THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

Response from
The Institute of Chartered Accountants of Scotland to
The Insolvency Service

Consultation on reforms to the regulation of Insolvency Practitioners

Introduction

The Institute of Chartered Accountants of Scotland (ICAS) regulates approximately 77% of insolvency practitioners (IPs) who take appointments in Scotland. ICAS also regulates 7 appointment taking IPs who are based in England & Wales and one who is based overseas. We have held four meetings to discuss the consultation with those directly affected by the proposals contained in the consultation.

We are concerned that there is little evidence provided in the consultation document in support of some of the issues which are stated as requiring to be addressed. ICAS is fully supportive of change where it can be demonstrated that change is needed and where the outcome will provide for a more efficient and competitive insolvency profession.

One important central issue in insolvency proceedings is the failure of unsecured creditors to engage with the processes despite provision being enshrined in legislation for them to do so. This important issue has not been given the attention that it deserves in the consultation document. ICAS suggests that attention requires to be turned to this matter.

We believe that whilst it is acknowledged within the consultation document that:

a) the OFT "did not identify problems with the fundamental structure of insolvency regulation", "nor did it identify the number of direct regulators as a problem in itself"
b) unsecured creditors, whilst legislation provides them with the tools to make enquiries into the actions of IPs and to challenge the level of fees, fail to engage fully with the insolvency process citing the costs of doing so or alternatively a failure to understand the processes, and
c) the Government has declared its "commitment to simplify, and where possible reduce, unnecessary regulation"

that nevertheless a significant number of proposals will require major legislative change, will increase regulation, and will incur substantial costs which ultimately will be passed on to creditors, all these changes resulting in minimal overall return to unsecured creditors.

ICAS believes that there are a number of voluntary changes that could be introduced which would improve the system of regulation but which could be achieved quicker and at a fraction of the cost.

Chapter 1 – General Information

1. ICAS questions the assumptions that have been made in the preparation of the Impact Assessment and considers that a detailed review and re-working of the costings requires to be carried out. We believe that the costs have been grossly underestimated. Significant insolvency expertise would be required by a new independent complaints body. Such

expertise does not appear to have been provided for in the impact assessment. In addition it is not acceptable to make proposals which are not based on hard evidence.

2. The calculation that trade suppliers will advance additional credit of £8 million per annum (paragraphs 1.21 & 1.22 on page 60), which is based on the survey carried out by the OFT is flawed. The reality of business is that "cash is king" and credit controllers are under pressure to keep credit to 30 days wherever possible.

Chapter 2 – Overview/Regulatory Framework

3. The public perception that there are too many regulatory bodies is understood however we do not believe that a single regulator would be in the best interests of creditors of Scottish businesses and individuals. Scotland operates under a separate jurisdiction which gives rise to a number of issues that require to be treated differently in Scotland from that which applies in England & Wales. The Scottish regulatory bodies are best placed to regulate the profession in Scotland having an in-depth knowledge of Scottish legislation, procedure and practice both in relation to the work of insolvency practitioners and in relation to the work of the courts. ICAS and the Law Society of Scotland work together closely through their insolvency committees and ICAS maintains an ongoing dialogue with the courts and with the Accountant in Bankruptcy.

4. ICAS believes, in the absence of evidence of major regulatory failure, that the current structure of IP regulation is the correct one, though it would benefit from some amendment. In our view the main improvements relate to the strengthening by the Insolvency Service of its oversight role and the introduction of some changes to the structure and operation of the Joint Insolvency Committee. These improvements are detailed in the comments offered in relation to Chapter 4.

Chapter 3 – Independent Complaints Body

5. The Consultation sets out to promote the protection of unsecured creditors and principally seeks to address the issue of practitioner remuneration. However, the proposals derive from a report which was predominately focused on the corporate insolvency market and which also made little reference to the Scottish position. ICAS strongly believes that these jurisdictional issues require to be given due consideration by BIS as many of the perceived deficiencies do not exist in the Scottish system (where there are enhanced controls) and we consider that there are existing processes which, if adopted in England and Wales, could present a robust alternative to the proposals set out in the Consultation, but more importantly a tried and tested solution to the perceived problem.

