

SUBMISSION TO THE

MINISTRY OF ECONOMIC DEVELOPMENT

ON THE

DISCUSSION PAPER

INSOLVENCY PRACTITIONER
REGULATION:

OPTIONS FOR CHANGE

Prepared by
the New Zealand Institute of Chartered Accountants

February 2007

INTRODUCTION

The Institute

1. The Institute's members make up the majority of the accounting profession in New Zealand. As at 30 June 2006, the Institute had approximately 29,000 members. The Institute's members operate throughout the economy, participating in and advising all types of businesses, entities and individuals.
2. The Institute operates under a statutory regime which includes functions that relate directly to regulating its members' activities and conduct in the public interest.
3. The Institute prepares its submissions through a synthesis of member views, in house regulatory experience, research and contracted specialist advice. Member views are sought through a variety of means including an open invitation to the membership for comment on issues of interest, standing committees of volunteers, ad hoc committees and informal networks of members. The Institute's submissions and work programme can be viewed at www.nzica.co.nz.
4. The Institute is committed to promoting public policy that enhances the overall interests of New Zealand.
5. As well as preparing submissions to government on issues of importance to its members and the wider business community, the Institute:
 - develops and promulgates ethical rules, professional standards and related guidance;
 - develops financial reporting standards;
 - provides quality assurance services to members;
 - promotes the "Chartered Accountants" and "Accounting Technicians" brands;
 - provides networking and career and practice development opportunities; and
 - provides professional education and information services to members.
6. The Institute welcomes the opportunity to comment on the Ministry of Economic Developments discussion document "Financial Intermediaries".
7. Contact details in relation to the submission are:

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Executive Summary and Introduction

8. The Institute welcomes the opportunity to comment on the Ministry of Economic Development's discussion document "Insolvency Practitioner Regulation: Options for Change". The Institute also welcomes the generous amount of time provided for submissions. The focus and brevity of the paper are also pleasing.
9. In June 2004 the Institute submitted to the Ministry on the discussion document "Draft Insolvency Law Reform Bill" as it related to the regulation of insolvency practitioners. The Institute continues to hold to the views expressed in that submission and has attached that submission. The two submissions should be read together.
10. The key area of departure in the current discussion document from the Ministry's earlier discussion document is the inclusion of a new option "competitive licensing". This appears to be the Ministry's preferred option.
11. While the Institute supports competitive licensing as an alternative to traditional, single provider licensing in some circumstances, the Institute considers competitive licensing has many of the draw backs of traditional single provider licensing and can be inferior in certain circumstances. The Institute's support of competitive licensing is conditional on:
 - all feasible, less intrusive means of reducing significant market failures having first been thoroughly explored and discarded as inferior; and
 - the government applying a "light touch" to oversight of the bodies undertaking the licensing function.
12. The Institute does not believe less intrusive means of dealing with the market failures have been adequately explored. In particular, amendments to the Companies Act 1993 arising from the wider insolvency review should deal with many of the problems and should be implemented and reviewed for effectiveness before further regulation is proposed. In addition, if the government is determined to introduce further measures, a strengthening of the existing negative licensing (through government enforcement) and certification regimes could be considered. This would be preferable to licensing, either "competitive" or "traditional".

COMMENT

Other options

13. The Ministry has put forward for consideration the option of licensing insolvency practitioners. The Ministry appears to favour this option.
14. Licensing should be reserved for the most severe of occupational market failures. To quote from the Ministry of Economic Development's framework for occupation regulation¹:

“Licensing workers in an occupation imposes costs and reduces flexibility more than any other means of control and should be reserved for occupations where there is a high need for control for safety reasons. Any of the other methods [*of occupational regulation*] are likely to be adequate control for occupations that do not affect health or safety.”

15. The guidelines go on to state:

“Because restricting entry to an occupation through licensing workers imposes costs and reduces flexibility more than any other means of intervening in the conduct of an occupation, it should be reserved for cases where the conduct of an occupation could pose a significant risk of harm, self regulation by industry will not work and other means of intervention by government will not solve the problem.”

16. The Institute concurs with these comments, and submits that it is not possible at this point to conclude that other, less distortionary intervention by government will not solve any problems at less cost.

Companies Act Amendments

17. Paragraph 18 of the Ministry's discussion document outlines a number of proposed amendments to the Companies Act designed to make it more difficult for unscrupulous and incompetent insolvency practitioners to practice.
18. The Institute disagrees with the sentiments expressed in paragraph 19 of the discussion document, ie, that the measures fail to adequately:
 - Prevent persons with insufficient skills and experience from entering the profession;
 - Deal with the information asymmetry problem for those appointing practitioners; and
 - Allow for co-ordination with the Australian VA regime.

