Regulation of Insolvency Practitioners

Regulatory Impact Statement

EXECUTIVE SUMMARY

Under insolvency, the main issue is that there is rarely enough money to pay all the creditors everything they are owed. The insolvency laws provide a simple and predictable system for financial failure to avoid creditors competing to be the first in line to recuperate their debts from the insolvent entity.
Insolvency practitioners (liquidators, administrators and receivers) are integral to New Zealand's insolvency system as they carry out a skilled task, and in doing so, protect and promote the integrity of the corporate insolvency system. There are a small number of practitioners who lack the necessary skills and competence to undertake this task, which has a negative impact on the returns to the creditors. There is anecdotal evidence to suggest that there are about 100 insolvency practitioners in New Zealand, of which 50 are considered to take up regular appointments.

Given the small size of the industry, it would cost several thousand dollars a year per practitioner to operate a positive licensing system. The preferred option is to introduce a negative licensing system and strengthen some of the existing statutory provisions in the Companies Act 1993 and the Receiverships Act 1993.

Under the proposed negative licensing system, the Registrar of Companies ("the Registrar") would undertake an investigation in relation to complaints received against an insolvency practitioner, which would relate to the practitioner's lack of skills, competence and breaches of the existing statutory duties and responsibilities under the Companies Act 1993 and the Receiverships Act 1993. This system would allow the Registrar to prohibit individuals from providing corporate insolvency services, and further, this system would extend the current banning provisions by giving the Registrar the ability to apply to the Court to get a liquidator prohibited from future appointments for persistently failing to comply with the duties under the Companies Act 1993.

In relation to further strengthening of the existing statutory measures, this paper recommends that the current disqualification criteria for the appointment of insolvency practitioners be tightened to prevent the appointment of certain insolvency practitioners from the outset, for example, practitioners that have been banned in other jurisdiction. It further recommends that the Courts powers to replace an insolvency practitioner be widened to deal with issues of conflict of interest and independence in relation to a particular appointment.

ADEQUACY STATEMENT

The Ministry of Economic Development (MED) confirms that the Code of Good Regulatory Practice and the regulatory impact analysis requirements, including the consultation RIA requirements, have been complied with. A RIS was prepared and

MED considers the RIS and the RIA analysis undertaken to be adequate. A draft RIS was circulated with the Cabinet paper for departmental consultation.

STATUS QUO AND PROBLEM

Insolvency practitioners are persons who are appointed to carry out a statutory corporate insolvency process. Insolvency practitioners carry out a skilled task which is crucial to the proper functioning of the corporate insolvency system.

Liquidators are appointed under the Companies Act 1993, as are administrators and deed administrators as part of the newly established voluntary administration process under the Companies Act. Receivers are appointed under the Receiverships Act 1993. The Companies Act 1993 and the Receiverships Act 1993 provides a set of disqualification criteria in relation to who can be appointed as an insolvency practitioner, and gives the High Court the power of supervision over liquidators, administrators and receivers.

Under the existing criteria, any person over the age of 18 with sound mental health can be appointed as an insolvency practitioner. There are no requirements that insolvency practitioners have any particular qualifications or level of education.

Concerns were raised by stakeholders that the current provisions in the legislation in relation to the appointment of insolvency practitioners did not address the issue that some insolvency practitioners lacked the necessary skills and knowledge to carry out corporate insolvencies competently. There are concerns that some insolvency practitioners do not carry out their role in accordance with their principal duty towards the creditors of an insolvent company and instead favour the interests of the directors of the debtor company.

As a person is not required to meet mandatory education or skill levels to be appointed an insolvency practitioner, currently there is no way for creditors and others appointing liquidators to assess whether the person has the appropriate skill levels, knowledge or competencies.

The status quo has a proven record of being unsatisfactory as it lacks any regulatory measures for effectively dealing with the minority of practitioners who are substandard.

OBJECTIVES

To ensure that:

- insolvency practitioners have the necessary skills and knowledge to carry out insolvency work competently;
- creditors and others involved in the appointment of the insolvency practitioner can have a good level of confidence in the skill of insolvency practitioners they appoint; and
- there are adequate remedies in place for creditors and other interested parties who consider that an insolvency practitioner is not acting competently, ethically or in accordance with his or her duties under the law.

ALTERNATIVE OPTIONS

Voluntary Accreditation

Under a voluntary accreditation scheme, an agency is empowered by statute to certify that accredited individuals have satisfied particular requirements for demonstrating competence in a particular field.

