15 November 2017

ASIC Enforcement Review
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ASICenforcementreview@Treasury.gov.au

Dear Sir/Madam

ASIC Enforcement Review
Positions Paper 7: Strengthening penalties for corporate and financial sector misconduct

Thank you for the opportunity to lodge a submission on the proposals for strengthening penalties for corporate and financial sector misconduct as set out in Positions Paper 7.

1. Phoenixing and penalties

ARITA has recently made a detailed submission to The Treasury in respect of the consultation paper on Combatting Illegal Phoenixing[1] (Phoenixing Submission)[2]. Illegal phoenix activity is a significant issue in Australia and the government has recently announced intentions to "crack down on illegal phoenixing activity that costs the economy up to $3.2 billion per year to ensure those involved face tougher penalties" [3]. As such we were surprised that Positions Paper 7 made no mention of penalties in relation to illegal phoenixing, insolvency or failure by directors to co-operate with liquidators[4], provide the company's books and records to a liquidator[5] or comply with their obligations to furnish a Report as to Affairs (RATA) to a liquidator[6]. Nor does it discuss penalties for persons involved in breaches of the *Corporations Act* (the Act), including the aiding and abetting and otherwise being knowingly concerned in such breaches[7].

---

[1] Reforms to address illegal phoenix activity: https://treasury.gov.au/consultation/c2017-t221952/
[2] ARITA submission of 30 October 2017.
[3] The Honourable Kelly O'Dwyer in a press release of 12 September 2017: http://kmo.ministers.treasury.gov.au/media-release/090-2017/
[4] s530A(2) Corporations Act
[5] s530A(1) Corporations Act
[6] s475 and s497 Corporations Act
[7] s79 Corporations Act

The failure by directors to comply with their obligations when their company enters into liquidation, and thus hamper a liquidator from conducting a proper investigation of the company's affairs, is in our view a key factor in illegal phoenixing flourishing in Australia.

ASIC operates a liquidator assistance program[8] that liquidators can apply to get ASIC's assistance with obtaining books and records and RATAs. ASIC's reports[9] state that:

- In the 2015-16 financial year:
  - ASIC received 1,538 requests for help from external administrators
  - Compliance was achieved in 399 instances, and
  - 372 individuals were prosecuted for 754 strict liability offences with an average fine of $1,352 per offence.
- In the 2014-15 financial year ASIC:
  - received 1,417 requests for help from external administrators
  - Compliance was achieved in 441 instances, and
  - 355 individuals were prosecuted for 680 strict liability offences with an average fine of $1,345 per offence.

As such, a director seeking to prevent the proper investigation of the failure of their company by a liquidator, can impose a significant barrier for a modest (apprehended average) fine of $2,704[10]. If a director is seeking to hide the transfer of assets for undervalue and other breaches of director's duties, this is an easy and cost-effective way to achieve it. Furthermore, not all acts of non-compliance are prosecuted, so there is a reasonable probability that the will "get away with it" with no consequence.

There is a recognised issue of unregulated pre-insolvency advisors (unregulated because they are not registered liquidators and have no registration required with ASIC to provide pre-insolvency advisory services) assisting directors with advice on how to phoenix their businesses. This was considered as part of our Phoenixing Submission.

The absence of significant consequences for not providing books and records and a RATA to a liquidator encourages continued non-compliance by phoenix operators because the benefits of non-compliance plainly outweigh the risks. This is contrary to the view in the Positions Paper that "penalties should represent a credible deterrent"[11]. There is no doubt that this fact will be made clear to directors that seek assistance from unregulated pre-insolvency advisors.

Where action is taken against pre-insolvency advisors, the inadequacy of the penalty obtained is more likely to encourage this illegal activity than deter it[12].

---

[8] http://asic.gov.au/for-finance-professionals/registered-liquidators/your-ongoing-obligations-as-a-registered-liquidator/liquidator-assistance-program-report-as-to-affairs-books-and-records/
[9] ASIC Report 532: ASIC regulation of registered liquidators: January to December 2016
[10] Assuming two offences of failure to provide books and records to the liquidator under s530A and failure to provide a RATA under either ss 475 or 497.
[11] Paragraphs 14 to 18
[12] ASIC obtained a conviction against Stephen Charles Hall for dishonestly aiding, abetting, counselling or procuring another director to breach their duties and the fine was $6,600.

Registered liquidators are part of the solution to addressing illegal phoenix activity. They are the gatekeepers that identify offences and report those offences to ASIC. Apart from the many statutory reports they provide to ASIC which identify misconduct, which generally are not acted upon[13], liquidators are often hampered by inadequate funding and again, a lack of documentary evidence (by reason of breaches of laws relating to books and records), which means that phoenix activity often passes unchallenged.

