



The World Bank
Insolvency and Creditor/Debtor Regimes
Task Force Meetings

THE REGULATION OF INSOLVENCY
REPRESENTATIVES

January 10, 2011
Held at the World Bank
Washington, DC

Rapporteur's Synopsis

By James Callon, Ottawa, Canada

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**The World Bank Insolvency and Creditor/Debtor Regimes
Task Force Meeting**

REPORT OF THE SESSION ON

**‘THE REGULATION OF INSOLVENCY
REPRESENTATIVES’**

Date: January 10, 2011

Panel Participants:

Chairperson: Ignacio Jose Tirado
(World Bank)

Panelists: Luis Manuel Méjan
(Mexico),

Luciano Panzani
(Italy),

David Stallibrass
(Office of Fair Trading, United Kingdom),

Gordon Stewart
(INSOL),

Mahesh Uttamchandani
(World Bank),

Jim Callon
(International Association of Insolvency
Regulators)

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Summary of proceedings¹:

On January 10, 2011, panelists convened to discuss the role of Insolvency Representatives (referred to as IRs) as a key part of an effective insolvency system in the context of a two day World Bank task force meeting on insolvency and creditor/debtor regimes. Ignacio Tirado (World Bank) chaired the meeting, introduced the panelists. Mr. Tirado presented the World Bank discussion paper on IRs, containing analysis and guidelines to review issues related to the general regulation of insolvency representatives. Luis Manuel Méjan (former Director of IFECOM, Mexico), Gordon Stewart (INSOL Vice President and Partner at Allen & Overy) and Luciano Panzani (President, District Court of Turin, Italy) were invited to present an overview of the insolvency administration systems adopted in their home countries: the Mexican experience as an example of an (almost) public model, the UK model as a mainly market-driven one, and the Italian insolvency regulatory framework as an example of a hybrid system consisting of several elements distinctive of the private/public models. The discussion was followed by the analysis of Mahesh Uttamchandani, (Global Product Leader, Insolvency Investment Climate Advisory Services, World Bank), who provided concrete examples of the difficulties that the World Bank faces in implementing reforms of insolvency administration systems in developing countries.

David Stallibrass, Project Director at the Office of Fair Trading (OFT) presented the market study on corporate insolvency practitioners published by the OFT in June 2010 urging for the adoption of a variety of measures to remedy market failures in the UK. Building on the OFT market study, Gordon Stewart, Vice President of INSOL, shared his experience as an insolvency practitioner in the UK and called into question some of the conclusions reached in the study. Lastly, Jim Callon, Chairman of the International Association of Insolvency Regulators (IAIR) and Superintendent of Bankruptcy, Canada, commended the authors of the OFT report and briefly touched upon other elements which the report should have taken into account. After the panelists' interventions, the floor was opened to questions from the audience.

The Debate:

The panelists focused on the level of oversight of IRs in 3 key areas, the process for appointment of the IR to an insolvency proceeding, the system of remuneration and the oversight of the profession of IRs. In addition, panelists discussed areas of improvement or reforms that could improve the performance and credibility of the system of oversight of IRs. This report highlights the discussions in each of these key topics.

¹ Acknowledgement and thanks to Mr. Giovanni Bo, World Bank, Washington for the professional support in producing this report.

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Appointments and Qualifications:

An important element in having an effective insolvency system is that the officials who are hired or appointed to manage the administration of insolvency files are trained, competent and ethical. This was a key focus of this panel as we reviewed three different models of oversight of Insolvency representatives, that being the models of Mexico, Italy and the UK.

To some degree, the courts play a role in the administration of insolvency files in all three models and thus provide a degree of oversight with respect to the activities of an IR while he carries out his duties in a specific file. While court oversight is important, the courts do not have the capacity or the mandate to analyze, audit and test the knowledge and performance of the IR over a period of time.

The three presentations by the countries demonstrated that there is a range of options available in terms of the design of an oversight system for appointment of Insolvency Representatives. In Mexico, it is the government insolvency regulator, Instituto Federal de Especialistas de Concursos Mercantiles (IFECOM), who is in charge of the register and the monitoring of insolvency specialists. These private sector insolvency practitioners are appointed by the IFECOM at different stages of the insolvency procedure as support to judges.

