



Bankruptcy Amendment (Debt Agreement Reform) Bill 2018

**Submission by
Credit Corp Group Limited**

16 February 2018

Table of Contents

Part 1 – Executive summary	2
Part 2 – Company profile	2
2.0 Introduction	2
3.0 Core business	3
4.0 Debt administration	3
Part 3 – Credit Corp’s concerns with debt agreements	4
5.0 Poor consumer awareness and understanding of debt agreements	4
6.0 Concerns with debt agreement proposals	4
Part 4 – Competition and innovation	5
7.0 Impact of voting exclusion on competition and consumer outcomes	5
Part 5 – Conflicts of interest	5
8.0 Impact of voting exclusion on creditor outcomes	5

Submission by Credit Corp Group Limited (Credit Corp)

Part 1 – Executive summary

- 1.1 Credit Corp is an ASX200 listed public company and is Australia's largest provider of sustainable financial services in the credit impaired consumer segment. In 2011 Credit Corp established a debt administration entity to bring competition on price and product features to the Part IX Debt Agreement marketplace. This entity offers a uniquely affordable product to consumers and delivers superior creditor returns through lower fee rates.
- 1.2 Credit Corp welcomes the 2018 debt agreement reforms, in particular those reforms which address our concerns as to the affordability and sustainability of some debt agreement proposals.
- 1.3 Credit Corp has substantial experience with debt agreements and is a creditor on approximately one in three debt agreement proposals and active debt agreements in Australia. Our presence as a creditor is unrelated to the marketing or administration of agreements, but rather because of our core business portfolio of 710,000 customers.
- 1.4 As the only major creditor who also operates a debt administration entity, Credit Corp is concerned with the reforms which would exclude our vote on proposals where our entities are both the proposed administrator and an affected creditor. Given the significance of our core business in the Australian marketplace this would substantially forfeit our rights on debt agreements administered by Credit Corp and would compromise the viability of our debt agreement business.
- 1.5 It is crucial that the debt agreement reforms do not stifle innovation and competition, in particular in circumstances where there is evidence of innovation and competition resulting in superior outcomes for both consumers and creditors.
- 1.6 The proposed reforms which would exclude Credit Corp's vote are based on a misguided view of conflict during the voting process, where the focus of concern should be on the inherent conflict and potential for consumer harm created during the proposal process.
- 1.7 Credit Corp recommends that the voting exclusion is limited to debts associated with debt management services or any other services associated with the debt agreement proposal itself.

Part 2 – Company profile

2.0 Introduction

- 2.1 Credit Corp is Australia's largest provider of sustainable financial services in the credit impaired consumer segment.
- 2.2 Credit Corp has been listed on the Australian Securities Exchange since 2000 and forms part of the S&P ASX 200 index. The company is an Australian success story employing over 1,500 people with business operations in Australia, New Zealand, the USA and the Philippines. The face value of Credit Corp's total receivables is approximately \$6 billion across 710,000 consumers.

