ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

9 October 2015

Corporations and Schemes Unit (CSU)
Financial System and Services Division
The Treasury
100 Market Street
Sydney NSW 2000

Email: asicfunding@treasury.gov.au

Dear Sir/Madam

Proposed Industry Funding Model for the Australian Securities and Investments Commission

The Australian Restructuring, Insolvency & Turnaround Association (ARITA) is grateful for the opportunity to provide feedback on the Government's Consultation Paper on the Proposed Industry Funding Model for the Australian Securities and Investments Commission (the Funding Model).

As the professional body for insolvency practitioners in Australia, our comments are primarily focussed on the proposed fees for registered liquidators.

At the outset, ARITA believes it is important to point out that there are significant negative market consequences of the three proposed models for registered liquidators which would diminish the proper, competitive operation of the market.

Furthermore, we consider these proposals will result in considerable unfairness given the very high cost per liquidator compared to others, the duplication, the disregard for work done by liquidators in support of ASIC and the quite limited benefits from the current ASIC supervision.

It is unfortunate that no proper economic modelling has not been carried out on these scenarios as part of the Consultation Paper. Regrettably, only the Australian Securities and Investments Commission (ASIC) has access to the necessary data for comprehensive modelling. Nonetheless, ARITA has attempted to highlight the likely consequences for which Treasury may seek to confirm.

Key Points of This Submission

- The regulation of insolvency practitioners is already duplicated across two government agencies (ASIC and AFSA) in addition to globally respected self-regulation already funded by professional association members.
- The quantum of $9 million being reportedly spent on regulation of insolvency practitioners by ASIC is excessive and has shown little result in substantive outcomes against registered liquidators nor in the contribution to the induction, education or supervision of the sector.
- ASIC should be focussed on the root cause of misconduct around insolvency, being director misconduct, rather than on liquidators. Relieving ASIC of its oversight of liquidators by creating a single regulator for practitioners would then allow ASIC to have this proper focus.
- All three proposed models will have significant negative impacts on the market.
- Due to the absence of a government liquidator, Registered and Official Liquidators already undertake tens of millions of dollars of unfunded work annually – a large portion of which is work on behalf of ASIC – and therefore should not be expected to further contribute to ASIC. Liquidators already subsidise ASIC well beyond the amount suggested to be recovered.
- The proposals will create unnecessary barriers to entry, reducing the number of expert insolvency practitioners, particularly in regional and small practices.
- The proper beneficiaries of regulation of insolvency practitioners are actually creditors and therefore levies should be recovered via a small ($4.23) additional charge on each annual company return or, on a new annual solvency statement.
- If the Government is committed to a recovery charge via liquidators then a model that recovers from dividends, as is used in the Canada, should be further investigated.
- There is a substantial lack of impact and economic modelling in the proposal for each of the models proposed.

ARITA would also like to raise our concern that the composition of the $9 million allocated for recovery in relation to registered liquidators has not been adequately disclosed, despite our request. We have some concerns that this cost may include costs of insolvency regulation generally, including where liquidators request the assistance of ASIC when directors fail to provide a Report as to Affairs or books and records on the appointment of a liquidator.

The failure to provide this information has prevented a reasonable analysis of the appropriateness of the costs and heightens concerns about a lack of transparency in the proposed arrangement. In addition to our concerns regarding the Funding Model, it remains

unclear if the allocated $9 million is solely for the regulation of insolvency practitioners or for the regulation of insolvency, more generally (e.g. director misconduct, insolvent trading etc.)

This submission highlights that if $9 million is being spent in the area of insolvency by ASIC its results are not significant and it raises concerns about the effectiveness and efficiency of ASIC to regulate this sector.

Further, it must be noted that ASIC's role is largely already duplicated by the work of the Australian Financial Security Authority (AFSA) which regulates bankruptcy trustees (the vast majority of trustees are also liquidators) with similar structures and resources. This duplication is a current inefficiency in government and creates burdensome red tape.

The bankruptcy regime is partly funded by a realisations charge on assets recovered, the annual calculation of which is subject to consultation with ARITA and others, according to a transparent process under Department of Finance Costs Recovery Guidelines.

The charges imposed on trustees directly, by way of annual registration and other fees, are in our view, more reasonable than those proposed in this discussion paper.

However, if cost recoveries for ASIC's work were also charged to registered liquidators, paying for this duplication is particularly objectionable to the profession and heightens calls for a move to a single regulator, if the government does not allow the profession to fully self-regulate.

Registered Liquidators are not the Primary Beneficiaries of ASIC's Regulation

The primary beneficiaries of oversight of the external administration process are actually creditors, not insolvency practitioners.

Creditors derive a benefit from regulation through an increased confidence that they are receiving the returns they are entitled to. One of the more telling comments in the recent review of the US Chapter 11 regime was a footnote that "the notion that money paid to professionals belongs to creditors is true only if the creditors could realize that value without the professionals"[1]. It is equally true, therefore, that those same creditors are the beneficiaries of the regulation of those professionals. Compared to the US regime, creditors also benefit from the Australian approach by avoiding the costly court oversight of all aspects of an insolvency.

