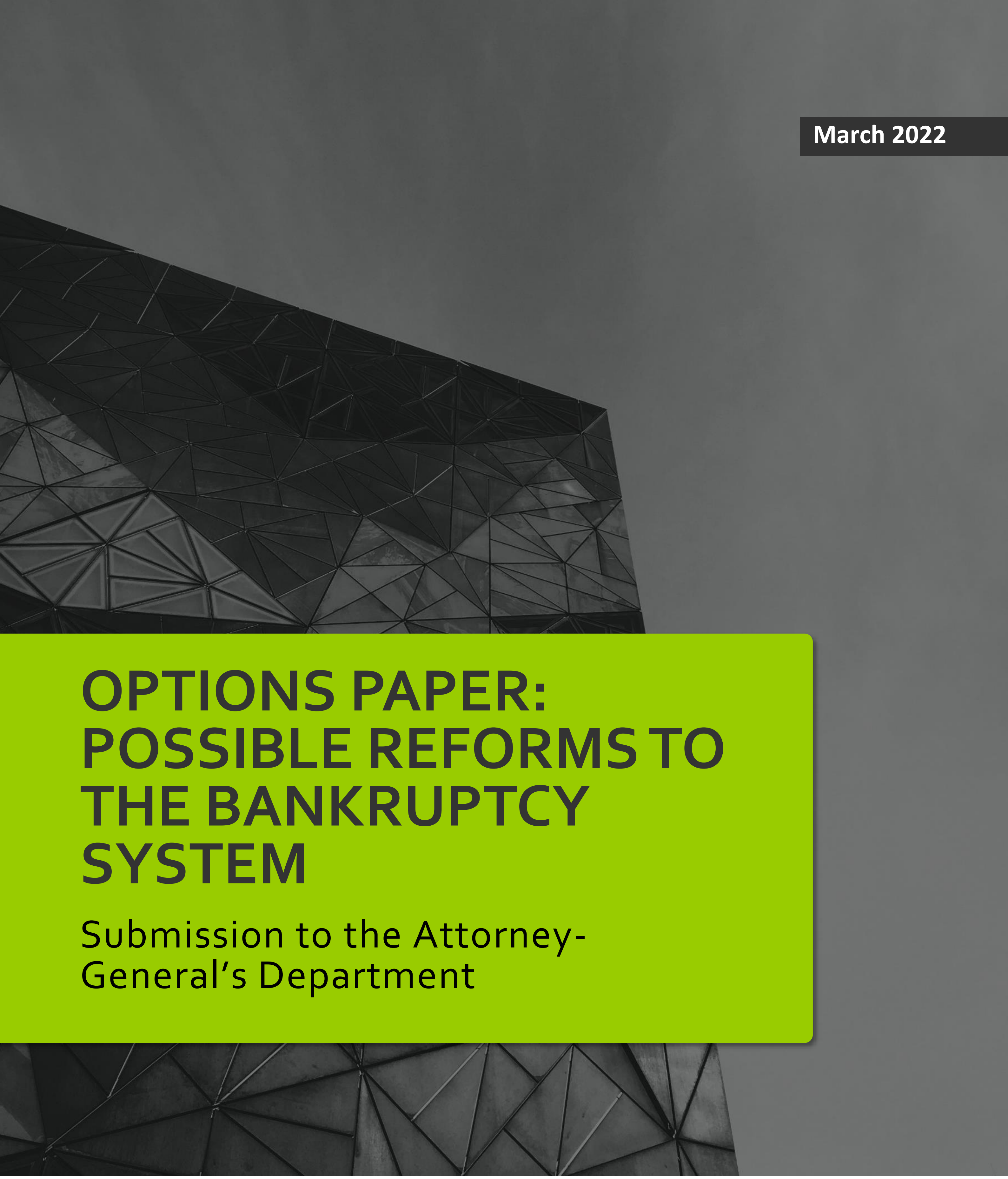

March 2022

OPTIONS PAPER: POSSIBLE REFORMS TO THE BANKRUPTCY SYSTEM

Submission to the Attorney-General's Department

Executive Summary

Thank you for the opportunity to comment on the Attorney-General's Department Options Paper on [Possible Reforms to the Bankruptcy System](https://) (January 2022) (**Options Paper**).

This submission is made on behalf of Consumer Action Law Centre and Financial Rights Legal Centre. Our organisations have extensive experience assisting people with personal insolvency, including bankruptcy and debt agreements under Part IX of the *Bankruptcy Act 1966* (**Debt Agreements**). This submission has also benefitted from the generous insights of members of the Economic Abuse Reference Group (**EARG**).[1]

Keep Debt Agreements limited to 3 years

It is staggering that the Government is proposing to rollback its own highly successful reform, implemented only in 2019, to limit the default term of debt agreements to three years.[2] Any attempt to extend the default term limit to 5 years, as proposed in the Options Paper, will be **strongly opposed** by consumer advocates.

We do not need to imagine a hypothetical outcome from extending the default term of debt agreements – we can look to the extensive data from the Australian Financial Security Authority (**AFSA**), academic research, and lived experience of debtors and creditors when 5-year debt agreements were permitted prior to 1 July 2019, referred to throughout this submission.

Pre-reform, unsustainable debt agreements were the norm, including for people on the aged pension, disability support pension, women carrying debts from abusive relationships, or for those experiencing only temporary hardship. The three-year limit has successfully stopped the well-documented problem of people with low or even no income being cajoled and misled into a plainly unsuitable debt agreement on the conflicted advice of an administrator (that stood to earn $20,000 or more in fees over the life of the agreement) or broker, when impartial advice would have seen the debtor in a far better option to manage their debts.

This submission includes six case studies from pre-reform debt agreements – many still on foot – which demonstrate the harm and inequitable outcomes for people.

In positive news, we are yet to see problems with debt agreements entered post-reform, which is a good sign that the reforms are working as intended. The three-year term limit appropriately restricts, on affordability grounds, many applicants for whom a debt agreement would be plainly unsuitable.

Indeed, the Government does not need to "promote" debt agreements when non-insolvency options work. As seen during COVID-19 responses by the Government and creditors, adequate income support combined with flexible hardship arrangements from creditors is a far better policy response to temporary hardship than funnelling people into unnecessary insolvencies, which includes high fees and significant negative consequences on future borrowing and entrepreneurial activity.

These policy settings do not need amendment – they are a success story.

Extending the default limit to five years will simply recreate old problems. It would also be an inappropriate fix for any ongoing issues with informal agreements and sole traders, which require tailored responses, rather than a change to the default term limit.

To be clear: if the Government proceeds with the disastrous proposal to extend term limits to five years or more, it will be selling out some of the most vulnerable members of our community in favour of debt agreement administrators, which can only turn a profit by funnelling a large volume of people into unsuitable debt agreements regardless of their client's best interests. This proposal must be abandoned.

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[1] https://earg.org.au/.

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

One-year bankruptcy

We are broadly supportive of the proposal to reduce the default term of bankruptcy to one year. However, without consequential amendments to reduce to bankruptcy's duration on credit reports, and the lifetime listing on the National Personal Insolvency Index (**NPII**), the Government's intention of reducing the stigma of bankruptcy and increasing entrepreneurialism will never be achieved.

Outstanding reforms to personal insolvency

This submission also comments on outstanding issues in personal insolvency. The *Bankruptcy Act 1966* (Cth) (**Bankruptcy Act**) is arcane, outdated and requires urgent modernisation.

This Options Paper, and the consultations that preceded it, are a missed opportunity for much-needed reforms, including to better support victim/survivors of family violence. After many responses to family violence in other aspects of the Attorney-General's portfolio, it is important that the personal insolvency system be included in an integrated, whole-of government approach to family violence that is safe, just, supportive, non-discriminatory and responsive to the needs of women and their children in accessing justice.

A summary of recommendations is available below.

About the Contributors

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 marketplace for all Australians.

Financial Rights Legal Centre

Financial Rights is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters.

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Summary of Recommendations

RECOMMENDATION 1. The Attorney-General's Department should ensure that the personal insolvency system is included in an integrated, whole-of-government approach to family violence that is safe, just, supportive, non-discriminatory and responsive to the needs of women and their children in accessing justice. The Department should, in conjunction with family violence experts including the Economic Abuse Reference Group, undertake further work on the interaction of family violence and the personal insolvency system to implement appropriate responses.

RECOMMENDATION 2. The Attorney-General's Department should provide a response to submissions following the February 2021 consultation on 'The bankruptcy system and the impacts of coronavirus'.

RECOMMENDATION 3. We support the proposal to reduce the default period of bankruptcy to one year.

RECOMMENDATION 4. To achieve the intention of reducing the stigma of bankruptcy and increasing entrepreneurialism, amend the *Privacy Act 1988* (Cth) to:

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 of default information to two years.

RECOMMENDATION 5. To achieve the intention of reducing the stigma of bankruptcy and increasing entrepreneurialism, drastically reduce the duration of NPII listings for first bankruptcies (with the appropriate duration to be set after further consultation) and empower the Official Receiver to extend NPII listings for repeat bankruptcies or egregious behaviour.

RECOMMENDATION 6. Regarding section 265(8) of the Bankruptcy Act, the offence of contracting a debt with no intention to pay:

a) do not increase penalties for breaches, as the current maximum penalty of one year imprisonment is a harsh penalty;

b) alternatively, apply a monetary threshold so this provision only applies to lending on large loans, and does not apply to lending regulated by the *National Consumer Credit Protection Act 2009* (Cth).

RECOMMENDATION 7. The Government should not extend the default time limit on a Part IX debt agreement to 5 years. The current time limits should remain.

