ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

29 October 2018

Mr Matthew Sedgwick
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: regmod@treasury.gov.au

Dear Mr Sedgwick

Modernising Business Registers & Director Identification Numbers - draft legislation

Thank you for the opportunity to comment on the draft legislation for the Modernising Business Registers and Director Identification Number regime.

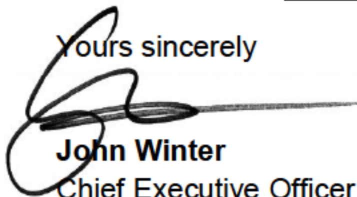
ARITA is strongly in favour of moves to introduce Director Identification Numbers (DIN) and to modernise Australia's business register regime to make it more accessible and transparent.

The following submission highlights a number of key considerations arising from the draft legislation including the:

a) need for DINs to be a unique and indelible identifier;
b) risks associated with the proposed retrospective nature of a DIN; and
c) need for insolvency practitioners to have full and free access to business data to fulfil their statutory obligations.

Should you have any queries concerning this submission please contact Natasha McHattan, Legal Director on [redacted] or [redacted]

Yours sincerely



John Winter
Chief Executive Officer

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents professionals who specialise in the fields of restructuring, insolvency and turnaround.

We have more than 2,400 members and subscribers including accountants, lawyers and other professionals with an interest in insolvency and restructuring.

Around 84 percent of registered liquidators and 87 percent of registered trustees are ARITA members. We represent firms of all sizes, from small practice through to multi-national firms, with the majority of our membership being drawn from those in small-medium practice.

ARITA's ambition is to lead and support appropriate and efficient means to expertly manage financial recovery.

We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large. In 2017, ARITA delivered close to 300 professional development sessions to around 5,000 attendees.

The Association promotes best practice and provides a forum for debate on key issues facing the profession. We also engage in thought leadership and public policy advocacy underpinned by our members' needs, knowledge and experience. We represented the profession at 23 inquiries, hearings and public policy consultations during 2017.

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1 Director Identification Numbers

ARITA has been a strong supporter and proponent of the use of director identification numbers (DINs) as part of the Australian corporate regulatory framework. Indeed, arising from the work of Prof Helen Anderson, ARITA first adopted a policy on DINs in 2014 as part of our "A Platform for Recovery" white paper. We went on to be the primary advocates of a DIN to the Productivity Commission in its Business Setup, Transfer and Closure inquiry.

The implementation of a robust regime for director identification and consent will operate to shine light into the shadows within which phoenix operators engage. It will also give greater confidence in the operations of business transactions by increasing the integrity of information available to counterparties, leading to lower levels of insolvency.

The release of the draft legislation to implement DINs is therefore a welcome development. However, there are a number of matters arising from the draft legislation which lack clarity or lead to confusion concerning the practical operation of the regime. These concerns are addressed below.

1.1 Unique identifier

Recommendation 1: Clarification of draft legislation and EM materials to confirm that the DIN is a unique identifier which is not able to be changed or re-issued.

The DIN issued to an individual director must be a unique identifier which is not able to be re-issued or changed. That DIN should apply to every appointment which the individual may hold, whether that be a company under the *Corporations Act 2001* (Cth) (Act), an Aboriginal and Torres Strait Islander corporation, a registered charity or other body the subject of the legislation.

A DIN should only be able to be cancelled in very limited circumstances (such as technical matters where a file or record is corrupted) and there must be an ability to link an 'old' number to the updated or current DIN which replaced any cancelled DIN.

The intention for DINs to operate as a unique and indelible identifier which remains permanently with an individual once allocated, was confirmed during round table discussions. However, references in the Explanatory Memorandum (EM) and draft legislation do not make this point sufficiently clear.[1]

While the intention as to how the DIN will operate in practice may be clear to the Government stakeholders the references in the documents may create unnecessary confusion.

[1] See for example proposed s.1230(3) of the Act (Item 7 – *Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2018*).

The DIN must also be searchable on the modern business register in its own right (e.g. searches of the register should be able to be conducted by DIN and by individual name.)

1.2 Timing

Recommendation 2: Every eligible officer must obtain a DIN and the requirement to obtain a DIN must operate prior to an individual being appointed as a director or giving their consent to act as a director.

The implementation of the DIN regime centres on the obligation in ss.1231 to 1234 of the draft legislation. The regime includes an allowance that a director has 28-days following their appointment to a director role to apply for a DIN.

