Submission by the
Financial Rights Legal Centre

Financial Systems Division, Treasury

Improving Bankruptcy and Insolvency Laws Proposal Paper, April 2016

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About the Financial Rights Legal Centre

The Financial Rights Legal Centre (*formerly known as the Consumer Credit Legal Centre (NSW)*) is a community legal centre that specialises in helping consumer's understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the Credit & Debt Hotline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took over 26,500 calls for advice or assistance during the 2014/2015 financial year.

Financial Rights also conducts research and collects data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

This submission is an example of how CLCs utilise the expertise gained from their client work and help give voice to their clients' experiences to contribute to improving laws and legal processes and prevent some problems from arising altogether.

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Credit & Debt Hotline 1800 007 007
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Monday – Friday 9.30am-4.30pm

Introduction

Thank you for the opportunity to comment on the *Improving bankruptcy and insolvency laws Proposal Paper*.

1. Reducing the default period

Overall Financial Rights supports the proposal to reduce the default period for bankruptcy to 1 year from 3 years. This strikes an appropriate balance between the interests of creditors, and ensuring that bankruptcy enables a fresh start for debtors, and is not needlessly punitive. Reducing the bankruptcy period as described in the proposals paper is likely to have a fairly minimal effect on the amounts recouped by creditors from bankrupt estates, but significantly improves the bankrupt's opportunities for early financial rehabilitation and participation in economic activity.

Recommendation Financial Rights supports the reduction in the default bankruptcy period from 3 years to 1 year.

1.1. Misconduct

Financial Rights general supports retaining the right for trustees objections to discharge for misconduct. We suggest that this should include extensions to 3, 5 & 8 years (in rare circumstances), as an extension from 1 to 5 or 8 years seems unnecessarily punitive. There should be an option for an extension for 3 years only, particularly where there has been no material disadvantage to creditors as a result of the bankrupt's conduct.

We anticipate that trustees may push for additional grounds for objection to discharge on the basis of the shorter period that would be available in which to gather evidence to support an objection. Financial Rights opposes any extension of the grounds for objection to include speculative matters. The mere fact that a bankrupt may have the potential to earn a higher income in future years, or the suspicion that there is undeclared property or voidable transactions should not form adequate grounds for extension. The trustee will retain the right to pursue vested property or challenge voidable transactions regardless of discharge as is currently the case. Objections to discharge should be based on actual misconduct and the current grounds for objection are sufficiently broad. The offences under the Act are also sufficiently broad and their prosecution will not be prevented because the bankrupt has subsequently discharged.

Recommendation

Financial Rights supports retaining the ability to extend a bankruptcy for misconduct.

There should be an additional option to extend the bankruptcy for 3 years only.

The current grounds for objection to discharge are sufficiently broad and there is no need add to them to accommodate the 1 year default period except possibly in relation to preventing poor trader conduct and "pheonixing" (see below under **Entrepreneurialism or serial misconduct**) .

1.2. Ongoing obligations for bankrupts

1.2.1. Requirement to assist trustee

Financial Rights supports amendment of the law to ensure that the obligations of the bankrupt continue for the current 3 years provided they are relevant to efficient administration of the bankrupt estate. This is consistent with the policy objective of balancing the rights of creditors and bankrupts.

Recommendation

Financial Rights supports extending the relevant obligations of the bankrupt for up to 3 years (2 years beyond the proposed discharge point) to ensure that trustees are able to continue to deal effectively with the bankrupt estate.

1.2.2. Income contributions

We support the continuation of the requirement to pay income contributions over a 3 year period despite discharge. We note that objection to discharge is a common method of enforcing payment of income contributions. For many bankruptcies this option will no longer be available. There are, however, a range of other options in the Act for enforcing payment of income contributions, including garnishees, court orders and supervised accounts.

Related issues - Hardship

Financial Rights occasionally receive calls from bankrupts who have arrears in relation to income contributions which they can no longer afford to pay, even though the assessment was correct at the time it was made. Bankrupts who are behind in their contribution obligations and have subsequently suffered from a change of circumstances such as unemployment, illness, or accident, have no options under the Act. Section 139T provides for the situations where the income contribution assessed produce an immediately harsh result for the reasons listed. It does not cover the situation where the assessment is valid at the time it is made but can no longer be met because of a subsequent change of circumstances.

