Joint submission by the
Financial Rights Legal Centre
Consumer Action Law Centre
Financial Counselling Australia

Attorney General's Department

Review of the bankruptcy threshold

21 August 2020

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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 and advocacy. Working in not-for-profit community organisations, financial counselling services are free, independent and confidential.

Introduction

Thank you for the opportunity to participate in this targeted consultation regarding the bankruptcy threshold. This is a joint submission by the Financial Rights Legal Centre (**Financial Rights**), Consumer Action Law Centre and Financial Counselling Australia. This will address each of the Discussion Questions posed by the Department.

Overarching comments regarding the bankruptcy threshold

Bankruptcy should be the last resort, not the first, when it comes to debt enforcement. We strongly support raising the threshold to protect low-income debtors from the harsh consequences of creditors pursuing bankruptcy over small debts that cannot be paid.

The existing threshold of $5,000 is far too low. This means a $5,000 debt from a credit card, small business supplier payment or overdue strata levy could lead to the loss of the family home. Being forced into bankruptcy by a debt collector, bank or other creditor, can have severe and unfair consequences, including relationship conflict and breakdown, deterioration of mental health and homelessness. It involves highly stressful court proceedings, with tens of thousands of dollars in legal and trustees' fees added to the debt in the process. Unnecessary bankruptcies over small debts do not benefit families, creditors or the broader community.

There is widespread support from industry for a higher bankruptcy threshold. Public statements have been made supporting raising the threshold from the Australian Banking Association as well as prominent debt collection companies and insolvency practitioners.[1] There also could not be a more important time to make these reforms as consumer advocates as well as insolvency practitioners are forecasting a surge in financial hardship when the Government income support payments potentially conclude at the end of 2020 – at the same time that many lenders will be looking to get repayments on deferred loans back on track.

In total, from 1st March to the end of July, the NDH has received 48,277 calls. Those numbers should be taken in the context that there has been a fall in the number of calls to the NDH. Nationally, calls to the NDH fell almost 20 per cent between mid-March to mid-April. Our services believe this is because many of the people who we normally hear from – people who spend a lot of their lives dealing with financial hardship – may be in an improved financial position temporarily. This is largely due to Government intervention, support payments, loan payment deferrals and temporary changes to the *Bankruptcy Act*. In fact, comparing calls before and after the 25 March 2020 temporary lift in the threshold to the National Debt Helpline in Sydney, calls about bankruptcy notices fell by 77% and calls about creditor's petitions fell by about 35%, When those support measures cease, we expect the NDH to start getting a flood of calls again.

[1] Industry support is laid out in more detail in the letter sent by consumer advocates to the Attorney General's Department in July 2020 (attached).

For some people in financial distress, filing for bankruptcy will be their best option. For everyone else, they should be given a fair opportunity to make repayment arrangements with their creditors. If the threshold reverts to its pre-pandemic level, there may be a tsunami of financially distressed people forced into bankruptcy at the end of this year and into 2021 for debts as small as $5,000. This would be a very poor outcome for those particular debtors and their families, but would also have flow on effects for the broader economic recovery. There is also the real risk of overwhelming the court system. While there may have been a slowdown in insolvencies during the Covid-19 period so far, this is likely to be followed by increased levels of insolvencies placing strain on court resources, unless systemic reform including an increased bankruptcy threshold is adopted.

Discussion Questions

Question 1: Should the bankruptcy threshold of $5000 be increased?

Yes, absolutely. Consumer groups strongly believe the threshold should be increased for all of the same reasons it has been increased in the past as detailed in the discussion paper, particularly:

- the increase in levels of personal debt since 2010; and
- to discourage bankruptcy action over small debts, as a means of intimidation and harassment.

However, we would also add:

- the punitive and disproportionate impact of bankruptcy when used to enforce small debts; and
- the economic fallout from the coronavirus pandemic.

