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Attention: Mr Timothy Beale

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Dear Mr Beale

THE REGULATORY FRAMEWORK APPLYING TO INSOLVENCY PRACTITIONERS

The Insurance Council of Australia¹ (Insurance Council) appreciates the opportunity to comment on the Options Paper – A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia (the Options Paper) released 2 June 2011. The Insurance Council will address in this submission only those aspects of the Options Paper which relate to general insurance, in particular Professional Indemnity Insurance (PII).

Section 1284 of the Corporations Act 2001 requires liquidators to maintain adequate and appropriate PII and fidelity insurance. ASIC's Regulatory Guide states that the objective of these requirements are to ensure, as far as possible, that funds are available to a registered liquidator to compensate creditors and other claimants for loss suffered as a result of the inadequate or improper performance of duties by a registered liquidator or their staff in connection with externally administered companies.

ASIC notes that the availability of PI and fidelity insurance for registered liquidators can be affected by changes in the insurance market. The Insurance Council submits that when considering the reform options outlined in the Options Paper, a key factor for the Government should be the impact those options would have on the availability of PII.

The Insurance Council does not discount the seriousness of the consequences of misconduct by insolvency practitioners and the hardship that it may cause for individuals. However, the Insurance Council recommends that the Government, when considering the need to reform the regulatory framework applying to insolvency practitioners, keep in perspective the level of misconduct occurring under the current regime. Insurance Council members are not aware of many instances of "rogue" insolvency practitioners causing

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. December 2010 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$33.4 billion per annum and has total assets of \$101.7 billion. The industry employs approx 60,000 people and on average pays out about \$87 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

problems. The number of instances where insurance requirements had been breached would be even fewer.

Although not raised for discussion, the Options Paper quotes concerns that run-off cover is not being provided to insolvency practitioners². Similar to the practice with other professions, general insurers will often agree to provide run-off cover to insolvency practitioners on a case-by case basis, where they are confident of assessing the risk they are taking on -- for example where the insolvency practitioner is a long standing client. This cover is usually provided on a twelve month basis. However, it is unlikely that Insurance Council members will offer **automatic** run-off cover to all, or even a majority of, practitioners.

REFORM OPTIONS FOR INSURANCE

Option One: increasing severity of the penalties for breach

The Insurance Council will leave comment on this option for those better able to comment on whether current penalties for breach of the insurance requirements are out of line with the penalties for other similar breaches of relevant Acts.

Option Two: requiring notification of lapsed insurance policies

This option poses a number of practical difficulties for insurers.

Generally speaking, the systems utilised by Insurance Council members do not cater for the provision of notices to third parties (such as regulators) in respect to cancellation or amendments to PII policies. System changes would come at some cost and it is questionable whether individual insurers would deem such changes as viable given the limited size of the premium pool generated by insolvency practitioners. It is possible that some insurers would choose not to embrace such a regime on the basis of practicality and cease to offer PI to insolvency practitioners. We would submit that this is not a desirable outcome for insolvency practitioners or creditors.

There are also issues with tracking insolvency practitioners in insurers' systems. Many practitioners are principals or employees of accounting firms that provide a range of services and where the insolvency related activities are a minor aspect of their operations. Such firms would generally be coded in insurers' systems as "accountants" rather than "insolvency practitioners". Any solution to this problem would involve system amendments and associated costs. Again, it is questionable whether many insurers would deem the cost of such amendments to be viable from cost/ benefit perspective and this may lead to withdrawal of some insurers from the market for insolvency practitioners' PI.

In any event and as highlighted above, the Insurance Council submits that costly systems changes are unnecessary given the small number of cases where PII has not been available because of a breach of the registration requirements. As the Options Paper points out³, the additional costs are likely to be passed on to creditors through increased fees.

² Options Paper, page 64.

³ Options Paper, page 65.

Option Three: establishment of a fidelity fund

As the Options Paper identifies, PII is unlikely to operate to provide money to compensate clients who have suffered from dishonest or fraudulent behaviour by sole practitioners. Clients in such situations would be one group able to obtain redress from an industry association run fidelity fund. However, as raised before, the Insurance Council would question whether the costs of establishing and running a fidelity fund would be warranted in view of the small number of people likely to benefit.

Option Four: mandated periodic checking of insurance cover

The Insurance Council would support ASIC being appropriately resourced to more actively check that insolvency practitioners have the required insurance cover.

The policy goal of ensuring that insolvency practitioners maintain valid insurance could be facilitated in a number of ways. It may be thought appropriate to amend the Insurance Contracts Act 1984 so that PII policies for insolvency practitioners are not subject to the usual provisions ensuring that insurance policies are cancellable and appropriate refunds of premium are made.

Similarly, if ASIC were to approach an insurer to confirm that an insolvency practitioner's cover was still current and met requirements, the insurer would need authorisation to be able to provide details of the insured's policy. This could be obtained by a request in the insurer's policy proposal or perhaps authorised by legislation.

DISCUSSION QUESTIONS FOR INSURANCE

Is there benefit in insolvency practitioners, creditors or other stakeholders in aligning the insurance requirements for liquidators and registered trustees?

The Insurance Council is not aware of any reason why the insurance requirements for these two groups should be different.

If the criminal penalty for not complying with insurance requirements is increased, at what level should the penalty be set to provide a sufficient deterrence against breach?

The Insurance Council is unable to comment on this issue.

Should a fidelity fund be established? If so, how should a fund be operated and funded?

See comments under Option Three above.

What other reforms might be put in place regarding insurance requirements?

See comments under Option Four above.

If you require further information, please contact Mr John Anning, Insurance Council's General Manager Policy – Regulation Directorate at janning@insurancecouncil.com.au.

Yours sincerely



Robert Whelan
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