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Dr Warren Mundy

Presiding Commissioner

Productivity Commission

Access to Justice Arrangements

LB2 Collins Street East

MELBOURNE VIC 8003

By email to business.inquiry@pc.gov.au

Dear Dr Mundy,

**Business Set-up, Transfer and Closure Draft Report May 2015**

The Australian Bankers' Association (**ABA**) is pleased to have the opportunity to provide comments to the *Business Set-Up, Transfer and Closure Draft Report* (**Draft Report**).

The ABA expresses it appreciation for the additional time the Commission has allowed for this submission to be made. We have endeavoured to keep a tight focus on those matters of greater interest to the ABA.

The Commission is commended for the overall quality of the Draft Report which provides valuable analysis and insights into the barriers to business entries and closures, in particular, as they relate to innovative new business models and entrepreneurial activity.

The ABA notes that we provided comments to assist in the development of the Draft Report at the Productivity Commission roundtables in February 2015. The ABA has also provided submissions to a number of recent inquiries that overlap with the issues addressed in this Draft Report, including the development of Government's White Paper on the Reform of Australia's Tax system, the Competition Policy Review ('Harper Review') and the Financial System Inquiry.

## 1. General comments

Subject to the ABA's comments under the several headings below, the ABA is generally supportive of the majority of findings and recommendations outlined in the Draft Report.

We note that the Commission found that access to finance is generally not a significant barrier to business set-up (DF 5.1). The banking industry regards small and medium businesses as a vital part of the economy and is committed to providing businesses with access to finance to support growth (DF 7.2).

While the ABA believes measures to encourage start-up small businesses are positive, we need to ensure that start-ups which use alternative sources of capital are not exposed to undue risks and that appropriate consumer protections are in place.

We also note that the Commission found that Government supported Credit Guarantee Schemes are not the most efficient way to improve access to debt finance for new and entrepreneurial businesses (DF 7.1).

This was supported by analysis of overseas examples that found the effect on the rate of business success is ambiguous and these schemes can create undesirable distortions in the lending market and unintended consequences for access to debt finance more broadly. Government should closely assess the potential costs and benefits before contemplating such schemes in Australia.

The ABA notes the comments in relation to the graduated regulation framework for payment systems (DR 9.1). The banking industry supports the lightest touch regulation in principle. However, we note there may be risks for systemic stability and consumer protection in having different degrees of regulation across competing payment systems which the Commission has recognised. Differential regulation could allow disruptive technology entrants, subject to the lighter regulatory regime, to quickly expand at the expense of existing more heavily regulated traditional providers. Consumer interests should be protected regarding those payments systems subject to lighter touch regulation or no regulation through public education, transparency and disclosure.

## 2. Business Restructuring

The ABA wishes to comment on several of the Draft Recommendations in this section of the Draft Report about which we have some concerns.

### 2.1. Draft Recommendation 15.1

In relation to the trigger for appointment of a Voluntary Administrator (VA) the ABA believes that the current legislative framework works effectively and this is supported by previous inquiries into the voluntary administration regime. This includes the basis upon which directors are able to appoint a VA as set out in section 436A of the Corporations Act. This section already allows a director to appoint 'early' i.e. if the director believes that the company "is likely to become insolvent at some future time", and given the recognition of the inherent difficulties associated with judging the precise moment when a company is considered to be insolvent, there is a valid case against the removal of directors' rights to appoint a VA when the company is already insolvent.

Further, Draft Recommendation 15.2, which is discussed in the following paragraph, supports the view that the determination of when a company is insolvent is not something that directors are able to readily conclude themselves.

### 2.2. Draft Recommendation 15.2

Under this proposal the directors of the company would appoint the advisers to explore restructuring options.

The ABA supports the notion that the directors of a troubled business should obtain sound expert advice before making a decision about an insolvency appointment such as a VA and that there is a form of safe harbour for them to achieve this.

If it is considered there is a need to improve the timing of a VA, then as an alternative there could be director education (for example through the Australian Institute of Company Directors) on when to appoint a VA, including raising the awareness of the creditors' voluntary liquidation (CVL) which provides a quick and relatively lower cost option for a company's liquidation.

