

## **EVALUATION OF BANKRUPTCY RESTRICTIONS ORDERS – SECOND INTERIM EVALUATION REPORT**

### **Section 1 - Purpose of the paper**

1. To provide details of the on-going evaluation work being undertaken in respect of the Bankruptcy Restrictions Order (BRO) provisions of the Enterprise Act 2002.

### **Section 2 – Background and Purpose of Evaluation**

2. On 1 April 2004, new insolvency legislation came into force contained in the Enterprise Act 2002. This new legislation introduced provisions whereby the court can make a BRO, which are designed to provide better protection for the public and a civil alternative to prosecution. BROs place restrictions on the most culpable bankrupts from between 2 and 15 years.

3. The objectives of the BRO provisions contained in the Enterprise Act 2002 are:

- To protect the public and commercial community, by enabling the court to make a BRO so that a culpable bankrupt will continue to be subject to the restrictions of bankruptcy for a period of 2 to 15 years;
- To allow lenders and public to differentiate between culpable and non-culpable and make better informed decisions in their dealings with bankrupts; and
- To deter fraud and misconduct.

4. A bankrupt can offer a Bankruptcy Restrictions Undertaking (BRU) to the Secretary of State, and a BRU has the same effect as a BRO. In this paper, the term 'BRO(s)' is used to cover Bankruptcy Restriction Orders and Bankruptcy Restriction Undertakings.

5. The principal aim of the evaluation is to provide a comprehensive assessment of whether, to what extent and how the provisions relating to BROs meet these policy objectives. The evaluation also provides information and data that can be used to inform future policy decisions.

6. The Insolvency Service made a commitment to the Government to undertake an evaluation of the Enterprise Act 2002 within 3 years of commencement of the various provisions. The BRO provisions commenced on 1 April 2004 and therefore, the evaluation is due to be completed by 31 March 2007. This is the second interim report to summarise the evaluation work and findings to date<sup>1</sup>.

### **Section 3 – Approach**

7. The evaluation uses both quantitative and qualitative evaluation methods, including:

- Analysis of data on individual insolvency cases held on The Insolvency Service's internal Information Technology system
- Sampling and review of files on individual insolvency cases to supplement information from other sources

---

<sup>1</sup> The first interim report dated March 2005 is available on The Insolvency Service's website ([www.insolvency.gov.uk](http://www.insolvency.gov.uk)).

- Meetings with professionals within the insolvency sector to seek their views regarding the appropriateness and impact of insolvency legislation
- Structured questionnaires and interviews with bankrupts, creditors, and other members of the public to obtain their views and experience of the impact of insolvency legislation and to obtain feedback on the wider issues associated with bankruptcy

8. In order to ascertain the impact of the Enterprise Act 2002 provisions, benchmark information was obtained regarding the operation and effect of the existing legislation, i.e. before the implementation of the Enterprise Act 2002 provisions.

9. A copy of the evaluation planning paper is contained at [appendix 1](#).

#### **Section 4 – Work Carried Out to Date**

10. All benchmarking information has been obtained.

11. Information relating to the operation and effect of the Enterprise Act 2002, i.e. from 1 April 2004, has been, and continues to be collected.

**Objective 1 - To protect the public and commercial community, by enabling the court to make a BRO so that a culpable bankrupt will continue to be subject to the restrictions of bankruptcy for a period of 2 to 15 years.**

12. The objective relates to the power of the court to make a BRO where the conduct of the bankrupt both before and during his bankruptcy shows that the public requires protection. The evaluation looks at the level of protection offered by the BRO regime and customer satisfaction with the way in which culpable bankrupts are dealt with.

13. The benchmark information mainly relates to bankruptcy prosecution action (which prior to the Enterprise Act 2002, was the only option available to deal with bankrupts whose conduct warranted further action<sup>2</sup>) and disqualification action taken against culpable directors of insolvent companies.

