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Dear Sir/Madam

Submission to Treasury – Insolvency reforms to support small business

Introduction

The Australian Credit Forum (**ACF**) welcomes the opportunity to make a submission to Treasury in respect of the exposure draft legislation released on 7 October 2020, proposed to give effect to the reforms to the *Corporations Act 2001* (Cth) (the **Act**) and the associated Regulations announced on 24 September 2020.

The ACF was established in the early 1970's by a group of senior credit professionals. The group recognised the need to develop an association where members could meet on a regular basis to exchange thoughts and ideas to strengthen their own knowledge but also the standards of the industry.

The association meets on a regular basis to discuss and review existing and proposed changes to the Federal and State Governments legislation that might have an impact on their company's credit policies and practices in their day to day role as credit professionals.

The members of ACF are drawn from all areas of the credit profession across a range industry groups including by not limited to senior credit managers, members of the legal profession, insolvency practitioners, credit insurance underwriters and brokers, mercantile agents and credit reporting agencies. The depth and diversity in experience of the members ensures that a broad cross section of the credit industry considers the impact of all relevant legislation

Overview

The ACF welcomes the proposed reforms which recognises the current one-size-fits-all approach is not suitable for all Australian businesses and provides an avenue for small business to effectively navigate financial distress without the formality of administration or liquidation.

This submission addresses some of the key issues arising from our review of the exposure draft of the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (the **draft Bill**).

The ACF endorses the submission on the proposed reforms of the Australian Institute of Credit Management (**AICM**) dated 12 October 2020. The ACF shares AICM's support of the intent of the measures created by the draft Bill and agrees with the concerns raised by AICM's members. The ACF is supportive of the implementation of the recommendations made by AICM in their submission.

Key issues on the draft Bill

(a) Small Business Restructuring Practitioner

The draft Bill and accompanying explanatory materials do not provide guidance on the required qualifications for Small Business Restructuring Practitioners, aside from the requirement to be a registered liquidator. ACF understands the Insolvency Practice Rules will be amended to include provisions which establish a new class of registered liquidator who will be limited to practicing as a Small Business Restructuring Practitioner.

While ACF welcomes the introduction of a Small Business Restructuring Practitioner, there is scope for the process to be abused by inexperienced pre-insolvency or debt advisors. The ACF recommends a Small Business Restructuring Practitioner should be required to satisfy further qualification requirements, including but not limited to:

- be a qualified Certified Public Accountant or Chartered Accountant, who is in good standing;
- be a full member of the Australian Restructuring Insolvency & Turnaround Association (**ARTIA**) and have completed the ARITA advanced insolvency program;
- have at least 5 years of demonstrated restructuring experience; and
- be subject to the same oversight from ASIC as a registered liquidator.

The ACF considers the requirement for Small Business Restructuring Practitioners to meet the above minimum qualifications will reduce the likelihood of inexperienced practitioners abusing the process, providing businesses the best chance of successfully implementing the debt restructuring process.

Further, the ACF considers the limited fixed fee remuneration expectations under the proposed debt restructuring process are not realistic. Although the investigations required to be undertaken by the Small Business Restructuring Practitioner are reduced and the trading requirements dispensed with, the work expected to be undertaken by the Small Business Restructuring Practitioner does not align with the limited fixed fee expectation.

The ACF recommends the remuneration expectations be increased in line with the required qualifications and work required to be undertaken.

(b) Liabilities test of eligibility for small businesses to access the proposed debt restructuring process pursuant to s 453C(1)(a)

The test for eligibility for the debt restructuring process is yet to be fully understood, as the draft Bill provides for the Regulations to further prescribe criteria. In principle, the criteria outlined provides a broad understanding of liabilities which may be included in the test; however, the ACF considers some practical concerns arise which should be addressed in the implementation:

- Ambiguity arises around what liabilities will be considered by the Small Business Restructuring Practitioner in assessing eligibility of a small business. It is unclear whether: contingent claims; unbilled yet incurred liabilities; all employee entitlements, including accrued leave; and any set off claims will be included in the liabilities test. To avoid any ambiguity, the ACF recommends clear drafting and appropriate use of definitions within s 453C(1)(a).

- The ACF considers there is a requirement for some leeway in relation to the total quantum of debts to account for the unknowns addressed at subparagraph (a), or the inclusion of an extensive list of excluded items. From experience, not all employee liabilities are paid in most of the small and medium enterprise (**SME**) administrator and liquidator appointments, which will likely disqualify most SMEs.
- Requirement for no directors to have previously used a debt restructuring process or a simplified liquidation process pursuant to s 453C(1)(b)

The ACF supports this requirement.

In principle, the criteria outlined by the draft Bill provides a broad understanding of businesses which may be eligible, however some practical concerns arise which ACF submits should be addressed in the implementation:

- Information regarding directors' previous appointments and whether directors have previously initiated the debt restructuring or simplified liquidation processes. ACF recommends consideration be given to whether the information is required to be recorded by ASIC and available on a searchable database. In addition to clear drafting, this requires qualitative assessment criteria based on ascertainable information about a director.
- ACF notes, directors may be registered under variations of their name, which may cause Small Business Restructuring Practitioners to miss previous appointments in their investigations. Clear drafting is required around who bears the onus in the event a director's prior appointment is missed, and who is required to make the final determination of the director's eligibility.

In ACF's view, this requirement will assist in reducing illegal Phoenix activity.

