cases in the sample was about 900. These cases are sorted into ascending value of receipts and divided into deciles in Table 4 below. The first decile contains 39% of the cases and that the costs of these "small IVAs" are disproportionately high.

Table 4: Breakdown of IVA Receipts

			AVERAGE VALUES					
Group	No of cases	Value of Receipts	Receipts	Nominee Fee	Supervisor Fee	Other Costs*	Payments to Creditors	Costs as percentage of receipts
1	202	Up to £15,700	£9,083	£1,277	£2,509	£1,189	£4,449	54.8%
2	96	£15,701-£23,800	£19,492	£1,431	£4,490	£1,592	£12,208	38.5%
3	64	£23,801-£33,800	£28,142	£1,695	£5,714	£2,538	£18,741	35.3%
4	49	£33,801-£45,380	£38,545	1,798	£6,925	£3,561	£25,912	31.9%
5	37	£45,381-£58,800	£49,352	£1,728	£8,642	£4,797	£32,067	30.7%
6	28	£58,801-£86,800	£67,647	£1,673	£11,349	£4,668	£49,536	26.2%
7	21	£86,001-£112,000	£97,462	£1,816	£14,743	£8,923	£70,896	26.1%
8	11	£112,001-£167,000	£140,333	£3,143	£16,005	£21,572	£100,079	29.0%
9	9	£167,001-£350,000	£204,451	£2,719	£20,924	£19,687	£153,264	21.2%
10	4	Above £350,000	£474,342	£3,338	£17,083	£38,760	£408,818	12.5%

** Other costs include VAT payments and disbursements (e.g. auction charges)*

5.20 The research also showed that nominees' fees ranged from about £150 to £9,000 with an average of about £1,500 a case. Supervisors' fees varied according to the length and complexity of the case. Figure 2 gives a breakdown of receipts from "small IVAs" over this period.

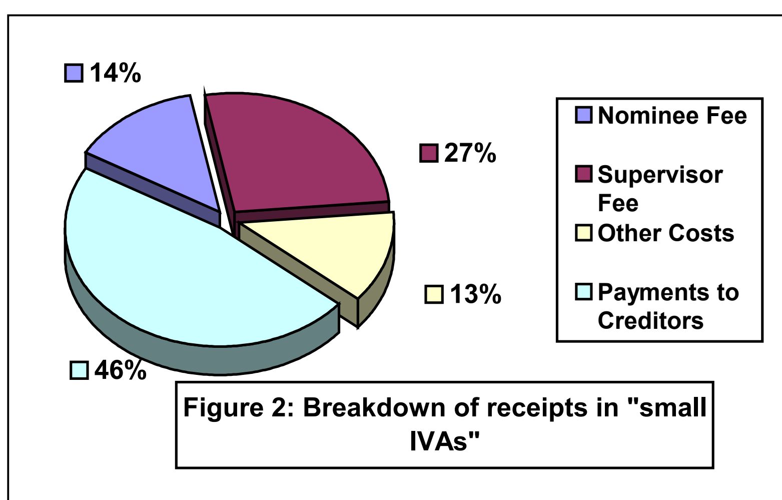


Figure 2: Breakdown of receipts in "small IVAs"

5.21 The Official Receiver will agree to act in small post-bankruptcy IVA cases that are viable and will charge a flat-rate

nominee's fee and a supervisor's fee based on a percentage of anticipated total receipts.

5.22 It is difficult to estimate the number of cases each year. However, there are currently around 12,000 outstanding cases where the trustee still has an interest in the bankrupt's home more than three years after the making of the bankruptcy order. In houses where there is sufficient equity, the bankrupt's house may be sold and the proceeds (less costs) realised.

Company

5.23 **Option 1** will be neutral, as it does not advocate change.

5.24 **Option 2** (non-legislative change) may contribute to the objectives of facilitating company rescue and preserving economic value but the benefits in terms of hard outcomes are hard to quantify and it is unlikely that voluntary initiatives would contribute significantly to a shift to collective insolvency procedure while the administration procedure remained unreformed.

5.25 **Option 3** (provisions in the Enterprise Act): The net impact of these changes on returns for the insolvency profession is likely to be neutral, assuming that restriction on administrative receiverships results in a compensating increase in the number of administrations.

