Consultation on reforms to the regulation of Insolvency Practitioners

Response by R3, the insolvency trade body

Section 1: Introduction

While we support greater transparency, consistency and visible independence, the degree of increased regulation proposed in this consultation is disproportionate and the policy objectives could be more effectively achieved through non regulatory means.

R3 is the insolvency trade body representing 97% of licensed Insolvency Practitioners (IPs). Our members include the 'Big Four' as well as a wide range of smaller practitioners. R3 is committed to promoting confidence in the insolvency profession. We want to ensure that the regulatory regime is as transparent, effective and equitable as it can be.

The Office of Fair Trading (OFT) report found that the insolvency market and regulatory regime work well in the majority of cases but could work more effectively in a minority of cases. The proportionate response would therefore be to make improvements to the regime, looking to non-regulatory solutions where possible, rather than wholesale revision and the imposition of regulation.

The Government is clear that regulation should not impose costs and obligations on business unless a robust and compelling case has been made. Any new regulation must constitute a proportionate response to the policy issue and Government must be sure that no alternative non-regulatory means of achieving the same outcome exists.

In this case, the consultation considerably underestimates the cost to business - both to the creditor community and insolvency firms - of the proposed reforms and significantly overplays the benefit to business. Looking at the available evidence relating to unsecured credit extension, a compelling case for change has not been made; while non-regulatory approaches to achieving the policy objective are not considered. Moreover, reaching for a regulatory solution before exploring a non-regulatory approach is counter to cross-Government policy. While it may be tempting to use the OFT report as an opportunity to bring about far-reaching changes, this does not represent a proportionate response.

Crucial to addressing the OFT's concerns about the minority of cases is ensuring that unsecured creditors have 'more of a say' over the insolvency process. R3 welcomes the consultation measures designed to increase unsecured creditor engagement and to ensure greater transparency over fees. We would also like the Service to encourage the Government departments who account for more than a quarter of unsecured debt to exert their considerable market power. This could include establishing internal teams to review fees - based on the existing and effective Voluntary Arrangement Service - which would pay for itself through enhanced dividends. This non-regulatory approach is more likely to enhance the power of unsecured creditors and increase returns than the regulatory reforms outlined in the consultation, which have the potential to reduce returns to creditors and actively discourage creditor participation.

Section 2: Executive summary

- **Creditor empowerment - a non regulatory solution:** Our response focuses on empowerment, greater transparency and increased opportunity to engage. It stresses the importance of creditors using the powers available to them to influence the insolvency process. Government departments account for more than a quarter of unsecured debt and have considerable market power, if only they would exercise it. We propose that the Government departments who are major unsecured creditors better exert their considerable market power. This could include setting up their own fee review teams to consider IP fees, based on the existing and effective Voluntary Arrangements Service (VAS). This non-regulatory solution would be self-funding, it is more likely to achieve the Service's policy objective and would enhance, rather than undermine, the existing fee setting process.

- **Streamlined regulatory structure:** We understand that there are concerns about the current regulatory regime - that it can seem to lack consistency, be complex and inaccessible, and insufficiently independent. We advocate a rationalisation of regulators and a single regulatory framework. This would do more to address concerns and increase confidence than many of the proposed reforms in the consultation. It would also achieve the cross-Government aim of making regulation more efficient.

- **Increased independence:** We appreciate that the existing complaints system would benefit from a single entry and exit point, and from a greater degree of visible independence. We would welcome model 2 as it retains many advantages of the current regulatory system while satisfying the external desire for visible independence. We also see the merit in models 3 and 4.

- **Unintended consequences of fee review:** We support the measures in the consultation to increase transparency over fees and give creditors greater influence over fee setting. However, we are opposed to the establishment of an 'after-the event', free to enter fee review body because this risks dramatically reducing creditor returns and opening up a lucrative market for ambulance chasing lawyers and advisors, at considerable cost to the creditor community. It would render the existing statutory fee-setting processes futile and actively discourage up-front creditor participation, while adding regulation where a non-regulatory solution would be more effective at achieving the policy aim.

- **Sensible safeguards:** If a fee review body is taken forward, we are keen to ensure it is designed and implemented sensibly and reasonably. It is vital that any complaints body contains strong protections against vexatious complainants to ensure it operates to minimise inappropriate costs to insolvent estates; and that it is imbued with a comprehensive understanding of the realities and complexities of insolvency work to ensure it operates effectively and fairly.

- **Arbitration or a 'fast track' fee review panel:** Although we are strongly opposed to a fee-review body for the reasons outlined above, we recognise that it may be pursued by the Government. If 'after the event' fee-review is to be a new feature of a reformed regulatory landscape, we favour an arbitration system or a fast track fee review panel.

Section 3: Impact Assessment

Q.1 Do you have any comments or evidence on the costs and benefits set out in the attached Impact Assessment?

The regulation agenda lies at the heart of Government policy across departments. It requires that new regulation should not impose costs on business unless a robust case has been made. If regulatory costs are to be incurred by business, then regulation of equivalent weight should be removed. In our analysis of the Impact Assessment, we argue that available evidence does not support the policy objective underlying the consultation (the extension of unsecured credit) and as such, the case for regulatory interference is extremely weak. In addition, the cost to business of the proposed regulatory changes has been considerably underestimated. The net outcome of the proposed policy changes would be costly, rather than beneficial, to business (both to the creditor community and insolvency firms).

3.1 Credit extension

The Government's main justification for intervention in the insolvency market and increasing regulation centres on a perceived increase in access to credit if unsecured creditors could exert more power during insolvency and therefore gain higher returns - an argument put forward by the OFT. Looking at the available evidence, we believe that the financial benefit to the economy from this source is negligible:

- The OFT's survey of unsecured creditors showed that just 1% say they would be 'much more likely' to extend credit if they received a 10p in the pound increase in dividend in insolvency. Only 11% say they would be 'more likely' to do so. By contrast, 84% say that this would make 'no appreciable difference' to their credit policy.

- According to the OFT report, the amount paid to IPs at the median where secured creditors are paid in full is £26,545. This compares to £24,345 where the secured creditors are not paid in full. In absolute terms, the average debt owed to unsecured creditors is £1.2 million. On these figures, the increase in the dividend would be 0.18p in the pound, rather than the 10p in the pound that formed the basis of the survey above. If creditors had been asked whether they would be more willing to extend trade credit for an extra 0.18p in the pound in the event of insolvency, it is highly unlikely that any businesses would say this would make a difference to their credit policy.

- The OFT survey of unsecured creditors demonstrates that there are a range of factors influencing unsecured creditors' willingness to extend credit, of which 'risk of insolvency' is only one. Although 41% state that fear of money not being paid back because of insolvency is a factor affecting their decision-making, 41% claim that they are constrained by their cash flow, 58% say extending credit does not apply to the way they do business, and 36% cite fear of not being paid back as factors impacting their willingness to extend credit. Their decision is clearly a result of a variety of factors and the interplay between them. Although risk of insolvency is a factor, it is by no means the primary driver of willingness to extend credit.

- The OFT report found that £78.4bn of unsecured credit is extended each year. If the OFT contention is correct, the total amount of unsecured credit that would be extended is £8 million - a 0.01% increase on existing levels. To put this into context, this is dwarfed by the £190bn that HSBC, Barclays, Royal Bank of Scotland, Lloyds Banking Group and Santander have committed to lend to business in 2011 under Project Merlin. Even the Impact Assessment (IA) admits that the policy would, if achieved, have a 'very marginal effect'.

- The Government also doubts whether the full extension of credit could be achieved. The IA admits that because 'the level of market harm experienced by unsecured creditors is calculated relative to secured creditors, any residual weakness in unsecured creditors' position via a vis secured creditors is likely to result in less than the full £8 million of credit being extended'.

