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# **Enterprise Act 2002 - the Personal Insolvency Provisions: Final Evaluation Report November 2007**

A report produced by The Insolvency Service.

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# Section 1: Executive Summary

## 1.1 Introduction

1. The individual provisions of the Enterprise Act 2002 came into effect on 1 April 2004<sup>1</sup>. These provisions introduced major changes as regards the impact of financial failure on individuals which supported the Department of Trade & Industry's objective<sup>2</sup> of 'Prosperity for All'.

2. Prior to the Enterprise Act 2002, the bankruptcy legislation made no distinction between those who are honest, but unlucky or undercapitalised, and the reckless or fraudulent. All bankrupts were subject to a number of restrictions for usually three years.

3. The 'fear of failure' is a major inhibitor to potential entrepreneurs<sup>3</sup>. The Enterprise Act 2002 aims to alleviate the serious social consequences of failure, by providing a modern bankruptcy regime that encourages business start-ups and allows those who have failed honestly to have a second chance to make an economic contribution. At the same time it aims to provide effective protection against the small minority of bankrupts who abuse their creditors and the public.

4. In the Regulatory Impact Assessment for the insolvency provisions of the Enterprise Act 2002, The Insolvency Service made a commitment to review the effectiveness of the provisions after they had been in place for 3 years. This report fulfils this commitment.

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<sup>1</sup> The individual provisions were implemented on 1 April 2004, apart from the provisions relating to sanction of antecedent recoveries, which commenced on 14 September 2003.

<sup>2</sup> The Department for Business, Enterprise and Regulatory Reform brings together functions from the former Department of Trade and Industry, including responsibilities for productivity, business relations, energy, competition and consumers, with the Better Regulation Executive (previously part of the Cabinet Office).

<sup>3</sup> The Global Entrepreneurship Monitor is produced annually by the London Business School. The reports for 2001, 2002 and 2003 show that 30.1%, 34.0%, and 31.7% (respectively) of the respondents said that the fear of failure would stop them from starting up in business

## 1.2 The Evaluation

1. There are six main individual insolvency provisions of the Enterprise Act 2002:

- **Discharge:** The Act introduced provisions whereby a bankrupt is automatically discharged one year after the commencement of bankruptcy, rather than three years (or in some circumstances 2 years). Further, discharge can occur earlier if the Official Receiver files a notice at Court stating that the investigations into the affairs and conduct of the bankrupt are unnecessary or completed.
- **Bankruptcy Restrictions Orders (BROs):** The Act introduced provisions whereby the court can make BROs, which are designed to provide better protection for the public and a civil alternative to prosecution. BROs will place restrictions on the most culpable bankrupts from between 2 and 15 years.
- **Bankrupt's home:** The Act introduced provisions whereby a bankrupt's interest in the home forms part of the bankrupt's estate (as it did previously) but the trustee must realise the interest within a three year period, otherwise the interest in the home reverts to the bankrupt at the end of this period.
- **Contributions from income by bankrupts:** The Act introduced income payment agreements (IPAs) as an administrative alternative to court-based income payment orders (IPOs).
- **Individual voluntary arrangements (IVAs):** The Act introduced changes to the IVA provisions whereby the Official Receiver can 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.
- **Sundry provisions:** The Act repealed certain bankruptcy offences and the summary administration regime and introduced a requirement for sanction to be obtained for a trustee to pursue antecedent recoveries<sup>4</sup>.

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<sup>4</sup> Insolvency legislation contains measures to enable trustees to take civil action to seek financial restitution for losses caused to the estate (antecedent recoveries). These measures are claims under the following sections of the Insolvency Act 1986 - section 339 (Transactions at an undervalue); section 340 (Preferences) and section 423 (Transactions defrauding creditors). Such claims may now only be commenced where the trustee has the sanction of the creditors, or in the absence of a creditors committee, the court.

## 1.2 The Evaluation (continued)

2. A retrospective (ex-post) evaluation has been undertaken, i.e. after the adoption of the Enterprise Act 2002, to know better what happened after the implementation of the Act and to apprehend the real effects of the legislative action. The evaluation attempts to comprehensively assess whether, to what extent and how the provisions of the Enterprise Act 2002 met its policy objectives.

3. The evaluation includes both quantitative and qualitative data collected from various sources over a four-year period. In order to fully 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 Act.

4. The evaluation fieldwork has mainly been undertaken in-house, but survey work and research projects to support the evaluation have been commissioned where appropriate.

5. The Insolvency Service has published two interim reports<sup>5</sup> to keep stakeholders informed as to the progress of the evaluation, and to confirm that the evaluation is being progressed in a timely manner.

6. The evaluation work has been subject to independent review by an Evaluation Group set up by The Insolvency Service. The Evaluation Group consists of external stakeholders and experts, as well as key personnel from The Insolvency Service<sup>6</sup>. The purpose of the Evaluation Group is to provide guidance to the evaluation process of The Insolvency Service, to ensure that there is an effective evaluation of insolvency policies and their implementation which meets the needs of both internal and external stakeholders and which informs future policy making. The Evaluation Group has reviewed both the evaluation planning papers, to agree the evaluation methodology, and the interim evaluation reports. The Evaluation Group greatly contributes to stakeholder engagement, as well as ensuring transparency and credibility of the evaluation work.

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<sup>5</sup> The interim evaluation reports are available at:  
<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/Reform.htm>

<sup>6</sup> The current Evaluation Group members are:  
The Insolvency Service's Director of Policy Unit (Development, Review and International Issues) (Chair) – Mike Norris  
The Insolvency Service's Deputy Inspector General (Headquarters) – Graham Horne  
The Insolvency Service's Deputy Inspector General (Official Receiver operations) – Les Cramp  
Insolvency academic – Adrian Walters, Geldards LLP Professor of Corporate and Insolvency Law, Nottingham Law School, Nottingham Trent University  
Insolvency practitioner – Mike Rollings, Baker Tilly Restructuring and Recovery LLP  
Insolvency lawyer – Frances Coulson, Moon Beaver Solicitors  
Evaluator – George Bramley (Evaluation and Research Team of BERR - Enterprise Directorate - Analytical Unit)

## 1.3 Key Findings

### Overall Summary

1. The evidence from the evaluation indicates that the Enterprise Act 2002 has achieved its intermediate policy objectives in most areas – of the 18 intermediate policy objectives, 15 have been fully or partially achieved (see Table following paragraph 5). Where intermediate policy objectives have been only partially achieved, this is mainly due to third-party actions over which The Insolvency Service has no control.

2. In summary:

- The discharge provisions of the Act have been successful in removing discrimination against ‘second-time’ bankrupts (judged to be non-culpable who have fully co-operated with the Official Receiver) and have sped up the process of suspending the discharge of a bankrupt due to non-cooperation where a trustee other than the Official Receiver has been appointed. However, the prompt rehabilitation of bankrupts (judged to be non-culpable who have fully co-operated with the Official Receiver) has been hindered by a bankrupt’s restricted access to the financial market, which has not improved due to lack of change in lenders’ policies. Further, the stigma associated with bankruptcy has not reduced. The evaluation has also identified that although the reduced automatic discharge period has contributed to the prompt rehabilitation of bankrupts, the early discharge provisions may not add any extra benefit.
- The BRO provisions of the Act have been partially successful in protecting the public and commercial community and allowing lenders and public to differentiate between culpable and non-culpable bankrupts. However, their full achievement has been hampered by the public’s lack of knowledge of the BRO regime, and the failure of lenders to change their policies to reflect the BRO regime. It is too early to say whether the BRO regime has deterred fraud and misconduct.
- The evaluation evidence available to date indicates that the bankrupt’s home provisions have provided some certainty to the bankrupt, the trustee and the creditors as to the time scale within which the bankrupt’s home will be dealt with, and a balance between the interests of the bankrupt and the creditors by providing ample time for the disposal by the trustee of the bankrupt’s interest in the most appropriate manner. However, there is no evidence to suggest that the provisions will help lift the stigma associated with bankruptcy.
- The provisions relating to contributions from income by bankrupts have been successful in reducing the time taken by the Official Receiver and Court in dealing with IPO applications where a bankrupt has consented to the application, and in improving returns to creditors.

## 1.3 Key Findings (continued)

### Overall Summary (continued)

- The IVA provisions have been partially successful in supporting the ‘fresh start’ of a bankrupt by ensuring that annulment of the bankruptcy order is obtained once an IVA is approved, and in improving returns to creditors. However, the FTVA regime has not provided an accessible alternative to bankruptcy and the evaluation evidence suggests that the FTVA regime in its current form provides no real benefit.
- The sundry provisions of the Act have all met their intermediate policy objectives.

3. The ultimate objectives of the individual insolvency provisions of the Enterprise Act 2002 were to alleviate the social consequences of bankruptcy and to encourage business start-ups.

4. As regards the alleviation of social consequences, this has been partially achieved - bankrupts are freed from bankruptcy restrictions quicker and they are subject to fewer restrictions. However, a bankrupt’s access to the financial market has not improved due to lack of change in lenders’ policies, and the stigma attached to bankruptcy remains the same.

5. As regards the encouragement of business start-ups, the insolvency provisions of the Enterprise Act 2002 only play a small part in affecting this headline outcome. The insolvency provisions of the Act have not yet affected the ‘fear of failure’ and a bankrupt’s ability to recommence trading is still hindered by a bankrupt’s restricted access to the financial market and business’s attitudes to bankrupts.

## 1.3 Key Findings (continued)

### An overview of whether the Enterprise Act 2002 has achieved its policy objectives

Policy Objectives	Objective Achieved?	Reasons Why Objective Fully Achieved (or Why Not Known)	Recommended Action for The Service	Future Insolvency
<u>Ultimate Policy Objectives</u>				
- To alleviate the social consequences of bankruptcy	<b>Partially</b>	Although bankrupts are freed from bankruptcy restrictions quicker and they are subject to fewer restrictions, the stigma attached to bankruptcy remains the same and a bankrupt's access to the financial market has not improved.	- To undertake surveys as regards attitudes to bankruptcy on a biennial basis - To continue to ensure non-insolvency legislation appropriately reflects the BRO regime - To work with credit reference agencies and lenders to ensure lending policies appropriately reflect a bankrupt's discharge - To continue to monitor insolvency statistics and future research on insolvency levels	
- To encourage business start-ups	<b>Not achieved</b>	The bankruptcy provisions of the Act have not yet affected the 'fear of failure' and a bankrupt's ability to recommence trading is still hindered by a bankrupt's restricted access to the financial market and the attitude of the business sector to bankrupts.	- To play a proactive role in taking forward discussions with BERR <sup>7</sup> and others regarding the impact of the personal insolvency regime on business start-ups - To work with credit reference agencies and lenders and undertake surveys as regards attitudes to bankruptcy (as above)	

<sup>7</sup> The Department for Business, Enterprise and Regulatory Reform (BERR) brings together functions from the former Department of Trade and Industry, including responsibilities for productivity, business relations, energy, competition and consumers, with the Better Regulation Executive (previously part of the Cabinet Office).

### 1.3 Key Findings (continued)

#### An overview of whether the Enterprise Act 2002 has achieved its policy objectives (continued)

Policy Objectives	Objective Achieved?	Reasons Why Objective Not Fully Achieved (or Reason Why Not Known)	Recommended Action for The Insolvency Service	Future Insolvency
<u>Policy objectives of discharge provisions</u>				
- To enable the prompt rehabilitation of bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver	<b>Partially achieved</b>	The shortened discharge period means bankrupts are freed from bankruptcy restrictions quicker and has psychological benefits. However, a bankrupt's access to the financial market has not improved.	- A detailed cost-benefit analysis of early discharge to assess whether the resources required to administer the early discharge process are justified by benefits afforded - Subject to above, a review of the early discharge process to see if process delays can be eliminated - To work with credit reference agencies and lenders to ensure lending policies appropriately reflect a bankrupt's discharge	
- To not discriminate against 'second-time' bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver	<b>Achieved</b>	N/A	None	
- To speed up the process of suspending the discharge of a bankrupt due to non-cooperation where a trustee other than the Official Receiver has been appointed	<b>Achieved</b>	N/A	None	
To help lift the stigma of bankruptcy	<b>Not achieved</b>	The stigma associated with bankruptcy remains the same despite the shortened discharge period	- To undertake surveys as regards attitudes to bankruptcy on a biennial basis	

### 1.3 Key Findings (continued)

#### An overview summary of whether the Enterprise Act 2002 has achieved its policy objectives (continued)

<b>Policy Objectives</b>	<b>Objective Achieved?</b>	<b>Reasons Why Objective Not Fully Achieved (or Reason Why Not Known)</b>	<b>Recommended Action for The Insolvency Service</b>	<b>Future</b>
<u>Policy objectives of the BRO provisions</u>				
- 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	<b>Partially achieved</b>	Although the BRO regime appears to have been the correct regime to implement for protection of the commercial community and general public, a lack of awareness of the regime and BROs obtained means that, in general terms, the public and commercial community do not feel protected.	- The publicity of the BRO regime and reporting on cases where BROs are obtained is increased	
- To allow lenders and public to differentiate between culpable and non-culpable and make better informed decisions in their dealings with bankrupts	<b>Achieved</b>	Although information on BROs is publicly available and free, the BRO regime is not reflected in lender policies and due to a lack of public awareness of the BRO regime, the public are unlikely to immediately understand the significance of a BRO.	- To work with credit reference agencies and lenders to ensure lending policies appropriately reflect the BRO regime - The publicity of the BRO regime and reporting on cases where BROs are obtained is increased (as above)	
- To deter fraud and misconduct	<b>Not known</b>	It is too early to assess whether any trends seen can be attributed to the BRO regime.	- Monitor enforcement statistics	

## 1.3 Key Findings (continued)

### An overview summary of whether the Enterprise Act 2002 has achieved its policy objectives (continued)

Policy Objectives	Objective Achieved?	Reasons Why Objective Not Fully Achieved (or Reason Why Not Known)	Recommended Future Action for The Insolvency Service
<u>Policy objectives of the bankrupt's home</u>			
- to provide some certainty to the bankrupt, the trustee and the creditors as to the time scale within which the bankrupt's home will be dealt with	<b>Partially Achieved</b>	Complete post-Enterprise Act 2002 information required to confirm how often, and why, property interests are not dealt with within 3 years from the bankruptcy order; the overall timeliness of dealing with property interests and how often methods of dealing with a property interest which may not offer certainty to the bankrupt, the trustee or creditors are used, and why.	- The post-Enterprise Act 2002 case sampling exercise as regards a bankrupt's interest in a family home is completed - Further enquiries are made on pre-Enterprise Act 2002 cases to establish the impact of the transitional provisions
- to provide a balance between the interests of the bankrupt and the creditors by providing ample time for the disposal by the trustee of the bankrupt's interest in the most appropriate manner	<b>Partially Achieved</b>	Complete post-Enterprise Act 2002 information required to confirm the effect of the re-vesting and 'de minimis' provisions.	- The post-Enterprise Act 2002 case sampling exercise as regards a bankrupt's interest in a family home is completed
- to help lift the stigma of bankruptcy	<b>Not achieved</b>	The stigma associated with bankruptcy remains the same and there is no evidence to suggest that the timescale introduced will help lift the stigma	None

## 1.3 Key Findings (continued)

### An overview summary of whether the Enterprise Act 2002 has achieved its policy objectives (continued)

Policy Objectives	Objective Achieved?	Reasons Objective Not Achieved (or Why Not Known)	Why Fully Reason	Recommended Action for The Insolvency Service	Future
<u>Policy objectives of provisions relating to contributions from income by bankrupts</u>					
- to reduce the time spent by the Official Receiver and Court in dealing with IPO applications where a bankrupt has consented to the application	<b>Achieved</b>	N/A		None	
- to improve returns to creditors	<b>Achieved</b>	N/A		None	

## 1.3 Key Findings (continued)

### An overview summary of whether the Enterprise Act 2002 has achieved its policy objectives (continued)

Policy Objectives	Objective Achieved?	Reasons Objective Not Achieved (or Reason Why Not Known)	Why Fully	Recommended Action for The Insolvency Service	Future
<u>Policy objective of IVA provisions</u>					
- to support the 'fresh start' of a bankrupt by providing an accessible alternative to bankruptcy	<b>Partially achieved</b>	Access to FTVA's is restricted by The Insolvency Service's internal guidelines		- A detailed cost-benefit analysis of whether, taking into account any amendment to supervisor fees, the resources required to deal with more complex cases and for a centralised FTVA administration centre are justified by any benefits afforded by FTVA's to debtors over that offered by non-FTVA post-bankruptcy IVAs - To work with credit reference agencies and lenders to ensure lender policies appropriately reflect annulments and IVAs	
- to support the 'fresh start' of a bankrupt by ensuring that annulment of the bankruptcy order is obtained once an IVA is approved	<b>Partially achieved</b>	Annulments are being obtained in a higher proportion of post-bankruptcy IVA cases, but are taking longer to obtain. Further, an annulment does not increase a debtor's prospects of access to financial services		- To consider the possibility of an automatic annulment of a bankruptcy order following approval of a post-bankruptcy IVA (after expiry of 28 days to allow for any objections)	
- to improve returns to creditors	<b>Partially achieved</b>	The costs associated with FTVA's are lower depending on the level of funds in the FTVA		- A detailed cost-benefit analysis (as above)	

## 1.3 Key Findings (continued)

### An overview summary of whether the Enterprise Act 2002 has achieved its policy objectives (continued)

Policy Objectives	Objective Achieved?	Reasons Objective Not Achieved (or Reason Why Not Known)	Why Fully	Recommended Action for The Insolvency Service	Future
<u>Policy objectives of sundry provisions</u>					
- to provide more effective protection of the public and the commercial community where bankrupts fail to keep proper accounting records, or undertake gambling and rash and hazardous speculation	<b>Achieved</b>	N/A		None	
- to enable the Official Receiver to allocate investigative resources to the cases that merit investigation, rather than based on the size of the bankrupt's deficiency	<b>Achieved</b>	N/A		None	
- to allow the creditors the choice as to whether estate monies should be used to fund antecedent recovery action <sup>8</sup>	<b>Achieved</b>	N/A		None	

<sup>8</sup> Insolvency legislation contains measures to enable trustees to take civil action to seek financial restitution for losses caused to the estate (antecedent recoveries). These measures are claims under the following sections of the Insolvency Act 1986 - section 339 (Transactions at an undervalue); section 340 (Preferences) and section 423 (Transactions defrauding creditors).

## **1.3 Key Findings (continued)**

6. The key findings in more detail are as follows:

### **Alleviation of the social consequences of bankruptcy – attitudes to bankruptcy**

- To date, the Enterprise Act 2002 has not significantly changed the perceived level of stigma associated with bankruptcy (see Section 3.1 paragraph 5).
- A person is more likely to believe that there is a stigma associated with bankruptcy as bankruptcy becomes a possibility/reality (see Section 3.1 paragraph 7).
- The perceived level of stigma associated with bankruptcy appears to not have significantly changed because the stigma associated with bankruptcy arises from factors (such as advertisement of the bankruptcy order) which were unaffected by the Enterprise Act 2002 (see Section 3.1 paragraphs 8-9).
- However, there are indications that the general public's attitude to repaying debts may have changed, whereby they feel that non-repayment of creditors now causes less stigma. This appears to be unrelated to the implementation of the Enterprise Act 2002 (see Section 3.1 paragraph 10).

### **Alleviation of the social consequences of bankruptcy - restrictions on bankrupts**

- Bankrupts are now freed quicker from the restrictions imposed on bankrupts under insolvency legislation (see Section 3.1 paragraphs 14-17).
- The level of mandatory or discretionary restrictions imposed on bankrupts under non-insolvency legislation has reduced, and are expected to reduce further in the future (see Section 3.1 paragraphs 19-20).

## **1.3 Key Findings (continued)**

### **Alleviation of the social consequences of bankruptcy – bankrupts' access to the financial market**

- A bankrupt's access to the financial market has remained substantially unchanged following the implementation of the Enterprise Act 2002 (see Section 3.1 paragraph 21).
- This is because the record of the bankruptcy order will remain on a bankrupt's credit reference file for the same period of time and there have been no specific changes made to lending policies in response to the implementation of the Enterprise Act 2002 (see Section 3.1 paragraph 22-23).

### **Encouraging business start-ups**

- The Enterprise Act 2002 does not appear to have impacted on the level of business start-ups to date (see Section 3.1 paragraphs 27-28).
- As regards the bankruptcy provisions of the Act, these have not yet affected the 'fear of failure', which is seen as a barrier to entrepreneurship (see Section 3.1 paragraphs 29-30).
- Furthermore, a bankrupt's ability to recommence trading is being hindered by a bankrupt's restricted access to the financial market, which has not been affected by the implementation of the Enterprise Act 2002 (see Section 3.1 paragraph 35).

### **The impact of the Enterprise Act 2002 on the level of bankruptcy orders**

- The implementation of the Enterprise Act 2002 in England and Wales coincided with an increase in bankruptcies in England and Wales (see Section 3.1 paragraph 38).
- The implementation of the Enterprise Act 2002 in England and Wales also coincided with an increase in all personal insolvency proceedings in the UK (see Section 3.1 paragraphs 39-40).
- Evidence suggests that there is no causal link between the implementation of the Enterprise Act 2002 and the increase in bankruptcies in England and Wales (see Section 3.1 paragraphs 50-60).

## 1.3 Key Findings (continued)

### **Discharge provisions - to enable the prompt rehabilitation of bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver**

- As a result of the implementation of the Enterprise Act 2002, all bankrupts (unless their discharge has been suspended) are discharged from bankruptcy quicker - over 95% of bankrupts are now discharged in one year or less, compared to just over 25% and around 65% of bankrupts being discharged in two and three years respectively prior to the Enterprise Act 2002 (see Section 3.2 paragraphs 5-9).
- Early discharge has been granted in around 50% and 43% of bankruptcy cases in 2004/5 and 2005/6 respectively and in such cases, the average discharge period is around 7 months (see Section 3.2 paragraphs 10-14).
- The shortened discharge period means that under the Enterprise Act 2002, bankrupts are freed more quickly from the legal restrictions imposed by the Insolvency Act 1986. However, the rehabilitation of bankrupts is being stifled by a lack of change in lender and credit reference agency policies, which, despite earlier discharge, will continue to deny bankrupts access to various types of financial products (see Section 3.2 paragraphs 30-31).
- For bankrupts, the majority believe that the shortened discharge provides a fresh start because, from a bankrupt's point of view, discharge has the greatest impact on a bankrupt emotionally, and the impact is, in the vast majority of cases, positive (see Section 3.2 paragraphs 32-33).
- However, the benefit of early discharge compared to automatic discharge after 1 year is not clear. Bankrupts, regardless of their date of discharge, are more likely to think that automatic discharge after 1 year, rather than an earlier discharge, offers a fresh start and are more likely to think that automatic discharge after 1 year, rather than an earlier discharge, gives sufficient time, if necessary, to 'learn' from bankruptcy. This indicates that perhaps less than 1 year is seen as not sufficient time for a bankrupt to reflect on, absorb and move on from the event of bankruptcy (see Section 3.2 paragraphs 34-37).
- In general terms, businesses do not agree that bankrupts should be discharged from bankruptcy quicker. However, there is no real evidence that the shortened discharge period has adversely materially affected businesses (see Section 3.2 paragraphs 25-26).

## **1.3 Key Findings (continued)**

### **Discharge provisions - to not discriminate against 'second-time' bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver**

- Prior to the Enterprise Act 2002, the average discharge period for a 'second-time' bankrupt was around 10 years. Since the implementation of the Act, nearly all 'second-time' bankrupts, as with 'first-time' bankrupts, are discharged in 1 year or less (see Section 3.2 paragraph 50).
- Businesses appear to not support the reduction in the discharge period for 'second-time' bankrupts, and believe that a 'penalty' for becoming bankrupt more than once (such as a longer discharge period for 'second-time' bankrupts) acts as a deterrent. However, the level of 'second-time' bankrupts has actually fallen since the implementation of the Enterprise Act 2002 from around 4% to around 1.5% of all bankrupts (see Section 3.2 paragraphs 54-56).
- As with 'first-time' bankrupts, although under post-Enterprise Act 2002 'second-time' bankrupts are being discharged from bankruptcy quicker, the record of the bankruptcy order will remain on their credit reference file for the same period of time. Given lender policies, this means that the reduced duration of bankruptcy will have a limited impact on a 'second-time' bankrupt's ability to obtain credit facilities, albeit that the statutory restrictions regarding obtaining credit are removed earlier (see Section 3.2 paragraphs 58-61).

### **Discharge provisions - to speed up the process of suspending the discharge of a bankrupt due to non-co-operation where a trustee other than the Official Receiver has been appointed**

- IPs appointed as trustees are making applications for suspension of discharge under the new power introduced by the Enterprise Act 2002, and such applications are being made quicker under these provisions compared to pre-Act provisions (see Section 3.2 paragraphs 64-71).

### **Discharge provisions - to help lift the stigma of bankruptcy**

- In theory, the reduction in the discharge period should have some effect on the level of stigma associated with bankruptcy. However, to date, the reduction in the discharge period has had no impact (see Section 3.2 paragraphs 76-79).

## 1.3 Key Findings (continued)

**BRO provisions - 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**

- BROs are being now obtained in around 3.5% of bankruptcies (see Section 3.3 paragraph 7).
- BROs last, on average, 5 years, which is consistent with the average length of a disqualification order under the Company Directors' Disqualification Act 1986. Therefore, on average, culpable bankrupts are subject to restrictions for an extra 4 years and the protection offered by a BRO is not being undermined by non-compliance to the terms of a BRO (see Section 3.3 paragraphs 16-19).
- The BRO regime appears to have been the correct regime to implement in order to afford protection to the business community and general public. However, in general terms, the BRO regime has not impacted on views of the wider business community and general public. This appears to be attributable to a lack of awareness of the BRO regime, both in terms of its operation and the level of cases where a BRO is in force (see Section 3.3 paragraphs 20-33).

**BRO provisions - to allow lenders and public to differentiate between culpable and non-culpable and make better informed decisions in their dealings with bankrupts**

- Information on BROs is publicly available and free, which allows lenders and the public to differentiate between culpable and non-culpable bankrupts and make better-informed decisions in their dealings with bankrupts (see Section 3.3 paragraphs 35-36).
- However, a lack of public awareness of the BRO regime suggests the public are unlikely to immediately understand the significance of a BRO being recorded against a bankrupt (see Section 3.3 paragraph 37).
- Further, although it is possible for lenders to differentiate between culpable and non-culpable bankrupts, to date, this is not reflected in their lending policies (see Section 3.3 paragraphs 38-40).

## 1.3 Key Findings (continued)

### **BRO provisions - to deter fraud and misconduct**

- The overall level of enforcement action in bankruptcy cases has risen since the implementation of the Enterprise Act 2002, but it is too early to assess whether the trends seen can be attributed to the BRO regime impacting on fraud and misconduct in bankruptcy cases (see Section 3.3 paragraphs 51-54).

### **Bankrupt's home provisions - to provide some certainty to the bankrupt, the trustee and the creditors as to the time scale within which the bankrupt's home will be dealt with, as previously that time scale was open ended**

- Before the Enterprise Act 2002, around 15% of property interests were dealt with more than 3 years from the date of the bankruptcy order (see Section 3.4 paragraph 11).
- The primary reason why, prior to the Enterprise Act 2002, it could take over 3 years to deal with an interest in a property is because the trustee had not taken any action in respect of the property and the bankrupt was not aware (or failed to realise) that the bankrupt's interest remained vested in the trustee until such time as the interest was realised (see Section 3.4 paragraphs 12-13).
- The provisions of the Enterprise Act 2002 should ensure that property interests are dealt with within 3 years (subject to exceptions provided for in the Act) (see Section 3.4 paragraph 17).
- On information available to date, the methods of dealing with a property interest that could be said not to offer certainty to the bankrupt, the trustee or creditors are not used in a high proportion of cases (see Section 3.4 paragraphs 21-26).
- The open-ended timescale within which an interest in a property could be dealt with by a trustee prior to the Enterprise Act 2002 led to a significant number of complaints by bankrupts or third parties who hold an interest in a property in which a bankrupt has an interest. The introduction of the 3-year time scale under the Enterprise Act 2002 to deal with such an interest should reduce this level of complaints (see Section 3.4 paragraphs 27-31).

## 1.3 Key Findings (continued)

### **Bankrupt's home provisions - to provide a balance between the interests of the bankrupt (and his/her family) and the creditors by providing ample time for the disposal by the trustee of the bankrupt's interest in his/her sole and principal residence in the most appropriate manner**

- Creditors received more money through the realisation of properties more than 3 years after the bankruptcy order compared to if that realisation had taken place within 3 years of the bankruptcy order. This is due mainly to the increase in house prices and, in most cases, a reduction in the mortgage as the bankrupt has remained in the property (see Section 3.4 paragraphs 43-44).
- However, many bankrupts say they were not aware that their interest in a property remained part of the bankruptcy estate until it was realised – if they had, many bankrupts may have sought to come to an agreement with the trustee earlier. Therefore, in many cases, creditors have benefited as a result of a bankrupt's ignorance, rather than a deliberate policy on the part of trustees to 'sit and wait' for an increase in the value of an interest in a property (see Section 3.4 paragraph 45).
- Further, although creditors may receive more money if a property is realised after 3 years, creditors will now receive a timely dividend from the realisation of a bankrupt's interest in a family home (see Section 3.4 paragraph 46).
- The Official Receiver, as trustee, is dealing with interests in properties with no value in a timely manner, rather than relying on the re-vesting provisions at the end of the 3-year period (see Section 3.4 paragraphs 48-52).
- The introduction of the 'de minimis' provisions do not appear to have impacted on the returns to creditors (see Section 3.4 paragraphs 53-57).

### **Bankrupt's home provisions - to help lift the stigma of bankruptcy**

- The level of bankruptcies where the bankrupt has an interest in a family home, and the breakdown of the petition type in such cases, has remained unchanged by the implementation of the Enterprise Act 2002 (see Section 3.4 paragraph 61).
- The bankrupt's home provisions contained in the Enterprise Act 2002 have not reduced the stigma associated with bankruptcy for those individuals who own their own home (see Section 3.4 paragraphs 63-66).

## 1.3 Key Findings (continued)

### **Provisions regarding contributions from income by bankrupts - to reduce the time by the Official Receiver and Court in dealing with IPO applications where a bankrupt has consented**

- The Official Receiver has saved at least 7,500 hours in the 3 years since the implementation of the Enterprise Act 2002 as a result of the introduction of the IPA regime (see Section 3.5 paragraphs 8-11).
- The Court has saved at least 3,800 hours in the 3 years since the implementation of the Enterprise Act 2002 as a result of the introduction of the IPA regime (see Section 3.5 paragraphs 12-16).

### **Provisions regarding contributions from income by bankrupts - to improve returns to creditors**

- Returns to creditors under the IPA regime have improved as a result of:
  - An increase in the number of payments proposed under an IPO/A since the implementation of the Enterprise Act 2002 (see Section 3.5 paragraphs 24-27);
  - An increase in collection rates under an IPO/A since the implementation of the Enterprise Act 2002 (see Section 3.5 paragraphs 28-30);
  - A reduction of at least £260,000 in the costs associated with the collection of IPAs compared to IPOs in the three years since the implementation of the Enterprise Act 2002 (see Section 3.5 paragraphs 32-39);
  - An increase in the proportion of self-employed bankrupts who make contributions from their income (see Section 3.5 paragraphs 42-44); and
  - An increase in the proportion of employee bankrupts who make contributions on the basis of an 'NT' tax coding<sup>9</sup> (see Section 3.5 paragraphs 45-47).

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<sup>9</sup> The Inland Revenue has been in the practice of claiming in the bankruptcy proceedings in respect of income tax due for the whole of the tax year in which the bankruptcy order is made less the amount of tax paid and deducted up to the date of the order. In consequence, a "nil tax" (or NT) code is applied to the bankrupt for the remainder of the tax year in which he was made bankrupt so that he does not pay any tax on his income for that period and is thus in receipt of extra money. Where this "nil tax" code is put into place, the extra funds made available to the bankrupt, following this revision of the tax coding, are included in calculating the amount he is able to pay under an IPA. The IPA is drafted so that when at the end of the tax year the Inland Revenue recommence tax deductions from the bankrupt's income, the amount payable can be reduced accordingly or the agreement may only run for the period in which the bankrupt is in effect tax exempt.

## **1.3 Key Findings (continued)**

### **IVA provisions - to support the 'fresh start' of a bankrupt by providing an accessible alternative to bankruptcy**

- The FTVA provisions are seldom used. This appears to be because the accessibility of FTVAs as an alternative to bankruptcy is restricted by The Insolvency Service's internal guidelines on FTVAs that preclude the Official Receiver agreeing to act as nominee for an FTVA in certain types of cases (see Section 3.6 paragraphs 8-13).
- The cost associated with an FTVA compared to other post-bankruptcy IVAs is lower at the point of entry – the nominee fee – which facilitates the accessibility of an FTVA. However, the 'saving' made on the FTVA nominee cost may be overshadowed by the level of supervisor fees charged depending on the level of funds in the FTVA (see Section 3.6 paragraphs 14-22).
- FTVAs take longer to set up than non-FTVA post-bankruptcy IVAs (see Section 3.6 paragraphs 23-25).
- Debtors appear to be satisfied by the process and provisions of an FTVA, except as regards the length of time involved (see Section 3.6 paragraphs 26-32).

### **IVA provisions - to support the 'fresh start' of a bankrupt by ensuring that annulment of the bankruptcy order is obtained once an IVA is approved**

- Since the implementation of the Enterprise Act 2002, the level of annulments obtained following the approval of a post-bankruptcy IVA has slightly risen, but on average, it is taking longer for the annulment to be obtained. However, although 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 institutions, which will hinder the 'fresh start' for that aspect of the debtor (see Section 3.6 paragraphs 45-54).

### **IVA provisions - to improve returns to creditors**

- The costs in an FTVA are lower depending on the level of funds in the FTVA (see Section 3.6 paragraphs 14-22).
- The higher average 'pence per pound' return to creditors seen in non-FTVA post-bankruptcy IVAs is due to a smaller deficit in bankruptcy liabilities over assets, which is primarily due to those cases having a higher level of bankruptcy assets (see Section 3.6 paragraphs 57-60).

## 1.3 Key Findings (continued)

### **Sundry provisions – to provide more effective protection of the public and the commercial community where bankrupts fail to keep proper accounting records, or undertake gambling and rash and hazardous speculation**

- A possible failure to keep proper accounting records or gambling/rash and hazardous speculation has been identified in around 0.5% of bankruptcy cases both before and after the implementation of the Enterprise Act 2002 (see Section 3.7 paragraphs 8-9).
- Prior to the Enterprise Act 2002, convictions were obtained in around 35% of such cases (see Section 3.7 paragraphs 10-12).
- Since the Enterprise Act 2002, BROs have been obtained in nearly all such cases due to the lower burden of proof required in the civil BRO proceedings compared to criminal proceedings. The average length of the BRO obtained is 5 years (see Section 3.7 paragraph 13).
- More creditors think that BROs provide protection to the business community and the general public, compared to the level of creditors who thought that criminal convictions offered such protection (see Section 3.7 paragraphs 16-19).

### **Sundry provisions - to enable the Official Receiver to allocate investigative resources to the cases that merit investigation, rather than based on the size of the bankrupt's deficiency**

- The repeal of the summary administration regime and amendment to section 289 of the Insolvency Act 1986 has not changed the Official Receiver's approach to investigations (see Section 3.7 paragraph 26).
- However, it has allowed the Official Receiver discretion to investigate based on more sensible criteria - the extent to which the initial information provided to him explains the causes of the bankruptcy and that these causes do not indicate misconduct or the commission of criminal offences (see Section 3.7 paragraph 25).

### **Sundry provisions – to allow the creditors the choice as to whether estate monies should be used to fund antecedent recovery action**

- The Enterprise Act 2002 provisions allow the creditors the choice as to whether estate monies should be used to fund antecedent recovery action<sup>10</sup> (see Section 3.7 paragraphs 28-30).

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<sup>10</sup> Insolvency legislation contains measures to enable trustees to take civil action to seek financial restitution for losses caused to the estate (antecedent recoveries). These measures are claims under the following sections of the Insolvency Act 1986 - section 339 (Transactions at an undervalue); section 340 (Preferences) and section 423 (Transactions defrauding creditors).

## 1.4 Recommendations for the Future

### Key recommendations

1. It is recommended that The Insolvency Service:

- Undertakes a detailed cost-benefit analysis of early discharge, as soon as possible, to assess whether the resources required to administer the early discharge process and the burdens placed on businesses, the courts and the Official Receiver are justified by the limited benefits afforded by early discharge, with a view to repealing the provisions (see Section 3.2 paragraphs 39-44);
- Subject to the results of the above, undertakes a review of the early discharge process to ascertain whether delays in the process can be eliminated (see Section 3.2 paragraphs 15-17);
- Increases its publicity of the BRO regime and reporting on cases where BROs are obtained, in order to enhance the knowledge and impact of the BRO regime (see Section 3.3 paragraphs 20-33);
- Undertakes a detailed cost-benefit analysis of whether, taking into account any amendment to supervisor fees, the resources required to deal with more complex cases and for a centralised FTVA administration centre are justified by any benefits afforded by FTVAs over those offered by non-FTVA post-bankruptcy IVAs (see Section 3.6 paragraphs 41-44); and
- Considers the possibility of an automatic annulment of a bankruptcy order following approval of a post-bankruptcy IVA (after expiry of 28 days to allow for any objections) (see Section 3.6 paragraphs 50-51)

### Evaluation work to be completed

2. It is recommended that The Insolvency Service completes:

- The post-Enterprise Act 2002 case sampling exercise as regards a bankrupt's interest in a family home to obtain full information on:
  - how often, and why, property interests are not dealt with within 3 years from the bankruptcy order and the overall timeliness of dealing with property interests (see Section 3.4 paragraphs 10-20);
  - how often methods of dealing with a property interest which could be said not to offer certainty to the bankrupt, the trustee or creditors are used, and why (see Section 3.4 paragraphs 22-26);
  - the effect of the re-vesting provisions (see Section 3.4 paragraphs 47-52); and
  - the effect of the 'de minimis' provisions (see Section 3.4 paragraphs 53-57).

## **1.4 Recommendations for the Future (continued)**

### **Evaluation work to be completed (continued)**

- Further enquiries on the sample of pre-Enterprise Act 2002 cases where no details are available on how the property interests were dealt with, to establish the impact of the transitional provisions (see Section 3.3 paragraphs 32-38).

### **Existing work to be continued**

3. It is recommended that The Insolvency Service continues to:

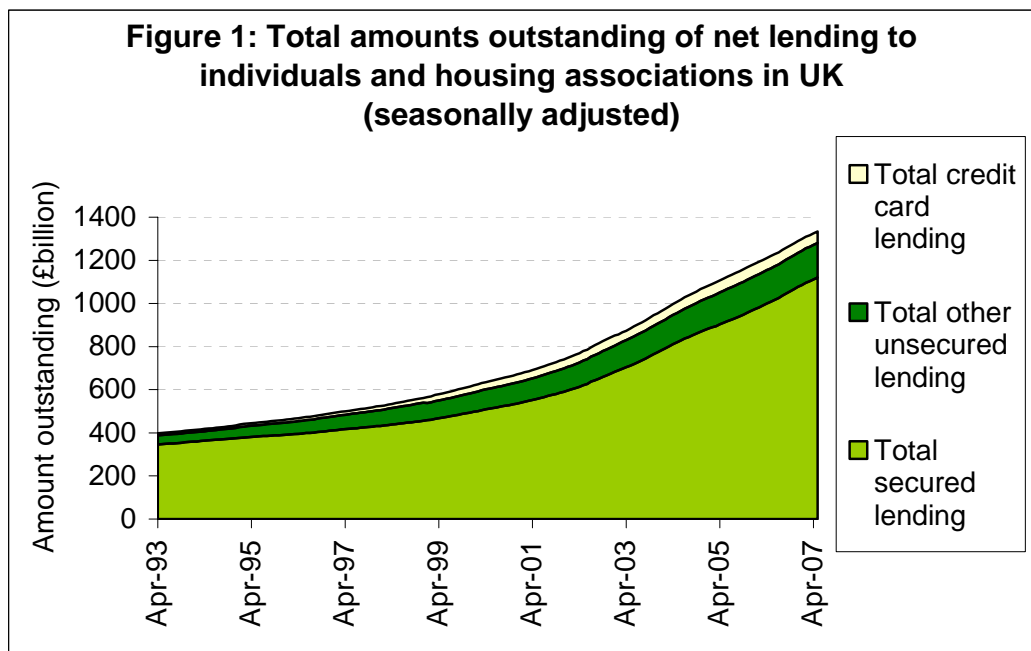
- Carry out the surveys as regards attitudes to bankruptcy on a biennial basis to:
  - ascertain whether the changes seen in the pre- and post-Enterprise Act 2002 surveys are sustained (see Section 3.1 paragraphs 10-11);
  - monitor business attitudes to bankruptcy (see Section 3.1 paragraph 31); and
  - assess the effect of the reduction in the discharge period (see Section 3.2 paragraphs 76-79).
- Work with policy-owning departments to ensure that they are aware of the BRO regime, and that future non-insolvency legislation is appropriately drafted to reflect that regime (see Section 3.1 paragraphs 19-20).
- Work with lenders and credit reference agencies to ensure that lender policies appropriately reflect:
  - a bankrupt's discharge (see Section 3.1 paragraphs 23-24 and Section 3.2 paragraphs 30-31);
  - the BRO regime (see Section 3.3 paragraphs 39-40); and
  - a post-bankruptcy IVA and annulment of a bankruptcy order (see Section 3.6 paragraphs 52-53).
- Play a proactive role in taking forward discussions with BERR and others regarding the impact of the personal insolvency regime on business start-ups (see Section 3.1 paragraph 37).
- Monitor insolvency statistics and future research on insolvency levels (see Section 3.1 paragraphs 38-60).
- Monitor enforcement statistics (see Section 3.3 paragraphs 53-54).

## Section 2: Introduction

### 2.1 Background

1. Prior to the implementation of the Enterprise Act 2002, there had been no major reform to bankruptcy legislation in England and Wales since the Insolvency Act 1986.

2. Since 1986, the level of debt owed by individuals has significantly increased and the level of consumer debt in the UK broke through the £1 trillion barrier during 2005<sup>11</sup>. Data available on debt levels shows that since 1993<sup>12</sup>, overall lending in the UK (both secured and unsecured) has more than tripled (see Figure 1).



<sup>11</sup> Bank of England, Lending to Individuals (December 2005) available at:

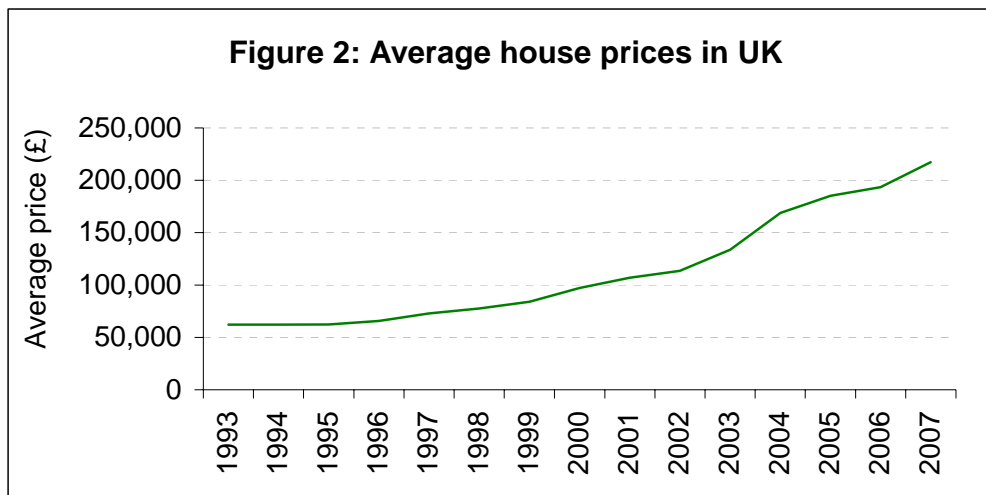
<http://www.bankofengland.co.uk/statistics/li/2005/dec/index.htm>

<sup>12</sup> Based on Bank of England data series (Tables LPMVTXC, LPMVTXK, LPMVZRI and LPMVZRJ)

## 2.1 Background (continued)

3. In 2003, the Bank of England suggested that the increase in secured lending was mainly attributable to an increase in home ownership and a fall in inflation (which has reduced the rate of inflation erosion of the debt burden)<sup>13</sup>.

4. There has been an increase in house prices<sup>14</sup> (see Figure 2). There are suggestions that the increase in average house prices has facilitated individuals raising funds through extended secured borrowing, by way of re-mortgage or loans secured on property.