3.0 Core business

- 3.1 Credit Corp's core business is debt purchasing. Credit Corp purchases charged-off (defaulted) unsecured consumer debts from major banks, finance companies and telecommunication and utility providers. By providing lenders with higher and more timely returns on charged-off debts, Credit Corp helps to reduce the cost of credit and to promote its wide availability within the Australian economy.
- 3.2 We are a recognised leader in sustainable business practices and maintain certifications under ISO 9001:2008 (Quality Management System) and ISO 27001: 2013 (Information Security Management System). Financial services have become a basic need in the modern market economy,¹ and Credit Corp plays an important role in working with consumers who suffer from financial exclusion. Our objective is to improve the situations of our customers by establishing pathways to mainstream financial inclusion. By pursuing this objective, Credit Corp has led a revolution in the business of late stage debt collection to the benefit of consumers.
- 3.3 In our core debt purchasing business, we work with consumers who have, for various reasons, found themselves in default of their credit obligations. We agree affordable repayment plans and work with our customers over several years to improve their credit standing as a pathway to financial inclusion. In effect, the objective of our activities with customers in our core business is aligned with the objectives of a debt agreement.
- 3.4 Credit Corp currently has a portfolio of \$1.3 billion dollars of defaulted consumer credit obligations, restructured into sustainable ongoing repayment arrangements across 153,000 individual customer accounts. This is the most successful financial hardship program in the industry, with more than 75% of our total collections made pursuant to mutually-agreed ongoing payment arrangements.
- 3.5 At Credit Corp, we set operational standards at levels significantly above minimum legal requirements. We have a strong compliance culture supported by a control framework to ensure that we adhere to the standards we have set for ourselves. We openly engage with consumer stakeholders and regulators for ongoing feedback and assistance. This includes a long-term partnership with Kildonan Uniting Care to promote respectful engagement with consumers and the proactive recognition and management of financial hardship.
- 3.6 These commitments have established Credit Corp as an industry leader. Despite being the largest and longest-established debt purchaser in Australia, Credit Corp has never been the subject of a regulatory order or undertaking. We have one of the lowest rates of External Dispute Resolution (EDR) complaints in the debt purchasing industry, with only 1.2 complaints for each one million dollars collected. Credit Corp has never had a reportable EDR systemic issue.
- 3.7 Credit Corp commenced debt administration operations with the objective of leading a similar revolution in the business of providing debt management services to the credit impaired consumer segment, by introducing competition on the basis of price and sustainable product features. This decision aligned with Credit Corp's existing commitment to increasing financial inclusion and leveraged its existing infrastructure and investment in sustainable and responsible business practices.

4.0 Debt administration

- 4.1 Credit Corp established a debt administration business in 2011 and was registered in 2012. We have a significantly differentiated offering, charging customers no upfront fee for the preparation of the debt agreement proposal, thus the entirety of Credit Corp's return is earned

as customers repay creditors. To our knowledge this is unique to the sector for commercial debt agreement administrators, with all others charging customers upfront fees which typically cost several thousand dollars.

- 4.2 The second key differentiator in Credit Corp's offering is our fee rate, which is set at a maximum of 20%. This is substantially less costly than the fees typically charged by commercial debt agreement administrators, which based on our experience are most commonly set between 25% and 30%. Lower fee rates result in higher returns to creditors and in practice can also result in lower customer repayments (see 6.4 below).
- 4.3 Whilst Credit Corp's debt administration business remains modest in scale (a total of 36 debt agreements have been established since the business commenced) we have demonstrated that it is commercially viable to propose and administer debt agreements without charging vulnerable consumers large fees and without passing on substantial administration fees to creditors.

Part 3 – Credit Corp's concerns with debt agreements

5.0 Poor consumer awareness and understanding of debt agreements

- 5.1 As articulated in the Exposure Draft, the commercial debt agreement administrator industry now performs a significant financial advising function, including in relation to vulnerable consumers.²
- 5.2 Credit Corp has had significant exposure to Part IX debt agreements. Credit Corp is an affected creditor on over 25,000 current debt agreements and votes on approximately 350 debt agreement proposals per month. These volumes indicate that Credit Corp is currently involved in approximately one-third of Part IX debt agreements active or being proposed in Australia.
- 5.3 Credit Corp has had, and has communicated with the Australian Financial Security Authority (AFSA), a number of concerns with the operation of the debt agreement industry over the past several years. A key concern with the manner in which debt agreements are currently marketed, explained and established is the generally poor level of awareness of consumers who have entered debt agreements have as to what a debt agreement is and the consequences for themselves and their creditors.
- 5.4 In October 2017 AFSA reported the results of a recent survey of consumers who had entered debt agreements which included the finding that only 12% of survey respondents had specifically sought a debt agreement to assist with their financial situation. AFSA reported that a common response was that consumers were looking for a debt consolidation solution, which is consistent with Credit Corp's experience. In our experience it is common for consumers who have entered debt agreements to be unaware that the product is not a typical consolidation loan.
- 5.5 Lack of consumer awareness extends to an understanding of the fees charged by commercial debt agreement administrators, with only 27% of AFSA surveyed consumers reporting that they had paid both an upfront fee and ongoing fees, when it is probable that all consumers surveyed would have paid upfront and ongoing fees.

