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Manager
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The Treasury
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Dear Sir/Madam

Submission to Treasury – Clarifying the treatment of trusts under insolvency law

Introduction

The Australian Credit Forum (**ACF**) welcomes the opportunity to make a submission to Treasury in respect of the potential reforms to clarifying the treatment of trusts under insolvency law.

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 of industry groups including but 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

Response to consultation paper

1. Should the corporate insolvency framework be amended so that it expressly provides for the external administration of insolvent trusts with a corporate trustee? If so, what external administration processes should the amendments apply to?

It is the ACF's view that the corporate insolvency framework be amended so that it provides for the external administration of insolvent trusts with a corporate trustee. The current framework has been historically problematic for most creditors and does not adequately cover how business trust structures and businesses proceed with an insolvency event.

The current framework does not provide transparency to businesses when dealing with trust structures.

It is the ACF's position that the mechanisms in play regarding liquidations and winding up of companies should generally apply to that of corporate trustees in addition to the requirement at equity principles which include recoupment, exoneration, subrogation, and apportionment.

The current formal appointments available under the *Corporations Act* 2001 (Cth) (**Corps Act**) should also be extended to insolvent trusts with corporate trustees. There are circumstances where businesses are not aware, they are doing business with a trustee company of a trust and a myriad of issues have arisen when they have been subject to an insolvency event including but not limited to:

1. Defective personal property and securities registers registrations where a registration has been made over a trustee company incorrectly.

2. Circumstances where there has been no/limited recourse to trust assets in the event a trustee company becomes insolvent.

3. Additional costs being borne by creditors because of the requirement for an external administrator to apply to the court to be appointed as a receiver of trust assets of trust when they have already appointed to the corporate trustee

It is the ACF's view that the Corps Act can be easily amended to provide for the winding up of a company its capacity as a trustee of a trust or trusts when that company is already in external administration.

2. What benefits would a legislative framework deliver?

It is the ACF's view that that an amended legislative framework would deliver.

1. Greater certainty to the business community overall with respect to ensuring their contractual obligations are enforceable against the correct party.

2. Greater transparency in the business community, in doing business with trust structures.

3. Closing a loophole that can currently be used to shield assets obtained with the benefit of a corporate trustees trading status.

4. Decrease the costs incurred by external administrators (and ultimately creditors) in administering and/or realising the trust assets of an insolvent trust/corporate trustee.

A legislated framework would also assist the liquidator in facilitating the external administration and deal with trust assets. The framework would allow procedures to determine proofs and debt procedures.

3. Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?

There is the potential for the division of assets of a trust in circumstances where a trustee company is the corporate trustee for multiple trusts to be both difficult and divisive and a mechanism to deal with this would need to be included if the regime was extended to include trusts.

Further there could be a compromise to the following:

(a) Beneficiaries.

(b) The trust deeds

(c) Trust and non-trust creditors.

4. Should legislation expressly set out when a trust is deemed to be insolvent?

The ACF is of the view that this must be expressly set out. A definition would be crucial to provide for the appointment of the liquidator and facilitate the liquidation.
Having an express definition would also assist businesses in assessing risk with businesses in which they do business with to ensure that they were not transacting with business that was insolvent.

5. What is the most appropriate way to prescribe when a trust is taken to be insolvent?

It is solvent if it can pay the debts it/its corporate trustee has incurred on its behalf, as and when they fall due. If it cannot, then it is insolvent.

Alternatively, if the trustee has no funds to facilitate the management of the trust and the liabilities cannot be met this may be another consideration.

6. Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?

Yes, that will decrease the costs of administering those assets as there will be no need for court intervention.

7. Should the law provide that, subject to a contrary order by a court, the same insolvency practitioner may administer both the company, and the assets and liabilities attributable to any trusts for which the company is trustee?

Yes, provided those assets/liabilities can be quarantined/separated effectively. If not, there is a potential for a conflict of interest in the division of assets to occur. The court and beneficiaries should retain the discretion to appoint the liquidator. This would result in clear cost savings.

Court liquidator amendments and voluntary liquidator amendments could provide for the appointment of the liquidator, subject to the corporate trustee already being in liquidation.

8. Should the affairs of a trustee company and each trust it administers be resolved separately in external administration?

