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McGRATHNICOL
CORPORATE RECOVERY

11 January 2013

The General Manager
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

Email: Safefinancialsector@treasury.gov.au

By Email

Dear Sir/Madam

Strengthening APRA's Crisis Management Powers

This submission is made by McGrathNicol, a firm of 30 partners and 320 staff including 22 registered liquidators, the majority of whom are members of the Insolvency Practitioners Association of Australia.

We welcome the opportunity to make a submission concerning the range of options set out in the Consultation Paper: Strengthening APRA's Crisis Management Powers (**Options Paper**).

It is relevant in the context of proposals presented in the Options Paper to note that Murray Smith, one of our partners, acted as judicial manager (and now liquidator) of the general insurers Australian Family Assurance Limited and ACN 000 007 492 (formerly Rural & General Insurance Limited), which are the only two occasions that the Court has appointed a judicial manager to general insurers on APRA's application.

Our comments are set out in the attachment to this letter and relate to chapters 1, 4, 5 and 6 of the Options Paper. Our comments address aspects of the Options Paper where we wish to point out practical implications, or concerns regarding the effectiveness of the proposals, or the manner in which they may be implemented.

As discussed between a representative of Treasury and Gary Busby of McGrathNicol, we have been provided with an extension until 11 January 2013 to finalise this submission.

If you have any queries in relation to our comments, please contact Gary Busby (02 9338 2609) or Murray Smith (02 9338 2660).

Yours faithfully

McGrathNicol
Contact: Murray Smith

Enclosure(s):
Comments on specific chapters of the Options Paper

Level 31, 60 Margaret Street, Sydney NSW 2000, Australia GPO Box 9986, Sydney NSW 2001 P +61 2 9338 2600 F +61 2 9338 2699
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Strengthening APRA's Crisis Management Powers

McGrathNicol Comments on Specific Chapters of the Options Paper

Glossary

2010 Act	*Financial Sector Legislation Amendment (Prudential Refinements and Other Measures) Act 2010*
ADI	Authorised deposit taking institute
APRA	(the) Australian Prudential Regulation Authority
ASIC	(the) Australian Securities and Investment commission
ATO	(the) Australian Taxation Office
Banking Act	*Banking Act 1959*
Business Transfer Act	*Financial Sector (Business Transfer and Group Restructure) Act 1999*
Corporations Act	*Corporations Act 2001*
DOCA	Deed of company arrangement
FCS	Financial Claims Scheme
Industry Acts	Refers collectively to the *Banking Act 1959*, *Insurance Act 1973* and *Life Insurance Act 1995* but does not include the *Superannuation Industry (Supervision) Act 1993*
Insurance Act	*Insurance Act 1973*
JM	Judicial manager
Life Insurance Act	*Life Insurance Act 1995*
NOHC	Non-operating holding company. This is a holding company that does not carry on a business, other than a business consisting of the ownership or control of other bodies corporate. In this paper, NOHC will generally refer to a holding company with an ADI and/or insurer as a subsidiary.
Options Paper	The consultation paper titled "*Strengthening APRA's Crisis Management Powers*" dated September 2012
SM	Statutory manager

Strengthening APRA's Crisis Management Powers

McGrathNicol Comments on Specific Chapters of the Options Paper

1 Effective resolution of groups

1.1 Broadening the scope for the resolution of groups

In principle, we support broadening the scope for the resolution of financial groups by increasing APRA's powers to intervene effectively in the event of a crisis where it may be necessary to maintain the cooperation of non-regulated members of the group to ensure the best outcome for depositors and policyholders.

1.1.1 Proposal for control over non-regulated entities in a group

Discussion questions

(a) ***Are there other options to ensure that APRA has adequate power to resolve distress within groups, especially where a subsidiary provides essential services to a regulated entity?***

The Options Paper identifies the following four options for dealing with the control over non-regulated entities in a group:

A Enable an SM (in the case of an ADI) or JM (in the case of insurers) to be appointed to an authorised NOHC and the subsidiaries of an authorised NOHC and of a regulated entity.

B Amend the Corporations Act to provide that any liquidator or receiver appointed over a subsidiary or NOHC must cooperate with APRA.

C Enhance and strengthen APRA's direction making powers over NOHCs and related entities – including in a receivership or liquidation situation. This option can be viewed as a supplement to the above options, as opposed to being an alternative.

D A combination of Option A to C above.

Whilst other options might exist, on the assumption that time is of the essence in any process to resolve distress in a group that includes an APRA-regulated entity and subject to our comments below, we consider the options set out in the Options Paper provide the most likely practical alternatives for dealing with non-regulated entities in a group.