Furthermore, the UK experience does not support the proposition that curtailing or abolishing receiverships leads to an increase in the likelihood of restructuring, or if that fails, increased recoveries by creditors.

On a related matter, we make the observation that the Draft Report appears to draw a distinction between "formal" and "informal" restructuring processes suggesting that a more formal process is needed as an alternative to "workouts" as they are described by banks in working with a troubled business customer to put the business in a condition where it able to continue to conduct its business.

There is a thriving workouts culture and practice by banks which often may not be apparent in the wider community.

It is important to recognise that a workout has formality and structure in the approach including restructured contractual arrangements with the customer. A key feature of the workout process is that it is conducted confidentially. This is to ensure that the business does not suffer from a lack of confidence by its creditors and customers if the workout process became generally known. Otherwise, there may be increased problems for the business' survival as a result of, for example, the imposition of restrictive credit terms by creditors, liquidity uncertainty and negative market and customer perceptions.

To ensure the best chances of success for a workout it is essential for it to be conducted confidentially.

For these reasons the approach in Recommendation 15.2 that a company which has appointed advisers should be required to notify ASIC (and where the company is listed, disclosure to the ASX where this would not be required under continuous disclosure obligations) is not supported.

### 2.3. Draft Recommendation 15.4

There is the further association of workouts with Draft Recommendation 15.4.

Apart from the question of *ipso facto* clauses which is discussed below, the ABA considers for the reasons set out above that the current workout practices of banks are consistent with and would not derogate from the objectives set out in Draft Recommendation 15.2.

On the question of *ipso facto* clauses and their capacity to detrimentally impact on a restructuring or workout process, the ABA's view is the proposal to introduce a moratorium on *ipso facto* clauses (DR15.4) is most often considered in the context of preventing the termination of supplier contracts but it seems this would also extend to loan agreements. In this regard, the ABA would seek to ensure that any drafting proposed is limited to preventing termination, and would not affect the set-off right of a bank when the bank is made aware of the appointment of a VA.

## 3. Corporate insolvency

### 3.1. Draft Recommendation 15.5

The ABA notes that a creditor's voluntary liquidation is a relatively simple, quick and low cost process to place an insolvent company in liquidation.

While the simplified "small liquidation" process in this Draft Recommendation is initially attractive, there is the concern that this could facilitate a risk of "Phoenix" activity due to the smaller amount of the company's liabilities i.e. less than $250,000, notwithstanding ASIC's role if it has concerns over illegality of the process.

### 3.2. Draft Recommendation 15.6

With regard to secured creditors (DR15.6), the ABA does not support the amendments suggested.

Court cases evidence that section 420A is readily accessible by creditors and other interested parties to contest whether a receiver (or controller) has discharged his or her obligations in exercising a power of sale in respect of property of a corporation. It is noted that the duty is of a high standard to take <u>all</u> reasonable care not simply reasonable care.

The proposal to introduce a further duty whether in section 420A or elsewhere in the Act for a receiver 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 an ongoing concern for sale purposes, at risk" would lead to the risk of increased litigation at a time when this would be the last thing needing to happen to a business in crisis.

The ABA considers that these amendments would significantly alter the rights of secured creditors in circumstances where there does not appear to be any market evidence to support a suggestion that in selling assets, receivers have caused "unnecessary harm to the interests of creditors, as a whole".

Further, the proposed duty would be vague and difficult to interpret, for example what are interests of creditors as a whole that must not be unnecessarily harmed, or must the receiver refrain from exercising the power of sale if it is foreseeable that realisation of the company's assets could result in a risk that the company may not remain as a going concern for ultimate sale? This would create an uncertain and unworkable situation in which a receiver must make a decision.

The existence of section 420A ensures that the company and unsecured creditors are already protected by the section, which requires a receiver to sell at market value, if there is a market value.

The proposed processes by which creditors of the company might vote on a sale of the company's assets would introduce significant complication and costs to the realisation process.

The additional processes would be likely to slow down the realisation process as it would likely include a need for classes of creditors to be identified for voting purposes including advertisements calling for creditors' claims and evaluating their proofs of debt for voting purposes, separate voting arrangements for each class of creditors all of which would add cost to the receivership.

A problem in calling for creditors' claims is the prospect that this will be taken up at large as an invitation for claims against the company irrespective of the legitimacy of those claims all of which would have to be assessed and decided upon. Inevitably, rejection of some claims would be disputed creating further cost and delay.

