Australian Institute of
CREDIT MANAGEMENT

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2017

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About the AICM

The Australian Institute of Credit Management (AICM) is Australia's leading professional member body for commercial and consumer credit management professionals across all industries and sectors, and the only credit industry specific Registered Training Organisation in Australia.

We have developed an accreditation process for Credit Executives to recognise current knowledge and practice in the credit industry. Today we have 121 members holding the title Certified Credit Executive.

The AICM was founded in 1937, incorporated in 1967 and has established a trusted reputation as the professional body for setting professional standards and providing for the education, career needs and interests of all who work in the credit industry.

The AICM represents, develops and recognises the experience of over 2,500 individual members working in over 1,300 companies including 34 of the ASX 100 and global organisations in all industries and sectors.

Our members are credit professionals in roles relating to consumer and commercial credit including the obtaining or providing credit, collecting debts, financing invoices, enforcement of payment obligations, credit scoring and managing security interests.

While the AICM membership represents businesses of all types, including banking and finance, this submission is made with a focus from the view point of our members in businesses that supply goods and/or services on extended payment terms i.e. they are credit/finance suppliers as a result of their core business. We refer to these organisations, as Trade Credit Providers ("TCP's) who (aside from PPSA rights) would be unsecured creditors in insolvency.

Treasury Laws Amendment (2017 Enterprise Incentives No.2) Bill 2017 [Provisions]

This Bill was passed with only minor amendments in September 2017. It makes amendments to the Corporations Act insolvent trading provisions to substantially reduce the potential for the personal liability of officers[1] (and that of holding companies[2]), for debts incurred by a company during the insolvent trading of a company[3]. These are called the "safe harbour" provisions.

It is AICM's view that a safe harbour defence should only be available to honest and diligent directors who (having ought to have reason to suspect insolvency of their company) seek professional insolvency advice. Unfortunately there is no requirement to obtain advice from an appropriately qualified independent professional advisor. This could have the following unintended consequences:

- Increased losses to creditors as a result of increased incidence of insolvent trading without adequate mitigation of risks for creditors.
- Increased losses to creditors as a result of illegal phoenix activity and unregulated, untrustworthy pre-insolvency advisors.
- Restriction in trade credit being provided to businesses who are seeking to restructure causing the benefit of a safe harbour defence.
- Increased cost and complexity to creditors as a result of unfair preference claims

The Minister must cause an independent review to be undertaken as soon as practicable after the last day of the 2 year period commencing on the new "safe harbour" provisions[4].

A safe harbour process that enables the orderly restructure of a business is supported by our members however there is concern that the defence as drafted will lead to significant unintended adverse outcomes arising from increased high risk trading.

A business that trades whilst potentially or actually insolvent does so at significantly higher risk of commercial harm to creditors than at other times. This risk cannot be fully minimised however all practical steps should be taken to ensure the risks are reduced and the chances of recovery are maximised.

Minimisation of the risks can be better achieved through the incorporation of a mandatory requirement to seek advice from an appropriately qualified independent professional which will significantly mitigate potential commercial harm to creditors. These mandatory requirements were not included in the safe harbour provisions. Key reasons to support this outcome include:

- Independence brings a fresh and unbiased perspective of the financial situation and the potential for better, more informed outcomes. The value of a truly independent expert advisor without vested interest, to businesses experiencing insolvency, cannot be underestimated.
- Appropriately qualified specialists bring knowledge and expertise of the unique circumstances of insolvency and restructuring.
- For a course of action to achieve a better outcome than a formal liquidation process, a strong understanding of insolvency processes and the costs and expected outcomes is essential.
- A safe harbour defence should only be available to honest and diligent directors and it is the AICM's view that a diligent director with reason to suspect insolvency ought seek professional insolvency advice and including this requirement ensures an appropriate level of risk management.

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[1] Section 588G(2) *Corporations Act* by safe harbour defence created under a new *588GA Corporations Act.*
[2] Section 588V by safe harbour for holding companies (who allow subsidiaries to trade whilst insolvent) under the new 588WA *Corporations Act*
[3] See sections
[4] Section 588HA *Corporations Act* (introduced as part of this Bill) requires this.

The AICM policy is that the current safe harbour provisions should be reviewed on an ongoing basis from members' opinion before the 2 year review period, and suitable submissions made again on such review for the introduction of the mandatory requirements.

