

RECOVERY

Brexit

What does it mean for the world of insolvency?

THIS ISSUE'S THEME:

Non-performing loans & secondary debt

Great Brexpectations?

Get a complete picture of the potential changes to insolvency law following the referendum.

Brexit practicalities

Keep calm and clarify the consequences of Brexit for professionals.

BHS (or Brexit hits schemes)

A look at the economic torpedoes fired at pension schemes over the last few months.

A Green future for defined benefit schemes?

The select committees' influence on pensions schemes is changing the landscape.

No firm footing: unexpected outcomes from law firm insolvencies

The causes of law firm insolvencies, how a disorderly winding up can end badly, and the surprise regulatory effects on IPs.

Testing the waters

An exclusive Q&A with two professionals who reveal their experiences with the Pre-Pack Pool.

The not-so-great reformation?

A complete analysis of the recent corporate insolvency framework reform proposals.

An interview with... Andrew Tate

R3's newest president addresses the corporate insolvency framework reforms and sets out some goals for the rest of his term.

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From the editor

Naturally we provide in this issue the restructuring and insolvency take on the summer's big political and economic story – Brexit. Richard Tett and Katherina Crinson consider the legal perspective, particularly in relation to cross-border work, in our main Legal Update piece on pages 10–12. An economic view, considering the restructuring market in particular, comes from Nick Edwards and David O'Neill on pages 34–35. Thirdly, we offer some Brexit Practicalities on pages 36–37 for who want to look through the noise and work out what to do in consequence of the referendum result.

Having a more direct impact on many IPs is the new official receiver's fee regime, announced without warning on 30 June (buried in the Brexit aftermath?) and effective from 21 July; and the re-issued 'Guidance to Official Receivers on appointing liquidators and trustees' announced in Dear IP 72 on 5 July. As SPG Chairman, Simeon Gilchrist addresses both on page 50. More bluntly, Gareth Limb expresses his own views in our opinion column on pages 8–9.

Reflecting on the new OR's fees regime, one wonders whether substituting 'OR' for 'IP' in the body of Professor Kempson's 2013 report on insolvency fees, particularly in relation to transparency for creditors, creditor engagement and creditor and independent oversight, would be instructive. Again from the creditors' (and where relevant the debtor's) perspective, will creditors' (and the debtor's) interests best be served by the OR deciding to hang on to and work cases and the assets in them, outside the highly regulated and professional IP environment with its protections such as bonding and independent monitoring, as part of a policy designed to generate fees for a government agency?

Our theme for this issue is non-performing loans and secondary debt, and on pages 20–28 we have a range of articles touching on loan book sales, both generally and from insolvencies; European NPL acquisitions; and an analysis of banks' non-core loan stock.

We also have an academic discussion of the government's recent corporate insolvency law reform proposals from Dr John Tribe on pages 30–33. I encourage you to read and reflect on John's entertaining and perceptive analysis, which seems to me to remind us what the things we do are all about.

And finally, if you don't already know him well enough, read the interview with our president, Andrew Tate, on pages 55–56 and his column on pages 6–7, and get to know him a bit better!



CHRIS LAUGHTON is editor of *RECOVERY*
and a partner at Mercer & Hole.

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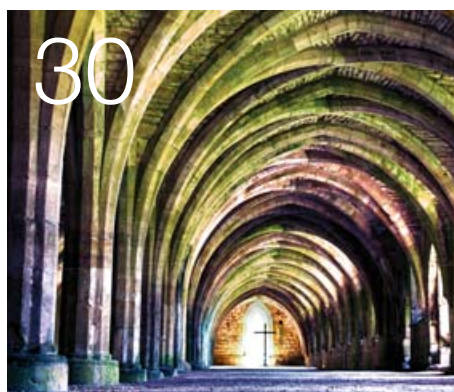
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Companies House proposes to forget history

Legal professionals, journalists, IPs and police investigators are decrying a new proposal by Companies House to delete the records of dissolved companies after six years. Currently the agency maintains records of all UK incorporated firms for 20 years. The proposed change to the rules could mean that more than 2.5m records would be lost.

Campaigners warn that the loss of such records would strangle attempts to track down white collar criminals and money laundering. For IPs it would mean that they could be denied access to information that would help to uncover incompetence or wrongdoing by directors and would not be able to refer to older records in an investigation.

Companies House has been bombarded with complaints from businesspeople seeking a 'right to be forgotten', and arguing that the maintenance of such records is a breach of EU data protection law. Many have filed complaints with the data protection watchdog, the Information Commissioner's Office.

The records have been invaluable to high-profile investigations in the past. It was Companies House information that revealed the past of the three-times bankrupt Dominic Chappell and shed light on the scandal around the failure of British car maker MG Rover.

Source: *The Guardian*



Liberator to be put in the stocks

A Preston-based pensions liberation scheme has been wound up following an investigation by The Insolvency Service. The Thames Trustees scheme had taken investments of over £3m from individuals' pension funds with the promise of a cash payment in return. The company had moved customers' funds to the Westminster Pension Scheme, which gave clients illegal access to their pension fund.

The High Court ruled that Thames Trustees had 'acted with a lack of transparency and commercial probity' and had taken commission payments from clients' investment funds without their knowledge. Some of the payments had been invested in unregulated collective investment schemes and were unsuitable for members, according to the court.

Source: *Citywire*

Company claims Brexit caused administration

An energy producer in the South of England has gone into administration claiming that the result of the UK's EU referendum is to blame. Rame Energy, based in Plymouth, said that difficult market conditions and the result of the referendum had left the company unable to complete its fundraising. Joint administrators from Leonard Curtis have been appointed to handle the case and are expected to try to maintain the company as a going concern.

Rame predominantly works in Latin America, producing renewable energy for private clients, although does have operations in the west country as well. At the end of April, the business stated that it needed £2.8m to fund ongoing business projects. The failure to raise funds means that should Rame survive, it will focus on its operations in South America.

Source: *Plymouth Herald*



Administrators, but not by royal appointment

A Norwich-based heritage building firm that has held a contract to work on Sandringham House has gone into administration. WS Lusher & Son fell into financial difficulties earlier in the year and was forced to sell a large site in Sprowston. Employees at the company had also taken pay cuts in order to keep the business afloat, according to one employee.

Administrators from McTear Williams & Wood have been brought in and are expected to try to trade the business as a going concern. The building firm was one of the few remaining in the UK that directly employed its own contractors. At its peak it had a turnover of more than £3.5m and since 1978 had held the Royal Warrant to work on Sandringham House. So far 24 employees have been made redundant.

Source: *Norfolk Eastern Daily Press*

Stacking up the success

A pallet maker in North Wales has been successfully rescued from administration. V Evans Group Ltd fell into administration in July following pressure from creditors. Joint administrators were appointed from Mazars and the business was bought out of administration, preserving all jobs.

Source: *Insider Media*



Faulty towers

A hotel and leisure club in Swindon has gone into administration following 'historic' and other losses. Joint administrators from PCR Insolvency in Bristol were appointed to handle the process. More than 40 jobs have been lost, although the hotel has been able to operate long enough to handle a major wedding. Future bookings may not be so lucky.

Source: *Insider Media*

Pre-pack scaffolding

A Southampton-based scaffolding firm has been successfully sold on as part of pre-pack deal following an administration. Modus Access UK, which had a peak turnover of £1m, fell into administration in July after a dip in turnover that prevented Modus from meeting its financial obligations. Administrators from RSM Restructuring Advisory were called in to handle the company's affairs and successfully sold on much of the equipment to Blencowe Scaffolding, a competing company seeking to expand to the south coast.

Source: *Insider Media*

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President's column

Andrew Tate addresses Brexit, the corporate insolvency framework and R3's work lobbying the government.

I recently kicked off my term as R3 president at the annual conference in Budapest. It was great to see so many of you there and I hope those that attended found it an informative and constructive opportunity to discuss changes to the profession over the past 18 months, and to look ahead to the future. Of course since then, everything has changed again.

The UK's decision to leave the EU has created a period of economic and political uncertainty. In the wake of the referendum, the markets have been in turmoil, the pound plummeted to its lowest level in 30 years, and the UK has been stripped of its final 'AAA' credit rating. The fallout of the 'Leave' vote is also rippling through Westminster. We have a new prime minister and new government departments to get to grips with. For insolvency, there is the new Department for Business, Energy and Industrial Strategy (BEIS), which merges

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The UK's insolvency regime does not exist in a vacuum but is entwined with rules on employment, tax, property and more, and all of these are

the Department for Business, Innovation and Skills (BIS) and Department of Energy and Climate Change (DECC), and there are wholly new departments established such as the 'Brexit' ministry and a Department for International Trade.

At the same time, the Labour Party is going through a leadership contest that will not be resolved until late September, with many shadow ministerial posts remaining vacant.

Going forward, we're looking at a period of prolonged economic adjustment for the UK. It will be even longer before we know what the implications will be for our insolvency regime.

No regime is an island

The UK's insolvency regime does not exist in a vacuum but is entwined with rules on employment, tax, property and more, and all of these are linked with European rules.

I know many of us involved in cross-border work are concerned about the potential impact of Brexit too.

R3 will work closely with the new government and shadow ministerial team to ensure that the UK's insolvency regime remains one of the best in the world and retains the effective tools we have become accustomed to using in our professional work.

What we recommend

At the same time that we'll be dealing with any Brexit 'fallout', we expect our domestic regime to be changed through proposals outlined in the government's corporate insolvency framework consultation. When the government launched its proposals in June focusing on four key elements (a moratorium, extending 'essential supplies', a flexible restructuring plan and rescue finance), R3 welcomed the focus on restructuring tools and business rescue given the rise in restructuring and advisory work the profession is undertaking. However, our response reflected a number of concerns the profession has with the proposals.

While we support the government's plan for a moratorium for struggling businesses, it is our view that the proposed three-month length is far too long. A shorter, more flexible length would be far more appropriate, and the only suitable supervisor would be an insolvency practitioner, who could ensure greater safeguards for creditors.

The extension of 'essential supplies' is also a laudable proposal but the current drafting of measures goes too far and could lead to significant extra costs and litigation, in a court system that as we know is already under pressure.

R3's response outlined that while members believe that a new restructuring tool may be a useful addition to our toolkit, it's thought that it should only be used in a very limited number of cases per year and has the potential to be abused, particularly within the SME market. There's also concern that the proposal could inhibit re-financing of businesses and so effect the wider lending landscape as lenders risk being 'crammed down'.

On the final proposal, relating to rescue finance, R3 doesn't believe legislation is needed to encourage more super-priority as secured creditors providing rescue finance already negotiate with a company to ensure they get 'super priority'.

I hope that the government takes careful consideration of our recommendations, and ensures that any

changes aid rather than hinder the ability of our profession to rescue businesses, and are implemented only at an appropriate time.

The nature of our work

Clearly we are facing a time of considerable change. Indeed, from the outset of my term, I've said that the changing nature of the insolvency profession – whether it's the type of work we do or the rules that underpin that work – was going to be the main focus of my year as president.

The measures proposed in the consultation could have a significant impact on the insolvency profession so we have made every effort to ensure our response reflected the views of the breadth of our membership. I'd like to personally thank all those who took the time to complete R3's member survey on the issue. The government's consultation documents made several references to previous R3 surveys so your input really is important.

During the short consultation period, R3 hosted a roundtable discussion with our large- and medium-member firms to hear what impact they believed the measures

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Insolvency practitioners are about much more than just formal insolvency processes! Getting this message across more widely is one of

would have on the business rescue landscape, while my colleague and SPG Chair, Simeon Gilchrist, gathered the views of the SPG community. R3 also met with a number of business bodies, including the Federation of Small Businesses, British Chambers of Commerce, the British Property Federation and the banks on the matter, as well as the RPBs. I also attended workshops held by The Insolvency Service to discuss the proposals.

A new kind of IP

It was encouraging that the government's consultation recognised the growing importance of restructuring. One of the major themes at this year's conference was the IP's skills set; something where there is



blanket ban on time-costs, for example – and I will try to shed some light for members on the work R3 does on their behalf during my term.

Not only do we have to think about ‘Brexit’ and the proposed corporate insolvency reforms, but we’re also addressing the new official receiver fees and updated guidance on case retention. Along with other stakeholders, R3 was not provided with the opportunity to discuss these changes with The Insolvency Service prior to them being announced. We are reviewing member feedback in response to the changes, and are assessing the impact that these changes will have on creditors, debtors and insolvency practitioners. R3’s CEO Graham Rumney and I attended The Insolvency Service’s stakeholder event at the end of July and we expressed initial views from members. I am sure that there will be more to report on this issue in the coming months, so please watch this space. In the meantime, please read Gareth Limb’s article on this issue on page 8.

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While formal insolvency work needs to be uniformly tightly regulated, maintaining a one-size-fits-all approach can lead to practical problems for IPs, typically smaller firms, dealing with

By the time we meet again in Dublin for the 2017 R3 conference, the UK economy could look very different. We don’t yet know what the longer term impact of Brexit will be, but I do know that it’s more important than ever for our insolvency regime to retain its flexibility and efficiency. As your representative I will strive to make our voice heard and our value and our contribution to the economy recognised. ▣



ANDREW TATE
is president of R3
and a partner at
Kreston Reeves LLP.

much more going on than meets the eye of the casual observer. Understandably, ‘insolvency practitioners’ can be pigeonholed as dealing only with formal insolvency appointments. With this assumption in mind, companies and individuals can make the mistake of leaving it until there is no choice but entering an insolvency procedure before seeking help from an IP. As you and I know, the earlier an IP can offer their help, the better; and in many cases, avoiding an insolvency procedure altogether is the best outcome. Insolvency practitioners are about much more than just formal insolvency processes! Getting this message across more widely is one of the goals I have set myself for my year as president.

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R3’s influence will be crucial for making sure a new government understands the profession’s concerns, whether they’re about the post-Brexit insolvency regime or

The IP’s skillset, while built on formal insolvency work and requirements, is incredibly versatile and equips the profession for work well outside the confines of the Insolvency Act and rules.

Increasing the understanding of what the profession can do away from formal appointments will involve work both inside

and outside of the profession. Of course, it will be important to continue to speak to stakeholders and policymakers about what the profession can do; but there is educational work to do inside of the profession, too.

Understanding change

Indeed, helping the profession adapt to recently implemented changes – and ensuring the government is aware of the impact of the reforms – is another item high up on my to-do list. There will be a lot of things to digest: fees, pre-packs, creditors’ meetings, investigations work, and more have all recently changed or will be in the process of changing by the time I hand over to Adrian Hyde (partner at CVR Global LLP) this time next year.

Writing as a former Smaller Practices Group chair, I also believe it’s important the government keeps a close eye on the impact of its reforms on smaller firms and smaller businesses in particular. While formal insolvency work needs to be uniformly tightly regulated, maintaining a one-size-fits-all approach can lead to practical problems for IPs, typically smaller firms, dealing with small- or micro-businesses with few assets. When it comes to insolvency, the government’s traditional maxim of ‘think small first’ doesn’t always seem to apply.

Taking your views to government

R3’s influence will be crucial for making sure a new government understands the profession’s concerns, whether they’re about the post-Brexit insolvency regime or new rules and regulations. As a former vice-president and deputy vice-president, I’ve seen first-hand how R3 was able to moderate the changes to which we now are adapting – a fees estimate is preferable to a



Moving the goalposts

Gareth Limb provides an initial reaction to the announcement on the changes to the OR's policy regarding Secretary of State appointments.

Much to everyone's surprise The Insolvency Service (IS) launched their new fees regime on an unsuspecting public and profession on 30 June, giving 21 days' notification of the changes. Apparently they couldn't get ministerial sign-off to make disclosure any earlier, although the impact assessment for the new regime was dated 18 March, nearly four months prior to it being launched.

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We thought that the buzz word in the insolvency profession for the past few years was 'transparency', but as with several requirements, it appears that there is

Caught unawares

The lack of consultation has certainly caught everyone on the hop, including R3 who, despite having a regular dialogue with The Insolvency Service, were not made

aware of the proposed changes. To be perfectly honest, IPs are a resourceful bunch and they could work around the new fee structure if it were just that being introduced. But no, problems come in pairs, and the second piece of bad news was the announcement of the official receiver's (OR) revised policy as regards Secretary of State (SoS) appointments set out in Dear IP 72.

Dear IP 72 says that the existing guidance about SoS appointments in the OR's technical manual is inaccurate and does not reflect the 'longstanding policy that the official receiver should remain as liquidator/trustee where asset realisations were reasonably achievable and the return to creditors would potentially be greater if the case were retained by the official receiver.' I am sure that IPs had noticed this policy steadily, if inconsistently, being applied to SoS appointments, but the IS has finally come out and admitted that they were doing so, and updated the publicly available guidance on the operation of the policy, albeit after the event. We thought that the buzz word in the insolvency profession for the past few years was 'transparency', but as with several requirements, it appears that there is one standard for the IS and one for IPs.

Since Dear IP 72 was published the IS have also updated their internal guidance for ORs, which is contained in chapter 17 of their technical manual. While it is internal guidance, it is available under Freedom of

Information provisions and can be found at www.insolvencydirect.bis.gov.uk/technicalmanual/default.htm. It expands on Dear IP and having read it I am not sure that Dear IP is actually a good enough precis of the information it contains. It would have been simpler and more transparent for the IS just to have included the text of the updated internal guidance in Dear IP 72.

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It appears to me that the new approach to SoS appointments is that the OR knows best, and one will not be made unless the OR is convinced that it is a case 'where the specialist skills of an insolvency

The OR knows best?

It appears to me that the new approach to SoS appointments is that the OR knows best, and one will not be made unless the OR is convinced that it is a case 'where the specialist skills of an insolvency

practitioner are required'. A similar approach also applies even if a majority creditor, or creditors, wants an IP to be appointed, given that the OR must be 'satisfied that the creditor is, or creditors are, making an informed decision'. The internal guidance expands on this and indicates that 'where the skills of an insolvency practitioner are not required the official receiver should not make an application' where it is a payment in full case or 'there is no evidence that the insolvency practitioner will discover any further assets'. It will be for the creditor, or the nominated IP, to convince the OR on a case-by-case basis.

“If it were just a matter of changing their approach to ‘compete’ with the OR then it would not

There is now a presumption that the case will stay in the hands of the OR, unless the creditors can convince them otherwise. That policy has been changed by the OR in a situation where the OR already has a vested interest to keep hold of cases in order to charge fees in order to fund the IS and help ensure their own survival. This is a significant 'self-interest' threat, although of course OR's are not bound by the Insolvency Code of Ethics. It cannot be right, however, for the regulator of regulators and supervisor of the insolvency regime to break one of the fundamental principles that apply to everyone else in the profession.

Ethical dilemma

When is a rota not a rota? This was not covered in Dear IP 72, but according to the internal guidance, when the OR decides that 'the next insolvency practitioner on the rota will not have the skills required to administer the estate, for example, where assets are located abroad'. In that situation the OR can seek the appointment of an IP they consider has the necessary skills out of turn from the rota 'or otherwise'. The internal guidance does indicate that these should be rare occasions, but does the OR actually know enough about the IP firms on their rotas to make such a judgement without first asking the IP themselves whether it is a case they are capable of administering? After all, having the necessary skills and resources to deal with a case is something for the IP to consider under the Insolvency Code of Ethics before taking on a case. The implication of the internal guidance is that IPs would not follow the code of ethics if they were approached by the OR about such a job.

Since Dear IP 72 was released we also had the inaugural Insolvency Live! event hosted by the IS, and in her opening remarks the inspector general and chief executive of the IS, Sarah Albon, did confirm that creditors can appoint an IP in a case if they want. I was in the audience and was very pleased to hear that announcement being made, but at the moment it is at odds with both Dear IP 72 and the OR's internal guidance. Perhaps we will have a Dear IP 73 that clarifies the position and addresses the differences between Dear IP 72, the OR's internal guidance and the chief executive's statement. Indeed, that may already have been issued before this article is published.

Two entities, one job?

IPs have learnt to adapt in an ever changing marketplace, so if it were just a matter of changing their approach to 'compete' with the OR then it would not be a problem. First, when acting as office-holders, do IPs and ORs actually undertake similar jobs when it comes to realising assets? I am not aware of any independent research that has been done into the quality of the work of the OR, and they are not subject to external monitoring, although I think that this should change on both counts. Without research being undertaken and a stringent monitoring regime in place then no direct comparison between the work of the OR and IPs can be made, such that creditors cannot make a reasoned decision as to who they want to act as office-holder to administer cases. It must also be in the interests of the IS to do this, as otherwise the perception will remain that ORs just realise the easy assets and do not bother trying to realise the more complex assets or investigate other potential assets.

Secondly, there is a difference in the amount of work that IPs have to do compared with ORs, which leads to increased costs of compliance for IPs that the OR does not have to incur. Leaving aside that IPs have to pay for a specific penalty bond while ORs do not, IPs also have to comply with the SIPs, take positive action to obtain fee approval from the creditors, and report annually to creditors. The rules on progress reports do not apply to the OR, such that, apart from their initial report shortly after appointment, the OR then only has to report when closing the case, which certainly does not aid either transparency or creditor engagement. The IS are increasingly concerned about the lack of creditor engagement in cases, but it appears that their concerns only extend to those cases involving IPs.

Conflicting policy

It is possible that the IS believe that ORs can do the simple cases cheaper than IPs, and that IP involvement is just an unnecessary additional cost, but the market is skewed in the OR's favour and there are

legislative and other barriers in place to prevent effective competition by IPs. Furthermore, there is also a conflict between the SoS appointment policy that has now been confirmed and the statutory role of the OR. According to the OR's technical manual: 'on the making of a winding-up order, the official receiver's main duty is to investigate the causes of the failure and identify the reasons for it'. While 'on the making of a bankruptcy order, the official receiver's main duty is to investigate the conduct and affairs of the bankrupt, and make any report he/she thinks fit to the court'. In fact, that is enshrined in the insolvency legislation, namely section 289 of the Insolvency Act in respect of bankruptcies, and section 132 in respect of compulsory liquidations, together with section 7 of the Company Directors' Disqualification Act. There is no mention made of asset realisations and distributions as being the main duty of the

“Without research and a stringent monitoring regime then no direct comparison between the work of the OR and IPs can be made, such that creditors cannot make a reasoned decision as to who they want to act as office-holder.

OR, but that will become the case if the OR is trustee or liquidator in all but the most complex cases. Surely it must be for parliament to properly scrutinise, debate and then decide on the revision of the statutory duty of the OR by changing the legislation, not for it to just happen incrementally over time so that it becomes the position by default. ■



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Great Brexpectations?

Richard Tett and **Katharina Crinson** take a look at what Brexit means for the restructuring and insolvency market.

On 23 June 2016, the UK voted to leave the European Union (the leave vote). The leave vote has far-reaching political implications, many of which remain unclear at present. Commentators are still forecasting economic consequences and the resulting volatility is likely to have commercial ramifications for the economy as a whole. While there is so much uncertainty as to how the UK will implement the leave vote, it is impossible to predict the exact outcome for the restructuring and insolvency sphere. However, we discuss below those areas that are probably most important for UK restructurings and insolvencies, being the recognition of insolvency proceedings across the EU and the impact on UK schemes of arrangements.

No immediate consequences

The leave vote, of itself, does not result in any legal change for the restructuring markets. Indeed, even the service of the article 50 notification will not change the status of EU-derived law in the UK. The UK will remain a member state until it concludes an agreement in relation to either its withdrawal from the EU or the two-year article 50 notification period expires (Brexit) – neither are likely before 2019.

Therefore the legal regime as between the UK and the EU for restructurings and insolvencies is the same today as it was on

23 June 2016 and will stay the same until legislation is passed or Brexit actually happens. Accordingly, the rest of this article looks to the future and, to be candid, speculates on the consequences of what might flow from Brexit in over two years' time.

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The legal regime as between the UK and the EU for restructurings and insolvencies is the same today as it was on 23 June 2016 and will stay the same until legislation is

Recognition of insolvency proceedings

The EC Regulation on Insolvency Proceedings (EIR) is the cornerstone for the recognition of insolvency proceedings across EU member states. It was adopted in 2000, came into force in 2002 and has just undergone a major recast.

The EIR fundamentally reformed the way European cross-border insolvencies are conducted. The EIR applies to all member

states except Denmark. This means that an insolvency proceeding listed in the EIR and commenced in a member state where the debtor has its centre of main interests (COMI) (or an establishment) is automatically recognised. As a general matter, such proceedings have primacy and exclusivity in any other EU member state, again except Denmark. The EIR is directly applicable in all member states (except Denmark) and, until Brexit, this includes the UK. If there is no replacement arrangement before Brexit, the EIR will cease to be binding on the UK. While it will continue to apply to the other EU member states, we would expect references to UK insolvency proceedings to be removed from Annex A.

