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Bounce Back Loan abuse and disqualification

In the space of 15 months, from March 2020, the three main covid loan schemes – Bounce Back Loan Scheme (BBLS), Coronavirus Business Interruption Loan Scheme (CBILS) and a scheme for larger loans, CLBILS – handed out nearly £80bn to businesses.

BBLS was the biggest scheme, distributing £47bn to 1.6 million recipients, who were able to borrow up to £50,000 each. Meanwhile, fraud losses were estimated at £4.9bn at the end of March – although PwC, the accountancy firm hired by the government, has since reduced its estimate to £3.5bn.

Banks, intent on protecting their finances, usually apply stringent credit checks to help avoid fraud and ensure customers can repay their loans, but what was eventually agreed for bounce back, amid pressure from the Treasury to speed up loan distribution, was that checks would be dispensed with altogether. The British Business Bank was clear with the lenders that they were prohibited from carrying out credit checks.

Borrowers, left to self-certify, had to confirm they met certain criteria, namely that they were based in the UK and affected by COVID and that they were in business as of 1 March 2020 and not insolvent as of 1 December 2019.

Unsurprisingly, what has come to light, is certain lenders paid bounce back loans to:

- already dissolved companies
- companies incorporated after the pandemic hit
- businesses who showed no evidence of trading at all – before or after March 2020
- businesses who were trading post March 2020, but not before; and
- businesses with no evidence of having traded before or after the qualifying date of 2 March 2020, but did

have other businesses active in this period – raising concerns the money may be siphoned off to the other companies.

The earliest estimates from the Department for Business, Energy and Industrial Strategy (BEIS) and the British Business Bank were for between 35% and 60% in write-offs. BEIS now expects a figure around the lower end of that estimate – a still monumental £17bn. Almost £5bn of that is ascribed to fraud, with the rest owing to defaults and error. Insolvency Service records also show some took loans to fund gambling or currency trading – money the government is unlikely to ever recover – while others spent it on home improvements, car raffles or luxury personal items.

Director disqualifications

As a consequence, what we are now already seeing is a plethora of disqualification of directors in cases where misuse/abuse of BBLS has been found and the following are examples of the types of cases being reviewed closely by the Insolvency Service (not an exhaustive list):

- Overstating turnover in an application for a Bounce Back Loan and the loan not being used for the economic benefit of the company.
- Dormant company with no history of trading, obtains a loan and withdraws the money from the company, transferred to unknown accounts and struck off. In the absence of accounting records, it was not possible to determine if these funds were used for the benefit of the company.
- Breach of the conditions of the Bounce Back Loan Scheme by using a loan of £50,000 contrary to the terms of the BBL Scheme by making a payment of £50,000 that was not for the economic benefit to the company

Central to dealing with Bounce Back Loan director disqualification claims includes:

- looking at the purpose of the Bounce Back Loan and why it was taken out;
- was the Bounce Back Loan for legitimate business purposes; and
- what the Bounce Back Loan was actually spent on.

In each case, it will therefore be crucial to look at the application process and what the money was ultimately used for.

Although the disqualification period sought in these circumstances range from lower (2-5 years) to top bracket (11-15 years), recent cases reveal that many are actually appearing in the middle to top bracket averaging 6-9 years with 13 years being the highest so far.

The Insolvency Service appear to be taking a tough approach to misuse of loans even in cases where the sums are relatively low. I have a case at the moment where the Insolvency Service are looking to my client to be disqualified for 10 years and repay the sum of £21,000 back by way of a compensation undertaking (more on these below) in circumstances where the money was applied for the benefit of the company. Prior to these types of cases, it would be the exception to the rule to see disqualification levels this high, absent quite serious allegations.

Most of these disqualifications have been dealt with by the Secretary of State accepting a disqualification undertaking which is the administrative equivalent of a disqualification order and can be entered into, voluntarily, without the need for court proceedings. Once accepted by the Secretary of State it has the same effect as a court order and can only be amended by the court.

In other cases, the misuse of BBLs has resulted in the winding up of companies or the extension of bankruptcy

restrictions.

Dissolved companies

One of the key motivations for introducing the Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Act 2021, was to grant the Insolvency Service extra powers to investigate BBLS fraud. Investigating cases where the company has been dissolved for the purposes of concealing possible misuse of loan(s) and where appropriate, take action to disqualify the former directors of those companies. The Act is retrospectively allowing an application for a disqualification order up to three years after a company has been dissolved.

Compensation orders / undertakings

Hand in hand with the disqualification now comes the compensation undertaking/order. Compensation orders were introduced in 2015 as an additional deterrent and (in short) enable the Insolvency Service to seek an order (in addition to disqualification) that a director pay compensation where their conduct has caused a quantifiable loss to one or more creditors of a company. Any compensation that is awarded can ultimately be distributed to the creditor(s) who suffered loss. They have rarely been used until the COVID-19 pandemic.

In order to be at risk a director must:

- be disqualified as a director; and
- have engaged in conduct which has caused loss to one or more creditors.

The first and only reported case on compensation orders is *Re Noble Vintners Ltd*; [2019] EWHC 2806.

The case brings much needed clarity on how the court will deal with issues such as identifying the loss caused by the director's misconduct, the level of any compensation and how that compensation is distributed to creditors. The decision will also be of interest to insolvency practitioners who are concerned about the compensation regime encroaching on their ability to recover sums from directors of insolvency companies. Judge Prentis, who decided that case, described the compensation regime as being one where to focus is on redressing losses suffered by individual creditors caused by the director's misconduct as opposed to losses suffered by the insolvent company.

Help for businesses

Here at Cripps we have a team of specialists able to advise and help with topics such as director disqualifications. Please get in touch if you have any questions on this topic.

Moore Kingston Smith are a specialist accountancy firm with information on their directors' hub and also offer advice to businesses on topics relating to this.

Tania Clench

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