



**Review of Debt Agreements
under the *Bankruptcy Act 1966***

Submission re the October 2012 “Proposals Paper”

December 2012

Financial Counselling Australia (FCA) is the
peak body for financial counsellors in
Australia.

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ABOUT FINANCIAL COUNSELLING

Financial Counselling Australia

Financial Counselling Australia (FCA) is the peak body for financial counsellors in Australia. FCA's members are the financial counselling associations in each State and Territory. Each association elects one person to the FCA Board.

Financial Counselling

Financial counsellors assist consumers in financial difficulty. They provide information, support and advocacy to help consumers deal with their immediate financial situation and minimise the risk of future financial problems. The majority of financial counsellors work in community organisations, although some are employed by government. Their services are free, confidential and independent.

Financial counsellors have extensive knowledge in a range of areas: consumer credit law, debt enforcement practices, the bankruptcy regime, industry hardship policies, and government concession frameworks.

It is relatively common for financial counsellors to see clients who are considering, or who have entered into, a debt agreement. As the representative body for the sector FCA is well placed to comment on the proposals for reform of the debt agreement regime.

This submission was based on consultation with financial counsellors from around Australia.

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1. Overall Comments

1.1. Submission from the Consumer Action Law Centre

FCA supports the submission from the Consumer Action Law Centre (CALC) in relation to the Proposals Paper and specifically, CALC's recommendation that there be a minimum income amount as part of the eligibility requirements for a debt agreement. This threshold would be the same as the income amount before contributions are required from a debtor entering bankruptcy. This would provide a clear benchmark in relation to the affordability of a debt agreement and would reduce the number of inappropriate agreements.

The statistical analysis in the CALC submission is compelling. It is reproduced here to reinforce the rationale for a minimum income threshold.

"ITSA statistics indicate that 79 per cent of people entering debt agreements have less than \$5000 in realisable assets, 69 per cent have no assets at all, 80 per cent do not own or are not purchasing a home and 20 per cent have gross incomes less than \$30,000 per annum. This suggests that a significant proportion of people with debt agreements genuinely cannot afford to repay their debts without significant hardship and are at no risk of losing assets were they to petition for bankruptcy. These debtors have taken out debt agreements not because it was in their best interests but simply because there is more money for practitioners in administering debt agreements than there is in bankruptcies."¹

To allow for flexibility, the law could allow for a presumption of ineligibility (where a person's income was below the minimum threshold), but this could be a rebuttable presumption.

1.2 Debt Agreement Brokers

The Proposals Paper states that the 2007 amendments were enacted to address two key issues: a lack of confidence in the system from creditors and the high failure rate of agreements.

An equally important reason was the enormous detriment suffered by many consumers. The human cost of a "high failure rate" was that people in financial difficulty were left worse off - after having often paid high fees to a debt agreement administrator - only to find that they could not meet the ongoing commitment.

The 2007 amendments addressed some of these concerns by changing the ways that administrators could charge fees. These were appropriate changes.

¹ Consumer Action Law Centre submission to the Proposals Paper, 16 November 2012 (CALC footnotes removed).

However, the intent of the legislation is being circumvented by relatively new businesses that effectively act as debt agreement brokers. These companies refer consumers to debt agreement administrators, charging a fee to the consumer for the service. These fees are unregulated. In some cases, where a debt agreement does not go ahead, the consumer has nothing to show for the service. There is also a clear intention to avoid the law by some debt agreement administrators who appear to have simply set up separate companies in order to avoid fee regulation.

This is an issue where it would be useful for ITSA to proactively undertake some investigation and research. This could consider for example, the number of these businesses, the fees they are charging and their general operations.

Financial counsellors continue to report that they see clients who have been told that a debt agreement is “government sponsored loan/scheme where you don’t have to pay all of your debts back”. They are not told that a debt agreement is an act of bankruptcy.

1.3 Advertising

The CALC submission included a number of examples of misleading advertising by debt agreement companies. Proposal 8 will give the Inspector-General the power to impose industry-wide conditions in relation to advertising.

