

EVALUATION OF DISCHARGE – SECOND INTERIM EVALUATION REPORT

Section 1 - Purpose of the paper

1. To provide details of the on-going evaluation work being undertaken in respect of the discharge provisions of the Enterprise Act 2002.

Section 2 – Background and Purpose of Evaluation

2. On 1 April 2004, new insolvency legislation came into force contained in the Enterprise Act 2002. This new legislation introduced provisions whereby a bankrupt is automatically discharged one year after the commencement of bankruptcy. Further, discharge can occur earlier if the Official Receiver files a notice at Court stating that the investigations into the affairs and conduct of the bankrupt are unnecessary or completed.

3. The objectives of the discharge provisions contained in the Enterprise Act 2002 are:

- To enable the prompt rehabilitation of bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver
- To not discriminate against 'second-time' bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver
- To speed up the process of suspending the discharge of a bankrupt due to non-co-operation where a trustee other than the Official Receiver has been appointed
- To help lift the stigma of bankruptcy

4. The principal aim of the evaluation is to provide a comprehensive assessment of whether, to what extent and how the provisions relating to discharge meet these policy objectives. The evaluation also provides information and data that can be used to inform future policy decisions.

5. The Insolvency Service made a commitment to the Government to undertake an evaluation of the Enterprise Act 2002 within 3 years of commencement of the various provisions. The discharge provisions commenced on 1 April 2004 and therefore, the evaluation is due to be completed by 31 March 2007. This is the second interim report to summarise the evaluation work and findings to date¹.

Section 3 – Approach

6. The evaluation uses both quantitative and qualitative evaluation methods, including:

- Analysis of data on individual insolvency cases held on The Insolvency Service's internal Information Technology system
- Sampling and review of files on individual insolvency cases to supplement information from other sources
- Meetings with professionals within the insolvency sector to seek their views regarding the appropriateness and impact of insolvency legislation
- Structured questionnaires and interviews with bankrupts, creditors, and other members of the public to obtain their views and experience of the impact of

¹ The first interim report dated March 2005 is available on The Insolvency Service's website (www.insolvency.gov.uk).

insolvency legislation and to obtain feedback on the wider issues associated with bankruptcy

7. In order to ascertain the impact of the Enterprise Act 2002 provisions, benchmark information was obtained regarding the operation and effect of the existing legislation, i.e. before the implementation of the Enterprise Act 2002 provisions.

8. A copy of the evaluation planning paper is contained at [appendix 1](#).

Section 4 – Work Carried Out to Date

9. All benchmarking information and information relating to the operation and effect of the Enterprise Act 2002, i.e. from 1 April 2004, has been, and continues to be collected.

Objective 1: To enable the prompt rehabilitation of bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver

10. The objective relates to the time scale involved in the duration of bankruptcy by reducing the impact of financial failure on individuals. The evaluation looks at the discharge periods, including early discharge, the impact of the discharge provisions, customer satisfaction with the discharge provisions and the rehabilitation of non-culpable bankrupts.

11. Full details of the evaluation information obtained in respect of this objective are contained at [appendix 2](#).

Objective 2: To not discriminate against 'second-time' bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver

12. The objective looks at the treatment of 'second-time' bankrupts. The evaluation looks at the effect of 'second-time' bankruptcy discharge provisions, creditor satisfaction with those provisions, creditor loss due those provisions and any discrimination against 'second-time' bankrupts.

13. Full details of the evaluation information obtained in respect of this objective are contained at [appendix 3](#).

Objective 3: To speed up the process of suspending the discharge of a bankrupt due to non-co-operation where a trustee other than the Official Receiver has been appointed

14. The objective relates to the power of an insolvency practitioner (IP) to apply for a suspension of discharge in cases where the IP is trustee. The evaluation looks at the level and timeliness of suspension of discharge applications where an IP has been appointed trustee, and IP satisfaction with the power to apply for a suspension of discharge.

