



**ASIC**

Australian Securities & Investments Commission

# **Productivity Inquiry into business set up, transfer and closure: ASIC's supplementary submission**

July 2015

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## Introduction

- 1 ASIC welcomes the publication of the Productivity Commission's Draft Report: *Business Set-up, Transfer and Closure* (Draft Report) and the opportunity to provide further input into the Productivity Commission's inquiry into the impediments faced by those setting up, transferring or closing businesses in Australia (the Inquiry).
- 2 This submission is ASIC's second public submission to the Inquiry and supplements our first submission. This submission responds to certain draft recommendations and information requests in the Draft Report; specifically, those where, in light of ASIC's experience as Australia's integrated corporate, markets, financial services and consumer credit regulator, we see opportunities to:
  - (a) improve the overall economic efficiency and effectiveness of market operations; and
  - (b) enhance ASIC's ability to deliver on our strategic priorities of:
    - (i) promoting investor and financial consumer trust and confidence;
    - (ii) ensuring fair, orderly and transparent markets; and
    - (iii) providing efficient and accessible registration.
- 3 This submission provides comments on:
  - (a) informal regulatory assistance to facilitate innovative business start-ups;
  - (b) efficient and effective regulation of alternative financing i.e. peer to peer lending and crowd sourced equity funding;
  - (c) the regulation of crypto currencies under the *Corporations Act 2001* (Corporations Act);
  - (d) promoting a rescue culture for financially distressed companies that have some prospect of rehabilitation;
  - (e) safe harbour reforms and the need to protect creditors;
  - (f) the need for appropriate investigations and reporting in a streamlined small liquidation process;
  - (g) the advantages of a director identification number and our concerns about implementation; and
  - (h) an additional option for law reform to deal with illegal phoenix activity.

## A Barriers to business set-up

### Regulation of new and innovative business models

#### Information Request

The Commission seeks participants' views on other regulatory tools available and their merits, such as 'no action' letters, that would provide some regulator discretion around the operation of new business models.

#### ASIC's Innovation Hub

- 4 ASIC's new Innovation Hub is an example of how informal regulatory assistance is another way for regulators to facilitate new and innovative business start-ups (in addition to exemptions and no action positions where relevant).
- 5 The Innovation Hub will make it quicker and easier for innovative start-ups and fintech businesses in Australia to navigate the regulatory system that we administer. ASIC's Innovation Hub initiatives focus on providing support to start-ups and fintech businesses with innovations that have the potential to be ground-breaking and benefit investors and financial consumers.
- 6 ASIC's will provide support to fintech start-ups using Innovation Hub under the following five-point plan:
  - (a) **Engagement:** ASIC will participate in Fintech initiatives and engage directly with the fintech sector e.g. by hosting events relevant to the sector or attending events hosted by industry hubs.
  - (b) **Streamlined processes:** ASIC is exploring how we can streamline ASIC's approach to facilitating business for new innovative business models – for example, by looking to streamline pre-licence and any related waiver application processes, including through the provision of dedicated contacts.
  - (c) **Enhanced accessibility:** Through the Innovation Hub, ASIC is now more accessible to fintech start-up businesses seeking guidance. For example, we are developing a dedicated website, which we hope will evolve to be a one stop shop for innovative businesses to access information and services directly targeted at them. We are also providing informal technical guidance to innovative businesses; this involves senior level assistance early on in the development of these businesses (e.g. by giving an informal steer on relevant regulatory issues).

- (d) **Improved coordination:** ASIC is adopting a coordinated approach to all of ASIC's work on financial innovation including the application of any reforms that may apply to innovative businesses in the future.
- (e) **Advisory Committee:** ASIC is in the process of establishing a Digital Finance Advisory Committee with members from a cross-section of the fintech community to help inform how we focus our efforts in this area.

## Peer to peer lending

### Information Request

Are current regulations around peer-to-peer lending efficient and effective? Are there any barriers – regulatory or otherwise – that restrict the operation and growth of peer-to-peer lending in Australia?

