Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Bill

Lead department	Insolvency Service (BEIS)
Summary of proposal	To expand the investigatory powers of the Insolvency Service to include former directors of dissolved companies to address legal loopholes via which rogue directors can abuse limited liability regimes to dissolve companies without a formal insolvency process.
Submission type	Impact assessment (IA) – 8 June 2021
Legislation type	Primary legislation
Implementation date	2022
Policy stage	Final
RPC reference	RPC-BEIS-IS-5065(2)
Opinion type	Formal
Date of issue	10 June 2021

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	The RPC issued an initial review notice and a red-rated opinion on previous versions of the IA to which this opinion refers. The Department has submitted a further revised IA, and the RPC considers the calculation of the EANDCB to be fit for purpose. The wider cost-benefit analysis, however, still relies heavily on assumptions and is based on limited evidence.

Business impact target assessment

	Department assessment	**RPC validated**
Classification	Qualifying regulatory provision	Qualifying regulatory provision
Equivalent annual net direct cost to business (EANDCB)	£6.3 million (initial IA estimate) £5 million (final IA estimate)	£5.0 million (*2019 prices, 2020 pv*)
Business impact target (BIT) score	£25 million	£25 million
Business net present value	-£43.0 million	
Overall net present value	-£43.0 million	

[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. RPC ratings are fit for purpose or not fit for purpose.

RPC summary

Category	Quality	RPC comments
EANDCB	**Green** (previously *red*)	The original IA assumed that all directors would have to familiarise themselves with the legislation. After the RPC's initial review contesting this assumption, the IA was amended to include a low estimate assuming that only the number of companies dissolved in a year would have to familiarise themselves. The IA took the mid-point between the high and low estimates, which the RPC did not consider to be robust. The estimate now assumes that, rather than a one-off cost, the estimated number of directors that intend to dissolve their companies each year will familiarise themselves with the legislation.
Small and micro business assessment (SaMBA)	**Green**	The IA states that evidence from consultation responses suggests the problem of abuse of the limited liability regime is particularly prevalent within small and micro businesses (SMBs). It is, therefore, not appropriate for SMBs to be exempt from the policy.
Rationale and options	**Satisfactory** (previously *Very weak*)	The IA now explains why the low number of complaints received about the abuse in question is believed to be a significant underestimate of the problem. The IA now also includes reference to the regulatory failure caused by the legal loophole and provides some evidence of the consequences of dissolved companies writing off debt. However, the IA would benefit from stronger evidence on the severity of the consequences of dissolution abuse for creditors and individual consumers. The IA now explains that the proposal is a civil enforcement, which will complement existing alternative options, such as prosecution by the Crown Prosecution Service or the Serious Fraud Office, to tackle *Bounce Back Loan* fraud.
Cost-benefit analysis	**Satisfactory** (previously W*eak*)	The IA explains that the Insolvency Service will need to prioritise cases for investigation from within the same funding envelope, meaning that the available budget will remain the same. The IA now clarifies that the analysis implicitly assumes that there is no change to the overall number of cases investigated or the impacts associated with them. The IA provides a limited sensitivity analysis on the possible impacts of a change in mix of cases investigated. The cost-benefit analysis is based on very limited evidence. However, the IA now attempts to demonstrate how likely the policy is to break even based on *willingness to pay*.
Wider impacts	**Satisfactory**	The IA provides details of the equalities impact assessment that has been carried out. The IA would benefit from a discussion of other wider impacts, such as the potential impacts on competition.
Monitoring and evaluation plan	**Satisfactory**	The IA states that a light touch post-implementation review will be carried out. The IA would benefit from providing further detail on the steps that will be taken to assess the extent to which the policy objectives have been met.

Response to initial review and red-rated opinion

The IA, as first submitted for RPC scrutiny, attracted an RPC initial review notice. The consequent revised IA received a 'not fit for purpose' RPC rating. Subsequently, the Insolvency Service submitted a further-revised IA for RPC scrutiny. The present IA is now fit for purpose as a result of a positive response to the RPC's previous 'not fit for purpose' opinions.

As originally submitted, the IA was not fit for purpose because of the approach taken to the calculation of the EANDCB. In the initial review notice, the RPC advised that the estimate appeared to be an upper bound, as it assumed all directors would have to familiarise themselves with the proposals. The RPC also suggested that the Insolvency Service should consider the impacts on compliant businesses and on businesses that would be affected by other investigations no longer being carried out. In addition, the IA's lack of information on, and quantification of, the counterfactual made it difficult for the RPC to identify and, therefore, validate the direct impact on business. The revised IA, submitted following the initial review, included a lower bound estimate based on the anticipated number of dissolutions, assuming that only directors considering a dissolution would familiarise themselves with the legislation. However, rather than using this low estimate for the calculation of the EANDCB, the IA used a mid-point estimate for its central EANDCB figure (i.e. the mid-point between the original estimate of all directors familiarising themselves with the legislation and the lower estimate based on the number of directors involved in dissolutions).

The IA now reflects an ongoing familiarisation cost based on the historical number of directors dissolving their companies each year. This is based on statistics on the number of dissolutions each year between 2011 and 2019, which are used to provide a high, low, and best estimate. The IA now also explains that the Insolvency Service will operate within a constant funding envelope and that the profile of directors of dissolved companies is the same as those involved in existing investigations. It is, therefore, assumed that the opportunity cost to business of an investigation is the same (on average) so no additional costs should feature in the EANDCB. While this assumption is based on limited evidence, the RPC accepts that the approach taken is the most appropriate given the uncertainty surrounding future investigations.

