Australian Institute of Credit Management

2017

Key policy positions

Items where action is needed

1. **Practices permitted by Corporations Act**
2. **Safe harbour defence to insolvent trading**

Items currently subject to formal consultation

1. **Prompt Payment Practices**
2. **Illegal Phoenix Activity**
3. **Australian Taxation Office to disclose defaults to Credit Reporting Bureaus**

General positions

1. **Incentive to extend credit to start ups**
2. **Clarity in contracting**

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.

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Items where action is needed

1 - 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.

2 - Safe harbour defence to insolvent trading

The Treasury Laws Amendment (2017 Enterprise Incentives No.2) Bill 2017 was passed in September 2017. It amended 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.

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.

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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.

Items currently subject to formal consultation

1 - 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.

Between November 2016 and April 2017 the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) conducted a Payment Times and Practices Inquiry. The AICM participated in this inquiry as a reference group member.

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. Industry codes which regulate business to business transactions to include best payment practices including set payment times.
3. Australian Government legislate larger businesses (top 100 ASX listed) to publicly disclose all of their payment times and practices and performance against those terms.
4. Australian Government to introduce legislation which sets a maximum payment time for business to business transactions.

Additionally the AICM believes the following initiatives could promote better payment practices and performance for all businesses:

1. There be mechanisms in place to regulate and monitor payment times, such as a Prompt Payment Code and register used 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
2. Government support and encouragement of credit management best practice, specifically:
    a. Simple and clear information for small and micro businesses
    b. Encouraging businesses of all sizes to employ and train qualified credit professionals such as via our policy “Incentive to extend credit to start ups”.

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.

The AICM continues to work with the ASBFEO to identify initiatives to improve payment times in Australia and currently await a formal response from the Minister for Small Business, the Hon. Michael McCormack MP, to the report present by the ASBFEO in March 2017.

2 – Illegal Phoenix Activity

Conservatively illegal Phoenix Activity is estimated to cost the Australian economy $3.2 billion annually with much of this cost born by AICM members organisations.

At the 2017 National (11-13 October 2017) Adrian Brown (ASIC) and Brett Martin (ATO) summarised some of the work of the phoenix taskforce. While the work of the taskforce is expansive and considerable, it was evident from our members' questions that extreme frustration remains at the perceived lack of enforcement of existing laws to combat issues relating to illegal phoenix activity.

In October 2017 the AICM provided a detailed submission to Treasury following the Turnbull Government announcement on 12 September 2017 of a proposed comprehensive package of reforms to address illegal Phoenixing.

Broadly the AICM welcomes efforts that deter and disrupt this activity and supports many of the proposals of the reform package. However the believes the current laws are not being used to full effect and strongly advocates for these to be enforced actively to provide the strongest deterrent.

A "hard line" approach to regulated advisors, directors and promoters who display behaviours likely to deny creditors access to assets to meet unpaid debts, would achieve the goals of deterring and disrupting illegal phoenixing as well as providing clear conduct parameters for all parties to observe.

Further, the AICM strongly encourages prioritisation of the governments previously stated objectives of disclosure of tax debt information and establishing Director Identification Numbers. These measures will help address existing gaps in the system that facilitate illegal phoenix activity.

Summary of reforms proposed and AICM's position

	Reform	**AICM position**	**AICM comments**
1.	Phoenix Hotline	supportive	Reporting will be limited until creditors perceive that action is likely to be taken.
2.	A specific phoenix offence	Supportive	This measure should allow Liquidators to require the recipient of assets to return or pay compensation unless they can prove to a court that the transfer was not for the purpose of avoiding creditors
3.	Designating breaches of existing provisions as phoenix offences	Supportive	On its own this measure will have limited affect but is valuable when combined with the High Risk Entity proposals
4.	Limiting backdating of director appointments and resignations	Supportive	Address a loophole used to avoid director liabilities
5.	Limit a sole director's ability to resign without a replacement director or winding up	Supportive	Prevents assets being stripped while no directors are in-place therefore avoiding liability.
6.	Restricting the rights of related creditors to vote at creditors' meetings	Supportive	Will prevent directors controlling outcomes of insolvency processes not in the interest of general creditors.
7.	Promoter penalties	Neutral	The AICM encourages measures that assist prosecution of advisors that facilitate illegal phoenix activity but recommends that existing laws are utilised and a requirement for advisors to be registered be adopted
8.	Extending the DPN	Supportive	stops the officers setting up another business unfairly competing

	regime to include companies' outstanding GST obligations		against proper businesses
9.	Strengthening security deposits	Supportive	By allowing the ATO to pursue the requested security deposit amount from a third party will be counter the current loop hole when penalties are less than the requested security.
10.	Dealing with Higher Risk Entities	Supportive	By identifying directors, promoters and facilitators of illegal phoenix activity as high risk operators is supported where it facilitates enforcement of available laws.
11.	Appointing liquidators on a cab rank basis	Unsupportive	This measure is not seen as efficient and feels that current regulations are sufficient (if fully enforced) to ensure independence.
12.	A Government Liquidator	Unsupportive	The AICM recommends the government play an active role by funding and supporting private liquidators. The AICM suggests that consistent funding at a significant and publicly promoted level will effectively and efficiently deter illegal phoenix.
13.	Removing the 21 day waiting period for a DPN	Supportive	Where entities have been deemed high risk this measure could reduce the ability of operators to dispose of personal assets.
14.	Providing the ATO with the power to retain refunds	Supportive	This measure will prevent lodgements being timed to obtain refunds prior to lodgements creating liabilities when applied to high risk entities.

