CONSULTATION PAPER 372

# Guidance on insolvent trading safe harbour provisions: Update to RG 217

September 2023

## About this paper

This consultation paper seeks feedback from directors, professional advisers, registered liquidators, turnaround and restructuring professionals, and other interested parties.

It sets out our proposals to update our guidance to help directors understand and comply with their duty to prevent insolvent trading, including guidance on the operation of the safe harbour provisions.

> Note: Draft updated Regulatory Guide 217 *Duty to prevent insolvent trading: Guide for directors* (draft updated RG 217) is available on our Consultation papers page under CP 372.

**About ASIC regulatory documents**

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers**: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides**: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets**: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports**: describe ASIC compliance or relief activity or the results of a research project.

## Document history

This paper was issued on 14 September 2023 and is based on the legislation as at the date of issue.

## Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

# Contents

# The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our guidance for directors on the duty to prevent insolvent trading and whether safe harbour protection may be available to them against potential liability for breaching this duty. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section C, 'Regulatory and financial impact'.

## Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our privacy policy for more information on how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by 26 October to:

RG 217 Consultation Feedback
Companies and Small Business
Australian Securities and Investments Commission
GPO Box 9827
Brisbane QLD 4001
email: RG217.Feedback@asic.gov.au

## What will happen next?

| | | |
|---|---|---|
| **Stage 1** | 14 September 2023 | ASIC consultation paper released |
| **Stage 2** | 26 October 2023 | Comments due on the consultation paper |
| **Stage 3** | Q1 2024 | Updated RG 217 released |

# A Background to the proposals

**Key points**

We first published Regulatory Guide 217 *Duty to prevent insolvent trading: Guide for directors* (RG 217) in July 2010.

The safe harbour provisions contained in s588GA and 588GAAB of the *Corporations Act 2001* (Corporations Act) came into effect on 19 September 2017.

An independent review of the safe harbour provisions was undertaken in 2021. The review report (tabled in Parliament on 24 March 2022) identified a lack of awareness and understanding of a director's duty to prevent insolvent trading (and the related safe harbour provisions). The report made a specific guidance suggestion that we update RG 217 with general guidance on the operation of the relevant provisions.

## Directors' duty to prevent insolvent trading

1 A director has a positive duty to prevent insolvent trading under s588G of the Corporations Act.

2 This duty requires a director of a company to prevent the company from incurring a debt if:

(a) the company is already insolvent when the debt is incurred; or

(b) by incurring that debt or a range of debts, including that particular debt, the company becomes insolvent; and

(c) at the time of incurring the debt, there are reasonable grounds for suspecting that the company is already insolvent or would become insolvent by incurring the debt (see s588G(1)).

3 A director has a defence against a civil claim for insolvent trading if they can prove one of the defences set out in the Corporations Act: s588H.

4 Following public consultation, we first published RG 217 in July 2010. The guide set out:

(a) key principles to help directors understand and comply with their duty under s588G to prevent insolvent trading; and

(b) the factors that we will look at when assessing whether a director has breached their duty to prevent insolvent trading.

## Introduction of the safe harbour provisions for insolvent trading

5 The *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* introduced the safe harbour provisions: see s588GA and 588GB of the Corporations Act. The provisions commenced on 19 September 2017.

6 The amendments introduced safe harbour protection for directors from civil liability for insolvent trading under s588G(2).

7 A director may be excluded from liability for a claim for insolvent trading if they can establish safe harbour protection for debts incurred at a time when they are developing a course(s) of action that would be reasonably likely to lead to a better outcome for the company. The safe harbour provisions protect directors against personal liability for debts incurred directly or indirectly in connection with developing and implementing the course(s) of action (see s588GA(1)).

8 While relying on the safe harbour provisions, directors must continue to comply with all their other legal obligations, including their duties as a director under Pt 2D.1 of the Corporations Act.

9 The legislation required the Minister to cause an independent review of the safe harbour provisions to be undertaken. The review was to focus on how the availability of the safe harbour protection affected:

(a) the conduct of directors; and

(b) the interests of creditors and employees of those companies.

10 From 1 January 2021, amendments introduced a small business restructuring regime for companies with liabilities of not more than $1 million. A director may also be excluded from liability for insolvent trading for debts incurred in the ordinary course of business during the restructuring of a company (see s588GAAB(1)).

