ARTICLE

To Change, or Not to Change: The Unresolved Question in UK's Insolvency Regulation

*Arguments about the number of regulators in the UK system have been running for years, and at a time when there were eight different bodies licensing about 1,600 IPs, you can see why; that didn't make a lot of sense. However, by the time the government came to the view that it might do something about that, the market had largely resolved the issue by itself. Recently, following its 2021 consultation, the Insolvency Service, which is equivalent to IBBI in India, has proposed several changes in the UK's insolvency regulation related to Recognised Professional Bodies (equivalent to IPAs in India), insolvency professionals, professional standards, and firms etc. In the present article, the author discusses the UK Government's response to its consultation on insolvency regulation. **Read on to know more…***

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Introduction

The UK Government, in the guise of the Insolvency Service (the oversight regulator, with a role similar to IBBI in India), has finally published its decision on what the future for the regulation of Insolvency Practitioners (IPs) will look like, following its 2021 consultation. Or has it?

For those who value and see the merits of the current regime based on delegated authority to well-established Recognised Professional Bodies (RPBs, equivalent to IPAs under IBC, 2016) – and I count myself among them – the sweetness of the 'fudge' over the issue of a single regulator for the profession has been soured by the threat of yet more uncertainty over what a future government might yet do, should it decide that further measures are necessary.

In one sense then, not actually a definitive decision at all, which is unhelpful on a such central point. The main announcement not to impose a new single regulator on IPs (for now, at least) was rather drowned out by a drum roll for other (expected and for the most part non-controversial) arrangements to introduce improvements to the current regime; it does though give the present RPBs a temporary reprieve, and for IPs simply means not much change for the time being.

This 'decision' on a single regulator wasn't the main thrust of the Government's statement on the subject, perhaps for obvious reasons. We will come to consider whether the proposed single regulator concept in the consultation was a justified and proportionate response to any perceived shortcomings in the current system. But the focus in the recent announcement was on a broadly supported new step to authorise and regulate firms … or more accurately, the partnerships and corporate entities in which most IPs work. This has been largely welcomed and is aimed at bringing some currently unregulated companies into the regulatory sphere, for example those running high volumes of Individual Voluntary Arrangements (IVAs) in the personal insolvency market.

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This and the other proposals might take another two years or more to bring in, because they may require primary legislation, for which time is limited. Will we see a Bill to cover this before the next general election (expected in late 2024), or in the first year of a new government in 2025? Perhaps not, so we are left with the possibility that a process that has its origins in legislation[1] in 2015 might now take a full ten years+ to be brought into fruition – a period in which a profession focussed on rescuing financially-distressed business and providing debt relief for thousands of individuals has had a regulatory shadow hanging over it. Notwithstanding the likely delay in implementation, the measures that have been announced merit some examination.

1. Single regulator

This may not have been the focal point of the government's public-relations push, but it will have been the first aspect that the profession will have looked for in the published statement. Arguments about the number of regulators in the UK system have been running for years, and at a time when there were eight different bodies licensing about 1,600 IPs, you can see why; that didn't make a lot of sense. However, by the time the government came to the view that it might do something about that, the market had largely resolved the issue by itself. The two law societies in England and Scotland had withdrawn from their RPB roles, and they were followed by the ACCA, each taking the view that their relatively small numbers of IPs made the role unviable for them. The rationalisation resulting from those steps left two main IP regulators in England and Wales (covering 90+% of active IPs), with two others mainly covering Scotland and Northern Ireland. There have also been some profession-led measures over the years that produced one set of entry exams, and a standardised suite of mandatory practice statements, and in collaboration with the Insolvency Service there were developments in the complaints arena with a new centralised portal for making complaints and a published common sanctions guidance to facilitate consistency of outcomes.

