# EXPLANATORY MEMORANDUM TO

# THE INSOLVENCY PRACTITIONERS (AMENDMENT AND TRANSITIONAL PROVISIONS) REGULATIONS 2024

## 2024 No. 1090

## 1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Insolvency Service, an Executive Agency of the Department for Business and Trade, and is laid before Parliament by Command of His Majesty.

## 2. Declaration

2.1 Justin Madders, Minister for Employment Rights, Competition and Markets at the Department for Business and Trade confirms that this Explanatory Memorandum meets the required standard.

2.2 Angela Crossley, Director of Strategy, Policy and Analysis at the Insolvency Service confirms that this Explanatory Memorandum meets the required standard.

## 3. Contact

3.1 Catherine Newell, Senior Policy Adviser of the Insolvency Service telephone: 0300 304 5920 or email: Policy.Unit@insolvency.gov.uk can be contacted with any queries regarding the instrument.

## Part One: Explanation, and context, of the Instrument

## 4. Overview of the Instrument

***What does the legislation do?***

4.1 This instrument amends existing minimum requirements for insolvency practitioner bonding, which is a form of security to protect creditors from losses caused by the fraud or dishonesty of insolvency practitioners during the course of their duties when appointed to an insolvency case (known as acting as an office-holder). The instrument updates the monetary and other thresholds relating to bonding cover, including clarifying what the bond should cover. The bonding framework protects and benefits creditors through pay-outs where a bond claim is made, and this instrument modernises that framework.

***Where does the legislation extend to, and apply?***

4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is Great Britain.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is Great Britain.

## 5. Policy Context

***What is being done and why?***

5.1 Around 1,540 private sector insolvency practitioners (IPs) are authorised and regulated on an individual basis by one of 4 recognised professional bodies (RPBs) in

order to take appointments as insolvency office-holders. The Insolvency Service, through its Insolvency Practitioner Regulation Section (IPRS), acts on behalf of the Secretary of State as oversight regulator of the RPBs.

5.2 There were 26,392 company and 111,571 personal insolvencies in England, Wales and Scotland in 2023, the majority of which were administered by IPs.[1] Where an IP is not the insolvency office-holder, those cases are administered by Official Receivers, acting on behalf of the Secretary of State within the Insolvency Service. Official Receivers are not regulated under this legislation.

5.3 In order to take appointments as an office-holder, an IP must have in place adequate security[2], known as a bond. When acting as an office holder (such as a liquidator, administrator or as a trustee in bankruptcy), IPs will be responsible for assets of an insolvent company or a bankrupt individual which must be realised to pay the creditors. The bond is a tripartite agreement between the IP, their RPB, and the bond provider. The bond makes the provider jointly liable with the IP for losses suffered by creditors as a result of fraud or dishonesty of the IP. The statutory requirements of a bond are set out in Schedule 2 of The Insolvency Practitioners Regulations 2005.

5.4 A bond is made up of two parts: a Specific Penalty Sum (SPS), which provides separate cover for each insolvency case, and a General Penalty Sum (GPS), which provides general cover for any cases where the SPS cover is insufficient. The GPS is renewed annually, and must be in place before an IP takes insolvency appointments. The SPS is specific to each insolvency case for which an IP agrees to act as office-holder, and cover is obtained by the IP completing a cover schedule which is then submitted to the RPB and bond provider, usually on a monthly basis. Cover for each case is then backdated to the date that the IP took the insolvency appointment, a premium is calculated for the SPS, and an invoice submitted to the IP for payment. The SPS must be at least the value of the assets in the case, and is subject to minimum and maximum cover levels of £5,000 and £5 million, respectively.

5.5 Where an IP is removed from office, the RPB will inform the bond provider, and a successor IP will usually be appointed to take over the former IP's cases. The successor IP assumes the statutory functions of the former IP and will investigate whether there were losses from the cases transferred to them, and if so, the cause. Where those losses have been caused by fraud or dishonesty, there may be a claim against the bond. Once the bond provider agrees and pays the claim, the funds can be distributed to creditors as appropriate. The bond provider may then seek repayment from the original office-holder whose fraud or dishonesty led to the claim.

5.6 IPs are highly-skilled and tightly-regulated professionals, and incidences of fraud and dishonesty are rare, but where this occurs there can be a significant impact on creditors. The bond therefore provides important protection, but consultation with stakeholders revealed that on the rare occasion that a bond claim is necessary, the framework did not work as well as it could. This was due to a lack of consistency, as set out in paragraphs 5.7-5.10 below, which created uncertainty for parties to the bond and involved increased time, effort and cost in investigating and agreeing bond claims. This impacted on the important protections that bonds provided to creditors.