14. Full details of the evaluation information obtained in respect of this objective is contained at [appendix 2](#).

**Objective 2 - To allow lenders and public to differentiate between culpable and non-culpable and make better informed decisions in their dealings with bankrupts.**

15. This objective relates to lenders and the public being aware that, in the absence of a BRO, it can be assumed that a bankrupt was non-culpable. The evaluation looks at the effect of the BRO regime on public and lender policies and public awareness of the BRO regime.

16. Full details of the evaluation information obtained in respect of this objective is contained at [appendix 3](#).

---

<sup>2</sup> The Official Receiver also had (and still has) the power to apply for the suspension of a bankrupt's discharge where the bankrupt failed to co-operate.

**Objective 3 – To deter fraud and misconduct**

17. This objective relates to the existence of the BRO regime acting as a deterrent. The evaluation looks at the effect of the BRO regime on the incidence of insolvency-related criminal offences and civil misconduct, and the rehabilitation of ‘offenders’.

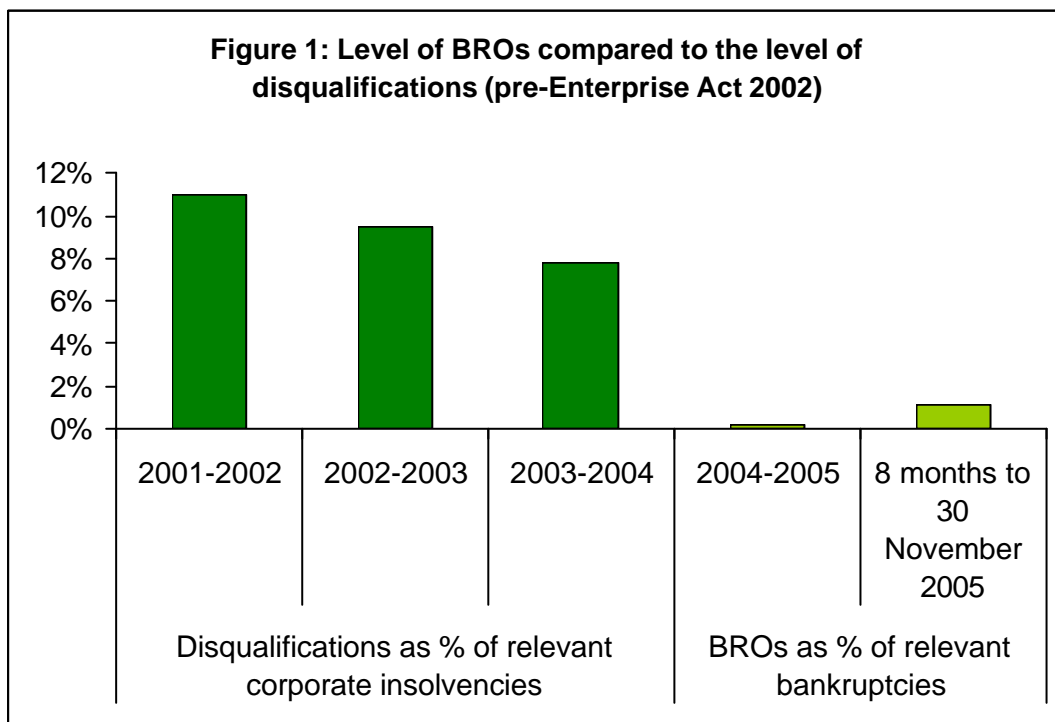
18. Full details of the evaluation information obtained in respect of this objective is contained at [appendix 4](#).