- The IA sees the quantifiable benefit of the proposals as extra trade credit available to unsecured creditors. However, it would be the return from the extra credit available that represents the actual benefit. The extension of extra credit, per se, does not automatically lead to any tangible benefit to business - it may not necessarily lead to growth of the economy on a pound for pound basis. Some credit may be extended without proper control and will not provide any benefit at all. For example: if the expected return were to be 10%, the benefit to the economy from £8m of extra trade credit could be as little as £800k.

Given the paucity of the evidence used by the OFT and the Government's own comments in the IA, it is unlikely that a marginal change in returns to unsecured creditors will have any significant impact on unsecured credit extension in the UK. We do not believe this objective justifies further regulation and intervention in the insolvency market, especially bearing in mind the costs to business of certain policy proposals (see below).

3.2 Costs of model one

We believe the costs of model one in both circumstances have been considerably underestimated.

We have enclosed revised estimates of the costs of model one. Two tables have been provided for the basic model - one for 700 complaints, the second for 1,000 on the reasonable assumption that the number of complaints is likely to increase, given that any change in IP behaviour, if achieved at all, will take time to have an impact. Another two have been provided for the model with fee review built in - one based on 300 fee complaints and another on what we believe to be a reasonable assumption, of 2,000 fee complaints.

Our main concerns area as follows:

- Determining complaints: In the model that represents the status quo (5), the cost of investigating complaints is estimated to be £1.9 million and the cost for the determination of complaints is allocated a separate line. However, in model one, the cost of investigating complaints is awarded a 5% decrease for economies of scale but no separate resource has been provided for the determination of complaints.

  We suggest that it would not be possible - even bearing in mind economies of scale - for the investigation of complaints and their determination to be carried out for 95% of the current cost of investigation alone. As such, we believe the proposed cost of model one is significantly understated. At the very least, it should replicate the cost of decision making in the other models.

  As a point of policy from the perspective of fairness, we think it highly undesirable for the same people to investigate a complaint and then to determine it. Under the current system, there is a distinct separation of these roles which we suggest ought to be retained.

- Appeal to the Court: Any appeal against the decisions of the complaints body under model one must be taken to the Court. Given that it is envisaged that there is no practitioner input into the complaints body under this model and no scope for appeal within the system, we expect considerably more cases to be appealed by IPs through the Courts than happens under the current system or is envisaged under the other models. The current estimate suggests that only 5 cases each year will follow this route under model one. This figure is a significant underestimate. The IA assumes that there will be 70 appeals per annum (para 1.43) equivalent to 10% of all cases. In the absence of any other appeal system we would envisage 35 appeals (5% of all cases) to the Court were model one to be implemented. This would raise the 'costs of court' as well as the 'legal contingency' and the new categories of 'adverse costs' and 'court time and resource' (see below).

- <u>Adverse costs</u>: 'Legal contingency' is stated in the IA to refer to legal advice for the complaints body and 'costs of court' refer to the cost of paying legal fees. Full account has not been taken of the risks of 'adverse costs' - the costs that must be paid by the complaints body in the event it loses a case and the Courts deem the body itself is at fault.

  As a point of policy, consideration should be given to the adequacy of funds at the complaints body's disposal to defend its decisions in Court. Insolvency cases taken to Court are likely to be complex; the large accountancy firms have the reserves to sustain long-running court cases; and the insolvency profession is accustomed to legal environments. As such, the complaints body would have to have sufficient reserves to enable it to sustain prolonged, costly and potentially frequent court cases. Allowing £100,000 for legal contingency and no funding at all for adverse costs is unrealistic. While we recognise that costs per case of £10,000 may be reasonable for 'run of the mill' cases, but we believe that recognition must be given to a small number of exceptional cases which would be far removed from the average costs. For example, in the model with 300 fee complaints a year, this could easily expose the complaints body to adverse costs in the region of £0.5m. In the model based on 2,000 cases, it is reasonable to assume that the risk will be proportionately higher.

- <u>Court time and resource</u>: Given that the 'costs of court' refer only to legal fees, the estimated costs under model one (and others) take no account of the costs of the Court itself - i.e. the resource implication for the courts of hearing a significant number of appeals.

- <u>Wind down costs:</u> The costs of 'winding down' the current RPB insolvency-related complaint function should be considered as a cost under model one. Although it is not incurred by the complaint body, it is a cost arising from this policy option.

The cost of the initial complaint section is estimated as £1.9 million in all models because this is assumed to be the level it is under the existing complaints model. Under model one, the cost of the initial complaint section is deemed to be 95% of £1.9 million. The £1.9 million figure is central to the costing of all models, yet it is not based on the actual cost of the current model but calculated by reference to other organisations undertaking 'similar activities in both the public and private sector'. The IA does not provide further details of the organisations referred to, their functions, or the reasons why they are to be considered to be comparable. As such, it is not possible to assess whether the costs are realistic. It would be much more appropriate and accurate to determine the costs of the current system by obtaining information from the RPBs.

The IA argues that because the same figure is used to inform each model, the actual amount is insignificant for comparative purposes. While this is the case, this cost also plays a key part in the overall costs of the models. Consequently, it informs the overall costs to business of taking forward the policy options in the consultation. This is critically important because it impacts on the policy of 'one in, one out' (see 3.6).

3.3 Increased costs for increased complaints

The number of complaints has a considerable bearing on the overall costs of all models. As a general rule: the greater the number, the higher the cost. Again, this is critically important not only in assessing the cost of the models, but also in looking at the impact this has on the overall cost to business.

The number of complaints is expected to increase if the structure of the complaints system is more independent. As such, it cannot be assumed that the cost for initial complaints will be the same as the existing complaints system. Nor can it be assumed that this cost would be static across models 2-5 and lower for model one. If anything, the costs for model 5 should be lower than all other models as this model is a continuation of the status quo rather than a new, more independent structure; while costs for model one should be highest as it is deemed to be the most visibly independent and therefore presumably most likely to attract complaints and appeals.

The IA assumes 300 fee related complaints and 700 complaints of other varieties, giving 1,000 complaints per year. As fee related complaints would be a new addition to the insolvency landscape, the level of complaints under the existing system bears no relation to the potential level of complaints the new system could invite. In the consultation document it is envisaged that there would be no cost to a complainant and no requirement for the complainant to have an economic interest in the outcome. While we think that neither of these features is at all desirable, if the new fee complaints system is to work in this way, our estimate is that there could be as many as 2,000 fee related complaints annually under each model - approximately one complaint in every ten corporate insolvency cases. Such a dramatic increase in volume would raise costs substantially across the various models. It should be noted that an increased level of fee complaints would not reflect any increase in 'wrongdoing' among the profession, but the development of an ambulance chasing industry dedicated to encouraging creditors to use their 'free ball' to challenge IPs.

We calculate that the cost of dealing with 300 complaints is estimated to be <u>£1.8 million</u> under models 1-4. If the number of fee related complaints increases to 2,000, the cost for the complaints body would rise to just over <u>£12.2 million</u> as an average for models 1-4 for fee related complaints alone. The attached table sets out how these costs are arrived at and provides for the 5% assumed efficiency savings for model 1 due to economies of scale.

3.4 Costs to insolvent estates

One of our key concerns is the intention that making a complaint should be free to the complainant, irrespective of whether the complaint is upheld and that the costs of making fee complaints that are not upheld should be paid out of the insolvent estate. This effectively means that the body of creditors as a whole are forced to pay for the fee review challenges of individual creditors. Given the impact this would have on the creditor community, it is important to estimate its cost.

