The Insolvency Service

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# DEAR INSOLVENCY PRACTITIONER
## Issue 73 – October 2016

*Message from Nick Howard*
*Head of Insolvency Practitioner Regulation*

*Dear Insolvency Practitioner*

*Attached is the latest edition of Dear IP.*

*We are aware that the article in Dear IP 72 setting out changes to guidance to Official Receivers has caused some concern amongst the profession. We are actively engaged in discussion with R3 on this issue, and propose to issue some clarification in our next edition of Dear IP.*

*Following the legislative changes in the Deregulation Act 2015, the Secretary of State has now ceased directly licensing insolvency practitioners. All those practitioners wishing to remain licensed have now been granted authorisation by the RPBs. If there are any queries relating to former SoS IPs or the function of Insolvency Practitioner Services please direct them to IPRegulation.Section@insolvency.gsi.gov.uk*

*Whilst every effort is made to ensure that the information provided is accurate, the contents of Dear IP are, unless stated otherwise, the view of the Insolvency Service, and articles are not a full and authoritative statement of law*

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## 26) Insurance Act – Insolvency Practitioner Bulletin

The Insurance Act 2015 entered in to force on 12 August 2016 and is the most significant legislation affecting insurance contracts in over a hundred years. There are some important changes for insolvency practitioners when arranging cover for insolvent estates, which are outlined below by Ed Brittain of JLT.

The Act applies exclusively to insurance contracts which are subject to the laws of England, Wales, Scotland or Northern Ireland. The Act changes the law governing insurance contracts to reflect modern business relationships between the policyholder and insurer and to re-balance rights and remedies in the event a claim arises.

The Act provides a better reflection on how insurance is carried out today and there are several implications for policyholders. The Act will apply to new, renewal and mid-term adjustments entered into on or after the 12th August 2016. Insurers do have the right to fully or partially contract out of the Act; however, they must comply with provisions relating to the abolition of “basis of contract” clauses.

**Duty of Disclosure**

Under the Act the obligation to disclose material facts arising from the duty of utmost good faith is replaced by a duty to make a fair presentation of the risk to insurers.

To comply with your duty to make a fair presentation, you must either disclose every material circumstance which is known or ought to be known to you or, failing that, you must give the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances. This would mean, making an insurer aware of a specific circumstance in order for them to be able to make further enquiries regarding the specific circumstance.

You must also ensure that every material representation as to a matter of fact is substantially correct, and that every material representation as to a matter of expectation or belief is made in good faith.

Under the Act you are assumed to “know” what is known by the “senior management” and any other individuals who are also responsible for your insurance. You now need to satisfy yourself that when your insurer requests information you have carried out a reasonable search of information that is available to you.

You should request the information required by insurers from those individuals in your company that are responsible for your insurance and from senior management of your company. You also need to keep a record of your search.

You may also need to consider any pertinent information that any external consultants (with whom you work) may have (including insurance brokers).

Data dumping is not acceptable.

You do not need to disclose to the insurer material information which the insurer:

- already "knows" i.e. information that the underwriter is already aware of and/or has in its possession;
- "ought to know" i.e. information which is readily available to the underwriters or is known by an employee or agent of the insurer who ought reasonably to have passed it on to the underwriter;
- is "presumed to know" i.e. matters it ought to know in the ordinary course of its business, such as class-specific industry knowledge.

The requirements above may prove a challenge for insolvency placements where by the nature of the appointment of the insolvency practitioner little information is known about the risk being insured, its insurance history, its previous claims experience and access to 'senior management' and/or the previous insurance team may well not be possible. There is no definition as to what constitutes a reasonable search and no 'one size fits all' answer.

**Remedies Available to Insurers**

A breach of the duty of disclosure will no longer automatically entitle the insurer to terminate the policy (other than where the breach is deliberate or reckless). Instead, the following remedies are available:

- to avoid the policy, your insurer will have to show that had they received a fair presentation of the risk, they would not have entered into the contract; but
- if the insurer can show that they would only have entered into the contract on different terms, then the insurer may treat the policy as having included those different terms from the outset; or
- if the insurer can show that they would have entered into the contract but only at a higher premium, the insurer may reduce the amount to be paid on a claim proportionately.

For insolvency practitioners and other insureds these remedies are an improvement of the insured's position under the pre-existing law.

**Other Key Changes**

- "Basis of Contract" clauses are abolished.
- Warranties will become "suspensive conditions" i.e. cover will be suspended until the breach is remedied by you, rather than cover being cancelled altogether.

