ASIC

Australian Securities & Investments Commission

Senate Inquiry into the Post-GFC Banking Sector

Submission by the Australian Securities and Investments Commission

June 2012

Contents

ASIC's submission

1 The Australian Securities and Investments Commission (ASIC) makes this submission to assist the Senate Economics Reference Committee with its inquiry into recent developments in the banking sector arising out of the impact of the global financial crisis and subsequent events (the Inquiry).

2 This submission sets out ASIC's regulatory framework, functions and responsibilities as they relate to the Inquiry's terms of reference (TOR). We only comment on the terms of reference that relate to ASIC's responsibilities—for example, we do not comment on the second term of reference because ASIC does not have a role in relation to the relative shares of specific banking markets.

3 ASIC's responsibilities in relation to the Inquiry's terms of reference for the most part relate to our role as the national regulator for consumer credit, as well as our responsibilities as the financial services regulator.

4 ASIC has three strategic priorities we are looking to achieve in our broad regulatory role. They are to ensure:

(a) confident and informed investors and financial consumers;

(b) fair and efficient financial markets; and

(c) efficient registration and licensing.

5 ASIC's work in relation to the terms of reference of this Inquiry generally falls under our first priority: confident and informed investors and financial consumers.

TOR 1: Impact of international regulatory changes, particularly liquidity and capital holding requirements

ASIC and Basel III liquidity requirements

6 As a member of the Basel Committee on Banking Supervision (BCBS), the Australian Prudential Regulation Authority (APRA) has indicated that it supports the Basel III reforms and the goal of promoting a more resilient banking system, and proposes to implement the liquidity coverage ratio (LCR) from 1 January 2015.

7 This has direct implications for term deposits, which are generally able to be broken at any time and as such would not be recognised for LCR purposes. Making them breakable only on 31 days notice, so as to obtain recognition for LCR purposes, would mean they might no longer be considered a basic deposit product (BDP) under the *Corporations Act 2001* (Cth) (Corporations

Act). BDPs are classified as 'Tier 2' financial products, which attract reduced disclosure and staff training obligations.

8 ASIC's Consultation Paper 169 *Term deposits that are only breakable on 31 days notice: Proposals for relief* (CP 169), issued in November 2011, proposed giving conditional class order relief so that term deposits of up to two years that can only be broken on 31 days notice would receive the same concessional regulatory treatment as BDPs.[1]

9 The proposed conditions attaching to that relief centre on disclosure of the 31-day notice period (e.g. a new product name and a consumer warning), and aim to address 'dual pricing rollover risk' (discussed in paragraphs 53–56).

10 CP 169 also considered whether any relief should apply to term deposits of between two and five years. While industry has suggested that it should, CP 169 proposed that limiting relief to term deposits of up to two years would be consistent with the definition of BDPs.

11 ASIC received responses from a range of stakeholders, and we are currently finalising our proposed policy response.

ASIC and the Financial Claims Scheme

12 ASIC has a role, albeit limited, in relation to the Financial Claims Scheme (FCS), which introduced protection for deposits.

13 As part of our responsibility for ensuring financial services providers do not engage in conduct that is misleading or deceptive, we actively monitor advertising and disclosure around the FCS, including the use of the FCS logo. Particularly during the initial implementation of the scheme, we intervened to have a number of entities clarify some of their marketing material due to concerns that it might mislead consumers on the level of protection available under the FCS for the products involved.

14 In a situation where there are claims on the FCS, much of our role would be to provide relevant information to APRA, dealing and redirecting inquiries from depositors, as well as handling queries about insolvency, in particular the impact on deposit holders of priorities.

[1] CP 169 is available on ASIC's website at www.asic.gov.au/asic/asic.nsf/byheadline/Consultation+papers?openDocument.

TOR 3: Current cost of funds for lending purposes

15 ASIC does not have access to primary data on the current cost of funds for lending purposes. We would expect that industry, the Reserve Bank and APRA would be able to provide such information.

16 Currently, Australia does not have a dedicated senior loan officer survey to determine the supply and demand conditions prevailing in the lending market. Such lending surveys currently exist in a number of countries, including the United States of America, the United Kingdom, Europe and Japan, and have been useful in researching the lending demand and supply dynamics for bank loans for businesses and households. For example, the US Federal Reserve issues the 'Senior Loan Officer Opinion Survey on Bank Lending Practices'.

17 It may be useful for a survey such as the US Federal Reserve's 'Senior Loan Officer Opinion Survey on Banking Lending Practices' to be issued in Australia.[2]

TOR 4: Borrowing and lending practices in the banking sector

ASIC's jurisdiction in relation to borrowing and lending practices

18 As part of its wider role, ASIC enforces and regulates company and financial services laws, as well as consumer credit laws, to facilitate confident and informed investors and financial consumers.

19 The two principal pieces of legislation that ASIC administers and enforces with respect to borrowing and lending practices are the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) and the *National Consumer Credit Protection Act 2009* (Cth) (National Credit Act).

ASIC Act

20 The ASIC Act provisions cover broad standards of conduct, including prohibitions on unconscionable conduct (s12CA), misleading or deceptive conduct (s12DA), and false and misleading representations (s12DB). These laws apply to the provision of financial products (including credit facilities) and services relating to credit facilities. ASIC's jurisdiction under the ASIC Act extends to small business as consumers where the lender is a bank or any other type of finance provider.

