Australian Institute of
CREDIT MANAGEMENT

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The Manager, Corporations and Schemes Unit
Financial Systems Division
The Treasury
Langton Cresent
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By email: insolvency@treasury.gov.au

Improving bankruptcy and insolvency laws: proposals paper April 2016

Thank you for the opportunity to submit our views on the proposals.

It is the AICM's view that reform is needed in a number of areas related to bankruptcy and insolvency to minimise unfavourable and unproductive outcomes affecting our members trading operations across many Australian businesses.

While it is in the interest of all Australians to encourage innovation and entrepreneurship, this needs to be achieved without shifting the burden and cost of failure to specific businesses or industry groups where those sectors are less able to assess risk and control outcomes.

Our members regularly support businesses facing temporary cash flow issues, through extended credit limits, payment terms and repayment arrangements. Astute credit managers are recognised as often having superior direct knowledge of the financial health of their customers to even the client's bankers.

Further, during times of economic shock such as the global financial crisis our members were able to mitigate difficulties for their customers by providing alternative sources of credit, effectively funding, that prevented additional deterioration in the economy.

We acknowledge that under current insolvent trading laws directors are advised to promptly appoint external administrators possibly to long term viable businesses. Potential directors are also adverse to accepting the risk of directorships of start-up companies.

The AICM supports measures that have regard to international best practice and seek to assist viable and well managed businesses to restructure while ensuring that less viable businesses are formally administered appropriately.

For clarity in our response we have:

1. Noted our views on the proposed amendments below each proposal, and
2. Attach an Annexure with further commentary, suggestions and explanation of these positions.

About the AICM

The Australian Institute of Credit Management (AICM) is Australia's leading professional member body for commercial and consumer credit management professionals across all industries and sectors, and the only credit industry specific Registered Training Organisation in Australia.

We have developed an accreditation process for credit executives to recognise current knowledge and practice in the credit industry. Today we have 121 members holding the title Certified Credit Executive.

The AICM was founded in 1937, incorporated in 1967 and has established a trusted reputation as the professional body for setting professional standards and providing for the education, career needs and interests of all who work in the credit industry.

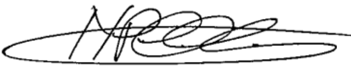
The AICM represents, develops and recognises the experience of over 2,400 individual members working in over 1,300 companies including 34 of the ASX 100 and global organisations in all industries and sectors.

Our members are credit professionals in roles relating to consumer and commercial credit including the obtaining or providing credit, collecting debts, financing invoices, enforcement of payment obligations, credit scoring and managing security interests.

While the AICM membership represents businesses of all types, including banking and finance, this submission is made with a focus from the view point of our members in businesses that supply goods and/or services on extended payment terms i.e. they are credit/finance suppliers as a result of their core business. We refer to these organisations, as Trade Credit Providers ("TCP's) who (aside from PPSA rights) would be unsecured creditors in an insolvency.

We are very keen to be involved with the ongoing development of these proposals and I welcome your direct contact.

Yours sincerely



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Comments on proposals

1 Reducing the default bankruptcy period

Proposal 1.1
The Government proposes to retain the trustee's ability to object to discharge and to extend the period of bankruptcy to up to eight years.

We support the proposed reduction from three years to one year for trustees to object or discharge.

The majority of bankrupts are cooperative, their affairs relatively simple and there is little benefit to them or their creditors by following a robust process, in fact this increased detail in the process reduces the return to creditors.

In tandem with the reduction to one year there needs to be clarity on, and urgency placed upon, the trustee to be proactive in their investigations.

There is the possibility that a small number of bankruptcies may be improperly discharged due to the trustee not being able to uncover sufficient evidence within the 12 month period when they are confronted with highly complex affairs that prevent discovery during the period.

Query 1.1
The Government seeks views from the public on whether the criteria for lodging an objection and the standard of evidence to support an objection should be changed to facilitate a trustee's ability to object to discharge.

The AICM believes the current criteria should be maintained as it strikes an appropriate balance.

The ability to refer the bankruptcy to a court and allow the process to be reviewed may afford both bankrupts and trustees the outlet they require in instances of high conflict.

Proposal 1.2.1
The Government proposes to change the Bankruptcy Act to ensure the obligations on a bankrupt to assist in the administration of their bankruptcy remain even after they have been discharged to allow for the proper administration of bankruptcy.

