



**International Association of Insolvency Regulators  
Mexico 2006  
Overview of Insolvency**

## **1. Background**

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**1.1** If insolvency legislation had largely been seen in the first 70 years or so of the 20<sup>th</sup> century as simply providing a mechanism for bringing business failure to an orderly conclusion (and generally penalising individual debtors), it has from the early 1980s become increasingly viewed as an essential part of countries' economic and social frameworks alongside the expansion of trade and credit and the increasing globalisation of business, finance and investment. Thus the major economies' longstanding and well used legislation required major overhauls; and the new market economies of Central Europe and the Baltic and Balkan States, of Asia and of Latin America required new laws.

**1.2** The process of review and revision continues in the light of demands, needs and expectations of national and international business, financial and investment communities, and of the public; and is focussed in an ever more complex world on achieving:

- simplification;
- clarification
- efficiency and reduction of costs;
- transparency;
- predictability and certainty;
- flexibility which recognises the need for solutions to financial failure to take account of different facts and circumstances; and
- accessibility and user friendliness.

## **2. Introduction**

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**2.1** IAIR Conference discussions have ranged across the spectrum of insolvency issues and the thinking behind how jurisdictions have sought to achieve their balance between the interests of debtors and of creditors, and of the public, in the context of their different histories, traditions, cultures and experiences; different legal bases; different socio-political and economic backgrounds and influences; and different institutional structures and capacities.

**2.2** This Paper looks to pull together these issues in an overview which might contribute to further discussion at IAIR Mexico 2006. It looks to illustrate by examples how jurisdictions have approached and developed their solutions to those issues. But individual solutions to individual issues should not be viewed in isolation – they are part of jurisdictions' overall schemes aimed at maintaining a balance between the different interests affected by insolvency within their different frameworks. Identification of further issues and further elaboration and examples, as well as updating and corrections, from members and observers would be welcome.

2.3 Four particular issues have been the subject of detailed studies and reports, and are therefore not covered in any detail here:

- No Asset Insolvencies
- Phoenix Companies
- Regulatory Frameworks
- Recognition of Foreign Proceedings and Foreign Insolvency Administrators.

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**3. Access to Insolvency Procedures – Cost**

3.1 For individual debtors seeking protection from their creditors, debt relief and rehabilitation, the cost of filing for bankruptcy or of formulating proposals for an arrangement with their creditors has been an issue in some jurisdictions, more particularly where governments have looked to recovering the cost of functions and services from charging fees (see para 18):

- In Australia, a recent review recommended that a fee should be introduced to cover the cost of processing individual debtors’ petitions and debt agreement proposals: in the event, it was concluded that this would be inconsistent with the overriding policy of ready access to mechanisms for protection, relief and rehabilitation, and the recommendation has not been implemented – although the discharge provisions have been revised (see below at para 8.1)
- Canada has streamlined its debtor proposal provisions, removing the need for a meeting and introducing automatic acceptance unless objected to by 10% of creditors.

- New Zealand and United Kingdom are developing proposals for a low cost streamlined debt relief procedure as an alternative to bankruptcy for those debtors with no or minimal assets and income and with a low level of debts (NZ's proposals envisage an upper debt limit of NZ\$40,000 and UK's an upper debt limit of £15,000).
- Singapore is also exploring an alternative procedure for those unable to make payments from their income which would avoid the costs and stigma of bankruptcy but would still allow their financial affairs to be brought within a structured framework.
- United Kingdom is also developing proposals for simplifying and reducing the cost of formulating and obtaining approval of individual voluntary arrangements for smaller cases (with an upper limit of debts of £75,000).

**3.2** Cost has not been identified as an issue for debtor companies in relation to their own winding up/liquidation.

**3.3** Cost has from time to time emerged as an issue in relation to re-organisation and re-structuring, where the procedures have been seen to be disproportionately costly for smaller companies: the United Kingdom has introduced amendments to its company administration procedure removing the need to apply to the court for the appointment of an administrator.

**3.4** Cost, including the payment of a fee and/or a deposit towards the costs and charges of the court and/or the agency or authority with insolvency responsibility and/or an insolvency administrator in relation to the insolvency, has also not been identified as an issue for creditors seeking enforcement of their debt:

- Latvia is proposing to introduce a requirement that creditors should have to pay a deposit to discourage unreasonable, unjustified or false actions aimed at competitor companies.

#### **4. Access to Insolvency Procedures – Debtors**

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**4.1** In some jurisdictions, the insolvency processes can only be used by business debtors, whether individuals or companies; but rises in consumer spending and credit (and debt), seen as an important factor in economic growth, is leading to consideration in those jurisdictions of the need for procedures for non-business individual consumer debtors: in Australia, Canada, Singapore and United Kingdom, consumer debtors account for between 70% and 90% of all individual insolvencies.

**4.2** In a few jurisdictions, protection on individual bankruptcy is not accompanied by relief and rehabilitation, and the procedures are therefore infrequently used.

