



RESPONSE TO CALL FOR EVIDENCE  
BONDING ARRANGEMENT FOR INSOLVENCY  
PRACTITIONERS

INSOLVENCY SERVICE

## **Executive Summary**

### **Introduction**

- 1 The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents over 21,000 members who advise and lead business across the UK and in almost 100 countries across the world. ICAS is a Recognised Professional Body (RPB) which regulates insolvency practitioners (IPs) who can take appointments throughout the UK. We have an in-depth knowledge and expertise of insolvency law and procedure.
- 2 ICAS's Charter requires it to primarily act in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and protect their interests. On the rare occasion that these are at odds with the public interest, it is the public interest that must be paramount.
- 3 ICAS is interested in securing that any changes to legislation and procedure are made based on a comprehensive review of all of the implications and that alleged failings within the process are supported by evidence.
- 4 ICAS is pleased to submit its views in response to the call for evidence issued by the Insolvency Service into Bonding arrangements for insolvency practitioners. We shall be pleased to discuss in further detail with the Insolvency Service any of the matters raised within this response.

### **Executive summary**

- 5 ICAS considers that the current statutory bonding arrangements are not fit for purpose and that substantial reform is required in this area. We therefore strongly welcome the review and the call for evidence.
- 6 We note that in the introduction reference is made to future reform of bonding requirements for IPs in England, Wales and Scotland. We appreciate that requirements for IPs in Northern Ireland is not a matter for the Insolvency Service or UK Government and is a matter for the Government in Northern Ireland, however we would wish to encourage discussion and collaboration with authorities in Northern Ireland to ensure as far as possible a consistent approach throughout the UK.
- 7 Since the statutory requirement for bonding was introduced, no bond claims have been made against any ICAS regulated IP. Much of our response is therefore based on a theoretical understanding of the process where fraud or dishonesty exists together with knowledge gained through discussions with other RPBs over time.
- 8 We broadly agree with the weaknesses of the current bonding system identified in the call for evidence.
- 9 Notwithstanding many of the weaknesses identified, there is a more fundamental question of whether the bonding system meets its primary objective of ensuring creditors do not suffer because of fraud or dishonesty against the estate. There appears to be no evidence to suggest that the bonding system is fulfilling this requirement. While this may suggest that repealing the legislative requirement would not result in any detriment to creditors (indeed it may benefit them through reduced costs associated with the relevant insolvency process) we do not consider that this would be an appropriate measure on its own.
- 10 We are strongly of the view that as part of a framework to ensure trust in the UK insolvency regime that protection against fraud or dishonesty on the part of an IP during or in connection with their office should be provided. This protection must extend to fraud or dishonesty carried out by not only the IP themselves but also cover situations where the fraud or dishonesty is carried out by another party operating under the IP, directly or indirectly.
- 11 We would suggest that a fundamental review of successor appointments and interaction with pursuing bond claims should be undertaken. Consideration should be given to separating out the two roles of ensuring the continued administration of an insolvent estate and investigating and pursuing a claim against an insurer.

- 12 We are broadly supportive of many of the suggested responses to the weaknesses identified. Further examination and evaluation will however be required particularly around any pricing adjustments to bond or other insurance premiums and their impact on insolvency practitioners and insolvent estates.
- 13 We consider that amending legislative provisions together with voluntary action taken by insurers, IPs and RPBs, will be required to address the weaknesses in the bonding system and ensure that an adequate protection framework is available in the future.

#### **Detailed Comments**

- 14 Our detailed responses to the questions posed within the call for evidence document are set out in [Appendix 1](#)

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## **Appendix 1 – Responses to questions posed in the call for evidence**

**Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.**

We broadly agree with the assessment of weaknesses identified in the current bonding system. Some of the weaknesses have a greater impact than others with difficulty in evaluating on an objective basis the impact of each weakness.

We do not hold information to accurately estimate the total cost of the current bonding requirements across all insolvent estates. We estimate that in a typical case an IP and their staff would spend on average around 2 hours administering the bonding requirements. The Call for Evidence identifies that nearly 56,500 cases in 2015 involved the appointment of at least one IP, although notes that this is an incomplete position and therefore this number will be understated from the number of cases which are bonded. A conservative estimate of the cost of bonding is therefore nearly £17m per year excluding premium costs. The true cost will be substantially higher.