[2] The US Federal Reserve's report for April is available at www.federalreserve.gov/boarddocs/snloansurvey/201205/default.htm.

National Credit Act

21 ASIC took over the regulation of consumer credit and finance broking on 1 July 2010 under the National Credit Act. Before 1 July 2010, consumer credit was primarily regulated by the states and territories under the Uniform Consumer Credit Code (UCCC). The UCCC did not apply where the predominant purpose of the loan was business or investment. In addition, the conduct of credit providers and intermediaries in a broader sense was, and continues to be, subject to the provisions of the ASIC Act and state and territory fair trading legislation.

22 In 2008 the Council of Australian Governments (COAG) agreed to implement the National Consumer Credit Reforms, to be enacted in two stages.

23 Phase 1 of the reforms was implemented by the National Credit Act and establishes the overall national consumer credit framework administered by ASIC as the single national regulator. Central to the reforms was the introduction of a licensing regime that imposes minimum standards of conduct, mandatory membership of an ASIC-approved external dispute resolution (EDR) scheme (see paragraphs 26–41) and new responsible lending obligations. Lenders must also comply with the National Credit Code, which largely mirrors the now-superseded UCCC together with some key enhancements, including:

(a) extended coverage (now encompassing lending to invest in residential property);

(b) preventing business purpose declarations being used to avoid the National Credit Code; and

(c) greater access to assistance for borrowers in financial difficulty.

24 The National Credit Act does not deal with lending for business purposes. Regulation of the provision of credit for small businesses is being considered by the Australian Government in Phase 2 of the consumer credit reforms: see paragraphs 61–62.

Margin lending

25 Phase 1 also included amendments to the Corporations Act to regulate margin lending as a financial product—to address problems in the market triggered by the global financial crisis. Margin loans became a regulated financial product, with licensing, disclosure requirements, a tailored responsible lending requirement and clarification on responsibility to notify borrowers of margin calls.

ASIC-approved dispute resolution schemes

Regulatory framework

26 Under the Corporations Act and the National Credit Act, Australian financial services (AFS) licensees (margin lenders) and credit licensees, respectively, are required to have compliant dispute resolution systems for handling retail client/consumer complaints.[3] The dispute resolution system must consist of:

(a) internal dispute resolution (IDR) processes that meet ASIC's approved standards and requirements; and

(b) membership of an ASIC-approved EDR scheme (i.e. Financial Ombudsman Service Limited (FOS) or Credit Ombudsman Service Limited (COSL)).

27 A credit representative, who is authorised by a registered person or credit licensee, must also separately be a member of an ASIC approved EDR scheme.[4] However, credit representatives do not need to have separate IDR procedures because a credit licensee's IDR procedures must cover disputes relating to its credit representatives.

28 ASIC's regulatory guidance in Regulatory Guide 165 *Licensing: Internal and external dispute resolution* (RG 165) and Regulatory Guide 139 *Approval and oversight of external dispute resolution schemes* (RG 139) set out our approach to approving schemes.[5]

29 On 1 April 2010, ASIC approved both FOS and COSL as dispute resolution schemes under the National Credit Act: see ASIC Class Order [CO 10/249] *External dispute resolution schemes (credit)*. Before this time, both schemes were approved by ASIC under the Corporations Act.

Jurisdiction of the schemes

30 Access to ASIC-approved EDR schemes is intended to provide consumers of credit with a cheaper, quicker and easier-to-access dispute resolution mechanism as an alternative to going to court.

31 Both FOS and COSL can handle credit disputes, where the industry participant has joined their scheme.

32 FOS's membership for credit largely comprises banks, credit unions, building societies, larger lenders and credit intermediaries (mortgage and finance managers) and credit representatives. In comparison, COSL's membership for credit largely comprises aggregators, micro–smaller lenders,

[3] Section 912A(2) of the Corporations Act and s47 of the National Credit Act.
[4] Sections 64 and 65 of the National Credit Act.
[5] RG 139 and RG 165 are available on ASIC's website at www.asic.gov.au/asic/asic.nsf/byheadline/Regulatory+guides?openDocument.

intermediaries (i.e. mortgage managers) and credit representatives, as well as some credit unions and building societies.

33 The jurisdiction of the schemes is set out in their respective Terms of Reference (TOR) and COSL's Rules. This forms the contractual arrangement between the scheme and each member.

34 Both FOS and COSL can generally handle disputes regarding:

(a) credit cards, home loans, investment property loans, car/boat and other loans and small business loans (where the 'small business' meets the Corporations Act definition—which has regard to the number of employees a manufacturing or other business has);

(b) hardship or financial difficulty, irresponsible lending, certain types of fee disputes (that relate to misleading/false disclosure of the fee or inappropriate application of the fee); and

(c) credit listings where other issues are involved.

35 Currently, lenders who provide loans to small business borrowers are not required to hold a credit licence, nor are they required to maintain a compliant dispute resolution system. While both COSL and FOS *can* handle complaints made by small business borrowers under their TOR/Rules, whether a small business borrower can access EDR may depend on how their lender's business is structured.

36 For example, small business borrowers from lenders who provide both personal and small business loans will be able to access the schemes (once it is a member of a scheme a lender cannot choose to exclude disputes from the unregulated side of their business from the scheme's jurisdiction). On the other hand, small business borrowers of lenders who provide small business loans only (e.g. because they segregate their personal loan business from their small business loan business so they are offered through separate, but perhaps related, corporate entities), will not be able to access EDR. This is because the company doing small business lending would not be required to hold a credit licence and have a compliant dispute resolution system (i.e. IDR process and EDR scheme membership).