**4.3** Most jurisdictions have special provisions for dealing with the financial failure of banks, financial institutions and insurance companies; and separate rules for financial and securities markets.

#### **5. Administration of Insolvencies**

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**5.1** It is a feature of many of the jurisdictions which derived their insolvency legislation from United Kingdom that they have government-employed officials

(called official receivers, official assignees, official trustees or official liquidators, and collectively referred to here as official receivers) who handle bankruptcies of individuals and court-ordered liquidations of companies, but usually with creditors having the power to appoint private sector insolvency administrators to take over the administration, realisation and distribution of the estate where there are significant assets. In more recent years, there have been increasing moves to use administrative powers to appoint insolvency administrators in place of official receivers – in part because it has been felt that estate administration is essentially a commercial function which should be undertaken by and at the risk of the private sector; and in part so that official receivers can focus their resources on discharging the public interest functions of investigating and prosecuting the conduct of individual debtors and directors of failed companies, while continuing to act as trustee or liquidator of last resort where there are no or minimal assets to meet the costs of an insolvency administrator:

- United Kingdom has since 1986 had administrative powers to appoint insolvency administrators as trustees in bankruptcy and liquidators in court-ordered liquidations at any time. No part of the charges of an insolvency administrator so appointed is met from government funds: he/she has to look to the assets for his/her remuneration, costs and expenses.
- Hong Kong SAR has administrative powers to outsource the administration of court-ordered liquidations, using competitive tendering to secure value for money; and has tabled a Bill which will allow outsourcing of small debtor petition bankruptcies

**5.2** In those jurisdictions where there are official receivers for court-ordered insolvencies, other insolvency procedures - arrangements, agreements, schemes, administrations, receiverships, official or judicial management, re-organisation or restructuring and voluntary liquidations – have generally been, and continue to be, handled by insolvency administrators.

**5.3** In other jurisdictions, all forms of insolvency procedures are handled by insolvency administrators, although:

- British Virgin Islands has recently introduced the concept of official receiver of last resort.
- Canada's Office of the Superintendent of Bankruptcy may act as official receiver where an insolvency administrator has his/her licence revoked or is removed or resigns or dies.
- Finland has recently introduced public receiverships to administer and investigate insolvencies where there are no or minimal assets to meet the costs of an insolvency administrator and the proceedings would otherwise lapse.

**5.4** The majority of insolvencies have no assets. In those jurisdictions where there is an official receiver to act in any event in an individual bankruptcy or a court-ordered liquidation, then unrecovered costs of administration are met from total fee income or by the government. If and in the event that there are identified grounds for proceedings, for example to recover assets or to attack undervalue and avoidable disposals, then essentially it is seen as a matter for the creditors to weigh up the risks and benefits to them of providing funding. In a few jurisdictions, the government may in certain circumstances where there are no or minimal assets meet all or part of the costs of an insolvency administrator's administration and/or further investigation and proceedings:

- In Australia, indemnity funding for proceedings in bankruptcy may be provided by the government if creditors have insufficient resources to do so or where there is a significant issue of law to be resolved – in 2004-05, 28 indemnities were approved involving a total of A\$385,000. A pilot programme has been launched to fund extended public interest investigations in company insolvencies where no funds are available.
- In Finland, where the insolvency would otherwise lapse and where at the request of the Bankruptcy Ombudsman it is brought into public receivership – see above at para 5.3 – the government meets the costs of the insolvency administrator to the extent that recoveries prove to be insufficient: there were expected to be 50 public receiverships in 2004-05.
- In Latvia, the Employees' Guarantee Fund may meet the remuneration and expenses of an insolvency administrator, subject to limits, where there are no estate funds.

**5.5** One feature of administrations in a number of jurisdictions is the increasing emphasis on securing payments from bankrupts from their income towards their debts, using generally accepted and widely used formulas to calculate liability to contribute, for example:

- Australia has introduced new provisions to improve a trustee's ability to collect contributions from self-employed bankrupts; and with more rigorous assessment of bankrupts' ability to pay, increased the amounts collected in 2004-05 over the previous year by some 15%.
- In Singapore payment is linked to an earlier discharge.
- Thailand has proposed that a bankrupt could apply for discharge before the automatic three year period where he/she was able to pay 50% of his/her debts.
- In United Kingdom, where automatic discharge no later than twelve months after the bankruptcy was introduced in 2004, income payments orders and agreements for three years have almost doubled since then.

