Chapter 5: Are there other options? Part 3

Updated: 1 May 2024

Content

Important: The options covered in this Chapter are formal arrangements under the Bankruptcy Act. An informal agreement with creditors is almost always better than a formal option under the Bankruptcy Act where it is possible. Financial counsellors can sometimes achieve fantastic results for clients with advocacy skills and perseverance.

Part 3: Personal Insolvency Agreements

Summary

A Personal Insolvency Agreement (PIA) is similar to a Debt Agreement in that it is an alternative to bankruptcy but also a formalised option under the Bankruptcy Act with many similar consequences to bankruptcy. An agreement is made with creditors to transfer property or funds or make periodic payments in return for a release from the provable debts at the conclusion of the arrangement. As with a Debt Agreement (and unlike bankruptcy), your client's property does not vest in the trustee (although some or all of it may have to be transferred to creditors as part of the agreement itself) but will be subject to the trustee's control. The debtor can also acquire property during the agreement without it vesting in the trustee or passing to creditors, subject to the terms of the agreement.

Like proposing a Debt Agreement, appointing a controlling trustee (the first step in setting up a PIA) is an act of bankruptcy.

Unlike Debt Agreements, a person in a PIA cannot be a director of a company for the duration of the agreement.

A PIA is expensive to set up and will not therefore be useful to most financial counselling clients.

What is a Personal Insolvency Agreement?

Part X of the Bankruptcy Act covers Personal Insolvency Agreements. A Personal Insolvency Agreement (PIA) is an arrangement whereby a person who is insolvent seeks to avoid bankruptcy by proposing a formal arrangement to their creditors to discharge their debts. The debtor commences the process by authorising a controlling trustee over the debtor's property, who will then call a meeting of creditors within 30 days. Although a PIA must comply with the substance requirements in s 188A(2), there is flexibility as to its terms. A PIA may provide that the debtor will:

- pay a lump sum payment to creditors (from his or her own money and/or the funds of a third party or parties such as family members); and/or
- transfer property to the trustee (of the PIA) to be sold by the trustee and the proceeds paid to creditors; and/or
- make periodic payments to the trustee for distribution to creditors.

Unlike a Debt Agreement, there are no limits to the income that can be earned by the person proposing the PIA or limits on the amounts owed or assets owned. The debtor however:

- must be insolvent; and
- must have an appropriate connection to Australia; and
- must **not** have proposed another insolvency agreement in the previous 6 months.

The trustee informs the creditors of the proposed agreement and holds a meeting where creditors either accept or reject the proposal according to a voting procedure at a creditor's meeting. This is explained further in **Chapter 12** under the heading **What is the Process for entering into a PIA?**

There are very few financial counselling clients who would be suitable for a PIA and this section is therefore relatively brief. The cost alone would be prohibitive for most people seeking financial counselling. More information is available on the AFSA website.

What are the consequences of a PIA?

Similar to bankruptcy and Debt Agreements, a PIA remains on the debtor's credit file for the latter of 5 years from the day it is executed and:

- if the trustee has issued a certificate under s 232 following the discharge of all obligations under the PIA, the day on which the certificate is signed; or
- otherwise, 2 years from the day the PIA is terminated or set aside.

Unlike Debt Agreements, a debtor who appoints a controlling trustee may remain on the National Personal Insolvency Index indefinitely. This can impact a debtor's ability to obtain credit and other services (such as rental accommodation, telecommunications contracts and insurance) in the future.

Appointing a controlling trustee (to set up a PIA) is also an ‘act of bankruptcy’ (like proposing a Debt Agreement) and can be relied on by creditors to petition the Court to make the debtor bankrupt if he or she fails to complete the terms of the agreement, or the creditors do not vote to accept the proposal.

It may also impact on a person’s ability to remain in a licensed or regulated profession, similar to both bankruptcy and Debt Agreements.

Like bankruptcy, a person in a PIA cannot be a director of a company until the terms of the PIA have been complied with in full (that is all agreed amounts are paid or property has been sold or transferred as provided for in the agreement). This is not the case with a Debt Agreement, where the person can continue to be a director of a company while in the Debt Agreement.

A PIA will also prohibit clients from being able to deal with their property (for example, a house or car) without the consent of the controlling trustee. The client will also be obligated to assist the trustee by providing information and documentation if requested.

Once a controlling trustee is appointed, all proceedings in respect of a Creditor’s Petition that has been presented against the debtor are stayed (suspended) including applications to extend the life of the Creditor’s Petition past the normal 12-month period. The stay lasts until the creditor’s meeting has been concluded or adjourned, whichever occurs first. If the PIA is accepted, the Creditor’s Petition cannot proceed.

If the PIA is not accepted, the stay will end, and the creditor can resume action under their Creditor’s Petition, and it is most likely that a sequestration order will be made against the debtor.

What is the advantage of a PIA over bankruptcy?

Compared to bankruptcy, a PIA offers greater flexibility as to the duration and terms of any arrangement and places less onerous responsibilities on the trustee. This can be particularly advantageous for debtors with businesses or complex financial relationships. Debtors are also able to avoid some of the consequences that follow from bankruptcy, such as restrictions on overseas travel or automatic restrictions on obtaining credit.

The assets of the debtor do not automatically vest in the trustee, although they become subject to the control of the trustee. The terms of the PIA will set out what is to become of the debtor’s property and income and, as a result, it is possible for those terms to provide that the debtor retains some property. However, in practice, it may be difficult to get the creditors to agree to the debtor retaining significant assets. Creditors may expect that property which would be divisible amongst the creditors in bankruptcy should be included in the PIA. That being said, creditors may agree to the debtor retaining business assets on the proviso that periodic payments be made to the trustee from the income generated by the business. Likewise, creditors will generally not object to the debtor retaining their home if there is little (if any) equity in the home.

