Australian Institute of
CREDIT MANAGEMENT

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5 March 2021

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Increasing the statutory demand threshold

The Australian Institute of Credit Management (AICM) appreciates the opportunity to participate in this consultation.

The AICM represents over 2,600 credit professionals who contribute to a resilient economy and drive successful business outcomes through.

- mitigating risk;
- maximising growth; and
- applying sound credit principles and practices.

Without our members, businesses are exposed to reputational damage, poor cash flow management and inefficient processes. Their employers are at risk of breaching regulatory requirements and not getting paid for hard won sales and services delivered.

Our members are the custodians of cash flow. They assess credit risk in all sectors and manage credit terms for the supply of goods, services and finance.

AICM members do not support an increase to the statutory demand threshold, with the key factors for this position being:

- Members are not aware of any research or data supporting claims that the current threshold is being systematically abused. Further, the cost or benefits of increasing the threshold have not been assessed.
- Members are concerned that an increased threshold will increase the cost of providing credit as a result of an increase in the intentional avoidance of debts and a reduction in debtor creditor engagement.
- Will reduce creditors ability to identify and mitigate high risk exposures.

- It may increase barriers to accessing to credit, reduce competitiveness and increase risks for small businesses.

We expand on these points in response to the questions in the discussion paper.

Question 1: Should the threshold at which a statutory demand can be issued on a company be increased?

AICM members do not support an increase to the threshold for the following reasons:

- There is no evidence that change is needed.

  While members initially felt $2,000 is a relatively low threshold, they do not support an increase as there are clear and significant known negative consequences (detailed throughout this submission) that will result from an increase.

  Members strongly recommend that research is conducted to understand the range of amounts statutory demands are currently issued for and what benefits would be achieved by increasing the threshold weighted against the negative consequences highlighted in this consultation.

- The threshold will increase active avoidance of obligations.

  A survey of AICM members in August 2020[1] following 3 months of the temporary increase to $20,000 and announcement of the extension until 31 December 2020 provided a clear indication that an increased threshold leads to an increase intentional avoidance of debts.

  The responses to our survey clearly showed:

  - Overwhelming opposition to the increased threshold and time frames.
  - The increases created significant negative consequences impacting creditors ability to:
    - engage with customers that are solvent,
    - support customers that are impacted but viable, and
    - identify those that are insolvent and not viable.
  - Debtors not impacted by COVID-19 used these extensions to actively avoid meeting their obligations.

  This survey shows that an increase in threshold will be used by a significant number of entities that actively seek to avoid their obligations.

[1] https://aicm.com.au/news-resources/articles-news/aicm-covid-19-survey-results-august-2020/

Additionally, at the current threshold of $2,000 members routinely experience customers with capacity to pay sighting the threshold as the only reason for not meeting their obligations to creditors. An increase in the threshold will increase this behaviour and increase the costs worn by credit providers.

- The threshold can reduce the ripple effects of insolvent trading and minimise unfair advantages obtained by business that avoid their obligations.

  The nature of the statutory demand process is that a solvent and viable business should be able to satisfy a demand. It follows that businesses unable to satisfy demands issued at or near the $2,000 threshold are not viable.

  A negative consequence of an increased threshold is that unviable businesses continue to trade and accumulate debt. This increases the ripple effects of insolvencies and is manipulated by businesses seeking to obtain an unfair advantage over businesses that do meet their obligations under this threshold.

  AICM members are reporting several incidences of businesses that were moving to insolvency in March 2020 that are only now close to or actually entering insolvency processes that have debt levels 10 times higher due to the temporary moratoriums.

- Issuance of statutory demands has a high correlation with future default.

  Credit providers rely on past performance to identify future credit behaviours of customers and manage risk exposures. Without efficient access to information that strongly correlates to future default risk, credit providers are unknowingly exposed to risk which they aren't able to mitigate.

  It is important to emphasise that credit providers take all information into account, both positive and negative, when making credit decisions. When presented with materially adverse information credit professionals will engage with customers to understand the viability of the business and mitigate risks in order to provide credit. Our members role is to make fully informed credit decisions to enable sales and credit that is mutually beneficial to customer and creditor.

  Discussion with Equifax has revealed that while issuance of statutory demands is not incorporated in credit reporting the resulting absence of court writs and court judgements of an increase in the threshold to $10,000 will result in impairment of the ability of credit providers to identify future:

  - defaults by anywhere up to 36% (court writs) and 52% (court judgements) respectively.