Registered Liquidators Already Fund Self-Regulation

ARITA notes that the position of registered liquidator, due to its high level of autonomy and responsibility, is a special and privileged one. However, it should also be noted the registered liquidators are already the subject of professional standards oversight from their

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[1] American Bankruptcy Institute Commission to study the reform of Chapter 11, 2012-2014

professional associations. Almost all liquidators are members of one of the Australian accounting or law bodies and around 76% are also ARITA members.

Membership of a professional association such as ARITA, CAANZ and CPA Australia carries onerous responsibilities for continuous professional development (which is a significant cost and time burden), significant professional membership fees, and, in ARITA's case, detailed obligations under Australia's only dedicated insolvency professional standards regime – ARITA Code of Professional Practice (the Code)[2]. The Code is even noted by ASIC and courts as being the standard for professional behaviour. We therefore submit that registered liquidators are already subject to proper governance and oversight through their professional body and the most professional practitioners, being ARITA members, subject themselves to an even higher standard.

Insolvency Practitioners Already Substantially Subsidise ASIC

Registered liquidators are expected to, and do, carry out substantial work on behalf of ASIC as the regulator, especially in conducting investigations as required by the *Corporations Act 2001*. Indeed, official liquidators act as officers of the court in their role. ASIC, in fact, describes liquidators as its front line investigators of insolvent companies in RG 16.

Much of the work that is carried out on behalf of ASIC is done without compensation and with no capacity to avoid that cost.

Indeed, research in 2012[3], supported by ARITA's Terry Taylor Scholarship, identified that official liquidators carry out some $47 million of work and pay $1.4 million in disbursements directly from their own pocket in unfunded court-appointed work alone each year – a significant part of which relates to investigations for reporting to ASIC. This arises when the liquidation of a company results in insufficient recoveries to fund the work of the liquidator let alone pay a dividend to either priority creditors or ordinary unsecured creditors.

While ASIC does provide an Assetless Administration Fund, liquidators are required to undertake the initial investigation work without funding in order to be able to provide the required information to apply for funding - with no certainty of funding being received. It should also be noted that many matters do not meet ASIC's criteria for funding from this source despite being worthy of further investigation against the directors.

We also point out that liquidators are even required to undertake and pay ASIC for the searches of the ASIC database that they must do to conduct their investigations and report back to ASIC. Often these searches are paid for from the liquidator's own pocket as there are insufficient funds in the administration to meet that cost, which in part explains the unfunded disbursements of $1.4 million referred to earlier.[4] Even if funds do come in at a

[2] http://www.arita.com.au/about-us/arita-publications/code-of-professional-practice
[3] http://www.arita.com.au/docs/events-documents/2012-tts-report---final-version-(2).pdf?sfvrsn=0
[4] http://www.arita.com.au/docs/events-documents/2012-tts-report---final-version-(2).pdf?sfvrsn=0

later date to reimburse these outlays, liquidators at any given time often carry a significant deficit in their accounts.

No other profession in Australia is required to carry out work on behalf of ASIC where such work may not be funded.

Again, the lack of a government liquidator to carry out this work is significant and represents yet another example of how liquidators currently subsidise ASIC.

It would be fair to say that there is no other profession where professionals are expected to carry out their duties whether they are going to be paid or not. Therefore, it is our contention that liquidators already carry a significant and costly regulatory burden that should not be further increased by the implementation of an ASIC industry funding model.

It should also be noted that liquidators have to take on substantial personal liabilities and risk with each insolvency appointment they take.

ASIC's Current Approach

ARITA has recently provided a detailed submission to the ASIC Capability Review Panel.

The core proposition of our submission is that ASIC is not focused on the root cause issues of misconduct in insolvency: director misconduct.

Instead, it takes a simplistic approach by targeting, without substantial success, the limited community of registered liquidators.

Given the small number of substantial actions taken against insolvency practitioners, and the relatively minor sanctions usually imposed when misconduct is found,[5] it is reasonable to assume that:

- there is no significant problem of insolvency practitioner misconduct, or
- if there is a misconduct problem, ASIC is failing to prosecute it.

If either case is true, one would have to question how wisely ASIC is spending its $9 million to regulate the insolvency sector.

Lack of focus on director conduct enforcement

By targeting director misconduct – where directors may attempt to siphon assets, act to avoid prosecution or unlawfully phoenix a business – the regulator would remove any incentive for directors to seek facilitators of this behaviour and, even if provided with

[5] See Table 1 below

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inappropriate advice by a practitioner (registered or unregulated), directors would be more likely to reject that inappropriate advice for fear of prosecution.

Prior to the Senate Economics Reference Inquiry into The Regulation, Registration and Remuneration of Insolvency Practitioners in Australia in 2010, ASIC maintained some focus on director misconduct that led to insolvency.

After this Inquiry, ASIC's regulatory focus, by their own admission, moved almost exclusively onto registered liquidator conduct, with limited results.

With claimed expenditure of $9 million per annum[6], since July 2011 ASIC has achieved only 25 outcomes with findings of some degree of misconduct against liquidators (almost all of these were administrative outcomes).[7] That amounts to an average of six outcomes per year at a cost of $1.44 million per outcome.