6.0 Concerns with debt agreement proposals

- 6.1 Alongside lack of product awareness, Credit Corp's concerns with debt agreements also extend to the proposal process and poor consumer outcomes on a number of proposals we have received.

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- 6.2 During the 2016 financial year, over 10% of debt agreement proposals received by Credit Corp were for consumers who had three or less creditors, excluding the debt administrator. Pleasingly, in 2017 AFSA's Official Receiver Practice Statement 12 clarified that it would no longer accept proposals where there is only one creditor unless there are exceptional circumstances.³ Whilst this deals with single creditor proposals, we remain concerned with proposals where there are only two to three creditors, in particular in circumstances where one creditor comprises the vast majority of indebtedness and it is clear that the vulnerable customer has not exhausted options such as a hardship variation with that creditor.
- 6.3 Credit Corp is concerned with debt administrators charging an upfront fee on debt agreement proposals that are never accepted by creditors. In these circumstances consumers have typically paid over \$1,000 and have received no outcome, placing considerable further strain on an already vulnerable financial situation.
- 6.4 Credit Corp's concerns extend to the affordability and sustainability of debt agreement proposals. Whilst customer repayments are designed to be calculated first by debt administrators before determining fee rates and dividends to creditors, in practice debt administrators are aware of the thresholds at which most major creditors will approve an agreement and may 'back solve' customer repayments to ensure approval and protect fees. This may strain a customer's budget beyond affordability, resulting in the variation or termination of the agreement which may add future cost and stress to a vulnerable customer's situation. Credit Corp welcomes the proposed reforms targeting the affordability of debt agreement repayments.

Part 4 – Competition and innovation

7.0 Impact of voting exclusion on competition and consumer outcomes

- 7.1 It is axiomatic that competition on price and product features in any market is more effective in improving consumer outcomes than regulation alone. It is therefore important that any lawmaking and regulatory activity provides an environment where ethical and responsible operators are encouraged and are not dis-incentivised to enter or remain in markets to promote such competition.
- 7.2 There are integration and synergy benefits associated with a creditor also acting as a debt administrator and Credit Corp has demonstrated the capability to leverage these synergies and profitably manage a commercial debt administration business without charging consumers upfront fees and charging an ongoing fee significantly lower than industry average.
- 7.3 To deliver improved consumer and creditor outcomes it is essential that competition and innovation is not stifled by the 2018 debt agreement reform. Credit Corp's debt administration entity is offering a unique, more affordable debt agreement product to Australian consumers and the implementation of items 39 and 40 of Schedule 1 and items 10, 11, 14 and 15 of Schedule 2 as currently drafted risks compromising the viability of this entity. We therefore urge the committee to adopt the proposal outlined below in paragraph 8.12 to serve the objective of promoting competition, innovation and improved consumer outcomes.

Part 5 – Conflicts of interest

8.0 Impact of voting exclusion on creditor outcomes

- 8.1 The Explanatory Memorandum states that allowing a proposed administrator or a related entity to vote on a debt agreement they propose to administer creates a conflict of interest and that this conflict of interest undermines public and creditor confidence in the debt

agreement system.⁴ However it is essential for the committee to recognise that debt agreement administrators are in an inherently conflicted position upon preparing and proposing any agreement they intend to administer.

