The Insolvency Service

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DEAR INSOLVENCY PRACTITIONER
Issue 135 – August 2021

Dear Reader

Please find enclosed the latest articles from the Insolvency Service.

111) Claims Management Companies – Regulated activities

N.B. This article supplements Chapter 13 Articles 71 and 94.

Please note that with effect from 1 April 2019, the Financial Conduct Authority (FCA) took over regulation of Claims Management Companies from the Claims Management Regulator (CMR). Where the CMR is referenced in articles issued before 1 April 2019, therefore, the FCA should now be substituted.

Since taking over the regulation of Claims Management Companies (CMCs) from the Claims Management Regulator, the Financial Conduct Authority (FCA) has identified some Insolvency Practitioners who have carried out regulated activities without authorisation.

Insolvency Practitioners are reminded that engaging in a regulated activity whilst neither authorised nor an exempt person is a criminal offence under section 23 of the Financial Services and Markets Act 2000 (FSMA).

Insolvency Practitioners are responsible for ensuring they comply with the relevant legislation and should carefully check the Claims Management Activity Order 2018 and the FCA Handbook to determine whether any aspect of their activities is a regulated activity and that they have the required permissions. Where there is any doubt as to the position, independent legal advice should be sought.

Some specific points to note are as follows:

- Before carrying out an activity, Insolvency Practitioners are responsible for considering whether there are any applicable exclusions (for example, 89P(a) Regulated Activities Order 2011); if not, the appropriate FCA permission will be required.

- If an Insolvency Practitioner is charging a fee for any single aspect of advising, representing or investigating a financial service or financial product claim, it is likely that this is a regulated activity, even if there is no further involvement.

- Similarly, each individual element of lead generation activities – which covers seeking out, referral and identification of claims and potential claims - also requires authorisation. If a lead generation activity is carried out before an individual voluntary arrangement is in place, the Insolvency Practitioner cannot benefit from the exclusion.

- **Please note:** There is no exemption from FCA authorisation under Part XX FMSA for CMC activities, which are specifically excluded under section 327(9) FSMA.

- CMCs are required to carry out due diligence on any Insolvency Practitioner passing on or selling client data to them, even if the practitioner benefits from an exclusion. The CMC must ensure the data they pass on is processed in compliance with relevant data protection legislation, including the General Data Protection Regulation (GDPR) and the Privacy and Electronic Communications Regulations (PECR).

- CMCs are also required to notify the FCA if a lead generator is not authorised. The FCA published a joint statement in February 2020 with the Information Commissioners Office and the Financial Services Compensation scheme in relation to Insolvency Practitioners and FCA-authorised firms attempting to sell client data unlawfully (*see also Dear IP Chapter 13, Article 102*).

- Where a CMC is ceasing its regulated claims management activities, it is required to comply with wind down rules. If the CMC handled client money which the Insolvency Practitioner has an agreement to reconcile, the client money rules for CMCs must be complied with.

The FCA would also like to draw Insolvency Practitioners' attention to its Claims Management portfolio letter from October 2020, which sets out its view of the main risks of harm in that area, the action expected of firms, and its own actions to reduce the level of harm in the sector.

Any queries regarding authorisation or exempt status should be addressed to the FCA: https://www.fca.org.uk/contact

General enquiries regarding this article may be sent to: IPRegulation.Section@insolvency.gov.uk

73) Examination of centre of main interests and establishment when opening insolvency proceedings

Following the UK's exit from the EU and the end of the implementation period, we have received requests for clarification regarding the duty to examine an insolvent's centre of main interests (COMI) when opening insolvency proceedings.

An Insolvency Practitioner's duty to determine whether there are grounds to open proceedings based on COMI, or alternatively because the insolvent has an establishment in the United Kingdom, is contained in article 4 of the EU Insolvency Regulation (EU 2015/848). This is one of a small number of articles within the Regulation that have been retained in UK law, and remains in effect.