What would Brexit mean for insolvency proceedings commenced in the UK?

Insolvency proceedings commenced in the UK would cease to be automatically recognised in any EU member state. The office-holder would need to rely on each member state's domestic law. This would be piecemeal and the outcome would likely differ between each member state. In Germany, for example, there are domestic provisions that would enable such recognition. Only Greece, Poland, Romania and Slovenia have adopted the UNCITRAL Model Law on Cross Border Insolvency.

Foreign companies are not only coming to the UK to restructure their debts

by way of a scheme of arrangement but also to implement a pre-pack administration. Sometimes, this is the main route for the group restructuring (see *Wind Hellas*); at other times, an administration may be the contingency in case the scheme fails (see *New World Resources*, where the administration and the scheme were 'twin-tracked'). While the UK courts are still likely to take jurisdiction, the critical question will be whether such an administration will be recognised in the place of incorporation of the company (or where its main assets are). Here, a piecemeal reliance on domestic legislation is likely to reduce the attraction of the UK as a restructuring hub for foreign companies.

A further important impact will be whether the UK can continue to coordinate insolvencies of European (sub)groups. Since 2002, large corporate group insolvencies such as Enron, MG Rover, Collins & Aikman and Nortel saw multiple European subsidiaries filing in England based on the argument that all the subsidiaries' COMIs were in England. These English main proceedings were then automatically recognised around the EU (excluding Denmark). While secondary proceedings could still be opened in local member states (and occasionally were), this centralisation of group insolvencies served greatly to increase the efficiency and cost effectiveness of proceedings. Over time, a practice evolved whereby the English administrators would recognise local member state expense priorities and the English court would write to the local courts asking for notice of proceedings to dissuade local creditors launching competing secondary proceedings. This market practice worked so well that it was adopted into the recast EIR.

With UK proceedings coming out of the EIR this process will effectively cease unless some form of recognition of English proceedings is continued. The European subsidiaries could probably still file in England, but an English administrator of a non-English subsidiary would face challenges in controlling that subsidiary's insolvency – especially if local proceedings were opened where the subsidiary was incorporated or had assets. The loss of automatic recognition and protection for the English proceedings and office-holder would significantly undermine the benefits from filing multiple European subsidiaries in the UK. Indeed, it may even be that groups look to see if all their subsidiaries' COMIs can be moved to a member state that is part of the EIR.

What would Brexit mean for insolvency proceedings commenced in EU member states?

Inward recognition of EU insolvency proceedings is likely to prove easier than outward recognition. EU insolvency proceedings would need to rely on the UK's domestic rules of recognition, such as the Cross Border Insolvency Regulations 2006 (which incorporate the UNCITRAL



Model Law on Cross Border Insolvency) (CBIR) or, for the Republic of Ireland only, section 426 of the Insolvency Act 1986. The CBIR came into effect on 4 April 2006 and does not require any reciprocity from the other country. It follows that, however Brexit is implemented, recognition by the UK courts of any European proceedings will be significantly easier than it was before the EIR was introduced in 2002 as the UK now has an additional tool for recognition, which was not available then.



Ultimately, many changes can be expected and it seems inevitable that insolvencies involving the UK and EU member states will become

A full discussion of the CBIR is beyond this article, but (broadly) it utilises the same concepts of COMI and establishment as the EIR and similar relief can be granted. That said, the CBIR requires an application to court and the relief is more discretionary, especially for non-main proceedings, ie where the applicant's non-UK proceedings are only based on an establishment. Therefore recognition of cross-border EU proceedings is expected to become more expensive and be at greater risk of challenge.

What else could happen?

The UK and the EU could agree that the EIR continues to apply as between the UK and the EU member states. This would be a good solution, though it must be seen as a challenge. UK insolvency proceedings would be the only non-EU insolvency proceedings automatically recognised across the EU. Alternatively, on a more piecemeal basis, the UK could enter into

bilateral treaties on the recognition of insolvency proceedings with as many EU member states as possible.

Schemes of arrangement

We consider that there will not be any material impact on schemes as a restructuring tool – either for domestic or foreign incorporated companies.

For many years, English courts have been willing to sanction schemes affecting companies incorporated outside of England where the company has a 'sufficient connection' with England. This is a comparatively low threshold to clear and, for example, has been demonstrated where the debt documents were governed by English law and contained a clause granting jurisdiction in favour of the English courts. Brexit will not affect this aspect of a scheme.

However, as the court will not act in vain, it must be satisfied that the scheme is capable of being enforced locally in the jurisdiction where the company is incorporated. In practice, the court is provided with an opinion given by a local expert stating that the scheme would be recognised. The basis of this local law enforcement opinion typically refers to either or both of (i) the EU Judgments Regulation (on recognition of judgments and its recast) and (ii) the EU Rome I Regulation (on choice of law). For as long as the UK remains in the EU, both these regulations will be of direct effect in the UK as well as throughout the EU. However, on Brexit, both will cease to be of any effect in the UK, but they will still apply in the EU member states.

The EU Judgments Regulation operates to (broadly) give a court judgment in one member state effect and enforceability in all member states (subject to limited exceptions). Therefore if the regulation applies to English schemes, then an English court order (and the scheme) would effectively receive automatic recognition around the EU. However, there is some doubt in the English court's eyes as to whether the EU Judgments Regulation applies to schemes at all. This issue is as yet unresolved but recent schemes have proceeded on the basis that the EU Judgments Regulation arguably applies.

A separate enforceability argument is based on the EU Rome I Regulation and the governing law of the claims subject to the scheme. This is most common for a foreign company where the parties have chosen English law and have submitted to the English courts. The EU Rome I Regulation provides (generally) that a contract is governed by the law chosen by the parties – this would include amendments or compromises to the contract.

What would Brexit mean for schemes?

On Brexit, the main question will be the impact on obtaining local member state enforceability opinions. Absent any alternative arrangements, both the EU »

Judgments Regulation and the EU Rome I Regulation will cease to be directly applicable in the UK, but will remain effective in the remaining EU member states. However, it will be in all parties' interests to avoid having to re-litigate matters in multiple countries. If the UK joins the EEA, it is possible that the UK might seek to sign up to the Lugano Convention. This is similar to the current EU regime set out in the EU Judgments Regulation and as a result there would be no significant change. The court would continue to hear arguments on local member state enforcement issues but, rather than looking to the EU Judgments Regulation the court would look at the Lugano Convention. If the UK did not join the EEA, then it could still sign up to the Lugano Convention or it could seek to sign up to the Hague Convention on Choice of Court Agreements, which provides a similar regime and is in force between the EU and Mexico. If the UK did not enter into any replacement arrangements for the EU Judgments Regulation, the local member state expert could still consider private international law recognition regimes. The fact that most recognition opinions to date for EU member states have not sought to reply upon such regimes makes one doubt how fruitful a replacement basis this would be.

Separate to the EU Judgments Regulation, schemes may continue to be enforceable in member states on the basis of choice of law. The choice of English law to govern contractual relationships (say, debt documents) should still be recognised by courts in EU member states. The relevant English law rules would be those set out in the Rome Convention. This is similar to the Rome I Regulation, which does not bind EEA countries but would continue to be applied by the courts of EU member states.

Finally on schemes and recognition, it is worth noting that English courts have dealt with recognition of schemes in non EU countries (eg the USA). While the route to recognition here may not be as straightforward as the EIR, it certainly can be and is done.

Credit institutions and insurers

The EIR does not apply to credit institutions, insurance undertakings, investment undertakings that provide services involving the holding of funds or securities for third parties, and collective investment undertakings (collectively financial institutions). These are instead covered by two separate EU directives that apply to both EU and EEA member states.

First, the Credit Institutions Winding Up Directive (CIWUD) and, second, the Insurers Winding Up Directive (IWUD). Under EU law, directives are not directly binding on member states. Instead, directives have to be implemented by each member state into national law in order to have effect. In England, they were implemented as the Credit Institutions

(Reorganisation and Winding Up) Regulations 2004 and the Insurers (Reorganisation and Winding Up) Regulations 2004 respectively.

Both pieces of legislation operate on the basis of providing recognition to insolvency and reorganisation measures commenced in financial institutions' and insurers' home (member) state without any further requirements and without the opportunity to open territorially limited proceedings.



Hopefully the UK government will be even keener to improve the UK regime to show that the UK is 'best in class' for doing

What would Brexit mean for financial institutions?

On a Brexit (without the UK being part of the EEA) both domestic pieces of legislation would – without any further legislative act – remain on the UK's statute books. This seems an unlikely outcome as the legislation would then operate to recognise the insolvency or reorganisation of EEA financial institutions and insurers without requiring any EEA member state to recognise insolvency or reorganisation measures commenced in the UK.

What else could happen?

If the UK leaves the EU but joins the EEA then the status quo would seem to be maintained. The recognition regime was seen most recently in the Icelandic bank collapses.

If the UK does not join the EEA, then it would fall to the UK and the EU to agree to replace CIWUD and IWUD with instrument(s) that cause recognition of UK insolvency or reorganisation measures of financial institutions and insurers, even though the UK would have left the EU bloc. This would form part of broader discussions concerning the regulation of financial institutions post-Brexit. It seems likely that what happens in this area of restructuring and insolvency will follow whatever is agreed as part of the wider issues about credit institutions and insurers.

Financial collateral arrangements

The UK has implemented the EU directive on financial collateral arrangements of 2002 in the Financial Collateral Arrangements (No 2) Regulations 2003. Like CIWUD and IWUD, as domestic legislation, the regulations will continue to be in force following Brexit. The UK may keep this legislation in its current form, revoke it or reform it. If the EU makes any amendments to the underlying directive, the UK will not be required to adopt these and it will be for the UK parliament to decide whether to amend this legislation in such an event. UK financial institutions lending into EU member states will continue to benefit from the financial collateral directive, as implemented in each member state.

Reform of insolvency law

The EU Commission published a consultation on an effective insolvency framework within the EU, which closed on 14 June 2016. The consultation asked about the key barriers to insolvency resolution and focused on the efficient organisation of debt restructuring procedures.

On a domestic level, the UK government is conducting a review of its corporate insolvency framework with an initial response from the government due in October. Given the leave vote, there must now be a question mark as to whether there will be sufficient parliamentary time to consider these proposals. It would be a shame if they were a casualty of Brexit – indeed hopefully the UK government will be even keener to improve the UK regime to show that the UK is 'best in class' for doing business.

To conclude, where are we at present? Nothing yet has changed legally, nor will anything change for quite some time – probably years. Until we know the specific terms of Brexit and what, if any, replacement arrangements will be put in place, the commentary is really more speculation. Ultimately, many changes can be expected and it seems inevitable that insolvencies involving the UK and EU member states will become more complicated and costly. However, cross-border recognition has come on substantially since before the EIR in 2002 and there are good grounds to hope that sensible arrangements can be agreed. It will certainly be interesting to see how matters develop. □



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The engine that drives director conduct reporting

Mark Danks takes a look at the development of the Director Conduct Reporting Service.

The Director Conduct Reporting Service (DCRS), a new online process for reporting on the conduct of the directors of insolvent companies, went live on the GOV.UK website¹ on 6 April 2016. In the Spring 2016 edition of *RECOVERY* my colleague Gareth Allen provided details of the background to the legislative changes, which required the development of an online reporting tool.

As set out in Gareth's article, for office-holders, the DCRS has meant:

- removal of the requirement for a fitted/unfitted opinion;
- earlier reporting by three months;
- a more structured, quicker and easier to complete conduct report;
- no unnecessary duplicate reporting (eg where a company moves from administration to CVL and nothing else changes); and
- no unnecessary provision of information available elsewhere.

The version of the DCRS that went live on 6 April 2016 was very much a basic application, which ensured that The Insolvency Service and office-holders could

comply with the terms of the legislation² (the rules) that commenced on that date. On a practical basis this meant that the DCRS allowed office-holders to use a website to submit a conduct report in respect of a case

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A service manager is someone with a higher level of access permissions, who can see all the cases for the office-holder who appointed them and also assign staff to cases in the same way

in which they were appointed from 6 April, apply for additional time and submit new information. Guidance was issued and can be found on the DCRS landing page on GOV.UK.

Staff, service and sorting

One of the main priorities to improve the service for office-holders was to allow them to add their staff to the DCRS, so that they could complete the conduct report on their behalf up until the point it needed to be reviewed and submitted by the office-holder. This was achieved in mid-May 2016 when it became possible to add 'service managers' and staff to the DCRS. A service manager is someone with a higher level of access permissions, who can see all the cases for the office-holder who appointed them and also assign staff to cases in the same way as the office-holder. Staff are assigned on a case-by-case basis and, for cases they are attached to, they can also complete the report up to the point where it needs to be submitted by the office-holder. Guidance on appointing service managers and staff can also be found on the GOV.UK landing page.

The next priority was to start to run submitted conduct reports through a rules engine to perform an initial bulk sift on a daily basis. This was achieved during June, which allowed staff within the insolvent targeting team to start working on cases that have been sifted in. Office-holders, »

service managers and staff assigned to cases are notified of the rules engine decision by email and, for those who are sifted in, the email states that they will be contacted by a member of staff from The Insolvency Service.

The rules engine carries out a sift based on the answers to the lead yes/no questions contained in the different sections. The DCRS report and functionality is being developed to allow it to take into account answers to the further questions, which are opened up when the answer to the lead question is yes. Office-holders are likely to notice when changes are made to the rules engine settings when they submit reports containing similar answers to those provided in previous cases and they receive notification of a different



The DCRS report and functionality is being developed to allow it to take into account answers to the further

rules engine outcome. The changes will be made based on experience gathered from early submissions where it is clear that the sift decision could be improved. The intention is that the rules engine will be capable of making an appropriate decision based on the information contained in the office-holder's report, and that cases will only be sifted in where further information is required to allow the targeting decision to be made within the insolvent targeting team.

On a practical basis, the point at which the rules engine carries out a sift is where the DCRS process starts to mirror the previous system in respect of cases with appointment dates prior to 6 April 2016.

The public interest test

While the DCRS has changed the way in which director conduct information is reported to the Secretary of State, there has been no change to the tests that need to be applied at the targeting stage and then throughout the life of a case that has been identified as suitable for investigation. These tests cover two distinct areas: public interest and evidence.

The public interest test applied by The Insolvency Service has the following elements in that protection of the public by director disqualification must:

- act as a deterrent or improve standards;
- afford protection to business and consumers from potential future losses or damage;
- observe the human rights of individuals and the justice and equity of proceedings;

- observe the reputational exposure of the Secretary of State in bringing proceedings; and
- effectively apply the public purse.

In terms of evidence, the test is whether the evidence to support the allegation is either available or likely to become available.

Office-holders whose reports are sifted by the rules engine should expect some form of contact from the insolvent targeting team. This will usually be an email or a telephone call to the person disclosed as having day-to-day responsibility for the case in the contact details page of the report. If this is someone other than the office-holder, their details should be provided there.

The purpose of this contact is to allow the targeting team to make a decision taking into account the public interest and evidential tests, and will involve a discussion based on the conduct issues flagged up within the DCRS report. The expectation will be that when a lead question has been answered yes, the office-holder will be able to provide the evidence to support the answers provided to the subsidiary questions. These questions are then opened up, all of which must be completed to allow the user to save and continue to the next part of the report.

It is likely that the targeting team will request sight of documents from the office-holder's or company's records, but these will only be made accessible when the documents are not available from other sources, such as Companies House. However, if accounts filed at Companies House are in an abbreviated format, the full version is likely to be requested from the office-holder.

Evidence and targeting

It is possible that there will be cases where the information held within the report is such that it will be possible to target a case for investigation without any further contact with the office-holder, although they will still be informed of the targeting decision. An example of such a scenario might be where a disqualified director was acting as director of the company. In such a case, the disqualification is a matter of public record and if the office-holder has confirmed within the conduct report that there is evidence to support the allegation the targeting decision would be straightforward.

Under the D1 process office-holders could submit enclosures in support of their report and, while these are useful for those cases, the preparation of the D1 and collation of the supporting documents will have taken some time, which the DCRS is saving with the use of a standard online report. While documents will be required by the targeting team, these will be obtained by a focused request related to the evidential test and the aim is to keep such requests to a minimum. However, if a case is targeted, the investigator is likely to require

access to the office-holder's files and company's records in the same way as they do for cases targeted under the D1 process.

The DCRS has been developed under the governance of the Government Digital Service, which has required it to follow the strict standards that all digital services on the GOV.UK platform must adhere to.

Future improvements

One of the digital standards is continuous improvement: I have already mentioned that changes to the rules engine are planned, which office-holders are likely to notice based on past experience of which answers result in a sift in/out decision, but this would be an internal improvement to help the targeting team. From an office-holder perspective the following improvements are planned:

- changes/additions to the questions;
- a preview function to allow an office-holder to see the complete report within a single web page prior to submission without having to navigate through each section of the report; and
- the ability to submit new information or apply for additional time from the case dashboard.

It's recognised that changes to the questions need to be communicated before they are implemented to allow office-holders and their staff time to prepare and change internal guidance and it's unlikely that changes will be made more than once or twice a year. However, the ability to make changes is an important feature of the new legislation, which no longer prescribes the content of the report. In the short term



The intention is that the rules engine will be capable of making an appropriate decision based on the information contained

there are some changes to the text within the current question set that need to be made, but these should not create any particular issues for office-holders or their staff and will be communicated to office-holders via email, the compliance sector we have engaged with so far and also by a notice on the GOV.UK page when they are applied.

Disseminating new information

The rules require that 'new information' must be submitted by the office-holder as soon as reasonably practicable, and is defined as information that would have been included in the report had it been available before it was sent. If new information is submitted it will be subject

to a review by a member of the insolvent targeting team, who will carry out a review of the original rules engine sift decision and any subsequent targeting decision. If the case has been targeted for investigation, the information will be passed on to the investigation team.

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Office-holders whose reports are sifted by the rules engine should expect some form of contact from the insolvent

While the rules provide for office-holders to apply for an extension of the three-month reporting period, office-holders are encouraged to submit reports based on the information available to them at three-months and if further information comes to light, that can be submitted as new information. It's recognised that there may be occasions when the office-holder is unable to submit any reports at all. This



might be due to premises being unavailable due to fire or flood, or perhaps the ill-health of the office-holder or key staff. However, case-related requests for additional time, which might be related to difficulties in obtaining director cooperation, access to records etc, are unlikely to be agreed to and SIP 2³ supports this approach.

I would like to take this opportunity to thank all the IPs and their staff who have volunteered their time to assist in user

research and also provide feedback on the DCRS so far. Feedback is essential to the future improvement of the DCRS and all users are encouraged to use the feedback tool, which features near the top of every page of the application. ■

¹ See www.gov.uk/government/publications/director-conduct-report-service

² *The Insolvent Companies (Reports on Conduct of Directors) (England and Wales) Rules 2016* and *The Insolvent Companies (Reports on Conduct of Directors) (Scotland) Rules 2016* (see www.legislation.gov.uk/uksi/2016/180/contents/made and www.legislation.gov.uk/uksi/1996/1910/made)

³ See [www.r3.org.uk/media/documents/technical_library/SIPS/SIP%20England%20and%20Wales%20\(effective%206%20April%202016\).pdf](http://www.r3.org.uk/media/documents/technical_library/SIPS/SIP%20England%20and%20Wales%20(effective%206%20April%202016).pdf)



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PERSONAL & COMMERCIAL INSOLVENCY ▼

Re Ahmed (A Debtor) [2016] EWHC 1536 (Ch)

The applicants were the trustees in bankruptcy of the first respondent (B). The trustees sought to challenge a transfer of B's shares in certain family companies to the second to fifth respondents, who were all members of his family, under s284 Insolvency Act 1986. The transfer had been made between the date of presentation of the bankruptcy petition against B and the date of the bankruptcy order.

The respondents resisted the claim until trial, when they finally accepted that the transfers had been void. In the time between transfer and trial the value of the shares had reduced substantially.

The respondents argued that the trustees must prove both when the shares would otherwise have been sold and their actual, not merely notional, loss. The trustees relied on restitutionary principles in support of their claim for damages, stating that the loss suffered *was* actual loss (being the difference in value of the shares between the date of transfer and the date of the return) and could be quantified by expert evidence.

The decision

The case was heard by Proudman J. In giving her judgment, the judge recognised that the effect of s284 is to render void certain transactions and to render any recipient of property under those transactions a trustee (subject to discretionary relief, which on the facts of the instant case, was not available). The trust arose upon the transfer being made, not upon the later making of the bankruptcy order. On the facts of the instant case, and given the time that had passed and the substantial decrease in value that the shares had suffered, the court held that the respondents could not now hide behind their belated restoration of the shares to the trustees and argue that specific restitution had thereby been made. Recognising the trustees' unusual position for restitutionary purposes (being, as they were, under a specific obligation under s305 Insolvency Act 1986 to realise B's property) the judge declined to apply the line of authority set out in *Brandeis Goldschmidt & Co v. Western Transport Ltd* [1981] QC 864 to the facts of the case and instead held that the trustees were entitled to claim the difference between the fair value of the shares at the date of transfer

and the fair value of the shares date of their return. In so doing she held that a 'fair' rather than 'market' value was appropriate, given that the transfers had been between identified family members who had inside knowledge of the companies and a stake in retaining the shareholding within the family.

The court in *Re Ahmed* recognised that there appeared to be no case or textbook authority on the question of reimbursement of value where a transfer was avoided under s284. The pragmatic approach adopted by the judge in this case is to be welcomed and will provide authoritative guidance on this question in future cases.

COMPANY INSOLVENCY ▼

(1) Jason Mark Evans; (2) Stephen John Burkinshaw v. (1) Peter Jones; (2) Helen Jones [2016] EWCA Civ 660

Liquidators of a company brought proceedings under s240(2) in respect of payments made to the respondent shareholders (the Joneses) in the period before the company's liquidation. Prior to its liquidation the company had had a property development business and it had historically been advanced certain monies by way of loan. Between June 2010 and March 2011 the company repaid the Joneses a total of £448,672.73 in reduction of their loans. It also declared and paid a dividend of £75,000 in June 2010. The company went into CVL on 21 April 2011.

In response to the action the Joneses acknowledged that the dividend had been unlawful and that the loan repayments had been preferences. They argued, however, that the loan payments had not been made at a 'relevant time' within s240(2) Insolvency Act 1986 as the company had not been insolvent within the meaning of s123 at the time they were made. The Joneses argued that the corollary of the dividend being unlawful was that the £75,000 payment had been void, and that the assets of the company for the purposes of s123 should therefore be taken to include the £75,000 payment as a debt due to the company.

The judge at first instance agreed with the Joneses' analysis and dismissed the action. The liquidators appealed.

The decision

The Court of Appeal affirmed that the correct approach to s123 was as set out in

BNY Corporate Trustee Services Ltd v. Eurosail-UK 2007-3BL plc [2013] UKSC 28. Citing Morritt C at first instance in *Eurosail* the court held that, unlike contingent liabilities, contingent assets could not be taken into account in an assessment of solvency under s123. It noted that nothing had been said in either the Court of Appeal or the Supreme Court to doubt Morritt C's proposition at [30] that '*the assets to be valued are the present assets of the company. There is no question of taking into account any contingent or prospective assets*', and that Lord Walker in his leading judgment in the Supreme Court had referred with apparent approval to Morritt C's judgment. The proposition also fit with the language of s123(2), which explicitly referred to contingent liabilities but not to contingent assets.

The court found that the company's claim for the unlawful dividend in the instant case was a contingent claim. It was contingent both on being discovered and on being pursued (which was in itself unlikely for so long as the Joneses remained in control of the company) and was, therefore, an '*unknown unknown*': see Lewison LJ at [22]. The court held that the first instance judge's treatment of the unlawful dividend as an asset of the company failed to accord with commercial reality, contrary to the guidance given by the Court of Appeal and Supreme Court in *Eurosail* (on which see Lord Neuberger at [62] of the Court of Appeal judgment and Lord Walker, citing *Re Cheyne Finance plc* [2007] EWHC 2402 (Ch) at [33] of the Supreme Court judgment). The court therefore held that the unlawful dividend claim should not have taken it into account in determining the question of solvency, and the appeal was allowed.

For a further recent application of the *Eurosail* decision, see also *Re Cosy Seal Insulation Ltd (in Administration)* [2016] EWHC 1255 (Ch) per judge Behrens. ▣



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► **LEGAL VOICE** The nature of the advice given is general and neither *RECOVERY* nor the writer is responsible for any consequential loss arising in connection with information given in this publication.

Legal Q&A

Mike Pavitt and **Shelley White** answer your insolvency queries.