¹ Policy Framework for Occupational Regulation: A Guide for Government Agencies Involved in Regulating Occupations, Competition and Enterprise Branch, Ministry of Economic Development, 1999.

19. There is little argument provided in support of the Ministry's view and evidence points towards the measures being effective. As commented in the Institute's earlier submission (refer paragraphs 16 to 20), prior to the Companies Act 1993 there were few concerns related to the performance of insolvency practitioners. A number of the amendments now proposed for the Companies Act are returning to the regulation that existed prior to 1993.
20. Further, as commented in the attached submission (paragraphs 21 to 23), the Institute views the primary problem in the insolvency market as inadequate enforcement rather than too few laws (including controls on who may practice). Insolvency practitioners who undertake assignments without due care, and to the required standard, or who act to defeat the interests of creditors, are acting in contravention of the existing legislation (eg, S. 286 of the Companies Act). The amendments to the Companies Act will make it easier for creditors and debtors to enforce their respective rights and hold insolvency practitioners to account.
21. For these reasons the Institute strongly supports implementing the proposed amendments to the Companies Act with a view to reviewing the efficiency of the insolvency market in two to three years time.
22. If the Ministry views it as essential to put forward additional proposals at this point, the Institute believes there are less intrusive measures that could be used to supplement the amendments to the Companies Act, in particular by enhancing the existing negative licensing and certification regimes.

Strengthening the existing negative licensing regime

23. While the Institute believes the Companies Act should be amended and reviewed for effectiveness prior to expanding the role of government, a supplementary option that could be considered at this point is for the government itself to take on a greater enforcement role. To this end, the Registrar of Companies National Enforcement Unit could be provided with the powers and resources to properly investigate and remove the small number of practitioners who are breaking existing laws (a figure of "up to 20" substandard practitioners is alluded to in the discussion document).
24. Once these practitioners are removed, the licensing (negative) regime would have greater credibility and the likelihood of other substandard practitioners taking their place would be reduced, thereby also reducing the ongoing cost to government.
25. This negative licensing approach, the Institute believes, would be far preferable to setting up and maintaining the infrastructure needed for a competitive licensing regime, quite apart from the better competition and choice outcomes that result from a negative licensing regime.

Strengthened certification

26. The Institute of Chartered Accountants and the Law Society currently certify those of their members providing insolvency services to the public as proficient in the provision of those services. The Institute “practice reviews” those of its members providing insolvency services and has robust complaints resolution and disciplinary processes in place.
27. A further, less intrusive option than licensing would be for the government to undertake a high level review of the Institute and Law Society regulation of their respective memberships, and to certify that the respective organisations are operating to an appropriate standard. This would assist the respective organisations to differentiate their members from non-certified members without incurring the high direct and indirect costs that come with a licensing system.

Competitive licensing

28. The Institute has in recent years noted a growing enthusiasm from the Ministry of Economic Development to introduce occupational licensing, and is not surprised to see it now put forward for insolvency practitioners².
29. In terms of the options available to the government from its regulatory tool box, licensing is one of the most heavy handed interventions available, only one level below the government providing the services itself, or nationalising the profession. Licensing is inherently anti-market, relying on administrative controls to drive standards of behaviour in preference to consumer choice and competition between providers.
30. While the Ministry has sought to improve on “traditional” single regulator licensing via “competitive licensing”, the Institute believes the above comments are equally applicable to both forms of licensing. This is because the fundamental aspects of the two approaches have little to separate them and, depending on how the government decides to implement competitive licensing, it could easily prove the more costly.
31. The fundamental aspect of licensing that makes it so costly is that it removes the safety valve that non-licensed providers are otherwise able to provide. That is, non-licensed providers would provide an important reality check on the regulators of licensed providers to ensure regulation remains relevant to the needs of the market (achieving the appropriate cost quality trade-off for consumers). In doing so, non licensed providers reduce the risk that anti-competitive measures are put in place for the benefit of the practitioner, but to the detriment of consumers.
32. In the Institute’s view, the gains from competitive licensing compared to traditional licensing are on the margin and will only arise if the government allows the “industry” regulators to compete across a wide front, ie, in setting the

² In contrast, the Ministry’s 2004 discussion document on regulating insolvency practitioners was more cautious on the possible benefits of licensing.

regulatory standards and how those standards are to be enforced. Compared to traditional licensing, competitive licensing should ideally lead to the following benefits: timelier and greater regulatory innovation; better matching of supply to consumer preferences; lower cost provision; and regulation better tied to the needs of the market.

