JOINT SUBMISSION FROM THE FINANCIAL COUNSELLING SECTOR

Attorney-General's Department

Consultation on the bankruptcy system – options paper

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About Financial Counselling and the Financial Counselling Sector

Financial counsellors provide advice and support to people experiencing financial difficulty. Working in community organisations, their services are free, confidential and independent.

This is a joint submission from the peak bodies in the financial counselling sector.

- Financial Counselling Australia
- Financial Counsellors ACT
- Financial Counsellors Association of NSW
- Financial Counsellors Association of Queensland
- Financial Counsellors Association of Tasmania
- Financial Counsellors Association of Western Australia
- Financial Counselling Victoria
- South Australian Financial Counsellors Association (also covering the NT)

Note about this submission

We refer in places to the "joint February 2021 submission". This reference is to the joint submission to the Attorney-General's Department Discussion Paper "The bankruptcy system and the impacts of coronavirus" from Financial Rights Legal Centre (the lead author), Consumer Action Legal Centre and Financial Counselling Australia.

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1 Reduce bankruptcy to one year

1.1 A one year default period will help people get back on their feet

We support a permanent reduction of the default period for bankruptcy to one year.

Financial counsellors work with a diverse spectrum of people – from individuals to small businesses – who will benefit from a shorter default period for bankruptcy. In our experience, people seeking financial counselling see bankruptcy as a last resort and will do whatever they can to avoid it. But for some people, with overwhelming debt, bankruptcy is a sensible option that does provide a fresh start.

A one-year bankruptcy will be particularly helpful for those impacted by the current pandemic, as well as those experiencing financial hardship for other reasons. This could be from, but is not limited to, an unexpected health crisis, a reduction in income, separation, family violence or a natural disaster. The pandemic has shown that financial hardship can strike at any time and impact anyone, particularly those without stable or liveable incomes or an asset base that may provide a financial buffer.

A reduction to one year strikes a fair balance between the interests of creditors and allowing debtors to get back on their feet. For creditors, they will retain their right to claim on the bankrupt's estate, and a bankrupt trustee's statutory powers to recover vested assets and voidable transactions will still be available. AFSA also noted in 2018 that a reduced default period would not affect the continued administration of an estate after discharge.[1]

For debtors, the shorter default period will be less punitive than at present, while still providing a reasonable timeframe for people to get their finances in order, allowing them to exit bankruptcy in a more financially resilient position. It will also help alleviate the wider toll of bankruptcy on debtor's lives. The 2016 University of Melbourne study "Bankruptcy and Debtor Rehabilitation" found that bankruptcy can play a key role in improving overall wellbeing: "for many Australian debtors, bankruptcy results in genuine improvements to financial stability, health, relationships and general well-being".[2]

In supporting a shorter default period for bankruptcy, we also note the feedback from some financial counsellors that specialise in helping people affected by gambling. They report that gambling cases are complex by nature and often it takes longer than one year for debtors like this to get back on their feet. They say that a longer time period can act as a circuit breaker for

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[1] https://www.afsa.gov.au/about-us/agency-overview/law-reforms/bankruptcy-amendment-debt-agreement-reform-bill-2018/bankruptcy-amendment-debt-agreement-reform-act-2018-badar-frequently-asked-questions

[2] Ali, O'Brien & Ramsay, 2016, "Bankruptcy And Debtor Rehabilitation: An Australian Empirical Study, Melbourne University Law Review, Vol40:688;pp688 737.https://law.unimelb.edu.au/__data/assets/pdf_file/0009/2494269/01-Ali,-OBrien-and-Ramsay.pdf

people with gambling addictions as it means they cannot access any “excess” money to gamble. Another way to address this problem however is to recognise that more intensive support outside of the bankruptcy system is needed, including gambling addiction support.

1.2 A reduction must go hand in hand with changes to credit reporting and NPII

Designing a bankruptcy system that reduces stigma and fosters entrepreneurship cannot be achieved by a shorter one-year default period alone, as future creditors will always look at a borrower’s credit report before lending.

