



The Insolvency
Service

A BEIS SERVICE

POST-IMPLEMENTATION REVIEW OF THE SMALL BUSINESS, ENTERPRISE AND EMPLOYMENT ACT 2015 (CONSEQUENTIAL AMENDMENTS) (REPORTS ON CONDUCT OF DIRECTORS) REGULATIONS 2016



January 2021



© Crown copyright 2020

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at www.gov.uk/government/publications

Any enquiries regarding this publication should be sent to us at enquiries@beis.gov.uk

Title: Report director misconduct: RTC proposals to change PIR No: BEIS001(PIR)-21-IPO Original IA/RPC No: BISINSS047 Lead department or agency: BEIS Other departments or agencies: Insolvency Service Contact for enquiries: Faisal Samih Faisal.samih@insolvency.gov.uk Hamish Hore Hamish.hore@insolvency.gov.uk	Post Implementation Review
	Date: 11/01/2021
	Type of regulation: Domestic
	Type of review: Statutory
	Date measure came into force: 05/04/2016
	Recommendation: Keep
	RPC Opinion: N/A Choose an item.

1. What were the policy objectives of the measure? (Maximum 5 lines)

The policy objective was to improve the process for director misconduct by streamlining the reporting process, replacing statutory paper forms with a single electronic return alerting misconduct at an earlier stage. The intended effects include:

- **Streamlined reporting** - single electronic return, digital by default;
- **Earlier investigation of director conduct following insolvency** - IPs reporting misconduct indicators earlier; more efficient investigation and enforcement outcomes;
- **Increasing consumer confidence and protection** - earlier focus on appropriate cases.

2. What evidence has informed the PIR? (Maximum 5 lines)

This PIR was informed by the following evidence:

- Insolvency Service Management Information - Misconduct Reports data
- Insolvency Service Financial Accounts - IT Project costs
- R3¹ Director Conduct Returns completion times

3. To what extent have the policy objectives been achieved? (Maximum 5 lines)

The policy objectives have been achieved and the continuation of the policy is strongly recommended. The changes have successfully improved the reporting process with a single electronic return which has replaced the older paper forms. The sector has complied with this new approach thereby achieving the original objectives.

Sign-off for Post Implementation Review: Chief economist/Head of Analysis and Minister

I have read the PIR and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

¹ R3 is the trade association for the entire community of the UK's insolvency and restructuring professionals

A handwritten signature in blue ink, appearing to read "Martin Callan". The signature is fluid and cursive, with a long horizontal stroke at the end.

Signed:

Lord Callanan

Date: 11/01/2021

Further information sheet

Please provide additional evidence in subsequent sheets, as required.

4. What were the original assumptions? (Maximum 5 lines)

The changes would result in one-off costs to implement and ongoing benefit from cost savings.

Costs

The changes would incur one-off familiarisation costs.

- Familiarisation costs for Insolvency Practitioners - £0.50m one-off
- Insolvency Service electronic platform costs - £0.375m one-off

Benefits

Streamlining the process will enable cost savings from reduced time spent on misconduct forms

- Cost savings from reduced time spent completing forms - £4.3m ongoing benefit

5. Were there any unintended consequences? (Maximum 5 lines)

The new electronic return worked as intended replacing the old statutory forms. However, the “Decision Engine” algorithm used by the Insolvency Service to sift electronic returns for further investigation did not work as expected due to the complexities inherent in identifying misconduct on returns. This has required an Investigation Examiner to perform further enquiries to decide on targeting for investigation, representing an ongoing cost to the Insolvency Service.

The reporting changes did not result in any cost savings from reduced time spent on completing misconduct forms as there were no time savings with the new form.

6. Has the evidence identified any opportunities for reducing the burden on business?

(Maximum 5 lines)

The Post-Implementation Review did not identify any opportunities for reducing the burden on business. The policy did not result in any savings to business from reduced burden however, it was noted the process was more efficient electronically.

7. For EU measures, how does the UK’s implementation compare with that in other EU member states in terms of costs to business? (Maximum 5 lines)

Not Applicable

Introduction

1. The purpose of this post-implementation review (PIR) is to examine the implementation of The Small Business, Enterprise and Employment Act 2015 (Consequential Amendments) (Reports on Conduct of Directors) Regulations 2016². This required a post-implementation review within five years of implementation, and that the results should be published on the GOV.UK website.
2. The Review covers the following:
 - Whether the objectives of the regulations remain appropriate?
 - Whether the regulations have achieved their original objectives?
 - Whether these objectives could have been achieved through a less onerous regulatory provision to reduce the burden on companies and/or increase societal value?
 - Whether the regulations are still required and remain the best option for achieving those objectives?
3. The expected impact of these changes was set out in an Impact Assessment³.

