ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

10 March 2017

Manager
Corporations and Schemes Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: asicfunding@treasury.gov.au

Dear Sir/Madam

ASIC Supervisory Cost Recovery Levy Bill 2017 and Related Bills Exposure Draft

The Australian Restructuring, Insolvency & Turnaround Association (ARITA) is grateful for the opportunity to provide feedback on the exposure draft of the Government's ASIC Supervisory Cost Recovery Levy Bill 2017 and Related Bills.

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

Key points

I refer to our previous submissions made in relation to the ASIC industry funding proposals which are attached at Appendix 1 and 2 for your ease of reference. We continue to hold the following concerns in relation to the exposure draft primarily and any model specifically applicable to registered liquidators:

- There are significant negative market consequences of the industry funding proposal for registered liquidators which would diminish the proper, competitive operation of the market.
- These proposals will result in considerable unfairness given the very high cost per liquidator compared to other similar regulated populations and international comparatives, the disregard for the work done by liquidators in support of ASIC and the limited benefits from the current ASIC supervision.

- the ex-post nature of the levy will result in creditors being disadvantaged due to the distinct and finite nature of insolvency appointments.

We hope that you can take a more considered approach to how this proposal might apply to the insolvency profession.

We are genuinely concerned that if it proceeds as proposed, the Australian economy will not have sufficient depth and competition in its insolvency profession to rely on it to assist distressed businesses in a future economic downturn. This will cost real jobs in the wider economy.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

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

We have more than 2,000 members including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency and restructuring.

Some 84 percent of registered liquidators and 89 percent of registered trustees are ARITA members.

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

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

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

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1 Economic and market implications

ARITA believes there are significant negative market consequences of the industry funding proposal for registered liquidators which would diminish the proper, competitive operation of the market.

We refer to our previous submissions in relation to the consultation process on the ASIC industry funding and remain deeply concerned that The Treasury and ASIC have not seriously considered the economic and market implications of the proposal on the insolvency profession.

We highlight that we expect that nearly 30 percent of registered liquidators will cease their registration after the implementation of this policy. Indeed, we have direct confirmation of this from members who have confirmed their intention to hand back registrations, restrict career progression of senior staff or exit the profession as a consequence.

Data from our recent ARITA State of the Profession Survey 2017 regarding the impact of the proposed imposition of the ASIC industry funding model on insolvency firms affirms the above and indicates that:

- 67% of firms will be more selective in the types of appointments taken (e.g. reject no or low funded jobs)
- 24% of firms will reduce their number of registered liquidators
- 13% of firms will reduce their total staff headcount
- 7% of firms will move away from taking formal insolvency appointments.

ASIC appeared to agree with our forecast at the various meetings we have attended about industry funding. It is expected that the vast majority of those who exit will be small practitioners, with a significant number of those in regional areas.

Put simply, this policy will take out the better part of a third of the profession and will dramatically reduce competition. It will also ensure that come the next economic downturn, small, low-cost insolvency providers will have been decimated and services for regional areas will be almost non-existent.

With a shift of this scale, the economy faces the real prospect of a significant increase in zombie companies and the attendant potential for greater exploitation by unscrupulous pre-insolvency advisers and directors engaging in phoenix activity.

We doubt there is another government policy that would have such an appalling impact on a profession as to force nearly a third of its number out of registration where there was absolutely no regard being taken for that impact.

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2 Quantum of cost

These proposals will result in considerable unfairness given the very high cost per liquidator compared to others, similar regulated populations and international comparatives, the duplication, the disregard for work done by liquidators in support of ASIC and the quite limited benefits from the current ASIC supervision.

We are also astounded at what ASIC claims it costs to regulate just 706 registered practitioners; $8.5 million amounts to approximately $12,000 per Registered Liquidator or $850 per insolvency in Australia.

To put that in another context, compare the $850 ASIC regulation cost per insolvency to the $5,000 default cost for undertaking an insolvency under the recently implemented *Insolvency Law Reform Act 2016*.

When you consider the significant amount of legally required work a practitioner must do on every insolvency, compared to what ASIC does, $850 per insolvency is plainly indefensible, especially when you calculate that ASIC has a salary and on-cost of $573,000 per staff member in this division.[1]

We understand and support the concept of industry funding. But, as we have previously highlighted, of ASIC's regulated populations, only registered liquidators act as gatekeepers for ASIC, operate as officers of the court, conduct important investigations on behalf of ASIC and the government and, most significantly, because of the unusual nature of the insolvency profession, are often forced to complete this work for free.

