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Submission for the inquiry into Australian Securities and Investments Commission investigation and enforcement

This submission focuses on ASIC's enforcement of conduct of officers and directors of companies in external administration under Ch 5 of the Corporations Act.

Inadequacy of ASIC enforcement

ASIC's track record on enforcement matters arising from reports to ASIC of alleged misconduct by liquidators, administrators and receivers (hereafter 'liquidators') has been manifestly inadequate for many years. ASIC's annual reports set out information received by ASIC each year from liquidators relating to potential offences that may have been committed in relation to companies that have entered liquidation, voluntary administration or receivership. Each year ASIC receives several thousand reports that set out a range of potential offences, such as breaches of directors' duties, failing to keep books and records, and failing to assist liquidators and failing to provide books and records ('misconduct reports').

ASIC's annual reports note that only a small proportion of these reports (typically 20% or less each year) are actually reviewed and, of those reviewed only a small proportion then generate a request to the liquidator for supplementary information, usually because the books and records of the company are often inadequate or non-existent. Of those reports that are subject to requests for supplementary reports, only a small (less than 20%) are then referred for further investigation. ASIC has recently introduced AI tools to assist with reviewing misconduct reports and this may assist in more reports being scrutinised (at least to some degree), but this will not result in higher levels of enforcement activity because ASIC is refusing to take action where there is little or no evidence, and there is usually little or no evidence in circumstances where the books and records have been destroyed or lost (or likely never kept in the first place) and there is no assets available for the liquidator to use to pursue further action.

For example, in the 2021-2022 ASIC Annual Report, Table 7.2.4 notes that 3,767 reports of liquidators alleged possible misconduct, but that only 332 supplementary reports were provided (while 593 supplementary reports were requested, roughly 16% of total reports alleging misconduct). In 80% of cases where supplementary reports were provided, ASIC noted that there was insufficient evidence to warrant commencing a formal investigation. Only 20% of supplementary reports (remembering these are themselves only a small subset of all misconduct reports each year) were then referred for further investigation (or 66 reports, out of 3,767 total reports). ASIC does not provide further information as to how many of those matters resulted in formal enforcement action and if so what the results of that action were.

These are not isolated statistics. A review of ASIC annual reports available on its website going back to 1998-1999 (the earliest available annual report on the website) shows (on p 37) that ASIC investigated only 1% of statutory reports from liquidators lodged during that financial year. In 2009-2010, the figure was 11% of misconduct reports being subject to requests for supplementary information, which resulted in 251 referrals for further investigation (p 40), but no further information on what proceedings were actually run and what the outcomes were was provided. In 2019-2020, the number of supplementary reports requested from the 7,163 misconduct reports was only 7% (520) and of those, only 23% (or 119) were then referred for further investigation, but again no data is provided as to whether any subsequent action was actually taken.

It is important to note that the reports that are provided by insolvency practitioners will often allege multiple offences having been committed, so the numbers of 6 or 7,000+ reports each year may well involve tens of thousands of potential offences and of all of those matters ASIC refers less

than 10% of reports for further investigation. I suspect that many of these matters end up in the 'small business engagement and compliance' team within ASIC. The activities of this team are something of a black box because small business engagement and compliance matters are not subject to a media release (unlike other enforcement actions), so there is no way of knowing what action (if any) is being taken. ASIC will periodically report on broad categories of civil and criminal actions and director banning and disqualifications in its annual reports and enforcement updates, but these figures are rarely tied to specific sections of the Corporations Act (offences) or to reports from liquidators. Broad figures of total actions and investigations from across ASIC's full regulatory remit are provided. While ASIC is entitled to pick and choose how to allocate its limited enforcement resources across its responsibilities and priorities each year, and no regulator is going to enforce every possible breach of the law, my concern is that ASIC is not accountable for its enforcement activity and it appears to be ignoring tens of thousands of potential breaches every year. As I suggest below, this may mean that we should rethink ASIC's enforcement toolbox and focus more on administrative and automated sanctions rather than focussing so much on costly (and slow) litigation enforcement.

It is impossible to know what ASIC is doing with misconduct reports because ASIC keeps its enforcement reporting at a high level of abstraction so that it is impossible to know which team within ASIC is responsible for that aspect of enforcement. The relationship between the Corporations and Corporate Governance Markets Enforcement Team, the Registered Liquidators, Auditors' and Financial Reporting Team and the Small Business Engagement and Compliance Team is unclear. Are all misconduct report references for further investigation sent to the Markets Enforcement team or are some (such as failing to assist liquidators or provide books and records) dealt with by the Liquidators' Team? If there is a small business company in insolvency, are offences outlined in the misconduct report dealt with by the Small Business Team? The fact that this is not explained in Annual Reports or in the 6 monthly Enforcement and Regulatory Updates demonstrates a lack of transparency and accountability by ASIC. If ASIC is ignoring tens of thousands of potential offences every year then the public is entitled to be made aware of this and questions should be asked about how the regulatory framework (including use of the full range of civil and criminal sanctions) can be made to work more effectively.

ASIC does take action against directors for destroying books and records, but the numbers of enforcement matters on these issues is woefully inadequate to address the endemic problem of systemic non-compliance, based on the sheer volume of misconduct reports each year. Corporate law rules are being broken thousands of times every year and the regulated population knows full well that if they are small company, with no books and records then it will be difficult for the liquidator and ASIC to do anything. This creates a distrust of the rule of law by businesspeople who see company directors breaking the law, often across multiple companies over many years and no action is taken. Anecdotal evidence from discussions with insolvency practitioners reveals that the repeat offenders are well known to liquidators and have been subject to multiple offence referrals, but ASIC sits on its hands and does nothing. Clear and blatant misconduct should be subject to some form of review and action.