If court liquidator and voluntary liquidator amendments were made, yes, provided those assets/liabilities can be quarantined/separated effectively. If not, there is a potential for a conflict of interest in the division of assets to occur. If not, then there should be a mechanism for the appointment of an independent third party and/or the court to intervene and decide based on the relevant information at hand.

Corporate trustee liquidation should be carried out separately as it relates to company creditors. Except for recoupment, adjudication of proofs of debt and payment of dividends is to creditors. Remuneration and expenses in respect of the company liquidation would be approved by company creditors. In relation to recoupment, it could be delt with by a pari passu apportionment between trust and non-trust creditors, approved by the creditors.

The special rules of statutory liquidation mean that corporate trustee work should also be carried out separately. If the corporate trustee conducts no other business, there may be a claim against trust property for costs and expenses. However, there may be an overlap between the activities of

the liquidator and trustee. In a situation where a liquidator does work entitling them to both liquidator remuneration and recovery from the trust assets, there may be two funds and contribution is made between them.

If resolution is separate, it will simplify remuneration and expense claims from trust property. Approval of claims can be made without having to apportion. Despite this, it is likely that some trust asset liquidator work will be of benefit of all funds. In that case, work will need to be recorded separately so that a pari passu appointment can be arrived at for payment.

Ultimately, corporate trustees and trusts should be administered separately to the greatest extent possible, keeping in mind that creditors and beneficiaries should benefit from work in respect of all trusts through less duplication and lower liquidator costs.

9. Should there be a statutory order of priority in the winding up of a trust?

Yes, should follow s556 of the Corps Act as the law in respect of exoneration has been clearly settled.

10. Should a statutory order of priority replicate the regime for companies? Do any additional factors need to be considered where a corporate trust structure is involved?

If the trustee company is the trustee of more than one trust and has incurred liabilities and produced income on behalf of more than one trust, there should be a mechanism of separating the relevant assets/liabilities that are attributable to the business of the separate trustee companies.

However, an exact replication may not necessarily be the most beneficial to trust creditors. Section 556 can be construed as if a corporate trustee's liquidator held separate funds, each for different groups of creditors. Therefore, any amendments to the liquidator definitions that provide for trust asset liquidations should preserve that construction.

11. Should there be additional limits on the enforceability of ejection clauses and/or clauses that seek to limit a trustee's right to indemnity, in situations involving insolvency or external administration?

Yes, to the extent of the assets available in the trust that can be attributable to the business of the relevant trustee company in circumstances where a trustee company is a trustee of multiple trusts.

If a corporate trustee becomes subject to an application for winding up in insolvency, any provision in the trust instrument providing for the removal of the company as trustee should be nullified. The role of the corporate trustee and a trust are related, so automatically ending that relationship upon appointment of a corporate trustee liquidator causes difficulties for both the corporate trustee and the administration of the trust.

The *Treasury Law Amendment (2017 Enterprise Incentives No. 2) Act 2018* (Cth) addresses ipso facto clauses in respect of corporate trustees in external administration, although further liquidator-specific amendments may be required.

12. What would be the impact of any such limits?

To attempt to ensure equity in the realisation and distribution of trust assets based on the benefits obtained from the business of the trustee company that are related to those trust assets. An alternative view may be that the assets are split pari passu in accordance with the quantum of the debts incurred on behalf of each trust by the trustee company.

13. Are there any other issues that need to be considered considering the questions above?

Whether the appropriate laws need to be amended to only allow for one trustee company to be the trustee of one trust at a time, not multiple.

Sections of the Corps Act that apply to liquidators may need to be amended to apply to trust asset liquidators. In some cases, this would be achieved by changing the definition of a liquidator.

The ACF believes there needs to be serious consideration of the provision of national trust register.

One of the greatest constraints businesses and more specifically credit providers in transacting with trust structures is the lack of transparency. This lack of transparency can reduce confidence in big business in dealing with small to medium enterprise which will ultimately result in less credit being provided and transactions being entered.

In opposition to this, businesses without transparency or in circumstances where there is no understanding of the trust structure credit could be provided to trusts which were in fact insolvent or a structure that is suffering hardship.

The ACF believes there should be more clarity on the financial position of the trust structure so that prior to entering into a transaction the credit provider is able to understand the manner in which the structure is set up and the assets and liabilities held. Over all it is the ACF's view that there needs to be more data available so that businesses can make informed decisions regarding trade with trust structures generally.

Anna Taylor
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Australian Credit Forum