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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
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Parliamentary Joint Committee on Corporations and Financial Services inquiry into corporate insolvency in Australia.

The Australian Institute of Credit Management (AICM) welcomes the opportunity to contribute to the inquiry and building an understanding of the current corporate insolvency landscape from the point of view of our members.

AICM represents over 2,800 credit professionals who contribute to a resilient economy and drive successful business outcomes through:

- mitigating risk;
- maximising growth; and
- applying sound credit principles and practices.

Without our members, businesses are exposed to reputational damage, poor cash flow management and inefficient processes. Their employers are at risk of breaching regulatory requirements and not getting paid for hard won sales and services delivered.

The AICM members work across all sectors of the economy as the custodians of cash flow. They engage with both consumer and commercial customers to assess credit risk, manage credit terms, resolve disputes and manage the full life cycle of the credit relationship.

The corporate insolvency regime in Australia is of close interest to our members, who have regularly called for reform to ensure the legislation supports their provision of credit that is essential to growth and vitality of businesses of all sizes.

The uncertainty, complexities and inefficiencies of the insolvency system limits the ability of credit professionals to support businesses displaying signs of potential insolvency. Key issues include:

- **Unfair preference claims**

Unrelated creditors are unfairly impacted by legislation that requires liquidators to claw back payments made in the 6 months prior to insolvency with the intent to distribute the funds to all creditors.

The very nature of this intent punishes creditors who follow normal business processes to obtain payment and favours those that are inactive. Further, the greatest risk of preference claim clawbacks is faced by creditors who have worked closely to support their customers to support the viability of their business.

Additionally, the litigious nature and complexity of these claims further eliminates any potential of the intent being achieved as most recoveries are absorbed in liquidator and legal fees with very little resulting in an increase in return to creditors, a significant contributor to the ripple effect of corporate collapses.

- **Unchecked growth in insolvent trading**

When last published, ASIC's statistics of reports by administrators in July 2018 to June 2019¹ identified that that 71% of reports identified a director misconduct of insolvent trading. This increased from 69% in July 2017 to June 2018 and 63% in July 2016 to June 2017.

As pressures on businesses increase and payment times deteriorate, members report clear signs that directors continue to be willing to trade whilst insolvent.

While all stakeholders seek to ensure businesses act at the earliest signs of insolvency, the non-existent enforcement of insolvent trading means directors are not deterred from continuing to trade whilst insolvent at the direct cost to creditors. Further, the longer a business trades whilst insolvent the less chance there is for a viable business to emerge from a formal insolvency process.

We expand on the above issues and provide recommendations in responses to the terms of reference.

1 - Recent and emerging trends in the use of corporate insolvency and related practices in Australia, including in regard to:

- a) temporary COVID-19 pandemic insolvency measures, and other policy measures introduced in response to the pandemic that may have had an effect on such trends and practices;**
- b) recent changes in domestic and international economic conditions, increases in material and input costs for businesses and inflationary pressures more broadly, and supply shortages in certain industries; and**
- c) any other contributory factors or events that have impacted insolvency patterns.**

AICM members found that the temporary COVID-19 pandemic insolvency measures that reduced the ability for creditors to enforce payment were manipulated by a significant number of businesses with the capacity to pay to avoid their obligations. At the same time, they reported that customers in genuine need of breathing space because of the pandemic were provided relief and this would have been provided irrespective of the measures.

¹ [REPORT 645 Insolvency statistics: External administrators' reports \(July 2018 to June 2019\)](#)

The AICM supports the government implementing measures during emergencies but encourages them to be targeted to minimise the impacts of manipulation. For example, increasing the power of the court to provide extensions of time and/or reject applications for wind up, bankruptcy and statement of claims where non-payment is due to the emergency unless the creditor can substantiate why relief is not appropriate or warranted.