Due to the removal the majority of the rest of the Regulation, the form of the declaration that the Insolvency Practitioner must make has been amended. Insolvency Practitioners were previously required to state whether the insolvency proceedings were "main, secondary, territorial or non-EU proceedings". These terms are not present in the retained legislation, and the current requirement is instead to state whether the proceedings are "COMI proceedings, establishment proceedings or proceedings to which the EU Regulation as it has effect in the law of the United Kingdom does not apply".

The retention of this requirement is intended to make it clear whether the insolvent's COMI is considered to be in the UK and assist cooperation with foreign jurisdictions that make use of this concept.

Enquiries regarding this article may be sent to: Policy.Unit@insolvency.gov.uk

74) Further guidance for Insolvency Practitioners on Part A1 moratorium monitor appointments

The Insolvency Service has received feedback from Insolvency Practitioners and others on the new Part A1 moratorium procedure. This article seeks to address the questions raised and to give assurance to practitioners considering consenting to an appointment as monitor. The article should be read in conjunction with the gov.uk guidance for monitors, which it is intended to complement rather than replace.

https://www.gov.uk/government/publications/insolvency-act-1986-part-a1-moratorium-guidance-for-monitors/test-doc

All section numbers refer to the Insolvency Act 1986 unless otherwise stated.

Can the monitor offer other services to the company in a moratorium?

Some practitioners have queried with the Insolvency Service if they are able to offer other services to the company over which they have been appointed as monitor, in addition to the statutory role.

The statutory role is intended to be a relatively narrow one – for example, giving a statement on the likelihood of the moratorium resulting in a rescue of the company as a going concern in section A6 and to monitoring that the company remains rescuable during the moratorium itself - rather than the practitioner taking control of the operation of the company itself. This helps to keep the direct costs of the process to the debtor company low.

The purpose of a moratorium is to give a company in financial difficulties a breathing space to facilitate its rescue while preventing legal action being taken against it. By its very nature it is likely that professional restructuring advice will be needed by such companies. While this need not be from the monitor or the monitor’s firm – the company at all times remains in the control of its directors and they are free to seek advice from whomsoever they wish – there is nothing in Part A1 Insolvency Act 1986 preventing the monitor offering such advice. Payment for such services will be a contractual matter between the company and the practitioner.

It is left to the practitioner’s professional judgement as to whether they can carry out their role as monitor with sufficient objectivity, having regard to the Insolvency Code of Ethics and any threats to their independence on a case by case basis. Given the wide range of matters that directors may ask for advice/help on there may be ethical issues on the monitor providing assistance. As with actions undertaken when appointed in other insolvency procedures, it is important for the practitioner to document accurately what they have done.

How much due diligence is required to be able to make the statement at section A6 on the rescuability of a company?

A condition of entry to the moratorium is that a prospective monitor must make a statement that it is likely that a moratorium will result in the company's rescue as a going concern (section A6(1)(e)). Practitioners have asked the Insolvency Service how much due diligence they need undertake in order to feel comfortable in making such a statement.

In the Insolvency Service's opinion, the due diligence that needs to be undertaken should be proportionate to the size and circumstances of the company. The statutory provision is predicated on the view – the opinion – of the practitioner and that it is 'likely' that the company will be rescued as a going concern. 'Likely' is not a certainty - the proposed monitor is giving their opinion on what may happen in the future based on facts available in the present and it is appreciated that not all moratoriums will lead to a rescue of the company as a going concern. The Insolvency Service considers that the use of the expression "in the proposed monitor's view" indicates that a degree of latitude is to be given to a monitor in this regard, recognising that the monitor's assessment will most likely require the exercise of a substantial amount of commercial judgment, often under significant time pressure.

Throughout the Corporate Insolvency and Governance Bill's progress through Parliament, the moratorium was referred to as a 'light touch' process. It is clear that Parliament did not intend the proposed monitor to conduct a full audit of the company to satisfy themselves for the purposes of a section A6(1)(e) statement. Neither should the statement be considered a return to the pre 2003 r2.2 report in administration. The wording of the subsection reflects this.

When considering if the company is likely to be rescued as a going concern does the proposed monitor need to consider how long the rescue might take, for example if it will be rescued in the initial period (20 business days)?