RECOMMENDATION 8. If sole traders and partnerships would benefit from a 5-year debt agreement, this should be only be enacted by a limited exception (as for home ownership exception) rather than changing the default term for all agreements, subject to:

a) Completing an independent analysis of AFSA's data, and a survey of debtors, about demonstrable outcomes for sole traders in 5-year debt agreements from the pre-reform period (i.e. prior to 1 July 2019); and

b) simultaneously introducing quality of advice requirements on debt agreement administrators (and their aligned brokers), to ensure upfront advice to enter a debt agreement is in the client's best interests.

RECOMMENDATION 9. The home ownership and 'substantial and unforeseen change in circumstances' exceptions should remain at a maximum of five years.

RECOMMENDATION 10. Do not extend exclusion periods for debt agreements.

RECOMMENDATION 11. We support the proposal that proposing a debt agreement to creditors is no longer an act of bankruptcy.

Outstanding issues

Before responding to the consultation questions, it is important to state that the Options Paper fails to address the most significant outstanding problems in our personal insolvency system. Unless more is done, this policy process will be a missed opportunity for much-needed reforms.

Family violence

Family violence, including in the form of economic abuse,[3] is at play in many personal insolvencies. Significant reforms are needed to the personal insolvency system relating to the impacts of family violence. The personal insolvency sector is lagging years behind other sectors, including banking and utility providers. We support AFSA's nascent work on family violence, however much more is needed, including legislative change.

Family violence experts, including lawyers, financial counsellors and advocates, and members of the Economic Abuse Reference Group[4] shared many concerns and examples during the current review. Below is a brief and non-exhaustive summary of the outstanding issues.

- A significant concern in family violence cases is where a victim/survivor of financial abuse has become bankrupt as a consequence of the financial abuse perpetrated by the non-bankrupt partner. The Bankruptcy Act does not provide any protections or recourse for an individual who has become bankrupt as a consequence of financial abuse. There are no safeguards to prevent unnecessary bankruptcies for victim/survivors. Financial counsellors report that some clients go bankrupt without being aware that they have a remedy to their situation through the Family Court and other avenues. Others are desperate and apply for "voluntary" bankruptcy where their debts aren't provable in bankruptcy. (By comparison, for example, Fines Victoria has a process to identify if a fine has resulted from domestic and family violence, in which case it can be waived.) Bankrupt victim/survivors then carry a lifetime listing on the National Personal Insolvency Index, which can compound the trauma and can make it difficult to recover and move forward with their lives, both financially and emotionally. This is an area that needs urgent legislative attention.
- The duration of bankruptcy can be unfairly protracted due to family violence. Perpetrators may hold information necessary for completing a Statement of Affairs, which means the victim/survivor cannot properly complete the forms and remain bankrupt longer than necessary.
- Bankruptcy can involve safety and other risks for victim/survivors. We are aware of instances where a creditor's petition against a couple contributed to escalating violence within the relationship. Personal insolvency practitioners will hold sensitive information, such as contact details for victim/survivors. The NPII lists contact information and, while there is a process to apply for an address to be suppressed on safety grounds,[5] this process is not actively promoted nor understood by victim/survivors and caseworkers. Indeed, there is no tailored information on AFSA's website about family violence and insolvency. A search on AFSA's website for 'family violence' results in a link to the Official Receiver Practice Statement and to a table listing contact details for 1800Respect. A search for 'domestic violence' results in an additional link to a fact sheet on suppressing addresses from the NPII.[6]
- At present, personal insolvency practitioners (including AFSA staff, registered trustees and debt agreement administrators) generally have little to no understanding or processes to deal with family

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[3] For a brief overview, see EARG, *Family violence and economic abuse – an overview*: https://eargorgau.files.wordpress.com/2018/04/family-violence-economic-abuse-april-2018.pdf.

[4] https://earg.org.au/.

[5] Under s 80 of the Bankruptcy Regulations 2021 (Cth); see also *Official Receiver Practice Statement 8: National Personal Insolvency Index*, s 3: https://www.afsa.gov.au/the-national-personal-insolvency-index; https://www.afsa.gov.au/insolvency/cant-pay-my-debts/can-i-hide-my-details-appear-national-personal-insolvency-index.

[6] https://www.afsa.gov.au/insolvency/cant-pay-my-debts/can-i-hide-my-details-appear-national-personal-insolvency-index.

violence, leaving victim/survivors unsafe. Practitioners often miss obvious signs of family violence (see Elena's story below at page 17). Even where personal insolvency practitioners have good intentions, it is clear that many feel ill-equipped and unsupported to identify and respond appropriately to family violence.

- One financial counsellor reported two positive examples of debt agreement administrators proposing a variation to complete the debt agreement when the debtor was experiencing family violence. However, at the date of writing, creditors had not voted to accept the variation proposals, so the outcome is unknown. If the variation proposal is rejected by creditors, these victim/survivors have little recourse under the current laws.
- We also see some debt agreement administrators (and their aligned brokers, referrers or other entities within its corporate group) push "solutions" that are not in the victim/survivor's best interest – as demonstrated in Elena's story, below. We frequently see failures to advise victim/survivors who are carrying debts incurred as a result of the family violence (for example, telco contracts, car loans, and payday loan taken out for his benefit – clear forms of economic abuse) of their options to challenge their liability for the debt through AFCA and the TIO, and of the hardship arrangements and debt waivers available to victim/survivors in these circumstances. The lack of front-end quality of advice requirements on debt and insolvency advice compounds this issue.
- Clarity and reforms are also needed at the intersection of bankruptcy and family law. For example, when proceedings are commenced by a non-bankrupt spouse during the course of a bankruptcy, it is the bankruptcy trustee that must be served. It is the bankruptcy trustee who will have the option as to whether they seek to participate in the family law proceedings. At that stage, the bankrupt spouse will have no standing to seek orders. However, if the term of the bankruptcy ends during the course of the proceedings, the bankrupt spouse could then potentially join as a party to those proceedings and seek orders for the division of property. The Court will then have to determine the competing claims between the non-bankrupt spouse, the trustee, and the bankrupt spouse. It is foreseeable that the non-bankrupt spouse will seek to adjourn the proceedings until the duration of the bankruptcy period has expired which could cause delays.

A full and appropriate discussion of these important issues is beyond the scope of this submission and the current consultation. The Attorney-General's Department has led important work in other areas of law impacted by family violence. There is an opportunity for the Attorney-General's Department to now address the impacts of family violence in our personal insolvency laws and systems to ensure an integrated, whole-of-government approach. If necessary, the Attorney-General's Department should commence a separate policy process to examine the interaction of family violence and personal insolvency, and implement appropriate responses in conjunction with family violence experts, including the Economic Abuse Reference Group.

RECOMMENDATION 1. The Attorney-General's Department should ensure that the personal insolvency system is included in an integrated, whole-of-government approach to family violence that is safe, just, supportive, non-discriminatory and responsive to the needs of women and their children in accessing justice. The Department should, in conjunction with family violence experts including the Economic Abuse Reference Group, undertake further work on the interaction of family violence and the personal insolvency system to implement appropriate responses.

Kiara's story – family violence – poor advice from DMF

Kiara had been experiencing domestic violence for five years when she finally escaped. When Kiara fled the relationship she had a lot of debts that were a result of the abuse. She did not get the benefit for the loans taken out in her name and her ex did not make any payments. Kiara has an AVO against him now.

After escaping the violent relationship Kiara reached out to a debt management firm (**DMF**) online to deal with her debts. The DMF directed her to an online portal to sign up to a debt agreement. Kiara does not have access to a computer and so could only access the online portal on her phone. It was impossible to clearly read the text on her phone – the font was too small and the portal would skip from page to page. Kiara asked the DMF to send her a copy of the paperwork by email so that she could read through it properly but she was told this was not possible. The DMF representative told her that she was running out of time to sign the documents. Kiara felt pressured and panicked, so she signed the documents on the portal, even though she could not read the documents properly.

The DMF set up a direct debit from Kiara's bank account and took $240 from her account. Kiara was sent a copy of the draft Debt Agreement Proposal by email and she was able to properly review the Proposal. She realised that important details were incomplete or incorrect. Kiara was concerned that the DMF had encouraged her to propose a Debt Agreement that she clearly could not afford.

Kiara was also not told by the DMF about options other than bankruptcy or entering into a Part IX debt agreement in dealing with her debts. After speaking with a free financial counsellor, she discovered there were other options available to her, such as requesting financial hardship assistance under the National Credit Code, or compassionate assistance in light of the DV circumstances in which she incurred the debts.

Case study provided by Financial Rights Legal Centre (C214882)

Other reforms

Our joint submissions to the January 2021 consultation on the remaking of the Bankruptcy Regulations[7] and the February 2021 consultation on The bankruptcy system and the impacts of Coronavirus[8] outlined proposals that would improve the fairness, efficiency and outcomes of the personal insolvency system. Community lawyers, financial counsellors and others spent much effort to prepare considered responses to the consultation, which developed ideas that would truly modernise personal insolvency. It is a disappointing outcome that this Options Paper was the only outcome of that consultation to date.

The Bankruptcy Act is arcane, outdated, and often harsh in its operation, and requires urgent modernisation. A brief and non-exhaustive list of outstanding issues include:

- **Implement the payment-to-income ratio** – the Attorney-General should make the long-overdue 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 ($60,515) or, alternatively, the National Minimum Wage ($40,175).
- **Protect total and permanent disability insurance payments in bankruptcy** – Section 116 of the Bankruptcy Act should be amended to protect the TPD payments in bankruptcy, in the same comprehensive manner as compensation for personal injury.
- **NPII listings** – A raft of reforms are needed to the operation of the NPII, including:
  - Drastically reducing the lifetime listing, which is needlessly punitive in most cases and clearly out of step with the Government's desire to reduce stigma and promote entrepreneurialism;
  - Amendments to ensure that NPII listings can be amended following a negotiated outcome or determination at the Australian Financial Complaints Authority (**AFCA**) – without which, AFCA's cannot give effective remedies following misconduct by debt agreement administrators.
- **Regulation of brokers, paid referrers and informal debt agreements**

[7] Joint submission available at: https://financialrights.org.au/wp-content/uploads/2021/04/201216_Joint-Submission-Bktcy-Regs_FINAL.pdf.
[8] Joint submission available at: https://financialrights.org.au/wp-content/uploads/2021/04/210201_COVID-Bankruptcy-Reforms_Submission_FINAL.pdf.