37 The schemes can also currently address debt collection issues and handle disputes where the member has commenced enforcement/debt recovery legal proceedings against the borrower. The jurisdictions of the schemes differ slightly on this, but once a dispute has been lodged with the scheme, legal proceedings/enforcement action must be stayed so the scheme has a reasonable opportunity to handle the dispute. ASIC is currently conducting a review of this jurisdiction: see Consultation Paper 172 *Review of EDR*

jurisdiction over complaints when members commence debt recovery (CP 172).[6]

38 We note that under Phase 2 of the National Consumer Credit Reforms the Australian Government is considering whether to bring small business loans within the reforms: see paragraph 61. It is not yet clear what definition of 'small business' would apply, although the definition could mirror the definition of 'small business' in the Corporations Act.

Credit disputes

39 Both FOS and COSL have experienced a significant increase in membership as a result of EDR becoming compulsory under the National Consumer Credit Reforms. This in turn has contributed to an increase in the number of credit disputes the schemes are handling.

40 In the 2010–11 financial year, the schemes reported in their annual reports that the respective schemes received a total of:

(a) 14,537 credit disputes of which 10,476 were accepted for handling—FOS; and

(b) 1,700 credit disputes—COSL.

41 The main type of dispute both schemes handled related to hardship or 'maladministration'. The schemes say that this suggests that more consumers are in financial difficulty as the job market tightens, the cost of living increases (with higher rent and utility bills) and certain consumers/retail investors are affected not only by natural disasters, but also by investment failures where lost life savings puts greater pressures on paying off the loan or where the client was advised to invest in a margin loan.

ASIC's activities in relation to lending practices

42 ASIC has recently been, or is presently involved in, a number of activities which are relevant to this term of reference, including our work around:

(a) specific risks during the global financial crisis;

(b) financial literacy;

(c) marketing and disclosure in the term deposits market; and

(d) the investigation into the collapse of Storm Financial.

Specific risks during the global financial crisis

43 In light of the potential that the global financial crisis could produce increasing levels of borrower hardship in managing loans and of default and

[6] CP 172 is available on ASIC's website at www.asic.gov.au/asic/asic.nsf/byheadline/Consultation+papers?openDocument.

debt collection activity, ASIC undertook a number of targeted surveillances and broader projects in these areas.

Financial hardship

44 From 2008 ASIC prioritised its ongoing work in relation to financial hardship, and undertook two major pieces of work examining relevant practices of mortgage lenders and brokers and, subsequently, authorised deposit-taking institutions (ADIs).

45 The first exercise resulted in Report 152 *Helping home borrowers in hardship* (REP 152), issued in May 2009, which set out examples of good and poor practices and provided guidance to industry on how to improve practices when dealing with borrowers experiencing difficulties.[7]

46 The second examined, at the request of the Federal Treasurer, implementation of and compliance with a set of principles: *A common approach for assisting borrowers facing hardship* (the Principles). The Principles are a set of agreed principles, adopted by all ADIs, to assist borrowers experiencing financial difficulties meeting their mortgage repayments. The findings of our review were generally positive.

47 We continue to actively monitor compliance with relevant obligations, and to encourage all lenders to ensure they provide relevant information and appropriate assistance to consumers experiencing financial difficulties. We are also aware that both FOS and COSL are receiving significant numbers of complaints about financial hardship, and we are discussing with both the implications of those complaints for the schemes and lenders.

Debt collection

48 We receive a relatively small, but consistent, number of reports of misconduct (ROMs) in relation to debt collection activities, ranging between 2% and 3% of total ROMs (recently trending downwards).

49 Since the global financial crisis we have commenced approximately 45 surveillances that directly relate to the debt collection activities of lenders and specialist collection agencies, leading to a range of compliance outcomes, including four public outcomes (including an enforceable undertaking from GE Money in May 2008) and another matter which is currently the subject of proceedings in the Federal Court.

50 In May 2009 ASIC, in conjunction with the Australian Competition and Consumer Commission (ACCC), issued Report 155 *Debt collection practices in Australia* (REP 155), which set out issues identified during information-gathering activities (including an industry forum) undertaken in

[7] REP 152 is available on ASIC's website at www.asic.gov.au/asic/asic.nsf/byheadline/Reports?openDocument.

2008.[8] We are currently working with the ACCC on a proposed review of joint industry guidance released in 2005 (by ASIC as Regulatory Guide 96 *Debt collection guideline: For collectors and creditors* (RG 96)).[9]

Financial literacy

51 ASIC is committed to improving the financial literacy skills of all Australians so they are well equipped to make informed choices about financial issues. Our approach is set out in the National Financial Literacy Strategy (www.financialliteracy.gov.au), and includes providing independent information, tools and support, embedding financial literacy in schools and further education, and working in partnership with other agencies.

