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By email: insolvency@treasury.gov.au

Manager
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The Treasury
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Dear Sir or Madam

Submission to Options Paper - A Modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on this options paper.

We have limited our comments to four areas covered by the Options Paper:

- remuneration framework for bankruptcy trustees;
- standards of entry into the insolvency profession;
- discipline and deregistration; and
- regulator powers, particularly in dispute-resolution.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Since September 2009 we have also operated a new service, MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians with changed financial circumstances due to job loss or reduction in working hours, or experiencing mortgage or rental stress as a result of the current economic climate.

Consumer Action's casework experience

As context for our recommendations in this submission, we outline below a number of case studies sourced from Consumer Action's casework where individuals are bankrupted over small debts despite the debtor being solvent. In our experience, the inappropriate use of bankruptcy as a tool to collect these kind of debts, combined with often unreasonably high trustee fees, cause considerable financial detriment and can unnecessarily place the bankrupt's home at risk. We note that there are other more appropriate and cost effective tools for creditors to collect debts (such as State and Territory judgment debt recovery legislation) and that the purpose of the bankruptcy framework is to address genuine insolvency.

A scan of Consumer Action's casework records (including both our legal advice and financial counselling services) since December 2010 reveals that we have received around 20 calls from consumers concerned that they would be the subject of a creditor's petition. For six of those clients, the debt is question is under $10,000.

Some of these recent records include:

- <u>Case Study 1:</u> A client who called in December 2010 was served with a bankruptcy petition for an debt of less than $6,500. The clients offer to pay $5000-5,500 immediately with the balance to be paid subsequently was rejected. The client is not in default to any other creditors.

- <u>Case Study 2:</u> A solicitor in another community legal centre approached Consumer Action regarding a client who was being bankrupted for a credit card debt of around $10,000. The client was not insolvent and their mortgagee had indicated that they would be willing to refinance an existing mortgage to allow the client to pay the debt.

- <u>Case Study 3:</u> A client called in February 2011 reporting that a debt collector had obtained a judgement debt of $6,000 against her and were threatening bankruptcy. The client was in receipt of a Commonwealth benefit but owned a house with their partner who was employed. The client was seeking to pay off as much of the debt as possible immediately and apply for an instalment order.

This older case demonstrates how a small debt can grow enormously because of an inappropriate decision by a creditor to seek bankruptcy:

- <u>Case Study 4:</u> Our client hired a solicitor in 2006 and on parting company understood he did not owe the solicitor any further payment. Our client later received a request to pay $2,000 which our client queried. The solicitor's office undertook to call him back and never did. The next our client heard, a sequestration order was obtained on the basis of a judgement by default in the amount of $2,644.15. Our client produced evidence to show that the Bankruptcy Notice had not been served on him personally, as had been claimed.

  A financial counsellor acting on our client's behalf endeavoured to get an indication of the amount the Trustee would accept to annul the bankruptcy. The trustee eventually nominated $21,673.38, of which $12,000 were the trustee's fees. With assistance from Consumer Action, a settlement was reached to pay $7,500 to the trustee, $6,000 to the petitioning creditor and to have the sequestration order set aside.

Another older case demonstrates the extent of trustee fees that can be accrued:

- Case Study 5: A client was bankrupted in March 2007 by his business partner for a debt of $12,000. Total claims of all creditors proving in the administration stood at around $42,000. In the twelve months to March 2008, the trustee had incurred professional fees and disbursements of over $100,000 with estimated future fees of $15,000. Of over $112,000 raised by liquidating our client's business and personal assets, not a cent had gone to pay the debt for which our client was made bankrupt. By March 2008, the trustee demanded another $93,000 to pay out the bankruptcy. The only way to raise the money was to sell the client's last remaining asset, their home.

  Our client co-operated with the trustee and was unaware of any reason why fees should be so high. Consumer Action subsequently contacted ITSA requesting that the Inspector-General take action against the trustee under s 179 of the Bankruptcy Act. ITSA's response which declined the request suggested that they were not convinced that there were "exceptional circumstances" to justify such action.

As well as the above, we draw your attention to the case studies in Jan Pentland's 2007 report *Homes at Risk: Using Bankruptcy to Collect Small Debts*[1].

