

Raising the bar on independence, remuneration and practice capacity



ASIC UPDATE

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In the current economic environment, corporate insolvency will continue to be a significant focus for ASIC.

Overseeing our work in this area will be Michael Dwyer, well known to you all as a former president of the IPA. Michael commenced as one of three new Commissioners in February this year, bringing the total number of ASIC Commissioners to six.

Michael's past experience with the IPA and extensive knowledge of the profession is proving a great asset for ASIC and will assist us in delivering upon a number of key priorities.

ASIC's approach to insolvency will be multi-pronged – we will be urging directors to act early if their companies become, or look to become, insolvent – and we will ensure that insolvency advisers and practitioners provide appropriate advice to directors of companies in distress.

We also look forward to working with industry members in continuing to build confidence in the integrity of the profession by focussing on conflicts for insolvency appointments (**independence**) and insolvency practitioner **remuneration**.

Further, with an expected increase in company insolvencies this year, we are concerned that insolvency practitioners have sufficient capacity to accept appointments, both in terms of numbers and scale of the appointments (**practice capacity**).

ASIC has previously highlighted some of these issues, following on from our review of liquidator conduct. At that time, we identified some areas of concern and provided guidance about the way in which insolvency practitioners should comply with their obligations.

Independence and remuneration matters, as well as practice capacity, will continue to be key priorities for the year ahead, particularly in an environment of increasing insolvencies. ASIC recognises that the conduct of insolvency practitioners in providing an independent and professional service is critical to maintaining confidence in the integrity of the profession.

That said, we are still observing circumstances which suggest that insolvency practitioners do not fully understand their legal obligations in relation to independence or remuneration or, in some very limited cases, are not complying with them, possibly under the pressure of heavy workloads.

We have recently written to insolvency practitioners nationally, highlighting the concerns we have identified, advising how we expect practitioners to comply and outlining how ASIC intends to respond. We will continue to work closely with the IPA to ensure ASIC's focus on these issues is in the best interests of all stakeholders.

These issues are discussed in further detail below.

Independence

The key legal obligation owed by an external administrator is that they must:

- be independent; and
- be seen to be independent at all times.

The reasonable perceptions of creditors and other third parties in evaluating the likely effect of an external administrator's relationships on their objectivity are key to an external administrator maintaining their independence.

ASIC is concerned that some practitioners believe that they are permitted to accept an appointment as an external administrator and then address independence issues by disclosure to creditors of circumstances that give rise to actual or perceived conflicts.

Mere disclosure of the circumstances that lead to the reasonable perception of a conflict of interest or other lack of independence is not an effective response and, in such circumstances, ASIC expects that a practitioner would not consent to the appointment.

The duty of the external administrator is to ensure that they do not place themselves in a position where there is, or might be (in the future or if certain circumstances arise), a conflict of duty and interest or of duty and duty. The obligation is therefore to avoid both **actual**, that is, currently existing conflicts, and **potential** conflicts.

ASIC's response

During 2009, ASIC will conduct reviews of practitioners' declarations of relevant relationships and declarations of indemnities (where applicable). If ASIC identifies circumstances where practitioners have not complied with their obligations, depending upon the seriousness of the breach, ASIC may take steps that include:

- seeking the voluntary resignation and replacement of the external administrator;
- taking action to seek court removal of a practitioner who is in breach of their duty of independence; or
- requiring amended disclosure to creditors.

Remuneration

The quality of information disclosed in remuneration reports and the reasonableness of fees and disbursements will be a key priority for ASIC this year.

An external administrator is entitled to reasonable remuneration that has been properly incurred and determined in accordance with the statutory provisions.

A time-based calculation of remuneration should include only time reasonably incurred at a scale that reflects reasonable rates.

External administrators must justify their remuneration claim by providing sufficiently complete and accurate information to a committee, the creditors or the court to enable an informed assessment to be made about whether the remuneration is reasonable.

ASIC's response

To ensure compliance with the remuneration obligations, ASIC will this year:

- challenge remuneration requests that do not disclose sufficient information to understand why work was done and the benefit to creditors;
- use our powers to require practitioners to provide better disclosure to creditors (for example, by amending the remuneration report) to enable fully informed decisions on remuneration; or
- challenge practitioners we identify as over-servicing or over-charging their clients by seeking court review of remuneration.

Practice capacity

The expected increase in insolvency work this year is likely to result in significant challenges for insolvency practices in terms of the availability of resources and skills. To remain registered as a liquidator, you must, on an ongoing basis, continue to meet the requirements of a fit and proper person. In ASIC's view, this includes a duty to continuously monitor your resources and the

demands of your current and anticipated workload to ensure that your practice capacities remain adequate, such as:

- adequate human and technological resources to enable you to accept appointments as an external administrator;
- appropriate processes for monitoring and ensuring the continuing adequacy of the human and technological resources available to you;
- appropriate processes for ongoing supervision and training of staff;
- appropriate operational procedures and manuals for conducting external administrations, including internal procedures for recording and handling complaints about the performance of duties by you or staff who perform duties on your behalf; and
- adequate systems for managing risks to your own practice and each entity to which you may be appointed.

ASIC is aware that some practitioners accept appointments to large external administrations, or accept too many smaller appointments, even though the practitioners do not have the capacity to effectively and efficiently conduct the necessary work.

Further, previous compliance reviews have shown that some insolvency firms lacked adequate internal control practices and procedures. These practice deficiencies led to undesirable outcomes, which included:

- inadequate investigations and reporting;
- undue delays in progressing administrations; and
- the imposition of additional costs that would otherwise have been avoided.

If, in assessing whether to accept an appointment, you conclude that you do not have sufficient resources and skills to undertake the required work, ASIC expects that you would decline the appointment.

ASIC's response

As part of our compliance activities, if we identify that a practitioner has accepted an appointment to an external administration but lacks sufficient resources, we may take action that includes:

- seeking the voluntary resignation and replacement of the external administrator; or
- taking action to seek court removal of an external administrator.

We appreciate that the vast majority of insolvency practitioners abide by their obligations and carry out their functions appropriately and professionally. However, in an environment where the volume of insolvencies will increase significantly and when the practices of insolvency practitioners will be under severe scrutiny, we encourage you all to lift the bar higher again and use the current economic circumstances as an opportunity to further develop confidence in the profession. 