IPRegulation.Section

From: Louise Brittain <Louise.Brittain@wilkinskennedy.com>
Sent: 15 September 2016 11:23
To: IPRegulation.Section
Subject: Bonding (A REPLY HAS BEEN SENT ON 15-09-2016)

The current binding arrangements are fine other than the lack of providers and lack of previous firm issues being taken into account.

Also the OR is not required to bond although they are. Ow actively acting as Trustee or Liquidator and this should be a requirement for all those accepting appointment as Trustee or Liquidator not just IPs

Kind regards
Louise Brittain
Sent from my Windows Phone

IPRegulation.Section

From: Paul Philmore <Paul@philmoreandco.com>
Sent: 15 September 2016 11:24
To: IPRegulation.Section
Subject: Bonding arrangements call for evidence (A REPLY HAS BEEN SENT ON 15-09-2016)

Dear Sirs

Thank you for the email.

It surprises me that 'the current arrangements are inflexible and prescriptive and fail to protect creditors' as they seem to have worked well from my point of view since the inception of the Insolvency Act, 30 years ago.

To assist me in forming a suitable response it would be helpful if you could;

- Identify the stakeholders making these assertions (for example is it HMRC, financial institutions, general trade creditors or others?)
- Specific evidence that the current bonding regime has failed to protect creditors generally, and the value of the losses incurred by them.

As an initial comment, I would say that creditors suffer increased bond premiums where sole practitioners are involved because of a perceived increase in risk.

I look forward to hearing from you.

Kind Regards

Paul Philmore
Licensed Insolvency Practitioner

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www.bis.gov.uk/insolvency

##

IPRegulation.Section

From:	David Cullen <DavidCullen@lawscot.org.uk>
Sent:	15 September 2016 12:08
To:	IPRegulation.Section
Subject:	Law Scoeity of Scotland - call for evidence in relation to bonding arrangements for insolvency practitioners (A REPLY HAS BEEN SENT ON 15-09-2016)

Thank you for your email to the Law Society of Scotland calling for evidence in relation to bonding arrangements for insolvency practitioners.

While this Society ceased to be a Recognised Professional Body under the Insolvency Act 1986 on 31 December 2015, our experience of bonding arrangements prior to this date of cessation may be of interest. That experience was that those very few Scottish solicitors who were insolvency practitioners and who took insolvency appointments were able to obtain insolvency bonds with relative ease.

Kind regards,
David

David Cullen
Registrar
The Law Society of Scotland
DD: 0131 476 8160

www.bis.gov.uk/insolvency

##

IPRegulation.Section

From: Ted Wetton <ecw@gibsonboothinsol.com>
Sent: 15 September 2016 12:58
To: IPRegulation.Section
Subject: Call for evidence (A REPLY HAS BEEN SENT ON 15-09-2016)

Question 1 & 2

A major weakness in the bonding system is that it is based on the assets at the start of a case.

It would be better if the SPS could be reduced as assets are realised this should reduce costs (via credit notes) and be more beneficial for all

The saving would allow IP's to pay for an increased GPS (SIP 9 disbursement issue)

As this cost GPS cannot be charged to cases individually

Question 3 No

Question 4 None

Question 5 Yes

Question 6 An increase in PII as the RPB's would insist on additional cover (not chargeable to the case under SIP 9)

Question 7 a Amend the current prescribed terms of a bond to cover the problems encountered **best option**
b Cannot work will need insurance to cover successors fees also
c see b
d Agreed see a
e This is not a burden with today's computerisation if any one says it is they have not got the correct software or trained staff.
Costs would spiral. The large firms will like this and probably self-insure.
f Increase this to cover costs of investigation we pay £50 for £1m therefore £300 for £6m this should cover it.
g The panel to agree to a agreed average/blended rate and open to review of hours charged by the RPB appointing them
h I thought it had to be paid the following month. Real problem is not notifying them of new cases.
I Agreed but may be very expensive. What do you mean ' for the same period as the bond SPS, GPS ????
J But it is the IP who is in charge and if an ee commits fraud it his problem. (I have fidelity insurance to cover me that is my choice)

The bond system as is needs amending and the wording of the cover needs to be agreed.

Sorry this is a poor document and in my opinion is not logical and not easy to answer.

How do you answer 7 from reading a to J

Kind Regards

Ted Wetton
Managing Director

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RESPONSE TO CALL FOR EVIDENCE RE BONDS 15/9/16

I am Mike Reeves, IP, IP authorisation no 7882, responding as an individual to the Call for Evidence re bonds. I respond as follows:

Question 6

a) The impact on IPs of payment for a bond is negligible, since a clear workable system is in place between the bond providers, the IPs and the RPBs, and as a result the time & effort and cost of administration of the bond system is negligible on a case by case basis.
The cost of the bond is not a burden for the IP since it is a Category 1 expense which can be recovered by the IP out of the first funds available in the insolvency.
In my view the result of the repeal of statutory bonding will reduce the confidence of all concerned in IPs and the profession generally since the results of wrongful or other actions reflecting negatively on an IP which could otherwise be at least partly covered by a bond claim would be much more likely to be the subject of widespread adverse publicity than would otherwise have been the case.

b) The impact on creditors of the cost of the bond is very low since the cost is proportionate to funds likely to become available in the insolvency.
I am a sole practitioner IP, currently paying a £28 premium for a bond covering up to £500 assets, £40 for up to £10,000, £70 for up to £25,000, £170 for up to £50,000, £250 for up to £100,000, £460 for up to £250,000, £660 for up to £500,000 and £940 for up to £1,000,000. For MVLs the bond premiums which I pay are one half of the above sums. In all cases the bond cover is for up to 6 years. I consider the above sums to be very low sums viewed in the context of the sums covered, and that the payment made for a bond results in a very small reduction in dividends to creditors.

Question 9

I favour option 3, to amend the existing legislation.

In my view the adoption of option b) on page 21 is likely to best meet and deal with the position currently, ring-fencing a proportion of bond claim funds for creditor distribution.

Mike Reeves

IPRegulation.Section

From: [redacted]
Sent: 15 September 2016 15:53
To: IPRegulation.Section
Subject: Bonding Arrangements Consultation (1 of 2) (A REPLY HAS BEEN SENT ON 16-09-2016)
Attachments: branded-meds-conresp.pdf; CAP 1277 Rebalancing ATOL 040315.pdf; cp221_consumer_prepayments_summary.pdf; getLatest.pdf; Insolvencypractitioners&costs_StephenBaister&StephenDaviesQC.pdf; our_proposed_approach_to_dealing_with_supplier_insolvency_and_its_consequences_for_customers.pdf; Practitioners-Guide-to-Open-Cover-December-2015.pdf; Sharman-Inquiry-final-report-FINAL.pdf

Dear Sirs,

I enclose various Risk and Impact Assessments report on the issue at hand for consideration, refer attached.

1 of 2 emails.

Sent from Samsung tablet

IPRegulation.Section

From: [redacted]
Sent: 15 September 2016 15:59
To: IPRegulation.Section
Subject: Re: Bonding Arrangements Consultation (2 of 2)
Attachments: AFME_InsolvencyReport2016_10_FINAL.pdf; Insolvency_Litigation_and_the_Jackson_Reforms_-_An_Update_April_2016_FINAL.pdf

2 of 2, refer attached.

Sent from Samsung tablet

-------- Original message --------
[redacted]
Date: 15/09/2016 15:47 (GMT+00:00)
To IPRegulation.Section@insolvency.gsi.gov.uk
Subject Bonding Arrangements Consultation

Dear Sirs,

I enclose various Risk and Impact Assessments report on the issue at hand for consideration, refer attached.

1 of 2 emails.

Sent from Samsung tablet

IPRegulation.Section

From: Stones and Co <stones.co@btconnect.com>
Sent: 19 September 2016 10:36
To: IPRegulation.Section
Subject: CALL FOR EVIDENCE (SENT A REPLY ON 22-09-2016)

Dear Sirs,

There needs to be thorough examination of bonding viz:-

1. The cost to sole practitioner has become excessive and detrimental to the wellbeing of small firms. All practitioners should have to pay the same bond premiums for the same total of assets whatever the firm's size.

2. The need for bonds to be taken out in nil asset / very small asset cases is highly questionable as any losses to creditors is almost certainly nothing. Perhaps a limit of £10000 could be imposed where a nil premium is set.

3. The Official Receiver's offices do not have to take out any bonds and yet they are now actively trading in opposition to IPs in the marketplace. There is not a "flat pitch".

Yours faithfully

GARY STONES F.C.C.A.
STONES & CO.

IPRegulation.Section

From: Paul Pittman <Paul.Pittman@pricebailey.co.uk>
Sent: 19 September 2016 16:34
To: IPRegulation.Section
Subject: call for evidence - bonding (SENT A REPLY ON 22-09-2016)

One area that does not seem to be covered by the current legislation is where an IP instructs an agent, and a principal at that agent has sticky fingers. In that case the IP is left with a claim against the agent, but the creditors miss out. I am informed that Crime insurance is required to cover that situation. Why isn't this all wrapped up together!! This happened in the cases involving Winterhill Largo Limited – where Mr Duckworth appears to have made off with funds that were in client accounts for various insolvency cases. The IP through no fault of his own is left without the funds available for creditors.

rgds

Paul Pittman
Insolvency and Recovery Partner
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###

IPRegulation.Section

From:	Paul Philmore <Paul@philmoreandco.com>
Sent:	22 September 2016 17:07
To:	IPRegulation.Section
Subject:	Call for evidence on bonding (SENT A REPLY ON 22-09-2016)
Attachments:	doc00576520160922170202.pdf

Dear Sirs

I refer to your email of 15 September 2016.

As a sole practitioner I have the following comments;

1. The bonding premiums for sole practitioners put them on a commercial disadvantage as premiums tend to be higher for weak reasons. The perception seems to be that sole practitioners are more likely to abscond with estate funds.
   I would have thought the opposite would apply.
2. IPs are expected to bond on the total anticipated contributions in VAs. In most cases the level of assets is contingent at the commencement of a case and I feel should be reviewed to reflect cash received and dividends paid on an ongoing basis (say annually).

There should be protection for creditors for assets there is no doubt. I do not believe that the solicitor 'fund' model is appropriate – who will police it? More unnecessary cost to creditors in the vast majority of cases.

It is still unclear to me how this review has come about from the information supplied. The call for evidence seems vague in this regard. Having worked for IPs and latterly as an IP for over 25 years I can't remember ever seeing a bond claim?

I would suggest that the Insolvency Service should perhaps be more concerned by the issues raised in the attached R3 news article attached, particularly as it is claimed that creditor interests are a priority.

I am happy to provide more input if required.

Kind Regards

Paul Philmore
Licensed Insolvency Practitioner

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##

Response to call for evidence on 'Bonding Arrangements for Insolvency Practitioners'

The views expressed in this document are my own formulated from 36 years of experience of working in the insolvency profession and are not necessarily the views of BHP Clough Corporate Solutions or any other organisation with which I have an association.

I am currently a member of IPA's M&A committee, INSOL's small firms committee, and INSOL's TaskForce review committee.

By its very nature the bonding procedure is an additional administrative process which doesn't help the IP do their job, but is there for creditor reassurance to protect the assets of the insolvent.

It is also a useful procedure for RPBs to monitor their IPs, to not only see the nature and volume of cases they are working on but on the time it takes for the IPs to complete the assignments.

The major problem with the current system is that it relies on the integrity and honesty of the IP and it is too easy for the dishonest or incompetent IP to work round the current system.

My responses to the questions are as follows:-

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

I think the paper covers most of the weaknesses of the current system, but current bonding requirements fail to recognise the current ownership structure of IP firms where often the IP is effectively an employee of a limited liability entity. It is not uncommon that the firm is owned by non IPs, who employ IPs to carry out the statutory functions required by the Insolvency legislation. It is my understanding that the bond will only cover funds under the control of the IP, and there is a risk that funds not allocated to a particular case account are outside the control of the IP and therefore not covered.

As you identify later in the document, there is need for rationalisation of the terms of the bond. The pricing of the bond is a matter for the insurers, but there is general concern in the IP profession that rising bond prices and restrictions on the availability of bonds could reduce the number of IPs, and thereby reduce consumer choice. A protocol would be helpful in dealing with claims. When it comes to the non-payment of premiums the early warning by insurers to the RPB is helpful. It is untrue that there are only a small number of IPs will to act as 'alternatives'. It has been perceived as a closed shop and requests to RPBs for information on how to join any list of willing IPs has been ignored. I am sure a number of respectable IPs will be willing to take on the task of acting as 'alternatives'. In my opinion RPBs have been less than transparent in how replacement IPs are appointed.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

No, as the profession is too small, and the costs could be proportionally too large for the smaller firm. The RPBs should insist on PII before issuing authorisation to the IP, and immediately withdraw it if they are advised the cover is not renewed or paid.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

A claims management protocol would be one solution to dealing with claims, but is fraught with danger from being controlled by those perceived as industry insiders, along with a lack of transparency and accountability.

A panel of approved IPs would be an improvement over the current arrangements as long as the criteria and membership of that panel transparent. The panel could be stratified so that an appropriate sized and type of firm/IP could take on the cases.

As identified the costs of investigation need to be appropriate and proportional to the outcome, and the assets of the case should not be depleted to meet these additional costs. As regards fees, I suggest a scale of fees be agreed.

The powers of the RPB(s) needs to be clarified, and the RPB needs to have the power to intervene and appoint an alternative at short notice, for example if there is no PII or no bond or if the IP fails to respond to enquiries which are giving a RPB serious cause for concern. At present from my own experience I believe there is too much handwringing over the issue, and RPBs need to be able to move swiftly to deal with bad IPs.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

No it simply wouldn't be enough and would leave the system with RPBs unable to take direct action.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?
Option 3

Put quite simply it would be a disaster for both creditors and the reputation of IPs as a profession and a return to the bad old days where IPs 'did a runner' with the funds to which ever country had a good climate and no extradition treaty with the UK.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

Yes in general, the bonds need standardising, whether for individual bonds or for a 'universal' bond. I would have thought simplification and common standards would be welcomed by the insurance profession. It is a limited specialised market, and variation from a standard just adds to costs and uncertainty.
Claims monies should be ring fenced, but the costs of recovering these monies should be met from the any fund created, but the fund should not be used to meet the general cost of liquidation, unless those funds recovered represent assets which had or should have been realised previously for the general body of creditors.
Of course a successor IP is going to want to carry out his own investigations into the affairs of the insolvent, but the bond shouldn't provide them with a blank cheque to do that. The IP should agree both the scope of their work and the budget before setting out on any in depth investigation.
As mentioned earlier the monthly schedule submitted to both RPB and bond provider, allows the RPB to monitor the IP in terms of appointments started and finished, and the length of time to complete those assignments. It may be an administrative burden, but it does provide a safe guard for the profession to allow the RPB to take the 'temperature' of the market place and ensure assets are safe guarded.

I believe the level of cover should be increased, the GPS raised to £500,000, and the SPS to £10,000,000 and the aggregate limit to £50,000,000. Of course it would create an additional cost to IP and the estate, but the safe guards for creditors would be greater. To tailor the bond size to firm size would be difficult, what would the criteria be? Fee income, asset value, and how do you deal with an unusually large case in a small firm. Firms could voluntarily restrict the size of case they take on to limit the cost of the bond.
If an IP fails to pay his bond, the RPBs should be advised and the authorisation suspended immediately, and if necessary an alternative IP appointed.
RPBs require IPs to have PII, what is proposed would increase the cost of PII to all IPs, probably the smaller firm would be worst affected. Again other insurance products if made compulsory would increase IPs costs.
IPs could be required to advise creditors what level and type of insurance they hold which would allow creditors to determine whether or not the IP was suitable to hold the appointment.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.
Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?
Question 10: Do you have any further comments you would like us to consider in relation to bonding?

In response to Q8, as said earlier, the paper fails to recognise fully the ownership structure of IP firms, in many cases the IP no longer has any interest in the firm, or no controlling interest. They are a ‘plug in’ IP who can be replaced if they do not follow the whim of the owners of the business.
The current problems surrounding the control of funds received and held by IVA bulk providers has exacerbated a relatively small problem, to one which has the potential to become out of control, threatening the hard work put in by debtors to get their financial lives in order, undermining the credibility of the regulatory process, and destroying confidence in the IP professional generally, and with consumer debtors in particular.
It fails to recognise that the RPBs are in part responsible for what has happened, and it appears that they have failed to hold IVA bulk providers to account for their questionable working methods, from no face to face meeting, to now offering loans to debtors to truncate the length of their IVAs.
Consideration should be given in this paper and elsewhere to a single regulator, with a single inspection regime, and a process of intervention to remove IPs who are not up to acceptable standards and this needs to be managed by an independent organisation.

In response to Q9 & 10, a single common bond recognisable by all, the continuation of monthly returns to monitor IP activity , ring fencing funds paid out under the bond, a panel of IPs willing to act as ‘alternative’ IPs, an agreed scale of fees, compulsory PII, all insurances not just cover the IP but the organisation in which they work. Why? So that all stake holders have confidence in well-regulated profession.

[redacted]

22nd September 2016

Bonding call for evidence response

Q1

Yes the assessment of weaknesses is generally agreed, however we would add the following comments:

- We do not agree that the current requirements are unclear and costly. They are clear if understood by practitioners, some of whom probably don't know where to look to fully understand the requirements. We believe this is more a matter of a need for education than clarity.

- Any increase in the value of the SPS and GPS is likely to result in an increase in the bonding premiums payable. Having made a number of claims recently on a portfolio of case, the caps did not seem to be an issue on any of the SPS claims but perhaps the GPS limit should be proportionate to caseload.

- You mention that sureties do not feel engaged in the process but I would point the finger at them instead. During our recent experience, the surety had no interest whatsoever in engaging with us, despite us proactively making contact and trying to find out more details surrounding the bond cover, and how investigations should be funded, whether premiums were paid and what the timeframe was for claiming. The surety referred us to the RPB. As the RPB did not have this information either, it was left to the surety's advisors to provide the information to us (which came about purely through conversation with the RPB and not the surety itself). As the advisor was, arguably, there to protect the position of his client, this was an odd set-up.

- ReSolve is absolutely willing to look at these appointments and has made representation to its RPB, having had very positive feedback from all parties following recent experience.

Q2

ReSolve has a number of concerns with how the present system works and these are identified below:

- **Initial information gathering**. The schedule of bond cover claim periods per case is not easily available. There is no one place that holds all of the information a replacement IP needs. A suggested solution might be to require the surety or broker to provide the information to the RPB. Generally the RPB might only hold the monthly returns, and these might not be held in their entirety. The information should contain for each case the SPS and GPS claim period end dates so that this is set out and clear from the onset.

- **Consideration of an initial fund to carry out investigations where absence of case funds.** In ReSolve's recent experience there was no pot of money available in any of the transferred cases. They were in effect clean of cash. Because of that every claim had to be investigated in the knowledge that the firm was effectively operating on a CFA basis until it became sure of evidence supporting a claim. This is perhaps one of the reasons why firms do not come forward to offer services in such cases. Perhaps a way around this is to apply a levy on enabling bond premiums to create a war chest for use in establishing positions at the onset which can be applied for and justified in the same way creditors are reported to on insolvency appointments. The pool of funds would need to be administered in the same way as the Pension Protection Fund (for example). Perhaps to be carried out by the RPBs.

    - **S.236 claims.** There is currently no funding available for this should it be a necessary next step in the investigations. In our example ReSolve was told it had a budget of £5,000 from the surety to carry out further work to determine next steps (which were not in fact needed in the end), but that seemed to be an anomaly and it was not procedural.

- **Lack of powers of the RPBs**. I understand there is a significant delay between the moment at which the RPB requires a portfolio of cases to be transferred and the Court ordering the transfer. In that time the RPB is powerless to act to prevent dissipation of assets or removal or destruction of records. Consideration needs to be given for RPBs to either act themselves in protecting the creditors and company records and assets, or perhaps more sensibly, the proposed appointees are appointed as quasi provisional liquidators in advance of a hearing to perform that role. Either way this is a real and significant issue.

- **Delays to the court application process.** The process simply takes too long. An expedited application process set in stone within the Court Procedural Rules or similar would get around the current delayed system. In that time so much can happen to the detriment of creditors. In addition, we have experience of being appointed over two companies that were in Administration at the beginning of the Court application stage, but were no longer in Administration at the replacement date.

- **Lack of guidance.** We appreciate that there are only a small number of such cases per year and therefore few firms have the experience to deal with such situations, but it would be useful to have written guidance on the 'Gov' website setting out next steps for a replacement IP in setting out on the bond claim journey. ReSolve found that even locating a solicitor with experience of helping in such matters was very difficult. The RPBs and the stakeholders in the claims process were themselves unable to assist in full or reluctant to do so for various reasons.

- **Understanding claim priorities (in the knowledge a trustee in bankruptcy of the prior IP can make General Penalty Sum claims).** We gather that it is possible to make a claim as trustee of the prior IP under the GPS where he is adjudged bankrupt. I am not sure how that is possible, but surely the solution would be to not allow it. ReSolve also understands that there is no established priority between making claims as replacement IP and making claims as trustee under the GPS. That is surely nonsense. Creditors must come before trustees' interests (if indeed they have any).

- **Brought forward WIP claims.** This has the capacity of frustrating the process. Not only is a replacement IP faced with the possibility of working on a CFA to investigate proceedings, he is also at risk of being subordinated to prior IP claims on the assets of each estate. Existing WIP claims generated by the firm acting by the dishonest or fraudulent IP should rank behind the replacement IP costs without exception, or be rejected in full.

Q3

Yes. ReSolve believes that such a system would assist with one or two of the matters raised above, such as applying to the fund for payment of upfront investigative costs and the costs of any s.236 application that could be necessary. It also makes sense for adequate PII cover to be evidenced to the RPB in all cases.

Q4

ReSolve welcomes the possibility of a claims management protocol and has no further comments save for ensuring that, where possible, the matters identified above are taken into consideration when drafting the protocol.

Q5

No we don't. The areas identified in Q2 above include matters that may not be covered in a claims management protocol and accordingly we would like to see taken into account when revising the present system. In particular, there needs to be better powers available to the RPBs or the proposed replacement IPs, a more expedient system for replacing IPs and far better control mechanisms in place from the moment the warning signs are displayed.

Q6

We think that removing the bonds would remove a layer of cost added to each estate, but that the layer of cost is not considered to be a large one. ReSolve does not agree that the bond cover premium is expensive in the circumstances. Removing the bond requirements and replacing with adequate PII cover creates the same issues as present. Instead of the existence of high cost in pursuing claims under bonds as at present, there will be high costs generated by the claimants in a PII claim case. It is apparent that the current system is weak, but the way to address it is to enforce a better structure and the claims management protocol and associated efforts to regulate the process would be best.

a. An IP has the investigative powers, skills and experience to tackle claims under bonds and is best placed to deal with such claims. The time and effort in putting together monthly bonding returns and arranging payment of the bonds would be saved. However, ReSolve carries out a number of solvent liquidations and we believe the current bonding requirement provides clients with a layer of comfort that there is some security in place when instructing us. The question of 'how do I know the assets will be safe with you' is not uncommon. ReSolve therefore thinks that on balance the existing bond cover requirements should remain in force, but the framework tightened.

b. ReSolve became aware of the possibility of some of its licensed IPs becoming replacement IPs following a phone call from its RPB. The RPB had itself taken a call from the surety, which flagged anomalies in the bonding pattern relating to the prior IP. In that case there was a warning system in place. Whilst the next steps were slow, potentially leading to a loss to creditors and the surety, it is apparent that the system enabled investigation to commence and action to be instigated. Would that be the case absent any bonding framework? We doubt it. Creditors are best protected by a bonding framework, but one that is fit for purpose.

Q7

Yes. They are all good points to raise and are balanced in their consideration.

Q8

Yes. Save for the additional comments raised by ReSolve above, in particular at Q2.

Q9

ReSolve does not think that the current requirement to file monthly returns is onerous, and believes that by ensuring each estate is bonded means the price of cover remains competitive. The issues seem to arise when claims are to be made. The process from start to finish is not fit for purpose. So, in order to rectify the process, a mixture of the options you set out may be best, rather than a focus on simply one of them. ReSolve believes that the following efforts would be sensible changes to the current system:

a) The bond wording needs to be standardised. There should not be any uncertainty when trying to recover assets for creditors
f) The SPS should be set correctly and monitored effectively by RPBs. The GPS is too low and should be adjusted in accordance with the caseload of a particular firm. The more cases a firm has, the greater the GPS (and quite probably the premium)
g) The introduction of a duty of proportionality is sensible but could operate without teeth if not monitored by RPBs or assessed effectively by sureties. Perhaps this should also extend to estimated costs in the same way fees are estimated now on insolvency cases
h) Non-payment of the bond needs to be reported immediately and RPBs should act with urgency thereafter. This should include immediate enforcement action
i) Provision of PII with run off cover is a necessary action arising from this assessment by the Insolvency Service
j) Agree that the fidelity insurance or similar to cover other staff members should also be a requirement

In addition to the areas above, ReSolve would like to see legislative change in the following areas:

- Greater powers to RPBs or proposed IPs in immediately protecting records and assets belonging to an IP. Dissipation of records has been apparent in our experience.

- A fast-tracked Court application process so such transfers of IPs are expedited for obvious and clear reasons. It is not acceptable for this process to result in Administrations being brought to an automatic end in the 'hiatus' period between application and Order.

- Prior WIP claims should be subordinated to agreed replacement IP investigative costs without exception. It is wrong to suggest that an IP with a dishonest past can still be paid in advance of the very people appointed to investigate their actions and recover sums for creditors.

Q10

No further comments to add.

The Insolvency Service

E

Call for Evidence

Bonding arrangements for insolvency practitioners

15 September 2016

Contents

1. General Information

This call for evidence will principally be of interest to the insolvency industry, including insolvency practitioners and their staff, Recognised Professional Bodies, current and prospective bond providers and brokers, compliance agents, and those involved in insolvency proceedings, in particular creditors. We would welcome responses from any member of these groups or from any other field.

How to Respond

When responding, please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who your organisation represents and, where appropriate, how the views of members were assembled.

Please respond in writing via email to IPRegulation.Section@insolvency.gsi.gov.uk or by post to:

Insolvency Practitioner Regulation Section
The Insolvency Service
4 Abbey Orchard Street
London
SW1P 2HT

Confidentiality and Data Protection

Information provided in response to this call for evidence, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

What Happens Next?

This call for evidence will close on 30 November 2016. The Government will analyse the responses received to inform our next steps, such as whether legislative action is required to reform the bonding system. If you have any queries on any of the issues raised please send them to IPRegulation.Section@insolvency.gsi.gov.uk.

2. Introduction

As part of the comments received on insolvency legislation during the Government's Red Tape Challenge initiative, there were a number of calls for changes to the bonding arrangements for insolvency practitioners. As a result, we have had initial discussions with a range of stakeholders, including the Recognised Professional Bodies (RPBs), the current bond providers, successor practitioners, creditor representatives, and industry bodies such as R3, to see whether the current system remains fit for purpose.

This call for evidence seeks your views on the current bonding arrangements and how any problems might be addressed in a future reform of the bonding requirements for insolvency practitioners in England, Wales and Scotland.

The document also explains some voluntary measures that we are currently working on with industry bodies to improve the bonding system, and seeks your views on what other measures could be included.

3. Background

The purpose of bonds was initially set out in the 1984 White Paper "A Revised Framework for Insolvency Law". The White Paper, in addition to proposing the regulation of insolvency practitioners, proposed that an insolvency practitioner should be required to take out insurance cover against losses caused by their dishonesty and negligence in insolvency appointments.

The White Paper led to the introduction of the Insolvency Act 1986, which requires a person to be authorised by an RPB to act as an insolvency practitioner. The Insolvency Practitioner Regulations 1986[1], which supplemented the Act, provided that, subject to certain exceptions, an insolvency practitioner appointed to act must have in place a bond under which, in accordance with the provisions of the Regulations, the surety or cautioner would be liable in the general penalty sum of £250,000. In addition, the 1986 Regulations provided for a specific penalty sum in respect of each appointment, limited to the value of the assets in the estate. Where the assets were deemed to be less than £5,000 the value of the specific penalty sum would be deemed to be £5,000. There was no maximum value set for the specific penalty sum.

The 1986 Regulations were replaced by the Insolvency Practitioner Regulations 1990[2] , which set a maximum of £5,000,000 for the specific penalty sum. Further amendments were made in 1993, requiring insolvency practitioners to submit to their RPB each month a schedule of appointments and extending the bond cover to losses caused by the fraud or dishonesty of the insolvency practitioner "in collusion with one or more persons" and "the fraud or dishonesty of any person committed with the connivance of the insolvency practitioner."

1 http://www.legislation.gov.uk/uksi/1986/1995/contents/made
2 http://www.legislation.gov.uk/uksi/1990/439/contents/made

How the current bonding system works

The current requirements for bonding (or caution, as it is referred to in Scotland) are prescribed by the Insolvency Practitioner Regulations 2005[3].

The legislative requirements provide that the bond must be in a form approved by the Secretary of State and should cover losses in the event of either the fraud or dishonesty of the insolvency practitioner (whether acting alone or with another), or the fraud or dishonesty of any person committed with the connivance of the insolvency practitioner.

There are two elements of cover that must be provided by the bond: the General Penalty Sum (GPS) commonly referred to as the enabling bond, and the Specific Penalty Sum (SPS).

The SPS is, as the name implies, case specific. The legislation prescribes that the cover provided per case shall be between £5,000 and £5,000,000 depending on the value of the assets under the insolvency practitioner's control. For each case the practitioner must estimate the value of the assets. If they are collectively worth less than £5,000 then the SPS is £5,000.

The GPS is in force for one year and is provided to the RPB by the practitioner as evidence of his security. The legislation provides a set amount of £250,000 cover across all appointments. The GPS is not specific to any one case. In the event that the cover provided by the SPS is insufficient to meet all claims arising out of any case, claims can be met from the GPS, until that is also exhausted.

Where appointments are taken jointly, each insolvency practitioner must have their own cover for the full value of the insolvent's assets. The premium payable is calculated according to the value of the assets and the assessed risk of the practitioner.

3 http://www.legislation.gov.uk/uksi/2005/524/contents/made

Every month the insolvency practitioner must submit a cover schedule, also referred to as the bordereau, to the insurer and the authorising body. The schedule details the new appointments in that month, any cases which have been closed for which cover is no longer required and any new estimate of the value of assets in existing cases. The insolvency practitioner must inform the insurer within a month of any increase in estimated value.

In practice, where fraud or dishonesty is suspected, a successor insolvency practitioner will normally be appointed in place of the existing one, usually by the relevant RPB. This generally follows the loss of licence of the existing practitioner but this may not always be the case. The successor insolvency practitioner then assumes the statutory functions of the office holder, investigates any loss from the estates through fraud or dishonesty and, where a loss is found, submits a claim to the insurer. Where a claim is agreed and paid, the fraudulent insolvency practitioner remains jointly and severally liable with the surety for the losses.

Bonds do not provide cover for negligence as there is no statutory requirement for insolvency practitioners to hold such insurance. Each RPB has their own regulations for Professional Indemnity Insurance (PII) which generally require (with some exceptions) a firm to obtain cover for at least £1.5 million for any one claim and in total. RPBs' PII regulations require that there be a period of run-off cover where a practice ceases.

The requirements for bonding apply only to insolvency practitioners – they do not extend to Official Receivers and likewise there are no requirements for PII to be held by Official Receivers (ORs) or the Insolvency Service.

The call for evidence is, however, concerned only with the bonding arrangements for insolvency practitioners, as this is the problem requiring immediate review.

Bonding is an important protection for creditors of insolvencies, as insolvency practitioners deal with thousands of cases each year. During 2015 there were a total of 104,346 insolvencies in Great Britain and of those cases at least 56,443 involved the appointment of at least one insolvency practitioner (there are no statistics of the number of IP appointments made in bankruptcy and compulsory liquidations).

During 2015 only one insolvency licence was revoked, though such a withdrawal does not automatically mean that there the individual was guilty of fraud. We do not hold any information about the number of successor IP appointments.

In 2015 the bond providers were notified of 3 bond claims, none of which have been resolved or fully quantified. These represent claims against 3 IPs in 92 cases, with a total amount claimed of £805,897.

4. What are the weaknesses with the current bonding arrangements?

A number of weaknesses with the current arrangements have been identified through our discussions with bond providers, RPBs and successor insolvency practitioners. These weaknesses cover both the legal framework and practical issues.

Legal framework

Prescribed bond requirements are unclear and costly

It is suggested that the statutory requirements are not entirely straightforward and could be open to interpretation. They do not allow for any innovation by insurance providers – requiring submission of cover schedules irrespective of the insurer's business model. Cover schedules are burdensome and increase costs for all parties.

Statutory cover limits are inadequate and inconsistent

The monetary limits have not changed since the introduction of bonding requirements some 30 years ago. The GPS amount of £250,000 over all appointments is prescribed as an absolute and may no longer be adequate. Several recent insolvencies would exceed the maximum level set for the SPS.

Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover

The applicability and amount of the SPS depends on the honesty of the insolvency practitioner to make a correct declaration. If the insolvency practitioner either under declares the value of the assets, or does not declare at all, then the only available cover would be a pro-rata portion of the GPS, assuming that the insolvency practitioner has that in place.

Proceeds of a bond claim are not ring fenced

Once a claim is made, it is paid into the estate and treated in the same manner as any other asset, and is subject to the usual order or priority of costs and fees of the proceedings. We are told it is often the case that creditors who may have been adversely affected by the fraud will receive no direct financial benefit from a successful bond claim.

Lack of provision/control over successor insolvency practitioner fees

The costs of investigating fraud are provided for by the bond, but the liability of the surety is capped at the value of the SPS. The only control over such costs is that they are at the discretion of the surety which can lead to uncertainty. Successor insolvency practitioner fees are determined in the usual manner of any insolvency, though different rates may be charged for bond claim work. Given the age of cases, it can be difficult to engage creditors on these issues. As a result, successor insolvency practitioner fees may exceed the amount available under the bond claim leaving no money left for distribution to creditors.

No statutory requirement for professional indemnity insurance

There is no statutory requirement for specialised PII, which is instead governed by the rules of the individual RPBs, whose requirements differ.

The bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner

There is no regulatory or statutory requirement for insolvency practitioners or firms to hold fidelity guarantee insurance which would cover fraud or dishonesty of a director or employee without the knowledge or collusion of the insolvency practitioner.

Practical issues

Variation in particulars of bond wording causes confusion

There are wide variations in cover between bond wordings, particularly in terms of reporting deadlines, limits on liability and maximum indemnity periods. These depend not only on the bond provider but on the date of issue. There are reported issues with successor practitioners obtaining copies of the relevant bonds, and having to submit protective claims in order to ensure that cover will be available.

Increasing costs of premiums

In response to increased perceived risk, we are informed that some bond providers have increased SPS premiums for smaller firms (two or less insolvency practitioners) by up to 200% for 2016. While pricing of risk is a commercial matter for the insurers, concerns have been raised that smaller insolvency practices could be priced out of the market, which would reduce competitiveness.

Adversarial nature of claims

We understand there is little interaction between successor practitioners and sureties, with the insolvency practitioner carrying out their usual statutory duties and any investigation according to their own judgement. There is often no discussion or sanction of investigatory work by the surety, who are presented with costs only at the claim stage. There is no agreement to determine the amount of work to be undertaken, which insurers claim can on occasions be disproportionate to the loss suffered by the estate. This lack of co-operation can lead to delays in settling claims and increases costs to the detriment of creditors.

Cessation of cover on non-payment

Some bonds provide that cover is only available when the premiums are paid. While the enabling bond is paid at the outset of cover, the SPS is collected throughout the year as appointments are taken. Where an insolvency practitioner fails to maintain payments, it is reported that in some instances insurers are terminating cover retrospectively which leaves estates without protection.

Limited number of insolvency practitioners willing to take on successor appointments

Currently there are only a small number of insolvency practitioners willing to take on successor appointments, which means that there is little competition and to some extent those undertaking successor appointments can set their price for undertaking this type of work.

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

We agree that the issues have been identified and that the current system is not working as expected by creditors.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

We cannot think of any other weaknesses.

5. What similar systems operate in other industries?

In the legal profession, solicitors must hold professional indemnity insurance with minimum terms and conditions which are set by the Solicitors Regulation Authority (SRA) Indemnity Insurance Rules. These are approved by the Legal Services Board and the latest rules in effect are those from 2013.

The SRA also administers the Solicitors Compensation Fund (the Fund), which is designed to replace money that has been misappropriated either by a solicitor or their employees. The Fund can also provide compensation where a solicitor did not have the proper professional indemnity insurance in place.

The Fund is established by the Law Society and funded by contributions from solicitors (including registered foreign or European lawyers), recognised and licensed bodies. During the 2013/14 financial year, any individual holding a practising certificate were required to pay a flat rate of £56. Any legal practice which has held client money in the previous 12 months also had to pay a contribution of £836. These contributions are calculated according to the minimum reserve of the fund and forecasting for the year ahead: the contributions are the balancing figure required to maintain the minimum reserve at the end of the current financial year.

The Fund is a fund of last resort, and payments from the Fund are entirely at the discretion of the SRA. There is no legal entitlement to compensation from the Fund.

Most other professions, including accountants, rely on requirements for individuals to have taken out PII.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

Yes.

6. Potential measures for reform

There are a number of ways that the bonding system could be reformed through non-legislative and regulatory change, as well as legislative changes.

Non-legislative and regulatory changes

The Insolvency Service is exploring options with industry to take forward some non-legislative and regulatory changes. These include:

- A claims management protocol agreed by the insurers and RPBs
- An approved panel of successor insolvency practitioners.
- A duty that investigative costs must be proportionate to loss
- Greater transparency over rates for investigation work

Claims management protocol

At present when a successor insolvency practitioner is appointed there is very little engagement between the insurers, RPBs and the insolvency practitioner. It is often only when the practitioner presents his/her claim for costs to the insurers that dialogue takes place and then it tends to be confrontational and adversarial. A claims management protocol will help to improve relationships by setting out the duties and responsibilities of each party. For example, it could set out the information that parties need to provide to each other and timescales for doing so. It could provide for regular reviews between the successor practitioner and the surety during the course of the investigative work.

The aim of the protocol would be to provide clarity of where responsibilities lie, so that parties know where they stand in relation to each other. This should help to reduce costs and avoid lengthy disputes, all of which will benefit the insolvent’s estate and ensure that the proceeds of any bond claim reach the creditors, which is the driving objective of bonding.

Approved panel of successor insolvency practitioners

The main aim of the panel would be to encourage a wider circle of insolvency practitioners wishing to taken on successor appointments in potential fraud cases, a function which is currently undertaken by a very small minority of insolvency practitioners. A panel comprised of insolvency practitioners who have expressed an interest in this type of work and have the necessary experience and resources to deal with a portfolio of cases, could encourage more insolvency practitioners to take such appointments.

Only insolvency practitioners on the approved panel would be eligible to be appointed as successor practitioners to investigate potential cases of fraud and dishonesty, and any practitioner on the panel would be agreeing to the terms and conditions set out in the claims management protocol, providing a method of enforcement. These terms and conditions could include provisions regarding the rate charged for investigation and proving a bond claim, for example.

Appointments from such a panel would generally be made by the RPBs.

A requirement that investigation costs must be proportionate to loss

In some cases we have seen evidence where the costs claimed by an insolvency practitioner in proving a bond claim are disproportionate to the loss suffered by the insolvent estate. While insolvency practitioners are expected to use their professional experience and commercial judgement in carrying out their work, it has been suggested that a requirement as part of the protocol for investigation costs to be proportionate could reduce costs to estates which have already suffered a loss.

Greater transparency over rates for investigation of fraud and dishonesty

The Government has never sought to impose statutory limits on the hourly rates or remuneration of insolvency practitioners, the question of remuneration being left to creditors who have an economic interest in the outcome.

Investigation into fraud and dishonesty is not reserved to insolvency practitioners and may be carried out by any suitable person – the Secretary of State may consent to a bond being assigned to any legal person. It is also typical that fraud and dishonesty occurs several years into an insolvency, where creditor engagement will be very low and it is right to protect the interest of those creditors.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

The document seems to cover all the relevant issues.

While a claims management protocol would be a non-statutory solution, we would expect it to have regulatory force. Therefore RPBs would be responsible for monitoring successor insolvency practitioners for compliance with the protocol, in a similar way to compliance with Statements of Insolvency Practice and the Insolvency Code of Ethics.

As well as a claims management protocol, we are also working with RPBs to improve early detection of the warning signs of fraud. The RPBs have quarterly meetings to share best practice and discuss common issues they encounter on inspections. One large bond provider has already attended meetings to relay their claims experience so that RPB monitors can consider this information in planning and carrying out visits.

Legislative changes - options

Option 1 – Do nothing

This option would maintain the current legislative status quo. The Secretary of State would continue (through the Insolvency Service) to approve bond wordings and would have limited scope to seek amendments to a proposed bond beyond the prescribed requirements.

The remuneration of the successor insolvency practitioner would, where based upon time spent on the case, be subject to the requirement to estimate their fees in accordance with the Insolvency (Amendment) Rules 2015. As this will only apply to cases where the basis of remuneration is amended after 1 October 2015, it will be several years before any effect is seen in bond claims.

The claims management protocol and regulatory measures outlined on pages 11 and 12 would be introduced alongside the existing legislative framework.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

Yes.

Option 2 – Repeal legislative requirements

This option would remove the legal requirement for an insolvency practitioner to take out a bond or caution. Therefore, there would be no statutory protection for creditors in the event of a loss to the insolvent estate through the fraud or dishonesty of the practitioner or anyone acting with the connivance of the practitioner. This would be similar to arrangements in insolvency jurisdictions in other parts of the world, e.g. Australia, which no longer has statutory bonding requirements.

In the absence of a legislative framework, the insolvency practitioner would retain a liability for any loss caused by their dishonesty or fraud, a right of action, which could be assigned by a successor practitioner if there is a prospect of recovery. RPBs could decide to make it a requirement for granting an insolvency licence that practitioners have adequate insurance in place to cover losses through dishonesty or fraud, in a similar way to the current regulatory requirements for professional indemnity insurance.

The repeal of the relevant legislation would remove the cost of obtaining bonds for insolvency practitioners themselves (in respect of the GPS), which would reduce costs for creditors. It would also remove administrative burdens from practitioners and RPBs in longer having to submit and process monthly bordereau returns.

This option recognises that under the current arrangements the proceeds of claims are often largely consumed by the remuneration and expenses of the successor insolvency practitioner. Hence the legislation is no longer meeting its purpose of protecting creditors' interests; instead creditors are effectively paying for the bond with no benefit to themselves.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

The removal of statutory bonding requirements would be of benefit to the IPs but there does need to be some certainty for creditor protection. Creditors will look to items such as proposed claims management protocol to provide this. If this is not provided then creditors will lose confidence in the integrity of Insolvency Practitioners and the system.

Option 3 – Amend the current legislation

There are a number of possible ways in which the legislation could be amended:

a) Amend the current prescribed terms of a bond

Certain terms of a bond are prescribed by Part 2 of Schedule 2 to the Insolvency Practitioners Regulations 2005. The Regulations also set out other terms which may be included in the bond.

Currently the Regulations prescribe terms covering the extent of liability, the manner in which the insolvency practitioner should inform the surety of the cases and asset values, the amount of cover and the limitations on the amount of cover. Other terms are set by the bond providers and different bond providers have different terms governing, for example, the time limit in which claims must be made and the maximum period in which the surety is liable under the policy.

The wording of each bond must be approved by the Secretary of State. In practice this means that when amending wording the surety must submit the proposed wording and any endorsements to existing wordings to the Insolvency Service to review. We then ensure that the minimum terms in the Regulations are covered by the bond but we do not express an opinion on other terms that may be included.

We are told that variations in bond wording can, in some cases, lead to uncertainty where the successor practitioner does not know which bond wording was in force at the relevant time. Also some of the existing requirements (for example, the use of cover schedules to calculate the amount of cover required) may be overly prescriptive and, we are told, have hampered the ability of at least one insurer to use an alternative model which would dispense with the cost to the insolvency practitioner of preparing and reviewing cover schedules in every case.

One option for amendment would be to prescribe terms for a single, universal bond, which would remove any uncertainty from the claims process and mean that the protection for all insolvent estates would be identical irrespective of the provider or the relevant period in which the fraud or dishonesty occurred. This option, however, could stifle competitive pricing of bonds, as all insurers would be bound by the same terms. Some insurers may also be unhappy with the prescribed terms and decide to withdraw from the market, which again would reduce competitiveness. Alternatively it may be possible to remove some of the more administratively burdensome requirements of the current prescribed terms.

A further solution would be to prescribe minimum terms and conditions that all providers must include, with the remainder at their discretion. This could help to reduce variations on claim time limits and limits on liability, but allow insurers flexibility over other areas of the policy wording.

b) Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs

Once a claim under a bond has been agreed, it is paid to the successor practitioner and into the estate account. As with any other funds received into the estate, the bond pay-out is then subject to the usual order of priority in an insolvency, and so is liable for the costs and fees of the proceedings, including the remuneration of the successor practitioner and the costs of the investigation.

In a typical bond claim, the surety will agree the amount of the claim for the loss suffered by the estate through fraud or dishonesty, then any unavoidable costs, such as where the successor has to repeat work that had already been charged to the estate by the initial office holder, and finally the costs of incurred in proving the claim.

Even where the successor practitioner agrees with the surety a settlement of their costs in proving the claim, once paid into the estate account all of the proceeds of the bond claim may legitimately be used to meet outstanding remuneration. This can mean that little or no benefit passes to the creditors, who are supposed to be the beneficiaries of bond claims. Hence one could argue that the investigation has served no purpose as the only beneficiary has been the successor practitioner.

To counter this and ensure the creditors benefit from the investigation, an option would be to amend the insolvency legislation to ring-fence the amount paid by the surety in respect of the actual loss to the estate, such as where money was taken from the estate through fraud or dishonesty. The amount would not be available to meet any other costs of the proceedings, for example the costs of the successor practitioner, but would only be used for distribution to creditors in the usual manner.

c) Provide for investigative costs as a prescribed requirement of a bond

The current system provides for “additional costs” and “unavoidable parallel costs” occasioned by fraud to be met from the bond. However, all of the bonds currently available limit the liability of the surety to the value of the SPS in every case. In practice this means that where the majority of the assets are removed from an insolvent estate there can be no cover for investigation costs.

There is also no provision for a review of other cases in the portfolio and the costs are only covered in those estates where fraud is proven. This has lead to the use of ‘central costs’ incurred across a portfolio of cases which is then met by payments from the cases where fraud is proven, effectively cross subsidising the costs of cases where no fraud was proven.

By setting a limited amount of investigative costs as a prescribed part of the bond, it would allow for a proper review of all cases where a successor practitioner is appointed, but would ensure that the enquiries would be proportionate as the amount available in each case would be limited. However, there could be a disadvantage in that the limit set could become the de facto amount for every case, which could increase costs overall and it could discourage investigation into complex cases.

d) Agree or legislate for a ‘de minimis’ maximum indemnity period

A recent case arose where the maximum indemnity period had expired three years before the successor practitioner had been appointed, which meant the estate was left without cover. By providing for minimum duration for the maximum indemnity period it would ensure adequate cover was in place to protect the estate and creditors in the event that fraud is discovered. However, such a measure is likely to increase the cost of premiums as there will be a longer period of risk.

e) Remove requirements for monthly cover schedules and provide for an annual or global bond cover

Currently an insolvency practitioner is required to declare the value of estate assets and submit cover schedules to their respective insurer and RPB on a monthly basis. This is an administrative burden on all parties. The asset estimates and cover schedules determine the amount of SPS that applies in each case and the premium to be paid. This limits the cover available to the value of the assets lost, and does not provide for additional or duplicate costs of investigation.

By providing for a single annual or global bond, it would reduce administrative burdens and allow insurers to determine the mechanics of operating the bond, rather than prescribing this in legislation. An annual global bond could hold more risk for the insurer, which could increase prices for smaller practices and may make it difficult for them to obtain insurance, but on the other hand, removing the legislative constraints would allow insurers the opportunity to innovate.

f) Amend the existing monetary limits of the GPS/SPS

The monetary limits for the GPS and SPS are currently prescribed by the Insolvency Practitioner Regulations 2005, as amended. They are:

GPS – absolute value of £250,000 across all cases
SPS – minimum of £5,000, maximum of £5,000,000
Global aggregate limit of at least £25,000,000

The amounts set have not been altered since 1993 and are now out of date. The GPS is intended to be available to make up any shortfall in the SPS, but is rarely, if ever, sufficient to do so. The amount could be increased and stated as a minimum, so that bonds could be tailored to practice size.

The SPS is the actual asset value per case. There should be no need to have a maximum – though an insurer may wish to apply an automatic limit that requires consent before a higher amount attaches. The advantages of this would be to allow the bond to meet the actual amount of cover required. The disadvantage is that an increase in the amount of cover will increase the risk and therefore the premiums.

g) Introduce a duty that investigative costs must be proportionate to loss/cover

There is currently no legislative provision that covers the work of the insolvency practitioner as a successor practitioner and bond investigations. Insurers tell us that investigations are frequently disproportionate to the SPS available or amount of any loss. One way to counteract this would be to introduce a duty or requirement that the successor practitioner acts in a proportionate and commercial manner. This would reduce the costs claimed on those cases where fraud is proven and thereby increase returns to creditors and reduce the costs of premiums. However, there is a risk that it might make successor appointments less attractive, lead to less investigation of cases and leave some dishonesty undetected.

h) Protect estate from non-payment

Where an insolvency practitioner fails to pay the bond premium, the bond will be terminated and the estate will be without cover. It is quite likely that a dishonest insolvency practitioner will not pay the bond premium. Therefore to protect the estate from losses and ensure that the bond cover remains in place, it could be a prescribed term in the bond that payment has to be made upfront. Non-payment of the bond should be reported to the RPB, which could then carry out an early monitoring visit with a view to assessing whether licence removal for the insolvency practitioner is appropriate.

i) Include professional indemnity as a requirement for security, including run-off cover

It is currently not a statutory requirement for insolvency practitioners to have professional indemnity insurance, although it is a requirement of the RPBs in granting an insolvency licence. However, we understand that where negligence claims arise after an insolvency practitioner loses their licence, the professional indemnity insurance is no longer available and there is no run-off cover in place. It is the responsibility of each IP to ensure that run-off cover is in place, but where a license has been revoked it may not be possible to arrange that cover.

The legislation could therefore be amended to make professional indemnity insurance a statutory requirement as well as insurance to cover fraud and dishonesty, and also to provide for run-off cover for the same period as the bond. This would give increased protection to creditors, but is likely to increase the costs of insurance.

j) Agree or legislate for insolvency practitioner firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by persons other that the insolvency practitioner

A bond is obtained personally by each insolvency practitioner, and applies to the insolvencies over which they are appointed. Cover does not extend to the firm in which the insolvency practitioner works and does not apply to employees or other officers of that firm.

This could be addressed either by regulatory action or legislation, to ensure that creditors are protected. Such cover might only be required where the firm employs a given number of staff, the ratio of staff per insolvency practitioner, or if the firm specialises in insolvencies where there is a greater risk of fraud.

There are insurance products available, such as fidelity guarantees which could provide wider protection for creditors.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

Yes, we agree with the overall assessment, particularly ring fencing the proceeds of claim for benefit of creditors and amending the existing monetary limits.

Conclusion

The purpose of this paper is to assess whether the current arrangements for bonding of insolvency practitioners remain fit for purpose and to gather evidence on the likely impact of possible legislative change.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.

Yes.

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

Option 3 seems to address the weaknesses in the current system and give confidence to creditors and others that the insolvency profession is working to the highest standards.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

No.

ROTHMANS
recovery

BONDING ARRANGEMENTS FOR INSOLVENCY PRACTITIONERS: CALL FOR EVIDENCE

Introduction

There follows the **personal** views of Rupert Mullins (Licence No 7258) in regard to current and future bonding for Insolvency Practitioners ("IPs"). They should not be taken as the views of Rothmans Recovery Limited, other IPs or staff of the company.

Background on which to establish change going forward.

It was clear from," A Revised Framework for Insolvency Law" presented to Parliament in February 1984 that Insolvency Practitioners should provide sureties, "... to guarantee that they will make good any loss which a person interested in the insolvency or insolvencies, in respect of which an IP is acting, may suffer as a consequence of a breach by him of his duties. A person will be incapable of acting as an IP unless he has provided such security and furnished evidence thereof".

This was a direct follow-on from the fidelity insurance that had existed before in certain insolvency procedures, but had not covered all and it was admitted in the 1984 review that it had allowed a minority of practitioners to, "engage in questionable, if not illegal, practices to the detriment of creditors."

The intention was clear and has been the foundation on which the bonding regime has been based since the Insolvency Act 1986 came into force. Since that date an IP has had a global bond and a specific penalty bond for each formal insolvency appointment. In addition most, but not all, IPs' have had Professional Indemnity Insurance ("PII") to cover their day to day professional conduct.

In the main the majority of the profession is honest and diligent and the three insurance covers have not needed to be used. However there are exceptions and the competence of the current system needs to be considered.

I believe that the current system should ensure that any professional conduct that results in an action against the IP should be covered by his or her PII. If however, the IP is a rogue or as was used in 1986, "a cowboy" then PII is unlikely to be available and the rogue IP will have syphoned of the estate funds, ".to the detriment of creditors".

Thus, to move forward the establishment of risk to the stakeholders in any insolvency must be established and from that the current system be updated but not radically changed. The present regime does not provide sufficient recovery to both put creditors back into the position they should have been or provide adequate resource to the successor IP to progress and close the specific case(s).

Regime going forward

Any person taking on any formal insolvency must be an authorised IP. Anyone else engaged in insolvency related work must report to and be under the control of an authorised IP. No person whatsoever should give insolvency advice unless they are an IP or under the control of an IP. Thus all advice given must be recorded and signed off by the IP even if he or she did not attend the meeting/call or other communication made.

Since the IP will be giving advice in situations where corporate or individuals livelihoods are at stake it follows that debt management, Citizen Advice Bureaux, debt management charities, IVA factories and related organisations must have an authorised IP overseeing and approving such advice.

Having re-established that only IPs may give insolvency advice it follows that the IP should be properly insured either personally or through the organisation for which they work. This would firstly take the form of PI cover. The level and premium being set annually calculated on the potential case load and the insurers' perceived risk. This premium would be a direct expense of the IP company and not a charge on individual insolvency estates.

To cover the rogues there must also be a global and specific bond for formal insolvency to cover misappropriation of funds and the cost of a successor IP to complete the formal appointment. The global cover would be based on the prior year's fee income as a proportion of total realisations across all insolvency appointments regardless of whether realisations are fixed, floating or free assets. This calculation should be simple, cause little extra work and be straightforward given the need to record all cases annually. The size of cover would also be loaded if the IP has had more than one upheld complaint against him or her in the last two previous years. The cover for the global bond would need also to ensure small firms and sole practitioners were treated fairly with premium levels.

The specific penalty for each case would be based on the current system of realisations but then doubled to cover a successor IP's potential costs. This premium would be allowable as an expense of the estate. The minimum cover would therefore be £10,000. The insurers would need to consider the risk based on the number of IPs and also the competence of sole IPs; and both would be considered using complaints upheld and monitoring inspections. Of course this specific penalty could be the same for sole or large IP firms as the level of realisations would be the governing factor.

SUMMARY

In summary

1. The level of risk to stakeholders should be ascertained to ensure that draconian measures are not taken when the perceived risk appears higher than the actual cases for which the system is supposed to be protecting them.
2. The IP authorisation should be tightened up. Unauthorised persons giving insolvency advice should be subject to legislation similar to other "holding out" provisions in other professions
3. All IPs and their staff should hold appropriate PI Cover
4. All IPs should have a global bond & specific bonds for each case based on the current system
5. The bonding should however cover not only for restoring the assets misappropriated but also the costs of a successor IP.
6. The assessment of the likely cover required and premium levels need to be proposed by the appropriate insurance companies and key insurance brokers. These should then be discussed with a committee to include The Insolvency Service, RPBs and the current president of R3.
7. The changes could be incorporated in a Statutory Instrument, without the need for parliamentary time for primary legislation.

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Grant Thornton

Insolvency Service

Response to Call for Evidence on bonding arrangements for Insolvency Practitioners

6 December 2016

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

Legal framework issues

- **Issue – Prescribed bond requirements are unclear and costly**

The administrative burden of monthly reporting of new appointments, increases in cover required and closures, and the payment of premiums is not significant.

The Insolvency Practitioners Regulations 2005 could benefit from a review of the definition of the value to be bonded. For example, it is unclear how assets held under reservation of title terms, VAT additional to the asset value and interest earned by the estate are to be dealt with. Likewise, cases are to be entered on the 'closures' bordereau when the practitioner is granted his release or discharge, but neither of those words is apposite to an administrative receivership or a voluntary arrangement.

Where a larger insolvency-practice firm is involved the cost of bonding is not an issue. For example, for general bond cover for all 35 Grant Thornton licence holders last year the cost was £680. It is much more expensive where a smaller insolvency-practice firm is involved, but that is where the risk of claims is perceived to be. The intervention portfolios of cases taken on by Grant Thornton (or by Robson Rhodes before the merger with Grant Thornton in 2007) have principally been from sole practitioners or other micro-firms. The bonding policies on offer currently are strictly commercial policies adopting the approach of looking at each risk on its merits rather than a one size fits all approach.

- **Issue – Statutory cover limits are inadequate and inconsistent**

The way general penalty (GPS) cover operates differs from provider to provider. It seems to be calculated either as a single sum per IP across all appointments or for appointments in a particular year.

We have set out the portfolios on which we have acted on an anonomised basis at Appendix A. The level of GPS cover at £250,000 has been inadequate on a number of the portfolios where we have finalised bond claims. As it is the insurers' practice not to agree claims once GPS cover is extinguished, there is a degree of estimation in some of our figures for these losses. We are able to provide further documentation to evidence our calculations if required.

Examples (see appendix A for further data)

- *Practitioner D (2009 block transfer) – claims of c.£2.4m against the GPS. This was due to the large number of cases with inadequate specific penalty (SPS) cover or no SPS cover.*
- *Practitioner E (2009 block transfer) – estimate of GPS cover sufficient to meet c.45% of claims on the GPS. This was due to the insurers arguing that GPS cover was unavailable due to expiry of time limits to claim against the GPS prior to our appointment (on Farringdon bonds). A compromise settlement was reached with insurers which included allowing for a reduced level of GPS cover.*
- *Practitioner H (2011 block transfer) – estimate of GPS cover sufficient to meet c.10% of claims on the GPS (not yet accepted). This is due to the insurers arguing that there is no*

SPS cover on 13 claims due to the maximum indemnity period under the SPS expiring shortly following the successor appointment, arguing that certain cases are only bonded to the extent of their assets rather than the upper limit of the bond level and that certain SPS premiums have not been paid and therefore there is no cover.

- *Practitioner K (2012 block transfer) – estimate of GPS cover sufficient to meet c.20% of claims on the GPS (not yet accepted). This is due to the insurers arguing that there is no SPS cover on c.40% of the claims submitted due to the maximum indemnity period under the bonds having expired prior to the appointment of the successor practitioners*

We have not encountered any situations where the upper limit of the SPS set at £5million has been inadequate to cover a claim. It would however seem to be illogical from the insurers' perspective not to provide (and charge for) higher cover on cases that exceed £5million of assets, thereby increasing the pool of funding, although we understand that this limit was insisted upon by the insurers in 1986 when the bonding system was first created.

We have also not encountered any situation where the overall limit of £25 million has been inadequate, but we submit that the apparently arbitrary cap is also illogical given the purpose of the cover.

- **Issue – Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover**

We agree that this is an issue - it seems unsatisfactory that the level of cover on the SPS is left, to a substantial degree, to the discretion of the IP himself. However, it does not seem likely that a dishonest insolvency practitioner would under-bond to defeat or restrict a claim. Issues on under-bonding appear to occur due to motivations concerning cash-flow, saving costs and maximising the funds otherwise available in the estate or inefficient systems, and therefore not identifying when increases are required.

Example – Practitioner D regularly bonded his cases (which were principally rota bankruptcies) for a minimum bond of £5,000, or sometimes £10,000, despite the cases having significantly more assets. We believe this was motivated by a desire to maximise the funds in the estates. There were also 17 cases within the portfolio that we administered with no bond cover but with bond claims. These claims were never adjudicated by the loss adjustor due to the fact that the GPS was already extinguished. A significant increase in the GPS would address this weakness in the bonding structure.

- **Issue – Proceeds of a bond claim are not ring fenced**

There has been no collection of data to indicate whether or not this is an issue.

