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Putting a cork in it : an appreciation of the May 2007 IVA consultation document

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Putting a Cork in it:

An appreciation of the May 2007 IVA consultation document

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Putting a Cork in it:

An appreciation of the May 2007 IVA consultation document[a]

Introduction

The May 2007 consultation on Individual Voluntary Arrangements (IVAs) proposes six reforms to current legislation to be enacted via Legislative Reform Order (LRO). This brief article outlines the six reform areas and discusses the key reforms against a background of the changes that have been seen in the insolvency "market" in recent years. The reforms combine Cork's practical approach to dealing with smaller debtors with current budgetary and administrative drivers and 20 years of experience of the IVA regime.

The "market" driven logic for these reforms is clear. Few commentators forecast the huge growth in IVA numbers following the Enterprise Act 2002 changes to bankruptcy law. Indeed, the death of the IVA was widely predicted[b], yet the underlying growth in consumer credit and its attendant problems is clearly linked to both bankruptcy and IVA growth[c].

The reforms

The six reforms proposed by The Insolvency Service fall into three categories: Substantive (1), Administrative (3), and Housekeeping (2).

The substantive reform is the introduction of the SIVA, a pared down version of the IVA, designed to complement other insolvency vehicles and to address the needs of the "consumer" debtor. The details of this are discussed in the next section but it is interesting to note that much of the SIVA was outlined in

Cork's 1982 report[d], being proposed as a Debt Arrangement Order (DAO). Cork's DAO was not enacted in 1986 but the logic of having a separate regime for professionals and traders (the IVA) and "consumer" debtors (the DAO) has not changed – today it is the huge number of cases that adds weight to the logic.

The three administrative reforms echo Woolf's civil justice reforms[e] as they aim to reduce unnecessary paperwork from the court process and reduce costs, thus improving recoveries for creditors (we shall see……). Exception reporting will be the norm with SIVA, FTVA (available only to un-discharged bankrupts) and IVA supervisors providing no routine paperwork (proposal etc) in the first instance and annual reports only where, in their judgement, factors exist that jeopardise the arrangement. Supervisors retain the obligation to keep comprehensive files, producing them only where court intervention is applied for. It will be interesting to see just how much cost this saves for the IP – court fees for sure but the time spent in preparing documentation will still be there. These reforms recognise that court papers are rarely referred to in practice and that the vast majority of cases proceed under the Insolvency Act 2000 reform, without benefit of an interim order.[f]

The third of the administrative reforms also flows from the Insolvency Act 2000 where the opportunity was given for non-IPs to act as nominees and supervisors of voluntary arrangements. Such persons would be authorised by RPBs or the Secretary of State. Since 2000 there has been little actual demand for this from individuals and the confusion in the legislation is pointed to as a reason. This reform would clarify the position whereby RPBs could authorise individuals to supervise IVAs or CVAs or both. It is thought that the IVA authorisation will be popular amongst debt advisors currently unable to act personally.

Finally, two housekeeping issues: The long awaited repeal of the Deeds of Arrangement Act 1914 (another Cork recommendation) since this regime has fallen into complete disuse, and the re-structuring of the oft-amended Part VIII

of the Insolvency Act 1986. Neither of these minor reforms appears to be contentious.

The SIVA

SIVAs will be restricted to debtors having undisputed (and unsecured) liabilities of less than £75,000 and will benefit from the streamlining reforms that require only an application to court rather than full documentation. The monetary limit is the only feature that indicates that this procedure is intended for "consumer" debtors although it can be seen that micro-businesses could also fall within its ambit. An estimated 80% of IVAs taken out in 2005 would have fallen within this figure[g] with average indebtedness of £40,000. Cork's proposed DAO limit was £10,000 but inflation and increased levels of debt over the intervening 25 years have had their toll.

SIVAs also dispense with the interim order under S.253IA1986, following the clear choices made by nominees since interim orders were made optional under IA2000. Clearly, where a threat from a creditor exists the IP can opt for the full IVA procedure and benefit from the interim order protection whilst the proposal is being considered.

More contentious appear to be the dilution of creditor rights envisaged in a SIVA. These include the inability to table amendments to proposals, the absence of a physical creditors' meeting and acceptance of proposals by simple majority (rather than 75% as required for full IVAs). In addition creditors will have to file claims within 90 days, presumably, failure to do this will disqualify the debt for both voting and recovery purposes.

Many of these reforms can be seen to have positive cost implications for those providing IVAs and SIVAs. It remains to be seen if lower fees will interfere with the business models of the AIM listed "IVA factories" launched over the past few years. IVA growth rates are unlikely to continue to increase at the rate seen since 2005[h] and so a consolidation in the industry is possible.

Leaner and fitter organisations are likely to survive whilst those reliant on high revenues will disappear.

