Chapter 11

The committee's views and recommendations

11.1 The final chapter of this report makes important recommendations on each of the report's three key themes—the regulation, registration and remuneration of the insolvency profession in Australia. The committee considers that there is clearly a strong case for a new framework to enhance oversight of the insolvency profession.

11.2 In making these recommendations, the committee is mindful of how its proposals are likely to interact with each other. As far as possible, the intent is to make these measures complementary and to ensure they build on existing structures and systems. There are useful systems and processes currently in place in the oversight of the insolvency industry in Australia. Notwithstanding the need for structural reform, the committee's intent is to preserve and enhance these elements.

Regulating the profession

11.3 As chapters 4 and 6 discuss in detail, the committee heard a range of evidence concerning the role and competence of the Australian Securities and Investments Commission (ASIC), the Companies and Liquidators Disciplinary Board (CALDB) and the Insolvency Practitioners Association of Australia (IPAA). The criticism of ASIC's approach to monitoring the insolvency industry as outlined in chapter 6 of this report is of particular concern for the committee.

11.4 ASIC has consistently claimed that it has the resources to fulfil its current responsibilities in insolvency matters.[1] It has also admitted that there are areas in which it could improve.[2] Taken together, these comments suggest that ASIC believes it can address these areas without more funding, provided its responsibilities in insolvency are not increased.

11.5 However, the committee believes that regardless of funding, ASIC is overburdened. The oversight of insolvency practitioners is just one of 13 'stakeholder teams' within ASIC's organisational structure.[3] Its 2008–09 Annual Report lists six strategic priorities, none of which relate directly to corporate insolvency matters.[4] Understandably, the strategic priority of managing the domestic and international implications of the Global Financial Crisis has consumed much of ASIC's time and resources.

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1 Senate Economics Committee, *Senate Estimates*, 11 February 2010, p. 183.

2 Mr Tony D'Aloisio, *Committee Hansard*, 23 June 2010, p. 22.

3 ASIC, *Annual Report 2008–09*, p. 57.

4 ASIC, *Annual Report 2008–09*, pp. 04–05. One of the priorities related to improving responsiveness to complaints.

11.6 The committee believes that corporate insolvency in Australia needs more priority and prominence in the regulatory framework. This will not be achieved through more funding and responsibilities for the same overburdened agency. Rather, as chapter 10 flagged, the committee argues that there is a need to combine the regulation of personal bankruptcy and corporate insolvency under the one body. This would be best achieved by transferring ASIC's corporate insolvency responsibilities to within the Insolvency and Trustee Service Australia (ITSA). The new agency would therefore be under the Attorney-General's portfolio.

11.7 The committee foresees several benefits in this reorganisation. These include:

- giving more prominence to corporate insolvency matters through enabling the Chief Executive of the new structure greater control and focus over day-to-day functions and more strategic oversight;
- promoting a more proactive mindset in the regulation of corporate insolvency, conducive to establishing a flying squad and a system of licensing (see recommendations 3 and 5);
- the opportunity to feed off ITSA's current processes to devise a panel interview and written exam to screen corporate insolvency practitioner applicants;
- greater coordination of the registration process and hence a lower compliance burden given that many practitioners are registered as both personal and corporate insolvency practitioners;
- improving corporate insolvency data gathering and dissemination through building on ITSA's systems;[5] and
- providing an opportunity to treat insolvency matters more holistically.

11.8 The committee recognises that the creation of a single insolvency regulator built on ITSA's framework would require a transfer of ASIC's skills and expertise on corporate insolvency matters. Both ITSA and the IPAA commented that ITSA does not currently have that knowledge.[6] The committee believes it should be possible to transfer resources, however.

Recommendation 1

11.9 The committee recommends that the corporate insolvency arm of ASIC be transferred to ITSA to form the Australian Insolvency Practitioners Authority (AIPA). The agency should be governed by the *Financial Management and Accountability Act* under the Attorney General's portfolio.

5 See David Morrison, *Committee Hansard*, 23 June 2010, p. 18.

6 See Mr Mark Robinson, *Committee Hansard*, 23 June 2010, p. 7; Ms Veronique Ingram, *Committee Hansard*, 13 April 2010, p. 60.

11.10 The Memorandum of Understanding between ASIC and ITSA should be updated to ensure that ASIC provides to the new agency adequate resources and the expertise needed to support the oversight of corporate insolvency sector.

11.11 The committee believes that as part of this restructure, the government should also review the *Bankruptcy Act 1966* and the *Corporations Act 2001* to examine opportunities to harmonise personal and corporate insolvency legislation (see chapter 10).

Recommendation 2

11.12 The committee recommends that the government commission the Australian Law Reform Commission to inquire into the opportunities to harmonise Australia's personal insolvency and corporate insolvency legislation. The Commission must report to the government within 12 months of the tabling of this report.

Proactive surveillance

11.13 Chapter 10 noted two options to improve the monitoring of corporate insolvency practitioners: an annual (or biennial) review of all practitioners and a random audit through a 'flying squad'.

11.14 Firstly, the committee believes that the current approach to monitoring the practices of insolvency practitioners is inadequate (see chapters 5 and 6). The complaints system alone, however responsive and attuned, will not deter all misconduct. A proactive approach is needed to deter misconduct and place practitioners on notice that, either on a random or systemic basis, they will be monitored.

11.15 The question then becomes, which of these two proactive options is preferable. The annual inspection program that ITSA employs has the advantage of being relatively thorough in the detection, and therefore the deterrence of misconduct.[7] A flying squad might use the regulator's market intelligence, but the surveillance of particular practitioners would be done randomly. One would therefore expect a flying squad to have lesser impact in terms of both detection and deterrence of misconduct.

11.16 The flying squad has the advantage of being less costly than the ITSA model. Chapter 10 noted ASIC's estimate that an additional 65 full time employees would be needed for it to conduct an annual inspection of all 662 insolvency practitioners. If correct, this constitutes a tripling of ASIC's current staffing load in the corporate insolvency area.

7 While ITSA inspects every practitioner, the selection of files is done randomly.

11.17 The committee's view is that as a first step towards a more proactive approach, the new regulatory agency should have a flying squad that conducts spot checks of insolvency practitioners. It believes that this initiative would have a considerably greater effect on both the detection and deterrence of practitioner misconduct than the current complaints system. The work of the flying squad must be based on detailed and accurate market intelligence and data analysis.

Recommendation 3

11.18 The committee recommends that a 'flying squad' be established within the new insolvency regulator. The unit should be responsible for conducting investigations of a sample of insolvency practitioners, some selected at random, others with the aid of a risk profiling system and market intelligence.

An Insolvency Ombudsman

11.19 Chapter 10 noted the support of several submitters to this inquiry for an Insolvency Ombudsman. In large measure, this support reflected complainants' frustration with ASIC's current complaints handling process and the widespread perception that the CALDB is inefficient in its role and subject to ASIC's direction.

11.20 The committee notes that the Office of Fair Trading in the UK has recently recommended the creation of an independent complaint handling body with the ability to review complaints and assess fees. It proposed that the body should be funded by the IP profession and should be able to sanction insolvency practitioners in a way that deters future transgressions. If the body finds that a practitioner has overcharged, it should have the power to order that any overcharge be returned to creditors.[8]

11.21 The committee can see several potential advantages to establishing an Insolvency Ombudsman. These include:

- a designated body to review promptly smaller financial matters;
- providing a voice for complainants;
- performing an educative role on what is acceptable conduct and reasonable fees;
- maintaining community confidence in the insolvency regime;
- a body that is independent from the regulator and is not subject to directions from the regulator;
- an Ombudsman appointed for a fixed term and must not be—or be able to be perceived as—an advocate for the insolvency industry;
- a body with statutory power to dismiss a liquidator from an appointment; and

8 Office of Fair Trading, 'The market for corporate insolvency practitioners', June 2010, p. 7.

- a body that is able to enquire into systemic issues as well as individual complaints.

11.22 However, the committee believes the priority must be to establish the structure and role of the new insolvency regulator. It is hoped that the new Authority's complaints system will be responsive to the concerns of small creditors and businesses. If a new regulatory insolvency agency is established and the government considers that it is *not* handling complaints promptly and effectively, then the committee believes that an Insolvency Ombudsman should be seriously considered.