In addition to the above, the RPBs incur costs in administrating the monthly returns from IPs, considering as part of monitoring visits to IPs and maintaining IT systems in connection with bonding. We estimate that the annual cost for ICAS in respect of administering the bonding system is in the region of £10,000 per annum or approximately £100 per regulated IP. If it were assumed a similar rate across all RPBs the RPB cost would be in the region of £160,000 per annum.

We do not necessarily agree that a lack of a statutory requirement for professional indemnity insurance (PII) is a weakness of the current system. All RPBs require their authorised members to hold adequate PII. We are not aware of any evidence of harm because of the current PII requirements and therefore what the weakness is or (if there is a weakness) it's effect.

**Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.**

In addition to the areas of weakness already identified, we would suggest that there is a lack of clarity over the role which RPBs play where a claim on a bond is notified. ICAS has no experience of a bond claim being submitted against any of our regulated insolvency practitioners but we understand that differing approaches are taken once a bond claim is notified. The approach taken to requests to assign the benefit of bonds is understood to be problematic. In our view, a robust regulatory system should concentrate on the systems of protection and oversight where issues occur. Involvement in the detailed working out of claims is undesirable as a matter of principle of good governance.

A further weakness which has not been identified is in relation to the additional cost to creditors where successor or replacement IPs are appointed to a case. As bond premiums are paid per practitioner per case, where a successor IP or replacement office holder is appointed this results in an additional premium or premiums being paid. As an example, where a practitioner moves firm and his appointments remain with his original firm and are transferred to another practitioner in that firm, then an additional premium is paid even though the case remains with the same firm, will be administered by the same people, has had no change in asset position or risk. We do not have access to information that would allow us to estimate the total cost to creditors in the UK because of double premiums in such situations but insurers may be able to provide this information. In addition to the cost of the additional premiums, administration costs are incurred.

We note that a weakness identified is that a bond only covers fraud and dishonesty by or with the collusion of the IP. We would suggest that this is perhaps not correctly reflected within the Call for Evidence as legislation currently refers to a bond covering fraud or dishonesty by or with the 'connivance' of the IP. We would suggest that there is a difference (albeit subtle) between collusion and connivance. We would suggest that collusion requires active participation in the act where connivance may include both active participation and a failure to do something to prevent an act where it would be a reasonable expectation to do so. The current weakness is that there is no clear definition 'connivance'. We do however agree that any protection should cover fraud or dishonesty by the IP or anyone connected with the IPs firm as the IP must accept ultimate responsibility for control over the case including control of all funds.

**Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?**

No. In addition to difficulties around the practicalities of setting up, maintaining and managing such arrangements, the size of fund required to allow adequate provision of claims would be prohibitive based on the small number of insolvency practitioners authorised within the UK. This would most likely have a significant impact particularly on sole or smaller practitioners and may lead to a significant withdrawal in the market provision. We are also aware that arrangements in relation to the legal profession are coming under increasing pressure resulting in increasingly restricted criteria over who is eligible to benefit from protection. We do not consider that discretionary protection would assist in providing confidence in the profession or protection for those affected by fraud or dishonesty.

**Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?**

We agree that a claims management protocol may be of benefit and address, at least in the short term, some of the weaknesses identified. We do however think that further examination of some of the issues will be required to ensure that any claims management protocol is effective.

We would wish to see further consideration of the remit and responsibility around successor IPs and claims management prior to any claims management protocol being pursued. There are two clear and distinct functions to be performed where an IP is replaced following fraud or dishonesty. The primary role is for a successor IP to be put in place to ensure a continued and efficient progression of the estate realisation and distribution. The secondary role is to ensure that the estate is reimbursed for the fraud perpetrated against it. The current assumption is that those two roles are best carried out by the same person however we would encourage a fresh review of that assumption. We do not consider that it is impossible for those two roles to be separated. Consideration would be required as to how the successor IP would be remunerated for the continued administration of the estate where assets had been depleted to an extent that there would be insufficient to meet their claim for remuneration, although this could be retained as part of the requirement for insurers to meet in the event of a claim.

We do not necessarily agree that an approved panel of successor IPs will encourage a wider circle of IPs to take on such appointments. To address that issue there needs to be an understanding of why there appear to be so few IPs taking such appointments. We do not believe that a lack of opportunity is the limiting factor. Limiting factors may include for example lack of scalable resources, perceived or actual skill gaps, and risk/reward considerations.

