The Practice of Insolvency

A Guide to Professional Conduct and Ethics

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Preface

This Guide to Professional Conduct and Ethics comprises two parts: first, the Insolvency Ethical Principles to which all insolvency practitioners must adhere; and secondly an annexed list of 'particular circumstances', common situations in which practitioners may face ethical dilemmas, analysed by reference to a Framework.

Introduction

The practice of insolvency is principally governed by statute and secondary legislation. This document guides insolvency practitioners in relation to circumstances applying outside both. Practitioners' principal guide will be the Insolvency Ethical Principles.

1. The Insolvency Ethical Principles

An insolvency practitioner must:

(1) behave with integrity in all professional appointments. Integrity implies not merely honesty but fair dealing and truthfulness. ('**Integrity**')

(2) strive for objectivity in all professional judgements. Objectivity is the state of mind that has regard to all considerations relevant to the task in hand but no other. ('**Objectivity**')

(3) not accept or perform work which he or she is not competent to undertake unless the practitioner obtains such advice and assistance as will enable him or her competently to carry out the work. ('**Competence**')

(4) carry out professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of a practitioner. ('**Due Skill**')

(5) conduct himself or herself with courtesy and consideration towards all with whom they come into contact during the course of performing their work. ('**Courtesy**')

1.1 Spirit of the Guide to Professional Conduct and Ethics

It is the Guide to Professional Conduct and Ethics, and the spirit that underlies it, that govern the conduct of practitioners. Failure to observe the Guide may not, of itself, constitute professional misconduct, but will be taken into account in assessing the conduct of a practitioner. Whereas the Competence of practitioners is a statutory requirement for the granting of a licence (and is therefore assessed by monitoring), the Insolvency Ethical Principle of Objectivity is the most common to be applied to the situations in which practitioners work, and experience has shown it is in this respect that practitioners need detailed guidance. It is therefore to that Insolvency Ethical Principle that the following Framework is addressed, though it has to be stressed that the others are of equal importance and application.

2. The Framework

Threats to objectivity

This Guide provides a Framework within which practitioners can identify actual or potential threats to objectivity, and whether there are any safeguards that might be available to offset

them. The practitioner's objectivity is most likely to be impaired by a **Conflict of Interest**. The Framework is directed to situations which involve potential conflicts of one kind or another. The practitioner should beware of **Conflicts of Interest**. They threaten the practitioner's objectivity in two ways, **(A) Self-Review**, and **(B) Self-Interest**.

2.1 Framework identification of (A) self-review threats and (B) self-interest threats

Objectivity can be impaired in two principal ways:

(A) if the practitioner's exercise of professional judgement may be influenced by an earlier such exercise in relation to the same entity, in which case a question of **'self-review'** may arise. It might also be that the practitioner's familiarity, either with the individuals or subject-matter connected with the appointment, is too great; and

(B) if the practitioner has a **'self-interest'** in an appointment.

(**A**) Self-review threats relate to situations where the practitioner has or had a 'Material Professional Relationship' with the company or individual in relation to which or whom the appointment is taken. 'Material Professional Relationship' is explained more fully below and see the Annex for specific examples.

There is a subset of self-review threats, know as Familiarity or Trust threats. These threats arise from personal contacts, either before or after the commencement of the insolvency process, between the insolvency practitioner and other individuals; be they the individual to whom, or individuals connected with the entity to which, the insolvency appointment is made. The insolvency practitioner may be over-influenced by the personality and qualities of those individuals or by trusting representations they make, or may fail to make adequate enquiries as to either.

(**B**) Self-interest threats are those which can affect the reasoning the practitioner applies because it is, or might be, affected by considerations that either favour or are prejudicial or disadvantageous to the practitioner. Again, Familiarity or Trust threats may be present in this context, where, for example, there is a personal connection between the insolvency practitioner and a director of an insolvent company.

Threats falling either within (A) or (B) may be general in nature or peculiar to the particular circumstances of the case. They require the practitioner to consider them in the light of the circumstances in which the appointment is offered or undertaken. It is always a matter for the practitioner to assess whether he or she may accept and/or continue an engagement in the particular context that obtains at the time.

It will always be up to the practitioner to justify his or her actions in cases of doubt. Whether the practitioner takes or continues an appointment will depend on what threats there are and whether, in that event, the introduction of safeguards would overcome those threats. Sometimes, though, the mere perception of risk or conflict will tend to undermine confidence in the practitioner's objectivity, and so make acceptance or continuation unwise.

The practitioner must not only be satisfied as to the actual objectivity which he or she can bring to their judgement, decisions and conduct, but also must be mindful of how they will be perceived by others.

A practitioner should also be aware of the threat to objectivity if he or she were to engage in regular or reciprocal arrangements in relation to appointments with another practice or organisation.

The Framework is essentially rule/prohibition-based because of the nature of insolvency.

The annexed groups of (A) self-review and (B) self-interest threats require the practitioner to decline or resign appointment, unless in the individual examples of each, there is stated a means by which appointment can be accepted.

2.2 (A) The self-review threats

These threats relate to circumstances existing before the appointment is offered compared with those existing at the date of acceptance (or during the currency) of an insolvency appointment. Where there has been a Material Professional Relationship with the company or individual, there will be a self-review threat. The threat that lies behind a Material Professional Relationship is that the insolvency practitioner, who is the custodian of what are often competing interests in the prosecution of an insolvency appointment, may improperly and inappropriately advocate or favour one or more of those interests. In that way, the practitioner's objectivity is lost. Any such relationship will normally require the practitioner to decline appointment.

There appears in the Annex a series of the most common situations in which practitioners are required to decline a particular appointment.

2.3 (B) The self-interest threats

It is improper for a practitioner to be influenced by a significant financial or other benefit accruing, or which might accrue, to the practitioner or to anyone with whom the practitioner is associated or connected, or by the avoidance of disadvantage to all or some of these.

There appears in the 'Annex of particular circumstances' a number of situations in which 'self-interest' threats have to be identified and assessed before an appointment is accepted.

Note: The Annex is a non-exclusive list of common situations in which groups (A) and (B) are often present. As such, it is subordinated to the body of the Guide, and the Insolvency Ethical Principles in particular.

3. Annex of particular circumstances

Group A – Examples of the self-review threats

Introduction

Paragraphs (i) to (xii) inclusive refer to specific situations in which a practitioner **may not** properly accept appointment because **the concept of 'Material Professional Relationship' is central to them**.

In situations other than those dealt with, a practitioner should only accept office in any insolvency role sequential to one in which the practitioner or his or her practice or a current employee or partner of the practice has previously acted after giving careful consideration to the implications of acceptance in all the circumstances of the case, and satisfying himself or herself that objectivity is unlikely to be, or appear to be, impaired, by a prospective conflict of interest or otherwise. If the practitioner remains in doubt as to his or her position, the matter should be drawn to the attention of his/her authorising body. The attention of practitioners is drawn to the statutory disqualification on acting as an insolvency practitioner in Section 390 of the Insolvency Act 1986.

(i) The concept of material professional relationship

A material professional relationship with a client, such as is referred to in paragraphs (ii) to (iv) below, arises where a practice or, subject to the provisions of paragraph xix (below), a principal or employee of the practice, is carrying out, or has during the previous three years carried out, material professional work for that client. Material professional work would include the following:

(a) where a practice or person has carried out, or has been appointed to carry out, audit work for a company or individual to which the appointment is being considered; or

(b) where a practice or person has carried out one or more assignments, whether of a continuing nature or not, of such overall significance or in such circumstances that a practitioner's objectivity in carrying out a subsequent insolvency appointment might be, or be seen to be, impaired.

A material professional relationship with a company or individual (as referred to in paragraphs (ii) to (iv) below) includes any material professional relationship with companies or entities controlled by that company or individual or under common control, where the relationship is material in the context of the company or individual to whom appointment is being sought or considered.

A material professional relationship could also arise where a practice or person has carried out professional work for any director or shadow director of a company of such a nature that a practitioner's objectivity in carrying out a subsequent insolvency appointment in relation to that company could be or could reasonably be seen to be prejudiced.

In forming views as to whether a material professional relationship exists, practitioners should have regard to existing or previous relationships with firms with which they are, or have been, associated which might impair, or appear to impair, their objectivity, including relationships whereby they or their firm are held out by name, association or other public statements as being part of a national or international association.

A practitioner should take reasonable steps prior to his acceptance of any insolvency appointment to ascertain whether any of the above work has been performed.

