



**ASIC**

Australian Securities & Investments Commission

## *ASIC's increased focus on insolvency*

by  
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Commissioner

A presentation to  
**Practical Insolvency & Practice Management**  
4 August 2005

## **ASIC's increased focus on insolvency**

I am delighted to again be speaking at this conference, in what is proving to be an exciting year for corporate insolvency – with INSOL in Sydney in March and the Government's announcement on law reform. ASIC has also been busy on the insolvency front, which means I have lots to say about my topic today: ASIC's increased focus on insolvency.

This continued focus is demonstrated here by the presence of many of ASIC's specialist insolvency staff. ASIC's National Insolvency Coordination Unit (NICU) currently has 13 permanent specialist insolvency staff as well as 7 senior secondments from the insolvency profession.

The key focus of my presentation today is our current insolvency activities and those proposed for this financial year. In this paper I propose to:

1. touch on insolvency law reform
2. talk about our policy and guidance work, including:
  - ASIC's guide on deeds of company arrangement involving creditors' trusts
  - our soon to be released liquidator registration policy statement, and
  - our proposed practitioner conduct guidance.
3. discuss ASIC's approach to approval of remuneration
4. give an overview of our forthcoming practitioner conduct program, and
5. update you on some of our other insolvency activities, including our National Insolvent Trading Program and our EXAD Project.

### **Insolvency law reform**

As you know, on 22 March this year, the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce, announced that the Government would develop an integrated set of proposals to improve the operation of Australia's insolvency laws. The integrated reform package will address corporate issues raised by the James Hardie Special Commission of Inquiry, as well as the Government's response to:

- The Parliamentary Joint Committee on Corporations and Financial Services (PJC) report *Insolvency Laws: a Stocktake*'
- The reports by the Companies and Securities Advisory Committee on voluntary administration and corporate groups.

The Government is expected to release its proposals for consultation by the end of 2005. It is not for ASIC to second guess what will be announced by the Government. We have provided Treasury with our response to the recommendations of the PJC report as well as a number of other suggestions for insolvency law reform but ultimately the Government will form its own view.

One of the recommendations of the PJC report, recommendation 28, was that the Government establish an assetless company administration fund to finance preliminary investigations of breaches of directors' duties and fraudulent conduct using the skills of registered insolvency practitioners. ASIC ran a limited pilot program to test the feasibility of a possible model for an assetless administration fund. The fund tested is not one that would be used in every assetless administration. It involves funding liquidators to investigate and prepare a detailed report into aspects of a company's failure where ASIC considers that there may be good prospects of ASIC taking action but there are insufficient resources available to enable the liquidator to conduct proper investigations of breaches of the Corporations Act. In this model, the term "assetless administrations" includes not only liquidations with no assets but also liquidations that have only enough assets to cover the basic tasks – which for the pilot we considered to be assets of under \$10,000.

As a result of the pilot, ASIC considers that the model could be used to fund reports from liquidators that would assist ASIC to investigate major matters and prepare prosecution briefs to the Director of Public Prosecutions or take civil action, as appropriate, as well as investigate and take follow up action on more routine matters such as director banning action. Such reports may also assist ASIC to take more action against those involved in illegal phoenix activity but who don't appear as directors on the company register. Details of the model have been provided to Treasury for consideration as a part of the law reform process.

I'd like to take this opportunity to thank Ferrier Hodgson, Deloitte, Pattisons, PPB, PricewaterhouseCoopers and Bentleys for their contribution to the pilot.

Whatever the Government's insolvency law reform package contains, it will involve ASIC and the profession alike providing submissions and responses to draft legislation. Further, but not too much further, down the track we will all need to come to terms with legislative changes and the challenges of developing new policies and procedures to implement these changes.

Before I leave law reform, one proposed amendment, which is already making its way through Parliament, is the Government's Bill to fix the problem created by the decision in the South Australian Supreme Court case of *Hanel v O'Neill* on s197 of the Corporations Act. I see that Peter Agardy is going to discuss this tomorrow, so I won't steal his thunder, other than to say that the Bill was introduced on 2 June but has yet to be debated, and the amendments in the Bill are not retrospective.

