Bonding Arrangements for Insolvency Practitioners

ICAEW welcomes the opportunity to comment on the *Bonding Arrangements for Insolvency Practitioners* published by The Insolvency Service on 15 September 2016, a copy of which is available from this link.

This ICAEW response of 16 December 2016 reflects consultation with the ICAEW Insolvency Committee which is a technical committee made up of Insolvency Practitioners working in large, medium and small practices. The Committee represents the views of ICAEW licence holders.

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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 under the Insolvency Act, currently licensing almost 800 practitioners.

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.

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MAJOR POINTS

1. We agree that the current bonding regime is flawed and needs review. It appears to be designed to meet two objectives, first to protect creditors against the risk of loss caused by fraudulent IPs and secondly to have cases involving fraudulent IPs investigated by the private sector. It appears from the Call for Evidence largely to have failed in the first objective (although we think further verification of this is required) but to have met the second one. The regime does not seem to be well designed to meet both objectives as, apart from anything else, the amount of bond is based on the amount of assets of the estate (rather than the amount of assets plus costs)

2. The Call for Evidence does not state clearly what the objectives of a reformed regime would be or provide sufficient evidence about the operation of the current regime or its failings to enable us to propose concrete alternatives at this stage; there are simply too many alternative scenarios, each of which would need the interests of those involved to be assessed and taken into account.

3. We therefore welcome the fact that the Insolvency Service is seeking more evidence through this consultation process and suggest that it issues a follow-up consultation when it has assimilated the evidence provided. A further consultation might set out the desired objectives of the regime and provide the underlying evidence, where possible, to enable participants to consider and suggest alternatives on an objective and grounded basis.

4. For instance, it is not clear what returns creditors would have received under the current regime absent bonding, what the total bonding costs (effectively born by creditors as a whole) have been, how the reasonableness or otherwise of successor practitioner fees has been assessed, how material those fees are in the overall context or whether the prescribed form of bond is in line with best legal practice.

5. That said, it seems reasonably clear that the prescribed form of bond leaves much to be desired. The language used is often opaque at best and we understand that there are variants used in the market targeted at different market segments. If the bond were to be written in clear terms to meet clear objectives, many of the concerns might be mitigated. The Insolvency Service needs to consider its own role in approving forms of bonds and whether or not, if the regime is to be continued, bond terms should be set centrally, whether there should be a single form or permitted variants or whether only minimum requirements should be set with more competition allowed on terms. Each option will have its own cost implications and a cost versus benefits exercise will be required for any change, including the potential impact on different sectors of the market, such as sole practitioners and large firms.

RESPONSES TO SPECIFIC QUESTIONS

Q1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

6. We generally agree with the assessment of the weaknesses of the current bonding arrangements with a couple of qualifications noted below.

7. There is a widespread belief that very few IPs take relevant successor appointments. However, for some years ICAEW has maintained a list of our licensees who have expressed an interest in taking successor appointments and seeks to have cases assigned on a fair basis. There have not been many cases of ICAEW licence withdrawal for fraud or dishonesty in recent years and a reasonable variety of successor IPs have been appointed in those cases. Nevertheless, we are open to considering whether there is more we, or others, might do in this respect.

8. Even if some IPs do, in practice, account for a disproportionate number of successor appointments involving fraud or dishonesty, this does not in itself explain why successor IPs may charge higher fees than in standard cases.

9. These sorts of case can involve considerable investigative work to ascertain what has happened and whether there are any bond or other claims and additional administrative work in dealing with bond issuers, particularly those who dispute their obligations to pay. The appointments may also involve risk of dispute with the former IP and risk to reputation simply by being involved in a case where fraud has been alleged or proven (for instance the public may mistakenly associate the name of the IP handling a case with a fraud). Appointments may also be taken at short notice before it is clear how many affected cases have sufficient assets to cover costs incurred. In some ways this is specialist work where specialist skills and experience may be called for to best serve the public interest. Successor IPs are subject to the same sort of disclosure requirements as others and higher rates may be justifiable on reasonable grounds for these sorts of reason.

10. If concrete evidence of excessive charging emerges as a result of the Call for Evidence we would, of course, consider how this might be addressed (as regards our licensees at least). However, we think that the emphasis on this concern in the Call for Evidence may be disproportionate and that there are manifest flaws in the regime (in particular the form of bond) which should be addressed regardless of any concerns in this area.

Q2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

11. As noted above, the approved form of bond is not ideal as it is difficult to understand, leaving potential for disagreement and uncertainty. The amount of the Specific Penalty Sum is limited to the amount of the insolvent's assets (subject to a cap), but if the intention is for the bond to pay up to this amount to creditors, then it should cover IP's fees in addition to the amount of the assets.

Q3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

12. We do not believe a compensation scheme of the kind required for solicitors by the SRA would be a good model to follow. There are around 140,000 practising Solicitors compared to around 1,700 insolvency practitioners licensed by the various recognised professional bodies (RPBs) so there would be practical difficulties in establishing a fund of sufficient size to cover the sort of risks involved (if the intention is to cover potentially large frauds).

13. The bonding regime creates a legal liability on the surety to pay but, as the consultation paper notes, payments under the SRA regime are at the discretion of the SRA. If an RPB were required to operate a scheme which, in effect, insures creditors, this would be a very significant risk which, if accepted, would in practice probably need to be re-insured. An RPB would then need to carry out a number of functions, including assessing risks and premiums, that are better carried out by the insurance industry itself. If a compensation scheme were discretionary, then we do not see that it would meet the objective of, in effect, insuring creditors and many questions would arise that would require further consideration.

Q4: Are there any other issues that you would like to see addressed through a claims management protocol?

14. Please see Q5 regarding the claims management protocol.

Q5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

15. **Claims protocol.** It is essential that the bond itself is clear as to the terms on which it will pay and on any conditions or formalities for valid claims to be made. It is unclear why a claims protocol would be needed in that case. There is a risk that a protocol would itself become a source of potential dispute or weaken the position of bond holders and if this option is pursued it will be important that the legal implications are considered carefully.

16. The paper focuses on the role of IPs, but ought also to consider whether the insurance industry could be more transparent and make it easier for IPs to claim on the bonds so obviating the need for any additional bureaucracy. Sureties, unlike IPs, do not owe duties to creditors and would naturally seek to reduce the amount of claims made against them and the amount of recoverable costs. It is in the interests of creditors that bond claims are pursued robustly to enforce rights under the bonds and we believe that skilled and experienced IPs are in the best position to do this.

17. ICAEW would be interested in seeing the detailed evidence gathered regarding practice of RPBs in assigning claims and outcomes. While sureties may prefer to deal with RPBs, there is a logic in the successor IP controlling claims and it might be that assignment should be made automatic once the successor has been appointed to avoid the potential for uncertainty and delay that can arise where RPBs have discretion in the matter. Any proposal to increase the role of RPBs in the claims process would require careful consideration because this could result in duplication of effort and, if additional resource were required, this could have cost implications for the sector (and so creditors) as a whole.

18. **Approved panel.** ICAEW already maintains a list of its licensees who are prepared to undertake this kind of work and supports widening the pool so far as possible, subject to the general comments about the specialist nature of the work involved above. It should be noted that not all successor appointments arise in connection with claims of dishonesty or fraud. For instance, successors may be appointed as a result of death or retirement and we do not believe that these require special treatment such as procedures for approved panels.

19. **Investigative costs**. We agree that insolvency practitioners should only incur investigatory costs on a reasonable basis and believe that this is already provided for in the regulatory regime. However, in cases where fraud or dishonesty is involved or alleged, it is inevitable that a high degree of due diligence will be required and that investigation costs may be higher than would otherwise be the case. If the Insolvency Service is aware of cases of abuse, we would expect it to inform the relevant RPBs so that they can take appropriate action. It would also be helpful if the amounts involved could be quantified so that the significance of this issue in the context of the cost and effectiveness of the bonding regime can be properly assessed.

20. **Greater transparency**. We are not clear what specific proposals the Insolvency Service has in mind in this section of the consultation paper. The fee regime has been changed recently to increase transparency, including requirements for fee estimates. Government has also considered mandating fixed fees or scale rates, but decided against doing so generally, a decision which we support. It is somewhat difficult to envisage how a fixed fee (or scale rate) could be applied to the investigatory work involved generally, as the amount of work required and risks involved might vary from case to case and will be difficult to assess at the outset. It might, however, be possible for certain defined investigatory tasks to be identified and charged for on a standardised basis.

21. In many cases, HMRC is the largest creditor and should be in a position to monitor fees and performance of relevant cases over the prolonged periods involved, indeed, one might think it would have a duty to taxpayers to do so.

Q6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

22. As noted in our introductory comments we believe that more evidence is required for questions like this to be adequately assessed. However, it seems likely that, without any prospect of bonding, IPs might be reluctant to take on cases where there are insufficient assets to cover costs. Arrangements would therefore need to be made for the Official Receiver to take these cases. Depending upon charging structures applied by government, this might result in taxpayers, rather than creditors (via the cost of bonding arrangements applied to IPs) funding investigations.

23. From the Call for Evidence, it might seem that removal of the regime would not make much difference to creditors as the inference is that any bond payments are consumed in the costs of investigatory work. However, we suppose that there must be some cases where bonds have resulted in some payments to creditors who would not otherwise have been paid. Whether or not the benefits merit the costs of the regime is a matter for the Insolvency Service to assess.