The Service suggests that a fee complaints body would receive 300 complaints each year. Working on the assumption that half of these will be unfounded (150), in each of these cases, the insolvent estate must cover the IP's legal and time costs. A conservative estimate would be £10,000 per case. With 150 cases, this amounts to £1.5 million each year at the initial stage. Under model one, any appeals on the 150 cases upheld by the complaints body would be through the Courts. Given that the insolvency profession is comfortable in legal environments and therefore unlikely to be deterred by the Court process, we suggest that half of the cases that pass through the initial stage in favour of the complainant would be appealed by the IP (75). Working on the assumption that a third of these cases would be overturned on appeal (25). In these cases the insolvent estate would cover the IP's legal and time costs for both the initial stage and the appeal stage. At £20,000 per case, this amounts to a further £500,000. Adding the costs of the initial stage and the appeal stage, insolvent estates would have to pay £2 million each year for unfounded fee challenges.

Although the Service suggests there would be 300 fee complaints each year, we believe this is a significant underestimate. A conservative estimate of the number of fee related complaints is around 10% of total corporate insolvency cases each year (2,000 complaints). We assume - again conservatively - that half of these will be unfounded (1,000). Repeating the process above, this would result in a cost to insolvent estates of £13.3 million each year. This is a considerable sum, especially bearing in mind the basis for a change in regulation is the assumed £8 million increase in the extension of unsecured credit for the benefit of the business community.

The considerable cost of a fee review body to insolvent estates - and therefore to business - would significantly diminish if the system were to guard appropriately against vexatious complainants, as this would reduce the number of unfounded complaints entering the system. We suggest a number of ways this could be achieved:

- 10% hurdle: The suggestion in the consultation is that vexatious complaints would be reduced by requiring that any complaint must have the backing of 10% of creditors by value. If this were the case, we estimate that around two thirds of potential complaints would overcome this hurdle. Using the same logic as above - but decreasing the proportion of unfounded complaints to one third rather than one half and reducing appeals to one third rather than one half because the hurdle ought to act as more of a filter - we calculate the resulting cost to insolvent estates would be £960,000 on 300 complaints and £6.4 million on 2000 complaints. This is a much smaller, though still significant, sum.

- Demonstration of engagement: We have also suggested that the complainant should have to demonstrate that they at least attempted to engage during the insolvency process before their complaint can be looked at by the complaints body. If this were the case, it would not only support the existing fee setting process, but would provide a further protection against vexatious complaints and reduce costs to the creditor community. This protection could potentially reduce fee related complaints by a third. As such, it could reduce the cost to insolvent estates to £960,000 or £6.4 million, as above.

- Both hurdles: If both guards against vexatious complaints were implemented - a 10% hurdle in addition to demonstration of engagement - we estimate that half of cases would reach the fee review body. This would lead to an annual cost to insolvent estates of £720,000 or £4.8 million.

It is unclear how the cost of unfounded fee complaints would be met in cases where there are insufficient funds in the insolvent estate.

3.5 Notifying creditors of a change of rates

The consultation proposes that hourly rates should be fixed at the time of the resolution, with any further increases agreed at a subsequent meeting of creditors. We support this policy, but it is important that the costs to business are understood.

- The IA assumes that holding a meeting to change hourly rates would only be required if an insolvency procedure lasted more than three years. We believe it is more likely that charge-out rates increase on a yearly basis and therefore an annual meeting would be required. We estimate that around 60% of liquidations run for longer than a year.

- The IA assumes that quoting on a time basis is used around 60% of the time. We believe a more realistic estimate would be 80%.

- The cost of holding the meeting to get approval is estimated at £750 in the IA. We suggest £500 is a more realistic figure.

Using the same methodology as the IA but the new estimates above, the sum becomes 15,706*0.8*0.6*500 which gives a total cost of £3.8million. This is a significant rise on the original estimated cost of £1.4million for the creditor community.

3.6 One In - One Out

Introduced in September 2010, the Government's 'one-in, one-out' policy is designed to ensure that the net cost to business of any given measure is calculated in order to understand whether the benefits to business will be offset against the costs to business.

According to the IA, 'all quantified costs and benefits are on business either on IPs, creditors or business in general. As there is a net benefit to business [of £46 million] there is no need to identify an out.'

The following tables lay out our assessment of the costs to business compared to the benefits to business:

Based on 700 complaints and 300 fee complaints:

Costs to business	Cost savings/benefits to business
£2 million cost to insolvent estates due to unfounded fee challenges (annual)	Extra credit advanced - benefit assessed at £nil for the reasons set out above
£1.9 million extra regulatory cost due to fee complaints, based on 300 complaints per year (annual)	£84,500 removing the IS as direct regulator (average)
£0.34m additional regulatory cost for complaints body models 1 to 4 averaged out above costs of current model (annual)	£45,500 in regulatory costs changing to reflect costs for each RPB
£3.8 million in notification of charge out rate changes (annual)	£97,000 closure of IPC
£63,000 to strengthen the oversight regulator (annual)	
£83,000 review of IP moving from admin to CVL (annual)	
TOTAL: £8.2m	**TOTAL: £0.3m**
NPV over 10 years: £71m	**NPV over 10 years: £2.6m**

Based on 1,000 complaints and 2,000 fee complaints:

Costs to business	Cost savings/benefits to business
£13.3 million cost to insolvent estates due to unfounded fee challenges (annual)	Extra credit advanced - benefit assessed at £nil for the reasons set out above
£12.7 million extra regulatory cost due to fee complaints, based on 2,000 complaints per year (annual)	£84,500 removing the IS as direct regulator (average)
£1.75m additional costs of complaints body models 1 to 4 averaged out above costs of current model (annual)	£45,500 in regulatory costs changing to reflect costs for each RPB
£3.8 million in notification of charge out rate changes (annual)	£97,000 closure of IPC
£63,000 to strengthen the oversight regulator (annual)	
£83,000 review of IP moving from admin to CVL (annual)	
TOTAL: £31.2m	**TOTAL: £0.3m**
NPV over 10 years £268m	**NPV over 10 years £2.6m**

The tables above show that there is negligible financial benefit arising from the proposals and substantial costs.

3.7 The adverse regulatory impact on micro-businesses and small firms

Despite large firms and big cases dominating the headlines, small firms comprise a significant proportion of insolvency firms. It is therefore vital that any proposed regulation should be considered in this context. R3's membership represents 97% of the profession and, as such, we can speak with authority on the insolvency landscape.

Our membership database highlights that a significant proportion of R3's membership can be classified as micro and small businesses. There are 366 small firms, of which 37% are micro businesses (fewer than 10 employees). To put these figures into context, just 9 firms within the membership can be defined as large and 15 medium sized[1].

In the 2011 Budget statement, the Government announced a three year moratorium on UK regulation for micro-businesses. The proposed additional regulations within this consultation are a direct contradiction to this recent exemption. It is unclear how the Service intends to address the discrepancy between the intended increase in regulation with the moratorium on regulation for micro-businesses.

In addition, the consultation suggests that the proposed regulations will have an equal impact across the insolvency landscape; that is, no additional/particularly adverse effect on small firms. R3 strongly challenges this assumption.

- Small insolvency firms will struggle to absorb the increased costs associated with additional regulation, as efforts to ensure compliance would prove time consuming and costly. Insolvency Practitioners running their own smaller practices often have responsibility not

[1] R3 classification for small firm = five or fewer insolvency appointment takers; medium firm = 6-24 appointment takers; large firm = 25 or more appointment takers.

only for their insolvency appointments, but also for ensuring that the practice is kept up-to-date with legislative and technical developments, training, compliance and the additional regulatory requirements associated with practice and office management. By comparison, larger firms are more likely to have in-house training and compliance teams and would therefore be better resourced to absorb the extra work associated with complying with new regulation.

- It would be highly unlikely that IPs in smaller firms would delegate the bulk of work surrounding defending fee related complaints, for example, which instantly impacts their viability.

- We are also concerned that smaller IP firms are more likely to deal with the owner managed business end of the market where a greater number of complaints may arise. Smaller IP firms tend to take on smaller corporate insolvency cases, where the owners of the business are also the directors. In these cases, directors often have a close relationship with creditors and may be creditors themselves. In the experience of some of our smaller members, directors in these cases tend to apportion blame for low returns on the IP's fees rather than the failure of the company, which can create or heighten creditor resentment towards the IP in an effort to direct it away from themselves. These cases may therefore be more likely to engender a greater number of complaints, disproportionately affecting smaller IP firms.

Additional regulation risks disproportionately squeezing small firms; in some cases, pushing them out of the insolvency market altogether. R3 does not believe that the IA has adequately addressed the impact of proposed regulation on micro businesses and small firms and calls for the Service to deal with this issue as a matter of urgency.

Section 4: Summary of questions

Q.2 Is the current structure of IP regulation the right one? How could it be improved?

R3 appreciates that there are concerns over consistency of approach from one regulator to the next and that the regulatory structure can be confusing for anyone who is unfamiliar with it. According to a survey of over 300 IPs, just 30% believe there is consistency of approach between the various regulators at the moment - i.e. one regulator enforcing and monitoring regulations to the same degree as another. 75% believe existing regulators should be forced to work to a single regulatory framework to ensure consistency in licensing, monitoring and complaints handling. IPs would also welcome a reduction in the number of regulators - 39% would support just one regulator and 38% are in favour of 'more than one but less than four'.

We would welcome a rationalisation of regulators, and consider that the introduction of a single regulatory framework (e.g. RPBs working to joint sanctions guidance and publication of disciplinary outcomes) would improve confidence in the insolvency profession initially.

Q.3 Would the creation of an independent complaints body be the best way to improve confidence in the handling of complaints and/or appeals?

There are three key concerns about the way the existing regulatory system handles complaints, which can serve to undermine confidence in the process: the complexity and accessibility of the current system given the number of regulators and a perception of inconsistency of decision making between regulators. A rationalisation of regulators, the introduction of a single regulatory framework and a single entry and exit point for complaints would be the most effective way of addressing these concerns and therefore improving confidence in the handling of complaints.

If a complaints body is to be established to increase confidence in the complaints handling process, it is vital that it protects against vexatious complaints (see Q14) and comprises individuals who have experience and expertise in insolvency (in addition to lay-members or other professionals):

- For a complaints body to be credible and just, its members should possess an excellent awareness of the commercial, legal and practical realities of insolvency work. Insolvency is a complicated discipline, involving intricacies and delicate commercial judgments. Complex decisions are taken in a fast-moving environment requiring a thorough knowledge of accountancy and several key areas of law (including company, property, security, employment and insolvency law). It would be highly unfair to criticise IP conduct and decision-making without sufficient expertise and an understanding of how the role is carried out in a practical sense.

- If an appeals body does not contain individuals with sufficient expertise, it is likely that complaints that would be rejected by the Courts may be ill-advisedly upheld, contravening legal precedent and without due regard for the statutory duties of an IP. Such decisions would subsequently be overturned by the Courts, wasting time and making a nonsense of the process.

- Many complaints to a new body are likely to stem from a lack of understanding of the role, function and legal position of an IP. It is therefore crucially important that members of the body are able to distinguish between genuine grievances (which should rightly be brought to light) and cases in which the IPs' conduct was unlawful or contrary to the regulations to which they are subject.

- As insolvency is such a complex issue with many varied scenarios, investigators must have sufficient knowledge of the field to ensure that they can uncover any malpractice. Far from 'protecting their own', those with experience in the profession are arguably much better placed to understand the intricate procedures and therefore identify wrongdoing than laypeople.

- Professional Chairs and panel membership in addition to lay membership is a feature of complaints boards in other professions (e.g. the Solicitors Disciplinary Tribunal and the GMC fitness to practice panel).

Q.4 Should such a body have the power to review the fees and remuneration charged by IPs?

No. A complaints body with the power to review fees charged by IPs 'after the event' risks diminishing returns for creditors - damaging the business community and lending climate - while rendering the existing statutory fee-setting system redundant and actively discouraging creditor participation.

- The Government intends that the costs of making a complaint that turns out to be unfounded (i.e. cases in which the IP did not overcharge) would be paid out of the insolvent estate. This effectively means that the body of creditors as a whole would be paying for the fee review queries of individual creditors. Rather than protecting the interests of unsecured creditors, the Government's proposals risk dramatically reducing returns for the body of creditors as a whole, impacting both secured and unsecured creditors. We estimate that insolvent estates will lose between £2 million and £13 million each year to cover the cost of unfounded fee complaints (see Q1).

  It is unclear how the cost of unfounded fee complaints would be met in cases where there are insufficient funds in the insolvent estate.

- A complaints body with the ability to review fees risks rendering the existing fee-setting process entirely irrelevant. An after-the-event complaints system would actively discourage creditors from engaging with the insolvency process until the very end - what is the incentive to get involved during the process if there is a simpler method open for use afterwards? This runs counter to the Government's aim of increasing creditor engagement, is highly inefficient, and unfair on the creditors who do engage during the process.

- Under the current system, creditors have a myriad ways to influence the fees charged by IPs, with changes introduced in April 2010 facilitating more cost-effective ways of doing so. It is within creditors' gift to influence IP fees - all it requires is a desire to participate. Creditors can not only agree the basis for fees, but can also review the time spent by the IP and challenge this through committee if they are not content, leaving the IP having to reduce fees or go to Court to have them fixed. The reforms introduced last year should be given sufficient time to take effect, while Government departments and agencies that account for more than a quarter of unsecured debt should take the lead in showing just how powerful unsecured creditors can be - influencing decisions at the time of their making and not simply complaining with the benefit of hindsight.

- IPs do not have a duty to any individual creditor. Their duty, as set down by statute, is to act for the body of creditors as a whole. The current system of setting fees reflects this, by enabling creditors - as a group - to determine fees. It effectively enables the majority to impose its will on the minority. A complaints body with the ability to review fees would turn this on its head, giving an individual creditor the power to revise the fees agreed, under statute, by the body of creditors as a whole. As the cost of unfounded complaints would be paid for out of the estate, a fee review body would effectively encourage individual creditors (the minority) to make fee complaints even though this may detrimentally impact other creditors (the majority).

- Any complaints body capable of reducing fees is likely to become quasi-judicial as IPs and complainants would appoint lawyers to argue their case. This would create an overall rise in participation costs and would defeat the main argument behind having a separate system outside of the existing court process.

  We are extremely concerned about a fee review system that would be free to complainants would open up a gravy train for 'no-win-no-fee' ambulance chasing lawyers and agents (see Q6).

- Unless a fee-review process is designed and implemented in a sensible manner, it may result in a 'cramdown' of IP fees across the board. Although this may seem like a desirable outcome for creditors, it may to have the unintended consequence of encouraging qualified IPs to exit the market, resulting in a lack of choice, or a poor choice, for the creditor (consumer). There is precedent for this in the personal insolvency market - as fees have been pushed down by creditor agents, many qualified IPs have exited the market, leaving unqualified advisors and lesser regulated providers of debt management solutions to fill the void. This may set a dangerous precedent for the corporate insolvency market.

- IPs may apply to the Court to have their fees fixed if they do not get creditor approval. It is unclear how having fees fixed before the process would sit with after-the-event fee review. It is assumed that the Court would still be the final arbiter and would thus override the decision of a fee review body/process.

For the reasons cited above, we are strongly opposed to an after the event fee-review process. We believe the policy objective - harnessing the market power of unsecured creditors - can be better achieved through a non-regulatory solution (see below). Despite this, we recognise that a fee review body could be an outcome of the consultation process due to the perennial Government desire to be seen to 'do something'. If this policy is pursued, we are keen to ensure it is implemented as sensibly and effectively as possible (see Q6, Q12 and Q14).