Consumer groups have strongly advocated for raising the bankruptcy threshold for some time and our arguments have been thoroughly prosecuted in both the report we released in mid-2019: *Who is making Australians bankrupt?* as well as in the joint letter sent to the Attorney General's Department on 21 July 2020 (both are attached to this submission).

Increasing levels of personal debt

Between June 2010 and June 2020 household debt in Australia has grown from $1,263 billion to $1,996 billion.[2] The increase of $733 billion (58%) is made of up $413 billion (54% increase) in owner occupier housing debt, $305 billion (84% increase) in investor housing debt and $15 billion in personal debt (11% increase).[3] While personal debt may appear the most relevant to the bankruptcy threshold, in our experience it is overall debt which dictates financial stress, with many households both taking on additional personal debt, and struggling to pay it, as a result of mortgage debt stress. Many households also refinance personal debt into their home loans, sometimes on numerous occasions, thus driving down personal debt balances and driving up housing debt.

Throughout this period, income growth has stagnated, resulting in a debt to income ratio of 200%, one of the highest in the world. According to the Reserve Bank of Australia (**RBA**), in 2019 the household debt-to-income ratio was at its highest in Australian history:

> *The household debt-to-income ratio rose from around 70 per cent at the beginning of the 1990s to around 160 per cent at the time of the GFC. The ratio steadied for a few years before*

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[2] Reserve bank of Australia, Statistical Tables, Lending and Credit Aggregates - D2, seasonally adjusted figures, available at https://www.rba.gov.au/statistics/tables/

[3] as above

> *starting to rise again around 2013 (around the same time that housing price growth began to accelerate) and is now around 190 per cent.*[4]

ABS data shows that between 2003/04 and 2015/16, debt growth (79%) outpaced both income (38%) and asset growth (51%) and drove up over-indebtedness from 21% to 29%.[5] While the ABS notes that most debt is held by higher income earners, our experience providing debt advice shows that many people who were formerly high income earners are no longer in that category as a result of illness, accident, unemployment or retirement and yet they carry large debts with them that they can no longer service. As the economy reels from the impact of the current public health restrictions as a result of the global pandemic, this transition will be felt by more Australians than possibly ever in our recent history.

Punitive and disproportionate impact of using bankruptcy to pursue small debts

The punitive effect of bankruptcy on debtors with small debts is disproportionate and causes more harm than it solves. Further it is unnecessary to protect the interests of creditors. As outlined in our report attached, bankruptcy proceedings against people with small debts results in disproportionate harm to the debtor, because:

- they are usually forced to sell their homes;
- they face all the restrictions and personal ignominy of bankruptcy; and
- even if they are able to annul the bankruptcy, it can cost tens of thousands of dollars in legal and trustee's fees. For a debt close to the threshold amount of $5,000, this can be 8-10 times the size of the original debt. For a debt of twice the current threshold this is still 4 or 5 times as high as the debt itself.

There are also disadvantages for the wider community:

- Creditors who are being paid on time, or who have accepted a sensible compromise, may be disadvantaged if another credit provider forces the debtor into bankruptcy and the assets available are insufficient to cover all the debts, especially after the addition of legal and trustee fees;
- Homelessness can become a broader problem for the government and community, when the person who was bankrupted cannot afford to secure a suitable rental property.

A number of clients we have assisted over the years in relation to involuntary bankruptcy have been either retired, or forced to retire early as a result of illness or disability, and their home was a crucial lynchpin in their plan to maintain a satisfactory standard of living in retirement.

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[4] Michele Bullock, 20 March 2019, Speech: *Property*, *Debt and Financial Stability*. Assistant Governor (Financial System), https://www.rba.gov.au/speeches/2019/sp-ag-2019-03-20.html

[5] ABS, 6523.0 - Household Income and Wealth, Australia, 2015-16, https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/6523.0~2015-16~Feature%20Article~Household%20Debt%20and%20Over-indebtedness%20(Feature%20Article)~101

There are other enforcement options available to creditors to enforce a judgment through the civil courts, as outlined in the attached report. Further, in our experience, many debtors are willing to make reasonable repayment offers, or compromise arrangements, that would result in a significant proportion of all creditor's debt being paid. In some cases people have paid the debt and it is the legal fees alone that drive them into bankruptcy: see cases studies in the attached letter and Sam's story (Attachment 2, page 18) .