Q I am the compulsory liquidator of a company that, after presentation of a relevant petition but before its advertisement, transferred (to the brother of one of its directors) a valuable minority shareholding in another company. When challenged, the brother (who continues to hold other shares and a directorship in that other company) claimed the transfer was in repayment of a debt owed to him by the company and both he and the director denied that the company was insolvent at the time. The current market value of the shares is much less than when they were transferred out and the director is now bankrupt and his estate is of nil value. The brother has now offered (two years since the transfer) to simply transfer the shares back or to buy them at market value, in full and final settlement of any claims against him and/or against the director. How should I approach the brother's offer?

A You seem to have concluded that there is little practical merit in your pursuing the director, but that the brother may be worth powder and shot. Your approach to the brother's offer should therefore reflect the strength of your possible routes to recovery against him, and of course your ability to fund those routes.

The share transfer to the brother is likely to have been a transaction at an undervalue or preference to a connected person under ss238-240 Insolvency Act 1986 (IA) but, despite the statutory TUV presumption weighing against the brother, these claims might not be straightforward, for example in terms of establishing that the transfer happened at a relevant time. Careful evidence gathering and analysis would be required and the availability of a conditional fee pursuit post LASPO and/or third party litigation funding and/or insurance might be uncertain.

In order to best serve the interests of creditors, therefore, we would suggest that you put your focus, initially at least, on s127(1) IA. The transfer was almost certainly a void disposition of the company's property and it is difficult to see how the brother could claim it should be validated by the court. The Court of Appeal has helpfully reaffirmed (*Express*

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Careful evidence gathering and analysis would be required and the availability of a conditional fee pursuit post LASPO and/or third party litigation funding

Electrical Distributors Ltd v. Beavis [2016] EWCA Civ 765) that the circumstances in which a recipient of a post-petition disposition could hope to validate such a transaction would be exceptional indeed, and that ignorance of the petition and good faith generally would be no defence.

It is all very well to say the transfer was void, however, but can s127(1) actually deliver an effective remedy on its own? Judicial opinions have varied as to the proper nature of s127(1), and its sister provision in bankruptcy s284, with the registrars, for example, often treating such applications as claims for money had and received. If that approach were adopted in your case, it might be that the best you could hope for from s127(1) alone would be the return of the shares at whatever value they now hold, and perhaps an account of any dividends declared and paid out on them since the transfer. That would imply that the brother's offer may be a reasonable one.

However, on considering these issues recently (albeit in the context of s284: see *Eatisham Ahmed* [2016] EWHC 1536 (Ch)) the High Court followed a much more purposive tack, finding that the void disposition jurisdiction gave the insolvency practitioner a free-standing right to recover any loss suffered as a result of the disposition, on the basis of a breach of trust. In that case the relevant respondents were not ordered to return the shares (which the trustees would have been under a duty to sell anyway) but to compensate the bankruptcy estate for the loss in value of the shares while they were holding them on trust. Moreover, it was found that as the title of the applicants had

relation back to the date of the transfer, that was the effective date for valuing the shares so as to assess the loss, and as the disposition was to associates who were shareholders and directors of the company in question, they should be valued on a fair value basis, rather than a market value basis.

Applying this analysis to the brother's offer, and accepting of course that every case must be viewed on its own merits and that it is always sensible to take specific legal advice in such circumstances unless the amounts involved are trivial, his offer perhaps will not seem that reasonable at all. Arguably he should be accounting to you for the loss in value of the shares against an historic share valuation prepared for the date when the shares were first transferred and, on the basis of the value of the shares, to him rather than the market at large, and then he can keep hold of the shares. We would suggest that you consider entering into further negotiations with the brother on that basis (but without prejudice to your other potential remedies) and if his offer is not increased appropriately that you take advice with regard to funding and pursuit options in the round.

Q I am a nominee of a debtor who I have assisted to prepare IVA proposals and the non-interim order procedure is being adopted. I did not think the proposals or reports would therefore need to be filed at court but more than one of my older colleagues disagree. Who is correct?

A On the face of it this should be a straightforward question, but we can understand why you and your colleagues may be struggling with it. We agree that the relevant provisions of the Act and rules, and relevant professional guidance, are not as clear or helpful as they could be.

Your primary frame of reference is, of course, s256A IA, which sets out no obligation on any party to file the proposals with the relevant court. We then look to the relevant insolvency rules, which are now rr5.14A and 5.14B, the old rule 5.15 (which used to provide for filing of the nominee's report, notwithstanding no interim order was being sought) having »

been revoked in 2010. These deal with court jurisdiction, but only in the context of a formal application needing to be made (eg for the replacement of the nominee). It follows that the proposals would only need to be filed, to assist the court, in the event that such an application is being made.

The obligation to file the chairman's report likewise only applies if there has been an interim order (see for example r5.27(3)). We are aware that some IPs still adopt the historic procedure of filing the proposals and nominee's report and/or chairman's report with the relevant court, whether out of habit or an abundance of caution. Some may be fuelled in this by paragraph 2.5 of SIP12 suggesting that the chairman's report should 'include such further information (if any) as the chairman thinks it appropriate to make known to the court', but it seems now to be beyond any real doubt that this is unnecessary. Only the Secretary of State needs to be informed, and then only of an approved IVA (r5.29).

This is of course in keeping with current legislative moves to remove

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It would be inconsistent if the law were to impose an obligation to engage with the court when incepting an IVA whilst having entrusted debt or

personal insolvency from the purview of the court, and whatever we may think of that, it would be inconsistent if the law were to impose an obligation to engage with the court when incepting an IVA whilst having entrusted debtor bankruptcy to an adjudication procedure. There appears to be nothing in the new insolvency rules (at least in their latest draft) that would alter this position.

In answer to your question, therefore, we suggest that it is you who are correct in your interpretation of the applicable law, but your colleagues' caution is well founded and based on established principles. □



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REVIEW

False Assurance

This is the ICAEW's first foray into film-making and, whilst it doesn't represent an immediate challenge to Hollywood, it's a cracking good tale.

It's about an audit – but including blackmail, bribery, bullying, bonuses, cybercrime, client relationship stress – oh, and the basis of valuation of intangible assets. All human life is here and no-one, with the possible exception of one of the audit juniors, comes out of it with their reputation unscathed.

The storyline follows two years in the life of D-Merton, a manufacturer of radar systems that are mainly sold overseas. There's heavy competition but the company has come up with a game-changing new version of its system. But there are delays in implementation and the customers aren't buying the earlier versions – why not? How can they be 'persuaded' to buy?

The company has a number of legacy IT systems, which are looking both a bit creaky and potentially insecure – but a replacement would need an increase in existing banking facilities at a time when trading has dipped.

No am-dram in sight

Stemming from this basic story, the film examines (*inter alia*) the relationship of the auditors with the management and indeed



within the audit firm, the role of the non-executive directors, the stresses brought on by potential breach of banking covenants and what happens when corners are cut...

The quality of the acting is remarkable – no question here of amateur dramatics – and it makes a real difference to the credibility of the scenarios being played out. One aspect that particularly came across was the role of non-executive directors and what an enormously difficult position they find themselves in when management is being less than open.

A sticky end?

Relevance to insolvency practitioners? Well, by the end of the film, the company is definitely teetering on the edge of insolvency – I'm fairly sure it's only a matter of time before the bank requires an

IBR. It's a case study to provoke discussion about the reactions of accountants, auditors and directors to stressful situations – so it's very much about scenarios that, if the principals don't get it right, may lead to them needing the advice of an IP.

The ICAEW are rather coy about how much it costs to get hold of a copy – to quote them:

'Pricing is based on firms taking either a UK or global training licence depending on size of firm/network. Workshops around the film are also being run by ICAEW's Academy for directors as well as customised training for boards of directors and senior management teams.' The ICAEW can be contacted for more information.

So I think the answer is to negotiate hard – if this is the sort of thing you might find useful, it's worth a try! □



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Under scrutiny: consumer credit lenders in administration

Jonathan Rogers, Christopher Ratcliffe and Katherine Hudson look at common issues around consumer lenders in administration in a regulated environment.

In April 2014, regulation of consumer credit lenders moved from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA). Consequently, regulated credit lenders are now subject to increased regulatory scrutiny and compliance obligations, while the legislative framework that governs credit agreements, the Consumer Credit Act 1974 (CCA), remains largely in place.

This article looks at some of the unique issues faced by an administrator of a regulated consumer credit lender in balancing their duties as administrators with some of the legal and regulatory problems that can emerge with handling or running off a regulated loan book.

Defects, notices and statements

Complications emerge for administrators when there are defects in the CCA documentation. The CCA, and its secondary legislation, prescribes that certain notices and statements need to be provided throughout the life of the loan and it imposes strict consequences for any failure to comply. Indeed, the occurrence of such defects is relatively common given the capacity of CCA provisions to be both rigid and opaque.

“The FCA has been known to exercise its regulatory powers broadly to dictate the terms of a sale, particularly when selling a consumer

For example, some of the common areas to be aware of (and their consequences) include:

- failure to provide certain pre-contract information (a SECCI) or loan documentation in the prescribed manner makes the loan unenforceable without an order from the court;
- failure to provide a copy of the credit



agreement to the borrower makes the loan unenforceable without an order from the court;

- failure to provide balance statements at the request of the borrower makes the loan unenforceable during the period of default;
- failure to provide annual statements, including complying with the strict content requirements in secondary legislation, means the loan is unenforceable and the debtor has no liability for interest during the period of non-compliance;
- failure to provide notice of sums in arrears (NOSIAs) in prescribed form means the loan is unenforceable and the debtor has no liability for interest or default fees during the period of non-compliance; and
- prescribed form default notices are required before a creditor can take any steps to terminate, demand earlier repayment or take security under a loan.

The consequences of CCA defaults are severe and can generally be divided into two categories: those affecting whether a loan can or should have been enforced, and those that affect the amount of interest that a borrower is actually liable to pay.

Navigating the defects

The need to decide how best to deal with systemic issues arising in the light of these legal and regulatory pressures can become acute during an administrator's appointment, not least as the firm is likely to be scrutinised by the FCA during such a period of difficulty, but also because the administration could involve a loan asset sale/company sale or the process of cancelling the firm's regulated licence. In the event there are defects with the documentation, navigating a way forward is not straightforward.

“An administrator needs to consider its duties as an administrator, its duties as an officer of the court and, finally, the duties of the defaulted firm as a

In determining the most appropriate course of action, an administrator needs to consider its duties as an administrator (which are generally creditor focused), its duties as an officer of the court (to act honourably and fairly) and, finally, the duties of the defaulted firm as a regulated entity. These regulatory duties include guidance in DISP 1.3.6G, which provides that when a regulated firm identifies recurring or systemic issues in respect of its regulated activities, it should ascertain the scope and severity of the consumer detriment and consider whether it is fair and reasonable to proactively undertake a redress or remediation exercise.

For example, if annual statements have been provided incorrectly, then under the CCA the borrower would not have been

liable to pay interest during that period of non-compliance. If the breach is purely technical then a regulated firm might look to regulation 41 of the Consumer Credit (Information Requirements and Duration of Licences and Charges) Regulations 2007, which allows errors or omissions that do *'not affect the substance of the information or forms of wording which it is required'*. This provision has attracted minimal case law, but it is generally understood to offer only narrow relief.

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The payment of any redress will also need to be considered in the context of an administrator's duties to the creditors as a whole, and whether voluntarily repaying any portion of the funds illegitimately received may leave an administrator vulnerable to a claim in respect of their conduct brought by

If the narrowly expressed regulation 41 does not apply, an administrator may be left with a difficult decision as to whether they have a legal or regulatory duty to acknowledge the issue to borrowers and provide redress. This is despite the fact that in doing so it might not seem fair or reasonable to reward customers with a windfall for minor and technical errors that, but for the penalties in the CCA, do not obviously cause detriment. In such circumstances, administrators may wish to be advised on whether or not there is a case for applying a 'fair and reasonableness' test to the facts, being in effect the test applied by the Financial Ombudsman Service (FOS) and to be applied by firms under the FCA's DISP complaints handling rules. In other cases (for example where loans have been enforced where they were unenforceable pursuant to the CCA), it can be even more

difficult to ascertain the extent of detriment and what the remedy should be.

Clearly any decision will need to be based on its facts and accommodate appropriate transparency to the FCA. The payment of any redress will also need to be considered in the context of an administrator's duties to the creditors as a whole, and whether voluntarily repaying any portion of the funds illegitimately received may leave an administrator vulnerable to a claim in respect of their conduct brought by creditors or a subsequently appointed liquidator.

Loan book sales

In the course of an administration, administrators may look to sell the firm's regulated loan book to a third party. In doing so, they are in a sensitive position of balancing the firm's legal and regulatory duties and their own duties to fulfil the objective of the administration. One of the fundamental principles FCA regulated firms must comply with in carrying on their business activities is to treat customers fairly (or TCF). In the context of a loan book sale, TCF involves consideration of the customers' position post-assignment, and in particular whether the new owner should assume some or all of the defaulted firm's liabilities to customers.

Under a proposed loan book sale, it may be that only the benefit of loan receivables is to be assigned and not the liabilities connected with the portfolio (notwithstanding that a new loan owner may assume certain responsibilities under the CCA and FCA rules). In normal circumstances the selling firm is likely to remain accountable for its misconduct to customers and to regulators, but in the context of an administration, the extent of this accountability may not be meaningful if the firm is to be wound up or is otherwise in a weak financial situation.

From a TCF perspective to ensure customer protection, a regulated firm might consider whether the loan book sale should require the new owner to assume some or all of the liabilities connected with that book. If so, the assumption of liability could comply with and refer to section 234B of the Financial Services and Markets Act 2000, which has the effect of extending FOS jurisdiction to the successor firm for those assumed liabilities, even where it is not itself regulated.

In each case, the desire to fulfil TCF obligations needs to be balanced against

the duties of the administrator. Any assumption of liability could significantly impact the value realised from the asset sale and could even prevent it. Transparency and cooperation with the FCA may be crucial for administrators that wish to obtain maximum regulatory assurance over their proposed course of action.

Even with this approach, the FCA has been known to exercise its regulatory powers broadly to dictate the terms of a sale, particularly when selling a consumer loan book to an unregulated vehicle. Under the UK's consumer credit licensing regime, it is not necessary that an assignee of loans is FCA regulated provided that, post assignment, a regulated firm is appointed to administer the loans (and no new loans are originated). In practice, though, the FCA could challenge a sale to an unregulated owner; either as a breach of the TCF principle or, in some cases, by challenging the firm's assignment rights as 'unfair terms' under consumer protection laws. The FCA may be motivated to look closely at these issues when post-sale, they will have no supervisory oversight or control over the new owner and the old owner will not have the substance to make good any historic malpractice to customers.

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In each case, the desire to fulfil TCF obligations needs to be balanced against

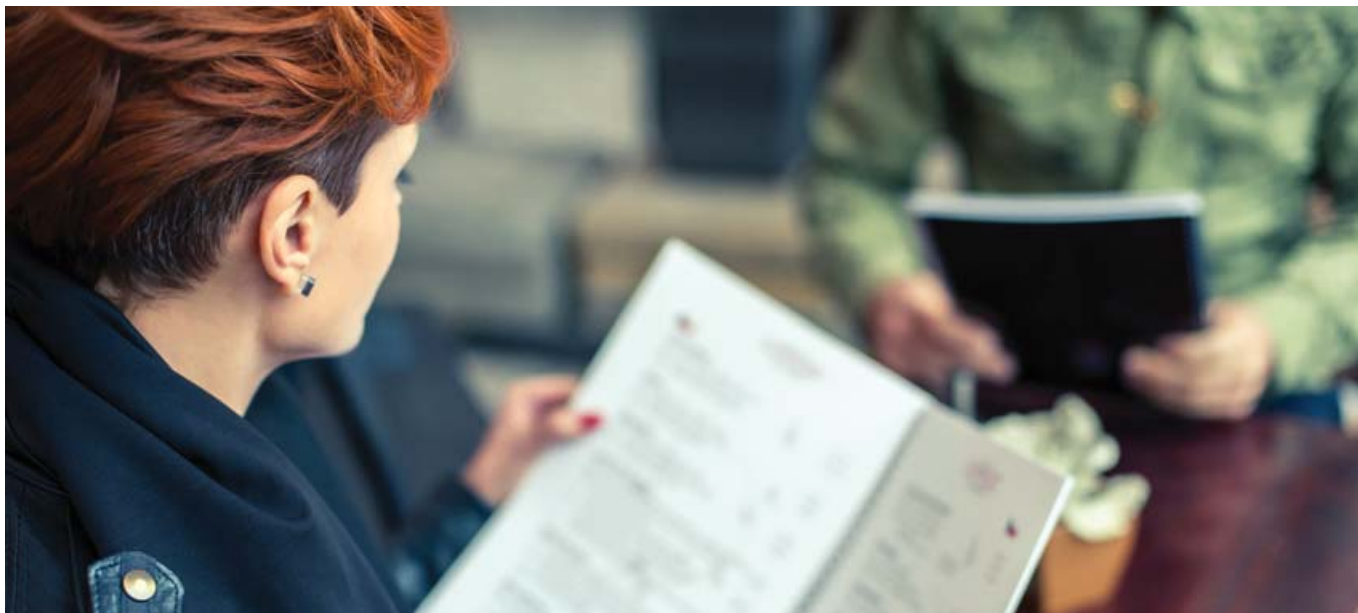
In such circumstances, we have seen the FCA require new owners to enter guarantees and/or deeds of indemnity with the regulator that effectively require the new owner to deal with the loans as if they were still owned by the defaulted firm. Further, these deeds can require an unregulated owner to agree to submit to FCA supervision as if it were a regulated entity (although there is no particular legislative framework in place for this approach and it can be difficult to identify how it would work in practice). What is clear is that failure by administrators and buyers to have regard under a sale proposal to the legitimate interests of borrowers, could result in the regulator stepping in and imposing its will. ▣



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An acquired taste?

The acquisition of NPLs in Europe

Louise Verrill, Henry Kikoyo and Sabina Khan explain the intricacies of non-performing loans and how they function in Europe.

The topic of non-performing loans (NPLs) can be a tricky one for IPs to get to grips with. As always with such a broad topic, it is not only limited to the UK, and there are many issues across borders that will need to be understood before any kind of transaction is undertaken. This article should provide a guide for IPs who may need to know about NPLs and understand how they function within Europe.

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Due diligence is important for defining the investor's strategy in relation to legal rights, obligations and

The European Banking Authority (EBA) defines an NPL as an exposure (i) that is more than 90 days past-due; and/or (ii) where the debtor is assessed as being unlikely to pay its obligations in full without realisation of security. In short, it is a loan that can be terminated for cause due to a borrower's breach of the loan agreement.

Last year, the EBA's risk assessment paper revealed that Europe's major banks

held about 1tn euros worth of NPLs (equivalent to 7.3 per cent of the EU's GDP). Since the 2008 financial crisis, European banks have been facing mounting regulatory pressure and capital constraints pursuant to Basel III pushing them to clean up their balance sheets, which has created an opening for non-banking entities to get their hands on distressed debt or NPLs.

The key risks when acquiring distressed debt or NPLs, include:

- the buyer being left holding a 'worthless' position, or a position worth less than originally anticipated;
- the borrower being unaware that a new lender is in place; and
- the buyer being prevented from accessing the security, or the security itself not being robust.

In summary, the process of buying and selling NPLs will normally involve the following stages.

Tender or auction by seller

Regardless of investors' strategies (ie buy to hold or sell), they will inevitably be seeking to pay a significant discount of face value and the level of such discount will invariably be linked to the results of due diligence. Depending on the selling bank's marketing strategy and drivers, in order to maximise price discovery, sellers will often auction or run a controlled tender process although in certain cases they may prefer off-market arrangements through brokers (eg to remain below the radar).

Confidentiality undertakings

As an initial step, any confidentiality, bank secrecy and data protection barriers will need to be overcome so the buyer can obtain information on the borrower and the debt. As a general rule, lenders owe duties of confidentiality to their borrowers. In some jurisdictions a lender may, however, be entitled to share certain information about the borrower with a potential buyer where such borrower is in default. Non-disclosure agreements may be executed or a staggered due diligence may be put in place to facilitate the disclosure process whilst adhering to confidentiality obligations.

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In practice, NPL transactions are complex and the precise considerations will vary widely and

Potential buyers must be cognisant of the risks of receiving such confidential data and are best advised to have robust internal information barriers in place to avoid inadvertently limiting any of their business lines by receiving market sensitive information that could potentially make them susceptible to accusations of insider trading.

Due diligence

General aims

Due diligence is key to price discovery and can broadly be split into two categories – legal and commercial. It is also important for defining the investor's strategy in relation to legal rights, obligations and remedies following acquisition of the NPLs. Factors including transparent legal regimes for seizing collateral with predictable outcomes, or strong guarantees can give the buyer some comfort but will equally restrict the discount on the NPL. There is currently no harmonised process of obtaining control over security in the EU, and the process of enforcing security can range from as little as 24 hours to over ten years and be riddled with jurisdiction-specific obstacles.

The buyer may need to contend with missing, incomplete or erroneous documents. As NPLs may be sold as a 'single name' or as part of a portfolio, this can be particularly problematic when the NPL portfolio contains a pool of loans with different terms, borrowers and spanning various jurisdictions.

Borrower restrictions

Any borrower restrictions on transfer should also be factored in. For example, competitors of the borrower or certain funds may be barred from acquiring the NPL. The borrower/agent may maintain a 'black list' of such entities. The borrower may also require its or its agent's

consent to be obtained (although this may be deemed to be waived in default situations).

Restrictions to transfer *can sometimes* be overcome by opting to sub-participate in the loan (ie where the buyer acquires an economic interest in the NPL but the NPL is not transferred to it), although this approach has certain drawbacks. As the grantor (seller) remains the 'lender of record', issues can arise with respect to voting, receiving borrower information and the arrangements between grantors and participants can themselves be marred with their own set of issues such as reputational, exposure to costs and administrative concerns.

Tax

It is important to check the tax position to ensure that no adverse tax implications are triggered for the buyer, for example withholding tax on interest payments and stamp duty. Loan agreements typically contain qualifying lender clauses, which can provide clarity in this regard.

Overriding restrictions

Additionally, a buyer should check that no further restrictions apply, for example, is it conflicted for any reason? Are there legal or regulatory barriers to acquisition of the NPL? Note that in certain jurisdictions, licenses or specific

authorisations may be required to engage in particular business activities, for example, where consumer or retail assets are concerned.

Governing law

Governing laws of the loan agreement and security, location of obligors and the structure of the trade (ie settlement location) may all have implications on transferability, access to and perfection of securities, impact on length of time to effect the transfer or enforce security and potential priority/subordination issues. There can also be additional formalities or steps to perfect the transfer depending on the type of the underlying asset, for example, in France a *huissier* may be needed to notify the borrower. In England, an assignment is perfected by notice to the debtor.



Security package

The buyer may not automatically benefit from security and/or guarantees in respect of the NPLs. Security documentation should therefore be reviewed to ensure the security is effective and transferred properly, as this can affect enforcement rights (for example, an English mortgage that has not been documented by way of a deed will subsequently preclude the power of sale for the secured party). Moreover, additional procedures may need to be complied with, which can be expensive. For example, in Spain a notarisation procedure can apply in respect of the assignment or transfer of mortgages. An NPL acquirer also needs to be conscious that any transfer of securities does not inadvertently reset the avoidance period as the borrower is in default and could well be heading down the insolvency route, which means that the security is vulnerable to being set aside. This is a particular risk in jurisdictions where the security trust structure is not recognised and/or the security is held by the seller/lender itself.

The security structure itself should also be reviewed, for example, under

English law security is normally held via a trust structure, yet a number of civil jurisdictions do not recognise a trust purporting to cover assets located in their jurisdiction, or the trust structure itself.



In short, an NPL is a loan that can be terminated for cause due to a borrower's breach of the loan

Trading documentation

The loan agreement may specify precise forms and process of transfer. Issues can potentially arise with respect to securing relevant consents, stapling rights and pre-emption rights.

It is normally recommended that the LMA standard forms should be used as

these incorporate the LMA's standard terms and conditions, which have back-to-back protections and representations that can consequently enhance liquidity of the position. Moreover, the LMA standard terms and conditions also incorporate additional protection for distressed debt.

On the flipside, where payment obligations are complex or ongoing, bespoke confirmation terms may need to be incorporated to fully reflect the parties' intentions. In the case of *Tael One Parties Limited v. Morgan Stanley & Co International plc* [2015] UKSC 12, the parties failed to specifically allocate a payment premium that was triggered some time after the trade occurred by the borrower pre-paying the loan. The Supreme Court held that the buyer did not need to account to the seller for any part of such payment premium.