5. Further, since 1986, there has been significant increase in the UK debt/income ratio<sup>15</sup> (see Figure 3). In other words, debt levels have been growing faster than national income.

<sup>13</sup> Bank of England – 'Trends in households' aggregate secured debt', available at:

<http://www.bankofengland.co.uk/publications/quarterlybulletin/qb030301.pdf>

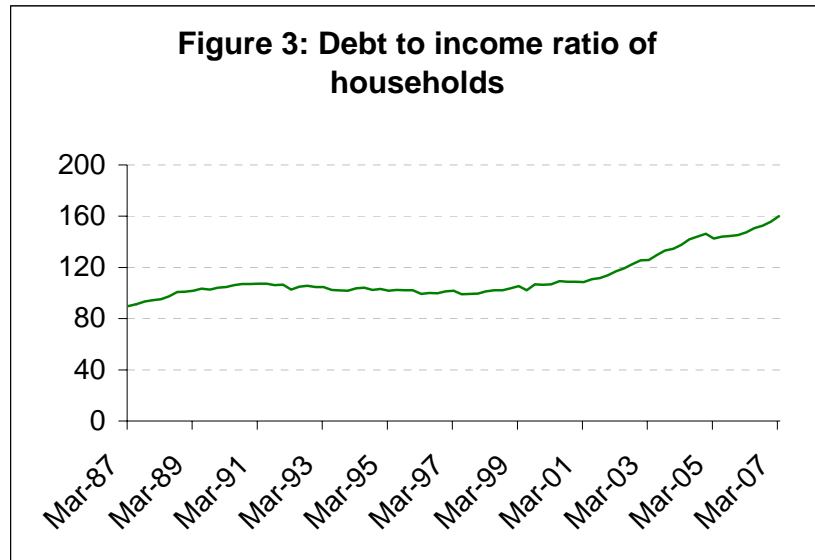
<sup>14</sup> Data produced by the Department of Communities and Local Government (Table 504), available at:

<http://www.communities.gov.uk/index.asp?id=1156110>

<sup>15</sup> Based on ONS data (Tables A40 (RPQK) and A64 (NNPP) of Quarterly National Accounts), available at:

<http://www.statistics.gov.uk/statbase/Product.asp?vlink=818&More=N>

## 2.1 Background (continued)



6. It was within this context of increasing debt levels that the bankruptcy provisions of the Enterprise Act 2002 were drafted, debated and finally implemented on 1 April 2004<sup>16</sup>.

7. The primary purpose of the individual insolvency provisions of the Act was to provide a modern bankruptcy regime that encourages business start-ups and allows those who have failed honestly to achieve financial rehabilitation whilst repaying the most they can reasonably afford to their creditors, and to have a second chance to make an economic contribution to society.

8. These provisions should not be seen in isolation. They should be viewed as one step in the Government's strategy for ensuring that the insolvency regime remains fit for purpose. The Explanatory Notes to the Enterprise Act 2002 state that *'The provisions in the Act form part of the Government's on-going strategy for dealing with the consequences of indebtedness and modernising the court's role in dealing with insolvency'*<sup>17</sup>.

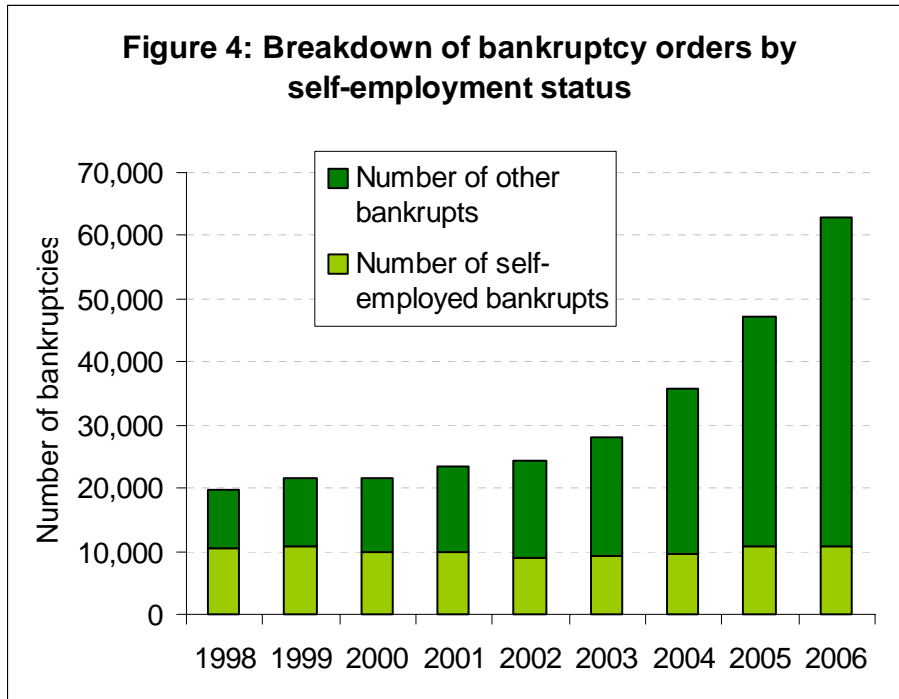
9. In the various recent profiling exercises that have been undertaken, it is clear that non-trading debtors make up the overwhelming majority of the populations of debtors going bankrupt (see Figure 4) or entering IVAs<sup>18</sup>.

<sup>16</sup> The individual provisions were implemented on 1 April 2004, apart from the provisions relating to sanction of antecedent recoveries, which commenced on 14 September 2003.

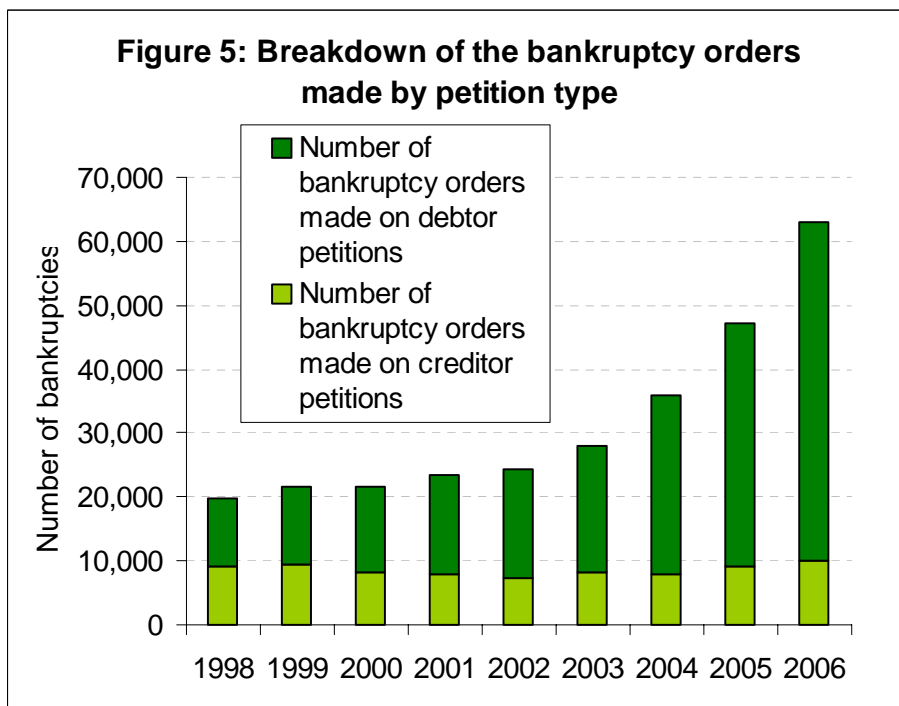
<sup>17</sup> Paragraph 638 of The Explanatory Notes to the Enterprise Act 2002.

<sup>18</sup> PricewaterhouseCoopers, *Living on Tick: The Twenty-First Century Debtor* (2006) available at <http://www.pwc.com/uk/eng/about/svcs/brs/PwC-IVAReport.pdf>

## 2.1 Background (continued)



10. It is also clear that over recent years, the proportion of bankrupts that present their own petition has steadily increased<sup>19</sup> (see Figure 5).



<sup>19</sup> Based on statistics published by The Insolvency Service.

## **2.1 Background (continued)**

11. With that changing profile in mind, the individual insolvency provisions of the Enterprise Act 2002 applied to all bankrupts irrespective of whether they were a trader or non-trader.

## 2.2 The Provisions of the Enterprise Act 2002

1. There are six main individual insolvency provisions of the Enterprise Act 2002:

- **Discharge:** The Act introduced provisions whereby a bankrupt is automatically discharged one year after the commencement of bankruptcy, rather than three years (or in some circumstances 2 years). Further, discharge can occur earlier if the Official Receiver files a notice at Court stating that the investigations into the affairs and conduct of the bankrupt are unnecessary or completed.
- **Bankruptcy Restrictions Orders (BROs):** The Act introduced provisions whereby the court can make BROs, which are designed to provide better protection for the public and a civil alternative to prosecution. BROs will place restrictions on the most culpable bankrupts from between 2 and 15 years.
- **Bankrupt's home:** The Act introduced provisions whereby a bankrupt's interest in the home forms part of the bankrupt's estate (as it did previously) but the trustee must realise the interest within a three year period, otherwise the interest in the home reverts to the bankrupt at the end of this period
- **Contributions from income by bankrupts:** The Act introduced income payment agreements (IPAs) as an administrative alternative to court-based income payment orders (IPOs).
- **Individual voluntary arrangements (IVAs):** The Act introduced changes to the IVA provisions whereby the Official Receiver can 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.
- **Sundry provisions:** The Act repealed certain bankruptcy offences and the summary administration regime and introduced a requirement for sanction to be obtained for a trustee to pursue antecedent recoveries.

## **2.3 The Evaluation Approach and Methodology**

1. The evaluation is centred around the policy objectives of the Enterprise Act 2002 and outcome-based measures.

2. The ultimate objectives of the Enterprise Act 2002 relate to the alleviation of the social consequences of bankruptcy and the encouragement of business start-ups. Additionally, each of the six main provisions of the Enterprise Act 2002 as detailed above have intermediate policy objectives that are intended to contribute to the achievement of the ultimate policy objectives. Where possible, the evaluation has tried to test the assumed 'cause and effect' link between intermediate and ultimate policy objectives.

3. Each policy objective has been translated into an outcome-based evaluation measure, the achievement of which would indicate that the policy objective has been met. Copies of all the evaluation planning papers, which contain a detailed description of the evaluation methodology for the six main provisions of the Act, are provided in appendix A.

## **2.4 Reporting the Evidence**

1. The conclusions drawn from the evaluation evidence is presented in section 3 of this report under seven themes:

Section 3.1: Overall Impact of the Enterprise Act 2002

Section 3.2: Evaluation of the Discharge provisions

Section 3.3: Evaluation of the Bankruptcy Restrictions Order provisions

Section 3.4: Evaluation of the Bankrupt's Home provisions

Section 3.5: Evaluation of the Contributions from Income by Bankrupts provisions

Section 3.6: Evaluation of the Individual Voluntary Arrangements provisions

Section 3.7: Evaluation of the Sundry provisions

2. Details of the results of the evaluation fieldwork (excluding data/information that are contained in the body of the report) are provided in appendices B and C.

## Section 3: Evaluation Results

### 3.1 Overall Impact of the Enterprise Act 2002

1. This section of the report contains evaluation evidence regarding the achievement of the ultimate objectives of the Enterprise Act 2002. It also reports on the impact of the Enterprise Act 2002 on the level of bankruptcy orders.

2. The ultimate objectives of the bankruptcy provisions of the Enterprise Act 2002 are to:

- Alleviate the social consequences of bankruptcy; and
- Encourage business start-ups

#### **Alleviation of the social consequences of bankruptcy**

3. As regards the social consequences of bankruptcy, the evaluation looks at three key areas – attitudes to bankruptcy, restrictions placed upon bankrupts and bankrupts' access to the financial market.

#### Attitudes to bankruptcy

4. Surveys have been undertaken to assess the attitudes to bankruptcy of bankrupts, small businesses and the general public both before and after the implementation of the Enterprise Act 2002<sup>20</sup>.

5. The survey results show that, overall<sup>21</sup>, there is a stigma associated with bankruptcy both before and after the implementation of the Enterprise Act 2002, and that the level of perceived stigma has not significantly changed. However, although the opinions of bankrupts and businesses have not changed significantly since the introduction of the Enterprise Act 2002, the opinions of the general public have changed significantly over this period (see Figure 6).

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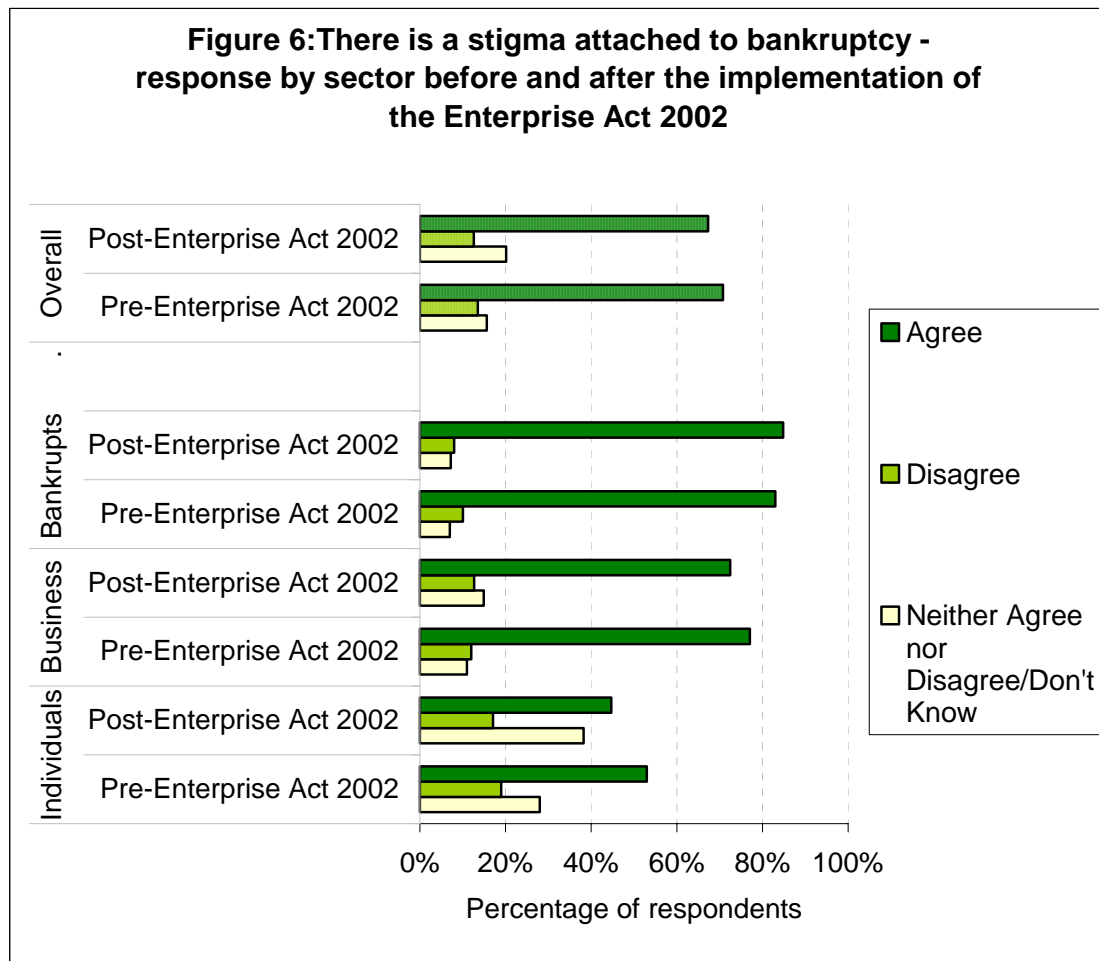
<sup>20</sup> The full survey results are available in reports entitled 'Attitudes to bankruptcy' (<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/attitudes/report-attitudestobankruptcy1.pdf>) and 'Attitudes to bankruptcy revisited' (<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/ABrevisited/ABrevisitedMenu.htm>)

The first set of surveys were run in 2004, and although some were run after the implementation of the Enterprise 2002 on 1 April 2004, it is assumed that these survey results provide an indication of attitudes existing prior to the Act's implementation.

<sup>21</sup> This overall opinion is the combination of the survey results of bankrupts, individuals and businesses, and is an average of these sectors' responses, i.e. each sector has been given equal weighting. The results have not been combined by way of a weighted average based on population size as, from a policy perspective, this would not be appropriate in the context of attitudes to bankruptcy acting as a deterrent to enterprise. If the overall opinion was a weighted average based on population size, it would mirror the individual sector responses due to its relative population size.

### 3.1 Overall Impact of the Enterprise Act 2002 (continued)

#### Attitudes to bankruptcy (continued)



6. Prior to the Enterprise Act 2002, just over half of individuals interviewed thought that there was a stigma associated with bankruptcy, with just over a quarter having no opinion. After the implementation of the Act, less than half of the individuals interviewed thought there was a stigma associated with bankruptcy, but more than a third had no opinion.

7. In general terms, it can be seen that bankrupts are more likely to think there is a stigma associated with bankruptcy compared to businesses, and businesses are more likely to think there is a stigma associated with bankruptcy compared to individuals. Further, it should be noted that post-Enterprise Act 2002, individuals who faced financial difficulties are more likely to believe there is a stigma associated with bankruptcy. This may indicate that the perceived stigma associated with bankruptcy increases as bankruptcy becomes a possibility/reality.

### **3.1 Overall Impact of the Enterprise Act 2002 (continued)**

#### Attitudes to bankruptcy (continued)

8. The surveys also sought information on why there was a stigma attached to bankruptcy. As regards the process of bankruptcy, overall, the main reason why the stigma exists is due to having the bankruptcy order advertised. All sectors identified this as the main process element contributing towards the creation of stigma both before and after the implementation of the Enterprise Act 2002. The Act did not change the provisions as regards the advertisement of the bankruptcy order.

9. As regards the effects of bankruptcy, overall, before and after the implementation of the Enterprise Act 2002, the main reasons why stigma exists is the fact that bankrupts are unable to repay creditors, problems in obtaining a bank account, and the effect on credit rating. The Act has not affected any of these issues (see paragraphs 21–24 of Section 3.1).

10. However, there may have been a major change in the opinion of the general public as regards the effects of bankruptcy since the implementation of the Enterprise Act 2002. Bankrupts and businesses identified not being able to pay creditors as the most significant effect of bankruptcy that contributes to the stigma associated with bankruptcy before and after the implementation of the Enterprise Act 2002. In contrast, whilst individuals identified this as the most significant effect prior to the Enterprise Act 2002, they identified it as the least significant effect after the implementation of the Act. However, whether this is due to the Enterprise Act 2002 is doubtful (see paragraphs 50-60 of Section 3.1).

11. After the implementation of the Enterprise Act 2002, individuals identified the possible loss of the family home as the most significant element of the effects of bankruptcy that contributed to the stigma associated with bankruptcy. In contrast, bankrupts identified the possible loss of the family home as the least significant element.

12. In general terms, before and after the implementation of the Enterprise Act 2002, bankrupts feel that bankruptcy is perceived more unfavourably than it actually is and overall, people are most concerned about the attitude of their family if and when they become bankrupt.

13. Both before and after the implementation of the Enterprise Act 2002, those who do not believe there is a stigma associated with bankruptcy attribute this to bankruptcy being part of the risk of being in business and because it is not necessarily the bankrupt's fault.

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### Attitudes to bankruptcy (continued)

#### **Summary**

#### **Alleviation of the social consequences of bankruptcy – attitudes to bankruptcy**

- To date, the Enterprise Act 2002 has not significantly changed the perceived level of stigma associated with bankruptcy (see paragraph 5).
- A person is more likely to believe that there is a stigma associated with bankruptcy as bankruptcy becomes a possibility/reality (see paragraph 7).
- The perceived level of stigma associated with bankruptcy appears to not have significantly changed because the stigma associated with bankruptcy arises from factors (such as advertisement of the bankruptcy order) which were unaffected by the Enterprise Act 2002 (see paragraphs 8-9).
- However, there are indications that the general public's attitude to repaying debts may have changed, whereby they feel that non-repayment of creditors now causes less stigma. This appears to be unrelated to the implementation of the Enterprise Act 2002 (see paragraph 10).

#### **Recommendations**

- That the surveys as regards attitudes to bankruptcy are regularly undertaken on a biennial basis to ascertain whether the changes seen in the pre- and post- Enterprise Act 2002 surveys are sustained (see paragraphs 10-11).

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### Restrictions on bankrupts

14. Prior to the Enterprise Act 2002, when an individual was made bankrupt, restrictions were placed upon the bankrupt under the Insolvency Act 1986. The following were criminal offences under the Insolvency Act 1986 for an undischarged bankrupt:

- Obtaining credit of the prescribed amount or more either alone or jointly with any another person without disclosing his/her bankruptcy;
- Carrying on business (directly or indirectly) in a different name from that in which s/he was made bankrupt, without telling all those with whom s/he does business the name in which s/he was made bankrupt;
- Being concerned (directly or indirectly) in promoting, forming or managing a limited company, or acting as a company director, without the court's permission, whether formally appointed as a director or not;
- Acting as an insolvency practitioner, or as receiver or manager of the property of a company on behalf of debenture holders; and
- Being a Member of Parliament in England or Wales.

15. All these restrictions, apart from being a Member of Parliament in England or Wales, still exist post-Enterprise Act 2002.

16. Prior to the Enterprise Act 2002, bankrupts received an automatic discharge after 3 years, and in cases where a certificate of summary administration was issued<sup>22</sup>, automatic discharge was received after 2 years. As a result of the Enterprise Act 2002, the automatic discharge period reduced to one year. Further, discharge can occur earlier if the Official Receiver files a notice at Court stating that the investigations into the affairs and conduct of the bankrupt are unnecessary or completed.

17. As detailed in Section 3.2, bankrupts are now discharged quicker. As a result, bankrupts are subject to the restrictions imposed under the Insolvency Act 1986 for less time.

18. Further, bankrupts are now allowed to be Members of Parliament. Instead, section 266 of the Enterprise Act 2002 places a ban only on those subject to a Bankruptcy Restrictions Order (BRO) (see Section 3.3).

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<sup>22</sup> A certificate of summary administration was issued by the court where:

- A debtor presented his own petition;
- The debtor's liabilities were less than £20,000; and
- Within 5 years ending with the date of presentation of the petition, the debtor had not been adjudged bankrupt nor had made a composition with creditors in satisfaction of his debts or entered into a scheme of arrangement of his affairs.

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### Restrictions on bankrupts (continued)

19. Additionally, prior to the Enterprise Act 2002, there existed approximately 200 non-insolvency pieces of legislation that imposed either mandatory or discretionary restrictions on bankrupts. The policy-owning departments of all the other mandatory restrictions were contacted and advised of the new BRO regime. As a result of this work, approximately 23 mandatory restrictions were identified which required amendment. This was achieved by a government-wide Statutory Instrument utilising the order making power contained in section 268 of the Enterprise Act, The Enterprise Act 2002 (Disqualification from office: General) Order 2006 (S.I. 2006/1722). Further amendments are expected in the future (see Section 3.3 for further details).

20. Lastly, there are certain trades and professions where the making of a bankruptcy order will affect an individual's ability to continue in their trade or profession, e.g. Armed Forces, accountancy. Also, there are other instances in legislation, regulations, bye-laws and private club rules of restrictions which refer to the individual being a 'fit and proper person' which may disqualify an undischarged bankrupt, e.g. an individual who applies to the local police for a taxi licence must be considered a 'fit and proper person'. With the concept of culpable bankruptcy introduced by the Enterprise Act 2002 and the BRO available where the conduct of the individual in question is taken into account, it may be that bankruptcy in itself will not lead to the restrictions being exercised unless the bankruptcy leads to the making of a BRO which would give an indication that the person is not fit and proper.

#### **Summary**

##### **Alleviation of the social consequences of bankruptcy - restrictions on bankrupts**

- Bankrupts are now freed quicker from the restrictions imposed on bankrupts under insolvency legislation (see paragraphs 14-17).
- The level of mandatory or discretionary restrictions imposed on bankrupts under non-insolvency legislation has reduced, and are expected to reduce further in the future (see paragraphs 19-20).

#### **Recommendations**

- That The Insolvency Service continues to work with policy-owning departments to ensure that they are aware of the BRO regime, and that future non-insolvency legislation is appropriately drafted (see paragraphs 19-20).

### 3.1 Overall Impact of the Enterprise Act 2002 (continued)

#### Bankrupts' access to the financial market

21. As detailed above, bankrupts are now freed quicker from the ban on obtaining credit and trading imposed under the Insolvency Act 1986. However, in reality, a bankrupt's access to the financial market has remained substantially unchanged as a result of the Enterprise Act 2002.

22. 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.

23. 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>23</sup>.

24. Therefore, although post-Enterprise Act 2002 bankrupts are being discharged from bankruptcy quicker, the record of the bankruptcy order will remain on their credit reference file for the same period of time. Given lender policies, this means that the reduced duration of bankruptcy will have a limited impact on a bankrupt's ability to obtain credit facilities, albeit that the statutory restrictions regarding obtaining credit are removed earlier.

#### **Summary**

##### **Alleviation of the social consequences of bankruptcy – bankrupts' access to the financial market**

- A bankrupt's access to the financial market has remained substantially unchanged as a result of the Enterprise Act 2002 (see paragraph 24).
- This is because the record of the bankruptcy order will remain on their credit reference file for the same period of time and there have been no specific changes made to lending policies in response to the implementation of the Enterprise Act 2002 (see paragraphs 22-23).

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<sup>23</sup> Based on information provided by members of the British Bankers' Association (BBA), which BBA advise is broadly representative of the industry position.

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### Bankrupts' access to the financial market (continued)

#### **Recommendations**

- That the Insolvency Service continues to work with lenders and credit reference agencies to ensure that a bankrupt's discharge is appropriately reflected in lending policies (paragraphs 23-24).

#### **Encouraging business start-ups**

25. As detailed above, one of the ultimate objectives of the bankruptcy provisions of the Enterprise Act 2002 is to encourage business start-ups.

26. In addition to the changes made to the bankruptcy regime, the Enterprise Act 2002 also contained a range of measures in relation to competition law and consumer protection designed to improve enterprise<sup>24</sup>. The substantive competition and consumer provisions of the Act were implemented in June 2003.

27. To assess whether the provisions of the Enterprise Act 2002 have impacted on the level of business start-ups in England and Wales, The Insolvency Service commissioned the DTI to develop a business start-up model. A statistical regression model has been developed with a measure of the number of business start-ups as a dependant variable and as many of the factors as possible identified through a literature review included as explanatory variables. Using a 'dummy' Enterprise Act 2002 variable, the actual level of start-ups in England and Wales, since the implementation of the Enterprise Act 2002 provisions, was compared with the level predicted by the model assuming the Act's provisions had not been introduced, to see if it was significantly higher<sup>25</sup>.

28. This analysis provides no evidence that the Enterprise Act 2002 has had any significant effect on the number business start-ups.

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<sup>24</sup> Further information on the competition and consumer provisions of the Enterprise Act 2002 can be found at: <http://www.dti.gov.uk/consumers/fact-sheets/page38117.html>

<sup>25</sup> A statistical analysis of the impact of the Enterprise Act 2002 on Business Start-ups in England and Wales - Paul Smith, Operational Research Unit, Strategic Policy Analysis, Department for Business, Enterprise and Regulatory Reform (BERR), September 2007 can be accessed at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/persdocs.htm>

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### Encouraging business start-ups (continued)

29. This is consistent with the findings of the UK Global Entrepreneurship Monitor (GEM). UK GEM 2005 and 2006 reports<sup>26</sup> shows that overall, there are few differences in entrepreneurial activity in 2005 and 2006 compared to previous years. Further, attitudes to entrepreneurship have remained broadly consistent for the last four years, with similar numbers seeing opportunities and thinking they have the skills to start up a business. However, the actual numbers expected to start up a business in the next three years has fallen since 2004 and the numbers fearing failure have risen to a six-year high.

30. In 2006, nearly 36% of the population would let fear of failure - which is seen as a barrier to entrepreneurship - prevent them from starting a business. This is higher than the US, where the figure is 21%, but it is lower than for the major European economies. GEM suggest that addressing fear of failure involves a sea change in culture, which takes a long time to effect.

31. Surveys carried out by The Insolvency Service show that bankrupts are hindered in recommencement of trading. Both before and after the implementation of the Enterprise Act 2002, businesses are most likely to trade with bankrupts once they are discharged from bankruptcy on modified business terms<sup>27</sup>. In theory, as bankrupts are now discharged quicker, this should facilitate trading by bankrupts. However, the percentage of self-employed bankrupts who recommenced trading within 1 year of the bankruptcy order fell slightly from 49% to 44% after the provisions of the Enterprise Act 2002 were implemented<sup>28</sup>.

32. Prior to the implementation of the Enterprise Act 2002, the main reasons given by self-employed bankrupts for not recommencing trade within 1 year of the bankruptcy order were because of the unavailability of capital and/or financial services, e.g. banking facilities; they did not want to be self-employed; they had found PAYE employment; ill-health and restrictions imposed by the bankruptcy specific to their trade.

33. After the implementation of the Enterprise Act 2002, the main reasons given by self-employed bankrupts for not recommencing trade within 1 year of the bankruptcy order were because of the unavailability of capital and/or financial services, e.g. banking facilities; they did not want to be self-employed; they had found PAYE employment; ill-health and retirement.

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<sup>26</sup> The Global Entrepreneurship Monitor reports for the UK can be accessed at:

[http://www.gemconsortium.org/files.aspx?Ca\\_ID=107](http://www.gemconsortium.org/files.aspx?Ca_ID=107)

<sup>27</sup> The Insolvency Service - 'Attitudes to bankruptcy'

(<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/attitudes/report-attitudestobankruptcy1.pdf>) and 'Attitudes to bankruptcy revisited'

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/ABrevisited/ABrevisitedMenu.htm>)

<sup>28</sup> The Insolvency Service – 'A Study of Self-employed bankrupts'

(<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/selfemployed/astudyofselfemployedbankrupts.doc>)

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### Encouraging business start-ups (continued)

34. Further, both before and after the implementation of the Enterprise Act 2002, around 70% of self-employed bankrupts who recommenced trading within 1 year had encountered problems with finance - the main financial problem encountered related to obtaining banking facilities.

35. This indicates that despite the reduction in the discharge period, a bankrupt's ability to recommence trading is being restricted primarily by a bankrupt's restricted access to the financial market, which has not been affected by the implementation of the Enterprise Act 2002 (see paragraphs 21-24).

36. It is interesting to note that post-Enterprise Act 2002, restrictions imposed by the bankruptcy specific to a trade was not a main reason given by self-employed bankrupts for not recommencing trade within 1 year of the bankruptcy order. This may be due to the reduction in mandatory or discretionary restrictions imposed on bankrupts under non-insolvency legislation (see paragraphs 19-20).

37. Research commissioned by The Insolvency Service suggests that the shorter discharge period may increase entrepreneurial activity<sup>29</sup>. It suggests that changes in bankruptcy law may impact on the social 'meaning' of business failure, whereby, over time, bankruptcy is 'de-stigmatised' - consequently, fear of failure is reduced. However, at this stage, the stigma associated with bankruptcy has not reduced (see paragraph 5) and fear of failure has actually increased (see paragraph 29). However, as suggested by GEM, it may be that it will take a long time for the changes in bankruptcy law to impact on attitudes to bankruptcy and consequently, fear of failure.

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<sup>29</sup> Bankruptcy Law and Entrepreneurship: John Armour and Douglas Cumming  
<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/personaldocs/ArmourCummingEntrepreneurship.pdf>

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### Encouraging business start-ups (continued)

#### Summary

##### **Encouraging business start-ups**

- The Enterprise Act 2002 does not appear to have impacted on the level of business start-ups to date (see paragraphs 27-28).
- As regards the bankruptcy provisions of the Act, these have not yet affected the 'fear of failure', which is seen as a barrier to entrepreneurship (see paragraphs 29-30).
- Furthermore, a bankrupt's ability to recommence trading is being restricted by a bankrupt's restricted access to the financial market, which has not been affected by the implementation of the Enterprise Act 2002 (see paragraph 35).

#### Recommendations

- That The Insolvency Service continues to play a proactive role in taking forward discussions with BERR and others regarding the impact of the personal insolvency regime on business start-ups (see paragraph 37).
- That the surveys as regards attitudes to bankruptcy are regularly undertaken on a biennial basis to monitor business attitudes to bankruptcy (see paragraph 31).

### 3.1 Overall Impact of the Enterprise Act 2002 (continued)

#### The impact of the Enterprise Act 2002 on the level of bankruptcy orders

38. The implementation of the Enterprise Act 2002 coincided with an increase in the level of bankruptcy orders in England and Wales (see Table 1). There has been a popular perception, which has been echoed in the media, that the implementation of the Enterprise Act 2002 has caused this increase in the level of bankruptcy orders. However, evidence suggests that the increases in personal insolvency levels are being influenced by factors other than changes in the law.

**Table 1: The total number of bankruptcy orders and individual voluntary arrangements in England and Wales**

	Total number of bankruptcy orders <sup>30</sup>	Total number of individual voluntary arrangements <sup>30</sup>
1998/9	20,508	5,113
1999/0	21,479	3,170
2000/1	21,961	7,480
2001/2	23,426	6,010
2002/3	25,177	6,425
2003/4	29,633	8,210
2004/5	37,562	11,613
2005/6	53,386	24,947
2006/7	64,610	47,975

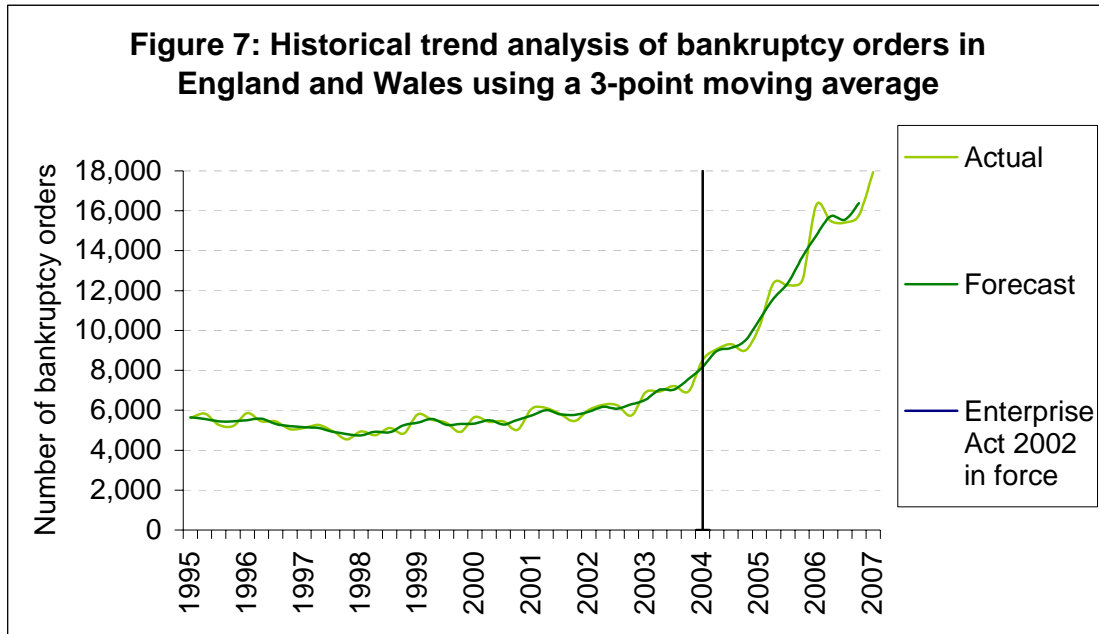
39. Firstly, the increase in the level of bankruptcy orders in England and Wales appears to be part of a trend established prior to the implementation of the Act<sup>31</sup> (see Figure 7).

<sup>30</sup> Based on statistics published by The Insolvency Service (previously the DTI Statistics Directorate) (not seasonally adjusted)

<sup>31</sup> The level of bankruptcy orders has been analysed on a 3-point moving average basis. A moving average analysis projects values in the forecast period, based on the average value of the level of bankruptcy orders (non-seasonally adjusted) over three quarters. A moving average provides trend information that a simple average of all historical data would mask.

### 3.1 Overall Impact of the Enterprise Act 2002 (continued)

The impact of the Enterprise Act 2002 on the level of bankruptcy orders (continued)



40. Moreover, as shown in Table 1, there has also been a rise in the number of individual voluntary arrangements (IVAs), where there has been no significant legislative change since their introduction in 1986. In percentage terms, the level of IVAs has seen a significantly greater rise than the increase in bankruptcy numbers. Since the implementation of the Enterprise Act 2002, the level of bankruptcies has approximately doubled; in contrast, the level of IVAs has increased by nearly sixfold over the same period.

41. Whilst reliable statistics on other means of debt resolution processes are not generally available, there also appear to have been increases in the usage of non-statutory debt resolution processes, such as debt management plans (DMPs)<sup>32</sup>. The Consumer Credit Counselling Service, one of the major providers of DMPs in the United Kingdom, has published statistics that show that DMPs have also materially increased since 2004 (see Table 2).

<sup>32</sup> Debt Management Plans are informal arrangements with creditors to repay monies owed, usually in full.

### 3.1 Overall Impact of the Enterprise Act 2002 (continued)

The impact of the Enterprise Act 2002 on the level of bankruptcy orders (continued)

**Table 2: Levels of Debt Management Plans (DMPs) in the United Kingdom dealt with by the Consumer Credit Counselling Service<sup>33</sup>**

Year	Number of DMPs
2001/2	11,433
2002/3	10,980
2003/4	16,089
2004/5	23,025
2005/6	27,992
2006/7	38,125

42. In percentage terms, the increase in DMPs is greater than the increase in bankruptcy orders in the period from 2003/4 to 2006/7 - DMPs have increased by 137% from 2003/4 to 2006/7 and bankruptcies have increased by 118% over the same period.

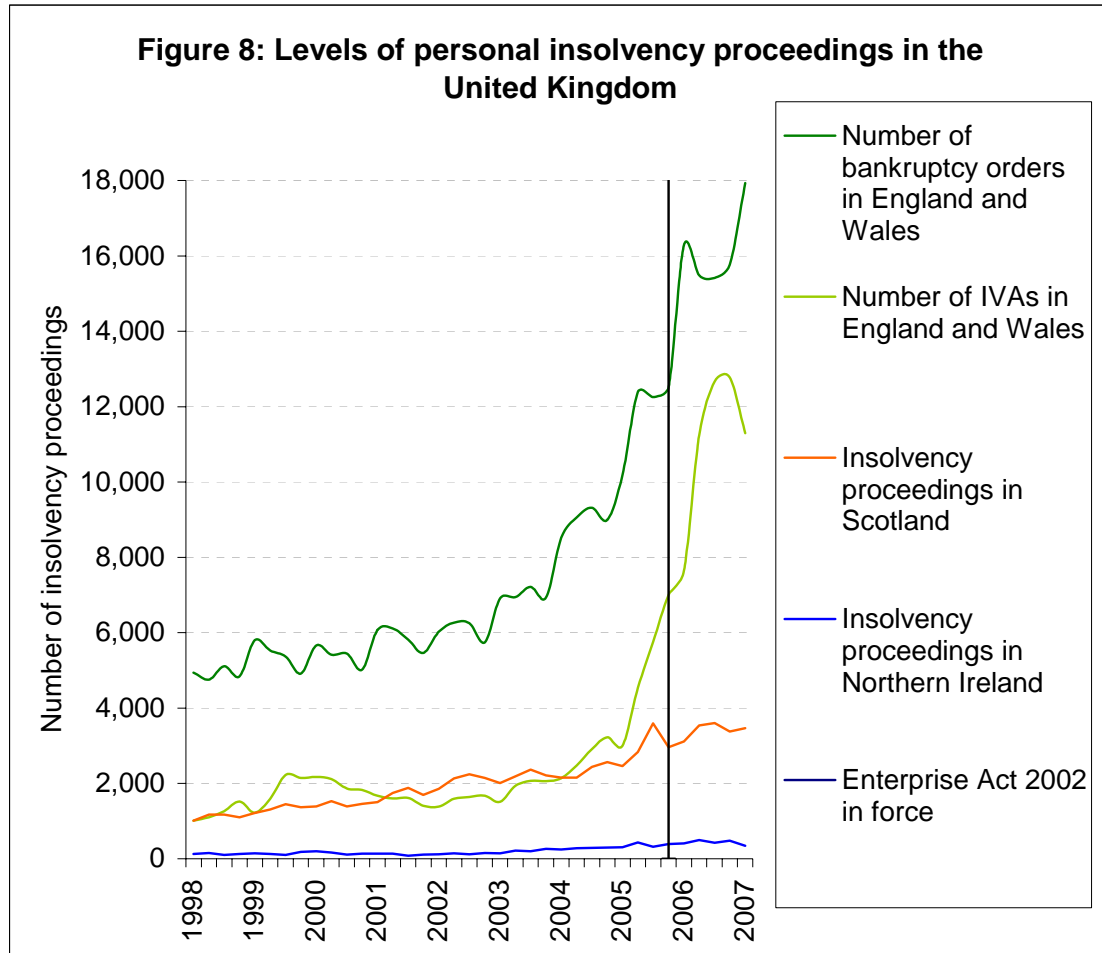
43. Looking at the rest of the United Kingdom, Scotland and Northern Ireland have also experienced increases in personal insolvency rates<sup>34</sup> (see Figure 8).

<sup>33</sup> Extracted from "Trouble Totals" press release dated 4 May 2006

<sup>34</sup> Based on statistics published by The Insolvency Service (previously the DTI Statistics Directorate) (not seasonally adjusted)

### 3.1 Overall Impact of the Enterprise Act 2002 (continued)

The impact of the Enterprise Act 2002 on the level of bankruptcy orders (continued)



44. Although the increase in personal insolvencies in Scotland<sup>35</sup> is not as steep as that in England and Wales, it is important to note that, to date, there has been no material change to Scottish insolvency law<sup>36</sup>. The Accountant in Bankruptcy has advised that the increase in Scottish personal insolvency proceedings is being seen against the increase in consumer debt, and the increase in insolvency numbers as a result of consumers failing to maintain their high level of debt.

<sup>35</sup> Scottish personal insolvency proceedings consist of sequestrations, the Scottish equivalent of bankruptcy orders, and protected trust deeds (PTDs), the Scottish equivalent of IVAs. No account is taken here of the debt arrangement scheme established with effect from 30 November 2004 by Part 1 of the Debt Arrangement and Attachment (Scotland) Act 2002. Under this scheme, individual business or consumer debtors with multiple debts can enter a debt payment programme amounting to a statutory form of DMP. As it turns out, the debt arrangement scheme has so far had a negligible impact. Less than 250 debt payment programmes were arranged between November 2004 and February 2007: see '£12m debt service helps only 202 people in three years', *The Scotsman*, 10 February 2007.

<sup>36</sup> The Bankruptcy and Diligence etc. (Scotland) Act 2007 received Royal Assent on 15 January 2007, and the Scottish Government intends to implement the bankruptcy reform provisions from April 2008. The Act proposes some reforms to the Scottish insolvency regime that are similar to the Enterprise Act 2002.

### 3.1 Overall Impact of the Enterprise Act 2002 (continued)

#### The impact of the Enterprise Act 2002 on the level of bankruptcy orders (continued)

45. Similarly, there has been an increase in personal insolvency proceedings in Northern Ireland<sup>37</sup>, with an upward trend emerging at the beginning of 2003 - although, again, the increase has not been as steep as that in England and Wales. Changes to insolvency legislation that are comparable with the Enterprise Act 2002 have been introduced in Northern Ireland<sup>38</sup>, but were not brought into force until March 2006.

46. Although the level of personal insolvency proceedings in England and Wales is higher than those seen in Scotland and Northern Ireland, it should be noted that the per capita rate in England and Wales has been consistently lower than in Scotland since the Enterprise Act 2002 came into force (see Table 3).

**Table 3: The per capita personal insolvency rates in the United Kingdom (based on mid-2005 population estimates<sup>39</sup>)**

	England & Wales		Scotland		Northern Ireland	
	Total number of personal insolvency proceedings	Number of personal insolvency proceedings per 1,000 of population	Total number of personal insolvency proceedings	Number of personal insolvency proceedings per 1,000 of population	Total number of personal insolvency proceedings	Number of personal insolvency proceedings per 1,000 of population
2003/4	37,843	<b>0.71</b>	8,919	<b>1.75</b>	942	<b>0.55</b>
2004/5	49,175	<b>0.92</b>	9,629	<b>1.89</b>	1,164	<b>0.68</b>
2005/6	78,383	<b>1.47</b>	12,495	<b>2.45</b>	1,560	<b>0.9</b>
2006/7	112,585	<b>2.11</b>	13,998	<b>2.75</b>	1,745	<b>1.01</b>

47. The Insolvency Service commissioned the DTI (now BERR) to develop a bankruptcy economic model. This shows that the main driver of the level of bankruptcy cases is the total amount of secured and unsecured debt in the economy.

