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The Manager, Corporations and Schemes Unit
Financial Systems Division, The Treasury
PARKES ACT 2600 By email to: insolvency@treasury.gov.au

PROPOSALS PAPER - IMPROVING BANKRUPTCY AND INSOLVENCY LAWS

Thank you for the opportunity to comment on the Proposals Paper dated April 2016 *Improving Bankruptcy and Insolvency Laws*.

This response is made on behalf of Australian Finance Conference (AFC) and its affiliated associations, the Australian Equipment Lessors Association (AELA), the Australian Fleet Lessors Association (AFLA) and the Debtor and Invoice Finance Association (DIFA), which together comprise over 100 Members. AFC and AELA Members include finance companies, banks, specialist equipment financiers and general financiers providing consumer, commercial (including small business) and wholesale credit facilities, as well as banks, building societies and credit bureaux. AFLA Members provide vehicle fleet leasing and management services. DIFA Members provide cash flow finance facilities under which suppliers sell unpaid invoices in return for immediate payment.

Australia's bankruptcy and insolvency laws impact on our Members in relation to their ability to recover quickly, efficiently and equitably any debts due to them by bankrupt and insolvent individuals and companies. Our comments on the three measures proposed in the Paper are set out below.

1. Reducing the default bankruptcy period

The proposal is to reduce the default bankruptcy period from three years to one year.

Our Members would only consider supporting this proposal if the current ability for the trustee to object to discharge of the bankrupt and apply for the bankruptcy period to be extended is retained and possibly enhanced. The Paper notes that there may be practical challenges for trustees in gathering sufficient evidence to support lodgement of an objection within a reduced bankruptcy period. We agree with this, and suggest that there should be a review of the processes, timing and factors to be taken into account when considering an extension, to ensure that creditors' interests continue to be protected.

Early discharge provisions that were formerly in the Bankruptcy Act were abolished in 2003 in response to creditor concerns about inappropriate use of the bankruptcy mechanism by some debtors. We suggest that the analysis carried out at that time be reviewed and updated by Treasury for relevance to the current proposals. We submit that the default period should be left at three years and that the early discharge provisions be re-instated, putting the onus on the bankrupt to apply to the trustee for early discharge (for example any time after twelve months) with appropriate supporting documents.

Our Members have advised us of a general increase in fraudulent credit applications. They would be concerned that a shorter default bankruptcy period could provide an opportunity for some debtors to abuse the process by incurring substantial debts they do not have an expectation of paying, then being discharged from bankruptcy after one year. We would therefore support Proposal 1.2.1 to ensure that a bankrupt's obligations to assist in administration of their bankruptcy remain even after they have been discharged; and suggest that these provisions be reviewed to ensure their ongoing effectiveness to protect unpaid creditors.

We would support Proposal 1.1.2 to separate the obligation to pay income contributions from the default bankruptcy period, so that individuals continue to pay income contributions for three years even with a reduced default bankruptcy period, and during any extended bankruptcy period.

In relation to Proposal 1.3.1b, we support the retention of a permanent bankruptcy record in the National Personal Insolvency Index.

In response to Query 1.3.1, we would not support a reduction in the retention period for personal insolvency information in credit reports. Insolvency and bankruptcy information is relevant to financiers when making credit decisions in both the consumer and commercial contexts. In particular, our Members, when providing financial services to consumers, are required to comply with responsible lending obligations under the *National Consumer Credit Protection Act 2009* - bankruptcy information is a very important compliance tool in relation to these obligations.

2. Safe harbour

The proposal is to introduce a 'safe harbour' for directors from personal liability for insolvent trading if they appoint a restructuring adviser to develop a turnaround plan for the company.

Our Members would only support safe harbour provisions with appropriate creditor protections. In particular, requirements for adequate financial records, qualifications for restructuring advisers, rules about when safe harbour would not be available and the indicia for establishing "reasonable steps" and a "reasonable period of time" would need to be clearly defined.

We favour Model B over Model A because it is focusses on achieving the objective of providing a safe harbour defence from claims of insolvent trading, without the issues raised by Model A. The precise terms of any such defence will need to be carefully considered by the banking and finance industry.

Our concerns with Model A include:

- the safe harbour defence being invoked simply by appointment of a restructuring advisor;
- it creates a new regime which, to be effective and appropriately balance the duties and interests involved, would need to prescribe further requirements; and
- directors should continue to have the duty to act in the best interests of creditors, notwithstanding the appointment of a restructuring advisor.

3. Ipso facto clauses

The Productivity Commission's 2015 report *Business Set-up, Transfer and Closure* recommended that the Corporations Act be amended so that *ipso facto* clauses that allow termination of contracts solely due to an insolvency event are unenforceable if the company is in voluntary administration or forming a scheme of arrangement. The Paper notes that for practicality the Government considers that this approach should be extended to include other types of ipso facto clauses (such as clauses that vary terms of a contract) which may be disproportionately detrimental to companies undertaking a restructure. The proposal is that any term of a contract or agreement which terminates or amends any contract or agreement (or any term of any contract or agreement) by reason only that an 'insolvency event' has occurred would be void.

This goes beyond the Productivity Commission's recommendation and would challenge a long history of the inclusion of such provisions in many types of commercial and finance contracts. Financiers often rely on these provisions to protect their interests when a company is in financial difficulties. We note that exclusions are proposed for certain classes of contracts (such as "prescribed financial contracts"), however our Members are concerned about the potential impact of this proposal and would not support it without further consultation and discussion with the banking and finance industry to ensure that there are no inadvertent or unintended consequences. It may be appropriate for all formal loan facilities and asset finance leases to be excluded.

Overall, we question whether there is a need to provide protection from ipso facto provisions. Our Members are not aware of any recent, compelling evidence indicating that there are systemic issues with these clauses in insolvency procedures. In fact, contrary to the objective of director safe harbour provisions, providing protection from ipso facto clauses in insolvency may lead financiers and other counter-parties to enforce termination or other rights ahead of an insolvency event.

In summary, we

If you would like any further information, please contact me by email to ron@afc.asn.au or Catherine Shand our Associate Director - Legal by email to catherine@afc.asn.au.

Kind Regards,

Yours truly,

Ron Hardaker
Executive Director