### **ASIC insolvency policy and guidance**

I will now turn to some of ASIC's recent, imminent, and proposed insolvency policy and guidance, starting with our recently released guide on deeds of company arrangement involving creditors' trusts. In doing so, I want to emphasise that ASIC takes its responsibility to regulate the corporate insolvency system very seriously. Our increased focus on insolvency includes ASIC taking a more active role in educating and guiding registered liquidators on what we think they need to do comply with the law in certain circumstances.

#### **ASIC's guide on deeds of company arrangement involving creditors' trusts**

In late May 2005, we issued a guide for registered liquidators on deeds of company arrangement involving creditors' trusts. Although common in Western Australia, the use of such mechanisms in the Eastern States is a relatively recent and increasing practice. ASIC was concerned that administrators appeared not to be aware of, or properly considering, all the issues raised by the use of a creditors trust and, consequently, not giving creditors all the information we believe is material before they vote on the deed proposal.

The guide clarifies the information that we think is material and should be given to creditors in this situation. It also discusses circumstances where we think it is inappropriate for an administrator to submit a DCA proposal involving a creditors' trust or to recommend such a proposal.

One question that we've been asked since the guide was released is how the aggregate value of the proposed trustee's civil liability insurance can be disclosed where the insurance policy contains a term prohibiting disclosure of the amount of cover. The purpose of the relevant clause of the guide (cl 2.13(e)) is to assist creditors to make an assessment of the existence and adequacy of a proposed trustee's insurance. It does not require disclosure of the precise amount of insurance where doing so would breach the terms of the insurance policy, because that would defeat the purpose of protecting creditors.

We expect a proposed trustee to discuss with their insurer the extent of disclosure the policy allows them to make about the amount of cover and tell the administrator so the appropriate disclosure can be made. It is not uncommon for insurers to allow an insured to disclose that they have applicable insurance cover of, for example, "in excess of \$x million". This will generally be an acceptable way of disclosing the value of cover, provided it is not done in a way that misleads creditors. It might be misleading if the actual amount bears no resemblance whatsoever to the "in excess of value" stated. A comparison between the amount of insurance available to the proposed trustee (in that capacity) and the compensation arrangements a deed administrator must have under s1284 and ASIC Policy Statement 33 may also assist creditors to assess the adequacy of a proposed trustee's insurance.

We'll let registered liquidators know our view on this particular issue in more detail in the next edition of our Insolvency Update newsletter.

Any other specific issues that may arise from our guidance on creditors' trusts will be discussed in our regular liaison forums with the profession.

## **Liquidator registration policy statement**

Moving on to imminent policy, our new liquidator registration policy statement is due to be released shortly. This follows on from the policy proposal paper (PPP) released in October 2004.

You might be wondering why it takes so long for a policy statement to be issued after the publication of a policy proposal. Sometimes, as was the case here, we allow extensions of time to make comments. We received final comments on this PPP at the end of January. All comments (48 responses in this case) are carefully reviewed and analysed before any amendments to the proposed policy are made. Depending on the issue at hand, various directorates of ASIC are involved in this process. ASIC's senior policy decision making body – the Regulatory Policy Group – sign off on the final policy, which then undergoes professional editing into our standard Policy Statement format before its release. In between consultation with affected parties and Regulatory Policy Group sign off, we are also required to prepare a regulatory impact statement (RIS) for the Office of Regulation Review, which is part of the Productivity Commission, and obtain their clearance on that document. A RIS sets out the policy issue; the various regulatory options for dealing with the issue; the costs and benefits of each option; the consultation undertaken; the recommended option; and the proposed implementation and review of that option. As you can see, it isn't just a simple matter of making a few changes to the original PPP.

We've listened to your feedback on liquidator registration and this is reflected in the final policy statement. So, what are some of the differences from the PPP?