Whether the Objectives of the Regulations Remain Appropriate

4. When a company has entered into formal insolvency proceedings Insolvency Practitioners (IPs) have a duty to report on director conduct⁴.
5. Prior to the regulation this duty was met through two statutory forms submitted by email by IPs: D1 to report misconduct or D2 form where Director conduct was “fitted”. There was a requirement to submit forms within 6 months of the insolvency event. However, the Impact Assessment showed just 68% of forms were submitted within this time.
6. The purpose of the regulations was to replace the outdated forms and streamline the reporting process through a single electronic return that is digital by default in line with the Government’s Digital Strategy⁵.
7. In addition to simplifying the process the regulations require IPs to report within three months of the insolvency event (rather than six). This enables earlier investigation of directors suspected of misconduct leading to greater public protection from miscreant directors and increased levels of consumer confidence.
8. **Improved reporting and earlier investigation of director conduct following insolvency remains an objective of the Government and we therefore conclude that the objective of the regulation remains appropriate.**

² <http://www.legislation.gov.uk/ukxi/2016/356/contents/made>

³ http://www.legislation.gov.uk/ukia/2016/69/pdfs/ukia_20160069_en.pdf

⁴ Company Directors Disqualification Act 1986

⁵ <https://www.gov.uk/government/publications/government-digital-strategy>

Whether the Regulation Has Achieved its Original Objectives

9. In this section we consider two issues, whether:
 - a. The initial objectives have been met, and
 - b. If there were any unintended consequences

Whether the objectives have been met

10. **The policy objectives have been met. The changes have streamlined reporting into an electronic return which has replaced the forms leading to improved reporting and earlier reporting of misconduct.**
11. To assess whether the regulations have met the objectives we consider
 - a) whether reporting has moved to the electronic return and
 - b) if this has led to earlier reporting of misconduct.
12. The electronic return contains questions with “yes”, “no” or multiple-choice responses. The return includes opening “parent” questions. If these are answered this may trigger follow up “child” questions. Therefore, the time expended on each return will vary depending on the responses, leading to a wide range of possible returns and times spent on the form. For example, if a return did not trigger any follow up question completion will take less time whilst if follow up questions are triggered the return will take longer.
13. For returns submitted to the Insolvency Service a “Rules Engine” is applied. This is an algorithm which analyses the responses to either “sift-in” or “sift-out” a case. A case which is recorded as “sift-in” is like the D1 “unfitted” form and will be passed to the Investigation and Enforcement Services’ Compliance and Targeting section. A “sift-out” is like the D2 “fitted” form and will not be investigated further unless new information comes to light.
14. Table 1 shows the Director conduct returns received in each year following the commencement of the measure on April 6th, 2016. The D1 and D2 returns have successfully been replaced by a single electronic return.
15. In the first year D1 and D2 forms continued to be submitted as the electronic returns only apply to insolvencies that occur after the commencement date 6th April 2016s. Excluding these legacy returns, there is a full transition to the new electronic forms after commencement and therefore the benefits of the electronic system are realised.

Table 1. Director conduct returns by year, Insolvency Service

Year (April-March)	D1 form	Sifted-in	D2 form	Sifted-out
16/17	2,057	5,664	3,936	4,144
17/18	2	9,034	4	5,414
18/19	0	9,269	0	5,647
19/20	0	8,730	0	5,976

16. The changes to reporting on the conduct of directors extend to Northern Ireland. Conduct returns are submitted to the Northern Ireland Department for Economy. In Northern Ireland

an electronic portal was not feasible, so returns are submitted electronically to a mailbox. When the IP submit their returns, they suggest whether they believe there is unfit conduct. All the returns are reviewed by Northern Ireland Department for Economy to decide if there is unfit conduct. Table 2 shows the Director conduct returns received in each year following the commencement of the measure on April 6th, 2016

Table 2. Director conduct returns by year, Northern Ireland

Year (April-March)	Unfit Conduct	No Unfit Conduct	Total Director Conduct Returns
16/17	150	244	394
17/18	113	126	239
18/19	122	192	314
19/20	157	174	331

