Association of Business Recovery Professionals

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Financial Conduct Authority
GC20/5: Guidance for insolvency practitioners on how to approach regulated firms

Email only – GC20-05@fca.org.uk

18 January 2021

Dear Sir / Madam,

FINANCIAL CONDUCT AUTHORITY ('FCA') - GUIDANCE FOR INSOLVENCY PRACTITIONERS ON HOW TO APPROACH REGULATED FIRMS

CONSULTATION RESPONSE FROM INSOLVENCY AND RESTRUCTURING TRADE BODY R3

1. INTRODUCTION

1.1 R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent licensed insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession. Our members work across the spectrum of the profession, from global legal and accountancy firms through to smaller, local practices.

1.2 The insolvency, restructuring and turnaround profession is a vital part of the UK economy. The profession rescues businesses and jobs, creates the confidence to trade and lend by returning money fairly to creditors after insolvencies, investigates and disrupts fraud, and helps indebted individuals get back on their feet. Our members have direct experience of insolvencies and their impact on the UK economy and insolvent companies' stakeholders.

1.3 This response has been prepared by R3 in collaboration with members of its General Technical Committee and we thank them for their input. The committee deals with issues of general importance and significance to the profession in the United Kingdom, keeping under review all UK and EU legislation, prospective and other matters relating to insolvency law. The Committee is multi-disciplinary and is made up of representatives from across the insolvency and restructuring profession, including practising insolvency practitioners, lawyers, solicitors, academics, and others.

1.4 If you would like to virtually meet or if you have any other queries, please contact R3's Technical Manager, Ben Luxford, at ben.luxford@r3.org.uk or on 020 7566 4218.

2. GENERAL OBSERVATIONS

2.1 The proposed guidance for insolvency practitioners ('IPs') is welcomed. We consider Annex 1 and Annex 2 to be useful and informative for all IPs, and their staff, when dealing with the insolvencies of regulated firms.

2.2 Whilst the guidance is welcomed, we do highlight a number of areas where a tightening of the guidance may avoid confusion for stakeholders and IPs and may more accurately reflect what is practically possible in insolvency situations, which we address these below. However, a consistent issue raised by R3 members is the practical and administrative difficulty they often face when required to report to public organisations on relevant matters. Members often spend a significant amount of time attempting to locate the correct individual or department of a public organisation to report matters to, which ultimately creates costs for creditors and stakeholders. We think it would be beneficial to establish a designated point of contact or office at the FCA where IPs and their staff are able to submit enquiries and requests. There are certainly times when FCA input is required at short notice and having such a designated contact would enable cases to be dealt with more promptly, to the benefit of creditors and stakeholders, the FCA, and IPs.

3. SPECIFIC COMMENTS

3.1 The guidance contains a number of statements, which are framed as expectations of the FCA. A number of these obligations are already imposed on IPs by either statute or by Statements of Insolvency Practice (also known as SIPs). For example, annex 1, paragraphs 33 and 34 on Creditors' Committees and paragraphs 35 to 38 on insolvency costs. It may be beneficial if the guidance acknowledges these existing and extensive obligations to avoid the perception of additional obligations being imposed on IPs.

3.2 Annex 1, paragraph 19 *"The FCA is entitled to participate in court proceedings in relation to the regulated firm, such as the hearing of an administration application. An administrator must therefore share any court documentation, administration applications and other documents required to be sent to creditors of the firm with us. The administrator should do so at the earliest opportunity, so that we have sufficient time to decide if our participation in the administration is appropriate."*

It is common for an IP to assist with the pre-administration court documentation; however, the IP is not the applicant or party responsible for submitting the relevant notices to court. Therefore, absent of any statutory duty, it would breach client confidentiality for an IP pre-appointment to share such documents without the applicant's/appointor's consent and sometimes the IP may not have access to such documents.

3.3 Annex 1, paragraph 23 *"Special Administration - The FCA is entitled to be heard at a hearing of a special administration order and any other court hearing in relation to the firm. The special administrator should therefore share court documentation with us at the earliest opportunity, so that we have sufficient time to decide if our attendance is appropriate. The FCA is also able to direct the special administrator to prioritise one of the special administration objectives over the other objectives."*

We suggest a slight amendment to the above - *"The FCA is entitled to be heard at a* ***petition for*** *hearing of a special administration order and any other court hearing in relation to the firm. The special administrator should therefore share court documentation with us at the earliest opportunity, so that we have sufficient time to decide if our attendance is appropriate. The FCA is also able to direct the special administrator to prioritise one of the special administration objectives over the other objectives."*

3.4 Annex 1, paragraph 25 *"Statutory demands - The service of a statutory demand on a regulated firm should be notified to the FCA. We therefore expect an IP engaged by a firm in this situation to ensure that the firm has notified the FCA if they have received a statutory demand."*

Prior to the formal appointment, an IP is not the office holder and is acting in an advisory capacity. Therefore, an IP does not have the ability or power to ensure a firm notifies the FCA. We suggest the word '*ensure*' is removed and replaced with advice or a similar phrase.

3.5 Annex 1, paragraph 28 *"The appointment of a liquidator must be notified to the FCA…"*

S365(4) and s371(3) of Financial Services and Markets Act 2000 ('FSMA') state that *"any notice or other document required to be sent to a creditor of the company [/body] must also be sent to the appropriate regulator"*. A liquidator is not statutorily required to send to creditors copies of the winding-up resolution or the certificate of appointment, so it is incorrect to state that these must be sent to the FCA.

With regard to 'footnote 22: Section 370 of FSMA', s370 relates to a liquidator's duty to report in the event of regulated activity in contravention of statutory standards. As mentioned above, we suggest s365(4) and s371(3) are more relevant.

3.6 Annex 1, paragraph 41 *"If a firm is considering entering or has entered into an insolvency process, we would expect an IP to provide regular updates to the FCA for a period agreed with us. We would expect updates on items including the following:"*

Whilst IPs would like to help the FCA, where possible, voluntarily surrendering information listed may lead to a waiver of privilege and could risk compromising the IP's/insolvent entity's claim. In addition, the Insolvency Service has instructed. IPs to refer to them all requests (including from "investigating authorities") for information on submissions to its disqualification team in relation to directors' conduct (Dear IP chapter 10 article 24). The FCA's expectations therefore appear to conflict with the Insolvency Service's. We suggest this is noted in some form within the guidance.

3.7 Annex 1, paragraph 43 *"Share draft versions of key client communications with the FCA (and other relevant authorities) for comment before finalising,"*

Whilst in office IPs are required to deliver certain documents to creditors "as soon as is reasonably practicable", for example notice of an Administrators' appointment (Para 46(3) Schedule B1 Insolvency Act 1986 ('IA86')) and the Administrators' Proposals (Para 49(5) Schedule B1 IA86). To delay issuing these documents would bring the IP in breach of the statutory requirements, given that they are not required by statute to allow the FCA (or other relevant authorities) time to review a draft. We suggest an expected timeframe for the FCA to return comment would be useful to IPs (and their staff) to assist in planning.

3.8 Annex 1, paragraph 48 *"Usually, the FSCS ranks as an unsecured, ordinary creditor for FCA related FSCS claims."*

We suggest the paragraph refers to *'Deposits covered by Financial Services Compensation Scheme'* as per para 15B Schedule 6 of IA86, which are preferential claims.

3.9 Annex 1, paragraph 65 *"Following appointment, an IP will need to take control of client assets (physical and electronic) and the books and records of the firm."*

Whilst the above may apply in most scenarios, the guidance may not be well suited to Voluntary Arrangements. In most Voluntary Arrangements, the IP does not take control of the company's business (or its books and records), but rather the company will continue to trade and make regular payments to the IP (as Supervisor), which they will then distribute to the company's pre-CVA creditors.