These figures suggest either a manifestly inefficient or ineffective regulatory process or the absence of a major issue in liquidator conduct.

At ARITA's May 2013 National Conference, ASIC's Greg Medcraft stated ""I acknowledge that the large majority of practitioners devote resources to their internal systems and staff training to ensure standards are maintained.

I'd also like to acknowledge the positive work the IPA (as ARITA was then known) does in raising standards through the Code of Professional Practice. I know that the IPA is keen to see those who can't meet those standards disciplined."

"The large majority of insolvency practitioners understand their gatekeeper role. They play their role in promoting a fair and efficient market and ensuring investors, including creditors, are confident and informed, by meeting the high standards imposed on them. Particularly in terms of independence, competency and ensuring they act in the creditors' interests at all times."

In contrast, as part of their statutory responsibility to undertake investigations into insolvent companies, registered liquidators lodged 7,218 reports of possible misconduct with ASIC, citing 18,195 possible breaches by directors, in the 2014 financial year alone [8]. In other words, possible misconduct was reported in 76.3% of external administrations.

Despite this substantial volume of possible misconduct being reported to ASIC, ASIC only achieves an average of 20 successful outcomes (again, mostly administrative) against Australia's estimated 2.2 million company directors per year. By way of comparison, the

[6] Proposed Industry Funding Model for the Australian Securities and Investments Commission Consultation Paper 28 August 2015

[7] ASIC enforcement outcomes: REP 444, REP 421, REP 402, REP 383, REP 360, REP 336, REP 299, REP 281

[8] ASIC REP 412 Insolvency statistics: External administrators' reports (July 2013 to June 2014)

UK's Insolvency Service recently published its 2015 annual report highlights its successful pursuit of "companies, directors and individuals abusing the insolvency and corporate frameworks:"

> *In 2014–15 we wound up 102 companies, disqualified 1,209 directors and obtained 578 restriction orders against insolvent individuals, as well as making 418 criminal referrals to prosecuting authorities and 27 further disclosures to other regulators.*
>
> *In 2014–15:*
>
> - *the average length of disqualification undertakings and orders secured against directors around 6 years*
> - *around 12% of directors disqualified for a period in excess of 10 years with some 49% disqualified for a period of five years or longer*
> - *net benefit to the market (in terms of creditor damage prevented) for each director disqualified: estimated at over £100,000.*[9]

We also note that "part of AFSA's commitment to reduce the regulatory burden for practitioners has been the introduction of pre referral enquiries (PREs). PREs aim to improve efficiency and save practitioners time in cases where it is not clear whether an offence has occurred."[10]

> *"Pre referral enquiries do not circumvent a practitioner's duty to refer evidence of any offences against the Bankruptcy Act 1966 to the Inspector-General. PREs aim to improve efficiency and save practitioners time.*
>
> *PREs should be used when a practitioner considers that an offence against the Act may have occurred and it is unclear (or the practitioner is undecided) whether there is sufficient evidence to support the completion of an offence referral."*[11]

Pre referral enquiries (PREs) were launched in December 2014 as part of AFSA's commitment to reduce red tape for practitioners when complying with their duty to refer evidence of offences against the Bankruptcy Act 1966 to the Inspector- General. PREs have proved popular with trustees and their staff with AFSA already receiving a significant number of referrals and positive feedback from practitioners.

It should be noted that the wide awareness of the lack of funds for proper investigation and the almost non-existent follow up of misconduct reports by ASIC is exploited by unregulated advisers who facilitate unlawful phoenix activity or advise directors on how to asset strip

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[9] p14 The Insolvency Service Annual Report and Accounts 2014–15
[10] https://www.afsa.gov.au/practitioner/alleged-offences
[11] https://www.afsa.gov.au/practitioner/alleged-offences/pre-referral-enquiries

businesses in financial distress. This creates a substantial moral hazard and has led to widespread rorting.

No focus on education to prevent insolvency or insolvency fraud

In the five years prior to 2010, ASIC undertook an insolvent trading project that showed the positive results a regulator can achieve by focusing on the root cause of financial failure[12]. This program was highly successful and resulted in

- ASIC visiting over 1530 companies displaying solvency concerns during the period from 2005–06 to 2009–10
- ASIC creating an awareness of director duties and ASIC's expectations of professional advisers when companies are experiencing financial difficulties
- ASIC encouraging directors to seek advice from an insolvency professional about the appointment of an external administrator where significant insolvency indicators were identified; and
- 15% of companies reviewed by ASIC were subsequently placed into external administration - mostly by the directors.

ASIC has recently disclosed[13] that only 5% of its insolvency-related funding is spent on education that would help avoid complaints, avoid corporate failure and avoid or reduce exposure of individuals involved. As an analogy, it is often noted that the best fire service is the one that educates a community in fire prevention to stop fires happening, rather than the one that turns out frequently to put out fires that have already caused damage. Or, simply put: prevention is better than cure.

Liquidator Admissions process flawed

ARITA first raised the need for a more stringent registration process for liquidators over 12 years ago. We note that the proposed *Insolvency Law Reform Bill 2014* does provide for potential improvements in this space, however, there is currently a lack of focus on ensuring that only appropriate people are admitted to the profession. The current process lacks even a basic interview and there is no liaison with professional bodies on the application process.

