R3 (Association of Business Recovery Professionals) consultation response
Clause 10 (Authorisation of Insolvency Practitioners) Deregulation Bill
February 2014

Introduction

1. R3 is the leading trade body for the UK insolvency profession. We represent 97% of the UK's Insolvency Practitioners (IPs) and another 1,500 insolvency professionals and students from the Big Four to smaller, high street firms. Our members have extensive experience of providing corporate and personal debt advice. In 2012, IPs:

   - Saved 750,000 jobs in the UK.
   - Advised more than 95,000 businesses, with just under 50% (45,000) continuing in some form.
   - Assisted UK businesses with combined turnover of more than £270billion.

2. R3 has expressed serious concerns about the impact of the partial licensing of IPs since the proposals were first suggested by the Insolvency Service in 2010 (originally referred to as 'partial authorisation'). We are particularly concerned about the negative impact partial licences will have on businesses and individuals seeking financial advice, smaller insolvency practices, and the quality and competitiveness of the UK insolvency regime.

3. R3 is pleased the government agreed to further consultation as proposed by the Joint Committee on the draft Deregulation Bill, but is disappointed the consultation was launched on the same day as the Bill was laid in Parliament. This gives stakeholders very little time to be heard, and any changes made.

4. R3 is aware of only one (out of seven – excluding the Secretary of State) Recognised Professional Body (RPBs - licence and regulate Insolvency Practitioners) that supports partial licences.

5. R3 welcomes all other insolvency proposals in the Deregulation Bill (Schedule 5).

Executive summary

6. The government believes smaller practices will benefit from the proposals – R3's smaller practice community disagrees: more than 90% say they will not train a partial licence holder.

7. Partial licences will be regulatory rather than deregulatory and therefore undermine the government's objective for the Bill (92% of smaller practices believe the proposals won't reduce regulation); they will cost smaller firms disproportionally more than large firms; and give large firms a competitive advantage over smaller practices.

8. The vast majority of partially licensed IPs will almost certainly need to re-train if, as is expected, they seek to be licensed in both personal and corporate insolvency later in their career – a view the government agrees with. Therefore, there is a strong argument that practitioners should

continue to train in both aspects of insolvency from the start of their career, as qualifying once is likely to be cheaper than having to do so on two separate occasions.

9. IPs do not know from the outset whether they are dealing with just a personal or corporate insolvency case – businesses and individuals seeking financial advice could be frustrated and harmed were an IP to start advising them and then find out they were unable to provide the necessary advice. To cross that line would also result in the IP facing disciplinary or regulatory action.

10. Partial licences could reduce standards in the profession and subsequently reduce returns to creditors – this could also damage the UK's World Bank ranking as the 7th most competitive regime in the world (in terms of the amount returned to creditors and the speed of the process).

11. R3 is concerned that the government is unaware of the concerns from smaller practices, and is only now asking the insolvency regulators to estimate the cost of the proposals to introduce two new licences.

12. R3 calls on the government to drop the proposal from the Deregulation Bill.

R3's detailed views

13. R3 is concerned that the government has not carried out an impact assessment on the goals (paragraph 14), and is only now seeking views on how much the proposals will cost the RPBs and what the impact will be on smaller firms. Furthermore, we have not seen any evidence to suggest those goals will be achieved. We believe the proposals will harm businesses and individuals seeking financial advice, reduce the high standards in the profession, and subsequently have a negative impact on returns to creditors.

14. The consultation document outlines the expected benefits of partial licences as:

    - Reducing the barriers to entry to the IP market and thereby increase competition.
    - Giving rise to savings on training fees, which are likely to be of proportionally greater benefit to smaller firms of IPs, including new entrants to the market.
    - Removing a burden from existing IPs who already choose to specialise in a particular area but are required to study areas that have little or no relevance to their work on benefit to their claims.

    R3 challenges the government's expected benefits (as outlined in the consultation) of partial licences in turn:

Proposed government outcome 1: Reduce the barriers to entry to the IP market and thereby increase competition

15. R3 understands that the government believes there is demand for partial licences in the smaller practice community and in the personal insolvency sector. We strongly disagree with this:
    a. R3's smaller practice community overwhelmingly disagree with the claims that smaller practices will benefit from the proposals (see Annex p8).
    b. We are concerned the government is using views collected in 2010 as evidence of the need for partial licences now. The information the government is using was originally gleaned from an entirely different proposal: the authorisation of practitioners to undertake Individual Voluntary Arrangements (IVAs). There was limited demand in 2010 for such licences as a result of an increase in the uptake IVAs. However, the market has already met this extra demand with the development of IVA-specialist businesses – these are businesses that focus on processing a high volume of consumer IVAs under the supervision of a small number of IPs.

16. The government has admitted that take-up of partial licences will be small: we understand the government has estimated this figure to be approximately 100 licences in the first year, although the government expects this figure to rise in subsequent years. R3 also believes that take-up will be very small: this would have a negligible impact on competition and would <u>add</u> rather than decrease costs for the profession (as regulators would have to develop new exam and monitoring processes to regulate little-used partial licences – see paragraphs 24 and 29). These costs would probably be passed onto IPs and ultimately debtors and creditors. Any (limited) take-up is more likely to be in large firms (see paragraph 20) – 90% of smaller practices have said they will not train a partial licence holder, and 81% say they would not employ a partial licence holder. Furthermore, in a 2013 R3 survey (carried out by ComRes), research found that only 5% of members specialise in personal insolvency, and 27% in corporate work.

17. There is no evidence to suggest the need for more IPs to enter the market – in fact, evidence suggests that the reverse is true. Insolvency firm Begbies Traynor cut 11% of its workforce between the summer of 2012 and the summer of 2013 in response to fewer insolvency cases. R3 therefore believes there is already competition in terms of expertise and fees and that the introduction of partial licences will not give rise to lower IP fees.

Proposed government outcome 2: Give rise to savings on training fees, which are likely to be of proportionally greater benefit to smaller firms of IPs, including new entrants to the market.

18. R3 believes there is no basis to support the claim that there will be a saving on training fees – and there will be no proportionally greater benefit for smaller firms or new entrants to the market.

19. A survey of R3's smaller practices community provides strong evidence that there will not be savings: 82% claim partial licences will not save them money on training fees, and 85% do not believe they will benefit from reduced training costs more than larger firms.

20. Partial licensing will also be relatively more costly for IPs in smaller or micro firms than those in large firms. It is more likely to be the very large firms that could adopt partial licensing as their business models are more likely to have scope for specialisation by IPs in corporate or personal insolvency work; IPs at smaller firms need to practise both for commercial and practical reasons. Therefore there is a risk that the proposals will give an unintended financial advantage to larger firms.

21. In terms of on-going training an IP is required to undertake, their Continuing Professional Development (CPD) is unlikely to be affected given that IPs already choose their CPD based on their specialism. Therefore, there is no obvious reduction in on-going training costs as a result of the proposal to introduce partial licences.

Proposed government outcome 3: Remove the burden from existing IPs who already choose to specialise in a particular area but are required to study areas that have little or no relevance to their work or benefit to their clients

22. As outlined above, the majority of IPs undertake both corporate and personal insolvency work. For those IPs who do specialise, there is still the demand to be qualified in both corporate and personal insolvency. An R3 member based in a smaller practice in the Midlands who specialises in personal insolvency said:

> *"As someone who has always specialised in personal insolvency, I do not see how partial licensing will work.*
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> *"What I do strongly believe, is that partial training in one or the other is very dangerous and will not benefit anyone in the industry – in fact I think that the reverse can be said. As someone who had only ever done personal work before I did my exams, I felt that I really benefited from having the wider picture of all insolvency processes and subsequently understood how the jigsaw all fitted together. In my mind, one process complements and interlinks with another."*
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> *"The majority of my work is personal but I still constantly have to deal with queries about company insolvency issues which I would be ill equipped to do without some knowledge of the various processes. A good understanding of all procedures is essential."*

23. The Insolvency Service has explained that it will be a criminal offence if a partially licensed IP becomes the appointment holder in a case they are not licenced to deal with. R3 is seriously concerned about this statement: IPs do not always know at the outset of a new case whether they are dealing with a solely corporate or personal insolvency situation. For example, an IP

dealing with a small business facing insolvency will very often need to provide advice on the director's personal debts; those debts might not be disclosed to the IP until much later on in the process. If this is the case, businesses and individuals seeking advice will be confused and their debts not dealt with appropriately – this could cause significant stress to the client, who relies heavily on the advice of the IP. Furthermore, an IP may face disciplinary action for giving advice on a case they are not licensed to work on.

