



7 August 2015

Ms Toni Matulick  
Committee Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
Parliament House  
CANBERRA ACT 2600

By email: [corporations.joint@aph.gov.au](mailto:corporations.joint@aph.gov.au)

Dear Ms Matulick

**Parliamentary Joint Committee Inquiry into the Impairment of Customer Loans**

Thank you for offering the Australian Restructuring Insolvency & Turnaround Association (ARITA) the opportunity to make a submission to this Inquiry.

We note from the terms of reference that the Inquiry is mainly focused on the conduct of lenders. To the extent that ARITA can comment on those issues we do so.

However, from our perspective as experts in insolvency and restructuring, we find it difficult to understand the motivation of any lender to unnecessarily devalue the property of a customer, or, in the absence of monetary default, to place any loan into distress.

These actions seem counterintuitive, as they would not be financially beneficial for lenders. We further suggest that we see little, if any, evidence of these practices actually occurring.

The law imposes high standards in relation to the sale of property by receivers under section 420A of the *Corporations Act 2001*. We are not aware of any real concerns about the operation of that section, although it has been raised by the Productivity Commission in its current Inquiry.

In court challenges by borrowers under section 420A, the courts have generally upheld the conduct of the receiver. Complaints to ARITA about receiver sales are generally dismissed on the basis the established process to ensure market value is obtained was followed.



We also explain that there is a trend away from formal insolvencies under the *Corporations Act*, including receiverships. The numbers of corporate (and personal) insolvencies have been falling for some time. Greater emphasis is being given to attempts to restructure troubled businesses at an earlier and more productive stage.

ASIC's Australian Insolvency Statistics Series 1 released July 2015 shows that the number of receiver and receiver and manager appointments has fallen over 35 percent from the 2010-11 financial year (915 in 2010-11, 850 in 2011-12, 739 in 2012-13 and 591 in 2013-14).

If more information can be provided on the issues raised in the terms of reference, for example in submissions that are made, we would be pleased to comment further. We're also happy to appear before the Committee, with subject matter experts, to answer any questions the Committee may have.

Yours sincerely

**John Winter**  
Chief Executive Officer



## About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents practitioners and other associated professionals who specialise in the fields of insolvency, restructuring and turnaround.

We have more than 2,000 members including accountants, lawyers, lenders, credit managers, academics and other professionals with an interest in insolvency and restructuring.

Some 76 percent of registered liquidators and 86 percent of registered trustees are ARITA members.

ARITA's mission is to support insolvency and recovery professionals in their quest to restore the economic value of underperforming businesses and to assist financially challenged individuals.

We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large.

The Association promotes best practice and provides a forum for debate on key issues facing the profession. We also engage in thought leadership and advocacy underpinned by our members' knowledge and experience.

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# 1 Terms of reference

We address each of the terms of reference in turn.

## 1.1 Paragraphs (a) and (c)

**ARITA is not aware of any practices as described in paragraphs (a) and (c) of the terms of reference.**

The scenario described seems counterintuitive in that it would not be financially beneficial for lenders to adopt such practices. As valuations are based on point-in-time assessments, it should be noted that any revaluation may be based on prevailing depressed market conditions that may be temporary or later improve.

ARITA is also not aware of any use of “punitive” suspension or off-set clauses. We note the transcript of the ASIC response of 4 June 2013 to the Senate Standing Committee on Economics’ Budget Estimates hearings. We are not aware of any further information about that issue arising from that hearing.

## 1.2 Valuations (b)

Insolvency practitioners often rely on licensed valuers in relation to the sale of property. A primary duty of a practitioner is to obtain the best return for creditors. Valuation of property is a matter of expertise. Reliance on licensed valuers is needed particularly in relation to sales conducted for lenders by receivers under the strict legal obligations imposed under section 420A of the *Corporations Act 2001* (the Act). That section refers to the need to obtain “market value”.

The power of a receiver to appoint a valuer is contained in the Act, i.e. to appoint a “professionally qualified person to assist” the receiver.

Again, we’re not aware of any improper role of property valuers in “constructive default” as the terms of reference describe. Of course, there is often legitimate dispute as to valuation evidence. Valuations are often the subject of rigorous assessment in court proceedings.

The courts have processes to obtain the best evidence from experts when there is a difference in view. The circumstances of the valuation being sought are often relevant, including as to timing and the nature of the asset.

