

GENERAL SUPERVISION

7.1. Apart from the registration function, the regulatory system must also deal effectively with the supervision of practitioners once they have been registered.

7.2. It is useful, for the purposes of this report, to categorise the supervision functions into those which are directed at maintaining general standards of practitioners ('general supervision') and those which are intended to address conduct in a particular matter, usually in response to a complaint, and possibly with a view to providing a suitable remedy to an affected person ('discipline and remedial supervision'). This chapter considers general supervision of practitioners, while discipline and remedial supervision is dealt with in Chapter 8.

INTRODUCTION

7.3. As noted by the former Trade Practices Commission in its 1992 report, it is important that effective mechanisms are in place to ensure that:

- appropriate standards are set for work undertaken by insolvency practitioners;
- there is widespread compliance with the required standards; and
- appropriate corrective action may be taken in the event there is non-compliance with recognised standards.

7.4. The main perceived shortcomings with the present institutional arrangements for supervision are:

- overlap in the responsibilities of the various bodies involved;
- unclear complaints mechanisms which do not always provide a prompt response; and
- the extent of ASC resources required to carry out the supervision function and possible lack of expertise on the part of ASC officers to properly assess complaints in relation to the conduct of practitioners.

7.5. There are six matters which are dealt with in this chapter:

- ethics and professional standards;
- continuing professional education;
- ongoing work levels;
- quality assurance and surveillance;
- performance bonds and professional indemnity insurance; and
- periodic reporting.

7.6. One key issue is relevant in relation to all of these matters. That is, the question of which body (or bodies) should be responsible for setting the appropriate requirements and monitoring practitioners for compliance? Should these matters be regulated by way of legislation, or should it be left to the professional bodies to self-regulate in relation to these matters?

ETHICS AND PROFESSIONAL STANDARDS

7.7. There is currently no requirement in the Corporations Law for registered liquidators to adhere to a professional code of ethics. This may have been considered unnecessary in light of the fact that membership of the ICAA or the ASCPA, which have their own professional codes of ethics and standards,¹ is one of the alternative conditions of registration and the vast majority of liquidators would be members of those organisations (or their equivalents).

7.8. In view of the recommendation of the Working Party that membership of an accounting or legal professional body should not be a mandatory requirement for registration,² the question arises whether there is a need for legislation to prescribe adherence to a code of ethics or whether this is considered unnecessary in light of the existing common law and statutory requirements regarding the duties of liquidators.

7.9. One view is that there is no need to legislate for matters such as professional conduct and ethics, as competition in the marketplace is the most appropriate mechanism to deal with such issues. Consumers of the services of insolvency practitioners will decide if they require the added protection that adherence to a code of conduct and ethics provides. If consumers feel it is desirable they may direct their

¹ Further discussion of the codes and standards of the professional bodies is in Chapter 6.

² See paragraphs commencing at 6.82.

custom to those practitioners who do adhere to a code of conduct through, for example, membership of a professional organisation. An example of this type of arrangement can be seen in relation to the provision of general accounting services. While accounting bodies such as the ICAA and ASCPA promote the standards and conduct required by their organisations as a means of distinguishing the quality of services provided by their members from services provided by non-members, there are no mandatory standards governing ethics and conduct in relation to general accountancy.

7.10. If the law itself was to mandate adherence to a code of conduct and ethical standards it would be necessary for the requirements to be contained in the law or regulations, or be approved by the ASC. The ASC and/or the CALDB would need to be conferred with power to undertake disciplinary action in respect of breaches.

7.11. Legal practitioners are subject to a system of professional ethics, standards and discipline administered by the various law societies. However, this is not tailored to insolvency practice. If lawyers were allowed to become registered insolvency practitioners, it may be possible for the law societies, or the Law Council, to develop rules and procedures specifically aimed at insolvency practice, just as the accounting bodies have done.

7.12. Another option may be for the professional legal and accounting bodies to apply uniform standards set by the IPAA in consultation with each of them.

7.13. The Working Party's view is that, on balance, the preferable course is to leave these matters to the marketplace. Practitioners who are bound by a code of practice and ethics will be able to use that to their advantage in attracting clients.

