



22 March 2023

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

By email: corporations.joint@aph.gov.au

Parliamentary Joint Committee on Corporations and Financial Services inquiry into corporate insolvency in Australia – Responses to questions on notice and further evidence

The Australian Institute of Credit Management (AICM) appreciates the opportunity to contribute to the inquiry by appearing at the hearing on 28 February 2023 and providing the additional detail and responses to questions on notice.

The AICM appeared with the Australian Credit Forum (ACF) and has worked in collaboration regarding this further submission, and the submissions made on behalf of the ACF.

The AICM endorses the further submissions of the ACF.

Unfair preference claims

As stated during the hearing, AICM members call for unfair preference claims to be abolished in totality against unrelated creditors.

Removing potential liability to preference claims will enable credit providers to confidently support customers displaying signs of potential insolvency by reducing the need to mitigate the risk of claims being brought.

The fact creditors rarely see increased distribution to creditors following successful recoveries by liquidators is clear evidence that the current regime is not achieving a key objective and amendments to the regime are unlikely to rectify this.

While AICM members support interim steps toward the abolishment unfair preference claims against unrelated creditors, these steps will only move the line in the sand and continue to result in unfair outcomes for credit provides and act as a handbrake on efficient trade.

Interim steps that could be considered include:

- Requiring actual knowledge of insolvency to be proven before a claim can be made against an unrelated creditor.

Alternatively, replicating the aspect of the United Kingdom's regime that requires the liquidator to show there was a "requisite desire to place the recipient in a better position that they would otherwise be in on the debtor's insolvency".

The UK's framework has been in place for many years and sees the UK's insolvency system operate effectively and unrelated credit providers unburdened by the risk of unfair preference claims brought on due to the use of normal and legitimate collections activities.

- Implementing thresholds below which preference claims cannot be brought, such as those currently in place for simplified liquidations.
- Reducing the relation back period from 6 months to 3 months.
- Requiring legal action to recover claims to be commenced within 12 months of appointment.
- Legislative clarity on the defences available to creditors that can give certainty in resolving claims without court mediation and excessive legal fees for all parties.
- Preventing claims being pursued on a speculative basis i.e. where liquidators are only liable for legal fees on a success basis.

While these interim steps begin to address specific issues currently faced by AICM members, we note that while creditors face potential liability for preference claims they will need to continue to implement mitigation steps that limit the effectiveness of trade.

The ACF submission provides further detail and examples provided by members ACF and AICM.

Unchecked growth in insolvent trading

In the July 2018 to June 2019 financial year an ASIC report¹ identified 71% of external administrators reports identified a director misconduct of insolvent trading. This increased from 69% in July 2017 to June 2018 and 63% in July 2016 to June 2017.

While the AICM is not aware of ASIC publishing more recent data, AICM members expect that the prevalence is only increasing and sight the following:

- ATO debt is escalating.

The ATO total debt reported in the Commissioner of Taxation annual report 2021-22² shows that total debt has increased 13% from \$58.8bn in 2020/21 to \$66.6bn in 2021-22.

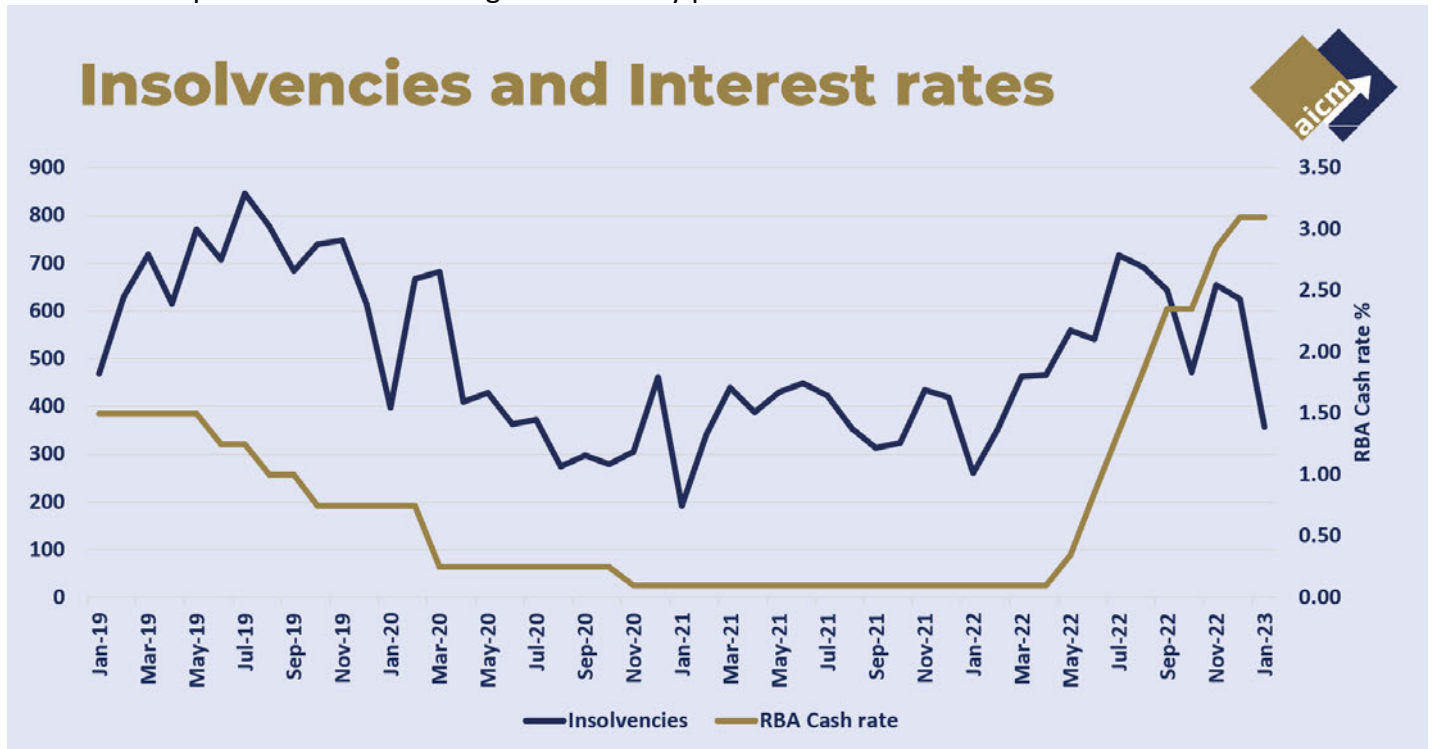
Collectable debt (which excludes debt subject to objection or appeal and insolvency debt) has more than doubled since 2016/17 from \$20.9bn in to \$44.8bn in 2021-22.

- Increase in insolvencies is lagging interest rate increases.

¹ [REPORT 645 Insolvency statistics: External administrators' reports \(July 2018 to June 2019\)](#)

² [Commissioner of Taxation annual report 2021 22](#)

The below graph³ shows the tight correlation between interest rates and the number of corporate entities entering an insolvency process.



While the timing of increases in insolvencies and interest rates is correlated, analysis of past trends suggests there should be significantly higher levels of insolvency. Additionally, interest rate increases are just one of the pressures businesses are facing.

