

29 January 2020

Ms Kate Carnell  
Australian Small Business and Family Enterprise Ombudsman  
GPO Box 1791  
CANBERRA ACT 2601

By email: [inquiries@asbfeo.gov.au](mailto:inquiries@asbfeo.gov.au)

Dear Ms Carnell

### **Insolvency Practices Inquiry**

The Australian Institute of Credit Management (AICM) represents the interests of over 2,500 credit professionals responsible for maximising the cash flow and minimising the bad debt risk of companies in a vast array of industries.

The credit provided by our members supports businesses of all sizes through the provision of various types of credit and finance. A significant portion of our membership provides unsecured trade credit which enables businesses to fund trading and manage cashflow. The value of trade credit to the Australian economy is significant, an RBA report put the total value of outstanding trade credit to be in excess of \$80bn at any one time<sup>1</sup>.

AICM members are regularly involved in the insolvency process and report that poor outcomes from formal insolvency situations restrict their businesses tolerance to support small businesses experiencing temporary financial difficulties. The poor outcomes include high incidence of preference claim demands, prevalence of insolvent trading and low distributions to creditors. As a result, credit terms are managed tightly in order to mitigate potential loss.

Our submission focuses on our members' experience with the insolvency process. Whilst managing exposures to insolvency is a core element of a credit professionals' value to a business and small businesses are unlikely to have access to this level of expertise, the experiences of our members closely replicates that of small business.

We welcome the opportunity to contribute further detail on the topics included in this inquiry. Specifically, the AICM is able to provide a unique perspective of the below issues drawing on our members daily experiences at an operational level:

- Unfair preferential payment claims
- Identifying excessive remuneration, disbursements and fees
- Obtaining information relevant to creditors
- Impacts of poor and inefficient practices
- Navigating complexity of current legislation

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<sup>1</sup> <https://www.rba.gov.au/publications/bulletin/2013/sep/5.html>

## Responses to questions for comment:

### 1. At the initial consultation with a registered liquidator, should the registered liquidator be required to provide a small business with:

- a. a hard copy plain language fact sheet that outlines the various types of external administration and the role of directors and owners in each?
- b. the reasons for recommending a particular course of action to the directors?

The AICM supports the simplification of information related to formal insolvency processes.

By clearly highlighting the risks of not engaging a registered insolvency professional the document may also deter activity such as illegal phoenixing and insolvent trading that has a significant impact on business owners, creditors and the broader Australian economy, specifically:

- Phoenix activity is estimated to have an annual direct to the Australian economy of between \$2.85 billion and \$5.13 billion<sup>2</sup>.
- Reports by external administrators identified possible insolvent trading in 71% of reports to ASIC between July 2018 and June 2019 (up from 69% or 5,264 instances in the prior year)<sup>3</sup>.

### 2. Should there be a control mechanism to prevent the total costs of an external administration from consuming the value of the company's assets? What form could this take?

Recent law reform provides a control mechanism by providing creditors the power to challenge remuneration, disbursements, fees and other aspects of insolvency processes. However, it is clear that these powers have not been widely used with the following factors limiting their use:

- Fear that a challenge may result in unfair preference claims being pursued more vigorously.
- The challenge may result in further fees being generated therefore reducing return to creditors.
- Cost of creditors enforcing their rights is prohibitive.

However, the AICM does not support preventing the consumption of a company's assets via caps or limiting remuneration and disbursements as this may limit the effectiveness of the important roles and outcomes such as:

- Ensuring orderly wind up
- Identifying breaches by directors
- Maximising returns to creditors

### 3. Should an information sheet of the average costs for a 'day in court' and the average numbers of court days for particular actions be included with each creditors report?

While this information may be beneficial there are numerous variables that will prevent relevance in all circumstances. The most relevant factor is if legal costs are incurred for a reasonable purpose i.e. likely to result in a better outcome for creditors or necessary to comply with the requirements of the insolvency process.

The AICM advocates for the approach detailed by Thea Eszenyi Senior Executive Leader, Insolvency Practitioners, Australian Securities and Investments Commission in the July 2019 article in Credit Management in Australia. This article recommends that remuneration reports "*should explain:*

- *what work has been done*

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<sup>2</sup> <https://www.ato.gov.au/General/The-fight-against-tax-crime/Our-focus/Illegal-phoenix-activity/The-economic-impact-of-potential-illegal-phoenix-activity/>

<sup>3</sup> <https://download.asic.gov.au/media/5416956/rep645-published-18-december-2019.pdf>

- *what has been achieved*
- *the cost of that work*
- *the future milestones.*

*Standard remuneration reporting templates that simply list tasks performed and the RL's hourly rates may not provide enough information."*<sup>4</sup>

This approach allows creditors to provide informed consent and understand why the cost are incurred.