24. It is not clear how the Joint Insolvency Examination Board (JIEB) will change its exam structure to reflect the new licences – and we believe there has been little discussion to date on what the papers might look like. However, with the exam papers needing to cover the two new licences, there will clearly be an additional cost. R3 understands the government appreciates the need for a corporate insolvency paper to include a significant amount of information about personal insolvency (given that directors of businesses may face separate but connected personal insolvency proceedings). Therefore, it is unclear how the exam for the partial licence will differ from the current licence exams and as such, the rationale for their introduction is questionable.

25. Given the nature of the market and individual career development and movement, it is almost certain that an IP will not specialise in either personal or corporate insolvency for their entire career. For those IPs only holding a partial licence, this will mean that many will need to re-train. This will be an unnecessary time and cost burden on an IP when they could have trained in the existing full licence at the start of their career.

Further concerns

1. The impact on small businesses

26. As outlined earlier but worthy of further emphasis, R3 believes that one of the key failings of partial licences is the impact that this could have on small businesses. The boundaries between personal and corporate insolvency are very blurred. What might appear to be a solely corporate insolvency case with a small business may well involve issues with personal guarantees given by directors; it is important that business owners in this situation know they could receive well-informed advice from any IP they approach for help. Having to move from one IP to another to receive help could delay a business receiving advice and cause unnecessary stress to the business owner (and often their family). This could mean the difference between the business' survival and failure. During the scrutiny of the Draft Deregulation Bill in October 2013, MP Kelvin Hopkins compared a partially licensed IP to a partially licensed NHS General Practitioner (GP). He said:

> "My own analogy is that, rather as when you go to your GP and he says, "I only deal with arms and legs," you have to go to another GP to look at torsos and heads or something."

NHS GPs do not specialise as it is their job to understand all essential areas of medicine. This is exactly the same with IPs – some will go on to specialise in the future (just like doctors), but they still require essential knowledge of all insolvency procedures.

27. R3’s smaller practice members’ concerns regarding the impact on small businesses and their own smaller practice include:

- *“In a smaller firm you need to be able to deal with all matters in insolvency – most individuals that we speak to would have both corporate and personal insolvency issues which are inter-related through guarantee.”*
- *“In a smaller practice it is important to have a rounded experience of corporate and personal insolvency as generally on corporate jobs we are asked to advise on personal debts for directors and employees, quite apart from regular bankruptcy advice for individuals.”*
- *“It is imperative, particularly for smaller firms, that staff have knowledge and experience of both corporate and personal insolvency processes - otherwise, it is not possible to provide the appropriate advice to clients. A client could require both corporate and personal insolvency advice at the same meeting - i.e. a director of a potentially insolvent company may require advice on whether to liquidate the company and also want to know how he will be affected in relation to the personal guarantees he has given. It would be embarrassing for the profession if an IP was only able to advise on one issue and not the other!”*
- *“This is without doubt one of the most ridiculous ideas ever to be put forward! If someone is specifically qualified for personal insolvency then how can they advise any client properly when questioned on a related corporate issue? You cannot expect that IP to stop and suggest the client goes elsewhere for that advice. It is naïve to believe the public will not be exposed to a lower standard of advice. Because small firms do not have weight in (employee) numbers they need their staff to have a rounded knowledge of insolvency and this is a misguided and ill-thought suggestion for reducing training costs.”*

2. The impact on the UK’s world ranking as a leading insolvency regime

28. Fully licensed IPs are essential to the public interest: ensuring that businesses and individuals get the best financial advice, and ensuring that creditors get back what they are owed. To work as effectively as possible in the public interest, IPs must understand the full breadth of insolvency legislation and options available and therefore must be fully qualified. The UK insolvency regime is currently one of the most competitive in the world (ranked 7th by the World Bank out of 189 countries – this is the 2nd highest in the G8 and 4th highest in the EU[1]) in terms of the amount returned to creditors and the speed of the process. However, that rating could be jeopardised if partial licences are introduced because the expertise of the insolvency professionals will be undermined. Furthermore, with the introduction of partially licensed IPs, the speed of the UK’s insolvency process will be slowed down as ‘unqualified’ IPs will need to pass on cases even when work has already commenced.

