



## **PRE-PACK POOL – ANNUAL REVIEW 2017**

*May 2018*

### **Foreword**

#### *Pre-packs in Context*

'Pre-pack' administrations, as we wrote last year, are one of the most visible, and most discussed, parts of the UK's insolvency and restructuring framework. They are an effective business and job rescue tool and, importantly, a way of maximising returns to creditors after an insolvency. Indeed, pre-packs should only be used when this is the case.

And yet, pre-packs tend to attract criticism from creditors and other stakeholders, particularly where they involve the sale of an insolvent company's assets to individuals or businesses already connected to the insolvent company.

Pre-packs have a difficult balancing act to strike. On the one hand, they can achieve the best possible outcome for an insolvent company's creditors. But, on the other, to achieve this goal there is an unavoidable element of speed and discretion which can leave creditors feeling like they have been kept in the dark. Creditors will only find out about a pre-pack once it has taken place; but transparency about a struggling company's woes before this point would potentially undermine the company's value – and the value of what could be returned to creditors.

Given creditors only find out about a pre-pack after the event, it is wholly understandable that they will seek reassurance that a pre-pack was the right thing to do. The insolvency practitioner is there to provide this assurance; the Pool was set up to provide additional such assurance.

It is also worth putting the concerns about pre-packs in some context: they are relatively rare, as are formal complaints about them.

In 2017, the period covered by this report, pre-packs were 2% of all corporate insolvencies. In 2016, the year for which we last have figures, less than 1% of complaints to the Insolvency Service were about pre-packs – that's three complaints in total. The Insolvency Service's report on insolvency practitioner compliance with pre-pack rules in 2016 found two-in-three pre-packs were wholly compliant, while in the "vast majority of the non-compliant statements, the breach was not deemed to be serious and was merely of a technical nature."

#### **Pool Referrals**

The rate of connected party pre-pack referrals to the Pool in 2017, our second year of operation, dropped from our opening period. In 2015-16, over one-in-four eligible cases were referred to the Pool; in 2017, that figure was closer to one-in-ten.

Why has the referral rate to the Pool dropped? The simplest answer is that connected party purchasers do not currently worry about the consequences of not making a referral. There are no regulatory penalties against the purchaser for not making a referral; and, just as importantly, there appears to be little pressure from suppliers and customers on purchasers to approach the Pool.

It is important to remember that the responsibility for making a referral to the Pool lies with the connected party purchaser, not with the insolvency practitioner or with creditors. The only mandatory part of the process is that the insolvency practitioner must inform the purchaser of the option to use the Pool. As the Insolvency Service's report on insolvency practitioner regulation shows, very few insolvency practitioners are failing to do this.

Within the existing framework, a change in approach from those companies doing business with a connected party-owned 'NewCo' could be an effective way of focusing connected party purchasers' minds. Significant 'NewCo' stakeholders, like the banks or HMRC, could add Pool referral to their conditions of doing business with a connected party-owned post-insolvency 'NewCo'.

As we reported last year, low creditor engagement is a recurring issue in insolvency procedures: many creditors are resigned to writing off their losses and moving on. Creditors, however, do have power over those businesses which have been through a pre-pack as, in many cases, the creditors of the 'OldCo' will be the lenders, customers and suppliers the 'NewCo' will rely on. Despite the lack of transparency during a pre-pack, there is still plenty of information available afterwards. The insolvency practitioner's SIP16 report which accompanies a pre-pack will set out the rationale for the pre-pack (and its advantages for creditors over alternative procedures) and whether or not the Pool has been approached. Creditors can put pressure on connected party purchasers by making use of this information.

This year, the Government will be reviewing the impact of the Pool and the other 2015 'Graham reforms' to pre-packs, as a prelude to deciding whether or not to ban or regulate sales to connected parties from administration (a power it gave itself in the 2015 Small Business, Enterprise and Employment Act). The experiences of the Pool will be a key part of this review.

The Pool exists to provide further assurance for creditors that a pre-pack was the best option in the circumstances. Although the referral rate is much lower than expected, the Pool does perform a useful function where it has been approached. Feedback from both connected party purchasers and creditors has been positive where we have received it. Hopefully, working with creditors, government, and the insolvency profession, we can find a way to increase the referral rate, so more can benefit.

Pre-packs are a valuable part of the UK's insolvency and restructuring framework and a 'ban' would be a blow to business and job rescue. But, creditor concerns about transparency do need to be addressed in order to maintain confidence in the process and the wider framework. The Pool can help provide this confidence – if it is used.

## About the Pre-pack Pool

The Pre-pack Pool was launched on 1 November 2015 following the recommendations of the Graham Review of 'pre-pack' administrations.

The aims of the pool are to increase the transparency of connected party pre-packs and to provide assurance for creditors that independent business experts have reviewed a proposed connected party pre-pack transaction before it is completed.

The Pool is a body of experienced business people who will provide an opinion on the proposed sale of a company's business and/or its assets to a connected party. This opinion is available to creditors (see below). One member of the Pool will review any application and they will offer one of three opinions on the proposed sale:

1. The case for the pre-pack is not unreasonable;
2. The case for a pre-pack is not unreasonable but there are minor limitations in the evidence provided;
3. The case for the pre-pack is not made.

The Pool's opinion is available to creditors as part of a 'SIP16' report. It is the responsibility of the connected party purchaser to submit an application to the Pool. Use of the Pool is not compulsory.

When a pre-pack sale to a connected party is proposed, an insolvency practitioner should inform the purchaser of their ability to approach the Pre-pack Pool. The insolvency practitioner should then include statements in a SIP16 report to explain whether the Pre-pack Pool has been approached by the purchaser or not, and that, if it has, a copy of the Pool's opinion has been requested from the purchaser. If a copy of the opinion is provided by the connected party, it should be included within the SIP16 statement. Ordinarily this will be provided to the insolvency practitioner directly via the online Pre-pack Pool portal.

As well as going to creditors, SIP16 reports must be sent to an insolvency practitioner's Recognised Professional Body (RPB). There are five RPBs:

- the Association of Chartered Certified Accountants (ACCA);
- the Chartered Accountants Regulatory Board (CARB);
- the Insolvency Practitioners Association (IPA);
- the Institute of Chartered Accountants in England and Wales (ICAEW); and
- the Institute of Chartered Accountants Scotland (ICAS).

The Pool is a limited company and independent of the government and insolvency and restructuring profession.

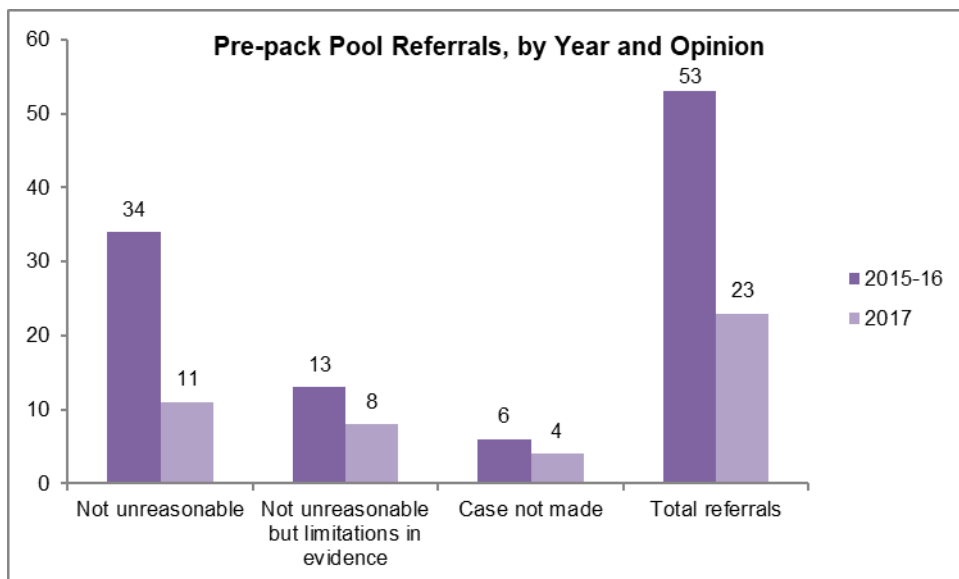
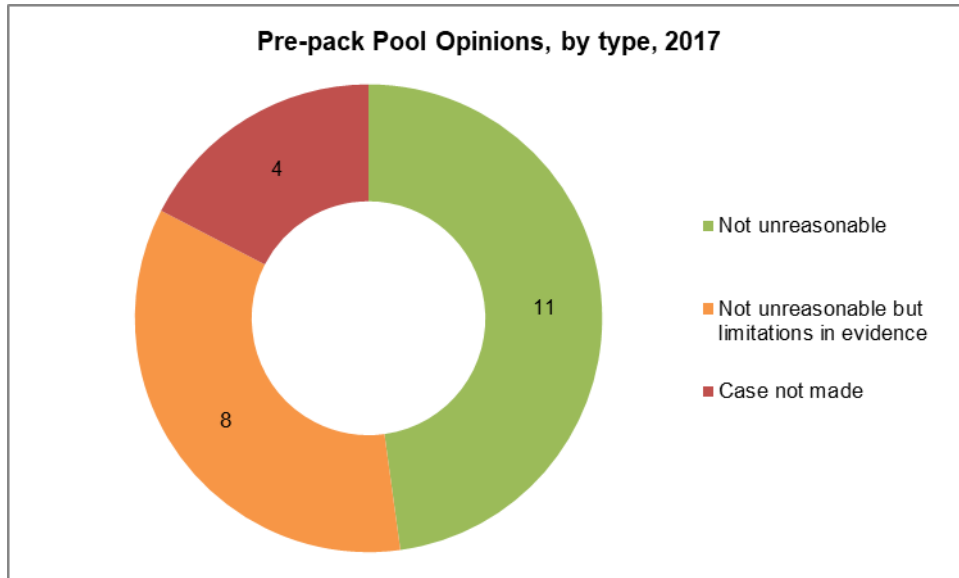
### *What is 'SIP16'?*

The Statement of Insolvency Practice 16 is part of the insolvency regulatory framework that dictates what insolvency practitioners should do when a pre-pack has been proposed. The report to creditors following a pre-pack is known as a 'SIP16' report.

