

6 February 2023

Senate Standing Committees on Economics

PO Box 6100

Parliament House

Canberra ACT 2600

via email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Sir/Madam,

### **Australian Securities and Investments Commission investigation and enforcement**

We welcome the Senate Economics References Committee (the committee)'s inquiry into the capacity and capability of the Australian Securities and Investments Commission (ASIC) to undertake proportionate investigation and enforcement action arising from reports of alleged misconduct. ASIC plays an important role in regulating Australia's financial and payments system, investigating misconduct and protecting Australian consumers from malfeasance. However, while investigation of insolvent companies for misconduct and subsequent enforcement action makes up a fraction of ASIC's focus, greater action in this area would benefit small businesses, their creditors, and the broader Australian public. We suggest that ASIC considers recommendations outlined in this submission to support its efficacy in undertaking investigation and enforcement arising from reports of alleged misconduct.

We have consulted with industry experts and insolvency practitioners in preparing this submission. Given the inquiry's focus on reports of alleged misconduct, the primary theme of our submission is to do with insolvency practitioners' reports of misconduct to ASIC. However, we acknowledge that there may also be reports by other interested parties, such as licensees and auditors. We make the following recommendations against the Terms of Reference (ToR):

1. ASIC should be more transparent about its decision-making and automated algorithm in acting on reports of corporate misconduct
2. ASIC should ensure adequate legislative flexibility to adopt a tailored approach to responding to disputes
3. ASIC should consider reducing the reporting requirements of insolvency practitioners in the legislation to ensure reporting prioritises cases which will result in ASIC investigation
4. The Australian Government should consider establishment of a single insolvency regulator
5. ASIC should improve the quality and useability of its data
6. ASIC should play a greater role in encouraging financial acumen among businesses.

### ***The systemic issue with investigation and enforcement of corporate misconduct in Australia***

The recent Parliamentary Joint Committee (PJC) on Corporations and Financial Services' inquiry into corporate insolvency considered the role of government agencies in the corporate insolvency system.<sup>1</sup> Witness statements highlighted concerns with ASIC's decision-making and algorithm in

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<sup>1</sup> PJC on Corporations and Financial Services' inquiry into *Corporate Insolvency in Australia*, September 2022 – May 2023



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acting on insolvency practitioners' reports of suspected illegal director activity. Practitioners are obligated to report possible misconduct to ASIC under the *Corporations Act 2001* (Cth), sections 422, 438D and 533. In 2018-19 (prior to COVID-19), initial external administrators' reports identified nearly 20,000 cases of possible misconduct. This fell to 8,769 in 2021-22, consistent with the fall in corporate insolvencies during COVID-19.<sup>2</sup> ASIC estimates receiving 3,767 initial statutory reports in 2021-22.<sup>3</sup> Of the initial reports received, about 16-19% progress to the supplementary reports stage.<sup>4</sup> The majority receive a 'no further action' automated response within 40 seconds.

In addition to the 81-84% of initial reports that ASIC does not investigate, there have been more than 82,000 voluntary company deregistrations and 65,000 involuntary (ASIC-initiated) deregistrations since 2012 that are not investigated by ASIC.<sup>5</sup> As these companies are not investigated prior to deregistration, it is unclear if and how many are deregistered as a result of misconduct or illegal activity, such as unlawful phoenixing. Latest available data from 2015-16 PricewaterhouseCoopers (PwC) estimates that illegal phoenix activity costs the Australian economy between \$2.85-\$5.13 billion.<sup>6</sup> As such, there needs to be a more sustainable solution to dealing with reports of misconduct and company deregistrations that do not get investigated and result in costs to the small business, its creditors, and the broader economy.

**Recommendation 1. ASIC should be more transparent about its decision-making and automated algorithm in acting on reports of corporate misconduct (ToR item b, c)**

We recommend that ASIC provides greater clarity about how it makes decisions on which reports of misconduct progress to the next stage of investigation. We also recommend that ASIC clarifies how it is mitigating the risk from the 147,000 deregistered companies since 2012 that do not get investigated for potential misconduct or credit owed to creditors. While we understand ASIC's concerns about providing total transparency behind their automated algorithm that filters incoming reports – which may enable malfeasant businesses to avoid ASIC's detection – we are concerned by the number of reports of misconduct that do not see any investigation or enforcement action. We are also concerned about the economic impacts of unchecked misconduct, highlighted in the illegal phoenix activity costs above. A clear understanding of how ASIC decides which reports progress would allow practitioners to target their investigation efforts. This would minimise costs to the businesses and their creditors, and result in greater enforcement action against illegal phoenixing.

