

PricewaterhouseCoopers' Submission on the Insolvency Practitioners Regulation Discussion Document

2 February 2007

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Insolvency Practitioner Regulation
Competition, Trade and Investment Branch
Ministry of Economic Development
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Insolvency Practitioner Regulation Discussion Document (“the Discussion Document”)

We are pleased to present our submission on Insolvency Practitioner Regulation. This submission addresses each of the questions raised within the Discussion Document and what we believe are the critical areas for consideration in implementing the proposed regulation. We also outline the key aspects of a regulatory regime that we believe would meet the primary objectives of regulation.

We welcome the introduction of a regulatory framework for insolvency practitioners. We believe that such regulation is an essential step in the progression of New Zealand’s corporate insolvency environment and, if governed appropriately, will aid in managing the risks within and public perception of the corporate insolvency industry.

We favour an independent mandatory licensing regime as opposed to a competitive licensing regime. We appreciate that it is important to strike a balance in the costs and benefits of regulation and adopt a viable regime that the corporate insolvency industry in New Zealand can support. Under Question 5 of our submission we outline a possible regulation system prototype, which we believe is an appropriate compromise between a mandatory and competitive licensing system and would be effective in managing the risks within the corporate insolvency industry.

Following, we address and comment on each of the seven questions raised for submission in the order they are listed within the Discussion Document.

Executive Summary

We believe that the regulation of insolvency practitioners is an essential step in the progression of New Zealand's corporate insolvency industry.

We favour a mandatory licensing system

Regulation requires a unified and tailored approach that will allow only competent practitioners, governed by a consistent code of ethics and disciplinary process, to take insolvency appointments.

We do not believe the competitive licensing system proposed by the Ministry of Economic Development will prevent individuals who do not have adequate competence or experience from taking insolvency appointments.

If a competitive licensing system is adopted then a comprehensive review of the system should take place 2-years after the date of adoption with a view to reporting on its effectiveness.

A key objective of New Zealand's regulation is harmonisation with Australia

Australia is currently reforming its regulation of insolvency practitioners, placing more emphasis on academic study and experience in the insolvency industry as opposed to enabling any Certified Public Accountant to become a registered liquidator. Australia's stance on regulation should be carefully considered when deciding on an appropriate regime for New Zealand.

It is important to strike a balance in the costs and benefits of regulation

In Section 5 of our submission we outline a proposed regulation system prototype, which we believe is an appropriate compromise between a mandatory and competitive licensing system and would be effective in managing the risks within the corporate insolvency industry.

We propose that current practitioners wishing to become licensed submit evidence of their experience in taking insolvency appointments together with two references obtained from other industry specialists attesting to the practitioner's competency and ethical demeanour to an Approval Body that administers the licensing process.

In future we propose that an individual seeking to become a licensed Insolvency Practitioner first obtains a professional qualification as either a Chartered Accountant or Solicitor of the High Court followed by a 2-year mentoring relationship with a licensed Insolvency Practitioner. Final entry as an Insolvency Practitioner would be obtained following an interview with a nominated panel of current Insolvency Practitioners and a Registrar of Companies representative.

We also support the requirement of continued professional development and professional indemnity insurance for all licensed Insolvency Practitioners.

We trust that our submission assists in the review of the Discussion Document.

1 Do you think that a competitive licensing system, in addition to the measures already contained within the Insolvency Law Reform Bill, will effectively manage the risks associated with corporate insolvency in relation to the competence and professionalism of practitioners?

- We do not believe that the proposed competitive licensing system on its own will be sufficient to effectively manage risks as it will not cater to the specific and unique requirements of the corporate insolvency industry.
- The corporate insolvency industry is unique in that the inherent risks lie within the fact that individuals are appointed de facto trustees to account for the distribution of proceeds to creditors from an insolvent estate. In most cases, creditors have little appreciation for an administrator's competencies or ethics.
- For a regulation regime to add value, it should facilitate a transparent environment in which only competent practitioners can take appointments and creditors can rely on the regime as a safeguard when entrusting practitioners to act in their best interests.
- Under the competitive licensing regime proposed in the Discussion Document, any member of an approved body is entitled to take an appointment as a Liquidator or Voluntary Administrator. Our main concern is that the majority of members within the proposed approved bodies, being the New Zealand Institute of Chartered Accountants ("NZICA") and New Zealand Law Society ("NZLS"), do not have the competence or experience to take insolvency appointments, yet all members will be entitled to do so.
- For these reasons, it is our view that for regulation to be effective it requires a more unified and tailored approach than the competitive licensing system proposed.

