29 July 2011

brianmuir4@gmail.com

The Manager
Governance and Insolvency Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600
Email: insolvency@treasury.gov.au

Options Paper - A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia

We make this submission in response to this Options Paper.

The Limitations of the Options Paper

At the outset, we say that the Paper is a rather selective set of options, based on assumptions not fully explained or substantiated, does not confront the obvious issue of the funding of insolvencies, and is otherwise a rather incomplete attempt at raising genuine issues for reform.

In particular it does not draw on international experience and comparisons where some of these issues have already been dealt with in other jurisdictions or are being actively considered. For example, the UK funds the administration of assetless liquidations, as does New Zealand, and there are at present debates and proposals in each of those countries concerning issues raised in the Options Paper which should have been discussed. In the UK, a Consultation Paper on insolvency practitioner regulation[1]– equivalent to our Options Paper – was issued in February 2011, from which there is being considered the setting up of an independent insolvency complaints body. The Australia-New Zealand cross-border insolvency working group has raised the need for domestic reforms to the regulation of insolvency practitioners,[2] and New Zealand is in the midst of a similar debate to ours.[3] Both ASIC's and ITSA's recent attendance at and presence on the International Association of Insolvency Regulators[4] should have more fully informed the range of options available in the efficient administration and regulation of the insolvency regime.

As to the education and experience required to practise insolvency, the emphasis overseas is on specialist insolvency qualifications and experience, not on the sterile debate whether practitioners have so many years studying accounting and law. In the UK, while practitioners have accounting

[1] See the UK Insolvency Service paper of February 2011 Consultation on Reforms to the Regulation of Insolvency Practitioners which is currently under consultation in the UK.

[2] http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/088.htm&pageID=003&min=wms&Year=&DocType=

[3] www.med.govt.nz

[4] http://www.insolvencyreg.org/sub_member_profiles/australia/index.htm

qualifications and backgrounds, and others are based in law, other background disciplines are represented as well, the point being that it is not necessary to be qualified as either an accountant or a lawyer in the UK. Their emphasis is more properly on qualifications and experience in insolvency, through the Joint Insolvency Examination Board exams, and the professional bodies' insolvency experience requirements. Canada has this year commenced its Chartered Insolvency and Restructuring Professional Qualification Program.[5] The focus is on insolvency education and experience rather than on accounting and law. It leads to a wider entry base for a profession that needs to eschew conservatism in favour of innovative and constructive approaches, while at the same time fully understand the fundamentals.

In sum, to respond to the Options Paper would therefore only serve to adopt its narrow approach. Our submission therefore does not respond to the Paper in the way it invites, nor to much of the detail. We prefer to respond broadly.

Four basic areas in need of reform

There are four overall reforms which the paper does address, but disjointedly, which if implemented, would then enable consideration of a more substantive set of options. Those need to be first addressed, or confirmed, before any real reform can proceed.

These are:

1. The lack of government involvement and funding in the administration of insolvencies;
2. The need for attention to the costs of many of the processes, by way of the modernisation of means of communication and decision making;
3. The need for the alignment of personal and corporate insolvency laws and processes and regulation, with a view to adopting best practice within each;
4. The need for statistics and other data. The fact that this is not available, while unsatisfactory, still allows the immediate commencement of the collection of that information in order to assess and progress reforms.

One - the lack of government involvement in the administration of insolvencies

Insolvencies involve limited money to go around and at the same time they call for attention to investigation and recovery processes that require that limited money to be spent. This has these aspects:

Just as recovery of a debt from a debtor will cost the creditor money, so too does the collective recovery of assets in order to try to recoup insolvency creditors their money. It costs money to recover money, whether that be in or outside the context of insolvency. In the non-insolvency context, the creditor may or may not succeed in its recovery, but its debt collector/lawyer will nonetheless expect to be paid. In the insolvency context, the creditors may or may not succeed in recouping their losses, but their liquidator or trustee will nonetheless expect to be paid, reasonably. That needs to be accepted – often in the Paper it is not readily acknowledged, and it is often, obtusely, not accepted by creditors.