In Italy, the authority to appoint an IR depends on the type of insolvency procedure that is initiated. The appointment may be made by the debtor in consensual restructuring proceedings; the court will appoint in liquidation proceedings while the government will appoint the IR in extraordinary administrations involving large enterprises. When the courts select the IR to administer an insolvency proceeding, the judges are expected to select an IR from practicing accountants, lawyers or partnerships of lawyers or chartered accountants that the judges deem as being experienced in insolvency matters.

In the UK, it is the debtor that will normally select the insolvency professional who will administer the voluntary insolvency file although in the case of an involuntary filing, the creditors and the courts may appoint the IR.

With respect to the level of qualifications required to be appointed in the administration of an insolvency file, all three models expect that the IR will have professional qualifications and training such as a lawyer, a chartered accountant, an auditor and who also have experience in the insolvency business. In the UK, the government has approved certain professional bodies referred to as Recognized Professional Bodies (RPBs) that act as self-regulatory organizations. These RPBs are authorized by the government to issue licenses to their members who complete the qualification

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requirements to become an IR (trustee). These self-regulatory professional bodies have established a stringent joint insolvency training and examination process which their members must pass if they wish to be licensed to practice as an IR (trustee).

All three models are concerned with having qualified professionals act as Insolvency Representatives but differ in how this is monitored. They also differ to some degree as to the method of appointment of an IR to an insolvency matter or to a particular type of proceeding whether the choice is left to the debtor, a court, a regulator or a decision of the majority of creditors. .

Remuneration:

In all three models, it will be the estate that is responsible for paying the fees and associate costs of the insolvency process and the work of the IR.

The issue of proper remuneration for IRs is a consistent point of discussion in the context of insolvency given the situation that a debtor must pay substantial administration costs/fees when the business is already having financial problems paying the bills. The issue of professional fees in other professional fields of a practice rarely attracts the same level of public attention as do fees charged by IRs; yet the level of knowledge, education and competencies are on an equal footing as to those of lawyers, auditors and accountants practicing in areas other than insolvency. However, given the level of attention on fees charged by an IR, each model has implemented an oversight mechanism for setting fees and/or reviewing and approving the proposed fees.

In Mexico, the remuneration of IRs is decided by the courts. However, a court's decision on remuneration is based on a scale of fees pre-set by IFECOM, through administrative rules. IRs are paid an hourly fee based on that scale. The Court authorizes the amount to be paid once the Regulatory Body has given its approval. Fees are based on a combination of two factors: 1) time; and 2) amount of credit (reorganization) or assets sold (liquidation). In Italy, the fees are also set in a similar manner whereby it is the Ministry of Justice who sets out the ranges of the fees that can be charged. It is then the court that has broad discretion in determining the actual amount of the fees that can be billed for the IR's actions.

In the UK, the IR is free to negotiate his own fees with the debtor company and set an agreement on fees in the case of a voluntary insolvency proceeding. If the creditors disagree with the fees, they may object and ask the courts to replace the IR with one that the creditors have approved. Where the insolvency process is initiated by the creditors, they will negotiate the fees with the IR before the appointment. Where disputes arise as to fees charged, the courts may be asked to review the fees.

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In spite of the fact that debtors and creditors having the ability to negotiate a proper level of fees in the UK, the Office of Fair Trading, represented by Mr. Stallibrass on the panel, was of the view that the regulatory system insufficiently protects unsecured creditors from high fees charged by the IR. Mr. Stallibrass maintained that the system for competitive pricing fails for two reasons, unsecured creditors have little incentive to look after their interests as there is normally very little in dividends (cash) available to be returned to the unsecured creditors regardless of the fees; and, the system is too complex and time consuming for many creditors to take effective action should they wish to contest the fees and for what would likely be very little return when averaged over all the unsecured creditors with claims in the file.

Oversight of the Profession

In order to promote effective administration of insolvency proceedings, it is essential jurisdictions provide a method of oversight over persons who perform the functions of IRs. Key objectives of oversight are to ensure that there is a level of professionalism, competency and ethics among the appointed practitioners.

In the United Kingdom, there are three levels of regulatory oversight: the Secretary of State for Business Innovation and Skills Department, which is tasked with recognizing certain professional bodies for the purpose of authorizing their members to act as IRs; the Insolvency Service, which has day to day responsibility for insolvency legislation, overseeing the development of regulatory policy and professional standards and providing guidance to the profession; and the Recognized Professional Bodies (RPBs), which set their own membership rules and regulations. Consistency across RPBs is achieved through a Memorandum of Understanding between the RPBs and the Secretary of State and by compliance with the Principles of Monitoring. Additionally, to practice as an IR, it is necessary to pass the Joint Insolvency Examination Board Exams in order to obtain a license from one of the RPBs (or the Insolvency Service), and be approved as a fit and proper person to administer insolvency proceedings. In terms of the activities and actions of an IR in a particular insolvency case, the courts also provide a degree of oversight.

