OFT market study into corporate insolvency: R3's response

In June 2010, the Office of Fair Trading (OFT) issued a report into the corporate insolvency market. The comprehensive study looked at every aspect of Insolvency Practitioner work. Its recommendations focus on the regulatory regime that governs and oversees Insolvency Practitioners (IPs).

R3, the insolvency trade body, challenges the basis of some of the conclusions drawn in the OFT's report, but appreciates that there is room for improvement in the current regulatory system.

We believe that certain regulatory changes - such as the introduction of a single regulatory framework and/or a rationalisation of regulators - would go a long way to addressing concerns about the status quo.

While we would welcome greater unsecured creditor engagement, we do not believe that establishment of a single complaints body would remedy perceived unsecured creditor frustration at IPs or the insolvency process - because this frustration is inextricably tied to the statutory order of priority, which a single complaints body could not change.

However, if a single complaints authority is to be established, we believe that complainants should have recourse to an independent appeals board or complaints committee that can hear complaints and discipline IPs. We do not believe that such an authority should review fees and award compensation.

This paper contains three sections:

We hope to work with Government to ensure that any changes to the existing regulatory regime are effective and reasonable; capable of retaining the best of the existing system while not under-estimating the need for the regulatory regime to modernise to address key concerns about its current operation.

Section 1: R3's questions and concerns regarding the OFT's report

The recommendations for certain changes to the regulatory system are based on concerns about the status quo highlighted by the OFT report. These centre on the ability of unsecured creditors to engage in formal insolvency processes, their apparent inability to constrain IP fees and the 'harm' that purportedly results. R3 challenges the basis of some of these conclusions.

The 'Prescribed Part'

The OFT report shows that the market works well in 63% of cases, but warned that in the remaining cases unsecured creditors have limited ability and incentive to engage in the insolvency process - receiving low returns and leaving them unable to exert significant influence over IPs' fees and actions.

We are concerned that using a relatively old data set (2006) leads the OFT to conclude that unsecured creditors receive lower returns than they in fact now do.

A reform called the 'Prescribed Part' was introduced in 2003 by the Enterprise Act 2002. As a result of this reform, a portion of realisations that would previously have been paid to the floating charge holder are now paid to the unsecured creditors. The reform effectively boosts returns to unsecured creditors.

However, the sample used by the OFT is not up-to-date enough to take its effects into account because a change like this takes time to have an impact (longer than three years). In fact, only 23 of the 500 cases looked at by the OFT involved 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. It therefore takes a while for cases affected by the Prescribed Part to 'trickle through' the system. This means that the OFT report is likely to have found that unsecured creditors receive smaller returns than they actually receive today, and to conclude that there is more of a cause for concern than there in fact is.

One of the OFT's key distinctions is between cases where secured creditors are paid in full and those where they are not. The report argues that where secured creditors are paid in full, IP fees are less constrained and returns are therefore smaller for unsecured creditors (because they are absorbed by fees).

However, the gradual 'working through' of the 'Prescribed Part' will decrease the number of cases where the secured creditors are paid in full. Consequently, it also increases the number of cases where - if the OFT's argument is to be believed - IP fees are larger and returns to unsecured creditors are smaller. The older sample used by the OFT is therefore likely to result in the analysis not being as reflective of the up to date position - and the resultant conclusions are likely to suggest that there is greater 'harm' than there actually is.

'Over-charging' and 'harm'

The OFT argues that unsecured creditors are 'over charged' because fees are apparently higher for them than secured creditors, which can otherwise be described as a 'harm' done to unsecured creditors.

The concept of 'over-charging' is predicated on the notion that there is a 'correct' fee level. It could equally be claimed that secured creditors are 'under-charged' (or simply charged less), rather than unsecured being 'over-charged'. In fact, this might be a more accurate view, given that secured creditors are often able - because of repeat work - to negotiate discounts from IPs. Such discounting is clearly standard practice in many business sectors.

