

Impact Assessment - Changes to reporting on the conduct of directors by insolvency office-holders. Red Tape Challenge Measure

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|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------|
| <p>Title: Report director misconduct: RTC proposals to change reporting processes</p> <p>No: BISINSS047</p> <p>Lead department or agency: Insolvency Service (Executive Agency of the Department for Business Innovation and Skills)</p> <p>Other departments or agencies:</p> | <h2>Impact Assessment (IA)</h2> |
| | <p>Date: 13/6/2014</p> |
| | <p>Stage: Final</p> |
| | <p>Source of intervention: Domestic</p> |
| | <p>Type of measure: Primary legislation</p> |
| | <p>Contact for enquiries: Clare.Quirk@insolvency.gsi.gov.uk</p> |
| <p>Summary: Intervention and Options</p> | <p>RPC Opinion: N/A (Deregulation measure RPC opinion not required)</p> |

| Cost of Preferred (or more likely) Option | | | |
|-------------------------------------------|----------------------------|------------------------------------------------------|---------------------------------------------------|
| Total Net Present Value | Business Net Present Value | Net cost to business per year (EANCB on 2009 prices) | In scope of One-In, Measure qualifies as One-Out? |
| 34.89m | 34.89m | -3.38m | Yes Out |

What is the problem under consideration? Why is government intervention necessary?

When a company has entered into formal insolvency proceedings Insolvency Practitioners (IPs) have a duty to report on director misconduct and are required to use two outdated statutory forms, D1:full report, to report misconduct or D2: interim or final return. Information from IPs can vary in timeliness and quality. Legislative change is required to update and streamline the reporting process; replacing statutory paper forms with a single, electronic return, alerting the Secretary of State (SoS) at an earlier stage to director misconduct and enabling a move to a more responsive, intelligence-led enforcement process.

What are the policy objectives and the intended effects?

The policy objective is to improve the process for reporting director misconduct .The intended effects include:

Streamlined reporting - single electronic return, digital by default;

Earlier investigation of miscreant directors - IPs reporting misconduct indicators earlier; more efficient investigation and enforcement outcomes;

Increasing consumer confidence and protection - earlier focus on appropriate cases.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Improvements in the quality and timeliness of information received from IPs were sought by issuing revised guidance notes, extending outreach and stakeholder programmes and reviewing feedback to IPs. However, changing reporting requirements, streamlining forms and enabling electronic submission can only be addressed through legislative change.

Will the policy be reviewed? Yes If applicable, set review date: 2020

| | | | | | |
|-----------------------------------------------------------------------------------------------------------------------------|-----------|----------|----------------|------------|--------------------|
| Does implementation go beyond minimum EU requirements? | | | No | | |
| Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base. | Micro Yes | < 20 Yes | Small Yes | Medium Yes | Large Yes |
| What is the CO₂ equivalent change in greenhouse gas emissions? (Million tonnes CO₂ equivalent) | | | Traded: | | Non-traded: |
| | | | 0 | | 0 |

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

**Signed by the responsible
SELECT SIGNATORY:**

Jerry Gillett

Date: 16th June 2014

Summary: Analysis & Evidence

Description: Proposal to change the procedure for reporting director misconduct

FULL ECONOMIC ASSESSMENT

| | | | | | |
|--------------------------------|-----------------------------|-----------------------------|----------------------------------------------|--------------------|-----------------------------|
| Price Base Year 2013 | PV Base Year 2013 | Time Period Years 10 | Net Benefit (Present Value (PV)) (£m) | | |
| | | | Low: 29.04 | High: 41.51 | Best Estimate: 34.71 |

| COSTS (£m) | Total Transition (Constant Price) Year | Average Annual (excl. Transition) (Constant) | Total Cost (Present Value) |
|----------------------|--------------------------------------------------|--------------------------------------------------------|--------------------------------------|
| Low | 0.9 | 0.0 | 0.9 |
| High | 0.9 | 0.0 | 0.9 |
| Best Estimate | 0.9 | 0.0 | 0.9 |

Description and scale of key monetised costs by 'main affected groups'

Familiarisation costs and electronic portal costs.

Other key non-monetised costs by 'main affected groups'

N/A

| BENEFITS (£m) | Total Transition (Constant Price) Year | Average Annual (excl. Transition) (Constant) | Total Benefit (Present Value) |
|----------------------|--------------------------------------------------|--------------------------------------------------------|-----------------------------------------|
| Low | 0.0 | 3.6 | 29.9 |
| High | 0.0 | 5.1 | 42.4 |
| Best Estimate | 0.0 | 4.3 | 35.8 |

Description and scale of key monetised benefits by 'main affected groups'

Cost savings from reduction in estimated time to complete single new electronic return v cost of completing current statutory form will enable more money to be returned to creditors. Best estimate of indicative savings in cost of submitting the new return is **£4.3m p.a.**¹

Other key non-monetised benefits by 'main affected groups'

Earlier investigation of miscreant directors leading to;

- more efficient investigations and enforcement outcomes;
- increasing consumer confidence and protection;

It has not been possible to quantify these benefits.