Case study –Adam's story

In August 2020 Adam called Financial Rights for advice about a creditor's petition hearing that was later that day. Adam owns a home jointly with his wife and there is about $170,000 of equity in the property (assuming it could be sold for a fair price in the current market). Adam currently has two unsecured debts which are each about $30,000. One of the creditors has been working with Adam to work out a repayment arrangement, but the other creditor refuses to negotiate and they have filed the creditor's petition against him. Adam has recently withdrawn $15,000 from his super which is sitting in his bank account, but the second creditor is still not willing to negotiate with him. Adam is suffering from mental health problems. He has tried several times to make offers of payment to his creditor but they will not engage and they just insist on continuing with the bankruptcy proceedings. Adam's debts will increase dramatically once trustees fees are added, and he will be forced to sell his family's home.

Source: Financial Rights C207648

The use of bankruptcy as a debt collection tool

While most creditors obtain a judgment because it is the surest way to establish an act of bankruptcy on which to found a creditor's petition, many do not use the other enforcement mechanisms available to them through the courts before proceeding to bankruptcy. This is because the threat of bankruptcy is a very effective mechanism for demanding payment, and often serves to put the interest of the creditor making the threat above all others.

The statistics in the discussion paper show that 50% of bankruptcy notices are settled without further action being necessary. Of the 4,000 creditor petitions, only 25%-50% result in bankruptcy. It is clear that in a significant number of cases, this is simply a very effective debt collection mechanism. Indeed, prior to the release of our report last year, the best advice that could be given to debtors of Collection House/Lion Finance was to pay them above all other creditors because it was well known that they would not hesitate to push debtors into bankruptcy – a very effective result for them but achieved at the expense of all other creditors competing for a share of what may be a very limited income or asset pool.

The changing value of money

The Discussion Paper acknowledges the changing value of money, but suggests this aspect alone would only warrant an increase to just below $7,000. We consider there are other more compelling policy reasons to raise the threshold higher than this inappropriately low level as outlined in this submission. However, we note that once a new threshold is determined, it would be beneficial to benchmark it to ensure it regularly increases going forward.

A much more relevant index than the changing value of money when setting the bankruptcy threshold, is the level of personal debt in the community.

The changing value of money is calculated by reference to the inflation rate, which is the change in the value of a basket of goods as measured by the Australian Bureau of Statistics. This tells you what it would cost to buy the same things at different time periods. While this may measure the cost of living, it does not take into account the significant changes in household debt and housing assets. For example, on the whole Australians who have purchased housing assets have seen them increase in value far in excess of the inflation rate. As set out above, Australia also has record levels of household debt. These are more relevant measures of an appropriate threshold.

The impact of the coronavirus pandemic on the economy

On 24 March 2020, the threshold was temporarily raised to $20,000 to 'avoid unnecessary bankruptcies' due to the economic impacts of coronavirus, which could see numerous individuals at risk of bankruptcy. We have publicly supported this step and believe it has been successful in preventing unnecessary bankruptcies to date. Comparing calls before and after the 25 March 2020 temporary lift in the threshold to the National Debt Helpline in Sydney, calls about bankruptcy notices fell by 77% and calls about creditor's petitions fell by about 35%, with a number of the calls in relation to creditors petitions we did receive pertaining to proceedings which had commenced prior to the changes coming into effect and working their way through the court system. However, it is impossible to say to what extent these decreases were due to the bankruptcy reforms and to what extent they were due to forbearance measures also taken by credit providers in response to the pandemic. What is clear, however, is that these economic impacts are not about to cease in late September 2020.