5.26 From a wider perspective the benefits will be seen in the form of increased survival rates and improved recovery rates for creditors through the streamlined administration procedure, although concrete outcomes are difficult to quantify.

5.27 Removal of the requirement for a Rule 2.2 report will reduce costs of administration for creditors and companies. The Association of Business Recovery Professionals (R3) estimates the cost of preparing a Rule 2.2 report to be between £4,000 and £8000 for a "standard" case (based on £1 million turnover, £500,000 book value of assets, expected to realise £200,000). Assuming 500 administrations a year (which is a highly conservative estimate based on 2001 numbers and assumes no increase in take up of the procedure as a result of streamlining the procedure), this will yield savings of between £2 and 4 million a year, which will accrue to companies and their creditors. Those insolvencies which take advantage of the new out-of-court entry routes into administration will reap further benefits through savings in legal costs.

Crown Preference

5.28 **Option 1** will be neutral, as it does not advocate change.

5.29 **Option 2** (provisions in the Enterprise Act): The removal of Crown Preference will result in some £70 million per annum flowing to other creditors. This is based on the fact that the Crown currently recovers some £90 million per annum preferentially in all insolvencies and the estimate that this will drop to some £20 million per annum when the Crown's position becomes unsecured. Removal of the Government's priority over employees will release up to £5 million.

5.30 Preferential creditors generally receive much more of the money owed to them than do unsecured creditors, who frequently get little or none. For example the figures for IVAs in the period August-October 2000 showed on average preferential creditors received 96% of the amount owed to them, while unsecured creditors received on average only 33% of the amount owed.

Financial Regime

5.31 **Option 1** (no change): No additional monetary benefit to the public or business.

5.32 **Option 2** (provisions in the Enterprise Act): The benefits can be quantified as follows:

- Fifteen fees for OR administration reduced to two will create a simpler, more transparent regime.
- The new regime is designed as far as possible to be self-financing.
- The amount of money released to estates will depend on investment returns at the time. However, it will be significantly increased. For example, in 1999/00, £43.4m was paid into the Consolidated Fund from the ISA. In 2000/01, the figure was £45.1m
- It would be clear which functions are paid for by creditors and which by the taxpayer.

6. COSTS OF EACH OPTION CONSIDERED

IMPLEMENTATION COSTS

Individual

6.1 **Option 1** (no change) will not place any new burden on businesses, charities or voluntary organisations.

6.2 **Option 2** (non-legislative change): It is difficult to quantify the cost of educating the wider community. This might, for example, involve the production and distribution of leaflets. It would be difficult to determine the target audience or assess the most effective method of distribution.

6.3 **Option 3** (provisions in the Enterprise Act) imposes no additional costs for business in general. However, there will be a need for insolvency practitioners to familiarise themselves and their staff with the revised individual insolvency regime and to set up systems to cope with it. It is anticipated that the training cost will largely be absorbed into existing regular staff training programs and continuing professional education but that the cost of setting up new procedures and systems might be between £500 and £5,000 per firm, for the overall package, including the corporate provisions depending on the size of the firm.

6.4 It may also have an impact on voluntary organisations in the debt advice sector (e.g. Citizens' Advice Bureau, Paylink, National Debtline and Consumer Credit Counselling Service) as they will need to be familiar with the new provisions but we expect that any costs will be assimilated into existing staff training programs. The provisions might also lead to some increase in the number of applications for advice, at least until the new regime settles in.

Company

6.5 **Option 1**: There would be neither costs nor benefits, as no change would take place.

6.6 **Option 2** (non-legislative change): The effectiveness of any code would depend on the extent of take-up and robust enforcement. This would be difficult and costly to deliver in a sector which is now very diverse and fragmented. In particular, a code of practice would require financial institutions, especially the lending community, to publish, publicise and enforce a code of practice.

6.7 **Option 3** (provisions in the Enterprise Act) imposes no additional costs for business in general but there may be some familiarisation and training costs. These costs will fall mainly on insolvency practitioners and those providing financial/legal advice. As with the individual insolvency provisions, these should be very modest and absorbed into existing staff training and continuing professional education. Some changes to systems may be required, but these are a very small part of the aggregate figures included in the individual insolvency section (paragraph 6.3).

Crown Preference

6.8 **Option 1** would involve no change from the current situation.

6.9 **Option 2** (provisions in the Enterprise Act) would not require creditors or the company to make any changes.

