

Concessions on ‘wrongful trading’ risk causing serious consequences

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Tuesday March 31 2020, 12.01am, The Times

Everything has changed. Even the sleepest regulator and minister recognises that — or at least recognises the imperative to be seen to be doing something in this terrible crisis. Hence the slew of concessions proffered to businesses in the past few days.

One of the most eye-catching was the business department’s decision on Saturday to [suspend the “wrongful trading” rules](#) for directors of companies being rescued or undergoing restructurings. These are the rules that protect creditors by requiring directors to cease trading the moment they know, or could reasonably be expected to know, that they cannot avoid insolvency.

The aim of the suspension looks pragmatic and commendable — to stop struggling businesses throwing in the towel prematurely. With a big dollop of luck and gigantic infusions of [government-backed loans](#) and grants for furloughed workers, most businesses should be able to survive until life starts to return to normal in three or six months’ time.



Intu has been paid only 29 per cent of rents from retailers

Economic visibility is as clear as the foggiest of pea-soupers. There can't be many company directors who could say, hand-on-heart with absolute certainty, that they are trading solvently and are taking every step, as the Insolvency Act 1986 requires, to minimise risks to their creditors. No one can survive for long with no money coming in. Company directors need to be deterred from pulling the plug for fear of breaching the rules.

The penalties for wrongful trading are unlimited personal liability for any additional creditor losses racked up by continuing to trade, as well as disqualification as a director for up to 15 years. Penalties for fraudulent trading, which is one notch up from wrongful trading, include prison. It would be madness to allow otherwise promising firms to fail because of over-scrupulousness about wrongful trading. The costs would be high, in terms of job losses and the permanent loss of productive muscle in the economy. So long as we are confident that economic paralysis will be short-lived, it is prudent to temporarily change the rules.

That “breathing space” philosophy has extended across Whitehall and other regulators. The Financial Conduct Authority has given listed companies an extra two months to file annual reports. The Prudential Regulation Authority has explicitly urged banks not to be too hasty in classifying loans as impaired. The Pensions Regulator is allowing employers a three-month holiday from making repair payments to their deficit-plagued pension schemes. HM Revenue & Customs is giving companies more time to pay taxes.

However, no one should be in any doubt that these concessions may have serious unintended consequences. The “wrongful trading” suspension, for example, might backfire if it sows additional doubts about the creditworthiness of business customers generally.

The rule is a fundamental tenet of capitalism, which in normal times gives businesses extra confidence to supply goods and services before being paid and gives banks the confidence to extend credit. Without that confidence, the entire credit chain seizes up. As Agustín Carstens, head of the Bank for International Settlements, put it at the weekend:

“The interlocking chain of receivables and payables is the glue that holds businesses together.”

That holds true whether you are talking about inter-dependent small businesses in the same town or the global supply chains on which the biggest publicly quoted companies depend. Finance directors pay supplier invoices when they fall due because they can be confident that their own invoices will be treated with the same respect.

That assumption is now being tested. Intu, the shopping centre landlord, says that only 29 per cent of its quarterly rents have been paid, while Hammerson, its rival, yesterday reported a payment figure of 37 per cent. Businesses worried that they won't get paid are likely to pause on paying their own bills. It's possible to envisage a contagion of invoice-paying paralysis spreading across the business world.

Duncan Swift, president of R3, the insolvency industry's trade association, has “serious concerns” about the suspension of the wrongful trading rules. That's because of the risk of damage to creditor confidence, but also because of the danger of abuse by a minority of companies, which could behave improperly and rack up debts that they have no hope of paying.

Those worries could be applied to virtually all the special “breathing space” measures. The PRA's decision to allow banks to interpret new accounting rules in the most optimistic way, and so minimise expected credit losses, could create much bigger problems. It also helps banks to indulge in the madness of paying out billions in dividends when they would be better off conserving cash — and loan-making capacity.

The Pensions Regulator's relaxation on deficit repair payments also could go wrong, enabling unscrupulous employers to dodge their responsibilities, leaving pension fund members at greater risk of not getting their full benefits and the Pension Protection Fund, the industry lifeboat, with a greater liabilities further down the track.

Regulators and ministers have little choice but to embrace the breathing space philosophy. The alternative is a once-in-a-century slump that would destroy jobs, living standards, tax receipts, pensions and public services.

But there will be unintended consequences. A minority of business rogues will take advantage of the freedoms. There will be more fraud and more losses that ultimately will be shouldered by the only true lender of last resort — tomorrow's taxpayers. Moral hazard hasn't disappeared.

The officials throwing the rulebook out of the window must be just as quick to reinstate it the moment the corner is turned. They will have to withstand a torrent of pleading that it's too soon.

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