48. Similarly, the Bank of England attributed the increasing numbers of personal insolvencies principally to the rise in household indebtedness and said that it is unlikely that the recent rise in bankruptcies are due to the changes introduced by the Enterprise Act 2002, given that the upward trend in insolvencies was established before the relevant provisions came into force<sup>40</sup> (see trend analysis above).

<sup>37</sup> Personal insolvency proceedings in Northern Ireland consist of bankruptcy orders and IVAs.

<sup>38</sup> Insolvency (Northern Ireland) Order 2005 (SI 2005/1455 (NI 10))

<sup>39</sup> The Office of National Statistics have produced mid-2005 population estimates as follows: England and Wales – 53,390,200; Scotland – 5,094,800; and Northern Ireland – 1,724,400.

<sup>40</sup> Extracted from The Bank of England's Financial Stability Review issued in June 2005.

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### The impact of the Enterprise Act 2002 on the level of bankruptcy orders (continued)

49. The Bank of England subsequently stated that the Enterprise Act changes may have increased the incentive for debtors to enter bankruptcy and so contributed to the rise in personal insolvencies while at the same time pointing to the growth in IVAs in England and Wales and personal insolvencies in parts of the United Kingdom where comparable legislative changes have only recently been introduced<sup>41</sup>.

50. Have the changes introduced by the Enterprise Act 2002 increased the incentive to enter bankruptcy? Is bankruptcy now seen as 'soft option'? The main reason cited for this perception is the reduction in the discharge period introduced by the Act, with scope for even earlier discharge should the Official Receiver decide that an investigation is unnecessary or concluded, coupled with the policy of 'reducing stigma' by relaxing legal restrictions on undischarged bankrupts.

51. Evidence from a survey carried out by The Insolvency Service<sup>42</sup> in 2006 assessing bankrupts' views on discharge from bankruptcy found that only 16% of bankrupts surveyed were aware of, and influenced by (in varying degrees) the reduction in the automatic discharge period when deciding to go through bankruptcy rather than another debt relief route. Furthermore, only 8% of bankrupts surveyed were aware of, and influenced by (in varying degrees) the early discharge provisions when deciding to go through bankruptcy rather than another debt relief route.

52. The results of the Bankruptcy Courts Survey 2005<sup>43</sup> show that around a third of bankrupts surveyed regarded the reduction in the period to discharge as an important factor influencing their decision to file for bankruptcy. Unlike the Insolvency Service's survey, these results cannot be safely generalised to the population of bankrupts as a whole. However, the Bankruptcy Courts Survey 2005 does provide useful impressionistic evidence suggesting that few people perceived bankruptcy as an easy way out of their debts; indeed, a number of respondents did not consider that they had any realistic alternative. The impact of the changes made to the discharge provisions are discussed in more detail in Section 3.2.

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<sup>41</sup> Extracted from the Bank of England's Inflation Report issued in May 2006

<sup>42</sup> Discharge from Bankruptcy

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/Discharge%20from%20bankruptcy.doc>

<sup>43</sup> Bankruptcy Courts Survey 2005 – A Pilot Study: John Tribe

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/personaldocs/BankruptcyCourtsSurvey.pdf>

The overall response rate averaged out across the six courts at 11.5%. Given the risk of possible self-selection bias, an appropriate degree of caution needs to be exercised in generalising Tribe's findings to the population of bankrupts as a whole.

### **3.1 Overall Impact of the Enterprise Act 2002 (continued)**

#### **The impact of the Enterprise Act 2002 on the level of bankruptcy orders (continued)**

53. In summary, it can be argued that in the three years since the implementation of the Enterprise Act 2002, the reduction in the discharge period may have had some marginal effect in influencing some debtors to choose bankruptcy over other options. However, the fact that growth in the IVA market has consistently and increasingly outstripped the rate of growth of bankruptcies implies that many more debtors are choosing an IVA rather than bankruptcy.

54. As detailed above, survey results show that overall, the stigma attached to bankruptcy has not changed. However, there are indications that the general public may now associate less stigma with bankruptcy (although individuals are more likely to believe there is a stigma associated with bankruptcy if they are in financial difficulties). The evidence suggests that this change in opinion is not as a result of the legislative changes introduced by the Enterprise Act 2002. Before the implementation of the Enterprise Act 2002, the main reasons given by individuals for why there is a stigma associated with bankruptcy were the possible loss of home, the effect on credit rating and not being able to repay creditors. After the implementation of the Act, the main reasons given were having the bankruptcy order advertised and the possible loss of home. None of these elements of bankruptcy were affected by the Enterprise Act 2002. Additionally, individuals identified the length of time bankruptcy restrictions are imposed, i.e. the discharge period, as the least significant effect of bankruptcy pre-Enterprise Act 2002 and the second least significant effect post-Enterprise Act 2002 (the least significant being not being able to pay creditors – see below). Further, post-Enterprise Act 2002, only 25% of individuals who did not believe there was a stigma associated with bankruptcy agreed that bankruptcy was socially acceptable.

55. However, the surveys do indicate that there may have been a major change the attitude of the general public to debt repayment. Prior to the Enterprise Act 2002, 71% of individuals agreed that not being able to pay creditors contributed to the stigma associated with bankruptcy. In contrast, post-Enterprise Act 2002 only 38% of individuals agreed that not being able to pay creditors contributed to the stigma associated with bankruptcy.

56. So, although there is no convincing evidence to suggest that the Enterprise Act 2002 has encouraged more people to enter into bankruptcy, there are indications that there may be a cultural shift in attitudes to debt repayment. This may explain why there have been significant increases in both bankruptcies and IVAs.

### 3.1 Overall Impact of the Enterprise Act 2002 (continued)

#### The impact of the Enterprise Act 2002 on the level of bankruptcy orders (continued)

57. Critically, the available macroeconomic evidence suggests that there is a structural relationship between the rate of increase in the numbers of individuals entering a formal insolvency procedure and changes in the credit market. The increasing availability of various forms of consumer credit leads to increasing numbers of people incurring debts and, where credit is expanding, the number of 'failures' increases.

58. Increases in consumer debt levels in England and Wales are strongly correlated with increases in the individual insolvency rate subject to a lagging effect<sup>44</sup>. Earlier research conducted by Hussain which sought to explain rising personal insolvency rates in the 1990s provides empirical support for the hypothesis that greater indebtedness and, in particular, a rising debt-to-income ratio, leads to more personal insolvencies<sup>45</sup>. The balance of evidence in the United States, where credit industry concerns about the rising trend in filings observable after the introduction of the current Bankruptcy Code in 1978 led to tightening of the law in 2005, suggests that the principal determinants are variables such as the deregulation of credit markets, the aggregate level of consumer credit in the economy and the household debt-to-income ratio<sup>46</sup>. In the light of this evidence, it is important to note that since 1995 there has been a sharp increase in the household debt-to-income ratio in the United Kingdom.

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<sup>44</sup> See the Official Report of the Enterprise and Culture Committee of the Scottish Parliament, 7 March 2006, cols 2720-21 available at <http://www.scottish.parliament.uk/business/committees/enterprise/or-06/ec06-0602.htm#Col2713>. According to the DTI's operational research unit, changes in the number of insolvencies lag four quarters behind changes in the amount of debt. The level of consumer debt in the UK broke through the £1 trillion barrier during 2005. By December 2005, aggregate personal debt in the United Kingdom (Britain and Northern Ireland) stood at £1,167.5 billion (and rising), of which £962.5 billion was secured on a dwelling, i.e. mortgage debt, and £192.3 billion was unsecured. See Bank of England – Lending to individuals (December 2005), available at: <http://www.bankofengland.co.uk/statistics/li/2005/dec/index.htm>

<sup>45</sup> Iftikhar Hussain - Macroeconomic determinants of personal bankruptcies (2002) 28(6) *Managerial Finance* 20

<sup>46</sup> See, for example, Jagdeep S. Bhandari & Lawrence A. Weiss, 'The Increasing Bankruptcy Filing Rate: An Historical Analysis' (1993), 67 *American Bankruptcy Law Journal* 1; Paul C. Bishop, *A Time Series Model of the US Personal Bankruptcy Rate*, BANK TRENDS (No. 98-01) available at [http://www.fdic.gov/bank/analytical/bank/bt\\_9801.pdf](http://www.fdic.gov/bank/analytical/bank/bt_9801.pdf); Diane Ellis, 'The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate', BANK TRENDS (No. 98-05) available at [http://www.fdic.gov/bank/analytical/bank/bt\\_9805.pdf](http://www.fdic.gov/bank/analytical/bank/bt_9805.pdf); Robert M. Lawless, 'The Relationship Between Nonbusiness Bankruptcy Filings and Various Basic Measures of Consumer Debt', available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=934798](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=934798); David A. Moss and Gibbs A. Johnson, 'The Rise of Consumer Bankruptcy: Evolution, Revolution or Both?', (1999) 73 *American Bankruptcy Law Journal* 311; Teresa A. Sullivan, Elizabeth Warren and Jay L. Westbrook, 'Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings', (2006) 59 *Stanford Law Review* 101 (2006).

## 3.1 Overall Impact of the Enterprise Act 2002 (continued)

### The impact of the Enterprise Act 2002 on the level of bankruptcy orders (continued)

59. More recently, Ronald Mann has demonstrated through quantitative analysis of data drawn from five jurisdictions (including the United States and the United Kingdom) that, where bankruptcy regimes are held more or less constant, perhaps not surprisingly, credit card use and borrowing seem to impact on the personal insolvency rate, subject to a lagging effect. He also found that a shift in the composition of consumer debt in which credit card debt increases and non-credit card decreases has an upwards effect on personal insolvency rates one year later<sup>47</sup>.

60. This evidence cumulatively implies that consumer credit expansion/debt accumulation leading to rising debt service burdens has been the main determinant of the increase in personal insolvencies.

#### **Summary**

##### **The impact of the Enterprise Act 2002 on the level of bankruptcy orders**

- The implementation of the Enterprise Act 2002 in England and Wales coincided with an increase in bankruptcies in England and Wales (see paragraph 38).
- The implementation of the Enterprise Act 2002 in England and Wales also coincided with an increase in all personal insolvency proceedings in the UK (see paragraphs 39-45).
- Evidence suggests that there is no causal link between the implementation of the Enterprise Act 2002 and the increase in bankruptcies in England and Wales (see paragraphs 50-60).

#### **Recommendations**

- That The Insolvency Service continues to monitor insolvency statistics and future research on insolvency levels (see paragraphs 38-60).

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<sup>47</sup> Ronald Mann 'Charging Ahead: The Growth and Regulation of Payment Card Markets' (Cambridge University Press, 2006), especially chapter 5.

## 3.2 Evaluation of the Discharge provisions

1. This section of the report contains evaluation evidence regarding the achievement of the intermediate objectives of the discharge provisions contained in the Enterprise Act 2002.

2. The objectives of the discharge provisions are:

- To enable the prompt rehabilitation of bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver
- To not discriminate against 'second-time' bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver
- To speed up the process of suspending the discharge of a bankrupt due to non-co-operation where a trustee other than the Official Receiver has been appointed
- To help lift the stigma of bankruptcy

3. The Insolvency Service has published a report entitled 'Discharge from bankruptcy'<sup>48</sup> reporting on the results of a survey carried out in 2006. The aim of the survey was to obtain views from bankrupts regarding discharge from bankruptcy. In this section, this survey is referred to as "the bankrupts' discharge survey".

### Prompt rehabilitation of bankrupts

4. The evaluation looks at the new discharge provisions - in particular the duration of bankruptcy, the early discharge provisions, the impact of the provisions and customer satisfaction with the provisions - and the rehabilitation offered as a result.

### Duration of bankruptcy

5. Under the Enterprise Act 2002, the automatic discharge period of a bankrupt was reduced from three years from the commencement of bankruptcy (and two years in summary administration cases<sup>49</sup>) to one year. Additionally, 'early discharge' provisions were introduced whereby discharge can be obtained in less than one year if the Official Receiver files a notice at Court stating that the investigations into the affairs and conduct of the bankrupt are unnecessary or completed.

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<sup>48</sup> The Insolvency Service: Discharge from bankruptcy, is available at:

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/Discharge%20from%20bankruptcy.doc>

<sup>49</sup> A certificate of summary administration was issued by the court where:

- A debtor presented his own petition;
- The debtor's liabilities were less than £20,000; and
- Within 5 years ending with the date of presentation of the petition, the debtor had not been adjudged bankrupt nor had made a composition with creditors in satisfaction of his debts or entered into a scheme of arrangement of his affairs.

## **3.2 Evaluation of the Discharge provisions (continued)**

### Duration of bankruptcy (continued)

6. Further, under the Enterprise Act 2002, the discharge provisions are the same regardless of how many times an individual has been previously adjudged bankrupt. Prior to the Enterprise Act 2002, a 'second-time' bankrupt was not entitled to an automatic discharge from bankruptcy; the bankrupt could only apply to court for discharge five years after the commencement of bankruptcy (see paragraphs 45-61).

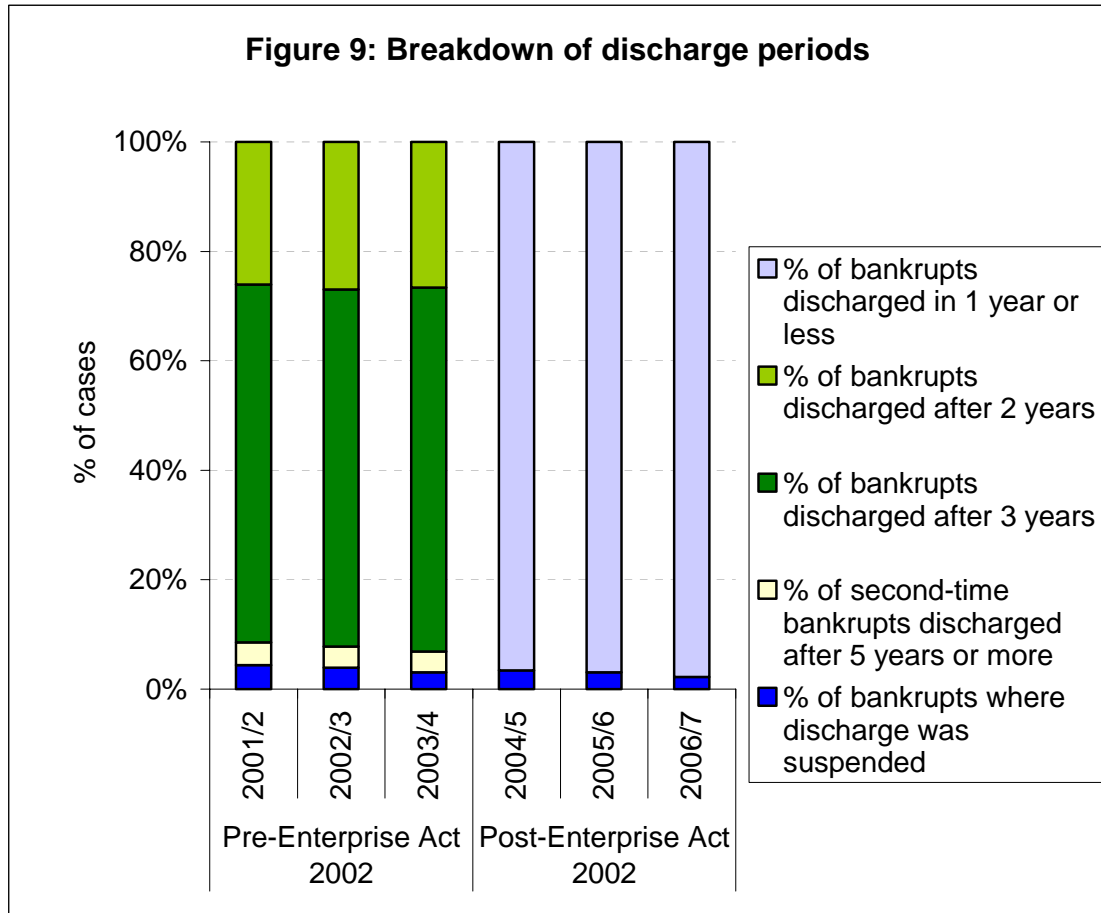
7. Both before and after the implementation of the Enterprise Act 2002, an application to suspend a bankrupt's discharge can be made where a bankrupt fails to co-operate with the Official Receiver and/or trustee.

8. Where a bankrupt is judged to be culpable for his/her failure, an application for a BRO will be made (see Section 3.3). A BRO (or the possibility of an application for a BRO) does not stop a bankrupt receiving an automatic discharge. However, a BRO imposes restrictions on a bankrupt that are broadly analogous with the restrictions imposed under insolvency legislation on undischarged bankrupts, and can last from 2 to 15 years.

9. As a result of the change in the discharge provisions, over 95% of bankrupts are now discharged in one year or less, compared to just over 25% and around 65% of bankrupts being discharged in two and three years respectively prior to the Enterprise Act 2002 (see Figure 9).

### 3.2 Evaluation of the Discharge provisions (continued)

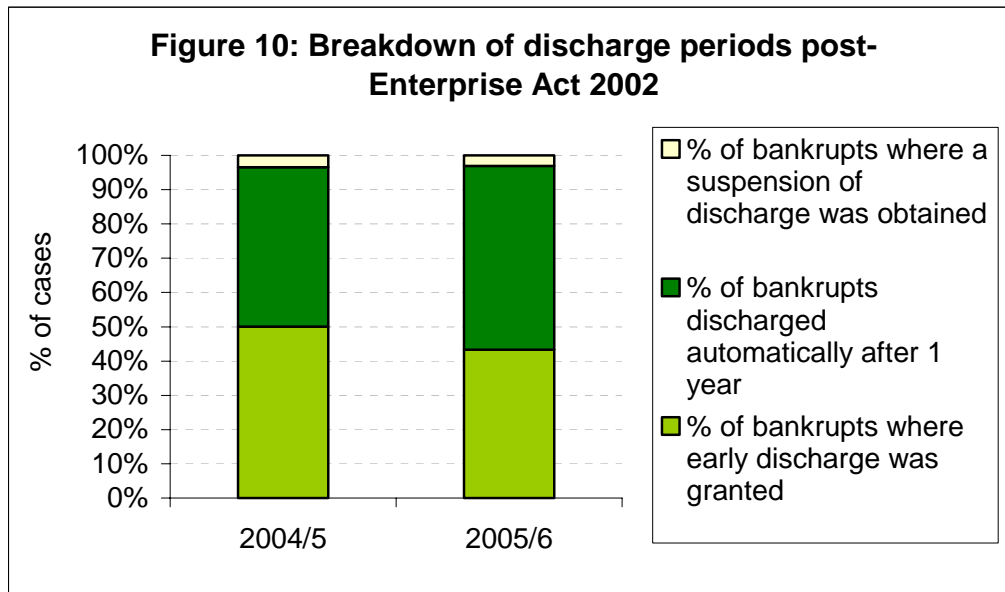
#### Duration of bankruptcy (continued)



## 3.2 Evaluation of the Discharge provisions (continued)

### Early discharge

10. Early discharge has been granted in around 50% and 43% of bankruptcy cases in 2004/5 and 2005/6 respectively, i.e. the two years since the implementation of the Enterprise Act 2002 (see Figure 10). Full data for 2006/7 is not yet available, but early discharge has been granted in 40% of bankruptcy cases in the 4 months to 31 July 2007.



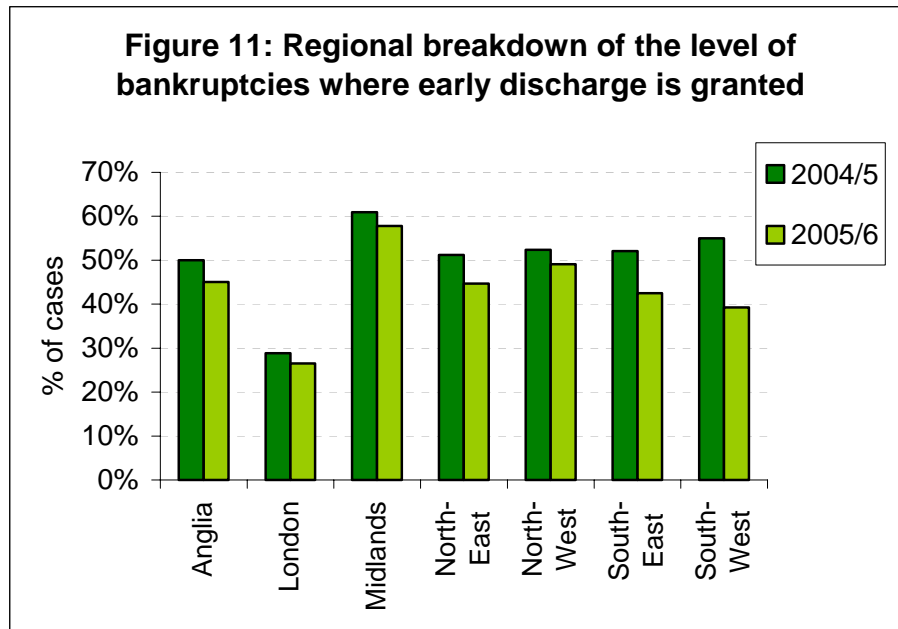
11. An analysis of the level of bankruptcies where early discharge is granted on a regional basis shows that there are variations across the regions<sup>50</sup> (see Figure 11).

<sup>50</sup> For the regional analysis, the bankruptcy data have been broken down according to The Insolvency Service's broad operational regions as follows:

Official Receiver operational region	Official Receiver offices covered by operational region
Anglia	Cambridge, Ipswich, Southend-on-Sea, St Albans, Northampton, Norwich
London	All London Sections, Croydon
Midlands	Birmingham, Leicester, Nottingham
North-East	Leeds, Hull, Newcastle, Sheffield, Stockton
North-West	Blackpool, Chester, Liverpool, Manchester, Stoke-on-Trent
South-East	Bournemouth, Brighton, Canterbury, Reading, Southampton, Medway
South-West	Bristol, Cardiff, Exeter, Gloucester, Plymouth, Swansea

## 3.2 Evaluation of the Discharge provisions (continued)

### Early discharge (continued)



12. It is particularly noticeable that early discharge is granted in a lower percentage of bankruptcies in the London region compared to other regions (see Figure 11). This appears to be attributable to the non-cooperation of bankrupts experienced in the London Official Receiver offices.

13. Firstly, these offices experience a higher level of non-cooperation by bankrupts overall<sup>51</sup>. Secondly, when the Official Receiver is considering applying for early discharge, in cases where no IPO/A has already been obtained, a letter is sent to the bankrupt asking for confirmation that there have been no changes to the bankrupt's income and expenditure. Unless a response is received to this letter, the Official Receiver will not apply for early discharge. Based on anecdotal evidence, the London region appears to have experienced a high level of non-response to this letter.

14. Where early discharge applications have been made, the average discharge period is around 7 months. Therefore, on average, where early discharge is granted, bankrupts are being discharged 5 months earlier compared to if they had received an automatic discharge from bankruptcy post-Enterprise Act 2002.

<sup>51</sup> In 2004/5 and 2005/6, applications for public examinations and suspension of discharges were applied for in 8% and 9% of cases respectively in the London Official Receiver offices, compared to an average of 4% and 3% respectively in England and Wales.

## **3.2 Evaluation of the Discharge provisions (continued)**

### Early discharge (continued)

15. The Insolvency Service's internal policy is that the Official Receiver should wait for 3 months after issuing the report to creditors before starting the early discharge process. The purpose of this time delay is to allow the opportunity for creditors to interact with the Official Receiver and make any representations they feel appropriate. On average, Official Receivers are starting the early discharge process at about 4 months after the report to creditors had been sent.

16. Further, the court determines the precise date of early discharge. The Official Receiver is required to file notice at court stating that investigation of the conduct and affairs of the bankrupt is unnecessary or concluded, and the date this notice is filed is the date of early discharge. Therefore, in practical terms, the Official Receiver needs to have an endorsed notice returned from the court before the Official Receiver can state that the notice has been filed and therefore that discharge has taken place. Official Receivers have reported that this notice can be caught up in the court administration and delayed.

17. Therefore, it appears that there is a delay in early discharge being obtained due to delays within the process of early discharge. Subject to comments at paragraph 44, steps should be taken to review the early discharge process to ascertain whether the process delays can be eliminated, or whether amendments are required to the process.

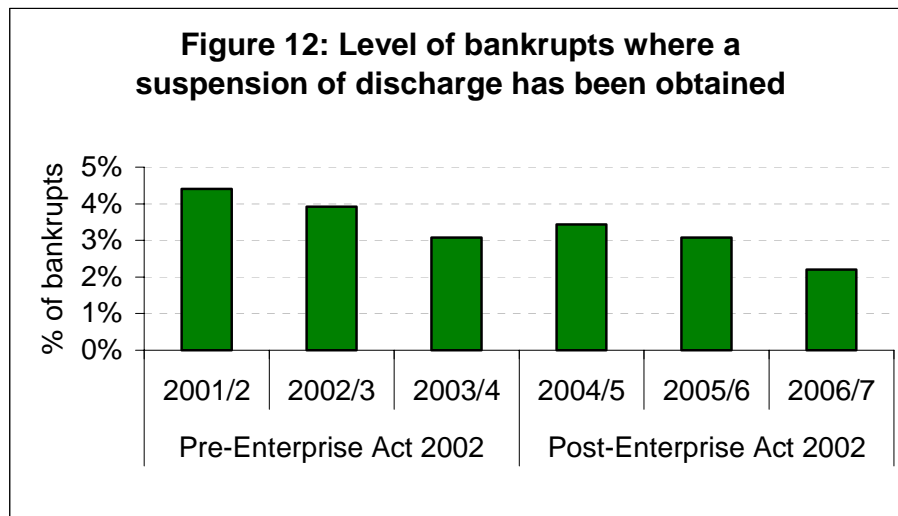
### The impact of discharge provisions

18. The evaluation also looked at whether the shortened discharge period had any unintended affects as regards co-operation of bankrupts, obtaining IPO/As, claiming after-acquired property and the Official Receiver's investigative duty.

19. The level of cases where a suspension of discharge was obtained was falling prior to the implementation of the Enterprise Act 2002. It then rose in the year after the implementation of the Act, and has fallen since (see Figure 12). It should be noted that, post-Enterprise Act 2002, suspensions of discharge can be obtained by both the Official Receiver and an insolvency practitioner (IP) appointed as trustee, and that there has been a fall in both such suspensions since the implementation of the Act (see paragraph 66). Therefore, it appears that the reduction in the discharge period may have facilitated the co-operation of bankrupts. This may be due to the reduction in the automatic discharge period, and the possibility of early discharge for bankrupts who have fully co-operated with the Official Receiver/trustee.

### 3.2 Evaluation of the Discharge provisions (continued)

#### The impact of discharge provisions (continued)



20. There are cases where a bankrupt has not co-operated with the IP appointed as trustee, but the trustee did not apply for a suspension of discharge (see paragraph 67). However, this happens in less than 0.5% of bankruptcies and therefore, non-cooperation levels are still lower in 2006/7 than 2003/4. Further, pre-Enterprise Act 2002, the IP may not have made a request to the Official Receiver in all such cases for a suspension of discharge.

21. However, the shortened discharge period has affected the ability to suspend discharge in non-cooperation cases. However, it should be noted that this only happens in a handful of cases – based on a case sampling exercise, an IP has not been able to apply for a suspension of discharge due to non-cooperation because the bankrupt was already discharged in less than 50 bankruptcies per year (see paragraph 68). However, this needs to be balanced against an overall increase in co-operation levels (see paragraph 19), the increase in which is greater than the level of cases where suspension of discharge has not been possible. Therefore, overall, it would appear that the impact of the shortened discharge period on co-operation is marginal.

## 3.2 Evaluation of the Discharge provisions (continued)

### The impact of discharge provisions (continued)

22. There are no known cases pre-Enterprise Act 2002 where there was a claim on an asset as after acquired property after one year from the date of the bankruptcy order<sup>52</sup>. From the case sampling exercise of IPOs obtained in 2001/2, around 1% of IPOs were varied after one year from the date of the bankruptcy order to increase the monies claimed under that IPO<sup>53</sup>. As IPOs were obtained in less than 10% of cases before the implementation of the Enterprise Act 2002, IPOs variations after one year from the date of the bankruptcy order to increase the monies claimed under that IPO occurred in around 0.1% of bankruptcies. Therefore, it does not appear that the reduction in the automatic discharge period to 1 year has significantly impacted on returns to creditors

23. An application for a Bankruptcy Restrictions Order must be made within one year of the making of the bankruptcy order, unless leave of the court is obtained. This period will cease to run if the bankrupt's discharge is suspended. Post-Enterprise Act 2002, there are no known cases where evidence of Bankruptcy Restrictions Order misconduct has come to light after 12 months from the date of the bankruptcy order and the bankrupt has been discharged from bankruptcy. Official Receivers have advised that where evidence of misconduct has arisen after 12 months, this is due to non-cooperation of the bankrupt, and therefore, a suspension of discharge has been previously obtained. If evidence were to arise after 12 months from the date of the bankruptcy order, Official Receivers would seek advice from the Authorisations Team<sup>54</sup>, who would decide whether an out-of-time application should be made. Therefore, it does not appear that the reduction in the automatic discharge period to 1 year has impacted on the protection of the public and commercial community.

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<sup>52</sup> A request was made to insolvency practitioners (via the publication 'Dear IP') and Insolvency Service staff for details of any cases where money/assets had been claimed as after acquired property after one year from the date of the bankruptcy order pre-Enterprise Act 2002. No such cases were identified.

<sup>53</sup> Based on The Insolvency Service's internal records, there were 2,396 IPOs in 2001/2. The case sample of 499 IPOs obtained in 2001/2 identified 5 variations of IPOs more than 1 year after the bankruptcy order involving an increase in money due.

<sup>54</sup> The Authorisations Team are part of The Insolvency Service, who issue authorities to proceed with a Bankruptcy Restrictions Order application to Official Receivers on behalf of the Secretary of State.

## 3.2 Evaluation of the Discharge provisions (continued)

### Customer satisfaction with the discharge provisions

24. Prior to the Enterprise Act 2002, there were minimal complaints regarding the discharge provisions, and they constituted less than 1% of all complaints received by The Insolvency Service<sup>55</sup>. Post-Enterprise Act 2002, there has been a rise in the number of complaints regarding discharge, and they constitute around 3% of all complaints received by The Insolvency Service<sup>56</sup>. Post-Enterprise Act 2002, around one third of the complaints were about the early discharge process.

25. As regards the discharge provisions post-Enterprise Act 2002, creditors do not appear to support the reduction in the discharge period, mainly due to fears that the reduction in the discharge period may encourage more people to enter into bankruptcy<sup>57</sup>. However, as detailed in Section 3.1, this fear does not appear to be substantiated.

26. As regards the opinion of businesses, in a survey carried out in November 2006<sup>58</sup> over 60% of businesses do not agree that bankrupts should be discharged quicker, and under half believe that the reduction in the discharge period assists in the rehabilitation of bankrupts. However, around 80% of businesses said that the reduction in the discharge period had no impact on their businesses (see Figure 13).

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<sup>55</sup> There were 1,164 complaints recorded in The Insolvency Service's complaints register in the 3-year period ended 31 March 2004. 10 of these complaints related to discharge matters – half of these were in connection with the issue of a certificate of discharge.

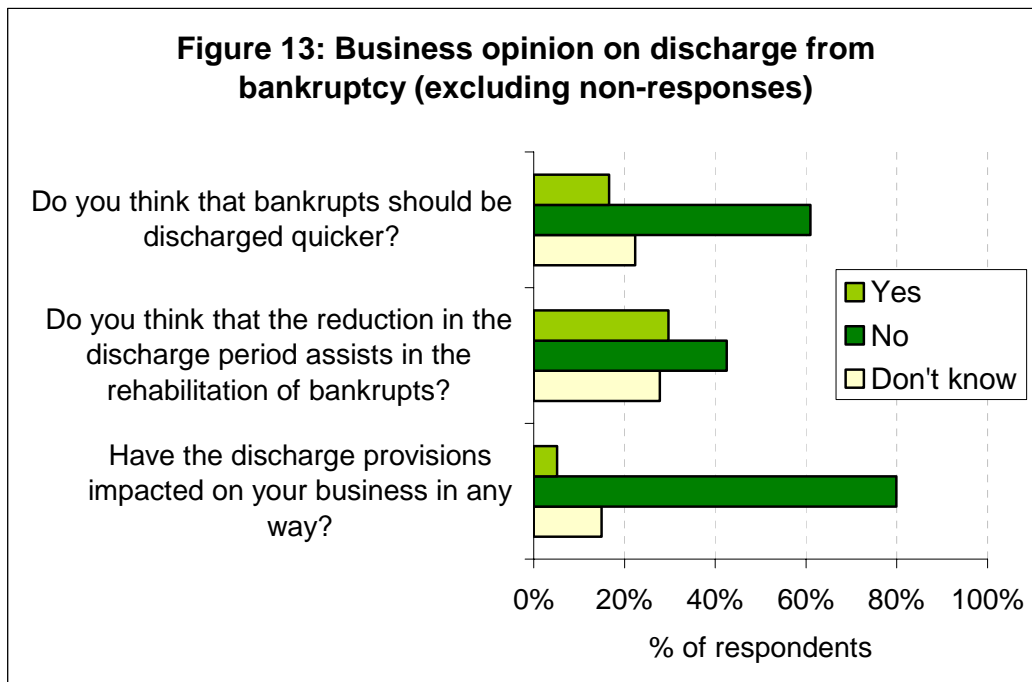
<sup>56</sup> There were 952 complaints recorded in The Insolvency Service's complaints register in the 3-year period ended 31 March 2007. 31 of these complaints related to discharge matters.

<sup>57</sup> Based on information provided by the British Bankers' Association (BBA) and the Institute of Credit Management (ICM)

<sup>58</sup> The questions were asked as part of the 'Attitudes to Bankruptcy' survey carried out by The Insolvency Service. Further information on the survey methodology is contained in the report 'Attitudes to Bankruptcy Revisited', available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/ABrevisited/ABrevisitedMenu.htm>

### 3.2 Evaluation of the Discharge provisions (continued)

#### Customer satisfaction with the discharge provisions (continued)

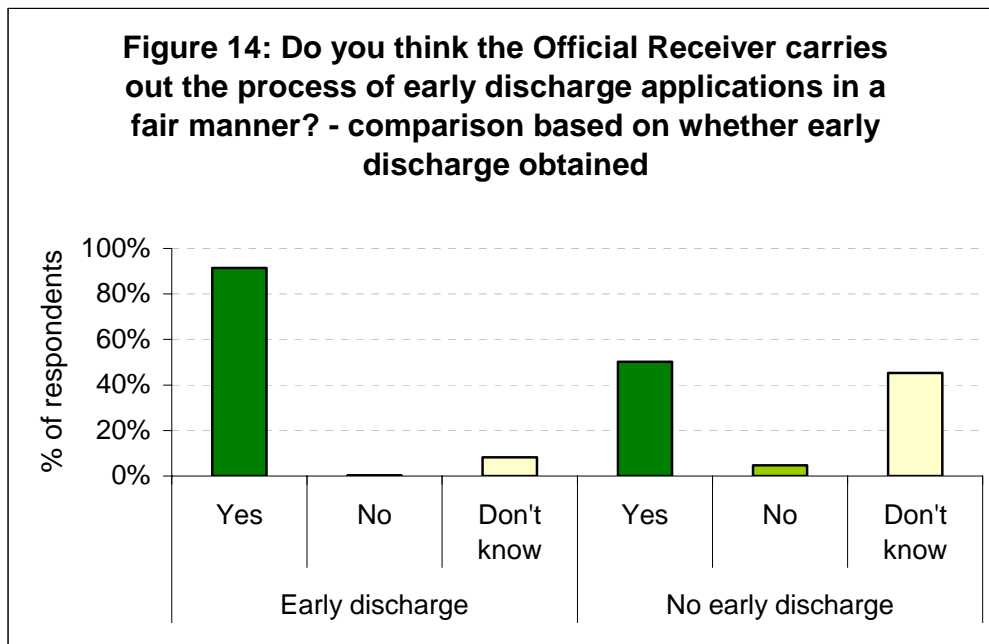


27. As regards early discharge, around 80% of bankrupts agreed with the principle of early discharge in the bankrupts' discharge survey.

28. Further, 75% of bankrupts agreed that the Official Receiver did carry out the process of early discharge applications in a fair manner. Bankrupts who had received early discharge were substantially more likely to agree that the Official Receiver carried out the process of early discharge applications in a fair manner (see Figure 14). Around 90% of bankrupts who had received early discharge agreed that the Official Receiver carried out the process of early discharge applications in a fair manner. In contrast, only 50% of bankrupts who did not receive early discharge agreed that the Official Receiver carried out the process of early discharge applications in a fair manner, with 45% being unsure.

## 3.2 Evaluation of the Discharge provisions (continued)

### Customer satisfaction with the discharge provisions (continued)



29. Just under 60% of bankrupts thought it was fair that creditors can object to a proposed early discharge application. An analysis of internal records of The Insolvency Service shows that in 2004/5, creditors objected in less than 5% of cases where the Official Receiver sent notice of his intention to apply for early discharge.

### Rehabilitation of non-culpable bankrupts

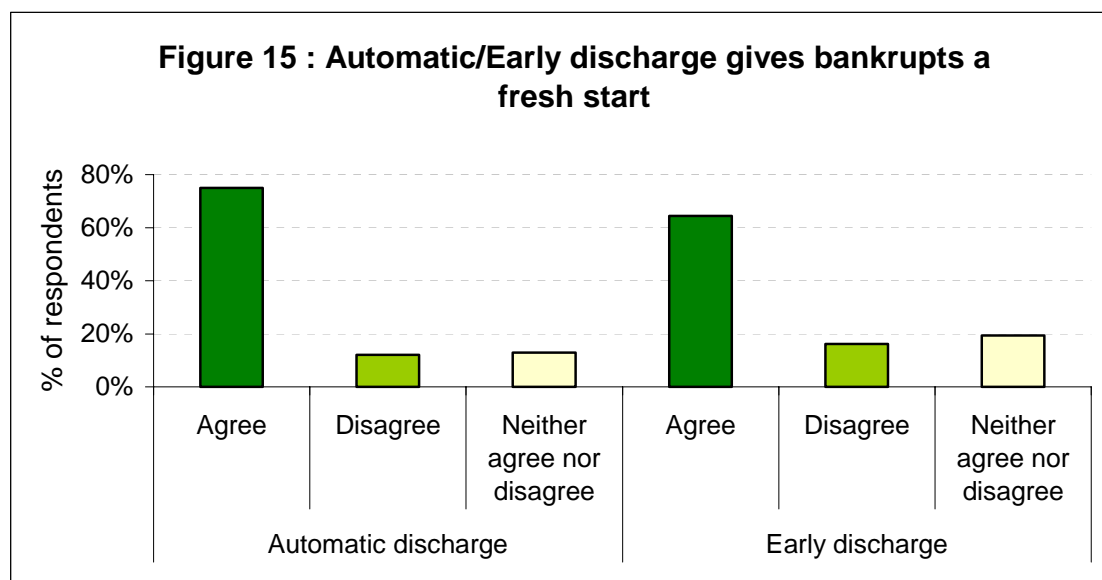
30. This overall reduction in the discharge periods means that under the Enterprise Act 2002, bankrupts are freed more quickly from the legal restrictions imposed under the Insolvency Act 1986, which should contribute to the prompt rehabilitation of those bankrupts. However, as detailed in section 3.1, the rehabilitation of bankrupts is being stifled by a lack of change in lender and credit reference agency policies, which, despite earlier discharge, will continue to deny bankrupts access to various types of financial products.

## 3.2 Evaluation of the Discharge provisions (continued)

### Rehabilitation of non-culpable bankrupts (continued)

31. Indeed, the bankrupts' discharge survey<sup>59</sup> showed that just over 25% of bankrupts had opened a bank account since being discharged from bankruptcy and less than 5% of bankrupts had started trading, obtained credit, traded under a name other than the one used in bankruptcy or become a company director since being discharged from bankruptcy.

32. However, despite bankrupts' limited access to financial products, 75% of bankrupts thought that automatic discharge after 1 year gave bankrupts a fresh start, and 64% of bankrupts thought that early discharge gave bankrupts a fresh start (see Figure 15). Bankrupts who received early discharge were more likely to agree that early discharge gave bankrupts a fresh start - around 70% of bankrupts who received early discharge agreed that early discharge gave bankrupts a fresh start, compared to around 55% of bankrupts who received automatic discharge.

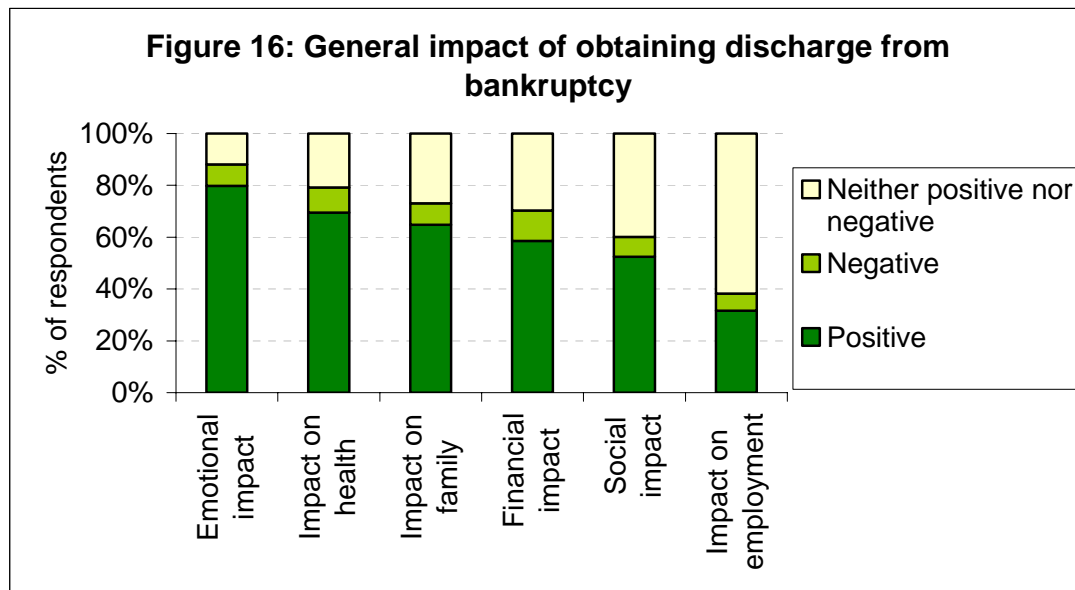


33. The reason that the majority of bankrupts agree that the shortened discharge provides a fresh start appears to be because, from a bankrupt's point of view, discharge has the greatest impact on a bankrupt emotionally, and the impact is, in the vast majority of cases, positive (see Figure 16).

<sup>59</sup> The Insolvency Service - Discharge from Bankruptcy  
<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/Discharge%20from%20bankruptcy.doc>

### 3.2 Evaluation of the Discharge provisions (continued)

#### Rehabilitation of non-culpable bankrupts (continued)



34. These results show that, currently, the rehabilitation of bankrupts offered through a shortened discharge period is psychological rather than financial. However, the value of early discharge is not clear. Although three-quarters of bankrupts agreed that an automatic discharge after 1 year offered a fresh start, less agreed that early discharge offered a fresh start (even of those who had received an early discharge). The reasons for this are unclear, although it may be connected with whether the discharge period gives a bankrupt sufficient time to 'learn' from their bankruptcy.

