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14 October 2015

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

asicfunding@treasury.gov.au

Dear Sir/Madam

By Email

Proposed Industry Funding Model for the Australian Securities and Investments Commission (ASIC)

McGrathNicol is a national practice including 16 partners that are registered liquidators. The majority of our registered liquidators are members of the Australian Restructuring & Turnaround Association **(ARITA).** Our insolvency practice is confined to corporate matters; we do not practise in bankruptcy.

McGrathNicol welcomes the opportunity to make comment in regard to the proposed industry funding model for ASIC and appreciates your preparedness to extend the deadline for our submission at our request.

Our response is structured in the following manner:

Part A: Submission addressing the fundamental concepts and the anticipated consequences of the industry funding proposal as described in the consultation paper

Part B: Responses to the specific questions posed in the consultation paper

Please do not hesitate to contact me if you have any questions or if we can provide any additional assistance.

Yours faithfully

Robyn McKern
Chief Executive Officer

ASIC PIFM 20151014

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PART A

Submission in respect of Proposed Industry Funding model

The following provides the views of McGrathNicol in regard to the industry funding model for ASIC in relation to ASIC's regulation of insolvency practitioners.

Responses to the specific questions posed in the consultation paper are included in Part B of this response.

Our responses are limited to the issues and questions which are pertinent to registered liquidators. Throughout we use the term insolvency practitioners to mean registered liquidators and official liquidators.

McGrathNicol makes the following observations of the propositions and assumptions in the consultation paper.

1 The need for funding

The consultation paper has as its premise the need for ASIC to be funded by users of its services.

We observe that ASIC is already funded by users of its services. Revenue from registry lodgements, fees and pay for view access to information ($763m[1]) exceeds the funding of ASIC from appropriation revenue totalling $347m in 2013-14[2].

Insolvency practitioners are heavy users of the services. ASIC data is purchased by practitioners for the purposes of assuring freedom from relationships which may cause conflict of interest and as part of the work involved in investigations into insolvent companies - such costs are passed directly to creditors or absorbed by the practitioner.

The community impacted by this proposal should clearly understand that they already significantly contribute to funding ASIC's services and the industry funding model will require them to pay again.

2 Does the proposal meet the objectives of government as set out in the Foreword?

The government sets out 3 key objectives for the Industry Funding model. In this section we comment on the alignment of the proposal to these objectives.

2.1 *Objective 1: to ensure the costs of the regulatory activities undertaken by ASIC are 'borne by those creating the need for regulation'.*

It is our submission that the proposal fails to meet the government's first objective.

In the case of insolvency practitioners, the proposed funding model adopts a simplistic contention in that it is solely insolvency practitioners who create the "need for regulation". We do not support this contention.

The need for regulation in the insolvency area arises from the legislative framework which is in place to address the economic reality of insolvency which is inherent in efficient capitalist economies.

Insolvency by definition involves parties incurring loss and human nature is such that loss gives rise to blame and complaint – it is not the blame or complaint which creates the regulatory need, it is the fact of insolvency. Moreover, the need for regulation arises from the critical importance of an effective and efficient system to deal

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[1] ASIC Annual Report 2013-2014, page 24

[2] Ibid.

with corporate insolvency as a means of instilling confidence and efficiency in Australia's economy and capital markets.

Insolvency Practitioners can be distinguished from virtually all others regulated by ASIC. Insolvency practitioners are professionals who perform roles created by legislation which imposes duties, powers, rights obligations and, significantly, personal liability on insolvency practitioners to deliver the outcomes sought by the community.

All companies and their shareholders, who enjoy the benefits of operating under a corporate structure in stable and efficient market, create the demand for a regulated insolvency system and enjoy the benefits.

In our submission, to achieve the policy objective of those creating the need for regulation bearing the cost of such regulation, the ASIC costs associated with regulating the insolvency sector should be borne by all corporates who enjoy the benefits of a sound and effective insolvency regime.

The Industry Funding model proposes a levy of $5 per annum for each company. Increasing this to only $10[3] would more than fully cover the $9m costs which the consultation paper indicates represents the expected cost of regulating insolvency (refer below in regard to our comments in this regard). Indeed, we would submit in the context of the benefits conferred from operating through a corporate entity, a more substantial levy of say $50 or $100 would be manageable and worthwhile if it meant that ASIC would be more active in educating directors, regulating corporate misbehaviour and director malfeasance and in following up of reported cases of such by the liquidator population.

This alternative proposal, in addition to achieving the first of the government's objectives, would simplify the administrative burden of the funding model by reducing the number of revenue streams to administer and remove the complexity of the proposed levies review program outlined in Chapter 6 of the consultation paper. It also removes the perception, implicit in the proposed consultation processes, that "the regulated" will have scope to influence the activity of "the regulator".