The proposed monitor's statement (section A6(1)(e)) must say that it is likely that the moratorium will result in the company's rescue as a going concern. While the initial period of a moratorium is 20 business days, it is appreciated that effecting a rescue as a going concern may take longer than this and, for more complex cases, much longer. The legislation anticipates this and provides a number of ways to extend the moratorium. In the making of a section A6 statement, the monitor is concerned on the company's rescuability, not on the time within which rescue can be achieved. If the proposed monitor thinks that rescue will take greater than 20 business days to effect, this in itself should have no bearing on their section A6(1)(e) statement.

Can the monitor be considered responsible for decisions made by the company when in a moratorium?

The central principle of the moratorium is that it is a 'debtor in possession' procedure. It allows vital breathing space for a company to consider its options for rescue. The directors remain in control of the company at **all** times (subject to certain restrictions) – the monitor should not be running the company and, in the statutory role, *will* not be running the company. While a practitioner acting as monitor, as noted above, may also undertake work outside their statutory role, this does not detract from the position that it is the directors who are in control of the company, not the practitioner. Accordingly, it is the directors who are responsible for their decisions in the day-to-day running of the business, not the monitor.

As would be expected in any appointment, insolvency practitioners acting as monitor should document their own decisions.

How much monitoring does a monitor need to do?

The monitor's statutory duty is that they must monitor the company's affairs to be able to form a view that the moratorium is likely to result in the rescue of the company. The appropriate amount of monitoring that is required in such a role will depend upon the size, nature and business of the company and may also include the method by which the directors propose the company will be rescued. In a simple example, if a rescue was predicated on additional capital being invested in the company, it would be proportionate for the monitor to monitor correspondence etc. between the company and the proposed investor. If it became clear that this money was no longer forthcoming, it would be proportionate for the monitor to bring the moratorium to an end.

How far does the monitor need to go to verify information passed to them by the company?

The moratorium is a 'debtor in possession procedure'. At all times the directors remain in control of the company (subject to certain restrictions). A monitor has wide powers to request information from the company's directors in order that they can execute their statutory duties, and if such information is not forthcoming the moratorium may be brought to an end. Section A35 notes that the monitor is entitled to rely on the information given to them by the company. This is unless the monitor has reason to doubt its accuracy.

Whether doubt is appropriate will be in the professional judgment of the monitor and depend on the size and nature of the case and the monitor's experience of the company and its directors to date. In so doing, it is not expected that the monitor will externally verify every piece of information given to them. This would be disproportionate and an unnecessary cost and be contrary to the spirit of section A35(2) and the 'debtor in possession' nature of the moratorium.

The monitor should document any deliberation and decisions they have taken regarding the veracity of information given to them by the company.

Bonding

The Insolvency Service has been asked why a specific penalty bond is required for a monitor when they will not be in direct control of the company's assets.

The Insolvency Service considers bonding to be important for protecting creditors from financial loss on those rare occasions where there is fraud or dishonesty by an IP. Although the IP does not have direct control of the assets in a moratorium, the Service has determined that there may be opportunities for the monitor to potentially act dishonestly or fraudulently (albeit only where they are in collusion with the directors). Limited control over assets, in the form of necessary consent for the company to take certain actions during the moratorium, is given by the legislation. An example could involve a monitor consenting to a large payment of a pre-moratorium debt to a person connected to the company, to the detriment of unconnected pre-moratorium creditors, or where the monitor consents to the sale of assets not in the normal course of business.

However, we did attempt to limit the cost of bond cover for the role of monitor. Usually a bond provider cannot charge an additional premium for subsequent insolvency appointments (for example for administration moving to CVL with the same practitioner acting office-holder), which means the risks of subsequent appointments are factored into the premium charged by the bond provider. In recognition that a moratorium poses less opportunity for a practitioner to act dishonesty or fraudulently than procedures where they are in direct control of the assets, coupled with the fact that a moratorium need not always result in another insolvency procedure, the Insolvency Practitioners Regulations 2005 were amended in a way that would allow bond providers to charge an additional premium should a company in a moratorium enter a subsequent insolvency procedure.

This allows the bond provider to limit their risk assessment for the premium charged for a monitor's appointment to the risks involved in that appointment rather than having to factor in the risk of a subsequent appointment.
It should also be noted that nominees in a CVA do not have direct control of company assets but must have bond cover. The specific penalty sum is based on the value of the assets subject to the terms of the proposed CVA. Where the CVA is approved and the same IP appointed as supervisor no further premium is charged for the bond cover.

How often can a monitor request information from the company before it is reasonable for the monitor to bring an end to the moratorium for non-disclosure?

The monitor has absolute discretion to request from the directors of the company information that they require to carry out their function as monitor. The directors must comply with such requests as soon as it is practicable to do so (section A36).

If a failure to comply with such an obligation means that the monitor cannot properly carry out their statutory function, then they must bring the moratorium to an end (section A38(1)(c)). It is in the professional judgement of the practitioner what constitutes an inability to carry out the statutory function properly. For example, if the failure to provide information means that the monitor cannot establish that the company will likely be rescued as a going concern, then the moratorium must be brought to an end. What 'practicable' means will also depend on the situation though it is a form of words used throughout the insolvency framework and practitioners should be familiar with its usage in practice. It is expected that monitors document their requests for information and any consideration they have given to termination in the information's absence.

A distressed company that meets the entry criteria benefits from a moratorium – it provides it with an opportunity to be rescued as a going concern, free from creditor enforcement action. Where the moratorium conditions continue to be met, it is in the company's interest (and therefore within its directors' interests, subject to their duty to consider creditor interests) that the moratorium should continue. Directors should therefore act to assist the monitor as and when a request for information is made.

Can the deferral of unpaid debts be made after the commencement of the moratorium?

If moratorium debts (and pre-moratorium debts not subject to a payment holiday) are left unpaid, the monitor must bring the moratorium to an end. However, when making the decision about whether to end the moratorium, if the monitor has reasonable grounds for thinking they are likely to be paid within 5 days, this need not happen. Equally, if at the point the monitor is deciding whether to end the moratorium, the company and the creditor in question have agreed to defer payment until a later date, the monitor need not end the moratorium. The Insolvency Service has been asked if such deferral agreements need be arranged prior to a moratorium's start.

The deferral agreement need not have been made prior to the start of the moratorium (in respect of pre-moratorium debts not subject to a payment holiday) but the agreement should be made before the liability in question becomes due or as soon as possible afterwards and in any case must be made in advance of the monitor's decision whether to bring the moratorium to an end under A38(1)(d). Any agreed deferral of a moratorium debt, as that term is defined in section A53, is by its nature agreed after entry to a moratorium.

It is to be expected that the monitor would document actions that they have taken/not taken based on evidence of such deferrals.

Creditor extensions to the moratorium

Some practitioners have asked the Insolvency Service about the timing of moratorium extensions granted by creditors. Creditors may extend the moratorium for up to a year (including the initial period). However, this extension cannot be made within the first 15 business days of the initial period (s A11(1)).

This limitation does not mean that the company is unable to discuss extensions with creditors within those first 15 business days, including calling a decision procedure to get their agreement to such an extension. Nothing in law prevents such a request being made as soon as the moratorium itself is in effect if the company so chooses.

The prohibition is on such an extension being given effect within those first 15 business days, i.e. that the notice extending the moratorium cannot be filed at court within the time period, even if creditors have already agreed to it.

How are creditor votes calculated for decisions to extend a moratorium?

Only the claims of unpaid pre-moratorium creditors with debts in respect of which the company has a payment holiday during the moratorium as defined in sections A18 and A53 are eligible to vote on extensions to the moratorium. This respects that these are the creditors whose enforcement rights are being restricted in the moratorium. As with decision procedures in other Insolvency Act procedures, proofs/statements of claim need be submitted prior to the decision or, for meetings, 4pm on the business day before the meeting is held (or, in Scotland, at or before the meeting). Proofs/statements of claim should follow the content expected in Insolvency (England and Wales) Rules 2016/The Insolvency (Scotland) (Company Voluntary Arrangements and Administration) Rules 2018. As noted in the gov.uk guidance for monitors, the monitor may give assistance regarding the decision procedure to the company.