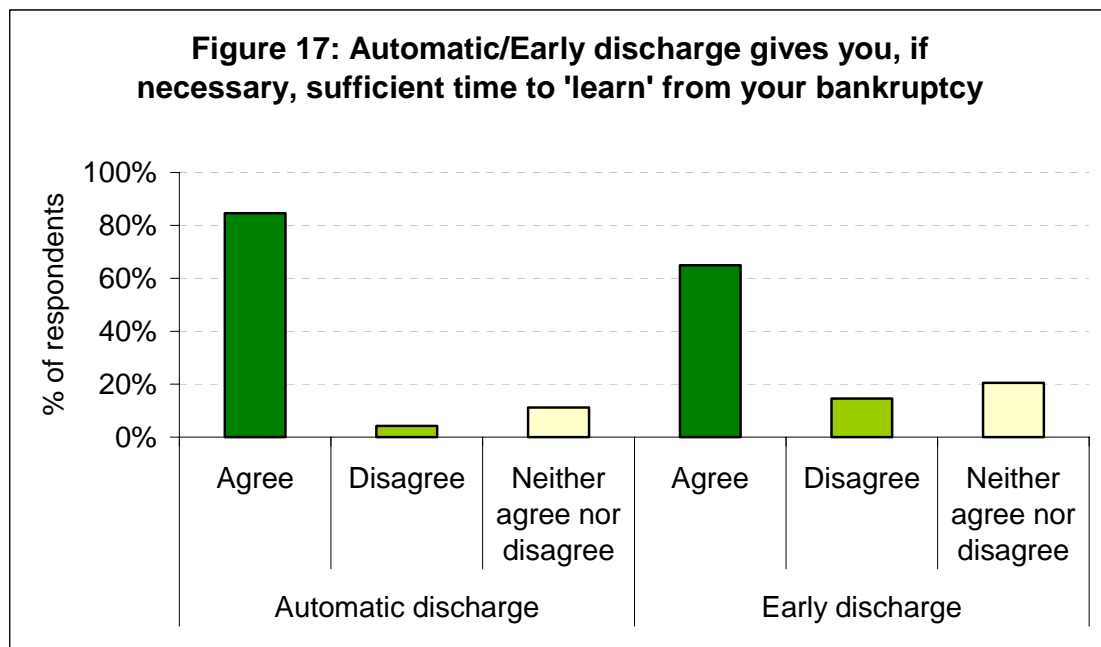
35. The bankrupts' discharge survey<sup>60</sup> showed that 85% of bankrupts agreed that automatic discharge after 1 year gives, if necessary, sufficient time to 'learn' from bankruptcy (see Figure 17). There was no real difference in responses received from those who received automatic or early discharge – 83% of bankrupts who received automatic discharge and 85% of bankrupts who received early discharge agreed that automatic discharge after 1 year gives, if necessary, sufficient time to 'learn' from bankruptcy.

<sup>60</sup> The Insolvency Service - Discharge from Bankruptcy  
<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/Discharge%20from%20bankruptcy.doc>

### 3.2 Evaluation of the Discharge provisions (continued)

#### Rehabilitation of non-culpable bankrupts (continued)

36. In contrast, 65% of bankrupts agreed that early discharge gives, if necessary, sufficient time to 'learn' from bankruptcy (see Figure 17). Bankrupts who received early discharge were more likely to agree that early discharge gives, if necessary, sufficient time to 'learn' from bankruptcy. Around three-quarters of bankrupts who received early discharge agreed that early discharge gives, if necessary, sufficient time to 'learn' from bankruptcy, compared to just under half of bankrupts who received automatic discharge. However, the proportion of bankrupts who received early discharge and agreed that it gives, if necessary, sufficient time to 'learn' from bankruptcy is less than the proportion who agreed that automatic discharge after 1 year gives, if necessary, sufficient time to 'learn' from bankruptcy.



37. These survey results show that bankrupts, regardless of their date of discharge, are more likely to think that automatic discharge after 1 year, rather than an earlier discharge, gives sufficient time, if necessary, to 'learn' from bankruptcy. This may explain why the bankrupts, regardless of their date of discharge, are more likely to think that automatic discharge after 1 year, rather than an earlier discharge, offers a fresh start – perhaps less than 1 year is seen as insufficient time for a bankrupt to reflect on, absorb and move on from the event of bankruptcy.

## 3.2 Evaluation of the Discharge provisions (continued)

### Rehabilitation of non-culpable bankrupts (continued)

38. It should also be noted that in the bankrupts' discharge survey<sup>61</sup>, bankrupts were asked whether the reduction in the automatic discharge period had reduced the stigma attached to bankruptcy. Around 40% of the bankrupts agreed that it had. Similarly, bankrupts were asked whether the early discharge provisions had reduced the stigma attached to bankruptcy. Again, around 40% of the bankrupts agreed that it had (see paragraph 76). Thus, early discharge does not appear to have any greater effect on reducing the stigma attached to bankruptcy than automatic discharge.

39. Therefore, the only benefit that early discharge provides compared to automatic discharge is the earlier lifting of the legal restrictions imposed under the Insolvency Act 1986. The value of this to bankrupts is negated by a lack of change in lender and credit reference agency policies, which, regardless of whether automatic or early discharge is obtained, will continue to deny bankrupts access to various types of financial products (see Section 3.1). In light of this evidence, it appears that early discharge serves no real purpose. Further, the process by which early discharge is obtained has resource implications for both the Official Receiver and the court.

40. The Insolvency Service's internal policy is that the Official Receiver should wait for 3 months after issuing the report to creditors before starting the early discharge process. The purpose of this time delay is to allow the opportunity for creditors to interact with the Official Receiver and make any representations they feel appropriate. In cases where the Official Receiver believes early discharge may be appropriate, the procedure set out below is followed:

- An income review is run on those cases in which there is not an IPO/A in force – this involves sending a letter to the bankrupt to confirm that there have been no change in circumstances which mean that an IPO/A may now be sought. If the bankrupt fails to respond to this letter within 21 days, the early discharge process stops.
- If a response is received within 21 days from the bankrupt, an IPO/A is sought in appropriate cases.
- The Official Receiver then sends notice of his intention to apply for early discharge to all creditors.
- The Official Receiver deals with any objections received from creditors and, if appropriate, the early discharge process stops.
- The Official Receiver then files notice of early discharge at court.
- The court then endorses and returns the notice to the Official Receiver. The date that the notice is filed at court is the date early discharge is deemed to have taken place.

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<sup>61</sup> The Insolvency Service - 'Discharge from Bankruptcy', available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/Discharge%20from%20bankruptcy.doc>

## 3.2 Evaluation of the Discharge provisions (continued)

### Rehabilitation of non-culpable bankrupts (continued)

41. In 2004/5, early discharge was granted in 18,790 cases. From internal records of The Insolvency Service, it appears that:

- 19,474 income review letters were sent, and 14,223 responses were received (which represents a 73% response rate). As a result of replies to the income review letter, action as regards obtaining an IPO/A was required in only 329 cases. Income review letters are not sent in cases where an IPO/A has already been obtained, where an insolvency practitioner has been appointed as trustee, or where the circumstances of the bankrupt mean the letter is unnecessary/undesirable, e.g. ill-health of bankrupt, bankrupt is retired, etc..
- The Official Receiver sent notice of his intention to apply for early discharge in around 19,000 cases. As each bankrupt has, on average, 7 creditors<sup>62</sup>, this equates to around 133,000 letters. The Official Receiver also sends notice to any insolvency practitioner appointed as trustee.
- The Official Receiver filed 18,790 notices of early discharge at court.

42. In 2005/6, early discharge was granted in 23,126 cases and is expected in around 25,800 cases in 2006/7<sup>63</sup>. Therefore, the number of letters sent in 2005/6 and 2006/7 will be higher.

43. Thus, it is clear that the early discharge process has considerable resource implications for the Official Receiver and, to a lesser extent, the court. Further, there are resource implications for creditors, many of whom will be businesses, in dealing with receipt of the letter. The only benefit the current process brings is the identification of further potential IPO/As – as detailed above, in 2004/5 this occurred in 329 cases, which represents less than 2% of cases where an income review letter was sent, and less than 1% of all bankruptcies in 2004/5. However, this part of the process could be separated from the early discharge procedure. Therefore, on the evidence available, early discharge imposes unnecessary burdens on businesses, the courts and the Official Receiver.

44. It is recommended that a detailed cost-benefit analysis of early discharge needs to be undertaken, as soon as possible, to assess whether the resources required to administer the early discharge process and the burdens placed on businesses, the courts and the Official Receiver are justified by the limited benefits afforded to bankrupts by being discharged in less than 1 year, and the identification of further potential IPO/As. If the resources are not justified, it is recommended that the early discharge provisions are repealed.

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<sup>62</sup> The average is the median of the number of creditors in the bankruptcy cases in 2004/5. See The Insolvency Service: Profiles of bankrupts 2003/4 – 2005/6 available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/profilesofBandC/Profilesbankrupts03040506.pdf>

<sup>63</sup> Assuming that early discharge is obtained in 40% of cases based on the figures for the 4 months ended 31 July 2007.

## 3.2 Evaluation of the Discharge provisions (continued)

### 'Second-time' bankrupts

45. The term 'second-time' bankrupt is used to refer to any bankrupt against whom a bankruptcy order has been made in the previous 15 years and there may be more than one previous bankruptcy order.

46. Under the Enterprise Act 2002, the discharge provisions are the same regardless of how many times an individual has been previously adjudged bankrupt. Prior to the Enterprise Act 2002, a 'second-time' bankrupt was not entitled to an automatic discharge from bankruptcy; the bankrupt could only apply to court for discharge five years after the commencement of bankruptcy. Therefore, a 'second-time' bankrupt was automatically subject to the restrictions of bankruptcy for a longer period.

47. The objective of the Enterprise Act 2002 provision is to not discriminate against 'second-time' bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver. The evaluation looks at the effect of the 'second-time' bankruptcy provisions – the level of 'second-time' bankrupts, 'second-time' bankrupt discharge periods, creditor satisfaction and loss – and discrimination against 'second-time bankrupts.

### Level of 'second-time' bankrupts

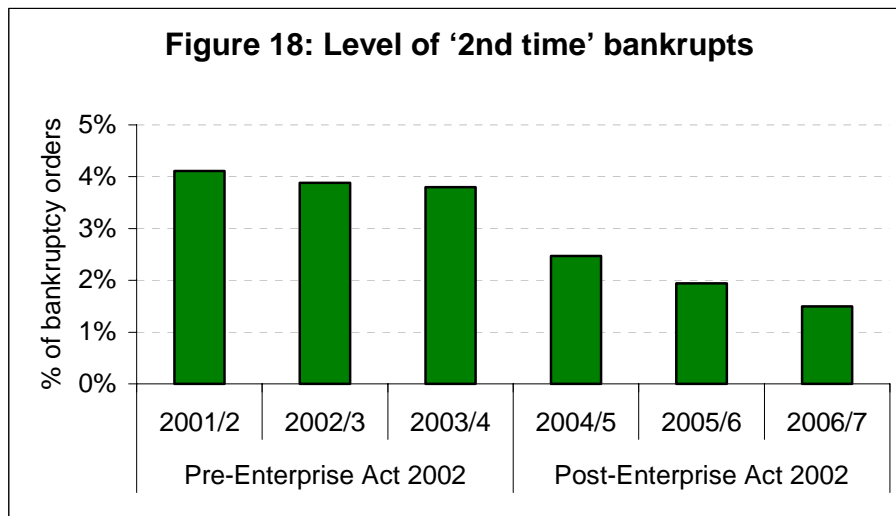
48. Prior to the Enterprise Act 2002, around 4% of bankrupts were 'second-time' bankrupts<sup>64</sup>. Since the implementation of the Act, the level of 'second-time' bankrupts has steadily fallen, and in 2006/7, around 1.5% of bankrupts were 'second-time' bankrupts<sup>64</sup> (see Figure 18). Therefore, it appears that the reduction in the discharge period for second-time bankrupts has not encouraged former bankrupts to enter into bankruptcy proceedings once again. Indeed, it is possible that the BRO regime introduced by the Enterprise Act 2002 may be having an impact (see paragraph 51).

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<sup>64</sup> This excludes cases where the first bankruptcy order was annulled.

### 3.2 Evaluation of the Discharge provisions (continued)

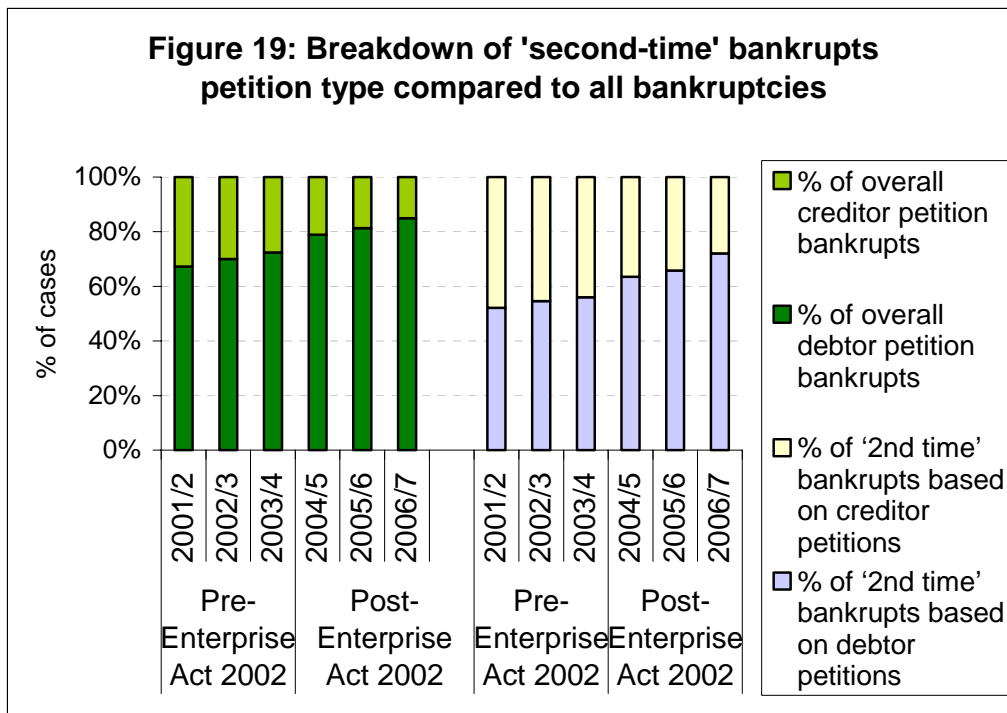
#### Level of 'second-time' bankrupts (continued)



49. Prior to the Enterprise Act 2002, just over half of bankruptcy orders against 'second-time' bankrupts were based on debtor petitions. Since the Enterprise Act 2002, this level has steadily increased almost three-quarters (see Figure 19). However, this rising trend in debtor petition cases is mirrored in all bankruptcies (see Figure 19). Further, both before and after the Enterprise Act 2002, the proportion of 'second-time' bankruptcies based on debtor petitions is around 15% lower than the proportion of all bankruptcies based on debtor petitions (see Figure 19). This suggests that both before and after the Enterprise Act 2002, 'second-time' bankrupts are less willing to initiate bankruptcy proceedings compared to 'first-time' bankrupts, regardless of the change in the 'second-time' discharge provisions.

### 3.2 Evaluation of the Discharge provisions (continued)

#### Level of 'second-time' bankrupts (continued)

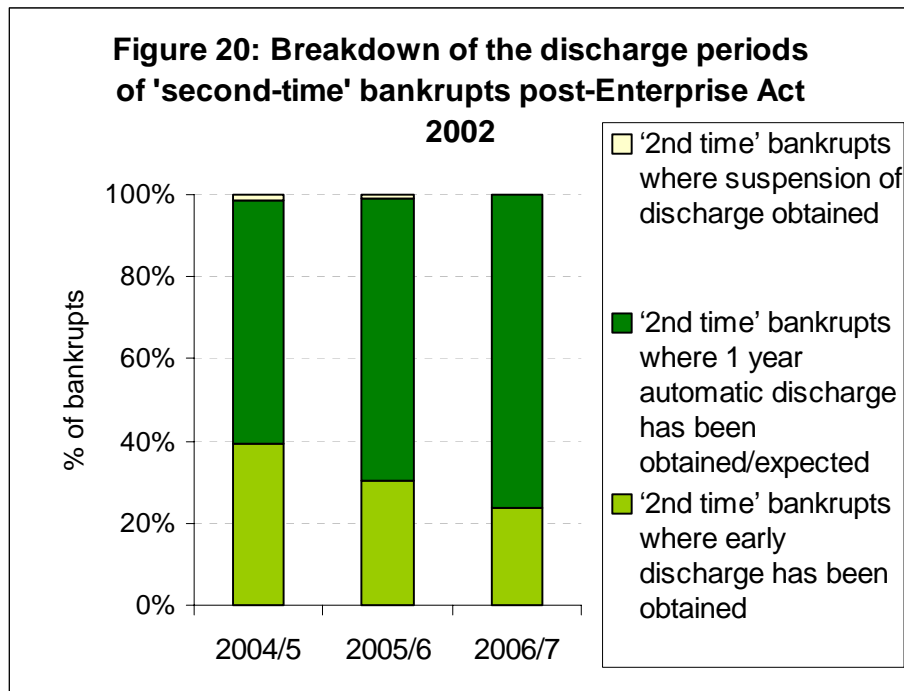


#### Second-time' bankruptcy discharge periods

50. Prior to the Enterprise Act 2002, based on a sampling exercise, the average discharge period for a 'second-time' bankrupt was around 10 years. Since the implementation of the Act, nearly all 'second-time' bankrupts are discharged in 1 year or less (see Figure 20).

## 3.2 Evaluation of the Discharge provisions (continued)

### Second-time' bankruptcy discharge periods (continued)



51. Under the Enterprise Act 2002, one of the grounds upon which a bankruptcy restrictions order (BRO) may be made is being a 'second-time' bankrupt (although it is highly likely that an application would only be made on this ground if there was associated misconduct). The restrictions imposed under a BRO are similar to those imposed whilst an undischarged bankrupt, and a BRO can last between 2 and 15 years. Therefore, it was possible that the change in 'second-time' bankruptcy discharge provisions could be counter-acted (or indeed, overshadowed) by the BRO provisions.

52. However, in the three years ended 31 March 2007, 2,732 BROs have been obtained, and in this period, only one BRO has been obtained where the most serious allegation relates to a 'second-time' bankruptcy. The BRO was for 3 years.

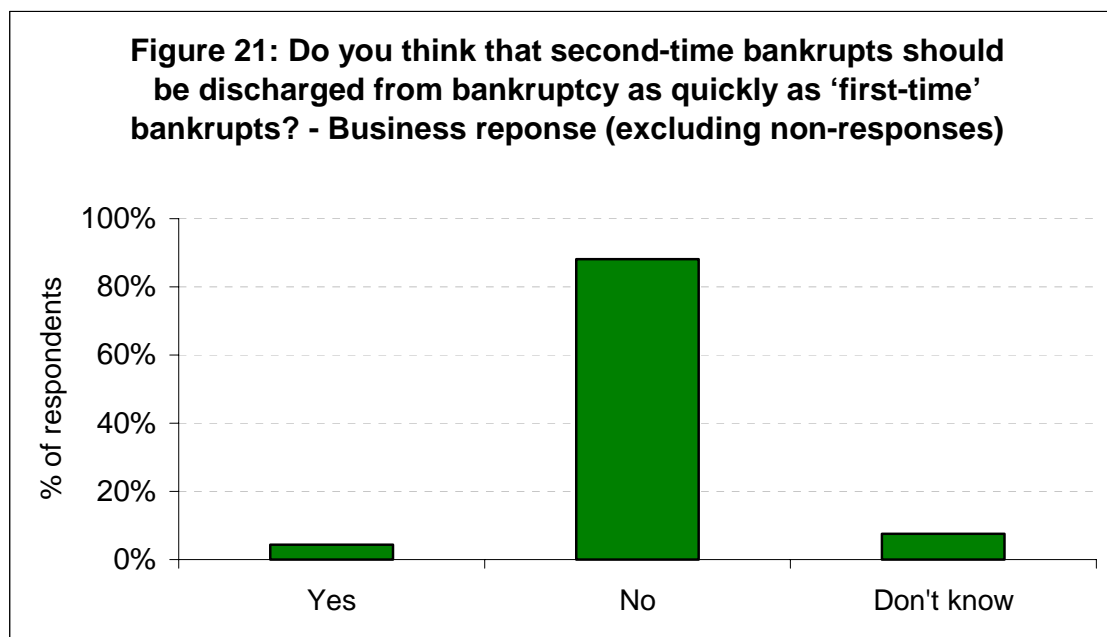
53. Therefore, 'second-time' bankrupts are now being discharged around 9 years earlier compared to prior to the Enterprise Act 2002, and they are discharged under the same terms as 'first-time' bankrupts.

## 3.2 Evaluation of the Discharge provisions (continued)

### Creditor satisfaction with the 'second-time' bankruptcy provisions

54. The Insolvency Service has not received any complaints regarding the 'second-time' bankruptcy discharge provisions in the 3 years before or the 3 years after the implementation of the Enterprise Act 2002. However, creditors do not appear to support the reduction in the discharge period for 'second-time' bankrupts<sup>65</sup>.

55. Further, a survey of businesses showed that nearly 90% of businesses do not think that 'second-time' bankrupts should be discharged from bankruptcy as quickly as 'first-time' bankrupts (see Figure 21).



56. Thus, it appears that businesses do not support the reduction in the discharge period for 'second-time' bankrupts. In general terms, businesses believe that a 'penalty' for becoming bankrupt more than once (such as a longer discharge period for 'second-time' bankrupts) acts as a deterrent. However, as detailed in paragraph 48, the level of 'second-time' bankrupts has actually fallen since the implementation of the Enterprise Act 2002. Therefore, it does not appear that the reduction in the discharge period for 'second-time' bankrupts introduced by the Enterprise Act 2002 has encouraged former bankrupts to enter into bankruptcy proceedings once again. Indeed, it is possible that the BRO regime introduced by the Enterprise Act 2002 may be acting as a deterrent (see paragraph 51).

<sup>65</sup> Based on information provided by the British Bankers' Association (BBA) and the Institute of Credit Management (ICM)

## 3.2 Evaluation of the Discharge provisions (continued)

### Creditor loss due to 'second-time' bankruptcy provisions

57. There are no known cases pre-Enterprise Act 2002 where there was an increase in the monies claimed under an Income Payments Orders, or a claim on an asset as after acquired property, after one year from the date of the bankruptcy order in 'second-time' bankruptcy cases, or orders recently made against the property or income on a discharge application of a 'second-time' bankrupt<sup>66</sup>. Therefore, it does not appear that the reduction in the discharge period for 'second-time' bankrupts has impacted on returns to creditors.

### Discrimination against 'second-time' bankrupts

58. As detailed at paragraph 53, 'second-time' bankrupts are now discharged under the same terms as 'first-time' bankrupts.

59. Credit reference agencies keep a record of a bankruptcy order for 6 years, together with a record of discharge where appropriate. In most cases, there is no link to any previous bankruptcy order. This has remained unchanged by the introduction of the Enterprise Act 2002.

60. Mainstream financial institutions have broadly similar policies in dealing with bankrupts. Prior to the Enterprise Act 2002, in general terms, it appears that 'second-time' bankrupts are treated the same as 'first-time' bankrupts; 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>67</sup>. Therefore, as for 'first-time' bankrupts, although under post-Enterprise Act 2002 'second-time' bankrupts are being discharged from bankruptcy quicker, the record of the bankruptcy order will remain on their credit reference file for the same period of time. Given lender policies, this means that the reduced duration of bankruptcy will have a limited impact on a 'second-time' bankrupt's ability to obtain credit facilities, albeit that the statutory restrictions regarding obtaining credit are removed earlier.

61. In summary, 'second-time' bankrupts are treated the same as 'first-time' bankrupts – they are discharged under the same terms and have the same ability to obtain credit facilities.

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<sup>66</sup> A request was made to insolvency practitioners (via the publication 'Dear IP') and Insolvency Service staff for details of any cases where money had been obtained through an increase in an Income Payments Order or claimed as after acquired property after one year from the date of the bankruptcy order pre-Enterprise Act 2002. No such cases were identified.

<sup>67</sup> Based on information provided by members of the British Bankers' Association (BBA), which BBA advise is broadly representative of the industry position.

## 3.2 Evaluation of the Discharge provisions (continued)

### Suspension of discharge applications

62. Prior to the introduction of the Enterprise Act 2002, only the Official Receiver could apply to court for an order suspending the discharge of a bankrupt. Therefore, an insolvency practitioner (IP) appointed as trustee needed to report any non-cooperation matters to the Official Receiver, who would then apply for a suspension of discharge order based on the facts provided by the IP. Under the Enterprise Act 2002, the IP appointed as trustee can apply to the court directly for such an order.

63. The objective of this provision was to speed up the process of suspending the discharge of a bankrupt due to non-co-operation where a trustee other than the Official Receiver has been appointed. The evaluation looks at the level and speed of suspension of discharge applications where an IP has been appointed trustee, and an IP's satisfaction with this new power.

#### Level of suspension of discharge applications where an insolvency practitioner (IP) has been appointed trustee

64. Based on the results of a case sampling exercise, it appears that pre-Enterprise Act 2002, around 11% of suspension of discharges obtained by the Official Receiver were based on requests from IPs (as trustees). Therefore, suspensions of discharge were obtained in less than 2% of cases that were handed over to IPs (see Table 4).

**Table 4: Level of suspensions of discharge obtained in cases where an IP was appointed trustee pre-Enterprise Act 2002**

	2001/2	2002/3	2003/4
Number of cases where an IP has been appointed trustee <sup>68</sup>	6,523	6,505	5,042
Estimate of the number of cases where the Official Receiver obtained a suspension of discharge on an IP's request (calculated at 11% of a suspensions obtained)	114	108	100
% of cases handed over to an IP where a suspension of discharge was obtained	<b>1.74%</b>	<b>1.67%</b>	<b>1.99%</b>

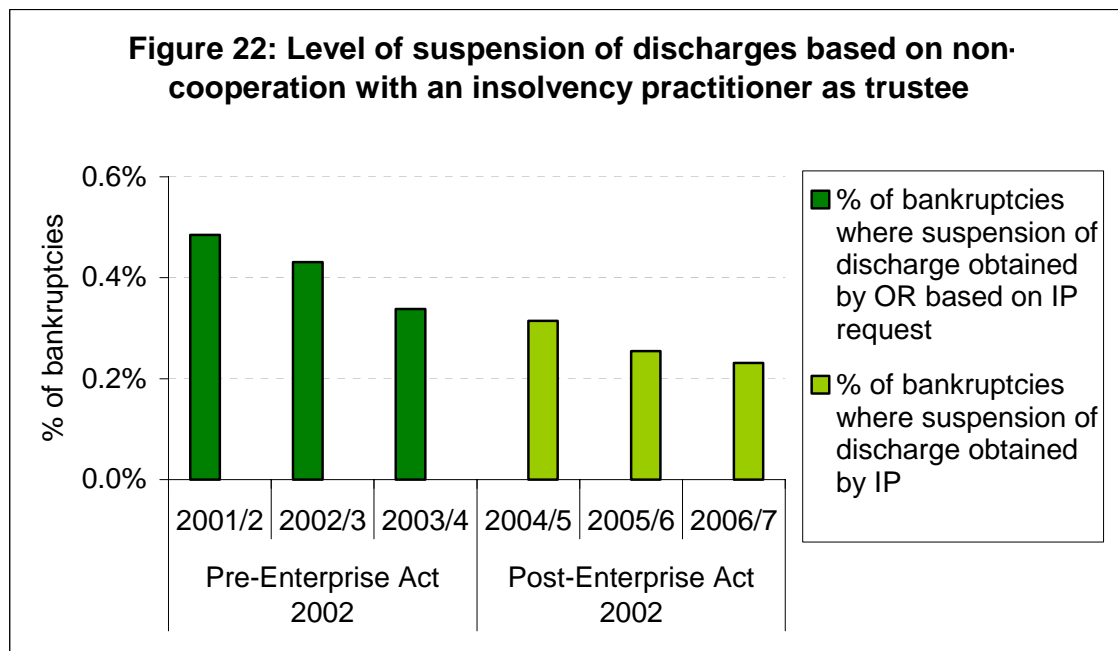
65. Based on the results of a case sampling exercise, it appears that post-Enterprise Act 2002, suspensions of discharge were obtained in around 2.5% of cases that were handed over to IPs.

<sup>68</sup> Information based on The Insolvency Service's performance data

### 3.2 Evaluation of the Discharge provisions (continued)

#### Level of suspension of discharge applications where an insolvency practitioner (IP) has been appointed trustee (continued)

66. When comparing the level of suspension of discharges obtained by the Official Receiver based on an IP's request pre-Enterprise Act 2002 and the level of suspensions obtained by IPs post-Enterprise Act 2002 to the overall level of bankruptcies, it can be seen that the level of such cases has fallen since the implementation of the Act (see Figure 22), However, this appears to be part of a trend established before the Act and is consistent with the fall in the overall level of suspension of discharges (see paragraph 19).



67. Post-Enterprise Act 2002, there are cases where a bankrupt has not co-operated with the IP appointed as trustee, but the trustee did not apply for a suspension of discharge. Based on the case sampling exercise, this happens in less than 0.5% of bankruptcies<sup>69</sup>. The main reasons given were that the suspension was unnecessary as it would not lead to any financial benefit to the estate and because the bankrupt was already discharged (see Table 5).

<sup>69</sup> Based on the case sampling exercise, it is estimated that there was non-cooperation with an IP as trustee, but no suspension was applied for in 3.85% of cases handed over to trustees. This equates to around 0.48%, 0.39% and 0.36% of bankruptcies in 2004/5, 2005/6 and 2006/7 respectively.

### 3.2 Evaluation of the Discharge provisions (continued)

Level of suspension of discharge applications where an insolvency practitioner (IP) has been appointed trustee (continued)

**Table 5: Reasons why an IP as trustee did not apply for a suspension of discharge (SOD) in non-cooperation cases post-Enterprise Act 2002**

	<b>% of cases</b>
No purpose in suspension - would not lead to financial benefit to estate	27.94%
Bankrupt already discharged	20.59%
SOD under consideration	10.29%
Official Receiver applied	10.29%
Threat of SOD led to cooperation	7.35%
Discharge already suspended	5.88%
Age/Illness of bankrupt	4.41%
No monies to fund application	2.94%
Not sufficient non-cooperation for suspension	2.94%
Other	7.35%

68. Therefore, it appears that the shortened automatic discharge period has affected an IP's ability to apply for a suspension of discharge in all appropriate cases. However, it should be noted that this only happens in a handful of cases – based on the case sampling exercise, an IP was not been able to apply for a suspension of discharge because the bankrupt was already discharged in less than 50 bankruptcies per year. Therefore, the impact is negligible.

The timeliness of suspension of discharge applications where an IP has been appointed trustee

69. Prior to the introduction of the Enterprise Act 2002, as only the Official Receiver could apply to court for an order suspending the discharge of a bankrupt, an IP appointed as trustee needed to report any non-cooperation matters to the Official Receiver, who would then apply for a suspension of discharge order based on the facts provided by the insolvency practitioner. Based on the results of a case sampling exercise, the average time between the date of such a request and the application for a suspension of discharge was 54 days.

## 3.2 Evaluation of the Discharge provisions (continued)

### The timeliness of suspension of discharge applications where an IP has been appointed trustee (continued)

70. Under the Enterprise Act 2002, the IP appointed as trustee can apply to the court directly for such an order. Based on the results of a case sampling exercise, the average time between the IP establishing non-cooperation<sup>70</sup> and making application for a suspension of discharge is 39 days.

71. Therefore, applications for suspension of discharge are being made quicker after the Enterprise Act 2002, compared to before the Act.

### Insolvency Practitioner (IP) satisfaction with power to apply for a suspension of discharge

72. As detailed in paragraph 65, the case sampling exercise shows that IPs are using the power to apply for a suspension of discharge. Further, The Insolvency Service is aware of insolvency practitioners who regard this power as a useful new 'weapon' for them.

73. However, the Insolvency Service has become aware of various cases where the IP has requested that the Official Receiver applies for the suspension of discharge, as there are no assets in the estate, e.g. where a trustee is appointed by creditor request to "investigate" aspects of the case, and therefore, the trustee is unable to pay for the application. In such cases, the IPs have asked the Official Receiver to fulfil a "public interest" role and make the application on their behalf.

74. Based on the case sampling exercise, having insufficient funds in the estate to pay for the application is only given as a reason in 3% of cases where a suspension of discharge was not applied for in cases where there was non-cooperation (see Table 5) – this equates to less than 10 cases per year.

75. The Insolvency Service has refused to make such applications (unless there are good reasons why the Official Receiver would apply for the suspension, such as the information needed by the IP may result in or coincide with investigation by the Official Receiver) on the grounds that:

- Presumably the trustee will only be seeking co-operation from the bankrupt in connection with realisation or distribution of assets. Therefore, the trustee's desire to obtain information from the bankrupt is likely to be related to trustee matters (rather than matters under the remit of the Official Receiver) and it is right that the trustee should make such application.

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<sup>70</sup> The date that the IP established non-cooperation is defined as the last occasion that the IP attempted to make contact with the bankrupt prior to making application for a suspension of discharge.

## 3.2 Evaluation of the Discharge provisions (continued)

### Insolvency Practitioner (IP) satisfaction with power to apply for a suspension of discharge

- The costs involved in making a suspension application are not excessive. There is the court fee for the application, but this is relatively small. Admittedly the Official Receiver does not have to pay this fee, as he makes applications for suspension of discharge as Official Receiver (and in any event for the most part makes them verbally in connection with a public examination). Many trustees may want a solicitor to carry out the application for them, but if the money is not available for this (or in any event) this is a task that the trustee could carry out himself. Applications are straightforward to prepare and take little time in court. There would be the trustee's time costs, but this is little different to any work being carried out by an IP or his staff on a case and then no assets being realised. Further, from the case sampling exercise, 54% of IPs who have applied for a suspension of discharge post-Enterprise Act 2002 did not use legal representation.
- The trustee could ask creditors to put up the funds for the application if the sum involved were significant (but the creditors might then want to know why it is significant) and if they are not interested, he could reasonably take no action.

### **Stigma of bankruptcy**

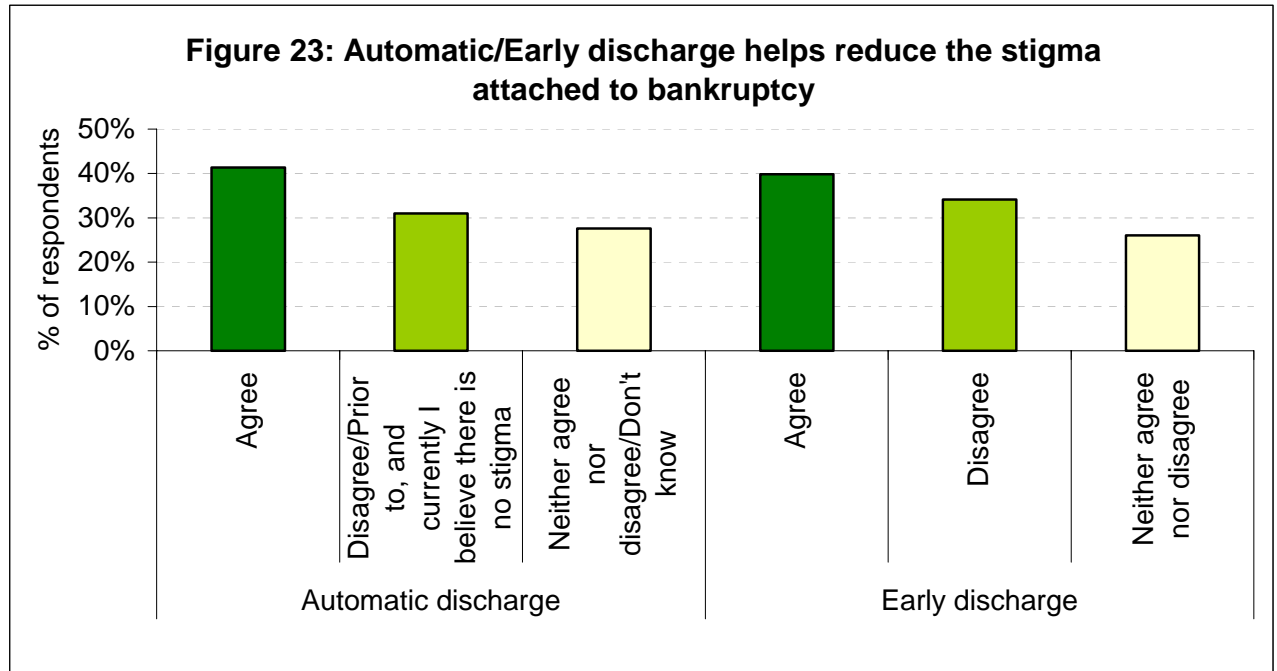
76. In the bankrupts' discharge survey<sup>71</sup>, bankrupts were asked whether the reduction in the automatic discharge period had reduced the stigma attached to bankruptcy. Around 40% of the bankrupts agreed that it had (see Figure 23). Similarly, bankrupts were asked whether the early discharge provisions had reduced the stigma attached to bankruptcy. Again, around 40% of the bankrupts agreed that it had (see Figure 23).

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<sup>71</sup> The Insolvency Service - 'Discharge from Bankruptcy', available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/Discharge%20from%20bankruptcy.doc>

## 3.2 Evaluation of the Discharge provisions (continued)

### Stigma of bankruptcy (continued)



77. However, the reduction of the discharge period under the Enterprise Act 2002 does not appear to have yet impacted on the level of stigma attached to bankruptcy. As detailed in section 3.1, overall<sup>72</sup>, there is a stigma associated with bankruptcy both before and after the implementation of the Enterprise Act 2002, and that the level of perceived stigma has not significantly changed.

78. Bankrupts, businesses and individuals identified the length of time bankruptcy restrictions are imposed, i.e. the discharge period, as one of the least significant effects of bankruptcy contributing towards the creation of stigma both before and after the Enterprise Act 2002 (see Table 6).

79. Therefore, it appears that in theory, the reduction in the discharge period should have some effect on the level of stigma associated with bankruptcy. However, to date, the reduction in the discharge period has had no impact. This may be due to the other effects of bankruptcy, which are considered to have greater impact, being unchanged under the Enterprise Act 2002. These include not being able to repay creditors, problems getting a bank account and the effect on credit rating (see Table 6).

<sup>72</sup> This overall opinion is the combination of the survey results of bankrupts, individuals and businesses, and is an average of these sectors' responses, i.e. each sector has been given equal weighting. As regards the survey results of just bankrupts, prior to the Enterprise Act 2002, 83% of bankrupts thought there was a stigma associated with bankruptcy and post-Enterprise Act 2002, 85% of bankrupts thought there was such a stigma.

### 3.2 Evaluation of the Discharge provisions (continued)

#### Stigma of bankruptcy (continued)

**Table 6: Creation of stigma due to the effects of bankruptcy – Percentages that agree by sector in 2006 and 2004**

	2006			2004		
	Bankrupts	Business	Individuals	Bankrupts	Business	Individuals
<b>Not being able to repay creditors</b>	<b>93%</b>	<b>89%</b>	<b>38%</b>	<b>88%</b>	<b>90%</b>	<b>71%</b>
<b>Problems getting a bank account</b>	<b>84%</b>	<b>84%</b>	<b>58%</b>	<b>76%</b>	<b>86%</b>	<b>64%</b>
<b>Effect on credit rating</b>	<b>79%</b>	<b>82%</b>	<b>57%</b>	<b>70%</b>	<b>85%</b>	<b>69%</b>
<b>Investigation of financial affairs</b>	<b>74%</b>	<b>71%</b>	<b>57%</b>	<b>60%</b>	<b>73%</b>	<b>66%</b>
<b>Possible loss of income</b>	<b>70%</b>	<b>72%</b>	<b>59%</b>	<b>57%</b>	<b>70%</b>	<b>63%</b>
<b>Imposed restrictions</b>	<b>66%</b>	<b>63%</b>	<b>59%</b>	<b>54%</b>	<b>63%</b>	<b>56%</b>
<b>Possible loss of other assets</b>	<b>64%</b>	<b>71%</b>	<b>60%</b>	<b>59%</b>	<b>73%</b>	<b>59%</b>
<b>Not being able to obtain credit</b>	<b>57%</b>	<b>81%</b>	<b>57%</b>	<b>49%</b>	<b>85%</b>	<b>68%</b>
<b>Length of time restrictions imposed</b>	<b>56%</b>	<b>48%</b>	<b>49%</b>	<b>42%</b>	<b>48%</b>	<b>46%</b>
<b>Possible loss of family home</b>	<b>49%</b>	<b>82%</b>	<b>62%</b>	<b>50%</b>	<b>83%</b>	<b>69%</b>

## 3.2 Evaluation of the Discharge provisions (continued)

### Summary

#### **To enable the prompt rehabilitation of bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver**

- As a result of the implementation of the Enterprise Act 2002, all bankrupts (unless their discharge has been suspended) are discharged from bankruptcy quicker - over 95% of bankrupts are now discharged in one year or less, compared to just over 25% and around 65% of bankrupts being discharged in two and three years respectively prior to the Enterprise Act 2002 (see paragraphs 5-9).
- Early discharge has been granted in around 50% and 43% of bankruptcy cases in 2004/5 and 2005/6 respectively and in such cases, the average discharge period is around 7 months (see paragraphs 10-14).
- The shortened discharge period means that under the Enterprise Act 2002, bankrupts are freed more quickly from the legal restrictions imposed under the Insolvency Act 1986. However, as detailed in section 3.1, the rehabilitation of bankrupts is being stifled by a lack of change in lender and credit reference agency policies, which, despite earlier discharge, will continue to deny bankrupts access to various types of financial products (see paragraphs 30-31).
- For bankrupts, the majority believe that the shortened discharge provides a fresh start because, from a bankrupt's point of view, discharge has the greatest impact on a bankrupt emotionally, and the impact is, in the vast majority of cases, positive (see paragraphs 32-33).
- However, the benefit of early discharge compared to automatic discharge after 1 year is not clear. Bankrupts, regardless of their date of discharge, are more likely to think that automatic discharge after 1 year, rather than an earlier discharge, offers a fresh start and are more likely to think that automatic discharge after 1 year, rather than an earlier discharge, gives sufficient time, if necessary, start to 'learn' from bankruptcy. This indicates that perhaps less than 1 year is seen as insufficient time for a bankrupt to reflect on, absorb and move on from the event of bankruptcy (see paragraphs 34-37).
- In general terms, businesses do not agree that bankrupts should be discharged from bankruptcy quicker. However, there is no real evidence that the shortened discharge period has adversely materially affected businesses (see paragraphs 25-26).

## 3.2 Evaluation of the Discharge provisions (continued)

### Summary (continued)

#### **To not discriminate against 'second-time' bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver**

- Prior to the Enterprise Act 2002, the average discharge period for a 'second-time' bankrupt was around 10 years. Since the implementation of the Act, nearly all 'second-time' bankrupts, as with 'first-time' bankrupts, are discharged in 1 year or less (see paragraph 50).
- It appears that businesses do not support the reduction in the discharge period for 'second-time' bankrupts, and believe that a 'penalty' for becoming bankrupt more than once (such as a longer discharge period for 'second-time' bankrupts) acts as a deterrent. However, the level of 'second-time' bankrupts has actually fallen since the implementation of the Enterprise Act 2002 from around 4% to around 1.5% of all bankrupts (see paragraphs 54-56).
- As with 'first-time' bankrupts, although under post-Enterprise Act 2002 'second-time' bankrupts are being discharged from bankruptcy quicker, the record of the bankruptcy order will remain on their credit reference file for the same period of time. Given lender policies, this means that the reduced duration of bankruptcy will have a limited impact on a 'second-time' bankrupt's ability to obtain credit facilities, albeit that the statutory restrictions regarding obtaining credit are removed earlier (see paragraphs 58-61).

#### **To speed up the process of suspending the discharge of a bankrupt due to non-co-operation where a trustee other than the Official Receiver has been appointed**

- IPs appointed as trustees are making applications for suspension of discharge under the new power introduced by the Enterprise Act 2002, and such applications are being made quicker under these provisions compared to pre-Act provisions (see paragraphs 64-71)

#### **To help lift the stigma of bankruptcy**

- In theory, the reduction in the discharge period should have some effect on the level of stigma associated with bankruptcy. However, to date, the reduction in the discharge period has had no impact (see paragraphs 76-79).

## 3.2 Evaluation of the Discharge provisions (continued)

### Recommendations

- That The Insolvency Service undertakes a detailed cost-benefit analysis of early discharge, as soon as possible, to assess whether the resources required to administer the early discharge process and the burdens placed on businesses, the courts and the Official Receiver are justified by the limited benefits afforded by early discharge, with a view to repealing the provisions (see paragraphs 39-44).
- Subject to the results of the cost-benefit analysis, The Insolvency Service should review the early discharge process to ascertain whether delays in obtaining early discharge caused by process elements can be eliminated (see paragraphs 15-17)
- That The Insolvency Service continues to work with credit reference agencies and lenders to ensure lending policies appropriately reflect a bankrupt's discharge (see paragraphs 30-31).
- To re-run biennial surveys to assess overall attitudes to bankruptcy and the effect of the reduction in the discharge period (see paragraphs 76-79).

### **3.3 Evaluation of the Bankruptcy Restrictions Order provisions**

1. This section of the report contains evaluation evidence regarding the achievement of the intermediate objectives of the Bankruptcy Restrictions Order (BRO) provisions contained in the Enterprise Act 2002. The objectives of these provisions 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.

2. The Insolvency Service has published a separate report entitled 'A study of the bankruptcy enforcement regime before and after the Enterprise Act 2002'<sup>73</sup>. This report contains evidence contributing to the evaluation of the BRO regime.