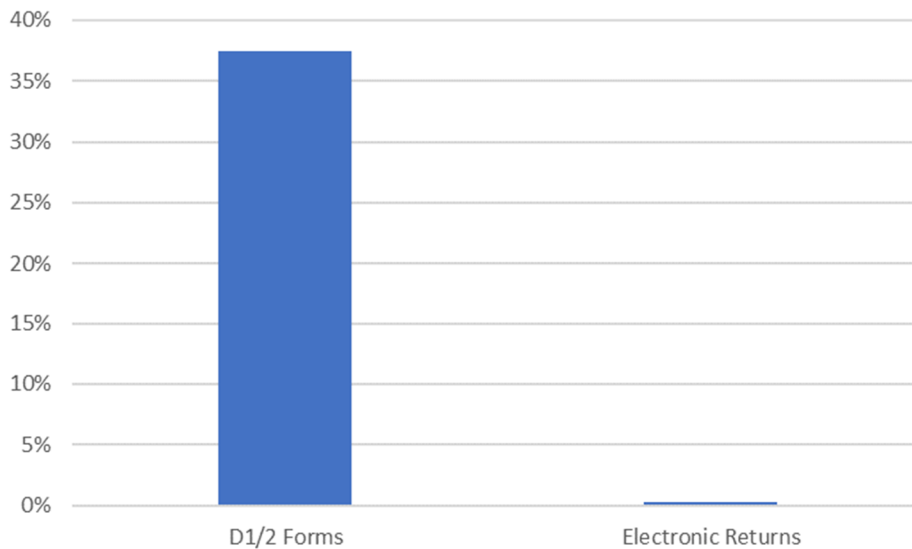
17. Northern Ireland returns will not benefit from cost savings through streamlined reporting as an electronic portal has not been put in place. However, Northern Ireland returns form a very small proportion of the overall numbers of returns and the remaining policy objectives, such as earlier reporting, have been achieved with 99% of Northern Ireland returns being received within the 3-month deadline.
18. The changes also had the goal of earlier reporting of misconduct by requiring IPs to report within three months of the insolvency event rather than six months set before the changes.
19. Prior to the measures being introduced timeliness of submissions was an issue with only 68% of reports being submitted within 6 months of the insolvency event⁶.
20. Electronic returns have on average been received within three months of insolvency, as a result the objective of earlier reporting has been met. This is shown in Table 3 covering Insolvency Service (England, Scotland and Wales) returns for the period after commencement. A minority of returns are received outside three months, however the percentage received beyond 6 months has dropped from 37% to under 1% and just 2-3% of returns are received after 100 days therefore the vast majority are within 90 days or just after (see Chart 1).

Table 3. Timeliness of Director conduct returns Insolvency Service: 1st April 2016 to 30th June 2020

	Sifted-in	Sifted-out
Mean number of days between insolvency and return date	85	83
Target (3 months = 90 days)	90	90
Percentage received beyond target	33%	30%
Percentage received after 100 days	2%	3%
Percentage received beyond 180 days (Old target)	0.3%	0.4%

⁶ http://www.legislation.gov.uk/ukia/2016/69/pdfs/ukia_20160069_en.pdf Page 7

**Chart 1. Percentage of Director conduct returns received beyond 6 months: Insolvency
1st April 2016 to 30th June 2020**



21. **We therefore conclude that the objectives of the regulations have achieved their original objectives and continuation of the policy and the statutory power is strongly supported.**

Evidence of any unintended consequences?

22. At the Impact Assessment stage, the form had not been designed and therefore assumptions had to be made on the time and cost for misconduct cases against non-misconduct as well as the mix between the two, post implementation. Many of these assumptions were not reflective of the actual implementation of the electronic form and did not fully consider the complexity of decision making.

Electronic returns and the “Rules Engine”

23. When implemented the electronic return included a series of multiple-choice questions. Key questions (“parent question”) in the return can also trigger follow up questions (“child questions”) meaning the eventual time required to complete will vary based on the responses leading to a wide range of possible returns. Therefore, the decision-making process is more complicated as answers to certain parent or child questions may be more indicative of misconduct than others.
24. Once returns are received a “Rules Engine” is applied to the returns. This is an algorithm which analyses the responses to either “sift-in” or “sift-out” a case. A case which is recorded as “sift-in” is like the D1 form to report misconduct and will be passed to Investigations and Enforcement Services, Compliance and Targeting team and “sift-out” is like the D2 form and will not be investigated further unless new information comes to light.
25. The “Rules Engine” works by examining the “parent questions” and where follow up “child questions” are triggered the return is “sift-in” otherwise “sift-out”. However, this approach is not perfect as certain combinations of parent and child responses are more indicative of

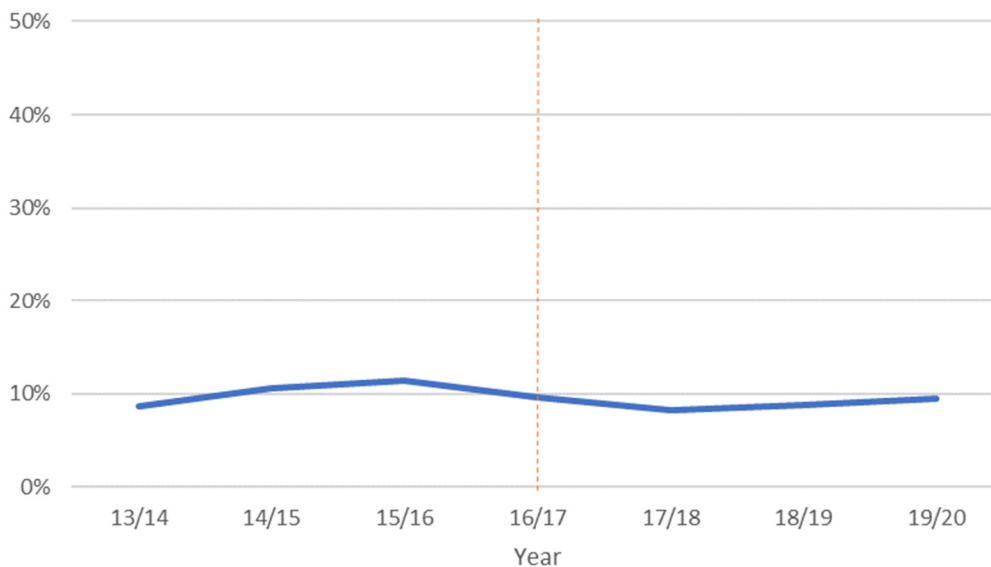
misconduct than others and triggering follow up questions does not necessarily mean there is misconduct. Ideally the algorithm would consider all responses in making decisions.

26. Consequently, the “sift-in” rate using the new “Rules Engine” post-implementation has been around 60% compared to a 30% rate of misconduct in the years prior to the changes (see Table 1). There has not been an increase in the actual misconduct rate to account for this (see Table 4 and Chart 2 covering England, Scotland and Wales). Chart 2 clearly shows investigation rates post-implementation (red dotted line shows implementation year - 2016/17) have remained stable, and it can be concluded that change is due to the “Rules Engine”.

Table 4. Insolvency Service Company Investigations: 1st April 2014 to 31st March 2020

Year (April-March)	Insolvency Service Company Investigations	Total Company Insolvencies	Investigation rate (Investigations/company insolvencies)
14/15	1,239	11,758	10.5%
15/16	1,333	11,745	11.3%
16/17	1,343	14,059	9.6%
17/18	1,236	15,021	8.2%
18/19	1,253	14,334	8.7%
19/20	1,327	13,963	9.5%

Chart 2. Insolvency Service Investigation Rate: 1st April 2013 to 31st March 2020



27. To work around this issue of over-reporting of misconduct in the “Rules Engine”, the Compliance and Targeting team passed all “sift-in” cases to an Investigation Examiner for more detailed enquiries to decide whether to target for investigation. The total costs of an Investigation Examiner is £50,546 for roles based nationally, this represents an annual cost to the Insolvency Service. However, Digital Technology Services (The Agency’s IT function) will be making changes to fix the issue and the initial sifting/triage work should no longer be required. Therefore, the additional annual cost of £50,546 to sift will occur only in the post-implementation review period and will not be a cost thereafter.

28. The unexpected cost of further targeting is small compared to the benefits of improved reporting through an electronic system and earlier, more targeted investigations from more timely returns. The changes made to fix the issue will ensure this cost is avoided in future. The changes enable the Insolvency Service to take a holistic view of misconduct to consider all cases and fulfil the intended objectives, of increasing consumer confidence and protection, from the measure.
29. The Impact Assessment⁷ set out that there were concerns that requiring IPs to report within three months of insolvency rather than six months previously could have the unintended consequence of IPs reporting less misconduct as insufficient information would be available. The investigations data above clearly shows this has not transpired as misconduct continues to be identified and trends remain stable.