- **Increasing the forced bankruptcy threshold to $20,000** – the temporary protections in response to Covid-19 showed that setting the threshold at $20,000 worked to prevent unscrupulous operators pursuing unnecessary and unfair insolvencies over small debts.
- **Financial hardship during bankruptcy –** the Bankruptcy Act should be amended to include further protections for people in situations of financial hardship including:
    - 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
    - Refunds payable to bankrupts who have overpaid contributions.
- **Financial hardship during a debt agreement** – 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.
- **Upfront fees** – 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.

RECOMMENDATION 2. The Attorney-General's Department should provide a response to submissions following the February 2021 consultation on 'The bankruptcy system and the impacts of coronavirus'.

Proposal: Reducing bankruptcy to one year

We support reducing the default period of bankruptcy from three years to one year. This strikes an appropriate balance between the interests of creditors, and ensuring that bankruptcy enables a fresh start for debtors. Reducing the default period to one year is likely to have a minimal effect on the amounts recouped by creditors from bankrupt estates, but significantly improves the bankrupt's opportunities for early financial rehabilitation and participation in economic activity.

Additional measures necessary to reduce stigma: Credit reports

The *Bankruptcy Amendment (Enterprise Incentives) Bill 2017* (**Enterprises Bill**) did not change the timeframes for deletion of information from credit information files under section 20X, Part IIIA of the *Privacy Act 1988* (Cth) (**credit reports**). The primary aim of the lapsed Enterprises Bill was to:

> foster entrepreneurial behaviour and to reduce the stigma associated with bankruptcy. Reducing the automatic discharge to one year will reduce stigma, encourage entrepreneurs to re-engage in business sooner and encourage people, who have previously been deterred by the punitive bankruptcy laws, to pursue their own business venture.[9]

This was and remains an appropriate goal. However, this goal will never be achieved until changes are made to lending practices post-bankruptcy. Lenders almost always review a borrower's credit report before lending. Therefore, the benefits of reducing the default period by two years won't help with future lending unless bankruptcy's duration on credit reports is also reduced by two years.

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,

[9] *Bankruptcy Amendment (Enterprise Incentives) Bill 2017—Explanatory Memorandum*, [4]: https://www.aph.gov.au/Parliamentary_Business/Bills_LEGislation/Bills_Search_Results/Result?bId=s1097.

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 or a hardship variation, on their credit report. Financial counsellors report that, when advising on the consequences of a potential insolvency, people are far more concerned about the impact on future borrowing than the stigma of disclosing that they are an undischarged bankrupt for the period of bankruptcy. This is particularly so for younger people, who are concerned that the bankruptcy will prevent them from buying a family home in future.

Reducing the period of bankruptcy will have little effect on entrepreneurial activity if insolvency (should the venture fail) adversely impacts perceived creditworthiness. Similarly, entrepreneurs will struggle to 'reengage in business sooner' if the impact on their credit report remains the same as present: effectively 5 years from the date of bankruptcy.

If the retention period for bankruptcy information is reduced, then the retention period for default information should also be reduced. A single credit default is a less significant event than a bankruptcy (and equally likely to result from "necessary risk-taking or misfortune rather than misdeed"). It would be anomalous for bankruptcy to be retained for a shorter period. We submit that in order to further the Government's policy objectives, default listings should be reduced to 2 years to delineate them from insolvency (or 3 years at the most).

The Privacy Act is within the Attorney-General's portfolio responsibilities, and could be easily introduced in a separate schedule with the amendments to the Bankruptcy Act giving effect to one-year bankruptcy.

RECOMMENDATION 3. We support the proposal to reduce the default period of bankruptcy to one year.

RECOMMENDATION 4. To achieve the intention of reducing the stigma of bankruptcy and increasing entrepreneurialism, amend the *Privacy Act 1988* (Cth) to:

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 of default information to two years.

Additional measures necessary to reduce stigma: National Personal Insolvency Index

As with credit report listings, the lifetime listing on the publicly accessible NPII is inconsistent with the Government's goal of reducing stigma and encouraging entrepreneurial activity.

In most cases, it is unnecessary and deeply unfair for people to carry a lifelong listing on the NPII, particularly where the insolvency resulted from hardship caused by the COVID-19 pandemic or poor creditor support during our economic recovery. The consequences of a lifelong NPII listing are particularly unfair for victim/survivors of family violence. Permanent NPII listings extend the impacts of family violence *permanently*. Through our casework, we see forced bankruptcy being used as a tool of family violence (through procedural abuse) and ultimately enabling private trustees to collude with perpetrators (for example, enabling contact from the abusive partner). We also see victim/survivors of family violence bankrupting on bad debts where they should have (with better upfront advice and advocacy) been released from liability for debts that were, in reality, their partner's.

A lifetime listing is punitive and denies bankrupts a fresh start. These listings are longer than criminal records for many serious criminal offences. The NPII listing can impact a debtor's credit report, and hence their ability to obtain credit, phone plans, and rental properties, as shown in John's story below.

We recommend the duration of NPII listings for first bankruptcies be drastically reduced. Any concerns about a particular bankrupt's behaviour could be easily managed by empowering the Official Receiver to require a longer listing in certain circumstances, such as repeat bankruptcies, or where there has been egregious behaviour, or application of the trustee. Further consultation with financial counsellors and other stakeholders should be undertaken to determine an appropriate NPII listing period.

RECOMMENDATION 5. To achieve the intention of reducing the stigma of bankruptcy and increasing entrepreneurialism, drastically reduce the duration of NPII listings for first bankruptcies (with the appropriate duration to be set after further consultation) and empower the Official Receiver to extend NPII listings for repeat bankruptcies or egregious behaviour.

John's story – NPII bankruptcy listing preventing our client from renting

John went bankrupt a couple of years ago, and is currently undischarged. He has been living in rental accommodation with a friend. John and his friend are applying for new rental accommodation and the real estate agent wants all people in house to be on the lease but, because John is bankrupt, when they apply they are being refused. John believes the real estate agent has looked at the NPII or his credit report. John doesn't know what to do. He got advice from a tenancy service but it did not help. Bankruptcy will be listed on the NPII for the rest of his life, so he is worried it will be impossible for him to find housing and he will be at risk of homelessness.

Case study provided by Financial Rights Legal Centre (C193550)

Proposal: strengthening offence provisions

As a general comment, the offence provisions in the Bankruptcy Act are already very harsh. It is unclear whether 'strengthening' penalties will successfully deter the conduct of a very, very small minority of people attempting to subvert the system.

The Options Paper suggests strengthening penalties for a breach of subsection 265(8) of the Bankruptcy Act, the offence of contracting a debt with no expectation to pay.[10] We have a number of concerns with this proposal:

- This offence has a current maximum penalty of one-year imprisonment, which is a very serious consequence. If that penalty is not operating as a deterrent, it is hard to see how increasing it will improve deterrence. Few, if any, Australians know about the Bankruptcy Act, let alone its numerous offence provisions – unless, perhaps, they are being advised by, to use AFSA's language, an 'untrustworthy advisor'. We're not aware of evidence that increasing the already-harsh penalties will improve compliance or act as an effective deterrent.
- In respect of lending by consumer credit providers, section 265(8) is inconsistent with the responsible lending laws under the *National Consumer Credit Protection Act 2009* (Cth) (**NCCPA**). Responsible lending laws place the onus on the lender, not the borrow, to assess the suitability of an application for credit.
- Assessing a breach of section 265(8) could be very difficult. People are often overly optimistic about their capacity to repay a debt. We do see people who had intended to repay their lender but, objectively, could never afford it. This is why the NCCPA places the onus on the skilled party to the transaction – the lender – who is in a much better position to assess capacity to repay.
- In other cases, we see people in poverty and struggling with addiction occasionally take desperate action, including taking out payday loans without any demonstrable intention to repay. Were a person to be prosecuted and jailed for one year (or more) under section 265(8), this would simply be jailing people for poverty and addiction.

[10] Section 265(8) of the Bankruptcy Act currently states: "A person who has become a bankrupt and, within 2 years before he or she became a bankrupt and after the commencement of this Act, has contracted a debt provable in the bankruptcy without having at the time of contracting it any reasonable or probable ground of expectation, after taking into consideration his or her other liabilities (if any), of being able to pay the debt, commits an offence and is punishable, upon conviction, by imprisonment for a period not exceeding 1 year."

For the above reasons, we do not support increasing the current harsh penalties for breaches of section 265(8).

If, contrary to our recommendation, penalties are increased, then two important qualifications must be added. Firstly, the provision should be amended to include a monetary threshold, so it only applies to large loans. Second, the provision should not apply to lending regulated by the NCCPA.

RECOMMENDATION 6. Regarding section 265(8) of the Bankruptcy Act, the offence of contracting a debt with no intention to pay:

a) do not increase penalties for breaches, as the current maximum penalty of one year imprisonment is a harsh penalty;

b) alternatively, apply a monetary threshold so this provision only applies to lending on large loans, and does not apply to lending regulated by the *National Consumer Credit Protection Act 2009* (Cth).