We note that a rigorous interview processes applies in personal insolvency via a committee including an experienced trustee, ARITA-nominated trustee, along with regulator and government nominees. A number of applicants are rejected in any given year. At the same time, the number of trustees found to be at serious fault in their conduct each year is minimal. This is explained partly by the rigorous entry process and the broader concept of

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[12] ASIC REP 213 National insolvent trading program report http://download.asic.gov.au/media/1343486/rep213.pdf

[13] Proposed Industry Funding Model for the Australian Securities and Investments Commission Consultation Paper 28 August 2015

“regulation”, that includes working closely with the practitioner to pro-actively and positively resolve issues, that is adopted by AFSA[14].

If there is a bona fide issue with the standard of professional practice among insolvency practitioners, which we do not accept, then it is reasonable to assume that the lack of a sufficiently comprehensive entry process must surely have contributed to that. For the profession to be now asked to fund a fix for that failure is inequitable.

Nature of Complaints

In considering the role and function of ASIC as a regulator of insolvency practitioners it is important to be mindful of the inherent conflict in the insolvency process. Due to the emotional nature and financial loss that is associated with insolvency, most stakeholders in an insolvency are aggrieved from the moment they enter the process. For many, the extent of loss can be life changing.

There is a natural desire to allocate blame for that loss to others. The nature of an insolvency practitioner’s work and their role in the process makes them a frequent target of that blame. This often results in baseless complaints from aggrieved stakeholders.

In 2013, responding to the latest statistics from ASIC at that time, ARITA’s then President succinctly summed this up, saying in a press release “The report also identifies that over 80% of the complaints received by ASIC about liquidators were either due to a misunderstanding of the law governing the liquidator’s work, and the role that they play when administering an insolvent business, or were matters where the alleged misconduct was inadvertent. This finding is supported by ...(ARITA)’s…experience in investigating complaints and concerns against its members," said Ms Erskine.

Through our own professional standards complaints process, ARITA sees many of these types of complaints. They also arise through a lack of understanding of the rights, or more particularly the lack of rights, of individuals once a formal external administration commences.

This is significant in assessing the role of the regulator when one considers that because of this, baseless complaints about insolvency practitioners are to be expected.

It is our contention that in undertaking to meet its charter, especially around promoting a *confident and informed participation by investors and consumers in the financial system* that ASIC should focus far more resources on educating those involved in insolvency about the process and their rights, in order to support insolvency practitioners in the discharge of their

[14] https://www.afsa.gov.au/about-us/policies-and-practices/inspector-general-practice-statements/igps1

role. As part of any user-pays model it should not be expected that liquidators should bear the cost of this, rather the beneficiaries of this education are, once again, creditors.

On this point we note that ASIC's educative insolvency information sheets[15] were last updated in December 2008 and contain superseded information.

International Comparisons

Models for the oversight of the insolvency profession vary greatly across jurisdictions, even in comparable markets. The US relies almost entirely on Court supervision of the insolvency process. New Zealand has a limited supervision model, however, the Financial Markets Authority engages directly with practitioners (who do not need to be registered) around director conduct.

In the United Kingdom, professional bodies (primarily bodies like ARITA such as the Insolvency Practitioners Association and the Institute of Chartered Accountants in England and Wales) have full responsibility for the oversight of practitioners. The Insolvency Service audits the professional bodies to ensure their conduct and complaints systems are operating appropriately. We reference the UK's Insolvency Service's just released Annual 2014-2015 Report[16] and note, in particular, the sections "Our Purpose", "What We do" and "How We Deliver" as a guide for how a regulator may better approach the Australian market.

We believe a model similar to the UK one would be effective in Australia as well. Professional bodies have a strong vested interest in maintaining high professional standards and have deep technical expertise. The Profession is better placed, more efficient and has the strongest interest in delivering good market outcomes. The Profession is also already funded by members.

We also note, the comparatively low cost of the UK Insolvency Service's user pays model and that it includes a government liquidator service to reduce the burden of unfunded work on the profession as part of it.

ARITA has a robust conduct and complaints system in place, backed by our highly regarded Code of Professional Practice[17]. We've further announced our intention to strengthen our systems by creating an Independent Insolvency Tribunal that will also offer alternative dispute resolution services and provide education and information to affected parties in insolvency situations.

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[15] http://www.asic.gov.au/regulatory-resources/insolvency/insolvency-information-sheets/

[16] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/460523/annual-report-14-15.pdf

[17] http://www.arita.com.au/about-us/arita-publications/code-of-professional-practice

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It is our contention that this model delivers a best-practice and more cost-efficient method of regulating an insolvency profession and, accordingly, recommend the legislative reform necessary to achieve this as opposed to ASIC's industry-funded model.

We also note that the UK Insolvency Service has recently been granted additional powers including to ban advisers who influenced or instructed a director to behave in a way that has resulted in the disqualification of that director or who have a track record of being involved in failing companies[18].

