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By email: aaron.jenkinson@treasury.gov.au
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Dear Mr Jenkinson and Mr Levy

Legislative reform – regulatory framework applying to insolvency practitioners

We refer to our recent telephone discussions and, as requested, provide:

A. a summary of our key concerns about the proposed insolvency reforms;

B. law reform proposals that Treasury may wish to consider further following our discussions;

C. issues for noting; and,

D. implementation issues for ASIC.

A. Summary of our key concerns about proposed insolvency reforms

1) Procedures in a creditors' voluntary winding up

We understand that the creditors' voluntary winding up procedure would operate as follows:

- The company directors must provide to the liquidator a report about the company's business property, affairs and financial circumstances ("the RATA") within 5 business days after the meeting of the company at which members pass the resolution for voluntary winding up (or longer period as the liquidator allows): cl 497(4) in Schedule 2 Part 3 of the draft Bill.

- The liquidator must, within 10 business days after the meeting of the company at which members pass the resolution for voluntary winding up, send creditors a summary of the company's affairs and a list of names, addresses and amounts owing to creditors, identifying any related party creditors: cl 497(1) in Schedule 2 Part 3 of the draft Bill.

- The liquidator must make a declaration of relevant relationships and give a copy to as many creditors as reasonably practicable within 10 business days after the meeting of the company at which members pass the resolution for voluntary winding up: Item 85 in the *Insolvency Law Reform Bill 2013: Corporations consequential amendments*.

- The liquidator is not required to convene a meeting of creditors unless a required percentage of creditors direct the liquidator to do so. Creditors must give that direction within 14 business days after the meeting of the company at which members pass the resolution for voluntary winding up: cl 28-15 in Schedule 1 of the draft Bill.

ASIC's proposals for reform

We believe that the reforms could achieve a more streamlined and cost effective voluntary winding up process where:

- the director prepared and tabled a RATA at the meeting where the directors put a motion to the members to wind up the company;

- the liquidator sends to creditors a summary of the company's affairs, (prepared from the RATA), a list of names, addresses and amounts owing to creditors, identifying any related party creditors, and provide the declaration of relevant relationships, within 5 business days after the meeting of the company where members resolve to wind up the company; and

- if the required percentage of creditors wants a meeting convened, they direct the liquidator to do so within 14 business days after the meeting of the company at which members pass the resolution for voluntary winding up.

Under ASIC's proposal, the liquidator would have the RATA in time to assist prepare the company's summary of affairs and send it to creditors at the same time as the initial notice of appointment (as required under clause 497(1) in Schedule 2 Part 3 of the draft Bill).

Meaningful reporting to creditors

We believe that ASIC's proposed amendment facilitates preparation and lodgement of a properly prepared RATA that enables meaningful reporting to creditors at an early stage in the administration. ASIC's experience, supported by informal discussions with the Australian Reconstruction, Insolvency & Turnaround Association (**ARITA**), is that it is often difficult for a liquidator to get a director's cooperation after the liquidator's appointment.

Failure to submit a detailed RATA early in an administration results in:

- the liquidator expending additional time and expense identifying the company's assets and liabilities and getting directors to comply with their statutory obligations.

- If directors don't comply, the liquidator then approaches ASIC under the Liquidator Assistance Program. ASIC expends valuable resources assisting the liquidator obtain a RATA. ASIC may then prosecute the director for non-compliance taking up further resources including those of the Courts.

Creditor's right to convene a meeting

The reforms remove default initial creditors' meetings in creditors' voluntary liquidations. If this reform proceeds, it will be important that creditors receive notification of the liquidator's appointment in sufficient time to allow them to properly consider whether they want to request a creditors' meeting of creditors to:

- obtain further information about the conduct of the winding up; or

- replace the person appointed by the company as liquidator over possible concerns, including independence.

An unintended result of the current reform proposals may be that creditors only have a very limited time within which to make this assessment. We believe that ASIC's proposal provides creditors with that time.

We consider the latter point a very serious one; particularly given the paramount importance of independence and the focus ASIC brings to the insolvency market on this aspect. We feel strongly that we can militate against possible misconduct through creditor oversight at the first creditors' meeting.