[1] 1. Japan; 2. Norway; 3. Finland; 4. Singapore; 5. Netherlands; 6. Belgium; **7. UK**; 8. Ireland; 9. Canada; 10. Denmark

3. The introduction of two new licences (alongside the existing full licence) is not deregulatory

29. The proposals are regulatory rather than deregulatory. Regulators will need to accommodate regulating three types of licence holder, rather than just one, along with the monitoring of holders of partial licences. R3 is concerned the government is only now asking the insolvency regulators how much the cost of partial licences will be and do not have an understanding of the additional costs and the full impact of the proposals. When the practice of a partially licensed IP is reviewed, the regulators will need to check that the practitioner has not crossed the boundary beyond their authorisation and this alone will produce an additional regulatory cost.

Conclusion

30. R3 believes the proposals to introduce partial licences should be dropped. The risks and harm to businesses and individuals seeking financial advice, and the quality and competitiveness of the UK insolvency regime, far outweigh any potential benefits of the proposals.

ANNEX – R3 Smaller Practices Group survey on partial authorisation

R3 surveyed the 635 members of its smaller practice community between 4th–7th February 2014, and received 137 responses (22% response rate). R3 defines a smaller insolvency practice as one with five or fewer appointment takers within the practice. This definition can cover firms of sole practitioners, boutique insolvency firms or regional accountancy or legal practices with a dedicated insolvency department/team.

Five multiple choice questions were asked:

1. Do you think partial licences will save smaller firms money on training fees?
2. Do you think smaller firms will benefit from reduced training costs more than larger practices?
3. Do you think partial licences are likely to reduce regulation?
4. Do you envisage that your practice would train a partial licence holder in the future?
5. Do you envisage that your practice would employ a partial licence holder in the future?

Key findings

- 63% disagreed with all five questions. They do not believe partial licences will save smaller firms money on training fees; will not allow smaller firms to benefit from reduced training costs more than larger practices; will not reduce regulation; and will not train or employ an individual with a partial licence.
- Only 1% of smaller practices agreed with all five questions. They believe partial licences will save smaller firms money on training fees; will allow smaller firms to benefit from reduced training costs more than larger practices; will reduce regulation; and will train or employ an individual with a partial licence.

The government claim partial licences will remove a burden from existing IPs who wish to specialise, and also open up the market to new entrants – R3 members say they won't train or employ an individual with a partial licence

Do you envisage that your practice would train a partial licence holder in the future?
Do you envisage that your practice would employ a partial licence holder in the future?

- 90% of smaller practices do not envisage training a partial licence holder and 81% do not envisage they will employ a partial licence holder.
- 5% believe they will train a partial licence holder and 7% will employ one.
- 13% don't know if they will employ a partial licence holder.
- 5% don't know if they will train a partial licence holder.
    - 30% of that 5% claimed they would rather see an employee fully qualified as smaller firms tend to have cases that deal with all aspects of insolvency and do not have the option for a personal or corporate department.

The government claim partial licences will reduce regulation – R3 members say it won't

Do you think partial licences are likely to reduce regulation?

- 92% of smaller practices do not believe partial licences will reduce regulation.
- 4% believe it will reduce regulation.

- 3% don't know if it will reduce regulation:
  - 30% of yes/don't know cautioned their answer. Comments included:
    - "It will be a bad day for the profession".
    - "Creditors will be less protected".
    - "Partially licensed IPs will be "ignorant of the implications of their advice outside their narrow band of training".

The government claim partial licences will give rise to savings on training fees, which will be of proportionally greater benefit to smaller firms of IPs – R3 members say it won't

Do you think smaller firms will benefit from reduced training costs more than larger practices?

- 85% of smaller practices do not believe they will benefit from reduced training costs more than larger practices.
- 12% believe they will benefit from reduced training costs more than larger practices.
- 4% don't know.

The government claim partial licences will save smaller firms money on training fees – R3 members say it won't

Do you think partial licences will save smaller firms money on training fees?

- 82% of smaller practices do not think partial licences will save them money on training fees.
- 15% believe they will save money on training fees:
  - 40% of the 15% expressed concern by claiming that savings would either be "insignificant" or be detrimental to the level of advice.
- 4% don't know.