Despite being one of the two main firms who act as successor practitioners (we have acted on 15 portfolios over the last 12 years and have administered c.1,400 cases following interventions) we have never been asked for any details of what dividends we have paid to creditors out of bond claim settlements (other than by HMRC). Please see appendix 1. There have been bond claims on c.45% of these cases (not all of which are yet settled). The comments that often creditors receive no direct financial benefit from a successful bond claim are not correct.

Please also see appendix 1 for details of distributions made portfolio by portfolio following bond claims. We have paid out over £6m following successful bond claims. Where the information is accessible we have added details of primary losses **paid out** for comparative purposes. The reason why creditors loose out at the moment is due to under-bonding.

Primary losses agreed will have been more than the amounts paid on a number of cases shown on Appendix 1 but there is insufficient cover to pay them.

Presumably other Successor Practitioners will provide similar data.

As with all other insolvency cases where the same priority of costs applies, the successor practitioner should ensure that their remuneration and expenses are appropriate and proportionate although investigations in the cases are necessitated dependent upon the circumstances of the intervention – eg if misappropriation of cash then all accounts will need reconciling. Whilst not easy to quantify retrospectively we would have taken write offs in many of these cases in order to ensure a return to creditors, and in the majority of cases where no bond claim was ultimately made.

In any event cases will have specific reasons why the entire primary loss is not available to creditors including:

- funding other investigations (so avoiding instructing solicitors or counsel on a CFA with related uplift),
- costs of paying dividends and closure (which would have been incurred had the dishonesty not occurred)
- Official Receiver debit balances needing to be paid
- Secretary of State (ad valorem) fees being deducted by operation of law
- Paying any tax that may be due (depending on nature of primary loss suffered)

Sub-issue – dealing with smaller claims

Particular problems arise in delivering proportionate results to creditors on the cases with the small bonds. The manner in which bond claims are adjudicated by the insurer is the same across all claims irrespective of quantum. Insurers often require detailed investigations to be carried out before they will acknowledge a claim and will prevaricate, sometimes for years, before payment is made which greatly increases costs. The insurers' standard of proof is not adjusted according to the quantum of claims. If proportionality of costs was a requirement within the terms of the bond, then it would be unviable to investigate any claims under perhaps £25,000 as costs could not be proportionate if full proof of the fraud was required. There is no fast track process for smaller claims.

> *Example – Practitioner E portfolio where 32 claims were submitted in April 2011, with the profile of the level of SPS claims as follows: -*
>
> - *under £10,000 — 17 claims*
> - *£10,000 to £25,000 — 3 claims*
> - *Over £25,000 — 12 claims*
>
> *In addition to the time spent preparing claims for submission (to the requisite standard required to establish proof of fraud) there followed 8 all day meetings and one half day meeting with loss adjustors between February and September 2012.*
>
> *No written proposals were ever received from the loss adjustors in relation to any claim submitted for consideration in advance of a meeting in order to reduce meeting times despite claims having been reviewed by loss adjustors in advance. There was reading in and preparation time in advance of those meetings and follow up work following each meeting where additional proof was requested. We were asked to provide a quantity of additional evidence, including information that had to be obtained specifically from third parties.*
>
> *There is no reasonable justification for this approach, which only serves to delay the process and increases costs.*

> *On this basis, on average, only 4 claims were agreed per day. At the end of this process in December 2012 the surety refused to accept the loss adjustors' proposals and only paid the element of the claims relating to primary losses and interest leaving us with no option but to get to the point of issuing proceedings in order to obtain agreement on costs (which took until June 2014 and as to which see further comments below under Adversarial Nature of Claims). We attended those meetings in good faith on the understanding that the loss adjustors were authorised to agree claims on behalf of the insurers including the associated costs.*

We are concerned that under the current system there is no incentive for insurers to settle on small cases and every incentive to prevaricate as once the bond cover is exhausted the costs of continuing negotiations is at the successor practitioner's expense. A substantial increase in the level of the GPS would be one way to address this problem.

Even if primary losses were to be strictly ring-fenced for creditors there would also need to be consideration as to what would happen in the event of the bond cover being insufficient to cover primary losses, interest and costs (which is commonplace and there is no safeguard against). The requirement is only to bond for the level of assets in a case although the bond specifies that it should indemnify the estate for the costs of investigating the fraud and duplication cost. It is usual practice to bond to the top of the bonding band which usually provides some additional cover to address this anomaly but there should be specific room built into the policy to cover investigation costs and interest if any form of ring-fencing was to be considered.

Historically in order to settle a number of disputes with the insurers there have been a number of global deals which do not apportion between primary losses and costs. The ability for such settlements to take place to avoid litigation would be restricted by a ring fencing of primary losses.

- **Issue – Lack of provision/control over successor insolvency practitioner fees**

The cost provisions of the bonds are ambiguous and open to interpretation but in general terms are understood to cover the reasonable and necessary additional costs of taking over the portfolio and (provided that proof of fraud or dishonesty is found) the reasonable costs in providing proof of claim. The bond does not cover costs of completing and closing the case and does not cover costs at all in estates that have been transferred but where fraud or dishonesty is not found. As shown on appendix 1 we have submitted bond claims on only c.45% of cases taken over in interventions. The cost of the investigations which have to be carried out in the rest of the cases to ensure no similar fraud had been committed is not recoverable.

The sureties have maintained a position that they will not pay any costs unless there is a fee agreement with creditors and hence, under the indemnity principal, a liability to pay. The sureties have specifically sought to inspect documentation concerning the fee approvals of creditors.

We have never charged uplifted rates on bond claims. This is despite having no guarantee of payment and there being significant delay before payment (see appendix 1 for evidence of the delays in settlement post submission of full particulars of claims). Whilst the insurers say they are indemnifying the estate and need to be satisfied of the estates liability to pay, they also say that if the estate is liable to pay uplifted rates they wouldn't indemnify that!

> *We attach at appendix 2 and 3 details of the primary losses and fees paid by the bondsman covering the duplication costs of taking on the cases and the costs of*

bringing the claims. These are the two most recent groups of cases we have settled. These cases have all been agreed through the loss adjustor without litigation.

Example one – appendix 2 – these cases relate to a portfolio of IVA's and CVA's from practitioner L on appendix 1. Despite being considered by all to be the urgent claims in the portfolio the claims have taken 29 months from the initial submission of claims to receipt of payment. Initial proposals put forward by the loss adjustors had to be rejected and further negotiations took place eventually resulting in improved settlements. Please note the higher costs on one of the cases which was submitted and adjudicated as a 'test case'. In this case given the length of time it had taken to settle the claim complaints were made to our Regulator.

Example two – appendix 3 – these cases relate to complex schemes (practitioner K on appendix 1) to sell assets back to directors at the price the directors were prepared to pay without marketing and using friendly valuers. The claims have taken 45 months to agree. We were initially told following submission of brief details of the claims that there was no need to submit detailed claims as the loss adjustors would review the files themselves in order to save costs. The proposals as a result of this review were woefully inadequate and were rejected. We were then asked to prepare detailed claims which resulted in much higher settlements:

- *Initial offers for primary losses excluding interest (September 2014) – £189,839*
- *Final settlements excluding interest (agreed January 2016, signed off May 2016 and paid June 2016) – £663,715*

We do not consider that costs agreed by the loss adjustor and paid as part of the bond claim are disproportionate to the losses on any of these cases except perhaps the test case if viewed in isolation and the bondsman through the loss adjustor has inspected the detailed time records on all of these cases and taken the opportunity to challenge the fees.

Costs become an issue that impacts creditors where either (1) the bond cover is insufficient to cover costs or (2) the bondsman refuses to agree the fees in full considering that they are either disproportionate or relate to matters other than the bond claim.

There are fee approval mechanisms which give control to the creditors. Ordinarily the successor practitioner inherits a fee resolution from the previous IP as a fee resolution applies to the case not the IP under the legislation. So different rates or uplifts could not be charged unless there is active engagement of creditors (or approval of the court) to obtain a different fee agreement. Specific problems will arise for the successor practitioner where fixed fee or percentage realisation bases have been agreed with creditors (and the fee may have all been drawn by the previous IP without completing all the work) or where there was no fee agreement or the fee agreements in place are not considered valid.

Where there was no fee agreement, or the previous fee resolution is considered not be 'safe' this leads to further costs of the successor practitioner in attempting to rectify this. We maintain that that under 1(b) of the bonds is it also open to the surety to approve the payment of costs to save costs. On at least one instance (a pre-2003 administration) we have been forced to apply to court for approval in order that the estate will be liable as the previous IP's resolution specified that fees could be drawn on a time basis with court permission. The loss adjustors had reviewed these fees, were fully apprised on the situation and were in a position to adopt a pragmatic approach and recommend that the insurers pay without further formality, but declined to do so

Until there has been an initial investigation into the conduct of each case in the portfolio, it is not possible to say whether there has been a fraud on any given case. Once the initial enquiry establishes prima facie evidence of fraud, more detailed investigations are undertaken to provide the insurers with evidence in support of the case for fraud or dishonesty. Although wording varies across providers, the wording of most of the bonds provides for the costs of investigating the claim where fraud is established, with the written consent of the surety, such consent not to be unreasonably withheld. In practice despite numerous requests to the loss adjustors for cost approval, no costs have ever been approved in advance of investigations.

We do not consider there is a lack of creditor engagement. HMRC is often a principal creditor in such cases and are very interested in delinquent IPs.

- **Issue – no statutory requirement for professional indemnity insurance**

In practice, as PI Insurance is on a 'claims made' basis and policies generally terminate upon bankruptcy or loss of licence, it has not been possible to make PI claims on these portfolios. There are a few exceptions where we have been able to protect the position prior to our appointments by negotiation with the former IP who has submitted the notifications.

We consider that the RPBs could play a more active role in ensuring PI claims are preserved for Successor Practitioners in the period before the loss of a licence. They could ensure IPs who receive complaints notify their PI insurers immediately so regardless of outcome the position is protected either for the IP in terms of costs recovery or for the creditors in terms of losses actually having been caused.

- **Issue – the bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner**

In practice, this is not usually an issue for us. The bondsman has accepted that where an employee of the IP drives the fraud eg colluding to sell a business back to the directors at a pre agreed value then it has been accepted that this is with the knowledge of/under the watch of/collusion of the IP. However, this could be more expressly stated in the bonds given the increasing number of consumer bankruptcies and IVAs administered by one IP where cases managed by others.

Practical issues

- **Issue – Variation in particulars of bond wording causes confusion**

In 2013 we sought counsel's advice on the IRS/Amlin bond wording due to problems we encountered over understanding the time limits. We cannot provide a full copy of the opinion as it concerns on-going proceedings. The following quotes are excerpts from that opinion which relate to the overall wording of the bond:

> *"All the bonds that I have been asked to consider take the rather archaic form of a conditional guarantee, a form which, as the House of Lords has pointed out[1], tends to obscure rather than identify the true nature of the obligations being undertaken."*
>
> *"I note only that the overall wording is poor, to the extent that almost every clause gives rise to numerous and potentially intractable issues of construction."*

[1] *Trafalgar House Ltd v General Surety Co* [1996] AC 199 at 208-9.

> *"The wording of these bonds is fraught with uncertainty, and the scope for argument and competing constructions appears to be almost unlimited."*
>
> *"The result is that the more recent bonds are open to the criticism that they are not fit for the purpose for which they are intended. Indeed, it seems to me that the Regulations themselves are open to the same criticism. But the remedy for that lies in a judicial review process and/or legislative reform…"*

Several bonds have been approved by the Secretary of State which are unfit for purpose and this must in part be attributed to the poor and unclear wording the impact of which had not been properly explained by the Insurers. Two examples of this we are aware of are:

> *Example one:*
>
> *It has been possible for the maximum indemnity period of cover under the bond to expire prior to the successor practitioner taking office let alone being allowed a period of obtaining information and investigation to determine whether there are any claims. This is the reason for the large number of bond claims declined on the Practitioner K portfolio (see Appendix 1).*
>
> *Example two:*
>
> *As widely publicised, Farringdon bonds for a number of years have contained a clause which enables the insurer to deny any further claims on the GPS after three years and allow only the SPS cover to continue. We understand that recent AXA bonds have contained a similar clause. This has led to the brokers for the Farringdon scheme issuing clarification to the industry that they will not take the point.*

One key problem is the setting out of the maximum indemnity periods established in the Amlin bonds (sold by IRS). The bonds themselves do not make clear the applicable deadlines for submission of claims or for what maximum indemnity periods bond cover has been agreed between the surety and the insolvency practitioner. To obtain this information relies on other correspondence between the bondsman and his broker and the former IP and the bordereau returns. It is unlikely that this information would be directly available to any successor IP so this would leave the successor dependent on the surety/broker for identification of the relevant deadlines (for which see responses question 2 – the brokers/sureties have never been willing to freely provide this information).

Secondly, most bonds contain wording along the lines that:

"The Authorising body shall notify immediately of any claim or any circumstance which may give rise to a claim… any claim arising from such circumstance shall be deemed to have been made within the period in which the circumstance was notified."

Under the bond a notification is not expressly required to take any particular form, or to contain any specified particulars. There is no explanation of what ‘immediately’ means, but the inference must be that as soon as the authorising body (or rather, in practice, the successor practitioner) becomes aware of facts giving rise to a potential claim they should give notification.

In practice authorising bodies have historically waited for the appointment of successor IPs and fully particularised claims to be made. This appears to contravene the above clause and there is an on-going risk that the insurers have the ability to seek to avoid claims on the basis that notification was not made on a timely basis thereby exposing the RPBs to claims for losses to the estates resulting from these oversights.

Over-reaching all of the above is also the issue of a successor IP getting access to the relevant bond wording in the first place (see question 2 for further details).

- **Issue – Increasing cost of premiums**

Since bonding was originally introduced in 1986, insolvency regulation has become more robust and this is likely to continue. People expect to be able to place trust and integrity in self-regulatory regimes and so in rare instances of fraud, full investigations need to be seen to be done. This together with a couple of firms being prepared to commit significant time to these investigations on an unfunded basis has resulted in more claims being identified and submitted.

This is a strong positive for the profession generally and it may be that premium income must increase to meet the higher incidence of claims. On offer currently is a purely commercial product, looking at the risk of each insolvency practitioner to be insured on its merits. Inevitably perhaps this is leading to premiums rising in the parts of the market where the risk is perceived to be higher.

We consider that one way of addressing this is by: -

- increasing the GPS to say £3 million per practitioner; and
- having one bond and one bond provider for the profession with insurers tendering to provide the Bond for a specific period to obtain the best commercial rates

This would go a long way to addressing any shortfalls to insurers and prohibitive costs to smaller practitioners.

- **Issue – Adversarial nature of claims**

It is agreed that some of the contact with insurers has been adversarial in order to get them to settle claims. We consider there is a lack of engagement/no incentive to settle on the part of the insurers once SPS cover is fully used (where the successor practitioner is on risk for continued costs) and this is a key disincentive to the insurers to act commercially.

> *Example – Practitioner E portfolio*
> *As explained above, in December 2012 the insurers rejected the loss adjustors' proposals in relation to costs and also in relation to primary losses on four cases. No proposals were made with respect to costs and the claims were rejected on the four cases. In relation to the four cases, having obtained a positive counsel's opinion we entered pre action correspondence from March 2013 which was unsuccessful and then incepted ATE insurance and issued proceedings in October 2013. Having issued we then immediately obtained an offer from insurers in relation to the primary losses which led to settlement of the proceedings in March 2014. In relation to the costs, also having obtained counsel's opinion, we entered protracted correspondence with the insurers' solicitors in March 2013; the matter was finally settled in December 2014 following our obtaining assignment of the bonds and a quote for ATE which the insurers requested us not to incept so that they could settle. These matters should have been settled two years earlier with a saving of all the costs unnecessarily incurred in the meantime.*

Communication between the surety and the successor practitioners is via the loss adjustors who have been resistant to any direct communication despite our numerous offers. We are reliant on them passing communications on accurately. The only direct communication has been on matters where legal proceedings have been threatened at which stage the insurers lawyers take over from the loss adjustors. Other than the situations when legal proceedings have been threatened, we attended one meeting with Amlin and their brokers in October

2012. At that meeting the insurers were less than helpful regarding disclosure of the workings of the maximum indemnity periods under the bonds, although this was central to the agenda of the meeting and our conclusion is that there was no willingness on the part of the insurers to engage on an open and honest basis.

As stated above until there has been an initial investigation into the conduct of each case in the portfolio, it is not possible to say whether there has been a fraud on any given case. There have been numerous requests made to insurers for sanction of costs for investigations which have never received responses. It should not be lost sight that these are fraud claims; an adverse finding can have far reaching implications for the former IP including personal bankruptcy and on occasions imprisonment – and such claims are going to generate high costs.

We have tried to encourage early communication with the loss adjustors but there is a reluctance to engage, we believe due to concerns about accepting or implicitly accepting liability.

Particular problems exist in relation to the cases with small SPS where the insurers have historically demanded the same level of proof as a large claim as explained above. There has been little acceptance of the principal of establishing a modus operandi through one test case and then acceptance that this is the likely scenario across other similar cases in order to reduce costs.

> *Example: On adjudication in respect of one early portfolio, after agreement of initial claims the bondsman accepted liability and focused only on quantum. This has not been the case with subsequent portfolios where we have been requested to prove fraud in every case.*

The number of months between submission of full claims to the insurers and payment of claims averaged out for each portfolio is set out in Appendix 1. Absent proceedings, these levels of delays are due the adjudication process and with the insurers in approving the settlements and obtaining payment.

- **Issue – Cessation of cover on non-payment**

This is supposedly a bond to protect third parties against fraud of the party taking out the policy and yet it relies on the honesty of that party in paying the premium with no immediate checks or controls against the practitioner on this and again appears to be at odds with the fundamental purpose of a bond to protect creditors from the fraudulent or dishonest acts of an office holder.

We have had a number of claims declined for non-payment of premiums across several portfolios.

> *Example: On the Practitioner H portfolio the majority of specific bonds that have been declined for non-payment of premiums are cases that were taken on shortly before the practitioner was declared bankrupt. This was a time when the practitioner was under severe cash flow pressure from the banks in relation to his other business ventures and when a large number of the misappropriations from cases occurred. The system appears to operate such that the bonds are incepted according to the bordereau and then an invoice for payment subsequently issued. An insolvency practitioner could take on new cases (or become liable for renewal premiums) which will not be invoiced and even fall due for payment until after the licence is lost and when it is deemed to be too late according to the brokers. The trustee in bankruptcy of Practitioner H tried to pay for these bonds but the insurers refused to accept payment from the trustee.*

The bond does not say *when* the premium has to be paid in order to avoid that consequence, nor do any of the terms and conditions issued by the brokers that we have had sight of, and a late payment by the principal normally appears to suffice. The procedure appears to be that a new case is included on the bordereau return and then an invoice issued for the premiums a month or so later. On the Practitioner H portfolio, we have seen invoices being issued the month following the bordereau. On the another portfolio (Practitioner F) there was a longer gap between the return and invoicing. There are no payment terms on the invoices we have obtained copies of.

We understand that for premiums due for renewal (where the scheme requires renewal rather than the SPS being for the duration of the case e.g. where the maximum indemnity period is about to expire), the procedure is that the cases are automatically identified by the broker and put on a renewals schedule. It is then the insolvency practitioner's responsibility to advise if cover is no longer required and remove the case so that no invoice is issued. We have seen one instance (Practitioner F) where the renewal was omitted from the renewals schedule and the claim subsequently declined as no cover was in place.

In the event of non-payment, a credit control department subsequently chase the insolvency practitioner for payment of overdue premiums. There is no suggestion in any of the correspondence that we have seen that the bond would be cancelled if there was no payment (or was not in place until the premium is paid). Under this system an insolvency practitioner could take on new cases (or renew premiums) which will not be invoiced and even fall due for payment until after the licence is lost and when it is too late. It seems that it is the insurers contention that cover is only ever declined once a claim has been submitted under the bond, but until that point there is valid insurance in place (otherwise the practitioners would be acting illegally).

Initially the payment clauses related only to SPS cover and not the GPS. We are aware that since 2010 under the Amlin Bond, the surety's liability under the GPS is also excluded in the event of non- payment.

> *Example: On the Practitioner H portfolio the loss adjustors have also informed us that there is no GPS for 2010 due to non-payment. This is against a background where there is no SPS either on a large number of the cases in this portfolio due to submission of claims outside of a maximum indemnity period. In this instance, we believe that we have subsequently provided the insurers with sufficient evidence that the practitioner did in fact pay his GPS premium for 2010 but to date have been unable to obtain confirmation that the insurers accept that they made an error in their assertion and that the GPS will pay out.*

From a legal perspective, it is not clear when the bond ceases to be in existence in circumstances of non-payment. If it was never in place, then the practitioners in question (and presumably all other practitioners with the same bonds and with premiums unpaid) commit an offence and in relation to that estate by operation of law and if it is the GPS that is unpaid no longer act in relation to any of the estates. If it is the insurers' case that cover only stops at the time a claim is made as a result of non-payment of premium, then there appears no foundation in law for such an approach. Given it is standard practice for premiums to be paid after the bond is incepted, either of the above approaches is unacceptable.

Under the bond there is no obligation on the broker to inform the authorising body of issues of non-payment – in correspondence they actively deny that they have any obligation in this regard.

- **Issue – Limited number of insolvency practitioners willing to take on successor appointments**

This is a narrow and specialist area and this is presumably a question of supply and demand. Only two firms, ourselves and Griffins have built up specialisms in this market. If the work had been more lucrative, presumably more firms would have entered and remained in the market.

The cases taken over are unlikely to hold significant (or any) assets to fund either on-going investigations or closures. There is no opportunity for due diligence prior to accepting appointments or ability to cherry pick which cases are transferred.

> *Example – on practitioner G, we only inherited funds of over £5,000 on four of the 66 cases in the portfolio, those funds only being available to fund on further investigations in one of those cases, the rest being due to charge-holders, reserved for prescribed parts etc.*

A large number of cases are required to be taken over all at the same time so the successor practitioner firm needs significant resource and the ability to invest time with no guarantee of payment. The IP may inherit on going proceedings which he will need to assume responsibility for. Alternatively, cases may often just require closure at the successor practitioner's firm's cost. Even if fraud is discovered elsewhere in the portfolio, this would be at the IP's own expense and the costs are not recoverable against the bonds. Usually there is no or limited co-operation with the former IP. Often files are missing and storage agents of the former IP have claimed a lien over books and records due to unpaid fees.

It requires a commitment of resource (often significant) to make sure the claims are investigated and pursued. It is not a straightforward process in any respect; understanding the bonds, obtaining the information on the available cover, securing sufficient documentation from the former IP, bringing the claims and dealing with the loss adjustors as described above.

Also the successor practitioner needs to be able to pursue unfunded antecedent transactions as these have often not been pursued by the delinquent and often debtor friendly IP. It is often these claims that have commercially justified taking over a portfolio, not the bond claims which only exist in less than half the cases.

> *Example – On Practitioner K, we have calculated that to date there have been £6.15 million of realisations other than bond claims. Of these realisations, we estimate that c.£360,000 would have been collected by the former IP (deferred consideration / voluntary arrangement contributions). The balance has required litigation to recover and has included a large number of settlements with directors and other parties that would not have been pursued by the former IP. Not all actions are concluded.*

Being able to commit £1 million plus of work in progress for several years is critical for a successor practitioner if he is to do the assignment properly and this is not something many practices would do where there is no guarantee of recovery at the end.

The comment that this means that successor practitioners can set their own prices for undertaking this type of work is simply wrong. It is a matter for creditors as with any other case. As set out above the successor practitioner is bound by the fee resolution obtained at the outset of the case, or must obtain their own from creditors in order to create an obligation that the insurers will pay any costs. We have never been paid on uplifted rates for this type of work.

The insurers employ one firm of specialist loss adjustors to review and challenge claims. They are specialists in this area and the Successor Practitioners also need to be specialists in response.

The resource issues for the successor practitioner and the high risk nature of the work are the real reasons that there is a small pool of people doing this work.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again it would be helpful if you could provide any supporting evidence

- **Issue – Difficulties in obtaining the bond documentation**

The successor practitioners will not know at the time of their appointment which version of the bond they will be dealing with, or even which brokers/insurers have provided the bond, although copies of the bond are supposed to be (but are not always) held by the relevant authorising body.

We have encountered considerable difficulty in obtaining copies of the bonds and the supporting schedules which give notice of the periods that cover has been provided for. Invariably these are not available from the former Insolvency Practitioner (although the authorising bodies' stance is they should be) and instead they have to be obtained from the broker. At the time of appointment, we are not even aware of who the relevant insurer is in order to be able to anticipate any of the limitations that there may be in the relevant bonds or to guide the authorising body to direct its queries to the relevant broker. The broker will not deal with a successor practitioner and insists on all requests for information coming from the authorising body. This scramble for information is against a backdrop where bond cover is expiring from the moment the former IP ceases to be licensed as there appears to be no ability to renew or extend cover thereafter. This unnecessary and sometimes costly obstruction could be removed with an agreed protocol with insurers / RPB's about provision of such documentation.

- **Issue – failure of insurers to maintain proper records on what premiums have been paid**

Related to the issue of non-payment of premiums we have concerns about the quality of the records concerning which premiums have and have not been paid. Details concerning payment of premiums are unlikely to be in the possession of the successor practitioner in order to allow them to challenge any assertions of non-payments made by the insurer, particularly where those payments have been made out of office accounts rather than the estate accounts. The insurers have resisted being put to proof that payments have not been received against bonds leaving the burden of proof on the successor practitioner to prove that the premium has been paid. This can be a very time consuming and costly process as the records to show this are not necessarily under the Successor practitioners controls.

We are concerned at the quality of the records maintained by the brokers as to what premiums have and have not been paid and there is a particular potential for difficulty where round sum amounts are paid from office accounts of IPs.

We have referred above to the instance of the GPS being declined on Practitioner H for alleged non-payment. We consider that we have provided proof to the insurers from information which we fortuitously found on Practitioner H's server that the payment was in fact made but we have not at the time of writing received confirmation of the brokers' error in this regard.

> *Further example: On the Practitioner F portfolio we have been provided by the lawyers representing the Insurer, statements of account listing premiums outstanding that omitted certain premiums that were also later claimed to be unpaid once claims on those cases were submitted. There are instances where the brokers allocate bulk payments*

of premiums as they see fit and do not follow instructions as to allocation from the IP. We have seen this in relation to the Practitioner F portfolio.

- **Issue – Failure of insurers to decline claims on a timely basis**

There is no procedure for formally notifying an IP or his regulator where a premium has gone unpaid. If payment within terms is to be required before the bond can be relied upon, the terms need to be clearly specified and cover should be formally declined as soon as payment is delayed with the RPB being notified of the decline in cover.

- **Issue – Difficulties in making notification in accordance with the terms of the bonds**

As prescribed in the bond, the authorising body (as beneficiary of the bond) is required to give notice in writing of a claim to the address referred to in the bond schedule or to any other address notified to the authorising body. All the current bonds are clear that notification should be made of "circumstances that could give rise to a claim".

RPB's currently interpret that they should only report after an investigation has been completed, which could be after a renewal has taken place. All complaints that go to honesty or overbilling should be reported by the RPB's on receipt.

The practical process of notifying claims to the insurers is frustrated by the insurers' failure to:

1) Have adequate systems to identify bond policies which they are responsible for (as opposed to other insurance products) and acknowledge claims or notifications in a timely manner.
2) Make provision for when they have moved address (including a failure to advise the authorising body of any change of address for service)

Example – Practitioner Q portfolio – insurer AXA

Notification of circumstances that could give rise to a claim was submitted on 28 September 2015 to the address set out on the bond (5 Old Broad Street, London). In this case, as successor practitioners, we had received an assignment of the bond so we, rather than the authorising body, were making the notification.

After 8 chaser letters/emails the correspondence was acknowledged on 27 April by the Liability Claims Department at an address in Bolton.

We make the following observations:

- *5 Old Broad Street is still a current address for AXA (their head office)*
- *Correspondence was returned to us marked "We have been unable to trace on all our systems"*
- *(This is despite copies of: the 2013 bond being included in corresponding setting out AXA provided cover, details of the signatory on behalf of AXA and provision of what we believe was a policy number)*
- *Our repeated requests for details of AXA's complaints procedure were ignored*
- *We confirmed with Practitioner Q's authorising body that they have not been provided with an alternative address for service by AXA*

It is unacceptable that it took 6 months for AXA to acknowledge receipt of our correspondence.

- **Issue – bond cover only covers the period in which the IP is in office**

In intervention cases, there may be issues that arise post the IP holding office. Instances have arisen where funds have been removed from cases in the hiatus period before transfer over to the Successor or on one portfolio where the entirety of the case files were destroyed or 'lost' during this period.

> *Example: On practitioner J intervention was delayed and files across 102 cases that existed and had been inspected pre loss of licence disappeared in unarguably suspicious circumstances. As there was evidence they were in situ at the time the GPS expired and any losses caused by the destruction of the files fell outside the bond cover.*

Equally, a common type of claim arises in relation to transactions that have taken place pre appointment, for example sale of assets or the writing off of overdrawn directors loan accounts. In such cases there is nothing left in the case on appointment and the case would be bonded for £5,000. We have had instances of insurers paying out on frauds in anticipation of the appointment when satisfied that it was part of overall modus operandi of the IP, but clarity in the bond that it covers the appointment and preparatory work leading to the appointment would increase certainty.

- **Issue – some schemes ensure that the bond terminates at the end of an administration and require the IP to purchase a new bond for the liquidation**

The Regulations state that bond shall provide for the payment of losses whether they arise 'during the period in which the Insolvency Practitioner holds office in the capacity in which he was initially appointed or a subsequent period where he holds office in a subsequent capacity'. A key area where bond claim losses are likely to arise, if there are any, are in the administration appointments due to the higher level of recoveries and the possibility of the IP colluding with the directors/charge-holders. Despite there being a clear intention of the Regulations that there should be continuing cover, certain providers require that the Insolvency Practitioner obtains a new bond on exit of administration to liquidation, thereby allowing the insurer to decline losses in the administration period and limit losses to the liquidation period only, if sufficient time has elapsed between the administration and the appointment of the Successor.

- **Issue – some schemes systematically limit the SPS cover to the statutory minimum of the level of assets**

The Lockton/IRS on-line bonding scheme does not appear to give discretion for the IP to request a level of bond, it is calculated by the broker and restricted to the level of assets. Despite this, premiums are charged to the top limit of the bond. Cover for costs of bringing bond claims is therefore systematically restricted under this scheme. The broker appears to breach his duty of care to the IP in his capacity as office holder to provide the best level of cover available for the price paid in doing this.

> *Example – on one Practitioner H case the SPS cover has been restricted to the funds that were expected to be realised in the case which was cash at bank of c.£660,000. This is despite the bordereau returns sent to the authorising body showing the level of cover to be £1 million (the top of the premium band) and Compliance on Call inspecting the bonding arrangements and noting that the IP should make sure he always bonded to the top of the band (which the IP did not have the discretion to do under these arrangements). The cash at bank was misappropriated by the IP and the value of the bond does not provide any interest or costs cover (other than through an*

inadequate GPS). We are disputing this, which is significantly increasing the costs that should be incurred in this claim.

- **Issue – the brokers sometimes appear to act in the best interests of the insurer rather than the insured**

The follow on concern from the above issue is that the brokers sometimes appear to operate to restrict the exposure of the insurers rather than in the best interest of the IP's. In particular, we understand Locktons/IRS is part owned by Amlin and appears to have conflicts of interest in this regard. Even in instances of tied brokers, we should expect them to act in the best interest of their IP clients and their estates.

- **Issue – the schemes currently marketed all provide cover on different bases making it difficult to move from one provider to another**

Example – under the IRS scheme, SPS bonds have a maximum indemnity period and need to be reviewed if this period ends before the case is complete. The GPS covers all the IP's appointments and is renewable on an annual basis with a time limit on claims. Under the Willis scheme SPS bonds are life-time SPS bonds taken out on appointment. The GPS cover is understood to cover all appointments in a bond year. An IP cannot easily move from a scheme such as JLT or Amlin to a scheme selling lifetime SPSs without making special arrangements to cover SPSs that expire on long running cases. Equally we consider there will be issues with continuity of GPS cover if an IP moves the opposite way.

The Insolvency Service approving one bond at a time for the entire profession with insurers tendering to be sole provider for a period of say 1 to 3 years would be one way of addressing this issue.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work for the insolvency profession?

Given the number of practising IP's is very much lower than the number of practising solicitors, it is unlikely the arrangements in place for solicitors would work. The law society interventions operate with a centrally funded body meeting the entire costs of the intervention with a statutory right to recover from WIP. In insolvency there is currently no equivalent and the RPB's are poorly funded and are not in a position to act as fraud investigators. The bond could specifically also cover costs incurred by the RPB in its investigation where fraud is proved which may assist the extent to which RPB's could carry out investigations. Currently many fraud investigations are undertaken by firms taking a (financially significant) commercial risk.

Further data would be required to assess whether it would be viable to set up some sort of similar central fund for our profession.

We see one positive that can be taken from the legal profession is the pooling of risk across the profession which could be achieved for our profession if one provider insured the whole profession for a pre-determined period.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

Claims management protocol

There is already a claims management protocol in place under the bonds but it is ignored. This provides for adjudication of claims within 90 days of receipt and pre authorising of certain costs. When we have tried to push insurers to work within their own stated parameters, they have failed to do so.

It is stated that the new claims management protocol is to be agreed by the RPB's and the Insurers. We strongly submit that the IPs who have acted regularly as Successor Practitioners will also have valid input to give. Any new or extended claims management protocol needs to also impose obligations on the insurers to act fairly including:

- to disclose the level of cover on a timely basis and if cover is disputed to provide full explanations as to why
- to act in a fair and proportionate way in adjudicating small claims and ensure their loss adjustors do the same.

A claims management protocol could also usefully incorporate:

- a data gateway to enable the RPB to share with the Successor IP the regulatory history of the former IP
- provision for assignment of the bond so that there is consistency across the RPB's in approach
- specific and consistent arrangements for the notification of claims
- a mediation procedure for situations where agreement cannot be reached so the successor IP is not forced to litigate.

Approved panel of insolvency practitioners

The appointing authorising body must be confident that the successor practitioners appointed will actually do a proper job and will bring and pursue claims. The authorising body should also satisfy itself that across the portfolio creditors (and other interested parties such as debtors and shareholders) have benefited from the intervention.

This will involve ensuring:

- the successor practitioner has sufficient resource and skills to take over the case transfer and continue the cases with minimum delay
- he/she has the skills to deal with the complexities of pressing claims against the insurers and can show instances of successful claims under the bond
- the successor practitioner's firm the IP operates within has the willingness and financial substance to support this work and carry contingent work in progress for a number of years.
- the successor practitioner has the ability to investigate and pursue antecedent transactions on an unfunded basis should the need arise (the former IP has perhaps worked with directors / debtors to bury transactions that should otherwise be investigated)
- the successor practitioner will take on all portfolios where a transfer may be required – for example some portfolios have no bond claims (see Appendix 1) and at worst the cases will simply require closure at the IP's own cost. In this sense the job is very much a favour to the regulators.

It is not in creditors interests to appoint a firm without the requisite experience or appetite to carry out these types of specialist investigations.

Investigation costs to be proportionate to loss

We do not agree that it is appropriate to include a requirement that investigation costs must be proportionate to loss (we note this term has already been incorporated into certain of the bonds). This would mean the abandonment of small claims and more generally lead to a windfall accruing to the insurers as a result of restricted investigations. If disproportionate costs are being incurred in some instances we would contend that this is principally because of the reluctance of the insurers, the loss adjusters and the brokers to engage in a more constructive manner. Instead there should liaison and agreement of test cases in a portfolio to establish liability and then a fast track process for smaller claims to agree quantum.

See 7 (g) for further comments.

Greater transparency over rates

We do not agree that there should be specific provisions involving charge out rates in circumstances where there is no guarantee of outcome of investigations and whether they will lead to claims (with sufficient cover). The question of charge out rates should be left to creditors who have an interest in the outcome as is the case across the rest of the profession. Creditor engagement is not necessarily low in intervention portfolios. HMRC is often a creditor and is always interested in delinquent IPs.

See further comments on fees under question 1 **- Issue - Lack of provision / control over successor insolvency practitioner fees**

Question 5: Do you think the introduction of a claims management protocol and regulatory action alongside the existing legislative framework would be sufficient to resolve the weaknesses with the current bonding regime

Simply, no.

The shortfalls of the current bonding regime are relatively easy to understand and thus address. As we see it, the bonding regime has become increasingly less fit for purpose as years have progressed because of a combination of four factors. These are:

- levels of bonding (specifically the GPS) have not increased as costs have increased.
- levels of claims have increased as contentious insolvency specialisms have developed and the expectations of working practises of IP's become more robust
- premium income has (most likely) reduced as case numbers/unsecured asset values have declined
- certain insurers have cherry picked lower risk business at premium pricing, leaving other insurers exposed on higher risk elements of market

As a result, insurers have reacted by:

- seeking to amend policies to reduce potential liabilities contrary to the purpose of the bond
- increasingly seeking to rely upon the ambiguous and oddly structured wording of bonds to deny or restrict claims
- delaying settlements increasing costs and sometimes necessitating proceedings

Whilst this stance is frustrating for those of us trying to recover funds for the benefit of the estates, from the commercial perspective the insurers, it can be understood.

For the bonding regime to work effectively an environment has to be created that

- is commercially attractive to insurers
- enables an environment where investigations can be undertaken and resulting claims discharged in timely basis with payments flowing through to creditors
- financially motivates insurers to respond to claims quickly thus reducing costs

As a self-regulated industry, it is in all our interests that the integrity of the profession is transparent, that fraudulent activities are identified with perpetrators debarred and misappropriated funds calculated and returned to the estates, with costs and interest.

To achieve this in the simplest way,

- the GPS should be increased from £250,000 to say £3 million, with premiums similarly increased and
- one bond per annum should be introduced underwritten by an insurer/syndicate with the risk of all those insured being pooled.

We would envisage that this level of GPS cover will ensure that there is sufficient cover to meet all scenarios of previous shortfalls of SPS cover (see Question 1: **Issue – Statutory cover limits are inadequate).** This will also ensure that Insurers are commercially incentivised to deal with claims.

We would envisage that having one bond with insurers being able to tender to provide the bond for the whole industry for a prescribed period would:

(1) provide clarity of prescribed terms of the bond;
(2) pool the risk of insuring the industry; and
(3) provide a mechanism to achieve best commercial rates.

This, together with tidying up of some bond wording designed to avoid or restrict claims, should

- increase income generated from premiums available to discharge losses
- claims would be dealt with expediently by insurers as costs incurred by delays/litigation would ultimately be paid by insurer from the GPS and not the Successor Practitioner or the estate as is currently the case
- result in losses being paid on to creditors as there would be room in the GPS for shortfalls in the SPS resulting from insufficient cover to meet costs of claims

These are steps that can be introduced relatively quickly without the need for full legislative reform and can be more easily adjusted in the light of practical experience.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners b) the protection of creditors?

There would need to be evidence provided of the cost of alternatives before this question can be properly answered.

The comment that "the proceeds of claims are often largely consumed by the remuneration and expenses of the successor insolvency practitioner" needs to be properly evidenced before it is concluded that the legislation no longer meets its purpose. In any event, the cases of an IP who has lost his licence cannot just be abandoned, but must at least be moved to formal closure, so the costs of transfer and of the successor practitioners picking up the reins will be present whether or not there has been dishonesty and bond claims are to be pursued. If there was no chance of pursuing them, then taking on portfolios of cases in this distressed position would not be attractive to even the small number of practises that volunteer for this role currently.

The number of claims over the last 12 years shows that creditors do need protection against the fraud/dishonesty of certain IPs, especially as the RPBs are not funded sufficiently to conduct complex fraud investigations themselves. Fraud is rarely detected from periodic inspections and is usually only known at the investigation stage if admitted by the practise themselves.

As a profession we require a system that is robust enough to restore public confidence when there has been fraud or dishonesty.

If the statutory bonding requirement were repealed it would need to be replaced with an alternative. As stated above under question 1 the format of professional indemnity insurance is currently on a 'claims made' basis and ceases on loss of licence, so the policies would need to be substantially changed to allow for a period of discovery following the appointment of the successor practitioner if a scheme along the lines of the Australian one were to be adopted.

The current bonding regime, however imperfect, allows for case specific cover and that cost to be recharged to the estate. The cost of professional indemnity cover is not recharged. Consideration of any alternative would need to involve consideration of whether it was possible to recharge as a category 2 disbursement or whether it was to be absorbed as an additional cost of practising as an IP with the knock-on impact that may have, placing a large burden on practises particularly on smaller practitioners.

An advantage of the current regime is that it allows the bondsman to pursue the defaulting IP for recovery of the losses paid out (if viable). An extension of professional indemnity cover would not necessarily bestow this. Our view is that losses caused by fraud/dishonesty (as opposed to negligence) should carry personal and not corporate responsibility.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above and the potential impacts? If not please give your reasons.

a) Amend the current prescribed terms of a bond

Trying to encourage innovation by the insurers is unlikely to be a good thing in this area of insurance. The key focus should be delivering certainty and clarity of cover in the products that are approved. We believe the system could be improved by the Insolvency Service approving one bond per year or periodically which is then provided to all IPs practising. This would provide consistency of wording and would prevent certain insurers targeting lower risk IPs pushing the price up for the remainder of the market.

b) Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs

We consider this is not workable unless there is a statutory requirement to obtain sufficient cover for investigation costs and agreement of claims with the insurer. If ring-fencing is introduced as suggested without making other changes, the successor practitioner would probably have to abandon most claims on commercial grounds, or more to the point successor practitioners will not be available if they are expected to undertake the onerous pursuit of claims for no reward. In addition, we have set out above, under question 1, a number of practical situations that may arise where the primary loss cannot be maintained in its entirety for creditors.

Also this would lead to an increase in the practise currently evident where insurers make payments for primary loss suffered but make no proposal for costs leaving the Successor Practitioner having to take further action and potentially litigate to recover costs.

c) Provide for the investigative costs as a prescribed requirement of a bond

We are concerned that setting a limit on the amount of investigation costs would encourage the insurers to employ delaying tactics to exhaust costs cover and thereby to defeat claims. It is impossible to predetermine set investigation costs for demonstrating fraud such that any IP can ensure that the correct level of SPS cover is purchased on any one case.

However, it is possible to include an allowance in the SPS for an agreed capped contribution to costs from insurers to investigation costs also covering cases within the portfolio where no fraud is proven. The existence of fraud in the portfolio necessitates the need for a certain level of additional investigations in any event and we consider that these additional costs should not be borne by the estate/ the successor practitioner. Historically there are only bond claims in c.45% of intervention cases (see appendix 1) and the costs of investigating the possibility of bond claims on the other 55% of cases are at the risk of the Successor IP.

In our view, the cover for costs is better dealt with through increased GPS cover.

There is a misunderstanding of central costs in the analysis given. Central costs do not relate to the costs of investigating cases where fraud cannot be proven. These costs on such cases are written off by the successor practitioner. Central costs relate to tasks carried out by the successor practitioner which cannot be accurately attributed to an individual case. Examples would be the initial costs of uplifting the case files and books and records, the costs of copying server information from the former IPs systems and interviewing the former IP and/or members of his/her staff. There is no agreement on a methodology as to how central costs should be recouped despite numerous proposals we have put forward both through the loss adjustors and directly to solicitors for the insurers. The insurers continue to argue that such costs should be written off against cases without claims despite this being clearly inequitable as the cases with claims are the ones that have ultimately benefitted from this work. This is an example of a change in approach of insurers as it was originally established practise that the central costs be paid in this way (ie met from the cases that had benefitted from the claims).

d) Agree or legislate for a 'de minimis' maximum indemnity period (MIP)

The MIP was introduced by insurers to give certainty of when insurers would come off risk, the previous cut off of life time bonds was two years from release and discharge for submitting claims, was shown by us to be flawed when a practitioner never in fact received his release. The MIP under certain of the bonds that were issued between 2009 and 2012 in the market ran simply from the date of appointment of the original IP for a set period of time of three years.

There have been a large number of instances of the MIP under these bond expiring prior to or shortly after the appointment of the successor practitioner. For this situation not to occur there also needs to be a reasonable period of discovery allowed (a 'sunset clause') for which is defined with reference to the date the original IP ceases to hold office or the date the successor practitioner is appointed. This was amended again from 2013 onwards.

It is essential that all bonds also include a separate discovery period if they have a MIP.

e) Remove requirements for monthly cover schedules and provide for an annual or global bond cover

This proposal would create difficulties in allowing cost recovery from individual estates pushing the cost burden on to IPs, which would be particularly burdensome for the smaller practice. We do not consider the monthly cover schedules to be an undue burden.

What is burdensome is accurately allocating payments under the monthly payment system when insurers claim, retrospectively, that non-payment invalidates the bond. Focus should be on restricting invalidity of bonds for non-payment.

f) Amend the monetary limits of the GPS/SPS

We are aware that the level of GPS cover was criticised on its first review in 1996, when at least one surety felt it should be increased to £1m. As referred to above, we consider that increasing the level of GPS cover to £3m per IP would result in eradicating much of the perceived weakness of the current structure (see Question 5 above). Such a step would:

- Bring the GPS cover up to a level where it achieves what it was set out to achieve
- Ensure that shortfalls on the SPS are more likely to be capable of being fully paid out of the GPS thereby protecting creditors from failings in the IPs practise, or delays and the costs incurred convincing insurers of the claim
- Increase the amount of premium income for the insurers across the 1,300 practising IPs so that the scheme works better and then payments out should flow more easily
- Incentivise the insurers to settle in situations where SPS cover is exhausted, for example blocks of smaller claims where ultimately the costs of proving the fraud/ convincing the insurer currently falls on IP and creditors often receive no or minimal return /wait years for return.

Further modifications could be made to have a tiered GPS system so it better matches the case profile of an IP, rather than the current one size fits all arrangement. The GPS could be tiered in a way that stated there was a GPS of £250,000 on each case (which is a suggested interpretation of what we currently have, but has not been agreed by insurers) but with a maximum coverage of £5 million. In this way practises in run off or with less than

20 cases would face less premiums if they restricted their appointments. Such insurance should be easily obtainable.

The £5 million limit per case of the SPS could also be removed as this appears to have no place in the structure and presumably denies income to insurers on the larger cases – it may require re insurance in some cases but as stated in question 1 we have never seen an instant where a claim has been made for more than £5 million.

Similarly having an overall £25 million cap does not seem to fit although no claims have ever been seen above that amount. It would be expected that if such claims did exist they would be within a larger practise where other insurance would likely also exist. In any event it should be increased given it has been at this level for 30 years.

g) Introduce a duty that investigation costs must be proportionate to loss/cover

We understand that this has already been incorporated as a term of the Amlin bond since 2013.

The insurers should not be able to dictate and limit how much investigation a successor practitioner should do in circumstances where there is no obligation on the insurer or his loss adjustor to act in a proportionate way to allow him to defeat claims.

> *For example, on Portfolio D where 39 claims paid out, 25 of the cases had primary losses of less than £10,000 and a further seven cases had losses of between £10,000 and £20,000. The practitioner who was a sole practitioner had made every effort to misappropriate assets from estates no matter how small the gain to him personally.*

The loss adjustor could quite easily act in a portfolio with losses like this to suffocate claims, making any cover that had been purchased unresponsive to losses.

The insurer has the fall back of court to assess whether the costs have been incurred in a reasonable way. Our concern about " proportionate costs" are that to have such a term effectively renders the bond ineffective if insurers dispute a claim if the claim is say less than £25k as it is difficult to prove a fraud claim in a proportionate way if the fact of fraud is being disputed. Accordingly, insurers will (and have) simply acted in a way to discourage successor IP's pursuing smaller claims.

For small claims there should be a claims management protocol and then costs could be ‘capped’ provided all parties kept within the protocol.

In our experience the insurer has had more difficulty with the duplication costs than the investigation costs. Duplication costs can be substantial when the only thing the case is being kept open for is the claim and the claim then takes a number of years to finalise. Costs such as statutory reporting, bank reconciliations, periodic internal file reviews and annual tax computations are rarely proportionate when they achieve nothing but keeping the file open.

h) Protect estate from non-payment

We maintain that a ‘Bond’ should not be invalidated by non-payment as it is effectively a guarantee to third parties and not an insurance product. However, if this is not accepted, the insurer should only be allowed to decline a bond cover for non-payment in circumstances where it has formally terminated the bond within a prescribed period and has reported that termination to the authorising body. The authorising body should be given a period to make good the bond payment given it is the beneficiary of the bond.

In circumstances where an IP is about to lose his licence, there could be a requirement placed on the RPB as the beneficiary to the bond to contact the insurer and pay all outstanding premiums.

Please note that as far as we are aware only one provider currently has a payment term as part of its bond and to obligate the RPB to pay would potentially place that insurer in an unfair position commercially.

If there is an increased level of GPS cover available, creditors should still be protected. The GPS should only be issued once payment has been made for the GPS, as a practitioner needs it to trade.

i) Include professional indemnity as a requirement for security including run off cover.

Agreed.

j) Agree or legislate for insolvency practitioner firms to hold a fidelity guarantee or similar to protect creditors from fraud by persons other than the insolvency practitioner.

Agreed. We think this should be part of the bond, giving insurers the right of recompense from the firm where it can be shown that it was the firms failings that allowed the losses to occur. It should not be for creditors to be concerned how the shortfall has occurred – that should be a matter later between insurers.

Question 8: Do you agree the paper sets out the full range of issues or is there anything further which should be considered?

The issues identified appear to be set out largely from the insurers' perspective which is concerning, given that the purpose of bonding is to provide protection for creditors. It is apparent that many of the comments are based on anecdotal evidence from the insurers. We are concerned in particular that we have never been asked for example of details of the dividends we have paid on portfolios and it has simply been concluded that nothing is paid back to creditors following bond claims without requesting details. This is unhelpful rhetoric.

If products have been priced incorrectly in the past leading to shortfalls in premium income against the level of claims, the answer is not to allow the insurers to continually reduce their exposure under the bond so it becomes more difficult and less beneficial to creditors to bring claims, but to rather to ensure that the risks are properly identified and commensurate premiums collected.

Other benefits of interventions

It is important not to lose sight of the fact that there are reasons to appoint an independent Successor Practitioner other than to pursue of bond claims. As referred to above at one end of the scale, the intervention may remove a problem for the RPB who are otherwise left with a portfolio of open cases with nobody to complete and close them. At the other end, certain of the IP's who have interventions will be portfolios where IP's may have been selected by those appointing them for their willingness to turn a blind eye and not pursue directors loans, antecedent transactions etc. Whilst as stated above there are unlikely to be funds available on appointment, there can be significant recoveries in some of these portfolio's that can be achieved by a Successor who is willing to work on a contingent basis.

> *For example, on the portfolio taken over from Practitioner K at appendix 1, we have calculated that to date there have been £6.15 million of realisations other than bond claims. Of these realisations, we estimate that c.£360,000 would have been collected by the former IP (deferred consideration/voluntary arrangement contributions). The balance has required litigation to recover and has included a large number of settlements with directors and other parties that would not have been pursued by the former IP. Not all actions are concluded.*

The body of case law in this area all shows that the Courts regard the RPB's as having a key role in the protection of the public and maintaining public confidence in the profession in circumstances where an RPB withdraws one of its practitioner’s licences. Where a practitioner's licence has been withdrawn for reasons of misconduct, the court does not consider that public confidence is maintained in circumstances where the misfeasant IP appoints or has a role in nominating his own successor.

Role of the RPBs

Authorising bodies should have a duty to act in the best interest of creditors and not that of the insurers. Certain authorising bodies have considered themselves to be arbitrators to mediate between the insurers and the successor practitioners and claim to have a role in determining what are valid claims. If required correspondence demonstrating this can be provided.

Certain of the authorising bodies have for example resisted assigning the bonds to the Successor Practitioners whereas other authorising bodies assign the bonds immediately following the appointment of the Successor. Being the beneficiary under the bond places obligations on that party to serve claims correctly. Not being the beneficiary denies that party the ability to issue proceedings under the bond if agreement cannot be reached through the loss adjustors leaving them exposed in negotiations. We believe the insurers put pressure on the RPB's not to assign and assignment of the bond should become automatic where a successor practitioner is appointed.

On the part of the Successor Practitioners, there has been regular reporting to certain RPB's. Some authorising bodies are more engaged than others regarding progress following the appointment of successor practitioners. There should be greater involvement by the authorising body which has instigated the appointment in monitoring the successor practitioners, including monitoring the overall returns to creditors following claims. This involvement should also benefit the authorising body which is likely to be pursuing disciplinary action and allow that authorising body to learn by understanding the facts that subsequently emerge as to how to improve their on-going monitoring of IPs.

The successor practitioners are also subjected to monitoring by their own authorising body. Case selection for review and overall monitoring could be more focused on the intervention portfolios. The legal authorities show that the courts regard the authorising bodies as having a key role in the protection of the public and maintaining public confidence in the profession in circumstances where that authorising body withdraws one of its practitioner's licences it is entirely consistent with this that the authorising body chooses the successor practitioners.

Monitoring of the insurers and role of the insolvency service

There is much consideration here given to who monitors the successor practitioners and how. There also needs to be consideration as to the monitoring of the insurers and loss adjustors. Consideration needs to be given to who monitors the insurers are delivering an effective product and abide by any claims management protocol. Whilst this role could fall to the Insolvency Service, we consider that it is more appropriate for the role to be undertaken by an Insurance Ombudsman given the specialist nature of the policies. If the Insolvency Service felt that any Insurer had not abided by the spirit of the protocol they could bar that insurer from tendering to provide cover for a set period of time.

Question 9: Of the proposed options for legislative change which would be your preferred approach and why?

We consider that introducing some sort of claims management protocol that is abided by, amending the current legislation in a minor way to increase the level of the GPS to £3 million and then authorising just one bond across the profession which insurers tender to provide on a periodic basis thereby pooling the risk should be sufficient (see questions 4 and 5 above for further details). Such changes could be achieved quickly and easily compared to wholesale legislative change.

To comment meaningfully on any of the proposed legislative changes, there would need to be data on the relative costs of such insurances.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

Final points:

Lack of transparency is wider than just Successor Practitioner costs

There is much focus in this Call for Evidence on successor practitioner fees and the apparent the lack of transparency regarding fees and returns to creditors generally. We have dealt with those issues earlier in this document.

However, there also is no transparency about the commercial returns generated by the insurers in this field. We have not been able to establish the levels of annual premium income from the GPS or SPS cover sold and how that compares to claims paid out. We consider this is also critical information to understand the extent of the financial pressure on the Insurers and if the bonding regime works when coming up with possible solutions. We have sought to suggest solutions in this document in the absence of that information.

The Regulators costs of their investigations

The costs of investigating and disqualifying an IP can be significant, particularly if contested. The Regulators only option for recovery is against the IP personally. We consider that this is a disincentive to regulators to pursue claims against potentially well-funded individuals.

We consider that in instances where fraud/dishonesty is proven (at the time or subsequently) then consideration should be given to the costs of the Regulators investigations also being recoverable against the Bond.

Appendix A.

Bond claim review - Grant Thornton cases - October 2016

	Portfolio	Cases in portfolio	Bond claims submitted	Notifications withdrawn	Bond claims paid out	Average time between submission of claims and settlement (months)	Bond claims denied / coverage issues	Bond claims denied / claim issues	Primary losses paid out (excluding interest) / (where available)	Distributions following bond claims £	Claims outstanding	Notes
1	Firm A - March 2003	153	100		94	36	2	4		2,775,050	-	
2	Practitioner B - Sept 2005	83	40		28	48		12		383,557	-	
3	Practitioner C - May 2009	12	11		10	26	1		249,043	270,889	-	1
4	Practitioner D - June 2009	98	45		39	24		6	145,124	142,467	-	
5	Practitioner E - April 2009	118	39	7	29	43		3	480,687	89,892	-	
6	Practitioner F - Nov 2009	104	17		13	45		4	153,276	133,453	-	
7	Practitioner G - Dec 2010	66	24				13				11	
8	Practitioner H - June 2011	123	52	4	11	26	25		1,936,691	1,469,041	12	2/4
9	Practitioner J - March 2012	102	100	78	22	18	22		-	-		5
10	Practitioner K - May 2012	175	63	7	10	45	25		880,275	775,125	21	4
11	Practitioner L - March 2013	98	63	10	12	29	8		OS	OS	33	6
12	Practitioner M - May 2014	11	-									
13	Practitioner N - Oct 2014	86	-									
14	Practitioner P - Dec 2014	21	7								7	
15	Practitioner Q - March 2015	118	83								83	
		1,368	644	106	268		96	29		6,039,474	167	

General notes

A We have acted as joints with Griffins on a number of portfolios splitting the portfolios 50 :50. The numbers of cases and claims above relate to the cases that we have administered only

B We would envisage Griffins have acted on a similar number of cases to us and bought a similar number of claims

C The primary losses paid shown above have been adjusted from the losses agreed in instances where the bond cover was insufficient

D The dividends set out above relate only to bond claims. There will have been further dividends which follow recoveries following bringing antecedent transaction claims.

Portfolio specific notes

1 In this portfolio the apparent anomolie of there being higher dividends than primary losses is due to one pre 1993 bond with a large amount of interest included in the settlement

2 Most of these settlements were for primary lossses only and costs have yet not been paid. Once costs are paid there will be further dividends creditors and the ratio of primary loss v. dividend will improve

3 The low dividend return on this portfolio is due to the fact that we were forced to obtain ATE and issue proceedings against the insurers in order to get the cost element of the claims paid and also to get primary losses paid on 4 of the cases

4 The claims denied due to coverage issues are principally due to the expiry of the maximum indemnity period under the bonds before claims could be identified and submitted (and in the case of the Practitioner K even before we were appointed).

5 The large number of notifications withdrawn were due to the fact that we could not obtain any books and records to substantiate losses. The only cover available was GPS cover. Due to the low size of losses we have not continued to dispute the MIP on this portfolio

6 This group of cases was prioritised as urgent as they were all IVA's / CVA's. Not withstanding this adjudication still took 29 months. NB recent settlement and dividend estimates are still outstanding

Appendix B

~~APPENDIX I~~

Haslocks Limited 46-48 East Smithfield, London E1W 1AW
Date:
Underwriters: Lloyds C162 Scheme
The Principal: [redacted]
The Authorising Body: ACCA

SCHEDULE OF PROPOSED SETTLEMENTS

Estate	Year of Account	SPS limit	Total primary loss	Interest at LIBOR + 2%	Total primary loss and interest	Grant Thornton Case Specific Costs	Grant Thornton Central Costs	[redacted] Costs	Total proposed settlement
		£	£	£	£	£	£	£	£
[redacted]	2010	100,000	12,000	1,012	13,012	5,197	Excluded from the settlement	Excluded from the settlement	18,209
[redacted]	2010	100,000	3,160	255	3,415	1,840	Excluded from the settlement	Excluded from the settlement	5,255
[redacted]	2010	50,000	4,000	326	4,326	6,964	Excluded from the settlement	Excluded from the settlement	11,290
[redacted]	2010	50,000	2,350	179	2,529	6,825	Excluded from the settlement	Excluded from the settlement	9,354
[redacted]	2009	25,000	Nil	n/a	N/A	n/a	Excluded from the settlement	Excluded from the settlement	n/a
[redacted]	2009	25,000	1,000	77	1,077	5,980	Excluded from the settlement	Excluded from the settlement	7,057
[redacted]	2008	50,000	9,200	848	10,048	24,614	Excluded from the settlement	Excluded from the settlement	34,662
[redacted]	2009	50,000	1,933	164	2,097	3,067	Excluded from the settlement	Excluded from the settlement	5,164
[redacted]	2010	100,000	6,200	530	6,730	7,307	Excluded from the settlement	Excluded from the settlement	14,037
[redacted]	2010	250,000	15,600	1,291	16,891	10,147	Excluded from the settlement	Excluded from the settlement	27,038
[redacted]	2010	50,000	2,077	155	2,232	2,923	Excluded from the settlement	Excluded from the settlement	5,155
[redacted]	2010	50,000	3,000	233	3,233	6,387	Excluded from the settlement	Excluded from the settlement	9,620
[redacted]	2010	250,000	8,000	672	8,672	12,847	Excluded from the settlement	Excluded from the settlement	21,519
			68,520	5,742	74,262	94,098			168,360

Appendix C

~~Appendix 1~~

Haslocks Limited
46-48 East Smithfield, London E1W 1AW

Date: 25 May 2016
Our Reference: 1207002
Underwriters: Lloyds C162 Scheme
The Principal: [redacted]
The Authorising Body: [redacted]

SCHEDULE OF SETTLEMENTS

	Bond	Total Primary Loss	Interest	Total Primary Loss and interest	Grant Thornton Case Specific Costs	Grant Thornton Central Costs	[redacted] LLP Costs	Total Proposed Settlement	To SPS	To GPS 2010	Year of Account
	£	£	£	£	£	£	£	£	£	£	
[redacted] [ADM]	100,000	46,641	7,629	54,270	-	-	-	54,270	54,270	-	2009
[redacted] [CVL]	50,000	8,126	1,177	9,303	25,856	-	1,975	37,134	37,134	-	2009
[redacted]	250,000	4,560	660	5,220	14,286	-	840	20,346	20,346	-	2008
[redacted] [ADM]	1,000,000	109,490	17,785	127,275	37,266	-	1,975	166,516	166,516	-	2008
[redacted] [CVL]	250,000	27,500	3,767	31,267	9,317	-	-	40,584	40,584	-	2009
[redacted] [ADM]	250,000	27,500	4,520	32,020	26,434	-	1,975	60,429	60,429	-	2008
[redacted] [CVL]	100,000	-	-	-	-	-	-	-	-	-	
[redacted] [ADM]	250,000	50,000	8,141	58,141	26,375	-	1,975	86,491	86,491	-	2009
[redacted] [CVL]	50,000	-	-	-	-	-	-	-	-	-	
[redacted] [ADM]	250,000	218,009	34,093	252,102	-	-	-	250,000	250,000	2,102[2]	2009
[redacted] [CVL]	100,000	8,475	1,164	9,639	51,938	-	2,198	63,775	63,775	-	2009
[redacted] [ADM]	250,000	67,334	10,459	77,793	27,709	-	1,975	107,477	107,477	-	2009
[redacted] [ADM]	250,000	27,990	4,562	32,552	16,265	-	1,414	50,231	50,231	-	2009
[redacted] [CVL]	100,000	47,500	7,271	54,771	27,602	-	-	82,373	82,373	-	2009
[redacted] [ADM]	50,000	25,150	4,438	29,588	18,264	-	2,148	50,000	50,000	-	2008
TOTALS		668,275	105,666	773,941	281,312	-	16,475	1,069,626	1,069,626	2,102	

[2] Only payable to the extent that this sum falls within the uneroded part of the General Penalty Sum (as defined in the Bonds), if any.

IPRegulation.Section

From: [redacted]
Sent: 11 December 2016 16:40
To: IPRegulation.Section
Subject: Call for evidence - Bonding - 15 September 2016 (A REPLY HAS BEEN SENT ON 12/12/2016)

Dear Sirs

Very good analysis of the situation. No time for structured response so some thoughts:

I am happy to continue with bonding as it is. It might be a slight pain every month but we are all used to it by now. We all are used to the bonding regime and we all generally have PI cover. The bond premiums are generally reasonable. So far!

Amendment of bonding with annual or global bond would probably destroy sole practitioners – easier to bond as cases arise rather than some huge upfront premium where you may be unable to generate much work at all in the period. At least having a specific bond for each case one can be reasonably sure of related realisations to cover one's cost such as the bond.

I am wary of fidelity cover – it seems so open-ended that the sky is probably the limit for premiums. This kind of control should be in the hands of the IP as regards access to case funds – I am the sole payer on all my bank accounts so the odds of anyone else being able to run off with the money is low. Sole practitioners would likely be priced right out of the market paying for such cover, leaving the market in a few large hands, often where the IP or IPs are just bigger sausages in a sausage factory owned by a non-IPs. I do not think the market should go that way so as a general principle if something tends to make the market more hostile for the small practitioner you should resist it.

Why can the insurance companies not set out parameters for the fees of successor IPs? Why not? Sounds like a nice little earner! I have offered my services but have not been offered any cases to date. I would be happy to take it on and to give upfront estimates – it is not unusual these days in getting work. Why do the creditors not get the option to meet and set fee parameters? Am I missing something? The costs should be proportionate and make commercial sense.

Apart from the successor IP charges issue – which sounds a bit dodgy to me – the current bonding regime works fairly well (or at least as well as any system devised by humans can work). I am used to it and although it can be a bit of a chore each month at least it is a cost that can be generally provided for from the flow of work to which it is directly related. If I get a case with big assets I am quite happy to pay a bond premium on it as the connection between the cost and the benefit that flows from it is clear.

[redacted]
Chartered Accountant & Licensed Insolvency Practitioner

Edward Walsh Corporate Services Limited
Moyard Killincarrig Greystones Co. Wicklow A63 Y683

Tel: 00353 1 2016245

[redacted] is licensed by Chartered Accountants Ireland to act as an Insolvency Practitioner in Great Britain and Northern Ireland and is authorised to practise as an Insolvency Practitioner in Ireland

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Insolvency Practitioner Regulation Section
The Insolvency Service
4 Abbey Orchard Street
London
SW1P 2HT

09 December 2016

Dear Sirs

<u>Bonding arrangements for insolvency practitioners – Call for Evidence</u>

We write with reference to the Insolvency Service's Call for Evidence dated 15 September 2016. This letter sets out the views of Farringdon Insurance Company Limited (Farringdon).

Farringdon is a Guernsey-based reinsurer which specialises in providing reinsurance under insolvency practitioner bonds (Bonds). Farringdon was specifically incorporated in the 1990s to act as reinsurer of Royal & Sun Alliance Insurance plc (RSA) which itself acted as Surety under the Bond scheme administered from 1995 by Willis insurance brokers (the Willis Scheme). Other London market insurers also became involved in underwriting the Bonds through schemes administered by other insurance brokers. Until recently the Willis Scheme comprised approximately 40% of the Bond market. Our understanding is that the Bond schemes were originally all based on the same form of Bond wording which (as required under the Insolvency Act 1986 (the Act) and the Insolvency Practitioner Regulations 2005 (the Regulations)) was approved by the Secretary of State for Trade and Industry (now Business, Innovation and Skills). Although the substantive cover has largely remained the same over the years, there is variation in the form of the Bond wordings in the market upon which we comment further below.

Farringdon ceased to write new business at the end of 2013 and is now in run-off. However, our views based on experience in the market are set out below in relation to each of the questions raised in the Call for Evidence.

<u>Question 1 – Issues identified by the Insolvency Service as weaknesses of the current bonding system</u>

"Prescribed bond requirements are unclear and costly"

We believe that the statutory requirements are sufficiently clear.

We cannot comment on whether the requirement to submit cover schedules is burdensome and increases the costs for all parties (Willis administer the Willis Scheme and deal with this aspect of the Bonds).

"Statutory cover limits are inconsistent and inadequate"

Our experience does not suggest that the statutory limits are inconsistent and inadequate. Where there is a shortfall more often than not this is caused, in our view, by excessive and disproportionate costs claimed by the successor insolvency practitioners (SPs) in investigating and pursuing claims under the Bonds. The amount of the SPS falls to be calculated so as to be at least equal to the value of the insolvent estate's assets, as estimated by the original insolvency practitioner (IP). No allowance, however, is required to be included in fixing the amount for the costs incurred by the SP which are covered under the Bonds. In most instances the amount of the SPS has been more than sufficient to cover the amount of the primary loss to the insolvent estate caused by the fraud/dishonesty of the IP. On the claims data available to us set out in Figure 1 below, there were only two cases out of 102 settled claims in which the SPS was less than the settlement – this was as a result of SP costs claimed.

FIGURE 1

Practitioner	Total number of settled claims	Number of cases in which SPS is less than settlement
IP1	39	1
IP2	28	
IP3	9	
IP4	8	1
IP5	18	
Total	102	2

"Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover"

Although in principle this statement is correct, Farringdon's experience in dealing with claims under the Bonds is that IPs who are shown to have been fraudulent/dishonest have nonetheless properly declared the value of the assets of the relevant estate following their appointment. The premium for the SPS is paid out of the insolvent estate and does not therefore form part of the IP's overheads.

"Proceeds of a bond claim are not ring fenced"

In Farringdon's experience this is a fundamental problem with the bonding arrangements as they currently stand. Where SPs incur costs which are excessive and disproportionate to the primary losses to the insolvent estate, there is little prospect of any significant benefit to the creditors as any recoveries under the Bonds (whether in respect of primary losses or SPs' costs) will be taken by the SPs on account of costs in priority to the creditors in the insolvency. Moreover, to the extent that reductions are negotiated by the Sureties and agreed with SPs on claims for costs under the Bonds, the SPs will reimburse themselves to make good the shortfall by drawing fees from the monies paid by Sureties to settle the primary losses of the insolvent estates. Thus there is often little real benefit to creditors at the end of the day and it is the SPs who are the real beneficiaries of payments under the Bonds. For some SPs the Bonds scheme has, in our view, become a business plan for making money. Such an approach undermines the entire purpose of the legislative and regulatory framework.

Figure 2 below based on the claims data available to us summarises settlements reached with three different firms of SPs on Bond claims in respect of four IPs and compares total realisations with payments to creditors (based on data from Companies House). It is striking that of total realisations of £5,434,675 (which also included other realisations of £1,580,308) across 79 insolvent estates just over £556,000 (or 10.2%) was returned to creditors with the remainder largely drawn from the estates in satisfaction of SP costs. In 68 of the 79 estates, creditors did not receive any dividends at all.

FIGURE 2

Practitioner	Number of Bond Settlements	Bond Realisations	Other Realisations	Payments to Preferential Creditors	Payments to Non-preferential Creditors
		£	£	£	£
IP1	10	1,364,084	751,718	Nil	291,008
IP2	15	481,773	249,200	196,829	2,004
IP6	4	151,210	40,526	Nil	Nil
IP7	50	1,857,300	538,864	6,741	59,446
Totals	**79**	**3,854,367**	**1,580,308**	**203,570**	**352,458**

"Lack of provision/control over successor insolvency practitioner fees"

This issue is exemplified by Farringdon's first-hand experience of SPs purporting to charge uplifts on their hourly rates of up to 300% for Bond claims which leads to charge out rates in excess of £1,000 per hour. In our view such uplifts and charge out rates are grossly excessive and detrimental to creditors' prospects of recovery. Moreover, in Farringdon's experience in many cases SPs do not even attempt to have their remuneration approved in advance by creditors. Instead the SPs embark on a detailed and costly investigation often in reliance on the fee resolution obtained by the original (allegedly dishonest/fraudulent) IP. Even where fee resolutions are obtained from creditors, this is often done after the event and on the basis that the insolvent estate will have no liability for the SPs' costs unless there is a successful claim under the Bonds. This is a breach of the indemnity principle and is contrary to the terms of the Bond which only cover costs for which the insolvent estate is liable.

Examples of reports to creditors by SP's seeking retrospective fee approvals include the following:

> *"At the same time as updating creditors, I would also like to obtain additional resolutions in respect of my fees…It should be noted that we will not recover any bond claim costs unless we are successful in making the claims under [the IP's] insolvency bonds.*
> *…*
> *…in view of the complexity and risks borne to date I will be seeking a resolution for our remuneration on a time cost basis, based upon my charge out rates with an uplift of 25%...As previously stated it should be noted we will not recover any bond claim costs unless we are successful in making the claims under [the IP's] insolvency bonds."*

And, in a case involving a different SP:

> *"The basis of the liquidators' remuneration be agreed by reference to the time properly given by the liquidators and their staff in attending to matters arising in the liquidation and subject to an uplift on standard rates of 50% to reflect the risks inherent in bringing claims against [the IP's] insolvency bonding."*

As to the fee rates charged by SPs, Farringdon has seen the following rates quoted in a report to creditors:

> *"The rates set by [SP] are subject to review periodically and are summarised as follows:*

Grade	***Rate per Hour £***
Partner	*1,050 – 1,185*
Director	*960*
Manager	*750 – 840*
Assistant Manager/Supervisor	*630 – 780*
Senior Administrator	*450 – 750*
Administrator	*165 – 300*

"No statutory requirement for professional indemnity insurance"

Given professional indemnity insurance will ordinarily not respond to fraud/dishonesty of the insured, Farringdon's view is that this is not a key consideration in the context of the bonding arrangements as a whole.

"The bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner"

Farringdon does not see this as an issue. Fraud/dishonesty of an employee whereby losses are caused to a third party would normally be covered under professional indemnity insurance of the firm in which they are employed. Fidelity insurance on the other hand normally covers direct losses suffered by the insured by reason of employee fraud.

"Variation in particulars of bond wording causes confusion"

As noted above, the substantive cover has largely remained the same but there is now variation in the form of Bond wordings approved by the Secretary of State which not only causes confusion but gives rise to particular problems.

The Willis Scheme which is based on the original form of Bond wording approved by the Secretary of State provides cover in respect of all appointments of the Principal as insolvency practitioner in relation to any person or company during the 12 month period of the Bond. Claims made after the end of the period of the Bond in respect of such appointments are therefore covered subject only to the contractual limitation periods in respect of the Penalty Sums. In contrast, the claims made form of wording subsequently approved by the Secretary of State upon which some other London market insurers operate only covers claims made during the period of the Bond (whatever the date of the original appointment of the Principal as insolvency practitioner). While it is perfectly possible for insolvency practitioners to transfer from the Willis Scheme to a claims made form of Bond wording, it is often impractical for them to transfer from a claims made form of Bond wording to the Willis Scheme as this would potentially leave them without cover in respect of continuing appointments which were originally taken out in earlier years. This situation has serious implications for competition in the market.

Moreover, there is a significant difference in the availability of the GPS under the different forms of Bond wordings. Ordinarily where claims are made in respect of a portfolio of cases (which is often the case where an insolvency practitioner has lost his/her licence and there is a block transfer of appointments to the SP) only one GPS will be available under the claims made form of wording being the GPS in the policy year in which the claims were first made/notified. Whereas under the Willis Scheme there are potentially multiple GPSs' available depending upon the year in which the appointments were originally taken out. Thus there is potentially a significant difference in the amount of cover available between the different forms of Bond wordings.

In Farringdon's view, therefore, it would be preferable and avoid both confusion and the particular problems that we have outlined if going forward there were a single approved form of Bond wording upon which the market operated.

With regard to reported issues with SPs obtaining copies of the relevant Bonds, Farringdon is not aware of any incidents where a SP has been unable to obtain a copy of the relevant Bond wording for the Willis Scheme. The reference to SPs "*having to submit protective claims*" is noted. However, in Farringdon's experience the reality is that "*protective*" claims are often notified to Sureties where the SP has not investigated the affairs of the original IP and makes a speculative notification which assists neither Sureties nor creditors.

"Increasing costs of premiums"

Farringdon is now in run-off as RSA no longer acts as Surety for the Willis Scheme and it cannot comment therefore on the increases in premiums charged by Sureties still active in the market. To the extent that SPS premiums are increasing, this no doubt reflects a perceived increase in risk and cannot have been helped by excessive and disproportionate claims for costs which have been pursued by some SPs in recent years.

"Adversarial nature of claims"

In Farringdon's experience it is correct that there is usually little or no engagement between SPs and the Surety before the SP begins an investigation into allegations against the original IP. In reality Sureties are regularly presented with Bond claims (including claims for SP costs) with little prior notice of the investigation. In the circumstances and given the issue over the level of SP costs (discussed further below) this often leads to disputes between SPs and Sureties.

The adversarial nature of Bond claims is not improved by the fact that Sureties are also regularly presented with claims which, on their face, appear speculative. On a number of occasions Farringdon has been presented with Bond claims where the SP has failed to identify any real evidence of fraud or dishonesty (despite incurring substantial costs) and yet seeks to recover both losses and costs under the Bond. These include negligence type claims where it is alleged that the IP failed to realise recoveries but with no evidence of fraud or dishonesty on the part of the IP.

Farringdon has also faced the added issue of SPs seeking to allege that all estates in a portfolio transferred from an IP are jointly and severally liable for the SP's common costs (sometimes referred to as "central" or "pooled" costs). Such arguments have been adopted in seeking to pursue claims for SP costs incurred on behalf of an insolvent estate where no fraud/dishonesty has been found or proven in respect of that estate. Indeed, SP's have sought to justify such an approach by obtaining retrospective fee resolutions from creditors, for example:

> *"To approve that the [SP] be paid from the estate of the company in relation to the central time costs incurred by [SP] in respect of the [IP's] <u>portfolio</u>, in accordance with the rates provided in the report to creditors, uplifted by 25%"* (emphasis added)

And in another case involving the same SP (in the context of an estate where primary losses had been settled at £55,238):

> *"To approve the sums of £4,789,393.84 (plus VAT) and £824,120.40 (plus VAT) to be paid to [SP] from the estate of the Company in relation to the central time costs incurred…<u>these are in relation to time costs…shared by other insolvency estates</u> representing reasonable and necessary additional costs to which the estate is liable…"* (emphasis added)

And in another case involving a different SP:

> *"I also attach a SIP 9 table of our general costs to date in respect of taking over [the IP's] portfolio of cases…Those costs total £364,070 plus expenses…I have apportioned the general costs equally across the estates in the portfolio <u>where I believe the bonding exceeds £75,000</u> and therefore there is a likelihood of a significant return to creditors should a bond claim be successful"* (emphasis added).

As set out above, in seeking such resolutions the SP will often have represented to creditors that they will in fact have no liability for SP costs unless a claim under the Bond is successful.

"Cessation of cover on non-payment"

Farringdon is not aware of any instances of a Surety terminating Bond cover retrospectively due to non-payment of premium by the IP. Farringdon's view, as advised, is that, strictly speaking, failure to pay premium is a repudiatory breach of contract which the Surety may accept. Farringdon's approach in practice, however, has been for the outstanding premium to be deducted from the losses claimed under the Bond. Farringdon considers that this is a fair approach which does not deprive an estate of the benefit of the Bond but which does not deprive the Surety of the premium to which it is entitled as consideration.

"Limited number of insolvency practitioners willing to take on successor appointments"

It may be correct that there are few IPs willing to accept SP appointments (perhaps three or four firms and only one or two individuals at each firm). However, it is Farringdon's view that the bonding arrangements have become a business model and vehicle for the generation of very substantial fees for those SPs in pursuing often speculative claims under the Bonds with little consideration for the creditors of the insolvent estate.

Question 2 – Other weaknesses with the current system

Assignment of Bonds

The Insolvency Service will be aware that the right to bring claims under Bonds is vested in the RPB as "Authorising Body" and that such claims are brought by the RPB for the benefit of the insolvent estate. Unless and until the right to bring a claim under a Bond has been assigned to an SP, the SP has no cause of action under the Bond. Given the concerns which Sureties have about the conduct of SPs and the costs which are claimed by SPs under the Bonds, the RPBs ought to play a more active role in the decision on whether or not to make a claim under the Bonds and to assign the right to an SP. Farringdon's experience is that RPBs are generally too ready to assign claims to SPs without conducting proper investigations of their own into the allegations of fraud/dishonesty against their members and to this extent are failing in their obligations to regulate their own profession. This is particularly acute in the case of IPs whose licences have not been removed by the relevant RPB.

Question 3 – Similar systems in the legal profession

Farringdon cannot really comment on whether a system akin to the Solicitors Compensation Fund would be appropriate for use in the case of insolvency appointments.

Question 4 – A claims management protocol

Claims Management Protocol

Farringdon has been advocating for some time now agreement of a claims management protocol in order to eliminate some of the most serious issues affecting the bonding arrangements. This would certainly be more effective if it also carried regulatory force. It is Farringdon's view that the protocol should deal at minimum with the following matters:

- The RPB/SP must consider at each stage of an investigation into fraud or dishonesty of an IP whether the steps which they propose to take are in the best interests of an insolvent estate and its creditors and consult with the Sureties.

- The RPB/SP must take steps to notify the police if it has grounds to suspect that the original IP is guilty of fraud/dishonesty.

- Following the notification of a Bond claim, the RPB/SP must engage with the Surety on the steps which they propose to take (i) in relation to investigating fraud/dishonesty; and (ii) in pursuing recovery actions against the IP and/or third parties. In respect of such proposed steps the RPB/SP must also provide the Surety with an estimate of the costs involved.

- Before assigning the right to bring a claim under a Bond to an SP, the RPB must satisfy itself that there is evidence of fraud or dishonesty which warrants bringing such a claim. The RPB must not assign a right to bring a claim under a Bond to an SP where the RPB's own investigations or disciplinary actions against the original IP have not been completed. No claim should be assigned by the RPB while the original IP remains licenced and unless his licence has been revoked.

- SPs must ensure that they have obtained an assignment of the Bond from the RPB before seeking to pursue any Bond claim against a Surety.

- SPs must obtain prior approval from creditors or from the Court for the basis of their remuneration for bringing a Bond claim. In fixing such remuneration regard shall be had to the requirements set out in the Practice Direction on the Remuneration of Insolvency Practitioners (the Practice Direction).

- The SP must also seek to obtain the Surety's written consent (such consent not to be unreasonably withheld/delayed) before incurring any costs under the Bonds.

Approved panel of successor insolvency practitioners

Farringdon has no objection in principle to an approved panel of SPs provided that this increases competition and does not unduly restrict freedom of choice. However, Farringdon is unclear as to how this would be implemented in practice given that SPs are ordinarily appointed by the Court following the removal of the IP.

A requirement that investigation costs must be proportionate to loss

As discussed more fully below, Farringdon would propose that provisions be introduced in the regulatory framework which would impose a cap on the costs recoverable under the Bonds.

Greater transparency over rates for investigation of fraud and dishonesty

In Farringdon's view the question of the rates charged by SPs for investigations into fraud/dishonesty is best dealt with by way of the requirement for prior approval of the basis of their remuneration and the need for consent of the Surety together with changes to the regulatory framework (discussed below).

<u>Question 5 – No legislative changes</u>

It is Farringdon's view that to maintain the status quo with regard to the insolvency legislation will make it difficult to resolve the issues which have been identified with the bonding arrangements. As set out further below, it is Farringdon's view that only a combination of statutory and regulatory changes will make the bonding arrangements fit for purpose.

<u>Question 6 – Repeal the legislative requirements</u>

As set out above and in more detail below, Farringdon's view is that the legislative and regulatory framework needs to be amended to resolve the issues identified. Farringdon does not consider that a wholescale repeal of the legislative requirements is necessary or desirable. In this regard it is not clear to Farringdon how the imposition of a statutory requirement on IPs to hold adequate professional indemnity insurance will assist given, as a general rule, insurance will not provide cover for fraud or dishonesty of the insured. It would require something akin to the Solicitors Compensation Fund to protect creditors against fraud and dishonesty of IPs if the legislation were to be repealed.

<u>Question 7 – Amend the current legislation</u>

a) Amend the current prescribed terms of a bond

In Farringdon's experience the major issue with the Regulations and the prescribed terms is that they are silent on the question of cover for costs under the Bond. As set out above, the issues with the bonding arrangements for the most part arise from the way in which claims for SP costs are pursued. Thus, if the Regulations were to include prescribed terms which address SP costs, this would be a step towards resolving the issues. By way of example only, it could be made a minimum term and condition that the SPS is set, say, at a level of at least 125% of the value of the assets of the estate (to provide an allowance for SP costs) with a cap on the maximum amount of costs recoverable under the Bond. As discussed further below, this would also need to be backed up by way of amendments to the primary legislation in order to prevent SPs from taking any shortfall on costs from other recoveries under the Bonds in respect of primary losses.

b) Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs

Farringdon is supportive of this proposal which it considers the only viable option is to prevent SPs from continuing to conduct what we consider to be an abuse of the current bonding arrangements. There must at the least be some form of carve-out from the usual order of priority in order to ensure that sums paid by a Surety in respect of losses to the insolvent estate caused by fraud/dishonesty are available to creditors rather than SPs.

c) Provide for investigative costs as a prescribed requirement of a bond

Farringdon has commented above on the issues arising in relation to "central costs" incurred by an SP on a portfolio of estates.

Farringdon would strongly object to any proposal that there should be a limited amount of investigative costs provided for as a prescribed part of the Bond such change. Whether it is appropriate for investigative costs to be incurred is a matter for the creditors of an insolvent estate. The purpose of the Bond is not to pay for costs where there has been no fraud/dishonesty. Providing for an amount of investigative costs as a prescribed term would, in Farringdon's view, only encourage further speculative investigations by SPs in the knowledge that such investigations would be funded by the Surety. This would, likely make the cover more difficult to obtain and increase premiums.

d) Agree or legislate for a 'de minimis' maximum indemnity period

Farringdon is aware of the concerns over the indemnity period provided for under the Bonds. The Regulations do allow for a limitation to be imposed on the period during which a Bond claim can be brought but it might be appropriate to include a prescribed term to the effect that such limitation period should not begin to run before a specified future date, for example the date the IP ceased his appointment.

e) Remove the requirements for monthly cover schedules and provide for an annual or global bond cover

Farringdon is in favour of reducing the administrative burden on IPs in relation to their bonding arrangements, but it is our view that to remove the requirement for cover schedules or to impose an annual or global Bond cover will simply not be workable. The purpose of the monthly cover schedules is to enable the Surety to understand the value of the assets of each estate and to calculate premium accordingly. It is essential that the Surety knows with as much certainty as possible the value at risk which would not be possible if there was to be some sort of open-ended global Bond.

f) Amend the existing monetary limits of the GPS/SPS

As set out above, in Farringdon's experience the SPS is usually sufficient to cover the losses caused to an insolvent estate due to fraud/dishonesty but, as set out above, Farringdon has proposed that allowance be included in the SPS for costs covered under the Bond. However, Farringdon does not see that an open-ended SPS with no maximum limit is workable. It is essential that the Surety is able to assess the value at risk. The concept of an open-ended SPS was considered when the bonding arrangements were in their infancy and it was dismissed as being completely unworkable. We do not see that anything has changed – the imposition of an open-ended SPS would likely cause sureties to exit the market.

Farringdon is not aware of any compelling reason as to why the maximum prescribed GPS should be increased.

g) Introduce a duty that investigative costs must be proportionate to loss/cover

Farringdon comments and proposals to limit SP costs are set out above.

h) Protect estate from non-payment

Farringdon has addressed this issue above. One solution would be for the Bond wording to provide that payment of premium is a condition precedent to liability under the Bond. The suggestion that non-payment of premium should then be reported to the relevant RPB would seem a sensible one.

i) Include professional indemnity as a requirement for security, including run-off cover

As set out above, Farringdon does not see that professional indemnity insurance provides a solution to the issues identified with the bonding arrangements.

j) Agree or legislate for insolvency practitioner firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by persons other than the insolvency practitioner

Farringdon has commented upon this above.

Questions 8 to 10 – Conclusions

In Farringdon's experience the principal issue with the bonding arrangements has been what we consider to be their abuse by some SPs who take advantage of the arrangements and cover available under the Bonds to generate substantial fees for themselves with little or no prospect of a benefit to the insolvent estate or its creditors. The Insolvency Service recognises these issues in the Call for Evidence.

As set out above, Farringdon's view is that changes to the existing legislative and regulatory framework should be sufficient to resolve the issues with the bonding arrangements. In summary, Farringdon considers that this would involve changes in four areas:

(1) Amendment to the legislation which will change the order of priority and ring-fence recoveries for the benefit of creditors;

(2) Amendment to the regulations in relation to the prescribed terms of the Bond to deal with the issue of SP costs;

(3) The introduction of a claims protocol with regulatory force; and

(4) The adoption of a single form of Bond wording for all IPs approved by the Insolvency Service.

In Farringdon's view if such changes are introduced, these would likely result in increased returns to creditors and greater competition in the Bond market. Indeed Farringdon would itself wish to give consideration to re-entering the market.

Yours faithfully

Farringdon Insurance Company Limited

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THE ACADEMY OF EXPERTS

OUR REF R Isaacs

YOUR REF

13th December 2016

Insolvency Practitioner Regulation Section
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By Email:
IPRegulation.Section@insolvency.gsi.gov.uk

Dear Sirs,

Call For Evidence - Bonding Arrangements For Insolvency Practitioners

Haslocks is a firm of forensic accountants with many years' experience of acting for underwriters, advising on the merits of bond claims advanced by successor practitioners either as or on behalf of the beneficiary.

1.0 Weaknesses of the current system

1.1 Statutory cover limits

1.1.1 In our experience the cover limits are generally adequate and sufficient to cover claims for primary losses and interest. The level of bonding was never intended to include an element for the fees of a successor practitioner and it is typically when these fees become disproportionate that the Specific Penalty Sums are exhausted.

1.1.2 Although it is true that the current scheme relies on a dishonest Insolvency Practitioner ("IP") making an honest declaration as regards the level of bonding, in our experience, the fact that Regulatory Professional Bodies ("RPBs") closely monitor the adequacy of bonding means that it is rare that even dishonest IPs fail to declare an accurate level of assets for bordereau bonding purposes.

1.2 Ring-fencing of primary loss and interest

1.2.1 We are aware of many cases in which successor practitioners have drawn fees from settlements paid in relation to primary losses and interest thereby diluting the amount returned to creditors.

1.3 Creditor engagement

1.3.1 In our experience successor practitioners appear to find it relatively easy to obtain fee resolutions from creditors in relation to the costs of pursuing bond claims on the basis of little engagement. Creditors' approval of fee resolutions appears to be predicated on an understanding that these fees will be paid by underwriters. In other words, creditors appear to be willing to approve any fee resolution on the basis that they will be unaffected by it and that, to the extent fees are drawn, they will be paid by underwriters. In practice, because settlements for primary loss and interest are not ring-fenced, amounts paid in settlement of claims for primary losses and interest can be used to meet the fees of successor practitioners.

1.4 Statutory professional indemnity or fidelity insurance

1.4.1 We would be in favour of a statutory requirement for professional indemnity and fidelity insurance albeit that a dishonest IP might well not be influenced to maintain such insurance cover even in the face of the fear of criminal prosecution in circumstances in which he or she is already acting fraudulently.

2.0 Other weaknesses

2.1 In our opinion, many of the costs incurred in the investigation of bond claims should and could be avoided if it were to be a pre-condition of a bond claim that the relevant RPB, as the beneficiary of the bond, had concluded, prior to making a claim (or assigning it rights to allow a successor practitioner to make a claim) that it was satisfied that there was *prima facie* evidence the bonded IP had been dishonest.

2.2 We are aware of instances in which a RPB has assigned its rights under the bond to a successor practitioner who has made a bond claim in circumstances in which the RPB had merely suspended an insolvency licence pending the completion of its enquiries. In our view this is an abrogation of responsibility by the RPB and could result in a situation in which the RPB concluded, having finalised its investigation, that the IP had not been dishonest and therefore lifted the licence suspension. However, the fact that a bond claim had been made would mean that it would be very difficult for the IP to find an underwriter willing to bond him or her meaning that for practical purposes the assignment would have had the effect of superseding the outcome of the RPB's disciplinary process. We do not consider this to be appropriate.

3.0 Analogies with the legal profession and the Solicitors Regulation Authority

3.1 We are not experts in the workings of the solicitors' indemnity fund but are concerned that the fact that the legal profession is vastly larger than the insolvency profession would render any comparison meaningless.

4.0 Claims management protocol

Subject to this having regulatory backing, the introduction of a claims management protocol has the potential to address some of the weaknesses identified by the Call of Evidence.

5.0 The way forward

5.1 In our opinion, it should be a pre-condition of a bond claim that the relevant RPB must have concluded that there was *prima facie* evidence that an IP had been dishonest before submitting a bond claim; allowing someone to submit a claim on its behalf; or assigning its rights under the bond.

Yours faithfully,

Haslocks

Roger Isaacs
for and on behalf of Haslocks Limited

Call for Evidence

Bonding Arrangements for Insolvency Practitioners – 15 September 2016

Questions	James Cowper Kreston's response
1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.	We have no evidence about the clarity or otherwise of bond requirements. Clearly, the intended beneficiaries of a specific bond have no control over the decision to take it out or the associated cost. We agree that the bonding levels are inadequate. We consider it perverse that a safeguard to protect against the dishonesty of practitioners relies on them to work effectively. The simplest and most effective way to address this would be to streamline the bonding requirement to one single enabling bond for a sum sufficient to cover the assets likely to be handled by the IP in the year which the bond covers. If the bond is not in place by the start of the year, the IP's licence should be suspended. We also consider it wrong that the proceeds of a bond claim are not ring-fenced - which was presumably the intention when the bonding regime was brought into force. It is a requirement of RPB that we hold PII. We do not have a view on whether IPs should also hold fidelity insurance. What seems more important than the holding of fidelity insurance is that the regulatory regime should operate effectively to ensure that only fit and proper persons are permitted to act as regulated and licensed practitioners in the first place.
2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.	No.
3 Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?	We do not feel sufficiently apprised of arrangements covering the legal profession to comment.

Questions	James Cowper Kreston's response
4: Are there any other issues that you would like to see addressed through a claims management protocol?	We are troubled by the suggestion of 'an approved panel of successor insolvency practitioners'. Whilst we have no particular interest in this type of work for commercial reasons, the regulatory framework should only be licensing persons who are fit and proper to be undertaking insolvency work generally. If that regime is operating properly then the call for successor IPs should not really arise but, if it does, successor IPs should act in the interests of the creditors – not in some self-serving manner. In any event, the proceeds of the bond should be ring-fenced for those entitled to benefit from the Estate.
5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?	No.
6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?	If the licensing regime was tightened up to exclude those who are not fit and proper – which ought to be the Insolvency Service's focus - then the impact should be minimal.
7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.	One further option would be to prescribe that in the event of a bond call the further administration of the estate and its distribution should not be payable from the bond which should be ring-fenced (save perhaps for some reasonable cost associated with agreeing claims; making distributions and case closure which would have been borne from the estate in any event). The work to conclude the estate in these circumstances could be performed by the Official Receiver. If successor IPs are to be relied on, however, separate provision should be made to fund their administration work. Successor IPs should not profit from investigating the failings of other members of the profession as this risks bringing it into disrepute.
8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.	Yes
9: Of the proposed options for legislative change, which would be your preferred approach and why?	Single general bond which is ring-fenced – see above.
10: Do you have any further comments you would like us to consider in relation to bonding?	No.

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14 December 2016

BY EMAIL

Dear Sirs

Bonding arrangements for insolvency practitioners consultation response

Please find below KPMG Restructuring's response to the request for responses to the call for evidence on bonding arrangements for insolvency practitioners, issued in September 2016.

Who we are

This response is prepared on behalf of the KPMG Restructuring practice, which is made up of 29 formal appointment takers and approximately 500 staff. We are a national practice with 13 of our offices within England, Wales and Scotland undertaking Restructuring work.

We have a strong presence on several of the Technical and Regulatory committees in existence for the insolvency profession, including representation on the Joint Insolvency Committee, the R3 General Technical Committee, the ICAEW Technical Committee, the ICAEW Regulatory Board, the IPA Council and the ICAS Technical Committee. In addition we have a representative on the R3 Education, Courses and Conferences Committee. This demonstrates the commitment we have made and continue to make to the insolvency profession.

Major issues and areas of concern

We have provided comments on what we consider to be the main areas of concern; for this reason we have chosen not to respond to the specific questions raised by the Insolvency Service as part of the consultation. We have not commented on professional indemnity insurance in this response as we believe that this a separate matter. Professional indemnity insurance is required to cover negligence rather than fraud, which is the stated purpose of the bond. The two are therefore separate.

We recognise the need for insolvency practitioners ('IPs') to hold a bond to protect creditors from fraudulent actions but also recognise the need for change to the current system.

We are concerned that without change the primary purpose of the Bonds as originally intended will not be achieved, i.e. the protection of creditors in the, hopefully, rare instances where a licensed practitioner has acted fraudulently.

Furthermore:

- Successor IPs will be discouraged from taking appointments as there are limited funds in many cases to investigate fraud.
- Cover limits will remain insufficient and any bond pay-outs are likely to be insufficient to cover the loss.
- Cover will be utilised to cover investigation costs rather than restoring creditors' positions.
- The wording of the bond will continue to make evidencing losses caused by "fraud or dishonesty" difficult and increase the level of work required to take action against fraudulent IPs.
- There will remain nothing in place to ensure that fraudulent IPs are bonded in any case.

Weakness with the current system

The main issue with the current bonding system is that there is currently nothing in place to detect cases that do not have adequate bonds in place, other than periodical Regulatory Professional Body ('RPB') visits for the IP. Cases could be under bonded for the net value of assets, after assets have been fraudulently removed beyond creditors' reach, allowing fraudulent asset removal to go undetected. Furthermore, they may not be bonded at all.

The monetary bond limits have not changed for 30 years and are now commercially unrealistic. The maximum Specific Penalty Sum ('SPS') of £5 million is not adequate to cover the assets in many cases now, let alone the assets in large insolvency appointments.

We agree that the General Penalty Sum ('GPS') of £250,000 is insufficient to cover all of an IP's appointments. It is likely that if an IP was to commit fraud, it would be committed over a number of cases and not just one, diluting the amount available per estate significantly. Furthermore, the GPS can only be called upon where the SPS has been extinguished. If an IP did not put an SPS in place on a case, there would be no means to call upon the IP's GPS to investigate and ultimately cover losses in that particular case.

Currently, bond claim proceeds are not ring fenced, form part of the insolvent estate and may be used to fund the investigation work of a successor IP. We appreciate that this prevents the creditors from receiving any direct financial benefit from a successful bond claim in many cases. However, as it currently stands, the successor IP has no other means of getting paid for the work required to evidence fraud which is itself a high hurdle. Both of these points could be remedied if the SPS was increased and an amount of that was ring-fenced to pay successor IPs for investigating whether a fraud claim could be made against the balance of the SPS for any particular case and then from the GPS.

We understand that a small firm may have less controls in place to provide a bond provider with comfort and therefore increase their perceived risk. However, small does not mean fraudulent and care does need to be taken in differentiating between perceived and actual risk.

Paragraph 3 of Schedule 2 to The Insolvency Practitioners Regulations 2005 states that a bond must:

"Contain a provision whereby a surety or cautioner undertakes to be jointly and severally liable for losses in relation to the insolvent caused by

(i) The **fraud or dishonesty** of the insolvency practitioner whether acting alone or in collusion with one or more persons; or

(ii) The **fraud or dishonesty** of any person committed with the connivance of the insolvency practitioner…."

The current bond wording therefore makes claiming against the bond difficult as proving that losses were categorically and without doubt caused by fraud or dishonesty is difficult. If this wording was amended, it may make the investigation process easier, perhaps with a lower hurdle (and therefore cheaper) and more likely to restore creditors' positions.

Options for reform

Do nothing

If the bonding system is left as it currently stands, the weaknesses we set out above will not be addressed.

It is clear that some level of reform is required to make the system more effective and that doing nothing is not an appropriate option for a self-regulated industry or for the oversight regulator which has control of this matter.

Repeal legal requirement for a bond

Whilst there are clear weaknesses in the current bonding system, IPs, the industry, and the Regulators do need to ensure that insolvent estates and creditors are protected from fraud. Removing the bonding system entirely will not do this.

Claims management protocol and successor IPs

Whilst a claims management protocol may make responsibilities and lines of communication clearer, this will not significantly reduce the costs of an investigation and compiling the evidence required to make a claim. It will also not improve any of the other inherent weaknesses in the current system.

A claims management protocol will not prevent fraud and will not encourage successor IPs to take appointments and investigate where there remains no obvious method of payment for their work.

A panel of successor IPs could work well, but this in itself would not encourage a wider circle of IPs to take these appointments; an appropriate route to payment for their work would. This could be remedied by increasing the SPS level and ensuring that a fixed element of that SPS would cover initial investigation costs, as set out below.

That said, it should be noted that our firm has volunteered to take these appointments, notwithstanding the current lack of clarity on cost coverage, but has not as yet been appointed on a successor case.

Amend terms of bond

As stated above and in the call for evidence paper, the monetary bond limits have not changed for 30 years and are now out of date. The maximum SPS of £5 million is not adequate to cover the assets in many cases now, let alone the large insolvency appointments. The GPS amount of £250,000 is, in reality, insignificant, especially in multi-fraud cases.

Increasing the monetary levels of the bond will increase the funds available to cover creditor losses on frauds in excess of the current limits.

Our view is that the SPS should be increased to £10 million, with the first £100,000 being available to cover initial investigations into whether there is an IP fraud claim to pursue. This will encourage a wider variety of IPs to sit on a panel for successor appointments, in the knowledge that there are funds available to cover their costs, at least initially. This segregated fund will also mean that successful bond claims from the SPS will directly benefit creditors.

We also believe that the GPS should be increased from £250,000 to £5 million to not only cover any multi fraud investigation costs but to also to provide meaningful additional cover for assets lost by fraud in excess of the SPS limit.

Conclusion

There is a need for IPs to hold a bond to protect creditors from fraudulent actions but there is an equal need for change to the current system.

We believe that the Insolvency Service should further consider:

- Increasing the monetary bonding limits significantly; for example from the current £5 million maximum SPS and £250,000 GPS to £10 million and £5 million respectively. This will increase the likelihood of bond claims having a direct financial benefit to creditors in light of the asset values on most modern insolvency appointments;
- Adding a separate provision within the SPS to cover the costs of an initial investigation by a successor IP to establish whether there is a fraud to pursue on any particular case. This is suggested to be approximately £100,000. This will encourage IPs to sit on a panel to take successor appointments and undertake investigations for the benefit of creditors, without diluting the compensation available to creditors from a successful bond claim;
- Amending the current bond terms, prescribed by Paragraph 3 of Schedule 2 to the Insolvency Practitioners' Regulations 2005, to make the evidence required to make a claim easier to prove for a successor IP, and
- A consideration by the Regulators as a whole on how bonding can be better enforced and policed to ensure that all IPs have them in place in the first instance and for the correct amount and that IPs who may either 'non-bond' or are fraudulent in their bonding can be quickly identified.

We would welcome the opportunity to work with the Insolvency Service and insurance industry to assist in the development of a more appropriate 21st Century framework

Yours faithfully

John Milsom
Partner

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15th December 2016

PRIVATE & CONFIDENTIAL
Insolvency Practitioner Regulation Section
The Insolvency Service
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London
SW1P 2HT

Dear Sir/Madam

CALL FOR EVIDENCE: BONDING ARRANGEMENTS FOR INSOLVENCY PRACTITIONERS

This letter is sent (by email) in response to the above consultation and sets out the views and comments of MAX Recovery Limited.

MAX Recovery Limited ("MAX")

MAX is a subsidiary of JP Morgan and which has operated since the early 1990's in the United States and since 2001 in the UK. It also operates in Canada and Australia. MAX purchases post-insolvent personal unsecured debt from mainstream lenders. MAX uses Eversheds LLP as its servicing partner in the UK which includes direct liaison with Insolvency Practitioners to file MAX's claims and collect any distributions.

MAX is one of the largest single unsecured creditors in Bankruptcies, Individual Voluntary Arrangements ("IVA") in England & Wales and, in Scotland, Trust Deeds. Since 2001 Max has made over 100 purchases of a total of approximately 1.5 milion claims with a face value of over £1 billion.

Max has no involvement in the corporate insolvency process and so all of the comments below relate to its experience in personal insolvency only. The responses in this letter should be seen in the context of the recent failure of Varden Nuttall.

Answers to Specific Questions

Q1 – Max Recovery agrees with the assessment of current weaknesses.

The Administration of Varden Nuttall has provided direct evidence and experience in connection with:

- <u>Lack of control over successor IP fees</u> – it is suspected that the costs of investigating and preparing the Bond claim will exceed the assets available. In the event of a successful claim this will likely give rise to an example of the impact on creditors of the <u>inability to ring-fence</u> such proceeds;

- The requirement for Office Holder collusion – a Bond should protect an Estate from any person and/or entity that plays a part in perpetuating any wrongdoing;

- Confusion over differences in Bond wording - there are multiple Bond providers in the case of Varden Nuttall;

- Confusion over the coverage of the Bond – there is a widespread belief (certainly amongst creditors) that the Bond covers the actions of those under the direct control of the IP not just the actions of the IP alone; and,

- The adversarial nature of the claim process – it is perceived that the insurers' principal role is to simply frustrate the process so as to avoid any liability.

- The level of potential loss to creditors in the Varden Nuttall administration illustrates the inadequacy of the current cover limits.

- MAX is not persuaded that the fact that increasing premiums could drive out smaller Practitioners is necessarily a "bad thing". It is better to have a proper level of coverage that provides adequate protection for creditors than inadequate coverage in the name of competition.

Q2 - Not at this current time

Q3 - It is the MAX view that this would not be appropriate.

PII alone, such as the model operated by accountants, or a discretionary fund, such as that administered by the SRA, would both provide insufficient protection. The principal reason for this is that an insolvent Estate is at increased risk. For example, one has to consider:

- The size of the Estate;
- The number of stakeholder groups and the number of members in each of those groups;
- The number and frequency of transactions;
- The number of staff involved in the administration of an insolvent Estate; and,
- The number of Estates being administered by one Office Holder/firm.

Q4 - At this time MAX is of the view that the Insolvency Service has adequately identified all issues that could be addressed by a claims management protocol.

Q5 - MAX is of the view that a robust claims management protocol alongside the existing legislation could address all of the issues identified.

MAX is also of the view that to rely solely upon a change in legislation would be protracted at a time when it is perceived that some form of reform is required urgently and immediately. It should also be noted that any change should apply retrospectively to all existing Estates - not just new Estates created post-change.

Q6 - MAX is of the view that the impact of repeal would be minimal and result in a system not dissimilar from that which currently exists. The RPB's would likely introduce their own Bonding requirements and creditors would remain as insufficiently protected as they currently are.

Q7 - MAX is of the view that the Insolvency Service has correctly identified the advantages, disadvantages and potential impacts.

Q8 - MAX is of the view that the paper sets out the full range of issues.

Q9 - MAX is of the view that there is an urgent requirement for timely reform.

A claims management protocol could quickly address most, if not all, of the issues set out in the paper. It would also be considerably quicker and cheaper than any proposed legislative change.

Legislative repeal alone would not achieve anything unless the RPB's were to propose their own Bonding requirements together with an associated claims management protocol similar to that outlined in the paper.

In the event that a claims management protocol is deemed unlikely to succeed in addressing all of the issues identified, it may be appropriate to adopt a combined approach whereby the claims management protocol is introduced at an early stage followed by any necessary legislative change.

Q10 - By way of conclusion, it should be noted that the nature of the failure of Varden Nuttall, combined with certain other practices being perpetuated by some of the larger IVA providers, has resulted in a level of distrust felt by creditors that has not been seen since before the introduction of the IVA Protocol.

Creditors and creditor agents feel it is evident that some IPs are not achieving a proper balance between the interests of debtors and creditors. Indeed, many are seen as acting directly against the interests of creditors in order to support their own business models. This is further compounded by the perceived inability of the RPB's to properly monitor volume IVA providers in a way that is commensurate with a large volume business where the practitioners are responsible for protecting large sums of money on behalf of creditors.

The Insolvency Service has the opportunity to put in place measures that will significantly improve the level of protection afforded to creditors by the UK insolvency process.

We hope you find these comments useful and please do not hesitate to contact us if you have any questions or require any further information.

Yours faithfully

Michael Norris
Director
For and on Behalf of
Max Recovery Limited

Private and confidential

Insolvency Practitioner Regulation Section
The Insolvency Service
4 Abbey Orchard Street
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SW1P 2HT

15 December 2016

Dear Sirs

Call for Evidence: Bonding arrangements for insolvency practitioners

I am writing to you on behalf of PricewaterhouseCoopers LLP in response to the above call for evidence.

We have contributed to the response from the Association of Business Recovery Professionals (R3) and accordingly do not propose to submit our own detailed response to you. However we will write to you again once R3's response has been finalised and submitted if there are any areas where we disagree with that.

In the meantime, we would summarise our own high level observations and key comments as follows:

- My firm has little direct experience of cases where a successor IP is appointed in circumstances where a claim may be made under the bond, although individual practitioners have some experience in their previous firms of returns to creditors from bond claims.

- If bonding is to be retained, in our view the current monetary limits of both the general and specific penalty bonds are too low, not having changed for 30 years. However any increase in limits is likely to result in higher premiums, and so a difficult balancing exercise is required.

- Although the current requirement for insolvency practitioners to produce monthly cover schedules is not an undue burden, it is an administrative nuisance and inevitably adds to the costs for creditors. Whatever solution is ultimately decided on, a reduction in the administrative burden would be beneficial to creditors.

- We note the concerns about lack of provision/control over successor insolvency practitioner fees, particularly the likely lack of engagement from creditors given the age of cases. Even if creditors are engaged, their interests may conflict with those of the bond provider. Creditors may wish to incur higher fees to enable more work to be done which will maximise the chance of realisations, whereas the bond provider is more likely to wish to keep costs to a minimum. We would not object to bond terms under which the bond holder is able to determine what is reasonable, with an ability to apply to court if there is disagreement.

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pwc

- We agree that other alternatives to bonding, including those used in other jurisdictions, are worth considering (although we do not think that similar arrangements to the Solicitors' Compensation Fund would be an appropriate option for the insolvency profession, given the much smaller size of the insolvency profession). However we note that one of the drivers for change is the increasing cost of the current system for smaller firms of IPs with the risk that they may be priced out of the market. In our view, the cost of the suggested alternatives is also likely to impact smaller firms disproportionately.

- We agree that creditors should be protected so far as possible against the fraud or dishonesty of insolvency professionals. However given the relatively small number of cases in which bond claims are made, we do wonder whether the issues warrant a full scale review at a time of significant other changes. As indicated above, we think that any change is likely to have similar, or indeed greater, cost implications for small firms, than the current regime.

I will write to you again if we have additional comments once R3's response has been submitted to you.

Yours faithfully

M J Jervis
Partner

Response to Call for Evidence

Bonding arrangements for insolvency practitioners

The Insolvency Service

the insolvency risk specialists

What are the weaknesses with the current bonding arrangements?

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

Legal framework

Prescribed bond requirements are unclear and costly

In the main the statutory requirements appear clear and unambiguous. There could be more clarity around the SPS requirements as follows:

- Some IPs appear confused about what assets should and shouldn't be taken into account when setting the SPS

- There have been issues with the procedure when the SPS needs to be increased due to the value of assets increasing

- The requirement for a bond at Nominee stage of a subsequent voluntary arrangement seems illogical as the Nominee is not in control of any assets

The current system requires cover to be taken out for each individual appointment for a prescribed amount. The current system of the submission of cover schedules has a number of advantages over alternative systems as follows:

- There is clarity as to the cover in place for each case; this is vital in the event of a claim to avoid disputes around the cover in place. There are recent examples of claims disputes over the cover in place even when there is a cover schedule evidencing this
- The submission of cover schedules to RPBs ensures they are aware of the cover in place and could cross check its adequacy and the IP's adherence to bonding requirements on monitoring visits
- Data at a case by case level allows sureties to analyse risk at a more granular level and apply a premium commensurate with the risk(s)
- By charging a premium per case aligned with the cover required, creditors of individual cases are not overpaying for cover e.g. if the premium per case was a flat amount, irrespective of the assets at risk, some creditors would be overpaying whilst some would benefit (it is likely the creditors of smaller cases would lose out if, for example, an average premium is charged)

Any alternative models would need scrutiny to ensure they
- Provide adequate data to the RPBs
- Accurately record the cover in place on a case by case basis should there be a claim

The submission of cover schedules forms part of the general case management undertaken by IPs. As such we do not believe this is burdensome. Of our current client base only just over 20% submit cover schedules on a manual basis. The remainder submit these electronically following export from case management systems or online directly into our bonds database. Electronic submissions account for approximately 90% of all individual bonds taken out.

The submission of cover schedules also ensures tracking of premium payment can be undertaken.

Whilst the current legislation is prescriptive this does ensure a degree of consistency in terms of the cover provided and the methodology of administration. Any innovation by sureties must be matched with adequate controls to ensure the core objective of protecting the creditors in the event of fraud or dishonesty is achieved.

Statutory cover limits are inadequate and inconsistent

The effectiveness of the GPS as a safety net in the event of either no or inadequate SPS cover has been diminished since its introduction.

If a claim is made against an IP this will generally result in the requirement for payment to be made under the GPS in addition to the individual SPS cover. It is rare that the whole of the GPS cover is not paid.

This would suggest that the amount is currently inadequate. £250,000 30 years ago is the equivalent of approximately £700,000 today. Adjusting for inflation a revised GPS limit of either £750,000 or £1m would seem logical.

It should be noted that any increase in the GPS would need to be agreed by sureties and is likely to result in increased premiums to reflect the greater exposure to sureties.

In terms of the SPS requirements, we believe that the minimum SPS amount of £5,000 is wholly inadequate. This amount, and more, will be taken up by any loss/successor practitioner's costs. Our view is that a minimum SPS of £50,000 should be set to adequately reflect this. Again this would result in an increase of premium and require the agreement of sureties.

Whilst the maximum SPS has also remained unchanged we do not believe this is inadequate. Claims received to date do not support any correlation between the size of the case and subsequent claims. We are not aware of any claims which have exceeded the maximum SPS limit.

Our recommendation would be that this is maintained at £5m. Any increase is likely to result in increased premiums.

Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover

The cover provided by the sureties is a guarantee rather than an insurance policy. As such, insolvency bonds do not fall under the Insurance Act 2015. This act sets out the expectation around disclosure to insurers and their potential remedies. As this Act does not apply to insolvency bond insurers, acting as sureties, they are at a disadvantage as they have no remedies in the event of an unfair presentation.

We do not believe the fundamental issue of IPs being responsible for submitting cover requirements can be avoided.

The RPBs should have a greater role in policing the bonding of cases. As they receive a copy of the cover schedules they should be able to check that the IP has at least taken out SPS cover. They should also be aware of any instances where no bond cover is in force.

The RPBs also have a role to play in checking bonding thoroughly during monitoring visits. Claims submitted have shown that errant IPs have sometimes shown a pattern of taking out cover at or just above the minimum SPS amount.

Proceeds of a bond claim are not ring fenced

Sureties deal with claims submitted by successor practitioners on the basis of:

- The primary loss – The loss suffered by the estate as a result of the fraud or dishonesty of the IP (including interest)

- The successor practitioner's costs in establishing the loss (including unavoidable parallel costs)

Once the amount of the claim has been agreed this is paid to the successor practitioners as one sum. The sureties have no control over how this is allocated or if any of the amount is returned to creditors.

Evidence gathered from claims notified since 1995 show that successor practitioner's fees can often significantly exceed the primary loss.

An analysis of IRS's records of 318 individual claims where the primary loss was known established the following

- In 211 instances the successor practitioner's fees were in excess of the primary loss – 66%

- The maximum involved successor practitioner's fees of £26,630 against a primary loss of £130 – 20,485% of the primary loss

- The average successor practitioner's fees incurred were 368% of the primary loss

The total loss will often exceed the cover available under the SPS and GPS. For example, of the 211 claims mentioned above, in 113 cases the SPS was insufficient to meet the total claim (primary loss, interest and successor practitioner's fees). In such circumstances, the current order of priority results in all proceeds being allocated to the successor practitioner's costs and none to the creditors. This incentivises successor practitioners to search for dishonesty or fraud, irrespective of the cost and of whether any relevant findings will result in a better return to the creditors/insolvent estate. This allows successor practitioners to incur cost without the normal constraints of having to justify the benefit to the creditors/insolvent estate. Rather, it becomes a business decision.

Further, more detailed data can be made available, subject to relevant confidentiality agreement.

Our view is that this is a serious weakness in the current system and should be addressed in the unique circumstances which apply following the fraud or dishonesty of an IP. There are a number of potential solutions available including ring fencing the primary loss payment by amending the order of priority in respect of cases involving a successor practitioner.

Ensuring any costs are proportional to the loss suffered would also assist in achieving better returns for creditors. This could be achieved as part of any claims protocol and be contained in the bond wordings.

Lack of provision/control over successor insolvency practitioner fees

The claims process, as it currently operates in the majority of cases, leads to successor practitioners incurring costs in investigation which have not been discussed with, or agreed by, the surety.

As previously mentioned, these costs can often exceed the primary loss and the available cover and do not appear to be proportionate.

The lack of engagement by creditors does suggest the actions of successor practitioners is under less scrutiny than other insolvency appointments.

We believe that the RPBs should take a more active role in the monitoring of successor practitioners to ensure the outcome to creditors is maximised. This could be achieved by compulsory desktop returns by successor practitioners enabling the RPB to monitor progress on cases. Also, there should be more of a focus on successor cases when scheduled RPB monitoring visits occur. There is also the potential to scrutinise cases on an event driven basis.

We also believe that sureties should be acknowledged as subordinate creditors in terms of the compliance with the notification of fees under The Insolvency (Amendment) Rules 2015. This would ensure sureties were as aware of the estimated fees of successor practitioners as any other creditor of the original appointment would be.

No statutory requirement for professional indemnity insurance

The lack of consistency in terms of the rules surrounding professional indemnity insurance (PII) is unhelpful and with creditors of the insolvent estates in mind, could be seen as a failing to fully protect their interests.

We believe there should be a statutory requirement for PII with a minimum level of cover applicable which applies across all RPBs.

The bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner

The bonds issued under the current regime are "personal" to the IP and as such the cover is not designed to extend to any employees or fellow partners/directors unless the IP was in collusion with them.

Any change to the fundamental nature of the cover to extend this would inevitably lead to additional costs and may lead to reluctance to provide cover for practices where the controls over employees may be deemed to be inadequate.

Practical issues

Variation in particulars of bond wording causes confusion

The insolvency bond market involves a small number of primary providers who have each developed a wording which has been approved by the Insolvency Service. The individual terms of these bonds do vary but the cover provided satisfies the requirements of the current regulations.

All RPBs are provided with a copy of the bond wording by each IP. As the beneficiary, it should therefore be possible for the RPB to provide a copy of the relevant bond wordings to the successor practitioner.

In conclusion, we do not feel that wording differences are detrimental. This is a normal part of the insurance market. Moving to a standard wording would limit innovation and competition.

Increasing costs of premiums

The premiums charged by sureties should reflect the risk of a claim occurring. Segmentation of a market to reflect the different risk profiles is a tool regularly used by the insurance market.

Claims notified since 1995 have identified a higher likelihood of a claim occurring at the smaller end of the IP market. As a result, premiums for this sector reflect this increased risk.

One of the fundamental causes of increased claims costs is the level of successor practitioner's fees. If this issue is not addressed our view is that premiums for smaller practitioners will only continue to rise with some providers refusing to offer cover (as is the case now for some providers)

Adversarial nature of claims

Whilst it is acknowledged that bond claims can be complex and time consuming the current process is not a collaborative one.

Often, following an initial blanket notification of "claims" there can be little or no interaction for many months or longer. It is also often the case that the sureties are then provided with confirmation that potentially disproportionate costs have been incurred without their approval or involvement.

Recent interactions with a successor practitioner who has not previously taken such appointments has demonstrated that this approach is optional and resulted in claims being settled more quickly and with lower successor practitioner's costs.

Cessation of cover on non-payment

The nature of the current system is such that retrospective requests for cover occur. For example an IP is required to declare new cases on a cover schedule at the end of the month. This means the surety is not aware of the individual cover in place until the cover schedule has been received.

IPs are in possession of relevant rating tables which allow them to calculate the premium due on individual appointments. In return for providing cover sureties do not believe it is unreasonable to expect that the relevant premium has been paid.

Cases of cover being refused due to non-payment of premium are relatively rare. Since 1995, we are aware of one case. This represents approximately 0.1% of the individual claims made.

As such, we do believe the current position on non-payment of premium is satisfactory. Any change made to the effect insurers are on risk whether the premium had been paid or not would lead to price increases to reflect the risk of non-payment.

Limited number of insolvency practitioners willing to take on successor appointments

The lack of competition and scrutiny in the successor IP market is of concern.

We believe this has led to a dysfunctional market with fees charged significantly higher than for standard insolvency work. This has ultimately resulted in increased costs which have fed through to premiums.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

We believe there are several other weaknesses as follows:

- There is no agreed definition of what constitutes Fraud and/or Dishonesty – this has led to claims disputes about negligence being treated as fraud (potentially due to the lack of any available PII to claim against). This could be included in Insolvency Practitioner Regulations, any potential claims protocol and the bond wordings themselves. In other areas of the insurance market wordings often contain a definition of fraud/dishonesty along the lines of “manifest intent to secure an improper personal gain”.

- The level of engagement by RPBs in the claims process is minimal.

- Once a successor practitioner has been appointed the disciplinary process against an IP can take many months if not years. This does not help in terms of knowledge sharing and learning lessons to help avoid future claims through smarter monitoring of IPs.

- There should be a consistent approach across RPBs regarding monitoring as far as bonding and fraudulent/dishonest behaviour is concerned. It is rare for a bond claim to be triggered by a monitoring visit, but more likely by a complaint or action by a potential successor practitioner. RPBs should be required to comply with a minimum set of detailed standards relating to bonding for monitoring visits.

What similar systems operate in other industries?