While we understand that it is against the policy objectives of the Act to allow bankrupts to easily shirk contributions they were obliged to make, and could ostensibly afford at the relevant time, there should be a mechanism to recognise that in some circumstances the bankrupt can no longer meet these obligations for valid and compelling reasons. Dogged pursuit of unpaid contributions where there is no prospect of recovery can lead to a subsequent bankruptcy which benefits no-one. There should be a mechanism for contribution collection to be suspended for a period, or arrears permanently waived, where there is no longer any capacity to pay or other prospect of recovery.

Related issues - Overpayments

Section 139ZH provides that there is no refund payable in relation to overpaid contributions, only set- off against a subsequent contribution assessment period. This is harsh, particularly if the overpayment is not due to any act or omission of the bankrupt (for example, miscalculation by the trustee). If anything, this section provides an incentive for bankrupts to under-estimate rather than over estimate income (better to have to pay extra later than to pay too much and not be able to recover it). There should be a capacity to account to the bankrupt where an overpayment occurs in the final contribution assessment period.

Related issues - Permitted use of income over the assessed contributions

In keeping with the intention of promoting financial rehabilitation and learning from mistakes, bankrupts should be able to keep their income earned after the date of bankruptcy. Arguably they should also be able to invest in assets, provided they have paid their assessed income contributions if applicable. Until recently it was assumed that bankrupts could retain savings from income earned after the date of their bankruptcy but could not convert those savings into an asset. A recent case *Di Cioccio v Official Trustee in Bankruptcy (as Trustee of the Bankrupt Estate of Di Cioccio)* [2015] FCAFC 30 not only confirmed that a bankrupt cannot convert income to an asset (in this case shares) without the asset immediately vesting in the trustee, but also cast doubt over whether savings in a bank account were safe from vesting in the trustee:

> *41. During the course of argument, counsel for Mr Di Cioccio submitted that if this construction of the Act was adopted, it would create an anomaly. An anomaly was said to arise because an amount standing to the credit of a bank account in the name of the bankrupt would be property (see Foley v Hill [1848] EngR 837; (1848) 2 HL Cas 28 and [9]-[10] above) that would immediately vest in a trustee (s 58) and be divisible amongst the creditors of the bankrupt (s 116(1)) even if the amounts standing to the credit of the bank account were in fact income derived by the bankrupt below the actual income threshold amount applicable to that bankrupt.*
> *42. There are a number of answers to that contention, all found in the Act. First, s 134(1)(ma) provides that, subject to the Act, a trustee may "make such allowance out of the estate as he or she thinks just to the bankrupt, the spouse or de facto partner of the bankrupt or the family of the bankrupt": see [17] above. Section 134 operates as a safety value. It is a*

provision which assumes that a trustee will act sensibly and fairly. A decision of the trustee is reviewable: s 178 of the Act. (Edmonds, Gordon and Beach JJ)

In short this means that whether a bankrupt gets to retain any savings they accumulate is *at the discretion* of the trustee. Anything they purchase with it, whether it be shares, paying off a home, buying supplies for a small business venture *will vest* in the trustee.

While we appreciate the logic behind these provisions – that is, bankrupts being allowed what they need to live from day to day and nothing further until discharge – this does not sit well with the government's agenda. Further, it encourages people to spend what they earn even if they have the capacity to save.

We submit that the appropriate balance between creditor's rights and encouraging financial rehabilitation would be to legislate to enshrine the bankrupts right to retain any accumulated savings. A logical extension of this would be to allow them to also invest this money without the asset vesting in the trustee, provided they could show that the asset was purchased with income generated after the date of bankruptcy and after payment of assessed contributions. Inheritances, winnings and other after acquired assets would continue to vest in the trustee; it would be unfair for the bankrupt to benefit from such windfalls to the detriment of their creditors.

Recommendation

Financial Rights supports the retention of the obligation to pay income contributions for 3 years.

Financial Rights recommends the government consider the following additional changes to give full effect to the government's policy intentions:

- Create a mechanism for suspending collection activity in relation to arrears of income contributions where the debtor has no current capacity to pay;
- Credit a mechanism for permanent waiver of income contributions where the debtor is unlikely to ever have the capacity to pay and has no assets divisible in bankruptcy;
- Amend the Act to require trustees to refund overpaid contributions when there is no set-off available ;
- Amend the Act to ensure that it is clear that the bankrupt can retain their post bankruptcy earnings above any assessed contribution. Consider exempting assets purchased with post bankruptcy earnings from vesting in the trustee provided all contributions have been paid.