Reasons for lack of enforcement

There is a legitimate question as to why ASIC is not more active in acting on misconduct reports? The answer appears to be that ASIC is seriously under-resourced and is significantly over-committed by a regulatory remit that is far too broad for the level of resourcing that ASIC receives. If ASIC has a regulatory remit that is too broad to be handled effectively then it should be broken up and a separate federal enforcement agency should be considered (as discussed in the Banking Royal Commission final report). Another answer may be that ASIC's processes are overly bureaucratic and take far too long to conclude investigations and impose administrative sanctions and/or bring court enforcement action. The law is very complex and for each potential offence involves multiple elements of proof that must be substantiated. Streamlining the penalties and sanctions is sorely needed.

Many of the enforcement activities that ASIC could bring against individuals (such as failing to keep adequate books and records) should be subject to a default automatic disqualification, rather than a months or sometimes years' long enforcement process. My review of ASIC annual reports

over the last 24 years reveals that ASIC brings approximately 211 court enforcement actions each year, and approximately 104 directors are banned or disqualified each year, and this has not changed substantially in that 24 year period despite large increases in funding and large increases in staff resources.[1] This pales in comparison to the experience in the United Kingdom where hundreds of directors are disqualified each year and pre-COVID well over 1,200 directors were disqualified each year.[2]

Inconsistency in reporting

The problems of accountability and transparency of ASIC annual reporting are broader than simply misconduct reporting. A review of ASIC's annual reports over 24 years (1998-2022) reveals a raft of inconsistencies and gaps in reporting on enforcement activities, including changing the way enforcement activities are reported from year to year, such as:

- using whole numbers in some years and percentages in others;
- using different groupings of enforcement activity from year to year;
- grouping investigations with court enforcement in some years but not others;
- including civil criminal and administrative enforcement outcomes in some years but then separating those matters out into separate categories in other years;
- reporting actions commenced in some years but actions concluded in others;
- reporting total court orders obtained in some years but individuals involved in court cases in others; and
- prior year enforcement totals are changed in future annual reports from what appeared in earlier annual reports with the result that enforcement activity appears to be increasing in the current reporting year compared to earlier years.[3]

The transparency and accountability of ASIC has been a problem for more than 20 years. Indeed, I appeared before this committee on 2 April 2014 and made similar comments. ASIC approaches reporting on enforcement activity by focussing on case studies and major actions while failing to report in detail exactly what it is doing each year and making it impossible to track its activities over several years. The inconsistencies in annual reports happen too often to be simply administrative error or oversight. This appears to be a deliberate strategy of obfuscation so that the public is kept in the dark about how little it is that ASIC actually does each year across its various teams. ASIC is able to deflect criticisms of inadequate enforcement action by pointing to total numbers of enforcement actions and litigation success rates above 90%, but without sufficient detail as to what these matters were, the public can't be confident that ASIC is bringing the most important cases or indeed is taking enforcement action in important areas. Broad general statements in annual reports are simply not good enough. The public deserves to know what ASIC is, and importantly isn't, doing each year. Questions need to be asked about why ASIC is not taking more action (even if it is at the lower levels of the enforcement pyramid) arising from misconduct reports each year.

ASIC appears to take a strategy of focussing enforcement activities within particular teams in particular years (based on the actions featured in annual reports) but its core job as an effective regulator has to be more than just focussing on specific areas each year and this should not come at the expense of completely ignoring other areas of misconduct. It may be that such a strategy is aimed at putting on its best face to justify annual increases in budget appropriations, but the lack of clear and consistent data on enforcement has been a problem for decades and needs to be addressed. This further supports the need for a separate civil enforcement agency as suggested by the Banking Royal Commission.

I would also like to draw the Committee's attention to the poor state of ASIC's website, particularly its search portal and the adverse effect that this has on its transparency and accountability. The

[1] Admittedly, in 3 years (98, 99 and 05) there were over 300 court enforcement actions, but in some years (in particular the last 3 years) there were less than 100 court enforcement actions.

[2] https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-monthly-data-tables-202122/commentary-insolvency-service-enforcement-outcomes-202122#director-disqualifications (viewed 27.2.230)

[3] ASIC would likely state that matters have been reclassified under different categories in annual reports, but the fact that this is not explained in the annual reports is most concerning.

ASIC website search engine is unhelpful and, in many cases, useless. It is very difficult to find information on ASIC publications and speeches on particular topics without receiving voluminous results without an appropriate number of filters available (for example, searching by specific section of the Corporations Act or specific regulation of the Corporations Regulations). ASIC's regulatory index is very helpful, and the general information on compliance responsibilities for small business, credit providers, companies seeking fundraising etc are all highly useful. However, trying to find information on what ASIC has done in a particular area is like looking for a needle in a haystack, which again makes it harder to hold ASIC to account on its enforcement track record. ASIC provides links to some media releases in its 6 monthly enforcement reports, but these again are just highlights packages, not an review of all matters in a particular area. We need more and better statistics of exactly what ASIC is doing with its budgetary allocation, because reporting on highlights from the past 12 months is not sufficient. The question is not simply is ASIC doing something, but is ASIC doing what is needed?

Reform is needed

We need clearer rules about exactly what ASIC needs to report on, because changing the reporting description each year is totally inappropriate. Clear and consistent reporting of what matters are investigated (including under what provisions of the law) and what matters are litigated is needed (including tracking litigation from investigation to litigation). ASIC has a tendency, developed over many years, to be bringing the same sort of cases to court each year. There are literally thousands of provisions in the Corporations Act that appear to have never been enforced by ASIC. Relying on inadequate books and records to refuse to bring action is not good enough. ASIC can, and should, do better, or we should consider breaking up ASIC and hiving off its enforcement function to a separate body as raised in the Banking Royal Commission final report.

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