A REVIEW OF THE CORPORATE INSOLVENCY FRAMEWORK

ICAEW welcomes the opportunity to comment on the Review of the Corporate Insolvency Framework published by The Insolvency Service on 25 May, a copy of which is available from this link.

This ICAEW response of 6 July 2016 reflects consultation with the ICAEW Insolvency Committee which is a technical committee made up of Insolvency Practitioners working in large, medium and small practices. The Committee represents the views of ICAEW licence holders.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City
icaew.com

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 145,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact: representations@icaew.com

icaew.com

MAJOR POINTS

1. We agree that the UK insolvency regime might benefit from new procedures of the kind outlined in the consultation. However, these would be significant changes and it is important that the detail is considered carefully and more detailed proposals developed and subjected to consultation before any decision is taken to proceed; some of the suggestions included in the proposal would not, in our view, be workable.

2. While giving businesses a breathing space may result in more failing businesses being saved, any reduction in creditor rights may make it more difficult for businesses to obtain finance in the first place and a number of elements of these proposals may alter commercial behaviours in ways that could be difficult to predict. Similarly, it is possible that essential suppliers could be small businesses whose own solvency might depend upon being paid all amounts owed and for whom the burdens of applying to court might be disproportionate. The government will need to assess the relative advantages and disadvantages taking into account comments from the affected sectors, including the banking sector.

3. With regard to the moratorium, further analysis is required as to why the current CVA regime is perceived to have been unsuccessful to avoid the proposed moratorium regime suffering a similar fate. In particular, we believe that the responsibilities (and associated liabilities) for insolvency practitioners deter use of the existing regime. If the moratorium is intended to allow directors greater freedom to continue to operate the business during the moratorium period, then it is important that they are accountable for their actions.

4. There are proposals to give creditors rights to request information at any time during the new moratorium regime and, perhaps, to extend this right to existing insolvency processes. We do not believe that this is a good idea and it is not clear what purpose it is intended to serve. It could add substantially to the costs of the process and distract supervisors from saving the business (or otherwise performing their statutory duties). There may be other implications, for instance regarding confidentiality and inequality of information between creditors (with possible risks related to insider dealing).

5. From the outline contained in the paper, it appears that the skills and experience required of a supervisor for a moratorium will be similar to those required in existing insolvency proceedings. We therefore believe that those performing the role should be similarly qualified and experienced. This means, in practice, that they should be insolvency practitioners. We understand that government wishes to reduce regulatory requirements and believes that costs could be reduced by reducing standards. However, we believe that the price to be paid through risk of mistakes being made by insufficiently expert advisors is too high, particularly in a context where creditor rights are being affected.

6. We understand the desire of the UK government to improve the UK's standing in World Bank statistical rankings and it is sensible to consider whether practices from other countries might usefully be adopted in the UK. However, there are risks in making comparisons on individual issues because the effectiveness of a regime in any jurisdiction needs to be judged as a whole in the context of the underlying policy objectives for that jurisdiction. We believe that government should focus on areas where UK practitioners and businesses believe the UK regime has weaknesses with an eye on practical realities such as costs and potential for abuse, particularly as regards small businesses that are failing.

7. We would like to more information provided on HMRC's role in the existing regime, in particular the degree to which it considers whether a business might be rescued before petitioning for insolvency and its record in participating in restructuring plans.

RESPONSES TO SPECIFIC QUESTIONS

The introduction of a new moratorium to help business rescue

Q1. Do you agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses?

8. A moratorium regime may be useful in certain circumstances but we think that further consideration is required regarding its scope and we hope that, if the proposal is to be taken forward, government will consult again on the basis of more detailed proposals. We have commented below on the specific questions raised but many other questions will need addressing depending upon how the proposals are developed, for instance on the role of the courts (and their ability and willingness to perform the functions attributed to them), the respective responsibilities (and liabilities) of supervisors and directors and the impact of freezing of debts, for instance on employees.

9. Many issues of detail will require further consideration, for instance,

- please see introductory comments, particularly regarding creditor requests for information [paragraph 7.9 of the consultation paper];
- the idea that arrears will be frozen and ongoing costs met [7.11] will be relatively straightforward for many simple businesses, but various scenarios may need to be considered for more complex businesses, such as margin calls for foreign exchange contracts (which can impact companies that would not be excluded from the regime as proposed).

Q2. Does the process of filing at court represent the most efficient means of gaining relief for a business and for creditors to seek to dissolve the moratorium if their interests aren't protected?

