



The Insolvency Service Consultation: Strengthening the regulatory regime  
and fee structure for insolvency practitioners.

ICAS Response

March 2014

## **Background**

The Institute of Chartered Accountants of Scotland (ICAS) received its Royal Charter in 1854 and is the oldest professional body of accountants in the world. 2014 marks our 160<sup>th</sup> year. We were the first body to adopt the designation “Chartered Accountant” and the designatory letters “CA” are the exclusive privilege of Members of ICAS.

ICAS is a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our CA qualification is internationally recognised and respected. We are a Recognised Professional Body (RPB) for insolvency, a respected Recognised Qualifying Body (RQB) and a Recognised Supervisory Body (RSB) for statutory audit. We regulate Insolvency Practitioners (“IPs”) who work throughout the UK and our practitioners account for the majority of the Scottish IP community.

## **Consultation**

ICAS welcomes the opportunity to comment on this further consultation on insolvency reform. While we recognise that, as an RPB, we have a level of self-interest in certain of the proposals, we have been very careful to set aside any views which could be construed as biased and have responded in a manner which we believe best reflects the public interest as required by the Royal Charter under which we operate.

## **General Comments**

### Part 1: IP Regulation

Our strong desire is for the UK to have an insolvency regulatory system which is robust, fit for purpose, and which delivers consistent outcomes and instils public confidence through a series of measures which promote enhanced transparency and accountability. This system should be delivered through a series of measures which bring the RPBs and the Insolvency Service together as ‘co-regulators’.

As the grant of RSB and RPB status for audit and insolvency respectively rest with the Secretary of State for Business, Innovation and Skills, ICAS agrees that there ought to be some consistency of approach in relation to the power to sanction. We are, however, unaware of any evidence of “poor performance, misconduct and abuse” by an RPB (paragraph 2 of the Executive Summary refers). If it is simply the case that the Secretary of State desires this power as a precautionary measure, this should have been made clear in the consultation. In terms of the proposed introduction of sanctions, directions and penalties, the consultation paper doesn’t set out the reasons why the Secretary of State needs all or any of these powers. In relation to statutory audit there are clearly powers which are delegated to the RSB bodies, whereas this practice does not apply to insolvency. We also note that sanctioning powers must always be subject to the safeguard of a satisfactory right of appeal.

We agree that there should be consistency across each of the RPB bodies and we would welcome initiatives which are designed to ensure that the same high ethical standards are upheld by each of the RPB bodies. To this end, we also support the introduction of common regulatory objectives.

Whereas the OFT Report sought independent regulation, the continuing desire (or threat) to introduce a single, independent regulator for insolvency is a disproportionate response. If independent regulation is the aim then none of the existing RPB bodies can meet this criteria and a new body would need to be formed (in which case there is also little merit in introducing application procedures for new RPB bodies at this stage). Admittedly the issue of a single regulator has arisen in two reports instructed by BIS but ICAS believes that there are alternative ways to nurture and improve public confidence in the insolvency profession.

By contrast, statutory audit regulation in the UK is not delivered through independent regulation but through a sophisticated and mature relationship between the RSB bodies and the Financial

Reporting Council (FRC). Some of the measures in the current consultation are intended to replicate for insolvency regulation some of the Secretary of State's powers in relation to the regulation of RSB bodies for statutory audit. Four of the RPB bodies for insolvency are also RSB bodies for statutory audit and we are very experienced in the regulation of services which directly impact public confidence.

#### Part 2: IP Remuneration

We accept that the fee proposals do not apply to Scotland. The Court Reporter and procedures for the approval and appeal procedures for both corporate and personal insolvency cases in Scotland safeguard against the potential "abuse" that is referred to in the consultation paper. However, ICAS also authorises a number of IPs who accept appointments in England and Wales and so we have responded to the questions on this basis.

The consultation makes frequent reference to the desire to deliver "value for money" for unsecured creditors as a key regulatory outcome, something which first arose in the original insolvency reform consultation. Value is subjective. There seems to be a failure to acknowledge that creditor apathy is still a very strong feature of most insolvency cases and in any event the approval procedures for IP remuneration in personal and corporate cases is largely governed by a legislative fee approval framework. To suggest that RPB bodies should step into the breach – even if one exists in relation to IP remuneration – will not address the issue without a sincere attempt by the UK Government to review the legislation. Regulators should not be asked to circumvent or overrule the law and to do so will almost inevitably expose the regulators to legal challenge.

