

Consultation

Regulation of insolvency practice

November 2014

Introduction

1. The SRA is an independent regulator of legal services providers in England and Wales. This paper seeks views on a proposal that we should take appropriate steps to stop authorising solicitors as insolvency practitioners. This means that solicitors wishing to carry out regulated insolvency activity would need to apply to another suitable regulator for authorisation.
2. This consultation paper will be of interest to solicitors currently authorised as insolvency practitioners (IPs), organisations employing solicitor insolvency practitioners, solicitors or regulated entities thinking about moving into insolvency practice and regulators, representative and consumer bodies with an interest in the insolvency market.

Background

3. We are a Recognised Professional Body (RPB) for the purposes of authorising solicitors to act as appointment holders in insolvency matters. This recognition is granted under the Insolvency Act 1986 to the Law Society which has delegated its regulatory functions to the SRA.
4. We are one of seven RPBs recognised under the Act. We currently authorise 124 solicitor IPs out of a total of 1677¹ across the seven bodies. Solicitor IPs form only a very small part of the insolvency market and only 21 of the 124 individuals we regulate currently take insolvency appointments. Some of the solicitor IPs that we regulate use the authorisation as confirmation of their competence to advise and assist insolvency office holders on legal issues arising from their appointments even though there is no legal requirement for them to be authorised for this purpose.

Regulation of insolvency practice

5. Insolvency practice in the UK is governed by statute and supported by Statements of Insolvency Practice and an ethical guide with which all IPs must comply. The SRA's standards for solicitor IPs are set out in the SRA Insolvency Practice Rules 2012. Regulation of insolvency practice is overseen by the Insolvency Service through a Memorandum of

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

Understanding (MoU) with the RPBs. The MoU sets out principles for authorisation, ensuring common professional standards, handling complaints, disclosure and exchange of information, retention of records and reporting.

6. We cover the cost of regulating solicitor IPs through an annual fee payable by each IP - currently £520. The fee covers levies payable to various third parties and the current operational costs of meeting our obligations under the MoU.
7. Prior to 2007, solicitors who wished to become insolvency appointment holders were required to be authorised by the Law Society/SRA unless they were directly authorised by the Secretary of State. Since 2007, solicitors can apply to any of the RPBs or the Secretary of State for authorisation.
8. Following that change, we issued a consultation in 2008 proposing that we withdraw from regulating insolvency practice and that solicitor IPs should seek authorisation from another regulator. During the consultation, some solicitor IPs argued that it was not the right time for the SRA to withdraw from this area as the Legal Services Act 2007 had recently been implemented and this might make insolvency a more attractive field for solicitors and therefore more central to the practice of some solicitors. As a result of discussions with solicitor IPs and the Law Society, we agreed to defer a decision to allow time for the effects of the market changes to be realised and for wider decisions regarding the SRA's approach to regulation to be taken. In fact, as we say below, the number of solicitor IPs has declined since 2008. Further, the government is proposing changes to the regulation of IPs which mean that if we continue as an RPB we would need to change our regulatory approach. It is an appropriate time to consider again whether we should withdraw from this activity.

Rationale for our current proposal

Inconsistency with SRA's approach to regulation

9. The SRA exists to protect consumers of legal services and support the operation of the rule of law and the proper administration of justice. Our approach to regulation is designed for the legal services market where the issues and risks are different from the insolvency market. We are focussed on developing and delivering regulation that is proportionate to the nature of an entity, the services it provides and the associated risks. Our approach has generally led to the removal of detailed and prescriptive rules.
10. The regulatory regime for insolvency is designed specifically for the insolvency market. It imposes detailed obligations on those it regulates. It requires us to regulate solicitor IPs in a way that is inconsistent with the way we regulate the legal services market. The regulatory regime for insolvency requires us to have a bespoke system for conducting monitoring visits to solicitor IPs, for handling complaints against solicitor IPs and for consideration and reporting of the outcomes of these activities. In recent years, the inconsistency between the approach required by the insolvency regime and our own regulatory system has led us to contract out these activities to other RPBs in order to ensure we can meet our regulatory obligations.

Capability and expertise

11. As stated above, despite predictions to the contrary, the number of solicitor IPs has reduced since we consulted in 2008 from 146 to 124 and we have only received 4 new applications in the last two years. The small number of IPs that we regulate, the fact that insolvency regulation is not a core function of our regulation of the legal services market and our contracting out of key insolvency activities mean that we have needed to rely heavily on the expertise of other RPBs. If we were to continue as an RPB, it would be important to build up our capability and expertise so that we could better understand the risks associated with this market. This would require us to recruit and train staff and is likely to take a considerable amount of time and resource. This could have disproportionate cost implications for firms and IPs and therefore for consumers.

Cost effectiveness

12. There is a strong drive within government to improve standards within the insolvency market. This follows recent reports² which have suggested there is both a failing in the regulatory system and a market failure when unsecured creditors bear the costs of an IP's remuneration. The improved standards will be achieved, in part, through greater obligations on RPBs. There is a clear expectation that RPBs must raise their game if they wish to retain their RPB status and this will be enforced through greater scrutiny of RPBs by the Insolvency Service. A package of reforms of insolvency regulation is included in the Small Business, Enterprise and Employment Bill 2014-5, which is currently going through the parliamentary process; if this Bill receives royal assent then these reforms may come into force towards the end of 2015.
13. If the regulatory change is implemented, we will be required, amongst other things, to have an enhanced role in identifying malpractice in the fees charged by IPs. This could include an obligation to ensure that our regulatory arrangements classify any excessive charging of fees as misconduct, to investigate complaints made about the quantum of an IP's fees in addition to complaints about the processes by which fees have been charged and to monitor IPs to ensure that fees charged are fair and reasonable for the work undertaken. We will also be subject to a wider range of regulatory sanctions, including the imposition of financial penalties and public reprimands, if we do not discharge our responsibilities as an RPB effectively.
14. There is also a focus on improving transparency in the process for handling complaints against IPs and we are likely to come under pressure to join the voluntary 'Complaints Gateway'³ which we have previously declined to join because we were concerned that it would increase the cost of regulation disproportionately. We will also be subject to greater scrutiny in how we manage the outcome of complaints to ensure our outcomes are consistent with those of other RPBs.

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

³ A centralised complaints portal operated by the Insolvency Service for anyone who wishes to make a complaint about an insolvency practitioner. The Insolvency Service passes on the complaint to the relevant RPB for investigation.

15. Now more than ever, therefore, we need to ensure that we have the necessary capability and expertise to regulate effectively in this area. The time and cost likely to be needed to ensure we can fulfil these new obligations is difficult to measure but, by way of example, the cost of joining the Complaints Gateway is £40 per IP per year and the Insolvency Service has indicated⁴ that the total additional cost across all RPBs to handle complaints about quantum of fees could be in the region of £1,684,650⁵. If this was spread across the RPBs according to the number of IPs they regulate, the potential cost to the SRA which would need to be recovered from the IPs that we regulate could be £124,565 (over £1,000 per IP).
16. We are also aware that the Insolvency Service is reviewing the way in which it charges RPBs for its oversight activities. One possible outcome is a flat fee per RPB. If these proposals are implemented, it will significantly increase the costs of regulation payable by the SRA to the IS and, as a result, the costs payable by the small number of IPs that we regulate.

Focus on our core activities

17. We find it increasingly difficult to see how we can continue to meet our obligations as an RPB within a regulatory regime which is fundamentally different from the one which we have developed for legal services and where we do not have economies of scale due to the small number of IPs we regulate. Up-skilling ourselves and committing the necessary time and resource needed both to regulate effectively in this area and to meet the new obligations will distract us from our core activities as a regulator of legal services.
18. We have already acknowledged our desire to focus on our core activities in our recent consultation on consumer credit. We have concluded that where there are other regulators who can regulate more effectively in a specific area outside legal services and where consumers would not be negatively affected, we should withdraw from that market and enable solicitors to be regulated by others with the necessary capability and expertise. This will ultimately benefit consumers who can have confidence that solicitors are being regulated effectively in all of the activities that they carry out.

Impact of our proposal

19. We have considered the impact of our proposal on solicitor IPs and the consumers that they serve. Our conclusion is that the proposals will have no detrimental impact on consumers and may in fact benefit consumers if solicitor IPs are regulated by RPBs with greater capability and expertise in this area and who can benefit from economies of scale due to the larger number of IPs they regulate. There is a risk that some solicitor IPs may decide not to seek reauthorisation with another RPB but, given the very small number of solicitor IPs who currently take appointments and the small market share that solicitor IPs represent, we do not believe that this would have any detrimental impact on the insolvency market. We are not aware of any issues

⁴ Insolvency Service impact assessment accompanying "Strengthening the regulatory regime and fee structure for insolvency practitioners 2014"

⁵ This does not include set up costs as the IS assumes that the current system for handling complaints would be used by RPBs.

with consumer choice adversely affecting the market for insolvency. Therefore, if solicitor IPs remove themselves from the market as a result of the SRA ceasing to be an RPB, it is reasonable to assume that the market will not suffer.

20. The proposal will have an impact on solicitor IPs who wish to continue to be authorised. They will need to seek authorisation from another RPB for this purpose. A number of the other RPBs have systems in place to license IPs from other professions and it would be up to individual solicitor IPs to choose a suitable body from whom to seek authorisation.
21. The cost of being regulated by another body varies depending upon the RPB but in most cases the annual licence fee charged by other bodies, for appointment takers in particular, is higher than our current fees. Other RPBs' annual fees for appointment takers range between £1650 and £3,400. Some RPBs charge a reduced fee for non appointment takers which range between £630 and £3,300. There could be a financial impact on solicitor IPs, therefore, in having to transfer to another RPB depending on the RPB they choose and whether or not they take appointments. However, this should be considered within the context of the discussion above which clearly indicates that if we decided to retain our RPB status the costs to the SRA of regulating solicitor IPs, and of being recognised for that purpose, would increase significantly and these costs would need to be recovered through changes to our fees to solicitor IPs.
22. We have already spoken to other appropriate regulators and they are aware of our proposals and the potential impact on solicitor IPs. If we decide to stop regulating in this market following consultation, we would work closely with the other RPBs to ensure that transitional arrangements are in place and that transition is as smooth as possible. We will also discuss the financial impact for solicitor IPs with other regulators and will share information with solicitor IPs regarding potential future costs of being regulated by another RPB.
23. Solicitor IPs will continue to be subject to the SRA Principles 2011 whilst acting in the course of an insolvency appointment even if they are regulated by another RPB for insolvency activity. We would be able to exercise the same regulatory powers and disciplinary powers in respect of any breach of the Principles in these circumstances as we would in relation to any other circumstances in which a breach of a Principle occurs. We would ensure that appropriate systems were in place to provide for the sharing of information between us and RPBs authorising solicitor IPs so that it is clear who is responsible for taking action against solicitor IPs in any given situation. This will avoid any unnecessary duplication and ensure appropriate protections are in place for the benefit of consumers.
24. There is also a dual bond system in insolvency work which insures the estate against losses arising from fraud or dishonesty, but not negligence – general cover up to £250k must be in place and specific appointment cover ranges from £5k to £5 million. In addition, a solicitor IP acting on an insolvency appointment would continue to be covered by the firm's indemnity insurance as the activity would still fall within the definition of "private legal practice". In determining whether the Compensation Fund would cover wrongdoing by a solicitor IP which occurred when he or she was acting on an insolvency

appointment, this would depend on whether or not we were satisfied that the applicant met the criteria set out in rule 3.4 of the SRA Compensation Fund Rules 2011, but it is unlikely that there is anything which would exclude these activities from the ambit of the Fund. The position would be different if the solicitor IP was in an SRA licensed body as it is unlikely that insolvency work would be caught by the definition of 'regulated activity' in the SRA Handbook's Glossary. We will do more work during the consultation period to understand the position for solicitor IPs in SRA licensed bodies and will publish our conclusions in our response to the consultation.

25. We have conducted an initial screening of the potential equality impact of our proposal. The major impact of our proposals will be on solicitor IPs, very few of whom have known protected characteristics. Of the 124 solicitor IPs, 83% are male and 17% female. 81% are aged between 40 and 60, and 90% are British or white European. 99% have indicated that they do not have a disability. We do not have any evidence to suggest that the proposal will impact disproportionately on individuals with protected characteristics, therefore, and have concluded that it is not necessary to undertake an equality impact assessment of these proposals. However, if you have any evidence that would indicate the potential for impact on any group with protected characteristics then please let us know as part of this consultation exercise.

Timescales and next steps

26. The deadline for receipt of responses to this consultation is 16 January 2015. We aim to publish our response to the consultation in late January/early February. If our proposals are taken forward, we will begin to take the appropriate steps to relinquish our status as an RPB.
27. We are talking to other RPBs, without prejudicing the outcome of this consultation, to exploring transitional arrangements for our IPs. The Insolvency Practitioners Association, the Institute of Chartered Accountants in England and Wales and the Association of Chartered Certified Accountants have all expressed a willingness to authorise solicitor IPs if we were to stop authorising them.
28. The annual licence fee is due at the end of the year. The largest proportion of this £520 fee is for the levies we pay to the Insolvency Service and the Department for Business, Innovation and Skills and to the Department of Enterprise, Trade and Investment for Northern Ireland. We will collect this as normal and pay the levies which will cover IPs for the whole of 2015.
29. We will contact our IPs separately when this consultation opens to give full details on transitional arrangements.

Consultation questions

Question 1: Do you agree with the proposal that the SRA should take appropriate steps to stop authorising solicitors to act as insolvency practitioners?

Question 2: If you do not agree with the proposal, please explain why.

Question 3: Do you have any views about our assessment of the impact of these changes and are there any impacts that we have not considered?

How to respond to this consultation

Online

Use your online consultation questionnaire to compose and submit your response. You can save a partial response online and complete it later.

Email

Please send your response to trainingconsultations@sra.org.uk . You can download and attach a consultation questionnaire.

Please ensure that:

- you add the title "SRA - insolvency regulation" in the title
- you identify yourself and state on whose behalf you are responding (unless you are responding anonymously)
- you attach a completed About You form
- you state clearly if you wish us to treat any part or aspect of your response as confidential.

If it is not possible to email your response, hard copy responses may be sent instead to:

Solicitors Regulation Authority
Education and Training Unit - Insolvency
The Cube
199 Wharfside Street
Birmingham
B1 1RN

Deadline

Please send your response by **16 January 2015**.

Confidentiality

A list of respondents and their responses may be published by the SRA after the closing date. Please express clearly if you do not wish your name and/or response to be published. Though we may not publish all individual responses, it is SRA policy to comply with all Freedom of Information requests.