



**ASIC**

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Australian Securities & Investments Commission

# **PJC inquiry into the impairment of customer loans: ASIC submission**

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## Executive summary

- 1 The Australian Securities and Investments Commission (ASIC) welcomes the opportunity to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services (PJC) Inquiry into the impairment of customer loans.
- 2 ASIC's role (relevant to the issues raised by terms of reference of this inquiry) is in:
  - (a) administering the broader regulatory framework for insolvency practitioners, including receivers, under the *Corporations Act 2001* (Corporations Act); and
  - (b) to the extent that it applies, the regulatory framework for lenders under the *Australian Securities and Investments Commission Act 2001* (ASIC Act) and the *National Consumer Credit Protection Act 2009* (National Credit Act)—noting that the National Credit Act does not apply to loans for business purposes.
- 3 While ASIC is not able to respond to all of the inquiry's terms of reference, we have provided details to assist the inquiry on:
  - (a) obligations on lenders in relation to defaults on loans: Section B;
  - (b) the appointment and role of insolvency practitioners in the impairment of customer loans: Section C; and
  - (c) obligations on receivers in relation to forced sales: Section D.
- 4 Where relevant, we have also provided our views on the adequacy of these current requirements, and any scope for reform, including through relevant recommendations of:
  - (a) the Senate Economics References Committee Inquiry into the post-GFC banking sector: see Sections B–C;
  - (b) the Productivity Commission's *Business set-up, transfer and closure—Draft report*: see Sections C–D; and
  - (c) the Financial System Inquiry: see Section E.
- 5 We note that, particularly in relation to insolvency practitioners, while there may be scope for reform of the regulatory framework, it is important to proceed with a number of current reform processes that are already underway: see Section C. However, proposals of the Senate Economics References Committee Inquiry into the post-GFC banking sector relating to lender conduct could address some of the specific concerns raised by commercial borrowers that are not currently addressed by industry codes of practice or the ASIC Act's general prohibitions on unconscionable conduct: see Section B.

- 6 We have also provided details of reports of misconduct made to ASIC about lenders and receivers: see Section A. These indicate that, in general, the number of reports we received relating to commercial lending and the issues relating to the inquiry's terms of reference is small, particularly relative to the total number of reports received by ASIC about credit matters or insolvency practitioners, more broadly.
- 7 We have also provided the following appendices to this submission:
- (a) Appendix 1 to this submission also sets out further information on the regulatory framework for receivers.
  - (b) Appendix 2 is ASIC's initial submission to the Productivity Commission's *Review of barriers to business entries and exits in the Australian economy*.
  - (c) Appendix 3 is ASIC's supplementary submission to the Productivity Commission's review, following the release of its draft report *Business set-up, transfer and closure—Draft report*.
- 8 Table 1 notes which parts of the submission cover particular terms of reference for the inquiry, so far as ASIC has been able to address these terms of reference within the scope of its role and regulatory experience.

**Table 1: Terms of reference**

Area	Term of reference	Section reference
<b>TOR 1a–i: Matters to be considered</b>	1a Practices of banks and other financial institutions using a <i>constructive default</i> (security revaluation) process to impair loans, where constructive default/security revaluation means the engineering or the creation of an event of default whereby a financial institution deliberately reduces, through valuation, the value of securities held by that institution, thereby raising the loan-to-value ratio resulting in the loan being impaired	Sections A–B
	1c Practices of banks and other financial institutions in Australia using non-monetary conditions of default to impair the loans of their customers, and the use of punitive clauses such as suspension clauses and offset clauses by these institutions	Section A–B
	1d Role of insolvency practitioners as part of this process	Section C and Appendix 1
	1e Implications of relevant recommendations of the Financial System Inquiry, particularly recommendations 34 and 36 relating to non-monetary conditions of default and the external administration regime respectively	Section E
	1f Extent to which borrowers are given an opportunity to	Section B

Area	Term of reference	Section reference
	rectify any genuine default event and the time period typically provided for them to do so	
	1g Provision of reasonable written notice to a borrower when a loan is required to be repaid	Section B
	1h Conditions and requirements to be met prior to the appointment of an external administrator	Section C
<b>TOR 2a(i–ii): Evidence</b>	2a Evidence on the incidence and history of: <ul style="list-style-type: none"> <li>i loan impairments; and</li> <li>ii the forced sale of property</li> </ul>	Section A
	2c The adequacy of the legal obligations on lenders and external administrators (including s420A of the <i>Corporations Act 2001</i> ) to obtain fair market value for the forced sale of property	Section D

## A Background on ASIC's role in regulating credit and statistics relevant to TOR 2 (a) (i) and (ii)

### Key points

This section provides a brief overview of ASIC's role in regulating credit as well as details of reports of misconduct made to ASIC about lenders and receivers.

ASIC regulates the conduct of lenders and receivers (and other insolvency practitioners) under the provisions of the following laws that we administer: the *Corporations Act 2001*, *Australian Securities and Investments Commission Act 2001* and the *National Consumer Credit Protection Act 2009* including the National Credit Code.

Generally speaking, ASIC does not intervene in individual disputes in financial services and corporate regulation, and is not resourced to undertake such a role. ASIC's role is not to provide an ombudsman or mediation service for individual disputes. This includes disputes between lenders and debtors. The exception is where such action would serve a broader public interest.

The regulatory obligations for commercial lending activity are far more limited than for retail (consumer) lending.

In general, the number of reports we have received relating to commercial lending and the issues relating to the inquiry's terms of reference is small.

### ASIC's role in regulating credit

- 9 ASIC is the national regulator for consumer credit under the *National Consumer Credit Protection Act 2009* (National Credit Act). Central elements of the National Credit Act include:
- (a) a licensing regime that imposes minimum standards of conduct for credit industry participants, including requirements for competence, mandatory membership of an ASIC-approved external dispute resolution (EDR) scheme, compensation arrangements, and adequate compliance and risk management systems. The licensing regime provides mechanisms to cancel an Australian credit licence (credit licence) and ban persons from engaging in credit activities;
  - (b) responsible lending obligations, which mandate that credit licensees must make inquiries into a consumer's objectives and financial situation and verify their financial situation. Credit licensees must assess this

information and not provide or suggest credit to a consumer if that credit will not meet the consumer's objectives or the consumer will not be able to meet their financial obligations without substantial hardship; and

- (c) lender disclosure and conduct obligations under the National Credit Code. Lender obligations under the National Credit Code include specific requirements for pre-contractual disclosures, interest charges, mortgages, and enforcement action.

Note: The National Credit Code constitutes Sch 1 of the National Credit Act, and largely replicates the Uniform Consumer Credit Code administered by the states from 1996 until July 2010 when primary jurisdiction for consumer credit was transferred to the Commonwealth.

- 10 ASIC also administers the *Australian Securities and Investments Commission Act 2001* (ASIC Act), which contains prohibitions on unconscionable conduct and false or misleading representations in relation to financial services, including credit. These ASIC Act provisions are not limited to consumer credit, and extend to credit for business and commercial purposes.
- 11 ASIC received 8,603 reports of misconduct about credit matters over the last 5 years. Less than 1% of these relate to the matters covered by this inquiry: see Table 2.
- 12 ASIC has undertaken extensive work in the regulation of consumer credit, especially since taking over national responsibility from the States in 2010. This has been described in more detail in other ASIC submissions, including the *Submission by ASIC on reforms to the credit industry and 'low doc' loans* to the Senate Economic References Committee Inquiry into the performance of ASIC.
- 13 ASIC's work in this area includes guidance for industry, consumer education, and a considerable body of enforcement work in areas including:
  - (a) home loans (see Media Release (15-220MR) *Lenders to improve standards following interest-only loan review* and Media Release (15-125MR) *ASIC concerns prompt Bank of Queensland to improve lending practices*);
  - (b) loan fraud (see Media Release (15-176MR) *Sydney man sentenced on charges relating to \$7 million home loan fraud* and Media Release (15-137MR) *Former Westpac Bank Finance Manager faces charges over \$2.5 million fraud*);
  - (c) credit cards (see Media Release (14-149MR) *GE Capital Finance Australia hit with \$1.5 million penalty over false or misleading representations* and Media Release (12-79MR) *Westpac withdraws unsolicited credit card limit increase invitation in response to ASICs concerns*);

- (d) payday lending (see Media Release (15-168MR) *Money3 provides over \$100,000 in refunds to consumers as ASIC's payday lending crackdown continues* and Media Release (15-056MR) *ASIC puts payday lending industry on notice to lift standards*);
- (e) consumer leases (see Media Release (15-181MR) *New 'Rent vs Buy' calculator for consumers on ASIC's MoneySmart website* and Media Release (15-141MR) *ASIC accepts EU from Amazing Rentals*); and
- (f) motor vehicle finance (see Media Release (15-189MR) *ASIC permanently bans Perth finance brokers* and Media Release (15-037MR) *BMW Finance pays \$306,000 penalty for poor repossession practices*).