Alternate Model

If ARITA's submission that liquidators should be justifiably exempted from the user-pays model is rejected, we suggest that an alternate model for recoveries by a percentage of dividends paid on each insolvency should be considered. This model is currently found in operation in Canada and is further discussed in our responses to Attachment D

Yours sincerely

John Winter
Chief Executive Officer

[18] https://www.gov.uk/government/news/strengthening-the-company-director-disqualification-process

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Specific Responses to Consultation Questions

Chapter 2: ASIC's Activities

1. *Do you agree that the exclusion of these activities from cost recovery is appropriate? If not, why not?*

   ARITA notes that the same justification used for the exclusion of the Assetless Administration Fund (AAF), should be applied more generally to registered liquidators. We also note that registered liquidators currently are required to undertake substantial, most likely unfunded work, to access the AAF for ASIC's benefit. Further, registered liquidators consistently report that the AAF is hard to access. We also remind that ASIC's prosecution record for directors involved in misconduct involving insolvency is extremely poor. This highlights a further inequity in the proposed model.

Questions 2-7 – ARITA has no position on these issues

Chapter 3: International funding models

8. *Are there any approaches to industry funding adopted by other regulators that you believe should be applied to an industry funding model for ASIC? If so, please describe and provide reasons why.*

   This section fails to address the different insolvency regimes in other markets. We have noted in our earlier comments that the not only does the insolvency profession in Australia already substantially fund its own regulation, but that there is no internationally comparable funding model to that proposed in the discussion paper for liquidators in Australia.

   Again, we recommend that a self-regulatory model is the most efficient, that having two regulators for insolvency in Australia is an unnecessarily and costly duplication and that a funding model, as proposed, would significantly harm the international competitiveness of Australia's insolvency regime, which already rates poorly on World Bank ratings due to red-tape. We also note that consideration of the Canadian model is worth undertaking.

Chapter 4: The proposed industry funding model

9. *Is the proposed methodology for determining the levy mechanisms appropriate? If not, why not?*

   While ARITA has no objection to the broad application of the general approach, ARITA has concerns about the risk assessment approach adopted by ASIC. We again submit that ASIC's excessive focus on registered liquidators appears to trace to a single Senate

Inquiry five years ago and has not delivered demonstrably beneficial outcomes. It is our view that this does not show evidence of a proper risk based approach.

To reinforce this, we again point out that despite a vast number of recommendations by liquidators regarding director misconduct, ASIC chooses to pursue almost none of these matters. So, despite evidence of malfeasance, ASIC chooses not to act. This does not accord with a proper risk-based approach.

10. *Are there any activities proposed to be recovered through fees that you believe should be collected through annual levies? If so, which activity or activities and why?*

The proposed $8,800 fee for an application to be a registered liquidator and the proposed fee of $5,100 to apply as an official liquidator are excessive and will provide a significant barrier to entry for new participants. It will act as a disincentive for the next generation of registered liquidators to become approved. We also believe that a fee of this size – for a single person's application processing which doesn't even include a basic interview process – is simply out of context with the true and reasonable cost of the work undertaken. In contrast, where AFSA have adopted a fee recovery model, their comparable charges are[19]:

Application to be registered as a trustee or debt agreement administrator	**$2200**
Initial registration	**$1300**
Renewal of registration (every 3 years)	**$1700**

11. *Is the proposed approach for calculating fees-for-service appropriate? If not, why not?*

The consultation paper indicates that *"the fees payable may not match ASIC's exact costs"*. We refer to our response to Question 10 above and reiterate that the proposed fee for liquidator registrations is clearly out of line with actual work undertaken to process the application. If ASIC's actual cost is represented by this, then ASIC's processes are inefficient and excessively costly.

12. *Do you have any suggestions for how the proposed methodology for calculating fees-for-service could be modified? If so, please provide details.*

[19] https://www.afsa.gov.au/resources/fees-and-charges

Costs should be calculated on a reasonable market comparison to similar processes in the private sector. This is the only way to ensure the efficient operation of ASIC. Work to be on charged must only represent best practice.

Chapter 5: Determining ASIC's annual funding and levies

13. *Do you support the proposed process for determining funding for ASIC's regulatory activities under an industry funding model for ASIC? If not, why not?*

    ASIC has proposed, as one of its preferred options a model based on asset realisations for which no market data is readily available. We do not believe that it is possible that a funding model based on asset realisations can be constructed within the allotted time due to this lack of available data. We also note that no economic modelling has been undertaken on any of the models and equally believe that this lack of modelling does not allow the proposed schedule to be held to.

14. *Do you think this process will provide industry with certainty as to the fees and levies to be charged? If not, why not?*

    We do not agree that this will provide certainty. Indeed, it is ARITA's view that the model is likely to see a substantial increase in fees for registered liquidators if any of the proposed models are to be adopted. We contend that given the current proposed recovery is of the order of $9 million, increases of what may be perceived as moderate rises (for example $1 million) would likely be readily approved by government as being minor. However, given the small population that these fees are recovered from (likely to be less than 600 practitioners), an increase of this type would lead to an order of magnitude increase in fees per practitioner.

15. *Are the proposed consultation arrangements on the levy mechanisms and funding appropriate?*

    We do not agree that they are appropriate. Again, we point out that there has already been substantial comment that industry should not be able to determine what regulatory work ASIC does. This will naturally extend to the fee consultation framework in a short space of time.

