



ASIC

Australian Securities & Investments Commission

**External administration:
Liquidator registration
Regulation impact statement (RIS)**

August 2005

What this regulation impact statement is about

This RIS relates to a proposed policy statement (PS) on the exercise of ASIC's discretionary powers under Part 9.2 of the *Corporations Act 2001* (the Act) to register persons as liquidators and official liquidators.

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Background

Introduction

1. ASIC is required by the *Corporations Act* (the Act) to register as liquidators natural persons who satisfy the criteria listed in s1282(2) and are not disqualified by s1282(4). Registered liquidators are eligible to be appointed to all types of external administrations referred to in Chapter 5 of the Act, except the role of court-appointed liquidator or provisional liquidator (see s532(8)).

2. Under s1282(2), ASIC must satisfy itself that an applicant for registration as a liquidator has appropriate qualifications, has winding-up experience, is capable of performing the duties of a liquidator and is fit and proper to be a registered liquidator.

3. ASIC also has power to register a natural person as liquidator of a specified body corporate (s1282(3)) or to register currently registered liquidators as official liquidators (s1283). Official liquidators are eligible to be appointed to the role of court-appointed liquidator or provisional liquidator.

4. ASIC has standing to apply to the Companies Auditors and Liquidators Disciplinary Board (the Board) for the Board to exercise its powers under s1292 to cancel or suspend a registered liquidator's registration in the event of inappropriate conduct by the registered liquidator. ASIC may also take direct action under s1291 in relation to conduct by an official liquidator.

5. ASIC's existing policy statements on liquidator registration were issued in 1992 and are limited in scope. They set out:

- (a) the type and amount of experience we require for s1282(2) (Policy Statement 40 *Registration of liquidators – experience criteria* [PS 40]). 'Experience' is only one of various criteria to be met by an applicant for registration as a liquidator; and
- (b) our approach to registering official liquidators (Policy Statement 24 *Registration of Official Liquidators* [PS 24]).

6. The policy in [PS 40] and [PS 24] was minimally updated in 1997, but these policy statements have not been substantively reviewed since the introduction of Part 5.3A (see below).

7. As at 30 June 2005, there were 762 registered liquidators of whom 367 were also official liquidators. Averaged over the five years to 30 June 2005, ASIC has received 30 liquidator and 15 official liquidator applications per year.

The nature of the market

8. The market for registered liquidator/external administrator services is regulated by the Corporations Act. In this market, the 'buyers' (creditors):

- (a) are 'captive' to the financial condition of the entity being or to be externally administered, and do not freely choose to enter the market;
- (b) have very limited rights to choose the identity of the supplier of the service or to negotiate a price for the service. In some instances, they will be given no right to participate in these decisions. For example, in a voluntary administration, the administrator is usually selected by the directors;
- (c) are almost totally dependent on information provided by the 'seller' (external administrator) as to what and how much service needs to be provided and the pricing structure for that service so that information asymmetry exists;
- (d) have their individual wishes sublimated to the wishes of the collective group, or at least a majority of that group.

9. The quality and appropriate quantity of service to be provided by an external administrator is not easily assessed by creditors either before or after the external administrator is appointed. Factors that determine the quality and quantity of service provided by external administrators include:

- (a) the funds available in the external administration;
- (b) the issues identified by the external administrator;
- (c) the statutory and fiduciary responsibilities of the external administrator when appointed to a particular role;
- (d) commercial considerations;
- (e) the professional judgment of the external administrator (which generally depends on experience); and
- (f) collective decisions of the creditors or a representative group of the creditors.

10. The primary source of funds for paying for the external administrator services is the externally administered entity itself (ie funds held by or accruing to the externally administered company and which are controlled by the external administrator). Creditors 'pay' for the service indirectly through reduction of the entity's assets that would otherwise be available to pay them a dividend.

11. The Act regulates the way the 'price' of registered liquidator/external administrator services is determined. As fiduciaries, external administrators are subject to an implied obligation to only charge 'reasonable' remuneration. Generally, the final 'price' of the external administrator services in a particular

case is subject to agreement (typically retrospective) by a representative group of creditors, a majority of the creditors attending a creditors' meeting, or a court.

12. Unlike in a competitive market, a change in the supply of registered liquidators/external administrators ('sellers') does not have an unequivocal (inverse) effect on the price of external administrator services. Therefore, regulatory measures that only modestly and/or temporarily affect the number of registered liquidators (eg by changing the barriers to entry) can be expected to not affect the price of services supplied by registered liquidators.

13. It must also be noted that, in this market:

- (a) due to the nature of external administrator appointments, services can be provided before there is any express agreement about price;
- (b) the persons responsible for approving the fees to be paid to the external administrator (creditors) typically receive very little information on comparable rates charged in the market place for similar services and have very little opportunity to 'shop around'. They may have to rely solely on information provided by the external administrator;
- (c) in the limited situations where creditors are able to be more involved in selecting the service provider (eg where an initial external administrator is being replaced), selection is typically based on factors of greater (or equal) importance than price, such as:
 - (i) the characteristics of the entity being externally administered, including its size and the nature and complexity of its businesses; and
 - (ii) the external administrator's reputation and experience in managing entities with those characteristics;
- (d) there is more than one possible method of price determination. 'Price' may be determined on a 'time spent', fixed fee or commission basis (eg a percentage of gross realisations). Other types of remuneration charging (eg contingency basis) are either not permitted under the Act or are incompatible with the fiduciary duties owed by external administrators to the entities they administer, and by extension, to the creditors of those entities. Most common is the 'time spent' basis, where external administrators apply a scale of hourly rates developed in their practices to cater for the different types of external administration appointments they take on. These rates are not directly affected by the supply of registered liquidators;
- (e) external administrators may not actually receive the full 'price' based on their hourly rates where the assets of the externally administered entity are insufficient (see paragraph 10 above). The external administrator may have to write off all or part of that 'price'. This risk is inherent in the nature of the work.

