



SUBMISSION

Submission to the consultation
paper on reforms to address
corporate misuse of the Fair
Entitlements Guarantee scheme

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The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

This is the Business Council's submission to the Department of Employment and Treasury's consultation paper on reforms to address corporate misuse of the Fair Entitlements Guarantee scheme.

Executive summary

The Business Council supports the government's efforts to reform the Fair Entitlement Guarantee (FEG) scheme to ensure its operation is consistent with the 'last resort' objective of the scheme.

Common sense changes to the *Corporations Act 2001* will help prevent misuse and ensure that government funding provides value for money. These types of changes will give the community greater confidence in the integrity of the scheme without disadvantaging employees.

In considering amendments, it is important that the changes do not penalise or increase the regulatory and administrative burden on all businesses, and that the FEG scheme's performance is reviewed periodically to identify and address unintended consequences of any reforms resulting from this review.

Key recommendations

The Business Council recommends that the Australian Government:

1. strengthen the integrity of the FEG scheme by making common sense changes to the *Corporations Act 2001* that will limit access in cases where an employer has used sharp corporate practices to prevent, avoid or reduce the payment of employee entitlements
2. periodically review the FEG scheme's performance, including the effectiveness of recovery arrangements and any unintended consequences of any reforms resulting from this review.

Discussion

Role of the FEG scheme

Under the FEG scheme, the Australian Government provides financial support to eligible employees who lose their job due to their employer entering liquidation or bankruptcy to cover specific employment entitlements — unpaid wages, annual leave, long service leave, payment in lieu of notice and redundancy pay — subject to some caps. The government then 'stands in the shoes' of the employee as a creditor in the liquidation and attempts to recover its outlay through the winding up process.

The FEG scheme is designed to operate as a last resort scheme, where no alternative avenue exists for employees to be paid their accrued employment entitlements on redundancy due to liquidation or bankruptcy of their employer.

A key principle underpinning the FEG scheme and its predecessor administrative schemes (Employee Entitlement Supports Scheme and the General Employment Entitlements Support Scheme), is that employers should be responsible for meeting employees' entitlements.

In this context, it is a business obligation to put aside money for their employees' entitlements.

Small business employers (less than 15 employees) tend to be more commonly represented in FEG than other size employers. Over the period 2004-05 to 2014-15¹, of all the businesses where employment entitlements were met under the FEG:

- 76.8 per cent were small business employers
- 22.5 per cent were medium business employers
- 0.60 per cent were large business employers.

However, in terms of amounts paid, claims relating to medium size employers represented the majority of cost under the scheme.²

The case for reform

The cost of the FEG scheme has dramatically increased over the past decade from \$60.8 million in 2007-08 to \$284.1 million in 2015-16, with the number of cases roughly doubling from 983 to 1746 cases.³

As is common with other forms of insurance, having a safety net creates an inherent 'moral hazard' risk because the parties involved no longer directly face the incentives and full costs created by the true level of risk associated with their actions. For example, a business may take on more risk than they might otherwise be inclined to take on, knowing that employees will receive support through the FEG scheme, or employees may not advocate to liquidators to recover their entitlements.

The 2015 introduction of the FEG Recovery Program, which provides funding to liquidators to enable recovery efforts that they would not otherwise have the resources to pursue, and the scheme's caps, are practical safeguards to reduce the risks associated with having the Australian Government act as a creditor.

Further, Part 5.8A of the *Corporations Act 2001* provides a legal mechanism to discourage improper behaviour by having provisions to prosecute cases as a criminal offence or civil action, where employers have avoided or reduced their employee entitlement liability.

¹ Department of Employment, 2015, Submission to the Productivity Inquiry into Business Set-up, Transfer and Closure, Productivity Commission, p. 14.

² Ibid.

³ Department of Employment, 2017, *Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme*, p.3, <https://docs.employment.gov.au/documents/consultation-paper-reforms-address-corporate-misuse-fair-entitlements-guarantee-scheme>, accessed 8 June 2017.

However, there have been no successful criminal or civil court actions under the provisions in this Part.⁴

The FEG Recovery Program undertook work to better understand the cost drivers of the scheme. This revealed clear evidence of an increasing trend of employers using a range of illegal and legal practices to deliberately and aggressively restructure their business to prevent, avoid or reduce paying employee entitlements in the event of insolvency (referred to as 'sharp corporate practices' in the discussion paper).

A sample of around 650 FEG cases over a three year period found that one in seven cases had used one or more sharp corporate practice, and that corporate misuse of the scheme was not isolated or quarantined to certain industries. Further, the cost of these behaviours was found to be significant.

The cost of providing a safety net for employees through the FEG scheme is borne by taxpayers so it is important the scheme's settings are fit-for-purpose and manage budget exposure.

The FEG Recovery Program review findings, combined with the fact there have been no convictions under Part 5.8A of the *Corporations Act 2001*, suggest that the current safeguards are insufficient to deter inappropriate corporate behaviour.

There is a compelling case for stronger deterrents to discourage employers from misusing the scheme and to ensure that FEG delivers on its objective of being a scheme of last resort.

It is sensible to look at tightening the integrity of the scheme. Amending the legislation to restrict access and increase the government's capacity to address poor employer behaviour, will give the community greater confidence in the integrity of scheme.

It will also level the playing field so businesses that are putting aside money to cover their employees' entitlements are not disadvantaged compared to business that are not meeting their obligations and therefore do not face the same costs.

Considerations for reforming the FEG scheme

The Business Council is broadly supportive of the government's proposal to amend the *Corporations Act 2001*.

Common sense amendments to ensure the misuse cannot continue will reduce budget exposure and ensure government funding provides value for money. These types of changes are able to be made without disadvantaging employees.

In considering amendments, it is important to ensure principles of best practice regulation are followed. The regulatory regime needs to be designed in a way to ensure a minority of companies cannot continue to abuse the scheme, while at the same time ensuring companies who have a legitimate need to access the scheme are not disadvantaged. It will also be important that any new penalties and powers are applied carefully by the

⁴ Department of Employment, 2015, Submission to the Productivity Inquiry, p. 14.

Australian Securities and Investments Commission to avoid unintentionally penalising or increasing the regulatory and administrative burden on all businesses.

In addition, the Business Council supports the Productivity Commission's previous recommendation that the scheme be reviewed periodically to monitor potential abuse and the effectiveness of recovery arrangements.⁵ This will allow the government to consider the impact and unintended consequences of any reforms resulting from this review. The government can then consider whether any additional legislative reform, or tightening of the scheme's administrative arrangements, is required.

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⁵ Productivity Commission, 2015, *Inquiry Report into Business Set-up, Transfer and Closure*, Productivity Commission, p. 422, <http://www.pc.gov.au/inquiries/completed/business/report/business.pdf>, accessed 8 June 2017.