Factors considered in forming our view

- The respective Codes of Ethics and disciplinary processes for NZICA and NZLS may have conflicting standards. Consistency is required in the ethical guidelines and disciplinary processes in place for all Insolvency Practitioners. Of particular note are guidelines in relation to the maintenance of trust accounts, which is an essential aspect of an insolvency practice.
- Competent practitioners currently in the industry who are not members of an approved professional body should be included within the parameters of regulation and entitled to take appointments. Such practitioners appear to be excluded under the proposed competitive licensing regime.
- Australia is currently reforming its regulation of its insolvency practitioners. The existing regime in Australia permits members of the Australian Institute of Chartered Accountants or a Certified Public Accountant to become a registered liquidator. However, the reform places more emphasis on academic study and practical experience in the corporate insolvency industry, together with compliance requirements regarding insurance and annual submissions.

2 What impact (positive and negative) do you see might be associated with such a scheme?

Positive impact of the proposed scheme

- Only individuals who hold a professional qualification with proven education and experience in a wider accounting and legal context and subject to ethical rules existing within their respective professional bodies will be entitled to take appointments. This may preclude some debtor-friendly liquidators from taking appointments in the future who currently act without an obvious appreciation for their statutory duties as a liquidator.
- All practitioners would be subject to disciplinary processes existing within the NZICA and NZLS.

Negative impacts of the proposed scheme

- Will not prevent members of an approved body who have no insolvency experience from taking appointments.
- It is not as robust as Australia's newly reformed regime. Therefore New Zealand's reform will not achieve a key objective being harmonisation with Australia's regime.
- Will preclude competent practitioners currently in the industry who are not members of a professional body from taking appointments.
- Different practitioners will be subject to disciplinary procedures of different approved bodies, which will likely introduce inconsistencies.
- The Codes of Ethics within each of the approved bodies may conflict and/or parts may be inappropriate or irrelevant for the insolvency industry.

3 In terms of entry requirements, what key features would you expect to see in the licensing systems of approved professional bodies and why?

- We are of the view that the requirements of an individual who seeks to become a licensed Insolvency Practitioner should be set commensurate with the level of responsibility vested in a practitioner who takes an appointment as a Liquidator or Voluntary Administrator.
- Notwithstanding those experienced practitioners who do not hold a professional qualification but have proven records of competency, we believe that all licensed Insolvency Practitioners should be either qualified Chartered Accountants or Solicitors of the High Court. The reason for this is that an individual who has gained a professional qualification has illustrated a foundation of technical competence, commercial exposure and ethical appreciation on which specific insolvency expertise can continue to be built.
- Our recommended entry requirements for a licensed Insolvency Practitioner under both the competitive licensing system proposed in the Discussion Document, but equally as applicable to the licensing system we propose under Question 5 of this submission, are as follows:
 - Professionally qualified (Chartered Accountant or Solicitor);

- 2 years post-professional qualification mentoring relationship with an Insolvency Practitioner, including competency sign-off;
 - Induction as an Insolvency Practitioner following sign-off by a panel of 3 industry specialists following 1 hour discussion/interview (Panel comprising a Registrar of Companies representative and two existing Insolvency Practitioners).
- In order to achieve the unified approach referred to earlier in our submission, a single centralised body should oversee the entry requirements for a licensed Insolvency Practitioner.

4 *Should on-going professional development or on-going competency testing be a mandatory feature of an approved body's systems and processes?*

- We believe that on-going professional development should be a mandatory feature of Insolvency Practitioner licensing.
- We do not support on-going competency testing of Insolvency Practitioners. The insolvency industry in New Zealand is relatively small and a considerable amount of consultation occurs between practitioners on development within the industry. On-going competency testing of Insolvency Practitioners is somewhat unnecessary and impractical.
- On-going competency testing would also require considerable resource and infrastructure whereas on-going professional development could utilise existing forums.

Do you have any views on the form this requirement should take?

- Arrangements for on-going professional development already exist with a number of associations in the industry holding regular conferences and training sessions. These organisations include: INSOL, Conferenz, NZCFI and NZICA. To implement a structured professional development programme the regulating body could simply endorse these forums and set minimum requirements for Insolvency Practitioners to meet. For example, Insolvency Practitioners would be required to complete 20 hours of continued professional development ("CPD") annually. We envisage that CPD hours obtained through forums that are endorsed by the regulating body that are also endorsed by NZICA will be able to be cross-credited to existing NZICA requirements.
- In addition to minimum requirements set by the regulating body, all Insolvency Practitioners would be required to maintain membership of NZICA or NZLS and meet the on-going professional development requirements of those associations respectively.