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

The establishment of a fund similar to the Solicitors Compensation Fund would be possible but we believe has the following drawbacks:

- The insolvency profession forms part of a far wider and larger group. Not all firms which conduct insolvency business do so in isolation and this may lead to complications in the collection of levies for multi-faceted firms

- The pool of qualified/appointment taking IPs is very small. There are currently approximately 1,300 IPs taking appointments. As at 31 July 2015 there were 168,226 solicitors on the roll. The small number of IPs may mean the contributions required to maintain the fund are high and the administration costs disproportionate

- The initial set up costs may also be high with agreement needed as to who runs the fund and what staff expertise is required

- Agreement would be required as to how the cost of levies were recovered from individual insolvency cases(or if they were expected to be borne by IPs and passed on as they saw fit)

- An initial injection of funding may be required to cover any claims received and agreed in the first few years as the fund was built up

- If the levy was a flat amount this would have a disproportionate effect on the smaller IP/Practice

Potential measures for reform

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

There are additional issues which we believe can be addressed through a claims protocol as follows:

- Notification of claims including:
    - When claims should be notified
    - When is a claim time barred
    - What constitutes a valid notification
    - Template for proof of claim

- Initial investigation including:
    - Work undertaken
    - Costs incurred
    - Indications of any fraud/dishonesty discovered

- Fraud/Dishonesty – An agreed definition of what constitutes Fraud and/or Dishonesty as per **Question 2**

- A mechanism for alternative dispute resolution

- The potential for work relating to the investigation of fraud or dishonesty to be undertaken by third parties e.g. Forensic Accountants or Loss Adjusters, rather than the successor practitioner

Legislative changes – options

Option 1 – Do nothing

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

We do not believe that the introduction of a claims protocol in isolation would resolve all the weaknesses identified.

Issues would remain with:

- The order of priority leading to successor practitioners fees being paid before creditors are reimbursed for fraud/dishonesty
- The minimum SPS is inadequate and requires increasing (our suggestion is to £50,000)
- Disproportionate fees could still be charged by successor IPs

Option 2 – Repeal legislative requirements

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

We would see the impact of removing the requirement for bonding as follows:

Impact on Insolvency Practitioners

As IPs would no longer be required to obtain a bond and submit monthly cover schedules the time and cost relating to the process would disappear.

Depending on the ultimate solution arrived at, the requirement to arrange adequate insurance elsewhere may result in:

- Additional cost (potentially to be borne by the IP or firm?)
- Additional time spent in ensuring the insurance arranged complied with the agreed requirements

Impact on the protection of creditors

Creditors would notionally benefit in that they, as a collective group, would not directly be paying for the insurance cover on a case by case basis. Ultimately, it is likely that the costs of insurance will be passed on by the IP by way of additional fees.

Any insurance solution must reflect the long tail nature of bond claims. Current bond wordings generally provide cover for a period of years. Depending on the insurance solution chosen, cover may only be available on a claims made basis (as per most PII policies). Cover arranged in this way, with no provision for automatic run off cover at no additional cost, would leave creditors exposed to the likelihood cover was not in force at the time a claim was made. It is by no means certain that the insurance market would respond and provide such cover, particularly for smaller practitioners.

Any cover arranged would also be subject to the Insurance Act 2015 and subject to the remedies available to insurers in the event presentation of risk information by the insured was deemed unfair namely:

- If the insurer can show that it would not have entered into the contract on any terms, it will still be able to avoid the contract and refuse to pay claims (but will have to return the premium, unless the misrepresentation was deliberate)

- If the insurer would have written the risk but on different terms, it can treat those different terms as applying from the commencement of the policy

- If the insurer would have charged a higher premium, it can reduce any claims payments in accordance with a formula set out in the Act

These remedies leave the creditors exposed to effectively having no insurance cover in place retrospectively. The current bond solution is not subject to the Insurance Act 2015 and these remedies are not therefore available to the surety.

Option 3 – Amend the current legislation

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

a) Amend the current prescribed terms of a bond

The bond wording in force at the time of a claim is a matter of fact and we do not consider that this causes undue delay or complication in the bond process.

It is quite normal for different insurers to have different terms and conditions applying to the cover they provide.

The current system of cover schedules has its advantages and ensures there is certainty on the cover provided at the time a claim is made. Certain providers have no experience of the claims process so there is a danger that removing the standard methodology of notification may lead to issues in the future if the implications are not thoroughly thought through.

We do not believe a prescribed bond wording would be beneficial as this would:

- Prevent innovation
- Potentially lead to a reduction in the number of insurers wishing to participate in the market
- Reduce choice and competition

A workable compromise may be that certain elements of the wording are prescribed as a minimum with the surety able to amend other, non-prescribed, areas and deal with different segments of the insolvency market in different ways.

Prescribed items may include:

- Clear timescales on notification of claims
- An alternative dispute resolution mechanism

b) Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs

We believe the ring fencing of the primary loss payment for creditors would be a positive step. This would ensure that the primary purpose of the bonding regime is served. Successor practitioners will also be encouraged to not incur unnecessary fees which they know will not be reimbursed by the surety and encourage a more collaborative approach with sureties.

c) Provide for investigative costs as a prescribed requirement of a bond

The introduction of investigative costs in isolation is not likely to be seen as a positive development by sureties. If it was accompanied by a claims protocol there may be merit in the idea. The issues which would need to be addressed include:

- there would need to be an agreed trigger for any costs to be incurred e.g. a certain level of evidence or expectation of fraud/dishonesty rather than negligence
- some form of overall cap may be required to limit insurers' exposure otherwise successor practitioners may work on the basis they are entitled to fees of £x per case irrespective of the individual circumstances of the case
- the introduction of a minimum £50,000 SPS may negate the need for the introduction of the investigation fund concept

If introduced in isolation it is likely premium costs would increase substantially. Our best estimate of effect on premiums would be an overall 20% - 50% increase in SPS premiums.

d) Agree or legislate for a 'de minimis' maximum indemnity period

The prescription of a minimum indemnity period may discourage some insurers from participating in the bond market. Some of those who decide to continue to participate may increase premiums to reflect the greater exposure period. It is difficult to quantify any increase without knowing the minimum indemnity period imposed.

e) Remove requirements for monthly cover schedules and provide for an annual or global bond cover

The cover schedule system brings certainty to the surety as to the exposure they are potentially facing and allows more detailed risk profiling depending on the types and size of appointment taken.

If this system was replaced by an annual or global bond there are a number of potential issues which would arise as follows:

- The claims process could become more complicated. At the moment the certainty created by a case having an SPS would be replaced by a global available sum insured, with this needing to cover both the loss suffered by the estate and the costs of the successor practitioner. Any shortfall in the available sum insured would need to be allocated across numerous cases and cause potential complications and additional expense to the claims process
- It would need to be agreed on what basis estates were charged for the cover (unless this was absorbed by the IP, which may disadvantage the smaller firms)
- Payment of the annual premium would be required up front. This may lead to issues with premium payment as the method of potential recovery from individual cases may be complex. Would all IPs be able to fund the premium?
- Non-payment of the premium is likely to invalidate all cover. At the moment non-payment of an individual SPS premium only invalidates that cover, not all cover
- Depending on the system adopted it is possible that insurers would be reticent to provide cover for smaller practices

- The system may be more dependent on the probity of the IP. If an IP under declares the total cover required how is any underinsurance allocated in the event of a claim?

- What is the period of cover granted if the bond is renewable annually? The exposure to insurers may significantly increase leading to additional premium being charged

- Would insurers be bound to continue run off cover once an IP's licence had been withdrawn?

For the above reasons we believe an annual or global bond is not a workable solution.

f) Amend the existing monetary limits of the GPS/SPS

The application of an increased GPS has merits but is likely to lead to increases in premium depending on the level chosen.

There is unlikely to be an advantage to insurers in providing a GPS above the minimum level agreed.

We believe a minimum SPS of £50,000 should be put in place. Doing so would negate the requirement to significantly increase the GPS.

The maximum SPS has not been an issue in any claims encountered to date. If a maximum limit per practitioner continues to apply (currently £25m) it is unlikely that any significant increase in premium will result, except for the largest cases.

g) Introduce a duty that investigative costs must be proportionate to loss/cover

We believe the introduction of a duty that successor practitioners act in a proportionate/commercial manner is a key reform that needs to be included in legislative changes.

In addition, the introduction of a minimum primary loss would lead to a more pragmatic approach to incidences of fraud or dishonesty which have resulted in a minimal loss to creditors.

Coupled with an agreed claims protocol we do not believe this would discourage new entrants to the successor practitioner market from taking such appointments

h) Protect estate from non-payment

The frequency of non-payment of premium resulting in bond claims not being paid is extremely low. Since 1995, we are aware of one case. This represents approximately 0.1% of the individual claims made.

The current system makes it extremely difficult to ensure payment is made immediately. For example, a new appointment could be taken on the 1st of the month. This must be declared on the cover schedule submitted by the 15th of the next month. It is therefore likely that we, as the surety's agent, will not be aware of the case until 6 weeks after the appointment. The only way to ensure payment has been received as of the date of appointment is to collect an on-going deposit premium from practitioners. This has the following disadvantages:

- The payment of a deposit premium may cause smaller practices issues

- It is possible that any deposit is fully utilised leading to a shortfall in premium

- Holding premiums on account can cause issues with insurance brokers' client money accounts and would lead to additional administration and costs

We agree that there should be a procedure in place between insurance brokers and RPBs to deal with non-payment of premium. This should include timescales by which brokers must inform RPBs of non-payment of bond premiums and that the RPBs agree to confirm the action taken against the IP within the timescales. 60 days may be a workable trigger point for the procedure to commence.

Any change made to the effect insurers are on risk whether the premium had been paid or not would lead to price increases to reflect the risk of non-payment.

Our view is that overall the non-payment of premium is a rare occurrence and not material.

i) Include professional indemnity as a requirement for security, including run-off cover

The lack of available PII cover after an IP's licence has been withdrawn has led to a blurring of the lines between negligence and fraud/dishonesty. In the absence of PII cover successor practitioners appear more likely to attempt to pursue a bond claim on the basis of fraud.

The main issue with PII cover is that it is provided on a claims made basis and it is rare for cover to remain in place after it becomes apparent claims are being made on bonds.

We strongly believe that it should be a statutory requirement that PII cover is in force with the automatic provision of run off cover in the event the IP has lost their licence.

There are challenges associated with this approach as follows:

- The insurance market would need to positively respond to the new requirements. This is by no means a forgone conclusion.
- The period of run off cover needs to be clearly stated (this may not be straightforward if the terms of bonds vary)
- Run off cover should be included with no additional premium payment required once the run off cover is triggered
- This is likely to increase the cost of PII cover

j) Agree or legislate for insolvency practitioner firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by persons other than the insolvency practitioner

It is not apparent from the vast majority of claims received to date that fraud perpetrated by persons other than the IP is a major issue.

If regulations required that Fidelity Guarantee (FG) cover was in place this could be achieved but the following would need to be considered:

- Cover could be provided under PII insurance. This may lead to additional costs which may affect smaller firms more than larger firms
- FG cover would only remain in force if the underlying policy was in run off. The same challenges as above re PII exist in terms of the insurance market responding to the requirement
- Standalone FG cover is an option, but it would need to remain in force after the related IP had lost their licence for any claims to be made
- The cover provided is likely to be based on an annual limit of indemnity. In the event of large losses this could be insufficient to meet claims

- Cover could be provided under the bond wording, but would lead to price increases following analysis of claims/circumstances

Our current view is that fraud by persons other than the IP is not a regular occurrence. However, the potential for losses can be substantial and the matter merits consideration.

Conclusion

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered?

Whilst these have been touched upon elsewhere in our response, we believe the primary issues are as follows:

- A clear definition of Fraud/Dishonesty
- A consistent approach from all RPBs to monitoring, including timescales and responses to issues discovered
- There do not appear to be adequate deterrents currently in place i.e. publication automatically of IPs subject to sanction

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

Our preferred option would be to amend the current legislation incorporating the following:

Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs

The current system results in creditors losing out. In recent years this has been the direct result of successor practitioner's fees using up the available cover. To ring fence the proceeds of a claim for creditors must be seen as a positive step to achieving the original objective of the bonding process.

Amend the current prescribed terms of a bond

Our view is there is a strong argument that the terms of the bond are too prescriptive. We believe a balance could be struck between the prescription of minimum terms and the ability for insurers to innovate in how cover is provided.

Amend the existing monetary limits of the GPS/SPS

It must be acknowledged that the current limits are inadequate when compared to the limits originally set. Any increase is likely to lead to increases in premium to offset the sureties' increased exposure.

Introduce a duty that investigative costs must be proportionate to loss/cover

We believe this is a simple and reasonable change which would ultimately benefit creditors. Reiterating that costs should be proportionate is difficult to argue against and including it in legislation would ensure the position was clear.

Include professional indemnity as a requirement for security, including run-off cover

The multitude of requirements of RPBs relating to PII seems incongruous with consistent regulation. We believe there should be a universal requirement for a minimum level of PII with automatic run off cover incorporated. There may be challenges in persuading the market but if explained in detail and with supporting evidence we believe this is achievable.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

The instances of fraud and dishonesty by IPs are relatively low. The current system appears to have evolved into one where instances of poor recordkeeping or minor negligence are portrayed as instances of fraud or dishonesty. This is driven by the lack of available PII cover at the time of a claim being made and the successor practitioner's only avenue for potential recoupment of their fees is to assert that the IP's actions are founded on fraud/dishonesty

The creditors should be protected against fraud or dishonesty and changes to the current system can achieve this.

Insolvency Service Call for Evidence: Bonding arrangements for insolvency practitioners

Response by the Association of Business Recovery Professionals ('R3') to the call for evidence issued in September 2016

Introduction

1. R3 is the trade body for the UK insolvency and restructuring profession. R3 represents insolvency practitioners working in firms of all sizes, from the global legal and accountancy firms through to smaller, local firms, as well as insolvency lawyers and other professionals working in the insolvency and restructuring profession.
2. R3 has focused this response on those areas where we can provide suitable comment based on the views gathered from our members. R3 represents a wide constituency across the insolvency and restructuring professions and we have therefore sought to provide a balanced summary of views. However, it should be recognised that R3 does not possess empirical evidence which may be required for substantive answers to a number of the questions raised. In such instances, this has been marked accordingly where it is believed that empirical evidence should be sought from third parties.
3. Members' views on the questions contained within the Call for Evidence were sought via meetings and email communication.

Executive Summary

4. R3 welcomes the Call for Evidence from the Insolvency Service. It is hoped that the evidence collected will enable government to undertake a comprehensive review of the current bonding system for insolvency practitioners and to draw substantiated conclusions on any proposals for reform. R3 is aware of the issues raised in relation to the current bonding system from a number of interested parties, including successor insolvency practitioners, the bond providers, and smaller insolvency firms facing increasing bond premiums.
5. R3 notes, however, that the incidence of insolvency cases featuring bond claims appears to be low based upon the Insolvency Service's reference (page 9 of the Call for Evidence) that 92 out of 56,443 cases in 2015 featured bond claims.
6. R3 believes that the introduction of a claims management protocol would be a welcome first step in resolving some of the issues with the current system. While this would not resolve specific fundamental weaknesses in the legislation, R3 believes that an effective protocol would improve communication, transparency, and help to simplify processes for all parties.
7. Whilst a claims management protocol is being developed, further consideration should be given to whether the bonding system needs to be removed entirely, or whether legislative amendments would be capable of resolving the issues which stem from weaknesses in the current legislation. In order for any further changes to be effective in achieving their objectives, a full consultation would need to be issued to provide adequate opportunity for all possible options and perspectives to be discussed and analysed.

Response

<u>Question 1:</u> These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

8. As detailed below, some of the weaknesses identified are issues with the current bonding system. However, R3 does not have evidence to support some of the weaknesses identified by the Insolvency Service. It would be necessary for the Insolvency Service to seek this evidence elsewhere in order to support the assertion that the issues identified are weaknesses within the system.

1. Legal framework

a) ***The prescribed statutory requirements for bonds are unclear and expensive.*** *The requirements may be open to interpretation and do not allow for innovation by bonders – requiring submissions of cover schedules irrespective of the insurer's business model. The requirements for monthly cover schedules are burdensome and increase costs for creditors.*

9. The prescribed requirements for bonds are contained within Schedule 2 of the *Insolvency Practitioners Regulations 2005* (the Regulations). The requirements are not overly detailed and, as such, in principle they enable innovation and commercial considerations to be taken into account in the wording of the bonds by the bond providers.
10. R3 agrees in principle that the prescribed statutory requirements for bonds are unclear, in the sense that the majority of the detail for inclusion in the wording of the bond is left to the discretion of the bond provider. There are also no statutory definitions, in the Regulations or elsewhere, for what is meant by the terms "dishonesty", "connivance" or "collusion", which, it has been stated, has created some uncertainty about the circumstances of dishonesty which are covered by the bond and those which are not. In addition, it is not clear how assets held under reservation of title terms, VAT which is additional to an asset's value, or the interest earned by the estate are dealt with by the bond.
11. As noted above, only certain details are specifically prescribed in the Regulations for inclusion in bond wordings. This has meant that there is a wide variety in the wordings for bonds between bond providers, which is covered in more detail at paragraphs 37 and 38. It has also meant that, as a result of only certain details needing to be considered, bond wordings with potentially unintended consequences have been approved by the Insolvency Service. For example, there have been changes to the basis on which a claim can be made from a "claims occurring" to a "claims made" basis, which R3 understands has created issues for successor insolvency practitioners bringing a claim against the bond for an estate where the fraud was discovered outside of the policy period and is therefore not covered by the bond. R3 understands that it has also created difficulties for insolvency practitioners seeking to change bond providers.

12. R3 does not believe that, in a well-run practice, the requirements for monthly cover schedules are burdensome (as the systems for producing monthly schedules are automated) and should not substantially affect costs for creditors. Indeed, the monthly submission of cover schedules has advantages to regulators and practitioners. However, R3 would not disagree that simplifying this process may still be beneficial.
13. The requirement for cover schedules to be submitted on a monthly basis to the RPBs may be expensive for the Recognised Professional Bodies (RPBs) themselves, in terms of the time and resources required to process and review the schedules. Empirical data to support this view would be better sought from the RPBs.
14. It should be noted that the requirements for the cover schedules to be submitted and to advise the bond provider of any changes in the value of the estimated assets in a case on a <u>monthly</u> basis are not specified within the Regulations. These state that these actions must be undertaken *as specified in the bond*, and it would therefore seem to be at the discretion of the bond provider to state the timeframes in which they require submission of cover schedules. The requirement for the insolvency practitioner to submit these cover schedules (where a cover schedule has been submitted to the bond provider in that month) on a monthly basis to their RPB is contained within section 13 of the Regulations.
15. In addition, the Regulations relating to the calculation of bond levels may sometimes not reflect the level of potential losses to creditors. For example, third party contributions to costs, which do not form part of an insolvent estate from which creditors would ever suffer a loss, are still included in the calculation of bond levels. Similarly, excluding secured assets from the bond does not reflect the fact that a successor IP would still be required to pay secured creditors in the statutory order of priority.

b) Statutory cover limits are inadequate and inconsistent. *The monetary limits have not changed since the introduction of bonding requirements some 30 years ago. The GPS amount of £250,000 over all appointments is prescribed as an absolute and may no longer be adequate. Several recent insolvencies would exceed the maximum level set for the SPS.*

16. The statutory cover limit of £250,000 for the general penalty sum (GPS) is inadequate for contemporary insolvency proceedings. In the majority of bond claims and the majority of cases, the specific penalty sum (SPS) limit of £5 million is sufficient. There are, however, a small but distinct number of cases where the SPS limit is also not adequate. A case example has been provided to R3 where the level of assets to be realised in a members' voluntary liquidation (MVL) was £100 million, for which it was not possible to obtain bond cover for more than £5 million. In these instances, the bond provider and insolvency practitioner are barred from having a bond arrangement in place which would adequately cover the level of assets - effectively leaving creditors (and in the MVL example quoted, members) exposed to a higher degree of risk.
17. It should be considered, however, whether any increases to the statutory cover limits may result in an increase in overall bond premiums charged to insolvent estates, as there will be

a corresponding increase in risk for the bond providers. If this only affects the larger asset cases that are able to more easily absorb any increases in premiums, this may be an acceptable solution, but the possibility that premiums for all insolvency practitioners may also be increased needs to be considered. The impact on premiums of any increases to statutory cover limits must therefore be weighed against the benefits that this would bring.

18. Alternative options could include a tiered approach to GPS limits, which may help with ensuring that any rise in the overall limit of the GPS does not disproportionately affect premiums for smaller insolvency practitioners, who may not have sufficient assets in their cases to require an increase to the GPS in their bond cover.
19. Consideration could also be given to a similarly tiered approach to SPS limits, which would enable different levels of SPS cover for different types of cases. This would need to be analysed in detail to determine whether it would have a material effect on the cost of premiums.
20. Finally, the £5 million SPS limit could also be removed entirely. The SPS limit for an individual case could then be determined by the bond provider and the insolvency practitioner/creditors/members (dependent on the circumstances of the case), or an "exceptional" provision could be included which states that the value of the SPS may be increased to the value of a case's assets, where agreed to by the relevant parties, i.e. the bond provider, insolvency practitioner, and the creditors/members. This would most likely only apply to larger firms with larger cases, and may not have a corresponding effect on the bond premiums for smaller firms, unless they are also undertaking work with high value assets above the £5 million threshold.

c) **Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover.** *The applicability and amount of the SPS depends on the honesty of the insolvency practitioner to make a correct declaration. If the insolvency practitioner either under-declares the value of the assets, or does not declare at all, then the only available cover would be a pro-rata portion of the GPS, assuming that the insolvency practitioner has that in place.*

21. It should be considered whether the monitoring systems of the RPBs adequately identify at a sufficiently early stage systematic under-bonding or other issues potentially indicative of fraud/dishonesty by an insolvency practitioner. An example was provided to R3 of a case where the successor insolvency practitioner had found that the original office holder had bonded all of their cases for the minimum £5,000 SPS. This had not apparently raised concern for either the relevant bond provider or RPB prior to the fraud/dishonesty being uncovered, despite cover schedules being submitted to both bodies as required.
22. While the RPBs are reliant on the information provided by the insolvency practitioners to determine the level of assets in the cases the insolvency practitioner is administering, it is important that the monitoring systems are sufficiently sensitive to identify where there may be issues in the cover schedules being submitted: this was, presumably, the intention behind

the statutory requirement for insolvency practitioners to submit the cover schedules on a monthly basis to their RPBs. More effective regulatory systems, and increased communication between bond providers and the RPBs, could help to reduce systematic under-bonding and instances of undetected fraud and dishonesty. This may also particularly assist with the situation whereby an insolvency practitioner does not make the necessary bond premium payments to the bond provider and may in effect not be bonded. Increased communication could mean that these situations are more quickly brought to the attention of the relevant RPB by the bond provider, who can then act as necessary in relation to the information.

23. R3 acknowledges that for a bond claim to be brought, it does not need to be proved that there was intent to be fraudulent or dishonest, which means that there may be instances where the actions undertaken by an insolvency practitioner could appear to be fraudulent or dishonest, although this was not the intention behind the actions. Similarly, it should also be noted that an insolvency practitioner may miss a premium payment or under-declare the value of assets for a range of reasons, including simple human error.

d) **The proceeds of a bond claim are not ring fenced.** *Once a claim is made, it is paid into the estate and treated in the same manner as any other asset, and is subject to the usual order of priority of costs and fees of the proceedings. We are told it is often the case that creditors who may have been adversely affected by the fraud will receive no direct financial benefit from a successful bond claim.*

24. R3 does not have access to empirical evidence to support the claim that creditors have not been receiving any direct financial benefit from successful bond claims. This evidence would be better sought elsewhere.
25. R3 believes that it is important from both an economic and moral position that fraud and dishonesty are uncovered and, insofar as is possible, restitution is made to the estate for the benefit of creditors and/or members. This should also be supported by robust regulatory processes that discipline the insolvency practitioner(s) involved.
26. However, it cannot be expected that successor practitioners undertake complex, and potentially lengthy, investigative work for no fee. While successor practitioners' fees should perhaps not be so high as to unfairly reduce the returns to creditors, the wider value of the work undertaken in uncovering instances of fraud needs to be acknowledged. This should, however, be considered in the wider context of a need for transparency and openness about successor insolvency practitioner fees to ensure that bond providers and creditors/members are given an adequate opportunity to understand and, if necessary, challenge fees.

e) **Lack of provision/control over successor insolvency practitioner fees**. *The costs of investigating fraud are provided for by the bond, but the liability of the surety is capped at the value of the SPS. The only control over costs is that they are paid at the discretion of the* *surety which can lead to uncertainty. Successor IP fees are determined in the usual manner with any insolvency, though different rates may be charged for bond claim work. Given the age of cases, it can be difficult to engage creditors on these issues. As a result, successor IP fees may exceed the amount available under a bond claim leaving no money left for distribution to creditors.*

27. R3 is not in a position to provide evidence to support the claim that successor practitioner fees may exceed the amount available under a bond claim leaving no money for distribution to creditors. R3 suggests that this evidence needs to be sought from the bond providers, successor practitioners, relevant creditor bodies, or creditors themselves (who have or may have been affected).
28. There are already controls in place for ensuring that successor insolvency practitioner fees are not excessive. The costs associated with a bond claim need to be agreed with the bond provider/loss adjustor before they are paid out as part of a claim. Further to this, the basis on which a successor practitioner may calculate fees is through either the original fees resolution agreed for the case, or through a subsequent resolution passed by creditors/committee/members as relevant.
29. For those cases subject to the new fees estimates regime, the involved successor insolvency practitioner will also be bound by the original fees resolution, unless they obtain a new approved resolution from creditors. This may have a future effect on the costs charged by a successor practitioner, although it may be some time before this is discernible.
30. R3 considers it important that a balance is struck between the need for investigation of dishonest and/or fraudulent activities in order to seek appropriate restitution for the estate, and the need for transparency and appropriate approval processes for the fees being charged for such work.

f) No statutory requirement for professional indemnity insurance. *There is no statutory requirement for specialised PII, which is instead governed by the rules of the individual RPBs, whose requirements differ.*

31. There is no statutory requirement for insolvency practitioners (or their firms) to hold professional indemnity insurance. This is not, however, a weakness of the legislation, as the RPBs require insolvency practitioners to hold this type of insurance in order to obtain and hold an insolvency licence. In practical terms, there is no material difference between the requirement for an insolvency practitioner to hold professional indemnity insurance being a statutory requirement or a regulatory requirement. Under the current system, if an insolvency practitioner does not hold the requisite professional indemnity insurance, then they are effectively barred from holding a licence and cannot take appointments.
32. There are, however, inconsistencies across the RPBs in terms of the requirements to hold professional indemnity insurance. Greater consistency in this area may be beneficial for the insolvency profession as a whole from a simplicity perspective, although it is not clear what

practical difference the different requirements have from the perspective of the claimant. Given the relatively small size of the profession, it is also not clear why there are different requirements for professional indemnity insurance across the different RPBs. If there is a practical difference, it may not be necessary for greater consistency to be achieved through legislative means, as it could also be achieved through other, less formal, mechanisms, such as the voluntary alignment of the current professional indemnity insurance regulations across the RPBs. Nonetheless, this alignment may still be beneficial

33. This type of alignment could also provide an opportunity to resolve some of the current differences with the professional indemnity insurance regulations. For example, the Insolvency Practitioner Association's regulations require a minimum professional indemnity insurance cover of 2.5 times the gross fee income. While the maximum figure for firms is set at £1.5 million, there is no maximum figure set for partnerships. In contrast, the Institute of Chartered Accountants in England and Wales require a minimum professional indemnity cover of 2.5 times the gross fee income, if the insolvency practitioner's turnover is less than £600,000 (with a minimum cover of £100,000), or a minimum cover of £1.5 million if their turnover is higher than this.
34. A review of the professional indemnity insurance regulations to identify inconsistencies and other issues which need to be resolved would be beneficial for the profession, regardless of any decision regarding the current bonding system.

g) **The bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner.** *There is no regulatory or statutory requirement for insolvency practitioners or firms to hold fidelity guarantee insurance which would cover fraud or dishonesty of a director or employee without the knowledge or collusion of the insolvency practitioner.*

35. The statutory requirements for bonding only cover instances where there is fraud or dishonesty by an insolvency practitioner, or fraud and dishonesty undertaken by an employee or colleague of the insolvency practitioner with the collusion or connivance of the insolvency practitioner. As noted above, there is no statutory definition for what precisely is covered by these terms. R3 agrees that it is a weakness that there are currently no consistent regulatory or specific statutory requirements which provide protection for creditors from fraud or dishonesty of a director or employee without the knowledge or collusion of the insolvency practitioner.
36. Fraud and dishonesty by an employee or director without the knowledge or collusion of the insolvency practitioner could be more likely to occur in firms with extended hierarchies, which may result in an insolvency practitioner having less direct oversight of their cases than would otherwise be the norm. This, in itself, may create more opportunities for employees to act fraudulently or dishonestly. However, larger firms with extended hierarchies also have more opportunities for third party review of cases, which in turn may reduce the instances of fraud or dishonesty.

37. Any changes in the requirement to hold fidelity guarantee insurance would need to be carefully considered. Such a requirement would likely result in an increase to insurance premiums for insolvency practitioners, which may be disproportionate to the risks involved. It would also need to take into the account the impracticality of requiring all firms to hold fidelity guarantee insurance; for example, there would be little point for a sole insolvency practitioner with no employees to hold this type of insurance.

2. Practical issues

a) Variation in particulars of bond wording causes confusion. *There are wide variations in cover between bond wordings, particularly in terms of deadlines, limits on liability, and maximum indemnity periods. These depend not only on the bond provider but on the date of issue. There are reported issues with successor practitioners obtaining copies of the relevant bonds, and having to submit protective claims in order to ensure that cover will be available.*

38. R3 does not have access to empirical evidence regarding any variations in cover between bond wordings, although anecdotally this appears to be the case. Some members have advised that the differences in wordings between the different bond providers have created difficulties when seeking to change bond providers. However, R3 acknowledges that, in line with the current statutory requirements, the wording of bonds is subject to the commercial considerations of the bond providers.

39. An area which may require greater clarification is that of early notification of claims. There appear to be differing interpretations about what constitutes early notification, who is able to provide this notification, and to whom it should be made. This seems to have created difficulties for successor insolvency practitioners, the RPBS, and the bond providers. Clarifying exactly what is needed for a bond provider to be notified at an early stage that there may be a potential claim may help to alleviate some of the apparent miscommunication and the perceived adversarial nature of some claims processes.

b) Increasing costs of premiums. *In response to perceived risk, we are informed that some bond providers have increased SPS premiums for smaller firms (two or less insolvency practitioners) by up to 200% for 2016. While pricing is a commercial matter for insurers, concerns have been raised that smaller insolvency practices could be priced out of the market, which would reduce competitiveness.*

40. There have been substantial increases in the SPS premiums charged by some bond providers for smaller practices since 2015, which is of particular concern to R3. R3 understands that the same increases have not been applied to larger firms. This is presumably due to a difference in perceived risk as a result of the greater third party scrutiny available to larger firms, and potentially fewer bond claims where a larger firm is able to cover any losses caused by fraudulent activity on an estate without recourse to the bond being required,

which smaller practices may not be resourced to do. Larger firms also often have risk or other oversight committees which provide a greater level of 'independent' oversight within the firm.

41. Smaller practices are extremely valuable to the insolvency profession, the wider UK business community, and the UK economy. Where there are sufficient funds, the costs of the SPS premiums are borne by the insolvent's estate, but any increase could nevertheless affect competitiveness. R3 is concerned that pricing smaller insolvency practices out of the market will reduce the availability of local small practices and will not just reduce competitiveness, but will very likely have a wider range of detrimental effects on the UK economy as a whole.
42. Across the UK, there are currently a large number of smaller firms of insolvency practitioners who are readily accessible to local small or medium enterprise (SME) business owners. These practitioners are uniquely well qualified to give personal, face-to-face advice on how SME businesses can manage and, where possible, recover from their financial difficulties.
43. Where an SME business has run into financial difficulty, the availability of a locally-based insolvency practitioner who understands their needs, the state of the local economy and market, and who can call upon a diverse range of local contacts and professionals to assist the business, can be crucial in finding the best possible solution.
44. It is therefore very important that smaller firms are not inadvertently priced out of the insolvency market. Continuing increases to bond premiums will likely result in smaller practice insolvency practitioners either leaving the profession entirely or merging with or joining larger sized firms, eventually resulting in fewer smaller firms in the profession.
45. Despite the above, R3 is aware that the pricing of bonds will depend on the risk profile of the firms that the bond providers are being asked to provide cover for. R3 acknowledges and respects that this is a commercial decision for the bond providers and that bond providers will make decisions about bond premiums based on the perceived risk to their own business.

c) Adversarial nature of claims. *We understand there is little interaction between successor practitioners and sureties, with the insolvency practitioner carrying out their usual statutory duties and any investigation according to their own judgement. There is often no discussion or sanction of investigatory work by the surety, who are presented with costs only at the claims stage. There is no agreement to determine the amount of work to be undertaken, which insurers claim can on occasions be disproportionate to the loss suffered by the estate. This lack of co-operation can lead to delays in settling claims and increase costs to the detriment of creditors.*

46. Some bond claim processes appear to be adversarial in nature, although R3 is aware that there are differing views on where the lack of engagement and adversity stems from. Regardless, anecdotal evidence suggests that there are issues with communication between the parties to a bond claim, which may be affecting the effectiveness of the bond system as a whole. There are requirements in the bond wordings regarding communication and notification, which may need to be clarified to ensure that each party is aware of their

obligations and when they need to become actively engaged in the bond claims process. As noted above, there seem to be particular issues surrounding what constitutes effective notification of a bond claim (including early notification of a bond claim), and it may be beneficial to provide further clarity on this to ensure that this is firmly understood by all parties.

47. R3's comments at paragraphs 27-29 set out R3's views relating to the costs of successor insolvency practitioner work. This has also been commented on further in response to the questions in the Call for Evidence relating to the claims management protocol.
48. Of equal concern appear to be issues with communication and engagement between the bond providers and the RPBs. It would seem prudent that, where RPBs have been notified that an insolvency practitioner has not been paying their bond premium (which may be suggestive of wider issues with the insolvency practitioner's practice), this triggers engagement on the issue. Stronger engagement between the bond providers and the RPBs should be encouraged and facilitated in order to ensure that 'early warning signs' of issues with bond cover or wider issues of misconduct are identified and acted upon.
49. It may also be worthwhile reviewing the matters which have triggered a successful bond claim in the past in the context of how this matter would be treated by an RPB if picked up as part of the regulatory process.

d) Cessation of cover on non-payment. *Some bonds provide that cover is only available when the premiums are paid. While the enabling bond is paid at the outset of cover, the SPS is collected throughout the year as appointments are taken. Where an insolvency practitioner fails to maintain payments, it is reported that in some instances insurers are terminating cover retrospectively which leaves estates without protection.*

50. R3 acknowledges that, from a commercial perspective, it is reasonable that bond cover is only available when premiums are paid (albeit only certain bond providers have this as a term included in the bond itself). It would be unreasonable to expect that bond providers should still pay out on a bond where an insolvency practitioner has committed fraud or acted dishonestly during a period of time when they not paid their bond premiums (although this becomes less clear cut when that premium was deferred/then paid at a later date).
51. However, it appears that there may be inconsistencies between the bond providers in terms of when bond covers remain in place despite a premium not being paid. R3 believes that the non-payment of bond premiums should act as a trigger point for further monitoring or review by the relevant regulator. While there may be innocuous reasons for the non-payment (including simple human error), this should be investigated and determined by the RPB at the earliest opportunity, given the potential ramifications of non-payment of bond premiums on the protection available for creditors.
52. Further clarification and consistency is also needed regarding how non-payment of bond premiums is treated and how this affects the application of bond cover. Clarification is also

required in instances where a new case has been placed on the cover schedule, and so a bond provider has been notified of its existence, but there is a gap of several months before the premium for this new case is invoiced. R3 has been informed that it is not clear, currently, whether the latter case would be covered by the bond at the point of notification or at the point of invoicing. While this is likely a commercial decision for the bond providers, further clarification and consistency on this issue would be beneficial.

e) **Limited number of insolvency practitioners willing to take on successor appointments.** *Currently there are only a small number of insolvency practitioners willing to take on successor appointments, which means that there is little competition and to some extent those undertaking successor appointments can set their price for undertaking this type of work.*

53. R3 is aware that there are only a small number of insolvency practitioners who currently undertake successor insolvency practitioner appointments. There are a variety of reasons for this, including the risks associated with this type of work (which may involve writing off large sums of costs and disbursements where cases, particularly those in a block transfer, are found to have no assets); the need for specific expertise in investigatory work which may take time and expense to acquire; and the time involved in reviewing a large number of cases and then undertaking a detailed analysis where instances of fraud or dishonesty are suspected.
54. R3 understands that a successor insolvency practitioner is rarely able to undertake any due diligence prior to taking an appointment, and will have to review the relevant cases after the appointment takes place. Anecdotal comments indicate that a large number of cases with a successor insolvency practitioner appointment need to be closed at great expense, which is not able to be recovered from the estate, although empirical evidence to support this would need to be sought from successor insolvency practitioners themselves. R3 cannot comment further on whether more insolvency practitioners should be involved in successor work, as this is a commercial decision for the individual insolvency practitioner and/or their firm.
55. It is not clear to what extent the small number of successor insolvency practitioners affects the setting of fees, although basic market theory would indicate that a greater number of successor insolvency practitioners could lead to lower costs.
56. There also appears to be a general lack of clarity and understanding within the wider profession around the processes for being alerted to the opportunity of a successor appointment, the processes for being appointed as a successor, and when an RPB should intervene in this appointment. It is not clear whether the RPBs appoint particular insolvency practitioners as successor insolvency practitioners to the exclusion of others, and, if this is the case, the reasons for doing so. More extensive and clearer information on this could be beneficial in making these appointments more accessible to the wider insolvency profession.
57. There needs to be greater clarity about the differences in the types of appointments and subsequent processes required to be undertaken by the successor insolvency practitioner. It

should be remembered that not all successor practitioners are appointed with bond claims in prospect. For example, cases where successor insolvency practitioners are appointed (usually because they have been named by another insolvency practitioner as their successor) where an insolvency practitioner has retired or is ill are distinct from cases where successor practitioners are appointed where there has been disciplinary action or there are suspicions of wrong-doing. Many insolvency practitioners are willing to act as successor insolvency practitioners in the former instance, but if this is to continue, any measures taken to resolve weaknesses in the bonding system should recognise and distinguish this largely non-contentious role. Clarity on the expectations and duties of the successor insolvency practitioners in each instance is therefore needed.

<u>Question 2</u>: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

58. R3 has identified other weaknesses in the current system, which include:

    a. The lack of transparency and oversight into successor insolvency practitioner work. There appears to be a particular gap in the monitoring of successor insolvency practitioners, especially with regards the investigatory side of their work, where it is not clear that this lies within the ambit and responsibility of the RPBs, as the work undertaken may not be that envisaged by the *Insolvency Act 1986*. This lack of transparency has potentially created issues and misconceptions, as R3 believe that it may not be clear to all the monitoring bodies whether this work is (and should be) regulated in accordance with the insolvency legislation. Greater clarity is required regarding who has the responsibility, and the processes that should be used, for monitoring the work of successor insolvency practitioners with regard to any investigations into fraud and dishonesty, particularly those which may become the subject of a bond claim.

    b. Instances of fraud and dishonesty not being identified during routine monitoring. As mentioned earlier, instances of fraud and dishonesty may not be identified during routine monitoring visits by the RPBs. This might imply that the current monitoring processes may not be robust enough to detect fraud, dishonesty, and potentially other issues at a sufficiently early stage. Further consideration should be given to how the monitoring processes of the RPBs could be improved to increase the likelihood that these issues are being picked up.

    c. The lack of a clear definition for what constitutes dishonesty. As noted above in paragraph nine, there need to be clearer definitions for what constitutes dishonesty for the purposes of the bond. While a successful bond claim for fraud requires a criminal conviction, there is no similar requirement for dishonesty – this not being a criminal offence. Greater clarity around what constitutes dishonesty, particularly to distinguish it from incompetence or a genuine mistake, and what is required to prove its existence in a particular case, would be beneficial for all parties and the bonding system as a whole.

<u>Question 3</u>: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

59. There would be significant barriers to introducing a similar arrangement (that is, an equivalent of a solicitors' compensation fund) to that used by the legal profession for the insolvency profession. The first barrier would be securing sufficient funding for the fund. Given that there are bond claims up to £5 million, any fund would need to be able to absorb such claims, requiring significant 'upfront' funding at the inception of the fund.
60. There are also currently approximately 176,000 solicitors (136,000 practising) paying into the Solicitors Regulation Authority Compensation Fund, compared to 1,600 insolvency practitioners (of whom around 1,300 take insolvency appointments). The attendant cost of paying into a fund would therefore be spread across a much smaller number of practitioners within the insolvency profession, meaning that the cost for each insolvency practitioner would be much higher than that for each solicitor. This may disproportionally affect smaller insolvency practitioner firms and could be more expensive than the current bond premiums.
61. If a fund was to be introduced, and adequate means to fund it found, it is not clear who would have responsibility for administering the fund. It would need to be considered whether there would be a number of funds (each administered by the relevant RPB for their members) or if there would be a central fund, with the associated difficulties in determining where responsibility for administering this fund would lie.
62. It should also be noted that there is no entitlement to money for claimants to the Solicitors Regulation Authority Compensation Fund as it is entirely discretionary. Unlike in bond claims, where the bond provider is required to pay out the bond money if fraud and/or dishonesty are proven, there is no such requirement for money from the fund to be paid to successful claimants. As such, the concept of a similar fund to replace the bonding system may only offer more limited protection to creditors.

<u>Non-legislative and regulatory changes</u>

a) Claims management protocol

63. A claims management protocol could be an effective means for managing some of the issues identified above. A protocol will not be able to resolve the fundamental issues with the legislation (which would require legislative change or repealing the entire bonding system, as has happened in other jurisdictions), but it may be able to mitigate some of these. It would be essential that any claims management protocol is established with the input of all relevant parties, including the bond providers, successor insolvency practitioners, and the

RPBs. As the trade body representing the insolvency profession, it would be logical for R3 to provide input to this process.

64. For a protocol to be effective, it is essential that it does not seek to cover in explicit detail every possible scenario that could arise as part of a bond claim process. Expectations regarding communication, engagement, and notification need to be clearly stated, and relevant definitions for dishonesty, collusion, and connivance should be included. The basic process for managing a bond claim, and also for undertaking the investigatory side of successor insolvency practitioner work, including around appointment of successor insolvency practitioners, should be outlined. There should be explicit requirements relating to transparency and the approval processes for successor practitioner fees and other associated costs.
65. The protocol should also address the timing of payments to the successor insolvency practitioner. The uncertainty surrounding the funding of work by a successor practitioner appears to be a deterrent to many insolvency practitioners becoming involved in this work. It would be helpful if the protocol was to promote transparency around this area for practitioners who comply with the protocol.
66. The role of the RPBs in monitoring successor insolvency practitioner work should be outlined, as should expectations on engagement between the bond providers and the RPBs where there are concerns around matters such as consistent under-bonding or missed bond premium payments. Clearer monitoring processes and methods to identify and determine instances of fraud and dishonesty at an earlier stage in the regulatory process may also need to be established, although this may be considered a separate issue.

b) Approved panel of successor insolvency practitioners

67. The introduction of an approved panel of successor insolvency practitioners is not necessary to resolve the issues associated with the current bonding system. While the idea of a panel, particularly if panel members are required to abide by the claims management protocol discussed earlier, has some merit, there are practical issues associated with a panel and other methods of resolving the identified issues are likely to be more effective.
68. If a panel were to be introduced, it should provide for the appointment of successor insolvency practitioners only where fraud or dishonesty is suspected (or where an insolvency practitioner has had their licence removed), rather than including the appointment of successor insolvency practitioners in non-contentious cases (that is, those where there is no expectation that a bond claim will need to be made). In the latter case, there is clearly a need for a much wider number of insolvency practitioners to be able to act as a successor insolvency practitioner. Insolvency practitioners should remain free to elect their successor in the event of their retirement or illness.
69. Consideration would need to be given, however, to the potential problems with such an approach for cases where a successor insolvency practitioner is appointed and discovers instances of fraud or dishonesty in the successor cases, although this was not suspected

prior to the transfer of cases from the original office-holder. In these instances, would it be necessary for another block transfer of cases (with the relevant costs and time involved) to occur to a successor insolvency practitioner who is also a panel member, and so able to investigate instances of fraud or dishonesty? A more sensible approach could to be to require, in these rare instances, that the successor insolvency practitioner agrees to observe the protocol and the processes contained within this in relation to any bond claims.

c) A requirement that investigation costs must be proportionate to loss

70. Further evidence is required as to what extent investigation costs for successful bond claims might have been disproportionate to loss; R3 cannot provide such evidence.
71. R3 believes that to specify that investigation costs must be proportionate to loss is not an appropriate measure to control successor insolvency practitioner costs. Instead, the protocol should focus on transparency and approval processes. The approval processes may need to accommodate engagement with the bond providers, as well as the normal creditor approval provided for in the insolvency legislation. It may be appropriate for it to distinguish between certain elements of the costs incurred.
72. It may also be appropriate for such measures to apply to other costs, such as legal costs, which may be undertaken by other professionals such as solicitors.
73. Any such requirement should also apply to any other profession which is qualified to take on the investigatory work of a successor insolvency appointment, such as an auditor or forensic accountant.

d) Greater transparency over rates for investigation of fraud and dishonesty.

74. There needs to be far greater transparency over the rates for investigation of fraud and dishonesty. Both bond providers and creditors/members need to have this information available to them when either approving a fees estimate or when settling a bond claim. Successor insolvency practitioners should also make clear in statutory reports to creditors/members what effect any difference in rates from their predecessor's has had, or is likely to have, on the overall costs to the estate.

<u>Question 4:</u> Are there any other issues that you would like to see addressed through a claims management protocol?

75. As noted earlier, the claims management protocol should not be overly detailed nor seek to cover all possible scenarios, but should instead use a principles-based approach. It should clearly outline the successor insolvency practitioner process and ensure that the processes used when dealing with successor cases are transparent, and able to be adequately monitored by the RPBs. Consideration could also be given to whether the principle in SIP 2, which requires an insolvency practitioner to consult with creditors before undertaking detailed investigations, especially where there are funds in the estate that could otherwise

be distributed, should also be included in the protocol for instances where an estate's funds could be being used to fund an investigation by a successor practitioner into a potential bond claim (especially if the suspicion originates from another case).

Legislative changes – options

Option 1 – Do nothing

<u>Question 5:</u> Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

76. While a claims management protocol, and contemporaneous changes to regulatory and monitoring processes, should be introduced as the initial steps towards resolving the issues and weaknesses in the current bonding system, the weaknesses identified in the legislation cannot be resolved without legislative change. Weaknesses in legislation cannot be solely addressed through non-legislative means, as the legislation will always have priority over any non-legislative/voluntary arrangements, such as a protocol.
77. Whilst R3 believes that the introduction of a protocol would be a positive first step, R3 also believes that further consideration should be given as to whether legislative change or removal of the bonding system entirely (in effect, the repealing of the legislation relating to bonding, which has occurred in other jurisdictions) is required. R3 recognises that any legislative changes will take time to implement and may not currently be of particular priority for the government. Nonetheless, it will be necessary if the weaknesses identified with the current system are to be properly resolved.

Option 2 – Repeal legislative requirements

Question 6: what do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

78. It is not possible to predict the likely impact of removing the statutory bonding requirements, without it first being clear what the replacement for these arrangements would be. It would not be advisable for these requirements to be removed without first having another mechanism in place to protect creditors/members in instances of fraud and/or dishonesty by insolvency practitioners or their staff. The impact of removing bonding arrangements could be positive for insolvency practitioners in terms of business costs and resulting competitiveness, but this would depend on the nature of the replacement. For example, extended professional indemnity insurance would probably result in higher premiums which would have to be borne by insolvency practitioners, but it is not possible to judge the likely costs of these premiums based on the current information available.
79. R3 understands that the requirement for bonding was removed in Australia and replaced with a version of extended professional indemnity insurance cover. R3 would suggest that the Insolvency Service undertakes research into how the insurance systems for insolvency

practitioners operate in other jurisdictions, and then undertakes a detailed analysis and consultation as to what would be the most appropriate replacement for bonding in the UK, if it were to be removed entirely.

Option 3 – Amend the current legislation.

a. Amend the current prescribed terms of a bond

80. The current prescribed terms of a bond need to be amended. Amendments should include statutory definitions for dishonesty, collusion, and connivance. Further amendments could be made to ensure that the language in the legislation is clear, which will help with reducing inconsistencies in bond wordings.

b. Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs

81. Given the importance and complexity of the work being undertaken, it is important that there is no perception (or reality) of successor insolvency practitioners being expected to undertake this work for no payment. If arrangements are put in place to ensure that there are robust requirements for transparency and approval of the costs and fees involved, R3 does not believe that the ring-fencing of a bond claim is appropriate or necessary.

c. Provide for investigative costs as a prescribed requirement of the bond

82. The paragraphs above relating to the introduction of a protocol envisage closer interaction between the bond providers and the successor practitioners, which should promote common goals to ensure that portfolios of cases where fraud and dishonesty are suspected are reviewed at an appropriate cost. It may be appropriate to bring an element of this into legislation in due course if it would assist to ensure that all bond providers now and in the future are required to promote such a pragmatic approach. It is important that flexibility exists so that the circumstances of each case or portfolio of cases are dealt with appropriately.

d. Agree or legislate for a 'de minimis' maximum indemnity period

83. R3 would support the introduction of a two year period to submit the bond claim post appointment of the successor insolvency practitioner or post the original office holder ceasing to act as the appointment taker. This time limit has been in place in most bonds that were written in the past and seems to be sufficient to allow for the notification of claims.

e. Remove requirements for monthly cover schedules and provide for an annual or global bond cover

84. . An annual or global bond cover may not be appropriate for all members of the insolvency profession and must be researched thoroughly.

f. Amend the existing monetary limits of the GPS/SPS

85. While R3 considers that other mechanisms would be more effective at resolving the issues in the current system, amending the existing monetary limit for the GPS or SPS could be supported, provided that extensive analysis is undertaken and other measures introduced to minimise any associated rise in premiums for insolvency practitioners, much of which would be borne by the insolvent estates.

g. Introduce a duty that investigative costs must be proportionate to loss/cover

86. Please refer to R3's comments at paragraphs 69 to 72. R3 does not believe it to be appropriate to include a legislative duty requiring investigative costs to be proportionate to loss and/or cover.

h. Protect estate from non-payment of the bond premium

87. Mechanisms need to be implemented to ensure that bond premiums are paid, and that estates are protected from any non-payment of premiums. It is not clear, however, why this should require legislative change. Alterations to the communication and monitoring processes of the RPBs and the bond providers may be more effective at ensuring that the estate is protected. It is important that any changes introduced are not so onerous as to force (the commercially unviable) result of a bond provider being forced to pay on a bond claim where bond premiums have not been met, as this may have unintended consequences in terms of the attractiveness of bonding insolvency practitioners for bond providers, who may then decide to leave the market. It may be that if cover is to be refused for non-payment of a bond premium, there could be a requirement for the termination of the bond cover to be formally notified to the insolvency practitioner's RPB, with a clause allowing reinstatement of cover should the RPB choose to pay the outstanding premium, in its role as beneficiary of the bond.

i. Include professional indemnity as a requirement for security, including run-off cover

88. While this does not necessarily need to be a statutory requirement, more consistent regulatory requirements for professional indemnity insurance, including run-off cover, could be considered. R3 would, however, have concerns regarding the potential cost of providing this run off cover and would suggest that the associated costs should be considered.

j. **Agree or legislate for IP firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by people other than the IP**

89. A requirement for insolvency practitioner firms to hold fidelity or similar insurance has merit. This is a particular gap in protection for creditors, who are currently not shielded from fraud committed by employees or other associated parties without the collusion or connivance of the insolvency practitioner. As with the other changes to arrangements, careful consideration would need to be given as to any increased costs for insolvency practitioners associated with this change.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options set out above, and the potential impacts? If not, please give your reasons.

90. The advantages, disadvantages, and potential impacts of the options have been outlined in both the Call for Evidence and in this response. Nonetheless, it is also worth emphasising the importance of ensuring that the consequential increases in premiums for insolvent estates and insolvency practitioners are taken into account when considering any changes to the current system.
91. If a claims management protocol is introduced, consideration should be given to the level of scrutiny required to ensure that all parties are properly engaging in the process, and with which body the responsibility for ensuring this should lie.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered?

92. It is essential that the Insolvency Service also considers the key performance indicators which will be used to determine that the implemented changes are successful in resolving the weaknesses and issues identified with the current bonding arrangements.
93. Measurements for success need to be determined, so that any change can be evaluated in terms of the positive impact that it has made. Potential measurements for success which the Insolvency Service could consider include:
    - More insurers entering into the market (if the bonding system is retained), with associated decreases in premiums which will allow smaller practice insolvency practitioners continued access to bonding.
    - Greater transparency over the appointment of successor insolvency practitioners and also increased monitoring and transparency of the processes used to deal with their cases.
    - An increased understanding of the bonding system and the processes used for making claims, which could be evidenced by a decrease in the number of bond claims being denied due to issues with cover originating from the initial office-holder.
    - A reduction in fraud and dishonesty bond claims across the profession. This could be the result of either education initiatives and/or more robust monitoring processes

which would be capable of picking up instances of potential fraud or dishonesty at an earlier stage.

<u>Question 9:</u> Of the proposed options for legislative change, which would be your preferred approach and why?

94. R3's preferred approach would be to introduce a claims management protocol in the first instance, whilst sufficient evidence is gathered to determine whether the bonding system should be removed entirely or whether amendments to legislation will be sufficient to resolve all of the issues identified with the current system.

<u>Question 10:</u> Do you have any further comments you would like us to consider in relation to bonding?

95. It should be noted that R3 is not a primary source of data or statistics. It is expected that the Insolvency Service will be seeking necessary data from the primary sources, that is, successor insolvency practitioners, bond providers, creditors, and the RPBs.

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BRIGHTER THINKING

Date: 16 December 2016

By e-mail only: IPRegulation.Section@insolvency.gsi.gov.uk

Insolvency Practitoner Regulation Section
The Insolvency Service

Dear Sirs

CALL FOR EVIDENCE – BONDING ARRANGEMENTS FOR INSOLVENCY PRACTITIONERS

Please find enclosed our response to the Insolvency Service Call for Evidence on bonding arrangements for insolvency practitioners dated 15 September 2016. This response is submitted on behalf of Menzies LLP, a top 20 firm of accountants, finance and business advisors and insolvency practitioners.

Yours faithfully

Menzies LLP

Menzies LLP

MENZIES
BRIGHTER THINKING

Menzies LLP

Response to Call for Evidence: Bonding arrangements for insolvency practitioners

Question 1: These are issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

Yes, except that there are currently a larger number of insolvency practitioners willing to take on successor appointments. The reason for the lack of competition is that only a few of these insolvency practitioners are actually appointed.

In addition to directors and employees, fraud could be committed by any other agent of the insolvency practitioner without his or her knowledge or collusion.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

The value of the specific penalty sum is "at least the value of the insolvent's assets… but ignoring the value of any assets charged to a third party to the extent of any amount which would be payable to that third party…". This means that there is no protection for fixed and floating charge creditors in a situation where the insolvency practitioner has access to all of the company assets, including the charged ones.

By contrast, insolvency practitioners have been advised that the current wording includes a requirement to bond for fees paid to them not out of the estate but by third parties. This seems to go against the purpose of the specific penalty sum.

Assignment of the bond to the insolvency practitioner's RPB, which then has to assign the bond to the successor IP, does not seem to serve any purpose, as the RPB has no real involvement in claiming under the bond. RPB involvement seems to add an unnecessary layer of cost and complexity.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

Possibly, although it is not clear how the amount of funding required would be calculated (or estimated), and how this would be divided amongst Insolvency Practitioners. Would it be a flat fee per Insolvency Practitioner regardless of the case portfolio, or would it be calculated by reference to their cases in some way? What would happen if the fund ran out? Who would decide what claims would be covered by the fund?

In addition, the charge would presumably be to the insolvency practitioners or their firms, and not to the individual estates. This penalises the firms and makes the insolvency industry less attractive for a practitioner.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

No. We would support a general protocol.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

No. A protocol can deal with practical weaknesses identified in the current system, but it cannot deal with legal weaknesses. A reformed legislative framework would be required.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

For insolvency practitioners there would be less certainty because claims would presumably be made against them personally rather than against the bond (i.e. against an insurance policy).

There may be a loss of confidence in an industry where creditors have little confidence. The perceived strength of the insolvency regime and confidence in it might affect the decision of investors looking to invest in the UK or elsewhere.

For creditors there may be less protection, although in many cases creditors do not receive a return from a bond claim.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options at set out above and the potential impacts? If not, please give your reasons.

a) **Amend the current prescribed terms of a bond**
We agree with the suggestion of single universal bond terms, so long as they are agreed by all parties. If there are minimum terms which allow some flexibility, there is a risk that some terms will be invalid.

b) **Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs**
It is reasonable for the proceeds to be ring-fenced. However, this would mean that the insolvency practitioner would have to be paid separately and in addition – to be agreed with the insurer or by the court if there is disagreement.

To avoid creditors receiving more than they would have received had there been no fraud, the investigation costs could be met by the insurer, with the usual work that should have been undertaken by the original insolvency practitioner (such as agreement of creditor claims) being paid from the estate/bond claim. There is a risk of disagreement as to allocation of costs between the insurer and the estate. Any disputes would have to be settled by the court.

c) **Provide for investigative costs as a prescribed requirement of a bond**
It is not clear how the level of investigative costs would be set. Such costs will vary greatly depending on the case. A fixed fee could be insufficient in a complex fraud case. The insurer and the insolvency practitioner should agree fees proportionate to the case.

d) **Agree or legislate for a 'de minimis' maximum indemnity period**
Any finite indemnity period could be insufficient in certain cases. The only means to avoid this is to require the indemnity to be open-ended.

e) **Remove requirements for monthly cover schedules and provide for an annual or global bond cover**
A quarterly bond might be a compromise, with less risk falling on the insurer than with an annual bond and less burden than monthly cover schedules.

f) **Amend the existing monetary limits of the GPS/SPS**
We agree that the current limits are too low, considering that asset values, particularly for solvent liquidations, can often run in excess of millions of pounds.

g) **Introduce a duty that investigative costs must be proportionate to loss/cover**
Costs should be proportionate to the necessary investigation work undertaken on that particular estate, and the insolvency practitioner's fees should be agreed with the party paying them. If the fees cannot be agreed then the court should arbitrate.

h) **Protect estate from non-payment**
Calculation of premium is not always straightforward, where there has been an increase in the SPS part way through the bond term or where there is a change of bond provider, for example. In order

for this suggestion to work, the process needs to be simplified and the premium must always be clear.

i) **Include professional indemnity as a requirement for security, including run-off cover**
Run-off cover in the name of the insolvency practitioner may be appropriate as well as cover in the name of the firm. A bond claim is personal in nature, so it is not clear whether the firm's professional indemnity insurance would respond to a claim, unless the required terms of the professional indemnity insurance are prescribed.

j) **Agree or legislate for insolvency practitioner firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by persons other than the insolvency practitioner**
This would be possible as an extension of the firm's insurance, but it should be noted that fraud might be committed by other agents of the insolvency practitioner.

Question 8: Do you agree that the paper sets out the full range of issues, or is there anything further which should be considered?

Other than as mentioned above, we believe the full range of issues has been considered.

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

Full legislative change, as it is the only way to deal with the legal weaknesses in the current system. This would be combined with a protocol to ensure consistency across the practical issues.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

Yes, we would like to see a Working Party formed to review the position, with representatives from across the insolvency profession. Menzies would be pleased to participate in such a group.

The voice of banking

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16th December 2016

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Bonding arrangements for insolvency practitioners – Call for evidence

1. The British Bankers' Association (BBA) is the leading trade association for the UK banking sector with 200 member banks headquartered in over 50 countries with operations in 180 jurisdictions worldwide. Eighty per cent of global systemically important banks are members of the BBA. As the representative of the world's largest international banking cluster the BBA is the voice of UK banking.

2. We welcome the opportunity to provide input into the call for evidence on bonding arrangements for insolvency practitioners.

3. A customers' confidence that any monies they send to an Insolvency Practitioner (IP) will be secure and distributed in a timely manner to creditors is a key element of trust in them seeking debt advice.

4. Consumers are unlikely to be aware that different debt solutions are subject to different regulation. An incident/ concern around the security of client monies held by IPs could have inadvertent consequences for the broader debt advice landscape, and affect confidence of debt advice provided by firms regulated by the Financial Conduct authority (FCA).

5. It is therefore key that appropriate controls and governance are in place to protect client monies and maintain confidence for customers' to seek debt advice.