    It is our contention that professions have the strongest vested interest in maintaining their own highest standards of regulation and should be given greater control over their own management. Indeed, this is why we advocate a self-regulation model as found in the UK.

16. *Do you support ASIC's fees-for-service being revised every three years? Alternatively, would you prefer that ASIC's fees for service be revised more regularly?*

ARITA believes that the three year cycle for the initial period is too lengthy to allow proper adjustment and review as any changes are bedded down. We would propose an annual review for the first three years, moving to a three-year cycle after that.

17. *Do you have any further suggestions for enhancements to be made to ASIC's accountability structure or industry funding model? If so, please provide details.*

    Following on from our feedback to the ASIC Capability Review Panel, we believe that a holistic approach needs to be taken to both the setting of ASIC's focus and any industry funding. We have contended that ASIC's current focus in and around insolvency is misguided. As a professional association with a deeply vested interest in promoting the highest possible standards in order to protect and enhance the reputation of our members, we believe it is essential for our views to be properly taken into account in how ASIC prioritises. This is particularly true if, as a profession, our members must now also finance this work.

    The Cost Recovery Stakeholder Panel should thus have its operations co-joined to the Capability Review Panel and it should include proper, guiding participation from industry and, in particular, from professional associations (as opposed to lobby groups).

18. *How should the Cost Recovery Stakeholder Panel operate? How should the membership be determined?*

    As above at Question 17

Chapter 6: Phase-in arrangements and levy administration

19. *Are the proposed arrangements for phasing in cost recovery levies appropriate? If not, what alternative approach would you suggest and why?*

    We do not believe ASIC has released adequate data either about industry metrics or about its internal cost structures to make a reasonable decision in the proposed timelines.

    We also do not believe that ASIC would be in a position to be able to implement some of its proposed recovery options due to a lack of available data.

20. *Is it appropriate to set fees to recover ASIC's costs from 1 July 2016? Why or why not?*

    We do not believe ASIC has released adequate data either about industry metrics or about its internal cost structures to make a reasonable decision in the proposed timelines.

We also do not believe that ASIC would be in a position to be able to implement some of its proposed recovery options due to a lack of available data.

21. *Are the proposed administration arrangements suitable? If not, why not?*

    We do not think it is reasonable that costs should be allowed to vary dramatically year on year. This process should be smoothed to allow market participants to budget for changes in costs. It is not reasonable for industry to take on further risk for ASIC's inability to properly forecast its costs or recoveries.

22. *Is it appropriate not to levy entities entering the market part way through the year? If not, how do you propose that these entities be treated?*

    If annual fees are to be levied, then they should apply pro-rata for mid period entrants.

23. *Is it appropriate for the Government to handle the over or under collection of levies through a reduction or increase in the levies payable for the next year? If not, why not?*

    We do not think it is reasonable that costs should be allowed to vary dramatically year on year. This process should be smoothed to allow market participants to budget for changes in costs. It is not reasonable for industry to take on further risk for ASIC's inability to properly forecast its costs or recoveries. We note that AFSA are currently able to manage this approach effectively.

24. *Are additional arrangements necessary to ensure appropriate administration by ASIC of its industry funding model? If so, please provide details.*

    We again submit, if other options such as self-regulation are not embraced, that any recoveries should be set based on the cost of the competitive commercial provision of these services in order to ensure efficiency.

Attachment A – Funding Model for Companies

Questions 25-29. Are the proposed arrangements for company levies appropriate? Why or why not?

It is ARITA's primary contention that a small additional charge on companies, as the main creditors in the economy, should be levied to cover any regulator cost for insolvency. This is particularly appropriate given that a substantial element of ASIC's work that is apparently covered in the $9 million proposed model is actually attributed to director conduct and in supporting the work that registered liquidators do to identify that director misconduct.

The fee could either be an increment of as little as $4.23 per annual ASIC return (based on the data in Attachment A) or, as an important market enhancement, directors of all companies could be required to make an annual solvency declaration return to ASIC for a fee. This concept replaces and expands upon the annual solvency resolution that companies should be making as part of the audit or AGM and formalises it. We believe that this would drive an important enhancement in practice whereby directors would feel an additional obligation to review and genuinely report on their solvency if this return was to be lodged with the regulator. It would also assist the liquidator when undertaking their investigations if the company were to ultimately fail and enter liquidation.

Attachment C – Funding Model for AFS Licensees

Questions 36 – 42

ARITA does not propose to comment substantially on this section other than to note that we are currently awaiting advice from ASIC as to whether liquidators will be required to hold an AFSL for advisory work done outside of formal appointments (i.e. restructuring and turnaround advice).

As the advice given to a firm (or individual) in financial distress, but not the subject of a formal administration, may involve giving advice around financial products, the exemption for liquidators may not apply. Currently ASIC cannot provide clarity on this situation. If the final advice is that an AFSL may be required, then liquidators will be hit with a further and substantial red tape cost and burden.

Attachment D – Funding Model for Registered Liquidators

43. Which of the potential levy arrangements for liquidators do you support? Why?

ARITA does not support any of the proposals.

