



1 March 2010

Australian Institute of Credit Management Submission re

Insolvent Trading: A safe harbour for reorganisation attempts outside of external administration

The Australian Institute of Credit Management (AICM) has carefully considered the three options outlined in the discussion paper *Insolvent Trading: A safe harbour for reorganisation attempts outside of external administration* namely:

Option 1: Status quo

Option 2: Modified business judgement rule

Option 3: Moratorium

AICM strongly supports option 1 to maintain the status quo. AICM is opposed to options 2 and 3. The reasons for this conclusion are set out below.

The substantial factors that have influenced AICM's position in relation to the proposed insolvency reforms is summarised as follows:

The number of small and medium sized businesses compared with the number of listed companies.

The Australian Bureau of Statistics states, in its publication *Counts of Australian Businesses, Including Entries and Exits*, that there were

'...2,011,770 actively trading businesses in Australia as at June 2007. At June 2007, there were 641,538 (32%) companies in Australia followed by 620,037 (31%) sole proprietors, 385,801 (19%) partnerships and 364,075 (18%) trusts.

At June 2007, there were 839,938 (42%) employing businesses and 1,171,832 (58%) non-employing businesses. Most employing businesses, 755,758 (90%) employed less than 20 employees. This comprised 527,445 (70%) businesses with 1-4 employees and 228,313 (30%)

businesses with 5-19 employees. There were also 78,304 (9%) businesses with 20-199 employees and 5,876 (<1%) businesses with 200 or more employees...¹.

AICM has highlighted this data as evidence of why AICM is so reluctant to support changes to the existing insolvent trading regime.

Companies which are of sufficient size and complexity are more likely to have access to the advice and guidance which would enable their directors to manage a 'work-out'. Small and medium sized businesses are less likely to have access to or even consider the engagement of appropriate expertise. This would mean that only 1% of the businesses counted by the ABS would, in AICM's view have, the potential to effectively manage a 'work-out'.

This number becomes even smaller if the number of listed companies is taken into consideration. Currently some 2,175 companies are listed on the Australian Stock Exchange (ASX). AICM would contend that this pool of organisations are the most likely to have the expertise available to manage a 'work-out'. Thus the proposed amendments would assist no more than 1% of the corporate demographic.

The extent of commercial credit

The value of the provision of credit to the Australian economy is significant. Whilst the Australian Bureau of Statistics (ABS) does not collect official figures for the value of commercial business to business credit, using the most recent ABS Input-Output Tables² together with the annual AICM National Credit Industry Survey it is conservatively estimated that commercial credit is provided to an annual value of \$600 billion. This figure does not reflect consumer credit or loans to business. Thus it may be concluded that any consideration of changes to insolvent trading must be considered with extreme care.

Consideration of the cost of possible alternatives should not only be considered from the perspective of the business at potential risk but also from the perspective of the creditors, many of whom will be businesses which can ill afford

¹ ABS *Counts Of Australian Businesses, Including Entries And Exits* Cat 8165.0 December 2007 www.abs.gov.au

² ABS *Input-Output Tables* 2004-2005 Cat No 5209.055.001 www.abs.gov.au

the possibility of incurring further losses should a company be able to continue to trade whilst insolvent. It would seem to AICM that the onus of protecting directors from possible penalties for trading whilst insolvent seriously overlooks the need to protect creditors from further detriment.

There would appear to be little incentive from a creditor's perspective to support the continued provision of credit to a company that is being managed by the same persons who allowed the company to become insolvent in the first place.

Better regulatory practice

It is AICM's conclusion that of the many lessons that can be gained from the impact of the 'global financial crisis' the dilution of appropriate regulatory infrastructure was a major contributor to the resulting unnecessary risk taking.

This conclusion is supported by research such as the Dahlem Report³.

AICM acknowledges Minister Bowen's recent statement to the ASIC Summer School that

'...The Australian Government's response to this is that the key to proper regulation is to have better regulation, not more regulation...'⁴

However, AICM is at a loss to determine how the proposal to have an alteration to the business judgement rule or a moratorium constitute better regulation.

Thus AICM believes that any diminution of the current regulatory provisions such as proposed in options 2 and 3 could lead to an enhanced risk appetite by directors and the outcome could be of a greater detriment to the Australian economy.

³ Kiel Working Paper 1489 *The Financial Crisis and the Systemic Failure of academic economics* Kiel Institute for the World Economy February 2009.

⁴ Chris Bowen Minister for Financial Services, Superannuation and Corporate Law; Minister for Human Services Luncheon Address ASIC Summer School Grand Hyatt, Melbourne 2 March 2010

Disadvantages of a 'work-out'

AICM believes that the disadvantages of a 'work-out' as outlined in the consultation paper serve to reinforce AICM's view that the proposed reforms would be detrimental. This conclusion has been reached taking into account the proposed protections outlined in the discussion paper. It is AICM's conclusion that the potential costs to the Australian economy of these reforms far outweigh any benefits that may accrue.

Conclusion

For the reasons outlined above AICM supports Option 1 and opposes Options 2 and 3.