Australian Government

Australian Financial Security Authority

# Financial System Inquiry

# Submission of the Australian Financial Security Authority in response to the Interim Report

Second round – August 2014

# Contents

# Introduction

1. The Australian Financial Security Authority (AFSA) notes the Financial System Inquiry's Interim Report.

2. Two policy options raised in the Interim Report would directly affect AFSA's regulatory responsibilities:

   - refining the scope of and breadth of the Australian Securities and Investments Commission's mandate by 'moving insolvency functions to AFSA' (see pages 3-127 and 3-128), and

   - implementing the 2012 proposals to improve liquidator competence, align corporate insolvency and bankruptcy, and promote market competition on price and quality (ie the proposals in the 2012 Exposure Draft of the Insolvency Law Reform Bill 2013 (see page 2-71).

3. This submission provides some comments and observations from AFSA's perspective on those options, as well as a further option of introducing an 'administrator of last resort' in the corporate insolvency context, which could play a role similar to that of the Official Trustee in personal insolvency.

4. Key points made in this submission are:

   - Australia's insolvency system is unlike a number of other jurisdictions, in that it has separate frameworks for personal and corporate insolvency (paragraphs 5 to 13 below)

   - suggestions for a partial or total 'merger' of personal and corporate insolvency systems have been mooted on a number of occasions over past years, and pros and cons have been examined (paragraphs 14 below and 28 to 33 below)

   - ASIC's insolvency functions are, to a large extent, intertwined with functions and powers that are not necessarily restricted to being exercised in an insolvency context (paragraphs 16 to 26 below)

   - a proposal to move ASIC's 'insolvency functions' to AFSA would ideally specify at an in-principle level what functions and powers are intended to be captured (paragraph 27 below)

   - a detailed proposal for a merger in the Australian context should be developed having regard to certain requirements regarding the legal foundation, resources, regulatory responsibilities, information sharing and cooperation(paragraphs 27 and 34 to 49 below), and

   - the 'administrator of last resort' role could be considered in the context of a proposal to move ASIC's insolvency functions to AFSA (paragraphs 55 to 65 below).

# Background

5. This section of the submission explains the current role of AFSA in the overall insolvency regulation framework, makes a comparison with other comparable jurisdictions and notes some previous suggestions about alternative arrangements.

## AFSA: structure and functions

6. AFSA is an executive agency established under the *Public Service Act 1999*. In broad terms, AFSA is responsible for the administration and regulation of the personal insolvency system, proceeds of crime, trustee services and the administration of the Personal Property Securities Register.

7. The functions performed by AFSA include:

- registering all bankruptcies, debt agreements and personal insolvency agreements
- administering, as the Official Trustee, more than 80% of bankrupt estates annually
- ensuring compliance by debtors, bankrupts and their associates, practitioners and others with the requirements of the Bankruptcy Act and associated legislation by:
  - operating the bankruptcy registry where debtor's petitions are lodged, debt agreement proposals are processed and public records of insolvencies are maintained
  - exercising Official Receiver powers to assist trustees to obtain information and recover property
  - investigating possible offences under the Bankruptcy Act and preparing briefs of evidence for prosecution
- maintaining the National Personal Insolvency Index (NPII)
- providing information about the formal options for dealing with unmanageable debt under the Bankruptcy Act
- regulating the administrations and activity of trustees and debt agreement administrators, and
- acting as a special trustee for Australian Government departments and agencies pursuant to court orders, particularly by locating, controlling and selling property under the proceeds of crime legislation.

8. AFSA is also responsible for administering the Personal Property Securities Register established under the *Personal Property Securities Act 2009*. The PPSR commenced operation on 30 January 2012 and is a national, online register that provides notice to the world of security

interests taken in personal property, for the benefit of prospective financiers, purchasers and other interested parties. It has replaced a multitude of Commonwealth and State-based registers, some online and some paper based. As at 30 June 2014 there were 8,231,281 current registrations on the PPSR. During the June quarter, 1,834,654 searches of the PPSR were conducted.

9. AFSA's functions are performed by AFSA officials in the capacity as officers, representatives or delegates of various statutory offices or entities established under the relevant legislation, for example the Official Trustee (a body corporate), the Official Receiver, the Inspector-General in Bankruptcy and the Registrar of Personal Property Securities.

10. AFSA has authority through the Bankruptcy Act and associated legislation to recover the cost of performing its personal insolvency activities. This involves both fees and charges for particular transactions and services, and a levy that allows collection of a proportion of the value of all realised assets in personal insolvency estates (the 'realisations charge'). AFSA also has legal authority to recover its costs, charges and expenses incurred in connection with the Official Trustee's performance or duties under the *Proceeds of Crime Act 1987* and the *Proceeds of Crime Act 2002,* and authority under the Personal Property Securities Act to impose fees and charges to recover its costs of maintaining the PPSR.