- An insurer may not use a breach of a term/condition by you to avoid paying a claim, unless that breach was directly attributable to the actual loss or relates to a term which defines the risk as a whole.
- Insurers will still be able to refuse to pay a fraudulent claim and to avoid their liability to pay claims resulting after the fraudulent act. The insurer may treat the insurance contract as at an end from the date of the fraudulent act.

**How can you prepare?**

The Insurance Act 2015 does bring some significant benefits to insureds, and while it brings some challenges to insolvency insurance placements, the Act also brings some restrictions to insurers' ability to avoid policies. All insureds should engage with their broker/agent to understand the implications of the Act. See action points below:

- Work with your broker to establish how you can comply with your duty of fair presentation;
- Ensure that all information submitted to underwriters is clear and detailed so as to comply with your duty of fair presentation;

Be aware that insurers are likely to look to protect their position by pushing the burden of disclosure onto you as much as is possible.

*Any enquiries regarding this article should be directed towards email: IPRegulation.Section@insolvency.gsi.gov.uk*

## 71) Closing an estate held in the Insolvency Service Account

Estate Accounts and Scanning (EAS) would like to remind insolvency practitioners of what is required to close an estate account.

In order for us to close a bankruptcy or liquidation case the following documentation is required;

- A covering letter/email with instruction to close the account.
- A copy of the final receipts and payments account (Form 1)
- A copy of the 'Notice to Court of Final Meeting of Creditors' (Form 4.42 for liquidations and 6.50 for bankruptcies)

In instances where there are surplus funds available to be returned to the debtor and practitioners are requesting a rebate of Secretary of State fees, the following documentation is required;

- A copy of an up to date receipts and payments account (Form 1)
- A copy of an abstract receipts and payments account, which is in effect a summary of Form 1.

In instances where a bankruptcy has been annulled and the account is to be closed, the following documentation is required;

- A covering letter/email with instruction to close the account.
- A copy of the annulment order.
- A copy of a final receipts and payments account

Although the majority of requests to close an account are received electronically via e-mail, we do still receive a number of hard copies via the postal system. Sending the relevant documentation electronically to CustomerServices.EAS@insolvency.gsi.gov.uk will expedite the process.

The main body of the email should describe in brief the nature of the query or request, and the subject box should conform to the following naming convention: 'case reference – case name – final documents or surplus to debtor',

Adhering to the guidance outlined above will reduce unnecessary delays in processing your requests.

*Any enquiries regarding this article should be directed towards Customer Services (EAS), PO Box 16652, Birmingham, B2 2HR telephone: 0121 698 4268 email: CustomerServices.EAS@insolvency.gsi.gov.uk*

## 45) Enforcement of Requirement to Provide Information under Section 7(4) of the CDDA 1986

This article relates to the Court's consideration of requests made by The Insolvency Service (in the context of contemplated proceedings under the Company Directors Disqualification Act 1986 (CDDA)) to the joint administrators for the provision of documentation and further information in respect of a failed business which had traded as a solicitors firm.

**Background**

Prior to 01 April 2016 (when the ambit of the section was extended to *"any person"*), Section 7(4) of the CDDA effectively stated that the Secretary of State may require the Office Holder to furnish such information/permit inspection of books and records relevant to an individual's conduct as a director, as the Secretary of State may reasonably require, to determine whether it was appropriate to seek disqualification of that individual. In accordance with their duties under Section 7(3) of the CDDA (since replaced by section 7A of the CDDA) and under the provisions of the Insolvent Companies (Reports on Conduct of Directors) Rules 1996 (since replaced by the Insolvent Companies (Reports on Conduct of Directors) (England and Wales) Rules 2016) the joint administrators filed a conduct report in respect of the members of the firm. The conduct report set out a number of potential allegations of unfit conduct against some of the firm's members.

After review of the conduct report, it was decided that further investigation was merited. The Insolvency Service then met with the joint administrators to discuss the firm and the investigation process, and to agree terms of access to the firm's books and records (both electronic and hard copy) and the joint administrators' files (the papers). Terms of access were also agreed to the firm's servers. The investigation team then reviewed and copied some of the papers, and also requested copy documentation, which was contained within the joint administrators' files. The joint administrators provided copies of some, but not all of the copy documentation requested, and refused access to the firm's servers.