(ii) Appointment as nominee and/or supervisor of a company voluntary arrangement, administrator, administrative or other receiver

Where there has been a material professional relationship (as to which see paragraph (i) above) with a company, no principal or employee of the practice should accept appointment as nominee or supervisor of a voluntary arrangement, administrator or administrative or other receiver in relation to that company. (See also paragraphs (v) and (xix) below).

(iii) Appointment as nominee and/or supervisor of an individual voluntary arrangement, trustee in bankruptcy or trustee under a deed of arrangement

Where there has been a material professional relationship (as to which see paragraph (i) above) with an individual, no principal or employee of the practice should accept appointment as nominee or supervisor of a voluntary arrangement or as trustee in bankruptcy or as a trustee under a deed registered under the Deeds of Arrangement Act 1914 in relation to that individual. (See also paragraph (xix) below).

(iv) Appointment as liquidator

Where there has been a material professional relationship (as to which see paragraph (i) above) with a company, no principal or employee of the practice should accept appointment as liquidator of the company if the company is insolvent. Where the company is solvent such appointments should not be accepted without careful consideration being given to all the implications of acceptance in the particular case, and a practitioner should satisfy himself or herself that the directors' declaration of solvency is likely to be substantiated by events. (See also paragraph (xix) below).

(v) Appointment as investigating accountant at the instigation of a creditor

A material professional relationship would not normally arise where the relationship is one which springs from the appointment of the practice by, or at the instigation of, a creditor or other party having a financial interest in a company or business, to investigate, monitor or advise on its affairs provided that:

(a) there has not been a direct involvement by a principal or employee of the practice in the management of the company or business; and

(b) the practice continues to have its main client relationship with the creditor or other party, rather than with the company or proprietor of the business, and the company or the proprietor of the business is aware of this.

If the circumstances of the initial appointment are such as to prevent the open discussion of the financial affairs of the company with the directors, an investigating practitioner or other principal in the practice may be called upon to justify the propriety of their acceptance of the subsequent appointment.

Where a practitioner or his/her firm has undertaken an investigation into the financial affairs of a company at the request of a secured creditor of the company, and he/she is asked, as a consequence, by that creditor to accept appointment as administrator or administrative receiver, he/she must satisfy himself/herself that the company, acting by its board of directors, does not object to his/her acceptance of the appointment. If the company does object, but the creditor still wishes to appoint the practitioner, he/she should separately consider whether the circumstances are such that, in accepting the appointment, he/she will be able to act and be seen to act independently and effectively.

Where in exceptional circumstances prior warning of an appointment is not given to the company by the secured creditor, the practitioner should objectively and independently consider all relevant issues, including the reasons for such decision, before accepting appointment.

(vi) Conversion of members' voluntary winding-up into creditors' voluntary winding-up

Where a practitioner has accepted appointment as liquidator in a members' voluntary winding-up and is obliged to summon a creditors' meeting under Section 95 of the Insolvency Act 1986 because it appears that the company will be unable to pay its debts in full within the period stated in the directors' declaration of solvency, the practitioner's continuance as liquidator will depend on whether he or she believes that the company will eventually be able to pay its debts in full or not.

(a) If the company will not be able to pay its debts in full and the practitioner has previously had a material professional relationship with the company such as is set out in paragraph (i) above, the practitioner should not accept nomination under the creditors' winding-up.

(b) If the company will not be able to pay its debts in full but the practitioner has had no such material professional relationship, the practitioner may accept nomination by the creditors and continue as liquidator with the creditors' approval, subject to giving careful consideration as to the implications, etc referred to in the Introduction to the Annex.

(c) If the practitioner believes that the company will eventually be able to pay its debts in full, the practitioner may accept nomination by the creditors and continue as liquidator. However, if it should subsequently appear that this belief was mistaken, the practitioner must then resign, and may not accept re-appointment, if he or she has previously had a material professional relationship with the company.

(vii) Insolvent liquidation following an appointment as administrative or other receiver

Where a principal or employee of a practice (subject to the provisions of paragraph (xix) below) is, or, in the previous three years, has been, administrative receiver of a company, or a receiver under the Law of Property Act 1925 or otherwise, of any of its assets, no principal or employee of the practice should accept appointment as liquidator of the company in an insolvent liquidation.

This restriction does not apply where the previous appointment was made by the Court. However, before a Court-appointed receiver accepts subsequent appointment as liquidator, the practitioner should give careful consideration as to whether his or her objectivity might be, or appear to be, impaired and, if so, the appointment should be refused.