1.3. Restrictions

1.3.1. Access to credit

Financial Rights agrees with the Government's proposals to reduce the credit restrictions to one year. We have no comment on the period which the bankruptcy should remain on the National Personal Insolvency Index (NPII).

Reducing the period of bankruptcy will have little effect on innovation and entrepreneurship if former bankrupts are prevented from further borrowing by their credit record. Logically the retention time for insolvency information should be reduced to 2 years from discharge, which is in effect a minimum of 3 years compared to the current 5 year minimum (on both commercial and personal credit records). This would create an anomaly as default information is currently retained for 5 years. A single credit default is a less significant event than a bankruptcy (and equally likely to result from "necessary risk-taking or misfortune rather than misdeed"). It would be anomalous for bankruptcy to be retained for a shorter period. We submit that in order to further the governments policy objectives, default listings should be reduced to 2 years to delineate them from insolvency (or 3 year at the most).

Another potential anomaly would be created in relation to debt agreements under the Bankruptcy Act. This is addressed in a separate section below.

1.3.2. Overseas travel

We support reducing the restriction from overseas travel in line with the shorter bankruptcy period. Any potential disadvantage to creditors could be dealt with under the existing offences and objections to discharge.

1.3.3. Licenses and industry associations

We support these proposals.

Recommendation

Financial Rights supports changing the provisions in relation to accessing credit (the disclosure provisions), and the restriction on overseas travel to the 1 year default bankruptcy period unless the bankruptcy has been extended.

Financial Rights supports the government working with industry associations and licensing authorities to ensure the employment restrictions are aligned with the new regime.

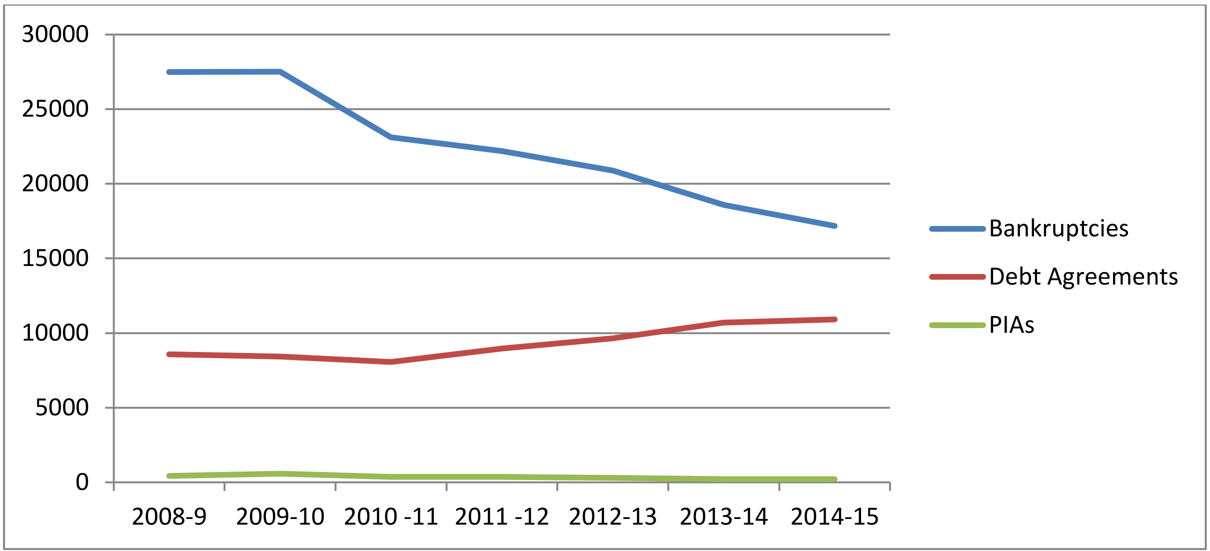
Financial Rights supports reducing the period the bankruptcy is retained on a person's credit report to 2 years from discharge (a minimum of 3 years) provided proportionate reductions are made in relation to defaults, debt agreements and other relevant listings.