6. The Government has identified an opportunity to reform the landscape and, for the reasons given above, we consider that any such review should include a review of the remuneration approval process in England and Wales as a whole, and should not just focus on the structure of regulation and the assessment of complaints.

Practitioner Remuneration

7. The Consultation relies on the OFT's finding that the current regulatory regime did not do enough to rectify the lack of power on behalf of unsecured creditors. Regrettably inadequate recognition has been given to the Scottish position. We believe that it is vital that BIS consider this in more detail as the perceived issues appear to have arisen, in part, due to a divergence of insolvency remuneration procedures north and south of the border.

8. In Scotland, 60% of corporate appointments are court liquidations. In these cases, there is an established mechanism for the approval of practitioner's remuneration; the fees are either fixed by the Court or by a creditor committee. In those corporate insolvency cases where the fees are approved by the Court a review is undertaken by the Court Reporter, who is an IP appointed by the Court to undertake the audit of insolvency remuneration in a particular case. The Court Reporter reviews the practitioner's files with a view to providing the Court with an assessment of the appropriateness of the proposed fee and further undertakes an audit of the practitioner's intromissions. It is then for the Court to determine the practitioner's fee based on the recommendation of the Court Reporter (and indeed because the Court Reporter is undertaking an audit of the practitioner's files and any intromissions there is a significant degree of accountability). This mechanism is a successful aspect of corporate insolvency in Scotland as, ultimately, the decision on practitioner remuneration is a judicial one, and therefore fair, transparent and objective. Given these principles, we believe it would be inappropriate to implement any arrangement which interferes with this court process or seek to diminish the role of the Scottish Courts.

9. We understand that this process does not presently apply to the same extent in England and Wales but it is clear that the judicial route provides a mechanism which is robust, fair, proportionate and would address all of the perceived issues identified in the Consultation. We would ask that further consideration be given to whether this process should be adopted/expanded in England and Wales. The Court Reporter mechanisms, and Court approval process, do not absorb a significant amount of court time and the Reporters are paid an appropriate fee for their review.

10. In other corporate insolvency cases, the fees may be set by a creditor committee, comprised of a selection of creditors (secured and unsecured). This process ensures that secured and unsecured creditors have a say over the extent of the practitioner's remuneration. This process also provides a mechanism for the audit of the practitioner's intromissions and enhances accountability. However, it must be recognised that the success of this model is almost entirely dependent upon creditor engagement. Unfortunately, in real terms, unsecured creditor apathy is a significant barrier to any model which seeks to enhance their role in the remuneration process. We are pleased to note that BIS also recognise that the OFT's proposals to promote the position of unsecured creditors will not succeed without unsecured creditor engagement.

Regrettably, there is no evidence that unsecured creditor engagement would improve as a result of the proposed measures.

11. In sequestration cases (personal bankruptcy) and in protected trust deeds where the deed provides for or creditors have asked for independent assessment of the fee, the trustee's remuneration and outlays are fixed by the Accountant in Bankruptcy, who is a government official (and not a court official). In these cases trustees are required to submit their accounts to the Accountant in Bankruptcy for audit and determination. The Accountant in Bankruptcy is paid a fee for approving such fees, which is likely to more than cover costs. For issuing a determination fixing the outlays and remuneration payable to an interim trustee or trustee the Accountant in Bankruptcy seeks payment of 17.5% of the sum fixed. The debtor or any creditor has a right of appeal to the Sheriff Court; again the Scottish system maintains an element of judicial engagement.

12. On the whole, ICAS does not consider that a significant step change is necessary. Instead, we consider that there is scope to provide for common remuneration approval mechanisms across the respective jurisdictions. We consider that the OFT ought to have considered the Scottish position more fully, and that the Consultation ought to have recognised the solution afforded by the adoption of an enhanced fee approval procedure.

