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Clarifying the treatment of trusts under insolvency law

The Australian Institute of Credit Management (AICM) welcomes the opportunity to contribute to the review of the treatment of insolvent trusts.

AICM represents over 2,600 credit professionals who contribute to a resilient economy and drive successful business outcomes through:

- mitigating risk;
- maximising growth; and
- applying sound credit principles and practices.

Without our members, businesses are exposed to reputational damage, poor cash flow management and inefficient processes. Their employers are at risk of breaching regulatory requirements and not getting paid for hard won sales and services delivered.

Our members are the custodians of cash flow. They assess credit risk in all sectors and manage credit terms for the supply of goods, services and finance.

Improvements to the interaction of trusts and insolvency law that increases clarity and reduces costs will create significant benefits for both creditor and business owners.

AICM members regularly express frustrations at the complexity and inefficiencies associated with every aspect of the credit relationship where a trust is involved and strongly support the clarification of how trusts are treated under insolvency law.

With these frustrations and the intent to improve the outcomes of small business that face distress in mind, we provide our the recommendation of a National Trust Register and accompanying legislation that would remove these inefficiencies, allow small business owners to focus on their business and obtain better access to credit.

The establishment of a register of trading trusts (i.e. any trust structure that engages in transactions with 3rd parties) and legislation that requires the key aspects of a trading trust to be recorded will provide clarity, efficiencies and reduce the use of this structure to defeat creditors.

The national register administered by government would require details (trustee, beneficiaries and the trust deed at a minimum) to be recorded before the entity is given legal standing providing significant benefits including:

- **Clarity in contracting**

Valuable time is lost and significant frustration caused during credit applications when a business is operated via a trust.

While trust structures are the preferred model for many small businesses, most business owners do not understand their legal structure. It is very common for a business owner to provide a business/trading name only and not know the trustee and trust details.

It is even more common for the business owner to not have quick access to the trust deed to clarify these details.

Our members fully understand why business owners are regularly not able to provide the full legal entity information as the concepts of trusts are complex and not intuitively understood. This compassion does not relieve the pressures to provide accurate credit decisions that meet all stakeholders expectations with appropriate risk mitigation.

Currently credit professionals undertake multiple searches, make assumptions, and are required to query customers accountants to determine correct legal structures. For all other trading structures this information is available through established and trusted information sources such as government sources and credit bureaus.

The nature of these enquiries requires experienced credit professionals to conduct this work as it cannot be automated or delegated to frontline staff.

Leveraging the capability and experience developed through establishment of the Australian Business Registry Service and Personal Properties Securities Register, a Trust register could be established incorporating linkages with various sources such as ABN and company registers to efficiently identify details including a registered trust deed.

- **Minimising the use of trusts to defeat creditors**

The absence of a national registry of trust deeds creates loopholes that are manipulated to avoid creditors. A prime example is that a trustee and details of a trust deed can be fundamentally changed to the detriment of creditors with no systematic way for creditors to be notified.

This is one of the many concerns credit providers currently mitigate by obtaining additional security such as personal guarantees.

The Personal Property Securities Register provides a good example of how this loophole could be closed by creating validity on registration.

This will significantly align the contracting risk of trading trusts with other corporate structures enabling small businesses operating in these structures to compete with similar access to credit.

- **Better access to credit**

Currently the risks and inefficiencies of trading with trusts are mitigated by:

- Providing credit terms less favourable than other structures (such as sole traders and companies).
- Obtaining greater security (such as Guarantors and charges over personal assets).
- Refusal to trade on credit terms with trust structures.

The reliance on these mitigating measures would be reduced by the implementation of a National Trust Register.

- **Informs responsible lending practices**

AICM members regularly experience problems matching data related to customers operating in trust structures due to the complexity of legal structures. This creates inaccurate credit assessments and exposure calculations.

These problems obscures credit providers view of individual entities total debt exposure and their limits their ability to identify small businesses that maybe over indebted.

By standardising the legal structures through the trust register, data obtained from government, credit bureaus and other sources will efficiently inform credit assessments and provide better outcomes for small businesses.

- **Creating certainty and avoiding legal costs**

By providing a source of truth for all parties engaging in transactions with trust structures the register will eliminate the errors that currently prevent parties from enforcing contractual obligations and avoiding legal expenses to identify the correct legal entities.

It should be noted that the business owners will also benefit from their entity being correctly identified in contracting arrangements they issue.

