Regulation of insolvency practice

Consultation response

17 March 2015

Introduction

1. This report summarises the feedback that we received during our recent consultation on the regulation of insolvency activities. It sets out our response to that feedback and our proposed next steps.

Background

2. Acting as an insolvency practitioner is a regulated activity that is separate and distinct from the provision of legal services and is subject to a separate authorisation regime under the Insolvency Act 1986. We are one of seven Recognised Professional Bodies (RPBs) for the purposes of authorising solicitors to act as appointment takers in insolvency matters. We authorise 129 solicitor insolvency practitioners (IPs) of whom only around 22 actually act as insolvency appointment takers. We are the second smallest RPB in terms of authorised IPs who take appointments. The remainder of our authorised IPs hold the authorisation to provide advice on legal issues to insolvency takers but there is no legal requirement for them to be authorised for this purpose.

3. In the consultation, we sought views on a proposal that we should take appropriate steps to stop authorising solicitors as IPs . This would mean that solicitors wishing to carry out regulated insolvency activity would need to apply to another suitable regulator for authorisation.

The consultation

4. The consultation was published following careful consideration of the rationale for the proposals and the potential impacts by our Standards Committee.

5. We asked stakeholders:

   - whether they agreed with our proposals;
   - if not, why not; and
   - whether there were any impacts of the proposals that we had not considered.

6. The key stakeholder group affected by our proposals consists of the 129 solicitor IPs that we authorise, including the 22 who actually take insolvency appointments. It also includes the Insolvency Service, the Law Society and the other RPBs who regulate insolvency practitioners.

7. We contacted all solicitor IPs individually to tell them about the consultation and to invite them to a meeting to discuss the proposals with senior SRA staff. 19 solicitor IPs attended the meeting and the feedback from the meeting has been included in this summary of consultation responses. We have also engaged with the Insolvency Service and feedback from them is included in this response.

8. Both before and during the formal consultation, we engaged with other RPBs to understand the potential impact on solicitor IPs and to understand the regulatory alternatives available to them. We obtained information about the potential cost and process involved for solicitor IPs in transferring their authorisation to another RPB should our proposals be implemented and this information was shared directly with all solicitor IPs. We engaged with the Law Society informally throughout the process and the Law Society attended the stakeholder meeting.

Summary of our response and next steps

9. We received 17 formal responses to the consultation. We received responses from the Law Society, the Insolvency Lawyers Association, Liverpool Law Society and the Sole Practitioners' Group, 12 responses from individual solicitor IPs and 1 response from a non IP solicitor who has recently taken the Joint Insolvency Examination Board exams. One of the respondents indicated that he was responding both in an individual capacity and on behalf of his firm. In addition, 19 attendees at the stakeholder meeting shared their views about the proposals which have been taken into account in the summary of responses. 6 of the attendees also submitted formal responses. Three of the formal respondents, Liverpool Law Society and two solicitor IPs, agreed with the proposals. The remainder did not agree and expressed a range of concerns.

10. There is substantial strength of feeling against the proposals and in favour of continued regulation by the SRA amongst the majority of solicitor IPs who engaged with us. Some respondents suggested that they would cease being authorised as an IP altogether if they were required to seek authorisation from another RPB. All of the concerns and issues raised, both those we had already considered and addressed in the consultation paper and issues which we had not previously considered, are set out below together with our response.

11. We have given full consideration to the range of views expressed. Whilst we acknowledge these concerns, we remain of the view that the public interest can best be served if solicitor IPs are regulated by other RPBs. We have set our rationale for this in full below but in summary:

- Acting as an insolvency practitioner is a regulated activity that is separate and distinct from the provision of legal services and is subject to a separate authorisation regime under the Insolvency Act 1986. Only 129 solicitors are authorised by us for this purpose and, of those, only 22 actually take insolvency appointments. The remainder hold the authorisation in order to market themselves as solicitors with some expertise in insolvency, although many of their competitors offering legal advice in this area do not do so. There is no requirement for them to be authorised for this purpose. Therefore, as acting as an insolvency practitioner is distinct from the legal services provided by those we regulate, we do not think it is in the public interest to devote regulatory resource and capacity to authorisation of insolvency practitioners.