33. Against this, the benefits would need to outweigh the added costs of: duplication and loss of economies of scale and scope that come through having multiple regulators; and the cost of the government's oversight function. Further, as industry bodies rather than the government would incur the primary cost of regulating, there would be fewer effective disciplines on the government not to unnecessarily extend the regulation over time. This is because the regulator's costs will not appear on the government's balance sheet so won't be subject to the disciplines imposed through the government's appropriations process, for example.

A light touch is needed for competitive licensing to work (better than traditional licensing)

34. Where the case has been made for a competitive licensing regime, the Institute favours the government adopting a light handed approach to the oversight of that regime³. This would be done through the government setting the performance outcomes needed to be achieved by the industry regulators, but leaving the regulators to determine for themselves how those standards are to be met. In this way the government would assess the likely effectiveness of the respective regulators' **total** quality assurance system rather than prescribing what must make up the constituent parts.
35. The Institute believes the more the government involves itself in the micro-management of the individual regulators, the more likely it is that the benefits will be compromised and the costs exacerbated. Examples of a regime where the government is too intrusive includes the government approving standards (and amendments) and stipulating the design of disciplinary procedures.
36. An intrusive oversight role by government would add to costs, tends to a one size fits all regulatory approach⁴, slow rule changes, inject an element of political risk into their development and impair the judgements made by specialist experts (government regulators tend to be more generalist⁵).
37. The Institute believes that it would be preferable for the government to undertake the regulatory role itself rather than put in place an intrusive oversight role. This is because intrusive oversight would mitigate the benefits of competitive licensing (paragraph 36) while still incurring the additional costs (paragraph 32) in comparison to a traditional licensing regime.

³ The Institute also recognises the risk that a light handed regime would over time develop into an intrusive and costly regime.

⁴ This is a consequence of centralising and bureaucratising regulatory decision making.

⁵ As a rule, the Institute believes micro regulatory decisions are better made by industry experts while more substantive regulation is best led by regulatory experts.



I n s t i t u t e o f
CHARTERED ACCOUNTANTS

o f N e w Z e a l a n d

SUBMISSION TO THE
MINISTRY OF ECONOMIC DEVELOPMENT

DRAFT INSOLVENCY LAW REFORM BILL

DISCUSSION DOCUMENT:

REGULATION OF INSOLVENCY
PRACITIONERS

Prepared by
the Institute of Chartered Accountants of New Zealand

June 2004

EXECUTIVE SUMMARY

The Institute of Chartered Accountants of New Zealand (the Institute) welcomes the opportunity to comment on the section of the Ministry's discussion document "Draft Insolvency Law Reform Bill" on the regulation of insolvency practitioners. This section of the Ministry's discussion document is thorough, balanced and highlights well the risks and issues that need to be considered before final decisions are made.

The Institute considers that greater regulation of insolvency practitioners is warranted. In our view, the changes brought about by the Companies Act 1993 to reduce the cost of the insolvency process and increase competition have swung too far, at the expense of creditors and insolvency practitioners who adhere to appropriate standards. In particular, it is too easy for "debtor friendly" practitioners to be appointed, and to operate unchallenged to the detriment of creditor interests.

The Institute has proposed for further consideration a number of measures designed to reduce the opportunity for incompetent and unscrupulous insolvency practitioners to operate. In particular, these options focus on voting, appointment, and disclosure safeguards. If designed and implemented carefully, it is intended that these measures would be effective at meeting the government's objectives, and the associated costs would be minimal.

With regard to certification, the Institute has taken the opportunity to comment that the Institute and the New Zealand Law Society both operate certification regimes for their members, regimes that encompass insolvency work. Both the Institute and Society have been exploring improvements to their respective regimes, and would be pleased to share with the Ministry work to date on issues of mutual interest.

Finally, the Institute does not favour licensing at this stage. Rather, there are less intrusive and less costly measures that should be attempted first, measures that pose less risk to the efficient operation of the insolvency market, and to the interests the regulation is seeking to protect, creditors.

INTRODUCTION

The Institute

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 - develops financial reporting and professional standards;
 - provides quality assurance services to members;
 - promotes the "Chartered Accountants" and "Accounting Technicians" brands;
 - provides networking opportunities; and
 - provides education and information services to members.
5. The Institute welcomes the opportunity to provide the Ministry of Economic Development with its views on the discussion document "Draft Insolvency Law Reform Bill". The Institute would be pleased to discuss any aspect of this submission with the Ministry should the Ministry so wish.
6. Contact details are:

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The Institute's submission

7. The Institute is submitting only on the regulation of insolvency practitioners. The Institute's views on the rest of the discussion document are contained in the submissions from the Institute's and Law Society's Joint Insolvency Committee. Also, the Institute sought the views of the Law Society on some aspects of this submission. Those comments are clearly attributed to the Society in the text.