Economic conditions in Australia are as bad as they have been for almost a century. The Reserve Bank has stated that the shock to the Australian economy is the most severe since the 1930s.[6] The economy shrank 0.3% in the March quarter[7] and RBA estimates a decline in GDP of around 7 per cent and a contraction in hours worked of around 10 per cent.[8]

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[6] RBA, Minutes of the Monetary Policy Meeting of the Reserve Bank Board https://www.rba.gov.au/monetary-policy/rba-board-minutes/2020/2020-08-04.html

[7] Michael Janda, ABC, Australia in its first recession in 29 years as March quarter GDP shrinks, 3 June 2020 https://www.abc.net.au/news/2020-06-03/australian-economy-gdp-recession-march-quarter-2020/12315140

[8] As above

The unemployment rate has now reached 7.5% - more than one million Australians – a figure that has yet to take into account the impact of the second stage four lockdown in Victoria.[9]

In a recent survey – the Small Business Commissioner NSW found that only 31% of business are confident about their business prospects over the next 12 months, while 44% are extremely or fairly worried.[10] For 66% of respondents, cash flow remains the greatest challenge to survival and the majority expect it will take over a year for revenue to return to pre-Covid-19 levels, if at all.[11] The August Sensis Business Index (SBI) has found that 26% of SMEs have been knocked back over May, June, July 2020.

The Consumer Policy Research Centre's survey of consumers[12] found that:

- Almost half of Australians (49%) are taking steps to manage their household expenses including dipping into savings (28%) and using credit cards or buy-now-pay-later services (22%)
- More than 1 in 4 Australians are worried about their ability to pay rent, mortgage repayments and energy bills
- Consumers are most concerned about their ability to manage housing costs – with 37% concerned about paying rent and 27% concerned about meeting mortgage payments

There were many reasons to increase the bankruptcy threshold when we released our report in July 2019. Since then, economic conditions have deteriorated significantly and all public policy is pivoting towards trying to chart an orderly way forward. Returning to a $5,000 bankruptcy threshold would not be consistent with these efforts, leaving individuals and small business operators highly vulnerable to individual low value creditors who aggressively pursue their full legal rights regardless of the economic reality and the obvious need for give and take on all sides. A large scale increase in bankruptcies will not assist our economic recovery nor improve business or consumer confidence. Last year increasing the threshold would have been good public policy. This year it is essential.

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[9] ABS, 6202.0 - Labour Force, Australia, Jul 2020, https://www.abs.gov.au/ausstats/abs@.nsf/mf/6202.0#:~:text=Full%2Dtime%20employment%20increased%2043%2C500,decreased%200.5%20pts%20to%2011.2%25.

[10] Small Business Commissioner, NSW Small Business COVID-19 Survey Wave 3 – Full Report, May 20, 2020

[11] As above

[12] CPRC, COVID-19 and Consumers: from crisis to recovery, June 2020, https://cprc.org.au/wp-content/uploads/Consumers-and-COVID-19_full-report_25June2020_compressed.pdf

Question 2: If the bankruptcy threshold is increased, to what amount should it be increased and why?

The threshold for a creditor's petition should be increased to $50,000. This increase is long overdue and would finally achieve the policy position that bankruptcy should be a last resort for debt enforcement and is a more realistic figure given the level of debt in the community.

According to the figures quoted in the Discussion Paper, raising the threshold to $50,000 would reduce Creditors Petitions by about 50% (based on 2018/2019 data). Creditors would still be free to pursue those debtors via alternative enforcement mechanisms. Some of those debtors might ultimately decide to sell their homes to pay their debts, or in rare cases even enter voluntary bankruptcy, but on their own terms and with significantly less additional costs. In many cases debtors will negotiate a reasonable compromise and pay off all or a significant proportion of their debts over time.