***What was the previous policy, how is this different?***

5.7 The bonding framework had not been substantively updated since its introduction in 1986. Stakeholders felt the £250,000 GPS limit did not provide adequate protection

[1] https://www.gov.uk/government/collections/monthly-insolvency-statistics
[2] Section 390(3)(b) Insolvency Act 1986.

for creditors. This instrument therefore increases the GPS level to £750,000, which is broadly in line with the increase in asset values within insolvency estates. Consultation with stakeholders suggested that the existing monetary limits for SPS (at paragraph 5.4 above) are sufficient, so these have not been amended.

5.8 The previous legislation allowed bond providers to set a time limit for making claims, but did not provide any further direction.[3] In practice, this translated into the use of run-off periods and maximum indemnity periods[4], which differed from one bond provider to another. The lack of clarity in the duration of cover and any applicable deadlines for claims led to confusion over the existence of cover and the time limits for submitting a claim once an IP had left office. This instrument sets a minimum run-off period of 2 years from the IP leaving office. Where a maximum indemnity period is stated, this must be a minimum of 6 years, with the ability to extend with the agreement of the bond provider.

5.9 In addition to the periods of run-off cover and indemnity, other terms differed between bond providers, which created inconsistency and uncertainty for IPs, and increased risk for creditors. For example, in some instances, where an IP failed to pay the required premium or to renew a bond, the cover provided under some bonds lapsed before the RPB or successor IP could make payment. Under the previous legislation, bond providers were not required to inform an IP's RPB of any failure to renew a bond, and there was no prescribed notice period to be given before cover lapsed following a failure to pay the required premium. This left creditors unprotected when cover lapsed, which could be aggravated by fraudulent or dishonest IPs failing to engage appropriately with their RPB to enable a smooth transition to a successor IP. These issues caused additional work and costs for both successor IPs and the bond providers, and impacted on returns to creditors. This instrument introduces a minimum period of 60 days' notice to be given to the RPB before a bond can expire due to non-payment.

5.10 Finally, the costs of investigating fraud and dishonesty, which need to be proven before a claim against the bond can be made, often consumed a large proportion of the amount paid out. The GPS portion of a bond claim was also limited to those cases for which the SPS was inadequate, and did not cover cases for which no SPS cover had been obtained at all. This impacted on returns to creditors and undermined the purpose of the bonding framework. The statutory minimum requirements now include an allowance for reasonable associated costs of making a bond claim, for a standard rate of interest to be applied to bond claims, and for the GPS to cover all of an IP's cases and not merely those for which the SPS is insufficient.

5.11 These changes protect creditors by ensuring that bonds cannot expire due to non-payment without at least 60 days' notice to the RPB, and by increasing the pool of money that creditors can be paid from. This is due to the higher level of GPS (£750,000), leading to potentially greater pay-outs. In addition, the statutory minimum requirements, including the provision for reasonable associated costs and minimum cover periods for bonds, provide certainty for successor IPs. These changes increase consistency between bonds, which will reduce certain costs, such as the time taken to check bond wording and the time and expense involved in submitting protective

[3] Paragraph 3(3) Sch 2 of Insolvency Practitioner Regulations 2005.

[4] A run-off period provides cover for historic liabilities after the IP has ceased to be the office-holder on an insolvency case. A maximum indemnity period is the maximum length of time for which liabilities are covered and benefits are payable under a policy.

claims. As a result, creditors benefit from higher returns, improving confidence in the insolvency regime.

## 6. Legislative and Legal Context

***How has the law changed?***

6.1 This instrument amends The Insolvency Practitioner Regulations 2005. Schedule 2, Part 2 to the Regulations sets out the requirements for the bonding framework. Each bond must be in a form approved by the Secretary of State which complies with Paragraph 3 of Part 2 of the Schedule. Paragraph 3 contains mandatory[5] and discretionary[6] provisions, which have been amended to incorporate the provisions described above.

6.2 This instrument updates and increases the monetary limit for the 'General Penalty Sum', sets minimum cover periods for bonds, provides additional requirements for what a bond should cover, and sets a standard rate of interest on the amount that can be claimed.

***Why was this approach taken to change the law?***

6.3 Section 390(3) of the Insolvency Act 1986 ('the Act') provides for the bonding of insolvency practitioners. This is a mandatory requirement for all officeholders.

6.4 According to section 390(3)(b) of the Act, the bond (or 'security') must meet the 'prescribed requirements' in order for an individual to be qualified to act as an insolvency practitioner.

6.5 In relation to insolvency practitioners and their qualifications, the Secretary of State has the power to make regulations for this purpose (i.e. Part XIII of the Act); and 'prescribed' means 'prescribed by regulations made by the Secretary of State'. Therefore, the prescribed requirements for bonding must be set out within regulations.

6.6 The current bonding framework is already set out in Schedule 2, Part 2 of The Insolvency Practitioners Regulations 2005 (S.I. 2005/524)('2005 Regulations'). Therefore, any amendments to the bonding framework would require an amendment to the 2005 Regulations.