We have eased the time requirements for corporate insolvency experience – feedback was that the approach in the PPP would make it difficult for part-time workers, those who had had career breaks and those in small practices, multi-disciplinary practices and regional practices to qualify.

Applicants to become a registered liquidator need corporate insolvency experience. We will recognise certain activities that engage someone in work that requires similar skills and capabilities to the registered liquidator role. However, the applicant will still have

to have a majority of their experience directly working on Chapter 5 external administrations.

Experience in members' voluntary liquidations can be taken into account as part of an applicant's non-insolvency corporate management experience.

We will also recognise that a registered liquidator can maintain their skills by undertaking corporate insolvency related work. However, we expect that a person who is registered will take appointments, as this is the whole purpose of registration. So, after three years, if a registered liquidator is not taking appointments, ASIC will generally see this as the registered liquidator not maintaining their skills. We were asked about how our policy would affect managers in firms who become registered but don't take appointments until they make partner. We did an analysis and found that it is very rare for a new liquidator to become registered and then not take an appointment for 3 years.

The triennial statement has been updated to reflect the new policy and so there are questions on the statement about Continuing Professional Development and the type of corporate insolvency work that a registered liquidator has been engaged in.

On the issue of practice capacities – we have made some wording changes in the policy to make it clear that not all practices are required to have the same level of infrastructure as the large firms taking on large and complex external administrations. However, within the context of the practice that the registered liquidator is operating, they must have a minimum level of infrastructure.

With leaves of absence, ASIC will expect practitioners to advise us of a leave of absence beforehand if this is possible. Obviously we cannot expect this if the absence is due to unexpected circumstances such as illness or injury.

When the feedback was carefully analysed it was clear that the majority of commentators felt that our new approach to official liquidator applications is, on balance, the way to go, although there are concerns that there should be some recognition that official liquidators act as officers of the court when appointed to court

liquidations. We are now intending to ask applicants to acknowledge this through a further undertaking. We also looked at the potential loophole where recently registered liquidators under the existing policy with less than 5 years experience might become eligible to practice as an official liquidator under the new policy. We have moved to close this loophole, although we believe there were very few current registered liquidators who would not have the 5 years experience by the time the new policy comes into force.

### **Future insolvency guidance and policy**

Looking now to the future. The conference program reference to my presentation today includes an item called 'New practitioner conduct policy statement'. This is a catchall term to include a number of policy pronouncements that ASIC intends to issue to provide some guidance to practitioners on specific matters where ASIC would like to ensure a high degree of compliance with legal requirements.

It is clear from the feedback we received on the registration PPP that many practitioners would like to hear from ASIC on certain topics and to be more fully aware of our interpretation of some legal provisions.

We expect this guidance might be issued in a number of different formats. We already have a Practice Note on lodging reports with ASIC and a number of Policy Statements, including one on the financial reporting and annual general meeting requirements for externally administered companies. I have just spoken about the recently released Guide on the use of DCA's involving creditors' trusts.

Currently, we are working on a remuneration guide and a guide on managing issues of independence and conflicts of interest. I'll say more on the remuneration guide later. We are also likely to provide guidance on certain aspects of conducting administrations under Part 5.3A and a guide giving our views on miscellaneous issues, including some previously touched on in the various ASIC Insolvency Update newsletters. These guides will be released to the profession in draft initially and following your feedback they will be published in final form. To have input into the end product, provide your comments for us to consider.

Down the track we will be reviewing all current ASIC policy that provides guidance to registered liquidators, and if necessary, updating it. We are open to suggestions of areas that you believe we should address in policy. These should be sent to Karen Axford in our Adelaide office at karen.axford@asic.gov.au

At the end we will have an integrated package of guidance so that it will be very clear to registered liquidators what is expected of them to fulfil their obligations. This is in line with the emphasis ASIC places in the registration policy statement on liquidators performing their duties adequately and properly.