- Requirement to provide declaration of relevant relationships pursuant to s 453D

The ACF is concerned that the requirement for a Small Business Restructuring Practitioner to provide the company's creditors and ASIC with a declaration of relevant relationships upon appointment, raises ambiguity as to when the declaration should be submitted.

The ACF recommends the insertion of a definitive timeframe within s 453D for the provision of the declaration to ASIC and creditors, as it would assist in removing this ambiguity. The ACF considers a period of 5 business days would be appropriate.

- Requirement to provide access company records held by a third party pursuant to s453G

The ACF supports this requirement, however it is the ACF's view that the draft Bill does not consider the event if access is not granted by the third party.

The ACF recommends further provisions be included within s 453G to include penalties for refusal of access similar to those established in s 453F.

- Use of 'given' in s 500AA(1)(f)

The ACF considers the word 'given' in the context of "*the company has given returns, notices, statements, applications or other documents as required by taxation laws*" is ambiguous.

It is unclear if the draft Bill requires the company to have lodged all required taxation documents with the Australian Taxation Office under the *Income Tax Assessment Act 1997* (Cth). The ACF recommends, if the intention of s 500AA(1)(f) is for the company to have lodged all taxation documents, the word 'given' should be substituted with 'lodged'. In the event, the intention of the

section is not for the company to have lodged taxation documents with the ATO, an appropriate definition should be inserted to remove any ambiguity.

- Use of 'at any time' in s 500AB

The ACF considers the use of 'at any time' in the context of "*a creditor may at any time give the liquidator of a company notice in writing requesting the liquidator not to follow the simplified liquidation process in relation to the company*" is inconsistent with s 500A(3)(c).

Section 500A(3)(c) appears to allow for creditors holding at least 25% in value to direct a liquidator not to adopt the simplified liquidation process within a specified time. While, the use of 'at any time' in s 500AB suggests a creditor can request the liquidator not follow the simplified process at any time, notably after the expiration of the specified time. The ACF recommends clear drafting of s 500A(3)(c) is required to remove this inconsistency.

1. Simplified liquidation process pursuant to s 500AE

The ACF supports the implementation of a simplified liquidation process.

It is ACF's view that the costs savings of utilising the simplified liquidation process are minimal. Aside from the removal of the requirement to complete a s533 report in the event no misconduct is found, the remainder of the requirements to be completed are similar to the current voluntary liquidation process.

2. Secured and Unsecured Creditors

The ACF recommends the moratorium on unsecured creditors be extended and apply equally to all secured creditors, with no provision for exceptions.

It does not seem fair to insist unsecured creditors who have agreed to work with and support the directors in the restructure process, cannot take action to recover their debt, if a secured creditor can undermine the restructure plan by enforcing their rights.

Further, the draft Bill does not provide recourse to suppliers for payments of goods or services supplied throughout the restructuring period. Under the current voluntary administration framework, a liquidator or administrator is personally liable to the supplier for any orders or services they incur. The ACF considers under the proposed process, a supplier may be reluctant to continue to supply goods or services to the business during the 35-day period without a guarantee for payment.

The ACF recommends the insertion of a provision which provides a process to trade creditors with a Purchase Money Security Interest registration to attend the business' premises, conduct a stocktake and verify items subject to their security upon appointment of a Small Business Restructuring Practitioner.

3. Requirement for the payment of employee entitlements before a vote on the restructuring plan

The ACF supports this requirement. From a financial standpoint, the requirement for employee entitlements to be paid before entering debt restructuring will reduce the financial burden on the Australian Government under the Fair Entitlements Guarantee.

In ACF's view consideration should be given to whether the employee wishes for all entitlements to be paid, as some employees may not want large entitlements to be paid prematurely. The ACF recommends the unpaid employee entitlements should be paid into a trust account.

Observations

The ACF makes the following general observations on the proposed amendments.

1. The draft Bill does not consider corporate trusts or trustees in relation to the reforms. If the records are intended to apply to corporate trusts and trustees, the ACF recommends clear drafting and appropriate use of definitions.
2. The ACF supports the prevention of related creditors from voting for the restructure proposal.
3. The ACF supports the requirement that the restructure proposed be accepted by 50% of the business' creditors by value.
4. The ACF supports the reduction in reporting requirements to ASIC and the removal of a Committee of Inspection.
5. The ACF supports the removal of the requirement of face-to-face meetings of creditors and the introduction of meetings to be held virtually.
6. The ACF considers the requirement for all tax returns and business activity statements to be lodged prior to the appointment of a Small Business Restructuring Practitioner will limit the number of small businesses who are eligible to utilise the simplified liquidation processes, as from experience the ACF understands SME's experiencing financial difficulty are not up to date with these lodgements.
 - In the event creditors do not accept a proposed debt restructuring plan, the ACF recommends directors should be obliged to place the company into simplified liquidation, rather than just have the option to. The ACF considers, directors who do not place the company into simplified liquidation upon the opposition of the restructuring plan, contravene their duties under sections 181 to 183 of the Act.
 - The ACF recommends further clarification be provided regarding the avoidance of unfair preferences, particularly around directors transferring funds and assets to themselves personally prior to entering the debt restructuring process.
7. The ACF recommends the insertion of provisions addressing director activity prior to appointment of a Small Business Restructuring Practitioner, to ensure directors do not utilise the process to avoid their obligations under insolvent trading.

It is imperative there is transparency in the proposed small business insolvency process, and that both secured and unsecured creditors are provided an opportunity to ensure their interests are protected to ensure the best possible outcome for all parties.



Anna Taylor
Chairman - Legislative Sub-Committee
Australian Credit Forum