



Response to

The Bankruptcy Fees (Scotland) Regulations 2018
(SSI 2018/127)

Economy, Jobs and Fair Work Committee

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 have the opportunity to submit its views to the Economy Jobs and Fair Work Committee of the Scottish Parliament in response to The Bankruptcy Fees (Scotland) Regulations 2018 (SSI 2018/127) (the SSI). The SSI has been laid following the Accountant in Bankruptcy (AiB) consultation on Funding the Accountant in Bankruptcy 2018-19 (the funding consultation). We shall be pleased to discuss in further detail with the Committee any of the matters raised within this response.

Executive summary

- 5 While we have reservations around aspects of the fee structure set out in the SSI, we acknowledge that it is necessary for the fees to be amended and that a further delay in doing so would have a detrimental impact on the continuing operations of the AiB and the public purse.
- 6 We would call on the Scottish Government to commit to a more detailed and independent review on the future of AiB funding to be carried out, providing greater transparency of funding policy and allowing consideration of more radical or innovative funding models to be considered.
- 7 The need for the review is evidenced by:
 - The Policy and development function carried out by the AiB in support of the Scottish Government is not provided with ringfenced public funding and in recent years has been funded by debtors and creditors. In our view this function should be transferred to the Scottish Government not only for funding reasons but as a matter of good governance, removing conflicts of interest. Should the Policy and development function not be transferred to the Scottish Government then this should be funded, in full, from the public purse.
 - Aspects of the AiB's functions are no longer appropriate given changes in the wider landscape and legislative developments. Steps should be taken to withdraw the supervision of and investigation of complaints against trustees as a function of the AiB for which there is a regulatory model under the Insolvency Act 1986. This is an unnecessary cost and burden which could be removed thus reducing the resource requirement on the AiB.
 - There are inadequate checks and balances for non-statutory functions carried out by the AiB. Non-statutory activity should have a clear rationale and agreement of stakeholders prior to being undertaken.
 - The AiB operates under full cost recovery which is only appropriate where there is responsible management and accountability. Full cost recovery is incompatible with income generation being imposed on third parties without alternative providers being available and where large societal principles are at stake.
 - Any fee structure should be designed to ensure that there is no unnecessary drain on the public purse by ensuring that the AiB is not trustee by default but trustee of last resort. It may be necessary in due course to amend legislation to achieve this objective.

- Cross-subsidy must be considered including funding for DAS.
- Cross-subsidy must be moderated, ensuring that there is not an unfair burden passed to those providing the subsidy. There must be clear justification for any cross-subsidy including an assessment of the fairness and impact on those affected by the subsidy.
- The fee for determining a trustee's remuneration and outlays would benefit from harmonisation across sequestration and trust deeds. A new fee structure relating to determining remuneration and outlays, more reflective of the work involved or using a different approach, should be considered.
- We would support the legislative provision of interest on overdue debts due to the AiB, but at a rate which is more realistic and commercially sensitive.

Response

- 8 While we have reservations around aspects of the fee structure set out in the SSI, we acknowledge that it is necessary for the fees to be amended and that a further delay in doing so would have a detrimental impact on the continuing operations of the AiB and the public purse.
- 9 We would however like to draw to the Committee's attention some wider issues around the funding of the AiB as we consider that the current mechanism for setting the funding could be improved.
- 10 As is explained in the Business and Regulatory Impact Assessment which accompanies the SSI and the funding consultation issued by the AiB prior to the SSI being laid, the AiB funding is susceptible to fluctuations in bankruptcy levels from year to year. It relies on a mixture of funding from debtors, creditors and the public purse each of which is impacted by external factors. The funding requirement is also inextricably linked to the functions carried out by the AiB and the work it performs to fulfil those functions.
- 11 Linking these factors together to provide a coherent funding proposal is a difficult task. It is made more difficult by a lack of agreed framework and underlying principles against which a funding strategy can be applied. We have therefore considered some of the fundamental principles which may require to be considered longer term.
- 12 It is acknowledged that some of the factors affecting funding may require legislative change beyond regulations. While primary bankruptcy legislation has been considered recently by the Scottish Parliament resulting in the Bankruptcy (Scotland) Act 2016, the consideration was restricted to aspects of consolidation and did not consider policy or other changes which would be beneficial to the primary legislation.
- 13 We were concerned about the lack of clarity within the consultation paper over funding. The paper seemed to conflate operating surplus/deficit with funding and income and expenditure. There appears to be a significant level of confusion over what is meant by funding and whether this is referring to how income is made up, the cashflow requirement of the AiB, or relates to the operating surplus/deficit (profit or loss).
- 14 For example, the funding consultation indicated that the Scottish Government contributed £134,000 of income in 2016/17¹. That contribution is not shown as operating income in Annex B (the analysis of income for that year). £134,000 is actually the operating deficit (excess of expenditure over income) during the year. The Scottish Government may have provided cashflow funding (the 2016/17 accounts indicate that the Scottish Consolidated Fund provided £732,000) but this is not the same as the Scottish Government providing income or public funding of services.