Key assumptions/sensitivities/risks

3.5

BUSINESS ASSESSMENT

¹ Including Northern Ireland

| | | | | |
|----------------------------------------------------------|----------------------|-----------------|--------------------|--------------------------|
| Direct impact on business (Equivalent Annual) £m: | | | In scope of | Measure qualifies |
| Costs: 0.1 | Benefits: 3.5 | Net: 3.4 | Yes | N/A |

Evidence Base (for summary sheets)

Scope of impact assessment

1. This is a final stage Impact Assessment (IA) that considers the likely costs and benefits of a measure aimed at streamlining the reporting by Insolvency Practitioners (IPs) of unfit conduct. Information has been gathered from a range of sources including from the Insolvency Service, respondents to the Insolvency Service's Red Tape Challenge consultation (which considered the proposed measure) and other engagement with stakeholders.

Consultation

2. The proposals were consulted on between 18 July and 10 October 2013.
<http://www.bis.gov.uk/assets/insolvency/docs/insolvency%20profession/consultations/redtapechallenge/rtc-consultation.pdf>
3. A Government response was issued on 23 January 2014.

Affected Groups

4. The main affected groups will be:
 - Insolvency professionals and their staff;
 - Government, in respect of internal administrative processes;
 - Government, in respect of any consequential amendments required to UK legislation;
 - Businesses and company creditors;
 - Directors.

The legislation

5. The Company Directors Disqualification Act 1986(CDDA) aims to maintain the integrity of the business environment. Those who become directors of limited companies should carry out their duties responsibly and exercise adequate skill and care and proper regard to the interests of the company's creditors and employees.
6. The majority of directors do this effectively but the CDDA is a powerful tool against those who abuse the privilege of limited liability. The CDDA applies not just to persons who are formally appointed as directors but to those who carry out the functions of directors.
7. The CDDA came into force on 29 December 1986. All sections of the CDDA apply to England, Wales and Scotland, but not to Northern Ireland (although equivalent legislation has been in force since 1986). The Act applies to "companies" which includes any company which may be

wound up under the Insolvency Act 1986. It also applies to foreign companies registered in the UK, building societies, incorporated friendly societies and NHS foundation trusts.

8. The CDDA provides that the court shall disqualify directors of insolvent companies where it is satisfied that a director's conduct makes them unfit to be concerned in the management of a company. The Act provides that if it appears to the office-holder (the official receiver, liquidator, administrator or administrative receiver) that the conditions for making a disqualification order are satisfied as respects a person who is or has been a director of the insolvent company, they shall immediately report the matter to the Secretary of State (SoS). In practice, reports are made to the Insolvency Service, which exercises the powers of the Secretary of State in relation to insolvent disqualifications.
9. The Act provides that the SoS, or the official receiver, may require the office-holder to produce such information with respect to any person's conduct as a director of the company, and produce and permit inspection of such books, papers and other records relevant as may reasonably be required.
10. There are separate proposals in the Deregulation Bill to amend the CDDA to enable the SoS or the official receiver to request information relevant to a person's conduct as a director of a company that has been insolvent, directly from any person, including from officers of the company themselves. The proposed changes would reduce the administrative burden on IPs who are currently asked to provide a signed authority to enable the Service to obtain information from third parties. This would reduce bureaucracy and delays in obtaining information.
11. The accompanying Rules to the CDDA (The Insolvent Companies (Reports on Conduct of Directors) Rules 1996 (as amended) provide statutory forms for use by the office-holder. The 'D1' report is used to report unfit conduct. The 'D2' return is used where no unfit conduct has been found or as an interim report. Minor revisions were made to the forms in 2001 but the forms have remained unchanged since.
12. Annex A sets out the office-holders' obligations and the reporting process.

Public protection

13. A disqualification order prohibits the person named, without leave of court, from acting as company director². It can be

² In addition to other restrictions

regarded as a punishment for unfit conduct but also as a measure taken for the protection of the public. Whilst the order is not in itself penal, it is restrictive of the liberty of the person against whom it is made and its contravention can have penal consequences. A disqualification order can be made for a period of 2 to 15 years. Disqualification protects the integrity of the business regime by dealing with corporate malpractice and abuse of limited liability; and by tackling wider abuse that can lead to market distortion.

