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Dr Kathleen Dermody
Committee Secretary
Parliamentary Joint Committee on
 Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

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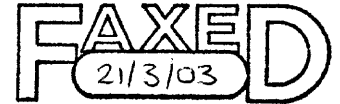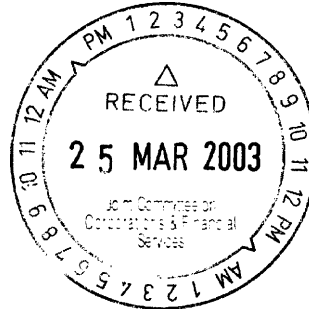
Dear Dr Dermody,

This is the first of two **ABA** submissions to the Parliamentary Joint Committee on Corporations and Financial Services' 'Inquiry into Australia's Insolvency Laws'. This submission deals with reference item *'(e) the treatment of employee entitlements '*. The second part of the **ABA**'s submission will be sent in due course.

In 2001, the Coalition announced a policy to protect employee entitlements. The package included a Government funded safety net scheme (GEERS) and a change in insolvency law to elevate certain employee entitlements above secured creditors with fixed charges against the company's assets. This is known as the Maximum Priority Rule (MPR).

Since then, the Government has been consulting with industry and labour groups to determine the impact of the policy in the community. The banking industry has continually stressed that we sympathise with the plight of workers who, through no fault of their own, find themselves out of work and without adequate protection for their entitlements. We support the legislation of the GEERS scheme.

Our strong conclusion from examining the MPR proposal, however, is that it will significantly impact on the lending and loan security arrangements of many businesses, and will in no way benefit employees. Direct impacts include higher lending rates, reduction in credit availability to many businesses and, in some cases, businesses may have credit withdrawn completely. Effects may be particularly severe on those companies with long-serving work forces (and thus high employee entitlement

provisions). The MPR proposal will also have material flow-on affects to security structure (where security may be taken outside of the legislative regime), to company performance and ultimately on employment.

The effect of the MPR will be to increase the risk of lending to businesses that have outstanding employee entitlements. If the company goes into default, banks and other financial institutions will have their security eroded by the value of the employee entitlements elevated in priority. This increased lending risk has to be priced into the structure of the loan, consistent with sound risk management principles.

The reason that the MPR will not benefit workers is because of the existence of the GEERS scheme. If a company is wound up without adequate reserves to pay out employee entitlements, the GEERS scheme will cover the lost entitlements. The worker is protected. The MPR proposal does not provide any wider protection than that offered by GEERS, so from the perspective of the employee, the MPR is redundant.

The only possible advantage of the MPR is that the Government may recoup ('claw back') some of its expenditure on GEERS. The Government has not released any estimates of revenue 'claw back', but because there is a small business carve-out in the MPR proposal and the fact that the overwhelming majority of insolvent businesses that cannot pay out entitlements are small businesses, the 'claw back' is likely to be insignificant. Hence, ABA believes the MPR proposal cannot be justified on the basis of sound public policy 'net benefit' principles.

ABA has made two submissions to Federal Treasury on this matter, including confidential data that shows the potential impact of the MPR proposal on bank lending. We strongly recommend that the data sourced from the banking industry on this matter, and in the possession of Federal Treasury, be considered confidentially by the Committee.

ABA is available to provide follow-up evidence to the Committee and would like to reserve an opportunity to comment on other submissions where necessary.

Yours sincerely,

Nicholas Hossack