## ASIC's role: assessing reports of alleged misconduct about lenders and receivers

- 14 While ASIC does not have specific data on rates of loan impairments and forced sales in Australia, to assist the inquiry, this section outlines data on reports of alleged misconduct made to ASIC about:
  - (a) banks' commercial lending practices; and
  - (b) receivers.
- 15 ASIC regulates the conduct of lenders and receivers (and other insolvency practitioners) under the provisions of the laws we administer, including the *Corporations Act 2001* (Corporations Act), ASIC Act and the National Credit Act including the National Credit Code.
- 16 To help us perform our regulatory role and ensure compliance with these obligations, we greatly value receiving reports of alleged misconduct from members of the public about their experiences as clients of lenders or their interactions with external administrators such as receivers. These reports provide ASIC with valuable intelligence information and help us to understand concerns affecting businesses and consumers in the market.
- 17 Disputes between lenders and debtors, including the actions of any receiver that a lender may have appointed, do not necessarily suggest that the lender or receiver has breached a regulatory obligation enforced by ASIC. This is more so the case in relation to commercial lending and borrowing, where ASIC has a limited jurisdiction compared with consumer credit. In addition, the focus of ASIC's regulatory action must be the public interest. Given limitations to our resources and other factors, ASIC's role does not extend to taking actions against lenders or receivers on behalf of individuals or businesses in relation to their private disputes.



- 18 We assess all reports of misconduct we receive to determine if the concerns raised suggest breaches of the laws we administer, and whether we have sufficient grounds to take further action to address any alleged breaches. We have released ASIC Information Sheet 153 *How ASIC deals with reports of misconduct* (INFO 153) to provide the public with information about our assessment process.
- 19 ASIC does not and cannot investigate every alleged breach of the law brought to our attention, and we exercise our discretion when to take further action in response to alleged breaches. We have released ASIC Information Sheet 151 *ASIC's approach to enforcement* (INFO 151) to explain to the public the factors we take into account when we select matters for investigation and enforcement action.
- 20 As with other industries that ASIC regulates, even where we decide not to take regulatory action in response to reports of misconduct, all such reports are recorded on our confidential intelligence database, and this information is available to assist ASIC's specialist teams in their surveillances of particular lenders or external administrators. We also endeavour to provide guidance and direct the public to other support services that are available to address their concerns.
- 21 Whether or not ASIC determines to take regulatory action in response to concerns raised in reports of misconduct, people retain their rights to pursue their concerns privately, and we encourage them to do so.
- 22 A detailed explanation of our assessment process is contained in Chapter E of ASIC's main submission to the Senate Economics Committee Inquiry into the performance of ASIC.

## **Reports of alleged misconduct about banks' commercial lending practices**

- 23 For commercial lending activity, ASIC's role is limited to administering the consumer protection provisions in the ASIC Act, including the prohibition on false or misleading representations and unconscionable conduct.
- 24 In making a finding of unconscionability, Courts have generally concluded that some moral fault or responsibility or lack of ethics was involved. This requires a consideration of legal, commercial and social norms. As such norms include that parties to a transaction act in good faith, including the faithful performance of promises freely made, a finding of unconscionability is not made lightly where a party has adhered to a contracted bargain.
- 25 ASIC's website and our MoneySmart website contains detailed information about our regulatory jurisdiction for credit. This public information focuses

on consumer credit, given our regulatory responsibilities, with some information about the exclusions for commercial lending. We are currently reviewing the information we provide to the public to explain our limited jurisdiction for commercial credit matters, with the aim of further developing public information in relation to the regulation of commercial credit.

- 26 We note that, under their terms of reference, EDR schemes can hear disputes for claims up to \$500,000, although the maximum amount the schemes can award is \$309,000. However the schemes will not consider commercial disputes between lenders and small business consumers where legal proceedings have been commenced for loans over \$2 million: see Section B for more details.

### **Complaints data**

- 27 We have set out below details of reports of alleged misconduct for matters we have received from debtors about banks that raise the issues stated in the inquiry's terms of reference, such as for allegations that a bank had engineered a loan default through revaluation of secured property.
- 28 ASIC's records indicate that in the five years from 1 July 2010 we have received 61 reports of alleged misconduct from people raising concerns about banks' treatment of commercial loans that relate to the issues raised in the inquiry's terms of reference. There were also five matters raising similar concerns about five different non-bank financial institutions. Generally these 66 reports of alleged misconduct came from the director of the company that borrowed the funds.
- 29 Over the same period, ASIC received 8,603 reports of alleged misconduct regarding credit and 60,031 reports of alleged misconduct relating to all areas of ASIC's regulatory responsibilities. Accordingly, the number of reports we received relating to commercial lending and the issues stated in the inquiry's terms of reference is small relative both to reports overall and reports about credit matters (less than 1%).
- 30 Table 2 compares the number of reports of alleged misconduct by banks' treatment of commercial loans, as well as the total number of reports of alleged misconduct we received in those years.

**Table 2: Total number of reports of alleged misconduct about banks' treatment of commercial loans with allegations of engineered default**

Bank	2010–11	2011–12	2012–13	2013–14	2014–15	Total
Total reports of misconduct: banks' treatment of commercial loans	7	5	28	11	10	61
Total reports of misconduct: non-bank financial institutions	1	1	1	1	1	5
Total reports of misconduct: bank and non-bank treatment of commercial loans	8	6	29	12	11	66
Total reports of alleged misconduct received by ASIC: credit matters	2,522	1,795	1,739	1,279	1,268	8,603
Total reports of alleged misconduct received by ASIC	15,634	12,516	11,682	10,530	9,669	60,031

Source: ASIC's Complaints Management System database; ASIC Annual Reports.

### ASIC's consideration of these reports of misconduct

- 31 ASIC conducted initial inquiries into each of these reports of alleged misconduct and prepared an assessment of the concerns raised about the relevant lender's conduct. This included using our compulsory information gathering powers to obtain information where relevant. Our specialist Deposit Takers, Credit and Insurers stakeholder team conducted further inquiries into two of these matters.
- 32 ASIC's inquiries into these 66 reports of misconduct identified features that were common to a number of the matters. We observed that there were disputed questions of fact about the lender's conduct in these matters, such as with respect to the timing of repayments by the borrower and the bank's decisions on when a borrower entered default, compared with when and whether the borrower considered they may have defaulted.
- 33 ASIC's inquiries into these reports of misconduct identified other features that were common to a number of the matters, including the following:
- (a) The relevant loans were commercial loans or commercial bill facilities, and not covered by the consumer protections in the National Credit Act or the National Credit Code (or the Uniform Consumer Credit Code for loans entered before 1 July 2010).

- (b) Half of these matters related to defaults occurring in the 2009–10 or 2010–11 financial years.
- (c) The debtors were using the loan for commercial activities, such as farming, property development, or operating hotels and licensed premises.
- (d) The debtors were likely to have received advice about the loan terms, or alternatively were expected to have sought advice and elected not to.
- (e) Some of the circumstances surrounding the dispute included:
  - (i) The debtors' financial circumstances had changed, they were experiencing financial difficulty, or the value of the security interest for the loan had changed, to result in the debtors defaulting on their obligations under the loan.
  - (ii) Changes to the value of security interests often resulted in debtors breaching the loan-to-value ratio covenants in the security instruments and triggering default and receiver appointment.
  - (iii) Alternatively, banks had determined not to roll-over commercial bill facilities at their discretion, advising the debtor long before the facility was to end.
- (f) Concerns that the banks had imposed unfair terms or used their strong bargaining position to disadvantage debtors could not be made out on the evidence presented, taking into account the commercial relationships between the parties. It appeared that the lenders were enforcing their contractual rights under the loan agreements.
- (g) The lenders had generally expressed a willingness to negotiate amended repayment arrangements for the loans once the debtors entered financial difficulty or default, and had provided commercial terms for repayment once the debtors had entered default. Debtors generally sought more generous amended repayment terms, and were dissatisfied with or could not meet the lenders' proposed amended terms.
- (h) The lenders had pursued recovery of the loans through courts, and had received court orders enforcing the terms of the loan contract and to recover on the loan.
- (i) Some of the debtors had brought private action against the lenders or sought to defend the lenders' recovery proceedings against them on various grounds, and the courts had not found in the debtors' favour or the parties settled the proceedings confirming repayment obligations.

34 ASIC ultimately determined not to pursue further regulatory action or enforcement proceedings against a lender in relation to these matters. Generally, this was because ASIC's inquiries did not reveal sufficient evidence of misconduct on which to base an enforcement action against

the relevant lender, and we concluded that we did not have sufficient grounds to take further action.

- 35 We consider that, to have intervened in matters where our limited jurisdiction for commercial lending may have been invoked would have resulted in ASIC effectively acting on behalf of the borrower in a private, commercial dispute, without sufficiently advancing some broader public interest.

## Reports of alleged misconduct about receivers

- 36 ASIC receives and assesses reports of misconduct about receivers. ASIC can consider the conduct of receivers appointed under a security instrument by a secured lender, including their conduct in relation to the sale of any secured asset. However, ASIC (and the courts) generally do not intervene in a receiver's commercial decision-making under their appointment.