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

6. We agree that the assessment has identified the weaknesses within the current bonding system.

7. The recent incident has brought these weaknesses into focus, with the particular concern that bonding requirements:
    - Only cover fraud and dishonesty by or with the collusion of the Insolvency Practitioner (IP). There is no requirement to have fidelity insurance.
    - The level of cover is reliant upon the honesty of the IP to declare the accurate value of the assets.
    - In the event of a claim, the bond claim is paid to the estate and not paid to the creditors that have been adversely impacted.
    - The successor fees and costs of investigating the fraud (including reconciliation at an account level) can be significant and materially reduce or even exceed the value of the claim that is available for distribution to creditors

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8. The increase in insurance premiums charged by some bond providers is being treated as a category one disbursement. This has the effect of increasing the costs of the Insolvency and reducing the dividend to creditors.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

9. We are not aware of any other weaknesses.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

10. The review should consider arrangements in other industries that provide customers/debtors with confidence that monies they pay to their IP, as client money, will be kept safe and separate, and that in the event of negligence or dishonesty, there is a method of obtaining redress.

11. Similar arrangements that are used in the legal profession could work within the insolvency profession, including Professional Indemnity Insurance (PII). The FCA published a thematic review on Professional Indemnity Insurance within the general insurance intermediary market on the 5th December. The findings of the review should be considered as part of the evaluation of the next steps. The review highlights the need for robust regulatory oversight of PII cover to ensure that protection is available to customers in the event of a claim, identifying inconsistent approaches with; the level of cover, exclusion clauses and variations in wording.

12. The review of these arrangements should also consider whether any changes to the IVA process needs to be made to minimise the level of potential risk in holding client money.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

13. No. A claims management protocol would ensure greater engagement and co-operation between stakeholders in the process, which should lead to better and more consistent outcomes.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

14. Whilst the introduction of the claims management protocol would be a positive step, there is a need to carefully consider the detail of the arrangements and the overall financial implications. The consultation indicates that the protocol would have an objective of ensuring that investigation costs would be proportionate to the loss suffered, however the outcome might still result in there being sufficient funds available to cover any mis-appropriated funds.

15. Further evaluation of such a proposal should consider the cost: benefit analysis. This could be assessed as a standalone proposal of the introduction of the claims management protocol, or combined with alternative suggestions such as increased bonding cover to meet investigation costs (or equivalent protection) that would result in creditor's funds being covered in full.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

16. Whilst the volume of claims against bonds has been relatively low in recent years, the recent claim has increased the focus.

17. Any proposal to remove the statutory bonding requirements should only be considered where this is replaced by an alternative form of cover that would provide ‘appropriate’ protection. We would suggest that Professional Indemnity Insurance which extends cover to all consumer monies held in trust would be a suitable option.

18. There is a potential concern that a lack of confidence or integrity of IP’s handling clients monies, could lead to contagion and concerns being raised in other areas of consumer debt management such as Debt Management Companies that are regulated by the Financial Conduct Authority (FCA).

19. Customers are probably unaware of the dual legislative / regulatory regime for consumer debt solutions. The safety of client monies should not become a factor in the customers’ choice of debt solution, and an equivalency of client money protection, regulatory oversight and regulatory sanctioning should be an objective.

20. The FCA’s Client assets Sourcebook (CASS) sets out in clear terms in Chapter 11 the rules that regulated firms must adopt when holding and distributing client monies.

    - Client money definition
    - Requirement to segregate
    - Requirement to distribute to creditors as soon as practically possible – normally within 5 working days

21. The adoption of elements of CASS would bring in a consistency across the consumer debt management landscape, and would help to minimise the potential for fraud as client funds will be required to be segregated and then distributed to creditors quickly. The FCA rulebook is rigorously enforced by the regulator and a range of sanctions can be applied to non-compliant firms, including the threat of withdrawal of permissions.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

22. Yes, we believe that the consultation assesses the advantages and disadvantages of the options set out.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.

23. Yes, it fairly summarises the specific issues with the current bonding requirements.

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

24. The desired outcome is for greater protection of client monies.

25. We believe that any combination of proposals that extend the coverage to protect against fraudulent activity by any staff associated with the Insolvency practice would achieve the best outcome.

26. This should however be subject to a cost: benefit analysis such that any increased insurance costs do not have a disproportionate impact on creditor dividends.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

27. We have long advocated that the debt advice landscape for consumers is too complex and that the dual regulatory and legislative environment is not the most efficient approach.

28. The regulation of firms providing advice to customers, whether Insolvency, Debt Management or Debt Advice would be better served under the control of a single regulator.

29. The benefits that a single regulator could bring to consumers would be

    - Allow an holistic review of the overall consumer debt solution landscape to be undertaken and be able to drive change
    - Provide consumers with a consistent experience and embed consistent standards for the debt advice sector, irrespective of the debt solution that the customer is taking up
    - Ensure best practice is adopted – for example the FCA CASS sourcebook which requires the segregation of client funds and the prompt disbursement to creditors.

30. The responsibilities of the Financial Conduct Authority could be extended to cover consumer insolvency, with The Insolvency Service providing technical support

If you have any questions regarding this response please contact Ian Fiddeman, Policy Director (Ian.fiddeman@bba.org.uk)

ICAEW REPRESENTATION 192/16

Bonding Arrangements for Insolvency Practitioners

ICAEW welcomes the opportunity to comment on the *Bonding Arrangements for Insolvency Practitioners* published by The Insolvency Service on 15 September 2016, a copy of which is available from this link.

This ICAEW response of 16 December 2016 reflects consultation with the ICAEW Insolvency Committee which is a technical committee made up of Insolvency Practitioners working in large, medium and small practices. The Committee represents the views of ICAEW licence holders.

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ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW's regulation of its members and affiliates in insolvency is overseen by the Insolvency Service, and ICAEW is the largest of the Recognised Professional Bodies under the Insolvency Act, currently licensing almost 800 practitioners.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact: representations@icaew.com

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MAJOR POINTS

1. We agree that the current bonding regime is flawed and needs review. It appears to be designed to meet two objectives, first to protect creditors against the risk of loss caused by fraudulent IPs and secondly to have cases involving fraudulent IPs investigated by the private sector. It appears from the Call for Evidence largely to have failed in the first objective (although we think further verification of this is required) but to have met the second one. The regime does not seem to be well designed to meet both objectives as, apart from anything else, the amount of bond is based on the amount of assets of the estate (rather than the amount of assets plus costs)

2. The Call for Evidence does not state clearly what the objectives of a reformed regime would be or provide sufficient evidence about the operation of the current regime or its failings to enable us to propose concrete alternatives at this stage; there are simply too many alternative scenarios, each of which would need the interests of those involved to be assessed and taken into account.

3. We therefore welcome the fact that the Insolvency Service is seeking more evidence through this consultation process and suggest that it issues a follow-up consultation when it has assimilated the evidence provided. A further consultation might set out the desired objectives of the regime and provide the underlying evidence, where possible, to enable participants to consider and suggest alternatives on an objective and grounded basis.

4. For instance, it is not clear what returns creditors would have received under the current regime absent bonding, what the total bonding costs (effectively born by creditors as a whole) have been, how the reasonableness or otherwise of successor practitioner fees has been assessed, how material those fees are in the overall context or whether the prescribed form of bond is in line with best legal practice.

5. That said, it seems reasonably clear that the prescribed form of bond leaves much to be desired. The language used is often opaque at best and we understand that there are variants used in the market targeted at different market segments. If the bond were to be written in clear terms to meet clear objectives, many of the concerns might be mitigated. The Insolvency Service needs to consider its own role in approving forms of bonds and whether or not, if the regime is to be continued, bond terms should be set centrally, whether there should be a single form or permitted variants or whether only minimum requirements should be set with more competition allowed on terms. Each option will have its own cost implications and a cost versus benefits exercise will be required for any change, including the potential impact on different sectors of the market, such as sole practitioners and large firms.

RESPONSES TO SPECIFIC QUESTIONS

Q1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

6. We generally agree with the assessment of the weaknesses of the current bonding arrangements with a couple of qualifications noted below.

7. There is a widespread belief that very few IPs take relevant successor appointments. However, for some years ICAEW has maintained a list of our licensees who have expressed an interest in taking successor appointments and seeks to have cases assigned on a fair basis. There have not been many cases of ICAEW licence withdrawal for fraud or dishonesty in recent years and a reasonable variety of successor IPs have been appointed in those cases. Nevertheless, we are open to considering whether there is more we, or others, might do in this respect.

8. Even if some IPs do, in practice, account for a disproportionate number of successor appointments involving fraud or dishonesty, this does not in itself explain why successor IPs may charge higher fees than in standard cases.

9. These sorts of case can involve considerable investigative work to ascertain what has happened and whether there are any bond or other claims and additional administrative work in dealing with bond issuers, particularly those who dispute their obligations to pay. The appointments may also involve risk of dispute with the former IP and risk to reputation simply by being involved in a case where fraud has been alleged or proven (for instance the public may mistakenly associate the name of the IP handling a case with a fraud). Appointments may also be taken at short notice before it is clear how many affected cases have sufficient assets to cover costs incurred. In some ways this is specialist work where specialist skills and experience may be called for to best serve the public interest. Successor IPs are subject to the same sort of disclosure requirements as others and higher rates may be justifiable on reasonable grounds for these sorts of reason.

10. If concrete evidence of excessive charging emerges as a result of the Call for Evidence we would, of course, consider how this might be addressed (as regards our licensees at least). However, we think that the emphasis on this concern in the Call for Evidence may be disproportionate and that there are manifest flaws in the regime (in particular the form of bond) which should be addressed regardless of any concerns in this area.

Q2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

11. As noted above, the approved form of bond is not ideal as it is difficult to understand, leaving potential for disagreement and uncertainty. The amount of the Specific Penalty Sum is limited to the amount of the insolvent's assets (subject to a cap), but if the intention is for the bond to pay up to this amount to creditors, then it should cover IP's fees in addition to the amount of the assets.

Q3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

12. We do not believe a compensation scheme of the kind required for solicitors by the SRA would be a good model to follow. There are around 140,000 practising Solicitors compared to around 1,700 insolvency practitioners licensed by the various recognised professional bodies (RPBs) so there would be practical difficulties in establishing a fund of sufficient size to cover the sort of risks involved (if the intention is to cover potentially large frauds).

13. The bonding regime creates a legal liability on the surety to pay but, as the consultation paper notes, payments under the SRA regime are at the discretion of the SRA. If an RPB were required to operate a scheme which, in effect, insures creditors, this would be a very significant risk which, if accepted, would in practice probably need to be re-insured. An RPB would then need to carry out a number of functions, including assessing risks and premiums, that are better carried out by the insurance industry itself. If a compensation scheme were discretionary, then we do not see that it would meet the objective of, in effect, insuring creditors and many questions would arise that would require further consideration.

Q4: Are there any other issues that you would like to see addressed through a claims management protocol?

14. Please see Q5 regarding the claims management protocol.

Q5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

15. **Claims protocol.** It is essential that the bond itself is clear as to the terms on which it will pay and on any conditions or formalities for valid claims to be made. It is unclear why a claims protocol would be needed in that case. There is a risk that a protocol would itself become a source of potential dispute or weaken the position of bond holders and if this option is pursued it will be important that the legal implications are considered carefully.

16. The paper focuses on the role of IPs, but ought also to consider whether the insurance industry could be more transparent and make it easier for IPs to claim on the bonds so obviating the need for any additional bureaucracy. Sureties, unlike IPs, do not owe duties to creditors and would naturally seek to reduce the amount of claims made against them and the amount of recoverable costs. It is in the interests of creditors that bond claims are pursued robustly to enforce rights under the bonds and we believe that skilled and experienced IPs are in the best position to do this.

17. ICAEW would be interested in seeing the detailed evidence gathered regarding practice of RPBs in assigning claims and outcomes. While sureties may prefer to deal with RPBs, there is a logic in the successor IP controlling claims and it might be that assignment should be made automatic once the successor has been appointed to avoid the potential for uncertainty and delay that can arise where RPBs have discretion in the matter. Any proposal to increase the role of RPBs in the claims process would require careful consideration because this could result in duplication of effort and, if additional resource were required, this could have cost implications for the sector (and so creditors) as a whole.

18. **Approved panel.** ICAEW already maintains a list of its licensees who are prepared to undertake this kind of work and supports widening the pool so far as possible, subject to the general comments about the specialist nature of the work involved above. It should be noted that not all successor appointments arise in connection with claims of dishonesty or fraud. For instance, successors may be appointed as a result of death or retirement and we do not believe that these require special treatment such as procedures for approved panels.

19. **Investigative costs**. We agree that insolvency practitioners should only incur investigatory costs on a reasonable basis and believe that this is already provided for in the regulatory regime. However, in cases where fraud or dishonesty is involved or alleged, it is inevitable that a high degree of due diligence will be required and that investigation costs may be higher than would otherwise be the case. If the Insolvency Service is aware of cases of abuse, we would expect it to inform the relevant RPBs so that they can take appropriate action. It would also be helpful if the amounts involved could be quantified so that the significance of this issue in the context of the cost and effectiveness of the bonding regime can be properly assessed.

20. **Greater transparency**. We are not clear what specific proposals the Insolvency Service has in mind in this section of the consultation paper. The fee regime has been changed recently to increase transparency, including requirements for fee estimates. Government has also considered mandating fixed fees or scale rates, but decided against doing so generally, a decision which we support. It is somewhat difficult to envisage how a fixed fee (or scale rate) could be applied to the investigatory work involved generally, as the amount of work required and risks involved might vary from case to case and will be difficult to assess at the outset. It might, however, be possible for certain defined investigatory tasks to be identified and charged for on a standardised basis.

21. In many cases, HMRC is the largest creditor and should be in a position to monitor fees and performance of relevant cases over the prolonged periods involved, indeed, one might think it would have a duty to taxpayers to do so.

Q6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

22. As noted in our introductory comments we believe that more evidence is required for questions like this to be adequately assessed. However, it seems likely that, without any prospect of bonding, IPs might be reluctant to take on cases where there are insufficient assets to cover costs. Arrangements would therefore need to be made for the Official Receiver to take these cases. Depending upon charging structures applied by government, this might result in taxpayers, rather than creditors (via the cost of bonding arrangements applied to IPs) funding investigations.

23. From the Call for Evidence, it might seem that removal of the regime would not make much difference to creditors as the inference is that any bond payments are consumed in the costs of investigatory work. However, we suppose that there must be some cases where bonds have resulted in some payments to creditors who would not otherwise have been paid. Whether or not the benefits merit the costs of the regime is a matter for the Insolvency Service to assess.

Q7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

24. **Amending prescribed terms of a bond**. We believe that the form of bond does need to be amended. However, issues of principle need to be clarified first, for instance whether the amount of bond should be based on the amount of assets plus costs and whether the maximum £5 million bond limit should be increased. The potential costs of these changes and impact on the market would also need to be assessed, particularly if a single form of bond is to be applied across the sector.

25. **Ringfencing proceeds of a claim**. If the IP’s fees are not to be covered by bond claims (through the usual priorities), this will increase the likelihood that IPs will not take on successor appointments in cases where there are insufficient assets. This would be contrary to the stated aim of the paper to increase the pool of IPs prepared to take on these cases or even make it impossible to find willing IPs and it would be necessary for the OR to be required to take on such cases. The costs of the regime would, however, continue to be incurred, or might increase if the administrative burdens of IPs are increased as a result.

26. **Investigative costs to be covered by bonds.** If one of the objectives of the bonding regime is to cover investigative costs, then, in principle, it seems sensible that any bonding regime should cover costs of investigation. However, any change that adds to the direct cost of insurance, or indirect costs (such as administrative burdens for IPs or RPBs) would need to be considered carefully as they will ultimately be borne by creditors as a whole.

27. **‘de minimis maximum indemnity period**. We agree with the comments, but also note that one example is not necessarily sufficient to justify wholesale reform.

28. **Annual or global cover in place of monthly schedules**. We agree that the current system of schedules is bureaucratic and that there is a risk of inaccuracy or discrepancy between records kept by an insolvency practitioner, RPB and insurer and a risk that cover fails due to error or deliberate acts of a fraudulent IP.

29. In principle, an annual cover regime seems a better alternative, but the commercial aspects would need to be considered further, including any minimum sums involved and the cost of insurance. Experience in similar kinds of insurance suggest that the costs might be disproportionately high for sole practitioners or IPs operating in very small firms. The potential impact of any change of this kind on the competitiveness and diversity of the market would, therefore, need to be researched carefully.

30. If it is correct that the current regime is ineffective in providing returns to creditors, one option would be to reform the bonding regime so that annual bonding for successor IPs covers investigatory fees only.

31. Monetary limits. The monetary limits are dated. However, there is insufficient evidence to assess what impact this may have had in practice. Again, the cost implications of increasing limits would need to be assessed.

32. Investigative costs to be proportionate. We have commented on investigatory costs above and the need for concrete evidence of any poor practices to be provided and assessed for materiality before conclusions are reached on this. There are obvious risks of imposing additional regulation where the objective is to increase the pool of willing providers and reduce costs.

33. Protect estate from non-payment. ICAEW does check on monitoring visits that premiums have been paid. It would be helpful if insurers were required to notify RPBs if IPs have not paid premiums when due. Having an annual insurance regime would probably be administratively easier in this respect.

34. Include professional indemnity. Professional indemnity insurance is a distinct matter from the bonding regime, which deals with dishonesty and fraud (rather than negligence). ICAEW already imposes PII requirements on its licensees and its members and we believe that other RPBs also do so. Any consideration of this issue would, therefore, need to take current practice into account and identify what, if any, concerns there may be with the current PII regime. Please note that ICAEW licensed IPs are already required to have professional indemnity insurance run-off cover.

35. Fidelity insurance for persons other than IPs. We agree that, if the bonding regime is to be continued in roughly its current form, bonding or fidelity insurance should cover those from an insolvency practitioner's firm who are working on the case, but, again, the costs would need to be assessed, particularly as regards any minimum sum requirements.

Q8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.

36. The paper raises the key issues arising, but we think much further consideration and discussion is required when more evidence as to the operation of the regime has been obtained. It is premature to consider legislative changes at this stage.

Q9: Of the proposed options for legislative change, which would be your preferred approach and why?

37. We believe that further consultation will be required on this issue when more evidence about the costs and shortcomings of the existing regime is available and the possible alternatives have been identified and their impact in practical terms considered more fully.

38. We do not believe that more changes in regulation of IP's fees would address the more fundamental flaws of the bonding regime.

Q10: Do you have any further comments you would like us to consider in relation to bonding?

39. It is important that policy on the bonding regime is designed with clear objectives against which its effectiveness can be measured and that the part to be played by the various participants is clear and based on reasonable and proportionate expectations and an understanding of costs and resource requirements involved.

40. ICAEW monitors its licensees through monitoring visits and where an IP has a portfolio of successor practitioner cases would consider a sample of these during the visit. We would be happy to consider how processes, whether our own or those of others, such as insurers, might be changed to address concerns that have arisen, but It is not realistic to expect RPBs to identify all errors, fraud or dishonesty of IPs in connection with the bonding regime in their routine monitoring activities or through information provided in the monthly schedules.

41. We would be happy to discuss further as the Insolvency Service's consideration of the issue progresses.

Call for Evidence
Bonding arrangements for insolvency practitioners

General Comments

The response set out below has been provided on behalf of RSM Restructuring and Recovery LLP and Baker Tilly Creditor Services LLP.

Overall, we welcome the government's proposals to address the ineffectiveness of the current bonding regime, and to improve the bonding system.

It is our view that the bonding system is not effective in its current guise and ought to be replaced by a more effective process, which should also cover fraud without the connivance of the Insolvency Practitioner; the cost and value of which should be determined by the size of the case and reduced by the level of controls in place. We understand that the Australian model effectively allows for an extension of the PI insurance, coupled with fidelity guarantee insurance, although we have not had opportunity to review this in detail. We believe a further review should be undertaken in relation to this to establish whether a similar model could be introduced in the UK, such that any extension to the PI Insurance, with some form of fidelity guarantee insurance, would also take into account circumstances where the Insolvency Practitioner commits the fraud.

We also consider that the existing minimum PI requirements should be standardised across the profession, as there are currently differing requirements across the regulatory bodies where there ought to be consistency.

It is somewhat incongruous, and must appear so to external parties and stakeholders, that this obligation is self-regulating; an individual with criminal intent is obligated to obtain and pay for a policy designed to protect stakeholders from the actions of that individual. And, indeed, in the event that the requisite individual either does not obtain the requisite bond, or fails to pay the premium, that the bond cover should lapse.

Consultation Questions

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

Whilst we are largely in agreement with the assessment set out in the call for evidence, and the issues identified therein, we believe that the starting point ought to be to identify the purpose for the bond in the first instance and, importantly, what it is designed to achieve: assumedly to restore the position to that which it would have been had the fraud not taken place. It does not necessarily follow that this will result in a distribution to creditors, say, in the event that there were insufficient assets in the estate in the first place to allow for a distribution to any particular class of creditor. Therefore the comment made at Page 11 that *"we are told it is often the case that creditors who may have been adversely affected by the fraud will receive no direct financial benefit from a successful bond claim"* is a misconception: creditors will not, and should not in our view, automatically benefit from a bond claim. However we agree, fundamentally, they should not be disadvantageously affected either as a consequence of the fraud, or a bonding claim being made. We consider that further evidence should be obtained to support the assertion made at Page 11, correlated to the anticipated returns to creditors in the event a fraud had not taken place. It is our view that the majority of Insolvency Practitioners who accept such work endeavour to ensure that there is a return to creditors. For example, our experience demonstrates on one such appointment, of 21 bond claims totalling approximately £271k, approximately £88k will be returned to creditors across five cases. None of these cases were significant on a case by case basis, with claims ranging from less than £1,000 to £52,000.

We agree that the *investigation* work and costs relating thereto should be proportional to the likelihood and level of recovery. Similarly, we agree that there should be an independent check against the Insolvency Practitioner undertaking this work, and an element of control exercised over the level and extent of the fees drawn in relation thereto. However, we do not consider appropriately for the surety to undertake such a review, or exercise an element of control over the level and extent of this work, as there would clearly be a conflict of interest in that scenario, given the surety has a vested interest in minimising the level and extent of claims made against the bond.

In the interests of clarity, whilst creditor engagement can prove difficult on older cases, we do not consider it appropriate for remuneration approval, within the context of the insolvency appointment, to be taken outside of the existing legislative framework, in relation to non-investigative work on cases. Approval for such remuneration should be subject to the usual legislative prsovisions.

We consider that bond claim funds *should* be paid into the estate and subject to the usual order of priority of costs and fees of the proceedings, given its purpose and intent. However, such costs and fees should not, in our view, include the necessary costs and fees of the Insolvency Practitioner in investigating the fraud, and identifying or quantifying the cost of any losses, which costs we believe should be discharged separately by the surety. We understand that this is, largely, the purpose of the General Penalty Bond, however, the current level is no longer adequate to cover all the costs of investigation across the portfolio.

Equally, the existing upper limit for the Specific Penalty sum, at £5m, is no longer reflective of some of the larger appointments (for example *Lehman Brothers*) where stakeholders ought have the same rights of protection as would be the case in relation to smaller appointments.

In the event that the existing bonding arrangements remain in place, we consider that there must remain consistency in the existence and time period of “run off” cover. Provisions need to be put in place to ensure that cover exists in the event that a fraudulent practitioner fails to obtain the requisite level of cover, or fails to pay the premiums. A statutory “run off” cover should be enshrined in legislation as a minimum.

We do not consider appropriate that the cost of the bond should be the same for an Insolvency Practitioner operating within a firm which has the appropriate level of PI cover and fidelity insurance, segregation of duties and strong controls in place, and one who does not; the cost should be proportional to the risk.

Further, we also agree that there should be some flexibility to allow innovation by insurers, and in particular the removal of the need to submit cover schedules, which we understand is a purely legislative requirement that appears to have a limited purpose and serves to increase costs unnecessarily. Similarly, we also agree that the current general penalty level, given the nature and purpose of this bond, is woefully inadequate and out of date, as is the upper level of the specific penalty which, as rightly noted, would not be sufficient in relation to a number of insolvencies that have occurred in recent years.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

From a successor Insolvency Practitioner perspective, the biggest weakness in the current system is the lack of portfolio approach in relation to costs of investigation, as well as the time taken to agree claims with the surety. In the event of fraud by an Insolvency Practitioner, it is impossible to identify which cases have been subject to fraud without undertaking a certain level of investigation. We believe that stakeholders expect, and are entitled to expect, that successor practitioners will undertake a minimum level of investigation on all cases. However, where no fraud has been identified, it seems that the successor practitioner is expected to undertake this work for free, or will, somehow, have otherwise been adequately compensated on cases where a fraud *has* been identified. We do not consider that this appropriate and results in a lack of transparency and clarity from a stakeholder perspectve.

We also consider that the existing scheme should cover fraud by employees or consultants, when it takes place without the connivance of the Insolvency Practitioner.

Consideration should be given to having either one bond provider or introducing a “central fund” with the ability to lay off the risk in excess of the minimum fund value, through reinsurance potentially, with either a minimum cost per case, or an annual levy based on average case numbers, or asset values, adopting a similar approach to the calculation of licence costs by regulators, based on fee bands. Obviously, it would be necessary to achieve a critical minimum fund in a short period of time and this, in itself, might prove a barrier to inception.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

Whilst we are largely supportive of this proposal, careful consideration would have to be given to the expediency with which the fund could be built to create the requisite ‘critical mass’. We would also need a greater understanding of how the fund would operate from an administrative and claims handling perspective before we could be fully supportive of this proposal. As a minimum we would expect such a fund to cover fraud both with and without the Insolvency Practitioner’s connivance, as well as covering the successor Insolvency Practitioner’s costs on a portfolio basis.

We note that the SRA fund also covers negligence, in circumstances where the relevant individual did not have the correct PII cover in place. We do not consider this to be necessary in relation to any fund set up to replace the existing bonding provisions. We also consider that there should be a fundamental entitlement to compensation from the fund in the event that fraud is identified in relation to any given appointment, either with or without the connivance of the Insolvency Practitioner.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

Whilst investigation into fraud and dishonesty can be undertaken by any suitable person, we would question whether a non insolvency practitioner would have the skills and technical knowledge to identify all of the potential issues arising. In such scenarios, it is unclear who would have any right of action, for example, would this be the successor liquidator, and in whose name the action would be brought.

We would welcome a protocol that ensures that claims are dealt with expediently; whilst all bonds state that they will pay out within 90 days, this is rarely case, albeit this can often be due to delays on the part of the RPBs, who are the bond holders. A clear protocol that reduces conflict and aids agreement of claims would have a considerable impact on the level of professional costs, which can often increase due to the time taken to agree the claim with the bond providers, and seek settlement and payment of any claims.

Similarly, we would welcome the implementation of agreed protocols, or a clear framework, to encourage open and early discussion between the RPBs and the sureties. It appears that there is a lack of clarity and understanding in relation to assignment bonds, which can take up to 12 months. We understand there is a Memorandum of Understanding between the RPBs and the sureties, which we believe states that bonds should be assigned where there is a suspicion of fraud. However, only one of the RPBs, the ACCA, routinely assigns the bond to the successor Insolvency Practitioner.

There is currently a lack of clarity as to whom the successor Insolvency Practitioner's should be dealing with in relation to agreeing and adjudicating on claims, and whether this should be via a mediator, the RPB or the insurer. In our view there is a clear conflict of interest in the insurer adjudicating on claims, and we would welcome clarity in this area.

We consider that, if the bond or any replacement scheme, is not designed to cover the costs of the successor Insolvency Practitioner on a portfolio basis, consideration should be given to introducing a fund to cover the costs of 'tidying up' the former Insolvency Practitioner's practice, and ensuring that all cases are appropriately administered and closed, in relation to those case where no fraud has been committed, but there are insufficient assets available to cover the costs of the successor Insolvency Practitioner.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system.

Our preference would be for the existing legislative requirements to be removed and replaced with a regulatory obligation for Insolvency Practitioners to have adequate insurance in place to cover the losses to the estate through fraud, either with or without the connivance of the Insolvency Practitioner. There should be adequate provisions in place to ensure that estates are returned to the position they were in before the fraud occurred, and that there is an element of independent review and control to ensure investigation work is proportional to the anticipated return to the case. We would otherwise refer to our comments at Question 1 above regarding the approval of remuneration and investigation costs. We also believe that there should be adequate provisions in place to meet the cost of a preliminary review and investigation on each case in a transferred portfolio, which we consider is a fundamental necessity to ensure that all fraud is uncovered, even on low or no asset cases.

If the statutory provisions are to remain, we believe that these should clearly state what the terms of the bond must be, to ensure that creditors and stakeholders are afforded the same level of protection and cover. We also consider it appropriate to remove the need to submit cover schedules, as referred to in Question 1 above.

Question 6: What do you consider would be the likely impact of removal of statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

We are largely supportive of this proposal, albeit we would welcome the opportunity to comment further once detailed proposals have been drafted. In this scenario, we believe that consideration should also be given to putting in place a ‘fund’ to meet investigation costs on a portfolio basis, to ensure that all cases are adequately investigated and that stakeholders to not meet the cost of such investigations.

Any steps taken to reduce administrative burdens, such as the requirement to submit bordereau returns on a monthly basis, would be welcomed.

We would further welcome further evidence to support the assertion that ‘proceeds of claims are often largely consumed by the remuneration and expenses of the successor Insolvency Practitioner’, with particular regard to the comments made at Question 1 above, in relation to drawing a distinction between investigation costs and the usual costs and expenses an Insolvency Practitioner will incur. We do not necessarily agree that creditors are effectively paying for the bond with no benefit to themselves, as this does not accord with our own understanding, as set out above.

Question 7: do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

Yes, other than the comments we have made elsewhere in our response.

Question 8: do you agree the paper sets out the full range of issues, or is there anything further which should be considered?

Yes, overall, we have commented elsewhere in our response, in relation to additional issues we believe are worth consideration.

Question 9: Of the proposed options for legislative change, which would be your preferred option and why?

As stated in our response to Question 5, our preference is for the existing PII provisions to be extended to cover fraud, coupled if appropriate with a central fund to cover the costs of work done on cases where no fraud has been identified.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

As mentioned elsewhere, there should be provisions in place to fund the work required to be done on cases that are transferred within a portfolio, but which have not suffered fraud but nevertheless all realisations have previously been defrayed, without all statutory and reporting obligations having been complied with. These costs should be explicitly permissible as a claim under the bond, or otherwise defrayed from a central fund created for that purpose.

As noted, we consider that it should be either a legislative requirement, or a requirement of obtaining a licence, that any PII cover includes adequate run off cover, which in our view should extend to a minimum six year period.

It should be noted that the successor Insolvency Practitioner is at the mercy of the bond chosen by the fraudulent Insolvency Practitioner. We are of the view that ‘not all bonds are created equal’. There should be absolute clarity within the terms and terminology, particularly in relation to the nature of the costs covered, and a consistency of cover.

We would welcome proposals that would expedite claims handling in relation to the bond, both in the time taken to settle claims as well as easing the process of adjudication.

In addition, if the existing bonding product is to remain in place, we would welcome proposals for regulators to monitor the position closely, outside of the regulatory process, for example, regular monitoring and matching of appointments to bordereau returns.

Think Ahead ACCA

Bonding arrangements for insolvency practitioners

A call for evidence issued by the Insolvency Service

Comments from ACCA
December 2016
Ref: TECH-CDR-1473

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 188,000 members and 480,000 students in 178 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 100 offices and centres and more than 7,400 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting, and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

Further information about ACCA's comments on the matters discussed here may be requested from:

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ACCA welcomes the opportunity to respond to the call for evidence.

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SUMMARY AND CONTEXT

ACCA issued and renewed Insolvency Licences to 149 individuals in the year ending 31 December 2015. Occasions on which it has been necessary for ACCA to intervene to arrange a block transfer of appointments to successor insolvency practitioners (IPs) have been few. However, on those occasions when ACCA has intervened there have been compelling reasons for doing so, and the number of appointments that have been transferred has been significant.[1]

From data available to ACCA, we estimate that more than 50% of transferred appointments have resulted in bond claims, and approximately 10% have generated professional indemnity insurance (PII) claims. It is notable that the rate at which bond claims are settled and paid is very low, and the percentage of claims rejected on the grounds of cover issues is high.

While it is acknowledged that ACCA is the beneficiary of the bonds, it is ACCA's established practice to assign the bonds to the successor IPs. It is the successor IP who pursues any claims against the bonds on behalf of the creditors. In this response to the call for evidence, we acknowledge that more detailed evidence concerning claims made, settlements, difficulties encountered with bond providers, and the proportion of amounts recovered paid out to creditors is best supplied by the successor IPs themselves.

The responses set out within this document are underpinned by the following considerations:

a) The purpose for which bonds were introduced (ie the protection of creditors) is no less compelling today than it was in 1984, when the White Paper *A Revised Framework for Insolvency Law* proposed that IPs should be required to take out

[1] Over a three year period between March 2012 and March 2015, there have been six interventions by ACCA, resulting in applications for six block transfers. These block transfers together represent 794 separate appointments.

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insurance against losses caused by both dishonesty and negligence. There remains a strong public interest imperative to have such safeguards in place, notwithstanding concerns that the current arrangements are not delivering the intended outcomes.

b) Where the insolvencies are personal insolvencies (IVAs or bankruptcies), it is even more important that safeguards are retained and improved, not only to protect creditors, but also to ensure insolvent individuals and their families do not have their difficult circumstances made worse by unscrupulous and dishonest IPs. This is particularly important given the cultural shift in personal insolvency since 1984, and the present day emphasis on assisting individuals to recover their financial equilibrium.

c) Although insurance companies are suppliers of the enabling general and specific bonds, the product significantly differs from professional indemnity and other insurances. The bond makes the IP jointly liable with the surety for losses in relation to the insolvent estate. One of the consequences of joint and several liability is that the surety can pursue the dishonest IP to recover the value of any claim the surety pays out. Therefore, settling a claim against a bond does not necessarily translate into a loss for the surety, as would be the case with an insurance policy.

d) Interventions by ACCA are triggered by serious incompetence or dishonesty or both and, therefore, the appointments transferred to successor IPs require a high level of expertise and resource to be able to identify and resolve complex issues. Moving to a position where the successor IP could only rely on the value in the insolvent estates to recover the costs of the work required would render this sector non-commercial and unsustainable.

e) The requirement for bonds to be in place helps to maintain public confidence in the insolvency profession. Suitable bonding arrangements, which are appropriately monitored and enforced, serve to demonstrate high standards of insolvency regulation and oversight.

Although this is a call for evidence, the document issued by the Insolvency Service goes further, to suggest possible reforms, including legislative changes. Therefore, we should like to highlight the following comments included in our responses:

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- Insolvency bonding is very different from PII. The latter covers negligence, and affords some protection to the IP (as well as to creditors) if the IP is sued; the insolvency bond is wholly to protect creditors (and insolvent individuals), but it is still funded by the IP. (Any claim on the bond is made by a successor IP on behalf of the creditors.) At times, the Recognised Professional Body (RPB) must act as intermediary.

- The Specific Penalty Sum bond (SPS) is focused and proportionate, but perhaps the General Penalty Sum (GPS) bond requirements are over-complicated.

- We raise the possibility of radical reform whereby only a general bond would be required, but based on specific appointments and the assets within those estates. In this respect, the PII model is not wholly appropriate, as estate values fluctuate quite significantly. In order to achieve fairness, and yet avoid excessive cover (and premiums), the submission of cover schedules would still be required, but this might be less frequently – perhaps quarterly.

- The fixed level of the GPS cover is somewhat arbitrary. It is now considered by most to be inadequate. We should like to highlight that any claim exceeding bond cover must surely be related to the size (as well as complexity) of the estates concerned.

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AREAS FOR SPECIFIC COMMENT:

In this section, we set out our responses to the specific questions set out within the call for evidence.

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

Legal framework

'Prescribed bond requirements are unclear and costly'

It is ACCA's view that the public interest is well served by an effective and proportionate bonding requirement. However, most of the IPs licensed by ACCA practise within small firms, and a complex and expensive bonding requirement is disproportionately burdensome, and threatens the IP's ability to achieve the protection provided. Nevertheless, ACCA considers under-bonding to be a serious failing, and in the event of a licensed IP failing to observe the statutory requirements, a referral is made to ACCA's Investigations department.

In practice, instances of under-bonding are minimised by notifications to IPs four weeks in advance of their bond expiry date - to remind them to submit a new enabling bond before their current bond expires - and this is followed by a series of reminders while they fail to submit one. Therefore, the administration of IP bonding requirements is burdensome for RPBs, although delay in submitting bonds to ACCA may be partly due to delays by the bond providers, rather than being the fault of the IPs themselves.

Given that the existence of a general bond is a prerequisite to being qualified to hold insolvency appointments, the importance of observing this requirement is something that is emphasised to ACCA licenced IPs. However, we believe that bond providers should be made more aware of the absolute necessity of ensuring general bonds are in effect and evidenced in a timely manner.

The fact that the general bond is required to be renewed annually enhances the administrative burden for RPBs (even though, in ACCA's case, the number of licensed

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IPs remains relatively small). Therefore, we question whether a general bond might, in future, remain effective for a term greater than one year.

'Statutory cover limits are inadequate and inconsistent'

Taking the current GPS and SPS bonding requirements together, it is clear, from the call for evidence, that the statutory limits are inadequate. Given the complexity of the current requirements, we believe that the time is right to consider a structure based entirely on a multiple of asset values. Although this might appear to risk excessive levels of cover, we believe this is not, in fact, the case. Having a single bond based on all the assets over which the IP has control is reasonable, and should not, in itself, have a disproportionate impact on premiums, as premiums will only increase to the extent that successful claims against the bond will be expected to be higher (which is the intention if creditors are to be better protected).

ACCA would not be supportive of measures that would unreasonably curtail competition. However, it would assist both IPs and successor IPs if there was greater standardisation in the terms of the bonds. This might include aligned renewal dates for general bonds, as well as the standardisation of certain terms and conditions of cover. (This might also make it easier for the RPBs to monitor compliance with the bonding requirements.)

'Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover''

While this statement is irrefutable, it does not of itself undermine the value of a robust bonding requirement. It is likely that any undervaluation of realisable assets will be driven not with the intent to frustrate a claim against the bonds, but rather an attempt to minimise costs. The risk of undervaluation (ie under-bonding) can only be addressed by measures to regulate IPs robustly, and RPBs being seen to do so. For example:

a) the obligations on IPs to obtain transparent and fair open market valuations of realisable assets could be strengthened;

b) part of an RSB's monitoring activity could be the testing of the extent to which an IP has exercised diligence in obtaining realistic valuations of assets for the

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purposes of bonding;

c) failure to put in place bonds that accurately reflect the underlying asset values should usually be a basis for bringing disciplinary proceedings.

‘Proceeds of a bond claim are not ring fenced’

‘Lack of provision/control over successor insolvency practitioner fees’

These two statements are linked.

It would clearly be wrong for those adversely affected by a fraud not to receive the benefit of a successful bond claim in respect of that fraud. It follows that, if the proceeds of the bond claim were applied to the benefit of other creditors, they would then, in effect, be benefitting from the original fraud. However, the assertion that ‘proceeds of a bond claim are not ring fenced’ should not be accepted without evidence. It might suit insurers to accept such an assertion, as it would support an argument that fees charged by some successor IPs (and therefore claims made against the bond) are excessive, because fees incurred are not related to a specific appointment (for which the SPS cover would have been inadequate).

ACCA is not in a position to comment on the veracity of the above statements. However, the nature of block transfers is such that there are inevitable costs - not only in investigating the complexities of suspected frauds, but also in continuing to realise the assets previously under the control of the original IP, and being mindful throughout of other areas worthy of investigation. There may be no dishonesty (eg when dealing with modest estates) or there may be a web of complex and sophisticated frauds across a significant portfolio of appointments.

In each case, the interpretation of what are ‘reasonable costs’ is likely to be the subject of negotiation (and where an individual is the victim of a fraud, his or her perspective of what are reasonable costs to be able to recover the loss is likely to be very different to that of the bond provider). We understand that, in respect of a block transfer of cases, there will often be a time-consuming process of the successor IP having to justify steps taken in respect of each claim on the SPS, despite there being commonality across the whole portfolio of cases. We also understand that this unnecessarily repetitious process is often perceived as being driven by the bond provider.

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Of course, there is no desire to achieve limitless bond cover, as this would neither be proportionate nor commercial. Therefore, excessive IP fees are not in the interests of creditors. In addition, they would be unfair to the bond providers, and must be challenged. However, having a single (general) bond, based on asset values, might allow more funds to be available to meet the successor IP's 'reasonable' fees. The surety must be able to challenge bond claim work that may be considered to be disproportionate. In determining what is 'proportionate' it may be argued (on behalf of a creditor) that *any* loss caused by fraud should be investigated and recovered, unless it was clearly insignificant. Therefore, it is for the surety to agree a claim at an early stage in order to avoid unnecessary investigation costs.

ACCA is of the view that there should be higher regard for proportionality in the conduct of both bond providers and successor IPs. From the limited information available to ACCA, it is clear that bond providers are generally reluctant to agree claims unless there has been a very detailed level of investigation – regardless of the size of the underlying estate. Equally successor IPs should, initially, confine their investigative activity to the minimum necessary in order to reasonably estimate the loss caused by a fraud, before establishing the bond provider's requirement for greater accuracy (and further investigation). It would not be reasonable for a bond provider to expect a high level of forensic investigation without a willingness to meet some of the additional cost. If bond providers were to accept a lesser degree of investigation, that would speed up the progress of claims, as well as helping to maximise returns to creditors.

'No statutory requirement for professional indemnity insurance'

'The bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner'

With regard to PII cover, although there is inconsistency between the RPBs, this is more around the basis for PII cover, rather than the importance of having cover.[2] The overriding objective is that PII cover should not become disproportionately high or burdensome in its complexity. It is, therefore, satisfactory that the RPBs have different requirements. It should be noted that practitioners licensed by an RPB (and their firms)

[2] Although there is no statutory requirement for PII, regulation 9 of ACCA's Global Practising Regulations sets out the requirements for PII cover. Regulation 11 of Annex 1 to the Global Practising Regulations binds holders of insolvency licences to the regulation 9 requirements.

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may also be engaged in activities other than insolvency. PII requirements should, if possible, remain consistent across those activities. Some of the RPBs also require fidelity guarantee insurance (FGI) cover, although the minimum level of cover may be considered inadequate for IPs.

Introducing a statutory requirement for PII cover may afford some comfort to creditors in insolvencies where there has been no dishonesty – where, for example the original IP has simply been overwhelmed by his or her workload, or lacked competence for some other reason. However, PII cover will not assist a successor IP to recover the costs of investigating incompetence or negligence.

Practical Issues

ACCA has no direct experience of the practical difficulties encountered in making bond claims and so, in many areas considered here, we defer to the evidence submitted by successor IPs.

'Variation in particulars of bond wording causes confusion'

We refer the reader to our comments above under the assertion that 'statutory cover limits are inadequate and inconsistent'. Apart from the apparent uncertainty and confusion caused by variations in bond wording, we understand that a further issue is the difficulty encountered by successor IPs in obtaining copies of the relevant bonds.

'Increasing costs of premiums'

We are concerned by the reported increase in SPS premiums for smaller firms, and the detrimental impact this could have on competition. This could, in turn, impact quality and costs. We suggest that this issue might be the subject of focused research in the future.

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‘Adversarial nature of claims’

At any point in the process of making a claim, it should be relatively easy for a surety to determine whether further investigation work should be carried out by the successor IP (if the surety is requiring more evidence to support the size of the claim). We say more on this matter above, under the subheading ‘Lack of provision/control over successor insolvency practitioner fees’.

‘Cessation of cover on non-payment’

Regardless of reason or fault, the cessation of cover for non-payment of premiums puts creditors at an unacceptable risk. Failure of an IP to obtain the SPS cover (and provide evidence to the relevant RPB) within a specified period from the date of appointment should be indicative of a serious regulatory breach, rendering the IP liable to disciplinary action. If the bonding structure is to be made more robust, sureties should be required to provide cover while they await payment of the premiums (for a reasonable period). To rely on regulatory action alone to rectify this issue would be inadequate, as regulatory action cannot be sufficiently swift to provide the necessary protection for creditors.

‘Limited number of insolvency practitioners willing to take on successor appointments’

Only a small number of IPs have the necessary experience or resources to accept block transfers of cases. It is unlikely to be practical or cost effective for IPs within small firms to undertake successor appointments. Although competition is usually considered to be advantageous (as an effective means of controlling costs), the specialist nature of successor IP work will deny access to that market by smaller firms. However, concentration of the market has the advantage that successor IPs are better able to retain their competence through obtaining successor appointments more regularly than would otherwise be the case.

On occasions, ACCA has sought to transfer a single block of cases to two IPs, which has the advantage of spreading the workload. However, we believe that, if block transfers were to be split between more than two successor IPs, that would risk complications and impede communication. For example, when actively seeking to

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identify patterns of behaviour which might suggest potential acts of fraud, an overview of the entire portfolio, associated bank accounts, etc is essential.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

Apart from the points raised above, we are not aware of any further weaknesses in areas where we would be able to provide evidence.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

ACCA would not support the introduction of a compensation fund. This would introduce another layer of complexity, and may have unintended adverse consequences, including obscuring the responsibilities of IPs and imposing a further administrative burden on all parties. It is also questionable whether there is a sufficiently large body of IPs to generate an adequate compensation fund.

The Law Society regulates all solicitors while IPs are regulated by a number of different regulators. The administration of a compensation fund would require a significant investment of resources from all the RPBs, and the RPBs lack the expertise to be able to operate such schemes effectively. Although the protection of the public is paramount, we believe that the introduction of a compensation fund would not be the best way to achieve it.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

The paper states that there is very little engagement between the insurers, the RPB and the successor IP.[3] In practice, ACCA always maintains communication with the successor IP, in order to retain an understanding of the matters being investigated. However, the RPB's communication with the insurers is usually limited to advising them

[3] Page 15 of the call for evidence

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of the claim on the bond – ensuring it is made within the necessary time limits. It adds a complication to rely on the RPB for this, and therefore it increases the risk that a valid claim may be out of time. There would be great value in clarifying the procedure so that the successor IP always makes the claim on the bond. Effective communication at this stage also provides the opportunity for the successor IP to keep the insurers aware of the costs of investigating the original IP. Other communications between the successor IP and the insurers would also be assisted by a proportionate claims management protocol.

With regard to the establishment of a panel of successor IPs, the anticipated benefit of encouraging IPs to take up successor appointments would not be assured. Neither does the document explain the benefit of having more IPs taking up such appointments. We do not assume that this would result in a reduction in fees (although a reduction in investigation fees would be desirable, as it would be expected to flow through to a reduction in bond premiums).

We are against the principle of fees being set out within a claims management protocol (which may apply to successor appointments regardless of whether the appointed IP is selected from a panel). The determination of reasonable fees should be based on principles; the basis of fees should be disclosed; and ethical principles must be safeguarded. (Undue pressure on fees threatens competence and the exercise of due diligence.) However, we would support greater transparency of fees among those most affected by the fees charged. It may be argued that insurers may already challenge the basis for fees charged. However, more effective communication between the successor IP and the insurers would be welcomed.

It may be difficult to determine, in a particular situation, what level of fees (and extent of investigation) would be disproportionate to the loss sought to be recovered. If the fees are to be covered within the bonding arrangement, investigation is more easily justifiable; alternatively, if the fees are not covered, the anticipated loss to be recovered must exceed the anticipated fees to be incurred in order to recover that loss.

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Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

We agree that a non-statutory claims management protocol would have regulatory force when viewed in conjunction with the Insolvency Code of Ethics (adopted by all the RPBs). Therefore, such a protocol must be agreed between insurers, the RPBs, IP representatives and the Insolvency Service. However, as evident from our proposals within this response document, a claims management protocol would not, in itself, be sufficient to resolve the current weaknesses in the bonding system.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

We note that the requirements of the Insolvency (Amendment) Rules 2015 have not yet had an impact on bond claims. However, they represent a significant movement towards greater proportionality with regard to fees. Given the proposal to introduce a claims management protocol, we do not perceive benefits from legislative changes.

There is a difference between the security provided by an insolvency bond and that provided by PII. We believe that insolvency is, potentially, high risk, and protection against dishonesty should remain a requirement of the law. However, we also believe that the bonding requirements should be simplified, requiring a single bond (based on periodic asset valuations) covering possible losses and the costs of investigating them.

The call for evidence states:

'… under the current arrangements the proceeds of claims are often largely consumed by the remuneration and expenses of the successor insolvency practitioner. Hence the legislation is no longer meeting its purpose of protecting creditors' interests; instead creditors are effectively paying for the bond with no benefit to themselves.'[4]

We would question the veracity, and even the relevance, of this claim. So long as a bond claim covers the investigation fees and some of the loss, there is value to the

[4] Page 19 of the call for evidence

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creditors. Also, without the bond cover for the fees, the successor IPs (of which there are already relatively few) would be less willing to act. The removal of the statutory bonding requirements would also be likely to undermine the confidence of insolvent entities and creditors in the integrity of IPs. It would also risk increased levels of dishonesty going undetected.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

a) Amend the current prescribed terms of a bond

We have suggested above how the terms of the bond might be amended. The bonding process should be simplified, and there should be only a general bond, based on asset values reported quarterly to the surety. (A late return of asset values would risk under-bonding, and so should be treated by the RPBs as a significant regulatory matter.) We believe the Secretary of State should be able to express an opinion on all terms included in the bond, and not only those set out within the Insolvency Practitioner Regulations.

We are not in favour of a single, universal bond. Contrary to the assertion on page 20 of the paper, instead of stifling competitive pricing, it would be likely to encourage competitive pricing as the only possible differentiator between insurers. We believe that this would be the likely reason for insurers withdrawing from the market, and it would also heighten the risk of disputes when claims are received.

b) Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs

We strongly support the proposals set out on page 21 of the paper. If the work of the successor IP is to recover losses on behalf of creditors, those same creditors must receive the proceeds recovered, and the successor IP must be rewarded for that aspect of the work. This would focus the IP's mind on the proportionality of seeking to recover certain losses.

The exercise of proportionality is also relevant to the realisation of assets that are not related to a claim on the bond. If these assets cannot be realised efficiently by the

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successor IP (such that the IP's costs would exceed the amount realised), there should be no attempt to realise them.

c) Provide for investigative costs as a prescribed requirement of a bond

We do not support setting a limited amount of investigative costs as a prescribed part of the bond for the reasons expressed on page 22 of the paper. Such a provision would also increase complication. The use of a single bond (GPS), based on asset values, would reduce the likelihood of cover being exhausted before investigation costs can be claimed (provided the level of cover is adequate). It would still be necessary for the successor IP to be able to justify time spent investigating losses claimed in respect of each estate.

d) Agree or legislate for a 'de minimis' maximum indemnity period

We agree that there should be a minimum duration for the maximum indemnity period. Although some premiums would increase, many would remain the same, and these would serve to control increases in other premiums. Protection of creditors is paramount.

e) Remove requirements for monthly cover schedules and provide for an annual or global bond cover

We agree that there should be a single bond, but this should still relate to assets values, and so regular returns to the insurer will be required. We suggest that these should be quarterly, and that it is not necessary to submit them to the RPB. The insurers are best placed to determine the cost of premiums, but the Insolvency Service should determine the correct level of cover (based on a multiple of the combined asset values of all appointments). The level of cover need not be excessive, but must be sufficient to cover all fees of the successor IP.

f) Amend the existing monetary limits of the GPS/SPS

We have already asserted that the framework of bonding involving both an SPS and a GPS is unnecessarily complicated. We have explained above how a single bond might operate. We should add that such a bond would be required to state the point at which permission would need to be sought from the insurer before accepting any further appointments.

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g) Introduce a duty that investigative costs must be proportionate to loss/cover

We are not in favour of adding regulations to require proportionality. We believe this would add complication, and be difficult to enforce. An appropriate bonding framework would achieve the desired outcome more effectively – by motivating successor IPs to act in a proportionate manner while encouraging them to seek to recover losses when they should be recovered on behalf of creditors.

It should also be remembered that IPs are subject to a Code of Ethics. The Insolvency Code of Ethics should be effective where unprofessional behaviour is alleged. Often, inappropriate regulations serve to undermine the effectiveness of a code of ethics.

h) Protect estate from non-payment

We have responded to the suggestion on page 24 under question 1 above. We do not believe that payment of premiums ‘upfront’ would be possible, as the necessary cover changes with new appointments and the values of assets within the estates.

i) Include professional indemnity as a requirement for security, including run-off cover

As stated under question 3, we believe that IPs should be required to hold PII, and this should include run-off cover. ACCA’s regulations already require PII and run-off cover.

The protection of the public is paramount. As stated under question 1 above, the RPBs differ with regard to the basis for PII cover. The requirement for PII cover should not become disproportionately complex, and it should also be borne in mind that individuals licensed by an RPB may be engaged in activities other than insolvency, and PII requirements should, if possible, remain consistent across those activities.

j) Agree or legislate for insolvency practitioner firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by persons other than the insolvency practitioner

Often, PII policies include a level of FGI. We believe there should be a reasonable level of FGI cover in any firm, and that is already a requirement of all those required to comply with ACCA’s Regulations (regardless of the size of the firm). This concern is best addressed by guidance, explaining that FGI is to be expected if due care to clients

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and creditors is to be demonstrated. Alternatively, legislating for adequate FGI cover will introduce a further layer of complication and, at best, encourage IPs to seek only the minimum level of cover.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered?

This question has been addressed throughout our response above.

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

We would advocate legislative change to simplify the bonding requirements. For the reasons expressed above, we would prefer a single bond, covering the combined value of assets for all appointments (based on quarterly returns to the insurers), with additional security for creditors in the form of PII and FGI.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

We have no further comments.

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IPRegulation.Section

From: Richard Haymes <Richard.Haymes@tdxgroup.com>
Sent: 19 December 2016 12:57
To: IPRegulation.Section
Subject: Call for evidence: Bonding arrangements for insolvency practitioners (A REPLY HAS BEEN SENT ON 19/12/2016)

Good afternoon,

Please find below a summary response from TDX Group.

The Insolvency Service Call for Evidence 'Bonding arrangements for Insolvency Practitioners' October 2016

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

- Yes, we agree with this assessment.
- The key requirement of any protections must be to secure payments made by insolvent consumers into insolvencies. There must be no opportunities for consumer monies to be used inappropriately.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

- We are not aware of any other weaknesses.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

- Similar arrangements from the legal profession may work in the insolvency profession. However, it is unlikely that this model will fully cover the potential exposure to consumers and creditors from IVAs.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

- This seems like a sensible approach. This would be a great way for the industry to demonstrate joint working and an effective market.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

- These would be positive steps but re-designed products to greater meet the industries requirements would be required.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

- Varden Nuttall has increased the focus on bonding through 2016. However, the volume of claims against bonds have been small in recent years. We would suggest the removal of the bonding requirements being replaced by PII requirements which covers all consumer monies held in trust by personal insolvency providers or other mechanisms that more effectively reflect the structures of IVA providers particularly the larger firms (i.e. that in most cases the IP does not run the firm and does not have the authority to control activity across the firm. One 2016 example of this resulted in an IP who previously reported to the firms CEO being restructured into a role where they reported into a member of the senior management team, two management layers lower – CEO – Executive Leadership Team – Senior Management Team).

- The FCAs Client Assets Sourcebook (CASS) set out clear requirements for the holding and distribution of consumer funds. One part of CASS is that firms must distribute consumer monies to creditors within five working days. This requirement, actively enforced by the FCA, limits the potential exposure to fraud against the consumer as client monies are held over much shorter periods by firms. Bringing the regulation of personal insolvency under the FCA with the technical support of The Insolvency Service would enable the simple adoption of these rules by the majority of personal insolvency providers who already have FCA regulated debt management entities.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

- Yes, the consultation correctly assesses the advantages and disadvantages of the options set out.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.

- Yes, if fairly summarises the specific issues related with the current bond requirements.

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

- A combination of the proposed options to extend the coverage of bonds to protect against fraudulent activity of any staff associated with the firm supervising the personal insolvency (i.e. activity by the executive running the insolvency provider which leads to a requirement to make a claim against the bond). If bonding continues they should cover all personal insolvencies no matter how large the firm providing.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

- The regulation of firms providing personal insolvency should fall under a single regulator which also covers Debt Management, Debt Advice and Debt Counselling. Our view is that this body should be the Financial Conduct Authority (FCA) with The Insolvency Service providing technical support. The consumer benefit of a move to a single regulator will be significant. It will provide consumers with a consistent experience giving them consistent debt advice and access to debt solutions whether they approach a debt management provider or a personal insolvency provider. It will also provide consistent approach to the requirements on those individuals own and operate the firms. The FCAs Client Assets Sourcebook (CASS) set out clear requirements for the holding and distribution of consumer funds. One part of CASS is that firms must distribute consumer monies to creditors within five working days. This requirements, actively enforced by the FCA, limits the potential exposure to fraud against the consumer as client monies are held over much shorter periods by firms.

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RESPONSE TO CALL FOR EVIDENCE

BONDING ARRANGEMENT FOR INSOLVENCY PRACTITIONERS

INSOLVENCY SERVICE

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Executive Summary

Introduction

1 The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents over 21,000 members who advise and lead business across the UK and in almost 100 countries across the world. ICAS is a Recognised Professional Body (RPB) which regulates insolvency practitioners (IPs) who can take appointments throughout the UK. We have an in-depth knowledge and expertise of insolvency law and procedure.

2 ICAS's Charter requires it to primarily act in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and protect their interests. On the rare occasion that these are at odds with the public interest, it is the public interest that must be paramount.

3 ICAS is interested in securing that any changes to legislation and procedure are made based on a comprehensive review of all of the implications and that alleged failings within the process are supported by evidence.

4 ICAS is pleased to submit its views in response to the call for evidence issued by the Insolvency Service into Bonding arrangements for insolvency practitioners. We shall be pleased to discuss in further detail with the Insolvency Service any of the matters raised within this response.

Executive summary

5 ICAS considers that the current statutory bonding arrangements are not fit for purpose and that substantial reform is required in this area. We therefore strongly welcome the review and the call for evidence.

6 We note that in the introduction reference is made to future reform of bonding requirements for IPs in England, Wales and Scotland. We appreciate that requirements for IPs in Northern Ireland is not a matter for the Insolvency Service or UK Government and is a matter for the Government in Northern Ireland, however we would wish to encourage discussion and collaboration with authorities in Northern Ireland to ensure as far as possible a consistent approach throughout the UK.

7 Since the statutory requirement for bonding was introduced, no bond claims have been made against any ICAS regulated IP. Much of our response is therefore based on a theoretical understanding of the process where fraud or dishonesty exists together with knowledge gained through discussions with other RPBs over time.

8 We broadly agree with the weaknesses of the current bonding system identified in the call for evidence.

9 Notwithstanding many of the weaknesses identified, there is a more fundamental question of whether the bonding system meets its primary objective of ensuring creditors do not suffer because of fraud or dishonesty against the estate. There appears to be no evidence to suggest that the bonding system is fulfilling this requirement. While this may suggest that repealing the legislative requirement would not result in any detriment to creditors (indeed it may benefit them through reduced costs associated with the relevant insolvency process) we do not consider that this would be an appropriate measure on its own.

10 We are strongly of the view that as part of a framework to ensure trust in the UK insolvency regime that protection against fraud or dishonesty on the part of an IP during or in connection with their office should be provided. This protection must extend to fraud or dishonesty carried out by not only the IP themselves but also cover situations where the fraud or dishonesty is carried out by another party operating under the IP, directly or indirectly.

11 We would suggest that a fundamental review of successor appointments and interaction with pursuing bond claims should be undertaken. Consideration should be given to separating out the two roles of ensuring the continued administration of an insolvent estate and investigating and pursuing a claim against an insurer.

12 We are broadly supportive of many of the suggested responses to the weaknesses identified. Further examination and evaluation will however be required particularly around any pricing adjustments to bond or other insurance premiums and their impact on insolvency practitioners and insolvent estates.

13 We consider that amending legislative provisions together with voluntary action taken by insurers, IPs and RPBs, will be required to address the weaknesses in the bonding system and ensure that an adequate protection framework is available in the future.

Detailed Comments

14 Our detailed responses to the questions posed within the call for evidence document are set out in Appendix 1

22 December 2016

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Appendix 1 – Responses to questions posed in the call for evidence

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

We broadly agree with the assessment of weaknesses identified in the current bonding system. Some of the weaknesses have a greater impact than others with difficulty in evaluating on an objective basis the impact of each weakness.

We do not hold information to accurately estimate the total cost of the current bonding requirements across all insolvent estates. We estimate that in a typical case an IP and their staff would spend on average around 2 hours administering the bonding requirements. The Call for Evidence identifies that nearly 56,500 cases in 2015 involved the appointment of at least one IP, although notes that this is an incomplete position and therefore this number will be understated from the number of cases which are bonded. A conservative estimate of the cost of bonding is therefore nearly £17m per year excluding premium costs. The true cost will be substantially higher.

