Joint submission by the

Financial Rights Legal Centre

Consumer Action Law Centre

Financial Counselling Australia

Attorney-General's Department

The bankruptcy system and the impacts of coronavirus - Discussion Paper

February 2021

Financial Rights Legal Centre |PO BOX 538, Surry Hills 2010 | Tel (02) 9212 4216 |Fax (02) 9212 4711 |
info@financialrights.org.au | www.financialrights.org.au | @Fin_Rights_CLC | ABN: 40 506 635 273

About the Financial Rights Legal Centre

The Financial Rights Legal Centre 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. Financial Rights took over 22,000 calls for advice or assistance during the 2019/2020 financial year.

About the Consumer Action Law Centre

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just market place for all Australians.

About Financial Counselling Australia

Financial Counselling Australia is the peak body for financial counsellors. Financial counsellors assist people experiencing financial difficulty by providing information, support, advice and advocacy. Working in not-for-profit community organisations, financial counselling services are free, independent and confidential.

Introduction

Thank you for the opportunity to comment on the proposed reforms to the bankruptcy system in light of the impacts of coronavirus. This is a joint submission from the Financial Rights Legal Centre, Consumer Action Law Centre and Financial Counselling Australia. This submission will address the:

- Specific questions posed in the Discussion Paper, focusing on the default period in bankruptcy and debt agreements, and
- Other proposed reforms including
    - Protecting TPD insurance payments and savings during bankruptcy
    - More accountability of private trustees and trustee fees
    - AFCA Determinations
    - Limiting the trustees' power to sell property after discharge
    - Mortgage debt relief options
    - Financial Counselling at the Federal Circuit Court
    - Repeal Section 271 - Gambling or hazardous speculations

1. Default period of bankruptcy

Question 1: How do current economic circumstances impact the policy setting for a default period of one year bankruptcy?

Current economic circumstances are favourable to the one-year bankruptcy initiative. While banks and some other mainstream lenders are being generous in their support, other creditors do not provide the same flexibility. Further, even bank support will come to an end for some people. Some people may not be able to work their way out of issues without serious intervention and long-term pain. The one-year bankruptcy is a good opportunity for people who have found themselves insolvent through events beyond their control to take advantage of a less punitive solution and get back on their feet faster.

Financial counsellors particularly noted the benefits of a one-year bankruptcy period for people whose bankruptcy was business-related and affected by COVID. The shorter timeframe will give this group an opportunity to re-establish.

The only concern with the one-year bankruptcy is that in hard economic times people might be pushed towards this option by debt management firms or unscrupulous debt advisers. There are of course many debtors who would be better off getting debt waivers or raising disputes with lenders for unsuitable loans or debts resulting from domestic violence rather than going bankrupt. Once bankrupt, these options are lost, and the consumer takes on the long-term impacts of bankruptcy, including a permanent listing on the NPII. We think this problem could be addressed by restricting (or banning) any fees for bankruptcy advice from unregulated service providers.

We see firms – even entities regulated by AFSA – charge exorbitant fees to people for assistance to enter voluntary bankruptcy, rather than refer them to the free assistance available. We are concerned that possible to charge fees also incentivises firms to recommend certain options. A financial counsellor at the National Debt Helpline reported speaking with a person charged $2,200 to go bankrupt over a $4000 debt, where the person owned no assets and whose sole income was the disability support pension – circumstances where a financial counsellor likely could have obtained a debt waiver for free, and bankruptcy could have been avoided.[1]

Recommendations

1. **The default period for Bankruptcy should be reduced to one year.**
2. **Charging fees for bankruptcy advice should be banned; alternatively, banned for any entity that is not a registered trustee, debt agreement administrator, accountant or lawyer.**
3. **AFSA should carefully monitor the quality of pre-bankruptcy advice given by its regulated entities and their associates to ensure that it is comprehensive and in the best interests of the client; and that fees are reasonable and proportionate to the work involved.**

   See also recommendation 15 below in relation to compulsory referrals to accredited financial counsellors in certain circumstances.

Question 2: Have stakeholder views about the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 changed due to the impacts of coronavirus?

In February 2018 our organisations put in a joint submission to the Senate Legal and Constitutional Affairs Legislation Committee about the *Enterprise Incentives Bill* (attached). In that submission, we supported reducing the default period for bankruptcy from 3 years to 1 year under Section 149 of the *Bankruptcy Act* 1966. We also supported the lifting of restrictions on overseas travel, obtaining credit and company board eligibility at the conclusion of the 1-year period.

[1] RN Law Report, Call for regulation of debt repair or credit management companies, 15 December 2020: https://www.abc.net.au/radionational/programs/lawreport/elder-abuse-and-covid19/12939054 at25:00

We believe these reforms strike an appropriate balance between the interests of creditors, and ensuring that bankruptcy enables a fresh start for debtors, and is not needlessly punitive. Our views have not changed as a result of the coronavirus pandemic, if anything these reforms seem even more important. The pandemic has really brought home how financial difficulty can strike anyone at any time. People end up in extreme financial hardship due to situations outside their control.

The proposed changes will likely have little impact on creditors, whose right to claim in the bankrupt's estate will be unaffected. Creditors receive very little return from estates of personal bankrupts. Likewise, the bankrupt's trustee's statutory powers to recover vested assets and voidable transactions will still be available. In 2018 AFSA submitted that a reduced bankruptcy period would not affect the continued administration of an estate after discharge. If more time was required, trustees would still be able to administer an estate after discharge.

To be clear, we support the change from three-year to one-year bankruptcies because a faster discharge is less needlessly punitive, with the majority of bankruptcies in Australia relating to consumer debt rather than business debt. However, with a significant number of small business facing viability challenges as a result of the pandemic, the Government's enterprise initiative may also be timely and prove beneficial in allowing some of those business owners (including sole traders) to get back on their feet.

While the possibility that income contributions may continue beyond one year may be confusing for some consumers, we are mindful of recent research into bankruptcy which has shown that "for many Australian debtors, bankruptcy results in genuine improvements to financial stability, health, relationships and general well-being".[2] Consumer advocates support any law reforms that will help reduce the stigma of bankruptcy and help bring the positive outcomes indicated in this research to debtors sooner.

Feedback from financial counsellors across Australia

Financial Counselling Australia (FCA) held three consultation meetings with financial counsellors nationally relating to these proposals over February 2021. FCA asked its Representative Council, held a zoom meeting with financial counsellors (invited via a Facebook post on its closed group page) and met with its Victorian state body's working group on bankruptcy. These are the results:

- *Financial counsellors are working with many clients, individual and small businesses, who are facing the prospect of bankruptcy caused by the coronavirus pandemic. There was particular support for assisting small business because of the pandemic as a way of providing a fresh start.*

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[2] Paul Ali, Lucinda O'Brien & Ian Ramsay, *Bankruptcy And Debtor Rehabilitation: An Australian Empirical Study*, Melbourne University Law Review , Vol 40:688 ; pp688-737.
https://law.unimelb.edu.au/__data/assets/pdf_file/0009/2494269/01-Ali,-OBrien-and-Ramsay.pdf

- *Reducing the default period to 12 months would make it easier for people to get back on their feet after financial hardship. It could also allow financial counsellors to work with them more closely during this period.*
- *A shorter period would alleviate emotional strain associated with the shame and pressure of being in bankruptcy, allowing people to more quickly rehabilitate financially*

This comment is interesting too:

"In general, I'm in favour of the reduction of bankruptcy period from 3 years to 1. The second-most common reason to avoid bankruptcy that our clients provide (after the damage to future borrowing) is the risk of not being able to travel internationally to care for family if needed. 'Only' a year is more likely to be accepted than three."

There were some financial counsellors however (the minority) who were concerned that 12 months was too short a timeframe.

Source: Financial Counselling Australia

Case study –Sal's story – Could benefit from a faster discharge

Sal's bank provided him with a short term hardship variation and agreed to freeze the interest and charges. As the variation plan was ending, the bank contacted Sal to see whether he could start repaying the debt. Sal told the bank representative that he is unable to make any repayments as his circumstances have not improved and he is unsure if they will improve. He asked the bank to put the loan on hold for six months to see if he is able to get more income, but it declined. Sal would like to know what other options he has. He is unable to offer any repayments because he barely has sufficient income to support himself. He is unsure if his circumstances will improve because he has no work coming in from the consulting services he was previously providing. He cannot file for bankruptcy because it will impact his ability to provide consulting services.

Source: C204380 – August 2020

Case study –Chloe's story – Could benefit from a faster discharge

Chloe is a sole trader and works as a caterer for small events. Because of COVID-19 her income has dropped and she has a number of debts totaling about $35,000 that she cannot service. None of her creditors have taken legal action against her yet but her accountant believes

bankruptcy is her best option. Chloe wants to keep trading because she thinks events will pick back up next year and she has two young children. She is not sure what her turnover is and she is currently receiving JobKeeper. She doesn't have any assets above the threshold amounts or any savings. She understands that she can keep trading while she is in bankruptcy but she will need to disclose to her suppliers and customers that she is an undischarged bankrupt when purchasing goods or promising services above the disclosure thresholds and she is worried that will hurt her events business.

Source: C210098 – October 2020

Case study –Diane's story – Could benefit from a faster discharge

Diane has been in-and-out of hardship arrangements with her bank over an old credit card debt for much of the past 6 years, since her business failed. Her bank gave her a payment holiday when COVID first hit, but now they are demanding she pay off her debts. Diane understands the bank's frustration, since she has been trying to pay off her debt for so long. She also owes some money to the ATO and a few other small lenders. She is 60 years old with no children and no assets. She has several small business ideas she wants to get off the ground but because of the pandemic she doesn't think any of them will come to fruition until 2021 and beyond. She wants to channel her energies and remaining working life into the potential pipeline of new income streams and securing her financial future, rather than endlessly trying to make inroads on her debts. Her income over the next couple of years at least is not likely to be near the income threshold.

Source: C189299 – December 2020

Case study –Brendon's story – Could benefit from a faster discharge

Brendon has $4000 of unpaid strata fees and the strata company have taken legal action to recover the fees. Brendon had a florist which he had to shut down due to COVID-19 restrictions and he has fallen behind in a lot of debts. He offered the strata company a repayment plan of $100 per week until the end of the COVID restrictions but they said no. The strata solicitors want Brendon to pay $1000 per month and pay all future strata bills on time. He simply cannot afford to do this and is thinking about bankruptcy. Brendon has about $60,000 in unsecured debts, a car loan and some business debts he has been struggling to pay for some time.

The strata fees are for a unit which he has rented out but the rent only covers his mortgage for the property. It is in negative equity or he would sell it. He is living with his parents and his wife

> *just had a baby. He wants to get his business going again after the pandemic but he needs a fresh start from his debts.*
>
> *Source: C208887– August 2020*

Consumer advocates also submitted in 2018 that the *Enterprise Incentives Bill* missed an important opportunity to change the rules surrounding situations of financial hardship and the deletion of information from credit reports. There are also other amendments to the Bankruptcy Act which would provide tangible benefits to consumers as well as aid in Australia's economic recovery. These additional reforms are set out later in this submission.

Financial hardship during bankruptcy

We note in the *Enterprise Incentives Bill* there has been no change to the rules surrounding situations of financial hardship. Section 139T provides for the situations where the income contribution assessment produces an immediately harsh result for the reasons listed – including as a result of illness, disability, dependents with high needs, high rental costs etc. However bankrupts who are behind in their contribution obligations, for an assessment that was not harsh at the time it was made, and have subsequently suffered from a change of circumstances such as unemployment, illness, or accident, it is not clear there is a remedy. It does not clearly cover the situation where the income contributions assessment is valid at the time it is made but can no longer be met because of a subsequent change of circumstances.

Also, 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 (it is 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.

Recommendations

4. **The Bankruptcy Act should be amended to include further protections for people in situations of financial hardship including**
    a) **Bankrupts who are behind in their contribution obligations, which were validly assessed at the relevant time, but they have subsequently suffered from a change of circumstances such as involuntary unemployment, illness, or accident, should be permitted to apply to reduce their contributions; and**
    b) **Refunds should be payable to bankrupts who have overpaid contributions.**

Changes to credit reporting regime in line with proposal to shorten the bankruptcy default period from three years to one year.

The *Enterprise Incentives Bill* does not change the rules with respect to the deletion of information from credit information files under section 20X, Part IIIA of the *Privacy Act 1988* (Cth) (**credit reports**).

At present, bankruptcy is retained on a person's credit report for the longer of 2 years from discharge or 5 years from the date of bankruptcy – effectively a minimum of 5 years. If the period of bankruptcy is reduced by 2 years then, logically, the period that bankruptcy remains on credit reports should also be reduced by 2 years, creating an effective minimum of 3 years.

Australians are very concerned about their perceived creditworthiness and the impact of any potential decision, such as bankruptcy, on their credit report. This is particularly so for younger people, who are concerned that the bankruptcy will prevent them from buying a home in future.

Reducing the period of bankruptcy will have little effect on entrepreneurial activity if the prospect of insolvency, should the venture fail, will adversely impact their creditworthiness. Similarly, entrepreneurs will struggle to 'reengage in business sooner' as envisaged by the Explanatory Memorandum issued with the previous version of the Enterprise Incentives Bill if the impact on their credit report remains the same – effectively a five-year minimum.

If the retention period for bankruptcy information is reduced on credit reports, then the retention period for default information on credit reports should also be reduced, so that they continue to be harmonised. 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 than a default. We submit that in order to further the Government's policy objectives, default listings should be reduced to 2 years to delineate them from insolvency (or 3 years at the most).

Case study –A financial counsellor's experience

I am a financial counsellor in Launceston, Tasmania. I am concerned that credit reports, especially bankruptcies listed on credit reports, are having a negative effect on access to housing in Tasmania. It has become commonplace for Property Managers to expect renters to provide a copy of their credit file along with their application. On speaking with all the different flavours of housing workers (private, social housing, etc.), the consensus is "No credit check, no lease". Housing workers and renters know that without one their chances of a successful application are very low, unless they are out of a main centre, where there are more properties than renters.

One housing worker I spoke with last week told me she picked up 6 new clients (for private rental support) and needed to pay for 4 credit checks, because the credit files they had were more than 3 months old. (The housing worker said that Property Managers usually grumble if the credit file is over 3mths old, so she will usually seek brokerage to pay for an updated credit file.)

When I relocated, I actually had to pay about $90 to get my own credit file ASAP, as there were only 2 properties for rent in the area that allowed pets.

Source: Tasmanian Financial Counsellor

Recommendations

5. **If the bankruptcy period is reduced to 12 months, amendments should also be made to the Privacy Act 1988 in relation to the credit reporting system:**
   a) **reduce the retention period for bankruptcy information to the longer of two years from discharge or three years from the date of bankruptcy; and**
   b) **reduce the retention period for default information to two years.**

Question 3: How might a default period of one year benefit debtors with business related debts such as sole traders?

In our experience trade creditors are far less flexible than consumer credit providers, for a variety of reasons. This makes it important that sole traders and other very small businesses affected by the pandemic have access to a fair and reasonable process for dealing with their insolvency. Some sole traders and small businesses have been impacted severely as a result of business restrictions introduced in response to the pandemic. This group of debtors are also less likely than individual debtors to have access to hardship mechanisms and free dispute resolution.

Owners of small businesses in Australia often need to secure business loans with their personal assets or provide personal guarantees. For some segments of the economy (ie travel related services) those businesses are not going to be able to recover. A fresh start for those owners would be the best outcome. As noted above, a one-year bankruptcy period could be extremely beneficial for these business at this time, and for the economy, if they are able to get back on their feet earlier than would be likely under the current bankruptcy rules.

We do however have some concerns about sole traders and small business owners that need to use their family home or make personal guarantees in order to get access to finance. While we would support protections for the personal assets of sole traders we also appreciate that many people operating a small business would not get access to finance without using their personal assets as security. One protection that could be put in place for these people is access to free dispute resolution to ensure that all options for potential resolution of their financial situation are explored prior to insolvency.

Small business lenders that also offer consumer credit are required to be members of AFCA as a requirement under their credit licence. However, lenders that only provide finance to small business are not required by law to be members of AFCA. We note that while some small business lenders (Prospa and Moula for example) are voluntary members of AFCA under industry codes of conduct (e.g. AFIA online small business code), these lenders could leave AFCA at any time without consequence. There are also many other small business lenders that are not members of AFCA at all. This means that if there is a complaint or dispute, there is no accessible jurisdiction for it to be resolved efficiently and effectively.

The Financial Services Royal Commission did not recommend extending the remit of the *National Consumer Credit Protection Act* to include small business lending. However the Final Report did comment on a number of existing legal protections that are vitally important in the small business lending context, including misleading and deceptive conduct, unconscionable conduct, implied warranties, unfair terms and the common law in relation to the enforcement of guarantees. In reality, most small to medium enterprises have insufficient resources to pursue these rights in any other forum except AFCA.

As experienced consumer advice services we have found that the best way for lenders to be held accountable to acting fairly with customers in hardship is through AFCA.

Recommendations

6. **All small business lenders should be required to become members of the Australian Financial Complaints Authority.**

Question 4: Do stakeholders have views on how the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 could be amended to respond to concerns about the one-year default period being made available to bankrupts for whom such a concession is not a desirable or justifiable outcome?

Consumer advocates submit there are adequate safeguards in the Act already to deal with the minority of people who might appear to be gaming the system. The legislation already makes it clear that assets can continue to be dealt with beyond discharge in line with the applicable time limits, and that contributions continue to be collected for 3 years anyway. Trustees can still object to discharge for the usual reasons and can extend the bankruptcy as needed. Any concerns that stakeholders have raised about certain debtors being unsuitable for a one-year discharge have already been addressed in the legislation.