During the following four months the joint administrators and/or their compliance & risk team provided various reasons for not providing the outstanding documentation/information and access to the firm's servers. Ultimately, the Insolvency Service issued a claim against the joint administrators seeking release of the outstanding documents/information and access to the firm's servers, and a hearing date was set.

Between the issue of the claim and the hearing, a draft order was agreed between the parties covering the release of the majority of the requested documentation/information, which included (but was not limited to), from the firm's books and records; board meeting minutes, management accounts, cash-flow forecasts, and details of distributions to members and from the joint administrators'

files; correspondence with members, government and regulatory bodies, the purchasers of the firm's business, court proceedings, bank documentation, and creditors committee meeting notes. However some issues remained outstanding, in particular access to the firm's servers.

At the hearing the Judge made an order in the terms agreed by the parties which directed the joint administrators to provide the Insolvency Service with all of the outstanding documentation/information (excluding documentation/information which was subject to Legal Professional Privilege, such documentation/information which had not been sought by the Insolvency Service). In respect of the firm's servers, the Judge further directed that the investigation team be allowed to review and obtain extracts from the firm's server and that the joint administrators bear their costs of the interrogation (the joint administrators having refused to allow the Insolvency Service to undertake the interrogation themselves). The Insolvency Service were awarded their legal costs of taking the action.

The Court's approach, in directing the release of documentation/information to the Insolvency Service, should provide comfort to office holders, and their risk and compliance teams.

*Any enquiries regarding the above including any requests to meet with any IP and their compliance & risk teams should be directed towards Business.DevelopmentTeam@insolvency.gsi.gov.uk*

## 46) What the compensation regime means for the Office Holder

Top Messages

- The compensation regime is not intended to usurp the asset recovery role of the office holder, whether an insolvency practitioner or Official Receiver.
- Dialogue between the Insolvency Service and the insolvency practitioner is vital from the outset.
- The emphasis will be upon the victim and the routes available to them to recover the loss caused by the conduct for which the director has been disqualified.
- It is anticipated that the number of compensation awards in any year will be relatively small.

The Provisions

The compensation regime [sections 15A to 15C of the Company Directors Disqualification Act 1986 (CDDA)] was introduced in the Small Business, Enterprise and Employment Act (SBEEA) 2015, and came into effect on 1 October 2015.

Rules governing the process for the institution and conduct of compensation proceedings will be contained in a stand alone Statutory Instrument, the Compensation Orders (Disqualified Directors) Proceedings Rules 2016, which is targeted for an October 2016 commencement date.

15A to 15C CDDA provide that where a director of an insolvent company has been disqualified and the unfit conduct for which he or she was disqualified has caused quantifiable loss to some or all of the creditors, the Secretary of State can seek a compensation order or undertaking requiring the director to compensate creditors for that loss.

The compensation can either be paid to the Secretary of State for the benefit of a creditor or class of creditors or as a contribution to the assets of the company.

Compensation can be sought for conduct that occurs on or after 1 October 2015.

What does the Compensation Regime mean for the Office Holder?

The compensation regime is aimed at making directors account for the consequences of their unfit conduct where other remedies have either failed or for, whatever reason, are not available.

It is not intended to usurp the asset recovery role of the Office Holder, whether an insolvency practitioner or Official Receiver. Indeed, a primary matter that the Secretary of State must take into account in deciding whether to seek a compensation order or undertaking is whether the director has made any other financial contribution in recompense for the conduct (whether under a statutory provision or otherwise)[1] .

For the Insolvency Service, this means that in targeting, investigating and enforcing a potential compensation case it is vital to maintain a constructive dialogue with the insolvency practitioner from the outset and throughout the life of the case. If we are made aware that the practitioner is taking or contemplating action against the director or is not doing so because the director is without means, then we would be less likely to seek compensation, as it is unlikely to be in the public interest to do so. For the practitioner, it means being ready to share information about what they are doing to hold the director to account. Although every case will be treated on its merits, where recovery proceedings are contemplated or are already under way, it would not be the Insolvency Service's intention to pursue compensation.

<u>How will the Insolvency Service select which cases are suitable for compensation?</u>

The Service will treat every case on its own merits. Our primary emphasis will be on the victim. What (quantifiable) loss has the conduct caused them? Do, or should, they have an alternative route to recovery? For example:

- Is the Office Holder taking recovery action?
- Do the creditors themselves have powers to pursue the director personally or to take action to limit their loss?
- Is the conduct the subject of a criminal referral, in which case it is open for the prosecution to seek and the court to make an order for compensation and/or confiscation upon conviction?