#### **Protection of the public and commercial community**

3. Prior to the Enterprise Act 2002, prosecution was the only option available to deal with bankrupts whose conduct warranted further action (and suspension of discharge in cases of non-cooperation – see Section 3.2 paragraph 7). The Enterprise Act 2002 contains provisions whereby the court can make a BRO where the conduct of the bankrupt both before and during his bankruptcy shows that the public requires protection. BROs place restrictions on the most culpable bankrupts from between 2 and 15 years and are designed to provide protection for the public and a civil alternative to prosecution, with a correspondingly lower level of proof. In short, a prosecution is designed to penalise whereas a BRO is designed to protect.

4. Additionally, a bankrupt can offer a Bankruptcy Restrictions Undertaking (BRU) to the Secretary of State, who will consider the BRO matters in deciding whether to accept the undertaking. A BRU has the same effect as a BRO.

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<sup>73</sup> The Insolvency Service – 'A study of the bankruptcy enforcement regime before and after the Enterprise Act 2002' can be accessed at:  
<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/enforcementreport.pdf>

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Protection of the public and commercial community (continued)

5. Where a BRO/BRU is in force, it is a criminal offence for the (former) bankrupt to:

- (a) act as a receiver or manager of the property of a company or on behalf of debentureholders;
- (b) act as an IP;
- (c) act as a director of a company, or directly or indirectly to take part in or be concerned in the promotion, formation or management of a company without the leave of court;
- (d) obtain credit of more than the prescribed limit; and
- (e) carry on business under a name other than that in which he was adjudged bankrupt without disclosing the name under which he was adjudged bankrupt.

In this report, the term "BRO(s)" is used to cover Bankruptcy Restriction Orders and Bankruptcy Restriction Undertakings.

6. As regards the protection of the public and commercial community provided by the BRO regime, the evaluation looks at the level of BROs obtained (including interim BROs), the length of BROs, breaches of BROs and customer satisfaction with the way culpable bankrupts are dealt with.

#### Level of BROs obtained

7. The level of BROs obtained has steadily risen since the BRO regime was introduced by the implementation of the Enterprise Act 2002 (see Table 7). However, it was anticipated that BRO figures for the initial years would be lower than in future years as BRO action can only be taken in respect of conduct after 1 April 2004.

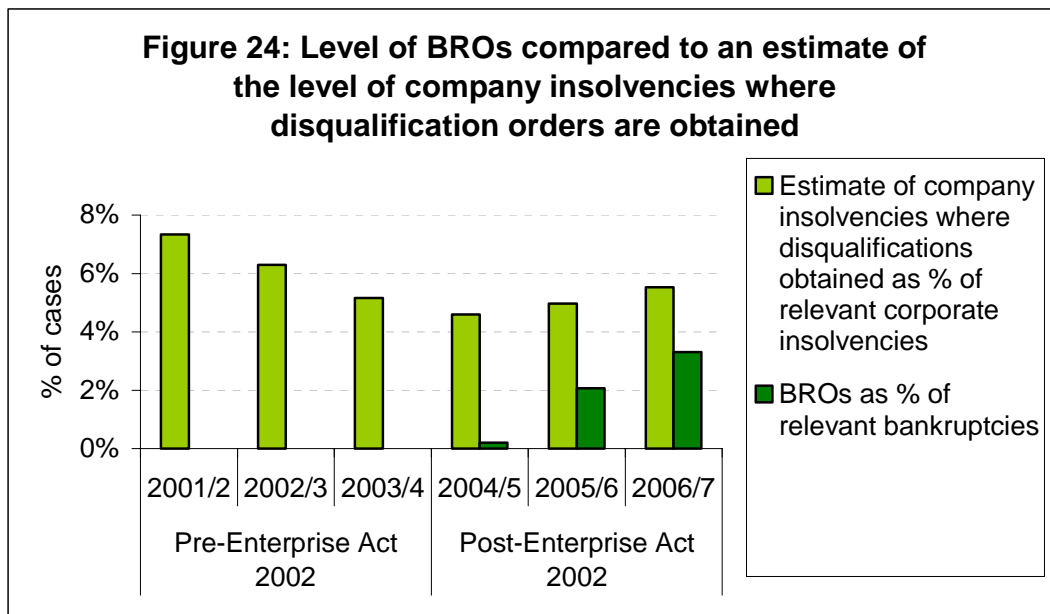
	<b>2004/5</b>	<b>2005/6</b>	<b>2006/7</b>
<b>Number of BROs</b>	<b>22</b>	<b>843</b>	<b>1,867</b>
Number of relevant bankruptcies <sup>74</sup>	9,060	40,840	56,537
<b>BROs as % of relevant bankruptcies</b>	<b>0.20%</b>	<b>2.06%</b>	<b>3.30%</b>

<sup>74</sup> Based on statistics published by The Insolvency Service (previously the DTI Statistics Directorate) (not seasonally adjusted). The number of bankruptcies has been lagged by 9 months. This is to reflect the time taken to obtain a BRO/U from the date of the bankruptcy order. According to internal data held by The Insolvency Service, the average time taken to obtain a BRO/U in 2004/5, 2005/6 and 2006/7 is 6.9 months, 8.9 and 10.4 months respectively. Further, BRO/U action can only be taken in respect of conduct after 1 April 2004. Accordingly, the 2004/5 relevant bankruptcies represent the level of bankruptcies in the 3 months to 30 June 2004, and the relevant bankruptcies for 2005/6 are the level of bankruptcies in the year ended 30 June 2005.

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Level of BROs obtained (continued)

8. In the Regulatory Impact Assessment for the Enterprise Act 2002, it was anticipated that BROs would be obtained in 7 – 12% of bankruptcy cases. This was based on the level of disqualification action at that time in corporate cases<sup>75</sup>. However, disqualification orders can be obtained against more than one director in a company case. It is estimated that, on average, the ratio of company cases where disqualification action is taken to the number of disqualification orders/undertakings is 2:3<sup>76</sup>. Currently, the level of BROs is lower compared to an estimate of the level of company insolvencies where disqualification orders are obtained (see Figure 24).



9. As previously stated, prior to the introduction of the BRO regime, the only enforcement action available in bankruptcy was prosecution and the power to suspend the discharge of a bankrupt who fails to co-operate with the Official Receiver or trustee. Where evidence of criminal misconduct comes to light, the Official Receiver submits a statement of facts to The Insolvency Service’s Criminal Allegations Team who decide whether the case should be referred for criminal investigation. In some cases, no further action is taken where there is insufficient evidence of criminality.

<sup>75</sup> This is based on the assumption that as the BRO provisions are broadly analogous to the provisions of the Company Directors Disqualification Act 1986, it is reasonable to expect that in percentage terms, the level of civil misconduct in bankruptcy cases would be similar to that seen in corporate cases. Therefore, it may be expected that a similar level of BROs will be achieved as disqualification orders.

<sup>76</sup> A sample of disqualification cases in 2006/7 shows that 591 disqualification orders/undertakings were obtained in connection with misconduct in 403 corporate insolvencies.

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Level of BROs obtained (continued)

10. The level of BROs obtained is now broadly similar to the level of bankruptcy statement of facts submitted in the periods prior to the Enterprise Act 2002<sup>77</sup>. The level of cases where a suspension of discharge was obtained was falling prior to the implementation of the Enterprise Act 2002. It then rose in the year after the implementation of the Act, and has fallen since (see Section 2.3 paragraph 19).

#### Level of interim BROs obtained

11. An interim BRO can be applied for in the period between the application for a BRO and the hearing date. The court can grant an interim BRO if there are prima facie grounds to suggest that a BRO will be granted and it is in the public interest to make an interim order. An interim BRO comes into force the day it is made and has the same effect as a BRO.

12. No interim BROs were obtained in the first year of the BRO regime, but 119 have been obtained thereafter (see Table 8).

	<b>2004/5</b>	<b>2005/6</b>	<b>2006/7</b>
<b>Number of interim BROs</b>	<b>0</b>	<b>47</b>	<b>72</b>
Number of BROs	22	843	1,867
<b>Interim BROs as % of BROs</b>	<b>0.00%</b>	<b>5.58%</b>	<b>3.86%</b>

<sup>77</sup> Bankruptcy statement of facts were submitted in 3.73%, 3.11% and 1.58% of bankruptcies in the periods 2001/2, 2002/3 and 2003/4 respectively.

### **3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)**

#### Level of interim BROs obtained (continued)

13. An application for a BRO must usually be made within 12 months of the bankruptcy order<sup>78</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. 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>79</sup>. This may explain why the level of interim BROs has fallen in 2006/7 compared to the previous year.

14. As regards the 119 interim BROs obtained in the 3 years ended 31 March 2007, substantive BROs have been made in all except 7 cases. The BRO application was withdrawn in 5 cases due to new evidence arising after the interim BRO was obtained which meant that it was not in the public interest to proceed with the BRO application. The BRO proceedings are on-going in the remaining 2 cases.

15. Therefore, it appears that interim BROs are being obtained in appropriate cases.

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<sup>78</sup> Schedule 4A of the Insolvency Act 1986

<sup>79</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.

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Length of BROs

16. The average length of a BRO is around 5 years, which is broadly consistent with the average length of a disqualification order (see Table 9). Bankrupts who fully co-operate with the Official Receiver/trustee are discharged from bankruptcy in 1 year or less. Therefore, on average, culpable bankrupts are subject restrictions for an extra 4 years.

**Table 9: Length of disqualification orders and BROs**

		years					
		Pre-Enterprise Act 2002			Post-Enterprise Act 2002		
		2001/2	2002/3	2003/4	2004/5	2005/6	2006/7
<b>Length of Disqualifications</b>	<b>Median</b>	5	5	5	5	5	5
	<b>Average</b>	5.4	5.4	5.2	5.5	5.2	5.5
<b>Length of BROs</b>	<b>Median</b>				5	5	4
	<b>Average</b>				5.5	5.3	4.8

#### Breaches of BROs

17. To date, there have been no known breaches of BROs.

18. Based on breaches of disqualification orders<sup>80</sup> and offences under the Insolvency Act 1986 that are comparable to a breach of a BRO<sup>81</sup> prior to the Enterprise Act 2002, it is expected that breaches will occur in less than 1% of BROs (see Tables 10 and 11).

19. Thus, to date, it appears that BROs are abided by and it is not anticipated that there will be a material level of breaches of BROs. Therefore, the protection offered by a BRO is not being undermined by non-compliance to the terms of a BRO.

<sup>80</sup> Section 13 of the Company Directors' Disqualification Act 1986 sets out the criminal penalties for acting in the contravention of a disqualification order. The frequency of this offence is an indication of the level of breaches of a disqualification order.

<sup>81</sup> A BRO makes it a criminal offence for a bankrupt to:

- (a) Act as a receiver or manager of the property of a company or on behalf of debentureholders (s31 IA86);
- (b) Obtain credit of more than the prescribed limit (s360 IA86);
- (c) Carry on business under a name other than that in which he was adjudged bankrupt without disclosing the name under which he was adjudged bankrupt (s360 IA86);
- (d) Act as an IP (s390 IA86); or
- (e) Act as a director of a company, or directly or indirectly to take part in or be concerned in the promotion, formation or management of a company without the leave of court (s11 CDDA86).

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Breaches of BROs (continued)

**Table 10: Breaches of disqualification orders (measured by the level of prosecutions under Section 13 of the Company Directors' Disqualification Act 1986 – Contravention of a Disqualification Order)**

	2001-2002	2002-2003	2003-2004
<b>Number of prosecutions under Section 13 of the Company Directors' Disqualification Act 1986<sup>82</sup></b>	<b>8</b>	<b>12</b>	<b>9</b>
<b>Total number of disqualification orders</b>	<b>1,761</b>	<b>1,594</b>	<b>1,367</b>
<b>Section 13 prosecutions as % of disqualifications<sup>83</sup></b>	<b>0.45%</b>	<b>0.75%</b>	<b>0.66%</b>

**Table 11: Level of offences comparable to a breach of a BRO**

Offence	Number of prosecutions <sup>84</sup>		
	2001-2002	2002-2003	2003-2004
<b>Section 11 of the Company Directors' Disqualification Act 1986</b>	<b>35</b>	<b>22</b>	<b>19</b>
<b>Section 360 of the Insolvency Act 1986</b>	<b>48</b>	<b>44</b>	<b>30</b>
<b>Section 390 of the Insolvency Act 1986</b>	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>
<b>Section 31 of the Insolvency Act 1986</b>	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>
<b>Total</b>	<b>83</b>	<b>66</b>	<b>49</b>
<b>Total no. of relevant bankruptcy orders<sup>85</sup></b>	<b>20,508</b>	<b>21,479</b>	<b>21,961</b>
<b>Offences as % of relevant bankruptcy orders</b>	<b>0.40%</b>	<b>0.31%</b>	<b>0.22%</b>

<sup>82</sup> Information extracted from The Insolvency Service's internal database.

<sup>83</sup> The level of s13 prosecutions has been compared directly to the number of disqualifications obtained in the same period. However, it is likely that there is a time lag, i.e. the s13 offences relate to disqualification orders obtained in previous periods. However, as the level of s13 offences is negligible, this should have minimal impact.

<sup>84</sup> Information extracted from The Insolvency Service's internal database.

<sup>85</sup> The number of bankruptcies has been lagged by 3 years to reflect the time taken to secure a conviction. This is to reflect the time taken to secure a conviction. This time period is an estimate based on a case sampling exercise.

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Customer satisfaction with the way in which culpable bankrupts are dealt

20. As stated previously, BROs are designed to provide protection for the public and a civil alternative to prosecution, with a correspondingly lower level of proof. In short, a prosecution is designed to penalise whereas a BRO is designed to protect. Therefore, prior to the introduction of BROs, the insolvency legislation contained no provisions (except for the suspension of discharge) that were specifically aimed to provide protection for the public.

21. The evaluation has gathered evidence to assess the public perception of the protection offered by the insolvency enforcement regime prior to the Enterprise Act 2002, i.e. prosecution (albeit that prosecution is designed to penalise rather than protect), as prosecution was the only option available to deal with bankrupts whose conduct warranted further action (and suspension of discharge in cases of non-cooperation – see Section 3.2 paragraph 7). The evaluation also looks at whether the BRO regime was the correct way to provide protection.

22. The Insolvency Service has carried out various surveys 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, and of creditors in bankruptcy cases where a BRO had been obtained<sup>86</sup>.

23. Over 70% of creditors in bankruptcy cases where a criminal conviction was obtained stated that they would feel 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. This suggests that the introduction of the BRO regime should make creditors feel protected, and this conclusion is partially supported by the results of the surveys.

24. Albeit that prosecution action is not designed to provide protection, just under 40% of creditors in bankruptcy cases where a criminal conviction was obtained thought that the criminal conviction provided protection to the business community, with 17% being unsure.

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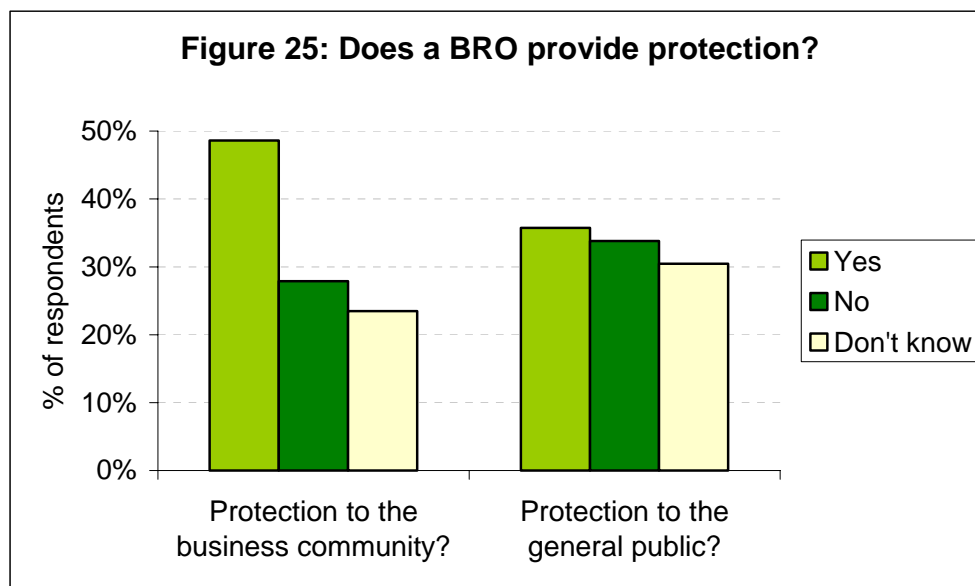
<sup>86</sup> For further information on the surveys, please see The Insolvency Service – 'A study of the bankruptcy enforcement regime before and after the Enterprise Act 2002', which can be accessed at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/enforcementreport.pdf>

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Customer satisfaction with the way in which culpable bankrupts are dealt (continued)

25. Just under half of the creditors in bankruptcy cases where a BRO was obtained thought that the BRO provided protection to the business community, with just under a quarter being unsure (see Figure 25). Creditors in bankruptcy cases where a BRO was obtained who had business dealings with the bankrupt are as likely to believe that a BRO offers protection to the business community, compared to creditors who had no business dealings. However, creditors in bankruptcy cases where a BRO was obtained who had no business dealings are more likely to express no opinion<sup>87</sup>.

26. Further, just over a third of creditors in bankruptcy cases where a BRO was obtained thought that the BRO provided protection to the general public, with just under a third being unsure (see Figure 25).



27. Creditors who feel that a BRO does provide protection to the business community and general public are most likely to rate the protection as moderate.

<sup>87</sup> The surveys showed that 51% of creditors who had business dealings with the bankrupt agreed that the BRO provided protection to the business community, with 14% providing a 'don't know' response. As regards of creditors who had no business dealings with the bankrupt, 50% agreed that the BRO provided protection to the business community, with 23% providing a 'don't know' response.

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Customer satisfaction with the way in which culpable bankrupts are dealt (continued)

28. The Insolvency Service has also carried out other survey/case studies to ascertain whether the introduction of BRO regime has impacted on the perceived level of protection offered by the insolvency enforcement regime. These show that the introduction of the BRO regime has not yet made creditors of bankruptcy cases (regardless of whether any enforcement action has been taken) feel more protected<sup>88</sup>. A similar pattern has been seen with The Insolvency Service's stakeholder organisations<sup>89</sup>.

29. In the surveys of The Insolvency Service's stakeholder organisations, 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.

30. Further, surveys of people aged 16 or over carried out in 2006 in 2007 (post-Enterprise Act 2002) showed that less than a third of the respondents agreed that the insolvency regime protected the public from dishonest or reckless bankrupts, with around a half being undecided (see Figure 26). In these surveys, respondents were also asked whether they had heard of BROs - 21% and 17% thought they had heard of them in 2006 and 2007 respectively, but no-one accurately described what they were. Therefore, it appears that there is currently a lack of public awareness of the BRO regime. This may change as number of the BROs in force increases.

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<sup>88</sup> 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.

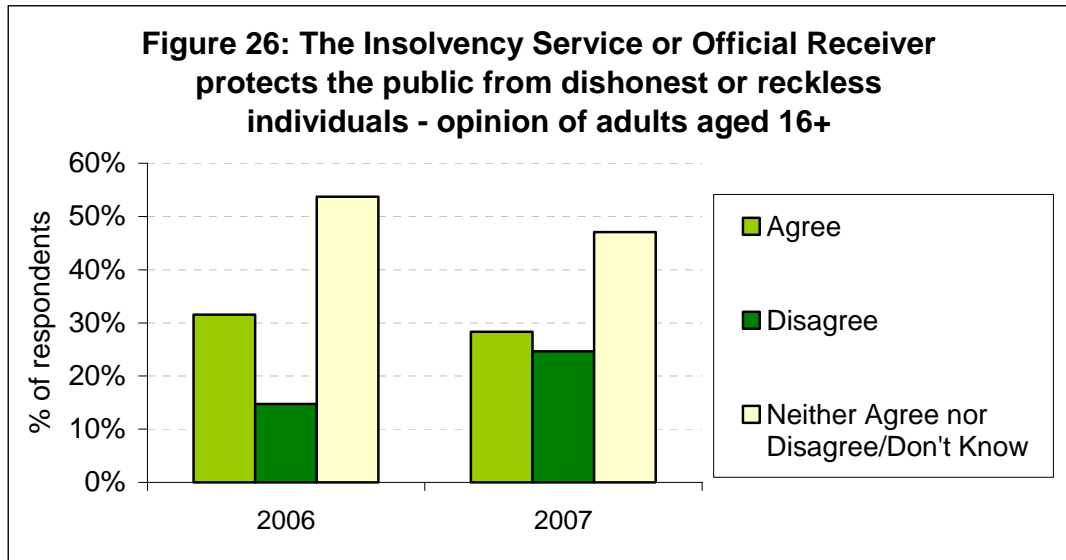
<sup>89</sup> The Insolvency Service has carried out surveys in 2004, 2006 and 2007 to ascertain the level of confidence in the enforcement regime amongst The Insolvency Service's stakeholder organisations. The stakeholder organisations fall into two broad categories, defined as follows:

- Advisors - these are organisations which advise individuals and senior business personnel regarding their own bad debts or dealing with bankruptcy/insolvency of their clients; and
- Non-advisors - these are organisations that have a responsibility for understanding the process of dealing with bad debts and maybe petitioning for or taking part in the bankruptcy or insolvency of any clients

Organisations were asked how effective The Insolvency Service sanctions were deemed to be as protection against financial wrongdoing. The Insolvency Service's sanctions include Bankruptcy Restrictions Orders/undertakings, Disqualification Orders/Undertakings and reporting to a prosecution authority in respect of allegations of criminality, and thus This opinion covered both corporate and individual provisions. In 2007, around two-fifths of organisations deemed the sanctions that the Insolvency Service currently implements to deter and protect against financial wrongdoing as effective, and this has changed little since 2004. This static trend disguises some difference of opinion between different respondent groups. For example, whilst organisations in insolvency areas have felt that sanctions as a deterrent are becoming less effective, the opposite has been felt in non-insolvency areas. A similar pattern has emerged amongst different types of organisation, with IPs and local authorities becoming more positive, and solicitors and accountants less positive. The Insolvency Service commissioned GfK NOP to carry out the surveys.

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### Customer satisfaction with the way in which culpable bankrupts are dealt (continued)



31. As regards the overall satisfaction of creditors with action taken against culpable bankrupts, both before and after the Enterprise Act 2002, the level of complaints received by The Insolvency Service are minimal. Analysis of The Insolvency Service's complaints register shows that prior to the Enterprise Act, around 0.2% of the complaints received were about investigation matters<sup>90</sup>; post-Enterprise Act 2002, such complaints are around 0.4% of all complaints received<sup>91</sup>. Around half of these complaints were upheld both before and after the Enterprise Act 2002.

32. Therefore, overall, the introduction of the BRO appears to have been the correct regime to implement in order to afford protection to the business community and general public. However, in general terms, the BRO regime has not impacted on views of the wider business community and general public. This appears to be attributable to a lack of awareness of the BRO regime, both in terms of its operation and the level of cases where a BRO is in force. Therefore, the impact of the BRO regime would be enhanced if there was greater publicity surrounding the BRO regime and higher visibility on the reporting of BROs obtained.

<sup>90</sup> In the three years ended 31 March 2004, there were 1,164 complaints in The Insolvency Service's complaints register. Two of these complaints related to investigation matters – one from a creditor complaining that he had not been kept informed (upheld) and another from a creditor complaining that no enforcement action had been taken against a bankrupt (not upheld).

<sup>91</sup> In the three years ended 31 March 2007, there were 1,381 complaints in The Insolvency Service's complaints register. Five of these complaints related to investigation matters – four from creditors complaining that no enforcement action had been taken against bankrupts (two complaints upheld) and one from a bankrupt about BRO proceedings being taken against him (not upheld).

### **3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)**

#### Customer satisfaction with the way in which culpable bankrupts are dealt (continued)

33. It is unlikely that the level of BROs currently being obtained will substantially increase – however, as a BRO lasts on average 5 years (see paragraph 16), it is expected that in the future, there will be around 9,000 BROs in force (based on the level of BROs obtained in 2006/7). Therefore, although the number of BROs obtained in a year may not increase, there will be a significant increase in the number of BROs in force. This should also assist in raising the profile of the BRO regime.

#### **Differentiating between culpable and non-culpable bankrupts**

34. 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. Bankruptcy orders are publicised through advertisement of the bankruptcy order and the Individual Insolvency Register, and prior to the Enterprise Act 2002, in general terms, bankrupts were subject to the same restrictions, i.e. third-parties did not try to distinguish between culpable and non-culpable bankrupts. The evaluation looks at whether lenders and the public can, and do, use the BRO regime to differentiate between culpable and non-culpable bankrupts.

#### Availability of information on BROs

35. 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.

36. Searches of the on-line Individual Insolvency Register are now in the region of 210,000 per month<sup>92</sup>, compared to searches of the on-line Index of Disqualified Directors maintained by Companies House in the region of 43,000 per month. Therefore, it would appear that the Individual Insolvency Register is being regularly used.

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<sup>92</sup> Based on information held by The Insolvency Service, searches on the Individual Insolvency Register for the period 2004/5, 2005/6 and 2006/7 were 534,206; 1,387,459; and 2,515,400 respectively.

### **3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)**

#### Availability of information on BROs (continued)

37. 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 paragraph 30). 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.

38. Credit reference agencies also use the Individual Insolvency Register to record appropriate information on an individual's credit reference file, including the record of any BRO obtained. Therefore, lenders have access to information on BROs obtained.

#### The impact of the BRO regime on lender policies

39. 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.

40. 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>93</sup>. Lenders do 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.

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<sup>93</sup> Based on information provided by members of the British Bankers' Association (BBA), which BBA advise is broadly representative of the industry position.

### **3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)**

#### The impact of the BRO regime on non-insolvency legislation imposing restrictions on bankrupts

41. Prior to the Enterprise Act 2002, there existed approximately 200 non-insolvency pieces of legislation that imposed either mandatory or discretionary restrictions on bankrupts. These ranged from:

- The Inclosure Act of 1776 – a bankrupt cannot be a field reeve or field master;
- The Wireless Telegraphy Act 1949 – A bankrupt could not sit on one of its arbitration tribunals (none were ever convened and the legislation was repealed in 2003); and
- Local Government Act 1972– a bankrupt could not be a local councillor.

42. The policy-owning departments of all the other mandatory restrictions were contacted and advised of the new BRO regime<sup>94</sup>. They were invited to review their current bankruptcy restriction policy to see if they wanted:

- No ban on bankrupts and those subject to a BRO
- A ban only on those subject to a BRO
- A ban on bankrupts and those subject to a BRO
- No change

43. Where the department wished to retain a ban on bankrupts, confirmation was sought that the restrictions were necessary for the protection of public and commercial community in accordance with the Department's own policy aims.

44. As a result, approximately 23 mandatory restrictions required amendment. This was achieved by a government-wide Statutory Instrument utilising the order making power contained in section 268 of the Enterprise Act, The Enterprise Act 2002 (Disqualification from office: General) Order 2006 (S.I. 2006/1722). However the scope of that power (section 268 (2) of the Enterprise Act) was not all encompassing because it only related to restrictions that were in place prior to Royal Assent of the Enterprise Act (November 2002) and was restricted to provisions that relate to an individual:

- Being elected to an office or position;
- Holding an office or position; or
- Becoming or remaining a member of a body or group.

45. Any restrictions outside those provisions, for example under the Estate Agents Act, will not be amended until such time as the policy owning departments have the opportunity to do so and for primary legislations such opportunities are restricted.

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<sup>94</sup> It should be noted that section 267 of the Enterprise Act 2002 now places a ban on those subject to a BRO being a local councillor, which replaces the ban on a bankrupt being a local councillor (contained in the Local Government Act 1972)

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

#### The impact of the BRO regime on non-insolvency legislation imposing restrictions on bankrupts (continued)

46. Many discretionary restrictions related to Non Departmental Public Bodies (NDPBs) are set up by individual government departments. The Public Appointments Unit of the Cabinet Office publishes *Making and managing public appointments - A guide for departments'* (available on their web site). That guidance now reflects the introduction of the BRO regime.

47. Lastly, there are certain trades and professions where the making of a bankruptcy order will affect an individual's ability to continue in their trade or profession. For example:

- Under the rules for enlistment in the Army, Navy and RAF a bankrupt is not permitted to enlist whilst remaining undischarged from the bankruptcy proceedings;
- A serving police officer may be dismissed for failing to pay a lawful debt<sup>95</sup>;
- If a bankruptcy order is made against a person who is member of the Association of Chartered Certified Accountants (ACCA), he must resign his membership within 2 months of the making of the bankruptcy order. The person remains excluded from membership for the duration of the bankruptcy. When discharged, a former member can reapply for membership.
- If a bankruptcy order is made against a person who is a member of the Institute of Chartered Accountants in England and Wales (ICAEW) he would be immediately delisted as a member. Although a bankrupt may continue to practise as an accountant, he cannot carry out audit work. The bankrupt may reapply for authorisation as a member on annulment or discharge, but readmission is not automatic and the circumstances of each case are considered.
- If a bankruptcy order is made against a person who is a solicitor, their practising certificate is immediately suspended. A solicitor may apply to the Office for the Supervision of Solicitors to have the suspension terminated and may apply in advance if bankruptcy seems probable. Conditions ( such as operating as a partner or in employment approved by the Law Society ) are usually imposed if a bankrupt solicitor's practising certificate is reinstated. Similar conditions are likely to be imposed on discharge.

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<sup>95</sup> The Police Regulations 1987 Regulation 10, Schedule2(4)

### **3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)**

#### The impact of the BRO regime on non-insolvency legislation imposing restrictions on bankrupts

48. Also, there are other instances in legislation, regulations, bye-laws and private club rules of restrictions which refer to the individual being a 'fit and proper person' which may disqualify an undischarged bankrupt, e.g. an individual who applies to the local police for a taxi licence must be considered a 'fit and proper person'. With the concept of culpable bankruptcy introduced by the Enterprise Act 2002 and the BRO available where the conduct of the individual in question is taken into account, it may be that bankruptcy in itself will not lead to the restrictions being exercised unless the bankruptcy leads to the making of a BRO which would give an indication that the person is not fit and proper.

49. Therefore, non-insolvency legislation has been amended to reflect the BRO regime, and thus, the level of mandatory or discretionary restrictions imposed on non-culpable bankrupts under non-insolvency legislation has reduced (and are expected to reduce further in the future).

#### **Deterring fraud and misconduct**

50. This objective relates to the existence of the BRO regime acting as a deterrent for fraud and misconduct. The evaluation looks at whether the BRO regime has had any impact on the level of bankruptcy enforcement action and 'repeat offenders'.

#### Impact on bankruptcy enforcement action

51. Prior to the implementation of the Enterprise Act 2002, the BRO regime did not exist. Therefore, the only data available pre-Enterprise Act 2002 regarding fraud and misconduct relates to prosecutions and suspensions of discharge.

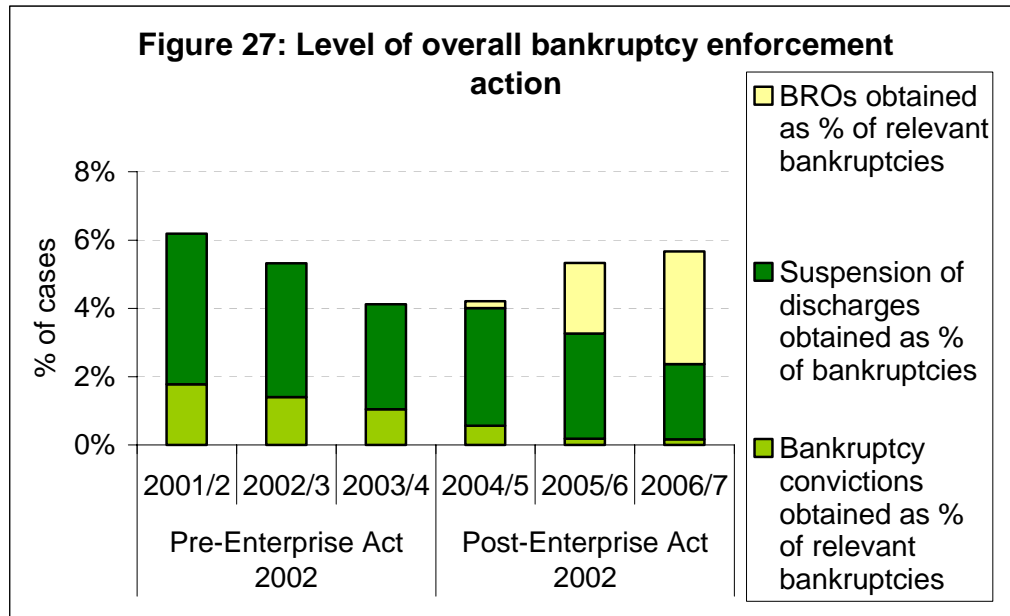
52. The overall level of enforcement action in bankruptcy cases has risen since the implementation of the Enterprise Act 2002<sup>96</sup> (see Figure 27).

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<sup>96</sup> The level of prosecutions has been calculated as a percentage of the total number of bankruptcies lagged by 3 years. This is to reflect the time taken to secure a conviction. This time period is an estimate based on a case sampling exercise. The level of BROs has been calculated as a percentage of the total number of bankruptcy orders lagged by 9 months. This is to reflect the time taken to obtain a BRO/U from the date of the bankruptcy order. According to internal data held by The Insolvency Service, the average time taken to obtain a BRO/U in 2004/5, 2005/6 and 2006/7 is 6.9 months, 8.9 and 10.4 months respectively. Further, BRO/U action can only be taken in respect of conduct after 1 April 2004. Accordingly, the 2004/5 relevant bankruptcies represent the level of bankruptcies in the 3 months to 30 June 2004, and the relevant bankruptcies for 2005/6 are the level of bankruptcies in the year ended 30 June 2005.

### 3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)

Impact on bankruptcy enforcement action (continued)



53. The overall level of convictions following a prosecution in connection with bankruptcy-related matters has fallen since the implementation of the Enterprise Act 2002, although this is partially explained by the repeal of offences under sections 361 and 362 of the Insolvency Act 1986 (see section 3.7). Further, this appears to be part of a trend established before the implementation of the Enterprise Act 2002. There has also been a decrease in the number of suspension of discharges obtained (see Section 3.2 paragraph 19), but an increase in the level of BROs obtained (see paragraph 7).

54. However, it is too early to assess whether the trends seen can be attributed to the BRO regime impacting on fraud and misconduct in bankruptcy cases.

#### 'Repeat offenders'

55. 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 is declining – see Section 3.2 paragraph 48), and the level of 'second-time' bankrupts where a prosecution was obtained in the first case is even less<sup>97</sup>.

<sup>97</sup> Based on information held on The Insolvency Service's internal databases, the number of second-time bankrupts where a prosecution was obtained in the first case was 16, 3 and 14 in the years 2001/2, 2002/3 and 2003/4 respectively.

### **3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)**

#### **Summary**

**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**

- BROs are now being obtained in around 3.5% of bankruptcies (see paragraph 7).
- BROs last, on average, 5 years, which is consistent with the average length of a disqualification order. Therefore, on average, culpable bankrupts are subject to restrictions for an extra 4 years and the protection offered by a BRO is not being undermined by non-compliance to the terms of a BRO (see paragraphs 16-19).
- The BRO regime appears to have been the correct regime to implement in order to afford protection to the business community and general public. However, in general terms, the BRO regime has not impacted on views of the wider business community and general public. This appears to be attributable to a lack of awareness of the BRO regime, both in terms of its operation and the level of cases where a BRO is in force (see paragraphs 20-33).

### **3.3 Evaluation of the Bankruptcy Restrictions Order provisions (continued)**

#### **Summary (continued)**

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

- Information on BROs is publicly available and free, which allows lenders and the public to differentiate between culpable and non-culpable bankrupts and make better-informed decisions in their dealings with bankrupts (see paragraphs 35-36).
- However, a lack of public awareness of the BRO regime suggests the public are unlikely to immediately understand the significance of a BRO being recorded against a bankrupt (see paragraph 37).
- Further, although it is possible for lenders to differentiate between culpable and non-culpable bankrupts, to date, this is not reflected in their lending policies (see paragraphs 38-40).

**To deter fraud and misconduct**

- The overall level of enforcement action in bankruptcy cases has risen since the implementation of the Enterprise Act 2002, but it is too early to assess whether the trends seen can be attributed to the BRO regime impacting on fraud and misconduct in bankruptcy cases (see paragraphs 51-54).

#### **Recommendations**

- That The Insolvency Service increases its publicity of the BRO regime and reporting on cases where BROs are obtained, in order to enhance the knowledge and impact of the BRO regime (see paragraphs 20-33).
- That the Insolvency Service continues to work with lenders and credit reference agencies to ensure that lender policies appropriately reflect the BRO regime (see paragraphs 39-40).
- That The Insolvency Service continues to monitor enforcement statistics (see paragraphs 53-54).

### 3.4 Evaluation of the Bankrupt's Home provisions

1. This section of the report contains evaluation evidence regarding the achievement of the intermediate objectives of the bankrupt's home provisions contained in the Enterprise Act 2002. The objectives of these provisions are:

- To provide some certainty to the bankrupt, the trustee and the creditors as to the time scale within which the bankrupt's home will be dealt with, as previously that time scale was open ended;
- To provide a balance between the interests of the bankrupt (and his/her family) and the creditors by providing ample time for the disposal by the trustee of the bankrupt's interest in his/her sole and principal residence in the most appropriate manner; and
- To help lift the stigma of bankruptcy.

2. The Insolvency Service has published a separate report entitled 'The bankrupt's home – before and after the Enterprise Act 2002'<sup>98</sup>. This report contains evidence contributing to the evaluation of the bankrupt's home provisions.

#### **Certainty in dealing with the bankrupt's home**

3. Prior to the Enterprise Act 2002, the timescale within which an interest in a property could be dealt with was opened-ended. The Act introduced provisions whereby the trustee must take action as regards that interest within three years, and if he does not do so, the interest in the family home reverts to the bankrupt at the end of this period (unless an application for an extension of time is made).

4. A bankrupt's interest in a family home will re-vest in the bankrupt after 3 years unless one of the following events occurs before that date;

- the trustee realises the bankrupt's interest;
- the trustee applies for an order for possession and/or sale;
- the trustee applies for a charging order;
- the trustee and the bankrupt agree that the bankrupt shall incur a liability in consideration of which the bankrupt's interest shall cease to form part of his estate; or
- the trustee sends notice to the bankrupt that he considers that the continued vesting of the dwelling-house in the bankrupt's estate will be of no benefit to creditors or that re-vesting will facilitate a more efficient administration of the bankrupt's estate.

5. The three-year period commences on the date of the bankruptcy order or, if the bankrupt does not inform the Official Receiver, or any insolvency practitioner acting as trustee, of his interest within 3 months of the bankruptcy order, the date that the Official Receiver or other trustee becomes aware of the interest.

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<sup>98</sup> The Insolvency Service – 'The bankrupt's home - before and after the Enterprise Act 2002' can be accessed at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/bankruptshomereport.pdf>

## 3.4 Evaluation of the Bankrupt's Home provisions (continued)

### Certainty in dealing with the bankrupt's home (continued)

6. The Enterprise Act 2002 also contains transitional provisions for cases where the bankruptcy petition was presented before 1 April 2004 where there is a bankrupt's interest in a family home<sup>99</sup>. The transitional provisions state that such interests must be dealt with by 31 March 2007 (unless an application for an extension of time is made) - otherwise, the interest reverts to the bankrupt on this date.

7. The evaluation looks at the timeliness of dealing with a bankrupt's interest in a property, the way it is dealt with, customer satisfaction with way it is dealt with and the impact of the transitional provisions.

### Timeliness in dealing with a bankrupt's interest in a property

8. Information has been collected on the timeliness of dealing with a bankrupt's interest in a property both before and after the Enterprise Act 2002<sup>100</sup>. However, it should be noted that the transitional provisions may well have affected this timeliness pre-Enterprise Act 2002 as trustees were required to take action to avoid the interest re-vesting in the bankrupt on 1 April 2007. Further, a number of post-Enterprise Act 2002 property interests in the case sampling exercise have not yet been dealt with as the three-year period has not yet expired.

9. When calculating the timeliness of dealing with the property interest, realisations through repossession have been excluded as the trustee has no control over such realisation.

10. On information available, the average time for a property interest to be dealt with pre-Enterprise Act 2002 (excluding repossessions) was 609 days, i.e. around 20 months, from the date of the bankruptcy order. On information available to date, 63% of post-Enterprise Act 2002 property interests have been dealt with in an average time (excluding repossessions) of 366 days, i.e. around 12 months. However, given the effect of the transitional arrangements as detailed above and the level of interests not yet dealt with post-Enterprise Act 2002, no conclusions on the timeliness of dealing with property interests can be drawn.

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<sup>99</sup> The transitional arrangements only apply to interests in a family home that fall under the definition of a 'qualifying interest' under the Enterprise Act 2002. A 'qualifying interest' is a bankrupt's interest in a dwelling-house that is the sole or main residence of the bankrupt, the bankrupt's spouse or former spouse.

<sup>100</sup> For full details of the case sampling exercises, please refer to The Insolvency Service's report 'The bankrupt's home – before and after the Enterprise Act 2002', which is available at:

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/bankruptshomereport.pdf>

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Timeliness in dealing with a bankrupt's interest in a property (continued)

11. However, as detailed above, the Enterprise Act 2002 aims to ensure that in almost all cases, the property interest is dealt with within 3 years of the bankruptcy order - the case sampling exercise shows that pre-Enterprise Act 2002, around 15% of property interests were dealt with after 3 years of the bankruptcy order.

12. The reasons why a property interest has not been dealt with before three years after the data of the bankruptcy order in the pre-Enterprise Act 2002 case sampling exercise are set out in Table 12. However, given the transitional provisions, trustees have been required to take action to avoid the interest re-vesting in the bankrupt. Therefore, these results may not be an accurate picture of why a property interest has not been dealt with before three years after the date of the bankruptcy order.

**Table 12: Reasons why a trustee has not dealt with a bankrupt's interest in a property after 3 years from the bankruptcy order in pre-Enterprise Act 2002 cases**

<b>Reason remains unrealised</b>	<b>% of cases not dealt with</b>
Bankrupt seeking annulment/bankruptcy annulled	22.8%
Negotiations on-going	18.4%
No offer received and insufficient equity to warrant sale of property	11.4%
Problems in establishing the trustee's interest	10.5%
Trustee intending to make application for order for possession and sale	7.9%
Trustee only recently appointed	7.0%
Sale on-going	4.4%
No offer received and trustee unable to sell property at current time	4.4%
Bankruptcy debts/costs paid in full without realising property	4.4%
Non co-operation of bankrupt	3.5%
Repossession proceedings being commenced	2.6%
No attempt to realise	2.6%

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Timeliness in dealing with a bankrupt's interest in a property (continued)

13. From case study material<sup>101</sup>, it appears that the primary reason for why, prior to the Enterprise Act 2002, it could take over 3 years to realise an interest in a property is because the trustee had not taken any action in respect of the property and the bankrupt was not aware (or failed to realise) that the interest remained vested in the trustee until such time as the interest was realised. This latter issue was the main source of complaints received by The Insolvency Service (see paragraphs 27-30).

14. Further, when the trustee is released from office, the Official Receiver becomes trustee ex officio. The Official Receiver, as trustee ex officio, is then responsible for dealing with any post-release enquiries and the realisation of outstanding assets. Prior to the Enterprise Act 2002, such cases with unrealised assets were dealt with by The Insolvency Service's Protracted Realisations Unit (PRU). An aged case analysis of cases with an interest in a property held by PRU shows that prior to the Enterprise Act 2002, The Insolvency Service was holding a sizeable number of property interests which were more than 3 years old (see Table 13). The vast majority of cases that were held by PRU as at 28 February 2004 had insolvency practitioners appointed as trustees to deal with the interest in the property.

**Table 13: Aged case analysis of cases with an interest in a property held by The Insolvency Service's Protracted Realisations Unit (PRU)**

Age of cases	Number of Cases as at:	
	31 August 2003	28 February 2004
Pre-1991	113	87
1991 – 1995	4,292	2,825
1996 – 2000	3,501	2,632
2001 - 2003	856	773
<b>Total</b>	<b>8,762</b>	<b>6,317</b>
<b>% of cases dated pre-2000</b>	<b>90.23%</b>	<b>87.76%</b>

<sup>101</sup> The case study material was sourced from Citizen's Advice Bureau, the Bankruptcy Advisory Service and records held by The Insolvency Service.

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Timeliness in dealing with a bankrupt's interest in a property (continued)

15. The role of PRU was taken over by Regional Trustee and Liquidator Units (RTLUs), and an aged case analysis of cases with an interest in a property held by them<sup>102</sup> shows that post-Enterprise Act 2002, the level of cases over 3 years old as at 31 August 2005 is around 13% (see Table 14). Additionally, as at 31 August 2005, PRU held about 200 cases with an interest in a property. About 60 of these cases were dealt with under The Service's low-cost transfer scheme and charging orders on health grounds were obtained.