  - insolvency by up to 28% (court writs) and 43% (court judgements) respectively.

  Further, Equifax analysis has shown currently any business having creditor demands, court judgements and/or writs between $2k to $5k is assessed as being approximately 10 times riskier than the population average.

- Existing measures protect viable businesses with temporary solvency issues.

The insolvent trading safe harbour is a well-established process that enables businesses of all sizes to orderly restructure their business and address solvency concerns.

Additionally, the commencement of the Small Business Restructuring Process on 1 January 2021 provides an additional avenue for businesses with temporary solvency concerns and unable to satisfy statutory demands to restructure and ensure viable businesses are able to continue.

- The existing threshold is on par with other jurisdictions.

  We note the research of Australian Restructuring Insolvency and Turnaround Association (ARITA) that the existing minimum debt threshold in Australia of $2,000 is of a similar quantum to that which applies in the United Kingdom (£750) and New Zealand (NZD $1,000).

- The current process provides protection from abuse.

  AICM members strongly oppose abuse of statutory demands and note that best practice credit professionals will undertake all reasonable steps to encourage engagement before issuing statutory demands, noting that the costs of issuing demands creates commercial motivation.

  Further the current process contains measures to validate, oppose or respond to the statutory demand. A debtor can have a statutory demands set aside due to existence of a dispute, set-off or if the debt is compounded.

Question 2: If the threshold is increased, to what amount should it be increased and why?

AICM members do not support an increase in the threshold.

If an increase to the threshold is to be considered further the AICM welcomes the opportunity to assist government research through its relationships with the major credit reporting bodies, credit providers, debt recovery firms and legal entities to quantify the impacts.

We are confident that research could quantify the impacts of multiple threshold levels to determine a threshold that maximises benefits and minimises negative consequences.

Question 3: If the threshold is increased, when should this change come into effect?

Noting the likely significant consequences, a minimum of 12 months should be provided from passing of legislation to enable industry to adapt.

Question 4: What will be the impacts of increasing the threshold?

Noting the earlier negative consequences of an increased threshold AICM members expect impacts to include:

- Lessen creditors appetite to provide credit terms for supplies under the threshold.

To negate the negative consequences of providing credit supplies below the threshold credit providers may impose greater requirements on these amounts or require payment before supply.

This would result in a situation where larger purchasers are afforded greater advantages and able to exert more market power over their competitors.

- Reduce motivation for debtors to engage with creditors.

  When reflecting on the impacts of the COVID-19 pandemic a positive outcome reported by AICM members is customers in financial distress have increasingly engaged in open discussions when experiencing financial pressures.

  AICM members advise that the temporary restrictions on issuing statutory demands was a small factor creating this change but sight commercial benefits as the key drivers including:
    - Providing the support creates stronger customer relationships.
    - A better return is achieved by providing viable businesses more time to pay as opposed to enforcement actions.
    - Legal enforcement is costly and time consuming.
    - Insolvency of the business is unlikely to provide any return to creditors.

  An impact of increasing the threshold will be reversing this positive trend due to a reduced incentive for debtors to engage with creditors as they rely on the increased threshold and don't engage to resolve their financial hardship.

  In addition to increasing costs and inefficiencies for credit providers, small business owners will face greater impacts on their ability to resolve their financial position and restart due to increased debt and lack of engagement. By engaging early credit providers are more likely to be able to assist viable businesses with debt forgiveness, payment deferrals and/or repayment arrangements maximising the outcomes for both parties.

- Impacts on small businesses.

  While not experts on small business members were drawn to comment on potential impacts.

  Small business credit as providers may be more financially impacted by an increased threshold as reduced avenues to enforce payment of debts and identify high risk customers may have more significant impacts on their solvency and personal finances.

  As customers, small businesses may be less able to obtain credit terms for supplies below the threshold if credit providers appetite to provide credit changes as a result of an increased threshold. Specifically the AICM notes AFSA statistics showing trade credit represents a similar proportion of the credit provided to individuals in business, with 32% of bankrupts' debt being owed to trade creditors and 35% to banks[2]. A restriction in access to this trade credit for small businesses may further tilt the tables in favour of larger businesses.

[2] https://www.afsa.gov.au/about-us/statistics/debts-business-related-personal-insolvencies

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We welcome the opportunity to discuss our submission further.

Yours Sincerely

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