As noted above, household debt to income is extremely high. It is also our experience that personal debt is not distributed equally, with a significant minority of people holding far larger debt balances than national averages would suggest. For example, data supplied by Way Forward Debt Solutions,[13] a not-for-profit debt management firm which has been operating in pilot mode since 2018, reports that of its 241 clients under management, the average amount of unsecured debt owed at the point of seeking assistance was $55,160. The average single debt size was $11,201 but this is somewhat skewed by a number of very small utility debts. When split into quartiles, the average debt size of the group in the top 25% clients by amount owed was $19,657. This accords with our experience advising consumers, who regularly report debts of between $5,000 and $35,000, and sometimes higher. Aggregate personal debts are often in the tens of thousands with some callers having an excess of $100,000 in personal debt.

Case study – Madeleine's story

Madeleine, who called the National Debt Helpline in August 2020, reported having a credit card debt to a major bank of $49,000. She is in her seventies and retired. She has held the card for 25 years but can no longer keep up with the payments. She has likely paid many thousands of dollars in interest over the life of the debt. She owns her home with a small mortgage.

Source: Financial Rights C208388

[13] Way Forward Debt Solutions is a not-for-profit debt management company with an Australian Credit License and an Australian Financial Services License. It has a board with an equal number of consumer and industry representatives, with an independent chair. It assists people who are struggling financially to make arrangements with their creditors, and administers those arrangements. It does not offer formal insolvency options such as debt agreements, personal insolvency agreements or bankruptcy. More information can be found at https://wayforward.org.au/about-us/. Data provided by David Berry, CEO.

The impact of legal fees on the threshold

The creditor's petition process alone involves the addition of significant legal fees. Many debtors who seek advice from our services can pay, or indeed have paid, the original debt but cannot afford the legal fees that have since been added. For example, in Cameron's story in the attached letter (Attachment 1, Page 4), his original debt was $6,000 in unpaid strata levies. He paid over $10,000 to settle the debt and legal fees, but was then told it would cost another $6,000 in legal fees to prevent a sequestration order being made. Similarly, Sheree, a small business owner had paid down her $27,000 debt to $4,000 when an aggressive solicitor collecting for a supplier added another $16,000 in legal fees and proceeded to issue a creditor's petition (Attachment 1, Pages 4-5)

Accordingly, there should be a significant buffer included in the threshold so that creditors cannot meet the threshold by the additional of legal fees alone. If single consumer debts for consumption are often as high as $30-$35,000, then a buffer of $15,000 for legal fees is reasonable.

Although outside the scope of this consultation, for the record, we note that in our report *Who is Making Australians Bankrupt*, we argued that reform was needed in relation to review processes for trustee fees and there needs to be better processes for the review of legal costs for debtors.

Pursuing small debts via the bankruptcy system

It has been raised by some stakeholders that small debts are rarely pursued through the bankruptcy process because it is simply not commercial to do so. This commercial reality supports a higher threshold without detrimental impacts for most creditors. While many creditors are acting commercially and fairly, it is clear from our report and the statistics in the Discussion Paper that some creditors are not. In 2018/19, 121 creditor's petitions resulted in sequestration orders for debts of between $5,000 and $9,999.[14] 387 sequestration orders resulted from debts of less than $20,000, and 660 in total for debts under $50,000.[15] For all of these sequestration orders there were likely double the number of creditor's petitions issues and double that again for bankruptcy notices. Clearly commercial considerations are insufficient to prevent all unnecessary and punitive bankruptcy action, and the threshold is a far more potentially effective mechanism.

In June 2020, at the Personal Insolvency Stakeholder Forum (which was attended by AGD's personnel) representatives from the Australian Restructuring Insolvency and Turnaround Association (**ARITA**) voiced their support for maintaining the higher threshold. They commented that the temporarily increased threshold during Covid-19 was not making a significant difference on insolvency practices, and that there would probably not be a big push back from insolvency practitioners if that increase was maintained.

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[14] Page 7, AGD, Review of the bankruptcy threshold Discussion Paper, Attachment B: Involuntary bankruptcy data

[15] As above

Question 3: Are there other approaches (e.g. administrative or legislative) to address concerns that the threshold enables the excessive use of bankruptcy proceedings to recover relatively small debts?