Consumer advocates do not believe that there is a problem in Australia with “rogue, reckless and repeat bankrupts” which would abuse a default period of one year. The vast majority of debtors that we speak to have ended up in financial hardship for reasons outside of their control.

They have not been reckless and they are not proud to be in the dire financial situations they find themselves in. Bankruptcy still holds a great deal of stigma as well as consequences.[3]

We recognise that the Department has been tasked with addressing stakeholder concerns that a one-year bankruptcy might be exploited by some debtors, but we urge you to make reforms to the Enterprise Incentives Bill based on real evidence of abuse only. Most debtors making use of a one-year bankruptcy would greatly benefit from a faster discharge and are not trying to game the system. Limiting this option for debtors based on a 'perception' that it makes bankruptcy too easy is not good policy-making.

As the Department is considering criteria that would exclude a bankrupt from accessing the one-year default period, we submit any new criteria be carefully defined as to not be too broad. We do not support implementing an early discharge application process. There are many reasons which can cause a person to bankrupt more than once – including for example, debt incurred as a result of financial abuse or fraud, traffic accidents, injury or illness, or business failure. There is no guarantee that a person will only encounter one of these in their lifetime.

The one-year discharge should be the default time period, with discretion for the Official Trustee to impose a 2 or 3 year bankruptcy period under certain circumstances. Such rejection should be based on clear and relevant criteria, and not simply the number of bankruptcies the person has entered considered in isolation.

Recommendations

7. **Consumer advocates do not support implementing an early discharge application process. The one-year discharge should be the default time period.**

Debt agreements

Question 5: What reforms, if any– either on a temporary basis or more permanently – should be made to the debt agreement system to respond to coronavirus?

The Debt Agreement reforms (the **Reforms**)[4] only commenced in 2019 and should be given an opportunity to work. The legislative instruments should be finalised to set useful parameters on affordability.

[3] Note the work by the University of Melbourne personal insolvency project: https://law.unimelb.edu.au/centres/ccl/research/major-research-projects/personal-insolvency-project; This project entails an in-depth academic study of the relationship between financial stress and Australian personal insolvency laws in order to evaluate the effectiveness of these laws in practice.

[4] *Bankruptcy Amendment (Debt Agreement Reform) Act 2018* (Cth).

Before the reforms, the vast majority of Part IXs were inappropriate or unaffordable, so numbers *should* be down.

Consumer advocates made a detailed submission on the need for reforms to the Senate Legal and Constitutional Affairs Legislation Committee (**attached**).[5] Any rollback of the Government's own reforms would reinstitute the very same problems discussed in the submission. We encourage the Department to read this submission in full, including the many stories from people impacted by rampant mis-selling of Part IXs pre-reforms.

The fact that new debt agreements are down is a sign that the reforms are working as intended. There is only a very narrow band of people for whom a debt agreement is a suitable option, and even fewer for whom it is their best option. Generally, competent advisors only recommend a debt agreement when the debtor is facing bankruptcy and has a substantial asset, such as the family home, that would be seized in bankruptcy, or where bankruptcy would impact their job. Otherwise, debtors generally have better options to resolve a situation of unmanageable debt.

Despite this, we frequently see people who have entered debt agreements pre-reforms on the advice of an administrator (or an aligned broker) when a hardship variation from a creditor, debt waiver or bankruptcy clearly would have been a better option for the debtor. People frequently report that they misunderstood or were misled about the cost and consequences of a debt agreement, or were not advised of other options. Debt agreements have significant implications for a person's credit report, even for years after they are completed. A 2017 survey of people in Part IX debt agreements commissioned by AFSA found: [6]

> *However, one in five debtors (20%) said they only discussed the option they ended up taking – people in casual or sporadic work were more likely to say this. 17% said they only discussed debt consolidation – respondents aged over 50 years were more likely to say this.*

Before the reforms, 75% of people in a debt agreement did not have a home to protect,[7] which suggest the vast majority of debt agreements were plainly unsuitable for the debtor. Academic research based on AFSA data confirmed found that between 2011 and 2016, 58 to 67 percent of debtors owned realisable assets of less than $5,000 at the time of entering a Part IX; and only 5 to 7 percent owned realisable assets worth between $50,000 to $100,000.[8]

The higher rates of Part IXs pre-reform was not a vote of confidence in the debt agreement regime. It was largely due to rampant mis-selling of Part IXs by administrators (and their aligned brokers) that stood to earn upwards of $20,000 in fees over the life of the agreement, not because a Part IX was the consumer's best option. Compared with bankruptcy, a debt agreement often involves higher costs to the debtor. If debtors are unable to sustain the

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[5] Also available at: https://consumeraction.org.au/submission-debt-agreement-reform/.

[6] Where To, *Assessing the experiences of debtors and creditors with practitioners during the personal insolvency process – a market research report for the Australian Financial Security Authority*, 25 May 2017.

[7] Australian Government, Insolvency and Trustee Service Australia, *Profile of Debtors 2011* (2012), 47-8, available at: https://www.afsa.gov.au/sites/g/files/net1601/f/profiles-of-debtors-2011.pdf.

[8] Chen, O'Brien and Ramsay, 'An Evaluation of Debt Agreements in Australia' (2018) 44(1) *Monash University Law Review* 151, 173: https://www.monash.edu/__data/assets/pdf_file/0005/1593626/Chen,-OBrien-and-Ramsay.pdf.

required payments and their debt agreements are terminated, bankruptcy may be the result. Those debtors will be left worse off financially than if they had opted for bankruptcy in the first place. By their very design Debt Agreements only work for a small number of debtors – people with a home or asset to protect and people whose employment would be affected by bankruptcy.

The pandemic should not be used as an excuse to trap people in unaffordable and unsuitable debt agreements. If the one-year bankruptcy goes ahead it may be a more suitable option for a lot of people currently entering debt agreements.

The only option that should be considered is allowing people to exit a Debt Agreement early without penalty if they cannot pay the balance of their agreement as a result of the pandemic, or other circumstances beyond their control. At the beginning of the pandemic AFSA encouraged debt agreement administrators to be flexible with people who were unable to meet their commitments due to the pandemic, including asking creditors to consider variations to the effect that payments to date be accepted as full and final settlement of those agreements, particularly when a substantial proportion of the payments under the agreement had already been made. We propose that this option be codified and made available systemically. For example, where a debtor has already paid a certain percentage of their repayments due under the agreement, (say 75% or more), and they can no longer meet their commitments due to a verified change of circumstance, then they should be released from the agreement and their debts as if the agreement was completed.

Case study –Colleen's story

Colleen is in a Part IX Debt Agreement but has been making reduced payments since COVID-19 began and she was placed on JobKeeper. Colleen has already paid off $33,000 of the $55,000 Agreement but since she has been making reduced payments she is not going to be able to completely pay off the $22,000 before the Agreement is set to expire. In July 2020, Colleen received a notice from her Administrator that if her creditors do not accept a variation her Agreement will be terminated and her creditors will be able to bring bankruptcy proceedings against her. She has offered to make a $4,000 lump sum payment hoping the rest of the debts could be waived, or at least extend the Agreement until April 2022 but her Administrator says he does not think her creditors will accept that. She is a sole trader and if she is made bankrupt she will lose her ABN, won't be able to work and it will jeopardise her JobKeeper payments. Colleen has worked so hard to pay off her debts and now she is at risk of losing everything.

Source: C208307

We also call on Government to undertake a comprehensive reform of debt agreement brokers and the debt management industry more broadly. There should be AFCA membership for

organisations that "assist" people into Debt Agreements,[9] stronger enforcement against misleading advertising of the benefits of Debt Agreements, a best interests' duty for debt advice and a ban on upfront fees. For more information, please see our joint submission to The Treasury's recent consultation on Licensing Debt Management Firms.[10]

The Attorney-General should finalise the legislative instrument in relation to the "payment-to-income ratio," which remains outstanding at the time of writing. We strongly recommend setting the prescribed figures so that the payment-to-income ratio creates an effective minimum annual income threshold to enter a Debt Agreement based on:

- the Base Income Threshold Amount ($59,031) to align Part IX repayments with income contributions in bankruptcy; or
- alternatively, the National Minimum Wage ($37,398), which is formulated with the living standards and the needs of the low paid in mind and is intended to guarantee a modest but adequate standard of living.[11]

If the Attorney-General is going to move ahead with reforms to the debt agreement system in response to the pandemic we believe the following stronger protections should be put in place:

- Introducing minimum eligibility thresholds and a statement of suitability to ensure that debt agreements are affordable, suitable and well-targeted at people who can genuinely benefit from this insolvency option;
- Affordability assessments for debt agreements including income and expenses assessments which determine what a debtor can realistically afford to pay[12];
- Restrictions on excessive and upfront fees which would help ensure affordable repayments, a fair return to creditors and would curb the rampant mis-selling of debt agreements; and
- Providing a statement of account and referral to a financial counsellor for debt agreements that terminate due to arrears.