**Section 5 - Preliminary conclusions and recommendations**

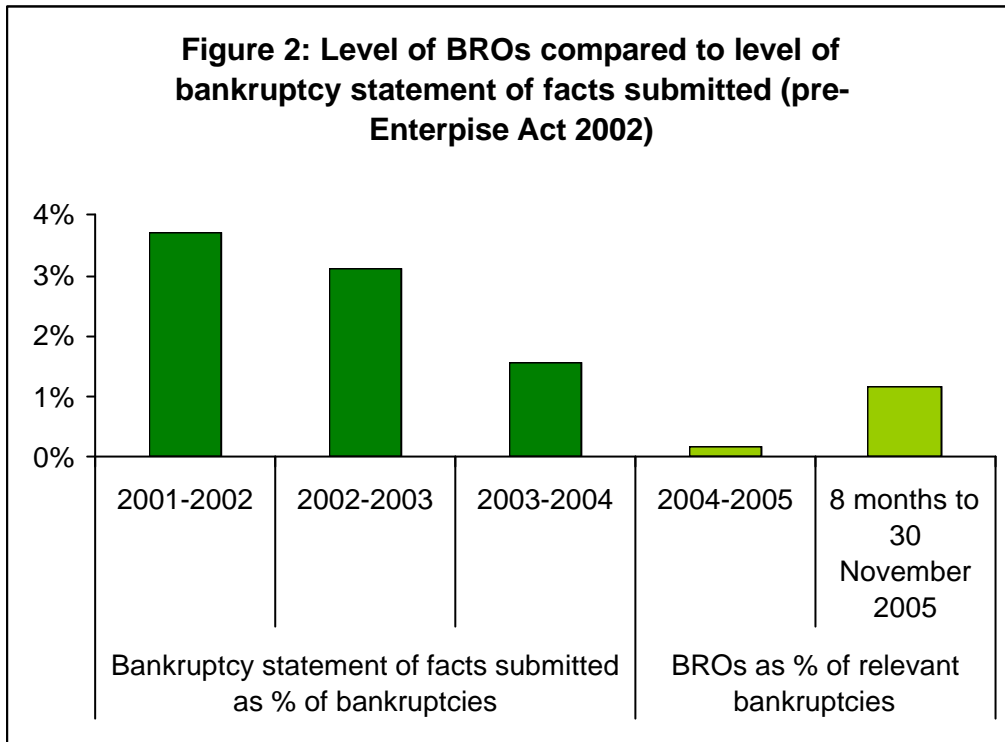
19. From the evaluation information available, the following observations can be made:

**Objective 1 - To protect the public and commercial community, by enabling the court to make a BRO so that a culpable bankrupt will continue to be subject to the restrictions of bankruptcy for a period of 2 to 15 years.**

- The level of BROs is rising, but is currently below the expected level based on the level of disqualifications obtained<sup>3</sup> and bankruptcy prosecutions submitted pre-Enterprise Act 2002 (see Figures 1 and 2). However, as detailed in the evaluation planning paper (Appendix 1), as BRO action can only be taken in respect of conduct after 1 April 2004, it was anticipated that BRO figures for 2004/5 and 2005/6 would be lower than in future years.



<sup>3</sup> The BRO provisions are broadly analogous to the provisions of the Company Directors Disqualification Act 1986, and therefore, it may be expected that in percentage terms, a similar level of BROs will be achieved as disqualification orders.



- The average length of a BRO is around 5 years, which is consistent with the average length of a disqualification order (see Table 1).

**Table 1: Length of disqualification orders and BROs**

	Length of Disqualifications			Length of BROs	
	2001-2002	2002-2003	2003-2004	2004-2005	8 months to 30 November 2005
<b>Median</b>	5	5	5	5.5	5
<b>Average</b>	5.4	5.4	5.2	5.5	5.4

years

- There have been no reported breaches of a BRO to date. Based on the benchmarking information, breaches of BROs are expected to occur in less than 1% of cases.