Remuneration framework for bankruptcy trustees

We acknowledge the amendments made to the *Bankruptcy Act* in 2010, including changes to the remuneration arrangements for bankruptcy trustees and increasing from $2,000 to $5,000 the minimum debt upon which a creditor's petition may be presented to the court. We strongly welcome those amendments, however we believe the minimum debt threshold should be increased to $10,000.[2]

The scenarios described in the case studies above prompt two questions for our clients—firstly whether bankruptcy is an appropriate way to recover these kinds of debts, and secondly whether trustee fees are reasonable in each case. We acknowledge the Options Paper is not considering the issue of the minimum debt threshold, however it is considering the issue of remuneration framework for insolvency practitioners. The reforms to date have focused on improving the framework for reviewing trustee remuneration and costs. Given the significant detriment outlined in the case studies above, we believe further reforms are required to prevent excessive trustee fees being initially incurred.

We suggest three mechanisms for achieving this:

- Make it clear that a creditors petition can only legally succeed in cases of genuine insolvency - for example, legislative amendment may be required to be more explicit that the court must genuinely consider a debtor's solvency before declaring a debtor bankrupt;
- Improve the framework by which the charges or a trustee may be reviewed, including removing any requirement for 'exceptional circumstances'; and

[1] The report can be accessed at http://www.financialcounsellingaustralia.org.au/discussion%20documents/Homes%20at%20risk%208%20dec.pdf

[2] See for example Consumer Action's joint submission regarding the Bankruptcy Legislation Amendment Bill 2009 exposure draft accessible at http://www.consumeraction.org.au/downloads/SubmissiontoExposureDraftBankruptcyBill2009140909.pdf.

- Impose further limits on trustee fees where a bankrupt is considered 'vulnerable'.

Regarding the third point above, the definition of a vulnerable bankrupt would need to be set out in either professional standards and/or relevant Acts or regulations. We suggest the 'vulnerable' definition would be limited to:

- individuals;
- who are bankrupted through a creditor's petition;
- who meet relevant vulnerability criteria listed either in standards, Acts or Regulations.

A full range of criteria for vulnerability would need to be developed through a proper consultation process. However we suggest the following would be relevant considerations:

- the person is at risk of losing their primary place of residence through the bankruptcy;
- the person has an unusually low level of financial expertise, whether because of impairment, naivety or any other reason;
- the person has had limited or no access to professional advice regarding the debt or bankruptcy;
- creditors of the bankrupt have little incentive to minimise fees charged trustee because the debt is very small compared to the value of the divisible assets (this is discussed below); and
- the person is of low income (perhaps defined in relation to current rates of Commonwealth pensions or payments).

Where a bankrupt meets the vulnerability test described above we recommend that trustees be required to apply to the Inspector-General in Bankruptcy to decide their remuneration. This process would be the same as the existing process for the Inspector-General to decide remuneration in cases where it is not fixed by creditors or a committee of inspection[3], except that in this case the purpose would be to protect the interests of the bankrupt rather than the creditors. Once remuneration was set through this process, there should not be any reason for trustees to charge a higher amount.

This additional requirement would not be necessary where creditors have an incentive to minimise trustee costs. However, in the cases we have described above, there is little or no incentive for creditors to do so. For example, if a sole creditor is owed $10,000 and the bankrupt has $250, 000 of equity in their home, the creditor has no incentive to keep the trustees fees low—as long as the trustee accrues fees of less than $240,000, the creditor will be repaid. In this case, only the bankrupt is harmed by unreasonable trustee fees, yet the bankrupt has the least power to ensure those fees remain reasonable. This requirement will provide protection for bankrupts without adversely affecting the interests of creditors.

We acknowledge and welcome the process introduced on 1 December 2010 allowing bankrupts to request the Inspector-General to review trustees fees and third party costs.[4] Although this provides an important avenue of appeal for bankrupts, in our experience the most vulnerable consumers will be least likely to know that these kind of avenues exist, how to use them, or how to seek assistance to use them. Allowing an independent authority to decide remuneration at the

[3] Under subsection 162(4) of the *Bankruptcy Act 1966* and rr 8.09-8.11 of the *Bankruptcy Regulations 1996*.
[4] under section 167 of the *Bankruptcy Act* and regulations 8.12D-8.12I of the *Bankruptcy Regulations*.

outset will provide an added layer of protection to vulnerable bankrupts, and would prevent disputes arising when the bankrupt receives a remuneration claim notice.