Assuming this goes ahead, it will still be some time before it takes effect and the Inspector-General can implement it. In the meantime, it would be timely for ITSA to undertake its own audit of advertising and in particular, follow up the examples provided in the CALC submission.

1.4 Key Fact Sheets

Debt Agreement Administrators should be required to give a Key Fact Sheet to consumers, before they enter a debt agreement that provides an “at a glance” summary of the agreement, including the fact that it is an act of bankruptcy.

This approach to consumer protection would replicate the disclosure regimes in credit legislation as well as in insurance (for home building and home contents policies)².

The Key Fact Sheet would set out information such as:

- The length of the agreement
- The amount to be repaid
- The consequences of default

² The regulations to give this effect are currently being drafted.

- That proposing a debt agreement is an act of bankruptcy
- Other relevant disclosures.

2. Responses to Proposals

Proposal 1: Registration as a debt agreement administrator to be made mandatory

It is proposed that the *Bankruptcy Act 1966* (the Act) be amended in order to provide that only registered administrators can administer new agreements. The proposed amendments would also provide that only registered administrators can sign the section 185C(2D) certificate. The section 185C(2D) certificate certifies (among other things) that the administrator has reasonable grounds to believe that the debtor is likely to be able to discharge the obligations created by the agreement. It is not proposed that there be an exception made for unregistered administrators who wish to administer their own debt agreements.

Response

FCA supports this proposal. We believe this will increase professionalism within the sector.

Proposal 2: Statement of suitability to be submitted with debt agreement proposals

It is proposed that the Act be amended in order to provide that when the administrator submits a certificate under section 185C(2D) they are also required to submit a Statement of Suitability. The administrator would be required to certify that a debt agreement is a suitable option for a debtor in light of the other options available to a debtor (bankruptcy, hardship programs etc.). As well as certifying that a debt agreement is a suitable option an administrator would be required to briefly set out why it's a suitable option after taking into account the financial circumstances of the debtor. For example if a debtor owes \$15,000 and is solely supported by Centrelink benefits it's unlikely that a debt agreement would be a suitable option for the debtor (even if the repayments were sustainable).

Note that the test would not be whether a debt agreement is the 'best option' for a debtor. In many cases a debtor will have more than one viable option available to them (each with their own pros and cons) and the debtor will ultimately have to choose which option they wish to adopt.

It's also proposed that the Act be amended to provide that it is a breach of an administrator's duties to submit a statement of suitability that states that a debt

agreement is a suitable option where a reasonable person would consider a debt agreement to be a clearly unsuitable option for the debtor.

It's unlikely that this proposal would result in higher fees being charged by administrators as administrators should already be making an assessment of the suitability of a debt agreement for a debtor.

Response

FCA supports this proposal. The statement should also set out the other options considered and discussed with the consumer. These could include for example:

- Hardship provisions under the National Credit Code;
- Informal repayment arrangements with respective creditors; or
- Discussing their situation with a financial counsellor.

The statement of suitability should also be provided to the consumer.

It is not clear what happens in situations where the statement of suitability was incorrect, that is, a "*a reasonable person would consider a debt agreement to be...unsuitable...*" This will be a breach of the duties of an administrator, but what will flow from it? There also needs to be mechanism for redress available for the consumer, including compensation.

The Inspector-General should also be empowered to review assessments of suitability, particularly where those debt agreements were subsequently terminated. The Inspector-General should also be given powers to provide guidelines about how suitability is to be assessed, and the ability to impose sanctions to ensure that suitability assessments are conducted in a fair and professional manner.

Proposal 3: Certificate to accompany variation proposal

It is proposed that the Act be amended in order to provide that when a variation proposal is put forward the administrator must certify that the variation proposal would be a suitable option for the debtor.

Response

FCA supports this proposal.

