8 May 2017

Select Committee on Lending to Primary Production Customers
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: primaryproductionlending.sen@aph.gov.au

Dear Chairperson

Select Committee on Lending to Primary Production Customers

Thank you for the opportunity to make a submission to the Committee's inquiry into Lending to Primary Production Customers.

This submission is being made by the Australian Restructuring Insolvency and Turnaround Association (ARITA). Further information about ARITA is included as part of our submission.

This submission primarily addresses the terms of reference which apply to customers experiencing financial distress, specifically paragraphs a. and b. of the terms of reference, as reproduced below.

a. The lending, and foreclosure and default practices, including constructive and non-monetary default processes; and
b. The roles of other service providers to, and agent of, financial institutions, including valuers and insolvency practitioners, and the impact of these services.

To the extent that ARITA can comment on the remaining terms of reference focused on the conduct of lenders, we do so.

In addition to the specific matters raised in this submission, we commend to the Committee our submissions to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the Impairment of Customer Loans and the Senate Economics References Committee Inquiry into the post-GFC banking sector, which we have appended for your ease of reference.

We have kept this submission brief, but would be prepared to assist the Committee if further information was required.

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Please do not hesitate to contact me

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents practitioners and other associated professionals who specialise in the fields of insolvency, restructuring and turnaround.

We have more than 2,200 members including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency and restructuring.

Some 84 percent of registered liquidators and 89 percent of registered trustees are ARITA members.

ARITA's mission is to support insolvency and recovery professionals in their quest to restore the economic value of underperforming businesses and to assist financially challenged individuals.

We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large.

The Association promotes best practice and provides a forum for debate on key issues facing the profession. We also engage in thought leadership and advocacy underpinned by our members' knowledge and experience.

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1 Lending, and foreclosure and default practices, including constructive and non-monetary default processes

ARITA submits that the issues raised in this term of reference is one to which lenders are better positioned to respond.

We note the comments in our submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the Impairment of Customer Loans in relation to concerns regarding the practices described in paragraphs (a) and (c) of its terms of reference, as follows:

a. practices of banks and other financial institutions using a constructive default (security revaluation) process to impair loans, where constructive default/security revaluation means the engineering or the creation of an event of default whereby a financial institution deliberately reduces, through valuation, the value of securities held by that institution, thereby raising the loan-to-value ratio resulting in the loan being impaired;

c. practices of banks and other financial institutions in Australia using non-monetary conditions of default to impair the loans of their customers, and the use of punitive clauses such as suspension clauses and offset clauses by these institutions;

We maintain that ARITA is not aware of any such practices and again note that the scenario described seems counterintuitive in that it would not be financially beneficial for lenders to adopt such practices. As valuations are based on point-in-time assessments, it should be noted that any revaluation may be based on prevailing depressed market conditions that may be temporary or later improve.

ARITA is also not aware of any use of “punitive” suspension or off-set clauses. We note the transcript of the ASIC response of 4 June 2013 to the Senate Standing Committee on Economics’ Budget Estimates hearings. We are not aware of any further information about that issue arising from that hearing.

2 Roles of other services providers to, and agents of, financial institutions, including valuers and insolvency practitioners, and the impact of these services

2.1 The role of valuers

Insolvency practitioners often rely on licensed valuers in relation to the sale of property. A primary duty of a practitioner is to obtain the best return for creditors. Valuation of property is a matter of expertise. Reliance on licensed valuers is needed particularly in relation to sales conducted for lenders by receivers under the strict legal obligations imposed under section 420A of the *Corporations Act 2001* (the Act). That section refers to the need to take reasonable care to obtain “market value”.

The power of a receiver to appoint a valuer is contained in the Act, i.e. to appoint a “professionally qualified person to assist” the receiver.

We are not aware of any improper role of property valuers in “constructive default”. Of course, there is often legitimate dispute as to valuation evidence. Valuations are often the subject of rigorous assessment in court proceedings.

The courts have processes to obtain the best evidence from experts when there is a difference in view. The circumstances of the valuation being sought are often relevant, including as to timing and the nature of the asset.

A deteriorating or perishable asset may need prompt valuation and decision on sale. A fixed asset may be retained and not sold until market conditions improve. This will however depend on the maintenance and other costs of holding on to the asset. In depressed market conditions (such as a drought where the asset is involved in agriculture) it is usually not in a lender’s best interest to sell, despite the fact that, from an economic viewpoint, it may put the property in the hands of someone better able to use it more profitably.

As to comparisons between valuations and sale price, a receiver would ordinarily obtain a valuation based both upon a “normal course of sale” and “forced sale” value. Nevertheless, the requirement under section 420A that reasonable care be taken to obtain market value under a forced sale sets a high standard for receivers.