If the government proceeds with the industry funding proposal through a fee levied on insolvency practitioners, the cost will likely be passed on through increased professional fees to be ultimately borne by the creditors of those companies which are subject to formal insolvency appointments – those who have already suffered as a consequence of the insolvency, including employees and the government in relation to its subrogated employee claims under the Fair Entitlements Guarantee framework.

2.2 *Objective 2: Establish price signals to drive economic efficiencies in the way resources are allocated within ASIC.*

Imposing a registration fee of $8,800 for registration as a liquidator, $5,100 for registration as an official liquidator (for which being an official liquidator is a pre-requisite, hence a total registration fee of $13,900) and applying an annual levy of $12,700 will, we submit, will establish clear signals.

Firstly, it signals that the government seeks a concentrated industry which easier to regulate and secondly, and more concerning, it potentially signals that the practitioners ASIC has registered to undertake insolvency work, require extensive regulation (almost 3 times as much as an auditor) suggesting little confidence in the registration process or in liquidator population, despite consistent investment in regulation.

If it is the government's intention to establish such signals we note the following concerns:

- The profession is already relatively small. Recent Senate inquiries, far from seeking further concentration, called for expansion of the profession in order to assure competition to mitigate the potential for fee escalation.

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[3] Consultation Paper- Proposed Funding Model for ASIC page 36, Table A2.

- The proposed fee structure will drive many practitioners from the profession.
  - This may be the desired outcome in terms of individual performance and capability and we fully support the removal of under-performing, incompetent or unethical practitioners from the sector. However, use of a price mechanism to secure an outcome, rather than through law reform and diligent exercise of ASIC's capability despite its powers to both register and regulate is, in our view, misplaced.
  - The impact of a significant reduction in the liquidator population will inevitably impact accessibility and cost, particularly for SME and regional companies.
  - In the current stage of the economic cycle, when formal insolvency work is at a low ebb, the economic impact of the proposed fees will likely lead to a significant attrition rate. This will undermine investment in succession in the profession and the capacity of the profession to serve the demand as the economic cycle turns.
- The funding proposal will facilitate the promulgation of the so called "unregulated" insolvency adviser sector. In particular, those businesses/advisers who operate outside the ambit of regulation, prey on vulnerable or desperate company directors (typically those where the corporate veil is undermined by personal guarantees) and seek to circumvent the protections which exist within the legislated corporate insolvency framework and promote practices including:
  - Illegal phoenixing – that is stripping a company of assets by transferring it to a third party with the intent of leaving little or nothing to pay creditors or fund investigations into the transactions.
  - Advancing sums to obtain a disproportionate share of security interest in assets and assuming full ownership of assets to the detriment of creditors and the original owners.

  The funding proposal will serve to support the business models and marketing appeal of the unregulated sector at the expense of the regulated sector and the community. As it is, the unregulated market heavily promotes the fact that "resolving" insolvency matters under their model is lower cost. Which of course it is, because the statutory and professional obligations under which the regulated profession operates do not burden the unregulated sector. Further impost on the regulated profession through the proposed funding model will be a fillip to this sector.

  We note that ASIC has expressed concern about the practises in the unregulated sector and its inability to directly regulate it. Its solution has been to adopt the regulated profession to act as "gatekeepers". Hence the regulated practitioners are called upon to conduct the investigations and report behaviours to ASIC. However, ASIC is known to rarely act upon liquidator reports of malfeasance by directors or others who contribute or contrive to exploit the insolvency laws and framework and this allows the activities of the unregulated sector to flourish.
- The disproportionate fee proposed for liquidators, and the message this sends as to the need for regulation of this group, will serve to diminish confidence in ASIC, liquidators and the efficacy of the Australia insolvency framework. (We suspect that this result arises because the $9m regulation cost is not in fact confined to regulation of practitioners, but rather encompasses all activities in which ASIC is engaged in the insolvency arena – much of which concerns director and corporate behaviour and community education not pure regulation of practitioners).

  In raising this concern, we do not suggest that the framework, its participants and stakeholders are without room for improvement. Indeed for many years now the profession, including this Firm, and ARITA as the profession's representative body has actively engaged with all manner of reviews, reform stocktakes, Senate Inquiries, Productivity Commission reviews, law reform proposals and has called for focus and reform to

improve the system, raise the standards of the participants and improve the outcomes for those directly but inadvertently impacted by insolvency.

It is more than disappointing that despite all the effort that has been exerted, little has been done or achieved in terms of legislative or regulatory reform. We fully endorse ARITA's call for a holistic review of the framework, law, regulation and participation – but only if there is genuine will on the part of the government to act.

In conclusion, we agree that the proposed funding model will establish clear price signals but that these are resoundingly adverse in the context of the purpose of and the need for confidence in Australia's insolvency framework.

2.3 *Objective 3: Improve ASIC's transparency and accountability.*

It is unclear how the funding model itself will deliver to this objective in the insolvency arena.

We note that there is presently a distinct lack of transparency with regard to the costs to be funded by practitioners under the Industry Funding model. From the deliverables we see from ASIC in terms of regulation of the liquidator population, costs of $9m are difficult to reconcile.

ASIC's Annual Report for 2013-14 refers to the Insolvency Practitioners team as having 23 staff.[4] Assuming an average salary cost of $150,000 per head[5] (which is likely to be an overstatement given that this is at the top of the Executive 2 salary range) this would amount to a total salary cost of approximately $3.5m, leaving a substantial additional amount that has been allocated to be recovered from liquidators and said to be related to the regulation of liquidators.

It would seem that the $9m encompasses all of ASIC's activity in the insolvency arena including the Liquidator Assistance Program, its pursuit of recalcitrant or malfeasant directors, its investment in systems to capture data. This all is valuable and necessary work, but it is not a cost of regulation of registered liquidators. It is a cost of ASIC's obligation to administer the Corporations Act. Further, if this is the case, ASIC's costs will vary, not with the numbers of liquidators, but with the number of companies and the extent of insolvency events - further evidencing the misalignment of the proposed funding mechanism.

More generally, as practitioners we would welcome an increase in ASIC's transparency and accountability. There are many examples of where an increase in these attributes would significantly improve the efficiency of the insolvency process and the community's understanding and appreciation of what insolvency involves and what they should, and should not, expect.

Such examples include:

- Improved information flow. ASIC should be able to advise practitioners of the history of companies to which they are appointed and the associated directors. Creditors should not have to bear the cost of practitioners undertaking independent investigations into matters which ASIC already knows.
- If ASIC has no will or capacity to act on investigations undertaken by registered liquidators into director or corporate malfeasance, it should be transparent about this. Much time, effort, cost, false expectations and resulting complaint will be avoided if ASIC were transparent about the fact that it cannot or will not act on reports of corporate or director misconduct.

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[4] ASIC Annual Report 2013-2014 page 20.

[5] ASIC Annual Report 2013-2014 page 72.

- ASIC reported that of the 7,509 section 533 misconduct reports lodged in 2013-14, only in 11% of the cases was a supplementary report requested. Of these 718 supplementary misconduct reports only 19% of the triggered further investigation or surveillance.[6]
- The fact that so few directors are subjected to regulatory scrutiny, feeds the unregulated sector which relies on the lack of enforcement to effect its strategies.
- At the same time, the regulated profession bears the brunt of creditor and community complaint and disaffection when, having borne the cost of investigations, nothing happens.
- Absent enforcement of the law in regard to corporate or director conduct matters, non-compliance will become increasingly attractive and confidence in our corporate sector and capital markets will erode.

3 Comments on Funding Model options

3.1 *3.1 Annual Levy*

The following comments are only relevant if our primary submission, that the funding of regulation of the profession should be borne by a levy on all corporate participants in the market, is rejected.

The funding proposal offers 3 funding options:

- A flat charge per registered liquidator estimated at around $12,700 per annum.
- A charge on assets realised during the relevant period in an external administration.
- The number of administrator appointments (new and ongoing) undertaken each year.

We comment on each method as follows:

3.1.1 Flat Fee

In our view this is the only methodology that comes close to being practical. However, we note the following observations as to how it may impact on the insolvency profession.

If imposed, we would expect:

- Many registered liquidators will cease to practice. This will occur in small and large firms.
- Under the proposed methodology, either the costs of regulation will reduce commensurately with each exiting liquidator (which is improbable) or registered liquidators will face an ever increasing levy as the pool of liquidators called upon to fund ASIC diminishes.
- Hourly charge rates will likely increase and be borne by creditors.
  - The extent of the increase necessary will be higher in smaller firms rendering them potentially less competitive, potentially accelerating their exit from the profession.
  - As noted above, an increase in the activity of the unregulated insolvency sector will likely follow.

[6] ASIC Annual Report 2013-2014 page 64.

3.1.2 A charge on assets realised

Whilst a charge on assets realised or tiering of the levy on this basis is superficially attractive, and is convenient from a practitioner perspective as the cost can be transparently on-charged to the relevant administration, this proposal suffers the following, in our view fatal, flaws:

- It will be viewed by the community as a tax to be borne by the creditors, who are already those that suffer most in insolvencies in which they are caught up. Given our initial observation that ASIC is already self-funding through it registry and information services, it will be difficult to explain to creditors that a percentage of what otherwise would have been returned to them is going to fund ASIC. Even more difficult in cases where creditors perceive, rightly or wrongly, that ASIC's tolerance of corporate or director misconduct has contributed to their loss.
- The likelihood of significant mismatches between revenue generated from an impost of this nature and the cost of ASIC's regulation in insolvency matters.