In addition to the above, the RPBs incur costs in administrating the monthly returns from IPs, considering as part of monitoring visits to IPs and maintaining IT systems in connection with bonding. We estimate that the annual cost for ICAS in respect of administering the bonding system is in the region of £10,000 per annum or approximately £100 per regulated IP. If it were assumed a similar rate across all RPBs the RPB cost would be in the region of £160,000 per annum.

We do not necessarily agree that a lack of a statutory requirement for professional indemnity insurance (PII) is a weakness of the current system. All RPBs require their authorised members to hold adequate PII. We are not aware of any evidence of harm because of the current PII requirements and therefore what the weakness is or (if there is a weakness) it's effect.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

In addition to the areas of weakness already identified, we would suggest that there is a lack of clarity over the role which RPBs play where a claim on a bond is notified. ICAS has no experience of a bond claim being submitted against any of our regulated insolvency practitioners but we understand that differing approaches are taken once a bond claim is notified. The approach taken to requests to assign the benefit of bonds is understood to be problematic. In our view, a robust regulatory system should concentrate on the systems of protection and oversight where issues occur. Involvement in the detailed working out of claims is undesirable as a matter of principle of good governance.

A further weakness which has not been identified is in relation to the additional cost to creditors where successor or replacement IPs are appointed to a case. As bond premiums are paid per practitioner per case, where a successor IP or replacement office holder is appointed this results in an additional premium or premiums being paid. As an example, where a practitioner moves firm and his appointments remain with his original firm and are transferred to another practitioner in that firm, then an additional premium is paid even though the case remains with the same firm, will be administered by the same people, has had no change in asset position or risk. We do not have access to information that would allow us to estimate the total cost to creditors in the UK because of double premiums in such situations but insurers may be able to provide this information. In addition to the cost of the additional premiums, administration costs are incurred.

We note that a weakness identified is that a bond only covers fraud and dishonesty by or with the collusion of the IP. We would suggest that this is perhaps not correctly reflected within the Call for Evidence as legislation currently refers to a bond covering fraud or dishonesty by or with the 'connivance' of the IP. We would suggest that there is a difference (albeit subtle) between collusion and connivance. We would suggest that collusion requires active participation in the act where connivance may include both active participation and a failure to do something to prevent an act where it would be a reasonable expectation to do so. The current weakness is that there is no clear definition 'connivance'. We do however agree that any protection should cover fraud or dishonesty by the IP or anyone connected with the IPs firm as the IP must accept ultimate responsibility for control over the case including control of all funds.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

No. In addition to difficulties around the practicalities of setting up, maintaining and managing such arrangements, the size of fund required to allow adequate provision of claims would be prohibitive based on the small number of insolvency practitioners authorised within the UK. This would most likely have a significant impact particularly on sole or smaller practitioners and may lead to a significant withdrawal in the market provision. We are also aware that arrangements in relation to the legal profession are coming under increasing pressure resulting in increasingly restricted criteria over who is eligible to benefit from protection. We do not consider that discretionary protection would assist in providing confidence in the profession or protection for those affected by fraud or dishonesty.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

We agree that a claims management protocol may be of benefit and address, at least in the short term, some of the weaknesses identified. We do however think that further examination of some of the issues will be required to ensure that any claims management protocol is effective.

We would wish to see further consideration of the remit and responsibility around successor IPs and claims management prior to any claims management protocol being pursued. There are two clear and distinct functions to be performed where an IP is replaced following fraud or dishonesty. The primary role is for a successor IP to be put in place to ensure a continued and efficient progression of the estate realisation and distribution. The secondary role is to ensure that the estate is reimbursed for the fraud perpetrated against it. The current assumption is that those two roles are best carried out by the same person however we would encourage a fresh review of that assumption. We do not consider that it is impossible for those two roles to be separated. Consideration would be required as to how the successor IP would be remunerated for the continued administration of the estate where assets had been depleted to an extent that there would be insufficient to meet their claim for remuneration, although this could be retained as part of the requirement for insurers to meet in the event of a claim.

We do not necessarily agree that an approved panel of successor IPs will encourage a wider circle of IPs to take on such appointments. To address that issue there needs to be an understanding of why there appear to be so few IPs taking such appointments. We do not believe that a lack of opportunity is the limiting factor. Limiting factors may include for example lack of scalable resources, perceived or actual skill gaps, and risk/reward considerations.

We do not agree that appointments from such a panel should be the responsibility of the RPBs. This confuses the role of a regulatory system in these circumstances. The RPBs have a responsibility to ensure a successor IP is appointed with a view to making sure that cases are progressed. RPBs should not be wholly responsible for selecting the replacement IP. There are already provisions within legislation to deal with replacement of IPs which will often require the court to make the appropriate appointment.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

No. While a claims management protocol and regulatory action may address some of the weaknesses, they will not address legislative weaknesses. Only through amendment of legislation can the legislative weaknesses be addressed. For example, only legislative action will address statutory cover limits being inadequate. We therefore consider that potentially a mixture of legislative and non-legislative measures would be required to address all weaknesses.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

The removal of statutory bonding arrangements would undoubtedly result in significant efficiencies and cost savings in insolvency procedures. In addition to the cost savings in premiums paid (which ultimately are borne by creditors), creditors may benefit from time no longer being incurred by insolvency practitioners calculating and documenting initial bonding levels, administering the initial bond notification to insurers and RPBs, period reviews of bond levels, and time involved in the release of the bond at the end of each case (see comments in question 1 around costs of the bonding system).

Based on evidence shown thus far, there appears to be no benefit to creditors of the current bonding system. It can therefore strongly be argued that the removal of the current statutory bonding requirements would have no detrimental impact on creditors or IPs. It is likely that the removal of the current statutory bonding requirements would have a positive impact on all stakeholders through elimination of costs which provide no benefit.

The removal of statutory requirements may have a negative impact on public trust and confidence in the UK insolvency regime, however it is not known the extent to which the public are generally aware of the current protection and therefore it is difficult to evaluate whether there would be any significant impact in this area as a result of the removal of statutory bonding requirements.

While we consider that non-legislative regulatory requirements could be introduced which would provide an appropriate level of protection for creditors, we would suggest that there should be legislative provision to support this.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

While the advantages and disadvantages of the options are discussed and set out in the Call for Evidence, further work will require to be done in evaluating and quantifying the impact of any proposed course of action. This is particularly the case around any pricing adjustments to bond or other insurance premiums and their impact on insolvency practitioners and insolvent estates.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.

We do not wish to raise any further matters at this stage.

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

In view of the weaknesses set out in the Call for Evidence and in our response above, we do not consider that Option 1 (Do nothing) is even a possibility.

Option 2 (repeal legislative requirements) has significant advantages. The release of IP time and RPB time administering the bonding requirements would result in reduced regulatory burden and ultimately reduced costs to creditors. As the current arrangements appear not to have achieved the objective of protecting creditors then repealing the legislation is unlikely to have any direct detrimental impact on creditors. There is however a requirement to maintain trust in the insolvency process and part of this must include protection against dishonest actions of those involved in the processes.

RPBs are required to act in a way which is compatible with the regulatory objectives. This includes a requirement to ensure that there is a system of regulating IPs in a way which secures fair treatment for persons affected by their acts (section 391B and s 391C(3)(a)(i)). It is therefore possible for a system of protection for creditors to be implemented under these provisions without the need for further detailed legislation.

While this option is perhaps the most attractive and pragmatic response we consider that there may be benefit, not least in public perception and ensuring trust in the UK insolvency framework, for legislative provision of a protection framework.

We therefore consider that the preferred approach would be an appropriate mix of amending current legislation and voluntary action involving all affected stakeholder groups although we do not underestimate the challenge that this would bring.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

We would highlight that in addition to PII requirements, RPBs also prescribe requirements around the handling of Clients' Funds. The issue of bonding is simply a symptom of mishandling such funds and therefore the review of bonding should be reviewed considering those requirements and the way banks operate clients' funds accounts. For example, we would suggest that it would be appropriate to ensure that banks cannot impose account conditions which allow them to set-off one account against another where clients' funds are involved.

We note the suggestion within the Call for Evidence that RPBs may be able to improve early detection of the warning signs of fraud. We would suggest that where frauds are perpetrated they are most often carried out in such a way that they are not easily detected. In the same way that statutory audits cannot be expected to discover frauds, monitoring visits should not be expected to discover frauds. While potential warning signs can be identified there can be (and often are) legitimate reasons for such indicators which are not linked to fraud or dishonesty. For example, late payments of bonds to insurers does not necessarily mean that the is struggling financially and therefore more likely to consider fraudulent methods to keep the business going. We would also highlight that it is not the purpose of RPBs through monitoring visits to provide reliance to insurers.

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Our Ref: NS/mb

22 December 2016

Insolvency Practitioners Regulation Section
The Insolvency Service
4 Abbey Orchard Street
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Dear Sirs

Call for Evidence 'Bonding arrangements for insolvency practitioners'

The Institute of Chartered Accountants in Ireland is a Recognised Professional Body (RPB) pursuant to the Insolvency Act 1986 and the Insolvency (Northern Ireland) Order 1989 recognised to perform the functions of authorising and regulating insolvency practitioners in Great Britain and Northern Ireland.

The Institute welcomes the opportunity to comment on the Call for Evidence 'Bonding arrangements for insolvency practitioners' issued by The Insolvency Service, which is intended to seek views on the current bonding arrangements and how any problems might be addressed in a future reform of the bonding requirements for insolvency practitioners in England, Wales and Scotland.

As previously indicated at the Regulatory Forum for RPBs, the frequently discussed weakness of the current bonding arrangements namely issues regarding successor insolvency practitioners, has not yet manifested as a major issue in Northern Ireland. We therefore have very limited evidence to provide meaningful data to support our response. Instead we have provided a summary of the views expressed by the members of the Insolvency Technical Committee comprised of insolvency practitioners from a range of insolvency firms within Northern Ireland of varying size and geographic location.

Key Points

Follow-Up Consultation
We agree that the current bonding system is flawed and welcome this review. As stated above we have very limited evidence and this appears to be an issue for other RPBs and the Insolvency Service, hence the need for this Call for Evidence. In these circumstances we would welcome a further Follow-Up Consultation when the appropriate evidence has been collated and assessed.

Minimum Wording
There has been discussion regarding the prescribed form of wording within bonds. The Insurers who provide Professional Indemnity Insurance for our practising members must be “Approved Insurers” and provide “Approved Minimum Wording” within the PII cover. We would suggest that there are various options to be considered should the bonding arrangements continue; there could be minimum wording or even prescribed wording with permitted variations. A full cost analysis would have to be pursued to assess the implications of the various options upon small, medium and large firms.

Responses to Specific Questions

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

We agree with the listed weaknesses. However we have not experienced to date issues with successor insolvency practitioners nor have we recently had reason to withdraw an insolvency practitioner’s licence for fraud or dishonesty.

In particular, members of the Insolvency Technical Committee noted the significant increase in cost of bonding in recent years with no explanation from insurers as to the reason why. The Committee further agreed that a major weakness within the current bonding arrangements is the lack of cover for fraud or dishonesty of a member of staff or employee.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

We have referred to the wording of the bond in above paragraphs but are not aware of any other weaknesses.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

We have limited information on how such a system would work in practise as there are significantly more Solicitors contributing to the Fund within the legal profession than we would have insolvency practitioners.

How would the annual contribution be calculated? Would this be an amount per insolvency practitioner; per firm; dependent on fee income; or commensurate with commercial risk? It would be helpful to have further information on the potential cost of such a system for insolvency practitioners.

Payments under the Solicitors Compensation Fund are at the discretion of the SRA, it is not clear how this model would be operated by the RPBs as under the current bonding arrangements there is a legal liability on the surety to pay.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

We are not aware of any other issues that should be addressed within the protocol.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system.

No the introduction of a claims management protocol (whilst in itself a positive proposal) and regulatory action alongside the existing legislative framework is unlikely to resolve all the weaknesses discussed on pages 10-13.

In particular, this would not address the problem of a dishonest IP not obtaining adequate cover, nor the dishonest employee or member of staff. This would also not provide greater transparency from the insurance industry.

We believe a distinction should be drawn between those successor insolvency practitioners appointed upon the death or retirement of an insolvency practitioner and those appointed where there are claims of dishonesty and fraud.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

In our opinion the key issue is the protection of creditors as the Call for Evidence is suggesting that the current bonding regime has made no real difference to the position of creditors – we suggest that further evidence is required from the insurance industry to illustrate when payments have been made to creditors through the bonding process. As stated above, insolvency practitioners have noted that the bonding costs continue to increase but creditor pay-outs do not appear to have increased.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

Terms of the bond – we agree that the terms of the bond need to be reviewed. There is also significant debate as to how investigative costs are to be treated – if these are to be included within the bond then the cost implications of such a change must be considered carefully.

Monthly Cover Schedules– we support a review of this bureaucratic system. However the cost implications of an annual cover must not be ignored as this could drive small and medium sized practices out of the industry.

Increasing Monetary Limits – this would seem appropriate but the cost implications must be considered.

Fidelity Insurance – the lack of cover for the dishonesty or fraud of a member of staff is a clear weakness within the current system and some form of fidelity insurance may be desirable. However, the cost implications of such insurance would need to be assessed before establishing any minimum requirements.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.

We believe this paper covers the key issues but would welcome a further Follow-Up Consultation once sufficient evidence has been collated.

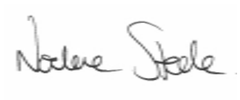
Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

As stated above we believe that there is insufficient evidence available at this stage to answer this question.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

We are happy to have further discussion with the Insolvency Service and the other RPBs in progressing this Review.

Yours faithfully



Noelene Steele
Head of Regulatory Policy
Chartered Accountants Ireland

Response to Call for Evidence 15/9/16

Response on behalf of JLT Specialty Ltd

Author: Ed Brittain

Interest: JLT Specialty Ltd is an Insurance Broker whom place insurance requirements on behalf of insolvency practitioners. JLT Specialty working with a surety provides bonds to Insolvency Practitioners.

All of the comments made herein are the understanding and view of the author and are derived by correspondence with the Insolvency Service regarding bond wordings over the period 2005 to 2016. They are not intended to be legally relied upon, or statement of fact. They are the opinion of the author.

Date: 13/10/16

Definitions:

2005 Regulations shall mean Insolvency Practitioner Regulations 2005

IP shall mean Insolvency Practitioner

We have structured our response and comment in order with the sections of the Call for Evidence document.

How the current bonding system works.

From this section as per the 2005 Regulations it correctly states that **the** bond (specifying a single bond) has two elements. There are bonds currently in use where the GPS and SPS are issued under two separate bonds, other bond providers provide a GPS and SPS under the same bond as per the stated requirements of the 2005 Regulations.

In paragraph 5 the call for evidence states;

"The GPS is in force for one year and is provided to the RPB by the practitioner as evidence of his security. The legislation provides a set amount of £250,000 cover across all appointments. The GPS is not specific to any one case. In the event that the cover provided by the SPS is insufficient to meet all claims arising out of any case, claims can be met from the GPS, until that is also exhausted."

The 2005 Regulations make no reference to the GPS being issued for one year, the Regulations state there must be in force a GPS and SPS.

The lack of clarity in respect of the GPS has led to several different market practices. With each bond working in a different way the outcome is that an Insolvency Practitioner may become tied to their bond provider by the way the GPS operates.

One provider issues an "annual" GPS that provides and additional £250,000 for all qualifying cases the IP is appointed on. We use the word "qualifying" as whilst all the bond providers offer the period of the appointment plus an additional 2 years run off however there is no requirement within the regulations to provide a run off period. This in itself is an issue as without the run off period after the IP is released (optionally or otherwise) the bond would not offer any protection as the indemnity to creditors as indemnity by a bond issued on a claims made basis would cease on release.

The current varying practices of issuing a GPS can be summarised into three main groups as follows;

1) *One year annually renewable GPS*. A GPS that provides an additional £250,000 for all of the live cases of Insolvency Practitioner. The GPS provided the year before ceases on renewal if the GPS is not renewed with that specific surety provider. If the Insolvency Practitioner does not renew the GPS as they no longer take appointments and do not renew with any other provider the GPS provides two years run off.
2) *A GPS provided for the period of the bond (a 12 month period) that includes two years run off after the end of the period of the bond.* This type of GPS would provide a GPS for all appointments taken in that specific period of the bond. The issue with this type of GPS would be that if the IP remained in office for a period longer than 2 years after expiry of the bond there would be no GPS in force. The second issue would be that there would be that no 2 year run off cover would be provided following release of the IP as the period of the GPS was restricted to two years following the end of the period of the bond.
3) *A GPS provided for the period of the bond that was concurrent with the SPS.* This type of bond provided a GPS for each appointment taken in the 12 month period of the bond and would remain in place concurrent with the SPS until release of the IP and then provide 2 years run off following release from a specific appointment. Such bonds may include a long stop such as 10 years from the appointment.

The issues with the above are best demonstrated by example;

IP Mr Adam Smith has 100 appointments. He took his appointments over 4 years being 2012, 2013, 2014 and 2015 and took an equal 25 appointments per year.

Under GPS type (1) he has £250,000 spread over all 100 appointments.

Under GPS type (2) he has £250,000 for each year hence £1,000,000 over all 100 appointments.

If Adam Smith had GPS type (1) and wanted to move bond provider in 2016 because he could obtain a lower cost GPS via a provider using type (3) he would have to purchase a new GPS for all 100 appointments as the existing GPS would cease.

If Adam Smith had GPS type (3) he would not incur any cost at all.

From this perspective the estates could be argued to be detrimentally effected by type (1) as the cost would have to be incurred by the estates (either directly or indirectly). Thus GPS type (1) could be argued to be tie the IP to type (1) and offer fewer benefits to estates than type (3). It could also be viewed as a practice that restricts the ability of an IP to move providers to obtain a lower cost GPS and SPS's for future appointments.

The 2005 Regulations are not specific that a GPS should last one year, and do not state as such.

Paragraph one of page 8 of the Call for Evidence states;

"Every month the insolvency practitioner must submit a cover schedule, also referred to as the bordereau, to the insurer and the authorising body. The schedule details the new appointments in that month, any cases which have been closed for which cover is no longer required and any new estimate of the value of assets in existing cases. The insolvency practitioner must inform the insurer within a month of any increase in estimated value."

Schedule 2 of Part 2, subsection 3 (2) c of the 2005 Regulations state:

(c) for a schedule containing the name of the insolvent and the value of the insolvent's assets to be submitted to the surety or cautioner within such period as may be specified in the bond;

Thus there is no requirement within the 2005 Regulations to submit a schedule each month if the bond wording does not state this. Thus there is no reason why this requirement cannot be amended without the need for any change to the existing regulations.

What are the current weaknesses with the current bonding arrangements

Legal Framework

We believe that the current wording does allow for innovation should the Insolvency Service approve the wordings. Yes we agreed the current regulations are open to interpretation however this is an opportunity to allow for non-legislative change to the current system.

Statutory cover limits are inadequate and inconsistent

The principal issue is that as long as the SPS is limited to the value of the assets any fees incurred will have to be deducted from the payment made and thus reducing creditor returns.

The wording of the GPS is vague in that it can only apply when the SPS has been inadequate. The role of the GPS could be amended and it made clear the role of the GPS me made to pay fees in addition to the SPS which would pay for the loss of value of assets to creditors.

Bonds rely on honesty of a dishonest person

The current requirements for submission of monthly schedules, and the requirement to only be able to bond for the maximum value of the assets creates this exposure. It is possible to design out this risk with an annual bond.

Proceeds of a bond are not ring fenced.

We believe this statement to be correct however also (with the best of intentions) misdirected. The issue is not that the proceeds are not ring fenced, the issue is where an SPS is limited by the value of the assets then any costs incurred in indemnifying fraud, and dealing with the loss to the creditors can only come out of the amount due to creditors. Costs need to be provided for in addition to the value of the assets and the costs not taken out of the loss incurred by the creditors.

Increasing cost of premiums

Whilst the statement regarding increasing cost is not regarding the surety provided via JLT we do fully agree that the cost of surety can only be made based on risk. If the risk is managed via a regulator or other such body then the cost would not increase. Whilst the risk is effectively unmanaged the only option available to a surety is to match the cost to risk. The cost is the result and outcome highlighting the actual problem. No surety will participate in a market where it is guaranteed to make a loss.

Adversarial nature of claims

The adversarial nature is a matter that creates significant cost. The issue is that a bond claim cannot be made with first proving fraud. Thus a successor is driven to prove fraud or will not be paid their costs they have incurred. The current structure drives this behaviour. The regulator has a role to play in how the claim is managed as it is the regulator who is the actual beneficiary of the bond. They in turn are in a difficult position trying to persuade a successor to take on and review a book of cases when fraud may or may not be proved in but a few. This in turn may lead to inadequate investigation in respect of the entire book but a focus on where fraud can be proved. A suggestion may be to have a GPS that provides an investigation pot controlled by the regulator and only enacted when the regulator believes there is a potential of fraud and where a successor IP is appointed to investigate. The remit and costs of the successor agreed at appointment with the agreement of the surety provider. Thus control is kept by the regulator. The current system creates a commercial dispute, and has no judge or jury required to provide direction and control on cost.

Limited number of insolvency practitioners willing to take on successor appointments

Given that all work is taken on a speculative basis and a successor IP is not guaranteed to paid for costs incurred the work will only be attractive to an IP willing to take on the risk of incurring significant cost that they may not be remunerated for. Also the remit as per the above will often mean the undertaking of the adversarial nature of bond claims again making the proposition unattractive. It is also a skilled role where the skill sets needed are not just those of an Insolvency Practitioner, they are in addition to being an Insolvency Practitioner. Any changes would have to be carefully understood to ensure that any successor insolvency practitioner has the correct qualifications and experience to undertake the required role.

Lack of provision/control over successor fees

The bond beneficiary is the Regulator. The Regulator thus has the ultimate control over fees as they need not assign the bond if they did not wish to and the successor IP would not be remunerated. However as the current practice is for the Regulator to step back (to be fair we are unsure what direction they are given as to their role and responsibilities) and allow an adversarial process to resolve the alleged claim. There is the ability without any legislative change required to put I place an arbitrator of some sort be it the regulator or someone else.

Lack of Provision/Control over successor insolvency practitioner fees

The control over fees sits solely with the beneficiary. If the beneficiary waives any responsibility or control then by definition there is no control.

No statutory requirement for Professional Indemnity Insurance

Professional negligence is arguably a bigger issue than fraud, however a PI policy is a claims made policy and following suspension of a licence (or removal) the insured IP would have to notify his insurer whom would undoubtedly cancel the policy making any future claim void. PI is not an insurance substitution for a bond. They are very different risk transfer vehicles that work in very different ways. Also a PI policy is an annual policy that requires renewal every 12 months. Given the nature of the work and time taken to do so by a successor IP the policy will almost certainly have been lapsed by the time a claim could be properly formulated. Also the fraud is likely to have been undertaken by the policyholder for smaller firms and again this is not always an insured event.

The Bond only covers fraud and dishonesty by or with the collusion of the IP.

Yes all firms should be required to have fidelity guarantee insurance, either as an extension to their PI cover or as a standalone cover. Employees can be correctly indemnified as they are not the insured or the person making the declarations under a PI policy.

Practical Issues

Variations in particular Bond wordings causes confusion

All wordings are approved by the IS. The wordings do vary due to the fact that the requirements to be authorised are not consistent. This is clearly not a deliberate matter, simply some bonds remain authorised that do not comply with the 2005 regulations. Again this is simply a result of time. In addition some brokers have approved wordings but then use their declaration schedules (that do not have to be approved) in a way that directly contravene what JLT have been advised by the legal advisers within the IS. There is also a bond authorised and used that is not a bond at all, it's an insurance policy. Most bonds however do provide the basic provision as required by the Regulations. Also it would not be possible to have a prescriptive wording that must be used as each surety must be allowed to use their wording provided it does what is required as a minimum standard. Rather than approve each wording it may be more effective to list what a bond must do, rather than authorise on the basis what it cannot due to the 2005 Regulations.

Increasing Premiums

JLT's Aviva premiums have not increased since JLT started to issue bonds for any client. However it is a commercial matter and the increased premiums reflect losses and future risk. The only way to avoid this inevitable mathematical certainty is to improve the loss ratios by reducing the number of claims. Ways to improve this is to introduce some sort of checks in to the Regulators visits regarding checks on time recording methods and minimum banking requirements.

Adversarial nature of claims

As previously stated this is a direct result of the beneficiary not playing any meaningful role. A Bond is a promise to pay and is assigned to the successor IP whom in turn has to prove fraud to receive any payment for their costs incurred. The outcome is inevitable. To change this the Regulator or beneficiary (it could be the IS or s new body) needs to take control as they already have the ability to do this under the current bond wordings.

Cessation of cover on non-payment

A bond is a promise to pay that cannot be withdraw. We would not like to comment about any other bond provider, but internally we would see non-payment of a premium as a very high risk indicator and simply stop issuing a bond at the first opportunity. As the IS approve all wordings this could be a matter addressed by the IS.

Limited number of insolvency practitioners willing to take on successor IP work

Given the speculative and the adversarial nature of the work this is an outcome of the present practice. If there were a guaranteed payment for investigational work there number wold increase. In addition there would become a competitive market for the type of work.

Question 1

Yes we agree with the overall assessment, and firmly believe the problems can be addressed without legislative change. Creditors clearly do need the protection offered by a bond because the issue of claims would not arise if there was not the problem to protect creditors from.

Question 2

There is significant cost to us in managing schedules and Nil returns that are simply not required. This adds cost to the IP and to JLT. This cost is approximately £55,000 per annum and would be reflected by a similar cost to clients. Each bond provider should be allowed to require declarations as specified by the surety as per the 2005 regulations and not per month as required by the Regulator. This change needs no regulatory change to implement, simply allow the 2005 Regulations to be applied as written.

Question 3

The size of the legal profession allows a size of industry to create such a market. The Insolvency market is simply not big enough to attract enough insurers to convince them to remove the standard exclusions that make the law society wording work. Also the largest IPs would use their own PI separate policies (some use captives for self-insurance) reducing the size of the market further. Further more each firm will have a deductible or excess (uninsured amounts) that would apply, with policies purchased by the larger firms with deductibles of £100,000 or more.

Question 4

Making costs proportionate could only be achieved if direction was given as to what was required and also a prior agreement to pay the IP even if fraud was not proved.

A panel could only be achieved if the work was less speculative and less adversarial

Question 5

No we do not believe that the introduction of a claims management protocol would solve the issues as it will not address the causes of the issues.

Option 1

We do not believe the do nothing option is an option as the current system does not protect those it is intended to protect.

Option 2

Given that the call evidence arises from claims there is clearly the need to protect creditors from miscreant Insolvency Practitioners. To remove bonds would also to be to remove the funding to uncover the fraud and thus allow them to continue to defraud creditors. Removing the bond would increase the numbers of frauds against creditors and expose creditors to greater risk.

Question 6

- **A)** Reduce cost to the IP firm. As Regulators do not check the basic risk management provisions as part of their inspections the removal of any oversight and means of funding detection of fraud would allow an IP greater ease to defraud creditors and make the less likely to be detected
- **B)** Would mean more creditors are defrauded. The average cost of a JLT bond is £85 and we do not believe this is material to the return to creditors in general.

Prescribed Terms of a Bond

We do believe that the full wording could not be prescribed but so believe the requirements of a bond could be mandated for that bond to be authorised and give clarity. All wordings will over time change with changes in law etc.

Ring fencing proceeds

We do not support this suggestion in isolation. It would simply be a mechanism to reduce the funds available to investigate a claim and deter a successor IP from undertaking investigatory work needed to prove a claim so the outcome would be less claims are pursued and fewer fraudulent IPs are identified. This cannot be in creditors benefit. This would also mean more fraudulent IPs continue to take new appointments and the bond provider would continue to issue more bonds where future frauds may occur and this actually increase their claims payments.

Investigative Costs

An amount has to be provided to allow for some basic investigation work that is not based on proving fraud. This would enable a much wider panel of firms willing to undertake the work and also remove the need to prove fraud. It could be delivered by using the current GPS to provide the surety to pay the costs.

De Minimis indemnity period

Increasing the indemnity period would cost more premium. The fault the fraud was not uncovered for three years was a failure of oversight to detect and not a failure of the bond provision.

Removal of monthly schedules

We support this suggestion. The schedules are costly and serve little purpose and have no effect on the indemnity given at all.

Amending Limits of GPS/SPS

The current GPS limit should be considered to allow for investigatory costs and increased to £500,000. It should be made available to the Regulator upon reasonable suspicion of fraud in the view of the Regulator (not the successor IP) and not assigned to the successor IP. The Regulator would then engage the Successor IP.

The current SPS limited at £5,000,000 we believe to be adequate.

The current Global limit of £25,000,000 we believe to be adequate.

Introduce a duty that investigative costs must be proportionate

We would question the rationale for this statement as it would suggest that if an IP only defrauded and estate by a limited amount for every case he defrauded he would never be properly investigated? This would allow him to continue to defraud and simply add the maxim of “don’t get greedy” when defrauding a case. There has to be some oversight but also some flexibility to allow a Regulator to decide what is proportionate in a specific circumstance.

Protect estates from non-payment.

Allow the successor to pay the outstanding amount or simply make such clauses not approved.

Include Professional Indemnity as a requirement for security, including run off

Would simply not work. The insolvency industry is simply not big enough or creates a big enough market to make an insurer pay a claim for a fraud undertaken by the person completing the proposal form. All insurance policies have terms and conditions and the basic principle is that you must not deliberately provide known false information which wold be occurring in many circumstances where there has been a claim under the bond. If you do the policy is invalid.

Further Comments

We believe that the bond can provide both protection for creditors and also the funding required to identify and also eliminate the future potential for fraud by an IP.

The current GPS/SPS arrangement could be used to provide some investigation cover and then specific cover where there has been fraud.

The Regulator (or someone to be the beneficiary) is required to take control to oversee costs and eliminate the adversarial process that is current practice.

To not have a bond would allow miscreant IP's to continue to defraud. If nothing else, today's system does allows for the identification and uncovering of fraud and thus the reduction of future fraud and removal of fraudulent IPs.

Insurance and Surety (Bonds) are not the same thing and cannot be interchanged. A PI policy for an insolvency practitioner will include terms and conditions that will render it impotent for surety purposes. Insurance such as Fidelity Guarantee is however complimentary to a bonded principal.

JLT believe a standard schedule of requirements of a bond(s) be applied to all providers scheduling what a bond must provide. Each provider has developed their bond wording at a particular time and this had led to a wide variation on what has been approved and is in use, and each provider is working to a different set of requirements. This provides a commercial advantage to some and uncertainty to all. The current approach also restricts the ability to innovate and reduce cost and provide greater efficiency.

MARSH RESPONSE TO THE CALL FOR EVIDENCE

BONDING ARRANGEMENTS FOR INSOLVENCY PRACTITIONERS

15TH SEPTEMBER 2016

THE INSOLVENCY SERVICE

4 JANUARY 2017

CONTENTS

1

Introduction

This document should be read in conjunction with the Insolvency Services Call for Evidence dated the 15th September 2016 and attempts to deal with the issues raised therein.

Firstly I would point out an error in the document, all firms are not required to have a minimum of £1.5 million professional indemnity insurance. For example ICAEW regulated insolvency practitioners (IP's) where the gross fee income of the firm is less than £600,000 must have a minimum limit of indemnity for any one claim and in total equal to two and a half times its gross fee income, with a minimum of £100,000.

Whilst the original aims of the bonding regime were wholly laudable it is manifestly failing now in its primary purpose of ensuring the actions of dishonest IP's do not impact adversely on creditors.

Bond wordings restricting the period of cover to the disadvantage of creditors have been allowed to creep in, proceeds of the bond claims are increasingly being taken as fees by successor practitioners and the recognised professional bodies (RPB's) seem to exercise no control over the process and seem disinterested in the fate of creditors.

The whole regime needs to be amended and refocussed on the need to protect creditors.

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

"Prescribed bond requirements are unclear and costly
It is suggested that the statutory requirements are not entirely straightforward and could be open to interpretation. They do not allow for any innovation by insurance providers – requiring submission of cover schedules irrespective of the insurer's business model. Cover schedules are burdensome and increase costs for all parties."

I think they have been interpreted over the years in ways which were never envisaged when they were first written. I feel the intention of the wording is clear but it needs to be tightened up to prevent creative interpretations and would favour a compulsory wording with no variations allowed.

I agree cover schedules are cumbersome although improved technology is making them less so.

"Statutory cover limits are inadequate and inconsistent
The monetary limits have not changed since the introduction of bonding requirements some 30 years ago. The GPS amount of £250,000 over all appointments is prescribed as an absolute and may no longer be adequate. Several recent insolvencies would exceed the maximum level set for the SPS."

Agreed although it will never be possible to set the SPS maximum at a level to cover all insolvencies (Lehmann Brothers for example) and if the SPS were done correctly the level of the GPS wouldn't be an issue.

Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover
The applicability and amount of the SPS depends on the honesty of the insolvency practitioner to make a correct declaration. If the insolvency practitioner either under declares the value of the assets, or does not declare at all, then the only available cover would be a pro-rata portion of the GPS, assuming that the insolvency practitioner has that in place.

Agreed

“Proceeds of a bond claim are not ring fenced
Once a claim is made, it is paid into the estate and treated in the same manner as any other asset, and is subject to the usual order or priority of costs and fees of the proceedings. We are told it is often the case that creditors who may have been adversely affected by the fraud will receive no direct financial benefit from a successful bond claim.”

This is the biggest problem at the moment. Proceeds are regarded as being there to meet successor practitioners fees rather than to reimburse creditors and this is an issue which must be dealt with.

“Lack of provision/control over successor insolvency practitioner fees
The costs of investigating fraud are provided for by the bond, but the liability of the surety is capped at the value of the SPS. The only control over such costs is that they are at the discretion of the surety which can lead to uncertainty. Successor insolvency practitioner fees are determined in the usual manner of any insolvency, though different rates may be charged for bond claim work. Given the age of cases, it can be difficult to engage creditors on these issues. As a result, successor insolvency practitioner fees may exceed the amount available under the bond claim leaving no money left for distribution to creditors.”

This is connected the preceding point. The successor IP’s feel that the cases where bond claims exist should subsidise the cases where there are no claims. This is evidently not the intention of the bond providers.

The RPB’s appear happy to assign the benefits of bond claims without first establishing that such claims properly exist. This encourages a mentality of looking for a claim to hang fees on rather than trying to establish right and wrong and protecting the interests of creditors.

One could also argue that it is an abrogation of the RPB’s responsibilities to their members.

“No statutory requirement for professional indemnity insurance
There is no statutory requirement for specialised PII, which is instead governed by the rules of the individual RPBs, whose requirements differ.”

This is easily fixed and such cover should either have provision for run-off cover or an extended claims reporting period to avoid the claims made nature of the cover causing any claims to be time barred.

“The bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner
There is no regulatory or statutory requirement for insolvency practitioners or firms to hold fidelity guarantee insurance which would cover fraud or dishonesty of a director or employee without the knowledge or collusion of the insolvency practitioner.”

Again easily fixed by demanding fidelity guarantee insurance although that would still leave the issue of the dishonesty of agents or sub contractors.

“Variation in particulars of bond wording causes confusion
There are wide variations in cover between bond wordings, particularly in terms of reporting deadlines, limits on liability and maximum indemnity periods. These depend not only on the bond provider but on the date of issue. There are reported issues with successor practitioners obtaining copies of the relevant bonds, and having to submit protective claims in order to ensure that cover will be available”

This would be fixed by having a standard wording and allowing less flexibility to the bond providers. The bond is there for the benefit of the creditors and the insolvency service should mandate very strictly the wording of the bonds.

“Increasing costs of premiums
In response to increased perceived risk, we are informed that some bond providers have increased SPS premiums for smaller firms (two or less insolvency practitioners) by up to 200% for 2016. While pricing of risk is a commercial matter for the insurers, concerns have been raised that smaller insolvency practices could be priced out of the market, which would reduce competitiveness.”

This is true but it is also worth mentioning that the premium for the big firms has reduced in this period and the cost of bonds is still relatively minor compared to the differential fee levels between the different sizes of firms.

“Adversarial nature of claims
We understand there is little interaction between successor practitioners and sureties, with the insolvency practitioner carrying out their usual statutory duties and any investigation according to their own judgement. There is often no discussion or sanction of investigatory work by the surety, who are presented with costs only at the claim stage. There is no agreement to determine the amount of work to be undertaken, which insurers claim can on occasions be disproportionate to the loss suffered by the estate. This lack of co-operation can lead to delays in settling claims and increases costs to the detriment of creditors.”

I’m not sure this is entirely true. The main two firms dealing with this type of work tend to be adversarial in their approach and this sets the tone for insurers responses. I have dealt with other claims through other IP’s which have gone smoothly with both sides being satisfied (if not happy) with the outcome.

“Cessation of cover on non-payment
Some bonds provide that cover is only available when the premiums are paid. While the enabling bond is paid at the outset of cover, the SPS is collected throughout the year as appointments are taken. Where an insolvency practitioner fails to maintain payments, it is reported that in some instances insurers are terminating cover retrospectively which leaves estates without protection.”

Again easily dealt with by a standardised wording that doesn’t allow insurers this option.

“Limited number of insolvency practitioners willing to take on successor appointments
Currently there are only a small number of insolvency practitioners willing to take on successor appointments, which means that there is little competition and to some extent those undertaking successor appointments can set their price for undertaking this type of work.”

Again, I don’t think this is true.Most IP’s don’t know how to apply and the RPB’s seem to like the simplicity of always using the same firms.

“Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.”

See answers to the individual points above.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

I think the above identifies the main problems.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

I think it is unlikely to work due mainly to the differing sizes of the legal and insolvency professions. It is essentially self-insurance and there are not enough IP’s to keep contributions down to a reasonable level and make up any shortfall between contributions and claims.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

I feel the RPB's should take some ownership of establishing if there is likely to be a claim before assigning the benefits of any claim to the successor practitioners. At the moment there seems a presumption of guilt from the RPB's and a culture of file trawling by the successor IP's based on getting their fees maximized and paid.

There should also be full transparency as to the operation of a rota by the RPB's.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

No, it would be a fudge which is unlikely to achieve anything in the medium/long term and seems to be designed purely to give the impression of action.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

The bonding requirements are there for the benefit of creditors and whilst we are in favour of making it as painless as possible for the IP, the good of creditors must be paramount. I think removing the bonding requirements would be welcomed by IP's as it would simplify their jobs, the more honest ones regard it as a waste of money and the dishonest ones wouldn't care about the creditors rights.

From the point of view of creditors it would be a disaster and I think the Australian example is a good one to cite as it shows what a disaster the scrapping of the bond provisions would be. The Act in Australia always allowed for the IP either providing a Bond or PI insurance. Historically the Bond requirement was about A$50k, then it moved to A$250k in about 2005. It was realistically at this point that most of the Aus IP market then simply went to PI to satisfy the requirement of their licencing to be a Registered Liquidator.

In 2007 ASIC (the Aus regulator of Liquidators) did a review of insurance requirements for Registered Liquidators .

They ultimately issued a guide in 2007 that enabled the RL's to achieve the required insurance standard in respect to "Fidelity" by either of the following methods –

1. Have a Fidelity sub-limit to the PI LOI (No amount specified other than putting the onus on the RL that the limit must be adequate & appropriate at all times)
2. Have a standalone Crime/Fidelity Policy (same condition as above re LOI)
3. Modify the Fraud & Dishonesty Section to include Cash/Currency/Money
4. Effect a Bind (like wehave in UK at present with enabling bind & job specific bond)

Given the allowable options, 99.9% of Insolvency Practitioners in Aus simply had a Fidelity sub-limit endorsed on their policy.

Options 1-3 above would not provide protection against the actions of the IP themselves, just their staff provided the IP didn't know what they had done. Not long after that there was a case involving an Insolvency Practitioner called Stuart Arrif – http://www.smh.com.au/business/reform-remains-elusive-for-troubled-insolvency-sector-20150308-13y9jw.html
As ASIC well now know, if they had enforced that RL's had to have the option 4 above effected, creditors wouldn't have been left wanting as they were.

The answer is to make the system work for the benefit of creditors not successor IP's and/or insurers.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

I agree with your summary and feel strongly that there should be a single proscribed wording and the proceeds of the claim must be ring fenced for the benefit of the creditors. We need to get back to the original principles of the Cork Report.

I also feel the RPB's must take more responsibility in the claims process.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered.

I feel the paper has not addressed the role of the licensing bodies in any claim. Currently they take no responsibility and this needs to change.

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

I think the first priority is to remember why bonds exist and who is supposed to benefit from the bonding system.
The protection of creditors must always be paramount.
To this end the first and most important change must be to ring-fence the proceeds of any claims.
I also strongly believe that a single proscribed wording must be the way forward. Over the years we have seen insurers diluting the extent of coverage available and successfully arguing it still meets the "principles", the focus thus becomes reducing cover and price to allow forum shopping, surely not in creditors best interests.

Thirdly I believe the introduction of a single global bond must be in everyone's best interest. It will obviate the risk of practitioners neglecting to bond or to pay for cover which must be good for creditors whilst eliminating the costly procedures of the monthly bordereau which will be popular with both insurers and insolvency practitioners.

Finally the RPB's must get more involved in the claims process and in ensuring the actions of the successor practitioners are first and foremost always for the benefit of the creditors.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

I feel now is the time for a fundamental review of a system which was set up with the best of intentions but has become dated and has seemingly lost sight of it's original purpose.

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Response to the Call for Evidence
from Griffins

16 December 2016

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Contents

INTRODUCTION

Our firm

1. Griffins are probably the leading firm in investigating claims against insolvency practitioners (IPs) and on occasion, where there is evidence of fraud or dishonesty involving the IP, this includes the making of claims against the insolvency practitioner's bond. Our experience has been set out in two leading articles jointly written with Dr John Tribe of Liverpool Law School and in an article of our own which revealed the substantial defect in the terms of one of the leading bond policies. It is a sector that is often misunderstood and certainly misrepresented, with many vested and commercial interests at play.

2. As this document will explain, whilst the investigation of claims against an IP is a highly skilled job, there is nothing special in law about a successor practitioner. They must still get in and realise the assets of the estate to which they are appointed and comply with the various Statements of Insolvency Practice (SIPs) and legislation that all officeholders deal with every day. The lion's share of work we do as successors is case-related as opposed to the specialised work of looking at the conduct of our predecessor, but it is the latter which gets the most attention. This exercise has given us an opportunity to shed some light on what really happens when an insolvency practitioner is malfeasant.

A Brief Summary of Our Response

3. Bonds are a vital part of the system to deal with fraud or dishonesty of insolvency practitioners alongside the regulatory role of the Recognised Professional Bodies (RPBs) and the investigatory work carried out by successor practitioners.

4. Whilst we would welcome exploring ways to improve or replace bonds we can see no grounds to support the premise of the Call for Evidence (CfE) that they are not fit for purpose. Bonds are used in the UK and many other countries as the primary tool for marking the integrity of many professions and our research has not discovered an obviously better system.

<u>The role of a successor practitioner</u>

5. We have sought to demystify the work of a successor practitioner and in particular to demonstrate that the perceived view equating the job of a successor practitioner to that of making bond claims is wrong. Bond claims are not the most significant aspect of a successor practitioner's work; they are not the largest asset; and do not constitute the greatest costs. The main financial benefit to creditors from regulatory successor appointments is the pursuit and realisation of claims not brought by the former officeholder. Any bond claims arise as a natural consequence of an independent review of the insolvency and that review may for example discover negligence and not fraud, or nothing at all.

<u>Fees</u>

6. The common theme that runs throughout the CfE is that successor insolvency practitioner fees are not sufficiently controlled and are consequently too high. There is no evidence to support this. The costs of a successor are capped by realisations, resolutions of creditors and the negotiations with PII or bond providers. We cannot comprehend how a further fee regime just relating to bond claims could possibly work.

7. The inference that successor practitioner fees are too high actually contradicts the other suggestion that there is not enough competition in this sector. It hardly needs explaining that if this is such a highly remunerated area there would be a surfeit of practitioners wishing to join the successor 'gravy train'.

8. What also needs to be borne in mind is that bond sureties usually engage a single specialist loss adjuster to challenge claims and it requires specialist knowledge to properly challenge their obstacles to payment.

<u>Dividends</u>

9. There is no evidence to support the 'too high fees/too low dividends' theory. Dividends paid following successor appointments in our cases are above the published averages and on occasion bond claims have funded the payment of creditors in full.

<u>Premiums</u>

10. We can see no basis for the underlying assumption of the CfE that the costs of bond claims are causing premiums to rise. On the contrary it would appear that the fees of successor practitioners are lower than just the commissions charged by brokers who sell bonds, let alone the tiers of charges that occur higher up the insurance chain. There is also some suggestion that in some cases bond premiums are set as loss-leaders to procure the insolvency practitioner as a customer to then sell add-on insurance products.

11. Conventional bond providers conduct significant initial due diligence when writing bonds but in insolvency it appears instead that they attempt to minimise losses at the claims stage like an insurance policy.

Recognised Professional Bodies

12. There is a great deal of evidence that RPBs do not understand the bonding regime and so we have made a number of recommendations around the importance of monitoring bonding.

Main proposal

13. We recommend a tender system for the right to bond the entire profession with all insolvency practitioners paying the same premiums regardless of size. This is on the basis that the present system unfairly penalises smaller insolvency firms and distorts the insolvency market, for reasons which are explained within our response.

14. There are significant disadvantages in the suggestions of the Insolvency Service. There is already a claims protocol in place which is now working much more effectively and can be improved further.

15. We recommend greater training of IPs (and RPBs) in the reporting of potential claims to indemnity insurers. The sureties also have a financial interest in such reports being made so that there is the possibility of the policies being used to indemnify their losses.

16. If there is the opportunity of legislative change, in addition to changing the statutory limits to bond cover, a change should be made to the concept of release or discharge of officeholders. A longer period with automatic release would provide a more certain position for a successor practitioner.

17. Bonds should be written in favour of the Secretary of State rather than the RPB to avoid the conflict of interest and financial risk that they currently face.

Call for Evidence

18. The tone of this Call for Evidence (CfE) is somewhat alarming and worth criticising at an early stage. Whilst it seems to admit a lack of evidence to support much of what might be called its suspicions, the Insolvency Service has put its name to a document which seems to mainly channel the unsupported assertions of insurance companies. It is somewhat surprising that the document refers to a meeting with insurers in formulating this document without meeting any firm that has had to deal with insurers in the claims process.

19. The underlying assumption of the CfE is that the costs of bond claims are causing premiums to rise and at the same time the bond regime does not serve the interests of the victims of dishonesty well. We are happy to deal with the first aspect simply and quickly at the start.

20. From our own experience and from conversations with other IPs who are making bond claims we believe that the gross amount of bond claims typically paid out per annum are within £1m to £5m. In most years the claims are around the bottom figure and sometimes almost nil. We are aware of only one single year in around 2009 where the total bond claims exceeded £5m. Also commonly the amount paid out to us by insurers relating to the costs of a successor practitioner is about 20%-25% of the sums paid out. So in general terms, an untypical heavy year for claims might amount to £5m of which £1m might be paid out in successor costs across a number of portfolios. We emphasise that every case is different and a single large claim or lots of small ones can distort figures but we are comfortable with the approximation for illustrative purposes.

21. AUA Insolvency Risk Services Limited are a significant broker in the insolvency market and we are able to see from their published accounts that in 2010 they handled £17m of gross premiums from insolvency practitioners. We do not know the exact split between bond premiums and other types of insurance but we understand it is likely to be around 25% of their business. What is clear is that according to these accounts AUA charged around £4.4m in commission for handling all the premiums in that year. In the most recent published accounts for 2015 they report handling £10m of gross premiums, taking £3m in commission for themselves.

22. For the purposes of our submissions we have assumed that the market in bond premiums is around £10m per annum. There is no definitive evidence to prove this but it is the sum we have arrived at from our various conversations with bond providers and our perception of their relative size in the market. Where we have asked them directly for broad figures they have refused, citing commercial sensitivity. We question why their turnover in a particular product would be such a sensitive topic where accounts are available for at least one company. The figure of £10m could be a little high but we doubt it is below £7m and there is the possibility that it could be as high as £20m. More work could be done to estimate the true levels using public information but we have not attempted that task.

Table showing estimated net total premium income from bonds across insurers operating in that sector*

Year	IRS/Amlin Gross Insurance Premiums (actual)	IRS/Amlin Gross Bond Premiums (est 25%)	IRS/Amlin Gross Commission (actual)	IRS/Amlin Broker's Commission from Bonds (est 25%)	Rest of the Bond market Gross Premiums (est)	Total Gross Bond Premiums (est)	Total Gross Brokers' Bond Commission Income (est using AUA %)
2010	17,900,000	4,475,000	4,388,000	1,097,000	5,000,000	9,475,000	2,368,750
2011	16,200,000	4,050,000	4,643,000	1,160,750	5,000,000	9,050,000	2,262,500
2012	12,900,000	3,225,000	3,816,000	954,000	6,000,000	9,225,000	2,306,250
2013	11,800,000	2,950,000	3,666,000	916,500	6,000,000	8,950,000	2,237,500
2014	12,700,000	3,175,000	3,569,000	892,250	6,000,000	9,175,000	2,293,750
2015	10,000,000	2,500,000	2,761,000	690,250	6,500,000	9,000,000	2,250,000
Total	**81,500,000**	**20,375,000**	**22,843,000**	**5,710,750**	**34,500,000**	**54,875,000**	**13,718,750**

*ASSUMPTIONS – Total market £9-10m bond premiums. Anecdotal evidence is that AUA has lost market share over the period rather than a downturn in the market. For IRS/Amlin the figures in the second and fourth columns are based on their annual accounts. Their bond premiums (third column) are calculated on the basis just described - by estimating that the bonding part of their income equates to 25% of the insurance services they provide.

Table showing IRS/Amlin net bond premiums in comparison to the sums paid to Griffins from bond settlements in the same years with AUA bonds.

Year	IRS/Amlin Gross Bond Premiums (est)	IRS/Amlin Broker's Commissions (est)	Total Amlin Bond Claim Settlements	% Total Amlin Bond Claims to estimated Net Premiums
2010	4,475,000	1,097,000	0	0.00%
2011	4,050,000	1,160,750	0	0.00%
2012	3,225,000	954,000	32,884	1.02%
2013	2,950,000	916,500	327,354	11.10%
2014	3,175,000	892,250	0	0.00%
2015	2,500,000	690,250	0	0.00%
Total	**20,375,000**	**5,710,750**	**360,238**	**13.20%**

23. We do not have figures for the commission and administration costs for the tiers of insurance companies and underwriters who take their profits from the remainder but the point is very clear. Fees and commissions represent a large proportion of the premiums for bonds. We are not the sole claimant in this period but even if the other claims are equal to ours then the numbers would still seem proportionate in comparison to premiums.

24. If this rough estimate is right then if the commissions paid from bonds were a little lower, or perhaps the administrative costs were streamlined, premiums would be reduced regardless of the level of claims. If we are wholly wrong in our assumptions then no doubt insurers can supply the correct figures as we would assert that this is a key part of the problems with bonding.

25. The rest of our document focuses on the legal framework, duties of an officeholder and RPBs, the reason for bonds, PII insurance, negligence and mixed claims and then addresses the questions raised in the CfE.

THE LEGAL FRAMEWORK

<u>Legislative landscape</u>

26. While the CfE provided a brief overview of some of the requirements of bonding, it is considered worthwhile to set out a bit more of the legislative landscape.

27. Section 390(3) of the Insolvency Act 1986 ('IA 1986') makes it a mandatory requirement for all officeholders to be bonded as part of the conditions to be filled to qualify to act as an IP:

> *"(3) A person is not qualified to act as an insolvency practitioner in relation to another person at any time unless –*
>
> *(a) there is in force at that time security or, in Scotland, caution for the proper performance of his functions, and*
>
> *(b) That security or caution meets the prescribed requirements with respect to his so acting in relation to that other person."*

28. The consequence of not being bonded and therefore not qualified to act as an insolvency practitioner is contained in the preceding provision, S389, where it states this is a criminal offence.

29. It is left to secondary legislation to prescribe the form the bond must take and the minimum requirements. The Insolvency Practitioners' Regulations 2005 (IPR05), Schedule 2, requires the bond to be:

> *"2A (a) a bond in a form approved by the Secretary of State which complies with paragraph 3."*

Paragraph 3 sets out the minimum requirements of a bond:

> *"3(1) The bond must -*
>
> *(a) be in writing or in electronic form;*
> *(b) contain provision whereby a surety or cautioner undertakes to be jointly and severally liable for losses in relation to the insolvent caused by—*
> *(i) the fraud or dishonesty of the insolvency practitioner whether acting alone or in collusion with one or more persons; or*
> *(ii) the fraud or dishonesty of any person committed with the connivance of the insolvency practitioner; and*
> *otherwise conform to the requirements of this paragraph and paragraphs 4 to 8."*

30. An IP needs to take out a bond (sometimes called an Enabling Bond) with two types of cover: the Specific Penalty Sum (SPS) provides case specific cover and the General Penalty Sum (GPS) provides global case cover which comes into play to meet claims in instances where the SPS cover is insufficient or non-existent.

31. As summarised in the CfE, the IPR05 prescribes that the SPS

> '*cover provided per case shall be between £5,000 and £5,000,000 depending on the value of the assets under the insolvency practitioner's control.'*

Where they are

‘*collectively worth less than £5,000 then the SPS is £5,000.’*

In so far as GPS cover is concerned the legislation provides a set amount of £250,000 across all appointments. The IPR05 provides under Paragraph 3(3)

‘*that the total claims in respect of the acts of the insolvency practitioner under all bonds relating to him are to be limited to a maximum aggregate sum (which shall not be less than £25,000,000).’*

The officeholder

32. The duties and obligations of a successor officeholder remain the same as the original office holder with some additional ones attaching to the successor role. This includes realising assets and making payments to creditors. The range of assets that a successor deals with include simple asset realisations to more complex matters involving bringing proceedings in respect of wrongdoing by former directors or the former officeholder. The latter may involve making PII or bond claims but this is only a small part of the successor’s role.

33. There is an obligation on the successor officeholder to comply with required practice contained within SIP 2 concerning investigating the activities of the insolvent estate. Connected with this is the obligation under section 7A of the Company Directors Disqualification Act 1986 to report on the conduct of directors of insolvent companies.

34. The successor officeholder has statutory reporting obligations to creditors and other interested parties. There are also other reporting duties under the Insolvency Act 1986, such as to report criminal offences, the details of which are contained in the table below:

Table showing provisions in the Insolvency Act 1986 where there is a duty to report criminal offences

Section	Insolvency Procedure	Statutory reporting duty
7A	CVAs	if it appears to the nominee or supervisor that any past or present officer of the company has been guilty of any offence in connection with the moratorium or, as the case may be, voluntary arrangement for which he is criminally liable, the nominee or supervisor shall forthwith report the matter.
262B	IVAs	if it appears to the nominee or supervisor that the debtor has been guilty of any offence in connection with the arrangement for which he is criminally liable, he shall forthwith report the matter.

218(3)	Compulsory liquidations	if in the case of a winding up by the court in England or Wales it appears to the liquidator, not being the official receiver that any past or present officer of the company, or any member of it, has been guilty of an offence in relation to the company for which he is criminally liable, he shall forthwith report the matter to the official receiver
218(4)	Voluntary liquidations	if it appears to the liquidator in the course of a voluntary winding up that any past or present officer of the company, or any member of it, has been guilty of an offence in relation to the company for which he is criminally liable, he shall forthwith report the matter to either the Secretary of State (England and Wales) or the Lord Advocate (Scotland).
305(3)	Bankruptcy	it is the duty of the trustee to furnish to the official receiver such information, records and assistance as he may reasonably require for the purpose of carrying out his functions. Section 289(1) states the official receiver shall (if he thinks fit) investigate the conduct and affairs of each bankrupt, including conduct prior to the bankruptcy order and report to the court if he thinks fit.

35. A further statutory obligation is to report suspicions of money laundering or terrorist financing to the National Crime Agency ('NCA').

36. It should be apparent that the obligation to make a bond claim where there is fraud or dishonesty is just one of a plethora of other duties and responsibilities. However, it is this relatively small aspect which is the centre piece of the CfE and from the tenor of this document it seems to be wrongly perceived as the raison d'etre for appointing a successor.

37. Whilst there is a duty on the IP to get in assets this is tempered by the decision in Ex parte James ([1874] LR 9CH 609) where there is a need to act honourably and fairly in the administration of insolvent estates. Therefore an IP may decide not to invoke strict legal rights over assets if this is contrary to ethical and fairness principles. In each case the successor practitioner has to consider the merits of taking any action and whether a proper benefit will arise from it. In the case of a bond claim this is not an easy task, especially early on when the misconduct is not always obvious and the existence of the bond or its level of cover is not available.

38. Competing against this duty is the issue of how deeply to investigate other estates when misconduct has been found in another. The successor practitioner might be criticised and indeed sued if a former officeholder had misappropriated assets from one estate and the successor had not made any attempt to investigate the others for the same misconduct.

RPB duties

39. RPBs are required to have in place rules, regulations and byelaws to ensure their IPs are fit and proper people to carry out their duties and meet requirements as to education, practical training and experience. They have in particular to comply with the Memorandum of Understanding (MOU) which sets out the agreed principles between these Bodies and the Secretary of State for the Department for Business, Energy & Industrial Strategy (DBEIS) on how IPs should be authorised and regulated. Each RPB is monitored by the Secretary of State for adherence to these principles. One of the agreed principles contained within section 5 of the MOU concerns bonding. Below we quote extensively from this as later in our response it will become apparent that we have a number of concerns with RPBs (referred to as a 'Body' below) not always following the requirements of the MOU concerning bonding:

> 'SECURITY AND CAUTION
>
> *'Each Body will have in place appropriate mechanisms to ensure that its members comply with legislative requirements for security (in England and Wales) or caution (in Scotland), and* ***to ensure that potential claims arising from the fraud or dishonesty of an insolvency practitioner are identified and made****'.*
>
> More specifically, section 5 goes on to state:
>
> *'The purpose of this section is to ensure both that insolvency practitioners comply with the legislative requirements as regards security (in England and Wales) or caution (in Scotland) (the bonding requirements); and that mechanisms are in place* ***to ensure that potential claims under bonds are identified and made****.*
>
> *The Body* ***will monitor*** *the performance of its practitioners in relation to the bonding requirements of the Insolvency Act 1986, detailed criteria in respect of which are prescribed in the Insolvency Practitioners Regulations 2005.*
>
> *The Body* ***will have a system*** *to record the receipt of enabling bonds and renewals of such bonds. It will also* ***take all reasonable steps to identify instances of non-compliance*** *by practitioners in relation to cover schedule returns* ***and take appropriate action*** *where there is evidence of non-compliance with the prescribed requirements.*
>
> *Where the Body has reasonable grounds to believe that a claim may be made against the bond of one of its authorised practitioners* ***the Body will take such steps as are necessary to ensure that an investigation is carried out*** *and where appropriate will process or arrange for an authorised practitioner (or by agreement with the Secretary of State, another suitably qualified person) by assignment, to process any claim arising under a bond or bonds.'*

40. One of the principles of the MOU is a requirement for the monitoring of insolvency practitioners, the particulars of which are set out in a further document, the 'Principles for Monitoring Insolvency Practitioners'. It is worth setting out in full what this document says concerning how RPBs should monitor insolvency practitioners' compliance:

5A ‘The body will take reasonable steps in seeking to confirm satisfactory levels of compliance on the part of the practitioner with all relevant aspects of insolvency law and practice, and other legislation that may impact upon an individual whilst acting as an insolvency practitioner. Reference to insolvency law and practice includes but is not limited to Statements of Insolvency Practice; the Ethical Guide; prevailing statutory and common law; the body’s byelaws, rules and regulations, and continuing professional education requirements.’

41. The above therefore requires RPBs to ensure IPs comply with IPR05 on bonding. To help them fulfil their duty in ensuring IPs comply with this legislation they have been given powers to inspect bonding information maintained by IPs under Regulation 15 of IPR05:

’15(1) Any records maintained by an insolvency practitioner pursuant to this Part shall on the giving of reasonable notice be made available by him for inspection by –

(a)any professional body recognised under S391 of the Act of which he is a member and the rules of membership of which entitle him to act as an insolvency practitioner;-‘

42. Schedule 3 of the Regulations states what these records should contain. These include, the amount of the specific penalty sum; the name of the surety or cautioner; the date of submission to surety or cautioner of a cover schedule with any increase in the amount of the specific penalty sum; the amount of any revised specific penalty sum; and the date of submission to the surety or cautioner of details of termination of the office held by the insolvency practitioner.