- 2 - The operation of the existing legislation, common law, and regulatory arrangements, including:**
- a) the small business restructuring reforms (2021);**
 - b) the simplified liquidation reforms (2021);**
 - c) the unlawful phoenixing reforms (2019); and**
 - d) the operation of the Personal Property Securities Act 2009 in the context of corporate insolvency.**

Small business restructuring reforms (2021)

While a small number of AICM members have experienced utilising a Small Business Restructuring (SBR), AICM members are still concerned the reforms require significant improvement to achieve their goals. These improvements are detailed in our submission to the draft legislation.²

Specifically, AICM members who have experienced a customer utilising a small business restructuring process have received payment in full while the Australian Tax Office (ATO) is the only creditor subject to a compromise.

Further, members are yet to see circumstances where they can justify the risk of continuing to trade on credit terms, including where they have been paid in full.

Most recommendations in our submission to the draft legislation remain relevant including requiring debt values to be verified as early as possible by:

- Providing a schedule of debts with the directors' declaration and this included with the notice to ASIC and Creditors; and/or
- Requesting creditors submit a proof of debt in the notice to creditors before a plan is proposed.

Simplified liquidation reforms (2021)

While AICM members welcomed the restricted circumstances for recovery or preference claims, none have reported experience with simplified liquidations.

From consultation with practitioners and Australian Restructuring Insolvency and Turn Around Association (ARITA) AICM understands that the complexity and issues with time frames are significant hurdles to these reforms achieving their goals.

Unlawful phoenixing reforms (2019)

² [AICM Submission 24 November 2020](#)

AICM members are at the core of the billion dollar impacts of illegal phoenixing.

Whilst noting COVID-19 has the limited opportunities for the reforms to be tested, they are significantly concerned that the \$3.2bn impact of illegal phoenixing to trade creditors identified in the 2018 report by PricewaterhouseCoopers for the ATO, Fair Work Ombudsman and ASIC³ are set to rise rapidly as untrustworthy advisors and unscrupulous directors respond to economic pressures and escalate illegal phoenixing activity.

AICM members recommend:

- ASIC and related bodies are directed, empowered, and funded to enforce all instances of illegal phoenix activity unless there is a public benefit not to pursue. Including pursuing advisors for related offences such as unlicensed financial or tax advice.
- Legislation be amended to include a clear definition of illegal phoenixing.

Operation of the *Personal Property Securities Act 2009* in the context of corporate insolvency

After 10 years of interaction with the Personal Property Securities Act (PPSA) and register, AICM members are accessing the benefits of registration. However, there is significant opportunity for simplification and clarity as identified by the 394 recommendations of the 2015 Review of the Personal Property Securities Act 2009⁴.

Related to insolvency, AICM members have noted:

- The expectation of trade creditors achieving the protections of a priority/secured creditor status has not been achieved, specifically obtaining a full defence to unfair preference claims.
- Frustration occurs on commencement of a formal insolvency as to the rights and obligations in relation to secured items e.g.:
 - Creditors expect to be notified of the insolvency and their right to recover items such as stock and inventory.
 - Insolvency professionals' obligations to allow access, store and maintain items and protect secured goods.

AICM Members recommend review and detailed consultation of the recommendations of the 2015 review with the view to implement modest changes that improve the efficiency of the PPSR but not substantially alter the system. AICM members are not in favour of significant changes as they expect the cost and time to adjust would outweigh the benefits that could be achieved.

3 - Other potential areas for reform, such as:

- a) unfair preference claims;
- b) trusts with corporate trustees;
- c) insolvent trading safe harbours; and
- d) international approaches and developments.

³ [The Economic Impacts of Potential Illegal Phoenix Activity, July 2018](#)

⁴ [Review of the Personal Property Securities Act 2009](#)

Unfair preference claims

To address the punitive impact of the current regime and to recognise the role creditors play in supporting viable business, **AICM members recommend** payments only being deemed an unfair preference when the creditor is a related party. For clarity, unless an unrelated creditor used unlawful practices to extract payment there should not be a requirement for any payments to be disgorged.