- 8.2 Most commercial debt agreement administrators expend substantial amounts of money and labour on acquiring prospective customers and are only remunerated through the upfront and ongoing fees charged on those agreements. Therefore the incentive for the administrator is to maximise the repayments proposed to be made by customers under a debt agreement in order to (a) maximise fees to offset customer acquisition costs and generate profits and (b) improve the likelihood of creditors accepting the proposal.
- 8.3 Whilst some commercial debt agreement administrators have affiliates that offer other services (commonly other debt management services as defined by the Australian Securities & Investments Commission)⁵ the revenues derived from debt agreements are substantial and administrators are not motivated to act in the best interests of consumers, giving rise to this inherent conflict.
- 8.4 This conflict is managed through AFSA's oversight of commercial debt agreement administrators and AFSA's review and approval of each individual debt agreement. AFSA's processes and controls are the same for all debt agreements, regardless of the identity of creditor entities and any relationships those entities may have with the proposed administrator.
- 8.5 Unlike the conflict that exists when debt agreements are prepared and proposed, there is no conflict of interest relating to any consumer in the voting process. The voting process is not a consumer protection measure, but rather a measure to ensure a proportionate degree of accountability to all creditors. Through this process, each creditor will vote in accordance with its own interests and is not required to consider the interests of a consumer in determining how it will vote.
- 8.6 To ensure proportionate fairness, it is crucial that all genuine creditors are provided with the opportunity to participate in this voting process. A debt agreement represents a substantial forfeiture of creditor rights and as such every genuine creditor must be provided with the ability to provide its input.
- 8.7 However, 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. In these circumstances votes from genuine creditors are diluted by the introduction of votes from one or more creditors which would not have existed but for the debt agreement and debt management services connected to that agreement. Such debts are, at least in part, created with a purpose of influencing the voting outcome and should be excluded on this basis alone.
- 8.8 To the best of our knowledge, Credit Corp is currently the only registered debt administrator where a related party is likely to be a genuine, pre-existing creditor on a high proportion of debt agreement proposals. As articulated above, the scale of Credit Corp's core business is such that we are present on approximately one in three of all debt agreements and debt agreement proposals.

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- 8.9 Credit Corp's presence as a creditor does not arise as a result of any activity relating to the advertising, preparation, proposing or administration of debt agreements. Credit Corp's presence on a large number of debt agreements is attributable to our existing receivables portfolio of approximately \$6 billion across over 710,000 consumer accounts. This places our debt administration entity in the unique position of being the only registered debt administrator with a related party likely to be a genuine creditor of a high proportion of consumers for whom a debt agreement may be suitable.
- 8.10 Items 39 and 40 of Schedule 1 of the Exposure Draft would legislate such that Credit Corp would be excluded from voting on any agreements proposed by its registered debt administration entity.⁶ Similarly, Items 10, 11, 14 and 15 of Schedule 2 exclude Credit Corp's vote on any variation or termination proposed by its registered debt administration entity.⁷ This would result in Credit Corp facing a significant forfeiture of rights despite there being no conflict of interest for the consumer.
- 8.11 Credit Corp is concerned with the absolute prohibition as presently drafted. The Explanatory Memorandum states that this conflict of interest undermines public and creditor confidence in the debt agreement system,⁸ however the present drafting is not in the interests of vulnerable consumers or creditors.
- 8.12 Credit Corp recommends that the proposed legislation be amended to only exclude voting in respect of any debt arising in connection with debt management services or any other services associated with the debt agreement proposal itself. This formulation is superior to the present proposal for the following reasons:
- 8.12.1 this proposal preserves the voting capability of all genuine and pre-existing creditors and avoids legislation which would result in such creditors being forced to forfeit rights without any voice;
 - 8.12.2 this proposal is a broader and more effective formulation to prevent potential avoidance measures such as a debt agreement administrator using informally connected third party marketers, introducers and advisors to circumvent the related party prohibition; and
 - 8.12.3 this proposal discourages the levying of excessive fees by such informally connected marketers, introducers and advisers in order to influence voting outcomes and thus provides a superior layer of consumer protection.

¹ The Centre for Social Impact, 'Measuring Financial Inclusion in Australia' (Report, National Australia Bank, April 2014) 8.

² Explanatory Memorandum, Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (Cth) 2 [2].

³ Australian Financial Security Authority, 'Official Receiver Practice Statement 12' 4 [2.9 – 2.10].

⁴ Explanatory Memorandum, Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (Cth) 19 [96], 27 [146] & 29 [159].

⁵ Australian Securities & Investments Commission, 'ASIC Report 465: Paying to get out of debt or clear your record: The promise of debt management firms' (Report, Australian Securities & Investments Commission, January 2016) 4 [1].

⁶ Exposure Draft, Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (Cth) 11 [39] & 12[40].

⁷ Exposure Draft, Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (Cth) 16 [10 - 11] & 19 [14 - 15].

⁸ Explanatory Memorandum, Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (Cth) 19 [96], 27 [146] & 29 [159].