The power to appoint an SM or JM and for APRA to be empowered to give directions to an NOHC or non-regulated subsidiary, should be subject to rigorous controls and only be used in extreme circumstances when all other alternatives have been exhausted.

(b) ***Would there be any unintended consequences of enabling APRA to appoint or seek to appoint an SM or JM to an authorised NOHC and subsidiary?***

The non-regulated subsidiary or the NOHC may have different stakeholders to the regulated entity. In such circumstances, the interests of the non-regulated subsidiary or the NOHC and the regulated entity are likely to be different. In particular, this is likely to be the case if the non-regulated subsidiary or the NOHC is insolvent.

It is therefore important to ensure that the stakeholders of the non-regulated subsidiary or the NOHC are not prejudiced as a result of an appointment or subsequent actions of an SM or JM.

The Options Paper recognises that the proposed powers do affect some existing creditor rights (eg, it would pre-empt the rights to appoint a receiver or liquidator), and that any changes should incorporate appropriate limitations on the powers and safeguards against their potential abuse. In particular, it mentions that any actions taken by the SM or JM would need to consider fair value.

Further details are required about how fair value would be determined and how long the assessment process would take. Insufficient compensation and/or unreasonable delay may prejudice creditors of the NOHC or non-regulated subsidiary.

Consideration should therefore be given as to how these matters are to be assessed and compensated (if applicable), so that stakeholders of the non-regulated subsidiary or the NOHC know how they will be dealt with in such an event.

(c) ***What would be the implications of APRA being empowered to give directions to a subsidiary of a regulated entity or of an authorised NOHC?***

The Options Paper recognises that the board of an NOHC or non-regulated subsidiary, or (if appointed) a receiver or liquidator of an NOHC or non-regulated subsidiary, may have different priorities to APRA.

If APRA were to be empowered to give directions to a subsidiary of a regulated entity or of an authorised NOHC, it should be on the basis that such directions do not prejudice the stakeholders in the NOHC or non-regulated subsidiary.

As with the proposal to extend statutory or judicial management to authorised NOHCs and subsidiaries (see 1.1.1(b) above), the Options Paper recognises that certain protections need to be built into the proposal to extend direction powers to subsidiaries and NOHCs. In particular, there is mention of including the explicit provision that no shareholder or creditor may be left worse off than they would have been if the entity had been liquidated and that no services or functions may be required to be taken on other than just terms.

It is unclear how (and by whom) an assessment is to be made as to whether a shareholder or creditor has been left worse off than they would have been if the entity had been liquidated, or that the value of services or functions provided has been on just terms.

In addition, consideration needs to be given where the NOHC or non-regulated subsidiary may have a funding requirement to enable compliance with directions from APRA. How would such funding requirements be determined and who would be responsible for procuring the required finance?

Consideration should be given as to how such issues are to be addressed, so that the non-regulated subsidiary or the NOHC and their respective stakeholders know how they will be dealt with in such an event.

(d) ***If an entity is in receivership or liquidation, should any power for APRA to give directions to subsidiaries be limited to defined instances, such as to the giving of directions to continue to provide essential services to the distressed entity for fair value?***

In principle, we do not consider that an appointment of a receiver or liquidator to a non-regulated subsidiary should require any specific limitation in any power that APRA might obtain to give directions to a non-regulated subsidiary (see comments at 1.1.1(c) above).

We reiterate our comments at 1.1.1(c) above regarding the importance of ensuring that stakeholders in the non-regulated subsidiary or the NOHC know how they will be dealt with in the event that they have been left worse off than they would have been if the entity had been liquidated. This would include any loss suffered as a result of directed services or functions being provided on less than just terms (including the receiver's or liquidator's reasonable costs associated with the service or function).

It is also important to note that a receiver or liquidator would need to know how any funding requirement to enable compliance with directions from APRA would be dealt with.

(e) ***Would a combination of Options A and C (or other combinations) provide a more flexible tool for resolving financial distress in groups, such that the ability for APRA to give directions to subsidiaries might reduce (but not necessarily eliminate) the need to appoint a statutory or judicial manager to a subsidiary?***

In principle, we consider that Option D (being a combination of Options A to C) would provide a more flexible tool for resolving financial distress in groups.

We reiterate our comments at 1.1.1(b) and 1.1.1(c) above regarding the importance of ensuring that stakeholders in the non-regulated subsidiary know how they will be dealt with in the event that fair value has not been obtained or they have been left worse off than they would have been if the entity had been liquidated.

We also reiterate our comments at 1.1.1(d) above regarding the importance of ensuring that a receiver or liquidator knows how any funding requirement to enable compliance with directions from APRA would be dealt with.

