



## Review of the proposed industry funding model for the Australian Securities and Investments Commission

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## 1. Introduction

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### 1.1 Who we are

SV Partners Pty Ltd (SV Partners) provides professional corporate and personal insolvency advice to accountants, financial institutions, corporations, financial and legal advisors, and individuals.

With a team of over 100 insolvency specialists across the eastern seaboard, our expert advisors focus on recovery, reconstruction advice and formal insolvency appointments. We also operate one of the largest private bankruptcy practices in Australia.

### 1.2 Our experience

Our executive team has extensive experience in the insolvency and turnaround industry and hold memberships with: Australian Restructuring, Insolvency and Turnaround Association (ARITA), Chartered Accountants Australia and New Zealand (CAANZ), Certified Practising Accountants Australia (CPA), Institute of Public Accountants (IPA), Australian Institute of Credit Management (AICM), Turnaround Management Association (TMA), Australian Institute of Company Directors (AICD) and the QLD Master Builders Association (QMBA). They also hold positions on the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO) Liquidator panels.

### 1.3 Disclaimer

This submission has been prepared based on the proposed reforms as they were presented for comment, as at the date of this submission. The absence of key information, such as the additional accountability mechanisms, the proposed: realisation charge percentage and the levy per appointment has impacted on our comments. Accordingly our views could change once this information has been released in full. We specifically disclaim all liability to any person who relies on this submission and offer no legal opinion or interpretation on any issue.

### 1.4 Summary of our submission

We do not support the introduction of an industry funding model for ASIC as outlined in the consultation paper dated 28 August 2015 for the following reasons:

- we question the appropriateness of a funding model for registered liquidators as our obligations to investigate misconduct, take action and also report to ASIC are required pursuant to the *Corporations Act 2001 (Cth)* and remain largely unfunded. On this point, we support the view taken by ARITA that liquidators should be exempt;
- the costs and benefits disclosed; such as transparency, economic efficiencies and accountability, are inadequately detailed and accordingly, no comments have been made;
- we believe competition will be impacted due to the following:
  - if smaller practitioners are unable to meet an annual levy and exit the industry, the increased annual burden on medium to larger firms will be unsustainable;

- additional costs will have a negative effect on firms supporting upcoming staff ready to obtain their liquidator registrations, which will impact the number of future liquidators; and
- competition between *unregulated* pre-insolvency consultants and registered liquidators would be impacted on price point.

However, should the model be introduced we make the following comments:

1.4.1 Our submission relates directly to the registered liquidator sector and we make no comments on the other sectors.

1.4.2 If the model is adopted we would be in support of an annual fee per registered liquidator, but on a sliding scale (refer to option 1(B) on page 7). Notwithstanding this, we found it difficult to adequately assess options 2 and 3 without either a declared percentage for a proposed realisation charge or a declared amount for each new and ongoing appointment. Should further information become available, which materially changes the effect of a potential annual levy on registered liquidators, we reserve our right to amend our opinion.

1.4.2 We question ASIC's ability to be both an effective corporate regulator and an enforcer when the industries with the most inherent risks will be the largest funders. A Financial Regulator Assessment Board, created to conduct independent annual performance assessments may combat this issue.

1.4.3 More certainty is required in relation to the following:

- the variability of change to annual levies;
- if the fee-for-service forms P-972 and P-903BA should be modified to align with the proposals in the Insolvency Law Reform Bill 2014;
- if Government funding for enforcement actions, through the Enforcement Special Account, will be increased;
- particulars of the further accountability measures; and
- the results of the capability review of ASIC.

## 2. Our understanding of the measures proposed

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The Financial System Inquiry 2014 (the Inquiry) recommended that an industry funding model would combat the lack of transparency around what supervisory actions ASIC undertakes and these associated costs [chapt1, pg1]. The Inquiry called for a Capability Review of ASIC (the capability review) to assess if it achieves its strategic objectives successfully, these being:

- identification and analysis of immediate and forward-looking priorities or risks;
- resource prioritisation and responsiveness to emerging issues, including:
  - how ASIC allocates its current resources among its regulatory tools, such as supervision, surveillance, education, policy, enforcement and litigation; and

- how ASIC allocates its current resources across its regulated population;
- the skills, capabilities and culture of the Commission and its staff; and
- organisational governance and accountability arrangements.

