



**ASIC**

Australian Securities & Investments Commission

## **ASIC — Focusing on insolvency**

*An opening address by Jeffrey Lucy AM, Chairman ASIC to the National Conference of the Insolvency Practitioners Association of Australia, 13 October 2005, Adelaide.*

I am delighted to be here this morning, opening the Insolvency Practitioner Association of Australia National Conference in my home town of Adelaide.

Beyond welcoming you all to Adelaide, there are a number of important insolvency and regulatory matters I'd like to speak about this morning.

Firstly, I'd like to take a brief snap-shot of the current corporate insolvency regime, specifically reflecting on the progress ASIC and the profession have made in this area over the past few years.

Secondly, I'll discuss the importance of building effective relationships between the regulator and profession, and particularly recognise the strong results we've achieved through a constructive partnership with the insolvency profession.

And finally, I will speak about ASIC's future strategic focus on insolvency issues in light of the Government's newly announced insolvency reform package. This is a robust, integrated package of reforms that will go a long way towards ensuring that creditors, employees and small businesses are protected when businesses collapse, and that misconduct of company officers in the lead-up to a company failure are appropriately investigated and punished.

The last time the IPAA had its National Conference in Adelaide, back in October 2000, we were in a vastly different space to where we are now. At that time, insolvency was not as high on the regulatory agenda.

The most important development of the time saw the States agreeing to refer sufficient powers to the Commonwealth, enabling re-enactment of the then Corporations Law and ASIC Law as exclusive laws of the Commonwealth, thus

resolving the constitutional problems which had arisen as a result of the High Court's decision in *Re Wakim*<sup>1</sup> the previous year. The referral of powers was subject to a five-year sunset clause that expires on 30 June 2006.

Since then, insolvency has become an increased priority for ASIC as we focus on reducing insolvent trading and phoenix companies, and more specifically, encouraging directors and officers of financially troubled companies to act promptly and in the interests of creditors. In support of this increased focus, ASIC initiated its national liquidator assistance program in July 2002, and also created our National Insolvency Coordination Unit (NICU) under the leadership of Mark Drysdale in October of that year. The visibility, range and impact of ASIC's insolvency activities has increased since then, year-on-year, such that it is now a significant national regulatory priority for our organisation.

Over the first two years of operation, ASIC's national insolvent trading program has achieved some impressive results. We have undertaken over 1,100 company surveillances, focussing specifically on potential insolvent trading by company directors. Just over 10% (134) of these companies had a voluntary administrator or liquidator appointed after ASIC's visit. More importantly though, many positive 'turnaround' outcomes have also been achieved through our visits.

In the three years since the creation of our National Assistance to Liquidators Program, we have produced solid results. Between 1 July 2002 and 30 June 2005, 1,280 company officers have been prosecuted for 2,231 liquidator assistance type offences, such as failure to deliver reports as to affairs, failure to deliver books and records, and failure to attend on a liquidator.

These prosecutions have resulted in the courts awarding a total of \$1,877,557 in fines and costs. Importantly, around 74% of company officers contacted by ASIC now choose to comply with their legal obligations, compared to 57% at the end of the program's first year. Our success in this regard has relied heavily on the contribution of practitioners in promptly referring non-compliance to ASIC and providing statements or affidavits of complaint to support our prosecutions.

On the insolvency policy front, ASIC has worked continuously over the past few years to update existing policy to reflect a stronger, clearer and more effective regulatory regime. Most recently, we issued our new policy statement on liquidator registration and the ongoing requirements for maintaining that registration, Policy Statement 186, on 30 September 2005.

Since 2002 we've also:

- Reissued Practice Note 50 on external administrators' reports;
- Issued new Interim Policy Statement 174 on the financial reporting and AGM requirements for externally administered companies;

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<sup>1</sup> [1999] HCA 27 (17 June 1999)

- Amended Policy Statement 33 on security deposits to reflect the reduced professional indemnity insurance requirements of the ICAA and to extend the policy to public practice members of the NIA; and
- Issued a Guide on deeds of company arrangement involving creditors' trusts.

We've also recently completed our EXAD project to deliver online lodgement of all external administration forms, making it simple to lodge in a timely and efficient manner.

On the compliance front, we've carried out exercises relating to both PI insurance and financial reporting requirements of externally administered companies. And, we've also monitored compliance activity relating to remuneration approval in voluntary administrations, as a result of the decision by Finkelstein J last December in the Stockford case<sup>2</sup>.