This 28-day allowance leaves open far too many opportunities for serial phoenix offenders to manipulate corporations in a manner which leads to the potential losses to the Australian economy as detailed in *The Economic Impacts of Potential Phoenix Activity*[2] report. It follows that a further period of time would follow the 28-days allowance to identify and notify the director of the breach and for corrective action to be possible, with enforcement action only commenced at a later time. This further extends the window of opportunity for exploitation by phoenixers.

The table following provides an illustration of how the 28-day allowance to apply a DIN may be manipulated by phoenix operators.

[2] Report of the joint Phoenix Taskforce members, ATO, ASIC and PwC, which estimated the cost of phoenix activity to range between $2.85 billion and $5.13 billion.

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Example: Exploitation of 28-day time frame for application for DIN by phoenixers

On 1 February 2019 a winding-up application is lodged by the ATO against "Old Co" for failure to remit GST.

Also, on that date, a phoenix operator, facilitates the appointment of two "associates", Mr Black and Ms Grey, as directors of Old Co. Mr Black and Ms Grey do not have DINs and, under the current draft legislation, have until 1 March 2019 to apply to the Registrar for a DIN.

The existing directors of Old Co (who were in place prior to Mr Black and Ms Grey being appointed) resign on 1 February 2019 and take up directorships of "New Co", leaving Mr Black and Ms Grey as the remaining directors of Old Co.

On 4 February 2019, the Old Co enters into a transaction which transfers all the assets from Old Co into New Co for minimal consideration.

Mr Black and Ms Grey do not apply for DINs by 1 March 2019. This failure is identified by the Registrar and, on 8 March 2019, the Registrar issues a notice directing Mr Black and Ms Grey to apply for DINs (under s. 1231(2)). Mr Black and Ms Gray have 28-days to respond to the direction (under s.1234(1)(b)), giving them until 29 March 2019 to comply.

Mr Black and Ms Grey fail to respond to the direction from the Registrar. The Registrar identifies this failure in early April and steps are taken to issue an infringement notice pursuant to s.1236.

On 5 April 2019, an infringement notice is issued to each of Mr Black and Ms Grey (applying s.1236 and Part 5 of the Regulatory Powers (Standard Provisions) Act 2014 (Cth) (RPSP Act)). Pursuant to s.104 of the RPSP Act, Mr Black and Ms Grey have 28 days after the day the notice is given to pay the amount payable under the notice.

The infringement notice (and penalty) is due to be paid by 3 May 2019.

On 2 May 2019, the Court makes orders to wind up Old Co and the appointed Liquidator is unable to verify the identities of Mr Black and Ms Grey.

The above example illustrates how any allowance for delay in the application for a DIN to occur after an individual has been appointed as a director provides phoenix operators with real opportunities to manipulate the process and take steps to delay and avoid an application for a DIN, continuing with the behaviours that are already costing the economy so significantly.

It is also noted that the EM (at 2.44) notes that the defences that apply in relation to the obligation for a director to apply for a DIN do not apply in relation to directions by the registrar, including the defence of being appointed without knowledge. As noted by the above example, it is equally possible for a director who has been appointed without their knowledge to be captured by these provisions.

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Given one of the key objectives of the DIN regime is to reduce phoenix behaviours, the obligation to obtain a DIN must be the key stand-alone obligation within the draft legislation.

Individuals should be obliged to apply for a DIN as part of their “pre-work” or due diligence activities when considering an invitation or application to join the board of a company or as part of the steps that are pursued to give effect to the set up of a corporation.

While it may not be feasible to obtain a DIN within a short timeframe, it is reasonable to expect that an application can be lodged, and the application number provided for verification purposes (akin to noting that a TFN has been applied for when completing a tax file number declaration for a new employer).

We consider any counter argument around first-time directors being elected as a “surprise” at an annual general meeting as justification for being able to apply for a DIN after election as being without basis.

If a potential director, who has never been a director before (i.e. is without a DIN) is so unprepared to take on a directorship, we would strongly suggest that they have not undertaken proper due diligence or sufficiently appraised themselves of the role and responsibilities of a director or of the business that they are preparing to take a directorship over, , and, in those circumstances it is likely that they are not fit and proper to take on that role at that time.

Further, any exceptional circumstances that may warrant creating the provision for post-registration are far outweighed by the potential abuse risks outlined above.

The *data standards* which are ultimately implemented as part of the modernisation of the business registers should allow for the real time issue of a DIN upon the provision and verification of the requisite identification documents.