## International comparison of insolvency systems

11. Australia's framework for insolvency regulation is clearly divided based on whether the insolvent person is a corporation or an individual. The division occurs in respect of the governing legislation, regulators, policy responsibility and ministerial responsibility. AFSA has no role in corporate insolvency. Corporate insolvency administrations are performed by the private sector, and regulated by the Australian Securities and Investments Commission (ASIC) under the *Corporations Act 2001* and associated legislation.

12. There is overlap in the regulated population of registered insolvency practitioners, as well as circumstances where related participants are involved at the same time with both corporate and personal insolvency proceedings. Given the nexus of AFSA's role in personal insolvency with the regulatory role of ASIC in corporate insolvency, including the overlap of practitioners being regulated by both organisations, AFSA has a collaborative relationship with ASIC. This relationship aims to leverage mutual interests in regulating the insolvency profession. A range of regular and ad-hoc liaison activities occur at various levels of both organisations.

13. A number of other jurisdictions have insolvency frameworks that do not have the same type of separation between personal and corporate insolvency regulatory frameworks. An overview of the framework in some other jurisdictions compared to Australia appears in the table below.

## Regulatory framework for insolvency – International comparison

| Country | Regulator structure[1] | Regulator(s) | Insolvency process administered by | Legislation |
|---|---|---|---|---|
| Australia | **Separate** | **Personal**<br>Australian Financial Security Authority<br><br>**Corporate**<br>Australian Securities and Investments Commission | **Personal**<br>1. Government – Official Trustee<br>2. Private sector – private Trustees<br><br>**Corporate**<br>Private sector – insolvency practitioners | **Personal**<br>*Bankruptcy Act 1966 (Cth)*<br><br>**Corporate**<br>*Corporations Act 2001 (Cth)* |
| | | | | |
| New Zealand | **Combined** | Insolvency and Trustee Service | **Personal**<br>Government – Official Assignee<br><br>**Corporate**<br>1. Government – for court appointed liquidations the Official Assignee<br>2. Private sector – insolvency practitioners | **Personal**<br>*Insolvency Act 2006*<br><br>**Corporate**<br>*Companies Act 1993* |
| Canada | **Combined** | 1. Office of the Superintendent of Bankruptcy<br>2. Courts | **Personal**<br>Private sector – trustees<br><br>**Corporate**<br>Private sector – trustees/ receivers | 1. *Bankruptcy and Insolvency Act*<br>2. *Companies' Creditors Arrangement Act*<br>3. *Winding Up and Restructuring Act* |
| United Kingdom | **Combined** | 1. The Insolvency Service<br>2. Professional organisations | **Personal**<br>1. Government – the Insolvency Service<br>2. Private sector – insolvency practitioners<br><br>**Corporate**<br>1. Government – Official Receiver<br>2. Private sector – insolvency practitioners | 1. *Insolvency Acts 1986 and 2000*<br>2. *Company Directors Disqualifications Act 1986*<br>3. *Companies Acts 1985 and 2006* |

[1] **Separate** = distinct regulators for personal and corporate insolvency; **Combined** = single regulatory agency overseeing both personal and corporate insolvency

| | | | | |
|---|---|---|---|---|
| United States of America | **Separate** | 1. The US Trustee Program<br>2. Securities and Exchange Commission<br>3. Bankruptcy Courts | **Personal**<br>Private sector – trustees<br><br>**Corporate**<br>Private sector – trustees | 1. *Bankruptcy Code 1978*<br>2. Federal Rules of Bankruptcy Procedure<br>3. Local Rules of each Bankruptcy Court |
| Republic of Ireland | **Separate** | **Personal**<br>1. The Insolvency Service of Ireland<br>2. Office of the Examiner of the High Court<br><br>**Corporate**<br>1. Office of the Director of Corporate Enforcement<br>2. Office of the Examiner of the High Court | **Personal**[2]<br>*Where <€20,000 of debt:*<br>1. Private sector – approved intermediaries<br>2. Private sector – personal insolvency practitioners<br>*Where > €20,000 debt:*<br>3. Government – Official Assignee<br><br>**Corporate**<br>1. Private sector – 'Liquidators', 'Receivers' and 'Examiners'<br>2. Official Liquidator (compulsory winding up) | **Personal**<br>1. *Personal Insolvency Act 2012*<br>2. *Bankruptcy Act 1988*<br><br>**Corporate**<br>1. *Companies Acts 1963-2009*<br>2. *Company Law Enforcement Act 2001* |
| Scotland | **Separate** | **Personal**<br>Accountant in Bankruptcy (AiB)<br><br>**Corporate**<br>1. AiB in respect of devolved elements<br>2. The Insolvency Service (UK) for reserved elements | **Personal**<br>1. Government – Accountant in Bankruptcy<br>2. Private sector – insolvency practitioner<br><br>**Corporate**<br>1. Private sector – insolvency practitioners<br>2. Government – The Insolvency Service (UK) | **Personal**<br>1. *Bankruptcy (Scotland) Act 1985*<br><br>**Corporate**<br>1. *Insolvency Act 1986* (as amended)<br>*2. Insolvency (Scotland) Rules 1986* |
| Singapore | **Combined** | 1. Official Assignee/Receiver of the Insolvency and Public Trustee's Office<br>2. Courts | **Personal**<br>1. Government – Official Assignee<br>2. Private sector – trustees<br><br>**Corporate**<br>1. Private sector – Liquidator<br>2. Government – Official Receiver (compulsory wind-up only) | **Personal**<br>1. *Bankruptcy Act*<br><br>**Corporate**<br>1. *Companies Act* |

[2] Recent amendments to the laws of personal insolvency in the Republic of Ireland have significantly changed relevant laws and procedures

| | | | | |
|---|---|---|---|---|
| Hong Kong | **Combined** | Official Receiver's Office | **Personal**<br>1. Government – Official Receiver<br>2. Private Sector – Insolvency Practitioner<br><br>**Corporate**<br>1. Private Sector – liquidator<br>2. Government – Official Receiver and special manager (compulsory wind-up) | **Personal**<br>1. Bankruptcy Ordinance<br>2. Bankruptcy (Forms) Rules<br><br>**Corporate**<br>1. Companies (Winding Up and Miscellaneous Provisions) Ordinance<br>2. Companies (Winding-up) Rules |

## Previous suggestions for reform

14. From time to time, the possibility of merging part or all of the corporate insolvency and personal insolvency regulatory frameworks has been mooted in Australia. A particular focus has been on the arrangements for regulation of the insolvency profession in the corporate and personal arenas, but consideration has also been given to a broader proposal for a unified personal and corporate insolvency system.

- In 1988, the Australian Law Reform Commission in the report on the General Insolvency Inquiry (the Harmer Report) recommended a single system of registration for insolvency practitioners. As to the issue of unifying personal and corporate insolvency systems more broadly, the Commission considered the goal of a unified system was not of major significance, but so far as possible there should be uniformity of the substance of provisions relating to personal and corporate insolvency.

- In 1997, a report of a Working Party convened by the Commonwealth Attorney-General recommended that the Government should examine further the costs and benefits of establishing a merged regulatory framework for the registration and supervision of personal and corporate insolvency with separate 'tickets' for each area of practice.

- In June 2004, the Parliamentary Joint Committee on Corporations and Securities published a report titled '*Corporate Insolvency Laws: A Stocktake*', in which arguments for and against a unified personal and corporate insolvency system were noted. The Committee recommended that, when changes were contemplated, the two streams should be harmonised.

- In September 2010, the Senate Economics References Committee released a report on '*The Regulation, Registration and Remuneration of insolvency Practitioners in Australia: The Case for a New Framework*'. The key recommendation was that 'the corporate insolvency arm of ASIC be transferred to ITSA *[now known as AFSA]* to form the Australian Insolvency Practitioners Authority (AIPA).' This report led to a range of proposals in the exposure draft *Insolvency Law Reform Bill 2013* directed at harmonising and streamlining the personal and corporate insolvency systems, discussed in more detail below (see ‘2012 Proposals’ at paragraph 50 below).

- In October 2010, the Productivity Commission released a research report titled ‘*Annual Review of Regulatory Burdens on Business: Business and Consumer Services’,* in which the arguments for and against a unified personal and corporate insolvency system were noted. The Commission recommended the establishment of a task force to ‘*identify personal and corporate insolvency provisions and processes that could be aligned. The case for making one regulator responsible for both areas of insolvency law should also be examined*’.

- In the report by the Senate Economics References Committee on the performance of ASIC (released 26 June 2014), the Committee noted that ASIC’s having responsibility for corporate insolvency was not a model that was generally shared by ASIC’s international counterparts. The Committee noted some support in submissions to its inquiry from academics for the 2010 recommendation of the Committee (see paragraph 25.30).

# Moving ASIC’s insolvency functions to AFSA

15. In response to the Inquiry’s request in the Interim Report (pages 3-127 and 3-128) for views on the costs, benefits and trade-offs of the option of refining the scope and breadth of ASIC’s mandate by moving insolvency functions to AFSA, the following part of the submission includes:

    - a discussion of the scope of ASIC’s ‘insolvency functions’

    - some likely costs, benefits and trade-offs of moving insolvency functions in comparison to the current arrangements, and

    - a description of four requirements that should be considered when developing a detailed proposal for an effective transfer– namely a robust legal foundation, adequate and sustainable resources, clear regulatory responsibilities between regulators, and arrangements for information sharing and cooperation.

## What are ASIC’s ‘insolvency functions’?

16. In considering the costs and benefits of moving ASIC’s insolvency functions, it is necessary to identify as a threshold issue what is within the intended scope of ‘insolvency functions’. Scoping the functions is particularly important when considering the options for the underlying legislative framework, discussed in detail below (see paragraphs 35 to 40).

### Types of external administrations in the Corporations Act

17. As the Interim Report noted (at 2-69), there are a range of processes available to businesses under Australia’s external administration regime in Chapter 5 of the Corporations Act.

Insolvency is not necessarily involved in all categories. For example, only one of the six sub-categories of liquidation has insolvency of the affected entity as a prerequisite.

## Liquidation/winding up

18. Liquidators are charged with investigating the affairs of entities, realising assets and distributing proceeds. Liquidators report to creditors and members and to ASIC. In some circumstances, liquidators must report suspected breaches of law by company officers to ASIC. There are six different types of liquidation:

- **Members' voluntary**: This can only be used by solvent entities. Generally only registered liquidators can be appointed, except in the case of a proprietary company.
- **Creditors' voluntary**: Similar to members' voluntary but used by insolvent entities. Generally only registered liquidators can be appointed.
- **Compulsory/court ordered**: Ordered by the court, usually on the basis of a creditor's petition on the ground of insolvency (but not always). Only official liquidators are eligible for appointment.
- **Ordered by ASIC**: ASIC has power to order a company be wound up on certain grounds, including the failure to lodge certain documents, that it is not carrying on business or that it is in the public interest for this to occur. In such a case, the liquidation is carried out as a members' voluntary liquidation and only a registered liquidator is eligible for appointment.
- **Provisional:** An interim administration ordered by the court to preserve the *status quo* while inquiries are made. Only official liquidators are eligible for appointment.
- **Part 5.7 body winding up**: A 'Part 5.7 body' includes a partnership, association or other body (whether a body corporate or not) that consists of more than five members, plus certain unincorporated bodies. They can be wound up under Part 5.7 by the court in certain circumstances (not limited to insolvency), even if they are also being wound up under their own laws.

## Voluntary administration/deeds of company arrangement

19. A voluntary administration allows the appointment of a voluntary administrator, who must be a registered liquidator, to take control of a company that is insolvent or likely to become so, and to make recommendations about whether it should proceed into liquidation, be returned to the control of directors or enter into a deed of company arrangement. If it enters into a deed of company arrangement, a deed administrator (who must also be a registered liquidator) is appointed. Voluntary administrators and deed administrators have a range of reporting obligations to creditors and to ASIC. Administrators have a duty to report possible offences or misconduct of company officers, and to cooperate with ASIC in any investigation it may institute.

## Receivers/receiver and managers

20. A receiver/receiver and manager is usually appointed by a secured creditor under the terms of a security agreement to realise secured property for the secured creditor, for example by a financial institution due to a default under a general security agreement (formerly known as a floating charge). In some circumstances, receivers may be appointed by a court pursuant to inherent jurisdiction on 'just and equitable' grounds (ie not necessarily connected with insolvency). ASIC and the courts have general supervisory jurisdiction over the activities of receivers/receiver and managers of corporate property. Only registered liquidators are eligible for appointment. Commonly, receivers and liquidators will be appointed to a corporation at the same time.

## Non-receiver controllers and managing controllers

21. A person that takes possession or control of a corporation's property for the purpose of enforcing a security agreement who is not a receiver or receiver manager is called a 'controller'. There are some obligations and duties on controllers in relation to reporting and exercising powers of sale. ASIC and the court have powers to inquire into their actions, and the court may remove a controller for misconduct. Under the Corporations Act, there are no restrictions on who can be appointed as a non-receiver controller/managing controller.

## Schemes of arrangement

22. A scheme of arrangement provides for a legally enforceable arrangement or compromise between a company or other registrable body and its members or creditors, or a class of them. Due to the expense involved, schemes of arrangement are usually reserved for high value transactions, often involving more than one entity. Scheme managers have some reporting obligations, similar to those imposed on receivers. Generally only registered liquidators may be appointed as scheme managers, although in some circumstances corporations may also be appointed. Members' schemes of arrangement are often used as alternatives to takeovers as a means of transferring corporate control. Members' schemes of arrangement are unconnected with insolvency, but still use the same legislative underpinnings as creditors' schemes (ie Part 5.1 of the Corporations Act).

## Managed investment schemes

23. The managed investment scheme (MIS) population is relatively small but includes a range of high-value entities that hold significant capital. In Chapter 5C of the Corporations Act, there are some general provisions about winding up of an MIS, including the power of ASIC to apply to court for an order for winding up on 'just and equitable' grounds. However, there is no detailed framework in the Corporations Act for external administration of MISs that are non-viable. Rather, the external administrations of MISs are determined by a mix of legislation, common law and equitable principles.

## Other parts of the corporate insolvency legislative framework

24. The external administration procedures in Chapter 5 are complemented and supported by a number of other legislative elements including:

- Part 9.2 of the Corporations Act, dealing with the registration of liquidators
- Parts 9.4 and 9.4B of the Corporations Act, dealing with offences and civil penalties
- Part 11 of the ASIC Act, dealing with the establishment and functions of the Companies Auditors and Liquidators Disciplinary Board (CALDB)
- Parts 3 and 3A of the ASIC Act, dealing with ASIC's powers to investigate and gather information and accept enforceable undertakings
- regulations under the Corporations Act and ASIC Act that supplement the primary legislation
- the Rules of Court (Commonwealth and State) deal in significant detail with various processes in relation to proceedings under Chapter 5 of the Corporations Act, and
- a range of insolvency provisions in various other Commonwealth and State laws governing specific entities (eg cooperatives, deposit-taking institutions and insurers).