Current IP reporting provisions

14. The legislation provides that a D1 (unfit conduct) report must be made immediately, once it appears to the Insolvency Practitioner (IP) that the director's conduct makes him unfit to be concerned in the management of a company.
15. A D2 (interim or fitted) return must in any event be made on the day one week before the expiry of the period of 6 months from the date of the insolvency event.
16. In submitting a D1 report, the IP must be satisfied that there is evidence of unfit conduct. Information can be delayed therefore whilst the IP ensures that he/she is satisfied that unfit conduct can be evidenced and justify his/her opinion. This impacts on the vetting and investigation process which is significant because the SoS currently has to make application for a disqualification order within 2 years of the insolvency event (there are separate proposals to increase that period to 3 years).
17. The decision as to whether to apply for disqualification is made by the SoS based on a variety of factors. The SoS must consider whether allegations can be made out taking into account their seriousness, availability of evidence and witnesses and any mitigating factors. These factors are considered before a decision is taken as to whether the case warrants investigation. Around 98% of disqualification cases are instigated in under 23 months.

Problem under consideration

The present reporting system has material shortcomings;

18. **Outdated statutory forms** - The current forms were last amended in 2001 and are out of date. For example they do not require provision of e mail addresses, mobile telephone numbers or information about computerized accounting records. Also the Insolvency Service address provided for form submission is out of date. There are also other pieces of information not currently requested which R3 (the body that represents 97% of IPs) state that IPs could usefully

provide plus information which would be beneficial at the early stages of an investigation, such as whether the IP has possession of the accounting records.

19. **Government Digital Strategy** - There is no mechanism to enable electronic submission of returns in line with the Government's Digital strategy.³
20. **Information quality and timeliness** - IPs are currently required to evidence misconduct in all cases where it is identified and may often delay their reports whilst they satisfy themselves that they have sufficient evidence of misconduct. Whilst a large number of reports are good, there can be quality issues including around evidence, litigation, and failure to requisition records or to provide an adequate audit trail around the security of accounting records. Analysis undertaken on a sample of 250 cases where D1 reports were submitted but not proceeded with indicated that a significant percentage of them should not have been submitted. Only 68% of reports are submitted within 6 months of the insolvency event.
21. **Impact on investigation** – The SoS has a period of two years from the date of the insolvency event to issue disqualification proceedings. The limitation period is less generous than it appears because the following activities need to take place within the two year period;
 - Case vetting;
 - Pre-action protocols;
 - Evidence gathering;
 - Report writing;
 - Authorisation process;
 - Issue of proceedings.
22. Also, a minority of cases are Company Voluntary Liquidations so the returns are not typically received until around 12 months from the insolvency event. Therefore delays in receiving the D1 report impact on any subsequent investigation by the SoS and often on the enforcement outcome.

Options considered

23. **Option 1 - Do nothing** – This option would mean that the system for reporting director misconduct would remain unchanged with IPs using two separate statutory forms to report director misconduct. These forms have remained unchanged since 2001 and are outdated. Current forms and information requirements can result in inefficiencies in the investigation process as, for example, the D1 form currently does not request information about the accounting records or whether they have been collected or requested, often

³ <https://www.gov.uk/government/publications/government-digital-strategy>

leading to targeting decisions which have to be overturned at a later stage.

24. The Insolvency Service has sought to drive improvements in the quality and timeliness of information received from IPs by issuing revised guidance notes, extending outreach and stakeholder programmes and reviewing feedback to IPs. These initiatives have resulted in less D1 reports being rejected outright, for example on evidential grounds. However, there are still limitations with the forms themselves which lead to additional requests for information at the vetting stage which could be avoided, a simple example being provision of the VAT registration number and tax reference.
25. In discussions with stakeholders, including R3, the body which represents 97% of IPs, it was clear that there was a need to streamline the reporting process; removing outdated statutory forms and moving towards electronic reporting. Support for the proposals to streamline the reporting process was reflected in consultation responses (see paragraph 46).
26. Changing reporting requirements, streamlining forms and enabling electronic submission can only be addressed through legislative change. Non-legislative options have been tried with little success, as noted in paragraph 24. The do nothing option is not viable. We have therefore only presented one course of action, option 2.
27. **Option 2 – Streamline the reporting process** - This option involves changing the system for IPs to report on director's conduct. Changes proposed in option 2 include;
 - **Provision of updated single return form** - Replacing two outdated statutory forms with a single, non statutory form submitted in all cases within 3 months of the insolvency event; and
 - **Enabling electronic submission** - Enabling electronic submission of that form in line with Government Digital Strategy.
28. The changes address stakeholder concerns about outdated reporting processes and make the reporting process more flexible and efficient. The quality of information should improve due to the return being submitted with greater proximity to events plus much of the required information will be available from the IPs own case records and can be supplemented by our own intelligence and information.
29. Earlier submission of the return will enable more engagement with IPs regarding missing information that is crucial to making robust targeting decisions. Electronic reporting will make it easier for IPs to report in a more timely fashion. Earlier submission of returns, in isolation, is not expected to generate additional costs or benefits, and so has not been considered as a discrete policy option.