The OFT argues that an IP has a duty to treat all creditors equally and that charging different rates for secured and unsecured creditors would constitute 'harm'. However, an IP's duty is to work in the interests of the *body of creditors as a whole*; their duty is not to treat creditors equally. In fact, in certain instances - and in full accordance with their over-arching duty - an IP may pursue a course of action that is in the interests of all the creditors, but that harms an individual creditor. In addition, the statutory 'order of priority' also dictates that creditors are not treated equally - the law gives priority to certain creditor classes over others. Treating all creditors equally is not part of an IPs role and function so this should not be used as part of an argument that claims that different treatment of various creditor classes is wrong – it may just be 'different'.

We question the basis on which the terms 'harm' and 'overcharge' are based and consider the use of these terms inaccurate and misleading.

Far from overcharging, it is worth noting that in many cases - where realisations are relatively low - IPs do not receive enough money to cover the costs of the work they carry out. In certain instances - where realisations are very low indeed - they remain entirely unpaid. The Companies House data used by the OFT shows that in around 80% of cases, IPs were not paid in full; and in 7% of cases, IPs did not receive any fee at all. This situation is highly anomalous - in no other industry or profession is it relatively accepted practice for professionals not be paid for work they have completed.

Findings relating to IP fees

The OFT report finds that IPs earn approximately £1 billion in fees from corporate insolvency processes, realising around £5billion worth of assets and distributing £4 billion to creditors. The report argues that fees paid to IPs are 9% higher when unsecured creditors bear the costs of the insolvency process than when secured creditors are not paid in full and they bear the costs of the insolvency process. This creates, the report estimates, a £15 million a year higher payment to IPs by unsecured creditors compared to secured.

The OFT argue that IP fees are 9% higher for unsecured rather than secured creditors, which equates to around £15 million (sections 4.94 and 4.95 and footnotes 88 and 89). The route to reach the 9% figure is a logical one, but the data present a correlation, rather than a causal relationship between fees charged and creditor class. Although the data only shows correlation, the OFT report argues that the 'overcharge' results from lack of unsecured creditor control over the fee setting process. As previously discussed, we do not agree with this contention, and there is no evidence to suggest that there is a causal relationship here - i.e. that unsecured creditors are charged higher fees because of their class status and ability to control the process.

We query some of the estimated figures produced by the OFT on IP fees. The OFT estimates that of the £5 billion a year that IPs realise from insolvency businesses, IPs earn around £1 billion in fees and return around £4 billion to creditors. The £1 billion figure has been reached on the basis of the fees

charged by 18 firms being extrapolated out for the whole industry. R3 would suggest that this sample is much too small to use as a basis for such an extrapolation.

We would also like understand which 18 firms provided this data to determine whether there is any reason why the fees charged by these insolvency firms are likely to be out of line with the rest of the industry.

We are also concerned that, if IPs realise around £5 billion from insolvent businesses, distributing £4 billion to creditors and earning £1 billion in fees, there is no room for the existence of other costs involved in an insolvency that are paid out of the realisations (£5 billion) - e.g. the expenses of the administration, agents' fees and solicitors' fees. This suggests that the OFT's estimates may be flawed, and that the £1 billion actually includes these related costs.

According to an Ernst & Young review of their firm's insolvency appointments taken over the last three years, the average return to preferential and unsecured creditors is 79.1% and 41.5% respectively. Anticipated fees for the appointments under review equate to 2.4% of the anticipated recoveries to creditors – a far cry from the 20% estimated in the OFT report.

Unsecured creditor engagement

The OFT report states that use of formal mechanisms for unsecured engagement is limited and that unsecured creditors therefore 'remain unable to constrain IPs' fees and actions'.

R3 would point out that there are a range of effective mechanisms open to unsecured creditors to engage in the insolvency process. Unsecured creditors frequently fail to take advantage of them.

Often cost or a lack of information is cited a reason for not using these opportunities for involvement. However, recent changes (introduced in April 2010) facilitate cost-effective ways of participating, and enable creditors to require more information from an IP about the basis for their fees. These changes are given scant regard in the OFT report (they occupy a footnote), but they reduce some of the perceived barriers to unsecured creditor engagement, and have the potential to increase unsecured creditor engagement – if only unsecured creditors want to take part.