10. Yes, but one of the strengths of the UK regime is the balance it draws between court and out of court processes and the role of skilled and regulated insolvency practitioners. This aspect of the proposals requires more development. If supervisors are not to be regulated persons, then greater court supervision may be required to minimise risks of abuse by directors and unfair prejudice of creditors. If supervisors are to be regulated (i.e., in practice, insolvency practitioners), then the role will need to be well defined. The costs of court processes should not be underestimated and, if government is concerned about World Bank rankings, the potential impact of proposals such as this on this element of the rankings should be taken into account.

11. We suggest that more consideration is required as to what should be included in the court filing, including whether the supervisor should already have been appointed and involved. If the process is too easy, there is a risk that directors will simply file because they have nothing to lose (but court fees) in order to delay taking decisions that would otherwise need to be made and to avoid risks of wrongful trading. Directors should remain accountable.

12. Creditors should be able to apply to court at any time during the moratorium, not just during the first 28 days. Circumstances may change during this time and a court could be expected to take into account whether an application should more appropriately have been made earlier in the process and the effect of any delay on restructuring plans. Creditors should be able to apply not only on grounds of unfair prejudice or suspected misfeasance, but also if they have the required majority to block any eventual restructuring plan.[7.25]

Q3. Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?

13. Yes, although if the regime is intended for use by medium sized or large businesses (or would in practice be most useful for these businesses), it might be clearer to limit it to them (and reform the CVA regime if appropriate, for small companies). The criteria that financial difficulty must at least be 'imminent' [7.18] is somewhat at odds with suggestions in the paper that the moratorium

will be flexible and allow businesses to 'explore options and develop a restructuring plan' [7.7] and 'financial difficulty' will need further definition.

Q4. Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

14. Yes, but if, as the paper suggests would be expected, debtors consult secured lenders before the moratorium, it is possible that secured lenders might exercise their rights straight away or seek to influence the process (for instance by insisting on a limited choice of supervisor). Is it intended that secured lenders should not be able to do this?

Q5. Do you agree with the Government's proposals regarding the duration, extension and cessation of a moratorium?

15. We are not convinced that the proposed duration would be suitable for all cases. For small businesses, it seems excessively long as it should be relatively quick and easy to determine whether or not the business is viable and to adopt a restructuring plan (e.g. through a CVA or administration). However, for very large complex businesses (particularly where a scheme of arrangement is contemplated) the period would often be too short.

16. We do not believe that the test for creditor approval of an extension should be 'all' secured creditors. [7.36] Rather we suggest it should be the same majority as required for passing the restructuring plan, otherwise a single secured creditor might be in a position to undermine a restructuring plan that would otherwise proceed. There will also need to be a connected party restriction so that only unconnected parties pass it.

17. We do not agree that the length of the moratorium should be deducted from the period of administration. It would be an unnecessary complication and it seems perverse to reduce the initial administration period when the 12 month period was only introduced by the Enterprise Act 2002. In practice, even the 12 month period can be problematic, not least because of delays within HMRC and applying for extensions adds to work and cost.

Q6. Do you agree with the proposals for the powers of and qualification requirements for a supervisor?

18. We do not agree with the qualification requirements. Please note that accountancy is not a regulated activity as such in the UK. There are various professional accounting bodies, so that it would be necessary for government to designate bodies that it thought appropriate in this context if it were to proceed on this basis (assuming that it would not want unqualified accountants, i.e. not members of professional bodies, to perform the role). We would, however, advise against this. So far as we can see from the current proposals, in practice, the supervisor will need to have the knowledge, skill and experience of an insolvency practitioner, which involves both accounting and relevant legal knowledge and ability, and we can see no reason why supervisors should not be required to be insolvency practitioners. The JIC examination is not restricted to accountants or solicitors and there is a large pool of practitioners and a competitive market. The Solicitors Regulatory Authority has recently ceased authorising insolvency practitioners due to lack of demand and we cannot see on what basis all solicitors as a class would be qualified to provide this function. [7.41]

19. Requiring the supervisor to sanction transactions not in the ordinary course will require careful consideration. It is a potentially onerous role and it might be necessary to absolve the supervisor from any personal liability. This regime is based on the premise that the debtor remains in control and that means that director responsibility for conduct of the business should be preserved. [43]

20. We agree that it is important to be clear on the issue of independence [7.45]. One advantage of requiring that the supervisor should not act as the insolvency practitioner after the moratorium is to avoid any public perception (or misperception) that the ultimate outcome was pre-planned

and the moratorium process was not used as intended. On the other hand the supervisor will be familiar with the business and issues so that it would typically be more cost effective for the supervisor to continue. Creditors, particularly secured creditors, might expect to have a say on this issue. It is for government to reconcile these conflicting drivers, but if it ultimately decides that supervisors should be able to continue in the interests of efficiency, then it should be prepared to justify its position to the public.