Whilst the intention of this review is to simplify and to reduce the stigma of bankruptcy and facilitate entrepreneurship, we must maintain the subtext of the impact (both economic and social) to credit providers of non-payment.

At all times there must be clarity and understanding of the transaction occurring, the relief being granted and the impact the bankrupt's behaviour will have on the credit provider, simply put there's a real cost to all Australians from bankruptcy.

Query 1.2.1a
The Government seeks views from the public on which particular obligations on a bankrupt should continue even after a bankrupt is discharged.

All current obligations should continue, specifically income contributions.

A key concern we hold is that by reducing the bankruptcy period from 3 years to 1 year there may be an increase in the likelihood of bankrupts structuring personal financial affairs to avoid liability in relation to after acquired property.

Trustees must be accountable for reviewing these constructs, particularly for serial bankrupts.

Query 1.2.1b

The Government seeks views from the public on what incentives and mechanisms should be in place to ensure compliance with obligations after discharge.

In line with proposed amendments and the plan to reduce the stigma of bankruptcy, the penalties for first time bankrupts need not be onerous should their situation be due to misadventure.

However if the bankruptcy is found to have occurred due to misdeed, whether first time or not, the penalties need to be of sufficient deterrent to dissuade persons using this option.

We recommend sufficient administrative penalties/sanctions given to AFSA to be applied upon application by the trustee.

Proposal 1.2.2
The Government proposes to separate the obligation to pay income contributions from the default bankruptcy period. Instead, individuals will continue to pay income contributions for three years even with the reduction in the default bankruptcy period. Further to proposal 1.1 above, where the period of bankruptcy is extended to five or eight years, income contributions will also be payable for that extended period.

The AICM deems the separation of the obligation to pay income contributions from the default bankruptcy period as essential. A three year minimum is required as:

- 12 months does not allow for significant return to creditors;
- Many bankrupts may require a significant part of the 12 months to find new employment or income generating ability; and
- Some bankrupts may be inclined to sit out the 12 months rather than see income contributions being made.

Proposal 1.3.1a
The Government proposes to reduce credit restrictions under the Bankruptcy Act to one year, subject to any extension for misconduct.

The AICM supports this proposal in line with current requirements that the bankrupt must inform the credit provider of their bankruptcy.

Proposal 1.3.1b
The Government proposes to retain the permanent record of bankruptcy in the National Personal Insolvency Index.

The AICM strongly agrees with this proposal. Prior bankruptcy is relevant to all subsequent credit decisions.

The AICM acknowledges that the “relevant weighting” of this information diminishes over time. This is taken into consideration in credit assessments.

The AICM notes that while there may be a point in time when a previous bankruptcy is not relevant to credit decisions, it is not possible to determine a specific time as all situations and credit decisions vary.

Query 1.3.1
The Government seeks views from the public on whether it is appropriate to reduce the retention period for personal insolvency information in credit reports.

The AICM strongly believes it is not appropriate to reduce the retention period in credit reports.

As noted in 1.3.1b this information is highly relevant to longer term credit decisions.

Incorporating the information in credit reports helps ensure efficiency in credit assessments and avoids the need for multiple searches.

Proposal 1.3.2
The Government proposes to reduce the overseas travel restriction to one year, subject to any extension for misconduct.

The AICM believes the restriction should remain for 3 years to:

- Maintain the disincentive of bankruptcy, and
- Prevent avoidance of income contributions.

Proposal 1.3.3
The Government proposes to consult with relevant industry and licensing associations with a view to aligning restrictions with the reduced period of bankruptcy, where appropriate.

AICM membership is not required to practice credit management but is highly regarded by employers.

The AICM requires members disclose bankruptcy and is able to revoke membership on these grounds. The AICM's current policy is to not revoke membership unless the circumstances leading to the bankruptcy indicate that the member is not a fit and proper person to practice credit management.

It is our opinion that the reduction in bankruptcy periods should not reduce the restrictions on the following professions:

- Accountants,
- Insolvency Practitioners,
- Mercantile Agents, and
- Lawyers.

2 Safe Harbour

The AICM is of the opinion that a safe harbour defence should not be allowed as it is reasonable to expect businesses to obtain advice and take action prior to the point that insolvent trading liabilities will arise and especially when the business is insolvent.

Further, once a business has reached a point where insolvent trading liabilities may arise for an effective safe harbour to occur an advisor with specific insolvency expertise must be engaged.

The cost of these professional services excludes the use of the safe harbour for the majority of entities that face insolvency situations. For small to medium enterprises (SME), this option will be cost prohibitive.

To explain, Australian Restructuring, Insolvency and Turnaround Association (ARITA) calculate that 43% of all insolvencies comprise of less than $250,000 in liabilities. These entities will be unable to afford to engage an appropriately qualified professional. This may result in an increased risk to the directors of adverse action through insolvent trading.

AICM members regularly assist businesses through periods of potential insolvency using extended payment terms and payment arrangements. This support would be further extended if there were refinement of the current Unfair Preference Claim regime contained in the Corporations Act (see Annexure).

The AICM has amended its position on safe harbour since our submission to the Productivity Commission Report on *Business Set-up, Transfer and Closure*, 2015 to be supportive of a safe harbour defence but only when:

- An appropriately regulated professional is appointed;
- Sufficient records are available to base a reasonable inquiry into solvency;

- A restructure can be implemented and return the company to a point of solvency that is not beyond the creditors tolerance for default;
- The company and restructuring advisors consider the creditors interests at all times; and
- The Directors follow the advisors' recommendations.

The above points are expanded from our previous submission due to these new proposals.

We also raise concerns about framing obligations during a safe harbour. These allow too much latitude during a period of crisis and high risk. In addition to points made below we believe that the requirement for the return to solvency should be tested against the directors obligation to take reasonable steps and to not increase the loss to creditors of the company by more than would be incurred through normal trading and not significantly more than would have occurred if the company was wound up.

In response to the following comment: "*Concerns over inadvertent breaches of insolvent trading laws are frequently cited as a reason early stage (angel) investors and professional directors are reluctant to become involved in a start-up."* The AICM agrees that encouraging early stage investment is essential for our economy but believes this should not be achieved by shifting risk to creditors.

Early stage investors are able to assess the multiple strengths of a business and adequately price for the risk as many of these investors are, indirectly, experts. On the other hand many creditors of these businesses are less able to assess the risks due to little information being available publicly or directly.

Creditors are even unable to determine if the tax obligations are being maintained, (See Annexure) and in competitive markets are often not able to price for risks.

Safe Harbour – Model A

Proposal 2.2 *It would be a defence to s588G if, at the time when the debt was incurred, a reasonable director would have an expectation, based on advice provided by an appropriately experienced, qualified and informed restructuring adviser, that the company can be returned to solvency within a reasonable period of time, and the director is taking reasonable steps to ensure it does so.* *The defence would apply where the company appoints a restructuring adviser who:* *(a) is provided with appropriate books and records within a reasonable period of their appointment to enable them to form a view as to the viability of the business; and* *(b) is and remains of the opinion that the company can avoid insolvent liquidation and is likely to be able to be returned to solvency within a reasonable period of time.* *The restructuring adviser would be required to exercise their powers and discharge their duties in good faith in the best interests of the company and to inform ASIC of any misconduct they identify.*

The AICM's position is that the seeking and adherence to appropriate advice is paramount to the success of this proposal however the majority of insolvency events are below the threshold where the engagement appropriately skilled advisors is uneconomic.

When an insolvency event is pending the books and records of an organisation are often neglected and while the AICM agrees that this requirement is central to this review and ASIC's direction, the actuality is often very different.

Query 2.2 *Subject to the further information on the proposal set out in the sections below, the Government seeks views from the public on whether this proposal provides an appropriate safe harbour for directors.*

Subject to the criteria for use of the safe harbour, the AICM believes that this is appropriate.

While the use of an external advisor may be restrictive due to cost, we see this independent person as essential. We believe this will limit its inappropriate use by businesses with less viable prospects for recovery.

Query 2.2.1a

The Government seeks views from the public on what qualifications and experience directors should take into account when appointing a restructuring adviser and whether those factors should be set out in regulatory guidance by the Australian Securities and Investments Commission, or in the regulations.
Query 2.2.1b
The Government seeks views from the public on which organisations, if any, should be approved to provide accreditation to restructuring advisers if such approval is incorporated in the measure.

