



Australian Government

Australian Financial Security Authority

Chief Executive & Inspector-General
in Bankruptcy

31 January 2018

Mr Tim Watling
Committee Secretary
Senate Legal and Constitutional Affairs Legislation Committee

By email: legcon.sen@aph.gov.au

Dear Mr Watling

Inquiry into the Bankruptcy Amendment (Enterprise Incentives) Bill 2017

Thank you for the invitation to make a submission for the inquiry into the Bankruptcy Amendment (Enterprise Incentives) Bill 2017.

Background

The Australian Financial Security Authority ('AFSA') is an executive agency in the Attorney-General's portfolio. AFSA's purpose is to maintain confidence in Australia's personal insolvency and personal property securities systems through delivering fair, efficient and effective trustee and registry services, and risk-based regulation. AFSA is responsible for administering the *Bankruptcy Act 1966*, the *Bankruptcy (Estate Charges) Act 1997* and associated Regulations. The Bankruptcy Act establishes:

- **Inspector-General in Bankruptcy**—AFSA's Chief Executive is also appointed as the Inspector-General in Bankruptcy. The Inspector-General is responsible for the general administration of the Bankruptcy Act and has powers to regulate bankruptcy trustees and debt agreement administrators, review decisions of trustees and investigate allegations of offences under the Bankruptcy Act.
- **Official Receiver**—On behalf of the Official Receiver, AFSA operates a public bankruptcy registry service with compliance and coercive powers to assist bankruptcy trustees to discharge their responsibilities.
- **Official Trustee in Bankruptcy**—The Official Trustee in Bankruptcy, a body corporate created under the Bankruptcy Act, administers bankruptcies and other personal insolvency arrangements when a private trustee or other administrator is not appointed. In 2016–17, the Official Trustee administered 81.5% of new bankruptcies. AFSA provides personnel and resources to ensure that the Official Trustee can fulfil its responsibilities. The Official Trustee also has responsibilities under the *Proceeds of Crime Act 2002* and the *Customs Act 1901* to control and deal with property under court orders made under those statutes.

All of the above offices are performed through the officials of AFSA. As the body responsible for administering the bankruptcy legislation, AFSA is in regular contact with the Attorney-General's Department, which provides advice to Government on bankruptcy policy matters.

Contents of the submission

Part 1 of this submission notes that a range of overseas jurisdictions have moved to a one year default bankruptcy period, and highlights some elements of an evaluation report on the United Kingdom's experience. Part 2 of this submission includes some information derived from AFSA data which may be of interest to the Committee. Part 3 of this submission includes some

observations from AFSA about how a change to the default bankruptcy period would be likely to affect certain administrative matters.

Part 1: International experience – the United Kingdom

A one year default bankruptcy period has been adopted in several countries with similar socio-legal environments to Australia; including England and Wales, Canada,¹ Ireland, Scotland and New Zealand.² There appears to have been few academic or government initiated evaluations to assess the impact of the reduction in default bankruptcy periods.

A review was conducted of the United Kingdom's reduction of its default period in 2004. The UK's report titled *Enterprise Act 2002 - the Personal Insolvency Provisions: Final Evaluation Report* November 2007³ provides the background to the change, noting that prior to 1 April 2004 the default bankruptcy period in the United Kingdom was three years. The Enterprise Act 2002 introduced automatic discharge one year after the commencement of bankruptcy. The report notes that the aim of the changes to discharge periods was to reduce the fear of failure and reduce the stigma of bankruptcy. In the report the summary of the evaluation with respect to discharge periods was that:

... the prompt rehabilitation of bankrupts (judged to be non-culpable who have fully co-operated with the Official Receiver) has been hindered by a bankrupt's restricted access to the financial market, which has not improved due to lack of change in lenders' policies. Further, the stigma associated with bankruptcy has not reduced. The evaluation has also identified that ...the reduced automatic discharge period has contributed to the prompt rehabilitation of bankrupts (p6)

The UK report also canvassed the impact of the Act on the number of personal insolvencies. It concluded that:

- the implementation of the Act coincided with an increase in bankruptcies but evidence suggests that there is no causal link between the implementation of the Act and the increase in bankruptcies
- the trend to greater numbers of bankruptcies was apparent before the Act commenced
- this trend was accompanied by a concurrent rise in the number of individual voluntary arrangements (IVAs - broadly similar to Australia's Debt Agreements), where there had been no significant legislative change since their introduction in 1986
 - in percentage terms, the level of IVAs saw a significantly greater rise than the increase in bankruptcy numbers.
 - since the implementation of the Act, the level of bankruptcies approximately doubled; in contrast, the level of IVAs increased by nearly sixfold over the same period.
 - there also appear to have been increases in the usage of non-statutory debt resolution processes (pp45-46).
 - the lack of a causal nexus was supported by a government economic modelling and the Bank of England, the latter attributing the increasing numbers of personal insolvencies principally to the rise in household indebtedness, concluding that it is unlikely that the rise in bankruptcies were due to the Act (p49).

¹ Minimum period of nine months. However, a bankruptcy will last for more than nine months if the bankruptcy court orders a bankruptcy extended.

² While bankruptcy period is 3 years after filing a statement of affairs, a bankrupt may apply to be discharged earlier and the 'No Asset Procedure' introduced in December 2007 has a 12 month discharge default period.

³ Available here:

<http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/evaluation/finalreport/report.pdf> .

More generally, the UK report noted that:

- the reduction in the discharge period may have had some marginal effect in influencing some debtors to choose bankruptcy over other options
- although there is no convincing evidence to suggest that the Act has encouraged more people to enter into bankruptcy, there are indications that there may be a cultural shift in attitudes to debt repayment. This may explain why there have been significant increases in both bankruptcies and IVAs (see above⁴) (p51)
- the evidence taken cumulatively implies that consumer credit expansion/debt accumulation leading to rising debt service burdens has been the main determinant of the increase in personal insolvencies (p53).

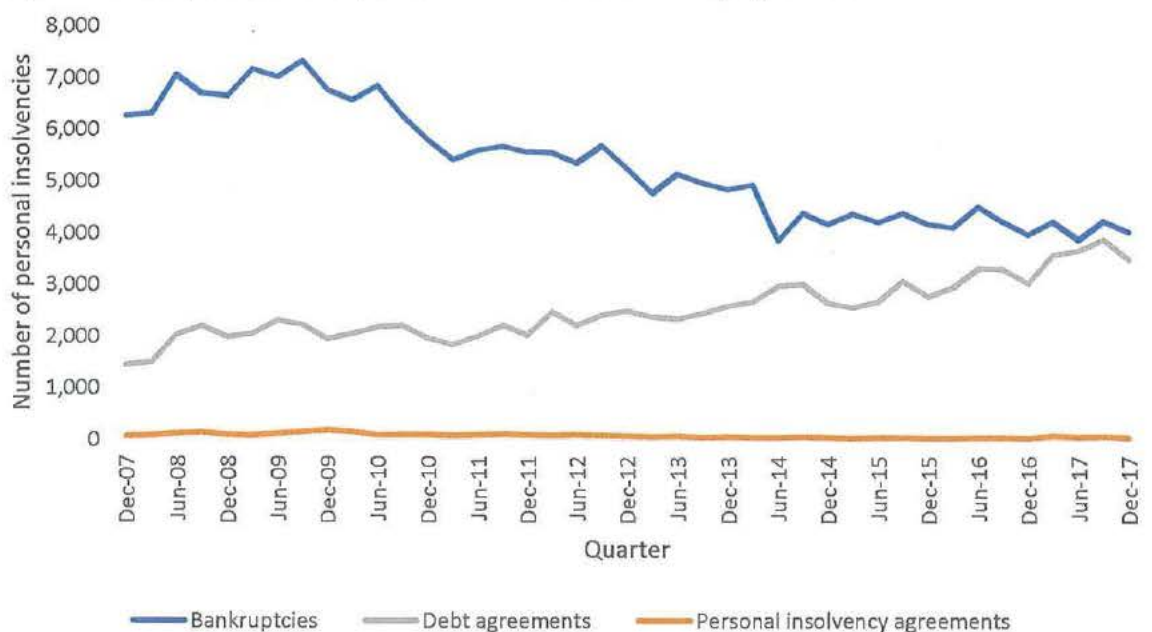
Part 2 – Selected AFSA statistics

AFSA collects a range of data, much of which is publicly accessible. This can be useful to inform and help to understand various economic issues. Some statistics that the Committee may find of interest in connection with this inquiry are below.