The review outcomes are due for release at the end of 2015 and will be purely observational<sup>1</sup>.

As an industry participant, understanding ASIC specific activities (outside of what is reflected in the *Corporations Act 2001 (Cth)*) and the actual costs associated with the performance of these tasks is not clear [chapt1, pg1].

Regulatory activities that ASIC is charged with undertaking are surveillance, enforcement, guidance, policy advice, stakeholder engagement, education, professional registration and licensing, applications for relief and document compliance reviews [chapt2, pg5]. The industries affected by ASIC supervision are: financial markets, companies and service professionals dealing with financial markets and companies [chapt1, pg2]. This is a very broad mandate.

As registered liquidators, we are regulated by ASIC in relation to professional registration, surveillance, enforcement and document reviews, all (except enforcement) are regulatory activities in nature. As part of our obligations when appointed to a company, we may also deal with ASIC's enforcement and litigation programs; specifically, the Assetless Administration Fund, and providing information on delinquent directors. Our understanding of the proposed measures is that these activities are excluded from industry funding.

## 2.1 Current funding arrangements

The Government's contribution to ASIC's regulatory obligations was \$260 million in the 2014/2015 financial period, which accounted for 85% of ASIC total funding. The remaining funds flow through other regulatory industry bodies, such as the Australian Prudential Regulatory Authority (APRA) and the Australian Taxation Office (ATO) which were \$28.5 million and \$7.1 million respectively<sup>2</sup> [chapt2, pg8].

## 2.2 ASIC's activities

The inquiry reviewed international funding models of regulators that were funded by industry, government, and a combination of both. Common aspects of these models are that levies are based on user or transaction activities, and that they are applied directly to regulation costs [chapt3].

The model being proposed is described as follows:

ASIC's regulatory activities funded by Industry are:

- surveillance to promote consumer and investor outcomes;
- enforcement through civil, criminal or administrative actions (director banning for example);
- guidance to industry through regulatory guides, consultation papers, reports and information sheets;

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<sup>1</sup> Media Release Assistant Treasurer Josh Frydenberg <http://jaf.ministers.treasury.gov.au/media-release/036-2015/>

<sup>2</sup> APRA Financial Levies 2014-15: <http://www.apra.gov.au/AboutAPRA/Documents/APRA-Financial-Industry-Levies-2014-15.pdf>

- policy advice to Government on operational implications of policy and legislative change;
- stakeholder engagement to set and maintain standards;
- educational tools and resources;
- licensing and professional registration;
- applications for relief from organisations and individuals seeking exemptions from the law; and
- document compliance review [chapt2, pg5].

ASIC's regulatory activities not funded by Industry are:

- operation of the Enforcement Special Account (ESA) which supports high-cost litigation activities;
- administration of the unclaimed moneys program;
- financial literacy programmes to educate investors and consumers; and
- operation of the Assetless Administration Fund used to finance preliminary investigations and reports by liquidators into the failure of companies with few or no assets. Enforcement action may result from these investigations [chapt2, pg6].

Current levies paid by APRA and the ATO

The following activities performed by ASIC are currently funded by APRA or the ATO:

- supervision of financial markets;
- operation of markets disciplinary panel;
- financial literacy programmes (MoneySmart website);
- regulatory and enforcement activities relating to APRA regulated institutes (SCT);
- changes to regulation to OTC markets; and
- regulation of SMSF auditors [chapt2, pg7].

These levies currently represent 15% of ASIC's funding. If the model is introduced, these costs would be recovered under the one model, rather than being collected on ASIC's behalf.

The federal Government provides and will continue to provide funding for:

- maintenance of the 31 registers for Australian companies, business names, financial services licensees, credit licensees and other professionals will continue to be funded by the Government [chapt2, pg9]; and
- the regulatory activities not funded by Industry listed above.

Fees for service for specific on-demand services to individual entities

Refer to 2.6 below.

### **2.3 Proposed annual levy for each regulated sector**

In the 2016-17 forecast, the model is projecting industry levies totalling \$196 million, which is anticipated to cover all industry regulated activities (stated in point 2.2).

Break up per industry sector is as follows [chapt4]:

| Industry Sector                 | Projected levy |
|---------------------------------|----------------|
| Companies                       | \$53 million   |
| Aust. Credit Licensees          | \$24 million   |
| AFS Licensees                   | \$91 million   |
| Registered Liquidators          | \$9 million    |
| Auditors                        | \$6 million    |
| Market infrastructure providers | \$13 million   |

## 2.4 Registered liquidators annual levy

The suggested mechanisms to determine the annual industry levy is based on the 2016-17 forecast cost of regulating registered liquidators, projected to be \$9 million. This represents 5% of ASIC regulation costs [chapt4, pg17].

The proposed calculation mechanisms are:

1. a flat annual fee – calculated on the number of registered liquidators divided by the cost forecast (ie. for 2015/16 financial period the forecast cost of \$9 million would be equally divided amongst the 700 registered liquidators, approximating \$12,857 per liquidator for this period); or
2. a percentage of assets realised annually, similar to that of the realisation charge levied upon Bankruptcy Trustees and administered by the Australian Financial Security Authority (AFSA); or
3. based on the number of appointments (new and ongoing) undertaken each year [attach D, pg 49].

We have assessed these three options, and provided an additional option based on the following assumptions:

| Registered Liquidators                     | Option 1 (A)   | Additional Option 1 (B)                                  | Option 2  | Option 3  |
|--|--|--|---|---|
|  | Flat annual rate per liquidator  | Flat rate on a sliding scale                             | Realisation Charge  | New and ongoing jobs                                  |
| General Assumptions: consultation paper    | \$9 million spread across 700 registered liquidators   | Flat annual rate per liquidator on a sliding scale       | Realisation charge similar to <i>Bankruptcy Act 1966 and Bankruptcy (Estate Charges) Act 1997</i>   | New and ongoing appointments for the financial period |
| Specific Assumptions: <b>applied by us</b> | That if an individual holds both registered liquidator and official liquidator registration, only one levy | Sliding scale is based on income of the liquidators firm | Applied a 1% realisation charge. <u>Excluded assets:</u> FEG, GST and dividends from entities in Liq. <u>Deductions:</u> secured creditor, indemnity, agent /legal fees | Based on \$200 per new and existing appointments      |

| Registered Liquidators                      | Option 1 (A)   | Additional Option 1 (B)  | Option 2  | Option 3   |
|---|--|--|---|--|
|   | Flat annual rate per liquidator  | Flat rate on a sliding scale   | Realisation Charge  | New and ongoing jobs   |
| Firms that may be disadvantaged             | Firms with several liquidators that have moderate turnover of jobs with average value assets | Limited on the basis that the firms which earn more are charged a corresponding levy | Those which realise minimal number of jobs with high value assets | Those which have high turnover of jobs with low value assets |
| Administrative costs to calculate levy      | Low  | Low  | High  | Moderate   |
| *Estimate per liquidator (excl. admin cost) | \$12,857   | \$10,050   | \$16,005  | \$25,614   |

\*We provide an estimate per liquidator for demonstration purposes to highlight the following:

- applying 1% as a realisation charge for option 2 is likely to achieve a substantially higher amount than \$9 million dollars of funding required by industry. The administrative costs on this option are extremely high;
- applying \$200 levied on each new and ongoing appointment, as per option 3, was considered on historical information. Based on this, we assumed that:
  - new corporate appointments (Australia wide) on average total 10,000;
  - ongoing corporate appointments are approximately three times the annual new appointment;
  - at 40,000 new and ongoing appointments per annum (across the industry), a fee of at least \$200 per unit would be required to achieve the funding required by the industry; and
- option 1(B) above is based on a flat rate (option 1) but modified to include a sliding scale according to annual income of the firm, an example being as follows:

| Sliding Scale based on firm income | Scale                              | Estimated liquidators in the Group |     | Annual levy per group |                |
|------------------------------------|------------------------------------|------------------------------------|-----|-----------------------|----------------|
| < \$5 million                      | 0.0015 cent per \$1                | 38%                                | 266 | 1,995,000.00          | Up to \$7,500  |
| < \$10 million                     | \$7,500 plus 0.0008 cents per \$1  | 6%                                 | 42  | 483,000.00            | Up to \$11,500 |
| < \$15 million                     | \$11,500 plus 0.0006 cents per \$1 | 28%                                | 196 | 2,842,000.00          | Up to \$14,500 |
| > \$15 million                     | \$14,500 plus 0.0004 cents per \$1 | 28%                                | 196 | 3,234,000.00          | > \$14,500     |
|                                    |                                    |                                    | 700 | \$8,554,000.00        |                |



The estimated liquidators in the groups above have been taken from the percentages for small, medium and large Liquidator firms in the consultation paper and applied as follows [Attach D, pg 49]:

| Sliding Scale  | Firm Size | Estimated percentage applied above              |
|----------------|-----------|---|
| < \$5 million  | Small     | 38% full amount as in the proposed model        |
| < \$10 million | Medium    | 6% full amount as in the proposed model         |
| < \$15 million | Large     | 28% half of the amount as in the proposed model |
| > \$15 million |           | 28% half of the amount as in the proposed model |

We see that this flat fee on a sliding scale would minimise the impact of the levy; increasing and decreasing in line with industry performance.

## 2.5 Our concerns about the annual levy

### Impact for liquidators

An additional levy will invariably increase the costs for all industries. A media release from ASIC on 28 August 2015 quotes ASIC Chairman, Greg Medcraft as stating *‘An Industry funding model is about ensuring that those industries that need the most regulation should pay for it, rather than taxpayers’*<sup>3</sup>. As the costs of a liquidation has a direct impact on any returns to creditors of a company, the reality for our industry is that a portion of this levy will ultimately be borne by taxpayers.

Phasing in the levy as detailed in chapter 6 of the consultation paper attempts to mitigate its impact. The phase-in arrangements allow registered liquidators until 1 July 2017 to gear up for the changes, if adopted at this time only 50% of the annual levy will be payable. The full annual levy does not commence for our industry until 1 July 2018.

### Impact on regulation

With increased funding for regulation activities, ASIC maintains it will be better equipped to ensure our industry has few or no rogue operators. However, the results of ASIC’s inquiry into liquidator misconduct since 2011 has been largely administrative.

As service providers, liquidators generally adhere to the following standards:

- The Australian Restructuring and Insolvency Turnaround Association’s (ARITA) code of professional practice (ARITA COPP);
- APES 320, being the Accounting Professional & Ethical Standards Board (APESB) quality control for firms (APES 320);
- APES 325, being the APESB Risk Management for Firms (APES 325);
- APES 330, being the APESB Insolvency services guidelines (APES 330);

<sup>3</sup> ASIC website: <http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-236MR> ASIC welcomes consultation on industry funding

- all lodgements with the Australian Investments & Securities Commission (ASIC) within the respective timeframes pertaining to the type of appointment; and
- obligations of an administrator, liquidator, controller, official liquidator, provisional liquidator and receiver and manager pursuant to the *Corporations Act 2001 (Cth)* (the CA).

We believe further regulation of liquidators will achieve few benefits as the insolvency industry is already adequately regulated by:

- self-regulation through industry bodies such as ARITA, Institute of Chartered Accountants & CPA Australia;
- market forces. Financiers, creditors and referrers will naturally gravitate to better practitioners and avoid rogue operators; and
- ASIC and AFSA.

