01 October 2021

Market Conduct Division
Treasury
Canberra
By email: Safe HarbourReview@treasury.gov.au

Dear Sir / Madam

Review of the insolvent trading safe harbour

We refer to the above consultation process.

The response of the Australian Banking Association (ABA) and its members is outlined below.

Key points

- The eligibility requirements to trigger the safe harbour protections are too onerous and should be amended
- Use of the safe harbour should be made more cost effective
- The safe harbour regime would be improved by reducing complexity and providing more certainty in interpretation
- The safe harbour regime should provide for better incentives for the involvement of professional advisers
- Provide for advice to be obtained from a registered liquidator to ensure that it is appropriate
- Increase awareness of the safe harbour regime
- Any changes to the disclosure requirements for safe harbour should recognise that disclosure of the safe harbour restructuring plan is not appropriate in all circumstances
- Consider shifting the burden of proof to establish safe harbour defences to insolvent trading

Overview

Consistent with the Treasurer's requirement to commission an independent review of the insolvent trading safe harbour provisions (safe harbour) in the Corporations Act 2001 (Cth) (the Act), it was announced in the 2021-22 Budget that a review would commence in August 2021 to assess whether the safe harbour is achieving its aims, including giving financially distressed but viable companies more 'breathing space' to restructure their affairs.

The ABA supports the safe harbour regime as a sensible motivator for early consideration of and engagement with restructuring options, which ultimately leads to better outcomes for the community. We are strongly aligned with the aims safe harbour is trying to achieve including giving companies of all sizes the best possible chance to successfully restructure and continue trading, to the benefit of the company and its creditors as well as the broader economy.

However, we are concerned that while there has been some take up of the safe harbour regime, there are a number of elements currently precluding its widespread use. The Government's independent review presents an opportunity for reform to facilitate a broader uptake and meaningful engagement with the regime by company directors.

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Greater use of safe harbour by company directors as a pro-active step early in the process to consider and implement balance sheet and operational restructures and engage with creditors to effect a solvent restructure would represent a good outcome. Where necessary, the breathing space offered by safe harbour as a defence to insolvent trading, should be utilised by directors to consider formal restructuring options and plan how to effectively access, engage with and manage those processes.

Targeted reform could have the result that safe harbour is seen less as a protection only for directors and more awareness is raised of its role as an effective tool in the restructuring tool kit and a means to manage solvent or formal restructures.

To assist the review panel, outlined below are the matters we see as key to suitable reforms.

Amend eligibility requirements

The eligibility requirements to trigger the safe harbour protections are onerous. For example, the requirement for a company to be meeting all its tax reporting obligations may not be realistic for distressed companies, particularly in the SME sector. In our experience, tax arrears and reporting disorganisation may not be related to financial stress or can appear much earlier in the stress cycle than insolvency considerations by company directors. Our view is that consideration should be given to revising the wording such that:

- company directors need only to have taken genuine steps to organise repayment or remediation arrangements with the ATO; or
- need to comply with only a clearly defined set of tax reporting obligations over a specified period rather than at all times (for example, tax or other payment obligations under agreed payment plans and financial statements are up to date for the previous 2 financial years).

Make safe harbour more cost effective

We understand from industry professionals that the cost of the initial legal advice and restructuring plans from the proposed safe harbour adviser can be significant and often come at a time of financial stress. For the SME sector, this is prohibitive.

Additionally, the requirement that directors should continually assess whether their chosen course of action will still lead to a better outcome has practically meant that qualified professionals are kept on retainer for an expensive monitoring process in order to comply with the safe harbour regime.

Our view is that the requirement to continually monitor the plan for its compliance with leading to a “better outcome for the company” should be reconsidered, for example:

- to permit directors to continue to act in good faith in continuance of a plan for a period of time without the need to continually monitor; and/or
- only requiring monitoring within certain time frames (such as once a month or quarter) or if material events occur which may impact the safe harbour plan, clearly being mindful of continuing to uphold the integrity of the regime.

Other measures which might reduce the cost should also be considered, for example, encouraging safe harbour advisers and legal advisers to provide flexible or alternative fee arrangements.

Addressing the issues raised in this submission will also contribute to reducing the cost of meeting the requirements of safe harbour.

Simplify and reduce uncertainty

The current test regarding one or more courses of action that are “reasonably likely to lead to a better outcome” for the company has not been tested by case law, and as a result, there is limited certainty on the meaning and how to comply.

The safe harbour regime would be improved by considering the following amendments:

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- an alternative test could require a director to take steps in good faith rather than the steps being "reasonably likely to lead to a better outcome";
- the legislation might also clarify the stakeholders that should be considered when considering what constitutes a "better outcome for the company". Those stakeholders should include creditors and would align with the common law directors duties; and
- until reforms are implemented, or even if no reforms are proposed, improved guidelines from regulators including clear examples illustrating common safe harbour situations might assist company directors and professional advisers as to the interpretation of the regime.

Additionally, there is an evidential burden on company directors seeking to rely on safe harbour. The review panel could consider the circumstances in which the burden of proof should be reversed.