**5.6** Other features of insolvency administration where there remain issues in some jurisdictions are:

- The family home – (i) whether, when and how the bankrupt's interest should be realised – United Kingdom has, to bring certainty for bankrupts and their families, introduced a three years time limit for insolvency administrators to deal with the bankrupts' interests; and (ii) the inter-relationship between insolvency and family law - Australia has recently enacted legislation to clarify the position.
- Personal pensions – (i) the extent to which an insolvency administrator is able to claim all or part of a bankrupt's pension fund lump sum and/or income - in several jurisdictions pension funds have become exempt property, recognising at least in part that governments had encouraged individuals to make their own pension provision, and otherwise bankrupts would be reliant to a greater extent on state provision; and (ii) the extent to which an insolvency administrator is able to recover "excessive" payments into a personal pension fund prior to and in anticipation of insolvency to the detriment of creditors – Australia has proposals for recovery currently under consideration and United Kingdom introduced "clawback" provisions in parallel with categorising personal pension funds as exempt property.
- Undervalue and other avoidable transactions – most jurisdictions have provisions under which such transactions could be attacked by an insolvency administrator; some have moved the ground for attacking them from intent to effect of the

transaction; and the relevant period prior to the insolvency varies with Australia recently having extended the period for attacking transfers to related parties from two years to four years. A further issue is whether creditors are prepared to have estate funds used or themselves to finance investigations and proceedings (see above at para 5.4): one option being considered in New Zealand is whether creditors financing recovery actions should be given priority for at least part of their claims over other unsecured creditors: another option in other jurisdictions is litigation funding by which costs may be underwritten by an insurer or by a third party.

## **6. “Walk Away” Insolvencies**

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**6.1** There have been concerns in a few jurisdictions that individuals and companies may “walk away” from their debts and creditors; and in the absence of identifiable assets, creditors may be reluctant to initiate formal insolvency proceedings and the appointment of an official receiver or insolvency administrator to investigate the failure, any disposal of assets which might be recoverable and any misconduct which might justify restrictions, sanctions or penalties:

- In Australia, a parliamentary commission recommended that an assetless company administration fund should be established to finance the preliminary investigation of breaches of directors’ duties and fraudulent conduct.

**6.2** Generally however this has not been seen to be an issue pointing to significant economic harm, or the jurisdictions consider that they have sufficient powers to deal with breaches and misconduct:

- Directors failing to submit returns and other documents may be fined and/or subject to restriction or disqualification: computerisation has enabled registrars of companies and other investigation and prosecution agencies to identify serial “walk away” directors.
- Some jurisdictions have powers to investigate and seek the liquidation of a company in the public interest, whether or not the company is insolvent, where there is evidence of unfair or illegal practices or criminality, particularly where the general public have been affected for example in relation to deposits for goods and services.
- In all jurisdictions, the police or other prosecuting authority have extensive powers to investigate where there is evidence of criminality: in a few jurisdictions, there may be an issue of whether the police have given appropriate priority to economic crime.

## **7. Business Rescue and Phoenixism**

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**7.1** In the wake of economic downturns and financial crises in the late 1980s and 1990s, particular focus has been on the procedures and techniques for re-organising and re-structuring businesses, effectively used in a number of high profile national and multi-national insolvencies:

- to preserve economic infrastructure and value, based on the proposition that “going concern” value generally exceed “break up” proceeds;
- to preserve jobs, avoid the economic and social consequences of unemployment, and maintain tax revenues; and
- to encourage directors to address financial problems at an earlier stage without the inevitability of liquidation.

## 7.2 Five particular issues have been identified:

- The problem of obtaining, and the terms of, interim finance pending restructuring, together with the rights of secured creditors in relation to their security and the continuation of occupancy, supply and service contracts: Canada has proposals pending to clarify some of these issues.
- The question of control - whether and to what extent the directors responsible for getting the company into financial difficulties continue to be responsible for or involved in its management and delivering the rescue “package” or to what extent and by whom they are subject to direction and oversight.
- The appropriateness of resorting to re-structuring procedures and gaining “breathing space” for unviable companies which should have moved straight to liquidation.
- Whether restructuring gives those companies relieved of debt a competitive advantage in both their domestic and international markets.
- Whether, at least in some jurisdictions, insolvency administrators have the necessary business management and negotiating skills to carry through successful rescues and re-structuring.

7.3 As noted above at para 3.3, there has been a further issue of the cost of proceedings making rescue procedures less accessible to smaller businesses. Here there have been moves in some jurisdictions to streamline and simplify procedures to reduce the costs and delays involved in securing “breathing space” to put together and carry through proposals.

7.4 A final issue which has been identified – and is the subject of a detailed IAIR study and report - is phoenixism, where the directors of a failed company acquire all or part of the assets and undertaking of that company and resume trading in the same or similar business – something which may take place before or after formal insolvency proceedings have been initiated. None of the jurisdictions which took part in the study had provisions which preclude phoenixism:

- Jurisdictions look to encourage entrepreneurship and have few requirements and few barriers, including cost, to formation of a company (other than those which operate in regulated activities, such as banking, financial services and insurance).
- Faced with an insolvent, loss-making, business which might be of a specialist nature operating in a limited market, the insolvency administrator might well find that the best (or only) offer for all or the greater part of the assets – and certainly better than “break up” value - comes from the directors: a requirement that the insolvency administrator should have to consult, or at least inform, the creditors should bring to light concerns about the facts and circumstances of the company’s failure and the directors’ conduct in relation to that.
- A “going concern” sale is more likely to maximise the ongoing economic value of the assets and continue employment of all, or at least some of, the work force.