30. **We are confident that Option 2 is an achievable option which will be well received by stakeholders.**

Rationale for intervention

31. The general economic rationale for dealing with unfit director conduct is to address the moral hazard⁴ problem generated by perverse incentives created by limited liability⁵. That is, directors are more likely to engage in unfit conduct or take more risks if they are not personally responsible for the consequences of their actions⁶. Information asymmetries mean that directors have more information than creditors about their likely future behaviour. High transaction costs (for example from trying to write the 'perfect contract') can prevent creditors from protecting themselves, inhibiting, in some instances, investment.
32. Generally, government intervention in the area of misconduct is therefore needed to minimise the unintended consequences of limited liability. This is done by achieving a better alignment of incentives and so discouraging directors from misconduct; hence enabling optimal levels of risk-taking and investment in the market.
33. Laws to address general unfit director conduct, primarily the CDDA, are currently in place. But it is the fair and consistent application and enforcement of these laws that determines the effectiveness in aligning director's incentives.
34. More specifically, government intervention is necessary here to help to address the regulatory failures associated with disqualification activities delivered by The Insolvency Service. This proposal is aimed at maximising the time spent investigating directors involved in insolvencies, to ensure a greater number of full and thorough investigations are undertaken more efficiently.
35. **Electronic reporting** will lead to savings to IPs in terms of the cost of completing and submitting returns. These savings are ultimately passed onto creditors by way of increased distributions. Currently both forms are statutory forms completed manually. Statutory forms cannot be amended without legislative change and are therefore inflexible. A single return made in all cases would streamline the process; make it easier to understand and more time efficient. Enabling submission of returns via an electronic gateway would improve the process further, enhancing the quality, consistency and submission times of information

⁴ In economic theory, a moral hazard is a situation where a party will have a tendency to take risks because the costs that could incur will not be felt by the party taking the risk.

⁵ Halpern et al. (1980) Limited Liability in corporate law

⁶ One of the consultation responses argued, that, although there is firm grounding in the literature that limited liability generates a moral hazard problem, there is little empirical evidence of the *extent* of this problem. The extent of the problem would determine the degree of regulatory action, rather than the need for regulatory action, which is the subject of discussion in this section.

from IPs and result in efficiencies in Insolvency Service investigations. As design of the new reporting process is still in the early stages, it has not been possible to estimate savings to The Insolvency Service resulting from implementation of the proposals. Any savings could be used to increase enforcement capability. However, decisions regarding the allocation of any freed up resource available have not yet been taken, therefore the likely impact, say of additional company director disqualifications or other enforcement outcomes, has not been estimated.

36. One of the Department for Business, Innovation and Skills' exemplar government digital service projects is being undertaken by the Insolvency Service. The project will deliver a digital replacement for the currently paper based Redundancy Payments Service. This iterative digital project will eventually deliver the platform required to enable electronic submission of the conduct returns. The incremental cost of including this is estimated at between £250,000 and £500,000.⁷ In the Impact Assessment we have included these as one off development costs of £375,000.
37. Removing the need for submission of a statutory form to provide a return in a form specified by the SoS would mean that the format of the return could be amended more easily to accommodate change. The proposal would be for the form to be pre-populated with information from Companies House when the INSS electronic gateway is available.
38. **Earlier reporting of misconduct** - If IPs report at an earlier stage (e.g. 3 months from the insolvency event), the SoS would be able to better consider behaviour identified by the IP in addition to available intelligence in deciding whether to investigate and in determining what further information he may reasonably require. This would require a change of emphasis, but no additional burden, in terms of what the IP submits as it is likely that requests for further information will be made in a smaller number of cases plus these requests will be more focused on matters relevant to enabling the SoS to make appropriate vetting and targeting decisions.
39. Currently the IP is asked to submit details and evidence of unfit conduct and can undertake a considerable amount of work to comply with statutory requirements. The proposed design of the new form would require the IP to highlight (at an earlier stage) information or behaviour which may indicate unfit conduct as opposed to providing a significant

⁷ In line with Government Digital Service advice, the Insolvency Service will be reviewing costs at each stage of development. The estimate is likely to change in response to user needs and following user testing.

amount of justification and evidence at that stage. Once the return is made, the IP will have fulfilled his/her initial obligation to report unfit conduct to the SoS but, as previously will be required to respond to requests for additional information or evidence and will be under an ongoing obligation to report any new information that he/she considers should have been included in the return. The IP does not decide whether a director should be disqualified. The IP merely provides information, and the Secretary of State makes the decision. If the IP completes a D1 or D2 return, and submits further information when asked, the statutory obligation is fulfilled.

40. IPs would still be obliged to provide (additional) information and produce and permit inspection of books, papers and other records in cases where the SoS requires it. It is anticipated that earlier reporting would lead to more focused requests for information and potentially greater engagement with IP staff dealing with the case. There would also be a requirement on IPs to submit (new) information about any unfit conduct uncovered after submission of the return.
41. The proposals presented in this Impact Assessment are aimed at making it easier to report director behaviour and facilitate earlier, more targeted investigation of miscreant directors.