- The public interest will be better served if solicitor IPs are regulated by Recognised Professional Bodies (RPBs) with specialist expertise in this area.

- A reduction in the number of RPBs regulating in this area is consistent with recent reviews of the insolvency market. It would promote consistency and efficiency and could reduce the overall cost of regulation which would ultimately benefit creditors.

- This is a low risk decision because, although it will have a significant impact on the small number of IPs that we regulate, they have the option to be regulated effectively elsewhere.

- This position is consistent with the approach that we have already taken in relation to MDPs where suitable external regulation is accepted in a areas outside of mainstream solicitor services.[1]

12. The Insolvency Service has itself noted that recent reviews of the insolvency market[2] have concluded that a reduction in the number of insolvency regulators would be a positive move which would improve both consistency and efficiency of regulation.

13. We will now make the necessary changes to our regulatory arrangements and seek approval from the Legal Services Board for these to take effect from 1 November 2015. We will contact all solicitor IPs directly once we have a decision from the Legal Services Board to explain the next steps in the process. We will also work with the Insolvency Service to seek an Order from the Secretary of State to remove the Law Society's RPB status in due course. We will work closely with the other RPBs to ensure as smooth a transition as possible and to ensure that effective arrangements are in place to share information and minimise the risk of confusion about where responsibility lies for disciplinary action.

[1] http://www.sra.org.uk/sra/policy/policies/multi-disciplinary-practices-sept-2014.page
[2] The Office of Fair Trading's 2010 report into the market for corporate insolvency practitioners and Professor Elaine Kempson's 2013 report into insolvency practitioner fees

Summary of issues raised

The proposals are not in the public interest

14. Respondents expressed the view that the proposals were made in the interests of the SRA rather than in the public interest.

> "In the consultation the SRA does not seek to suggest that there would be any benefit to anyone or the public interest if the Law Society ceased to be an RPB and the SRA was thereby relieved of its resultant responsibilities. That is unsurprising because it is impossible to see what benefit to anyone could possibly result. Clearly therefore what lies behind the SRA's proposal is simply its own preference as to what should be expected of it...." [A solicitor IP on his own behalf and on behalf of his firm]

15. Respondents argued that the proposals would be to the detriment of creditors because they would increase costs and that it could not be in the public interest if the number of solicitor IPs was reduced, restricting choice, competition and access. They suggested that concerns about our ability to regulate IPs as effectively as some of the other RPBs should not be a driver for ceasing to regulate them and that we should make the necessary investment to build up our capability and capacity and call on the expertise of the solicitor IPs that we regulate to assist with this.

Our response

16. The SRA exists to protect consumers of legal services and uphold the rule of law. We agree that any decision about whether or not to continue to regulate solicitor IPs should be taken from a public interest perspective. We do not believe that it is in the interests of the public to divert regulatory resource to an area that is not integral or necessarily linked to the services provided by those we regulate and where solicitor IPs can be regulated elsewhere by other RPBs with specialist expertise.

17. We have discharged our regulatory obligations up until now by contracting out key activities to other RPBs. This enables us to continue to authorise solicitor IPs but it has also prevented us from building up our own expertise. It has been suggested that we should simply continue to contract out the key regulatory functions, including any new functions, to other RPBs. However, it is not in the public interest for us to regulate in an area unless we have the capacity and expertise to identify emerging risks and to know when to take regulatory action, as well as to undertake the enhanced regulatory obligations for RPBs being proposed by Government.

18. As we said in our consultation, the regulatory regime for insolvency is designed specifically for the insolvency market. It is out of step with the way in which we regulate the legal market and requires us to have specialist expertise and bespoke systems to regulate the 129 solicitor IPs that we authorise. This activity requires us to divert both staff and resources from our core regulatory activity. We do not believe this is in the public interest.

Concerns about regulation by another RPB

19. Many of the solicitor IPs who engaged with us expressed a range of concerns about the prospect of being regulated by another RPB. Some expressed concern that solicitor IPs might find it difficult to get authorisation or re-authorisation from the accountancy RPBs who would be concerned about competition from solicitors.

