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McGRATHNICOL
CORPORATE RECOVERY

31 January 2012

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

By email: insolvency@treasury.gov.au

BY POST AND EMAIL

Dear Sir/Madam

Review of December 2011 Proposals Paper (Insolvency Law Reform)

McGrathNicol is a national practice of 30 partners, 18 of whom are registered liquidators; in addition, three of our senior employees are also registered liquidators. Our insolvency practice is confined to corporate matters typically the larger, more complex matters; we do not practice in bankruptcy.

We welcome the opportunity to make a submission in regard to the proposals set out in the Proposals paper: A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia ("the Proposals"). Our comments are set out in the attachment to this letter and follow the chapters of the Proposals document. References in square brackets are to the paragraphs of the Proposals.

Our comments address aspects of the proposals where we wish to point out practical implications, concerns regarding the effectiveness of the proposals or the manner in which they may be implemented.

If you have any queries in relation to our comments, please contact me.

Yours faithfully

Robyn McKern
Partner, CEO

Enclosure(s):
McGrathNicol's submission

Level 8, IBM Centre, 60 City Road, Southbank VIC 3006, Australia GPO Box 9986, Melbourne VIC 3001 T +61 3 9038 3100 F +61 3 9038 3199
McGrathNicol Partnership ABN 41 945 982 761. Liability limited by a scheme approved under *Professional Standards Legislation* **mcgrathnicol.com**

Attachment 1 – McGrathNicol's feedback and comments on the Proposals paper

Glossary of terms and abbreviations

COI	Committee of Inspection
CoPP	The IPA Code of Professional Practice
ICAA	Institute of Chartered Accountants in Australia
IEP	Insolvency Education Program
IP	Insolvency Practitioner
IPA	Insolvency Practitioners Association of Australia
VA	Voluntary administration or voluntary administrator

Chapter 2 – Standards of Entry into the Insolvency Profession

Qualifications requirements

The reform proposals, which only require as little as one year of each prescribed area of study [26(a)] represent a significant lowering of standards. Currently, study in accountancy of not less than three years duration and commercial law of at least two years in addition to a relevant post graduate course of study is required. The proposal to reduce the education requirements appears contrary to the overall goal of the reform package of promoting "a high level of professionalism and competence by practitioners" [4]. Accordingly, we do not support this proposal.

We acknowledge that the study of commercial law is useful for the practice of corporate insolvency, however we consider a single year of accounting studies for a corporate insolvency practitioner to be inadequate, particularly in light of the demands on practitioners in the following matters:

+ trading engagements (voluntary administrations, receiverships and occasionally liquidations) where understanding the financial position of the company and managing cash flow ramifications of trading is essential;
+ investigations into antecedent transactions and insolvent trading which requires skill in interpreting financial information and identifying "window dressing" accounting practices; and
+ VA engagements which inevitably involve significant accounting skills in preparing the s439A report. Although outsourcing may solve this to an extent, the availability of funding as well as tight time constraints may prevent significant accounting advice being obtained in VA engagements.

The proposals suggest a further weakening of educational standards in that the IPA IEP (a post graduate course which includes insolvency specific law and accounting content), or similar, may form part of the collective 3 years of tertiary study. In our view such a post graduate qualification should be obtained in addition to the three year course of undergraduate study, not form part of that requirement.

Experience

The experience requirements are proposed to be reduced (from 5 to 3 years) in the case of corporate insolvency, although increased for personal insolvency practitioners (from 2 to 3 years). If the current registration pre-requisite of broad experience across a range of external administrations and for all major categories of tasks within these (at a senior level on complex engagements) prevails, then this timeframe is inadequate. We do not think in practical terms the breadth of experience currently required can be achieved in as little as 3 years. Harmonisation of the personal and corporate insolvency regimes does not fit well in this aspect; the demands of the two regimes are not directly comparable; there are fewer types of appointments in personal insolvency and trading engagements are significantly less common.

We do not support reducing experience requirements on the basis that lowering of standards is unlikely to be conducive to improved quality and efficiency of insolvency services.

The proposals provide little detail about the experience requirements in terms of quality or breadth. In our view it is appropriate, and aligned with the overall objectives of the reforms, to provide that the experience counted as relevant for qualification as a registered liquidator be broader than is currently the case. The current position is that the registration process is heavily focussed on court and creditors voluntary liquidations and voluntary administrations; it affords little credit for receivership/controllership work or for restructuring advisory work which involves referable insolvency skills. Taking this broader view of relevant experience would render the years of experience required more attainable and thereby potentially extend the population of professionals eligible to obtain registration.

Classes of registration – is discussed under Chapter 3 below.

Chapter 3 –Registration of Insolvency Practitioners

We support harmonisation of the personal and corporate insolvency regimes where appropriate but consider that the registration regimes cannot be identical; Trustees and Registered Liquidators should be separate registrations.

