28 March 2014

Our ref: ICAEW Rep 47/14

By email: Policy.Unit@insolvency.gsi.gov.uk

Dear Sir

Strengthening the regulatory regime and fee structure for insolvency practitioners

ICAEW is pleased to respond to your request for comments on *Strengthening the regulatory regime and fee structure for insolvency practitioners*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

STRENGTHENING THE REGULATORY REGIME AND FEE STRUCTURE FOR INSOLVENCY PRACTITIONERS

Memorandum of comment submitted in March 2014 by ICAEW, in response to The Insolvency Service consultation paper Strengthening the regulatory regime and fee structure for insolvency practitioners published in February 2014

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Strengthening the regulatory regime and fee structure for insolvency practitioners* published by The Insolvency Service on 17 February 2014, a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world leading professional membership organisation that promotes, develops and supports over 142,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession. As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. ICAEW's regulation of its members and affiliates in insolvency is overseen by the Insolvency Service, and ICAEW is the largest of the Recognised Professional Bodies (**RPBs**) under the Insolvency Act, currently licensing over 700 practitioners.

5. ICAEW is also a regulator for audit, financial services, consumer credit and is an accredited body for the issue of statements of professional standing. And this month, the Lord Chancellor has accepted ICAEW's application to regulate probate and license alternative business structures.

6. This response reflects the views of ICAEW as a regulator and consultation with the following ICAEW committees:

- Insolvency Committee (a technical committee made up of Insolvency Practitioners working within large, medium and small practices).
- Insolvency & Restructuring Group Committee (which offers support to ICAEW licensed insolvency practitioners and their staff belonging to the Group).
- Insolvency Licensing Committee (the committee responsible for regulation of ICAEW insolvency practitioners, via licensing and the consideration of monitoring reports).

MAJOR POINTS

Part 1 – Regulation of insolvency practitioners

7. We endorse the overarching aims of the regulatory regime for IPs to ensure fair and consistent regulatory outcomes for the benefit of all those with an interest in insolvency cases. But we do question the assertion that the regulatory regime as it stands is not fit for purpose. The majority of the steps proposed in this document appear to us to be a series of reactive measures to deal with unsatisfactory outcomes, rather than a pro-active approach to ensuring that the consumer and other interested parties receive the best and fairest service at the outset. Many of the shortcomings outlined are outcomes from the law as it stands, rather than malfeasance by the regulator or the practitioner, and we believe stronger attention to educational programmes for the consumer and the practitioner and the strengthening of best practice guides such as through the SIPs are far better tools for the government to achieve its aims in

this area.

8. We do welcome the introduction of regulatory objectives for the regulatory regime. Regulatory objectives provide certainty for both the oversight regulator and the RPBs and provide a framework against which any new initiatives may be assessed. We believe though, that the Insolvency Service should take the opportunity to devise regulatory objectives for the entire insolvency regime rather than just for the regulatory regime.

9. However the increased powers of sanction by the oversight body seem to be little more than window dressing to address non-existent illegal actions. We are not convinced that the Insolvency Service as oversight regulator requires any additional powers over the RPBs. In our view, the system of regulation operates at its most effective when the oversight regulator and the RPBs work together, as demonstrated through the introduction of the complaints gateway. In our response, we have set out some suggestions as to how the Insolvency Service could play a greater role in the complaints process – for example via case conferences, receiving reports at key stages in the process and attending tribunal hearings.

10. We are also unconvinced that there is a need to take a reserve power to designate a single regulator. This seems contrary to developments or current arrangements in most other aspects of regulation. With effective oversight, the number of regulators should be irrelevant. We also believe that such a step could reduce competition and therefore be in direct conflict with the proposed regulatory objectives. The current regime with competing RPBs, appears better to meet the objective to promote competition. We would add that taking such a power could be interpreted as a lack of confidence in the current regime and therefore counter-productive given the overall aims of the consultation.

11. We would ask the Insolvency Service to consider using professional standards such as statements of insolvency practice to deliver their policy objectives. We comment in our response to Part 2 on how SIP9 could be used in relation to the fee setting process. Using statements of insolvency practice also has the advantage that the changes can be applied UK-wide – one of our concerns is that the changes proposed will only apply in England and Wales.

12. Overall, we are strongly of the view that much of the cause of the supposed lack of confidence in the insolvency regime stems from a knowledge gap amongst the infrequent users of it. It should not be left to the insolvency profession to educate creditors via the administration of a particular insolvent estate. There is much more that the Insolvency Service could do to provide a basic level of information about the operation of the insolvency regime for those who may only experience insolvency once or twice in their business career. The material the Service produces about bankruptcy and personal debt is often commended by its users, so the offering for creditors could equally be enhanced.

13. Trade bodies which represent creditors should also support their members in this area as well as providing guidance on how to avoid becoming a creditor of an insolvent entity – for example by effective credit control or detailed client acquisition processes and due diligence. We also think that more could be done to encourage participation in creditors' committees, particularly by other government departments and that use of technology could make participation in the committee process more straightforward.

14. In 2012 ICAEW launched the Insolvency Quality Forum. As part of the OFT review and subsequent consultation, some stakeholders in the insolvency process raised concerns about their interactions with the insolvency profession. They said that the only time they normally get together with representatives of the insolvency profession is when the Government minister calls them to a meeting. The Insolvency Quality Forum aims to address these concerns.

15. The forum has a strong educational slant and is aimed at understanding stakeholders' concerns. The main purpose of the forum is to encourage stakeholders to work together by promoting open and constructive dialogue about transparency, accountability and confidence

in the insolvency profession. For example as part of her review of the pre pack process, Teresa Graham has attended a meeting of the Insolvency Quality Forum which shows that the Forum can be used as a mechanism to bring together the participants in the insolvency process and break down barriers.

Part 2 – Insolvency practitioner fee regime

16. The objective underlying the fee proposals is to increase net returns to unsecured creditors. There is, however, nothing in the consultation document to suggest that the fee reforms will, in fact, meet this objective. In our view, the proposals for fixed or scale fees are unlikely to further this objective and may well be counterproductive.

17. The proposals also appear to be motivated by a desire to address negative public perception of IP fees. We would also like the public to have a better appreciation of the value of the work carried out by IPs and some of our suggestions in the response are intended to help achieve this. However, the negative perception appears to derive from an impression that IPs are overcharging (in effect, abusing their position) and this impression is misplaced. Lack of engagement of unsecured creditors combined with the current court process for challenging fees could, result in the **potentia**l for charging excessive fees. However, there other constraints on fees and we do not believe that fees are, in fact, generally excessive.

18. As a result, we believe that the Insolvency Service should focus on improving the existing regime (rather than imposing scale or fixed fees), in particular: to minimise risks of actual abuse occurring; to encourage creditor engagement; and to improve information available and public understanding of the regime.

19. We comment in our responses to Part 1 of the consultation on the extent to which the proposed reforms of the regulatory regime could be expected to result in improvements in these respects.

20. The 2010 reforms (and revised SIP9) were designed to address some of the concerns about creditor engagement, including by increasing the information available to creditors. While the Insolvency Service appears already to have concluded that those reforms failed, we believe that it would be useful to obtain and consider recent evidence on this more fully.

21. We believe that fee reporting requirements could be changed to address a number of the specific concerns highlighted in the consultation. SIP9 could for instance, be amended to provide for estimates to be given at the outset of the case and for periodic reporting with reference to that estimate. Given the inherent uncertainties at the outset of the case, there would necessarily be caveats to any estimate but this could be explained to creditors. As will be apparent from responses from the IPs we license and their firms, there are a number of other aspects of the current regime which might be changed, for instance the timescale for setting fees or timing of payment of fees. If the Insolvency Service is minded to take any of these forward we would be happy to consider the potential advantages or disadvantages further with the Insolvency Service and IPs licensed by us.

22. We believe that reforms in this area should apply throughout the UK and comment further on this in our response to Q13.

23. As regards creditor engagement, it may be that practices from other jurisdictions could be adapted for use in the UK, although we highlight general risks of this approach below and any specific measure would require careful consideration. For instance, if it could be established that paying unsecured creditors to attend creditor committees would increase creditor engagement without materially increasing the costs of the insolvency process (and so returns to creditors), this could be worth considering in more detail.

24. More could also be done to move away from physical meetings which can be time consuming and expensive to attend. There could be more use of telephone conferencing, e-meetings or resolutions by correspondence, all of which will be less expensive for attendees.

25. It should also be possible to increase engagement of certain classes of unsecured creditor, in particular government departments or bodies (such as HMRC). It is disappointing that more has not been done across government to encourage other departments to engage with the insolvency process already, as this is not a new issue. It sends a strong negative message to other creditors if government itself does not exercise its rights as a creditor in the insolvency process.