**Table 14: Aged case analysis of cases with an interest in a property held by The Insolvency Service's Regional Trustee and Liquidator Units (RTLUs)**

	Number of cases as at 31 August 2005
Pre 31 August 2002	105
Post 1 September 2002	765
Total	870
<b>% of cases over 3 years old</b>	<b>12.68%</b>

16. Therefore, post-Enterprise Act 2002, the level of cases with property interests held by the Official Receiver as trustee ex officio that are over 3 years old has reduced to around 30%<sup>103</sup>. The reduction in aged cases since 28 February 2004 has been achieved mainly by the appointment of insolvency practitioners as trustees in cases to deal with the property interests and under the transitional provisions, the vast majority must now have been dealt with. Therefore, the implementation of the Enterprise Act 2002 and its transitional provisions has ensured that such property interests are dealt with and in the future, it is extremely unlikely that the Official Receiver as trustee ex officio will be holding a large number of cases with property interests.

17. However, there are instances where, under the Enterprise Act 2002, a property interest will not be dealt with within 3 years from the bankruptcy order. They are:

- Where the 3 year period does not start from the date of the bankruptcy order because the bankrupt does not inform the Official Receiver, or any insolvency practitioner acting as trustee, of his interest within 3 months of the bankruptcy order - in such cases, the 3 year period will start from the date that the Official Receiver or other trustee becomes aware of the interest; or
- The trustee applies for an extension of time.

<sup>102</sup> A further 257 cases were held on which aging data was not available.

<sup>103</sup> On available information as at 31 August 2005, Regional Trustee and Liquidator Units (RTLUs) held 870 relevant cases, of which 105 were over 3 years old (a further 257 cases were held by an RTLUs for which no ageing data is known). The Protracted Realisations Unit held another 200 cases, all over 3 years old.

### **3.4 Evaluation of the Bankrupt's Home provisions (continued)**

#### Timeliness in dealing with a bankrupt's interest in a property (continued)

18. Full information on post-Enterprise Act 2002 property interests is not available as in many cases, the three-year period has not yet expired. However, to date no cases have been identified in the post-Enterprise Act 2002 case sampling exercise where the 3-year period does not start from the date of the bankruptcy order. Further, from the results of the case sampling exercise, pre-Enterprise Act 2002, a trustee has applied for an extension of time in one case (because of the transitional provisions); none have been identified in post-Enterprise Act 2002 cases. Further extensions may arise in post-Enterprise Act 2002 cases.

19. In summary, before the Enterprise Act 2002, around 15% of property interests were dealt with more than 3 years from the date of the bankruptcy order. It appears that the primary reason why, prior to the Enterprise Act 2002, it could take over 3 years to deal with an interest in a property is because the trustee had not taken any action in respect of the property and the bankrupt was not aware (or failed to realise) that the interest remained vested in the trustee until such time as the interest was realised. Although full information on post-Enterprise Act 2002 property interests is not yet available, the provisions of the Enterprise Act 2002 should ensure that property interests are dealt with within 3 years (subject to exceptions provided for in the Act). Further, it appears that the 3-year time limit will ensure that a material 'back-log' of cases over 3 years old with property interests does not occur. Not only will the 3-year time limit ensure that such a 'back-log' does not occur in the future, the transitional provisions of the Enterprise Act 2002 has had the effect of clearing the existing 'back-log'. Further details regarding the impact of the transitional provisions are contained at paragraphs 32-39.

20. In order to establish how often, and why, property interests are not dealt with within 3 years from the bankruptcy order under the Enterprise Act 2002 provisions, the post-Enterprise Act 2002 case sampling exercise needs to be completed. This will also provide further information on the overall timeliness of dealing with property interests.

#### The method of dealing with a bankrupt's interest in a family home

21. Although the Enterprise Act 2002 aims to ensure that in almost all cases, the property interest is dealt with within 3 years of the bankruptcy order, there are instances where the method of dealing with the property interest may not offer certainty to the bankrupt, trustee or creditors. This is because in some cases, the way the property interest is dealt with involves changing the nature of that interests, which will require further action in the future to actually realise the property interest.

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### The method of dealing with a bankrupt's interest in a family home (continued)

22. The instances where dealing with a property interest involves changing the nature of that interest are as follows:

- the trustee and the bankrupt agree that the bankrupt shall incur a liability in consideration of which the bankrupt's interest shall cease to form part of his estate;
- The trustee applies for a charging order; or
- The trustee applies for an order for possession and/or sale.

23. From the case sampling results to date:

- No cases have been identified either before or after the Enterprise Act 2002 where the trustee and the bankrupt agree that the bankrupt shall incur a liability in consideration of which the bankrupt's interest shall cease to form part of his estate;
- Pre-Enterprise Act 2002, the trustee obtained an order for possession and/or sale in less than 2% of cases, compared to less than 1% of cases to date post-Enterprise Act 2002. Further such orders may arise in post-Enterprise Act 2002 cases; and
- Both before and after the Enterprise Act 2002, a trustee has applied for/obtained a charging order in less than 1% of cases. Further charging orders may arise in post-Enterprise Act 2002 cases.

24. It should be noted that prior to the Enterprise Act 2002, it was Insolvency Service policy not to apply for charging orders, although Official Receivers did have discretion in this matter. It is probable that if an Official Receiver was contemplating a charging order, they would have consulted The Insolvency Service's Technical Section<sup>104</sup>. Technical Section are not aware of any charging orders obtained by Official Receivers in the period 2000 to March 2004. Since the implementation of the Enterprise Act 2002, The Insolvency Service has reviewed its policy as regards charging orders.

25. Post-Enterprise Act 2002, where the Official Receiver, as trustee, is unable for any reason, to realise the bankrupt's interest in a qualifying property the Official Receiver may apply to a court for a charging order against that interest. Full details of The Insolvency Service's policy on charging orders are laid out in The Insolvency Service's Technical Manual<sup>105</sup>. Thus, it is possible that the level of charging orders may increase.

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<sup>104</sup> Technical Section are part of The Insolvency Service who deal with technical queries from Official Receivers.

<sup>105</sup> The technical manual can be accessed via The Insolvency Service's website at:  
<http://www.insolvency.gov.uk/freedomofinformation/technical/techmanvol1/Default.htm>

### **3.4 Evaluation of the Bankrupt's Home provisions (continued)**

#### The method of dealing with a bankrupt's interest in a family home (continued)

26. In summary, on information available to date, it appears that the methods of dealing with a property interest which could be said not to offer certainty to the bankrupt, the trustee or creditors are not used in a high proportion of cases. However, the post-Enterprise Act 2002 case sampling exercise needs to be completed to provide full information on how often methods of dealing with a property interest which could be said not to offer certainty to the bankrupt, the trustee or creditors are used, and why.

#### Customer satisfaction with trustees' dealings with bankrupts' homes

27. Prior to the implementation of the Enterprise Act 2002, complaints relating to the bankrupt's home constituted just under 10% of all the formal complaints received by The Insolvency Service<sup>106</sup>. The nature of the complaints mainly relate to a lack of action by the trustee in respect of a property and to the bankrupt not being aware (or failing to realise) that the interest remained as part of the bankruptcy estate until such time as the interest was realised.

28. In the 3 years since the implementation of the Enterprise Act 2002, complaints relating to the bankrupt's home also constituted just under 10% of all complaints received by The Insolvency Service<sup>107</sup>. However, it should be noted that over 90% of such complaints relate to pre-Enterprise Act 2002 cases. Further, 70% of such complaints relate to a lack of action by the trustee in respect of a property and to the bankrupt not being aware (or failing to realise) that the interest remained as part of the bankruptcy estate until such time as the interest was realised. It appears that many of these complaints have arisen because of action taken in respect of the property interest prior to 31 March 2007 in light of the transitional provisions.

29. All such complaints are from bankrupts, or third parties who hold an interest in a property in which a bankrupt has an interest. No complaints have been identified by creditors either before or after the implementation of the Enterprise Act 2002.

30. A similar pattern is seen in the emails received by The Insolvency Service via its Insolvency Enquiry Line.

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<sup>106</sup> There are 1,164 complaints recorded in The Insolvency Service's complaints register in the 3-year period 1 April 2001 to 31 March 2004, i.e. pre-Enterprise Act 2002, and 110 of the complaints relate to the bankrupt's home.

<sup>107</sup> There are 952 complaints recorded in The Insolvency Service's complaints register in the 3-year period 1 April 2004 to 31 March 2007, i.e. post-Enterprise Act 2002, and 89 of the complaints relate to the bankrupt's home.

### **3.4 Evaluation of the Bankrupt's Home provisions (continued)**

#### Customer satisfaction with trustees' dealings with bankrupts' homes (continued)

31. In summary, the open-ended timescale within which an interest in a property could be dealt with by a trustee prior to the Enterprise Act 2002 led to a significant number of complaints by bankrupts or third parties who hold an interest in a property in which a bankrupt has an interest. The introduction of the 3-year time scale under the Enterprise Act 2002 to deal with such an interest should reduce this level of complaints.

#### The transitional provisions

32. The Enterprise Act 2002 also contains transitional provisions for cases where the bankruptcy petition was presented before 1 April 2004 where there is a bankrupt's interest in a family home<sup>108</sup>. The transitional provisions state that such interests must be dealt with by 31 March 2007 (unless an application for an extension of time is made) - otherwise, the interest reverts to the bankrupt.

33. As a result of the transitional provisions, the 'back-log' of cases held by the Official Receiver as trustee ex officio where the bankrupt held an interest in a property (that fell within the Enterprise Act 2002 provisions) have now been dealt with (see paragraphs 14-16). This has given rise to a number of complaints to The Insolvency Service since the implementation of the Enterprise Act 2002 (see paragraph 28). However, it is assumed that these complaints would have arisen at some time in the future when the property interest was dealt with – the Enterprise Act 2002 has merely accelerated the receipt of the complaint.

34. However, the Official Receiver held a number of cases as ex officio trustee where the interest in the property fell under the transitional provisions and that interest was not dealt with by 31 March 2007. Therefore, the interest in the property has reverted to the bankrupt, and in some cases, the bankrupt's estate has suffered a loss as a result. In such cases, The Insolvency Service is investigating why no action was taken, and, if appropriate, The Insolvency Service is reimbursing the bankrupt's estate with the amount lost as a result of a failure to deal with the property interest, known as a 'fruitless payment'.

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<sup>108</sup> The transitional arrangements only apply to interests in a family home that fall under the definition of a 'qualifying interest' under the Enterprise Act 2002. A 'qualifying interest' is a bankrupt's interest in a dwelling-house that is the sole or main residence of the bankrupt, the bankrupt's spouse or former spouse.

### **3.4 Evaluation of the Bankrupt's Home provisions (continued)**

#### The transitional provisions (continued)

35. As at October 2007, the Insolvency Service was dealing with 25 such 'fruitless payment' cases. The Insolvency Service estimates that in 12 cases, it may pay out in excess of £280,000 in 'fruitless payments', with enquiries ongoing in 13 cases to establish whether the Official Receiver is at fault.

36. It should be noted that where it is clearly the case that the property interest was lost because an insolvency practitioner as trustee, when seeking his release, failed to notify the Official Receiver of the outstanding property interest, The Insolvency Service's view is that the Official Receiver cannot be held to be responsible for this and thus a 'fruitless payment' by The Insolvency Service is not merited.

37. The Insolvency Service is aware of such cases. Under section 299(5) of the Insolvency Act 1986, where a trustee (or the Official Receiver) has been released, he is discharged from all liability both in respect of acts or omissions in his administration of the bankruptcy estate. Therefore, a creditor would need to make an application to court under section 304 of the Insolvency Act 1986 for an order that the trustee, for the benefit of the estate, repays such sum by way of compensation as the court sees fit.

38. The level of cases where there is a potential claim against an insolvency practitioner as (former) trustee is not known. No such cases have been identified in the pre-Enterprise Act 2002 case sampling exercise – however, details are not available on how property interests were dealt with in around 11% of cases. Therefore, it is recommended that further enquiries are made as regards these cases to establish the impact of the transitional provisions in this respect.

39. In summary, the transitional provisions have speeded up the realisation of existing interests in properties that fall within the Enterprise Act 2002 provisions. The transitional provisions have also lead to a number of possible 'fruitless payments' by The Insolvency Service, and there may be a number of claims made against insolvency practitioners as (former) trustees under section 304 of the Insolvency Act 1986.

#### **Balance between the interests of the bankrupt and creditors**

40. The Enterprise Act 2002 provisions aim to provide a balance between the interests of the bankrupt (and his/her family) and the creditors by providing ample time for the disposal by the trustee of the bankrupt's interest in his/her sole and principal residence in the most appropriate manner. Essentially, the Act seeks to ensure that an interest in a property is still an asset of the estate, and creditors will receive a return from the timely sale of this asset accordingly.

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Balance between the interests of the bankrupt and creditors (continued)

41. The evaluation looks at the impact of the Enterprise Act 2002 on returns to creditors and creditor satisfaction with the way a bankrupt's interest in a property is dealt with.

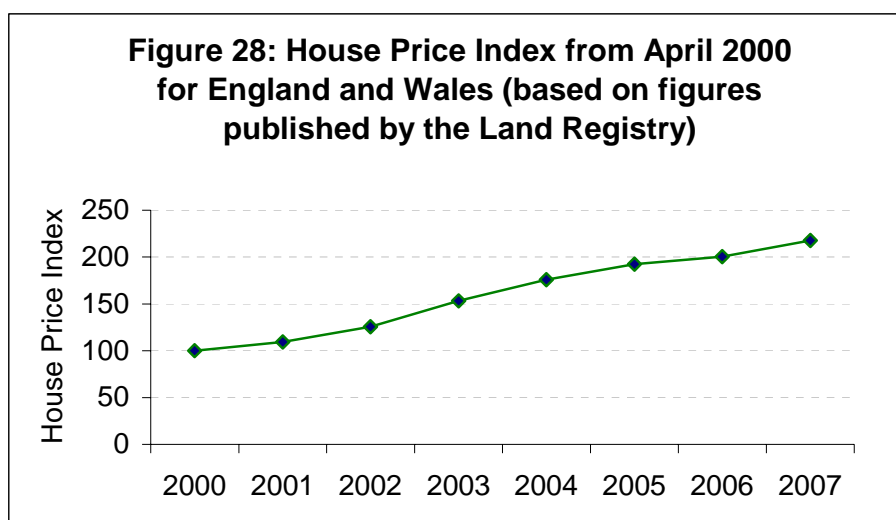
#### Returns to creditors

42. The Act introduces three provisions that will potentially impact on returns to creditors as follows:

- The 3-year time limit within which a bankrupt's interest in a family home must be dealt with (see paragraphs 3-5);
- The re-vesting provisions; and
- The 'de minimis' provisions.

43. Because of the impact of external factors, such as the changes in house prices, it is not appropriate to compare the realisation amounts of property interests in cases before and after the Enterprise Act 2002. Therefore, it is not possible to assess whether creditors are receiving a lower return as a result of time scales imposed by the Enterprise Act 2002.

44. However, it is clear from case studies that pre-Enterprise Act 2002, creditors received more money through the realisation of properties more than 3 years after the bankruptcy order compared to if that realisation had taken place within 3 years of the bankruptcy order. This is due mainly to the increase in house prices (see Figure 28) and, in most cases, a reduction in the mortgage as the bankrupt has remained in the property.



### **3.4 Evaluation of the Bankrupt's Home provisions (continued)**

#### Returns to creditors (continued)

45. However, the increase in monies received through the realisation of properties more than 3 years after the bankruptcy order has to be balanced against the timeliness of any dividend paid to creditors, and the interests of the bankrupt. It is clear that the protracted realisation of a bankrupt's interest in a family home has given rise to a substantial number of complaints by bankrupts (see paragraph 27). Further, it appears that many bankrupts say they were not aware that their interest in a property remained part of the bankruptcy estate until it was realised – if they had, the bankrupts may have sought to come to an agreement with the trustee earlier. Therefore, in many cases, creditors may have benefited as a result of a bankrupt's ignorance, rather than a deliberate policy on the part of trustees to 'sit and wait' for an increase in the value of an interest in a property.

46. Therefore, although creditors may receive more money if a property is realised after 3 years, creditors will now receive a timely dividend from the realisation of a bankrupt's interest in a family home, and bankrupts are not unfairly penalised.

47. Prior to the Enterprise Act 2002, all property interests were eventually realised unless the property interest was disclaimed. Under the Act, a property interest can re-vest in a bankrupt if either the trustee sends notice to the bankrupt that he considers that the continued vesting of the dwelling-house in the bankrupt's estate will be of no benefit to creditors or that re-vesting will facilitate a more efficient administration of the bankrupt's estate, or if the trustee fails to deal with the property interest within the 3 year period. A property interest can also be disclaimed post-Enterprise Act 2002.

48. From the results of the case sampling exercise, pre-Enterprise Act 2002, no property interests were disclaimed, but around 12% were realised for £1 or less - around 4% were under the low cost conveyancing scheme and around 2% were by agreement with the trustee (see Table 15). The low-cost conveyancing scheme is a scheme set up by The Insolvency Service where a third-party, or the bankrupt, agrees to purchase the bankrupt's interest in the property from the Official Receiver as trustee.

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Returns to creditors (continued)

**Table 15: Level of cases realised for £1 or less broken down by realisation type**

Realisation method	% of cases	
	Pre-Enterprise Act 2002 cases	Post-Enterprise Act 2002 cases
Voluntary sale on open market	4.98%	-
Low cost conveyancing scheme	4.15%	14.71%
Sale by agreement with the trustee	2.07%	-
Other	0.41%	-
<b>Total % of cases realised for £1 or less</b>	<b>11.62%</b>	<b>14.71%</b>

49. Post-Enterprise Act 2002, around 15% of property interests have been realised for £1 or less, all under the low cost conveyancing scheme (see Table 15). Further, post-Enterprise Act 2002, around 1% of property interests have been disclaimed. Further such realisations may occur in post-Enterprise Act 2002 cases.

50. Further, pre-Enterprise Act 2002, property interests re-vested in a bankrupt in less than 1% of cases (under the transitional provisions), compared to around 1.5% of post-Enterprise Act 2002 cases. Further re-vestings may arise in post-Enterprise Act 2002 cases.

51. These results indicate that:

- Despite the re-vesting provisions, the Official Receiver as trustee is still realising a bankrupt's interest in a property that has, in effect, no monetary value. This is consistent with The Insolvency Service's policy<sup>109</sup>. Insufficient information is available to ascertain whether IPs, as trustee, are seeking to realise such interests, or whether they will simply rely on the re-vesting provisions.
- The re-vesting provisions are being used in a small number of cases both in post-Enterprise Act 2002 cases, and pre-Enterprise Act 2002 cases under the transitional provisions. The level of cases where the interest re-vests in post-Enterprise Act 2002 cases may rise.

<sup>109</sup> The Insolvency Service's policy is set out in its technical manual, which can be accessed via The Insolvency Service's website at: <http://www.insolvency.gov.uk/freedomofinformation/technical/techmanvol1/Default.htm>

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Returns to creditors (continued)

- Prior to the Act, around 13% of property interests were realised for £1 or less<sup>110</sup>. Based on information available to date, a higher proportion of cases post-Enterprise Act 2002 will be realised for £1 or less.
- Post-Enterprise Act 2002, property interests are being disclaimed, which was very rare prior to the Act.

52. Therefore, on the basis of available information, it appears that the Official Receiver is dealing with interests in properties with no value in a timely manner, rather than relying on the re-vesting provisions at the end of the three year period. It is recommended that the property case sampling exercise is completed to provide full information on the effect of the re-vesting provisions.

53. The Enterprise Act 2002 also introduced 'de minimis' provisions, whereby if the value of the bankrupt's interest in a family home is below £1,000, the court will dismiss any application by the trustee for either an order for sale of, an order for possession of or charging order on that property. In effect, if the bankrupt's interest in a family home is less than £1,000 and no agreement can be reached, the trustee has no method of realising that interest.

54. Prior to the implementation of the Enterprise Act 2002, in a typical bankruptcy case, the fees chargeable were around £550<sup>111</sup>. If £1,000 was received as an asset of the estate, fees of £385 would have been payable<sup>112</sup>. Therefore, the surplus available on a £1,000 realisation would have been minimal. As such, assuming there are no other bankruptcy assets, creditors are not losing money as a result of the 'de minimis' provisions.

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<sup>110</sup> This is based on the 12% that were realised for £1 or less (see paragraph 48) and the level that have re-vested under the transitional provisions (see paragraph 50), assuming that in the absence of the transitional provisions, the property interest would have been realised for £1 or less.

<sup>111</sup> The fees chargeable would have been:

	£
Gazette fee (incl. VAT)	22.47
Local Advertisement (est.)	30.00
Administration fee	320.00
Stationery fee	<u>175.00</u>
Total	547.47

<sup>112</sup> The following fees would have been payable on a realisation of £1,000:

	£
Realisation fee (20%)	200.00
VAT on realisation fee	35.00
SOS fee (15%)	<u>150.00</u>
Total	385.00

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Returns to creditors (continued)

55. From the results of the case sampling exercise, pre-Enterprise Act 2002, around 12.5% of property interests were realised for £1,000 or less - around 4% were under the low cost conveyancing scheme and around 2% were by agreement with the trustee (see Table 16).

56. Post-Enterprise Act 2002, around 17% of property interests have been realised for £1,000 or less, with around 16% being realised under the low cost conveyancing scheme (see Table 16). Further such realisations may occur in post-Enterprise Act 2002 cases.

57. Therefore, it is clear that despite the introduction of the 'de minimis' provisions, trustees are still seeking to realise property interests valued at less than £1,000. Therefore, the introduction of the 'de minimis' provisions do not appear to have impacted on the returns to creditors. It is recommended that the property case sampling exercise is completed to provide full information on the effect of the 'de minimis' provisions.

**Table 16: Level of cases realised for £1,000 or less broken down by realisation type**

Realisation method	% of cases	
	Pre-Enterprise Act 2002 cases	Post-Enterprise Act 2002 cases
Voluntary sale on open market	5.81%	0.84%
Low cost conveyancing scheme	4.15%	15.97%
Sale by agreement with the trustee	2.07%	-
Other	0.41%	-
<b>Total % of cases realised for £1,000 or less</b>	<b>12.45%</b>	<b>16.81%</b>

#### Creditor satisfaction with trustees' dealings with bankrupts' homes

58. There is no record of any complaints from creditors in The Insolvency Service's Complaints Register either before or after the Enterprise Act 2002 regarding the way a bankrupt's interest in a family home is dealt with.

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

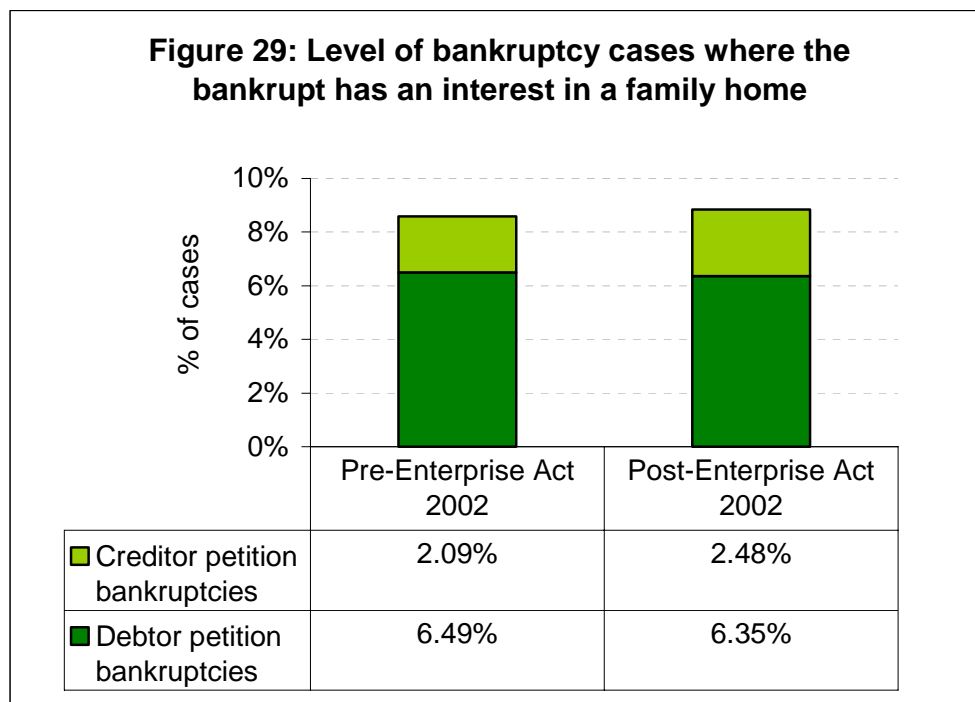
#### Stigma of bankruptcy

59. It was believed that providing certainty as to the time-scale in which a bankrupt's interest in a family home would be realised would help to lessen the stigma associated with bankruptcy.

60. The evaluation looks at the impact of the bankrupt's home provisions on the level of bankruptcies with such an asset and on attitudes to bankruptcy.

#### Level of bankruptcies with an interest in a family home

61. In broad terms, the level of bankruptcies where the bankrupt has an interest in a family home<sup>113</sup>, and the breakdown of the petition type in such cases, has remained unchanged by the implementation of the Enterprise Act 2002 (see Figure 29). Both before and after the implementation of the Enterprise Act 2002, less than 9% of bankrupts have an interest in a family home, and similarly, both before and after the implementation of the Enterprise Act 2002, less than 7% of debtor-petition bankrupts have an interest in a family home.



<sup>113</sup> An interest in a family home is defined as a property interest that fall under the definition of a 'qualifying interest' under the Enterprise Act 2002. A 'qualifying interest' is a bankrupt's interest in a dwelling-house that is the sole or main residence of the bankrupt, the bankrupt's spouse or former spouse.

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Level of bankruptcies with an interest in a family home (continued)

62. Therefore, it would appear that the new provisions under the Act have not affected a debtor's willingness to enter into bankruptcy proceedings, where the debtor has an interest in a 'family home'.

#### Attitudes to bankruptcy

63. The surveys carried out by The Insolvency Service as regards attitudes to bankruptcy<sup>114</sup> show that, overall<sup>115</sup>, there is a stigma associated with bankruptcy both before and after the implementation of the Enterprise Act 2002, and that the level of perceived stigma has not significantly changed.

64. As regards the effects of bankruptcy, overall<sup>2</sup>, the main reasons why stigma exists are problems in obtaining a bank account, the fact that bankrupts are unable to repay creditors and the effect on credit rating. Post-Enterprise Act 2002, individuals identified the possible loss of the family home as the most significant element of the effects of bankruptcy that contributed to the stigma associated with bankruptcy. In contrast, bankrupts identified the possible loss of the family home as the least significant element.

65. However, both before and after the Enterprise Act 2002, a bankrupt's interest in a family home is an asset in bankruptcy – the Act provisions merely set a time scale for when that interest is dealt with.

66. Therefore, it appears that the bankrupt's home provisions contained in the Enterprise Act 2002 will not reduce the stigma associated with bankruptcy for those individuals who own their own home.

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<sup>114</sup> The full survey results are available in reports entitled 'Attitudes to bankruptcy' (<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/attitudes/report-attitudestobankruptcy1.pdf>) and 'Attitudes to bankruptcy revisited' (<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/ABrevisited/ABrevisitedMenu.htm>)

<sup>115</sup> This overall opinion is the combination of the survey results of bankrupts, individuals and businesses, and is an average of these sectors' responses, i.e. each sector has been given equal weighting. The results have not been combined by way of a weighted average based on population size as, from a policy perspective, this would not be appropriate in the context of attitudes to bankruptcy acting as a deterrent to enterprise. If the overall opinion was a weighted average based on population size, it would mirror the individual sector responses due to its relative population size.

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Summary

**To provide some certainty to the bankrupt, the trustee and the creditors as to the time scale within which the bankrupt's home will be dealt with, as previously that time scale was open ended**

- Before the Enterprise Act 2002, around 15% of property interests were dealt with more than 3 years from the date of the bankruptcy order (see paragraph 11).
- The primary reason why, prior to the Enterprise Act 2002, it could take over 3 years to deal with an interest in a property is because the trustee had not taken any action in respect of the property and the bankrupt was not aware (or failed to realise) that the interest remained vested in the trustee until such time as the interest was realised (see paragraphs 12-13).
- The provisions of the Enterprise Act 2002 should ensure that property interests are dealt with within 3 years (subject to exceptions provided for in the Act) (see paragraph 16).
- On information available to date, the methods of dealing with a property interest that could be said not to offer certainty to the bankrupt, the trustee or creditors are not used in a high proportion of cases (see paragraphs 21-26).
- The open-ended timescale within which an interest in a property could be dealt with by a trustee prior to the Enterprise Act 2002 led to a significant number of complaints by bankrupts or third parties who hold an interest in a property in which a bankrupt has an interest. The introduction of the 3-year time scale under the Enterprise Act 2002 to deal with such an interest should reduce this level of complaints (see paragraphs 27-31).

### **3.4 Evaluation of the Bankrupt's Home provisions (continued)**

#### **Summary (continued)**

**To provide a balance between the interests of the bankrupt (and his/her family) and the creditors by providing ample time for the disposal by the trustee of the bankrupt's interest in his/her sole and principal residence in the most appropriate manner**

- Creditors received more money through the realisation of properties more than 3 years after the bankruptcy order compared to if that realisation had taken place within 3 years of the bankruptcy order. This is due mainly to the increase in house prices and, in most cases, a reduction in the mortgage as the bankrupt has remained in the property (see paragraphs 43-44).
- However, many bankrupts say they were not aware that their interest in a property remained part of the bankruptcy estate until it was realised – if they had, many bankrupts may have sought to come to an agreement with the trustee earlier. Therefore, in many cases, creditors may have benefited as a result of a bankrupt's ignorance, rather than a deliberate policy on the part of trustees to 'sit and wait' for an increase in the value of an interest in a property (see paragraph 45).
- Further, although creditors may receive more money if a property is realised after 3 years, creditors will now receive a timely dividend from the realisation of a bankrupt's interest in a family home (see paragraph 46).
- The Official Receiver, as trustee, is dealing with interests in properties with no value in a timely manner, rather than relying on the re-vesting provisions at the end of the 3-year period (see paragraph 48-52).
- The introduction of the 'de minimis' provisions do not appear to have impacted on the returns to creditors (see paragraphs 53-57).

#### **To help lift the stigma of bankruptcy**

- The level of bankruptcies where the bankrupt has an interest in a family home, and the breakdown of the petition type in such cases, has remained unchanged by the implementation of the Enterprise Act 2002 (see paragraph 61).
- It does not appear that the bankrupt's home provisions contained in the Enterprise Act 2002 will reduce the stigma associated with bankruptcy for those individuals who own their own home (see paragraphs 63-66).

### 3.4 Evaluation of the Bankrupt's Home provisions (continued)

#### Recommendations

- That The Insolvency Service completes the post-Enterprise Act 2002 case sampling exercise as regards a bankrupt's interest in a family home to obtain full post-Enterprise Act 2002 information on:
  - how often, and why, property interests are not dealt with within 3 years from the bankruptcy order (see paragraphs 10-20);
  - the overall timeliness of dealing with property interests (see paragraphs 10-20);
  - how often methods of dealing with a property interest which could be said to not offer certainty to the bankrupt, the trustee or creditors are used, and why (see paragraphs 22-26);
  - the effect of the re-vesting provisions (see paragraphs 47-52); and
  - the effect of the 'de minimis' provisions (see paragraphs 53-57).
- That The Insolvency Service makes further enquiries on the sample of pre-Enterprise Act 2002 cases where no details are available on how the property interests were dealt with, to establish the impact of the transitional provisions (see paragraphs 32-38).

### **3.5 Evaluation of the Contributions from Income by Bankrupts provisions**

1. This section of the report contains evaluation evidence regarding the achievement of the intermediate objectives of the contributions from income by bankrupts provisions contained in the Enterprise Act 2002. The objectives of these provisions are:

- To reduce the time spent by the Official Receiver and Court in dealing with IPO applications where a bankrupt has consented; and
- To improve returns to creditors.

#### **Time saved**

2. Prior to the Enterprise Act 2002, a bankrupt would make payments out of income to his trustee for the benefit of his creditors through an Income Payments Order (IPO), which is an order made by the court. However in many cases, a bankrupt consented to the terms of that order and therefore there was no obvious benefit derived from the need to have a Court hearing. Such hearings involve time and expense on behalf of the trustee, the court and the bankrupt and are often nothing more than a “rubber-stamping” exercise by the court. This serves only to delay the process and use up funds that would otherwise be available for creditors. Further, if any variations to an IPO were necessary (resulting from, say, a change in the bankrupt’s income), an application to court was also required.

3. The Enterprise Act 2002 introduced Income Payments Agreements (IPAs) as an administrative alternative to court-based IPOs. An IPA is an agreement between a bankrupt and his trustee or the Official Receiver – in writing – that the bankrupt will pay an amount of his income to the trustee/Official Receiver for a specified period or such an agreement where the money is paid by a third party from money due. Any variation of the IPA can be made by written consent of both parties. IPAs will carry the same conditions as IPOs and both will be able to run for a period of three years. In cases where a bankrupt and the Official Receiver cannot agree on an IPA, an IPO can be applied for.

4. Prior to the Enterprise Act 2002, in the majority of cases the Official Receiver would initially act as the trustee in cases where an IPO was obtained and the case would be subsequently handed over to an insolvency practitioner (IP). In some instances, an IP as trustee may have applied for an IPO where the IP has been appointed on the basis of other assets within the bankruptcy estate. After the Enterprise Act 2002, the Official Receiver can enter into an IPA and under The Insolvency Service’s internal policy, the case will usually remain with the Official Receiver. Once again there will be some instances where the IP has been appointed on the basis of other assets within the bankruptcy estate, and thus an IP as trustee will apply for an IPA. However, it is assumed that as the Official Receiver dealt with most IPO applications prior to the Enterprise Act 2002, it will be the Official Receiver, rather than IPs acting as trustees, who will benefit as a result of any time-savings as a result of the introduction of IPAs.

### 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

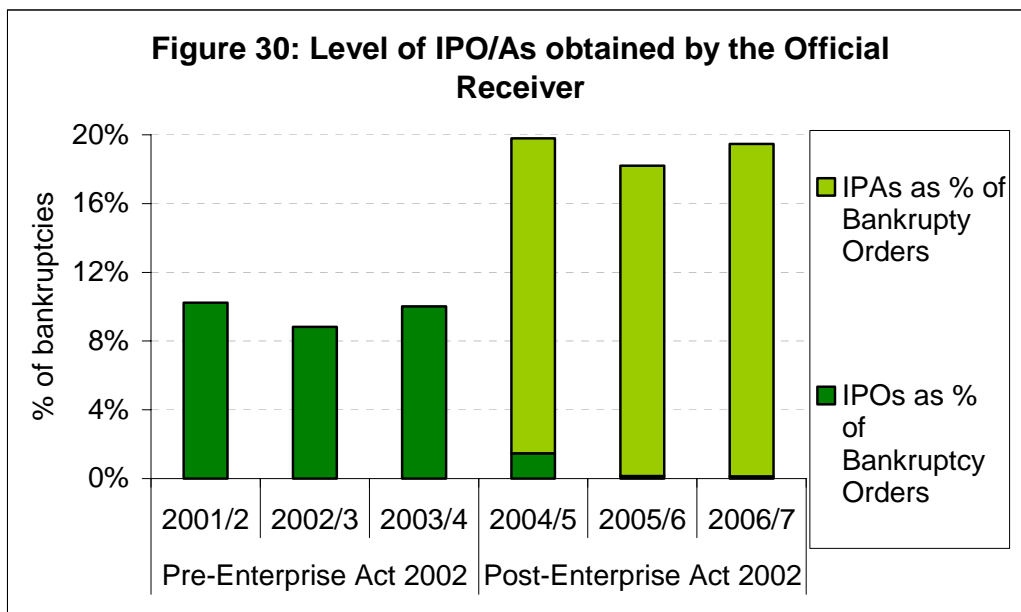
#### Time saved (continued)

5. As regards the time saved as a result of the introduction of the IPA regime, the evaluation looks at the level of IPO/As obtained, the impact on the time of the Official Receiver and Court and the impact on IPO/A contestations and variations.

#### Level of IPO/As

6. Since the implementation of the Enterprise Act 2002, the IPA provisions have been well used. The IPA regime has been used in almost all post-Enterprise Act 2002 cases where contributions from bankrupts have been obtained by the Official Receiver as trustee (see Figure 30).

7. Prior to the Enterprise Act 2002, the Official Receiver obtained IPOs in about 10% of bankruptcies. Figures post-Enterprise Act 2002 show that the level of IPO/As obtained by Official Receivers in relation to bankruptcy orders has nearly doubled (see Figure 30). The increase in IPO/As obtained post-Enterprise Act 2002 is explained by the increase in IPAs obtained based on income of self-employed bankrupts and IPAs based on the 'NT' tax coding of employee bankrupts (see paragraphs 40-47).



## 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

### Time saved by the Official Receiver

8. It is estimated that there is a saving of 30 minutes by Official Receivers as regards the administration of IPAs compared to IPOs<sup>116</sup>. The time saved is in relation to the work involved in making the application to court. Therefore, in the 3 years since the implementation of the Enterprise Act, the Official Receiver saved over 14,000 hours of administration as a result of the introduction of the IPA regime<sup>117</sup>. This time saving is counteracted by the increase in IPO/As obtained post-Enterprise Act 2002. However, based on the level of IPOs prior to the Act, the Official Receiver has still saved in the region of over 7,000 hours in the 3 years since the implementation of the Act as a result of the introduction of the IPA regime<sup>118</sup>.

9. Further, prior to the Enterprise Act 2002, if an IPO was to be varied, application needed to be made to court to vary the IPO, even if the Official Receiver did not contest the variation. As the court is not involved in IPAs, an IPA can be varied simply by agreement between the Official Receiver and bankrupt. A court application is only necessary if the IPA variation is contested by either party.

10. It is estimated that, prior to the Enterprise Act 2002, an IPO variation took, on average, around 1.4 hours<sup>119</sup>. Assuming a saving of 30 minutes by Official Receivers as regards the administration of IPAs compared to IPOs, it is estimated that an IPA variation would take around 50 minutes. From a case sampling exercise of post-Enterprise Act 2002 IPAs obtained in 2004/5, variations of IPAs occurred in around 22% of IPA cases<sup>120</sup>. Therefore, the Official Receiver has saved around 3,000 hours as a result of being able to vary an IPA without reference to the court<sup>121</sup>.

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<sup>116</sup> Staff have been consulted regarding potential time-savings as a result of the introduction of Income Payment Agreements. The consensus view is that there is no time saved in respect of obtaining the necessary information from the bankrupt (as the dialogue with the bankrupt is essentially the same). However, as regards the administration of Income Payment Agreements, the consensus view is that time is saved as regards the preparation of the necessary papers, as no application to court is necessary. It is estimated that the time saved is approximately 30 minutes and this estimate is consistent with data available through The Insolvency Service's time recording system.

<sup>117</sup> Based on statistics published by The Insolvency Service, there were 29,030 IPAs obtained in the three years ended 31 March 2007. This is assuming all IPO/As obtained in this 3 year period would have been obtained regardless of the introduction of the IPA regime.

<sup>118</sup> Prior to the Enterprise Act 2002, on average, IPOs were obtained in 9.68% of bankruptcy cases. In the 3 years since the implementation of the Enterprise Act 2002, there were 155,558 bankruptcy cases and the split between IPO and IPA cases is 1: 41 approximately. Therefore, ignoring the increase in the level of IPO/As obtained, we can assume that the Official Receiver would have obtained in the region of 15,060 IPO/As in the 3 year period post-Enterprise Act 2002, consisting of around 367 IPOs and 14,693 IPAs.

<sup>119</sup> Based on a small sample of time recording data which is clearly attributable to the work involved in an Income Payment Order variations.

<sup>120</sup> The Insolvency Service has undertaken a case sampling exercise of IPAs. The sample was drawn from IPAs obtained in the year ended 31 March 2005. There were 6,885 such IPOs, and 498 cases were randomly sampled. Variations were made in 95 cases, with details not being available in 58 cases.

<sup>121</sup> There were 29,030 IPAs obtained in the 3 years ended 31 March 2002. This is assuming that all IPAs obtained in this 3 year period would have been obtained regardless of the introduction of the IPA regime.

### **3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)**

#### Time saved by the Official Receiver (continued)

11. However, it should also be noted that before the Enterprise Act 2002, based on a case sampling exercise of IPOs obtained in 2001/2, formal variations to IPOs occurred in around only 8% of cases<sup>122</sup> - in many other cases, the monies due under the IPO have not been received but it does not appear that a formal variation of the Court Order was sought. Therefore, assuming that this level of formal variations would have been sought, the Official Receiver has saved around 1,000 hours as a result of being able to vary an IPA without reference to the court<sup>123</sup>. As before, this time saving is counteracted by the increase in IPO/As obtained post-Enterprise Act 2002. However, based on the level of IPOs prior to the Act, the Official Receiver has still saved in the region of over 500 hours in the 3 years since the implementation of the Act as a result of the introduction of the IPA regime<sup>118</sup>.

#### Time saved by the Court

12. The court will also benefit from the induction of IPAs as the involvement of the court has been removed from the IPA process (except in cases of dispute).

13. From case records, it appears that prior to the Enterprise Act 2002, nearly all uncontested Income Payment Order applications/variations were made by way of an application without notice (ex parte application). Presumably, this is because the bankrupt has provided written agreement to the making of the order/variation. Therefore, the only Court time saved is as regards 'rubber-stamping' the Income Payment Order/variation.

14. From anecdotal evidence provided by the Court Service, the 'rubber-stamping' of an order takes around 15 minutes. This includes the time to locate the necessary file, a judge checking that the order is correct and dealing with the necessary paperwork and administrative tasks.

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<sup>122</sup> The case sample of 499 IPOs obtained in 2001/2 identified 41 variations.

<sup>123</sup> There were 29,030 IPAs obtained in the 3 years ended 31 March 2002. This is assuming that all IPAs obtained in this 3 year period would have been obtained regardless of the introduction of the IPA regime.

### **3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)**

#### Time saved by the Court (continued)

15. Therefore, in the three years since the implementation of the Enterprise Act 2002, the Court has saved over 7,000 hours of administration as a result of the introduction of the IPA regime, assuming that the court would have had to deal with all the IPAs obtained as IPO applications<sup>124</sup>. However, it may be that the level of IPA/Os obtained since the implementation of the Act would not have been achieved in the absence of the IPA regime; but, based on the level of IPOs prior to the Enterprise Act 2002, the Court has still saved in the region of over 3,500 hours in the 3 years since the implementation of the Act as a result of the introduction of the IPA regime<sup>125</sup>.

16. As detailed above, from a case sampling exercise of IPOs obtained in 2001/2, formal uncontested variations of IPOs occurred in around 8% of IPO cases. Therefore, ignoring the increase in IPO/As obtained post-Enterprise Act 2002, the court has saved a further 300 hours in the 3 years since the implementation of the Enterprise Act 2002, as a result of not having to deal with uncontested IPA variations<sup>125</sup>.

#### Impact on IPO/A contestations and variations

17. The evaluation has also looked at whether the IPA provisions have impacted on the level of cases where the bankrupt contests the Official Receiver's claim for contributions from the bankrupt's income, and the level of variations.

18. Prior to the Enterprise Act 2002, based on case sampling results, around 3% of IPO applications were contested<sup>126</sup>. Since the implementation of the Enterprise Act 2002, the Official Receiver has only sought IPOs in cases where the bankrupt will not consent to an IPA. In the three years since the implementation of the Enterprise Act 2002, IPOs were sought in around 2.5% of all IPO/As obtained<sup>127</sup>. Therefore, it appears that the introduction of the IPA regime has not had a significant impact on the level of cases where the bankrupt contests the Official Receiver's claim for contributions from the bankrupt's income.

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<sup>124</sup> Based on statistics published by The Insolvency Service, there were 29,030 IPAs obtained in the three years ended 31 March 2007. This is assuming all IPO/As obtained in this 3 year period would have been obtained regardless of the introduction of the IPA regime.

<sup>125</sup> Prior to the Enterprise Act 2002, on average, IPOs were obtained in 9.68% of bankruptcy cases. In the 3 years since the implementation of the Enterprise Act 2002, there were 155,558 bankruptcy cases and the split between IPO and IPA cases is 1: 41 approximately. Therefore, ignoring the increase in the level of IPO/As obtained, we can assume that the Official Receiver would have obtained in the region of 15,060 IPO/As in the 3 year period post-Enterprise Act 2002, consisting of around 367 IPOs and 14,693 IPAs.