These matters would need to be addressed in the drafting.

(f) ***Would any of the options discussed increase the cost of doing business?***

We consider that the options discussed above are likely to increase the cost of business to the extent that the board of an NOHC or non-regulated subsidiary, (or, if appointed, a receiver or liquidator) are likely to seek legal advice on their obligations following an appointment of an SM or JM or upon receiving directions from APRA.

In addition, in the event that a receiver or liquidator is required to keep the administration open longer than would otherwise be necessary to comply with directions from APRA, additional compliance and administrative costs are likely to be incurred.

1.1.2 Management of insurers in a crisis

In principle, we support amending the Insurance Act and Life Insurance Act to empower APRA to appoint an SM to a general or life insurer, an authorised NOHC and subsidiaries of an authorised NOHC and insurer in particular situations. Such situations would be where the insurer is large, or its distress poses a risk to the financial system or economy, or it is part of a complex financial group, or a rapid resolution response is needed.

Discussion questions

(a) ***Are there any reasons why APRA should not be empowered to appoint an SM (in addition to its existing power to apply to a Court for the appointment of a JM) to insurers (and related parties, as discussed above) in the circumstances outlined above?***

No. We consider that the proposals offer the flexibility to be able to move quickly in appropriate circumstances.

(b) ***Are the proposed limits on the power outlined above appropriate?***

Whilst the proposed grounds upon which APRA might appoint an SM to a general or life insurer, an NOHC or non-regulated subsidiary include the same grounds for applying to the Court to appoint a JM, they also include additional grounds. These include the introduction of criteria that differ to those set out in the Banking Act that apply to the appointment of an SM to an ADI. This involves situations where APRA has reasonable grounds to conclude that an insurer's financial position is "rapidly deteriorating" or its circumstances have the potential to "pose a risk to the stability of the Australian financial system, the economy, or a significant part of the economy".

We recommend that the circumstances under which this power is exercised would need to be defined more clearly.

(c) ***Are there other circumstances in which APRA should be empowered to appoint an SM to an insurer?***

No comments.

1.2 Clawback of capital transfers from regulated entities

In principle, we do not support the proposed amendment that the clawback provisions of the Corporations Act be temporarily prevented from having effect, as this would prejudice a fundamental right of recovery for creditors of the NOHC or related entity and would be inconsistent with how voidable transactions are dealt with in the normal course of a winding up.

The onus to prove a clawback claim rests with the liquidator of the NOHC or related entity. In practice, it is likely to take the liquidator a period of time to investigate the potential voidable transaction in order to determine whether there is a prima facie claim. Generally, if the liquidator determines that there is a prima facie claim, he or she is likely to seek legal advice on the merits and prospects of such a claim, before seeking recovery from the regulated entity. Depending upon the complexity of the relevant transaction(s) and/or quality of the evidence, this stage of the process could range from several weeks to many months.

If the regulated entity was to defend such a claim and Court proceedings were required to resolve the issue, assuming that the Court grants leave for the liquidator to commence proceedings, the whole process could be extended by many more months if the matter went to judgment.

The reality is that the regulated entity is unlikely to be in a position that it is obliged to compensate the NOHC or related entity as a result of a clawback claim during the early days following the appointment of an SM.

Discussion questions

(a) ***If this proposal were adopted, what safeguards and limitations should be imposed on APRA's power to temporarily limit clawback?***

We reiterate our comments at 1.2 above.

However, if the proposal was to be adopted to ensure that APRA has a guaranteed minimum period to assess the situation and provide alternative financial support to the regulated entity if necessary, we consider that the period of suspension should be limited to a maximum period (see comments at 1.2(b) below).

In addition, some form of financial compensation should be available for the NOHC or related entity for forgoing its right to pursue the clawback claim earlier. Such compensation would be subject to the claim either being agreed or settled between the parties or determined by the Court (**Resolved Amount**). The compensation could be in the form of interest payable on the Resolved Amount calculated for the period the clawback claim was suspended.

If the clawback claim was successfully defended or subsequently withdrawn, no compensation would be payable.

(b) ***For what period would it be appropriate to suspend clawback?***

We reiterate our comments at 1.2 above.

However, if the proposal was adopted to suspend clawback to ensure that APRA has a guaranteed minimum period to assess the situation and provide alternative financial support to the regulated entity if necessary, we consider that the period of suspension should be limited to no more than six months from the date of appointment of an SM.

2 Enhancing APRA's direction powers – scope and efficacy

No comments.

3 Australian branches of foreign entities

No comments.