Policy objectives of the reforms

We believe that our proposals align with the reform's policy objectives because they improve efficiency in a creditor's voluntary winding up, enhance communication and transparency and support the creditors' right to replace a liquidator.

Our proposed reforms also align with the current personal insolvency regime. For example, a debtor must provide a completed Statement of Affairs before an authority to appoint a Controlling Trustee under Part X of the *Bankruptcy Act 1966* (**Bankruptcy Act**) becomes effective. Also, an individual is required to prepare a Statement of Affairs prior to presenting a petition for their bankruptcy.

2) Electronic lodgement of the annual administration return

As you know, ASIC encourages electronic lodgement of documents. We therefore believe consideration should be given to mandatory online lodgement, or at least, provide a meaningful disincentive to lodge paper forms.

We are particularly concerned to encourage electronic lodgement of the proposed annual administration return so that ASIC can:

- capture data in a consistent, structured and timely manner;
- quickly analyse the information; and
- more readily produce and publicly report insolvency statistics

In drafting the consequential amendments to the *Corporations (Fees) Regulations 2001* (**Fees Regulations**), we ask that you review the current schedule of fees.

If the law introduced fees for applications or documents lodged with ASIC, the prescribed fee for lodging an application or document could be lower, (or even zero), if the law mandates electronic lodgement. There is established precedent for this under the Fees Regulations; for example, see items 3, 3A and 52 of Schedule 1 of the Fees Regulations.

We believe that this fee regime would more accurately reflect the costs ASIC incurs in processing an application or document. Further, there would be a strong incentive for liquidators to lodge electronically because, in many cases, it is the creditors who bear the fee cost. Arguably, the liquidator would not be acting in the creditors' best interests if they do not lodge electronically.

3) Companies and Liquidators Disciplinary Board (CALDB)

Speed and Cost

We ask that Treasury carefully consider the proposal to replace the CALDB with a committee process mirroring the committee system in personal insolvency. We note that the reforms responded to a number of submissions to the Senate Committee Inquiry critical of the speed and cost of the CALDB process. Since that time, the CALDB has implemented revised and streamlined procedures.

The CALDB recently delivered decisions on five ASIC applications concerning liquidator misconduct. We expect to shortly file four new applications to add to one existing matter with CALDB. This follows a number of years during which ASIC brought no significant applications to the CALDB. Our recent experience strongly

evidences a more effective and timely process which we believe CALDB could sustain given the revised processes. We would be happy to provide you with case studies on this point if needed.

In light of our recent experience, we believe that CALDB's independent disciplinary role is now a much more important element of the regulatory framework for insolvency practitioners. Importantly, its decisions now better guide the profession on the meaning of "adequately and properly" carrying out their duties.

Transition to the disciplinary committee

If Treasury proceeds with the proposal to replace the CALDB, we are extremely concerned about how the transitional provisions operate. As currently drafted, the CALDB must cease to consider a matter if it has not made an order concerning the application or dealt with the person under s1292(9) of the old Act before the commencement date of the reforms. We believe that this will result in unnecessary cost and delay for both the applicant and the respondent because, regardless of how progressed the proceedings may be, they must recommence in another forum. ASIC cannot afford to lose resources invested in these matters and fears losing momentum in its enforcement program.

We believe that a smoother transition to a disciplinary committee is possible if the CALDB continued to hear ASIC applications filed before the commencement date of the reforms.

4) Competency Standards

ASIC believes that, for corporate insolvencies, rather than, or in addition to, having a common set of minimum initial and ongoing standards for registration, it is appropriate to prescribe some performance standards common to all forms of external administration as well as some standards specific to each particular form of external administration.

The duties and functions of registered liquidators and registered trustees in bankruptcy do differ. Further, registered liquidators are subject to different duties and functions depending on the form of external administration.

Schedule 4A of the Bankruptcy Act already contains a set of general prescribed performance standards and specific standards relevant to different types of personal insolvency administrations. Regard is had to these prescribed standards when considering whether a person should continue to be registered as a Trustee (s155H).

