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Mr James Mason
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: insolvency@treasury.gov.au

26 April 2017

Dear Mr Mason,

AFA Submission – Improving Corporate Insolvency Law

The Association of Financial Advisers Limited (AFA) has served the financial advice industry for 70 years. Our objective is to achieve Great Advice for More Australians and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practising financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Summary of the AFA's position

The AFA supports measures to improve Australia's corporate insolvency laws and make it less attractive for Directors (or where Directors feel less compelled) to choose insolvency over trying to work their way through what could be temporary difficulties. The AFA considers that this is a good first step in addressing gaps in the consumer protection framework whereby corporate insolvency is used to avoid unpaid Ombudsman Determinations or court judgment. The measures proposed are sensible and will be welcome clarity for Directors and their advisers about what constitutes insolvent trading.

The AFA considers that further reforms to corporate insolvency and Directors duties and liabilities should be explored as well. In our submission to the Senate Economics Committee's inquiry into the consumer protection framework in the financial services sector, we recommended that the Australian Law Reform Commission could be tasked with researching whether there are other reforms to Director liability and

corporate insolvency laws that could better protect Australian consumers and achieve more sustainable businesses in the long run.

Submission to the Senate Economics Committee

Over the past decade, many financial advisers have been held to be responsible for large portions of consumer losses where the loss was as a result of a financial product failure (e.g. agribusiness, Westpoint, and several MIS schemes). Part of this is due to a lack of recognition of the difference between a failure of product and a failure of advice within Ombudsman Determinations which in turn discourages a better understanding and application of contributory negligence principles in determining awards of compensation as well as the elements of causation, such as proximate causation and ultimate causation.

Whilst some financial advisers acted inappropriately when advising clients to invest in managed investment schemes, so too did many accountants who have avoided a similar requirement to compensate their clients. The dispute resolution framework failed those people. Likewise, for the self-invested who attended seminars held by the representatives of the failed schemes. When the schemes were legally allowed to enter liquidation without any intervention by ASIC prior to collapse or during, the Directors of those schemes largely escaped convictions prosecuted by the regulators and also avoided compensation claims by investors.

In some cases, those schemes may have been able to continue operating but for certain arrangements that those companies had entered into. The AFA welcomes Treasury's proposals to improve the corporate insolvency law by clarifying the situations where insolvent trading may not be presumed, but can be rebutted. To support these measures, the AFA recommends the issues be better understood.

The AFA supports the principle of external dispute resolution and in many cases Ombudsman Determinations are correctly decided and consumers equitably compensated. As highlighted by the Financial Ombudsman Service in the 'Unpaid Determinations' Circulars published for the last couple of years, Ombudsman Determinations are not always able to be enforced against financial services providers. Further, there has never been a financial impact analysis or an assessment of how Ombudsman scheme jurisdictional limits affect the accessibility of financial advice. These unintended consequences of the dispute resolution regime show that gaps and inconsistencies exist in the consumer protection framework.

In the AFA's view, the corporate insolvency system makes it too easy for the directors of licensees to choose non-compliance with Determinations – incentivising directors of licensees to elect to place their company into administration despite a rigorous investigation and finding of misconduct by an Ombudsman scheme about the actions of representatives of the licensee. To avoid these practices continuing to disadvantage Australian consumers most, the AFA recommends that the Australian Law Reform Commission (**ALRC**) be tasked with researching possible changes to the *Corporations Act 2001* that could:

- restrict licensees entering liquidation specifically to avoid paying an award of compensation;
- place conditions upon directors' limited liability rules to place a more direct obligation upon directors who put their companies into liquidation whilst an Ombudsman case is open or Ombudsman scheme award of compensation has been made, and
- examine how to effectively prevent phoenix companies re-joining the same or a different Ombudsman scheme as well as the general issue of regulatory approval for phoenix activity.

The AFA considers that these three areas contribute to the problem of unpaid Determinations because it is far too easy for recalcitrant directors of licensees to hide behind their fiduciary duty to their shareholders

whilst disregarding their licencing requirements and conditions. These recommendations seek to prevent the recurrence of historical examples where managed investment schemes, financial planning practices, mortgage brokers and other licensees place themselves into voluntary administration only for a similarly named or located and managed company to take over their customers and re-join the same or another EDR scheme.

The AFA supports the ALRC being given the task of investigating structural contributors to unpaid Determinations as well as exploring other options to mitigate against the risks of unpaid Determinations, improve corporate sustainability, whilst continuing limited liability protections for those Directors who do meet their obligations in good faith and genuinely try to nevertheless meet the company’s regulatory, licensing and compliance obligations at the same time. The AFA considers that there may be changes to directors’ duties and liability available as well as widening administrators’ and regulators’ powers to be explored in order to prevent companies with open Ombudsman disputes from choosing non-compliance, as well as to mitigate the risk of further managed investment schemes choosing liquidation over investor’s rights. The AFA considers that the results of the ALRC’s research does not necessarily need to be restricted to corporate entities engaging in the financial services sector and consequently all Australian consumers and the wider Australian system will benefit from the recommended research.

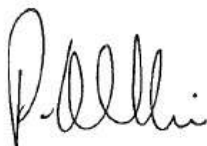
Concluding remarks

The AFA supports Treasury’s proposals to improve the corporate insolvency law and we are sure that many will welcome the clarity that the proposals bring with respect to perceptions of insolvent trading. The ipso facto clarifications and safe harbour proposals are a good initial step in reforming this important structural area that affects so much of Australian life. We consider that more could be done subsequent to these proposals and recommend that to give the Government the information it requires to assess further reform options, the Australian Law Reform Commission should be tasked with researching and better understanding the corporate insolvency system.

Outlined above are some of the key areas that we consider should be further analysed to better protect consumers in the financial services sector. However, we welcome the mandate of the ALRC being widened to ensure common application to the problems experienced by other corporate entities and their stakeholders, such as customers and shareholders. More needs to be done in this area to better protect Australians and support more sustainable businesses and we encourage Treasury to take a holistic approach that addresses all related issues with the corporate insolvency system.

If you require clarification of anything in this submission, please contact us on 02 9267 4003.

Yours sincerely,



Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd