

Insolvent customers

Critical considerations for the Bank

BANKERS' BOOT CAMP

2020



Expert panel



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Housekeeping

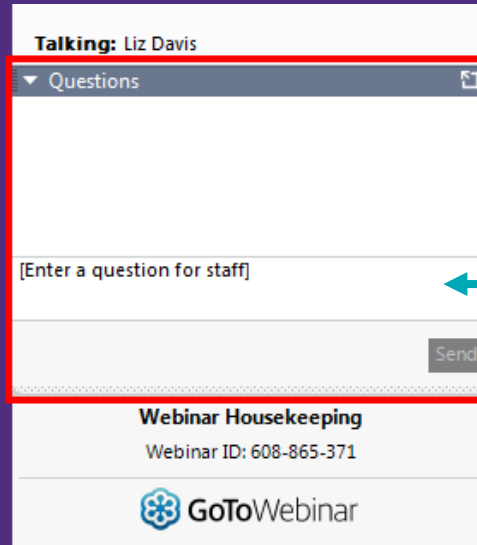


This is an interactive session so we encourage your participation



This session is being recorded and will be shared with all registrants and on our GTAL website and socials.

How to ask questions?



Submit your questions via the Questions panel

Agenda

1. Early warning signs
2. Restructuring options
3. Overview of insolvency appointments
4. Advantages / disadvantages for the Bank
5. Secured creditors – rights, assets & considerations
6. Wrap up & questions



