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Chief Executive and Inspector-General in Bankruptcy
AFSA
Submission made online through AFSA Sandpit

Dear Mr McCormick

Best Practice in Registered Trustee Remuneration

Thank you for the opportunity to comment on AFSA's Best Practice report on Registered Trustee remuneration in the personal insolvency system. As a community legal service providing both legal advice and financial counselling to the public, we receive many calls about personal bankruptcy and other insolvency options under the Bankruptcy Act. Those calls range from people who are contemplating bankruptcy as a solution to insurmountable debt to those who are being made bankrupt by their creditors and those who have already become bankrupt, in some cases without their knowledge or understanding of the process.

We generally support any provisions which will make Trustees more accountable. However, we note that the commentary in the Best Practice report 2019 is almost exclusively about the rights of creditors, and accountability to creditors. As recognised in the report, debtors and bankrupts are fundamentally affected by insolvency laws, and their perspective should be balanced with the needs of creditors. In the examples given below there is little conflict between the concerns of creditors and debtors at all, and in some cases their concerns coincide completely. Unsophisticated creditors would be just as unfamiliar with trustee remuneration as debtors, resulting in a lack of complaints about remuneration orders. This also suggests that the systemic reliance on creditors as the main mechanism to contain trustee costs is unrealistic.

In this submission the Financial Rights Legal Centre (**Financial Rights**) will address:

- Times when Trustee remuneration most affects debtors;
- Remuneration and costs guidance from AFSA; and
- Registered Trustee remuneration incentive structures.

Recommendations

1. AFSA should issue further guidance on how trustees can balance the need to protect the legitimate interests of creditors with the need to minimise costs for debtors seeking to set aside or annul a bankruptcy.

2. There should be a process for trustee's fees to be reviewed in the context of court proceedings, where the debtor accepts liability in principle but disputes the amount.
3. Debtors should be informed of possible increased costs if they do not comply or cooperate with their trustee and information should be provided to debtors of rights of review in relation to fees and costs.
4. The Review Process should be revised to ensure that the bankrupt does not have to identify or particularise matters of which they cannot be expected to be aware.
5. AFSA should issue a series of standard remuneration reports for a simple administration, a moderately complex administration and a complex administration. Alternatively AFSA should publish an interactive table of expected cost ranges for work performed by a trustee.
6. AFSA should immediately audit any estates where the Remuneration Report is in excess of AFSA's published standard reports or estimated ranges.
7. AFSA should encourage registered trustees to quote a fixed amount of fees or opt for a legally set percentage of asset realisations instead of calculating hourly rates.
8. Consideration should be given as to whether trustee fees should be regulated or capped when the estate has a surplus of assets to liabilities.
9. There should be a more comprehensive review of trustee remuneration and incentive structures to encourage efficient administration practices and maximum realisation of estate assets, while effectively balancing the rights of creditors, debtors and affected third parties.

Registered trustee remuneration effect on debtors

While concerns about the level of Trustee's remuneration are primarily the prerogative of creditors there are two situations where they become a key concern for the debtor:

1. When seeking to challenge a sequestration order (often made in their absence)
2. When seeking to annul a bankruptcy (either because they have always had the means to pay their debts and either did not know about or did not understand the proceedings, or because they have acquired substantial funds since the bankruptcy, through an inheritance for example).

In our experience the expenses of administering a bankrupt estate (including trustee remuneration) can be very considerable, even in circumstances where the debts were very small, or the administration very short.

Seeking to have a sequestration order set aside

The first point in time where trustee's fees become an issue is when a debtor becomes aware that there has been a sequestration order made against him or her and is seeking to have that order reviewed. Usually there will be at this point an amount of Trustee's fees claimed as a result of the administration of the estate to date.

The fees claimed by trustees at this point vary considerably. It was noted in *Vaucluse Hospital Pty Ltd v Phillips & Anor [2006] FMCA 44 (20 January 2006)* for example that “the debt was for a relatively small sum, which is equivalent to **only one third** of the trustee’s claims for remuneration and expenses. The debt was for hospital fees the bankrupt thought were covered by his medical insurance. The bankrupt is unable to properly manage his own affairs. The debt was paid by his father soon after the sequestration order was made. He is solvent and should never have been made bankrupt.....Had the trustee proceeded cautiously, few expenses needed to be incurred in this administration in the early stages it had reached before payment.” [Riethmuller FM, emphasis added]. In this matter an application for review of a sequestration order had been made within 3 weeks and yet the trustee claimed \$14,000 in remuneration and expenses. The Federal Magistrate noted a number of seeming anomalies in the trustee’s claims and observed in passing that the “bankrupt is a disability pensioner unable to properly manage his own affairs receiving a fortnightly pension of little more than the trustee’s hourly rate”.