ASIC has also been active in the area of insolvency law reform, making submissions to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the operation of Australia's insolvency laws. Our response included making recommendations to the Government for a possible model for an assetless administration fund, piloted by ASIC. This has been included in the reforms announced by the Government yesterday.

In order to ensure a strong, consistent and efficient approach to dealing with non-routine liquidator and auditor conduct matters, ASIC took the important step of establishing a National Company Auditors and Liquidators Disciplinary Board team in 2003. This has proven to be a successful initiative that has seen, over the past two financial years, 9 liquidators disciplined by the CALDB or surrendering their registration for misconduct. Another 6 were disciplined or surrendered their registration prior to a CALDB decision for failure to comply with administrative requirements.

At the same time as undertaking these insolvency activities, ASIC has continued to carry out its other important enforcement work. Much of which has included an insolvency connection, including banning directors of failed companies; winding up companies and managed investment schemes; as well as civil and criminal action against company officers who have committed offences relating to failed companies. High profile matters over the past few years that have arisen from failures include HIH, Harris Scarfe Ltd and Waterwheel. We have now added Sons of Gwalia to the companies being investigated for insolvency-related matters.

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<sup>2</sup> Re Stockford Limited (subject to a deed of company arrangement); Korda & Anor (2004) 52 ACSR 279

Reflecting on our achievements over the past few years, it is clear that much of this work has been made possible through regular consultation, liaison and a strong working relationship with the insolvency profession.

In establishing NICU, the Commission took a deliberate and necessary step in reviewing and building on our national insolvency liaison arrangements. We actively sought industry specialist secondments into ASIC, and also established a consistent liaison format in each region in order to foster a productive, informed dialogue directly with the profession. This involves over 60 liquidators and specialist insolvency lawyers representing the profession at the grass roots level.

This liaison has provided an invaluable source of feedback on current issues in the market place and a key sounding board for our policy initiatives. It has meant that we, as the national corporate regulator, are able to target our insolvency regulatory activities in the areas they are most needed and in a way that is practical in today's market.

Enhancing our strong partnership with the profession, ASIC has introduced more regular communication with liquidators, in the form of our Insolvency Update newsletters three times a year – keeping you informed of our activities and advising of ASIC's expectations on emerging conduct issues. New insolvency policy is now emailed to all liquidators once released, and we continue to publish regular articles in the IPAA's Australian Insolvency Journal.

In the course of much of our insolvency policy work, we have sought and obtained feedback from the profession, particularly in relation to the policy proposal papers on financial reporting and AGMs and on liquidator registration. As a general rule, where the need for timely guidance precludes a full consultation process prior to policy release, we have carefully reviewed any issues subsequently raised by the insolvency community to see if clarification or amendment is required.

So, what about the view looking forward?

As I've already mentioned, corporate insolvency as one of ASIC's key regulatory priorities over the coming year. It also features in ASIC's five year strategic plan.

Our activities in this area have been significantly enhanced through yesterday's announcement by the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, of the Government's integrated package of reforms to improve the operation of Australia's insolvency laws.

I expect that the package and its implications for ASIC's regulatory and enforcement activity will be discussed in more detail at tomorrow's "Where to from here" session involving ASIC's Mark Drysdale. However, I might take this

opportunity to make a few comments on this significant development before I finish this morning.

As you may know, the package proposes a number of reforms including, improved access to the General Employee Entitlements and Redundancy Scheme (GEERS), enhancing the prospect of payment of employee entitlements and personal injury claims in insolvency, and the establishment of a fund to finance preliminary investigations of 'asset-less' companies to reduce fraudulent phoenix activity.

Of particular relevance to ASIC, is the Government's allocation of \$23 million over four years to establish the Assetless Administration Fund and a complementary enforcement program by ASIC.

Ultimately, ASIC believes the establishment of an Assetless Administration Fund is a significant and valuable development for corporate Australia.

The Assetless Administration Fund will be established to finance investigations by liquidators in cases where it appears to ASIC that further investigation and reporting may lead to enforcement action. This approach utilises the skills of private sector practitioners to ensure that ASIC is provided with adequate information to identify and pursue misconduct by company officers in the lead-up to a company failure.

Establishment of such a fund helps close a systemic problem with behaviour by some directors, who use corporate structures to deliberately avoid their responsibilities to creditors by structuring phoenix-type transactions.

As you know, phoenix activity is typically associated with directors who transfer the assets of an indebted company into a new company of which they are also directors. They then place the initial company into administration/liquidation with no assets to pay creditors, and continue the business using the new company structure.