## Observations about ASIC's 'insolvency functions'

25. It is apparent from the above list that elements of ASIC's functions and powers in relation to insolvency as expressed in Chapter 5 of Corporations Act and related legislation are closely linked with functions and powers that are not necessarily connected, or are entirely unconnected, with the actual insolvency of the target entity. For example, included in the winding up provisions of the Corporations Act is a power of ASIC to order that a company is wound up for failure to pay ASIC annual fees, or for the failure to carry on a business. A further example is that ASIC has powers and functions with respect to arrangements and reconstructions under Part 5.1 of the Corporations Act, which need not be in connection with insolvent entities.

26. As well as the insolvency and non-insolvency functions and powers being mixed at the legislative level, there is also an element of 'intermingling' at the practical level. For example, in the external administration of a corporate group as a single economic entity, there may be entities in the group that are not insolvent, or of a different legal form to the other entities in the group.

27. As the insolvency functions and powers are intertwined with aspects of the regulatory framework that are not insolvency-related, AFSA suggests that any proposal for a moving of corporate insolvency functions:

    - Identifies at an 'in principle' level which functions are intended to be within the scope of the proposal. References to the transfer of ASIC's 'insolvency functions' could be given a range of interpretations. At one extreme, it could be all functions and powers related to external administration (whether or not involving insolvent entities). At the other, it could be restricted to functions and powers that can only apply in relation to insolvent entities. In between, there are a range of options whereby powers and functions that could be (but do not necessarily need to be) associated with regulating insolvent entities are allocated to

AFSA, or ASIC, or both. For example, it would be possible to transfer to AFSA only powers and functions that relate to the registration and supervision of insolvency practitioners.

- Should be developed in detail having regard to the requirements noted below (see 'Requirements for successful move of insolvency functions' at paragraphs 34 to 49 below). AFSA does not suggest that those issues represent insurmountable barriers to a partially or fully unified insolvency system being adopted in the Australian context, but notes that in order to produce an optimal and certain outcome they need to be addressed in the course of developing a detailed proposal.

## Costs, benefits and trade-offs of a move to AFSA compared to current arrangements

28. The costs, benefits and trade-offs associated with the merging of some or all of the personal and corporate insolvency systems have been considered previously. As pointed out in the 2004 report of the Parliamentary Joint Committee on Corporations and Securities, '*A "merger" may, of course, take different forms. A minimalist merger may, for example, focus on particular aspects of corporate and personal insolvency law such as a single system for registration and regulation of insolvency practitioners…'* As that 'minimalist' form of merger has been specifically considered in the past, as well as broader options, it is convenient to list the likely costs, benefits and trade-offs in respect of a single system for regulation of insolvency practitioners separately from the costs, benefits and trade-offs of establishing a unitary system more broadly.

### Single system of registration and regulation of corporate and personal insolvency practitioners

29. Arguments that have been made for moving to a single system of registration and regulation of corporate and personal insolvency practitioners include:

    - cost savings through economies of scale
    - a single database of registered practitioners
    - ease of regulatory burden for practitioners operating in both fields
    - a common approach to registration procedures and guidelines
    - consistency in decision-making and policy, and
    - removal of anomalous situations, where practitioners have registration cancelled in one field but continue to be registered in another.

30. Arguments against have included:

    - the demands of each field require quite different knowledge and skills

- apparent similarities between the objectives of personal and corporate insolvency practice are largely illusory, and
- the transitional costs would be significant.[3]

31. The Proposals in the 2012 Exposure Draft of the Insolvency Law Reform Bill (discussed in more detail below, see paragraph 50) includes proposed rules setting out common rules regarding the registration, regulation, discipline and deregistration of corporate and personal insolvency practitioners.

## Unified system for regulation of personal and corporate insolvency

32. Arguments that have been made for a more generalised merger of the personal and corporate insolvency systems covering not only registration and supervision of practitioners, but also common rules and a common regulator for both personal and corporate insolvency, have included:

    - a number of fundamental concepts in personal and corporate insolvency are common to both
    - practitioners operating in both fields would benefit from savings arising from dealing with common system and set of rules, and there would be reduced complexity and scope for error
    - lack of uniformity between systems creates confusion for participants in the system, particularly creditors
    - it is desirable for insolvency policy to be controlled by a single government department
    - there is often a significant interaction or overlap (and/or common issues to consider) between personal and corporate insolvency, particularly when dealing with small or micro businesses, and
    - under a unitary system there would be scope to introduce the equivalent of a government administrator for corporate insolvencies (see further '*Liquidator of last resort'* discussion below).

33. Arguments against a more generalised merger of the personal and corporate insolvency systems have included that:

    - there are obvious differences between natural and corporate persons that any merged system would still need to take into account
    - a merger would be a protracted and difficult exercise, given the tradition of separate insolvency laws in Australia and the terms of the Constitution

[3] See Chapter 4, *Review of the Regulation of Corporate Insolvency Practitioners: Report of the Working Party* (1997), http://archive.treasury.gov.au/documents/295/PDF/ch04.pdf

- corporate insolvency law is an integral feature of corporate law and a unified insolvency system would fragment corporate law, and

- a corporate insolvency scenario may require expertise in complex issues involving pre-insolvency matters (eg prior dealings by a financial institution) and that expertise resides with the corporate regulator.[4]

## Requirements for successful move of insolvency functions

34. AFSA submits that there are four key requirements that should inform and guide development of a detailed proposal to move ASIC's insolvency functions to AFSA. Those are requirements for:

    - a robust legal foundation for the transferred functions and powers
    - adequate and sustainable resources to enable the effective exercise transferred functions and powers
    - clear boundaries between regulatory responsibilities, and
    - effective mechanisms for information sharing and cooperation.

### Robust legal foundation

35. Under the Constitution, there are two heads of power that stand out as being relevant to Commonwealth legislation in relation to insolvency functions:

    - section 51(xvii) – bankruptcy and insolvency, and
    - section 51(xx) – foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth.

36. As illustrated by the types of external administrations under Chapter 5 of the Corporations Act listed above, the insolvency of the relevant entity is not a necessary pre-requisite to exercise of all of the functions and powers. Indeed, in some instances (eg members' voluntary liquidation) insolvency of the entity is a bar to using the process. Further, the current external administration legislation does not restrict its application to constitutional corporations, as listed in section 51(xx) of the Constitution. Rather, the external administration provisions cover entities beyond 'foreign corporations, and trading and financial corporations formed within the limits of the Commonwealth'. For example, Australian corporations that do not engage in trading for financial activities, and some non-corporations (eg Part 5.7 bodies) are within the scope of the external administration provisions.

[4] For more details of the arguments see Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*, June 2004, pp 225-228, http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/completed_inquiries/2002-04/ail/report/ail.pdf; Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework,* September 2010, paragraphs 10.3-10.16, http://www.bankruptcy.net.au/docs/Senate%20report%20September%202010.pdf

37. The gaps in Commonwealth legislative power to support the external administration provisions (such as the winding up of a non-corporation on grounds other than insolvency) are filled by a reference of legislative power from the States, under section 51(xxxviii) of the Constitution. In accordance with an Intergovernmental Agreement, the Corporations Agreement 2002, each State has passed an Act referring its power to the Commonwealth to support, where necessary, the Commonwealth's legislative power. An example of a gap that is filled by legislative power referred by States is the winding up of entities that are not constitutional corporations (eg non-trading companies such as non-operating holding companies) on grounds other than insolvency.

38. A proposal to move any of ASIC's functions or powers to AFSA that could potentially be exercised in relation to entities that are neither constitutional corporations nor insolvent would need to be implemented in such a way that either:

- the function or power as exercised by AFSA was restricted to entities that are either constitutional corporations or insolvent, or was supported by some other relevant head of Commonwealth legislative power, or

- the function or power as exercised by AFSA would be supported by the current State referral, or a new referral of State power.

39. Failure to implement a transfer using either of the above approaches would risk the transferred functions and powers being seen as uncertain and vulnerable to legal challenge. Accordingly, the details of a proposal to transfer functions to AFSA should be developed in close consultation with persons having expertise in relation to constitutional issues, and is likely to require a longer timeframe than would ordinarily be required for developing a proposal to transfer functions and powers between two Commonwealth regulators.

40. A further consideration in developing the legislative framework for a transfer of functions and powers to AFSA would be whether the transfer needs to be specifically recognised in other related State and Commonwealth legislation that supports and complements Chapter 5 of the Corporations Act. For example, provisions dealing with the external administration of specific entities such as cooperatives, deposit-taking institutions, and insurers.

## Adequate and sustainable resources

41. AFSA notes the recommendations of the Senate Economic References Committee (see Chapter 25 of the Report on the Performance of the Australian Securities and Investments Commission, 26 June 2014).

42. AFSA's funding model currently supports its own activities on a full cost recovery basis. In order for AFSA to continue to operate on the basis of cost recovery in an effective way, there would need to be adequate resources made available to AFSA on a sustainable basis to exercise the transferred functions and powers effectively and efficiently, to support the integrity of, and confidence of participants in, a revised regulatory framework for insolvency in the period following the transfer and into the future.

43. A particular consideration is that an insolvency regulator, from time to time, is likely to find itself needing to understand and analyse pre-insolvency transactions. Some of those,

particularly in the context of the insolvency of a financial institution, are likely to be complex and require specialist expertise. If insolvency functions were moved to AFSA, there would be a need for appropriate resources to facilitate access to such specialist expertise from alternative sources as required. This requirement needs to be factored in to the revised model.

44. There are a range of funding options that might be examined to support AFSA performing responsibilities in respect of corporate insolvency/external administrations while maintaining cost-recovery principles. Details of the arrangements would need to be formulated as part of developing a detailed proposal, with some possibilities being:

- allocating a proportion of revenues currently collected by ASIC from corporations in the form of, for example, annual review fees, and
- applying a form of the 'realisations charge' model currently applicable to personal insolvency estates to corporate external administrations.