This article seeks to highlight limited recurring issues that are pertinent in the distressed and NPL trading world. It is not intended to provide a comprehensive overview. In practice, NPL transactions are complex and the precise considerations will vary widely and depend on a range of factors. □



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Strategic reassessment fuelling rise in banks' non-core loan stock

Richard Thompson and Declan Ferguson present research on non-core loan stock across Europe.

PrWC research shows that more than eight years on from the onset of the financial crisis, European financial institutions still hold €2.3tn in loan assets that they have designated as non-core. It is a common misconception that all non-core assets are non-performing loans (NPLs) – in reality, more than half of the estimated total of non-core stock comprises performing credit positions (€1.2tn). These are typically being traded because they are no longer central to banks' strategies as they look to free-up capital and concentrate resources in an effort to improve profitability. Despite the enormous volume of NPL transactions that have taken place since the beginning of the financial crisis, banks across Europe continue to hold NPLs of around €1.1tn which have been designated as non-core.

At our 2016 annual European Bank Restructuring Conference, we surveyed 650 market participants. Their responses reflected the scale of investment by the fact that 74 per cent of these participants believe that up to €1tn of the €2.3tn in non-core lending will end up trading as a portfolio.

It is interesting that the research shows that, since 2012, the volume of non-core loan portfolio assets has not materially decreased. While many banks have been active in selling or refinancing non-core exposures, at the same time there has been an ongoing strategic reassessment of which activities are core, leading to a continuing stream of new assets being designated as non-core. We expect this trend to continue for a number of years.

Key trends in the European Portfolio Market

In our Q2 2016 market update, we estimate that loan portfolios with a face value of approximately €95.5bn have either been transacted, are in the process of being transacted, or are being readied for sale. This equates to around 68 per cent of completed volumes for the full year in 2015 of €141bn, which compares to €91bn in 2014.

The surge in 2015 volumes was primarily driven by an increase in secured retail transactions, which included a large number of performing assets, most notably in the UK. Although many commentators predicted a reduction in UK transactions, this was one of the largest markets during

2015, driven by disposals from UK Asset Resolution (UKAR) and GE.

On the whole, we have seen an increase in investor appetite towards performing portfolios and this has been most prevalent in the secured retail mortgage market, where completed transactions in 2015 reached over €50bn, mostly driven by UK deals. For many non-trade investors, we anticipate that securitisation will be the exit route.

“We surveyed 650 market participants. Their responses reflected the scale of the opportunity by the fact that 74 per cent of these participants believe that up to €1tn of the €2.3tn in

Commercial real estate (CRE) remains a popular asset class throughout Europe, with approximately 53 per cent of 2015 completed CRE transaction volumes being UK and Irish assets.

Although the Irish market has historically been driven by a large number of CRE transactions, we believe that secured retail will play a much larger part

in the Irish market during the remainder of 2016 and into 2017 and beyond.

Emerging European geographies – Italy, Greece and Central and Eastern Europe (CEE)

Looking to 2016 and beyond we believe that markets in Italy, Greece and CEE will become much more important and will present increasingly interesting investment opportunities.

At our 2016 annual European Bank Restructuring Conference, we asked audience participants the question: ‘You have €100m, would you invest in Italy or Greece?’ Most (65 per cent) said Italy while 35 per cent opted for Greece. Interestingly, when we asked the same question two years ago, the split was a much closer 55:45. Therefore, there has clearly been a reassessment of the investment opportunities in these two geographies.

Indeed, the Italian banking sector has been widely discussed in the last 18 months, as NPL volumes have continued to weigh heavily on Italian banks' balance sheets. Although 2015 completed transactions increased in excess of 150 per cent over 2014 volumes to a total of €19bn, as the long awaited programme of deleveraging by Italian banks gathered pace, this is a minute proportion of troubled loans within the Italian banking system.

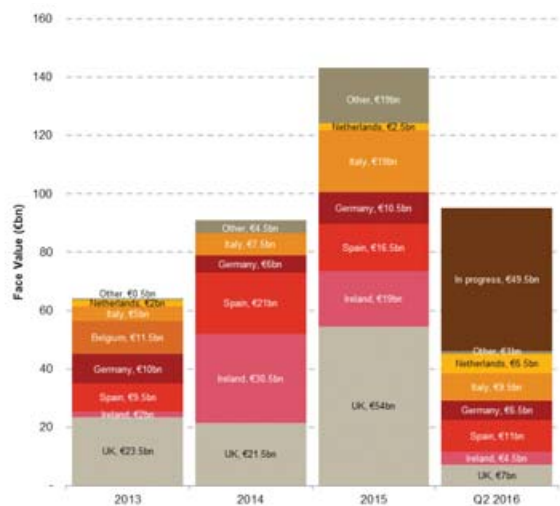
At the end of 2015 we predicted that Italian transactions would increase further in 2016 and, with €9.5bn of transactions already completed during 2016 and a further €12.5bn in progress, this estimate looks as though it will be comfortably achieved. Despite a number of transactions being put on hold in recent months, investor appetite in Italy remains very strong, as does supply, with approximately €200bn of NPLs and a further €141bn of non-performing exposures (NPEs).

The government has put in place various reforms designed to facilitate NPL transactions, including the shortening of foreclosure timelines via legal and regulatory measures, facilitating NPL portfolio funding and improving the tax regime. For most investors their success in the market will largely be dictated by their ability to effectively service, and therefore fully realise value and return on a loan-by-loan basis, particularly where a loan is supported by real estate.

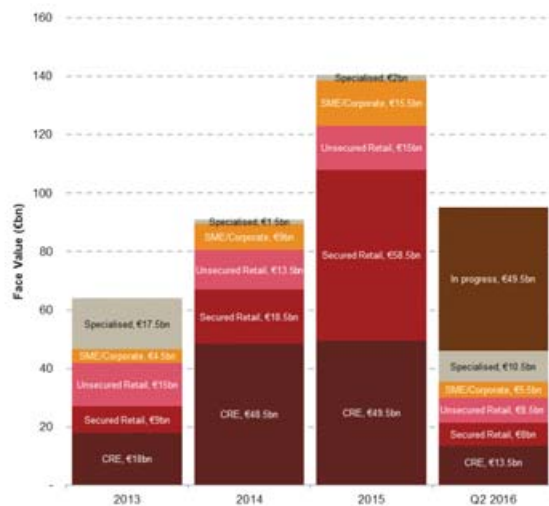
A summary:

- €2.3tn in non-core loans (up from €1.5tn in 2011) – €1.2tn is performing and €1.1tn is non-performing.
- €91bn of loans transacted in 2014, €141bn in 2015 and €95.5bn already in play or completed in 2016.
- Secured retail and commercial real estate most popular asset classes with secured lending to SMEs and corporates increasingly sought after.
- Italy, Greece and Central and Eastern Europe increasingly interesting for investors.
- What will drive future loan portfolio transactions?

Value of transactions by country



Value of transactions by loan type

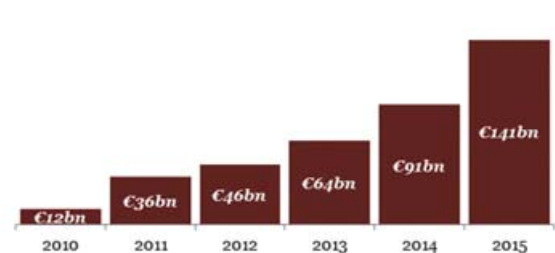


Source: PwC Portfolio Advisory – Market Update Q2 2016, based on PwC analysis. Note: 'Specialised' includes certain structured and asset backed products, shipping, infrastructure, energy and aviation.

European non-core loan volumes



Completed transaction volumes



Source: PwC Portfolio Advisory – European Bank Restructuring Conference 2016, based on PwC analysis

Although Greece appears to be a less favoured investment opportunity, the regulatory landscape is improving and, in particular, providing a stimulus for the continuing development of servicing capabilities, which is helping to attract a broader range of investors to the market.

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The referendum result appears to have led to a temporary reduction in deal volumes as both vendors and investors have taken stock of the likely

As with Italy, investor success will largely be driven by improvements in the regulatory landscape and, in particular, for the most competitive of investors the acquisition and development of proprietary servicing platforms.

Elsewhere, in CEE, there continues to be strong interest from international investors towards these geographies, particularly as the more established NPL markets in Western Europe continue to remain highly competitive and have attracted interest from a small number of global funds.

One of the most sought after asset classes is secured lending to SMEs and corporates, especially where portfolios are concentrated in a particular country as

these are usually easier to underwrite, diligence and service. Differences in the legal and regulatory frameworks of the various countries in CEE mean that it is wrong to think of it as a homogeneous region and therefore investment needs to be considered on a country by country basis. This means that many countries offer relatively small investment opportunities in comparison with some other markets - hence, in general, the region is appealing to the mid-sized investors rather than the larger players.

What will drive future transactions?

For the remainder of 2016 one question is likely to be how the UK and wider European economy react to the result of the UK EU referendum and the consequent impact this may have on deal volumes.

At the time of writing, we believe it is too early to form any meaningful conclusions. However, overall, the referendum result appears to have led to a temporary reduction in deal volumes as both vendors and investors have taken stock of the likely impact of the outcome. We expect both the cost and availability of

leverage to be a key factor in a number of deals. Although it is too early to fully quantify the impact on loan-on-loan leverage, we have already begun to see an increase of up to 100+bps in credit spreads.

Similarly, we have seen and heard of certain investors attempting to price chip, and the continued volatility in UK real estate values could contribute to price erosion. However, this might be offset by the devaluation in sterling, which could serve as an upside to dollar denominated investors in the market.

As the financial institutions operating within the UK begin to come to terms with the effect that Brexit will have upon their ability to operate and do business, this could be a further impetus to bank restructuring and hence a trigger for further transactional activity.

Outside the UK, the 2016 bank stress test results have revealed a number of weaknesses in European banks and contributed to sharp decreases in stock market values of some banks.

At the beginning of the financial crisis we predicted that the process of bank deleveraging and balance sheet restructuring would take many years. We see no end in sight and believe that this market is likely to continue for many years to come. ■



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From an economic and financial markets perspective, 2008 was an unprecedented year for the world's major economies. Due to the onset of the sub-prime financial crisis, by early 2009, many major global economies had plunged into a period of recession and uncertainty. Credit markets closed, consumer confidence dropped and liquidity was scarce. This extraordinary level of financial instability required immediate remedial action, and one of the key takeaways from the crisis was the need for European banks to clean up their balance sheets. Increased pressure from regulators and the market to act more responsibly drove many of the banks to redefine their core businesses and search for capital.

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For the seller, a portfolio transaction provides the certainty of early cash receipts in comparison to the uncertainty of recovery timings in a hold-to-term or run-

Non-core and non-performing loans

As a result of the clean-up exercise performed by the banks, a number of financial institutions identified elements of their operations that they deemed to be non-core. Whether it was exposures to a certain country, to a specific asset class or to a particular group of borrowers, the banks determined these exposures no longer formed a core part of their business and set about exploring how best to dispose of these loans.

In addition to identifying which exposures were non-core, the banks also focused on their non-performing loans (NPLs). NPLs were typically those loans that had suffered some form of default, whether by covenant breach, non-repayment of facility at maturity or missed interest payments over a period of time. As seen in past historic crises across the globe, NPL and non-core loan portfolio sales form an important component of any significant deleveraging exercise.

Seller advantages of a loan sale

Loan portfolio sales always result in benefits for both the selling and buying parties. For the seller, a portfolio transaction provides the certainty of early cash receipts in comparison to the uncertainty of recovery timings in a hold-to-term or run-off scenario. A hold-to-term strategy for the bank potentially exposes them to a long tail risk in relation to long dated facilities; however a portfolio sale



Road to recoveries

Andrew Orr and Hardip Bhatti give an inside view on the mechanics of a loan sale process and how the portfolio market continues to evolve.

mitigates this risk and allows an early exit from the portfolio. Perhaps the biggest benefit of derecognising NPLs from the balance sheet is the reduction in risk-weighted assets, essentially freeing up capital for the bank, which can be deployed elsewhere and onto the core operations of the bank.

Another advantage for the banks is reducing the scale of the internal work out operations, which results in increased management time to focus on core activities. Portfolio sales also provide reductions in the headline NPL ratio following derecognition.

Determining the parameters of a portfolio

There are a number of factors banks typically consider when packaging portfolios together for a potential disposal. These include potentially tranching portfolios by;

- asset class, such as industry-focused portfolios;
- product focus, ie residential mortgage loans portfolio;
- geographic exposure, for example bringing out a portfolio with assets located only in a certain region or country; and
- nature of the borrower, such as loans extended to medical professionals.

The loan sale process and investor considerations

A typical competitive loan sale process consists of a four-week phase one and four-week phase two process. Post-receipt of a signed NDA, a number of investors are usually invited into the first phase of the

transaction and provided with limited information in order to allow them to provide indicative non-binding bids at the end of phase one. With regards to which investors are invited into the process, a number of considerations are taken into account;

- track record – bidders must have a proven track record in completing large and/or complex transactions in a limited time frame. Investor asset management plans and conduct risk are also considered in assessing investor track record. These are key to minimise execution risk;

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As seen in past historic crises across the globe, NPL and non-core loan portfolio sales form an important component

- ability/appetite to bid for large portfolios – with the larger portfolios that are often multi-tranched, investors may only be interested in acquiring one or two tranches of a specific portfolio. If the seller of a portfolio will only consider bids for the entire portfolio, or wishes to trade the entire book under one negotiation, this will tend to impact the choice of bidders;

- segmentation considerations – if the portfolio has been segmented to a specific asset class or geographical location, this will impact on which bidders are invited into the process. Those with a known interest in that particular segment are more likely to provide credible bids than those who have no particular experience and a limited appetite for that asset class or geography;
- financing – bidders may require financing to be in place before completing any large transactions and therefore the appetite of the financing parties should also be taken into consideration; and
- willingness of potential investors to undertake significant diligence work and commit resources in a competitive process.

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Perhaps the biggest benefit of recognising NPLs from the balance sheet is the reduction in risk-weighted assets, essentially freeing up capital for the bank, which can be deployed

Post-receipt of phase one indicative bids, the next stage of the portfolio sale usually consists of the top bidders from phase one being invited into phase two of the process. This phase involves the bidders being provided with the full suite of documents and credit material. Bidders are then asked to provide binding bids with a view to signing the terms of the loan sale and purchase agreement as soon as possible, with the migration of the portfolio from seller to purchaser taking place soon after.

Investor due diligence

Phase one due diligence material normally consists of just data tapes and asset valuations. Bidders are able to price the portfolio using this information and the experience they have within their teams. External advisors are used to assist in triangulating value and assessing credit notes.

During phase two, a full suite of documentation is typically provided depending on product type. The phase two underwrite typically involves a wide range of advisors including legal, tax, asset management, financial and real estate advisors.

Investor work out solutions

Investors typically have a range of work out solutions at their disposal once the loans

have been purchased from the seller. These include some of the following;

- negotiating a settlement with the borrower whereby the debt is paid off by the borrower at a discounted rate in a full and final settlement;
- agreeing a consensual sales programme with the borrower whereby a portfolio of assets is sold either privately or at auction, with a majority share of the proceeds being used to repay the exposure to the investor;
- debt for asset swaps whereby further (typically unencumbered) assets are introduced into the debt structure;
- debt for equity swaps whereby equity stakes in businesses are provided in exchange for more favourable debt terms; and
- taking enforcement action and gaining control of the assets, at which point it is either held for yield or disposed of to pay down the loan.

The impact of Brexit

Over the last three years, over €200bn of loan portfolio sales have been completed in Europe as financial institutions continue to tackle over €2tn of non-core and non-performing assets. While the loan portfolio market saw significant activity throughout 2015, H1 2016 has seen a slower start to the year. The single biggest impact on the first half of 2016 has been the United Kingdom's referendum on its EU membership. In the preceding months prior to the 23 June referendum, activity in the loan portfolio and the general M&A market had been relatively subdued, as both investors and sellers expressed caution in completing transactions ahead of a potentially landmark decision.

The decision to leave on 24 June has had a dramatic impact not only on the financial markets but also on the political landscape in the United Kingdom. Financially, we have seen large movements in the sterling currency markets as well as tentative signs of distress in the commercial real estate market, with a number of retail property funds temporarily closing their funds to redemptions.

While it is difficult to ascertain the longer-term effects of Brexit on the economy, the commercial real estate and loan portfolio market, what is clear is that financial institutions and investors will

continue to assess the risks over the next few months.

The European loan portfolio market

The UK and Ireland led the way in 2015 with €45bn and €23bn of portfolios traded respectively (€1.1bn and €12.8bn traded in the six months to H1 2016). Italy and Spain registered the next highest volumes with €17bn and €12bn of completed deals (€25bn and €11.7bn during H1 2016). Increased regulatory pressures and capital requirements are expected to continue to stimulate further activity through the ECB driver Single Supervisory Mechanism (SSM), Basel III and Solvency II. Equity markets are forcing the financial sector to accelerate divestitures of non-core businesses, emphasising the need to focus on home markets and core businesses.

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Investor appetite remains exceptionally strong, with significant fundraising and the availability of loan-on-loan leverage continuing to fuel activity. Buyers with strong track records in the market are expected to continue to dominate the transaction tables in 2016 as they did in 2015.

Evolution of portfolios and outlook

The focus on certain countries and asset classes continue to shift as the European loan portfolio market matures. This shift has led to a noticeable pick up in performing loan transactions, as financial institutions look to capitalise on investor sentiment and macroeconomic performance throughout the continent. When looking further into 2017 and 2018, we expect markets such as China, India, South East Asia, Latin America and South East Europe to become the next hotbeds of loan portfolio transactions. □



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Pence in the pound

Kevin Bishop explains how debt buyers operate and how this new market is changing.

The buying and selling of debt is not an old concept; in fact, the market is less than 20 years old.

You would think that debt recovery would be a key element in any business model, but for Financial Services Companies (FSCs) such as banks, mortgage companies and credit agencies, pursuing debt is complex. It requires activities such as tracing, affordability analyse and negotiations; skills not always contained within the FSCs' internal credit control departments.

FSCs have historically been reducing their investment in collecting debt and, with increased regulation by the Financial Conduct Authority (FCA), collection costs are spiralling. Alongside this, less than five per cent of typical unsecured loan books go into default, making it a matter of customer priority with creditors focusing primarily on more profitable recoveries.

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Less than five per cent of typical unsecured loan books go into default, making it a matter of customer priority, with creditors focusing

This left a need to be fulfilled and in stepped the debt purchasers (DPs). The specialist nature of DPs and their ability to drive higher returns than the in-house FSC departments allows them to collect debt more profitably.

Owed and uncollected

The majority of debt sold in the UK falls under what is known as regulated debt – that is to say debt mainly owed to the FSCs in the form of credit agreements, credit cards and personal loans.

When an account defaults, in the first instance the FSCs would go through internal procedures using their credit control departments. They may even put the debt out to an FCA-regulated third party debt collection agency to recover, as this would give them a valuable filter and a higher percentage return of any collected debt.



After a period of time, perhaps 180 days (although this time varies depending on the particular FSC), any outstanding debt can then be bundled into a portfolio and sold. This is typically sold either through one-off (spot) transactions or more regular, long term (forward flow) agreements. The latter provides the purchaser with a supply of new debt at regular intervals, usually monthly, over a pre-agreed timescale.

The value of the portfolio is normally sold as 'X pence in the pound' of debt and depends on two factors: the age of the debt and its perceived collectability.

Negotiation for portfolios

The main buyers of debt in the UK belong to the Debt Buyers Association (DBA), which is part of the Credit Services Association (CSA).

Most of the larger DPs have a regulated debt collection agency as part of their organisation. They would use this to try to collect the debt from the acquired portfolio – either by collecting the debt as a whole or by signing the debtor up to a time dependent repayment plan, predominantly on a monthly basis.

The business model of the DP is to buy at 15p in the pound, say, and then collect more than 15 per cent of the portfolio debt to make a profit. It is quite normal for this process to happen many times and for the price to drop to a 'penny in the pound' or less. It has also been known for DPs to become debt brokers; buying debt at one price through contacts and good negotiation, and selling the portfolio on at a higher price without touching any of the debt included.

Collection tactics can vary but usually the procedure starts with a letter, followed by an email before being sent to the 'power dialing' department where the debtor is contacted. Debt that is not collected at this stage can again be parcelled into a portfolio and resold on the debt buyers' market for the whole process to start again. The value of the portfolio decreases as the debt ages and the collectability becomes harder.

The length of time that a portfolio is held depends entirely on the DP. Some DPs never sell on debt due to the transient nature of people, which means that they can become more financially able to repay their obligations at a later date.

Changing market

From the early 2000s the DP market has become more consolidated due to the availability of funding, economies of scale and increased compliance and other regulatory costs. Mergers and acquisitions have replaced boom, and expansion into foreign markets means that the debt purchasing market is maturing.

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From the early 2000s the debt purchasing market has become more consolidated due to the availability of funding, economies of scale and increased

The DP market is driven by a few key players, with debt sellers tending to resort to panels of tried and trusted DPs. However, with demand outstripping supply, the price of portfolios has risen over the last few years causing DPs profits to fall and again forcing consolidation.

There is room in the market for the smaller DP; profits can be made from portfolios that have aged sufficiently for the 'bigger boys' to have sold it on. These smaller companies, affectionately known as 'bottom feeders', buy at a much lower rate therefore needing smaller returns in order to make a profit. □



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The recent corporate insolvency law reform proposals (*Review of the Corporate Insolvency Framework – A Consultation on options for reform*, Insolvency Service, May 2016, hereafter *Options for Reform*) have put me in mind of the long history of English and Welsh laws providing a policy guide and inspiration for the rest of the European Union (EU) in terms of the fruitful ways to develop and reform regulation across member states.

A brief perusal of the company law directives and pan-European reform in the areas of insider dealings, takeovers and mergers, the juristic person, as well as consumer over-indebtedness, consumer credit, and personal insolvency solutions, to name a few in one relatively narrow area, demonstrate a long history of English and Welsh positive and constructive influence across the EU when it comes to the future direction of law reform.

In the realm of corporate insolvency law, this positive influence has been most recently demonstrated by the European Commission's (EC) publication of its reform initiatives regarding company rescue (*European Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*, Brussels, 12.3.2014 C(2014) 1500 final. Hereafter *EC New Approach*.) The use of the word 'new' in the document is interesting from an English and Welsh perspective, not least because the ideas enunciated in the document are anything but new.

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The Insolvency Service's recent reform proposals are the latest attempt to continue this interest in developing

These EC proposals closely mirror the long-held 'rescue culture' that has permeated English and Welsh insolvency law since it was first proposed in modern times by the Cork Committee, whose proposals largely reached the statute book in the shape of the Insolvency Act 1986 (IA). This statute has now been heavily amended by the Enterprise Act 2002 (EA2002). Readers of *RECOVERY* will be familiar with the minutiae of both statutes and the ethos they engender. Indeed, many insolvency practitioners (IPs) may now consider the rescue culture to be old hat – at least in the sense that it is an ingrained axiom for every corporate case. 'What can be saved?', 'Where is the value?' and 'Is there viability?', are just some of the questions that IPs routinely consider,



The not-so-great reformation?

Dr John Tribe examines the recent corporate insolvency framework reform proposals, the 'bonkers' Brexit and England and Wales' contribution to EU law reform.





subconsciously or consciously, when handling a corporate insolvency.

I say 'modern' deployment of the term rescue in the above paragraph because there is a much longer history that shows that the English and Welsh legislature and practitioners have been interested in rescue, recovery and renewal (to coin a phrase) for over a century. Joseph Chamberlain MP, speaking in the House of Commons in March 1883 during the passage of what became the Bankruptcy Act 1883, observed that '*parliament had to endeavour, as far as possible, to protect the salvage and also to diminish the number of wrecks*'. (Hansard, Insolvency Bill, March 1883, col 621). Rescue is an axiom. As a policy and mind-set it is deeply entrenched in the English and Welsh insolvency landscape.

Bonkers Brexit

The Insolvency Service's recent reform proposals are the latest attempt to continue this interest in developing a corporate insolvency system. It might yet also provide future food for thought for our EU friends, despite the bonkers Brexit outcome. The referendum vote result is deeply troubling for a number of reasons. The rise in incidents of racial hatred, the closing down of pan-European academic funding bids, the massive fall in the pound, possible threats to recruitment of EU undergraduates, the academic brain drain and the huge loss of value on RBS shares etc, are all worrying developments. More is undoubtedly yet to come, which may include a knock-on effect on insolvency statistics. The incidence of recourse to insolvency provisions may increase.