As we have demonstrated in the past, liquidators undertake over $47 million in unfunded work annually on court liquidations alone. The ARITA State of the Profession Survey 2017 indicates that a staggering $70.8 million of unrecovered remuneration was incurred by survey participants in the past 12 months alone. That's over eight times what ASIC claims it costs to regulate the profession.

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[1] We were advised by ASIC that 63% of the Insolvency Team of 13 FTE staff spend time on regulatory activities relating to registered liquidators at a cost of $4.7m of the estimated total of $8.5m.

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3 Ex post nature of proposal

The ex-post nature of the levy will result in creditors being disadvantaged due to the distinct and finite nature of insolvency appointments.

The ex-post nature of the levy will place unreasonable restrictions on the fair and equitable operation of the insolvency profession and removes any ability of practitioners to reasonably budget for the levy.

In effect, the proposal is akin to the Government being able to move the tax rate at the end of an income year and levy a bill, which is immediately payable, based on the amended rate, notwithstanding any reasonable provisioning based on the previous rate.

The unpredictable nature of insolvency appointments would make any reliable estimate of the levy difficult, particularly given:

- The variable amount of regulatory funds ASIC can expend, noting that ARITA has expressed its general concerns about the regulatory approach of ASIC in this sector.
- The ability for the allocation of costs to be impacted by uncontrollable factors such as fluctuations in the number of registered liquidators and any other measures which are used to calculate the levy. For example, the failure of a large corporate group could significantly impact the allocation of costs for the whole profession.

Insolvency appointments are distinct and finite in nature. Registered liquidators do not have enduring client relationships with their ‘clients’ as other ASIC-regulated populations do. Indeed, community and government expect that a liquidator’s engagement will be as short as possible.

The practical implementation of the levy may well result in the payment of dividends in liquidations, where funds are available, being delayed until after the quantum of the levy is known to ensure that any levy directly attributable to the appointment can be recovered prior to the distribution of funds to creditors.

We emphasise that, given the very small regulated population of liquidators, reasonably small shifts in the total budget allocated to ASIC insolvency team can have a profound impact on the costs of individual liquidators, especially those who manage a high volume of appointments. Under an ex-post model they cannot budget or plan for this and may themselves be placed into financial distress, especially if they are a small or regional practice.

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4 Lack of availability of regulations and final model

We believe that contemplation of this legislation without the proposed Regulations and a confirmation of the final recoveries model is unfair and unreasonable.

It does not allow Parliament or affected parties to be able to make a full and proper consideration of the proposal. We strongly believe that all legislative instruments related to this proposal should be considered holistically so that a comprehensive assessment of their economic, social and competition impacts can be considered.

The recent experience with the introduction of the *Insolvency Law Reform Act 2016* reforms bears out this point. The final Insolvency Practice Rules 2016 (IPRs) were made some nine months after the ILRA received Royal Assent.

Since the IPRs were made – only recently in December 2016 – numerous errors and issues have been identified with the way the suite of legislation operates collectively. These issues might have been avoided if consultation had been undertaken on the legislative package as a whole.

5 Other comments

We also highlight that the Exposure Draft of the Explanatory Materials makes reference to administrative actions for the non-payment of the levy for 12 months which may result in the 'suspension of a liquidator's registration by the Inspector-General under section 40-25 of Schedule 2 to the *Corporations Act 2001*' (at 1.107).

This appears to be an error and the reference to the Inspector-General should be a reference to ASIC (section 40-25 of Schedule 2 to the *Bankruptcy Act 1966* provides the Inspector-General with the power to suspend a Registered Trustee).

This error does not impact the draft ASIC Supervisory Cost Recovery Levy (Consequential Amendments) Bill 2017.

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Appendix 1 – ASIC Industry Funding proposals submission: 16 December 2016

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AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

16 December 2016

The Treasury
Langton Crescent
PARKES ACT 2600

ASIC Industry Funding proposals

As the professional body representing close to 90% of Australia's Registered Liquidators, ARITA is profoundly concerned by the ASIC Industry Funding proposals and their impact on the profession and, in turn, on the wider economy.