Impact of Part 5.3A

14. Part 5.3A of the Act was introduced in 1993. It created two new types of external administration - voluntary administration and administration under a deed of company arrangement. The aims of Part 5.3A are outlined in s435A and are to maximise the chances of a company or its business continuing in existence or, if that is not possible, to provide a better return to creditors and members than would result from an immediate winding up of the company.

15. Part 5.3A has significantly changed the insolvency landscape because:

- (a) the administration procedure is available to entities that are likely to become insolvent, as well as those that are already insolvent;
- (b) the procedure focuses on the rehabilitation and continued trading of businesses. This gives rise to more complex issues than are generally involved in winding up an insolvent entity;
- (c) the procedure is designed to provide flexibility, and greater reliance is placed on the judgment of the administrator with limited supervision by ASIC or the court;
- (d) the short time frames involved place higher demands on external administrators to perform required tasks, including carrying out initial investigations, assessing proposals for a deed of company arrangement, and communicating with creditors;
- (e) appointments under Part 5.3A have become the most lucrative type of appointment for insolvency practitioners because companies entering voluntary administration typically have assets and therefore the external administrator is more likely to receive full remuneration for their services.

16. All registered liquidators are eligible to accept appointments as an administrator under Part 5.3A (provided they are not disqualified by the factors outlined in s448C).

17. The number of voluntary administrator appointments has more than trebled, from 827 in 1993/94 (the first full year after insertion of Part 5.3A) to 2652 in 2003/04. Appointments under Part 5.3A (as voluntary administrator, deed administrator or as liquidator in a subsequent creditors' voluntary winding up) are now the most frequent type of external administration appointment.

18. Part 5.3A raises two main risks that are not adequately addressed by current ASIC policy:

- (a) Part 5.3A administrations have characteristics that heighten the dependence of creditors on the external administrator; and

- (b) with the increased use of Part 5.3A, the features that make Part 5.3A administrations unique (such as ease of entry, timeliness, flexibility) have created regulatory risks to which we need to respond.

19. These risks give rise to problems 1 and 2 identified below. Addressing risks involved in conduct by registered liquidators requires a focus on both initial accreditation and ongoing obligations of registered liquidators.

Characteristics of Part 5.3A

20. Certain characteristics of the Part 5.3A processes increase the regulatory reliance on proper performance by registered liquidators and create a need for higher levels of skill, experience and integrity. These characteristics include the following:

- (a) voluntary administration is usually initiated by the directors of the debtor (rather than by a creditor). Directors' interests differ from, and may be opposed to, those of the creditors. It is not unusual for a registered liquidator to provide advice to the directors before being appointed as administrator. Once appointed, the administrator must act in the interests of creditors and is paid (indirectly) by the creditors (see paragraph 10 above). The fact that the service provider is selected by someone other than those 'paying' for the service and whose interests must be served increases the importance for administrators to be, and be seen to be, independent, particularly given the difficulties for creditors in changing the administrator (see paragraph (b));
- (b) creditors have limited opportunity to remove and replace the administrator. Creditors are only able to replace an administrator at the first meeting of creditors, which occurs within 5 business days of the appointment of the administrator. By the time creditors receive notice of the first meeting, there is little time to gather information to make an informed decision about whether an administrator should be removed. Creditors would also need to contact an alternative administrator willing to act. A creditor proposing an alternative administrator would then need to convince other creditors at the meeting to vote for the replacement. Where a vote for removal is deadlocked, the administrator has the casting vote and can vote to confirm his/her own appointment, although this can be challenged in court. Given these circumstances, successful votes to replace an incumbent administrator are rare. Applications to the court to replace an administrator are also rare. The court takes into account the interest of creditors as a whole and will consider the inconvenience and expense associated with replacing an administrator. If creditors later vote for the company to be wound up, the administrator automatically becomes the liquidator;
- (c) administrators are personally liable for debts incurred during the administration (s443A), although they are entitled to a limited indemnity against the company's assets (and in some cases may be indemnified by third parties). Other types of external administration do not impose personal

liability on the external administrator. Personal liability means that Part 5.3A administrators must have good commercial and risk management skills;

- (d) administrators often assist parties to develop a proposal for a deed of company arrangement. They must then take an impartial view of that proposal and express an opinion as to whether it is in the best interests of creditors. This balancing act further relies upon the skill, experience and independence of administrators;
- (e) administrators must chair the creditors' meeting that decides the company's future. The administrator has a casting vote in certain circumstances and can determine the outcome for all creditors. This aspect of the voluntary administration process further increases the regulatory reliance on the skill, experience and integrity of administrators.