Promoting debt agreements

Preliminary comments

Before we address the specific consultation questions, it's important to state that the aim of "promoting" debt agreements, including by "improving access to the debt agreement system," in the Options Paper an entirely unnecessary goal of any meaningful policy process on improving outcomes for people in financial difficulty.

People in financial difficulty do not need "access" to debt agreements – they need impartial, tailored and timely advice on the myriad options to manage debts, and they need a sustainable, affordable solution. This they rarely get from debt agreements.

An extensive policy process underpinned the reforms in the *Bankruptcy (Debt Agreement Reform) Act 2018* (the **Reforms**), which came into effect on 1 July 2019. This process benefitted from academic research[11] and market research[12] both based on AFSA data, as well as the lived experiences of people in debt agreements, and the data and experiences of creditors.

It is staggering that the Government is proposing to rollback its own highly successful reforms.

These reforms have only in operation for 2.5 years, and are working exceedingly well to prevent unsuitable debt agreements that were common pre-reform.

The Options Paper provides no evidence of the need for the proposed changes, other than noting the decrease in new debt agreements post-reform. Pre-reform, approximately 80% of debt agreements were inappropriate or unaffordable and should never have been entered. So, post-reform, the number of new debt agreements *should* be significantly lower. This suggests that fewer people are being cajoled, funnelled or misled by a debt agreement administrator (or aligned brokers, referrers and other firms) into unsuitable debt agreements.

Covid-19 measures offered by the Government and creditors revealed that we need debt agreements less than ever. It is very strange to be "promoting" insolvency when non-insolvency options can work. Many of the unsuitable debt agreements pre-reform were in circumstances where a temporary hardship arrangement would have been more appropriate. Adequate income support, combined with flexible hardship arrangements from creditors, is a far better policy response to temporary hardship than funnelling people into an unnecessary

[11] Vivien Chen, Lucinda O'Brien and Ian Ramsay, 'An Evaluation of Debt Agreements in Australia' (2018) 44(1) *Monash University Law Review* 151, available at SSRN: https://ssrn.com/abstract=3036315.

[12] WhereTo, 'Assessing the experience of debtors and creditors with practitioners during the personal insolvency process – a market research report for the Australian Financial Security Authority', 25 May 2017.

insolvency in the form of a debt agreement, which results in high fees and significant negative consequences on future borrowing and entrepreneurial activity.

The underlying problem that can never be fixed by "improving access" is that debt agreements are a **conceptually flawed product**. The debt agreement system incongruously assumes that people on no or low incomes can't pay their creditors, but do have sufficient and stable income to pay creditors and a middleman – the Debt Agreement Administrator – well into the future. As a result of this flaw, debt agreements rarely work as a solution to unmanageable debt.

Indeed, when the debt agreement system was first established, for-profit administrators were not envisaged to play any role in the regime. The Explanatory Memorandum to the 1996 Bill that introduced debt agreements into the Bankruptcy Act states that:

> It is not proposed that there be any fees or administrative charges associated with debt agreements. Oversighting of agreements will be provided on the basis that it is fully funded by Government. It is thought that **if fees were charged, debt agreements would in many cases not be viable either for the debtor, or for his or her creditors**, which would of course **defeat the purpose** of creating a further alternative to existing regimes.[13]

This very problem has played over the last 15 years, defeating the purpose of debt agreements. With AFSA no longer administering agreements (but charging a 7% realisation fee) together with eye-watering fees of 20-30% of repayments going to registered debt agreement administrators in addition to set-up fees of $2000 or more, it is little wonder that debts agreements are no longer viable for most debtors and their creditors.

The proposals in this Options Paper do not fix this underlying flaw. New ideas are needed, rather than simply reviving old problems that the Government just fixed.

Question – the government seeks stakeholder views on whether the default term limit for debt agreements should be extended to 5 years.

We are strongly opposed to this proposal.

The Options Paper states at page 5 that:

> The aim of extending the default term is that debtors will have access to a sustainable debt agreement with a defined term limit, while providing creditors with reasonable prospects to receive a commercially acceptable return.

This is not an appropriate aim, nor is it achievable, particularly without an effective affordability gauge in the current regime or the Options Paper.

It is particularly concerning that the Government is considering rolling back the most important reform of the 2018 reforms when it has not even implemented the primary affordability mechanism – the payment-to-income ratio.

To be clear: if the Government proceeds with this disastrous proposal, it will be selling out some of the most vulnerable members of our community in favour of debt agreement administrators, which can only turn a profit by funnelling a large volume of people into debt agreements, regardless of whether it is in their client's best interests.

<u>Pre-reform: Problems with the debt agreement system</u>

We do not need to imagine a hypothetical outcome from extending the default term to 5 years – we can look to the data, research and lived experience prior to 1 July 2019, when 5-year debt agreements were permitted.

Pre-reform, the debt agreement system was rife with problems.

[13] *Bankruptcy Legislation Amendment Bill 1996* – Explanatory Memorandum, 16-7: http://classic.austlii.edu.au/au/legis/cth/bill_em/blab1996344/memo_0.html.

Compared with bankruptcy, a debt agreement often involves higher costs to the debtor. If debtors are unable to sustain the required payments, the debt agreement will terminate for arrears after 6 months, and bankruptcy may be the result. Those debtors will be left worse off financially than if they had opted for bankruptcy in the first place, experiencing prolonged financial difficulty and stress. Debt agreements have significant implications for a person's credit report for years after they are completed. Pre-reform, people frequently reported that they misunderstood or were misled about the cost and consequences of a debt agreement, or were not given balanced (or any) advice about options. Many thought they were in a debt consolidation, rather than a form of insolvency.

Debtors generally have a range of options to resolve a situation of unmanageable debt. Depending on their circumstances, this can include:

- hardship arrangements (from lenders, utility providers, telcos)
- debt waivers
- bankruptcy
- judgment-proof options
- 'stop contact' letters where debt collectors are engaging in illegal debt collection practices, or
- challenging liability for the underlying debts – an available avenue where there is family violence, or irresponsible lending contrary to the *National Consumer Credit Protection Act 2009*.

Due to the underlying conceptual flaw, there 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. Given the significant costs and serious consequences of a debt agreement, and availability of other options to resolve unmanageable debt, a debt agreement should only be chosen where there is a demonstrable benefit to the debtor. Competent and impartial advisors will typically only recommend a debt agreement where people:

1. are otherwise facing bankruptcy and:
    a) own or have equity in their home (because under bankruptcy the debtor would lose the home during the liquidation process) or other significant assets;
    b) earn reliable income over the Actual/Base Income Thresholds in the Bankruptcy Act (currently $60,515 and increasing with dependents), [14] from which they would have to make income contributions in bankruptcy; or
    c) would have their employment threatened by bankruptcy; and, crucially
2. can realistically afford the proposed repayments without ongoing hardship.

Pre-reform, very few debt agreements met these criteria. Research by Vivien Chen (Monash University), and Lucinda O'Brien and Ian Ramsay (The University of Melbourne)[15] confirmed our casework experience that many people found themselves in plainly unsuitable agreements. Their analysis of AFSA data found that in 2016, in which there was 12,150 new debt agreements:

- 54 percent stated expected incomes of $30,000 to $49,999; and
- 13 percent of debtors stated expected incomes of $10,000 to $29,999; and

[14] https://www.afsa.gov.au/insolvency/how-we-can-help/indexed-amounts-0.
[15] Chen, above n 10.

- 1-2 percent stated expected incomes of $0 to $9,999, which raises serious doubts about their capacity to afford repayments under debt agreements without diverting money away from essentials like putting food on the table.[16]

The research also found that between 2011 and 2016, when their debt agreements commenced:

- 58 to 67 percent of debtors owned realisable assets of less than $5,000; and
- only 5 to 7 percent owned realisable assets worth between $50,000 to $100,000. [17]

This is consistent with data from the 2011 Profile of Debtors, which revealed that 75 percent of people in a debt agreement did not own or were not buying real estate[18] and, therefore, were not using a debt agreement for its best purpose—saving the family home.

Together, these statistics confirm our casework experience that unsuitable debt agreements were routinely offered to people with no realisable assets and low incomes, wholly or partially from Commonwealth benefits. Chen et all found that 24% of surveyed people in debt agreements reported that Centrelink was their main source of income at the time of insolvency.[19] People in this situation are better off seeking other solutions, such as debt waivers, or failing that bankruptcy, which can be negotiated by free, independent, accredited financial counsellors. Generally, creditors recognise that, in such situations, it is unfair and futile to try to draw blood out of a stone. As the researchers found, 'debtors who rely primarily on Centrelink benefits are among the clearest examples of people unsuited to debt agreements.'[20] They are unlikely to be able to make even the smallest repayments without hardship, and directing Commonwealth benefits to repaying debt is a poor use of public funds that have been provided to give recipients a basic standard of living.

The main way administrators crafted debt agreements for people in these circumstances was by reducing the amount of repayments and extending the term. Sometimes, payments would increase or 'step up' in later years of the agreement.

The unaffordability of debt agreements was also linked to the high rate of dividends paid to creditors (often around 70 cents in the dollar) and excessive fees to administrators. The longer the debt agreement, the higher the total fees to administrators. The research by Chen, O'Brien and Ramsay found that some administrators were charging 'excessive and unwarranted fees'.[21] Administrators' fees accounted for 22.9% of total monies received in 2016. These statistics did not include the set-up fees that are generally added to the agreement as an unsecured debt owing to the administrator, enabling voting rights on the debt agreement proposal – a huge conflict of interest.

In many pre-reform debt agreements, the administrator's fees were *more* than the initial debts – calling into question the dubious and misleading marketing of debt agreements as a form of 'debt relief'. A statistical analysis by Credit Corp Group, a party to more than half of debt agreements in force at June 2015, found that after fees and charges:

- 64 percent of agreements required debtors to pay more than 100 percent of their original debts;
- 13 percent of agreements required debtors to pay more than 120 percent of their original debts.[22]

These statistics raised two concerning questions: were these debtors able to meet their commitments without substantial hardship; and, if they could, were they even insolvent?