Debt Agreements

Debt Agreements are an alternative to bankruptcy under the Bankruptcy Act. Under a Debt Agreement the debtor proposes to pay their creditors a lesser amount in equal proportions in return for avoiding enforcement action and keeping their assets. Most commonly debt agreements are paid in equal regular instalments and last for a number of years. A typical debt agreement may include the debtor paying the same amount as their outstanding debts over 3-5 years, with about 20-30% of this going to the debt agreement administrator, and the remaining 70-80% going to creditors. The main saving to the debtor is usually the freezing of interest. They only keep the benefit of this saving if the agreement continues to completion, with all benefit being lost if the agreement is terminated before completion.

While personal bankruptcies have generally fallen over the last few years, Debt Agreements have consistently risen.

Insolvency Activity in Australia



Source: Australian Financial Security Authority Annual Statistics available at www.afsa.gov.au

This trend has continued with bankruptcies falling in the March quarter 2016 by 5.8%, personal insolvency agreements falling by 9.5% and debt agreements increasing by 15.6%, contributing to a net increase in insolvency activity of 2%. This rise in Debt Agreements is the third consecutive rise when compared to the same quarter in the previous year.[1]

[1] AFSA Quarterly Statistics available at https://www.afsa.gov.au/resources/statistics/provisional-bankruptcy-and-personal-insolvency-statistics/quarterly-statistics/quarterly-statistics-march-quarter-2016

This could be a positive development overall (although not necessarily for each individual debtor) if it could be assumed that every Debt Agreement would otherwise have been a bankruptcy, representing a greater return to creditors than otherwise would have been the case. We do not believe this assumption can be made on the basis of our contact with consumers who indicate they would never have proceeded down the path of a debt agreement if they had appreciated what it really meant from the outset. Further, a significant proportion of the consumers we speak to were never in sufficient financial stress to consider bankruptcy.

In our experience consumers are frequently misled about the nature and consequences of debt agreements. Debt agreement administrators and other parties who set up debt agreements and/or refer potential debtors on to debt agreement administrators have a vested interest in recommending debt agreements because it represents the only scenario which leads to them being paid. A debtor who is above the prescribed income, asset and debt limits may be referred to other options, and debtors who are very clearly unable to pay anything may be referred to financial counselling, but it appears anyone else is likely to funnelled into a debt agreement regardless of whether it is really their best option. The advantages are consistently oversold and the disadvantages downplayed, leading to a greater take up of debt agreements than would otherwise be the case.

Advertising in this market segment focuses on relieving stress (one easy payment, no interest) yet never mentions bankruptcy or insolvency. Consumers are also channelled into debt agreements when they respond to ads for other services such as budget management and credit repair.

Case study 1

John was struggling with managing his finances. He responded to an advertisement for a budget management service. He ended up in a Debt Agreement for his $57,000 in debts at the same time as using the budgeting service. In effect his money was paid into one money management account, for which he paid an establishment fee and an ongoing service fee, and then paid across to another to meet his obligations under the Debt Agreement, with further set up fees and ongoing administration fees attached. The agreement was set up for 5 years. He tried to get out of the budgeting service part of the deal after 18 months but was not given any other means of paying his Debt Agreement. He felt trapped.

See also Sally's case study below.

Common misconceptions about debt agreements among consumers who ring our service include:

- That it is a debt consolidation rather than an insolvency option

- That there will be no effect on their ability to obtain credit, or a lessor effect than bankruptcy (debt agreements have the same retention period on a credit report as bankruptcy and often have the same effect on creditworthiness)
- That there will be no effect on the debtors trade license or ability to continue in their profession (the effect of a debt agreement varies considerably in his regard but is the same as bankruptcy in quite a few situations)
- That there are no other options available to deal with financial difficulty (there are rights to hardship variations under the national credit law, hardship obligations on essential service providers and telcos and free financial counsellors available to give genuinely independent advice and assistance)
- That payments made upfront for the preparation of the debt agreement will ultimately be set off against the debts (The payment is for the preparation of the debt agreement and is not set off against anything. It is rarely refunded if the debt agreement is rejected and many clients put themselves into default on their credit obligations in order to make these payments.)

The group of debtors who could benefit from a debt agreement are largely those who fit within the applicable debt, assets and income thresholds and have an asset to protect – most commonly their home they are paying off. Company directors and people in a narrow range of employment roles where people in debt agreements are permitted to continue in that capacity and bankrupts are not, may also benefit. Despite this the vast majority of consumers we advise who are in debt agreements fall into none of these categories.