15. Full details of the evaluation information obtained in respect of this objective are contained at [appendix 4](#).

Objective 4: To help lift the stigma of bankruptcy

16. This is a cross-cutting objective of the EA. The evaluation looks the effect of the discharge changes on stigma.

17. Full details of the evaluation information obtained in respect of this objective are contained at [appendix 5](#).

Section 5 - Preliminary conclusions and recommendations

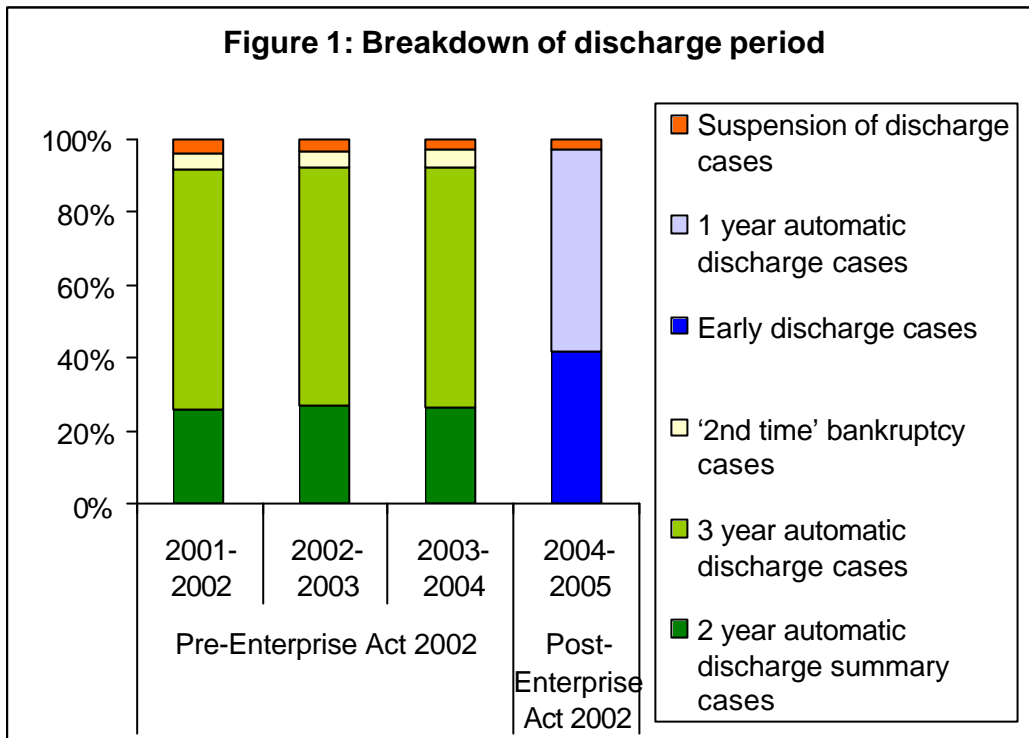
18. From the evaluation information available, the following observations can be made:

Objective 1: To enable the prompt rehabilitation of bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver

- Prior to the Enterprise Act 2002, the level of bankrupts who received an automatic discharge remained relatively constant (see Figure 1) – about two-thirds received an automatic discharge after 3 years, and about a quarter received an automatic discharge after 2 years.
- As a result of the Enterprise Act 2002, the automatic discharge period reduced to one year. Further, discharge can occur earlier if the Official Receiver files a notice at Court stating that the investigations into the affairs and conduct of the bankrupt are unnecessary or completed.
- Post-Enterprise Act 2002, in 2004/5², just over a half of bankrupts received an automatic discharge after 1 year, and about two fifths received an early discharge (see Figure 1).
- On average, in 2004/5, bankrupts who received an early discharge were discharged from bankruptcy in just under 7 months.
- The level of early discharge applications in the London region³ are noticeably less than other regions; in the London region, 23% of bankrupts received an early discharge compared to an average of 42% in England and Wales. This may be due to problems in obtaining the necessary information from the bankrupt to enable the Official Receiver to apply for early discharge; in 2004/5, the London region applied for suspension of discharge applications in around 26% of cases compared to an average of just over 3% in England and Wales.

² 2004/5 refers to the period 1 April 2004 to 31 March 2005.

³ The London region consists of the Official Receiver offices in London and Croydon. Full details of The Insolvency Service's regions can be found on our website (www.insolvency.gov.uk).



- Therefore, overall, the discharge periods of bankrupts who have co-operated with the Official Receiver have reduced as a result of the provisions of the Enterprise Act 2002. As a result, bankrupts are free from the restrictions imposed under legislation⁴ quicker than prior to the Act, unless a Bankruptcy Restrictions Order is obtained⁵.
- The level of cases where a suspension of discharge has been obtained has not materially altered since the introduction of the Enterprise Act 2002 (see Figure 1). Therefore, it does not appear that the reduction in the discharge period has affected the level of non-cooperation.
- There are no known cases pre-Enterprise Act 2002 where there was an increase in the monies claimed under an Income Payments Orders, or a claim on an asset as after acquired property, after one year from the date of the bankruptcy order.

⁴ The following are criminal offences under the Insolvency Act 1986 for an undischarged bankrupt: obtaining credit of £500 or more either alone or jointly with any another person without disclosing his/her bankruptcy; carrying on business (directly or indirectly) in a different name from that in which s/he was made bankrupt, without telling all those with whom s/he does business the name in which s/he was made bankrupt; and being concerned (directly or indirectly) in promoting, forming or managing a limited company, or acting as a company director, without the court's permission, whether formally appointed as a director or not. Additionally, a bankrupt may not act as an insolvency practitioner, or as receiver or manager of the property of a company on behalf of debenture holders, or be a Member of Parliament in England or Wales. Further restrictions are imposed under non-insolvency legislation.

⁵ If the Official Receiver considers that the conduct of a bankrupt has been dishonest or blameworthy, the Official Receiver can apply to Court for a Bankruptcy Restrictions Order, which imposes similar restrictions upon the bankrupt as those imposed on an undischarged bankrupt under the Insolvency Act 1986.