Practices permitted by Corporations Act

Our members regularly experience actions that are in accordance with the Corporations Act but which are clearly unfair, inefficient and of no benefit to the majority of stakeholders. Further, our members regularly state that as unsecured creditors they unfairly bear the cost of the liquidation process.

Considering the changes introduced by the the safe harbour defence there is escalated need to continue to review members' opinion and experience as to their effect and whether they suitably address the issue and implement reform in respect of unfair preferences.

The ASIC in its information sheet 45, "Liquidation a guide for creditors" defines a Preference payment as "a creditor receives an unfair preference if, during the six months prior to liquidation, the company is insolvent, the creditor suspects the company is insolvent, and receives payment of their debt (or part of it) ahead of other creditors. To be an unfair preference, the payment must put the creditor receiving it in a more favourable position than other unsecured creditors."

The ATO define a preference payment as *"Unfair preferences usually involve transactions that discriminate in favour of one creditor at the expense of other creditors. The aim of the law outlined below is to ensure creditors are treated equally by preventing any unsecured creditors from receiving an advantage over others."* https://www.ato.gov.au/tax-professionals/your-practice/insolvency-practitioners/preference-payments/preference-payments-for-companies/ accessed 3/7/15.

Conceptually the preference payment regime seems reasonable but in practice it results in undue burden on businesses. The AICM's concerns are best summarised as:

1. The time frame for liquidators to commence recovery action is currently 3 years from the commencement of insolvency. This time period is unreasonable as demonstrated by the example below.

2. Preference claims are routinely pursued and which result in no return to unsecured creditors, effectively meaning unsecured creditors are funding the insolvency process.

3. The test of suspicion of insolvency is too onerous.

4. Organisations that undertake effective collections activity are penalised in favour of other organisations that may not have taken any collections activity.

In summary the current regime is unproductive and burdensome on organisations that are following normal commercial practice.

The AICM strongly holds the position that the *Corporations Act* should be amended to:

- Limit the time period for liquidators to commence action to recover preference claims to 12 months from the commencement of the liquidation.

- Limit preference claims to circumstances where the creditor was aware of insolvency and used influence other than that available to creditors generally.

  This would limit the liability to circumstances where the creditor has used their unique position in order to obtain a preference over general creditors. An example may be a creditor supplying a unique component withholds supply and seeks payment earlier than it has previously or the franchising example noted in the next section.

The AICM acknowledges that an impact of this recommendation may be the reduction in the options available to fund the insolvency process. However this does not justify the current arrangements which see unpaid third party creditors or "victims" of insolvency, they regularly receive no return, bearing significant cost of the insolvency and are the lowest priority in terms of distribution.

The small liquidation recommendation and increasing the funding of the assetless administration fund as recommended in the draft report are significant measures that could be used to address this funding issue.

The unfair preferential payments regime definitely has a place but we feel this should be limited to situation where the creditor has used a position or tactics not in line with those reasonably expected by a creditor in the normal course of business.

Prompt Payment Practices

The AICM is concerned that the Australian economy is being held back by slower payment times and action is needed to reset businesses attitudes to payment times.

The recommendations of the Australian Small Business and Family Enterprise Ombudsman are supported by the AICM namely:

1. Government at all levels acting as a role model and setting best practice payment times, including through their contracting and supply chains
2. There be mechanisms in place to regulate and monitor what is Prompt Payment times, such as a Prompt Payment Code and register such as in the UK with the key elements being:
    a. Initially voluntary registration
    b. All participants uploading information in standard forms documenting their payment practices, requirements for invoicing and internal dispute/complaints processes
    c. All participants agreeing to adhere to a maximum payment term
    d. Monitoring of compliance to the published documents and maximum payment terms, with a review process and potential removal from the register
    e. Potential mandatory registration via legislation
3. Legislation such as mandatory reporting of payment times, practices and performance by ASX listed companies and setting of maximum payment times

The feedback from our members and via our participation in the inquiry gives the AICM certainty that there is an issue with payment times in Australia and without action driven by government there will be no sustainable motivation for change

Clarity in contracting

The AICM strongly supports initiatives that aid credit providers identify their counterparty and therefore conduct efficient risk assessments.