There are no alternative approaches to raising the threshold which will have the same widespread and permanent protection for consumers from the excessive use of bankruptcy proceedings to recover relatively small debts.

For example, after our report was released, the ABA issued new industry guidelines to be applied by Australia's banks to debt collection agencies to protect vulnerable customers, but those guidelines do not cover strata corporations, accrued legal fees or small business debts. An industry-led approach, while commendable, will never protect debtors from all types of aggressive creditors. In our experience as consumer representatives we have found that strata corporations are some of the most egregious users of the low bankruptcy threshold.

When considering any alternative legislative or administrative approaches, our organisations have argued for the Federal Court to be specifically empowered to refuse a sequestration order if:

- the debt is small;
- there are reasonable prospects for payment in the short term (under three years);
- the only significant asset of the debtor is the family home; and/or
- other enforcement options have not been utilised.

While we still believe those reforms will reinforce the public policy position that bankruptcy should be a last resort for debt enforcement, they will not stop the problem of debtor intimidation and harassment. As noted in the discussion paper, only 50% of bankruptcy notices result in creditor's petitions, and 25%-50% of creditors petitions settle before the court could apply these measures. As long as the bankruptcy threshold remains low creditors will be able to threaten debtors with bankruptcy, even if the court was empowered to refuse the sequestration order.

Furthermore, even a creditor's petition dismissed by the Federal Court can have harsh and long-term impacts on a person's ability to obtain credit in future.

Question 4: What are the possible consequences (unintended or adverse) of increasing the bankruptcy threshold?

The following addresses the most common concerns with increasing the threshold.

Debtor's running up multiple debts below the threshold

This argument that "unscrupulous debtors to run up debts … with multiple creditors"[16] has no validity because under the *Bankruptcy Act 1966* creditors may join together to petition for a debtor to be made bankrupt: section 44(1)(a). Similarly, one or more creditors may be substituted into the proceedings where the original creditor is not prosecuting the matter with due diligence or the court considers it appropriate to do so: section 49. This could include the scenario where the debt to the original petitioning creditor has been brought under the relevant threshold but the combined debt to the new creditor or creditors is sufficient to reach the threshold. Furthermore consumers acting in the way is unlikely for similar reasons outlined below with respect to the assertion that a higher threshold introduces a moral hazard, people don't know what the threshold is and don't make decisions based on it. To suggest otherwise goes against all we know about consumer behaviour.

It is worth unpacking the unscrupulous debtor argument in a logical way. It is our experience in assisting tens of thousands of Australians each year struggling with debt that people do not go into debt in the hope that they might not have to repay it. In fact it is the opposite – so many of clients go to extraordinary lengths to repay their debts.

Moral hazard

The argument that a higher threshold introduces a moral hazard where there is "the possibility that legal protection from risk leads to abuse and reckless behaviour by a company or person"[17] does not reflect reality. People generally don't have an awareness of the bankruptcy threshold or its implications and certainly do not arrange their affairs based on these factors. As noted above, many people have personal debts far in excess of the current bankruptcy threshold; it has no bearing whatsoever on borrowing behaviour.

People's willingness to pay debt is also largely dependent on their capacity to pay, or their perception of the legitimacy of the fairness of the debt, rather their perception of available creditor remedies. Further, taking away bankruptcy as an option for smaller debts does not leave creditors without recourse as there are other enforcement options available.

Small to Medium Enterprise creditors

As for any potential adverse impacts an increased threshold can have on creditors, especially Small to Medium Enterprise (**SME**) creditors, in our experience small businesses are just as likely to be at the receiving end of a creditor's petition as on the issuing end, and would benefit from

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[16] Page 4, AGD, Review of the bankruptcy threshold Discussion Paper

[17] As above

an increase in the threshold to give them some breathing space from aggressive creditors: see Sheree's story, Attachment 1, Pages 4-5. The most frequent users of the creditor petition process include the Australian Tax Office (**ATO**), owner's corporations pursuing strata levies, and professional debt collectors rather than SMEs. While 21% of creditor's petitions in the period covered in our report were initiated by "suppliers or companies," more information would be required to determine how many of these could be classified as SMEs and how many of the recipients of these petitions were actually individual operators of SMEs. Further, as with other creditors, SMEs would not be left without other enforcement options.

