ASIC
Australian Securities & Investments Commission

Level 7, 120 Collins Street,
Melbourne VIC 3000
GPO Box 9827, Melbourne VIC 3001
DX 423 Melbourne

Telephone: +61 3 9280 3200
Facsimile: +61 3 9280 3444
www.asic.gov.au

10 July 2017

Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament house
Canberra ACT 2600

By email: **economics.sen@aph.gov.au**

Dear Sir/Madam

Inquiry into the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 (the Bill)

ASIC refers to your letter dated 21 June 2017 to Mr Greg Medcraft, Chairman of ASIC, and welcomes the opportunity to make a written submission to the above inquiry.

ASIC supports reforms which aim to promote a rescue culture for legitimate restructuring, recognising that reforms should strike an appropriate balance between encouraging entrepreneurship, promoting good corporate governance and protecting creditors' interests.

ASIC insolvency statistics show that the majority of corporate insolvencies reflect small-to-medium enterprise (SME) failure and return only a nominal amount to creditors. ASIC also notes that it is often small business creditors who bear much of the loss from corporate insolvency.

Striking the appropriate balance between encouraging entrepreneurship and creditor protection is important to protect the interests of small business and militate against misuse of the corporate form. Misuse includes illegal phoenix activity, an activity that can be challenging, at times, to distinguish from legitimate business restructuring. ASIC believes legislative reform is one way to achieve this balance by influencing director behaviour and encouraging early director engagement with financial distress (particularly for directors of SME enterprises).

Comments on the Bill

To help strike the appropriate balance between encouraging entrepreneurship, promoting good corporate governance and protecting creditors' interests, we think the following issues are worthy of further consideration.

1) Certainty for directors and creditors

ASIC believes that providing directors with a high level of certainty about the requirements to access 'safe harbour' protection is very important. This would provide a greater level of confidence to engage early with financial distress and pursue a restructuring plan. We also believe that the following measures might be worthy of further consideration. They would provide greater protection and certainty for trade creditors who may otherwise be unaware that directors have accessed the 'safe harbour' protection. This, in turn, promotes market trust and confidence.

a) **Documenting the restructure.** There may be strong benefits for directors to carefully consider and document a restructuring plan. While not, in our view, imposing a heavy compliance burden on the director, a documented recovery plan would support and assist the director to adduce evidence that the course of action developed and taken is reasonably likely to lead to a better outcome for the company. It would also:
   i. promote market confidence and militate against inappropriate access to a 'safe harbour' (that is, when achieving a genuine restructure or better outcome for the company is unlikely); and
   ii. assist liquidators and creditors determine when the 'safe harbour' period commences and to decide the merits of prosecuting a claim of insolvent trading.

b) **Better outcome for the company and its creditors.** Directors and others may seek greater clarity about what a director *must* do when taking action that is reasonably likely to lead to a better outcome for the company. The Bill provides an indicative list of factors to consider. In order for a director to determine whether the course of action is reasonably likely to achieve the best outcome for the company and to promote good corporate governance, we consider a director should:
   i. properly inform themselves of the company's financial position;
   ii. take steps to maintain financial records consistent with the size and nature of the company;
   iii. seek appropriate advice on the proposed course of action; and
   iv. monitor progress against the recovery plan.

c) **Appropriate advice.** It is presently not certain who might provide "appropriate advice" although the person need not be a registered liquidator. For example, it is not clear whether the advisor requires any particular qualifications or experience or needs to maintain adequate insurance. An appropriately qualified and experienced advisor plays a key 'gatekeeper' role to safeguard against the potential risks of misconduct such as illegal phoenix activity (including giving independent advice as to whether the proposed course of action is reasonably likely to lead to a better outcome for the company). Greater certainty in this area might militate against the unintended consequence of potentially supporting growth in the unregulated and problematic part of the pre-insolvency advice market. In ASIC's experience, this segment of the market is involved in illegal phoenix activity and ASIC has taken significant steps to disrupt such activities to date.

d) **Ongoing obligations**. While a matter for Government, ASIC considers it desirable that the Bill and Explanatory Memorandum clarify that the director's duties under ss180-184 of the Act continue to apply; including when making decisions about the course of action being developed and taken to invoke the 'safe harbour', and that current continuous disclosure requirements apply while the company is under 'safe harbour' protection.

2) Impact on legitimate insolvent trading claims

The effect of the Bill is to impose an additional burden of proof on a party, such as a liquidator, who contemplates proceedings against a director for a claim of insolvent trading under the civil penalty provisions. Insolvent trading cases under the current law involve complex evidentiary issues. It may be relevant to canvass views from liquidators on whether the additional evidentiary hurdle would likely stifle parties from pursuing such claims; claims which can give creditors (including small business creditors) recourse to compensation. Similarly, it may be relevant to consider the views of criminal prosecutors as to whether the Bill permits director conduct that might frustrate those prosecutors establishing the evidence necessary to prove criminal insolvent trading.

3) International developments

ASIC notes recent international developments in the UK and Singapore that emphasise, among other things, clear guidelines, transparency and creditor protection for a company which seeks a moratorium during which it might develop a restructuring plan. We can provide further analysis comparing the approaches of these jurisdictions to that taken in the Bill if required.

If you have any questions regarding the issues raised in this submission, please contact Adrian Brown on [redacted] or email [redacted] or Kate O'Rourke on [redacted] or email [redacted]

Yours faithfully

[redacted]

John Price
Commissioner