ARITA's Code of Professional Practice for Insolvency Practitioners guides its members on the required standards of conduct required in discharging professional duties and responsibilities.

However, not all registered liquidators are ARITA members. ASIC believes that there is substantial merit in the law containing a set of general prescribed performance standards and specific standards relevant to different types of corporate insolvency administrations that applies to all registered liquidators. Rather than duplicating existing guidance, they would support and enhance the disciplinary regime and clarify for all registered

liquidators the minimum standard of conduct. In other words, they would provide a more level playing field for the profession.

5) Creditor access to information

The reforms seek to align and enhance the creditors' right to request information. The external administrator must comply with a creditor's request for information unless:

- the information is not relevant to the external administration of the company;
- the external administrator would breach their duties if they did so; or
- it is otherwise not reasonable to comply with the request.

We note that the Proposals Paper for the Insolvency Practice Rules outlines instances when a request would be deemed reasonable and also circumstances in which a request would not be considered reasonable.

We are concerned about how these rules will operate in practice and whether the reforms will achieve their objective; particularly if the external administration has limited funds. We are also concerned with how these rules might interact with other laws, (for example, privacy and confidentiality obligations).

The principal concern about the rules in practice arises in the interpretation of what is reasonable. Experience demonstrates an expectation gap between what an external administrator deems reasonable and what a creditor deems reasonable.

Rather than resulting in creditor access to relevant information about an external administration, the provisions are likely to result in creditors mistakenly alleging misconduct on the part of the external administrator and seeking ASIC's intervention - adding cost to the conduct of the external administration and creating a perception of greater practitioner misconduct than is the reality.

B. New proposals for law reform

1) Declaration of relevant relationships

The very recent decision of the Full Court of the Federal Court of Australia in *Australian Securities and Investments Commission v Franklin (Liquidator), Re; Walton Constructions Pty Ltd [2014] FCAFC 85* (**Walton Constructions**) raises doubt about whether the disclosure regime in s60 of the *Corporations Act 2001* (**the Act**) achieves its policy objective.

The Explanatory Memorandum to the Corporations Amendment (Insolvency) Bill 2007 addresses the legislative purpose underlying the disclosure regime in s60 of the Act by stating that its object is to address administrator independence concerns by requiring them to declare any relevant relationship that, although it may not raise a conflict at law, may be relevant to creditors in considering independence. These relationships should be disclosed so creditors can make an informed decision, when exercising their statutory right to replace the external administrator (see paragraphs 4.71 – 4.73 of the Explanatory Memorandum).

We believe that the Walton Constructions decision highlights the need to clarify legislative disclosure requirements. Specifically, we believe that administrators should

not only disclose the relevant relationships but also disclose the underlying factual situation underpinning the relationship and the reasons why there is no conflict of interest or duty.

Briefly, in Walton Constructions, the respondents to the appeal were appointed administrators and then liquidators of the Walton companies on the referral of corporate advisers, the Mawson Group. Mawson Group had referred six other administrations to the respondents, resulting in fee income for the respondents of about $500,000 in 2012 and $250,000 in the 2013 financial year. The Mawson Group provided advice about insolvency issues to the Walton companies prior to their collapse. Further, related entities of the Mawson Group entered into transactions with the Walton companies involving asset transfers and debt assignments.

ASIC alleged that the respondents failed to comply with their obligations under s60 and s436DA of the Act by failing to disclose in the Declaration of Independence, Relevant Relationships and Indemnities (**DIRRI**) that they would need to investigate transactions between the Walton companies and the Mawson Group. The respondent's DIRRI merely noted their relationship with the Mawson Group as an 'other relevant relationship' and indicated that the relationship did not cause any issue with accepting the appointment.

The court held that the need to investigate the transactions between the Walton companies and the Mawson Group related to the performance of the respondents' duties, which is beyond the scope of what the law requires the DIRRI to disclose.