We would like to propose a non-regulatory policy to significantly increase unsecured creditor engagement in insolvency and influence over IP fees. We would like the Government departments who are major unsecured creditors in most insolvency cases (e.g. HMRC and the RPS) to better exert their considerable market power. This could include setting up their own fee review teams internally to consider IP fees, much like the existing Voluntary Arrangements Service (VAS) which employs a core staff to ensure the optimal returns for creditors in CVAs and IVAs. The VAS model works well as its staff actively engage in dialogue with IPs and become an experienced body comparing IPs and their outputs in different cases. A similar fee review team would soon achieve the experience and knowledge to challenge fees which would empower and protect unsecured creditors. A fee review team within a Government department could also take action on behalf of other creditors in cases where they have, say, more than 10% of claims.

This approach would be a pragmatic and effective solution to the perceived concerns about the status quo. It does not require legislation or additional regulation, and would enhance rather than undermine the existing fee setting process. Although this would involve an initial set up and running cost, it should pay for itself by ensuring enhanced dividends.

Q.5 Should all fee complaints be reviewed in this manner, or should some (such as more complex cases) be reserved to the court? Who would decide the criteria in individual cases?

If a fee review body is established, it should be capable of dealing with all types of cases.

Q.6 How should the costs of a fee related complaint be paid where i) the IP is found to have overcharged and ii) where they are found not to have overcharged?

We are extremely concerned about a fee review system that would be free to complainants because this would open up a gravy train for 'no-win-no-fee' ambulance chasing lawyers and agents (ironically at a time when the Ministry of Justice is clamping down on this behavior). If a complainant's costs are paid by the insolvent estate if they lose, 'no-win-no-fee' lawyers would jump on the back of every insolvency case to persuade creditors to challenge the IP's fees. The unintended consequence of a laudable policy aim would be extremely damaging, as the fee review process would become congested, insolvency cases would be prolonged, distributions could be delayed and overall returns to creditors would be reduced.

Even setting aside the likely actions of 'no-win-no-fee' lawyers, a system that is free to the complainant even if they lose is likely to have a detrimental effect on creditor returns. If the costs of making a complaint that turns out to be unfounded are met by the insolvent estate, a raft of unfounded complaints could be made in each insolvency case, the cost of which would effectively be borne by other creditors, reducing their returns (through the estate). The system would effectively encourage individual creditors to make fee related complaints even though this may detrimentally affect other creditors. We estimate that between £2 million and £13 million each year would be paid out of insolvent estate each year to cover the cost of unfounded fee complaints (see Q1).

To guard against this state of affairs, a fee-review complaint system should stipulate that the legal costs of the process would be met by the applicant if they lose their case. Although this may be undesirable, the consequences of not taking this precautionary measure would be highly damaging to the creditor community and overall efficacy of the insolvency regime.

Q.7 What are your views on the single first tier independent complaints body model? Do you agree with the benefits and disadvantages that we have set out? What are your thoughts on the relative importance of the positives and negatives?

In considering all models, our response assumes that it will not have the ability to review IP fees.

Model one is a very risky approach and stands in opposition to the stated Government policy of reducing regulation.

- Model one would replace a system that even the OFT argues works well for the majority of creditors with a new untested quango, at a time when Government policy centres on reducing bureaucracy.
- Any appeal against the complaints body's decisions would require going to court. Unless the body had the confidence of the profession, it is likely that a considerable proportion of its decisions would be challenged by IPs in the courts, consuming significant resources and court time. Our estimates suggest that this model would require the body to pay £200,000 for legal contingency and £350,000 for the costs of court annually, assuming 35 appeals.
- The OFT report was extremely critical of the current system's requirement that appeals against RPB decisions must be made to the Court, citing its prohibitive expense for complainants. Model one removes the right of appeal that exists in the current regulatory structure within the RPBs which exacerbates, rather than remedies, the perceived 'flaw' identified by the OFT.
- Model one removes the link between complaints handling and monitoring. Currently, if the RPBs receive a complaint, they can accelerate monitoring activity on the IP concerned and as a result, disciplinary activity can occur more quickly. This is much harder to achieve under model one as it would require a dialogue between the new body and the RPBs (matters such as gaining legal clearance could easily hold up the process).
- As model one essentially replaces the existing regulatory framework, it is an extremely risky approach. Unless it is staffed by those who fully understand insolvency, complaints based on a misunderstanding of the role and function of IPs would be heard rather than filtered out, at considerable cost to the profession and insolvent estates.
- Although a key advantage to this model is that it would appear more accessible, a single point of entry for complaints could be easily achieved within the existing system. This is a role the IS could take, funded by the profession.
- Model one would require primary legislation, while all other models could be achieved without this.
- Under model one as we understand it, it is envisaged that members of the profession would not have any involvement at all. If model one is to be implemented, it is vital that the Government reconsiders inclusion of practitioner involvement (see Q3).

The OFT study found a lack of confidence among creditors because they believe the existing complaints system lacks independence. The restoration of creditor trust is therefore a primary reason given for establishing a new independent complaints body. While we see the merit in greater independence in the regulatory system, we would guard against perceiving increased creditor confidence in the system as a result of this reform.

Creditors often distrust the system because they have 'lost out' in insolvency and therefore need 'someone to blame', even if the IP on the case has abided by the laws and regulations to which they are subject. IPs frequently have to make decisions that are unpalatable to a single creditor (e.g. R.O.T) but in the interests of the body of creditors as a whole; or are unable - because of the statutory order of priority - to give certain classes of creditor the level of returns they believe they deserve. This can lead to a range of understandable, but ultimately unfounded claims that there should be 'someone independent' to complain to. If an independent complaints body acts in an appropriate manner, it would reach the same conclusions as the existing RPBs and the Courts in cases of this nature. While it may be helpful for creditors to hear the same decisions from a body they accept is independent rather than from the RPBs, a new body may still be unable to resolve feelings of resentment caused by insolvency among creditors and consequent claims that the system is 'broke'. As such, it may be unwise to use this as a basis to justify wholesale revision.

Q.8 What are your views on the independent appeals body model? Do you agree with the benefits and disadvantages that we have set out? What are your thoughts on the relative importance of the positives and negatives?

We favour model two because it retains the expertise of the existing system, while ensuring an appropriate degree of independence.

- An independent appeals board should be considered sufficiently independent to satisfy perceived complainant desire to have recourse to an accessible 'outside the profession' complaints body. It must be remembered that the OFT found the current system works well in the majority of cases.

- Model two retains the best of the current system, including the expertise and experience of the RPBs.

- Model two contains appeal within the system, rather than requiring complainants to go to court for appeal. This is more accessible for complainants and therefore addresses the OFT's concerns about the cost of appealing decisions in the courts.

- Many complaints that arrive to RPBs are based on a misconception about the role and function of an IP. Under model two, the RPBs can act as a filter for these complaints.

- Under model two, an independent hearing would only take place after the complainant goes through the RPBs. This would require complainants to demonstrate their commitment to their complaint rather than just 'trying their luck', which would help to protect against frivolous complaints.

- Over time, the RPBs would become more consistent in their decision-making as the appeal body's decisions accumulate and the RPBs acclimatise to them. If the Service's stated intention to eventually reduce the number of regulators comes to fruition, this would further enhance consistency.

Q.9 What are your views on the decision making body model? Do you agree with the benefits and disadvantages that we have set out? What are your thoughts on the relative importance of the positives and negatives?

Similarly, model three is a desirable option:

- It contains sufficient independence to meet the perceived need for greater 'outside the profession' influence.
- Meanwhile, it retains the expertise of the RPB investigatory teams which should aid its ability to uncover any wrongdoing.
- Model three fits well with the existing system's structure. As such, it could be easily achieved without legislation and in a cost-effective manner.
- As the decision making body hears all complaints regardless of which RPBs carry out the investigatory work, this model would achieve consistency.
- Model two is perhaps preferable as its appeals would not be through the courts.

