



25 October 2017

Australian Securities and Investments Commission
By email policy.submissions@asic.gov.au

Dear Sir/Madam

**ASIC SUPERVISORY COST RECOVERY LEVY
COST RECOVERY IMPLEMENTATION STATEMENT (CRIS)**

I attach my firm's submission on the CRIS.

As is pointed out in the CRIS, there has been significant consultation in relation to the ASIC industry funding proposal. Our industry body, ARITA, has participated extensively in this process both by way of submissions and by attendance at various round table discussions. Throughout this process substantive concerns were raised by ARITA and these concerns remain unaddressed. These concerns principally related to unintended consequences of the cost of the recovery model on what is a small regulated population.

The information provided in the CRIS has further consolidated our concerns with a significant (approximately 20%) increase in the costs to be recovered from registered liquidators since the consultation period. This means that the average recovery from a registered liquidator has increased from \$12,000 to \$14,350 in just one year. This is a significant increase over what ARITA were told during the consultation process.

Executive Summary

Our submission identifies the following issues in relation to the CRIS:

1. While registered liquidators have experienced a \$1.7 million (20%) increase in their levy, the companies levy (listed, unlisted public, large proprietary and small proprietary companies) has decreased by \$10.6 million (16%). This seems contradictory considering the significant number of offences reported by liquidators in relation to director misconduct and the government focus on illegal phoenix activity, which, when it occurs, is a breach of director's duties. The CRIS provides no commentary on the reasons for these changes.
2. The levy applied to registered liquidators is disproportionate when compared to any other fees levied on individuals under the model. Each registered liquidator bears an average cost of \$14,350 which is well in excess of any other levy on an individual. All other large levies are imposed on businesses. Globally there is no other jurisdiction with regulatory costs this high for our profession.
3. ASIC's expenditure on IT support, operations support and property and corporate services appears high in light of the size of the department. As regulated populations are unable to directly influence ASIC's overhead expenditure and thus the amount levied (for example, by reducing the need for regulatory oversight), regulated populations would expect that overhead expenditure be maintained at reasonable levels.
4. The reporting provided in the CRIS provides insufficient information for the regulated population to understand what activities have been included in the budgeted costs to regulate registered liquidators. This makes it difficult for regulated populations to provide accurate feedback during the consultation



process. We recommend that ASIC's levy each year is subject to an independent audit and report to stakeholders to verify that the levy charged to each regulated population is appropriate and complies with the statutory requirements.

5. The ASIC sourced revenue amount does not appear high enough to include an offset for revenue from registered liquidator notices included on the Public Notices Website (PNW).
6. Will the increase in the levy by 20% (\$1.7 million) mean that there needs to be an update to the estimated cost per notifiable event? This has been currently set at \$110 per event for registered liquidators. A 20% increase would mean this cost may now need to be \$132.

Please contact me with any issues.

Yours faithfully

A handwritten signature in black ink, appearing to read "David Levi".

David Levi

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1 Changes in levy allocation

While registered liquidators have experienced a \$1.7 million (20%) increase in their levy, the companies levy (listed, unlisted public, large proprietary and small proprietary companies) has decreased by \$10.6 million (16%). This seems contradictory considering the significant number of offences reported by liquidators in relation to director misconduct and the government focus on illegal phoenix activity, which, when it occurs, is a breach of director's duties. The CRIS provides no commentary on the reasons for these changes.

We also note that this represents a significant shift in the percentages proposed to be cost recovered from the subsectors of the corporate sector as set out in the consultation paper:

Subsectors	Consultation	CRIS
Corporate	83%	78%
Audit	6%	8%
Insolvency	11%	14%

According to ASIC Annual Report for 2015/16, only 3% of misconduct reports received by ASIC relate to insolvency practitioner misconduct, but 40% related to corporations and corporate governance. This equates to misconduct reports against liquidators being only 7.15% of complaints in relation to the Corporate sector, though liquidators have now been allocated 14% of the budget.

One of the most important tasks undertaken by a registered liquidator is the investigation of the company and the reporting of any offences to ASIC. ASIC's Annual Report 2015/16 reported that liquidators lodged 9,951 reports with 8,258 alleging misconduct. Of those, following supplementary reports, only 129 reports (1.5% of the reports alleging misconduct) were referred for compliance, investigation or surveillance.