We believe that, in the circumstances of this administration, a need existed to disclose how the pre-appointment transactions involving the Mawson Group did not give rise to a conflict of interest or duty. This was relevant because the question of the existence of a conflict of interest could not be answered meaningfully absent any reference to it. In submissions, ASIC said that, for section 60 not to require disclosure of that fact, emasculated the provision as creditors needed this information to properly consider the administrators' independence.

We are concerned that the Court's narrow construction of the relevant provisions in the Walton Constructions case leads to uncertainty about the disclosure requirements in, and may lead to, incomplete disclosure in the future. In our view, law reform is needed so that the legislation is more prescriptive about:

- the types of relationships that require disclosure;
- the nature and extent of information that should be disclosed about those relevant relationships; and
- the external administrator's reasons for believing why these relationships, in the context of the particular administration, do not give rise to a conflict of interest or duty.

Reliance on guidance provided in ARITA's Code of Professional Practice is inadequate as the Court said it was not relevant to interpreting the requirements of the Act.

If Treasury is minded to consider possible law reform, ASIC would welcome the opportunity to assist.

2) *Voting at meetings*

The Walton Constructions matter, and other surveillance activities ASIC has carried out, also highlights the role related parties can play in controlling the outcome of creditors' meetings.

In Walton Constructions, a party related to the Mawson Group paid $30,000 for an intercompany debt with a face value of $18.9M. The meeting's chair admitted the related party to vote for the full amount and, in doing so, that party could then, with the chair not exercising a casting vote, control the meeting's outcome.

Current investigations also include a matter where the principal allegation is that the liquidator promoted the interests of related parties in the way he adjudicated on their right to vote. The related parties then controlled the meeting's outcome necessitating a court application seeking the liquidators' removal.

Given the influence related parties can have in corporate insolvencies, we believe that law reform is needed to address:

- The rights of related parties to vote at creditors meetings
- If the law entitles related parties to vote at creditors meetings, the level of documentation and evidence required to substantiate a related party debt for voting purposes; and
- the amount that a party can vote for at a meeting when that party acquires a debt from a creditor for consideration less than the amount of the outstanding debt.

Consideration could be given to including a provision similar to s64ZB(8) of the Bankruptcy Act which limits the amount a party can vote to the consideration actually paid to acquire the debt.

3) *Illegal phoenix activity*

ASIC has previously discussed with Treasury proposals targeting illegal phoenix activity.

We suggested that government consider introducing a provision similar to s121(1) of the Bankruptcy Act, making it an offence to transfer property from Company A (where Company A is subsequently wound up or abandoned) to Company B, if the main purpose of the transfer was to prevent, hinder or delay the process of the transferred property from becoming available for division amongst Company A's creditors.

Section 121(2) of the Bankruptcy Act states that the main purpose in making the transfer will be taken to be the prescribed purpose, "*if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent*". Rebuttable presumptions of insolvency apply. Such a transaction should be both void against a liquidator (so that a liquidator can claw back the assets) and an offence. Consideration could also be given to whether such an offence should give rise to a right in creditors, liquidators and ASIC to sue for compensation against directors who engage in the prescribed conduct and those who are knowingly involved in that conduct under s 79 of the Act for the loss caused by the conduct.

Similar defences to those available under s 121(4) of the Bankruptcy Act could be available, (regarding paying market value for the property, knowledge of the main purpose of the transfer and inability to infer that the transferor was or was about to become insolvent at the time of the transfer).

Evidentiary difficulties involved in proving illegal phoenix activity

Demonstrating that Company A owns the transferred assets, and that Company B did not pay fair market value for them is one of the significant difficulties in bringing action against directors involving illegal phoenix conduct (for both ASIC and liquidators). Often, the cost of investigations, examining persons of interest to ascertain property transfers and, if transfers occurred, whether the transferor paid proper value, is prohibitive.

Section 139ZQ of the Bankruptcy Act allows the Official Receiver to send a notice to a person who the Official Receiver considers received property in contravention of s121, demanding payment of the property's value. The notice must set out the facts and circumstances pursuant to which the Official Receiver considers that the transaction is void against the trustee.