ARITA notes that disputes sometimes arise when borrowers have an inflated opinion of the value of their asset compared to a realistic, current market valuation. It is important to note that a current market valuation is based on what an independent, informed purchaser would pay; it is not based on past value or what amount may have been invested in the asset. Also, the value of an asset may have been reduced by the activity that led to the asset becoming distressed.

2.2 The role of insolvency practitioners

2.2.1 Investigative Accountants

In general terms, an Investigative Accountant (IA), who is a registered insolvency practitioner, is engaged by a lender to review a business and make recommendations based on the scope of the engagement, usually in relation to its viability and quality, causes of failure or distress and/or to identify inappropriate activities. Their work, in circumstances relevant to this inquiry, is generally commissioned by a lender to assure the lender of the status of their security. There is no contractual relationship between such an IA and the borrower.

The Australian Small Business and Family Ombudsman inquiry into small business loans made a number of recommendations in relation to IA engagements by lenders. Namely, Recommendations 9 and 10 as follows:

> **Recommendation 9** - Every borrower must receive an identical copy of the instructions given to the investigating accountant by the bank and the final report provided by the investigative accountant to the bank.
>
> **Recommendation 10** - Banks must implement procedures to reduce the perceived conflict of interest of investigating accountants subsequently appointed as receivers. This can be achieved through a competitive process to source potential receivers and by instigating a policy of not appointing a receiver who has been the investigating accountant to the business.

While we have not had the opportunity to formally respond to these recommendations, we note that we have concerns that the requirements of recommendation 9 would limit the full extent of advice an IA could make to a lender.

We reject the proposition in Recommendation 10 that a conflict of interest exists when an IA is subsequently appointed receiver. Separating the two will duplicate costs and harm other stakeholders, be they unsecured creditors, owners or guarantors. We believe that a requirement to separate the appointments is as illogical as seeking the advice of a lawyer to litigate, then being required to go to a fresh lawyer to undertake such litigation.

2.2.2 Receivers

A comprehensive overview of what a receivership is and the role of a receiver is detailed in ARITA's (then the IPA) submission to the Senate Economics References Committee Inquiry into the post-GFC banking sector (see Appendix 2).

We consider that, generally, the profession properly attends to its requirements under the law and the ARITA Code of Professional Practice in this area. The statutory and professional conduct requirements impose on practitioners a duty to maximise the value of returns to creditors in any type of administration. In the context of receiver sales, section 420A imposes a particular responsibility on an appointee to realise property according to the requirements of that section.

By way of background, the history of the provision is that the duty of receivers under Australian case law was one of 'good faith' only. The 1988 Harmer Report considered that this was not adequate and that there should be a specific obligation imposed to secure the best price in the circumstances of the sale. Thus, section 420A was introduced.

The purpose behind the introduction of section 420A was stated in the Explanatory Memorandum to the relevant Bill:

> "It is sometimes said of receivers that they are prepared to sell property at a price less than the best obtainable, so long as it is sufficient to cover the debt of the chargeholder who appointed them. Proposed s 420A makes it clear, that in selling company property, a controller must take all reasonable care to sell the property for the best price that is reasonably obtainable having regard to the circumstances existing when the property is sold."

That law has now been in operation for over 20 years. We are not aware of any issues about the high standard it imposes. It is a section that has been the subject of a number of decisions from the courts in relation to the process of obtaining market value. Many of these cases raise complex and difficult issues. However, as a general statement, the introduction of section 420A has made receivers more accountable for, and focussed on, properly 'testing the market' for the assets they are selling.

In addition to the specific requirements under section 420A, analogous state legislation may also apply to a sale on behalf of a lender, which imposes similar duties.

A receiver is also subject to other controls and responsibilities under Part 5.2 and elsewhere in the Act. They are officers of the company and are therefore subject to the significant duties of care and diligence, good faith, and other duties under s 180-184 of the Act.

They assume liability for debts incurred in trading on, they must lodge regular accounts with ASIC and must also report any misconduct or breaches of the law. They can also require company officers to report to them on the operations of the business. Their remuneration is subject to oversight by ASIC and the court. Section 423 of the Act permits a court to inquire into any misconduct of a controller/receiver and order payment of damages.

3 The appropriateness of internal complaints handling and dispute management procedures within financial institutions

ARITA submits that the issues raised in this term of reference is one to which lenders are better positioned to respond. However, we do note Recommendation 13 of the Australian Small Business and Family Ombudsman inquiry into small business loans that “[e]xternal dispute resolution schemes must be expanded to include disputes with third parties that have been appointed by the bank, such as valuers, investigating accountants and receivers, and to borrowers who have previously undertaken farm debt mediation.”