Below is our response to the questions raised in the consultation paper.

Question 1: Should the corporate insolvency framework be amended so that it expressly provides for the external administration of insolvent trusts with a corporate trustee? If so, what external administration processes should the amendments apply to?

AICM members support amending the corporate insolvency framework to incorporate external administration of insolvent trusts with a corporate trustee.

While AICM members call for simplification and improvements to the corporate insolvency framework, providing for trading trusts within the existing frameworks aligns with expectations that all corporate entities should follow the same insolvency processes.

Question 2: What benefits would a legislative framework deliver?

AICM members expect significant benefits from a legislative framework. For example, currently a negative bias is assumed when assessing credit risk of businesses that trade in trust structures as it is often significantly more costly to commence proceedings to enforce payment obligations against trust structures than it is for other corporate structures.

The cost and uncertainty of the insolvency process is a significant factor that contributes to credit providers refusing to trade with trusts, requiring personal guarantees and/or additional security more frequently than other corporate structures.

Question 3: Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?

From the viewpoint of credit professionals there are no unforeseen consequences.

Question 4: Should legislation expressly set out when a trust is deemed to be insolvent?

AICM members support legislation providing certainty when an entity is deemed to be insolvent.

A clear definition of insolvency will benefit all stakeholders in the insolvency process by limiting the cost and ambiguity involved in establishing various creditor rights and obligations, for example voidable preference payments.

Question 5: What is the most appropriate way to prescribe when a trust is taken to be insolvent?

AICM members support the view that an entity that can pay its debts (out of its own assets) as they become due and payable, is solvent. An entity that is not solvent is insolvent.

Question 6: Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?

AICM members support the powers of an insolvency practitioner being expressly provided for in the legislation, including the powers being granted automatically and to prevail over terms of the trust deed.

As most insolvencies involving trusts are relatively simple, most court applications do not add value. The use of court rulings should be allowed to determine appropriate settings where complex trust structures are involved.

Question 7: Should the law provide that, subject to a contrary order by a court, the same insolvency practitioner may administer both the company, and the assets and liabilities attributable to any trusts for which the company is trustee?

Yes, requiring court approval for the same insolvency practitioner to administer the company and trust assets/liabilities should not be required as conflict is unlikely to arise in the most appointments.

Additionally current rules associated with administering a corporate insolvency should apply and ensure any conflict is managed appropriately.

Question 8: Should the affairs of a trustee company and each trust it administers be resolved separately in external administration?

The requirement for a trust to be administered separately should be determined by the ability to separately identify and quarantine the assets and liabilities of each trust. Where this is not possible there should be a provision that allows for independent review and arbitration preferably by an independent 3rd party, otherwise the courts.

Question 9: Should there be a statutory order of priority in the winding up of a trust?

The priority should align with the current priorities of the Corporations Act.

Question 10: Should a statutory order of priority replicate the regime for companies? Do additional factors need to be considered where a corporate trust structure is involved?

The priority should replicate the regime for companies. Consideration maybe required for the treatment of assets and liabilities when a trustee company operates multiple trusts.

Question 11: Should there be additional limits on the enforceability of ejection clauses and/or clauses that seek to limit a trustee's right to indemnity, in situations involving insolvency or external administration?

AICM members support the automatic limitation of ejection and indemnity clauses on the commencement of an insolvency process, with the administrator of the insolvency process required to approve use of the clauses where it is in creditors best interests.

Question 12: What would be the impacts of any such limits?

AICM members are not aware of any negative impacts of such limits.

Question 13: Are there any other issues that need to be considered in light of the questions above?

The personal insolvency laws should also be amended to account for insolvencies where the trustee is an individual.

To achieve significant improvements for all stakeholders, harmonising the treatment of trusts in insolvency should be considered in conjunction with the issues surrounding the contracting and trading with trusts.

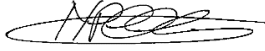
As noted, the establishment of a trust register and accompanying legislation will provide better trading conditions for both small businesses operating in these structures and credit providers.

Question 14: *What is the most appropriate model by which a statutory regime could be expressed in the legislation?*

AICM members strongly encourage amending the Corporations Act provisions to incorporate the treatment of trusts. Establishment of additional legislation should be avoided to ensure complexity is minimised for all stakeholders.

We welcome the opportunity to further contribute to the discussion of the reforms.

Yours sincerely



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