TRANSPARENCY & TRUST DISCUSSION PAPER
Consultation Closing Date: 16 September 2013

RESPONSE OF THE INSOLVENCY PRACTITIONERS ASSOCIATION

INTRODUCTION

There follows the response of the Insolvency Practitioners Association to the BIS discussion paper "Transparency & Trust: Enhancing The Transparency of UK Company Ownership and Increasing Trust In UK Business", as prepared by the Corporate Consultation Committee of the IPA; a committee comprised of IPA members with particular interest and expertise in the field of corporate insolvency.

Further information about the IPA may be found at the end of this document.

This response is not intended to reflect the views of every member of the Association, who are themselves at liberty to submit their own responses, but rather to reflect the broadly agreed views of the Association and its Corporate Consultation Committee (CCC).

OVERVIEW OF RESPONSE AND GENERAL REMARKS

The objects for which the IPA is established are, for the public benefit, to promote and maintain high standards of practice in the performance and discharge of all those functions, powers and duties which are attached or incidental to "Insolvency Administration Offices" and the performance and discharge of such functions; ancillary to which the Association is empowered to advise and make recommendations to any government department or other body regarding any changes in law or practice affecting Insolvency Administration Offices or otherwise relating to Insolvency Administration, and to promote and support any policies calculated to improve any aspect of Insolvency Administration.

Our responses, therefore, are predominantly in respect of those proposals which directly affect the functions of insolvency practitioners (those in Part B). We have not responded to those that are outside of either our sphere of direct knowledge, or that of the members who have participated in preparing this response, although we have commented generally, where considered appropriate.

Part A: Enhancing the transparency of UK company ownership

We do not propose to respond in detail to Part A as the impact of such changes would reach beyond the context of insolvent entities. However, we concur that the ability to identify controlling individuals is central to both the attribution of responsibility and the pursuit of recoveries in insolvent situations.

We have no doubt that enhancing transparency of UK company ownership could be of great assistance to insolvency practitioners generally, in all forms of insolvency proceedings, when investigating the affairs of the insolvent entity, identifying potential assets (and how they may have been divested or misapplied) and ultimately in pursuing their recovery for the benefit of creditors. However, whilst we are supportive of these objectives, we have some reservations about whether they will be achieved via the mechanisms currently proposed.

Our practitioners' experiences of delinquent directors (and shadow directors) suggest that the worst abusers of opaque and/or complex structures are unlikely to be deterred by the current proposals. This is particularly so where the beneficial ownership of assets is within the criminal fraternity, who we suspect will largely ignore such provisions.

Our practitioners considered that more practical approaches, such as presumed control for bank account signatories might be more effective in rendering those in control of companies more directly accountable. More punitive sanctions, together with effective machinery for enforcement and and/or increased publicity "naming and shaming" those concerned would be required to create an effective deterrent.

Alternatively, a system of strict interpretation of ownership (legal ownership being deemed to be beneficial ownership unless the contrary were proven), could be considered.

We are unable to comment on the broader impact that the proposed changes might have on business generally.

Part B: Increasing trust in UK business

Again, we are broadly supportive of the proposals' objectives. We believe that greater individual accountability, in both reputational and financial terms, is central to changing behaviours and creating effective motivators amongst those controlling corporate structures. It may also help to address the legitimate concerns of stakeholders who experience understandable frustration when the directors of companies are seen to walk away from a company's debts without significant personal consequences. We would suggest that these concerns are in fact at the root of stakeholders' dissatisfaction with the outcome of many insolvency processes.

Our practitioners frequently express their frustration that proceedings are not brought against directors in circumstances where, in their view, they would have been warranted. Existing legislation provides a robust raft of procedures which do not appear to be being utilised to their full extent. This may be due to resourcing issues, or other public interest considerations. However, it is difficult to conclude that existing measures require legislative re-enforcement when it would appear that, for whatever reason, the current provisions are under-used.

There also appears to be a danger of legislating for the margins. Banking failures, whilst currently high profile, represent a small proportion of corporate insolvencies. The enforcement regime needs to cater for delinquent directors from all types and sizes of companies, whilst recognising that the entrepreneurial activity of the vast majority of directors is making a vital contribution to the economy.

