A JOINT SUBMISSION

FROM PIPA AND BOND UNIVERISTY FACULTY OF LAW

IMPROVING BANKRUPTCY & INSOLVENCY LAWS

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The Personal Insolvency Professionals Association Limited (ACN: 110-819-611) was founded 11 October 2004 as a professional non-for-profit organization. Initially named the Debt Agreement Practitioners Association, the Company was renamed in 2013 to more readily identify with the nature and function of its members. The Association generally referred to as PIPA represents the majority of registered debt agreement administrators in Australia; and includes a number of trustees.

This Association is a Member of the Bankruptcy Reform Consultative Forum and enjoys regular interaction with the Australian Financial Security Authority, major local and international creditors; and financially distressed consumers through its members. The Executive of the Association comprises practicing debt agreement administrators who are actively engaged within the industry.

In the main, the role of our members is to administer debt agreements that have been accepted by those creditors affected by the insolvency of a consumer. Tens of thousands of such agreements are currently on foot and the returns made available to creditors are substantial.

Our members have a sound understanding of personal insolvency issues and the impact insolvency has upon the economy, the insolvent individual and those creditors affected by such failures.

PIPA does not support the proposal expressed in the Executive Summary that the bankruptcy discharge period be reduced from three (3) years to one (1) year and submits its reasoning herein together with its comments on the balance of proposals.

PIPA enjoys a special relationship with Bond University and in particular the Faculty of Law. In September 2016 Bond University will introduce a unique Personal Insolvency Education Program which will be available to those, engaged in business, touched by personal insolvency issues.

Richard Symes PIPA

Executive Chairperson

Executive summary

Regulatory changes to bankruptcy laws in Australia have been a priority of legislative change for some time now. Central to both major political parties' economic platform's is the mantra of economic growth, job creation and future prosperity, all of which are underpinned by innovation and entrepreneurial spirit. However, lost in the translation of political rhetoric lies the harsh reality of business failure in entrepreneurial ventures and the consequent fallout for related entities and economic trade partners. Such consequences ought to be considered when proposing changes to the default bankruptcy period.

As a net capital importer, Australians and investors around the world will be urged to support these proposed amendments in a bid to attract foreign investment as economic stimulus. While the proposed reforms may attract more interaction from the global marketplace, Australia risks becoming an outcast of credit agencies and a haven for risky multinational ventures; eager to offload potential financial burden and trial risky business ideas.

Improvement of Bankruptcy Law in Australia, does not necessarily mean shorter default periods. If entrepreneurs 'will fail several times before they achieve success', [1] it needs to be balanced with protecting the economy and public from financial and reckless destruction. Improvement means education, accessibility and support. Conceivably it is not as simple as reducing the default time period by two thirds. Further, since only 22%[2] of bankruptcies in 2015 were related to business, and reasonably an even smaller fraction of that is entrepreneurial, the Government must balance the entrepreneurial benefit against the interest of the public as a whole. This submission finds that the Government has not justified the change of Commonwealth legislation for less than 22% of users. Especially considering the massive impact proposed changes that will have across the country in various sectors.

A proposed reduction in bankruptcy stigma as a justifying factor for the proposed changes is flawed. Prima facie these changes have very little visible affect on stigmatising bankrupts; names are still recorded and restrictions imposed, albeit for a shorter time period. Care must be taken not to confuse the creation of precedent for irresponsible business and personal credit practices, with positive change. This submission proposes that stigma is reasonably rooted in the credit file implications of bankruptcy not the default period. Australia is not like other systems such as the UK and bankruptcies are not published daily in the London Gazette.[3] Stigmatising of

[1] The Treasury, "Improving Bankruptcy And Insolvency Laws Proposals Paper" (Australian Government, 2016).
[2] 22% for 2014-15, calculated from Business time series data from *Selected Statistics 2016 — Australian Financial Security Authority* (2016) Afsa.gov.au <https://www.afsa.gov.au/resources/statistics/selected-statistics/selected-statistics>.
[3] The Insolvency Service, "Guide To Bankruptcy" (UK Government, 2016).

bankrupts can be improved through education and support of other less severe actions and options. The UK precedent, which the Government appears eager to follow, endorses bankruptcy as the last and final option for debtors. Bankruptcy administration even offers debt agreements within the early administration of bankruptcy to try avoid ever entering the more onerous requirements and processes of personal insolvency.