Our primary concern is that we expect nearly 30% of Registered Liquidators will cease their registration after the implementation of this policy. Indeed, we have direct confirmation of this from members who have reported their intention to hand back registrations, restrict career progression of staff or exit the profession as a consequence. ASIC appears to agree with our forecast at the various meetings we have attended about industry funding. The clear majority of those who will exit will be small practitioners, with a significant number of those in regional areas.

By forcing out the better part of a third of the profession this policy will dramatically reduce competition. It will also ensure that, come the next economic downturn, small, low-cost insolvency providers will have been decimated and services for regional areas will be almost non-existent.

Past feedback not acknowledged

We are deeply disappointed to note that our feedback from the first round of consultation in October 2015 has not been acknowledged or responded to. We, in particular, note that despite being the representative body for close to all Registered Liquidators and lodging significant concerns about the proposal, there is no reference to these issues in Chapter 6 or any proposal to address the concerns raised.

Our previous submission led with '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.' For this not to be addressed in the second round of proposals is a grave oversight.

We further point out that Chapter 6 implies a general acceptance of the proposal. To that end, we draw your attention not just to our submission, but others such as Chartered

ARITA
ACN 002 472 362
Level 5, 33 Erskine Street, Sydney NSW 2000 Australia | GPO Box 4340, Sydney NSW 2001
t +61 2 8004 4344 | e admin@arita.com.au | arita.com.au

Accountants Australia and New Zealand, whose submission indicated clearly that they did 'not support the current proposals, arguing that they would have a detrimental effect on existing Australian business and undermine the Government's broader policy objectives towards supporting a robust business environment.'

Our initial submission was equally direct in stating that 'we consider these proposals will result in considerable unfairness given the very high cost per liquidator compared to other regulated sectors, the duplication, the disregard for work done by liquidators in support of ASIC and the quite limited benefits from the current ASIC supervision'. This statement remains the cornerstone of our submission in this round of consultation.

Registered Liquidators are a unique class amongst ASIC regulated population. Indeed, ASIC's own corporate plan recognises the work that Registered Liquidators do on behalf of ASIC and the Courts when it recognises Registered Liquidators as 'gatekeepers' for ASIC. Our model for corporate insolvency involves Registered Liquidators being officers of the court and for them to undertake investigations into potential corporate crime that surrounds corporate insolvencies.

To that end, the Government outsources work that would otherwise be necessary for ASIC to complete to Registered Liquidators. The significant, but often missed point, is that Registered Liquidators are not remunerated for much of this work. When an insolvent company has no assets remaining, a Registered Liquidator is unlikely to be paid, yet ASIC still requires this work to be done on its behalf and has taken disciplinary action against Registered Liquidators for not doing so.

No other profession or regulated population carries this unreasonable burden. To then be charged additional ASIC fees on the basis of 'industry funding' is, quite simply, inequitable and unreasonable.

ASIC regulatory focus is misdirected

ARITA also gave strong feedback as part of the ASIC Capability Review regarding ASIC's ineffectiveness in properly regulating the insolvency profession. We reject ASIC's current stance of investing significant resources in pursuing Registered Liquidators for minor compliance issues versus effectively pursuing substantive conduct issues, which it purports exist.

ASIC's Public Notices Website and lodgement project has been underway since 2013 to assess whether Registered Liquidators are complying with statutory lodgements and publication requirements. This project was initially intended to be undertaken for a two-year period, but remains underway nearly three years on.

In our view, whilst worthwhile, we question whether this project contributes to confidence in the market by stakeholders to the insolvency process. ASIC have expressed a view that

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'failing to lodge documents or publish notices can cause harm or injustice'.[1] We question the extent of harm when similar lodgements and advertisements are not required in personal insolvency. In fact, a decision was made to remove them some years ago.

As the professional body, we are firmly of the view that Registered Liquidators need to comply with the law. However, we question the extent of the resources that have been dedicated to this project and whether it was an appropriate focus considering the more substantive issues that are currently facing the insolvency profession, including:

- the rise of pre-insolvency advisors,
- increasing difficulties with obtaining director compliance,
- increased phoenixing activity in the lead up to the insolvency appointment,
- asset stripping to deprive the liquidator of funds to conduct their investigation,
- failure to provide books and records to the liquidator.