Controllership only registrations

Practitioners who focus on serving secured creditors (banks and financiers) ultimately find that much of their work ends up being receivership appointments. However, commonly, alternative appointments are necessary (VA, Scheme of Arrangement) to best preserve the value of the business (and, in turn, the return to creditors). Furthermore, it is very common that receiverships co-exist with VA and it is important for the efficiency of the overall outcome that both the VA and Receiver and Manager are experienced in the conduct, powers and duties the other appointment entails. Accordingly, in practical terms, we do not think the restricted registrations will hold any attraction for practitioners or secured creditors.

Restricted or conditional registrations in general

Adding additional classes of registration or qualifying registrations on the basis of experience adds unnecessary complexity to the registration regime and would likely be confusing for stakeholders. In practical terms, parties seeking out insolvency services commonly do not know what outcome or type of appointment may be necessary or appropriate until they have sought advice. Under the proposed regime a stakeholder could seek advice from a potential provider but find that ultimately the provider cannot service the optimal outcome; there is also the risk that a sub-optimal solution is proposed because that is the one which the practitioner is registered to provide. In our view opening up the regime to these possibilities is unnecessary. Aspiring registered liquidators should have the skills and experience to undertake all types of corporate insolvency or they should not be eligible to obtain registration. In our view the registration process should be kept as simple and transparent as possible.

Committee involvement in registration process

We are generally supportive of the proposal to have a Committee involved in registration decisions but note:

+ The insolvency profession is relatively small and it is important that protections be built into the processes to guard against the risks of this proposal requiring disclosure of commercially sensitive information to a competitor (e.g. details of work done, referral sources, methodologies or other intellectual property).
+ The Registration committee should be structured to maintain a reasonable degree of continuity of membership in order to facilitate efficient, consistent processing of applications.
+ The Registration Committee should not also have involvement in disciplinary matters.
+ We support the proposal to introduce an interview element into the registration process.
+ We oppose the proposal that the Committee be given the power to require certain applicants to undertake an examination to supplement the proposed interview. Insolvency practitioners should be able to conduct themselves effectively in an interview situation and, if they are unable to do so, then their application should be rejected.
  – We query the educational value of an examination in addition to the requirement to complete the IEP program (or similar) and suggest that the cost of administering the examination (which will be particularly high per candidate given the small number of applicants per annum) would outweigh any corresponding quality benefits.
+ We support the proposal to require the renewal of liquidators' registration tri-annually, but recommend that there be no fee additional fee to that levied on lodgement of the annual Form 908s.
+ Whilst not addressed in the proposals paper, we suggest that it would be beneficial if the title "Registered Liquidator" be replaced with a term which excludes the word "Liquidator". It is easy for the public to be confused that a Registered Liquidator does not have the powers of a Liquidator if (s)he is acting as a Receiver or Controller. Perhaps "Registered Insolvency Practitioner" would suffice.
+ We support the concept of ASIC being able to impose conditions on all registered liquidators.
+ As our earlier comments suggest, we are of the view that a practitioner should have adequate qualifications and experience before being registered. Conditions which go to limiting the type of company or appointment which can be taken are, in our view, unnecessarily complex and likely impractical. It is the very nature of insolvency that the complexities which may arise in any particular assignment are not necessarily known in advance and the complexity of a matter is not necessarily a function of the type of company, the value of assets or the quantum of creditors involved. Further, if the practitioner specific conditions restrict the practitioner from involvement in matters of a particular type, the lack of experience in that type of matter is perpetuated.

Chapter 4 – Remuneration Framework for Insolvency Practitioners

Streamlining of minimum remuneration provisions

+ We support the streamlining of the minimum remuneration requirements but note that the amount of the minimum fee in liquidations has remained unchanged since 2007. Section 473(4A)(e)(ii) provides for an amount to be specified in regulations. We would like to see a new regulation introduced that increases the minimum fee amount in line with CPI.

Fee Caps and disbursements

+ We support the proposals regarding fee caps and disbursements which are aligned with the IPA CoPP.

Casting Vote

+ The IPA COPP provides that except in very limited circumstances, a Practitioner should not use the casting vote in relation to any resolution determining or fixing the Practitioner's remuneration. Whilst the proposed prohibition on the use of the casting vote for the approval of remuneration would remove any perception of self-interest, it would not resolve deadlocked votes which require cost to be incurred on seeking a resolution in the courts.

+ We do not believe it necessary to change the current arrangements for use of the casting vote, however, if the casting vote is to be prohibited so as to align with the bankruptcy law, then the resolution requirements should also be made to align, as this would obviate deadlocks by allowing the resolution to be passed by a majority in value.

Cost assessment in corporate insolvency

+ Whilst this reform is reasonable in principle, appropriate rules are required to prevent nuisance or vexatious requests, which could cause the administration to incur unreasonable costs and delays.