- An application for a Bankruptcy Restrictions Order must be made within one year of the making of the bankruptcy order, unless leave of the court is obtained. This period will cease to run if the bankrupt's discharge is suspended. Post-Enterprise Act 2002, there are no known cases where evidence of Bankruptcy Restrictions Order misconduct has come to light after 12 months from the date of the bankruptcy order and the bankrupt has been discharged from bankruptcy. Official Receivers have advised that where evidence of misconduct has arisen after 12 months, this is due to non-cooperation of the bankrupt, and therefore, a suspension of discharge has been previously obtained. If evidence were to arise after 12 months from the date of the bankruptcy order, Official Receivers would seek advice from the Authorisations Team⁶, who would decide whether an out-of-time application should be made.
- Therefore, it does not appear that the reduction in the automatic discharge period to 1 year has impacted on returns to creditors, or the protection of the public and commercial community.
- As stated above, in early discharge cases a bankrupt can be discharged from bankruptcy in less than 1 year. Before the Official Receiver makes such an application, the Official Receiver is required to give notice to creditors of his intention to apply for early discharge, to allow creditors the opportunity to object. Results of a case sampling exercise show that creditors objected in less than 5% of cases where the notice was sent in 2004/5.
- To date there is no evidence to suggest that assets have been missed as a result of the early discharge of bankrupts. Further, early discharge does not impact on the time in which an application for a Bankruptcy Restrictions Order - an application must be made within one year of the making of the bankruptcy order, unless leave of the court is obtained, regardless of when discharge occurs. Therefore, it does not appear that the early discharge of bankrupts has impacted on returns to creditors, or the protection of the public and commercial community.
- Prior to the Enterprise Act 2002, there were minimal complaints regarding the discharge provisions. As regards the discharge provisions post-Enterprise Act 2002, creditors do not appear to support the reduction in the discharge period, mainly due to fears that the reduction in the discharge period may encourage more people to enter into bankruptcy⁷. This issue is discussed later in this report.
- A survey of self-employed bankrupts pre-Enterprise Act 2002 is on-going. The responses to date show that just under half of the bankrupts have recommenced trading, and the main problems regarding recommencement of trade related to difficulties in obtaining a bank account.
- Credit reference agencies keep a record of a bankruptcy order for 6 years, together with a record of discharge where appropriate. This has remained unchanged by the introduction of the Enterprise Act 2002.

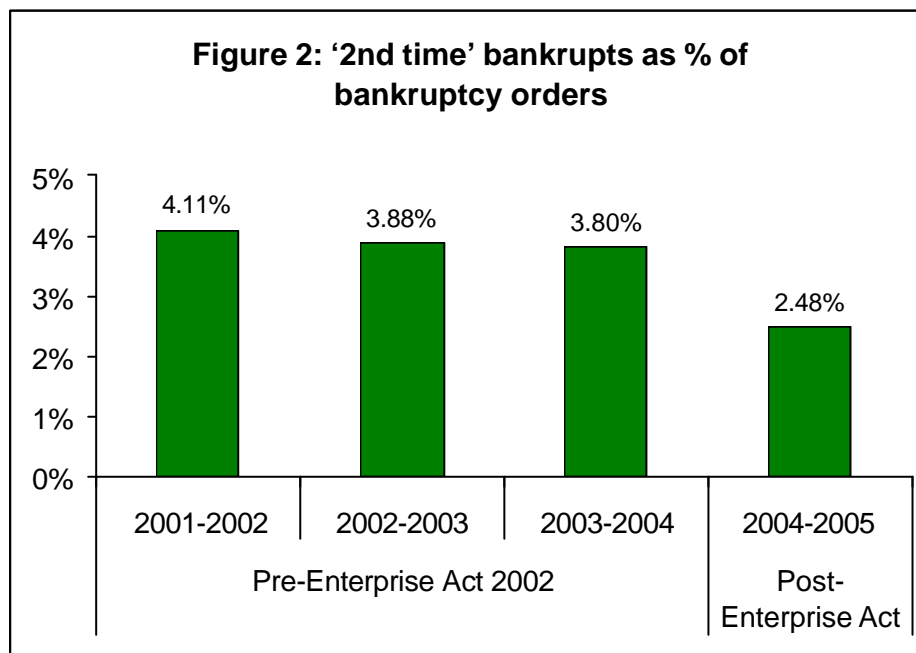
⁶ The Authorisations Team are part of The Insolvency Service, who issue authorities to proceed with a Bankruptcy Restrictions Order application to Official Receivers on behalf of the Secretary of State.

⁷ Based on information provided by the British Bankers' Association (BBA) and the Institute of Credit Management (ICM) Second Discharge interim evaluation – Caroline Burton – March 2006

- Mainstream financial institutions have broadly similar policies in dealing with bankrupts. Prior to the Enterprise Act 2002, in general terms, applications by undischarged bankrupts for accounts or loans were refused. Applications by discharged bankrupts were shown more consideration, but due to inevitable 'bad' credit reference histories, the applications were likely to be refused. There have been no specific changes made to these lending policies in response to the implementation of the Enterprise Act 2002⁸.
- Therefore, although post-Enterprise Act 2002 bankrupts are being discharged from bankruptcy quicker, the record of the bankruptcy order will remain on their credit reference file for the same period of time. Given lender policies, this means that the reduced duration of bankruptcy will have a limited impact on a bankrupt's ability to obtain credit facilities, albeit that the statutory restrictions regarding obtaining credit are removed earlier.