4 Enhancing the statutory management and judicial management legislative frameworks

4.1 Appointing a statutory or judicial manager

4.1.1 Broaden the grounds for appointing a statutory manager to enable earlier appointment

In principle, we support amending section 13A of the Banking Act to broaden the grounds for appointing an SM to enable earlier appointment in appropriate circumstances.

Discussion questions

(a) ***Is it appropriate that APRA's power to appoint an SM to an ADI be expanded in the manner proposed?***

The first of the proposed expanded grounds is where there has been, or APRA has a reasonable basis to believe there will be, a material deterioration in the ADI's financial condition that could pose a risk to the ADI's depositors or to the stability of the financial system in Australia. This is similar to one of the proposed amendments to empower APRA to appoint an SM to a general or life insurer, an authorised NOHC and subsidiaries of an authorised NOHC and insurer in particular situations referred to at 1.1.2(b) above.

We recommend that the circumstances under which this power is exercised would need to be defined more clearly.

The second of the proposed amendments to expand the grounds where APRA can appoint an SM to an ADI is where the ADI has failed to comply with a direction given to it by APRA. This proposed amendment is vague and we recommend that further guidance on the specific types of directions be provided (similar to section 104 of the Insurance Act and section 230B of the Life Assurance Act).

(b) ***Are there any safeguards that should be attached to the power?***

It is very difficult to comment without seeing more detail of the criteria for the proposed expanded powers (see comments at 4.1.1(a) above).

4.1.2 Enable a statutory or judicial manager to be appointed to a regulated entity if an authorised NOHC is placed into external administration

In principle, we support amending section 13A of the Banking Act and the corresponding sections of the Insurance Act and Life Assurance Act to permit APRA to appoint an SM to the ADI, in circumstances where APRA believes that the appointment of an insolvency administrator to the authorised NOHC poses a significant threat to the operation and soundness of the ADI.

We recommend that the circumstances under which this power is exercised would need to be defined more clearly.

4.1.3 Broaden the grounds to appoint a judicial manager to an insurer

In principle, we support amending the relevant sections of the Insurance Act and Life Assurance Act to broaden the grounds where the Federal Court may make an order to appoint a JM to an insurer where it is in the interests of the policyholders of the insurer or of financial system stability in Australia.

We recommend that the circumstances under which this power is exercised would need to be defined more clearly.

4.1.4 Enable a statutory manager to be appointed to a bridge bank or bridge insurer

Discussion questions

(a) ***Is it appropriate for an SM or JM to be appointed to a bridge bank or bridge insurer?***

In principle, we support amending the Banking Act to empower APRA to appoint an SM to a bridge bank or bridge insurer in appropriate circumstances. This proposed amendment would allow APRA to move quickly to transfer the business of a financially distressed ADI or insurer without having to wait to find suitable directors and a CEO for the bridge bank or bridge insurer.

(b) ***Are there any risks associated with appointing an SM or JM to a bridge bank or bridge insurer?***

Any SM or JM should have appropriate capacity and experience to operate the bridge bank or bridge insurer and have a clear mandate in which to operate. Whilst a bridge bank or bridge insurer would be a new and solvent vehicle relieved of the financial distress of the original entity, an insolvency practitioner experienced in managing complex trading operations may be suitable for the SM or JM role, as they would have the commercial expertise and risk management skills to assume effective control at short notice.

APRA might like to give some consideration to how the relevant bridge bank or bridge insurer would be run once an SM or JM has been appointed, and what expertise would be available that was adequate for the challenges that would be faced by the SM or JM. While the ability to appoint an SM or JM might potentially be a useful power, it raises the prospect of how an SM or JM would carry out its function, and we think this needs further consideration.

4.1.5 Clarify that the appointment of a statutory/judicial manager (or a compulsory transfer of business) does not enable a party to a contract with a regulated entity to access security/collateral lodged under the contract

In principle, we support amending section 15C of the Banking Act and the equivalent provisions in the Insurance Act, Life Insurance Act and Business Transfer Act to make it clear that the mere appointment of an SM or JM, or the compulsory transfer of a business does not trigger terms in contracts entitling counterparties to realise or otherwise obtain the benefit from security or collateral lodged by regulated entities with these counterparties.

We note, however, that the benefit of such amendments is unlikely to be realised if the entity is already subject to an insolvency administration. This is because the “ipso facto” clauses found in many commercial agreements allow counterparties to terminate contracts upon a company’s entry into external administration. Therefore, if the entity has entered external administration prior to the appointment of an SM or JM, any right on the part of the counterparty to take action in realising or otherwise obtaining benefit from the security or collateral may have already been triggered.