- 7 ASIC supports peer-to-peer lending (P2P) as a developing form of investment (for both retail and wholesale investors) and as a potential source of funding for consumers, small business and start-ups.

### How is peer-to-peer lending regulated?

- 8 There are compliance requirements and some regulatory barriers to entry for P2P operators in Australia. The regulatory requirements under the Corporations Act for P2P will depend on the business model used and whether the P2P lender operates in the wholesale or retail market.
- 9 The P2P models operating in Australia to date have all been structured as a managed investment scheme but P2P could also be offered by transferring debentures issued by the borrowers, in particular where there is lending to corporate business. The regulatory requirements for these respective business models were set out in ASIC's first submission to the Inquiry and in the Draft Report.
- 10 In Australia, we are aware that there are currently two P2P operators to wholesale clients (SocietyOne and ThinCats) and one P2P operator to retail clients (RateSetter).

### Is the regulation efficient and effective?

- 11 Some argue that the current regulatory regime creates a high cost to entry for P2P operators, which lessens their competitiveness with traditional credit lenders. ASIC believes that the regulation of P2P should balance the need to support small business and facilitate innovation with the need to promote investor and financial consumer trust and confidence.

- 12 ASIC believes that P2P lending poses some risks to retail investors that justify a level of consumer and investor protection including:
- (a) **Liquidity:** investors may not appreciate that the investment is typically non-liquid while the money invested is on loan and they cannot withdraw their investment on demand.
  - (b) **Creditworthiness of borrowers:** the concept of creditworthiness and any rating or grading that may be given may provide investors with an inappropriate impression of the quality of the product.
  - (c) **Responsible lending:** there may be challenges in meeting the responsible lending obligations e.g. higher chance of reliance on automated systems to complete inquiries, verification and assessment.
  - (d) **Risk of fraud:** as an on-line business there is arguably greater risk of fraud. There is also the risk of money laundering and other illegal activities being attempted through the P2P platform.
  - (e) **Debentures:** P2P offers involving debentures may significantly increase risks and undermine investor confidence in the P2P model (given the significant losses that retail investors have suffered in the past with debenture offers).

### ASIC assistance

- 13 ASIC will shortly issue an Information Sheet to provide guidance to P2P operators on the existing regulatory requirements they must meet and the risks they must manage.

## Crowd sourced equity funding

### Draft Recommendation 6.1

The Australian Government should introduce a two tiered regulatory structure for crowd-sourced equity funding. The first tier would be directed at those investors determined under the Corporations Act 2001 to be 'sophisticated' or 'professional' and would not restrict possible investment. The second tier would be directed at other less experienced investors and would include a cap on individual investors.

- 14 ASIC has contributed extensively to the CAMAC review of the regulatory settings for crowd sourced equity funding (CSEF) and in February 2015 ASIC made a submission in response to the Government Discussion Paper, *Crowd Sourced Equity Funding*.
- 15 ASIC believes that the regulatory safeguards for CSEF need to take into account the potential risks posed by CSEF and the types of investors who are likely to participate. ASIC therefore supports the recommendation to introduce a two tiered regulatory structure for CSEF.

- 16 We strongly support a cap on the amounts retail investors can invest in CSEF in a 12 month period to safeguard against the risk of a retail investor being overly exposed to CSEF generally or in relation to a particular company.
- 17 We believe that investor caps should not apply to sophisticated investors. Further, if the regulatory regime was to include limitations on the amount that an issuer can raise via CSEF, funds raised from sophisticated investors should not be included when calculating the total funds raised.
- 18 Overall, we consider it important that the CSEF regime should not be seen as an alternative source of funding for companies that traditionally raise funds through regulated fund raising avenues. This could be achieved by limiting the amount raised through CSEF by an issuer in any 12 months period to a low threshold, perhaps \$2m (excluding funds raised from sophisticated investors). If CSEF were used for large well established businesses or businesses that traditionally raise fund through regulated financial markets then the risk of adverse impact on investor confidence in Australian capital markets more broadly may arise. In this regard, we understand that 25% of ASX-listed companies have a market capitalisation of less than \$5million.
- 19 It is also important that intermediaries are effectively regulated and play an oversight role. We also consider that directors of CSEF companies should have some responsibilities, including potential liability for any misleading and deceptive disclosure.
- 20 ASIC's view on these issues is set out in more detail in our public submission in response to the Government Discussion Paper, *Crowd Sourced Equity Funding* included as an attachment to our first submission.