## 4. Personal insolvency

### 4.1. Draft Recommendation 13.1

The Australian Financial Security Authority (AFSA) convenes a Bankruptcy Reform Consultative Forum (BRCF) from time on which the ABA has participated for a number of years.

Bankruptcy reform has been considered by this Forum from time to time. The Bankruptcy Act was amended relatively recently to increase the amount on which a creditor's petition may be made for a debtor's bankruptcy to $5,000.00.

The period of bankruptcy was not changed with effect that a bankrupt is automatically discharged from bankruptcy after 3 years unless the court extends the period of bankruptcy.

The ABA considers the current period of bankruptcy of 3 years is appropriate noting that bankrupts are required to make income contributions (if assessed as necessary) during their bankruptcies, that the rate of bankruptcies has been in decline[1] and that relatively few bankrupts would be likely to fall into the category of entrepreneurs seeking to start a new business.

## 5. Commission hearing 30 June –questions on notice

The ABA appreciated the opportunity to participate in this hearing and the further opportunity to take on notice three questions for response to the Commission.

[1] AFSA data March 2015 Bankruptcies have fallen in four consecutive quarters compared to the same quarter in the previous year. All of these falls have been higher than 10%.

## 5.1. Is there any data on the frequency and/or nature of informal workouts and instances where banks call in loans made to small businesses

The ABA notes that there is currently a Parliamentary Joint Committee (**PJC**) on Corporations and Financial Services' inquiry into the impairment of customer loans. These issues raised by the Commission with regard to workouts will likely be considered by the PJC.

To extract these data that the Commission is seeking would take a significant amount of time and resources to do.

As mentioned in the section about on Draft Recommendation 15.2 there is a thriving workouts culture and practice by banks which often may not be apparent in the wider community.

In the Senate Economics Committee inquiry into Inquiry into Access of Small Business to Finance in June 2010, the Treasury submitted:

> *More generally, there are also signs that Australian lenders continue to support the small business sector. For example, in early 2009, a number of banks, including major banks, announced additional initiatives to support small business through the global financial crisis. While these varied depending on the institution, they included forums to provide advice to small businesses, discounted interest rates, improvements to e-commerce, employment of additional small business experts and relationship managers, and offers of assistance to small businesses experiencing hardship.*[2]

This is reinforced by the ABA's Code of Banking Practice which obliges a bank, with the agreement and cooperation of its small business customer to try and help the customer overcome its financial difficulties with its credit facility with the bank including working with the customer to develop a repayment plan.[3]

## 5.2. Evidence on what effects the Commission's recommendation on changing the duties of receivers might have on the cost of capital/loans provided to businesses

Banks, as prudentially regulated financial institutions are required by the Australian Prudential Regulation Authority to price their business loans according to risk and loss given default and hold capital against these exposures.

Regulatory change can affect a bank's assessment of risk and have an impact on the pricing of risk. In the question above, the potential for a receiver acting on the appointment of a bank to a financial troubled company to be subject to the increased risk of litigation in the conduct of the administration, including the risk that a process of realisation of the company's assets may be delayed or thwarted by a creditors' vote could directly impact the bank's risk assessment and its pricing decisions.

## 5.3. Views on how APRA might treat an investment made by a bank into a peer-to-peer lender

The ABA recognises the competitive market aspects in the emergence of peer-to-peer lending.

It is not known how APRA might respond to a bank investing in a peer-to-peer lending business.

It is expected that APRA would require the bank to ensure that its investment and arrangements with the lender would not give rise to risk contagion for the bank.

The Commission may prefer to ask APRA for its view.

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[2] See http://www.aph.gov.au/DocumentStore.ashx?id=e7180d1b-99f3-4845-bb89-f93be9820ab0

[3] See Code of Banking Practice clause 28.2 at http://www.bankers.asn.au/Industry-Standards/ABAs-Code-of-Banking-Practice/Code-of-Banking-Practice-2013---Online-Version

In conclusion, if you need further information or wish to discuss or clarify any aspects of this submission, please contact Amanda Pullinger, Policy Consultant or me directly.

Yours sincerely,

Ian Gilbert