Unless changes are made to commercial insolvency law along the lines of the existing section 15C of the Banking Act, APRA will need to ensure that any appointment of an SM or JM is made before the commencement of an insolvency administration if the value of the commercial agreements of the regulated entity is to be preserved (see our comments at 4.1.6 below).

4.1.6 Clarify the effect the appointment of a statutory manager or judicial manager has on a deed of company arrangement

We support amending the Industry Acts to make it clear that the appointment of either an SM or JM has the effect of terminating all other forms of external administration, including a deed administrator and the terms of a DOCA, to ensure that depositors and policyholders' interests are adequately protected.

We do not support empowering the Court to be able to make orders setting aside transactions entered into or payments made under the DOCA before the appointment of the SM or JM, or altering the terms of the deed itself, as this is likely to undermine the integrity of the DOCA process and create uncertainty for creditors.

It would be better for APRA to appoint an SM of JM (if considered appropriate) prior to the proposal meeting at which creditors decide on the future of the company (which may include that the company execute a DOCA). The proposal meeting is to be held within 28 to 35 business days of the commencement of administration, unless the court orders otherwise (it may, however, be adjourned but for no longer than a maximum of 45 business days, without court permission).

If APRA were to intervene at the stage prior to creditors approving a DOCA, it would avoid the issue of trying to unravel transactions or payments made in accordance with the DOCA, or trying to alter terms of the DOCA that have been agreed to by creditors.

The proposals at 5.2.3 below regarding extending legislative amendments so that APRA requires advance notification of all forms of external administration of a regulated entity may help avoid this situation altogether, by providing APRA with a final opportunity to appoint an SM or JM before a voluntary administrator is appointed.

As mentioned in our comments at 4.1.5 above, as the appointment of a voluntary administrator to a regulated entity is likely to trigger the "ipso facto" clauses that allow counterparties to terminate contracts upon a company's entry into voluntary administration, we consider that it would be preferable for APRA to intervene (if appropriate) before a voluntary administrator is appointed.

4.2 Moratorium provisions

In principle, we support the current moratorium provisions being repealed and replaced with a new, standardised set of provisions in the Industry Acts, drawing on relevant provisions in the Corporations Act and in the external administration regimes in other jurisdictions.

We feel it is important that the Court be the final arbiter in relation to moratorium issues. Providing that creditors and counterparties have a right to present their case to the Court, we consider that the proposed measures strike the right balance between the protection of depositor/policyholder interests and Australian financial system stability on the one hand, and the recognition of creditor and counterparty rights on the other.

In addition, we recommend that consideration be given to expressly including "garnishee" notices issued by the Tax Commissioner. Under section 260-5 of the *Taxation Administration Act 1953*, the Commissioner for Taxation is empowered to collect tax due by a taxpayer by giving notice to the debtors of the taxpayer that such debts are to be repaid not to the taxpayer, but instead to the Commissioner. If not protected by the moratorium, there is potential for assets of the ADI or insurer to be diverted to the ATO before the SM or JM has had an opportunity to determine and implement appropriate resolution measures. (Please refer to our comments at 4.6 below regarding recognition of the statutory and judicial management regimes by the ATO)

4.3 Powers and immunity of statutory and judicial mangers

4.3.1 Ensure that a statutory manager's ability to manage an ADI's business is not compromised by the priority provision in the Banking Act

In principle, we support that the Banking Act be amended to put beyond doubt that an SM is able to manage an ADI's business in accordance with the provisions of the Banking Act without being constrained by the operation of subsection 13A(3).

4.3.2 Statutory immunity for statutory and judicial managers

In principle, we support that the immunity provisions in the Industry Acts be amended to ensure that the higher level of protection currently applicable to APRA staff and agents under the APRA Act is accorded to SMs and JMs.

4.4 Removing statutory managers

4.4.1 Enable APRA to terminate its control of an ADI or to remove a statutory manager

In principle, we support that section 13C of the Banking Act be expanded to enable APRA to terminate its control or to remove an SM where APRA is satisfied that the ADI has been restored to a sound financial condition and that APRA's control or statutory management are no longer required; or where voluntary winding-up proceedings have been commenced.

4.4.2 Replacement of a statutory manager

In principle, we support that section 14E of the Banking Act be amended to make clear that APRA can terminate the appointment of an SM and replace that person with another SM where APRA believes this would be desirable for the purpose of satisfactorily resolving the business of the ADI in statutory management, maintaining confidence in the resolution process, protecting the interests of depositors or maintaining the stability of the financial system.

We recommend that the circumstances under which this power is exercised would need to be defined more clearly. In addition, we consider that the mechanism for replacement of a removed SM together with the associated "handover" obligations needs to be addressed in the drafting.

4.5 Obtaining information from entities under statutory or judicial management

4.5.1 Require directors to submit a report to statutory or judicial managers

In principle, we support provisions similar to section 475 of the Corporations Act being inserted into the Industry Acts to provide that directors and the secretary (including former directors and secretaries) of an ADI or insurer must submit to the SM or JM a report as to the affairs of the institution upon the appointment of an SM or JM unless the SM or JM, with APRA's approval, waives the obligation. This would include penalties for non-compliance without reasonable excuse.

4.5.2 Power to obtain information under judicial management

In principle, we support the Insurance Act and Life Insurance Act being amended so that these Acts are consistent with section 14AD of the Banking Act, to empower APRA to require, by notice, a person to provide APRA with information relating to the business of an insurer that is under judicial management.

4.6 Minor and technical amendments

In principle, we support all of the proposed amendments to the statutory and judicial management regimes set out in this section of the Options Paper.

In addition, we recommend that consideration be given to amending the relevant legislation so that the Australian Securities & Investments Commission (**ASIC**) and the Australian Taxation Office (**ATO**) are required to recognise SM and JM appointments.

Our experience has been that ASIC does not recognise the lodgement of notices concerning the appointment of a JM. Accordingly, there is nothing on the ASIC register to indicate that the institution is subject to a judicial management regime.

Our experience also reveals that the ATO does not recognise the concept of judicial management in terms of the lodgement of a company tax return and a notice of assessment. Accordingly, there is great scope for confusion and uncertainty concerning the ATO's powers to issue notices and returns when the company is in judicial management.

5 Powers in relation to winding up and external administration of regulated entities

5.1 Clarifying the winding up regime under the Industry Acts and Corporations Act

5.1.1 Clarifying provisions in the Industry Acts regarding the winding up of regulated entities

In principle, we support all of the proposed amendments to the Insurance Act and Life Insurance Act set out in this section of the Options Paper to remove the uncertainty regarding the grounds under which the Federal Court is able to make a winding up order in respect of a general insurer and life company.

5.1.2 Clarifying that voidable transactions are applicable where a winding up order has been made under an Industry Act

In principle, we support the relevant legislation being amended to ensure that the Corporations Act provisions concerning voidable transactions (in particular, the definition of "relation-back day") are applicable in a situation in which a Court has made a winding up order under the Insurance Act or Life Insurance Act.

5.1.3 Specifying the relation-back day

In principle, we support the relevant legislation being amended to recognise that where the entity was under statutory management or judicial management immediately before the order was made, the deemed commencement of winding up and relation-back day are the date of appointment of the SM or JM.

In the event that the entity was under external administration at the time of appointment of the SM or JM, we consider that the deemed commencement of winding up and relation-back day should be the commencement date of the first external administration.

5.2 Expanding the scope of the winding up and external administration provisions in the Industry Acts

5.2.1 Ensuring that APRA's existing powers in the winding up of a regulated entity extend to where a provisional liquidator is appointed to the regulated entity

In principle, we support the proposal that APRA be given standing to apply to the Court to give directions in relation to the powers of a provisional liquidator appointed to an APRA-regulated entity.

5.2.2 APRA to apply for the winding up of an ADI without the ADI having first been placed in statutory management

In principle, we support the proposal that section 14F of the Banking Act be amended to empower APRA to apply to the Court for the winding up of an ADI where APRA considers that the ADI is insolvent and could not be restored to solvency within a reasonable period, regardless of whether an SM has been first appointed to the ADI.

5.2.3 Providing APRA with notice of proposed applications for external administration

In principle, we support the proposal that the 2010 legislative amendments be extended so that the notification requirement is applicable to all forms of external administration, including those that are Court appointed.

As mentioned in our comments at 4.1.6 above, we consider it important for APRA to receive information about any prospective appointment of an external administrator to a regulated entity, or to a regulated entity's property, before the external administrator is appointed. This would allow APRA to understand the circumstances giving rise to the proposed appointment and for APRA to take appropriate and timely action if necessary.

Generally, we would anticipate that there would have been a period of engagement between APRA and the regulated entities and its advisors (including insolvency practitioners) preceding any final decision about external administration.

Discussion question

Will the proposed amendment impose any material compliance costs on regulated entities or insolvency professionals appointed to administer a regulated entity?

Depending upon the level of detail required by APRA, the actual cost of a written notification might not be material. In order to keep costs to a minimum, we would recommend that consideration be given to drafting a standard form of notice for this purpose.