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[16] Chen, above n 10, 172.
[17] Ibid 173.
[18] 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.
[19] Chen, above n 10, 179.
[20] Chen, above n 10, 188.
[21] Ibid 189.
[22] Credit Corp Group Limited, 'Part IX Debt Agreement Insights' (Paper, June 2016); see also Chen, above n 10, 189.

Pre-reform, five-year debt agreements set people up to fail. Life can be very unpredictable, and circumstances can change. A debt agreement is **only beneficial if it is completed**. Once terminated for arrears, the purported benefits are undone. Debts at reinstated at the original undiscounted amount, with interest backdated. Creditors can immediately commence collection and enforcement action. The debtor will have incurred significant costs (in the form of upfront and ongoing administration fees) and consequences (to their credit reports) for little benefit. Other options that may have been available earlier, such as negotiating a full and final settlement, may not be available where the person's limited funds have been paid towards fees.

Therefore, it is essential that any debt agreement is realistically affordable and sustainable for the life of the agreement when proposed. It can be very difficult for a person in financial stress to make a realistic assessment of their capacity to meet a repayment schedule for three years into the future, let alone five or seven years. Making such calculations poses an unfair risk to the debtor of termination, should their circumstances unexpectedly worsen later in the debt agreement. Five-year debt agreements are almost never in the consumer's interest unless the debtor is trying to save their home, which the 2018 reforms already allow.

Most of the examples of plainly unsuitable debt agreements in our submission to the 2018 Bill were 5-year debt agreements – see Case Studies 1, 2, 4, 5.[23]

In 2016, 1973 debt agreements were terminated. In June 2021, over 1300 debt agreements were terminated for being 6-months in arrears.[24] This is concerning but unsurprising given the large number of unsustainable pre-reform debt agreements of 5 (or more) years still on the books – a legacy problem that will be made worse by this proposal.

The foreseeable risks that an unaffordable debt agreement will terminate for arrears, together with lax regulation of administrators by AFSA, can put people at risk of appalling debt collection behaviour. We note ASIC's current legal action against registered debt agreement administrator A&M Group Pty Ltd (trading as Debt Negotiators).[25] ASIC alleges it sent text messages and emails to six separate debtors, including to:

- threaten them with fraud charges and imprisonment if they failed to make payments;
- threaten to contact friends, family, work colleagues and landlords if debtors failed to contact A&M Group;
- falsely claim that creditors were in the process of terminating the debtors' debt agreements and were considering legal action;
- falsely claim that, if their debt agreement was terminated and they were forced into bankruptcy, the debtors' finances would be examined to determine if they had been able to make payments under their debt agreement; and/or
- falsely claim that if creditors obtained a garnishee order against the debtor, the creditors would be entitled to take 80% of the debtor's income.'[26]

Debt Negotiators still holds a registration to administer debt agreements.[27]

Elena's story

The partner of our client, Elena (name changed) forced her to enter into credit and telecommunications contracts for his benefit. In approximately October 2016 an online inquiry was made in Elena's name for a "consolidation loan" – Elena thinks that her then-partner made that application. Internet-loans.com.au then passed on Elena's

[23] Available at: https://consumeraction.org.au/submission-debt-agreement-reform/.
[24] AFSA, *Snapshot of debt agreements as at 30 June 2021*: https://www.afsa.gov.au/statistics/snapshot-debt-agreements.
[25] ASIC, *21-306MR ASIC sues A&M Group for false and misleading, threatening and coercive conduct against debtors*, 17 November 2021: https://asic.gov.au/about-asic/news-centre/find-a-media-release/2021-releases/21-306mr-asic-sues-a-m-group-for-false-and-misleading-threatening-and-coercive-conduct-against-debtors.
[26] Ibid.
[27] As at 3 March 2022: https://services.afsa.gov.au/insolvency-dashboard/practitioner/public/view/1403?searchId=1&source=debt-agreement-administrator.

contact details to Debt Negotiators, who contacted her and immediately advised her to enter into a part IX debt agreement, but consistently referred to their product as a "debt consolidation".

Elena was not sure that a debt agreement was the right option for her and so delayed in providing documents to Debt Negotiators. Debt Negotiators actively pursued Elena to enter into a debt agreement and Elena relented.

The first debt agreement proposal in July 2017 records that Elena had no income and was solely reliant on her partner's income ($720 per week) and that her partner was also entering a debt agreement. Elena was not eligible for social security payments. The July 2017 debt agreement proposal (under which Elena would have paid $55 per week for 5 years) was rejected.

Debt Negotiators submitted a further proposal for Elena to pay $65 per week for 5 years that was accepted in October 2017. The total amount payable under the debt agreement was $16,900 with $4,647.50 of this being for Debt Negotiators' administration fees (27.5% of her repayments) in addition to the $1,400 set-up fee. Due to fees to Debt Negotiators and AFSA, the total repayments were more than her total unsecured debts of $15,586 – 108% of her initial unsecured debts.

Concerningly, Elena's accepted proposal again states that her expected income for the next 12 months was $0, with all income support coming from her partner. The proposal also notes that her partner used her car to get to work.

Elena's understanding of the debt agreement was that the $65 per week was to pay all of her debts – including her car loan. In fact, Debt Negotiators were not paying any money towards her car loan (as it was a secured debt) and she subsequently lost the car in March 2019.

The debt agreement was unaffordable from the beginning. Elena often missed payments and in fact missed the first 4 payments. In October 2017, Elena's son was born and there was greater financial strain on her and her partner. Her partner became increasingly violent. From March 2018 until the agreement was terminated on 2 October 2020 (for 6 months of non-payment), Debt Negotiators repeatedly sent Elena messages to shock her into prioritising the payment to Debt Negotiators. For example:

"My manager is pushing me to contact your family, friends, Neighbours and landlord, however i believe we can come to a resolution without going to that extent."

"…your creditors are looking to force you into bankruptcy. If they are successful your trustee will closely examine all of your financial situation and if they feel that you in actual fact had the ability to service your debt, then you could be charged with fraud, facing up to 12 months imprisonment."

"When you entered the Debt Agreement you disclosed vehicle with a value of $8,000. As you have failed to return calls and are currently in arrears your Debt Agreement is in danger of being terminated. Termination can lead to the creditors commencing Bankruptcy action. If Bankruptcy action were to be taken against you this would result in the vehicle potentially be taken by the trustee and sold to the pay the creditors."

In fact, none of Elena's unsecured debts (mostly to payday lenders, telcos, and Debt Negotiators for its set-up fee) were over $5,000 and therefore were ineligible for a creditor's petition.

During this time, Elena's partner was very violent toward her, and she was looking after her infant child who had serious medical issues. Elena says that Debt Negotiators' conduct accelerated her depression and darkened her thoughts.

Case study provided by Consumer Action Law Centre

If people in debt had better options, then why were so many ending up in unsuitable and unaffordable debt agreements pre-reform? The higher numbers of new debt agreements pre-reform were not a vote confidence in the regime, nor an indicator they were in the debtor's best interests. Rather, the high numbers were due to rampant mis-selling by many (not all) administrators (and their aligned brokers and paid referrers) that stood to earn upwards of $20,000 in fees over the life of the agreement. In addition to the inherent conflict in getting debt advice from the administrator, there were other issues with the sales process, including misleading or imbalanced advertising, and no duty on administrator to act in their client's best interests.

Even for administrators that mean well and genuinely want to help their clients – if a debt agreement is the main debt solution they offered, then a debt agreement was typically what was promoted even where other options existed.

Lee's story – Poor advice from DMF, multiple breaches of law

Lee was in debt with a Bank for a personal loan. Lee did an online search for debt help and found a for-profit debt management firm (**DMF**). Lee explained to the DMF that he really had one creditor for outstanding debts and a very small debt for another creditor. About 95% of his $40,000 debt was with the Bank.

Lee says the DMF did not offer him any solutions other than a debt agreement under part IX of the Bankruptcy Act, including any information about how he could access a financial counsellor, ask for hardship from the Bank or enter into bankruptcy.

Lee entered into the debt agreement to resolve this one main debt with the Bank. Lee was not aware of the $2400 fee charged to the debt agreement and he does not recall anyone from the DMF speaking to him about this.

Lee was paying $155 a week but this was causing financial hardship as his work was sporadic. Lee tried to negotiate with the DMF to reduce the amount payable. Previously, the DMF agreed to a reduction but recently they refused unless he paid the regular payments for three months. His debt agreement is now heavily in arrears and is facing termination. The DMF advised Lee to take out his super early or get money from his family to meet the repayments.

Case study provided by Financial Rights Legal Centre (C215088)

Joanna's story – 4-year-old DA, unaffordable, wishes she went bankrupt

Joanna and her husband both entered into separate Part IX Debt Agreements with a debt management firm (**DMF**) about 4 years ago. Joanna says they both consistently paid large sums of money back to the DMF until COVID hit and they both lost their jobs.

Joanna's husband is working again but they cannot afford to pay back both DAs as they were doing before the pandemic. They have a son with a disability and it has been really difficult to keep him in school. Joanna is now home with him and not working. Joanna has communicated this with the DMF who is still acting as her debt agreement administrator and she was advised to put in a variation seeking the creditors accept the payments to date in full and final settlement in light of Covid and her circumstances. Joanna says the creditors rejected her variation and they are still waiting to hear about her husband's variation. They have 16 months to go to finalise both DAs. Joanna still owes over $25,000 and her husband owes about $9,000.

