



ASIC

Australian Securities & Investments Commission

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Mr James Mason
Financial System Division
The Treasury
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Dear Mr Mason

Public submission on law reform to combat illegal phoenixing

ASIC welcomes and strongly supports the Government's law reform proposals to combat illegal phoenix activity. The reforms would further and significantly promote market trust and confidence as well as further protect public finances.

Introductory comments

ASIC participates in the Phoenix Taskforce which contributed to certain of the law reform proposals contained in the Government's consultation.

The underlying methodology of the Phoenix Taskforce involved identifying the points of misconduct along the phoenix pathway and then identifying reforms which might address perceived gaps in the law thereby addressing illegal phoenixing.

A guiding principle of that methodology was the importance of identifying reforms that might curb illegal activity as early as possible on the phoenix pathway so as to reduce the need for enforcement action "downstream". Removing incentive and prevention through reducing opportunity is often a better alternative to investigations and enforcement action after harm has occurred. In addition, the costs of our regulatory work in this area will be recovered in future through ASIC industry levies on companies and registered liquidators and may impact creditors through reduced dividends.

Our comments are limited to those aspects of the reform proposals affecting ASIC's remit under the *Corporations Act 2001*.

Finally, Appendix A of our submission includes a two page summary of our current financial year business plan aimed at combatting illegal phoenix activity together with our recent successes.

Phoenix Hotline

ASIC queries whether the ATO, as the lead agency on the Phoenix Taskforce, should operate the hotline so that it could then disseminate input from the hot line to all taskforce agencies. However, no matter which agency operates the hot line, it must be adequately resourced noting that it involves additional work that is not currently funded.

It is reasonable to expect that the public generally might not appreciate what makes phoenix activity illegal, and contact the phoenix hotline in the hope of recovering debt. The government agency operating the hotline will need to communicate the hotline's purpose of collecting intelligence relating to suspected illegal phoenix activity and, that the hotline cannot provide personal legal advice, financial counselling or debt recovery services to members of the public generally.

Addressing issues with directorships

The ASIC Corporate Register currently records approximately 2.5 million registered Australian companies and 6.5 million officeholders. In 2016/2017, 242000 forms were lodged with ASIC to notify an appointment or cessation of one or more officeholders and 14000 forms were lodged by a director notifying ASIC of the director's resignation.

Law reform opportunities relating to the ASIC Corporate Register should ensure an appropriate balance between facilitating business through efficient and accessible registration, minimising red tape and targeting illegal phoenixing.

In that light, we have the following comments.

Director Identification Number: ASIC notes the initiatives to seek introduction of a Director Identification Number (DIN) separately from the initiatives set out in the consultation paper. Director identification will require a significant change to the ASIC Corporate Register and notifications about directors. A DIN would certainly aid the reform proposals concerning directorships.

Limiting backdating of director appointments and resignations: The purpose of the ASIC Corporate Register is to record notifications lodged with ASIC by a company in a timely manner and to make the information available to the public.

ASIC does not verify the content of notifications lodged with ASIC however, to reduce the risk of unauthorised lodgements, we authenticate notifications by means of a unique Corporate Key number issued only to the company.

Failure to notify ASIC in a timely manner of the appointment or resignation of a director is a strict liability offence and a statutory fee¹ applies to the late lodgement. A copy of the notice submitted by a company to ASIC is publicly available and it sets out the date of appointment or resignation and the date of signing the notice. Regulatory agencies may use the lodged forms as evidence in actions relating to corporate misconduct.

¹ The current late fees are \$78 if the notification is within 1 month and \$323 if the notification is more than one month after the effective date.

The company and a director may, in some cases, have good reasons for failing to lodge a notification of appointment or resignation within the statutory time requirements. The reasons may relate to an internal dispute involving legal proceedings to determine the correct date of appointment or resignation or the reasons may relate to a person's incapacity to execute the required documents at the relevant time. In addition, our experience is that some small companies have poor administration procedures resulting in the late lodgement of notifications to ASIC.