21. The processes involved under Part 5.3A mean that creditors are almost totally reliant on the administrator. The administrator is the conduit for information to the creditors about both the insolvent company and any rehabilitation proposal.

22. The potential for abuse in the directors' selection of the administrator is compounded by the absence of any legal requirement for disclosure of a prior relationship between the director and the administrator and the limited opportunity for creditors to replace the administrator. This potential for abuse has been well-documented¹. For example, an administrator who is a 'puppet' of the directors may not invite some creditors to the first meeting or their invitation may be deliberately delayed so it does not reach them in time.

Developments under Part 5.3A

23. Practices under Part 5.3A have developed over the years since that Part was introduced. For example:

- (a) many very large corporate entities and groups have been subject to Part 5.3A, including the Ansett group of companies;
- (b) deeds of company arrangement are now commonly used for complex restructurings and corporate reorganisations, effectively replacing Part 5.1 for insolvent companies;
- (c) use of the s447A power has expanded the scope of the administration procedure.

24. As companies, registered liquidators and their legal advisers have become more familiar with Part 5.3A and courts have considered its possibilities and limitations, it has become apparent that the legal boundaries of Part 5.3A are

¹ Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*, June 2004; and Companies and Securities Advisory Committee, *Corporate Voluntary Administration*, June 1998.

wide. Under that Part, insolvent companies and their external administrators have a great degree of flexibility in the type of arrangements that can be included in deeds of company arrangement. At the same time, the role of ASIC and the courts in supervising proposals submitted to creditors and the content of deeds of company arrangement is relatively limited, reflecting the legislative objectives underlying Part 5.3A of flexibility and speed.

25. An example of the way practices under Part 5.3A have developed is the use of creditors' trusts in deeds of company arrangement. The effect of this practice is that creditors are removed from the scope and protections in Chapter 5 of the Act and instead become reliant on trust law. It is unlikely that the use of Part 5.3A in this way was contemplated when the Part was introduced. Other unforeseen practices may similarly evolve in the future.

26. The scope for practices under Part 5.3A to evolve in this way underlines the greater regulatory dependence on the capability, fitness and propriety of persons eligible to be appointed under Part 5.3A.

Our experience administering Part 5.3A

27. ASIC has needed recently to issue a guide on the use of creditors' trusts in deeds of company arrangement (see paragraph 25 above) to address a number of risks and conduct matters raised by that developing practice.

28. ASIC may refer matters to the Companies Auditors and Liquidators Disciplinary Board when we become aware, through a complaint or other means, of concerns about a registered liquidator's conduct. Between July 1998 and July 2005, ASIC referred 27 registered liquidator conduct matters to the Board. More than half (16) of those matters involved misconduct allegations in Part 5.3A administrations.

29. The size of a registered liquidator's practice appears to be a risk factor. Of the 27 conduct matters referred to above, 25 matters involved sole practitioners or practitioners who work in small to medium-sized ('small business') practices. All 16 of the Part 5.3A misconduct matters referred to in the previous paragraph involved 'small business' practices.

Policy Proposal Paper (PPP)

30. On 8 October 2004, ASIC published a PPP *External administration: Liquidator registration*. A copy of the PPP is available from ASIC's website at www.asic.gov.au/insolvency. The PPP outlined ASIC's proposed new approach to the registration of liquidators and official liquidators under Part 9.2.

31. ASIC conducted extensive consultation with external parties on these proposals. The result of this consultation is set out in paragraphs 55 to 59 of this RIS.

Possible law reform

32. On 22 March 2005, the Government announced its intention to develop an integrated set of proposals to improve the operation of Australia's insolvency laws. ASIC understands that proposals will be released for public consultation by the end of 2005. The timing and content of the proposed law reform is therefore uncertain. However we understand that it is unlikely to materially affect Part 9.2 or our recommended option in this RIS.

Issue/problem

1: [PS 40] contains inadequate guidance on the registration process

33. ASIC's review of the current environment has highlighted the inadequacy of [PS 40] in assisting:

- (a) ASIC to assess applications for registration as a liquidator; and
- (b) applicants to know when ASIC will assess them as meeting all the criteria for registration.

34. This is because:

- (a) [PS 40] directly addresses only corporate insolvency experience, which is only one aspect of the various criteria that ASIC must be satisfied about before registration occurs;
- (b) the corporate insolvency experience requirements in [PS 40] do not adequately reflect the mix of skills and experience a registered liquidator needs in the current environment for any appointment they take on immediately after registration;
- (c) [PS 40] does not directly address the wider aspect of capability that includes 'practice capacities'; and
- (d) [PS 40] does not address how we will assess the other criteria for registration as a liquidator where ASIC has a discretion, including 'fitness and propriety' more generally.

35. These inadequacies in [PS 40] mean that the application process takes longer than it should because of uncertainty in the process and as a result both ASIC and applicants incur higher costs in the application process. There is also a risk that applications will not be dealt with consistently over time and that, because of the uncertainty, ASIC may register applicants who are not suitable for registration.

2: Greater regulatory emphasis is needed on maintaining qualities necessary for remaining registered

36. [PS 40] is also inadequate in assisting both ASIC and registered liquidators to assess whether they are complying with their ongoing obligations as a registered liquidator.

