Policy Unit
Insolvency Service

By email only

21 March 2014

Dear Sir/Madam

Strengthening the regulatory regime & fee structure for insolvency practitioners

We welcome the opportunity to respond to this consultation.

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality for corporate reporting and governance. As part of this role we provide independent statutory oversight of the regulation of auditors by the Recognised Supervisory Bodies (RSBs). We also oversee, on a non-statutory basis, the way in which the RSBs plus two other professional bodies regulate their members outside of audit. Four of these bodies are also Recognised Professional Bodies (RPBs) for the purpose of insolvency and we have a keen interest in the work of the Insolvency Service in this area. We also operate an independent disciplinary scheme which investigates those cases of potential misconduct by auditors, chartered accountants and actuaries which are deemed to raise important issues affecting the UK public interest.

In strengthening the current regime for insolvency, it is important to avoid regulatory gaps and to minimise overlap between the various regulators in this area. We have confined our detailed response to the first section of the consultation (on strengthening the regulatory regime). We support the objectives of transparency and value for money for creditors and other stakeholders but we do not have the knowledge or expertise to comment in detail on issues surrounding the fee structure for insolvency work. We would note the need for safeguards to minimise the risk that a move towards fixed percentage scales results in overcharging in simple cases.

Our comments on strengthening the regulatory regime are as follows.

1 Objectives and powers to sanction RPBs (Questions 1 – 6)

We support the proposed regulatory objectives and the consultation's proposals to introduce additional powers for the Secretary of State to sanction, direct and reprimand RPBs. We

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agree that the proposed mechanisms for doing so appear appropriate. In 2012 the FRC acquired similar powers with respect to the RSBs as part of our Reform process and these are now an important part of our regulatory toolbox, allowing proportionate action without the need for the "nuclear option" of derecognition.

2 New powers to sanction insolvency practitioners directly (Question 7)

The consultation proposes a new power for the Secretary of State, via the Insolvency Service, to investigate and to impose sanctions directly on an individual insolvency practitioner (IP).

We support the principle that there should be a provision for an independent regulator to investigate potential misconduct by IPs. The consultation suggests that this power would only be exercised in "exceptional circumstances" and goes on to indicate that these would be cases which raise important issues affecting the public interest. We agree that is an appropriate definition and is one which mirrors the FRC's "public interest test" for commencing an investigation. This is however an area where there is some overlap with the FRC's own professional disciplinary function and we are keen to ensure that there is clarity in this area.

Four of the RPBs have signed up to the FRC's Accountancy Scheme, which provides for the FRC to investigate and to sanction their members for misconduct. The Scheme is not limited to audit and covers all members of participating bodies regardless of their professional role, including those acting as IPs, although to date we have not taken an insolvency case. Some participating bodies challenge whether the Scheme was intended to cover IPs, although the basis for this challenge is not clear from the Scheme itself, the drafting of which clearly covers all members regardless of their particular role. We would like to explore how the current Accountancy Scheme might interact with the proposed independent investigation/disciplinary arrangements IPs.

There appear to be three possible options:

(1) With the agreement of the participating bodies, we amend the Accountancy Scheme so that matters relating to regulated work by insolvency practitioners are explicitly excluded. We note however that the sanctions proposed in the consultation paper are limited to:

- An order to refund some or all of the IP's fees; and/or
- A warning, reprimand, suspension or revocation of the IP's authorisation.

The Accountancy Scheme provides for additional powers, including the imposition of a financial penalty in excess of the fees charged and the exclusion of the individual from his professional body. If this option is chosen we suggest that the Insolvency Service's new arrangements also provide for these outcomes either directly or via directions to RPBs.

(2) The Accountancy Scheme continues to operate alongside the new arrangements, and the decision on who deals with a public interest case involving a member of one of the bodies for which we share regulatory responsibility is taken on a case by case basis.

(3) The FRC participates in the Insolvency Service's complaints gateway and public interest cases involving members of RPBs which also participate in our Scheme are referred to us directly for investigation. Other arrangements would need to be made for lawyers and IPA members.

On balance our preference would be option 2. The flexibility offered by this option is particularly important in cases where the alleged misconduct straddles both insolvency and other types of accountancy work; it is more effective and efficient for such cases to be dealt with by a single regulator. We would welcome the opportunity to discuss with the Insolvency Service how this might work in practice to ensure there was appropriate clarity as to which regulator took the lead in which circumstances.

3 Power to require information (Question 8)

We support the proposal for the Secretary of State, acting through the Insolvency Service, to require information from an RPB, IP or other specified person. We suggest that the Insolvency Service consider whether the list of persons from whom information can be required is sufficient. For example, it is possible to envisage situations where it might be helpful to require a debtor or creditor to provide information.

In this context we would find it helpful for it to be made clear that IPs are also required to supply information relevant to FRC investigations in respect of companies to which they have been appointed administrator. Other regulators may welcome similar clarity. We would ask the Insolvency Service to consider whether it is possible to incorporate this into any proposed changes.

Finally, this may be an opportunity to formalise arrangements between the FRC and Insolvency Service so that there can be no doubt that we can share information with each other.

4 Reserve power to designate a single regulator (Questions 9 and 10)

We recognise the arguments for and against a single regulator but can see the value of a reserve power. The Insolvency Service might wish to consider adopting a similar arrangement to that envisaged for audit in the draft European Directive ie a single competent authority with the ability to delegate certain activities to professional bodies. Under such a framework the Insolvency Service would be best placed to take on the competent authority role.

In this context we would also note the trend for regulators to be independent of both government and the profession or industry which is being regulated. As part of the proposed

strengthening of the regulatory architecture for insolvency, we suggest consideration be given to greater independence for the Insolvency Service.

5 Other issues

There are three areas which are not covered by the consultation but which we wished to flag up as matters which we believe the Insolvency Service should seek to address in the near future:

(1) **Conflicts of interest.** From time to time the FRC receives complaints about alleged conflicts of interest on the part of insolvency practitioners. These complaints typically refer to previous work done by the insolvency practitioner's firm for the insolvent company or individual or for one or more parties otherwise related to the insolvent company or individual. The current Guidance on Professional Conduct and Ethics prohibits insolvency appointments where the IP or his firm has had a prior "material professional relationship" with the individual or company in relation to which the appointment is taken. However, other than in the case of an audit relationship, the decision what constitutes a material professional relationship is largely left to the discretion of the IP. More definitive rules on what is and is not permissible in this area would improve consistency.

(2) **Insolvency practitioner vs firm**. Insolvency practitioners are licensed and appointed individually rather than via their firm. We question the extent to which this reflects the reality of modern professional service firms. The insolvency practitioner will make use of his firm's staff, systems and technical specialists and where things go wrong will be supported by the firm's legal teams. We believe that consideration should be given to moving towards a regime which more closely resembles that in audit, where the firm's responsibility for the overall quality system is acknowledged as well as the actions of the individual partner.

(3) **Thought leadership**. We note the public policy debate around aspects of insolvency legislation and practice (such as the use of "prepacks"). It would be helpful to understand the extent to which the Insolvency Service intends to engage with and to lead the public debate in this area.

Please let me know if any clarification is required.

Yours faithfully

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