26. There will be limits to the extent disinterested creditors can be expected to become actively engaged, but we believe that reform of the existing regime as outlined above would largely address the concerns identified by the Insolvency Service. By contrast, adopting the more radical approach of fixed or scale fees, will, in our view, produce a much worse result, inherently so when judged in terms of 'fairness' and most likely when judged in terms of maximising net returns to creditors (or creditor engagement).

27. The Insolvency Service has based its proposals on the 2010 OFT report and the 2013 Kempson report (together with the consultation, the **Reports**). Collectively, these paint a distorted picture of the profession and create the impression that, because creditors are not engaged, there are no constraints on IPs' fees, but this is simply not the case; IPs operate in a competitive market. The fact that creditors often receive no returns results from lack of available assets, rather than IP's fees (and IPs themselves are frequently unable to recover all their costs for the same reason).

28. The Reports rely far too heavily on a finding by the OFT of a differential between charges negotiated by secured creditors and certain unsecured creditors and imply (through use of terminology such as 'overcharging') that this is 'unfair', when that is not the necessarily the case.

29. The Reports do not produce any evidence that IPs are charging in an abusive way (and Professor Kempson acknowledges that the concerns related to 'inefficiencies' rather than 'a deliberate attempt to inflate fees' and that 'the evidence base is thin'). In fact, there is clear evidence that fees are generally fair, because there are very few fee complaints (even informal ones). This inference of 'unfairness' in the current regime underlies the proposal for fixed or scale fees on the basis that they would be 'fairer' or result in 'fair value'. However, there is nothing inherently fair in a basis of charging where the results depend upon the amount and quality of realisable assets, rather than the work required.

30. We do not believe that the proposals are best designed to meet the declared objective of increasing net returns to unsecured creditors (or the other key objective underlying the existing regime of bringing wrongdoers to justice). The proposals can also be expected to have other unanticipated adverse outcomes. There is a base cost associated with every insolvency. There are many actions taken by the IP that are prescribed by law and follow a detailed process as set out in the Insolvency Rules. IPs are also required by law to fulfil functions in the wider public interest such as CDDA and AML reporting, all of which take time. If the scale rate does not allow an IP to fulfil his or her statutory obligations then they will not seek appointment in a particular case, or depending on the nature of their practice, may decide to exit the formal insolvency market. The Insolvency Service risks designing a system where an insolvent is unable to access a formal insolvency process because it is not commercially viable for that process to be provided – this seems contrary to the public interest.

31. We have answered the specific Questions below in the interests of completeness, but we do not consider that they seek to address many of the broader issues necessary for a proper perspective. We have, therefore, expressed our views on some of the broader issues arising further in the Appendix to this response.

32. We understand that this initiative is to some extent driven by a desire to address public perception of unfairness in the insolvency process, irrespective of whether or not there is, in fact, widespread 'overcharging' or abuse. However, that perception may, for the most part, be formed from those who are infrequent participants in the process and see IPs being paid when they themselves are receiving little or nothing by way of dividend. We suggest that an increase of 0.1 p in the pound in the returns they would receive (if the proposed reforms were to have the effect anticipated by government) is unlikely to change their opinion of the process or justify the risks involved making the changes.

Consultation process

33. We would have expected the consultation period for such significant proposals to have been twelve, rather than six weeks, or for an explanation to have been given for the short timeframe, given government policy on this (cited in the consultation). The fact that the consultation follows on from the OFT and Kempson reports is not sufficient reason.

34. The short timeframe means that we have not necessarily obtained substantiating data as extensively as we might otherwise have done and this is particularly pertinent when considering in detail how the existing fee regime might be improved (for instance, through additional or changed reporting requirements).

35. We would be happy to work with the Insolvency Service further on these matters (and conduct further detailed research if necessary). It is important that any reform is based on transparent, up-to-date and accurate data wherever possible.

36. While the reforms to the regulatory regime would require primary legislation, there would be scope to address changes to the existing fee regime through revisions to SIP9 or other standards (which would not need to be tied to the legislative timetable).

37. R3 has conducted a survey in the limited time available and we understand that it will include the results in its response to the consultation (**R3 Survey**). We believe that this is consistent with our views on the broader aspects of the proposed fee reforms.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Part 1 – Regulation of Insolvency Practitioners

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

38. We support the introduction of regulatory objectives for the regulatory regime.

39. Any objectives should provide the framework for delivery and a benchmark against which the regime may be assessed. The Insolvency Service should be able to justify all requirements it imposes on the RPBs and the profession generally by reference to the regulatory objectives. Similarly, all policy initiatives as regards the regulatory regime should display clear links to the regulatory objectives and support those objectives. This will benefit the RPBs who will have a clear understanding of the purpose of any change and will also assist the Joint Insolvency Committee with its role as standard setter.

40. Before commenting on the proposed regulatory objectives in detail, however, we question why the regulatory objectives focus only on the regulatory regime for insolvency practitioners. As the Insolvency Service has policy responsibility for insolvency matters beyond the regulation of the insolvency profession, this is an opportunity to develop regulatory objectives for the insolvency regime as a whole. As the introduction of regulatory objectives for regulatory

regime requires a change to primary legislation this would appear to be an opportunity to include overarching objectives for the insolvency regime as a whole as the Financial Services and Markets Act 2000 does for financial services.

41. Turning now to the proposed regulatory objectives as detailed in the consultation document:

Objectives 1 & 2

1. Protecting and promoting the public interest

2. Having a system of regulating persons acting as IPs that:

(i) delivers fair treatment for persons affected by their actions and omissions,
(ii) reflects the regulatory principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and any other principle considered to represent best regulatory practice, and
(iii) delivers consistent outcomes

42. We have no real concerns about the design of these two objectives, which draw very strongly on the objectives included in the Legal Services Act. However, we would question two small points of detail. Objective 2 uses the expression 'persons'. The Interpretation Act defines person as including a body of persons corporate or unincorporated. The use of person would appear unsuitable in this context as only a natural person may be an insolvency practitioner. We also question the inclusion of the phrase 'and any other principle considered to represent best regulatory practice' at 2(ii). Although this objective directly reproduces s3(b) of the Legal Services Act, in the context of Legal Services, the Legal Services Board must only have regard to 'any other principle considered to represent best regulatory practice'. The RPBs by contrast (see paragraph 51) must act in a way which is compatible with the regulatory objectives. The open ended nature of the expression 'any other principle considered to represent best regulatory practice' seems contrary to the desire to provide certainty in the approach to regulation.

43. We also note that there is no reference in the objectives to fairness in the treatment of the IPs who will be subject to the regulatory processes.

Objective 3:
Encouraging an independent and competitive IP profession whose members:
(i) Deliver quality services transparently and with integrity, and
(ii) Consider the interests of all creditors in any particular case.

44. The first sub paragraph of this objective is exactly the same as the second regulatory objective proposed in your consultation paper Reforms to the regulation of insolvency practitioners issued in 2011. We will therefore repeat the comments we made in our consultation response.

45. This objective mixes some of the ethical standards that apply to the profession via the insolvency code of ethics (integrity, objectivity, professional competence and due care, confidentiality and professional behaviour) with the need for a competitive profession. There appears to be an obvious tension within the wording of this objective. We are supported in this view by the design of the regulatory objectives in the Legal Services Act where competitiveness is a standalone objective.

46. It's also unclear which aspect of competition you are expecting the RPBs to encourage. Taking legal services as an example, the competition aspect of the regulatory objectives is interpreted as allowing access to the market rather than in relation to pricing. We're assuming that this regulatory objective also refers to the process to become an IP, as with legal services, but would welcome clarification of this. If this objective does not encompass the criteria and process for becoming an IP, we would flag that the objectives as currently designed make no

reference to the licensing process, which is an omission. If competitive is meant as a reference to fees, we would refer to our response to Q19, as in other professions the use of a fee scale is seen as a barrier to competition, and the proposal to use a scale made later in the consultation could be seen as being in conflict with this regulatory objective.

47. You may also wish to consider whether paraphrasing some of the ethical principles applying to IPs dilutes the impact of those principles.

48. Sub paragraph (ii) of objective 3 is interesting as insolvency law sets out the treatment of creditors and a regulator can only monitor an IP's compliance with the law. We would not expect an IP to act contrary to the law, but the objective as currently phrased may raise false hope amongst users of the insolvency regime who may expect greater weight to be given to their interests than is required by law, and may therefore make complaints to the RPB on that basis.

Objectives 4 and 5

4. Promoting the maximisation of the value of returns to creditors and also promptness in making those returns

5. Ensuring that the fees charged by IPs represent value for money

49. The consultation document offers further explanation of objective 5, but we would suggest that objective 4 is in fact suggesting a similar concept to objective 5 as an IP's fees will have an impact on the value of returns to creditors. Whatever the underlying purpose of objective 4, we'd suggest that the phrase 'and also promptness in making those returns' is unnecessary as quality of service (which would include timeliness of returns) is captured by objective 3. Overall we consider objective 4 to be unnecessary.