---

[5] See generally, the 2011 INSOL Directory

It also costs money to attend to the investigations and reporting of offences and dealing with misconduct. The law imposes this role on the insolvency practitioner. The funds are not provided by the government, but by creditors. Again, that needs to be accepted; it is not often understood by creditors or the community.

That leads to what we consider is a failure of the paper to confront the fact that insolvencies are expensive exercises – they involve experienced and qualified professionals, strict compliance with legal and regulatory requirements, including reporting and accounting, the need for investigation and recovery, with the potential for disputes and lack of co-operation. These circumstances exist in a situation where funds are necessarily limited. The practitioners can generally only be paid from those funds. There is, generally, no government role or assistance, despite, for example, the benefit of an insolvency regime to the community, and the extent of public interest tasks pursued by a practitioner. The Paper does not confront this. In both the UK and New Zealand, the government administers corporate insolvencies, along with the private profession. That option is not raised. Instead, for example, the paper focuses on what it calls cross-subsidisation of practitioner's fees between administrations without any or enough assets, and those with assets. The Australian government appears to expect that private individuals attend to these costs out of some sense of community or professional spirit; and then, assuming that expectation, the government then queries the processes by which those private professional attempt to fund them as mattes of "concern".

Either the government take on the public and necessary responsibility for winding up companies, as in many other comparable jurisdictions, or it allows and accepts that the insolvency regime has to be funded either by the community – tax receipts - by all creditors across all administrations.

The government itself accepts that approach in the cost recovery processes of its own bankruptcy trustee - ITSA - where, for example, the government charges on a commission basis $3,200 + 20% of the amount recovered. If in a bankruptcy there is $10,000 in a bank account, the government charges $5 200 to recover that ($3,200 + 20% of $10,000).

The significance of our comments relate to issues of cost, returns to creditors, fairness and equity ad overall productivity.

You will be, or should be, aware of previous reform suggestions for the funding of assetless administrations, in particular the Harmer Report of 1988, and international examples.

Two - the modernisation of means of communication and decision making

Insolvency is a backwater in relation to cost effective and efficient communications with its stakeholders. A government that is on the verge of investing billions in a national computer network accepts the fact that a cost sensitive area like insolvency must continue to rely on 19th century means to communication with creditors and others – through notices in the daily newspapers and the gazette. The costs to creditors in corporate insolvencies of such means of communications are estimated at $7.5 million per annum in terms of newspaper charges alone. Modern means of communication – via a website email or whatever may be available by way of communication to creditors and others – should be available.

The relevance of this is as to several issues raised throughout the Options Paper, as to the costs and time taken in administering an insolvency, and as to the cost and time and effectiveness of communicating with creditors.

There is little point in debating issues of cost and time of insolvency administrations and the extent of communication with creditors while ever attention is not given to the underlying issue that the law imposes costly and outdated limitations on those processes occurring.

You will be aware of previous reform suggestions for the modernisation of communications, in the CAMAC report of 2008, and in insolvency commentaries.

Three - the alignment of personal and corporate insolvency laws

That Australia has unnecessary separate laws and processes, separate regulation, separate government departments, and separate Ministers in any particular regulated industry is poor, and is a factor that is in general focus in terms of national productivity and other tenets of a progressive economy.

That Australia has these deficiencies is worse in the context of insolvency where, given the costs considerations, every attempt at refinement and efficiency should be made. This separation is evident from the disjointed content of the Options Paper. It ill behoves the government to focus adversely on the practices of the industry when its own attention to previous law reform and productivity recommendations are lacking.

The starting point should be the administration of insolvency law and policy under the one minister, and one department, with one agency administering the regime. In contrast, the reasons given in the Paper for protecting ASIC's insolvency work, that the "removal of corporate insolvency from the corporate regulator would result in corporate insolvency losing its important connections with other parts of ASIC" is a poor and limited explanation for the rejection of a major recommendation of the Senate report. It also says nothing about the regulation of the profession itself.

