Council of Small Business of Australia

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Submission to the Australian Government's option paper: Modernisation and harmonisation of the regulatory framework applying to insolvency practitioners

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The Manager
Governance and Insolvency Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

Re: Small Business Response to the Options Paper

The Options Paper (the Paper) canvasses options to improve regulation of corporate insolvency professionals; amendments to the *Corporations Act 2001;* an effective insolvency framework so that financial distress is addressed and minimises negative outcomes for creditors, debtors, consumers and employees; by professionals which are skilled, honest and accountable for the efficient operation of the insolvency regime.

It looks to introduce reforms necessary to address misconduct in the profession and improve insolvency services by ensuring the framework/structure promotes: professionalism and competence by practitioners; competition on price and quality; efficiency in administration; and communication and transparency between stakeholders.

There are 2.4M small businesses in Australia and they are said to be the driving force of the economy and have unique needs for the legislation, regulation and application of insolvency to be effective so that it operates with less risk and higher efficiency which flow from the introduction and application of safeguards in the *Corporations Act 2001* (the Act).

Our response is as follows:

STANDARDS FOR ENTRY INTO THE INSOLVENCY PROFESSION

We refer to the *Insolvency Practitioners Association* [the IPA] *of Australia Code of Professional Practice* [the IPA Code] clause 1.2 which states 'Members must exhibit the highest levels of integrity, objectivity and impartiality in all aspects of administrations and practice management... [which is] honest, open, clear, succinct and timely to ensure effective understanding of the processes, rights and obligations

of the parties. Members must act in a professional manner and maintain objectivity, independence, integrity and impartiality in their business."

Small business believes that the Options set out in the paper should go further and ensure the above principles are legislated and regulated, so that the principles both exist and are seen to exist by all stakeholders. Additionally, small business believes licensed practitioners should receive training from the Beyond Blue organisation to assist them identifying people who are not dealing with stress, and refer them to appropriate support organisations.

REGISTRATION PROCESS FOR INSOLVENCY PRACTITIONERS

Small business believes that the Options set out in the paper are the responsibility of the profession and ASIC to ensure professionals are skilled, honest and accountable for the efficient operation of the insolvency regime.

REMUNERATION FRAMEWORK FOR INSOLVENCY PRACTITIONERS

Small business believes that potential for conflicts of interest is a serious impediment in the efficient operation of the insolvency regime. Small business agrees with Option One which seeks to "prevent a registered liquidator from using the casting vote as chair of a creditors' meeting, where the resolution is one for the approval of the remuneration of the liquidator in any external administration."

However, legislation should look at potential conflicts of interest between all parties involved in insolvency administration and the relationship between their appointing banks and the receivers/managers, administrators/liquidators and other parties. Small business believes there is an opportunity for practitioners to hide behind their appointing banks, the principal funders of the profession, which may compromise their ability to act in good faith, and in a professional manner, maintaining objectivity, independence, integrity and impartiality.

COMMUNICATION AND MONITORING

Small business believes the following reforms should be legislated:

- Receivers and managers be required to sign a declaration stating that all information provided by them to creditors and stakeholders, is true and correct and ensure a copy of their reports can be accessed by creditors and stakeholders;

- Administrators and liquidators be required to sign a declaration stating that all information provided by them to creditors and stakeholders is, to the best of their knowledge, true and correct and ensure a copy of their reports can be accessed by creditors and stakeholders;

- Insolvency practitioners' reports must not provide misleading information, and where there is a perception of overcharging, maladministration or misconduct, creditors and stakeholders should be able to refer complaints to ASIC, which has a duty to investigate them;

- Insolvency professionals should be bound by principles of governance so that each sector remains independent and avoid potential conflicts of interest and the perception of conflicts of interest, and in the event there is evidence of conflicts of interest, creditors and stakeholders have a right to refer them to ASIC, which has a duty to investigate;

- Within each insolvency firm, there should be personal responsibility by practitioners to ensure they are free from conflict of interest and the perception of conflict of interest and not indemnified by their firms for maladministration based on negligence, fraud or dishonest conduct;

- Penalties should be introduced by legislation to protect creditors and stakeholders from misleading information, overcharging, maladministration, negligence, fraud and/or dishonesty by firms and practitioners, employed by the firms; and

- If the IPA makes a commitment to creditors and stakeholders that it will investigate allegations of maladministration, negligence, fraud and/or dishonesty, IPA managers and officers should be responsible and accountable for applying the standards set out in the IPA Code.

Small business believes that administrators and liquidators have a duty to advise creditors and stakeholders that they have a right to appoint a Committees of Inspection (COI) under the *Corporations Act* and set out the benefits to creditors and stakeholders in doing so. This would provide creditors with greater access to information and allow them to make transparent decisions and determine whether there has been maladministration, negligence, fraud or dishonest conduct and refer it to ASIC for investigation and determination.

Small business agrees the *Corporations Act* should be amended to empower creditors greater influence on the direction of the winding up by allowing them to make a resolution directing an insolvency practitioner to act or not act in a certain way. In the event that banks are creditors and have appointed receivers and managers, they should not be entitled to vote on the direction of the winding-up where there is a perception of maladministration based on negligence, fraud or dishonest conduct until ASIC has investigated and made its determination.

FUNDS HANDLING AND RECORD KEEPING

Small business believes that the Options set out in the paper are the responsibility of the insolvency profession and ASIC has a duty to ensure the standards are applied.

INSURANCE REQUIREMENTS FOR INSOLVENCY PRACTITIONERS

Small business agrees with Option One that penalties should be imposed on firms and practitioners that fail to hold proper and adequate insurance and this might be achieved through increasing the pecuniary penalty amount and imprisonment time, and through amendments to the *Corporations Act*, and make breaches of the insurance legislation subject to a civil and criminal penalties.

DISCIPLINE AND DEREGISTRATION OF INSOLVENCY PRACTITIONERS

Small business believes that ASIC's application of its powers should be enhanced to ensure that it applies the *Corporations Act* such that justice is done and seen to be done. Under the status quo where receivers and managers are indemnified by appointing banks, lack of speed and cost are barriers to effective administration.

The Paper refers to ASIC's powers to deal with breaches of insolvency professionals. However, given the disparity between the powers of receivers and managers, and their appointing banks, and small business creditors and stakeholders, ASIC's powers should be more clearly defined and impose a duty, not a right, for ASIC to investigate purported maladministration, negligence, fraud and dishonest conduct. The use of courts by receivers and managers indemnified by their appointing banks, and the threat of using courts, forces small business to seek redress in courts when, in most cases, it lacks the financial resources to do so.

It may therefore be appropriate to amend the *Corporations Act* to make available to creditors and stakeholders the AAT process which is quicker, cheaper and has less formality. Small business agrees that it is not desirable to deal with a specialist tribunal such as CALDB and in the event that ASIC has a duty to investigate maladministration, CALDB may not be necessary in the improved regulatory framework.

REMOVAL AND REPLACEMENT OF INSOLVENCY PRACTITIONERS

Small business supports Option One. However, liquidators should be appointed by the Court and must call a meeting of creditors and stakeholders within a specified period following their appointment. They have a duty to inform creditors and stakeholders of potential conflicts of interest and refer to provisions of the *Corporations Act* that would allow them to be replaced at the first meeting of creditors and stakeholders.

Small business believes that creditors and stakeholders should not be faced with difficulties that arise as a result of the limited opportunities for the removal of poorly performing liquidators or administrators and those engaged in misconduct. After the appointment, it is unlikely that there will be sufficient knowledge of the registered liquidator or other reason to remove them from office.

These problems commonly stem from information asymmetries as liquidators have greater knowledge and access to information than creditors and stakeholders. Under the current provisions, removal of insolvency practitioners are unlikely unless serious misconduct occurs. Until the legislation requires ASIC to investigate perceptions of maladministration, administrators and liquidators, being unfunded, are unlikely to pursue allegations of negligence, fraud and/or dishonest conduct.