In the majority of such cases, however, there is no review of the claims by the trustee by the court to expenses, and such costs are usually borne by the debtor in an attempt to obtain a sequestration order set aside by consent. This puts the debtor in an extremely powerless position in relation to questioning the trustee’s fees, because the only alternative is to continue with a set aside application that they may not win (adding to the cost of ultimately annulling the bankruptcy).

There is also a tension between steps that a trustee reasonably needs to take to protect the estate versus the unnecessary incurring of fees and charges.

Recommendations

1. AFSA should issue further guidance on how trustees can balance the need to protect the legitimate interests of creditors with the need to minimise costs for debtors seeking to set aside or annul a bankruptcy.
2. There should be a process for trustee’s fees to be reviewed in the context of court proceedings, where the debtor accepts liability in principle but disputes the amount.

Annulment

AFSA’s proposed guidance around estates with a surplus of assets encourages Trustees to handle assets with a view to achieving the maximum return from the assets to satisfy the claims of the creditors and to provide the best surplus possible for the bankrupt debtor. Trustees should be careful to safeguard assets, make sure staff are informed to take a minimalist approach to give the debtor the opportunity to achieve an early annulment.

To achieve an early annulment a debtor will need to pay:

- the debts;
- contractual interest to the date of annulment;
- the trustees remuneration and any other costs incurred by the trustee in the administration of the estate; and
- the government imposed realisations charge.

Debtors have a right to seek a review of the registered trustee remuneration. The bankrupt will receive a notice and they have 28 days to challenge the fees by lodging an application for review with the Inspector General.

Case study –Mary’s story –C146375

Mary, an aged pensioner with multiple health conditions, contacted the National Debt Helpline about her strata levies. It turned out she had already been made bankrupt by the strata management firm and was in danger of losing her home and facing costs of tens of thousands of dollars over a debt of just over \$5,000.

One of our solicitors contacted the trustee in bankruptcy within a couple of weeks of the sequestration order and let them know the client would be either seeking to have the sequestration order set aside or the bankruptcy annulled. The solicitor then sought to determine whether there were any grounds for setting aside the sequestration order but found none. She assisted the client to enquire whether her bank (which had already provided her with a reverse mortgage) would extend further funds to annul the bankruptcy. The bank said it could not extend any more credit, but it was willing to donate the funds to save Mary’s home.

The only debts in the bankruptcy were the strata levies and a Telstra debt. The client was in arrears on her council rates, but there was a repayment arrangement in place and the council did not lodge a proof of debt. A free financial counsellor assisted the client to complete her statement of affairs. Our solicitor spent many hours sorting out a breakdown in communication between Telstra and one of their debt collectors, who both purported to lodge a proof of debt when there was essentially only one debt. She also spent at least 3 hours chasing down a current copy of the client’s credit report, all in aid of cutting down the costs of administering the estate by saving the trustee time and effort.

The solicitor then negotiated a payout figure with the trustee, which came in at more than \$46,000 against an original debt of \$5,000.

In our experience trustees fees are often multiples of the original debt. Earlier this year Financial Rights along with our consumer representative colleagues released a report called *Who is making Australians Bankrupt?* (copy attached). We refer to the example at page 8 in that report, supplied by the Consumer Action Law Centre, which indicates trustee fees of \$38,000 in a bankruptcy where the original debt was \$5,000. With interest and legal fees this bankruptcy would have cost \$60,000 to annul. This is not at all unusual for clients we advise, and one of the reasons we are advocating to increase the threshold at which a person can be made bankrupt.

In short, our point is not just that Trustee’s fees are often too high, although that does sometimes seem to be the case, but rather that it is impossible for the debtor to be able to make a judgment about whether they are reasonable or not. Further, the process for challenging the level of

remuneration claimed presumes a level of knowledge and understanding on the part of the debtor they simply do not have in most cases.