The AICM believes the criteria for appointment of an adviser should be clearly set out and as a minimum require the advisor to:

1. Be a member of an organisation, approved by the Minister, with its own:
    - disciplinary framework;
    - educational framework; and
    - ethical standards.
2. Hold current credentials relevant to insolvency and/or restructuring

The AICM believes it would not be satisfactory to have a legal or accountancy professional perform this role unless they have specific insolvency and/or restructuring experience as our members all too regularly see generalist advisors providing incorrect advice (where they exhibit little or no understanding) of insolvency fundamentals such as the Personal Properties Securities Act.

Therefore the AICM strongly believes that the restructuring advisor should be registered member of a body with:

1. Standards specific to insolvency;
2. Regulatory oversight; and
3. Insolvency specific education and continuing professional development requirements.

We understand that currently this criteria would restrict the advisor to being members of the ARITA and believe this is essential to ensure the directors are receiving proper advice, the advisors have appropriate skills in order to construct viable commercial plans with genuine chances of success and to ensure creditors rights and roles are considered.

In the longer term we believe CPA Australia, Chartered Accountants Australia and New Zealand, Turnaround Management Association as well as Law Societies may be appropriate organisations to provide accreditation to restructuring advisors once complying programs have been developed.

These requirements are deemed essential to maintaining the integrity of the safe harbour regime.

To not enshrine this rigour in the legislation leaves the role open to unregulated insolvency advisors who have been prevalent in recent years in advising directors on ways to avoid creditors and remove assets out of a company prior to liquidation.

Query 2.2.1c
Is this an appropriate method of determining viability?

Query 2.2.1d
What factors should the restructuring adviser take into account in determining viability? Should these be set out in regulation, or left to the discretion of the adviser?

The AICM believes that a prime factor in determining the viability of a business is the time period within which the business can be restored to a solvent position and this should always take into consideration the creditors tolerance for default. Therefore a maximum period of 120 days should be applied unless:

1. Creditors are being paid to agreed terms; and
2. Any creditors not being paid to agreed terms have agreed to a repayment plan endorsed by the restructuring advisor.

The logic for this:

1. The longer debts age, the more likely recovery action is to be instigated;
2. Recovery action may include legal action and/or recording of payment defaults; and
3. Both actions will significantly affect restructuring ability and signal actual insolvency.

Factors to consider should also include not increasing the exposure/risk of creditors without providing full disclosure of the risk - e.g. a restructuring plan may involve cost saving initiatives such as new equipment with lower rental/operating costs, if the new equipment is on a fixed/long term contract this must be considered so as to not unfairly expose the supplier.

Scenario 1 - a $1,000 month copier at end of lease replaced with a $500 month copier with new 60 month term.

Scenario 2 - Obtaining a discount on stock based on a bulk order discount that will take an extended period to on sell.

On the assumption that without the safe harbour these transactions wouldn't have occurred and the company would have entered formal insolvency to enter these agreements without consideration or disclosure of the risk to the creditor simply creates additional unknown risk to creditors.

Query 2.2.1e
The Government seeks views from the public on whether these are appropriate protections and obligations for the restructuring adviser, and what other protections and obligations the law should provide for.

We believe that there should be a direct liability of the restructuring adviser to creditors should contracts in the above example/scenarios above be entered. De-registration is not a sufficient deterrent nor a significant enough of a control to ensure creditors are considered fully or allowing them to make a fully informed decision.

This liability will ensure the restructuring adviser is entrenched in the business which will increase the likelihood of success. While it may increase the cost of this process for the company that is preferable to increasing costs to creditors who are likely to be exposed to losses should the restructure not succeed.

Further, we are of the opinion that should a formal insolvency process commence the appointed insolvency professional be obliged to review the advice provided by the restructuring advisors to ensure that appropriate advice was provided and there was no abuse of the safe harbour period. Specifically ensuring that the creditor's interests were considered at all times and creditors were not adversely affected by actions during this period.

Query 2.2.2a
Do you agree with this approach?

We agree the limiting of the defence to insolvent trading is appropriate.

We recommend that substantial consideration be given to the period creditors may face liability for preferential payments.

A safe harbour will allow a business to trade whilst arguably insolvent. The likelihood that payments made to creditors during this period may be deemed preferential will increase. The likelihood of this will be amplified if recommendations of the AICM in response to earlier queries (2.2.1a, b, c, d, e) are not adopted.

To illustrate our point:

- In order to prevent a creditor taking recovery action and therefore frustrating the restructure, a payment of $100,000 may be prioritised for one creditor over others. This payment may be deemed preferential but is unlikely to have occurred if the safe harbour were not available.

- The creditor may accept this payment as a sign of solvency and continue to trade incurring a further $200,000 in debt.
- Presume the restructuring is unsuccessful and the subsequent formal insolvency and liquidation.
- Up to 3 years later the liquidator instigates legal action to recover the preference.
- A lengthy, costly and legal battle follows.
- Any amounts recovered by the liquidator used to cover costs of the liquidation with little or none of the recovery benefiting.
- The creditor left with a loss of the $100,000 preferential payment, $200,000 debt at time of liquidation (less any dividend) and hefty legal bills.

To in some way address this issue the AICM recommends the review of the payment regime is prioritised. We also seek the implementation of the recommendation of the Productivity Commission Report on Business Set-up, Transfer and Closure, 2015 in relation to a "small liquidation" process.

The pursuit of unfair preference claims should be limited to those within three months of insolvency and only of material amounts. The duty to pursue unfair preferences should be explicitly removed unless there is a clear net benefit to unsecured creditors and it will not delay conclusion of the liquidation.

See Annexure for further information on our position on Unfair Preference Claims.

Query 2.2.2b *Do you agree with our approach to disclosure?*

We generally agree with the outlined approach and suggest that there should be an obligation on the advisor to disclose to ASIC when it has been determined that it is not possible to restore the business in a reasonable time period and this should not be left to the directors.

Query 2.2.3 *The Government seeks views from the public on in what other circumstances should the safe harbour defence not be available.*

Safe Harbour Model B

Query 2.3 *The Government seeks your feedback on the merits and drawbacks of this model of safe harbour.*

The AICM strongly disagrees with this proposal. Without the controls as included in Model A and the AICM's recommendations, the use of a safe harbour will be open to significant abuse and remove the current deterrent to insolvent trading.

3 Ipso Facto Clauses

The AICM is opposed to uniformly voiding ipso facto clauses but is in favour of preventing actions that unreasonably restrict restructure of the insolvent business.

The AICM is aware that ipso facto clauses have been used by creditors to establish a significantly superior bargaining position and to achieve results better than other creditors. While an argument can be made to preserve the status quo whilst restructuring activities are being conducted, we agree that certain creditors should not be able to achieve superior commercial outcomes to other creditors.

We provide further comment below.

Proposal 3.2
The Government proposes that any term of a contract or agreement which terminates or amends any contract or agreement (or any term of any contract or agreement), by reason only that an 'insolvency event' has occurred would be void.
Any provision in an agreement that has the effect of providing for, or permitting, anything that in substance is contrary to the above provision would be of no force or effect.

Under external administration it is feasible for the controller to disclaim contracts at their discretion. However should the contract not be disclaimed a supplier may be bound to continue supply.

A supplier may have priced their supply based on recovery of costs through the reliance on the full fixed term to recover all costs - e.g. a supplier of hire equipment may provide a discount from normal hire fees and/or agree to waive costs of transporting equipment, installation/run up the equipment in return for a high volume or long term contract. If an administrator disclaims the contract and requires the supplier to collect at their cost, this causes further loss to the supplier.

We do not object to this ability just that the right should be mutual.

Another example of suppliers being disadvantaged is where the administrator returns nine items and retains one. In this instance it would be unfair to not allow the supplier to vary the rate to the normal commercial rate for the hire of one item.

In summary if an administrator has the ability to disclaim a contract, the supplier should retain the same rights to the extent it is not detrimental to the business. Further, the supplier should not need to take legal action to retain the right.

Query 3.2.a
Are there other specific instances where the operation of ipso facto clauses should be void. For example by prohibiting the acceleration of payments or the imposition of new arrangements for payment, or a requirement to provide additional security for credit.
Query 3.2b
Should any legislation introduced which makes ipso facto clauses void have retrospective operation?

We agree acceleration of payments should not be allowed as long as all payments are kept up to date, ie this protection should not be viewed by the administrator as another method to delay/negotiate payment to suppliers.

The unilateral exclusion of ipso facto clauses from contracts can be detrimental to suppliers of homogenous goods or services. In the case of readily available commodities we propose that ipso facto clauses are allowed unless sourcing an alternate supplier would be detrimental to the business and/or unreasonably restrict restructure of the insolvent business.