5.2.4 Harmonising the Industry Acts on APRA's involvement in the external administration of regulated entities

In principle, we support the proposal to harmonise the Industry Acts by inserting provisions into the Banking Act that currently exist under the Insurance Act and Life Insurance Act, regarding APRA's rights:

+ to apply to the Court for directions on any matter arising under the winding up of the regulated entity, its authorised NOHC or non-regulated subsidiaries; and
+ to request information from the liquidator about the winding up of the regulated entity, its authorised NOHC or non-regulated subsidiaries.

Discussion question

Will the proposed amendment impose any material compliance costs on regulated entities or insolvency professionals appointed to administer a regulated entity?

Whilst we consider the proposed amendment has potential to impose material compliance costs, we believe that it is important for the industry regulator to have such rights given the potential impact on the interests of depositors or policyholders.

5.2.5 Ensuring that a judicial manager may be appointed to an insolvent insurer

In principle, we support the proposal to amend Part VB, Division 1 of the Insurance Act and Part 8, Division 1 of the Life Insurance Act to ensure that the Federal Court may appoint a JM to an insolvent insurer.

5.3 Clarifying circumstances surrounding 'courses of action' for insurers under judicial management

In principle, we support the proposal to amend the Insurance Act and Life Insurance Act so that the Court and JMs are not unduly constrained by the requirement to promote financial stability in cases where broader financial system stability is not relevant.

6 The Financial Claims Scheme

6.1 Proposed enhancements to the FCS framework for both ADIs and general insurers

6.1.1 Automatic declaration of the FCS

In principle, we support the proposal that the FCS for general insurers be activated automatically at the time that APRA applies to the Court for the winding up of an insolvent general insurer and where, at the time the application is made, the general insurer may be subject to claims that are eligible for protection under the FCS.

We are pleased to note that the Minister would retain the discretion to declare the FCS for a general insurer before the application for winding up, such as when a JM is appointed, upon the recommendation of APRA.

At present, a specific value (estimated claim deficit) is required to be determined before the FCS can be set up. It is unclear to us how the quantum of funding would be determined if the FCS is automatically triggered. Further guidance on this issue would be helpful.

6.1.2 Enabling the FCS to be used to facilitate a transfer of insurance business from a failed general insurer where this is more cost-efficient than effecting a payout to claimants

In principle, we support the proposal that the Insurance Act be amended to enable funds appropriated under an FCS declaration to be used to facilitate the transfer of policy liabilities from the failed general insurer to another general insurer willing to assume those liabilities in circumstances where APRA determines this to be feasible, cost-effective and efficient.

Discussion questions

(a) ***Is it appropriate to allow FCS funds to be used to facilitate the transfer of policy liabilities from a general insurer subject to an FCS declaration to another general insurer willing to accept the policy obligations where APRA assesses this to be feasible, cost-effective and efficient?***

Yes.

(b) ***Are there legal or practical impediments to enabling the FCS to be applied to facilitate the transfer of policy liabilities from a failed general insurer to another general insurer?***

It is important to ensure that the transferee company deals with policyholders/ claimants appropriately and in line with the FCS provisions for protected policyholders. Accordingly, appropriate policing of the management of eligible policyholders' claims may be required.

6.1.3 Enabling APRA to obtain information from third parties in relation to the FCS

In principle, we support the proposal that the Banking Act and Insurance Act be amended to enable APRA to require information from a third party where such information will facilitate FCS administration.

On occasions, we have had difficulty in obtaining information from policyholders (or their representatives) to allow FCS eligibility to be determined. We would therefore recommend that such proposed amendments expressly include the policyholders themselves and their representatives.

Discussion question

Are there practical/legal considerations or other impediments to enabling APRA to require information relating to the FCS from third parties?

We consider that there are likely to be issues around compliance costs. Third parties are likely to look to APRA to cover the reasonable costs of compliance.

In addition, there could be occasions where third parties assert a lien or a claim of legal professional privilege over documents that would provide relevant information relating to the FCS. Consideration should also be given to amending the Industry Acts to enable APRA to overcome such situations, to the extent that it is possible to achieve this through changes to the relevant Acts.

6.1.4 Ensuring certainty of payment of FCS entitlements made by APRA

In principle, we support the proposal that the Banking Act and Insurance Act be amended to require a liquidator of an ADI or general insurer that is declared to be subject to the FCS to accept as proof of debt the amounts paid under the FCS by APRA.