We do not agree that appointments from such a panel should be the responsibility of the RPBs. This confuses the role of a regulatory system in these circumstances. The RPBs have a responsibility to ensure a successor IP is appointed with a view to making sure that cases are progressed. RPBs should not be wholly responsible for selecting the replacement IP. There are already provisions within legislation to deal with replacement of IPs which will often require the court to make the appropriate appointment.

**Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?**

No. While a claims management protocol and regulatory action may address some of the weaknesses, they will not address legislative weaknesses. Only through amendment of legislation can the legislative weaknesses be addressed. For example, only legislative action will address statutory cover limits being inadequate. We therefore consider that potentially a mixture of legislative and non-legislative measures would be required to address all weaknesses.

**Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?**

The removal of statutory bonding arrangements would undoubtedly result in significant efficiencies and cost savings in insolvency procedures. In addition to the cost savings in premiums paid (which ultimately are borne by creditors), creditors may benefit from time no longer being incurred by

insolvency practitioners calculating and documenting initial bonding levels, administering the initial bond notification to insurers and RPBs, period reviews of bond levels, and time involved in the release of the bond at the end of each case (see comments in question 1 around costs of the bonding system).

Based on evidence shown thus far, there appears to be no benefit to creditors of the current bonding system. It can therefore strongly be argued that the removal of the current statutory bonding requirements would have no detrimental impact on creditors or IPs. It is likely that the removal of the current statutory bonding requirements would have a positive impact on all stakeholders through elimination of costs which provide no benefit.

The removal of statutory requirements may have a negative impact on public trust and confidence in the UK insolvency regime, however it is not known the extent to which the public are generally aware of the current protection and therefore it is difficult to evaluate whether there would be any significant impact in this area as a result of the removal of statutory bonding requirements.

While we consider that non-legislative regulatory requirements could be introduced which would provide an appropriate level of protection for creditors, we would suggest that there should be legislative provision to support this.

**Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.**

While the advantages and disadvantages of the options are discussed and set out in the Call for Evidence, further work will require to be done in evaluating and quantifying the impact of any proposed course of action. This is particularly the case around any pricing adjustments to bond or other insurance premiums and their impact on insolvency practitioners and insolvent estates.

**Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.**

We do not wish to raise any further matters at this stage.

**Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?**

In view of the weaknesses set out in the Call for Evidence and in our response above, we do not consider that Option 1 (Do nothing) is even a possibility.

Option 2 (repeal legislative requirements) has significant advantages. The release of IP time and RPB time administering the bonding requirements would result in reduced regulatory burden and ultimately reduced costs to creditors. As the current arrangements appear not to have achieved the objective of protecting creditors then repealing the legislation is unlikely to have any direct detrimental impact on creditors. There is however a requirement to maintain trust in the insolvency process and part of this must include protection against dishonest actions of those involved in the processes.

RPBs are required to act in a way which is compatible with the regulatory objectives. This includes a requirement to ensure that there is a system of regulating IPs in a way which secures fair treatment for persons affected by their acts (section 391B and s 391C(3)(a)(i)). It is therefore possible for a system of protection for creditors to be implemented under these provisions without the need for further detailed legislation.

While this option is perhaps the most attractive and pragmatic response we consider that there may be benefit, not least in public perception and ensuring trust in the UK insolvency framework, for legislative provision of a protection framework.

We therefore consider that the preferred approach would be an appropriate mix of amending current legislation and voluntary action involving all affected stakeholder groups although we do not underestimate the challenge that this would bring.

**Question 10: Do you have any further comments you would like us to consider in relation to bonding?**

We would highlight that in addition to PII requirements, RPBs also prescribe requirements around the handling of Clients' Funds. The issue of bonding is simply a symptom of mishandling such funds and therefore the review of bonding should be reviewed considering those requirements and the way banks operate clients' funds accounts. For example, we would suggest that it would be appropriate to ensure that banks cannot impose account conditions which allow them to set-off one account against another where clients' funds are involved.

We note the suggestion within the Call for Evidence that RPBs may be able to improve early detection of the warning signs of fraud. We would suggest that where frauds are perpetrated they are most often carried out in such a way that they are not easily detected. In the same way that statutory audits cannot be expected to discover frauds, monitoring visits should not be expected to discover frauds. While potential warning signs can be identified there can be (and often are) legitimate reasons for such indicators which are not linked to fraud or dishonesty. For example, late payments of bonds to insurers does not necessarily mean that the is struggling financially and therefore more likely to consider fraudulent methods to keep the business going. We would also highlight that it is not the purpose of RPBs through monitoring visits to provide reliance to insurers.