Policy objective

42. The policy objectives are modernisation of the law around reporting director misconduct. The intended effects are as follows:
43. **Streamlined reporting** - modernising the way information is submitted in line with Government Digital Strategy; delivering what stakeholders want by replacing two outdated statutory forms with a single return which can be submitted electronically. Removing the requirement to use the statutory forms and replacing this with a proforma increases flexibility as the proforma can be updated when required without legislative change. IPs will be engaged in the design of the new return. The Insolvency Service will continue to provide guidance to IPs on how to complete the return and will continue to provide feedback to IPs on investigation decisions as part of the reporting process.
44. **Earlier investigation of miscreant directors** – The requirement to report three months from the insolvency event will mean that we can work more closely with IPs to identify cases which warrant further investigation at an earlier stage. This will enable focus on collecting information which will assist the SoS in deciding whether to make a

disqualification application. Generally, receiving misconduct indicators at an earlier stage should result in more efficient investigation and enforcement outcomes. Cases not suitable for disqualification action can be identified at an earlier stage enabling resources to be directed elsewhere⁸.

45. **Increasing consumer confidence and protection** – earlier submission would enable investigation of potential unfit conduct to commence at an earlier stage with greater proximity to events, fresher information, contact details and creditor interest. It would remove some of the barriers to timely disqualification action and enable the SoS to target cases for investigation sooner with earlier focus on misconduct leading to greater public protection from miscreant directors and increased levels of consumer confidence. Commencing investigations at an earlier stage may act as a deterrent to miscreant directors who might otherwise set up further limited companies.
46. Case numbers fluctuate and investigation decisions are taken on a case by case basis with prioritisation linked to a wider enforcement strategy. It is not possible therefore to estimate the likely impact of the proposals on the number of disqualification orders. Streamlining the reporting process could result in savings which could be used in delivering our enforcement priorities or to reduce funding requirements. Allocation of these savings has not yet been decided therefore the impact, say of additional enforcement outcomes, has not been calculated for the purpose of this Impact Assessment.

Consultation

47. As part of the Red Tape Challenge agenda, the Government carried out a consultation between 18 July and 10 October 2013 relating to regulations affecting IPs, the practice of insolvency and the reporting duties of IPs on the conduct of directors.

Consultation responses

48. **Streamlined reporting – responses** – there was unanimous support for changing reporting processes, which indicate that a change to the current processes could lead to a more efficient outcome. We have reflected consultation responses in the detail of the proposals in Option 2. This option proposes requiring a single return in all cases and for the two statutory forms to be replaced with a proforma provided by the Secretary of State. Pre-population of the form with company data from the Registrar of Companies was welcomed subject to some minor concerns regarding checking the accuracy.

⁸ As the reporting process is in the early stages of design, savings to The Insolvency Service have not been estimated.

49. Subject to a small number of comments regarding the thoroughness of investigations and the IP acting as an initial filter in the reporting process, the proposal to remove the requirement for IPs to evidence their opinion on director conduct also received widespread support.
50. **Earlier reporting of miscreant directors - responses** – there was a mixed response to the proposal that IPs submit information within three months of the insolvency event. There was some support for submission at three months, a significant minority suggested that the return be made four months and the remainder favoured six months. In addition to the consultation responses, stakeholders approached in the course of the Service’s outreach presentations gave their reaction on earlier reporting; again providing a mixed response with one suggesting four months but others stating that three months would be feasible. Comments around the three months included concerns that this could result in IPs reporting less misconduct as insufficient information would be available.
51. The Government believes that in view of the reduced level of information being required and the fact that information will be submitted electronically and added to the Insolvency Service’s own information and intelligence, returns should be submitted 3 months from the insolvency event in line with original proposals. Requiring returns by 3 months will enable earlier investigation and will signal a change to an intelligence enhanced investigation and enforcement process, working more collaboratively with IPs to share information and focus requests for further information requests on appropriate cases. In the minority of cases where new information comes to light post 3 months, IPs will be required to submit that information to the Secretary of State.
52. Earlier investigation will provide the opportunity for investigation cases to be taken forward earlier. Also, cases where there is no misconduct, or where misconduct cannot be pursued e.g. due to lack of evidence, witnesses etc. could be identified and abandoned earlier, focusing resources on other cases or enforcement opportunities.⁹ We do not anticipate any detrimental effect on the disqualification regime.

⁹ As the reporting process is in the early stages of design, savings to The Insolvency Service have not been estimated.

53. **Process design** - The Insolvency Service will engage with IPs in both the design of the return itself and the electronic reporting process. The reporting system will be designed to comply with the Government's Digital by Default Service Standard.