As well as establishing the fund, ASIC will use additional funding provided in the reform package to establish an enforcement program targeting misconduct by the officers of assetless companies. This program will focus on disqualifying directors of assetless companies who are involved in repeat phoenix activity and that deliberately incur debt knowing that creditors will not be paid. This activity is not only offensive, it frequently materially impacts the lives of Australians who are either employees of these businesses or suppliers of services or products to them. The financial and emotional costs to these groups of Australians is high.

I believe this initiative is a significant step towards helping honest business compete on a level playing field and will address dishonest and unfair behaviour that costs business significantly.

Implementation of the Assetless Administration Fund will commence immediately, with applications for funding by liquidators being accepted from early 2006, when the fund becomes operational. ASIC looks forward to working closely with the insolvency profession to ensure the implementation of this important initiative, and prevent phoenix-type behaviour.

To support the Assetless Administration Fund, it is also proposed that the privilege against exposure to a penalty, be abrogated in proceedings where ASIC is seeking only disqualification or banning orders. This would restore the longstanding interpretation of the applicability of the privilege that existed prior to the 2004 Rich case.<sup>3</sup>

In accordance with the Parliamentary Secretary to the Treasurer's announcement yesterday, access to the General Employee Entitlements and Redundancy Scheme (GEERS) will also be improved with the Government allocating an additional \$62 million over four years to enhance the range of entitlements.

Importantly, the Government has clearly stated that the existing priority of employee entitlements in insolvency will be retained. Indeed, the Government has announced that it will move to prevent this priority being downgraded in deeds of company arrangement without the agreement of employees or where the court orders that the deed be upheld.

Other elements of the announcement include proposals to:

- amend the Corporations Act to outlaw payments or inducement to secure an appointment;
- introduce a statutory 'pooling' mechanism to facilitate the external administration of corporate groups;
- amend the schemes of arrangement provisions to improve creditor protection;
- enhancing the regime for regulation of insolvency practitioners, including changes to independence, remuneration, registration and improved disciplinary procedures; and
- finetuning the voluntary administration regime to enhance the efficiency and effectiveness of the process.

Draft legislation reflecting these proposals will be prepared in consultation with industry groups, with commencement of the reforms expected thereafter. I sincerely hope the proposed amendments will be widely supported by Parliament.

For ASIC, implementing the Assetless Administration Fund and other applicable insolvency law reform is high on our agenda, although it forms just one important

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<sup>3</sup> Rich v Australian Securities and Investments Commission (2004) 209 ALR 271

aspect of our insolvency regulation program for the future. Over the next 12 months, ASIC will undertake a range of additional insolvency-related regulatory activities.

Our National Insolvent Trading Program will focus on specific industries that are potentially struggling as a result of market conditions. Previous examples of this included several Queensland boat building companies and a number of Victorian building and construction companies.

ASIC will continue to take seriously the obligations of registered liquidators to properly perform their duties and functions, with our approach to practitioner compliance over the coming year being multifaceted.

We will continue to undertake our usual reactive program, responding to matters that are reported to us.

We will run a number of compliance exercises to ensure that the information on the corporate database and the liquidator register is correct. An outline of the five planned compliance activities is given in ASIC's article in the IPAA's September Australian Insolvency Journal and our August Insolvency Update newsletter. If you receive a letter from us as part of these activities, we ask that you work with us by responding promptly and comprehensively.

The Commission has also recently determined to establish a dedicated liquidator surveillance unit within ASIC. This unit will initially target insolvency practitioners who support directors involved with phoenix activity. ASIC's National Insolvency Coordination Unit will be responsible for this program and experienced insolvency staff will undertake this work. I know the profession will support this initiative as we have been asked by many of you to be more active in liquidator surveillance. I am pleased that the profession agrees with ASIC that the conduct of its members is important for overall market confidence. This work will be undertaken by experienced insolvency staff.

ASIC is also preparing guidance for practitioners on a series of specific matters including a remuneration guide and also a guide on managing conflicts of interest. In addition, we will soon be releasing a package of general insolvency information sheets aimed at the wider business community who are not expert or familiar with insolvency laws and processes.

Going forward, we will continue to work closely with the IPAA and the insolvency profession on policy and other matters. While we may not always agree, we will achieve better results by talking to each other and better understand our respective positions. In doing so, we will more often than achieve better results under a more effective regulatory regime.

I welcome you all to this Conference and urge those of you from interstate to sample some of the pleasures Adelaide has to offer while you are here – starting with some good South Australian wine at tonight's dinner at the National Wine Centre. I'm sure you'll find your time here rewarding, both within and outside the Conference. It gives me great pleasure to formally open the 2005 National Conference.

Thank you.