- An application for a BRO must usually be made within 12 months of the bankruptcy order<sup>4</sup>. Until February 2006, the guidance to Official Receivers was that where there was a gap between the first anniversary of the bankruptcy order and the hearing of the BRO application, an application should be made for an interim BRO. In practice, this guidance gave rise to a great number of interim BRO applications to bridge the gap between the anniversary and the substantive BRO hearing; it is estimated that interim BROs have been obtained in the region of 90 cases<sup>5</sup> up to 31 December 2005.
- The Insolvency Service sought Counsel's opinion on this matter. As a result, new guidance was issued to Official Receivers in February 2006, advising that an application for an interim BRO is not always necessary and the decision to make such an application should be made on a case-by-case basis, taking into account the nature of the allegations, the length of the gap between the anniversary and the substantive BRO hearing, and the 'damage' to the bankrupt<sup>6</sup>
- There have been no complaints received to date regarding bankrupts potentially acting in breach of a BRO. The level of calls to the Disqualified Directors' Hotline shows an increasing trend, which appears to reflect an increase in public awareness of the Hotline, as well as an increase in the number of disqualification orders in force over the period. Therefore, as the number of BROs in force increases, complaints are expected to be received in the future.
- A case study of creditors in 2004 (the year in which the Enterprise Act 2002 was implemented) showed that 28% of bankruptcy creditors felt that the insolvency regime protected the public from dishonest or reckless individuals, with 23% being undecided. A case study of creditors in 2005 produced broadly the same results. Therefore, at this stage, it would appear that the introduction of the BRO regime has not yet made creditors feel more protected. However, as the level of BROs obtained increases, this may change – this view is supported by the results of a survey of creditors in bankruptcy cases where a criminal conviction has been obtained against the bankrupt (see below).
- A survey of insolvency stakeholders prior to the implementation of the Enterprise Act 2002 showed that around 38% of the respondents felt that The Insolvency Service's sanctions deterred and protected against financial wrong-doing, with 3% being undecided. This opinion covered both corporate and individual provisions. A similar survey in 2006 (post-Enterprise Act 2002) showed that around 43% of respondents felt that The Insolvency Service's sanctions deterred and protected against financial wrong-doing, with around 2% being undecided. Therefore, it is possible that introduction of the BRO regime may have contributed to a slight increase in stakeholder confidence. In the 2006 survey, respondents were also asked what The Insolvency Service could do to increase the level of protection from financial wrong-going; the most popular answer was to take action in more cases.

