PIPA PERSONAL INSOLVENCY PROFESSIONALS ASSOCIATION

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018
Submission

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Mr. Tim Watling
Committee Secretary
Senate Legal and Constitutional Affairs Committee
PO Box 5100
Parliament House
Canberra ACT 2600

Dear Mr. Watling,

Re: Bankruptcy Amendment (Debt Agreement Reform) Bill 2018

Thank you for the invitation to make a submission for the inquiry into the Bankruptcy Amendment (Debt Agreement Reform) Bill 2017/18.

Introduction

The Personal Insolvency Professionals Association (**PIPA**) is the peak industry body mainly representing Registered Debt Agreement Administrators (**RDAA**). It also counts a number of professionals working in the debt management industry as its members. There are currently 2 main streams of professional who deal in debt management. RDAA and debt purchasing companies (**DPC**). All of PIPA's members are RDAA and are professional bodies required to abide by a strict Code of Conduct and an established protocol to deal with grievances and complaints. RDAAs are subjected to audit by AFSA regularly for compliance with the law and strict account management rules and can face disciplinary action and disqualification if found to be in breach. PIPA's members also hold significant credibility with banks and creditors – all Debt Agreements submitted by RDAA must adhere to the highest standards of ethics and best industry practices. PIPA works closely with the Australian Financial Security Authority (AFSA), to address issues concerning members, processing of Debt Agreements and any other operational roadblocks experienced by the regulators and administrators. RDAAs are trusted professionals who have credibility with both creditors, the legal profession, debtors and government agencies.

By the same token, you have the DPC who do not have to adhere to similar rules and regulations as RDAA. DPC often encourage debtors to enter into informal debt agreements which are not recognised and do not receive the same level of protection under the Bankruptcy Act and which enables DPC to have greater freedom in the collection of arrears.

RDAA and DPC do not operate on the same level playing fields. In order to ensure that the debt management industry continues to operate with integrity that it had operated under and successfully advocate for recovery of debtors whilst ensuring debts are being repaid in whole or in part, the whole industry must operate under consistent rules. The more restrictions RDAAs have; the more competitive advantage DPC has in the market. Already RDAAs are reporting that DPC are voting against debt agreements as a matter of principle because then they can enter into informal unregulated and lengthy debt arrangement with the debtors.

PIPA is concerned that the inputs provided by this association have not been incorporated and this Amendment Bill often ignores the reality that a debtor is subjected to. With key reforms being introduced, some of which may have significant ramification to debtors and the economy in general, it is hard to identify who the ultimate beneficiaries of the proposed changes are. On the surface, it seems that the proposed changes would benefit more DPC who are market leaders in the field rather than benefit the industry as a whole. PIPA is of the view that if the proposed amendments are accepted without change then the outcome will have limited benefit to debtors, originating creditors and RDAA's. It could create an unfair advantage to DPC who may operate under the regulatory radar and will create a working platform which is not attractive to creditors to accept debt agreements.
Further, contrary to the Statement of Compatibility with Human Rights mentioned in the Exposure Draft, the Bill does not take into account the 'human touch and aspect' of the implications of implementing these amendments. A near perfect regime of Debt Agreement is now being amended to create unforeseen implications for debtors and the economy at large. At the end of the day, the intention of all participants in the debt management industry is to ensure a win-win situation whereby debtors get rehabilitated and creditors get paid their arrears to the extent possible thus benefiting the economy and ensuring that thousands of families are not impacted by bankruptcies.

Feedback

Paragraph 2

1. It is essential to highlight that the Debt Agreement regime formalised in 2007 has seen immense success with debtors and creditors alike. It provides the debtors the ability to pay back an affordable portion of their debt whilst having significant protection under the Bankruptcy Act. This system has afforded an average debtor the opportunity to avoid bankruptcy and honour their debts over an agreed period of time and retain any assets including their family home. The high acceptance rate by creditors and the record level of utilisation of this regime as per AFSA Statistics (13,597 DA's processed in 2016-17) and the negligible amount (1) of complaints/compliance breach lodged at AFSA by debtors and creditors (Category A error – 0, Category B error – 1) highlights the fact that the system is working well with the current legislation. To put things into perspective, there was an increase in Debt Agreements of 11.9% in 2017 compared to 12,150 in 2016. 2017 witnessed the highest numbers on record for the sixth consecutive financial year. This shows that the system is working in rehabilitating a negative debt situation where over 77% of all Debt Agreement proposals accepted by the Official Receiver in 2015 were accepted by the creditors.
2. Any proposed amendments must be compared to other options currently available to debtors that are not legislated or protected by any Acts of Parliament thus exposing the debtor to significant threats of unregulated misguidance, misinformation and extreme financial hardship. This will include debtors trying to maintain minimum payments on high interest credit cards and loans indefinitely.
3. The proposed amendments do not incorporate the urgent need to legislate ongoing formal education of those wanting to register/continue to operate as RDAAs. Further, it does not require the RDAAs to be a member of a professional body – PIPA and adhere to its Code of Professional Practice.