(viii) Liquidation following appointment as supervisor of a voluntary arrangement or administrator

Where a practitioner, or any principal or employee of his or her practice, has been supervisor of a voluntary arrangement or administrator of a company, the practitioner may, if the considerations indicated in the Introduction to the Annex above are satisfied, accept appointment as liquidator if so nominated by the creditors or appointed by the Secretary of State under Section 137 of the Insolvency Act 1986.

However, where the relevant previous role is that of administrator, the practitioner should not accept nomination or appointment as liquidator unless either:

(a) the practitioner has the support of a creditors' committee appointed under Section 26 of the Insolvency Act 1986; or

(b) the practitioner has the support of a meeting of creditors called either under the Act or informally, of which all known creditors have been given notice.

(ix) Bankruptcy following appointment as supervisor of an individual voluntary arrangement

Where a practitioner, or any principal or employee of his or her practice, has been supervisor of a voluntary arrangement in relation to a debtor, the practitioner may, provided the

considerations indicated in the Introduction to the Annex above are satisfied, accept appointment as trustee in bankruptcy of that debtor provided that it is effected by a general meeting of the creditors under the provisions of Section 292(1)(a) of the Insolvency Act 1986, or if the practitioner has been appointed by the Court under Section 297(5) of the Act, or by the Secretary of State under Section 296 of the Act.

(x) Administrator, nominee and/or supervisor of a voluntary arrangement following appointment as administrative receiver or LPA or other receiver

Where a principal or employee of a practice (subject to the provisions of paragraph (xix) below) is, or in the previous three years has been, an administrative receiver of a company, or a receiver under the Law of Property Act 1925 or otherwise, of any of its assets, no principal or employee of the practice should accept appointment as administrator or nominee and/or supervisor of a voluntary arrangement of the company, unless the previous appointment was made by the Court.

(xi) Audit following appointment as supervisor of a voluntary arrangement, administrator or administrative or other receiver

Where a principal or employee of a practice (subject to the provisions of paragraph (xix) below) has acted as supervisor of a voluntary arrangement, administrator or administrative receiver of a company, or receiver of any of its assets, no principal or employee of the practice should accept appointment as auditor of the company for any accounting period during which the supervisor, administrator or receiver acted.

(xii) Pension schemes of companies in liquidation, administration or receivership – appointment of 'Independent Trustee'

A practitioner should not appoint a principal or employee of his or her practice, or any close connection of any of the above or of himself or herself, as 'Independent Trustee' of the pension scheme of a company of which he or she is the liquidator, administrator or administrative or other receiver.

Group B – Examples of the self-interest threats

(xiii) Personal relationships

The current legislation includes specific duties to report on the conduct of directors or shadow directors of an insolvent company. (See for example the requirement under Section 7 (a) of the Company Directors Disqualification Act 1986 to report 'unfit' conduct to the Secretary of State, and Sections 213 and 214 of the Insolvency Act 1986 on fraudulent trading and wrongful trading.) Practitioners should have regard at all times to the spirit of objectivity and should not accept an insolvency appointment in relation to a company where any personal connection with a director, former director or shadow director of the company, is such as to impair or reasonably appear to impair the practitioner's objectivity.

Nor should a practitioner accept an insolvency appointment in relation to an individual where any personal connection with the individual is such as to impair or reasonably appear to impair the practitioner's objectivity.

The attention of practitioners is also drawn to the definitions relating to persons 'connected' with a company in Sections 249 and 435 of the Insolvency Act 1986. This concept of 'connection' or 'relationship' is explored in a different context below (see paragraph (xviii)).

(xiv) Relationship with a debenture holder

A practitioner should, in general, decline to accept an insolvency appointment in relation to a company if he or she, or a principal or employee of the practice, has such a personal or close and distinct business connection with the debenture holder as might impair or appear to impair the practitioner's objectivity. It is not considered likely that a 'close and distinct business connection' would normally exist between an insolvency practitioner and, for example, a clearing bank or other major financial institution. However, such a close and distinct business connection would exist where a practitioner, or a principal or employee of the practice, holds an insolvency appointment to such a bank or financial institution.

(xv) Purchase of the assets of an insolvent company or debtor

The Insolvency Rules 1986 contain prohibitions on members of a liquidation or creditors' committee acquiring any asset in the estate of an insolvent company or debtor (save with leave of the Court or the committee). Save in circumstances which clearly do not impair the practitioner's objectivity, a practitioner appointed to any insolvency appointment in relation to a company or debtor, should not himself or herself acquire, directly or indirectly, any of the assets of the company or debtor, nor knowingly permit any principal or employee of his or her practice, or any close relative of the practitioner or of a principal or employee, directly or indirectly, to do so.