## Crypto-currencies

### Draft Recommendation 9.4

Crypto-currencies, such as Bitcoin, should be treated as a financial supply for GST purposes. This would require that the definition of money be updated to include crypto-currency in both the *A New Tax System (Goods and Services Tax) Act 1999* (Division 195) and relevant GST Regulations.

- 21 In general terms, there are two issues that arise for ASIC in relation to digital currencies:
- (a) **Digital currencies as financial products:** whether digital currencies or facilities associated with those currencies, are financial products that are regulated under the Corporations Act or the *Australian Securities and Investments Commission Act 2001*.

- (b) **Criminal activity:** where digital currencies are being used to facilitate certain types of crime. In this area, ASIC's primary interest relates to financial crime under the legislation we administer, as well as assisting other agencies in their work on other types of crime.

## Digital currencies as financial products

- 22 Draft Recommendation 9.4 does not address whether the categorisation of digital currency as money may be applied to other legislative regimes. The treatment of digital currency as a 'currency' may have an impact on whether contracts for the sale and purchase of digital currency amount to financial products (i.e. foreign exchange contracts).
- 23 It is ASIC's view that digital currencies themselves do not fit within the current legal definitions of a 'financial product'. This means that a person does not need:
- (a) an Australian market licence to operate a digital currency trading platform; and
  - (b) an Australian financial services (AFS) licence in order to:
    - (i) trade in digital currency;
    - (ii) hold a digital currency on behalf of another person;
    - (iii) provide advice in relation to digital currency; and
    - (iv) arrange for others to buy and sell digital currency.
- 24 Contracts for the sale and purchase of digital currencies are typically settled immediately and as a result are unlikely to be financial products (derivatives). However, if there is a delay between the entry of the agreement to sell and the delivery of the digital currency, the contract may be a derivative and the financial services and financial markets regimes would apply in the normal way.
- 25 ASIC has also considered how the law applies to facilities associated with digital currencies. It is our view that some facilities that are developed to enable the use of a digital currency to make payments may be a financial product that is regulated by ASIC (e.g. a bill payment facility utilising digital currencies may be a non cash payment facility), but this will depend on the way the facility works and its particular terms. Some other financial products that are associated with digital currency, such as contracts for difference over bitcoins, are also products that are regulated by ASIC.

## Implications of regulatory change

- 26 ASIC notes that the law could be changed to accommodate digital currencies within existing regulatory regimes—for example by treating digital currencies



in a similar way to national currencies or declaring digital currencies to be 'financial products'.

- 27 Treating digital currencies as financial products may result in a large number of entities being regulated by ASIC and subject to obligations under the Corporations Act (although the number of affected persons is not currently known). However, this is likely to result in practical challenges as there are key conceptual differences between digital currencies and facilities that are currently treated as financial products.

### **ASIC assistance**

- 28 ASIC notes that there are a number of Parliamentary inquiries considering the place of digital currencies within existing regulatory regimes and the broader payments system. ASIC has provided policy advice to Government and the Financial System Inquiry in relation to bitcoins and other digital currencies.
- 29 ASIC has also responded to requests for guidance from industry participants, as well as preparing more general information on the risks associated with digital currencies for consumers on our MoneySmart website.