52 Major initiatives within this framework include:

(a) the MoneySmart website (www.moneysmart.gov.au), launched in March 2011 with over 300 pages of content, including audio and video, 26 calculators and tools (including five mobile calculators), information in 26 languages, a monthly e-newsletter and over 25,000 hard copy publications distributed per month;

(b) ASIC's work in the education system, including ensuring that financial literacy is part of the new Australian Curriculum, delivering professional learning and digital resources for teachers through the Helping Our Kids Understand Finances initiative (www.teaching.moneysmart.gov.au), and developing financial literacy competencies for apprentices in the vocational education and training (VET) system;

(c) consumer credit and Indigenous outreach teams, which work with vulnerable people who are excluded from traditional avenues for financial information and advice; and

(d) ongoing partnerships, such as our well-established financial literacy Community of Practice, with over 400 participants across Australia and New Zealand, and annual MoneySmart Week (the first one in September 2012) supported by over 50 industry, community and government organisations.

Marketing and disclosure in the term deposits market

53 One of the early consumer responses to the global financial crisis was a 'flight to quality', with bank deposit products such as term deposits and high-yield online saving accounts becoming increasingly popular. In that context, and informed by a small number of complaints, ASIC undertook a

[8] REP 144 is available on ASIC's website at www.asic.gov.au/asic/asic.nsf/byheadline/Reports?openDocument.
[9] RG 96 is available on ASIC's website at www.asic.gov.au/asic/asic.nsf/byheadline/Regulatory+guides?openDocument#81-100.

review of household-sourced term deposits offered by eight issuers (a mix of large banks and mutuals).

54 ASIC's review found that all structured their term deposits so that, unless otherwise instructed by the investor, a maturing term deposit rolled over into a new term deposit for the same term at the prevailing interest rate. Relevantly, seven of the eight also utilised a 'dual pricing' approach, meaning that passive roll-overs were likely to attract a lower interest rate than that which applied at point of entry.

55 Report 185 *Review of term deposits* (REP 185), issued in March 2010, made a number of recommendations in response to practices identified, including in relation to advertising, the disclosure of both interest rates and the risk of dual pricing, and the use of grace periods.[10]

56 We have conducted a follow-up review to examine the implementation of our recommendations, and the incidence of investors passively rolling into and remaining in low-interest term deposits. We have also assessed whether improvements to advertising, disclosure and grace periods have been effective in reducing the incidence of rollover into low-interest term deposits. We anticipate that our follow-up report will be released in the second half of 2012.

Investigation into the collapse of Storm Financial

57 ASIC has been investigating a range of issues relating to the affairs of Storm Financial Limited (Receivers and Managers Appointed) (In Liquidation) (Storm), including investment home lending, margin lending and related advice. These investigations formally started on 12 December 2008. One of the key parts of ASIC's investigations is to consider recovery of compensation for Storm investors who suffered financial loss as a result of a Storm investment.

58 ASIC has commenced legal proceedings against the Commonwealth Bank of Australia (CBA), Bank of Queensland Limited (BOQ) and Macquarie Bank Limited (MBL), seeking compensation for investors arising out of these entities' involvement in an alleged unregistered managed investment scheme operated by Storm. ASIC has also commenced compensation proceedings against BOQ, Senrac Pty Limited and MBL, on behalf of two named investors. These second compensation proceedings are based on alleged breach of contract, unconscionable conduct by the banks and their alleged liability as a linked credit provider of Storm under s73 of the *Trade Practices Act 1974* (Cth).

[10] REP 185 is available on ASIC's website at http://www.asic.gov.au/asic/asic.nsf/byheadline/Reports?openDocument

59 ASIC has also commenced civil penalty proceedings against Mr and Mrs Cassimatis, the former directors of Storm, for alleged breaches of their directors' duties.

60 ASIC's investigations into the collapse of Storm continue.

TOR 5: Need for further consideration of the state of the finance and banking sector

Law reform proposals

61 Phase 2 of the National Consumer Credit Reforms is being implemented in three legislative tranches. It also incorporates some of the Australian Government's commitments set out in the Competitive and Sustainable Banking System Reforms announced in December 2010 and August 2011, particularly bringing forward credit card reforms and banning exit fees.

(a) The first tranche of legislation on credit card reforms (in relation to credit limit increase offers, over limit fees, and payment allocation) and key fact sheets (KFS) for home loans received royal assent on 25 July 2011.[11]

(b) A second tranche of reforms (the 'Enhancements' Bill) was introduced into parliament in September 2011 and includes reforms to short-term lending, consumer leases, reverse mortgages and other National Credit Code enhancements (such as expanding a lender's consideration of hardship assistance for consumers).

(c) Possible regulation of investment lending and small business lending in some form, and anti-avoidance mechanisms, among other things, are being considered for a possible third tranche of reforms in mid-2012.

62 ASIC has provided Treasury with assistance in developing and implementing the policy reforms.

TOR 6: Any other relevant matters

Receivers and receivers and managers

63 We note some public comments made about the relationship between the banking sector and the role of receivers and receivers and managers. To assist the Inquiry in this regard, we have extracted in the appendix to this

[11] The obligation to provide a KFS for home loans commenced on 1 January 2012. The credit card obligations are set to commence on 1 July 2012.

submission the relevant sections of ASIC's submission, dated June 2010, to the Senate inquiry into the role of liquidators and administrators, their fees and their practices, and the involvement and activities of ASIC before and after the collapse of a business.

Reports of alleged misconduct

64 Reports of alleged misconduct and enquiries regarding receivers and receivers and managers account for a relatively small percentage of the total number of reports and enquiries ASIC receives in relation to external administrations, which in turn is a relatively small percentage of the total number of reports of alleged misconduct and enquiries we receive.