A certified insolvency practitioner would be given the exclusive right to use that title, but insolvency practitioners who were not certified could still offer their services in competition with certified practitioners (i.e. could still be appointed liquidators or administrators) so long as they did not use the title "certified insolvency practitioner".

Voluntary accreditation of this kind would be similar to existing voluntary accreditation for accountants established by the Institute of Chartered Accountants of New Zealand Act 1996.

Voluntary accreditation would provide information about whether a person has the necessary qualifications to undertake the work. However, as accreditation would be voluntary, this option would not deal with the issue of preventing persons with insufficient skills and experience from carrying out insolvency work. Indeed, it could be counterproductive because it would provide information to company directors who are looking to appoint a debtor-friendly practitioner about who not to appoint.

This option is not preferred because it would still allow insolvency practitioners to be appointed as liquidators, administrators and receivers that may not have the necessary skills and qualifications to carry out the work competently. Furthermore, it would not provide adequate remedies for creditors or other parties that were concerned with the actions of an insolvency practitioner.

Mandatory Licensing

Licensing regimes typically prohibit all but licensed people from undertaking certain functions. The granting of a licence is usually dependent on a person meeting certain prescribed requirements in relation to education, experience, standards of character and fitness and ongoing competence requirements.

A licensing regime, similar to that in force in Australia for liquidators and auditors in Australia was considered which would require New Zealand to allocate the licensing function to an existing or new independent body, establish a new disciplinary body to hear any complaints about licensed practitioners, and permit appeals to the High Court.

Of the options considered, this would be the highest cost option. The stakeholders have also stated that the insolvency profession was too small to self-fund a mandatory licensing system. These costs would be spread across the reasonably small number of insolvency practitioners working in New Zealand. Accordingly, this option is not preferred.

Competitive Licensing

This is a variant on the government-run licensing model. In essence, this approach would require all persons carrying out corporate insolvency processes to be members of an approved professional organisation, such as the New Zealand Institute of Chartered Accountants.

An oversight body, such as the Registrar of Companies would approve professional bodies to register and carry out the functions associated with the registering of insolvency practitioners. Only registered insolvency practitioners could be appointed as liquidators, administrators or receivers, and it would be an offence for any person to use the title "Registered Insolvency Practitioner" in the course of work or practice if he or she was not registered with a professional body.

Registration would allow creditors and other persons appointing insolvency practitioners to be assured that the person they were appointing had the minimum levels of skills and experience to carry out the work competently. The registration of insolvency practitioners should improve the skills of liquidators, administrators and receivers which in turn impacts on the returns to creditors, and improved confidence in the credit market.

However, there would be similar cost ineffectiveness issues under a competitive licensing system as outlined in the mandatory licensing option above. An oversight body would only approve bodies that have the relevant regulatory systems and processes in place covering such matters as minimum entry qualifications and experience, ongoing competence requirements, investigation and disciplinary processes and practice review processes. Neither of the likely approved bodies (NZICA and the New Zealand Law Society) have the necessary insolvency-specific systems in place and the cost of creating an insolvency practitioner brand would be prohibitively expensive.

Further, as appointments would be restricted to registered insolvency practitioners, persons who now undertake liquidation, administration or receiverships work and are known to be competent may not meet the criteria for registration and be unable to continue with this work.

A competitive licensing regime would deprive those individuals of their livelihoods without good reason for doing so and they would be forced to exit the market, leading to decreased competition in the market that is already considered to be small.

PREFERRED OPTION

The preferred option has two limbs:

a strengthening existing statutory measures; and

b introducing negative licensing.

Strengthening existing statutory measures

An option to achieve the objectives above would be to strengthen the existing measures as follows.

- The minimum disqualification criteria for the appointment of insolvency practitioners can be tightened under the Companies Act and the Receiverships Act;

- The role of the High Court can be widened to consider application from the Registrar, creditors and other interested parties to replace liquidators that are not independent or have a conflict of interest;

- The Registrar can be empowered to apply for prohibition orders in relation to substandard liquidators along the same lines as the Registrar's current powers to prohibit administrators and receivers.

Although these amendments would allow for some improvements to the quality of practitioners that are appointed and increase regulatory oversight by the High Court, strengthening the existing regulations would not, on its own, achieve the objective of giving creditors and others appointing insolvency practitioners assurance about the skills, competencies and knowledge of the persons they were appointing.

Benefits

With the tightening of the disqualification criteria, practitioners can be precluded from taking appointment from the outset, reducing the need to get them removed and replaced by the Court or at creditors meetings, which would save time and money for the creditors of the insolvent entity.