37. This is because ASIC has not explained in current policy its approach to what registered liquidators must do to maintain their registration.

38. ASIC has power under s1292(2) to refer a registered liquidator to the CALDB where it considers that the registered liquidator has failed to perform adequately and properly their duties or functions, or is no longer a fit and proper person to be registered.

39. Registered liquidators need at a minimum to maintain the qualities they had upon registration if they are to remain capable of performing their role. Taking external administration appointments is important for maintaining the currency of their skills and because it is the purpose for which they were registered. ASIC's corporate database indicates that approximately twenty percent of currently registered liquidators have not taken a new appointment for more than two years.

40. A number of matters have arisen through ASIC's enforcement role where concerns have been raised about whether a registered liquidator has maintained their professional skills. This includes all the matters referred to the Board (see paragraph 28 above) as well as matters that were considered for referral.

3: Current policy distinction between registered and official liquidators is too restrictive

41. Only official liquidators are eligible for appointment in a court liquidation (s532(8)). All official liquidators are registered liquidators.

42. ASIC considers that there is no continuing justification for distinguishing between the qualities required for registered liquidators and official liquidators on the grounds of work complexity, which is the basis for the current distinction in [PS 24] between their respective registration requirements.

43. Part 5.3A has significantly increased the quantity and complexity of work performed by registered liquidators and has highlighted both the need for specific capabilities in registered liquidators and the lack of justification for continuing to distinguish between registered liquidators and official liquidators on the basis of work complexity.

44. As has been noted by the AAT (eg *Re Lofthouse and ASIC* [2004] AATA 327) and various courts, the work performed by an official liquidator under a court appointment cannot be considered as inherently more complex or of a higher

profile than work undertaken by a registered liquidator under Part 5.3A or as receiver and manager of a large entity.

Objectives

45. ASIC's objectives are to:

- (a) improve the quality and performance of new and existing registered liquidators;
- (b) simplify and improve the application processes for registration as a liquidator and as an official liquidator; and
- (c) establish a less restrictive approach to the distinction between the categories of registered liquidator and official liquidator that recognises the current demands of those roles in both the legislation and the marketplace.

Options

Option 1 – Issue new policy on liquidator registration under Part 9.2

46. This option involves publishing a new PS to supersede [PS 40] and [PS 24]. The proposed PS would reflect the changes effected by the introduction of Part 5.3A and other developments affecting the insolvency industry, and provide comprehensive guidance on ASIC's new approach to the registration of liquidators and official liquidators, including:

- the criteria that a person must meet to become a registered liquidator;
- what a registered liquidator must do to remain registered; and
- when ASIC will register a liquidator as an official liquidator or liquidator of a specified body corporate.

47. The new PS would:

- (a) change the capability requirements (experience and practice resources) that an applicant for registration as a liquidator must meet, as set out in the table below (proposed Section A and Schedule);
- (b) express new policy on ASIC's interpretation of the other criteria (in addition to experience) that must be satisfied for registration as a liquidator (proposed Section A and Schedule);
- (c) require registered liquidators to satisfy ASIC on an ongoing basis that they are maintaining their fitness and propriety (including their capability) to be a registered liquidator (proposed Section B);

- (d) reduce the additional requirements that registered liquidators must meet for registration as an official liquidator, as set out in the table below (proposed Section C); and
- (e) simplify the type, detail and format of information to be provided in the applications for registration as a liquidator and for registration as an official liquidator (proposed Sections A and C and Schedule).

48. The table below compares the existing and proposed capability requirements for initial registration as a registered liquidator. It also compares the existing and proposed requirements for registration as an official liquidator. No comparison can be given for the registration criteria other than capability or for ongoing liquidator registration requirements as ASIC has no existing policy corresponding to the remainder of proposed Section A or to proposed Section B.

Comparison of initial requirements

Current policy on 'capability' for registered liquidators (RL)	Proposed policy on 'capability' for registered liquidators (RL)
<p>Applicant must have:</p> <ol style="list-style-type: none"> 1. Worked 5 years in 'public practice'. This means holding a 'public practice' certificate from ICAA, CPA Australia or NIA. It therefore implies: <ul style="list-style-type: none"> • full membership of ICAA, CPA Australia or NIA • completion of an additional training programme in public practice • periodic quality assurance reviews by independent quality assurance auditor (including of practice capacities) 2. 3 years continuous corporate insolvency experience under the supervision of an official liquidator 3. Wide range of corporate insolvency experience 4. Supervised external administrations on a full-time basis for at least 2 consecutive years out of last 5 	<p>Applicant must have:</p> <p><i>Personal capacities</i></p> <ol style="list-style-type: none"> 1. Worked in corporate insolvency for full time equivalent (FTE) of 5 out of last 10 years: <ul style="list-style-type: none"> • Up to 20% of experience can be in corporate insolvency work other than external administrations. The rest must be under the supervision of an RL or overseas equivalent • If experience gained overseas, 1 year out of last 2 must be external administration work in Australia 2. Broad range of corporate insolvency experience including insolvent windings up and Pt 5.3A 3. Experience at a very senior level for FTE of 3 out of last 5 years 4. Experience in a range of complex matters 5. Demonstrated skill and diligence <p><i>Practice capacities</i></p> <ol style="list-style-type: none"> 6. Human and technological resources and processes for monitoring the adequacy of these, including: <ul style="list-style-type: none"> • Ongoing supervision and training of staff • Operational procedures and manuals • Risk management systems