Financial Regime

6.10 **Option 1** (no change) would place no additional costs on businesses, charities or voluntary organisations at the present time.

6.11 On **option 2** (provisions in the Enterprise Act) there would be minimal costs to business, except perhaps for a small one-off cost for some IPs who may need to alter their accounting systems to be compatible with the new regime. For the present, the amount expected to be raised under the new fee structure will be similar to the amount raised under the current regime.

POLICY COSTS

Individual

6.12 **Options 1 and 2** would not result in any direct costs to business.

6.13 **Option 3** may result in some loss of money to creditors. The principal reason for this cost is that creditors may claim against assets acquired between the date of bankruptcy and the date of discharge. A shorter discharge period will mean that assets acquired after one year will no longer be available to creditors, although this is little used. However, payments made under IPOs and IPAs beyond discharge will help offset any disbenefit to creditors depending on the circumstances of the cases and assets.

6.14 The limitation on the time in which a trustee may act in respect of the bankrupt's home will reduce the amount paid to some creditors. Currently, this amount is often small due to trustees fees, the costs and expenses of selling the property and the difficulty in finding creditors as time goes on. This will be the case for both new and outstanding cases.

Company

6.15 **Options 1 and 2** would not result in any direct costs to business.

6.16 **Option 3:** Those entering administration via out-of-court routes will have to pay a fee to cover Court Service Agency costs of filing, but this will be substantially less than the total cost to applicants of a petition and full court hearing.

Crown Preference

6.17 It is not expected that either option would involve any direct costs to business.

Financial Regime

6.18 **Option 1** would not result in any direct costs to business.

6.19 **Option 2** would involve a modest increase in costs to Insolvency Practitioners.

- There will be a new fee for regulation. Given the light touch approach to regulation in this area, the new fees will be low.
- There will be an increase in the application fee currently charged to IPs authorised by the Secretary of State, which has been largely unchanged since

1986 and well below the level of full cost recovery as required by the new regime to ensure equity in this area.

- All new fees will reflect full economic costs to ensure full cost recovery, and petition deposits will be raised at least with inflation.

TOTAL COMPLIANCE COSTS

6.20 The estimated non-recurring cost to Insolvency Practitioners should be between £500 and £5,000 per firm, depending on its size.

IDENTIFY ANY OTHER COSTS

Costs to Government Departments and Agencies

6.21 **Option 3** of the individual insolvency proposals and **option 2** of the financial regime proposals would require Insolvency Service staff to be trained in administering the new procedure.

6.22 It is expected that the cost of the new procedures, principally the Bankruptcy Restrictions Order regime, will be met in part by refocusing existing investigative resources but it is likely that the number of specialist examining staff will need to be restored to 1 April 2000 levels. Administration costs in bankruptcies may be marginally reduced through the early discharge provisions but the full cost of case administration, and any costs of Official Receivers undertaking work on Individual Voluntary Arrangements, are expected to be recovered in full under the new financial regime.

6.23 There may be some IT replacement costs in respect of the financial regime, but this is part of a planned replacement of legacy systems.

6.24 **Option 3** of the individual insolvency proposals will also impact on the court system, as they will have to deal with the new regime for making Bankruptcy Restriction Orders (BRO). However the Act will provide an option for a bankrupt to agree to a BRO without involving the court. As stated, between 7 per cent and 12 percent of all bankruptcies (currently around 21,000) might result in BROs. Of these, it is estimated that at least half will not involve a court hearing, as this approach has been very successful in relation to the CDDA. Using a figure of 10% would give approximately 2,100 BROs per year of which about a thousand will need a court hearing. Figures from the Court Services Agency estimate the cost to the court service of a hearing at around £13.59, giving a total cost of £13,590. Furthermore, this additional work should be offset by a reduction in the number of cases taken through the criminal justice system.

6.25 Table 5 shows figures for breaches of S11 of the Company Directors Disqualification Act (CDDA). We expect that the rates of breaches of BROs would be similar to those of breaches of CDDA orders. An average of the three figures in table 5 would imply an average rate of 6.5%– around 120 cases per year.