Another factor to weigh up when considering whether the proposal was a proportionate response is the extent to which (if at all) the present system was broken. Despite some weaknesses, there is a case to be made to suggest it was not. For a start, the Service has been the oversight regulator (in effect, the regulator of the RPB front-line regulators) since 1986 (when licensing of IPs was first introduced into UK law) and has monitored the RPBs for competence/consistency and published annual reports on regulatory activity. More recently, it has published its monitoring reports. So, there has been increasing transparency, but more importantly there has been no suggestion in any of these reports that any of the RPBs have significantly under-performed. In 2015, the Service took the powers it had sought to enable it to become a more effective oversight regulator – it can issue public directions and reprimands, and thereby take regulatory action based on a lower threshold than would be required to terminate an RPB's authorisation. And yet, in the eight years following the 2015 provisions, only once (earlier this year) has it used those powers in a public way.

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Notwithstanding the absence of visible action by the oversight regulator, were there material shortcomings in

[1] *Small Business, Enterprise & Employment Act 2015.*

the performance of the RPBs? They were criticised sometimes for delay, for example in dealing with complaints from creditors and others – some taking more than a year to resolve – not always the fault of the regulator but nonetheless not good for complainants or IPs, and not a great advert for regulatory efficiency! However, it is surely a stretch to argue (as would be necessary for the Service to have met its own test in the consultation) that these delays constituted a 'significant concern currently affecting confidence in the regime', for if that was the case then surely it would have acted. There were also criticisms around consistency as between the RPBs, but there is a (published) common sanction guidance which should drive consistent outcomes. It is difficult to draw too many conclusions from the limited information in the public domain, but to the extent that inconsistency has been a real issue, then arguably that is matter for the oversight regulator.

Perhaps the Service's proposal to become the single regulator came too soon. Distractions attributable to the pandemic, with a perfectly natural focus on new temporary legislative measures, arguably took two years out of the period originally allowed for assessment of the effectiveness of the regulatory objectives and other changes introduced in 2015. So, maybe there is a case for extending the deadline, which in one sense is what the Service has now done.

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(a) Lessons from aspects of the IBC/IPA system for the UK?

Could the Insolvency Service have learnt something from the IBC regime in India? The requirement in India for IPAs to have Byelaws conforming to a model imposed by the legislation, providing for majority law representation on governing boards and restricting the IPAs to functions related to insolvency (and specifically excluding functions which may be inconsistent with those of an IPA regulator) is arguably a good way to minimise any risk of conflicts arising in the way front-line regulators are run. It creates a degree of independence which some might say is absent from the UK system.

Nobody yet knows what a future UK single regulator might look like (and it may never happen), so let's look at the other announcements.

2. Regulating firms

The use of the term 'firm' here is perhaps a little misleading, as the real targets here are likely the corporates that dominate the IVA world. Most insolvency work that is focussed on dealing with failing 'companies' is undertaken by professional firms, which are self-regulating to a degree, and in some other ways are covered by light-tough regulation by, for example, the accountancy bodies of which their principals may be members. However, the market for services to over-indebted 'individuals' has seen a business model built around entrepreneurial corporates in which the IPs may not be principals and in which consequently the IPs may be unable to influence a focus on regulatory compliance to the same extent.

Bringing firms into the sphere of influence of insolvency regulators has been broadly welcomed, not least by the RPBs, which will have new powers to hold those corporates to account in ways previously not possible. Instead of indirect influence via IPs, the regulators will be able to sanction firms as well as the IPs working in them.

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This new aspect of the current regime will sit alongside the present regulation of individual IPs, rightly retaining personal responsibility for IPs, in whose names' appointments are made, whilst also recognising the role of the firms in which they work. Those firm names are often prominent in marketing and PR, but to date have not been directly linked to any sanctions imposed on individual IPs – that will now change. There will also be a new searchable register of all IPs and firms providing insolvency services, with details of any sanctions.

It is not so unusual for firms in the accounting sector to be regulated. In audit and financial services, regulation of firms is the norm. This new measure sensibly blends regulation of IPs and insolvency firms in a way that should build confidence in the system.