7.14. The Working Party recommends that the legislation should not mandate adherence to a code of conduct and ethical standards.

PROFESSIONAL DEVELOPMENT

7.15. Currently, there are no legislative requirements concerning ongoing professional development. However, membership of a professional accounting body goes some way towards achieving a similar outcome.³

³ See the discussion of the professional bodies' ongoing professional education requirements in Chapter 6.

7.16. The ICAA, the ASCPA and the IPAA require members who hold public practising certificates to complete a minimum amount of continuing professional development. One of the key aims of the IPAA is to advance education in the study of insolvency and, to this end, the IPAA runs a structured Workshop Program.

7.17. The Working Party considers that professional accounting bodies are well placed to make decisions on the activities which should count towards the annual education requirements. Furthermore, they can monitor each member's compliance level as part of the process of annual renewal of membership.

7.18. In some jurisdictions, there are regimes in place for ensuring lawyers participate in continuing legal education (CLE). The requirements vary from jurisdiction to jurisdiction. In New South Wales, for example, the CLE requirements have been mandatory since July 1987 and failure to fulfil the requirements can result in suspension, cancellation or refusal to renew a solicitor's practising certificate.⁴ By contrast, the Australian Capital Territory has no mandatory CLE requirements.

7.19. As the Working Party has already indicated,⁵ making membership of a professional accounting body a prerequisite to registration as an insolvency practitioner is not an ideal means of ensuring all practitioners undergo continuing education. This position will be complicated if a wider class of participants from outside the accounting area become registered.

7.20. Accordingly, consideration needs to be given to an alternative mechanism for ensuring registered practitioners undergo appropriate levels of continuing education. Such a mechanism could involve the applicant agreeing to undertake a level of continuing professional education as approved by the ASC. In this regard, the Working Party envisages that the professional bodies would develop education programs which encompass a range of educational activities in various forms (such as lectures, videos, seminars, workshops and so on). Some or all of those activities may not necessarily be organised or provided by the professional bodies themselves. However, it is not contemplated by the Working Party that the ASC would approve the individual activities. Rather, it is envisaged that the professional bodies and the ASC would agree on a comprehensive program. The program would be reviewed every two years by a working group of the professional bodies and the ASC.

⁴ Frank Riley LLM, *New South Wales Solicitors Manual* (loose leaf service), Law Society of New South Wales and Butterworths, paragraph [5050].

⁵ See discussion in Chapter 6.

7.21. The Working Party recommends that there should be an ongoing requirement for practitioners to undergo continuing professional education as agreed between the professional bodies and the ASC. The Working Party envisages that the professional bodies and the ASC would specify continuing education programs administered by the professional bodies and review these at least every two years.

ONGOING WORK EXPERIENCE

7.22. Related to the issue of continuing professional education is the issue of continuing practical experience.

7.23. At present, there is no express requirement in the legislation to maintain a certain level of work to retain classification as an official, or registered, liquidator. However, practitioners are required to submit to the ASC details of the number of administrations performed in a three year period in a triennial statement.

7.24. In some jurisdictions a rotation system for court appointments serves to ensure that each official liquidator receives a certain minimum amount of work. However, as discussed later in this report, the rotation system is not an ideal way of maintaining experience levels.⁶ In the case of registered liquidators, there is no existing mechanism to deal with the experience issue.

7.25. The Working Party considers that maintaining a reasonable level of practical experience is important to ensure insolvency practitioners remain competent in their field. How this should be achieved is also being considered by the Working Party reviewing the requirements for registration and regulation and of auditors.⁷ That Working Party has suggested in its draft report that mandating continuing professional education obviates the need for strict annual requirements in this regard. However, the Auditors Review Working Party recommended that, if a registered company auditor did not perform relevant work for a period of five years, the supervisory body should be able to request the auditor to show cause why his or her registration should not be cancelled.

7.26. The Working Party agrees that a strict annual requirement for ongoing practical experience should not be imposed. However, a review over a longer time frame is appropriate.

⁶ See discussion in Chapter 9.