3.1 “Expansion” of EDR to Financial Ombudsman’s Service is Not Appropriate

ARITA rejects the proposition that EDR schemes must be “expanded” to include investigative accountants and receivers. We note the use of the phrase “expanded” as opposed to “created”. We take that to imply the use of the Financial Ombudsman Service (FOS) and we reject that approach.

In the first instance, FOS has no expertise in the areas of insolvency or investigative accounting and should therefore not be called upon to adjudicate matters beyond its expertise. Nor is it appropriate for it to expand its expertise into these areas.

FOS is an entity created and owned by lenders to manage their complaints process. It is not proper, nor reasonable to compel parties beyond those lender-owners into their commercial processes. ARITA made a strong submission to FOS on this matter in September 2016 in reply to its “Expansion of FOS’s Small Business Jurisdiction – consultation paper”. You will find much of our response to this recommendation mirrors that reply, which is also provided below for your information.

3.2 Role of Investigative Accountants

Specifically, in relation to investigative accountants (IAs): there are no grounds to force investigative accountants into an EDR scheme. IAs hold no decision-making power. At the conclusion of their reporting, any dispute about steps taken because of that report is between the lender and the borrower. A dispute about the findings of an IA is not properly the domain of an EDR process as no reasonable outcome of an EDR process could be to direct the IA to alter their professional opinion or recommendation. To do so would compromise the professional standing and expertise of the IA and, likely, trigger significant professional indemnity issues for the IA.

3.3 ARITA to trial EDR scheme for registered liquidators including receivers

There are many significant and valid reasons to reject compulsory EDR schemes for registered liquidators including receivers. However, since 2015 ARITA has had, as part of our strategic plan, the intention to develop an ADR scheme to support our members in reducing disputes. Implementation of this was delayed. We emphasise that our planned scheme is voluntary and observes the proper right of the liquidators/receivers to refuse to enter ADR/EDR if they consider that it conflicts with their statutory obligations or it would result in an unreasonable burden or impact on creditors (the latter being in line with elements of the *Insolvency Law Reform Act 2016*). We also note that any ADR/EDR scheme would be limited to commercial disputes but would not extend to issues such as validity of appointment etc. Importantly, such an ADR/EDR scheme would be complimentary to ARITA's existing and extensive complaints and conduct processes, including the enforcement of our Code of Professional Practice.

Where EDR can offer an expeditious and agreed outcome between parties, this is valuable both to our members and, most particularly, to the complainant. While we note that all ARITA members are currently required to have a complaints management arrangement in place, the value of our ADR scheme initiative comes from the independence of the review.

ARITA will commence a trial of our ADR service in the second half of 2017. The trial will offer both binding and non-binding options to the complainant. The ADR arbitrator will be an independent, eminent person with either legal or insolvency experience whose appointment would be subject to the agreement of the complainant.

4 The appropriateness of loan contract terms particular to primary production industries, including loan-to-value ratios and provision of reasonable written notice

ARITA submits that the issues raised in this term of reference is one to which lenders are better positioned to respond.

4.1 Loan to value ratio

ARITA has no direct view on the appropriateness of the loan to value ratio (LVR) set by lenders as a mechanism to cause a loan to default. In any event, as we have said, our members' experience is that there is little evidence of LVR revaluations for the purpose of creating a default, certainly in the primary debt market.

4.2 Timing of notice

The timing of any notice by lenders to exercise their power to appoint a receiver is one addressed by court decisions over the years and is reasonably settled – ie, based on a reasonable period of time being given.

Appendix 1 – ARITA Submission: Parliamentary Joint Committee on Corporations and Financial Services inquiry into the Impairment of Customer Loans

7 August 2015

Ms Toni Matulick
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

By email: corporations.joint@aph.gov.au

Dear Ms Matulick

Parliamentary Joint Committee Inquiry into the Impairment of Customer Loans

Thank you for offering the Australian Restructuring Insolvency & Turnaround Association (ARITA) the opportunity to make a submission to this Inquiry.

We note from the terms of reference that the Inquiry is mainly focused on the conduct of lenders. To the extent that ARITA can comment on those issues we do so.

However, from our perspective as experts in insolvency and restructuring, we find it difficult to understand the motivation of any lender to unnecessarily devalue the property of a customer, or, in the absence of monetary default, to place any loan into distress.

These actions seem counterintuitive, as they would not be financially beneficial for lenders. We further suggest that we see little, if any, evidence of these practices actually occurring.

The law imposes high standards in relation to the sale of property by receivers under section 420A of the *Corporations Act 2001*. We are not aware of any real concerns about the operation of that section, although it has been raised by the Productivity Commission in its current Inquiry.

In court challenges by borrowers under section 420A, the courts have generally upheld the conduct of the receiver. Complaints to ARITA about receiver sales are generally dismissed on the basis the established process to ensure market value is obtained was followed.