65 In the period July 2009 to December 2011, ASIC assessed a total of approximately 37,000 enquiries and reports of misconduct. Of these 1,281 related to alleged misconduct by insolvency practitioners, representing approximately 3.4% of both total enquiries and reports of misconduct. Of the 1,281 enquiries and reports about insolvency practitioners, only 111 or 8.7% related to receivers and receivers and managers.

66 While receivers and receivers and managers are appointed by secured creditors, many of which are banks, only 11.7% (13) of the reports of misconduct about the conduct of receivers and receivers and managers dealt with since July 2009 specifically raised issues about the conduct of the appointing bank. This represents only 0.03% of all enquiries and reports of misconduct dealt with in this period.

Proposals for law reform

67 On 14 December 2011, the Parliamentary Secretary to the Treasurer and Attorney-General jointly released a proposals paper, *A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia*.

68 The proposals paper sets out the Australian Government's proposed reforms to the framework for corporate and personal insolvency regulation (including receivers and receivers and managers). ASIC supports the Australian Government's aims of ensuring the regulatory framework for insolvency practitioners:

(a) promotes a high level of professionalism and competence by practitioners;

(b) promotes market competition on price and service;

(c) provides for increased efficiency in insolvency administration; and

(d) enhances communication and transparency between stakeholders.

Appendix: Extract from ASIC's further submission to the Senate Inquiry into the Conduct of Insolvency Practitioners (June 2010)

Key points

This appendix provides an outline of the regulatory environment and ASIC activities as they relate to receivers, as if receivers had been included in the original terms of reference of the Inquiry.

Environment and regulatory framework

Primary purpose

69 A company goes into receivership when a receiver[12] is appointed by a secured creditor,[13] or in special circumstances by the court, to take control over some or all of the company's assets. The function of most receiverships is for the receiver to collect and sell sufficient of the company's charged assets to repay the debt owed to the secured creditor. Less commonly, a receiver may be appointed by a court to protect the company's assets or to carry out specific tasks.

Basis for appointment

70 A receiver can be appointed by a court or by a private appointee.

Private appointment

71 A private appointment can be made by anyone with the contractual power to do so. Most commonly, a private appointment is made pursuant to an express agreement between the parties with an interest in the property over which the appointment is made (e.g. under the terms of a mortgage or debenture). The mortgage, debenture or other agreement will usually set out preconditions or events which may give rise to the power to appoint a receiver. The conditions are usually events that indicate that a party's interest is likely to be prejudiced, such as a default in repayment.

[12] For the purposes of this submission, unless the contrary intention appears, we have used the term 'receiver' to include a 'receiver and manager', 'controller' and 'managing controller'. See paragraphs 79–82 for the definitions of these terms.
[13] A secured creditor is someone who has a charge, such as a mortgage, over some or all of the company's assets, to secure a debt owed by the company. An unsecured creditor is a creditor who does not have a charge over the company's assets.

72 A private appointment may also be made following a statutory power of appointment.[14]

73 It is possible for a company in receivership to also be in provisional liquidation, liquidation, voluntary administration or subject to a deed of company arrangement. A receiver can be appointed to a company in liquidation or under any other form of external administration. A receiver can be appointed to a company in voluntary administration with the consent of the court or the administrator, where the consent is provided within the first 13 business days of the appointment of an administrator and where the charge, under which the receiver is being appointed, is over substantially the whole of the assets of the company.[15] In most cases the appointment of an external administrator is a trigger for the appointment of a receiver.

Court appointment

74 The court has an inherent jurisdiction to appoint a receiver. This inherent power has been restated in various statutes.[16] The court also has power under the Corporations Act to appoint a receiver. For example, the court may appoint a receiver upon the application of an aggrieved person[17] or upon the application of a liquidator or provisional liquidator in the circumstances where an officer of the company in liquidation, or of a related entity of the company, may otherwise avoid liability to the company in liquidation.[18]

75 The powers of a court-appointed receiver will be expressed in the court order and will be specific to the facts giving rise to the application and be supported with powers under the Corporations Act.

Landscape

76 Appointments of receivers, receivers and managers, and controllers account for a relatively small percentage of the total number of annual insolvency practitioner appointments.

77 For the period July 2008–June 2009, receiver/receiver and manager appointments accounted for 11% and controllers accounted for 6% of all external administration appointments.

[14] For example, s115A of the *Conveyancing Act 1919* (NSW) allows a mortgagee under a mortgage to appoint a receiver if the default has been made in respect of the mortgage.
[15] Refer to s441A—a charge with a charge over substantially all the assets can appoint during the 'decision period' (refer to s9 for the definition of 'decision period').
[16] For example, s67 of the *Supreme Court Act 1970* (NSW) and s62(2) of the *Supreme Court Act 1958* (Vic).
[17] Section 1323(1) of the Corporations Act.
[18] Section 486A of the Corporations Act.

Types of 'receiver' appointments

78 There are a number of different types of appointments in this area: receivers, receivers and managers, controllers, and managing controllers.

Receiver

79 A receiver is appointed to administer property. The appointment may be limited to mere protection of one particular item of property or it may extend to managing the affairs of the company. The term 'receiver' is defined to include a receiver and manager under Part 5.2 of the Corporations Act.[19]

Receiver and manager

80 A receiver and manager is a receiver who has, under the terms of their appointment, the power to manage the company's affairs.[20]

Controller

81 A controller is defined as a receiver, receiver and manager, or any other controller who has entered into possession or control of the corporation's property for the purposes of enforcing a charge.[21]

Managing controller

82 A managing controller is a receiver and manager or any other controller who has entered into possession or control, but additionally has functions or powers in connection with managing the company.[22]

83 The statistics for controller and receiver appointments for the 2006–07 financial year through to December 2009 are shown in Table A1.1.