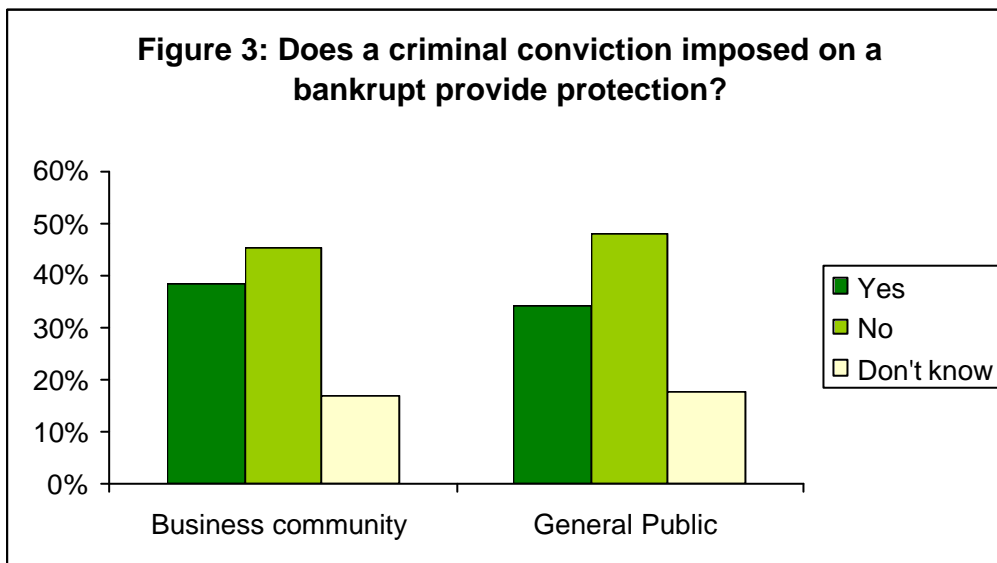
---

<sup>4</sup> Schedule 4A of the Insolvency Act 1986

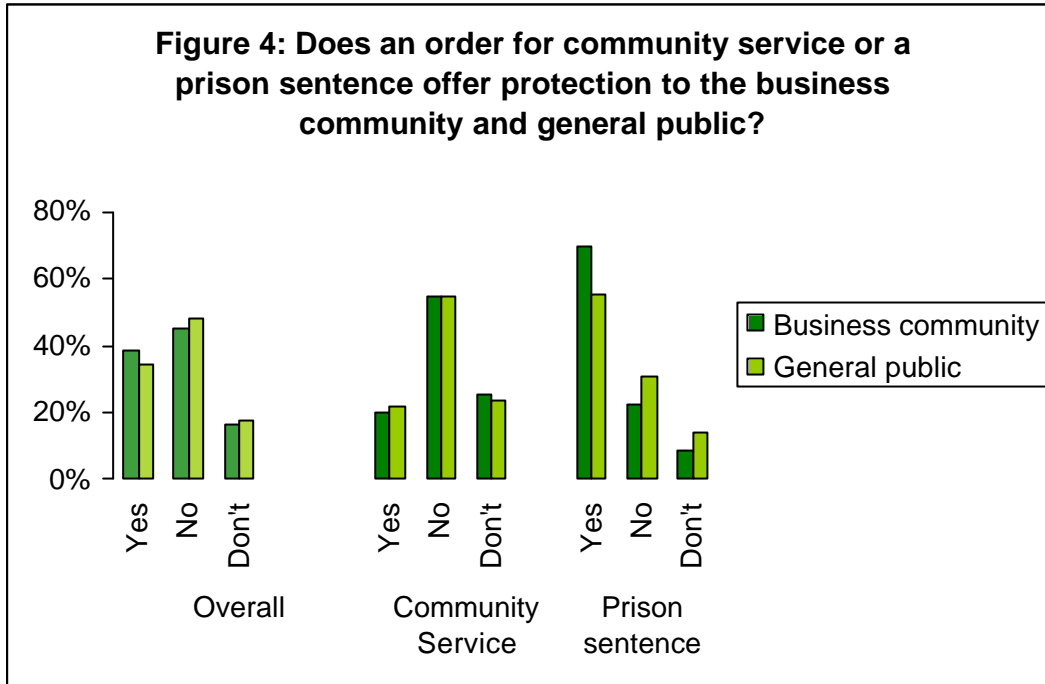
<sup>5</sup> Based on information provided by The Authorisations Team.

<sup>6</sup> There are Human Rights considerations, as the bankrupt has not received a fair trial when the court grants an interim BRO and there is no mechanism for compensation as there is with other kinds of injunctions.

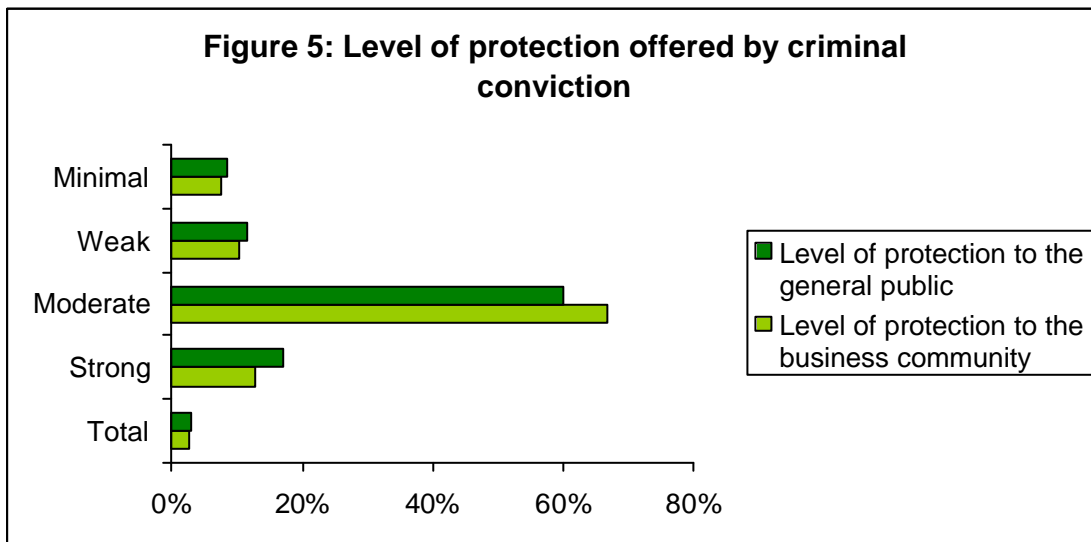
- A survey of people aged 15 or over carried out in 2006 (post-Enterprise Act 2002) showed that 32% of the respondents agreed that the insolvency regime protected the public from dishonest or reckless individuals, with 54% being undecided. This opinion covered both corporate and individual provisions. In this survey, respondents were also asked whether they had heard of BROs; 21% thought they had heard of them, but no-one accurately described what they were. Therefore, it appears that there is currently a lack of public awareness of the BRO regime. However, this may change as number of BROs in force increases.
- The Insolvency Service has carried out a survey of creditors in bankruptcy cases where a criminal conviction has been obtained against the bankrupt in connection with the bankrupt's conduct prior to or during his/her bankruptcy, to establish whether such prosecution action provides protection to the business community and more generally, the general public.
- The survey of creditors in bankruptcy cases where a criminal conviction was obtained against the bankrupt shows that overall, just over a third of creditors feel that the conviction imposed on the bankrupt provided protection to the business community and general public (see Figure 3).