It would be trite to say observing these changes will be interesting, not least because any upswing involves real effects on real people and the companies that employ them – another unthought-of consequence that the four horsemen of the Brexocalypse (Gove, Grayling, Johnson and Leadsom) did not consider, or wantonly disregarded, in what one of my colleagues, Professor Michael Dougan, has recently referred to as their campaign of '*dishonesty on an industrial scale*'.

In *Options for Reform* the insolvency Service notes that the document has been formulated in response to 'an increasing European focus on providing businesses with the tools to facilitate company rescue'. If history is anything to go by, the damage wrought by Brexit might not still divert from the positive influence we have had on pan-European business rescue techniques. May this trend long continue.

Before we descend into the minutiae of *Options for Reform*, one thing must be asked – do we actually need more reform or has our insolvency law already reached a point of perfection that is so good that it leads the EU in terms of policy development? The then Secretary of State for Business, Innovation and Skills, Sajid Javid MP, makes this perfection clear in his

introduction to *Options for Reform* when he notes: 'The UK's corporate insolvency regime is already highly regarded.' This does beg the question, 'If it isn't broke, why fix it?'

As Manson made clear in the late 19th century in the context of company law reform, continued tinkering can lead to problematic outcomes. Manson ((1890) 24 LQR 428, at 428-429) observed:

'The English mind, by a curious paradox, is constitutionally distrustful of change while full of reforming energy. The result is a superabundance of legislation, but of a tentative and temporising kind, unscientific, crude, confused; the despair of judges and all who value law as a science.'

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The time might be ripe for rationalisation, but to tinker for tinkering's sake, particularly when those basic procedures are self admitted ly

Fear of Manson-like fiddling does not seem to have put The Insolvency Service off tinkering. Indeed, in its executive summary it claims by way of justification that 'basic insolvency procedures have remained largely unchanged since 2004.' If one ignores the panoply of statutory instruments, case law, SIP changes etc that have reformed insolvency law and practice then this point may be acceptable, but one cannot. The time might be ripe for rationalisation, but to tinker for tinkering's sake, particularly when those basic procedures are self admittedly world-leading, is frankly nonsensical. A watching brief – yes. A Manson hyperactivity in the realm of reform – no.

Let us now see if the proposed new toolkit from The Insolvency Service equips IPs, creditors, debtors with what they need to facilitate the ongoing rescue agenda.

The Options for Reform proposals

Options for Reform contains four substantive proposals. These will be addressed seriatim. First though, a brief note on language. *Options for Reform* begins with the salvo, 'An efficient and effective insolvency regime is central [so that] viable, businesses can be rescued quickly and efficiently.' The reversion to 'businesses' as opposed to 'company' in the s8 IA/Schedule B1 sense is interesting. Is this a conscious use of 'business' as a term? Are we moving away from Warren-like communitarianism objectives or is it merely a slip of the pen (See further: (1987) UCLR, Vol 54: Iss. 3, Article 1. Hereafter Warren pluralism).

Does 'business' signify a tacit admission that rescuing the 'company' is not as achievable as the architects of the EA2002 had hoped? Rescue is still a paramount objective, at least from this introductory quote. This is reinforced when we are told that the intention of the reform initiative is, '...to enable more corporate rescues of viable businesses and ensure that the insolvency regime delivers the best outcomes'.

We can now turn to the proposals. Unsurprisingly the majority are not new in terms of substance and ideas. They are:

- (1) creating a new moratorium
- (2) helping businesses to continue trading through the restructuring process
- (3) developing a flexible restructuring plan, and
- (4) exploring options for rescue financing.

(1) Creating a new moratorium

The moratorium issue is not new either in the sense of usage (eg administration and CVA practice, see: (2009) JBL, 5, 454-487) or in the reform sense (eg schemes of arrangement, see: (2009) JIBFL, 24(7), 386-392).

The proposed moratorium would last for three months (with a potential extension) and seems to be such that it will exist outside current procedures. While the timescale is analogous to Chapter 11 stays and the German umbrella proceeding, the other qualities of the 'three-month moratorium' are not (on the latter see Bork's *Rescuing Companies in England and Germany*, OUP, 2012 – which seems to have influenced The Insolvency Service and in this sense reverses the direction of EU influence mentioned above). How is this new procedure to be balanced against current procedures and who does it benefit and why? Moratoriums are costly and tend towards the hostile, ie forestalling negative creditor action using a stay to preclude the exercise of rights *in rem*. The only rights available during the moratorium would be a right to information from the IP. But does this right not already exist but through the route of an IP's statutory and professional guidance accountability? What is this extra dimension? *Options for Reform* seems to find the informal negotiation stage with creditors in some way inappropriate. Why? Isn't the very bedrock of a pre-pack administration this flexible and speedy informality? The professionalism of IPs ensures informality does not tend towards iniquity. Sometimes this 'behind the scenes' activity is exactly what is needed. If the government does want to reduce the 'costs and risks of restructuring' (para 7.6) why is it introducing a new layer into the mix? Why not leave these early stages to the professionalism and expertise of IPs? Would facilitating and incentivising consensual approaches to restructuring not be more imaginative and novel? This would reduce compliance costs and be more likely to facilitate a genuine viable rescue, as creditors would be more likely to »

act less aggressively for fear of upsetting the potentially more valuable apple cart.

Supervisory power

The new moratorium is proposed as a gateway. Following the introduction of the EA2002, this was what administration was meant to be. Is this new moratorium another layer of cost and regulation that need not be introduced? This reform proposal may tend towards the Manson tinkering variety, particularly veering towards superabundance. We are in danger of having a smörgåsbord of restructuring options that will be confusing to stakeholders who are not IPs. When a director or a creditor who is not a specialist is faced with at least six options will they not be slightly bewildered? If a new moratorium must be introduced, why not for schemes of arrangement as has often been discussed before?

“We are in danger of having a smörgåsbord of restructuring options that will be confusing to stakeholders who are

Perhaps the most serious issue with the moratorium proposal is the expansion of who can supervise the moratorium and therefore who controls an insolvency process, which interferes with creditors' rights *in rem*.

Options for Reform states (paragraph 7.41): ‘It is proposed that the supervisor can be any individual who meets certain minimum standards and qualifying criteria; **must have relevant expertise in restructuring** and be a member of the following regulated professions; insolvency practitioner, solicitor or accountant.’ (author’s underlined emphasis)

The IA effected a major change to the regulation of IPs in the professional regulation and examination sense. IPs are specialists with deep knowledge and experience of insolvency processes and factual situations that have arisen around insolvency and business rescue. We have moved far beyond the dark days when so called ‘cowboy’ liquidators rode roughshod across the legislation and stakeholder interests. Why are we seeking to revert to remove the control and administration of insolvency procedures from the professional hands of IPs and give them to individuals who might, for example, not have the competence to engage in the next step if a moratorium is unsuccessful? The paragraph 7.41 wording seems to indicate that a solicitor with relevant experience in restructuring could be a supervisor of the moratorium. Is this sensible? Solicitors are generally experts in the minutiae of the

law, not running complicated businesses (save for their own practices). Similarly, would an accountant who has spent their entire career doing audits fall under that definition? Could a solicitor who is now an academic be a moratorium supervisor even though their engagement with restructuring has been purely theoretical for over a decade? There is much uncertainty that is not really resolved by the ‘must have relevant experience of restructuring’ part of the paragraph. Much work needs to be done around this element of the *Options for Reform* moratorium proposal. I would suggest that the supervisor role should be restricted to IPs not least because of the facilitation of the next option point made above, ie progression into administration, a CVA or winding up. Although this seamless progression point seems already to have been countered in advance in *Options for Reform*, as there is a preclusion on a supervisor IP being a subsequent officeholder. This is apparently to ensure that during the currency of the moratorium, ‘the supervisor acted independently and to avoid potential conflicts of interest that may arise.’ Where is the trust in IPs’ professionalism and objective independence in this sentence? Why is it assumed that IPs would act in their own interest, even as officers of the Supreme Court of judicature? It must be said that the idea of expanding potential supervisors seems to open the door to the undoing of the work that was done by the IA in ensuring the insolvency processes are properly used and not abused. There is more danger in the opening up of who can be a supervisor of the moratorium proposal than there is in the potential for self-interested IPs to recommend that an administration follows the new moratorium because it is in that IP’s interest because of fees they may then charge.

(2) Helping businesses to continue trading through the restructuring process

The second major proposal of ‘helping businesses to continue trading through the restructuring process’ again smacks of the recycling of previously mooted ideas or, more worryingly, sloppy language deployment.

One of the purposes of administration, as enacted, was to trade the company as a going concern (s8 (3)(a) IA). The section stated: ‘the survival of the company, and the whole or any part of its undertaking, as a going concern.’ The term ‘undertaking’ provided a door through which IPs were able to rescue parts of the business that were viable. In reality the company was not saved. What generally occurred were hive downs and the rescue of the business, ie the ancestor process of what we now call pre-pack administration. The term ‘company’ is also deployed in Schedule B1 paragraph 3 (see below).

The EA2002 reforms to some extent closed the door on this hive down of the business/undertaking, particularly with the hierarchy of aims enunciated in Schedule B1 paragraph 3 IA, ie the purpose of administration is now primarily, ‘rescuing the company as a going concern’. ‘Company’ is wider than undertaking or ‘business’ in the Warren pluralism sense.

Why is the insolvency service using the term business? Is this ‘business’ as opposed to ‘company’ term deployment a reversion to Corkian ideas of saving the undertaking (for which see business) in the style of Sir Kenneth Cork (eg Wilstar) and his descendant IPs, or a more concentrated focus on how that business is run during the currency of an insolvency process?

The preamble to this ‘new’ aim mentions the ‘prospects of a fair and successful rescue solution to benefit all creditors.’ ‘Creditors’ is not all stakeholders in the Warren pluralism sense, it is just creditors. This switch from ‘company’ (which can include debtors, employees, suppliers, shareholders, etc) to ‘business’ is a re-visitation of the old s8 undertaking aims.

“Perhaps more imaginative reform such as government or private sector support regarding essential services during a rescue period would be fairer to suppliers of

Language and stakeholder issues aside, the substance of this part of *Options for Reform* is interesting in the facilitation of rescue sense, ie continuing contracts that are essential to the continuation of the company’s activity. Following the October 2015 reforms to the IA, to ensure continuity of supply of utilities and IT goods or services to insolvent businesses, the government is now seeking to expand the definition of essential contracts but with an emphasis on the insolvent company determining what is essential. In paragraph 8.12 we are told that the decision as to what is essential, ‘...will be based on whether the continued provision of a good or service by the supplier would contribute to the success of the rescue plan...’

We might expect some objectivity if the decision on what is essential is made by an IP, but within the newly-proposed moratorium the company itself is permitted to make the decision (see paragraph 8.12). This leaves the door wide open for nefarious activity at worst and problematic interference with private contracts at best.

The trade-off against this rescue objective of forcing 'essential' contracts to continue during the currency of a rescue, ie interfering with private contractual arrangements between (potential) creditor and debtor, is deeply troubling in the sanctity of contract sense. Insolvency laws have historically superseded private arrangements, so again this interference point idea is not new. However, whereas in the past we might cite disclaimer of onerous property, this reform initiative is placing a positive obligation on a supplier to continue trading if they are deemed essential, even if they decide they would rather not, due to a termination clause upon the advent of insolvency, or perhaps because in the freedom of contract sense they decide no longer to trade with the insolvent. How will this differentiation be made between an insolvency trigger that ends a supply relationship and a commercial choice to no longer trade? Again this proposal is fraught with difficulty. What at first blush looks sensible is in fact problematic when you descend into the minutiae of what the proposal might mean in practise.

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One Canada Square is a beacon and testament to the rescue culture. Anyone surveying the London skyline might mull over this lasting legacy that the

While it is accepted that termination clauses and the disruption of supply of essential services can severely disrupt a rescue, is the forced continuation of supply by a private supplier the way forward? Perhaps more imaginative reform, such as government or private sector support regarding essential services during a rescue period, would be fairer to suppliers of the services we are discussing. They would not be manacled to a debtor who they did not want or choose to support and whom they feel no philanthropic desire to help rescue because that is not their function. Allowing a debtor company to designate what is an essential supply may lead to this outcome.

Ransom payments and contractual re-negotiations in the shadow of insolvency which further benefit the supplier, and other such behaviour, is troubling and must be addressed. A simple solution would be to legislate against such behaviour if the tests for insolvency are satisfied by the debtor company.

(3) Developing a flexible restructuring plan

From the advent of what we now call 'the rescue culture', the exponents of the art of business reorganisation, such as Cork, have been nothing if not flexible in their approaches to rescuing viability. The Wilstar example given above is an early 1970s example of this type of behaviour. Piecemeal disposal of large sections of the property empire controlled by Willie Stern by Sir Kenneth Cork showed a flexible adaptation to the property market and the dramatic effect placing all the property would have had on property values. Numerous examples of flexible use of the various insolvency procedures can be cited, no doubt numerous subscribers to this publication took part in such recovery operations.

The Docklands rescue (see: *Re Olympia & York Canary Wharf* [1993] BCC 866 – which includes the famous 'pig in a poke' idiom as deployed by Sir Donald Nicholls VC, later Lord Nicholls of Birkenhead, the law lord and University of Liverpool graduate) is the paradigm of this flexible approach. KPMG and Allen & Overy used nearly all of the insolvency procedures to ensure that what is now a famous London landmark survived and was not a casualty of, *inter alia*, the City of London's defensive rent setting. One Canada Square is a beacon and testament to the rescue culture. Anyone surveying the London skyline might mull over this lasting legacy that the IA was able to contribute to the capital. This flexibility of approach is borne from trust in the professionalism of IPs who have an expansive and adaptable toolkit. The consultation document acknowledges both the flexibility of the CVA and scheme of arrangement procedures and how well-regarded they are internationally. Again, why are we Manson tinkering?

Is a cram down-type procedure needed? Has it worked well in the United States? Evidence must be adduced to support such a serious incursion into secured creditor rights. As argued under heading (2) above, a consensual approach to restructuring with less stick and more carrot might be a preferable way forward. Thought should be given to incentivising creditors, not to seeking ways to disrupt their property rights.

(4) Exploring options for rescue financing.

Much like the preceding reform initiatives there is nothing new in this fourth proposal, *plus ça change, plus c'est la même chose!* With a less cynical hat on, however, the idea of exploring new potential avenues for rescue finance is to be welcomed, even if it has been done before. The voluminous amount of academic work, particularly in America, and the lobbying and responses to The Insolvency Service's 2009 consultation 'Encouraging Corporate Rescue', which discussed rescue financing, must be considered carefully with any new response.

Conclusion

The reform proposals are interesting and certainly provide some food for thought for us here in England and Wales, but perhaps also for our European cousins as well. As the language in this article makes clear, personally speaking I am aghast at the Brexit result because of the consequences I have very briefly alluded to, but also because of how insular and myopic the result seems to make us as a nation. I request the readership's indulgence for the emotive language that I

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I hope England and Wales continues to contribute to law reform activity on an EU, and global, scale in the area of corporate insolvency

have deployed. This country has a proud and long history of being, *inter alia*, an outward looking, migrant welcoming, global link-forging contributor to the world stage. In an insolvency context this goes back as far as the 14th century, with Lombard merchants and their (sometimes) insolvent activity. We dealt with the issues then and hopefully we will continue to deal with them in the future. I write this article in a city which has over 400 years of trading alliances with the farthest corners of the earth. Indeed as long ago as 1886 Liverpool was referred to as a global city that '...has become a wonder of the world. It is the New York of Europe, a world city rather than merely British provincial'. (*Illustrated London News*, 15 May 1886). Long may this internationalist outlook continue. To this same end I hope England and Wales continues to contribute to law reform activity on an EU, and global, scale in the area of corporate insolvency but also in the broader context. Hopefully the latest insolvency service reform document will serve as a reform signpost here and abroad. I look forward to seeing how the ideas enunciated in *Options for Reform* progress. ▣



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The obvious statement is that the UK's vote to leave the EU creates a period of uncertainty. In the immediate aftermath of the vote that uncertainty was heightened by the resignation of the prime minister and the Conservative Party leadership election. Over the past six weeks some of the immediate uncertainties have been resolved. We now have a prime minister and cabinet; we have seen the initial policy responses and statements from the government and the Bank of England; and equally importantly heard the reaction of the leading EU countries.

In terms of the future economic impact of Brexit the key legislative uncertainties are; the lack of clarity over the UK's future trading relationships in goods and services (to include financial services) with Europe and the rest of the world; the changes required to UK legislation where it has followed EU laws; and the changes in rules on the freedom of movement of people. Those uncertainties will take some time as there appears to be no rush to trigger Article 50. There is then a minimum two-year negotiation period, after which the UK's future trading relationships with the EU may still be unresolved.

Effects of the referendum

While the legislative picture will take time to resolve, the scale of the immediate impact of Brexit will be determined by business and consumer confidence. There have been a number of different economic surveys and indicators published since the vote and the emerging pattern is that business confidence has been heavily impacted. The most recent Deloitte quarterly CFO tracker was published shortly after the referendum, and it showed that business confidence was already falling prior to the vote and fell heavily in the immediate aftermath.

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The scale of the immediate impact of Brexit will be determined by business

Business confidence is influential in its impact on investment decisions, from hiring and discretionary spend through to major capital expenditure programmes. The picture on consumer confidence is more mixed. There have been some surveys such as the Thomson Reuters Consumer Confidence Index that point to a decline, but the retail data for July and other indicators have been generally positive. Given that the majority of the electorate voted for Brexit, we expect the immediate impact on consumer confidence



to be less than on business confidence but, as we saw with the unfolding of the financial crisis, this could start to shift in the coming 12–18 months. The consensus on economic forecasts has been improving since the initial downgrades post-Brexit. The expectation now is for lower growth than was forecast pre-Brexit for a 2–3 year period, but not a recession in 2017.

Stocks and deals

The stock markets have recovered from their initial falls and are now back at, or above, pre-Brexit levels, although, as discussed below, the picture varies by sector. The effects in the currency markets have been more sustained, with sterling down close to ten per cent against the past 12 months' average for both the dollar and euro. It would be expected that a decline in sterling would lead to higher inflation, which in turn would be countered by interest rate rises. A rise in interest rates now would be challenging for the economy, but the Bank of England has moved to cut rates and provide other stimuli for the economy, demonstrating a determination by the Bank of England and government to try and support the economy.

The mergers and acquisitions landscape is evolving quickly. While there was an initial pause for reflection we have seen a number of deals, notably Softbank–ARM, complete, which provides confidence, albeit ARM is very much a global, rather than UK-focused business. M&A should be a long-term investment decision and for overseas purchasers the price of a UK business has fallen significantly. The reaction of the debt markets is also important in determining the impact of Brexit on the economy. If the availability of credit for consumers or corporates changes significantly then the near-term impact on corporates will be

much more severe. The strong volume of new public issuance and evidence of activity in the private markets suggest that the debt markets remain open.

Restructuring activity

The UK restructuring market has been muted for some time in light of strong economic growth, low interest rates and strong debt markets. So, many practitioners are wondering whether Brexit will lead to an uptick in activity. Logically, lower economic growth must mean a

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If the availability of credit for consumers or corporates changes significantly then the near-term impact on corporates will be

greater risk of distress and therefore higher restructuring activity. However, our analysis is that the impacts will be seen across a number of different time horizons and will vary significantly by sector.

In terms of whether distress emerges we believe that:

- In the next 3–6 months businesses are most likely to encounter distress; either if they are exposed to unhedged forex risk that impacts trading or financial covenants, or alternatively if they were progressing a stressed/distressed M&A transaction or debt refinancing that has been halted. This is because other negative impacts will take time to work through into liquidity or covenants. In



practice most businesses are hedged against the majority of their foreign exchange exposures but the collapse of Lowcostholidays was in part blamed on a lack of hedging.

- In the 24 months following the Brexit negotiations, the trading impacts of any weakness in consumer confidence or business investment will be felt through covenant issues or liquidity challenges. It is in this period that, if there is any impact of Brexit on restructuring activity, it is most likely to occur. However, for businesses that are export led this might actually be a very strong period when exchange rates make them highly competitive and there are no changes in trading relationships. For them the more significant impact will be in the period post-Brexit when new trading arrangements are introduced.
- Post-Brexit implementation, the impacts of different trading regimes in goods, services and financial services will be felt alongside any changes in UK-EU finances. Until the negotiations are progressed we cannot attempt to predict the impact of trading arrangements. In terms of funding, a good example is agriculture which receives around £50m a week in EU subsidy. The sector is vulnerable to lower levels of support from the UK Government, especially in light of the Brexit campaign's slogan of '£350m a week to spend on the NHS'.
- Individual sectors will be impacted differently by Brexit. To understand those impacts we have identified five factors that matter. The five factors are: exposure to changes in exchange rates, business confidence, consumer confidence, EU trading and funding, and labour markets. We have mapped these against sectors and also against share price movements since the Brexit

vote. To illustrate the issues:

- In the travel sector the airlines have shown substantial share price falls. This illustrates the exposure to:
 - i) exchange rates as airlines pay for aircraft leasing, maintenance and fuel in USD but earn revenue in GBP or EUR;
 - ii) the impact of exchange rates and economic growth on demand; and
 - iii) the regulatory changes as a result of EU exit. These effects for airlines and travel companies come on top of the impacts of terrorism, which have been damaging.
- Similarly, retailers that source products in USD, but earn in GBP and cannot pass the cost increases through to customers, will be impacted once hedges expire. The declines in the stock market point to these effects with general retailers, which frequently source overseas in USD, falling further than the food retailers. There could also be an impact from falls in consumer confidence on retail sales.
- The financial services industry, and banks in particular, is likely to be most affected by the changes in regulation as a result of Brexit because of potential changes in passporting rights, regulation and capital requirements, the impact of lower interest rates on their lending margins and lower domestic economic growth.



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However, without a clear view on the future framework it is challenging to judge the extent of the impact.

- The real estate sector has seen substantial falls in share prices, particularly amid concerns over London commercial and residential development and investment valuations given Brexit risk. Critically, developments not yet started have the potential to be delayed pending greater clarity around the political and economic landscape with consequential impacts on construction. The decline in sterling does appear to create an opportunity for some overseas investors, which acts as a counter-balance. Analysis shows that the housebuilders who have seen significant share price declines have significantly stronger balance sheets than in 2008 so should be more robust.

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In the 24 months following the Brexit negotiations the trading impacts of any weakness in consumer confidence or business investment will be felt through

- The automotive sector is heavily exposed to the future trade arrangements. There are unlikely to be immediate impacts given investment cycles but in the medium term there could be a real impact on automotive activity and the associated supply chain. There are, however, very few quoted UK companies in the automotive sector.

Conclusions

Restructuring activity is generally correlated to economic activity. The market has been slowing over the past three years as the economy has recovered. If the vote for Brexit had not happened then consistent economic growth and low interest rates would have been expected to see activity remain low, except for sectors such as oil and gas. The vote for Brexit does change the dynamic but the impacts are complex and may not be as dramatic, or as immediate, as some commentators originally suggested. □

Brexit practicalities

Chris Laughton provides a calm, rational look at the salient facts for professionals following a historic EU referendum result.

What are the business consequences of Brexit and how should we react to them? This article intends to bring some clarity to a notably uncertain business outlook, rather than to be a political, economic or legal analysis.

One observation on the market reaction to the vote to leave the EU, was:

'The most important thing that we can all do right now is to try to look through the noise.'

– Martin Gilbert, chief executive of Aberdeen Asset Management.

I declare my interests in the Brexit debate: I voted to remain in the EU and was disappointed by the referendum result, but I believe that the opportunities offered by Brexit will best be exploited through pragmatism, optimism and confidence in one's abilities as a business professional.

What do we know?

In a referendum that was not legally binding, but resulted in a political imperative, 37 per cent of the UK electorate voted on 23 June 2016 to leave the EU, 35 per cent voted to remain and 28 per cent did not vote. There have been no changes as yet to any of the laws relating to or affected by the UK's relationship with the EU. Nor will there be any time soon.

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We can expect that as a result of the political and economic uncertainty some businesses will cut back on spending,

For example, the European Insolvency Regulation applies now exactly as it did before the referendum and will continue to do so (in original or recast form – see below) until Brexit actually happens.

For Brexit to happen, the UK has to notify the EU of its intention to leave, pursuant to Article 50 of the Lisbon Treaty.

Departure will then be negotiated and, unless extended with the agreement of all the member states, will automatically take effect two years later.

There have of course been political consequences of the vote – in brief, the UK has a new prime minister, who effected a significant government reshuffle, and the opposition is in some disarray. Economically, while the pound is weaker, the major impact is the significant uncertainty we all face.

And that's it. That's what we know. Anything else is a forecast, an estimate or just supposition.

What can we expect?