The quantum of fees and IP remuneration do not generally fall within the scope of regulation of the current RPB bodies, four of whom also regulate the accountancy profession more widely. Many of the RPB bodies offer arbitration services, so that there is a means of an independent review (albeit we do not mandate it at present). To date, RPB bodies have resisted any move to bring IP remuneration within our regulatory scope for reasons outlined above and below. Any evidence of market failure in relation to IP remuneration should be shared. We note that less than 2% of the complaints submitted to the Insolvency Service Gateway in its first six months related to IP remuneration, which is hardly the landscape depicted by the OFT report which introduced these reforms.

In December 2010, HM Government issued a publication "Reducing Regulation Made Simple". It offered a view of regulation which is relevant in the current context.

The report suggested as follows:

*"Regulation can appear to be a solution with relatively low costs for government itself. It can seem the most familiar and lowest risk option available to policy-makers to address a problem.*

*But the reality is that regulation is never cost-free, either for government or for those whose behaviour is being regulated. It can be ineffective in achieving its intended outcomes if its effects on the system as a whole have not been properly considered. If the details of its proposed implementation have not been thought through at the outset, including the costs on the economy and the potential impact of enforcement, the burden of regulation can be much higher than necessary. In fact, hastily conceived regulation may prove to be unenforceable and could, in some cases, be more harmful than doing nothing."*

This does not mean that the Insolvency Service should not champion measures to improve regulation by the RPB bodies and be able to positively effect change if necessary; however, we are not persuaded that the measures set out in the consultation paper will address the key issues which will truly lead to enhanced public confidence. There is a will to seek continuous improvement and to work with the Insolvency Service to develop a model which provides a

holistic solution and recognises the balanced interests of the Minister, the profession and the public interest.

We would respectfully suggest that having acknowledged that the system in Scotland provides appropriate checks and balances such that the same issues do not apply in Scotland, it perhaps would seem more appropriate to consider the introduction of a similar Reporter mechanism in the other UK jurisdictions rather than the complex measures proposed. The mix of insolvency procedure, with or without creditor committee, legal jurisdiction, etc will simply add to an already confused landscape for creditors with the likely outcome that creditors will have an increased apathy and further disengagement.

### **Consultation Responses**

We would respond to the consultation questions as follows:-

#### **Part One – Regulation of Insolvency Practitioners**

##### **Q1. Are the proposed regulatory objectives and the requirements for RPBs to reflect them appropriate for the insolvency regulatory regime?**

Protecting the public interest is one of the ICAS objectives, conferred by our Royal Charter. Initiatives and measures which seek to deliver consistent outcomes and instil public confidence by enhancing transparency and accountability are to be commended.

While we support the proposed regulatory objectives in principle, the current drafting would require some further discussion and amendment. It is crucial that the meaning and interpretation of the objectives is as clear and unambiguous as possible. This may be particularly challenging with concepts such as the 'public interest' and 'value for money'. There is likely to be a need for the Insolvency Service to produce guidance to clarify each of the objectives for the benefit of the RPBs and interested third parties.

We note that the fifth regulatory objective – 'ensuring that the fees charged by IPs represent value for money' – will need to be subject to the different processes which operate in Scotland, as recognised in paragraphs 20 – 23 of the consultation document.

##### **Q2. Do you have any comments on the proposed procedure for revoking the recognition of an RPB?**

We acknowledge that the grant of RSB status rests with the Secretary of State and fully agree that there ought to be transparency surrounding the revocation process.

The proposal that revocation be linked to the regulatory objectives further emphasises the need for clarity of the objectives, as set out in our response to Q1 above.

We have concerns over the proposal to issue a public notice on possible revocation (paragraph 60 of the consultation document) in advance of an RPB having exercised its opportunity to make representations to the Insolvency Service. The clear prejudice to the reputation of the RPB requires a strong justification for a public notice. We do not agree that such a notice is necessary to allow the Insolvency Service to take representations from third parties (e.g. the IPs authorised by the RPB concerned).

##### **Q3. Do you have any comments on the proposed scope and procedures for the Secretary of State to issue a direction to an RPB?**

We are concerned by the proposal that the Secretary of State should be able to intervene in the regulatory process and direct an RPB to act, or omit to act.

The consultation paper provides no evidence as to:

- Why such powers are required (for example, evidence of previous refusals of RPBs to follow recommendations of the Insolvency Service).
- The benefits of such powers.
- How and when such powers would be used.

The introduction of these powers would simply increase the regulatory and legal costs for an affected RPB, particularly for the RPB bodies established by Royal Charter who have already had to satisfy HM Privy Council as to the adequacy of their constitutional and disciplinary arrangements.