## 2017 Pool Statistics

### Cases Reviewed – Responses

Between 1 January 2017 and 31 December 2017, a total of 23 proposed connected party pre-pack purchases were submitted to the Pool for review. Of these, 11 received a ‘not unreasonable’ opinion (49%), 8 received a ‘not unreasonable but limitations in evidence’ opinion, and 4 received a ‘case not made’ opinion.



### Cases Reviewed – Share of Pre-packs and Administrations

Following any pre-pack administration, the insolvency practitioner must send a copy of the SIP16 report to their RPB. According to the RPBs, between 1 January 2017 and 31 December 2017, there were 356 SIP16 reports filed, of which 203 involved a purchase by a connected party (57%). The cases referred to the Pool represents 11% of those cases eligible for referral.

This compares to 371 SIP16 reports filed between 1 November 2015 (when the Pool opened) and 31 December 2016, of which 188 involved a sale to a connected party (51%). Of those eligible for referral to the Pool in this period, 28% were referred.

The 356 pre-packs in 2017 were 28% of the 1,289 administrations which took place in the same period. By contrast, in the Pool's first 14 months of operation, pre-packs were approximately equivalent to 22% of all administrations.

## Background to the Pool

### *The Insolvency Landscape*

It's important that any assessment of pre-pack numbers is carried out with and awareness of the historical context.

The overall number of insolvencies increased in 2017 from 2016 – the first such annual increase since the financial crisis – but, notably, administrations continued their steady post-crisis fall: administrations in 2017 (1,289) were just 27% of their 2008 peak (4,808) and were 6% lower than 2016 (1,374).

As administration numbers have fallen, so have the numbers of pre-packs: in 2017, pre-pack numbers were roughly half of what they were in 2010 and 2011 (the years for which we have data).

That said, it is notable that there was a slight increase in the share of pre-packs involving a connected party purchaser from the Pool's first year of operation to its second, albeit a small one. Still, compared to the available historical data, the proportion of connected party pre-pack numbers are now is also well down on previous years.

	2010*	2011*	1 November 2015 – 31 December 2016	2017
Total administrations	2,835	2,808	1,689	1,289
Total pre-packs	769**	723	371	356
Pre-packs as a % of administrations	27%	26%	22%	28%
Total pre-packs with a connected party purchase	554 (approx.)**	571 (approx.)	188	203
% of pre-packs with a connected party purchase	72%**	79%	51%	57%
Total pre-packs without a connected party purchase	215 (approx.)**	152 (approx.)	183	153
% of pre-packs without a connected party purchase	28%**	21%	49%	43%

*\*Numbers are from the Insolvency Service's reports on the operation of SIP16 for 2010 and 2011. NB. Total administration figures in these reports differ to those given in the Insolvency Service's official quarterly insolvency statistics.*

*\*\*Research carried out by the University of Wolverhampton for the Graham Review found that, based on a sample of 499 2010 pre-packs, there were 316 connected party sales (63%)*

### 2015 Graham Review

In July 2013, the government commissioned Teresa Graham to lead an independent review into pre-pack administrations and their economic impact

The Graham Review noted that pre-pack numbers are relatively small but that a perceived lack of transparency around the process meant pre-packs attracted a disproportionate level of attention and criticism.

The review concluded that 'there is a place for pre-packs in the UK's insolvency landscape' and that 'the benefits that pre-packing brings to the UK's insolvency framework mean that reform of the process is worthwhile.' The review also stated that pre-packs can preserve jobs and that they are cheaper than other insolvency procedures. However, the review also found that pre-packs 'lack transparency' and that the marketing and valuation of potential pre-pack companies needed to be improved, and that more consideration should be given to the future viability of a company once it has been through a pre-pack.

The review made six recommendations for reforming pre-packs:

1. Pre-pack Pool. On a voluntary basis, connected parties approach a 'pre-pack pool' before the sale and disclose details of the deal, for the pool member to opine on.
2. Viability Review. On a voluntary basis, the connected party completes a 'viability review' on the new company.
3. SIP 16: that the Joint Insolvency Committee considers, at the earliest opportunity, the redrafted SIP16 [proposed by Teresa Graham].
4. Marketing: that all marketing of businesses that pre-pack comply with six principles of good marketing and that any deviation from these principles be brought to creditors' attention.
5. Valuations: SIP16 be amended to the effect that valuations must be carried out by a valuer who holds professional indemnity insurance.
6. SIP 16: that the Insolvency Service withdraws from monitoring SIP16 statements and that monitoring be picked up by the Recognised Professional Bodies.

The reforms recommended by the Graham Review, including the Pre-pack Pool, were introduced in 2015. At the same time, the Government gave itself the power to 'ban or regulate' sales to connected parties from any administration (not just pre-packs). This power expires in 2020. To make a decision on whether or not to use this power, the Government has begun a review of the impact of the Graham reforms, which will take place during the first half of 2018.