5 *Do you have any other views on variations to the proposals that could be used to manage risks effectively?*

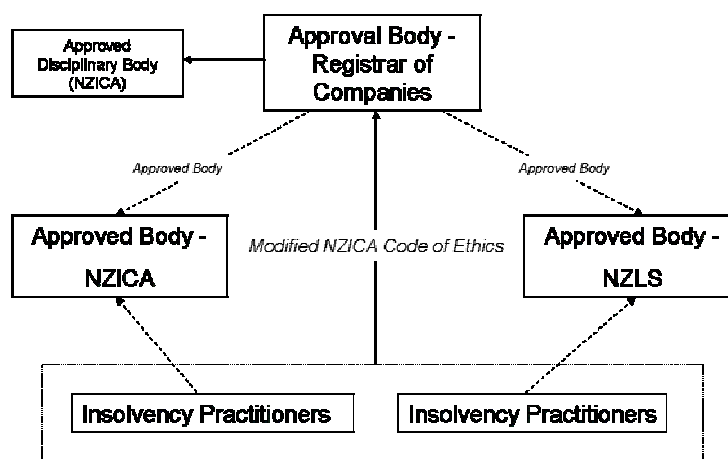
- We favour the attributes of an independent mandatory licensing regime as opposed to the competitive licensing regime proposed within the Discussion Document. However, we appreciate that it is important to strike a balance in the costs and benefits of regulation and adopt a viable regime that the corporate insolvency industry in New Zealand can support.
- Below we outline a possible regulation system prototype, which we believe is an appropriate compromise between mandatory and competitive licensing, in that it offers a

robust regime unified by a central body, being the Registrar of Companies, while utilising existing infrastructure within frameworks such as NZICA to reduce costs.

- We believe that such a system would be effective in managing the risks associated with corporate insolvency in relation to the competence and professionalism of practitioners but not as resource intensive as a fully fledged mandatory licensing system.

PROPOSED REGULATORY FRAMEWORK

Diagram 1 – Proposed Structure for Regulation



Approval Body

- The Registrar of Companies could act as the designated Approval Body, assuming the role of the central regulating body. A Board of nominated Insolvency Practitioners may serve this function with a representative and mandate from the Registrar of Companies.
- The Approval Body should have representatives from the wider business community for example Inland Revenue, the Commerce Commission, the Employers and Manufacturers Federation and the New Zealand Council of Trade Unions.
- The high level functions of the Approval Body will be to:
 - Oversee the functions of and endorse the Approved Bodies;
 - Oversee entry requirements for Insolvency Practitioners (discussed below under Entry Requirements);
 - Maintain an electronic register of Insolvency Practitioners;
 - Receive, filter and file complaints (i.e. first step of disciplinary process);
 - Oversee progression of the NZICA Code of Ethics modified to suit the insolvency industry; and
 - Address and review the development of Insolvency Practitioner Regulation.

Code of Ethics

- The NZICA Code of Ethics is likely to be the most appropriate to implement for Insolvency Practitioners given that the majority of current practitioners are Chartered Accountants and members of NZICA. The NZICA Code of Ethics is based on a number of fundamental

principles that express the basic tenets of ethical and professional behaviour and conduct, being - integrity, objectivity and independence, competence, quality performance, and professional behaviour. Observance of these Fundamental Principles is central to the public interest – consistent with an objective of Insolvency Practitioner Regulation.

- It is likely that the NZICA Code of Ethics would require some modification to certain aspects, including:
 - Requirement to maintain a trust account;
 - Customising competence requirements; and
 - Reference to the statutory duties of a Liquidator and Voluntary Administrator.
- All Insolvency Practitioners would be required to abide by the modified NZICA Code of Ethics principles at all times.