  We think of the large and complex administrations conducted by McGrathNicol liquidators and the hundreds of millions of dollars of assets realised; we then consider the proposed methodology of the prior year activity level informing the levy for the subsequent year the necessary presumption of the consultation paper that "liquidators' activity across years tends to be reasonably constant" is readily debunked.

If the proposal is that a flat levy be imposed, but that the level of the levy be informed by the quantum of assets realised, we foresee a range of difficulties including those arising from the significant variability in timing and quantum of assets realised as follows:

- Current year appointment creditors will suffer an increased cost burden because of high asset realisations in matters dealt with in the prior year in which they do not participate;
- High value assets realisations can co-exist with minimal creditor returns and so if the levy were to be on-charged to creditors proportionate to asset realisations, the impact on creditor returns across matters may vary significantly;
- It involves a significant further administrative burden on practitioners and ASIC in determining the levy;
- We consider it unsound policy for the government to impose a levy which may be perceived as disincentivising maximisation of asset realisations.

3.1.3 Levy based on a number of administration appointments undertaken each year (or flat fee tiered on this basis).

The assertion in the consultation paper to support imposing a levy tiered on the basis that registered liquidators who conduct more external administrators or conduct administrations with higher asset values "generally presents a larger risk and require more regulatory oversight"[7] is entirely without foundation.

To the contrary it is our understanding that the bulk of complaints, investigation and enforcement activity by the regulator concerns liquidations in which there are fewer assets and fewer sophisticated creditors and/or concern practitioners who conduct fewer administrations and hence have less accumulated or collective experience or possibly currency in their practice standards.

The commentary within the consultation paper in respect of the rationale for a regulatory levy based on numbers of appointments taken by practitioners demonstrates the flaws in this proposal. We would seriously question whether

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[7] Consultation Paper- Proposed Funding Model for ASIC page 50.

the relationship between regulatory risk and either assets under management or numbers of appointments is sufficiently robust to use as a basis for levying what will be a substantial fee.

Such an approach would impose a proportionally larger financial burden on smaller insolvency practices and would be likely to have the effect of discouraging entry into the industry, contrary to the benefits that a competitive professional environment brings.

3.2 *Registration Fees*

We are sympathetic to the proposal to increase the initial registration fees for liquidators provided the proposed fee:

- Reflects the reasonable cost incurred by the regulator in investigating, reviewing and processing applications.
- Results in a cohort of registered liquidators in whom the community, including other registered liquidators, can be confident.

However our view is that the proposed fee levels are:

- Excessive in the context of the effort exerted by ASIC.
- Likely to be a barrier to entry which will adversely impact succession within the profession and create a scarcity of resource in regional areas and times to come.

If the registration process were commensurately improved and more in the nature of a licensing regime, we would support a fee in the vicinity of $5,000 for registered liquidator and a further say $1,000 for the marginal additional work required to convert from registered to official status.

Part B

Responses to selected questions for ASIC Proposed Industry Funding Model- Consultation Paper

Chapter 2: ASIC's Activities

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

We agree that the regulatory activities which have been identified on page 6 of the Consultation Paper[8] are appropriately excluded from the proposed cost recovery model. We also agree with the basis of their exclusion, that is "the scope of recoverable cost should be limited to specific government activities provided for identifiable non-government recipients."[9]

However, in the context that the "industry" identified as being the relevant funder of ASIC's activities, comprises registered liquidators, we submit that this rationale has not be applied consistently, with only the administration of the Assetless Administration fund and to a much lesser extent, the administration of Unclaimed Monies accounts, impacting directly on the profession. As detailed in our response to question 2 below, we are of the view that these exclusions do not go far enough.

In contrast, if the government accepted our submission in Part A, that the entirety of ASIC's activities in connection with corporate insolvency were for the benefit of the entire corporate population, few exclusions would be necessary (even those which are presently excluded).

This approach does not necessarily preclude imposing levies on registered practitioners.

- As set out in Part A 3.2 we support a fee for registration commensurate with the reasonable effort required and value delivered from diligence in admitting only those who demonstrate the requisite qualifications and capability to undertake the important work of registered and official liquidators.
- We would also not object to an increased flat annual fee to an amount commensurate with the fee imposed by AFSA on Registered Trustees or as proposed for auditors, by way of a contribution to the overall cost, which would largely be otherwise funded by a levy on the corporate population.

Such a model would more properly reflect where the benefit of ASIC's endeavour lies, minimise adverse impacts within the profession, create a budget for extending ASIC's capacity to address matters in the insolvency area pro-actively (not least oversight of director conduct) whilst also being far more simple and cost effective to implement and manage on an ongoing basis.

2. Are there any specific regulatory activities undertaken by ASIC, such as those that support innovation, that should not be recovered from industry? If so please provide examples.