7.5 A number of jurisdictions identified measures aimed at those who used phoenixism for their advantage and the disadvantage of creditors. Where the business and assets of a company had been intentionally arranged, usually in advance of formal insolvency, that the directors took the benefit for little or no consideration, sometimes linked with payment of those creditors who they were looking to rely on for future finance and supplies (and which they may have guaranteed) and leaving particularly employee and sales taxes, utilities and consumers unpaid, then in most jurisdictions there are provisions to overturn the transactions as at undervalue or otherwise

avoidable or for criminal prosecution for fraud. There are further measures available in some jurisdictions, including:

- Disqualification: Northern Ireland reported that in 1995, phoenixism was identified in around 23% of disqualification cases, but it was now rarely seen.
- Limitation on the use of the same or similar name or trading style of the failed company, and where a breach is subject to criminal penalty and civil liability for the debts of the new company.
- Publicity for disqualifications and other regulatory action

**7.6** Particular industries seemed particularly prone to phoenixism in some jurisdictions – for example in Australia the building and construction industry where the principal creditor was invariably the government for unpaid taxes: that had led to introduction of a system of licensing linked to tax registration. In other jurisdictions clothing and textiles had been seen to be a target industry, and the tax authorities had therefore set up systems for the closer monitoring of new businesses. But the overall scope and size of the problem is not seen as such to require the imposition of general licensing or similar requirements likely only to add to business and regulation costs.

## **8. Avoiding Individual Bankruptcy – Arrangements/Agreements**\_\_\_\_\_

**8.1** Many jurisdictions have in place provisions for individual debtors to bring forward proposals for the settlement or compounding of their debts and avoiding bankruptcy, involving regular payments from income and which may also involve the realisation of some of their assets and/or the provision of additional funds from for example relatives to provide a better return for creditors than they would get from bankruptcy:

- In Australia debt agreements account for around 20% of individual insolvencies.
- In Canada around 15% of consumer insolvencies are debt proposals.
- Finland had 4,449 individual debtor petitions for debt adjustment in 2004 compared with a total of 2,428 petitions for bankruptcy which cover both individual and corporate businesses, but where individuals may not be discharged from bankruptcy unless they have paid their debts in full.
- United Kingdom has seen, with high employment rates, significant increases in the numbers of debtors entering into voluntary arrangements with their creditors – around 25% of individual insolvencies in 2004-05 – and, as noted above at para 5.5, at a time when it has reduced the period of automatic discharge from bankruptcy from three years to a maximum of one year.

**8.2** One issue which has emerged is the rate of failure of agreements and arrangements – around 50% of Australia’s agreements have been terminated - and whether that might be due to:

- Aggressive promotion by insolvency administrators leading to debtors putting forward proposals which they cannot sustain; and/or
- Creditors pressing for too high levels of payments or other modifications which may prove to be overly burdensome.

## **9. Individual Insolvency Discharge**

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**9.1** Generally in relation to individual bankrupts the trend has been towards shortening the period of the bankruptcy and providing for automatic discharge after a specified period, subject to suspension or extension where the bankrupt has failed to co-operate or to make a full disclosure or, as in some jurisdictions, where the trustee or the creditors object on the ground of for example the bankrupt's misconduct which led to his/her failure or that he/she has not made adequate repayments:

- Australia has recently extended the period before a bankrupt can apply for a discharge – from six months after filing a statement of affairs to three years after filing a statement of affairs, and which can be extended to five or eight years for those subject to a requirement to make contributions; and the United States has also tightened its discharge provisions.
- Thailand proposed that the three year automatic discharge period should be extended to ten years where there was evidence of dishonesty.

**9.2** The discussion paper “‘No Fault’ Insolvency – Success or Failure?” tabled at IAIR Helsinki 2005 explored a number of issues about the policy thinking behind automatic and early discharges, and encouraging enterprise and responsible risk taking. What has emerged alongside that discussion has been a concern about the social implications of consumer overindebtedness and the development of proposals for dealing with minimal asset/low income individuals with relatively low levels of debts but which they are unable to service, let alone repay – for example, as noted at para 3.1, the New Zealand and United Kingdom's proposed debt relief procedures.

**9.3** There has also been, and continues to be, a wider, and hotly debated in some jurisdictions, issue – the extent of irresponsible lending and whether it is necessary or justified:

- to have some elaborate and costly formal insolvency mechanism whose purpose is effectively to write off debts which banks and credit cards companies have frequently allowed with the minimum of checking or effective control and which they have already built into the “price” of lending and credit; and
- to have to maintain that mechanism - because if bankrupts are not discharged then they should be subject to some form of continuing monitoring, otherwise what is the point?