Disciplinary Procedures

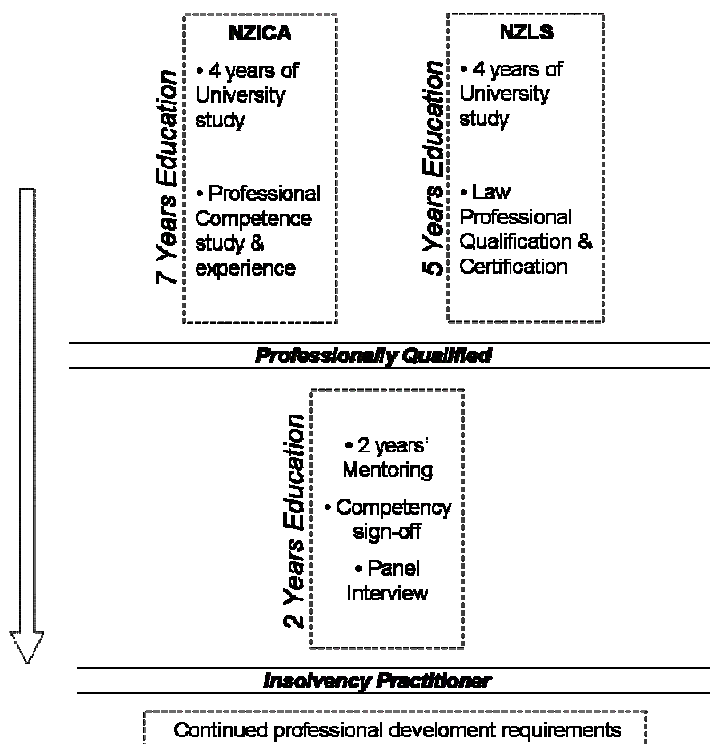
- The Approval Body will receive complaints regarding the conduct of Insolvency Practitioners.
- In our experience, insolvencies, in which loss is incurred by aggrieved third parties, tend to generate complaints of dubious merit regarding the professional performance of the insolvency practitioner involved.. Complaints received that warrant further investigation will be forwarded by the Approval Body to the NZICA – the Approved Disciplinary Body. The benefit of this is that the NZICA already has an established disciplinary process thereby reducing new process requirements and costs.
- To ensure public awareness of the disciplinary procedures, we suggest that all first reports contain an industry-standard paragraph on how interested parties can complain about the competence of an Insolvency Practitioner as in the way the Broadcasting Standards Authority promotes its complaints procedures.

Cost of Membership

- It is likely that NZICA will require Insolvency Practitioners (including Chartered Accountants) to pay an additional annual membership fee. However, we envisage that this fee will be less than what may be required if a mandatory licensing system were implemented due to the utilisation of existing infrastructure within the NZICA.
- Other options available to off-set the costs of implementing a licensing system include a levy imposed on all new company incorporations, a percentage levy on liquidation realisations in tandem with Government funding.