Whilst it is unlikely that our arrangements would be found wanting, the suggestion that the Secretary of State should be able to direct an RPB to amend its constitutional and/or disciplinary arrangements thereafter would undermine the self-regulation model and our existing constitutional arrangements and relationship with the Privy Council.

This power was afforded to the Secretary of State in relation to statutory audit because there are aspects of public entity audit regulation which are delegated to the RSB bodies. This does not apply in relation to insolvency.

The position is particularly unclear in the context of directions which would be given for investigations and disciplinary matters. While we accept that it may be appropriate for the Insolvency Service to direct an RPB to conduct a disciplinary investigation, it would be wholly inappropriate for the Insolvency Service to mandate that a particular decision be reached. Such a power would defeat the purpose of self-regulation and would create uncertainty for all parties.

If a power to issue a direction is introduced then it should be subject to a right of appeal and not simply to Judicial Review (which is a lengthy and costly process).

**Q4. Do you have any comments on the proposed scope and procedures for the Secretary of State to impose a financial penalty for an RPB?**

We are familiar with the powers approved in relation to the FRC under the Companies Act 2006 and would be content if this process is replicated under the Insolvency Act 1986. While we are anticipating that the arrangements in contemplation for insolvency would be similar to those introduced in 2012 relating to the RSB bodies, this is not clear from consultation paper. Further details would be required to enable us to comment fully on the scope or proposed procedures.

Furthermore, the consultation paper does not explain:

- What would happen to any penalties received by the Insolvency Service; for example, it would be helpful to know whether the funds would simply be allocated (by virtue of the secondary legislation) to the Consolidated Fund.
- The manner in which the Insolvency Service would calculate the level of the financial penalty and the facts which would be taken into account.

With reference to the common sanctions guidance which the RPBs have introduced, we would invite the Secretary of State to issue a similar policy document in relation to RPB regulation so that RPBs can enjoy the same degree of transparency and certainty as IPs who are subject to sanction.

**Q5. Do you have any comments on the proposed scope and procedures for the Secretary of State to publicly reprimand a RPB?**

While we accept that the grant of RPB status rests with the Secretary of State and agree that there ought to be a means by which an RPB can be reprimanded without the need for full withdrawal of its registration, the consultation paper does not provide sufficient detail to enable us to comment fully on the scope or proposed procedures.

We are familiar with the powers approved in relation to the FRC under the Companies Act 2006 and would be content if this process is replicated under the Insolvency Act 1986.

**Q6. Do you agree with the proposed arrangements for RPBs making representations?**

We note that very short timescales are being proposed. We would suggest that there is a balance to be struck between progress and fairness. An RPB is likely to have complex governance arrangements and we would suggest that the minimum response timescale should be 28 days.

In addition, consideration should be given to accepting representations from an RPB other than in writing, e.g. oral representations taken in the course of a meeting or hearing.

In relation to all of the proposed new powers, we would encourage the Secretary of State to introduce a right of appeal and not simply require an RPB to revert to judicial review. As noted in our response to Q3 above, judicial review would likely incur considerable costs for all parties and would take considerable time.

**Q7. Do you have any comments on the proposed procedure for the Secretary of State to be able to apply to Court to impose a sanction directly on an IP in exceptional circumstances?**

It is not clear from the consultation paper why this power is required by the Secretary of State. If an act or omission or an IP has particularly serious consequences for the reputation of the profession, the RPB should be taking action. There is no need for the Secretary of State to have a power of intervention in that regulatory relationship. The consultation paper does not provide any historical evidence in support of this proposal; it is reasonable to ask why steps have not been taken to remove the RPB status of any such body if such precedent exists.

The introduction of such a power would raise a large number of questions over the definition of the 'public interest' in an insolvency matter. The power of the FRC relates to statutory audit and, as outlined above, this power is largely based on the audit of public interest entities, rather than public confidence in the audit regime.

The consultation paper raises more questions than answers in respect of the process for sanction which is envisaged. Principally, there is no information as to how the Insolvency Service would investigate and prosecute public interest complaints (with regard to resource and skills). What opportunity would be given to IPs to respond? Similarly, there is no indication as to how this process would be funded (with the costs likely to be considerable).

In our experience, public interest investigations are costly and lengthy (more so than comparable investigations by RPBs). Public confidence in the regime and the reputation of the profession would be better served strong and robust RPBs which are able and minded to take swift, regulatory action.