Property acquired in future (after the PIA has been accepted and executed) will not automatically become available to creditors (unlike the situation for an undischarged bankrupt), unless the terms of the PIA provide for that to occur.

The process commences when the debtor signs a s 188 Authority appointing a controlling trustee. When the Section 188 Authority becomes effective, the debtor's property (whilst not technically vesting in the controlling trustee) becomes subject to the control of the controlling trustee. Accordingly, there is a certain loss of autonomy in relation to dealing with property, especially any assets of the debtor's business. Normally, the trustee will only allow the debtor to keep their business operational where it is considered be in the interests of the creditors.

Whilst the Controlling Trusteeship is in place, the debtor's property is subject to a charge in favour of the creditors, plus the Controlling Trustee is entitled to be indemnified out of the debtor's property for his/her remuneration and expenses.

The proposal must also detail whether the antecedent transactions provisions of the Act apply. If they do not apply, the trustee is precluded from taking recovery action in respect of any under-value property transfers, transfers to defeat creditors and/or preferential payments to creditors made prior to the proposal. However, creditors can insist on the antecedent transactions provisions applying in the PIA as one of the conditions of the agreement.

If the debtor's proposal states that the antecedent transactions provisions do not apply, the creditors may be suspicious and assume (rightly or wrongly) that there have been undervalue transactions, transfers to defeat creditors and preferential payments to creditors prior to the proposal. Accordingly, debtors are usually advised to state in the proposal that the antecedent transactions provisions do apply so as not arouse the suspicions of creditors, even if there is a possibility that the trustee of the PIA might take action to recover property. As with bankruptcy, the trustee of the PIA will not take any recovery action unless creditors provide funding to do so or authorise the use of moneys in the estate plus give the trustee an unlimited indemnity as to costs in the event the recovery action fails, and the trustee is ordered to pay the other party's costs. Accordingly, creditors are usually most reluctant to provide funding and an indemnity.

The creditors must vote on the PIA proposal at a meeting arranged in accordance with the Act. The proposal must be approved by a majority of unsecured creditors (by number) who represent at least 75% of the dollar value of the total debts of the creditors who attend the meeting and vote on the resolution. This is referred to as a special resolution. Once the agreement is accepted, the trustee is appointed to administer the agreement and will have control over any property necessary to the completion of the agreement.

If the proposal is not accepted or if the PIA is not executed within the prescribed time period of 21 days from the day the special resolution requiring the debtor to execute a PIA was passed; then the Controlling Trustee remains in control of the property until either: the creditors vote at the meeting for the property to cease to be subject to the trustee's control; four months pass; the Court orders the release; or the debtor becomes a bankrupt and property vests in the Trustee (in bankruptcy).

If the PIA is completed (all obligations under the agreement complied with), then the agreement will specify the extent to which the debtor is released from any debts that would be provable in bankruptcy at the date the PIA was executed. A PIA cannot release a debtor from debts in circumstances where the debtor would not be released after discharge from bankruptcy. It also does not affect the creditor's rights against any co-borrower or guarantor, or the rights of secured creditors to enforce their security.

Who should consider a PIA?

In practice most controlling trustees in Sydney, for example, would commonly seek at least $15,000 upfront to accept an appointment. This means the debtor must be very sure that they have sufficient funds to cover this, that they have a proposal that creditors are likely to accept, and that they will still end up better off than if they had gone bankrupt.

Accordingly, most financial counselling clients would not be suitable for a PIA because they have little, if anything, to offer their creditors that would be superior to what was available to them in bankruptcy. In the rare case that a client has available assets (but insufficient to sell and pay out the debts) and/or a significant income from which amounts could be offered above and beyond contributions payable in bankruptcy, then the following should be considered:

- Have negotiations been undertaken to try to convince creditors to accept repayments and or lump sum settlements without needing to resort to bankruptcy?
- Is bankruptcy inevitable? If, for example, if there is a Creditor's Petition on foot and the client is clearly insolvent, a PIA may be the only alternative (always ensure your client gets urgent legal advice about the Court process) if the client does not qualify for a Debt Agreement. Similarly, even if there is no advanced enforcement action against your client, he or she may have no prospects of improvement in their position (for example they have a permanent illness or disability) and have some assets to offer to avoid bankruptcy.
- Does the person qualify for a Debt Agreement instead?
- Has the client considered the comparative benefits and disadvantages of bankruptcy? Like Debt Agreements, a PIA will only be effective if the debtor is able to complete all the obligations. Failure to do so will be likely to lead to bankruptcy further down the track.
- Can the person pay the fees and costs associated with a PIA?

Personal Insolvency Agreements versus Debt Agreements

If your client wants to be (or continue to be) a company director, then a Debt Agreement is the only option which allows this. Of course, the person would have to meet all the other preconditions such as the income, property, residency and debt thresholds and must not have been a bankruptcy, a party to a Debt Agreement or appointed a controlling trustee in the last 10 years.

Generally, the cost of proposing and administering a Debt Agreement will be much less than the cost of proposing and administering a PIA.

A PIA, however, gives more flexibility in the types of agreements that can be made and there are no limitations on the extent of the debtor's assets, liabilities and income. For example, creditors do not have to be paid in equal proportions to the size of their debts. PIAs may also include transfers of property.

If your client is suitable for a PIA, then they will need to consult a suitably qualified Controlling Trustee. AFSA can provide referral information, also available on their website.

See also **Chapter 12** on the process for proposing/entering a PIA, dealing with complaints about PIAs, varying and terminating PIAs.

Read the checklist for this chapter in Chapter 11: Tools and Resources