As pointed out in our Phoenixing Submission to The Treasury, there are already a variety of laws and penalties for transactions, acts and omissions which either constitute or facilitate illegal phoenix activity. Rather than creating new laws, the present laws need enforcement and stiffer penalties. However, action cannot be taken to overturn illegal phoenix

[13] Significant information about phoenix activity, transfers of assets and breaches of director's duties is reported to ASIC by registered liquidators under ss 533, 422 or 438D of the Act.
ASIC's Annual Report 2015/16 reported that liquidators lodged 9,951 reports with 8,258 alleging misconduct. Of those, following supplementary reports, only 129 reports (1.5% of the reports alleging misconduct) were referred for compliance, investigation or surveillance.
In ASIC's most recent report on external administrators' reports (July 2015 to June 2016: Report 507), ASIC reported that registered liquidators lodged 9,465 reports under ss 533, 422 or 438D of the Act.
In those reports, the following levels of misconduct were reported against directors:

- Possible misconduct in 7,797 (82.4%) reports
- Insolvent trading (5,736 or 61% of reports) and of these 1,118 (19.5%) were claims for over $1 million. Six reports alleged a criminal breach involving more than 200 creditors with three of these estimated an insolvent trading claim of $1 million to $5 million and two alleged a claim exceeding $5 million
- Failure to keep financial records (3,357 or 42% of reports)
- Failure to assist the liquidator (2,684 or 13% of reports)
- Breach of s 180 (care and diligence) – Directors' and officers' duties (3,636 or 38% of reports).

These allegations of misconduct against company directors are substantive and extensive, with few ending up referred for further consideration.
We have attempted to determine the number of prosecutions of directors that result from liquidator's report of misconduct. However, ASIC does not provide sufficient detail in its enforcement reports to be able to identify the actual director misconduct prosecuted. For example, refer ASIC Report 536 where enforcement outcomes on corporate governance is reported as follows:

Table 6: Corporate governance—Results by misconduct type

Type of misconduct	Criminal	Civil	Admin	Enforceable undertaking	Negotiated outcome
Action against directors	2	1	1	0	0
Insolvency	0	1	0	0	0
Action against auditors	0	0	1	0	0
Action against liquidators	1	0	0	1	1
Other corporate governance misconduct	0	0	1	0	0
Total	**3**	**2**	**3**	**1**	**1**

ASIC's Annual Report for 2016/17 reported that there were only 36 director bannings for that period, with 34 of these as a result of reporting by a liquidator and funding under ASIC's Assetless Administration Fund (which would usually result from the initial s 533, 422 or 428D report). These numbers also seem to be declining with disqualifications by ASIC under s206F consistently dropping from over 70 in the years 2009/10 to 2011/12, to 32 in 2014/15 and 36 in 2016/17.

transactions or prosecute offenders without evidence. By failing to meet their fundamental obligations, directors prevent access to the evidence required.

That is why in our view, the first step to addressing illegal phoenix activity is creating penalties that are sufficient to deter directors from failing to comply with their obligations in the event of their company entering liquidation. Those penalties must also then be applied.

Not only must the financial cost of the penalty be a deterrent, but it must be able to be administratively imposed and in that regard we support the proposal for ASIC to be able to issue penalty notices for up to half of the maximum penalty units for strict liability offences, where administrative handling of that type of offence is appropriate. We consider matters such as provision of books and records to a liquidator and completion of a RATA to be an offence which should be handled administratively. Either you have complied with your legal obligations, or you have not. Furthermore, liquidators are officers of the courts and highly regulated professionals and their reporting of non-compliance, with evidence, should be sufficient for ASIC to issue a penalty notice.

Our members advise us that the current process, with the need for involvement of the courts, is inefficient and time-consuming for the practitioner, in situations where the liquidation is usually without funds to meet the liquidator's costs.

2. Liquidator action for offences

We suggest that there is merit in giving power to liquidators to pursue penalties against directors for non-provision of books and records and RATAs, and to seek director bannings through the Courts under s206D without the involvement of ASIC. ASIC should also retain their rights.

The involvement of the Court ensures that consideration is given to the evidence provided by the liquidator and appropriate penalties/banning orders are made.

We recognise that there are constraints on the number of matters that ASIC can pursue. The benefits of providing this opportunity to liquidators would be that more matters are likely to be pursued, resulting in more "regulatory" action which may deter this corporate misconduct.