50. We are most concerned about the proposed introduction in objective 5 of the concept of value for money in relation to IP's fees. Firstly, we are somewhat perplexed that the concept is described as enhanced monitoring, but the impact assessment only provides costings for the investigation of fee complaints and provides no details for the additional costs of monitoring – which we believe will be significant. We revisit this issue in our response to Q11.

51. We think this objective is impractical if achieving it is placed solely in the hands of the RPBs. Value for money work is most prevalent in the public sector and takes two forms. Auditors of local public bodies have to provide a value for money conclusion as part of their audit opinions. And the Audit Commission publishes extensive guidance on how this work should be conducted. We are of course aware that the Audit Commission is in the process of being abolished, but the value for money work carried on by auditors in the public sector will continue under the National Audit Office.

52. In central government, the National Audit Office undertake value for money studies on large projects – their current work programme includes the privatisation of Royal Mail and the building of the Hinkley Point C nuclear power station. These studies can take anything from 3 to 12 months. We appreciate that most insolvency cases cannot be compared with the large scale projects reviewed by the National Audit Office (though some could be), but you should recognise that to perform a 'value for money' assessment in a case will require a detailed audit of the case whether as part of a monitoring visit or the investigation of a complaint which will be a very time consuming (and therefore expensive) process.

53. We also suggest that unless the Insolvency Service issues detailed guidance, similar to that which is produced by the Audit Commission, any reviews conducted will be subjective and will not provide the consistency of approach which is being sought.

54. We would add that monitoring and the complaints process necessarily takes place after the event, so will not achieve the objective regulatory objective of ensuring that the fees charged are value for money, except to the extent that an individual IP may change their working practices after a monitoring visit or a successfully prosecuted complaint. There is also the possibility that other IPs make take note of the publicity associated with a complaints and amend their behaviour, but overall this seems to be the wrong means to change behaviour. We suggest that a more positive approach would be an education programme or issuing of industry guidance such as SIPs, so that fees charged are 'value for money'. The Service also has the opportunity via the legislative change proposed in the consultation document to ensure that the fees charged by IPs are value for money. We are unconvinced that the changes proposed will deliver value for money, but will address this in our responses to the questions in Part 2.

55. We have also noted that, at paragraph 51 of the consultation, a further amendment is proposed which will require the RPBs to act in a way which is compatible with the regulatory objectives. We have no difficulty with the concept but would challenge the proposed wording (albeit without sight of any draft legislation which has not been included in the consultation document). Paragraph 51 appears to paraphrase section 3 of the Legal Services Act 2007, but there are significant differences in drafting which we do not think justified. The Legal Services Board must act in a way that is compatible with the regulatory objectives so far as is reasonably practicable. To be consistent with this, the Insolvency Service proposals would need to be changed so that the Insolvency Service is required to act in a way which is compatible with the regulatory objectives (rather than merely being required to 'have regard' to the objectives) and the requirements of both the Insolvency Service and RPBs would need to be qualified with ''so far as is reasonably practicable'.

56. If the regulatory objectives are to be adopted it will be helpful for the RPBs to know to what extent the Service thinks that the current arrangements comply with the objectives. If any changes are required, the Service should allow sufficient time for such changes to be made.

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

57. We would oppose the publicising of the notice of intention to revoke an RPB's recognition given that this intention could subsequently be reversed by persuasive representations envisaged in paragraph 60, and on the basis that the notice of intention to revoke, might of itself cause irreparable damage to the RPB before a final decision has been made.

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

58. We don't believe it is necessary for the Secretary of State to acquire new powers to sanction the RPBs. Whilst there is a theoretical disconnect between the powers of the Insolvency Service as oversight regulator and other oversight regulators in the UK, there is no evidence provided which demonstrates that the Secretary of State actually needs any additional powers to sanction the RPBs.

59. We have the opportunity to develop an open and constructive relationship between the oversight regulator and the RPBs within the existing framework. It is in the interests of all that the regulatory system operates effectively but that can be achieved by working in together in a positive fashion rather than for the Secretary of State to take powers which suggest that there is a need for the RPBs to be controlled by directions or otherwise. We'd suggest that the acquisition of these powers by the Secretary of State will suggest to stakeholders that there are flaws in the current system which can only undermine confidence in the regulatory regime.

60. The consultation document does not include any proposed legislation to introduce the power to issue the direction, so it is difficult to comment on the detail of the directions process. The Legal Services Act, which is quoted as a model for this power includes extensive detail on the

process for issuing a direction and the parameters for issuing such a direction. We believe that consultees should have the opportunity to review any proposed legislation as the detail of these proposals will have a bearing on our views and enable us to provide more detailed feedback.

61. We would like to highlight one particular issue. Section 32 of the Legal Services Act restricts the Legal Services Board from using a direction in respect of a specific disciplinary case or other specific regulatory proceedings. So we are surprised that the consultation document suggests that the Secretary of State should be able to direct an RPB to commence an investigation into individual IPs. It is worrying that the Secretary of State would wish to acquire the ability to control individual enquiries, which could undermine the fairness of the procedure (and hence be contrary to the proposed regulatory objectives) or be seen as a means by which the Secretary of State could pursue a political agenda. In our response to Q7, we have suggested an alternative means whereby the Insolvency Service could participate in the complaints process, without the potential to compromise the fairness of the regulatory system.

62. Another issue arises in the possible use of a direction to compel an RPB to change its rules and practices in relation to disciplinary proceedings. This use of a direction could also be seen as compromising the fairness of the system (and therefore contrary to the proposed regulatory objectives). It is also the case that, with the exception of one RPB, the RPBs are subject to oversight of other bodies such as FRC, LSB, FCA, and IAASA. So a change directed by the Insolvency Service could be contrary to the regulatory objectives of another regulator. We are not suggesting there should be a hierarchy of regulators but we would like to see an obligation on the Insolvency Service to consult with other oversight bodies should they seek to make a direction about something as fundamental as an RPB's disciplinary rules.

63. We also note that the only route to challenge a direction is to do so via judicial review. This is obviously an onerous and costly process and places an RPB at an immediate disadvantage should they wish to challenge the issue of a direction.

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

64. As stated above, we do not believe it is necessary for the Secretary of State to acquire new powers to sanction the RPBs, which includes a power to impose a financial penalty on an RPB.

65. In particular, we would object to the unlimited amount of potential penalty stated in paragraph 74. In this regard, the Service has not followed the precedent regimes they have quoted because the Legal Services Act provides that there be a maximum penalty which will be reviewed from time to time and does not provide for an unlimited penalty. The consultation document offers no explanation as to why the Insolvency Service should be able to impose an unlimited fine yet the Legal Services Board is restricted by a maximum penalty.

66. The possibility of an unlimited fine would make it very difficult for the RPBs to carry out any effective risk management planning.

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

67. As stated above, we do not believe it is necessary for the Secretary of State to acquire new powers to sanction the RPBs.

68. Again, we note that the route to challenge any such reprimand would be by way of judicial review and that judicial review is an onerous and costly process and places an RPB at a disadvantage.

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

69. Again, we note that the route to challenge any such reprimand would be by way of judicial review and that judicial review is an onerous and costly process and places an RPB at a disadvantage.

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?

70. We have serious concerns about this proposal, which we consider to be an unnecessary power and unworkable in practice. Firstly, we question the basis for the need to change as set out in paragraph 79 where it suggests that RPBs 'felt they were unable to bring disciplinary proceedings against an IP that they authorise'. We are not aware that this has ever been the case with any of the RPBs. It would be helpful if the Service could provide details of these examples so that we are able to understand the scale and the nature of the problem this proposal seeks to address.

71. While a lot is made in paragraph 79 of the objective of the Insolvency Service being able to take action similar to that available to other regulators like the FRC, what the draft goes on to say about the detail of what is intended is completely different to the operation of the FRC with the only similarity being that the Insolvency Service wants to be involved in public interest cases.

72. Neither paragraph 79 nor 80 deal with how 'public interest' cases are to be defined, whether they will be based upon the same criteria as set out by the FRC. Given the difficulties in determining where the line should be drawn with the FRC, any such legislation in this area should perhaps be more prescriptive.

73. The key problem is the machinery for determination of any public interest case as set out in paragraph 81. According to this paragraph the process would appear to be for the Insolvency Service to investigate using the types of powers set out in paragraphs 82 and 83 to reach a determination as to whether misconduct took place and then to decide on an appropriate sanction. This would then be offered to the IP who would be invited to enter into an undertaking in relation to the sanction, failing which the Secretary of State would refer the matter to the court for 'an order to impose the sanction'.