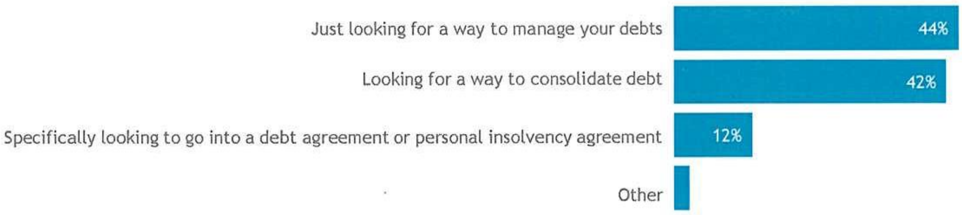
The DMF told Joanna that she can either put in a new variation with reduced payments to the creditors or apply for bankruptcy. She is not making any payments on the DA at the moment. At this stage Joanna just wishes she had applied for bankruptcy four years ago.

Case study provided by Financial Rights Legal Centre (C225217)

Our casework experience of people not being given full and impartial advice before entering debt agreements was borne out in 2017 market research commissioned by AFSA to evaluate the integrity of the personal insolvency system. This research involved an initial qualitative phase comprising 15 interviews with creditors and 6 with bankrupts and debtors, followed by an n=653 quantitative survey with bankrupt and debtors. The sub-report on the findings in relation to debt agreements, 'Assessing the experiences of debtors and creditors with practitioners during the personal insolvency process' (**AFSA Market Research**).[28] Insights and lowlights from this important work include:

- **People being funnelled into debt agreements by their administrator** – only 12% of debtors specifically wanted a debt agreement – most wanted to manage or consolidate debts.[29]

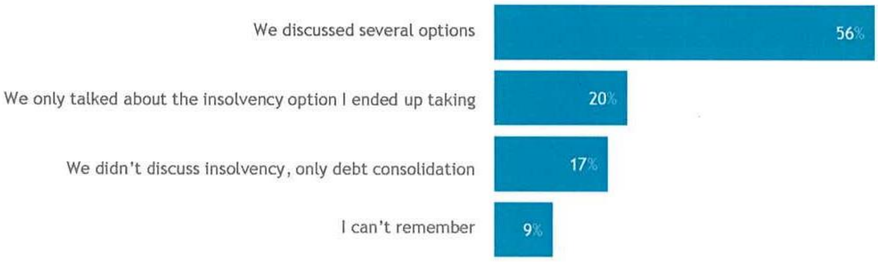
Figure 5. Reason for pursuing insolvency



QB.1 Thinking back to the beginning of the process that lead to you becoming insolvent, were you initially: Base: Debt Agreement, n=209

- **Options covered** – Concerningly, 17% said 'we didn't discuss insolvency, only debt consolidation'.[30] One in five debtors (20%) said that they only discussed the option they ended up taking – people in casual or sporadic work were more likely to say this.[31]

Figure 13. Options covered in initial conversation



QB.4.What options for insolvency did your initial conversation cover? Select all that apply. Base: Debt Agreement, n=209

- **No shopping around for debt help** – 77% of survey respondents said they dealt with only one company when applying for insolvency.[32]
- **Informal options likely better** – 7% of respondents had only one creditor, and 34% of respondents had 2-3 creditors, indicating that informal options may have suited them.[33]
- **Access to financial counselling** – Approximately 62% of debtors were not aware that they could access the services of a free financial counsellor, and of those who were not aware of this service, 36% said that they thought access to a counsellor might have made a difference to their situation.[34]

[28] AFSA Market Research, above n 11.
[29] Ibid 4-5.
[30] Ibid 8.
[31] Ibid 8.
[32] Ibid 6.
[33] Ibid 7.
[34] Ibid 9.

The researchers also conducted a latent class analysis, which revealed that 28% of the surveyed bankrupt/Part IX debtors profiled as highly vulnerable. Comparing the vulnerable cohort against the overall sample, the research found:[35]

> In more detail, the 28% vulnerable cohort was:
>
> - more likely than the rest of the sample to enter into the personal insolvency process 'just looking for a way to manage their debts' (46% vulnerable vs 38% overall)
> - less likely than the rest of the sample to have discussed several insolvency options with their personal insolvency administrator (31% vulnerable vs 49% overall)
> - more likely than the rest of the sample to say that their administrator never mentioned informal options (42% vulnerable vs 23% overall)
> - more likely than the rest of the sample to say that accessing free financial counselling services would have made a difference (44% vulnerable vs 22% overall)
> - more likely than the rest of the sample to agree that the documentation provided was too complex to read properly (29% vulnerable vs 16% overall)
> - more likely than the rest of the sample to agree that their personal insolvency administrator should have raised issues to prevent nasty surprises later on (40% vulnerable vs 16% overall)
> - more likely than the rest of the sample to agree that they weren't given good advice (36% vulnerable vs 15% overall)
> - more likely than the rest of the sample to agree that their insolvency option was the only one they knew about (18% vulnerable vs 11% overall)

The report concludes that:[36]

> In the qualitative study, both creditors and debtors spoke of circumstances where people had been nudged by unmediated online information and advisors into taking out a debt agreement, including against their own best interests.
>
> The survey provided evidence to support this point of view. It mapped a narrow consideration process, where a significant minority of debtors did not — and were not encouraged to — consider alternatives to insolvency, a range of insolvency providers, or alternative sources of advice.
>
> Not all were told of the full consequences of becoming insolvent with respect to their ability to access credit, or were asked for all the information that would have enabled their debt administrator to put together a realistic proposal.

Intention of the 2018 reforms

Following the failings of the debt agreement system to provide equitable and sustainable outcomes for all debtors and creditors, the *Bankruptcy Amendment (Debt Agreement Reform) Act 2018* was enacted. Although it is not noted in the Options Paper, a key part of these reforms was to improve the equity of the debt agreement system. The Explanatory Memorandum states:

> It is intended that the measures in the Bill will boost confidence in the professionalism of administrators, deter unscrupulous practices, enhance transparency between the administrator and stakeholders, and ensure that the debt agreement system is accessible and **equitable**.[37]

When the debt agreement regime was first introduced in 1996, debt agreements were expected to last no longer than three years, with a possible extension of six months for payment delays.[38] The length of debt agreements then increased over time. In 2010, 53 percent of debt agreements were expected to run for 5 years.[39] By 2016, this had increased to nearly 85 percent.[40]

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[35] Ibid 16.
[36] Ibid 4.
[37] Explanatory Memorandum – *Bankruptcy Amendment (Debt Agreement Reform) Act 2018* (Cth), [4]: https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6046_ems_f61ce550-9e96-4dc8-ae47-e92c4d62d687/upload_pdf/662694.pdf;fileType=application%2Fpdf (emphasis added).
[38] Chen, above n 10, 155.
[39] Ibid 170.
[40] Ibid 170.

The three-year term limit was the most important reform in the 2018 Act. It was introduced the interests of equity, to ensure debt agreements were fair, sustainable, realistic and aligned with the duration of income contributions in bankruptcy. In introducing a three-year limit, the Explanatory Memorandum stated:

> The absence of a limitation on the proposed timeframe could also contribute to **unreasonably high dividend rates for lower income debtors.** For example, if a debtor can only afford to pay a certain amount of money per month, it will **always be possible to lengthen an agreement to meet that monthly payment**. A creditor or the proposed administrator is therefore able to request **an unreasonably high dividend or remuneration rate**.
>
> **A long debt agreement prevents an insolvent debtor from achieving a fresh start**. Item 1 of Part 1 Schedule 2 inserts a new provision into section 185C to specify that a debt agreement proposal must not propose to make payments under the agreement for a timeframe longer than three years from the day the agreement was made. A note in the new provision directs the reader to section 185H which clarifies 'when' a debt agreement is made. **A three year timeframe aligns with the length of income contributions under bankruptcy**.[41]

The then-Attorney-General said in his second reading speech on the Bill:

> This bill will **prevent people spending an excessive amount of time in a debt agreement** and will ensure that debtors can only propose a debt agreement of a three-year period or less. In reducing the length of a debt agreement proposal, the Turnbull government is making sure that debt agreements are an avenue for debtors to **achieve a fresh start.**[42]

These reasons for the three-year term limit still apply today.

Indeed, the inequity between bankruptcy and debt agreements will not only be recreated but expanded if the default period of bankruptcy moves to one year, and the default period of debt agreements moves to five years.

<u>Post-reform</u>

Our casework services are yet to see new problems with debt agreements entered post-reform, which is a good sign that the reforms are working as intended.

The three-year term limit appropriately restricts, on affordability grounds, many applicants for whom a debt agreement would be plainly unsuitable.

Financial counsellors and community lawyers are, however, still helping people to clean up the mess from inappropriate debt agreements entered pre-reform, including where:

- they have terminated, or are at risk of terminating, for 6-month arrears;
- multiple variations were necessary because it was not sustainable;
- they could never afford the debt agreement and should have bankrupted years ago, and would already be discharged from bankruptcy and moving on with their lives; and
- are exiting completed debts agreements only to find that, despite being told by their administrator at the beginning that it wouldn't impact their creditworthiness, the debt agreement will be on their credit report for years to come and is impeding their "fresh start".

Gilbert's story – called January 2022 – 7-year-old debt agreement – barely half paid off

Gilbert entered a Debt Agreement 7 years ago (the **DA**). The DA was arranged with the assistance of a debt management firm (**DMF**) and was due to be completed after 3 years, where he would be discharged from $35,000

[41] Explanatory Memorandum – Bankruptcy Amendment (Debt Agreement Reform) Act 2018 (Cth), [113]-[114]: https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6046_ems_f61ce550-9e96-4dc8-ae47-e92c4d62d687/upload_pdf/662694.pdf;fileType=application%2Fpdf (emphasis added).
[42] https://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansardr/10bbc6a7-ab94-4e90-9e2c-317c61ae2064/0056/hansard_frag.pdf;fileType=application%2Fpdf

of debt after repaying about $20,000, of which $16,000 would be distributed to creditors. The payments after an initial 14 months were due to increase from $120 to $700 reflecting when payments to a secured creditor would end, however, the DMF made an error miscalculating when he could afford the increase. The DA agreed to waive some fees, and a variation was entered. At the time of variation, a new unsecured debt was also added.

