

## **EVALUATION OF INDIVIDUAL VOLUNTARY ARRANGEMENTS – 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 individual voluntary arrangement (IVA) 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. The new legislation introduced changes to the IVA provisions whereby the Official Receiver could act as nominee and supervisor of post-bankruptcy IVAs, to be known as ‘fast-track voluntary arrangements’ (FTVAs). Additionally, it is now mandatory for the court to annul the bankruptcy order on the application of the bankrupt or Official Receiver.

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

- To support the ‘fresh start’ of a bankrupt by:
  - Providing an accessible alternative to bankruptcy; and
  - Ensuring that annulment of the bankruptcy order is obtained once an IVA is approved; and
- To improve returns to creditors.

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

5. 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 IVA 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**

6. 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
  - 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

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<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)).

insolvency legislation and to obtain feedback on the wider issues associated with bankruptcy

7. 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.

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

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

9. All benchmarking information and 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 support the ‘fresh start’ of a bankrupt by providing an accessible alternative to bankruptcy**

10. The objective relates to the introduction of FTVAs as an alternative to bankruptcy. The evaluation looks at the level of FTVAs, the time and costs involved in FTVAs, the FTVA failure rate, the FTVA debtor profile, and customer satisfaction with the FTVA provisions.

11. The benchmark information mainly relates to post-bankruptcy IVAs administered by insolvency practitioners (IPs), which prior to the EA, was the only option available to bankrupts who wanted to enter into an IVA after the making of a bankruptcy order.

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

#### **Objective 2: To support the ‘fresh start’ of a bankrupt ensuring that annulment of the bankruptcy order is obtained once an IVA is approved**

13. The objective relates to the benefit to a bankrupt of an annulment and the consequent lifting of bankruptcy restrictions. The evaluation looks at the level and timeliness of annulments following approval of a post-bankruptcy IVA, the working practices of an OR as regards annulments following approval of a post-bankruptcy IVA and credit agency and lender policies as regards annulments and IVAs.

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

#### **Objective 3: To improve returns to creditors**

15. The objective relates to the lower costs involved in FTVAs (compared to post-bankruptcy IVAs where an insolvency practitioner acts as nominee/supervisor) and the overall aim to increase the number of post-bankruptcy IVAs. The evaluation looks at the level and timeliness of returns to creditors and the impact of FTVA on post-bankruptcy IVAs.

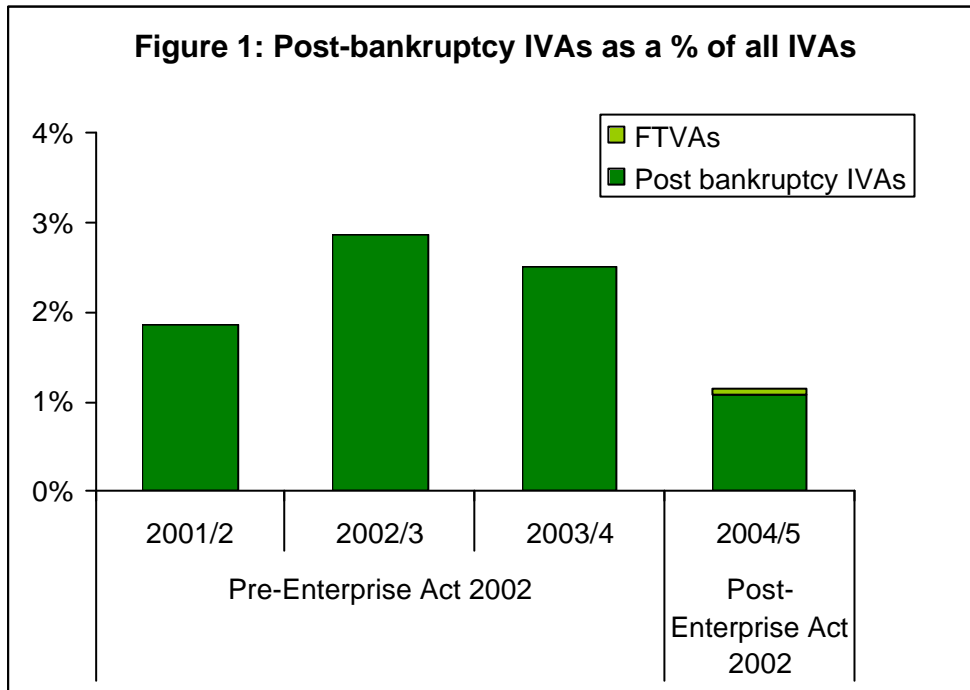
16. Full details of the evaluation information obtained in respect of this objective are contained at [appendix 4](#).

