Response to the Proposals Paper:
Improving Bankruptcy and Insolvency Laws

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By email: insolvency@treasury.gov.au

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Financial Counselling Australia (FCA) is
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About Financial Counselling

Financial counsellors assist consumers in financial difficulty. They provide information, support and advocacy to help consumers deal with their immediate financial situation and minimise the risk of future financial problems. The majority of financial counsellors work in community organisations, although some are employed by government. Their services are free, confidential and independent.

Financial Counselling Australia

FCA is the peak body for financial counsellors in Australia. FCA's member groups are the eight State and Territory financial counselling associations.

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- *Credit restrictions* - FCA supports a commensurate reduction in credit restrictions of one year for people who are bankrupt.

- *Overseas travel* – FCA supports a reduction in this restriction to one year.

- *Credit reporting system* – FCA recommends that a bankruptcy remain on a credit report for three years. To maintain parity within the credit reporting system, listing timeframes debt agreements, defaults and court judgments will also need to reduce.

- *Savings* – As a result of a recent court case, there is now some doubt about the ability of a person to save any money (after any required income contributions) during bankruptcy. We recommend law reform to clarify that saving money above the contribution threshold is acceptable.

- *Other reforms* – we are concerned that some people after the shorter period of bankruptcy finishes, may be more at risk of targeting by predatory lenders. It is important that other reforms in the marketplace also proceed as set out in the government consultation paper "Credit Cards: Improving Outcomes and Enhancing Competition" and tighter regulation of payday loans and consumer leases.

1.1 Why bankruptcy can be an option for some financial counselling clients

Financial counsellors day-to-day work is assisting clients experiencing financial difficulty. Each year, the national telephone financial counselling service (1800 007 007) answers around 140,000 phone calls and face-to-face financial counsellors assist around 100,000 clients.

The overwhelming feedback from clients is that they want to pay their debts. We see clients however who could only pay their debts if they instead stopped paying their rent or utility bills or stopped buying food – these are clearly not realistic options. Many of these clients are also being contacted by debt collectors and report significant personal stress and health issues. For clients in these circumstances, bankruptcy is one option that a financial counselor may explore with them.

The Australian Financial Security Authority collects information about the causes of personal insolvency.[1] The most recent statistics on the website are from 2013-14 and indicate that the four most common "causes" of insolvency, in order are: unemployment or loss of income, excessive use of credit, domestic discord or relationship breakdown and ill health.

We note that debtors are required to choose just one "cause" from the AFSA list when completing a debtor's petition. In our experience however, this simplifies what is often a very complex range of personal circumstances - there may be no single cause or it is difficult to know which came first. The list of "causes" also does not include wider marketplace issues such as irresponsible lending, inappropriate marketing by financial institutions or exploitation. These can also be factors in personal insolvencies.

What we do know is that financial counselling clients do not enter into bankruptcy lightly and see it as a last resort. A lengthy three-year period of bankruptcy, only serves to punish people for what are often circumstances beyond their control, generally resulting from a myriad of complex and interrelated causes.

Anecdotally, financial counsellors also report seeing more clients experiencing financial difficulty who have been, or are involved in, running businesses. This is not surprising as there has been an economy-wide shift toward sub-contracting and people who may previously have been employees, now find themselves with ABNs and all of the obligations that go with managing cash flows and businesses. These clients can be personally liable for business-related debts and may have used various forms of personal credit to support a failing business.

Finally, we also want to make an important point about bankruptcy as an option for severely disadvantaged consumers. For this group, there is no such thing as a "fresh start" as the core problem is inadequate income. For example, the current rate of unemployment benefits for a single person is $263.80 per week. Financial counsellors see many people who simply don't have enough money to live on because social security benefits are not sufficient to cover rent, electricity and food.

[1] See https://www.afsa.gov.au/resources/statistics/socio-economic-statistics/causes-1/causes-non-business-related

1.2 FCA supports a reduction to one year

FCA supports the proposed reduction of the period of bankruptcy from three years to one year. We see the purpose of bankruptcy as a chance to give people a fresh start and an opportunity to get back on top of their financial situation, while at the same time ensuring appropriate protection for creditors.

We appreciate that the drivers for the reduction in the term of bankruptcy, is to encourage entrepreneurs and risk-taking, with the Proposals Paper noting that our "current insolvency laws put too much focus on penalising and stigmatising the failures".[2] Exactly the same arguments apply for many of the consumer debtors who seek advice from financial counsellors. It is not a failure to find yourself in financial difficulty because you lose your job, get sick or your partner leaves you.

1.3 Income contributions

The large majority of people who enter bankruptcy are so poor they unable to make any contribution at all toward their estates. For 2013-14 for example, the most recent data available on the AFSA website, the average rate of return for all unsecured creditors in all finalised estates was 1.08 cents per dollar.[3]

We do not see any point in imposing an obligation to pay income contributions on people who have been unable to make any contribution at all while bankrupt. This would not collect any more money and only add administrative costs.

The situation is different for people who are able to make income contributions while bankrupt. We support a separate obligation that would see this continue for three years in total (including the period of bankruptcy).

1.4 Credit reporting system

As the proposals paper notes, a bankruptcy currently remains on a consumer's credit report for five years.[4] If the period of actual bankruptcy is reduced to 12

[2] Page 3.
[3] Table 5: Rate of return in bankrupt estates that were finalised during the year, https://www.afsa.gov.au/resources/statistics/selected-statistics/rates-of-return-1/table-5-rate-of-return-in-bankrupt-estates-that-were-finalised-during-the-year
[4] The required listing timeframe is the longer of five years from the date of entering the bankruptcy or two years after discharge.

months, the credit listing would effectively negate some of the benefits of the reduction, as consumers would still have difficulty in accessing credit.