ARITA suggests that the process reflected in the draft legislation should take the following approach:

a) The obligation for an “eligible officer” to have a DIN should be the first statement in the new Part 9.1A in the draft legislation.
b) An eligible officer is obliged to provide their DIN to the company at the time of appointment as director.
c) If an eligible officer does not yet have a DIN, they should apply for a DIN before confirming their consent to act as a director and provide details of their application number for verification purposes.
d) It is a strict liability offence to consent to act as a director of a company without a DIN.
e) There may be scope for a limited defence to the strict liability offence if the person without a DIN can show that they had applied for a DIN but there was a delay in the provision of the number due to administrative matters relating to the Registrar.

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An alternative approach may be that any directorship for which a person is elected "without-notice" would not take effect until a DIN is issued, although this comes with risks around shadow director activities becoming more likely.

1.3 VOI and consent requirements

Recommendation 3: The introduction of a DIN regime should not be unduly delayed by a focus on which technology or process to implement under the data standards.

It is acknowledged that the detail of the verification of identity and consent mechanisms for individuals applying for a DIN will be contained in the *data standards*.

The use of the *data standards* under the draft legislation is designed to be technology neutral and allow the easy adoption of technological changes and advancements. However, this approach does leave uncertainty in the draft legislation as to how the VOI and consent requirements will operate in practice.

Having participated in the DIN co-design workshop process, ARITA presses for ongoing engagement with stakeholders to keep updated with the proposed developments for the intended process and content of the *data standards.*

At a minimum however, the provision of 100 points of identification (to be verified through an online portal or existing Government service provider) should be reflected in the initial approach to be adopted or adapted for implementation of a DIN regime. ARITA believes that the current Tax File Number regime provides a more than sufficient basis for initial operations. Indeed, there is significant merit in using a DIN which is bound to, but not the same as, a director's existing TFN.

Use of a DIN bound to the TFN would provide for consistency of identification and expedient rollout.

The process for a two-way consent by both individual director and company to which they have been appointed is a crucial element for the DIN regime and existing systems and infrastructure (such at the Commonwealth My Gov or NDIS portals) may be able to be adopted or adapted to provide a system for a 2-factor authentication type approach to allow for consent of both an individual who has been appointed as a director of a company to confirm that appointment and for the company to confirm that an individual has in fact taken up a director role with it.

ARITA is adamant that a two-way consent regime must be adopted for the system to be robust and effective given the aggressive approach taken by phoenix facilitators to use dummy directors.

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1.4 Director education

Recommendation 4: Access to director education on basic obligations should be mandatory as part of the application process for a DIN.

Consideration of whether the DIN is an identifier alone or also contains aspects of a licence or minimum qualification has been part of the consultation and co-design process.

ARITA continues to support the inclusion of an education element to accompany the DIN application process. It should apply at the initial point of application for a DIN (rather than at the point when a director gives consent to an appointment).

While the overall improvement in the quality of the "director pool" within the Australian economy is a wider issue, the implementation of a DIN regime is an opportunity to embed a conduit through which individuals who are applying to become directors can access information to properly understand their obligations.

ARITA does not suggest that extensive education such as that provided by the Australian Institute of Company Directors is at all necessary. However, we do strongly believe that a potential director should have to complete a simple, possibly online, program of as little as 90 minutes duration, that outlines their basic legal obligations and reminds them of key functional obligations such as ensuring they are familiar with the operation and profitability of the business, ensuring good books and records are kept, etc. We strongly believe that a simple course like this would greatly reduce the insolvency risk of MSMEs and start-ups.

1.5 Penalties

ARITA strongly supports the use of strong penalties to support the implementation of a DIN regime and to the strengthening of enforcement for corporate and financial sector misconduct.[3]

We note that there are some inconsistencies in penalties recorded in the EM and draft legislation. For example, Table 2.1 in the EM suggests the maximum criminal penalty is 60 penalty units (or $12,600) for a dishonest breach but the civil penalty is $200,000 for simply failing to register for a DIN. There is also a reference to a body corporate being subject to a maximum penalty of $1million, however, it is unclear how a body corporate may be in breach of the requirement to apply for a DIN, which is specific to the individual.

Finally, it is not clear why the penalties for breaches of the DIN requirements should be less under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) (CATSI Act) when the contravening conduct is exactly the same as under the Act.

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[3] ARITA submission on reforms to strengthen penalties for corporate and financial sector misconduct dated 18 October 2018.

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1.6 Company secretaries

Recommendation 5: The DIN regime should also apply to company secretaries.

The present DIN regime is not intended to apply to company secretaries. This omission seems to be anomalous, particularly in light of one of the purposes of the DIN regime is to prevent phoenix activity.