Due to the extent of unfunded work that registered liquidators are required to carry out – much of it investigations work on behalf of ASIC – that registered liquidators must be given an exemption from the user-pays model. We further contend that the ultimate

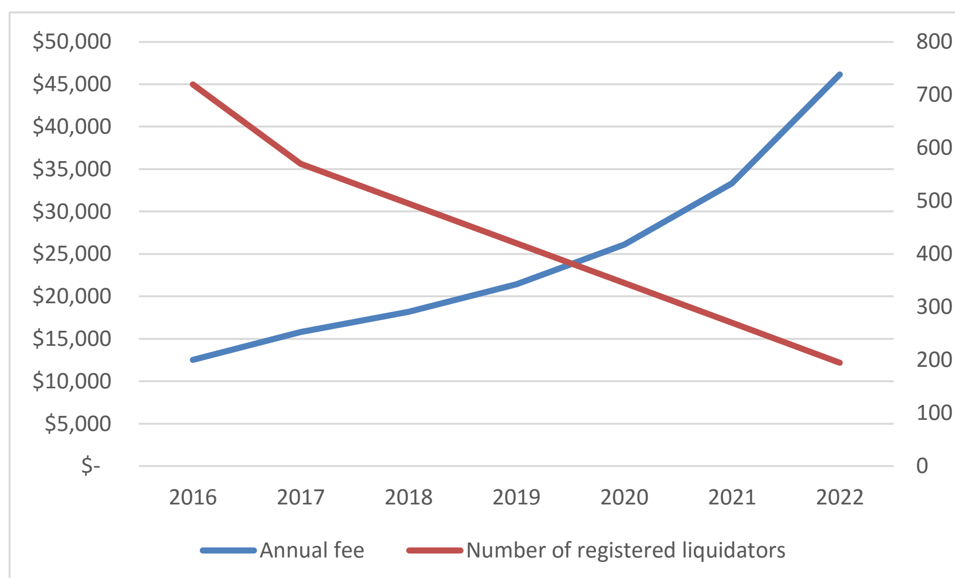
"user" is, in fact creditors and have already proposed methods where they could be charged equitably.

The Consultation Paper proposes three alternate models. As mentioned previously, it is ARITA's contention that all three models are flawed.

1. **Flat Levy**
   There are currently some 720 registered liquidators. Our information suggests that around 150 of those take no or few appointments. It would be expected those 150 registered liquidators would immediately relinquish their status. This would force the fee up to in excess of $16,500 per registered liquidator which, in turn, would force further practitioners from the market.

   ARITA has already had extensive feedback from the profession that many firms would choose to adopt a "licensing" style model rather than be hit by multiple registered liquidator fees per firm. This would force registered liquidators to take a far higher number of appointments, paying less attention to the detail of work being undertaken and would likely lead to a far higher level of "paperwork" non-compliance (which has been ASIC's primary "regulatory" enforcement focus for registered liquidators).

   This model is significantly flawed and globally anti-competitive (the proposed fees are more than 10 times the fee of any other market). Indeed, as ARITA is working towards expanding the potential for Australian insolvency practitioners to export their services into Asia, this would substantially cruel their ability to compete in markets which face no similar fees.



2. **Tiering on assets realised**
In the first instance, ASIC has no compiled data that has ever been released about assets realised from external administrations. So suggesting this model is somewhat fanciful as the appropriate percentage of realisations cannot currently be calculated nor readily determined.

The concept of the model – having largely been copied from the AFSA funding model – does hold some merit. However, one would need to account for the likely flight away from formal insolvencies.

One of the most substantial challenges to the proper oversight of formal insolvencies is the rise of so-called "pre-insolvency" advisers, who primarily advocate asset stripping and unlawful phoenixing of businesses – exploiting the lack of director prosecutions by ASIC. By providing a further competitive advantage to these types of operators, an asset realisation model will only assist with their growth.

A further concern is that the proposed model does not explain if it is to be levied purely on liquidations or also on receiverships. If the fee is to be levied on receiverships then this represents a further impost on lenders alongside the range of new fees that they will also carry outlined elsewhere in the broad user pays model.

As noted previously, registered liquidators already face massive losses from unfunded work. Stripping an additional percentage from assets realised would only further reduce the potential cost recovery for registered liquidators.

It should be noted that the Canadian model does enable cost recovery from dividends paid. This model warrants further research. But the problem of ASIC's lack of published data on asset realisations would need to be overcome before a sensible percentage could be set.

ASIC at least does hold records of dividends paid via Form 524 disclosures required as part of all insolvency administrations.

A payment from dividends also protects the proper prioritisation of secured creditors and employees, rather than further impacting the Fair Entitlements Guarantee (FEG) scheme – where a realisations model would see ASIC taking money from assets that could create or increase a shortfall to employees that, in turn, would be require the FEG scheme to fund the shortfall).

The discussion paper also posits "a registered liquidator who realises a higher value of assets each year either undertakes more external administrations or completes administrations with higher asset values. As a result, they generally present a larger

risk and require more regulatory oversight." There is absolutely no evidence to support the notional conjecture that a liquidator who undertakes more or higher value liquidations requires more oversight. The statement is utterly without evidence and must be rejected as the basis for this model.