Impacts of the options considered

Option 1 - Do Nothing

54. There are no additional costs or benefits, either transition or recurring, expected under the Do Nothing option.

Option 2 – Electronic reporting

Costs

55. **Transition costs** - We estimate that the only cost to business will be transition costs incurred by IPs. To calculate the scale of transition costs, we estimated the amount of time that an IP and his/her staff would need to familiarise themselves with the new return and guidance. We expect that most IPs will require at least one hour to familiarise themselves with the changes. There are 1352 appointment-taking IPs and, based on an IP hourly rate of £366 we would estimate that transition costs would total around £494,832 in the first year.
56. **Costs to the Insolvency Service** – We estimate that the cost of providing the electronic platform for receipt of the new return is £375,000. The Insolvency Service is undertaking a project to deliver a digital replacement for the paper-based Redundancy Payments Service. The intention is that this digital capability will be extended to other Insolvency Service functions. The estimated cost of extending this to enable electronic submission of the new return is estimated at between £250,000 and £500,000 with a best estimate of £375,000.
57. **Transition/other benefits** - No additional transition benefits are expected under Option 2. As design of the new reporting process is still in the early stages, it has not been possible to estimate benefits to the Insolvency Service.
58. **On-going benefits** – It is expected that the proposals to streamline the reporting process will deliver on-going benefits as the time that it takes an IP to comply with his/her statutory duty to report to the SoS will be permanently reduced. The monetised value of those benefits is based on the estimated reduction in the cost of completion of returns made by IPs to the SoS. The methodology for calculating the estimated savings is to compare the current estimated cost of completing the D1: Full Report and D2: Interim with the estimated cost of completing the new single, electronic return.

59. We have based the benefit calculations on the following assumptions:

Current D1 report

60. That the current D1 form takes 3.5 hours to complete - In response to the consultation and in subsequent stakeholder engagement, the majority of respondents indicated that the time taken to complete the D1 form varies according to the case. Where estimated completion times were provided, they varied between 1 and 4 hours per case. R3, the industry body for IPs, estimate that the form takes 2-3 hours per director to complete. Based on an average of 2 directors per case, R3's estimated completion time is around 4 to 6 hours per report.
61. In view of the majority of respondents pointing to a variance in completion times, we have taken R3's estimate of 6 hours per case as the upper estimate and 1 hour as the lower estimate with a best estimate of 3.5 hours. Based on responses detailing the level and complexity of work involved in preparation and submission of the D1 form, we have included a notional cost of completion of 3.5 hours comprised of 2 hours of insolvency case manager's time (at £253 per hour) and 1.5 hours of an IP's time (at £366 per hour)¹⁰.
62. In the 3 years between 2011/12 and 2013/14 the average number of D1s reports submitted per year was 4997 so the estimated total cost per annum of completing D1 reports was **£5,271,835**.¹¹

Current D2 return

63. That the current D2 return takes 1.25 hour to complete. In response to the consultation and from further stakeholder engagement, respondents stated that the time taken to complete the D2 form varies according to the case. The majority of the respondents provided estimates of between 0.5 and 2 hours. R3 originally estimated that the form takes 0.5 hours per director to complete. Based on an average of 2 directors per case, their estimate was a completion time of 1 hour per return.
64. In view of the variance in completion times, we have taken 2 hours as the upper estimate and 0.5 as the lower estimate, with a best estimate of 1.25 hours (1.3). Based on consultation responses describing the level and complexity

¹⁰ IPs are highly qualified professionals and charge fees at rates similar to other professionals such as accountants and lawyers. In 2013 the Insolvency Service published a report on the fees charged by IPs undertaken by Professor Elaine Kempson of Bristol University. The hourly charge-out rates used in this IA are based on the average figures contained in Professor Kempson's report. <http://bis.gov.uk/insolvency/insolvency-profession/review-of-ip-fees>

¹¹ $(2 \times £253 + 1.5 \times £366) \times 4997 = £5,271,835$

of work involved in preparation and submission we have costed this at 0.65 hours of manager's time (at £253 per hour) and 0.65 hours of an IP's time (at £366 per hour) In the 3 years between 2011/12 and 2013/14 the average number of D2 returns submitted per year was 11,536 so the estimated total cost per annum of completing D2 returns was **£4,641,510**¹²

We estimate that the average annual cost of submitting D1 reports and D2 returns is **£9,913,345**.¹³