As set out in Part A of our submission, insolvency practitioners, in contrast to many other groups whose conduct ASIC regulates, are not the primary beneficiaries of regulation of this sector. In undertaking formal insolvency appointments, practitioners themselves play an important regulatory role, including investigating why companies fail

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[8] Consultation Paper- Proposed Industry Funding Model for the Australian Securities and Investments Commission, 28 August 2015 page 6.

[9] Ibid, page 6.

and where possible holding directors accountable for their misconduct. Indeed ASIC itself refers to practitioners as 'gatekeepers' for ASIC. As part of this process, insolvency practitioners call on ASIC, for example by seeking assistance from the Liquidator Assistance Program, with its greater powers to enforce director compliance.

Another important obligation of external administrators is the provision to ASIC of director misconduct reports[10] which identify potential offences committed by directors of companies that have become insolvent. We submit that in undertaking this investigatory work insolvency practitioners are assisting ASIC to achieve its strategic priority of detecting and responding to wrongdoing.[11]

ASIC's costs in respect of these matters, where ASIC is called upon to utilise its capability and powers to enable insolvency practitioners to ensure directors comply with statutory obligations, is in the interest of a stable and effective economy and should also be excluded from the proposed costs recovery model.

We further submit that ASIC's cost of collecting information which is required by law to be lodged with ASIC (for example the six monthly Presentation of accounts and statement[12]) should be excluded on the basis that it is not an activity being provided for insolvency practitioners or indeed any other 'identifiable non-government recipient' but rather should be recognised as costs incurred by ASIC of administering the Corporations Act.

Whilst it is not at all clear whether or not it is the case, we fear that the proposed $9m includes ASIC's costs in developing systems or processes to enhance data collection. We submit that such costs should not be included in any costs to be borne by registered liquidators. The liquidator population already bears a significant burden in aligning their systems and processes to ASIC's requirements and ASIC's costs in such matters do not benefit the liquidator population.

We expect there are probably more examples of the work undertaken by ASIC's Insolvency Practitioners team that should be excluded from industry cost recovery. But the lack of transparency around the breakdown of the $9M proposed to be allocated to the insolvency profession hampers proper analysis and in turn prevents identification of ASIC's activities which relate specifically to the regulatory needs created.

We reiterate that any difficulty in finalising policy in regard to what is or isn't to be industry funded, let alone the challenge of ASIC implementing "time and motion" methodologies to isolate the costs of activities which may be inherently intertwined, would be obviated by adopting the alternative funding model, under which all ASIC costs in relation to insolvency are funded by a modest levy on the corporate population, potentially supplemented by appropriate direct levies paid by practitioners.

Chapter 3: International Funding Model

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 the reasons why.

Our answer is confined to the regulation of the insolvency profession rather than the provision of financial services generally.

Each of the three overseas systems for the regulation described in the Consultation Paper is very different to the Australian regulatory regime, which makes drawing conclusions from the comparison challenging.

In the UK for example, the three main Professional bodies undertake practitioner regulation and licencing, with the Government's Insolvency Service having oversight of the professional body regulators. The Insolvency Service also

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[10] Report to ASIC under Sections 422, 438D or 533 of the Corporations Act.

[11] ASIC's Corporate Plan 2015-16 to 2018-19

[12] Corporations Act Form 524

investigates director misconduct in an insolvency context, in conjunction with practitioners and enforcement agencies. We see significant merit in this model.

The Consultation Paper refers to the UK's FCA as wholly funded by industry[13] but this does not appear to be the case in respect of the regulation of the insolvency profession. The Insolvency Services' Annual Report and Accounts 2014-15 refers the sources of its revenue as follows:

> "The Insolvency Service aims to recover the full cost of its activities either from fees and charges from users of the agency, from HM Revenue & Customs in respect of the administration of the Redundancy Payment Scheme (RPS) or from **direct funding from BIS in respect of insolvency policy and investigation** (other than official receiver investigations) **and enforcement**."[14] (Emphasis added).

BIS refers to the Department for Innovation for Business Innovation and Skills, which receives funding from Treasury which is then allocated to the Insolvency Service.

So in the UK it would appear that there are elements of the work undertaken by the Insolvency Service which are analogous to the work undertaken by ASIC in relation to director misconduct (surveillance and enforcement) in an insolvency context which are funded from general revenue rather than directly from the profession. Following on from our position articulated in question 2, we submit that a similar carve out is equally appropriate in Australia.

As the US insolvency regime operates so differently from the Australian model and the market is so significantly larger, we are of the view that the funding model operating there provides little to assist in the design of a model for Australian circumstances.