We also explain that there is a trend away from formal insolvencies under the *Corporations Act*, including receiverships. The numbers of corporate (and personal) insolvencies have been falling for some time. Greater emphasis is being given to attempts to restructure troubled businesses at an earlier and more productive stage.

ASIC's Australian Insolvency Statistics Series 1 released July 2015 shows that the number of receiver and receiver and manager appointments has fallen over 35 percent from the 2010-11 financial year (915 in 2010-11, 850 in 2011-12, 739 in 2012-13 and 591 in 2013-14).

If more information can be provided on the issues raised in the terms of reference, for example in submissions that are made, we would be pleased to comment further. We're also happy to appear before the Committee, with subject matter experts, to answer any questions the Committee may have.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

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We have more than 2,000 members including accountants, lawyers, lenders, credit managers, academics and other professionals with an interest in insolvency and restructuring.

Some 76 percent of registered liquidators and 86 percent of registered trustees are ARITA members.

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We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large.

The Association promotes best practice and provides a forum for debate on key issues facing the profession. We also engage in thought leadership and advocacy underpinned by our members' knowledge and experience.

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1 Terms of reference

We address each of the terms of reference in turn.

1.1 Paragraphs (a) and (c)

ARITA is not aware of any practices as described in paragraphs (a) and (c) of the terms of reference.

The scenario described seems counterintuitive in that it would not be financially beneficial for lenders to adopt such practices. As valuations are based on point-in-time assessments, it should be noted that any revaluation may be based on prevailing depressed market conditions that may be temporary or later improve.

ARITA is also not aware of any use of "punitive" suspension or off-set clauses. We note the transcript of the ASIC response of 4 June 2013 to the Senate Standing Committee on Economics' Budget Estimates hearings. We are not aware of any further information about that issue arising from that hearing.

1.2 Valuations (b)

Insolvency practitioners often rely on licensed valuers in relation to the sale of property. A primary duty of a practitioner is to obtain the best return for creditors. Valuation of property is a matter of expertise. Reliance on licensed valuers is needed particularly in relation to sales conducted for lenders by receivers under the strict legal obligations imposed under section 420A of the *Corporations Act 2001* (the Act). That section refers to the need to obtain "market value".

The power of a receiver to appoint a valuer is contained in the Act, i.e. to appoint a "professionally qualified person to assist" the receiver.

Again, we're not aware of any improper role of property valuers in "constructive default" as the terms of reference describe. Of course, there is often legitimate dispute as to valuation evidence. Valuations are often the subject of rigorous assessment in court proceedings.

The courts have processes to obtain the best evidence from experts when there is a difference in view. The circumstances of the valuation being sought are often relevant, including as to timing and the nature of the asset.

A deteriorating or perishable asset may need prompt valuation and decision on sale. A fixed asset may be retained and not sold until market conditions improve. This will however depend on the maintenance and other costs of holding on to the asset. In depressed market conditions (such as a drought where the asset is involved in agriculture) it's usually not in a lender's best interest to sell, despite the fact that, from an economic viewpoint, it may put the property in the hands of someone better able to use it more profitably.

As to comparisons between valuations and sale price, a receiver would ordinarily obtain a valuation based both upon a “normal course of sale” and “forced sale” value. Nevertheless, the requirement under section 420A for reasonable care to be taken to obtain market value under a forced sale sets a high standard for receivers.

ARITA notes that disputes sometimes arise when borrowers have an inflated opinion of the value of their asset compared to a realistic current market valuation. It is important to note that a current market valuation is based on what an independent, informed purchaser would pay; it is not based on past value or what amount may have been invested in the asset. Also, the value of an asset may have been reduced by the activity that led to the asset becoming distressed.

1.3 The role of insolvency practitioners (d)

We consider that, generally, the profession properly attends to its requirements under the law and the ARITA Code of Professional Practice in this area. The statutory and professional conduct requirements impose on practitioners a duty to maximise the value of returns to creditors in any type of administration. In the context of receiver sales, section 420A imposes a particular responsibility on an appointee to realise property in terms of the requirements of that section.

By way of background, the history of the section is that the duty of receivers under Australian case law was based in negligence only. The 1988 Harmer Report considered that this was not adequate and that there should be a specific obligation imposed to secure the best price in the circumstances of the sale. Thus section 420A was introduced.

The purpose behind the introduction of section 420A was stated in the Explanatory Memorandum to the relevant Bill:

> “It is sometimes said of receivers that they are prepared to sell property at a price less than the best obtainable, so long as it is sufficient to cover the debt of the chargeholder who appointed them. Proposed s 420A makes it clear, that in selling company property, a controller must take all reasonable care to sell the property for the best price that is reasonably obtainable having regard to the circumstances existing when the property is sold.”