Other considerations revolve around the need to establish a causal link between conduct and loss:

- We need to be able to attribute a quantifiable loss to the conduct. An example of where we might not be in a position to do this this may be where the allegation is failure to maintain, preserve or deliver up accounting records.
- The provision is quite specific in that the conduct has to have "caused" the loss. There may be evidential difficulties where the allegation is that the director allowed the conduct or abrogated their responsibilities.
- It can also be the case that the insolvency was precipitated by a fine for a statutory or regulatory breach. Such a fine does not represent a "loss" to the

[1] Section 15B (3) (c)

body levying the fine. Although it could be argued that the fact that the fine triggered the insolvency means that the conduct that resulted in the fine ultimately resulted in a loss to some or all of the creditors, it is likely to be difficult to attribute the whole of the loss to that conduct.

Finally account will need to be taken of the director's ability to pay the compensation.

*Any enquiries regarding this article should be directed towards email: Business.DevelopmentTeam@insolvency.gsi.gov.uk*

## 89) Financial Sanctions and Insolvency Practitioners

The Insolvency Service is aware of some individuals who may be subject to financial sanctions who are seeking to use both solvent and insolvent liquidations to circumvent financial sanctions. This article provides some information about financial sanctions and details of a free subscription service to identify designated persons, entities or bodies to which insolvency practitioners are encouraged to subscribe.

### Overview

Certain formal insolvency procedures could be used to circumvent or breach financial sanctions. Breaching financial sanctions is a criminal offence. This notice sets out the responsibilities of insolvency practitioners and directions to further sources of information and guidance.

Financial sanctions are in force against a number of regimes, individuals and companies. In practice this means that you cannot do business with such designated individuals or companies, companies owned or controlled by designated entities, or undertake any relevant transaction that may be indirectly benefitting a designated entity, unless there is a relevant exemption in the sanctions regime or, you have a licence from the Office of Financial Sanctions Implementation (OFSI). For further information on financial sanctions, see the OFSI guidance; https://www.gov.uk/government/publications/financial-sanctions-faqs.

### How do sanctions affect Insolvency Practitioners?

In order to comply with financial sanctions, insolvency practitioners must ensure the following:

- insolvency services are not provided to, or for the benefit of, a designated person (a company or individual subject to financial sanctions) or an entity owned and/or controlled by a designated person;
- transactions which are subject to financial sanctions (for example, transfers of funds in some circumstances) are not carried out;
- assets which should be frozen must not be realised or made available to a designated person;
- formal insolvency processes are not used as a route to circumvent sanctions;

unless there is a relevant exemption in the legislation of the sanctions regime or you have an OFSI licence that permits you to do so.

Insolvency practitioners should familiarise themselves with financial sanctions and understand how they apply to their business. When conducting usual anti-money

laundering checks, practitioners should refer to the OFSI list of financial sanctions targets:
https://www.gov.uk/government/publications/financial-sanctions-consolidated-list-of-targets (section 3 gives more information on this list and how to use it).

Practitioners may also find Section 9 of the OFSI Guidance useful: Compliance for Businesses:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/513838/OFSI_Financial_Sanctions_-_Guidance_-_April_2016_Final.pdf

It is a criminal offence to breach the prohibitions in financial sanctions regimes. If you find that you have already carried out an economic transaction that was prohibited by sanctions (for example by dealing with a designated person's funds without an OFSI licence) you should contact OFSI to regularise the position. (OFSI@hmtreasury.gsi.gov.uk).

**Licences**

Under certain circumstances a licence may be issued to allow transactions to take place. These circumstances are limited to the licensing grounds as set out in the legislation of the sanctions regime and practitioners should be aware that not all transactions or insolvency services can be licensed. For more information on licences including the process of applying for a licence and the circumstances in which they can be provided please refer to the OFSI guidance.

Licences cannot be issued retrospectively so it is important to apply for a licence before any work takes place.

Please note that OFSI will only consider licence applications where you have identified a valid and appropriate licencing ground that permits a licence to be issued as set out in the relevant EU legislation.

**Further Information**

OFSI operates a free subscription service which allows subscribers to receive updates whenever there are changes to financial sanctions effective in the UK. Practitioners can find out how to subscribe at:
(https://public.govdelivery.com/accounts/UKHMTREAS/subscriber/new)

*Any enquiries regarding this article should be directed towards HM Treasury's Office of Financial Sanctions Implementation; email: OFSI@HMTreasury.gsi.gov.uk telephone 020 7270 5454.*