Objective 2: To not discriminate against 'second-time' bankrupts judged to be non-culpable who have fully co-operated with the Official Receiver

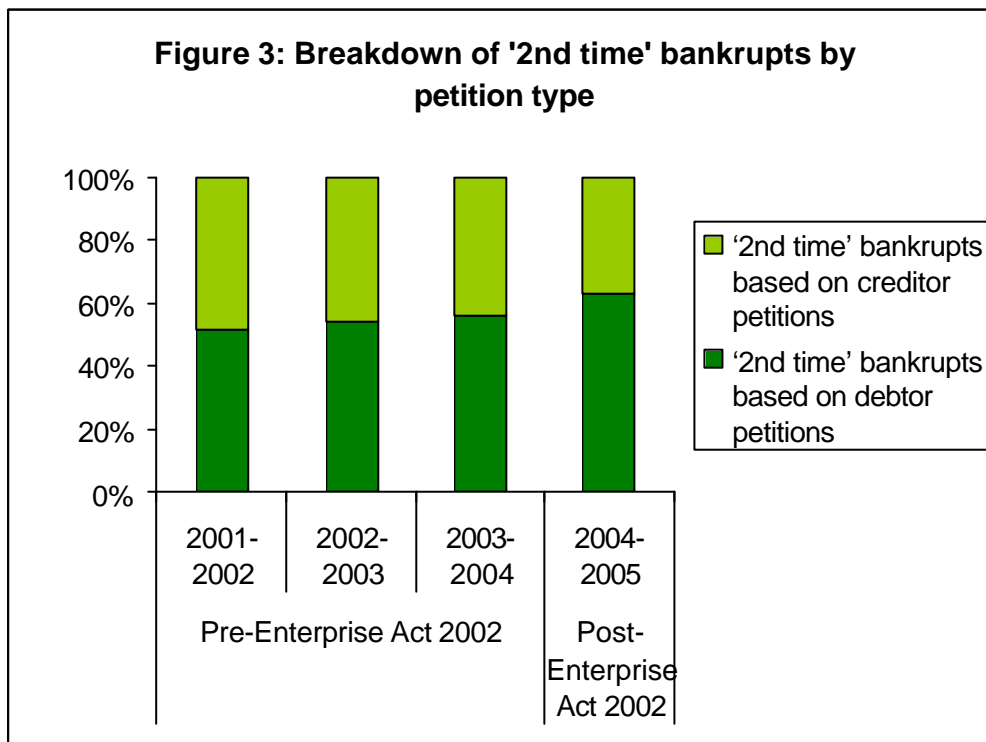
- Prior to the Enterprise Act 2002, around 4% of bankrupts were '2nd-time' bankrupts; in the year after the Act was introduced, the level dropped to around 2.5% (see Figure 2).



- Prior to the Enterprise Act 2002, just under 50% of bankruptcy orders against '2nd-time' bankrupts were based on debtor petitions; in the year after the Act was introduced, this level increased to over 60% (see Figure 3).

⁸ Based on information provided by members of the British Bankers' Association (BBA), which BBA advise is broadly representative of the industry position.

- Looking at just '2nd-time' bankrupts based on debtor petitions, prior to the Enterprise Act 2002, just over 2% of bankrupts were '2nd-time' bankrupts who had presented their own bankruptcy petition; in the year after the Act, this level dropped to just over 1.5%.
- Therefore, if this trend continues, it does not appear that the reduction in the discharge period for '2nd-time' bankrupts introduced by the Enterprise Act 2002 (see below) has encouraged former bankrupts to enter into bankruptcy proceedings once again. Indeed, it is possible that the new Bankruptcy Restrictions Order (BRO) regime introduced by the Enterprise Act 2002 may be having an impact. One of the grounds on which a BRO may be sought is being a 'second-time' bankrupt (although it is highly likely that an application would only be made on this ground if there was associated misconduct); to date, no BRO has been obtained based on an allegation relating to a previous bankruptcy order against a bankrupt.



- Prior to the Enterprise Act 2002, '2nd-time' bankrupts were not entitled to an automatic discharge, and based on a sampling exercise, the average discharge period for a '2nd-time' bankrupt was around 10 years. As a result of the Act, '2nd-time' bankrupts have the same discharge provisions as a '1st-time' bankrupt, and in 2004/5, 37% of '2nd-time' bankrupts received an early discharge, and 58% are expected to be discharged after 1 year.

- Prior to the Enterprise Act 2002, there were no complaints regarding the '2nd-time' bankruptcy discharge provisions. As regards the '2nd-time' bankruptcy discharge provisions post-Enterprise Act 2002, creditors do not appear to support the reduction in the discharge period for '2nd-time' bankrupts⁹.
- There are no known cases pre-Enterprise Act 2002 where there was an increase in the monies claimed under an Income Payments Order, or a claim on an asset as after acquired property, after one year from the date of the bankruptcy order in '2nd-time' bankruptcy cases, or orders recently made against the property or income on a discharge application of a '2nd-time' bankrupt. Therefore, it does not appear that the reduction in the discharge period for '2nd-time' bankrupts has impacted on returns to creditors.
- Credit reference agencies keep a record of a bankruptcy order for 6 years, together with a record of discharge where appropriate. In most cases, there is no link to any previous bankruptcy order. This has remained unchanged by the introduction of the Enterprise Act 2002.
- Mainstream financial institutions have broadly similar policies in dealing with bankrupts. Prior to the Enterprise Act 2002, in general terms, it appears that 'second-time' bankrupts are treated the same as 'first-time' bankrupts; applications by undischarged bankrupts for accounts or loans were refused. Applications by discharged bankrupts were shown more consideration, but due to inevitable 'bad' credit reference histories, the applications were likely to be refused. There have been no specific changes made to these lending policies in response to the implementation of the Enterprise Act 2002¹⁰.
- Therefore, as for '1st-time' bankrupts, although post-Enterprise Act 2002 '2nd-time' bankrupts are being discharged from bankruptcy quicker, the record of the bankruptcy order will remain on their credit reference file for the same period of time. Given lender policies, this means that the reduced duration of bankruptcy will have a limited impact on a bankrupt's ability to obtain credit facilities, albeit that the statutory restrictions regarding obtaining credit are removed earlier.

