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Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: SafeHarbourReview@treasury.gov.au

Review of the insolvent trading safe harbour

The Australian Institute of Credit Management (AICM) welcomes the opportunity to contribute to the review of the insolvent trading safe harbour.

AICM represents over 2,600 credit professionals who contribute to a resilient economy and drive successful business outcomes through:

- mitigating risk;
- maximising growth; and
- applying sound credit principles and practices.

Without our members, businesses are exposed to reputational damage, poor cash flow management and inefficient processes. Their employers are at risk of breaching regulatory requirements and not getting paid for hard won sales and services delivered.

Our members are the custodians of cash flow. They assess credit risk in all sectors and manage credit terms for the supply of goods, services and finance.

AICM members support the ability for viable businesses to restructure, when faced with temporary impacts on solvency, and work with businesses daily to achieve this.

AICM members primary task is to facilitate payment and maximise recovery, this is most efficiently achieved when legal and insolvency actions are avoided. When there is genuine engagement creditors can work with customers to:

- Structure repayments and credit facilities to enable customers to navigate uncertain times.
- Build customer/supplier relationships that benefit both in the long term.
- Avoid expense, delays and poor returns associated with formal insolvency processes.

While AICM members support the ability for directors to restructure under the insolvent trading protections provided by the safe harbour defence they believe changes in the following areas will further improve the ability for businesses to restructure efficiently:

- Removal of unfair preference claims risk for unrelated creditors.
- Strengthening the requirement for a qualified and experienced advisor.
- Greater clarity on eligibility requirements.
- Greater disincentive to engage in insolvent trading.

We expand on these elements in our responses to the following questions in the discussion paper.

Are the safe harbour provisions working effectively?

AICM members are concerned the provisions are contributing to the growing incidence of insolvent trading and therefore increasing the burden and risk of credit providers.

ASIC's statistics report that 71% of reports by administrators in July 2018 to June 2019 identified a misconduct of insolvent trading,. This has increased from 69%¹ in July 2017 to June 2018 and 63% in July 2017 to June 2018. While AICM has not been able to obtain more recent statistics there is no indication these trends have declined as there is no current effective deterrent for directors to not engage in this activity.

Without appropriate controls to the use of the safe harbour provisions AICM members are concerned that insolvent trading will continue to increase. Continued increase in insolvent trading will impact viable businesses as credit providers become increasingly averse to supporting businesses as they seek to mitigate the risk of losses as a result of insolvent trading.

What impact has the availability of the safe harbour had on the conduct of directors?

As a result of the safe harbour provisions, AICM members are increasingly focused on minimising risk of unfair preference payment claims. This is due to payments received by creditors while a safe harbour is in place and are at an increased likelihood of being deemed unfair preferences in a subsequent insolvency.

The mechanisms creditors need to employ to mitigate unfair preference claim risk impact all businesses through reduced availability of repayment arrangements, increased security requirements and reduced access to credit terms necessary to ensure viability of the business.

In the absence of a general removal or reduction of unfair preference claim liability for unrelated creditors in all insolvencies, the safe harbour provisions should provide a counterbalancing protection to the director's insolvent trading protections.

AICM members acknowledge that this protection is complicated to implement due to the undisclosed nature of the provisions. However, as the protection would provide significant benefit, specific additional review of this element is warranted.

¹ REPORT 645: Insolvency statistics: External administrators' reports (July 2018 to June 2019)

What impact has the availability of the safe harbour had on the interests of creditors and employees?

The absence of a clear obligation to ensure a better outcome for creditors is a significant concern for AICM members.

While directors have a general requirement to act in the interest of all stakeholders including creditors, AICM members recommend a specific duty to act in the best interests of creditors. Considering the extreme and hidden risk creditors are exposed to because of the protection provided to directors, it is reasonable to require creditors to be specifically considered at all stages of the safe harbour.

How has the safe harbour impacted on, or interacted with, the underlying prohibition on insolvent trading?

The continued growth of insolvent trading, as referenced earlier, leads AICM members to attest that there is no current effective prohibition on insolvent trading.

The current structure of the safe harbour provisions increases the likelihood that directors will allow insolvent businesses to continue trading.

AICM members recommend that greater prescription of the pre-conditions to access the defence significantly are required to address this concern and minimise the impacts on creditors.

What was your experience with the COVID-19 insolvent trading moratorium, and has that impacted your view or experience of the safe harbour provisions?

AICM members have continually reported that while the insolvent trading moratorium may have provided comfort to directors to not enter a formal insolvency process, the moratorium had significant negative impacts on creditors.

AICM members are ready and willing to support viable businesses under all economic conditions. This has been seen clearly during the COVID-19 pandemic, specifically following the end of the restrictions on debt enforcement. Creditors have not created the predicted tsunami of insolvencies and continue to support viable customers.

When the moratoriums were in place, AICM members reported a rise in directors of solvent businesses, intentionally avoiding liabilities sighting the moratoriums. This activity has continued post the expiry of the moratoriums.

A significant impact of the moratoriums has been the decrease in engagement from businesses seeking support for temporary cash flow issues. AICM members are experiencing customers demanding deferrals and extended payment arrangements rather than engaging in an open and honest way.