### Complaints data

- 37 We have set out below details of reports of alleged misconduct about receivers that raise the issues stated in the inquiry's terms of reference, namely for allegations of misconduct about the sale of secured property such as alleged breaches of s420A of the Corporations Act.
- 38 Our search identifies that in the five years from 1 July 2010 we have received 45 reports of alleged misconduct from borrowers raising concerns about receivers in relation to the receivers' appointments by banks or non-bank financial institutions over charged property.
- 39 Over the same period, ASIC received 2,219 reports of alleged misconduct about insolvency practitioners and 60,031 reports of alleged misconduct relating to all areas of ASIC's regulatory responsibilities. Accordingly, the number of reports we received relating to receivers' conduct and the issues stated in the inquiry's terms of reference is small relative both to reports overall and reports about insolvency practitioners: see Table 3.

**Table 3: Total number of reports of alleged misconduct about banks' treatment of commercial loans with allegations against the appointed receiver**

Bank	2010–11	2011–12	2012–13	2013–14	2014–15	Total
Total relevant reports of misconduct: bank lending	5	4	18	6	7	40
Total relevant reports of misconduct: non-bank financial institution lending	1	1	1	1	1	5
Total bank and non-bank financial institution	6	5	19	7	8	45
Total reports of alleged misconduct: insolvency practitioners	461	510	460	418	370	2,219
Total reports of alleged misconduct received by ASIC	15,634	12,516	11,682	10,530	9,669	60,031

Source: ASIC's Complaints Management System database, ASIC Annual Reports.

### ASIC's consideration of these reports of misconduct

- 40 ASIC's preliminary inquiries and assessment for these matters included consideration of the concerns raised about the relevant receiver with respect to their obligations under s420A of the Corporations Act and as registered liquidators more generally.
- 41 ASIC's inquiries into these matters identified common features in the reports of misconduct. Generally, these matters included the following features:
- Concerns with the validity and timing of the receiver's appointment, such as disputes about the timing of the borrower's default.
  - Concerns about the receiver's fees, which are generally provided for in the security document with unsecured creditors having no role in setting or approving the receiver's fees.
  - Concerns about receivers not providing updates to borrowers. However, receivers are not obliged to report to unsecured creditors or third parties, apart from obligations to the secured creditor and reporting requirements to ASIC.
  - Secured properties were sold through open processes, such as by invitation, tender, or auction, following public and targeted marketing campaigns.

- (e) Receivers took advice from independent, third party, real estate firms and property valuers regarding the sale process and sale price of the property. Some matters included allegations that property valuers were conflicted, though further inquiry by ASIC did not indicate any corresponding misconduct by the receiver with respect to this allegation.
- (f) Decisions on the sale process were generally taken by the receivers in consultation with the secured creditors.
- (g) Concerns that the receivers sold the secured property for less than market value, or sold the property to a third party who then on-sold the property for a higher value.
- (h) Certain debtors alleged that the receivers would not accept offers for the secured property from parties connected with the debtor, which they believe resulted in the receiver accepting lower offers from unrelated third parties.

42 ASIC's specialist Insolvency Practitioners stakeholder team conducted further inquiries into five of these matters about the concerns raised about the receiver.

43 ASIC ultimately determined not to pursue further regulatory action against a receiver identified in these matters. Generally, this was because ASIC's inquiries did not reveal sufficient grounds to pursue a receiver for a breach of their statutory duties or to consider further disciplinary action against them in the Companies, Auditors and Liquidators Disciplinary Board (CALDB).

44 ASIC did not identify systemic concerns about any particular receiver in these matters, and ASIC's assessment and inquiries could not substantiate breaches of s420A which warranted further regulatory action.

## **B TOR 1(f)–1(g): Obligations on lenders: Defaults on loans**

### **Key points**

The specific circumstances that may give rise to a default on a loan and the effect of such a default will generally depend on the particular terms of the loan contract. This includes any steps to be taken by the lender to enforce the loan and the borrower's opportunity to rectify the default.

In seeking to enforce loans, lenders are subject to a prohibition on engaging in unconscionable conduct.

Where they are regulated under consumer credit legislation, lenders seeking to enforce loans must also meet certain other requirements, including that:

- at least 30 days be given to the debtor to rectify a default; and
- a lender cannot commence enforcement action until it has dealt with any hardship application made by the debtor.

For such consumer loans, the National Credit Code also generally requires lenders to provide debtors with a written default notice containing prescribed particulars.

- 45 The specific circumstances that may give rise to a default on a loan and the effect of such a default will generally depend on the particular terms of the loan contract. This includes any steps to be taken by the lender to enforce the loan and the borrower's opportunity to rectify the default.
- 46 Lenders are also subject to:
- (a) a prohibition on unconscionable conduct (see paragraphs 47–48); and
  - (b) where loans are regulated under consumer credit legislation, additional requirements including complying with hardship provisions: see paragraphs 49–54).

### **Prohibition on unconscionable conduct**

- 47 Section 12CB of the ASIC Act prohibits unconscionable conduct in relation to credit facilities, including commercial loans. This can apply to conduct in relation to the initial provision of credit as well as the collection of a debt owing under a contract, including enforcement action.
- 48 Whether particular conduct is unconscionable turns on the specific facts of the case. Establishing unconscionable conduct across a number of loan



transactions can be more difficult than establishing unconscionable conduct in an individual transaction. In addition, the courts impose a high bar when a party is seeking to establish unconscionable conduct in relation to a commercial loan, as performance of contracted promises freely and fairly made is central to commerce.

## **Additional requirements for loans provided to consumers**

- 49 In Australia, consumer credit is regulated and subject to additional protections under the National Credit Act and National Credit Code.
- 50 The National Credit Act applies only to credit that is:
- (a) provided to a natural person or strata corporation (i.e. a consumer);
  - (b) provided wholly or predominantly for:
    - (i) personal, household or domestic purposes; or
    - (ii) residential property investment;
  - (c) charged for, or may be charged for, by the lender; and
  - (d) provided in the course of carrying on a business of providing credit in this jurisdiction (i.e. Australia) or as part of, or incidental to, any other business of the lender carried on in this jurisdiction.
- 51 Therefore, the protections of the National Credit Act, including those described below in relation to the enforcement of loans, only apply to consumer loans, and not, for example:
- (a) loans provided for a commercial purpose; and
  - (b) loans provided to small businesses.
- 52 Prior to 1 July 2010, consumer credit was primarily regulated by the states and territories under the Uniform Consumer Credit Code (UCCC). The National Credit Code forms Sch 1 to the National Credit Act and largely replicates the provisions of the UCCC, which commenced operation in 1996. The National Credit Code imposes a number of specific obligations on credit providers, including:
- (a) pre-contractual disclosure of various matters, including credit fees, charges, annual percentage rates and default rates;
  - (b) limitations on interest charges, including the circumstances in which default interest applies;
  - (c) restrictions on mortgages securing obligations under credit contracts;
  - (d) notification requirements in relation to changes to credit contracts; and

- (e) actions to be taken prior to enforcing a credit contract or mortgage, including the provision of default notices allowing debtors at least 30 days to remedy the default.
- 53 The National Credit Code also provides debtors mechanisms to seek changes to credit contracts on the grounds of hardship and for the courts, on the application of a debtor, mortgagor or guarantor, to reopen unjust transactions or to annul or reduce unconscionable interest or other charges.
- 54 With the commencement of the National Credit Act in 2010, ASIC became the primary regulator of consumer credit. The National Credit Act also:
- (a) extended the regulation of consumer credit to also include credit for residential property investment;
  - (b) established licensing requirements for lenders and finance brokers, including conduct obligations, competency standards and mandatory membership of an ASIC-approved EDR scheme; and
  - (c) introduced responsible lending obligations to ensure that consumers only obtain credit that meets their objectives and that they are able to repay without substantial hardship.

### **Credit reforms and commercial lending**

- 55 In December 2012, the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 was released for public consultation. Among other items, the Bill proposed amendments to the National Credit Act to extend regulation to small business lending, with a focus on disclosure of fees by finance brokers and responsible lending provisions focused on equity stripping (i.e. the practice of lending to small business borrowers seeking to refinance another loan on which they had defaulted on repayments and where the new loan is to be secured by a mortgage over residential property).
- 56 In February 2013, the Government announced that it had decided that any reforms to small business finance would be deferred as consultation had indicated a need to further examine a number of key issues, including whether the benefits could be delivered in a more targeted and effective way, through the development of a different model from that in the Phase 2 Bill. Further reforms have not been proposed. ASIC's understanding is that some small business representatives were concerned that the proposed amendments may restrict lending in this sector.

## **Requirements for lenders seeking to enforce consumer loans**

- 57 As described in paragraph 52, for consumer loans regulated under the National Credit Act, the National Credit Code prescribes specific requirements for lenders seeking to enforce loans.

## **Default notices**

- 58 Under the National Credit Code, a lender must provide a defaulting debtor or mortgagor with a default notice allowing at least 30 days to remedy the default before commencing enforcement proceedings, unless the Code specifically provides otherwise.
- 59 A default notice is not required where:
- (a) the lender reasonably believes that it was induced by fraud on the part of the debtor or mortgagor to enter into the credit contract or mortgage; or
  - (b) the lender has made reasonable attempts to locate the debtor or mortgagor without success; or
  - (c) the court authorises the lender to begin the enforcement proceedings; or
  - (d) the lender reasonably believes that the debtor or mortgagor has removed or disposed of mortgaged goods under a mortgage related to the credit contract or under the mortgage concerned, or intends to remove or dispose of mortgaged goods, without the lender's permission or that urgent action is necessary to protect the mortgaged property.
- 60 The default notice must contain a prominent heading stating that it is a default notice and specify a number of matters, including:
- (a) the default;
  - (b) the action necessary to remedy the default;
  - (c) a period for remedying the default;
  - (d) the date after which enforcement proceedings may begin if the default is not remedied;
  - (e) that repossession and sale of mortgaged property may not extinguish the debtor's liability;
  - (f) information about the debtor's right to give a hardship notice, give a postponement request or make an application to the court for the same; and
  - (g) information about the lender's EDR scheme.

- 61 However, if a credit provider reasonably believes that a default is not capable of being remedied the default notice need only specify the default and enforcement proceedings can be commenced 30 days from the notice.
- 62 If the debtor, mortgagor or guarantor remedies the default within the period specified in the notice, the contract or mortgage is reinstated and any acceleration clause cannot operate. However, to be properly remedied, the default has to remain remedied at the end of the period and there must not be any other breach of the same type which is not remedied at the end of the period.

### **Hardship provisions**

- 63 Under the National Credit Code, if a debtor has given the lender a hardship notice, a lender cannot commence enforcement proceedings against the debtor until 14 days after the lender has given notice to the debtor that it does not agree to change the contract in response to the hardship notice. However, the lender can commence enforcement prior to this if the borrower has given another hardship notice in the previous four months which is not materially different.
- 64 A lender may agree to change the terms of the credit contract in response to the hardship notice by reducing the repayments, extending the period of the contract or postponing the due date, or any combination of changes.
- 65 The lender need not agree to change the credit contract as a result of a hardship notice. This is especially true if the lender does not believe there is a reasonable cause (such as illness or unemployment) for the debtor's inability to meet their obligations or the lender reasonably believes the debtor would not be able to meet their obligations under the contract even if it were changed.
- 66 If the lender decides not to change the credit contract, the debtor may take the matter to an EDR scheme. This has become a significant source of disputes for EDR schemes.

## **Previously proposed reforms for commercial lending**

### **Requirements for lenders seeking to enforce loans**

- 67 Matters relating to commercial loan defaults were previously considered in 2012 by the Senate Economics References Committee Inquiry into the post-GFC banking sector.
- 68 The inquiry's report (released in November 2012) noted that in order to encourage entrepreneurial activity and allow sufficient flexibility for

contracting parties, it did not propose government intervention in relation to commercial lending practices.

69 Instead, it recommended that industry address small business lending concerns through development of a code of conduct for small business lending by the Australian Bankers' Association (ABA). The inquiry noted that a failure by industry to appropriately address small business lending concerns would strengthen the case for more prescriptive government regulation.

70 The Inquiry into the post-GFC banking sector also made a number of recommendations for improving banking practices relating to the enforcement of security interests and the conduct of receivers when exercising the power of sale under s420A of the Corporations Act. These include recommendations that:

- (a) The voluntary code of conduct for small business lending (to be developed by the ABA) should set out, as a minimum, requirements that:
  - (i) loan documents, and any changes to facility terms, be clearly explained to the borrower;
  - (ii) valuations associated with the initial transaction be relied upon for a reasonable period of time unless a major defined adverse event occurs;
  - (iii) borrowers automatically receive copies of any valuation reports, including instructions to the valuer, they pay for or on which the secured party relies to demonstrate the borrower is in default;
  - (iv) a notice of demand served on the borrower for repayment of the secured money provide a minimum period of 14 days to the borrower to remedy default;
  - (v) the secured party (and a receiver if appointed) cooperate with reasonable requests for information to assist the borrower secure refinance;
  - (vi) prevent a secured party appointing a receiver unless the 14 day period specified in the notice of demand has expired and, if the secured party is a member of Financial Ombudsman Service (FOS), advising the borrower that they may apply to FOS to determine a dispute, if any, between the borrower and the secured lender; and
  - (vii) the secured party regularly inform the borrower about the costs and fees associated with the receivership and take reasonable care to ensure that those costs and expenses are reasonable.
- (b) The receiver demonstrate to the borrower that they have considered all unconditional offers when exercising the power of sale.

- 71 In December 2012, ASIC wrote to the ABA and asked whether the ABA would be implementing a code of conduct for small business lending or making changes to its existing Code of Banking Practice in line with the recommendations outlined above. The ABA advised ASIC that it had carefully considered the recommendations of the inquiry and concluded that the existing Code of Banking Practice provides comprehensive coverage for small businesses.
- 72 In light of this, ASIC is of the view that further consideration could be given to the recommendations of the Inquiry into the post-GFC banking sector that have not been implemented voluntarily by the banking industry.
- 73 Recommendation 9.1 of the this inquiry suggested, among other things, that banks be required to provide borrowers with notices of demand that include a minimum deadline of 14 days for repayment, and that borrowers automatically be provided with valuation reports being relied on by the bank. ASIC considers that these types of measures are not likely to have a significant impact on the cost and availability of credit to business, and are worthy of further consideration. On this point, it is worth noting that these proposed measures are different from the requirements that exist in the National Credit Act for consumer credit.
- 74 These proposed measures could address at an industry wide level some of the specific concerns raised by commercial borrowers that would not be addressed by individual legal action under the unconscionable conduct provisions.
- 75 The current inquiry could also consider whether other aspects of existing consumer lending regulation (e.g. those relating to enforcement of credit contracts under the National Credit Code) could be extended to small business lending. In considering whether the more prescriptive requirements of the National Credit Act are extended to small business lending, careful regard will need to be had to the possible impact on the cost and availability of credit to business.

### **External dispute resolution schemes**

- 76 Credit licensees must join an ASIC-approved EDR scheme such as FOS and the Credit and Investments Ombudsman (CIO) (formerly the Credit Ombudsman Service Limited), as a condition of their licence where they provide regulated services.
- 77 Because the National Credit Act does not apply to loans for business purposes, lenders that do not provide consumer credit are not required to hold an Australian credit license and are therefore not required to belong to an EDR scheme. Where a lender is a member of an EDR scheme, whether

on a voluntary basis or because they provide regulated consumer credit, the EDR scheme may consider small business disputes.

- 78 An EDR scheme's ability to consider small business disputes relating to lending is not based on any legislative requirement but is limited to the general consumer law, existing voluntary codes of industry practice and by the monetary value of the claim.
- 79 Separate inquiries have considered monetary limits at EDR schemes. The 2012 Senate Economics References Committee Inquiry into the post-GFC banking sector recommended that the terms of reference of FOS be amended so that FOS may consider disputes from small business applicants where the value of the claim is up to \$2 million, and that the cap on the maximum compensation that FOS can award be increased to \$2 million when the dispute relates to small business.
- 80 In June 2014, the Senate Economics References Committee Inquiry into the Performance of the Australian Securities and Investments Commission recommended that ASIC consider amending the terms of reference for FOS and CIO so that the caps on the maximum value of an EDR claim and the maximum amount that can be awarded are increased and indexed to the consumer price index (Recommendation 6).

Note: The jurisdictional limit—calculated by reference to the value of the consumer complaint—is not subject to indexation.

### **EDR claims and compensation caps**

- 81 Regulatory Guide 139 *Approval and oversight of external dispute resolution schemes* (RG 139) sets the jurisdictional limit of approved EDR schemes at \$500,000. This limit is aligned to the retail client definition as set out in the Corporations Act: s761G(7)(a) and regs 7.1.18–19.
- 82 Approved schemes also operate a compensation cap which is the maximum amount a scheme is able to award in compensation to a retail client. Until 2012, the compensation cap for most complaints about credit and financial services was \$280,000. RG 139 requires that the compensation cap be increased every 3 years. Therefore, on 1 January 2015, the cap increased from \$280,000 to \$309,000.
- 83 RG 139 requires that EDR scheme coverage under the Corporations Act and National Credit Act must be sufficient to deal with the vast majority of consumer complaints or disputes in the relevant industry, up to the jurisdictional limit of \$500,000. It is intended that high value and complex disputes of a more commercial character are excluded from the jurisdiction of the schemes. The level at which jurisdictional limits and compensation caps are set affects all industry participants providing financial services to

retail clients and will have particular implications for EDR scheme members who require professional indemnity insurance to meet any claims.

- 84 In 2014, FOS consulted on the adequacy of both its jurisdictional limit and compensation caps. This arose during implementation of changes recommended in the 2013 Independent Review of the scheme.
- 85 Most submissions to FOS at this time did not support increasing the jurisdictional limit or compensation caps, and so FOS did not proceed with any changes beyond the scheduled indexation of the caps due on 1 January 2015. FOS noted that there insufficient evidence to indicate that the current jurisdictional limit or the (then soon to be increased) compensation caps were inappropriately excluding retail clients from accessing EDR.



## C TOR 1(d) and 1(i): Role and appointment of insolvency practitioners in the impairment of customer loans

### Key points

This section considers the role of an insolvency practitioner in the impairment of loans, prior to and following their appointment by a secured party, as a receiver.

In ASIC's view, while there may be scope for reform of the regulatory framework for insolvency practitioners, it is important to proceed with current reform processes that are already underway.

- 86 The terms of reference of this inquiry are concerned with the role of an insolvency practitioner in circumstances where a secured party appoints a receiver to a debtor who has defaulted under a loan contract. This section considers the role of an insolvency practitioner, prior to and following their appointment by a secured party, as a receiver.