Case study 2

Sally is sole parent reliant on Centrelink. She had one personal loan and a debt to a family member. She wanted to refinance the personal loan to reduce her repayments but she had a default listing for a telephone bill that she disputed. Sally searched on the internet "free debt help" and found a debt management firm offering credit repair services.

After a 2 hour "free consultation" with the company Sally felt her only option was a Debt Agreement. She was told include the telco even though she said the phone debt did not belong to her.

She was also told to get her family member to agree to a lesser amount for the purposes of the Debt Agreement, but she could pay her family the rest "on the side."

Sally was signed up over the phone to pay for a Debt Agreement after they recorded her verbal consent. They then sent her out some forms and told her to stop paying her personal loan. The debt management firm immediately started to direct debit her account.

She had no assets to protect, few debts and clearly had other options to manage her finances without considering insolvency. She had a valid dispute with the telecommunications company she could have pursued with for free through the Telecommunications Industry Ombudsman.

Case study 3

June entered a debt agreement when she was 20 years old and at the time she worked in retail. The debt agreement consisted of 5 debts which totalled $6,746. Four of her creditors were payday lenders and she had one credit card with a bank ($1200). She incurred the debts, as her she was residing with her mother, who lost her job and she obtained the loans to help her out. Given the number of pay day loans she had, it would be arguable that she had various defences under the responsible lending provisions of the NCCP that may have led to her not being liable for the interest, fees and charges. June was seeking to "consolidate" the debts into one easy payment. However, what she ended up with was a debt agreement.

The Debt Agreement administrator charged an upfront fee of $600 and a further $1500 which was to be paid a debt through the agreement. This increased her debt to $8,246 ($8,400 inclusive of fees). The administrator was to receive 25% in administration charges being $2,141.00 in addition to the dividend paid on the $1500 ($944.34) being a total of $3,085.34. This represents close to 50% of the original debt owed by June. The creditors were to receive $5,702 under the agreement if it reached completion. The agreement was for 2 ½ years, and required weekly payments of $60 per week.

Had June obtained advice from our service, or an independent financial counsellor prior to entering the Debt Agreement, her situation could have been addressed without any need to resort to insolvency.

Case study 4

Val is a sole parent with 2 children. She had no assets and rented her home. She had one secured car loan and one credit card debt. She was not in default under any of her payments but she was interested in consolidating her debts. She found a debt management firm online and had several telephone conversations with them about her situations. They advised her to stop making payments.

The debt management firm started debiting $50 per week from her account, and later $71. The firm recommended a Debt Agreement but did not act on that recommendation because they were waiting for Val's fees to accumulate to a point where they covered a significant amount of the upfront costs of setting up the agreement. In the meantime she received a default notice in relation to her car loan and started getting debt collection calls in relation to her other debt.

After many months Val became agitated by the contact from her creditors and starting pushing the debt management firm to hurry up with their solution. They sent her a pre-filled debt agreement proposal and the prescribed information about Debt Agreements. By this time she was very stressed and did not appreciate the implications of these documents. Besides, she had come so far that she felt there was no turning back.

Ultimately the Debt Agreement was rejected because of the secured loan (which never should have been included in a Debt Agreement). By this time she had paid over $1000 and ruined her credit report for two years.

Financial Rights has negotiated resolutions in all of the above matters but while fees can be refunded it is impossible to restore the client's financial position.

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.

A major factor for people entering debt agreements is their inability to keep up the payments over the entire period of the agreement. We receive many calls from consumers who have paid for a couple of years and can pay no longer (either because of a subsequent change in circumstances, or because the agreement was not sustainable in the first place). When a debtor defaults 2 or 3 years into a debt agreement, all the debts and interest are restored, less any amounts paid to creditors and the payments for setting up and administering the agreement are lost. In most cases this means bankruptcy in any event, several years down the track. This is completely at odds with the concept of bankruptcy as an opportunity to draw the line in the sand and access a fresh start.

Case study 5

Laura contacted a debt agreement administrator ("the DAA") in January 2014 because she was having difficulty managing her debts with a bank. She had three facilities (two credit cards and an overdraft) with the same bank, totalling approximately $16,000. She had no other debts, and no significant assets which needed to be protected. She was 56 years old and working casually.

The DAA placed her in a Part IX debt agreement, although they did not explain the full circumstances of entering into the debt agreement. She was made to believe that the only other option available to her was bankruptcy, and no other steps were proposed to manage her debt, other than speaking to the DAA. She was also not aware that the interest would only be waived, if she successfully completed the debt agreement. The DAA also charged a $1,600 set up fee of which $600 was paid in advance and $1,000 added to the Debt Agreement, and ongoing administration fees of 23% administration fee ($3,787 over the life of the agreement)

Two years later, Laura suffered a physical injury which significantly reduced the amount of hours she could work. She is now unable to meet repayments on the debt agreement and we are trying to negotiate an appropriate solution with the DAA.

We are concerned that the proposed changes to the bankruptcy provisions will create an even starker contrast between the consequences of bankruptcy and debt agreements, to the detriment of those entering debt agreements. Intuitively it would seem that debt agreements would drop in popularity because debtors would clearly opt for one year of bankruptcy over 3-5 years or more of a debt agreement. However, we have no confidence this will occur because people entering debt agreements are not getting proper independent, conflict free advice.

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. Financial Rights recommends the government consider the following measures:

- Further limiting access to debt agreements by requiring potential debtors to have a material divisible asset to protect;
- Ensuring that all forms of advertising are not misleading and contain the equivalent of a health warning: *"This is an insolvency option under the Bankruptcy Act."*
- Requiring AFSA to publish more comprehensive statistics in an accessible format so that it is easy to discern what percentage of debt agreements from any particular year are completed, varied, terminated (or voided) and by what mechanism, their length and rate of return. [2]

The retention period for Debt Agreements on a debtor's credit report should also be decreased in line with any reduction in the retention period for bankruptcy.

Recommendation

Financial Rights recommends that Part IX of the Bankruptcy Act is repealed.

[2] This information is currently published but it is difficult to track any particular cohort of agreements to determine their ultimate outcome.

In the event that the section is not repealed, we submit that it should be subject to detailed review to address the issue of debtors entering inappropriate debt agreements and to improve transparency in relation to the effectiveness of debt agreements.

2. Safe harbour

We do not have expertise in corporate insolvency and only propose to make one observation in relation to safe harbour models proposed. We prefer Model B because it is based on evidence of relevant facts and does not require the appointment of an external adviser, without excluding such an appointment where the directors feel they would benefit from advice. We are concerned that Model A will generate a ready made market for advisers which will benefit considerably from the income derived from this role without necessarily adding value. While the duties and obligations proposed are appropriate, directors will be focussed on the process of the appointment of the restructuring adviser rather than the substantive circumstances of the company's financial position. There is nothing to prevent director's taking professional advice under Model B when they are of the view that such advice may be beneficial, but they are not compelled to do so to avoid falling foul of the law.

Our experience of the enactment of Part IX of the Bankruptcy Act, is that the availability of Debt Agreements as an alternative to bankruptcy has spawned an industry of not only registered debt agreement administrators, but also a range of other purported advisers and referrers, who promote this alternative for profit, have a vested interest in increasing the numbers of debtors entering this form of insolvency, and an inherent conflict of interest in recommending it to potential clients[3]. This, in our view, has resulted in extensive take up of an insolvency option which is not always in the best interests of debtors or their creditors.

3. Ipso facto clauses

Ipso facto clause protection has been very useful in the personal bankruptcy space and it is consistent with the government's policy objectives to legislate for similar protection in the context of corporate insolvency.

Recommendation

Financial Rights prefers Safe Harbour Model B to Model A and generally supports legislative protection against ipso facto clauses in the context of corporate insolvency.

Entrepreneurialism or serial misconduct

[3] There were over $52 million in trustees fees generated from Part IX Debt Agreements in 2014/15 according to AFSA's statistical tables – Monies administered under Part IX of the Bankruptcy Act available at https://www.afsa.gov.au/resources/statistics/annual-administration-statistics

Policies which are intended to encourage risk-taking and experimentation should not as far as possible, also facilitate repeated poor behaviour. There is a difference between useful innovation and manipulating the system to rip off consumers and creditors alike. We are aware of situations whereby a company goes into liquidation and is unable to meet its financial obligations including court, tribunal or external dispute resolution orders to repay consumers for breaches of consumer protections law. Then the same director (or directors with or without additional parties) sets up a different corporate entity and continues to trade in the same field, or a related one ("phoenixing"). In some cases these directors may have been personally bankrupt, sometimes more than once.