Reform suggestions for the alignment of personal and corporate insolvency laws dated back to the 1988 Harmer Report, and were further recommended by the 2004 PJC Report, the 2010 Senate report, and the 2010 Productivity Commission report. We deliberately list these to show that the responsibility for much of the inadequacies of the insolvency regime must lie substantially with government.

Four - statistics and other data

This is reinforced by the endemic lack of attention in Australia to producing statistics and other data on insolvency. Many of the issues raised in the Options Paper would be clearer, and some concerns may even be substantiated, or not, if such data were available. The inattention of the government to this over the years has been the subject of much adverse academic and other comment. The consequence is evident in the Paper – it has "concerns" about the apparently high rate of fees, "anecdotally" there appears to be little indication of active price based competition, and so on. These comments are on issues on which there is clear source data which could have been, and still can, be collected. The fact that we do not have this data does not mean that that steps cannot be implemented now for its immediate collection.

As an example, in the UK we can learn that information from the Office for National Statistics leads to estimates that the insolvency profession "saved 7% (1,951,743) of the working population in the UK from redundancy".[6] In Australia, there is no or only limited information available on such basic

[6] http://www.accountancyage.com/aa/news/1809002/insolvency-industry-saves-jobs

information as the returns paid to creditors, the extent of employee losses, the fees paid to practitioners, the extent of assets available and recovered, let alone any estimates or analysis available in the UK.

Previous reform suggestions for the gathering and analysis of statistics were made in the Harmer Report 1988, the PJC Report of 2004, the Senate report of 2010 and the Productivity Commission report of 2010.

General comments

We have not gone into the detail of the questions asked in the paper for reasons we have explained. There may well be issues of standards of conduct, excessive fees, or inadequate regard for creditors by practitioners that need regulatory reform attention. But we say that unless and until the four reforms we invite are attended to, including at least some "evidence, there cannot be a clear picture of what wrongs exist that may then need serious attention, or any attention. Other ideas on the Paper should be attended to in terms of the four areas we suggest, as self evident in their need for reform.

Many of these issues have been the subject of informed debate in the UK and they are generally universal in comparable insolvency regimes internationally. The UK Consultation Paper, referred to earlier, reports of higher fees and less returns for unsecured creditors than for the more sophisticated banks and others secured creditors, who may be more able to dictate their terms. It also reports on disengagement of creditors in the process, perhaps understandably so.

We make this general comment which the Paper does not explore. Insolvency is not a palliative for creditors' losses – it can only do so much , and often, not much at all by way of recoupment. It has other more important purposes – the order and stability imposed on a financial collapse, the security provided for investment, the protection of the debtor, the investigation of financial misconduct, the return of assets to more productive use. Certainly it is well accepted in Australia and England that the public interest in the proper administration of the insolvency laws, and the needs and wishes of creditors, are not co-extensive.[7] Creditors and the community have to understand that, and indeed creditors have to take some responsibility for their losses, and act cautiously in the future.

Where the standards of practitioners and their multitudinous roles are to be set is difficult, and perhaps ultimately has to be an expedient compromise – the more regulation, the higher standards, the more cost and time is involved. This is not unique to insolvency, but its costs pressures make the achievement of the proper balance critical.

Summary

In summary, we want to simply presuppose some givens which are so elementary as not to be worthy of much further consideration. They have been so much the subject of recommendation already, in some cases, for decades.

Hence we simply assume a regime where:

- communications are efficient and effective and cost minimal;

---

[7] In Re Hester (1889) 22 QBD 632

- the small, routine or assetless insolvent companies are handled by the government;
- insolvency processes and procedures are as one, with separate differences between companies and individuals acknowledged, and with those processes and procedures of effective and efficient standard; and
- preferably, these issues of reform are based on or substantiated by evidence collected and analysed - though most of these reforms do not need to await that evidence, though it would assist to refine them.

Only then can we usefully debate how the insolvency system may be improved - as to the best options for recovery of assets and the payment of creditors; for the pursuit of investigations; for the involvement of creditors; and for achieving a proper balance between maintaining the integrity of the regime and giving returns to creditors.

B Muir

B Muir