Some things about the future are reasonably foreseeable. For example, Brexit will happen.

'Brexit means Brexit.'

– Theresa May, prime minister.

What Brexit really means, however, is not quite so clear, especially if considered in the absence of any partisan Leave or Remain bias. Will Brexit be absolute, with the UK no longer being a member of the EU, going its own way on freedom of movement and free trade? Or will it be 'Brexit-lite', preserving significant features of the relationship concerning capital flows and trading in goods and services, while limiting the movement of people across UK-EU borders? Or will we see the many potential influences on policy combine to change the realpolitik such that there is a non-Brexit? Some outcomes are more likely than others, but there is no certainty.

It is likely, according to recent statements from a variety of EU diplomats and UK politicians, that Brexit will not happen until 2019 at the earliest. That suggests a longer period of uncertainty than some would like: it certainly gives plenty of opportunity for a variety of known and unknown unknowns to affect what is to happen and how.

That the uncertainty currently being felt will continue is a reasonable expectation. So too is it likely that the uncertainty will diminish over time, both as plans become clearer and as uncertainty itself becomes the new normal. At the time of writing there is speculation about whether the Bank of England will reduce interest rates below the 0.5 per cent that has been the norm for several years now.

We can expect that as a result of the political and economic uncertainty some businesses will cut back on spending, investment and/or corporate transactions. Equally, other businesses will look to seize opportunities. The advisers amongst us will need to prepare for those effects on the businesses we advise – and the knock-ons to our own businesses.

In the world of restructuring and insolvency, most of the provisions of the recast European Insolvency Regulation will come into effect automatically in the UK (as in the rest of the EU except Denmark) on 26 June 2017, and each of those member states (including the UK) will have to have a searchable electronic insolvency register in place by 26 June 2018. We probably should not, however, expect the UK to connect its register to those of the rest of the EU by 26 June 2019.

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Would it be right for the UK to legislate unilaterally to recognise EU insolvency office-holders, knowing that UK office-holders

It will not be unreasonable to expect the government to continue its work on domestic corporate insolvency, following the consultation launched before the referendum, which is intended to lead to the implementation of a pre-insolvency moratorium. Although some industry commentators have doubted whether the issue is significant enough to obtain the necessary parliamentary time, the moratorium and other measures attractive to capital markets could well prove too tempting to resist as an encouragement to inward investment.

What would be mere supposition?

As mentioned above, what Brexit actually means cannot yet be forecast. There will likely be a myriad of laws to change – but which ones, and how?

Will most laws change to reflect the status quo at the time of Brexit (which might be thought to be a relatively easy option for



parliamentary draftsmen), with prospective amendments then being made as successive bills pass through parliament over a period of several years? How does that work for laws involving reciprocal treatment between member states? Using the reasonably straightforward example of the European Insolvency Regulation, would it be right for the UK to legislate unilaterally to recognise EU insolvency office-holders, knowing that UK office-holders would not be recognised in most other member states?

Alternatively, will all the European cross-border laws developed over the last 40-odd years be reviewed individually before Brexit, amended to reflect then-current government policy and brought into force upon Brexit? Neither approach is impossible, nor would a mixture of the two be an unreasonable supposition, but whichever route we go will not be trivial.

Consideration of policy changes will also drive supposition. With a whole new set of government ministers there are likely to be many material policy changes, not specifically related to Brexit, that could have a significant impact on businesses. A small collection of examples is the major infrastructure projects currently being reconsidered, such as Hinkley Point, HS2, the Gatwick/Heathrow runway and Crossrail 2. Then there are external geopolitical influences: has anyone worked out the impact on the UK of Donald Trump being in the White House; how will ISIS affect us over the next few years; and what about the global economy? We shouldn't let

Brexit make us think we could in any event be sure about what things will look like in three years' time!

A final thought on supposition and the government's approach to Brexit comes from a former senior British diplomat:

'This is a case where we hang loose, we trust in God, and we keep our powder dry, and we don't take the decision until very near the moment when we take the decision.'

– Sir Christopher Meyer, writer, broadcaster and former British ambassador.

What are the consequences of Brexit?

So much for what we know now, can reasonably expect and might merely suppose, but what should we be doing as a result of the Brexit vote in the short, medium and long term?

Short term

Given the overriding uncertainty that needs to be managed, planning and preparation is central to the immediate response required. As with any event giving rise to uncertainty, one should explore the options, use tools such as 'what if?' scenarios to consider the range of outcomes, weigh

them according to their likelihoods and devise a strategy to fit the results.

One prominent quote in relation to Brexit remarked on the potential:

'We are in uncharted territory and when you are in uncharted territory with effectively a blank sheet of paper in front of you then you have an opportunity to try to think things that might previously have been unthinkable and shape the future.'

– Nicola Sturgeon, first minister of Scotland.

Not everyone will think the unthinkable – or even plan ahead – and one consequence will be more opportunities for restructuring professionals.

Uncertainty may be the key challenge, but one of the few 'knowns' is the depreciation of the pound. Being paid in other currencies for UK-produced goods or services will be beneficial for businesses, while businesses paying in foreign currencies for goods or services used in the UK will suffer by comparison.

Medium term (6–36 months)

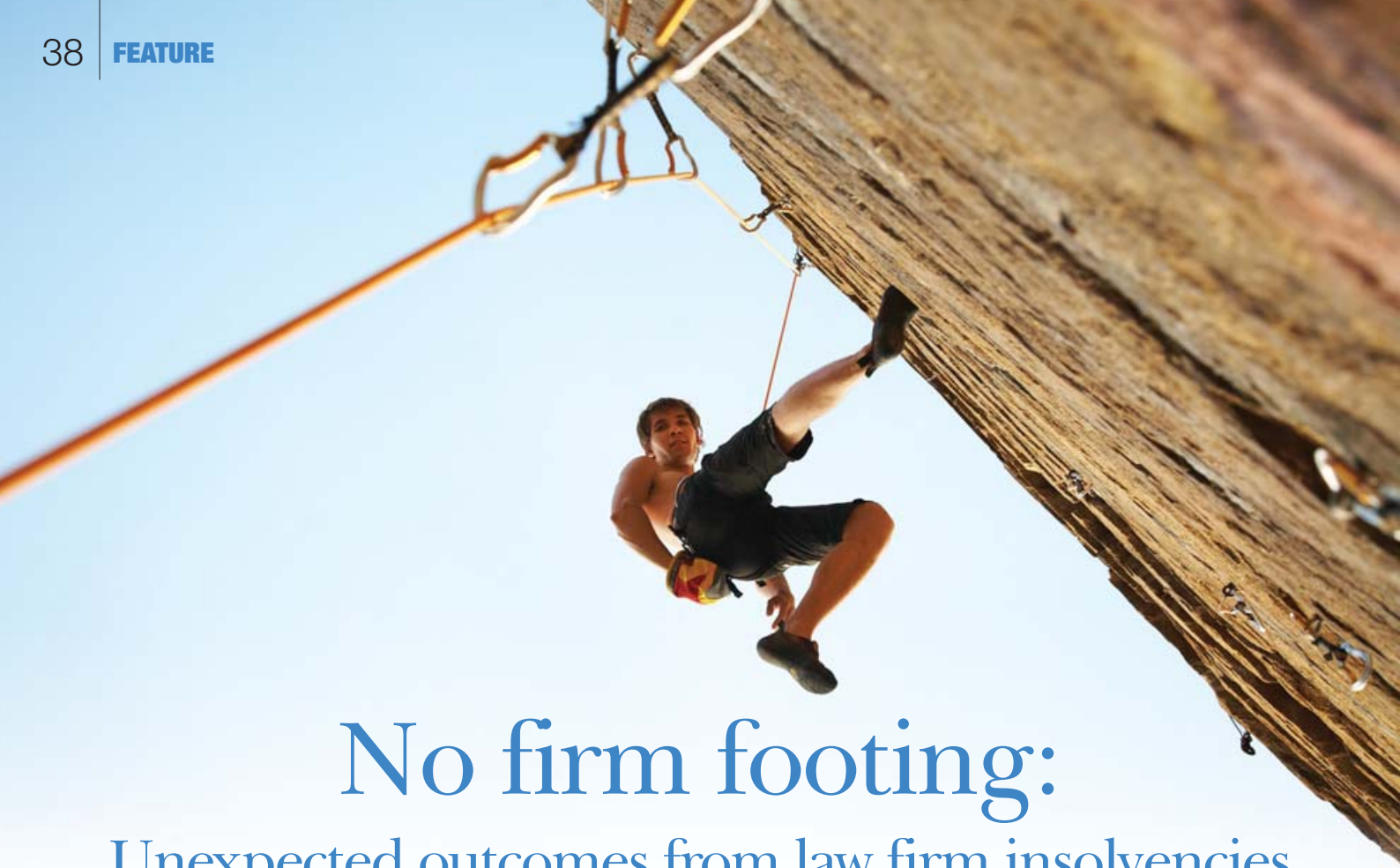
Uncertainty will be the new normal in the medium term, but as it becomes more normal its impact will lessen. Nevertheless, planning and preparing to manage the uncertainty will remain important. Wise business managers will keep their strategies under review, but will not change them unnecessarily. They may include seeking to influence policy as a desirable objective, if they can see a prospect of change that will enhance business performance or value. Supporting R3 in its representation of the restructuring and insolvency profession might be relevant to readers' own businesses. Ultimately the best businesses will prosper and the weakest will need our help.

Long term

How relevant will the Brexit vote have been to the success of businesses in 3–5 years' time? Perhaps the editor should arrange a follow-up article in 2021. ▣



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No firm footing:

Unexpected outcomes from law firm insolvencies

David Johnstone and **Samantha Palmer** examine some of the causes of law firm insolvencies, how a disorderly winding up can end badly and the surprise regulatory effects on IPs.

As UK businesses of all shapes and sizes began to recover from the most recent recession it was inevitable that there would be some casualties in the form of financial difficulty, and law firms are not exempt from the financial struggle.

Increased competition, regulatory changes and increasing, rapid consolidation have seen a large number of law firms placed into an insolvency process. This may be due to lack of forward planning, a lack of realisation on behalf of the partners or management board, or simply because they have buried their heads in the sand, not wanting to admit the reality.

Within the mid-tier, a significant number of law firms are not making the critical changes that could prevent their business from failing. Is it because they think that, as a mid-sized firm, they are neither too small to be concerned with work in one particular area of law drying up nor too big that they face large rent/salary/utilities or tax payments? Or that they think they can trade through their financial downturn? Perhaps they don't know where to turn for support and advice or fear the consequences of seeking such advice. It could be because they cannot face the reality that the business is struggling or it could be that they are putting their reputations before remuneration.

Why do law firms fail?

The Solicitors Regulation Authority (SRA) recently conducted a financial stability programme, which included intensive engagement with firms that were struggling financially, in order to understand the main reasons why law firms were failing and what risks this posed to meeting regulatory objectives.

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If no solicitor manager is appointed, the burden of SRA regulation will fall on the IP regardless of the fact that their practice is not

Following this, a report was produced on the key findings. It found that the main reason for financial instability in law firms was overdrawing by partners who did not appreciate the difference between profit and cash in the bank. However, there were several other factors contributing to law firm failure including:

- Many law firm partners were never trained to manage and market a business.

- Much of the financial management at a firm is left to one or two individuals.
- High borrowing to fund payments due adds to the pressures, with firms often seeking funding from second- and third-tier lenders with high interest payments, which ultimately makes the cash position worse in the long run.
- Continuing to pay monthly drawings to partners based on previous years' profits despite pressures on cash flow.
- Firms controlled by an 'inner circle' of senior management with rank and fixed-share partners not aware of the difficulties.
- Succession planning pressures and funding departing partners' returns on equity.
- Rogue behaviour from partners or staff, linked to poor supervision.
- Financial information not being shared amongst all the partners.
- No reserves for VAT, partner tax and PII.
- VAT receipts used as office account, with consequential second-tier borrowing to fund the VAT.
- A weak or non-assertive financial director without forward cash flow planning.

Market consolidation and regulatory changes are also making it harder for many law firms to stay ahead of the game and run a financially viable business.

In addition to this, the effect of the EU referendum has placed strain on all law

firms, particularly those with clients and business in Europe, meaning that a large proportion of their efforts is now focused on supporting those clients and putting their 'crisis plan' into practice – on the proviso they have such a plan! This ultimately has an effect on new fee-earning work obtained and profit and cash collection for those firms.

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Avoiding a heavily discounted cash sale to a single purchaser by placing the work into the hands of multiple firms can improve recoveries by a significant factor.

The uncertainty of Brexit will undoubtedly have an impact on the consumer, and ultimately law firms of all shapes and sizes, but it will put a particular strain on small- to medium-sized law firms, meaning we are likely to see more law firm failures in the years to come.

Putting a law firm into an insolvency process brings more responsibilities and expertise than any other business and this makes the task more challenging for the IP.

What makes law firms so unique?

Law is a highly regulated profession and putting a law firm through an insolvency process incurs more responsibility, specialist knowledge and expertise than any other business. Few IPs have had this experience, which is why the role of a solicitor manager is ever more important. A solicitor manager is appointed upon administration/liquidation by the administrators/liquidators and it is key that the solicitor manager has the confidence of the SRA and the experience of communicating with the regulators (the Legal Ombudsman, SRA, Financial Conduct Authority) for a number of crucial reasons:

1. A law firm must not be seen to be conducting reserved legal activities following the insolvency process.
2. A law firm cannot be traded post appointment.
3. There is a danger for a solicitor IP where they could be deemed a successor practice if they trade a law firm post appointment.
4. The solicitor manager is appointed by the office-holder and oversees the safe transfer of client funds and files subject to a regulatory framework agreement. Combined with regular regulatory reporting, these protective steps provide reassurance to the regulator that clients' interests are being protected.

5. If no solicitor manager is appointed, the burden of SRA regulation will fall on the IP regardless of the fact that their practice is not regulated by the SRA. Where an IP takes an appointment of a law firm, he/she is also subject to the SRA's regulatory reach.
6. The protection of clients' interests is of paramount importance to the SRA and no consideration is given to the interests of creditors, which is the complete opposite of what an IP would be concerned with.
7. The SRA can intervene in the practice at any stage, pre- or post-appointment. If this were to occur, realisations for creditors would melt like ice-cream. Disciplinary proceedings may ensue for the IP if the SRA is not satisfied with the IP's handling of client protective matters, including for example, client confidentiality, client consent, conflicts of interest, client monies and client files.

If a law firm starts to struggle and is just left to unwind in a disorderly fashion, the situation is likely to result in a regulatory intervention. This has consequences not just for the firm and its people, but also for every other law firm in England and Wales, because ultimately, the cost of one firm's intervention will be picked up by every other regulated entity by way of Compensation Fund payments on the annual renewal of solicitors' practising certificates. Intervention costs are substantial; if Cobbetts (a Manchester firm that was sold as a pre-pack in 2013) had been intervened, the anticipated intervention costs would have amounted to £6m. Challinors (a Midlands firm, dispersed in 2013) was costed out at £4m.

The solicitor manager's role is to ensure the safe transfer of client files and monies and to regularly communicate with the SRA as to the progress of the managed wind down of the law firm. Ensuring regular communication with the SRA can help to ease the regulators' concerns and effect a smooth, orderly wind down of the business, which ultimately assists with recoveries for the creditors.

What does the future hold?

For all of the above reasons we can expect to see more law firm failures in the coming months as the consolidation of the sector continues.

Traditional methodology will give way to a more joined up approach and, as experience has shown, a better outcome for both the clients of the departing firm and the creditors should be achieved.

Recognition on the part of the IP to utilise the services of an appropriate solicitor manager will dramatically reduce the likelihood of negligence within the management of the insolvency process, and experience is showing that recoveries can be dramatically improved by embracing alternative methodology in relation to asset realisation.

Nowhere has this been more clearly demonstrated than where failing firms have an exposure to claimant personal injury clients. Avoiding a heavily discounted cash sale to a single purchaser by placing the work into the hands of multiple firms can improve recoveries by a significant factor. This also has the added benefit of ensuring that individual cases are placed with firms that have the right skill sets in place to act for the clients without significant change management.

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If a law firm starts to struggle and/or is just left to unwind in a disorderly fashion, the situation is likely to result in

In a similar manner, as when assets are placed with auctioneers or specialist vendors, the management of an outsourced run off to realise the full WIP value can be policed and administered on behalf of the IP by specialised accountancy service providers, alleviating the additional and specialised resources required.

The area of liquidating distressed law firms will no doubt continue to develop, it is, however, refreshing that the last three years have seen sector-specific knowledge and innovation materialise to the point where if approached the IP now has the ability to call upon external assistance and advice. ■



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Since November 2015, connected parties purchasing a business or its assets through a pre-pack administration have had the option to approach the Pre-Pack Pool for a review of their proposed transaction. Whether or not the Pool has been approached must now be included in SIP 16 reports.

The introduction of the Pool was part of a wider package of pre-pack reforms – including new powers for the government to ban all connected party sales out of administrations if the reforms are not seen to be working.

Below, a solicitor and insolvency practitioner tell *RECOVERY* about their experiences of using the Pool, the lessons they've learned and how they think the Pool has made a difference.

Q What difference do you think the Pre-pack Pool is having on the trust and transparency of the UK insolvency regime?

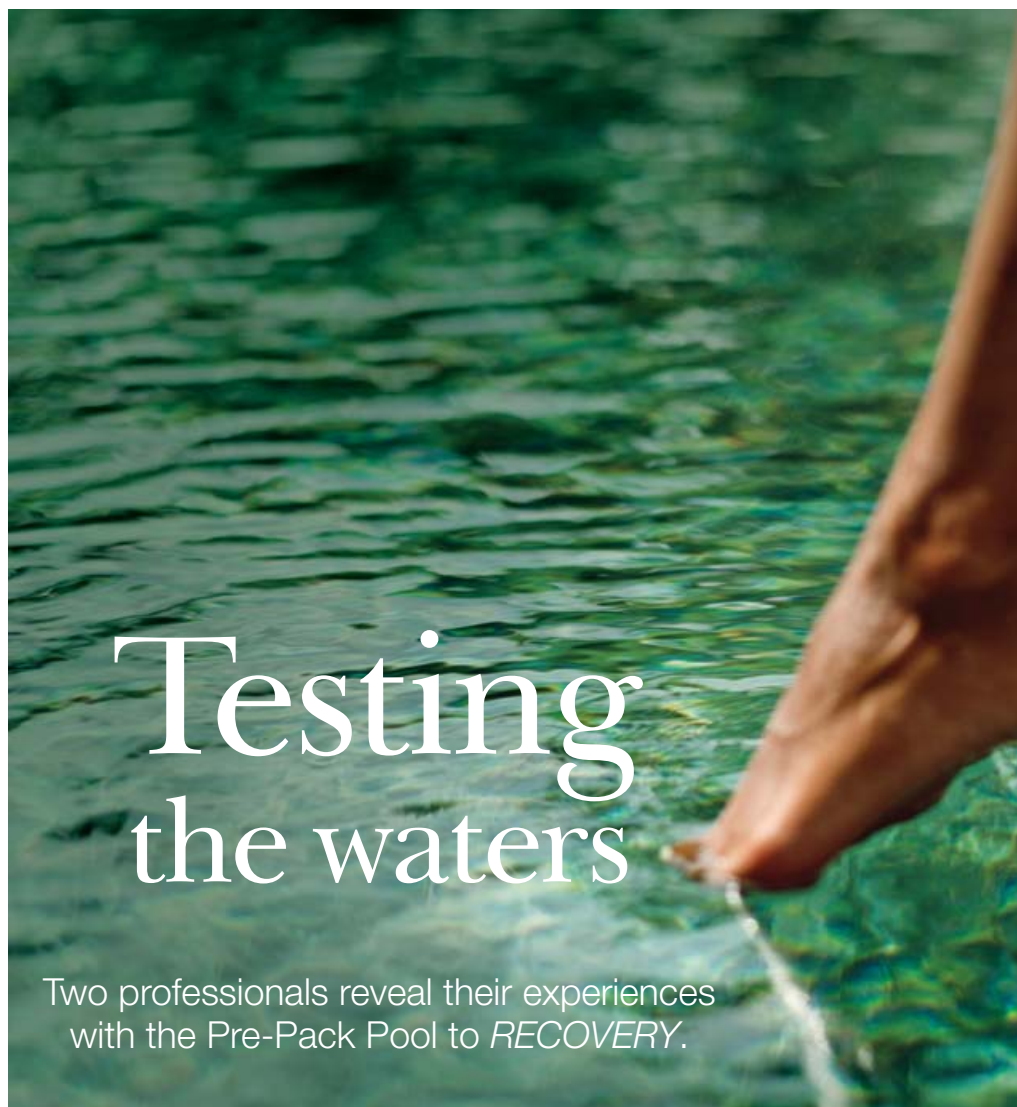
James Hillman, solicitor, Irwin Mitchell LLP: There is no doubt that public scepticism towards pre-packs will always be present to a certain extent, particularly from creditors, but the use of the Pool will provide them with comfort that the pre-pack process has been conducted fairly. A positive opinion from the Pool provides a clear indication from an independent and experienced third party that the proposed transfer to a connected party is not unreasonable.

James Snowden, director, corporate recovery and insolvency, CBW: From my experience of the Pre-pack Pool, relating to an appointment, and subsequent sale, to a connected party in December 2015, I got the impression from a pretty lively creditors meeting that the fact the connected party's bid had been reviewed by the Pre-pack Pool provided a degree of confidence and therefore trust in the regime generally. In this specific case, there

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The use of the Pool will provide the public with comfort that the pre-pack process has been

were a number of potentially connected parties with competing bids who were also creditors and it appeared had attended the creditors meeting primarily to understand why the lead bid had been chosen and why each of their bids had not progressed. Notwithstanding that the short



answer was that none of the other bids in their current format were capable of acceptance for a variety of reasons, and that I had provided extensive disclosure under SIP 16, I still found myself being asked to justify my decision. It is not possible to be 100 per cent conclusive, but it did appear that reference to the Pre-pack Pool had a significant sway in addressing some of the concerns of those creditors who attended. I would suggest this is evidenced by the unanimous support I received in favour of my proposals.

Q What steps did you take to persuade directors to use the Pool?

Hillman: As a solicitor, a large part of my role entails minimising risk and cost for my clients. Seeking an opinion from the Pool may not always be appropriate, particularly where there has been significant marketing of the business or if the connected party simply does not have the funds to obtain an opinion from the Pool. However, for the majority of transactions, it minimises the risk that third parties will criticise or seek to challenge the transfer. The fact that

administrators need to specify whether an opinion has been sought from the Pool in their SIP 16 statements also means that the other party to the transaction is keen for the Pool to be consulted.

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Seeking an opinion from the Pool may not always be appropriate, particularly where there has been significant marketing of the business or if the connected party simply does not have the funds to obtain an

Snowdon: I had an initial conversation with them and explained both what the objectives of the Pool were generally and how it may give confidence in the sale to them as a connected party. This was then



followed up in writing to the connected party. As the company in administration was part of a wider group and there was extensive tension between a number of the key stakeholders, I got the impression that the connected party was more than happy to pay to have someone externally to look at the transaction.

Q What advice would you give about how to persuade directors to use the Pool?

Hillman: I think it is simply a case of making directors aware that a positive opinion from the Pool is likely to increase stakeholder confidence in the transaction. Simply put, the more confidence stakeholders have in transactions, the lesser the likelihood that those directors will need to deal with challenges post-completion.

Snowdon: I would advise IPs to explain to directors the merits of using the Pool and also explain that, should they decide not to, the disclosure that would have to be made would potentially not reflect well on the newco and may not be at all well

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Inevitably, where parties are conscious that the proposed transaction must be reviewed by an independent third party, there will be a greater focus on

received by the creditors who may be key suppliers to the newco. There is an important wider picture in play in terms of general public perception and government accepting that the pool is being suitably promoted by IPs generally.

Q Do you feel the Pool has led to more successful outcomes for creditors and directors than would have been achieved otherwise?

Hillman: Inevitably, where parties are conscious that the proposed transaction must be reviewed by an independent third party, there will be a greater focus on ensuring that a fair transaction is achieved.

Snowdon: From my initial experience I would suggest the main benefit was in managing the expectations of the creditor base, particularly those whom also may have been interested parties.

Q Would you say the outcome of using the Pool has been the same or better than if it hadn't been used?

Hillman: While use of the Pool may not be appropriate for all transactions, my view is that generally its use provides a better outcome for stakeholders and the insolvency profession as a whole than not using it. The profession has been hit by some difficult reforms in recent years and public perception of the profession has sadly worsened. Anything that improves that perception can only be to the benefit of those working within it.