**Section 5 - Preliminary conclusions and recommendations**

17. In the period 2004/5<sup>2</sup>, only 8 FTVAs were entered into. Therefore, the robustness of the current post-Enterprise Act 2002 evaluation information available is limited. However, the following observations can be made:

**Objective 1: To support the ‘fresh start’ of a bankrupt by providing an accessible alternative to bankruptcy**

- Less than 3% of IVAs are entered into post-bankruptcy, and for the period 2004/5, just under 6% of all post-bankruptcy IVAs were FTVAs (see Figure 1).



- Post-bankruptcy IVAs are entered into in less than 1% of bankruptcy cases, and in 2004/5, FTVAs were entered into in only 8 bankruptcy cases (which represents around 0.02% of all bankruptcy cases).
- The nominee fee in FTVAs is currently set at £300 (excluding VAT). In comparison, the average nominee fee in 2001/2 post-bankruptcy IVAs is £1,500 - £2,000 (excluding VAT). Therefore, the lower nominee fee in FTVAs minimises a perceived potential barrier to entry to post-bankruptcy IVAs and contributes towards the accessibility of FTVAs.

<sup>2</sup> The period 2004/5 refers to the period 1 April 2004 to 31 March 2005.

- The supervisor fee in FTVA's is currently set at 15% of realisations. In comparison, the average supervisor fee charged in 2001/2 post-bankruptcy IVAs is around 11% of realisations. The impact of this is discussed below under 'Returns to creditors'.
- No modifications can be made to FTVA's. It appears that post-approval modifications to 2001/2 post-bankruptcy IVAs were made in around 10% of cases – the most common modification was an extension of the length of the IVA. As regards the costs involved, these are rarely explicitly stated, but case study material regarding the costs are contained at Table 1. However, the costs involved in modifications need to be balanced against returns to creditors achieved as a result of any modification, rather than the IVA failing.

**Table 1: Examples of the costs involved in modifications of post-bankruptcy IVAs**

<b>Nature of Modification</b>	<b>Cost (£)</b>
Extension of length of IVA	2125.58
Extension of length of IVA, with the supervisor fees being restricted to no more than £2,000 plus VAT	258.50
Change in nature of realisations within the IVA	2,000.00

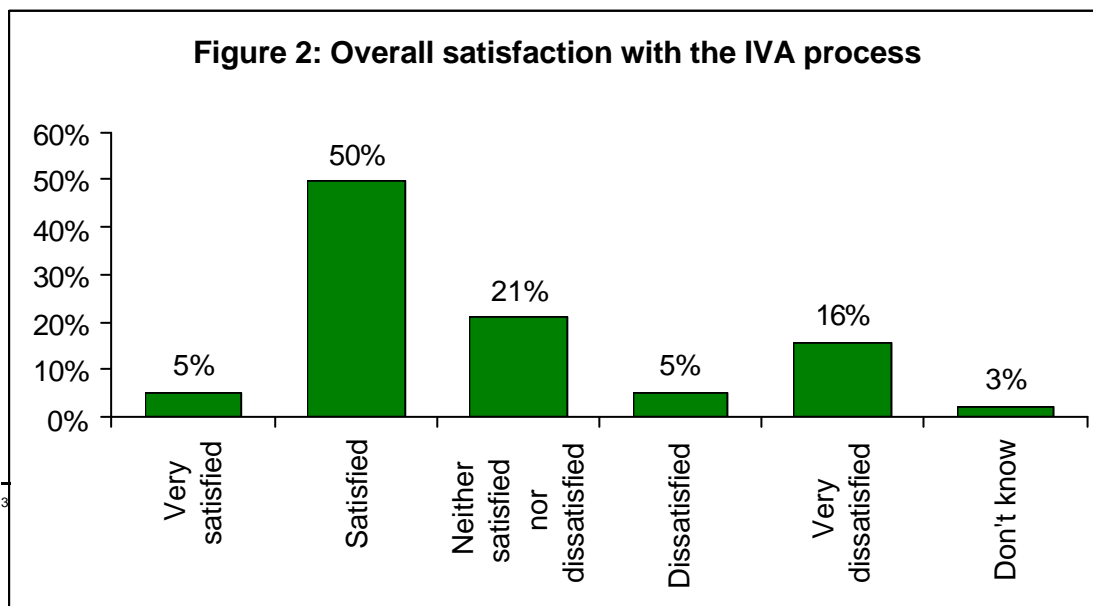
- For the FTVA's entered into in 2004/5, the time taken between the making of a bankruptcy order and the approval of an FTVA ranged from around 7 weeks to over 400 days. However, two of the FTVA cases relate to bankruptcy cases which pre-date the implementation of the Enterprise Act 2002. If these cases are excluded, the time taken between the making of a bankruptcy order and the approval of an FTVA ranged from around 7 weeks to 21 weeks.
- The time taken between the making of a bankruptcy order and the approval of a post-bankruptcy IVA in 2001/2 ranges from around 4 weeks to over 400 weeks, with the majority (58%) of post-bankruptcy IVAs being entered into between 4 and 16 weeks after the bankruptcy order.
- Therefore, on the basis of the 2004/5 FTVA's, it appears that overall, there is less likelihood of a substantial delay in obtaining approval of an FTVA compared to other post-bankruptcy IVAs.
- A comparison of the profiling information of debtors who entered into post-bankruptcy IVAs in 2001/2 compared to debtors who entered into FTVA's in 2004/5 is shown at Table 2. There were only 8 FTVA's in 2004/5, and therefore, the overall profiling results of FTVA debtors is likely to change.
- It can be seen that, so far, FTVA debtors have lower bankruptcy assets, liabilities and overall deficiency compared to post-bankruptcy IVA debtors.