## Recommendations of the independent review

11 The Government announced in the 2021 Budget that it would undertake an independent review of the insolvent trading safe harbour.

12 The review was led by an independent panel of experts (comprised of Genevieve Sexton as Chairperson, and Leanne Chesser and Stephen Parbery as panel members). The review took place from August to November 2021.

13 On 24 March 2022, the panel's report, *Review of the insolvent trading safe harbour—Final report* was tabled in Parliament, setting out the findings of the review, and the Australian Government released its response.

14 The panel identified a lack of awareness and understanding of a director's duty to prevent insolvent trading (and the related safe harbour provisions. It

made a specific guidance suggestion that we update RG 217 'to refer to the insolvent trading prohibition, and the safe harbour provisions, together with general guidance on the operation of the relevant provisions': see *Review of the insolvent trading safe harbour—Final report*, p. 90. The Australian Government noted this suggestion.

15 Further, the panel identified that the level of awareness of the safe harbour provisions differed between large and small companies; with directors of large companies more likely to have knowledge of the safe harbour compared to directors of small-to-medium sized enterprises.

## Timing of this consultation

16 The safe harbour is not a public process and board confidential decisions relating to it do not normally become public.

17 Given the lack of available information about how the safe harbour legislation was operating, we deferred work to update RG 217 pending the outcome of the statutory review of the safe harbour provisions. The final report was tabled in Parliament on 24 March 2022 and the Government also released its response.

18 Following the Government's response to the safe harbour review final report, our consultation was deferred as we responded to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry (the Inquiry) into corporate insolvency in Australia which began on 28 September 2022.

# B Our proposed guidance for directors

**Key points**

We seek feedback on the existing guidance for directors about their duty to prevent insolvent trading: see proposal B1.

Amendments have been made to the existing guidance where necessary to refer to the safe harbour provisions and to refer to the liability of a holding company which is not referred to in the existing guidance.

We are also proposing to provide additional guidance on the safe harbour provisions. We have included this guidance in draft updated Regulatory Guide 217 *Duty to prevent insolvent trading: Guide for directors* (draft updated RG 217): see proposal B2.

19 Nothing in draft updated RG 217 will affect the ability of:

(a) a liquidator of a company to bring proceedings against the company's directors to recover compensation for loss resulting from insolvent trading; or

(b) the company's creditors to bring similar action if they have first obtained the liquidator's consent or the leave of the court.

20 However, the liquidator of a company or the company's creditors may take the proposed guidance into account when considering whether to bring such proceedings.

## Guidance for directors on the duty to prevent insolvent trading

**Proposal**

**B1** We seek feedback on whether the existing guidance in RG 217 for directors about their duty to prevent insolvent trading remains relevant and adequate.

*Your feedback*

B1Q1 Do you think the existing guidance about the scope and nature of the director's duty to prevent insolvent trading remains relevant and adequate? If not, what further guidance should we provide?

B1Q2 Do you think the key principles set out in Section B of the existing guidance (unchanged in draft updated RG 217) are helpful? If not, explain how we could improve them or what further guidance we could provide.

B1Q3 Are the indicators of potential insolvency set out in Table 2 of the existing guidance (unchanged in Table 3 of draft updated RG 217) sufficient? If not, what further guidance should we provide?

B1Q4 Do you consider that the existing guidance helps directors of both small-to-medium enterprises (SMEs) and large or listed companies? If not, what additional guidance would you suggest we provide?

B1Q5 Do you think SME directors need separate guidance? If so, what should that guidance be?

B1Q6 Do you consider including guidance on the liability of a holding company is necessary and, if so, is the information provided sufficient? If not, what additional guidance would you suggest we provide?

### Rationale

21 In November 2009, we released Consultation Paper 124 *Duty to prevent insolvent trading: Guide for directors* (CP 124), seeking feedback from directors, professional advisers, and other interested parties on proposed guidance for directors to help them understand and comply with their duty to prevent insolvent trading.

22 Respondents generally agreed with the nature and scope of our proposed guidance and offered useful suggestions about how our proposed guidance could be improved. We refined our proposed guidance to take into account the feedback in the submissions we received and released RG 217 in July 2010.

23 We have not received feedback that the existing guidance is no longer relevant and adequate.

24 We have amended the existing guidance to:

(a) include the potential liability of a holding company for the insolvent trading of a subsidiary which was omitted from the original guidance; and

(b) note the new safe harbour provisions where they are relevant to the existing guidance.

