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23 September 2003

Ms Kathleen Dermody
The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Room SG. 64
Parliament House
CANBARRA 2600

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

Dear Ms Dermody

INQUIRY INTO AUSTRALIA'S INSOLVENCY LAWS

We refer to your conversation with our Corporate Lawyer, Helen Gordon, of 1 September, and as discussed, would appreciate if the Committee would consider three further issues for members of the Australian Finance Conference (AFC) relevant to the review of the current framework of Australia's insolvency laws in addition to those identified in our submission of 10 July.

1. External Administration - Controllers

Under the Corporations Act, financiers exercising their security rights against defaulting corporations, even in relation to minor items of secured plant, may be construed to be "controllers" and thereby required to meet stringent requirements of the Corporations Law (eg opening of a bank account, reporting obligations). This is because under the Act, a controller of property is broadly defined as:

> (a) a receiver, or receiver and manager of that property; or
> **(b) anyone else who (whether or not as agent for the corporation) is in possession of, or has control of, that property for the purpose of enforcing a charge** (see section 9).

The wide definition of controller captures those who enforce mortgages or charges registered at land titles offices, ASIC and other government bodies, as well as those who enforce unregistered charges. The mortgage or charge may relate to only a small part of the assets of the company. For example, often the finance will involve a single-asset (eg loan secured by a chattel mortgage over a motor vehicle). However, the obligations imposed on a "controller" of a significant portion of the company's assets are equally imposed on the single-security holder. We submit that in the latter case, these obligations are generally out of proportion to the "control" being exercised and unnecessarily add to the costs of the financier which are usually borne by the corporate customer (or others in the insolvency framework). We also note that, if the customer had selected to finance their equipment acquisition by way of equipment lease or hire-purchase; comparable forms of finance, these obligations would not

arise for the financier when looking to protect its interests. Often the impact of other laws, for example GST and state tax, influences customer choice in favour of the chattel mortgage. However, for the reasons outlined above, the impact of the "controllers" provisions of the Corporations Act may mean this product is more costly for them in the long run as the increased compliance costs imposed on the financier are reflected in the pricing of the product.

We recommend that the bulk of the requirements imposed on "controllers" should be quarantined to "managing controllers"; that is, controllers who have taken control or possession of the whole, or substantially the whole, of a company's assets or who actually exercise powers of management. The AFC has raised this concern through a range of Government enquiries and suggested this solution.

In recognition of our concerns, an interim solution was arrived at with the Australian Securities & Investment Commission (then the Australian Securities Commission) to gain administrative relief from the controller's requirement to open a bank account unless money belonging to the corporation comes under their control (see ASIC Policy Statement 106 – copy attached). In the majority of cases this does not occur and yet, without PS 106, the controller may nevertheless have been required to open the bank account. The removal of this requirement through PD 106 allowed streamlining of our members' processes with the attendant cost savings.

However, while providing some relief, our members are still required to comply with the more onerous and costly obligations (eg reporting). As a matter of policy, we suggest that the Committee give consideration to recommending that the term "managing controller" should be limited to controllers who have taken control or possession of the whole, or substantially the whole, of a company's assets or who actually exercise powers of management. Further, the most significant regulation should be confined to those persons. This accords with the discussion of these provisions by the Attorney-General's Department (referred to in the ASIC PS 106 see 106.6) in 1996.

2. Administrator's Notification to Financiers that are Owners / Lessors

The current insolvency provisions of the Corporations Act, particularly those that allow a company to voluntarily put itself into administration when insolvent have implications for equipment financiers. Members of the AFC have experienced difficulties locating equipment financed by them by way of lease or hire-purchase that is no longer required by the Administrator. Under the terms of these financing arrangements, the financier is and remains the owner of the equipment.

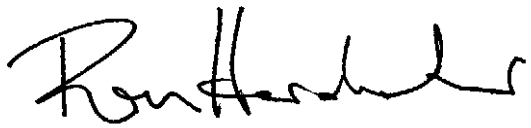
To address the difficulties our members have had when dealing with the Administrators in this regard, we recommend that Administrators should have a greater obligation to ensure that owners of equipment (including Lessors / Financiers) who have been notified that the company does not propose to exercise rights in relation to the equipment can quickly and easily repossess or recover it. In line with this, we suggest that Administrators should be required to detail the location of the equipment in the relevant notice and to ensure that the equipment is available for collection at the location for a set time after service of the notice. Failure by the Administrator to ensure the equipment is at the location when the Owner / Financier seeks to recover it within the time frame should constitute use of the equipment and the notice cease to have effect.