Acknowledging the significant shift this change would have on the operation of insolvency, AICM members would support extending the limitations under simplified liquidation to all insolvencies as an interim step, however this should be accompanied by changes that address specific issues with current legislation including:

- Reducing the 3-year period to bring a claim

Currently a liquidator has 3 years to bring a claim, and this is routinely extended. This is a significant burden to creditors that have already incurred a bad debt due to the insolvency and then face additional costs to defend a claim and debt write-offs. In addition, the ability to obtain the detailed information needed to defend a claim significantly impacts the creditors' ability to defend the claim and arguably provides an incentive for liquidators to delay claims.

Considering only 9.8% of Administrations were expected to take more than 12 months to complete in 2018-19⁵, AICM members believe it is unreasonable to carry the risk of a preference claim for up to 3 years.

AICM members recommend the time to bring a claim is reduced to 12 months, and the court only allowed to grant extensions where there are extenuating circumstances or due to the size and complexity of the insolvent entity.

- Knowledge of insolvency

It is a core requirement of credit professionals to be alert to signs of insolvency. Good credit professionals use these signs as a reason to engage with their customers, manage exposures and mitigate risk often resulting in ongoing support to work through tough times.

Credit professionals are in a unique position to encourage directors to engage with insolvency professionals at an early stage.

The current legislation actively discourages credit professionals from leveraging this position for the benefit of all stakeholders due to the inclusion of the indicia of a preference claim being suspicion of insolvency or ought to have known of insolvency.

Currently, credit professionals may require additional security and complex arrangements to mitigate the risk of preference claims or simply be unwilling to provide assistance and additional supplies on credit terms.

AICM members recommend amending the legislation to require actual knowledge of insolvency as the relevant indicia. This would allow credit professionals to play a positive role in maximising the

⁵ [ASIC Series 3: External administrators' reports](#) accessed 25/11/2022

options available for their customers to avoid formal insolvency, such as providing extended time and repayment arrangements.

- Defences available

Currently the ambiguity as to defences available and methods of calculation further penalise creditors with legal fees and protracted negotiations.

AICM members recommend clarifying the appropriate defences to ensure clear and reasonable defences are available enabling claims to be resolved with less requirement for court mediation and legal fees on both sides.

Trusts with corporate trustees

Trading with trusts is one of the most complex, time consuming and risky areas of credit management.

The added complexity of administration of insolvent entities structured through trusts is a significant frustration for credit providers and leads to extra security being required and/or more restrictive credit terms being offered to these businesses, especially small businesses.

AICM members believe significant benefits to small business and all creditors can be achieved by increasing transparency and clarity of trusts with the implementation of a Trust register. The register would assist credit professionals, insolvency professionals, financial institutions, regulators, and other stakeholders to obtain information and verify the entities' structure, in the same way the ASIC company register does for other corporate structures.

AICM members recommend that a register incorporating details of the trustee, beneficiaries and the current trust deed is established along with legislation that gives legal effect to the entity once registration is completed. The concept is similar to how the PPSR gives legal effect to security interests.

AICM members recommend the treatment of insolvent trusts be clarified and aligned with the treatment of corporate entities to eliminate the current cost and complexity caused using court processes in most insolvencies involving trusts.

Insolvent trading safe harbours

The AICM members support reform of the safe harbour regime to provide greater confidence to creditors and ensure the intent is achieved.

Implementation of the recommendations of the Independent Review of Safe Harbour arrangements⁶ would significantly improve the regime for AICM members. Additionally, **AICM members recommend**:

- Including creditors interests in the analysis of the better outcome analysis to mitigate the risk of misuse of the safe harbour defence to defeat creditors and aid the enforcement of insolvent trading.

⁶ [Independent Review of Safe Harbour arrangements](#)

- Appointment of either a registered liquidator or other regulated professional should be mandatory, rather than just a factor that directors should consider.
- Specifically protecting unrelated creditors from preference claim liability for payments received during insolvent trading will increase the ability of directors or advisors to obtain creditor support to restructuring plans.