That law has now been in operation for over 20 years. We are not aware of any issues about the high standard it imposes. It is a section that has been the subject of a number of decisions from the courts in relation to the process of obtaining market value. Many of these cases raise complex and difficult issues. However as a general statement, the history of court decisions has supported the receiver in relation to their compliance with the section. In other words, challenges to section 420A sale are generally unsuccessful.

A receiver is also subject to other controls and responsibilities under Part 5.2 and elsewhere in the Act. They are officers of the company and are therefore subject to the significant duties of care and diligence, good faith, and other duties under s 180-184 of the Act.

They assume liability for debts incurred in trading on, they must lodge regular accounts with ASIC and must also report any misconduct or breaches of the law. They can also require company officers to report to them on the operations of the business. Their remuneration is subject to oversight by ASIC and the court. Section 423 of the Act permits a court to inquire into any misconduct of a controller/receiver and order payment of damages.

1.4 Financial System Inquiry Report (e)

The terms of reference at (e) refer to the relevant recommendations of the Financial System Inquiry (FSI) Report, particularly recommendations 34 and 36 relating to non-monetary conditions of default and the external administration regime respectively.

Recommendation 34 expresses support for the government's action in extending unfair contract term protections to small businesses, and to encourage industry to develop standards on the use of non-monetary default covenants. We have no particular comment on this except to note that it appears to have only limited application to the sale of property.

Recommendation 36 is that the government consult further on possible amendments to the external administration regime in order to provide additional flexibility for businesses in financial difficulty.

The recommendation notes that submissions indicated that Australia's external administration provisions are generally working well and do not require wholesale revision. In particular, it says that submissions "*present little evidence to suggest the Australian regime causes otherwise viable businesses to fail".* It goes on to address other issues concerning directors.

We advise that following that FSI Report, Treasury called for submissions on the operation of the insolvency regime and other issues in the Report. ARITA lodged its submission by the due date of 31 March 2015. We raised no issue about the operation of section 420A. The government has yet to respond to the FSI Report and to those further submissions.

At the same time, the Productivity Commission was referred an Inquiry into Business Set-up, Transfer and Closure. We made a submission to the Commission in February 2015. The draft report, issued in May 2015, adopted many of the recommendations for reform proposed by ARITA.

The Commission made a draft recommendation about potential changes to the sale of asset requirements in receiverships. ARITA's submission on the draft report raised practical implementation issues with the draft recommendation. The Commission is due to report to Government by August 2015.

1.5 Opportunity to rectify default (f)

Term of reference (f) refers to the "extent to which borrowers are given an opportunity to rectify any genuine default event and the time period typically provided for them to do so. ARITA submits that this is a matter to which lenders are better positioned to respond.

The view of our members is that most often lenders tend to attempt to resolve impaired assets outside of a formal insolvency appointment.

Even if a receiver is appointed, it's not unusual for the receiver to continue to trade on an underperforming enterprise for an extended period, with a view to maximising its value, rather than implementing an immediate sale process.

The power to do that exists under section 420C. A role of receivers is often to take over a business, with existing management (where appropriate) and employees, in order to review and improve the operations of the business. It may be that the business is sound but began to fail because of poor management decisions. The experience of a receiver can in fact restore the viability of a business.

However, there is also the view that if a lender grants a poor business extended concessions for extraneous reasons, other borrowers whose loans are properly managed might rightly express dissatisfaction. In economic terms, the prolonging of a poor business without real prospects of rehabilitation results in unfair competition with other businesses, and the delayed release of the capital of that business for more productive use in the economy.

1.6 Timing of notice (g)

The timing of any notice by lenders to exercise their power to appoint a receiver is one addressed by court decisions over the years and is reasonably settled based on a reasonable period of time being given.

1.7 Loan to value ratio (h)

ARITA has no direct view on the appropriateness of the loan to value ratio (LVR) set by lenders as a mechanism to cause a loan to default. In any event, as we have said, our members' experience is that there is little evidence of LVR revaluations for the purpose of creating a default, certainly in the primary debt market.

1.8 The pre-conditions and requirements for appointment of a receiver (i)

The conditions and requirements to be met prior to the appointment of an external administrator are set in the loan document and invariably are activated only on significant default by the borrower.

Nevertheless the default conditions set are a matter of agreement between the lender and the borrower. A right to challenge the appointment of a receiver exists under section 418A.

2 Insolvencies in decline, including receiverships

We wish to point out that formal insolvency appointments are declining in number, across all types of administrations. This extends to personal bankruptcies.

We see this as a trend towards restructuring a business outside the formal insolvency regime. Our members are increasingly working to this end, often on the instructions of lenders. The lenders themselves are adopting this approach. It is seen as a trend internationally based partly on low interest rates and existing economic conditions.