Snowdon: I expect that over time the cumulative effect of the Pool may lead to marginally higher recoveries on certain cases where the directors may consider increasing the value they offer based upon the knowledge that it may be scrutinised by the Pool. I also think the alternative to a voluntary Pool may increase costs considerably or frustrate what may be the only 'going concern' offer available, which could significantly reduce the level of realisations and perhaps affect a secured lender's appetite to risk in the first place. ■



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BHS (or Brexit hits schemes)

Kevin Murphy and **Sarah Brown** look at the economic torpedoes fired at pension schemes over the last few months.

Over the last few months, many of us have been riveted by the joint select committee investigations in connection with the collapse of BHS. The proceedings have caused more than a ripple in the defined benefit pensions world, and have provided a fascinating insight into the difficult decisions and judgements that pension trustees are required to make, particularly where there is concern as to the financial strength of the employer and doubt as to whether obligations to the scheme will be met.

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Once it became clear that the result of the referendum was in favour of leaving the EU, markets reacted swiftly – with an immediate drop in UK equity values, a reduction in the value of the pound and a fall in the

The committee's report, published on 25 July 2016, contains pointed criticism of certain parties involved. It also contains observations regarding the funding of the BHS pension schemes including:

- The 23-year recovery period was 'extraordinary'.
- Trustee demands for increased contributions were initially resisted on the grounds that investing in the business would be more lucrative and then, when BHS's struggles intensified, on the grounds they could not be afforded.

- The company repeatedly rejected demands for the pension schemes to take security over company assets.

Divisive dividends

It now seems certain that MPs will extend their review to consider the entire system of regulation of defined benefit schemes. It remains to be seen whether the justified anger over the lost jobs and lost pension benefits in BHS will lead to an upheaval in the pensions regime, and in particular whether there will be demands for a more adversarial relationship between pension trustees and employers, or demands for trustees to strive for shorter recovery plans for the elimination of deficits.

The thorny issue of dividends is an area likely to be under scrutiny, and in particular the extent to which dividends should be declared where there is a pension liability. A recent article in the *FT* highlighted that FTSE 350 companies are paying dividends ten times higher than they have spent fixing their pension deficits. While this is by itself a meaningless statistic, the media interest may well have an effect on the attitudes of legislators.

We have seen calls for some form of matching between dividends and pension contributions, or a mechanism to claw back dividends if an employer becomes insolvent during a set period after the payment of the dividend. Another possibility is a redefining of 'distributable reserves', with the inclusion of higher pension liability than currently included in statutory accounts under FRS 102 (and previously IAS19 / FRS17).

However, the committee emphasises that it has not sought to judge the regulatory framework on the basis of this one 'unusual' case.

Power to TPR

It should also be remembered that there is currently a very different pension regime in operation than in 2004, when the last BHS dividend was paid.

Firstly, the Pensions Act 2004 established the Pensions Regulator (TPR), whose objectives include the protection of members' benefits of occupational pension schemes while also include minimising its adverse impact on the sustainable growth of employers. TPR also makes it clear that the payment of dividends is a normal part of corporate life. The anti-avoidance framework includes substantial 'moral hazard' powers which are available for TPR (ie contribution notices and financial support directions), and although these powers are infrequently used, they do have a deterrence effect.

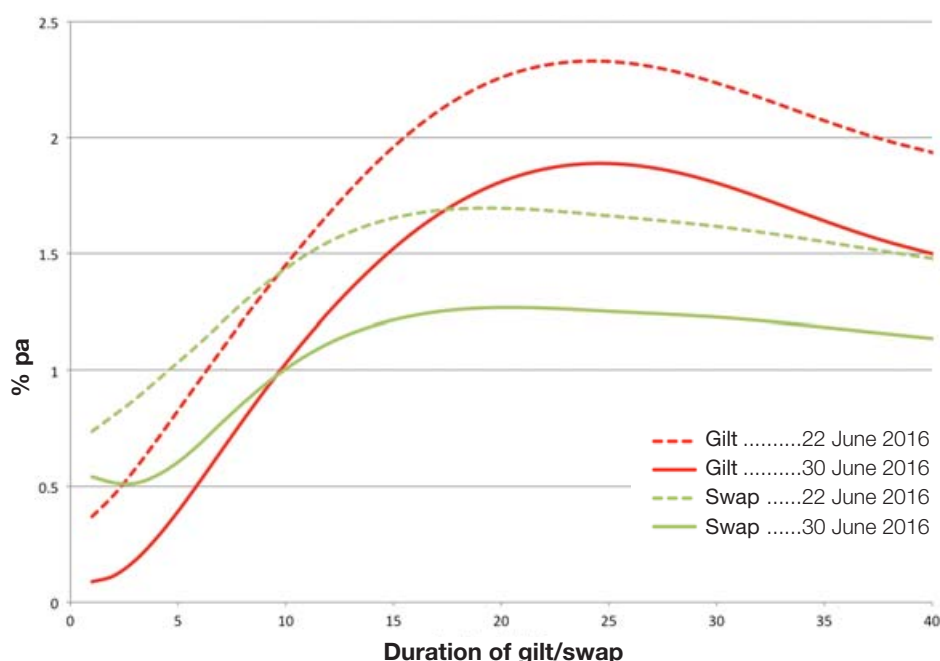
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The thorny issue of dividends is an area likely to be under scrutiny, and in particular the extent to which dividends

However, one possible outcome of the review may be a recommendation that TPR's responsibilities be increased. As the committee observes, TPR will increasingly be called upon to make decisions crucial for thousands of employees and pensioners in a fast-moving and uncertain environment, and it is essential that TPR has the powers, resources, leadership and commercial acumen to act decisively.

Secondly, since 2004, a new profession has emerged, advising pension trustees on the strength of employers' covenants and on the impact of corporate transactions. (For further information, check out the website of the Employer Covenant Working Group at ecwg.co.uk). Covenant advisers are routinely asked by

Changes to curves 22–30 June 2016



trustees to comment on the extent to which dividend payments are affordable and whether they are materially detrimental to the strength of the covenant. Where there are concerns over the level of a dividend, trustees and employers often agree mitigation, such as payment of a special contribution to the scheme.

Furthermore, company directors already have a duty to consider the implications of dividend payments, notwithstanding that there are sufficient distributable reserves. In *Re HCL Environmental Projects (in liquidation)* [2013] EWHC 2876 [893], the court said that: 'the underlying principle is that directors are not free to take action, which puts at real (as opposed to remote) risk the creditors' prospects of being paid, without first having considered their interests rather than those of the company and its shareholders'.

Finally, the safety net created by the establishment of the PPF is perhaps the single most important development since 2004. The PPF is a lifeboat fund set up by the government and funded by an annual levy on all defined benefit pension schemes. Where a sponsor becomes insolvent, then the outcome expected for the majority of schemes is for the scheme to fall into the PPF.

The bigger story

We all know that the uncertainties of business life mean that some employers will fail over time, including companies that are currently seen as having strong covenants and where trustees are doing everything expected of them. The failure of one high-profile company should not necessarily lead to a sea-change in the regime.

However, while the BHS affair has been a big story in the pension world, it has been replaced by an even bigger story

– the likely impact of Brexit.

Once it became clear that the result of the referendum was in favour of leaving the EU, markets reacted swiftly – with an immediate drop in UK equity values, a reduction in the value of the pound and, arguably most importantly for pension schemes, a fall in the yields both on UK government bonds (gilts) and interest rate swaps. Chart 1 shows the shift between the day of the referendum and the end of June in the yields applying over different time periods.

Many pension schemes use these yields as a starting point for the calculation of their liabilities, so these falls will translate to an increase in liabilities for many schemes. The effect on the scheme's deficit will depend on the investment strategy adopted by the scheme's trustees, in particular on whether they hold gilts or instruments such as swaps, which will have moved in the same direction as the liabilities.

Where deficits have increased, trustees may be seeking additional contributions from the scheme's sponsor, especially where they have concerns that Brexit may threaten the future health of the sponsor. Where the scheme is currently undertaking a triennial valuation, this may form part of the

negotiations. If this is not the case, trustees may alternatively call an early valuation or could simply negotiate additional payments from the sponsor without initiating this formal process.

There will be a balancing act between obtaining additional funds for the scheme to increase the security of benefits and the sponsor's need to use those funds to help it survive any periods of uncertainty arising from Brexit. This is particularly relevant where there are concerns over the strength of the sponsor and in such situations trustees are likely to seek more information from the sponsor about why the funds are better used within the business, and to request regular information to monitor the situation.

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Covenant advisers are routinely asked by trustees to comment on the extent to which dividend payments are affordable and whether they are materially

However, it is not all bad news for pension schemes. Some schemes will actually have seen an improvement in their funding and many sponsors remain strong. Those schemes may still be focusing on their longer term plans and considering how to reach full funding on an alternative measure such as the cost of securing benefits with an insurance company. Even where buy-out is not affordable in the short term, sponsors and trustees who view this as their ultimate target should be planning ahead so they are ready to transact quickly if conditions improve, or when the scheme has naturally reduced in size due to the passage of time.

Ultimately, the best way to ensure that benefits are paid in full is for the sponsor to continue to support the scheme over the long term. However, it is clearly far too early to ascertain the extent of the long-term impact of Brexit on UK plc. ■



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Overhauling insurance

Jon Yorke and Sam Tacey investigate the impact of the Insurance Act 2015 on insolvency.



Much of the focus of legal commentators on the Insurance Act 2015 (the Insurance Act) has been, understandably, on the major changes that it heralds in relation to the application of certain insurance law principles enshrined in the venerable Marine Insurance Act 1906. But the Insurance Act, together with a recent statutory instrument¹, will also finally bring into force the Third Parties (Rights Against Insurers) Act 2010 (the 2010 Act), which modernises and overhauls another act of parliament that was also, perhaps, rather past its sell-by date, namely the Third Parties (Rights Against Insurers) Act 1930 (the 1930 Act).

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Clearly, the coming into force of the 2010 Act will be of great assistance to third parties seeking to take advantage of liability insurance policies in an

This article seeks to investigate the changes that the Act will make to the current law and to consider the implications of those changes from an insolvency perspective.

History

The 1930 Act was, in its time, a groundbreaking piece of legislation. It was created in order to address the perceived injustice

to individuals who, having been injured by a company (or an individual), which subsequently became insolvent, would find that they had only a claim in the insolvent estate, of perhaps a few pence in the pound. Meanwhile, the proceeds of liability insurance purchased to cover such claims would swell the estate to the full value of the claim for the benefit of all creditors, rather than reaching the injured individuals whom the policy was, ultimately, designed to protect.

In response to this, the 1930 Act was introduced. In very general terms, the rationale behind the statute was to permit individual claimants to gain direct access to liability insurance that would cover their claim. This was facilitated by a statutory assignment of the rights to claim on an insurance policy from the insured to the affected third party, upon the insolvency of the insured.

Change required: the 2010 Act

While the 1930 Act had noble aims, and has, in the main, provided a useful method for individuals to gain access to insurance proceeds in insolvency situations, it had, by 2010 (if not before) begun to show its age.

A number of issues have arisen in relation to the operation of the 1930 Act over time, which have, taken together, tended to make the process of claiming under the provisions of the 1930 Act unnecessarily complex and convoluted.

Perhaps the most obvious example of this is the requirement under the 1930 Act (and subsequent case law interpreting it) that the third party is required to establish the insured's liability prior to commencing proceedings against the insurer. Clearly, this requirement tended to make the process of bringing claims against insurers more burdensome for third parties and resulted in particular issues where the

insolvent insured had been dissolved (in such circumstances, a further administrative step – an application to restore the insolvent company to the register of companies – was also required).

This deficiency was not the only one; other issues also caused substantial difficulties over time. For example, although the 1930 Act provides that certain information in relation to the relevant insurance policy can be provided to the third party by the insured², it was the position until fairly recently³ that such information was only available once the liability of the insolvent insured had been established, leading to the situation where third parties were often forced into litigation against an insolvent insured not knowing whether any valid insurance was in existence. Furthermore, information

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The rationale behind the 1930 statute was to permit individual claimants to gain direct access to liability insurance

relating to the insurance policy could only be sought from the insurer itself once the third party had, from the information provided by the insured, ‘reasonable ground for supposing that there have or may have been transferred to him under this Act rights against any particular insurer’⁴.

As a result of these (and other) problems, a Law Commission report was published in 2001, recommending reforms

to address the deficiencies of the 1930 Act. After various delays, the 2010 Act was drafted and passed. After still further delays, the Insurance Act made certain minor amendments to the 2010 Act, paving the way for the act, at long last, to be brought into force this year.

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While the 1930 Act had noble aims, by 2010 (if not before) it had begun to

The broad scheme and purpose of the 2010 Act remains the same as the 1930 Act. However, a number of significant changes will occur when the 2010 Act comes into force on 1 August 2016:

- Proceedings against insurers. The 2010 Act will allow a third party with a claim against an insolvent company to proceed directly against the insolvent company's insurer, without having to first proceed against the insolvent company. It will still be necessary to establish liability against the insolvent company, although this can be achieved by seeking a declaration of liability in the action against the insurer⁵.
- Rights to information. The 2010 Act clarifies and extends a third party's rights to information concerning the insurance policy⁶. The 2010 Act allows a third party to request information in relation to the relevant insurance policy from the insured, provided that the third party reasonably believes that the insured has incurred a liability to it. Information may also be sought from other parties that may have access to relevant information (such as brokers, insolvency practitioners or the insurer itself) if the third party reasonably believes that a liability has been incurred, that a potentially responsive insurance policy exists, that the rights under that policy have been transferred to it and that the person from whom information is sought is able to produce such information. The information that can be sought under the new provisions is extensive, and includes information concerning: the existence of the insurance policy; the identity of the insurer; the terms of the policy; and the extent to which any limit on the fund available to meet the third party's claim might have been exhausted. Once a notice seeking information is received by the relevant individual or company, the recipient must respond, either with the relevant information or an explanation of why such information cannot be provided,

within 28 days. If the recipient of a notice fails to respond within the time limit, the third party may seek a court order requiring a response.

- Defences available to the insurer. Although the 2010 Act retains the general position of the 1930 Act that claims brought by third parties are subject to the same defences as they would have been had they been brought by the insured, certain changes have been introduced in order to limit the effect of 'technical' defences that were thought to operate unfairly against third parties. So, for example, anything done by the third party, which, if done by the insured, would have fulfilled a particular requirement under the insurance, will be treated as though done by the insured⁷ (this will prevent insurers relying on notice clauses that require notice to be given personally by the insured within certain periods of time, provided the third party gives the relevant notice). In a similar vein, insurers will not be able to rely on clauses that require the insured to provide information or assistance in circumstances where the insured is a dissolved company or an individual who has died⁸. It is interesting to note that the insurer can still require information or assistance while a company is subject to a form of insolvency procedure. Whether an insolvency practitioner is willing or able to provide such information or assistance will depend on the circumstances in each case.

Closing comments

Clearly, the coming into force of the 2010 Act will be of great assistance to third parties seeking to take advantage of liability insurance policies in an insolvency situation, but what about the implications for insolvency practitioners?

On the one hand, the fact that third parties can now bring claims directly against insurers where relevant insurance exists, rather than bringing a claim against the insolvent insured, will tend to benefit those tasked with administering insolvent estates, as the administrative and financial burden of defending those claims will now fall squarely with insurance companies, rather than administrators or liquidators. However, by the same token, to the extent that such claims might previously have been handled by administrators or liquidators (rather than by insurers

exercising rights to have conduct of litigation) a certain degree of control over the claims being made on the estate may be lost. This will be of particular relevance if the insurance policies in question have high deductibles, such that some liability in respect of the third party claims may remain with the insolvent insured.

A further issue may arise in relation to the new requirements concerning the provision of information to third parties, and in particular to the requirement that a response must be provided with 28 days. Clearly, insolvency practitioners, particularly those who have been recently appointed, may find that they face considerable difficulties in responding to

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The 2010 Act will allow a third party with a claim against an insolvent company to proceed directly against the insolvent company's insurer,

requests for information concerning the insurance arrangements of insolvent companies in such a short time frame, and may find themselves heavily reliant upon brokers, and to some extent the insurers themselves, to assist them in locating the relevant information. This issue is particularly relevant where the claims that give rise to the information requests relate to historical liabilities (such as industrial disease claims), which might involve insurance policies that are many decades old. ■

¹ The Third Parties (Rights against Insurers) Act 2010 (Commencement) Order 2016 dated 28 April 2016

² Section 2(1), 1930 Act

³ The position changed in 2004 with the decision in *OT Computers* (in Administration) [2004] Lloyd's Rep IR 437

⁴ Section 2(2), 1930 Act

⁵ Section 2, 2010 Act

⁶ Section 11 and Schedule 1, 2010 Act

⁷ Section 9(2), 2010 Act

⁸ Section 9(3), 2010 Act



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A Green future for defined benefit schemes?

Maria Riccio writes about the fallout on pensions from BHS and the select committees.

The BHS saga has gripped the pensions industry for months and we now have some answers. The collapse was created by Sir Philip Green, according to a scathing report produced by the Work and Pensions and the Business Innovation and Skills Select Committees (the committees). The committees have wasted no time after having waded through thousands of pages of written evidence and hours of oral evidence, some of which was absolutely farcical. The press and news channels have had a field day and I am quite sure the Hollywood scriptwriters are already penning what could be a money spinning trilogy, allowing even more people to make millions out of BHS!

The report points the finger squarely at Sir Philip Green as the man who sold BHS to Dominic Chappell for £1, driving the deal to remove the BHS millstone around the neck of his reputation. He knew Chappell was a wholly unsuitable purchaser but overlooked or 'made good' Chappell's shortcomings.

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While many schemes saw a significant worsening of deficits following the 2008 financial crisis, it appears that the BHS schemes weakened more markedly than their

While I have been intrigued by the entire episode and the various stands that led to the end of BHS, it is the pension issue that is my focus; the role of the Pensions Regulator (TPR) and to a lesser extent the Pensions Protection Fund (PPF), and what might be around the corner in terms of ensuring that this cannot happen again.

BHS pre-sale

When Sir Philip purchased BHS in 2000, the pension schemes had a combined surplus of £43m. At the 2006 valuation

there was a £7m deficit, which then increased at each further valuation until it stood at £345m at the 2012 valuation. It is now over £570m.

Contributions paid into the schemes were not enough to maintain their sustainability. Although the trustees had persistently sought additional contributions and security over assets, their demands were constantly rejected. While many schemes saw a significant worsening of deficits following the 2008 financial crisis, it appears that the BHS schemes weakened more markedly than their comparators. At both the 2009 and 2012 valuations, the company took a fixed pensions budget position without any apparent regard to sustainability. It all appears to have come to a head at the 2012 valuation, when a 23-year recovery plan was agreed but the payments barely covered interest. As it was an exceptionally long recovery plan, TPR opened a valuation investigation.

Pension restructuring

Project Thor was the Arcadia plan to allow a solvent restructuring of the BHS business. It included three strands:

- writing off intra-group BHS debt;
- negotiating with the landlords and suppliers; and
- restructuring the pension schemes.

The trustees of the schemes were told that unless Project Thor were implemented, BHS would become insolvent and the schemes would go into the PPF. In broad terms the proposal was that members with benefits having capital values of up to £18,000 could receive a lump sum. Those not taking that option, or having bigger capital values, would be transferred to a new scheme. The new scheme would provide benefits above PPF compensation levels but substantially below the accrued entitlements under the existing schemes. The assets of the existing schemes would be transferred to the new scheme together with an additional one-off contribution of £54m.

The respective advisers could not reach agreement on the 'estimated outcome statement' which would show whether the proposed arrangements would in fact exceed the PPF compensation levels. Other concerns raised by the trustees were the unusualness of the proposition and that it would attract TPR interest; that they were

not certain if the 'burning platform' of inevitable BHS insolvency had actually been established and the data given was not helpful as it did not distinguish between BHS and Arcadia. Although the trustees had these concerns, they did broadly concur that a restructuring along the proposed lines was desirable.

TPR was notified and given a Project Thor storybook. A draft clearance application then followed and this included a request for a regulated apportionment arrangement (RAA), which was necessary to

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Sir Philip, Arcadia and RAL's position was to place the blame on TPR for the failure of Project Thor (and the later version called Project Vera) and on the relevant pensions

implement Project Thor. When TPR reviewed the storybook it began to express concerns about moral hazard and told the trustees that additional information was needed, which included data on dividends, intra-group payments and the use of BHS as collateral, all as far back as the acquisition in 2000. It was after this that Arcadia withdrew the clearance application. Although a number of excuses were given, MPs say that Project Thor was paused because of TPR's intervention and this demonstrated Sir Philip's unwillingness to secure the pension schemes in the future.

The sale

Although Project Thor needed TPR sign off, the sale of BHS to Dominic Chappell's Retail Acquisitions (RAL) and the subsequent switch of direct sponsor responsibility did not. The sale was materially detrimental to the pension schemes and RAL had been given an informal assurance of security, which proved illusory as BHS collapsed. The schemes had not been the focal point during the due diligence phase of the sale transaction. Indeed even in RAL's board minutes



approving the purchase, it is noted that a direct approach to the trustees without the seller's agreement risked 'derailing the deal'. Based on the limited high-level information provided to RAL, its advisers said that unless a Thor-type arrangement could be agreed, there was a 'threat to the viability of the business'. RAL was also warned that such a deal could be rejected by the trustees, TPR or the PPF. In addition, the trustees highlighted to Arcadia that TPR's interest would be heightened by a sale. The trustees were right and TPR wrote to Arcadia on 3 March 2015 (eight days before the sale) requesting an urgent meeting, which took place the next day. As a follow up, Sir Philip was then informed that the meeting would be the start of a 'more intense period of engagement between TPR and his company'.

The report recognises that occupational pension schemes are perhaps the greatest challenge facing longstanding British

In the MPs' opinion, Sir Philip acted to conceal the true state of the pension schemes from RAL and its advisers and encouraged RAL to believe that a pension solution through a restructuring was more imminent and achievable than was actually the case.

Role of TPR

Sir Philip, Arcadia and RAL's position was to place the blame on TPR for the failure of Project Thor (and the later version called Project Vera) and on the relevant pensions regulations. Lesley Titcomb, chief executive of TPR, upon criticism of the regulations, told the committees that TPR

did not accept that the regulatory framework was responsible for the non-agreement of Project Thor, but rather that not enough information was provided to TPR to properly assess and judge if the criteria for an RAA had been met. The committee's report agreed with Titcomb saying 'TPR, which has the primary purposes of defending the rights of current and future pensioners, is not placed to barter or accept informal assurances. Plans without numbers are quite reasonably deemed insufficient'.

Pension regulation

The report recognises that occupational pension schemes are perhaps the greatest challenge facing longstanding British businesses. In an environment of rising longevity, interest rates close to zero and intense international competition, defined benefit pension liabilities accumulated in a different age can appear burdensome and unaffordable. The committees made the point that it should not be forgotten that these liabilities are promises of deferred pay to employees. However, they say that it is imperative that the regulatory framework does not allow sponsor companies to evade those responsibilities and in doing so pass the burden onto other schemes that pay the PPF levy. They say that there may be a case of stronger more proactive regulation but is it equally important that balance is found to enable otherwise viable companies to continue to operate. There is also the recognition that jobs of those currently in employment are inevitably in some competition with the pension entitlements of their forebears.

The Work and Pensions Committee's (WPC's) ongoing inquiry commences in September, looking at the sustainability of defined benefit schemes. This will include reviewing the TPR, the PPF and the legal framework and to take evidence of the kind of flexibility needed so that schemes can survive. The Business Skills and Innovation Committee will look separately at the corporate failure points eg due diligence and governance.

Some of the possible results are:

- More robust anti-avoidance powers given to TPR, which are proactive rather than reactive. This might then mean a tightening up of the requirements in corporate transactions, with the possibility that clearance might be made compulsory in certain situations and additional intervention trigger points.
- Mandatory purchaser access to the pension scheme trustees on a confidential basis.

“

The Work and Pensions Committee's (WPC's) ongoing inquiry commences in

September, looking at the sustainability of defined benefit schemes. This will include reviewing the TPR, the PPF and the legal framework and to take evidence of the

- A part merger of TPR and PPF to create a joint unit working together in a BHS or similar type of distressed situation instead of the current regime where they cut across each other and often disagree on fundamental issues.
- TPR given statutory powers to demand and be supplied with information with hefty penalties for non-compliance.
- TPR given statutory powers to agree recovery plans that exceed a specified length, being a departure from the current position where TPR can only open an investigation after the event.
- A review of how PPF levies are made up to deal with the concern that smaller employers with defined benefit pensions are bearing a heavier load.