Table A1.1: Companies entering receiver appointments[23]

Type of external administration	2006–07	2007–08	2008–09	Jul–Dec 2009	Total
Receiver or receiver and manager	309	400	829	409	1,947
Controller of managing controller	137	206	415	266	1,024
Total	**446**	**606**	**1,244**	**675**	**2,971**

Source: ASIC insolvency statistics—Companies entering external administration

[19] Section 416 of the Corporations Act.
[20] Section 90 of the Corporations Act.
[21] Section 9 of the Corporations Act.
[22] Ibid.
[23] Members' voluntary liquidations are not included as the companies are not insolvent.

Registration framework

84 The Corporations Act provides that a receiver must be a registered liquidator.[24] A court-appointed receiver must be registered as an official liquidator.

85 The requirements for a liquidator to be registered with ASIC were outlined in ASIC's first submission to the Inquiry (dated March 2010) at paragraphs 14–16 and Appendix B4. These requirements also apply to a receiver. However, in addition to those requirements, the Corporations Act provides that certain persons are excluded from acting as a receiver. For example, a person cannot be appointed as a receiver if they are a mortgagee of the property of the corporation, or an auditor or a director, secretary, senior manager or employee of the corporation.[25]

Obligations of receivers

86 The conduct obligations imposed on a receiver are derived from a number of sources. A receiver is subject to requirements under the Corporations Act and general law as well as ASIC regulatory guidance explaining, among other things, when and how ASIC will exercise specific powers under the legislation and how ASIC interprets the law. Receivers who are members of a professional body (e.g. the IPA and/or professional accounting bodies) will also be subject to the professional conduct standards of that body.

General law duties

87 At general law, a receiver owes a duty to the secured creditor and the company. These duties are derived from:

(a) the agreement under which the receiver was appointed;

(b) the agency relationship with the company (or more rarely with the secured creditor); if the receiver is court-appointed, from being an officer of the court; and

(c) being an officer of the company.

Privately appointed receiver

88 The fundamental duty of a privately appointed receiver is to exercise their powers bona fide for the purposes for which they were appointed and, therefore, a receiver's primary duty is to the secured creditor.

89 The receiver will also be subject to general law duties to the company as a consequence of the agency relationship that arises from the terms of the

[24] Section 418(1)(d) of the Corporations Act.
[25] Section 418 of the Corporations Act.

agreement. While the receiver is acting for the secured creditor, the agreement will invariably provide that the receiver will be the agent of the company rather than the secured creditor. This is to ensure that the secured creditor is not liable as the receiver's principal and as mortgagee in possession. This agency relationship ceases if a liquidator is appointed, although there is an opportunity to continue if the liquidator consents.

90 As an agent of the company, the receiver has certain duties to the company which are directly enforceable by the company. Australian case law indicates that these duties include a duty to:

(a) exercise his or her powers in good faith (including a duty not to sacrifice the company's interests);

(b) act strictly within, and in accordance with, the conditions of his or her appointment; and

(c) account to the company after discharging the secured creditor's security, not only for the surplus assets, but also for his or her conduct of the receivership (including the duty to terminate the receivership as soon as the interests of the secured creditor have been satisfied).[26]

Court-appointed receiver

91 The nature of the powers endowed on a receiver is determined by the order of the court.

92 Unlike a privately appointed receiver, it is not the fundamental function of a court-appointed receiver to see that the security holder is repaid. As an officer of the court, the appointment is for the benefit of those interested in the relevant assets.[27] For example, a court-appointed receiver may be appointed to preserve property pending the hearing or resolution of the dispute, as opposed to a privately appointed receiver whose role it is to realise the secured assets.

Corporations Act

93 The Corporations Act deals with the qualifications of a receiver and imposes a number of specific duties on receivers. These requirements apply equally to a privately appointed receiver and a court-appointed receiver. For example, a receiver is required to:

(a) lodge a notice of appointment with ASIC within 14 days of appointment;

(b) take all reasonable care to sell the property of the corporation for not less than market value or the best price that is reasonably obtainable;

[26] *Expo International Pty Ltd (Recs and Mgrs Apptd) (in liq) & Another* v *Chant & Others* [1979] 2 NSWLR 820 per Needham J at 834.
[27] *Cape v Redarb Pty Ltd (Rec and Mgr Apptd)* (1992) 107 FLR 362.

(c) open and maintain a bank account, and deposit into this account all money of the company which comes under the receiver's control;

(d) keep financial records that correctly record and explain all transactions that the receiver enters into as a receiver of the company and permit access by any director, creditor or member to records kept;

(e) lodge six-monthly accounts of receipts and payments with ASIC;

(f) pay certain debts in priority to repayment of debts that are secured by a floating charge;

(g) prepare and lodge a report with ASIC on the affairs of the company within two months of being appointed if the receiver is managing the company; and

(h) report any possible misconduct to ASIC.

94 These obligations provide a level of protection for stakeholders, such as unsecured creditors and members of the company, and accountability through the reporting and lodgement requirements with ASIC. It should be noted, however, that receivers have no obligation to report directly to unsecured creditors.