**Recommendation 2. ASIC should ensure adequate legislative flexibility to adopt a tailored approach to responding to disputes (ToR item a, b, c, d)**

We recommend that ASIC ensures it has adequate legislative flexibility to adopt a tailored approach in responding to disputes, including availability of operator support where automated support is not appropriate or helpful. We understand that the existing lack of flexibility in legislation is a barrier to ASIC providing customised responses. Legislative flexibility to adopt a tailored approach and provide operator support would enable practitioners to dispute matters of serious misconduct where a report was not progressed to the supplementary reporting stage by

<sup>2</sup> ASIC, *Insolvency Statistics Series 3: External administrator reports*, Series 3.3, table 3.1.4. Note: A single initial statutory report can contain multiple allegations of misconduct.

<sup>3</sup> ASIC, Submission 29 to PJC inquiry into *Corporate Insolvency in Australia*, December 2022, p. 26

<sup>4</sup> ASIC in Proof Committee Hansard: PJC on Corporations and Financial Services, *Corporate Insolvency in Australia*, Day 2, 14 December 2022, p. 65

<sup>5</sup> Murray-Harris, Submission 18 to PJC inquiry into *Corporate Insolvency in Australia*, December 2022, p. 4

<sup>6</sup> PwC, *The Economic Impacts of Potential Illegal Phoenix Activity*, July 2018, p. 29



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ASIC's algorithm. At present, we understand that ASIC's system is not designed for practitioners to escalate particular reports. We have also received complaints from small business owners about their difficulties contacting ASIC to raise disputes. They too would benefit from accessible operator support.

We further recommend legislative reform to enable the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) and other credible dispute resolution agencies to act as 'super-complainants'. This would enable the relevant agencies to substantiate serious complaints to ASIC and trigger its review, allowing the relevant agencies to better assist with serious disputes. We have previously attempted to escalate to ASIC over 1,000 cases received in relation to the Viewble Media investment failure (refer case study below), for ASIC to disrupt the illegal operation and protect further businesses from being affected. The introduction of a super-complainant function would allow ASIC to prioritise these systemic complaints or recurring matters, reducing the detrimental impact on small businesses and the economy.

#### **ASBFEO Case Study: ASIC slow to act to disrupt investment failure**

*Viewble Media operated a business that provided an audio-visual screen (AV screen) to small business owners. The screens were used to display advertisements managed by the Shoppers Network. The Shoppers Network agreed to pay the small businesses an amount equal to required ongoing payments to third party financiers. Business owners commonly stated that they were unaware of this financial arrangement with the third party until the Shoppers Network stopped trading and making the payments. We received over 1,000 cases concerning Viewble Media. We advised ASIC of the matters and referred relevant cases to the Australian Financial Complaints Authority (AFCA) for a determination (noting also that a number of the third-party financiers were not AFCA members). Unfortunately, given the time for action to occur, small businesses were still adversely impacted.<sup>7</sup>*

We continue to recommend the establishment of a Federal Small Business and Codes List (the list) in the Federal Circuit Court of Australia. Among other things, this would enable small businesses to pursue their own commercial interests rather than seeking to rely on regulator-initiated litigation. The list would provide a low-cost alternative for small businesses who experience anti-competitive behaviour to seek redress in a cost effective and timely manner. For more detail, refer ASBFEO submission to the Treasury Laws Amendment (Competition and Consumer Reforms No. 1) Bill 2022 consultation.<sup>8</sup>

#### **Recommendation 3. ASIC should consider reducing the reporting requirements of insolvency practitioners in the legislation to ensure reporting prioritises cases which will result in ASIC investigation (ToR item b, c)**

We are concerned by the significant number of reports of potential misconduct that do not get investigated or enforced by ASIC. In the absence of greater resourcing for ASIC to investigate the full quantity of reports of misconduct, we recommend that ASIC considers amending requirements in the *Corporations Act 2001* (Cth) (the Act), Insolvency Practice Rules (Corporations) 2016 and Regulatory Guide 16. The Act places a legislative requirement on insolvency practitioners to investigate insolvent companies and directors for possible misconduct and report these to ASIC (sections 422, 438D and 533). The Act does not specify precisely what information is to be included

<sup>7</sup> ASIC, 22-191MR ASIC disqualifies former Viewble Media director for four years, 26 July 2022

<sup>8</sup> ASBFEO in Treasury's Treasury Laws Amendment (Competition and Consumer Reforms No. 1) Bill 2022: More competition, better prices consultation, August 2022