## B Barriers to business transfer and closure

- 30 ASIC supports the Productivity Commission's aims of seeking reform to Australia's insolvency system to improve the effectiveness of corporate restructure options and ensure that winding up processes are as efficient as possible.
- 31 ASIC is generally supportive of the draft recommendations for the implementation of these aims set out in the Draft Paper. However, we would be concerned if reforms were introduced at the expense of liquidators properly performing their function as gatekeepers in the financial system. Liquidators play an important role in promoting a fair and efficient market and ensuring investors and creditors are confident and informed. They do this by meeting the high standards imposed on them, particularly in terms of independence, competency and ensuring they act in the creditors' interests at all times.
- 32 ASIC believes that prioritising the role of liquidators as gatekeepers is consistent with the aim of facilitating business because markets cannot fully perform their fundamental purpose if investors and creditors do not have trust and confidence in them.

### Improving the timing of voluntary administration

#### Draft Recommendation 15.1

Section 436A of the Corporations Act should be amended such that a company may only appoint an administrator (and commence an 'independent restructuring' process) when the directors form the opinion that the company may become insolvent at some future time, but is not currently insolvent.

- The option to appoint an administrator to restructure when the company is insolvent should be removed.
- If an administrator determines the company is insolvent, the liquidation should be commenced.

- 33 ASIC supports the policy rationale that promotes a true rescue culture for financially distressed companies that have some prospect of rehabilitation.
- 34 ASIC believes that the Draft Paper makes an important distinction between solvency and economic viability<sup>1</sup>. In some cases, a company may be technically insolvent under s95A of the Corporations Act but still operate an

<sup>1</sup> 'Economic viability' is defined in the Draft Paper (at p.326) as, "... a function of the net present value of the business as a going concern. Provided that the business has a going concern value which is greater than the value of its assets sold on a break-up basis, and also greater than zero, then it is economically viable."

economically viable business e.g. if an economically viable business takes on more debt than it can service.

- 35 In light of this distinction, we query whether the proposal in Draft Recommendation 15.1 to remove the option to appoint an administrator when the company is insolvent. That is, it might prevent an insolvent company with an economically viable business, from restructuring.
- 36 The Productivity Commission may wish to explore framing access to the voluntary administration process around economic viability rather than insolvency. This approach might better maximise the chances of as much as possible of an economically viable business, operated by an insolvent company, continuing in existence.
- 37 We also note that Draft Recommendation 15.1 may have the unintended consequence of preventing a liquidator from appointing an administrator. Section 436B of the Corporations Act gives the liquidator the power to appoint a voluntary administrator under certain circumstances, including if the liquidator thinks that the company is insolvent. However, under Draft Recommendation 15.1 a liquidation must be commenced if the administrator determines that the company is insolvent i.e. the administrator could not accept an appointment if the company was insolvent.

## A safe harbour for directors

### Draft Recommendation 15.2

The Corporations Act should be amended to include a provision for a 'safe harbour' to allow companies and their directors to explore restructuring options without liability for insolvent trading. During such a period, the directors would retain control of the company, but receive independent advice from registered advisers.

- In informing themselves and the adviser, and determining whether to act on any restructuring advice, directors would be under a duty to exercise their business judgment in the best interests of the company's creditors as a whole, as well as the company's members.
- If the positive thresholds above are met (and evidenced), a director's duty not to trade while insolvent would be considered to be satisfied during the period of advice and for actions directly related to implementing the restructure advice.

- 38 ASIC supports consideration and consultation on safe-harbour reforms to facilitate informal corporate restructure. We are conscious of the need to protect creditors and the potential risks, including the possibility that safe harbour reforms may provide an opportunity for directors to divest assets to related parties and encourage asset siphoning or other misconduct that defeats the creditors' interests.

## Safe harbour advisers

- 39 ASIC has previously identified pre-insolvency advisers, particularly their relationship with registered liquidators, as a key risk. This is so given they are largely unregulated operators and may design and implement transactions that defeat creditor's interests (including those aimed at facilitating illegal phoenix activity).
- 40 ASIC believes that any reforms to introduce a safe harbour for directors should focus on the conduct of safe harbour advisers in the areas of:
- (a) independence;
  - (b) competency; and
  - (c) improper gain.
- 41 We believe that if the law offers greater protection from the insolvent trading provisions during a genuine restructure, then the reforms should also require that the safe harbour adviser is an independent, suitably qualified and experienced professional, (for example, a registered liquidator acting as a Chief Restructuring Officer). To provide some regulatory oversight to the informal workout process, the safe harbour adviser could be required to: exercise their powers and discharge their duties in good faith in the best interests of the company and all stakeholders; and have a duty to report potential misconduct to ASIC.