95 It should also be noted that a person appointed as a controller or managing controller does not have to comply with the requirement for independence and a receiver does not have to provide creditors with a Declaration of Independence, Relevant Relationships and Indemnities. This is in accordance with the law that requires these types of declarations to be made only in voluntary administrations and creditors' voluntary liquidations.

Duties as an 'officer'

96 An 'officer' is defined in the Corporations Act to include a receiver.[28] The general duties that apply to 'officers' of a corporation will therefore apply to receivers, in particular those duties under Ch 2D of the Corporations Act:

(a) to act in good faith at all times;

(b) to exercise a reasonable degree of care and diligence;

(c) not to make improper use of information; and

(d) not to make improper use of position.

ASIC's regulatory guidance

97 We have issued the following regulatory guides to assist receivers to understand their obligations under the Corporations Act:

[28] Section 9 of the Corporations Act.

(a) Regulatory Guide 14 *Receivers: Retention of company records* (RG 14); and

(b) Regulatory Guide 106 *Controller duties and bank accounts* (RG 106).

98 We have also issued two information sheets to assist stakeholders to understand the process of receivership and the implications for the particular stakeholder, namely:

(a) Information Sheet 54 *Receivership: a guide for creditors* (INFO 54); and

(b) Information Sheet 55 *Receivership: a guide for employees* (INFO 55).

Professional conduct standards

99 A receiver will be subject to professional standards, practices and principles, including codes of conduct and statements of best practice of a relevant professional body or an insolvency industry body of which the registered liquidator is a member. These professional conduct standards are:

(a) APES 330 *Insolvency Services*, effective 1 April 2010 (replacing APS 7), issued by the Accounting Professional and Ethics Standards Board Limited; and

(b) the IPA Code of Professional Practice (the IPA Code).

100 These professional conduct standards were considered in ASIC's first submission at paragraphs 124–131.

IPA Code

101 By way of example, a receiver who is a member of the IPA must comply with IPA's professional standards, the IPA Code.

102 The IPA Code imposes various obligations on 'members' of the IPA and/or 'practitioners' as defined in the Code. Receivers, although practitioners, do not have the same fiduciary responsibilities to all creditors and therefore receivers are excluded from certain requirements of the IPA Code.

103 If a receiver breaches the IPA Code, the IPA may instigate action against them. The IPA Code is referred to by the courts when considering the required level of professional competence and conduct and consequently is also taken into account by ASIC when assessing possible contraventions of the Corporations Act.

Remuneration and disbursements

104 In the case of a private appointment, a receiver is entitled to receive such remuneration as is determined by:

(a) the debenture agreement and the document of appointment;

(b) where the appointment is made following a statutory power of appointment, the terms of that legislation;[29] or

(c) in rare cases, an express or implied agreement between the receiver and the debenture holders where he or she is acting as their agent.

105 Most commonly, the terms of the debenture agreement and the document of appointment will provide how the receiver's remuneration is to be determined, including who will approve the remuneration, the method for calculating remuneration and who is liable to pay the remuneration. Subject to the terms of the agreement, the company will usually bear the receiver's remuneration and the receiver will draw their remuneration during the course of the receivership by submitting an account for their remuneration to the secured creditor, and those costs will generally then be added to the outstanding debt of the company. This account will normally be scrutinised by and approved for payment by the secured creditor. Commonly, the receiver will secure an indemnity for remuneration and expenses from the secured creditor.

106 The secured creditor has a significant degree of influence over the level of remuneration of the receiver, due to the direct nature of the appointment. In some situations, this position can result in lower hourly rates being charged by receivers.

107 A court-appointed receiver is entitled to receive such remuneration as is determined by the court. There is no fixed or predetermined basis for calculating remuneration for a court-appointed receiver, but in attempting to set a reasonable level of remuneration the courts often accept fees charged based on hourly rates.[30]

108 We should also highlight the situation where multiple insolvency practitioners may be appointed to a company—for example, where a company may be in voluntary administration as well as having a receiver and manager appointed; or where a company is in liquidation in addition to having a receiver and manager appointed. Where a company has multiple appointments, in particular where there is a concurrent appointment of a liquidator as well as a receiver, the liquidator is entitled to an accounting in relation to the conduct of the receivership.

Approval process

109 Unlike the types of external administration considered in ASIC's first submission at paragraphs 132–150, the Corporations Act does not prescribe

[29] For example, a receiver appointed under the powers in the *Conveyancing Act 1919* (NSW) is entitled to receive (unless the mortgage deed provides otherwise) remuneration at a rate not exceeding 5% of the gross money received, or such higher rate as the court will grant on application: s115(6).
[30] *Waldron* v *MG Securities (Australasia) Ltd & Others* (1979) CLC 40–541.

the process for the approval of a receiver's remuneration, as the appointment of a receiver is essentially a private appointment.

110 The IPA Code is somewhat helpful in this regard, although it is limited in its application to members of the IPA. The IPA Code states principles and gives guidance on the remuneration of receivers. The second remuneration principle in the IPA Code requires that a claim for remuneration must provide sufficient, meaningful, open and clear disclosure to the approving body so as to allow that body to make an informed decision.