The new proposal required payment of $30,000 which was again stepped with initial payments at $50 for fortnight, increasing to $200 and a final one-off payment of $12,000 after 3 years which was identified as a possible one off payment from some possible legal action he was involved in. When Gilbert contacted Financial Rights, the final payment was due and Gilbert could not pay as the matter is still on going. He has been negatively impacted by Covid, and loss of employment over the last few years and so he fell behind on payments.

The DMF is suggesting he borrow from friends and family to pay off the final payment. Gilbert is reluctant to do this, and he has tried to borrow money or access his superannuation. Both of which have failed. He is thinking of letting the DA terminate and filing for bankruptcy. As the debt agreement is still in force, the listing has been on his credit report for the last 7 years.

Case study provided by Financial Rights Legal Centre (C117740)

Alternative solutions

Instead of trying to revive a conceptually flawed product in the interests of the middleman it served, the Government should be considering new options to manage insolvency for those on low incomes, or sole traders. Many considered proposals were put forward to the Attorney-General's Department January 2021 consultation, 'The bankruptcy-system and the impacts of Coronavirus'.[43] If the Government wants to improve options for low-income debtors with a house, it could:

- introduce new options, such as mortgage debt relief, which we described in our January 2021 submission.[44]
- regulate informal debt agreements – which will continue to exist unregulated regardless of the term limit;
- encourage creditors to accept amounts paid as full and final settlement when people have paid the majority of their obligations under the debt agreement and encounter increased financial difficulty near the end of the term. 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.
- introduce quality of advice requirements for debt advisors, so that people end up in the right solution for them.

Informal agreements

It is unclear what problems a 5-year agreement will solve. There are problems with unregulated 'informal debt agreements'. However, these problems will remain, regardless of whether the default limit is 5 years or 20 years. The term limit does not prevent firms offering informal arrangements.

It's possible that increasing the term limit may even fuel such arrangements. Pre-reform, some creditors voted against debt agreement proposals where there were high fees to Administrators – and total fees paid increase with an increasing term of repayments. The Options Paper makes no proposals that will fix the issues with unregulated informal agreement – more work must be done.

[43] https://financialrights.org.au/wp-content/uploads/2021/04/210201_COVID-Bankruptcy-Reforms_Submission_FINAL.pdf.
[44] Ibid 27-35.

Sole traders

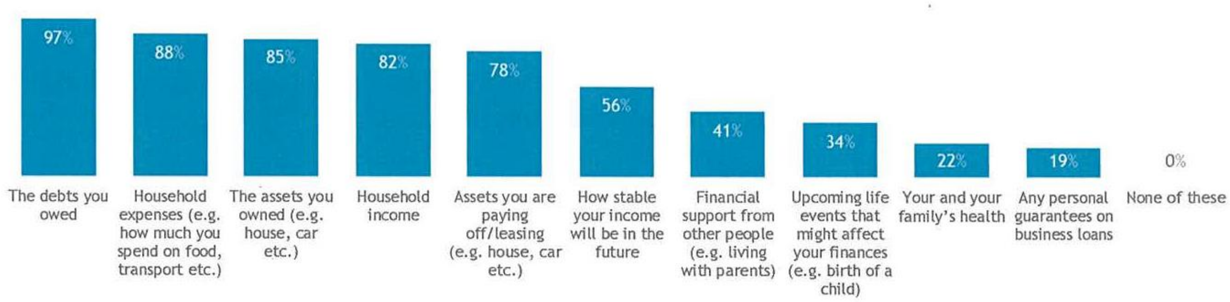
Some stakeholders have suggested that a 5-year debt agreement could assist sole traders and partnerships. We are very supportive of new options to help sole traders, however, are sceptical that 5-year debt agreement will assist. It may just prolong the financial difficulty due to the administration fees and will be of no benefit unless it is affordable and completed. If, contrary to our views, a 5-year limit is necessary to assist sole traders (and there are no other viable policy solutions) then sole traders and partnerships could be given a specific exception, like the existing exception for people with a home. We should not change the default term for all debt agreements simply to fix issues for sole traders.

Again, we do not need to imagine outcomes based on hypothetical scenarios – we can look to the real-world data about the experiences of sole traders in 5-year debt agreements pre-reform. If sole traders, based on the data, would benefit from a 5-year debt agreement, this can be accommodated by allowing another exception, as already exists for home ownership. However, if the Government intends to pursue this, it should:

- commission an independent analysis of AFSA's data and a survey of debtors about demonstrable outcomes for sole traders in 5-year debt agreements pre-reform, before permitting any sole trader exemption to the default 3-year term limit; and
- simultaneously introduce quality of advice requirements on debt agreement administrators (and their aligned brokers), to ensure upfront advice to enter a debt agreement is in the sole trader's best interests.

Nothing in the 2018 reforms prevents poor quality advice from Administrators. AFSA's market research revealed serious concerns about the quality of advice. The research found a lesser number of debtors were asked about income stability, financial support from other people, upcoming events that may impact their finances, health issues, and any personal guarantees on business loans, which 'suggested that debt administrators were typically failing to capture all the information needed to develop accurate and sustainable debt agreement proposals.'[45]

Figure 17. Information requested from debtor upon application



We acknowledge that limiting an exemption to sole traders may pose some practical difficulties. In our casework experience, 'sole traders' may also be very vulnerable individuals, including gig workers and intermittent workers forced to establish their own business (for example, outsourced cleaners or transport drivers). Our experience is that there are many people using insolvency after their 'sole trader business' is no longer, because it failed, and while they may have incurred personal debts keeping it afloat, these are personal debts are severely impacting their wellbeing. An unsustainable debt agreement may only extend those negative impacts for sole traders and may terminate for arrears unless sustainable, for the same reasons given above.

Summary

Extending the default limit to 5 years will simply recreate old problems, and would be clumsy fix for any ongoing issues with informal agreements and sole traders. There is no good reason to change the default settings from 3 years to 5 years. When this was permitted in the past, unsustainable debt agreements were the norm, including

[45] AFSA Market Research, above n 11, 10.

for people on the aged pension, disability support pension, women carrying debts from abusive relationships, or those experiencing temporary hardship. People in these circumstances should not be funnelled into unnecessary insolvencies by debt agreement administrators when impartial advice from other sources would see them in better options to manage their debt.

This proposal should be abandoned.

RECOMMENDATION 7. The Government should not extend the default time limit on a Part IX debt agreement to 5 years. The current time limits should remain.

RECOMMENDATION 8. If sole traders and partnerships would benefit from a 5-year debt agreement, this should be only be enacted by a limited exception (as for home ownership exception) rather than changing the default term for all agreements, subject to:

a) Completing an independent analysis of AFSA's data, and a survey of debtors, about demonstrable outcomes for sole traders in 5-year debt agreements from the pre-reform period (i.e. prior to 1 July 2019); and

b) simultaneously introducing quality of advice requirements on debt agreement administrators (and their aligned brokers), to ensure upfront advice to enter a debt agreement is in the client's best interests.

Proposal: Extending the home ownership and hardship exceptions

<u>Question – the government seeks views on whether the home ownership exception should remain to allow a debtor with a real interest in property to propose a longer debt agreement beyond a 5-year default term.</u>

We are strongly opposed to this proposal for the above reasons.

We have not seen problems with home owners unable to save their home in the current settings. Banks have been largely supportive of consumers and small businesses during Covid, allowing flexible repayments on the mortgage, and we remain in a low-rate environment.

Extensions beyond 5 years will only see more people in terminated debt agreements – the very problem that the 2018 reforms were designed to address. It is hard to see how paying an administrator 25-30 precent of their repayments in fees (rather than to creditors) for seven years will help people stay in their homes. The longer it goes on, the more that people pay to the administrator – and the higher the chance that they will be unable to complete their debt agreement. People who can afford to make stable payments for more than five years don't need a debt agreement – they can work through other options with creditors.

<u>Question – Section 185M of the Bankruptcy Act gives debtors the flexibility to vary their debt agreement to up to 5 years if they suffer a substantial and unforeseen change in circumstances. The government seeks views on what form this variation exception should take if the default term for debt agreements is extended to 5 years.</u>

We are strongly opposed to this proposal for the above reasons. If someone has paid their debt agreement for five years but has not completed it, a good debt agreement administrator would be assisting the client to propose a variation to complete with nothing more to pay. The problems of debt agreements extending beyond five years are known and should not be recreated. The current settings of a three-year default period, with the option to extend to five, are appropriate and should not be changed.

RECOMMENDATION 9. The home ownership and 'substantial and unforeseen change in circumstances' exceptions should remain at a maximum of five years.

Proposal: Reducing the exclusion period for proposing debt agreements

Question – for debtors who have previously been party to a debt agreement only, views on providing a specific exclusion period of 5 years (rather than the proposed 7 years which would still apply to the other insolvency options (bankruptcy and PIA)).

Again, we are not aware of evidence that this is a significant problem. If a person needs a second debt agreement within a mere five years of their first, this is a sure sign that the original debt agreement did not enable a fresh start or led to financial stability. We do not support any outcome that would see people on low incomes perennially in debt agreements.

RECOMMENDATION 10. Do not extend exclusion periods for debt agreements.

Proposal: Proposing a debt agreement will not be an 'act of bankruptcy'

This is the only measure in the debt agreement section of the Options Paper that we support.