74. The fundamental problem with this is that the proposed legislation does not envisage there being any stage at which a proper disciplinary hearing will be held to allow the IP to deal with and refute the findings of the Insolvency Service investigation and it is envisaged that the Secretary of State, through the good offices of the Insolvency Service would be investigator, prosecutor and judge (determining both guilt and sanction). Despite the prior references to following the FRC model, there is no suggestion of the Insolvency Service setting up a Conduct Committee which would decide after preliminary enquiries whether there was sufficient evidence to merit a formal investigation, or an independent disciplinary tribunal to make determinations in relation to misconduct and, if so, to decide on appropriate sanction.

75. All that is envisaged instead is that, if the IP failed to accept the sanction, a Court would be asked to enforce without there being any further process. Aside from having to prescribe a whole new Court process (as it is difficult to see how it would fit into any current judicial process) we wonder whether this process could be susceptible to challenge on the basis of human rights legislation given that there appears to be no provision for a fair trial by an independent tribunal.

76. That is unless what the Insolvency Service mean is that the Court will not just be asked to sanction but will provide the forum for the IP to contest and to have a public hearing into the misconduct of which he or she has been accused. If this is what is meant then this could end up being a more costly and lengthy way of determining matters than the current FRC machinery. For instance, there would need to be a process to be followed whereby the IP

could present a defence or an appeal against the determination and perhaps also the rights to disclosure followed by a hearing to allow the hearing and cross-examination of witnesses etc.

77. Our other linked concern is the question of who picks up the likely significant costs of the new machinery which would have to be created for the Insolvency Service to have sufficient investigation capability (or for the granular investigation work being outsourced to private firms at significant hourly charge rates) and then the costs of either the machinery which would need to be put in place to provide for a disciplinary tribunal etc. or for a lengthy court procedure at the end of each investigation. If the intention of government is that these costs would be passed back to the RPB then these costs would have to be passed on by each RPB to their licensed population. This might, in turn, lead to a huge increase in the cost of insolvency licences which may then require all IPs to increase their charges in order to run a commercially viable business or this could lead to a significant reduction in the number of licensed IPs which would then in turn diminish competition and this in itself could drive higher overall insolvency costs. This possible effect would be contrary to the proposed regulatory objective to encourage an independent and competitive IP profession, and also lead to a dilution of the objective seeking to maximise creditor returns.

78. All RPBs would have to consider carefully whether they wished to continue as RPBs given the considerable risk of bearing losses between the costs to be paid out for the public interest cases and the ability to recoup all of these costs from their IPs. If all RPBs reached the conclusion that they could not continue, there would be no licensing authority for IPs as the Secretary of State is to cease direct authorisation.

79. We suggest the following as a means of ensuring greater independent scrutiny of public interest cases without all of the human rights and costs issues entailed in the current proposals:

- The Insolvency Service would agree with each RPB when a complaint is received by the RPB from the Complaints Gateway whether the case raised important matters affecting the public interest.
- Each public interest case would then be closely monitored at the various stages of the RPB's process by the Insolvency Service.
- The Insolvency Service could agree a special process for public interest cases with RPBs which could include the requirement for some or all of the following:
    - written progress reports at agreed intervals;
    - the holding of case management conferences during the case where the Insolvency Service could satisfy itself as to the nature, direction and progress of the investigation and make suggestions of other issues or matters to be followed up by the RPB
    - a report on the investigation's conclusions prior to the listing of the matter before a RPB's investigation or disciplinary committee
    - the ability to attend the RPB's investigation or disciplinary committee hearing which will adjudicate on the complaint

80. This alternative solution would allow the Insolvency Service to take a greater role in the oversight of public interest cases, satisfying itself that those matters were fully and properly investigated and determined and without incurring the very significant costs of replicating the same investigation and determination apparatus of the FRC or the costs of conduct matters being litigated in the Courts. This is particularly relevant consideration given the understanding that the Insolvency Service would only be seeking to investigate matters directly in a very small number of cases. The adoption of this alternative solution would also avoid there being any additional significant costs and the question of who would fund those costs.

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?

81. Firstly, we see no need for the Secretary of State to have a power to require information from an RPB. We are unaware of any occasion where an RPB has refused to provide information to the Insolvency Service.

82. Also the memorandum of understanding between the Secretary of State and the RPBs requires the free sharing of information between the RPBs and the Secretary of State. The memorandum also requires the bodies to furnish the Secretary of State with sufficient information to enable the Secretary of State to be satisfied that the bodies are meeting its legislative and otherwise agreed obligations.

83. We have also noted that the power proposed extends much further than s1224 of the Companies Act, in that this new power extends to an IP's employer, employees and other third parties. We would be interested to know why the Insolvency Service is of the view that this wider requirement is necessary as the consultation document doesn't offer any explanation of this.

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

84. We do not agree with the proposal.

85. Outside of mainstream financial services, there are few professions where there is a single regulator. There are multiple regulators in audit, legal services and 'non mainstream' financial services. Multiple regulators should not necessarily lead to inconsistency - the key is effective oversight of those bodies. The structure for legal services regulation is a new model having become fully operational on 1 January 2010. The adoption of this structure was subject to extensive consultation and review.

86. It is interesting to note that this consultation uses the model of the Legal Services Board on which to base the regulatory objectives. The Legal Services Board sees multiple regulators as a key constituent in its drive to encourage a competitive market, so it could be argued that a single regulator would be contrary to competition as a regulatory objective as proposed in the consultation.

87. We also question whether the introduction of such a power would have a negative effect on confidence in the current regime as it could be seen to demonstrate on the part of the Insolvency Service a lack of commitment to the changes proposed for the regulatory regime and a lack of confidence in its part in the RPBs.

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

88. As noted above, we do not support the proposal to designate a single regulator.

89. We think it would have been helpful, even if this is only a proposal to take a reserve power, to have prepared an impact assessment for this proposal. A proposal which may seem attractive at a theoretical level, may seem less so when the costs of such a proposal are set out.

Part 2 - Insolvency practitioner fee regime

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

90. We are not convinced that giving the RPBs the role envisaged will achieve the aims sought. We also note that there are currently few complaints about fees and any additional regulatory requirements should therefore be proportionate. There is a risk that the Insolvency Service's

proposals on scale rates or fixed fees would result in an increase the number of complaints. We comment on these issues further in the Appendix.

91. Turning, now to the costs, we are somewhat perplexed that the concept is described as enhanced monitoring, but the impact assessment only provides costings for the investigation of fee complaints and provides no details for the additional costs of monitoring – which we believe could be significant.

92. When carrying out insolvency monitoring visits, ICAEW's reviewers already look in detail at the insolvency practitioner's time records. They will question the time recorded against specific tasks, where it doesn't appear commensurate with the work evidenced on the case files; where it appears to have been carried out by a more experienced member of staff than we would consider appropriate; or where it appears excessive. For larger cases (where a significant number of hours have been worked) and where the time records are extensive, (running to several hundreds of pages) this would currently be done on a sampling basis. We understand from a recent meeting with the Consultation Policy Lead that this is the type of work envisaged by the reference to 'Enhanced monitoring by the regulators – providing value for money'. If that is the case, we wouldn't expect this change to increase our monitoring costs. But if the intention is for a much greater level of review, as is understood by value for money reviews conducted by other bodies (see our response to Q1) and for the RPBs to effectively conclude on each file reviewed that the IP's costs represent value for money, we would expect there to be a significant impact on our monitoring costs; potentially doubling them.

93. The costs of the complaints process seem reasonable, though we think that the costs of the committees may be overstated – it is unlikely that every case that an RPB investigates will lead to a committee hearing. However, there are risks which could increase the costs beyond those stated. Legal costs will increase significantly if there is an increase in appeals or cases taken to judicial review. Any necessary up-front costs for example process and systems development would also need to be considered. We are also uncertain about the treatment of any fines paid.

94. Any process which increases the costs to the RPBs will lead to an increase in the costs charged for an insolvency licence. IPs will then have to decide whether to bear that increased cost or to pass these on to the users of their service.

95. We also question whether creditors will really benefit from having a system to raise complaints about fees, unless there is more done to educate creditors as to the purpose of the disciplinary process. A creditor unfamiliar with the regulatory framework may expect that the disciplinary process would deliver greater returns in a particular insolvency rather than action being taken against a particular IP. Unless there is serious expectation management amongst the creditor population, confidence in the regime could in fact decline as creditors may not receive the results they were expecting.

96. We also think it will be challenging for some creditors to grasp the concept of 'value for money'. An unsophisticated creditor may see an IP receiving payment when they themselves have lost money and simply complain on that basis. If their complaint is rejected, this could also impact on confidence in the regime overall.

97. An alternative approach would be to consider a low cost but binding fee arbitration system. ICAEW already operates an arbitration scheme to deal with fee disputes and we would be happy to provide you with more information about how this scheme works.

98. When the possibility of the RPBs dealing with fee complaints has been debated previously there have always been criteria applied to prevent vexatious complaints (similar to those applied to an application to court). We'd expect to see similar entry criteria for any new system, including any arbitration scheme.

99. As we state in our response to Q1, the monitoring process and the complaints process necessarily takes place after the event, so will not achieve the objective regulatory objective of ensuring that the fees charged are value for money, except to the extent that an individual IP may change their working practices after a monitoring visit or a successfully prosecuted complaint. There is also the possibility that other IPs may take note of the publicity associated with a complaint and amend their behaviour, but overall this seems the wrong means to change behaviour. We suggest that promoting an education programme or issuing of industry guidance such as SIPs, so that fees charged are value for money, would be a more positive and proactive approach.

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

100. ICAEW already investigates cases for potential misconduct where there appears to us the possibility that excessive fees have been charged either by way of very high hourly charge-out rates (in comparison to fees charged by the same IP on other cases) or charging for work which we can prove was not carried out. We would also investigate complaints where it was alleged that fees were not properly authorised. And as stated in our response to Q11 ICAEW's reviewers already look at the fees charged. We take these actions now without reference to any regulatory objective.

101. We could in theory run a service for the handling of complaints about fees, helping to avoid challenges to fees being heard in the courts but this presents a number of practical challenges:

- The assessment we make in considering a complaint, and which could be made by our investigation or disciplinary committee, will necessarily have to be a subjective judgement both in terms of appropriate hourly rate and in the time spent on particular tasks. This judgement would be susceptible to challenge by an IP who might easily be able to obtain expert evidence suggesting that the hourly rate and / or time spent was justified. Such matters could end up being challenged in the High Court.
- Assessments made on the appropriate hourly rate and the amount of time spent on a piece of work may end up being inconsistent between those making the assessment within an RPB or between RPBs. This inconsistency could be reduced considerably if the Insolvency Service were to publish detailed guidance on what are the acceptable parameters for hourly rates (which may have to reflect different geographic areas and complexity of cases) but we think that this would be difficult to do.

102. We also believe that the Insolvency Service has significantly underestimated the work involved in assessing whether an IPs fees are value for money on a case by case basis (see our response to Q1 and Q11). In our view, it would be more appropriate for professional standards such as the SIPs to set out a framework which represents a means of achieving 'value for money' which can be applied positively in each and every case. It is worth noting that the standard setting body now includes 3 lay members – Association of British Insurers, HMRC, and Institute of Credit Management, and that all proposed new standards are subject to scrutiny via a public consultation, so the views of all participants in the insolvency process are taken in account in the design of standards.

103. It could also be argued that the Service has the opportunity via the legislative change proposed in the consultation document to ensure that the fees charged by IPs are value for money. We are unconvinced that the changes proposed will deliver value for money and comment further on this in the Appendix.

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?

104. It will always be helpful to provide information to creditors which will enable them to exercise their rights and participate fully in the insolvency process. We all recognize that there will be some creditors who are infrequent or one–time participants in the insolvency process and will need detailed guidance to assist them.

105. This is therefore the opportunity to mention something touched on only briefly in the introduction to the consultation document – the jurisdictional scope of the proposals. The introduction states that these proposals will not apply in Scotland (paragraphs 20-23) or Northern Ireland (paragraph 25). And certain insolvency procedures are also scoped out of the proposals (see paragraph 112).

106. If these changes are considered necessary, then they should be applied UK wide irrespective of the implications of devolution. It is disappointing that the Insolvency Service has not worked more closely with colleagues in other jurisdictions to devise proposals for the UK as a whole. Creditors will not necessarily distinguish between the jurisdictions and if the systems differ this will be an obvious cause for confusion, which in itself could have an impact on confidence in the regime.

107. This is where the use of standards rather than legislative change would be beneficial as a standard can be applied UK wide.

Q14. Do you think that any further exceptions should apply? For example, if one or two unconnected unsecured creditors make up a simple majority by value?

108. We do not agree with the proposals for fixed or scale fees and providing for further exceptions would not overcome the objections. However, the proposal appears designed to protect, in particular, those unsecured creditors who are assumed not to understand the processes (for instance, because they only rarely encounter insolvency) and who would not be expected to become engaged because they are owed a small proportion of the debt and might not expect to have influence. In other cases, creditors could be expected to exercise requisite control. There would, therefore, be a logic in excluding cases where there are any government creditors or creditors regulated by a body such as FCA (including banks), as they can be expected to understand the position and exercise control (if no-one else does). Where any creditor is (or creditors who are connected are) owed a substantial proportion of the unsecured debt, they should not be indifferent and relevant cases should also be excluded.

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 or where secured creditors will not be paid in full?

109. Given our objection in principle to the proposed changes, we do not comment on the detailed proposals in Annex A at this stage. Should the Insolvency Service proceed as proposed, we would have comments as our cursory review already indicates a number of problematic provisions.

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

110. We think that there will be an adverse impact. Please see our Major Points above (and the Appendix).

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?

111. We agree that the proposed changes should apply as narrowly as possible (if they must apply at all), but do not necessarily agree with the Insolvency Service's rationale for this.

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?

112. We do not agree that a scale should be imposed. We comment more fully on this issue in the Appendix, but note here that RICS abolished its fee scales for valuation as far back as 2000 after an adverse report from the Monopolies and Mergers Commission concluded that they restricted competition and worked against consumers and were against the public interest[1]. If the Insolvency Service is intent on pursuing this course of action it will need to consult with the Competition Commission to ensure that mistakes of the past are not being repeated.

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?

113. We do not believe that any one scale will be 'appropriate' (or necessarily reflect 'fair value') for all cases. It is disappointing that neither the consultation document nor the impact assessment contains an assessment of the commercial viability of what is being proposed.

114. Professor Kempson's report was published in July last year and it would have been helpful had the Insolvency Service developed an evidence base for the use of scale rates in the consultation. If the scale rate proposal is to be pursued a great deal more work needs to be done to establish a feasible scale and we would be happy to do further research to provide an analysis of the impact of scale rate on particular case types and asset levels.

115. One of the regulatory objectives proposed is for 'a competitive IP profession'. As noted above, in an analogous case the Monopolies and Mergers Commission concluded that scale rates restricted competition.

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

116. In our view the current regime should be retained and any specific concerns regarding cases of abuse or other failings addressed through more targeted reforms. We explain more fully in the Appendix why we think hourly rates are an appropriate form of charging and some of the risks of adverse consequences should the proposals for fixed or scale fees be implemented.

Impact assessment questions

Q21. Do you agree with this estimation for familiarisation costs for the changes to the fee structure?

117. 'Familiarisation' would also need to cover assessment of the impact of the proposed regime on the income and returns to an IP's business, possible effect on normal hourly rates (where still permitted) and, possibly, introducing procedures for assessing whether or not a case should be accepted if likely to be uneconomic. The estimate seems low.

[1] http://www.rics.org/uk/knowledge/more-services/guides-advice/chartered-surveyor-fees/

Q22. As a secured creditor, how much time/cost do you anticipate these changes will require in order to familiarise yourself with the new fee structure?

118. N/A

Q23. To what extent do you expect the new fee structure to reduce the current level of overpayment?

119. Use of terminology such as 'overpayment' is inappropriate for reasons outlined elsewhere in this response. We do not believe that there is currently sufficient evidence to assess the impact of the changes on IP's fees. We think that there is the possibility that the proposals could result in an increase in the IP's fees in some cases.

Q24. Do you agree with the assessment that the requirement to seek approval of creditors for the percentage of assets against which remuneration will be taken, will not add any additional costs?

120. There is bound to be an increase in costs, even if this would be a small increase, if an IP has to perform an additional action.

Q25. Do you agree with these assumptions? Do you have any data to support how the changes to the fee structure will impact on the fees currently charged?

121. Given the time made available to respond to this consultation it would be difficult to acquire data to support or refute any of the assumptions on the impact assessment. We would, however, question the benefits of making these changes if the benefits in a best case scenario only equate to 0.1p in the pound.

Q26. Do you agree or disagree in adding a weight in the relative costs and benefits to IPs and unsecured creditors? If you agree, what would the weight be?

122. We do not think that the proposals result in a 'fairer' result at all, so do not comment on particular weightings attributed.

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

123. No. See Q28 below.

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

124. This should be treated as our response to Q27 and 28.

125. The impact assessment contains no measure of either market confidence or the reputation of the insolvency profession.