Q.10 What are your views on the decision making body overlaid with an investigative appeals function model? Do you agree with the benefits and disadvantages that we have set out? What are your thoughts on the relative importance of the positives and negatives?

Model four is also a desirable option, containing many of the benefits of models two and three and avoiding the flaws of model one. It would achieve consistency, retains the expertise of the current system, could be achieved without legislation, and contains appeal within the system rather than through the courts. With independence at both the decision making and appeals stage, it certainly meets the perceived need for this quality.

Q.11 Should the appeals or decision making body also act as the single point of entry for all complaints?

Yes. To ensure the system is easy to navigate for those outside the profession, it would be sensible to have one portal for all complaints. After this initial point of entry, complaints should then be directed to the relevant body. The single point of entry is a role the IS could take, with financial assistance from the profession. It could also potentially act as a gateway, filtering the most obviously misdirected and unfounded complaints in the first instance, and could also be a central portal for publishing the disciplinary decisions taken by all RPBs.

Q.12 Do you think that settling fee complaints through arbitration would bring advantages over the other suggested complaint models? Do you think any other alternative dispute resolution regimes may work better, i.e. conciliation?

Yes. Arbitration is one of our preferred routes for fee-related complaints:

- In arbitration, there is always an outcome agreed at the end of the process that both parties have to accept. The decision of the arbitrator is binding and cannot be appealed (except procedural irregularity or error of law). Arbitration would therefore complete the fee-review process and bring it to a definite end.
- Arbitration is a 'tried and tested' process for resolving disputes - including over fees - and is extremely well respected by professionals and laymen alike.

- By definition, arbitrators are entirely independent - a key criterion of any fee-review process.

- Insolvency is such a complicated field that disputes arising over fees require an excellent understanding of insolvency process as a whole (including legal matters, commercial decisions and accountancy). Typically - and where used in other fields - arbitrators have considerable experience and expertise, and are imbued with the skill set to understand both sides of a dispute, weigh up competing arguments and come to a decision. Given the complex nature of insolvency, expert arbitrators are in a far better position to preside over disputes than a body set up to examine fee complaints.

- Unlike the other models put forward, arbitration would involve a degree of thought and commitment from the complainant. This would act as a natural filter to ensure it is used by those with genuine grievances rather than vexatious complainants.

- Arbitration is less bureaucratic than any of the other options proposed. This would sit well with the Coalition desire to cut 'red tape' and simplify regulation across Government.

Clearly it is important that an arbitration system is designed to be as simple as possible for complainants, which is achievable if designed correctly. The arbitrator should exercise the same discretion as the Court currently does over who would pay the costs if the IP is found to have materially overcharged, but the system itself (e.g. the secretariat) should be funded by the insolvency profession.

We would also like to propose a fast-track fee review panel which would be able to determine fee complaints swiftly, consistently and cost-effectively. The panel would comprise a lay Chair, two lay members and two IPs to ensure balance, expertise and independent input. Upon receipt of a fee complaint, the panel would request documentation from the IP (e.g. basis of fee approval, minutes of meetings, reports to creditors and committees, receipts and payments accounts, explanation of fees by IP), advising the relevant RPB of their action. Using their expertise in relation to the information received, the panel would determine whether the fee was in the bounds of what would be a reasonable level for the kind of case, bearing in mind its nature and complexity - a 'benchmark rate'. If they determine it is a fair rate, the panel will not take any further action (without prejudice to other remedies available to creditors - e.g. the creditor may still apply to court if he wishes). If the panel consider the fee charged was not reasonable for the case in question, the panel would make a determination, requiring the IP to either refund the proportion of the fees that it determines to be excessive or apply to the court for review or approval of fees.

The fast-track process:

- Could manage a large volume of cases;

- Would ensure a quick process and definite outcome for all parties;

- Could set precedents which can change behaviour;

- Is sufficiently independent through majority lay membership

- Retains the expertise of the profession;

- Puts the onus on the IP to go to Court if they are not content with the outcome. This addresses the OFT's main concern that taking a case to court if daunting and costly for creditors.

Q.13 How many complaints (fee and non-fee related) do you expect to be made annually?

We estimate a total of 1,000 non-fee related complaints each year and 2,000 fee related complaints annually (Q1).

Q.14 What safeguards would be appropriate to protect against frivolous or vexatious complaints? Would requiring the support of 10% of creditors (by value) be appropriate?

If a fee-review complaints process were to be accessed without cost to the complainant, there are likely to be a vast number of vexatious complainants by the very nature of insolvency and the feelings of frustration and anger it can naturally engender. Ensuring that the system protects against vexatious complaints is important because unfounded fee complaints will be paid for by other creditors involved in insolvent estates. Unless a sufficient filter is in place, unfounded complaints will rapidly consume the returns for other creditors. This is likely to be exacerbated because ambulance chasing lawyers and advisors will approach creditors (their details are publicly available) to persuade them to make a challenge in the hope that they can enhance their returns if the complaint is upheld, and at a cost to the estate if they lose. Sensible safeguards are therefore imperative:

- <u>Percentage threshold:</u> 10% of creditors (by value) seems a reasonable threshold for complaints to be heard, bringing the proposed out-of-court process in line with the current court provision. Consideration must be given to how this 10% is calculated, as in many cases the IP will not have an agreed list of creditors and the statement of affairs figure for total creditors is notoriously unreliable. Additionally, we are concerned that a percentage threshold alone would not protect sufficiently against vexatious complaints because it could be rendered ineffective if debts are acquired for the purpose of mounting a challenge (i.e. companies will be able to buy creditors' debts in order to make a fee complaint).

- <u>Time limits:</u> There should also be a time limit for making fee-related complaints. This is important because once an insolvency case is concluded, an IP is released from liability and has no continuing power. We suggest that 8 weeks before the proposed conclusion of the case would be a sensible time limit for making complaints, again bringing the out-of-court process in line with the court-based complaints system and ensuring that fee complainants cannot prolong a case to the detriment of other creditors.

- <u>Demonstrating an interest:</u> We believe that complainants should have to demonstrate an economic interest in order to be eligible to make a complaint - they would have to show that the returns they received in a case were affected by the level of IP fees, such that had the IP fees been lower, they would have received higher returns, or any return at all (i.e. that they stood a chance of being 'in the money'). This would filter out genuine cases.

- Engagement during insolvency: It is important that the complaints process does not become a complete alternative to using the engagement mechanisms available during insolvency. As such, the process should define the responsibilities of the complainant by taking into account the extent to which the complainant has engaged with the insolvency process so far (e.g. taking simple steps like attending creditors meetings, putting themselves forward for committee membership and voting on resolutions setting the basis of remuneration). If prior participation is not taken into account, there would be no incentive for creditors to engage in the insolvency process at all until the very end - which is counter to public policy and highly inefficient.

The more unfounded complaints that enter the system, the more creditors will lose out as the cost of unfounded complaints is covered by insolvent estates. Protecting against vexatious complaints would reduce the cost to insolvent estates because fewer unfounded complaints would enter the system. We estimate that introducing a 10% hurdle would reduce the annual cost from up to £13 million to £6 million. Introducing a requirement to demonstrate an economic interest would have the same effect. Introducing both requirements simultaneously could reduce the cost to insolvent estates to just under £5 million annually.

We appreciate that the complaints system should be as accessible as possible for those with genuine grievances, but this must be balanced with sensible safeguards unless unfounded complaints congest the process at significant cost to other creditors. The safeguards do not have to be onerous - a simple form should suffice.

Q.15 What are your views on the location of the body tasked with carrying out the complaints function? Is the Insolvency Service or the Adjudicator's Office suitable to undertake the role of the appeals body? If you have chosen the creation of a new body please explain your reasons for rejecting the alternative options.

If an independent complaints body it to be pursued, it should comprise individuals who have experience and expertise working in the insolvency profession as well as lay-members or other professionals, so that they understand the commercial pressures, legal and accounting aspects of insolvency work, and can therefore take decisions appropriately.