### **Insolvency information sheets**

As well as providing more guidance to the profession, ASIC will soon be releasing a package of general insolvency information sheets aimed at insolvency stakeholders with little or no knowledge of the insolvency process. The need for more comprehensive information on insolvency for that audience was highlighted in a number of recommendations of the PJC report.

The first five information sheets, for directors, shareholders and employees, are currently with stakeholders, including the IPAA, for comment. Drafting of more detailed creditor information sheets is also well underway. A glossary of insolvency terms is also part of the package. We encourage insolvency practitioners, once the information sheets are released, to provide them to those involved in the insolvency process or advise these stakeholders of their existence, as appropriate.

### **ASIC's approach to insolvency practitioner remuneration**

I'll now turn to the very topical matter of ASIC's approach to insolvency practitioner remuneration. The decision of Finkelstein J last December in the Stockford case and the Clinton Court case that followed has given us all reason to think about this important area.

It is very important that practitioners follow legal, ethical and transparent practices for remuneration approval. This is a key issue for the credibility of the industry and the confidence of creditors in the work that is performed by insolvency professionals.

There are still some areas of legal uncertainty and we believe it is important that ASIC takes a position on what we believe is the correct legal interpretation of the legislative provisions. One of these areas is prospective fee approval where it relates to fees charged on a time basis. As a result of Finkelstein's comments in the Stockford decision, we realised that this was an area where clarification was needed.

We have obtained advice from counsel that states unequivocally that remuneration cannot be 'fixed' prospectively where a practitioner intends to charge on a time basis. This is the case whether or not the resolution seeking remuneration states an upper limit or 'cap'. In the case where such resolutions are open ended, there is a lack of certainty or objectivity of the time factor reasonably involved. Where such resolutions are capped, merely to confine something within a certain limit does not 'fix' or 'determine' it. The IPAA has since obtained its own counsel opinion, which expresses a different view – that time based remuneration can be 'fixed' prospectively when it is capped. ASIC and the IPAA have discussed the possibility of a test case to have this important practical issue for the profession judicially determined.

ASIC will hold off on issuing the draft guidance if the test case is decided in the next 6 weeks or so.

We acknowledge that ASIC's view, based on its advice, may give rise to practical difficulties. If the test case decides in favour of ASIC's view, we will explore with the IPAA the possible options for dealing with these difficulties, for inclusion in the draft guide.

I do not want to pre-empt the other contents of the guide but the approval and payment of external administrator remuneration is an area where we believe there is a need for more clarity.

Other areas that will be covered in the guide include:

- Contingency fees;
- What information and assistance should be provided to committee members and creditors when they are being asked to fix fees;

- When committee members and creditors should be provided with this information and assistance; and
- The demarcation between what expenses should be classified as remuneration or as disbursements. This is an area that has caused some concern in the UK and we believe it is inevitable that concerns will eventually be raised here. Indeed, Justice Finkelstein alluded to this in his original judgment in the Stockford case.

In the development of the guide, we have already sought input from the IPAA. Although we may not agree on every issue, we are very grateful for the practical input that the IPAA representatives provide to our policy development process.

Another ASIC activity arising from the Stockford decision was to write to all 759 registered liquidators asking them to let ASIC know whether they had received remuneration in voluntary administrations without first ensuring the amount has been properly assessed and fixed either by the creditors or by the court (or in accordance with directions made by the court), as required under the Corporations Act.

All but 16 liquidators with current Part 5.3A administrations have replied. These 16 are being contacted to obtain a response. Included in the replies were 105 liquidators with issues falling within the criteria. The majority of administrators advised that they would rectify the matter by holding meetings of creditors. ASIC has asked these liquidators to advise ASIC on completion, and for those who haven't already let us know, to tell us how they intend rectifying the non-compliance.

### **Insolvency practitioner compliance program**

Moving now from practitioner remuneration to practitioner compliance. In the feedback on the registration policy proposals, we received many comments about the need for ASIC to conduct industry surveillance to support the proposed policy on what liquidators must do to remain registered, outlined in Section B of the PPP.