3. Administrator's Payment of Company's Finance Obligations to Financiers that are Owners / Lessors During Period of Grace

A further area arising from the insolvency provisions on the equipment financing business for our members relates to liability for costs arising from the use of such equipment during the period of grace given to the Administrator to determine whether or not the equipment should be retained for on-going use by the company. We are advised by our members that in a significant proportion of cases, financed equipment that the Administrator eventually has decided in favour of disclaiming or retaining has been used during the grace period to generate income. However, we are also advised that there appears to be some divergence in the interpretation of the current provisions of whether the Administrator should bear some responsibility from that income for the costs of the equipment financier during that period. As a matter of fairness we suggest that clarification to support payment of the obligations to the financier in the period of grace should be made by an appropriate amendment to the current provisions.

Thank you for the opportunity to respond to the Inquiry. We understand that the Committee is proposing to hold public hearings in Sydney in November. Should the Committee have any questions about our submissions or require further information we would be happy to appear before it to respond. Alternatively, we would be happy to answer queries either through (02) 9231-5877 or email afc@afc.asn.au.

Yours sincerely,



RON HARDAKER
Executive Director

Attachment:
Australian Securities & Investment Commission – Policy Statement 106 – Controller Duties & Bank Accounts

ASIC - Policy Statement 106
Controller duties and bank accounts

Chapter 5 External administration (Section 421)
Issued 6/5/1996

Headnotes

Controllers and bank accounts; s421; 421(1)(a); money belonging to the debtor company; receivers; receivers and managers of property; charge; power to exempt from or modify s421(1)(a); enforcement of national scheme laws; failure to open and maintain a bank account; money to be accounted for under Pt 5.2 of the Law.

Purpose

[PS 106.1] This Policy Statement sets out the ASC's views on s421. This section requires controllers of property to open and maintain a bank account for depositing money that belongs to a debtor company. Money from the sale of encumbered assets in the possession of a controller must be deposited in such an account.

[PS 106.2] In this Policy Statement references to statutory provisions are to those in the Corporations Law.

Background

[PS 106.3] A controller of property of a corporation is defined as:
(a) a receiver, or receiver and manager of that property; or
(b) anyone else who (whether or not as agent for the corporation) is in possession of, or has control of, that property for the purpose of enforcing a charge (see s9).

[PS 106.4] The wide definition of controller includes those who enforce mortgages or charges registered at land titles offices, the ASC and other government bodies, as well as those who enforce unregistered charges. The mortgage or charge may relate to only a small part of the assets of the company.

[PS 106.5] On one interpretation of s421 the obligations imposed on controllers to open and maintain a bank account arises on the actual appointment of the controller (s421(1)(a)). This is irrespective of whether there is, or will be, any money belonging to the company which must be deposited into that bank account.

[PS 106.6] It has been suggested to the ASC that requiring controllers to open and maintain a bank account in such circumstances imposes unnecessarily onerous and costly requirements on them without any corresponding practical benefits. The issues surrounding the obligations imposed by s421 were recently discussed in two separate papers released by the Attorney-General's Department. The discussion papers considered, among other matters, amending this section so that it would not be necessary to open and maintain a bank account when there is no money belonging to the debtor company.

ASC's enforcement of s421

[PS 106.7] The ASC has no specific power to modify or exempt persons from the duties imposed on controllers by s421. The only discretionary power the ASC has in relation to this section, is how it exercises its

enforcement powers under the national scheme laws to ensure compliance with the section.

[PS 106.8] The ASC considers that no policy objectives are advanced by requiring a bank account to be opened when there is no money belonging to the debtor company to be deposited under s421.

[PS 106.9] Therefore, until the Parliament considers this section, the ASC will not take any enforcement action against a controller who fails to open and maintain a bank account. It will not take action if no money of the debtor company should be, or is likely to be, accounted for under s421.

[PS 106.10] However, if money of the debtor company is required to be accounted for under s421, it is clear that the intention of the Law is that the controller should keep a full record and account of all such moneys. A controller of a debtor company should therefore carefully examine whether at any time during which they act in this capacity they are in control of "money of the corporation" (see s421(1)(b)). This is because in such circumstances they are required to:
(a) pay that money into a bank account maintained by the controller, within three business days after coming in control of money of the debtor company;
(b) ensure that this bank account does not contain any money other than money of the debtor company under the control of the controller; and
(c) keep such financial records as correctly record and explain all transactions that the controller enters into as controller (s421(1)).

[PS 106.11] It has been suggested to the ASC that money held by a controller will only be money of the corporation if it exceeds the amount secured by the charge being enforced by the controller. The ASC does not endorse this as a general view. Whether this is true in any particular case depends on the relevant security documentation evidencing the charge and the transactions entered into under such documentation.

[PS 106.12] This should not be seen as pre-empting the outcome of the review being undertaken by the government. The ASC will review this Policy Statement in light of any final recommendations, if any, made by the proposed legislative review of s421.

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