Current policy for registering official liquidators (OL)	Proposed policy for registering official liquidators (OL)
<p>Applicant must:</p> <ol style="list-style-type: none"> 1. Be an RL 2. Since becoming an RL, have at least 2 years continuous experience in external administrations (some of which must be court appointed) 3. Be working at a senior level under the direct supervision of an OL 4. Demonstrate involvement in liquidations including complex windings-up 5. Have staff and other resource back-up facilities so as to be able to conduct an OL's practice 6. Have appropriate training and operational manuals 7. Undertake to ASIC that they will consent to take all court appointments 	<p>Applicant must:</p> <ol style="list-style-type: none"> 1. Be an RL or be making concurrent applications to be RL and OL 2. Provide: <ul style="list-style-type: none"> • a written request with brief explanation of why registration is sought • a written undertaking that they will not refuse consent to be appointed by a court on the ground that the liquidation will be assetless • a written acknowledgement that court-appointed liquidators act as officers of the court 3. Be fit and proper

49. Under this option, the policy on initial capability for registered liquidators would:

- (a) rely on both s1282(2)(b) and s1282(2)(c) to assess an applicant's relevant experience;
- (b) require the minimum five years' experience to be in corporate insolvency work rather than in general public practice with only three years in corporate insolvency;
- (c) directly assess practice capacities for registered liquidators according to the type of practice the applicant is likely to operate;
- (d) focus the assessment of capability on the aspects from the applicant's career that should provide the best indication of an applicant's capability to be a registered liquidator;
- (e) take account of the similarity of the types of work performed by registered liquidators and official liquidators, as noted by the AAT in the *Lofthouse* decision (see paragraph 44).

Option 2 – Do nothing

50. Continue to rely on existing [PS 40] and [PS 24].

Impact analysis

Affected parties

51. Those primarily affected by the problem and the potential solutions are:

- (a) Current registered liquidators and official liquidators (approximately 762 and 367 respectively);
- (b) Aspiring registered liquidators and official liquidators;
- (c) Creditors of externally administered companies. (Shareholders are also potentially affected parties, but because shareholders have only a residual (and usually remote) interest in an insolvent external administration, they are not considered an affected party for this RIS);
- (d) ASIC;
- (e) The Federal Court and Supreme Courts of the States and Territories (in relation to official liquidators).

Costs and benefits of each option

Option 1 – Issue new policy

Costs

Insolvency practitioners

- The revised approach to testing capability may mean that some aspiring registered liquidators will need to delay their applications until they attain the quantity and type of experience required in the proposed policy.
- Supervising referees will need to provide a more detailed (and useful) report and this may increase preparation time. The extent of the increase depends on a range of factors including the closeness of the supervisory relationship and hence the referee's familiarity with the work performed by the applicant as well as the accuracy and comprehensiveness of the application. (The referee has the benefit of the prepared application and is requested to offer comments relating to the matters covered in the application.) It is possible that a supervising referee with a high degree of familiarity with the external administration work relied upon by the applicant will not spend any more time on a report under the new policy than she or he would have spent preparing a report under [PS 40]. A senior practitioner was asked to provide an estimate on the time taken to prepare a referee's report for an aspiring registered liquidator currently employed in his practice. He estimated that the time taken under the current policy would be approximately one and a half hours and under the new policy he would expect this to increase to two and a quarter hours. He cautioned that a general estimate is impractical as it

would depend on many circumstances related to the individual applicant and referee. As there are only an average of 30 liquidator applications per year (see paragraph 7), the aggregate cost of this change will be relatively small.

- The proposed policy will expressly require applicants and registered liquidators to have (and maintain) practice capacities adequate for the type of practice they are likely to operate (and do operate). This may result in compliance costs for those applicants and registered liquidators who do not currently have adequate practice capacities. It is not possible to quantify these costs. However, it must be noted that the proposed policy merely states more explicitly an aspect of the current requirement in the Act to be "capable" and that all currently registered liquidators should be maintaining practice capacities that would be adequate under the proposed policy. Current policy already requires (indirectly) adequate practice capacities (through the requirement to hold a public practising certificate, see the table in paragraph 48). We estimate that the number of insolvency practitioners who do not hold a public practising certificate from the ICAA, CPAA or NIA is around 8. We are unable to ascertain whether these persons would need to incur costs to meet the proposed policy on practice capacities, given that adequacy under the proposed policy is linked to the type of practice they are likely to operate (and do operate). However, it is expected that the aggregate cost of compliance will be relatively small.
- The greater emphasis on ongoing obligations may mean that some registered liquidators incur compliance costs to restore their personal capacities to the appropriate level. Registered liquidators have an existing obligation to remain fit and proper, although ASIC has not previously expressed policy linking this requirement to maintenance of professional skills. Registered liquidators who are members of a relevant professional body such as the ICAA, CPAA, NIA or the Insolvency Practitioners Association of Australia (IPAA) are already required to undertake continuing professional education, so the aggregate cost of compliance should not be significant.