Early warning signs of insolvency or financial distress



Early Warning Signs



Cash flow difficulties



ATO repayment plans



Breach of finance covenants



Losses



Audit qualifications



Disorganised internal accounting procedures



Loss of key customers / suppliers



Working capital constraints



Legal / landlord disputes



Forecasting losses

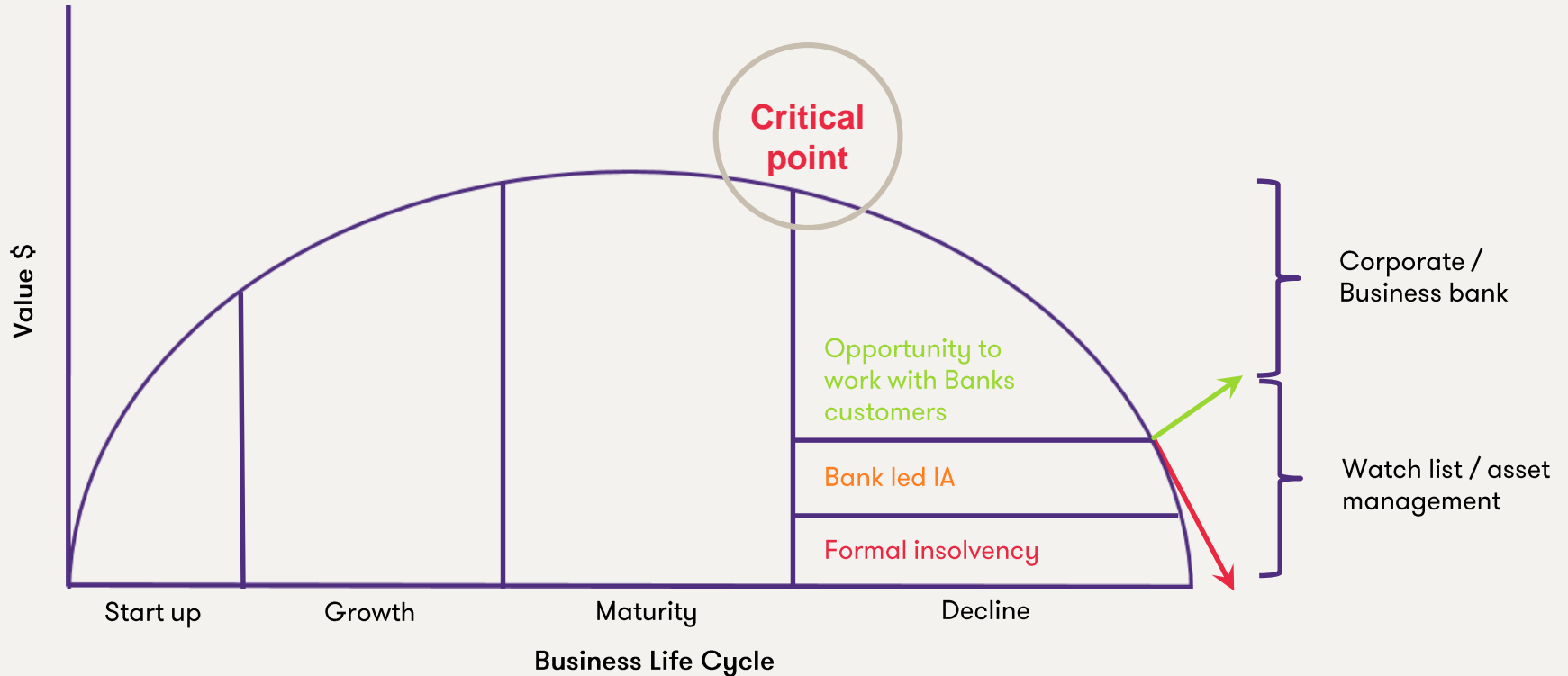


Issues collecting debtors



Absence of budgets and corporate plans

Critical Point for Customers



Restructuring options outside formal insolvency

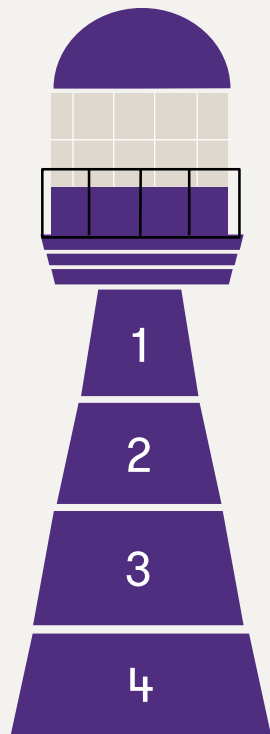


Safe Harbour

Overview

- Legislation that came into effect in 2017
- Director retains control of the business
- Provides a defence for directors against personal liability for insolvent trading claims while pursuing turnaround strategy. (“Better Outcome”)
- Encourages directors to take reasonable risks to trade out of financial difficulty
- Implemented to promote investment, innovation & entrepreneurial behaviours.
- **But... doesn't prevent appointment of an administrator / liquidator / receiver**

Safe Harbour



Safe Harbour defence is only available if directors to continue to meet certain obligations, namely:






Develop a restructuring plan: A course of action that is *reasonably likely to lead to a better outcome* than an immediate insolvency appointment

Protection from debts incurred either directly or indirectly in connection with any such course of action

Employee liabilities & reporting obligations must remain up to date

Maintain financial records & comply with obligations to assist an external administrator if appointed

‘Reasonably likely’ *to lead to a better outcome*

-  Keep **properly informed** about the company’s financial position
-  Took steps to **prevent misconduct** by the company’s officers and employees
-  Took appropriate steps to ensure that the company is keeping **appropriate financial records**
-  Obtained advice from an “**appropriately qualified entity**”
-  Developed and implements a **plan to restructure** the company to improve its financial position

Directors claiming safe harbour will need to provide evidence

Other considerations

For the bank...

Independent Business Review (IBR) / Investigative Accountant Report (IA)

- Gives confidence to the lender/stakeholder
- Request for new or more money, covenant breaches, underperformance, no transparency, conflicting/incomplete information etc.
- Banks need to be satisfied that their borrowers have a vision for the future which is sustainable and bankable

To be aware of...