It is our view that the limited regulator budget should be focused on these substantive misconduct issues that, if managed better, would provide greater confidence in the market as a whole.

Liquidators already subsidise ASIC well beyond the amount suggested to be recovered

We understand and support the concept of 'user pays'. But, as we've pointed out in the past, among ASIC's regulated populations only Registered Liquidators act as a gatekeeper for ASIC, operate as officers of the court, conduct important investigations on behalf of ASIC and the government and, most significantly, because of the unusual nature of the insolvency profession, are forced to often complete this work for free.

As we've demonstrated in the past, liquidators undertake over $47 million in unfunded work annually on court liquidations alone. That's nearly five times what ASIC claims it costs to regulate the profession. In addition, Registered Liquidators are required to pay significant ASIC advertising and search fees on behalf of insolvent entities even when they may not recover that cost. Indeed, we estimate that with the current proposal, Registered Liquidators will be at an average $1,200 loss on each job in ASIC-related fees from the outset of an appointment.

Quantum for recovery is excessive

We are also astounded at what ASIC claims it costs to regulate just 710 people - $8.5 million is $12,000 per Registered Liquidator $850 per insolvency in Australia. To put that in another context, compare the $850 regulatory cost to the $5,000 default cost for undertaking an insolvency under the Government's recent *Insolvency Law Reform Act*.

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[1] Australian Insolvency Journal, March 2005

Given the significant legally-required work that a practitioner has to do on an insolvency compared to what ASIC actually undertakes, $850 per insolvency is plainly indefensible, especially when you calculate that ASIC has a salary and on-cost of around $573,000 per staff member in this division.[2]

Any metric must provide certainty

The proposals are deeply flawed in that it may be 20 months after taking an appointment before a Registered Liquidator knows the cost they may have to bear. It is simply not possible to run a commercial enterprise with that level of uncertainty. Just as AFSA does, if a levy of any type is to be introduced, ASIC must provide a locked-in fee for at least the year ahead that Registered Liquidators can forward budget for. Any matters of variability of recovery must be managed by ASIC's budgeting.

The importance of this is underscored by the lack of certainty that liquidators have as to what ASIC's budget for regulation of the profession will be year-to-year, and that it may vary dramatically, without notice and without recourse. Further, ASIC cannot be certain of the market metrics on which the calculations are even made, let alone the quantum to be recovered. This transfers unreasonable business risk onto Registered Liquidators.

The likely dramatic exit of some 200 Registered Liquidators will also radically shift the metric. Again, there is no way that other Registered Liquidators can budget for this type of shift in the proposed model.

Anti-competitive and destructive to small and regional businesses

We have already flagged the expected departure of up to a third of Registered Liquidators. Such a scale of reduction in competition would be unprecedented. This is directly contrary to the intent of the recent *Insolvency Law Reform Act*, which was to increase competition.

Small insolvency firms will be the least likely to be able to absorb these costs and are most at risk. Small insolvency firms provide a vital service, at an affordable price point to distressed small and micro businesses. These small firms are also typically found in regional areas. The removal of the already limited number of regional insolvency service providers will cause significant harm to regional business communities and their economies.

Unnecessary duplication and cost

The regulation of insolvency practitioners is already duplicated across two government agencies: ASIC and AFSA. Additionally, insolvency practitioners are subject to globally respected self-regulation, self-funded by professional association members.

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[2] We were advised by ASIC that 63% of the Insolvency Team of 13 FTE staff spend time on regulatory activities relating to Registered Liquidators at a cost of $4.7m of the estimated total of $8.5m.

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This duplication of regulation is grossly inefficient and costly to the community. If Registered Liquidators are to be asked to fund regulation, they should not be burdened with clearly unnecessary and inappropriate duplication of infrastructure.

ASIC should be focussed on the root cause of misconduct around insolvency, namely director misconduct and the facilitation of that misconduct by pre-insolvency advisors, rather than on liquidators. Relieving ASIC of its oversight of liquidators by creating a single regulator for practitioners would allow ASIC to have this proper focus.

Registered Liquidators need to be treated differently

It is apparent from our above comments, from our first submission and from the detailed answers to the questions posed in this round, that the proposed model will not just fail the profession but it will fail the wider economy.