PROPOSED INSOLVENCY PRACTITIONER ENTRY REQUIREMENTS

Diagram 2 – Entry Requirements for Insolvency Practitioners

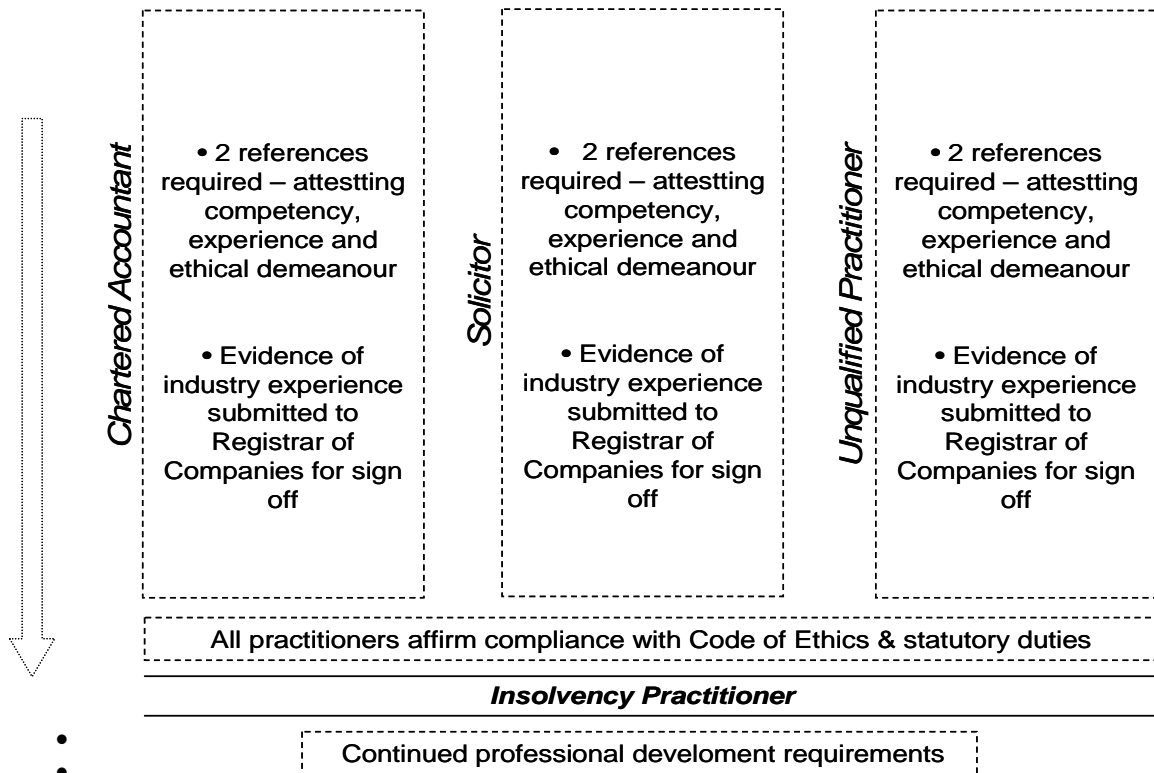


- All individuals wishing to gain entry as an Insolvency Practitioner will be required to first gain entry to NZICA or NZLS as a Chartered Accountant or Solicitor respectively.
- Following admission to NZICA or NZLS an individual wishing to gain entry as an Insolvency Practitioner will be required to commence a 2-year mentoring relationship under an existing Insolvency Practitioner.
- This 2-year mentoring requirement is consistent with the requirements of NZICA, where Chartered Accountants are required to have had 2-years of acceptable practical experience after becoming a Chartered Accountant in order to obtain a Certificate of Public Practice.
- Throughout the mentoring relationship, an individual will be required to attain competencies in various areas of insolvency. The Approval Body will be tasked with setting the appropriate levels and areas of the competency.
- In order for a Chartered Accountant to commence the 2-year mentoring relationship toward entry as an Insolvency Practitioner, they will be required to have gained in-depth competency in the area of Insolvency and Reconstructions as defined by NZICA admission requirements. Consideration will have to be given to a similar requirement for a Solicitor.

- On successful completion of the 2-year mentoring relationship, an individual will be required to obtain a character reference from an Insolvency Practitioner other than the individual's mentor.
- The final step in being inducted as an Insolvency Practitioner is to obtain sign-off of all requirements being met from the Approvals Body, who will conduct a panel discussion/interview with an individual wishing gaining entry as an Insolvency Practitioner.
- We believe that it should be a requirement that all Insolvency Practitioners obtain appropriate professional indemnity insurance.
- As previously noted within this submission, we support on-going professional development requirements once qualified as an Insolvency Practitioner in the form of CPD hour requirements.

TRANSITIONAL PHASE - PROPOSED INDUCTION OF EXISTING PRACTITIONERS

Diagram 3 – Grandfathering: Induction of Existing Practitioners



- We propose that all current practitioners be required to meet the following entry requirements:
 - Obtain 2 references from other industry specialists to support their entry as an Insolvency Practitioner. The referees will have to be individuals who also intend to seek entry as an Insolvency Practitioner. The references will have to support a practitioner's competency, experience and ethical demeanour;
 - Submit a record of current experience in taking appointments as at the date regulation is introduced;
 - Provide evidence of professional indemnity insurance; and

- Affirm understanding and compliance with a modified NZICA Code of Ethics.
- Existing practitioners with appropriate experience who do not hold any professional qualification would also be able to gain entry by meeting the above requirements. However, for such an individual both of the referees would have to be qualified Chartered Accountants and/or Solicitors seeking to gain entry as an Insolvency Practitioner.

6 What would be the appropriate lead-in time that would ensure a smooth transition into the new regime?

- Our comments below relate to both the competitive licensing system proposed within the Discussion Document and the system we have outlined under Question 5 above.
- We believe that for a period of 1-year from the introduction of the regulation, current practitioners would be able to apply for a “grandfathered” induction into the regime (i.e. they are not required to undergo a 2-year mentoring process). A current practitioner’s experience requirements for obtaining a “grandfathered” induction would crystallise as at the official date regulation was introduced. We believe that a 1-year period is sufficient for current practitioners to complete the application process. A period any longer than this would unnecessarily delay the effects of regulation.
- Individuals with insufficient experience for a “grandfathered” induction into the regime as at the date of regulation may commence the 2-year mentoring process from anytime after the introduction of regulation.

7 Are there any other factors that you consider to be relevant to the transitional arrangements?

- If a competitive licensing system is introduced then a review of the system should be scheduled for 2-years after the date of introduction. The review should be comprehensive and include feedback from practitioners and stakeholders in the industry with a view to reporting on the effectiveness of regulation in managing the risks of corporate insolvency.
- If a system is introduced which includes a specialised process for becoming an Insolvency Practitioner, such as the system we outline in Question 5 above, then a review should be scheduled for around 4-years after the date of introduction after the time the first Insolvency Practitioners are inducted.

We trust that our submission assists in the review of the Discussion Document. We would be happy to discuss our submission or any issues you would like to raise with us at any later stage.

Please contact the writer by telephone (09 355 8646) or by email (richard.agnew@nz.pwc.com) to discuss or clarify any matters further.

Yours faithfully



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