Small business restructuring reforms (commencing 1 Jan 2020)

- ‘Director in Possession’ restructuring model - permanent change!
- Key facts:
 - Debts <\$1m
 - Employees paid /
 - More than 50% creditors agree

Informal restructuring

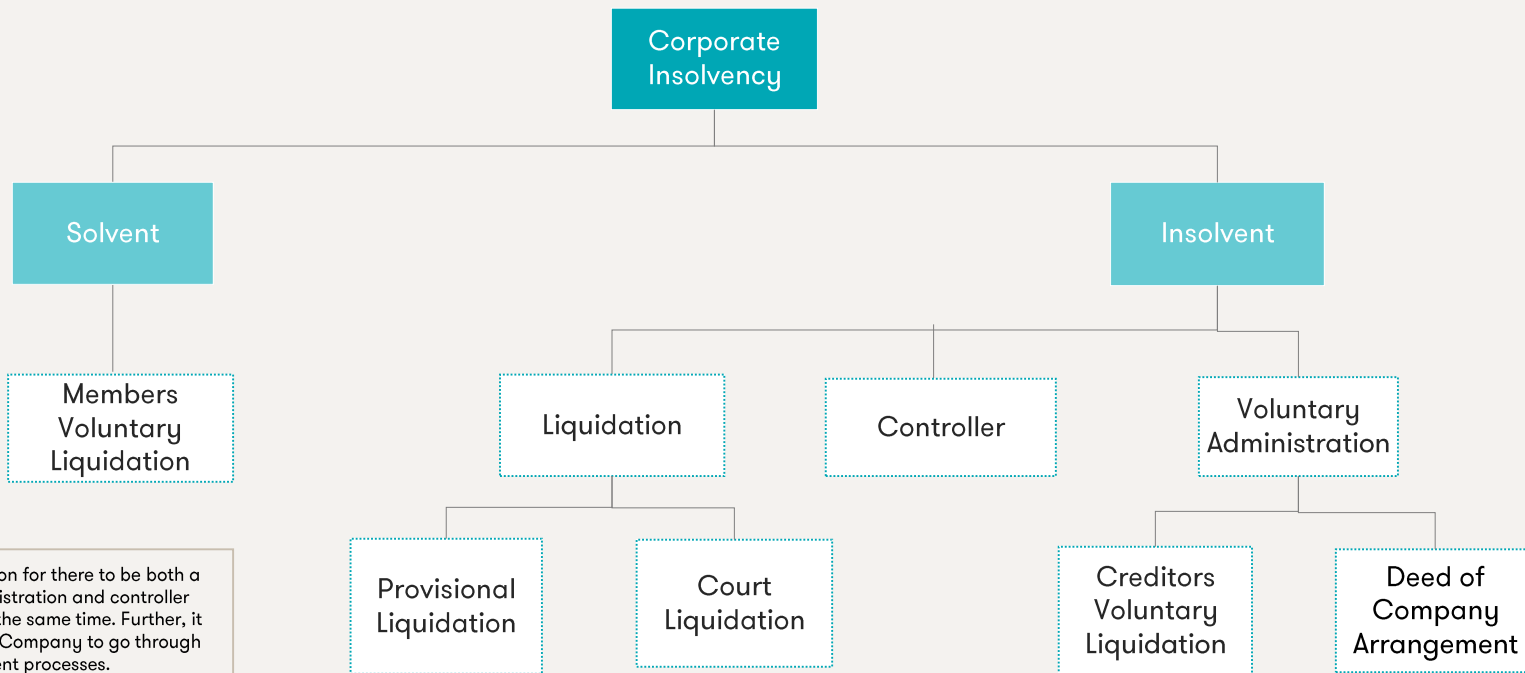
- Of business / operations
- May be no notification to lender

Insolvency

Understanding external administrations



Types of Insolvency Appointments



Note: It is common for there to be both a Voluntary Administration and controller appointment at the same time. Further, it is common for a Company to go through numerous different processes.

Example: Voluntary Administration and Receivership (concurrently) followed by a Creditors Voluntary Liquidation.