Do ‘GAME’ principles apply on the payment of rent?

If a company subject to a moratorium does not pay liabilities that it is required to, the monitor must bring the moratorium to an end (other than where para 37 (England and Wales) or para 77 (Scotland) Schedule 4 Corporate Insolvency and Governance Act 2020 applies). This applies to liabilities to which the company becomes subject during the moratorium other than where the obligation was entered into before that time, defined as ‘moratorium debts’ at section A53. It also applies to liabilities arising out of certain obligations entered into prior to this point, known as pre-moratorium debts not subject to a payment holiday (see section A18).

One such pre-moratorium debt not subject to a payment holiday is rent in respect of a period during the moratorium. The Government’s intention with the Part A1 moratorium was that the legislation be drafted in such a way as to reflect the GAME judgment regarding rent in an administration (*Jervis v Pillar Denton Ltd* [2014] EWCA Civ 180). For this reason, section A18(3)(c) specifically refers to ‘rent in respect of a period during the moratorium’. This means that, regardless of when a lease’s due date for rent is (before or after the entry to the moratorium), it is only the rent for the period of the moratorium that qualifies as a ‘pre-moratorium debt not subject to the payment holiday'. This balances the interests of a company's rescue with the interests of a landlord to receive payment for legal occupation of their property.

However unlike administration, the rent in question is all rent arising from a company's estate – not just that part of the estate in use during the moratorium. This reflects the different nature and statutory intent of the two procedures.

It is only rent for these periods that receives the protection as a priority pre-moratorium debt at s899A Companies Act 2006 (where the company enters a scheme of arrangement within 12 weeks of the end of a moratorium), s901H Companies Act 2006 (where the company enters a restructuring plan within 12 weeks of the end of a moratorium) or s4(4A) (company agrees a CVA within 12 weeks of the end of a moratorium). Where a company enters administration or liquidation within twelve weeks of the end of a moratorium, it is only unpaid rent in respect of the moratorium period that receives super priority.

Where a moratorium expires through the effluxion of time, does the former monitor need to notify anyone of this fact?

Moratoriums are time-limited. For example, if the end of the initial period is reached without extension, it will expire without any further action from the company or the monitor after 20 business days have passed. The Insolvency Service has been asked if the monitor should send a notice to any party of such terminations through the effluxion of time.

The moratorium is intended as a light-touch procedure, with notice-giving kept to a minimum to keep costs low. Monitors must inform certain parties of the commencement of a moratorium and its length (and any extensions). As the projected expiry of the moratorium will be given in such notices, no further notice need be given should the time period reach its end without further extension or early termination.

Does a monitor need to co-operate with a successive office-holder?

Unlike for other procedures (e.g.r3.70 Insolvency (England & Wales) Rules 2016), there is no statutory requirement for the passing of information etc from the ex-monitor to a new office-holder (where a different practitioner is subsequently appointed following the end of a moratorium). This reflects the moratorium's nature as a light-touch procedure. However, it is the Insolvency Service's view that the Insolvency Code of Ethics compels a former monitor to respond to reasonable requests for information from a subsequent office-holder, as to do otherwise risks discrediting the profession.

> *An Insolvency Practitioner shall comply with the principle of professional behaviour, which requires an Insolvency Practitioner to comply with relevant laws and regulations and avoid any conduct that the Insolvency Practitioner knows or should know might discredit the profession*

Relevant accelerated debts and super priority

Those who do business with a company in a moratorium receive certain protections. These provisions were made in order to encourage businesses and consumers to trade with a company during a moratorium. Those who contract with the company can be assured that if moratorium debts (or pre-moratorium debts not subject to a payment holiday) are unpaid the monitor will bring a moratorium to an end pursuant to section A38, thereby limiting their exposure from continued non-payment. A CVA, scheme of arrangement or restructuring plan cannot compromise debts in these categories without the consent of the creditor in question. And if the company enters liquidation or administration within twelve weeks of the end of a moratorium, debts in these categories receive 'super priority' in that procedure. Taken together, these protections are intended to increase business/consumer confidence in trading with a company in a moratorium.