People rarely understand that proposing a debt agreement to their creditors is an act of bankruptcy, or what that means. It is very unfair if people, on the advice of their administrator or debt management firm, propose a debt agreement that is then not accepted for processing (as it would cause undue hardship) or rejected by creditors (due to low returns or high administration fees).

The above analyses of the debt agreement system suggested that people entering debt agreements weren't necessarily insolvent. Some people who were in financial stress but were not insolvent ended up be sold into it by the administrator (or another debt management firm) under the guise of 'debt consolidation' or 'debt relief' – see the Debt Correction Australia example at page 28 below. The AFSA Market Research included one debtor who thought she was in a debt consolidation, even months into her debt agreement.[46] This is linked due to the misleading advertising of debt agreements.[47] 'Debt consolidation', which is a form of credit assistance under the *National Consumer Credit Protection Act 2009*, is a fundamentally different product to a debt agreement, which is a form of insolvency under the *Bankruptcy Act 1966* with serious consequences. Case law confirmed that marketing a debt agreement as 'debt consolidation' was misleading and deceptive conduct and is accordingly prohibited by the consumer law (and Inspector-General Practice Direction 4).[48] Despite this, we continue to see people misled by the administrator or aligned broker that their debt agreement is debt consolidation.

While we support this proposal, it may have the consequence of exacerbating the ongoing problem of administrators and brokers advertising debt agreements as an 'alternative to bankruptcy,' unless AFSA and ASIC increase surveillance and enforcement action. The phrase 'alternative to bankruptcy' is misleading and confusing for debtors, as a debt agreement is a form of insolvency. The phrase has great significance to many of our clients who do not want to bankrupt due to the stigma, even where bankruptcy is clearly their best option. The words 'debt agreement' do not suggest insolvency, and many people are shocked to learn to its true nature later. The confusion and potential to mislead debtors would greatly reduce if the Inspector-General's Practice Statement required administrators to refer to 'a different type of bankruptcy' or a 'form of insolvency' instead of an 'alternative to bankruptcy'. This would flag at a critical early stage that a 'debt agreement' is in fact a type of insolvency with serious consequences.

While the consumer laws and Inspector-General Practice Statements prohibit these forms of misleading advertising in theory, these practices still flourish. AFSA and ASIC must take industry-wide enforcement action to curb these problematic advertising practices.

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[46] AFSA Market Research, above n 11, 8.
[47] https://consumeraction.org.au/wp-content/uploads/2013/05/Fresh-start-or-false-hope-April-2013.pdf.
[48] https://www.afsa.gov.au/advertising-and-promotional-activities-of-personal-insolvency-practitioners.

RECOMMENDATION 11. We support the proposal that proposing a debt agreement to creditors is no longer an act of bankruptcy.

Untrustworthy advisors

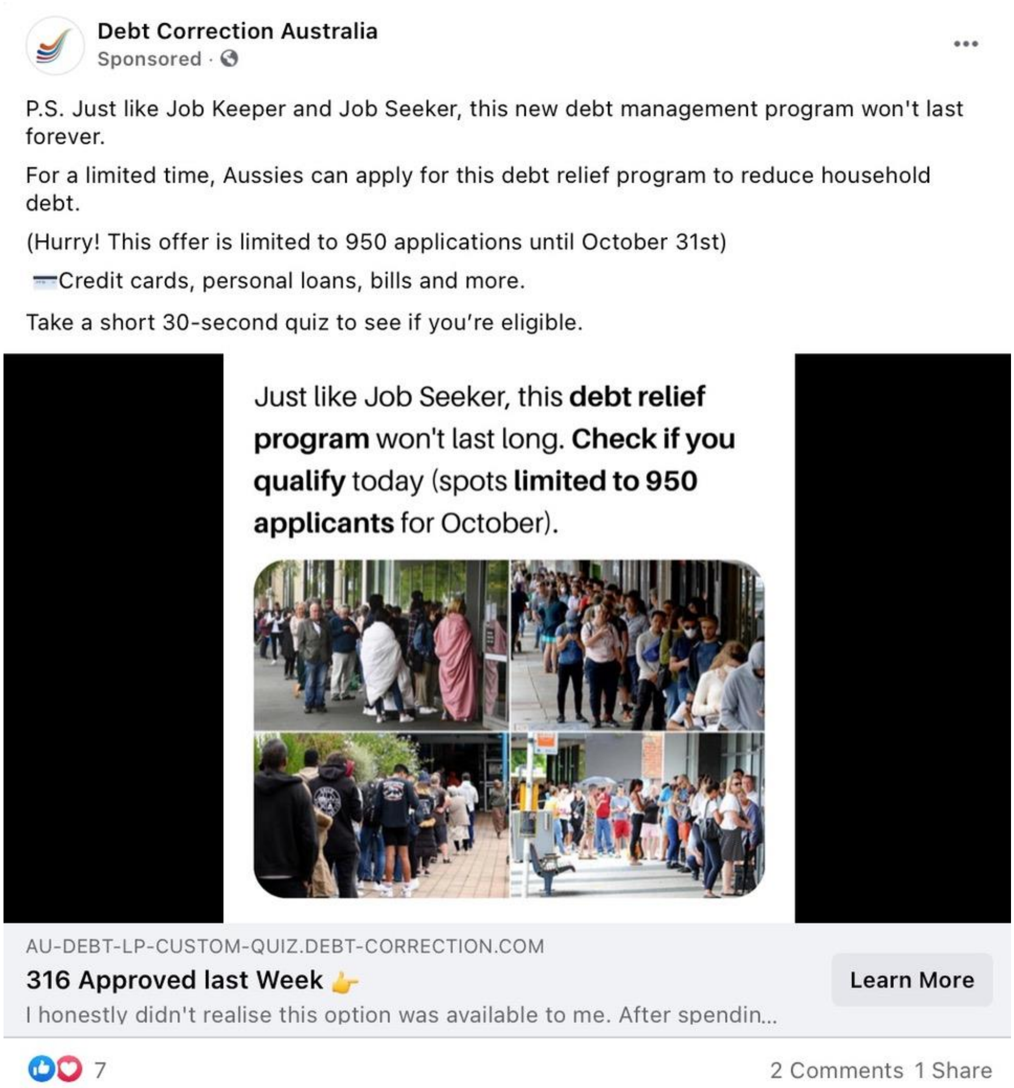
We are not opposed to the proposals in this section of the Options Paper. We support efforts to address the apparent problem of certain registered trustees receiving a pipeline of work from unethical pre-insolvency advisors that attempt to help higher-worth people minimise the impacts of insolvency.

Holding a registration as a personal insolvency practitioner is a privilege, not a right. All insolvency practitioners will come into contact with people at one of the most vulnerable times in the lives. They will be dealing with people who are incredibly stressed, facing the loss of their livelihood, and perhaps experiencing mental ill-health or family violence. Practitioners must have the skills and integrity to act appropriately with these debtors – most of whom are not 'rogue' or 'reckless' but are struggling with overcommitment or an unexpected change in their circumstances. It is clear that not all insolvency practitioners have these skills or commitment to ethical practices, thereby giving the whole industry a bad name.

AFSA does not always take action against registered trustees (or debt agreement administrators) even where there are egregious legal and ethical breaches. Until AFSA is empowered and emboldened to take a robust approach to regulating insolvency practitioners (including de-registration where appropriate) then poor behaviour will continue to flourish.

As well as a focus on pre-insolvency advice from unlicensed or other advisors, the legislation should also take into account misleading statements made in advertisements which direct a consumer to, but don't name, a registered trustee or registered debt agreement administrator.

For example, Debt Correction Australia doesn't appear to be the name of any existing business. However, if a consumer clicks on the ad reproduced below and requests more information, the consumer receives an email from a debt agreement administrator. The advertisement (which appeared on Facebook) doesn't identify the debt agreement administrator, but wrongly claims that the debt management program time limited and limited to 950 applications.



The proposals in the Options Paper will do nothing to fix the known and ongoing problems with poor quality advice on debt and insolvency options by debt management firms, some administrators and even some bankruptcy trustees. Examples of problems we see, detailed throughout this submission, include:

- people being misled about the impacts of a debt agreement on their creditworthiness – even where breaches of the ASIC Act prohibition against misleading and deceptive conduct are found by the Australian Financial Complaints Authority, it has no power to require removal of the listing on the National Personal Insolvency Index, meaning the person unfairly carries to negative consequences of the administrator's misconduct for years;
- other debt options (that don't earn the firm any fees) being downplayed;
- grossly negligent advice to bankrupt when not in the client's best interests, leading to people losing their homes or assets;
- a failure to advise people that they won't be released from tax debts in bankruptcy, despite the tax debt being the primary issue;
- poor or non-existent approaches to vulnerability, particularly in the case of family violence;

- inappropriate and misleading advertising; and
- encouraging debtors to access their super or borrow money from friends and family to enable them to make otherwise unaffordable debt agreement payments.

RECOMMENDATION 12. AFSA should actively 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.

Charging fees to 'assist' with bankruptcy

Finally, there is a known problem with certain regulated firms charging exorbitant fees for inappropriate pre-bankruptcy advice. For example, 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.

Even where bankruptcy is a good option, $2000 is an outrageous amount to pay a firm to simply fill in bankruptcy forms – something the person could do themselves, or that a financial counsellor can assist with for free. Typically, the fees are collected over a period before the forms are filed, which keeps the person in a state of stress and exposed to debt collector harassment.

RECOMMENDATION 13. 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.

Contact Details

We would welcome the opportunity to discuss the issues in the submission further. Please contact Senior Policy Officer Cat Newton at Consumer Action Law Centre on 03 9670 5088 or at cat@consumeraction.org.au if you have any questions about this submission.