Objective 3: To speed up the process of suspending the discharge of a bankrupt due to non-co-operation where a trustee other than the Official Receiver has been appointed

- Prior to the Enterprise Act 2002, only the Official Receiver could apply for the suspension of discharge of a bankrupt. Therefore, an insolvency practitioner appointed as trustee needed to report matters of non-cooperation to the Official Receiver, who would then apply for a suspension of discharge based on the facts provided by the insolvency practitioner. Under the Enterprise Act 2002, the insolvency practitioner appointed as trustee can apply to the court directly for such an order.

⁹ Based on information provided by the British Bankers' Association (BBA) and the Institute of Credit Management (ICM)

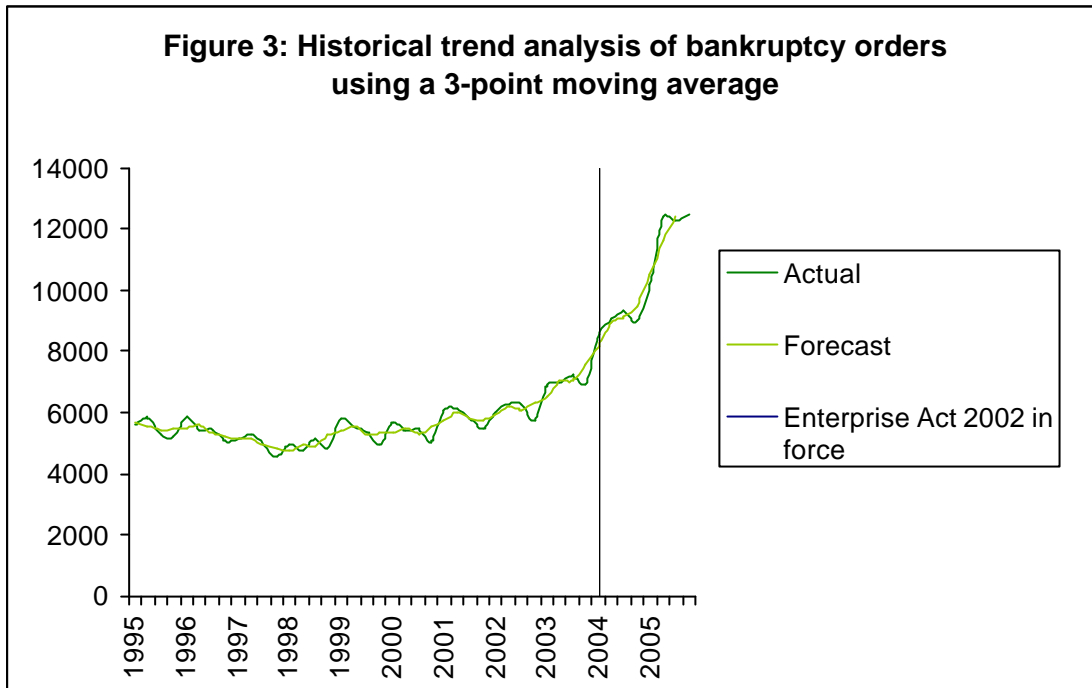
¹⁰ Based on information provided by members of the British Bankers' Association (BBA), which BBA advise is broadly representative of the industry position.

- Prior to the Enterprise Act 2002, around 10% of suspension of discharge orders were made on application of the Official Receiver at the request of an insolvency practitioner as trustee.
- Based on a sampling exercise, prior to the Enterprise Act 2002, the average time taken to obtain the suspension of discharge from the time the request was made by the insolvency practitioner was just over 3 months.
- Enquiries are on-going to ascertain the level and timeliness of suspension of discharge applications by insolvency practitioners post-Enterprise Act 2002.
- The Insolvency Service is aware of insolvency practitioners who are using the power to apply for a suspension of discharge and regard it as a useful new 'weapon' for them. However, the Insolvency Service has also become aware of various cases where the insolvency practitioner has requested that the Official Receiver applies for the suspension of discharge, as there are no assets in the estate and therefore, the trustee is unable to pay for the application. In such cases, the insolvency practitioners have asked the Official Receiver to fulfil a "public interest" role and make the application on their behalf.
- The Insolvency Service has, to date, refused to make such applications on the grounds that the trustee will only be seeking co-operation from the bankrupt in connection with realisation or distribution of assets, and therefore the application relates to trustee matters; the costs involved in making a suspension application are not excessive; and the trustee could ask creditors to put up the funds for the application if the sum involved were significant and if they are not interested, he could reasonably take no action.
- The Insolvency Service is monitoring the situation, and intends to seek the wider views of insolvency practitioners.