¹ Paragraph 6 of [Funding the Accountant in Bankruptcy 2018-19](#)

Functions of the AiB

- 15 How and to what extent the AiB is funded will largely be determined by the functions and work carried out by the AiB. It is therefore somewhat surprising that in consulting on the funding of the AiB that there was no consideration of what functions the AiB is required to carry out. ICAS has raised on several occasions in recent years that it would be appropriate to consider whether the AiB still requires to carry out certain functions or indeed whether the functions would be more appropriately carried out by other bodies. For example, we consider that there is a clear conflict of interest in the AiB providing policy and development support for the Scottish Government while acting as a provider of insolvency services. Similarly, the AiB's supervision of trustees stems from a time prior to the introduction of insolvency practitioner licencing under the Insolvency Act 1986 and is double regulation of the insolvency profession in Scotland.
- 16 The policy and development function carried out by the AiB would be more appropriate as a direct function of the Scottish Government. It is not appropriate for the costs associated with running the Scottish Government to be funded by debtors and creditors through AiB funding.
- 17 Even if the function were to remain with the AiB, funding of policy and development should be funded on a full cost basis by the public purse and not subject to funding by debtors and creditors. Annex C of the funding consultation set out the income for the AiB in 2016-17 and shows that no funding was received from the Scottish Government to fund the policy and development functions of the AiB during that year.
- 18 In recent years the AiB have invested heavily in IT projects. These have delivered systems such as BASYS, ASTRA and DASH. These projects and systems seem to on occasion to extend beyond the [statutory functions of the AiB](#). For example, developing IT systems to allow creditors to vote on the protection of trust deeds or to facilitate communications between trustees and creditors are arguably beyond the AiB statutory functions. There are inadequate mechanisms for such developments and spend to be challenged with the result that those bearing the burden of full cost recovery are presented with a fait accompli.

Full cost recovery principle

- 19 A central tenant of the AiB mission is 'to provide access to fair debt relief' (AiB 2017-18 Business Plan). This reflects a social desire by the Scottish Government to ensure that debt relief is available to the people of Scotland where required and is over and above the rights of creditors to take steps to recover amounts through an insolvency process. This is a principle which we support.
- 20 The question then is who should pay for policies which benefit society as a whole? There is no right or wrong answer to that question and many funding models exist. It is probably appropriate to recognise that funding should come from a mixture of governmental sources and private sources.
- 21 The majority of respondents to the funding consultation who expressed a view considered that the principle of full cost recovery was not appropriate in a bankruptcy system. The challenge therefore is finding an appropriate balance between funding sources.
- 22 We acknowledge the efficiency savings targets set by the AiB in recent years. Over 40% of costs relate to staffing and accommodation costs and a further 37% of costs are directly relational to sequestration activity. A further 10% of costs are identified as non-cash costs. In effect, only 13% of costs are available against which efficiency savings can be made when set alongside the Scottish Government policy of no compulsory redundancies.
- 23 The principle of full cost recovery is laudable for public services but must also be recognised as having onerous restrictions.
- 24 If full cost recovery is to be implemented, then it must also come with responsible management and accountability. Full cost recovery is incompatible with a system where income generation is imposed on third parties without alternative providers being available and where there are large societal principles at stake. Full cost recovery is also incompatible with artificial impediments to cost savings such as no compulsory redundancy policies.