Creditors

- There are no direct costs to creditors. There may be indirect costs if any costs of compliance (referred to in dot points 3 and 4 of Costs to Insolvency Practitioners) are passed on to creditors in the cost of external administration services. This impact cannot be quantified, but it should be minimal due to the way prices for external administration services are determined, as noted in paragraph 11 of this RIS.

ASIC

- ASIC will incur some costs in training staff engaged in the registration function. The training is expected to take 2 days in preparation time and will

be delivered in two half-day sessions. It will involve approximately 11 ASIC staff.

- Increased emphasis on monitoring compliance with ongoing obligations referred to in Section B of the proposed PS will incur some costs and may lead to greater regulatory intervention with associated costs. We estimate that increased monitoring under Section B may require 1/4 of a full-time employee. It is not possible to estimate the costs of any subsequent regulatory intervention that may be required.

Benefits

Insolvency practitioners

- Better guidance about how ASIC will exercise its discretion in dealing with applications will reduce costs for applicants and give practitioners greater certainty.
- The proposed policy would be less restrictive than current policy in several respects. For example, [PS 40] requires experience to be continuous and gained under the supervision of an official liquidator, rather than a registered liquidator, and requires that supervised experience to be gained on a full-time basis over consecutive years. The proposed policy takes account of the flexible working arrangements of potential registered liquidators in the current environment, including that applicants may have spent a period of their career working in a related field (not under the supervision of a registered or official liquidator), worked on a part-time basis, or gained relevant experience overseas.
- The proposed policy would have more flexible and/or similar requirements for 'practice capacities' than current policy. The requirement in [PS 40] for experience in 'public practice' refers to holding a public practice certificate from a relevant accounting body. Most practising registered liquidators are members of the ICAA. Holding a 'public practice' certificate requires them to establish and maintain systems and procedures of quality control (ICAA Regulation 4, By-Law 34(b)). This quality assurance requirement includes (and exceeds) the type of 'practice capacities' identified in the proposed PS.
- The revised application format is expected to significantly decrease the time taken to prepare an application. Currently, most preparation time is taken up in gathering information about an applicant's experience in corporate insolvency work. Applicants do not provide information on the time taken to prepare their applications, although anecdotal comment is that it is an arduous process. In an effort to satisfy the requirements of [PS 40], applicants usually provide information about every external administration they have worked on (including the number of hours). This involves gathering details from past and present employers and from historical time

records. One recent applicant detailed this process for ASIC and provided an estimate of 80 hours in preparation time over a three month period. Under the proposed PS, this applicant would be required to provide much less detail, and could do so substantially from memory or reference to a few key records. Preparation time for this sample applicant would be expected to be less than 10 hours.

- Guidance on the ongoing obligations of registered liquidators will provide greater certainty and should reduce the risk of non-compliance, thereby reducing potential costs. Registered liquidators incur costs in defending actions taken by ASIC to the Companies Auditors and Liquidators Board and incur further costs if the Board imposes a penalty, which may include cancellation of registration.
- Better performance of all their duties and functions is expected to reduce time spent by registered liquidators dealing with complaints or disciplinary action.
- Higher standards for registered liquidators should improve creditor confidence in registered liquidators. Recent public comment in the media² indicates the effect that a poor public perception can have on the standing of the entire insolvency industry.

Creditors

- The expected better performance by registered liquidators of all their duties and functions includes better decision-making, better communication with creditors and better management of externally administered companies, leading to better outcomes (including financial returns) for creditors. This should also reduce the number of creditor complaints about conduct by registered liquidators.
- Greater transparency in ASIC's expectations of liquidators will assist creditors in their dealings with insolvency practitioners.

ASIC

- The proposed streamlined application process will decrease ASIC's costs of assessing applications because ASIC will no longer need to sift through irrelevant details about an applicant's prior experience. It is also expected to decrease the decision-making delays and associated costs caused by the need for correspondence between ASIC and applicants requesting more specific information to support their applications. Under the proposed revised application process, applicants will have a clearer understanding of the information they should provide and as a result should only provide

² For example, *"Bottom Feeders" Business Review Weekly, June 2-8, 2005.*

information about their corporate insolvency experience that is directly relevant to demonstrating that they have the experience referred to in the proposed PS. This aspect is also discussed in dot point 4 under Benefits for Insolvency Practitioners above.

- Better guidance about how ASIC will deal with applications and apply its discretion will also enhance consistency in ASIC's decisions.
- The need for enforcement action against registered liquidators should be reduced because of better awareness of, and compliance with, ongoing obligations.
- New policy will overcome a general industry view that ASIC's current policy is not stringent enough to ensure that only persons with the appropriate qualities become and remain registered.

52. We have been unable to obtain information on the financial and other impacts of the proposals, other than as set out above. Although the PPP asked respondents to provide information on the financial and other impacts of the proposals, very little cost/benefit information was provided. The information that was provided has been included in this section.

Option 2 – Do nothing

Costs

Insolvency practitioners

- Lack of guidance on all the criteria for becoming registered will mean unnecessary costs and delays will continue to be incurred on applications for registration, and through uncertainty about how to comply with ongoing obligations.