REGULATION OF INSOLVENCY PRACTITIONERS

Current disciplines on insolvency service providers

Market disciplines

8. Ideally, performance consistently below that demanded by clients and employers should result in sub-standard insolvency service providers being removed from the market through their failure to retain existing and attract new clients, and to form and maintain employment relationships.
9. Complementary market disciplines include insurance, with sub-standard (high risk) providers exiting insolvency practice because insurers refuse to provide them with professional indemnity cover.

Professional bodies

10. Complementing the work of the market are professional bodies such as the Institute of Chartered Accountants and the Law Society. The Institute, for example, markets the quality and assurance advantages to firms and others of engaging a Chartered Accountant. As the Ministry's report comments, both professions (chartered accountants and lawyers) are self-regulating: the Institute and the Society set rules of professional conduct that apply to their members, and have complaints and disciplinary regimes.

Courts and common law

11. Complementing and reinforcing the normal operation of the market and operation of professional bodies, common law and the courts operate to allow clients to enforce standards where, in particular, the action or inaction of those providers has resulted in loss to others.

General legislation

12. Insolvency practitioners must, notwithstanding the effectiveness of current enforcement, meet general regulatory standards set by government, including:
 - The Consumer Guarantees Act 1993 (to provide services with reasonable care and skill, and to provide services that are fit for purpose);
 - The Fair Trading Act 1986 (which prohibits misleading conduct in relation to services); and
 - For more serious breaches of standards, the Crimes Act 1961 (in particular, offences relating to fraud).

Specific legislation

13. The Companies Act 1993 (S. 280) provides only limited controls on who may be an insolvency practitioner. Among other things, it prohibits liquidators from acting for a company in which they were a shareholder, director, auditor or receiver of the company in the previous two years. The Act also gives the

court the power to determine a person unfit to act as a liquidator and prohibit that person for doing so for up to five years (S. 286). The Act also imposes a number of duties on the liquidator in favour of creditors, and provides for the court to provide directions to liquidators.

Current Problems

The market failure problem

14. The market for professional services does not always operate as efficiently as it should. In particular, there may be too many incompetent and unethical providers putting at risk the interests of the public. Professor Allan Fels⁶ identifies the principal reason why this might occur to be the information asymmetries between provider and purchaser. The asymmetries arise principally because the services are not observable or easily assessed before or after they are purchased, and consumers tend to be infrequent purchasers, making the loss of repeat custom a less important factor for removing sub-standard providers. These factors are relevant to the provision of insolvency services.
15. In addressing this market failure, the purpose of government action is to promote consumer interests by:
 - reducing information problems;
 - ensuring a minimum level of service; and
 - promoting compensation/damages.

The New Zealand experience

History

16. Up until the late 1980s early 1990s, there were few calls for greater regulation of insolvency service providers. Up to that point there was a small number of established providers and demand for insolvency services was comparatively limited. Also, there was a far greater number of receiverships where the debenture holder was usually a bank and who had the information to select wisely and did so. Almost all liquidations were carried out by the Official Assignee.
17. A number of changes occurred after this point. In 1988 the rapid fall in property and equity values forced many companies into insolvency, significantly driving up demand for insolvency services. This demand was met, in some cases, by practitioners who lacked the requisite skills and experience. Also, the number of receiverships declined dramatically so that now most insolvencies are liquidations.

⁶ Professor Allan Fels, Chairman Australian Competition and Consumer Commission, APEC Regulatory Reform Symposium, 1998.

18. Also, in 1993 the new Companies Act was passed. The Act sought, among other things, to realise efficiencies in the provision of insolvency services by:
- reducing the cost of administering company insolvencies, thereby promoting greater overall returns to creditors; and
 - increasing competition, thereby keeping costs down, promoting greater choice and encouraging innovation. For example, the Official Assignee began to contract out liquidations to the private sector.

Removal of safeguards

19. However, in doing so the Act removed a number of creditor safeguards, including requirements for:
- a meeting of creditors to confirm or appoint a liquidator;
 - a statement of affairs;
 - an annual meeting of members and creditors; and
 - a committee of inspection to review the actions of the liquidator.

Additional risks

20. In addition to reducing the circumstances when these safeguards apply, the new Act also:
- allows the liquidator to be appointed by the shareholders or directors⁷ of the company; and
 - allows the liquidator to compromise disputed debtors and approve liquidators fees, for example, without recourse to the Court or Committee of Inspection.

Enforcement

21. Statutory protections for consumers are still provided, for example, insolvency practitioners who undertake assignments without due care, and to a certain standard, or who act to defeat the interests of creditors, are acting in contravention of the existing legislation (eg, S. 286 of the Companies Act). Enforcement, however, has proven problematic.
22. The principal responsibility for enforcement rests with creditors through private action. There are a number of reasons why this enforcement is largely ineffective:
- creditors may have insufficient money to pursue insolvency practitioners;
 - creditors may be reluctant to risk “good money” trying to reduce losses already incurred;
 - the probability of success may be too uncertain;

⁷ In practice directors rarely if ever appoint the liquidator.

- creditors may have insufficient information of the actions/inactions of the practitioner; or
 - the amount per creditor may not warrant the transaction costs of taking action, especially as under the existing provisions prosecution is difficult.
23. Thus, while creditors often have the correct incentive to pursue action, they often lack the capacity (including the ability to co-ordinate their actions) or the information necessary for effective enforcement. This problem is more pronounced where the company is small, and or the remaining assets per creditor are minimal.

Problem insolvency practitioners

24. The factors identified above have allowed two types (often interrelated) of sub-standard insolvency practitioner to operate.

Practitioners lacking the requisite skills and experience

25. Since the late 1980s, early 1990s, insolvency work has been undertaken by a wider range of occupational classes, and within the Chartered Accountant brand, by a wider range of practitioners. While there is now more choice, it is clear, in the Institute's view, that there are too many practitioners operating in the insolvency field who lack the necessary competencies. This is to the detriment of creditors, debtors and others whose interests are tied to the efficient administration of company insolvency (including courts and fully competent insolvency practitioners).
26. With provision being made in the Insolvency Bill for a voluntary administration regime, which requires new skills around business rehabilitation, it is feared there is now even greater opportunity for creditor and other interests to be put at risk by substandard insolvency practitioners. The skills required for rehabilitation (compared to burial) are more extensive. Clearly, where this work is undertaken by people without the necessary skills (or who are unscrupulous), the policy objectives underlying voluntary administration will not be met.

Conflicted practitioners

27. The insolvency practitioner's primary responsibility is to creditors (in the case of a receiver, to the holder of the security interest which has appointed the receiver).
28. Where the liquidator is appointed by the Court (through the Official Assignee) or where a receiver is appointed, in the main, the insolvency practitioner can be expected to act in the interests of the creditors.
29. It is possible, however, for directors and shareholders to appoint a liquidator (S. 241 of Companies Act). In the Institute's view, there have been too many instances where this has allowed creditor interests to be defeated by the appointment of a liquidator "friendly" to the debtor's interests, for example:

- Director/shareholder appointing a liquidator after a creditors’ petition for winding up a company is filed, but before the Court appoints a liquidator;
 - Not calling a meeting of creditors because the liquidator does not consider more than 20 cents in the dollar is recoverable (Companies Act, S. 255);
 - Not providing a list of creditors so that creditors might organise themselves collectively to best pursue their common interests, and to minimise any “free-rider” issues;
 - Engineering the vote at a creditors’ meeting in favour of the debtors’ preferred liquidator (for example, accepting directors as creditors, or creating a bogus charge in favour of a party related to the company); and
 - Creditors are not aware of their rights in liquidation or are apathetic.
30. Existing safeguards and enforcement have proven insufficient to prevent these appointments. The impact is a reduction in the return to creditors, and increase in the cost of credit (including higher monitoring and enforcement costs).

Options

31. The Ministry has identified three reform options for discussion.

Strengthening existing statutory measures

Ministry proposals

32. As discussed in paragraphs 21 to 23 above, a key weakness with the current regime is enforcement. To this end, a strengthening of the Registrar of Companies’ powers of enforcement and adequate resourcing of this function is a sensible approach. We emphasise, however, that adequate resourcing is essential. When additional powers are provided for, there will be a market expectation that those powers will be enforced. To not do so risks encouraging complacency and its related costs.
33. That said, it is recognised that the Registrar of Companies would have limited resources and would need to apply those resources carefully to get maximum return. For example, the Registrar should concentrate on those areas where:
- the offence is significant or the offending persistent;
 - private enforcement is inadequate;
 - any deterrent effect is likely to be the greatest; and
 - the action is likely to be successful.
34. A basic principle of good regulatory design is to ensure existing rules are adequately enforced before designing new rules. The Institute considers, however, that a compelling case can be made for strengthening remedies and offences concurrently with increasing enforcement effort. To this end, the Institute supports the Ministry’s proposals with regard to compensatory orders and offences for breaches of duty. These measures would target both the

practitioners who lack the necessary insolvency skills, and the “debtor friendly” practitioners who breach their duties to creditors.