Discussion questions

(a) ***Are there practical/legal considerations or other impediments to making amounts relating to FCS payouts binding upon liquidators in the winding up of an ADI or general insurer in respect of which the FCS has been declared?***

We accept that amounts relating to FCS payouts made on the basis that APRA has complied with the requirements of the Banking Act and Insurance Act (as the case may be), and with any applicable contractual arrangements entered into with the liquidator, should be binding upon liquidators. Any amounts paid out under the FCS that do not meet this criterion, however, should be subject to the normal claim adjudication process, to ensure that the position of creditors generally is not prejudiced. For example, a liquidator would need to consider the admissibility for dividend purposes any ex-gratia payments approved by APRA on compassionate (or sensitivity) grounds, which might not necessarily constitute liability under the policy.

(b) ***Are other creditors of a failed ADI or general insurer adequately protected by the proposed safeguard?***

So long as any amounts claimed relating to the FCS that do not comply fully with the requirements of the Banking Act and Insurance Act (as the case may be), and with any applicable contractual arrangements entered into with the liquidator, are subject to adjudication by the liquidator, we consider that the other creditors should be adequately protected.

(c) ***Are there other safeguards that should be considered in this proposal?***

See our comments at 6.1.4(a) and 6.1.4(b) above.

6.2 Proposed enhancements specific to the ADI FCS framework

6.2.1 Enabling regulations to be prescribed for refining the definition of 'net credit balance' to suit particular circumstances

Discussion question

Is it appropriate that regulations to be made to allow APRA to determine what fees and charges are to be applied where this is not clear under the agreement under which an account is kept?

We consider it would be reasonable for APRA to determine what fees and charges are to be applied where this is not clear under the agreement under which an account is kept.

Any regulations to allow APRA to determine what fees and charges are to be applied should be accompanied by further regulation that would allow the account holder the right to appeal to the Court for a review of any such determination by APRA.

6.2.2 Enabling the suspension of FCS payments in respect of accounts that are the subject of a suspension, injunction or freezing order pending a determination that payment is appropriate

Whilst in principle we are supportive of the proposals to amend the Banking Act to enable the suspension of FCS payments in respect of particular frozen accounts, it is very difficult to comment further without seeing more detail.

6.3 Proposed enhancements specific to the general insurance FCS framework

6.3.1 Ensuring that the liquidator of a general insurer in respect of which the FCS is declared provides reasonable assistance to APRA in administering the FCS

In principle, we support the proposal that the same amendments as those mentioned in this section of the Options Paper made to the Banking Act by the 2010 Act, be made to the Insurance Act in respect of liquidators of general insurers for which the FCS has been declared.

6.3.2 Ensuring the effective payout of FCS entitlements to third party claimants of a policyholder of a failed general insurer where the policyholder is in liquidation

In principle, we support the proposal that the relevant legislation be amended to provide that amounts paid out under the FCS to an insolvent policyholder must be paid by the liquidator of the policyholder to whom they are due in priority to all payments under section 556 of the Corporations Act.

6.3.3 Enabling APRA to make interim payments to claimants under the FCS

In principle, we support the proposal that the Insurance Act be amended to provide APRA with the discretion to make interim payments under the FCS.

6.3.4 Extending the interim period of notional insurance coverage to 90 days

In principle, we support the proposal that the Insurance Act be amended to extend the interim period of notional insurance coverage to 90 days after the FCS has been activated.

Consideration may like to be given as to whether the 90-day extension should be optional at the Minister's discretion.

Discussion question

Would the extension of the 28-day period of notional insurance coverage under the FCS to 90 days have any consequences other than those outlined above?

No comments.

6.3.5 Clarifying that APRA need not make separate decisions in relation to claim validity/quantum and claimant eligibility in every case of a claim made under the FCS

In principle, we support the proposal that the Insurance Act be amended so that APRA has a single obligation to make a decision as to whether a person is entitled to be paid under the FCS, rather than having obligations to make separate decisions as to validity/quantum and eligibility.

6.3.6 Clarifying that APRA may do various things in determining a claim under the FCS

In principle, we support the proposal that the Insurance Act be amended to clarify the kind of actions that APRA may take in the course of determining a claim under the FCS, such as engaging claims assessors, legal advisors, actuarial advisors and medical experts. We also support an entitlement for APRA to be able to prove in the winding up of an insolvent general insurer for the reasonable costs of such third party assistance, subject to the normal liquidation adjudication process.

We consider that it would also be appropriate to consider providing clarity concerning the responsibility for payment of run-off related administrative costs of the claims manager.

6.4 Minor drafting amendments to the Banking Act and Insurance Act in respect of the FCS

In principle, we support the proposal to make the minor drafting amendments to the Banking Act and Insurance Act set out in this section of the options Paper.

7 Financial market infrastructure

No comments.

8 Simplification and streamlining of Acts administered by APRA

No comments.

9 Proposals specific to Acts supervised by APRA

No comments.

10 Request for cost-benefit analysis information

No comments.