

Chapter 4

Committee view

4.1 As noted by the Attorney-General's Department (the Department), 'both bills share a common purpose in seeking to modernise and improve the accessibility of their respective debt management mechanisms.'¹ Additionally, both bills aim to strike a careful balance—in the case of the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 (BAEI bill), a balance between encouraging entrepreneurial activity, and providing protection for creditors and regulators; in the case of the Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (BADAR bill), a balance between safeguarding the interests of debtors and the interests of creditors, while also ensuring an accessible debt agreement regime.

4.2 The committee is keen to ensure that legislative amendments take into account that creditors are often the losers in bankruptcy action, and that to the extent possible, creditors should be protected.

4.3 As noted by a number of submitters, the proposed changes to each of the bills may affect the operation of the other. A key concern was that the proposed amendments to the BADAR bill may make debt agreements less viable for many debtors, while concurrently, the proposed amendments to the BAEI bill may result in bankruptcies being a more favourable option and potentially open to abuse. However, as noted by a number of submitters, the intention of the personal insolvency regime is to provide options to different situations. Different eligibility requirements and restrictions exist for bankruptcy as compared to debt agreements.

4.4 In considering each bill, the committee has thus sought to consider the evidence in the context of the bankruptcy scheme at large, particularly noting the impact minor changes proposed in each of the bills may have on the provisions of the other, or on other alternatives under the Act.

BAEI bill

Reduction of the default period

4.5 The committee notes and shares the concerns raised by submitters in relation to the reduction of the default period. The committee in particular notes the various potential means of differentiating between business and personal bankruptcies suggested by submitters. However, the committee has weighed this evidence against advice from the Department which suggested that it was impractical and potentially impossible to achieve a true distinction between the two types of bankruptcies. The committee is also mindful that the causes of bankruptcy are often multifaceted and may not be clearly identified through statistical data.

1 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, Attorney-General's Department, *Proof Committee Hansard*, 5 March 2018, p. 1.

4.6 The committee finds that the evidence on balance suggests that a one year default period is appropriate, at least for some classes of bankruptcy, having regard to the issues raised and the aims of the bill. However, the committee strongly encourages the government to consider the comments and recommendations made later in this section, which are aimed at ameliorating some of what the committee, and many submitters, saw as the potential risks in curtailing the current default period.

Anti-abuse provisions

4.7 The committee is satisfied that the protections offered by the bill, primarily the trustee's ability to object to discharge of bankruptcy and the enforcement of the three year income contribution obligation period, are sufficient to provide protection against abuse. The committee notes in particular that the proposals in respect of income contribution obligations were generally supported by submitters.

Amendments to other legislation

4.8 The committee notes that many submissions recommended changes to other legislation, such as the *Corporations Act 2001*, in response to the amendments made in this bill. In particular, the committee notes, and was impressed by, the recommendations made by the Australian Securities & Investments Commission (ASIC). The committee considers that the recommendations made by ASIC are prudent and that the Government should implement these recommendations, or others that would operate similarly.

4.9 Submitters warned the committee that the reduction of the default period would not change certain legislative and industry requirements to disclose a bankruptcy or the repercussions of having been bankrupt. The committee notes that this inconsistency has the potential to cause confusion for bankrupt persons. Furthermore, the committee recognises that this may have significant effects for entrepreneurs, such as when securing credit. The committee trusts that the Government will remain mindful of the potential need for further legislative amendment to fully realise the stated aims of the current bill.

Technical amendments

4.10 The committee notes the recommendations from the Law Council of Australia in relation to technical amendments to enhance clarity and considers that there may be merit in the Law Council's recommendations.

Recommendation 1

4.11 The committee recommends that the Government give positive consideration to the suggestions from ASIC to amending the *Corporations Act 2001* (Cth), to ameliorate the risk of the one-year default period being made available to bankrupts for whom such a concession is not a desirable or justifiable outcome.

Recommendation 2

4.12 Subject to the foregoing recommendation the committee recommends that the Senate pass the BAEI bill.

BADAR Bill

Debt agreement administrators

4.13 With the increase in popularity of debt agreements, one of the BADAR bill's aims is to increase the public's trust and confidence in debt agreement administrators. The committee considers that the proposed amendment to limit the type of practitioners who are able to administer a debt agreement, along with enabling the Attorney-General to set industry conditions for administrators, will assist to boost confidence in the professionalism of administrators.

4.14 The committee notes the various recommendations made by a number of submitters including requiring debt agreement administrators to:

- complete formal training on personal insolvency, including undertaking ongoing formal education;
- hold membership of a professional body with a commitment to a Code of Conduct;
- provide more information to debtors prior to entering into a debt agreement as well as at other stages of the debt agreement; and
- join the Australian Financial Complaints Authority, once established.

4.15 While the committee makes no specific recommendation in respect of these suggestions, it notes that the suggestions have merit and that the professionalism of the debt agreement regime may benefit from further regulation.

Three year limit

4.16 In relation to the proposed introduction of a three-year limit to debt agreement proposals, the committee is of the view that this is a potentially useful measure to minimise the chance of debtors entering into unsustainable debt agreements. The committee has given careful consideration to the concerns raised by submitters—that the three year limit will result in one of two things—creditors rejecting debt agreement proposals due to the potential decrease in return; or fewer debtors being able to service a debt agreement due to an increase in payments.

4.17 The committee notes that currently, a majority of debt agreement proposals (85 per cent in 2016-2017) ran for five years and notes that creditors will in many circumstances achieve less return if agreements are capped to a maximum of three years. While acknowledging that differences in the respective cohorts make direct comparisons problematic, the committee also notes that, based on the statistics from AFSA and the Department, on average creditors currently receive 59.68 cents per dollar owed under debt agreements and only 1.15 cents per dollar under bankruptcies. While creditors will continue to receive more under a three year term debt agreements than they would under a bankruptcy scenario, the relative success of the existing arrangements—which typically run over five years—cannot be ignored, especially in respect of the enhanced returns to creditors that a longer term can offer.

4.18 The committee also notes evidence from submitters about the rigidity of the proposed reform noting that sudden changes to a debtor's circumstances should be

accounted for by including a greater degree of flexibility in the arrangements. Having regard to the views and concerns expressed by submitters the committee considers that while an initial three year cap is reasonable and appropriate, the bill should provide for more flexibility. Specifically, the committee recommends that the bill provide for extensions of up to an additional two years to the term of debt agreements, to be made by agreement between debtors, creditors and debt agreement administrators. This would provide for a debt agreement originally running for one year to be extended to a maximum of three years, or a three year agreement implemented under the three year initial cap being able to be extended to run for a maximum of five years in total.

Payment to income ratio

4.19 The committee is equally of the view that the introduction of the payment to income ratio is a useful measure to help ensure that debtors are not signed up to unsustainable agreements. While the committee notes that there are other methods of ensuring that debtors do not sign up to debt agreements which they cannot afford, the committee considers that the payment to income ratio will offer some assistance to debtors from undertaking excessive payment schedules. Nonetheless, the committee sees potential merit in the minister having regard to considerations such as the cost of living for low-income households, and in particular the cost of housing for those households, when setting the payment to income ratio. The government should also consider whether differential ratios should apply based on a debtor's ability to cover costs of living at a reasonable standard.

Restriction on voting

4.20 The committee notes that all bar one submitter supported the restriction on a proposed administrator, or a related entity of a proposed administrator, from voting on a debt agreement proposal. The committee agrees that a conflict of interest exists in allowing a proposed administrator, or its related entity, from voting on a debt agreement proposal, which it intends to administer. Consequently, the committee is of the view that it is appropriate and timely for this conflict of interest to be addressed, and supports the amendment.

4.21 On balance, the committee is of the view that the amendments proposed in the BADAR bill will increase confidence in debt agreement administrators, minimise the practice of unscrupulous administrators, and help protect vulnerable debtors, while also ensuring that the debt agreement regime is accessible and equitable. The committee recommends that the BADAR bill be passed.

Recommendation 3

4.22 The committee recommends that the government consider amending the BADAR bill to allow for debt agreements implemented under a three year cap to be capable of being extended by up to an additional two years by agreement of the debtor, creditors, and debt agreement administrator.

Recommendation 4

4.23 The committee recommends that the government consider including provision in the BADAR bill to require the minister to have regard to the cost of living for low-income households, the average cost of housing, and potential CPR increases, when setting the payment to income ratio, and whether differential payment to income ratios based on a debtor's ability to cover costs of living at a reasonable standard could be appropriate.

Recommendation 5

4.24 Subject to recommendations 3 and 4, the committee recommends that the BADAR bill be passed.

Senator the Hon Ian Macdonald

Chair