## Timing of the safe harbour

- 42 Under draft recommendation 15.2, the safe harbour would operate during the period of advice and for actions directly related to implementing the restructuring advice.
- 43 ASIC believes that there must be appropriate limitations on the ability of directors to access safe harbour, both in terms of the duration of the safe harbour period and the number of times a company can access safe harbour. We acknowledge that imposing a time limit on the application of the safe harbour is difficult because the restructuring process may legitimately involve lengthy negotiations which may appear, for some time, to be unproductive. Directors and safe harbour advisers should be required to diligently pursue the restructure during the safe harbour period.
- 44 Consideration should also be given to including anti-avoidance provisions. For example, if a company is permitted to access safe harbour once every three years, then this limitation period should apply notwithstanding that a company changes its name or appoints new directors.
- 45 We believe that imposing limitations on the ability of directors to access safe harbour will help ensure that directors do not abuse safe harbour. As the Productivity Commission observed in the Draft Report:

*"...safe harbour should not be seen as a 'free pass' for directors to wash their hands of any liability. Instead, it should be used only as an opportunity to pause when financial difficulty appears imminent and seek external advice to ensure that directors are informed of the options for continuing the company's existence."*

## Streamlined liquidations for small to medium enterprises

### Draft Recommendation 15.5

The Corporations Act should be amended to provide for a simplified 'small liquidation' process.

- This would only be available for those companies with liabilities of less than \$250,000, creditors would be able to opt out of the process and into a standard creditors' voluntary liquidation, and ASIC would be able to initiate further investigations if it has concerns of illegality.
- The primary role of the liquidator would be to ascertain the funds available, to a reasonable extent given a reduced timeframe.
- In line with this, there be no requirement for meetings of or reports to creditors, nor investigations into officers' conduct or other illegalities (unless ordered, and recompensed, by ASIC).
- Liquidators for these processes would be drawn from a pool of providers selected by tender to ASIC. Tenders would be subject to review every five years.

46 In principle, ASIC supports a simplified, streamlined liquidation process, including a review of the fee setting mechanism for registered liquidators, for small to medium enterprises.

47 ASIC is concerned that any reforms to streamline the liquidation process:

- (a) **Preserve fundamental creditor rights.**
- (b) **Ensure appropriate investigation and reporting** to both creditors and ASIC. Liquidators' reports are a critical source of intelligence for ASIC. The information obtained from reports helps ASIC focus its regulatory efforts and, importantly, allows ASIC to report publicly on insolvency industry statistics utilised by the market more generally. ASIC could not have provided the statistics it did in the first submission to the Inquiry without the reports provided to ASIC by liquidators.

For creditors, some form of reporting is vital. Many reports of alleged misconduct to ASIC from creditors arise out of poor communication from liquidators to creditors. Technology, and revised forms and processes, can contribute to a form of reporting which is cost effective and communicates to creditors what they need to know.

- (c) **Set the right access;** whether that is an amount of liabilities, such as \$250,000, or some other determinant. The right determinants will assist

in ensuring that access to the process is not, for example, artificially engineered.

- (d) **Promote creditor engagement.** This is particularly critical in the context of the proposal that creditors be able to opt out of a streamlined liquidation process and convert into a 'full' liquidation.

The lack of creditor engagement and their sense of powerlessness to adequately monitor the liquidation process were common features of submissions to the Senate Economics References Committee 2009/10 inquiry into *the role of liquidators and administrators, their fees and their practices, and the involvement and activities of ASIC, prior to and following the collapse of a business.*

### Liquidator appointment and remuneration

48 ASIC believes that the Commission proposal to reform the appointment and remuneration practices in small liquidations is an important development in promoting the liquidator independence as well as reducing costs to creditors through increased competition and efficiency.

