The Senate

Legal and Constitutional Affairs Legislation Committee

Bankruptcy Amendment (Enterprise Incentives) Bill 2017

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 [Provisions]

March 2018

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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.

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.

Chapter 1

Introduction and background

1.1 On 30 November 2017, pursuant to a report of the Senate Standing Committee for Selection of Bills, the Senate referred the provisions of the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 (BAEI bill) to the Senate Legal and Constitutional Affairs Legislation Committee (the committee).[1] On 7 December 2017, the provisions of the Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (BADAR bill) were referred to the committee through a similar means.[2]

1.2 Both bills were referred for inquiry and report by 19 March 2018.

Conduct of the inquiry

1.3 In accordance with usual practice, the committee wrote to a number of persons and organisations, inviting submissions to the BAEI bill and the BADAR bill by 31 January 2018 and 16 February 2018 respectively. The inquiries were also made public on the committee's website.

1.4 The committee received 20 submissions to the BAEI bill inquiry and 19 submissions to the BADAR bill inquiry, which are listed at Appendix 1. Submissions are also available in full on the committee's website.[3]

1.5 The committee held concurrent public hearings for both bills in Sydney on 5 March 2018 and in Melbourne on 6 March 2018.

Bankruptcy verses debt agreements

1.6 The *Bankruptcy Act 1966* (Cth) (the Act) provides a number of options for a debtor with unmanageable debt to take control of their personal affairs, while also allowing for creditors to receive a portion of what they are owed. Debt agreements, which were introduced in 1996 in Part IX of the Act, were 'designed to be a low cost alternative to bankruptcy for persons with few if any divisible assets, and low income levels.'[4]

1.7 The eligibility requirements and restrictions differ between the schemes. The following table, produced by the Australian Financial Security Authority (AFSA), compares a number of the key eligibility requirements and restrictions for bankruptcies and debt agreements:

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1 *Journals of the Senate*, No. 75, 30 November 2017, pp. 2401–2402.

2 *Journals of the Senate*, No. 79, 7 December 2017, pp. 2512–2513.

3 The committee's website can be found at https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Legal_and_Constitutional_Affairs

4 Bankruptcy Legislation Amendment Bill 1996, Explanatory Memorandum, p. 34.

Table 1—Comparison between bankruptcies and debt agreements[5]

	Bankruptcy	Debt Agreement
Australian connection	Must have a residential or business connection.	No residential or business connection required.
Previous insolvency	While previous insolvency does not by itself make a person ineligible, the Official Receiver may not accept the petition if the debtor was previously bankrupt and some other conditions are met.	Must not have been a bankrupt, proposed a personal insolvency agreement or made a debt agreement in the previous 10 years.
Income threshold	No.	Yes, a person cannot propose a debt agreement if their after tax income for the year is more than $83,756.40
Asset threshold	No.	Yes, a person cannot propose a debt agreement if their divisible property is more than $111,675.20.
Debt threshold	No.	Yes, a person cannot propose a debt agreement if their unsecured debts are more than $111,675.20.
Ability to retain assets	No, unless it is exempt property (for example, household furniture, tools of trade up to a certain value).	Yes, unless terms of the agreement provide otherwise.
Ability to travel overseas	Prior consent of trustee required. A fee is payable where the trustee is the Official Trustee.	No statutory restrictions.
Ability to be a director of, or otherwise manage, a corporation	No.	Yes.

5 Key elements of the eligibility requirements and restrictions have been copied from tables produced by the Australian Financial Security Authority (AFSA). A more detailed comparison between bankruptcy, debt agreement and personal insolvency agreement can be found on the AFSA website: afsa.gov.au/insolvency/i-cant-pay-my-debts/compare-formal-options (accessed 6 March 2018).

Purpose of the bills

1.8 The two bills propose significant changes in relation to bankruptcy and debt agreements.

Bankruptcy Amendment (Enterprise Incentives) Bill 2017

1.9 The BAEI bill proposes to amend the Act to provide for a reduction of the default period, and other time periods associated with bankruptcy, from three years to one year.[6]

1.10 The Explanatory Memorandum to the BAEI bill sets out the purpose of the proposed amendments:

> The aim of the Bill is to foster entrepreneurial behaviour and reduce the stigma associated with bankruptcy while maintaining the integrity of the regulatory and enforcement frameworks for the personal insolvency regime.[7]

1.11 Introducing the bill into the Senate, the Assistant Minister to the Prime Minister, Senator the Hon. James McGrath, explained that under existing arrangements, personal insolvency laws have heavy consequences for those declared as bankrupt. Bankrupts are subject to penalties such as being locked out of their profession, the inability to travel overseas, and having to identify as a bankrupt. Under current law, these penalties are applied to the bankrupt person for a period of three years following the declaration of bankruptcy.[8] The Assistant Minister stated that these penalties are viewed as 'stigmatising and penalising failure'.[9]

1.12 The proposed amendments address a recommendation made by a Productivity Commission report in 2015 that the default bankruptcy period should be reduced, particularly in relation to restrictions on travel, finance and employment.[10]

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018

1.13 The BADAR bill provides for tighter regulation of the debt agreement regime, which is intended to boost confidence in the sector's integrity, 'deter unscrupulous practices, enhance transparency, and ensure that the regime is accessible and equitable.'[11]

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6 Bankruptcy Amendment (Enterprise Incentives) Bill 2017, Explanatory Memorandum (BAEI Explanatory Memorandum), p. 2.

7 BAEI Explanatory Memorandum, p. 5.

8 Senator the Hon. James McGrath, Assistant Minister to the Prime Minister, *Senate Hansard*, 19 October 2017, p. 8029.

9 Senator the Hon. James McGrath, Assistant Minister to the Prime Minister, *Senate Hansard*, 19 October 2017, p. 8029.

10 Productivity Commission, *Business Set-up, Transfer and Closure: Productivity Commission Inquiry Report*, No. 75, 30 September 2015, p. 2.

11 Bankruptcy Amendment (Debt Agreement Reform) Bill 2018, Explanatory Memorandum (BADAR Explanatory Memorandum), p. 2.

1.14 The Attorney-General, the Hon. Christian Porter MP, explained the rationale for the proposed changes to the debt agreement regime as follows:

> Between 2007 and 2016, new debt agreements increased from 6,560 to 12,640 per year. Over the same period, new bankruptcies declined from 25,754 to 16,842 per year. To respond to increasing usage of debt agreements and evidence of consumer exploitation by the debt agreement industry, the government is proceeding with a comprehensive reform of Australia's debt agreement system.
>
> It will boost confidence in the professionalism of debt agreement administrators, deter unscrupulous practices and enhance transparency. This bill will ensure that the debt agreement system is accessible to debtors who have the financial capacity to enter into debt agreements.[12]

Key provisions of the bills

Bankruptcy Amendment (Enterprise Incentives) Bill 2017

1.15 Section 149 of the Act currently provides that a bankrupt qualifies for an automatic discharge after a period of three years, and is subject to a number of restrictions during the period of bankruptcy. The bill would reduce the default period of bankruptcy to one year. As part of the reduction of the default period, other relevant time periods associated with bankruptcy would also be reduced to one year.

1.16 The key proposed amendments include:

- inserting a new subsection to section 149 that would provide for an automatic discharge after one year of bankruptcy to apply to persons who become bankrupt after the commencement of the new subsection, which would remove certain restrictions such as overseas travel, obtaining credit and company board eligibility (Items 18 and 19) at the expiration of the bankruptcy period; and
- repealing subsection 80(1) and replacing it with a requirement for the bankrupt to notify the trustee within 10 business days of changes to their name, address, and phone number during the 'prescribed period'. It also would insert a new definition of 'prescribed period' and of 'bankrupt' for the purposes of section 80 (Items 4 and 5).

1.17 The amendments in the BAEI bill would commence six months after receiving Royal Assent in order to allow trustees, debtors and creditors to adjust and to prepare any objections to discharge.[13]

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018

1.18 The provisions of the BADAR bill would enact a suite of reforms to Australia's debt agreement regime. The amendments would address a broad spectrum

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12 The Hon. Christian Porter MP, Attorney-General, *House of Representatives Hansard*, 14 February 2018, p. 7.

13 BAEI Explanatory Memorandum, p. 2.

of areas regarding debt agreements, including who can be a registered debt agreement administrator, the powers of the Official Receiver and the Inspector-General, and the administration of debt agreements.

1.19 The key proposed amendments include:

- amending subsection 185C(2) to restrict the category of persons who may be authorised to deal with debtor's property (Schedule 1, Items 1 and 2);
- inserting 185C(2AA), which would provide that a debt agreement proposal cannot propose for payments to be made under the agreement for a timeframe longer than three years from the day the agreement was made;
- amending subsection 185C(4)(c) to increase the asset value threshold for a debtor entering a debt agreement[14] (Schedule 1, Item 17);
- inserting subsection 185C(4)(e), which would provide that a debtor cannot give the Official Receiver a debt agreement proposal if the total payments under agreement exceed the debtor's income by a certain percentage (Schedule 1, Item 20). Further, the percentage may be determined by the Attorney-General by legislative instrument as per new subsection 185C(4B) (Schedule 1, Item 21);
- inserting subsection 185E(2AB), which would provide that the Official Receiver can refuse to accept a debt agreement proposal for processing if the Official Receiver reasonably believes that the debt agreement would cause undue hardship to the debtor (Schedule 1, Item 23);
- amending section 185LA to extend the duties of a debt agreement administrator to reflect those conferred on trustees under paragraphs 19(1)(h) and (i) of the Bankruptcy Act (Schedule 2, Item 23); and
- conferring power on the Inspector-General to refuse to approve an application for registration as a registered debt agreement administrator if the individual is not a fit and proper person (Schedule 3, Items 5 and 6).

1.20 The majority of the amendments in the BADAR bill would commence six months after receiving Royal Assent. According to the BADAR Explanatory Memorandum, this would allow debt agreement administrators and AFSA time to sufficiently prepare for the commencement of the reforms.[15] Amendments under Division 2 of Part 1 Schedule 1 would commence twelve months after receiving Royal Assent.

Reports of other committees

1.21 The Senate Standing Committee for the Scrutiny of Bills (Scrutiny Committee) noted that subsection 80(1) of the Act requires a bankrupt to 'immediately' inform the trustee, in writing, of a change of name or principal residence

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14 This would increase the asset threshold from $111,675.20 to $223,350.40.