#### **4. In consideration of technology available today, how beneficial would it be to automatically provide the Annual Administration Return report lodged with ASIC to creditors, directors, owners?**

Providing information is important however providing clear and relevant information is more important than volume. Providing more reports as a matter of course may create additional work and fees which is unlikely to be offset by benefits to the creditors, directors and owners.

Improving the ability and reducing costs for creditors, directors and owners to access relevant reports to ASIC as required would be beneficial to all parties. This should be a future consideration of the Modern Business Register currently being developed.

#### **5. Should valuations be provided to, and proposed marketing strategies require approval from, creditors?**

Realisation of assets is a commercial activity with liquidators often at a disadvantage due to the fire sale nature. Disclosures that further undermine the liquidators bargaining position would have detrimental consequences on realisations and therefore returns to creditors.

Equally, AICM members are often frustrated when realisations do not reconcile with their assumptions of asset values.

The AICM supports post sale reporting to creditors with explanation of factors that were used to maximise realisations and what conditions affected these. For example, where an asset is sold below its book value the liquidator could report on factors that impacted this such as obsolescence, expert reports or limited pool of potential purchasers.

Simple, clear and outcome focused reports enable creditors to efficiently review the reasonableness of asset sales and seek detailed clarification as required and/or make appropriate referrals to ASIC.

#### **6. Should demands to recover payments determined to give a creditor an unfair preference in a winding up require the registered liquidator to include the evidence they relied on in making that determination?**

The AICM strongly supports this recommendation and is able to supply numerous examples where the absence of this requirement has caused detrimental impacts, such as:

- Receiving demands for significantly inflated values.
- Issuing demands without reference to security interests registered on the PPSR.
- Significant time costs reviewing archives and contacting past employees to investigate claims which can be issued 3 years after the point of insolvency.
- Recoveries absorbed by legal fees, often much of the fees relate to work that could be performed by the liquidator.

<sup>4</sup> [https://aicm.com.au/files/1815/7594/0915/AICM\\_Iss\\_5\\_July\\_2019\\_p25-28\\_-\\_Thea\\_Eszenyi\\_-\\_Fair\\_pay\\_for\\_fair\\_work.pdf](https://aicm.com.au/files/1815/7594/0915/AICM_Iss_5_July_2019_p25-28_-_Thea_Eszenyi_-_Fair_pay_for_fair_work.pdf)

AICM members are continually frustrated at these impacts as:

- They have simply followed responsible and best practice collection practices.
- They have not used a position of special knowledge or power such as a related party.
- Recoveries commonly do not result in distribution to creditors which is the intention of the legislation.

In addition to providing evidence the AICM advocates for the following amendments to legislation:

- The time frames related to preference claims be reduced as follows:
  - o Payments subject to preference claims be reduced from 6 months prior to the point of insolvency to 3 months.
  - o Time for liquidator to bring a claim following appointment reduced from 3 years to 12 months.
- Reduce the number and type of payments captured to:
  - o Where creditors have actual knowledge of insolvency, rather than the current suspicion or reasonable grounds to suspect insolvency.  
To expand, currently if a creditor did suspect (or should have suspected) that their customer was insolvent they are exposed to preference claim liability. The AICM attests that credit professionals are employed to suspect insolvency and many customers will display several signs of insolvency without actually being insolvent.
  - o Where undue influence is used or there is a non-arms lengths relationship.

The current practices are a significant concern to AICM members who regularly obtain legal advice, training and formal education on how to minimise and avoid preference claim liability. This adds to the bad debts incurred and is a misallocation of economic resources.

Addressing these issues, whilst maintaining the integrity of insolvency processes, will provide significant benefits to all businesses and the AICM welcomes the opportunity to further elaborate on this topic.

### **7. Should it be mandatory for individuals seeking to be directors of companies to undertake core education on running a business and the potential risks of personal exposure to liabilities before being eligible for appointment?**

The AICM supports the recommendation that all new directors complete a course and knowledge test to ensure they understand directors' duties, components of good corporate governance and financial management.

This may help to dispel some commonly held mis-conceptions (e.g. directors are fully protected from personal liability) that result in poor outcomes for the business owners and the broader Australian economy.

A better understanding of the consequences of breaching director responsibilities could also deter directors being seduced by unscrupulous advisors that proliferate illegal phoenix activity.

### **8. Should it be mandatory for individuals seeking to start a company or register an ABN to undertake core education on running a business and the potential risks of personal exposure to liabilities?**

AICM supports this education for reasons outlined in question 7.