Reliance on court orders and depletion of the asset pool

The argument that the use of debt enforcement processes outside of bankruptcy proceedings will deplete the asset pool to the detriment of other creditors glosses over the fact that the large majority of creditors who issue bankruptcy notices are paid before they ever get as far as a sequestration order. This has exactly the same effect as if they had pursued other enforcement options through the courts – that is, that this creditor is paid at the potential expense of others.

However, successfully using bankruptcy proceedings to enforce a small debt will unquestionably result in a reduction in the asset pool because of the addition of trustee's fees. In our experience there is either plenty of assets to go around because the debtor has a house that can be sold and other enforcement mechanisms would have been just as effective, or there is insufficient money to go around and therefore trustee fees will deplete the pool.

As AFSA reports in its recent remuneration report:

> *Registered Trustees (RT) are highly skilled practitioners who are entitled to be fairly paid for the work they perform in administering the estate and reimbursed for out-of-pocket costs. Generally, the only sources of funds for their remuneration are the funds from sale of assets or other property recovered by the registered trustee and from income contributions from the minority of bankrupts on relatively high incomes. Registered trustees necessarily have a priority over those funds for their remuneration before the funds are available for creditors.* [18]

In 2018-19, of the $230.35 million distributed by registered trustees, 32.2 % was paid in dividends to creditors while 40% was paid in practitioner remuneration.[19]

For this reason, it is far more appropriate that reasonable negotiations, backed up by other court enforcement mechanisms are used for smaller debts.

A number of the case studies included in our report and accompanying letter also reveal that creditor's petitions are issued where these are no other creditors, or only creditors who are owed very small amounts, such as to phone or utility providers that the debtor could otherwise comfortably pay. The only person who suffers in these circumstances is the debtor: see Lynda's case (Attachment 2, Page 17) and Mary's case (Attachment 2, Page 23).

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[18] Page 5, AFSA, Registered Trustee Remuneration in the Personal Insolvency System: Best Practice Report 2020, https://www.afsa.gov.au/sites/default/files/afsa_remuneration_report.pdf

[19] Page 8, AFSA, Registered Trustee Remuneration in the Personal Insolvency System

Question 5: If the bankruptcy threshold is increased, should this occur immediately or should there be a delay before it takes effect?

Immediately. There is no reason to delay the increase considering it has been temporarily raised since March 2020, and the poor economic conditions are continuing to impact millions of Australians. As discussed above, it would be particularly problematic to lower it again.

Recommendation

1. **The bankruptcy threshold should be raised to $50,000.**

Other issues

Temporary debt protection initiative

We have some concerns about the Temporary Debt Protection (**TDP**) initiative. In particular, we consider the name misleading as it offers very little protection. While it does stop the Sheriff from seizing goods under a court order and stops the garnisheeing of wages or money from a person's bank account, it is an 'act of bankruptcy'. Creditors can use this act of bankruptcy to make the person bankrupt without needing to obtain a court judgment or issue a bankruptcy notice. Creditors can also conduct debt collection activities, including demanding repayment and starting fresh legal proceedings in court (and get a court judgment) despite the temporary debt protection.

In many cases, debtors would be better off negotiating with their creditors directly and avoiding this formal step, particularly at a time when creditors are offering forbearance. We recommend:

- a review as to whether the name change to TDP from "Debtors Intent to file a debtors petition" has caused unintended confusion, and led to inappropriate lodgements from people with assets and/or who could have pursued less high risk options;
- that if TDP continues, that the name be changed.