- The most common result following a criminal conviction against a bankrupt is community service. An order for community service is seen as one of the least effective means of providing protection to the business community and general public, whereas a prison sentence is seen as the most effective (see Figure 4).



- Creditors who feel that a criminal conviction does provide protection to the business community and general public are most likely to rate the protection as moderate (see Figure 5).



- Over 70% of creditors in bankruptcy cases where a criminal conviction was obtained would feel more protected if the bankrupt's discharge had been suspended, or restrictions were imposed on the bankrupt.

- The most popular restrictions suggested by the creditors were restrictions on obtaining credit and running businesses.
- The results of this survey suggest that the introduction of the BRO regime should make creditors feel more protected. Further surveys, including a survey of creditors in BRO cases, creditors generally and the general public, will be carried out to ascertain the impact of the introduction of the BRO provisions.

**Objective 2- To allow lenders and public to differentiate between culpable and non-culpable bankrupts and make better informed decisions in their dealings with bankrupts.**

- There exists non-insolvency legislation that imposes restrictions on undischarged and discharged bankrupts. The Insolvency Service continues to work with the relevant bodies to encourage them to recognise that the existence of a BRO (rather than a bankruptcy order) is an indicator of 'unfitness', and legislation should reflect this (where it does not conflict with their own policy aims).
- Credit reference agencies keep a record of a bankruptcy order for 6 years, together with a record of discharge where appropriate. This has remained unchanged by the introduction of the Enterprise Act 2002. A record of a BRO will be recorded for 6 years (where the BRO is for 6 years or less), or until the BRO ceases.
- Mainstream financial institutions have broadly similar policies in dealing with bankrupts. Prior to the Enterprise Act 2002, in general terms, applications by undischarged bankrupts for accounts or loans were refused. Applications by discharged bankrupts were shown more consideration, but due to inevitable 'bad' credit reference histories, the applications were likely to be refused. There have been no specific changes made to these lending policies in response to the implementation of the Enterprise Act 2002<sup>7</sup>. Lenders so appear to be aware of the BRO regime, but do not appear to have different lending policies for those individuals subject to a BRO. As credit reference agencies are recording BROs, it is possible for lenders to differentiate between culpable and non-culpable bankrupts, although to date, this is not reflected in their lending policies.
- A record of a BRO obtained against a bankrupt is recorded on the Individual Insolvency Register, which is a public register maintained by The Insolvency Service on behalf of the Secretary of State. The Register also contains details of bankruptcies that are either current or have ended in the last 3 months and current individual voluntary arrangements and fast track voluntary arrangements. The Register can be searched free-of-charge online (via The Insolvency Service's website) or in person at any Official Receiver's office. Therefore, the public (and lenders) have access to the relevant information required to enable them to differentiate between a culpable and non-culpable bankrupt.