The new measures claim to protect creditors but there is a fundamental issue of preference and order. It is reasonable to conclude that the Australian Taxation Office (ATO) and banks will remain the largest creditors, particularly in the case of new start-ups which have drained capital and funding resources for a short period of operation and income gaining activities, if any. A difficulty will arise when a singular bankrupt has multiple obligations due to multiple bankruptcies.

Other businesses and the population stand to lose if the disincentive to bankruptcy is removed by shortening the default period. In single cases of bankruptcies, suppliers, other start-ups, small businesses and the supportive Australians employed in entrepreneurial business will be left vulnerable and lacking economic confidence. It is the secondary, smaller creditors that will also suffer from tightening of credit facilities in industries as bankruptcies leave debts outstanding. Particularly if consumers take advantage of the proposed bankruptcy changes, as is the concern of this submission.

Australians need to embrace risk, learn from mistakes, be ambitious and experiment to find solutions. There is a subtle but important difference between responsible and irresponsible risk taking that must be considered. Learning from mistakes seems to have been overlooked as we utilise incompatible precedent and outdated statistics while also reverting to a system that we rejected almost fifteen years ago. Australia should be ambitious in tackling bankruptcy stigma; but whether a Commonwealth legislative change is the appropriate platform is up for debate and indeed the discussion of this paper. We submit for the reasons that follow and have been raised that this is not the case.

Time should rather be spent marketing Part IX's debt agreements[4] and educating credit card abusers. Arguably, time and money would also be better spent policing banks and educating small businesses in responsible money management instead of changing the law to benefit a target group of less than 22% of the total. There is no reassurance in the use of outdated statistics and this submission expresses concern for mimicking precedent from a different region and system. These reforms leave more questions than answers in a process where the individual foreseeably enduring a trying struggle, seeks stability, answers and intelligent structure.

[4] *Bankruptcy Act 1966* (Cth).

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1 Reducing the default bankruptcy period

Changes by the Government strongly mirror provisions in place in the UK. This submission seeks to highlight that the UK has a prima facie more sophisticated and consumer-friendly Insolvency system. With simple ‘how to guides’ and a unified administration system, it outshines Australia and is completely different. It is the concern of this submission that the Australian system cannot simply pick and choose elements for substitution in to insolvency practices.

Australia does not need to hold the coat tails of the UK; their system is not the same. They strongly encourage Bankruptcy as a last resort and there are significant obstacles to restarting in the business industry after bankruptcy. The official trustee in the UK can choose to continue imposing business restrictions on the bankrupt individual after discharge, especially if there are concerns about dishonesty.

1.1 Misconduct

It is our view that not every bankrupt should be discharged on the expiration of the first anniversary of filing a debtor's petition. Rather, the legislation should revert to an application for discharge by the debtor and such discharge should be considered subject to the recommendation of the trustee based upon:

- The level of loss sustained by creditors as a result of the bankruptcy;
- Full compliance of the bankrupt with his or her legislated obligations;
- If the bankruptcy is a first or subsequent bankruptcy;
- All asset issues have been resolved by the trustee;
- Contributions have been met in a timely manner, and continue to be met;
- Steps taken to compromise the indebtedness prior to bankruptcy.

Although there is no direct mention in the paper concerning a debtor's bankruptcy by way of a creditor's petition it is presumed that the same processes, as outlined, are likely to apply.

We perceive that a one year bankruptcy default period will invite an avalanche of filings from the lower socio-economic groups and those consumers who show little or no regard for personal indebtedness. Gamblers will perceive the proposals as a wind fall. Multiple filings during a prescribed period, by an individual, should involve penal consequences. Alternatively, as in the United Kingdom, the bankrupt should be subjected to a:

- Bankruptcy Restrictions Order; or
- Bankruptcy Restrictions Undertaking[5]

Grounds of objection that may be set out in a Notice of Objection 6 appear to be substantial and sufficient.

1.2 Ongoing obligations for bankrupts

It is the view of this submission that those consumers seeking relief under the proposed reduction in the bankruptcy discharge period will possess few, if any, assets of consequence.

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[5] *Insolvency Act* (1986), Sch 4A, para 7(1).

1.2.1 Requirement to assist trustee

1.2.1 The requirement that a discharged bankrupt give assistance[6] is well expressed in the current legislation with an appropriate penalty.

The cooperation of the bankrupt is essential to the operation of insolvency proceedings. However there is a dangerous loophole if administration of shorter bankruptcy periods allows for manipulation of mandatory compliance with the trustee and less restrictive overseas travel provisions. This situation will be exacerbated, if fears concerning the inability to properly lodge discharge objection applications in the shorter default time, are found to be warranted. Simply this submission is concerned about bankrupts that choose to flee the country post discharge and therefore also escape any further income contribution.

1.2.1a The obligation on a bankrupt to continue with contributions is considered a primary obligation and should continue.

There are concerns that must be expressed regarding enforcement in this area. Bankrupts may exploit innovation motives to seek leniency in compulsory extended payback periods. There are no provisions in place to stop this.

Further since there is no limitation on the number of shorter default periods available to individuals is it possible that individual may have multiple repayment obligations but there is no guidance for the priority and hierarchy of payments.

1.2.1b The obligation to pay contributions should be enforced by mandatory garnishee of income.

1.2.2 Income contributions

This submission supports the obligation of income contributions upon a bankrupt individual however it also seeks an explanation for the following issue. If the motive is to increase entrepreneurial pursuits in business, once bankruptcy restrictions have come in to effect and the likely sole trader has been removed as Director where will the incentive be for them to continue working to achieve income contributions?

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[6] s152 Bankruptcy Act 1966 (Cth).

The UK precedent[7] offers inspiration should this area be implemented. It imposes income payment agreements, and mandatory orders failing cooperation by the bankrupt. These arrangements and orders include contributions from all revenue streams of the bankrupt for three years following bankruptcy, especially when only welfare payments are received. Welfare payments and a lack of income earning activity imposes stricter allowable expense provisions. This acts as a deterrent from relinquishing responsibility to work and pay back debts. This system is ingrained in the UK's bankruptcy administration and allows for adaption to different family circumstances to maintain its desired effect.

Directors of start-ups and entrepreneurial ventures, which these proposed changes stand to support and encourage, have no incentive to continue working. This proposal is very similar to the UK model but it has a fundamental flaw that needs to be addressed. Potential risk arises for the encouragement of fraud as bankrupts seek alternative methods to avoid continued contributions but may be inclined to begin another venture possibly with a family member or associate that also has the benefit of a shorter bankruptcy period, to fall back on.

1.3 Restrictions

Bankrupts retain the ability, in the majority of circumstances, to obtain credit from last resort lenders albeit at a premium interest rate. This practice should be eliminated by legislation particularly if repayment of such loans hinders the payment of contributions. These reforms reducing the disincentive to bankruptcy may also create hardship in the lives of everyday Australians as financiers tighten criteria and decrease lending to protect themselves as credit providers from the actions of credit abusers.

1.3.1 Access to credit

If the purpose of the proposals is to engender greater innovation and boundless risk taking by those wishing to embark on business ventures it would be a futile proposition to reduce the bankruptcy discharge period to one (1) year whilst retaining five (5) years annotations on credit files. If credit file annotations remained at five (5) years then the intended purpose of unlocking available credit will be lost.

1.3.1a

This submission finds a fundamental flaw and risk as consumers with credit card debts that have benefited from reduced bankruptcy periods, may become trapped in a continuing cycle of bankruptcy and higher interest rates.

[7] *Insolvency Act 1986*, (UK), Part IX C1, s281A and Schedule 4A.

1.3.1b The NPII is anachronistic and other than its commercial value to credit reporting agencies it serves no real function beyond gathering statistics. If the purpose of the proposals is to assist consumers to be innovative and to 'take more risks' then NPII annotations should be extinguished after a prescribed period of time.

The proposed changes to the law claim to also reduce stigma surrounding bankruptcy, making the introduction of a permanent record: counter intuitive. Especially if there is no beneficial administrative purpose, such as a predefined threshold before punitive action commences against repeat consumers. Business persons are likely to shy away from a practice and path that led to a permanent association with their name and financial failure, no matter how long its repercussions were.

Further the entrepreneurial beneficiaries of these proposed changes may face difficulties seeking funding and financial support for future benefits. This could introduce new obstacles to entrepreneurship itself.

1.3.2 Overseas travel

This submission does not support the proposal as expressed as it fails to provide for enforcement situations where an income obligation applies to the bankrupt individual after discharge. The individual may choose to leave the country to a destination of their choosing and could foreseeably avoid repayments through certain destination decisions such as non-expediting countries. Ultimately there is a flight risk that will further decrease the disincentive effect of final repercussions such as continued income contribution periods.

1.3.3 Licences and industry associations

The UK precedent prohibits Directorships while paying back the debts due during and after bankruptcy under the various provisions. There is a foreseeable issue here for a continuing entrepreneurial sector. There are other options available that could relieve the debt stress of individuals in the entrepreneurial sector. Changes such as increasing the threshold of Part IX debt agreements would be more beneficial. Not entering bankruptcy to begin with would result in less industry and authority restrictions, instead be encouraging individuals to manage their difficult debts in a structured and sustainable manner.

2 Safe Harbour

This submission supports the concept of a safe harbour for directors.

2.1 Background

This submission supports the concept of introducing a safe harbour to the current insolvent trading offences.

2.2 Safe Harbour Model A

This submission offers no comment.

2.2.1 The restructuring adviser

As the restructuring of a business is essentially the preserve of the company directors, we see no reason for regulatory guidance from ASIC. Failure will most likely result in liquidation.

This submission advocates for accreditation by way of specific ‘turnaround’ licencing through ASIC and submits that those accredited should include members of:

- CPA Australia;
- Chartered Accountants Australia;
- Institute of Public Accountants;
- ARITA.

Additionally, a corporation which has directors qualified to undertake the role of adviser should be included. Example:

- Director 1 Certified Practicing Accountant
- Director 2 ARITA Qualified
- Director 3 Lawyer

We do not agree that a member of the Law Society, acting in the capacity of a solicitor, is qualified to undertake restructuring of a company unless aided by a qualified accountant with insolvency qualifications.

We believe that the methodology outlined as a test of viability would be adequate.

The dynamics of a restructuring should be left with the adviser in consultation with the directors, as there may be numerous issues to be considered that will influence an outcome.

This submission supports the obligations and protections expressed for the role of a restructuring adviser.

2.2.2 Other features of safe harbour

This submission offers no comment.

2.2.3 Where safe harbour is not available

This submission offers no comment.

2.3 Safe Harbour Model B

This submission offers no comment.

3 Ipso Facto clauses

This submission offers no comment.

3.1 Background

This submission offers no comment.

3.2 The Ipso Facto Model

This submission offers no comment.

3.2.1 Anti-Avoidance

This submission offers no comment

3.2.2 Exclusions

This submission offers no comment.

3.2.3 Appeal

This submission offers no comment.

4 Summary

We recognize that reform in the area is long overdue, however the likely consequences to other personal insolvency regimes as a direct result of the adoption of the proposal to reduce the bankruptcy discharge period from three (3) years to one (1) year is concerning. Specifically, the impact this proposal may have on the willingness of consumer debtors to seek a compromised settlement arrangement with their affected creditors, even if they have a diminished capacity to honour their obligations. This will also result in implications for major lenders.

4.1 Rehabilitation

Historically, it has been a cultural obligation for a debtor to repay monies borrowed, or at the very least (in Australia) to offer creditors a compromised settlement. Bankruptcy Law has been diluted over the years in Australia and elsewhere leaning toward an emphasis on rehabilitation of the debtor. Bankruptcy has always been viewed as an option of last resort.

4.2 Small Business Enterprise

It is government's stated aim to allow consumers greater flexibility to be innovative and to take greater risks. We support this view but question if the proposed legislation will achieve its goal or end up a nightmare.