126. For market confidence, the impact assessment relies on the belief of the 2010 OFT report that, if confidence increases, users will approach IPs to provide other services or seek advice earlier. We struggle to see how this can genuinely be used as a measure of confidence, given that most people approach an IP only in times of crisis. It would have been helpful had the consultation included an evidence base to support this measure, but if this idea is to be pursued it would be necessary to obtain relevant data now against which to measure the success (or failure) of the proposed initiatives (and we would be happy to assist in this).

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127. These questions presuppose that the perceived low levels of market confidence and reputation suggested in the Reports are justified on an objective and substantiated basis, which we do not think is the case. If we turn to objective measures, a different picture emerges. In particular, the World Bank report referred to at the end of this response can be expected to be objective and shows that the UK remains one of the most effective jurisdictions for resolving insolvency.

128. We should also recognise that the majority of the repeat users of the UK insolvency regime, such as secured creditors are satisfied with the service they obtain from IPs. The dissatisfaction in the insolvency process and with the profession stems in the most part from those who are infrequent participants in the process and see IPs being paid when they themselves are receiving little or nothing by way of dividend. We suggest that an increase of 0.1 p in the pound in the returns they receive is unlikely to change their opinion of the process.

129. Overall, we are strongly of the view that much of the cause of the supposed lack of confidence in the insolvency regime stems from a knowledge gap amongst the infrequent users of the insolvency regime. It should not be left to the insolvency profession to educate creditors via the administration of a particular insolvent estate.

130. There is much more that the Insolvency Service could do to provide a basic level of information about the operation of the insolvency regime for those who may only experience insolvency once or twice in their business career. The material the Service produces about bankruptcy and personal debt is often commended by its users, so the offering for creditors could be equally enhanced. Trade bodies which represent creditors should also support their members in this area as well as providing guidance on how to avoid becoming a creditor of an insolvent entity – for example by effective credit control or detailed client acquisition processes and due diligence.

131. In 2012 ICAEW launched the Insolvency Quality Forum. As part of the OFT review and subsequent consultation, some stakeholders in the insolvency process raised concerns about their interactions with the insolvency profession. They said that the only time they normally get together with representatives of the insolvency profession is when the Government minister calls them to a meeting. The Insolvency Quality Forum aims to address these concerns.

132. The forum has a strong educational slant and is aimed at understanding stakeholders' concerns. The main purpose of the forum is to encourage stakeholders to work together by promoting open and constructive dialogue about transparency, accountability and confidence in the insolvency profession. For example as part of her review of the pre pack process, Teresa Graham has attended a meeting of the Insolvency Quality Forum which shows that the Forum can be used as a mechanism to bring together the participants in the insolvency process and break down barriers.

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APPENDIX

Fee proposals - broader issues to be taken into account

IP fees are not unfair - competitive constraints apply and recovery rates are low

1. Professor Kempson acknowledges that concerns on fees related to 'inefficiencies' rather than 'a deliberate attempt to inflate fees' and that 'the evidence base is thin'. We agree that there is no evidence of generally inflated fees (or 'overcharging'), although there will of course, be isolated examples of bad practice as in any walk of life.

2. The implication from the Reports is that because unsecured creditors fail to exercise their powers of control, IPs are unconstrained and could charge what they want. This is far from the case. In administrations (the only example covered by the OFT, but the same would apply more broadly), IPs are often appointed by the directors who (or whose lawyers) will typically seek competitive bids for work. Indeed the trend for aggressive tendering process appears to have increased in recent years, in particular in the context of s98 meetings.

3. This competitive environment has led to cost pressures and redundancies in many firms which carry out insolvency work and a resulting increase in the number of IPs operating as sole practitioners or micro practices. This demonstrates both that there is competition, and in itself results in increased competition, at least at the smaller end of the market. Feedback we have received suggests that, at the lower end of the market, at least, fee rates (and income) are declining due to competitive pressures.

4. The OFT report itself (point 4.13) shows that larger firms (which typically have higher hourly rates) are used more for higher value cases. While this relates to secured creditors, it is indicative of a market which is competitive and sensitive to differing hourly rates.

5. In short it is not right for the Insolvency Service to characterise the charges to unsecured creditors as being above the 'market rate' just because they may be different to rates charged to secured creditors.

Differential in pricing for different clients is not in itself unfair

6. In concluding that there is 'unfairness' in the current charging regime, the Reports rely heavily on the OFT conclusion that unsecured creditors are charged 9% more on average than secured creditors (once the secured creditors have been paid in full).

7. The OFT data used is now considerably out of date. In particular, it does not take account of the impact of the reforms introduced in 2010. The methodology used is somewhat impenetrable but, even if we were to take the findings at face value, we do not agree with the conclusions drawn from them by the Insolvency Service. In particular:

    - There is an inference permeating the Reports that IPs are increasing their fees to take advantage of lack of control by unsecured creditors, through use of terms such as 'overcharging', 'increased fees' and the like. This inference is unfair to IPs. As noted above, Professor Kempson makes clear that the differential is not indicative of abuse on the part of IPs. We believe that this should be accorded far more prominence in the analysis than has been the case to date and that neutral terminology more objectively reflecting the facts (such as 'price differential' or 'undiscounted fees') should have been used.

    - It is natural in a competitive market for certain categories of buyer to be able to negotiate greater discounts than others. Given the strong negotiating position of the

banks including prospect of repeat or additional work, it is difficult to see why a differential of, say, 9% should be considered inherently concerning. The differential, for instance, between prices charged for consumer goods to wholesale or retail customers could be expected to be much higher (and still not exploitative of consumers).

- The Kempson report notes that banks surmise that, even after the reductions they have negotiated, 'work was being done on a lower profit margin rather than a loss'. In fact, this could be a wrong assumption, because IPs could do some work at a loss but maintain overall profitability elsewhere. However, if the aim of the Insolvency Service is to reduce IPs fees in aggregate to a break-even level, it seems unlikely that a high quality profession will be sustained.

- Any discount afforded to secured creditors also benefits unsecured creditors, whether or not they are offered the same terms once the secured creditors have been repaid. This is because the reduced fees will increase the amount of net realisable assets available to unsecured creditors.

- Even if regulatory reforms were to result in convergence of rates applied between different classes of creditor (by whatever means), it cannot be supposed that charges would necessarily fall in aggregate. In order for business to remain economic, IPs might be unable to offer banks the current level of discounts (where work for unsecured creditors would be involved).

8. We therefore disagree that a differential shows 'market failure'.

9. The consultation notes that 'despite numerous discussions with the profession and the regulators little has changed to address' the issue. In fact, the regulations were changed in 2010 and SIP9 has also been updated. We believe that further time is required to judge the impact of those changes. It is difficult to see that the industry could itself have introduced the sort of changes proposed, which require government action. In particular, imposition of common scale rates by the industry would have been (or at least appeared to be) anti-competitive.

Low level of complaints

10. The impact assessment on regulatory change notes that there is a low level of complaints against IPs, particularly considering the nature of insolvency (which will typically involve loss). While the cost implications may in part account for a low level of formal complaints through the courts, our understanding is that the level of informal complaints (eg, to IPs) is also very low. The low level of fee complaints has recently been confirmed in Parliament[2], where it emerged that fee complaints are low in absolute terms (13 in 2013) and relative to all complaints (2% in 2013) and at their lowest levels (in absolute and relative terms) since 2010. The R3 survey also substantiates this.

11. General lack of engagement during the insolvency process would not itself explain a low level of complaint at the end of the process were there to be genuine widespread concern about fee levels. The obvious conclusion from the low level of complaints is that IPs generally charge fairly.

12. Following the OFT report, the Insolvency Service, with the support of ICAEW, introduced the single complaints gateway to address the concern that creditors may not know where to address complaints given the complexity of the regulatory regime. Neither the Insolvency

2 http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm140311/text/140311w0002.htm#140311w0002.htm_spnew20

Service, nor the Kempson report say whether or not this initiative has been effective (in reducing confusion), nor how many legitimate complaints on fees have been received through the gateway. Our understanding is that there have been very few indeed.

13. Some of our practitioners recall the pre-1986 regime, when fees were paid according to a fixed scale and we are informed that the level of complaints was far higher then than it is now. Should the Insolvency Service proceed with its proposal for scale fees, there is a risk that complaints will increase (irrespective of any reforms to the regulatory regime on complaints).

14. Despite this, the impact assessment cites Professor Kempson's objective of 'reducing the number of complaints and challenges relating to fees' as the starting point for reform.