## 7. Consultation

***Summary of consultation outcome and methodology***

7.1 The proposals forming the basis of this instrument were put to stakeholders as part of a public consultation that ran from 21 December 2021 to 25 March 2022. The questions on bonding were contained within Part C of the consultation, and 47 stakeholders provided responses to some or all of the questions in this section. This rate of response was expected given that few outside of the insolvency profession will have had experience of bond claims. The responses came from a range of stakeholders including IPs, firms offering insolvency services, bond providers, RPBs, professional bodies, and creditor representatives. A response to the consultation was published on 12 September 2023, and both the response and the original consultation can be found at https://www.gov.uk/government/consultations/the-future-of-insolvency-regulation.

7.2 Responses to the bonding proposals were overwhelmingly positive, with 98% of respondents in favour of increasing the minimum requirements for bonds. The main

[5] Sub-paragraph 2.
[6] Sub-paragraph 3.

concern across all stakeholder groups was the potential impact on bond premiums. However, stakeholders felt that the increase in GPS to £750,000 was a sensible compromise that would provide adequate protection for the majority of cases without being unduly costly for individual IPs.

7.3 Alongside the formal consultation, consultation was carried out on an informal basis between officials in the Insolvency Service, the Accountant in Bankruptcy (Scotland) and the Department for the Economy (Northern Ireland). The devolved administrations support the changes set forth in this instrument. Officials in the Insolvency Service have also engaged with bond providers and with the RPBs in advance of laying this instrument.

## 8. Applicable Guidance

8.1 Guidance on this instrument has been published through Dear IP https://www.gov.uk/guidance/dear-insolvency-practitioner which is an electronic means for the Insolvency Service to share news and guidance on compliance matters directly with IPs and other insolvency stakeholders. In addition, it is expected that RPBs will create and publish their own guidance for their members.

## Part Two: Impact and the Better Regulation Framework

## 9. Impact Assessment

9.1 In line with Better Regulation requirements, a full Impact Assessment has not been prepared for this instrument because the policy changes fall within De Minimis IA thresholds. The insolvency profession is small, with around 1,270 IPs that actively take appointments, and there is a low level of impact per business with an estimated increase in cost of premiums of up to £271 per annum per IP. In addition, there will be one-off familiarisation costs for IPs, RPBs and bond providers. Bond providers will benefit from increased premiums, although the pay-outs to creditors will potentially be larger.

9.2 Overall, there is estimated to be an annual net direct cost to business of £0.1 million. However, there are wider benefits to the changes, which were welcomed by many respondents to the consultation, but which are not easily quantifiable. By setting out minimum statutory requirements in bonds that align with current best practice, IPs, RPBs and bond providers will save time and administrative costs in negotiating the cover provided. The changes will also aid efficiency and will increase confidence in the insolvency regime.

***Impact on businesses, charities and voluntary bodies***

9.3 There is no, or no significant, impact on business, charities, or voluntary bodies because the costs to business are small as set out above at paragraph 9.1.

9.4 The legislation does impact small or micro businesses, as it is estimated that 46% of IPs and at least 1 of the 4 RPBs operate as small businesses. It is not known whether any bond providers are small businesses. Although the policy does impact small and micro businesses, exemptions and mitigations are not proportionate and the cost to these groups is small.

9.5 There is no, or no significant, impact on the public sector because IPs are private sector professionals authorised and regulated by professional private sector bodies. There is expected to be a very small benefit to public sector creditors via improved pay-outs. Oversight regulation is provided by the Insolvency Service, but the changes

are estimated to have a net benefit due to the reduction in time taken to approve bond wording.

## 10. Monitoring and review

***What is the approach to monitoring and reviewing this legislation?***

10.1 The approach to monitoring this legislation is through ongoing and regular engagement with stakeholders to assess the impact of the changes. In addition, the Insolvency Service is undertaking a significant programme of reform to the regulatory framework. As part of this, a public consultation will be issued on wider reform to the bonding framework, which will include analysis of the impact of this instrument.

10.2 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, the Minister for Employment Rights, Competition and Markets has made the following statement: "the net impact on business of these changes is not expected to be significant, being £0.1 million. As the net impact is below +/- £5 million net annualised and in line with Better Regulation requirements, a statutory review clause is not required."

# Part Three: Statements and Matters of Particular Interest to Parliament

## 11. Matters of special interest to Parliament

11.1 None.

## 12. European Convention on Human Rights

12.1 The Minister for Employment Rights, Competition and Markets has made the following statement regarding Human Rights:

"In my view the provisions of the Insolvency Practitioners (Amendment and Transitional Provisions) Regulations 2024 are compatible with the Convention rights."

## 13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").