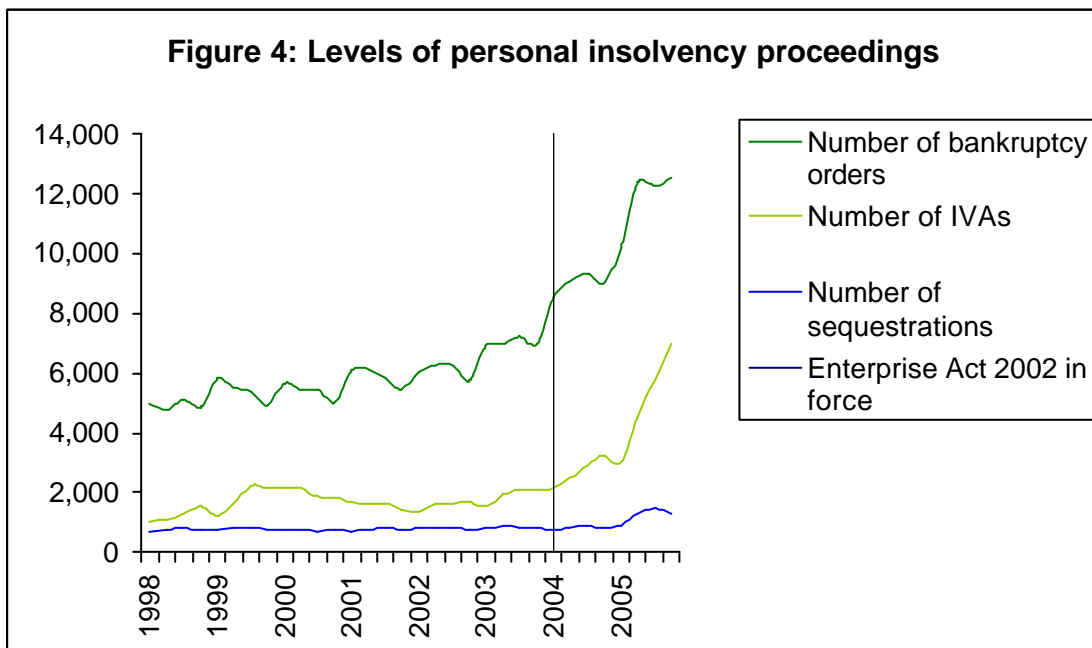
Objective 4: To help lift the stigma of bankruptcy

- Since the introduction of the Enterprise Act 2002, the level of bankruptcy orders has risen. However, this appears to be part of a trend established prior to the implementation of the Act¹¹ (see Figure 4).

¹¹ The level of bankruptcy orders has been analysed on a 3-point moving average basis. A moving average analysis projects values in the forecast period, based on the average value of the level of bankruptcy orders (non-seasonally adjusted) over three quarters. A moving average provides trend information that a simple average of all historical data would mask.

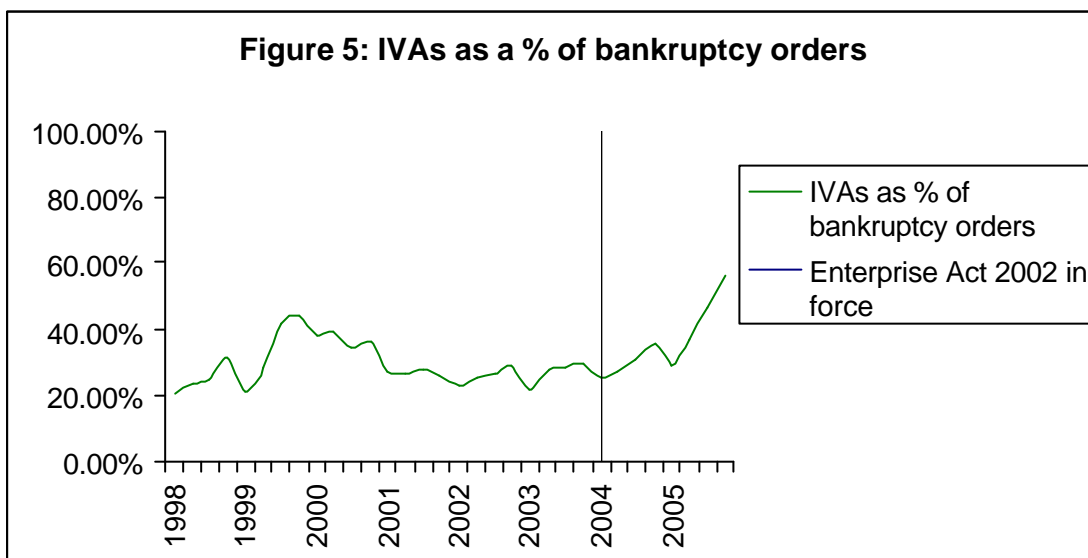


- Further, the level of all formal personal insolvency proceedings has risen since 2004, when the Enterprise Act 2002 came into force (see Figure 4)¹².



¹² The level of protected trust deeds, the Scottish equivalent of IVAs, have also risen on an annual basis. Quarterly statistics are not available and hence not included on the graph.

- It can be seen that the level of sequestrations, the Scottish equivalent of bankruptcy orders, has not risen as steeply as bankruptcies in England and Wales. The level of protected trust deeds (PTDs), the Scottish equivalent of IVAs, has also increased although, similarly, not as steeply as IVAs in England and Wales. To date, there have been no changes to Scottish insolvency law¹³. The Accountant in Bankruptcy has advised that the increase in sequestrations and PTDs is being seen against the increase in consumer debt, and the increase in insolvency numbers as a result of consumers failing to maintain their high level of debt.
- Looking at the level of bankruptcy orders and individual voluntary arrangements (IVAs) in England & Wales, IVAs are increasing at a faster rate than bankruptcy orders (see Figure 5).