Changing composition of personal insolvencies

Over the last decade, debt agreements have increased while bankruptcies have declined. As a result, debt agreements account for an increasing proportion of personal insolvencies. Over the 2017 calendar year, debt agreements accounted for 47% of total personal insolvencies.

Graph 1: Composition of personal insolvencies by quarter



Notes: As significant reforms to the Debt Agreement system were implemented in 2007, this year provides the best comparator. Table 1 at Attachment A contains data from which Graph 1 was derived.

⁴ The Act introduced the concept of fast track voluntary arrangements (FTVAs), whereby the Official Receiver acts as nominee and supervisor of a post-bankruptcy IVA. Once a post-bankruptcy IVA is approved, the bankruptcy order can be annulled.

Business vs non-business related personal insolvencies

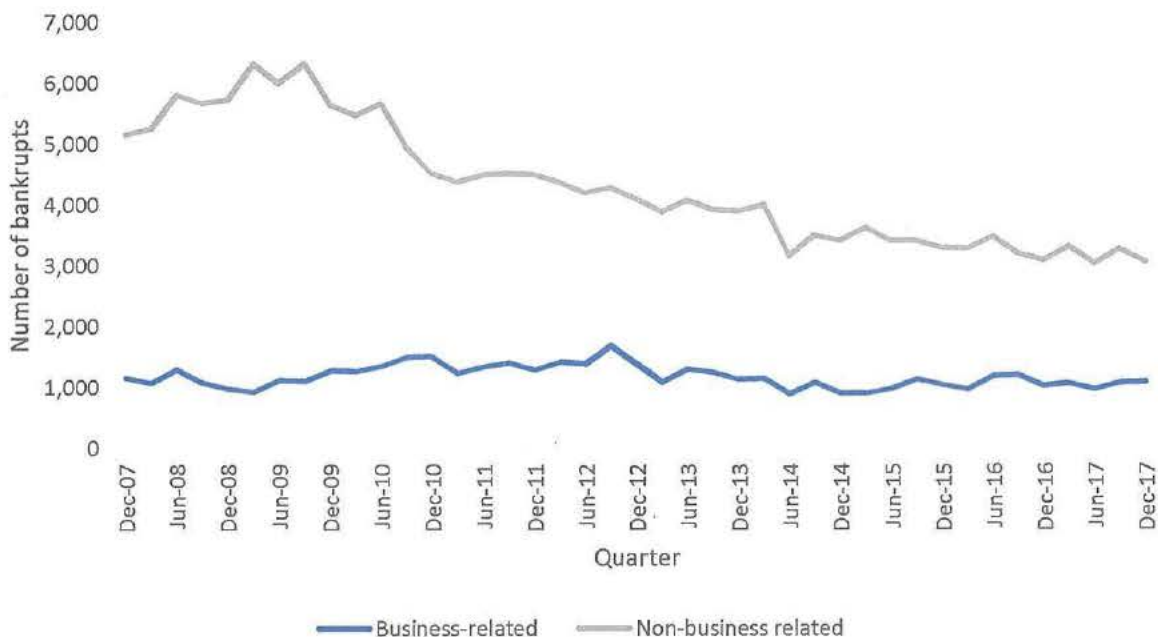
Consistent with previous years, in 2016–17 some 89.6% of bankruptcies were by debtors' petitions and the remaining 10.4% were by sequestration orders.

A debtor's self-assessment of the main cause of their insolvency (as recorded on their statement of affairs filed by a bankrupt with AFSA at the beginning of the bankruptcy) determines whether or not their bankruptcy is categorised as business related in the AFSA statistics. The categorisation of bankruptcies as business or non-business related does not (and cannot) record or report on the number of people who were deterred from entrepreneurial activity due to a concern about the consequences of failure, including the impact of a bankruptcy.⁵

In the 2017 calendar year 24.7% of bankruptcies were categorised as business related. Since the March quarter 2003:

- on average, 21.5% of bankruptcies were business related each quarter
- business related bankruptcies have fluctuated between 12.9% of bankruptcies (September quarter 2009) and 28.2% (September quarter 2012).

