DEBT AGREEMENT
SUBMISSION

TRUST | FREEDOM | UNDERSTANDING

Personal background

I am writing to highlight my concerns about the Bankruptcy Amendments (Debt Agreement Reform) Bill 2018, currently being considered by the Legal and Constitutional Affairs Legislation Committee.

I am a Registered Debt Agreement Administrator at DCS Group Australia; we have prepared over 13,000 Debt Agreements.I hold a Masters in Accountancy and a Masters of Business Administration. I have over ten years of experience in the Debt Agreement Industry and am currently on the board of the Personal Insolvency Professionals Association.
I would also be happy to appear as a witness.

The main reason people entered into a Debt Agreement, according to recent research commisioned by AFSA (Australian Financial Services Authority), was they thought "repaying their debts was the right thing to do". From my discussions with international insolvency professionals and creditors, this would seem to be a unique cultural feature of Australians. None of the stated legislative goals of debt agreement reform is allowing insolvent individuals, the dignity of repaying their debts, which I believe is a major oversight. Many of the proposed changes will exclude people from being able to do a debt agreement and make bankruptcy the only insolvency option available to them, which we believe is a mistake.

The current debt agreement system has broadly accomplished the stated legislative goal of providing a low-cost alternative to bankruptcy. Completion rates are dramatically higher (approximately 85%) compared to other jurisdictions (65% in the UK). The creditor acceptance rates are high and increasing. A recent survey of debtors conducted by Monash University found that debt agreements can be a 'relief' and 'life-changing' for debtors. The survey is broadly in alignment with DCS Group's internal research of all completed debtors, showing a satisfaction rating of 96% with their debt agreements.Debtor complaint levels are very low and dropping. In the 2016-2017 financial year, there were only 29 complaints to AFSA, of which four were found to be justified from 75,000 active Debt Agreements, a complaint rate of 0.00533%. Given that the system is broadly working, changes should be made with some caution.

There is concern that a minority of debtors are inappropriately placed in a debt agreement and that it causes financial hardship, this is broadly acknowledged within the industry and PIPA was in the process of implementing a policy to address this before this legislation was introduced. Any legislative change needs to ensure that damage is not done to the vast majority of debtors for whom the system works to prevent a negative outcome for a tiny minority.

There have been some concerns that debtors are ill-informed. However, this seems groundless. A recent AFSA commisioned survey of debtors showed that 99% of people were able to identify that they were in an insolvency agreement and the majority of debtors "were told the consequences of personal insolvency."

Executive summary of recommendations

- Utilise the Henderson Poverty Line (Melbourne Institute – University of Melbourne), rather than a flat percentage of income. This will be a progressive system that doesn't fall hardest on low-income earners.
- Remove the Budget Section from the Official Form.
- Set a maximum term for Debt Agreements of five years from the start date of the Debt Agreement.
- It should not be the role of the Official Receiver to reject a Debt Agreement based on a subjective definition of affordability.
- Debt purchasers should ONLY be able to vote on the consideration paid for a debt. This harmonises voting in Debt Agreements with voting in Part IV and Part X of the Bankruptcy Act.
- The default vote should be 'yes', if no creditors vote, to prevent Debt Agreements from lapsing.
- Debt Agreement Administrators should receive (by priority payment) a 'set up fee' to be voted on by creditors.
- Arrears should be reported to creditors only when they reach $300 or 20% of the total agreement, whichever is higher, and thereafter when arrears reach multiples of these figures.
- There should be no requirement for professional indemnity insurance.
- Income and debt thresholds should be increased to $500,000.
- Debt Agreements should not be able to be terminated unless there is an arrears event.
- There should be a "Declaration of intention to present a Debt Agreement. A form that gives people a 28 day period free from interest, fees and legal action to consider their options.

Payment to income ratio

The Minister will be able to set a maximum debt to income ratio. There are several potential issues with this idea.

It falls hardest on low-income debtors

Setting a maximum debt to income ratio is not progressive.

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. However, if Person B had an after-tax wage of $1,600 per week (the upper-income threshold), they would be left with $1,280 per week, despite being able to afford higher payments.