15 BADAR Explanatory Memorandum, p. 8.

that occurs during their bankruptcy.[16] The Scrutiny Committee noted that pursuant to subsection 80(1) of the BAEI bill this would be amended to 'within 10 business days' and the way in which the trustee is informed would be amended to 'a manner determined or approved by the trustee'.[17]

1.22 The Scrutiny Committee reported that, pursuant to subsection 80(1A) of the Act, a breach of this requirement is subject to six months imprisonment and that this offence is a strict liability offence.[18]

1.23 The Scrutiny Committee raised concern that the punishment of six months imprisonment for a strict liability offence is beyond the recommended punishment of up to 60 penalty units for a strict liability offence, as outlined in the *Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers*.[19]

1.24 In response to this concern, the Attorney-General acknowledged that proposed subsection 80(1) does not comply with the Guide and that he 'will seek to amend item 4 Schedule 1 of the Bill to ensure compliance with the Guide.'[20]

1.25 The Scrutiny Committee made no further comments in light of the Attorney-General's undertaking.

1.26 The Parliamentary Joint Committee on Human Rights (PJCHR) also considered the BAEI bill and reported that the bill does not raise human rights concerns.[21]

1.27 At the time of writing, neither the Scrutiny committee nor the JCHR have commented on the BADAR bill.

Report outline

1.28 This report consists of four chapters:

- this chapter provides a brief background and overview of the bills, as well as the administrative details of the inquiries;
- chapter 2 sets out the issues raised by submitters in relation to the BAEI bill;
- chapter 3 sets out the issues raised by submitters in relation to the BADAR bill; and
- chapter 4 outlines the committee's views and recommendations in relation to both bills.

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16 Senate Standing Committee for the Scrutiny of Bills (Scrutiny Committee), *Scrutiny Digest 13 of 2017*, 15 November 2017, p. 4.

17 Scrutiny Committee, *Scrutiny Digest 13 of 2017*, 15 November 2017, p. 4.

18 Scrutiny Committee, *Scrutiny Digest 13 of 2017*, 15 November 2017, p. 4.

19 Scrutiny Committee, *Scrutiny Digest 13 of 2017*, 15 November 2017, p. 5. See also Attorney-General's Department, *A Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers*, September 2011, p. 23.

20 Scrutiny Committee, *Scrutiny Digest 15 of 2017*, 6 December 2017, p. 7.

21 Parliamentary Joint Committee on Human Rights, *Human Rights Scrutiny Report: 12 of 2017*, 28 November 2017, p. 96.

References to the Hansard transcript

1.29 References to the Hansard are to the proof Hansard. Page numbers may vary between the proof and the official transcript.

Acknowledgements

1.30 The committee thanks all organisations and individuals who made submissions and provided evidence to this inquiry.

Chapter 2

Key concerns regarding the BAEI bill

2.1 Many submissions that the committee received were from firms specialising in bankruptcy and personal insolvency. These submitters focused on the amendments in Schedule 1 concerning the reduction of the default period, which would limit the restrictions placed on a bankrupt, such as directorship and travelling internationally, to one year rather than three years. These key concerns included:

- inconsistency between the bill's intention and its practical operation;
- the reduction in the default period;
- lack of anti-abuse provisions;
- operation of the income contribution obligations scheme;
- impact on the debt agreement regime; and
- inconsistency with other laws requiring financial reporting.

2.2 This chapter discusses the main concerns raised by submitters about the Bankruptcy Amendment (Enterprise Incentives) Bill 2018 (BAEI bill).

Will the bill succeed in fostering entrepreneurship and reducing stigma?

2.3 A number of submitters raised concerns that the BAEI bill would not achieve its stated intention of fostering entrepreneurism.[1]

Distinguishing between personal and business bankruptcies

2.4 Submitters argued that the majority of bankruptcies in Australia are in relation to personal or consumer debt. Submitters suggested that approximately 20 per cent of personal bankruptcies are business-related, the remainder being personal or consumer-related bankruptcies.[2] Furthermore, the Australian Financial Security Authority (AFSA) provided statistics suggesting that the main reasons for personal bankruptcy are excessive use of credit, unemployment, or loss of income, as opposed to business-related reasons.[3]

2.5 The Assistant Minister explained in the BAEI bill's second reading speech that distinctions between personal and business bankruptcies can be blurred in cases where owners of small businesses need to secure business loans with their personal assets or provide personal guarantees.[4]

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1 See for example, J P Downey & Co Ltd, *Submission 2*, BAEI bill, p. 1.

2 SellersMuldoonBenton, *Submission 7*, BAEI bill, p. 2; CPA Australia, *Submission 8*, BAEI bill, p. 1; and Australian Restructuring Insolvency & Turnaround Association (ARITA), *Submission 10*, BAEI bill, p. 1.

3 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5.

4 Senator the Hon. James McGrath, Assistant Minister to the Prime Minister, *Senate Hansard*, 19 October 2017, p. 8030.

2.6 The Department stated that it had considered restricting the application of the proposed one-year default term to business-related bankruptcies, but found that it was extremely difficult to draw a distinction between personal and business-related bankruptcy:

> There is the abstract notion of how you define it, what basis you define it on and who falls through the cracks as a result of that. There's also the real world blur between the two, and that comes to the fore for small businesses and sole traders. Small businesses often need to secure their business loan with their own personal finances—use their own credit cards to fund their business—and at that point it's even harder than in the abstract to define the difference between the two.
>
> Moreover, even if theoretically it was possible to draw a distinct line, whilst yes, the centre of gravity of the government's policy intention here is to encourage entrepreneurship, it's to reduce the stigma of bankruptcy across the board, to encourage people to engage in business ventures—whether that be people who are already engaged in business ventures to re-engage, or people who are not yet engaged in business ventures to become engaged in business ventures. Even if you could draw that line and only allow one-year bankruptcy for business bankruptcy, there are people who might be going through what is able to be defined as personal bankruptcy. This reform would encourage them and allow them to step out of that as quickly as possible and allow them to undertake business ventures should they choose to do so.[5]

Fostering entrepreneurship

2.7 The BAEI Explanatory Memorandum draws a connection between the reduction in the default period and the intended aim of fostering entrepreneurship:

> As part of the National Innovation and Science Agenda these reforms aim to foster entrepreneurial behaviour and to reduce the stigma associated with bankruptcy. Reducing the automatic discharge to one year will reduce stigma, encourage entrepreneurs to re-engage in business sooner and encourage people, who have previously been deterred by the punitive bankruptcy laws, to pursue their own business ventures.[6]

2.8 Mr Michael Lhuede, an insolvency practitioner, noted that this bill's provisions are similar to those enacted in the *Bankruptcy Amendment Act 1991* (Cth), which was subsequently changed in the *Bankruptcy Legislation Amendment Act 2002* (Cth). Mr Lhuede argued that the 2002 amendments arose in recognition that the earlier provisions had encouraged debtors to act irresponsibly in relation to bankruptcy.[7] He further expressed concern that the BAEI bill 'advances a proposition

5 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, Attorney-General's Department (AGD), *Proof Committee Hansard*, 6 March 2018, p. 55.

6 BAEI Explanatory Memorandum, p. 2.

7 Mr Michael Lhuede, *Submission 3*, BAEI bill, pp. 2–4.

that may well favour a regime designed to promote entrepreneurship over individual responsibility for financial decisions'.[8]

2.9 Many submitters expressed concerns that the measures in the BAEI bill, namely the proposed reduction in the default period, would not foster entrepreneurship. CPA Australia stated that its previous submission to the Treasury Proposals Paper 'National Innovation and Science Agenda-Improving bankruptcy and insolvency laws' (Proposals Paper) outlined its concern with this approach, stating that the types of people and the reasons behind personal bankruptcies did not indicate that entrepreneurs were routinely bankrupted, and that the proposal to foster entrepreneurship was 'illusory'.[9]

2.10 Evidence collected by the committee suggested that the industry was divided on whether the amendments proposed by the bill would achieve its objectives. The Australian Restructuring Insolvency & Turnaround Association (ARITA) stated:

> …among our members who practice in the field of personal insolvency (bankruptcy) there are divided views as to whether this stated goal will be achieved by the reduction of the default bankruptcy period to one year. Apart from scepticism as to the 'untapped entrepreneurialism' which will be engaged by a one-year default period of bankruptcy, registered trustees are more familiar than most with the practices and behaviour of those debtors who will seek to either abuse or 'game the system' of a one-year bankruptcy for their own benefit (and to the detriment of creditors).[10]

2.11 Nonetheless, the Attorney-General's Department (the Department) advised that the bill would positively affect a number of entrepreneurs who are currently impeded by bankruptcy restrictions. According to AFSA statistics, approximately 35 per cent of all debtors in a bankruptcy between September and December 2017 self-reported that their bankruptcy was related to business-incurred debt.[11] The bill would therefore address a large number of relevant business-related bankruptcies and thus assist in fostering entrepreneurship.

Reducing stigma

2.12 Many submitters were generally supportive of the BAEI bill's aim to reduce the perceived stigma associated with bankruptcy.

2.13 For example, the Law Council of Australia (Law Council) noted that the bill seeks to implement changes recommended by the Proposals Paper. The paper noted that the aim of the reforms was to drive a 'cultural shift' away from the perceived

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8 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5.

9 CPA Australia, *Submission 8*, BAEI bill, p. 1.

10 ARITA, *Submission 10*, BAEI bill, p. 5.

11 Mr Michael Johnson, Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, BAEI bill, p. 55.

failure of bankruptcy, and encouraging entrepreneurship. To this end, the Law Council was supportive of the bill's aim.[12]

2.14 However, some submitters were sceptical that the bill's measures would actually counter the stigma of bankruptcy.[13] The Commercial and Property Law Research Centre (CPLRC) noted recent Australian research indicating negative public attitudes toward people who are, or have been, bankrupt.[14] The study suggested that there is a divergence in attitudes between business and consumer bankruptcies, as business-related bankruptcies are perceived as attributable to 'unscrupulous entrepreneurs'. The study concluded that a reduction in the default period for business-related bankruptcies may increase stigma by perpetuating current attitudes.[15]

2.15 Similarly, the Australian Banking Association (previously the Australian Bankers' Association) argued that the bill would not affect the stigma of bankruptcy because:

> …reducing the discharge period alone would have no effect on the numerous restrictions (for example, barriers to entry to professions) which currently exist, which add to the stigma of bankruptcy in employment and business.[16]

2.16 However, the Department stated that the proposed reduction of the default period, and consequently other associated limitations on travel and other matters, would reduce the stigma attached to bankruptcy by encouraging entrepreneurs to move onto new business ventures:

> The Productivity Commission found Australia's current personal insolvency laws put too much focus on stigmatising and penalising failure. A reduced bankruptcy term is designed to decrease the stigma associated with entering into bankruptcy by recognising the importance of giving bankrupts a fresh start. This reduced period is designed to encourage entrepreneurs who have previously been deterred by punitive bankruptcy laws to pursue their own business ventures. This of course includes people who have already experienced bankruptcy. Not only will these people be able to exit bankruptcy and therefore enter into business again sooner; they will also be less deterred from taking sensible risks in future business endeavours. However, this also covers people who have never been through bankruptcy but who might be deterred by the stigma of the regime from taking the same sensible risks that are necessary to make a successful business. Certain

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12 Law Council of Australia (Law Council), *Submission 9*, BAEI bill, p. 1.