## Clarity of regulatory responsibilities

45. Regardless of how the legislative foundation of AFSA's involvement in corporate insolvency/external administration is structured, there is no 'bright light' boundary between insolvency functions and powers and other functions and powers in relation to external administration. As such, it is likely that grey areas will emerge at the boundaries where it is not readily apparent whether a matter is the responsibility of the corporate regulator or the insolvency regulator.

46. For example, it could emerge during the external administration of an insolvent company that company officers have engaged in a series of transactions prior to the external administration commencing that were designed to benefit themselves at the expense of creditors and/or members. Such behaviour is likely to be subject to remedies under insolvency laws, but the same or related behaviours may also be in violation of general corporate laws, such as breaching directors' duties. Ideally, there would be as much clarity as is reasonably possible at the legislative level around the boundaries between the responsibilities of the corporate and insolvency regulators, so as to minimise inefficiencies and/or practical difficulties arising from any gaps or overlaps.

47. AFSA notes that international jurisdictions that have specialist insolvency regulators that are separate to corporate regulators are likely to have models that could be used to inform how this issue could be addressed in the Australian context.

## Information sharing and cooperation

48. A further requirement in order to ensure that the transfer of insolvency functions out of the corporate regulator is effective would be that there are mechanisms and powers in place to allow for a flow of relevant information between the insolvency regulator and the corporate regulator, and that the regulators can continue to cooperate in relation to matters that cross the boundary under the new regulatory arrangements.

49. The ability to cooperate would need to be supported by a robust mechanism to share between regulators matter-based information, where necessary and appropriate to carry out their respective regulatory functions. Separating responsibility for regulation of insolvency/external administration from other corporate regulatory functions should not be allowed to act as an unintended barrier to the regulators accessing the market information required to effectively perform the respective regulatory functions.

# 2012 Proposals

50. In response to the Inquiry's request (at page 2-71 of the Interim Report) for views on the costs, benefits and trade-offs of the 2012 Proposals contained in the Exposure Draft of the Insolvency Law Reform Bill 2013 as compared to the current arrangements, AFSA notes:

- In December 2012, the Government released the draft Insolvency Law Reform Bill and draft Explanatory Memorandum for public exposure, and submissions on the Bill were invited.

- Release of the Exposure Draft Bill followed release of a proposals paper in December 2011 by the then Attorney-General and Parliamentary Secretary to the Treasurer titled *A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia*. The proposals paper proposed some reforms to address concerns about misconduct in the insolvency profession and to improve the value for money for recipients of insolvency services. More generally, the paper suggested 'harmonising', to the extent appropriate, the regulatory regimes applying to personal and corporate insolvency practitioners. Key reform areas in the proposal paper were reflected in the exposure draft Bill.

- A Regulation Impact Statement setting out in detail the costs and benefits of the proposals in the exposure draft bill was published on the Office of Best Practice Regulation website on 18 January 2012 – see http://ris.dpmc.gov.au/files/2012/01/03-Insolvency-Practitioners-RIS.pdf. AFSA is not aware of any developments since that time that would impact significantly on the costs and benefits of the proposals identified in the RIS.

- AFSA has been advised that some refinements have been made to the drafting of the Bill in light of submissions received on the exposure draft and stakeholder meetings (organised by Treasury) held in January and February 2013.

- The Attorney-General's Department is responsible for personal insolvency policy development and legislation and AFSA works closely with the Department assisting with advice on implementation aspects of reforms and taking into account stakeholder feedback, including in the development of the Bill.

# Administrator of last resort

51. There is no equivalent, in the Australian corporate insolvency context, of the 'administrator of last resort' role performed by the Official Trustee in personal insolvency. Rather, all external

administrations are performed by the private sector, but there has been established an 'Assetless Administration Fund' in order to provide a source of funding for the liquidation of assetless companies. It has, from time to time, been suggested that the introduction of a government liquidator would provide an alternative mechanism for dealing with the winding up of assetless companies.[5] The following part of the submission contains some information about the current arrangements for dealing with the administration of assetless companies and notes how the role of the Official Trustee in personal insolvency operates.

## The assetless administration fund in corporate insolvency

52. ASIC is responsible for the management of the Assetless Administration Fund (AA Fund) that provides funding to a liquidator in a situation where he or she is appointed to liquidate a company with no assets. As there will be no prospect of recoveries in such liquidations and as there is the need for the filing of reports with ASIC under section 533 of the Corporations Act, funding can be made available to the liquidator from the AA Fund.

53. ASIC's Regulatory Guide 109 states *'When a company fails with few or no assets, the liquidator may not be able to carry out full investigations into the circumstances of the insolvency or prepare full reports for ASIC. As a result, possible offences or other misconduct by company officers may not be brought to our attention or actions may not be taken to recover assets for the benefit of creditors where directors have breached their duties.'* ASIC notes that the main function of the AA Fund is to curb fraudulent or illegal phoenix activity.

54. The guidelines provide for the payment of $7500 (GST exclusive), or a greater amount in a more involved case, to a registered liquidator to prepare a further section 533 report(s) after the first such report has been lodged with ASIC.