Finally financial counsellor referrals should be mandatory for any debt agreement proposal where there are no assets to protect and the debtor's professional occupation will not be negatively affected by going bankrupt. Consumer advocates are concerned that people struggling with reduced incomes due to the pandemic will be vulnerable to unscrupulous for-

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[9] A licensing regime has been proposed by Government as part of its 2021 Credit Reforms, but this regime would only require firms which provide services relating to credit activities to hold an Australian Credit License. This proposed regime will not target firms that charge fees for bankruptcy-related advice. The Government's exposure draft regulations to licence debt management firms are available at: https://treasury.gov.au/consultation/c2021-139564.

[10] Available at: https://consumeraction.org.au/licensing-debt-management-firms-exposure-draft-regulations/.

[11] For our views on the payment-to-income ratio, please see our joint submission to the Attorney-General's Department, Legislative Instruments Consultation: Bankruptcy Amendment (Debt Agreement Reform) Act 2018, 23 October 2018, available at: https://consumeraction.org.au/debt-agreement-reform-proposed-legislative-instruments/.

[12] This would be far more effective as an affordability gauge then the payment-to-income ratio.

profit debt management firms. There will be desperate and vulnerable people advised to sign up for Debt Agreements when better options are available to them.

Recommendations

8. **If a debtor has already paid 75% or more of their commitments under a Debt Agreement and they are unable to pay as a result of circumstances beyond their control they should be able to exit the agreement early and be released from their debts as if it were complete.**
9. **Finalise the legislative instrument to set the 'payment-to-income ratio' such that the effective minimum annual income threshold to enter a Debt Agreement is the Base Income Threshold Amount ($59,031) or, alternatively, the National Minimum Wage ($39,197).**
10. **Government to undertake a comprehensive reform of debt agreement brokers and the debt management industry more broadly which includes those firms providing bankruptcy advice.**
11. **Minimum eligibility thresholds should be introduced and a statement of suitability required to ensure that debt agreements are affordable, suitable and well-targeted at people who can genuinely benefit from this insolvency option.**
12. **Affordability assessments for debt agreements should be introduced including income and expenses assessments which determine what a debtor can realistically afford to pay.**
13. **Restrictions should be placed on excessive and upfront fees which would help ensure affordable repayments, a fair return to creditors and would curb the rampant mis-selling of debt agreements.**
14. **Debt Agreement Administrators should be required to provide a statement of account and referral to a financial counsellor for debt agreements that terminate due to arrears.**
15. **Free financial counsellor referrals should be mandatory for any debt agreement proposal where there are no assets to protect and the debtor's professional occupation will not be negatively affected by going bankrupt.**

Question 6: Are there changes that could be made to the debt agreement system to make it more useable for those with business related debts such as sole traders?

As discussed in response to Question 3 above, consumer advocates believe all small business lenders should become members of the Australian Financial Complaints Authority.

Question 7: Should the income, debt, and/or asset threshold amounts for debt agreements be increased? For example, the income and/or debt threshold could be increased to match the current asset threshold of $236,126.80.

No, we do not support increasing income, debt or asset threshold amounts for debt agreements. There should be no increase in the potential pool of candidates for debt agreements unless it has been demonstrated that the problems with people being placed in unsuitable debt agreements has been adequately addressed.

Recommendations

16. **Consumer advocates do not support increasing the income, debt and/or asset threshold amounts for debt agreements.**

Question 8: Does the impact of the coronavirus give rise to the need to re-consider the term limit of a debt agreement?

Absolutely not. Five-year debt agreements are almost never in the consumer's interest unless the debtor is trying to save their house. Even so, there could be better options available for debtors trying to stay in their family home (*see discussion on mortgage debt relief below*).

Term limits were the most important reform of 2019 and the reasons they were introduced still apply. Increasing term limits of debt agreements would increase the use of debt agreements for debtors that do not have a house to save. The three year term limit restricts, on affordability grounds, many applicants for whom a debt agreement would be unsuitable.

This pandemic proves the case that life can be very unpredictable, and circumstances can change. A debt agreement is only beneficial if it is completed. From our experience working with debtors, we know it is very hard for people to commit to a realistic budget even for 3 years' time – let alone 5. Nevertheless, there is already provision in the current law to extend a 3 year debt agreement to a 5 year agreement on grounds of hardship provided the overall amount paid does not increase.

Instead, more should be done to encourage creditors to accept amounts paid as full and final settlement when people have paid the majority of their obligations under the agreement and encounter increased financial difficulty near the end (see recommendation above). This would give appropriate recognition to the amounts they have paid above and beyond what would have been payable in bankruptcy. Even if this is not introduced as a right, Debt Agreement Administrators should be required to assist people to propose such variations free of charge or for very minimal cost.

Recommendations

17. **Consumer advocates strongly oppose reconsidering the term limit of a debt agreement.**

Question 9: What are the possible consequences (unintended or adverse) to making reforms to the debt agreement system in response to the impacts of the coronavirus?

The recent drop in the use of debt agreements and the impacts of the coronavirus should not be used as the reason to herd more people into debt agreements when there are more appropriate responses available in the market.

In our view, there is only a very narrow band of people for whom a debt agreement is a suitable option, and even fewer for whom it is their **best** option. This is discussed in more detail above at Question 5.

Debt agreements should only be used appropriately and there is a risk that any move to make them more accessible because of the pandemic will mean that more people will be steered into debt agreements to their detriment. The drop in debt agreements since the lead up to the amendments is entirely appropriate because the group of people who can realistically benefit from a debt agreement compared to other options is relatively small. This should not be seen as a negative.

Put simply: debt agreements are not a solution to problems caused by the pandemic – and will only cause more problems for people in financial difficulty.

Any rollback of the Government's own reforms to debt agreements in 2018 would be strongly opposed by consumer advocates.

Question 10: If you support reforms to the debt agreement, should there be a transition period before any reforms take effect?

All of the recommendations we have made above under Question 5 should take effect immediately.

Personal insolvency agreements

Questions 11-13

Consumer advocates have no relevant expertise to comment on questions regarding Personal Insolvency Agreements. They are generally too expensive for our clients to consider.

Please refer to out comments below on the Irish mortgage debt relief reforms.

Offence provisions

Question 14: What new or expanded offence provisions could respond to concerns about the abuse of a one year default period of bankruptcy?

The current offences appear adequate to cover all potential issues. In our experience, the overwhelming majority of debtors do not attempt to game the system. For any that do, there are offences covering the range of likely conduct already, including but not limited to failing to disclose income and assets, making false declarations, disposing of property and leaving Australia with the intent to defeat creditors. There are also numerous grounds available to the trustee to apply to extend the bankruptcy should the bankrupt fail to co-operate in the initial one year period.

Question 15: What new or expanded offence provisions could respond to concerns about the behaviour of untrustworthy advisors, including pre-insolvency advisors?

Advisors should be properly regulated and required to have effective internal dispute resolution and complaints handling as well as mandatory AFCA membership. Fees from unlicensed bankruptcy advisors should be restricted or banned. Offence provisions could be added for mis-leading advertising and placing a consumer into an unsuitable agreement that is not in his or her best interests.

We cannot comment on systemic problems regarding 'pre-insolvency advisors' who advise people under financial stress how to defeat the legitimate interests of creditors through the creation and or use of false information. The systemic problems we see with unlicensed pre-insolvency advisors have more to do with debtors being steered or pressured to use insolvency options which are patently unsuitable or not in the debtor's best interest.

Recommendations

18. **Pre-insolvency Advisors should be properly regulated including:**
    a) **Being required to have effective internal dispute resolution and complaints handling;**
    b) **Mandatory AFCA membership; and**
    c) **Restricted (or banned) from charging fees for bankruptcy advice unless they hold a financial services license.**
19. **Offence provisions could be added for mis-leading advertising and placing a consumer into an unsuitable agreement that is not in his or her best interests.**

Other suggested reforms

Total and Permanent Disability insurance payments to be protected in all circumstances in bankruptcy

Most Australian adults have access to a potential total and permanent disability claim through insurance purchased on their behalf by their superannuation fund. 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 insurance payments are not explicitly protected from vesting in the trustee under s116 (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 s116(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.

The case of *Berryman v Zurich Australia Ltd [2016] WASC 196 (1 July 2016)* provides support for the protection of insurance payments received as a result of an injury, but does not touch on payments received to compensate for a debilitating illness or degenerative disease. 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 an insurance payout intended to assist either an injured person, or a person who is seriously ill or incapacitated due to a disease or genetic condition, should be afforded the same protection. S 116(2) should be amended to put this beyond doubt.

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, puts more pressure on government and community resources for supporting and treating people who are sick and injured, and undermines the quality of life of a group of very vulnerable people.

Recommendations

20. **The Financial Rights Legal Centre considers s 116(2) should be amended to protect total and permanent disability insurance payments in the same comprehensive manner as compensation for personal injury.**

Protection of savings

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, provided their assessed contribution payments have been made.

The income contribution framework in bankruptcy assesses the amount of income a bankrupt must contribute towards their debts by applying a percentage to all income earned above an indexed threshold. It has long been assumed that bankrupts could retain savings from income earned over and above their assessed contribution, but could not convert those savings into an asset. The 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.

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, or 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 policy agenda of encouraging innovation and providing a fresh start. Further, it encourages people to spend all that they earn, even if they have the capacity to save. This is counter-productive if the goal is to improve people's financial resilience and reduce the likelihood of subsequent insolvencies[13].

We submit that the appropriate balance between creditors' rights and encouraging financial rehabilitation would be to legislate to enshrine the bankrupt's right to retain any accumulated savings, even during the period of being an undischarged bankrupt, provided they have paid their assessed contributions. Inheritances, winnings and other after-acquired assets would continue to vest in the trustee if received prior to discharge.

Recommendations

21. **A bankrupt should have the right to retain any accumulated savings, even during the period of being an undischarged bankrupt, provided they have paid their assessed income contributions.**

[13] https://www.financialcounsellingaustralia.org.au/docs/everybody-needs-a-savings-buffer/ p7: "Having a savings buffer is a key element in building financial resilience within households, and in enabling consumers to take control of their finances."

Concerns about private trustees

Consumer advocates have a number of concerns regarding private trustees which could be addressed in these reforms.

Vulnerability training

Consumer advocates have seen some distressingly poor practices from trustees when dealing with vulnerable bankrupts. We believe there is a need for some basic vulnerability and cultural safety training for trustees. Required training should include:

- Cultural awareness and safety;
- Identifying and responding to family violence; and
- Generally dealing appropriately with people experiencing vulnerable circumstances.

From our perspective a cultural shift is needed among Trustees, especially when compared with other debt related professions such as financial counselling.

AFSA should also be more active in providing regulatory guidance in relation to how trustees can best negotiate the challenge of complying with their statutory duties at the same time as identifying and responding appropriately to vulnerable people, whether they are bankrupts or others impacted by the actions of the trustee in the course of carrying out their duties.

Accountability of trustees fees

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:

- When seeking to challenge a sequestration order (the debtor has been forced into bankruptcy), and
- 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. For home owners, this can force the loss of their home in circumstances where this would not otherwise be necessary, or greatly reduce the amount able to be retained by the debtor after the sale of the home with which to start again. If there was more accountability of trustees fees, bankrupts with equity in their estates would have the means to get back on their feet more quickly.

The fees claimed by trustees at this point vary considerably. Our organisations have seen examples of relatively simple administrations where trustee remuneration and legal fees reached over $40,000.

In the majority of such cases, however, there is no review by the court of the expenses claims by the trustee. In cases where the debtor is trying to have a sequestration order set aside by

consent these costs are usually borne by the debtor. 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 in court which they may not win (adding to the cost of ultimately annulling the bankruptcy).

There is always a tension between steps that a trustee reasonably needs to take to protect the estate versus the unnecessary incurring of fees and charges. This is something that AFSA has tried to issue guidance on in recent years but we continue to hear from bankruptcy facing what appear to be unnecessarily high amounts to annul or set aside their bankruptcies.

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.

Recommendations

22. **Trustees should be required to undertake training in cultural safety, working with domestic violence victims, and general how to deal with vulnerable people.**
23. **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.**
24. **The Government should examine the effectiveness of current review processes for trustee fees.**
25. **The Australian Financial Security Authority should undertake more and better enforcement in relation to trustee fees that are unjustifiably high. Bankruptcy legislation requires trustees to administer bankrupt estates efficiently and to avoid unnecessary expense. There should be more auditing for compliance with these requirements.**
26. **Consideration should 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.**

AFCA Determinations

AFCA determinations on misconduct by Debt Agreement Administrators

A current limitation of the Bankruptcy Regulations is that they do not appear to give effect to certain determinations of Australian Financial Complaints Authority (**AFCA**) on misconduct and breaches of the law by registered Debt Agreement Administrators (**RDAAs**).

As a result of the Government's 2018 reforms to Part IX Debt Agreements,[14] registered Debt Agreement Administrators must now be a member of AFCA. This is a critical reform to ensure the people have access to free, fair and accessible dispute resolution when their Administrator breaches the law, and to restore trust and confidence in the RDAA sector. AFCA is able to hear disputes about RDAAs under its terms of reference.

A common problem we encounter in our casework is where RDAAs (and others) make misleading representations on the impacts and suitability of Part IXs. This can include advice on the impact of proposing or entering a Part IX on the debtor's ability to obtain credit in future, the impact of listings on the NPII and credit reports. RDAAs are subject to the general consumer law, including prohibitions on misleading and deceptive conduct, unconscionable conduct, and requirements to provide services that are fit-for-purpose and with due care and skill – claims that may be available based on the pre-agreement conduct of the RDAA.

While a debtor could pursue these remedies through the courts, the reality is that such litigation is complex, expensive and risky for most people, and entirely inaccessible without legal representation. The Government has acknowledged the benefits of external dispute resolution over courts and tribunals with the establishment of AFCA, and acknowledge the harm caused by Part IX with the 2018 reforms.

A recent determination of AFCA details this problem.[15] AFCA found, among other breaches of the law,[16] that:

> The financial firm misled the complainant about the effect of the agreement on her credit file and her employment prospects when it told her that:
>
> - there would be no further impact on her credit file if she entered into the agreement because she had an existing default listing her credit file and
> - a National Personal Insolvency Index listing would not affect her employment prospects.[17]

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[14] Bankruptcy Amendment (Debt Agreement Reform) Act 2018 (Cth).

[15] Case Number 661320, 9 June 2020, accessed 21 August 2020, available at https://service02.afca.org.au/CaseFiles/FOSSIC/661320.pdf.

[16] AFCA also found that (at pages 1-2): 'The financial firm misled the complainant about her options for dealing with her debts when it told her that: she could only stop interest accruing on her debts by declaring bankruptcy or entering the agreement; she had two options to deal with her debts: to declare bankruptcy or enter the agreement; if she applied for hardship assistance, her creditors would not grant her repayment moratoria but would instead require her to continue making some repayments and; hardship assistance from her main creditor was unlikely to last longer than a fortnight. … The financial firm failed to ensure that the complainant understood the fees payable under the agreement. The financial firm also misled the complainant when it said that she would only pay back 61 cents in the dollar on her debts, when her total payments under the agreement were approximately 96 cents in the dollar.'

[17] Ibid p 1.

AFCA determined that the financial firm (which is a RDAA) must 'do all things necessary to remove the listing of the complainant's name and listing from the National Personal Insolvency Index'.[18]

However, we understand that the Official Receiver takes the view that it is not empowered under the Bankruptcy Regulations to remove listings to give effect to AFCA determinations to amend NPII listings.

Where a firm engages in misleading conduct, the general principle underlying the remedy is that the consumer should be put back in the position they would have been, but for the misleading representation. Thus, the NPII listing should be removed, where the person would not have entered the Part IX if not for the misleading representation. The inability to amend NPII listings perpetuates injustice for people who have been misled by an RDAA into entering a Part IX.

On one view, the Official Receiver could amend the NPII under Reg 13.04(1)(c) as being inaccurate. However, to put this beyond doubt, we recommend that the Bankruptcy Regulations be amended to specifically require the Official Receiver to give effect to determinations of AFCA. Until such reform, the intent of the Government's reforms to Part IX will be undermined. This reform would also incentivise RDAAs to provide accurate advice to debtors in the first place

With Covid-19 expanding the market for RDAAs, it is more important than even that people receive accurate, good quality advice on their options for managing debt, and the negative consequences of Part IX debt agreement.

Compensation from AFCA when bankrupt

One of the barriers to justice for aggrieved debtors who terminate a Part IX debt agreement, often for arrears, and then bankrupt is that pursuing a complaint about the administrator or broker's misconduct is not worth the time, effort and stress when any return of fees would form part of their bankrupt estate and go to their creditors. Complications also arise from requiring the Trustee's permission to commence legal action.

To resolve this problem, we recommend that any monetary award in the debtor's favour at AFCA should not form part of the debtor's bankrupt estate if they bankrupt after terminating or voiding a Part IX. This will reduce the incentives for Administrators to collect set-up fees towards Part IXs that were always unlikely to proceed or complete because the debtor could not sustain repayments.

Recommendations

27. **Amend the Bankruptcy Regulations to empower the Official Receiver to amend the NPII: to give effect to AFCA determinations.**

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[18] Ibid p 2.

28. Amend the Bankruptcy Act to allow bankrupts to keep awards of compensation from AFCA.

Trustee's power to sell property after discharge

Under the current law the trustee retains the power to sell secured and disclosed property after the bankrupt is discharged. The trustee has this power of sale even if a bankrupt had no equity in the property at the time of bankruptcy, but later builds up significant equity, for example due to increases in land values.

The trustee has the power to make a claim on any equity that the bankrupt might have accrued in the property for a certain period of time after the bankrupt is discharged (ss 127, 129AA).[19]

Where the property has been disclosed by the bankrupt in their statement of affairs, or in the case of after-acquired property, within 14 days of acquisition, the period is 6 years from discharge (or the date the property was disclosed)(S 129AA(3)). The trustee can extend the six-year period by giving the bankrupt written notice within the six-year period. The notice can extend the period for up to three years. There is no limit on the number of extension notices that a trustee might give (s129AA(4) – (6)). We believe these extensions are unfair and leave the bankrupt in a state of uncertainty for years, unable to make long-term decisions for their own financial well-being.

We note that where the bankrupt has failed to disclose the property, the trustee has 20 years from the date of the bankruptcy to make a claim. We are not proposing a change to this time limit. Consumer groups submit that the trustee should only have six years after discharge to make a claim on secured property where the bankrupt has complied with the relevant disclosure obligations.

Recommendations

29. The trustee should only have six years after discharge to make a claim on secured property, with no extensions.

[19] The trustee can also make a claim on property that was not disclosed in the statement of affairs up to 20 years from the date on which the person became bankrupt. We are not suggesting this rule be amended.

Mortgage debt relief under the Bankruptcy Act

While recent data released by the Australian Banking Association has shown that the majority of loan deferrals are now back on track, as of 17 February 13% of deferred housing loans are yet to resume repayments. That means from just the four major banks over 60,500 home loans remain deferred.[20] While banks will continue to work with homeowners that are in financial difficulty, inevitably there will be thousands of Australians that never can go back to paying their normal mortgage payments. Under our current bankruptcy laws, the only option which potentially prioritises keeping people in their homes is a debt agreement[21]. A debt agreement, however, does not change the secured debt over the home, regardless of how onerous its terms may be. Bankrupts who have little or no equity in their homes may be permitted to remain in occupation of the property, but this is a temporary reprieve unless they are in a position to purchase back the property from the trustee upon discharge.

While interest rates are currently at record lows, this has not always been the case. In the wake of the Global Financial Crisis many clients presented with interest rates that far exceeded the prevailing cash rate (from non-bank lenders), some of whom had entered debt agreements to save their homes, but were ultimately unable to do so because of the punitive rates charged by their mortgage providers. Even now, in a low interest rate environment, we hear of isolated examples of borrowers paying interest rates which represent multiples of the rates being offered by mainstream lenders. Australia does not currently have a large negative equity problem, however, there are isolated pockets where this is a problem and the full impact of the global pandemic couple with the pending withdrawal of government support is yet to be felt.

Secured creditors are given preferential treatment, and have certain rights regarding taking possession of the property if the debt is not paid in accordance with the terms of the loan. This is the case whether a person goes bankrupt or enters into a debt agreement. What if instead, the Federal Court had the power to modify a home loan, reducing the debt to the asset's current market value and adjusting interest to current market rates? The trustee and Court could ensure that ongoing adjusted mortgage payments are sustainable and the bankrupt would be able to stay in their home. We recommend introducing new rules under the Bankruptcy Act which would allow secured debt to be renegotiated, and give the Federal Court oversight to approve debt agreements even over the objections of creditors.

These ideas are not completely unprecedented. Similar measures were debated in America after the GFC, and are being proposed again in 2021 by Senator Elizabeth Warren. Her new plan permits people to modify their mortgages in bankruptcy by creating a streamlined, standardised mortgage modification option under American bankruptcy law.[22] Under this proposed procedure, if a foreclosure has started, and the homeowner certifies that she has attempted to negotiate a modification in good faith, she could seek an automatic modification of the mortgage

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[20] Australian Banking Association, Media Release, 17 February 2021: https://www.ausbanking.org.au/banks-launch-new-phase-of-pandemic-support/

[21] In reality, debt agreements are more commonly entered by people who are not paying off their homes.

[22] https://elizabethwarren.com/plans/bankruptcy-reform

debt to the market value of the property, with interest rates reduced to achieve a sustainable debt-to-income ratio. Senator Warren also argues that "the possibility of a mortgage modification in bankruptcy should encourage more negotiated modifications outside of bankruptcy."[23]

Mortgage debt relief has also been legislated in Ireland since 2012, and was amended to give debtors even stronger protections in 2015. The Minister for Justice and Equality, Frances Fitzgerald TD explained the protections this way:

> *"The new Court review introduces an independent oversight mechanism to ensure that the right balance is struck between the interests of mortgage lenders and other creditors, and the interests of borrowers who want to work their way out of debt sustainably with a view to keeping their homes. It will make sure that this balance is fair, and is seen to be fair."*[24]

There is always a balance to be struck in bankruptcy between the goal of debt collection and the maximisation of creditor returns on one hand, and on the other the provision of debt relief to over-indebted individuals under the 'fresh start' policy.[25] We argue that a key purpose of bankruptcy law should be to discharge debtors' liabilities and offer them the ability to start contributing to the economy again. In Australia today, bankruptcy should be properly understood as a social issue linked to the pervasiveness of credit, rather than an issue of personal morality or individual failings. As consumer advocates we see consumer credit markets as prone to failure and demanding regulatory intervention. Providing a fresh start to over-indebted households is necessary for economic growth. Research has shown that recessions like the one Australia is currently recovering from are further fuelled by collapsing consumption among debt-laden households.[26]

How the Irish mortgage debt relief works

Irish personal insolvency law provides a very persuasive example for reforms that could take place in Australia to help keep people in their homes. The Irish law allows for both secured and unsecured debt to be renegotiated when a person enters into a Personal Insolvency Agreement (similar to Part IX Debt Agreements in Australia). Priority debts (like family law orders) and secured creditors are still protected from a full discharge, but insolvency practitioners **must** prepare arrangements on such terms as will not require debtors to leave their homes, insofar as reasonably practicable.[27]

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[23] Id.

[24] Media Release: Minister Fitzgerald commences new court review where creditors refuse personal insolvency deals, 19 November 2015. Available at: http://www.inis.gov.ie/en/JELR/Pages/PR15000598

[25] E. Warren, 'Principled Approach to Consumer Bankruptcy, A' (1997) 71 Am Bankr LJ 483, 483

[26] International Monetary Fund, 'Dealing with Household Debt' Debt', *World Economic Outlook 2012* (2012)

[27] Spooner, p799; Irish Personal Insolvency Act 2012, ss 69, 104; Note: There is still a 'claw-back' provision which entitles a secured creditor whose mortgage debt is reduced during insolvency

The terms of an Irish Personal Insolvency Agreement (**PIA**) are worked out between the debtor and their personal insolvency practitioner (like a trustee).[28] There are certain elements that the PIA must contain including the following (this is an abbreviated list):

- The maximum duration of the agreement must be 6 years
- The PIA must clearly distinguish between secured debts and unsecured debts and must make provision for the manner in which the security held by the creditor is to be treated.
- If you keep to the terms of the agreement your remaining debts to your unsecured creditors will be discharged
- It cannot require you to sell any assets that are reasonably necessary for your employment or business unless you agree to such a sale
- You must be left with enough income to maintain a reasonable standard of living for yourself and your dependents
- It must not require you to dispose of your principal private residence (your home) or to cease to occupy it unless specific conditions are met

Protection for the family home is clearly set out in the Irish legislation and has as its starting point that the PIA procedure is aimed at preventing evictions and repossessions for households with mortgage debt problems. The 2012 legislation lists various examples of the types of mortgage restructuring mechanisms that could be implemented as part of a plan for the household to keep its home (e.g. interest-only arrangements, "splitting" the mortgage into a payable component and a second component to be paid at some point in the future, principal sum due be reduced, etc.)[29], but these are merely suggestions and it is for the debtor (through her Personal Insolvency Practitioner) and her creditors to come up with an arrangement based on the individual circumstances which provides for part-repayment on terms allowing the household to stay in its home.[30] If a majority of creditors do not agree to the proposal and approve the agreement, Court has the power to approve the PIA over the objections of mortgage lenders.

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proceedings to recover the principal reduction if the debtor's home is sold at a higher value any time within a period of 20 years (see Spooner, p800; Irish Personal Insolvency Act 2012, ss 88, 121)

[28] Citizens Information website, Personal Insolvency Arrangements. Available at: https://www.citizensinformation.ie/en/money_and_tax/personal_finance/debt/personal_insolvency/personal_insolvency_arrangements.html ; See also: the Insolvency Service of Ireland publishes summaries of its personal insolvency procedures on its website, there is a detailed guide to the Personal Insolvency Arrangement here: https://www.isi.gov.ie/EN/ISI/PAGES/PERSONAL_INSOLVENCY_ARRANGEMENT

[29] Personal Insolvency Act 2012, Chapter 4, ss102(6): http://www.irishstatutebook.ie/eli/2012/act/44/enacted/en/print

[30] Information provided to Financial Rights Legal Centre by Dr Joseph Spooner, Associate Professor at the Law Department of the London School of Economics Law Department. Information provided in January 2021.

A further important factor is that the 2012 legislation establishes a concept of "Reasonable Living Expenses"[31], and the Insolvency Service of Ireland has set out detailed guidance on the living standards that a household can expect to maintain while being party to an insolvency arrangement.[32] Any PIA proposal will have to allow a household this reasonable income, while also keeping it in its home, but also allowing for (maximum possible) repayment to creditors within those two assumptions.

So the main idea of this Irish debt agreement option is that each proposal will come up with some sort of repayment plan based on keeping the debtor in his or her home, within the confines of the Reasonable Living Expenses. A range of options can flow from those two starting points. Australians do not currently have an option like this under the Bankruptcy Act.

Why this solution could work in Australia

Under bankruptcy law in Australia, a person may not necessarily lose their home in bankruptcy if they do not have any equity in the property. Since the sale of the home will not produce any returns for other (unsecured) creditors, a trustee may allow a debtor to keep her home and to negotiate some sort of repayment arrangement directly with the mortgage lender. The mortgage lender may be happy to agree to this, since any other option would involve crystallising losses. But we don't have systematic data on how this actually works out in practice; only anecdotal evidence from our advice lines and services. However, the threat of losing the home should it ever build equity is real, even after discharge. The trustee has the power to make a claim on any equity that the bankrupt might have accrued in the property for a certain period of time after the bankrupt is discharged (ss 127, 129AA).[33] *See section above.*

As in Ireland, a mortgage debt relief option in bankruptcy in Australia could act as somewhat of a last resort. Already we have seen through COVID that a great deal of mortgage restructuring can take place under a "consensual" renegotiation process between lender and borrower. The detail of these renegotiations are not legally prescribed and our current lending regime gives lots of discretion/power to the lender. In Ireland the personal insolvency legislation actually provides that in order to be eligible to enter the PIA procedure, a debtor must have cooperated with the mortgage lender – this means trying to renegotiate voluntarily. But in Australia (similarly in Ireland) the consensual restructures are generally very conservative and don't involve much reduction in the mortgage debt ultimately owed (sometimes the debt actually rises due to interest-only measures, and arrears capitalisation arrangements etc.).

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[31] If you tackle your debt using one of the Insolvency Service of Ireland's solutions, there is a reasonable standard of living that you are entitled to which allows for expenses such as food, clothing, health, household goods and services, communications, socialising, education, transport, household energy, childcare, insurance and modest allowances for savings and contingencies. Insolvency Service of Ireland, RLE Information: https://www.isi.gov.ie/en/ISI/Pages/RLE_calculated

[32] Insolvency Service of Ireland Guidelines: https://www.isi.gov.ie/EN/ISI/PAGES/RLE_INFORMATION

[33] The trustee can also make a claim on property that was not disclosed in the statement of affairs up to 20 years from the date on which the person became bankrupt. We are not suggesting this rule be amended.

In fact, we would argue (along with Dr Spooner) that a key weakness of the PIA regime in Ireland and the new court review procedure is that the arrangements proposed by practitioners/debtors tend to be quite conservative, and involve little debt forgiveness. So, while the Irish measures keep people in their homes (and eviction rates are very low in Ireland compared to other countries with similar mortgage debt problems), they often do so in a manner which keeps people under considerable mortgage debt for their entire lifetime. Rather than writing down the mortgage debt to deal with the negative equity problem, the outstanding mortgage debt remains in place to be paid at some point in the future, while the households pays what it can in the meantime.

Ireland continues to struggle with large mortgage shortfalls left over from the GFC, so many households using the PIA option have large arrears to contend with. Arguably, because Australia does not have the same systemic problem with mortgage shortfalls a mortgage debt relief option would work better here.

Consumer advocates submit it is time to allow bankruptcy law to embrace mortgage debt and to provide for restructuring of mortgage debt. Because Australia does not have a systemic negative equity problem, this seems straightforward as it requires neither (1) huge debt write-downs which are politically tricky; nor (2) overly conservative (and artificial) restructuring approaches which keep households in their homes now, but by storing up repayment problems for the future.

Bankruptcy law has ignored mortgage debt for too long, and should have some mechanism for dealing with it. Senator Warren's *Consumer Bankruptcy Reform Act of 2020* has been endorsed broadly by experts in consumer and bankruptcy law as well as insolvency practitioners.[34]

Academic research and policy papers from organisations like the IMF have increasingly recognised the 'debt overhang' problem, under which excessive household debt levels constrain consumption and economic growth.[35] Dr Joseph Spooner argues:

> *The 'harshness of debt' shifts losses of economic downturn onto society's borrowers (as employment, incomes and house prices fall), while creditors are protected in retaining claims both to security and full loan repayment. Since society's debtors have a higher marginal propensity to consume than its creditors, this unequal distribution of the costs of crisis leads to significant falls in aggregate demand and consequent economic downturn. A vicious cycle can develop, in which slow economic growth makes household deleveraging difficult, while debt overhang impedes growth. Measures such as household debt relief laws can then offer a means of breaking this cycle, restoring debtors' ability to contribute to growth through increased consumption.*[36]

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[34] https://www.warren.senate.gov/newsroom/press-releases/warren-and-nadler-introduce-the-consumer-bankruptcy-reform-act-of-2020

[35] Spooner, Joseph. (2018). *The Quiet-Loud-Quiet Politics of Post-Crisis Consumer Bankruptcy Law: The Case of Ireland and the Troika: The Case of Ireland and the Troika*. The Modern Law Review. 81. 790-824, p804-805

[36] Spooner, Joseph. (2018). *The Quiet-Loud-Quiet Politics of Post-Crisis Consumer Bankruptcy Law: The Case of Ireland and the Troika: The Case of Ireland and the Troika*. The Modern Law Review. 81. 790-824, p805.

Consumer groups argue that as Australia continues to recover from the economic effects of COVID-19 there will be bankrupts with little to no equity in their homes that could have their home loans modified under a new mortgage debt relief option to reduce the principal and interest to reflect current market value of the property and market rates of interest. If ongoing mortgage payments could be reduced to the point where they are sustainable, then bankrupts should be able to stay in their homes.

The following case studies demonstrate client stories where people are trying to stay in their homes or negotiate with secured creditors but they are out of options. If Australian bankruptcy law required trustees to prepare arrangements that would keep people in their homes, insofar as reasonably practicable, these people could potentially benefit greatly.

Case study –Rob's story – trying to keep his home

Rob has had financial hardship arrangements with his bank for the past two years. He has recently been contacted by a debt collector demanding full payment of the debt. Rob is struggling financially and is worried about losing his family's home. Rob is a jeweller whose business declined. Rob's income reduced further because of COVID-19. Rob now receives Jobkeeper. Rob has $40,000 in existing credit card debt.

Rob has been paying between $20 and $60 off his credit card when he can. The bank advised Rob about a month ago not to make any further payments and that someone would contact him to arrange a hardship payment plan. A few days ago a debt collection agency contacted Rob demanding full repayment. The demands for full repayment have been reduced to $28,650. Rob is contributing to a $1.1 million mortgage on his family home along with his wife who works part-time. Rob also has a $200,000 mortgage on his city office. He wants to know how he can protect his home and what arrangements he can make with his bank.

Source: C209312

Case study –Leon's story – trying to keep home but debts becoming unmanageable

Leon is self-employed and during the pandemic income from his business has reduced. Leon is now receiving JobKeeper and his wife has been receiving workers compensation since April 2019. She is recovering from a major surgery and unlikely to be able to return to a normal work life. Leon and his wife each have a credit card with $20,000 owing to a major bank. In 2020, their bank gave them an arrangement with no repayments and 0% interest. Leon and his wife had a hardship arrangement even before the pandemic started, and for 4 months up and until February 2020 the bank had reduced the interest rate to 5%. Leon's bank has now advised that

this is all the assistance they will give. The interest rates for the cards have returned to 21% and 14% respectively. Leon cannot afford to pay the minimum payments for both cards and he fears if he pays what he can then the debt will increase as the payments will not cover the interest.

Leon and his wife also have a $700,000 mortgage over their home with another big bank. When our service spoke to them their repayments were on hold until September. Up until COVID hit Leon was paying interest only $2,500 per month. This was the minimum amount. Leon's mortgage lender has indicated that they need to move to principal and interest and repayments will be $3,600 per month. There is some equity in the property and Leon is looking at renting it out and moving in with his father. Leon and his wife have had the house for 5 years. They sold their first home on the South Coast and moved to Sydney because they have a child with a disability.

Source: C195168

Case study –Joseph's story – problems negotiating secured debts

Joseph is self employed as a plant mechanic and business has been slow especially during the pandemic. Plants and factories where he would normally work have been slowing down production and closing temporarily. Unfortunately he and his wife were struggling financially before COVID-19. In late 2019, his bank issued a default notice following which Joseph entered into a hardship arrangement. Joseph has over $500,000 in equity in the property. Joseph has fallen behind on the repayment arrangement and he is worried the bank will issue another default notice. Joseph has also received a default notice for his car loan. His car was almost repossessed in December but he agreed to catch up on the payments. Now that he is behind again his lender is withdrawing assistance. Joseph also owes money for his energy, water and council rates.

Source: C202791

Case study –Byron's story – Trustee forcing him out of his home in a pandemic

Byron was made bankrupt by a creditor in 2019. He reached out to Financial Rights after he received court documents from his Trustee that said they are applying to evict him within 30 days. Byron was quoted $166,000 to annul the bankruptcy. Byron has underlying health issues and doesn't want to move during COVID-19. He walks with a cane and is being investigated for Parkinson's Disease. Byron has a mortgage on his property for about $300,000. The Trustee

thinks the property is worth $400,000 but Byron doesn't think it will sell for that because of the pandemic.

Source: C207809

Case study –Paul's story – struggling to negotiate secured debts

Paul has a lot of debt and is thinking about applying for bankruptcy, but he has a home secured with a mortgage and a car secured with finance that he needs for courier work. He owes several large unsecured debts in personal loans, credit cards, and a debt from a motor vehicle accident. There is currently no equity in his home. He has been renting out his home and living with his parents to try to save money but he does not want to lose his house. He lost his job in March because of COVID-19. He is on Jobseeker and trying to get more courier work. He has been prioritising paying his car loan so that he can keep his vehicle. Not all of his lenders are in AFCA and he is struggling to arrange repayment arrangements.

Source: C210606

Case study –Scott and Kiri's story – need assistance with modifying mortgage

Scott and Kiri are an Aboriginal couple living in regional NSW. They refinanced their home loan from a mainstream lender to a second tier lender in 2007 in order to refinance a credit card debt which they were struggling to pay. At its highest the mortgage was 15% per annum in 2011. Even now, against a back drop in rates of 2-3% for home loans generally, they are paying 9.99% per annum. Scott and Kiri have never been able to pay the debt, despite withdrawing their super and paying it towards the mortgage most years. Financial Rights is currently challenging the original lending decision under the law at the time. They now owe about $250,000, which is more than they originally borrowed in 2007, despite having made payments of over $700,000. If the interest rate was reduced, or default fees were removed Scott and Kiri would be able to afford the mortgage.

Source: C83626

Recommendations

30. **We recommend introducing new rules under the Bankruptcy Act which would allow secured debt to be renegotiated, and give the Federal Court oversight to approve debt agreements even over the objections of creditors.**

Financial counselling at the Federal Circuit Court

Since September 2014, the Federal Circuit Court (**FCC**) in Melbourne has provided direct financial counselling services to self-represented debtors in the FCC's Bankruptcy Lists. This service, was implemented by the FCC in collaboration with the Federal Court of Australia, Consumer Action Law Centre and the Melbourne Law School (MLS). This service, initiated by the Court, aims to promote the efficient operation of bankruptcy proceedings and to achieve the just resolution of bankruptcy matters.

The objectives of the projects are to:

- assist self-represented debtors to understand the nature of bankruptcy proceedings, so they are better able to determine their rights, and to make effective decisions in presenting their cases; and
- increase efficiency in the FCA and FCC in achieving the just resolution of bankruptcy matters involving self-represented debtors, as promptly and inexpensively as possible.

To achieve these objectives, the project provides on-site financial counselling in conjunction with hearings in the Bankruptcy List. The location of the service at the Court makes it possible for Registrars to refer debtors for immediate financial counselling assistance, without the need for an adjournment. During Covid-19, these referrals have happened electronically, with financial counselling offered by teleconference.

The need for the service Australia-wide is clear:

> In many cases, vulnerable debtors do not understand legal language, the purpose of the hearing or the steps they can take to avoid bankruptcy. They are often highly stressed and have trouble explaining their circumstances to the Court. The Court will often offer an adjournment, to allow a self-represented debtor to seek legal and other advice. Unfortunately, however, many debtors do not know where to go for help. In these cases, adjournments only serve to prolong the debtor's ordeal, while causing delay and expense to creditors and the Court.[37]

[37] Paul Ali, Lucinda O'Brien and Professor Ian Ramsay, *Federal Circuit Court Financial Counselling Project Evaluation*, August 2015, p7, available at: https://consumeraction.org.au/wp-content/uploads/2016/07/Financial-Counselling-Project-Evaluation-Aug-2015.pdf.

The project is a highly effective and efficient intervention in forced bankruptcy proceedings and benefits potential bankrupts, creditors, and the Court. An evaluation of the project by the University of Melbourne concluded that the project was 'highly successful' in meeting its objectives and found that:

- the project helped some debtors to demonstrate solvency (thereby avoiding bankruptcy) and helped others to accept bankruptcy as a positive option in their particular circumstances;
- the project increased the Court's efficiency by reducing the number of hearings taken to finalise matters involving self-represented debtors;
- Bankruptcy Registrars stated that the project made better use of Court resources, while also ensuring that debtors can participate meaningfully in the court process;
- notably, 89% of creditors' solicitors agreed that debtors were better off as a result of the financial counsellors' assistance.[38]

This effective project should be expanded to all registries around Australia, as recommended by the evaluation.[39] With an increase in bankruptcies expected to increase as temporary measures responding to the COVID-19 crisis end, this expansion should be progressed as a matter of urgency in 2021.

Recommendations

31. **Expand and fund the financial counselling service at the Melbourne Registry of the Federal Circuit Court to all registries.**

Repeal Section 271 - Gambling or hazardous speculations

Section 271 of the Bankruptcy Act says:

Gambling or hazardous speculations

A person who has become a bankrupt after the commencement of this Act and:

(a) within 2 years before the presentation of the petition on which, or by virtue of the presentation of which, he or she became a bankrupt, whether the petition was presented before or after the commencement of this Act, materially contributed to, or increased the extent of, his or her insolvency; or
(b) during any period between the presentation of that petition and the date on which he or she became a bankrupt, lost any of his or her property;

[38] Ibid 5-6.

[39] Ibid 20.

> by gambling or by speculations that, having regard to his or her financial position at the time and any other material circumstance, were rash and hazardous, being gambling or speculations not connected with a trade or business carried on by him or her, commits an offence and is punishable, on conviction, **by imprisonment for a period not exceeding 1 year.** (*emphasis added)*

This is a section of the Bankruptcy Act that debtors and financial counsellors are often concerned about. One financial counsellor told us her concern about "*the likelihood of prosecution (for gambling losses) is an issue for pretty much all of her clients*." Another said "*people shouldn't be jailed for gambling addictions. These people struggle with their addiction so much, that the urge to gamble outweighs any logic. The gambling should be treated with addiction intervention*". For many years AFSA has had a Guidance Note which states that it will not refer a case if "*it appears that the debtor could be classified as having been a problem gambler and had not engaged in any associated criminal activity to finance their gambling habit*".[40] However, the policy statement emphasised that an allegation of problem gambling will not prevent referral unless supported by evidence confirming that the debtor is a sufferer. If long-term offending and or repeat allegations are alleged, AFSA would expect to see evidence of self-help having been undertaken by the bankrupt, or the matter would proceed to investigation with prosecution action being recommended.

Consumer advocates have now confirmed with AFSA that its Guidance Note IGPS6 on rash and hazardous gambling has been repealed. Specifically we were told that the policy provisions still remain in that for a gambling related offence to be referred to the CDPP it must have substantially contributed to the insolvency of the debtor in being both rash and hazardous.

We were also told that gambling is a complex matter and AFSA recognises that where there is evidence of a true gambling addiction, then it may not be in the public interest to pursue.

Nevertheless, Section 271 has long been criticised by financial counsellors and other advocates. Now that AFSA has repealed its Guidance Note this section is even less clear for advocates when this section may or may not be enforced.

The provision is effectively retrospective because it is the ultimate insolvency of the debtor which criminalises conduct carried out up to 2 years previously that was not, in and of itself, illegal at the time. There is uncertainty about how problem gambling is defined by AFSA and what evidence will be sufficient to establish that the person is a problem gambler. Finally, potential under-reporting of gambling is likely happening among bankrupts as a result of the potential to be charged with a criminal offence. This is an impediment to contributing useful data to public policy debate about problem gambling.

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[40] AFSA "Referral Of Offences Under Section 271 Of The Bankruptcy Act 1966 Rash and Hazardous Gambling Policy Statement", Inspector General Practice Statement 6, updated January 2013

Recommendations

32. Section 271 (Gambling or hazardous speculations) should be repealed.

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 Julia Davis at the Financial Rights on 0478504634.

Kind Regards,

Karen Cox
Chief Executive Officer
Financial Rights Legal Centre
Direct: (02) 8204 1340
E-mail: karen.cox@financialrights.org.au

Gerard Brody
Chief Executive Officer
Consumer Action Law Centre

Fiona Guthrie
Chief Executive Officer
Financial Counselling Australia