Q7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

24. Amending prescribed terms of a bond. We believe that the form of bond does need to be amended. However, issues of principle need to be clarified first, for instance whether the amount of bond should be based on the amount of assets plus costs and whether the maximum £5 million bond limit should be increased. The potential costs of these changes and impact on the market would also need to be assessed, particularly if a single form of bond is to be applied across the sector.

25. Ringfencing proceeds of a claim. If the IP's fees are not to be covered by bond claims (through the usual priorities), this will increase the likelihood that IPs will not take on successor appointments in cases where there are insufficient assets. This would be contrary to the stated aim of the paper to increase the pool of IPs prepared to take on these cases or even make it impossible to find willing IPs and it would be necessary for the OR to be required to take on such cases. The costs of the regime would, however, continue to be incurred, or might increase if the administrative burdens of IPs are increased as a result.

26. Investigative costs to be covered by bonds. If one of the objectives of the bonding regime is to cover investigative costs, then, in principle, it seems sensible that any bonding regime should cover costs of investigation. However, any change that adds to the direct cost of insurance, or indirect costs (such as administrative burdens for IPs or RPBs) would need to be considered carefully as they will ultimately be borne by creditors as a whole.

27. 'de minimis maximum indemnity period. We agree with the comments, but also note that one example is not necessarily sufficient to justify wholesale reform.

28. Annual or global cover in place of monthly schedules. We agree that the current system of schedules is bureaucratic and that there is a risk of inaccuracy or discrepancy between records kept by an insolvency practitioner, RPB and insurer and a risk that cover fails due to error or deliberate acts of a fraudulent IP.

29. In principle, an annual cover regime seems a better alternative, but the commercial aspects would need to be considered further, including any minimum sums involved and the cost of insurance. Experience in similar kinds of insurance suggest that the costs might be disproportionately high for sole practitioners or IPs operating in very small firms. The potential impact of any change of this kind on the competitiveness and diversity of the market would, therefore, need to be researched carefully.

30. If it is correct that the current regime is ineffective in providing returns to creditors, one option would be to reform the bonding regime so that annual bonding for successor IPs covers investigatory fees only.

31. **Monetary limits**. The monetary limits are dated. However, there is insufficient evidence to assess what impact this may have had in practice. Again, the cost implications of increasing limits would need to be assessed.

32. **Investigative costs to be proportionate**. We have commented on investigatory costs above and the need for concrete evidence of any poor practices to be provided and assessed for materiality before conclusions are reached on this. There are obvious risks of imposing additional regulation where the objective is to increase the pool of willing providers and reduce costs.

33. **Protect estate from non-payment.** ICAEW does check on monitoring visits that premiums have been paid. It would be helpful if insurers were required to notify RPBs if IPs have not paid premiums when due. Having an annual insurance regime would probably be administratively easier in this respect.

34. **Include professional indemnity.** Professional indemnity insurance is a distinct matter from the bonding regime, which deals with dishonesty and fraud (rather than negligence). ICAEW already imposes PII requirements on its licensees and its members and we believe that other RPBs also do so. Any consideration of this issue would, therefore, need to take current practice into account and identify what, if any, concerns there may be with the current PII regime. Please note that ICAEW licensed IPs are already required to have professional indemnity insurance run-off cover.

35. **Fidelity insurance for persons other than IPs.** We agree that, if the bonding regime is to be continued in roughly its current form, bonding or fidelity insurance should cover those from an insolvency practitioner's firm who are working on the case, but, again, the costs would need to be assessed, particularly as regards any minimum sum requirements.

Q8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.

36. The paper raises the key issues arising, but we think much further consideration and discussion is required when more evidence as to the operation of the regime has been obtained. It is premature to consider legislative changes at this stage.

Q9: Of the proposed options for legislative change, which would be your preferred approach and why?

37. We believe that further consultation will be required on this issue when more evidence about the costs and shortcomings of the existing regime is available and the possible alternatives have been identified and their impact in practical terms considered more fully.

38. We do not believe that more changes in regulation of IP's fees would address the more fundamental flaws of the bonding regime.

Q10: Do you have any further comments you would like us to consider in relation to bonding?

39. It is important that policy on the bonding regime is designed with clear objectives against which its effectiveness can be measured and that the part to be played by the various participants is clear and based on reasonable and proportionate expectations and an understanding of costs and resource requirements involved.

40. ICAEW monitors its licensees through monitoring visits and where an IP has a portfolio of successor practitioner cases would consider a sample of these during the visit. We would be happy to consider how processes, whether our own or those of others, such as insurers, might

be changed to address concerns that have arisen, but It is not realistic to expect RPBs to identify all errors, fraud or dishonesty of IPs in connection with the bonding regime in their routine monitoring activities or through information provided in the monthly schedules.

41. We would be happy to discuss further as the Insolvency Service's consideration of the issue progresses.