



17 April 2014

Dr Kathleen Dermody
Committee Secretary
Senate Standing Committees on Economics
Parliament House
Canberra ACT 2600
by email to economics.sen@aph.gov.au

Dear Dr Dermody

Inquiry into the performance of ASIC – risk-scoring

ARITA was called and appeared before the Committee on 2 April 2014.

At the hearing, the Committee raised with us the question of liquidators' reports of offences and breaches of the law to ASIC, under s 533 of the *Corporations Act*, and related sections,¹ to which we now respond. The particular question raised by the Committee was in relation to "risk-scoring" of information in liquidator's reports. This was raised in the context of the many thousands of s 533 reports that are lodged with ASIC each year, only a few of which lead to action against those who committed the relevant offences.

In brief, while ARITA thinks there should necessarily be a risk-scoring process by ASIC in how it assesses these reports for action, it is properly a decision for ASIC, although one on which the profession should be consulted. We also consider that funding arrangements for liquidators to assist ASIC with its regulatory tasks could be reviewed and improved. We also offer some prospect of law reform in order to deal with this issue.

Background

ASIC refers to insolvency practitioners as the "front-line investigators of insolvent corporations" who "contribute to maintaining the integrity of the marketplace and promoting investor and consumer confidence".² This is largely based on the liquidator's obligation under s 533 to investigate offences and report these to ASIC. The same obligation applies to bankruptcy trustees in their reports to AFSA under s 19 of the Bankruptcy Act.

Section 533 essentially requires liquidators to investigate whether offences and breaches of the law have occurred, and if so, to refer the details to ASIC. ASIC may request the liquidator to further investigate and refer further information. The matters referred range from the director's failure to provide a report as to affairs (RATA), insolvent trading, through to fraud and misappropriation of company property. A fifteen page form – Form EX01 – must be completed and lodged by the practitioner. ASIC's Regulatory Guide 16 gives detailed guidance to practitioners on their obligations to investigate and report offences.³

Liquidators are obliged to investigate and refer offences even if there are no funds in the insolvency for their remuneration. Liquidators may apply to ASIC under the Assetless Administration (AA) Fund for further investigations and recovery actions.

¹ Section 422 (receivers) and s 438D (administrators), *Corporations Act*.

² ASIC Regulatory Guide 16 – External administrators: reporting and lodging.

³ The equivalent in bankruptcy is Inspector-General Practice Statement 14, *Referring Offences against the Bankruptcy Act 1966 to the Inspector-General*.



Under s 13 and s 15 of the ASIC Act, ASIC may investigate matters raised in s 533 reports and may take various actions. These include taking enforcement proceedings - civil, criminal or administrative - releasing information to a more appropriate law enforcement agency, or taking no action, and so informing the external administrator.

Risk-scoring

It seems that the question from the Chair of the ASIC Senate inquiry is whether the insolvency profession could assist in developing criteria for risk scoring and use that in statutory s 533 reports to assist ASIC in distinguishing between the very serious breaches from the less so.

ARITA could assist ASIC to determine a risk scoring profile if we were to be consulted. But we consider that the decision on how the information required by s 533 is "risk-scored" for action is ultimately one for the regulator and its decisions and methods should not be publicly disclosed. For one thing, this would appear to give the "green light" to the commission of certain offences that are deemed not serious enough to warrant action by ASIC. Risk-scoring criteria would also need to be fluid and varied as trends indicated by s 533 reports are revealed.

In that respect, we mention that the Productivity Commission is currently examining the performance of regulators, including ASIC, in regard to the compliance costs they impose on business and other regulated entities. Risk based assessments of the regulators are an aspect of the Commission's focus in its Regulator Audit Framework paper.⁴

Funding

We also suggest that, in order to assist ASIC with its regulatory obligations to pursue offences and breaches of the law, that funding be provided to liquidators in order to pursue these. The terms of the AA Fund should be reviewed to accommodate the work required and more fully recognise the expertise of liquidators as the "front-line investigators of insolvent corporations".

A more co-operative approach between ASIC and liquidators should be also be pursued. There are occasions where this does occur in major matters but these are the exception rather than the rule. There will be occasions where ASIC's regulatory interests may diverge in the event of criminal misconduct, where the external administrator's focus will be on recoveries but these issues can be managed.

Further information

We note the submission of Mr P Keenan, who noted that the ANAO found in 2006 that ASIC had processes in place to risk score s 533 reports so as to identify those matters where regulatory action is available and appropriate.⁵ The ANAO made certain recommendations which included that "given the large number of reports received each year that allege offences ... ASIC identify opportunities for increasing the number of statutory reports that are investigated". We do not know of ASIC's response to that and other recommendations. It would assist if we were to know.

Also, our trustee members, who are often also registered liquidators, are required to report offences and breaches of the law to AFSA. AFSA regularly reports on its prosecution outcomes. AFSA itself would have some risk-scoring process whereby it determines what matters are pursued. We do not know but assume that ASIC and AFSA consult on their regulation under their respective laws.

⁴ See www.pc.gov.au See for example Regulator Audit Framework, Box 1 *Risk-based approaches for regulators*.

⁵ See paragraphs 15 and 16 of Audit Report, No 18, 2006-07.



Other approaches

ARITA is in the process of considering law reform ideas for the stream-lining of the insolvencies of SME companies. Based on ASIC's figures for the 2012/13 financial year, 85% of insolvent businesses have assets of \$100,000 or less, around 80% have fewer than 20 employees and over 40% have liabilities of under \$250,000.

In considering law reform, we are taking into account the fact that in the small to medium enterprise insolvencies, much of the investigative and reporting work done by liquidators does not appear to be warranted, or in any event is not actioned, and those issues that are actioned result in minimal outcomes.

We are therefore considering a proposal whereby those 40+% are dealt with largely administratively, without reporting of offences to ASIC. This involves in effect a risk-scoring in relation to these small companies, with provision for further investigation and reporting if circumstances warrant it. Unless the misconduct in these small matters is very serious, the cost benefit assessment of commencing any litigation action either by the liquidator or ASIC is usually prohibitive.

If this large volume of small insolvency matters were addressed administratively, the number of reports lodged would reduce substantially, therefore making the task of identifying the most serious misconduct requiring ASIC action more manageable. Our proposal would serve to reduce the number of report to ASIC by over 4000 annually.

Once we have finalised a position, we will be raising these ideas with the appropriate ministers, government departments and regulators.

Conclusion

In conclusion, ARITA is open to any consultation by ASIC, or AFSA, in relation to the better reporting of offences and breaches of the law. Ultimately, we consider that it is also a matter for law reform to provide a regime that balances the rights of creditors and the need for cost effective administration of corporate failure.

If you have further questions about this, please contact our Legal Director, Mr Michael Murray

Yours sincerely

John Winter
Chief Executive