A deteriorating or perishable asset may need prompt valuation and decision on sale. A fixed asset may be retained and not sold until market conditions improve. This will however depend on the maintenance and other costs of holding on to the asset. In depressed market conditions (such as a drought where the asset is involved in agriculture) it’s usually not in a lender’s best interest to sell, despite the fact that, from an economic viewpoint, it may put the property in the hands of someone better able to use it more profitably.

As to comparisons between valuations and sale price, a receiver would ordinarily obtain a valuation based both upon a “normal course of sale” and “forced sale” value. Nevertheless, the requirement under section 420A for reasonable care to be taken to obtain market value under a forced sale sets a high standard for receivers.

ARITA notes that disputes sometimes arise when borrowers have an inflated opinion of the value of their asset compared to a realistic current market valuation. It is important to note that a current market valuation is based on what an independent, informed purchaser would pay; it is not based on past value or what amount may have been invested in the asset. Also, the value of an asset may have been reduced by the activity that led to the asset becoming distressed.

### 1.3 The role of insolvency practitioners (d)

We consider that, generally, the profession properly attends to its requirements under the law and the ARITA Code of Professional Practice in this area. The statutory and professional conduct requirements impose on practitioners a duty to maximise the value of returns to creditors in any type of administration. In the context of receiver sales, section 420A imposes a particular responsibility on an appointee to realise property in terms of the requirements of that section.

By way of background, the history of the section is that the duty of receivers under Australian case law was based in negligence only. The 1988 Harmer Report considered that this was not adequate and that there should be a specific obligation imposed to secure the best price in the circumstances of the sale. Thus section 420A was introduced.

The purpose behind the introduction of section 420A was stated in the Explanatory Memorandum to the relevant Bill:

“It is sometimes said of receivers that they are prepared to sell property at a price less than the best obtainable, so long as it is sufficient to cover the debt of the chargeholder who appointed them. Proposed s 420A makes it clear, that in selling company property, a controller must take all reasonable care to sell the property for the best price that is reasonably obtainable having regard to the circumstances existing when the property is sold.”

That law has now been in operation for over 20 years. We are not aware of any issues about the high standard it imposes. It is a section that has been the subject of a number of decisions from the courts in relation to the process of obtaining market value. Many of these cases raise complex and difficult issues. However as a general statement, the history of court decisions has supported the receiver in relation to their compliance with the section. In other words, challenges to section 420A sale are generally unsuccessful.

A receiver is also subject to other controls and responsibilities under Part 5.2 and elsewhere in the Act. They are officers of the company and are therefore subject to the significant duties of care and diligence, good faith, and other duties under s 180-184 of the Act.

They assume liability for debts incurred in trading on, they must lodge regular accounts with ASIC and must also report any misconduct or breaches of the law. They can also require company officers to report to them on the operations of the business. Their remuneration is subject to oversight by ASIC and the court. Section 423 of the Act permits a court to inquire into any misconduct of a controller/receiver and order payment of damages.

## 1.4 Financial System Inquiry Report (e)

The terms of reference at (e) refer to the relevant recommendations of the Financial System Inquiry (FSI) Report, particularly recommendations 34 and 36 relating to non-monetary conditions of default and the external administration regime respectively.

Recommendation 34 expresses support for the government's action in extending unfair contract term protections to small businesses, and to encourage industry to develop standards on the use of non-monetary default covenants. We have no particular comment on this except to note that it appears to have only limited application to the sale of property.

Recommendation 36 is that the government consult further on possible amendments to the external administration regime in order to provide additional flexibility for businesses in financial difficulty.

The recommendation notes that submissions indicated that Australia's external administration provisions are generally working well and do not require wholesale revision. In particular, it says that submissions "*present little evidence to suggest the Australian regime causes otherwise viable businesses to fail*". It goes on to address other issues concerning directors.

We advise that following that FSI Report, Treasury called for submissions on the operation of the insolvency regime and other issues in the Report. ARITA lodged its submission by the due date of 31 March 2015. We raised no issue about the operation of section 420A. The government has yet to respond to the FSI Report and to those further submissions.

At the same time, the Productivity Commission was referred an Inquiry into Business Set-up, Transfer and Closure. We made a submission to the Commission in February 2015. The draft report, issued in May 2015, adopted many of the recommendations for reform proposed by ARITA.

The Commission made a draft recommendation about potential changes to the sale of asset requirements in receiverships. ARITA's submission on the draft report raised practical implementation issues with the draft recommendation. The Commission is due to report to Government by August 2015.

## 1.5 Opportunity to rectify default (f)

Term of reference (f) refers to the "extent to which borrowers are given an opportunity to rectify any genuine default event and the time period typically provided for them to do so. ARITA submits that this is a matter to which lenders are better positioned to respond.