New single electronic return

65. Currently misconduct is reported on form D1 in around 30% of cases. Completion time of the new single return will depend on whether or not the IP is reporting behaviour which may indicate misconduct. It is anticipated that earlier submission coupled with the reduced initial evidential burden may lead to an increase in returns indicating misconduct and have factored this into our estimated savings using sensitivity analysis. We have estimated completion time of the new return as follows dependent on the nature of the return;
66. **Return where no misconduct indicated (replacing the D2 report)** – Insolvency Service officials with direct experience of investigating companies and reporting director's conduct to the SoS have estimated that the proposed new return will take 15 minutes per director to complete where no misconduct is indicated. Based on an estimated average 2 directors per case we have estimated that the per submission cost will be £155 which includes 15 minutes of an insolvency case manager's time (at £253 per hour) and 15 minutes of an IP's time¹⁴ (at £366 per hour). These assumptions were included in the Impact Assessment which accompanied the original consultation and did not attract any dissenting consultee responses or subsequent stakeholder comment. Respondents to the consultation indicated that time savings were likely to be significant.
67. **Return where misconduct is indicated (replacing the D1 return)** – Insolvency Service officials with direct experience of investigating companies and reporting on director's conduct to the SoS have estimated that the proposed new return will take 1 hour per director to complete where misconduct is indicated. This estimate is supported by consultation responses which suggested that time savings would be significant. Based on an estimated average 2 directors per case we have estimated that the cost will be £619 which includes 1 hour of an insolvency case

¹² $0.65 \times £253 + 0.65 \times £366 \times 11,536 = £4,641,510$

¹³ $£5,271,835 + £4,641,510 = £9,913,345$

¹⁴ Split estimated from information provided by Insolvency Service officials with direct experience of reporting director's conduct and from consultation responses describing the background to IPs reporting to the SoS.

manager's time (at £253 per hour) and 1 hour of an IP's time¹⁵ (at £366 per hour). These assumptions were included in the Impact Assessment which accompanied the original consultation and did not attract any dissenting consultee responses or subsequent stakeholder comment.

68. We have illustrated 3 different scenarios, dependent on;

- The split between no misconduct: misconduct reported being the same as the split for the previous 3 years (around 70:30) – Based on the current total number of returns, the estimated cost of completing the new returns using the current conduct: misconduct split would be **£4,881,223**.
- The split between no misconduct: misconduct reported changing to 60:40 – Based on the current total number of returns, the estimated cost of completing the new returns would be **£5,631,140**.
- The split between no misconduct: misconduct reported changing to 50:50 – Based on the current total number of returns, the estimated cost of completing the new returns would be **£6,398,271**.

69. Compared with the estimated current cost of completing D1 reports and D2 returns, this would result in indicative savings of **£5,032,122**, **£4,282,205** and **£3,515,074** per annum respectively. In the Impact Assessment calculations we have included a best estimate in terms of benefits derived from reporting changes of **£4.3 million per annum**, being the average saving from this sensitivity analysis.

70. Consultation responses were mixed as to whether the proposal to require returns at an earlier stage would result in an increase in reporting behaviour which may indicate unfit conduct. Some respondents thought that there would be no increase likely but the majority of respondents were unsure.

Table 1: Summary of estimated savings associated with earlier, shorter, electronic reporting

| No misconduct:misconduct split | 70:30 | 60:40 | 50:50 |
|---------------------------------------------------------------|---------------------------------------|-----------|-----------|
| | £ | £ | £ |
| Indicative savings | 5,032,122 | 4,282,205 | 3,515,074 |
| Best estimate of Indicative savings post sensitivity analysis | 4,282,205 (per annum average benefit) | | |

Savings

¹⁵ Split estimated from information provided by Insolvency Service officials with direct experience of reporting director's conduct and from consultation responses describing the background to IPs reporting to the SoS.

71. The estimated savings associated with the proposals range from £3,515,074 to £5,032,122 with a best estimate of **£4,282,205 p.a.**

Summary of costs and benefits

| Table 2: Summary of costs v benefits over 10 year period | | |
|----------------------------------------------------------|---------------------------|------------|
| Year | Costs£ | Benefits £ |
| 1 | 869,832 ¹⁶ | 4,282,205 |
| 2-10 | 0 | 38,539,845 |
| Total | 869,832 | 42,822,050 |
| Total net benefit* over 10 years | £41,952,218 ¹⁷ | |

* This figure excludes the following costs and benefits which it has not been possible to quantify as this stage:

- Savings resulting from Insolvency Service efficiencies generated from reporting process changes. These savings could be used to increase enforcement capability, impacting on business and consumer confidence and benefitting creditors ¹⁸or to reduce the level of taxpayer funding of investigation and enforcement.

Northern Ireland

72. The CDDA applies to England, Wales and Scotland, but not to Northern Ireland. However, equivalent legislation has been in force since 1986. Subject to a Legislative Consent Motion being passed, the intention is to extend changes to reporting on the conduct of directors by insolvency office-holders to Northern Ireland.

73. In 2013/14, the Insolvency Service Northern Ireland received 65 D1 reports from Insolvency Practitioners and 103 D2 returns. Using the same methodology and assumptions re submission costs as used above, the total current cost of submitting D1 and D2 returns in 2013/14 was £110,017¹⁹. This would lead to indicative annual savings in relation to Northern Ireland as follows;

| Table 3: Estimated savings associated with earlier, shorter, electronic reporting in IP cases in Northern Ireland | | | |
|-------------------------------------------------------------------------------------------------------------------|--------|--------|--------|
| No misconduct:misconduct split | 70:30 | 60:40 | 50:50 |
| | £ | £ | £ |
| Indicative savings | 60,777 | 52,889 | 45,001 |

¹⁶ Estimated transition costs of £494,832 and estimated incremental cost of electronic portal £375,000.