3. **Tiering on the number of external administration appointments**
   Again, the generalisation of regulatory intensity required, as mentioned in the discussion paper has no basis in evidence.

   Further, any model that charges on a per-appointment basis is likely to have a very negative effect on the group of practitioners who operate in the high-volume, low margin segment of the market.

   This market is critical to the operation of the financial system – it is where the majority of SME insolvencies with little or no assets occur. Not only is this market price-sensitive, it is the most likely to be impacted by no or limited assets to fund the work required by ASIC.

   It is worth pointing out that the fees for insolvency practitioners are already, generally erroneously, seen as a basis for complaint by creditors. Further pressure on this segment of the market will only exacerbate the issue.

   It should also be noted that ARITA has proposed reforms calling for the streamlining of SME liquidations. This fee model would directly and unnecessarily harm this.

   This segment of the market most under threat from the "pre-insolvency" advisors. An additional cost impost on registered liquidators who operate in this segment would cause further hardship.

44. Would any of the proposed levy arrangements for registered liquidators not be competitively neutral? If so, why?

As noted in response to Question 33, ARITA contends that all three proposed models would have negative flow on effects, either by harmfully reducing the number of practitioners, causing a disparate impact on firms who concentrate on high volume SME liquidations or by pushing insolvencies to outside of the regulated framework.

45. Would any of the proposed levy arrangements for registered liquidators have detrimental impacts on small business? If so, why?

All of the proposed fee models, given the scale of recovery that it is proposed, are likely to have a deleterious effect on small business.

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Negative impact is likely to be felt on both the small insolvency practices and also on the external administration of small businesses in financial distress where those additional costs need to be passed on. Further cost impost on distressed small businesses will reduce their likelihood of being able to traded-on to sustain jobs and economic value.

Additional cost in the insolvency process will also be felt by small businesses as creditors where these proposals are likely to further reduce what they may be able to recover from a distressed business that owed them money.

46. *Would any of the proposed levy arrangements for registered liquidators have detrimental impacts on access to liquidators in regional Australia? If not, why not?*

Liquidators in regional areas often concentrate their businesses on SME insolvencies. This is often the most cost-constrained type of work, with many assetless or near-assetless insolvencies. In turn, that means many of the insolvencies that regional practitioners work on do not allow for liquidators to recover their fee.

Further, liquidators in regional areas are more likely to offer insolvency services in conjunction with other services. The additional cost impost on regional practitioners may force some of them from the formal insolvency market, leaving a regional area without liquidators or reliant on more expensive providers from capital cities.

Attachment G – Proposed Fee Schedule

58. *Are the proposed fee amounts for professional registration, licensing and document compliance review forms appropriate? If not, why not?*

As previously mentioned, an application fee of $8,800 to become a registered liquidator and the $5,100 fee, in addition, to become an official liquidator, does not seem to tie into the real costs incurred given the brevity of the current application process. It is excessive for the work currently undertaken by ASIC.

59. *Do you think that the proposed fee amounts may act as a disincentive for some entities from submitting a professional registration or licence application, or a document for compliance review, with ASIC? If so, why?*

ARITA has already noted the rise of unregulated "pre-insolvency" advisers. The magnitude of the proposed fees is likely to further encourage the growth of these types of advisers who are not subject to proper oversight, qualification, continuous professional development or other standards.

Feedback from our member firms is that they would become less inclined to support "up and coming" insolvency professionals to gain their registration, due to both the application cost and the excessive annual fees proposed. This would lead to firms preferring to retain a limited number of licensed practitioners and would be unhelpful in leading generational renewal and ensuring the sustainability of the profession.

Questions - 60-63

ARITA has no further position on these questions

Table 1: Relevant ASIC and market statistics

ASIC actions against <u>directors</u>	July-Dec 11	Jan-Jun 12	July-Dec 12	Jan-Jun 13	July-Dec 13	Jan-Jun 14	July-Dec 14	Jan-Jun 15	Total	**Average p.a.**
Criminal	18	5	3	1	7	7	7	4	52	**13.0**
Civil	10	2	2			1	4	2	21	**5.3**
Admin Remedies			2					5	7	**1.8**
EU/Negotiated		1	1						2	**0.5**
Total	28	8	8	1	7	8	11	11		**20.5**

- *2.2 Million company directors in Australia*
- *2.1 million trading businesses in Australia*
- *Approx 10,000 external administrations per annum*
- *7,218 possible misconduct reports by registered liquidators (76.3% of external administrations)*
- *18,195 breaches reported*

ASIC action against <u>liquidators</u>	July-Dec 11	Jan-Jun 12	July-Dec 12	Jan-Jun 13	July-Dec 13	Jan-Jun 14	July-Dec 14	Jan-Jun 15	Total	**Average p.a.**
Criminal	1								1	**0.3**
Civil		1			2		1	1	5	**1.3**
Admin Remedies	3			2	2	3	1	1	12	**3.0**
EU/Negotiated		1	2	1		1		2	7	**1.8**
Total	4	2	2	3	4	4	2	4		**6.3**
710 registered liquidators in Australia									**Cost per outcome**	**$1,440,000**