If there is evidence of inconsistency among the existing RPBs, this is perhaps an area on which the Insolvency Service ought to focus, to raise standards and to ensure consistently high levels of

regulation of IPs by all RPBs. There should be no scope for 'regulator shopping' by IPs who might otherwise be minded to seek a light touch regulator.

**Q8. Do you have any comments about the proposed procedure for the Secretary of State to require information and the people from whom information may be required?**

While we have no objection to the principles in this regard, we observe that the Insolvency Service already enjoys considerable powers in respect of information requests (whether from the RPBs or IPs). One example is the Memorandum of Understanding agreed with the RPBs.

**Q9: Do you agree with the proposal to provide a reserve power for the Secretary of State to designate a single insolvency regulator?**

**Q10: Do you have any comments on the proposed functions and powers of a single regulator?**

We will address both of these questions together.

We do not agree with the proposal to reserve the power. If the regulatory landscape moves towards single regulation then that should be a separate, dedicated, consultation. It would be impulsive to seek to introduce a power without provision of any detail or full consultation.

We accept that it is possible that the market might be better served by a reduced number of RPB bodies but the move to a single regulator would not bring about any distinct regulatory changes that could not be achieved with multiple RPB bodies. The role of the Secretary of State or the Insolvency Service would be no stronger with a single regulator, and would be inconsistent with the other accountancy related reserved (or statutory) licensing regimes.

With reference to paragraph 46 of the consultation paper, there seems to be a failure to recognise that many IPs are already members of bodies which operate with the best regulatory models for professionals. If there are RPB bodies which do not yet meet this standard then naturally the Insolvency Service should address these matters rather than introduce wholesale changes to the existing structure.

**Part Two – Insolvency Practitioner Fee Regime**

**Q11. Do you agree with the assessment of the costs associated with fee complaints being reviewed by RPBs?**

Our comments in relation to the suggestion that regulators deal with fee related complaints are set out in the 'General Comments' section on the first page of our response . Beyond this, it is difficult to assess the costs associated with fee complaints. There doesn't appear to be an accurate impact assessment included with the consultation paper: it only appears to focus on the increased Insolvency Service costs (which it assumes will be transferred to the RPBs), with no consideration given to the additional costs which the RPB bodies will need to incur in order to be able to consider fee complaints under the proposed arrangements.

Much would depend on the level of fee complaints which would be received. Although current indications are that complaint levels would be relatively low, this could change rapidly if creditors and other interested parties believe there is a free and easy way to challenge fees.

IPs already fund aspects of the Insolvency Service. There is clearly a high financial burden being placed on the IP population by the proposed reforms.

**Q12. Do you agree that adding IP fees representing value for money to the regulatory framework, greater compliance monitoring, oversight and compliant handling of fees can be delivered by the regulators?**

The existing monitoring regime of IPs carried out by ICAS currently considers IP remuneration both in terms of compliance with the legislative process for the approval of remuneration and in terms of potential misconduct in relation to overcharging by reference to time incurred or hourly rates applied. This is also reflected in our complaints and disciplinary processes. We do not therefore believe that by providing a specific regulatory framework reference to this work will enhance public confidence in the system.

ICAS maintains that the RPBs should not be required to deal with IP fees, particularly as the fee approval procedures are set out in a legislative framework and it falls to be assumed that any failings in the current system must be capable of being remedied by the legislators.

**Q13. Do you believe that publishing information on approving fees, how to appoint an IP, obtain quotes and negotiate fees and comparative fee data by asset size, will assist unsecured creditors to negotiate competitive fee rates?**

There should be full transparency about insolvency appointments and regulation. Any process that is shrouded in mystery is not in the public interest and the Insolvency Service and RPBs have a duty to work together to address any lack of clarity in general. SIP 9 and legislation already require full disclosure and separate creditor guides have been produced. Information on fees is therefore already widely available to creditors. Unfortunately, as outlined above, there is a high level of creditor apathy and no educational measures will be capable of addressing this underlying issue.

With reference to unsecured creditors, often no single creditor is capable of exerting pressure and real change can only be achieved by providing a mechanism for creditors to collaborate in order to exert influence over IP appointments and fees. HMRC and the Insolvency Service (via the Redundancy Payments Office) are often the largest creditors in any corporate insolvency and experience of our members is that HMRC and the RPO rarely exercise their rights as creditors in relation to the appointment of an IP or the approval of remuneration. Active involvement of Governmental departments and agencies alone is more likely to have an impact on the objectives.

Should comparative data be produced this would have to take account of geographical location, IP firm type and asset category in addition to asset values to make this information of statistical and practical relevance.

**Q14. Do you think that any further exceptions should apply?**

We do not support a change in the fee structure to a fixed fee or a percentage of realisations only as there are significant practical difficulties which are foreseen in adopting this approach. Irrespective of the level of assets, it is vital that policy makers recognise there is a *de minimis* amount of work required by an IP in statutory compliance and investigation, which would include reports on directors' conduct, but may not lead to asset realisation.

If creditor committees are considered to be an effective means of exerting control over fees then further thought needs to be given to addressing the difficulties faced by IPs in having creditor committees established. This might require the quorum for a committee to be reduced to one or two creditors.



Further exceptions should apply to:

- Administrations where no dividend expected to be paid to unsecured creditors (other than cases where is a possible prescribed part distribution).
- Administrative Receiverships - responsibility is to deal with charged assets only.
- Appointments where it is not possible to establish a creditors committee.
- Appointments where a small number of creditors (say no more than 5) have a majority in value.
- Appointments where no creditor holds an interest less than 10% of total value of claims (that is, any creditor claims with a value > 10% already have the right to lodge appeals).

**Q15. Do you have any comments on the proposal set out in Annex A to restrict time and rate as a basis of remuneration to cases where there is a creditors committee of where secured creditors will not be paid in full?**

For the reasons outlined above, we do not support a change in the fee structure to a fixed fee or a percentage of realisations only. Similarly, all other professions are able to charge time in line (for example the solicitors and statutory auditors are not constrained by such restrictions and much of the consultation paper seeks to draw a comparison with these two areas).

As for the quoted Schedule 6 rates, these have not been amended for many years and as a result we would question whether this scale is relevant at all.

**Q16. What impact do you think the proposed changes to the fee structure will have on IP fees and returns to unsecured creditors?**

We perceive that there are three main risks:-

1. The introduction of fixed or percentage fees could lead to increased returns to the IP in cases with high value asset realisations, which would undermine any regulatory rationale for the regime.
2. There would be no incentive to carry out in-depth investigations into director conduct and potential pursuit of additional assets, leading to less effective regulation of company directorships under the Companies Act. During the short consultation period, we have been unable to obtain information to establish the percentage of director disqualification proceedings which stem from insolvency investigations as this will influence the risk rating.
3. The IP may avoid the pursuit of additional assets where the increased level of remuneration would not cover the time incurred, which could be to the detriment of all creditors.

**Q17. Do you agree that the proposed changes to basis for remuneration should not apply to company voluntary arrangements, members' voluntary liquidation or individual voluntary arrangements?**

We do not believe that this model is appropriate for any procedure.

**Q18. Where the basis is set as a percentage of realisations, do you favour setting a prescribed scale for the amount available to be taken as fees, as the default position with the option of seeking approval from creditors for a variation of that amount?**

ICAS is opposed to the proposal to introduce percentage fees which are aligned with realisations. We recognise that this may still be introduced and, if adopted, we would suggest that a prescribed scale be implemented (by which we mean that the Schedule 6 scales would need to be updated to reflect current day values), with an option to seek approval for a variation. Finally, we would encourage the setting of a *de minimis* level to reflect the statutory work which every IP needs to complete.

**Q19. Is the current statutory scale commercially viable? If not what might a commercial scale, appropriate for the majority of cases, look like and how do you suggest such a scale should be set?**

As noted above, we do not believe the current statutory scale is viable and it does not adequately reflect the amount of work currently undertaken by IPs. We have also commented on the scale at Question 18 above.

**Q20: Do you think there are further circumstances in which time and rate should be able to be charged?**

We think the ability to charge time in line should remain in all circumstances, but in particular in respect of the following areas of work:

- Investigations
- Antecedent transactions

**Qs21 – 26:**

We consider that our response to each of these questions is sufficiently covered above.

**Q27: Do consultees believe these measures will improve the market confidence?**

**Q28: Do consultees believe these measures will improve the reputation of the insolvency profession?**

To a large extent, our position on these questions is covered in our responses above; particularly in the section 'General Comments'.

We believe there is a general will amongst the RPBs to ensure that the insolvency profession is respected and appropriately regulated. These common aims can be achieved through RPBs and the Insolvency Service working together.

We are not convinced that the measures proposed in this document are necessary to improve market confidence and/or the reputation of the profession. Further, we are concerned that the unintended consequences of some of the measures could make matters worse, rather than better.