Initiatives such as the Director Identification Number, uniformity of Trusts information and identifying small businesses will aid all credit providers and specifically trade and unsecured credit providers.

The RBA put the value of outstanding trade credit at any one time at $80bn in 2013 showing that this source of credit is important to the Australian economy. Most credit providers are unable to require provision of supporting documentation when opening an account and rely on government data and credit bureaus (such as Dun and Bradstreet and Equifax).

When dealing with other than ASX listed or those required to provide financial reports to ASIC the clarity of information is limited and this is amplified with Trust structures and small businesses.

Director and Sole Trader Identification Number

Will ensure integrity of ASIC information therefore improving credit bureaus data and reporting and essentially leading to better risk mitigation by credit providers. Benefits will also flow to government and business through better identification and prevention of illegal phoenix activity.

Equally, the provision of a identifier to a sole trader would also ensure transparency and better quality of credit reporting.

The linking of such identifier numbers to the AFSA data base of bankrupts would further make efficient credit checking better available to providers of business and consumer credit.

Uniformity of trust information

Many credit providers are exposed to un-necessary risks by not correctly identifying or contracting when businesses are operated via trusts.

Trade Credit providers are not able to insist on trust deeds being supplied let alone being notified of changes. The inconsistent form of trust deeds also inhibits efficient assessment of these documents.

These complexities often result in businesses not trading with trusts or lack of enforceability or additional costs to enforce liabilities.

The requirement for Trust Deeds to be in a standard form and/or to be registered has the potential to alleviate these complexities, increase credit provided to these businesses and reduce costs and bad debts.

AICM strongly supports the ABN register being enhanced such that the legal entity trustee of the ABN for a trust is also identified on the public face of the ABN register, and is so liable for the obligations incurred whilst they so appear on such ABN register.

Identifying small businesses

With various legislation and government entities all having different interpretations of small businesses confusion is constant.

Harmonising the definition will have benefits for businesses in adhering to obligations, such as unfair contracts legislation, and supporting small business, by providing faster payment terms than standard. The flow on effect of this is that small businesses are stronger and are more able to grow their business, invest and hire more staff leading to a stronger economy.

Incentive to extend credit to start ups

Our members are the controllers of the financial quality of their firm's accounts receivable asset and are responsible for protecting this asset and to in due course convert it to cash. Our members are often closer to their customers than their bankers and have a detailed understanding of these customers industries and funding needs.

A current constraint in the Australian economy is the reliance upon the ownership of real property as security before credit will be granted. This impacts the ability of business owners to access funds at competitive rates. This situation is ameliorated once a business matures and reaches a certain size.

For a credit manager to open a credit account they must test the creditworthiness of the customer and consider appropriate security such as a personal guarantee of the director(s).

This work is all undertaken from the perspective that the credit manager and these processes are a cost to the business and that the granting of credit is necessary to support to sales. This is balanced with the fact that there is no incentive to the business owners to take unnecessary risk when their competitors also follow the same strategy.

Our members have access to further credit facilities which could be deployed to assist with the transformation of the economy to a more entrepreneurial and jobs growth focus, stimulating innovation and economic prosperity. The Reserve Bank's September 2013 paper "The Use of Trade Credit by Businesses" calculated that in March 2013 trade credit owed by Australian businesses exceeded $80 billion.

As noted by Senator Amanda Vanstone in her address to the AICM's National Conference as far back as May 2000, "training is essential for staff to correctly identify fraud in credit applications." Fraud and credit management and therefore specific skills used by our members and competent, qualified credit managers. A qualified credit manager (those holding a minimum of Certified Credit Executive and/or Diploma status) could be encouraged to increase their credit risk to start-up businesses if there were favourable taxation consequences. The qualified credit executive would review the credit application and based on defined taxation criteria would be entitled to a 150% tax write off of the debt should that entity become insolvent and the debt not be recovered from the guarantor.

Our initial proposal for businesses to be included in this incentive would be:

1. Business assessed for credit by approved reviewer to prevent fraud, and
2. Trading for less than 5 years before insolvency, and
3. Personal guarantee is held which is not recoverable.

This tax incentive would be available across all non-banking sectors thereby giving all trade credit suppliers with appropriately qualified risk controllers the incentive to support emerging businesses particularly those without real property asset backing in start-up mode.