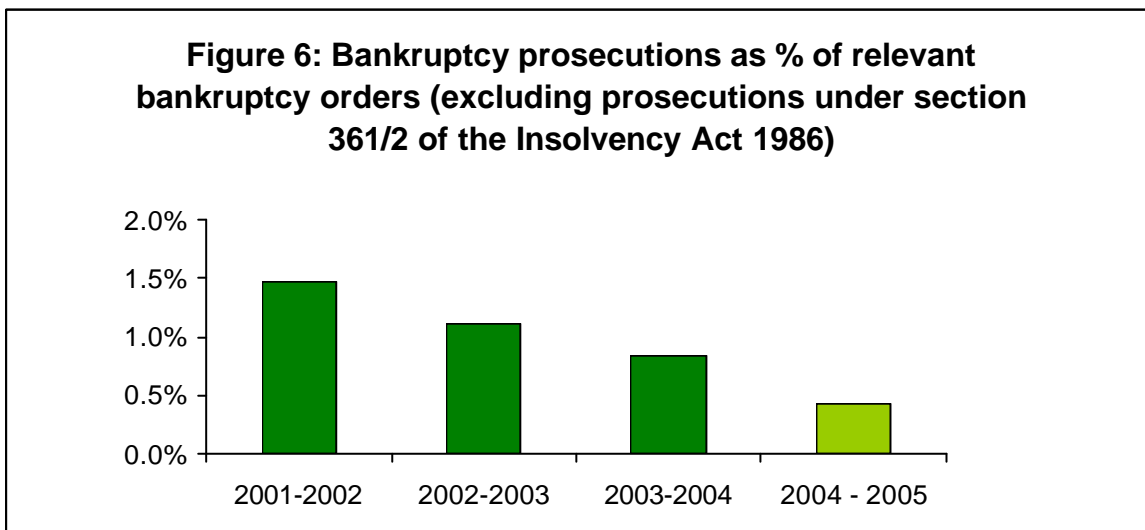
---

<sup>7</sup> Based on information provided by members of the British Bankers' Association (BBA), which BBA advise is broadly representative of the industry position.

- Searches of the on-line Individual Insolvency Register are in the region of 110,000 per month<sup>8</sup>, compared to searches of the on-line Index of Disqualified Directors maintained by Companies House in the region of 46,000 per month. Therefore, it would appear that the Individual Insolvency Register is being regularly used.
- However, the results of the survey of the public post-Enterprise Act 2002 suggest that there is currently a lack of public awareness regarding the BRO regime (see above). Therefore, although the public have access to, and appear to be using the Individual Insolvency Register, they are unlikely to immediately understand the significance of a BRO being recorded against a bankrupt. However, the on-line Individual Insolvency Register does automatically refer users to information on BROs. Therefore, the free, publicly available information does allow the public to differentiate between culpable and non-culpable bankrupts and make better informed decisions in their dealings with bankrupts.

**Objective 3 – To deter fraud and misconduct**

- The level of bankruptcy prosecutions since the introduction of the Enterprise Act 2002 has declined. However, this appears to be part of a trend established prior to the Act (see Figure 6)<sup>9</sup>.



- To date, there have been no 'second-time' bankrupts where a BRO has been obtained in the first case. A minimal number of such cases is expected in the future as the level of 'second-time' bankrupts is negligible, and the level of 'second-time' bankrupts where a prosecution was obtained in the first case is even less.

---

<sup>8</sup> Based on information held by The Insolvency Service for the period April to December 2005.

<sup>9</sup> Offences under section 361 and 362 of the Insolvency Act 1986 have been excluded to ensure comparability of figures, as such offences were abolished under the Enterprise Act 2002.

18. No changes to the evaluation planning paper are recommended at this time.

Caroline Burton  
March 2006