Chapter 4: The proposed industry funding model

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

In relation to the regulation of the insolvency profession we repeat our concern that it is important to properly consider the costs of regulating the profession and exclude from this the costs of assisting insolvency practitioners to play their gatekeeper role in identifying and reporting director misconduct. We would welcome a review of the appropriate balance of ASIC resource allocation between:

- ensuring that insolvency practitioners perform to the high standards imposed on them to maintain public confidence in the profession, in coordination with ARITA; and
- holding directors of insolvent companies that have committed breaches of the Corporations Act accountable to stakeholders impacted by the insolvency process,

as a first step in determining appropriate annual levies under an industry funding model[15]. Currently, we suggest that insufficient regulatory endeavour is directed to the latter category and that a re-evaluation of the risk model would realign the relativities of this investment.

Steps 2 and 3 of the proposed mechanism for determining levies[16] refer to identifying industry sectors and apportioning budget to activities. Unfortunately, on the basis of the information made available in the Consultation

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[13] Consultation Paper- Proposed Industry Funding Model for the Australian Securities and Investments Commission, 28 August 2015 page 11.

[14] The Insolvency Services Annual Report and Accounts 2014-15 page 53.

[15] Consultation Paper- Proposed Industry Funding Model for the Australian Securities and Investments Commission, 28 August 2015 page 17.

[16] Ibid page 17.

Paper as well as the ASIC Annual Report 2013-14, it is not possible to understand either what ASIC regard as comprising the industry sector (presumably it is both registered liquidators and directors of insolvent companies but this is not clear) nor how the amount of $9M has been identified as relating to these activities. The absence of this information makes it difficult to comment meaningfully on the proposed levy mechanism. We refer to Part A of our submission and our response to Question 1 above which set out our preferred alternative funding 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?

We are supportive of the concept of cost recovery on a fee for service basis where the recipient of the service can be identified, as is the case where ASIC administers the licencing requirements of a particular industry sector.

The only specific fee for service activities mentioned in Table 3 on page 20 of the Consultation Paper relevant to insolvency practitioners is in relation to applications for registration.

Our views on this issue are set out in section 3.2 of Part A of this submission.

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

We have provided a detailed response in relation to the fees that is are proposed to be charged for the administration of the registration of liquidators in our response to Attachment G below and in section 3.2 of Part A of this submission.

In summary, we accept that it is appropriate to charge a material fee for registration, however the fees proposed to be levied for the registration of both classes of liquidators are too high and cannot be justified in terms of the effort that ASIC applies.

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

We make no specific comments in this regard other than the fee for service must ultimately represent value, which in turn requires that the processes involved are designed to achieve the desired outcome and be efficient and effective in their implementation.

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?

In addition to our responses in Part A of our response and the answers to specific questions in this Part B, we observe that mechanisms described on page 23-25 of the Consultation Paper, as they relate to the determination of levies to be applied to the insolvency industry, are unnecessarily complex and involve significant resources to be applied by all stakeholder groups. We are also concerned that the consultation may be perceived by stakeholders as "the regulated" influencing the activities of "the regulator".

We do not support the proposed process and reiterate that under our submission as to an alternative corporate levy funded model, such a process would be necessary.

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 the process will provide certainty and indeed it will potentially have the opposite effect, depending upon the realignment of ASIC's strategic priorities or budget. For the insolvency profession, with its small number of participants, even modest increases to the ambit of ASIC's activity or the costs of those activities (say 10% of the current $9M) will result in a significant impost in terms of the increase in levies payable per practitioner based on the flat fee model.

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

We do not agree that the consultation proposals are appropriate in the context of insolvency practitioners because of the level of complexity of the proposed mechanism and the effort that would need to be applied by a small profession to annually debate the premises of and constituent elements of the levy charged by ASIC.

We refer also to our response to question 1 which summarises a preferred and pragmatic alternative funding model which would obviate the need for complex consultation. We also reiterate our concerns that the consultation as proposed will, rightly or wrongly, create the inference that the regulated practitioners have inappropriate influence over the regulator.

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

In the context that we do not support the industry funding model as proposed for registered liquidators, we agree that this is an appropriate time frame in the context of the insolvency profession although it may be that an annual review is necessary through an initial transition period.

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

We reiterate our earlier observations that greater transparency around the breakdown of the activities which underlie the costs allocated to the regulation of industry sectors is critical to enable a proper evaluation and fair operation of the proposed funding model.

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

In the context that we consider the proposed model as it relates to insolvency practitioners is misplaced and over-engineered, we make no specific comments in regard to the Cost Recovery Stakeholder Panel other than to say that ARITA must play a significant role.

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?

If the substance of our views in regard to the funding proposal is rejected, the phasing in arrangements appears reasonable.

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

We believe that the time frame for introducing the fee recovery is inappropriate. Such a timeframe gives businesses little time to prepare for very substantial increases in the quantum of fees payable**.** This timeframe would not enable the increased fees to be properly accounted for in budgeting processes for 2016/17 that would be underway in many organisations well before the cost recovery model is likely to be finalised.