Complaints

13. The Consultation highlights the differences between the relevant RPBs but does not consider the merits of a cohesive approach among the RPBs to regulation/complaints handling. We consider that the Insolvency Service, in its supervisory role, is best placed to promote greater consistency across the RPBs' complaints handling procedures.

14. The Consultation also focuses on the provision of a cost effective route for fee assessment. First, we do not immediately accept that fees form a valid basis for complaint where there is an adequate and robust mechanism for the approval of those fees in the first instance, and where there is a judicial right of appeal. The administrative approach outlined in the Consultation is presented as a solution to the perceived "fee" issues whereas ICAS considers that the solution to this perceived problem lies elsewhere, namely a change in the way fees are approved to provide for the common approval mechanism across the jurisdictions as proposed above.

15. For Scottish insolvency cases the determination of practitioner remuneration is predominantly either a judicial one (vested in the Court) or an administrative function (vested in the Accountant in Bankruptcy). We accept that aspects of the proposal are intended to make these rights of appeal more accessible but the success of any changes would be dependent on the ability to reduce creditor apathy. We consider that fees should not form a valid basis for complaint where there is an existing mechanism for a creditor to express its dissatisfaction and where it has been unsuccessful, or has chosen not to pursue its right of appeal.

16. We have considered each of the Complaints Models in turn and believe that a fifth model should be considered. In this section we have refrained from addressing each of the Consultation questions in turn and would prefer to focus on the high level principles. However, before considering the details of a fifth model we would make the following observation about the proposed models:-

Model 1

17. The establishment of a fully independent complaints body would cause many of the RPBs to subject their members to more than one regulatory complaints function. For example, Members of ICAS who do not hold an Insolvency Permit would be subject to the jurisdiction of the Institute's investigation and disciplinary functions. Many individuals who hold Insolvency Permits also carry out general practice accountancy work and so would be subject to more than one complaint body. This seems to be at odds with the overall aim to reduce regulation within the accountancy profession. Equally, ICAS could not impose the regulatory and disciplinary decision of the complaints body without a change to its Royal Charter and Rules, which would require the approval of the membership in AGM and also of Her Majesty's Privy Council. There could be no guarantee given, even if our Council were so minded, that the membership would agree to such changes to our constitution.

Model 2

18. In our response to the OFT, we endorsed the establishment of an independent review mechanism. Model 2 is an extension of our proposal but we do not consider that any new body's function should extend to an appellate function. Furthermore, paragraph 3.38 suggests that this body would be entitled to review decisions of the RPBs own investigation, disciplinary and membership committees. We would find it difficult to accept any such proposal. ICAS is established by Royal Charter. We have established appeal procedures (with an independent appeal mechanism of our own) and could not transfer those powers to another body without a change to our Royal Charter and Rules. We believe that this proposal (that is a body which has an appellate function) would create inconsistency within our constitutional arrangements and, furthermore, lead to confusion and conflict between our insolvency and non-insolvency processes.

Model 3

19. This proposal is a significant departure from the RPBs' existing structures, whereby the investigation and disciplinary functions are separated. In the instance of model 3, it is proposed that the body would determine the outcome of a case having regard to the RPB's report (irrespective of the outcome of that report). If disciplinary action were to follow there is no indication given as to which disciplinary function would consider the matter and whether this function would continue to be carried out by an independent tribunal. If not, then we would be concerned that this proposal would lead to a weakening of our existing regime, from one which is quasi-judicial to one which is largely administrative based and which relies on the remedy of judicial review to ensure HRA compliance. Judicial Review proceedings are prohibitively expensive (bearing in mind that it would be the practitioner rather than the complainer who would normally exercise

the right of review in disciplinary proceedings). We cannot accept that this option would be fair or reasonable and there would remain the issue over the body's inability to impose a sanction without reference to the RPB. We believe Model 3 would be a serious departure from our own robust and HRA compliant procedures.