Unsecured creditors often claim that there is no point in getting involved in the insolvency process because the level of debt they are owed is relatively small, and because they are unfamiliar with the process. However, HMRC debt accounts for 24% of total unsecured debt, and the department is often the main unsecured creditor in an insolvency case. Another significant unsecured creditor is the Redundancy Payments Office (RPO) – again part of a Government department. While we understand that certain unsecured creditors may find it difficult to engage in insolvency - due to lack of experience, size of debt or lack of familiarity with the process - it is hard to believe that Government departments cannot do so and are therefore disenfranchised.

In our experience, in most corporate insolvencies, HMRC and the Redundancy Payments Office do engage with the insolvency process - most usefully by voting by proxy and sometimes by attendance at meetings. Our experience does not therefore tally with the OFT's view that large and frequent creditors like HMRC '*suffer to some extent from the same problems of coordination as smaller*

unsecured creditors…often have a lack of understanding and information and are frustrated by procedural difficulties'.

R3 believes that the position of unsecured creditors in the priority order (as set down by statute) is the main reason behind their lack of confidence in the insolvency process, and their feelings of alienation and discontent. Unsecured creditors' claims certainly fall far down the priority order when an insolvent business's assets are distributed (subject to their participation in the 'Prescribed Part' which will entitle them to up to 20% of net floating charge realisations). In the majority of cases, there is simply not enough money to provide unsecured creditors with a return at all (because in an insolvency, there is rarely enough money to go around), and certainly not enough to provide them with the kinds of returns that creditors higher up in the priority order would receive. The crux of unsecured creditor engagement is the level of returns they stand to receive. This is a product of the statutory order or priority. No amount of regulatory change is capable of remedying this; it would require a change to the law, which would have an enormously detrimental effect on the lending climate in the UK.

Questionable findings relating to unsecured credit extension

The OFT report claims that 'some unsecured creditors say that if their recovery rate from insolvency increased, they would extend more credit'. R3 questions the validity of this suggestion. We are concerned that available evidence does not lend itself to this conclusion - which seems to have been made using certain questionable leaps of logic. We fear that the conclusion does not accurately or appropriately reflect the reality of the decision-making process involved in determining whether or not to extend credit. We are therefore unconvinced that a relatively small increase in returns to unsecured creditors would have a significant impact on the extension of credit in the UK.

- The OFT's survey of unsecured creditors shows that just 1% of unsecured creditors say they would be 'much more likely' to extend credit if they received a 10p in the pound increase in dividend in the event of insolvency and 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. These results suggest that returns in insolvency bear little relation to willingness to extend credit. Moreover, stating an intention to act in a survey is a far cry from actually taking that action in reality – i.e. actually extending more credit.

- 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 from extending credit by their cash flow, 58% say extending credit simply does not apply to the way they do business, and 36% cite fear of not being paid back for reasons other than insolvency as a factor impacting on their willingness to extend credit.

  R3 suggests that the decision over whether to extend credit is a result of a variety of factors, and the complex interplay between them. Although risk of insolvency is a factor, it is certainly not the primary reason affecting willingness to extend credit. We therefore doubt whether a change in the returns to unsecured creditors would have a significant impact on extension of credit in the UK.

- The report states that the IP 'overcharge' is £15m per year (£500m x 0.33 x 0.9). If unsecured debt averages £1.2m/case, (footnote 7, page 18) total unsecured debt on 3,832 cases would be £4.6bn (based on Table 1, page 19). We question whether a sum equivalent to 0.03% of debt would truly affect credit extension decisions.

Finally, we note that, according to the OFT's research, only around 15% of trade creditors have Trade Credit Insurance (citing cost as a key reason for not taking out a policy). This lack of insurance clearly leaves creditors in a more vulnerable position in the event of insolvency. It is within the gift of unsecured creditors to take out insurance - and thereby improve their position and ability to recover monies when affected by an insolvency. Insolvency is a risk of doing business, and businesses make a decision over the extent to which they protect themselves.

Inaccuracies in the report?