Bonds

Reason for bonds

38. There are three purposes:

To increase public confidence in insolvency officeholders and the insolvency practitioner profession

39. While IPs are regulated professionals there will always be a small number of cases where they act fraudulently or dishonestly. In such circumstances, the public need to have confidence that there are safeguards in place. One type of protection is in the form of a bond to assist in compensating losses arising from this behaviour. The UK is ranked as one of the best insolvency regimes in the world according to the World Bank and by investigating fraud and dishonesty and providing a way of compensating those who have lost out as a result instills even greater confidence in the insolvency sector.

40. The existence of the bond is one of many measures that sets the licensed practitioners aside from the unlicensed, unregulated and uninsured advisors that are regularly investigated and shut down by DBEIS.

To provide financial protection to creditors and others in the event that insolvency practitioners commit or connive in fraud or dishonesty

41. A.R. Keay in '*McPherson's Law of Company Liquidation*' described the purpose in the following way:

> *"to ensure that there is compensation available for any person who has suffered pecuniary loss, especially creditors, due to the failure of the [IP] to carry out his or her duties adequately and properly."*

To encourage IPs faithfully to discharge their duties as officeholders of insolvency estates

42. Dr John Tribe and Stephen Hunt in their published paper entitled, '*Insolvency bonds: history, policy and substance*' expressed the purpose of a bond as

> *'…encouraging a faithful devotion to the IP's duties, obligations and truth'*

The bonding market

43. A bond is not meant to be an insurance policy. Insurance is a form of risk management in the form of a two-party contract between the insured and the insurance company. This contract (insurance policy) assumes a guaranteed promise that the insured will be compensated by the insurance company in the case of a covered loss. The premium paid is designed to cover the potential losses. Losses are expected and insurance rates are adjusted to cover losses depending on many factors. When a claim is paid the insurance company usually does not expect to be repaid by the insured.

44. A Surety bond is a contract among at least 3 parties. It is issued by one party (the surety) on behalf of a second party (the principal). This contract guarantees that the second party will complete an obligation to a third party (obligee). If the obligation is not met, the third party can recover its losses from that bond. The premium paid is for the guarantee the principal fulfils his obligation. Losses are not expected so surety bonds are issued only to qualified individuals or businesses whose projects require a guarantee. A surety bond is a form of credit, so the principal is responsible to pay any claims.

45. The purpose of Bonds is helpfully summarised in this passage by Surety Bond Insider[1]:-

> "*Their main purpose is to prevent illegal and otherwise unethical business practices. Governments establish surety bond requirements to keep unqualified individuals from gaining access to a position through which they might take advantage of consumers. As a neutral third party, the surety that issues the bond thoroughly reviews every applicant's credentials before issuing a bond. Those who fail to meet the qualifications cannot get a bond, and thus won't be allowed to work in the industry. In this way surety bonds function as risk mitigation tools that reinforce industry regulations.*
>
> *Each surety bond executed provides a financial guarantee that a principal will follow industry regulations and avoid certain business practices. For this reason license and permit bonds are some of the most prevalent in the surety market. Surety bonds are even used to regulate insurance professionals themselves. For example, insurance broker bonds protect consumers from brokers who coerce clients into purchasing unnecessary or inappropriate insurance products."*

46. This explanation is very useful in the context of this exercise. When claims are being made on bonds then it appears that this is prima facie evidence of a failure of regulation. The sureties might expect the odd claim but their fundamental purpose seems to be to price the quality of the professionals that they are regulating. Where premiums are rising it will be evidence that the market does not think that the profession is as ethical as it should be. This explanation also suggests that the proper role of the surety is to refuse bonds and to therefore remove professionals from the market where it deems the risk of that particular individual is too great. We have to say that our impression is that the insolvency bond insurers have not always acted like that. Their agents have professed to us a great deal of reluctance to step on the toes of the RPBs. It would seem that the consequence of this policy is to have more claims.

47. The insolvency market is relatively small with around 300 firms and just over 1,300 appointment takers. This is not a huge pool from which to draw premiums yet there are many bond providers. This makes no sense. Under the combined Questions 8 and 9 we propose how we could have one provider.

48. It has long been a mystery to us why the concept of competition in bonding has been given the priority it has for the reasons set out later. It seems to us that there should be a public tender to procure the contract to insure the entire profession in this area so that the successful bidder has a sufficient client base from which to draw premiums.

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[1] https://www.suretybonds.com/blog/surety-bonds-and-insurance-whats-the-difference/

49. There are further problems caused by the nature of the product itself. A claim against a bond is not protection for the dishonest IP or their partners so the surety pays out and then pursues them for recovery. Therefore in practical terms there is almost no value in an IP from a large firm bonding at all and in a sole practitioner firm there are often no assets for the surety to turn to for recovery. This means that for insolvency practitioners from large firms there is essentially no service provided by the surety for the bonding they sell. The bond providers to these insolvency practitioners can expect to make considerable profits with the remote possibility of a claim which if made, can be easily recovered from another source. For sole practitioners the risk is so different that they are purchasing a different product. It is at this lower end where all the main claims have been made and unrecovered losses incurred by the bond providers. We have a lot of sympathy for the bond providers operating at this end of the market, as well as the honest sole practitioners who have to procure their bonds.

50. In 1995 this problem was recognised and the then president of R3 (then SPI) Colin Bird set up Farringdon Insurance Company Limited to provide a new bond which declared that it would protect the interests of the insolvency profession by providing low cost bond cover and reinvest its profits back into the profession by way of training vouchers for R3 courses. Writing in 2001 Colin Bird said[2]:-

> *"…by 1995 new sole practitioners were largely unable to get cover, without which they could not practice. In addition insurers were advising that they intended to withdraw from the market, so there was a serious risk of insolvency practitioners not being able to get the cover they needed."*

and

> *"In 1995 SPI and the DTI agreed a policy statement including the objectives of the arrangements to guide future generations about what was expected from the trust. It was hoped that premiums would level off and over time reduce as Farringdon created competition in the market. This is exactly what happened."*

51. This was a laudable aim although ultimately doomed to failure (Farringdon has now closed and ceased issuing grants to the profession some years before that) as it flew in the face of the reasons why premiums were higher for small firms and sole practitioners. There was also a concern as to the bona fides of charging premiums to creditors against the dishonesty of practitioners and the profits of this enterprise being used to subsidise the training costs of insolvency practitioners. It does not require that much training to avoid being dishonest!

The level of premiums

52. Many outside the profession will be surprised to learn how much the premiums are for IPs to insure against their own dishonesty. Where solicitors and their firms pay many thousands into their own scheme the premiums paid by IPs are much smaller. Griffins for example pay just £100 a year for the combined bonds of all its appointment-takers. The other premiums are expenses of insolvency appointments that we do not personally bear unless there no funds in the estates. Despite this very

[2] http://www.insolvency-practitioners.org.uk/download/documents/782

low and presumably typical sum, the suggestion of increasing premiums paid by IPs has been raised in the past and strongly resisted. The strength of this lobbying has been seen in recent years as claims against bonds have risen. The market first reacted by reducing and limiting cover rather than increasing premiums and it was only when the Insolvency Service became alert to this tactic, that the bond wording was strengthened and premiums rose.

What causes a bond claim?

53. The starting point for a discussion about the bonding of insolvency practitioners is to understand the underlying behaviour that it tries to underwrite. Existing legislation requires cover for the dishonesty of the insolvency practitioner or the collusion of the insolvency practitioner in the dishonesty of others. This second aspect is often forgotten and is a common part of a claim. The 'others' could be directors who act improperly and the insolvency practitioner conspires in that misconduct by agreeing not to make claims or destroy evidence relating to it. Equally it could be the dishonesty or negligence of an employee of the insolvency practitioner that the insolvency practitioner then conceals. A huge part of what we see is classic burial jobs; the IP conspiring to shut the company and avoid claims in exchange for a Statement of Affairs' (SOAs') fee.

54. The meaning of dishonesty also needs to be clarified, particularly where the nature of the misconduct may have significant consequences for which a policy may be required to make payment. Whilst dishonesty obviously includes theft and fraud, it also includes acting with a lack of integrity, turning a blind eye to the obvious and many other shades of wrongdoing. It is important not to be too prescriptive but equally it must be the aim of the regime to ensure that every act falls to either a bond or PII to cover. There may be an overlap but there cannot be a gap.

55. The list below illustrates some types of conduct this firm investigates:

- Taking cash payments without accounting for them into the estate
- Receiving cheque payments into the client account and then failing to account to the estate and/or the Insolvency Service Account (ISA)
- Forging time records
- Charging fees to cases where there is no entitlement to withdraw fees
- Paying introducer fees for the introduction of cases
- Bribing company officers by offering overly generous terms in respect of expected litigation proceeds
- Failing to pursue claims against company officers i.e. Directors' Loan Accounts (DLAs)
- Turning a blind eye to theft of assets by directors

56. It will be clear that some of the above conduct can be considered fraud or dishonesty whereas other behaviour may not be clear cut. It is the role of the successor insolvency practitioner to grapple with and analyse the conduct and culpability of the former officeholder in such circumstances and determine whether there is fraud or dishonesty, negligence or a level of incompetence which falls below these classifications.

57. Dishonesty is not unique to this profession and it is also nothing new. In Sir Kenneth Cork's autobiography 'Cork on Cork' published in 1988 he recalls what conduct was around in the late 1940s.

> *"Their method was that all the insolvency practitioners would meet before a meeting of creditors, state the amount of creditors each person was representing, and then the one with the most would go for the job, and later share out his fees with all the other people who had voted for him. This of course was illegal, as was touting for business…"*
>
> *"Cork Gully were threatened that, unless we were prepared to participate in an arrangement of this kind, those who were would combine against us and make sure we got no more work.*
>
> *We had no sense of holier-than-thou self-righteousness in refusing to share remuneration of a liquidator with others, or indulging in what was tantamount to bribery of the other representatives to elect one of them as liquidator. It was simply illegal."*

58. In the 1990s such stories of what went on before licencing in 1986 were viewed as the bad old days. Yet in 2000 two MPs and three academics produced the infamous '*Insolvent Abuse: Regulating the Insolvency Profession*[3]', a document that took an aggressively partisan swipe at the entire profession. Whatever the validity of much of this report, the document does have some value in recording the complaints of constituents in the 1990s and their allegations of dishonesty by insolvency practitioners. We also had the imprisonment of several insolvency practitioners through the decade to show that the issue persisted.

<u>Why have bond claims increased in recent years?</u>

59. In 2003 this firm made its first claim on a bond following the failure of Casson Beckman & Partners ("Cassons") in late 2002. Those claims broke all records after wave after wave of fraud by a number of partners and staff of the firm was found. There were also significant pay-outs for negligence. Several partners were bankrupted and one fled the jurisdiction. Former partners had left the firm and continued their practices in those firms, ultimately causing their demise too. The claims included widespread time sheet fraud, evidenced by among other things an excel spreadsheet called a *randomised time sheet*. The member of staff typed in the amount of fee required and the formulas in the spreadsheet assisted in creating random amounts of fake time to be billed to the cases up to that amount.

60. Cassons also held training courses which taught its staff activities that were specifically prohibited by regulators. At a conference a few weeks after its senior partner had lost his licence because in part, for paying illegal introduction commissions, they played a role-play game. The staff were divided into six groups and were asked to develop a sales and marketing budget for an office other than their own. Staff were provided with a table that included various costs of sales and marketing. Of particular interest to us is that the budget also allowed for *"introduction*

[3] Insolvent Abuse: Regulating the Insolvency Profession

commission (limit of 100 times, av.fee £3,000)". The conference was attended by almost all the partners and staff of the firm as well as several lawyers and other associates. The behaviour was as open as Sir Kenneth Cork found it in the late 1940s.

61. Cassons even recharged to estates the costs of its partners losing their licences. After the transfer of Mr Nisbet's appointments to other partners in the firm, they instigated a special billing process to recharge all of their time costs as well as that of their lawyers for the legal action around the transfer, to the estates as an expense charge. They sought £130,000 across many estates, making a profit from the loss of their senior partner's licence. When they received a JIMU inspection they engaged external compliance advisors to deal with the regulatory problems arising. Following the visit they recharged the costs of these advisors to each estate inspected by way of a flat fee.

62. Taking our experiences as a whole, the two most common areas of misconduct are likely to be related to remuneration and the classic 'burial job'. We will address the question of the grey area between negligence, error and dishonesty in the next part of these submissions as these situations frequently occur in all of these.

63. Dishonestly taken remuneration is found generally where there is evidence that the time records have been fabricated or that the time recorded cannot have been honestly incurred. In the Cassons cases there was more than evidence of fake time recording. The time that was recorded often had no purpose and there was the strong suspicion that the time recorded was intended to reflect the sort of level of work that the creditors would have expected to see, not what was actually undertaken. In other portfolios we have successfully proven claims for dishonesty relating to overcharging for quite simple work.

64. Overcharging can often be subjective and sometimes this is the issue between the claimant and the bond's loss adjuster. Overcharging can also be the result of lax or bad practices in a firm where crossing the line may not have been spotted by those who had done it. One well-known IP once accosted one of the partners at Griffins and objected to some of his comments about over-charging in the profession. He blurted out "*Are you saying that if I do 30 minutes work but record an hour, that's wrong?*"

65. As for 'burial jobs', we see IP firms whose model is to get in new work and collect up-front fees. The resources devoted to them doing the work are much smaller and their compliance with post-appointment duties seems perfunctory at best. In these firms we see evidence that the insolvency practitioner is turning a blind eye to antecedent transactions that are very obvious. There is little effort to obtain records and even declared assets such as intercompany loans or DLAs are settled cheaply. In such cases our strategy is primarily to see whether such claims can still be pursued or transactions reversed before considering whether a claim may be made against the former insolvency practitioner. Even then, further work is required to conclude whether the misconduct arises from negligence or dishonesty by the former officeholder. Often in such cases the work of the RPB in discovering such conduct and bringing it to the attention of the former insolvency practitioner can be very helpful. If the insolvency practitioner is aware of the problem and continues the misconduct then it is easier to characterise it as dishonesty.

66. We understand that the Cassons claims and the subsequent failure of some of their associates caused a dramatic change in the fortunes of the bond providers. Those insuring the smaller firms received many claims and with the coinciding failure of the firms and bankruptcy of the dishonest insolvency practitioners they incurred heavy losses. Our understanding is that in the late 2000s this caused the bond providers to attempt to limit the wording of bonds, specifically withdrawing cover that had previously been used as the basis of successful claims arising out of Cassons. It is very important to understand that the dishonesty remained; it was just the bond providers changed the wording so as to not pay out in every proven case, mainly by changing the time limits within which a claim could be made.

67. It was partly as a result of these changes in wording that the inadvertent breach of the regulations occurred and many bonds became non-compliant with the legislation. More specifically, the time periods became so limited that the time to make a claim often expired whilst the insolvency practitioner was still in office. This clause was so effective in repelling claims it meant that no claims could be made, thus breaching the requirement for there to be cover in place and consequently rendering the insolvency practitioner to automatically cease to be in office by virtue of section 390(3)(a).

68. Griffins were appointed as successor practitioners of five separate IPs in 2009 and that remains our busiest year. Four of those portfolios led to at least one bond claim, one of which was a small portfolio of cases following the death of an insolvency practitioner with no regulatory problems. On appointment we discovered wholesale theft from estates and every form of misconduct. This reaffirmed our view that each insolvency requires at least some sort of review regardless of the circumstances of appointment but especially so where there is initial evidence of misconduct. Once misconduct is found in one or a few cases the successor practitioner is likely to be negligent if they do not search for similar misconduct in similar cases.

69. Our firm developed a specialist unit from an existing litigation team just to deal with the unique and special circumstances that exist in the instance of a malfeasant insolvency practitioner. Like wrongful trading, these issues are better handled by staff who have handled them before and who can identify potential claims quickly and, more importantly where there is no funding, cheaply. Certainly in our experience we are much better at identifying potential claims (including bond claims, PII and antecedent claims not pursued) and making them than we were 15 years ago. The speed with which we can make a claim and the loss adjuster can consider them has also improved, especially in the last year or so.

70. There are still many issues that we will address in detail below, but it is a system that through custom and practice has solved or learned to cope with the inherent difficulties in the system. We believe that this puts us in a unique position in making recommendations for change.

71. From the standpoint of 2016, thirty years on from the licencing of insolvency practitioners, it is clear that the profession is much improved and the misconduct that a bond is required to cover is probably rarer than it has ever been. At the same time, the existence of this firm's specialism and the experience of the various RPBs mean that the chance of it being discovered is also much greater. It is hoped that these two trends continue and are enhanced by a reform of the bonds so that the reputation of the profession can continue to improve.

72. Twenty or thirty years ago the issue of dishonest IPs was discussed within the profession on the basis of hints and comments about the practices of certain IPs. It was rumour and innuendo that tagged certain insolvency practitioners, with the occasional scandal and perhaps arrest. In 2016 we think the issue has changed as the efforts to improve transparency have made it harder for outrageous and simple theft to take place. In our experience such dishonesty now has to be accompanied by a degree of false accounting to conceal it. The effect of this is to make discovery of a fraud a little harder but the degree of certainty over the nature of the misconduct is improved. See for example the case of Bridge Business Recovery and James Bradney.

73. When IPs persistently and repeatedly breach the fundamental requirements of their licence and do so always to their own advantage then perhaps the line might be more blurred. In our appendix we exhibit a document recently issued by a bond provider, Marsh. This document seeks to suggest that dishonesty can be committed accidentally and the insolvency practitioner can take steps to avoid such situations with improved documentation. This is a good example of the lack of understanding of the bond claims process even by the bond providers themselves. Whilst many claims often contain references to monies being taken from estates without proper evidence such as remuneration; the lack of documentation itself is not necessarily proof of dishonesty, although many bonds pay out on that basis on a negotiated basis. In practice the dishonesty comes from other key documents such as a review by an RPB which highlights the misconduct by the insolvency practitioner who then fails to remedy the position by obtaining authority or refunding the money. The evidence of dishonesty lies in a wider search of the underlying practices of the insolvency practitioner.

74. In summary, the emergence of specialism in investigating and making bond claims has made it more likely to uncover fraud and make successful claims. The results of these claims have been fed back to RPBs and alongside other improvements in regulation this has led to further discoveries of misconduct. Without any evidence to support it we feel that the level of claims will stay the same or gently drift down as regulation continues to improve and investigation of claims also evolves and streamlines.

<u>Successor practitioner does not equal bond claim</u>

75. From the perspective of the bond providers, regulatory successor practitioner appointments mean an assault on the bonds but this is not the case. Nor it is a money making exercise as the statistics will show. Taking on a portfolio blind is a significant risk in resources as the successor practitioner will have to deal with regulatory issues but there may be no assets and it might be too late to pursue antecedent claims or assets not pursued by the former officeholder.

76. The task of a successor practitioner appointed in such circumstances is much wider than making bond claims. Our firm uses a 22 page checklist specifically relating to the task of a successor and only half a page relates to bond claims. In the main the focus is on capturing the records of the insolvent and the former officeholder as quickly as possible.

77. Often when an insolvency practitioner loses their licence there is a long period of regulatory activity and during the period the outgoing insolvency practitioner loses the interest or motivation or funding to maintain the compliance requirements on their appointments. The successor IP is required to undertake an urgent exercise to identify time-critical assets and act to secure the books and records of the IP and the estates. After this urgent period the same themes appear. Often the records of the former officeholder are in disarray and require some reconstruction. The records of the insolvent estates are usually held at off-site storage centres where the former officeholder may not have paid the bill. Without a proper schedule of records it can be a laborious and expensive task for the successor practitioner to secure these records. It is these tasks that occupy the successor practitioner at first and it is only through a thorough and urgent review do other issues such as bond claims arise. These bond claims are also found within negligent or similar conduct and indeed, negligence is much more common among Insolvency practitioners than dishonesty.

78. The successor practitioner must protect the estates from any further damage and that includes making protective claims against a variety of policies whilst further investigations continue.

79. Within our reply we set out some statistics that we have gathered regarding the last 13 portfolios to which we have been appointed. It is notable that there are several instances where our investigations and those of our joint appointees have uncovered no bond claims at all. This is most surprising in the case of one former insolvency practitioner who has recently been sentenced to prison for fraud. Our view is that it is a common misconception that a loss of licence automatically leads to a bond claim. That is not our experience.

80. In conclusion, it must be remembered that the ultimate cause of bond claims is evidence of dishonesty involving the insolvency practitioner. If that did not exist then the bond providers would not pay out the loss or the associated costs. This point often seems to be lost when there is a debate about bonding.

PI insurance, negligence and mixed claims

81. The existing regime has been tested in a recent and quite well-publicised case of Papanicola. Mr Papanicola was appointed Administrator and CVA Supervisor of a trading restaurant in 2000 and the company went into liquidation in 2005. The restaurant had been trading insolvently throughout the period of Administration and it appears that the Administrator had been negligent in failing to control the trade.

82. Griffins were appointed Liquidators with the remit of investigating the conduct of Mr Papanicola and the directors of the company. Claims were issued and in 2011 Mr Papanicola agreed to a Tomlin Order in the sum of £1.9m. The claim was a hybrid, seeking compensation for the negligent trading but it also contained evidence of an attempt to conceal these losses in a variety of ways. Mr Papanicola sought the protection of his PII policy but cover was denied on the basis that he had deliberately concealed the claim from his insurers at the time. That left the bond claim for losses arising from the subsequent dishonesty. However, the level of specific bond was only £250,000 and this claim was denied on the basis that Mr Papanicola had received his discharge some years earlier and accordingly the claim was out of time. As a direct result of having his PII cover refused Mr Papanicola petitioned for his own bankruptcy in 2012.

83. The story of a failure by an IP to make a proper claim against their PII is a very common one present in almost every case we have investigated. In the majority of portfolios to which we have been appointed PII cover has lapsed or been denied. In several cases this has led to the bankruptcy of the former officeholder where that need not have been the case. In our view this is a major factor when considering the issue of bonding.

84. The risk of loss of PII cover in a small firm makes a huge difference to the risk faced by the bond provider and therefore the premium they will charge. If the former officeholder is a member of an insolvency firm with partners then there is the prospect that their PII policy covers dishonesty by a partner and which can be used to compensate the bond. If the bond provider could be sure of obtaining recovery in such a way then the issues surrounding premiums and costs would largely fall away. We take the view, and have communicated this strongly to all the RPBs, that work needs to be done to train insolvency practitioners in how to preserve their PII. Unlike bonds the PII policy protects the interests of the insolvency practitioner. Often a proper report to a PII is the only thing stopping a negligent insolvency practitioner becoming an ex-insolvency practitioner. We feel that if insolvency practitioners were trained and monitored over their compliance with their own PII then that would dramatically improve the state of the profession.

85. We also feel that the bond surety ought to take a proactive role in ensuring that there is proper PII in place when they renew the bond. It is after all one of the major factors in whether they will ultimately suffer a loss. Given that the policy currently provides for claims to be made within 2 years of release or discharge then we would expect sureties to make it a condition of cover for insolvency practitioners to maintain PII with at least this run off period so that they can make their own protective claims to improve their position. This would reduce the amount of bond premiums that they pay and help RPBs push insolvency practitioners into better PII compliance.

86. It is more important than ever that insolvency practitioners are fully aware of their responsibilities under PII following the coming into force of the Insurance Act 2015 on 12 August 2016. This legislation not only changes the duty of disclosure on insolvency practitioners to their PII insurer but alters the remedies available where there is a failure to do so. Under the Act there is now a duty to make fair presentation of the risks to the insurers which replaced the obligation to disclose material facts. Ed Brittain of JLT explained the impact of these changes on insolvency practitioners in the October 2016 edition of Demario:

> *'You must disclose every material circumstance which is known or ought to be known to you or, failing that, you must give the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances.'*

87. It therefore is incumbent upon an insolvency practitioner (and the RPB where it has become aware) to notify the PII insurer of such material circumstances. While the insurer is not now automatically able to terminate the policy where material circumstances were not disclosed, it can still do so if they would have not entered into the contract if they had received a fair presentation of the risk.

88. Within such a culture there would be more transparency of conduct between the insolvency practitioner, RPB and insurer. No doubt dishonesty would find it harder to exist in such a system and when it was found the step from a PII report to a protective bond report would be a smaller one. After all, the purpose of this review must be to prevent misbehaviour as far as we are able.

89. We now propose to address the 10 questions set out in the CfE in more detail:-

Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

90. The CfE considered 12 potential areas of weakness with the current bonding arrangements which are to do with the legal framework and some practical issues. We agree with a large number of these weaknesses and consider each one in turn. We do however disagree that there is a weakness which requires the proceeds of a bond claim to be ring fenced and it is questionable that there is a lack of provision/control over successor insolvency practitioner fees.

<u>Prescribed bond requirements are unclear and costly</u>

91. This is a view that we also share. The terms of a current bond differs from previous versions issued by a surety and from one surety to another. It is considered fair to say that the terms of a bond are like a secret document as they are not publically available. When it is possible to obtain a copy of the appropriate bond, the early versions in particular are impenetrable and interpreting them is very difficult. One example concerns an issue on David Nisbet's cases from Cassons, where neither the surety nor his RPB had a copy of the relevant bond.

92. There are connected issues such as the surety appears to apply an overly restrictive interpretation of the bond and that we are not convinced they fully understand their own documents. These issues are considered under the heading 'Consent and agreement of the surety to incur costs' when addressing Question 2. We have proposed a solution to overcome the weakness identified which is to have a tender process where one bond provider is chosen for the whole insolvency market with the terms of the bond being an important element in choosing the right provider. [See the combined response under Questions 8 and 9 where this proposal is considered].

<u>Statutory cover limits are inadequate and inconsistent</u>

93. We agree that statutory cover limits are inadequate and inconsistent. We have set out some suggested increases to monetary limits under Question 7. What is considered under the present heading is what can be achieved within the existing monetary limits to ensure that SPS cover is better able to meet the losses and costs from fraud or dishonesty.

94. The majority of IPs are complying with the bonding requirements for SPS but are still almost inevitably underbonded. This problem lies not in the way the Regulations are drafted but in how they are applied.

95. The specific provisions on bonding requirements are contained in The Insolvency Practitioner Regulations 2005 ('IPR05'). Schedule 2, Paragraph 4 of IPR05, sets out the amount of SPS cover required:

> *'…the amount of the specific penalty….shall equal* ***<u>at least</u>*** *the value of the insolvent's assets….' (our emphasis)*

96. Part 2, Regulation 8, of IPR05 assists in providing a basis for estimating the insolvent's assets requiring SPS cover. This includes using:

> '*any statement of affairs produced in relation to that insolvent pursuant to any provision of the Act…'*

97. In practice IPs comply with IPR05 in a narrow way by calculating cover based on asset values without standing back and thinking how much cover is needed should there be fraud. This is not surprising as they are not asked to yet this is the entire purpose of the bond. A standard bond covers the assets stolen plus interest and costs which is obviously going to require a level of cover higher than the value of the assets.

98. To illustrate the problem caused by only taking account of asset values in bond cover take for instance an estate with £50,000 in assets. The IP bonds for £50,000 which accords with the legislative requirements for cover, and which are then stolen by that IP. The successor IP is appointed, investigates and makes a claim for the £50,000 assets stolen plus interest and costs. It can be seen straight away that there is no money set aside under the bond to pay the interest and costs. The problem becomes more pronounced if the evidence of dishonesty is disputed, the matter litigates, or even that there is a delay where other costs might be triggered under the Bond. Therefore aside from increasing the cover ceiling of the SPS bond (which we will turn to shortly) there needs to be recognition that cover should be calculated to include an extra sum to take account of the last two elements of a potential claim which are provided for by statute. What happens in practice is that the shortfall gets met from the GPS cover.

99. To highlight the problem further consider frauds arising where the provisions for bonding small estates at £5,000 is in place. There would inevitably be insufficient funds to cover an investigation into the fraud, the accumulated interest, as well as claiming for the loss of the asset(s) misappropriated. The chances of the claim leading to a dividend to creditors would also be remote.

100. To cover the interest and costs of a bond claim does not require the Regulations to be amended. We therefore propose that the Secretary of State creates guidelines on interpreting IPR05 Schedule 2, Paragraph 4 so as ensure all elements of a claim are covered. This change alone would greatly affect the concerns of the CfE regarding the returns to creditors from successful bond claims and increase dividends at a stroke.

101. These guidelines would need to propose a method to calculate cover so that it would meet any claim for loss of assets plus interest and investigation costs. A consequence of doing so would be that cover would finally meet the requirement under paragraph 3 of Schedule 2 of the Regulations which states that the bond should be sufficient to meet *"...the losses in relation to the insolvent caused by...the fraud or dishonesty of the Insolvency practitioner..."*

102. If the bond covers losses arising from dishonesty it seems conceptually wrong to not cover things that pass through the hands of the insolvency practitioners that can easily be stolen or the basis of loss to the estate. Secured assets can and have been stolen or diverted and similarly a chose in action can be settled dishonestly cheaply or buried.

103. We refer in more detail to the last named asset, a chose in action. Where reliance is made on the assets as at the date of the Statement of Affairs, little if any regard is ever taken of the subsequent change to the asset position where legal action is commenced which is likely to result in a settlement into the estate. Such legal action would typically include wrongful trading actions, transactions at undervalue and preferences.

104. The need to include choses in action in bond cover is even more important following the coming into force on 1 October 2015 of Sections 117-119 of the Small Business, Enterprise and Employment Act 2015 which extends to insolvent administrations the power for an officeholder to bring fraudulent or wrongful trading actions; previously such powers were available only in insolvent liquidations. These claims are now capable of sale or assignment and will become more tangible.

105. The obstacle to bonding for the full value of a chose in action is the cost to the insolvency practitioner of funding the bond premium. We would ask the market whether it is possible to extend the existing market of self-insured premiums in ATE to cover bond SPS premiums on unrealised assets. If it were possible to bond for the full potential asset value but purchase a product that funded the deferment of premiums until any realisation then that would increase business for insurers and remove an excuse by IPs for non-compliance. If the asset is not ultimately realised then the product itself would meet the bond premium. We would imagine that the product could extend to most other premiums taken out by the IP that require funding to ease the cash flow pressure, particularly of small IPs.

<u>Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover.</u>

106. This is of course correct and so what is required is proper policing of what bonds are in place and the adequacy of cover. It falls on the RPB to carry out this role. It is shown under the heading, 'Failure of RPBs and the Secretary of State to comply with MOU and Insolvency Regulations' that there have been some shortcomings in this regard and there certainly needs to be a tightening of procedures to capture instances of no or inadequate bonding.

107. What should help RPBs to fulfil this responsibility is for them to be alert to the types of situation which can often lead to failures in properly bonding. These include where restrictions are placed on an insolvency practitioner's licence and similarly where they are about to lose their authorisation.

<u>Ring-fencing bond for creditors</u>

108. In insolvency legislation the administrator, liquidator and trustee is under a duty to distribute funds (such as those arising from bond claims) in accordance with a statutory order of priority which broadly speaking, requires that the expenses of the insolvency are paid before the creditors.

109. The CfE appears to suggest that the proceeds of a bond claim are special assets which ought to be subject to a different regime from all other assets. This is misconceived. Bond receipts are, by definition, replacing the assets of the estate which have been lost through dishonesty. The intention of them is to put the estate back in the position that it was before the assets were lost. If that is the case then they must be returned to the estate so that they can be then applied as they ought to properly have been if the dishonesty had not taken place.

110. Consider this simple example to demonstrate the problem with ring-fencing. There is a small insolvency with £10,000 of assets and the IP is properly required to do £10,000 work, leaving no dividend. If instead of doing that work the insolvency practitioner steals the money and loses his licence, a bond claim for £10,000 will be made. When those funds are received the successor practitioner is still required to undertake the £10,000 of proper work that was initially required. If the proceeds were ring-fenced then there would be no assets to meet the costs of the work required and the creditors would receive a windfall without any justification.

111. The priority for payment of costs and expenses are set out in the Insolvency Rules 1986 for company liquidations (Rule 4.218(3)) and bankruptcy (Rule 6.224(1)). The primary expenses or costs which must be paid are those which are chargeable and incurred by the liquidator or trustee and which include:

- Getting in assets, including preserving, realising and pursuing or defending legal proceedings relating to assets.
- Paying the costs of the petitioner whose costs are allowed by the court.
- Any other expenses properly chargeable by the liquidator or trustee in carrying out his/her functions.

112. By diverting the proceeds of a bond claim away from the normal statutory priorities we foresee many hazards and litigation arising. They are such that we cannot take this suggestion seriously. It would be absurd to create a stand-alone statutory costs system for a couple of portfolios a year.

113. We are currently in correspondence with the Insolvency Service Technical Section (ISTS) over the correct treatment of bond claim receipts as to whether they are chargeable receipts for the purposes of calculating the SOS administration fee. The ISTS takes the view that all sums arise from misfeasance claims and are therefore chargeable. The counterview is that the primary losses often reimburse the estate for assets already realised and upon which fees had already been charged. The additional fees reduce the potential dividend to creditors. As for the bond receipts relating to the reimbursement of costs of the successor practitioner, the application of SOS fees to this payment by a surety further complicates the costs calculation and increases the claim. Should the bond provide for payment of the additional SOS fees on top of costs so as to put the estate back into the same net position or should the creditors bear that cost (or the successor IP where there is a shortfall of cover or assets)?

114. The suggested proposal to ring-fence is also covered under Question 7 which raises the same suggestion.

<u>Lack of provision/control over successor insolvency practitioner fees</u>

115. It is unlikely that there is lack of provision or control over successor IP fees. Following the coming into force of the amendments to the Insolvency Rules in 2010, there is now a specific provision in bankruptcy (Rule 6.142B), liquidations (Rule 4.131B), and administrations (Rule 2.109B) which deals with the remuneration of a successor insolvency practitioner office holder. This provision provides that any 'determination, resolution or court order' obtained by the outgoing office holder with respect to fees continues to apply to their successor until a further decision is reached by one of the methods just quoted.

116. The remuneration regime (and SIP 9) therefore equally applies to successor practitioners as the original office holders. Successor IPs are not therefore operating outside the fee approval mechanisms already in place and, as highlighted, explicit provisions providing for this were incorporated into insolvency secondary legislation.

117. It perhaps is worth referring to how remuneration in bankruptcies, liquidations and administrations is determined as this emphasises that it is primarily the creditors who control the method of how fees are paid – not successor insolvency practitioners.

118. There are three methods for fixing the remuneration in bankruptcies, liquidations and administrations:

- Hourly rate and time charged (time-cost)
- Fixed fee
- Percentage of realisations

119. These can be used in combination with a different fee basis for different work streams. In bankruptcy and liquidation fees are fixed by a creditor committee and where not in place, by a creditor meeting and ultimately the court where such a meeting is not quorate.

120. There are similar provisions in administration but where it significantly differs is that if no distribution to unsecured creditors is expected, fees are fixed by all secured creditors and 50 per cent of preferential creditors in cases where there is a distribution to them. If the company moves to a Creditors' Voluntary Liquidation (CVL) with a new IP being appointed as liquidator, the remuneration is fixed afresh.

121. The question is therefore what evidence is there that there is something special about a successor practitioner that requires additional safeguards? We cannot think of any.

122. We have reviewed our portfolios and have identified 338 estates where we have held meetings of creditors to fix our remuneration. These cases will be where realisation had occurred from both bond and non-bond sources. Where there is any doubt as to whether remuneration was fixed by the previous office holder, mainly as a result of a failure to record whether this has taken place or a lack of records, it is our policy to convene a second meeting so that our remuneration will be fixed.

123. We also sometimes seek specific resolutions relating to the sharing of pooled costs across portfolios and the reporting, calculation and wording of these resolutions have been arrived at through working with the ICAEW.

124. More recent changes that came into effect on 1 October 2015 by way of the Insolvency (Amendment) Rules 2015 have strengthened the fee regime. These Rules require IPs in administrations, creditor's voluntary liquidations, compulsory liquidations and bankruptcy to provide creditors with an upfront estimate of their fees and expenses when charging on a time and rate basis. The aim is to increase transparency for creditors and give them an early indication of the costs of an insolvency case. Therefore where a successor practitioner seeks, for example, to increase the estimated cost of an insolvency case, this cannot be done without creditor approval.

125. Regardless of the basis of remuneration, there is an additional requirement whereby office holders have to provide an indication of the likely work that will be needed and the anticipated expenses in a case. While this is primarily for information purposes as it does not require creditor approval, it still acts as a restraining influence to ensure appropriate fees are charged.

126. Ultimately of course where creditors consider that remuneration or other expenses are excessive they continue to have the right to go to court.

<u>Alleged difficulty in engaging creditors on fee matters</u>

127. It is suggested that the age of cases at the time a successor IP is likely to be appointed is a factor in creditor engagement. This is a fallacy and we cannot understand the evidence for this assertion. It is a rare case where a loss of licence occurs where an IP has not taken new appointments for many years and so their cases might be thought of as stale or dormant. Often many of our issues are on relatively new cases where assets are still to be recovered.

128. In our experience if creditor engagement has waned in a long-standing insolvency, the appointment of a successor practitioner re-ignites their interest as it affords them an opportunity to engage the new officeholder with any concerns about the insolvency, the former insolvency practitioner, asset or dividend related matters, and of course fees. We find regular examples of the commonplace (and misplaced) view of creditors that an IP appointed by the debtor or directors is biased and they see their replacement as a positive step. Some of our best sources of evidence come from a newly-enthused creditor.

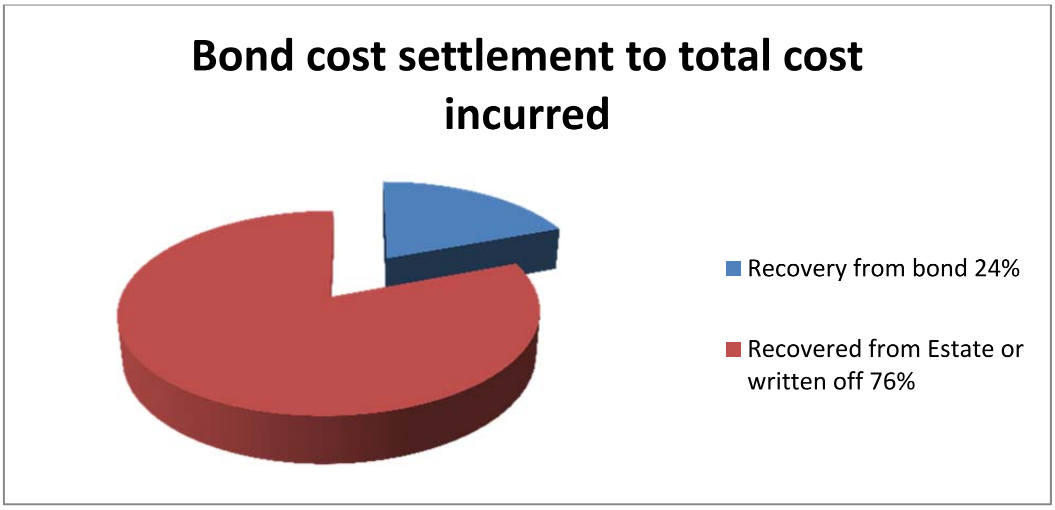
<u>Successor insolvency practitioner fees exceeding the amount available under the bond</u>

129. This point has been made without any real consideration of the causes. We have identified significant problems with the regulatory guidance on the setting of bonding levels as it leads automatically to a lack of cover to meet costs and interest at any level. It is therefore difficult to accept that any excess is caused by the level of fees themselves and not the lack of proper cover. Each estate is different and the reasons for the level of costs differ in every case. A simple case with easily proven dishonesty attracts relatively low investigation costs but a lack of sufficient cover might mean that even these are not reimbursed.

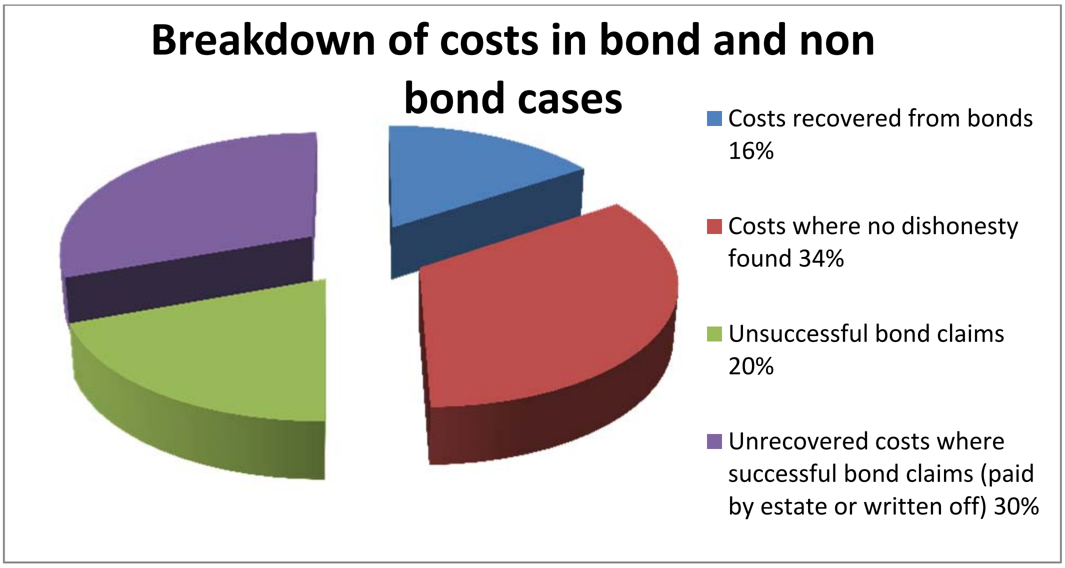
130. Within the costs incurred are case costs and pooled costs. The latter costs are incurred as a result of an appointment as successor practitioner over the portfolios but which do not relate to one particular estate. This is because the work carried out benefits each of the cases within the portfolio. An example of this would be work relating to the making of applications for a Block Transfer Order. Another would be the costs of identifying records and recovering them from storage. Such costs are recorded on a central time ledger in the form of pooled costs, as opposed to case specific costs charged against a particular estate. There may be many pools as not every estate benefits from every item of cost.

131. The pie chart below shows the bond cost settlement as a proportion of the total bond cost claim. In percentage terms the recovery of costs incurred on our bond cases is only 23.84% of the actual amount incurred.

132. In negotiations we find the surety to be most hostile to the remuneration of the successor practitioner whereas they seem very willing to meet what have been in the past quite significant legal costs. If the creditors pass resolutions to pay costs with any uplift the surety will only reimburse the base costs and the uplift is borne by the estate. Sureties have always refused to accept there is a correlation between hourly rates and the risk of recovery. We have issued proceedings in at least one case which has forced settlement of claims but the sureties have seemed unwilling to test their aggressive stance by agreeing to have the costs independently assessed. We take the view that the best evidential step for this issue is for a portfolio of costs to be independently assessed, including the question of uplift and rates. If an appropriate rate can be established then perhaps this issue will become less contentious and RPBs could use the court's determination to benchmark the appropriate rates for investigation and bringing bond claims.



133. The following pie chart shows how the total costs incurred by this firm in dealing with all portfolios (including those without a bond claim) are split into various cost categories. The bond claim settlement represents approximately 16% of total costs paid.



134. It is apparent from the above that a large proportion of costs are incurred by Griffins as successor practitioners where no dishonesty is found or the claim is unsuccessful or that there is insufficient SPS or GPS to meet a valid claim. These costs may be incurred in realising other assets, administering the estate or other work. There is presently no system to meet the specific successor practitioner costs arising as a consequence of the circumstances of their appointment and they are written off or paid from other assets in the estate. In general there are few realisable assets in a typical portfolio and so many costs incurred are written off or are paid from claims brought by the successor practitioner against other parties.

<u>A requirement that investigation work costs must be proportionate to loss</u>

135. As we explained above, it is a fallacy to equate the job of a successor practitioner to that of making bond claims. Any such claims arise as a natural consequence of an independent review of the insolvency and that review may for example discover negligence and not fraud, or nothing at all.

136. It is not possible to have a uniform approach where this option could in any way be viable. Costs are decided on an individual basis based on the complexity or otherwise of the case, any exceptional responsibility of the officeholder, and the type and nature of the investigation carried out. Some of these factors are already contained within legislation on fixing remuneration and it really is not possible to have a requirement which does not take such matters into account. There are a multitude of different investigations and actions that can be taken by a successor such as dealing with the overcharging of fees, the stealing of physical assets and settling claims against directors. These range from simple recovery actions to more detailed investigations. Costs therefore vary and need to be commensurate with the nature and extent of the work properly carried out.

137. The above approach is consistent with the recommendations in the Ferris Report published by the Lord Chancellor in July 1998. Paragraph 4.3 of the report emphasised the need for proportionality:

> "*An important matter which we have endeavoured to keep in mind and which needs to be kept in mind by every court or body which has to fix or approve the remuneration or disbursements of an office-holder is the need for what, in the absence of a better term, we describe as "proportionality". The administrations undertaken by office-holders are of almost unlimited range of size and complexity. Mega-insolvencies, or even medium sized insolvencies where the remuneration claimed is large in cash terms or as a proportion of the value of assets dealt with, justify and require a higher degree of evaluation and justification than small and straightforward cases where the suggested remuneration is comparatively modest. This makes it impossible to prescribe, except in general terms, a universal approach applicable to all cases. It would be counter-productive if, for example, an office-holder were to feel that he has to explain and prove every element which goes to make up what is self-evidently a modest charge in a simple case, regardless of the expense he incurs in doing so and hopes to recover from the estate which he is administering. Over-zealous recording of the minutiae and exact timing of an office-holder's activities is a waste of the office-holder's time and the creditors' money. What is, however, needed (and thus required by the principle of proportionality) is the provision of sufficient information to enable creditors or*

the court to have a clear view of what the office-holder has done or intends to do and of the value he has protected for the creditors. "

Greater transparency over rates for investigation of fraud and dishonesty

138. We are transparent about our rates as is required by SIP 9. In particular we comply with paragraph 12 of SIP 9 by breaking down fee estimates or charges into common activities which includes investigation costs. The report by Professor Elaine Kempson entitled, 'Review of Insolvency Practitioner Fees', provided a range for headline hourly rates charged by insolvency practitioner firms from those who completed a survey to assist with this purpose. Our rates for successor practitioner work are no different from our other work and are in line with the typical rates found in the Kempson Review.

139. Aside from the bare figures for charge out rates, a key component of total fees charged is actually how much time a partner spends on case portfolios. The reason for this is obvious, an insolvency practitioner partner falls into the highest charge out band and so the more time spent on cases impacts more significantly on the overall fees charged. Total partner time across the portfolios dealt with by this firm averaged 4.62%. By excluding the Cassons portfolio partner time from the total as this required significant partner input due to the large and complex claims required (both PII and bonds), then average partner time spent on portfolios would be 3.24%.

Distribution to creditors

140. The report on insolvency outcomes presented to the Insolvency Service by Dr Sandra Frisby in June 2006 is one of the most significant pieces of academic research in this area. She examined dividend payments to unsecured creditors in 2,063 companies which had entered into administration or administrative receivership. While having acknowledged there was a *'paucity of data'* concerning this Dr Frisby nevertheless was able to reach the following conclusion:

> *'…on current figures, the average level of return to unsecured creditors where information is available is 3.3% and that in 597 (28.9%) of the 2063 cases on the database unsecured creditors received no dividend at all.'*

141. Dr Frisby did not set out the specific methodology used in how she calculated the 3.3% average level of return. We have attempted to produce similar statistics across our portfolios but have found it difficult to produce meaningful numbers. The percentage dividend depends as much on the size of the creditors as it does on the amount of assets realised. A large successful individual bond claim led to a significant payment to creditors but as there were £15m of debts, the dividend reported was only a few pence in the pound.

142. The more recent 2010 Office of Fair Trading report on 'The Market for corporate insolvency practitioners' found unsecured creditors had a 4 per cent recovery rate.

Comparison of dividend payments in bond claim settlements compared to dividend payments in non-bond realisations

143. In terms of raw data we can say that the average dividend payment across all of the portfolios was 15.89 pence in the pound in cases where a dividend was paid at all. Behind these numbers we can say that in all bar two portfolios the realisations from bond claims were lower than that from non-bond assets. Consequently, and as far as we are able to calculate, the dividends from non-bond assets are greater than from bond recoveries.

144. We do not find that there is any material difference between the ratio of costs to realisations incurred on bonded and non-bond assets. Our statistics are distorted by the lengthy claims process in the Cassons portfolio but excluding those the principal still applies. Across all portfolios we see that non-bonded assets are around 5% of realisations cheaper to collect than bonds. We feel that bonds could and should be cheaper to realise if the reforms we recommend are implemented.

145. In conclusion we find that creditors are financially benefitting from bond claims. Where there is good bond cover such as in the Bradney portfolio the dividend resulting from the bond claim is high, being somewhere between 40% and 100% of the bond payment going to creditors. Where there are low offers of settlement by insurers or where there is a low SPS or GPS bond cover this has a negative impact on dividends payments, sometimes meaning that no dividend will paid at all.

Delay in settling bond claims and cost implications

146. A further factor which can reduce dividend levels is any delay in settling bond claims. The common bond wording on timing states that '*The Surety shall be given 90 days' notice before payment is required to be made and the Principal shall pay on demand.'* The table below shows that bond claims generally take between 1 to 4 years to settle with some exceptional instances where they were concluded many years beyond this time range. The wording clearly is not being followed by sureties.

Table showing period of time to settle a bond claim once submitted

Portfolio	Appointed	Claims Submitted	First Claim Settled	Delay (years)	Last Claim Settled	Delay (years)
Nisbet	2003	2003	2009	6	2016	13
Webb	2009	2010	2013	3	2014	4
Rees	2009	2011	2012	1	2012	1
Mears	2009	2011	2012	1	2012	1
Hepworth	2009	2011	2013	2	2013	2
Price	2011	2011	2012	1	2013	2
Bradney	2011	2012	2014	2	2014	2
Papanicola	2012	2012	2016	4	2016	4
Morfakis	2013	2013	2016	3	2016	3

147. One of the consequences in the time taken to settle cases is that the affected estates remain open and costs are increasing as a result of such matters as complying with statutory reporting requirements. In addition, interest payments would continue to increase until settlement.

148. Currently we incur an average cost of less than £2,000 per estate to investigate and make an initial bond claim. The costs we incur from that point in negotiating the claim and keeping the case open is usually much greater than this and it is this period that we believe contributes most to costs. We estimate that if settlements were to be made within 90 days then costs could possibly be a quarter of the existing post-claim amounts.

<u>Other issues raised</u>

149. The other issues listed below are not dealt with by way of separate headings under Question 1 but are contained elsewhere in this response. For ease of reference, we indicate where they are dealt with below.

- No statutory requirement for professional indemnity insurance: (see Question 7 – 'Include professional indemnity as a requirement for security, including run off cover')
- The bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner (see Question 7 'Agree or legislate for insolvency practitioner firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by persons other than insolvency practitioner')
- Variation in particulars of bond wording causes confusion (see the penultimate paragraph under 'Public tender to have one provider insuring the whole profession' contained in the combined answers to question 8 & 9)
- Adversarial nature of claims (see Question 2 'Consent and agreement of the Surety to incur costs' and under Question 4 'custom and practice')
- Cessation of cover on non-payment (see Question 7 – 'protect estate from non payment' where we agree with the remedy proposed in the CfE)
- Limited number of insolvency practitioners willing to take on successor appointments (see Question 4 'Approved panel of successor insolvency practitioners', particularly the final three paragraphs)

Question 2: Are you aware of any other weaknesses with the current system that have not been identified?

150. We detail a number of weaknesses with the current system that have not been identified. We consider how RPBs are not always complying with their responsibilities under the MOU, the IPR05 and then more generally. We go on to look at some failings by the surety. Finally we look at more disparate bonding issues.

<u>Recognised Professional Bodies never follow the MOU on closed cases</u>

151. There is a failure by RPBs when it comes to complying with the MOU provision on the transfer of cases from an outgoing insolvency practitioner to a successor. Namely, RPBs do not consider '*seeking to transfer recently closed cases'*. By not doing so this causes the successor many difficulties.

152. It should come as no surprise that where an insolvency practitioner knows they will be losing their licence they are cognisant to the fact that their open cases will immediately come under the scrutiny of a successor appointee and therefore are more likely to 'bury' cases where there is wrongdoing by way of closure. RPBs are obviously in a unique position as the regulator to check the monthly bordereau returns to monitor when cases are closed; they can also consider other regulatory information, such as complaints or monitoring data, which may flag up any concerns about cases which have been closed in the latter stages in which a licence was held.

153. We feel that this lack of compliance with the MOU in this respect is likely to distort the data on dishonesty in the profession and thus undermine efforts to tackle it. The Secretary of State should move quickly to enforce compliance by the RPBs and monitor closely the results as a separate exercise from the general level of claims.

<u>Failure of Recognised Professional Bodies and the Secretary of State to comply with MOU and Insolvency Regulations with respect to security and caution</u>

154. We set out under the heading, 'RPB duties', the requirements of the MOU and IPR05 with respect to security and caution with which these Bodies and the Secretary of State are required to comply.

155. There is both a failure by malfeasant insolvency practitioners to bond or to bond sufficiently and for RPBs to identify that this is happening despite being required to monitor the bonding of their members under the MOU and with the powers available for inspection under the IPR05.

156. There are several instances in cases which this firm has dealt with where there was no bonding in place or under bonding which were not picked up by the RPBs. In one portfolio, out of the 9 bond settlements negotiated 8 of the claims fell into the GPS because of this issue. In another, the IP failed to bond in 38 cases and had under-bonded in a further 26 cases out of a portfolio of 100 cases. In another portfolio there were 18 under-bonded cases out of 98.

157. The MOU refers to taking '*appropriate action where there is evidence of non-compliance with the prescribed requirements'* which would therefore cover the necessity to ensure bonding was in place and there was sufficient cover.

158. Specific failings with respect to the monitoring of bonding arrangements by RPBs and the Secretary of State are referred to in the ICAEW Monitoring Report 2015; the Follow-up ICAEW Monitoring Report April 2016 ; the IPS Monitoring Report 2014 and Follow-up Monitoring Report 2015. It can be seen that there have been a number of errors and we would say that it is likely that there is more to be done by RPBs to maximise the current bonding facility.

RPBs not appointing independent successor practitioners

159. The vast majority of block transfer orders relate to portfolios being transferred between members of the same insolvency firm in circumstances where an insolvency practitioner has left the practice, retired or died. The Insolvency guidance paper on succession planning published on 7 April 2014 actually provides that insolvency practitioners have '*appropriate contingency arrangements in place to cover a change in the Insolvency Practitioner's circumstances*.' The guidance states that '*In a firm with other Insolvency practitioners, it is likely that the arrangements would include, at the least, an understanding that another Insolvency practitioner will take over open cases, and make an application to Court for the transfer of those cases*.' For sole practitioners, it is recommended that a continuity agreement is put in place with a nominated successor.

160. The recommended guidance providing for cases to be transferred to non-independent successors is in itself not at issue where the outgoing and successor insolvency practitioners' RPBs have determined that there are no major regulatory concerns on the part of either of the practitioners. The successor practitioner must also of course carry out the necessary pre-appointment ethical checks prior to potentially taking the insolvency appointments.

161. The situation changes though where there is a loss of licence, major regulatory issues or where third parties raise credible concerns of a serious nature about a practitioner.

162. In the case of the *Institute of Chartered Accountants for England & Wales v Webb [2009] EWHC 3461 (Ch)* Mr Justice Norris made it very clear that the court would not consider a transfer to an insolvency practitioner who was in any way connected or even nominated by the outgoing office holder. In his judgment Mr Justice Norris reconfirmed the principles established in *HM Customs & Excise v Allen [2003] BPIR 830* namely that:

> *"Where there is no suggestion that there has been no misconduct by the outgoing office holder or by anybody for which he works, and the body is a reputable body, the court can properly be satisfied that the appointment can be transferred to another insolvency practitioner within the organisation. However, where misconduct is raised, either on the part of the outgoing practitioner or the body for whom he works, as it is in the present case, the approach of the court should, in my view, be very different. The appointment is an appointment by the court and the court should be very vigilant to ensure, not only that any misconduct will be properly investigated, but that also that those whose responsibility it will be to consider whether there has been misconduct, and if so what steps should be taken to deal with the matter, are seen to be independent of the alleged wrongdoer. It is of the highest importance that the confidence should be maintained in the propriety of any appointment by the court."*

163. Mr Justice Norris in the Webb judgment further explained the need for an independent successor when referring to Mr Webb's nominated successor Mr Bowen:

> *"……There is no basis for suggesting that Mr Bowen is anything other than independent and a professional competent practitioner. But he will be seen as being the favoured candidate of the outgoing office holder whose licence has been withdrawn and who is in significant default. The incoming office holder will have to remedy the acknowledged defaults and consider what further steps ought to be taken in the interests of the creditors."*

164. The judgment in *ACCA v Koumettou & Morfakis* was the first time an RPB reversed a transfer between its members. This was on the basis that there had been non-disclosure of important, relevant information at the previous hearing that would have impacted on the decision to transfer the cases to the successor. In addition, the judge made reference to the original transfer having involved agreements that appeared to guarantee the outgoing officeholder an income stream from some of the cases.

165. Judge Purle in the Koumettou case made specific reference to the role of an RPB with respect to a transfer. He said they should have due regard to the public interest and that its judgement must carry *"significant, and in very many cases decisive, weight.*" It has been rightly argued that this implies a higher duty on RPBs to appoint the right replacement insolvency practitioner.

166. The 2010 amendments to the Insolvency Rules 1986 allowing RPBs to make an application for a block transfer order was a welcome step as they are naturally in the best position to do so where they have removed one of their member's licence.

167. Some RPBs struggle with the conflict over appointing a successor. Case law and common sense says there must be an independent insolvency practitioner but RPBs are self-regulating and run by members who have a vested interest in preserving the firms hit by dishonesty. It could be them next (or indeed us!) This leads to the unedifying position of RPBs engaging lawyers to justify the appointment of conflicted associates of a dishonest insolvency practitioner.

168. Our concerns were further heightened in the recent case of Ian Pankhurst. We understand that following an inspection by the IPA that they had identified that Mr Pankhurst had misappropriated assets from several estates[4]. We were shocked to discover that the IPA gave Mr Pankhurst notice of their intention to withdraw his licence and instructed him to find his own successor practitioner. Mr Pankhurst duly sold his cases to someone whom he already knew and made arrangements to be employed by the successor practitioner. Griffins made an application to appeal the bulk transfer order in two cases in which we had an interest. We gave notice of our application to the IPA and the Insolvency Service and presented them with the evidence relied upon. We even held a meeting with the IPA to explain the issues and invited them to make their own application to review the transfer following the ACCA's example in Koumettou. They took no action. The successor practitioner has

[4] http://www.insolvency-practitioners.org.uk/regulatory-notices/regulatory-notices

now consented to our application and has agreed to be removed in favour of ourselves.

169. We would argue that the Secretary of State should set out the rules for an RPB to follow in these circumstances and that these should closely follow the case law. These are rare events as the statistics show and the reputational harm to an RPB caused by their inaction could be very considerable. One way of enshrining the principle of having an independent successor appointed in the circumstances described above is to have this as a requirement in the MOU under paragraph 2(c)(i) which deals with the transfer of cases where an insolvency practitioner is no longer authorised.

<u>Risk to Recognised Professional Bodies in not making protective claims or delaying the assignment of the bonds to the successor insolvency practitioner</u>

170. Prior to the successor insolvency practitioner's appointment a heavy responsibility falls on the RPB to ensure that any regulatory issues that singularly or collectively might affect an insolvency practitioner's licence are reported timeously to the surety. This would include the reporting of any complaints which have been taken forward for assessment and misconduct identified as a result of a monitoring visit as these could lead to a possible bond or PI claim.

171. The problem is that RPBs have a potential conflict in both keeping premiums down for its members and making protective claims on bonds. If they hold back on a protective claim, or if they make a mistake in their reporting of it, this could lead to any later claim discovered by the successor officeholder being out of time. The successor practitioner and creditors may well then have a claim for negligence against the RPB if such a situation arose. At its most extreme this could result in a claim for £25m against an RPB.

172. One possible way of solving the above is to have the Secretary of State take over the role of holding the rights under a bond. This avoids the potential conflict of interest, particularly as the Secretary of State is now no longer a regulator. It would also provide comfort that sufficient funds would be available in the event of any negligence in handling the claim.

173. Since June 2013 the Insolvency Service has been responsible for the Complaints Gateway which provides a single point of entry for regulatory complaints against insolvency practitioners. They are therefore best placed on behalf of the Secretary of State to both review the complaints and determine whether any protective notification needs to be made to the bond or PI insurers. A common term of bonds is for reports to be made to them of circumstances that might give rise to a claim and a copy of a complaint is likely to be such an event.