To explain, to force one supplier to continue supply when other suppliers of the same product are not faced with the same risk will place undue burden on that supplier and potentially cause an insolvency event for them which is not the intent of this relief.

Query 3.2.b
Are there any other circumstances to which a moratorium on the operation of ipso facto clauses should also be extended?

Yes when the contract for supply is for an item where a substitute is readily available and would not unreasonably restrict restructure of the insolvent business for the reason explained above.

Query 3.2.1
Does this constitute an adequate anti-avoidance mechanism?

We agree with the anti-avoidance mechanisms proposed however we seek a carve out for the ability to adjust prices from the current price supplied to a list price or non-discounted price.

Query 3.2.2
What contracts or classes of contracts should be specifically excluded from the operation of the provision?

Contracts for supply of items where sourcing an alternate supplier would be detrimental to the business and/or unreasonably restrict restructure of the insolvent business.

Query 3.2.3
Do you consider this safeguard necessary and appropriate? If not, what mechanism, if any, would be appropriate?

We consider some safeguard such as a referral to a court of appeal appropriate to prevent abuse of superior bargaining powers.

We believe an appropriate framework would be that an Administrator can elect an ipso facto clause as void when and if:

1. Supply is essential for the continuation of the business;
2. Price for continued supply offered by the supplier is greater than otherwise commercially available;
3. It is unreasonable to source an alternate supplier without detriment to the business and/or unreasonably restricting the restructure of the insolvent business.

Annexure

<u>Lack of information in the lead up to Insolvency</u>

The AICM firmly believes that there is a significant gap in the information available to assess risk of insolvency as well as phoenix activity.

When a business defaults on its credit obligations TCPs regularly make this information available to other TCPs by the recording of payment defaults and other payment data with various credit bureaux.

Currently the one creditor common to all businesses and potentially most relevant to all credit providers is unable to provide this information to the system, being the Australian Tax Office (ATO) as well as other State and Federal Revenue offices.

The AICM firmly believes the community and economic value of making information available relating to businesses that are not maintaining their tax obligations would be significant for all areas of the community for example:

- Greater recovery of tax debt will reduce the government's reliance on other revenue raising;
- The knowledge that delaying tax obligations will make obtaining credit and finance harder will ensure greater tax compliance;
- Credit providers will be better able to manage their risk exposures putting less pressure on price increases;
- Phoenix activity and/or losses as a result of phoenix activity will be reduced specifically in instances where the ATO is the only creditor not paid out of the insolvent company. This will be achieved by the default to the ATO being detected in directors' credit histories when there is a common directorship or other identifiable connection between entities. Further, it will be evident that the prior company was closed due to an insolvency;
- Insolvency action will be reduced as the impacts of poor cash flow will occur earlier e.g. trade creditors reducing payment terms leading restructuring occurring prior to technical insolvency;
- Losses from insolvency may be reduced through earlier action and creditors being better able to manage their exposures.

The AICM strongly recommends that the ATO (and other government revenue offices) are properly considered creditors not purely regulators and authorised to release suitable and timely information about ABN holders' unpaid tax obligations.

<u>Practices permitted by *Corporations Act*</u>

Our members regularly experience actions that are in accordance with the *Corporations Act* but which are clearly unfair, inefficient and of no benefit to the majority of stakeholders. Further, our members regularly state that as unsecured creditors they unfairly bear the cost of the liquidation process.

While not currently identified as an issue of this review we strongly urge that relevant, related significant reform is due in respect of unfair preferences.

The ASIC in its information sheet 45, *"Liquidation a guide for creditors"* defines a Preference payment as *"a creditor receives an unfair preference if, during the six months prior to liquidation, the company is insolvent, the creditor suspects the company is insolvent, and receives payment of their debt (or part of it) ahead of other*

creditors. To be an unfair preference, the payment must put the creditor receiving it in a more favourable position than other unsecured creditors."

The ATO define a preference payment as *"Unfair preferences usually involve transactions that discriminate in favour of one creditor at the expense of other creditors. The aim of the law outlined below is to ensure creditors are treated equally by preventing any unsecured creditors from receiving an advantage over others."* https://www.ato.gov.au/tax-professionals/your-practice/insolvency-practitioners/preference-payments/preference-payments-for-companies/ accessed 3/7/15.