11.23 If an Insolvency Ombudsman is created, it is important to establish a clear delineation between its powers and responsibilities and those of the regulator and the disciplinary board. While an Ombudsman must not be subject to direction from either the regulator or the disciplinary board, there would need to be some level of coordination between these bodies.

11.24 An Ombudsman should have the power to obtain information from the regulator and must be able to refer a matter it has investigated to the CALDB for disciplinary proceedings. The regulator should be able to refer a matter to the Ombudsman, where it is deemed appropriate. Both the regulator and the Ombudsman should be able to obtain information on matters that the other has investigated. The Ombudsman should have an unconditional right to make public reports and statements on the findings of investigations and on issues giving rise to complaints.[9]

The CALDB

11.25 The committee believes that the CALDB should be retained in its current form. The Board's focus will continue to be on determining the disciplinary action to take against practitioners.

11.26 The committee is concerned, however, that the CALDB's investigative and adjudicative processes lack transparency. It believes that the Board's deliberations and findings should be given in open unless there is a ruling otherwise. Past hearings and evidence of the CALDB should also be open to inspection by any person.

Recommendation 4

11.27 The committee recommends that section 213 of the *Australian Securities and Investment Commission Act 2001* be replaced with the following:

9 This is consistent with the criteria for an Ombudsman as endorsed by the Executive Committee of the Australian and New Zealand Ombudsman Association (ANZOA). See 'Essential criteria for describing a body as an Ombudsman', *ANZOA Policy Statement*, February 2010, http://www.anzoa.com.au/ANZOA%20Policy%20Statement_Ombudsman_Essential%20Criteria.pdf (accessed 9 July 2010).

All hearings, evidence and reasons shall be heard or given in open session unless otherwise ordered by a judge of a Court of any State or Territory or the Federal Court of Australia who may, at any time during or after the hearing of a proceeding in the Court, make such order forbidding or restricting the publication of particular evidence, or the name of a party or witness, as appears to the Court to be necessary in order to prevent prejudice to the administration of justice or the security of the Commonwealth. Subject to section 216(2), any past hearings, evidence and/or reasons shall be open to inspection by any person, and a register of past matters with the names of parties shall be published and made available for inspection by the public by means of the internet.

Registration

11.28 Chapter 7 of this report referred to the idea of a licensing system to replace the current registration system for insolvency practitioners. The committee strongly supports this idea for the flexibility that a licensing system gives the regulator to review, suspend and cancel a practitioner's appointment.

Recommendation 5

11.29 The committee recommends that the new Insolvency Practitioners Authority establish a licensing system for corporate insolvency practitioners similar to the system currently used by ITSA. Practitioners should be required to renew their license every three years.

11.30 The new regulator should have the power to suspend a practitioner's license if they are not adequately insured or if a matter referred to the CALDB is of sufficient concern as to warrant suspension.

11.31 The committee also supports the idea of a licensing fee to be levied prior to licensing new practitioners and upon renewing licenses. It should be clearly stated on forms requiring this payment that purpose of the fee is to cover the insurance industry for its new responsibilities.

Recommendation 6

11.32 The committee recommends that as part of the licensing and re-licensing processes, all corporate insolvency practitioners are required to pay a licensing fee.

11.33 As discussed in Chapter 7, the committee believes that insolvency practitioners, like other professionals, should undertake continuing professional development and education.

Recommendation 7

11.34 The committee recommends that it be a condition of a practitioner's first license renewal (ie: after three years of registration) that he or she has completed the IPAA's Insolvency Education Program.

A written exam and / or an interview

11.35 The committee supports the introduction of a written examination, the passing of which should be a pre-requisite for gaining a license as an insolvency practitioner. The examination should be 'closed book' and must test candidates' knowledge of their fiduciary duties as a practitioner. It should cover issues including the conduct of meetings, the use of casting votes, different types of resolutions, basic equitable legal concepts, as well as recent legislative changes to consumer protection and corporations law.