Although the Service clearly engages in insolvency processes, we do not consider that it would fit the criteria, lacking any experience of IVAs or complex corporate insolvency case work. The Adjudicator's Office is even less well placed, dealing only with public bodies at present and therefore far removed from the commercial nature of insolvency. The Office lacks any experience of insolvency at all and their remit is simply to see whether the bodies they hear complaints about have followed their own procedures. Neither of these bodies is suitable to carry out a complaints function.

We would prefer a new independent panel appointed by the Insolvency Service, comprising lay members and expertise from the profession (see Q3 and Q12).

Q.16 Which of the funding models (A – D) would be most appropriate for the complaint body? Can you suggest any alternative funding model? Do you agree with the suggestion to fund the establishment of the body by a levy on each RPB according to its number of IP members?

At this stage, we would expect a complaints body/fee setting system to be funded by the insolvency profession via a levy on the RPBs. This seems equitable as long as there are adequate protections against vexatious complaints and as long as the body comprises a majority of members who have understanding and experience of the nature of insolvency work.

It should be noted that, as with other costs of regulation, a subsidy paid by IPs to the RPBs to help fund a complaints system or fee-assessing body will essentially add to the overheads of an IP's business. Ironically, but necessarily, IPs will seek to recover this through a change to their charge-out rates (i.e. a fee increase).

Q.17 Do you agree that it would be helpful to set objectives for the regulatory regime? What objectives would you favour?

There can be no objection to setting objectives for the regulatory regime, provided they are confined to determining the way regulation is designed and implemented. However, regulatory objectives should not be confused with the objectives of insolvency policy.

Policy is about deciding what the aims and objectives of the statutory insolvency regime ought to be, the respective rights of the various affected parties, and other matters of wide public interest and economic significance, including the framework within which insolvency office holders carry out their functions. Professional regulation is concerned with providing a system of rules and procedures to ensure that insolvency practitioners carry out their role within the statutory framework competently, professionally and ethically thereby fulfilling the policy objectives. Regulation should not be used as a policy making tool; albeit policy can underlie the way regulation is designed and implemented.

If objectives are to be set for the regulatory regime, it is vital that they are entirely compatible with existing insolvency legislation and do not contradict the existing statutory duties of an IP. With this in mind, we welcome the first two objectives stated in 4.9 but suggest that three and four could turn out to be incompatible, or in conflict, with office holders' statutory duties under insolvency legislation. For example, it is well established that office holders owe duties to creditors as a class, and not to any individual creditor. An office holder may act in a way which is perceived as harmful to an individual creditor, thereby potentially contravening objective four (protecting the interests of vulnerable creditors), whilst acting properly in accordance with his statutory duties to the creditors as a whole. The objective of correcting market failure by protecting vulnerable creditors should not inform regulation because insolvency legislation clearly sets out the way each creditor class should be treated by IPs. To seek to change the rights of creditors would effectively be using regulation as a way of reversing the effects of existing policy as set down by statute.

Q.18 Do you agree that the IS should no longer act as direct regulator, except as regulator of last resort if no RPB existed? Should any other changes be made to the number of regulatory bodies?

Yes. We have previously expressed concerns that the Service's role as authorising body may impede its ability to perform the more important role of 'regulator of regulators'. Relinquishing their licensing function should enable the Service to focus more on their supervisory role, and we therefore support this proposal.

Ideally, changes should be made to the number of regulatory bodies. We would welcome a rationalisation in the number of regulators (see Q2 and Q3).

Q.19 Do you agree the oversight regulator should be given increased powers to monitor and sanction? If so do you agree these should include the power to fine RPBs, the power to issue a formal reprimand and the power to publicise enforcement action?

Yes. A range of sanctions would better enable the IS to monitor the RPBs and ensure high standards are maintained.

Q.20 Should the cost of oversight be recovered by a combination of fixed and variable charges to the RPBs?

Yes, we agree that this would more accurately reflect the actual cost of regulation. This may in time lead to a rationalisation of regulators, which we endorse.

Q.21 Do you agree that the oversight regulator should be given greater powers to influence the setting of standards? If so are the suggested powers of veto and a positive power to direct standards, appropriate powers to give? If not what powers would be appropriate?

No. As oversight regulator, the IS should focus on regulating the regulators to ensure high standards are met, rather than directly setting standards. As we argue in our response to Q23, standard setting should be carried out by practitioners, with appropriate lay input. Where a standard or regulatory action is disliked by the Service their sanction should lie in action against the RPBs rather than in the imposition of a standard or a veto.

Q.22 Is the oversight regulator best placed to ensure the regulatory objectives are being met?

Yes, the oversight regulator ought to be best placed to ensure the regulatory objectives are being met by the RPBs.

Q.23 Do you support the proposal to establish a new standard setting board to replace the JIC? What membership should it comprise?

If there is to be a new standard setting body we would prefer to see it take the form of a modified and augmented version of the JIC, which would also take on the coordination of regulatory action in other areas.

There has always needed to be a forum for discussion of issues of common interest and concern and the coordination of joint initiatives by the different RPBs. At present, the Joint Insolvency Committee acts as such a forum, but the need for a joint forum existed in the days before the formation of the JIC, and will continue to exist even if the JIC were disbanded.

Part of the function of the JIC is to coordinate the production of practice standards (in the days before the JIC practice standards were produced by a single body, the Society of Practitioners of Insolvency). Although the JIC is described in the consultation document as a standard setting body, it does not have a separate or distinct authority over and above the RPBs. The adoption, enforcement and monitoring of standards is a matter for the RPBs.

Practice standards are issued by the RPBs in the form of guidance set out in the Code of Ethics and Statements of Insolvency Practice (SIPs). SIPs set out the standards to which insolvency practitioners are required to work, and provide guidance to practitioners on how to meet the policy objectives of the insolvency legislation. As SIPs are intended as practical guidance to assist insolvency practitioners to do their job, they need to be produced by practitioners with appropriate qualifications and experience. The document suggests that a standards setting board should consult on guidance to ensure that a wide range of views is taken into account. However, there is limited scope for lay input into purely practical and technical guidance. You would not expect practical guidance on heart surgery to be produced by government or members of the public; you would expect it to be produced by heart surgeons. Practitioner input is therefore of primary importance.

We have no problem with standards being set to achieve the regulatory objectives, provided the objectives are purely regulatory, and do not stray into the field of policy (see Q17).

Furthermore, any new board set up to replace the JIC should not only be about practical and ethical standard setting, but will also have to cover the other regulatory matters currently dealt with by the JIC. The two tasks are necessarily linked; poorly drafted standards give rise to difficulties with regulation. The formation of two new Boards (the standard setters and the regulators) is therefore undesirable. In effect a JIC mark 2 with the same responsibilities as the existing JIC would seem to be the preferable option.

The following are some possible features of JIC mark 2 some of which reflect the suggestions set out in paragraphs 4.33 to 4.35 of the document:

- Lay representation consisting of a barrister, solicitor ICM, Consumer Association, BBA, ABI.
- It might be sensible to have a lay chairman.
- R3 (as representatives of the profession) and the Service (as Regulator of Regulators) should be there as non-voting participants. As noted, standards are promulgated for the RPBs to measure insolvency practitioners' performance and to guide practitioners. The Service role as Regulator of Regulators is to measure the RPBs' performance. It is important that the capacity in which the Service participates is properly understood.
- The participating RPB representatives should be from the RPB's members not the secretariats (as suggested at paragraph 4.34).
- The secretariat should be a part time role for a lawyer/accountant with insolvency experience.
- Funding should be by RPBs in proportion to their licence holders.
- Where voting is necessary proportional voting may be more appropriate.
- Where a standard or regulatory action is disliked by the Service their sanction should lie in action against the RPBs rather than in the imposition of a standard or a veto.