Note: For the purposes of this submission, unless the contrary intention appears, we have used the term 'receiver' to include a 'receiver and manager', 'controller' and 'managing controller'.

- 87 Appendix 1 to this submission sets out background information about the regulatory environment and ASIC activities as they relate to receivers.

## Role of insolvency practitioners in the impairment of loans

### Pre-appointment—the role of an investigating accountant

- 88 Prior to exercising its contractual rights to appoint a receiver, a secured party would ordinarily assess its security position. In the first instance, a secured party might engage the prospective receiver as an 'investigating accountant' prior to a formal appointment as external administrator. The investigating accountant would then assess the debtor's financial circumstances and the options available to the secured party. However, a person does not necessarily need to be a registered liquidator to act as an investigating accountant.
- 89 The investigating accountant's report will not usually recommend a specific course of action but provide information to enable the secured party to decide future steps.

90 An insolvency practitioner conducting such an investigation on behalf of the secured party owes a duty to the secured party to protect the interests of that party, even if the company pays for the cost of the investigation.

91 The Corporations Act (s418, 448C and 532) does not prohibit an insolvency practitioner who has acted as investigating accountant from subsequently accepting an appointment as a receiver or liquidator of the company. However, the insolvency practitioner must have regard to how their investigating accountant's report may affect their independence or the perception of their independence. If appointed, the Court may remove them if there is an actual or distinct possibility of a conflict of interest.

## **Conditions and requirements for appointment**

### **Secured parties**

92 The ability of a secured party to appoint a receiver will depend on the terms of the security instrument and whether there are any pre-conditions to appointment; for example a prescribed notice period (see paragraphs 104–107).

93 The Courts have generally upheld a secured party's ability to enforce its rights and remedies to appoint a receiver provided the secured party acts in accordance with the provisions of the contract regarding notices and other provisions of the contract.

### **Receiver**

94 A person cannot be appointed as a receiver<sup>1</sup> unless they are a registered liquidator: s418(1)(d). Section 418(1) disqualifies certain persons from acting as receivers. A person may also be restricted from accepting an appointment for other reasons; for example, the appointment might create a lack of independence. See Appendix 1 for more information on the qualifications for appointment as a receiver.

95 How a receiver comes to be appointed will depend on the terms of the security instrument. While not always obligatory it is desirable for a demand for payment to be made before the appointment takes place.

96 The appointment of a receiver is not effective until the appointer or the appointer's authorised agent delivers the document to the receiver.<sup>2</sup> The appointment commences when the receiver accepts the appointment and from that time the receiver must follow all of the requirements in the Corporations Act.

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<sup>1</sup> In this instance we mean a receiver and receiver and manager but not a controller of assets.

<sup>2</sup> *NZI Securities Australia Ltd v Poignand* (1994) 51 FCR 584.

- 97 There are a number of formalities imposed on the appointer and the receiver. The appointer must file notice of the appointment of the receiver with ASIC within 7 days (s427(1)) and the receiver must do so within 14 days: s427(2). The receiver must also serve notice of the appointment on the company as soon as practicable: s429(2)(a). The receiver is not obliged to inform creditors of the appointment.
- 98 See Appendix 1 for the conduct obligations imposed on a receiver from a number of sources including the Corporations Act, general law, ASIC regulatory guidance and professional conduct standards.

### **Post appointment—receivers**

- 99 Insolvency practitioners acting as receivers can exercise powers over assets subject to security, including powers of sale. Such practitioners would usually act in circumstances where loans were impaired at the time of the appointment of that practitioner, with that impairment acting as the catalyst to the appointment.

Note: The powers of a receiver are found in the appointing instrument and the Corporations Act. Section 420 provides a general power to do all things necessary or convenient to be done for or in connection with, or incidental to, the attainment of the objectives for which the receiver was appointed as well as a number of specific extra powers. See Appendix 1 for more information on the powers of a receiver.

- 100 External administrators appointed under a security interest would generally check the validity of the security to ensure the validity of their own appointment. The secured party would ordinarily brief a prospective appointee on the circumstances leading to the appointment.
- 101 Before accepting appointment as receiver and entering into possession or taking control of a company's property, the insolvency practitioner should satisfy themselves that:
- (a) the security interest under which they are being appointed is valid and properly registered;
  - (b) an event of default within the terms of the security document has occurred;
  - (c) the requirements of the security document as conditions precedent to the appointment (including the making of a demand for the secured money and providing reasonable notice to the company of the intention to terminate the loan facility) have been strictly complied with; and
  - (d) other relevant statutory requirements have been complied with.
- 102 A prudent insolvency practitioner would not accept appointment as a receiver on the basis of a monetary or other default except with clear evidence that the default has occurred. If an appointment is based solely on a non-monetary default (e.g. a loan-to-value ratio default), a prudent

insolvency practitioner would generally inquire into the client's loan history further before accepting the appointment.

103 A practitioner acting as a receiver would also, ordinarily, seek an indemnity from the secured party.

### **Period of notice before appointment**

104 One of the difficulties faced by a lender is determining how much time must be allowed after delivering a demand on the borrower before appointing a receiver. Often the speed of appointment is crucial because it might be imperative for the lender to safeguard the assets which are subject to the security.

105 Debtors must be given reasonable time for payment after the giving of a demand.<sup>3</sup> What is reasonable notice depends on the circumstances of the case. Factors which are relevant to this issue include:

- (a) the nature of the security and the amount owed;
- (b) the risk to the secured party (i.e. whether the secured assets are in jeopardy);
- (c) the period of the relationship between the secured party and the debtor;
- (d) the circumstances leading up to the demand; and
- (e) the debtor's ability to satisfy the demand.

106 Where the debtor clearly has no resources to meet a demand and the secured assets are in jeopardy, it should be possible to appoint a receiver immediately after making demand.<sup>4</sup>

107 Although the appointment of a receiver may occur quickly after a formal demand for the secured money is made, it is likely this action would follow a relatively lengthy period during which there has been ongoing discussions between the debtor and secured party about the status of the loan facility.

### **Misconduct by receivers**

108 The Corporations Act requires external administrators to report alleged offences by company officers and others to ASIC. Section A sets out details of reports of misconduct we have received concerning receivers.

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<sup>3</sup> *Bunbury Foods Pty Ltd v National Bank of Australasia Ltd* (1984) 153 CLR 491

<sup>4</sup> We note that there may be a prescribed notice period under statute, for example, under the *Farm Debt Mediation Act 1994* (NSW) a secured creditor cannot take enforcement action against a farmer in respect of a farm mortgage, including appointing a receiver under the security instrument, until at least 21 days have elapsed since notice was given to the farmer.

## Scope for reform

### Independence

- 109 An insolvency practitioner is not required to complete a Declaration of Relevant Relationships or a Declaration of Indemnities when appointed by a secured party as a receiver<sup>5</sup>. Further, although the investigating accountant's report may not specifically recommend a formal insolvency appointment, it is possible that the insolvency practitioner might privately make representations in favour of their appointment as a receiver.
- 110 To address concerns that the insolvency practitioner may act without regard to the debtor's or guarantor's interests, consideration could be given to law reform to require a receiver to prepare and serve on the company a Declaration of Relevant Relationships or a Declaration of Indemnities that discloses:
- (a) the nature and extent of their relationship with the secured party;
  - (b) the services provided concerning the company prior to the appointment; and
  - (c) details of any indemnity provided.

### Remuneration

- 111 When courts assess the reasonableness of a receiver's remuneration, ASIC believes they should have regard to proportionality—that is, the reasonableness of remuneration compared to the benefits realised. Recent court decisions have, in fact, considered the issue of proportionality.
- 112 In *Australian Securities and Investments Commission v Letten* (No 23) [2014] FCA 985, Justice Gordon was required to determine among other things, the reasonableness of receivers' remuneration claimed in relation to work undertaken in the adjudication of investors' claims. One factor her Honour relied on in applying a 20% discount (on top of a voluntary 10% reduction) to the remuneration to be allowed, was that the claimed remuneration '*appeared large*' (\$4 million) when compared to the amount anticipated to be made available for distribution to the investors (\$10 million). On appeal, ASIC made submissions concerning the issue of proportionality. This matter has been appealed, and we await the decision of the Full Court of the Federal Court.<sup>6</sup>
- 113 The concept of 'proportionality' is not expressly dealt with under the Corporations Act. However, the list of matters for a Court to consider in

<sup>5</sup> For example, s436DA of the Corporations Act requires a declaration of relevant relationships (as defined in s60) and a declaration of indemnities (as defined in s9) to be supplied by an administrator appointed under s436A, 436B or 436C.