Recommendation 8

11.36 The committee recommends that the new Australian Insolvency Practitioners Authority set and administer a 'closed book' written examination. The passing of this examination should be a pre-requisite for gaining a license as a corporate insolvency practitioner.

11.37 The committee recommends that the new regulator convene an eight person advisory panel to discuss and devise the format and content of the examination. The panel should include a senior official from the new Insolvency Authority, a representative from the Institute of Chartered Accountants of Australia, a representative from the Insolvency Practitioners Association (IPAA), an insolvency practitioner nominated by the IPAA, two academic experts on insolvency law, a person nominated by the Australian Bankers' Association and a person nominated by the Council of Small Business Organisations of Australia. The committee suggests that this panel reconvene annually to discuss any changes that should be made to the content and format of the examination.

Recommendation 9

11.38 The committee recommends that the new Australian Insolvency Practitioners Authority convene an eight person advisory panel to devise a written examination. The panel should be chaired by the Chairman of the Authority and should also include:

- **a representative from the Institute of Chartered Accountants of Australia;**
- **a representative from the Insolvency Practitioners Association (IPAA);**
- **an insolvency practitioner nominated by the IPAA;**
- **two academic experts on insolvency law chosen by the Authority;**
- **a person nominated by the Australian Bankers' Association;**

- **a person nominated by the Council of Small Business Organisations of Australia; and**
- **a person nominated by a consumer advocacy group.**

Professional indemnity insurance

11.39 The committee believes it is very important that the administration of section 1284 of the *Corporations Act* relating to professional indemnity (PI) insurance is tightened. Currently, ASIC's approach is to wait for confirmation in annual statements by liquidators that practitioners have adequate PI insurance. It is also of concern that insurance companies have advised the IPAA that they do not offer run-off cover. This is despite ASIC's *Regulatory Guide* stating that practitioners should obtain run-off cover for as long as reasonably practicable (see chapter 7).

11.40 Other requirements should be put in place to provide the regulator and the public greater assurance that registered practitioners have not let their PI insurance lapse. In the committee's opinion, the regulator must work with insurance companies to devise a system whereby the company advises the regulator when a registered liquidator is operating without PI insurance. If the insurance company advises that a practitioner's PI insurance has lapsed or expired, the regulator should contact the practitioner and give 14 days to update their insurance. If it is not updated in this time, the regulator should suspend the practitioner's license.

11.41 The regulator should, as part of its random and routine checks of practitioners (see recommendations 3 and 5), sight the PI insurance documents of the practitioner. The licensing fee (see recommendation 6) should be hypothecated to assist the insurance industry to cover the monitoring costs of this system.

Recommendation 10

11.42 The committee recommends that the new insolvency regulator work with the insurance industry to ensure that insurance companies notify the regulator if a practitioner's insurance lapses or expires. In these cases, the regulator should contact the practitioner immediately and allow the practitioner 14 days to acquire the policy. If this is not done, the regulator must suspend the practitioner's license.

11.43 The regulator should sight the insurance documents of practitioners as part of its 'flying squad' activities.

Recommendation 11

11.44 The committee recommends that the *Corporations Act 2001* be amended to impose a penalty on registered insolvency practitioners who operate without professional indemnity insurance.

11.45 As chapter 10 discussed, a typical PI insurance policy will cover practitioners for negligence but not fraud. Premia are considerably higher for policies that cover fraud and wrongdoing. The Law Society operates a fidelity fund to cover its members

for fraud and wrongdoing. The committee believes a similar arrangement would be appropriate for the insolvency profession.

Recommendation 12

11.46 The committee recommends that the major accountancy bodies—the Institute of Chartered Accountants of Australia, CPA Australia and the National Institute of Accountants—establish a fidelity fund to ensure that creditors are insured for fraud and wrongdoing.

Remuneration

11.47 The committee notes the concerns of many contributors to this inquiry about the high level of fees being charged by liquidators. It recognises that in some cases, these charges may well be justified given the complexity of the task and the practitioner's exposure to risk. In other cases, there is clearly overcharging and over servicing.