49 As we noted in our first submission, there are potential conflicts inherent in the current referral process for appointing liquidators.<sup>2</sup> We believe that the proposal to introduce a, 'next cab off the rank', system for appointing a liquidator to a small liquidation would promote independence and therefore, greater confidence in the process. We believe that creditors are more likely to accept that a liquidator appointed under such a model will act in their interests and, for example, properly scrutinise pre-appointment transactions.

50 The proposal to appoint liquidators from a pool through a tender process would likely promote competition and innovation in fee setting. Australian liquidators predominantly use hourly rates to calculate their remuneration but, arguably, hourly rates can lead to inefficiencies because there is no major incentive to drive efficiency; particularly in administrations where there are available funds. The tender process may encourage liquidators to: consider changing the basis of fee setting to an option other than hourly rates; that is, other options for fee setting set out in the Code of Professional Practice for Insolvency Practitioners issued by the Australian Restructuring Insolvency and Turnaround Association.

### Funding of the liquidation

51 ASIC notes that, during the Productivity Commission's consultation, the possibility was raised that the Assetless Administration Fund (AA Fund) finance the streamlined liquidation process.

<sup>2</sup> See for example, the decision in *ASIC v Franklin (liquidator) & Ors, in the matter of Walton Constructions Pty Ltd* [2014] FCAC 85.

- 52 The Australian Government established the AA Fund to finance preliminary investigations and reports by liquidators in cases of company failure where the company has few or no assets and where it appears to ASIC that further investigation and reporting may lead to enforcement action.
- 53 It was never contemplated that the AA Fund be used to fund liquidators administering small liquidations. It simply does not have adequate funds to do so and meet its original objective set out above.
- 54 The Productivity Commission proposal that the AA fund should be accessed if ASIC determines that further investigation is warranted is more consistent with the current objects of the AA Fund and the funding criteria.

## Protecting against illegal phoenix activity

### Draft Recommendation 15.8

Section 117 of the Corporations Act should be amended to require that, at the time of company registration, that directors must also provide a Director Identity Number (DIN).

A DIN should be obtained from ASIC via an online form at the time of an individual's first directorship. In order to obtain a DIN, individuals should be required to provide 100 points of identity proof, and verify that they have read brief materials on directors' legal responsibilities provided as part of the online registration.

For existing companies, their directors should be required to obtain a DIN. The director DINs should then be provided to ASIC at the annual review date for the company, as a change to company details. To enforce these requirements, ASIC should be empowered under section 205E of the Corporations Act to ask a person who is a director to provide their DIN.

### Director identification number

- 55 In principle, ASIC supports the draft recommendation to introduce a director identity number (DIN) to assist in eliminating illegal phoenix activity. However, we do have concerns about the implementation of this proposal.
- 56 ASIC believes that the introduction of a DIN would improve the integrity of the company register by minimising the appointment of fictitious identities as directors. The DIN would also assist ASIC to better track directors, help identify directors who manage companies whilst disqualified and provide intelligence for our work to curb illegal phoenix activity. We do not have information quantifying the regulatory costs and benefits of this proposal but believe that the benefits would be significant; for example, illegal phoenix

activity is said to cost the Australian economy between \$1.78 billion and \$3.19 billion per annum.<sup>3</sup>

57 ASIC is concerned, however, about the cost of implementing this draft recommendation and how it would work in practice. It would be extremely costly to build a stand-alone authentication process and implement it across our technology and services. ASIC would need to modify registers, portals, machine to machine services with software developers etc. Further, most registrations (over 90%) are made via third party agencies. Any reform proposal would need to develop a solution for effecting identification checks by third parties. Finally, ASIC could not support in-person interactions at our offices. If we could not collect 100 points of identity proof on-line it may be necessary to engage a third party like Australia Post to perform this function.

58 In light of these concerns, we do not believe that ASIC should develop a stand-alone identity authentication service. Indeed it would be inconsistent with the work being undertaken by the Digital Transformation Office to develop a Trusted Digital Identity Framework (the Framework) to support the Government's Digital Transformation Agenda. We understand the Framework will involve establishing a common strategic approach to identity across government and preventing agencies from investing in bespoke solutions. This will mean that individuals and businesses will no longer have to prove their identity multiple times to government when accessing services.

