

12 October 2020

Manager
Market Conduct Division
Treasury
Langton Crescent
Parkes ACT 2600

Via email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam

Insolvency reforms to support small business

Thank you for the opportunity to provide a submission on the *Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Exposure Draft)*.

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership reflects the diversity of Australia's director community: while 192 of the nation's ASX 200 companies have one or more AICD members serving on their board, our membership of more than 45,000 is drawn from directors and leaders of not-for-profits, large and small businesses and the government sector.

The AICD has long taken the view that the primary objective of Australia's insolvency regime should be corporate recovery. This is all the more important against the backdrop of COVID-19. The insolvency regime should encourage entrepreneurialism, preserve employment and operate to save businesses that are fundamentally viable in the long-term.

Against this background, the AICD welcomes the Government's announcement to introduce reforms to support small business, including the simplified restructuring process. Given the technical nature of the Exposure Draft, the AICD has limited its comments in this submission to provisions that impact directors and their role in the restructuring process.

While the proposed reforms are important, equally, more needs to be done to craft insolvency law settings that better support businesses (both large and small) to recover. This could include lifting the personal liability threshold for insolvent trading so as to bring Australia closer into line with comparable jurisdictions such as the UK or Singapore. This would be due recognition of the important role that the Treasurer's temporary relief from insolvent trading liability played during COVID-19, encouraging directors not to prematurely enter voluntary administration for fear of personal liability.

Exposure Draft

The AICD has engaged with restructuring experts and academics as part of its consultation on the Exposure Draft. These experts have advised that the simplified restructuring process appears to be

relatively complex and may not be as flexible and accessible for small businesses as intended by the Government. The AICD understands that this is largely because the Exposure Draft incorporates many of the provisions in the *Corporations Act 2001 (Cth)* (**Corporations Act**) that apply to voluntary administrations.

The AICD suggests consideration be given to whether some of the lengthy and rigid procedures that apply to voluntary administrations are necessary in the context of small business restructuring.

We have set out specific comments on certain provisions below.

Registered liquidator to be a small business restructuring practitioner (SBRP) (proposed section 456B of the Corporations Act)

Proposed section 456B of the Corporations Act provides that a SBRP must be a registered liquidator. We consider it crucial that a broader range of qualified persons be available to help companies and their directors restructure, noting that liquidators' skill-set and experience is focused on liquidating a company and distributing assets rather than overseeing a restructuring process, which is the intended scope of the proposed legislation. In our view, requiring SBRPs to be a registered liquidator would significantly harm the flexibility, practicality and scalability of the proposed simplified restructuring process, and potentially render it ineffective.

The reality is that in many instances the best people to assist directors with restructuring their business will be a local trusted accountant or adviser, particularly in rural and suburban settings. Enabling a broader range of persons to be SBRPs will increase access to the proposed regime given the large number of small businesses that may avail themselves of this process, relative to the number of liquidators. Many directors may also be deterred from utilising the process due to the stigma associated with engaging a registered liquidator.

While we understand that a new classification of registered SBRP is being contemplated, the Exposure Draft does not include detail about this classification and the AICD is of the view that this should be clarified. To this end, the AICD would support consideration of criteria that might include SBRPs:

- being a member of an appropriate professional association with a code of ethics;
- being an appropriately skilled and competent to perform the task, and have adequate professional indemnity insurance;
- being a 'fit and proper person' (i.e. never been convicted of a financial crime, be an undisclosed bankrupt, have previously been bankrupt, etc);
- holding a tertiary degree in business, finance, accounting or law; and
- agreeing to participate in an appropriate disciplinary process and/or alternate dispute resolution at their cost (e.g. through the professional association referred to above).

Previous use of a debt restructuring process or a simplified liquidation process (proposed sections 453C(1)(b) and 500AA(1)(e) of the Corporations Act)

The AICD is concerned about the eligibility criteria proposed by section 453C(1)(b) of the Exposure Draft. This requires that no director of the company has been a director of a company that has been

the subject of a debt restructuring process or a simplified liquidation process during the period prescribed by the regulations.