35. Similarly, strengthening reporting requirements (to the Registrar) to include suspected offences by a company or its directors could expose “friendly” liquidators in particular to greater legal risk. However, if the offences for breaches of duty and greater enforcement powers are implemented, the impact of the reporting requirements may be marginal.

Additional proposals

36. In addition to the Ministry’s proposals, the Institute is putting forward for consideration a number of amendments to the Companies Act which may further protect the interests of creditors, without excessive cost or reduction in competition. These include:

Voting

37. Consideration could be given to prohibiting directors from voting at creditors meetings, even where they are also creditors of the company. Directors’ interests are so closely tied to the events leading up to the insolvency, and their capacity to subvert proceedings in their favour (to the detriment of other creditors) so great that introducing the prohibition would reduce opportunities for appointing friendly liquidators.
38. Further, there would be benefit in introducing a restriction on related party voting. The restriction would need to be designed with some care to minimise the risk that legitimate interests would be captured. The restriction could be based on one of the related party tests provided for in the Income Tax Act, where there is already some experience in the test’s application.

Appointment of liquidator

39. Where it is the directors or shareholders that place the company into liquidation, the Official Assignee could be required to appoint the liquidator. Directors and shareholders should not be prevented from nominating to the Official Assignee a liquidator.
40. Official Assignee involvement would considerably reduce the opportunity for the debtor to appoint a “friendly” liquidator. This would need to be worked through carefully with the Official Assignee as they may be reluctant to perform this function, or lack the necessary capability.
41. Alternatively, if an accreditation regime is developed, it would be expected that accredited providers would be on a publicly available list. There may be merit in requiring that where directors or shareholders appoint the liquidator, it must be from that list, unless creditors opt for someone else.
42. Finally, after a creditor’s petition for winding up a company is filed, it should not be possible for the shareholders/directors to appoint a liquidator before

that application is decided by the court, unless the creditor(s) agree, ie, where they withdraw the petition.

Disclosure

43. Currently, S 255 of the Companies Act provides for the liquidator to prepare a list of every known creditor of the company, and to provide every known creditor, shareholder and the Registrar with a statement of the company's affairs (assets and liabilities), proposals for conducting the liquidation and a notice explaining the right of a creditor or shareholder to require the liquidator to call a meeting of creditors. The liquidator is not required to comply with these provisions if the liquidator is satisfied that the value of the assets of the company available for distribution to unsecured creditors is not likely to exceed 20 cents.
44. S 255 too easily allows liquidators to avoid accountability to creditors. As a minimum, all liquidators should be required to provide the Registrar with the statement of the company's affairs, proposals for conducting the liquidation and a list of known creditors. This work must be done anyway, and the cost of filing this information with the Registrar would be marginal.
45. In addition, the Institute sees merit in requiring that liquidators disclose their previous experience and qualifications, that they have not been the subject of a prohibition order, disclosing any relationships with and that they are independent of the company or related persons. Again, the cost of providing these disclosures should be minimal.
46. A letter should be sent to all known creditors and shareholders informing them:
 - of the liquidator's appointment;
 - the information listed in paragraph 45 above;
 - of their right to call a meeting of creditors; and
 - that the information listed in paragraph 44 is held by the Registrar and is available for inspection.
47. Currently the list of creditors and contact details is not made publicly available due to privacy considerations. The Institute considers there are sound public interest reasons for making this information available, in particular as it better allows creditors to co-ordinate their efforts and knowledge to further their collective interests. We also note that public disclosure is consistent with Part XIV of the Companies Act which provided for creditor information to be made publicly available. There would be no need to identify the amount of debt due to each creditor.
48. Finally, the liquidation should be notified to the public via a major daily news paper and the New Zealand Gazette. Again, this cost should not be excessive, and should be incurred to ensure significant creditor interests are not overlooked.

49. Together, the disclosures proposed above would significantly enhance the accountability of liquidators to creditors, reduce the opportunity for the appointment of debtor friendly liquidators and increase only marginally the cost of the liquidation process.

Good regulatory design and unintended consequences

50. Applying additional resources to removing sub-standards practitioners, building in additional safeguards for creditors and amending the law to make it easier to remove liquidators will increase transaction costs.
51. More importantly, it will have wider economic impacts on the efficient operation of the market. The possible impact on competition is commented upon in the Ministry's discussion document. Other impacts include the risk to legitimate liquidators and their actions, and this is commented upon below.
52. By its nature, insolvency is adversarial and litigious. Per member, the Institute receives more complaints against its insolvency practitioners than any other grouping.
53. While the measures proposed will make it more likely sub-standard liquidators will be removed from the market, it also increases the risk that good liquidators and their actions will be challenged. The measures, while increasing positive disciplines on insolvency practitioners, contemporaneously increase legal risk and liquidation costs. It is important that these consequences be considered carefully before the measures proposed above are implemented. In particular, protections against frivolous and vexatious complaints should be considered to protect the overall interests of creditors.
54. No regime will remove all sub-standard insolvency practitioners from the market. The objective of reform is to put in place measures up to the point where their marginal cost can be justified by the resulting additional benefit. Clearly, the objective is not to prevent all sub-standard practices – the cost of doing so would be prohibitive, in particular to other insolvency practitioners and to creditors.