In ASIC's most recent report on external administrators' reports (July 2015 to June 2016: Report 507), ASIC reported that registered liquidators lodged 9,465 reports under ss533, 422 or 438D of the Corporations Act.¹

In those reports, the following levels of misconduct were reported against directors:

- Possible misconduct in 7,797 (82.4%) reports
- Insolvent trading (5,736 or 61% of reports) and of these 1,118 (19.5%) were claims for over \$1 million. Six reports alleged a criminal breach involving more than 200 creditors with three of these estimated an insolvent trading claim of \$1 million to \$5 million and two alleged a claim of in excess of \$5 million
- Failure to keep financial records (3,357 or 42% of reports)
- Failure to assist the liquidator (2,684 or 13% of reports)
- Breach of s180 Care and diligence – Directors' and officers' duties (3,636 or 38% of reports).

These allegations of misconduct against company directors are substantive and extensive, with few ending up referred for further consideration.

¹ It is noted that the numbers reported in these reports do not align. No reconciliation of this difference is provided by ASIC.

We have attempted to determine the number of prosecutions of directors that result from liquidator's report of misconduct. However, ASIC does not provide sufficient detail in its enforcement reports to be able to identify the actual director misconduct prosecuted.²

Disproportionate costing

The levy applied to registered liquidators is disproportionate when compared to any other fees levied on individuals under the model. Each registered liquidator bears an average cost of \$14,350 which is well in excess of any other levy on an individual. All other large levies are imposed on businesses. Globally there is no other jurisdiction with regulatory costs this high for our profession.

This levy is going to increase the cost of administering insolvencies which will decrease Australia's competitiveness in the global market. Markets such as Singapore have already made changes to their system to make it a more attractive jurisdiction.

Increased costs in Australia are more likely to result in:

- large administrations moving offshore outside of the regulation of ASIC and the Corporations Act; and
- more companies being dealt with in the pre-insolvency space and then being abandoned.

Abandonment of companies, and potentially hidden phoenixing, is a significant problem identified by leading academics conducting research in this area³.

The significant regulation of insolvency practitioner is unjustified based on ASIC reported data on complaints and enforcement outcomes.

During the 2016 calendar year, ASIC received 401 complaints or enquiries in relation to liquidators. Sixty eight percent of these related to educational matters where the complainant did not understand the insolvency process. Of the balance, 31 (7.7%) were referred to the Insolvency Practitioners team for further action.

The following 12 enforcement outcomes were obtained during 2016⁴:

² For example, refer Report 532 where reporting on corporate governance is reported as follows:

Table 6: Corporate governance—Results by misconduct type

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

³ Professor Helen Anderson, Professor Ian Ramsay and Mr Jasper Hedges, Melbourne Law School, and Professor Michelle Welsh, Monash Business School, Monash University, Phoenix Activity: Recommendation on Detection Disruption and Enforcement, February 2017.

⁴ ASIC Report 532 ASIC regulation of registered liquidator: January to December 2016

- 8 voluntary undertakings⁵
- 1 court application for an inquiry under s536
- 2 enforceable undertakings
- 1 CALDB application

ASIC reports regulatory action on a calendar year basis but reports financial results on a financial year basis which makes the comparison of cost to result difficult. However, based on the information provided in the “Proposed Industry Funding Model for ASIC: Supporting attachment to the Government’s Proposals Paper” of November 2016, ASIC forecast costs of \$43.4 million dollar for enforcement actions for the corporate sector and liquidators were estimated at 11% of this cost. This equates to \$4.775 million dollars or \$398,000 per enforcement outcome.

The cost of taking enforcement action against registered liquidators seems to be disproportionate to the outcomes obtained, particularly considering that:

- 8 of the 12 matters were voluntary undertakings negotiated with the practitioner,
- 4 of those voluntary undertakings involved partners in firms therefore those 4 matters are actually 2, and
- 7 of those voluntary undertakings related to the Public Notices Website project which is straightforward compliance based regulation and not a complex regulatory matter.

The large number of complaints and enquiries that related to educational matters demonstrates the need for greater work by ASIC in educating stakeholders on the insolvency process, what to expect from an insolvency practitioner and their rights. However, this cost is not one that relates to the regulation of registered liquidators and is not a cost that should be recovered from registered liquidators.