Conceptually the preference payment regime seems reasonable but in practice it results in undue burden on businesses. The AICM's concerns are best summarised as:

1. The time frame for liquidators to commence recovery action is currently 3 years from the commencement of insolvency. This time period is unreasonable as demonstrated by the example below.

2. Preference claims are routinely pursued and which result in no return to unsecured creditors, effectively meaning unsecured creditors are funding the insolvency.

3. The test of suspicion of insolvency is too onerous.

4. Organisations that undertake effective collections activity are penalised in favour of other organisations that may not have taken any collections activity.

In summary the current regime is unproductive and burdensome on organisations that are following normal commercial practice.

The AICM strongly holds the position that the *Corporations Act* should be amended to:

- Limit the time period for liquidators to commence action to recover preference claims to 12 months from the commencement of the liquidation.

- Exclude payments made to third party creditors in the normal process of recovering a valid debt from the definition of a preferential payment.
- Limit preference claims to circumstances where the creditor was a related party and was actually aware of insolvency (rather than reason to suspect insolvency).

  The AICM notes the definition of preference claims in New Zealand is in line with this recommendation.

- Limit preference claims to circumstances where the creditor was aware of insolvency and used influence other than that available to creditors generally.

  This would limit the liability to circumstances where the creditor has used their unique position in order to obtain a preference over general creditors. An example may be a creditor supplying a unique component withholds supply and seeks payment earlier than it has previously or the franchising example noted in the next section.

The AICM acknowledges that an impact of this recommendation may be the reduction in the options available to fund the insolvency process. However this does not justify the current arrangements which see unpaid third party creditors or "victims" of insolvency, they regularly receive no return, bearing significant cost of the insolvency and are the lowest priority in terms of distribution.

The small liquidation recommendation and increasing the funding of the asset less administration fund as recommended in the draft report are significant measures that could be used to address this funding issue.

The unfair preferential payments regime definitely has a place but we feel this should be limited to situation where the creditor is not at arm's length or has used a position or tactics not in line with those reasonably expected by a creditor in the normal course of business.

Incentive to extend credit to start ups

Our members are the controllers of the financial quality of their firm's accounts receivable asset and are responsible for protecting this asset and to in due course convert it to cash. Our members are often closer to their customers than their bankers and have a detailed understanding of these customers industries and funding needs.

A current constraint in the Australian economy is the reliance upon the ownership of real property as security before credit will be granted. This impacts the ability of business owners to access funds at competitive rates. This situation is ameliorated once a business matures and reaches a certain size.

For a credit manager to open a credit account they must test the creditworthiness of the customer and consider appropriate security such as a personal guarantee of the director(s).

This work is all undertaken from the perspective that the credit manager and these processes are a cost to the business and that the granting of credit is necessary to support to sales. This is balanced with the fact that there is no incentive to the business owners to take unnecessary risk when their competitors also follow the same strategy.

Our members have access to further credit facilities which could be deployed to assist with the transformation of the economy to a more entrepreneurial and jobs growth focus, stimulating innovation and economic prosperity. The Reserve Bank's September 2013 paper "The Use of Trade Credit by Businesses" calculated that in March 2013 trade credit owed by Australian businesses exceeded $80 billion.

As noted by Senator Amanda Vanstone in her address to the AICM's National Conference as far back as May 2000, "training is essential for staff to correctly identify fraud in credit applications." Fraud and credit management and therefore specific skills used by our members and competent, qualified credit managers. A qualified credit manager (those holding a minimum of Certified Credit Executive and/or Diploma status) could be encouraged to increase their credit risk to start-up businesses if there were favourable taxation consequences. The qualified credit executive would review the credit application and based on defined taxation criteria would be entitled to a 150% tax write off of the debt should that entity become insolvent and the debt not be recovered from the guarantor.

Our initial proposal for businesses to be included in this incentive would be:

1. Business assessed for credit by approved reviewer to prevent fraud, and
2. Trading for less than 5 years before insolvency, and
3. Personal guarantee is held which is not recoverable.

This tax incentive would be available across all non-banking sectors thereby giving all trade credit suppliers with appropriately qualified risk controllers the incentive to support emerging businesses particularly those without real property asset backing in start-up mode.