Further, the impact of the policy will run counter to other Government policies that encourage competition, small business and regional services. The cornerstone of our contention is that not only do Registered Liquidators already carry more than their fair share of ASIC's costs but that the quantum ASIC seeks to recover reflects an inefficient and ineffective approach to the regulation of insolvency generally, and liquidators in particular, which will only be further encouraged by this funding model.

Yours sincerely

John Winter
Chief Executive Officer

ARITA

Key points of concern in the proposal:

- The model proposed will be injurious to the Australian financial system and the economy.
- Registered Liquidators already contribute significantly by completing unfunded work, a large portion of which is on behalf of ASIC. If this were an equitable 'user pays' system, ASIC would need to compensate Registered Liquidators for this work as an offset.
- Registered Liquidators are already forced to pay for ASIC search and advertising fees even when they may not have funding in an appointment.
- Quantum is too high – $8.5 million for only 720 liquidators or around $800 per appointment.
- Regulation is not correctly focused – should be focussed on director misconduct and pre-insolvency advisors.
- The fee includes costs which are not 'created' by Registered Liquidators.
- The assessment of the fee is retrospective – doesn't allow for financial certainty for liquidators. Liquidators may not know the actual cost for up to 20 months after an appointment is taken.
- The final fee is uncertain due to change in quantum, metrics and the small number of Registered Liquidators (ASIC can change its budget for liquidator programs at any time).
- Liquidators cannot budget effectively for the fee.
- Likely not tax deductible.
- The high cost will force many liquidators to give up their registration – in regional areas, small practitioners starting out, and practitioners not working full time in insolvency.
- The high cost will act as a disincentive to new practitioners entering the profession.
- The proposal will go against the intent of the Insolvency Law Reform Act 2016 which was to increase competition and reduce the cost of insolvencies.
- Impact will most strongly be felt in small and regional practices which is likely to leave some areas poorly serviced by insolvency professionals.
- There is a clear duplication of services in the separate regulation of personal and corporate insolvency, with both ASIC and AFSA providing similar regulatory services to largely overlapping populations. Liquidators and trustees should not be asked to bear the cost of this inefficient duplication.

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Response to direct questions in the consultation paper:

Question 1

Do you agree with the proposal that all of ASIC's regulatory costs should be included in the industry funding model, excluding ASIC's registry costs and criminal prosecutions incurred by the DPP? If not, please describe your preferred approach and reasons for it.

No, we do not agree.

We have concerns that some costs that are being allocated are not 'created' by the regulated population (e.g. financial literacy, refer page 7).

We understand that the operation of ASIC's MoneySmart website is also to be included, along with the cost of responding to complaints about Registered Liquidator where an educative outcome for the complainant is required rather than misconduct of the liquidator (72% of all complaints against Registered Liquidators in the 2015 calendar year). Such costs should be borne by the public/government and not by the regulated population.

The Proposals Paper is not clear on where the cost of the Assetless Administration Fund (AAF) will be attributed. The AAF and its administration is not a cost 'created' by Registered Liquidators and should not be recoverable from them.

Question 2

Will the proposed model design objectives ensure consistency of approach to setting levies and fees across ASIC's regulated population? Are there other objectives that should be considered? If so, why?

No, it does not.

The model fails to consider the economic impact on insolvency practitioners, especially those in regional and small practices

Regulatory charges are required to be set to avoid volatility, but the retrospective nature of the model is inherently volatile for Registered Liquidators:

- Although an estimate is provided, there is no certainty that this will be the final cost of ASIC's regulation for the year.
- It's a small regulated population, so any change in cost or a metric will result in a substantial shift in the charge.
- There is uncertainty over the amount that will be spent by ASIC regulating Registered Liquidators and any change will have a substantial impact that cannot be anticipated.
- Registered Liquidators have little control over the number of appointments they are asked to consent to in a financial year, even if the total number of insolvencies remain relatively consistent year on year.
- If the metric changes to a realisations basis, Registered Liquidators have no ability to estimate their realisations in a particular year and thus cannot budget for this expenditure.

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- The fees will encourage Registered Liquidators to cancel their registration (ARITA estimates that up to 200 practitioners will cancel their registration), resulting in a potential 38% increase in the user pays fee per Registered Liquidator.