- There has been no significant change to the law relating to individual voluntary arrangements. Therefore, this suggests that the increase in bankruptcy orders in England & Wales is primarily attributable to factors other than the change in law introduced by the Enterprise Act 2002.
- Moreover, whilst reliable statistics on other means of debt resolution processes are not generally available, there also appears to have been increases in the non-statutory debt resolution processes, such as debt management plans (DMPs)¹⁴. The Consumer Credit Counselling Service, one of the major providers of DMPs, has published statistics that show that DMPs have also materially increased since 2004 (see Table 1).

¹³ The Bankruptcy and Diligence etc. (Scotland) Bill is currently being considered by the Scottish Parliament. The Bill proposes some reforms to the Scottish insolvency regime that are similar to the Enterprise Act 2002.

¹⁴ Debt Management Plans are informal arrangements with creditors to repay monies owed in full.

Table 1: Levels of Debt Management Plans (DMPs)¹⁵

Year	Number of Debt DMPs
2001	11,342
2002	10,693
2003	11,845
2004	15,624
2005	23,252

- When comparing the increase in bankruptcy orders, IVAs and DMPs, bankruptcies have increased the least, showing a 32% increase from 2004 to 2005, compared to a 49% increase in DMPs and an 89% increase in IVAs (see Figure 6).
- As regards bankruptcies made on a debtor's own petition, since the introduction of the Enterprise Act 2002, these have risen. However, this appears to be part of a trend established prior to the implementation of the Act (see Figure 7).
- The Insolvency Service commissioned the DTI to develop a bankruptcy economic model. This shows that the main driver of the level of bankruptcy cases is the total amount of secured and unsecured debt.
- Similarly, the Bank of England principally attributes the increasing numbers of personal insolvencies to the rise in household indebtedness and goes on to say that it is unlikely that the recent rise in bankruptcies are due to the changes introduced by the Enterprise Act 2002, given that the upward trend in insolvencies was established before the change to legislation¹⁶ (see trend analysis above).
- Therefore, despite creditor concerns (see above), there is currently no evidence to suggest that the shortened discharge period has encouraged more people to enter into bankruptcy. Furthermore, the results of the Bankruptcy Courts Survey 2005¹⁷ show that prospective bankrupts were not actually aware of the statutory changes to the law of personal insolvency brought into effect by the Enterprise Act 2002 or the effects these statutory changes would have on them personally and that bankrupts were not swayed by the reduced discharge period. It further concludes that few people see bankruptcy as an easy way out of their debts but rather that they have no real alternative.

¹⁵ Extracted from "Trouble Totals" press release dated 3 February 2006.

¹⁶ Extracted from The Bank of England's Financial Stability Review issued in June 2005.

¹⁷ Bankruptcy Courts Survey 2005 – A Pilot Study: John Tribe

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/personaldocs/BankruptcyCourtsSurvey.pdf>

Figure 6: Change in level of insolvency proceedings compared with the previous year