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in a report of possible misconduct, instead stating that practitioners “must give ASIC such information, and such access to facilities for inspecting and taking copies of documents, as ASIC requires”. This instruction does not provide sufficient clarity for compliance, potentially leading to over-investigation or over-reporting of companies. We recognise that the investigation of corporate misconduct is vital to Australia’s economy, however over 81% reports of potential misconduct never get investigated by ASIC. Practitioners’ investigations cost time and money – costs which are passed to the business owner and creditors. Amending and clarifying the legislative requirements for reporting to focus on the more material matters with greater returns, or matters with most severe misconduct, would likely result in fewer reports to ASIC. This would enable ASIC to focus its resources on matters of more significant misconduct. A compliance system that is simple to understand and execute is a simpler system with which to comply.

**Recommendation 4. The Australian Government should consider establishment of a single insolvency regulator (ToR item c, f, g)**

In our submission to the PJC’s inquiry into corporate insolvency, we recommended establishing a singular corporate and personal insolvency regulator.<sup>9</sup> This regulator would have the powers, resources and expertise to regulate the whole sector. Like the UK’s Official Receiver, this regulator could have a role in conducting basic investigations into corporate misconduct and other matters of public good. The establishment of a single regulator would likely allow practitioners to focus on investigations that result in greater returns to creditors. This solution is sensible because:

- There are close linkages between corporate and personal insolvency for a small business owner, with almost 50% of small business loans secured by personal assets such as the family home and 40.8% of bankruptcies business-related.<sup>10,11</sup>
- Insolvency practitioners often work in both areas of insolvency, but are regulated separately by ASIC (for corporate) and the Australian Financial Security Authority (AFSA) (for personal), which adds to the overlapping regulatory burden
- A singular insolvency regulator for corporate and personal insolvency aligns with international best-practice models such as that of Canada, the UK, the US and Singapore.

In our consultations, most stakeholders supported the suggestion for a singular insolvency regulator, albeit with questions about which regulator is best placed to oversee insolvency. In the absence of greater funding to ASIC to dedicate appropriate attention to insolvency, or legislative reform to reporting requirements, we see this as the next most credible solution. ASIC’s broad remit requires significant resources and may be contributing to its reduced efficacy in investigating and enforcing action against corporate misconduct. A singular insolvency regulator would be able to give appropriate attention to insolvency, while freeing up ASIC resources for other matters under its remit.

**Recommendation 5. ASIC should improve the quality and useability of its data (ToR item d)**

Greater data that is easy to navigate and interpret would help provide transparency behind ASIC’s investigation and enforcement actions arising from reports of alleged misconduct. It would also help academics and policymakers to develop more targeted recommendations on improving Australia’s insolvency system. Specifically, we recommend that ASIC:

<sup>9</sup> ASBFEO, Submission 31 to PJC inquiry into *Corporate Insolvency in Australia*, December 2022, p. 9

<sup>10</sup> *Ibid*

<sup>11</sup> AFSA, *New personal insolvency numbers decrease in December 2022*, 31 January 2023





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- includes data in its insolvency series statistics on the estimated size of the business, extent of phoenixing activity, the outcomes of liquidations, insolvency-related fees per appointment type, and financial positions of deregistered companies (including cause of company failure)
- provides this data in a user-friendly format to assist with interpretation and
- creates a data portal, data inventory or data dictionary to assist ASIC's internal staff and external users to understand their data holdings.

Our consultations and research highlighted concerns with the availability of ASIC's data and its user-friendliness. The insolvency statistics, while helpful, are relatively high level and limited to the number of insolvencies by the type of appointment. This is a missed opportunity for ASIC to broaden the data to include the estimated size of the business in its insolvency series statistics. Currently, ASIC provides this data in some of their annual reports, but it is difficult to find and requires the reader to know their location. Providing this information along with the insolvency statistic series would be more time-efficient and provide a more immediate sense of the condition of the small business landscape, including an understanding of what percentage of insolvency is made up of small business. In addition to data on insolvent business size, it would also be helpful to have data on the extent of phoenixing activity, the outcomes of liquidations (such as returns to creditors), insolvency-related fees per liquidation/restructuring, and financial positions of deregistered companies (including the cause of company failure). We note that practitioners are already obligated to provide ASIC with a lot of this extensive information. Making this information publicly available would benefit research and policymaking.