## Proposed guidance on the safe harbour provisions

### Proposal

**B2** We propose to provide additional guidance on:

(a) the nature and scope of the safe harbour provisions and when a director may be able to rely on the safe harbour to protect them from liability for insolvent trading;

(b) the steps a director might consider if seeking to rely on safe harbour protection against a claim for alleged breach of duty to prevent insolvent trading;

(c) when a course of action may be reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator;

(d) who may be an appropriate adviser to help directors develop and assess whether a course of action is reasonably likely to lead to a better outcome for the company;

(e) the evidentiary onus on the director who wishes to rely on safe harbour protection; and

(f) some of the factors we will take into account when assessing whether a director may establish safe harbour protection against liability for insolvent trading.

Note: See Table 2 and Section C of draft updated RG 217.

*Your feedback*

B2Q1 Do you think the scope and nature of the safe harbour protection is adequately explained in draft updated RG 217 at RG 217.24–RG 217.27 and Part C? If not, what further information should be provided?

B2Q2 Is the proposed guidance in draft updated RG 217 at RG 217.61, on the steps a director may take to establish safe harbour protection, helpful? If not, explain how we could improve the guidance.

B2Q3 Is the proposed guidance in draft updated RG 217 at RG 217.65–RG 217.77, on when a course of action may be reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator, helpful? If not, explain how we could improve the guidance.

B2Q4 Is the proposed guidance in draft updated RG 217 at RG 217.83–RG 217.88, on who may be an appropriate adviser, helpful? If not, explain how we could improve the guidance.

B2Q5 Is the proposed guidance in draft updated RG 217 at RG 217.90–RG 217.92, on the evidentiary onus on the director who wishes to rely on safe harbour protection, helpful? If not, explain how we could improve the guidance.

B2Q6 Is the information in Table 2 of draft updated RG 217, about evidentiary material we will take into account when assessing whether a director can establish safe harbour protection, helpful? If not, explain how it could be improved.

B2Q7 Is further guidance required? If so, what further guidance should we provide?

B2Q8 Should ASIC take further steps to raise awareness of the insolvent trading and safe harbour provisions? If so, explain how we could raise awareness of the provisions, particularly for directors of small-to-medium sized enterprises.

## Rationale

25 A director may be able to establish safe harbour protection from liability for insolvent trading if:

(a) at the time the debt was incurred, the company is paying its employees on time and complying with its lodgement obligations under taxation laws—this requirement is subject to some exceptions; and

(b) they are taking steps to develop and implement a course or courses of action that are reasonably likely to lead to a better outcome for the company.

26 There are statutory factors that may assist in establishing whether a course of action is reasonably likely to lead to a better outcome for the company. These include whether the director is properly informed about the company's financial position, whether appropriate financial records are being kept and whether advice has been obtained from an appropriately qualified entity.

27 A director may also be excluded from liability for insolvent trading for debts incurred in the ordinary course of business during the restructuring of a company.

28 A director who wishes to rely on the safe harbour protection in proceedings bears the evidential burden of establishing that the protection applies.

# C Regulatory and financial impact

29 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

(a) raising director awareness of the potential safe harbour protection from personal liability for insolvent trading;

(b) reducing the risk of directors breaching their duty to prevent insolvent trading;

(c) protecting the interest of creditors; and

(d) not unduly placing additional and burdensome costs on directors in complying with their duties.

30 Before settling on a final policy, we will comply with the Australian Government's Policy Impact Analysis (PIA) requirements by:

(a) considering all feasible options, including examining the likely impacts of the range of alternative options that could meet our policy objectives;

(b) if regulatory options are under consideration, notifying the Office of Impact Analysis (OIA); and

(c) if our proposed option has more than a minor or machinery impact on business or on the not-for-profit sector, preparing an Impact Analysis (IA) or an IA equivalent (Independent Review).