    "There are possible conflict of interest issues regarding regulation by ICAEW/ACCA who may take the view that their primary role is to protect the accountants profession and the accountants that they represent. There is some concern that, as a profession, the accountants would prefer not to face competition within the field from solicitors with the result that the regulatory regime is more appropriate for accountant qualified office holders rather than for solicitors." [Individual solicitor IP]

20. Some respondents expressed the view that the accountancy profession has different values from the solicitors' profession and that they would have more confidence in an investigation carried out by the SRA than an accountancy body. They also argued that solicitor IPs have higher standards than IPs regulated by other RPBs and they would prefer to continue being regulated by a dedicated RPB that is tailored to the legal market and can promote "a more aggressive approach to standards".

21. Concern was also expressed that, if solicitor IPs choose not to be regulated by another RPB, this will result in a monopoly for accountants. They suggest that solicitor IPs provide a unique set of skills that provides a choice beyond that available from accountant IPs and that consumers who seek a solicitor IP do so because they expect solicitors to adhere to higher standards. If the number of solicitor IPs is reduced, this would restrict consumer choice and competition.

Our response

22. We have engaged with the other key RPBs as part of the consultation process and they have all indicated a willingness to authorise solicitor IPs if our proposals are implemented. Indeed, some of them already authorise a number of solicitors as IPs. They have all provided information which we have made available to solicitor IPs about the costs and process involved with transferring authorisation. Some RPBs have made commitments regarding the future cost of authorisation to assist solicitor IPs with the transition. They also offer reduced rates for non appointment takers and they have established bespoke procedures for authorisation that will make it as simple as possible for solicitor IPs to transfer if they wish to. We will continue to work closely with the other RPBs to facilitate this process.

23. We do not accept the suggestion that the other RPBs will make it more difficult for solicitor IPs to be authorised in order to protect their own members. The accountancy membership bodies already provide authorisation to non-members and all of the other RPBs will be subject to the same regulatory standards as the SRA currently is and their regulatory activities will be overseen by the Insolvency Service to ensure that they are discharged fairly. It would be inappropriate for them to unjustifiably restrict

access to solicitor IPs and as responsible regulators we do not believe that they would seek to do so.

24. We do not believe that there is a significant risk of competition and choice being reduced if our proposals are implemented. We currently authorise only 129 IPs out of a total of 1677[3] IPs. Our proposals do not mean that solicitors can not continue as IPs, only that they must be authorised by another RPB. They will continue to be regulated by the SRA as solicitors and they will still be able to market themselves on that basis. Only 22 of the IPs that we regulate actually take insolvency appointments and of those only a handful take more than 10 new appointments each year. Solicitor IPs regulated by us do not make up a large share of the current market, therefore. We are not aware of any problems with the supply of IPs and do not envisage any detrimental impact on the market if a small number of solicitor IPs choose not to seek authorisation with another RPB.

25. We do not accept that the implementation of our proposals will result in a monopoly for accountants. The insolvency market consists not just of solicitor and accountant IPs but also individuals who have chosen insolvency as a specialism and who do not necessarily have an accountancy or legal background. Solicitors have a choice between a number of regulators from which to seek authorisation, one of which is not a specialist accountancy body and has a diverse membership.

Solicitor IPs will be subject to dual regulation and 'double jeopardy'

26. One of the most frequently cited concerns raised during the consultation period related to 'dual regulation' of solicitor IPs which could result in conflict between the regulatory requirements of the other RPB and the SRA principles. This concern was raised by both the Law Society and the Insolvency Lawyers Association. There was also concern that solicitor IPs would be at risk of 'double jeopardy' where they are subject to two separate disciplinary investigations. It was suggested that this could not only be frustrating for the solicitor IP but could also cause confusion for consumers.

27. The Insolvency Lawyers Association said in their response: "The prospect that solicitor IPs would need to seek a new RPB (whose founding ethos is not to provide for the needs of solicitors or lawyers) creates a risk of "double jeopardy" for those persons being subject to two separate regulatory bodies in the performance of their professional work. At best this would be parallel regulation of the same person's practice but carries risk that such parallel regulation becomes divergent rather than convergent.....There should be one regulator for solicitors. Consumers (ie clients and creditors) expect to find a clear and single gateway to raise their concerns: they should not have to face a multiplicity of routes."