⁷ Review of the Requirements for the Registration and Regulation of Auditors, Draft Report prepared by a Working Party appointed by the Commonwealth Government, April 1996, pp. 77–78.

7.27. The Working Party recommends that the ASC should be permitted to require a registered liquidator who does not perform any substantive insolvency work over a period of five years [or an official liquidator who does not perform any substantive insolvency work over a period of two years], to show cause why his or her registration (or official status) should not be cancelled.

SURVEILLANCE AND QUALITY ASSURANCE

7.28. The Working Party considers that surveillance programs are an important mechanism for the maintenance of standards.

7.29. The ASC has engaged in a surveillance program aimed at creating a climate of compliance and cooperation amongst insolvency practitioners. The program sought to maintain good practice and focused on lodgement of prescribed forms, keeping proper books and records, carrying out impartial investigations and ensuring returns to creditors are maximised.⁸

7.30. The ASC selected practitioners for surveillance primarily on matters of which it became aware which indicated there may have been a problem in the insolvency practice concerned. Surveillance visits involved a detailed examination of the practice. Although the focus was on encouraging compliance, the program included an investigative element. In 1994–95, 87 liquidators were visited which resulted in three referrals to the CALDB⁹ and 37 cases where other action was taken.¹⁰ The ASC's surveillance program was recently terminated due to budgetary constraints and the ASC now only conducts a complaints-driven program.

7.31. The ICAA and ASCPA also conduct surveillance programs known as the Quality Assurance Program. This program was introduced in 1994. It involves a review of a sample of members' files to ensure that the work performed meets minimum professional standards.¹¹ The reviews are conducted by trained reviewers. Practitioners are selected for review by the accounting bodies on the basis that each member will be subject to review at least once every five years. Unlike the former ASC program, members are not 'targeted' for review primarily on the basis of possible concerns in their practice. The focus of the Quality Assurance Programs is on education, rather than investigation.

⁸ 1995 *ASC Digest*, SPCH 136.

⁹ ASC referrals to the CALDB are discussed further in Chapter 8.

¹⁰ 1995 *ASC Digest*, INFO 353.

¹¹ ASCPA Handbook, PP5.

7.32. Arguably, the professional bodies are better placed than the ASC to conduct surveillance programs, because practitioners would have intimate knowledge of industry standards and would be better placed to apply those standards in a practical context. Furthermore, practitioners may be more ready to accept judgements made by fellow practitioners.

7.33. However, there are some possible concerns with a self-regulatory body having sole responsibility for this function. Where there are relatively few practitioners operating in a market, such as outside the major cities, there may be difficulties in finding an adequate number of unbiased practitioners to conduct surveillance visits. For a self-regulatory system to work effectively, independence of the reviewers would be of critical importance.

7.34. If the Quality Assurance Program is to be the only surveillance program involving insolvency practitioners, ideally the focus would shift from a solely educational program to include an investigative element. Client confidentiality, right of access to records, potential liability of the reviewer for defamation, and possible courses of action available where deficiencies are identified may need to be addressed, most likely through legislation.

7.35. The Working Party does not accept, at this stage, that the program conducted by the professional bodies, with its focus on education, is an acceptable alternative to an ASC program. Further, some practitioners may choose not to be members of professional bodies, so there should be some kind of independent surveillance system to cover those persons.

7.36. The Working Party recommends that the ASC should retain its complaints-based surveillance program and examine the feasibility of reviving the surveillance program it previously operated. The Working Party further recommends that the ASC and the professional bodies examine whether there is scope for greater mutual education and cooperation in the surveillance area.

7.37. Whichever body performs the surveillance role, there must be mechanisms in place so that appropriate disciplinary action can be taken to ensure compliance. This aspect is discussed further in Chapter 8.

PERFORMANCE BONDS AND PROFESSIONAL INDEMNITY INSURANCE

7.38. Currently, there are no statutory requirements for registered insolvency practitioners to obtain, or maintain, professional indemnity insurance.