We have made it clear that we take very seriously the obligation on registered liquidators to perform adequately and properly their duties and functions and that in

order to do this, registered liquidators must be, and remain, competent, independent and diligent. This is a key consumer (i.e. creditor and shareholder) protection mechanism.

Our approach over the coming year will be multifaceted – the Enforcement Directorate will continue to respond to matters that are reported to us and where necessary, will be ensuring that practitioners comply with the law such as the recent exercise in response to the Stockford decision.

We will also be running a number of compliance exercises through NICU and our Public Information Program to ensure that the information on the corporate database and the liquidator register is correct. This also supports our policy work.

There are five planned compliance activities:

- The first is to ensure liquidators lodge 905A forms to make sure their details are up to date.
- We will be checking that all current registered liquidators are complying with the ongoing requirements for registration in Section B of the new policy statement, particularly to make sure they are maintaining their skills and remaining resident.
- Our database shows current external administrations recorded against registered liquidators who have ceased their registration. We need to check that those files are no longer active. Either the paperwork needs to be lodged to complete the external administration or the files need to be transferred to another practitioner.
- There are approximately 2200 external administrations that are over five years old. These files may be still current because of unresolved issues such as litigation. However, we intend to check with practitioners to make sure that all old external administrations remain open for a reason and that where files can be closed, they are closed. It is important that creditors know that matters are being finalised as soon as possible.
- The fifth activity is scheduled for the last quarter of 2005/2006. We intend to check compliance with our remuneration guide. This exercise has not been fully scoped yet. However, the purpose of the exercise will be educational and

also to gather some intelligence to see if any improvements or finetuning needs to be made to the guide.

### **ASIC's other insolvency activities**

I don't have time to cover all ASIC's insolvency initiatives today, so I'll just discuss a couple – Electronic lodgement and our National Insolvent Trading Program.

Attachment 1 to my paper gives results for 2004/2005 for some of our other insolvency initiatives.

#### **Electronic lodgement**

An important milestone was recently achieved when our final group of insolvency forms went 'live'. Thirty forms can now be lodged electronically on-line through our registered liquidator portal. This has been a significant feat, with the EXAD project involving many ASIC staff from different parts of the organisation over a number of years. Those behind the scenes deserve to be congratulated. Particular thanks are due to the initial Project Manager, Maggie Hammerton, who many of you will have dealt with, and her successor, Joy Hadley. Joy is here today, outside the conference room, demonstrating how easy and useful electronic lodgement is for liquidators and their staff. I encourage those of you who have not yet signed up or who lodge electronically but have questions, to take the time to go and see Joy. We will also be running a series of workshops around the country to update practitioners and their staff during September and October on electronic lodgement and providing information to ASIC. Presenters at these workshops will also be talking about liquidator conduct, the liquidator assistance program and enforcement. Now that all liquidator forms can be lodged electronically we are aiming to increase uptake of this facility.

Related to, but not directly a part of the EXAD project, we finally succeeded in having a number of insolvency forms removed from the regulations to become ASIC approved forms, in late December 2004. This enabled us to roll out the new form 908, liquidator's triennial statement, and form 524, six monthly statement, on 1 July 2005. These new forms can be lodged electronically. Practitioners will receive an email reminder when it is time to lodge their triennial statement.

### **National Insolvent Trading Program**

At the end of its second year of operation, ASIC's National Insolvent Trading program continues to have an impact in the market place. As you know, the program, operated by NICU, conducts reviews of companies of all sizes suspected of trading while insolvent with the aim of company directors actively managing their company's financial position and seek early advice when financial difficulties arise.

In the 2004/2005 financial year, ASIC visited 488 companies, including a number of related companies. Pleasingly, many positive outcomes, ranging from companies seeking professional advice or obtaining an accurate financial position, through to restructuring, refinancing or raising further capital, have been achieved through these visits.