Creditors

- Creditors may incur costs from mistakes or other inefficiencies in the conduct of external administrations by registered liquidators who fail to comply with all their ongoing obligations. Some examples of such 'failures' that may result in a cost to creditors are where an external administration lasts longer than it might otherwise due to poor or wrong management decisions; or where creditors receive lower dividend returns than might otherwise have been achieved due to poor or wrong management decisions (such as failing to identify or properly market saleable assets, or commencing ill-advised legal actions).

ASIC

- ASIC's reputation will suffer from out-of-date and inadequate policy.

- ASIC will have higher costs because of the need to address complaints and performance issues arising from conduct by registered liquidators who do not have adequate qualities for their role.
- This option is considered to be inconsistent with ASIC's role in protecting consumers in a 'preventative' way and in promoting compliance by registered liquidators with their obligations.

Benefits

Insolvency practitioners

- Aspiring registered liquidators can continue to seek registration after only 3 years' corporate insolvency experience (where they also have experience at a sufficiently senior level).
- Registered liquidators may perceive greater flexibility in how they perform their ongoing obligations in the absence of ASIC policy. There may be lower compliance costs for registered liquidators who do not adequately maintain their capabilities.

Creditors

- As lower compliance costs from practitioners who are currently not maintaining their skills are unlikely to be passed on to creditors, there appear to be no substantive benefits for creditors from this option.

ASIC

- There are no substantive benefits for ASIC from this option.

Consultation

53. The PPP was published on ASIC's website on 8 October 2004 and was publicly announced by Information Release.

54. Industry groups were specifically advised of its release and invited to submit feedback. Articles appeared in journals of the Insolvency Practitioners Association of Australia (IPAA) and the Australian Institute of Credit Management (AICM). Two articles appeared in the general press about the proposals. National presentations were held to explain and discuss the proposals in the PPP. A total of 230 interested parties participated in these sessions.

55. ASIC received 48 submissions from industry bodies, professional firms and interested individuals. These can be grouped as: insolvency practitioners and the IPAA [33]; general accountants and the accounting professional associations [5]; insolvency lawyers and legal professional associations (including academics) [8]

and government agencies [2]. These responses to the PPP have been incorporated into the proposed PS to the extent considered appropriate (see below).

56. Of the 48 submissions received, 20 were from registered liquidators or accountants who are sole practitioners or in "small to medium" practices.

57. Only one submission was received from a creditor, the Commonwealth Department of Workplace Relations, which administers the General Employee Entitlements and Redundancy Scheme. No submissions were received from shareholders or shareholder representatives. This is not surprising because shareholders have only a residual interest in an insolvent external administration (see paragraph 51 above).

58. There is strong support in the insolvency industry for ASIC to have policy that reconciles the requirements for registered liquidators, at both the initial registration stage and subsequently, with the demands of the roles played by external administrators in 2005. This reflects a general industry view that ASIC's current policy is not stringent or comprehensive enough to ensure that only persons with the appropriate background become (or remain) registered liquidators. The IPAA, as the peak industry body, has been calling for more appropriate regulatory requirements from ASIC for some time.

Responses to PPP

59. The following is a brief summary of the responses to the PPP. Where we refer to "most submissions", this means that the remaining submissions did not make a relevant comment on this point, or that a small number of submissions expressed a different, but not necessarily opposed, view.

Registration as a liquidator

- (a) most submissions expressly supported the proposed changes in the nature and amount of corporate insolvency experience required for registration as a liquidator, and no submission opposed it;
- (b) most submissions expressly supported ASIC's proposed policy on the other requirements for registration as a liquidator (in addition to corporate insolvency experience). No submission expressly opposed the proposals although some respondents provided constructive criticism on specific proposals, which has been taken into account in the proposed PS;
- (c) all submissions supported the provision of ASIC policy on the ongoing obligations of registered liquidators and strongly supported active monitoring by ASIC of compliance with these obligations;
- (d) most submissions supported the proposed simplified presentation of corporate insolvency experience in the application for registration. A couple of respondents wanted to see further enhancements, including confidential

referee reports. This has been partially addressed in the guidance for referees in the proposed Schedule;

- (e) most submissions supported the proposed 'standardised' competency-based referee report. A couple of respondents questioned the time it would take to complete the report but did not provide a comparison with time taken currently for referee reports;
- (f) all submissions supported the introduction of our new policy for registered liquidators without a transition period;
- (g) registered liquidators and accountants in "small to medium" practices generally supported the proposals. Their main concerns were:
 - o in relation to corporate insolvency experience, some wanted ASIC to take a more restrictive approach while others asked that ASIC make it easier for applicants who may have part-time experience and experience in generalist practices or in practices operating in rural and regional areas;
 - o in relation to practice capacities, some submissions argued that the requirement should be commensurate with the type of practice being undertaken.

Registration as an official liquidator

- (h) most submissions supported reducing the distinction between registered liquidators and official liquidators on the basis of experience and resources. Two submissions opposed this, arguing that official liquidator applicants must have experience in working for an official liquidator in order to be well equipped to take on the role as an officer of the court. This view is contrary to the AAT decision in the *Lofthouse* decision (see paragraph 44);
- (i) a small number of submissions argued that the relationship of official liquidators with the court should be recognised in the application process. This has been taken into account in the proposed PS.