The practical reality for the majority of proprietary companies is that the secretary role is also held by a director of the company, in which case that individual will be obligated to have a DIN in any event. Further, the compliance obligations which company secretaries fulfil are likely to be enhanced by ensuring that those in the role are properly identified and consent to the position. It is unlikely that there will be any significant burden to also requiring them to be subject to the DIN regime.

The structure of the *eligible officer* definition in the draft legislation allows the scope of the DINS regime to be extended by legislative instrument and ARITA supports the extension of the DIN regime to ensure there are no unintended consequences whereby a company secretary is not also subject to consent and identification requirements.

1.7 "Unused" DINs not to expire

Recommendation 6: A potential director should continue to hold a DIN, once applied for, even if a directorship is not commenced.

We note that the proposals as currently outlined stipulate that directors who apply for a DIN but do not use it within 12 months would have that DIN expire. While we are aware of some legal constraints that have led to this approach being adopted, we do not see merit in revoking a DIN once it has been applied for. Continuing to hold a DIN even absent commencing one's first directorship, also reduces the need for a post-application regime which we explored in Section 1.2 of our submission above.

2 Modernising Business Registers

ARITA strongly supports the streamlining of Australia's business data registry system and has previously stressed the importance of having accurate and up to date business data openly available within the Australian economy.

The modernising business registers regime (through the proposed new *Commonwealth Registers Act 2018* and related amendments to existing legislation) (MBR), details an ambitious program which includes a significant number of changes to seek to consolidate various registers.

However, the critical issue of access to business data, including what information will be searchable and whether there will be charges for searches, has been left to the *disclosure framework* instrument which is yet to be developed.

As made clear in previous submissions on this issue, ARITA strongly supports free access to business data to be held on the business register developed under the MBR.

2.1 Access for external administrators

Recommendation 7: Insolvency practitioners, who have been appointed as liquidators, voluntary administrators, administrators under a deed of company arrangement, scheme administrators or receivers, must be given full access to the data in the modernised registers free of charge to fulfil their statutory obligations.

To the extent that there is to be a spectrum of access to data in the new register under the MBR, it is critical that insolvency practitioners are given access as “trusted users” to obtain full access to detailed business data, free of charge, in order to carry out their work.

At present insolvency practitioners must pay to conduct searches of business data held on the ASIC registers (this is despite recent announcements by the now former Minister for Revenue and Financial Services which granted free access to journalists).

Detailed below is a summary of usual searches which are conducted by insolvency practitioners in carrying out their statutory duties upon appointment as an external administrator.

Example: Costs to Liquidator for company and related searches in a typical appointment

An insolvency practitioner is required, by the nature of their role and the statutory requirement for investigations, to conduct a large number of searches for various information detailed in numerous business registers. At this point they are charged for each search.

- Current and historical company search for company to which they will be appointed (which is particularly important for assessing potential issues as to independence).
- Further company searches of related companies to determine corporate structure.
- Name searches on directors of company (to confirm contact details and information of any other directorships).
- Searches of real property registers to assess what real property may be held in the name of the company.
- Searches of the PPSR to assess security interests asserted over company property.
- Searches to determine asset holdings of directors (which can be relevant to pursuit of recovery actions).

These searches may be repeated a number of times throughout the course of an appointment so the costs can readily multiply throughout the course of an otherwise straightforward external administration appointment.
The costs associated with these searches will vary depending on the size and complexity of the searches and whether they are undertaken by a data provider. However, the current search costs (which have only recently been reduced) are:

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A) ASIC searches: range from $9 to $43 per search
B) PPSR searches: range from $2 to $7 per search
C) Property searches: from $14.50 per title search.

These significant search costs form part of the fees and expenses which are generally unrecoverable and borne by insolvency practitioners each year for properly fulfilling their statutory duties under the Act. In addition, legislation does not allow for the recovery of any searches conducted prior to the appointment of the insolvency practitioners in preparation for their appointment.

Surveys conducted of ARITA members suggest that up to $100 million in fee revenue is written off by insolvency practitioners annually due to work done on files which is unrecoverable. Fees for necessary searches of the business registers forms a significant part of this amount and are especially onerous on liquidators when undertaking assetless administrations in which they have no prospect of recovering any administrative costs, let alone being able to recover fees for the work they are statutorily required to undertake. Indeed, ensuring free access to searches for liquidators in these assetless scenarios is likely to encourage more active searching of databases, closing off another avenue often exploited by illegal phoenix facilitators.