The AICD appreciates that the eligibility criteria are required as an important safeguard to prevent a pattern of behaviour from directors that could indicate illegal phoenixing activity. Nonetheless, we are concerned that this will mean that companies may be needlessly excluded from the simplified restructuring and/or liquidation regime.

The AICD urges exemptions to be included in the legislation to ensure companies are not excluded in circumstances where two small businesses are unrelated and may only have one director in common. For example, consider an individual who is a non-executive director on the board of multiple companies, such as an investment professional who is a director of each of their investee companies (such as in the private equity and venture capital industry). It would not be appropriate to exclude all small businesses from both the simplified restructuring and liquidation processes solely because another, unrelated company in that investment professional's portfolio had used the process during the prescribed period.

Insolvent trading liability (existing section 588G and proposed section 455A(2) of the Corporations Act)

Under the simplified restructuring process, directors still control the company and consequently the risk of insolvent trading liability under existing section 588G of the Corporations Act will continue to apply to directors during this period.

As currently proposed, directors are required at the outset of the restructuring process to resolve that the company is insolvent or likely to become so, and the company will be taken to be insolvent when it proposes a restructuring plan which increases the insolvent trading risk.

It is not clear why directors must deem the company insolvent in circumstances where the company proposes a plan. It is conceivable that this could disincentivise directors from using the process. Notably this is not required under the safe harbour regime (legislated in 2017) and the AICD suggests that proposed section 455A(2) be deleted.

We understand that new section 588GAAB appears intended to provide directors some protection in this regard for debts incurred during the restructuring of the company. However, it is unclear whether this protection also applies to debts incurred as a consequence of a restructuring plan. The AICD is of the view that this should be clarified to capture debts incurred in implementing the restructuring plan.

Consultation on insolvent trading duty

The AICD strongly supported the Government's decision to provide insolvent trading relief to directors early in the crisis, as well as the decision to extend this relief until the end of the 2020 calendar year. An AICD member survey conducted in May-June 2020 indicated that the Government's relief had influenced 12% of respondents' decision to trade through the pandemic, rising to 16% for SME directors.

Australia's insolvent trading rules are among the strictest in the world, according to comparative analysis by law firm Allens Linklaters.¹ This pandemic and the need to introduce temporary relief for directors from personal liability for trading while insolvent has highlighted the urgent need for permanent reform to the insolvent trading duty in section 588G of the Corporations Act. As Treasury recognised in its recent background paper² on the small business insolvency reforms: "Companies that could be viable in the long term may be unnecessarily pushed into external administration by creditors through use of statutory demands or **by directors' fear of personal liability for insolvent trading** [emphasis added]."

As the temporary relief comes to an end on 31 December 2020, we encourage Treasury to consider increasing the threshold of the insolvent trading duty to that of "recklessness" or "intentional trading", in line with comparator jurisdictions such as the UK or Singapore. Such reform would support all organisations – not just small businesses – recover from the crisis and encourage innovation and risk-taking to ensure long-term economic prosperity.

We would be happy to provide further detail on this suggestion in due course.

Next steps

We hope our comments on the Exposure Draft will be of assistance as you undertake this important consultation. If you would like to discuss any aspects further, please contact Christie McGrath, Senior Policy Adviser at cmcgrath@aicd.com.au or Christian Gergis, Head of Policy, at cgergis@aicd.com.au.

Yours sincerely,



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¹ AICD commissioned research. *Australia's "uniquely burdensome" director liability environment*. Refer Section 1.6 of Schedule 1. <https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/policy/pdf/2020/aicd--advice-for-publication-including-organograms.ashx>

² Treasury. *Insolvency Reforms to Support Small Business – Background*, 2020, p. 2.