Despite the positive outcomes achieved by the program, invariably some companies visited cannot be saved and require the appointment of an insolvency practitioner. ASIC's involvement contributed to the appointment of external administrators 'sooner rather than later' to 63 of these companies. Five of these were listed companies. Eight of the 63 appointments resulted from successful ASIC applications by our Enforcement directorate for the appointment of a provisional liquidator, liquidator or receiver and manager, following a referral from NICU. A further 2 of the 63 appointments were made by listed companies who appointed voluntary administrators following ASIC making applications for the appointment of an external administrator, but before those matters were heard. While ASIC prefers directors to take their own action to appoint an external administrator where the company is insolvent or likely to become insolvent, ASIC will not hesitate to pursue its own action if they are unable or unwilling to do so.

Prominent companies in the 63 include:

- Australian Foods Company Pty Ltd (WA)
- Henry Walker Eltin Group Ltd (NSW)
- Collins Booksellers Pty Ltd (VIC)
- Sam's Seafood Holdings Ltd (QLD)

The coming financial year will see the program looking to focus on specific industries that are potentially struggling as a result of market conditions. For example we have recently looked at a number of Queensland boat building companies and a number of Victorian building and construction companies.

A key factor in the program's success is the use of specialist insolvency staff to carry out the reviews. In 2004/2005, Bentleys MRI, Deloitte, Ferrier Hodgson, Horwath, McGrath Nicol & Partners, PricewaterhouseCoopers, and PPB provided senior secondments to support ASIC's own senior insolvency staff. We very much appreciate the support of these firms and others that have previously, or will in future, provide secondments to the program.

### **Conclusion**

ASIC has achieved some significant insolvency results in the past year, including the delivery of the EXAD project. Our focus on insolvency will continue and evolve in the coming year. Some of our new activities will include issuing new guidance for registered liquidators and a program of practitioner compliance activities. Our successful Liquidator Assistance and National Insolvent Trading programs will continue, with the latter taking an industry specific focus. There seem certain to be further developments on the approval and payment of external administrators' fees. Both ASIC and the profession will face the challenges of the, as yet unknown, brave new world of post-law reform insolvency.

## Attachment 1

### Summary of results of other ASIC insolvency activities for 2004/2005

(Not referred to in body of paper)

#### Liquidator Assistance Program

Our Liquidator Assistance initiative continues to clock up some big numbers. Results for the 2004/2005 financial year were:

- 423 company officers have been prosecuted for 772 liquidator assistance type offences.
- These prosecutions have resulted in the courts awarding \$917,094 fines and costs.
- 74% of company officers contacted by ASIC chose to comply with their legal obligations.

As at 30 June 2005, before the courts were another 290 individuals facing 354 charges (268 of which are liquidator assistance type matters) and another 176 individuals being investigated for liquidator assistance type offences.

#### CALDB activity

Three liquidator conduct matters were determined by the CALDB in 2004/2005:

- 2 suspension of registration
- 1 reprimand

One of the suspensions is currently being appealed and has not yet been publicly announced.

A further liquidator received a severe reprimand for a conduct matter in July 2005.

ASIC is currently working on the following liquidator conduct activities:

- 6 applications before the Board
- 7 practitioners currently being investigated with a view to CALDB action.

During 2004/2005, four administrative liquidator matters were referred to the CALDB:

- 1 cancellation of registration
- 1 admonishment
- 2 settled prior to hearing on cancellation of registration and payment of costs

#### Enforcement action against liquidator

Former Adelaide liquidator (John Henderson Jackson) was found guilty in May 2005 of five counts of fraudulent conversion from one of his receiverships and sentenced to 3 years jail, wholly suspended on a \$2000 good behaviour bond.

## **Liquidator registrations**

In the 2004/2005 financial year, 32 registered liquidators and 20 official liquidators were registered. This compares to 24 registered liquidators and 18 official liquidators in 2003/2004.

As at 30 June 2005, 9 applications for registration as a registered liquidator and 1 application for registration as an official liquidator were on hand.