Scale rates are inherently unfair compared to hourly rates, do not provide certainty or give creditors control and do not incentivise desired behaviours

15. Unless knowingly agreed, a scale fee (percentage of realisations) is inherently unfair. Scale fees applied before the reforms which led to the 1986 Act and the *Cork Report* identified the key difficulty, that 'they result in poor recompense for the liquidator in relation to the amount of work involved in a complex case and are over-generous on occasions (eg where the only asset is a bank account)'. Sliding scales would also need to be adjusted to take account of inflation. Another difficulty is that IPs are expected to do work which is not directly related to realisations or distributions. The consultation refers to some elements of this, but is not comprehensive (for instance, it does not consider work done by IPs in dealing with creditor queries or the like). An immense amount of work is required to investigate the position in insolvencies, including reviewing records, interviewing directors, doing money laundering checks, irrespective of whether or not there will ultimately be any assets available.

16. By contrast, there is nothing inherently 'unfair' about hourly rates. On the contrary they will typically be the fairest mechanism (which is why use remains widespread). They are fair to IPs because they are set on a basis reflecting the IPs costs and therefore enable an IP to operate at economic level, or at least know if work is uneconomic. They are fair to creditors because IP rates can be compared on that basis, so encouraging competition and the benefits that a competitive market brings. This is not to suggest that they cannot be open to abuses of the kind outlined in the Kempson report.

17. Any suggestion that a scale fee produces 'certainty' for creditors is also misplaced, because the fee will be based on the amount of realisations (or distributions) which will be unknown until the end of the process. An unsecured creditor will still not know at the outset what return he can expect or how much (in absolute terms or terms of 'fairness') an IP will be paid for his efforts.

18. Neither will scale rates result in more unsecured creditor 'control'. Indifference of unsecured creditors will not be altered merely because of a type of charging mechanism applied. Indeed, where scale rates apply, there will be nothing to control, because the rates apply irrespective of work done and creditor engagement could be expected to decline. It may be that the rates will be so uneconomic in particular cases, that IPs themselves will be motivated to bring about creditor engagement (if possible) in order to have an alternative charging rate applied. In cases where realisable assets are low, it is perhaps more likely that an IP would decline the case than make these efforts with uncertain result. If the scales are designed so that IPs would need to seek alternatives even in cases with high levels of realisable assets, there is a risk that, in the face of continuing lack of engagement by creditors, an industry of creditor representatives encouraged by the IPs themselves could develop (at the expense of creditors).

19. Scale fees may also reduce effectiveness of the insolvency regime in relation to other government objectives, in particular in bringing wrongdoers to justice and to increasing net returns to unsecured creditors (on which we comment further below).

20. Hourly rates incentivise IPs to pursue even difficult and relatively small claims, so long as there will, ultimately, be sufficient assets, at least, for the IPs to be paid. A scale fee provides an incentive to recover only the easiest or largest assets. An IP may not pursue a claim at all if the work required would be uneconomic on scale rates, and the creditor would then recover nothing.

21. This is not to suggest that IPs are so motivated by profit that they would fail to carry out work to recover assets (or other work) whenever it would be uneconomic for them to do so. Indeed, evidence suggests that this is far from the case under the current regime. IPs frequently carry out work where there may be insufficient assets recovered to pay their charges and charges are frequently ultimately written-off. Nevertheless, it is clearly preferable for the fee regime to incentivise the desired outcomes, and the proposed scale rate (or fixed fee) regime is not best designed to do so.

Levels of hourly rates are reasonable, scale or fixed rates at any level will produce unreasonable results in some cases

22. Professor Kempson notes that much the disquiet about the reasonableness of IP's fees stems from the headline hourly rates. However, neither the OFT nor Professor Kempson establish that hourly rates currently charged by IPs are in themselves unfair (particularly when compared to other professionals such as accountants or lawyers acting as advisors or otherwise than as IPs). Neither does the consultation seek to establish to what extent those rates have changed over recent years. Any analysis of rates needs also to take account of relevant risks, in particular that an IP has personal liability and the Reports fail to do so.

23. In many cases (in fact, typically), there will not be sufficient assets for the IP to recover the full amount of the fees chargeable on an hourly basis because there will be insufficient assets available to pay them. From our enquiries (and research noted below in relation to the Official Receiver's scale) it is clear that the level of write-offs is substantial, in the region of 40%. This is also supported by the R3 Research. The use in the Reports of 'headline' hourly rates therefore gives a misleading impression of the level of fees actually paid to IPs and the resulting 'disquiet' is misplaced.

24. As regards scale rates, a number of options are considered in the consultation, including use of the Official Receiver's scale rate. We do not see any particular logic in reference to this scale. While much work done by IPs is for the public good, unlike the Official Receiver, IPs operate in the private sector and a competitive environment and assume the risks of business (as well as personal liability). This view is backed by judicial authority. For instance, Ferris J in *Mirror Group Newspapers v Maxwell 1998* said of the Official Receiver scale that 'by its very nature that scale is one applicable to the services of a public official'.

25. Given the brief consultation period, we have not had the opportunity to develop a detailed evidence base regarding the likely effect of any given scale rate, but we have conducted some limited research. In addition to indicating that IPs are already generally writing off significant costs, it shows that fees based on the Official Receiver's scale rate would not adequately recompense the level of work required. Our research was based on a sample of insolvency reports filed at Companies House, for different case sizes. On these cases, the IPs were unable to recover between 35% and 52% of their time costs. Also, across the sample, fees based on the current Official Receivers' scale rate would have been 15% to 19% of the time actually incurred. With increasing regulatory and compliance requirements and a decreasing asset base, we do not believe this would support a viable insolvency industry. The R3 Survey also highlights consistent underpayment (or non-payment) to IPs, particularly in smaller practices.

26. Secretary of State fees includes a band of 100%. This is akin to a fixed fee (so long as there are sufficient assets to cover that band). While this route might be appropriate to cover some elements of an IPs work carried out irrespective of returns (such as initial investigations), it

would not overcome the inherent difficulty that a scale does not necessarily relate to work actually done as cases vary in complexity etc.

27. Comparison with the official scales does, however, highlight just how lucrative scale fees can be (compared to work done). In a case with £50,000 of assets and no distribution, the total fees of the Official Receiver and Secretary of State would be £15,220. The fact is that scale fees can result in large payments for little work, as well as inadequate recompense for some types of difficult and important work.

28. It follows from our comments on the inherently unfair nature of scale rates that there is no 'right' rate for any scale. Each case is different and if a scale rate is 'fair' for one case, it can be expected to be 'unfair' for another (in contrast to hourly rates). We do not, therefore, comment further on the possible rates as such, save to note that the risks for the Insolvency Service in setting rates too low could have severe adverse consequences (on which we comment further below).

29. Professor Kempson herself clearly saw perils of scale rates as she suggests that it might be more 'promising' to explore an approach which allows for different methods of charging for different aspects of a case, as provided in the 2010 rules. We agree that it might be possible to reduce (although not eliminate) the intrinsic unfairness of a mandatory scale fee with a more nuanced approach, but the Insolvency Service has ruled this out as being, in effect, too complicated (or having the 'potential for over charging' in respect of hourly elements). We do not necessarily agree that it would be too complicated to address the obvious shortcomings of current proposals in this sort of way. However, the fact that it would be necessary to do so and the complications that would inevitably arise, merely serve to highlight that the basis of hourly charging would remain preferable.

30. The Reports compare the position in the rest of the UK with the position in Scotland. We are unclear to what end the comparison is made. Hourly rates in Scotland might be lower than elsewhere for a variety of reasons including lower overheads. If it is correct that a high proportion of all fees in Scotland are reduced through independent scrutiny, that scarcely suggests that the regime is a working effectively. It is also possible that where fees are routinely subject to reduction, the base rates might be increased to anticipate this.

The fee proposals should not be expected to increase net returns to creditors

31. The consultation document might be taken to suggest that, were it not for IP fees (but nevertheless IPs carried out the necessary work), creditors would always recover some of their debt. For instance, the Forward refers to 'ensuring that there will be funds available to make payment to creditors' and one of the objectives is stated to be that 'not all realisations are swallowed up in fees and remuneration.' We take it that the Insolvency Service does not mean this literally but, as it is potentially misleading, note here that it is self-evident that creditors will receive nothing if there are no assets (or no assets after payment of other fees, such as those of the Official Receiver or Secretary of State).

32. In fact, it is often the case, probably increasing in recent years, that there are insufficient assets to result in any meaningful distribution to unsecured creditors (irrespective of IP fees). This is in part attributable to companies granting security to creditors more extensively and creatively than in the past, but also to more sophisticated and widespread use of retention of title mechanisms by suppliers to companies. Assets, such as stock, which may appear to be an asset of the company, in fact, remain assets of the supplier who is able to recover them. The supplier is not a creditor as such (secured or unsecured), but is able to recover his assets. A scale rate would not recompense an IP for work carried out in establishing legal claims of assets of this kind, but it would be part of the IP's role to do so.