+ Typically insolvency work has a high working capital requirement due to the difference in payment terms of key inputs (staff costs) and recovery of fees (which is periodic). If this reform regularly adds further process to delay receipt of revenue, it may lead to increased base charge rates across the industry.

+ In terms of process, we submit that:

  – The regulator should be required to show cause as to why it is intending to appoint a cost assessor.

  – There should be a preliminary process before a creditor seeks a formal assessment. For example, this could involve:

    - firstly, the creditor seeking engagement with the IP to clarify and/or obtain additional information within 7 days of receipt of the remuneration report;

    - secondly, if dissatisfied with the responses from the IP, the creditor would serve a notice on the IP clearly setting out their issues and concerns regarding the remuneration report and requiring the IP to respond within a 14-day period;

    - finally, if the creditor remains dissatisfied after considering the IPs response to the formal notice, they would have a further period of 14 days to apply to court for an assessment.

  – The remuneration report and subsequent correspondence, notice and response would be put before the court to assist it in determining whether an assessment is reasonable and appropriate in all the circumstances.

  – The reform must involve time limits within which information requests must be made and complied with (as suggested above) so as to provide greater clarity for stakeholders and the progress of the administration and avoid a situation where an assessment is sought after an inordinate delay, particularly where the remuneration has been duly approved and drawn in the interim.

+ The introduction of a standard form remuneration report would assist creditors in assessing remuneration requests. The remuneration report format recommended by the COPP provides a practical template and could be introduced as a prescribed form for remuneration reporting.

Chapter 5 – Communication and Monitoring

Committee of inspection ("COI")

The expansion of the role of the COI to include "supervisory" in addition to "advisory" responsibilities is inappropriate. COI members are neither qualified, impartial nor regulated; they should not be positioned as supervising IPs.

We submit that items (e), (f) and (g) in the proposal at [87] are unnecessary and are more likely to cause cost and delay in matters run by reputable, professional IPs than have the desired effect in matters run by unprofessional, rogue IPs. In our view, the proposed power for creditors to remove an IP is adequate to address differences in views as to how an administration is run. Composition of COI

We comment on these reforms as follows:

+ This reform would be enhanced by introducing minimum and maximum numbers for a COI.
  – We suggest that a COI should comprise of a minimum of three members and a maximum of 11 members, depending upon the size and complexity of the administration. We consider that a committee exceeding 11 is likely to become unworkable.
+ The proposal to require the COI be representative of creditors [92] is impractical. In practice, it is commonly difficult to secure the interest of creditors in participating in a COI, particularly after the initial strategy and likely outcome of the matter has been settled. It would be close to impossible to maintain a "representative" committee.
+ The composition of the COI should remain an issue for the IP to consider and recommend to the creditors who are entitled to vote on the membership of the COI. The proposed ability for creditors to remove the IP is adequate to balance this power.

Reporting to stakeholders [94 – 99]

+ Whilst these reforms are reasonable in principle, appropriate rules are required to prevent nuisance or vexatious requests, which could cause the administration to incur unreasonable costs and delays.

Meetings of creditors [105 – 108]

Whilst this reform is reasonable in principle, appropriate rules are required to prevent nuisance or vexatious requests, which could cause the administration to incur unreasonable costs and delays.

Annual estate returns [110 – 112]

+ The current requirement of six-monthly Form 524 reporting on corporate insolvency is not burdensome and is a useful tool supporting efficient administration of matters. We submit that this requirement should be retained.
+ If annual reporting is to be introduced, we submit that the reporting date should be the anniversary of the date of appointment of the IP on the basis that, for any reasonable sized practice, it is impractical to concentrate this workload into a single month.
  – The CoPP already provides that any late fee or penalty imposed by a court, regulator or agency for late lodgement or other default should be borne by the IP. APES 330 does not have this requirement set out as precisely, but does require that fees and expense must be "necessary and proper" (in para 8.2) – a test which fines would fail.

Chapter 6 – Funds handling and record keeping

Funds handling

+ We support the proposal to introduce compound accounts subject to monetary and transactional caps [115]. However, consideration is required in regard to how interest is to be dealt with. In our view, compound accounts need to be held on a no interest, no fee basis; this will likely limit the extent to which compound accounts are used in practice.

+ In regard to the proposals to introduce penalty interest for late banked monies [116 – 117] we make the following comments:

  – In contrast to bankruptcy, regular regulatory reviews are not undertaken for corporate appointments, accordingly it is unclear how penalty interest is to be assessed.

  – In some instances it is not commercially prudent to deposit funds promptly (e.g. if cheques are received under terms that banking denotes acceptance of "full and final settlement" in a disputed matter).

  – We consider this regime would be likely to deliver little net benefit to creditors in corporate insolvency – particularly if compound accounts are introduced (which as noted above would need to be operated on a no interest basis) and in light of the increasing use of electronic funds transfers such that the receipt of cheques is less and less common. If harmonisation is the goal, we would recommend abolition of this regime in bankruptcy rather than introduce it into corporate insolvency.

Reviews [128 – 130]

In principle, we support the power of the regulator or court to instigate independent practitioner reviews but note that the proposal has limited detail. Matters which require consideration in the drafting include:

+ Clarification as to whether the ASIC reviews are part of a quality review process or in response to specific incidents. If part of ongoing quality review requirements there needs to be a limit as to the frequency with which IPs can be subject to review.

+ Clarification as to who constitutes an interested party for the purposes of court initiated reviews.

+ Court initiated reviews should be subject to ASIC consent and require the applicant to show cause to limit an IP's exposure to unwarranted and costly court actions.

+ ASIC reviews should require that the IP be notified of the basis of the application.

+ Protections will be necessary to guard against competitor IPs acting as reviewers and gaining access to commercially sensitive information and/or intellectual property through the course of reviews.

In regard to the report arising from a review, we submit that:

+ The IP subject to review should have the opportunity to comment on the report prior to its circulation.

+ The initial notification from ASIC or the court should clearly define the proposed recipients of the report.

+ The IP should have the opportunity to make recommendations and concerns regarding the risks to the administration in relation to the disclosure of the report and ASIC should be required to have regard to these views.

Chapter 7 – Insurance and annual fees

No comments

Chapter 8 – Discipline and deregistration of IPs

We make the following comments in regard to the proposals:

+ The IPA and Ministerial representatives on the Committee convened for disciplinary purposes should not be current practising IPs so as to prevent the risk or appearance of a conflict of interest.

+ Committees [166] and regulators [169] will be publicising decisions and reasons on disciplinary matters – we assume this would be similar to the ICAA's current publishing of disciplinary matters where in many cases the member is not named. As part of the natural justice process, publication of names should be withheld until any AAT appeal process [147] has been exhausted.

Chapter 9 – Removal and replacement of IPs

We accept the proposal to introduce the right for creditors to remove an IP but submit that this should not extend to "all forms of insolvency administration" [181]. This power should not extend to receivership and agent for mortgagee in possession which are in essence appointments made pursuant to contractual terms, albeit regulated under the corporations law. Court approved schemes should also be considered for exclusion as they are very expensive to initiate and they have already had extensive court scrutiny in that process and it should also be considered whether it is appropriate to allow this power in Provisional Liquidation given it is a short term, court supervised appointment.

In regard to the proposal that the court is not empowered to consider a party's application to remove an IP on the basis of merit or cost [184], we find it difficult to envisage how a court could consider whether the removal was improper without considering arguments as to merit. We submit that this requires further consideration.

We query whether an early initial notification to creditors [186] be required in assetless administrations and Provisional Liquidations.

We note that the proposals are largely silent in regard to the requirement and mechanism for replacement of a removed IP; this needs to be addressed in the drafting.

We are concerned as to how 'administration records' are to be defined for the purposes of transfer to a replacement IP – does it include the company records and the records of the IP him/herself? We are concerned about the commercial risk and potential conflict between professional indemnity insurance requirements and the proposed requirement to hand over work product and proprietary materials. We would submit that the regime which applies to auditors (where the outgoing auditor retains the original documents but provides any required copies to the incoming auditor) is more appropriate.

Chapter 10 – Regulator powers

We have some concern about the potential for conflict between the proposed disclosure of information provisions [199] and the need to retain commercial in-confidence information and comply with privacy law. We submit that the provisions regarding discretion to be exercised should be extended to include commercial in-confidence and privacy requirements as valid reasons for non-disclosure. IP's should retain the right to not disclose proprietary information and intellectual property.

The regulator-disclosure provisions are focussed on obstructive IPs [200]. We submit that this should be set as the starting point, that is the regulator's powers to intervene should be limited to cases where the IP has been obstructive.

The factors set out in [201] which are to be considered in the context of whether an IP can be directed to make direct disclosure, should also apply where the regulator makes the disclosure under [199]. In particular, the regulator must have regard to the IP's submissions regarding disclosure before the regulator proceeds with disclosure.

Increased reporting by ASIC is supported, provided it remains at a high level i.e. individual firms and IPs are not named [210-211].

Chapter 11 – Small business issues

No comments.

Chapter 12 – 2010 Corporate Insolvency reforms

Subject to reviewing the detailed legislation and understanding the mechanics and cost of the website for publication of notices we fully support the proposal to enable communications and notices by electronic means, by which we understand there will be an ASIC managed website where notices can be published. We submit that there needs to be some protections in event that ASIC website fails or is "down" preventing IP compliance with notice requirements.