27 May 2016

By email: insolvency@treasury.gov.au

Manager
Corporations and Schemes Unit
Financial Systems Division
The Treasury
Langton Crescent
PARKES ACT 2600

Improving bankruptcy and insolvency laws – Proposals paper

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to provide input to proposed changes to Australia's bankruptcy and insolvency laws.

We do not object to the primary proposal to reduce the default bankruptcy period to one year. However, there are some consequent reforms that will be necessary to avoid unintended consequences, particularly to avoid driving further demand toward Debt Agreements made under Part IX of the *Bankruptcy Act 1966,* which can be entirely inappropriate for the people who enter them. We urge the Government to take the opportunity to address ongoing problems with Debt Agreements as a priority area for reform.

Our comments are detailed more fully below.

Summary of recommendations

- Listings on the National Personal Insolvency Index (**NPII**) should include Debt Agreements and bankruptcies for the same period—whether it be indefinite or up to five years;
- Personal insolvency information should remain on a credit report for two to three years;
- Consideration should be given to whether there are any unintended consequences that may result in increased phoenixing activity and ways to mitigate that outcome;
- The minimum bankruptcy threshold for creditors should be increased to $20,000;
- Information about bankruptcy options to debtors should be expanded and targeted to reach people before they are made bankrupt;
- A full review of the role of Debt Agreements needs to be initiated—including information provided to debtors and fees charged;
- Australian Financial Security Authority (**AFSA**) statistics should provide detailed information about completion rates of individual agreements, and clear information about debt and repayment ratios;
- Advertising of Debt Agreements should investigated; and
- Debt Agreements should have minimum standards for entry—including an income above the income threshold in the Bankruptcy Act, and an asset that could be seized under bankruptcy.

Consumer Action Law Centre
Level 6, 179 Queen Street Telephone 03 9670 5088 info@consumeraction.org.au
Melbourne Victoria 3000 Facsimile 03 9629 6898 www.consumeraction.org.au

ABN 37 120 056 484 ACN 120 056 484

About Consumer Action

Consumer Action Law Centre is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Income contributions

A general observation is that requiring income repayment beyond the period of bankruptcy appears punitive and at odds with the notion of bankruptcy facilitating a fresh start. We refer you to research conduct by the University of Melbourne on personal insolvency on this issue.[1]

Retention of NPII listings for bankruptcy

Recent changes to the listing of Debt Agreements on the National Personal Insolvency Index (**NPII**) mean that Debt Agreements are removed between two and five years after the agreement finishes, depending on the circumstances of the conclusion of the agreement.

It is absolutely critical that changes to bankruptcy laws do not inadvertently create incentives to push people toward inappropriate Debt Agreements. We discuss the problems with inappropriate Debt Agreements in greater detail later in this submission.

Maintaining a difference in NPII duration is dangerous for both creditors and those entering insolvency. Creditors may well want a full history to acts of insolvency before they decide to extend credit—and both are acts of insolvency. Offering a limitation on the NPII is a real incentive to enter a Debt Agreement rather than bankruptcy—even where bankruptcy is the best course of action for the individual at the time.

There are significant problems with people entering Debt Agreements even where they are entirely inappropriate. Offering an inducement in the form of a time limit on the NPII listing gives Debt Agreement Administrators another sales tactic.

Recommendation: Listings on the NPII should include Debt Agreements and bankruptcies for the same period—whether it be indefinite or up to five years.

The Review has sought advice about the length of retention of this information on credit reports. We suggest a period of either two to three years would be appropriate.

Recommendation: Personal insolvency information should remain on a credit report for two to three years.

Safe harbour provisions

Case 1
Our client was awarded $17,000 through Victorian Civil and Administrative Tribunal (**VCAT**) for defective building works by a landscaping business. When the client went to VCAT there was no response from the trader. It subsequently began trading at the same address under a different name. The new company director is the spouse of the previous company director.

[1] P. Ali, L. O'Brien, and I. Ramsay, *Perspectives of Financial Counsellors and Consumer Solicitors on Personal Insolvency*, 2015. Online at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2660712

We note the proposed safe harbour provisions, and ask that the Review considers if there are additional ways to ensure the public interest is protected, particularly where traders phoenix.

We have clients who are unable to get redress, for example enforcing a court or tribunal order, because a trader appears to close but reappears at the same address and contact details. Any changes should consider if this could be a consequence. While we recognise that companies are subject to a different insolvency framework, there may be unintended consequences associated with this reform.

Recommendation: Consideration should be given to whether there are any unintended consequences that may result in increased phoenixing activity and ways to mitigate that outcome.

The bankruptcy threshold should be raised from $5,000 to $20,000

Currently, a debt of just $5000 can allow creditors to bankrupt Australians in financial difficulty. Charges, trustee fees and other legal fees imposed can add tens or hundreds of thousands of dollars to the initial debt. The threshold, in place since 2010, is too low and in many cases gives creditors the power to force the sale of the family home to recover what began as a reasonably small debt to a credit card provider or utility company.

In the cases outlined below, the clients in question faced bankruptcy for relatively low amounts and from a single creditor. In all these cases, there were multiple reasons the client was pursued, including problems with utility meter charging and income insufficiency. It was not simply that they did not pay their energy bills.

Case 2

We came across the client at the Federal court in late 2015. Her energy retailer (represented by a law firm) was seeking a sequestration order for a debt of $8,000.

The client attended court with a friend who had also assisted her putting together a folder of information to show the creditor and registrar information that indicated significant vulnerability and financial hardship. The folder included a Centrelink statement, medical letters and photographs of the client's injuries she sustained as a result of family violence (where the client ended up in a coma). The client was also illiterate.

As a result of direct advocacy by Consumer Action, the retailer annulled the bankruptcy and agreed to write off the debt.

Case 3

Our clients were sued in the Magistrates Court by an energy retailer for an unpaid bill of around $12,000. The final debt ended up over $30,000. They own a small property, but have little income.

An outsourced firm was involved with the debt recovery and bankruptcy proceedings were then initiated, with our clients being made bankrupt and a trustee appointed. Our clients had not engaged with the trustee and the trustee was seeking to evict them from their property. Trustee fees mean that the amount to be recovered was likely to be in excess of $80,000.

The couple have four dependent children and came to our attention through a social worker assigned to their case as they were about to be made homeless. We worked with the retailer and the trustee, and the retailer agreed to annul the bankruptcy and waive the debt.

Case 4

Our client was not working and his wife was on a disability support pension. Their energy retailer was pursuing a debt of $20,000. We had also helped the clients with other creditors pursing debts.

We were able to have proceedings delayed. The retailer indicated they would accept the client's proposal to make a fortnightly debt payment. The debt was reduced to $17,000. The payment arrangement avoided bankruptcy and sale of their home and saved the client $6,000.

Our casework experience reveals that it is the most vulnerable people who can be subject to bankruptcy proceedings over relatively small debts, including those experiencing illness, disability or mental health concerns. These types of vulnerability generally mean that the clients are unable to engage with service providers, or debt collectors, often through no fault of their own. The ability of the debt recovery process to proceed seemingly automatically to bankruptcy, without the need to engage a vulnerable person, means that the system is almost designed to disadvantage the most vulnerable.

The current and increasing level of consumer and household debt means it is more likely, but no less reasonable, that people could be at risk of losing their home over a debt of as little as $5,000. For this reason, the threshold should be increased to restore balance in the system for the thousands of Australian households experiencing financial stress.

Recommendation: The minimum bankruptcy threshold for creditors should be increased to $20,000

Bankruptcy information should be provided at an appropriate time to help people make a good choice

All acts of insolvency are serious. We know that people aren't getting access to the broad range of insolvency options. AFSA's predecessor, Insolvency and Trustee Service Australia (**ITSA**), reported in its *Profiles of Debtors 2011* report that Debt Agreement Administrators are the major source of advice for 88 per cent of people entering a Debt Agreement.[2] Only two per cent got their information from a financial counsellor—despite them being a free and independent service.

There is a need to provide impartial information to debtors who are exploring insolvency options. One example of a timely, appropriate intervention is a pilot service at the Federal Circuit Court providing direct financial counselling services to self-represented debtors in the Court's bankruptcy lists. The pilot service was a collaboration between Consumer Action, the Court, and a research team from the University of Melbourne Law School (**MLS**).

The objective of the project was to assist self-represented debtors to understand the nature of bankruptcy proceedings so they are better able to determine their rights, and to make effective decisions in presenting their cases. The MLS evaluation of the project found that the project has achieved this aim, helping several debtors to demonstrate solvency (thereby avoiding bankruptcy) and helping others to accept bankruptcy as an appropriate option in their particular circumstances. The Court Registrars have also stated that the project has ensured that debtors can participate more meaningfully in the court process.[3]

Overall, we have seen that assistance for debtors at courts has improved in recent years. However, this does not assist people who don't attend court, including in bankruptcy or debt recovery processes. These are often the most vulnerable people—they commonly don't respond to court documents because they don't understand what is happening, are suffering significant personal stress, or are experiencing mental health issues or other disabilities. Targeted intervention is needed to ensure people in this situation are required to come to court or

[2] AFSA, *Profiles of Debtors 2011*, 37, available at https://www.afsa.gov.au/resources/statistics/profiles-of-debtors-documents/profiles-of-debtors-2011

[3] Consumer Action Law Centre, Annual Report 2015, p9; P Ali, L O'Brien and I Ramsay, 'Financial Counselling and the Self-Represented Debtor in the Federal Circuit Court Bankruptcy List: An Analysis of a Recent Pilot Service' (2015) 23.4 Insolvency Law Journal 161, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2732824.

have some further action that helps them understand what is happening, before the next legal steps with significant ongoing consequences are taken.

Recommendation: Information about bankruptcy options to debtors should be expanded and targeted to reach people before they are made bankrupt.

Debt Agreements should be subject to a wholesale review

Bankruptcy reforms will inevitably have an impact on other forms of personal insolvency, and it is critical those reforms are concurrent. We have particular concerns about Part IX Debt Agreements, which in our experience are often entirely inappropriate for the people entering them.

Debt Agreements are a form of personal insolvency regulated by Part IX of the *Bankruptcy Act 1966* and are designed as an alternative for lower income consumers.[4] They are one of a number of options available to people who would otherwise consider bankruptcy, including a Part X Personal Insolvency Agreement or informal negotiation, perhaps with the assistance of a financial counsellor.

The Debt Agreement process typically involves some of the consumer's debt being written off, and repaying the remainder over a term usually lasting three to four years. The most significant difference between bankruptcy and a Debt Agreement is that a debtor with significant assets (such as equity in their home, or a motor vehicle worth more than $7600) will lose those assets under bankruptcy but can retain them with a Debt Agreement.

However, Debt Agreements are otherwise very similar to bankruptcy. Proposing a Debt Agreement to the Official Receiver is an act of bankruptcy under section 40 of the *Bankruptcy Act 1966*. Both are recorded on the debtor's credit report for long periods, and both lead to a publicly accessible listing on the National Personal Insolvency Index—though only bankruptcy is presently permanent. Bankruptcies and Debt Agreements must both be disclosed to a potential credit provider if a consumer is seeking a certain amount of credit, and both may prevent a debtor from practicing in certain professions.

A Debt Agreement is only a superior option for debtors who have an asset to protect. Further, bankruptcy will actually be a better choice for debtors who have very low incomes and no divisible assets because it clears all unsecured debt without requiring any repayments from the debtor.[5] This is usually a painful situation for a person to be in—almost all debtors want to repay their debt and feel extremely ashamed when they cannot—but the reality is that requiring repayments from a person in financial distress will only exacerbate their hardship and delay any possibility of them achieving financial stability in the future.

We suspect that for many people, Debt Agreements offer little value beyond what could be negotiated in an informal arrangement, and that the fees imposed by administrators negate any reduced amount paid out to creditors.

In recent years, more people have been entering into Debt Agreements while fewer have been presenting debtors petitions for bankruptcy. The most recent AFSA statistics available[6] show that 75 per cent of those

---

[4] A debtor cannot propose a Debt Agreement if their annual after tax income exceeds $81,777.15 or the amount of unsecured debt or the value of their divisible property exceeds $109,036.20. These amounts are indexed twice per year. See https://www.afsa.gov.au/resources/indexed-amounts/indexed-amounts

[5] A bankrupt is not required to make contributions to the debt from their income unless they earn more than $54,518.10 per annum (or more if the bankrupt has any dependents). Vehicles with a value of $7600 or less, and tools of trade with a value of $3,600 or less are protected against bankruptcy. See https://www.afsa.gov.au/resources/indexed-amounts/indexed-amounts

[6] AFSA hasn't published a Profiles of Debtors report since 2011.

entering Debt Agreements have less than $5,000 of divisible assets (66 per cent have none at all),[7] 75 per cent do not own or are not purchasing a home,[8] and 21 per cent have an after-tax income of less than $30,000.[9] This suggests that a large number of people with a Debt Agreement would have no income or assets that could be realised through bankruptcy, and (judging by the high number of people earning under $30,000) many are reliant on Commonwealth benefits.

It is clearly not in the interests of a debtor, with an income of less than $30,000 and no assets, to enter a Debt Agreement. This kind of debtor is unlikely to be able to make even modest repayments without hardship, and for those on Commonwealth benefits, directing this income to repaying debt is a poor use of public funds that have been provided to give recipients a basic standard of living.

We believe people are entering these agreements, even where they are clearly not in their interests, because there are considerable incentives for Debt Agreement Administrators to promote Debt Agreements whether or not they are in the interests of their clients. Debt Agreement Administrators are only paid administration fees (usually worth thousands of dollars) if a debtor enters into an agreement. It is also in the interests of the administrator for the debtor to pay as much of the debt as possible, as the administrator's ongoing fees are calculated as a percentage of the total amount paid.

Our financial counsellors and solicitors frequently assist clients who have entered Debt Agreements on the advice of a Debt Agreement Administrator when an informal hardship arrangement or even bankruptcy would have been a better option. These clients frequently say that they misunderstood or were misled about the true nature of a Debt Agreement and the impact it would have on their credit history, and may be struggling to make the payments required under the agreement.

Case 5

Rose (not her real name) contacted a Debt Agreement Administrator in 2012 after struggling with around $13,000 of debts, including debts to payday lenders. The Administrator entered Rose into a Debt Agreement even though bankruptcy would have been a better option in her circumstances. At that time, Rose was receiving an income well below the bankruptcy threshold and did not have any assets that could have been lost under bankruptcy. The Administrator also gave Rose incorrect information about her options. For example, Rose was advised that she would not be permitted to travel overseas if she entered bankruptcy. The Administrator also failed to advise Rose that entering a Part IX Debt Agreement was an act of bankruptcy.

Rose had made around $2,300 in instalments under the agreement (as well as fees paid to the Administrator), but by early 2013 her circumstances had changed and the payments became unaffordable. Rose sought assistance from a financial counsellor who advised Rose to apply to terminate the Debt Agreement, partly on the grounds that the incorrect information given by the Debt Agreement Administrator had led her into an unsuitable option. Rose successfully terminated the Debt Agreement and petitioned for bankruptcy.

Case 6

Glen is a 45 year old man with a long history of mental health problems. He works on a part time basis and has no attachable assets. Glen was in significant financial stress, owing approximately $45,000 in unsecured debts. He contacted a Debt Agreement company in 2014 after seeing an advertisement that promised to help people like him get out of debt.

[7] AFSA *Profiles of Debtors 2011*, p 47. Accessed from http://www.afsa.gov.au

[8] AFSA, *Profiles of Debtors 2011*, p 48.

[9] AFSA, *Profiles of Debtors 2011*, p 28.

After speaking with the Debt Agreement company, Glen entered a Debt Agreement at a cost of $2,100. The Debt Agreement company didn't inquire about Glen's mental health, capacity, income or assets before recommending it.

Glen told the Debt Agreement company he did not want to bankrupt. They didn't advise him that he was committing an act of bankruptcy where he would be obliged to repay his creditors. From financial information provided, the Debt Agreement company should have been aware that he could bankrupt with no necessity to repay his creditors.

At the time he entered the Debt Agreement in 2014 he was heavily medicated and it is doubtful that he understood the nature and effect of his actions.