Quite when the change will be made is another question. Once again, it will depend on parliamentary time, and we may therefore have to wait quite a while before this is enacted.

3. Compensation

One of the other changes promised is the power for regulators to direct an IP or firm to pay compensation or 'otherwise make good loss or damage' – that is, damage caused by IPs. So, potentially something that has been done by an IP, or that the IP has omitted to do, causing loss to say a creditor, could be the subject of a claim for compensation. This could become problematic, and some IP representatives have raised understandable concerns about how this might work, and in particular whether it might lead to a new 'industry' in claims. It could clog up the complaints system and delay completion of insolvency cases, for little benefit to the majority of creditors.

There is a proposed cap of £250 for any claim, which suggests it may be directed more at consumers in IVAs than other cases, but any monetary incentive to make a complaint is likely to increase the number of them. There will also be a need to distinguish those matters where a complainant/claimant has suffered loss directly as a consequence of an act or omission by an IP, and where that has affected one claimant as opposed to a class of creditors more generally. The latter scenario is probably best left to the courts using existing rights of action.

In what circumstances might an IP have caused loss to a particular creditor/claimant? Perhaps by failing an answer correspondence, leading to a creditor incurring legal costs? Could that even arise in cases where creditors have been advised that there is no prospect of a financial return?

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This looks out of place in a corporate insolvency world and is pitched at such a low level as to be of little benefit to most of those who might be minded to claim, but the burden on IPs could be considerable, particularly on smaller IP practices, and some have claimed that it could have 'consequences for the profession's ability to deliver for clients and creditors, and potentially undermine the UK's national and international reputation for having an effective insolvency framework and profession'.

4. Standards

Currently, the mandatory practice standards for IPs are set by the Joint Insolvency Committee (JIC), in which the RPBs, Insolvency Service, IP and creditor representatives participate. This involvement of specialists and stakeholders has served the profession well. It may not produce the quickest results, but its outputs are generally well thought through and practical. It is responsible for the Code of Ethics and Statements of Insolvency Practice which IPs must observe, across the profession irrespective of the RPB that regulates them. Common standards achieved with lay input to maintain and raise standards of practice.

The JIC replaced the lay-dominated Insolvency Practices Council which previously had the standards-setting role. All of which makes the latest proposal for the Insolvency Service to be the final arbiter on such matters look like a step backwards. It is not clear how giving the Service the final say on standards will lead to an improvement in this arena, particularly as it remains unclear to what extent external stakeholders representing creditors and others will still be at the table.

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Perhaps the aim is to remove the need for consensus and facilitate speedier decisions, but as with other aspects of the announcement, there remain many unanswered questions. One of those is the extent to which lay/stakeholder input will continue, for example creditor input. That has been a valuable part of not only the standards-setting process, but also a key element of the regulatory decision-making committees which determine sanctions – with contributions on behalf of the Chartered Institute of Credit Management. A past chairman of CICM reinforced the need to retain that going forward, commenting that it is 'Crucial that creditors are heard and that relevant committees take their views into account in these processes. Setting standards for the profession is an important part of the mix, and the Service should ensure that future arrangements retain lay/stakeholder input'.

There are other proposed changes that will likely not have a great impact on creditors in the majority of insolvency cases and will not be in force for some time. They include increases in the cover on the bonds IPs are required to put in place to protect creditors. Bond claims are relatively infrequent, and sensible though these measures are, it is important that the changes really do benefit creditors. Time will tell.

Nobody would deny that there are areas in which the present regulatory regime can be improved, but the Insolvency Service perhaps should be congratulated for eventually coming to the view that there is great merit in preserving the best of the present RPB regime, with improvements in some areas, rather than ripping it up to start again with a government agency taking a direct active role in regulating IPs. Arguably, the Service as oversight regulator is a better way forward, but it too must be willing to use its powers in a more effective and transparent way to enhance confidence in a regulatory regime that has gained world-wide respect over three decades.