ASIC recognises the important function that liquidators perform in winding up companies[14]. This role would be enhanced through granting liquidators these additional powers. We note that liquidators previously had the power to make an application for disqualification under s 230 of the *Corporations Act 1989 (Cth)* and liquidators currently have the power to take direct action for breaches of other provisions relating to director's duties.

[14] ASIC report 532: ASIC regulation of registered liquidators: January to December 2016

3. Obligations to keep books and records

Section 344 creates an obligation on a director to take reasonable steps to secure the company's compliance with its obligation to keep financial records and prepare financial reports. This is a civil penalty provision, but only contraventions that are dishonest are treated as a criminal offence – it is not a strict liability provision like the obligation placed on the company under s286.

We note that there is a strict liability requirement in s530A to provide the books and records to a liquidator.

It is proposed in Positions Paper 7 (paragraph 24 and 25) that the criminal penalty for failure to keep financial records be increased. We argue that the civil penalty and the strict liability penalty also need amendment to recognise the harm caused by directors when obstructing the proper course of a liquidation.

As mentioned at point 1 above, the average penalty for not providing books and records to the liquidator is currently $1,352. However, we know from feedback from our members that fines can be as low as $500.

Also, we understand that where a director provides incomplete (often substantially incomplete) books and records, the offence will not be pursued even though the records are not in compliance with s286.

4. Entering into agreements to avoid employee entitlements

We note that Positions Paper 7 (paragraphs 22 and 23) refers to increasing the penalties associated with s596AB: Entering into agreements or transactions to avoid employee entitlements. This provision has proven to be wholly unsuccessful with no criminal or civil court actions under Part 5.8A since its introduction in June 2000. The introduction of greater penalties will not increase its effectiveness.

In June this year the Department of Employment consulted[15] on the need to improve Part 5.8A, recognising its ineffectiveness to date to act as a deterrent to poor corporate conduct. The consultation paper made a range of suggestions for improving the effectiveness of the provision, which ARITA supports.

[15] Consultation Paper – Reforms to address corporate misuse of the Fair Entitlement Guarantee scheme: https://docs.employment.gov.au/documents/consultation-paper-reforms-address-corporate-misuse-fair-entitlements-guarantee-scheme

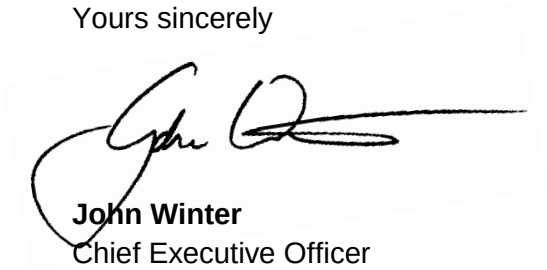
5. Disqualified persons

We agree with the increase in the penalty for a person who is disqualified from managing corporations from participating in management responsibilities. However, this increase in penalty is only effective if directors are prosecuted and banned in the first place (putting aside the automatic bannings under s206B for matters such as bankruptcy) and the restriction placed upon them is then regulated and enforced. We note that, notwithstanding the large number of possible misconduct reported by liquidators against directors, only 36 bannings occurred in the 2016/17 financial year[16]. From our preliminary research, we were not able to find any recent matters where a penalty was applied for breaching s206A[17].

We reiterate that penalties are only of use where prosecutions occur.

Should you wish to discuss any aspect of this submission, please contact Ms Kim Arnold, ARITA Policy & Education Director, on 02 8004 4340.

Yours sincerely



John Winter
Chief Executive Officer

[16] Refer footnote 7

[17] ASIC releases reports on its enforcement outcomes. Prior to July 2011, a full listing of prosecutions was provided (refer Summary Prosecutions section of ASIC website) and prosecutions under s206A were included in the listing. From July 2011 only summary information is provided and there are no mentions of s206A in Report 281, which is the first of the new summary reports, or since.

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents practitioners and other associated professionals in Australia who specialise in the fields of restructuring, insolvency and turnaround.

We have more than 2,200 members including accountants, lawyers, bankers, academics and other related professionals.

ARITA's mission is to support restructuring, insolvency and turnaround professionals in their quest to restore the economic value of underperforming businesses and to assist financially challenged individuals.

We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government, and promoting the work of the profession to the public at large.

Some 84 percent of registered liquidators and 89 percent of registered trustees choose to be ARITA Professional Members.

ARITA promotes best practice and provides a forum for debate on key issues facing the profession. We engage in thought leadership and advocacy underpinned by our members' knowledge and experience.