If the default period is reduced, it is important that the rules surrounding credit reporting are harmonised. Currently, bankruptcy is retained on a person’s credit report for two years from the date of discharge or five years from the date of bankruptcy - a minimum of five years. If the bankruptcy period is reduced by two years, then the reporting period of bankruptcy on credit report should also be reduced by two years.

The recording of bankruptcy on a credit file can cause significant and tangible challenges in a person’s life. In Tasmania for example, it can stop people from being able to obtain a rental property. In that State, real estate agents commonly ask for a copy of a person’s credit report. If it shows a bankruptcy, people are unlikely to get access to housing. In the current housing market, where Hobart has the tightest rental market in the country with a 0.9% rental vacancy rate, it can mean the difference between someone having a home or not.[3] Access to adequate housing is a human right and bankruptcy should not take this away. There have also been cases where utility providers refused connections because of default listing in their credit report.

In addition, the lifetime reporting of bankruptcy on the National Personal Insolvency Index (NPII) is a significant contributor to the stigma of bankruptcy, resulting in bankruptcy following debtors for the rest of their life. The purpose of the bankruptcy system should be to strike a fair balance between addressing creditor interests and giving debtors a chance to rebuild their financial wellbeing from scratch. The act of going into bankruptcy and its wider impact on finances, health, family and potentially employment, should be contained to a distinct period of a person's life. We would recommend that the reporting of most NPII listings for first bankruptcies be drastically reduced, with longer listings considered on a case-by-case basis for repeat bankrupts or in the case of egregious behaviour.

[3] Hobart's rental market is 'tightest' out of Australia's capitals and it may be getting worse, 16 February 2022, https://www.abc.net.au/news/2022-02-16/tas-hobart-rental-market-affordability-for-tenants/100833150

1.3 Action is needed to reign in unscrupulous advisors and improve access to financial counselling services

As noted in the joint February 2021 submission, we remain concerned about debtors being pushed into bankruptcy by debt management firms and unscrupulous debt advisors. Once bankrupt a debtor loses other options that may have been better for them, such as obtaining a debt waiver or disputing their loan as being unsuitable. They also take on the long-term impacts of bankruptcy, including the punitive lifelong NPII listing. This could be addressed by banning any fees for bankruptcy advice from unregulated service providers and making it compulsory for all bankruptcy administrators to refer debtors to speak with an accredited and non-profit financial counselling service to explore all options prior to proceeding with bankruptcy. This will ensure debtors are provided with impartial information, free from market incentives that may not benefit debtors.

1.4 Response to consultation questions

Consultation question	**Our response**
If the default period for bankruptcy is reduced to one year and this proposed exclusion applies, the government seeks stakeholder views on whether a repeat bankrupt that meets certain eligibility criteria (e.g. has satisfied all their tax obligations, has not engaged in voidable transactions, has been cooperative throughout the bankruptcy process etc.) should be able to apply for early discharge from a 2 year or 3-year bankruptcy after the first year.	If the Government implements a tiered system then we broadly support the ability to be discharged earlier. For repeat bankrupts, this provides incentives to get their financial affairs in order. Financial counsellors could also provide specific advice, such as supporting people to negotiate appropriate repayment arrangements with the ATO.
The government seeks stakeholder views on what offence provisions should exclude a bankrupt from one-year bankruptcy.	The proposed offence provisions strike a fair balance.
The government seeks stakeholder views on what current Bankruptcy Act offences could have penalties strengthened to target abuse of one-year bankruptcy.	Section 265 of the Bankruptcy Act already includes the potential for terms of imprisonment for a range of offences, including failing to disclose assets or contracting for a debt with no expectation to pay.

	There is no evidence in the options paper that increasing these penalties would improve compliance or act as an effective deterrent. If the Government is seeking to strengthen penalties, it is important that this is targeted to those that may be taking advantage of the system. Most debtors that financial counsellors see are people who have ended up in hardship out of their control. They are not rogue, reckless or repeat bankrupts. Sometimes they are experiencing poverty and have taken out loans to pay for food, accommodation, and other essential costs.