We note that for those few debtors for whom a TDP may be appropriate, 21 days is a very short timeframe in which to seek advice and take appropriate action. We therefore also recommend a review of the time period for the TDP to determine the most appropriate timeframe going forward. It is important to strike the right balance between the rights of the parties, and to ensure that debtors are not induced into entering a TDP when they have a better option, or simply to delay the inevitable when they could be serving out their bankruptcy period. A further extension of the 6-month timeframe may be appropriate to allow this review to take place, especially given the high likelihood that the effects of the pandemic will continue well beyond the end of September 2020.

Modernisation of the Bankruptcy Act

There has not been a comprehensive review of the *Bankruptcy Act* in decades. There are many provisions that are out-of-date, operate harshly on families (including certain NPII listings and some offence provisions) and do not account for the current interaction of the bankruptcy regime with the emerging debt management sector and developments in credit law and dispute resolution (such as the establishment of AFCA). In light of the significant changes, a comprehensive review of the entire Act and the Regulations is well overdue. An independent expert panel could be established to consult appropriately and identify areas of the Act and Regulations for review and modernisation. This would ensure we have a fit-for-purpose bankruptcy regime, particularly during a period likely to see a rise in personal insolvency.

The sections below comment on some of the problems with the Act and Regulations that need urgent review.

Process and duration of NPII listings

The process and timeframes for listings on the National Personal Insolvency Index (**NPII**) can cause unfairness and should be amended. Below are two issues that should be amended as part of this review.

Creditor's Petitions dismissed by the Court

Many creditor's petitions are ultimately dismissed by the Federal Court. Despite this, a permanent listing will remain on the publicly available National Personal Insolvency Index (**NPII**). This is because, unfortunately, Reg 13.03(1)(a) of the Bankruptcy Regulations makes clear that a creditor's petition is to be listed on the NPII, even if a sequestration order is not made.

For example, Consumer Action has been contacted by a person who reported that he found out he was on the NPII after applying for finance. He told us that he paid a $17,000 credit card debt in full and the creditor's petition was dismissed.

For people in this circumstance, the creditor's petition will remain on the NPII for life, and will likely impair their ability to obtain further credit – and all for a debt that was ultimately paid. This provision operates harshly particularly where the delay in repayment was due to mental health issues, family breakdown, or other difficult circumstances, or where the underlying small debt was due to irresponsible lending, or there was no basis for the creditor's petition.

The duration of such listings should be reduced. At the very least, there should be a discretion for the Official Receiver to remove NPII listings in these circumstances.

AFCA determinations on misconduct by 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,[20] registered Debt Agreement Administrators are due to become required to join an external dispute resolution scheme, like the Australian Financial Complaints Authority (**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. Some RDAAs are already members. 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

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

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, inaccessible, 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.[21] AFCA found, among other breaches of the law,[22] 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.[23]

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'.[24]

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.

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

[22] 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.'

[23] Ibid p 1.

[24] Ibid p 2.

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 their 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

2. **There should be a review as to whether the name change to Temporary Debt Protection (TDP) from "Debtor's Intent to file a debtor's petition" has caused unintended confusion and/or led to inappropriate lodgements from those debtors with assets who could have pursued high risk options.**
3. **There should be a review of the time period for the TDP to determine the most appropriate timeframe going forward.**
4. **If the TDP continues, that the name be changed.**
5. **Appoint an independent expert panel to review the Bankruptcy Act and Regulations.**
6. **Amend the Bankruptcy Regulations to empower the Official Receiver to amend the NPII:**
    a) **to give affect to AFCA determinations and**
    b) **in other circumstances causing unfairness, such as dismissed creditor's petitions.**
7. **Amend the Bankruptcy Allow to allow bankrupts to keep awards of compensation from AFCA.**

Concluding Remarks

Thank you again for the opportunity to comment. If you have any questions or concerns regarding this submission please do not hesitate to contact Financial Rights Julia Davis, Policy and Communications Officer at julia.davis@financialrights.org.au on (02) 8204 1384.

Kind Regards,

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