It would seem a better idea to use all income above the Henderson Poverty Line (HPL) plus accommodation costs and secured loan repayment/s. Using the HPL sets aside enough income for living expenses, but allows high-income earners to contribute more.

For example, The HPL for a single person not in the workforce is $248.27 per week. Maximum DSP is $442.20 per week. If Person A's board is $175 per week, they would be able to contribute $18.93 per week ($442.20 - $248.27 - $175 = $18.93) toward their Debt Agreement. The HPL for someone in the workforce is $345.33. If Person B is earning $1,600 per week, their rent is $500 per week, and they have a $200/week car loan they would be able to pay $554.67/week ($1,600 - $345.33 - $500 - $200 = $554.67) to their creditors each week.

Removal of Budget section

Administrators are required to send a household budget to creditors as part of the Official Form. The budget is used to show creditors what is affordable. Creditors do not receive budgets in Personal Insolvency Agreements (Part X of the Bankruptcy Act) or Bankruptcy. If the 'income percentage' proposal is adopted, the budget may show that the debtor can afford more than is allowable under the law leading the creditor to reject the agreement even though the debtor cannot pay more.

We recommend removing the budget section of the form.

The Administrator will still prepare a budget as part of their certification duties. However, there seems little reason to provide a budget to creditors if the income ratio is accepted. Administrators frequently get into arguments with creditors over five dollars in entertainment expenses or grocery budgets.

Ratio needs to be higher than 50%

Creditors, in the preponderance of cases, only approve Debt Agreements if the return is greater than would be obtained under Bankruptcy. Under Bankruptcy, assets are liquidated, and income above a threshold will be distributed to creditors. Under the proposal, many debtors will be left unable to offer more to creditors than what is available under Bankruptcy, thereby rendering bankruptcy as inevitable. The top maximum income threshold for a Debt Agreement is $83,756.40 after tax, and the Bankruptcy income threshold is $55,837.60. The income contributions under Bankruptcy would be $13,959.40 per year for three years, or $41,878.20. This equates to 50% of the debtor's annual income. **The Minister needs to set the income ratio at a minimum of 50%, and, realistically, higher than 100%.**

The Asset problem

One of the reasons people enter into a Debt Agreement is to protect an asset, typically their owner-occupied property. As discussed above, debtors need to improve upon what would be available to creditors under Bankruptcy. If the maximum income ratio is adopted it would take very little in assets to make it impossible to exceed the Bankruptcy rate of return. At the top end of the income threshold, $83,756.40, it would take $70,000 in assets to have a Bankruptcy rate of return of 100%, assuming the debtor has the maximum amount of debt available under a debt agreement. **Setting a maximum income ratio will prevent people from exceeding the Bankruptcy return making Bankruptcy and the loss of their owner-occupied property inevitable.**

Debt Agreements' maximum term of 3 years from NPII, including Variations

Most Debt Agreements currently have a term of 5 years, due to creditors requirement for higher rates of return. Setting a maximum term of three years will reduce the term of debt agreement on average by two-fifths.

We recommend that the maximum term be five years in line with current industry practice due to the following:

Drop in returns to creditors

According to our modelling, reducing the maximum term to three years will reduce creditor returns from an average of 63 cents to 38 cents in the dollar. This would reduce money returned to creditors by $70 million per year. Creditors will presumably recoup this money through higher interest and fees on the rest of their lending, or by restricting the supply of credit to vulnerable people.

Assets

The reduction in term will make it impossible for most people with a house to better the rate of return Bankruptcy would deliver to their creditors, thereby forcing insolvent debtors into Bankruptcy. Setting a limit of three years reduces the amount you can offer by two fifths. In Bankruptcy, all assets excluding Bankruptcy protected assets are sold and distributed to creditors. The primary place of residence is the main asset people have, and this asset is distributable to creditors under Bankruptcy.

Payments in the bank

There is a common practice among Administrators of putting the official start date of the agreement several weeks after the approval date. This allows the debtor to be several weeks in front with the agreement from the beginning. If for whatever reason, they dishonour a payment they are not automatically in arrears. If the debtor falls into arrears and they cannot make the payment within the three month arrears period, this has to be reported to creditors who may opt to Terminate the agreement. Commencing the three year period on the NPII date will prevent this practice and lead to an increase in Terminations. **The agreement should start at the date identified by the Administrator, not the NPII.**

10 to 15% increase in fall overs

Between 10 and 15% of Debt Agreements will require a formal Variation during the life of the agreement. A Variation is a proposal, put to creditors, to change the Debt Agreement when the debtor's circumstances change (reduced income, another child, lost job, etc.). Creditors in the main refuse to accept a reduction in the rate of return; necessitating an increase in the term to maintain returns. This will be impossible under the suggested maximum three-year term. It seems unlikely that a creditor will vote to accept a further reduction in their debt. If and when they allow the agreement to Terminate, they can collect on the full amount and backdate interest to the NPII date.

The Official Receiver can refuse to accept an agreement if they believe it will cause undue hardship

There are no objective criteria as to what defines undue hardship in the proposed law. Whether or not to accept a proposal for processing will be at the subjective whim of the Official Receiver.

A law that makes an Australian potentially ineligible for a Debt Agreement at the whim of a public servant is poor policy. We believe that the prevention of undue financial hardship could best be accomplished by the adoption of our Henderson Poverty Line proposal which sets aside a sum of money for expenses.This makes the subjecting "Undue Hardship Proposal" redundant.

We recommend that there be no powers given to the Official Receiver to reject Debt Agreements due to financial hardship.

Debt Agreement Administrators will not be able to vote on Debt Agreements or Variations

There are several problems with voting.

Debt Purchasers

Debt Purchasers buy debt for very little, 1 to 30% of the face value of debt, but can vote on the whole debt. In Bankruptcy and Personal Insolvency Agreements, they can only vote on the amount they paid for the debt. This is a fairer treatment. For example, if Creditor A has a $10,000 debt, and Creditor B purchased a $10,000 debt for $1,000. In a Debt Agreement, they can both have an equal vote of $10,000, but Creditor A has a potential loss of $10,000 while Creditor B only has the potential to lose $1,000. This is vastly unfair to the normal, non-purchasing creditors. **Creditors should only be able to vote on the amount of consideration paid for the debt.**

Problems with creditors not voting

If no creditor votes, which happens often, a Debt Agreement lapses; this has the same effect as a rejected debt agreement. This problem is currently addressed by Debt Agreement Administrators voting on their uncollected fees. If Administrators are not able to vote on their debt, many Debt Agreements will lapse, leading to an increase in government submission fees. **We recommend that votes should be assumed to be in favour of the Debt Agreement unless a creditor actively votes no.**

Debt Agreement Administrators

Many Debt Agreement Administrators include their upfront fees in the Debt Agreement, and will then get paid over the term of the agreement, at a reduced return and in line with other creditors. If this proposal is to be accepted, Administrators will collect all their upfront fees before submitting the agreement, and therefore delaying the processing. In Personal Insolvency Agreements, Trustees receive a 'Controlling Trustee fee' as a priority payment. This allows the Trustee to be remunerated for their extensive upfront expenses. **To encourage the prompt processing of agreements, we strongly recommend that Debt Agreement Administrators receive a priority payment that creditors would vote on, similar to the 'Controlling Trustee fee'.**

The creation of a penalty for offering any consideration to a creditor in return for a vote

There has been no evidence provided that Administrators are bribing creditors. If any cases are found, these can be dealt with under existing anti-bribery laws. The adoption of this clause would cause the following unanticipated consequences:

Secured Creditors

It is quite common for debtors in Debt Agreements to have a secured debt with no securing assets, or an asset of very little value. For example, a car loan of $10,000 where the car was written-off and the debtor did not have suitable insurance. The debtor has frequently breached their loan contract, for example, not having insurance, or selling the asset.

Many creditors will request a small payment from the debtor to 'unsecure' the asset and are then happy to be included in the agreement as an unsecured creditor. We believe these payments would be swept up in this clause and thereby would make a Debt Agreement unviable for these people.

We recommend that the committee reject this clause.

Only reporting on arrears if the arrears exceeds $300 or 20% (whichever is higher)

There is little doubt that the existing arrears reporting legislation is a nightmare both for creditors and Administrators. The existing legislation is incredibly labour intensive. DCS Group currently has five full-time, and one part-time employee to ensure compliance, at the cost of $275,000/year. However, this clause does nothing to alleviate this, in fact it adds more complexity as it still requires the Administrator performs three months of arrears monitoring. However, it adds an additional requirement to monitor for when it exceeds $300 or 20% of the payments today.

We recommend that section 135LF be replaced by reporting to creditors only when $300 or 20% (whichever is higher) and then again on multiples of these.

Requirement for professional indemnity insurance

Professional Indemnity insurance is designed to protect professionals and their customers against legal costs and damages which may occur as a result of a breach of professional duty. There needs to be a loss for there to be damages. I am unaware of any case of an Administrator being pursued for losses, and this is unlikely given that administrators are dealing with an insolvent clientele.

The responsibilities of Administrators differ to those of Trustees. An Administrator does not deal with an insolvent person's assets. A debtor may propose to sell an asset and distribute those funds to their creditors, however the asset will never vest in the Administrator nor will they ever sell an asset. Administrator's duties are limited to certifying that the payments are affordable, receives payments from a debtor, and distributing those funds to creditors. I find it difficult to conceive a situation that would give rise to a loss, and there is no evidence insurance is required for this. It will also lead to Administrators incurring significant costs. Preliminary quotes we have obtained for insurance are more than $50,000 per annum. **We recommend that the proposal for requiring professional indemnity insurance does not proceed.**

Increasing the asset threshold

This increase will accomplish absolutely nothing. Assets do prevent people from entering Debt Agreements rather; it makes Bankruptcy more attractive to creditors and thus they reject Debt Agreements.

For example, Debtor A has $100,000 worth of debt and $200,000 worth of equity in a property; they can afford to propose $50,000 over five years, or 50%. Creditors will reject this as under Bankruptcy they would get 100% of their debt back, within six months. Unless there is protection for the owner-occupied home introduced into Bankruptcy, creditors will continue to reject Debt Agreements for commercial reasons. However, debtors are frequently prevented from doing a Debt Agreement due to having too much debt or income. **We recommended that the thresholds for Income and Debt be increased to $500,000.**

Extra items

There is a concerning emerging practice of Debt Purchasers moving terminate agreements where the debtor is fully compliant with the terms of their debt agreement. This allows the Debt Purchaser to collect on the full amount rather than the reduced portion and to backdate interest to the NPII date.

For example. A Debt Purchaser purchases several debts in a debt agreement, for 10cents in the dollar. The debt agreement rate of return is 50%. The face value of the debts owed to the Debt Purchaser is $100,000. The Debt Purchaser paid $10,000 and will collect $50,000 over five years under the agreement. The Debt Purchaser submits a termination request and no other creditor bothers to vote. The debt agreement now terminated, the Debt Purchaser pursues the debtor for $150,000, the $100,000 face value of the debt plus $50,000 in interest backdated to the start of the agreement. The debtor who is trying to avoid bankruptcy because they will lose their home enters into a "hardship arrangement" to pay the Debt Purchaser $150,000 over 25 years.

The above situation has happened several times now. Concerns have been raised with AFSA about the practice. However, I have been told by David Bergman – The Official Reciever that "Creditors are well within their rights to terminate an up to date agreement".

We recommend that debt agreements not be able to be terminated unless they have a reported arrears event.

There is some concern that debtors make decisions in a stressful situation and that this affects their decision-making ability. If a debtor wishes to file for bankruptcy, they can file a "Declaration of Intention to present a Debtors Petition". This hits the metaphorical pause button. It gives the debtor a 21 day period, where debtors cannot pursue legal action, debt collection activity, or charge interest or fees. This removes stress and grants the debtor space to make a decision. Many debtors do not end up filing for bankruptcy having found some other solution in that period. Someone submitting a debt agreement should be afforded the same privilege. We feel however this period is not long enough to properly consider their circumstances and that 28 days would be more appropriate

We recommend that a "Declaration of Intention to submit a Debt Agreement", that affords 28 days of protection be introduced.

PO Box 3074, Newstead QLD 4006
Phone: 1300 725 052
Fax 1300 329 327
Email contact@dcsgroup.com.au
WWW.DCSGROUP.COM.AU

Australian Credit Licence 382607

Debt Agreement Administrators Reg No: 1126