13 See, for example, Ms Karen Cox, Coordinator, Financial Rights Legal Centre, *Proof Committee Hansard*, 5 March 2018, p. 13; Mr John Winter, Chief Executive Officer, ARITA, *Proof Committee Hansard* , p. 57; Mr Clifford Mearns, Director, SRMC Limited, *Proof Committee Hansard*, 6 March 2018, p. 24.

14 Commercial and Property Law Research Centre (CPLRC), *Submission 19*, BAEI bill, pp. 5–6.

15 CPLRC, *Submission 19*, BAEI bill, p. 6.

16 Australian Bankers' Association (ABA), *Submission 15*, BAEI bill, pp. 1–2.

restrictions, such as overseas travel, obtaining credit and company board eligibility, will be lifted after the one-year default bankruptcy period.[17]

Reduction of the default period

2.17 A significant number of submitters objected to the bill on the grounds that a reduction of the default period would have unintended and far-reaching consequences.[18] A submitter representing personal insolvency and accounting firms told the committee that industry members do not support a reduction in the default period, citing concerns regarding the potential for abuse and unintended consequences.[19]

2.18 Some submitters noted that the majority of bankruptcies are consumer-related, rather than business-related.[20] These submitters argued that, as bankruptcy tends to be in relation to consumer debt, targeting all bankruptcies indiscriminately will create unintended consequences in addition to failing to promote entrepreneurship.[21]

2.19 The Law Council recommended that a distinction should be drawn in the bill between consumer-related personal bankruptcies and business-related bankruptcies.[22]

2.20 This was similarly suggested by Pitcher Partners, who also submitted that the bill should establish three categories of bankrupts in order to reflect the differing circumstances:

- Category 1, which deals with 'compliant bankrupts' who are fully compliant with their obligations, have little or no divisible property, pay income contribution assessments in the manner required by their trustee and where a longer period as an undischarged bankrupt would be unnecessary and unfair;
- Category 2, which deals with 'non-compliant bankrupts' who do not comply with obligations, co-operate with their trustee or pay income contribution assessments in the manner required by their trustee; and
- Category 3, which deals with bankrupts likely to abuse the bankruptcy process, including those whose pre- or post-bankruptcy conduct and behaviour are risky or unlawful, those who are non-compliant with tax law or have unpaid tax liabilities, or those who engage in illegal phoenix activities.[23]

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17 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 5 March 2018, p. 1.

18 See for example, Law Council, *Submission 9*, p. 2; J P Downey & Co, *Submission 2*, pp. 1–2; and DCS Group Australia, *Submission 4*, BAEI bill, pp. 1-5.

19 CPA Australia, *Submission 8*, BAEI bill, pp. 1-2.

20 See for example, Law Council, *Submission 9*, BAEI bill, p. 1; and ABA, *Submission 15*, BAEI bill, pp. 1–2.

21 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5; Law Council, *Submission 9*, BAEI bill, p. 2.

22 Law Council, *Submission 9*, BAEI bill, p. 2.

23 Pitcher Partners, *Submission 12*, BAEI bill, pp. 2–3.

2.21 Pitcher Partners argued that bankrupts in Categories 1 and 2 should be eligible for a reduction in the default period, provided that those in Category 2 were compliant with duties and obligations under the Act. However, Pitcher Partners stated that those in Category 3 should not be eligible for a one year default period except in exceptional circumstances.[24]

2.22 Further, Pitcher Partners stressed that the one year period should not be an automatic discharge but instead that eligibility for early discharge should be assessed. They also stated that the trustee be empowered to object to early discharge, on prescribed grounds which were outlined in detail in their submission.[25] Pitcher Partners stated:

> While Pitcher Partners recognises that the prospect of a one year bankruptcy would foster entrepreneurial activity by reducing the restrictions that would otherwise be placed on prospective business people and entrepreneurs, a bankrupt wishing to avail themselves of a 'fresh start' sooner than the three year period of bankruptcy should apply to do so through an administrative process. This process would facilitate the ability of the vast majority of bankrupts to take up the opportunity for a 'fresh start' after one year, but will provide a safeguard to ensure a small minority of 'non-complying' bankrupts are not inappropriately and automatically discharged.[26]

2.23 AFSA noted that the reduction of the default period would not restrict the time period that a bankrupt trustee can administer a bankrupt estate.[27] AFSA further noted that:

> The reduction of the default period will directly impact on:
>
> - *Objections*: The period of time a trustee can lodge an objection to discharge will be reduced. This has implications for incentivising cooperation by debtors with the process post-discharge and may impact on the volume of objections to discharge lodged by trustees, particularly in the lead up to commencement of the reforms.
> - *After acquired property*: Shortening the default bankruptcy period will impact on the value of after-acquired property vesting in bankrupt estates. For example, it is less likely that inheritances received after the commencement of bankruptcy would vest in the estate with a shortened bankruptcy period.
> - *NPII [National Personal Insolvency Index] and credit reporting*: On commencement of the reforms AFSA (as administrator of the National Personal Insolvency Index) and credit reporting bodies would need to

24 Pitcher Partners, *Submission 12*, BAEI bill, p. 3.

25 Pitcher Partners, *Submission 12*, BAEI bill, pp. 4–5.

26 Pitcher Partners, *Submission 12*, BAEI bill, p. 4.

27 Australian Financial Security Authority (AFSA), *Submission 14*, BAEI bill, p. 5.

ensure that the personal insolvency records of affected individuals reflect the change to the default bankruptcy period in a timely way.[28]

2.24 The Australian Securities and Investments Commission (ASIC) similarly raised concerns about whether the proposed one year default period would be sufficient to protect creditors, consumers and financial investors. ASIC stated:

> Businesses regulated by ASIC (which offer financial products and services to the public) often fail because the owner/manager lacks the necessary business acumen and fails to keep adequate accounts and records. A question therefore may arise as to what is an appropriate period to allow a businessperson, whose business fails and is disqualified as a director, to undertake appropriate education and skills development training to reduce the risk of future failures[.][29]

2.25 ASIC further noted the risk posed by a shortened period of directorship disqualification under the default bankruptcy period, which it could unintentionally promote excessive risk-taking.[30]

2.26 ASIC recommended amending subsection 201A(a) of the *Corporations Act 2001* (Corporations Act) to require that a person made bankrupt within the last three years cannot be included for the purpose of satisfying the minimum director requirement, which currently provides that a proprietary company have at least one director. ASIC stated that if a proprietary company has as its sole director a person made bankrupt in the past twelve months, 'risks such as inadequate skills and excessive risk-taking within the company are exacerbated'.[31] According to ASIC, the suggested amendment would be consistent with the bill's objectives and enable bankrupt persons to act as directors, but would also require that management of a company be shared with at least a third party who would also be responsible for the company's actions and be subject to the care and diligence obligations under the Corporations Act.[32]

2.27 In the second reading speech, the Assistant Minister to the Prime Minister explained that the reduction in the default period was appropriate for the majority of bankrupts. The Assistant Minister stated:

> One year is sufficient time for the administration of the vast majority of bankruptcies. Currently, where more time is required, trustees can continue to administer a bankruptcy after discharge. This may occur for various reasons, including: ongoing investigations, assets to be realised, outstanding income contributions, and incomplete distribution of funds. This safeguard

28 AFSA, *Submission 14*, BAEI bill, p. 5.

29 Australian Securities and Investments Commission (ASIC), *Submission 6*, BAEI bill, p. 2.

30 ASIC, *Submission 6*, BAEI bill, p. 2.

31 ASIC, *Submission 6*, BAEI bill, p. 3.

32 ASIC, *Submission 6*, BAEI bill, p. 3.

> will continue to operate to ensure trustees can properly administer a bankruptcy even after a bankrupt's one year discharge.[33]

2.28 Some submitters also raised concerns regarding the capacity for creditors to recover debts owed within the one year default timeframe proposed by the bill. One submitter noted that unless AFSA was able to action all referrals promptly, income contribution collections may diminish.[34]

2.29 The Department noted concerns raised by submitters regarding the one year default period. The Department stated in its submission that a number of suggested solutions had been considered during the stakeholder consultation period:

> Limiting a one year bankrupt to first-time bankrupts, or restricting access to return bankrupts to once every 10 years, would contradict one of the core aims of the reforms, being to reduce the stigma associated with bankruptcy. To effectively combat the stigma, the reforms must ease bankruptcy laws for all debtors, without discrimination.[35]

2.30 The Department explained that:

> …the intent of government in putting these reforms forward is that if you are going to encourage risk-taking, risk-taking by definition is going to result in failure sometimes. So, if you are going to encourage risk-taking you have to tolerate failure. If you are going to tolerate failure, saying you're only going to tolerate failure once, or tolerate failure twice, but then the third time you're going to say that necessarily means you're a bad person as opposed to an unlucky person, or you took a risk that just didn't turn out, is contrary to the intention.[36]

2.31 Further, the Department advised that treating distinct groups of bankrupts differently would be contrary to the bill's intention of simplifying the regime and lead to additional burdens on regulatory bodies.[37]

2.32 However, the committee also notes that some submitters were supportive of the reduction of the default period.[38] The Financial Rights Legal Centre, Financial Counselling Australia and Consumer Action Law Centre (FRLC, FCA and CALC) stated:

> [The amendment] strikes an appropriate balance between the interests of creditors, and ensuring that bankruptcy enables a fresh start for debtors, and is not needlessly punitive. Reducing the bankruptcy period as described in

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33 Senator the Hon. James McGrath, Assistant Minister to the Prime Minister, *Senate Hansard*, 19 October 2017, p. 8029.

34 Mr Geoff Green, *Submission 1*, BAEI bill, p. 2.

35 AGD, *Submission 17*, BAEI bill, p. 2.

36 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 64.

37 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 60.

38 Justice Connect, *Submission 18*, BAEI bill, pp. 1–2.

> the bill is likely to have a fairly minimal effect on the amounts recouped by creditors from bankrupt estates, but significantly improves the bankrupt's opportunities for early financial rehabilitation and participation in economic activity.[39]

Lack of anti-abuse provisions

2.33 Many submitters expressed concerns that the proposed amendments do not contain anti-abuse provisions. The submissions raised two issues in particular: the possibility of serial bankrupts, and the perceived increased risk of phoenix activity.