The model is deeply disproportionate for Registered Liquidators in comparison to other comparable regulated professions (e.g. auditors). It's also much higher than in comparable international jurisdictions which will make Australia less internationally competitive.

We fundamentally disagree that there is a controllable nexus between the volume of public complaints and the behaviour of Registered Liquidators. The adversarial nature of insolvency work and its extraordinary legal complexity mean that the vast volume of complaints in insolvency come in against Registered Liquidators who have performed exactly what is required of them.

The framework is meant to provide for individuals or organisations that 'create' the demand for a government's activity to meet that cost. On this basis, it is not reasonable for Registered Liquidators to pay for ASIC's management of these 'complaints' when the Registered Liquidator did not reasonably cause them.

We do not believe that it is reasonable for Registered Liquidators who properly perform their duties to be burdened by enforcement costs against the small group who do not. These properly performing liquidators have no control over the poor behaviour of a few.

Actual enforcement costs should be recovered by way of fines and costs against those who are prosecuted. As an industry, the majority of insolvency professionals already choose to make a substantial investment in enhancing professional standards by electing to join ARITA and subscribing to the Code of Professional Practice and to undertake the requisite compulsory professional development each year.

Further, **the failure to prevent poor quality Registered Liquidators obtaining their initial registration is the fault of ASIC**. Inadequate controls have been in place for many years with almost no barriers to entry, notwithstanding that ARITA has been requesting improvements to the registration process for close to 14 years.

This is not the fault of the wider profession, and accordingly, the wider profession should not be held accountable for the failings of the regulator.

We understand that the fee is not likely to be tax deductible which will multiply the detrimental effect on Registered Liquidators.

Questions 3 & 4

3: Do you agree with the proposed model for calculating levies? Is there an alternate approach you would prefer? If so, please explain why.

4: Do you agree with the proposed definitions for industry subsectors and levy metrics at Schedule 1? Is there an alternative approach you would prefer? If so, please explain why.

No, we do not agree with the proposed model.

The proposed calculation model fails to allow Registered Liquidators to conduct their business with any financial certainty. This is a fundamental violation of Model Design Objective 2: 'Certain'.

If fees are to be levied, they should be on forward projected basis to allow Registered Liquidators to not only recover those fees as part of administrations under way (i.e. as a fee to be levied per appointment). This would also allow them to more reasonably manage for the cost of the significant annual fees (not directly recoverable).

We expect volatility in the current model due to the uncertainty over the metric (whether number of appointments or realisations or any other basis), expected reduction in the number of liquidators and uncertainty as to the quantum of ASIC's final annual costs.

This volatility is unavoidable if the current model of charging actual costs eight months after the end of the relevant financial year is maintained – changing the metric will not overcome this fundamental flaw.

The model should be the same as AFSA where an accurate estimate of a percentage of realisations is determined in advance of the start of a relevant year.

ASIC and Treasury should have sufficient data to be able to forward forecast insolvency activity (given the vast amount of data they collect from Registered Liquidators). 'Smoothing' to obtain the stated goal of not creating systematic over- or under-recovery of costs over time, should be reasonably achievable even on a forward projected basis.

If the charge is to be a fee per appointment, it must be certain so that it can be charged at the time of appointment to enable direct recovery from the estate as a cost of the administration.

No matter the metric, any delay in the determination of the fee will create significant budgetary impacts on insolvency firms and may result in delays to the conclusion of formal appointments to align with the date the fee is determined, so that it may be recovered from that administration prior to final distributions (if any).

The term 'Principal Appointee' in Table 4 is contrary to the intentions and actual legislation within the Corporations Act. Where an appointment is joint and several, one appointee is not able to be deemed as more responsible than the other.

Fees must be able to be passed through to appointments otherwise Registered Liquidators will be placed at substantial financial risk.

If the fee is to be a fee per appointment, the metric does not recognise that that a **significant number of these appointments are assetless** and on acceptance of the appointment the Registered Liquidator will immediately be an estimated $550 out of pocket (plus costs of advertising and search fees which are also paid to ASIC).

This may have the unintended consequence of distorting the insolvency market and reducing the pool of liquidators able to take these appointments or result in the cost having to be met upfront by the person requesting the appointment (directors or petitioning creditor).

Questions 5 & 6

5: Do you agree with the proposed timeline for the annual reporting? Are there any reasons as to why the suggested timelines may not work for your organisation's business cycle?