Standards of entry into the insolvency profession

We generally support the proposal to align the standards of entry into the insolvency profession for corporate insolvency professionals and personal insolvency professionals. A particular concern we have is that some insolvency professionals who do not meet the entry standards for corporate insolvency work, or who have had their registration as a liquidator revoked by ASIC for misconduct, are able to continue to perform personal insolvency work as a trustee registered by ITSA. We believe standards of entry should be designed to ensure high standards among insolvency practitioners across both personal and corporate insolvencies, yet the current system allows for those shown to have been involved in misconduct in corporate insolvency to continue to offer personal insolvency services.

We suggest that the framework should expressly allow one regulator to recognise and take account of disciplinary action or deregistration by the other.

Discipline and deregistration

We note the discussion in the recent Senate Economics Committee Inquiry report, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, about the problems and reputational damage that has been sustained by the corporate insolvency industry as a result of poor performers or 'rogue' registered liquidators. We would suggest that there are similar 'rogue' bankruptcy trustees undertaking personal insolvency work causing similar harm—many of the private trustees involved in the case studies outlined above could be considered rogue operators. For example, the trustee in case study five above resigned as a liquidator following ASIC concerns regarding their conduct and capacity. As at 21 July 2011, this person is still listed by ITSA as a registered trustee.

We agree that more should be done to remove poorly performing registered insolvency practitioners as a way of maintaining the integrity and credibility of the system. The Inspector-General should undertake investigations about the conduct of registered trustees where there is misconduct identified—either from consumer complaints or on its own motion. These investigations should result in discipline and deregistration where it is demonstrated that misconduct has occurred. We believe that the charging of excessive fees where a bankrupt is not insolvent and has property should trigger a finding of misconduct leading to discipline and deregistration. A robust system could be linked to the functioning of an external dispute resolution body such as an ombudsman (discussed further below) which could monitor complaints in the industry as well as assess breaches of any industry codes of practice, which also might trigger investigations by the Inspector-General.

Regulator powers—dispute resolution

We note the Inspector-General's process for resolving complaints against registered trustees as set out in its guidance *Resolving Complaints about Trustees and Administrators.* Nevertheless, we believe that the supervisory and enforcement functions of a regulator is significantly different to dispute resolution and there is significant merit in establishing an independent ombudsman for the insolvency industry. In our view, a regulator should focus on compliance with the law and ensuring high standards within the sector, while dispute resolution should focus on resolving complaints and disputes to the benefit of consumers and insolvency practitioners and is an alternative to court based dispute resolution. We note that the Senate Committee Inquiry also stated that 'an Insolvency Ombudsman should be seriously considered'.

Independent industry-based ombudsman schemes have been effective at resolving consumer complaints efficiently and fairly in a range of other sectors, including banking, telecommunications, and utilities. The advantages of these schemes include:

- membership of the schemes is typically a condition of holding a relevant licence or being registered, so all in an industry must participate in external dispute resolution;
- operation of the ombudsman schemes is funded by industry, so industry has a financial incentive to minimise consumer disputes;
- the schemes are typically required to investigate and report on systemic problems to the regulator; and
- the schemes keep detailed records and make detailed reports that assists the advancement of consumers' interests.

Importantly, industry external dispute resolution schemes are free and preserve consumers' legal rights if they are unsatisfied with the outcome. This ensures the schemes are accessible by all in the community.

There are well-recognised benchmarks for industry external dispute resolutions schemes (known as the DIST benchmarks).[5] These are:

1. Accessibility: The scheme makes itself readily available to customers by promoting knowledge of its existence, being easy to use and having no cost barriers.
2. Independence: The decision-making process and administration of the scheme are independent from scheme members.
3. Fairness: The scheme produces decisions which are fair and seen to be fair by observing the principles of procedural fairness, by making decisions on the information before it and by having specific criteria upon which its decisions are based.
4. Accountability: The scheme publicly accounts for its operations by publishing its determinations and information about complaints and highlighting any systemic industry problems.
5. Efficiency: The scheme operates efficiently by keeping track of complaints, ensuring complaints are dealt with by the appropriate process or forum and regularly reviewing its performance.

[5] Department of Industry, Science and Tourism (DIST), Benchmarks for Industry-Based Customer Dispute Resolution Schemes, 1997, available at <http://www.anzoa.com.au/National%20Benchmarks.pdf>

6. Effectiveness: The scheme is effective by having appropriate and comprehensive terms of reference and periodic independent reviews of its performance.

Industry ombudsman schemes also observe relevant standards on complaints handling and dispute resolution which is not necessarily the case where regulators have the function of dispute resolution. We recommend the establishment of an independent ombudsman scheme for the insolvency sector.

Thank you again for the opportunity to comment. Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
CONSUMER ACTION LAW CENTRE

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