We welcome ASIC's release of the *Review of small business restructuring process* report on 17 January 2023. We encourage ASIC to continue this series, as it provides valuable insights on the effectiveness of the small business restructuring provisions. This data will be helpful in providing analytics on the effectiveness of the provisions and identifying gaps for policymakers to address. To further support analysis of the small business restructuring process, ASIC should consider including a comparison of outcomes from restructuring versus liquidation in any future reports.

We suggest ASIC considers how to make its data easy to interpret and locate for users with limited expertise in data interpretation or understanding of technical terminology. This may include:

- A data portal with search and filter functions, which would assist users to quickly locate the information they need and
- A data inventory or data dictionary, which would be further helpful in assisting ASIC's internal staff and external users to understand their data holdings.

At present, the data and the guidance on how to interpret the data are difficult to understand or time-intensive to locate. The Office of National Data Commission's *Foundational Four* provides practical guidance for agencies on how they can start improving their data practices.

#### **Recommendation 6. ASIC should play a greater role in encouraging financial acumen among businesses (ToR item b, d)**

We recommend that ASIC plays a greater role in encouraging financial acumen among businesses to help prevent avoidable insolvency. Avoidable insolvency includes instances where the business was wound up due to a poor understanding of director requirements and duties. ASIC data shows that in 2020-21, company failures were caused:

- in 16% of cases, by inadequate cash flow or high cash use

- in 13% of cases, by poor strategic management of business
- in 11% of cases, by poor financial control including lack of records and
- in 4% of cases, by poor management of accounts receivable.<sup>12</sup>

These cases of insolvency could have potentially been avoided by better business planning and awareness. ASIC should consider targeted education for small and family business owners and provide clear and simple guidance on director duties, early signs of insolvency and potential solutions to financial distress.

We consider the National Insolvency Trading Program (NITP) an effective information program and would welcome its reintroduction. ASIC used to run the NITP between 2005-2010. Its goal was to encourage directors to seek professional advice at an early stage to address their company's solvency issues or increase the likelihood of a return to creditors in the event of liquidation.<sup>13</sup> The NITP improved directors' awareness of their duties and provided guidance to help them understand and comply with those duties. Through the NITP, ASIC:

- visited 1,530 companies experiencing financial distress
- improved directors' awareness of their duties and financial management skills, and encouraged them to seek early advice from practitioners
- improved directors' awareness of insolvency options, including the restructuring pathway to save their business.

The NITP, or a NITP-like program, will function as a preventative measure, reducing avoidable insolvencies by improving financial acumen. Alternatively, the Australian Government should consider funding a similar program to ensure small and family businesses have adequate access to appropriate and timely expert advice to support with business planning and development. This could be achieved by establishing a business viability program, as previously recommended by this office, to make it easier for small business owners to access and navigate expert business advice and support.<sup>14</sup> Such a program would provide a viability service to improve businesses' financial acumen, forward planning skills, and understanding of insolvency processes. It would also provide an opportunity to identify cash flow or other problems early and provide tools to remedy them, such as through restructuring, which may avoid an insolvency. This would free up ASIC's investigative and enforcement resources to focus on reports of serious or intentional misconduct. Our consultations showed broad support for this measure.

#### ***Other related matters (ToR item h)***

There have been numerous inquiries and reviews of ASIC over the past eight years, most recently the Financial Regulator Assessment Authority (FRAA) review of ASIC's effectiveness as a regulator.<sup>15</sup> Stakeholders advised our office that many of their recommendations in submissions to previous reviews are still relevant and have not yet been implemented. We suggest the committee considers these recommendations as part of its current inquiry.

<sup>12</sup> ASIC, *Insolvency Statistics Series 3: External administrator reports*, Series 3.1, Table 3.1.3, January 2023

<sup>13</sup> ASIC, *National insolvent trading program report*, Report 213, October 2010, p.4

<sup>14</sup> ASBFEQ, *Quarterly Report: Q1 (January-March) 2022*, p. 11

<sup>15</sup> FRAA, *Scope of assessment of the Australian Securities and Investments Commission* (29 November 2021 – 28 January 2022)



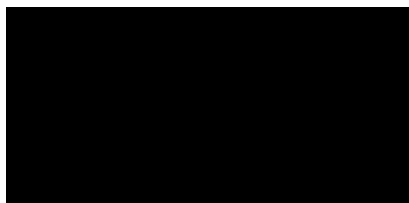
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Thank you for the opportunity to comment. If you would like to discuss this matter further, please contact [REDACTED] on [REDACTED] or at [REDACTED]

Yours sincerely



**The Hon Bruce Billson**

Australian Small Business and Family Enterprise Ombudsman