6: Do you agree with the proposed engagement and accountability measures? Are there additional measures you would prefer? If so, please explain why.

We do not agree with the proposed timeline for annual reporting.

A retrospective determination of a fee up to 20 months after the relevant event (in the event of Registered Liquidators up to 20 months after the acceptance of an appointment) will not allow Registered Liquidators to conduct their business with any certainty.

Insufficient information has been provided to understand how Registered Liquidators require $8.5 million in regulation. Despite repeated requests no proper cost breakdowns have been provided. This is at complete odds with the standards of transparency and accountability that ASIC demands of Registered Liquidators.

The proposed Dashboard Reporting provides insufficient detail to satisfy the requirements of transparency and accountability.

There is no incentive for ASIC to efficiently undertake their regulatory activities. There is no incentive for ASIC to ever seek to reduce costs for the regulation of Registered Liquidators nor any mechanism to ensure the regulatory service is being provided in a commercially competitive and cost-efficient fashion.

There is no restriction on unconstrained escalation of regulatory costs. There may be a significant incentive to continue to allow ASIC to increase its enforcement costs, given there is no budgetary impact on any current or future government.

Question 7

Do you have any preliminary comments on the legislative arrangements?

No.

Question 8

Do you have any comments on the proposed implementation timetable? Please provide details of any concerns.

If a per appointment fee is to be levied, Registered Liquidators already provide this information to ASIC via a Form 505. Liquidators should not be required to resubmit this information as part of the industry funding model. This is an unnecessary red-tape burden.

Question 9

What do you estimate the regulatory cost of complying with the new requirements in the model to be? In order to answer this, you may wish to consider information such as the following:

- **How many hours will it take to train relevant staff about the new compliance requirements?**
- **How many hours will it take to implement / update systems to ensure compliance?**
- **Will you need to procure professional advice or services to comply with the model? What is your estimate of the total cost of this procurement?**

- **How many hours will it take for relevant staff to evaluate and plan for the new regulatory requirements?**
- **How many hours will it take for staff to assemble and report any information required?**
- **What is the estimated total labour cost of these activities?**

Please only consider the cost of additional activities, beyond compliance activities that you currently perform. Please do not include the costs of levies and fees to be paid or opportunity costs in answer to this question. We seek this feedback elsewhere.

Registered Liquidators already provide ASIC with all the data needed to assess any user pays funding on a per appointment basis. Registered Liquidators should not be subjected to any process or costs of duplication.

If a realisations basis is to be applied, the information will be reported to ASIC via the Form 524 receipts and payments, which is a document already submitted to ASIC on all insolvency appointments.

Questions 10–13

10: Do you agree with the proposed business activity metrics and subsector groupings for calculating levies? If not, please outline you preferred approach and reasons for this preference.

11: Which levy metrics are available within your business? And which are you currently reporting?

Specific sector questions:

12: For the public company (listed, disclosing) levy, do you agree that the levy should apply to foreign companies listed on a domestic exchange and stapled securities? Is there an alternate approach you would prefer for levying this subsector? If so please explain why, ensuring that any proposed alternative is consistent with the model design objectives.

13: For Registered Liquidators, do you agree the levy should include a graduated component based on number of external administration appointments? Or do you support, once accurate data is available, that the levy be based on the assets realised throughout the period? Is there an alternate approach you would prefer for levying this subsector? If so, please explain why, ensuring that any proposed alternative is consistent with the model design objectives.

We do not agree with the metrics.

The proper beneficiaries of regulation of insolvency practitioners are creditors and therefore levies should be recovered via a small ($4.23) additional charge on each annual company return.

Alternatively, every company should be required to make a new annual solvency statement to ASIC (a formal return to ASIC as opposed to the normal directors' resolution) and there should be a small fee associated with this. The lodgement of such a statement has many benefits beyond the collection of a fee, including focusing director's attention on the issue of solvency and providing readily available information to a liquidator in the event of a subsequent insolvency.

ARITA

If liquidators are to be levied, our preferred model is a percentage of funds available to pay a dividend rather than assets realised. This is the model used in Canada.