Our response

28. We accept that our proposals will result in dual regulation for solicitor IPs as they will need to seek authorisation from a separate regulator for their

[3] Correct at 1 January 2014 - "Strengthening the regulatory regime and fee structure for insolvency practitioners" The Insolvency Service 2014

insolvency activities. However, we do not accept that this will result in 'double jeopardy' in the case of an investigation and, as we said in the consultation paper, we will put in place appropriate systems for the sharing of information with the other regulators to avoid any unnecessary duplication and ensure appropriate protections are in place for the benefit of consumers.

29. The position is the same as it is for solicitors who are regulated elsewhere for the provision of certain services eg financial services. Solicitor IPs would need to be clear with their clients in what capacity they are acting so that their clients know who to complain to. Where the complaint relates to their role as an insolvency practitioner , the insolvency regulator would investigate it. If the complaint is upheld, the other regulator would share the information with the SRA and we would need to consider whether it had any implications for the individual's fitness to practise as a solicitor. This is not double jeopardy but the result of operating in two fields and is no different from the position in relation to a criminal offence, for example, which might result in both criminal and disciplinary proceedings. We already have systems and procedures in place for the sharing of information and responsibilities with other regulators in other fields and we will set up similar systems in respect of solicitors regulated elsewhere for insolvency practice.

Loss of influence

30. A number of respondents were concerned that solicitor IPs would lose the ability to influence insolvency practice and regulation under our proposals since the Law Society/SRA will no longer be represented on stakeholder groups such as the Joint Insolvency Committee and the Joint Insolvency Examination Board. It was suggested that "the Law Society has significant influence over insolvency matters by this representation" and this voice would be lost. The Law Society pointed out that it would be hard to imagine other professional bodies lobbying on behalf of non-members.

Our response

31. We accept that our proposals will mean that the Law Society/SRA will no longer be represented on stakeholder groups. However, the small number of IPs that we regulate compared to the overall market has meant, in practice, that our influence on the regulatory regime has been limited. Our role as a regulator also means that it is not appropriate for us to dedicate regulatory resource to activities that would be more appropriate for a representative body to carry out.

32. The accountancy bodies already authorise and represent non member IPs and the other RPB is a membership body focusing solely on insolvency practice with a diverse membership base. We believe that solicitor IPs will receive better support and be better represented by other RPBs whose economies of scale and greater focus on this area of regulation enable them to provide bespoke services to their authorised IPs including representation, newsletters, webinars, roadshows, conferences and CPD events, online communities and dedicated web resources. The other RPBs also have

dedicated committees which provide an opportunity for IPs to influence insolvency practice and regulation. The establishment of such a committee would not be appropriate for the SRA.

Cost implications

33. Some respondents commented on the increased cost if they were regulated by another RPB. Some also commented on the need for the SRA to invest in its capability and capacity to regulate solicitor IPs and the cost increases that would result. However, many of the solicitor IPs who engaged with us indicated that cost was not a key factor and that they would be prepared to pay more to avoid being regulated by another RPB. They were happy to pay an increased fee if they were effectively regulated and if the Law Society represented them well.

    "Most solicitors who are regulated in the same way would be willing to pay more if necessary not to have to take on the burden of dealing with two regulators and pay two sets of fees." [Individual solicitor IP]

34. It was also suggested that, as the number of solicitor IPs is small, it would not cost the SRA a significant amount to deal with the new obligations that will arise as a result of the forthcoming reforms to insolvency regulation. The Sole Practitioners' Group indicated that we should continue to regulate solicitor IPs only if we can properly regulate them at a cost that can be reasonably met in full by solicitor IPs. If the cost had to be met by the whole profession, they concluded that solicitor IPs should be regulated by another RPB.

Our response

35. We agree that cost is only one of a range of factors that must be considered in making this decision. If the SRA were to continue to regulate solicitor IPs we would need to increase the time and budget allocated to this activity. We acknowledge that solicitor IPs would be prepared to pay more to continue to be regulated by the SRA. However, as we have already said, continuing to regulate insolvency practice, particularly in the context of the new regulatory obligations, requires us to divert both staff and resources from the regulation of core legal services. This is not an efficient way to manage our resources. We do not believe it is in the public interest to divert our limited resource to a regulatory activity that is not integral, or necessarily linked, to the practice of a solicitor and where the option exists for those individuals to be regulated more effectively and efficiently by other regulators. In addition, it would always be uneconomic for us to provide the level of support and additional services that solicitor IPs desire and that the other RPBs are able to.