- Further, over three-quarters of post-bankruptcy IVA debtors were self-employed, compared to a quarter of FTVA debtors, and over half of the post-bankruptcy IVAs debtors attributed their insolvency to a failure to deal with tax affairs.

**Table 2: Profiling of debtors who entered into a post-bankruptcy IVA in 2001/2 compared to those entering an FTVA in 2004/5**

	Post-bankruptcy IVAs in 2001/2	FTVAs in 2004/5
<b>Gender split</b>	90% male	88% male
<b>Average age</b>	45	39
<b>Average bankruptcy assets<sup>3</sup></b>	£35,548	£12,074
<b>Average bankruptcy liabilities<sup>2</sup></b>	£42,482	£22,105
<b>Average bankruptcy deficiency<sup>2</sup></b>	£19,409	£10,031
<b>Most common cause of failure</b>	Failure to deal with tax affairs	Failure to deal with tax affairs and relationship breakdown
<b>Most common employment status</b>	Self-employed	Employee

- In 2004/5, there were 13 FTVAs proposed and 8 were accepted by creditors.
- A survey of 2001/2 post-bankruptcy IVA debtors shows that, overall, debtors were satisfied with the IVA process (see Figure 2).



- The survey also showed that 30% of debtors found out about IVAs through the Official Receiver, and were, on the whole, satisfied with the information provided about IVAs, the speed of obtaining an IVA, and the simplicity of the cost structure. The only area where post-bankruptcy IVA debtors had concerns was regarding the level of costs associated with the IVA – nearly 70% of debtors thought that the costs were high.
- As regards whether an IVA provided a fresh start, opinions were divided; 47% of the debtors thought that the IVA did provide a fresh start and 47% of the debtors thought that the IVA did not provide a fresh start, with the rest being undecided.
- There have been very few complaints received regarding post-bankruptcy IVAs.
- To date, just under a third of the post-bankruptcy IVAs in 2001/2 have failed, with the majority failing in the first two years. In just under half of those cases, a bankruptcy order has been made on the petition of the supervisor of the IVA. To date, no FTVAs have failed.

**Objective 2: To support the ‘fresh start’ of a bankrupt ensuring that annulment of the bankruptcy order is obtained once an IVA is approved**

- Prior to the Enterprise Act 2002, around 90% of 2001/2 post-bankruptcy IVAs resulted in the annulment of the bankruptcy order. Since the Enterprise Act 2002, a similar level of annulments has been obtained following post-bankruptcy IVAs.
- The average time taken between the approval of an IVA and annulment of the bankruptcy order has increased since the Enterprise Act 2002, although there is less likelihood of a substantial delay in obtaining the annulment. Prior to the Enterprise Act 2002, on average<sup>4</sup>, it took 75 days for the bankruptcy order to be annulled following approval of a post-bankruptcy IVA, compared to 122 days post-Enterprise Act 2002. However, prior to the Enterprise Act 2002, the time taken between the approval of a post-bankruptcy IVA and annulment of the bankruptcy order ranged from less than 4 weeks to over 80 weeks, compared to less than 4 weeks to 68 weeks post-Enterprise Act 2002.
- The Insolvency Service has revised its technical guidance as regards annulment of the bankruptcy order following approval of a post-bankruptcy IVA. Prior to the Act, Official Receivers were advised to apply for directions if the bankruptcy failed to apply for an annulment. Post-Enterprise Act 2002, Official Receivers are now advised to consider applying for an annulment if the bankrupt fails to do so. As detailed above, the level of annulments obtained following approval of a post-bankruptcy IVA has not changed since the Enterprise Act 2002 and therefore, this issue has been raised with the Official Receivers Operational Section with a view to ensuring that the Official Receiver does obtain annulment where the bankrupt fails to do so.