If there is an increase in funding to regulate liquidators, we expect these funds would be used to:

- develop a transparent regulation framework as current regulation seems to be reactive, usually driven by complaints, media or high profile matters;
- help liquidators improve their systems and methods of operation to achieve efficiencies; and
- reduce red tape in insolvency compliance. An example is the report to creditors required pursuant to section 439A of the CA which has been developed to the point where the cost of producing the report has increased costs significantly for creditors.

The following should be communicated to industry:

- the outcome of the capability review;
- suggested measures for transparency of regulated activities by ASIC for specific industries; and
- the specific regulatory outcomes sought (ie. Focus on improving liquidators methods of operation).

We share the views of Australian Institute of Company Directors (AICD) Managing Director, John Brodgen that was expressed by the AICD media release on 24 July 2015 specifically that...*“A well-funded and effective corporate regulator is essential for efficient financial markets and good corporate governance .... over regulation has a negative impact on business and on the performance of a regulator itself.”*<sup>4</sup>

### Impact on ASIC's independence

Even though a significant proportion of the proposed industry levies would be paying specifically for regulatory activities (rather than enforcement and litigation) we query if the level of Government funding that would then be available for enforcement action would increase.

The Sydney Morning Herald published an article in January 2014 which drew conclusions between the reduction of Government funding to ASIC and many financial planning scandals. The most public

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<sup>4</sup> AICD website: <http://www.companydirectors.com.au/general/header/media/media-releases/2015/asic-capability-review-should-clarify-role-of-regulator>

example saw ASIC being accused of being too slow and soft on the Commonwealth Bank when allegations of fraud, forgery and other misconduct of the bank's financial advice department became known<sup>5</sup>.

In the media, the external perception is those who pay the highest levy would have a high influence on ASIC's enforcement actions, which is a threat to ASIC perceived independence and actual power<sup>6</sup>. To change this opinion; if the model is adopted:

- education programs for specific industries be provided to ensure the smaller industry sub-sectors recognise their obligations; and
- industry be given an avenue to request specific rulings (or practice guides) on various industry issues as and when they arise and these be made publically available within a reasonable time after the request.

A Financial Regulator Assessment Board was called for in the Inquiry to conduct independent annual performance reviews, which we are in support of should the model be adopted.

How much will the levies vary annually?

We acknowledge that chapter 5 of the consultation paper details review processes that the Government proposes to adopt in order to support the model. Initially it is anticipated that industry and stakeholder consultation would be considerable; however, would future years also see consultation.

If the consultation process for future years is complicated and levies become unpredictable, this would place unnecessary administrative burden on liquidators of small and medium size firms. Fixing the levy on a sliding scale and fee for service amounts for a three year period would be preferable to ensure certainty in managing businesses obligations [chapt5, pg24 & chapt7].

The introduction of a system to communicate future levies to industry (through the proposed annual Cost Recovery Implementation Statement (CRIS)) should be simple with industry responses streamlined into specific options, preferably with the introduction of an electronically lodged form.

The proposed treatment of over and under levies, in terms of rolling over the additional levies obtained for future years rather than providing a refund, is our preferred option.

## 2.6 Fees for service levies

These fees will be determined by the actual cost in providing the service to an entity. Previously these entity specific requests equate to 12% of ASIC's regulatory costs. The change to the current method would be a reassessment of costs associated with lodgement of specific forms.

The proposed changes which would affect registered liquidators are as follows:

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<sup>5</sup> The Sydney Morning Herald: Financial regulation: neither party able to deliver <http://www.smh.com.au/business/>

<sup>6</sup> ABC News: ASIC to be funded by companies it regulates <http://www.abc.net.au/news/2015-08-28/p-talks-down-chance-of-subsidy-after-hearing...>

| Form Reference | Purpose of lodgement                                   | Current lodgement fee (\$) | Proposed lodgement fee (\$) |
|----------------|--|----------------------------|-----------------------------|
| P-972          | Application for registration as an official liquidator | 366                        | 5,100                       |
| P-903BA        | Application for registration as a liquidator           | 366                        | 8,800                       |
| P-908          | Annual statement by a liquidator                       | 150                        | Nil                         |
| NONUM          | Lodgement of notice on Insolvency Notice website       | 145                        | Nil                         |

The proposed change in fees for service for registered liquidators is at odds with the proposed changes detailed in the Insolvency Law Reform Bill 2014 (ILRB) being:

- lodgement of registration document to attract a \$2,000 fee [section 20-5 of the ILRB];
- on acceptance of registration, a fee of \$1,200 is payable [section 20-30 of the ILRB]; and
- renewal fee every three years of \$1,600 [section 20-70 of the ILRB].