Appointments - overview

| | VA | CVL / OL | Controller |
|-------------------------------|------------------------------------------|----------------------------------|---------------------------|
| Solvent or Insolvent | Insolvent | Insolvent | Solvent or Insolvent |
| Who appoints | Director, Secured Creditor or Liquidator | Shareholders (CVL) Court (OL) | Secured Creditor or Court |
| Continue trading | Yes | Limited | Yes |
| Investigate collapse | Yes | Yes | No |
| Bring Actions | Yes | Yes | No |
| Deal with creditors | Yes | Yes | No |
| Report to ASIC | If required | Yes | If required |
| Employee access to FEG | No | Yes | No |
| Primary Duty to | Creditors | Creditors | Appointor |
| Statutory Reporting | High | Low | Limited |
| Cost/Fees | High | Medium / Low | High/Medium |

Voluntary Administration

- Provides best opportunity for Company to restructure and continue in the future
- Moratorium relief allows an Administrator to trade the business with more ease whilst a decision is made on the Company's future
- Secured Lender can appoint a Receiver within 13 days
- From a PR perspective can appear as a 'softer' touch by the Secured Lender than a Receivership
- Primary duty of the Administrator is to all creditors, not just the Secured Lender. The Secured Lender therefore has less control over the process
- Can be costly due to significant statutory reporting requirements

Receiverships

- Secured Lender has significant control in the process
- Receivers primary duty is to the appointor (Secured Lender). No need to deal with unsecured creditor claims
- Statutory reporting minimal
- Costs typically less than in a Voluntary Administration. However, likely an Administrator or Liquidator will be appointed at the same time to deal with creditors
- No ability to pursue antecedent transactions
- Employees do not have access to FEG and Company creditors can be left in limbo

Liquidation

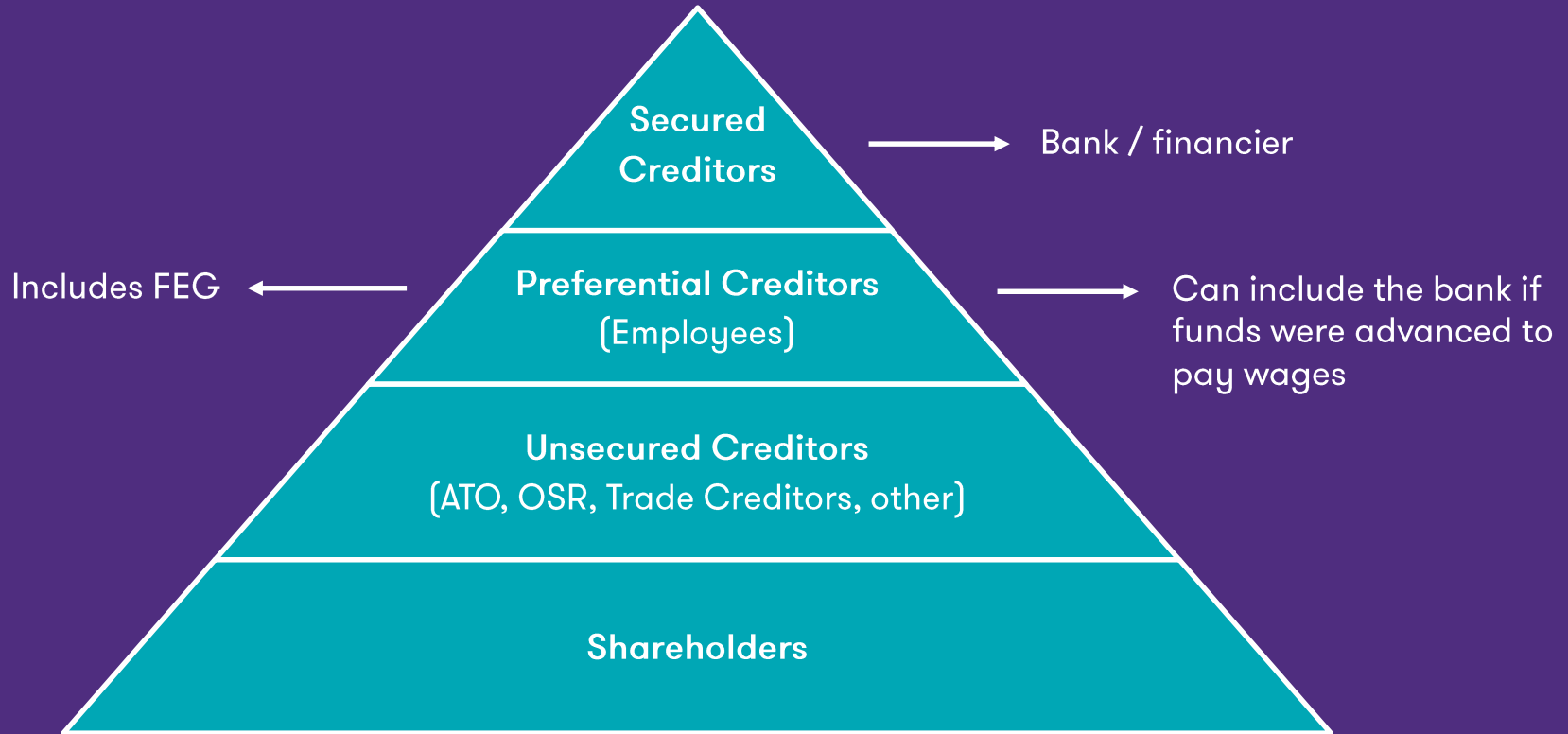
- Liquidator has significant legal rights to take legal actions against various parties including antecedent transactions
- Liquidators primary duty is to all creditors. Secured Lender has less control over the process
- Viewed as the ‘death’ of a Company and unlikely for the Company to be restructured
- Typically results in lowest return to creditors as asset sales can be viewed by external third parties as a ‘fire sale’
- Employees have immediate access to FEG