We helped Glen and his mother to write letters of demand to the Debt Agreement company to get a refund of the monies paid and made complaints to AFSA and the Australian Competition and Consumer Commission (**ACCC**). We believe that at all relevant times the company had engaged in unconscionable conduct and that they had failed Glen by providing a service without due care and skill.

Case 7

Susie earns around about the threshold for bankruptcy contributions and lives in rental accommodation. She owns a low value car, and has no significant assets. Susie has a number of debts - credit cards and personal loans, all which are unsecured and include one Flexirent lease.

After viewing its website, Susie approached a Debt Agreement company about her debts in October 2015. In the phone call she indicated that she would like a copy of her credit report. Susie was "up sold" a "debt solution" – they didn't talk about other options, and made her feel like she had no other options.

They prepared a Part IX Debt Agreement proposal which requires her to pay 130 fortnightly payments of $142 totalling $18640 of which $11,999 paid to unsecured creditors and $5,100 in administrator fees to the Debt Agreement company. Susie says she was not told about the administrators fees, they told her only about an $1,800 fee, and was not advised it would last 5 years.

She did not sign the Debt Agreement and the Debt Agreement company are now they are saying she owes $2000 fee for service. Susie is not planning on going bankrupt. She has seen a financial counsellor and is she is paying off her debts.

Our 2013 research into online advertising by Debt Agreement Administrators *Fresh start or false hope?*[10] confirms this experience. Our scan of online advertising found significant variability amongst Debt Agreement Administrators in meeting AFSA's requirements in its guideline on advertising.[11] Many of the websites we reviewed contained multiple, serious problems including representations that contain inaccurate information, are exaggerated, or are likely to leave consumers with an unbalanced view of the nature of the service.

For example, the websites:

- highlighted the negative effects of bankruptcy, whilst downplaying similar consequences of undertaking a Debt Agreement—particularly the effect on credit report listings;
- indicated that Debt Agreement Administrators are balanced or independent advisers acting in the best interests of a consumer, while underplaying the fact that they charge for their services;
- were extremely optimistic about what a Debt Agreement can achieve for someone in debt, such as the amount of debt that could be forgiven by creditors or the likelihood of saving assets;

[10] The report can be accessed here: http://consumeraction.org.au/fresh-start-or-false-hope-are-debt-agreement-administrators-overstating-their-abilities/

[11] The guidelines can be accessed from https://www.afsa.gov.au/about-us/policies-and-practices/inspector-general-practice-guidelines

- did not give a balanced picture of the positives and negatives of applying for a Debt Agreement, usually simply not mentioning the negatives;
- implied or claimed endorsement by the government or ITSA (as it was then); and
- claimed that bankruptcy is stressful when anecdotal reports and other research indicates that bankruptcy relieves stress.
- Given that most debtors (and most Australians in general) know very little about insolvency law, and that Debt Agreement Administrators are the primary source of information for 88% of debtors entering an agreement, these misrepresentations will be persuasive.

Placing a minimum income threshold for entry into Debt Agreements will reduce the number of inappropriate Debt Agreements being sold. We suggest that an individual should be presumed to be ineligible for a Debt Agreement if their income and assets could not be lost under bankruptcy, that is:

- their income is below the actual income threshold in the Bankruptcy Act; and
- their only assets could not be accessed by their creditors under Bankruptcy.

The presumption of ineligibility could be displaced where there are clear reasons why a Debt Agreement would be a better option for a debtor than bankruptcy, for example where bankruptcy would put the debtor's job at risk.

Recommendations

- **A full review of the role of Debt Agreements needs to be initiated—including information provided to debtors and fees charged;**
- **AFSA statistics should provide detailed information about completion rates of individual agreements, and clear information about debt and repayment ratios;**
- **Advertising of Debt Agreements should investigated;**
- **Debt Agreements should have minimum standards for entry—including an income above the income threshold in the Bankruptcy Act, and an asset that could be seized under bankruptcy.**

Please contact me on 03 9670 5088 or at deniseb@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
CONSUMER ACTION LAW CENTRE

Denise Boyd
Director, Policy & Campaigns