Cost savings

30. The Impact Assessment assumed that the cost saving of the new electronic form would differ based on whether there was misconduct indicated or not. The savings were assumed to be greater where none was indicated. However, in practice the time taken for each return depends on the responses to the questions leading to a wide range of possible returns. The decision regarding misconduct lies with the Insolvency Service now rather than IPs and it is impossible to know the decision ex-ante.
31. Therefore, to account for the varying time to complete the return an average time approach is more appropriate. The Insolvency trade body, R3, were consulted and advised that on average their members estimated the electronic form took 2 hours to complete. However, there were too few responses to gauge the time split between IPs and case managers.
32. Since the implementation period there has been a decrease in the number of corporate insolvencies⁸, consequently the average number of returns in the past three years, 14,690, has been lower than the numbers prior to implementation, 16,533⁹.
33. The weighted average time using the historical misconduct ratio¹⁰ (0.9055 hours for an IP and 1.055 hours case managers time) for D1 and D2 forms stands at 1.96 hours whilst the new electronic form took around 2 hours. There are therefore no savings from the changes, however some respondents to R3 noted that though there was no time saving the process was more efficient being electronic.
34. The changes did not have the anticipated benefit in the Impact Assessment, which estimated an ongoing cost saving of £4.3m. The cost savings from reporting changes were

⁷ https://www.legislation.gov.uk/ukia/2016/69/pdfs/ukia_20160069_en.pdf Page 13

⁸ <https://www.gov.uk/government/collections/company-insolvency-statistics-releases>

⁹ 16,533 annual returns on average in the three years between 2011/12 and 2013/14 composed of 4,997 D1 and 11,536 D2 forms on average.

Source: Impact Assessment http://www.legislation.gov.uk/ukia/2016/69/pdfs/ukia_20160069_en.pdf

¹⁰ In the three years between 2011/12 and 2013/14 the misconduct to non-misconduct ratio was 30:70.

The average D1 (misconduct return) took 2 hours case manager and 1.5 hours IP time. The average D2 (non-misconduct return) took 0.65 hours IP and 0.65 hours case manager time.

To calculate the weighted average time the timings are weighted by the misconduct ratio as below.

Weighted average IP time = $(0.3 * 1.5) + (0.7 * 0.65)$ = 0.905 hours

Weighted average case manager time = $(0.3 * 2) + (0.7 * 0.65)$ = 1.055 hours

Weighted average time total = 1.96 hours (0.905+1.055)

the main benefit of the changes and therefore the anticipated net direct benefits to business will not be realised.

Impact on the Insolvency Service

- The main cost to the Insolvency Service identified in the Impact Assessment was the one-off familiarisation cost estimated at £375,000 to develop the electronic system for returns. This represents the incremental cost of including electronic submission of director returns in the Redundancy Payment Service (RPS) digital project. The estimated cost for the RPS digital project including the changes was £1.38m.
- Insolvency Service teams have confirmed the cost of implementing the Redundancy Payment Service project including the electronic system for returns at £710,000, lower than that estimated. The complexity of the project means that it is difficult to split out the costs between the RPS and electronic system costs. However, as the final costs are much lower than expected the electronic system costs should be lower.
- No ongoing impact on the Insolvency Service was anticipated from the Regulations at the Impact Assessment. However, the measure did have the unintended consequence of requiring an Investigation Examiner to sift through the returns during the review period, incurring £50,546 in annual cost to the Insolvency Service.

Could the Objectives be Achieved through Less Onerous Regulatory Provisions?

Impact on Small and Micro Businesses

- The impact Assessment suggested that there would not be any negative impact on small and micro businesses beyond the small one-off familiarisation costs on Insolvency Practitioners. No evidence was found to contradict this assessment.

Judgement on whether the regulation could have been achieved through less onerous means

- The Post-Implementation Review did not identify any opportunities for reducing the burden on business. The policy did not result in any savings to business from reduced burden however, it was noted the process was more efficient electronically.
- The Impact Assessment set out that the only cost to business was a small one-off familiarisation cost (£494,000). We estimate that the net direct annual cost to business is £0.1m, a reversal from the £3.4m annual benefit anticipated in the Impact Assessment, reflecting the lack of any savings from reporting changes
- We judge therefore that the measure still falls under the De Minimis threshold.

Conclusion

Our conclusion is that the regulations have achieved their original objectives and it is recommended that the regulations are maintained in their current form. The review also found:

- a. The cost savings did not materialise as the times taken to complete forms did not reduce post-implementation. However, some respondents to the R3 survey noted that the electronic process was more efficient. As the cost savings were the main source of anticipated benefits the changes did not result in any ongoing savings.
- b. Unintended consequences were discovered, namely that the “Decision Engine” did not perform the sift as expected, requiring the Insolvency Service to employ an Investigation Examiner to perform targeting, resulting in an annual cost of £50,546 to

the Insolvency Service during the review period. Changes to fix the issue should ensure that sifting is no longer required, and the cost is no longer incurred.

Given the nature and scale of this regulatory change we do not consider that another review of this measure would be proportionate.