36. Whilst cost alone is not the only driver for our proposals, we are concerned that the costs of regulation will increase if the Insolvency Service reviews the way that it charges RPBs for its oversight activities. One possible outcome is a flat fee per RPB. If such a proposal is implemented, it would significantly increase the costs of regulation payable by the small number of IPs that we regulate and this, together with the increased costs that would be payable by

solicitor IPs in order for us to regulate effectively under the new regime, would have a negative impact on creditors. A regime with fewer regulators which can benefit from economies of scale will be more efficient and effective in the public interest.

The SRA's power to decide

37. Attendees at the stakeholder meeting and many of the respondents to the consultation queried the SRA's power to make the decision about whether or not to regulate solicitor IPs, suggesting that it was only the Law Society, as the RPB, that had the power to make this decision.

Our response

38. Following the Legal Services Act, regulatory functions including those in relation to insolvency practice, have been delegated to the SRA. The Law Society is an important consultee but is not the decision maker on this issue. The Law Society has not argued this point either in discussions or in its response to the consultation. We will, of course, need to apply to the Legal Services Board for approval of the necessary change to our regulatory arrangements and the Secretary of State will need to make an order to remove the RPB status.

Authorisation as a 'kite-mark'

39. It was suggested at the stakeholder meeting and by a number of respondents to the consultation that the SRA should continue to regulate those solicitor IPs who do not take insolvency appointments but who provide legal advice on insolvency matters on the basis that the licence provides these solicitors with a 'badge of quality' which differentiates them from other solicitors advising in this area who do not hold the licence. Solicitor IPs argue that the insolvency licence has become a recognised kite-mark and it would not be in the public interest if the number of non-appointment takers with the kite-mark declined as a result of our proposals.

Our response

40. Continuing to regulate solicitor non-appointment takers in order to provide them with a 'badge of quality' would be akin to the SRA running a voluntary accreditation scheme (along the lines of the Law Society's voluntary accreditation schemes). Such activity would not represent a targeted or proportionate approach to regulation in this area and would not be consistent with our regulatory obligations or our wider strategy.

Solicitor IPs as role holders in solicitors' firms

41. Some respondents pointed out that when a solicitors' firm is in financial difficulty and needs to appoint an insolvency practitioner, the SRA recommends that the IP is a solicitor (except in the case of a pre-pack administration sale to another law firm). It was suggested that this could be

problematic if the number of solicitor appointment takers declines as a result of the proposals.

Our response

42. It is correct that our current guidance to firms in financial difficulty recommends the appointment of a solicitor IP in the role of administrative receiver, administrator or liquidator. We are currently reviewing this guidance and will be issuing revised guidance on this point in due course.

Indemnity insurance and compensation fund

43. Some respondents requested more information on the impact of our proposals on solicitor IPs in licensed bodies and one respondent queried whether we had considered the impact on insurance premiums of solicitor IPs being regulated by another RPB.

Our response

44. We said in the consultation that, in addition to the dual bond system which insures the estate against losses arising out of fraud or dishonesty, a solicitor IP acting on an insolvency appointment would continue to be covered by indemnity insurance as the activity would still fall within the definition of "private legal practice" for that purpose. We also said that there was nothing that would exclude this work from the SRA Compensation Fund in the case of recognised bodies.

45. In the case of licensed bodies, we said that we would do more work to understand the position. Of the 129 solicitor IPs, only 7 are in licensed bodies and only 1 of these takes appointments. Pure insolvency work, for example, disposal of assets or agreeing creditors' claims will not be covered by the Compensation Fund or the minimum terms and conditions (MTC) of professional indemnity insurance as this activity would not fall within the definition of 'regulated activity' in the SRA's Handbook unless specifically stated in the terms of the licence. This is the case whether or not the solicitor IP is regulated by us or by another RPB and is consistent with other non legal activity undertaken by a licensed body eg estate agency. Our proposals do not change the current position, therefore.

46. The advice that we have received from our professional indemnity insurance advisers is that, to the extent to which a relevant SRA firm has cover for both its legal services and IP activities, they do not believe a change of regulator for the solicitor IPs would result in any increased professional indemnity insurance cost.