Clarifying the responsibilities of directors

39. The merits of strengthening responsibilities of banking directors by amending the directors' duties in the CA06 to create a primary duty to promote financial stability over the interests of shareholders. *This should be considered in the context of the banking regulation reforms the Government has already committed to and the further economy-wide measures set out in the rest of this paper.*

We concur that there should be greater individual accountability within corporate governance generally. However, we are not convinced of the merits of singling out a particular sector, particularly when other sectors may present a similarly high risk of consumer or broader societal detriment. We are not persuaded that any one sector presents a sufficiently distinct risk to warrant separate treatment and suspect that definitional difficulties would be encountered in attempting to do so.

As a point of principle, we consider that all directors should owe the same duties at law, particularly when transacting with vulnerable consumers. Robust provision exists already within the Companies Act and the CDDA, and we suggest that it is the rigour of its application and enforcement that are in issue, particularly outside of formal insolvency proceedings.

In the context of recent banking failures, it is notable that the corporations involved were spared from the formal insolvency processes which would have brought objective and independent review to bear upon their directors, by insolvency office holders appointed by their creditors. We would suggest, therefore, that the existing mechanisms were not deployed to their full effect.

Whilst noting that a small number of individuals were "named and shamed" by industry regulators (which may have produced some deterrent effect), none of these individuals were subject to the penalties they could have been, had their companies entered into insolvency processes.

Moreover, we would expect that the sectoral regulation would itself place appropriate infrastructures in place to manage the sector-specific risks. In the context of banking, we understand that new capital adequacy requirements (amongst other measures) are intended to address the sector-specific risk of banking failure.

Generally, we believe that appropriate legislative provision already exist to tackle delinquent directors and consider that the perceived failings in the disqualification system are a function of deficiencies in its application and enforcement.

Allowing sectoral regulators to disqualify

40. Whether, in certain circumstances, directors barred or prohibited from senior positions in key sectors should be considered for disqualification from acting as directors of any CA06 company?

Yes. However, we consider that disqualification should be from acting as a director of any company, as is currently the case. Disqualified directors may apply to Court for leave to act, but the onus is upon them to justify why they should be permitted to do so.

If a director is considered to be unfit to be concerned in the management of a limited company, we do not consider that it is appropriate to limit that restriction to certain sectors only. This would produce a significant unfairness to directors of small general companies, whose disqualification would not be limited in this way.

41. Which sectoral regulators should have the ability to make an application to the Court for a disqualification order, or to accept a disqualification undertaking from a director?

Regulators will invariably have more detailed knowledge of their sectors, acceptable standards of practice (and unacceptable divergences from it). Therefore, we consider that any sectoral regulator could feasibly have the ability to report sufficiently serious breaches of regulation or other misconduct that, in their view, is relevant to that party's fitness to act as a director.

Such reporting could be via allowing them to use the same system as is proposed for the reporting by insolvency office holders and, therefore, would not incur addition costs.

A discrete process, as is the case for insolvency office holders, would also assist regulators to bring matters to the attention of the disqualification authorities, without the costs or risks of directly instigating proceedings themselves, which might deter them from doing so.

We also consider that there should be greater utilisation of existing provisions for disqualification in the case of non-insolvent entities, which would be facilitated by the submission of adverse reports by a sectoral regulator.

However, whilst significant weight could be afforded to an adverse report from a regulator, we believe that the decision to instigate disqualification proceedings and the proceedings themselves should be brought centrally by a single prosecuting authority. Having multiple prosecutors could lead to unnecessary duplication of actions and a lack of joined-up intelligence gathering as well as potential disparity of outcomes.

42. The potential costs and benefits of this proposal.

If implemented, a system of multiple prosecutors would require investment in staff training and infrastructure. It may also lead to unnecessary duplication of resource. We do, however, perceive the benefit of greater involvement of sectoral regulators in disqualification processes, through the availability of industry-specific knowledge and understanding. Ultimately, with better informed prosecution would come improved rates of disqualification and increased deterrent from delinquent behaviour.