The relevance of these concerns to this review is the safe harbour provisions also increase the perception that directors do not need to engage with their creditors. The review should focus on how the provisions encourage directors to engage with their creditors.

Maximising creditor/debtor engagement is the most effective way for all stakeholders to achieve better outcomes for viable businesses and the earlier this engagement happens, the better the outcomes.

Are you aware of any instances where safe harbour has been misused?

While AICM members have not seen misuse directly, they're concerned the provisions allow misuse by directors and have seen an increase in un-regulated advisors promising unrealistic outcomes. Members believe the reason they have not seen misuse directly in recent years is due to the COVID-19 stimulus payments and moratoriums on enforcement.

These concerns are likely to be realised in coming months and years as the pressure on unviable businesses increase.

Are the pre-conditions to accessing safe harbour appropriate?

AICM members support the following pre-conditions as appropriate and essential to accessing safe harbour:

- Obligation to pay employee entitlements.
- Obligation to maintain tax reporting.
- Books and records are in order.
- Directors to properly inform themselves of the company's financial position.

The above pre-conditions are in line with the minimum expectations of a director and therefore essential to be met to access the safe harbour.

AICM members believe the following pre-conditions require clarification and review:

- Directors should consider appointing an advisor.

Due to the complex considerations required to assess the ability to achieve a better outcome, develop a plan and monitor a plan it is essential that directors appoint an advisor.

AICM members recommend that appointment of an advisor with insolvency and turn around experience should be a pre-condition to access the provisions.

- Pay all tax obligations

The inability to pay tax obligations as they fall due is a clear indicator of insolvency, therefore AICM members believe that directors should take action to protect all stakeholders before tax obligations are not paid.

Requiring payment of tax obligations as a pre-condition of accessing safe harbour should be considered to encourage early engagement with the right advice.

- Developed a course of action that will lead to a better outcome for the company

This requirement is too vague and doesn't consider creditors.

AICM members recommend it is revised:

- The course of action will be reasonably likely to lead to a better outcome for unrelated creditors.
- Compare the outcomes of the course of action to formal insolvency alternatives.

Prescribing additional and clear pre-conditions will benefit all parties. Benefits of this clarity will include:

- Increase credit professionals' confidence in the process, specifically from the requirement to appoint a safe harbour advisor with insolvency and turnaround experience.
- Less likelihood of the provisions being abused. This will provide credit professionals' confidence to support viable businesses through flexible repayment arrangements and continued access to credit terms, due to less risk of insolvent trading and or a poor outcome for creditors.
- Greater certainty to directors, through clear pre-conditions that provide certainty to directors.
- More viable businesses avoiding formal insolvency. AICM members understand that currently some directors may prefer the certainty of a formal process rather than the relative uncertainty of safe harbour.
- Reduced cost. With greater certainty on the pre-conditions expensive analysis and legal advice may be avoided.
- Directors that engage early and follow best practice will be rewarded.

AICM members acknowledge that a higher bar to accessing the safe harbour may create barriers when directors act at a late stage. However, it's appropriate to restrict access to safe harbour to directors who have followed best practice. Formal processes are most appropriate in circumstances where directors have not followed best practice as they are better able to monitor the interests of stakeholders.

Does the law provide sufficient certainty to enable its effective use?

As noted in the prior response, AICM members believe there are significant inefficiencies created by the current law.

Is clarification required around the role of advisers, including who qualifies as advisers, and what is required of them?

To support and put into affect other recommendations, AICM members strongly recommend:

- An advisor must be appointed by directors as a precondition to accessing the safe harbour.
- The advisor be appropriately qualified as an insolvency/turnaround practitioner that is regulated and recognised by ASIC: to have demonstrated experience in creating and implementing a turnaround plan, assessing the solvency of a company and understanding the consequences and likely outcomes of a formal insolvency appointment on a company.

Are there any improvements or qualifications you would like to see made to the safe harbour provisions and/or the underlying prohibition on insolvent trading?

As noted throughout this submission the safe harbour provisions will better achieve their intended outcomes by:

- Providing protection to unrelated creditors from unfair preference claims.
- Clarifying and strengthening the pre-conditions to accessing the safe harbour.
- Requiring appointment of an advisor with clear qualifications for the advisor.
- Attitudes to insolvent trading are addressed.

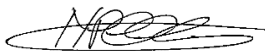
AICM members acknowledge that safe harbour provisions may encourage viable businesses to restructure without the need for formal insolvency appointments. However, AICM members attest they aren't required for creditors and directors to achieve best outcomes. The current preference claim risk is the greatest hurdle to efficient engagement, removal of this barrier will benefit all stakeholders.

AICM members believe the safe harbour provisions will not be widely used or directors encouraged to take early action when faced with potential insolvency until a change in attitude to insolvent trading is achieved. The widespread prevalence of insolvent trading and the lack of enforcement clearly shows there is no incentive for directors to avoid insolvent trading.

The current ambiguity creates the potential for misuse of the provisions including unregulated advisors manipulating the provisions and insolvent trading prosecutions becoming uneconomical to pursue due to the use of the safe harbour defence.

We welcome the opportunity to further contribute to the discussion of the reforms.

Yours sincerely



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