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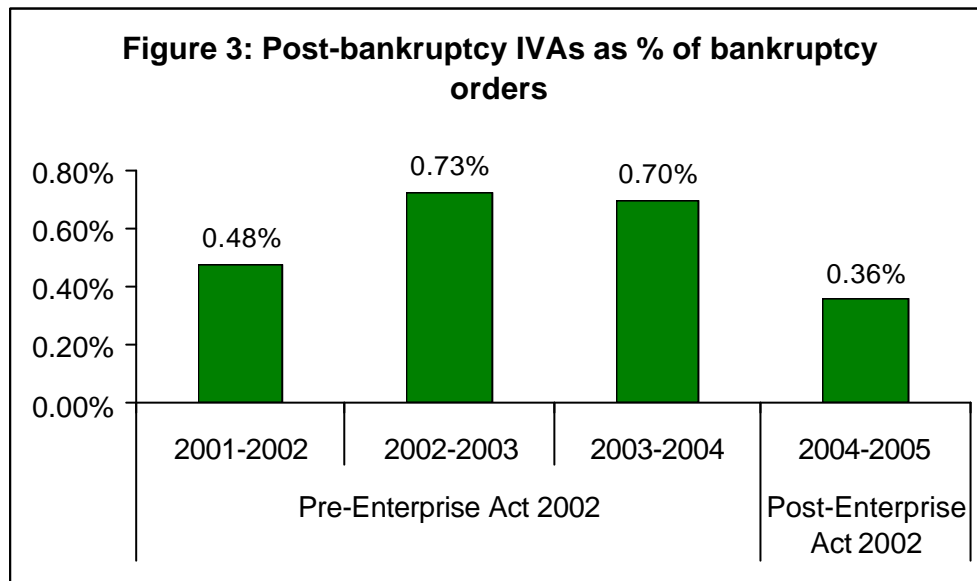
<sup>4</sup> Excluding outliers.

- As regards credit reference agencies, prior to the Enterprise Act 2002, IVAs were recorded for 6 years from the date of approval regardless of whether they failed or were successfully completed, and where a bankruptcy order was annulled, notice of the bankruptcy order was completely removed in some cases – in others a note was added. The provisions post-Enterprise Act 2002 are substantially the same.
- Mainstream financial institutions have broadly similar policies in dealing with bankrupts and IVA debtors. It appears that any individual subject to an IVA would be refused credit, and as regards annulled bankruptcies, it depends on what information is recorded at the credit reference agency as to what credit facilities would be offered. Financial institutions do not appear to have made changes in specific response to the Enterprise Act 2002.
- Therefore, it would appear although that obtaining a post-bankruptcy IVA and annulment of the bankruptcy order removes legal restrictions on obtaining credit, it does not actually increase a debtor's prospects of obtaining credit facilities from financial institutes.

**Objective 3: To improve returns to creditors**

- As no FTVAs are completed to date and the number of FTVAs obtained in 2004/5 is minimal, a proper analysis of the returns under FTVAs compared to post-bankruptcy IVAs cannot be undertaken.
- However, on the basis of the information available to date, FTVAs are currently providing a lower average 'pence per pound' return to creditors compared to post-bankruptcy IVAs. The proposed average return to creditors in FTVAs for 2004/5 is 62p (per pound), compared to a proposed average return to creditors in post-bankruptcy IVAs in 2001/2 of 77p (and an actual return of 79p to date).
- In post-bankruptcy IVAs in 2001/2, over 60% of cases propose full payment of creditors and full payment to creditors would have been achieved in around 70% of these cases under bankruptcy proceedings. In contrast, to date, only 3 of the 8 FTVAs obtained propose full payment of creditors and full payment to creditors would have been achieved in those 3 cases under bankruptcy proceedings.
- It was assumed that the costs under FTVAs would be lower than other post-bankruptcy IVAs. As previously stated, the supervisor fee, as a percentage of realisations, is actually lower in post-bankruptcy IVAs compared to FTVAs. Further, looking at the relative levels of assets, liabilities and overall deficiencies (see Section 4 in Appendix 2), the FTVA cases have a lower level of assets, liabilities and overall bankruptcy deficiency. Therefore, further analysis is required (if this trend continues as more FTVAs are obtained) to ascertain whether the lower return to creditors in FTVAs is due to differences in the type of IVA proposals under the FTVA regime compared to the post-bankruptcy IVAs in 2001/2, e.g. proposals based on contributions from income, introduction of 3<sup>rd</sup> party funds, etc. and/or the higher supervisor fee.

- The average length of post-bankruptcy IVAs in 2001/2 was just over two years. In comparison, the average length of FTVAs in 2004/5 was just over three and a half years. Therefore, it would appear, broadly speaking, that creditors receive returns under post-bankruptcy IVAs quicker than under FTVAs.
- Post-Enterprise Act 2002, the total level of post-bankruptcy IVAs has reduced, both as a percentage of all IVAs (see Figure 1) and as a percentage of bankruptcies (see Figure 3). Given the small number of FTVAs, it does not appear that the reduction in post-bankruptcy IVAs is connected with the introduction of the FTVA provisions.



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

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