**9.4** But there is also seen to be a need to avoid the suggestion or appearance that somehow bankruptcy is a “debtors’ charter”, and in some jurisdictions this is a sensitive issue: what is acceptable to creditor communities and the public in one jurisdiction at one time may not be acceptable in another jurisdiction at the same time – or indeed in the same jurisdiction at another time.

## **10. Restrictions, Sanctions and Penalties**

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**10.1** Investigating individual insolvents and failed companies and seeking restrictions, sanctions or penalties where misconduct is identified and evidenced may be the responsibility of official receivers or their agency or authority; or insolvency administrators; or a separate government agency; or the police. That, as the IAIR No Assets Insolvencies Report identifies, may present problems where the responsibility for investigation falls to an insolvency administrator, or in Thailand to the official

receiver, and there are no estate funds available to meet his/her costs. As set out in the Report and here at para 5, a number of jurisdictions have addressed those problems in different ways: the Uncitral Legislative Guide proposal that an insolvency administrator's costs in a no asset insolvency might be cross-subsidised from other insolvencies with assets which he/she is administering (and by the creditors in those insolvencies) would be open to serious objection in many jurisdictions.

**10.2** One important development in some jurisdictions has been that as regimes for individual bankrupts generally have been relaxed in terms of permitting earlier discharges, and as for example official receivers have been expected to focus their resources increasingly on their public interest investigating and prosecuting functions, so there has been seen to be a need to demonstrate more effective action against those who fail to co-operate or to meet their other obligations to disclose and deliver up their assets, etc or who have committed criminal offences. That balance has been carried further in United Kingdom which, alongside introducing a maximum twelve months discharge, has brought in civil bankruptcy restrictions orders for those found to have been irresponsible or reckless or to have committed other misconduct: the orders, of between two and fifteen years, impose restrictions such as obtaining credit and acting in the management of a company, with criminal penalties for breaches. British Virgin Islands has also introduced bankruptcy restrictions orders.

**10.3** Another important development has been in relation to companies and their directors. While directors of failed companies are liable to prosecution for criminal offences, they had not generally been subject to civil sanctions and restrictions – a position to be contrasted with that of individuals who had been made bankrupt, and based in part around the general concept of limited liability (albeit such limitation is in relation to the liability to contribute to assets of the company in the event that they are insufficient to meet its debts). A number of jurisdictions have introduced provisions by which directors found to have been irresponsible, reckless or dishonest may be disqualified from being directors of, or involved in the management of, other companies for specified periods generally up to fifteen years, with criminal penalties for breaches; or as in Ireland, may be subject to restriction that they may only act as a director in the ensuing five years if the company maintains a minimum level of capital in cash paid up shares. Directors may also be held liable to contribute to the assets of the failed company where they have been found to have been involved in wrongful or fraudulent trading.

**10.4** That has been taken further in Ireland: the High Court may order a director's disqualification where his/her company has been struck off the register for failing to file annual returns, providing that the company was insolvent and liabilities remained outstanding at the date of the application for disqualification.

**10.5** Hong Kong SAR has seen the court impose significant fines on criminal conviction reflecting the increasingly serious view taken in relation to, for example, the absence of accounting records which hinder investigations into assets, financial dealings and transactions and the causes of failure.

**10.6** A relatively recent development in other jurisdictions has been the use of warning letters where there is evidence of criminal offences but where which are not considered serious enough to justify the cost of proceedings. The letters are intended

to warn against the commission of future transgressions or offences, in the event of which proceedings would be likely and the earlier matters brought into consideration.

**10.7** A few jurisdictions have power to impose travel restrictions on individual bankrupts and/or directors of failed companies preventing them from leaving the country – for example Finland and Singapore.

**10.8** One issue in a number of jurisdictions is the extent to which agencies and authorities with insolvency responsibility have access to other information and intelligence in the hands of, for example, tax departments which may assist in their investigations: their legislation impose strict limits on information obtained for one purpose being used for another purpose, even the prosecution of criminal offences.

**10.9** A second issue going forward is the extent to which restrictions and sanctions, in relation to for example an undischarged bankrupt and a disqualified director, imposed for the protection of the public in one jurisdiction are capable of being effective in other jurisdictions – not only for the protection of the public in those other jurisdictions but also to constrain the continuing activities of those bankrupts and directors transacting business from another jurisdiction into the jurisdiction in which the restrictions and sanctions were imposed. This has been identified as a particular issue for offshore jurisdictions, such as British Virgin Islands, where key directors are invariably resident outside and work outside the country; but with multi-national businesses and migrant working, this has become a general issue for other jurisdictions.