<sup>6</sup> *Damian John Templeton & Ors v Australian Securities and Investments Commission* VID 587 of 2014.

assessing the reasonableness of a receiver's remuneration include the time properly taken in completing work, the necessity of the work, the complexity of the work performed by the receiver and the value and nature of the property dealt with by the receiver.<sup>7</sup>

### Current reform

- 114 In ASIC's view, while there may be scope for reform of insolvency laws, it is important to proceed with current reform processes that are already underway.
- 115 On 7 November 2014, Treasury and the Attorney General's Department announced the release of the draft Insolvency Law Reform Bill 2014. Consultation closed on 19 December 2014. The Insolvency Law Reform Bill 2014 seeks to implement the reform package outlined in the former government's Proposals Paper: *A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia* (December 2011). The Insolvency Law Reform Bill 2014 includes measures aimed at addressing concerns around practitioner remuneration.
- 116 ASIC also notes that:
- (a) the Senate Economics References Committee Inquiry into post-GFC banking sector raised concerns about receivers' remuneration including, for example, the recommendation that the secured party must regularly inform the borrower about the costs and fees associated with the receivership and take reasonable care to ensure that those costs and expenses are reasonable;
  - (b) ASIC's submission to the Productivity Commission's *Review of barriers to business entries and exits in the Australian economy* (attached as Appendix 2) canvasses the opportunity to improve regulation of insolvency practitioner remuneration; and
  - (c) reforms to require that a receiver must prepare and serve on the company a Declaration of Relevant Relationships or a Declaration of Indemnities (see paragraph 110) are not being considered as part of the current reforms.

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<sup>7</sup> Section 425(8) of the Corporations Act

## D TOR 2(d): Obligations on receivers: Forced sales

### Key points

The Corporations Act imposes certain requirements on receivers when exercising the power of sale, including to take reasonable care to sell the property for not less than market value.

This obligation is not breached simply because market value (where it exists) or the best price reasonably obtainable is not achieved, but where the receiver has not taken all reasonable care.

The Senate Economics References Committee Inquiry into post-GFC banking sector made a number of recommendations for improving banking practices relating to the enforcement of security interests and the conduct of receivers when exercising the power of sale under s420A of the Corporations Act.

### Requirement to obtain fair market value for the forced sale of property

#### The legal obligation

117 Under the current law, when exercising the power of sale:

- (a) a receiver must take reasonable care to sell the property for not less than market value (if the property has a market value at the time of sale) or otherwise for the best price reasonably obtainable having regard to the circumstances at the time the property is sold: Corporations Act, s420A; however,
- (b) a receiver and manager does not have to retain the property until the relevant market improves before taking steps to sell it.<sup>8</sup>

Similarly, a breach of the law does not occur simply because the receiver and manager did not obtain the best price on sale. Rather, courts focus on whether the receiver and manager undertook a proper sales process in the circumstances.

118 A breach of s420A is not established merely because market value (where it exists) or the best price reasonably obtainable is not achieved. Rather, a breach of s420A requires a failure by the receiver to take all reasonable care to sell the property for not less than market value or the best price that is

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<sup>8</sup> *Commonwealth Bank of Australia v Geoffrey Anthony Shannon* [2013] NSWSC 1076, 99. 151–154.

reasonably obtainable having regard to the circumstances existing when the property is sold’.

- 119 In forming a judgment as to whether a receiver took all reasonable care it is necessary to have regard to the sale process the receiver adopted. Whether reasonable care has been exercised will be assessed in light of the circumstances of each sale including whether the receiver has:
- (a) obtained appropriate independent valuations and engaged an agent who has relevant experience and who is familiar with the type of property to be sold and where it is located;
  - (b) obtained the agent’s advice as to where and how to advertise the property for sale; including how long the advertising campaign should run to ensure the property is properly marketed and comes to the attention of potential buyers. If the property is unique, this may involve considering additional forms of advertising such as specialist industry or trade publications;
  - (c) obtained and considered advice from appropriate experts and followed that advice;
  - (d) closely monitored and supervised the sale process; including the activities of the agent;
  - (e) determined the best method of sale (auction, tender, private treaty) to ensure market value is obtained for the particular property being sold; and
  - (f) carefully considered all offers received; including the risk of offerors not completing a contract of sale.

- 120 The relevant authorities illustrate that the courts will adopt a commercial approach to these factors. The failure to take a particular step may constitute a breach of s420A(1)(a) in some cases but not others. For example, in some circumstances a receiver is justified in concluding that a private sale rather than an open market sale process is more likely to achieve a sale price of not less than market value.<sup>9</sup>

### **ASIC action**

- 121 The dominant view is that s420A does not confer a right to damages or any other remedy. Section 420A is not an offence or civil penalty provision. ASIC can take action against the receiver for a breach of s420A, under s423 for failing to observe a requirement under the Corporations Act or for a breach of the receivers duties as an ‘officer’ under the Corporations Act. ASIC will assess the circumstances of each case in light of the statutory requirements and relevant case law.

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<sup>9</sup> *Boz One Pty Ltd v McLellan* [2015] VSCA 68



- 122 The principal remedies available for a breach of s420A are for a breach of the general law duties and the general law remedies of set off and or account (i.e. the difference in the value of the property as if it had been sold in accordance with the receiver's obligations and the amount obtained).
- 123 For the period July 2010 to June 2015, ASIC received a total of 45 enquiries and reports of misconduct raising concerns about receivers. ASIC assessed all of these matters against s420A obligations (and other provisions where relevant). ASIC's assessment and inquiries could not substantiate breaches of s420A which warranted further regulatory action. Generally, ASIC determined that there was insufficient evidence to suggest that the receiver contravened s420A having regard to the sale process and the factors set out at paragraph 119. Further, ASIC is reluctant to interfere in a receiver's commercial decision-making. The remedies available would be for the affected parties to pursue.

## Scope for reform

- 124 As noted in Section B, the Senate Economics References Committee Inquiry into post-GFC banking sector made a number of recommendations for improving banking practices relating to the enforcement of security interests and the conduct of receivers when exercising the power of sale under s420A of the Corporations Act: see paragraph 70.
- 125 We also note that the Productivity Commission's *Business Set-up, Transfer and Closure—Draft Report* recommends that s420A should be subject to a duty not to cause unnecessary harm to the interests of creditors as a whole, including putting the continuation of the company, or the preservation of the company as a going concern for sale purposes, at risk (see: draft recommendation 15.6).

## E TOR 1(e): Implications of FSI recommendations

### Key points

The current inquiry's terms of reference include consideration of the implications of relevant recommendations of the Financial System Inquiry.

These are Recommendations 34 and 36 relating to non-monetary conditions of default and the external administration regime, respectively.

On these two recommendations:

- recommendations made in 2012 by the Senate Economics References Committee Inquiry into the post-GFC banking sector are relevant to Recommendation 34; and
- the Productivity Commission's *Business Set-up, Transfer and Closure—Draft Report* identifies a range of proposed reforms relevant to Recommendation 36.

### Recommendation 34: Extend unfair contract term protections to small businesses and encourage industry to develop standards on the use of non-monetary default covenants

- 126 This recommendation overlaps with a recommendation made in the November 2012 report of the Senate Economics References Committee Inquiry into post-GFC banking sector.
- 127 That report noted that in order to encourage entrepreneurial activity and allow sufficient flexibility for contracting parties, it did not propose government intervention in relation to commercial lending practices. It therefore recommended that industry address small business lending concerns through development of a code of conduct for small business lending by the ABA. The report also noted that a failure by industry to appropriately address small business lending concerns would strengthen the case for more prescriptive government regulation: see Section B.
- 128 In light of the FSI's recommendation, further consideration could be given to the recommendations of the Senate Economics References Committee Inquiry into post-GFC banking sector.

### Recommendation 36: Additional flexibility for businesses in financial difficulty

- 129 In November 2014, the Government requested that the Productivity Commission undertake a *Review of barriers to business entries and exits in*

*the Australian economy* and identify options for reducing these barriers where appropriate, in order to drive efficiency and economic growth in the Australian economy. The Productivity Commission's review raises similar issues to Recommendation 36 of the Financial System Inquiry (FSI).

- 130 The Government is still considering the recommendations of the FSI.
- 131 In May 2015, the Productivity Commission released a draft report, *Business Set-up, Transfer and Closure—Draft Report*. This draft report identifies a range of proposed reforms aimed at improving the effectiveness of restructuring options and ensuring that winding up is streamlined.
- 132 The report includes recommendations that aim to improve the environment for financially distressed businesses, including:
- (a) allowing a formal restructure of companies through voluntary administration only when a company is not yet insolvent;
  - (b) the introduction of a 'safe harbour' to allow companies and their directors to explore restructuring options without liability for insolvent trading;
  - (c) limiting the contractual right of a party to terminate a contract solely on the occurrence of an insolvency event (*ipso facto* clauses); and
  - (d) the introduction of a simplified liquidation process to reduce the time and expense of winding up businesses with low value recoverable assets.
- 133 The attached Appendix 3—ASIC's supplementary submission to the Productivity Commission's review, which responds to its draft report, sets out ASIC's views on the Productivity Commission's draft recommendations.
- 134 ASIC supports proposed reforms that promote a rescue culture for financially distressed companies that have a real prospect of rehabilitation. However, in many cases involving the impairment of loans there are limited or no realistic options available to attempt a restructure because the debtor has engaged in protracted negotiations with the lender and exhausted its funds.
- 135 We note that these reforms are aimed at corporate restructure and will not assist a business that is held by another vehicle such as a partnership, trust or as a sole trader.