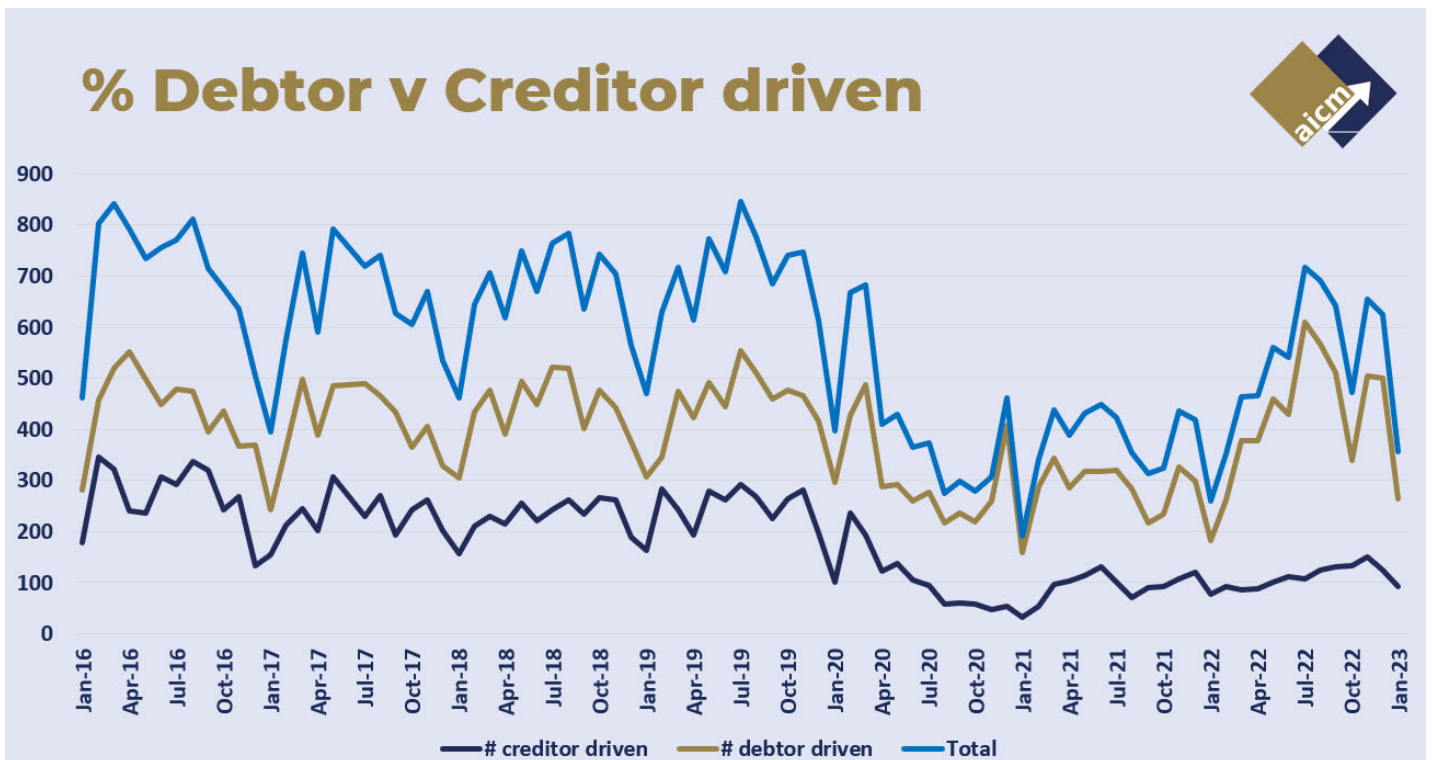
- Major creditors are not commencing wind up proceedings against insolvent entities.

Analysis of ASIC insolvency statistics shows that creditor enforcement is not driving the increase in insolvencies experienced in late 2022.

The below graph⁴ shows that the level of creditor wind ups has remained at historically low proportions. This the understanding of AICM members that the ATO and major creditors (such as banks) remain reluctant to commence recovery action.

³ Data sourced from Australian Securities and Investments Commission [Insolvency statistics - Series 1 Insolvency appointments](#). & [Reserve Bank of Australia](#)

⁴ Data sourced from Australian Securities and Investments Commission [Insolvency statistics - Series 1 Insolvency appointments](#)



The fact that ATO debt is increasing, insolvencies are lower than expected and ATO/major creditors are not instigating the wind up of insolvent entities indicates that the prevalence of insolvent trading is likely to be increasing significantly.

The above factors highlight the need to act swiftly to address insolvent trading through strong enforcement.

AICM members are confident that strong enforcement of insolvent trading will support the economy by:

- Reducing the ripple effect of insolvencies.
- Reduce the unfair advantage obtained by businesses not paying liabilities as they fall due.
- Improved payment times.
- Provide confidence to creditors to trade freely and be less risk adverse.
- Encourage early engagement with regulated advisors to achieve better outcomes and hopefully avoid formal insolvency.