## **11. Creditors – Government Taxes**

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**11.1** Generally, governments had been given preferential creditor status for unpaid taxes, in part on the basis that they were involuntary creditors – that is, that they did not grant “credit” and could not control the tax liabilities “incurred” by debtors in relation to employees, sales and profits. They shared that status with employees who were similarly seen as involuntary creditors, although invariably their (governments’) claims significantly outweighed those of the employees and took a major share of any distribution where there was insufficient for the preferential creditors to be paid in full; or, where there was sufficient to do so, impacted on the amount available to unsecured creditors. Governments were also subject to criticism that they did not take sufficiently early and effective action to obtain payment in the knowledge that all or part of their claims would be preferential.

**11.2** Most jurisdictions have now removed, or are considering removing, their government’s preferential status, either in a single step or in two or more steps.

## **12. Creditors – Employees**

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**12.1** Employees generally continue to have preferential status in respect of some or all of the categories of their claims, subject to different monetary limits and different periods to which the claims may relate: the balance of claims outside the preferential categories, monetary limits and/or periods rank alongside the claims of other unsecured creditors.

**12.2** A number of jurisdictions have specific or general Funds (variously referred to as unemployment, redundancy, protection, provident, guarantee, social security or social insurance funds) from which employees may claim in the event of the insolvency of their employer, or in some jurisdictions where the employer has defaulted but is not subject to a formal insolvency procedure: again, what can be claimed is generally subject to limits. The Funds may be funded from specific levies or from general taxation. Invariably, where a Fund makes payments to employees, it is subrogated to their rights (including any preferential rights) to claim in the insolvency.

**12.3** In a few jurisdictions, the directors of a failed company can be held personally liable for unpaid employees' entitlements – for example, Canada (and also for unpaid sales tax) and New Zealand; or for unpaid fund contributions – for example, Singapore.

**12.4** One interesting recent development has been in Latvia and the United Kingdom where the Fund is administered by the agency with insolvency responsibility.

### **13. The Role of the Court**

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**13.1** There has been a clear move in common law jurisdictions to transfer functions from the courts to the agency or authority with insolvency responsibility to eliminate the cost and almost inevitable delay of court proceedings – for example:

- The Insolvency & Trustee Service Australia has for some years now accepted petitions for bankruptcy presented by debtors; the Insolvency & Trustee Service New Zealand is considering a similar step; and in the United Kingdom applications for the proposed debt relief orders will be submitted to The Insolvency Service's official receivers.
- Ireland is drafting legislation under which the Office of the Director of Corporate Enforcement will be able to administratively impose disqualifications and restrictions on company directors.
- The Department of Insolvency Malaysia and the Insolvency & Public Trustee Office Singapore have for several years now issued certificates of discharge.
- The Insolvency & Trustee Service New Zealand is proposing that it should be able to receive and administer instalment orders.
- The United Kingdom Insolvency Service has for several years now had power to accept disqualification undertakings from directors of failed companies which have the same effect as disqualification orders made by the court; and it has recently been given power to accept bankruptcy restrictions undertakings and income payment agreements from bankrupts, which again have the same effect as court orders.

**13.2** Further factors in the shift in this and other areas have been the increasing transparency and accountability of agencies and authorities in relation to the exercise of administrative powers; and where it has involved insolvency administrators, the introduction of some form of registration or licensing within a regulated framework which has removed the perceived need for the court to exercise detailed control of the conduct of cases.

**13.3** There are invariably provisions to appeal from administrative actions and decisions to the court, with the court's role increasingly seen in these jurisdictions to be the resolution of disputes and the determination of legal issues.

**13.4** Some of the new market economies have recognised the need to address the issues scarce judicial resources, court priorities and the costs and delays of court proceedings in the way in which they have developed their institutional structures and procedures, including the creation of agencies or authorities to regulate the standards and conduct of insolvency administrators:

- The State Insolvency Administration Agency has assumed responsibility from the Latvia courts for assessing the competence and suitability to act as insolvency administrators and being appointed in individual cases, and examining complaints by creditors or debtors about the actions and decisions of insolvency administrators: Hungary is considering establishing an agency with similar powers.

## **14. The Role of Creditors**

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**14.1** In all jurisdictions, the creditors have a role to play – in some in the appointment of the insolvency administrator; and in most in overseeing, usually through a committee, the insolvency administrator’s administration of the estate, giving directions or approving his/her actions and fixing his/her remuneration.

**14.2** What however has become an increasing issue in a number of jurisdictions is the extent of creditors’ real involvement beyond those major insolvencies with significant assets and the likelihood of significant dividends. To what extent is a creditor with a substantial claim in an insolvency where there is expected eventually to be a distribution of perhaps no more than 1%-2% going to spend time in carrying out a supervisory role over a period of several years but which is going to have little or no noticeable effect on the outcome? Do creditors see themselves as being better off using that time to pursue debtors who are not insolvent or to generate new, paying, business?

**14.3** What is not clear is whether the relative new (following the United States) phenomenon of debt trading will result in creditors who have bought debt more closely involving themselves in the oversight of insolvency administrators and the outcomes of cases.