Our experience is that the number of "forced" sales by receivers is very low.

3 The legal regime

As we have explained, there is a settled regime under Part 5.2. We are not aware of any real concern about how this operates. The Productivity Commission draft report does suggest a revised provision. Many submissions in response considered that the Commission's ideas were not practical.

The concept of market value in section 420A has been mirrored in some state and territory laws in relation to the sale of property of individuals.

For example, s 111A of the NSW *Conveyancing Act 1919* provides that in exercising a power of sale over land, the mortgagee "must take reasonable care to ensure that the land is sold for: (a) if the land has an ascertainable market value when it is sold not less than its market value, or (b) in any other case-the [sic] best price that may reasonably be obtained in the circumstances."

4 Other relevant inquiries

ARITA has made submissions on section 420A and other related issues to other inquiries.

We have mentioned the FSI Report and the Productivity Commission.

The Senate Economic References Committee Inquiry into failed forestry managed investment schemes (MIS) involves sales by receivers of failed schemes. It is due to report on 17 September 2015. We understand an issue arises in that Inquiry as to farmers and other agricultural producers who have been left with the uncertainty of timber plantations linked to forestry MIS on their land.

CAMAC's report of 2012 and its 2014 discussion paper on MIS raise the need for a broad review of that area of law.

5 Conclusion

ARITA is of the view that the pretext of this Inquiry is not borne out by the reality of what ordinarily occurs in the market.

The claim that there is value in causing assets to be deliberately distressed is counterintuitive and doesn't fit with the evidence we see in the market. As the professional body for restructuring, insolvency and turnaround practitioners, all evidence that we see indicates lenders are probably over-cautious in moving to take charge over assets, being deeply mindful of community reactions, their reputations and license to operate.

It may even be considered that due to this caution assets are left too long before they are sold. Ironically, their value may be reduced as a result. In almost all cases we are aware of, enforcement action over assets is only taken once a borrower has failed to service their loan for some period of time.

The inference that there is collaboration between lenders and insolvency practitioners to "manufacture" outcomes whereby insolvency practitioners do not meet their statutory obligations under the Act to maximise returns, we reject out of hand as being completely unsubstantiated.

If in the course of this Inquiry submissions are made that indicate concern about practitioners we would like the opportunity to consider those and respond further.

Appendix 2 – ARITA (then IPA) Submission: Senate Economics References Committee Inquiry into the post-GFC banking sector

31 May 2012

Mr T Bryant
Committee Secretary
Senate Economics Legislation and References Committees
Parliament House
CANBERRA ACT 2600
AUSTRALIA

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

Dear Mr Bryant

Inquiry into the post-GFC banking sector

The IPA is the professional body of company liquidators and bankruptcy trustees, and lawyers, financiers, academics and others concerned with insolvency law and practice. We make this submission on the law and practice of 'receivers',[1] in order to assist the Committee understand the role that members of the insolvency profession, who act as receivers, play in relation to the banking sector. In that respect while the terms of reference do not appear to deal with this aspect, we have noted that some submissions to date have raised the role of receivers acting on behalf of banks in selling assets of the banks' customers.

This submission therefore seeks to assist the inquiry in understanding that role.

We note that in the Economic References Committee's 2010 report on liquidators and administrators, a short explanation is given on receiverships[2] although the Committee's report did not deal with that particular role.

1 What is a Receivership?

A "receivership" is an administrative procedure by which a person – who must be a registered liquidator - is appointed to administer property on behalf of a secured creditor. The secured creditor, often but not always a bank, appoints the receiver. The appointment may be limited to mere protection of one particular item of property – for example factory

[1] Throughout this submission, the term 'receiver' is used which is the common usage, and we use it to include a 'receiver and manager'. The distinction between them mainly relates to the extent of their powers. The Corporations Act – *Part 5.2 Receivers, and other controllers, of property of corporations* - uses slightly different terminology – "controller" and "managing controller".

[2] *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, 14 September 2010

premises - or it may extend to general control over all of the property and business affairs of a company – for example the factory and the engineering business carried on there.

A receiver may be appointed privately under contract, or by the Court. We only deal with the former which is by far the most common type of receivership and the type that is relevant to this inquiry.

A bank is invariably a secured creditor, meaning that the customer has been required to give some form of security as a condition of the loan, to protect the bank's position in the event of its customer's default. The security might be, for example, a mortgage over particular real property or it might be a registered security interest over some or all of the assets of the customer. The mortgage or security document sets out the rights and obligations of the debtor (the customer who owes the bank money) and creditor. It is commonly a condition of the loan being given by the bank that it have the right to appoint a receiver and sell the customer's assets if the customer defaults. This is standard loan policy and applies in the majority of commercial property and home loans.