5 - The role, remuneration, financial viability, and conduct of corporate insolvency practitioners (including receivers, liquidators, administrators, and small business restructuring practitioners)

AICM Members value the role of insolvency professionals in ensuring best outcomes in the insolvency process and regularly collaborate to achieve outcomes benefiting all stakeholders.

The vast majority of insolvency professionals act within the bounds of legislation, regulation, and industry codes such as ARITA's. However, the complexity of legislation and regulation and the non-compulsory codes mean practices not in the best interests of creditors are regularly raised by AICM members including:

- Creditors losing rights due to incorrect application of legislation.
- Incorrect dealing of secured items due to poor understanding of PPSA.
- Incorrect/unfounded unfair preference claim demands.
- Poor practices such as scatter gun unfair preference claim demands.
- Not engaging with creditors in a genuine way to resolve issues and queries.

AICM members believe the pressure for Insolvency professionals to favour interpretations unfavourable to creditors or omit informing creditors of their rights is exacerbated by the pressure caused by the fact as (reported by ARITA) that millions of dollars of insolvency professionals work goes unpaid each year.

Whilst like all professions there are a small minority of bad actors, the cause of most frustration, poor outcomes and creditor disengagement can be traced back to the complexity of legislation and the lack of clarity this creates.

- 6 - The role of government agencies in the corporate insolvency system, including:**
- a) the role and effectiveness of ASIC as the corporate insolvency regulator;**
 - b) the ATO's role and enforcement approaches to corporate insolvency, and relevant changes to its approach over the course of the COVID-19 pandemic;**
 - c) the role, funding and operation of relevant bodies, including the Assetless Administration Fund and the Small Business Ombudsman;**

Role and effectiveness of ASIC as the corporate insolvency regulator

AICM members believe significantly better regulatory and enforcement outcomes would be achieved through the implementation of a single agency with responsibility of personal and corporate insolvency.

AICM members understand that enforcement is complex, costly and challenging and positive outcomes can be achieved through education and non-enforcement actions. However, AICM members have little confidence that egregious behaviour such as Philip Whitman⁷ and insolvent trading is being deterred due to the lack of enforcement activity.

Additionally, the low penalties when enforcement is undertaken may have the counter effect of encouraging egregious behaviour. AICM members recalled \$500 fines handed out to directors involved in alleged illegal phoenixing as being a small price to pay for the financial benefits of the illegal behaviour which isn't pursued.

As stated earlier, **AICM members recommend** that ASIC and related bodies are directed, empowered, and funded to enforce all instances of illegal behaviour that results in creditors being defeated.

ATO's role and enforcement approaches to corporate insolvency, and relevant changes to its approach over the course of the COVID-19 pandemic

As Australia's largest creditor, the ATO's enforcement approaches drive insolvency outcomes. Credit providers look to the ATO to have consistent, transparent, and act as an exemplar to best practice credit management including approaches to enforcement and insolvency.

In contrast to the ATO many AICM members act for organisations without the commercial power to obtain detailed information needed to assist fully informed assessment of viability such as tax compliance and additional information from the entity or their accountant. Therefore, they rely in a large part on the expectation that if the ATO hasn't taken enforcement action the entity is viable and continue to provide credit.

However, levels of ATO debt continue to escalate. The 2021-22 annual report showed that total debt has increased 13% from \$54.3bn in 2020/21 to \$61.6bn in 2021-22⁸ and collectable debt has more than doubled since 2016/17 from \$20.9bn in to \$44.8bn in 2021-22.

These debt levels are a significant concern to credit professionals who are exposed to the risk associated with businesses carrying aged tax debt. This risk is hidden from credit professionals and generally revealed in insolvency when the creditors report often shows years of unpaid tax.

While the Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Act 2019 – Disclosure of business tax debts allowed the ATO to disclose, AICM understands the current thresholds and ATO policies have limited disclosures to just a few dozen since March 2022.