Proposal 4: Applicants for registration would be required to pass an exam

It is proposed that the Guidelines be amended in order to provide that applicants must pass a written examination as part of the application and assessment process. The exam would be taken prior to the applicant sitting for an interview with the Inspector-General's delegate. The exam would include questions on the personal insolvency

system and financial counselling. In particular the exam would test the applicants' knowledge of the consequences for a debtor of becoming bankrupt, becoming party to a debt agreement, or becoming a party to a personal insolvency agreement.

Response

FCA supports this proposal.

Proposal 5: Membership of professional accounting bodies to be made prescribed qualifications

It is proposed that membership of a professional accounting body (such as the Institute of Chartered Accountants or the Certified Practicing Accountants Australia) be made a prescribed qualification under the Regulations.

Response

FCA supports this proposal.

Proposal 6: Equivalent qualifications from a foreign institution to be made a prescribed qualification

It is proposed that the Regulations be amended in order to provide that a degree, diploma or similar qualification from a foreign university or college of advanced education that is equivalent to or exceeds the requirements of the Certificate IV could be made a prescribed qualification under the Regulations.

Response

FCA supports this proposal.

Proposal 7: Applicants for registration would be required to have relevant experience

It is proposed that the Act be amended in order to provide that individuals who apply to become administrators must have been engaged in "relevant employment" on a full-time basis for a total of not less than one year in the preceding five years.

Response

FCA supports this proposal.

Proposal 8: Power for the Inspector-General to impose industry wide conditions

It is proposed that the Act be amended in order to provide that the Inspector-General would be able to approve conditions that apply to all administrators with respect to certain specified areas. The Inspector-General would be empowered to impose industry wide conditions in relation to:

- continuing professional education;
- insurance (must be consistent with (and would be supplementary) to legislated obligations); and
- advertising by administrators.

Response

FCA supports this proposal.

The power for the Inspector-General to impose conditions in relation to advertising is particularly important. As described in the CALC submission, there are continuing concerns about the advertising of debt agreements in the marketplace.

In formulating these conditions, ITSA could have regard to the approach taken by ASIC in Regulatory Guide 234 "Advertising financial products and advice services: Good practice guidance". This document includes very clear standards together with examples.

Proposal 9: Statistics on debt agreements to be published on ITSA's website

It is proposed that statistics on set up fees, administration fees, acceptance rates and agreement lengths be published on ITSA's website. That would provide debtors who are contemplating submitting a debt agreement proposal with an opportunity to gauge whether the price that an administrator charges is below or above the industry average.

Response

FCA supports this proposal. This information should be in a prominent place on ITSA's website. The key facts should also be summarised, rather than leaving it for a consumer to find the information in a table. For example, "in the quarter ending 30th September 2012, the most common administration fee charged was \$(to be filled in)."

Proposal 10: Changes to voting process for debt agreements

It is proposed that the Act be amended in order to provide that after the Official Receiver writes to creditors under section 185EA(1) a creditor (or creditors) who hold a majority in value can propose a modification to the debt agreement proposal. The modification proposal could relate to a modification to the proposed level of administration fees or the level of proposed dividends.

The Official Receiver would notify the debtor and their administrator that a modification proposal has been received. The Official Receiver would then notify the other creditors that a modification proposal had been received (and the details of the modification proposal). Voting on the original debt agreement proposal would be suspended and the debtor would be given a set time to consider whether to accept the proposed modification. If the debtor accepts the proposed modification then the debt agreement is made. The Official Receiver would then write to all creditors to advise them of the outcome of the process.

If the debtor declines to accept the proposed modification the debt agreement proposal would fail.

Response

FCA does not support this proposal. As outlined in the CALC submission, the effect of this change will be that creditors will seek to modify agreements in order to obtain higher returns. This will place considerable pressure on the consumer debtor to agree.

Proposal 11: Power for the Inspector-General to obtain information concerning administrator trust accounts to be strengthened

It is proposed that section 186LA be amended in order to provide that the Inspector-General can obtain information concerning an administrator's trust account from a bank if the Inspector-General believes on reasonable grounds that the monies are not being dealt with in accordance with the Act and/or in accordance with the administrator's fiduciary duties.