In Italy, insolvency practitioners are expected to be lawyers or chartered accountants who would be bound by the professional standards of their respective professional association, thus the association would provide the professional standards and oversight. In terms of the activities and actions of an IR in a particular insolvency case, the courts also provide a degree of oversight.

In Mexico, IFECOM has the responsibility for the selection, registration and appointment of IRs, and as such, it has contributed to building a roster of competent professionals and

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has contributed to controlling corruption, strengthening the courts and achieving neutrality in the process

Continuous improvement / reforms to the insolvency system

Each of the panelists had noted the search for improvements in their respective models of oversight of IR's.

With respect to Mexico, Mr. Méjan mentioned some of the drawbacks to the Mexican insolvency administration system. With the screening of IR by the regulator and limiting the IRs to natural persons, the large accounting and law firms are excluded from appointment de facto. Also, the system does not adequately administer non assets cases given the inability to recover sufficient revenue to pay all the IR's costs and fees. Improvements could be made as well through a structure that would provide continuing professional education for IRs.

In Italy, Mr. Panzani noted that there is movement towards reducing the number of IR's and improving the transparency in the section process allow with finding the appropriate method of remuneration for IRs. With the exception of courts in the major city centres, there is a concern as to the level of expertise in insolvency proceedings throughout the country given the diversified nature of the courts and that the courts are not specialized into commercial or insolvency matters.

With respect to the UK, the panel focused on the presentation by Mr. Stallibrass who reviewed the key findings of the Office of Fair Trade (OFT). The study focused on the appointment, actions and fees of corporate IRs and determining the level of efficiency of the regulatory framework for IRs. To address marketplace distortions that it had detected, the study suggests remedies that would increase the efficiency and effectiveness of the regulatory system, and the regulations it enforces. In particular, the OFT proposes:

- A. establishing an independent complaints body to restore creditor trust in the regulatory regime by providing a simpler and cost-effective route to have the IRs fees properly assessed;
- B. setting clear objectives for the self regulatory regime to hold RPBs accountable for their actions or lack of actions; and changing some of the regulatory processes and responsibilities to increase returns to creditors; protect vulnerable market participants and to encourage a competitive and independent IR profession;
- C. amending some of the detailed regulations to better control IRs actions and fees in the interest of the unsecured creditor group.

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Mr. Stewart questioned some of the conclusions of the OFT report. His views are summarized as follows:

With respect to complaints about higher fees being charged in certain cases, clearly the setting or negotiating of fees is a very difficult task at the outset of an insolvency proceeding when in fact the complexity of the insolvency matters may not be clear or even fully identified. There is also the reality that when it is clear as to the complexity of the case and that it is judged to be a sizable amount of work, IRs often charge a lesser sum of money for their services based on the volume of the demand for services, a volume discount.

With respect to unsecured creditors not playing an active oversight role concerning actions by IRs and their fees, Mr. Stewart noted that there is an established system to object to fees and improper behavior by IRs and it is through a Court review and or through the complaint handling by professional bodies. While it may be true unsecured creditors may have little financial incentive to use available complaint mechanisms or lack the know-how, it also true that there are unsecured creditor that do have the capability and resources to use such mechanisms, yet the mechanisms are rarely used and which perhaps is a sign of a mature, abuse-free and efficient system.

Mr. Callon found the OFT report to have been a good study of the issues. He noted that from the point of view of a regulator, the insolvency system will never be perfect as the system relies on stakeholders to be engaged and to carry out their responsibilities as laid out by the rules. Furthermore, a lack of engagement to the process by a party can have a negative impact on holding people (IRs) accountable for their actions. It is very difficult to legislate a creditor's level of engagement in the process. If the expectation of the report is to add more regulatory rules or frameworks, then one must also address the need to properly empower the oversight bodies with the authorities to enforce the rules using proper compliance tools and ensure there is the funding necessary to properly monitor that the system is working as expected. The OFT report perhaps could have also focused on the issues of improved transparency, regulatory leadership given the UK's a complex matrix structure, effective information sharing and active collaboration within the existing in the framework. Mr. Callon was cautious with an OFT recommendation of a new complaints agency as that would stack on even more layers onto an already complex framework perhaps weakening the sense of accountability of existing bodies.