Table 5: CDDA Breaches of Section 11

	Orders Made	Reports Accepted	Convictions
April 1999-Mar 2000	1540	73 (4.7%)	60 (3.9%)
Apr 2000-Mar 2001	1548	151 (9.7%)	99 (6.4%)
Apr 01-Mar 2002	1961	124 (13.76%)	101 (9.2%)

Note: figures are guidelines, as for each case, orders reports and convictions will not normally occur in the same year.

6.26 It will further offset the impact of BROs on court time by introducing income payments agreements. There are currently some 2,300 income payments orders a year all of which require court time. It is anticipated that a large proportion of those

cases will be dealt with under the IPA system thus reducing both court time and administrative time for Official Receivers.

6.27 There will be offsetting savings for the courts under **option 3** of the company proposals since these include provision for out-of-court entry into the administration procedure. There are at present some 500 administration applications a year of which it is expected the large majority will no longer involve a court hearing.

6.28 Costs to the courts would be in the region of £15,000 for additional work on the individual side, although the changes on the company side will produce offsetting savings.

6.29 The Government will forgo revenues worth up to £115 million per annum through abolition of Crown Preference and payments to the Consolidated Fund of investment returns on insolvency funds, to the direct benefit of other creditors in insolvencies.

7. SUMMARY OF COSTS AND BENEFITS OF OPTIONS CONSIDERED

Table 6: Individual

Option	Description	Costs	Benefits
1	No Change	Nil	Nil
2	Reduce stigma of bankruptcy through education	Costs may include, for instance, production and distribution of leaflets	Increased business awareness and possible reduction in stigma of bankruptcy
3	Provisions in the Enterprise Act	Costs to **Insolvency Practitioners (IPs)** for setting up new procedures and systems (estimated between £500 and £5,000 per firm for the whole package of insolvency reforms) Possible increase in calls on **voluntary organisations** in the debt advice sector, at least until the new regime settles in. **Government** will have court costs of about £15,000 per year for additional work. Some **creditors** may see a smaller dividend where realisation of the bankrupt's home would have occurred after three years form the bankruptcy order. However, in practice, dividends on such realisations are small.	Reducing the stigma of bankruptcy and prompt rehabilitation of non-culpable bankrupts will contribute to the **economy** by encouraging responsible risk-takers back into business. Rogues will have greater restrictions placed on them so protecting the **public and business community**. Legislating to allow Income Payments Agreements will allow more people to make out-of court arrangements. Extending these and Income Payment Orders beyond discharge will provide a fair deal for **creditors**, providing that debtors who can pay do so. Allowing the Official Receiver to supervise post-bankruptcy Individual Voluntary Arrangements will provide wider choice for **creditors and debtors**, and make out of court

			arrangements cheaper and more accessible, in particular at the lower end of the market. **Many bankrupts** will benefit from the security of a time limit in which a trustee must act in relation to the interest in the bankrupt's home.

Table 7: Company

Option	Description	Costs	Benefits
1	No Change	Nil	Nil
2	Introduce a voluntary code of practice	Costs to lending community in publishing, publicising and enforcing a code of practice	No certainty of a reduction in the number of administrative receiverships
3	Provisions in the Enterprise Act	Lenders will need to familiarise themselves with the new arrangements. No direct costs to business; implementation costs for IPs are dealt with above.	Greater transparency and accountability through collective insolvency proceedings under which a duty is owed to all creditors of the company. Streamlined administration procedure will facilitate the rescue of viable companies and provide better returns for creditors. Secured Lenders and companies will benefit from out of court entry routes to administration, which will reduce costs and make the procedure more accessible. Removal of the Rule 2.2 report through changes to the insolvency rules is expected to yield savings of between £2 and £4 million a year to companies and their creditors.

Table 8: Crown Preference

Option	Description	Costs	Benefits
1	No Change	Nil	Nil
2	Provisions in the Enterprise Act	There will be no direct costs to **business**. **Government** will lose the money which previously went to the Crown, including	There will be more money in insolvencies for distribution to other **creditors** (estimated at up to £70 million). Abolition will bring major benefits to trade and other

		through removal of the Government's priority over employees.	unsecured creditors.

Table 9: Financial Regime

Option	Description	Costs	Benefits
1	No Change	Nil	Nil
2	Provisions in the Enterprise Act	A modest increase in costs of fees for regulation of the **insolvency profession** to reflect full economic costs. **Government** will lose the money which previously went to the Consolidated Fund.	The fee structure in the new regime will be simpler and more transparent for both **debtors and creditors**. No retention in the Consolidated Fund of investment returns generated on the Insolvency Service Investment Account. Instead the benefits will flow to **creditors** of insolvent estates. Currently worth around £40 million per year.