11.48 Chapter 10 noted various proposals for reforming the remuneration system. These included:

- a committee-set schedule of fees;
- reintroducing scale rates for each staff member, depending on education and experience;
- establishing a fixed price government tendering process for appointments;
- limiting appointments to a timeframe that is pre-set with company directors;
- requiring the administrator to set a baseline value for assets and fixing remuneration according to the realisation of this value;
- a competitive tendering process for each appointment;
- broadening the educational statutory requirement for registration; and
- improved disclosure and itemising of fees.

11.49 In this context, the committee makes two points. The first is that the market must set prices to remunerate practitioners. It is important that complex work done to a high standard attracts commensurate financial reward. The committee believes that any attempt to control practitioners' fees will create distortions and disincentives. The first four of the options listed above fall into that category.

11.50 The suggestions of a competitive tendering process and a set timeframe (items 3 and 6, above) are appealing in principle. However, they would force insolvency practitioners to meet pre-agreed estimates on cost and time. The committee feels that this is unreasonable given that the complexity of an insolvency job is often not apparent prior to an appointment.

11.51 The second point, however, is that the market for insolvency practitioners is distorted as it is. Practitioners lack adequate incentives to offer fees that are genuinely

commensurate with the efficient and effective performance of their duties. The market lacks the competitive tension that would put downward pressure on practitioners' fees, and return more to creditors' pockets.

11.52 In this context, mention should also be made of the priority payment system for liquidators and administrators. The committee is aware of the arguments for keeping and for changing this system. On the one hand, there needs to be a guarantee that a practitioner will be remunerated for his or her work. The priority payment system provides that assurance. On the other hand, a system whereby the liquidator receives full payment before a secured or unsecured creditor receives any return seems to lack incentives for the practitioner to maximise returns to creditors.

11.53 In the absence of data on the proportion of funds taken by the liquidator as fees and by secured and unsecured creditors, it is difficult to recommend any change to the priority payment system. The committee suggests that once this data is collected and properly analysed (see recommendation 17), consideration should be given to various options for reform. One option is to set a pre-agreed baseline fee for the liquidator, beyond which secured and unsecured creditors would be paid. If there are funds remaining after these payments, the liquidator would receive a further payment.

Introducing competition

11.54 The committee believes the best way to resolve the problem of overcharging and over servicing is to open the profession to more entrants. Presently, the requirements for registration as a liquidator are for 'a course of study in accountancy of not less than three years' and 'a course of study in commercial law of not less than two years'.[10] The committee believes the profession should also attract applicants with suitable experience from the legal profession as well as applicants with a Masters in Business Administration and relevant commercial experience. The committee emphasises, however, the importance of a written examination to screen the wider range of applicants (see recommendations 8 and 9).

Recommendation 13

11.55 The committee recommends that section 1282(2)(a)(i) of the Corporations Act is amended to read:

> **…is an Australian Legal Practitioner holding a current practising certificate with at least five years' post admission experience as a practising commercial lawyer;**
>
> **and / or**
>
> **…holds a Masters of Business Administration with at least five years' commercial experience.**

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10 Section 1282(2)(a)(ii), *Corporations Act 2001*

Dismissing a liquidator

11.56 The committee is concerned that there are no checks against a dishonest liquidator from charging more than the costs cited in the remuneration report. As in the Ariff case, there is nothing that creditors can do to stop a liquidator in the middle of the process to check the veracity of the remuneration report.[11]

Recommendation 14

11.57 The committee recommends that as part of the proposed licensing system, the insolvency regulator can suspend a liquidator's license if they believe overcharging has occurred.

11.58 The committee believes that in addition to the proposed insolvency regulator having the power to dismiss a liquidator, the courts should be able to remove a liquidator. Currently, section 503 of the *Corporations Act* states that '[T]he Court may, on cause shown, remove a liquidator and appoint another liquidator'. This section should be amended to state that:

> For purposes of this section, cause shown includes:
>
> (a) A vote of no confidence by a majority of creditors;
>
> (b) Where it appears time based charging of the incumbent liquidator has not or will not result in a reasonable cost-benefit analysis for the company.