2.34 It was observed that the reduction of the default bankruptcy could potentially increase the risk of serial bankrupts abusing the proposed system. Pitcher Partners stated to the committee that it manages a number of 'rogue' bankrupts who actively abuse the bankruptcy system:

> We say rogue bankrupts are those bankrupts whose behaviour either pre-or post-bankruptcy demonstrates what we would call a willingness to abuse bankruptcy and other laws to their benefit at the expense of others. They are often dishonest or have engaged in undesirable commercial behaviour. A significant proportion of rogue bankrupts have complex affairs. They involve tax avoidance, fraud or evasion and sometimes even serious criminal conduct.[40]

2.35 Pitcher Partners argued that the legislation should aim to balance the need to reduce perceived stigma with the risk of rogue bankrupts abusing the system.[41] They proposed that this could be achieved by implementing three changes to the bill:

- Clearly identifying and separating rogue bankrupts from eligibility for the one-year default period by prescribing behaviour or events that would restrict the rogue bankrupt from seeking early discharge;
- Strengthening the objection-to-discharge procedures; and
- Incentivising post-discharge compliance through the income contribution assessment period.[42]

2.36 The Law Council recommended that the bill provide that a bankrupt should be required to demonstrate to the trustee that their bankruptcy is in relation to business-related debt. The trustee would subsequently be empowered to decide whether to approve the early discharge, subject to the review of the Inspector General in Bankruptcy.[43]

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39 Financial Rights Legal Centre, Financial Counselling Australia and Consumer Action Law Centre (FRLC, FCA and CALC), *Submission 13*, BAEI bill, p. 2.

40 Mr Gess Rambaldi, Partner, Pitcher Partners, *Proof Committee Hansard*, 6 March 2018, p. 5.

41 Mr Gess Rambaldi, Partner, Pitcher Partners, *Proof Committee Hansard*, 6 March 2018, p. 5.

42 Mr Gess Rambaldi, Partner, Pitcher Partners, *Proof Committee Hansard*, 6 March 2018, p. 5.

43 Law Council, *Submission 9*, BAEI bill, p. 2.

2.37 Some submitters raised concerns about the bill adequately protecting against phoenix activity.[44] The Australian Criminal Intelligence Commission (ACIC) stated in its submission that its intelligence suggested that the reduction of the default bankruptcy period may increase the risk of serious and organised crime groups exploiting the bankruptcy provisions. It stated:

> Through the use of illegal phoenix activity as a business strategy by serious and organised crime groups, ACIC intelligence indicates that there are individuals who exploit bankruptcy provisions to facilitate illegal activity. These individuals and groups are often aided by professional facilitators, who are intrinsic enablers of serious and organised financial crime. A current concern to the ACIC are liquidators and unregistered pre-insolvency advisors who are developing a niche in the criminal environment by facilitating and promoting the exploitation of bankruptcy provisions and illegal phoenix type activities. For example, by encouraging directors and accountants to transfer assets to new entities for less than market value, or to destroy or alter company records.[45]

2.38 Some submitters suggested that the risk of abuse of the proposed regime may undermine public confidence in the strength of bankruptcy laws, especially in the case of high-profile examples.[46]

2.39 The Department noted that existing compliance mechanisms in the wider bankruptcy regime provide anti-abuse protections:

> So the bankruptcy regime provides a mechanism for consequences when risks are taken and fail without being unduly punitive and discouraging that sort of risk-taking but understanding that there is that risk for people to abuse the system. The rating already includes a number of safeguards, and those safeguards will either be retained or enhanced through these reforms. There are four safeguards, in particular, I draw senators' attention to. These are the income contribution payments; the objection to discharge regime; the Official Receiver's rejection of a petition power; and interim control orders under section 50 of the bill.[47]

2.40 The Department further noted that provisions in the BAEI bill are designed to combat potential abuse, such as a proposed commencement date being six months after Royal Assent to enable trustees to prepare objections to discharge of bankruptcies on foot.[48]

2.41 The Department also pointed to the income contribution obligations as a mechanism to enforce compliance and deter abuse:

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44 DCS Group Australia, *Submission 4*, BAEI bill, pp. 2–3.

45 Australian Criminal Intelligence Commission, *Submission 16*, BAEI bill, p. 1.

46 ARITA, *Submission 10*, BAEI bill, pp. 1–2.

47 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 5 March 2018, p. 3.

48 AGD, *Submission 17*, BAEI bill, p. 2

> This is the first safeguard; bankrupts will still be required, if they earn over the income threshold, to make income contributions for the full three years, as is the case now, and there are also a number of mechanisms in the act to ensure and facilitate the payment of those payments, including garnishee notices and the supervised account regime.[49]

2.42 Additionally, the Department advised the committee that the Government's priority was to simplify the bankruptcy regime in order to assist genuine bankrupts:

> I'd like to say it's a balance. Sure, we could introduce a regime to make it particularly complicated and have criteria that have to be assessed. We could probably not guarantee but we would probably have a very good shot that all these so-called rogue bankrupts would be excluded or given a more punitive or more difficult regime. But the consequence of that would be that the majority of bankrupts, who aren't rogue bankrupts, would have to go through a far more complicated, far more administratively involved process to get into bankruptcy That's pretty much the antithesis of what the government is seeking to achieve with these amendments, which is a combination of the stigma notion, but there's a sub-element of that, which is simplification—trying to make the bankruptcy regime a bit simpler, a bit more efficient.
>
> …
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> The safeguards in the system, I would assert, are sufficient to allow mechanisms for those rogue players, such as the ability for the official trustee to reject the petition based on grounds of abuse.[50]

Income contribution obligations

2.43 The bill proposes to extend income contribution obligations for discharged bankrupts for a minimum period of two years following discharge, or, in the event of the bankruptcy's extension due to non-compliance, for a period of five to eight years.[51]

2.44 Submitters were generally supportive of the extension to income contribution obligations. For example, FRLC, FCA and CALC noted in its submission that, while it supported the income contribution payments scheme as a method of enforcing post-bankruptcy compliance, there had been no change to rules regarding financial hardship. They recommended amending:

- Section 139T, which details situations in which the income contribution assessed produces an immediately harsh result, to include a situation where the assessment is valid at the time it is made but can no longer be met because of a subsequent change of circumstances;

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49 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 5 March 2018, p. 3.

50 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 59.

51 BAEI Explanatory Memorandum, p. 2.

- Section 139ZH, which provides that there is no refund payable regarding overpaid contributions. This was argued to be unduly harsh in situations where overpayment is not due to any act or omission of the bankrupt and provides an incentive for bankrupts to under-estimate income, and it was recommended to account to the bankrupt where overpayment occurs in the final contribution assessment period; and
- Allowing bankrupts to keep income earned after bankruptcy at the discretion of the trustee.[52]

2.45 ARITA recommended amendments to improve a bankrupt's accountability to the trustee:

> The extension of income contribution obligations for two years following an automatic discharge after one year is an important measure to accompany any decision to reduce the default bankruptcy period. While there are measures open to a trustee in bankruptcy to enforce these obligations post-discharge, it is worth considering whether a breach of a discharged bankrupt's obligations of payment and provision of information should constitute an 'act of bankruptcy' under s 40 of the Act. This would make it easy and less costly to bring about a second bankruptcy for any discharged bankrupts who default on their income contribution obligations.[53]

Impact on debt agreement regime and other alternatives under the Act

2.46 A number of submitters raised concerns that the proposed amendments would negatively impact on the debt agreement regime.[54] Mr Lhuede argued that the development of the debt agreement regime could be seen as a reflection of the social perception of the stigma associated with bankruptcy. Mr Lhuede further noted:

> If that attitude is being discouraged in favour of being accepting of financial failure then we may well be altering the very assumptions on which debtors to date have been willing to reach agreement under Part IX with their creditors. Any changes to the Act should be careful to avoid any distortions that would discourage debtors from reaching commercial arrangements with creditors under Part IX of the Act.[55]

2.47 Additionally, the submission stated that the proposed one-year default period may significantly impact on post-bankruptcy arrangements with creditors under section 73 of the Act.[56]

2.48 The Department advised the committee that the intention of the bill, in addition to the BADAR bill (considered in the next chapter), was to provide choice for

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52 FRLC, FCA and CALC, *Submission 13*, BAEI bill, pp. 3–5.

53 ARITA, *Submission 10*, BAEI bill, pp. 1–2

54 See for example, J P Downey & Co, *Submission 2*, BAEI bill, pp. 1–2.

55 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5.

56 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5.

debtors. The Department stated that bankruptcy is suitable for certain situations while debt agreements are better for others, and the Government sought to provide options for individual situations.[57]

Inconsistency with other laws requiring financial reporting

2.49 The committee received submissions that the proposed amendments would result in inconsistency with other legislation and industry rules which place restrictions on bankrupts.[58]

2.50 SellersMuldoonBenton noted in its submission that the bill's proposal to eliminate the need for individuals to disclose their bankrupt status after the one-year default period is inconsistent with financial practices requiring full reporting. They note:

> Most applications for finance, leases etc will note or ask whether the individual has been bankrupt or subject to another form of insolvency within the past 7-10 years. It is unclear how the responses to this question will be dealt with any differently due to the change[.][59]

2.51 It was further observed that current credit reporting requirements also require disclosure regarding bankruptcy.[60]

2.52 FRLC, FCA and CALC submitted that the bill does not change the rules regarding deletion of information from credit information files under section 20X, Part IIIA of the *Privacy Act 1988* (Cth). They stated:

> At present, bankruptcy is retained on a person's credit report for the longer of 2 years from discharge or 5 years from the date of bankruptcy – effectively a minimum of 5 years. If the period of bankruptcy is reduced by 2 years then, logically, the period that bankruptcy remains on credit reports should also be reduced by 2 years, creating an effective minimum of 3 years.[61]

Other issues

2.53 In its submission, ASIC suggested that the Corporations Act could be amended in relation to disqualification of directors who have been made bankrupt.[62] ASIC recommended that section 206F of the Corporations Act be amended to provide for:

57 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 61.

58 See: SellersMuldoonBenton, *Submission 6*, BAEI bill, p. 1;

59 SellersMuldoonBenton, *Submission 6*, BAEI bill, p. 1.

60 SellersMuldoonBenton, *Submission 6*, BAEI bill, p. 1.

61 FRLC, FCA and CALC, *Submission 13*, BAEI bill, p. 4.

62 ASIC, *Submission 6*, BAEI bill, pp. 2–4.

- expanding ASIC's powers in order to direct the bankrupt person to take specific actions prior to participating in the management of a company, such as corporate and financial management training;
- increasing the maximum length of disqualification from five years to seven years in order to deter phoenix activity; and
- providing for automatic disqualification where a director has been an officer of four or more corporations that have wound up in the previous seven years and where, in each case, a liquidator has lodged a report under the Act's requirements under section 533(1). This process determines whether the wound up companies are related, thus further deterring phoenix activity.[63]

2.54 ASIC made further recommendations regarding section 206BA(5) of the Corporations Act. Under section 206B(3) of that Act, a bankrupt is automatically disqualified to manage a corporation if they are an undischarged bankrupt. Section 206BA enables ASIC to apply to court to extend the period of automatic disqualification by up to 15 years if a person has been convicted of a relevant offence, while section 206BA(5) allows the Court to have a broad discretion in taking any appropriate matters into account. ASIC recommended that the scope of section 206BA(5) be broadened to enable ASIC to apply to extend the period of disqualification to run a corporation where the person is an undischarged bankrupt in situations where it can be demonstrated that there are serious concerns regarding a person's capacity to manage a corporation.[64]

2.55 The Law Council also made a number of recommendations for minor technical amendments to the bill.[65] The Department confirmed to that these recommendations were being considered;[66] however, in response to a question on notice, the Department outlined its reasons why the suggested amendments were not accepted.[67]

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63 ASIC, *Submission 6*, BAEI bill, pp. 2–4.