8. IMPACT ON SMALL BUSINESS

General Consultation

8.1 We have been in touch with the Small Business Service (SBS) to ensure that these proposals complement the initiatives already being implemented by the SBS, such as the Better Payments Practice Group. In addition, we kept in touch with the SBS as proposals in the White Paper have developed.

8.2 In addition to the formal White Paper consultation process (see section 9) we have remained in touch with small firms' representative bodies, including the Federation of Small Businesses, the Confederation of British Industry and the British Chambers of Commerce.

The Small Business Litmus Test

8.3 Small firms of insolvency practitioners and solicitors were consulted, along with individual bankrupts, financial institutions and directors of limited companies that have entered either administration or administrative receivership. In total 15 firms or individuals were contacted on the bankruptcy proposals and 25 on the corporate proposals. They were asked to return a questionnaire in order to help us identify any costs and benefits of implementing the proposals.

8.4 We received seven responses, four covering the bankruptcy proposals and three covering the company proposals. All of the respondents commented on the proposals, but only two firms of IPs gave any indication of implementation costs. One of these expressed concern that the proposal to allow the Official Receiver to administer IVAs would result in a loss of business while the other estimated the training and other costs of implementing the proposals at around £1,000. This fits in with the figures given in section 6.

8.5 There was some concern about the bankruptcy proposals, with little support for the rehabilitation of any bankrupts, but the main criticism concerned the definition of "culpability" for the BRO, and whether the Official Receiver would be able to police the new

procedure. There was general support for streamlining administration, although one respondent expressed a fear that the nature of lending would change if administrative receivership were restricted. These views were based on the procedure outlined in the White Paper. Additionally, most of the respondents supported the proposal to abolish Crown Preference although one respondent felt that Crown preference allowed the Inland Revenue to defer collecting tax – effectively helping small business.

9. RESPONSES TO CONSULTATION

9.1 The consultation period for the White Paper "*Productivity and Enterprise – Insolvency: A Second Chance*" ended on 5 October 2001. There were 81 responses covering all aspects of the policy. Copies of the White Paper, along with a summary of responses can be found on the Insolvency Service website at www.insolvency.gov.uk/compwp.htm.

9.2 There were mixed views on allowing earlier discharge for people who become bankrupt through no fault of their own, with most respondents feeling that the BRO proposal would need to be properly implemented and enforced. Some respondents queried the criteria that would be used in deciding who was culpable while other feared that if investigations were not sufficiently rigorous, the proposal for early discharge would benefit culpable bankrupts. This could lead to bankruptcy being seen as an easy option, which could in turn increase the number of bankruptcies. A number of responses said that the family home was an area of concern, and this view has been reinforced by contact with various interested parties, and an amendment on the issue was tabled at the Committee stage in the House of Commons.

9.3 A majority of respondents endorsed the principle of corporate rescue, but many of the responses from legal firms and banks expressed concern over the restriction of administrative receivership, which they were convinced had major benefits in terms of speed, flexibility and control. There was concern as to whether the new streamlined administration procedure would be able to match these advantages. Many questioned whether the proposal for interim administration would work in cases of real urgency.

9.4 In developing the corporate insolvency proposals contained in the Enterprise Act, the Government took into account these responses. Officials have met with representatives from a number of bodies, including the City of London Law Society, the British Bankers' Association and the Association of Business Recovery Professionals, and these groups have helped develop the streamlined administration procedures, including the new out-of-court entry routes.

9.5 There have also been extensive previous consultations:

- **Individual** – The Insolvency Service published the consultation document "Bankruptcy A Fresh Start" in April 2000, which covered most of the proposals contained in the White Paper. A copy of this document can be found on The Insolvency Service website at www.insolvency.gov.uk/introduction/freshstart/foreword.htm.
- **Company** – The Insolvency Service published the consultation document "A Review of Company Rescue and Business Reconstruction Mechanisms" in November 1999 and a report on that consultation was published in February 2001. Copies of those documents can be found on The Insolvency Service website at www.insolvency.gov.uk/introduction/condoc/reviewof.htm and www.insolvency.gov.uk/introduction/condoc/condocreport.htm respectively.