Model 4

20. Again, we are concerned that the proposed model would appear to combine an investigation and disciplinary function, which we believe would be a serious departure from our own robust and HRA compliant procedures.

Human Rights Act 1998

21. Many aspects of the proposed models would result in a process which affords individuals less protection than they are already afforded under our own existing regime. We note that the Consultation refers to the completion of a HRA review. We would have welcomed sight of that review.

ICAS Proposal

22. We remain of the view that a central independent examiner route would offer a viable review mechanism. ICAS already appoint Independent Examiners (who are Queen's Counsel or retired Sheriffs). These individuals have no affiliation with ICAS. They have a right of review and are able to make recommendations to the investigation function of ICAS and may direct that a case be re-considered but cannot substitute their decision for the decision at first instance. We consider that an independent arrangement of this nature is the most appropriate way forward and would present the most cost effective means of addressing any perceived lack of independence. The authorising bodies could jointly agree on a panel of Independent Examiners, thereby affording consistency.

Fee Related Arbitration

23. ICAS offer a Fee Arbitration Scheme and it is utilised by members and their clients on a consensual basis and we recognise the benefits of arbitration on this basis. We consider that any mechanism could proceed on this basis for insolvency, providing that to do so would not interfere with the existing court procedures. We do not accept that participation in the scheme should be mandatory, particularly as many fees in Scotland are fixed by the Court. We consider that it would be improper for any arbitration scheme to take precedence over the court process.

24. Finally, with reference to the scale of complaints, we consider that it would be difficult to predict. In our experience, fee related complaint levels are low and, if this were to be the case, the costs associated with the establishment of a new regulatory regime would be disproportionate to the issues perceived by the OFT.

Chapter 4 – Changes to the regulatory framework

25. The Joint Insolvency Committee (JIC) has been hampered in the past by a lack of clarity from government on what government wanted to achieve over a specified period of time. ICAS would support a system whereby the Insolvency Service (IS) clearly sets out government policy, which would enable the authorising bodies to act accordingly. ICAS considers that it would be helpful if regulatory objectives were set annually. We would support the first two objectives detailed on page 30 of the consultation document. The objective regarding promoting growth is one for government. Whilst we agree with the principle that parties should be treated fairly IPs are required to comply with legislation which provides how the claims of creditors are to be handled; the fourth objective may thus be at odds with legislation. ICAS welcomes the opportunity of working with IS and with the authorising bodies to agree a set of regulatory objectives.

26. ICAS agrees with the proposal that the IS should cease to act as a direct regulator. This would remove any conflict that arises from acting both as authorising body and as regulator, and it would allow IS to concentrate on its oversight regulatory functions. Whilst the number of regulatory bodies is perceived as being too high the current number in part reflects the fact that there are three jurisdictions, which give rise to differences in legislation requiring jurisdictional expertise. Our view is that careful consideration is required, including freedom of choice and competition, prior to any decision being made on the number of regulators. In addition to insolvency many firms perform other services which are also regulated by their RPB. If IPs were monitored in isolation by a single regulator, then due to the structure of firms within which most IPs operate, it may lead to greater fragmentation of regulatory oversight. There are cost benefits to be derived from ensuring that all members' activities are, where possible, monitored by the same RPB with the relevant jurisdictional expertise. Cost benefits ultimately impact on the charge-out rates of practitioners.

27. As the oversight regulator IS should have appropriate powers to enable it to discharge its role effectively. Authorising bodies, having signed up to a Memorandum of Understanding will be eager to ensure that they comply with its terms. In view of this it is incumbent on IS to bring serious divergence to the attention not only of the particular body but also to alert the other authorising bodies of the issues in order to avoid the situation arising in future. Except in extreme circumstances we do not consider that the matter should be publicised. Whilst we are not averse to financial sanctions being imposed for repeated divergence consideration should be given as to whether the imposition of financial sanctions will necessarily address any wrongdoing or whether formal reprimands or a curtailment in activity of the RPB may be more effective.

28. Whilst we accept that IS should be able to recover its direct oversight costs from the authorising Bodies we strongly oppose the concept of fixed charging unless it is calculated on a proportionate basis according to the number of IPs within the authorising body. These bodies set fee income based on IP numbers and charge a fee based on either the size of firm or the level of insolvency income per IP, as this most fairly

represents the level of regulatory activity. The IS supervisory activities should take into account the size and nature of the bodies and their licensees and should not take a "one size fits all" approach to charging fees and supervision, as this would not reflect the risk in the market place and would mean that the smaller bodies would be more heavily charged than the larger bodies.

29. We firmly believe that the authorising bodies are best placed to set and deliver professional and ethical standards with which insolvency practitioners must comply. The authorising bodies regularly assess the performance of their members and are uniquely placed to take necessary action when the need arises, due to the contractual relationship between the body and its members. The proposals in the consultation document would result in a fragmentation in regulation whereas we believe that it is essential that all members of a body are subjected to the same obligations and rules. We therefore do not support the proposal to establish a new standard setting board to replace JIC. We believe that a number of reforms to JIC should be debated and agreed by the authorising bodies. Reforms to be considered include the introduction of lay members with relevant insolvency expertise, the introduction of a number of creditor bodies to JIC, changes to the manner in which decisions are reached, an agreement between the authorising bodies on the application of standards, and an agreement between the authorising bodies on a strategic plan. The introduction of such measures would in our view result in marked improvements. To address the public interest concern the authorising bodies could consider appointing an independent lay chairman to JIC provided that the selection process ensured that the individual had the necessary level of expertise in insolvency law and procedure.

30. The role of the oversight regulator should be, in discussion with the authorising bodies, to set clear regulatory objectives, to monitor whether or not those objectives are being met, and where they are not, to take action to ensure that the relevant authorising body is held to account. We believe that any influence on standards should result from the regulatory objectives mentioned at paragraph 25 above. We do not therefore agree that the oversight regulator be given greater powers to influence the setting of standards, nor should it have a power of veto.

31. At a time when the government's stated aim is to streamline regulation we cannot see the need for the establishment of new boards, whether standard setting or advisory. Provided JIC extends its membership to lay involvement we believe that the public interest would be served by those individuals, thereby apparently negating the need for the Insolvency Practices Council (IPC). We are concerned at the apparent attempt on occasion to use regulation as an alternative to amending legislation, a situation which should not occur. We note that the government considers that IPC's role extended beyond its original remit. We consider that there may be merit in retaining the Insolvency Practices Council but with a limited and revised remit to include oversight of the performance of IS as an oversight body.

Chapter 5 – Detailed suggestions for changes to insolvency legislation

32. As previously stated the consultation sets out to promote the protection of unsecured creditors but recognises that extensive creditor engagement has hitherto been lacking. We cannot identify any provisions within the consultation which are capable of improving creditor engagement. A number of high profile insolvency cases have involved the loss by members of the public of deposits paid for goods or services which were not delivered prior to insolvency. Such situations could be avoided if legislation were to be introduced requiring businesses that accept deposits to hold them in separate bank accounts on trust principles, not available for set-off against borrowings, which would mean that in the event of insolvency those funds would be ring fenced and therefore those unsecured creditors would receive enhanced returns.

33. The proposals in the consultation derive from a report largely based on empirical evidence obtained in England & Wales and which in our view do not reflect the Scottish position. The proposals are largely biased towards consideration of the process for approval of fees and improving returns to unsecured creditors. Enhanced controls operate in Scotland as detailed in paragraphs 8 to 11 and in the following paragraphs.

34. In Scotland a majority of corporate appointments are court liquidations. In these cases the IP applies to the Court for the appointment of a Reporter. The Court will typically appoint an IP from a panel, though some Sheriff Courts do not operate a panel system in which case the nominated Reporter who will be an IP may be appointed. The Court Reporter is an officer of the Court for the purpose of the assignment and is accountable to the Court. The Reporter is required to make a fair assessment of the work that the IP has done. He reviews the practitioner's files and time records, undertakes an audit of the practitioner's intromissions and provides the Court with a recommendation on the level of an appropriate fee. The Court determines the fee. The Reporter and the Courts charge for their services, such charges being paid as an outlay of the insolvency. We understand that the Court Reporter mechanism and the Court approval process do not absorb a significant amount of court time. This mechanism is a successful aspect of corporate insolvency in Scotland the decision on practitioner remuneration being a judicial one. We believe that it would be inappropriate to implement arrangements in Scotland which interfere with this court process.

35. In other corporate insolvency cases, where there is a Committee of Creditors the fees are fixed by the committee. If creditors are dissatisfied with the level of fee that has been fixed they can apply to have a Court Reporter appointed; the procedure is as outlined in paragraph 34 above. We offer no objection to presenting creditors with separate fee resolutions if this will concentrate minds. In relation to question 28 of the consultation the question of creditors agreeing hourly rates at the time of the resolution does not arise in Scotland due to our different fee approval procedures.

36. In our view there may be merit in re-evaluating the basis on which the level of the prescribed part is set. To have any marked effect on the return to unsecured creditors

there would have to be a significant increase in the level. If an increase can be justified it will only be effective if it is supported by lenders since any reduction in returns to that class of creditor will inevitably have a negative effect on the cost of borrowing, on the availability of credit and on the economy. The important issue is the net recovery for creditors as a whole. We believe that in the Scottish context it is misguided to consider that IPs charge unsecured creditors higher rates than they charge secured creditors. It must be recognised that the cost of dealing with numerous creditors is often greater than dealing with one secured creditor. The focus would be better placed on the time required to be spent on a job and the complexity of it rather than on hourly rates. Where due to market forces discounted fees have been offered to secured creditors we believe that the majority of IPs would have no issue with disclosing this in reports to creditors. Many IPs already disclose, in the initial circular to creditors, the hourly rates and the basis upon which fees are fixed. We have no issue with greater transparency.

37. We have no evidence that Administrations are being used in situations where a CVL would be more appropriate. It should be recognised that there are advantages of speed of process in getting into administration over the CVL process and that on liquidation many contracts fall automatically, which may not be in the interests of creditors.

38. We do not agree with restricting out of court administration appointments by directors as this would be contrary to the rescue culture. In our view it would be inappropriate to require IPs to give an undertaking that the relevant objective could be achieved; decisions are taken on information that is available at the relevant time, which is subject to change and which could affect the outcome. We have seen little evidence that unsecured creditors are engaged with the administration process or that they seek greater oversight. It must be recognised that when companies go into administration it is usually because they are bankrupt and frequently from the outset there is no prospect that there will be a return to unsecured creditors, other than the prescribed part. In our view engagement should be with those who have an economic interest in the outcome.

39. We consider that if the funds available for unsecured creditors are insignificant then there is no merit in a different practitioner being appointed as liquidator since this will necessarily incur greater cost. We would prefer to see provisions introduced which would allow the administrator in such cases to distribute the available funds. Where there are significant funds we can see no objection to the administrator advising creditors, in his final report, of his intention (or otherwise) to assume the role of liquidator thereby affording them the opportunity of moving for an alternative liquidator.

40. It is our considered opinion that if IPs are required to provide at the outset an estimate of the duration and cost of a case (other than the simplest consumer type case) then in complex cases such estimates will be accompanied by caveats which will render the estimates meaningless. Where it is reasonably practical for the IP to provide an estimate it is currently provided in Scotland in most cases.

41. In relation to who should bear the cost of a successful challenge to an IP's fees, in many cases in Scotland this will be at the discretion of the Court which deals with the challenge. We see no need for change.

42. In accordance with legislation creditors are already provided with a significant amount of information. If there is a lack of knowledge or understanding of the insolvency process we do not consider that this will be addressed by providing them with more information. What is required is a sustained programme of education of the general public by government and by organisations that represent them. The experience of our members is that interested creditors engage with the process and maintain a dialogue with the appointee.

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