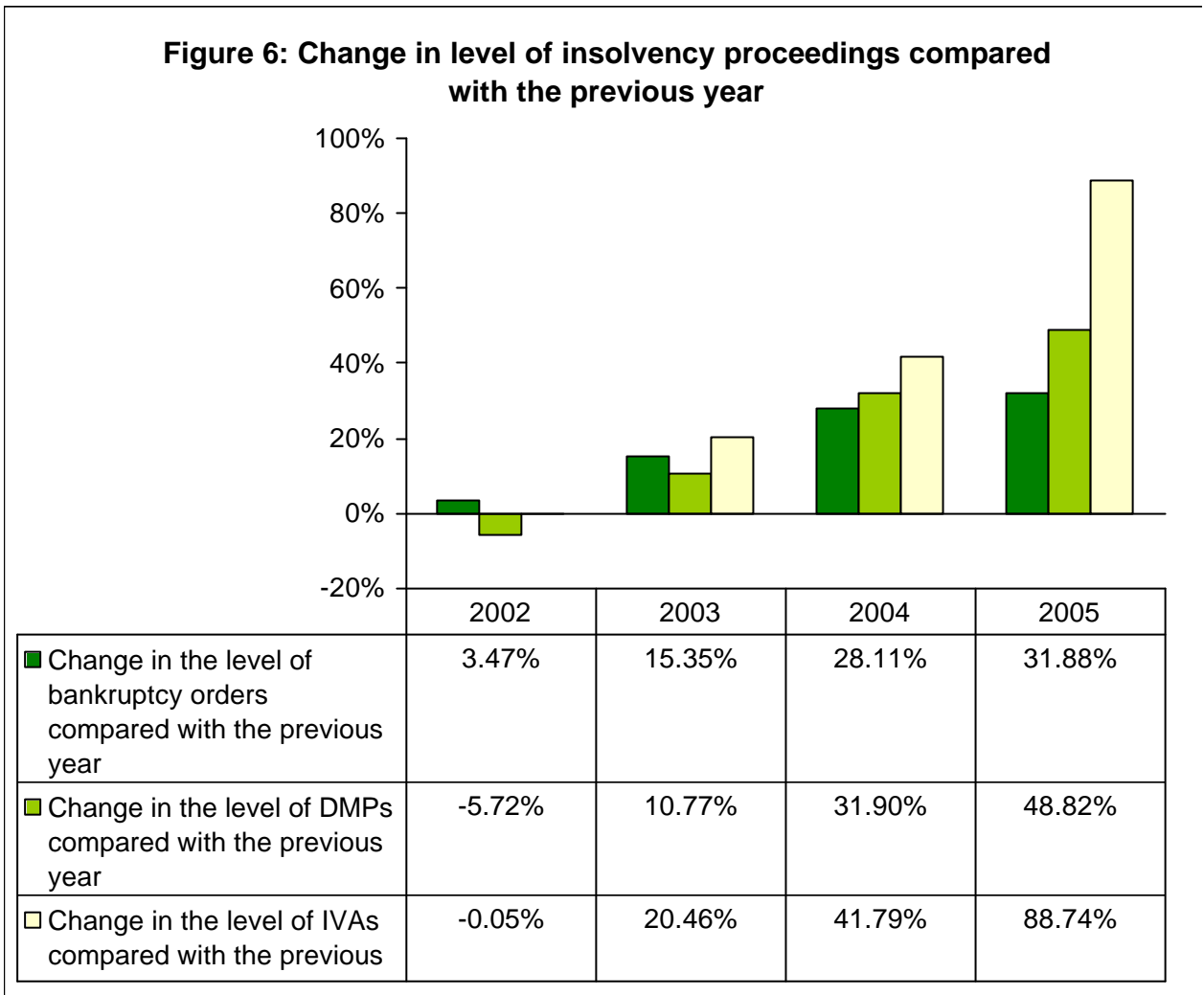
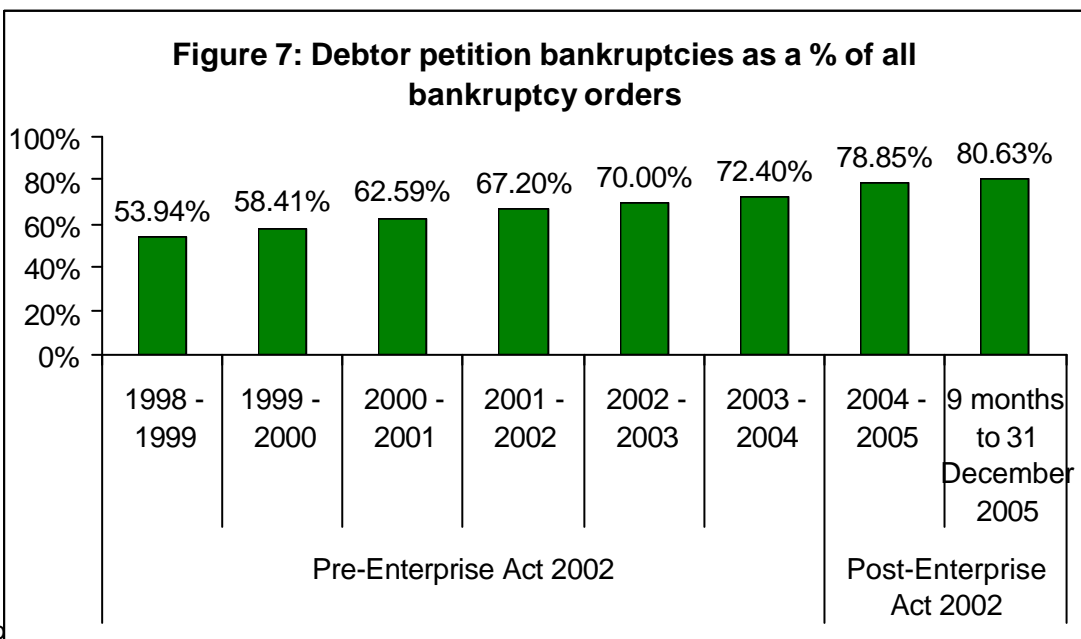


Figure 7: Debtor petition bankruptcies as a % of all bankruptcy orders



- These findings are consistent with a survey regarding attitudes to bankruptcy which showed that as regards the effects of bankruptcy, the length of time restrictions are imposed is the least significant factor that contributes to the stigma associated with bankruptcy - not being able repay creditors, problems with getting a bank account and the effect on a bankrupt's credit rating were seen as greater contributors towards the stigma associated with bankruptcy. Therefore, it appears that the reduction in the discharge period introduced by the Enterprise Act 2002 will not materially lessen the stigma associated with bankruptcy. Further surveys will be carried out to ascertain whether attitudes to bankruptcy have changed.
- The Insolvency Service has also commissioned the DTI to develop a start-ups model to assess whether the Enterprise Act 2002 has impacted on the level of business start-ups in England & Wales. Work is on-going.
- Research commissioned by The Insolvency Service suggests that the shorten discharge period may increase entrepreneurial activity¹⁸. However, further research is needed to explore how the duration of bankruptcy impacts on entrepreneurial activity, given that evidence to date suggests that the reduction of the discharge has not significantly impacted on a debtor's willingness to enter into bankruptcy. It may be that the attitudes of 'entrepreneurial' bankrupts differ from bankrupts generally.
- The UK Global Entrepreneurship Monitor (GEM) 2005 report shows that overall, there are few differences in entrepreneurial activity in 2005 compared to 2004 (although since 2002 the trend has been slightly upwards). Further, the fear of failure, which is seen as a barrier to entrepreneurship, has remained static. GEM suggest that addressing fear of failure involves a sea change in culture, which takes a long time to effect.

19. No changes to the evaluation planning paper are recommended at this time.

Caroline Burton
March 2006

¹⁸ Bankruptcy Law and Entrepreneurship: John Armour
<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/personaldocs/ArmourCummingEntrepreneurship.pdf>