# Appendix 1: The regulatory framework for receivers

## Environment and regulatory framework

### Primary purpose

- 136 A company enters receivership when a secured party appoints a receiver, or in special circumstances the court appoints a receiver, to take control over some or all of the company's assets. The function of most receiverships is for the receiver to collect and sell sufficient of the company's charged assets to repay the debt owed to the secured party. Less commonly, a receiver may be appointed by a court to protect the company's assets or to carry out specific tasks.

Note: A secured party is someone who has a security interest, such as a mortgage, in some or all of the company's assets, to secure a debt owed by the company. An unsecured creditor is a creditor who does not have a charge over the company's assets.

### Basis for appointment

- 137 A receiver can be appointed by a court or by a private appointee.

### Private appointment

- 138 A private appointment can be made by anyone with the contractual power to do so. Most commonly, a private appointment is made pursuant to an express agreement between the parties with an interest in the property over which the appointment is made (e.g. under the terms of a mortgage or debenture). The mortgage, debenture or other agreement will usually set out preconditions or events which may give rise to the power to appoint a receiver. The conditions are usually events that indicate that a party's interest is likely to be prejudiced, such as a default in repayment.
- 139 A private appointment may also be made following a statutory power of appointment.<sup>10</sup>
- 140 It is possible for a company in receivership to also be in provisional liquidation, liquidation, voluntary administration or subject to a deed of company arrangement. A receiver can be appointed to a company in liquidation or under any other form of external administration. A receiver can be appointed to a company in voluntary administration without the consent of the court or the administrator, where the consent is provided within the first 13 business days of the appointment of an administrator and

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<sup>10</sup> For example, s115A of the *Conveyancing Act 1919* (NSW) allows a mortgagee under a mortgage to appoint a receiver if the default has been made in respect of the mortgage.

where the charge, under which the receiver is being appointed, is over substantially the whole of the assets of the company.<sup>11</sup> In most cases the appointment of an external administrator triggers the appointment of a receiver.

### Court appointment

- 141 The court has an inherent jurisdiction to appoint a receiver. This inherent power has been restated in various statutes.<sup>12</sup> The court also has power under the Corporations Act to appoint a receiver. For example, the court may appoint a receiver upon the application of an aggrieved person<sup>13</sup> or upon the application of a liquidator or provisional liquidator in circumstances where an officer of the company in liquidation, or of a related entity of the company, may otherwise avoid liability to the company in liquidation.<sup>14</sup>
- 142 The powers of a court-appointed receiver will be expressed in the court order and will be specific to the facts giving rise to the application and be supported with powers under the Corporations Act.

### Landscape

- 143 Appointments of receivers, receivers and managers, and controllers account for a relatively small percentage of the total number of annual corporate insolvency practitioner appointments: see Table 4.

**Table 4: Appointment of receivers expressed as a percentage of total external administration appointments**

Type of external administration	2010–11	2011–12	2012–13	2013–14
Receiver or receiver and manager	9.31%	7.90%	6.88%	6.02%
Controller or managing controller	4.38%	4.03%	4.38%	6.18%

Source: ASIC Australian insolvency statistics—Series 1: Companies entering external administration

### Types of ‘receiver’ appointments

- 144 There are a number of different types of appointments; receivers, receivers and managers, controllers, and managing controllers.

<sup>11</sup> Refer to s441A—a charge with a charge over substantially all the assets can appoint during the ‘decision period’ (refer to s9 for the definition of ‘decision period’).

<sup>12</sup> For example, s67 of the *Supreme Court Act 1970* (NSW) and s37 of the *Supreme Court Act 1986* (Vic).

<sup>13</sup> Section 1323(1) of the Corporations Act.

<sup>14</sup> Section 486A of the Corporations Act.

**Receiver**

- 145 A receiver is appointed to administer property. The appointment may be limited to mere protection of one particular item of property or it may extend to managing a company's affairs. The term 'receiver' is defined to include a receiver and manager under Pt 5.2 of the Corporations Act: s416.

**Receiver and manager**

- 146 A receiver and manager is a receiver who has, under the terms of their appointment, the power to manage the company's affairs: Corporations Act, s90.

**Controller**

- 147 A controller is defined as a receiver, receiver and manager, or any other controller who has entered into possession or control of the corporation's property for the purposes of enforcing a security interest: Corporations Act, s9.

**Managing controller**

- 148 A managing controller is a receiver and manager or any other controller who has entered into possession or control, but additionally has functions or powers in connection with managing the company: Corporations Act, s9.
- 149 The statistics for controller and receiver appointments for the 2010–11 through to the 2013–14 financial years are shown in Table 5.

**Table 5: Companies entering receiver appointments<sup>15</sup>**

Type of external administration	2010–11	2011–12	2012–13	2013–14	Total
Receiver or receiver and manager	915	850	739	591	3,095
Controller or managing controller	431	434	471	607	1,943
<b>Total</b>	<b>1,346</b>	<b>1,284</b>	<b>1,210</b>	<b>1,198</b>	<b>5,038</b>

Source: ASIC Australian insolvency statistics—Series 1: Companies entering external administration

**Registration framework**

- 150 The Corporations Act provides that a receiver must be a registered liquidator: s418(d). A court-appointed receiver must be registered as an official liquidator.

<sup>15</sup> Members' voluntary liquidations are not included as the companies are not insolvent.

- 151 To register a person as a liquidator, ASIC must be satisfied that all the requirements for registration are met. An applicant must be a natural person who:
- (a) has certain base level qualifications (s1282(2)(a));
  - (b) has experience in externally administered bodies corporate (s1282(2)(b));
  - (c) is capable of performing the duties of a registered liquidator and is otherwise a fit and proper person to be a registered liquidator (s1282(2)(c));
  - (d) is not a person disqualified under Pt 2D.6 from managing corporations (s1282(4));
  - (e) is a resident in Australia (s1282(5)); and
  - (f) will maintain adequate insurance under s1284.
- 152 These requirements also apply to a receiver. However, in addition to those requirements, the Corporations Act provides that certain persons are excluded from acting as a receiver. For example, a person cannot be appointed as a receiver if they are a mortgagee of the property of the corporation, or an auditor or a director, secretary, senior manager or employee of the corporation: Corporations Act, s418.

### **Obligations of receivers**

- 153 The conduct obligations imposed on a receiver are derived from a number of sources. A receiver is subject to requirements under the Corporations Act and general law as well as ASIC regulatory guidance explaining, among other things, when and how ASIC will exercise specific powers under the legislation and how ASIC interprets the law. Receivers who are members of a professional body (e.g. the Australian Restructuring Insolvency & Turnaround Association (ARITA) and/or professional accounting bodies) will also be subject to the professional conduct standards of that body. The courts also refer to the ARITA Code of Professional Practice (ARITA Code) when considering matters about professional conduct and competence and therefore the ARITA Code is relevant to all receivers.

### **General law duties**

- 154 At general law, a receiver owes a duty to the secured party and the company. These duties are derived from:
- (a) the agreement under which the receiver was appointed;
  - (b) the agency relationship with the company (or more rarely with the secured party); if the receiver is court-appointed, from being an officer of the court; and

- (c) being an officer of the company.

*Privately appointed receiver*

155 The fundamental duty of a privately appointed receiver is to exercise their powers bona fide for the purposes for which they were appointed and, therefore, a receiver's primary duty is to the secured party.

156 The receiver will also be subject to general law duties to the company as a consequence of the agency relationship that arises from the terms of the agreement. While the receiver is acting for the secured party, the agreement will invariably provide that the receiver will be the agent of the company rather than the secured party. This is to ensure that the secured party is not liable as the receiver's principal and as mortgagee in possession. This agency relationship ceases if a liquidator is appointed, although there is an opportunity to continue if the liquidator consents.

157 As an agent of the company, the receiver has certain duties to the company which the company can directly enforce. Australian case law indicates that these duties include a duty to:

- (a) exercise his or her powers in good faith (including a duty not to sacrifice the company's interests);
- (b) act strictly within, and in accordance with, the conditions of his or her appointment; and
- (c) account to the company after discharging the secured party's security, not only for the surplus assets, but also for his or her conduct of the receivership (including the duty to terminate the receivership as soon as the interests of the secured party have been satisfied).<sup>16</sup>

*Court-appointed receiver*

158 The nature of the powers endowed on a receiver is determined by the order of the court.

159 Unlike a privately appointed receiver, it is not the fundamental function of a court-appointed receiver to see that the security holder is repaid. As an officer of the court, the appointment is for the benefit of those interested in the relevant assets.<sup>17</sup> For example, a court-appointed receiver may be appointed to preserve property pending the hearing or resolution of the dispute, as opposed to a privately appointed receiver whose role it is to realise the secured assets.

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<sup>16</sup> *Expo International Pty Ltd (Recs and Mgrs Apptd) (in liq) & Another v Chant & Others* [1979] 2 NSWLR 820 per Needham J at 834.

<sup>17</sup> *Cape v Redarb Pty Ltd (Rec and Mgr Apptd)* (1992) 107 FLR 362.



### **Corporations Act**

160 The Corporations Act deals with the qualifications of a receiver and imposes a number of specific duties on receivers. These requirements apply equally to a privately appointed receiver and a court-appointed receiver. For example, a receiver is required to:

- (a) lodge a notice of appointment with ASIC within 14 days of appointment;
- (b) take all reasonable care to sell the property of the corporation for not less than market value or the best price that is reasonably obtainable;
- (c) open and maintain a bank account, and deposit into this account all money of the company which comes under the receiver's control;
- (d) keep financial records that correctly record and explain all transactions that the receiver enters into as a receiver of the company and permit access by any director, creditor or member to records kept;
- (e) lodge six-monthly accounts of receipts and payments with ASIC;
- (f) pay certain debts in priority to repayment of debts that are secured by a circulating security interest;
- (g) prepare and lodge a report with ASIC on the affairs of the company within two months of being appointed if the receiver is managing the company; and
- (h) report any possible misconduct to ASIC.

161 These obligations provide a level of protection for stakeholders, such as unsecured creditors and members of the company, and accountability through the reporting and lodgement requirements with ASIC. It should be noted, however, that receivers have no obligation to report directly to unsecured creditors.

162 It should also be noted that a receiver does not have to provide creditors with a Declaration of Relevant Relationships and a Declaration of Indemnities.

#### *Duties as an 'officer'*

163 An 'officer' is defined in the Corporations Act to include a receiver.<sup>18</sup> The general duties that apply to 'officers' of a corporation will therefore apply to receivers, in particular those duties under Ch 2D of the Corporations Act:

- (a) to act in good faith at all times;
- (b) to exercise a reasonable degree of care and diligence;
- (c) not to make improper use of information; and
- (d) not to make improper use of position.

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<sup>18</sup> Section 9 of the Corporations Act.

### **ASIC's regulatory guidance**

- 164 We have issued the following regulatory guides to assist receivers to understand their obligations under the Corporations Act:
- (a) Regulatory Guide 186 *External administration: Liquidator registration* (RG 186);
  - (b) Regulatory Guide 14 *Receivers: Retention of company records* (RG 14); and
  - (c) Regulatory Guide 106 *Controller duties and bank accounts* (RG 106).
- 165 We have also issued two information sheets to assist stakeholders to understand the process of receivership and the implications for the particular stakeholder, namely:
- (a) Information Sheet 54 *Receivership: a guide for creditors* (INFO 54); and
  - (b) Information Sheet 55 *Receivership: a guide for employees* (INFO 55).

### **Professional conduct standards**

- 166 A receiver will be subject to professional standards, practices and principles, including codes of conduct and statements of best practice of a relevant professional body or an insolvency industry body of which the registered liquidator is a member. These professional conduct standards are:
- (a) the ARITA Code; and
  - (b) APES 330 *Insolvency Services*, issued by the Accounting Professional and Ethical Standards Board.

### **ARITA Code**

- 167 By way of example, a receiver who is a member of ARITA must comply with ARITA's professional standards, the ARITA Code.
- 168 The ARITA Code imposes various obligations on 'members' of ARITA and/or 'practitioners' as defined in the Code. Receivers, although practitioners, do not have the same fiduciary responsibilities to all creditors. Therefore, the ARITA Code excludes receivers from certain requirements.
- 169 If a receiver who is a member breaches the ARITA Code, the ARITA may instigate action against them. The courts have regard to the ARITA Code when considering the required level of professional competence and conduct and the Code is also considered by ASIC when assessing possible contraventions of the Corporations Act.

## Remuneration and disbursements

- 170 In the case of a private appointment, a receiver is entitled to receive such remuneration as is determined by:
- (a) the debenture agreement and the document of appointment;
  - (b) where the appointment is made following a statutory power of appointment, the terms of that legislation;<sup>19</sup> or
  - (c) in rare cases, an express or implied agreement between the receiver and the debenture holders where the receiver is acting as their agent.
- 171 Most commonly, the terms of the debenture agreement and the document of appointment will provide how the receiver's remuneration is to be determined, including who will approve the remuneration, the method for calculating remuneration and who is liable to pay the remuneration. Subject to the terms of the agreement, the company will usually bear the receiver's remuneration and the receiver will draw their remuneration during the course of the receivership by submitting an account for their remuneration to the secured party (generally, those costs will then be added to the company's outstanding debt. The secured creditor will normally scrutinise the account and approve it for payment. Commonly, the receiver will secure an indemnity for remuneration and expenses from the secured party.
- 172 The secured party has a significant degree of influence over the level of remuneration of the receiver, due to the direct nature of the appointment. In some situations, this position can result in the receiver charging less than their standard hourly rates.
- 173 A court-appointed receiver is entitled to receive such remuneration as the court determines. There is no fixed or predetermined basis for calculating remuneration for a court-appointed receiver, but in attempting to set a reasonable level of remuneration the courts often accept fees charged based on the receiver's hourly rates.<sup>20</sup>
- 174 We should also highlight the situation where multiple insolvency practitioners may be appointed to a company—for example, where a company may be in voluntary administration as well as having a receiver and manager appointed; or where a company is in liquidation in addition to having a receiver and manager appointed. Where a company has multiple appointments, in particular where there is a concurrent appointment of a liquidator as well as a receiver, the liquidator is entitled to an accounting from the receiver in relation to the conduct of the receivership.

<sup>19</sup> For example, a receiver appointed under the powers in the *Conveyancing Act 1919* (NSW) is entitled to receive (unless the mortgage deed provides otherwise) remuneration at a rate not exceeding 5% of the gross money received, or such higher rate as the court will grant on application: s115(6).

<sup>20</sup> *Waldron v MG Securities (Australasia) Ltd & Others* (1979) CLC 40–541.

### **Approval process**

- 175 Unlike other types of external administration, the Corporations Act does not prescribe the process for the approval of a receiver's remuneration, as the appointment of a receiver is essentially a private appointment.
- 176 The ARITA Code is somewhat helpful in this regard. The ARITA Code states principles and gives guidance on the remuneration of receivers. The second remuneration principle in the ARITA Code requires that a claim for remuneration must provide sufficient, meaningful, open and clear disclosure to the approving body so as to allow that body to make an informed decision as to whether the proposed remuneration is reasonable.
- 177 For court-appointed receivers, the method for applying for approval for remuneration is for the receiver to present his or her accounts and remuneration claim to the court. The approval process for the remuneration of privately appointed receivers is determined by negotiation between the parties. However, the court retains wide powers under the Corporations Act to set and review the remuneration of receivers.<sup>21</sup>

### **Rights of review**

- 178 The Corporations Act provides for a review process regarding the remuneration payable to receivers. The court retains wide powers to set and vary the remuneration of receivers. Applications to fix or vary a receiver's remuneration may be made in certain circumstances by ASIC, a liquidator, voluntary administrator or deed administrator of the company.
- 179 The 2007 reforms to the Corporations Act introduced amendments that require the court, when reviewing or setting a receiver's remuneration, to have regard to whether the remuneration is reasonable, taking into account various matters, including whether the work performed was reasonably necessary.<sup>22</sup>

### **Remuneration and unsecured creditors**

- 180 Unsecured creditors have no role in setting or approving a receiver's fees. If a liquidator is appointed to the company then the liquidator is able to review the validity of the appointment of the receiver and to monitor the progress of the receivership, including remuneration and reporting back to all unsecured creditors.
- 181 Often in receiverships, the secured party suffers a significant deficit on the recovery of the debt owed by the company. If there are insufficient assets, the secured party pays the receiver's remuneration out of their own funds.

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<sup>21</sup> Section 425 of the Corporations Act.

<sup>22</sup> Section 425(8) of the Corporations Act.

## **Disciplinary and deterrence framework**

- 182 The Corporations Act provides that a receiver must be a registered liquidator<sup>23</sup> and ASIC may:
- (a) take administrative or conduct proceedings against a receiver before the Companies Auditors and Liquidators Disciplinary Board (CALDB);
  - (b) instigate court proceedings; or
  - (c) enter into an enforceable undertaking with the receiver.

### **CALDB**

- 183 CALDB can apply penalties ranging from a reprimand to suspension or cancellation of the liquidator's registration. CALDB does not impose pecuniary penalties and is not empowered to make orders as to restitution or compensation.

### **Court proceedings**

- 184 If a receiver has not faithfully performed his or her functions, ASIC may instigate court proceedings against a receiver and the court may take such action as it sees fit, including making orders for compensation or restitution.<sup>24</sup>
- 185 A receiver is also subject to a number of specific duties as a receiver and as an 'officer' under the Corporations Act. The penalties for breaching these provisions range from civil damages for not exercising a duty of care in disposing of property,<sup>25</sup> to both civil and criminal penalties for breaching the Ch 2D duties imposed on officers. The sections can all result in the application of civil penalty provisions, with compensation orders<sup>26</sup> and pecuniary penalty orders up to \$200,000.<sup>27</sup> Section 184 makes it an offence for an officer, including a receiver, to be reckless or intentionally dishonest and fail to exercise their powers and discharge their duties in good faith in the best interests of the company, attracting a penalty of up to \$360,000<sup>28</sup> and/or imprisonment for five years.

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<sup>23</sup> Section 418(1)(d) of the Corporations Act.

<sup>24</sup> Section 423 of the Corporations Act.

<sup>25</sup> Section 420A of the Corporations Act.

<sup>26</sup> Section 1317H of the Corporations Act.

<sup>27</sup> Section 1317G of the Corporations Act.

<sup>28</sup> Based on the value of a Commonwealth penalty unit of \$180 as at 1 August 2015.