Secured creditors

Rights, critical
considerations
& assets available



Creditor overview



Secured Creditors

Overview

- Registered security on the Personal Properties and Securities Register (“PPSR”)
- Generally a bank will have an ‘ALLPAP’ security interest over the circulating and non-circulating assets of a company
- Secured creditors are ranked by their security (first ranking, second ranking etc.) and have different rights and priorities in an insolvency proceeding based upon their ranking

Secured Creditors

Important notes when dealing with an external administration

Can appoint an external administrator by way of:

- ‘Controller’ (i.e. Receiver and Manager, Agent for Mortgagee in Possession)
- Voluntary Administration
- Court Liquidation

Security interest ‘vesting’

- If there is an insolvency appointment <6 months after registration of security interest, the property may vest in the administration

Secured Creditors

Important notes when dealing with an external administration

Decision period

- In VA, 13 business days after the date of appointment to appoint a Receiver to act on their behalf (an extension of time may be requested to make a decision). In a liquidation, this can be made at any time.

Preferential payments

- A Liquidator cannot make a claim against a secured creditor for a preference payment (to the extent of the value of their security)

Secured Creditors

Important notes when dealing with an external administration

Voting at creditors meetings

- Cannot vote at a creditors meeting without compromising their debts (VA exception)
- Can vote / rank for dividend to the value of the outstanding debt that exceeds security

Decision making

- Certain decision require the approval of the secured creditor (i.e. approval of sale of assets/business in a Receivership, releasing security to allow a sale/transfer of assets)

Right to request information

- An external administrator must provide information to a creditor if the request is 'reasonable', relevant to the external administration, and does not cause a breach of duties

Asset realisations

In an external administration

Non-circulating assets

'Fixed' charge assets

Examples: PP&E, factored debtors, some IP

Less costs and expenses properly incurred in preserving & realising the property

Available first to secured creditors with a 'non-circulating security interest'

Available next to priority creditors

Circulating assets

'Floating' charge assets

Examples: cash, debtors, inventory

Less costs and expenses properly incurred in preserving & realising the property

Available first to priority (employee) creditors

Available next to secured creditors

Wrap up



Stay aware of
early warning signs



There are options
available



Get (the right)
advice!



In external administrations,
remember the bank's rights



Know what assets
are available to you



Q&A



Thank you

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