Only 17% of bankruptcies are due to sole trader business failures. The balance of 83% relate to households. If the possibility of bankruptcy acting as less of a deterrent than it does, it remains to be seen if that will have a positive impact on entrepreneurial behaviour or if it will encourage risk taking by those with business aspirations but no business acumen. Although we support the concept that entrepreneurs do, and will fail in ventures, we express concern that this could force major lenders to be less willing to advance loans. Current business culture tends toward incorporation rather than sole trader and partnership arrangements thereby circumventing bankruptcy legislation unless personal guarantees are involved.

4.3 Household Debtors

This group is the major filer of debtors' petitions and a substantial portion of individuals in this group are government beneficiaries. Those in the higher income brackets filing debtors' petitions have generally suffered a major event in their lives that has drastically curtailed their ability to meet creditors' demands.

4.4 Willingness to effect a compromised settlement

Many financially distressed consumers, for whatever reason, find the prospect of bankruptcy to be abhorrent and willingly enter into compromised debt settlement arrangements with affected creditors. Subject to thresholds, Part IX[8] has proven to be a mechanism that, in the main, satisfies creditors and delivers substantial returns. This may not be the case if the proposals are implemented.

4.5 Unwillingness to effect a compromised settlement

It is perceived that a one (1) year bankruptcy discharge period will be misunderstood by many distressed consumers as 'the easy way out' of their financial problems irrespective of any side-effects that may be incurred. Such an attitude may lead to communal disrespect for incurring indebtedness and result in consumers preferring bankruptcy to any form of debt settlement.

4.6 Creditors

How creditors react to the proposals is unknown, but it would not be unreasonable to assume that the losses they will incur will be substantial and uncollectable. The cost of such losses will ultimately be borne by consumers at large.

4.7 Debt Agreements

Since the introduction of debt agreements in 1996 under Part IX,[9] consumers have been able to offer a compromised settlement to affected creditors, at an affordable rate, retain assets that they could afford to keep and not be subjected to many of the consequences of bankruptcy. This regime has operated very successfully over the years.

Reducing the bankruptcy discharge period to one (1) year places those who have chosen to settle with creditors; and those who may choose to make offers in the future, at a clear disadvantage.

- Debtors are making efforts to honour their indebtedness.
- The majority of proposers have asset-less estates.

[8] *Bankruptcy Act 1966* (Cth) s185.

[9] *Bankruptcy Act 1966* (Cth).

- In the main, debtors enter into five (5) year arrangements to repay.
- There are consequences to bear under bankruptcy legislation.
- Declarations concerning their insolvent state are required to be made in certain circumstances.
- Sole traders cannot operate under a business name without personal identification.

An asset-less bankrupt, on the other hand, simply walks away from indebtedness (irrespective of the losses to creditors), subject to the liability to pay contributions – which is unlikely in the majority of cases, and it is proposed that after one (1) year they will have the ability after discharge to seek further credit, irrespective of the financial hardship that may have been caused to lenders, small businesses or individuals.

There is a clear inequity in the proposals, as they relate to filing for bankruptcy and being prepared to honour one's obligation to some extent.

4.8 Categories of Bankrupts

Consideration should be given to categorizing bankrupts in legislation and dealing with their discharge according to prescribed regulation.

- First or subsequent bankruptcy;
- Cause of bankruptcy;
- Attempts to compromise creditors prior to bankruptcy;
- Cooperation with trustee;
- Timely contributions;
- Financial awareness.

As there is no threshold on the amount of debt discharged under bankruptcy such regulations should have regard for the level of indebtedness at the date of bankruptcy. In monetary terms 'writing off' $1,000,000 or more from business failure has a far greater impact on the economy than does house-hold debt of $30,000. However concerns are raised regarding the likelihood of household debtors who will file for relief under the one (1) year proposal.

4.9 General

We perceive that the number of consumers seeking relief under Part IX or Part X will decrease with individuals opting to file a debtor's petition. The proposed changes will therefore have far reaching consequences in the industry; particularly, it is likely consumers already accepted into compromise arrangements with creditors will apply

to terminate those agreements and file for bankruptcy. It remains to be seen if that will have a positive impact on entrepreneurial behaviour, however, it is clear it will have far reaching consequences for lenders.