31 All IAs are submitted to the OIA for approval before we make any final decision, or if an IA equivalent—to the OIA for agreement. Without an approved IA or agreed IA equivalent, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

32 To ensure that we are in a position to properly complete any required IA or IA equivalent, please give us as much information as you can about our proposals or any alternative approaches, including:

(a) the likely compliance costs;

(b) the likely effect on competition; and

(c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

# Key terms

| Term | Meaning in this document |
|---|---|
| ASIC | Australian Securities and Investments Commission |
| Corporations Act | *Corporations Act 2001,* including regulations and rules made for the purposes of the Act |
| director | A natural person appointed as a director of a company who is then responsible for directing and managing the affairs of the company, or a de facto or shadow director<br>Note: See also the definition in s9 of the Corporations Act. |
| insolvent | A person (including a company) is insolvent if they are not solvent—that is, they are unable to pay all their debts as and when they fall due for payment<br>Note: See also the definition in s95A of the Corporations Act. |
| RG 217 (for example) | An ASIC regulatory guide (in this example numbered 217) |
| s588GA (for example) | A section of the Corporations Act (in this example numbered 588GA) |
| safe harbour provisions | The provisions in the Corporations Act that protect company directors from civil liability for insolvent trading under s588G(2)<br>Note: See s588GA and 588GB. |
| SME | Small-to-medium enterprise |

# List of proposals and questions

| Proposal | | Your feedback | |
|---|---|---|---|
| B1 | We seek feedback on whether the existing guidance in RG 217 for directors about their duty to prevent insolvent trading remains relevant and adequate. | B1Q1 | Do you think the existing guidance about the scope and nature of the director's duty to prevent insolvent trading remains relevant and adequate? If not, what further guidance should we provide? |
| | | B1Q2 | Do you think the key principles set out in Section B of the existing guidance (unchanged in draft updated RG 217) are helpful? If not, explain how we could improve them or what further guidance we could provide. |
| | | B1Q3 | Are the indicators of potential insolvency set out in Table 2 of the existing guidance (unchanged in Table 3 of draft updated RG 217) sufficient? If not, what further guidance should we provide? |
| | | B1Q4 | Do you consider that the existing guidance helps directors of both small-to-medium enterprises (SMEs) and large or listed companies? If not, what additional guidance would you suggest we provide? |
| | | B1Q5 | Do you think SME directors need separate guidance? If so, what should that guidance be? |
| | | B1Q6 | Do you consider including guidance on the liability of a holding company is necessary and, if so, is the information provided sufficient? If not, what additional guidance would you suggest we provide? |

| Proposal | Your feedback |
|---|---|
| B2 We propose to provide additional guidance on:<br>(a) the nature and scope of the safe harbour provisions and when a director may be able to rely on the safe harbour to protect them from liability for insolvent trading;<br>(b) the steps a director might consider if seeking to rely on safe harbour protection against a claim for alleged breach of duty to prevent insolvent trading;<br>(c) when a course of action may be reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator;<br>(d) who may be an appropriate adviser to help directors develop and assess whether a course of action is reasonably likely to lead to a better outcome for the company;<br>(e) the evidentiary onus on the director who wishes to rely on safe harbour protection; and<br>(f) some of the factors we will take into account when assessing whether a director may establish safe harbour protection against liability for insolvent trading.<br>Note: See Table 2 and Section C of draft updated RG 217. | B2Q1 Do you think the scope and nature of the safe harbour protection is adequately explained in draft updated RG 217 at RG 217.24–RG 217.27 and Part C ? If not, what further information should be provided?<br>B2Q2 Is the proposed guidance in draft updated RG 217 at RG 217.61, on steps a director may take to establish safe harbour protection, helpful? If not, explain how we could improve the guidance.<br>B2Q3 Is the proposed guidance in draft updated RG 217 at RG 217.65–RG 217.77, on when a course of action may be reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator, helpful? If not, explain how we could improve the guidance.<br>B2Q4 Is the proposed guidance in draft updated RG 217 at RG 217.83–RG 217.88, on who may be an appropriate adviser, helpful? If not, explain how we could improve the guidance.<br>B2Q5 Is the proposed guidance in draft updated RG 217 at RG 217.90–RG 217.92, on the evidentiary onus on the director who wishes to rely on safe harbour protection, helpful? If not, explain how we could improve the guidance.<br>B2Q6 Is the information in Table 2 of draft updated RG 217, about evidentiary material we will take into account when assessing whether a director can establish safe harbour protection, helpful? If not, explain how it could be improved.<br>B2Q7 Is further guidance required? If so, what further guidance should we provide?<br>B2Q8 Should ASIC take further steps to raise awareness of the insolvent trading and safe harbour provisions? If so, explain how we could raise awareness of the provisions, particularly for directors of small-to-medium sized enterprises. |