There is an exclusion to this super priority in respect of 'relevant accelerated debts' (defined at s174A). These are certain financial services debts that fall due because of the operation or exercise of early termination or acceleration rights under the relevant contracts. Such accelerated debts will lead to the termination of the moratorium by the monitor if left unpaid (as they will be pre-moratorium debts not subject to a payment holiday) but will not receive super priority should the company then enter liquidation or administration within twelve weeks. This modification was made to prevent holders of such contracts from 'gaming' the super priority provisions. The definition of relevant accelerated debts at s174A was drafted intentionally widely to cover all financial services contracts or other instruments that contain such acceleration or early termination provisions. This will include overdrafts, loans, RCFs etc.

Will we issue further guidance?

The Insolvency Service will continue to monitor feedback on the moratorium process. If you have further queries not answered in this article, please send them to us at the email address below. If common areas arise from additional feedback given in this way and where further guidance seems useful, we will consider issuing a further Dear IP article.

Additionally, the temporary rules schedule in the Corporate Insolvency and Governance Act 2020 is intended to be replaced later on this year by a permanent addition to the 2016 rules (2018 rules in Scotland). We will consider closer to the time how best to communicate the content of the new rules to practitioners.

Any enquiries regarding this article should be directed towards email:
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or

General enquiries may be directed to email: policy.unit@insolvency.gov.uk

48) COVID-19 Financial support schemes – Reporting misconduct (Bounce Back Loans)

This article should be read alongside Dear IP Chapter 29, Article 38. For further information about the schemes offered as part of Covid support measures, please see Chapter 29, Article 23.

Please note: this article deals primarily with the Bounce Back Loan (BBL) scheme, although similar principles will apply with other Covid-19 financial support schemes. Further guidance will be issued as more information becomes available.

Further to the launch of the Bounce Back Loan (BBL) scheme, loans are now approaching their first anniversary, with first repayment instalments becoming due. Whilst it is expected that most of these loans will have been accessed and utilised correctly, it is anticipated that the commencement of repayments may lead to an increase in directors and debtors reassessing the position of their businesses and considering formal insolvency, some as a way of avoiding repayment.

Insolvency Practitioners are reminded to familiarise themselves with the terms of BBLs, and to review company books and records to verify receipt and disposal of BBL funds. Where concerns are identified or BBL abuse suspected, Insolvency Practitioners should ensure that these are reported under the Director Conduct Reporting Service (DCRS), in line with their obligations under SIP 2.

Any concerns not otherwise covered in the compulsory online return should be reported via the DCRS contact button or via email to DCAS@insolvency.gov.uk. Where concerns are identified in relation to a bankrupt trader, these should be reported to the owning Official Receiver’s office.

Some indicators of potential BBL abuse may include:

- failure to disclose a BBL in the statement of affairs;
- minimal creditors, e.g. a BBL and bank overdraft, and/or HMRC;
- funds not being used for the benefit of the business;
- where there was no intention after receipt of the BBL to carry on trading or make attempt to repay;
- businesses not trading in the UK or resident for UK tax;
- businesses not trading as at 1 March 2020;
- company dormant, i.e. filing dormant accounts for 2019 and/or 2020;
- sole traders falsely declaring start date of trading;
- businesses overstating turnover by more than 25%, or a loan of more than 25% of turnover;
- multiple applications to different lenders for a BBL (N.B.: Companies can apply for other Covid support loans such as a Coronavirus Business Interruption loan (CBIL) but must use those funds in part to repay the BBL);

- knowledge of insolvency prior to application;
- applications close to, or after, insolvency event, including post-petition or post-liquidation;
- sole traders who were bankrupt, in an IVA or DRO at date of application.

The Insolvency Service will review conduct concerns for potential disqualification and bankruptcy restriction action and, where appropriate, refer to the relevant prosecution authority.

Queries regarding reporting potential misconduct and the DCRS may be sent to: DCAS@insolvency.gov.uk

General enquiries regarding this article may be sent to: IPRegulation.Section@insolvency.gov.uk