<sup>126</sup> The Insolvency Service has undertaken a case sampling exercise of IPOs. The sample was drawn from IPOs obtained in the year ended 31 March 2002. There were 2,396 such IPOs, and 499 cases were randomly sampled. There were 17 contested IPO applications in the sample

<sup>127</sup> From statistics published by The Insolvency Service, in the 3 years since the implementation of the Enterprise Act 2002, there were 707 IPOs and 29,737 total IPO/As obtained.

## 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

### Impact on IPO/A contestations and variations (continued)

19. Prior to the Enterprise Act 2002, based on case sampling results, around 8% of IPOs were subject to variations<sup>128</sup> - no contested IPO variations were identified (either by the bankrupt or Official Receiver), which suggests that contested IPO variations were very uncommon pre-Enterprise Act 2002. Further, pre-Enterprise Act 2002, in many other cases, the monies due under the IPO have not been received but it does not appear that a formal variation of the Court Order was sought. Case study material shows that in many cases, pre-Enterprise Act 2002, monies due under an IPO have not been received due to a change in the circumstances of the bankrupt, rather than simply choosing not to pay. Since the Act, based on case sampling results, around 22% of IPO/As have been varied – no contested IPO/A variations have been identified.

20. Therefore, although the level of formal variations has increased post-Enterprise Act 2002, this appears to be due to the ability to vary an IPA without reference to court. In effect, the Official Receiver is now formally varying an IPA (because it can be done administratively), whereas prior to the Enterprise Act 2002, formal variations of IPOs were not routinely made albeit that the terms of an IPO could not be met due to a change in the circumstances of the bankrupt.

### **Returns to creditors**

21. The internal records of The Insolvency Service show that there has been an increase in the average receipt collected on IPO/As since the implementation of the Enterprise Act 2002. The average receipt collected on completed IPO/As in pre-Act cases, where the Official Receiver was trustee, was around £770<sup>129</sup>. In contrast, the average receipt collected in the 17-month period after the implementation of the Enterprise Act 2002 on post-Act bankruptcies was around £1,400<sup>130</sup>. However, the receipt collected on an IPO/A is dependent on the circumstances of the bankrupt - in particular, the bankrupt's income level. As no data is available on the income levels of bankrupts, we cannot infer that the increase in the average receipt collected on IPO/As post-Enterprise Act 2002 is solely attributable to the introduction of the IPA regime.

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<sup>128</sup> The case sample of 499 IPOs obtained in 2001/2 identified 41 variations.

<sup>129</sup> Based on banking records maintained by The Insolvency Service, the average receipt collected on IPO/As completed in the year ended 30 September 2005 was £768.99.

<sup>130</sup> Banking data held by The Insolvency Service shows that in cases where the Bankruptcy Order was between 1 April 2004 to 30 June 2004 and the Official Receiver is trustee, the total amount collected up to 30 August 2005 was £2,302,804. There were 1,608 cases with IPO/A receipts and therefore, the average receipt per case was £1,432.

## 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

### Returns to creditors (continued)

22. Therefore, this evaluation looks at the aim of the introduction of the IPA provisions to improve returns to creditors through:

- A possible increase in the number of payments under an IPA/Os;
- A reduction in costs charged to the estate; and
- A possible increase in the level of IPA/IPOs obtained.

23. With this approach, the impact of any changes in income levels (or other circumstances) of bankrupts is minimised.

### Number of payments under an IPA/O

24. Prior to the Enterprise Act 2002, where an IPO was based on surplus monthly income rather than to cover a temporary situation such as seasonal overtime, it was The Service's policy to obtain orders until discharge unless there were specific reasons why this should not be done (such non-co-operation of the bankrupt or suspension of discharge). This meant that IPOs in summary cases would only last for a maximum of 24 months. Under the Enterprise Act 2002, IPO/As can be obtained for 36 months regardless of when discharge occurs.

25. Additionally, prior to the Enterprise Act 2002, it took between 2 and 4 months for the IPO to be obtained (and often longer where the bankrupt did not consent to the IPO). This meant that an IPO may have lasted for less than 36 months (in non-summary cases) or 24 months (in summary cases) if a bankrupt did not pay voluntarily prior to obtaining the order of court. Post-Enterprise Act 2002, as an IPO/A is not tied-in to discharge, the majority of IPO/As should last for 36 months regardless of when the agreement is made.

26. Based on case sampling results, prior to the Enterprise Act 2002, around 20% of IPOs obtained based on monthly surplus income were agreed for 24 monthly payments or less, with less than 5% of IPOs being agreed for over 36 monthly payments<sup>131</sup>. Post-Enterprise Act 2002, around 5% of IPO/As obtained based on monthly surplus income were agreed for 24 monthly payments or less<sup>132</sup>.

27. Therefore, the number of proposed payments has increased since the introduction of the IPA regime.

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<sup>131</sup> In the case sample of 499 IPOs obtained in 2001/2, there were 412 IPOs based on monthly contributions. In 84 cases, the number of monthly agreements was 24 or less, and in 15 cases, the number of monthly agreements was more than 36.

<sup>132</sup> In the case sample of 498 IPOs obtained in 2004/5, there were 316 IPOs based on monthly contributions. In 16 cases, the number of monthly agreements was 24 or less.

### **3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)**

#### Number of payments under an IPA/O (continued)

28. Prior to the Enterprise Act 2002, based on case sampling results, 36% of IPOs based on monthly surplus income were paid in full<sup>133</sup>. Further, in around 36% of cases, less than half of the monies due were actually collected, with nothing being collected in around 9% of cases.

29. Post-Enterprise Act 2002, based on case sampling results for 2004/5 to date, 16% of IPAs based on monthly surplus income have been paid in full, with a further 28% of cases on target to be paid in full<sup>134</sup>. Further, in around 35% of cases, less than half of the monies due were actually collected, with nothing being collected in around 13% of cases.

30. Therefore, despite the increase in the number of proposed payments, the collection rates on IPO/As after the Enterprise Act 2002 are projected to be better than before the Act.

31. Both before and after the Enterprise Act 2002, where variations occur, the effect is usually to reduce, or cease, the payments due. Therefore, the Enterprise Act 2002 provisions do not appear to have had an impact on the type of IPO/A variations made.

#### Costs of an IPA

32. Prior to the Enterprise Act 2002, all applications for IPOs and IPO variations were made to the court and thus a court fee was payable on every such application. As an IPA does not involve an application to court and can be varied by agreement without the court's involvement, these court fees will not be incurred.

33. The majority of uncontested IPO applications/variations were made by way of an application without notice. Applications with notice were only requested where the bankrupt contested the IPO application. Prior to January 2006, the court fees payable for an application without notice and an application with notice were £25 and £50 respectively. However, from the results of the case sampling exercise, it appears that the court fee was waived in around one third of uncontested IPO applications/variations.

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<sup>133</sup> Of the 412 IPOs based on monthly contributions (in the case sample of 499 IPOs obtained in 2001/2), 147 IPOs were paid in full, 266 were not paid in full, and details could not be confirmed in 3 cases.

<sup>134</sup> Of the 316 IPOs based on monthly contributions (in the case sample of 498 IPOs obtained in 2004/5), 51 IPAs have been paid in full; 88 are on track to be paid in full; 129 were not paid in full, and details could not be confirmed in 6 cases.

## 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

### Costs of an IPA (continued)

34. As regards uncontested IPO applications, in the three years since the introduction of the Enterprise Act 2002, court fees in the region of £480,000 have been saved as a result of the IPA provisions<sup>135</sup>, assuming that the court would have had to deal with all the IPAs obtained as IPO applications. However, based on the level of IPOs prior to the Enterprise Act 2002, around £240,000 has still been saved in 2004/5 as a result of the introduction of the IPA regime<sup>136</sup>.

35. As regards uncontested variations of IPOs, these occurred in around 8% of IPOs pre-Enterprise Act 2002. The level of such variations to IPAs post-Enterprise Act 2002 is 22%, and this increase is attributable to the introduction of the IPA regime (see paragraphs 19-20). Therefore, it is reasonable to assume that in the absence of the IPA regime, uncontested IPA variations would occur in around 8% of cases. Therefore, in the three years since the introduction of the Enterprise Act 2002, additional court fees in the region of £39,000 have been saved as a result of the IPA provisions<sup>137</sup>, assuming that the court would have had to deal with all the IPAs obtained as IPO applications. However, based on the level of IPOs prior to the Enterprise Act 2002, around £20,000 has still been saved in 2004/5 as a result of the introduction of the IPA regime<sup>138</sup>.

36. No contested IPO/A variations have been identified in the case sampling exercises either before or after the Enterprise Act 2002, which indicates such applications are rare. Therefore, the impact of any court costs connected with such applications is not significant.

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<sup>135</sup> There were 29,030 IPAs in the three years to 31 March 2007. This is assuming all IPO/As obtained would have been obtained regardless of the introduction of the IPA regime, and that court fees would have been waived in one third of cases.

<sup>136</sup> Prior to the Enterprise Act 2002, on average, IPOs were obtained in 9.68% of bankruptcy cases. In the 3 years since the implementation of the Enterprise Act 2002, there were 155,558 bankruptcy cases and the split between IPO and IPA cases is 1: 41 approximately. Therefore, ignoring the increase in the level of IPO/As obtained, we can assume that the Official Receiver would have obtained in the region of 15,060 IPO/As in the 3 year period post-Enterprise Act 2002, consisting of around 367 IPOs and 14,693 IPAs.

<sup>137</sup> There were 29,030 IPAs in the three years to 31 March 2007. This is assuming all IPO/As obtained would have been obtained regardless of the introduction of the IPA regime, and that court fees would have been waived in one third of cases.

<sup>138</sup> Prior to the Enterprise Act 2002, on average, IPOs were obtained in 9.68% of bankruptcy cases. In the 3 years since the implementation of the Enterprise Act 2002, there were 155,558 bankruptcy cases and the split between IPO and IPA cases is 1: 41 approximately. Therefore, ignoring the increase in the level of IPO/As obtained, we can assume that the Official Receiver would have obtained in the region of 15,060 IPO/As in the 3 year period post-Enterprise Act 2002, consisting of around 367 IPOs and 14,693 IPAs.

## **3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)**

### Costs of an IPA (continued)

37. In the case of contested applications for IPOs (and contested IPO variations), the Official Receiver as trustee would usually attend a court hearing. In such cases, a court attendance fee was payable in addition to any travel and subsistence costs. As an IPA does not involve the court, these fees and costs will not be incurred (unless the variation is disputed). However, as detailed at paragraph 18, the introduction of the IPA regime has not had a significant impact on the level of cases where the bankrupt contests the Official Receiver's claim for contributions from the bankrupt's income and therefore, there are no potential significant savings.

38. Additionally, prior to the Enterprise Act 2002, it was The Service's policy to hand-over the majority of cases where an IPO had been obtained to an insolvency practitioner (IP). Since the implementation of the Enterprise Act 2002, The Service has introduced a new policy whereby the Official Receiver will remain trustee in the majority of cases with IPAs. Therefore, if the Official Receiver's remuneration claimed for dealing with an IPO/A is less than that charged by an insolvency practitioner, there may be a potential saving in the costs charged to the estate.

39. Post-Enterprise Act 2002, the Official Receiver, as trustee, does not charge for remuneration on the realisation of assets, although the costs of agents used in the collection of monies due under IPO/As are charged. Currently, no fee is payable if no realisation is made; otherwise, the fee for the collection of IPO/As is fixed at 10% of the sum realised plus VAT. However, it has not been possible to ascertain the level of remuneration charged by an IP for the collection of monies due under IPO/As.

### **Level of IPA/IPOs**

40. Because of the simplified process in obtaining an IPA, it should make it easier to recover payments from the self-employed and others whose income fluctuates such as employees who receive an 'NT' tax coding ('tax holiday')<sup>139</sup>.

41. As detailed at paragraph 7, the level of IPO/As obtained as a percentage of all bankruptcy orders has almost doubled since the introduction of the IPA regime.

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<sup>139</sup> The Inland Revenue has been in the practice of claiming in the bankruptcy proceedings in respect of income tax due for the whole of the tax year in which the bankruptcy order is made less the amount of tax paid and deducted up to the date of the order. In consequence, a "nil tax" (or NT) code is applied to the bankrupt for the remainder of the tax year in which he was made bankrupt so that he does not pay any tax on his income for that period and is thus in receipt of extra money. Where this "nil tax" code is put into place, the extra funds made available to the bankrupt, following this revision of the tax coding, are included in calculating the amount he is able to pay under an IPA. The IPA is drafted so that when at the end of the tax year the Inland Revenue recommence tax deductions from the bankrupt's income, the amount payable can be reduced accordingly or the agreement may only run for the period in which the bankrupt is in effect tax exempt.

### 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

#### Level of IPA/IPOs (continued)

42. Prior to the Enterprise Act 2002, case sampling results for 2001/2 IPOs show that around 11% of IPOs obtained were based on income of self-employed bankrupts. This means that IPOs were obtained from around 3% of self-employed bankrupts<sup>140</sup>.

43. After the Enterprise Act 2002, case sampling results for 2004/5 IPO/As show that around 7% of IPO/As were based on income of self-employed bankrupts. This means that IPO/As were obtained from around 5% of self-employed bankrupts<sup>141</sup>.

44. Therefore, since the IPA regime has been introduced, IPO/As have been obtained from a greater proportion of self-employed bankrupts. This suggests that the simplified process in obtaining an IPA has made it easier to recover payments from the self-employed.

45. Further, there has been a substantial increase in the proportion of IPAs obtained based on an 'NT' tax coding compared to IPOs obtained prior to the Enterprise Act 2002 (see Figure 31). Case sampling results for 2001/2 IPOs show that just over a quarter of IPOs obtained were based on an 'NT' tax coding – 18% were solely based on an 'NT' tax coding and 9% were based on an 'NT' tax coding plus monthly contributions. Since the Enterprise Act 2002, in 2006/7, the proportion of IPAs obtained based on an 'NT' tax coding was around two-thirds – 38% were solely based on an 'NT' tax coding and 27% were based on an 'NT' tax coding plus monthly contributions (see Table 17).

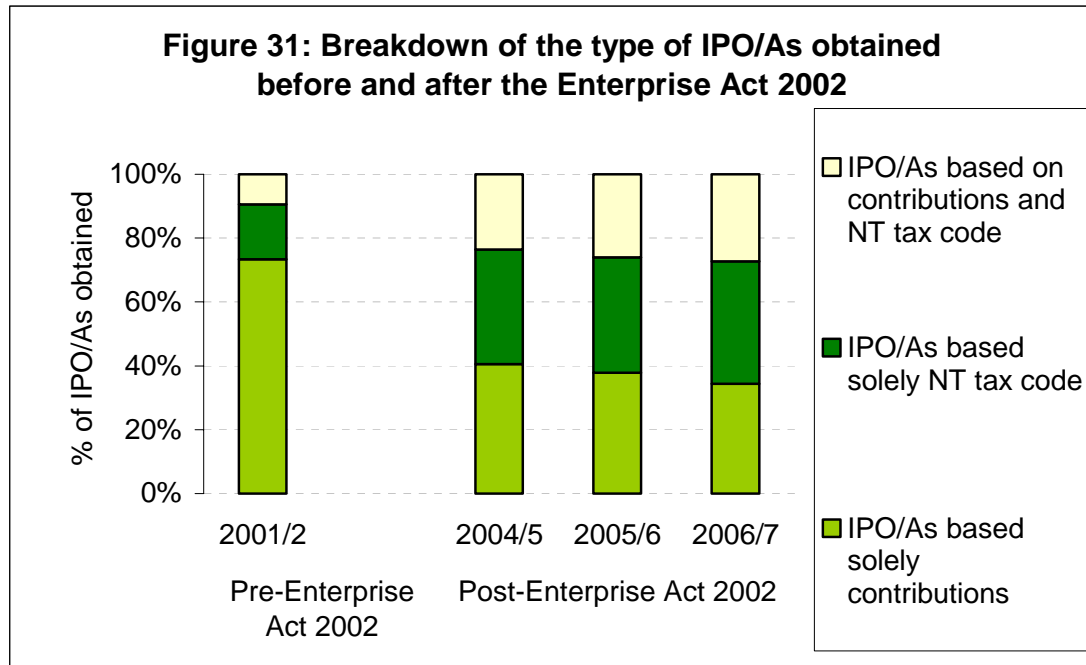
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<sup>140</sup> Results of the cases sampling exercise of 499 IPOs in 2001/2 show that IPOs were obtained from 406 employee bankrupts, 50 self-employed bankrupts, with details not being available in 43 cases. There were 2,396 IPOs in 2001/2. Statistics published by The Insolvency Service show that there were 9,434 self-employed bankrupts in 2001/2.

<sup>141</sup> Results of the cases sampling exercise of 498 IPOs in 2004/5 show that IPOs were obtained from 34 self-employed bankrupts. There were 7,349 IPO/As in 2004/5. Statistics published by The Insolvency Service show that there were 9,573 self-employed bankrupts in 2004/5.

### 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

#### Level of IPA/IPOs (continued)



46. When comparing the level of IPO/As based on an ‘NT’ tax coding to the level of employee bankrupts, based on case sampling results for 2001/2, IPOs based on an ‘NT’ tax coding were obtained from just under 11% of employee bankrupts. Since the Enterprise Act 2002, the level of IPAs based on an ‘NT’ tax coding obtained from employee bankrupts has increase more than threefold – in the three years since the introduction of the Enterprise Act 2002, IPAs have been obtained from more than 35% of employee bankrupts (see Table 17).

47. Therefore, since the IPA regime has been introduced, IPAs based on an ‘NT’ tax coding have been obtained from a greater proportion of employee bankrupts. This suggests that the simplified process in obtaining an IPA has made it easier to recover the fluctuating payments under an ‘NT’ tax coding from bankrupt employees.

### 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

#### Level of IPA/IPOs (continued)

**Table 17: Breakdown of IPO/As obtained compared to the level of employee bankrupts**

	Pre-Enterprise Act 2002	Post-Enterprise Act 2002		
	2001/2	2004/5	2005/6	2006/7
Total number of IPO/As obtained <sup>142</sup>	2,396	6,741	9,605	12,533
% of IPO/As based solely on contributions from income <sup>143</sup>	73.3%	40.6%	37.8%	34.4%
% of IPO/As based solely on an 'NT' tax code <sup>143</sup>	17.2%	35.9%	36.2%	38.4%
% of IPO/As based on contributions and NT tax code <sup>143</sup>	9.4%	23.6%	26.0%	27.2%
Estimated number of IPO/As based on an 'NT' tax coding <sup>144</sup>	639	4,007	5,974	8,226
Number of employee bankrupts <sup>145</sup>	6,006	10,639	16,514	20,825
% of employees where IPO/A obtained based on 'NT' tax coding	<b>10.6%</b>	<b>37.7%</b>	<b>36.2%</b>	<b>39.5%</b>

<sup>142</sup> The number of IPO/As obtained is from statistics published by The Insolvency Service, except from the number of IPOs obtained in 2001/2, which is based on internal data held by The Insolvency Service. The number of IPOs obtained in 2001/2 differs from the statistics published by The Insolvency Service due to timing differences in when the data was collected.

<sup>143</sup> Based on data held by The Insolvency Service.

<sup>144</sup> This includes the proportion of IPO/As based solely on an 'NT' tax coding and the proportion of IPO/As based on an 'NT' tax coding and monthly contributions.

<sup>145</sup> This figure includes company directors and is based on statistics published by The Insolvency Service. For 2006/7, statistics are only available for the 6 months up to 30 September 2006, which show there were 30,907 total bankrupts, of whom 9,962 were employees and company directors, i.e. 32.2%. This percentage has then been applied to the total number of bankrupts in 2006/7, i.e.64,610.

### 3.5 Evaluation of the Contributions from Income by Bankrupts provisions (continued)

#### Summary

##### **To reduce the time spent by the Official Receiver and Court in dealing with IPO applications where a bankrupt has consented**

- The Official Receiver has saved at least 7,500 hours in the 3 years since the implementation of the Enterprise Act 2002 as a result of the introduction of the IPA regime (see paragraphs 8-11).
- The Court has saved at least 3,800 hours in the 3 years since the implementation of the Enterprise Act 2002 as a result of the introduction of the IPA regime (see paragraphs 12-16).

##### **To improve returns to creditors**

- Returns to creditors under the IPA regime have improved as a result of:
  - An increase in the number of payments proposed under an IPO/A since the implementation of the Enterprise Act 2002 (see paragraphs 24-27);
  - An increase in collection rates under an IPO/A since the implementation of the Enterprise Act 2002 (see paragraphs 28-30);
  - A reduction of at least £260,000 in the costs associated with the collection of IPAs compared to IPOs in the three years since the implementation of the Enterprise Act 2002 (see paragraphs 32-39);
  - An increase in the proportion of self-employed bankrupts who make contributions from their income (see paragraphs 42-44); and
  - An increase in the proportion of employee bankrupts who make contributions on the basis of an 'NT' tax coding (see paragraphs 45-47).

#### Recommendations

- None

## **3.6 Evaluation of the Individual voluntary arrangement provisions**

1. This section of the report contains evaluation evidence regarding the achievement of the intermediate objectives of the individual voluntary arrangement (IVA) provisions contained in the Enterprise Act 2002. The objectives of these provisions 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.

2. The Insolvency Service has published a separate report entitled "A comparative study of fast track and post-bankruptcy individual voluntary arrangements"<sup>146</sup>. This report contains evidence contributing to the evaluation of the IVA provisions.

### **Providing an accessible alternative to bankruptcy**

3. Prior to the Enterprise Act 2002, the Official Receiver could not act as nominee or supervisor in an IVA. The Act introduces the concept of fast track voluntary arrangements (FTVAs), whereby the Official Receiver acts as nominee and supervisor of a post-bankruptcy IVA. Once a post-bankruptcy IVA is approved, the bankruptcy order can be annulled.

4. The evaluation looks at the accessibility of an FTVA compared to a post-bankruptcy IVA where an insolvency practitioner (IP) acts as nominee and supervisor. The evaluation focuses on the overall level of FTVAs, the costs of an FTVA, the timeliness of FTVAs and customer satisfaction with FTVAs. The evaluation also looks at the profile of FTVA debtors.

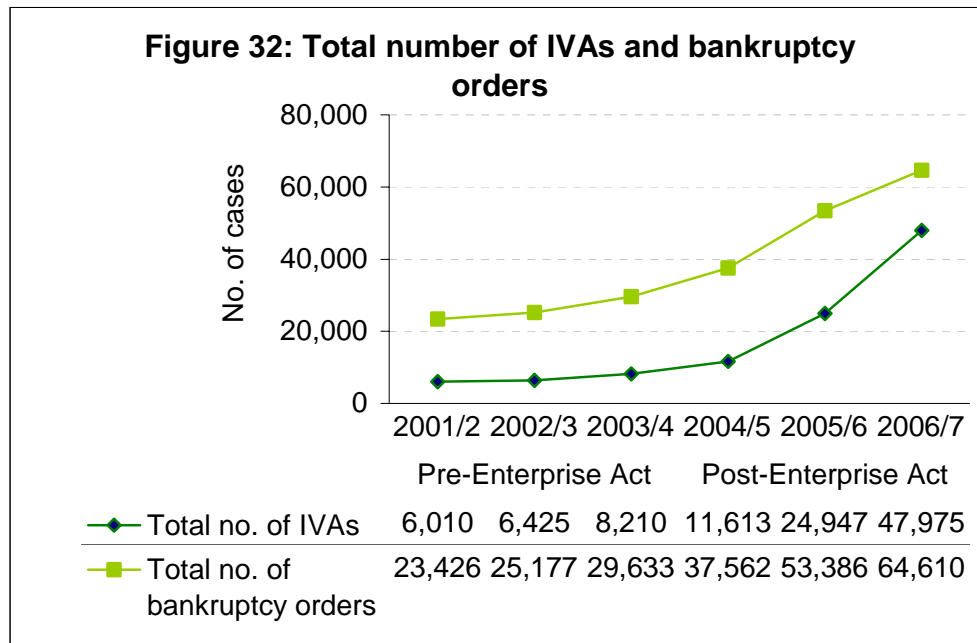
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<sup>146</sup> 'A comparative study of fast track and post-bankruptcy individual voluntary arrangements' is available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/FTVAreport.pdf>

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Overall level of FTVAs

5. Since the implementation of the Enterprise Act 2002, there has been an increase in both the level of bankruptcy orders and IVAs (see Figure 32).



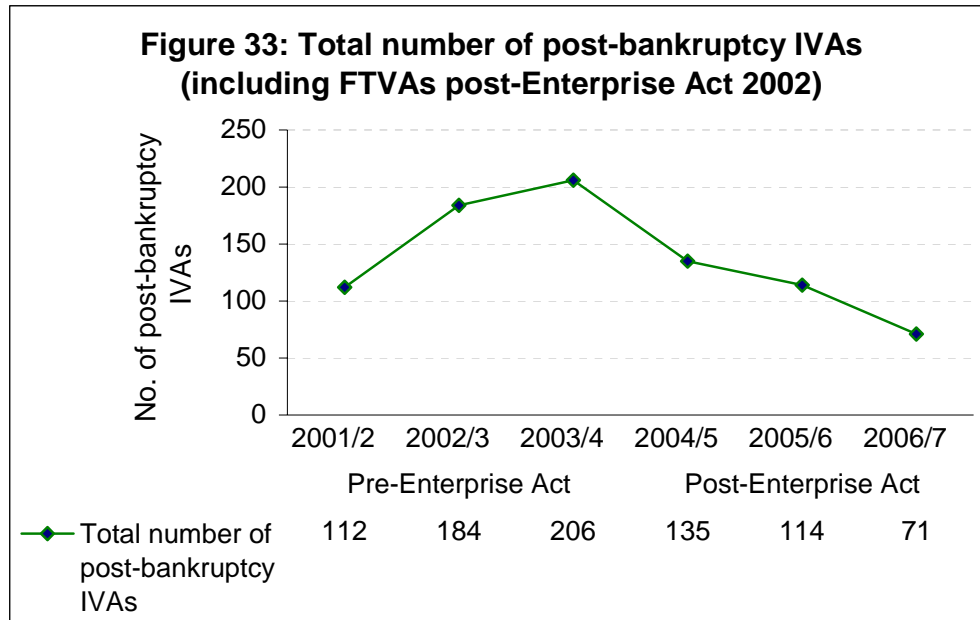
6. However, despite the increase in bankruptcies and IVAs, the overall number of post-bankruptcy IVAs (including FTVAs) has fallen since the implementation of the Enterprise Act 2002 (see Figure 33). Further, the level of annulments of bankruptcies has also fallen since the implementation of the Enterprise Act 2002<sup>147</sup>. Therefore, this indicates that there has been a general shift away from bankrupts taking steps to 'get out of' bankruptcy. This may be because debtors are more proactive in choosing pre-bankruptcy IVAs or other forms of debt relief prior to bankruptcy. Alternatively, bankrupts are unable, or do not want to 'get out of' bankruptcy.

<sup>147</sup> Statistics on annulments (as a percentage of bankruptcy orders), excluding post-bankruptcy IVA annulments, are:

	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7
Annulments as % of Bankruptcy Orders	3.42%	3.98%	4.12%	3.88%	3.64%	2.81%

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Overall level of FTVAs (continued)



7. Currently, post-bankruptcy IVAs account for less than 1% of all IVAs obtained, and post-bankruptcy IVAs are obtained in less than 1% of bankruptcy cases (see Table 18).

8. Since the implementation of the Enterprise Act 2002, there have been a nominal number of FTVAs obtained (see Table 18), and they account for less than 10% of the post-bankruptcy IVAs obtained since the implementation of the Act.

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Overall level of FTVAs (continued)

	Pre-Enterprise Act 2002			Post-Enterprise Act 2002		
	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7
<b>FTVAs<sup>148</sup></b>	-	-	-	<b>8</b>	<b>9</b>	<b>3</b>
Total number of post-bankruptcy IVAs <sup>149</sup>	112	184	206	135	114	71
<b>FTVAs as % of post-bankruptcy IVAs</b>	-	-	-	<b>5.93%</b>	<b>7.89%</b>	<b>4.23%</b>
Total no. of IVAs <sup>150</sup>	6,010	6,425	8,210	11,613	24,947	47,975
<b>Post-bankruptcy IVAs as % of all IVAs</b>	<b>1.86%</b>	<b>2.86%</b>	<b>2.51%</b>	<b>1.16%</b>	<b>0.46%</b>	<b>0.15%</b>
Total no. of bankruptcy orders	23,426	25,177	29,633	37,562	53,386	64,610
<b>Post-bankruptcy IVAs as % of bankruptcy orders</b>	<b>0.48%</b>	<b>0.73%</b>	<b>0.70%</b>	<b>0.36%</b>	<b>0.21%</b>	<b>0.11%</b>

9. A further 28 FTVAs were proposed in the 3 years ended 31 March 2007, but were unsuccessful; the proposals were rejected by creditors in 14 cases, the Official Receiver refused to act in 13 cases and in the remaining case, the proposal was withdrawn by the debtor.

10. Information regarding FTVAs (and post-bankruptcy IVAs and annulments) is provided to every bankrupt. It is contained in The Insolvency Service's publication "A Guide to Bankruptcy"<sup>151</sup>, which is sent to every bankrupt.

<sup>148</sup> Based on information held on The Insolvency Service's internal database and represents all FTVAs entered into in the relevant financial year.

<sup>149</sup> Based on information held on The Insolvency Service's internal database and represents all post-bankruptcy IVAs entered into in the relevant financial year.

<sup>150</sup> Based on statistics published by The Insolvency Service (previously the DTI Statistics Directorate) (not seasonally adjusted)

<sup>151</sup> The Insolvency Service – 'A Guide to Bankruptcy' is available at: <http://www.insolvency.gov.uk/pdfs/guidanceleafletspdf/guidetobankruptcy.pdf>

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Overall level of FTVAs (continued)

11. However, under The Insolvency Service's internal guidelines, the Official Receiver will only agree to act as nominee for an FTVA in cases where:

- assets are readily and easily available<sup>152</sup>, e.g. cash at bank, contributions from PAYE income, or the introduction of third party funds;
- the creditors will receive additional monies that would not normally be available in the bankruptcy e.g. the inclusion of third party funds or contributions from income over a period longer than that which could be obtained in bankruptcy; and
- There are no clear grounds for a bankruptcy restrictions order (BRO), or for the submission of a criminal allegation statement of fact<sup>153</sup>.

Therefore, the number of cases suitable for an FTVA is restricted.

12. Indeed, an analysis of the 68 non-FTVA post-bankruptcy IVAs in 2006/7 shows that in 66 of the cases, an FTVA may not have been appropriate under the guidelines issued to Official Receivers (see Table 19). In the remaining 2 cases, the possibility of an FTVA was raised with the bankrupt.

**Table 19: Reasons why non-FTVA post-bankruptcy IVAs in 2006/7 were not suitable for an FTVA under The Insolvency Service's guidelines**

Reason	Number of cases
Bankrupt was self-employed and funds in FTVA dependent on that trading, e.g. contributions or trade assets	38
Not a simple asset realisation case	11
Bankrupt did not surrender to the bankruptcy proceedings	6
Further investigation required	4
Bankrupt already in process of obtaining post-bankruptcy IVA	4
Other	3
<b>Total</b>	<b>66</b>

<sup>152</sup> Other assets capable of inclusion in an FTVA include the bankrupt's interest in a property where the bankrupt is able to introduce a 'cast iron' purchaser who is content to use The Insolvency Service's low-cost conveyancing scheme. The Official Receiver should not agree to act as nominee in cases involving complex asset realisation, e.g. where there has been trading or where the assets are 'risky' or time consuming to realise. Should the bankrupt wish to proceed with an application for an IVA he/she should be advised to seek the advice of an insolvency practitioner.

<sup>153</sup> This is to avoid a conflict of interest between the duty to protect the public and a duty to obtain the best return for creditors. The duty to protect the public takes precedence.

### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

#### Overall level of FTVAs (continued)

13. Therefore, in summary, only a nominal number of FTVAs has been obtained and it appears that the accessibility of FTVAs is being restricted by The Insolvency Service's internal guidelines on cases that the Official Receiver can agree to act as nominee for an FTVA.

#### The costs of an FTVA

14. It was thought that the fees of an FTVA should be lower than that charged by IPs in post-bankruptcy IVAs. From calculations provided in the Regulatory Impact Assessment for the Enterprise Act 2002, in cases with receipts of up to £15,700, for example, an IP's average fee is £3,786. In an FTVA, the fees charged by the Official Receiver would be no more than £2,655.

15. The nominee fee (excluding VAT) charged in post-bankruptcy IVAs in 2001/2 is most commonly between £1,000 – £2,000, with an average of £1,678 being charged<sup>154</sup>. In contrast, the nominee fee in FTVAs is currently set at £300 (excluding VAT).

16. Therefore, the entry cost – the nominee fee - of an FTVA is much lower than that of a post-bankruptcy IVA, which facilitates the accessibility of an FTVA.

17. As regards the supervisor fees, these are charged on a time and cost basis in the majority of post-bankruptcy IVAs in 2001/2, with an average level of around 11% of realisations being charged<sup>154</sup>. The supervisor fee in FTVAs is currently set at 15% of realisations.

18. Therefore, although the entry cost (the nominee fee) of an FTVA is lower, the costs associated with the collection and distribution of the FTVA funds (the supervisor fee) is higher compared to a post-bankruptcy IVA. On the basis of the average figures for post-bankruptcy IVAs, the nominee and supervisor costs associated with an FTVA will be lower compared to post-bankruptcy IVAs in cases where the FTVA funds are lower than £34,450; if the funds are higher, the nominee and supervisor costs associated with a post-bankruptcy IVA will be lower compared to FTVAs.

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<sup>154</sup> Full details of the case sampling exercise and the derived statistics are contained in The Insolvency Service's report 'A comparative study of fast track and post-bankruptcy individual voluntary arrangements', which is available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/FTVAreport.pdf>

### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

#### The costs of an FTVA (continued)

19. As detailed at paragraph 37, the average asset level in the FTVAs obtained in the 3 years since the implementation of the Enterprise Act 2002 is £5,345 (compared to £35,548 in post-bankruptcy IVAs in 2001/2). Therefore, FTVA debtors have been charged lower total nominee and supervisor costs than if they had entered a non-FTVA post-bankruptcy IVA.

20. No modifications can be made to FTVAs. Analysis of post-bankruptcy IVAs entered into in 2001/2 shows that it is usual for modifications to be introduced at the meeting of creditors held to consider the IVA proposal. For example, the Crown requires standard terms to be included in an IVA regarding the filing of tax returns and payment of post-arrangement tax liabilities. Therefore, if these have not been included in the IVA and the Crown is a creditor of the IVA, the Crown will require a suitable modification.

21. Further, post-approval modifications were made in around 11% of all post-bankruptcy IVAs entered into in 2001/2. As regards the costs involved in modifications, these are rarely explicitly stated. 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.

22. In summary, the cost associated with an FTVA compared to other post-bankruptcy IVAs is lower at the point of entry – the nominee fee – which facilitates the accessibility of an FTVA. However, the ‘saving’ made on the FTVA nominee cost may be overshadowed by the level of supervisor fees charged depending on the level of funds in the FTVA. Although no modifications can be made to FTVAs, and hence there are no cost implications, the costs involved in post-bankruptcy IVA modifications need to be balanced against returns to creditors achieved as a result of any modification, rather than the IVA failing.

#### Timeliness of FTVAs

23. The process of obtaining an FTVA should be simpler and quicker. The Official Receiver is well placed to establish whether an IVA would be appropriate for a bankrupt as he already has details of assets and income through his examination of the bankrupt’s affairs. Further, there are no meetings of creditors, no requirement for the nominee to report to the court and the FTVA proposals are offered to creditors on a ‘take it or leave it’ basis. This contrasts with the IVA process where an IP acts as nominee and supervisor.

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Timeliness of FTVAs (continued)

24. Analysis of post-bankruptcy IVAs after the implementation of the Enterprise Act 2002 shows that the average time taken between the date of the bankruptcy order and approval of a post-bankruptcy IVA or FTVA varies each year. However, over the 3 years ended 31 March 2007, the average time taken between the date of the bankruptcy order and approval of a post-bankruptcy IVA is less compared to the average time taken to approve an FTVA<sup>155</sup> (see Table 20).

	2004/5	2005/6	2006/7	Average over 3 years to 31 March 2007
Average time taken between a bankruptcy order and the approval of:				
Post-bankruptcy IVA	22 weeks	18 weeks	19 weeks	18 weeks
FTVA	18 weeks	23 weeks	14 weeks	22 weeks

25. Therefore, despite the simpler process for an FTVA to be obtained compared to other post-bankruptcy IVAs, an FTVA takes longer to implement. This may well be as a consequence of there being so few FTVAs – the Official Receiver's staff are not all fully familiar with the administrative process of obtaining an FTVA. This could be solved by centralising the administration of FTVAs in order to create a 'centre of expertise'.

#### Customer satisfaction with FTVAs

26. As detailed in paragraph 9, a further 14 FTVAs were proposed in the 3 years ended 31 March 2007, but the proposals were rejected by creditors. There is no information available on the level of post-bankruptcy IVAs proposed but rejected by creditors. Therefore, no conclusions can be drawn.

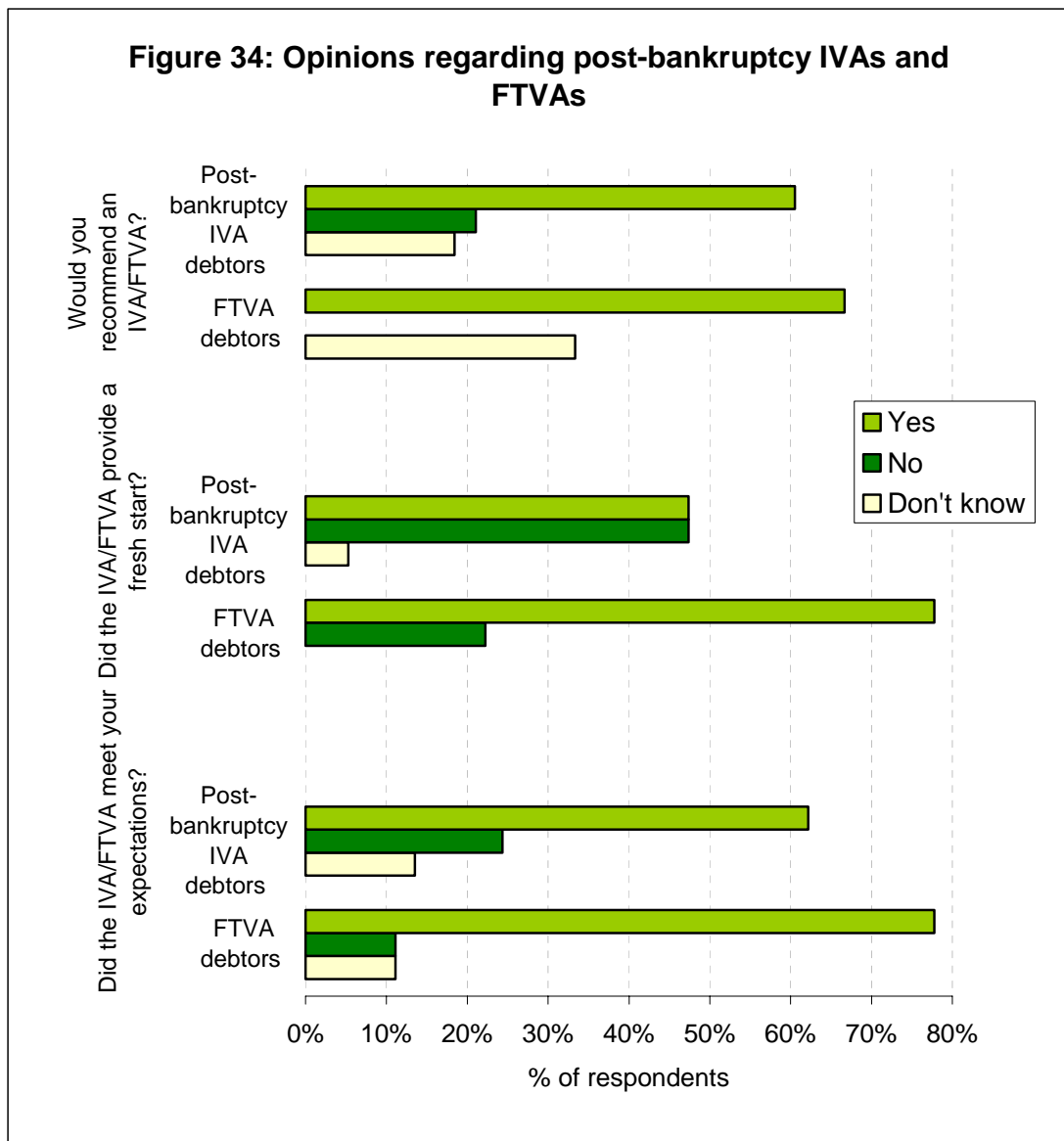
27. The results of surveys carried out by The Insolvency Service<sup>155</sup> show that in broad terms, bankrupts are more satisfied with the FTVA process compared to bankrupts of post-bankruptcy IVAs - except as regards the speed of the process.

<sup>155</sup> Full details of the case sampling exercise and the derived statistics are contained in The Insolvency Service's report 'A comparative study of fast track and post-bankruptcy individual voluntary arrangements', which is available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/FTVAreport.pdf>

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Customer satisfaction with FTVAs (continued)

28. Further, in general terms, FTVA debtors are more positive about FTVAs compared to post-bankruptcy IVA debtors regarding IVAs - FTVA debtors are more likely to recommend an IVA, believe that an IVA provides a fresh start and agreed that the IVA met their expectations (see Figure 34).



### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

#### Customer satisfaction with FTVAs (continued)

29. To date, around 36% of post-bankruptcy IVAs obtained in 2001/2 have failed. A bankruptcy order was then subsequently made against the debtor in around 60% of these cases (the majority on the petition of the supervisor of the failed IVA). On average, these post-bankruptcy IVAs failed after 2 years. To date 15% of the FTVAs obtained in the three years ended 31 March 2007 have failed, and on average, these FTVAs failed after 18 months. The failure rate and timeliness of failures may change in the future, as some post-bankruptcy IVAs and FTVAs are still on-going.

30. Therefore, on the basis of current information, it appears that FTVAs provide a long-term alternative to bankruptcy in the majority of cases where an FTVA is obtained.

31. Prior to the Enterprise Act 2002, there were very few complaints regarding post-bankruptcy IVAs<sup>156</sup>. In the 3 years since the implementation of the Enterprise Act 2002, The Insolvency Service has received 2 complaints regarding FTVAs. One complaint was that the Official Receiver had provided misleading information regarding FTVAs – this complaint was not upheld. The other complaint was that the bankrupt was not advised of the possibility of an FTVA. However, the bankrupt had indicated that he was to apply for an annulment of the bankruptcy on the grounds of payment in full – therefore, the case would not have been appropriate for an FTVA under The Insolvency Service's internal guidelines (as creditors would not be 'better off' under an FTVA) (see paragraph 11).

32. In summary, debtors appear to be satisfied by the process and provisions of an FTVA except as regards the length of time involved. Further, FTVAs appear to provide a long-term alternative to bankruptcy in the majority of cases where an FTVA is obtained.

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<sup>156</sup> There are no relevant complaints regarding post-bankruptcy IVAs recorded in The Insolvency Service's Complaints Register in the 3-year period ended 31 March 2004. The Adjudication Office records show they received no complaints regarding post-bankruptcy IVAs/FTVAs in the 4-year period ended 31 March 2007. The Insolvency Practitioners' Association (IPA) have confirmed that in 2003, they received 147 complaints of which 11 related to IVAs. Further, in 2004 (up to November), they had received 157 complaints of which 20 related to IVAs. However, the IPA were unable to provide details of the reasons for the complaints or whether they were post-bankruptcy IVAs. From the email enquiries received via The Insolvency Service's Central Enquiry Line in the period 1 July 2002 to 31 March 2004, only one complaint regarding a post-bankruptcy IVA was received. The grounds for the complaint were that the debtor entered into an IVA and felt insufficient information was provided regarding IVAs. The debtor claims that £7,000 contributions were paid over a 14 month period and only £238 went to creditors (the rest being used to meet the supervisor's fees).

### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

#### Profile of FTVA debtors

33. Information has been gathered on FTVA debtors and post-bankruptcy IVA debtors in 2001/2 to assess whether FTVAs are utilised by debtors with a similar profile as those entering post-bankruptcy IVAs<sup>157</sup>.

34. The debtors are predominantly male debtors and most commonly fall in the age range 40-49 in both post-bankruptcy IVAs in 2001/2 and FTVAs.

35. Around 80% of debtors in post-bankruptcy IVAs are traders, compared to only 40% of debtors in FTVAs. The lower level of traders seen in FTVAs is probably due to The Insolvency Service's guidelines on FTVAs that preclude the Official Receiver agreeing to act as nominee for an FTVA in certain types of cases.