Recommendation 15

11.59 The committee recommends that section 503 of the *Corporations Act 2001* be amended to insert the following provision:

> **For purposes of this section, cause shown includes:**
>
> **(a) A vote of no confidence by a majority of creditors;**
>
> **(b) Where it appears time based charging of the incumbent liquidator has not or will not result in a reasonable cost-benefit analysis for the company.**

Disclosure

11.60 The committee believes that the remuneration report template established by the IPAA's Code of Professional Practice is a sound and clear basis upon which to inform creditors of past and future expenses. The committee views the remuneration report as a key measure to hold liquidators to account and guard against overcharging and over servicing. It is crucial that company directors and creditors can readily access an itemised list of past and proposed expenses.

11.61 The committee believes that while disbursement payments are an inevitable part of the insolvency process, they need to be clearly and accurately listed in the

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11 See *Committee Hansard*, 14 April 2010, pp. 43–44.

remuneration report. It is also important that the new regulator alerts creditors to their right to query disbursement payments. The regulator must also be alert to and dissuade attempts to blur the distinction between disbursement payments and the section 449E understanding of 'remuneration'.

Recommendation 16

11.62 The committee recommends that the new insolvency regulator work with the IPAA and the Institute of Chartered Accountants to ensure that insolvency practitioners comply with the remuneration report template set out in the IPAA Code of Professional Practice.

Better data

11.63 The committee considers that there is a strong need for industry-wide data on the fees charged by insolvency practitioners. Properly gathered, published and analysed, this data will be a useful source for the regulator to identify potential cases of over charging and for creditors and the public at large to make an assessment of what is a reasonable fee for a practitioner's services. For each appointment, data must be gathered on:

- the type of insolvency (VA, court appointed etc);
- the proportion of total assets recovered;
- the return to creditors;
- the method of calculating fees;
- the hours spent and staff rates paid;
- the cost of disbursements; and
- the size of the liquidator or administrator (employees and capital).

Recommendation 17

11.64 The committee recommends that within the new Insolvency Practitioners Authority, there is a unit established that is responsible for gathering, collating and analysing data on a range of corporate and personal insolvency matters. The data must be made publicly available in the Authority's Annual Report and online. There should be no charge for accessing these data.

A final comment

11.65 The committee recognises that the role of the insolvency practitioner is important to the proper functioning of a market economy. Practitioners require a range of financial, investigative, written and interpersonal skills to perform their role well. Their proficiency allows troubled businesses to stay afloat and, where this is not possible, enables vulnerable creditors to maximise their returns. The committee also acknowledges that the process of corporate insolvency is often turbulent and

distressing for company directors and employees. Insolvency practitioners deserve to be properly remunerated.

11.66 By the same token, the insolvency profession must also be properly regulated. There are significant responsibilities vested in the insolvency practitioner to act in the interests of creditors and employees and in the public interest. Accordingly, there must be an effective framework to promote high performance and deter misconduct.

11.67 This inquiry has found several regulatory gaps in the framework for regulating insolvency practitioners in Australia. Of greatest concern is that ASIC lacks a proactive approach and its response to complaints is often slow and unsatisfactory.

11.68 The recommendations made in this chapter are bold and substantive. The committee believes they are necessary and, in many cases, long overdue. It foresees several advantages from transferring ASIC's insolvency functions to within ITSA, all of which will improve the monitoring of the corporate insolvency profession.

11.69 In the committee's opinion, the financial costs associated with implementing the recommendations are far outweighed by the deterrent effect they will have on misconduct. Moreover, if properly implemented and enforced, the recommendations will restore stakeholders' and the public's confidence in the performance and reputation of corporate insolvency industry.

11.70 To this end, the committee believes it is important that there is a review of the effectiveness of the recommendations that are implemented from this inquiry. In particular, it is necessary to evaluate the effect of the proposal to widen eligibility to become an insolvency practitioner (recommendation 13). If this recommendation is implemented, the Senate Economics References Committee should, after five years, revisit the matter in light of the trends in fee growth. If fees have increased substantially over this period, there may be a strong case to consider more prescriptive measures to ensure the clients of insolvency practitioners receive value for money.

Senator Alan Eggleston
Chair