

# Accountants urged to engage with insolvency consultation

by  
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**Fears that the government's Insolvency Consultation will not support a rescue culture are mounting.**

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As accountants in practice continue to become more involved with their clients' businesses, the accountancy profession is in a prime position to help create a rescue culture that sees clients survive, avoid insolvency, and protects accountancy practice revenue.

Since the concept of the rescue culture was first laid out in the Cork Report in 1982 which became the foundation of the Insolvency Act 1986, we have seen various Acts supporting a 'rescue culture'.

The Enterprise Act 2002 for example, introduced reforms designed to assist troubled companies including the removal of HMRC's preferential rights as secured creditor. This has now been reversed 20 years later under the Finance Act 2020, and many in the insolvency sector say this hampers business rescue.

Fast forward some 36 years since the introduction of the Insolvency Act 1986, and the government has launched its open The Future of Insolvency Regulation consultation laying out for discussion some ambitious proposals to designed to strengthen and modernise an insolvency service to make it fit for the future.

## **Don't leave it to insolvency profession**

“The challenge for accountants everywhere is: ‘Are you engaging in this debate? If not, why not?’ Don't leave it to the insolvency profession,” warned Tony Groom, turnaround investor at K2 Partners.

“This consultation is highly relevant to accountants who are in the key position to help any of their clients in difficulties achieve a turnaround rather than fall into insolvency. In helping rescue clients accountancy practices can protect their own revenues.”

“At the moment, the consultation only covers regulated insolvency practitioners. We believe that the consultation should be extended to cover all firms who offer insolvency related services including those involved in turnaround and rescue, as opposed to those who just offer insolvency services. This might include chartered accountants and certified turnaround professionals.”

## **Rescue culture has been ignored**

The key is to address developing a real rescue culture. “Accountants need to be concerned about achieving changes to protect their clients' interests. The consultation needs to go further and say that before any accountant makes a referral of a client to an insolvency practitioner, they must have gone through a process to explore the options for rescuing the business beforehand,” said Mark Blayney, turnaround specialist at K2 Partners.

“In the same way, a lawyer is obliged to explore all the options before allowing a client to pursue one course of action.”

***“The rescue culture has been totally ignored in the consultation”***

Nick Hood, senior advisor at Opus Business Advisory Group agreed, “The rescue culture has been totally ignored in the consultation. Rescue should always be the

first choice in insolvency. To have the opportunity to save a business, support the workforce, and generate economic growth should be the aim of every Insolvency Practitioner (IP).”

### **The other missing element!**

But it’s not the only thing missing from the consultation. Many IPs are now asking if the proposed system of regulation will also apply to the insolvency work carried out by the Official Receiver.

“The government needs to set out how the Official Receiver would carry out its work alongside the proposed new regulator, and how it would create a level playing field for the public and private sector elements of the insolvency profession. However, there is a long time until the consultation closes, and we hope that the government will address this substantial issue,” said Christina Fitzgerald, vice president, R3.

“Nobody regulates the Official Receiver. They seem immune to criticism and complaints – yet they do a substantial amount of insolvency work,” added Hood. “So, it will be interesting to see how the Insolvency Service is going to regulate the Official Receiver as it is also part of the Insolvency Service.”

### **Could bonding solve the compensation problem?**

Before taking an insolvency appointment IPs need to have a surety bond. A bond is purchased per case and covers the IP in the event of wrongdoing so that should it be necessary for an IP to be replaced, the new IP can call for costs under the bond.

Under the consultation proposals in addition to individual IPs needing a bond, it is proposed that the firm under which the IP operates will also need to be covered by some sort of ‘super bond’.

Whilst this is likely to add to the costs, it will encourage IPs to adhere to best practice because the firm will also be liable for financial penalties should the IP to be found not to have operated correctly.

The super bond could then be used to pay compensation claims to parties affected by the IP's wrongdoing such as fraud, trespass, money laundering etc – whether that be creditors, directors, or charge holders.

***“To create a super bond fit for purpose for the insolvency industry will require something similar to the bonds created in the aviation, marine and construction industries”***

As Paul Rowland, insurance expert and senior partner at Invictus Risk Solutions LLP explained, “A surety bond is a legally binding contract that ties three parties together to protect the ‘obligee’ against financial loss resulting from the actions of the ‘Principal’ through the issuance of a bond by the ‘Surety’ underwriter. To create a super bond fit for purpose for the insolvency industry will require something similar to the bonds created in the aviation, marine and construction industries.”

For the IP industry this could mean the possible creation of a bond required as part of the process of licensing or registering an IP business as a guarantee that the individual IP principals will conduct business in an ethical and lawful manner in keeping with industry standards.

"In addition, a contract performance bond will more specifically guarantee that the IP firm's service and the work of its individuals will be delivered in accordance with the terms and conditions of their contract. Together, this dual bond will provide the financial protection for an obligee in the event of the IP individual and IP firm's contract default, non-performance and/or insolvency," continues Rowland.

“Every year, the IP firm would need to take out an umbrella bond which would be a facility worth ‘x’ amount to cover, for example, £10m of annual contracts, and at the start of the year the IP firm would negotiate and agree the premiums for the year. As the IP firm's individual IPs take appointments, the IP firm would draw

down from that umbrella facility the surety cover they would need for each specific case and new contract.”

Rowland recommended the insolvency industry’s regulatory authority should consider sourcing a panel of underwriters to provide a sort of super bond or umbrella facility on behalf of the entire IP industry.

“If the IP’s regulatory body agrees a consistent ABI wording (similar to the ATOL Bond wording for the tourist industry), a panel of pre-qualified underwriters could offer the IP industry the freedom of choice for individual surety brokers to negotiate the very best cover available for each Obligee whose needs will be different.

“As the underwriters will know that there will be ‘x’ amount of premium income coming through their books, they can go out and buy the necessary capacity from their reinsurance partners to deliver those bonds at a more cost-effective basis.”

“With less than a dozen corporate and Lloyd’s markets in total, there is not an abundance of individual Surety underwriters in the UK. This narrow panel means that the integrity of any new surety proposition from the IP industry will need to evidence a strong combination of scope of coverage, clarity of terms and conditions, premium and continuity of service,” said Rowland.

A poorly performing or financially damaged IP firm and individuals represent the biggest threat to the success of any project and pose a huge risk to their industry’s reputation, said Rowland.

However, he said, “An effective surety solution can be built upon gaining access to credible and timely financial information of the IP firm and a dynamic broker. Accordingly, the surety underwriters can seek to ‘validate’ an IP firm as well established and well managed possessing a robust business model, strong market character, credible profile, sufficient capital, technical competence to ensure contractual certainty and integrity going forward.

“This means that the IP firm’s participation in a specific project will be far more attractive to banks, creditors, employers and investors, and will act as a stimulus to their appointment.”

### **Possible role of existing RPBs**

The proposal for a single regulator will a big game changer for the industry, yet many IPs have been calling out for it for years.

*“It does need to set out how this regulator would be able to maintain its operational and strategic independence”*

However, how a single regulator will operate and what will happen to existing Recognised Professional Bodies (RPBs) currently regulating the industry is causing concern.

“Detail of how the single regulator will operate from within the Insolvency Service without creating a conflict of interest is missing from the consultation. We appreciate the government may contend that this wouldn’t be an issue, but it does need to set out how this regulator would be able to maintain its operational and strategic independence from the Insolvency Service,” said Fitzgerald.

But until this is clarified, questions remain about how this new approach will work. "At the moment, the government appears to be proposing that it should set insolvency legislation, regulate insolvency practitioners and then effectively compete with those same insolvency practitioners for work through the Official Receiver – while not being subject to the same regulation as those in the private sector,” said Fitzgerald.

To handle the work undertaken by existing RPBs, the Insolvency Service will need to increase its headcount and recruit inspectors with the right skillset to understand the intricacies of the insolvency world – all adding to operational costs.

But the possibility of additional costs is not the only issue of a single regulator. Dealing with RPBs will be another.

It is possible that existing RPBs will become monitoring arms for the Insolvency Service. However, unless the Insolvency Service addresses the conflict of interest that the membership issue of RPBs brings, ‘monitoring RPBs’ will still be subject to the constraint of not wanting to upset its members who undertake insolvency work.

## **Get involved**

With the outcome of the Consultation not due until Q4, it gives the opportunity for everyone in the world of business to participate.

As accountants continue to become the ‘go to’ adviser for their clients, it is not just the insolvency industry – but I am also urging you – to get involved with the Consultation and together we can all help shape an insolvency industry that will be fit for purpose in the post-pandemic world.



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