Summary of proposal

The proposal aims to close a technical loophole in the insolvency enforcement landscape to address two concerns: public concerns, by enabling rogue directors, who abuse the company and insolvency law regimes, to be investigated and held to account; and to provide an option to deal with a likely and urgent scenario that such enforcement powers will be needed to deal with *Bounce Back Loan* fraud by company directors, who may use the dissolution of a company to avoid repayment.

The proposal is for the Insolvency Service to have the power to investigate and, where appropriate, take action to disqualify directors of dissolved companies. The Insolvency Service believes that this will also deter undesirable behaviour by rogue directors.

The Insolvency Service estimates a net present value (NPV) -£43.0 million, a business NPV of -£43.0 million and an EANDCB of £5.0 million. The IA indicates that familiarisation with the legislation will be the main cost to businesses, which will apply to directors of dissolved companies and insolvency practitioners; and costs to the Service for investigations and enforcement. The IA uses a standard 10-year appraisal period.

EANDCB

The RPC now considers the calculation of the EANDCB to be fit for purpose. The present IA uses evidence of the number of dissolved companies to provide a realistic estimate of the subset of directors that would consider actions that may fall foul of the proposed legislation. The IA now also justifies that there will be no other business impacts (such as disproportionate costs to compliant micro businesses being investigated, or benefits to businesses from avoided fraud) because the opportunity costs and benefits to creditors are expected to be the same as those in the existing funding of investigations. While there is a lack of evidence supporting this, the RPC recognises the Insolvency Service' justification and suggestion to monitor these impacts.

SaMBA

The SaMBA is sufficient and fit for purpose. The IA states the policy will apply to companies of all sizes, with SMBs constituting 99 per cent of the business population. However, it may be more useful for the IA to present data on the proportion of dissolutions accounted for by SMBs. Evidence from consultation responses suggests that the problem of abuse of the limited liability regime is particularly prevalent with SMBs.

Rationale and options

The RPC considers the evidence underpinning the rationale and options to be satisfactory. The IA now usefully includes evidence on the scale of the problem under consideration. The IA states that there were 529,860 companies dissolved during 2019 but only 92 complaints were made from February 2018 to December 2020. The IA now explains why the number of complaints received is believed to be a significant underestimate of the problem. The IA now also includes reference to the regulatory failure caused by the legal loophole and provides some evidence of the consequences of dissolved companies writing off debt. However, the IA would benefit from stronger evidence on the severity of the consequences of dissolution abuse for creditors and individual consumers.

The IA now explains that the proposed reforms complement existing alternative options to tackling *Bounce Back Loan* fraud such as prosecution by the Crown Prosecution Service or the Serious Fraud Office. The proposal is for a civil enforcement framework, which will enable the most-proportionate action to be taken based on the abuse in question.

The IA now provides some justification that the proposal is proportionate, stating that companies would need to have a 'willingness to pay' of only around £1.50 each per year for stronger action against rogue directors, for the overall cost of £5 million to businesses to be justified.

Cost-benefit analysis

The RPC considers the cost-benefit analysis to be satisfactory. The IA explains that the Insolvency Service will need to prioritise cases from within the same funding envelope, meaning that the available budget will remain the same. The IA now clarifies that the analysis implicitly assumes that: there is no change to the overall number of cases investigated; investigations under this new power will displace other investigations on a one-for-one basis; there is no change to the overall economic benefit; there is no change to the impacts on creditors; and there is no change to the business costs associated with investigations. The IA provides a limited sensitivity analysis in paragraph 60 on the possible impacts of a change in mix of cases investigated. The RPC recognises that these assumptions are made "…*given the impossibility of predicting the impact of the measure on future case mix*" but believes it is still important to highlight that the cost-benefit analysis is based on very limited evidence.

While the IA does not monetise any benefits to society, it now includes some evidence from the Home Office and the Australian Tax Office on the losses associated with dissolved companies when they write off debt. The IA now attempts to provide a narrative on how likely the policy is to break even based willingness to pay, as referred to in the rationale and options section above.

Wider impacts

The IA includes public sector costs and usefully provides details on the equalities impact assessment that has been carried out. The IA would benefit from a discussion about any other wider impacts relevant to the proposals, such as the potential impacts on competition.

Monitoring and evaluation plan

The RPC considers the monitoring and evaluation plan to be satisfactory. We recognise that it now sets out that some of the key assumptions will be tested and that it is necessary to take a proportionate approach. However, the IA could set out more clearly how the success of policy will be measured in terms of achieving a genuine reduction in the number of abuses.

Other comments

The RPC commends the Insolvency Service for separately making it clear where, and how, it has addressed RPC comments made in the initial review notice and red-rated opinion.

The Insolvency Service should ensure that all terms used in the IA (for example, "*phoenixed*"), with which some readers may not be familiar, are clearly defined.

Regulatory Policy Committee

For further information, please contact regulatoryenquiries@rpc.gov.uk. Follow us on Twitter @RPC_Gov_UK, LinkedIn or consult our website www.gov.uk/rpc.