64 ASIC, *Submission 6*, BAEI bill, p. 4.

65 Law Council, *Submission 9*, BAEI bill, pp. 3–4.

66 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 62.

67 AGD, answers to question on notice, 6 March 2018 (received 14 March 2018), pp. 6–7. The full response is available on the committee's website.

Chapter 3

Key concerns regarding the BADAR bill

3.1 Debt agreements in Australia have continued to increase in popularity while the number of bankruptcies has declined. Between 2007 and 2016, new debt agreements increased from 6,560 to 12,640 per year and new bankruptcies declined from 25,754 to 16,842 per year.[1] The Australian Financial Security Authority (AFSA), reported that 'in 2016–17, debt agreement administrators received $263.5 million from debtors in payments pursuant to debt agreements.'[2] As at 30 June 2017, 46,651 debt agreements were being administered by debt agreement administrators.[3]

3.2 Despite the growing popularity with debt agreements, a recent study found that debtors are being signed up to unsuitable or unsustainable agreements; insufficient information is being provided to debtors; some debt agreement administrators are charging 'excessive or unwarranted fees'; and there exists a lack of redress for debtors.[4]

3.3 The BADAR Explanatory Memorandum notes the objective of the bill:

> 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.[5]

3.4 This chapter discusses the main concerns raised by submitters about the Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (BADAR bill). These concerns included:

- the tightening of registration standards for debt agreement administrators;
- the introduction of a three year limit for debt agreements;
- the reasonableness of the payment to income ratio;
- doubling the asset threshold;
- restricting the voting process; and
- the potential effect the BADAR bill may have on bankruptcies.

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1 Bankruptcy Amendment (Debt Agreement Reform) Bill 2018, Explanatory Memorandum, (BADAR Explanatory Memorandum), p. 2.

2 Australian Financial Security Authority (AFSA), *Submission 5,* BADAR bill, p. 3.

3 AFSA, *Submission 5,* BADAR bill, p. 3.

4 Ms Vivien Chen, Ms Lucinda O'Brien and Mr Ian Ramsay (Chen et al), 'An Evaluation of Debt Agreements in Australia', *Monash University Law Review*, 44(1), 2018, pp. 39–41.

5 BADAR Explanatory Memorandum, p. 2.

Debt agreement administrators

3.5 The BADAR bill proposes to tighten the registration standards of debt agreement administrators. The BADAR Explanatory Memorandum notes that currently, in certain circumstances, a debt agreement is able to be administered by a person who is not a registered debt agreement administrator.[6] Item 1 of the BADAR bill would limit the type of practitioners who are able to administer a debt agreement to include a registered debt agreement administrator, registered trustee or the Official Trustee. Additionally, Schedule 3, Part 2 of the BADAR bill enables the Attorney-General to set industry conditions for registered debt agreement administrators. As explained by the AGD, '[a] legislative instrument is a flexible mechanism which could be used to set appropriate advertising, advisory and disclosure standards to prevent misconduct.'[7]

3.6 Submitters were generally supportive of the proposed changes to strengthen the registration and standards of debt agreement administrators and some considered that the bill could go further. For example, SRMC Limited (SRMC) recommended that all administrators be required to complete a personal insolvency course as well as undertake ongoing formal education.[8] SRMC also suggested that administrators be required to hold membership of a professional body with a commitment to a Code of Conduct.[9] Additionally, SRMC argued for brokers to hold a sub-registration:

> In current bankruptcy law, a debt agreement administrator is not appointed until such time as the proposal is accepted by the majority of creditors (in value), and becomes a debt agreement. It is this irregularity that has created the situation of 'external' brokers becoming involved in the regime. This company has for many years, been urging the Australian Financial Security Authority to introduce a sub-registration system for those wishing to be brokers. It is this submissions view that a broker should be aligned to an administrator and should hold a sub-registration attached to the debt agreement administrator's registration similar to the manner in which a real estate sales person can only conduct business by being sub-licenced to the principal. Such a system would alleviate many of the criticisms and cause the administrator to be liable for the actions of its broker.[10]

3.7 Mendelsons National Debt Collection Lawyers, Prushka Fast Debt Recovery, and Zurick Capital and Finance Pty Ltd (Mendelsons), argued for tighter regulation for advertising of debt administrator services and for more information to be provided

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6 BADAR Explanatory Memorandum, p. 10.

7 Attorney-General's Department (AGD), *Submission 17,* BADAR bill, p. 4.

8 SRMC Limited, *Submission 2*, BADAR bill, p. 2. See also Fox Symes & Associates, *Submission 10*, BADAR bill, p. 2.

9 SRMC Limited, *Submission 2,* BADAR bill, p. 2.

10 SRMC Limited, *Submission 2*, BADAR bill, p. 4.

to debtors both prior to entering into a debt agreement as well as at other stages of the debt agreement.[11]

3.8 A joint submission from Consumer Action Law Centre, Financial Rights Legal Centre, and Financial Counselling Australia (CALC, FRLC and FCA) recommended that debt agreement administrators be required to join the Australian Financial Complaints Authority (AFCA), as a condition of registration.[12] CALC, FRLC and FCA observed the following:

> While the expanded voiding provisions are a vast improvement on the current voiding provisions in the Act, they will not provide a remedy for breaches of the general consumer law prohibitions against misleading and deceptive conduct and unconscionable conduct—claims that may be available based on the pre-agreement conduct of the administrator. 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.[13]

3.9 At the hearing, Ms Cat Newton, Policy Officer of CALC, explained that lenders and people providing debt consolidation or financial advice are required to maintain membership of AFCA and that this same requirement should extend to debt agreement administrators.[14] Ms Newton noted that AFCA is a free service and is therefore more accessible for debtors.[15]

Three year limit

3.10 Currently, the Act does not specify a maximum timeframe for making payments under a proposed debt agreement. New subsection 185C(2AA) sets a three year limit on debt agreements. It provides that a debt agreement proposal cannot propose for payments to be made under the agreement for a timeframe longer than three years from the day the agreement was made.

3.11 The BADAR Explanatory Memorandum explains that the three year timeframe 'aligns with the length of income contributions under bankruptcy.'[16] Further, that the absence of a limitation on the proposed timeframe of a debt agreement could result in debtors prolonging a debt agreement through a variation as

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11 Mendelsons National Debt Collection Lawyers, Prushka Fast Debt Recovery, and Zurick Capital and Finance Pty Ltd (Mendelsons), *Submission 11,* BADAR bill, pp. 3–4.

12 Consumer Action Law Centre, Financial Rights Legal Centre, and Financial Counselling Australia (CALC, FRLC and FCA), *Submission 18,* BADAR bill, p. 21. Note, the Australian Financial Complaints Authority is due to commence operations by 1 November 2018 and is the amalgamation of the Credit Investment Ombudsman and the Financial Services Ombudsman.

13 CALC, FRLC and FCA, *Submission 18,* BADAR bill, p. 21.

14 Ms Cat Newton, Policy Officer, CALC, *Proof Committee Hansard,* 5 March 2018, p. 15.

15 Ms Cat Newton, Policy Officer, CALC, *Proof Committee Hansard,* 5 March 2018, p. 15.

16 BADAR Explanatory Memorandum, p. 22.

well as contribute to unreasonably high dividend rates for lower income debtors.[17] As explained in the BADAR Explanatory Memorandum:

> For example, if a debtor can only afford to pay a certain amount of money per month, it will always be possible to lengthen an agreement to meet that monthly payment. A creditor or the proposed administrator is therefore able to request an unreasonably high dividend or remuneration rate. [18]

3.12 AFSA reported that of the new debt agreements in 2016–17, more than 85 per cent were for a duration of five years.[19] While AFSA was able to provide some figures in relation to the rate of return for debt agreements that were five years in term, compared to three years in term, they were not able to predict the sustainability of the proposed changes:

> We do see at the moment the average rate of return for debt agreements of five years or longer having around 60 cents in the dollar return to creditors and for those of three years in the current pool around 69 cents in the dollar to creditors. It's not possible to predict the sustainability or the impact to the returns to creditors in the three-year mark if more were consolidated into that three-year pool. That would require, if they were looking at the same returns, a higher cents-in-the-dollar return to creditors as a result of that. We wouldn't be able to determine the sustainability. But we have seen that trend to reduction in the fees to creditors since 2011 and 2012 from around 74 cents in the dollar down to 69 currently, and, through that same period, a marginal increase to the debt agreement administrator fees in that area from around 22 cents in the dollar to 23½.[20]

3.13 The Attorney-General's Department (the Department) noted that 'the most influential factor to determine what will happen in this space will be the intentions or behaviour of creditors in voting on debt agreement proposals.'[21]

3.14 While debt agreement administrators were supportive of placing a timeframe on the term of a debt agreement, they considered the three year timeframe to be unreasonable and instead suggested that a five year timeframe was more suitable.[22] The Australian Bankers' Association (ABA) explained why it disagreed with the three year limit:

> Reducing the period to 3 years will mean one of two things - increased payments meaning fewer debtors will be able to service a debt agreement

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17 BADAR Explanatory Memorandum, p. 22.

18 BADAR Explanatory Memorandum, p. 22.

19 AFSA, *Submission 5,* BADAR bill, p. 3.

20 Mr Gavin McCosker, Deputy Chief Executive, AFSA, *Proof Committee Hansard,* 5 March 2018, p. 63.

21 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, Attorney-General’s Department, *Proof Committee Hansard*, 6 March 2018, p. 60.

22 SRMC Limited, *Submission 2*, BADAR bill, p. 3; DCS Group, *Submission 6,* BADAR bill, p. 5; Fox Symes & Associates, *Submission 10,* BADAR bill, p. 5; and Mr Michael Lhuede, *Submission 15,* BADAR bill, p. 3.