## **15. Insolvency Administrators and Change**

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As noted above at para 5, in most jurisdictions some or all of the insolvencies are administered by private sector insolvency administrators. Changes in approach and in underlying cultures are not always easily and readily achieved. There is an issue whether insolvency professions are sometimes too entrenched in their attitudes, protective of their position and averse to change, with the result that new procedures and practices are not taken forward with the enthusiasm and innovation needed.

## **16. Remuneration of Insolvency Administrators**

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**16.1** Remuneration is generally based on one or a combination of (a) a commission or percentage of assets realised and/or funds distributed; (b) a tariff related to functions carried out; and (c) time and rate. The basis of remuneration and commissions/percentages, tariffs and rates may be determined by statute; by code promulgated by the government or its agency or by a professional body; or on an

individual case basis by the creditors (or their committee), by the court or by the agency or authority with insolvency responsibility.

**16.2** The essential principle is that an insolvency administrator should be fairly remunerated for his/her work, together with being reimbursed costs and expenses properly incurred by him/her in the performance of his/her duties and functions; and that the system should seek to achieve a balance between reward and risk to attract appropriately qualified and experienced people to act as insolvency administrators:

- Commission/percentage or tariff basis can lead to under- or over-recovery of the cost of time spent by the insolvency administrator, but does give some certainty to creditors that they should receive a proportion of the realisations.
- Time and rate may be more appropriate where there is uncertainty about the amount of work which will be involved or there are complex matters to be resolved.
- Commission/percentage or tariff basis may not provide a sufficient incentive to insolvency administrators to pursue matters where the work may be disproportionate to the outcome or may prove fruitless.
- Time and rate may compensate the cost of time spent but not necessarily the value achieved, for example in pursuing unnecessary and fruitless investigations.

**16.3** Who is in the best position to reach on view on how much an insolvency administrator should be paid? In a number of jurisdictions, it is a matter for the creditors who have some overseeing role and who are effectively paying for the insolvency administrator to act on their behalf since he/she is paid out of the asset realisations. There is an issue of creditors maintaining an interest in anything but the largest cases; whether in other cases the process of fixing remuneration is anything more than a formality; and whether, since the creditors are effectively paying, that should be a matter of any wider public interest and intervention.

**16.4** Mexico provides for a tariff for insolvency administrators (auditors, conciliators and trustees), but they may apply to the Instituto Federal de Especialistas de Concursos Mercantiles for an additional or special fee in the circumstances of the particular case.

**16.5** Some jurisdictions, such as South Africa, have sought to address differences in the amount of time and cost of resources likely to be spent and the complexity and difficulty (or otherwise) of the work by having different percentage rates for realising different types of assets, with the court having the power to increase or reduce the rates in the circumstances of the particular case. But there would expect to be objection to a “swings and roundabouts” approach by which an insolvency practitioner who administers a substantial number of small and relatively unprofitable cases might expect to be “compensated” in a large and particularly profitable case.

**16.6** In other jurisdictions, the agency or authority with insolvency responsibility has powers to make representations to the court on applications to fix remuneration

**16.7** Is the court better placed to reach conclusions on the appropriate amount to be paid? The court may be required by the legislation to do so, either at first instance or where there is a dispute between the insolvency administrator and one or more of the creditors. But the process is time consuming and costly, and is realistically likely only to be worthwhile where there are significant amounts at stake. Canada for example

provides an alternative for remuneration disputes to be referred to arbitration which is less costly and faster; while in Australia official receivers act as taxing masters in fixing insolvency administrators' remuneration in individual bankruptcies.

## **17. Regulation of Insolvency Administrators**

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**17.1** Jurisdictions have introduced or are developing a range of solutions to the regulation of private sector insolvency administrators. The subject is extensively covered in IAIR papers prepared for the World Bank Principles & Guidelines for Effective Insolvency and Creditor Rights Initiative, and is therefore not discussed here.

**17.2** It is however interesting to note that, aside from Finland and United Kingdom, the developed market economies in the European Union do not have independent (of the private sector professions) regulatory bodies, but rather rely on the courts to oversee insolvency administrators on an individual case basis; while the new market economies have put in place or are looking at setting up government agencies to undertake a regulatory role - for example Latvia, Russia and Serbia.

**17.3** Issues going forward with increasing globalisation are:

- Co-operation between courts and between insolvency administrators appointed in different jurisdictions.
- Sharing of information and co-operation between regulatory bodies.
- Supervision of local and foreign insolvency administrators in cross-border insolvencies, and in particular the role of a regulatory body in relation to foreign insolvency administrators operating in its jurisdiction.

**17.4** In discussion at IAIR Helsinki 2005, it was suggested that if an administrator acted improperly or illegally in a foreign jurisdiction, then the appropriate course would be that he/she should be reported to the body by which he/she was authorised/licensed/certified in his/her own jurisdiction. That rather underlines the need for cooperation between regulators and the development of protocols for dealing with such matters. The problem might be that some jurisdictions did not have an equivalent regulatory body, but rather that appointments are made on a case by case basis by the court and there might not be effective sanctions other than in relation to the particular case involved. There could be a tension between the action which the regulator in the foreign jurisdiction either wants to take itself or wants taken, and the action which the regulator in the insolvency administrator's jurisdiction decides to take.