R3 is concerned that there are a few inaccuracies in the OFT's report, which we would like to address:

- In section 4.84, the OFT report states that 'the fact that the costs of IPs who come to court to have their remuneration assessed are allowable out of the assets, even if the costs claimed are excessive, appears to pose no deterrent to charging unjustifiably high fees where IPs are in a position to do this. The worst that can happen is they have to return the fees without incurring any of the costs of defending their case in court'.

  We believe that the OFT approach is too simplistic. While costs incurred by IPs are generally payable out of the estate, that is always at the discretion of the court. If it is the case that IPs are being awarded their costs out of the estate in such creditor actions, that can only be on the basis that the court considers that IP is entitled to those costs. IPs can - and do - have personal costs orders made against them by the Court.

- Section 4.52 of the report states that where a CVL follows administration there is no creditors' meeting and "the hourly rates that applied in administration will not necessarily apply in a subsequent CVL". Following the recent changes in the Insolvency Rules the basis of remuneration fixed in the administration will apply in the CVL (r.4.127(5A) Insolvency Rules 1986).

- In section 4.69, the report states that guidance sets out the time period by which IPs make creditors aware of their rights in relation to setting fees and the basis of remuneration – in fact, this is determined by a statutory notice period set by legislation.

- In section 3.17, the OFT report states that IPs are not bound by the hourly rates specified in their proposals. This is not quite correct. The rates are specified but can be increased if provision is made to do so in the relevant resolution.

Use of survey data

- R3 is concerned that in section 1.29, the OFT report states that '*a survey of IPs suggests that 72 per cent are in favour, in principle, of a single complaints handling body*'. In fact, the R3

survey asked whether IPs would like to see a single complaints system, not a single complaints body. We would like to emphasise that these are very different concepts.

- The OFT report implies a high level of perceived inconsistency among IPs between complaint handling within and across RPBs. However, the questions IPs were asked referred to consistency of approval in enforcement and monitoring of regulations - no mention is made of complaints.

Sampling and methodology concerns

- From one response to an OFT questionnaire by one court official, the OFT report claims that 'it is common for routine, unopposed applications by IPs to fix remuneration results in the IP getting what he applied for or something very close to it'. We are unconvinced that there is any evidence to suggest this is in fact the case and argue that no conclusion should be made on this basis.

- The OFT report estimates that there is £80 billion unsecured credit extended in the economy, explained in footnote 106. The figure is calculated from the online survey of creditors, where participants were asked about the proportion of turnover extended as unsecured credit. This proportion is then extrapolated for SMEs as a whole. Given that the sample of the survey is focused on businesses beyond the usual SME range (i.e. companies are included with more than 250 employees), R3 questions the OFT's decision to extrapolate using ONS data for SMEs' turnover.

Other concerns

- In section 6.6, the OFT report suggests that one of the objectives for the regulatory regime should be ensuring that 'IPs act in the wider public interest'. We would emphasise that the main function of an IP is to rescue companies and maximise returns to creditors. IPs do a very complex and difficult job, involving a intricate interplay between competing interests. In an insolvency, it is not uncommon for every party affected to believe that the IP has a duty to act in their best interests. This is not the case - an IP's main duties are to rescue the company, and to maximise returns for the body of creditors as a whole. To suggest that IPs should also have a duty to act in the wider public interest (however that loose concept may be defined) is to fundamentally fail to understand their role and function – unless, of course, acting in the public interest means facilitating company rescue or ensuring returns to creditors (which we consider it to).

- In section 6.23, the OFT claim that IPs face 'an overall lack of severe punishment' - yet IPs can have their licences withdrawn resulting in a loss of their existing cases and the opportunity to act as office holders in future cases.

Section 2: R3's broad view of regulation

R3 supports a regulatory regime that is effective, fair and consistent. We appreciate 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. We would welcome effective reform and rationalisation of the regulatory system, with the possibility of reducing the number of regulators and/or introducing a single regulatory framework, under which anyone advising on, and acting in, insolvency cases would operate.