Please email nick@aicm.com.au for a copy of the AICM submission.

3 - Australian Taxation Office to disclose defaults to Credit Reporting Bureaus

In the 2016-17 Mid-Year Economic and Fiscal Outlook (MYEFO), the Government announced that from 1 July 2017, it will allow the Australian Taxation Office (ATO) to disclose to Credit Reporting Bureaus (CRBs) the tax debt information of businesses that have not effectively engaged with the ATO to manage these debts.

This measure will apply to taxpayers with Australian Business Numbers and a tax debt balance exceeding $10,000 for more than 90 days.

It is the AICM's position that this measure not only significantly (not fully) closes a gap in information needed to allow credit providers to fully assess the risk of providing credit but also has the potential to limit illegal phoenix activity.

Currently credit professionals are generally not aware of current status of a customer's tax obligations and regularly face situation where significantly aged and high value tax debts are only known on commencement of a formal insolvency process. Obtaining this information at an earlier stage would have assisted the credit professional in mitigating the creditors exposure.

Further, once fully established this measure has the potential of increasing confidence when providing credit to small and new businesses as an absence of default information may provide comfort that obligations are being met. Currently, a negative bias can be assumed due to the lack of information.

The AICM believes that the following should be considered in respect to the drafting of legislation and in answer to concerns and assumptions that may be raised by various parties to this measure:

- Defaults remaining after payment
  The AICM strongly supports defaults remaining on file once paid or under a payment arrangement, on the understanding the status is updated to reflect this. This is current industry practice and is vital data point.

  Disclosures of tax debt increases transparency. To remove them reduces transparency.

  While a paid default does have some negative impact on a credit assessment this is balanced by the fact payment has been made and other relevant factors.

  Removing the default without trace:
  - provides a misleading picture of the tax payer
  - removes an opportunity for potential risks to be mitigated
  - lessens incentive to engage with the ATO

- Defaults remaining after dispute
  The AICM supports defaults remaining whilst the account is in dispute, on the understanding the status is updated to reflect this.

  The default remains relevant to show there has not been engagement and allows better assessment of the risk.

  Importantly, to remove the defaults would encourages gaming of the system

- Defaults loaded in error
  Any defaults loaded in error must be removed immediately. The longer erroneous information remains on file the greater the impact.

  The AICM encourages the ATO to ensure adequate resources are allocated to ensure claims of errors (from tax payers or their agents e.g. credit repairers) are expediently investigated and responded to. Delays and inefficiencies in addressing these claims have the potential to undermine the effectiveness of this process.

- Ability to obtain finance
  It is a common misconception that a company with a default on its credit file, whether outstanding or paid, will not be able to obtain credit while this remains on file. The AICM strongly disagrees with this position as AICM members regularly provide credit to entities with such records and the customer works with them to document their capacity and credit worthiness. Defaults are one on of a number of data sets used to assess credit and are weighted according to dollar value, age and status. Even where security is not available, credit may be provided with lower credit limits and/or terms e.g. 15 days rather than 30 days.

- Adverse effects on small business
  The AICM strongly supports the proposal to only disclose defaults when the tax payer has not effectively engaged with the ATO. This engagement measure means that tax payers facing short term impacts on their ability to meet their obligations will not be disclosed provided they are engaging with the ATO.

  Organisations that do not engage with the ATO or are facing permanent/long term impacts represent increase risk to credit providers, including small businesses.

  The proposal also ensures businesses that are not meeting their obligations are obtaining an unfair competitive advantage.

  Further, the clear indication of a credit risk will enable small businesses to assess the risk of their customers.

  Essentially, the vast majority of small businesses that intend to meet their obligations will benefit through a better risk assessment of their customers and lessening artificially low pricing of competitors that are not meeting their obligations (such as illegal phoenix operators), whilst maintaining the ability to work with the ATO when faced with short term cash flow problems.

- Phased implementation
  Once legislated the AICM encourages the ATO to implement in a methodical and phased manner to ensure the correctness of defaults and their processes

- $10,000 value and 90 days
  The AICM sees these values as being appropriate minimums for the recording of defaults with the understanding that the ATO will have exhausted all efforts to encourage engagement prior to the 90 days period.

  The $10,000 minimum may have potential for some organisations to manipulate the system and the AICM suggests that a mechanism for review be included.

General positions

1 - 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.

2 - 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.