These fees and write offs are also in addition to the ASIC industry funding charges for insolvency practitioners for which registered liquidators will be charged an average fee of $16,500 each to maintain their registration.

2.2 Data to be available on register

The structure of the MBR relies on the adoption of the *disclosure framework* legislative instrument to provide detail of what information will be publicly available and what will not. The detail of the *disclosure framework* has not yet been set.

There are a variety of iterations of information which may be available for public search on the registers once the *data framework* is adopted.

ARITA suggests that a framework which allows for the following information to be displayed publicly strikes an appropriate balance between transparency and privacy protections:

- Full Name
- DIN
- Year of Birth
- Suburb of address for service

The register should also display the “status” of the individual such as:

- Active
- Inactive
- Applying

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- Disqualified (including period of disqualification)

As noted above, insolvency practitioners should be given access to a full range of data to support their statutory investigatory roles. Therefore, insolvency practitioners must be able to access complete information including date of birth and address for service.

It is ARITA's view that, given the risk of identity fraud or potential safety risks for directors that having full birth date details and home addresses available on the public record is an unnecessary risk. The current disclosure levels are a legacy from a time in which identity fraud and safety risks were not even remotely as evident as they are today.

That said, ARITA strongly believes that, like insolvency practitioners, investigative journalists must be given special and full access to detailed searches under some special framework. Investigative journalists fulfill an essential service in identifying and exposing dodgy director and business activity. The goals of insolvency professionals and journalists are completely aligned in this regard.

We note that investigative journalists have substantially fewer research/inquiry tools at their disposal than regulators and yet often carry a higher evidentiary burden in order to protect themselves from legal action once accusations are leveled. As a result, their work must be facilitated and supported wherever possible.

We are aware that the MEAA is pushing for the continuation of full disclosure of address and date of birth details and we understand and acknowledge their justification in doing so. However, we hold the view that bona fide journalists should be given access to greater detail than is on the open public record rather than having the data fully open to the public.

2.3 Duality of lodgments

The amendments to the Act (and related legislation) proposed under the MBR has the effect that insolvency practitioners will, under the new regime, be required to lodge information with two different registers (i.e. the Registrar and ASIC).

A majority of the lodgments will be moved to the new register but certain information will still need to be lodged with ASIC. We understand that the recipient will be dependent on whether the lodgment is a registry lodgment or a regulation lodgment.

Noting the tight timeframe for consultation on the three bills which make up the MBR draft legislation, ARITA has not yet been able to assess each of the proposed changes to lodgments under the new regime.

However, the fact of dual lodgments will necessarily bring additional compliance costs for insolvency practitioners in dealing with the proposed changes.

We believe any dual lodgment requirements must be prevented for the obvious burden it creates and that the government should be responsible for distributing data it receives in a single lodgment to any additional government user.

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2.4 DIRRI

Recommendation 8: There needs to be interaction between the new register and ASIC to streamline the process for ASIC to review and consider DIRRIs in a timely fashion which avoids the need for insolvency practitioners to lodge the document in two places.

A key lodgment for insolvency practitioners is the Declaration of Independence, Relevant Relationships & Indemnities (DIRRI) which is required under the Act.

Under the changes to the Act as a result of MBR the DIRRI will be required to be lodged with the new register notwithstanding it is ASIC's role to oversee the independence of insolvency practitioners in their appointments.[4]

A DIRRI is required to be lodged in every one of Australia's 10,500 insolvencies. The lodgment of the DIRRI with ASIC is intended to provide a safeguard to the independence of the external administrator.

It will therefore be crucial that there are systems in place to ensure that ASIC has effective, efficient and contemporaneous access to DIRRIs lodged with the register to avoid delay, duplication of effort or assertions by ASIC that the DIRRI obligations are not being fulfilled.

2.5 Regulatory costs

The intention of the MBR program to streamline registers and related forms is admirable and supported by ARITA.

However, the consequences of revising and updating the forms to reflect the changes are likely to involve significant regulatory and compliance costs.

2.6 Interaction of MBR with existing service providers

Insolvency practitioners, like other professionals, generally use practice management software provided by third party businesses to facilitate their lodgment processes.

Two of the main platforms used by insolvency practitioners are Core IPS and MYOB Insolvency (a specific platform specialised for insolvency).

The extent of changes proposed by the MBR will require interaction with and input from these third-party providers to ensure that systems can be developed to support practical implementation of the changes proposed under the MBR.

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[4] See for example, Schedule 1, Item 684 – *Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2018*) which changes s. 436DA(4A) of the Act from ASIC to Registrar