Response

FCA supports this proposal.

Proposal 12: Power for the Inspector-General to obtain information concerning accounts held by an unregistered administrator and to freeze accounts with a Court order

It is proposed that the Act be amended to provide that if the Inspector-General believes on reasonable grounds that the proceeds of debt agreements received by an

unregistered administrator are not being dealt with in accordance with the Act and/or in accordance with the administrator's fiduciary duties they can make an application to the Court.

If the Court finds that there is reasonable cause to believe that the monies are not being dealt with in accordance with the Act and/or in accordance with the administrator's fiduciary duties the Court may make an order that requires the bank/s to provide information on accounts held by the unregistered administrator. The Court may also make an order freezing any account held by the unregistered administrator.

Response

FCA supports this proposal.

Proposal 13: New duty for administrators to refer possible offences

It is proposed that the Act be amended to provide that administrators have a duty to refer to the Inspector-General or to relevant law enforcement authorities any evidence of an offence under the Act by a debtor who is a party to a debt agreement.

Response

FCA supports this proposal.

Proposal 14: Debt agreement administrators must hold appropriate insurance

It is proposed that the Act be amended in order to provide that debt agreement administrators are required to have professional indemnity insurance and fidelity insurance. An administrator would be required to take all reasonable steps to maintain adequate and appropriate professional indemnity insurance and fidelity insurance.

It is proposed that an offence of up to 10,000 penalty units (\$110,000) would apply for a breach of this duty.

Response

FCA supports this proposal. The issue of what is considered "appropriate" will need to be addressed. The powers provided by Proposal 8 would be relevant.

Proposal 15: Proof of insurance to be a prerequisite for renewal of registration

It is proposed that the Act be amended in order to provide that an administrator's registration cannot be renewed unless they have provided evidence that they have the requisite insurance.

Response

FCA supports this proposal.

Proposal 16: Declaration of relationships

It is proposed that the Act be amended in order to provide that the section 185C(2D) certificate must disclose any relevant relationships (for example with brokers). The definition of a relevant relationship could include circumstances where a third party has referred the debtor to the administrator or where a third party has assisted with the preparation of the paperwork for a debt agreement proposal.

Response

FCA supports this proposal. We refer also to our comments in Section 1.

This disclosure should be provided to the debtor as well as the creditor. Disclosure is a fundamental consumer protection and given that the third party relationship impacts on the consumer, they have a right to know of its existence.

The timing of the disclosure is also important, for example, where the relationship is between a broker and a debt agreement administrator, the disclosure should be at the time of referral.

The declaration should cover:

- the amount of any commission/fee/benefit payable (where the precise amount of a commission is not ascertainable a “best effort” amount should be provided to the consumer);
- the reason for the commission/fee/benefit (e.g. referral, administration assistance etc);
- where a commission/fee/benefit is not cash, the approximate cash value or nature of the benefit should be disclosed; and
- whether the fee/benefit is conditional on acceptance of the agreement.

The disclosure could be included in the Key Facts Sheet.

Proposal 17: Increase income, assets and unsecured debt thresholds for debt agreements by 20%

It is proposed that the debt, income and divisible property thresholds be increased by 20%. This would make debt agreements available to a wider range of debtors, giving them an opportunity to avoid the restrictions and consequences of bankruptcy and providing creditors with a greater return than they would receive through bankruptcy. It could be argued that this level of increase would also recognise the increases in debt, wealth and incomes since the thresholds were last revised.

Response

FCA understands the rationale for this proposal. It should be accompanied by the introduction of a minimum income threshold as outlined in Section 1 above.

Proposal 18: Failure to submit annual return

It is proposed that the Act be amended in order to provide that the penalty of five penalty units (or one penalty unit by way of infringement notice) be repealed. Instead a failure to lodge an annual return within the specified period would result in a default late lodgement fee being payable.

Response

FCA supports this proposal.