Q.24 Do you support the proposal to establish a new standard setting board to act as an advisory board to the oversight regulator? What membership should it comprise?

No. The establishment of a new advisory board is predicated on the oversight regulator setting standards. We believe a new standard setting board should have the power to set standards, rather than standards being set by the oversight regulator.

Q.25 Do you agree with the recommendation to fold the Insolvency Practices Council?

We see the merit in the existence of a public interest body which has oversight of the efficacy of the regulatory regime, including the performance of the Service. Given the Service's direct role in regulating IPs (albeit this is due to come to an end), their role as the predominant appointment takers in bankruptcy work, and their role as regulator of regulators, the Service is not in a position to fulfil this role itself as this would present a conflict of interest. We also agree with the IPC's contention that a regulator linked to a Government department can be subject to pressures from elsewhere in Government to use regulation as a policy making tool, which should be strongly resisted. This further highlights the undesirability of the IS taking the role of protecting the public interest.

Q.26 Do you think that increasing the level of the prescribed part would help to constrain IP fees for unsecured creditors? If so how do you propose this should be achieved?

It is too early to consider raising the level of the prescribed part. The carve out of funds for creditors created by the prescribed part only applies where floating charges were created after the 15th September 2003 so it will take a while for cases affected by it to 'trickle through' the system. The gradual working through of the prescribed part should be given a chance to occur and should then be evaluated before consideration is given to revising the level. The consultation document admits that the initial review in 2007 was too soon to assess the prescribed part's effects and no subsequent evaluation has taken place.

If the Service intends to increase the prescribed part by a considerable amount, they ought to consider the negative impact this would have on secured lending by eroding the value of the floating charge. This may be inadvisable at a time when access to finance is a critical concern for the business community and for Government.

The OFT is concerned about the level of fees where the charge-holder is repaid. Where that happens the prescribed part is irrelevant. Increasing the prescribed part would necessarily increase the number of cases where the charge-holder was not paid off but in many cases it would be irrelevant and would not achieve the policy objective of harnessing secured creditor power for the benefit of unsecured creditors.

If the prescribed part is increased by a relatively small degree, individual unsecured creditors in any insolvency case would barely see any difference to the dividend they receive (as any increase would be distributed between them all). It would therefore make very little difference to their overall returns or ability to constrain IP fees by retaining the floating charge holder's involvement for a longer time.

There are more effective mechanisms to influence IP fees, which are covered and supported by R3 in subsequent questions.

Q.27 Would you welcome greater transparency in the remuneration of IPs? Should the provision of further details be mandatory or upon request? Q.28 Do you favour hourly rates being agreed by creditors at the time of the resolution either specifically or subject to a maximum amount?

Yes. To empower creditors where fees are agreed on a time-cost basis, we believe IPs' hourly rates should be agreed by creditors at the time of resolution and that IPs should have the option to go back to creditors with a new resolution if their rates change at any point during the case.

It should be noted that, while we support creditor empowerment through the setting of hourly rates at the time of resolution, informing creditors of a change in rates or holding a meeting to agree fees again will inevitably result in a cost to the estate, which must be ultimately borne by creditors. We estimate this cost would be £3.8 million annually, rather than the £1.4 suggested in the consultation.

Q.29 Do you have any evidence that the administration process is being used where a CVL would be more appropriate? Q.30 Do you agree with the proposed approach of restricting paragraph 22 appointments and paragraph 14 appointments? If not do you have any alternative suggestions?

We do not consider this practice to be rife and therefore do not believe there is any need to restrict paragraph 22 appointments.

There are many reasons why cases which may seem more appropriate for CVL enter administration instead (in particular, the greater and immediate protection afforded against creditor distraint and other actions). Conversely, there may be cases which may appear more appropriate for administration entering a CVL instead when - for example - there is an urgent need to disclaim an asset or onerous contract. Each case is treated on its individual characteristics and circumstances.

One of the advantages of a CVL over an administration is that it allows creditors to hold a meeting to express their concerns to the director. We therefore believe it would be appropriate for directors to be required to attend an initial meeting of creditors in an administration, ensuring a consistent approach between the two procedures.

Q.31 Should creditors be given an opportunity to review the choice of an IP to act as liquidator, prior to the company converting from administration to CVL?

Yes. To increase transparency and creditor empowerment, this would rightly enable creditors to review the performance of the IP who acted as administrator and decide whether they wish to continue with the IP in question or appoint another. We suggest that when the administrator sends a final report to creditors, this should include a reminder of the intention to take on the role of liquidator (in the majority of cases, creditors would already have been made aware of this intention within the first 8 weeks of appointment). For a period of 28 days afterwards, creditors should have the opportunity to convene a meeting to object. This could be triggered if a certain proportion of creditors wish to pursue this (e.g. 10%). As the resolution is passed to appoint the IP, it would be sensible to agree a fee resolution concurrently.

Q.32 Does Rule 2.106 need further clarification?

No. The Rules provide clearly that a separate fees resolution must be taken under rule 2.106 in every case. Consequently we do not believe the rule needs any further clarification.

The OFT's suggestion seems to be that because the administrator's proposals have to contain a statement of the proposed basis of remuneration, where the proposals as a whole are approved, there is no need for a further resolution to fix the administrator's fees. This is not correct - rule 2.33 provides that the proposals must include a statement of 'the basis upon which it is proposed that the administrator's remuneration should be fixed *under Rule 2.106*' (emphasis added). It therefore clearly envisages that a separate resolution will be taken under Rule 2.106. It provides no warrant for supposing that approval of the proposals constitutes approval of the remuneration without a further resolution.

Q.33 Should IPs be required to provide an estimate of the duration and cost of the insolvency process at the outset? If Yes, should they publish the amount to which these estimates were exceeded?

Yes. To increase transparency and provide creditors with as much information as possible, we think is it reasonable for IPs to provide the best indication possible of the duration of the insolvency at the outset. It is important that IPs are not tied to these indicative cost estimates (unless of course the fee is fixed) because of the flexible and unpredictable nature of insolvency. Also, in some cases - e.g. those involving litigation or investigation - IPs will not have sufficient information to make a robust estimate, so those provided should be simply the 'best indication possible'.

We believe it is reasonable to require IPs to include in their reports to creditors the amount by which initial estimates were exceeded and the reasons for this, and consider that this should constitute sufficient 'publication'.

Q.34 Should any discounted hourly rates negotiated in an administration be applied to a subsequent CVL? If so, should this be mandated?

This question is based on a fundamental misunderstanding of the nature of discounting in insolvency cases. There is no evidence that discounting in the manner identified by the OFT occurs in practice:

- Where secured creditors get paid in full and there are funds available to unsecured creditor, unsecured creditors will have the opportunity to vote on the fee resolution both in administration and liquidation - this is rightly democratic. In these cases, and in cases where the IP is not sure whether or not there will be a surplus, the IP does not have the power to agree rates with secured creditors.

- In cases where the secured creditor does not get paid in full and there are no funds available for unsecured creditors, the secured creditors (and more than 50% of the preferential creditors by value) may negotiate a discount from the IP in view of the low returns they have received. This discount cannot be passed to the unsecured creditors because they would not share in the realisations.

Q.35 If an IP is unsuccessful in defending a challenge to his fees, should the costs be borne by the IP?

This question is also based on a misunderstanding of the status quo. Under the existing system, the court uses discretion to determine whether IP fees were excessive to a 'material extent'. If this is the case, the court can order the IP to pay all of the costs. The existing system, in which the court makes a judgement based on materiality, is objective and independent. It is reasonable for this to be maintained.

Q.36 Is there a need for clearer and more consistent information to be a) provided to creditors and b) filed at Companies House? How could this be achieved?

There is currently plenty of guidance which, if followed, should give creditors clear and extensive information. If there are concerns, they would best be addressed through regulation, education and training, and amendments to professional standards if necessary.