### **9. Where a small business seeks advice when facing financial difficulties, should the individual proposing a course of action be required to provide the small business with:**

- a. a hard copy plain language fact sheet that outlines the various types of external administration available and the role of directors and owners in each?**
- b. the reasons for recommending a particular course of action to the directors?**

Similar to our response to question 1 the AICM supports the provision of this information and notes if the individual proposing a course of action is not a part of a registered population (e.g. accountant, lawyer or insolvency professional) the avenues for enforcing non-compliance may be limited. To be effective on the unregulated population the requirement would require significant legislated penalties backed up by repeated and strong enforcement. Specifically, due to the often exorbitant rates charged by illegal phoenix advisors significant penalties would be required to adequately deter the practice.

**10. How can the safe harbour provision be improved to encourage small businesses to take action early and gain time to assess the viability of the business?**

The AICM believes the regime is appropriate with the exception of not requiring directors to seek advice of an advisor with appropriate insolvency qualifications. Considering the process is inherently not transparent this requirement ensures the rights of all stakeholders are fully considered with a full understanding of the complex factors involved in insolvency. Specifically, The absence of insolvency expertise brings increased likelihood of plans failing and creditors being unknowingly exposed to greater risk.

Rather than further legislation the AICM believes that promoting the benefits of early action and the consequences of not proactively seeking appropriate assistance to manage insolvency situations will have the best return for all stakeholders.

**11. How can accountants and bookkeepers best support small businesses to seek help early?**

The AICM recommends that accountants and bookkeepers are educated on the need to refer small businesses to appropriately qualified and registered insolvency professionals.

**12. Should increased funding and resources be provided to the financial counselling sector to enable them to provide services to small businesses experiencing financial difficulty?**

The AICM strongly supports additional funding for the work financial counsellors currently do.

It is the AICM's understanding that financial counsellors are focused at assisting individuals therefore they should be competent in areas relating to bankruptcy.

A strong understanding of the corporate insolvency process would aid financial counsellors to better assist directors and business owners through these processes and ensure they are directed to appropriately qualified professionals to provide insolvency services.

For clarity financial counsellors would be best placed to assist the individuals and the corporate insolvency process by not providing services related to corporate insolvency but by having a strong knowledge of corporate insolvency processes (at a similar level as credit professionals) in order to help individuals understand their rights and obligations, how to best engage with the process and to identify situations that do not conform with legislation and best practice.

**13. Should the impact on the mental health of small business owners and directors be cause for a pause in proceedings?**

While the small business owner's mental health should be a high focus and consideration for the insolvency professionals we are hesitant to agree that a blanket pause would provide the best outcomes considering timeliness of many aspects is vital to preserve the value of the company.

The AICM strongly supports training and resources being made available to insolvency professionals so they can adequately identify mental health concerns, support and refer individuals to appropriate services and adjust proceedings accordingly.

As a minimum the processes should be capable of adjusting for mental health concerns as it would for other health concerns. Further, legislation prescribes numerous strict time frames which may warrant review to allow for variances when mental health issues arise.

#### **14. Are there other changes that could assist the parties where there are mental health issues?**

Despite the real and potentially life changing impacts the insolvency process is likely to have on the individuals involved, the communication does not consider the recipient of the information instead is very technical and prescriptive.

The vast proportion of directors of insolvent businesses may only engage with an insolvency process once in their lifetime and most are facing significant personal impacts that have played a part in the cause of the insolvency and/or as a result of the insolvency.

Similarly, many small business creditors experience an insolvency process for the first time when a major customer enters insolvency. For many businesses this may threaten their business and personal solvency creating significant stress and mental health impacts.

We understand that the Australian Restructuring Insolvency and Turnaround Association has commenced work with other parties to improve these communications and the AICM advocates for the government to fund this initiative.

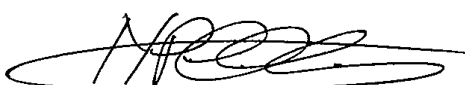
#### **15. General submissions are sought on the fairness of having one system and the benefits and risks of implementing different processes so the costs and time to complete an external administration achieves the optimum outcome for creditors, employees and the company.**

The AICM supports simplified processes generally and for small business insolvencies that reduce costs increase returns improve outcomes generally, whilst ensuring breaches of duties are identified.

A key requirement of credit professionals is that there is transparency and fairness in the process, therefore the AICM does not support the use of pre-packs arrangements where outcomes are predetermined and credit providers provided little or no opportunity for overview, especially where significant losses arise.

Should you have any queries arising from our submission please contact me.

Yours sincerely

A handwritten signature in black ink, appearing to be 'A. P. ...', written over a horizontal line.

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