A key factor restricting enforcement of insolvent trading is that there is a low hurdle for directors to clear in order to defend insolvent trading actions.

AICM Members recommend a clear definition of insolvency and insolvent trading to be established with a dedicated insolvency regulator taking an active role in enforcement to create an effective deterrent to insolvent trading and other forms of poor conduct related to insolvency.

Small Business Restructuring

The AICM's submission⁵ to the draft legislation recommended several changes to ensure the process works efficiently and does not leave avenues for the process to be used to defeat creditors. The following are the key recommendations that should be reviewed:

- Inclusion of a requirement to have good books and records as a criteria for eligibility.
- Creditors debt values are verified as early as possible by:
 - Providing a schedule of debts with the directors' declaration and this be included with the notice to ASIC and creditors; and/or
 - Requesting creditors submit a proof of debt in the notice to creditors.
- Currently the director's declaration specifically permits the directors to omit preference payments to related parties from this declaration. This is a significant omission with the potential to be manipulated.
- Review or change to the \$1 million liability threshold to only be considered once the process has been subject to a thorough review and improvements implemented to ensure the process doesn't result in manipulation and unintended consequences.
- Unperfected PPSA registrations should not vest with the company on commencement of a restructuring as this could unjustly enrich the company if a plan is not entered and the business continues to trade. While unperfected PPSA registrations vest in voluntary administration, AICM members believe this isn't appropriate for restructuring as creditors do not vote on the outcome if a plan is not accepted.
- More detail should be required in the plan to help creditors justify the proposed compromise and inform their assessment.
- Align the approval of plans with Voluntary Administration to give all creditors greater input to the plan. i.e. approval by number not just value.
- A poll of creditors should determine the next step if a plan is terminated, e.g. continues to trade, voluntary administration or liquidation.

The AICM notes that the use of Restructuring is increasing rapidly, from 33 in 2021 calendar year to 209 in 2022⁶, and strongly recommends improvement of this process to ensure the issues identified do not result in manipulation and/or barriers to efficient trade.

A recent survey of AICM members that have experienced an SBR revealed that generally:

- They withdraw supply on credit terms on commencement as there is no certainty of payment unlike voluntary administration.

⁵ <https://www.aicm.com.au/about-aicm/advocacy/2020-november-corporations-amendment-bill-2020-draft-regulations/>

⁶ Australian Securities and Investments Commission [Insolvency statistics - Series 1 Insolvency appointments.](#)

- There isn't sufficient information provided in restructuring proposals to assess the commercial benefits of accepting the proposals.
- On approval/completion of a proposal AICM members remain hyper vigilant but assess future credit on a commercial basis.

Trusts with corporate trustees

As trading with trusts is one of the most complex, time consuming and risky areas of credit management and this was not raised during the hearing we reiterate our recommendations that action is taken to improve the effectiveness of trading with trusts.

AICM members believe significant benefits to small business and all creditors can be achieved by increasing transparency and clarity of trusts with the implementation of a Trust register. The register would assist credit professionals, insolvency professionals, financial institutions, regulators, and other stakeholders to obtain information and verify the entities' structure, in the same way the ASIC company register does for other corporate structures.

AICM members recommend that a register incorporating details of the trustee, beneficiaries and the current trust deed is established along with legislation that gives legal effect to the entity once registration is completed. The concept is like how the PPSR gives legal effect to security interests.

A trust register will also provide clarity to the insolvency process as outlined in the ACF submission under the heading "Simplification of trusts – trusts with corporate trustees".

The trust register should not impact the practical operation of trading trusts and maybe possible to be implemented at a federal level.

Payment Times

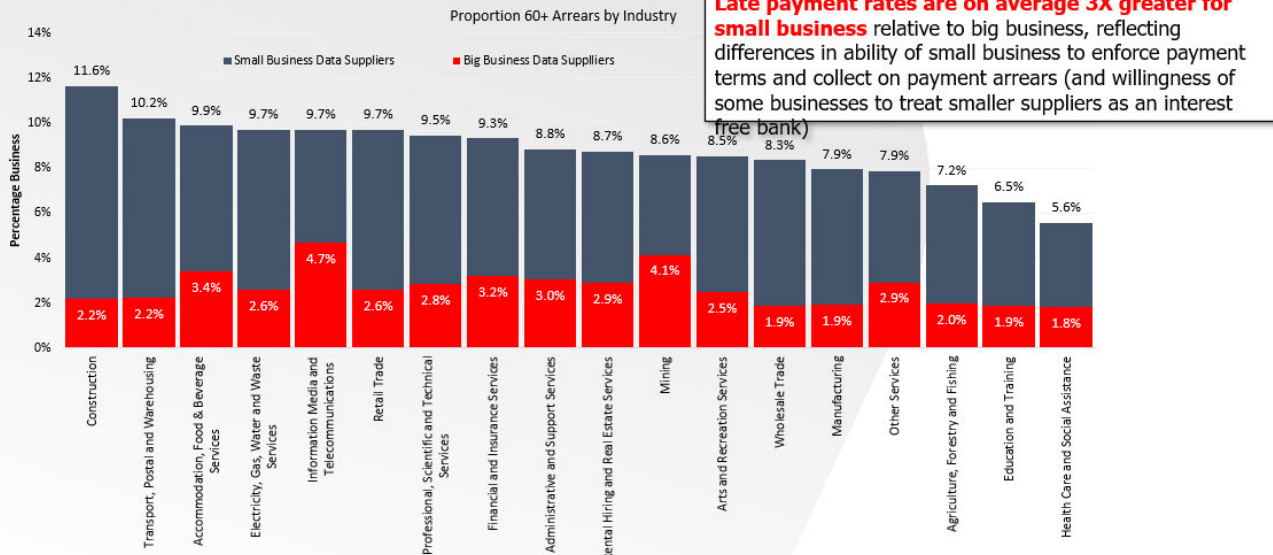
The committee requested some sources of information to understand "how the interest rates and the current state of the economy are going to impact on insolvency" and trends in payment times in Australia.

We advise CreditorWatch, Equifax and illion are credit reporting bodies that obtain information on how their clients are being paid and can provide timely information on how business conditions are impacting payment times. They publish regular information and the AICM can facilitate connections to obtain further insights.

In relation to questions of the committee put to other witnesses on the payment behaviours of different size businesses the AICM has obtained the following data:

- In late February 2023 illion provided indicative data which shows that on average.
 - Small pays Large 9.7 days late
 - Small pays Small 10.6 days late
 - Large pays Small 12.7 days late
 - Large pays Large 13.4 days late
- CreditorWatch provided the below graph:

Trade payments to big vs small businesses



Data Source: [CreditorWatch Business Risk Index](#)

The above data shows that there are problems with the payment culture in Australia and initiatives such as the Payment times reporting Act should be expanded to encourage prompt payment to all size entities (not just from large to small) as this will maximise the ability of all entities to pay promptly.

In the AICM submission to the Statutory Review of the Payment Times Reporting Act 2020⁷ AICM members makes a range of recommendations to improve the payment culture in Australia which would significantly improve the effectiveness of trade in Australia and lessen insolvency risk.

AICM members believe the payment culture in Australia is a relevant factor for the inquiry to consider as highlighted by ASIC statistics which confirms inadequate cash flow is the number one cause of failure sighted in reports of administrators in 2018/19⁸.

On behalf of our members the AICM thanks the committee for undertaking this inquiry and we look forward continuing to contribute to the discussions to ensure best outcomes for all stakeholders in the system.

Yours sincerely

Nick Pilavidis
Chief Executive Officer
Australian Institute of Credit Management

⁷ <https://www.aicm.com.au/about-aicm/advocacy/2023-march-statutory-review-of-the-payment-times-reporting-act-2020-consultation-paper/>

⁸ <https://download.asic.gov.au/media/5416956/rep645-published-18-december-2019.pdf>