It would work in a similar way to the realisations basis discussed in the proposal paper, except that it ensures that other key payment obligations are made prior to calculating the basis for any fee. Again, this fee must be able to be passed through to the appointment. This model is:

- clear and easy to understand
- closely linked to the specific activity
- can be set to recover the full efficient costs of the specific activity with any over- or under-charging smoothed in following years
- efficient to determine, collect and enforce as the information is already collected and reported to ASIC. Plus, a similar model is used by AFSA and is readily understood and accepted by the market.
- smoothing from year to year enables it to be set to avoid volatility and maintain flexibility.

An alternative, though less desirable, model is on an asset realisations basis where the percentage is set in advance at the beginning of the relevant financial year. This model is currently applied by AFSA in relation to registered trustees and has the same benefits as set out for a dividend-based fee above.

There are too many timing and uncertainty issues around any model where the charges are determined retrospectively. Charges must be set in advance before the commencement of the relevant financial year. Any adjustments for over- or under-recovery can be made in subsequent financial years.

ARITA

Summary of additional issues

- The regulation of insolvency practitioners is already duplicated across two government agencies: ASIC and AFSA. Additionally, insolvency practitioners are subject to globally respected self-regulation, self-funded by professional association members.
- This duplication of regulation is grossly inefficient and costly to the community. If Registered Liquidators are to be asked to fund regulation, they should not be burdened with clearly unnecessary and inappropriate duplication of infrastructure.
- The quantum of $8.5 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, namely director misconduct and the facilitation of that misconduct by pre-insolvency advisors, rather than on liquidators. Relieving ASIC of its oversight of liquidators by creating a single regulator for practitioners would allow ASIC to have this proper focus.
- The proposed model for RLs 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 done 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 areas and small practices.
- The proper beneficiaries of regulation of insolvency practitioners are creditors. Therefore, levies should be recovered via a small ($4.23) additional charge on each annual company return or, on a new annual solvency statement.
- There is a substantial lack of impact and economic modelling in the proposal for each of the models proposed.

Appendix 2 - Proposed Industry Funding Model for the Australian Securities and Investments Commission: 9 October 2015

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.

ARITA
ACN 002 472 362
Level 5, 33 Erskine Street, Sydney NSW 2000 Australia | GPO Box 4340, Sydney NSW 2001
t +61 2 8004 4344 | f +61 2 8006 5540 | e admin@arita.com.au | arita.com.au

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

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[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

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[5] See Table 1 below

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

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[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

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

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

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

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.

ARITA

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.

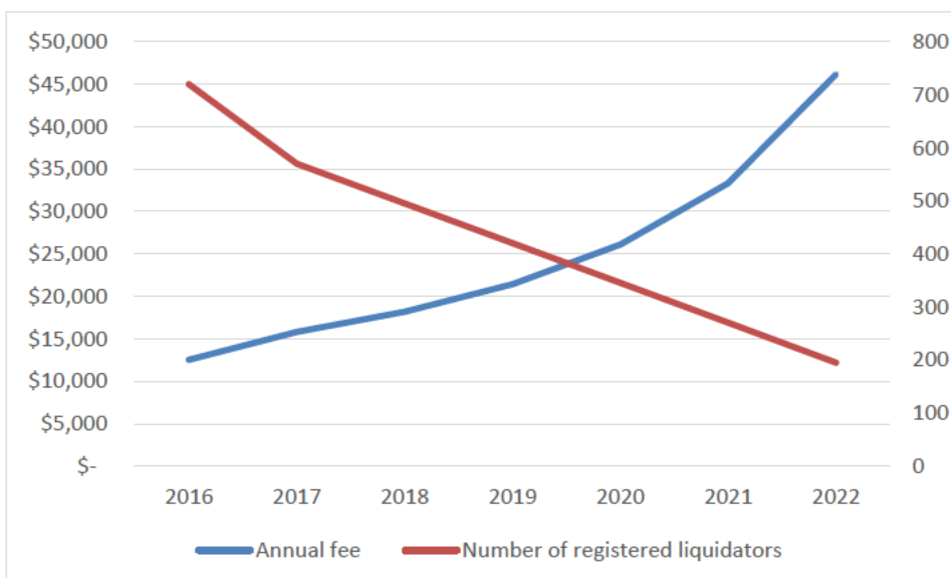
The Consultation Paper proposes three alternate models. As mentioned previously, it is ARITA's contention that all three models are flawed.

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 directors	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 liquidators	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**