Funding the AiB as trustee

- 25 Paragraph 9 of the funding consultation paper referred to the “fundamentally important role of the Accountant in Bankruptcy acting as a Trustee of last resort..”. We agree that this is an important role and that there are many reasons why it is appropriate for a trustee of last resort to be available in order that access to debt relief may be obtained by many of the most vulnerable in society.
- 26 It is unclear however whether the AiB is actually a ‘trustee of last resort’ or whether the AiB is perhaps more appropriately characterised as the ‘default trustee’. In 2016/17, the AiB was appointed in 84% of all sequestrations, a rate which has been increasing in recent years. We are not aware of any research having been carried out or statistical analysis undertaken to substantiate that the AiB is being used as a ‘trustee of last resort’.
- 27 The true nature of AiB as a bankruptcy trustee provider is important. We are led to understand that the average cost to run a sequestration by the AiB is greater than the income generated (i.e. there is a loss incurred)
- 28 There is evidence that the AiB is being used as a ‘default trustee’. For example, HMRC who account for a substantial proportion of creditor petitions will seek the appointment of the AiB in most instances. Many local authorities also appoint the AiB as trustee by default. Overall in 2016/17 the AiB was appointed trustee in 86% of debtor applications and 80% of creditor applications.
- 29 The implications of this is that the AiB acts as a direct competitor to the private sector but without costs of regulation or commercial requirements. The AiB stated in evidence to the Economy, Jobs and Fair Work Committee (21 March 2017) that they incur a loss on the majority of creditor sequestration cases although there does not appear to be information available to verify this.
- 30 To ensure there is not a drain on the public purse unnecessarily, the fee structure and other measures should ensure that there is no incentive for the AiB to be appointed as trustee by default and that the AiB should only be appointed as trustee of last resort. It may be necessary in due course to amend legislation to achieve this objective.

Cross-subsidy and the audit fee

- 31 The funding consultation set out in paragraphs 19-21 some background to the audit fee charged by the AiB. The consultation document stated “*Understandably, private Insolvency Practitioners only take cases where there are likely to be sufficient funds to cover their costs – and there is an argument that it is fair to ask these cases also to cross subsidise the administration of the majority of cases which contain no funds.*”. The argument of why it is fair to ask those cases to cross-subsidise cases which contain no funds (which by implication the AiB is trustee of) is not provided. It is difficult therefore to evaluate whether this statement is correct or not.
- 32 The principle of whether cross-subsidy is appropriate or not needs considered separately from the basis of the audit fee calculation.
- 33 If cross-subsidy is acceptable then consideration must be given to the work of the AiB as a whole. The consideration of fees in sequestration and trust deeds must be considered alongside fees in DAS. While we welcome that there will be a consultation on DAS fees in the coming months, it is unfortunate that the two consultations were not carried out at the same time to allow a wholistic view of the debt relief system to be taken.
- 34 The funding consultation indicated that DAS is a cost burden for the AiB. The implication therefore is that the fees associated with asset based sequestrations and trust deeds must therefore be subsidising DAS. As DAS is an alternative to sequestration or a trust deed where debt can be repaid over an extended period there is no logical reason for this cross-subsidy.
- 35 The funding consultation suggested that it is acceptable to charge a significantly higher fee for the audit than is justified by the work on the basis of cross-subsidy. The funding consultation also indicated that private trustees will only take on cases with assets. While that is likely to be the case in most circumstances, the consultation failed to acknowledge that in many instances

a private trustee will not make a full recovery of the time and costs incurred on a case. There is no ability for a private trustee to cross-subsidise those cases with additional fee recoveries from cases in which there is a great abundance of assets.

36 While we believe that an element of cross subsidy is acceptable, this must be moderated with ensuring that there is not an unfair burden passed to those providing the subsidy. There must be clear justification and rationale for any cross subsidy including an assessment of the fairness and impact on those affected by the subsidy.

37 We believe that the audit fee charged on trustee remuneration must be fundamentally reviewed. There are numerous examples of the fee being entirely disproportionate to the work carried out by the AiB and indeed to the other costs associated with administering the sequestration. Some examples are provided below:

Case A –

The debtor owned a small number of properties which were over secured to the bank. Due to the nature of the case, a lot of outlays were incurred and the insurance cover over all the properties totalled approximately £47,000. The Trustee's fee totalled just under £11,000 while audit fee was £14,163.