7.39. There is a requirement to lodge and maintain a security deposit with the ASC in order to obtain registration. This deposit can be used by the ASC to pay compensation to any person who suffers loss or damage as a result of the failure of a registered practitioner to carry out their duties adequately and properly.¹² The ASC has determined that the security deposit must be in the form of a performance bond issued by certain financial institutions for a sum not exceeding \$250,000.¹³

7.40. In July 1994, the ASC amended its policy statement dealing with the lodgement of security deposits.¹⁴ As an alternative to lodging a performance bond, the ASC will now accept an undertaking from registered liquidators who hold practising certificates from the ICAA or the ASCPA to maintain professional indemnity insurance in accordance with the requirements of those professional bodies.

7.41. The policy statement indicates that the terms of the professional indemnity insurance must include:

- (a) a minimum of \$250,000 on each and every claim;
- (b) cover for any civil or legal liability or any act, error or omission, subject to reasonably common exceptions; and
- (c) provision for so called 'run-off' cover, whereby the liquidator maintains the policy for at least 7 years (or such period as the ASC deems appropriate) after registration ceases.

A practitioner seeking to use this option rather than a security deposit must also undertake to maintain a current practising certificate with the ICAA or the ASCPA.

7.42. Issues arising in relation to the regulation of professional indemnity insurance for insolvency practitioners are:

- whether it is necessary to regulate for a 'safety net' in the form of security deposits or professional indemnity insurance for corporate insolvency practitioners; and
- if so, the form that the regulation should take.

¹² Section 1284, Corporations Law and Regulations 9.2.05 and 9.2.06, Corporations Regulations.

¹³ The form of the performance bond is set out in ASC Pro Forma 14, *ASC Digest*, PF 199.

¹⁴ ASC Policy Statement 33, *ASC Digest*, PS 7/159.

Is Any Regulation Needed?

7.43. It is arguable that insolvency practitioners, like other professionals, have an incentive to maintain arrangements which would enable them to meet possible liabilities in order to protect their own assets. Accordingly, there is no need to regulate for these matters. However, a contrary view is that some professionals may choose to protect their interests not by taking out insurance, but by declining to hold any significant assets in their own names. As a consequence, the substance of any recovery for personal liability may be limited in the event that there is a successful action. There may, therefore, be a legitimate need to regulate for some kind of compensation mechanism. The Working Party favours this view.

Security Deposit v Insurance

7.44. The question arises whether professional indemnity insurance is a preferable mechanism to a security deposit as a means of protecting persons who suffer loss or damage as a result of a liquidator's default.

Procedure

7.45. Claims for compensation out of a security deposit lodged with the ASC may be made by lodging a claim in writing with the ASC.¹⁵ After giving the liquidator an opportunity to be heard, the ASC makes a decision on the claim.¹⁶ If the ASC decides that a person is entitled to a payment, the ASC will give the liquidator an opportunity to pay the amount directly to the successful claimant. If the liquidator will not or cannot make the payment:

- the payment will be made by application of the security deposit; and
- the ASC will consider whether to make application to the CALDB to have the liquidator's registration cancelled under paragraph 1292(2)(d) of the Corporations Law.¹⁷

7.46. By contrast, it would be necessary for a claimant to bring a successful action against a liquidator in court (or successfully settle such an action) in order to obtain the benefit of professional indemnity insurance cover. It could be assumed that insurers would have rights of subrogation which would allow them to defend or settle actions on behalf of the liquidator.

¹⁵ Subregulation 9.2.05(3), Corporations Regulations.

¹⁶ Subregulation 9.2.05(5), Corporations Regulations.

¹⁷ ASC Policy Statement 33, *ASC Digest* PS 7/159, paragraph 13.

7.47. In terms of procedural burdens and costs to claimants, the security deposit system is likely to be more advantageous than relying on professional indemnity insurance as it only requires claimants to lodge a claim with an independent administrative body at virtually no cost. In the event that the claim is settled expeditiously, there would be little difference relying on professional indemnity insurance. However, if this does not occur, claimants would have to go through the expensive, time consuming and uncertain process of bringing a court action which may be defended by insurers who have an advantage in terms of funding and tactical expertise. Bringing such an action involves risking significant adverse costs awards if the claim is unsuccessful.