Sadly we thought all the bases were covered after Maxwell. Here is an opportunity to look at defined benefit pension provisions with fresh eyes and in a new Brexit world – we must have confidence in the WPC. ■



MARIA RICCIO is a partner in the pensions team at Penningtons Manches LLP.

THE MOVING MARKETS

Mark Beaumont looks at the nature of funding and acquisition in relation to non-performing loans and reflects on litigation funding and ATE insurance.

You might wonder why an investor would get involved in non-performing loans and secondary debt, or anything that has such a high risk of defaulting, but the simple answer is that 'the greater the risk, the greater the potential rewards'. Distressed debt sells at a very low percentage of par value, and if the once-distressed company emerges from bankruptcy as a viable firm, then the once-distressed debt will sell at a sizeable profit. Equally, if a portfolio of NPLs can be picked up for pennies in the pound then there is the potential to work the book and turn a tidy profit: large potential returns attract investors such as hedge funds who can afford to build a large portfolio and so reduce their risk of investment failure.

“

Existing players are modifying their business models to adapt to the changes in regulations, and new entrants are seeking to carve a niche for themselves

The huge secondary debt market is likely to become more and more important to the insolvency sector because of the regulatory changes that came into force from 1 October 2015, which give far greater power to liquidators and administrators to assign causes of action. The ability to 'sell' claims and the appetite of hedge funds and others to acquire them will make for interesting viewing.

Lower value claims

Now consider the more recent April 2016 changes, which end the *inter parties* recoverability of conditional fee agreement (CFA) success fees and after-the-event (ATE) insurance premiums. Most practitioners agree that on large-scale litigation the changes will have little impact – the general view being that most cases settle 'all-in' and so recoverability has always been more theoretical than actual. However, on cases with a lower value (and certainly those claims under £100,000) the lack of recoverability could have much

greater impact, making many cases uneconomical to run under a traditional CFA & ATE model.

It is these lower value cases that could be looked at in a different way. If picked up for a low price and run aggressively by a well-funded specialist then there is the potential to turn a profit, and pass some of that profit back to the IP, and therefore creditors. By building a large book of lower value claims a funder can minimise the risks of failure – and at the same time develop a reputation for making recoveries. Once the model is recognised then it should be easier to bring errant directors (as an example) to the table and hammer out a quick settlement, without incurring large legal bills.

There are already several active buyers of insolvency-related claims, such as Cavendish IP, Ferguson, Henderson & Jones and Manolete. Annecto Legal has also been approached by several other new entrants recently so we know this market will only grow, both in terms of buyers but also in the way IPs seek to sell certain types of claims.

What you need to know

Key issues for IPs to consider will be the appropriate price for such claims, and how that price should be structured (in terms of upfront fees versus override on successful conclusion of a claim). As the market develops there is now greater competition for claims and the prices are rising, although it's clear that not all IPs are securing the best possible price – often simply approaching one buyer rather than assessing the whole market. One wonders whether this may lead to professional negligence actions against IPs in the future? Let's hope not.

One of the other developments we are seeing is debt recovery practices and litigation teams joining forces with funding and insurance providers to offer comprehensive outsourcing options for lower value claims. These 'hybrid'

businesses are seeking to combine the efficiency of a large-scale debt recovery business, with the intellectual capabilities of specialist insolvency litigators and the economic might (and intimidatory approach!) of deep-pocketed litigation funders. This is a fascinating area that makes tremendous use of the flexibility allowed by alternative business structures (ABS) in the legal profession.

“

By building a large book of lower value claims a funder can minimise the risks of failure – and at the same time develop a reputation

Evolving models

To summarise then, the funding of insolvency litigation either on a non-recourse basis or through acquisition of claims, continues to evolve. Existing players are modifying their business models to adapt to the changes in regulations, and new entrants are seeking to carve a niche for themselves in an increasingly competitive environment.

The final questions should therefore be for the insolvency professionals reading this: what are you doing to adapt (and thrive) in this fast-moving environment? Have you sought to understand the way funders and insurers are seeking to work with you? Or have you simply decided that you are just going to carry on working the same way you always have?

The present climate is one of change and that means opportunities for those willing to change with it. It also means even greater opportunities for those willing to get ahead of the market and do something different. And that's probably a good note to conclude on. □



MARK BEAUMONT is co-founder of Annecto Legal Ltd, an FCA-regulated broker of after-the-event (ATE) legal expenses insurance and non-recourse litigation funding that allows meritorious insolvency claims to be pursued without cost and risk to the IP.

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Official receiver changes announced in Dear IP 72

Simeon Gilchrist addresses the new fees order and policy on the appointment of insolvency practitioners.

On 1 July 2016, The Insolvency Service announced changes to the official receivers' fees regime, resulting in a new suite of fees being introduced from 21 July. Existing fees for all cases have also increased for bankruptcy orders or compulsory winding-up orders made on or after 21 July. The government estimates that the new fees will generate almost £8m per year and this is required to address a funding gap in the finances of The Insolvency Service.

One consequence of these increased fees may be lower returns and increased costs to creditors in lower asset cases. Returns to creditors and costs of insolvency processes are both key measures of the effectiveness of the UK insolvency regime on the world stage. R3 is therefore concerned that the new fees order will undermine our insolvency regime, will make it more difficult for individuals to get out of bankruptcy and will disenfranchise creditors who have no say in the increased fees.

Shortly after the new fees regime was announced, The Insolvency Service also issued Dear IP 72, which, in addition to the new fees order, announced a revision to the official receivers' policy on the appointment of insolvency practitioners as trustees in bankruptcy and liquidators in compulsory liquidation cases. The key change in emphasis that concerns R3 and practitioners is the statement that was previously worded as *'creditors' views must have been sought and adhered to...*, which the updated guidance now cites as *'the wishes of the majority creditor(s) will always be respected where the official receiver is satisfied that the creditor is...making an informed decision'*.

The new guidance also states that *'the official receiver will continue to make a decision as to whether the case is one where the specialist skills of an insolvency practitioner are required'*.

By the time this article hits your desk, the above changes will have been in force for nearly two months and we will have a better idea of the effect of these changes on case numbers being administered by IPs

and those retained and administered by the official receiver, and also on the anticipated returns for creditors. We wanted to take this opportunity, however, to reassure SPG members that R3's work in responding to the changes on behalf of members is ongoing. We are also aware of some discrepancies between the wording of Dear IP 72 and the revised official receiver technical manual guidance on appointment of IPs released following Dear IP 72, which we are also reviewing. We will provide updates to members as soon as possible. □



SIMEON GILCHRIST

is the R3 SPG chairman and a partner at Edwin Coe LLP.

Keep a date in your diary for the 2016 R3 SPG Forum

We're very much looking forward to welcoming SPG delegates to the 2016 R3 SPG Forum, which will be held on Thursday 17 and Friday 18 November at the Chesford Grange Hotel in Warwickshire. Yes, by popular demand, we're back in the Midlands, the 'traditional' home for the Forum!

We think that the programme over the two days is extremely strong, packed with technical and practical updates of particular relevance to practitioners based within smaller firms. As ever, we are looking to surpass the success of previous conferences, making the programme informative and relevant for the SPG community, as well as providing the networking opportunities and 'community feel' that we know delegates value.

Conference programme

As a preview of what you can expect at the conference this year, we thought we'd let you know how the programme is shaping up. Day one will include sessions covering a review of how the IP fees estimate regime is working in practice one year on; an 'update from the bench' with Chief Registrar Baister (we can guarantee that it'll be frank and informative); joint appointments and succession planning; a session looking at the theory and practice of pursuing investigations and claims by office-holders in insolvency proceedings; and a personal insolvency legal update covering the status and legal implications of some important decisions currently being considered by the Court of Appeal.



Day one also wouldn't be complete without the ever-popular update on the UK economy. This year, of course, we have the backdrop of the EU referendum result, presented to us by the Bank of England agent for the West Midlands. We also have an update from The Insolvency Service on policy and official receiver operational matters. Delegates will also benefit from an up-to-date analysis of the current position in relation to collective redundancies and HR1 forms – a session no practitioner can afford to miss.

After a long night (dare we say, all night?) of networking, Day two will continue to deliver on the quality and content of sessions. We'll kick off with an update on the long-awaited Insolvency Rules 2016, explaining some of the key changes and the practical consequences for practitioners, followed by a review of the year in corporate insolvency terms. The day will also include a presentation exploring the tools in an IP's skill set that can be applied to restructuring and advisory options for businesses and will I hope provide some food for thought on the changing role of

IPs and how they can expand their services to embrace the advisory and restructuring model.

We're also really looking forward to welcoming Benjamin Mee from Dartmoor Zoo as our guest speaker on the Friday morning, who will provide an inspirational session on his experiences (good and bad) when he bought Dartmoor Zoo and his work to turn it around into a successful business.

So what are you waiting for?

We hope you'll agree that the programme for this year looks excellent – our thanks go to Charles Turner (mim Solutions), Andrew Turner (Lovewell Blake LLP) and Myles Jacobson (Streets SPW) for helping to pull it together.

The full conference programme, along with the booking form, is available on the R3 website, or alternatively please email the R3 Courses team at Courses@r3.org.uk. We look forward to seeing you there!



EMMA HOBSON

is a director at R3.

R3 events, courses and conferences

	Date	Event	Venue
September	6	Introductory Series, A-Z of Insolvency	Prospero House, London
	8	Construction Sector Insolvency	Renaissance Hotel, Manchester
	8	Property Issues in Insolvencies	Renaissance Hotel, Manchester
	8	R3 in Scotland Annual Dinner	The Grand Hotel, Glasgow
	12	North West Regional Meeting	Manchester, JMW LLP offices
	13	South West & Wales Regional Meeting	Osborne Clarke LLP offices, Bristol
	13	Eastern Golf Day	Ely Golf Club, Ely
	14	North East Regional Meeting	Bond Dickinson offices, Newcastle
	15	Insolvency Conference: Changing Perspectives	Millennium Gloucester Hotel, London
	19	JIEB Student Workshop 1	Linklaters LLP offices, London
	20	JIEB Student Workshop 2	Linklaters LLP offices, London
	20	Introductory Series, A-Z of Insolvency	Prospero House, London
	20	London & South East Regional Meeting	Farrer & Co offices, London
	21	Yorkshire Regional Meeting	Leeds
	21	North West Golf Day	Clitheroe Golf Club, Clitheroe
	22	Thames Valley Summer Ball	Crowne Plaza, Reading
	27	Personal Insolvency	Holiday Inn Regents Park, London
	27	Midlands Golf Day	Edgbaston Golf Club, Birmingham
	28	Renewable Energy Sector Breakfast Briefing	Clyde & Co LLP offices, Manchester
	29	Renewable Energy Sector Breakfast Briefing	Clyde & Co LLP offices, London
October	5	South West & Wales Golf Day	Celtic Manor, Newport
	5	London & South East Panel Event	Pinsent Masons LLP offices, London
	6	East Midlands Annual Dinner	Nottingham Conference Centre
	6	Insolvency Day	Burges Salmon LLP offices, London
	11	Introductory Series, A-Z of Insolvency	Prospero House, London
	11	Midlands Regional Meeting	Colliers International offices, Birmingham
	12	Thames Valley Meeting	Reading
	13	Advanced Tax	Novotel Birmingham City Centre
	13	Southern Regional Meeting	Venue to be announced
	14	London Ladies Lunch	Grosvenor House Hotel, London
November	17	Joint R3 & ICAEW Eastern Regional Meeting	Ravenswood Hall Hotel, Bury St Edmunds
	18	Insolvency Litigation	Cophorne Tara Kensington, London
	25	Southern Region Technical Breakfast	KPMG LLP offices, Eastleigh
	8	Personal Insolvency	Cheltenham Chase Hotel
	8	Introductory Series, A-Z of Insolvency	Prospero House, London
	8	South West & Wales Regional Meeting	Bristol
	10	Advanced Restructuring	Holiday Inn Bloomsbury, London
	10	Midlands Region Quiz Night	Villa Park, Birmingham
	10	Southern Annual Dinner	Southampton, St Mary's Stadium
	10	North West New Professionals Winter Ball	Manchester
	17-18	SPG Forum	Chesford Grange Hotel, Warwick
	22	Construction Sector Insolvency	Cophorne Tara Kensington, London
	22	Property Issues in Insolvencies	Cophorne Tara Kensington, London
	24	Insolvency Day	Burges Salmon LLP offices, London
	29	Insolvency Litigation	Queens, Leeds

● Regional events

● R3 events

For further information on R3 courses and conferences, please visit the R3 website www.r3.org.uk, where you can download the 2016 Autumn–Winter programme.

Alternatively, call the Courses team on 020 7566 4234 to request further details.

Fighting fraudulent funds

Frances Coulson outlines R3's response to the Home Office consultation on anti-money laundering and counter-terrorist finance.

Following the high-profile Anti-Corruption Summit held in London in May of this year, the Home Office launched a consultation on legislative proposals relating to anti-money laundering and counter-terrorist finance.

R3 submitted a response reflecting the key role insolvency practitioners play in tackling fraud and our view on the government's proposals. The profession has extensive powers to investigate and, under civil litigation, pursue those involved in fraudulent activities, which puts us in a unique position to fight financial crime and help the government deliver their policy objectives.

Removing SARs

The consultation sought responses to a range of proposals contained in the government's action plan. The principal legislative change proposed by the paper related to the suspicious activity reports (SARs) regime.

SARs is the end-to-end system by which industry spots suspicious activity related to money laundering or terrorist financing and it is reported to the UK Financial Intelligence Unit of the National Crime Agency (NCA). Reports are then logged, analysed and pertinent information is shared with law enforcement agencies.

The government is considering removing the SARs consent regime, whereby the NCA offers a judgment on the legality of particular behaviour or transactions. R3 believes this would be hugely harmful. The procedure was introduced to trap proceeds of crime, and while we understand that government resources are constrained, that shouldn't impinge on a scheme that has the potential to return considerable sums of money.

The consultation sought views on a change in focus of the SARs regime to *entities* responsible for money laundering and terrorist financing. The current regime is *transaction* focused. R3 believes this proposed shift in emphasis would be detrimental. Our members undertake considerable investigatory work and believe that transactions are of central importance. Transactions produce paper trails that unearth those responsible for committing fraud and, critically, provide evidence that is crucial to securing convictions. Shifting the focus to entities related to this kind of crime would be much more difficult to impose and execute. Our concern is that there is a great risk of losing intelligence and undermining returns to creditors if this change were to occur.

The government is also looking at new powers to allow criminal funds held in UK bank accounts to be forfeited more easily. R3 suggested that in cases where funds are frozen by a bank, and the entity which is the account holder has disappeared or ceased to respond, that a procedure should be in place whereby tainted funds could be seized without having to have the account holder notified if they cannot be traced. However, it would be important to have proper safeguards in place including significant efforts made to engage with the account holders and a potential to claw back funds if they can later show the money is not tainted or they had good reason for not engaging.



We believe better information sharing among the public sector should be the

Tools we already have

Our response mentioned that at present the NCA civil recovery and taxes team can already access tax in criminal funds, and obtain a significant proportion of the funds with penalties and interest. We also signposted the powers, available under the insolvency regime, to seize criminal funds held in bank accounts and the ability, by court order, to take over the financial affairs and property without notice of those conducting fraud.

The insolvency regime has an existing statutory framework for determining claims and returning money to victims. By highlighting the ability of appointed insolvency practitioners to take suspended funds out of bank accounts in cases where the entity has been wound-up, we emphasised the availability of this 'resource-light' means for retrieving money and distributing it to appropriate parties.

The government is also considering powers to require individuals to explain their sources of wealth. This would be a useful tool in tackling money-laundering and terrorist-financing crime. Currently the primary means of investigating an individual's wealth is through the tax regime and this is slow, cumbersome and largely ineffective.

A proposal to provide legislative cover to support better data sharing within the private sector was among the measures up

for discussion. While R3 encourages improved communications among private businesses, we believe better information sharing among the public sector should be the priority. Our members' experiences often point to blockages and obstacles in retrieving relevant information from government departments, which has an impact on the profession's ability to promptly investigate and disrupt criminal financial activities.

Money laundering

Finally, the consultation sought input on additional powers for tackling money laundering. Our response reflected the proposals in R3's fraud landscape report, which includes proposals for boosting the fight against fraud. Among these were simple and practical changes to Companies House, which would deter fraudulent activity by directors and 'shadow' directors. We also believe that government should take steps to reintroduce the courts' powers to impose criminal bankruptcy orders on defendants. This step, combined with extending the powers of the Secretary of State to issue petitions to make individuals bankrupt in the public interest, would provide further means to tackle fraud, disrupt fraudulent activity and increase recoveries for victims.

Financial criminal activity is an increasingly expensive problem for the UK economy. Coupled with the fact that law enforcement agencies' budgets are subjected to mounting pressure and cuts, the fight is all the more difficult. The insolvency profession has wide-ranging powers to assist but these could be more extensively utilised. Furthermore insolvency and civil recovery regimes have quicker more effective purchase internationally.

We look forward to seeing the government's response to the consultation and hope that any changes to legislation are practical and support the profession's work in disrupting financial criminal behaviour. □



FRANCES COULSON
is a partner at Moon
Beever and is chair of
R3's Fraud Group.

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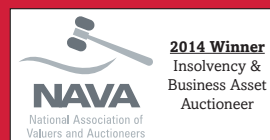
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An interview with...

Andrew Tate

Matt Jukes speaks to **Andrew Tate**, president of R3, who sets out his priorities and challenges for his term as president.

Q You've been president now for a few months. How are you finding it?

A Being the insolvency profession's representative is a big honour and I'm looking forward to making the most of my year in the role. I've already spent the past two years supporting my predecessors, Phillip Sykes and Giles Frampton, getting involved in R3's work on things like IP fees, partial licences and pre-pack reforms, which has been good practice for the year ahead.

The first month for any R3 president is dominated by the annual conference. This year's conference in Budapest was a roaring success and a really encouraging start to my year. The programme we put together was forward thinking and thought provoking, and really tied in with the policy debates that are happening at the moment, including the government's proposals for reforming the UK's corporate insolvency framework.

Q There has been a lot of positive feedback from the conference. What stood out for you on the programme?

A The theme of the conference for me was celebrating the skill set of insolvency and restructuring professionals. One of the highlights was an interesting session undertaken by Andrew Jackson from Funding Circle, John Nelson who's an asset financier with IGF and Sarah Paterson from LSE. They talked about the psychology of the debtor-creditor relationship, how people approach that relationship and the emotions that go with it. I think we can work to understand the psychological impact of what we say and do on those who engage with our profession.

Q You mentioned the skill set of insolvency and restructuring professionals, and we know from your president's column that restructuring is going to be a big focus during your term. Why do you feel that restructuring is so important?

A It's important because it reflects the direction the profession is heading in many areas. We're proud of the insolvency work that we do and we know that it adds value, but for the last few years, the word *insolvency* has generated a negative perception with politicians and with people who have a business that is distressed.

Practitioners at all levels have been looking at ways in which we can empathise more with businesses in distress and give them positive hope, rather than a feeling that they're just heading towards something terminal.

Our members have been developing restructuring tools that allow businesses to have the best possible chance of surviving in a controlled and protected environment, where there's a definite weather-eye on the regulations and insolvency law. Certainly, especially as far as the bigger firms are concerned, a lot of the work has been around informal restructuring; using insolvency procedures as a tool when they need to,

but not seeing insolvency as the be all and end all.

I think there's a great opportunity for R3 to embrace that work, to talk about it more than we have done, to look at how we can actually train people to do that work, and then to represent these people in political forums. In PR terms: to shout about the fact that we do this sort of good work.

There are people out there doing restructuring work that perhaps don't remember that R3 stands for 'rescue, recovery and renewal', and that it's more than the trade body for just insolvency practitioners. We want to embrace those people and make sure they feel we represent them. »

Andrew Tate biography

● Andrew Tate is the current president of R3. He served as chair of the Smaller Practices Group Committee from 2012 and became vice-president in April 2015.

● Andrew entered the world of insolvency when, upon joining the Civil Service, he was given three options: tax inspector, customs officer or join The Insolvency Service. He later went on to take his professional examinations and worked for firms that later became BDO and Deloitte.

● In July 2011 he became partner at Kreston Reeves LLP, and heads up the insolvency and restructuring department.



Q You said big firms are already doing this kind of work, but aren't you a big advocate of the work of smaller practices?

A I was proud to chair the Smaller Practices Group Committee for three years and I very much believe in the value of smaller practices. What I want to encourage is the view that 'one size fits all' doesn't always work for the creditors of small companies that have gone into an insolvency procedure. I do feel that the increased regulation that we have to deal with has a disproportionate impact on creditors of small businesses. As new legislative procedures or changes are made, I would like to see us encouraging the government to make that distinction and take it into account when they're formulating new legislation.

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We've got to look at how the insolvency regime can be best unwound from Europe without 'Brexit' stopping the insolvency and restructuring

When legislation and regulations are being developed, we would like policy-makers to keep in mind whether what's being proposed should be applicable in the same way at all levels, or whether there should be any distinctions relating to the size of the company going through an insolvency procedure.

Q You've been heavily involved in the corporate insolvency framework consultation. What new proposals are there and what more needs to be done?

A There are a few limbs to the corporate insolvency framework consultation, including a business rescue moratorium – similar to one proposed by R3 – and further reforms to essential supplies rules – again, building on earlier work by R3. There are also proposals on rescue finance and introducing a new restructuring tool similar to a scheme of arrangement.

While R3 has been supportive of the government's focus on business rescue, the proposals do need further adjustments. It would be good to see a shorter moratorium, for example, with a clearly defined oversight role for an IP. There are encouraging signs that the government might take some of R3's suggestions on board.

With the other proposals, more work is needed to ensure any changes actually add to our insolvency regime and that safeguards for creditors and suppliers are there. The government should also see what it can improve in the existing regime without introducing new bits and pieces. Improving CVAs and the role the government can play as a creditor to support business rescue are two things that could be looked at.

Alongside the consultation, the government has also made changes to the official receivers' fees and policy on case retention. This wasn't something that the government consulted on, and we're incredibly disappointed at the lack of transparency. We've made our views known to the government and will make sure these changes are properly scrutinised. As well as being a threat to smaller firms, we believe that the changes will mean fewer returns to creditors and the disenfranchisement of creditors at a time when the profession is trying to boost creditor engagement. On the one hand, the government is looking to improve the insolvency regime with its framework consultation; and on the other it comes out with something like these other changes.

Q R3 has previously called on the government to 'cool down' on changes, with new fees provisions and insolvency rules. The profession is obviously a bit 'embattled', but does this mean the changes are bad?

A There have been many changes since the Insolvency Act came along in 1986 and the law has been constantly evolving with new statutory instruments etc. Where it becomes an issue is where the profession sees changes being made that are not fundamentally improving what we are doing. It does seem that some are put through based on marginal issues – I would say partial licenses are a marginal issue because they are emotive or a reaction to media or political interest, which is not necessarily empirical.

Q As well as the consultation, you're the man steering R3 through the direct aftermath of the 'Brexit' vote. What's that like?

A It's a fascinating prospect to see how this is going to evolve. I'm as interested, and I suppose as worried, as anybody else about the consequences for the wider economy. From an R3 perspective, we've got to look at how the insolvency regime can be best unwound from Europe without 'Brexit' stopping the insolvency and restructuring profession from doing its job. A lot will depend on what deal the government secures with the European Union, but it's up to the profession to feed into the government what it wants that deal to look like as part of any negotiation.

Q Carefully stepping away from the undecided, ultra-divisive issues, what would you have done if you hadn't become an insolvency professional?

A I would have been a rockstar. I was quite a keen musician, and at the time I was being encouraged to take that more seriously. When it came to organising the conference in Budapest I was put in charge of picking the music. I spent a couple of hours coming up with my favourite songs. *Kashmir* by Led Zeppelin, covered by P Diddy, was my introductory track.

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The last thing the UK needs at the moment is to have a loss of the skill set of insolvency

'Rockstar' is maybe a bit tongue in cheek. I think in reality I would probably have looked at banking. I suppose it comes back to that debtor-creditor relationship, because I do find that area quite fascinating.

Q To close our interview, as newly inaugurated president of R3, is there a message you'd like to send out to the profession?

A The last thing the UK needs at the moment is to have a loss of the skill set of insolvency practitioners. There are lots of challenges for us, whether that is Brexit or the legislation that we have to cope with or falling insolvency numbers. My message would be that R3 will be fighting to make sure that, as far as we can, the insolvency and restructuring profession is something that people still want to come into and can still provide satisfying careers – and that the profession remains as relevant to the wider business community and economy as ever before. We will do all that we can to make sure it stays that way and that those who do that work are respected. ■



MATT JUKES is publishing manager of *RECOVERY* magazine.



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