There are practical and historical reasons why the current system of regulation has developed in the way it has – not least because there are three different jurisdictions (England and Wales, Scotland and Northern Ireland) with devolved responsibility for insolvency and differing insolvency regimes. Additionally, some firms comprise a variety of professionals (such as those working on tax and audit, as well as insolvency) and may therefore want to ensure that all their staff are regulated by one body able to cover the variety of disciplines; while by contrast, certain IPs believe it is beneficial to be regulated by a regulator with a specific focus on insolvency.

If the regulatory system is to be simplified, it is important to ensure that regulators remain independent of Government, and that they are aware of the commercial and practical realities of insolvency work.

We are concerned that the Insolvency Service's role as authorising body may impede their ability to perform the more important role of 'regulator of regulators'. We therefore support the OFT's proposal that the licensing function of the Insolvency Service should be removed to enable them to direct more time and resources to their supervisory role.

R3 fervently believes that the vast majority of Insolvency Practitioners carry out their statutory functions diligently and professionally; but, as with all industries, it is important that the regulatory regime is capable of strong enforcement to deal with misconduct in order to protect the integrity of the profession.

We believe the cost of regulation should be proportionate and that the administrative burden it imposes on Insolvency Practitioners should be kept to a minimum, to enable Insolvency Practitioners to concentrate on their primary function of maximising returns to creditors. As regulation inevitably creates costs through the bureaucratic burden of compliance, any new - as well as existing - regulations should be reviewed to ensure that they do not unnecessarily obstruct an IP's ability to secure returns to creditors.

R3 is firmly committed to an effective and transparent regulatory approach that facilitates and guarantees the environment necessary to allow IPs to perform their vital and important functions to the very best of their ability.

Section 3: An independent complaints body

The OFT study recommended a variety of changes to insolvency regulation, one of which is:

A. Establishing an independent complaints body to increase the efficacy and consistency of after-the-event complaint and review, restore creditor trust in the regulatory regime, and allow a cost-effective route of fee assessment.

We believe that certain regulatory changes - such as the introduction of a single regulatory framework and/or a rationalisation of regulators - would go a long way to negating the perceived need to establish a single complaints body.

We do not believe the establishment of a single complaints body would remedy any perceived unsecured creditor dissatisfaction with the status quo (directed towards IPs or the insolvency process) because their frustration is inextricably tied to the statutory order of priority, which a single complaints body could not change.

However, if a single complaints authority is to be established, we believe that it would be advisable that complainants should have recourse to an independent appeals board or complaints committee that can hear complaints and discipline IPs. We do not believe that such an authority should review fees and award compensation.

A simplified, more consistent regulatory system

The insolvency regulatory framework may appear complicated to those outside the profession. It can be argued that the sheer number of regulators can be confusing to potential complainants and difficult to navigate - creating the impression that the system is inaccessible. It has also been argued that there is inconsistency in the monitoring and enforcement actions of the various insolvency regulators (i.e. two Insolvency Practitioners could receive different sanctions on the back of the same complaint). The Joint Insolvency Committee seeks to increase consistency, but concerns persist.

- We would welcome effective reform and rationalisation of the regulatory system, with the possibility of reducing the number of regulators.

- We also encourage the RPBs to explore the possibility of working to a single regulatory framework to simplify the system and address concerns about inconsistency. This proposal is supported in principle by the profession - in a survey of over 300 Insolvency Practitioners in May 2010, 72% said they believed there should be a unified monitoring system, and single complaints and disciplinary system shared by all regulators.

A rationalisation of regulators, or a system whereby all RPBs work to a single regulatory framework has the potential to address key concerns about the accessibility and consistency of the current regulatory regime. A more effective and streamlined regulatory system would also go a long way to alleviating the perceived need for a single complaints authority.

Has the case for change been sufficiently well-made?

It is only advisable to establish a single complaints authority if the case for doing so is well made and capable of remedying concerns about the status quo. In this instance, the desire for change is motivated out of concern for unsecured creditors. Under the current system, creditors of all classes have many mechanisms open to them to allow them engage in the insolvency process - most of which are not court based. However, unsecured creditors often fail to use these opportunities. It is overly-indulgent to instigate a serious revision of the fee-setting system because unsecured creditors do not engage in it.