Quantum

7.48. Issuers of performance bonds would, in most circumstances, require the person whose performance they are guaranteeing to provide them with some kind of protection in the event that the bond is called upon. For example, a bank or other institution issuing a bond to the ASC may require the liquidator concerned to provide security in the form of mortgages over property or third party guarantees which the institution may enforce in the event that the ASC calls upon the bond. Accordingly, there are limits to the amounts that may realistically be required in the form of performance bonds. As mentioned above, the maximum figure used by the ASC is presently \$250,000. If part of the bond is used by the ASC to pay a claim, the liquidator must top-up the bond to that amount if they wish to remain registered.¹⁸ If a liquidator chooses not to 'top up' the bond, they would be in breach of the registration conditions and liable to have their registration cancelled. If that occurred, there would no longer be a source of funds from which claims could be paid.

7.49. The level of professional indemnity insurance cover is limited primarily by the amount of the premium a practitioner is required to pay. Currently, the ASC requires the insurance cover to be at a minimum level of \$250,000 *on each and every claim*. This is liable to provide a greater level of protection in terms of quantum than the security deposit arrangement which does not exceed \$250,000 at any one time. Further, the provision of 'run-off' cover for a period of seven years after registration ceases also provides further protection.¹⁹

7.50. Accordingly, in terms of quantum of available compensation, professional indemnity insurance provides a greater level of protection than the security deposit arrangements.

¹⁸ ASC Policy Statement 33, *ASC Digest* PS 7/159, paragraph 11.

¹⁹ However, it is not clear what action would be available to enforce this requirement after registration has ceased.

Conclusion

7.51. The Working Party considers that the current system whereby the ASC allows practitioners to take out professional indemnity insurance instead of security deposits on condition that practitioners comply with requirements of a professional body is working satisfactorily. It does not require any immediate change except to expand it to encompass the legal professional bodies. However, in the long term, professional indemnity insurance could be expressly recognised as an ongoing requirement of registration in legislation and facilities used to monitor compliance, for example, by requiring practitioners to submit details of insurance on the annual statement or having a professional body certify maintenance of cover to the ASC.

PERIODIC REPORTING

7.52. The existing requirements for the lodgement of triennial statements are a means of keeping track of the activities of practitioners, including checking whether a practitioner is eligible to remain registered.²⁰

7.53 The ASC is currently responsible for administering the lodgement of triennial statements and is given certain powers in relation to extensions and requiring lodgement in respect of specific periods.

7.54. The Working Party considers that periodic reporting requirements could operate as a key mechanism to ensure that practitioners comply with their ongoing obligations in a number of areas. However, the current system does not utilise the periodic reporting requirements to their full potential, since minimal information is required to be provided on the current statement and many of the ongoing requirements, such as professional education, are not mentioned. Rather, the current regulatory system relies heavily on criteria assessed at the point of registration. It is assumed that if practitioners meet the requirements at the time of registration they will, in the main, continue to meet those requirements for life (or at least while they continue to pay the charges for lodging the triennial statement).

7.55. The Working Party considers that this is not necessarily a valid assumption. Ongoing obligations such as continuing professional education, continuing practical experience and maintenance of appropriate professional indemnity insurance cannot be regulated by way of a registration criterion alone. Consequently there needs to be a system of monitoring practitioners after registration.

²⁰ For a description of the requirements and the form of the statement, see paragraph 3.37.

7.56. In the view of the Working Party, the utility of the statement for monitoring practitioners would be enhanced if it:

- was made into an annual statement, rather than triennial;
- required practitioners to provide, in addition to personal particulars:
 - certification of professional development courses undertaken;
 - a summary of insolvency work undertaken; and
 - details of professional indemnity insurance.

For ongoing requirements which overlap with requirements imposed by the professional bodies, there could be a streamlined system whereby practitioners could comply merely by providing evidence of continuing membership of a professional body.

Failure to comply with the ongoing requirements in respect of such matters would allow the ASC to issue a notice requiring the practitioner to show cause why he or she should not be deregistered and the ASC should have powers to deregister a practitioner if not satisfied with the response.