THE INSOLVENCY SERVICE

ICAEW SIP 16 Webinar

SIP 16: A Masterclass

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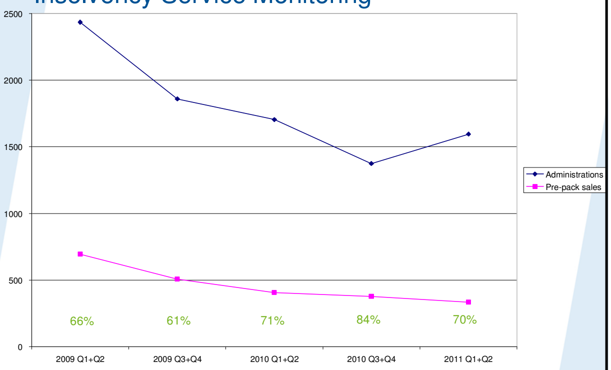
SIP 16: A Masterclass

Topics covered today:

- Update on SIP 16 monitoring
- Main areas of concern
- Guidance on best practice / examples
- Going forward

Insolvency Service Monitoring



Guidance in Dear IP 42

- Guidance issued in October 2009 – produced in consultation with the RPBs
- Purpose of guidance was to assist IP's in interpreting the SIP and to improve compliance in areas of particular weakness
- R3 Breakfast Briefings
- Compliance improved to 84% in the second half of 2010, although a sustained improvement is not yet evident.

Why are statements not compliant?

From our monitoring, the following areas are the most common pitfalls:

- Bullet point disclosure
- Timing
- Extent of prior involvement
- Marketing
- Valuations
- Details of assets and of the transaction
- Consideration
- Identity of the purchaser and any connection

Detailed explanation and justification

Key Principle (para 8 of SIP 16):

"It is important that [creditors] are provided with a detailed explanation and justification of why a pre-packaged sale was undertaken, so that they can be satisfied that the administrator has acted with due regard for their interests."

Detailed explanation and justification

- Aim - provide sufficient information so that creditors do not need to ask further questions about the justification for the pre-pack sale and details of it.
- Background information - creditors should be able to understand the context in which the practitioner has been appointed.

Detailed explanation and justification

Context should normally include matters such as:

- What the company did
- Financial pressures
- That the company is (or would become) insolvent
- QFC appointments
- Restructuring
- Speed

Whatever is necessary for an otherwise uninformed party to understand what has occurred

Timing

- Presumption is usually within ‘a few days’
- In all but the most exceptional cases, SIP 16 information should be disclosed **within 14 days** of completion
- If unable to comply an explanation should be provided
- SIP16 disclosure is retrospective. Not seeking approval
- Administration proposals are prospective and need approval

Extent of prior involvement

- Not always clear what role the IP had – especially when advising a floating charge holder. Possible conflicts of interest must be dealt with.
- Details of *when* prior involvement commenced are often missing
- Expect to see nature and purpose of the IP's introduction
- Creditors should be able to understand process that led to the decision to sell to the eventual purchaser

Marketing

- In the first 6 months of 2011, 52% of statements viewed showed no marketing activities were carried out by the administrator.
- In a good proportion of cases the reasons for not marketing the business for sale were well explained.
- However in too many cases an explanation for not marketing the business for sale was insufficient.
- Vital if creditors are to know they have received the best possible deal.

Marketing Examples – complaint Y/N?

1) "*The business had been marketed by the directors prior to the involvement of the administrator. The directors advised that no interest had been received. It was therefore decided that further marketing by the administrators would not be cost-effective*"

2) "*the directors had previously undertaken an extensive marketing exercise with a view to obtaining new investment or achieving a sale of the business, which was ultimately successful. The administrators are satisfied that the business has been adequately exposed to the market and that further marketing would be unlikely to achieve a higher offer than the one accepted. This view has been supported by [independent valuation agent].*"

Marketing – Best practice

- Always provide a full explanation of the decision not to market the business for sale.
- Provide details of where and how the business was marketed.
- Give information on the results of the marketing
- Give details of all offers received and why they were not proceeded with

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Valuations

- Too often value of the business and assets are not being disclosed.
- Some cases, overall value disclosed but not broken down among individual assets.
- In some cases no valuations were obtained for important assets.
- Vital if creditors are to see the pre-pack was in good faith

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Valuations Examples – compliant Y/N?

1. "*An independent valuation of the company's assets was carried out by [agent]. The agent recommended that the offer received should be accepted as it was in line with the valuations provided*"
2. "*All of the company's assets were valued by [agent]. The agent reported that the assets had a value of £65,000 on a going concern basis and a value of £19,000 on an Ex-situ basis*"

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Valuation Examples – Compliant Y/N?

- *"An independent valuation of the business was carried out by [appointed agents]. Details of the valuations received are summarised below:*

Basis	Going Concern	Ex-situ
Plant & Machinery	11,400	5,000
Stock	8,000	2,000
Book debts	19,999	3,500
Goodwill	1	Nil
Total	39,400	10,500

Valuations – best practice

- Always disclose details of all assets that have been valued and what those valuations are.
- If an asset has not been valued, an explanation should be provided.
- Include valuation of goodwill or appropriate explanation.
- What does in line mean?
- Are the valuers independent? Name them
- If the accepted offer is lower than the valuation, explain and justify

Assets

- Practitioners should provide details of the assets, including value, by reference to categories
- Provide other related information regarding assets sold whose value is complex or not readily ascertainable , e.g.
  - Rights of action
  - Sale of shares (distinguish subsidiary /investment)
- Significant assets not included in the sale agreement, e.g. book debts

Consideration for the transaction

- Consideration should be apportioned by asset category
- Deferred consideration - structure of payments, and any security should be disclosed
- When dealing with a group of companies, show the apportionment between the companies in the group

Details of Connections

- In most cases adequate information is provided
- In a minority of cases full disclosure is missing
- Important for public confidence that connections are disclosed

Connections best practice

- Disclose all types of connection (directors, shareholders, lenders)
- Disclose name of connected party
- Disclose name of anyone connected with a vested interest in the new company (eg former director now an employee)
- Avoid phrases such as "*Not known*".
- Full explanation on lender connections

Why is it important to get this right?

- Risk of reputational damage to the profession if pre-packs are not properly explained or justified
- Practitioners are best placed to provide the case-by-case justification
- More information provided “up-front” is likely to reduce the number of queries later
- The process of educating creditors is in the interests of the wider insolvency community
- Compliance with SIPs is mandatory

Non compliant statements

- We no longer write to IPs in every case where the disclosure is considered inadequate
- Where disclosure is deemed inadequate, noted as non compliant
- If the nature of the non disclosure is deemed sufficiently serious, it is referred directly to the RPB
- It is for the RPB to determine whether any breach has occurred and if further action is appropriate

Future SIP 16 monitoring by The Service

- The Service (IP Policy Section) will continue to monitor SIP16 disclosures for as long as the public interest demands
- We will not review all statements, but not less than 25%
- Will continue to publish annual reports of monitoring, but no other official release of compliance rates
- SIP16 itself likely to require review following introduction of additional controls

Summary

- Practitioners should consider the SIP16 disclosure as an opportunity to show how they added value
- The rationale behind the sale of the business needs to be explained and put into a proper commercial context
- Sales to a connected party may require more detail
- Does the disclosure make sense?