Introduce a voluntary accreditation regime

Advantages

55. The key advantage of an accreditation scheme is that it addresses the information problem, at least in part, that characterises the market for professional services (refer paragraph 14 above). If a consumer seeks services or products from an accredited provider, the cost of information is reduced because assumptions can be made as to the competence and performance of that provider. Further, compared to licensing, this can be done with less risk to market competition and consumer choice and price. Also, competition from non-accredited providers and other accredited providers promote disciplines on the accreditation scheme to set appropriate standards and keep those standards relevant to end users.

Existing accreditation arrangements

56. New Zealand already has accreditation regimes that apply to some, but not all insolvency practitioners. While not insolvency specific, the Institute and the Law Society subject their members to entry and ongoing requirements that must be met prior to practicing, and on an ongoing basis. These requirements offer consumers a greater level of assurance on the quality of work provided, and provide the option of their using the respective organisations to pursue sub-standard providers through the respective disciplinary processes.

Strengthening current accreditation regime

57. In 2002 the Institute spent a considerable amount of time assessing the feasibility of developing a specialist designation for its members who are insolvency practitioners. Admission to the designation would have required, among other things, verified practical experience and interviews, and ongoing assessment against insolvency related criteria.
58. The Institute estimated the cost of developing and maintaining the specialist designation, and divided that cost by the number of members who could be expected to take up the designation. Members were surveyed on their willingness to meet those costs. At that time, the designation was not deemed to be viable. The Institute would be pleased to make its analysis available to officials.
59. The Institute does envisage, however, that in time New Zealand will follow the course now being taken in a number of other countries to introduce this designation with the CA brand. International developments simultaneously enhance the value of the brand, and reduce the cost of developing it.
60. For its part, the Law Society is currently assessing the feasibility of a wide specialisation scheme for the legal profession. This too would be a voluntary scheme, based on branding.

Going forward

61. The Society and the Institute are reviewing the merit of putting greater effort into marketing the benefits to debtors and creditors of using Institute and Society members as liquidators.
62. In the event government decides to undertake further work on assessing an accreditation scheme for insolvency practitioners then the Institute would wish to be involved. The Law Society is firmly of the view that, in that event, accreditation should be considered only for that part of the industry which is not already subject to regulation by the Institute or the Law Society. The Society comments that lawyers should not be double-regulated by being made subject to an external accreditation regime for this aspect of their work.

Mandatory licensing regime

63. The insolvency practitioners may be seen as an appropriate target for mandatory licensing. Assessing the work of insolvency practitioners against the criteria identified in the Ministry of Economic Development's framework for occupational regulation⁸, it appears that:
- There is substantial risk of significant harm from sub-standard performance;
 - Existing measures and safeguards are insufficient;
 - There is a significant market failure (information asymmetry); and
 - There is a prevalence of sole practitioners, ie, the absence of added disciplines that can come from an employer/supervisory arrangement.
64. Also, we note that many overseas countries operate a licensing regime for registered insolvency practitioners. We are aware that insolvencies involving companies operating in New Zealand and these countries has resulted in confusion in these overseas jurisdictions because of the absence of a licensing regime in this country. And in the case of Australia, it has meant that the Trans Tasman Mutual Recognition Agreement does not automatically grant New Zealand insolvency practitioners access to the Australian market.
65. That said, we note the Ministry comment that "Because restricting entry to an occupation through licensing workers imposes costs and reduces flexibility more than any other means of intervening in the conduct of an occupation, it should be reserved for cases where the conduct of an occupation could pose a significant risk of harm, self regulation by industry will not work and other means of intervention by government will not solve the problem."
66. The Institute concurs with these comments, and submits that it is not possible at this point to conclude that other, less distortionary intervention by government will not solve the problem. In particular, it is important that the Ministry's and other proposed reforms such as those discussed above are put in place first. If these measures are subsequently found to be insufficient to deal with the problem, licensing could be revisited. Again, the Law Society is firmly of the view that, in that event, licensing should be considered only for that part of the industry which is not already subject to regulation by the Institute or the Law Society. Lawyers should not be double-regulated by being made subject to a second registration and regulatory regime for this aspect of their work. The Society points out that it has the capacity, if necessary, to make and enforce specific rules relating to lawyers acting as insolvency practitioners within its own regime.
67. In further support of the Ministry's comment, the Institute would add that a licensing regime risks producing a number of unintended adverse consequences which, taken together, can detract from the public interest. The

⁸ Policy Framework for Occupational Regulation: A Guide for Government Agencies Involved in Regulating Occupations, Competition and Enterprise Branch, Ministry of Economic Development, 1999.