111 For court-appointed receiver, the method for applying for approval for remuneration is for the receiver to present his or her accounts and remuneration claim to the court. The approval process for the remuneration of privately appointed receivers is determined by negotiation between the parties. However, the court retains wide powers under the Corporations Act to set and review the remuneration of receivers.[31]

Rights of review

112 The Corporations Act provides for a review process regarding the remuneration payable to receivers. The court retains wide powers to set and vary the remuneration of receivers. Applications to fix or vary a receiver's remuneration may be made in certain circumstances by ASIC, a liquidator, voluntary administrator or deed administrator of the company.

113 The 2007 reforms to the Corporations Act introduced amendments that require the court, when reviewing or setting a receiver's remuneration, to have regard to whether the remuneration is reasonable, taking into account various matters, including whether the work performed was reasonably necessary.[32]

Remuneration and unsecured creditors

114 Unsecured creditors have no role in setting or approving a receiver's fees. If a liquidator is appointed to the company then the liquidator is able to review the validity of the appointment of the receiver and to monitor the progress of the receivership, including remuneration and reporting back to all unsecured creditors.

115 Often in receiverships the secured creditor suffers a significant deficit on the recovery of the debt owed by the company. In these circumstances, the unsecured creditors are not further disadvantaged by the quantum of the receiver's remuneration, as they are paid by the secured creditor.

[31] Section 425 of the Corporations Act.
[32] Section 425(8) of the Corporations Act.

Disciplinary and deterrence framework

116 The Corporations Act provides that a receiver must be a registered liquidator[33] and therefore ASIC's powers in respect of alleged misconduct by a receiver are the same as those considered for a registered liquidator in ASIC's first submission at paragraphs 151–166.

117 In summary, we may:

(a) take administrative or conduct proceedings against a receiver before CALDB;

(b) instigate court proceedings; or

(c) enter into an enforceable undertaking with the receiver.

CALDB

118 CALDB can apply penalties ranging from a reprimand to suspension or cancellation of the liquidator's registration. CALDB does not impose pecuniary penalties and is not empowered to make orders as to restitution or compensation.

Court proceedings

119 If a receiver has not faithfully performed his or her functions, ASIC may instigate court proceedings against a receiver and the court may take such action as it sees fit, including making orders for compensation or restitution.[34]

120 A receiver is also subject to a number of specific duties as a receiver and as an 'officer' under the Corporations Act. These duties were discussed at paragraphs 93–95. The penalties for breaching these provisions range from civil damages for not exercising a duty of care in disposing of property,[35] to both civil and criminal penalties for breaching the Ch 2D duties imposed on officers. The sections can all result in the application of civil penalty provisions, with compensation orders[36] and pecuniary penalty orders up to $200,000.[37] Section 184 makes it an offence for an officer, including a receiver, to be reckless or intentionally dishonest and fail to exercise their powers and discharge their duties in good faith in the best interests of the company, attracting a penalty of up to $220,000 and/or imprisonment for five years.

[33] Section 418(1)(d) of the Corporations Act.
[34] Section 423 of the Corporations Act.
[35] Section 420A of the Corporations Act.
[36] Section 1317H of the Corporations Act.
[37] Section 1317G of the Corporations Act.

International position

121 To assist the Inquiry, and noting the issues raised during the course of the public hearings, we provide some background information about the status of 'administrative receiverships' as they exist within England and Wales.

122 The *Enterprise Act 2002* (UK) (EA Act) commenced in England and Wales on 15 September 2003,[38] providing for major changes to the corporate insolvency regime in that jurisdiction. The key elements of this legislation were around:

(a) streamlining administrations;

(b) restricting the use of administrative receiverships; and

(c) abolition of Crown preference and introduction of the 'prescribed part'.

123 The EA Act therefore prohibits, subject to certain exceptions, the right to appoint an administrative receiver in all cases where a floating charge was created on or after the commencement of the provisions on 15 September 2003. This change, as well as the streamlining of the administration process, sought to promote the use of administrations more generally.

124 The exceptions created to the general abolition of administrative receiverships are aimed primarily at facilitating the proper working of capital markets or ensuring the continued operation of certain public services.[39] The exceptions are highly specific to certain large scale financial arrangements or particular entities and still permit the appointment of an administrative receiver in highly prescribed circumstances. The exceptions relate to:

(a) capital market arrangements;

(b) public–private partnerships;

(c) utilities;

(d) urban regeneration projects;

(e) project finance;

(f) financial markets;

(g) registered social landlords; and

(h) protected companies.

[38] The concept of an administrative receivership was created by the *Insolvency Act 1986* (UK) and although also subject to certain legal duties, an administrative receiver primarily owes a duty of care to the party making the appointment in seeking repayment of the debt due, and not to the general body of creditors as a whole. Concerns as to this approach were discussed in the UK Government's 2001 white paper, noting that the process was insufficiently transparent and that an administrative receiver was not accountable to stakeholders other than the charge-holder that had made the appointment. Additionally, an administrative receiver has no express duty to seek to rescue a company and there was a belief that the process may have been overused and perhaps had caused some companies to have failed unnecessarily.

[39] Any dilution of a secured creditor's rights to appoint a receiver and manager may impact on the availability of credit. However, at both a legal and commercial level there are already a number of mechanisms in the Australian regime that may reduce this risk.

125 The evaluation of the EA Act, 'Enterprise Act 2002—Corporate Insolvency Provisions: Evaluation Report, January 2008', notes that the exceptions appear to be operating as intended and are not a general loophole for the appointment of an administrative receiver in what could be termed 'normal' insolvencies.