Mr. Mahesh Uttamchandani contributed to the discussion by providing examples of the barriers that the World Bank faces in supporting insolvency reforms in developing countries. Political, institutional and economic constraints in developing countries often require departing from the ideal setting. Instead, the World Bank provides the client with the best options for the client country based on the characteristics of the country's

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political, legal and economic systems. Countries are often constrained by political and economical considerations that can significantly limit the scope of action and may result in the adoption of unbalanced solutions.

While Mr. Uttamchandani recognizes that not one size fits all, he commends the adoption of internationally recognized standards and principles to which reforms shall be inspired. Tailoring reforms to the specific characteristics of the client's legal system ensures that they are not perceived as foreign and externally imposed. It is therefore crucial that client countries understand the objectives of the reform and the hoped-for economic impact. To achieve this, efficiency, transparency, and affordable insolvency procedures are crucial. Lastly, cultural features are also an important element to be taken into consideration while putting forward reforms in the insolvency administration system. In some countries, notion of self-regulation may be unheard of while in others, government oversight of the private sector is a non-start.

Response to the Panel discussions – key comments from the floor:

Mr. Nick Brainsby (European Bank for Reconstruction and Development): Mr. Brainsby shared the EBRD's experience working on the insolvency regime in the Russian Federation which has undergone significant reform in recent years, moving from a public model to more a self-regulated structure. The Russian system, requiring that insolvency office holders such as trustees and administrators be members of a self-regulating organization, is found to raise potential problems, given that there are no generally recognized standards regarding the powers allocated to such organizations. The EBRD works with the Ministry of Economic Development to overcome poor compliance with international standards and international best practices for effective insolvency and creditor rights systems.

Mr. Neil Cooper (INSOL): Mr. Cooper referred to the EBRD devised principles (*Core Principles for an Insolvency Law Regime*) as general standards that have been used to assess more than 30 countries across Europe. The EBRD derived specific diagnostic standards that it uses to evaluate countries both on their formal insolvency laws and on implementation. Similarly, he argued that these principles should guide experts when putting forward reforms of the insolvency regime in developing countries. He pointed out that corruption and the lack of resources, both from an economic perspective and in terms of human capital, are a major obstacle to successful reforms. There is an urgent need for reform beneficiaries to understand the potentialities of the system that international experts recommend.

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Riz Mokal (World Bank): Mr. Mokal welcomed the conclusions of the OFT in light of the impartiality with which the authors have analyzed the British regime of insolvency administration. He called attention to the need of setting up a system of controlling decision-makers that is affordable and easily accessible. Also, the proper realization of the estate is a crucial element as the absence of incentives to avoid misallocation of resources may result in the termination of viable businesses.

Mr. Gordon Stewart responded by stressing that no such case of unjustified business termination has ever been recorded in the UK.

Stephen Lubben (USA): Mr. Lubben made the point that it would be necessary to establish the differences between large cases and small/medium cases when it comes to assessing a system of IRs and their remuneration.

Concluding remarks:

The World Bank Task Force meeting provided an excellent session which went beyond the theoretical and presented the practical experience in dealing with 3 distinct oversight models for IRs in modern economies. It was clear that the models were different, yet they still were trying to address very similar issues that being a desire to instill a sense of a predictable process, of credibility, ethics and transparency.

The overall discussion raised various perspectives as to the development of oversight responsibilities for an insolvency system, specifically focused on the oversight of insolvency representatives and their administration of insolvency proceedings. One could see that there are commonalities as to the motivation for change in terms of developing and improving insolvency systems, that being a desire to instill in an insolvency system a high degree of credibility and professionalism, a predictable process, a system free of corruption and influence and a system that offers transparency to the stakeholders.

The panelists raised a variety of factors that any government would be faced with when developing or changing an insolvency system. Clearly the insolvency system will be reflective of the culture of the country, its economic health; it must consider the capacities of professional infrastructures in such areas as law, accounting, auditing and of course the judiciary. As change is often difficult, there must be the political understanding and will for introducing change to their economic framework. Some panel members noted that despite the advancement of the various models, there is still a need for the political will to address corruption, favoritism and conflicts of interest that occurs in the system. There must also be a willingness to fund the cost of implementing a formal insolvency system including costs of the institutions needed to support the system

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such as the courts, a regulator (government or self-regulatory) or some other method for development of standards and enforcement of the rules.

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