The suspension of enforcement activity during COVID-19 increased uncertainty for credit professionals and assumptions that without the motivator for payment tax debt would be growing and a large volume of businesses will enter insolvency once enforcement recommenced. If not for the cash boost provided by government allowing businesses to maintain obligations with creditors, the lack of enforcement would have been seen as a significantly greater risk indicator and led to credit terms being withheld more readily.

While at a simplistic level this leads to a call for the ATO to be consistent with enforcement proceedings the AICM does support the ATO using its informed position to provide support to viable businesses with temporary impacts to solvency. However, this variable approach must be supported with transparency of

⁷ <https://www.abc.net.au/news/2016-10-17/unwitting-clients-signed-up-as-directors-to-failing-businesses/7939622>

⁸ [Commissioner of Taxation annual report 2021 22](#)

information to enable credit providers to also make informed decisions. This would include the expansion of the disclosure of tax debt measure to consistently move towards the recommendations of the AICM submission of 6 September 2019⁹ specifically **AICM Members recommend**:

- Amend the threshold amount from \$100,000 to \$10,000; or alternatively provide a mechanism for regular review of this threshold amount.
- Information be included on credit reports for five (5) years from date of disclosure, and during this period it is updated in the same manner as any other commercial default (i.e. updated to paid, or if arrangement entered into) and only removed if reported in error.

7 - Any related corporate insolvency matters.

While the insolvency regime rightly provides powers to creditors to challenge and approve decisions of insolvency professionals, complexity and cost are two significant factors that lead to creditor disengagement.

Credit professionals require a clear understanding of the process and legislation to have confidence to query an insolvency professional, challenge a decision or assert their rights. Due to the complexity of the current system this confidence can only be obtained with the benefit of legal advice which is not commercially viable for most creditors.

The impact of the complexity and cost of obtaining clarity is compounded by the fact creditors can generally expect little to no return from the insolvency, as evidenced by ASIC statistics in 2018-19 that showed in 96% of cases, the dividend estimate was less than 11 cents in the dollar¹⁰.

Considering a lack of funds is the cause of insolvency it may be optimistic to expect significant growth in dividends because of modernisation of Australia's insolvency regime. However, it will provide creditors with clarity and certainty allowing them to better manage their exposures and assert their rights.

Factors of complexity and cost could be significantly addressed through a holistic review, modernisation and alignment of the corporate and personal regime.

Separate legislation and regulation of corporate insolvency and bankruptcy creates inefficiencies and frustrations for many AICM members who interact with both regimes. This is most common with exposures to small businesses where the finances of the business and the owner are interlinked, and personal guarantees are provided.

Concerns raised include:

- Need to interact with multiple insolvency professionals for the one exposure for example:
 - An administrator/liquidator for the corporate entity.
 - Potentially a receiver if appointed by a secured creditor.
 - A trustee for the personal guarantor is also likely.

⁹ [AICM Submission 6 September 2019](#)

¹⁰ [REPORT 645 Insolvency statistics: External administrators' reports \(July 2018 to June 2019\)](#)

- Complication and lack of clarity caused by of two sets of legislation.
- Multiple processes with different time frames and requirements.
- Inefficiencies due to the time required to understand the operation of different processes.

Unnecessary costs and delays because of duplicated administration and investigation.

A modern insolvency regime could improve creditor engagement by removing confusion if it is designed to ensure creditors are able to understand the processes and their rights. As a result, the effectiveness of the system will be maximised with creditors being confident and incentivised to challenge processes that aren't conducted appropriately.

AICM members recommend a holistic reform and alignment of the regulation of corporate insolvency and bankruptcy which will deliver significant benefits from efficiency and clarity.

On behalf of our members the AICM looks forward to engaging with the committee to further contribute to the discussion on how to simplify, clarify and modernise Australia's insolvency landscape to ensure best outcomes for all stakeholders in the system.

Yours sincerely

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