Main differences between PPP and proposed PS

60. As a result of the comments received during consultation (both positive and negative), we have made some changes in the proposed PS to the approach we proposed in the PPP. The main differences are summarised below.

Initial registration (Section A and Schedule)

- Our assessment of equivalence of non-standard overseas accounting qualifications recognises and will rely more on the existing assessment regime supported by the Commonwealth Government through the National Office for Overseas Skills Recognition. Effectively, this will mean an assessment conducted by one of the professional accounting bodies.

- We allow greater flexibility in the gaining and calculation of corporate insolvency experience.
- We have removed requirements to have specific practice capacities where an applicant intends to practise outside the home state.

Ongoing registration as a liquidator (Section B)

- We provide greater flexibility, clarity and certainty in our approach to the obligation to maintain capability of performing duties and functions and have expanded the type of corporate insolvency work we think is relevant.
- We have clarified the interrelationship between "maintaining capability", "residing in Australia" and taking an "extended absence" by linking our approach to compliance with any information provided to us before taking the extended absence.

Registration as an official liquidator (Section C)

- We have inserted a requirement for the applicant to provide a written acknowledgement of the special relationship between an official liquidator and the court that appoints them.
- We have modified the transitional arrangements to ensure that all registered liquidators who become official liquidators under our proposed new policy will have a minimum 5 years' corporate insolvency experience and adequate practice capacities.

Conclusion and recommended option

61. ASIC has identified three problems, or risk areas, in the current policy environment for registration of liquidators:

- current policy contains inadequate guidance on the registration process for both ASIC and applicants for registration as a liquidator;
- greater regulatory emphasis is needed on maintaining the qualities necessary for remaining registered; and
- the current policy distinction between registered and official liquidators is too restrictive.

62. This RIS has considered how ASIC can approach its role in registering persons as liquidators and official liquidators to achieve the following objectives:

- (a) improve the quality and performance of new and existing registered liquidators;
- (b) simplify and improve the application processes for registration as a liquidator and as an official liquidator; and

- (c) establish a less restrictive approach to the distinction between the categories of registered liquidator and official liquidator that recognises the demands of those roles in both the legislation and the current marketplace.

63. Two options were considered. Option 1 is to issue new and comprehensive policy on liquidator registration. This would replace existing policy statements [PS 40] and [PS 24]. Option 2 is to do nothing.

64. ASIC's recommended option is option 1 (issue new policy). This option addresses the identified problems, achieves the identified objectives and delivers benefits that significantly outweigh costs.

65. The current requirements of the external administrator roles that can be performed by registered liquidators mean that both initial accreditation and ongoing regulatory supervision are important mechanisms for protecting creditors, particularly given the complex and unique characteristics of the Part 5.3A processes and the regulatory risks inherent in the evolving practical application of those processes.

66. Our revised policy approach refocuses and extends current policy with a more transparent process that minimises compliance costs as far as possible. The approach in the proposed PS reflects comments from the respondents on our policy proposals. The proposals received express support from a significant majority of the regulated population.

67. The proposed approach to assessing capability of registered liquidators is a balanced one that reworks and supplements current capability requirements so as to better assess whether applicants are equipped to meet the demands of the work actually performed by registered liquidators in the current environment.

68. The proposed PS will enhance the accreditation process, promote better and more certain ongoing regulatory supervision, and improve the protection for creditors and others who rely upon the services of external administrators. We consider it will not increase in any significant way the barriers to entry or the restrictions on competition. In some aspects, barriers and existing restrictions are removed or lessened. It will not unduly restrict competition in the market for registered liquidator/external administrator services.

69. We consider that the policy in the proposed PS will have no medium or long term effect on the number of persons who become registered liquidators. There may be a limited short term, transitional effect while insolvency practitioners become familiar with the new policy. For official liquidators, the proposed PS will lessen existing restrictions and the number of persons who become registered as official liquidators is expected to increase.

70. In summary, we consider that Option 1 will:

- (a) improve the overall quality and performance of registered liquidators by making sure at the registration stage that they have the right mix of

capacities and qualities, and by ensuring that those capacities and qualities are maintained on an ongoing basis;

- (b) not affect in any significant way the number of registered liquidators or the price of their services; and
- (c) produce an overall net benefit.

71. Option 2 (do nothing) is not recommended because it does not address any of the identified problems or objectives.

Implementation and review

72. We propose to implement the recommended option by publishing the PS with an Information Release in September 2005. We will notify all registered liquidators, the IPAA and the AICM of its publication. A copy of the PS will be published on ASIC's internet website.

73. ASIC will monitor any difficulties associated with compliance with the PS and will consider the need for review of the PS in light of our continuing regulatory experience or changes in the law. Our policy is likely to be discussed at regular liaison meetings between ASIC and the IPAA.

Small business

74. Paragraph 59(g) of this RIS refers to the responses of 'small business' to our proposals and the potential impacts on small to medium-sized insolvency practices. Paragraph 29 refers to risks that appear to be associated with those practices.

75. Our proposed policy on initial and ongoing capability and fitness and propriety accommodates as far as possible the potential impacts on business, including small to medium-sized insolvency practices. We are not able to reduce any further the potential impacts of our proposed policy on small insolvency businesses.