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

We do not think it is reasonable that costs should be capable of dramatic variation year on year. It is not reasonable for practitioners to bear further financial risk in their budgetary planning because ASIC may not be able to adequately forecast its costs.

To avoid dramatic fluctuation would require a consistent relationship between the number of practitioner and ASIC's costs. The data available provides no comfort that this will be the case. Indeed we consider it improbable that a commensurate costs reduction will accompany the anticipated reduction in practitioner numbers which will follow the impost of the proposed fees. This is because we presume (in the absence of detail) that ASIC's costs will vary not with the number of practitioners it regulates but the quantum and severity of corporate insolvencies which occur.

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

If levies are to be applied, 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 refer to our comments in Section 3.1 of Part A which articulate the commercial impracticality and the inequity inherent in this proposal under each of the potential funding mechanisms. We refer also to our response to Question 21 above in regard to the need for any levy to be reasonably predictable year on year.

Attachment A- Funding Model for Companies

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

We refer to section 3.1 of Part A of our response.

Attachment D- funding Model for Registered Liquidators

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

In our opinion all of the proposed levy arrangements on registered liquidators are flawed; of the three alternatives articulated, the flat fee levy is the only feasible option. Refer 3.1 of Part A of our response.

For any levy to be acceptable, only the work undertaken by ASIC on the regulation of the insolvency profession, as opposed to the costs of insolvency regulation generally, which encompasses the much larger area of director misconduct in an insolvency context, should be funded by way of a levy on practitioners. To determine the proper allocation of costs would require much more detailed economic modelling of the activities of ASIC and particularly the Insolvency Practitioners team. In the context of insolvency related work comprising only some 4% of ASIC's overall operating costs and presuming practitioner regulation represents some smaller part of this, our view is that the proposed model is overly complex and unnecessary. We set out in Part A and summarise in our response to question 1 above, a much more simple approach.

Tiering on assets realised

As set out in section 3.1 of Part A of our response, we disagree with the proposition that "Basing the levy for registered liquidators on 'assets realised' would be a good proxy for supervisory intensity"[17] and dispute that there is any evidence to support this contention in Australia.

In general terms, the larger insolvency practices undertake the large and complex external administrations and preside over significant asset realisations. McGrathNicol has specialised in large and complex insolvency engagements since its inception. Larger organisations tend to have the ability to invest more heavily in their processes and risk management frameworks including internal compliance review programs.

In addition we note that there will be significant challenges in gathering the data needed to perform these asset realisation calculations, without substantial changes to the current ASIC reporting mechanisms.

Tiering on the number of external administration appointments

We also reject the proposition that "The number of external administration appointments undertaken reasonably predicts ASIC's effort in regulating registered liquidators"[18].

External administrations vary enormously from receiverships of multi-faceted businesses with national operational presence through to assetless and unfunded Court liquidations of defunct companies. In addition to this we note that in our experience just because appointments involve smaller values of assets and lower creditor claims doesn't necessarily translate to more straightforward appointments; the variety of industries and the legislative framework that insolvency practitioners must navigate can also make smaller size matters challenging to resolve. Specialists in liquidation work may undertake a high volume of appointments with a relatively low rate of asset recovery, but we do not accept that volume is an accurate predictor of regulatory effort and are not aware of any evidence that supports this proposition. Certainly a levy determined on this basis would have an adverse impact on these liquidation specialist types of insolvency practices.

We suggest that the great variation in the size of and issues arising in external administrations makes tiering a levy on the basis of either the quantum of assets recovered or the number of appointments taken undesirable and potentially damaging to the profession.

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

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[17] Consultation Paper- Proposed Industry Funding Model for the Australian Securities and Investments Commission, 28 August 2015 page 50.

[18] Consultation Paper- Proposed Industry Funding Model for the Australian Securities and Investments Commission, 28 August 2015 page 51.

We refer to our comments in section 3.1 of Part A of our submission and reiterate that in our opinion there are potentially negative anti-competitive outcomes from each of the proposed levy arrangements.

- The flat fee, if the amount levied is prohibitively high, will encourage exits from the industry (which will in turn result in further increases to levies) rather than robust competiveness.
- The proposed 'value of assets' basis would not spread the cost of regulation fairly, because of the lack of causal link between the value of recoveries and regulatory risk. The burden of larger scale levies would be borne by bigger practices that often undertake appointments for secured creditors, notwithstanding the lack of evidence that these practices create a higher need for regulation.
- The third possibility propounded, tiering on the number of external administration appointments, is likely to have the negative effects on smaller insolvency practices as noted in our comments in response to question 43 above.

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

We refer to our comments in section 3.1 of Part A of our submission and note that small business is likely to be affected in the following ways:

- The unregulated pre-insolvency adviser sector will receive a fillip from being outside the regulatory regime and immune from the financial impost – such businesses prey on vulnerable and typically small business
- Small business, as creditors of corporates, will ultimately bear the cost of increased costs of insolvencies (as the ASIC levies are passed on by practitioners)
- Small business suffering insolvency events will have fewer regulated professionals available to assist them navigate the issues and take appointments and this impact may be significant in regional areas where the workflow is inadequate for practitioners to absorb the significant annual levy.