Graph 2: Business related bankruptcies by quarter



Note: Table 2 at Attachment A contains the data from which Graph 2 was derived.

Objections to a bankrupt's discharge from bankruptcy

Objections to discharge of a bankrupt must be lodged by a trustee before discharge and generally extend the bankruptcy to a period of 5 or 8 years from the date the bankrupt filed their statement of affairs, depending on the grounds of the objection.⁶ Objections can be withdrawn by the trustee or

⁵ The Australian Bureau of Statistics publishes *Counts of Australian Businesses, including Entries and Exits*, catalogue number 8165.0. The current edition provides statistics for June 2012 to June 2016. An update is due in February 2018.

⁶ Objections based on some types of overseas travel by a bankrupt may extend the bankruptcy by 5 or 8 years from the date of return to Australia.

cancelled after a successful request for a review at any time during the bankruptcy period. If the objection is withdrawn or cancelled, the bankruptcy will end three years from the filing of the statement of affairs, or until the date of withdrawal/cancellation of the objection, whichever is longer.

In 2016–17, there were 519 objections to discharge filed with AFSA. At 30 June 2017, there were 57,923 undischarged bankrupts in Australia. A trustee may lodge multiple objections to discharge for a single bankruptcy.

The Official Trustee is more likely to lodge objections to discharge within the first year of bankruptcy than registered trustees. Registered trustees are more likely to lodge objections to discharge 33 months or more after a bankruptcy commences.

Part 3 – Observations on the impact of a change to one year default period in relation to administrative matters and impacts on the administration of bankrupt estates

AFSA notes that the proposed reduction in the default period does not directly restrict the time period during which a bankruptcy trustee can administer a bankrupt estate. Trustees can, and often do, continue administering a bankrupt estate after a bankrupt has been discharged. Reducing the default bankruptcy period, of itself, will not prevent that from occurring.

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 and credit reporting:* On commencement of the reforms AFSA (as administrator of the National Personal Insolvency Index) and credit reporting bodies would need to ensure that the personal insolvency records of affected individuals reflect the change to the default bankruptcy period in a timely way.

If you require further information on this submission please do not hesitate to contact me or Andrew Sellars, who can be contacted on _____ by email.

Yours sincerely

Hamish McCormick
Chief Executive and Inspector-General in Bankruptcy

ATTACHMENT A

Table 1: Personal insolvency administrations by type

Financial year	Number of bankruptcies	Number of debt agreements	Number of personal insolvency agreements	Total number of personal insolvencies
2007–08	25,961	6,620	347	32,928
2008–09	27,520	8,564	452	36,536
2009–10	27,509	8,427	603	36,539
2010–11	23,093	8,052	373	31,518
2011–12	22,163	8,955	388	31,506
2012–13	20,876	9,652	294	30,822
2013–14	18,601	10,705	208	29,514
2014–15	17,163	10,911	214	28,288
2015–16	17,202	12,150	175	29,527
2016–17	16,320	13,597	244	30,161

Table 2: Bankrupts with a business related bankruptcy

Financial year	Number of bankrupts: business related	Number of bankrupts: non-business related	Total number of bankrupts	% of bankrupts with a business related bankruptcy
2007–08	4,767	21,372	26,139	18.2%
2008–09	4,128	23,709	27,837	14.8%
2009–10	5,001	23,102	28,103	17.8%
2010–11	5,585	18,335	23,920	23.3%
2011–12	5,484	17,570	23,054	23.8%
2012–13	5,454	16,333	21,787	25.0%
2013–14	4,391	14,964	19,355	22.7%
2014–15	3,838	13,933	17,771	21.6%
2015–16	4,323	13,445	17,768	24.3%
2016–17	4,219	12,620	16,839	25.1%

The data in Table 2 indicates that over the past 10 years bankrupts describing the cause of bankruptcy as business related ranged from 14.8% to 25.1%. In contrast in 2016-17 people entering debt agreements described the cause of their insolvency as business related in 7% of cases. Personal insolvency agreement debtors have the highest propensity to enter a business related personal insolvency. However, this is the smallest category, accounting for less than 1% of total activity. In 2016–17 32.9% of personal insolvency agreements were business related.