REGULATOR POWERS

Small business believes that the paper provides an opportunity to introduce changes to the *Corporations Act* which allow ASIC, as regulator, to address disparity between

receivers and their appointing banks, and small business creditors and stakeholders. To achieve this, ASIC should not only have the power to monitor the application of the Act but also be required to do so.

By setting out these duties and powers, ASIC would have a duty to ensure an effective insolvency framework so that financial distress is addressed and negative outcomes for creditors and stakeholders minimised which leads to an efficient insolvency regime and addresses misconduct in the profession by ensuring the framework/structure upholds standards of professionalism and competence, efficiency in administration and transparency between stakeholders.

Small business supports the introduction of an independent Ombudsman comprising equal representation by the principle stakeholder bodies: ASIC, IPA, small business and consumer advocates, chaired by Treasury. Its duty would be to handle complaints independently, properly, effectively and fairly on behalf of all business' creditors and stakeholders to avoid relying on courts by more financially-resourced parties.

SPECIFIC ISSUES FOR SMALL BUSINESS

Small business supports Option One which requires the duties of the regulators to be clarified, however, these parties should also be accountable. ASIC should be required to investigate perceptions of maladministration, negligence, fraud and/or dishonest conduct. This would result in ASIC's ability to adopt a 'one stop shop' approach to interconnected issues linking the various parties in the insolvency sector, and in personal and corporate small business insolvencies.

This is important because it's common practice for small businesses owners to use personal assets to secure loans taken out for their businesses, by banks. Where a small business fails, it triggers guarantees made by directors for corporate borrowings which may not only push directors into bankruptcy but also be intended to push them into bankruptcy where they have no rights at law to protect their interests. In this case, it should be possible to appoint the liquidator who then deals with both personal and corporate insolvency.

SUMMATION

Small business believes the above points establish a need for parties involved in insolvency, including banks, to be independent and be seen to be independent. Independence appears lacking in the current framework and legislation and regulation may be the best avenues to address shortcomings which disadvantages small businesses obtaining both start up and continuing credit, increasing the risks to investors and banks and therefore acting as a deterrent to investment and borrowings by an important sector in the economy.

It also acts as a deterrent for well qualified professionals being willing to act as directors of small businesses. Therefore it limits investment, increases cost of funds, and deters qualified professionals from playing an active roll in the development and continuing operation of the small business sector.

In summary, small business concerns include:

1. The relationship between insolvency practitioners and banks, which indemnify them, introduces a conflict of interest and undermines the importance of

professionalism and competence by practitioners, competition on price and quality, effectiveness and efficiency in administration, and transparency between stakeholders;

2. The potential conflict of interest provides opportunities for insolvency firms to retain the status quo and therefore introduces a need for auditors to ensure that breaches or potential breaches of the *Corporations Act* are brought to the attention of banks and practitioners and, if not addressed by these firms or officers which manage the firms, referred to ASIC;

3. The inter-relationships between the receivers and managers, administrators and liquidators and the IPA raises further conflict of interest because of the slash and grab approach by receivers/ managers and administrators/ liquidators which undermines professionalism, competition, efficiency in administration and transparency;

4. The *Corporations Act 2001* could be refined to ensure ASIC, as regulator, has a duty, not a mere power, to uphold industry standards of professionalism, objectivity, independence, integrity and impartiality. ASIC would then be required to investigate perceptions of maladministration, negligence, fraud and/or dishonest conduct;

5. In instances where the regulator finds evidence of maladministration or misconduct, it should refer the evidence and its preliminary report to the Commonwealth Department of Public Prosecutions in the case of insolvency practitioners and/or banks, or to the Commonwealth Ombudsman in the case of ASIC or government parties, and these latter two bodies be responsible to take necessary action;

6. The *Corporations Act 2001* should ensure practitioners and their appointing banks, and the IPA, and the directors of both to act fairly and without bias in assessing the competing interests of the insolvency practitioners, and creditors and stakeholders. The regulator and the IPA, acting as industry watchdogs, should be responsible for ensuring practitioners are accountable for damages flowing from maladministration or misconduct.

Yours sincerely

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