> over the shorter term because the amounts payable will be higher, or lower payment plans which creditors will be less likely to accept because of the reduced amount offered compared to payments made over 5 years.
>
> Inevitably, this means more debtors' plans will be rejected with debtors likely to resort to formal bankruptcy, increasing the numbers of bankruptcies.[23]

3.15 DCS Group submitted that the introduction of a three year timeframe for debt agreements would have the effect of reducing creditor returns by two-fifths, given the current life of a debt agreement was five years.[24] Mr Clifford Mearns, Director, SRMC, explained that creditors would be reluctant to accept the return offered over the three years:

> …creditors have a very rough time accepting a debt agreement that doesn't offer 60c. Now, some creditors demand 75c in the dollar, otherwise they reject it. I think the industry generally works on between 60c to 70c. If you have a debtor that can fall into that range, the possibility of acceptance is fairly good.[25]

3.16 Personal Insolvency Professionals Association (PIPA) provided the following table to illustrate that the return to creditors would decrease from 60 per cent to 36 per cent if debt agreement proposals were reduced from a five year term to a three year term:

Table 2: Return for creditors under five years compared to three years[26]

Debt Agreements	**5 year Regime – 60 months**	**3 year Regime – 36 months (Proposed)**
Unsecured Debt	$64,000.00	$64,000.00
Uncommitted income per month	$640.00	$640.00
Amount available to distribute	$38400.00 over 60 months	$23040.00 over 36 months
Effective Return	60c/$	36c/$

3.17 Professional bodies, such as the Institute of Public Accountants (IPA), supported the three year timeframe, however warned that the timeframe could have

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23 ABA, *Submission 14*, BADAR bill, p. 2. Note that since making a submission the Australian Bankers' Association changed its name to the Australian Banking Association.

24 DCS Group, *Submission 6*, BADAR bill, p. 5.

25 Mr Clifford Mearns, Director, SRMC Limited, *Proof Committee Hansard*, 6 March 2018, p. 26

26 Personal Insolvency Professionals Association (PIPA), *Submission 13*, p. 5.

the unintended consequence of debtors choosing bankruptcy over debt agreements.[27] The Australian Restructuring Insolvency & Turnaround Association (ARITA) also expressed support for introducing a cap to the length of debt agreements but believed that a five year cap would equally address the current issue of having unlimited debt agreements.[28]

3.18 In contrast, other submitters, such as Professor Christopher Symes, supported what he considered being 'the most substantial amendment that is to impose for the first time a limitation of the time-period for making payments under the proposed debt agreement.[29]

3.19 CALC, FRLC and FCA noted that it 'strongly support[ed] the proposed reform…to limit the maximum length of debt agreements to 3 years'[30] and explained the reason they supported this proposal:

> When the debt agreement regime was first introduced, debt agreements were expected to last no longer than three years, with a possible extension of six months for payment delays. The length of debt agreements has increased over time. In 2010, 54 percent of debt agreements were expected to run for 5 years. By 2016, this had increased to nearly 85 percent.
>
> It can be very difficult for a person in financial stress to make a realistic assessment of their capacity to meet repayment schedule for 5 or more years into the future. Making such calculations—generally during a time of high financial stress—poses an unfair risk to the debtor of termination, should their circumstances unexpectedly worsen later in the debt agreement. If the agreement falls over in the later years, the debtor may have incurred significant costs and consequences for little benefit.[31]

3.20 The Department confirmed that on average, creditors receive 59.68 cents per dollar owed under debt agreements, compared to 1.15 cents per dollar under bankruptcies.[32] While the Department acknowledged that the three year timeframe could reduce returns to creditors, it noted that the returns under debt agreements 'remain an appealing option to creditors':

> The proposed amendment balances the interests of creditors in maximising returns with reducing the prevalence of unsustainable debt agreements which place debtors under additional financial stress. Given the variation between creditor returns under debt agreements and bankruptcies, debt agreements are likely to remain an appealing option to creditors even if returns are reduced in some circumstances due to the three year limitation.

27 Institute of Public Accountants, *Submission 7,* BADAR bill, pp. 2–4. See also PIPA, *Submission 13,* BADAR bill, p. 4.

28 ARITA, *Submission 9,* BADAR bill, pp. 7–8.

29 Professor Christopher Symes, *Submission 16,* BADAR bill, p. 1.

30 CALC, FRLC and FCA, *Submission 18,* BADAR bill, p. 19.

31 CALC, FRLC and FCA, *Submission 18,* BADAR bill, p. 19.

32 AGD, *Submission 17,* BADAR bill, p. 4.

> Moreover, during earlier consultation in development of the Bill, creditor groups expressed support for a three year timeframe, in part because a shorter timeframe entails a lower risk.[33]

3.21 At the hearing, the Department explained that the three year limit also provides a safeguard for debtors:

> Debt agreements which extend beyond three years are often a sign that the debt repayment schedule is burdensome and unsustainable. It certainly results in a debtor being under the rigours and associated stresses of debt repayment for longer. Limiting proposals to three years encourages austere but realistic debt repayment schedules to be put forward. It is important to note that the three-year limit only applies to proposals for debt agreements, and mechanisms exist to extend the repayments schedule where they have not been completed by the end of the three-year term.[34]

3.22 Mendelson's Mr Roger Mendelson shared the views expressed by the Department stating that the three year timeframe could 'give a degree of certainty to creditors.'[35] Mr Mendelson explained that in his view, the three year limit would ensure that debtors were more likely to complete debt agreements:

> Once you get out to four and five years, it's a long way away. I would prefer to see agreements in place which can work, which can expunge the debt—which is really what it is about—and get some cash back on the table for creditors who, with these small debts, don't have that many options. It avoids them having to enforce the option to sue and garnish the wages of the debtor. It does reduce that. I believe it will make them much more workable because it's a time frame that debtors can work to. Once you get to four and five years, it's just too far out. I would rather get $0.50 in the dollar over three years then $0.65 over five years.[36]

Variations

3.23 In addition to proposing a maximum three year timeframe for debt agreements, paragraph 185M(1C)(1D) of the BADAR bill states that the proposal must not seek to vary the agreement beyond the three years beginning on the day the agreement was made. While the proposed amendment would prevent variations to a debt agreement that attempted to extend its term beyond three years, the effect of current section 185QA of the *Bankruptcy Act 1966* would allow debt agreements to run for up to a further six months where a debtor has defaulted on payment for up to that period of time. After which, the debt agreement is automatically terminated for being in arrears for six months.

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33 AGD, *Submission 17,* BADAR bill, p. 4.

34 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard,* 5 March 2018, p. 2.

35 Mendelsons, *Submission 11,* BADAR bill, p. 2.

36 Mr Roger Glave Mendelson, Chief Executive Officer, Pruska Fast Debt Recovery Pty Ltd, *Proof Committee Hansard,* 6 March 2018, p. 39.

3.24 AFSA noted that currently 'around 80 per cent of variations are actually to increase the length of the debt agreement.'[37]

3.25 A number of submitters raised concern with the inflexibility of this proposed provision in cases where a debtor's financial circumstances unexpectedly changes. One submitter noted that where a debtor has lost their job or becomes very ill, debt agreement administrators currently put forward a variation to extend the term of the debt agreement, which results in a low rate of terminations.[38] Ms Newton explained that if agreements are terminated early, creditors are able to commence collection action 'on the full undiscounted amount of the debt and backdate all the interest.'[39]

3.26 PIPA also expressed concern with proposed paragraph 185M(1C)(1D) and explained how the rigidity of this provision may have unintended consequences:

> If a Debt Agreement extends over the time limit and is terminated due to this reason, the current legislation allows creditors and [debt purchasing companies] to reinstate all the interest, fees and penalties applicable whilst in a Debt Agreement. The prohibitions proposed by the changes to Section 185M fails to recognise the dynamic nature of the industry [registered debt agreement administrators] work in. Debtor's circumstances frequently change and [registered debt agreement administrators] need to be able to adapt to these changes in order to ensure the successful completion of the debt agreement. Restricting a debt agreement to 3 years without the ability to vary the term for unforeseen circumstances creates a rigid rule that inevitably will see many debt agreements fail and debtors pushed towards either bankruptcies or…unregulated lengthy debt agreements with [debt purchasing companies].[40]

3.27 Mrs Melissa Glenn, Committee Member of PIPA also noted the following:

> There seems to be a suggestion that variations are common as the arrangement was unaffordable in the first instance. We reject this argument, as affordability is a key consideration to any [registered debt agreement administrators]. As an [registered debt agreement administrator] myself, a variation means many hours of unpaid extra work. Like other PIPA members, we do variations as a last resort and in exceptional circumstances. Entering into an unaffordable debt agreement is nonsense, as failure is inevitable, which is in no-one's interest.[41]

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37 Ms River Paul, Australian Financial Security Authority Statistician, AFSA, *Proof Committee Hansard,* 5 March 2018, p. 65.

38 Ms Janice Paris, *Submission 12,* BADAR bill, pp. 1–2.

39 Ms Cat Newton, Policy Officer, Consumer Action Law Centre (CALC), *Proof Committee Hansard,* 5 March 2018, p. 17.

40 Personal Insolvency Professionals Association (PIPA), *Submission 13,* BADAR bill, p. 6.

41 Mrs Melissa Glenn, Committee Member, PIPA, *Proof Committee Hansard,* 5 March 2018, p. 47.

3.28 CALC, FRLC and FCA suggested that AFSA be provided discretion to 'allow a proposal to extend a debt agreement to four years where there is a *genuine* and *significant* change in circumstances.'[42]

3.29 However, the Department argued that the proposed amendment maintains a degree of flexibility by allowing debt agreements to continue for six months after the three year timeframe until it is terminated by default by virtue of it being six months in arrears:

> The debt agreement system still maintains its flexibility and allows debt agreements to continue running beyond the three year mark if the payment obligations have not yet been discharged. An undischarged agreement will continue to run until it terminates by six months arrears default, or earlier by another termination mechanism.[43]

Payment to income ratio

3.30 Currently paragraph 185C(2D)(c) of the Act requires a debt agreement administrator to certify that the debtor is likely to be able to discharge the obligations under the debt agreement as and when they fall due. Item 20 of the BADAR bill, which proposes to insert new paragraph 185C(4)(e), provides that a debtor cannot give the Official Receiver a debt agreement proposal if the total payments under agreement exceed the debtor's income by a certain percentage.[44] Pursuant to new subsection 185C(4B) of the BADAR bill, the minister may determine this percentage by legislative instrument and that this percentage may exceed 100 per cent.

3.31 The BADAR Explanatory Memorandum notes that this would allow the minister to 'calibrate the determined percentage to a three year payment schedule', which is 'a key consumer-protection safeguard.'[45]

3.32 DCS Group explained how the ratio might be applied:

> For example, The Minister sets the threshold at 60% (20% per year). Person A lives on a Disability Support Pension ($442.20/week). Person A would be living on just $353.76 per week after 20% of their income went to the Debt Agreement.[46]

3.33 A number of submitters were concerned that setting a payment to income ratio would negatively impact low-income debtors. Mr Michael Lhuede expressed the view that 'an income ratio test will immediately exclude anyone on a nominal income, such as a young adult or non-working spouse.'[47]

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42 CALC, FRLC and FCA, *Submission 18*, BADAR bill, p. 20.

43 AGD, *Submission 17*, BADAR bill, p. 3.

44 BADAR Explanatory Memorandum, p. 15.

45 BADAR Explanatory Memorandum, pp. 15-16.

46 DCS Group, *Submission 6*, BADAR bill, p. 4.

47 Mr Michael Lhuede, *Submission 15*, BADAR bill, p. 3.

3.34 Some submitters suggested other mechanisms would be more appropriate to calculate the amount a debtor should pay towards a debt agreement. For example, DCS Group argued that using the 'Henderson Poverty Line'[48] to determine the amount a debtor should pay would provide a fairer outcome as it would allow high-income earners to contribute more than low-income earners.[49] DCS Group explained that the basic income amount set by the Henderson Poverty Line would be subtracted from the person's income, which would provide an amount that should be paid to creditors.[50]

3.35 Fox Symes & Associates (Fox Symes) argued that, given the circumstances of each debtor is different, a debtor's circumstances should be assessed on an individual basis rather than applying a set ratio for all debtors.[51] Ms Deborah Southon, Executive Director of Fox Symes, elaborated on this point:

> …again, we think that careful consideration should be given to this amendment, because debtors' circumstances do vary and they are affected by things like where they live. If I live in regional Australia, compared with metropolitan Sydney or whatever, that may impact on things like my cost of living. If I live in the Kimberleys, that may impact on my food bill, for example, because it's remote. There are other issues: for example, the age of the debtor. If I'm 60 years old, I'm likely to have reached my maximum earning capacity compared to someone who is 25. The number of dependents that a debtor has has a great impact, as does their age and whether they are healthy. There are journey-to-work factors. So just legislating for a payment-to-income ratio is problematic, and I'm not sure the government should regulate how much a debtor should repay their creditors.[52]

3.36 Fox Symes suggested that instead, the National Consumer Credit Protection should be enacted:

> In 2009 the Government enacted the National Consumer Credit Protection Act (NCCP). A key component was the introduction of the responsible lending provisions. The NCCP moved away from relying upon the use of indexed percentages (ratios) or statistical benchmarks to using actual borrower living expenses to access how much a borrower could afford to borrow or more critically, afford to repay. It was argued this would logically lead to a superior outcome.[53]

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48 The Henderson Poverty Line provides a benchmark income that is required to support the basic needs of a range of family sizes and circumstances. Where a person or family earns below the set benchmark, they are said to be living in poverty. The poverty lines are updated every quarter: http://melbourneinstitute.unimelb.edu.au/publications/poverty-lines (accessed 7 March 2018.

49 DCS Group, *Submission 6,* BADAR bill, p. 4.

50 DCS Group, *Submission 6,* BADAR bill, p. 4.

51 Fox Symes & Associates, *Submission 10,* BADAR bill, p. 4.

52 Ms Deborah Southon, Executive Director, Fox Symes & Associates, *Proof Committee Hansard,* 5 March 2018, p. 41.

53 Fox Symes & Associates, *Submission 10,* BADAR bill, p. 4.

3.37 CALC, FRLC and FCA were supportive of the introduction of a payment to income ratio, stating that the current framework 'has no effective mechanism to gauge sustainability.'[54] However, CALC, FRLC and FCA suggested that if the ratio were to be applied, it should be applied to the person's income after the deduction of housing costs.[55]

3.38 Submitters expressed mixed views in relation to the actual income ratio that should be set by the minister. For example, DCS Group argued that for debt agreements to be a viable alternative to bankruptcy, the income ratio should be set at a minimum of 50 per cent, and realistically, higher than 100 per cent.[56] However CALC, FRLC and FCA were 'strongly opposed' to the ratio exceeding 100 percent and instead suggested that an appropriate ratio would be 15 percent over the three years.[57]

3.39 The Department explained that the ratio 'would only prevent certain types of agreements, rather than deeming lower income debtors ineligible. Therefore, the Bill preserves debtors' access to the system while protecting them from undertaking excessive payment schedules.'[58]

Doubling of asset threshold

3.40 Currently, paragraph 185C(4)(c) of the Act prevents a debtor from proposing a debt agreement to the Official Receiver if the value of the debtor's property is greater than the asset threshold, which is currently $111,675.20.[59] Item 17 of the bill proposes to double the asset threshold to account for Australian property prices, and 'to ensure a greater proportion of debtors have access to the debt agreement system.'[60]

3.41 Submitters were generally of the view that the increase to the asset threshold would not have much impact on the debt agreement regime and suggested that all three thresholds which limit a debtor's access to the debt agreement regime should be reconsidered.[61] Mr Clifford Mearns, argued that if the asset threshold were to be increased as proposed, then the debt threshold and income threshold should also be doubled—'All three thresholds should be equal as they have been in the past.'[62]

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54 CALC, FRLC and FCA, *Submission 18*, BADAR bill, p. 18.

55 Ms Cat Newton, Policy Officer, CALC, *Proof Committee Hansard*, 5 March 2018, p. 19.

56 DCS Group, *Submission 6*, BADAR bill, p. 4.

57 CALC, FRLC and FCA, *Submission 18*, BADAR bill, p. 18.

58 Attorney-General's Department, *Submission 17*, BADAR bill, p. 5.

59 BADAR Explanatory Memorandum, p. 14.

60 BADAR Explanatory Memorandum, p. 14.

61 ARITA, *Submission 9*, BADAR bill, p. 7.

62 Mr Clifford Mearns, Director, SRMC Limited, *Proof Committee Hansard*, 6 March 2018, p. 25.

3.42 CALC, FRLC and FCA were supportive of the increase to the asset threshold. However, the submitters recommended that a minimum threshold be concurrently introduced.[63] Ms Newton explained how the minimum eligibility would work:

> You would be presumed to be ineligible for a debt agreement if two conditions applied: firstly, you have no realisable assets, assets that you would lose in bankruptcy; and, secondly, your income is below the threshold for compulsory contributions. We would suggest that that is a rebuttable presumption—and you could rebut that presumption if there is a clear demonstrable benefit for being in the debt agreement.[64]

Restriction on voting

3.43 Item 39 of the BADAR bill would require the Official Receiver to not request a vote on a debt agreement from a 'proposed administrator' or 'a related entity of the proposed administrator'.[65] The BADAR Explanatory Memorandum notes that this current situation creates a conflict of interest and consequently, 'undermines public and creditor confidence in the debt agreement system.'[66] The Department elaborated further on the potential for a conflict of interest to exist:

> Creditor confidence in the debt agreement administrator industry could also be undermined by proposed administrators or their related entities voting on debt agreements. This situation occurs when the debtor has not paid the administrator the full upfront fee at the proposal time. The administrator then becomes a creditor for the unpaid amount of the upfront fee. Alternatively, the administrator could be a creditor due to money they lent the debtor at an earlier time. In other circumstances, an organisation may separately operate credit and administrator functions, in which case the two businesses would be related entities.
>
> A voting administrator, or related entity, has a conflict of interest when voting on debt agreements, because most of the administrator's remuneration is dependent on the agreement being approved. Conversely, other affected creditors would primarily base their vote on the merits of the agreement, such as the risk and return of entering into the debt agreement, relative to other recovery options. Enabling an administrator or their related entity to vote would thereby distort the voting process and increase the likelihood that substandard debt agreements are approved.[67]

3.44 Credit Corp Group (Credit Corp) disagreed with this proposal. Credit Corp explained that it is both a debt purchasing company, as well as a debt agreement administrator and hold the status of a creditor through one or both of those means.[68] It

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63 CALC, FRLC and FCA, *Submission 18,* BADAR bill, p. 20.

64 Ms Cat Newton, Policy Officer, CALC, *Proof Committee Hansard,* 5 March 2018, p.19.

65 BADAR bill, subsection 185EA(4).

66 BADAR Explanatory Memorandum, p. 19.

67 AGD, *Submission 17*, BADAR bill, p. 4.

68 Credit Corp Group, *Submission 8,* BADAR bill, pp. 2–3.

argued that as a genuine creditor, it should be provided the opportunity to participate in the voting process.[69] Credit Corp argued that the conflict of interest does not exist with it being a creditor and an administrator, but rather when debt agreement administrators are also involved in debt management services:

> …there is indeed a fundamental conflict which arises in the voting process when a proposed administrator is also a creditor in circumstances where their presence as a creditor arises solely out of debt management activities and other activities associated with the debt agreement proposal. For example, where debts exist that are attributable to marketing of debt agreements or debt management services, advertising and referral expenditure associated with debt agreement services, advice to consumers in relation to budgets, credit files and debt agreements and the preparation and proposal process then the integrity of the voting process is undermined.[70]

3.45 However a majority of other submitters supported this proposed amendment, with some submitters, such as Ms Southon, arguing that the bill should go further:

> In all other insolvency regimes—that is, administrations and liquidations under the Corporations Act; bankruptcy and personal insolvency under the Bankruptcy Act—the concept and application of the independence of the administrator is sacrosanct. ASIC's definition of 'independence' includes that an administrator of an insolvent estate must not have or should not have had a close personal or business relationship with any person or entity involved in the insolvency. It is important that, at all times, the administrator is both independent and expected to be independent. We are therefore curious as to why, under the debt agreement regime, an affected creditor can also be an administrator. We therefore recommend that the bill prevent a [debt agreement administrator] from acting as an administrator for an administration in which it is an affected creditor, and this therefore allows it to conform to all other insolvency administrations.[71]

Increase to the number of bankruptcies

3.46 An underlying concern raised by many submitters was that the proposed changes to the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 and the BADAR bill would have the effect of decreasing the number of debt agreements and increasing the number of bankruptcies. ARITA warned that the changes to debt agreements, combined with the proposed change to the default period for bankruptcy from three years to one year, could have 'the potential for those changes to shift the focus of those in financial distress from one personal insolvency option to another.'[72]

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69 Credit Corp Group, *Submission 8,* BADAR bill, p. 6.