The proposed fees should be aligned with the ILRB fees in the event that the bill receives Royal assent.

### 3. Our comments on the measures proposed

Detailed in attachment J of the consultation paper there are various questions that you have asked industry to provide feedback on. As one of the smaller industries, we have limited views on most of these specific matters.

Notwithstanding the above, our comment on the following key areas are:

#### 3.1 The appropriateness of the industry funding model

The issue that ASIC is ineffective at protecting consumers, investors and creditors due to a lack of funding is a general statement.

Due to the broad mandate of regulatory and enforcement activities ASIC must perform, coupled with the decline in Government funding, it's arguable ASIC is currently unable to adequately fulfil its duties as Australia's corporate watchdog.

We agree that obtaining industry funding for regulatory activities may allow for sufficient Government funding to be made available for enforcement and litigation actions. Without transgressions being identified and pursued quickly, participants are likely to lose confidence in financial markets.

In terms of a pricing model for the registered liquidators market:

- the annual levy must be set at an amount that insolvency firms of all sizes can absorb without a significant increase in charge rates;
- if the levy is too high, *unregulated* pre-insolvency consultants (who usually do not hold the same level of experience as registered liquidators) may be more price competitive for distressed companies. This may cause an even greater shift to the use of unregulated pre-insolvency businesses that current exists;

- ASIC's future regulatory and educational activities for the insolvency market should be clearly identified and promoted; and
- a transparent plan for enforcement of rogue operators, whether it be through Companies, Auditors and Liquidators Disciplinary Board (CALBD) or not, be prepared and promoted amongst industry participants.

Of the three options proposed for an annual levy [Attach D], we support a fixed annual levy. The other options presented would be more inequitable depending on your market share, and impose a heavy administrative burden.

### 3.2 The costs and benefits

The consultation paper states the benefits of the funding model to be:

- increased transparency and accountability of ASIC to industry and Government on the use of funds and performance of statutory obligations;
- user pays model will ensure the costs of regulation will be applied to those wanting it; and
- drive economic efficiencies in the way resources are allocated in ASIC [chapt1].

With the current information available, we disagree that the above benefits would be delivered in our industry as it is unclear if regulatory activities will be focused on liquidators or the insolvent company's (director) misconduct.

The Inquiry has recommended further accountability mechanisms, which are being considered by Treasury. Details of these mechanisms are to be released later this year and we make our comments in the absence of these particulars.

### 3.3 The impact on competition

You have advised that pursuant to the Commonwealth Government's Cost Recovery Guidelines (the Guidelines) it is not appropriate to recover or implement full cost recovery where it would have an adverse impact on competition [Chapter1, pg3].

As detailed in 3.1, we believe a fixed annual levy applied on a sliding scale would have a neutral effect on competition in the regulated insolvency market. However, the pre-insolvency market, which is an unregulated market may have a competitive advantage due to the absence of any levy imposed on them.

The Australian Restructuring, Insolvency and Turnaround Association (ARITA) discussion paper on dealing with corporate financial distress in Australia calls on the need to regulate pre-positioning consultants in order to formalise and promote independence in this market<sup>7</sup>.

The effect on competition will depend on the levy selected and the variables associated with calculating it.

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<sup>7</sup> <http://www.arita.com.au/docs/default-source/Though-leadership/a-platform-for-recovery-2014.pdf>



Comments on the proposed industry funding model for the Australian Securities and Investments Commission (ASIC)

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