36. The most common cause of failure in post-bankruptcy IVAs in 2001/2 is a failure to deal with tax affairs, whereas the most common cause of failure in FTVAs is living beyond the debtor's means. This is consistent with difference seen in debtors' employment status as detailed above.

37. As regards assets and liabilities:

- FTVAs have lower average bankruptcy asset and liability levels compared to post-bankruptcy IVAs in 2001/2 (see Table 21);
- FTVAs have a higher average bankruptcy deficiency compared to post-bankruptcy IVAs in 2001/2 (see Table 21); and
- A lower proportion of FTVA cases had a surplus of bankruptcy assets over liabilities compared to post-bankruptcy IVAs in 2001/2 (see Table 21).

38. The lower asset levels seen in FTVA cases is probably due to The Insolvency Service's internal guidelines on FTVAs that preclude the Official Receiver agreeing to act as nominee for an FTVA in certain types of cases, i.e. a sizeable level of assets are unlikely to be 'easily realisable'.

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<sup>157</sup> Full details of the profiling information are contained in The Insolvency Service's report 'A comparative study of fast track and post-bankruptcy individual voluntary arrangements', which is available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/FTVAreport.pdf>

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Profile of FTVA debtors (continued)

**Table 21: Average<sup>158</sup> asset and liability levels in post-bankruptcy IVAs in 2001/2 and FTVAs**

	Post-bankruptcy IVAs in 2001/2	FTVAs in 3 years ended 31 March 2007
Average bankruptcy assets	£35,548	£5,345
Average bankruptcy liabilities	£42,482	£27,241
Average bankruptcy deficiency	£19,409	£33,619
% of cases where there was a surplus of assets over liabilities in bankruptcy	42%	35%

39. Therefore, the difference in profiles seen in FTVA debtors compared to post-bankruptcy IVA debtors is mostly attributable to The Insolvency Service's guidelines on FTVAs that preclude the Official Receiver agreeing to act as nominee for an FTVA in certain types of cases.

40. In summary:

- The FTVA provisions are seldom used. This appears to be because the accessibility of FTVAs as an alternative to IVAs is restricted by The Insolvency Service's internal guidelines on FTVAs that preclude the Official Receiver agreeing to act as nominee for an FTVA in certain types of cases;
- The cost associated with an FTVA compared to other post-bankruptcy IVAs is lower at the point of entry – the nominee fee – which facilitates the accessibility of an FTVA. However, the 'saving' made on the FTVA nominee cost may be overshadowed by the level of supervisor fees charged depending on the level of funds in the FTVA;
- FTVAs take longer to set up than non-FTVA post-bankruptcy IVAs; and
- Debtors appear to be satisfied by the process and provisions of an FTVA, except as regards the length of time involved.

<sup>158</sup> The average is defined as the IQR trimmed mean. The data range has been trimmed to take into account outliers, with reference to the Inter Quartile Range (IQR). Outliers identified as data points where  $Q1 - 1.5IQR > X > Q3 + 1.5IQR$ . The outliers identified are valid readings, but are not typical.

### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

41. If FTVAs are to be made more accessible, The Insolvency Service needs to amend its internal guidelines on FTVAs. If the guidelines were changed to improve the accessibility of FTVAs, one consequence would be that the Official Receiver will deal with more complex cases, which may have resource implications.

42. Further, The Insolvency Service needs to review the level of fees charged in FTVAs. It should be noted that the evaluation information in this report is based on IVAs in 2001/2 and therefore, it may be that the current fees charged in non-FTVA post-bankruptcy IVAs have changed.

43. Further, if The Service does decide to amend its internal guidelines on FTVAs in order to make FTVAs an accessible alternative to bankruptcy, it should consider centralising the administration of FTVAs in order to create a 'centre of expertise' in order to ensure FTVAs are obtained in a timely manner.

44. Therefore, it is recommended that The Insolvency Service undertakes a detailed cost-benefit analysis of whether, taking into account any amendment to supervisor fees, the resources required to deal with more complex cases and for a centralised FTVA administration centre are justified by any benefits afforded by FTVAs over those offered by non-FTVA post-bankruptcy IVAs.

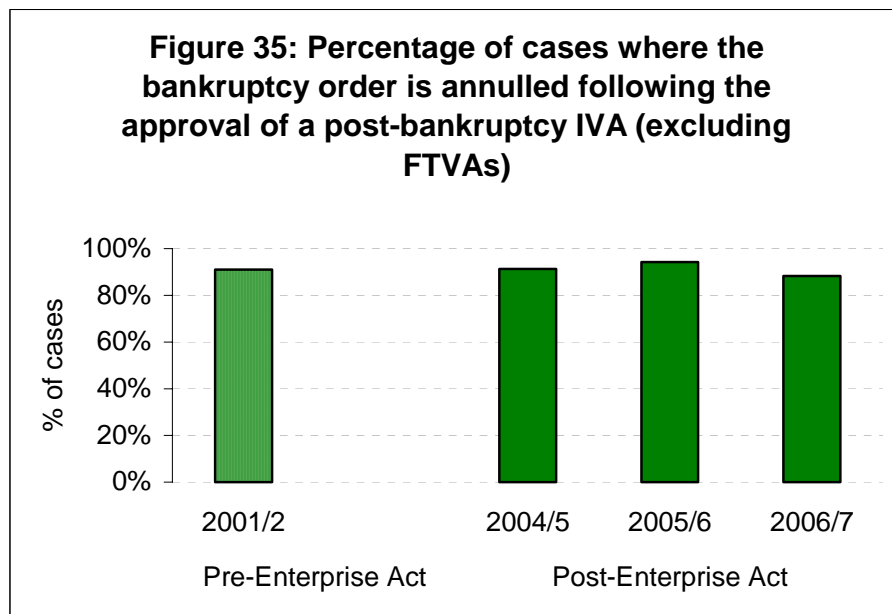
### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Annulment of the bankruptcy order is obtained once an IVA is approved

45. Prior to the Enterprise Act 2002, once a post-bankruptcy IVA was approved, the court had discretion to annul the existing bankruptcy order. An application for such an annulment could not be made until at least 28 days after the report of the creditors meeting was made to court.

46. The Enterprise Act 2002 makes it mandatory on the Court to annul the bankruptcy order on an application by the bankrupt or the Official Receiver (where the bankrupt has not applied) after the approval of an IVA by creditors. In the case of FTVAs, only the Official Receiver can apply. In either case, such application cannot be made until 28 days after approval is obtained (to allow time for any objections). In the past, bankrupts have often failed to apply for annulment and the bankruptcies are left in limbo. This change is designed to stop this situation occurring and ensures that bankrupts are given a 'fresh start' without the hindrance of the record of a bankruptcy order.

47. Analysis of post-bankruptcy IVAs entered into in 2001/2 shows that 92% of bankruptcy cases were annulled<sup>159</sup>. Since the implementation of the Enterprise Act 2002, the level of cases being annulled following the approval of a post-bankruptcy IVA (excluding FTVAs) slightly decreased in 2004/5 and then increased in 2005/6 (see Figure 35) to 94%. The level of annulments for 2006/7 is low due to IVAs obtained in the latter part of 2006/7 not yet being annulled.



<sup>159</sup> According to available records, 103 of the 112 post-bankruptcy IVA cases in 2001/2 have been annulled.

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Annulment of the bankruptcy order is obtained once an IVA is approved (continued)

48. Annulments have been obtained in 95% of the FTVA cases in the three years since the implementation of the Enterprise Act 2002.

49. Analysis of post-bankruptcy IVAs in 2001/2 shows that, on average<sup>160</sup>, the time taken between the approval of the post-bankruptcy IVA and annulment of the bankruptcy was around 12 weeks; the average time post-Enterprise Act 2002 is 15 weeks. Further, the average time taken between the approval of the post-bankruptcy IVA and annulment of the bankruptcy is less compared to the average time between the approval of an FTVA and such annulment (see Table 22). Once again, this may well be as a consequence of there being so few FTVAs – the Official Receiver’s staff are not all fully familiar with the process subsequent to an FTVA being obtained. This could be solved by centralising the administration of FTVAs in order to create a ‘centre of expertise’.

**Table 22: Time taken between approval of a post-bankruptcy IVA/FTVA and annulment of the bankruptcy order after the implementation of the Enterprise Act 2002 (to nearest week)**

	2004/5	2005/6	2006/7	Average over 3 years to 31 March 2007
Average time taken between approval of a post-bankruptcy IVA/FTVA and annulment of the bankruptcy order:				
Post-bankruptcy IVA	16 weeks	14 weeks	14 weeks	15 weeks
FTVA	15 weeks	18 weeks	24 weeks	21 weeks

<sup>160</sup> The average is defined as the IQR trimmed mean. The data range has been trimmed to take into account outliers, with reference to the Inter Quartile Range (IQR). Outliers identified as data points where  $Q1 - 1.5IQR > X > Q3 + 1.5IQR$ . The outliers identified are valid readings, but are not typical.

### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

#### **Annulment of the bankruptcy order is obtained once an IVA is approved (continued)**

50. 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 bankrupt 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 risen slightly.

51. The failure to annul a bankruptcy order following the approval of a post-bankruptcy IVA has an impact on both the debtor and creditors. Firstly, it leaves the debtor in limbo, as s/he is subject to both a bankruptcy order and IVA. Further, if an annulment of the bankruptcy order is not obtained, a bankrupt is released from the bankruptcy debts on discharge<sup>161</sup>. Therefore, if annulment of the bankruptcy order is not obtained following the approval of a post-bankruptcy IVA, and that post-bankruptcy IVA fails, creditors have no legal right to pursue the debtor for the unpaid debts. Therefore, The Insolvency Service should consider a possible legislative change for the automatic annulment of the bankruptcy order following approval of a post-bankruptcy IVA, after expiry of the 28 days from the approval of the IVA to allow for any objections. Such provision would ensure that all bankruptcies are annulled following approval of a post-bankruptcy IVA and that such annulments are obtained in a timely manner.

52. 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.

53. 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.

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<sup>161</sup> Section 281 of the Insolvency Act 1986

### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

#### **Annulment of the bankruptcy order is obtained once an IVA is approved (continued)**

54. In summary, there are indications that since the implementation of the Enterprise Act 2002, the level of annulments obtained following the approval of a post-bankruptcy IVA has risen slightly, but on average, it is taking longer for the annulment to be obtained. However, although 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 institutions, which will hinder the 'fresh start' for that aspect of the debtor.

#### **Returns to creditors**

55. This objective relates to:

- Whether the costs involved in FTVAs are lower compared to other post-bankruptcy IVAs; and
- The overall aim to increase the number of post-bankruptcy IVAs – IVAs, in general, produce a better rate of return in comparison to bankruptcy proceedings as creditors will not accept a post-IVA proposal unless creditors will be better off under the IVA compared to the bankruptcy proceedings.

#### Lower costs involved in FTVAs

56. As detailed at paragraph 15, the nominee cost associated with an FTVA compared to other post-bankruptcy IVAs is lower. However, the 'saving' made on the FTVA nominee cost may be overshadowed by the level of supervisor fees charged depending on the level of funds in the FTVA. Although no modifications can be made to FTVAs, and hence there are no cost implications, the costs involved in post-bankruptcy IVA modifications need to be balanced against returns to creditors achieved as a result of any modification, rather than the IVA failing.

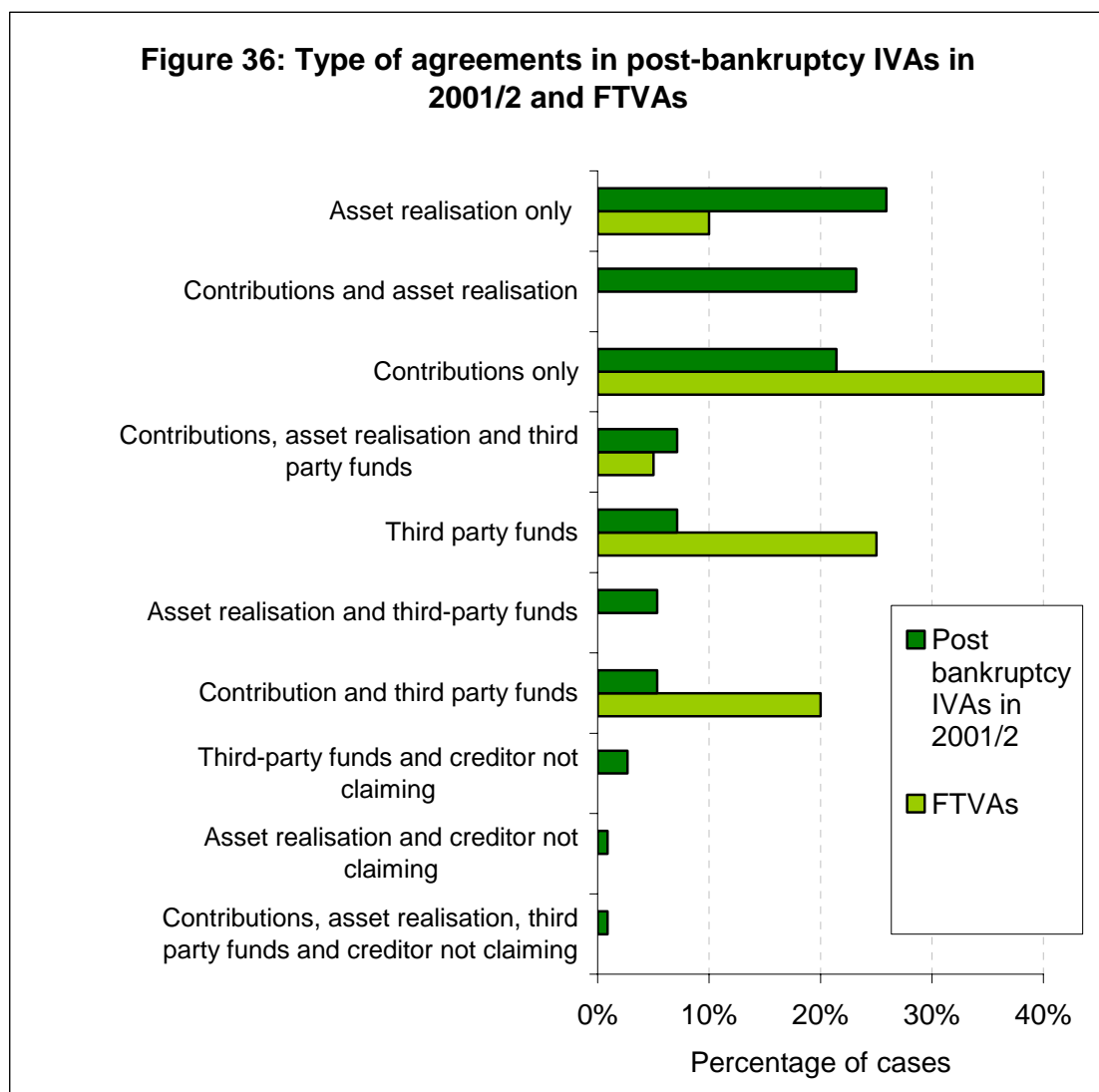
57. The average proposed return to creditors in post-bankruptcy IVAs in 2001/2 is 77p in the pound, compared to 57p in the pound in FTVAs in the 3 years ended 31 March 2007.

58. The average actual return to creditors in the post-bankruptcy IVAs in 2001/2 that have successfully completed is 76p in the pound. The average actual return to creditors in the FTVAs that have successfully completed to date is 71 p in the pound.

### 3.6 Evaluation of the Individual voluntary arrangement provisions (continued)

#### Lower costs involved in FTVAs (continued)

59. Therefore, 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. However, looking at the relative levels of assets and overall deficiencies, FTVA cases have a lower level of assets, and a higher overall bankruptcy deficiency (see paragraph 37). Further, the majority of post-bankruptcy IVAs in 2001/2 are based on contributions and/or asset realisation, whereas the majority of FTVAs are based on contributions and/or third-party funds (see Figure 36).



## **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

### **Lower costs involved in FTVAs (continued)**

60. Therefore, it appears that the higher average 'pence per pound' return to creditors in post-bankruptcy IVAs is due to a smaller deficit in bankruptcy liabilities over assets, which is primarily due to those cases having a higher level of bankruptcy assets.

61. As regards the timeliness of returns to creditors, the most commonly proposed length of a post-bankruptcy IVA in 2001/2 is 1 year or less, with an average length of 27 months. Most commonly, no time is specified for the duration of an FTVA. Instead, the level of funds to be received is set. Where specified, the average length of an FTVA is 34.5 months.

62. Analysis of post-bankruptcy IVAs in 2001/2 that have successfully concluded to date shows that, on average, post-bankruptcy IVAs take around 11 months longer than the proposed length. On that basis, we would expect the average actual length of a post-bankruptcy IVA in 2001/2 to be around 28 months<sup>162</sup>. 12 FTVAs have successfully concluded to date and analysis of those FTVAs show that, on average, FTVAs last 16 months. However, as so few had the length of the FTVA specified in the proposal, reliable information on the actual length of FTVAs cannot be extracted.

63. In summary, the costs in an FTVA are lower depending on the level of funds in the FTVA. The higher average 'pence per pound' return to creditors seen in post-bankruptcy IVAs is due to a smaller deficit in bankruptcy liabilities over assets, which is primarily due to those cases having a higher level of bankruptcy assets. As regards the timeliness of returns to creditors, no reliable information is currently available.

### **The number of post-bankruptcy IVAs**

64. Post-Enterprise Act 2002, the total level of post-bankruptcy IVAs has reduced, both as a percentage of all IVAs and as a percentage of bankruptcies (see paragraph 6). Given the small number of FTVAs, it does not appear that the reduction in non-FTVA post-bankruptcy IVAs is connected with the introduction of the FTVA provisions.

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<sup>162</sup> The average has been calculated using the actual length of post-bankruptcy IVAs that have successfully concluded, plus the proposed length, plus 11 months, of post-bankruptcy IVAs that are on-going.

### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

#### **Summary**

#### **To support the 'fresh start' of a bankrupt by providing an accessible alternative to bankruptcy**

- The FTVA provisions are seldom used. This appears to be because the accessibility of FTVAs as an alternative to bankruptcy is restricted by The Insolvency Service's internal guidelines on FTVAs that preclude the Official Receiver agreeing to act as nominee for an FTVA in certain types of cases (see paragraphs 8-13).
- The cost associated with an FTVA compared to other post-bankruptcy IVAs is lower at the point of entry – the nominee fee – which facilitates the accessibility of an FTVA. However, the 'saving' made on the FTVA nominee cost may be overshadowed by the level of supervisor fees charged depending on the level of funds in the FTVA (see paragraphs 14-22).
- FTVAs take longer to set up than non-FTVA post-bankruptcy IVAs (see paragraphs 23-25).
- Debtors appear to be satisfied by the process and provisions of an FTVA, except as regards the length of time involved (see paragraphs 26-32).

#### **To support the 'fresh start' of a bankrupt by ensuring that annulment of the bankruptcy order is obtained once an IVA is approved**

- Since the implementation of the Enterprise Act 2002, the level of annulments obtained following the approval of a post-bankruptcy IVA has slightly risen, but on average, it is taking longer for the annulment to be obtained. However, although 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 institutions, which will hinder the 'fresh start' for that aspect of the debtor (see paragraphs 45-54).

#### **To improve returns to creditors**

- The costs in an FTVA are lower depending on the level of funds in the FTVA (see paragraphs 14-22).
- The higher average 'pence per pound' return to creditors seen in non-FTVA post-bankruptcy IVAs is due to a smaller deficit in bankruptcy liabilities over assets, which is primarily due to those cases having a higher level of bankruptcy assets (see paragraphs 57-60).

### **3.6 Evaluation of the Individual voluntary arrangement provisions (continued)**

#### **Recommendations**

- That The Insolvency Service undertakes a detailed cost-benefit analysis of whether, taking into account any amendment to supervisor fees, that the resources required to deal with more complex cases and for a centralised FTVA administration centre are justified by any benefits afforded by FTVAs over those offered by non-FTVA post-bankruptcy IVAs (see paragraphs 41-44).
- That The Insolvency Service continues to work with credit reference agencies and lenders to ensure that post-bankruptcy IVAs and annulments are appropriately reflected in lender policies (see paragraphs 52-53).
- That The Insolvency Service considers the possibility of an automatic annulment of a bankruptcy order following approval of a post-bankruptcy IVA (after expiry of 28 days to allow for any objections) (see paragraphs 50-51).

### **3.7 Evaluation of the Sundry provisions**

1. This section of the report contains evaluation evidence regarding the achievement of the intermediate objectives of the sundry provisions contained in the Enterprise Act 2002 as follows:

- Repeal of offences under sections 361 and 362 of the Insolvency Act 1986
- Discretionary investigation of a bankrupt's affairs by the Official Receiver
- Sanction required for a trustee to pursue antecedent recoveries

#### **Repeal of offences under sections 361 and 362 of the Insolvency Act 1986**

2. The Enterprise Act 2002 repealed bankruptcy offences under sections 361 and 362 of the Insolvency Act 1986 - 'failure to keep proper accounting records' and 'gambling and rash and hazardous speculation'. Instead, conduct of this nature is addressed under the Bankruptcy Restrictions Order (BRO) regime with the intention to provide more effective protection of the public and the commercial community.

3. The objective of repealing offences under sections 361 and 362 of the Insolvency Act 1986 was to provide more effective protection of the public and the commercial community.

4. Prior to the Enterprise Act 2002, where there was evidence of a failure to keep proper accounting records or gambling and rash and hazardous speculation, the Official Receiver would submit a statement of facts to The Insolvency Service's Criminal Allegations Team who would decide whether the case should be further investigated. A submission of a statement of facts could ultimately lead to conviction, a warning letter<sup>163</sup> being issued to the bankrupt or no further action. Action would not be taken if there were insufficient evidence to support prosecution action.

5. Since the implementation of the Enterprise Act 2002, a failure to keep proper accounting records or gambling and rash and hazardous speculation is addressed under the BRO regime. Where an Official Receiver believes that a BRO application is appropriate, the matter is referred to The Insolvency Service's Authorisations Team. This team then decides whether an authority to proceed with a BRO application (ATP) should be issued on behalf of the Secretary of State.

6. The evaluation looks at the protection provided where a bankrupt has failed to keep proper accounting records or has gambled/ undertaken rash and hazardous speculation, and creditor satisfaction with that protection.

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<sup>163</sup> A warning letter is a letter from the Secretary of State to acknowledge that a criminal offence may have been committed but due to the public interest criteria (e.g. ill health or potential unreliability of witnesses), the facts will not be prosecuted or subject to criminal investigation.

### 3.7 Evaluation of the Sundry provisions (continued)

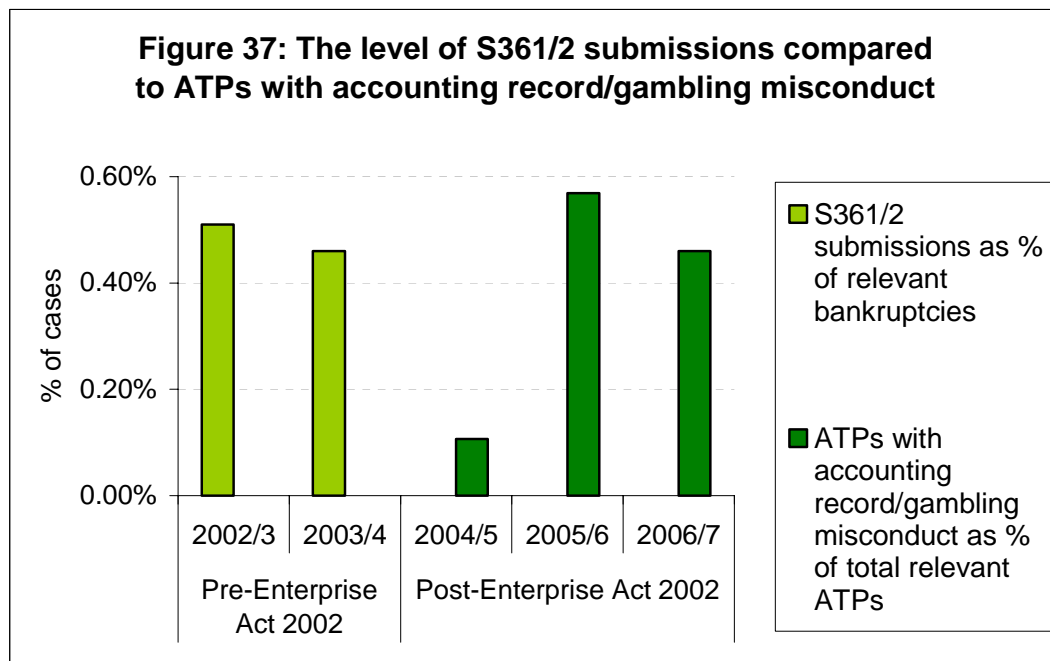
#### Repeal of offences under sections 361 and 362 of the Insolvency Act 1986 (continued)

7. The Insolvency Service has published a separate report entitled “A study of the bankruptcy enforcement regime before and after the Enterprise Act 2002”<sup>164</sup>. This report contains evidence contributing to the evaluation of the repeal of offences under sections 361 and 362 of the Insolvency Act 1986.

#### The protection provided where a bankrupt has failed to keep proper accounting records or has gambled/ undertaken rash and hazardous speculation

8. Based on the level of facts submitted prior to the Enterprise Act 2002, a possible failure to keep proper accounting records or gambling and rash and hazardous speculation was identified in around 0.5% of bankruptcy cases.

9. Since the implementation of the Enterprise Act 2002, the level of ATPs where conduct comparable to possible offences under sections 361 or 362 of the Insolvency Act 1986<sup>165</sup> is the main allegation is now at a similar level as section 361/2 submissions (see Figure 37). The low level of ATPs seen in 2004/5 is because BRO action can only be taken in respect of conduct after 1 April 2004.



<sup>164</sup> The Insolvency Service – ‘A study of the bankruptcy enforcement regime before and after the Enterprise Act 2002’ can be accessed at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/enforcementreport.pdf>

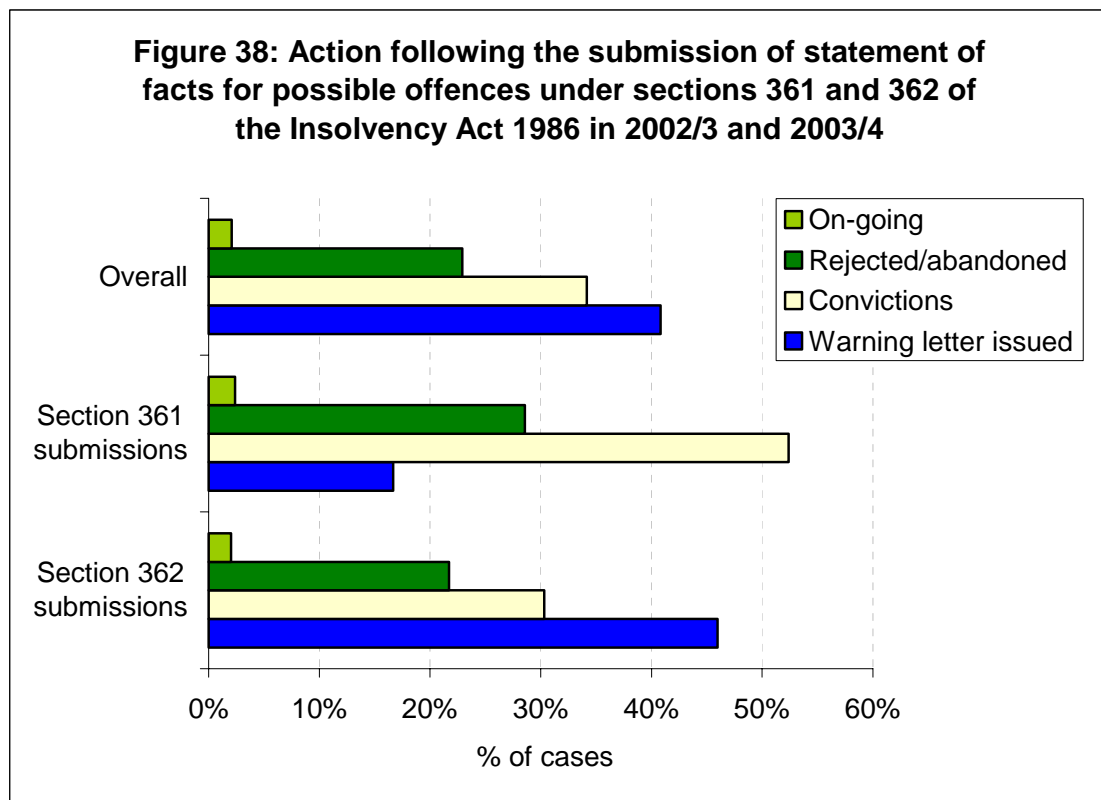
<sup>165</sup> Allegations of gambling/rash and hazardous speculation includes unreasonable extravagance

### 3.7 Evaluation of the Sundry provisions (continued)

The protection provided where a bankrupt has failed to keep proper accounting records or has gambled/ undertaken rash and hazardous speculation (continued)

10. Analysis of submissions regarding a possible offence under sections 361 or 362 of the Insolvency Act 1986 pre-Enterprise Act 1986 shows that, overall, no action was taken in just under 25% of these cases due to insufficient evidence to support prosecution action. As regards the remaining submissions, overall, convictions were obtained in around 35% of cases and a warning letter issued in around 40% of cases (with a handful of cases still on-going) (see Figure 38).

11. Following a submission of a statement of facts regarding a possible offence under section 361 or 362 of the Insolvency Act 1986, a conviction was more likely in respect of a section 361 offence (see Figure 38).



### 3.7 Evaluation of the Sundry provisions (continued)

The protection provided where a bankrupt has failed to keep proper accounting records or has gambled/ undertaken rash and hazardous speculation (continued)

12. The most common sentence imposed following a conviction of an offence under section 361 or 362 of the Insolvency Act 1986 was Community Service (see Table 23).

**Table 23: Sentences imposed following convictions of an offence under section 361 or 362 of the Insolvency Act 1986**

Sentences imposed on convictions	Section 361 convictions	Section 362 convictions	Total
Community Service	9	29	38
Conditional discharge	3	16	19
Fine	8	1	9
Probation/Rehabilitation Order	-	6	6
Prison sentence	2	4	6
Absolute discharge	-	2	2
Suspended sentence	-	2	2
<b>Total</b>	<b>22</b>	<b>60</b>	<b>82</b>

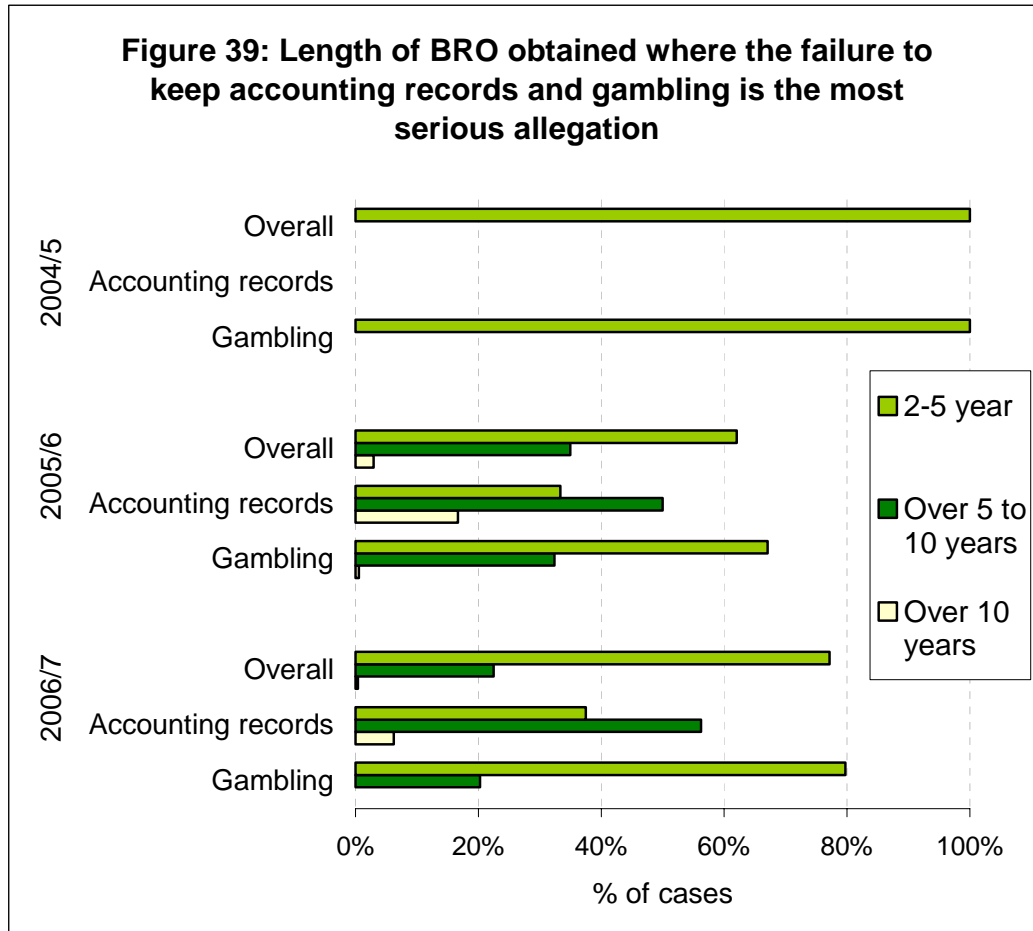
13. As regards the 515 ATPs for BROs issued where the main misconduct was a failure to keep proper accounting records or gambling/rash and hazardous speculation (including unreasonable extravagance) in the three years ended 31 March 2007, to date an order has been obtained in all but 2 cases. This is due to the lower burden of proof required in the civil BRO proceedings compared to criminal proceedings. The average length of the BRO obtained was 5 years<sup>166</sup>.

14. A longer BRO is more likely to be imposed where the main allegation relates to a failure to keep accounting records compared to gambling (see Figure 39). This is consistent with the greater likelihood of securing a conviction following a submission of a statement of facts regarding a possible offence under section 361 offence compared to a section 362 offence pre-Enterprise Act 2002 (see paragraph 11).

<sup>166</sup> The average length of a BRO where the most serious misconduct was a failure to keep proper accounting records or gambling/rash and hazardous speculation was 5 years, 5.4 years and 4.6 years for 2004/5, 2005/6 and 2006/7 respectively.

### 3.7 Evaluation of the Sundry provisions (continued)

The protection provided where a bankrupt has failed to keep proper accounting records or has gambled/ undertaken rash and hazardous speculation (continued)



15. In summary, BRO action is now being taken against a similar level of bankrupts who have failed to keep proper accounting records or have gambled/undertaken rash and hazardous speculation, compared to prosecution action prior to the Enterprise Act 2002. Prior to the Act, convictions were obtained in around 35% of these cases. In contrast, post-Enterprise Act 2002, BROs with an average length of 5 years have been obtained in nearly all cases due to the lower burden of proof required in the civil BRO proceedings compared to criminal proceedings.

### 3.7 Evaluation of the Sundry provisions (continued)

#### Creditor satisfaction with the protection provided where a bankrupt has failed to keep proper accounting records or has gambled/ undertaken rash and hazardous speculation

16. The Insolvency Service has carried out a survey of creditors in bankruptcy cases where a criminal conviction has been obtained against the bankrupt under sections 361 and 362 of the Insolvency Act 1986 - 'failure to keep proper accounting records' and 'gambling and rash and hazardous speculation' respectively. The purpose of the survey was to establish whether, albeit that prosecution action is designed to penalise not protect, such creditors felt that such prosecution action provided any protection to the business community and more generally, the general public. A survey was then carried out of creditors in bankruptcy cases where a BRO had been obtained where the most serious misconduct was a failure to keep proper accounting records or gambling/rash and hazardous speculation (including unreasonable extravagance) to establish whether such creditors felt that the BRO offered any such protection<sup>167</sup>.

17. Albeit that prosecution action is not designed to provide protection, around 12% of creditors in bankruptcy cases where a criminal conviction was obtained under sections 361 or 362 of the Insolvency Act 1986 thought that the criminal conviction provided protection to the business community, with 27% being unsure. Similarly, around 9% of creditors in bankruptcy cases where a criminal conviction was obtained thought that the criminal conviction provided protection to the general public, with 27% being unsure.

18. As regards BROs, around 43% of creditors in bankruptcy cases where a BRO was obtained (where the main misconduct was a failure to keep proper accounting records or gambling/rash and hazardous speculation) thought that the BRO provided protection to the business community, with 24% being unsure. Similarly, around 32% of creditors in bankruptcy cases where a BRO was obtained (where the main misconduct was a failure to keep proper accounting records or gambling/rash and hazardous speculation) thought that the BRO provided protection to the general public, with 34% being unsure.

19. Therefore, it appears that creditors feel that the BRO regime offers protection to the commercial community and general public, compared to criminal convictions.

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<sup>167</sup> For further information on the surveys, please see The Insolvency Service – 'A study of the bankruptcy enforcement regime before and after the Enterprise Act 2002', which can be accessed at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/enforcementreport.pdf>

## 3.7 Evaluation of the Sundry provisions (continued)

### Summary

- A possible failure to keep proper accounting records or gambling/rash and hazardous speculation has been identified in around 0.5% of bankruptcy cases both before and after the implementation of the Enterprise Act 2002 (see paragraphs 8-9).
- Prior to the Enterprise Act 2002, convictions were obtained in around 35% of such cases (see paragraphs 10-12).
- Since the Enterprise Act 2002, BROs have been obtained in nearly all such cases due to the lower burden of proof required in the civil BRO proceedings compared to criminal proceedings. The average length of the BRO obtained is 5 years (see paragraph 13).
- Creditors believe that BROs provide protection to the business community and the general public, compared to criminal convictions (see paragraphs 16-19).

### Recommendations

- None

### **Discretionary investigation of a bankrupt's affairs by the Official Receiver**

20. Prior to the Enterprise Act 2002, the Official Receiver had a statutory duty under section 289 of the Insolvency Act 1986 to investigate the affairs of all bankrupts, unless a certificate of summary administration was issued<sup>168</sup>. The Enterprise Act 2002 repealed the summary administration regime and amended section 289 of the Insolvency Act 1986, to give the Official Receiver discretion to exercise his power to investigate a bankrupt's affairs in all cases.

21. The objective of this provision is to enable the Official Receiver to allocate investigative resources to the cases that merit investigation, rather than based on the size of the bankrupt's deficiency.

22. The evaluation looks at the level of investigation work carried out by the Official Receiver and his working practices.

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<sup>168</sup> A certificate of summary administration was issued by the court where:

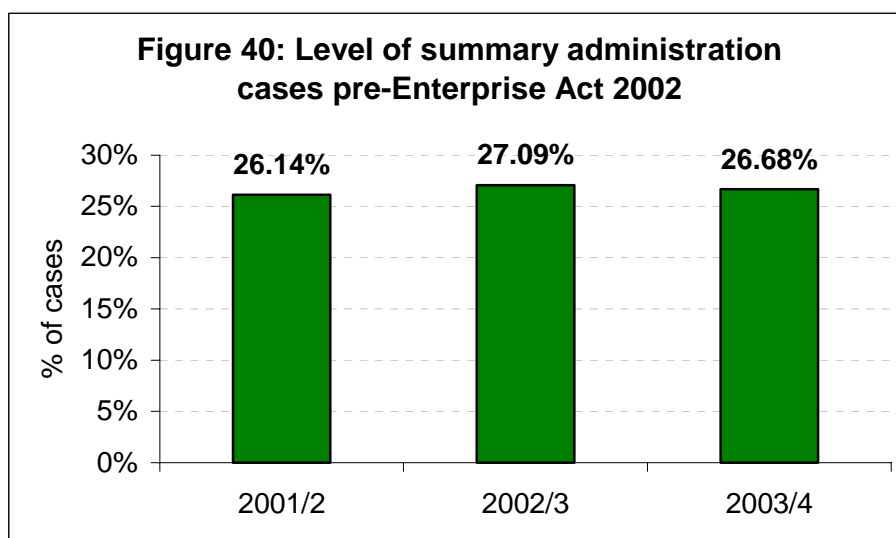
- A debtor presents his own petition;
- The debtor's liabilities are less than £20,000; and
- Within 5 years ending with the date of presentation of the petition, the debtor has not been adjudged bankrupt nor has he made a composition with creditors in satisfaction of his debts or entered into a scheme of arrangement of his affairs.

Where a certificate of summary administration was issued, the Official Receiver had a discretionary, rather than mandatory, duty to investigate the bankrupt's affairs. Further, the bankrupt was automatically discharged after two, rather than three, years.

### 3.7 Evaluation of the Sundry provisions (continued)

#### Level of investigation work carried out by the Official Receiver

23. Prior to the repeal of the summary administration regime, the level of summary administration cases compared to all bankruptcy orders remained consistent (see Figure 40).



24. On 1 April 2004, The Insolvency Service altered its case processing system, which impacts upon the comparability of relevant evaluation data pre- and post-Enterprise Act 2002. Further, the impact of the introduction of the BRO regime and repeal of offences under sections 361 and 362 of the Insolvency Act 1986 cannot be removed to ascertain the true impact of the repeal of the summary administration regime. Therefore, a full evaluation of this provision has not been possible.

25. However, prior to the Enterprise Act 2002, the insolvency legislation only permitted the Official Receiver to exercise discretion as regards whether to investigate a bankrupt's affairs in summary cases. This equated to about 27% of cases (see Figure 40) and the criterion was mainly based on the size of the debts owed by the bankrupt. The repeal of the summary administration regime has allowed the Official Receiver discretion to investigate based on more sensible criteria - the extent to which the initial information provided to him explains the causes of the bankruptcy and that these causes do not indicate misconduct or the commission of criminal offences.

### 3.7 Evaluation of the Sundry provisions (continued)

#### Working practices of an Official Receiver as regards investigations

26. The Insolvency Service has not introduced any new business or investigation processes as a result of the repeal of the summary administration regime. Therefore, in reality, the repeal of the summary administration regime and amendment to section 289 of the Insolvency Act 1986 has not changed the Official Receiver's approach to investigations.

#### **Summary**

- The repeal of the summary administration regime and amendment to section 289 of the Insolvency Act 1986 has not changed the Official Receiver's approach to investigations (see paragraph 26).
- However, it has allowed the Official Receiver discretion to investigate based on more sensible criteria - the extent to which the initial information provided to him explains the causes of the bankruptcy and that these causes do not indicate misconduct or the commission of criminal offences (see paragraph 25).

#### **Recommendations**

- None

#### **Sanction required for a trustee to pursue antecedent recoveries<sup>169</sup>**

27. Sanction<sup>170</sup> is required for a trustee to pursue antecedent recoveries. It had been presumed that, with the necessary sanction, a trustee could use bankruptcy assets to bring such actions, but this appeared not to be the case following the decision in *Lewis v. Commissioners of Inland Revenue and Others* and subsequent legal advice. Therefore, following the Lewis case, a trustee could not use money available for distribution to fund an antecedent recovery and in effect, the Enterprise Act 2002 reverses this position.

28. This provision of the Enterprise Act 2002 came into effect on 15 September 2003, and its objective is to allow the creditors the choice as to whether estate monies should be used to fund antecedent recovery action.

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<sup>169</sup> Insolvency legislation contains measures to enable trustees to take civil action to seek financial restitution for losses caused to the estate (antecedent recoveries). These measures are claims under the following sections of the Insolvency Act 1986 - section 339 (Transactions at an undervalue); section 340 (Preferences) and section 423 (Transactions defrauding creditors).

<sup>170</sup> Sanction is the agreement of the creditors committee in bankruptcy proceedings. In the absence of a creditors committee (or The Insolvency Service's Insolvency Practitioners' Unit acting on behalf of the Secretary of State), the trustee would apply for sanction from the court.

### **3.7 Evaluation of the Sundry provisions (continued)**

#### **Sanction required for a trustee to pursue antecedent recoveries (continued)**

29. Information has been sought on the level and results of antecedent recoveries made under a court order in the period November 2000 to 14 September 2003, or antecedent recoveries made with sanction since the implementation of the new provisions. In the absence of any appropriate records from which to extract this data, the Insolvency Service has sought case study material from insolvency practitioners<sup>171</sup>. However, no example cases have been identified to date.

30. Therefore, there is no evaluation evidence available to assess the impact of this provision. However, the amendment of the legislation to require creditors committee agreement to the trustee using money that would otherwise be available for distribution to fund antecedent recoveries does, in itself, fulfil the principal objective of the provision, i.e. to allow the creditors the choice as to whether estate monies should be used to fund antecedent recovery action.

#### **Summary**

- The Enterprise Act 2002 provisions allow the creditors the choice as to whether estate monies should be used to fund antecedent recovery action (see paragraphs 28-30).

#### **Recommendations**

- None

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<sup>171</sup> A request was made to insolvency practitioners (via the publication 'Dear IP') and Insolvency Service staff for details of any such cases.