The proposed widening of the Court's powers to replace practitioners who are conflicted or lack independence provides a safeguard that ensures that insolvency practitioners are appropriately accountable to the creditors. The ability for an individual creditor to apply to Court under the Court's widened powers to replace practitioners would also supplement creditor action, which in parts of the New Zealand market is inadequate because many creditors are poorly co-ordinated and resourced.

Giving the Registrar the power to apply to the Court to prohibit or ban a practitioner from future appointments would act as a deterrent for the unskilled and incompetent practitioners. While the creditors may lack resources to take legal action against delinquent practitioners, the Registrar, as an official of the government, is not under the same constraints, especially if the Registrar in his new role under the proposed negative licensing regime has evidence relating to criminal activity or dishonesty.

Costs

There would be some cost involved in taking action at the High Court to replace practitioners. With the proposed negative licensing system, the need to take a legal action to replace a practitioner is likely to decrease over time, given the Registrar's ability to prohibit and ban substandard practitioners from future appointments under the proposed negative licensing system below.

Negative Licensing

Negative licensing involves the preclusion or suspension of incompetent or delinquent practitioners (as demonstrated by their prior action and performance) from operating as liquidators, administrators and receivers. The Registrar of Companies

would be empowered to prohibit or ban a practitioner from future appointments after a thorough investigation has been undertaken by the Registrar upon receiving complaints from a creditor or other interested parties. The Registrar would also be able to impose remedial measures, such as suspension and supervision. The complaints would primarily relate to debtor-friendly appointments, lack of necessary skills and competencies and knowledge to carry out an insolvency process in a manner that does not breach the statutory duties of the practitioner to look after the interest of creditors.

Benefits

Given the small size of the insolvency industry and the small number of substandard practitioners operating in the industry, the negative licensing regime will provide the most cost-effective solution that is appropriate and proportionate to the problem and size of the insolvency industry.

The small number of practitioners that are substandard will be dealt with expediently by the Registrar of Companies, which would mean that some of these practitioners would be, in extreme cases, prohibited from taking up further appointments, or supervised in order to upskill themselves. This should improve the performance and reliability of the practitioners, and further, provide better returns to the creditors of the insolvent entity.

The creditors are going to have an increased level of confidence and assurance that the person that was appointed would have the minimum level of skills and experience to carry out the insolvency process competently. With the widening of the Court's power, creditors and the Registrar will have the option of going to Court to get a practitioner replaced if there are conflict of interest and independence issues.

The proposed negative licensing system would ensure that practitioners perform well in their role as there would be reputational risks and risk of prohibition from future appointments. With these risks, and the potential risk of losing their livelihood, the practitioners would endeavour to improve their skills, which would have a positive impact on the returns to creditors, and improved confidence in the credit market. This would also act as a deterrent to other poor performers seeking to enter the market.

The negative licensing regime does not preclude skilled and competent practitioners who are not chartered accountants or lawyers from operating in the industry. This maintains competition in the insolvency industry that is already considered to be comparatively small.

Costs

There is some risk that the proposed negative licensing regime may not be as fully effective as a positive licensing regime, however, it would nevertheless provide most of the benefits at a considerably lower cost to the practitioners, and most importantly to the creditors of the insolvent entity. This risk dissipates with the propose strengthening of the existing statutory provisions in relation to appointment and replacement of insolvency practitioners.

IMPLEMENTATION AND REVIEW

New provisions will need to be added to the Companies Act 1993 and the Receiverships Act 1993 to implement the proposals. It is intended that a Bill implementing these changes will be introduced in Parliament in December 2008.

The new negative licensing system and the additional minimum disqualification criteria proposed in this paper will apply to all current insolvency practitioners. The funding of the Registrar's new function under the negative licensing system will come from the Liquidation Surplus Account The Liquidation Surplus Account is a statutory fund that is administered by the Public Trust and is primarily contributed to by monies that have not been claimed a year after a liquidation has been completed**.**

The Ministry will continue to work with the major insolvency specialist bodies, such as NZCIA, NZLS and INSOL New Zealand and will provide regular updates by email and its website as the Bill makes its passage through Parliament.

CONSULTATION

The following government agencies have been consulted on the proposals in this paper: the Treasury, Ministry of Justice and the Office of the Privacy Commissioner. The Department of the Prime Minister and Cabinet was informed. No significant concerns were raised.

The two main insolvency specialist bodies in New Zealand, namely the Joint Insolvency Committee (comprising of law practitioners and chartered accountants with expertise in insolvency law and practice)) and INSOL New Zealand, were consulted on the proposed negative licensing system.