Although the receiver is appointed by the secured creditor, the security document provides for the receiver to be appointed to act as agent for the customer. In this way the secured creditor does not itself become a 'mortgagee in possession' and thereby become directly responsible for liabilities attaching to the secured property. The receiver is also typically given an indemnity by the secured creditor in relation to any liability found against the receiver, but this usually contains exceptions in relation to the receiver's negligence or fraud, leaving the receiver personally liable if that occurs.

The purpose of the appointment of a receiver by a bank as a secured creditor is to take control of the assets of the bank's customer. The receiver must then decide how best to satisfy the debt owing to the bank. While the receiver will take instructions from the bank on how this may best be done, the receiver has serious responsibilities under the Corporations Act 2001 that they must comply with.

Central to this is the obligation under section 420A of the Corporations Act. It provides that in exercising a power of sale in respect of property of a company, the receiver must take all reasonable care to sell the property for - if, when it is sold, it has a market value-not less than that market value. Otherwise, the receiver must obtain the best price that is reasonably obtainable. This duty applies having regard to the circumstances existing when the property is sold. The duties of a receiver as an 'officer' of the company – good faith, honesty, avoidance of conflict – also apply during the receivership.

2 A bank's appointment of a receiver

The most common default leading to the right to appoint a receiver is failure to make a repayment on a due date. There can also be non-monetary defaults such as failure to provide accounting information as agreed, dealing with specified assets contrary to the loan agreement such as by unauthorised factoring of debtors or not meeting certain debt/equity ratios.

The security documentation may also include the requirement that the secured creditor give notice of default to the borrower company in order to provide it with the opportunity to remedy the default before any receiver is appointed.

Once the necessary pre-conditions are satisfied, the secured creditor can proceed and appoint a receiver without reference to the courts or any other regulatory authority. The normal method of appointment is for the secured creditor to find a receiver who is prepared to act and then execute a deed of appointment. It is usually a very simple and quick procedure.

In reality, many of our members are involved in assisting the bank in reaching its decision whether to appoint a receiver. They may be instructed to do an investigating accountants' report for the bank, which involves the practitioner conducting an extensive review of the company's business to determine whether and when a formal appointment of a receiver

may be needed. It may be the case that the practitioner will recommend some changes to the operations of the business that will restore its performance and allow the bank to be satisfied that its debt will in fact be repaid. Alternatively, the practitioner may recommend that the company attempt to refinance its facility with an alternative lender.

For completeness, it should also be noted that section 436C of the *Corporations Act* also enables a secured creditor with a security interest over all or most of the company's assets to appoint a voluntary administrator under Part 5.3A of the Corporations Act. This is an alternative approach available to a bank in that circumstance.

3 Practical role of a receiver

No two receiverships are the same and will depend very much on the type of business and the nature of the assets involved. Typically, a receiver will take possession of the property or business assets and then analyse the company's business position with a view to adopting the best course of action to enable repayment of the secured creditor's debt.

In some instances, this may involve trading on the business with a view to repaying the bank as secured creditor without major asset sales. This may further involve the receiver in working to build up the business for a period of time so that it can be sold for a good price as a going concern.

In other instances, the receiver may decide to sell some or all of the assets of the company to try to recoup the secured creditor's debt.

Generally, the receiver will normally consult with the secured creditor before the major assets are sold to ensure that there is no objection to the proposed method of sale and price. However, the receiver must at all times have regard to their statutory duty of sale under section 420A of the Act. Moreover, if the secured creditor seeks to control the conduct of the receivership, the position of the receiver as agent of the borrower can be severed, leaving the secured creditor directly liable for the receiver's conduct. This legal framework is well understood by practitioners.

The sale of assets at market value is a significant legal obligation of a receiver and it is one that is sometimes contested in the courts. This action may be taken by the directors based on their claim that the receiver did not sell their business for the best price. Directors and others are entitled to take these challenges but we find that the owners of the business often have an overly optimistic view of the value of the business, and a limited sense of their responsibility for its decline. Also, questions of market value are often contentious, more so in what we may call a post GFC climate when expectations of sale price have to be adjusted. The law generally requires receivers to engage in a competitive process, for example, involving tender or auction, and based on valuation and sale advice. Assets sold by receivers also attract those looking for a reduced price. Most court challenges to receivers' sales do not succeed.

4 Personal liabilities of the receiver

In common with other types of insolvency administration, receivers have personal liabilities imposed upon them under the Act. For example, they can be personally liable for rent payable by the company under a lease of premises. The receiver has a 7 day period to make a decision whether to continue to lease the property, beyond that, personal liability is imposed. This means that prompt decisions have to be made by the receiver about the business, for example whether it is worthwhile to continue to rent the premises from which it operates.