Proposal 19: Registration not to be renewed in certain circumstances

It is proposed that the Act be amended in order to provide that the Inspector-General must not renew an administrator's registration if the administrator owes more than \$50 for estate charges under the *Bankruptcy (Estate Charges) Act 1997*, more than \$50 for late payment penalties in respect of such charges or more than \$50 in unpaid fees.

Response

FCA supports this proposal.

Proposal 20: Dealing with unclaimed money and unidentified money

It is proposed that the Act be amended in order to provide that the existing section 254(2) only applies to monies where the person entitled to the money has been identified (in accordance with the Inspector-General's position).

Response

FCA supports this proposal.

Proposal 21: Allow for unclaimed monies to be applied for administratively up to a cap

It is proposed that the Act be amended to provide that a person can make an administrative claim for moneys that have been paid to the Commonwealth under section 254 if they are seeking an amount of less than \$5,000. If they are seeking an amount that exceeds \$5,000 they would still have to seek an order from the Court.

Response

FCA supports this proposal.

Proposal 22: Disclosure of expense claims in debt agreement proposals

It is proposed that a definition of expenses be added to the Act and the Act be amended to provide that a debt agreement proposal must include details of the types of expenses which can be recovered in relation to the administration of the agreement. Setup fees would fall outside any definition in the Act of “expenses”.

Response

FCA supports this proposal.

Proposal 23: Fit and proper person test

It is proposed that section 186A of the Act be amended in order to provide that an individual must be a “fit and proper” person to pass the “Basic Eligibility Test”.

Response

FCA supports this proposal.

Proposal 24: Increase in time to approve application for registration

It is proposed that section 186C(1) be amended in order to provide that the Inspector-General must approve or refuse an application for registration as an administrator within 90 days.

Response

FCA supports this proposal.

Proposal 25: Alignment of offences

It is proposed that the Act be amended to provide that:

- it is an offence to fail to comply with section 185LD(1) and that a penalty of ten penalty units or two penalty units by way of an Infringement Notice applies;
- it is an offence to fail to comply with section 185LE(1)(a) and that a penalty of five penalty units or one penalty unit by way of Infringement Notice applies; and

-it is an offence to fail to comply with section 185LE(1)(b) and that a penalty of five penalty units or one penalty unit by way of Infringement Notice applies.

Response

FCA supports this proposal.

Proposal 26: Three months arrears reporting obligation

It is proposed that the Act be amended in order to provide that administrators are only required to report a three months arrears in relation to a particular debt agreement if the amount in arrears exceeds a monetary threshold.

Response

FCA supports this proposal.

Proposal 27: Prohibition on inducements being offered for votes

It is proposed that the Act be amended in order to provide that cash incentives cannot be offered to creditors in return for them voting a certain way in relation to a debt agreement proposal, a proposal to terminate a debt agreement or a proposal to vary an agreement.

Response

FCA supports this proposal. Incentives should also extend to non-cash benefits as well. The intention of the provision could be avoided otherwise.

Proposal 28: Debt agreements and the NPII

In April 2011, the Government released an Exposure Draft of proposed legislation to implement reforms to the current credit reporting provisions of the *Privacy Act 1988*. It is proposed that the retention times for debt agreement information on the NPII be aligned with the proposed retention time for debt agreement information that is set out in section 125 of the Exposure Draft.

Therefore, the Regulations would be amended to provide:

-entries on the NPII about a debt agreement that ends on the discharge of the debtor's obligations would be removed either five years after the agreement is made or on the discharge of the debtor's obligations (whichever date is later);

-entries on the NPII about a debt agreement that does not end on the discharge of a debtor's obligations would be removed five years after the agreement is made or two years after the agreement is terminated/voided (whichever date is later); and

--entries on the NPII about a debt agreement proposal would be removed when the proposal lapses, is withdrawn, is not accepted for processing or is cancelled after being accepted for processing.

Response

FCA supports this proposal. This is a more proportionate response in comparison to the current situation.