The reforms also recognise that experience of IVAs over the years has produced a fairly standardised proposal structure for "consumer" debtors. Most proposals now anticipate likely amendments to duration, windfall gains, asset re-valuation and fee scrutiny procedures that creditors have tabled in the past. Recent agreement between the British Bankers Association, on behalf of key lenders, and various IVA providers should mean a code of conduct and self-policing for IVAs in the future[i]. Thus, the reforms rely on the industry players to work within their agreed codes of conduct and for the market to police "good practice". The continued monitoring of the IVA marketplace by the Insolvency Service and by those providing meeting and administrative services to lenders will be an essential part of this process.

Authorised supervisors

It is second time around for the proposal to allow "authorised persons", who are not qualified and licensed IPs, to act as nominees and supervisors of IVAs and SIVAs. The reform was part of the IA2000 but has found little uptake since the onus is on RPBs to authorise individuals to act in voluntary arrangements. A swift review of a number of key RPB website reveals that no separate licensing route for voluntary arrangement authorisations exists – only full membership. The consultation document reveals that the IA2000 was equivocal with its definition of voluntary arrangements and that the current reform makes it clear that RPBs and the Secretary of State may authorise individuals to act in individual or corporate arrangements or both.

Encouragement of price competition from other debt professionals may be behind this clarification. However, such authorised individuals would need to undergo education; training and qualification regimes, secure bonding etc and so fixed costs may well be high – too high, perhaps for effective rivalry?

Cork saw the need to protect debtors and creditors from a small number of rogues acting as IPs and whilst his report outlined, substantially, the RPB and qualification structure that came into force in 1986 it also warned against creating a restrictive trade practice (a monopoly). Perhaps this reform will encourage charitable bodies to enter the fray – but at what cost? It can be argued that an IP can offer wide and more general advice on debt problems whilst specialists may only be able to offer SIVAs.

Risk analysis

Legislative change via the LRO procedure requires certain tests to be met. These tests approximate the scrutiny that a full Bill would receive in its committee stages and include: proportionality of benefits and costs, fair balance to all parties, desirability and achievability. Importantly the tests also include a risk analysis to ensure that necessary protections remain and that individuals do not lose rights and freedoms.

The key risks embodied in the proposals appear to centre on the protection of creditors (both specific creditors in IVA cases and the credit community) and the protection of debtors from inappropriate advice.

Much of the consultation's reforms can be seen as a pragmatic deferral to market forces. The reforms simply codify what is happening and facilitate efficiencies by removing little used procedural steps. The SIVA framework simply mirrors practice in many "consumer" IVA cases. If a key objective of the reforms is to make IVA administration more efficient (with the hope that this reduces costs) then this objective is likely to be achieved.

There are, however, costs to these reforms and these fall largely on creditors and, to a lesser extent, on RPBs. Creditors, in particular, are placed in a front-line monitoring role in order that court intervention (and production of paperwork) can be triggered. They can no longer rely on court scrutiny (real or imagined). Creditors, too, will be best placed to monitor fee levels and costs. Creditors' incentives are always felt to be linked to increasing returns

but they will lose certain rights to influence return levels in over 80% of VA cases. In reality, creditor influence will be at the more general level of the industry code of conduct rather than the level of the individual case.

If a key objective is to encourage competition in the provision of IVAs then the future is less clear and the outcome less reliant on a legislative change alone. The market forces that have produced the current situation of dominance by a few well-funded and focused providers will change over time. There may be less competition as the credit boom softens and industry consolidation occurs. Meanwhile, individual debtors will be faced with a bewildering array of choice in "debt solutions" and may not be best served by entertaining any kind of insolvency regime at all.

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[a] The Insolvency Service, (2007), A consultation document on proposed changes to the Individual Voluntary Arrangement(IVA) regime contained in the Insolvency Act 1986 and associated ,matters, May, www.insolvency.gov.uk

[b] Professor Adrian Walters at Insolvency Lawyers Association Academic Advisory Group seminar, Said Business School, Oxford, March 2007.

[c] Hussain I, (2002), Macroeconomic determinants of personal bankruptcies, Managerial Finance, Vol 28 No. 6, pp20-33

[d] Cork Committee, (1982), Insolvency Law and Practice: Report of the Review Committee, Cmnd.8558.

[e] Woolf LJ, (1996), Access to Justice, www.dca.gov.uk/civil/final/

[f] Insolvency Service, (2006), Evaluation of the Insolvency Act 2000, www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/evaluationIA2000.doc

[g] PWC, (2006), Living on tick: The 21st century debtor, www.pwc.com/uk/eng/about/svcs/brs/PwC-IVAReport.pdf

[h] DTI data 1986 – 2006 shows a distinct congruence between growth in bankruptcy and IVA numbers up to 2005 with IVAs accounting for 20 – 25% of insolvency cases in the new millennium. This relationship now favours IVAs with around 40% of cases being IVAs in 2006.

[i] BBA, (2006), Debt summit agreement, www.bba.org.uk/bba/jsp/polopoly.jsp?d=145&a=8026