For example Reg. 8.12F(1) provides that the Inspector-General must refuse to accept an application where (Reg. 8.12F(1)) among other things:

- *The applicant has not adequately particularised the issue giving rise to the review.*

The Practice Statement further clarifies that claim with only general phrases like “remuneration appears excessive” or “every item of work is disputed” will not be considered adequate to justify a review. Unfortunately, in most cases bankrupts will have nothing further on which to base their complaint than a vague sense that the amount claimed seems like too much. Bankrupts have no knowledge of the obligations of trustees, or of what is a reasonable cost for performing those tasks.

“Exceptional circumstances” – may include but is not limited to (PS 16, para 3.7):

- Evidence provided of errors on the part of trustees or their staff requiring remedial action including work done poorly and having to be reworked
- Systemic and justified complaints made to AFSA Regulation about conduct which indicates trustee or staff have been performing unnecessary work or work not properly executed
- Evidence of inefficiency or inappropriate billing practices having been discovered (either by applicant or AFSA Regulation staff upon investigation) e.g. giving routine work to expensive senior staff, charging for communication with regulator, or inordinate delays without explanation in the distribution of the estate.

Most bankrupts would be unable to identify any of the above from the material they are privy to. The vast majority would not even be able to identify these types of issues if they were given access to the files. It is useful that the Inspector General can apply its own knowledge of any of the above, but they would only have such knowledge in a minority of cases. For most applicants they have no knowledge of what is a reasonable amount of fees in any given situation. This is true for unsophisticated creditors as well. The 2019 Best Practice report says that for smaller creditors, many don’t feel able or confident to challenge the basis on which registered trustees charged remuneration. There is no standard or benchmark by which to judge or argue whether registered trustee remuneration was reasonable.

We note that there are certain tasks that the Trustee is required to do by law for which he or she is entitled to be remunerated despite the fact that they do not generate any additional funds for the estate (for example, reporting to creditors, lodging statutory records with AFSA and maintaining accounts). There is no guidance available as to what is a reasonable amount to charge for such activities and what characteristics of a particular estate might make such duties more or less complicated or time consuming.

The Practice Statement also sets out the types of considerations that will be taken into account in a review:

- Was the work performed within the scope of the Trustee’s powers?
- Was the work performed prior to the appointment of the Trustee?

- Did the Trustee undertake a proper assessment about whether a particular cost was reasonable given the value and complexity of the administration (keeping in mind that the fact that certain expenses appear pointless in hindsight - because little or no additional funds were recovered for the estate - is not sufficient to render the original decision to undertake the action/cost unreasonable)?
- Were there instances of double billing for essentially the same tasks, obvious inefficiency, incompetency (charging for organising invalid creditor's meeting), billing at senior staff rates for routine, non-complex tasks?
- Did the Trustee behave appropriately and properly manage any conflicts of interest?
- Did the Trustee properly record work done and costs incurred?
- Did the Trustee drag out the administration unnecessarily (incurring additional costs) once the bankrupt indicated a willingness and ability to pay out all debts and expenses?

Not only is it beyond most bankrupts and unsophisticated creditors to identify any of the above, it is not clear to us that there is any reliable way of determining this without a full review of the trustee's file by someone with adequate knowledge of the trustee's duties and the circumstances of the administration.

The Review Process should be revised to ensure that the bankrupt does not have to identify or particularise matters of which they cannot be expected to be aware. For example, once a review application has been lodged, the Inspector General could be required undertake an initial review of the remuneration and expenses charged to ensure that they are proportionate for the size and complexity of the administration. A simple questionnaire for completion by the bankrupt and the trustee could provide some basic information about the particular administration, along with an internal guide setting out likely fee and cost ranges. Where it appears that the amounts charged exceed the amount expected in the circumstances, *or* one or more of the above problems currently referred to in the Practice Statement as exceptional circumstances, have been identified, the Inspector General or the bankrupt, then the Inspector General should agree to undertake a more thorough review of the evidence.

AFSA should also develop and publish a series of standard remuneration reports which would give debtors and unsophisticated or smaller creditors some benchmark for reasonability of trustee remuneration. There could be separate standard reports for simple, moderate and complex administrations. Alternatively AFSA could publish an interactive table of indicative costs for work performed by a registered trustee which would be easily searchable on AFSA's website. For instance, the creditor or bankrupt could answer a series of questions about the features of the estate (number of debts, whether they are joint or not, number and value of assets) and the program could produce a likely range of fees for the type of estate. AFSA already has a well-established practice of monitoring remuneration and would have a good idea of what is fair in different types of administrations. These standard reports or table of costs would not be binding, but would give debtors and creditors an idea of what is normal, and could use it to query specific charges or tasks undertaken by the trustee. If a registered trustee wanted to charge an amount in excess of the range in the standard report for the type of estate, then AFSA should immediately consider an audit and the trustee would need to be able to explain the abnormally high charges. This type of specific guidance from AFSA would go a long way towards

encouraging debtors and creditors to make appropriate complaints to would add a layer of accountability to trustee remuneration.

More could also be done in the context of initial contact with bankrupts to ensure they are made aware of the relationship between co-operation with the trustee and costs. Debtors who are made bankrupt by sequestration order are often either extremely angry and/or completely disempowered by the process. Where assets exceed debts it is important that they are made aware that their co-operation can reduce ultimate costs and therefore any surplus returned, and failure to co-operate or active opposition may have the opposite effect.

Recommendations

3. Debtors should be informed of possible increased costs if they do not comply or cooperate with their trustee and information should be provided to debtors of rights of review in relation to fees and costs.
 4. The Review Process should be revised to ensure that the bankrupt does not have to identify or particularise matters of which they cannot be expected to be aware.
 5. AFSA should issue a series of standard remuneration reports for a simple administration, a moderately complex administration and a complex administration. Alternatively AFSA should publish an interactive table of expected cost ranges for work performed by a trustee.
 6. AFSA should immediately audit any estates where the Remuneration Report is in excess of AFSA's published standard reports or estimated ranges.
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Registered Trustee remuneration incentive structures

According to AFSA's monitoring activities most registered trustees calculate their remuneration using hourly rates, based on time spent by them and their staff working on the administration. Although they have the option of quoting a fixed amount or a legally set percentage of asset realisations, they usually instead opt for hourly rates. Accountability of trustee remuneration relies heavily on creditor approval. However, as the 2019 Best Practice report notes remuneration costs have only been the subject of 10% of complaints even though evidence suggests that the level of dissatisfaction with registered trustee remuneration and costs is higher than that.

By allowing most registered trustees to charge hourly rates, there are very poor incentives in place for trustees to achieve a maximum return from estate assets or to work as efficiently as possible. If an estate has a surplus of assets over liabilities the only thing constraining a trustee from over-administration is the risk that creditors might not approve the proposed fees. If all of the creditors are getting paid in full then why would they care what the trustee is charging the estate? In this case it is only the debtor who suffers, and as discussed above it is nearly impossible for a debtor to challenge a trustee's remuneration.

Debtors are also directly penalised for asking questions of the trustee or trying to familiarise themselves with their own obligations during the administration if the trustee is charging hourly rates to the estate. Debtors do not understand that every time they call the trustee to clarify

something that their own possibly solvent estate is being diminished. Financial Rights sees this as fundamentally unfair.

In the attached *Who is Making Australians Bankrupt?* report we called for consideration to be given as to whether trustee fees should be regulated. Creditors approve trustee remuneration, and where there are assets sufficient to pay the debts and trustee fees, there are few incentives for them to choose a lower-charging trustee over a higher-charging trustee. In these circumstances, there is little opportunity for competitive pressure. In this context, there is a case for caps to be set on trustee fees.

We are not arguing that all or even many registered trustees are abusing the current system, but it is clear that the incentives for efficient and lean administration practices are weak. If trustees were constrained to standard fees for administration or were paid from a percentage of the assets they could find and realise, then they would be much better incentivised to maximise the value of the estate or work as efficiently as possible, without eroding the rights of debtors and affected third parties. The system which requires all trustee remuneration to be extracted from the minority of estates (37%) also seems to be a potential driver for gouging. While we do not support a fee for going bankrupt, a more equitable system for remuneration of trustees for handling estates with minimal or no assets or income contributions should be explored.

Recommendations

7. AFSA should encourage registered trustees to quote a fixed amount of fees or opt for a legally set percentage of asset realisations instead of calculating hourly rates.
 8. Consideration should be given as to whether trustee fees should be regulated or capped when the estate has a surplus of assets to liabilities.
 9. There should be a more comprehensive review of trustee remuneration and incentive structures to encourage efficient administration practices and maximum realisation of estate assets, while effectively balancing the rights of creditors, debtors and affected third parties.
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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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About Financial Rights

Financial Rights is a community legal centre that specialises in helping consumers 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 National Debt Helpline, 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, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters.