Association of Business Recovery Professionals

R3

Rescue
Recovery
Renewal

Insolvency 2020

A vision for the next parliament

R3 manifesto
for the 2015 General Election

UK insolvency landscape

The 2010 General Election was a turning point for the UK's insolvency landscape: following financial crisis and recession, corporate insolvencies hit a near-twenty year peak the year before the election, while personal insolvencies hit their record high in the months before polling day. Since then, insolvencies have fallen every year. But with May 2015 fast approaching, the sense is that things might be about to turn again.

The conditions that have helped keep downward pressure on insolvencies since 2010 are already shifting: low interest rates are due for a rise, and the economic recovery is no longer stuttering. These shifts will put pressure on businesses' finances and will encourage creditors – who have so far been unusually tolerant – to get tougher on debts.

Even without a rise in interest rates, personal insolvencies are already climbing again. The country's mountain of personal debt shows no sign of becoming more affordable any time soon.

The UK has one of the world's best insolvency regimes – the World Bank says it is the 7th best, ahead of countries like the US, Germany, or France – but there is certainly room for improvement. The challenges that face business and personal finances are constantly changing and it is important that the insolvency regime is regularly reviewed and updated to keep up with the pace of change.

A new parliament from May 2015 provides politicians and policymakers with the opportunity to do this. Using the insight and experience of R3 members, this short document suggests ways that politicians can enhance the UK's business rescue culture, better help indebted individuals back onto their own two feet, and ensure that creditors – from small businesses to the taxpayer – get a fairer deal from insolvency.

Graham Rumney
R3 CEO

Insolvency 2020

Insolvency is about achieving a balance: on the one hand you have creditors who deserve to be protected from reckless borrowing or trading by customers and suppliers; on the other you have indebted businesses and individuals who deserve a chance to turn their fortunes around as fairly as possible.

Business and personal financial failure can have a serious knock-on effect on others – one-in-six corporate insolvencies are caused by another business' failure, according to R3 members – so a strong, transparent, and fair insolvency regime is essential for a healthy UK economy.

To strengthen the UK's insolvency regime even further, R3 would like to see all political parties commit to insolvency reforms that by 2020 will provide:

- **A better deal for small businesses**
- **A better deal for the taxpayer**
- **Personal insolvency solutions fit for 21st century personal debt**

A few facts about the UK's insolvency regime

- Insolvency often doesn't mean permanent financial failure; insolvency procedures are a solution to debt worries.
- The UK's regime is the 7th best in the world, according to the World Bank. This means it has one of the highest rates of returns to creditors, is one of the quickest, and one of the cheapest regimes.
- In 2012 UK insolvency practitioners (IPs)
  - Saved more than 750,000 jobs.
  - Advised more than 95,000 businesses, with just under 50% (45,000) continuing in some form.
- UK IPs return more than £4bn a year to creditors (including HMRC and businesses), according to the Office of Fair Trading.
- There are approximately 1,700 IPs in the UK and around 10,000 professionals who work in the insolvency profession.
- Most IPs are accountants or lawyers. They are all qualified and regulated (by one of eight regulatory bodies) and have a statutory objective to maximise returns to creditors.

A better deal for small businesses

Small businesses are the lifeblood of the UK economy. However the current insolvency regime can sometimes see them lose out when they are a creditor in an insolvency.

R3 would like the next government to commit to proposals that will give small businesses a greater chance of seeing more of their money back, and provide better support for businesses facing financial difficulty or being owed money in an insolvency. Such changes would bring long term benefits to small businesses and help to improve the UK's business rescue culture.

R3 recommends:

1. Taking small businesses' and taxpayers' money back from rogue directors

Every year, £160m is returned to creditors (mainly small businesses and HMRC) as a result of legal action against directors of insolvent companies who have wrongly, negligently, or fraudulently taken money.

Small businesses and HMRC will lose millions of pounds a year from April 2015 unless changes are made to the 2012 Legal Aid, Sentencing and Punishment of Offenders Act (LASPO).

Government can stop rogue directors from keeping money that is owed to small businesses and HMRC by providing insolvency litigation with a permanent exemption from the 2012 LASPO Act.

2. Returning more money owed to small businesses by insolvent football clubs

The 'Football Creditors Rule' used by the football leagues means that small businesses usually receive only a tiny fraction of what they are owed when they are a creditor in a football club insolvency; at the same time, football creditors like players, agents, and other clubs get paid in full. For example small businesses owed money by Plymouth Argyle (which entered administration in 2011) received 0.77p in the pound but the football creditors were paid in full. This is unfair.

The government must do more to put pressure on the football authorities to protect and improve the position of small businesses in football insolvencies.

R3 would like to see a minimum amount of money (for example, 35p in the pound over three years) paid to small business creditors by insolvent football clubs to ensure that they receive some of what they are owed.

3. Better guidance for businesses (creditors and debtors) from government

Insolvencies are complex and can be difficult to navigate for businesses. Working with business organisations, R3 has developed an online tool to help small businesses better understand how insolvencies work.

Government should also review the information it provides to small businesses to help them understand insolvency procedures and the ways in which, where possible, they can recover the money they are owed. R3 also encourages the government to do more to promote the importance of small businesses seeking advice as early as possible when faced with financial difficulty; the earlier a business seeks advice, the more likely it is the business can be saved.

A better deal for the taxpayer

Like small businesses, HMRC often loses out when it is a creditor in an insolvency. On average, HMRC debt accounts for 24% of unsecured debt in an insolvency, often making HMRC the largest unsecured creditor.

The government currently estimates its tax gap to be £35bn per year; £4.4bn (12%) of this is down to 'non-payment' or tax write-offs that HMRC says are mainly owed by insolvent businesses or individuals.

In 2002, HMRC lost its status as a 'preferential creditor' in insolvencies. As a result, it has become much harder for HMRC to receive back all that it is owed in an insolvency.

The government must take steps to help HMRC fight for the money it could lose as a result of insolvencies; this would help close the tax gap and help other creditors such as small businesses potentially get a better outcome where they are owed money.

R3 recommends:

1. Resolving the conflict between employment and insolvency law in collective redundancies

The rules on consulting with employees before making redundancies are reasonably clear, as is the over-riding objective governing what insolvency practitioners should do in an insolvency.

Unfortunately, the collective redundancy rules and the over-riding objective pull insolvency practitioners in opposite directions when they are appointed to a struggling business where redundancies need to be made. This often puts insolvency practitioners, staff, and the taxpayer in a difficult position.

In an insolvency, it can often be impossible for an insolvency practitioner to consult properly on redundancies: the situation may be moving too fast or may be too unclear; there might also be no alternative to redundancies. On top of this, there may be no money left in the business to pay for a full consultation.

At the same time, insolvency practitioners must keep in mind the objective to maximise returns to creditors: they may have to move fast and make redundancies quickly to prevent the company losing value.

Compensation payments relating to redundancy consultations in insolvencies have cost the taxpayer millions of pounds because of the tensions between the collective redundancy rules and the insolvency practitioners' objective.

R3 has proposed changes to the consultation process that would help resolve the conflict between insolvency and employment law, and urges the government to take steps to resolve the issue.

2. Greater engagement from government departments in insolvency cases

Creditor engagement is vital for a fair and transparent insolvency process. The more involved in the process creditors are, the better chance they have of seeing more of their money back.

Some creditors struggle to get involved. For newcomers, the insolvency process can be difficult to navigate and some small businesses don't have the time. Insolvency procedures often benefit from experienced creditors engaging on behalf of all creditors.

In its 2013 report, the Business Innovation and Skills Committee concluded that it was important for the Insolvency Service to encourage unsecured creditors such as HMRC (the largest 'unsecured creditor'), government departments, and the Redundancy Payments Service to actively participate in creditor committees.

R3 encourages greater engagement from government departments in creditor committees. This would help return more money to the taxpayer and should help other 'unsecured creditors' (such as small businesses) get a better outcome from an insolvency.

Personal insolvency solutions fit for 21st century personal debt

Although the cost of living and struggles to payday attract plenty of comment from policymakers and press commentators, relatively little attention is paid to what happens once people enter – or attempt to enter – a formal insolvency procedure.

The number of people in this situation has dramatically increased since the turn of the century. In 2003, fewer than 36,000 people entered a formal insolvency procedure; by 2010 this had more than trebled to 135,000.

England & Wales' personal insolvency regime (the regime in Scotland and Northern Ireland is devolved) has developed in bits and pieces over the last three decades. Despite the changing size and nature of personal debt, a number of the entry requirements for insolvency procedures have not changed for many years (some were last changed in 1986), whilst others are long overdue for review.

The government published a 'call for evidence' on Debt Relief Order thresholds and the creditor bankruptcy threshold petition in the summer of 2014. Whilst the review was welcome, R3 would have liked to have seen the government go much further in addressing concerns around the personal insolvency regime.

R3 recommends:

1. A full review of the personal insolvency regime

The regime is far from broken, but it can be improved. Changes are needed to ensure creditors are protected from reckless spending by debtors and to make sure debtors can access an insolvency procedure suitable for their needs, allowing them to get back on their own two feet financially, as soon and as fairly as possible.

R3 believes now is the time for a comprehensive review of England & Wales' personal insolvency regime.

As part of that review, R3 would like to see specific changes including:

a) An increase to the creditors' bankruptcy petition threshold

An individual can be made bankrupt by a creditor if they owe £750 – this figure is known as the creditor's bankruptcy petition threshold. This threshold was set in 1986 and would today be worth just under £2,000 if it had risen in line with inflation.

Making somebody bankrupt is a very serious step and it is very important that there are safeguards in place to ensure that people are not put into bankruptcy (or threatened with bankruptcy) when an alternative debt solution might be more appropriate for their needs. Unfortunately, inflation means the protection afforded by the creditor's petition threshold has become weaker and weaker every year.

R3 would like the creditors' bankruptcy petition threshold raised to £3,000. This level would cover the creditor's petition costs and ensure an element of legislative 'future-proofing' against inflation.

b) Updated entry requirements for Debt Relief Orders and bankruptcy

Debt Relief Orders were introduced in 2009 as a low-debt, low-asset alternative to bankruptcy. Unfortunately, the way that Debt Relief Orders and bankruptcy work mean some insolvent people are caught between the two procedures and are unable to resolve their debts.

To enter bankruptcy, individuals must pay £705 in upfront court and administration fees (to the Insolvency Service): finding £705 if you are insolvent can be difficult. Debt Relief Orders only cost £90 to enter, but entry requires debts of under £15,000 and assets of under £300. According to research published by Christians Against Poverty in 2014, around 315,000 people are trapped in debt because they cannot afford the bankruptcy fee.

R3 calls on the government to allow bankruptcy entry fees to be payable in installments (whilst in bankruptcy) and DRO entry limits to be raised to £2,000 of assets and £30,000 of debts.

About R3

R3 is the trade body for the UK insolvency profession. From senior partners at the 'Big Four' accountancy firms to practitioners who run their own small and micro-businesses, our members have extensive experience of both corporate and personal insolvency.

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