It is important that rather than facilitating a fresh start, bankruptcy/insolvency does not become a mechanism for undermining the effectiveness of consumer protection and trade practices laws. The government should consider whether any of these proposals will have the unintended consequence of facilitating unlawful or unconscionable conduct by traders and corporations by allowing them to avoid their obligations and quickly begin trading as another entity, and whether it is possible to introduce measures to counter that effect.

Recommendation

Financial Rights recommends the government consider whether any of these proposals are likely to facilitate serial trader misconduct and enact appropriate counter measures.

Protection of total and permanent disability payments

Most Australian adults have access to a potential total and permanent disability claim through insurance purchased on their behalf by their superannuation fund (or funds). Premiums are deducted from their accumulating funds. The logic behind this arrangement is that whereas usually superannuation accumulates throughout a person's working life in order to provide for his or her retirement, where a person is permanently incapacitated by illness or injury and unable to work, they are provided for by this insurance instead.

Currently total and permanent disability payments are not explicitly protected from vesting in the trustee under s. 116 (2) of the Bankruptcy Act. In circumstances where such a payment is received directly from a superannuation fund, on or after the date of bankruptcy, it should be protected by virtue of s. 116(2)(d)(iv) – a payment from a regulated superannuation fund. However, in all other circumstances, such as where the payment is received direct from the insurer, or where the payment has been received prior to the date of bankruptcy, the payment is not protected.

Compensation payments for personal injury received by the bankrupt are protected regardless of when they are received (s 116(2)(g)), as is any property purchased with such funds. It makes sense that funds intended to assist an injured person to cope with their injury in both a physical and emotional sense, to replace their income and ensure they can access appropriate treatment and services should not be available to creditors. We submit that total and permanent disability payments should be treated in the same manner as compensation payments and protected regardless of when and how they are received. To enable creditors to access these funds defeats the purpose of superannuation policy, shifts the responsibility for supporting sick or injured people back onto the government, and potentially undermines their remaining quality of life.

Recommendation

Financial Rights considers total and permanent disability payments should be protected in bankruptcy in the same comprehensive manner as compensation for personal injury.

Creditor's petitions

A creditor's petition can currently be issued where a debtor owes a minimum of $5000 and has committed an act of bankruptcy. The act of bankruptcy will most commonly be an unpaid bankruptcy notice based on a judgment debt. Once a creditor's petition has been issued, a debtor has few options to avoid bankruptcy. Even payment of the debt is not an assured answer as the creditor is not compelled to accept the payment lest it be clawed back eventually as a preferential payment. An application to pay by instalments will no longer prevent the bankruptcy proceedings from continuing to sequestration and there is no longer an option to go to an external dispute resolution scheme such as the Financial Ombudsman Service. For many debtors this means inevitable bankruptcy. While for some debtors this is an appropriate solution, for others it is an extremely punitive result. Immediately trustee's fees begin to accumulate, and even those who have assets to sell to annul the bankruptcy find they lose a lot more than the debt plus interest.

Case study 6

A caller to Financial Rights was being made bankrupt over Strata Fees of $15,000. She made a payment of $6,000 and claimed they owed her $2,500 for work performed for the Owner's Corporation. The amount remained over $5,000. She was struggling to attend the allocated court date because it was at very short notice and she had a disabled son who was ill and she could not find anyone to care for him. If the matter proceeded to sequestration both she and her son would likely be homeless as they would never be able to catch up with addition of legal fees and up to tens of thousands in trustee fees. In our experience Strata Corporations opt for bankruptcy over other forms of enforcement.

We submit that there should be a substantial threshold before a creditor can proceed to have a debtor declared bankrupt. There are other options available for the enforcement of debts including garnishees and writs for levy of property (in NSW for example). Insolvency should not be used a first resort debt collection or for relatively small debts. Financial Rights submits that the threshold for issuing a creditor's petition should be raised to $20,000 and indexed. Further, creditor's should be required to exhaust other debt collection avenues first unless they can convince the court that bankruptcy that there are no other options realistically available or there is significant risk of assets being removed from creditor's reach if a sequestration order is not made immediately.

Recommendation

Financial Rights recommends increasing the minimum debt on which a creditor' petition can be based in section 44 to $20,000 and adding an additional limb in relation to exhausting other enforcement options.

Concluding Remarks

Thank you again for the opportunity to comment. If you have any questions or concerns regarding this submission please do not hesitate to contact Financial Rights on (02) 9212 4216.

Kind Regards,

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