Better incentives for professional advisers

Under the current regime a safe harbour adviser is expressly conflicted from taking any subsequent formal insolvency appointments. This could be driving limited uptake of safe harbour and the unintended consequences that advisers recommend formal appointments as part of their initial advice or engagement with directors, instead of recommending that safe harbour be considered or utilised. While we acknowledge and support matters of independence, it is clear this should be a focus. There would be inherent conflicts of interest should a safe harbour adviser be subsequently appointed as a voluntary administrator. An administrator would be required to investigate and assess decisions made by directors in the context of a safe harbour restructure plan. They could not do that independently if they had advised on the plan.

However, we also think there is a real, practical economic disincentive for practitioners to recommend safe harbour as part of a solvent restructuring plan or a pre-planning tool for formal process. Limiting the exclusion of further appointments to appointments as administrators or liquidators would allow the safe harbour adviser to take appointments as a receiver, adviser through a scheme, or otherwise effect the safe harbour plan. This would assist and support the directors and the company through the whole process, even where a formal process is required, rather than only being engaged to provide advice.

Ensuring appropriate advice

The safe harbour regime requires advice from an "appropriately qualified entity". This term is undefined. It may be preferable for advice to be obtained from a registered liquidator to ensure that appropriate advice is being given. Alternatively, a separate category of safe harbour advisers could be considered such as successful existing turnaround firms, noting registered liquidators remain included in that category.

Director education and awareness

Currently the use of safe harbour protections is viewed as a late or last minute option in the stress cycle when companies are in significant financial distress. While we have limited visibility of the steps being taken by directors leading into safe harbour, we consider that the awareness and understanding of safe harbour could be improved.

Our view is that better education of company directors will help to provide broader awareness of the safe harbour regime and encourage more focus on turnaround and restructuring. We hope that this will bridge any disconnect and foster genuinely better outcomes by safe harbour being known as an effective option available far earlier in the stress cycle.

The Australian Securities and Investments Commission (ASIC) should provide guides and commentary for directors to understand the safe harbour regime. While such guides are available for formal processes, ASIC does not currently provide guidance on this important tool. The ATO could also provide guidance on their views on compliance requirements and how they would engage with directors working through a safe harbour plan. Finally, the Australian Institute of Company Directors could be engaged on how to best improve director education and awareness of safe harbour.

Disclosure

Disclosure is a complex and nuanced issue for directors. Currently, safe harbour is considered by directors behind closed doors and no or limited disclosure of the process is made to creditors. There are valid commercial reasons for this including that disclosure could affect market value or cause trading partners to change or limit their terms of trade which would make implementing a safe harbour restructure plan more difficult. These reasons arise due to the stigma of insolvency associated with safe harbour.

Recognising the concerns about disclosure and the stigma of insolvency, we also recognise that there are times when disclosure of the safe harbour restructure plan may be necessary to actively engage with the company's stakeholders. Communicating a restructure plan may assist in implementing and negotiating required change to commercial terms. For these reasons we would support a clear statement in the Act that safe harbour is aimed at achieving a restructure of the company to maintain its solvent position and to maximise the chances of the company continuing in existence in addition to facilitating a plan when directors suspect the company may become insolvent. This would change the context in which safe harbour is considered and mean that safe harbour should be considered as part of a solvent restructure.

However, disclosure of the safe harbour restructuring plan is not appropriate in all circumstances. Creditors are exposed to risk in circumstances where a safe harbour restructuring plan is disclosed to certain creditors without disclosing the same information to other creditors. This results in disparity of information between the creditors of the company. There is little or no guidance and no protections for creditors with knowledge of a safe harbour restructuring plan. This is unfair for such creditors. We consider that there should be clear guidance that the safe harbour restructuring plan must be kept confidential unless it is necessary to make a disclosure in order to effect the plan, required by law or if the plan is disclosed to all parties.

Insolvent trading provisions

The safe harbour regime addresses the strict personal liability imposed on directors for insolvent trading (section 588G of the Act) and creditor-defeating dispositions (sections 588GAB and 588GAC of the Act). While the review is focused on the parts of the Act comprising the safe harbour regime, consideration could be given to whether the insolvent trading provisions could be amended to encourage company directors to more freely pursue restructuring and turnaround measures with less fear of civil penalty. For example, the burden of proof of defences could be shifted to require a lack of objective good faith be proven to establish insolvent trading, rather than requiring a director to prove this as a defence.

Aims of safe harbour applied more broadly in director duties

The aims of safe harbour could be extended to other sections of the Act to broaden the obligations of directors when sustainability or viability of the business is questioned. This would align with clarifying that the purpose of safe harbour is to allow directors to implement a plan to maintain the solvent position of the company and to maximise the chances of the company continuing in existence as well as to facilitate a plan when directors suspect the company may become insolvent.

All stakeholders will benefit from clearer guidelines articulating that safe harbour could also outline obligations that directors are mindful to plan and consider restructuring options early and that steps are taken in good faith and/or which would be reasonably likely to lead to a better outcome for the company.

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We consider that early engagement will help to give company directors, employees, creditors and communities better options and more time to work through them.

Yours faithfully

Jerome Davidson
Director, Legal Affairs
8298 0419
Jerome.davidson@ausbanking.org.au