33. In addition to fees of the Official Receiver and Secretary of State, VAT (If not recoverable) and the costs of other professionals billed as disbursements (such as lawyer's fees) all serve to

reduce the amounts available. Bonding costs are imposed upon IPs by law. If the government wishes to reduce the costs of insolvency, it might look to reducing these costs. We note, however, that the Insolvency Service is increasing Official Receiver's fees[3].

34. If IP's fees are reduced through fixed scales, it seems reasonable to suppose that some work that might otherwise have been conducted by an IP within the IP fee, will be done elsewhere, possibly (eg for lawyers) billed on an hourly fee basis and charged as a disbursement (resulting in no reduction in overall levels of fees).

35. Even if scale rates were to be set at a level which would reduce IP's fees compared to the current regime of hourly rates, it is unclear what evidence the Insolvency Service relies on to conclude that this would increase net amount recovered. As noted above, scale rates (or fixed fees) are not necessarily best designed to incentivise IPs to maximise returns. Returns to unsecured creditors are also dictated by the priority order set by government under insolvency legislation which, for instance, gives priority to secured creditors.

36. The Kempson report makes some selective international comparisons, in particular regarding practices in Australia, Austria and Germany. While it is completely appropriate to consider whether good practices abroad could usefully be applied in the UK, a cautious approach is required as controls over fees cannot be looked at in isolation from other aspects of a regime in judging effectiveness.

37. We have not done a full comparative study (the time allowed would not permit apart from anything else), but, by way of illustration, the effectiveness (or otherwise) of the Australian regime, taking into account recent proposed reforms, was considered by a prominent Australian law firm[4], based on various industry sectors (considered to be generally representative). Of the 5,698 companies covered that went into external insolvent administration in the period July 2010 to June 2011, 5,332 (or over 93 per cent) of them paid creditors no dividends at all. In the author's opinion 'Despite the significant impact of insolvency on unsecured creditors and shareholders, there does not appear to be anything in the Australian law, or in the current legislative programme of reforming insolvency law, that will improve these outcomes.' In considering whether any particular foreign practices should be applied in the UK, careful consideration is therefore required and any particular proposal would need to be considered in the UK context. We would be happy to consider this further, but more time would be required to do so meaningfully.

Recovering assets and pursuing wrongdoers; Jackson reforms

38. The Reports do not describe the efforts that are often required to recover assets for unsecured creditors. In practice, assets may have been removed from the company shortly before insolvency, or generally hidden, often for the benefit of directors or persons connected to them.

39. Pursuing these assets can be difficult, time consuming and costly, involving Counsel and Solicitors fees. It may be that claims may not ultimately result in meaningful returns to creditors, yet it is in the public interest that they be pursued.

40. IPs are personally liable for pursuing claims and should under no circumstances be required to pursue action where they may be personally exposed to irrecoverable costs.

41. Conditional Fee Arrangements and After the Event Insurance facilitate action by IPs in this context. However the exemption from the Jackson reforms was expressed by the government

[3] http://insolvency.presscentre.com/Press-Releases/Changes-to-the-fees-charged-by-the-Insolvency-Service-announced-69a30.aspx

[4] http://whoswholegal.com/news/features/article/29821/current-trends-insolvency-australia

to be a temporary measure. If IPs are to have the best available tools to recover amounts owed to creditors, it is important that this exemption is made permanent.

Unintended Consequences

42. As noted above, IP's charges cover work done in connection with disqualification of unfit directors. The government has expressed concerns[5] that the director's disqualification regime is failing adequately to sanction directors who fail to comply with the law. There is a risk that paying IPs solely by reference to realisations or distributions will reduce incentives to carry out this work to high standards and undermine this objective of government. This is an important issue for unsecured creditors who wish to see wrongdoing addressed. The Insolvency Service itself could improve market perceptions and confidence in this respect by pursuing more vigorously cases of wrongdoing reported by IPs, particularly in serious cases where sentences might exceed six years.

43. If scale fees are set at a level which reduces IPs' fees (in aggregate), there is a risk that the work will become uneconomic and IPs will leave the market, particularly in the case of smaller practices. This will reduce choice and competition in the market. It will also risk driving down standards.

44. Another possible knock on effect would be a reduction in cases where unfit directors are identified if a company remains outside the formal insolvency system as a zombie company or left as a shell on the Companies House register. Again, it would be inappropriate to charge RPBs with responsibility for practices that result from a fee regime imposed by government which can be expected to have these consequences.

45. Another possibility is that low returns would result in changes in the market akin to those seen in the IVA market with so called IVA 'factories'. The Reports do not contain any meaningful analysis of that sector, such as whether it is currently operating to produce best long term results for all stakeholders (debtors as well as creditors) or whether similar approaches could, in fact, be applied to other sectors. If this is an intended or expected outcome, this issue should be considered more fully and a further consultation conducted on that basis, as it is not without risks. Our assessment is that fees are controlled to such a level that anyone with more complex financial affairs struggles to find an IP willing to act as supervisor to an IVA and so is left in debt limbo, or contemplating bankruptcy.

46. If the proposed new regime were to be successful in reducing IP fees (or its failure to do so were not to be apparent), it is difficult to see why creditors would choose to play a more active role in the insolvency proceedings. This seems contrary to the aim to encourage greater creditor control of fees, which in itself relies on active participation by creditors and may even lead to fewer creditors' committees being formed than are currently.

The supposed benefits of the proposals do not justify the costs and risks

47. The impact assessment highlights a number of potential concerns about the proposals:

'..if the percentage fee is too low, more work will then fall to the Official Receiver, with costs incurred with no benefit or prospect of repayment (for instance where assets are not investigated and do not materialise or where costs of realising them are more than the value of the asset). In some cases, this could mean that insolvent companies could continue to trade with a detrimental impact on the economy as a whole…..Creditors will be out of pocket as their debts will be written off with no prospect of a return and more assets will be written off.'

[5] https://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper

We agree with this, but that suggestion in the impact assessment that the concerns will be 'overcome' through regulatory objectives of RPBs and monitoring is fanciful. The consequences would result from a fee regime imposed upon the profession by the government and RPBs would not be in a position to do anything about it.

48. The private sector cannot be expected to take on cases that would be uneconomic. They will fall to the Official Receiver. The government will, therefore, need to take this into account in setting any scale and be prepared to make resources available to the Official Receiver. Whether or not an enlarged Official Receiver service would ultimately produce better returns for creditors than the private sector is a matter of speculation, but we have seen no evidence to suggest that it would.

49. The Insolvency Service itself recognises that the 'quantifiable benefits' of the proposal are difficult to quantify. We agree with this, because we think it completely unproven that, even if the reforms were to reduce IP fees in aggregate, this would result in a corresponding increase in returns to unsecured creditors. The lower estimate of benefits in the consultation is less than the estimate of increased costs of regulation and industry costs of 'familiarisation', so that, even on the Insolvency Service's own estimates, this could cost more than it saves in quantifiable terms.

50. As regarding the non-quantifiable benefits, it is clear from the above, that we do not believe that imposing a fee scale will increase efficiency, result in fairness or otherwise be beneficial to creditors or the industry.

51. The Reports refer to IPs charging about £1bn in fees as against £4bn made in distributions. We do not believe that IP fees are nearly as high as £1bn. We assume that the £1bn figure includes costs of administration (including disbursements such as legal fees) and this could have been made clearer so as not to create an unfavourable impression regarding IP fees.

52. The proposition (obliquely made in the impact assessment) that a reduction in charges by IPs would increase the absolute amounts of credit made available by unsecured creditors is unsubstantiated and, in our view, completely unconvincing. The whole premise of the consultation is that these unsecured creditors are unknowledgeable and disinterested (even when they have lost money). It is difficult to see that these individuals would alter their behaviour because IP fees in aggregate in the UK might be reduced by a relatively small percentage. Well informed creditors will take steps to minimise exposure to failing companies (and do so, which is one reason why there is so little left for unsecured creditors). If the government wishes to increase the amount of unsecured lending in the UK, there would be more effective ways of doing so.

53. The very limited and speculative advantages that Insolvency Service thinks might result from the proposed fee reforms need to be considered against the potential disadvantages. A number of these are highlighted above, but there is a risk of looking at this issue too narrowly. The reality is that insolvency regimes involve balancing various interests, including those of secured creditors against unsecured creditors. The OFT report referred to World Bank input. The 2013 World Bank report[6] shows the UK insolvency regime to be highly successful by international standards, ranking 7th (compared to 8th in 2012), ahead of all the countries whose practices are noted in the consultation for comparative purposes (and ahead of the United States). The UK also performs well when measured in terms of fees as a cost to the estate. The UK insolvency regime also attracts forum shoppers – so called bankruptcy tourism, which also demonstrates the attractions of the UK insolvency regime.

[6] http://www.doingbusiness.org/data/exploretopics/resolving-insolvency#sub-menu-item-link