**The view of our members is that most often lenders tend to attempt to resolve impaired assets outside of a formal insolvency appointment.**

Even if a receiver is appointed, it's not unusual for the receiver to continue to trade on an underperforming enterprise for an extended period, with a view to maximising its value, rather than implementing an immediate sale process.

The power to do that exists under section 420C. A role of receivers is often to take over a business, with existing management (where appropriate) and employees, in order to review and improve the operations of the business. It may be that the business is sound but began to fail because of poor management decisions. The experience of a receiver can in fact restore the viability of a business.

However, there is also the view that if a lender grants a poor business extended concessions for extraneous reasons, other borrowers whose loans are properly managed might rightly express dissatisfaction. In economic terms, the prolonging of a poor business without real prospects of rehabilitation results in unfair competition with other businesses, and the delayed release of the capital of that business for more productive use in the economy.

## 1.6 Timing of notice (g)

The timing of any notice by lenders to exercise their power to appoint a receiver is one addressed by court decisions over the years and is reasonably settled based on a reasonable period of time being given.

## 1.7 Loan to value ratio (h)

ARITA has no direct view on the appropriateness of the loan to value ratio (LVR) set by lenders as a mechanism to cause a loan to default. In any event, as we have said, our members' experience is that there is little evidence of LVR revaluations for the purpose of creating a default, certainly in the primary debt market.

## 1.8 The pre-conditions and requirements for appointment of a receiver (i)

The conditions and requirements to be met prior to the appointment of an external administrator are set in the loan document and invariably are activated only on significant default by the borrower.

Nevertheless the default conditions set are a matter of agreement between the lender and the borrower. A right to challenge the appointment of a receiver exists under section 418A.

# 2 Insolvencies in decline, including receiverships





We wish to point out that formal insolvency appointments are declining in number, across all types of administrations. This extends to personal bankruptcies.

We see this as a trend towards restructuring a business outside the formal insolvency regime. Our members are increasingly working to this end, often on the instructions of lenders. The lenders themselves are adopting this approach. It is seen as a trend internationally based partly on low interest rates and existing economic conditions.

**Our experience is that the number of “forced” sales by receivers is very low.**

### 3 The legal regime

As we have explained, there is a settled regime under Part 5.2. We are not aware of any real concern about how this operates. The Productivity Commission draft report does suggest a revised provision. Many submissions in response considered that the Commission’s ideas were not practical.

The concept of market value in section 420A has been mirrored in some state and territory laws in relation to the sale of property of individuals.

For example, s 111A of the NSW *Conveyancing Act 1919* provides that in exercising a power of sale over land, the mortgagee “must take reasonable care to ensure that the land is sold for: (a) if the land has an ascertainable market value when it is sold not less than its market value, or (b) in any other case-the [sic] best price that may reasonably be obtained in the circumstances.”

### 4 Other relevant inquiries

ARITA has made submissions on section 420A and other related issues to other inquiries.

We have mentioned the FSI Report and the Productivity Commission.

The Senate Economic References Committee Inquiry into failed forestry managed investment schemes (MIS) involves sales by receivers of failed schemes. It is due to report on 17 September 2015. We understand an issue arises in that Inquiry as to farmers and other agricultural producers who have been left with the uncertainty of timber plantations linked to forestry MIS on their land.

CAMAC’s report of 2012 and its 2014 discussion paper on MIS raise the need for a broad review of that area of law.

### 5 Conclusion

**ARITA is of the view that the pretext of this Inquiry is not borne out by the reality of what ordinarily occurs in the market.**



The claim that there is value in causing assets to be deliberately distressed is counterintuitive and doesn't fit with the evidence we see in the market. As the professional body for restructuring, insolvency and turnaround practitioners, all evidence that we see indicates lenders are probably over-cautious in moving to take charge over assets, being deeply mindful of community reactions, their reputations and license to operate.

It may even be considered that due to this caution assets are left too long before they are sold. Ironically, their value may be reduced as a result. In almost all cases we are aware of, enforcement action over assets is only taken once a borrower has failed to service their loan for some period of time.

The inference that there is collaboration between lenders and insolvency practitioners to "manufacture" outcomes whereby insolvency practitioners do not meet their statutory obligations under the Act to maximise returns, we reject out of hand as being completely unsubstantiated.

If in the course of this Inquiry submissions are made that indicate concern about practitioners we would like the opportunity to consider those and respond further.