70 Credit Corp Group, *Submission 8,* BADAR bill, p. 6.

71 Ms Deborah Southon, Executive Director, Fox Symes & Associates, *Proof Committee Hansard,* 5 March 2018, p. 42.

72 Mr John Winter, Chief Executive Officer, ARITA, *Proof Committee Hansard,* 5 March 2018, p, 57.

3.47 However, a number of submitters were of the view that debtors generally did not file for bankruptcy if their debt agreement proposal was rejected or terminated. For example, Ms Southon noted that in her experience, the number of people who file for bankruptcy after their debt agreement is terminated 'is not significant'.[73] Mr Benjamin Paris, Registered Debt Agreement Administrator, DCS Group stated the following:

> My personal experience demonstrates that Australians do not want to file for bankruptcy. They'll avoid it at all costs. It's an error in logic to think that insolvent debtors are choosing between bankruptcy and debt agreements. Bankruptcy for most people is never on the table. It's also an error to think that, because the bankruptcy return is low, creditors will be willing to accept a dramatic drop in debt agreement returns. Creditors know that debtors in reality are choosing between debt agreements and hardship arrangements. AFSA's data shows that very few people whose debt agreements are rejected or terminated actually file for bankruptcy.[74]

3.48 In relation to the amount that creditors would receive under the proposed changes to both bills, Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit of the Department, explained that it was unlikely to have an impact in the bankruptcy regime but that they were not able to make a determination under the debt agreement regime:

> Under the reforms to that regime, creditors in most respects will receive the same amount of money. From the debt agreement regime, there would likely be an impact, but, again, that's the necessary outcome of the balance drawn through these proposals of trying to make those debt agreement repayments for debtors more sustainable and less financially detrimental to the debtors.[75]

3.49 Additionally, Mr Johnson acknowledged that debtors who are no longer eligible under the debt agreement regime may file for bankruptcy, however, may alternatively avail themselves to another approach under the regime:

> I think you are correct to a degree, Senator, in saying that, if you are no longer eligible for the debt agreement regime, you may turn to bankruptcy either on your own volition or your creditor's behest, but there is a bunch of other options as well, including continuing to pay off your debts without the structured legal regime around it. That also goes to the crux of the government's intention in these reforms, which is to provide options which are suited to different situations. The debt agreement regime is suitable in a particular context, with the asset threshold and the income threshold and the debt threshold, provided they are met and in a circumstance where creditors

73 Ms Deborah Southon, Executive Director, Fox Symes & Associates, *Proof Committee Hansard,* 5 March 2018, p. 44.

74 Mr Benjamin Paris, Registered Debt Agreement Administrator, DCS Group, *Proof Committee Hansard,* 6 March 2018, pp. 43–44.

75 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard,* 5 March 2018, p. 11.

> are satisfied with the return that they're getting, taking into account the other options that might be out there. The bankruptcy regime is suited to a slightly different context. I wouldn't put it that the debtors have the choice. There was a witness earlier today who said it's not quite like that, and I would agree with that. But, between the debtors and the creditors and the professional advice that they avail themselves of, they have different approaches available to them under the regime.[76]

76 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 61.

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.

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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

Appendix 1

Public Submissions

Bankruptcy Amendment (Enterprise Incentives) Bill 2017

1 Mr Geoff Green

2 J P Downey & Co

3 Mr Michael Lhuede

4 DCS Group Australia

5 Dye & Co Pty Ltd

6 Australian Securities & Investments Commission

7 SellersMuldoonBenton

8 CPA Australia

9 Law Council of Australia

10 Australian Restructuring Insolvency & Turnaround Association

11 Australian Institute of Credit Management

12 Pitcher Partners

- 12.1 Supplementary to submission 12

13 Financial Rights Legal Centre, Financial Counselling Australia & Consumer Action Law Centre

14 Australian Financial Security Authority

15 Australian Bankers' Association Inc.

16 Australian Criminal Intelligence Commission

17 Attorney-General’s Department

18 Justice Connect

- 18.1 Supplementary to submission 18

19 Commercial and Property Law Research Centre

20 Mr Peter McNamee

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 [Provisions]

1 Professor Ian Ramsay, Harold Ford Professor of Commercial Law and Ms Lucinda O’Brien, Research Fellow, Melbourne Law School

2 SRMC Limited

3 Legal Services Commission of South Australia

4 Australian Criminal Intelligence Commission

5 Australian Financial Security Authority

- 5.1 Supplementary to submission 5

6 DCS Group

7 Institute of Public Accountants

8 Credit Corp Group

9 Australian Restructuring Insolvency & Turnaround Association

10 Fox Symes & Associates

11 Mendelsons National Debt Collection Lawyers; Prushka Fast Debt Recovery; and Zurich Capital & Finance

12 Ms Janice Paris

13 Personal Insolvency Professionals Association

14 Australian Bankers' Association Inc.

15 Mr Michael Lhuede

16 Professor Christopher Symes

17 Attorney-General's Department

18 Consumer Action Law Centre, Financial Rights Legal Centre, and Financial Counselling Australia

19 Ms Betty Weule A.M

Additional information, answers to questions on notice and tabled documents

Additional information

Bankruptcy Amendment (Enterprise Incentives) Bill 2017

1 Additional information from the Australian Criminal Intelligence Commission - Hansard corrections

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 [Provisions]

1 Additional information from the Australian Criminal Intelligence Commission - Hansard corrections

2 Response from Credit Corp to adverse comment

Answers to questions on notice

Bankruptcy Amendment (Enterprise Incentives) Bill 2017

1 Consumer Action Law Centre - answers to questions on notice from public hearing 5 March 2018 (received 13 March 2018)

2 Australian Restructuring Insolvency and Turnaround Association - answers to questions on notice from public hearing 5 March 2018 (received 9 March 2018)

3 Australian Banking Association - answers to questions on notice from public hearing 5 March 2018 (received 9 March 2018)

4 Australian Financial Security Authority - answers to questions on notice from public hearing 5 March 2018 (received 14 March 2018)

5 Attorney-General's Department - answers to questions on notice from public hearings 5 and 6 March 2018 (received 14 March 2018)

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 [Provisions]

1 Consumer Action Law Centre - answers to questions on notice from public hearing 5 March 2018 (received 13 March 2018)

2 Australian Financial Security Authority - answers to questions on notice from public hearing 5 March 2018 (received 14 March 2018)

3 Attorney-General's Department - answers to questions on notice from public hearings 5 and 6 March 2018 (received 14 March 2018)

Tabled Documents

Bankruptcy Amendment (Enterprise Incentives) Bill 2017

1 Document tabled by the Australian Criminal Intelligence Commission at the public hearing on 05 March 2018 - Serious Financial Crime in Australia 2017 report

2 Document tabled by CPA Australia at the public hearing on 06 March 2018 - opening statement

3 Document tabled by the Australian Securities and Investments Commission at the public hearing on 05 March 2018 - opening statement

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 [Provisions]

1 Document tabled by the Australian Criminal Intelligence Commission at the public hearing on 05 March 2018 - Serious Financial Crime in Australia 2017 report

2 Document tabled by CPA Australia at the public hearing on 06 March 2018 - opening statement

3 Document tabled by Mr Clifford Mearns, SRMC Ltd at the public hearing on 06 March 2018 - reports and data tables

4 Document tabled by Personal Insolvency Professionals Association at the public hearing on 05 March 2018 – pamphlet

5 Document tabled by Mr Benjamin Paris, DCS Group at the public hearing on 06 March 2018 - documents provided by Credit Corp

Appendix 2
Public hearings and witnesses

Monday, 5 March 2018 – Sydney

BEREGI, Mr Thomas, Chief Executive Officer, Credit Corp Group Limited

COX, Ms Karen, Coordinator, Financial Rights Legal Centre

EDWARDS, Ms Victoria (Tori), Head of Pro Bono Partnerships, Justice Connect

FARMER, Ms Alexandra, Principal Lawyer, Self-Representation Service, Justice Connect

FORD, Ms Melissa-Jane, Principal Legal Officer, Private International Law and Commercial Policy, Civil Law Unit, Attorney-General's Department

GILBERT, Mr Ian, Executive Director, Legal and Regulation, Australian Banking Association Inc.

GLENN, Mrs Melissa, Committee Member, Personal Insolvency Professionals Association

GRAY, Mr Warren, State Manager, New South Wales Operations, Australian Criminal Intelligence Commission

GRAYBURN, Mr Murray, Director, Personal Insolvency Professionals Association

JOHNSON, Mr Michael, Acting Assistant Secretary, Civil Law Unit, Attorney-General's Department

McCOSKER, Mr Gavin, Deputy Chief Executive, Australian Financial Security Authority

MERCHANT, Mr Rasad, Secretary, Personal Insolvency Professionals Association

MITRA, Mr Dipen, Director, Insolvency and Trustee Service, Australian Financial Security Authority

NEWTON, Ms Cat, Policy Officer, Consumer Action Law Centre

PANGBOURNE, Mr Mark, Senior Specialist, Australian Securities and Investments Commission

PAUL, Ms River, Australian Financial Security Authority Statistician, Australian Financial Security Authority

PORTER, Mr Jason, Committee Member, New South Wales, Australian Restructuring Insolvency and Turnaround Association; and Director, SV Partners

ROSS, Mr David, Head of Determination, Financial Crime Intelligence Hub, Australian Criminal Intelligence Commission

SELLARS, Mr Andrew, General Counsel, Australian Financial Security Authority

SHAW, Mr Paul, National Manager, Regulation and Enforcement, Australian Financial Security Authority

SOUTHON, Ms Deborah, Executive Director, Fox Symes & Associates

STOGDALE, Mr George, Senior Executive, Australian Securities and Investments Commission

SYMES, Mr Richard George, Chair, Personal Insolvency Professionals Association

WELLARD, Mr Mark, Legal Director, Australian Restructuring Insolvency and Turnaround Association

WINTER, Mr John, Chief Executive Officer, Australian Restructuring Insolvency and Turnaround Association

Tuesday, 6 March 2018 – Melbourne

CULL, Mr Innis, Senior Manager, Pitcher Partners

DOWNEY, Mr James, Private capacity

FORD, Ms Melissa-Jane, Principal Legal Officer for Private International Law & Commercial Policy, Civil Law Unit, Attorney-General's Department

GIASOUMI, Mr Nicholas, Director, Dye & Co. Pty Ltd

JOHNSON, Mr Michael, Assistant Secretary, Civil Law Unit, Attorney-General's Department

LEECH, Mr Peter, Chair of the Insolvency and Reconstruction Committee, Business Law Section, Law Council of Australia

LHUEDE, Mr Michael, Private capacity

MEARNS, Mr Clifford, Director, SRMC Limited

MENDELSON, Mr Roger Glave, Chief Executive Officer, Prushka Fast Debt Recovery Pty Ltd

PARIS, Mr Benjamin, Registered Debt Agreement Administrator, DCS Group

PURCELL, Dr John, Policy Adviser ESG, CPA Australia

RAMBALDI, Mr Gess, Partner, Pitcher Partners

ROZEA, Ms Jennifer, Private capacity

RUHE, Mrs Alice Fay, Partner, SellersMuldoonBenton