59 We would be happy to assist the Productivity Commission to calculate the estimated costs and benefits of this proposal.

### **Other reforms to address illegal phoenix activity**

60 ASIC noted in our first submission to the Productivity Commission, that current law, like section 596AB of the Corporations Act, has had limited effectiveness to date in combatting illegal phoenix activity. Further, bringing action under sections 180-184 or s588G of the Corporations Act can be costly. ASIC believes that there is merit in considering reforms that specifically target the misconduct rather than the symptoms of illegal phoenix activity and make it easier to prove that illegal phoenix activity has occurred.

61 We suggest that the Productivity Commission consider the merit of introducing a provision similar to s121 of the *Bankruptcy Act 1966* (Bankruptcy Act) into the Corporations Act, making it an offence to transfer property from Company A (where Company A is subsequently wound up or abandoned) to Company B, if the main purpose of the transfer was to

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<sup>3</sup> PricewaterhouseCoopers, *Phoenix activity: Sizing the problem and matching solutions report for the Fair Work Ombudsman*, June 2012.



prevent, hinder or delay the process of the transferred property from becoming available for division amongst Company A's creditors.

Section 121(2) of the Bankruptcy Act states that the main purpose in making the transfer will be taken to be the prescribed purpose, "*if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent*". Rebuttable presumptions of insolvency apply.

- 62 Such a transaction should be both void against a liquidator (so that a liquidator can claw back the assets) and an offence. Consideration could also be given to whether such an offence should give rise to a right in creditors, liquidators and ASIC to sue for compensation against:
- (a) directors who engage in the prescribed conduct; and
  - (b) those who are knowingly involved in that conduct under s79 of the Corporations Act for the loss caused by the conduct (e.g. lawyers, insolvency practitioners and accountants).
- 63 Similar defences to those available under s 121(4) of the Bankruptcy Act could be available, (regarding paying market value for the property, knowledge of the main purpose of the transfer and inability to infer that the transferor was or was about to become insolvent at the time of the transfer).

### **Evidentiary difficulties involved in proving illegal phoenix activity**

- 64 Demonstrating that Company A owns the transferred assets, and that Company B did not pay fair market value for them, is one of the significant difficulties in bringing action against directors involving illegal phoenix conduct (for both ASIC and liquidators). The cost of investigations, examining persons of interest to ascertain property transfers and, if transfers occurred, whether the transferor paid proper value, is often prohibitive.
- 65 Section 139ZQ of the Bankruptcy Act allows the Official Receiver to send a notice to a person who the Official Receiver considers received property in contravention of s121, demanding payment of the property's value. The notice must set out the facts and circumstances pursuant to which the Official Receiver considers that the transaction is void against the trustee.
- 66 The Productivity Commission might consider a notice regime similar in concept to, (but not the same as), the notice regime in place under s 139ZQ of the Bankruptcy Act. This would significantly assist in pursuing illegal phoenix activity because it could reduce the cost of pursuing recovery action.
- 67 The new provision could do the following:

- (a) where ASIC, (or a liquidator), suspects illegal phoenix activity involving a transfer of Company A's assets to Person B for no market value or less than their market value;
- (b) ASIC may issue a notice to person B (either on ASIC's behalf or at the request of a liquidator who is able to satisfy ASIC as to the matters in paragraph (a)) requiring that Person B return the property or pay market value for the property if Person B cannot provide evidence that Company A never owned the property or Person B paid fair market value for the property; and
- (c) Person B would have the right to apply to the Court or ASIC to have the notice set aside.

68 We believe that these reforms would provide a clear indication of the seriousness with which the government and its agencies regard illegal phoenix conduct, and would facilitate ASIC's strategic priority of ensuring investor confidence, including creditors, and fair and efficient markets by encouraging equity and fairness for creditors and a level playing field for market participants.