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?

In this answer our comments are confined to two of the fees for service for professional registration types listed on page 61 of the Consultation Paper; applications for registration as a liquidator and applications for registration as an official liquidator.

We have considerable experience with the process of liquidator registration. McGrathNicol has 16 current registered liquidators, 17 of who are also Official Liquidators. Six of these Corporate Recovery partners have applied to be registered liquidators during the last six years and seven have applied to be official liquidators. All of these recent applications lodged with ASIC have been successful.

We are supportive of a material fee being charged for the provision of the service of administering applications for registration and accept that the current fee of $382, which has had only minor incremental rises for many years, is low in the context of the significance of the registration of a practitioner.

By way of contrast, the amount charged by the Australian Financial Security Authority for administering an application to be registered as a trustee or debt agreement administrator (which admittedly is a more involved

process than liquidator registration) is currently $2200 with a further initial registration charge of $1300 [19]. In our view this larger fee has the benefit of not only providing proper compensation for the service provided by AFSA but also, in conjunction with a significantly more robust application and review process, acts as an appropriate inhibitor to those who are not committed to the practice.

We note that on page 19 of the Consultation Paper it is stated in relation to licencing that "..fees would be set to match ASIC's costs in processing and assessing these forms." No other stated motivation is mentioned in terms of determining the costs that should be applied to registration application processing fees.

Based on our recent experience in obtaining liquidator registrations we suggest that the proposed fee of $8800 (significantly the highest amount for any of the proposed fees for registrations of individuals) is excessive in terms of the time necessary to assess the applications. As it is not possible to point to any publically available data in support of our contention due to the lack of granular information about the operation of the industry sub sectors within ASIC, our observations on this issue are necessarily anecdotal.

Our recent registered liquidator applications were processed and approved within an average period of 8 weeks. Most applications received 2-4 queries or requests for clarifications from ASIC and the minority received 0- 1 requests for further information from ASIC. Although the application packs were lengthy (between 35-60 pages due to the level of detail to be provided about experience plus all of the annexed material evidencing qualifications, insurance arrangements, professional memberships etc), we suggest that experienced licensing analysts would still be able to review these, check references, resolve queries and recommend a position on the appropriateness of the application in 15 hours or less. If the proposed fee level is used this would equate to an hourly rate of more than $500 per hour.

The current process to apply to be registered as an official liquidator is much more straightforward than that applying to registered liquidators. ASIC's website gives the instructions for undertaking this application[20] which does not involve a prescribed form, but simply a short one page letter giving just the following information:

1. The reasons why you want to register as an official liquidator;
2. The names of the registered and official liquidators you have worked with in the last five years;
3. An undertaking to ASIC that, if you are registered as an official liquidator, you will not refuse consent to act as liquidator in a court winding up solely because the company has no assets or otherwise may not have sufficient funds to cover the anticipated professional costs of the liquidation;
4. An acknowledgement that an official liquidator is an officer of the court, and as a result, has special responsibilities I connection to the winding up of the company when appointed by the court.

While we accept the current fee is low, the proposed fee of $5,500 bears no reasonable connection to the effort required to process these applications. All of our recent applications (since the changes to the process with the introduction of the Corporations Amendment (Insolvency) Act 2007) have been granted within a very short period of time (between 1 day and 1 month) and only one received a very minor query from ASIC, the other six we received none.

We are entirely sympathetic to the proposal to increase the initial registration fees for liquidators provided the proposed fee:

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

[20] http://www.asic.gov.au/for-finance-professionals/registered-liquidators/applying-for-and-managing-your-liquidator-registration/registration-of-official-liquidators/

- Reflects the reasonable cost incurred by the regulator in investigating, reviewing and processing applications; and
- Results in a cohort of registered liquidators in whom the community, including other registered liquidators, can be confident.

However our view is that the proposed fee levels are:

- Excessive in the context of the effort exerted by ASIC; and
- Likely to be a barrier to entry which will adversely impact succession within the profession and create a scarcity of resource in times to come.

If the application process were commensurately improved we would support a fee in the vicinity of $5,000 for registered liquidator and $1,000 for the marginal additional work required to convert from registered to official status.

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?

Yes.

The costs for applying for registration as either registered or official liquidators are significantly higher than any other individual registration fee proposed by ASIC in the Consultation Paper and represents a massive increase from the current cost structure.

In our view the high level of this fee, coupled with the quantum of the proposed annual levy on insolvency practitioners, is likely to have an anti-competitive effect which will impact succession, retention of talent and availability of resource in regional areas and in the event of a significant economic downturn.