ASIC's records indicate that a relatively small number of director appointment/resignation notifications are not lodged within the required 28 day period.

Shifting the onus for reporting director resignations generally to the resigning director may impose a regulatory burden on the vast majority of resigning directors and companies which comply with their obligations, without necessarily addressing the backdating issue.

If the onus of notifying ASIC is shifted to the resigning director, further consideration would also need to be given to the authentication mechanism for a resigning director, the evidence required and how to deal with dual notifications - by a company and a resigning director. The *Corporations (Review Fees) Amendment Act 2007* repealed dual notifications to reduce the perceived red tape compliance burden in this area.² Dual notifications would add a new obligation on resigning directors who at all other times have not dealt directly with ASIC.

A risk would also remain that resigning directors and the company will not notify ASIC but simply wait until ASIC deregisters the company for failing to pay its annual review fees.

Other options that might be considered to deal with this issue include:

- provide additional information on a company extract by way of the date ASIC receives the notice of resignation/appointment;
- increase the fee on the late lodgement of director resignations to a more substantial penalty (noting though that the fee may not be paid);
- require approval from a court or other independent party before notification of resignation is lodged with ASIC after a prescribed period has passed.

ASIC notes that the third of these options provides a degree of protection to the market when making decisions about who entities do business with but the first two do not. That is, up until a director lodges the necessary form, the market is entitled to believe the person remains a director.

Abandoned companies

ASIC supports amending the law to militate against misconduct involving sole directors, or where a company has more than one director who simultaneously (or nearly simultaneously) resign, abandoning companies after implementing illegal phoenix transactions where ASIC is left to deregister the company.

To minimise abandoned companies, it may be preferable to align the final director resignation to a voluntary deregistration process which involves the director providing

² Explanatory Memorandum, Corporations (Review Fees) Amendment Bill 2007 (Cth) [2.20].

better information about what happened to the business and its assets and what liabilities, including contingent liabilities, exist. The law could also require the appointment of a liquidator in certain circumstances (such as where the company is associated with High Risk Phoenix Operators (HRPO) or where other indicators of illegal phoenix activity exist – including appointments of so-called, "dummy" or "straw" directors). Also, where a director is a director of a certain number of these types of deregistration or windings up, the law could provide for grounds for banning as a director or even automatic banning. This might also apply where ASIC deems a company abandoned because a director does not lodge the requisite form to update contact details (and ASIC correspondence is returned unanswered).

Consideration may be needed as to whether the proposed reform to deem a 'last person standing' resignation ineffective may encourage unintended behaviour and internal disputes resulting in early director resignations.

Restriction of related party voting

ASIC has previously provided officer level comments to Treasury on this aspect of the proposed reforms.

Appointing liquidators on a cab rank basis

ASIC agrees that *"Appropriate measures to address actual or perceived concerns regarding independence arising from the current referral system for the appointment of external administrators are central to combatting illegal phoenix activity"*³.

The proposed 'cab rank' rule reflects the Phoenix Taskforce guiding principle of reforms identifying and militating against misconduct at the earliest point on the phoenix pathway.

ASIC supports a restricted 'cab rank' rule, that is, a rule applying only to HRPOs where the cab rank utilises registered liquidators. Outside of the rule, the private market appears best placed to undertake the external administration of non-HRPO entities.

The growth in pre-insolvency advisers in recent years, with those advisers forming referral relationships with certain registered liquidators, together with the results of our surveillance and enforcement work, indicates that some advisers and liquidators do facilitate illegal activity including by ensuring little or no scrutiny of pre appointment transactions through proper investigation, recovery action and reporting to ASIC and creditors.

In the period August 2013 to October 2017, ASIC sanctions against registered liquidators show that indicia of illegal activity existed in 19 of those matters. Current surveillance and enforcement work continues to focus on registered liquidators who appear to facilitate illegal phoenixing.