We consider that these benefits could be harnessed as suggested above, whilst minimising costs through centralising the decision-making and prosecuting functions.

Factors to be taken into account

43. Whether Schedule 1 to the CDDA should be amended to provide that any breach of sectoral regulations is a matter of unfitness that may be taken into account by the court in disqualification proceedings?

Yes - see above.

44. Whether Schedule 1 to the CDDA should be amended to provide that 'wider social impact' is a matter to be taken into account by the courts in disqualification proceedings?

We are not persuaded of the merits of this approach. It would be extremely difficult to assess 'wider social impact' and to do so necessitates the quantification of the relative merits of potentially conflicting interests (e.g. shareholders, employees, trade supplies, consumers, other creditors). This would be a highly subjective exercise and the social impact itself does not bear, per se, on the level of the directors' culpability for it.

We are supportive of the concept that sanctions should be reflective of the harm occasioned by the conduct, although we understand that this is already taken into account when assessing whether it is in the public interest to seek disqualification and the resulting sanction.

45. How wider social impact should be defined and whether a materiality test should be applied?

N/A

46. Whether, where unfitness meriting disqualification has been found against a director of a company that dealt with high volume deposits or otherwise vulnerable creditors, two tariffs of disqualification should be handed down (or agreed by way of undertaking):

- A tariff with respect to acting in the management of all companies; and

The disqualification period should be a reflection of the harm done, but we suggest that the existing provisions cater for this already.

As stated above, we are not in favour of sector-specific disqualification as this would lead to potentially more lenient treatment of culpable directors in some sectors (their disqualification being limited to those sectors alone), whilst directors of general companies could expect to be subject to a general disqualification.

- An increased tariff with respect to acting in the management of any company dealing with high volume deposits or otherwise vulnerable creditors (or a company engaged in a business similar to that in relation to which he had been disqualified).

N/A

47. Whether Schedule 1 to the CDDA should be amended to provide that failure to pay particular regard to the protection of deposits, pre-payments or otherwise vulnerable creditors once a company has become insolvent is a matter to be taken into account by the court when deciding whether a director is unfit and should be disqualified (or by the Secretary of State in deciding whether to accept a disqualification undertaking)?

N/A – see above. We understand that these issues are taken into account by the Disqualification Unit when considering whether to bring proceedings.

48. What account the court (and the Secretary of State when deciding whether to take action) should take of the track record of the director (including the number of failures a director has been involved in) when deciding whether or not to disqualify an individual and for how long?

Involvement in previous failures is a matter of fact and that information should be available to the prosecuting authorities and to the Court. However, it should be taken into consideration when considering the length of a disqualification as whilst it may be indicative, it is not itself evidence of unfitness.

49. Whether there should be a certain number of failures beyond which the presumption is that a director is unfit and should be disqualified. If so, what should that number be?

No.

Improving financial redress

50. How frequently the possibility of bringing wrongful and fraudulent trading claims arise, are pursued and what value the existing civil remedies for wrongful and fraudulent trading provide?

The availability of these actions is always considered by the liquidator, however, our practitioners suggest that proceedings are infrequently brought, largely through lack of funding (creditors' being understandably unwilling to fund actions) and evidential difficulties.

However, practitioners also report that the threat of these actions is more frequently used to ellicit a settlement from directors. Whilst there are not readily available statistics as to the rates of settlement, anecdotally, we are advised that the threat of these actions is an important mechanism for liquidators to seek redress for creditors.

51. Whether, if liquidators were able to sell or assign wrongful and fraudulent trading actions, more actions would be taken? If so, how many more?

The ability to threaten such action is currently in the hands of a qualified and regulated insolvency office holder, who acts under the general control of the Court and the threat of regulatory censure. This mitigates against such threats being used inappropriately. IPs have a high degree of objectivity and are able to bring an element of independent review to bear upon the merits of pursuing the case and the likely cost/benefits of doing so. It is also of note that wrongful and fraudulent trading actions are not exclusively concerned with financial restitution, they assist in the promotion of a culture of accountability.

Allowing the sale of such claims will merely precipitate the growth of a new industry of US-style claims handlers. There would be no practical mechanism for ensuring that a director was not "behind" the offer and the negotiating position of liquidators' would be weakened.