¹⁷ at current price value not present value.

¹⁸ In 1999, the NAO undertook a study which quantified the benefits from disqualifying unfit directors. The study developed methodology to estimate the potential savings to creditors. Using this methodology and updating to 2012/13 figures, the average potential saving to creditors per disqualification order is around £100,000.

¹⁹ $(2 \times £253 + 1.5 \times £366) \times 65 + (0.65 \times £253 + 0.65 \times £366) \times 103 = £110,017$

| | |
|---------------------------------------------------------------|---------|
| Best estimate of Indicative savings post sensitivity analysis | £52,889 |
|---------------------------------------------------------------|---------|

74. The estimated saving anticipated following introduction of the new reporting system in Northern Ireland range from £45,001 to £60,777 with a best estimate of **£52,889 p.a.**²⁰ In the Impact Assessment summary, the total savings shown of £4.3m include those attributed to the proposals being implemented in Northern Ireland.

One-in two out

75. The measure is in scope as it is deregulatory, involving a forced change to submit the new return to the SoS. The measure removes the need to submit statutory forms and moves towards electronic submission in line with the Government's Digital Strategy. We estimate that the measure will reduce the cost of reporting misconduct. Any resultant reduction in IP costs benefits creditors as it means that there are likely to be more funds available to distribute to them.

76. The direct incremental benefit to business exceeds the direct incremental cost to business.

Wider Impacts

77. We do not consider that the proposal, and electronic submission in particular, will have an impact on greenhouse gas emissions as, currently, D1 and D2 forms are submitted by e mail. There are no anticipated impacts on wider environmental impact; health and well-being; human rights; rural proofing or sustainable development.

Equalities Impact

78. We do not expect the policy to have a disproportionate impact on any protected characteristic as all IPs will be required to submit the new return. The Insolvency Service does not hold significant equality data on authorised IPs.

79. Creditors: Most creditors in corporate insolvencies are businesses rather than individuals, and insolvencies occur over a wide range of business sectors. We do not expect any disproportionate impact on different genders or races of creditors, or owners of creditors.

80. Company directors and shareholders: Insolvencies occur across a wide range of business sectors. We do not expect

²⁰ The savings in NI have been combined with the overall benefits in the summary sheets.

any disproportionate impact on different genders or races of individuals who are directors or shareholders of companies.

Competition Impact

81. We expect the policy to have no impact on competition in the IP market.

Small Firms Impact

82. We do not anticipate that there will be any particular negative effect on small firms beyond the moderate familiarisation costs outlined above.

Annex A

Current procedure for reporting director misconduct and making application for disqualification

In accordance with section 7(3) of the CDDA, if it appears to the office-holder (the official receiver, liquidator, administrator or administrative receiver) that;

- A person is or has been a director of a company that became insolvent while they were a director or subsequently; and
- Their conduct as a director of that company (considered either alone or along with their conduct as a director of another company) makes them unfit to be concerned in the management of a company;

then the office-holder must report the matter to the Secretary of State forthwith.

In accordance with The Insolvent Companies (Report on Conduct of Directors) Rules 1986 (as amended) the 'Reporting Rules', the report must currently be made using statutory form D1.

Office-holders must in any case make a return (on statutory form D2) in respect of every person who was a director or shadow director to the Secretary of State within 6 months of the relevant date (the date of their appointment) in accordance with the Reporting Rules.

The costs of submitting the statutory forms are included as an expense of the insolvency procedure, i.e. the cost is met from available assets before any distribution to creditors.

The Insolvency Service acts for the Secretary of State and undertakes a vetting process on all reports received and considers whether it is in the public interest to make application for disqualification.

At the targeting stage all cases are allocated a "score" which indicates their priority and are placed in a pool awaiting allocation to an investigator. Cases will only be abandoned without investigation if they are at the very low end of the public interest score range, and there is little time left to investigate them (the law requires proceedings to be issued within two years so if the case is more than a year old then there is generally insufficient time to investigate, go through the authorisation process and issue proceedings)

The Service considers whether allegations can be made out, taking into account their seriousness, availability of evidence and witnesses plus any mitigating factors.

Completed investigations require the Secretary of State's approval to proceed with disqualification applications. This work is undertaken by The Insolvency Service's authorisations team who bring disqualification proceedings. The matter is heard, and decided by the court, unless the Secretary of State accepts a disqualification undertaking from a director. (An undertaking has the same legal effect as a court order but negates the need to go to court).

Currently, except with the leave of court, an application for disqualification must be made within 2 years beginning with the day on which the company became insolvent.