We believe Treasury should consider introducing a notice regime similar in concept to, (but not the same as), the notice regime in place under s 139ZQ of the Bankruptcy Act. This would significantly assist in pursuing illegal phoenix activity because it could reduce the cost of pursuing recovery action.

The new provision could do the following:

a) where ASIC, (or a liquidator), suspects illegal phoenix activity involving a transfer of Company A's assets to Person B for no market value or less than their market value;

b) ASIC may issue a notice to person B (either on ASIC's behalf or at the request of a liquidator who is able to satisfy ASIC as to the matters in paragraph (a)) requiring that Person B return the property or pay market value for the property if Person B cannot provide evidence that Company A never owned the property or Person B paid fair market value for the property; and

c) Person B would have the right to apply to the Court or ASIC to have the notice set aside.

C. Issues for noting

1) Penalties

We note that the some of the penalties in the Insolvency Law Reform Bill are very low. For example, if a registered liquidator fails to lodge an annual return concerning his or her practice the registered liquidator commits an offence punishable by a maximum fine of $850. We believe that the penalty regime should reflect the seriousness of the breach and be sufficiently punitive to promote a very high level of compliance.

2) Registration regime

We note that the Government has retained a registration regime with some targeted amendments rather than introduce a licensing regime. Further, where a registered liquidator applies to have ASIC renew their registration, ASIC *must* renew the registration where the application is properly made, evidence is provided to ASIC in writing that the applicant maintains adequate and appropriate insurance and that the applicant has complied with any condition dealing with continuing professional education. Registration is, therefore, a right rather than a privilege.

3) Financial reporting obligations for externally administered companies

We note that the reforms do not address financial reporting obligations for externally administered companies. This is a contentious issue and one we suggest should be dealt with expressly in the law rather than through ASIC policy as is currently the case.

D. Implementation concerns for ASIC

Finally, we set out some of ASIC's operational concerns in implementing the reforms.

1) Implementation timeline

As you know, ASIC is concerned about the need to commence planning and implementation of the IT and policy build as soon as possible. We cannot effectively commence this work until we have a high level of certainty about the final form of the legislation (including the Insolvency Practice Rules).

We appreciate your efforts in committing to expedite your consultation and the finalisation of the elements of the reforms that will have the most impact on ASIC's IT and policy build.

When further information is available, we will review and advise what we can achieve by the proposed implementation date and identify the time critical elements.

2) ASIC funding

ASIC submitted an initial NPP bid nearly three years ago in November 2011 to implement the insolvency reforms. If the legislation's final form departs significantly from the 2011 reform proposals, this could result in materially different implementation costs for ASIC. Further, given the passage of time and ongoing work to ASIC's IT infrastructure, we are concerned that our cost estimates are out-dated and the NPP funding may be inadequate to fund ASIC's implementation of the reforms.

The reforms also have an unanticipated funding impact on ASIC if we are required, for example, to provide full secretariat support for Committees or appoint a replacement liquidator where a person's registration is suspended or cancelled. These additional costs were not part of the NPP bid. Further, the proposed reforms will affect the Published Notices Website (formerly called the Insolvency Notices Website). The extent of that work, and the costs to complete it, were not expected when ASIC lodged the NPP bid. ASIC cannot fully assess these costs until we can assess the impact of any changes made by the new Insolvency Practice Rules.

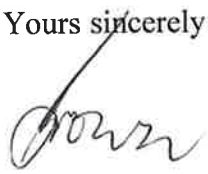
Further comments

We are pleased to provide further comments on the proposed reforms but note that our comments are somewhat qualified because we are yet to see the detail of the proposed changes to the Insolvency Practice Rules. This is important because the draft Bill leaves much of the detail to the Insolvency Practice Rules.

We remain very positive about the reforms and look forward to providing further comments on the Exposure Draft Bill and proposed Insolvency Practice Rules.

If you have any questions, please contact me on (03) 9280 4199 or email adrian.brown@asic.gov.au or Adrian Furby on (07) 3867 4840 or email adrian.furby@asic.gov.au.

Yours sincerely



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