Currently, CFA arrangements are still possible in insolvency and provide a vehicle to pursue these claims in suitable cases. We would strongly advocate an extension of the insolvency exemption to the Jacksons reforms as an alternative to allowing the sale of such actions.

52. To what extent creditors would benefit from this proposal?

There is nothing whatsoever to suggest that allowing claims handlers to buy these claims would result in increased returns to creditors. Recent experience within the insolvency profession of bond claims being pursued against insolvency professionals does not suggest that the creditors' position is necessarily improved, largely due to costs associated with pursuing the claims.

Moreover, the ability to sell claims could engender a proliferation of early sales in return for potentially lower levels of realisation than might otherwise have been achieved, at the behest of larger creditors minded to take a "bird in the hand" approach. This seems unlikely to produce better returns to creditors as a whole.

53. What practical difficulties might prevent third parties pursuing claims and how these might be overcome?

N/A – we do not consider that this avenue should be pursued in any event.

54. Whether safeguards would need to be introduced to prevent certain parties acquiring such a claim? If so, who should they apply to and what form they should take?

N/A – we do not consider that this avenue should be pursued in any event.

55. Whether this proposal would improve confidence in the insolvency regime?

N/A – we do not consider that this avenue should be pursued in any event.

56. The benefits of giving courts the power to make compensatory awards against directors?

Whilst we support the concept of greater personal accountability for directors, we have concerns about the proposal to give Courts the power to make compensatory awards.

Within the context of insolvency proceedings, there is probably sufficient provision for financial reparation to be made in the form of the existing wrongful trading and other restorative provisions. Were such awards to be possible, careful consideration would need to be given to the interaction with the wrongful and fraudulent trading provisions and the recourse that may be available for breach of other directors' duties and the antecedent transaction provisions.

Alternatives for such provision, were it enacted, may be to provide for the Court to make a finding of wrongful or fraudulent trading when making a disqualification order (noting a correlative provision exists in s.10 of the CDDA allowing a disqualification order to be made where wrongful trading or fraudulent trading has been established). Alternatively, the proceeds could be made part of the Prescribed Part, either in lieu of or in addition to assets that would otherwise have been available.

In non-insolvency situations, where the wrongful trading provisions do not apply, we can see some merits in compensatory awards being available. However, we suggest that some difficulties may exist in channelling the resulting funds to the intended beneficiaries in the absence of a formalised distribution process (as exists within insolvency proceedings).

57. The potential costs and drawbacks of this proposal?

Ultimately, the director as an individual will have a defined and limited wealth i.e. one pool of assets upon which to draw. The current proposals appear to envisage the initial beneficiary of the compensation provisions to be the Secretary of State rather than the creditors. If a compensation award is made against a director, the liquidators' ability to bring (or indeed settle) wrongful trading claims, or any other claim to restore the assets of the company, (such as a preference or transaction at an undervalue), would be prejudiced.

It should also be noted that the proceeds of a wrongful trading action are not caught by a floating charge, whereas the proceeds of other actions (such as preferences) are floating charge assets. Thought would need to be given about whether such an award would prejudice the rights of secured creditors that might otherwise have expected to make recoveries.

58. Who should receive any monies recovered by action: should it be creditors generally or left to the court to determine?

See above.

59. Whether the IS (acting on behalf of the Secretary of State) should be able to request and agree a compensation award from a director when it accepts an undertaking from the director not to act in the management of a company for a certain number of years?

No. This will lead to directors bargaining the length of their disqualifications as against the level of the award.

60. Whether this proposal would improve confidence in the insolvency regime?

No.

Time limit

61. Whether the period within which disqualification proceedings under section 6 of the CDDA must be instituted should be extended beyond two years?

We agree that there should be an ability to extend this period in appropriate cases, such as where the complexity of the corporate structure or the conduct complained of necessities further investigation, or where the alleged conduct is particularly serious in nature.

62. If yes, should that period be five years, some other period, or no limit at all?

We are of the view that five years is an unduly long period to be applied routinely and in all cases. We can envisage scope for an extension to three years, by application.

63. How many directors are likely to be affected?

Unknown. Although extending a period of uncertainty to the significant majority in order to cater for the delinquent minority is not considered appropriate.

Educating directors

64. Whether, if some form of director education were to be introduced, it would increase trust in the enforcement regime?

We are sceptical about the likely value and efficacy of such a scheme.

Where a director is found to be unfit to be concerned in the management of a company, this is generally as a result of sufficiently culpable behaviour that it cannot reasonably be attributed to a lack of education.

We are of the view that better utilisation of existing legal provision combined with robust enforcement and greater publicity would do more to increase trust.

65. What form the training should take and who should provide it?

The roles of directors and the nature of the companies in which they work vary to such an extent that we are not convinced it would be possible to provide meaningful “one-size-fits-all” training product.

66. What would be the likely cost of such training?

Unknown.

67. Whether successfully completing any such training should enable a reduced period of disqualification; or should be a pre-condition for any disqualified director wishing to seek leave of the court to run a company whilst disqualified?

No. Reducing disqualification periods where training is undertaken could undermine confidence in the enforcement regime.

68. Whether there would be value in offering such training to all directors of failed companies – irrespective of whether they were disqualified - having regard to the fact that the director would need to cover the cost?

We would suggest that any generic training as to directors' general duties and obligations would be better delivered as a prophylaxis rather than a cure. There appears to be limited demonstrable value in providing education after the event.

Overseas restrictions

69. Whether regulations should be made using the powers in Part 40 of the CA06 to prevent persons who are subject to foreign restrictions (which fetter their freedoms to act in connection with the affairs of a company) being able to be directors or act in the management of companies in the UK?

Yes.

70. If yes, should the foreign restrictions be made to apply automatically in the UK, or should they require the Secretary of State to make an application to a court?

No. We can envisage difficulties and potential unfairness arising from an automatic disqualification, particularly as the fairness of other regimes is not known. We believe it would be appropriate for the Secretary of State to apply to Court, where it was considered in the public interest to do so.

71. If not, should a person subject to foreign restrictions be obliged to notify the Registrar of Companies if they act in the promotion, formation or management of a company in the UK?

Yes.

72. Whether the Secretary of State should have the power to bring disqualification proceedings against a person on the sole basis that that person has been convicted of a criminal offence overseas in connection with management of a company or business overseas?

Yes - subject to an appropriate public interest test.

ABOUT THE IPA

The Insolvency Practitioners Association (IPA) is a membership body recognised by the Secretary of State for Business, Innovation & Skills (BIS) for the purposes of authorising Insolvency Practitioners (IPs) under the Insolvency Act 1986. It is the only recognised professional body to be solely involved in insolvency and for over fifty years, the IPA is proud to have been at the forefront of development and reform within the industry.

As of 01 January 2013, the IPA had approximately 2,000 members, of whom 554 are currently licensed insolvency practitioners (IPs). In addition to its recognition under the Insolvency Act for the purpose of licensing IPs, the IPA is also a Competent Authority approved by the Official Receiver for the purpose of authorising intermediaries to assist with debtors' applications for Debt Relief Orders.

The IPA currently license approximately one third of all UK insolvency appointment takers, who are subject to a robust regulatory regime, applied by the IPA's dedicated regulation teams carrying out complaints handling, monitoring and inspection functions. Additionally, the IPA conducts inspection visits of those appointment-takers licensed by the Law Society (Solicitors Regulation Authority), one of the other recognised professional bodies under the Insolvency Act. The IPA also undertakes monitoring visit work for the Debt Resolution Forum, a membership body which sets standards for its members when involved in providing non-statutory debt solutions to insolvent individuals (such as Debt Management Plans).

The IPA has a longstanding and continuing commitment to improving standards in all areas of insolvency (and related) work. It was the first of the recognised bodies to introduce insolvency-specific ethics guidance for IPs, and the IPA continues to be a leading voice on insolvency matters such as the development of professional standards, widening access to insolvency knowledge and understanding, and encouraging those involved in insolvency case administration and insolvency-related work to acquire and maintain appropriate levels of competence and skills.

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