2 Promote debt agreements

2.1 We strongly oppose a five year debt agreement term

We are strongly opposed to the option to increase the term of debt agreements to five years. We note that this is contrary to the Government's 2018 reforms ('the reforms'), which were put in place just a few years ago.

Th reforms were intended, amongst other things, to make the debt agreement system more equitable. As noted in the Explanatory Memorandum to the *Bankruptcy Amendment (Debt Agreement Reform) Bill 2018* 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.*

The success of the reforms is reflected in the lower number of debt agreements. After just a few years in operation, the reforms are working as intended with feedback from financial counsellors confirming a drop in unsuitable debt agreements.

The fact that fewer people are entering into debt agreements is also likely to reflect broader trends in the economy. These include:

- vastly improved bank hardship practices, including earlier identification of people experiencing financial hardship;

- a sizeable portion of people were able to pay down debt during the pandemic.[4] This was also as a result of a number of factors, including the level of Job Seeker doubling for a period of time, access to Job Keeper, large numbers of people accessing their superannuation early and people during lockdowns being able to save more money.[5]

The rationale for increasing the term of debt agreements to five years appears to be simply that there are not enough of them. This is a woefully poor policy justification and seems to cast aside any assessment of whether debt agreements actually benefit people.

2.2 Debt agreements were not suitable for most debtors prior to the Reforms

The stated aim of "improving access to the debt agreement system" misses the fundamental point that more debt agreements will not help more people out of financial difficulty.

Debt agreements are only of benefit to a small group of people, such as those seeking to protect their home or whose occupation would be at risk because of bankruptcy.

The extensive research that informed the reforms illustrates why they were needed and why we must not walk them back. Prior to the reforms, 75% of people in a debt agreement did not have a home to protect.[6] An academic report based on AFSA's data found that between 2011-2016, 58-67% of people owned realizable assets of less than $5,000 at the time of entering a debt agreement, and only 5% to 7% owned realizable assets worth between $50,000 to $100,000.[7]

This data was reflected in the case work of financial counsellors, who prior to the reforms commonly saw debtors who had been cajoled and funnelled into debt agreements by administrators or aligned brokers who had a financial incentive to do so. Further research by

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[4] For example, in January 2020, credit card debt was $47 billion. By October 2021, it was $35 billion. See

[5] At the end of December 2019, the household savings ratio was 7%. It had hovered between 5% - 8% for the previous 10 years. In June 2020, the household savings ratio jumped to 23.6%, the highest level since this first started being measured in 1973. See ABS Australian National Accounts -
https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/latest-release

[6] Australian Government, Insolvency and Trustee Services Australia, Profile of Debtors 2011 (2012), 47-8, available at: https://www.afsa.gov.au/sites/default/files/profiles-of-debtors-2011.pdf?acsf_files_redirect

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

AFSA prior to the reforms, found that only 12% of people wanted a debt agreement from the start. Most wanted to manage or consolidate debts[8] and 77% of people only dealt with one company and had not considered other options for debt help. Once locked into a debt agreement, it was common for them to cost more in the long-term, when other alternatives including bankruptcy may have been a better option. This led to people entering unaffordable and unsuitable debt agreements. When people were unable to make repayments, they risked having their debt agreement terminated and being made bankrupt.

The reforms sought to address these inequities, in the spirit of protecting consumers. As noted by the then Attorney General, Christian Porter, in the Bill's second reading speech: "debt agreements should not be used to exploit vulnerable people". We agree and that is why the reforms need time to be embedded and continue doing as they are intended – to stop the exploitation of vulnerable people by selling debt agreements to people without assets to protect or at no risk to their occupation.