Unsecured creditors often claim that there is no point in getting involved in the insolvency process because the level of debt they are owed is relatively small, and because they are unfamiliar with the process. However, this cannot apply to all unsecured creditors - according to the OFT report, HMRC debt, for example, accounts for 24% of total unsecured debt, and the department is often a key unsecured creditor in an insolvency case. Another significant unsecured creditor is the Redundancy Payments Office (RPO) – again part of a Government department. While we understand that certain unsecured creditors may find it difficult to engage in insolvency - due to lack of experience, size of debt or lack of familiarity with the process - it is hard to believe that Government departments cannot do so and are therefore disenfranchised.

Key to unsecured creditor engagement is their comparatively low position in the statutory order of priority by which returns are distributed. It is unlikely that the establishment of a single complaints authority would be capable of 'lancing the boil' of unsecured creditor frustration at their inevitably low returns in event of insolvency.

Changes to the status quo – giving other changes a chance to bed in

We would welcome greater unsecured creditor engagement with insolvency, and believe it is a great shame that unsecured creditors do not tend to use the mechanisms available to them to do so. Unsecured creditor engagement has also been the subject of recent changes, which have not yet had sufficient time to take full effect. On the 6th April 2010, a range of measures to facilitate greater unsecured creditor participation in the insolvency process, and remove certain burdensome requirements to achieve cost savings that can be passed to creditors, were introduced. Given that these sets of changes seek to remedy some of the barriers to unsecured creditor engagement, it may be wise to assess their ability to affect change, before establishing a single complaints authority.

Someone to complain to

It can be argued that public confidence in the insolvency profession would increase if individuals had 'someone to complain to', a body or organisation that is completely independent of the profession.

However, many complaints about the insolvency profession stem from a lack of understanding of the role, function and legal position of an Insolvency Practitioner. It is highly likely that many complaints made to a single complaints authority would be wrongly-directed. By way of precedent, the Financial Ombudsman Service is continually faced with a considerable proportion of cases that are outside its jurisdiction, and it is likely that insolvency would attract an even higher proportion of unfounded complaints. We question the logic of insisting that the insolvency profession fund a new complaints authority because an IP's statutory function is misunderstood.

Most complaints are likely to come from creditors (usually unsecured) who believe they have a grievance against an IP. However, in some instances, IPs have to make decision that are unpalatable to a single creditor, but in the interests of the body of creditors as a whole - in line with their statutory duty. The courts have held, for instance, that where an administrator acted in a way that caused loss to an individual creditor (because the administrator terminated his contract to supply services) they were acting properly in accordance with their statutory duties, and the creditor was not entitled to be compensated or to receive special treatment. It is important to ensure that complaints that would be thrown out by the Courts are not ill-advisedly upheld by a single complaints authority, contravening legal precedent, without due regard for the official duties of an Insolvency Practitioner.

Independence: models for a single complaints authority

Although we believe that a more effective and streamlined regulatory system would negate the need for the creation of a single complaints authority, R3 has considered the OFT recommendation for such an authority and would like to share our ideas about how it might best be achieved, if it is to be taken on. We are keen to ensure that any reforms are practical, cost-effective and can be implemented swiftly, without resorting to legislation. As such, we recommend that either of the following options is given serious consideration:

Option one – RPB entry point with appeal board review

As with the current system, a complainant would take their complaint to the relevant RPB - the RPB would investigate the complaint and take a decision on the case.

If the complainant was dissatisfied at the end of this process, they would be able to escalate their complaint to an independent appeals board. The appeals board would be majority lay, but consist of a mixture of lay-members and Insolvency Practitioners. The Chair would be appointed by the Insolvency Service. The independent appeals board would hear the case, using the evidence collected from the RPBs, and take a decision on it.

Option two – single entry point, independent hearing, and further appeals process

The RPBs would pool their resources to create a 'complaints committee' – this would be the first port of call for a complainant (rather than individual RPBs). The committee would be at least part lay to ensure its independence and would work to an agreed single set of standards.

When a complaint is received, the complaints handling - i.e. the investigatory and background work - would still be done by the RPBs, but the independent, joint complaints committee would hear the case and make a decision.

There would be around 15 members of the Committee, with around 3-5 members hearing each case. If the complainant remained dissatisfied with the committee's decisions, a final appeal would be heard by the Committee, but the case would be heard by a different set of committee members than those involved in the first hearing.

We are attuned to the fact that those outside the profession fear that the current regulatory system amounts to 'IPs looking after their own' and this perception may damage the reputation of the profession. The introduction of a part-lay appeals board or complaints committee ought to increase confidence (of the public and creditors of all classes) that decisions made regarding IP conduct are impartial, consistent and transparent, secure in the knowledge that the system is sufficiently independent of the profession.

Recourse to the Courts

An IP must still have recourse to the Courts if they wish to challenge the decision of the appeals board or complaints committee. The Courts should have the power to over-rule the decisions of the appeals board or committee. This is an important aspect of the system because it would act as a check on the appeals board or committee to ensure it makes sensible decisions in accordance with the law.

Engagement before complaint and appeal

It is important that the appeals process does not become a complete alternative to using the engagement mechanisms available during insolvency. As such, the appeals body should only hear cases in which a complainant has already exhausted the existing complaints system. As precedent, the Financial Services Ombudsman and the Energy Ombudsman abide by similar principles.

The appeals body should also 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). 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.

Mechanisms must also be put in place to guard against persistent or malicious 'abusers' of the complaints process.

Lay-membership of an appeals board or complaints committee

An appeals board or Complaints Committee should include a mixture of insolvency practitioners and lay-members. Ensuring the board or committee is at least partly lay is crucial in achieving its independence, but it is also extremely important that the body includes members of the insolvency profession. This is advisable because:

- For an appeals board or complaints committee to be credible and just, it is important that at least some members of it are aware 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. It would be near impossible - and highly unfair - to judge IP conduct and decision-making with the benefit of hindsight without sufficient expertise to do so.

- Most complaints are likely to come from creditors (usually unsecured) who believe they have a grievance against an IP. However, in some instances, IPs have to make decision that are unpalatable to a single creditor, but in the interests of the body of creditors as a whole -

in line with their statutory duty. The courts have held, for instance, that where an administrator acted in a way that caused loss to an individual creditor (because the administrator terminated his contract to supply services) they were acting properly in accordance with their statutory duties, and the creditor was not entitled to be compensated or to receive special treatment. If an appeals body does not contain individuals with sufficient expertise, it is likely that complaints that would be thrown out by the Courts may be ill-advisedly held, contravening legal precedent and without due regard for the official duties of an Insolvency Practitioner.

- Many complaints stem from a lack of understanding of the role, function and legal position of an Insolvency Practitioner. It is highly likely that many complaints made to an appeals body would be wrongly-directed. By way of precedent, the Financial Ombudsman Service is continually faced with a considerable proportion of cases that are outside its jurisdiction, and it is likely that insolvency would attract an even higher proportion of unfounded complaints. It is therefore crucially important that members of the appeals body are able to distinguish between genuine complaints and cases in which the IPs' conduct was not against the law or regulations to which they are subject.

Funding

The OFT report recommends that an appeals body is funded by the insolvency profession. We believe that an appeals board or complaints committee would be a relatively cost-effective solution to the concerns about a lack of independence in the existing regulatory system. To cover any modest additional costs, we envisage the RPBs pursuing a small increase in costs charged to Insolvency Practitioners when they obtain and renew their licences.

Fees and compensation

We do not believe that such an authority should review fees and award compensation, for the following reasons:

- 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. An appeals board or complaints committee with the ability to review fees would turn this on its head, giving an individual creditor the power to revise the fees agreed by the body of creditors as a whole.

- An appeals board or complaints committee with the ability to review fees would risk rendering the existing fee-setting process entirely irrelevant and could actively discourage creditors from engaging with the insolvency process until the very end. After all, why bother to get involved during the process if there is a simpler method open for use 'after the event'? This would be contrary to existing public policy, highly inefficient and unfair on creditors who engaged during the process.

- For fear of the fee review process, IPs would be likely to seek sanction in the Court to have their fees fixed in the first place. This would render the appeals board or complaints

committee's powers to review fees useless, while taking Court time and increasing costs for creditors.

- It is not common practice in other industries for fees to be agreed, but later revised as a result of an appeal. The only body in the UK, as far as we are aware, that has this power is the Legal Ombudsman. This is a newly created body, so this process has not yet been tried and tested.

  Indeed, when reviewing fees, the Legal Ombudsman makes decisions based on what seems reasonable and fair for the service provided, looking at the terms initially agreed between the complainant and the lawyer, and making a comparison between the charges levied and the service provided. The OFT seems to be suggesting that assessment of IP fees should work by an entirely different process – i.e. by referring to some kind of 'correct' fee level, an independent assessor would have the power to reduce IP fees if they are thought to be too 'high'. IP fees are currently determined by a free market and are the product of a negotiating process between the practitioner and the creditors (both secured and unsecured). If a fee-assessing body were established, on what basis would it decide whether fees are too low or too high? The notion of fee assessing assumes that there is a 'correct' level at which fees for insolvency work should be set. However, insolvency cases vary enormously and different kinds/complexity of work requires differing levels of expertise and time - consequently the fees which creditors agree vary from case to case.

- Unlike other industries where compensation is awarded, there is no client/customer relationship between an Insolvency Practitioner and potential complainants in cases in which an Insolvency Practitioner acts as an office holder. In other industries, the notion of compensation is predicated on the basis that the person against whom a complaint is brought provides a service to, and owes some sort of duty to, the complainant - if this person falls short, he or she can be required to pay compensation. However, IPs do not provide a service: they perform a statutory function.

  IPs' duties are creditor-class-based and they are required to act in the interests of the body of creditors as a whole - they do not owe a duty to any individual creditor. In some instances, IPs have to make decisions that are unpalatable to a single creditor, but in the interests of the body of creditors as a whole. As such, an individual award of compensation would be contrary to the long-established principle that the IP owes his/her duty to the creditors body as a whole, rather than to an individual creditor.

  Presumably, if compensation were to be awarded to creditors, it would have to be awarded to all creditors on a collective basis - except in rare instances in which a creditor can prove that they have been disadvantaged more than any other creditor. This process would be highly complex, especially if an insolvency case has closed by the time compensation is awarded. In these instances, it would presumably be up to the appeals board or complaints committee to distribute the compensation award among creditors, according to their class. This process would be technical and time-consuming, and would rely on the paper-work being readily available.

- Once an insolvency case is concluded, an IP is released from liability. The timing of any compensatory process is therefore extremely important. Precedent would suggest that an appeals board or committee would take a certain length of time to hear a case - but if there are lengthy delays, an IP may no longer be legally liable for his/her actions during the case. To avoid this situation, there would presumably have to be a specific time-frame in which a complainant would have to submit their complaint, and a specific time limit in which the board or committee would have to hear it. The release from liability would also affect the timing of complaints about fees - presumably complaints about fees would have to be made before a case closes to fit with this release and to avoid the practical complexities of re-opening a closed case.

- Any appeals process capable of awarding compensation would undoubtedly become quasi-judicial as Insolvency Practitioners would appoint lawyers to argue their case. This would create an overall rise in participation costs and defeats the main argument behind having a separate system outside of the existing court process.

Conclusion

We appreciate concerns that the existing regulatory set-up can be difficult to navigate for complainants, that there may inconsistency between regulators, and a lack of independent oversight. We believe that certain regulatory changes - such as the introduction of a single regulatory framework and/or a rationalisation of regulators - would go a long way to addressing these concerns.

We welcome greater unsecured creditor engagement in insolvency, and look forward to the impact that recent and upcoming changes are likely to have in encouraging this.

However, we do not believe that establishment of a single complaints body would remedy perceived unsecured creditor frustration dissatisfaction with the status quo (directed towards IPs or the insolvency process) because their frustration is inextricably tied to the statutory order of priority, which a single complaints body could not change.

If a single complaints authority is to be established, we believe that complainants should have recourse to an independent appeals board or complaints committee that can hear complaints and discipline IPs. We do not believe that such an authority should review fees and award compensation.