3.10 Annex 1, paragraph 85 *"Distributions of client money - After determining entitlements to the CMP, an IP must, as soon as reasonably practicable, distribute the client money to each client who is a beneficiary of the CMP rateable to their entitlement. In this process, an IP will need to consider the following issues:*

- *how money is returned to the relevant client (e.g. whether it should go directly to the client, should the client be able to nominate a receiving broker, or should it be part of a transfer of client money/custody assets to another firm)*
- *if being returned directly to the client, verifying a client's bank details, and completing any required KYC, before returning client money*
- *costs of returning client money to each client, and*
- *if the client cannot be contacted or disclaims their entitlement"*

With regard to the second bullet point, we think it would be beneficial for the guidance to specify what Know Your Client / Anti-Money Laundering processes are required by IPs in these circumstances.

3.11 Annex 1, paragraph 107 *"The continuity of supply provisions is not available for liquidations. An IP must therefore consider on an ongoing basis how they ensure the insolvency is conducted in compliance with our rules."*

The footnote for para 106 refers to s233 and s233A of the IA86. Whilst s233A does not apply to liquidations, s233 and s233B do apply to liquidations.

3.12 Annex 1, paragraph 118 *"Phoenixing is a common term used to describe the practice of closing a firm and that firm re-appearing under a new guise to avoid liabilities arising from the old firm…"*

While the FCA definition of phoenixing is correct, this may cause confusion given that, for example, the House of Commons' briefing paper defines it differently and makes the clear statement that "*it is not illegal to start up a phoenix company following the liquidation of the original company, but there are rules to be followed".* Phoenixing is also a term that is usually only used to describe the emergence of a Newco once Oldco has gone into insolvent liquidation, as s216 of the IA86, which incorporates the "rules" referred to in the briefing paper, only applies in insolvent liquidations.

3.13 Annex 1, paragraph 121 *"…Notice to the FCA: An IP should notify the FCA in good time, including sufficient details, if they are planning to sell a client book."*

We suggest the terms 'in good time' and 'sufficient' are defined. It is also unclear whether the FCA wishes this information when the IP first plans to sell a client book or whether this should be done once the IP has settled on a purchaser. Also, an explanation on the intentions of the FCA upon receiving the information would be helpful.

3.14 Annex 2, paragraph 23 *"Insolvency Costs – Given the role of the creditors' committee in this process, it is important that it appropriately represents the customer base of the firm. IPs should consider how they ensure appropriate representation across all types of stakeholders of the failed firm on the committee throughout the insolvency process."*

Again, the use of the word *'ensure'* is not appropriate. IPs cannot ensure appropriate representation of all stakeholders on a creditors' committee, as the composition of the committee is voted on by the general body of creditors. An IP could *seek* appropriate representation; however, the end result is primarily down to the creditors.

3.15 Annex 2, paragraph 40 *"Take control of relevant funds - Following appointment, an IP will need to take control of relevant funds and assets, and the books and records of the firm. The IP should also identify key individuals and systems required to manage relevant funds of the firm, including third party administrators, system suppliers and employees of the firms. Furthermore, the IP should cooperate with any payment systems to facilitate settlement or completion of inflight payments."*

It may not be possible to facilitate completion of in-flight payments where there is a cash shortfall within a failed firm.

3.16 Annex 1 and Annex 2 – Certain paragraphs within "Chapter 2: Pre-insolvency" appear to refer to post-insolvency matters and would read better in "Chapter 3: Post-insolvency". These are as follows –

Annex 1

- Paragraphs 28 and 29 (Liquidations)
- Paragraph 32 (Members' Voluntary Liquidation and conversion to Creditors' Voluntary Liquidation)
- Paragraphs 35 to 39 (Insolvency costs)

Annex 2

- Paragraphs 17 to 18 (Creditors' Committees)
- Paragraphs 19 to 23 (Insolvency Costs)

4. CONCLUSION

4.1 Whilst we have made a number of suggested amendments and highlighted some practical considerations, this proposed guidance welcomed, useful and informative for all members of the profession dealing with the insolvencies of regulated firms. Once again, we would encourage some further consideration of a designated point of contact or department being set up for insolvency enquiries.

Yours faithfully

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R3, the insolvency and restructuring trade body.

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