21. The above comments on the role of the supervisor are based on our understanding of the proposals and the limited amount of detail contained in them. If it is a priority for government that non-insolvency practitioners should be able to perform the role, then it might be necessary to consider the scope of the role and the possible impact of a moratorium on any following insolvency processes further in that context.

Q7. Do you agree with the proposals for how to treat the costs of the moratorium?

22. Yes

Q8. Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?

23. We do not agree with this proposal – see our introductory comments. Instead, we suggest that there could be a mechanism for standard reporting at fixed stages in the process to all creditors, for instance 7 days after appointment, at the conclusion of the process and to support any requested extension. It should, however, be noted that the preparation of reports and information involves time and cost. [7.47-7.49]

Helping Businesses Keep Trading through the Restructuring Process

Q9. Do you agree with the criteria under consideration for an essential contract? Is there a better way to define essential contracts? Would the continuation of essential supplies result in a higher number of business rescues?

24. We agree that some additional safeguards might be appropriate to prevent suppliers taking unfair advantage of a business that is seeking to restructure, but the proposals in the current form may be too favourable to the debtor and open to abuse by debtor businesses. It is possible that provisions of this kind might influence wider commercial practices in ways not currently anticipated (e.g. with suppliers seeking to avoid the prospect of being essential suppliers). [8] It is not clear how the provisions would be enforced against non-UK suppliers.

Q10. Do you consider that the Court's role in the process and a supplier's ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

25. The proposed court process is weighted in favour of the debtor and we are concerned that the regime as a whole does not sufficiently protect the interest of suppliers, given the costs of making court applications.

26. It is not clear whether the regime would include requirements for personal guarantees by office holders or others and we suggest that any proposals for increasing liability of insolvency practitioners should be the subject of further consultation.

Developing a Flexible Restructuring Plan

Q11. Would a restructuring plan including these provisions work better as a standalone procedure or as an extension of an existing procedure, such as a CVA?

27. We suggest that the plan be introduced as a separate stand-alone plan rather than as an extension of CVAs, although we think further analysis should be undertaken as to why the CVA moratorium is so little used to inform consideration of these proposals. [9]

Q12. Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissention from some creditors?

28. Yes, we believe that a cram down regime would be useful where it is possible to assess the liquidation outcome for junior creditors, but the detail will require careful consideration and it is likely that the regime would only be appropriate for use in larger more complex cases, which are likely to be relatively rare. Safeguards should be included to prevent use in other cases. The following are our initial thoughts on the points noted:

- Cram down should apply also to shareholders
- The plan should cover preferential creditors as well as secured creditors [9.10]

Q13. Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

29. Broadly speaking, we agree that the role envisaged by the courts is appropriate in this context, but, as noted above, greater court involvement involves greater cost and the proposed process is, in practice, likely to be appropriate only for larger, more complex business restructurings. If the proposal is taken forward, we believe that provisions will be needed to restrict use of the regime to appropriate cases and to provide safeguards against potential abuse, in order to protect creditors.

30. We agree that those involved in financial markets as noted should be excluded. [9.23].

31. We suggest that majorities should be of those present and voting, as is currently the case. [9.24]

32. A restructuring plan is typically designed to result in permanent change and it would be helpful for more detail to be given regarding the 12 month time limit in paragraph 9.29.

Q14. Do you agree that there should be a minimum liquidation valuation basis included in the test for determining the fairness of a plan which is being crammed down onto dissenting classes?

33. Yes, there needs to be a clear, not marginal, benefit if creditors are to be forced to accept a plan. We agreed that a liquidation value is the appropriate test as it is necessary to show that no creditor will be worse off than in a liquidation.[9.35]

Rescue Finance

Q15. Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?

34. The priorities of creditors may affect not only business rescue but also the willingness of creditors to extend credit to solvent businesses, and it is important that government considers the evidence and views provided by a range of finance providers carefully. We do not comment further at this stage, save to note that if the priority of costs of administration may be affected, the potential impact on the willingness of insolvency practitioners to accept appointments should be taken into account.

Q16. How should charged property be valued to ensure protection for existing charge holders?

35. No comment.

Q17. Which categories of payments should qualify for super-priority as 'rescue finance'?

36. No comment.

Impact on SMEs

Q18. Are there any other specific measures for promoting SME recovery that should be considered?

37. As noted earlier, we do not agree that a larger pool of advisors is required. If the new regime results in increasing demand, then it is open to members of the regulated professions to take the necessary exam and become insolvency practitioners.

Do you have any other comments that might aid the consultation process as a whole? Comments on the layout of this consultation would also be welcomed.

38. We do not have additional comments at this stage, but would be happy to participate in further consultations and discussions with government as the proposals are developed further.