The insolvency profession generally would benefit from a mechanism which removes the ability of HRPO's to appoint a registered liquidator of their choice to wind up companies with which they are associated. It is difficult to imagine a HRPO seeking out a registered liquidator who will not facilitate the HRPO's interests. Our experience suggests this is exactly what they do. The market generally would likely benefit from these proposals in three key ways namely:

³ Page 27, Australian Government, 'Combatting Illegal Phoenixing' consultation paper, September 2017

1. Through disempowering those pre insolvency advisers who promise a director that their "friendly" registered liquidator will exercise wilful blindness, ignoring illegal or other transactions that defeat creditors' interests. A cab rank for HRPOs significantly reduces, or eliminates, the effectiveness of collusion between advisers, directors and registered liquidators ensuring a wholly independent registered liquidator acts in the creditors' interests.
2. Building creditor trust and confidence in registered liquidators through the transparency of an independent registered liquidator acting in circumstances where the controlling mind and associated parties behind the insolvent company is a higher risk to public finances.
3. Creating a real opportunity to reduce the ASIC industry funding levy on registered liquidators and on companies by dealing with illegal phoenixing in a more proactive manner before harm occurs rather than simply relying on enforcement after the event. This would be a direct consequence of removing the opportunity for "friendly" liquidators to wind up companies referred to them directly by a HRPO.

Important issues requiring consideration with key industry participants include setting the mechanism by which:

- a director or adviser can readily identify the relevant company or group as a high risk to the public finances and, therefore, the need to access the cab rank;
- the appointment of an independent, competent and resourced registered liquidator occurs to conduct the external administration; and
- the appointed liquidator is funded to undertake an investigation and report to ASIC and creditors.

ASIC stands ready to contribute further if required.

If you have any queries regarding this submission, please do not hesitate to contact Mr Adrian Brown, Senior Executive Insolvency Practitioners, on (03) 9280 4199.

Yours sincerely



John Price
Commissioner

APPENDIX A



2017–18 ASIC business plan summary Illegal Phoenix Activity (IPA)

Key Projects	Project status	Focus
Stakeholder engagement		
Engage with industry stakeholders to better understand the environment	Ongoing	<ul style="list-style-type: none"> Engage with stakeholders, including individual firms, industry bodies (such as the Australian Restructuring Insolvency and Turnaround Association) and building and construction entities
Engage with other government agencies to identify, deter and prosecute IPA cases and the IPA facilitators	Ongoing	<ul style="list-style-type: none"> Engage with other government agencies such as the Australian Taxation Office and Department of Employment to share information and, identify and respond to IPA Participate in and contribute to the ATO led Phoenix Taskforce, the AFP led Serious Financial Crime Taskforce and the Black Economy Taskforce.
Education		
Educate directors and the public about IPA	Ongoing	<ul style="list-style-type: none"> Contribute to a report on IPA's impact on the Australian economy Communicate with stakeholders (e.g. through media releases, presentations, journal articles, ad-hoc bulletins, regular newsletters), including in relation to surveillance outcomes, to reinforce standards and articulate expectations.
Guidance		
Information for small business, registered liquidators and other stakeholders	New project	<ul style="list-style-type: none"> Issue regulatory guidance about director and company obligations
	Ongoing	<ul style="list-style-type: none"> Improve the information provided in the Report as to Affairs so that Registered Liquidators receive better information about alleged IPA to conduct investigations and report to ASIC.
Surveillance		
Surveillance of high-risk companies	Ongoing	<ul style="list-style-type: none"> Surveillance activity targeting directors of companies in financial distress with a history of involvement in failed companies where indicia of IPA exist.
Surveillance of facilitators (pre-insolvency advisors and registered liquidators)	Ongoing	<ul style="list-style-type: none"> Surveillance activity aimed at disrupting the facilitation of IPA through collusion between advisors, directors, registered agents and registered liquidators.