Wages of employees of the company can also be the personal liability of the receiver. As to employees, it may often be that, even if the business is traded on, the services of some employees will have to be terminated as being excess to the business' requirements. The receiver can be personally liable also for worker health and safety; this is another reason why a receiver will often have to make a quick decision in deciding whether the business has been meeting its obligations to employees and whether trading should or can be continued.

5 Directors' obligations

Once a receiver is appointed, the directors' powers over the company assets cease. However, the directors' normal statutory responsibilities continue, including in relation to the company's statutory reporting obligations. In particular, a director is required to submit a report as to affairs to the receiver, in the same way that directors of companies in liquidation are also required. Section 590 of the Act provides a listing of obligations of directors in assisting the receiver, and potential offences for non-compliance. It applies to receiverships in the same way as it applies to liquidations.

6 Effect on unsecured creditors

The main purpose of a receivership commenced by private appointment is to repay the secured creditor's debt. Given this, it is not the duty of the receiver to convene meetings of unsecured creditors or provide reports to the unsecured creditors about the conduct of the receivership. It is this misunderstanding of the role of the receiver which can lead creditors and directors on occasion to feel aggrieved and cause them to say that a receiver has acted inappropriately or may not have discharged their duties correctly. It should also be noted that even if there are surplus funds after payment of the secured creditor's debt, a receiver does not have authority to distribute those funds to ordinary unsecured creditors. In that respect, liquidations and voluntary administrations are the regime that primarily serve the interests of unsecured creditors.

7 Roles of liquidators and administrators in conjunction with receivers

Those unsecured creditors may in fact decide to commence winding up proceedings against the company and they will often do so; or the directors themselves may initiate the company's voluntary winding up. As an alternative, the directors may decide to appoint a voluntary administrator to the company. In that instance in particular, a bank may choose to appoint a receiver and have the receiver act to sell the secured property despite the voluntary administration; or the bank may chose to await the outcome of the voluntary administration process before exercising its rights.

It is therefore quite common for both a receiver and a liquidator or administrator to be appointed concurrently to the same company, each with their different roles.

7.1 Example

As a very recent example, banks appointed partners of McGrathNicol as receivers & managers over companies in the Hastie Group. At the same time, partners of PPB Advisory were appointed as voluntary administrators of those and other companies in the Group. Each firm has information on its website[3] which explain their respective roles.

8 Remuneration

Receivers are in effect paid from the sale of the assets of the company, or by the bank if those assets are insufficient. The secured creditor will normally set the rates by which the receiver is to be paid. The right to do so is usually spelled out in the security agreement the customer signs, but the remuneration of the receiver can be challenged and reviewed by the court on the application of ASIC or of a subsequent liquidator or administrator.

9 IPA Code

The IPA Code of Professional Practice sets standards of conduct required of IPA members. These include members when they are acting as receivers. While liquidators and administrators have standards of conduct in relation to their independence and their fiduciary duties, a receiver is different in that he or she acts for a bank to whom a duty is owed to assist in recovering the bank's debt. Notwithstanding the receiver's duty to the appointing secured creditor, the law imposes some overlaying duties of a receiver to the company itself, and to the interests of unsecured creditors. This is recognised in the IPA Code.

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[3] http://www.mcgrathnicol.com/news/Documents/Hastie%20-%20MediaRelease%20280512.pdf

http://www.ppbadvisory.com/news/d/2012-05-28/ppb-advisory-appointed-administrators-by-hastie-group

10 Current reforms about receivers

At present, the law requires a receiver to be registered with ASIC as a liquidator, just as a voluntary administrator must also be a registered liquidator.

The government insolvency proposals paper of December 2011 proposes a new separate registration of persons as receivers only.[4] The rationale given is that there are many people in the insolvency industry who currently specialise in receivership whose skills and experience well qualify them for that work, but which are not enough to allow them to work as a liquidator. The IPA has opposed the reform on the basis that while a receiver may have different fiduciary and other obligations to a liquidator or administrator, receivership often involves intersection with other external administrations, and duties owed as an officer of the company, and to unsecured creditors. It is also often the case that receiverships can be very complex, more so than many liquidations. The IPA considers that it is important that persons appointed as receivers have the same broad qualifications and experience as other insolvency practitioners and have detailed knowledge of the other forms of insolvency administration.

11 Further comment or assistance

We trust these comments on the nature of receiverships and the role, powers and responsibilities of a receiver are helpful. Should other issues arise in the inquiry in relation to the role on which the Committee considers we could assist, we would be pleased to do so. This includes more detailed issues about the law or practice, or about particular receiverships that are raised in submissions where the Committee considers IPA's view would assist.

Please contact either myself, or the IPA's Legal Director,
- as necessary.

Yours sincerely

Robyn Erskine
President
Insolvency Practitioners Association

[4] *Proposals paper: A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia*, December 2011