Bankruptcy remains a serious step however and a 12-month credit listing timeframe would be too short. This would also "throw out" the relative timeframes for other credit reporting information in the current system: debt agreements (five years), defaults (five years), serious credit infringements (seven years) and court judgments (five years).

A reasonable balance would be a three-year listing timeframe for bankruptcy. This would have implications for the other credit reporting information listed above, which, to maintain parity, would also decrease to three years.

1.6 Overseas travel

Consistent with the arguments above, we support the reduction in the overseas travel restriction to one year.

1.7 Saving during bankruptcy

Some debtors, after making any required income contributions, are able to save some money during bankruptcy. This is a positive behaviour, consistent with sound financial literacy outcomes and helps a person to re-establish themselves post bankruptcy.

As a result of a 2014 Federal Court case, *Di Ciocco v Official Trustee in Bankruptcy*[5] there is now some doubt as to whether any cash savings in a bank account would instead vest with the trustee. This would have the perverse outcome of discouraging a savings habit and instead encouraging bankrupts to spend all of their income. This would leave consumers in this position with no savings buffer and make it much harder for them to get back on their feet post-bankruptcy.

Given is some uncertainty about the impact of this recent court decision, we recommend that the Government clarify the situation by amending the legislation appropriately to provide that a bankrupt may save any money beyond that required for income contributions.

1.8 Responsible lending needs to be part of the package

A one-year period of bankruptcy will allow people to re-establish themselves more quickly and this a good thing. We are concerned however, that after a bankruptcy

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[5] [2014] FCA 792.

ends, some entrepreneurs/small business people and consumers, may be easy targets for unsound or predatory lending practices or unrealistically optimistic about business opportunities. Reckless lending could have the potential of saddling people with new debt.

It is therefore important that other proposed reforms, particularly for credit cards, also proceed. These are set out in the current consultation paper from the Federal Government titled “Credit Cards: Improving Outcomes and Enhancing Competition” and include proposals that will:[6]

- require an assessment of credit card limits based on the ability of a consumer to repay the whole limit within a reasonable period;

- prohibit unsolicited credit limit increase offers

- improve cost disclosure, consumer information and comparison information between credit card products.

Similarly, the Government is also considering proposals to tighten legislation applying to payday lending and consumer leases. These reforms are also vital.

2 CREDITORS PETITIONS

The threshold for a creditor’s petition needs to be raised from the current $5,000 to $20,000.

Financial counsellors have long argued that the threshold for a creditor’s petition needs to be increased to a realistic level. The current threshold of $5,000 does not get the balance right between creditors and debtors - it allows creditors to bankrupt a consumer over a relatively small amount and to use bankruptcy as a first resort debt collection technique.

People experiencing financial hardship are almost always under significant stress and do not understand our debt collection system. It is not appropriate that a person might lose their home over a debt as small as $5,000. By the time trustee fees are added, a consumer might owe many thousands of dollars in fees.

[6] http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Credit-card-reforms

3 DEBT AGREEMENTS

Part IX of the Bankruptcy Act is subject to a comprehensive review

There has recently been some academic research, through a survey, gathering the experiences of financial counsellors and consumer lawyers about the impact of bankruptcy and debt agreements on their clients.[7] Financial counsellors and consumer lawyers were extremely critical of debt agreements. The researchers noted that:

> "several advocates elaborated on their view that debt agreements cause continuing financial hardship. They said that most debt agreements require clients to make regular repayments that they cannot afford."[8]

Advocates pointed to problems with debt agreement administrators not taking into account that a debtor's situation may change over the course of the agreement, that the costs of an agreement are high, that many clients do not fully understand these agreements and that debt agreements are marketed inappropriately.

We agree with our colleagues in the Financial Rights Legal Centre and the Consumer Action Law Centre in their submissions responding to the Proposals Paper, that the problems with debt agreements are extremely serious and that change is needed.

The Consumer Action Law Centre wrote:

> "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 … 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.
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> In recent years, more people have been entering into Debt Agreements while

[7] Paul Ali, Lucinda O'Brien and Ian Ramsay, *Perspectives of Financial Counsellors and Consumer Solicitors on Personal Insolvency*, Social Science Research Network, September 2015, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2660712

[8] ibid, p 11.

fewer have been presenting debtors petitions for bankruptcy. The most recent AFSA statistics available show that 75 per cent of those 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, and 21 per cent have an after-tax income of less than $30,000. 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."[9]

The Financial Rights Legal Centre wrote:

"In our experience consumers in Debt Agreements are either:

a) not insolvent at all but in temporary difficulties or mild ongoing financial stress and could manage to recover using hardship provisions, negotiations and/or some strategic advice; or

b) better off bankrupt – because it would cost them less, be over faster, the implications would be more or less exactly the same, and there would be certainty about the consequences and end date …. [10]

Financial Rights is of the view that Part IX of the Bankruptcy Act should be repealed because it serves the interest of debt agreement administrators and associated entities far more than the debtors and creditors it was created to assist. At the very least there should be a comprehensive review of debt agreements, with a view to ensuring that they only entered in appropriate circumstances." [11]

[9] Consumer Action Law Centre submission, pages 5 – 6 (footnotes from the text removed)
[10] Financial Rights Legal Centre submission, page 12.
[11] Financial Rights Legal Centre submission, page 13.