2.3 People don't need more debt agreements, they need access to impartial advice

People need access to impartial advice about all of their options for addressing unmanageable debt. AFSA's research showed that less than one fifth of advisors (17%) provided debtors with other informal options – such as seeking hardship with creditors.[9] The study also found that 67% of debtors believed they would have been better off approaching creditors for a hardship arrangement, as an alternative to a debt agreement.[10]

A lack of knowledge about free financial counselling services often leaves people relying on for-profit advice. AFSA's study found that two-thirds (62%) of people were not aware that they could access the services of a free financial counsellor.[11] A further 36% said they thought access to a financial counsellor might have made a difference to their situation:[12]

> *I think it would be great if you actually had to speak or contact the free financial counselling service first before you got stitched up with one of the debt reduction companies. When I think back to how I felt at the time I was broken. The company representation was ok but really, I should have had a financial advisor talk to me about information agreements with my creditors...I should have spoken to a free financial counsellor, but when you are wit's end and ashamed a person on the phone telling you*

[8] Where To, May 2017, 'Assessing the experiences of debtors and creditors with practitioners during the personal insolvency process – a market research report for the Australian Financial Security Authority', p4-5

[9] Where To, May 2017, 'Assessing the experiences of debtors and creditors with practitioners during the personal insolvency process – a market research report for the Australian Financial Security Authority', p7

[10] Where To, May 2017, 'Assessing the experiences of debtors and creditors with practitioners during the personal insolvency process – a market research report for the Australian Financial Security Authority', p7

[11] Where To, May 2017, 'Assessing the experiences of debtors and creditors with practitioners during the personal insolvency process – a market research report for the Australian Financial Security Authority', p9

[12] Where To, May 2017, 'Assessing the experiences of debtors and creditors with practitioners during the personal insolvency process – a market research report for the Australian Financial Security Authority', p9

things will be much better... seems like an easy end to the pain. This process needs regulation. I could have absolutely used independent help. Maybe if I was forced to do that first it would have negated my shame and guilt - Debtor[13]

2.4 We support debt agreements not being considered as "an act of bankruptcy"

We support the proposal for debt agreements to not be considered as "an act of bankruptcy". It is important that when people enter a debt agreement, they are given the space to pay down their debts without the risk of being forced into bankruptcy hanging over them at every step. Most people who are appropriately using debt agreements are not insolvent and should be able to get access to funds to make repayments, if given reasonable time to do so.

2.5 Response to consultation questions

Consultation question	**Our response**
The government seeks stakeholder views on whether the default term limit for debt agreements should be extended to 5 years	We strongly oppose this proposal. There is no justification for a longer time frame. This proposal walks back an important part of the Government's reforms that, in the words of the Attorney General at the time, sought to prohibit debt agreements "being used to exploit vulnerable people". This proposal has the potential to lock people in unaffordable and unsuitable debt agreements.
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 stakeholder views on what form this variation exception should take if the default term for debt agreements is extended to 5 years.	We strongly oppose the proposal to extend debt agreements to 5 years.

[13] Where To, May 2017, 'Assessing the experiences of debtors and creditors with practitioners during the personal insolvency process – a market research report for the Australian Financial Security Authority', p9

The government seeks stakeholder views on reducing the exclusion period for lodging a debt agreement proposal from 10 years to 7 years.	No comment
For debtors who have previously been party to a debt agreement only, the government also seeks 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)).	It would be concerning if someone needs a debt agreement within five years of their first, suggesting it may not have been appropriate in the first place. We do not support any outcome that would see people with low incomes stuck within the debt agreement system.

3 Targeting untrustworthy advisors

3.1 Overall response

We broadly support the proposals targeting untrustworthy advisors. It is important that action is taken against pre-insolvency advisors whose main purpose is to support high-worth people lessen the impact of insolvency.

Financial counsellors do not see this end of the debtor-spectrum but do see the poor quality of advice on debt and insolvency from debt management firms, some administrators and even some bankruptcy trustees. This poor advice can range from a lack of options being given outside of bankruptcy or debt agreements, through to a lack of support, or no support, around vulnerability.

We urge the Government to address the lack of quality and impartial advice, including through empowering AFSA to take strong action in the area of regulating insolvency practitioners.

3.2 Response to consultation questions

Consultation question	**Our response**
The government seeks stakeholder views on what other existing Bankruptcy Act offences should include an offence to advise, instruct,	We are broadly supportive. We encourage the Government to empower AFSA to take a more robust approach to regulating insolvency practitioners.

assist or counsel any person to commit or attempt to commit those offences.	