Case B –

The debtor owned a small number of properties which were over secured to the bank. Many of the properties were rundown, and works were required to be carried out as an insurance requirement. Due to the nature of the case, a lot of outlays were incurred at the outset of the case and were paid by the firm. The audit fee was £5,949. No fee was paid to the Trustee.

Case C –

The debtor jointly owned a property with his wife which had a high level of equity. The debtor was a very difficult individual to deal with and attempted to impede the sequestration at every stage. The Trustee required to engage legal agents to assist with the raising of an Action for Division and Sale which was challenged by the debtor. The debtor instructed various firms of solicitors to act on his behalf during the period of the sequestration. The time costs on this case were accordingly very high and the Trustee required to restrict his fee to just over £13,000 while an audit fee of £20,924 was payable.

Case D –

Outlays totalling £38,747 were incurred, mostly a single invoice from legal agents of £29,255 for Court of Session action. An audit fee of £5,119 was payable for reviewing that single invoice, what had already been taxed by the Court (for which a fee was also incurred).

38 A tenant of fees must be that they are fair and reasonable. If the above examples were reflective of fees charges in a private sector scenario there would rightly be a public outcry. This situation is equally untenable in the public sector.

39 The current fee structure, which is proposed to be retained, also contains an anomaly between the fee structure for auditing the remuneration and outlays of a trustee in a sequestration and that of a trustee under a trust deed. The fee in sequestration is based on 17.5% while the fee in a trust deed is based on 5%.

40 As set out above, disproportionate fee charges are often because of expenses of sequestration which are disproportionate in value to the level of work required to be carried out as part of the audit. The definition of expenses of realisation is unduly restrictive by referring to 'any outlays incurred by the trustee in realising the debtor's estate which in the course of normal business practice are deducted from the price payable to the trustee.' Expenses of realisation often

require to be paid by the trustee rather than being deducted from the price payable to the trustee. This definition no longer reflects modern working practices.

- 41 We would suggest that if the audit fee is to be retained then there requires to be some alignment of fees charged in sequestration and trust deeds, it is more reflective of the work carried out and reflects modern day working practices.

Interest on overdue debts due to AiB

- 42 We were surprised that the proposal within the 2017 Fee Regulations which were subsequently withdrawn to charge interest on late payment of debts due to the AiB was not retained in the SSI. Although this is unlikely to generate significant income, the objections raised when the 2017 regulations were laid in Parliament were around the interest rate specified rather than the principle of interest being applied.
- 43 In principle, we would have no objection to provisions being included for interest on overdue debt payable to the AiB. We do not consider in principle that a public sector creditor should be treated significantly different from a private sector creditor in relation to overdue debts, especially when the debt is likely to be due from a commercial firm.
- 44 If such a proposal were to be re-introduced, then the rate of interest should be set at a more realistic and commercially sensitive level. We do not see any imperative for this to be linked to the judicial rate of interest. We would also suggest that it be set against a fluctuating base rate (for example 2% above Bank of England Base Rate).

Funding the AiB

- 45 Funding the AiB requires a clear policy to be set out and with greater transparency. This must set out the respective roles of Scottish Government, debtors and creditors who are the stakeholders who ultimately bear the costs.
- 46 Once the policy is set then the funding requirements must be considered against a longer-term cycle to take account of fluctuations in bankruptcy numbers over several years. Surpluses generated should be available to mitigate against deficits in other years.
- 47 We would also suggest that opportunities may exist for more radical changes to funding to be made. A significant proportion of debt issues arise due to credit being provided which is unaffordable. While steps have been taken to address this ultimately creditors take a decision on whether a debt is capable of repayment. In most of personal insolvencies, the associated debt is mainly consumer debt. It is perhaps arguable that those providing consumer debt should bear more of the cost associated with personal bankruptcy through the creation of a Scottish Consumer Credit Levy.
- 48 The [Independent Review of the Funding of Debt Advice in England, Wales, Scotland and Northern Ireland](#) carried out by Peter Wyman considers in Chapter 3 how debt advice should be funded and by whom. While clearly the report relates to the funding of debt advice, many parallels can be drawn against the funding of debt relief.
- 49 We would call on the Scottish Government to commit to a more detailed and independent review to be undertaken on the future funding of the AiB. This would provide greater evidence and transparency around future funding sources and would allow consideration of more radical or innovative funding models to be considered.

1 May 2018

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