<u>ICAS insolvency practitioners have much lower insurance requirements</u>

174. We recently had cause to review the requirements of the PII cover required by the ICAS for its insolvency practitioners and noticed that it was based on a multiple of turnover for some smaller insolvency practitioners. As a result, in the case we reviewed, the level of PII cover for that insolvency practitioner was much lower than if they had been licenced by say ICAEW. Given our views on the relationship between bond premiums and recoverability to PII cover then we assume that the position for sureties is worse in Scotland. This may be a consideration in the review as it would be undesirable to have a situation where Scottish insolvency practitioners were forced to pay higher bonding premiums because of a different PII regime.

Consent and agreement of the surety to incur costs

175. The CfE focuses on the sureties' complaints that costs are incurred by successor practitioners without any controls or agreement by the surety.

176. The common wording in bonds provides cover for;

> *'reasonable costs in providing proof of claim, taking steps to prevent fraud or dishonesty, or recover the proceeds thereof or compensation in relation thereto and unavoidable parallel costs incurred by the successor practitioner with the written consent of the Surety* ***such consent not to be unreasonably withheld****.'*

177. In our 15 years of making bond claims, no surety has ever consented to our costs being incurred where permission has been sought. That is not to say that they oppose or object to them. Their standard response is to say that they cannot make any comment on costs until they see evidence of dishonesty. As many of these costs are intended to be incurred in proving whether there has been fraud or dishonesty the requirement appears entirely redundant.

178. We therefore no longer seek permission to incur costs and instead act as a prudent uninsured and this issue is not raised with us during settlement negotiations (although this is not without its perils[5]).

Costs generally

179. The common wording in bonds provides cover for;

> '*reasonable and necessary additional costs to which the estate is liable consequent upon the appointment of a successor practitioner to act in relation to any Matter in place of the Principal due to Fraud or Dishonesty…*'

180. As we have stated above, the purpose of a bond is not to act as an insurance policy but rather to act as part of the regulatory framework to underpin the profession. It seems to us to be a bar on a proper investigation of a former officeholder to create a legal hurdle to funding of an investigation based on its outcome. As there are so few cases of a loss of licence we feel that the Secretary of State should seek a change in the standard wording of bonds to cover the basic costs of investigation regardless of the outcome. All cases require a minimum level of investigation to determine whether there is a pattern of that behaviour across the portfolio.

Loss of records

181. While one of the conditions within a block transfer order will generally require the former office holder to deliver up all case files and books and records this is not often a straightforward task as those insolvency practitioners involved in misconduct

[5] How English Law Tilts Toward Insurers - http://blog.willis.com/2014/02/insurers-consent-to-settlement-the-perils-of-acting-as-a-prudent-uninsured/

will go to extreme lengths to make the discovery of such behaviour as difficult as possible. This is commonly by failing to supply some or all of papers, particularly relating to financial transactions involving asset realisations and the transfer of funds. Some particular reasons for not doing so are that they were accidently destroyed, are held by another party, or were sent to the successor by post (but then failed to arrive).

182. In such circumstances, the successor practitioner has to try other ways of establishing what has happened in insolvency. This would involve obtaining bank statements, accessing the Insolvency Service Account (ISA), interviewing debtors and other interested parties. Often the costs of this exercise are underestimated by the surety.

183. The RPBs could do more to identify the location of and secure the records in anticipation of our appointment. Paragraph 2C(iii) of the MOU states that the RPB should;

> *'Seek, by its membership rules or otherwise, to obtain the agreement of the outgoing IP to transfer cases, deliver up all relevant paperwork and attend upon the successor if required.'*

184. There is also no clear route by which a RPB can disclose to a successor practitioner all that they know about the misconduct of the former IP and the issues in particular estates. It would be helpful for the successor to have sight of inspection material, statements by the former IP and other material relating to the cases over which they have been appointed or the likely misconduct that they will encounter.

<u>Rules relating to release or discharge of a former officeholder</u>

185. The rules relating to release or discharge of a former officeholder are unhelpful and ought to be amended. This is dealt with more fully by way of a recommendation under Question 8 and 9.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

198. There are major differences in size and scale of the legal profession and in level of fraud so it is not directly comparable with the insolvency regime. They have extremely large claims; a different ratio of claims made and paid and are able to directly intervene in firms. One of the big disincentives from having something similar to the Solicitors Compensation Fund is the cost. As the CfE details, any individual holding a practising certificate was required to pay a flat rate of £56 during the 2013/14 financial year but more significantly £836 had to be paid by any legal practice which held client monies in the previous 12 months. That said, it appears to operate extremely effectively.

199. Research conducted by the Law Society in their Market Assessment Report for 2012 indicates the scale of the legal services market in England and Wales. It comprises between 267,000 and 320,000 regulated and unregulated individuals supplying legal services in around 30,000 entities, generating turnover of £25.6bn. This is in contrast to appointment taking insolvency practitioners which number approximately 1,300. During the 12 months to 31 October 2014 the Fund received 1,701 claims with the average claim amount paid out in the year being £80,000. The total paid out was over £23.8m. This is far in excess of bond settlements.

200. These figures show that the scale and cost of the scheme far exceeds that involved in the bonding system for IPs. While we do not consider a similar Compensation Fund is such a good fit for the IP profession, we consider the key idea that can be taken from this is to pool all premiums into the one pot thereby having sufficient funds out of which settlements can be made. This is why we are promoting the idea of having one bond provider who is selected by way of a tendering process. More details on this proposal are contained later in this response.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol.

201. Claims management protocols are particularly useful in circumstances where there are either a large number of firms in a market and/or wide customer base and there is therefore a need to have a consistent approach and standard conditions and procedures. That is why the IVA Protocol works well as the coverage is so wide (13,917 IVAs for the period covering July to the end of September 2016).

202. However, considering the number of bond claims made annually it is difficult to see the merits of a protocol especially given the uniqueness of each situation. Also one of the difficulties in adopting a protocol for bond claims is that there are too many competing interests with the process being adversarial in nature. That said, this firm and Grant Thornton have in the past proposed such an approach but these suggestions have been ignored.

<u>Custom and practice</u>

203. It can be argued that there is already an unofficial protocol in place. It comprises the terms and conditions set out in the bond and the custom and practice that has been adopted over the years between the surety, the loss adjuster and the successor practitioner. There is the potential for this unofficial protocol to be effective without the necessity of an official protocol, for the reasons that will be explained.

204. The standard terms of the bond which we also refer to later in this response restrict the surety's liability to certain types of losses suffered by an estate as a consequence of fraud and dishonesty; in particular -

> *'a sum equivalent to the losses caused by fraud and dishonesty together with interest…';*
>
> *'reasonable and necessary additional costs to which the estate is liable consequent upon the appointment of a successor practitioner'*

and (provided that proof of fraud or dishonesty is found) the

> *'reasonable costs in providing proof of claim, taking steps to prevent fraud or dishonesty, or recover the proceeds thereof or compensation in relation thereto and unavoidable parallel costs incurred by the successor practitioner with the written consent of the Surety such consent not to be unreasonably withheld.'*

205. Where a claim arises under the terms of the bond the surety shall be given 90 days' notice before payment is required to be made and the Principal shall pay on demand.

206. The period is provided in which to make claims following the principal obtaining their release or discharge from that that estate

207. The old custom and practice was to submit a claim in long form which involved setting out the full particulars of claim and detailing all the evidence; now the surety is sent a letter with a schedule of claims in short-form comprising a brief narrative of the fraud or dishonesty found in the individual insolvency estates. Rather than having innumerable meetings with the loss adjuster to discuss claims and supporting documents the loss adjuster now visits this firm and spends a number of weeks examining all the relevant insolvency case files. This also gives them an opportunity to copy documents of interest such as time records.

208. Following the attendance of the loss adjuster at this office the surety now provides structured offers with respect to all the claims. There would then follow a subsequent meeting to discuss these. Where there was a disagreement over the terms of any offer, counter offers would be made with a view to settlement on the basis of a revised settlement figure.

209. In summary, the move away from the position of an unwieldy and costly claims process which took far too long to reach a determination on claims to the much more recently slimmed down and cost effective process has been a significant and welcome change in custom and practice. If this were to continue and the proposed single provider of bonds chosen from a tendering process in place this would alleviate the need for a protocol. Under the heading, 'Failure by Surety to comply with own policy', examples have been given where they do not adhere to the terms of their bonds. It is difficult to see a protocol being any more effective at ensuring compliance by sureties.

Approved panel of successor insolvency practitioners

210. Our understanding is that only our firm and Grant Thornton regularly accept these types of appointments and as a result most of the RPBs use us as an informal panel. We are either appointed alternately over small portfolios or, where there is a large number of cases that would be administratively difficult to absorb quickly or where there is a greater chance of conflicts arising, we are appointed jointly. As far as we are aware neither firm has had to meet any particular criteria but this position has arisen through our previous experience with these RPBs (except the IPA who as far as we are aware do not make such applications).

211. In theory the idea of a formal panel has some merit but there are difficulties. The most obvious being that setting up a panel for such a small number of cases where a licence has been revoked would seem excessive and impractical.

Table showing IP licences revoked over the last three years

Year	2015	2014	2013
Licences revoked	1	4	3

212. The criteria for inclusion would have to be very narrow given the number of cases involved. A large number of insolvency practitioners might register interest in being on the panel but the work is so limited that there would be little scope to take cases even if potential successors could demonstrate the expertise and resources to do so. We are on the POCA and NAMA panels and the criticisms of how those panels operate are very similar with the suggestion that, unless there is a critical minimum volume of appointments, it is very difficult for an IP to justify the costs of maintaining any specialism to maintain their status on the panel.

213. The idea of such a panel also has some parallels with the National Civil Recovery rota which was introduced on 1 January 2004. This rota was for Official Receivers to use in cases in which there was potential for civil recovery action but which had no funding from creditors nor could an agreement for repayment be made with the relevant parties. Some 57 firms agreed to go on the rota and there had been a total of 23 appointments in the 3-year period up until January 2007 when a Dear IP article highlighted that the rota had been rarely used.

214. We would obviously argue from a position of self-interest but the evidence is that several IP firms have accepted appointments as successor practitioners but they have not remained in the 'market'. Anecdotally we have been told that they have found the work difficult and unremunerative and their partners have been unwilling to finance the work in progress required to take on a portfolio without any funding or information about the estates. For whatever reason the existence of two firms undertaking the work has through custom and practice been sufficient to meet the existing volume of cases without them either being swamped or falling idle. If there were a dramatic increase in IP misconduct then no doubt IPs could be found to accept the increased work and then their performance or their own profits from it would dictate whether they stayed in the 'market'. If there were no regulatory appointments then our firm's specialism would atrophy over time.

215. A further point to consider regarding the benefit of a small number of specialist successor practitioners is to look at how the sureties defend bond claims. Sureties could go to any loss adjuster to act on their behalf in assessing and agreeing claims but as far as we are aware they exclusively instruct Haslocks. Haslocks have been the sureties' main or sole loss adjusters since the creation of bonds and as a result they have the in-depth knowledge and expertise to represent the sureties in this very specialist area. Almost all of our bond claim work is spent dealing with them. If the sureties have decided to rely on a specialist, why then should it be any different in choosing a successor insolvency practitioner to investigate those bond claims?

216. If there were a panel then in our view it would need to be a minimum of two and probably a maximum of three firms to adequately cover the likely volume of appointments. One firm alone would create difficulties where there are potential conflicts and four or more would mean that there might be years between appointments and the firms would not be able to retain specialist staff.

217. The RPBs need to work with the Secretary of State to develop their policy in this area so that they can appoint successor IPs who can bring claims effectively. The RPB cannot replace the role of creditors and the court in controlling the conduct of a successor officeholder but they can express a view on the public duty aspects of the MOU and make positive arguments for a more thorough investigation where misconduct occurs. We and other experienced successor practitioners have many ideas for how to improve regulation through this specialist role. Those ideas need an outlet through regular discussions with regulators.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system.

219. No we do not consider these measures are sufficient. Listed under Question 8 and 9 are all our recommendations contained in this report.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

220. We stated at the beginning what the purpose of a bond is and it is worth repeating here.

> "*Their main purpose is to prevent illegal and otherwise unethical business practices. Governments establish surety bond requirements to keep unqualified individuals from gaining access to a position through which they might take advantage of consumers. As a neutral third party, the surety that issues the bond thoroughly reviews every applicant's credentials before issuing a bond. Those who fail to meet the qualifications cannot get a bond, and thus won't be allowed to work in the industry. In this way surety bonds function as risk mitigation tools that reinforce industry regulations.*
>
> *Each surety bond executed provides a financial guarantee that a principal will follow industry regulations and avoid certain business practices. For this reason license and permit bonds are some of the most prevalent in the surety market. Surety bonds are even used to regulate insurance professionals themselves. For example, insurance broker bonds protect consumers from brokers who coerce clients into purchasing unnecessary or inappropriate insurance products."*

219. We therefore take the view that the removal of bonding would be an admission that the insolvency profession is not sufficiently ethical to maintain the existence of bonds. This is something that we strongly disagree with. The instances of dishonesty among insolvency practitioners remain low and the existence of the bond is one of several features that distinguish our profession from the unregulated market.

220. As for creditors, without any idea of what might replace it we can only assume that creditors will suffer as a result of removing the statutory bonding requirements. The protection of creditors is much wider than the dividend they receive on a particular insolvency that has suffered a loss. The existence of the regime has affected behaviour which can be seen from the efforts that some practitioners have made to avoid an independent investigation of their conduct.

221. The premiums borne by creditors of estates are very small and insignificant on an individual basis. We assume that if bonding were removed then it would have to be replaced and the costs are unlikely to be materially lower. We have identified in this document that there are opportunities for costs savings within the bonding system itself which may be of benefit to creditors. Fundamentally after the costs of administration and commissions are taken out, the level of premiums ultimately paid by creditors are based on the level of dishonesty discovered in the profession. Since we cannot contemplate any system which seeks to conceal misconduct, the way to reduce the premiums is to tackle that behaviour. This we think the regulatory system has done well in past years and can still improve.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

222. There are a number of options listed under this question which have real merit and some which if modified would be of real benefit; there are though a number of options which we reject completely as being either unworkable or there being no justification for such a proposed solution.

<u>Amend the current prescribed terms of the bond</u>

223. We have already set out at length our views on the possibilities within the existing legislative framework. The current statute requires that the bond **MUST** comply with Paragraph 3(1) Sch 2 IPR05 and **SHALL** comply with Paragraph 3(2) Sch 2 IPR05. Beyond this we think there is considerable scope for the Secretary of State to demand additional benefits and terms on public interest grounds. The financial limit for the level of GPS is the largest problem that cannot be fixed without legislation although much greater work on the SPS limits will ameliorate this.

224. One further option suggested in the CfE which has considerable merit is to '*prescribe terms for a single, universal bond, which would remove any uncertainty from the claims process and mean that the protection for all insolvent estates would be identical irrespective of the provider or the relevant period in which the fraud or dishonesty occurred*.' However we would go further and have a tendering process to have the one provider.

225. The CfE mentions that one disadvantage in adopting a universal bond is that it '*could stifle competitive pricing of bonds, as all insurers would be bound by the same terms*.' By having a competitive tendering process the successful provider would be able to draw premiums from the whole market which would ensure the risk to gross premiums ratio remains low and so assist in driving down the cost of premiums. This idea is discussed more fully under Questions 8 & 9 which has been combined together.

<u>Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs</u>

226. While there was a sound basis for ring fencing the prescribed part for the benefit of unsecured creditors in administrations and liquidations following the coming into effect of the Enterprise Act 2002, there is no possible justification for the suggested change here.

227. When addressing the ring fencing of a bond claim under Question 1 we stated that by diverting the proceeds of a bond claim away from the normal statutory priorities we foresee many hazards and litigation arising. We went on to say that these are such that we cannot take this suggestion seriously and that it would be absurd to create a stand-alone statutory costs system for a couple of portfolios a year.

228. Why treat this area any differently to other asset realisations and the associated costs? For instance, bringing civil proceedings against a director or an insolvency practitioner requires similar investigation work and levels of proof to that of bond work so to elevate the latter as requiring a special ring-fenced regime makes no sense.

Provide for investigative costs as a prescribed requirement of a bond

229. The CfE makes the valid point that '*where the majority of assets are removed from an estate there can be no cover for investigation costs'* which is why we have proposed under Question 1 that guidelines are produced to calculate cover so that it would meet any claim for loss of assets plus interest and investigation costs.

230. There is an obvious benefit to a successor practitioner in having a source of finance to meet the immediate and necessary costs that we have identified that are a natural consequence of the appointment of a successor practitioner. It would also meet the fundamental purpose of a bond to underpin the propriety of the profession and its professionals.

231. We have indicated that £2,000 per case would be sufficient to cover most basic investigations and making a protective claim. We would be wary of creating too high a sum which might have the effect of creating 'a bounty' on the head of every IP and create a financial incentive to investigate even where no investigation was warranted. We recall the case of an IP who lost their licence as a result of a criminal act unrelated to insolvency or financial matters. The RPB quite rightly decided that it was not a situation that required an independent successor to conduct an investigation of the cases. The existence of a significant investigation fund might have caused a change in that decision.

Agree or legislate for a 'de minimis' maximum indemnity period

232. Whilst we understand the argument for a maximum indemnity period we are not in favour of them. Bonds existed for many years without this term and they arose following our successful claims in Cassons. In those cases we demonstrated that David Nisbet had not obtained his release and thus were within time to make claims although our appointment was 4 years after he had lost his licence. We therefore conclude that the existence of such clauses is not required as a result of the way the underlying insurance market works but it is simply a device to attempt to evade liability. If there is a financial consequence of not having such clauses then we would wish to see the sureties' evidence on what the cost would be of omitting this term.

233. The two year period to make claims contained within some bond terms is too short. The length of the time limit for making claims is a matter of discretion for the Secretary of State (it is not set out in legislation) and so there is no practical problem with the SOS seeking to extend the period. It is in the nature of the bond that it should be a long term period of cover. There currently seems no issue bonding for a liquidation which runs for six years with a further two year claim period when a typical liquidation might run for only two years. With the recent change in case law on limitation being 6 years for dishonest assistance then this would seem to be a sensible period to adopt.

234. One of the practical difficulties is that the person making the claim, the successor IP, has no knowledge that the time is running and so a 6 year period would provide a sufficient discovery period.

235. We make the point in answer to Question 8 that we feel that some changes to the concept of Release or Discharge of a former IP may be another solution.

Remove requirement for monthly cover schedules and provide for an annual or global bond cover

236. The provision of monthly cover schedules to sureties and RPBs is burdensome and bureaucratic but serves a real purpose. It provides RPBs with current data so they can see changes to new cases, cases closed, and increases to asset cover.

237. We do not see why this cannot survive in some electronic format that requires little or no input from the RPB or IP. For instance the overwhelming majority of firms use the Turnkey IPS system and all data on bonding is held within it. It must be entirely possible for RPBs and sureties to meet with Turnkey to agree a system whereby the data is transmitted automatically to both the RPB and surety. We see no reason why this could not be daily from appointment. With such a facility the RPB and surety will be able to see instantly by way of exception reporting if there were increases required or premiums not being paid.

Amend the existing monetary limits of the General Penalty Sum/Specific Penalty Sum

238. There is an argument that can be made to increase the current SPS ceiling of £5m. Claims made by this firm have reached this level on occasion. The type of claim which could surpass the current ceiling is antecedent transaction claims being waived. A £20m ceiling is suggested which is a large increase and will be rarely reached but will provide comfort where there is a large, complex claim.

239. The maximum amount under all bonds to which a surety will be liable of £25m has never been engaged so far so probably does not need to be increased. That said if these figures are not being reached it is not a factor in the premium so could be raised cheaply for the slight risk of a major theft.

240. The amount of £250k for the 'General Penalty Sum' is fixed by statute and as mentioned in the CfE has not altered since 1993. The amount is woefully inadequate.

241. In considering GPS it not only covers shortfalls from exceeding the value of claims under the SPS amount but should act as a safety net for when no SPS has been declared. It may be considered unusual not to have any SPS but this is actually relatively common particularly where an insolvency practitioner is in the process of losing their licence.

Table showing both GPS and SPS deficits across portfolios dealt with by this firm

Portfolio	GPS Deficit (£)	SPS Deficit (£)
Webb	0	0
Rees	825,727	949,687

Mears	0	0
Bradney	0	40,140
Morfakis	115,909	240,909
Papanicola	125,301	274,872
Price	0	0
Nisbet/Bennett	0	0
Hepworth	85,220	149,060
Total	1,152,157	1,654,668

242. There was therefore just under £3m (£2,806,825) in underbonding or no bonding when looking at the GPS and SPS deficits combined.

243. Why does this happen? From the perspective of the IP, bonding for the minimum with a requirement to increase the bond if a realisation is made is open to abuse. The dishonest IP who intends on stealing is not going to declare the realisation or bond for any increase arising from those stolen assets. In a number of bankruptcy cases contained within the portfolio of the former insolvency practitioner, William Price, there were pension realisations which he did not declare or bond. He simply stole the money. In another case, Mr Price sold the company book debts to the director for cash and then failed to declare it as a realisation.

244. A contributory factor in underbonding or failing to bond was referred to earlier. Bonds may not get taken out in the month of the loss of licence or the IP does not bother to ensure there is the appropriate level of cover. What we have found in particular is that where an insolvency practitioner has had their licence suspended and it is likely to be revoked, one of the last things they consider is bonding. This may additionally lead to premiums not being paid and the policy becoming ineffective.

245. In summary, SPS bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover or any cover at all. One remedy would therefore be to substantially increase the coverage of the GPS.

246. A suggested increase of GPS cover to £2.5m is proposed. At this level it certainly would have provided sufficient cover in the cases dealt with by this firm.

247. Similar arguments may be raised that this will lead to a rise in premiums. However, as previously explained, GPS and SPS cover and the respective premiums are inter-connected and where the premiums rise with respect to one bond because of increased cover it can drive down the premiums of the other. There may not therefore actually be any net increase in total bonding costs even if there was a slight increase in GPS premiums.

248. Even where there is a modest increase, the advantages of solving the issues of having no, or inadequate, SPS cover by being able to fully rely on the greater GPS coverage, far outweighs any rise.

Alternative Solution

249. Another solution might be to make the issue much simpler and provide each insolvency practitioner with a bond that covers their likely claims. As we have indicated above, there has yet to be a claim for £25m so what would be the cost of each insolvency practitioner obtaining a single bond policy to cover all of their cases for £25m? This is 100 times the size of the current GPS so crudely 100 times the premium for each of the Griffins insolvency practitioners would be £3,300 each. This is a lot cheaper than our PII and not a great deal more than we pay to R3 for our membership.

250. But for insolvency practitioners already paying thousands for their enabling bond this would be an impossible increase to swallow. There is also the question of where the premiums would come from. In the case of Griffins we pay many thousands of pounds in SPS premiums and the sum of all these goes towards the overall cost of bonding a Griffins' IP. Against this is the evidence, some but not all of it anecdotal, that much of the premiums are absorbed in administration and commission. And of course multiplying insurance cover by 100 rarely means an increase of the same factor for the premium as the higher level of cover is rarely engaged.

251. As we began this document, we estimated that there is £10m in premiums collected annually in this market through a highly burdensome and no doubt expensive system. Claims run at much less than this. Divided among 1,300 IPs the premiums average out at £7,700 per insolvency practitioner. We hear of sole practitioners being charged much more than this for just their GPS which will cause them financial difficulty and distort the market for their services and make it hard for them to compete with larger firms. In turn all larger firms could afford this average sum. If the system were based on a single premium then we suspect that there would be a dramatic reduction in costs and so the premium would be much lower than we have just calculated.

252. At the very worst the single premium could be recharged to the estate by the insolvency practitioner in some way up to a maximum amount they have incurred. The effect would be comprehensive cover for all insolvency practitioners at a much lower cost than is currently available. This would result in the successor practitioner and the loss adjuster not having to be concerned with the level of bonding in every case and the issues could be focused on whether there was any evidence of dishonesty.

Introduce a duty that investigative costs must be proportionate to loss/cover

253. We have consistently made the argument that one size does not fit all. We reiterate that is impossible to have such a duty when dealing with so many disparate types of claims that vary in size and complexity. Rather than repeating the arguments again why this would not work we refer you to what we have said under the various ring-fencing proposals concerning claims.

Protect estate from non-payment

254. We agree with what the CfE says under this head.

Include professional indemnity as a requirement for security, including run off cover

255. We agree with the suggested solution of amending legislation to make PII a statutory requirement as well providing run-off cover for the same period as the bond. The latter is particularly important as where the period has ended in one this limits a claim to the other. It obviously then narrows down the culpability the claim relates to one of fraud or dishonesty, or negligence.

256. Whatever the merits of the claim it also provides the surety to whom the claim has been made with an opportunity to argue that the behaviour displayed is such that it would have more appropriately fallen under cover of the out of time policy.

Agree or legislate for insolvency practitioner firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by persons other than the insolvency practitioner

257. Similarly we can see the necessity for fidelity cover to be in place in situations where employees or other officers of an insolvency practice commit fraud or dishonesty without the *'connivance'* of the IP.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered and Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

258. We have combined the above questions so we can capture under the one head all our proposals and suggestions for reform.

Potential measures for reform

Public tender to have one surety for the whole profession

259. There are just over 1,300 appointment taking IPs and many bond providers and so the limited pool from which to draw premiums is dispersed among the sureties. It seems to us that there should be a public tender to procure the contract to bond the entire profession so that the successful bidder has a sufficient client base from which to draw premiums. This will ensure that the risk to gross premiums ratio remains low. Also one or two really large settlements should no longer significantly impact on future premium costs.

260. In many respects having one surety and one pool from which settlements are made would be similar to how the Solicitors Compensation Fund operates where everyone is a party to the same scheme. This model appears to work effectively with a sufficient pool of funds to meet claims.

261. There are effectively really two bond markets operating at present. One market is providing cover for the very big firms where the risk to the surety is minimal or non- existent. This is because the firm and its partners would inevitably seek to make good the loss to estates without reliance on the bond. At the other end of the market is where the risk lies, the independent IP or 'two man band'. The premiums are obviously higher for the latter given the greater potential risk to reimbursement.

262. What is proposed is a more equitable solution for the profession as a whole. That is to have a contractual rate set across the profession, so that the cost of cover would be the same irrespective of the size of the practice. It would simply be based on the cost of covering the asset e.g. all IPs pay £50 for £50K of cover. Some may baulk at large firms effectively subsidising smaller practices but there are advantages. In particular, premiums being set at a competitive rate would encourage insolvency practitioners to properly bond a case.

263. We would expect to see a great deal of innovation by bidders as they sought to create new ways to bond the profession as cheaply and effectively as possible. Some might bid on the existing model as set out in the previous paragraph or along the lines of the single premium mentioned above. It would be useful for the SOS to seek indicative bids of what current sureties might offer if a tender were announced. There would obviously have to be a change of legislation to remove certain prescriptive parts of IPR05 to allow for innovation.

264. What would need to be addressed in the tendering process is ensuring that the pool by which any claims would be met are an appropriate portion of the gross premiums. An assessment would therefore need to be made of the administration and re-insuring costs (and profit element) of the surety to ensure these are reasonable and do not inappropriately diminish the settlement pool. This would be achieved in part through the competitive tendering process.

265. It is proposed that the contract would be for 3 years which would provide a sufficient period of certainty before the next tendering process commenced.

266. A consequence of having one bond provider would be to resolve one of the other issues raised, the bond wording confusion. Without a multiplicity of providers and bonds the confusion in wording and the divergent terms and conditions would go away. This would be particularly so as the tendering process would be required to consider the wording of the bond and the appropriateness or otherwise of the conditions. We would wish to see innovation in reducing administration for the sureties to make a profit rather than them directing their efforts into avoiding claims after they occur.

267. Were the above proposal not taken forward then serious consideration should be given to the main alternative described under Question 7. That is for each insolvency practitioner to obtain a single bond policy to cover all of their cases for £25m as this amount has never been reached.

Legislative measures

268. A problem with some claims arises from the time limits imposed by a bond. A successor practitioner will have no knowledge of the nature of the claim at the time of their appointment nor of the time limits to a bond to which they are not a party. We have addressed this by proposing lengthening the time limits in bond wording but there is an alternative solution.

269. The existing legislation on release or discharge is a version created by watering down the legislation that existed before the IA86. In previous legislation the release was granted commonly by the court and was an absolute protection from suit unless it could be shown that the release was granted as a result of an improper or dishonest disclosure by the IP. Such legislation still exists abroad such as in New Zealand. Now release or discharge in the UK is an administrative step which, because of the ability to bring claims after it with the permission of the court, has rendered it almost otiose.

270. We suggest that the concept of release or discharge is reviewed so that it can be used in the context of bond and PII claims. We suggest that where an IP leaves office then they should receive their release or discharge at some later date, perhaps 6 years. We see no practical impact on other legislation except that claims could be made without the requirement of the leave of the court. As insolvency practitioners ourselves we cannot see any material impact on our firm by this change. If we have done wrong on a case and a claim can be brought with leave of the court then nothing has really changed by changing our date of release. The references to release and discharge within bonding regulations would have to be amended but that would not affect the large majority of the practitioners.

271. Bonds would then be required to meet all losses caused to the estate up to the date of discharge and thus this would also deal with the issue of post-removal from office theft which has occurred. It would reduce the effectiveness of a malfeasant IP closing their cases from which they have stolen to trigger bond claim dates and to avoid detection. Documents might be destroyed in compliance with other legislation but it would be disproportionate to change that legislation for the relatively small number of potential bond claims that might be affected.

272. We would recommend an increase in the SPS ceiling from £5m to £20m.

273. We would recommend an increase in the GPS cover to £2.5m. It is interesting to note that in response to the '*Insolvency Practitioner Regulation- Ten Years On review',* published in 1998 by the then named DTI, there were calls for it to be significantly increased. In particular, Simon Dodd, the then National Insolvency Director at Willis Corroon Insolvency Services (now known as Willis Towers Watson, a major bond provider), stated:

> *'The Enabling Bond of £250,000 was set in 1986 and should be increased to a minimum level of £500,000, possibly even £1M.'*

A further 19 years have elapsed since Mr Dodd made this point and it was justified then. It is even more important now and our evidence supports his view.

Non-legislative measures

<u>Self-certification of bond claims</u>

274. One suggested proposal is to introduce a self-certification process for the approval of bond claims. This would involve the successor IP declaring that the claims they have made up to a certain level of quantum are valid. After making this self-declaration the successor insolvency practitioner would submit a return to the surety and the appropriate RPB. One or the other of these bodies could then 'sign off' the work carried out using a risk based approach where a certain number of cases are audited. The main advantage of this suggestion is that this will assist in achieving the duty to maximise returns to creditors by in particular eliminating the cost and delay of making and settling bond claims.

275. While there may be some scepticism about this approach given the general negative tenor of the CfE in so far as the role of successor IPs are concerned, it is seen as a cost effective solution. From the analysis provided elsewhere in this response it is clear that costs could be reduced significantly were claims settled expeditiously rather than waiting up to four years as is presently the case. In particular, insolvency cases could be closed quicker and the loss adjuster costs in adjudicating upon claims would be less or non-existent.

276. The successor IP as an officeholder, an officer of the court, as well as a fiduciary, is well placed to carry out this function responsibly and with reasonable care.

<u>Increasing bond coverage</u>

277. The Secretary of State to produce clear guidance on calculating SPS cover to include assets, investigation costs and interest. This can be done by way of interpreting the Schedule 2, Paragraph 4 of IPR05: *"…the amount of the specific penalty….shall equal **at least** the value of the insolvent's assets…."* so that the words 'at least' allows for these additional elements. We have suggested that the SOS issue guidelines on how the Regulation should be interpreted. We suggest for the moment that it could be based on the level of assets plus 25%.

278. Insolvency practitioners to include choses in action when calculating SPS cover and make ongoing assessments of the value of such claims.

279. Seeking bonding products where the premiums themselves are insured so that there is no disincentive for IPs bonding for intangible assets such as choses in action.

<u>Regulatory activities of the Recognised Professional Bodies</u>

280. RPBs to put in place a robust monitoring system for checking PII cover and ensuring potential negligence claims are reported.

281. RPBs to ensure insolvency practitioners are educated on the benefits of making PII claims through webinars and by other means.

282. RPBs to ensure their regulations requiring PII run off cover are complied with as it has been evidenced in one instance that this was excluded from one particular policy.

283. RPBs to undertake an urgent review of the case files of an insolvency practitioner where QAD inspections/monitoring visits reveal regulatory issues. This is particularly so where the IP has failed to pay monies into the ISA and does not remedy this, or has taken fees without approval. In such circumstances RPBs should ascertain whether there is fraud and whether this forms a pattern. Consideration should be given by RPBs at an early stage as to making a formal criminal complaint where fraud appears to have taken place.

284. RPBs to follow the MOU on closed cases and identify what, if any, need to be transferred to a successor practitioner

285. RPBs to appoint independent successor practitioners where a licence is revoked or there are serious regulatory issues in line with case law. Enshrining the principle of having an independent successor by amending paragraph 2(c)(i) of the MOU to reflect this.

<u>Actions of the insurers</u>

286. To place an onus on insurers to notify the IP and RPB where there is a failure to pay premiums in open cases so that remedial action can be taken prior to any termination clause being triggered.

<u>Other measures</u>

287. To have the Secretary of State take over the role of holding bonds

288. Bonds not case based but the IP to bear the cost of a single premium to reduce the significant administrative costs of bonding.

289. Bonds should cover an element of investigation costs without linking to the outcome of that investigation so that the bond acts to support the integrity of the profession rather than to be seen as just a fraud policy.

290. Bonds to be written to consider the non-estate specific costs that are naturally incurred when a successor practitioner is appointed. These would include the gathering and reconstruction of records and other pooled costs.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

294. We have used the opportunity presented here of highlighting the impact of fraud on individuals, other entities and in different types of procedures.

Impact of fraud

295. The impact of fraud by an IP is wide-ranging and many parties suffer detriment as a result not only in financial terms but there are other damaging consequences on personal and professional lives. It is worth considering what this impact is and how the role of the successor can at least ameliorate some if not all of the consequences.

IVAs and CVAs

296. Fraud in these procedures takes many forms. The fraudulent IP may receive the IVA fee upfront to set up an IVA (on average this is in the region of £5,000) then purportedly formalise the arrangement when not actually having done so. The insolvency practitioner nevertheless then collects the monthly debt repayments. This results in the debtor having lost the fees and contributions paid without an IVA being in place. This can push a debtor into bankruptcy and lead, for instance, to the family home being realised instead of it being protected under an IVA were the terms allowing for this.

297. Where an IVA was properly entered into and there was subsequent fraud involving the monies introduced or monthly contributions paid then this is likely to mean the IVA will need to be kept open beyond the period agreed. This is to allow the successor to pursue recovery action including making a bond claim. Therefore the formalities of closing an IVA including issuing a Completion Certificate, notifying the Secretary of State, and notifying the creditors could not take place until there has been a bond settlement or determination.

298. Prolonging an IVA can also have implications for the debtor's credit history. The IVA appears on the debtor's credit report for a minimum of six years from the date of arrangement, and longer if the arrangement lasts more than six years. During the IVA, organisations will almost certainly ask for information about the debtor's situation and may refuse to give credit.

299. Once a successor IP becomes Supervisor there will in all likelihood be fee implications especially where the IVA remains open beyond its normal completion date. A variation of the arrangement would need to be agreed for this purpose.

Administrations

300. A successor practitioner appointed in portfolios including Administrations will in all likelihood be up against time constraints arising from there being only a one year statutory period for this procedure. The Act says that this procedure can only be extended by creditors' consent once and for a maximum of 6 months. Any further extension must be by way of application to court. Where the latter is required this will have quite large cost implications. Solicitors will have to be employed and it will be necessary to prepare a detailed chronology of the administration up to the application and a report to creditors.

Director Disqualifications

301. One of the more common frauds involve an officeholder in a corporate insolvency taking fees, such as a S98 fee in a Creditors' Voluntary Liquidation, and accepting other inducements with an agreement not to investigate potential misconduct of the directors. The officeholder then reports to the Secretary of State with a fitted D Report. This basically provides the directors with a clean bill of health in so far as their conduct in the insolvent company is concerned. The effect of this to allow errant directors to extend their misconduct to other companies to other businesses and consumers causing the suffering of unnecessary losses without the prospect of disqualification action being taken.

302. The successor's role is to uncover unfit conduct and report this to the Secretary of State. Often the successor will be operating against the time limit for bringing disqualification action against directors where an application for disqualification has to be made within three years of the date of the corporate insolvency (winding-up order, voluntary liquidation, administrative receivership or administration), unless the Court extends the time. This was extended from two years by the Small Business, Enterprise and Employment Act 2015.

303. The successor's role is therefore extremely important on a macro-economic level in ensuring a fair market in which companies can trade.

HMRC

304. The successor IP's role is to examine the financial affairs of the entity and is then in a position to provide HMRC with information pertaining to any potential tax implications arising from investigations carried out. A common fraud partly described above involves an IP being appointed to a corporate insolvency, taking their fees, and agreeing not to, for instance, pursue a director over their overdrawn loan accounts.

305. An overdrawn director's loan account may effectively be an interest-free loan. The successor insolvency practitioner would notify HMRC as they would want to particularly consider the personal tax implications arising from this for the director.

306. The successor would investigate tax fraud which a previous officer turned a blind eye to – such as Missing Trader fraud, also known as Missing Trader Intra-Community (MTIC). This is where there is abuse of the VAT rules on cross-border transactions within the EU. The successor would report their findings to HMRC which would not only aid tax recovery action but any particular unusual nuances of the fraud would act as intelligence in them better able to investigate this fraud in future cases.

307. The successor is also able to piece together financial information and complete the jigsaw where there have been missing books and records by gathering such material from other sources. Again this can help the fight against tax fraud.

308. More generally as a creditor even though HMRC's preferential status no longer exists, they are likely to receive dividends from successful asset recovery action that a successor has pursued.

Impact on good insolvency practitioners

309. It can bring the reputation of the profession into disrepute and lead to a lack of trust in the honesty and integrity of the profession as a whole.

310. On a more individual level there can be serious implications. Where there is fraud or dishonesty by one partner of a firm the other partners can suffer immeasurably. Following any successful bond claim the surety will come after the partners to make good the loss as they are jointly and severally liable. While bond cover will not therefore protect the partners against fraud, protection is offered by their PII cover so they do not become a second casualty. However this protection is only afforded where there is reporting of suspicions early by the partner(s).

Introducers

311. When appointed successor practitioner, individual insolvency cases are examined to see whether the IPs gained appointment as officeholder as a result of any inappropriate payment or commission by an introducer. The Insolvency Code of Ethics in place for insolvency practitioners expressly states that;

> '*the special nature of insolvency appointments makes the payment or offer of any commission for or the furnishing of any valuable consideration towards the introduction of insolvency appointments inappropriate.*'

By doing so we are able to identify whether there is any organised network of introducers and whether other IPs are involved. In the latter instance their actions can then be reported to their respective RPB.

312. Also where introducers are not acting in the public interest this can be reported to the Insolvency Service which has the power to wind-up companies in such circumstances. In 2013, the Insolvency Service wound up eight companies which offered misleading, inaccurate and financially damaging information to ailing businesses. These companies promoted pre-pack administrations to businesses in financial trouble in an inaccurate and misleading way.

Creditors/bankrupts

313. As mentioned earlier in this response, where there is fraud or dishonesty by an IP creditors are receiving a 'double blow' as the financial impact of this has followed any loss suffered by the original insolvency event. A good example of how beneficial the actions of the successor IP can be comes from the William Price portfolio (the case study of which is in the appendix). Mr Price stole £38,000 from a bankrupt who was a pensioner. Following our investigations and a bond settlement there were sufficient funds to pay off all his creditors and his bankruptcy is in the process of being annulled.

Industry intelligence

314. A successor IP who has acted in that capacity for some time and has dealt with a number of portfolios quite often comes across the same employees having moved from one insolvent insolvency practitioner firm to another and where similar misconduct is established in both. This likewise equally applies to insolvency practitioners who have lost their licence where they move to firms connected with their previous practice and operate in a consultancy practice. This is helpful by way of industry intelligence particularly as it can provide an early warning signal as to what might be happening in ‘live’ companies to which these people have moved.

Bonding arrangements for insolvency practitioners

A call for evidence issued by the Insolvency Service

About the IPA

The Insolvency Practitioners Association (IPA) is a membership body recognised in statute for the purposes of authorising Insolvency Practitioners (IPs) under the Insolvency Act 1986 and Insolvency (Northern Ireland) Order 1989. It is the only Recognised Professional Body (RPB) to be solely involved in insolvency and for over fifty years the IPA is proud to have been at the forefront of developments and reform within the insolvency profession.

The IPA has approaching 2,000 members, of whom approximately 600 are Licensed Insolvency Practitioners. Additionally, the IPA now regulates IPs authorised by the ACCA under a collaboration agreement effective from 1 January 2017.

The IPA's IPs are subject to a robust regulatory regime, applied by the IPA's dedicated regulation teams carrying out complaints handling, monitoring and inspection functions.

The IPA has a longstanding and continuing commitment to improving standards in all areas of insolvency (and related) work. It was the first of the recognised bodies to introduce insolvency-specific ethics guidance for IPs, and the IPA continues to be a leading voice on insolvency matters such as the development of professional standards, widening access to insolvency knowledge and understanding, and encouraging those involved in insolvency case administration and insolvency-related work to acquire and maintain appropriate levels of competence and skills.

The comments and opinions expressed below represent the views of the IPA's Council and relevant committees, and are not intended to reflect the opinion of each individual and firm member of the IPA. Our comments in this response are based primarily on our role as an RPB, in which capacity we act as the beneficiary in respect of statutory insolvency bonds, subject to assignment of those benefits where appropriate to successor practitioners (SPs) where bond claims arise in respect of fraud or dishonesty on the part of original practitioners (OPs).

We set out below our responses to the specific questions within the call for evidence. Further enquiries should be addressed to:

David A Kerr FIPA MCICM, Chief Executive Officer
Insolvency Practitioners Association
Valiant House
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Question 1: These are the issues that have been identified as weaknesses of the current bonding system. Do you agree with this assessment? If you have any evidence, which demonstrates the impact of these weaknesses, it would be helpful if you could provide this.

Legal framework

'Prescribed bond requirements are unclear and costly'

The basic statutory requirement is clear in its intent, and we should remember that there is an overriding public interest imperative in the bonding system as there is in the insolvency regime more generally. That should drive policy making, and any changes that are contemplated as a result of this call for evidence. The public interest in this case is served by a system which succeeds in replenishing insolvency estates for the benefit of creditors when an IP/OP has misappropriated funds through fraud or dishonesty.

Some might interpret that as *acting* in the public interest, for example to investigate wrong-doing and seek to hold OPs to account, regardless of the outcome for creditors – a quasi-policeman role which serves the profession by 'cleaning up' its wayward members and demonstrating a robustness in self-regulation. This role, however, is not clearly defined, nor is there a clear funding model for it. As things stand the bond makes the OP jointly liable with his/her insurers for losses caused by the fraud. The usual route is for the SP to claim against the bond (which has more certainty of recovery) and then for the Insurers to take action against the OP although it appears they rarely do. Were policy-makers to decide that such a role is desirable, then some further consideration would need to be given to how that should work, and whether the associated costs (ultimately borne by creditors in one way or another for the most part) are worth the perceived benefits. Those benefits are likely to be intangible, though not unworthy, in terms of trust in the profession in a very general sense.

The first thirty years of the regime have seen a sort of hybrid develop, where the specialism for undertaking the sometimes (but not always) complex investigation work needed to bring bond claims has largely been undertaken by small number of commercial firms, usually following block transfers of cases from the OP. This, and the process/costs of agreeing claims, has led to circumstances in which costs appear to be disproportionate in some cases and as a consequence there is no net replenishment for the benefit of creditors.

'Statutory cover limits are inadequate and inconsistent'

The IP is required to bond each estate for the value of the assets coming into the IP's hands – the specific penalty sum (SPS) – and that aspect of the system is straightforward and for the most part. The 'top-up' general penalty sum (GPS) arrangement is applied inconsistently by different bond providers, and that causes unfortunate and unnecessary confusion for all concerned. This could be resolved by the Insolvency Service issuing minimum policy terms on a principles basis, rather than agreeing the individual bond wording, to ensure consistency.

One of the underlying problems with this approach to quantification of the SPS cover is the lack of provision of a consistent level of cover for costs of investigation on top of the value of the assets that may have been misappropriated from the estate. This leads to regular calls on the GPS.

The upper limit to the SPS has rarely proved to be inadequate, and there is little or no evidence of which we are aware to support an increase in the upper limit of £5m. In theory this limit could be inadequate to cover large asset-value cases, but in reality the conduct of such cases has seldom if ever not given rise to bond claims.

It is of course possible that an IP may have failed to secure a bond for a case or may have bonded to an inadequate level; whilst we do not have any direct evidence of that circumstance, we understand one of the SPs has found that position in at least one portfolio and has consequently needed to rely upon the GPS to meet a claim. Once costs of the SP are taken into account, SP's have needed to rely on the GPS cover for most portfolios transferred. The lower limit of £250,000 for the GPS could therefore be problematic.

If there is an inadequacy here, it is perhaps in the way in which the SPS and GPS work together. Whilst the former is case specific (and paid for by creditors), and the latter is general and enables the IP to act (and is paid for by the IP), is there good reason from an operational perspective to retain the two elements? At the very least, a consistent approach to the way the GPS applies, and a revision of the adequacy of the GPS limit, would be beneficial. If the GPS is required to provide cover in a case which an IP has failed to take out a bond, then a limit of £250,000 may prove to be inadequate; is there a sound logic for this being a fixed sum, rather than say related to the value of cases held by an IP?

Any changes to bond levels should take into account the impact on IPs in terms of the costs of premiums, particularly in respect of the GPS (and the SPS where there are no assets to cover the cost).

'Bonds rely on the honesty of a potentially dishonest insolvency practitioner to obtain adequate cover"

While in theory this is true, in practice we see bonding deficiencies in relatively few cases (on around 10% of inspections in 2015); that is not insignificant, but it is more commonly an isolated rather than systemic issue, and is not a major feature of our findings on inspection visits.

Where we do identify under-bonding, it is usually through inadvertence rather than dishonesty. We should remember that the number of IPs found to be unfit to act is very small; the regulatory regime is a mature one, and most IPs are honest and diligent in their work. In rare cases where dishonesty is proven, it is in our experience more likely to be opportunist and pressure-driven, as opposed to being the product of a fundamental state of mind.

The SPS premium is paid out of the insolvency estate and so incentives to reduce cover (and premiums) are low, although there is perhaps a greater risk in cases in which there are no unencumbered assets. Our monitoring programme tests bonding levels on a sample basis. Under-bonding is taken seriously and may attract regulatory action and/or corrective measures to address the issue.

‘Proceeds of a bond claim are not ring fenced’

This is perhaps the most significant single measure which alone might be capable of ensuring that the fundamental objectives of the regime are met – i.e. restoring funds to the estate for the benefit of creditors. We do not believe it requires legislative reform.

It is linked to the next point about fees, and at the core of that debate is a less-than-straightforward question about who approves and pays the fees.

The OP may have obtained a resolution from creditors in respect of his remuneration for undertaking the usual IP’s functions of asset realisation etc. The SP may seek to rely on that authority for fees, but given the very different (largely investigative) role of the SP, is this appropriate? Creditors are expected to take into account the nature and complexity of the tasks to be performed, and now have the opportunity to use one or more of three different bases for remunerating IPs.

Arguably, a fresh resolution ought to be sought by the SP in each case. This gives the creditors an opportunity to make an informed decision on the merits of the steps proposed by the SP, and the proportionality of the costs to be incurred, provided that the SP sets out a clear and transparent argument (on a case by cases basis, but see further comments below). Going forward, given legislative changes introduced in 2015, this should include an estimate of costs

Statement of Insolvency Practice (SIP) 9 could be enhanced on points of proportionality but already provides, as a central principle, that:

- *Those responsible for approving payments to an office holder …should be provided with sufficient information to make an informed judgement about the reasonableness of the office holder’s requests*

and identifies a number of key concerns including:

- *the work that an office holder anticipates will be done and why that work is necessary*
- *whether it is anticipated that the work will provide a financial benefit to the creditors*

To the extent that the bond covers the costs of bringing claims, there seems to be a process by which the agents for the underwriters agree to meet certain costs (usually settling on an amount less than that claimed by the SP), but on the basis of indemnifying the SP in respect of costs to which the SP may be entitled based on the authority from creditors. The bonds provide for the SP's duplicated costs in taking over the case and the reasonable costs of investigating the claim to be met from the bond (subject to available cover). The ring-fencing issue either arises because (1) the SP may seek to recover any shortfall out of the funds representing the principal loss agreed to be paid by the underwriters or (2) there is a shortfall in cover and it is not sufficient to cover both agreed costs of the SP and the primary loss. The follow example illustrates point (1):

£’000s

	Claim	**Settled**
Principal loss	100	100
Fees/costs	<u>200</u>	<u>100</u>
Total	300	200

If the bondsman only pays half of the fees claimed, and the estate receives a payment of £200,000, is it reasonable for the SP to draw on the sum paid in respect of the principal loss to recover the shortfall on fees? That would leave the creditors empty-handed, and some would argue that this would render the process pointless from a creditor perspective – notwithstanding the point made above about the greater, intangible, good in pursuit of worthy claims.

In most insolvency situations, there would need to be a careful evaluation of the costs of realising an asset before embarking on a course of action, and creditors and/or a creditors' committee would expect to be consulted. Ordinarily, costs would be expected to be less than the recovery sum being pursued.

Whether the dialogue that takes place in the above scenario is always in accordance with those principles and is fully transparent (e.g. as regards what has been allowed/disallowed by the bondsman and why) is something on which further evidence could be sought from relevant case files.

In one recent example, where we were asked not to assign but instead indicate whether we had any objection to a proposed settlement, we responded to the SPs' solicitors as follows:

> *In one sense, we are not a party to the settlement, and it is not for us to approve it. We are certainly not in a position to approve any of the fees and disbursements quoted by your clients. That is a matter for the creditors. So, at one level we are able to confirm that we have no objection to the settlement and would not wish to stand in the way of creditors receiving whatever sums may be due to them.*
>
> *We do however note that creditors are due to receive a distribution in only a small number of cases (5 out of 21), and that overall the amount available for distribution is only 11% of the total settlement sum. In some cases, the benefit to creditors of the action taken looks questionable, and will no doubt require some careful explanation to the creditors, not least to justify the costs incurred; an example here is the case of X, where funds in hand of nearly £18k have been expended in pursuit of a bond claim of £1k to the point where the costs exceed the total funds available and creditors receive nothing.*
>
> *In the context of the Government's call for evidence on bonding issues, this raises some interesting questions. They are not questions we can resolve in the context of this particular settlement, but we make these observations in the expectation that the successors will make a full disclosure and explanation/justification to creditors in each individual case so that creditors can make informed decisions about costs etc and avail themselves of the opportunities afforded to them in the legislation should they wish to challenge them.*

Further evidence of the settlement sums on this case is attached as appendix A.

We note also that currently there do not appear to be any effective protocols in place for agreement of claims, and this can exacerbate the costs issue.

'Lack of provision/control over successor insolvency practitioner fees'

The control here lies principally with creditors, but regulators have a part to play in ensuring transparency and compliance with existing practice directions, SIP 9, and the insolvency ethics code. Difficulties from a regulatory point of view may be confined to cases commencing prior to the introduction of fee estimates (i.e. pre-October 2015).

‘No statutory requirement for professional indemnity insurance’

RPBs set regulatory requirements as regards professional indemnity insurance (PII), and there is no obvious need for that to be strengthened by statute.

The cover limits though are generally less than those for the bond, and that may be important in certain cases where the bond is not activated (e.g. if the fraudulent act was perpetrated by someone other than the bonded OP). We have seen such a case in 2016, and the gap between the bond and PII is an issue under consideration at the moment, not least in the shape of a revised draft SIP 11; if regulators and consultees agree to the proposal in that draft for additional fidelity cover where funds control is delegated to persons other than the bonded IP, then we believe that would go some way to closing the gap, subject to addressing issues/inconsistencies around run-off cover for PII policies written on a claims-made basis, and the practical enforceability of those arrangements once an OP’s licence and professional membership has been terminated.

‘The bond only covers fraud and dishonesty by or with the collusion of the insolvency practitioner’

See above.

Practical Issues

Practical difficulties encountered in making bond claims are best evidenced by SPs. However, the obligations on RPBs are noteworthy. The deadlines for making claims often means that the SP lodges a protective claim close to the deadline date, and sometimes on that date; these invariably come to the RPB for onward transmission to the bondsman, and can put pressure on RPB staff to respond and act with an immediacy that is rarely warranted.

There is also the relatively rare phenomenon of claims being made in respect of currently-licensed IPs/OPs. In one example we are dealing with, the SP is acting only in respect of certain cases, not a complete portfolio, and there are differing views on whether the matters identified amount to fraud; fraud has not yet been proven and the OP’s licence has not been withdrawn, and this certainly gives rise to some practical issues - e.g. can an RPB make a bond claim, rather than merely notify "*circumstances which may give rise to claim*"? As part of this bonding review it would be useful to give more clarity over the circumstances where the RPB should assign the benefit of the bond. The current position can create a conflict. The RPB may be in a position of appearing to support a claim for fraud while at the same time licensing an OP, when the latter assumes that the OP is a fit and proper person to hold a licence and is not therefore guilty of fraud or dishonesty?

‘Variation in particulars of bond wording causes confusion’

Arguably the biggest issue here surrounds the GPS as noted above.

'Increasing costs of premiums'

We note that some premiums, particularly for IPs in smaller practices, have increased. That is largely something for the market to resolve, but we would not want to see changes that price IPs out of business. That would not serve the objective of promoting competition in the profession.

'Adversarial nature of claims'

Again, SPs are best placed to offer evidence here. There is a natural tension between the different interested parties, but some fast-track process for agreeing straightforward claims of modest value, assuming costs are also proportionately modest, would be in creditors' interests.

It is not clear whether the reliance on one main firm of loss adjusters is an advantage or disadvantage in this respect; on the one hand they have a degree of expertise, but on the other hand their apparent monopoly could cause a blockage in the system.

'Cessation of cover on non-payment'

A bond is a bond. The RPB issues a licence on the strength of it, and creditors are entitled to assume that the IP is bonded, as required by statute. It is entirely inappropriate in our view for an underwriter to grant credit terms to an IP and then seek to use the remedy of cancellation for non-payment. Such action renders the checks carried out by RPBs pointless. In no circumstances should cancellation/cessation have retrospective effect. Reasonable notice both to the IP *and the RPB* of an intention to cancel at a future date, or not to renew, is another matter; this requires a clear understanding between the parties as to how and when this might be activated, and sufficient time to deal with the consequences of those measures.

'Limited number of insolvency practitioners willing to take on successor appointments'

Only a small number of IPs currently act as SPs. There is no reason to restrict that work to a few, provided those wishing to undertake the role have the capacity and competence to do it, and agree to any protocol that may be put in place. If we were to be actively seeking the appointment of an SP, then subject to the above proviso and any other considerations we would look to an IP that we license so as to be able to monitor directly the activities of the SP.

Question 2: Are you aware of any other weaknesses with the current system that have not been identified? Again, it would be helpful if you could provide any supporting evidence.

The comments we wish to make are covered elsewhere in this submission.

Question 3: Do you think that similar arrangements to those covering fraud and dishonesty in the legal profession would work in the insolvency profession?

We would not support the introduction of a compensation fund. This would introduce another layer of complexity and cost. There is an insufficient number of IPs to render such a scheme economically viable. It would effectively mean the majority of honest practitioners would be heavily subsidising the dishonest ones.

Question 4: Are there any other issues that you would like to see addressed through a claims management protocol?

There would be a need to ensure that all interested parties are able to contribute to this, including SPs, RPBs, bond providers, loss adjusters and perhaps also a representative of creditors, such as the Chartered Institute of Credit Management and/or HMRC.

Question 5: Do you think the introduction of a claims management protocol and regulatory action, alongside the existing legislative framework, would be sufficient to resolve the weaknesses identified with the bonding system?

We think that a non-statutory claims management protocol or equivalent, when built into RPBs' regulations, could have regulatory force when viewed in conjunction with the ethics code, SIPs and existing statutory provisions and practice directions regarding fees.

Question 6: What do you consider would be the likely impact of removal of the statutory bonding requirements for a) insolvency practitioners and b) the protection of creditors?

We do not think this is advisable. We are seeing some claims, and so there is demonstrably a need for a bonding regime. Dismantling it rather than fixing its deficiencies seems an inappropriate solution, and would send the wrong signals to stakeholders. It is important that any changes made to the present system are conducive to strengthening trust and confidence in the insolvency profession.

a) The burden on IPs is not great, subject to our comments elsewhere regarding GPS premiums;
b) Protection of creditors would be undermined by removal of the scheme, subject to current deficiencies being addressed.

Question 7: Do you consider we have correctly assessed the advantages and disadvantages of these options as set out above, and the potential impacts? If not, please give your reasons.

a) Amend the current prescribed terms of a bond

We comment above on the two main areas we see for change – firstly, the GPS cover level, the way this works with the SPS, and the deadline for claims; and secondly addressing the remedies around non-payment of premiums. These should be standardised in our view.

b) Provide that the proceeds of a claim for the benefit of creditors are ring-fenced from the investigation costs

We support this in principle. We recognise the value in the work that some SPs carry out, the investment they make and the expertise they have built up, and that there is a need to ensure that they are properly remunerated for work reasonably undertaken in the necessary performance of investigation and other tasks for the benefit of creditors. Creditors' interests are paramount however, and costs must be based on a proportionate approach with creditor consultation and full transparency. If the creditors do not wish to pursue a claim as they perceive it is too costly to be worthwhile, they should surely be at liberty to reach that decision.

The role of the SP is to serve the creditors, not act without reference to their wishes or the costs involved

The costs of distribution of the proceeds of a claim (the agreed principal loss) are of course a necessary expense of the estate, but a call on that sum to meet a shortfall disallowed by the bondsman should be fully justified in the same way that any fee paid to a 'trustee' in respect of administration of an estate must relate to work demonstrably undertaken for the beneficiaries of that estate. Particular care must be taken where an SP seeks to recover general or pooled costs relating to a portfolio of cases; it is difficult to see how creditors would be persuaded of the justification for recovering costs incurred in one estate from assets recovered in another.

c) Provide for investigative costs as a prescribed requirement of a bond

We understand SPs' concerns that the bond level, fixed in relation to asset values, might be inadequate in certain circumstances. If the bond, as now, is designed to cover costs in addition to the value of funds misappropriated, then there is a case for considering an up-lift in the bond cover to reflect this. We have seen suggestions of asset value plus 25% and think this is worth exploring further, subject to remarks above regarding the £5m upper limit and premiums.

d) Agree or legislate for a 'de minimis' maximum indemnity period

We have commented above on a need to harmonise arrangements in this respect.

e) Remove requirements for monthly cover schedules and provide for an annual or global bond cover

We would not wish to see this removed or amended without very careful consideration. The IPA is perhaps alone amongst the RPBs in logging all the data we receive from the monthly cover schedules. We believe this plays in important part in our monitoring of IPs' activities and provides early warning of practice changes that may flag risks and a need for regulatory action. We do not believe the time spent (and cost) by IPs in complying with this requirement is burdensome. The regulatory benefits that flow from the use of this information outweigh any administrative advantages in removing the requirement in our view.

f) Amend the existing monetary limits of the GPS/SPS

We comment on this above, in particular regarding the limit on the GPS and how that works in conjunction with the SPS.

g) Introduce a duty that investigative costs must be proportionate to loss/cover

We comment on this above, but in principle support this suggestion. As we note elsewhere though, this is an existing requirement in respect of all fees and costs. There may be more that can be done to actively enforce those requirements, and perhaps communication with creditors could be improved – our guidance to IPs on transparency is a relevant consideration here; see –

http://www.insolvency-practitioners.org.uk/download/documents/718

h) Protect estate from non-payment

We comment on this above. This is vital in our view if the bond is to be relied upon.

i) Include professional indemnity as a requirement for security, including run-off cover

As noted above, we do not believe this requires statutory intervention. However, there may be a case for the Insolvency Service to set some minimum requirements for IPs' PII to cover the issues flagged above regarding run-off cover periods, cover limits etc.

j) Agree or legislate for insolvency practitioner firms to hold fidelity guarantee or similar insurance to protect creditors from fraud by persons other than the insolvency practitioner

We support this and would like to see the provisions of the present draft of SIP11 agreed and implemented as soon as possible.

Question 8: Do you agree the paper sets out the full range of issues, or is there anything further which should be considered?

This has been addressed throughout our response above.

Question 9: Of the proposed options for legislative change, which would be your preferred approach and why?

The most pressing legislative fix is in relation to the GPS for the reasons stated above.

Question 10: Do you have any further comments you would like us to consider in relation to bonding?

We have no further comments.