Key Projects	Project status	Focus
Transactional reviews	Ongoing	<ul style="list-style-type: none"> ◆ Undertake reviews to better understand referral relationships between facilitators and registered liquidators ◆ Undertake reviews of registered liquidator declarations of independence, relevant relationships and indemnities to identify: <ul style="list-style-type: none"> – inappropriate relationships between registered liquidators and pre-insolvency advisers; and – inadequate declarations of relevant relationships.
Joint operational matters with other government agencies	Ongoing	<ul style="list-style-type: none"> ◆ Joint operational matters to assist other government agency programs aimed at IPA, including prosecuting facilitators of IPA and challenging and removing the appointed registered liquidator ◆ Use other agency intelligence, including data analytics and risk profiling to assist identify matters of joint agency interest and manage risks.
Fund registered liquidator action through the Assetless Administration Fund	Ongoing	<ul style="list-style-type: none"> ◆ Fund the investigation of failed companies with few or no assets which raise concerns about IPA.
Enforcement		
Investigate and, where appropriate, initiate administrative or court action	Ongoing	<ul style="list-style-type: none"> ◆ Investigate and take appropriate enforcement action for misconduct by directors and IPA facilitators (including pre-insolvency advisers and registered liquidators).
	Ongoing	<ul style="list-style-type: none"> ◆ Take administrative action to disqualify directors with two or more failed entities from managing companies when warranted.
Administer our Liquidator Assistance Program	Ongoing	<ul style="list-style-type: none"> ◆ Investigate and take action against directors who fail to provide books and records and a Report as to Affairs to enable registered liquidators to investigate IPA.
Policy advice		
Support development and/or implementation of key Government law reforms and other initiatives	New	<ul style="list-style-type: none"> ◆ Contribute to the development of Government law reform to combat IPA.
	Ongoing	<ul style="list-style-type: none"> ◆ Submissions to Government inquiries involving IPA.
		<ul style="list-style-type: none"> ◆ Participate in inter-government agency Phoenix Taskforce.

**ASIC ENFORCEMENT ACTION AGAINST ILLEGAL PHOENIX
ACTIVITY (IPA)
FOR THE PERIOD AUGUST 2013 TO OCTOBER 2017**

Summary of enforcement action against registered liquidators, directors and facilitators that involved, at least as an aspect of, (or where we suspected the behaviour assisted or facilitated), IPA.

Type of enforcement action	Outcomes – August 2013 to October 2017
Court proceedings commenced	2 x registered liquidators (seeking a Court inquiry) Sample of outcomes against directors: 8 x s590 (failure to keep books and records, non-disclosure etc) prosecutions including <ul style="list-style-type: none"> - Matthews – three years jail 1 x IPA prosecution 4 x s184 (directors' duties) prosecutions <ul style="list-style-type: none"> - Wood – imprisoned eight months
Court decisions	5 x registered liquidators (including prohibition, removal, suspension)
CALDB decisions	5 x registered liquidators (including suspension, cancellation or admonishment)
Enforceable undertakings	7 x registered liquidators (including prohibition, quality reviews)
Director banning	In 2016/17, ASIC banned 32 company directors, many of which we suspect were involved in IPA
Liquidator assistance program	In 2016/17, ASIC prosecuted 409 individuals for 723 offences for failure to keep appropriate books and records. This conduct can be a risk indicator for IPA

Ongoing activities include surveillances and investigations focused on (including joint operations with the ATO) directors, advisors and registered liquidators that involve, at least as an aspect of (or where we suspect the behaviour assists or facilitates), IPA. This is in addition to our more general work in disqualifying directors of multiple failed companies and prosecuting people who do not keep appropriate books and records following reports to ASIC from registered liquidators.

The above also does not include our funding of registered liquidators under the Assetless Administration Fund to advance their investigations, and reporting to ASIC, into companies with few or no assets where IPA may be involved.