Institute notes that the New South Wales Regulations Reduction Act 1997 repealed 85 occupational licences considered to be acting against the public interest. Typically, unintended consequences might include:

That standards will be set too high

68. This risk is higher if standard setting is captured by producer (rather than consumer) interests. If standards are set too high, there will be too few insolvency practitioners, costs will be excessive (reducing returns to creditors, and reducing access to insolvency services), there will be less choice and innovation will be lower.

That standards will be set too low

69. If standards are set too low, there will be insufficient consumer protection.
70. A more dangerous configuration, however, is where standards are set at the appropriate level, yet there is negligible enforcement of those standards. This can increase the gap between expectations and reality, giving the impression that licensing indicates an actual level of safety or competence that is illusory. As a result, consumers will spend less time selecting a provider appropriate to their needs and, in the case of liquidators, spend less time ensuring a debtor appointed liquidator will act in the creditor's best interests.
71. This outcome is likely to be worse than were there to be no regulatory standards. This is because, in a competitive market, far more sub-standard providers will be removed from the market through the actions of consumers than regulator could ever match. For example, compared to a regulator:
- there are strong self-interest reasons for consumers to identify (and avoid) sub-standard providers;
 - the burden of proof required by consumers to avoid/remove a provider from the market is very low in comparison to a regulator; and
 - collectively, consumers will devote greater resources to selecting and monitoring a provider than any regulator could match.
72. It is important that regulation compliment, rather than retard the positive disciplines consumers impose on producers. Regulation that promises more than it delivers fails on this count.

That standards will be inappropriate

73. Standards can be inappropriate if they exclude people from practising who shouldn't be excluded, or if they allow people to practise who shouldn't. This is more likely with prescriptive standards, or with performance based standards where insufficient resources are devoted to applying and enforcing those standards. Standards are also inappropriate if meeting those standards is unrelated to, in this case, achieving the objective of consumer protection. Over time, as practices, risk, consumer sophistication and market

arrangements evolve, the risk that the standards will become inappropriate will increase. This risk needs to be managed through periodic review.

74. Appendix A provides a brief discussion of the appropriateness of standards under a licensing regime versus a negative licensing regime.

Promoting Appropriate Standards: Licensing Versus Negative Licensing

Input versus performance standards

A licensing regime operates by restricting who may undertake certain work. It does this principally by controlling and specifying **input standards** such as education, work experience, on-going professional development, compliance with standards etc that are deemed necessary to provide the work to a satisfactory standard.

Input standards are more appropriate when the inputs needed to satisfactorily undertake the work are:

- relatively uniform for the types of regulated work, and over time;
- there are relatively few ways to satisfy those standards; and
- the inputs for which standards can be applied are the key inputs impacting the quality of the work.

Where inputs do not have these characteristics, standard entry criteria for the profession will be difficult to apply, or even counter productive to the interests of consumers through, for example, restricting access to providers capable of providing the service to the required standard.

The Companies Act is designed to operate as a negative licensing regime. Rather than certifying who may practice as an insolvency practitioner, negative licensing is intended to identify who may not, based principally on their performance. That is, negative licensing works to remove providers who fail to meet appropriate **performance standards**.

Insolvency practice

With regard to insolvency, there are generic skills all practitioners should have. Some can be acquired through education (finance and accounting skills and a knowledge of the Companies and Insolvency Acts, for example) and on the job training (whether assets are better sold as a going concern or broken up, and how to run a creditors meeting, for example). In many instances, on the job training and education will be interchangeable. There are other necessary skills which are more difficult to learn, for example, good judgement, natural attention for detail, ability to relate to a wide range of stakeholders, and conflict resolution skills, for example.

In addition, different insolvency projects will require a different mix of skills to satisfactorily complete the assignment. Sometimes the insolvency practitioner (or their immediate superior) will be expected to possess these skills, on other occasions it would be expected that the appropriate skills would be contracted for.

On balance, the Institute considers these characteristics of insolvency practice lend themselves more to a negative licensing regime than to a licensing regime. The caveat, of course, is that the negative licensing regime needs to be effective.