## The role of the Official Trustee in personal insolvency

55. The *Bankruptcy Act 1966* provides formal options for debtors regarding permanent relief from some unmanageable debts, which are:

- *bankruptcy*: a legal status that arises from either a debtor presenting their own petition (a debtor's petition) or a creditor successfully petitioning the court to have the debtor made bankrupt (a sequestration order)

- *personal insolvency agreement*: a legally-binding arrangement between a debtor and his or her creditors whereby creditors are offered full or part payment in final settlement of debts. Personal insolvency agreements are infrequent and are subject to an extensive process of investigation and reporting by a trustee prior to creditors voting on the debtor's proposal, and

[5] See, for example, Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*, June 2004, paragraphs 7.48 and 12.76, http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/completed_inquiries/2002-04/ail/report/ail.pdf

- *debt agreement*: a legally-binding arrangement between a debtor and their creditors whereby the debtor offers to pay creditors a set amount, usually less than the full amount owed. Unlike a personal insolvency agreement, there are asset value, income and debt limits affecting eligibility to propose a debt agreement.

56. Australia's personal insolvency system operates on the basis that a trustee or administrator is appointed in every formal arrangement under the Bankruptcy Act. The Official Trustee in Bankruptcy is a statutory corporation resourced by AFSA that administers bankruptcies and other personal insolvency arrangements when a private trustee or other administrator is not appointed.

57. The Official Trustee is a trustee and administrator of last resort and so does not initially consent to administer bankrupt estates, personal insolvency agreements or debt agreements. The Official Trustee receives administrations where:

    - in the case of bankruptcies, no trustee has consented to act and it becomes the trustee by default

    - in the case of all insolvencies, the original trustee or administrator ceases to be registered (for example, he or she dies, is convicted of an offence, becomes bankrupt).

58. The Official Trustee has adopted a categorisation process to determine which administrations require investigation and which do not. The categorisation process assists in determining how much time, if any, should be spent on administrations that will not achieve a material outcome. The decision that a particular administration does not require investigation can be revisited at any time, for example if additional information is provided to the trustee about the bankrupt having acquired an asset or having not disclosed an asset on his or her statement of affairs, which assists in promoting confidence in the insolvency system.

59. In 2013-14, there were approximately 18,000 bankruptcies, with the Official Trustee becoming trustee by default of approximately 15,000. Of these, approximately 70 per cent were identified as not requiring investigation because they did not involve any assets or potential offences and no additional information was required beyond that supplied by the bankrupt.

60. Of the approximately 30 per cent of administrations that were identified as requiring investigation, these comprised almost all of the Official Trustee's insolvency work in the year. Of these, approximately half were finalised within three months because preliminary enquiries indicated that there were unlikely to be returns to creditors or issues of concern. The remaining administrations involved asset sales and investigations to achieve returns to creditors, identification and referral of relevant offences and/or actions to address matters in the public interest or that relate to public confidence in the personal insolvency system. Such involved investigations could continue for some time until completion.

61. The administrations 'inherited' by the Official Trustee in its role as trustee and administrator of last resort can be significant. For example, in 2010-11 as a result of the deregistration and resignation of 10 trustees and debt agreement administrators, the Official Trustee received 1520 administrations that required thorough forensic reviews, with a large proportion then requiring continuing investigations.

62. The Bankruptcy Act provides mechanisms (sections 157 and 181A) for transferring bankrupt estates from one trustee to another. The Official Trustee uses a rotation system when nominating a registered trustee for transfer of an estate. There are presently 156 (out of 180 registered trustees) on the rotation roster and the Official Trustee considers transferring estates due to:

- resource reasons, with consideration given to its investigators' capacity to administer estates and whether compliance, quality or performance standards will be compromised due to excessive workloads
- location aspects (that is, where there are benefits to having an estate administered in a particular location due to the location of assets and/or the bankrupt)
- economies of scale (for example, having the estates of a husband and wife administered by the same trustee), and
- conflicts of interest (for example, if a former AFSA employee became bankrupt, it would not be appropriate for the Official Trustee to administer the estate).

63. In 2013-14, 1547 estates were transferred to registered trustees after the Official Trustee had initially been appointed as the default trustee.

## Observations about 'administrator of last resort'

64. The possibility of introducing an 'administrator of last resort' in the corporate insolvency context could be considered independently of a proposal to move responsibility for corporate insolvency functions to AFSA. In any event, the proposal for creation of a single insolvency regulator raises more starkly the significant difference between the personal and corporate insolvency systems in respect of how low-value administrations are treated – in particular, the proportion of assetless administrations that receive external scrutiny.

65. Whether the AA Fund would be retained in its current form, or whether some form of government liquidator/administrator of last resort similar in role to the Official Trustee should be introduced for corporate insolvency and, if so, how that function would be funded, is a matter that could to be considered in the context of a proposal to move insolvency functions to AFSA. Possible options in respect of funding such an 'administrator of last resort' role that could be considered include those mentioned above (see paragraph 44).