10. DEVOLUTION

10.1 The insolvency provisions in the Enterprise Act will apply in England and Wales. The implications of devolution as regards Scotland and Northern Ireland are set out in table 10. The provisions on the financial regime of the insolvency service affect England and Wales only.

Table 10: Devolution Implications

	Scotland	Northern Ireland
Individual	Individual insolvency is almost wholly devolved and legislation to modernise the law in this area would be a matter for the Scottish Parliament. The Scottish Executive has indicated that it will study carefully the extension of the proposed provisions on personal bankruptcy to Scotland.	Individual insolvency is devolved and any changes will require separate legislation.
Company	The corporate insolvency provisions of the Enterprise Act will extend to Scotland. The Scottish Parliament gave its consent to Westminster legislating on those limited aspects which are devolved on 17 April. This will ensure that the same regime on corporate rescues applies on both sides of the border.	Corporate Insolvency is devolved and any changes will require separate legislation.
Crown Preference	The Crown preference provisions of the Enterprise Act will extend to Scotland. This will ensure that the same regime applies on both sides of the border.	Crown preference is devolved and any changes will require separate legislation.

11. GUIDANCE, ENFORCEMENT, AND EVALUATION

11.1 The Insolvency Service will issue guidance on the provisions before they are implemented. Such guidance will be available in hard copy and on the Internet.

11.2 The individual insolvency provisions will repeal two offences in the Insolvency Act 1986 (section 361 failure to keep proper accounts of business and section 362 gambling). Conduct that would currently be dealt with under these provisions will be dealt with under the BRO regime. The effectiveness of the new legislation will be monitored after the new legislation has been in operation for a period of three years.

11.3 The company provisions will create new offences. For floating charge-holders and directors, the offences will be for of making false statutory declarations, failing to notify administrator of filing of papers for administration. The offence for Administrators failing to give notice of appointments will be extended to the out-of-court procedure. The effectiveness of the new procedures will be monitored after the legislation has been in operation for three years.

12. SUMMARY

12.1 Options 3 in individual and company insolvency, and options 2 for Crown preference and the financial regime have been taken forward in the Enterprise Act as the most effective means of ensuring the Government's objectives of company rescue, and where that is not possible of improving the returns made to creditors. The overall costs of these options are unlikely, for the reasons set out above, to be material as the regulatory burden they will place on businesses generally will be minimal. There will be some one off costs for the insolvency

profession, financial and voluntary sectors, restricted to one-off costs of training, and familiarisation of the new arrangements.

13. DECLARATION

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed____

Parliamentary Under-Secretary of State
for Competition, Consumers and Markets

Date: November 2002

14. CONTACT POINT

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Annex A

GLOSSARY OF TERMS

Administration
A rescue procedure where an insolvency practitioner (IP) is appointed to manage the affairs of a company and seeks to rescue it, or bring about a better result for its creditors. In such a case the IP is known as the administrator.

Administrative receivership
The process where an IP is appointed by a floating charge holder to realise a company's assets and pay preferential creditors and the floating charge-holder's debt. In such a case the IP is known as the administrative receiver.

Fixed charge
A security interest held over specific assets. The debtor cannot sell the assets without the consent of the secured creditor or repaying the amount secured by the charge.

Floating charge
A security interest held over general assets of a company. The assets may change (such as stock) and the company can use the assets without the consent of the secured creditor until the charge "crystallises" (becomes fixed). Crystallisation occurs on the appointment of an administrative receiver, when the company is wound up, or as otherwise provided for in the document creating the charge (in England and Wales).

Income payments order
The court may order the debtor to pay part of his/her wages, salary or other income to the trustee if his/her income is more than he/she or his/her family need to live on.

Insolvency practitioner
An authorised person who specialises in insolvency, usually an accountant or solicitor. They are authorised either by one of a number of recognised professional bodies or by the Secretary of State.

Liquidation (winding up)
Applies to companies or partnerships. It involves the realisation and distribution of the assets and usually the closing down of the business. There are three types of liquidation - compulsory, creditors' voluntary and members' voluntary.

Preferential creditor
A creditor in insolvency proceedings who is entitled to receive certain payments in priority to other unsecured creditors. These creditors currently include government departments, occupational pension schemes and employees.