Overhead expenditure

ASIC’s expenditure on IT support, operations support and property and corporate services appears high in light of the size of the Insolvency Practitioners team. As regulated populations are unable to directly influence ASIC’s overhead expenditure and thus the amount levied (for example, by reducing the need for regulatory oversight), regulated populations would expect that overhead expenditure be maintained at reasonable levels.

Based on information publicly available from the ASIC website, we have undertaken some basic analysis of the levy proposed to be recovered from registered liquidators.

	ASIC				Insolvency regulation			
	Total \$	IT \$	Operations \$	Property \$m	Total \$	IT \$	Operations \$	Property \$
Cost	264.4m	26.567m	12.996m	34.719m	10.2m	1.292m	0.631m	1.622m
No. of FTE Employee	1,627 ⁶				13 ⁷			
Cost / Employee	162,507	16,328	7,987	21,339	784,615	99,384	48,538	124,769
No. of registered liquidators					711			
Cost per registered liquidator					14,345	1,817	887	2,281

⁵ ASIC Report 532 - 7 VUs for PNW project, 2 VUs reported in Figure 3: Outcomes of formal investigations and enforcement actions, but per Table 4, one of those related to a VU that commenced in 2014

⁶ Pages 106 and 107 of ASIC Annual Report 2015-16

⁷ As advised to ARITA by ASIC during the consultation process at a meeting of 29 September 2016 with representatives from Treasury and ASIC.

As can be seen from this basic analysis, the cost per ASIC FTE employee allocated to the regulation of liquidators is disproportionately high when compared to ASIC as a whole, but no explanation has been provided.

A consideration of the number of complaints against liquidators and the number of enforcement outcomes as discussed previously in this submission, demonstrates that the costs allocated are unwarranted.

Furthermore, each liquidator will be paying over \$5,000 for overheads which they are unable to directly influence.

Transparency and accountability

The reporting provided in the CRIS provides insufficient information for the regulated population to understand what activities have been included in the budgeted costs to regulate registered liquidators. This makes it difficult for regulated populations to provide accurate feedback during the consultation process. We recommend that ASIC's levy each year is subject to an independent audit and report to stakeholders to verify that the levy charged to each regulated population is appropriate and complies with the statutory requirements.

It is inappropriate for ASIC to be determining the levy without independent verification. This is of particular concern due to:

- the material increase (20%) in budgeted costs to be recovered from registered liquidators which has not been explained, and
- the information in the CRIS which indicates that costs unrelated to the registration of registered liquidators has been included (refer point 1 above).

The possible inclusion of costs unrelated to the registration of registered liquidators has been a consistent issue raised by ARITA during the consultation process. The issues we raised have apparently resulted in costs being removed. But our concern is that we cannot be sure that unrelated costs have been removed (particularly considering the large increase for registered liquidators) or that other unrelated costs have been added.

The proposed dash board reporting will also not provide sufficient detail to be able to determine what costs have been allocated. We note that the consultation paper stated that "[t]here would be transparency in how the funding has been spent, the regulatory activities that ASIC has undertaken and the outcomes delivered". The example dashboard provided in the consultation paper does not provide this.

The lack of transparency in what is included in regulatory costs that make up the levy cause us concern that leviable entities will be charged costs unrelated to the regulation of any regulated population, for cost overruns in relation to "chargeable matters" (ie for registration as a liquidator), or that costs will not be appropriately allocated to the correct regulated population.

2 PNW revenue

The ASIC sourced revenue amount does not appear high enough to include an offset for revenue from registered liquidator notices included on the Public Notices Website (PNW).

In correspondence to ARITA of 21 July 2017, ARITA were advised that any fees paid by registered liquidators for notices on the PNW would be offset against the levy. In their letter to ASIC of 10 July 2017, ARITA roughly estimated that this revenue would be in excess of \$430,000.

This revenue does not seem to have been included in the calculation in Table 9.

3 Updated estimates

Will the increase in the levy by 20% (\$1.7 million) mean that there needs to be an update to the estimated cost per notifiable event? This has been currently set at \$110 per event for registered liquidators. A 20% increase would mean this cost may now need to be \$132.

Commentary in Table 59 (page 107) indicates that ASIC will provide an update of any changes to estimates as soon as it become apparent in order to provide as much advance notice as possible.

We are concerned that in conjunction with this substantial levy increase, Australia is also experiencing a significant reduction in the number of insolvency appointments (down 22.6% in the 2016/17 year from 2015/16). This reduction is likely to have a significant effect on the per notifiable event cost.