**17.5** British Virgin Islands envisages that in relation to multi-national companies where there are existing proceedings in a foreign jurisdiction, then the foreign insolvency administrator might be appointed jointly with a BVI-licensed insolvency administrator in relation to matters within the jurisdiction of the BVI court

## **18. Funding of Governments' Roles in Insolvencies**

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**18.1** Governments and their departments, ministries, agencies and public authorities have different roles in different jurisdictions in relation to insolvency policy and legislation, regulation, practice and administration and information and education. A

common issue is however resources and how they should be provided – whether from general taxation and/or from fees, how fees should be structured and who should pay.

**18.2** Modern government has brought with it commercial-style accounting requirements, transparency and accountability:

- The Insolvency & Trustee Service Australia is now required to fix fees and charges by reference to the cost of the services provided in accordance with its government's cost recovery policy.
- New Zealand had looked at whether time and rate charging for its official receivers would impose a more focussed approach on managers and staff in relation to time usage and case completions, and provide a benchmark with the private sector.
- The United Kingdom Insolvency Service already fixes its fees by reference to the cost of the services provided – administration of estates, banking and investment of estate funds and regulation of insolvency administrators - which enables it to increase resources in line with increases in demand for its services: its non-fee earning public interest functions in relation to bankruptcy restrictions, disqualifications and prosecutions are funded by the government from general taxation.

**18.3** Where however an agency or authority is expected to operate on a full cost recovery basis in delivering monopoly services, the issue arises as to how fees should be controlled. Canada has new user fee legislation requiring it to consult on the level of its fees, and to provide comparators.

**18.4** A more commercial approach and pressure on resources and delivery of service standards, combined with the increasing use and development of information technology, has led some agencies and authorities to centralise some of their functions, for example enquiry lines and the provision of information, the realisation of assets and distribution of funds and conduct investigations.

## **19. Case Forecasting**

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Linked with fees and resources is the issue of forecasting future revenues and workloads – something for which Canada has developed models for business and consumer insolvencies: the models are also used by the Office of the Superintendent of Bankruptcy to plan where its resources, more particularly its staff, will be required in the future as well contributing to the evaluation of the impact of legislative changes and an understanding of the factors likely to affect the numbers of cases.

## **20. Information and Education**

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**20.1** In most jurisdictions, the department, ministry, agency or public authority with insolvency responsibility issues information about insolvency procedures and practice in booklets, leaflets, press notices and/or their websites: they may also be involved in speaking at conferences, seminars and other forums to a range of audiences.

**20.2** In some jurisdictions, there is a specific responsibility for providing awareness, education and training programmes to the business community, to consumers and to insolvency administrators.

**20.3** United States have introduced legislation requiring that individual debtors have to undergo debt counselling before they can file for bankruptcy, and financial education before being granted a discharge.

## **21. Accountability of Agencies and Authorities**

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**21.1** In the majority of insolvencies there were no assets and no misconduct which would justify civil or criminal sanctions. What the agency or authority with insolvency responsibility seeks to do is to carry out its functions promptly, efficiently and cost effectively; and an increasing number of them publish annual reports setting out how they have discharged their functions and the costs of doing so.

**21.2** Many of those agencies and authorities have service standards, for example relating to the promptness of answering telephone calls, sending notices and reports, replying to correspondence and dealing with complaints: the standards and performance are published. That has raised the issue in Canada as to whether a failure to meet performance standards should be subject to some penalty.

**21.3** In addition to internal measurement, it has been increasingly common to conduct surveys of users, either on a continuous basis or as a series of studies targeted at specific issues or particular groups of users as well as communities and the general public.

**21.4** In a number of jurisdictions, there are independent adjudication or ombudsman systems to which complainants can refer in the event that they are dissatisfied with the way in which the agency or authority has dealt with their complaint.

**21.5** There is an increasing expectation that policy and practice is evidence-based and is subject to post-implementation evaluation and review; and therefore an increasing use of statistical information and research in the development of proposals and assessment of the impact of changes. Linked with that has been the creation of consultative groups of stakeholders – either on a standing permanent basis or for specific matters - to consider changes to legislation and improvements to service delivery.

## **22. Other Issues**

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- Pension funds and deficits when a business is insolvent.
- Forum shopping - that is, businesses transferring their centre of main interests to countries where they perceive there to be a less rigorous/punitive insolvency regime.
- Arbitration, mediation and dispute resolution which is a feature in a few jurisdictions aimed at reducing the costs and delays involved in court proceedings.



**The IAIR is a world-wide organisation of government departments, ministries, agencies and public authorities with responsibility for insolvency policy and legislation, regulation and practice and administration**  
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