Where a contract is already in existence between the insolvent company or debtor and a principal or employee of the practitioner's practice, the practitioner should draw the matter to the attention of his/her authorising body.

(xvi) Obtaining insolvency work

The special nature of insolvency appointments makes the payment or offer of any commission for, or the furnishing of any valuable consideration towards, the introduction of insolvency appointments inappropriate. This does not, however, preclude an arrangement between a practitioner and a bona fide employee whereby the employee's remuneration is based in whole or in part on introductions obtained for the practitioner through the efforts of the employee.

Other potential conflicts of interest

(xvii) Group, associated and family-connected companies

Practitioners should be particularly aware of the difficulties likely to arise from the existence of inter-company transactions or guarantees in group, associated or 'family-connected' company situations. Acceptance of an insolvency appointment in relation to more than one company in the group or association may raise issues of conflict of interest. Nevertheless it may be impracticable for a series of different insolvency practitioners to act. A practitioner should not accept multiple appointments in such situations unless the practitioner is satisfied that he or she is able to take steps to minimise problems of conflict and that his or her overall integrity and objectivity are, and are seen to be, maintained.

(xviii) Relationships between insolvent individuals and insolvent companies

A practitioner who, or a principal or employee of whose practice, is acting as insolvency practitioner in relation to an individual may be asked to accept an insolvency appointment in relation to a company of which the debtor is a major shareholder or creditor or where the company is a creditor of the debtor. It is essential, if the practitioner is to accept the new appointment, that the practitioner should be able to show that the steps indicated in the paragraph above have been taken. Similar considerations apply if it is the company appointment which precedes the individual appointment.

(xix) Transfer of principals and employees including practice mergers

When two or more practices merge, principals and employees of the merged practice become subject to common ethical constraints in relation to accepting new insolvency appointments to clients of either of the former practices. However existing appointments which are rendered in apparent breach of guidance by such merger need not be determined automatically, provided that a considered review of the situation by the practice discloses no obvious and immediate conflict, such as a potential need to sue a new colleague.

Where a principal or an employee of a practice has, in any former practice, undertaken work upon the affairs of a company or debtor in a capacity which is incompatible with an insolvency assignment of his new practice, the practitioner should not personally work or be employed on that assignment, save in the case of an employee of such junior status that his or her duties in the former practice did not involve the exercise of any material professional judgement or discretion.

(xx) Joint appointments

A practitioner who is invited to accept an insolvency appointment jointly with another practitioner should be guided by similar principles to those set out in relation to sole appointments. Where a practitioner is specifically precluded by the guidance herein from accepting an insolvency appointment as an individual, a joint appointment will not render the appointment acceptable.

(xxi) Solicitation for proxies

In addition to any statutory consequences which it may incur, solicitation for insolvency work in any way amounting to that which a reasonable person would regard as harassment, or otherwise so as to represent a breach of the guidance will be taken into account when considering whether a practitioner should continue to be authorised.

In terms of the Insolvency Rules 1986, remuneration may be disallowed to a liquidator (Rule 4.150) or trustee (Rule 6.148) whose appointment has been procured by improper solicitation.

Examples in respect of cases conducted under Scottish Law

(xxii) Appointment as Trustee under a Trust Deed for creditors, Trustee in Bankruptcy or as an agent of the Accountant in Bankruptcy

Where there has been a material professional relationship with a client, no principal or employee of the practice should accept appointment as Trustee in a Trust Deed or as Interim or Permanent Trustee in Sequestration or as an agent of the Accountant in Bankruptcy in relation to that client.

(xxiii) Bankruptcy following appointment as Trustee under a Trust Deed for creditors and where the Accountant in Bankruptcy is Permanent Trustee

Where a member, or any principal or employee of his practice, has been Trustee under a Trust Deed for creditors, the member may, provided the considerations under the self-review threat and the material professional relationship clauses are satisfied, accept appointments as Interim or Permanent Trustee in Sequestration. Where the Accountant in Bankruptcy is the Permanent Trustee, a member may, provided the considerations above are satisfied, accept appointments as agent in the sequestration.

1 January 2004