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Specific Response to Proposed Amendments

Part 2 Schedule 1 Recovery of Fees and Expenses

PIPA welcomes the introduction of clarity in relation to the recovery of fees and expenses but the proposed introduction of Section 183C(3B) may again restrict the ability of administrators to recover fees and charges and create an unfair level playing field between DPC and RDAA. RDAA are well aware of the sensitivities and tension around return to creditors and protection of debtors but limiting the scope of recovery of fees and expenses can severely impair the operation of the RDAA. Further consideration must be given to enable general scope of recovery which will facilitate the debt agreements and not hinder them.

Part 3 of Schedule 1 – Value of Debtor's Property – Item 17

Although this is a positive change and in the right direction, there should be a consideration made to exempt the value of the entire family home (given this is not an income producing asset) from the Asset Eligibility threshold. This would put the system in line with the other countries with similar Debt Agreement arrangements, reduce the burden on the community housing availability and minimise the impact on a highly stressed rental market in most cities and towns across Australia. As you are aware, Melbourne had experienced one of the highest growth per capital in Australia in the past few years and that resulted in pressure on the housing market and a substantial increase in house pricing. The increased in value of the family home resulted in many debtors in certain suburbs to be excluded from the debt arrangement regime (above the assets threshold). The increase in value of the family home does not impact the cash flow position of these debtors yet they must be excluded. This may leave only one solution and that is to sell the family home which may seem like a simple solution to a credit problem but it carries with it significant economic, health and social cost including social exclusion, poverty, homelessness, children schooling integration by moving to cheaper locations and sense of failure and hopelessness.

Further, as will be discussed below, limiting the timeframe of a Debt Agreement to three years would exacerbate the issue. Under the National Consumer Credit Protection Act 2009 (see for example Section 118) it is presumed that, if the consumer could only comply with the consumer's financial obligations under the contract by selling the consumer's principal place of residence, the consumer could only comply with those obligations with substantial hardship. This highlights the contradicting position that the debtor may be subjected to in the proposed changes to this legislation. On one hand the legislation prohibits RDAA to enter into debt agreements that will cause hardship and on the other hand, the legislation itself will result in hardship.

Part 4 of Schedule 1 – Payment to income ratio – Item 19 to 21

There are a number of issues this section raises which will have significant ramification on the Debt Agreement Regime.

1. Percentage – Payment to income ratio
2. 3 year limit on the Debt Agreement including variations
3. Expected rate of return & voting patterns of Creditors/Debt Purchasers
4. Other available alternatives to a Debt Agreement
5. Enhanced income & debt threshold.

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Percentage – Payment to income ratio - This paper vehemently opposes the introduction of a percentage based calculation where the percentage has not been disclosed in this amendment. With the Minister having the power to set an arbitrary percentage, it may impact debtors who may fall just over this threshold. The introduction of an arbitrary payment to income ratio whilst not increasing the income threshold is unworkable. Firstly, it creates a one rule fits all and in the debt management industry if there is one thing that we have learnt is that flexibility can achieve better results than rigidity. Secondly, it creates a rule that does not take into account the different spending habits of individual debtors. Some individual debtors will decide to forego discretionary expenses such as entertainment in order to allocate more cash towards debt payments. Different debtors will have different needs, wants and outlook on life. A rigid rule may see debtors being disqualified from entering into a debt agreement in circumstances where without the rigid rule, an RDAA would have worked with the debtor to find a solution that will see accommodate their needs and see a return for creditors.

Thirdly, the rigid rule will inevitably result in lower returns to creditors. This in turn will see more creditors rejecting debt agreements resulting in either an exponential growth in number of bankruptcies or an exponential growth in the number of informal unregulated and lengthy debt arrangements between DPC and debtors. None of these inevitable solutions are attractive and conducive to the economy and to the social and mental welfare of debtors and their families.

As will be discussed further below, the introduction of time bound contracts (3 years), percentage ratio and limit on recovery of expenses distorts the ability of RDAA to compete with DPC and gives DPC unfair commercial advantage.

3 year limit on Debt Agreement including variations - A three-year limit coupled with the unrealistic returns expected by creditors/DPC will add a significant pressure on the debtors to seek unregulated alternatives to a Debt Agreements. This will make DA regime less appealing and undo the success achieved over the last decade. Creditors may be more inclined to force debtors into bankruptcy when there is an available asset (under the proposed (increased) asset eligibility threshold) to liquidate and obtain a quicker and enhanced return, which defeats the purpose of the DA regime. There have been numerous studies by academics (The University of Melbourne, Monash University Law Review) and reports published by the regulators highlighting that a 5-year tenure is most conducive for the ensuing success of the debt agreement regime. The entire Debt Agreement regime is designed to nurture clarity and flexibility in times of distress for a debtor. By limiting the tenure, the new system introduces rigidity, uncertainty and restricts access to those who would have been able to afford this agreement over a longer period of time. Given 'recovery' is the key focus, albeit with different connotations, for debtor and creditor, this system allows 'recovery as a rehabilitation mechanism' for the debtor and 'recovery of monies' owed to the creditor within a legislated ecosystem where the financial stability of the economy is the ultimate beneficiary of this regime.

Example: Mr. John Citizen (with 3 dependants) is a construction worker earning $72,000 annually, with $64,000 of unsecured debt paying 60c/dollar to all the affected creditors. His wife is an administration assistant who shares the household expenses.
Mr. Citizen is stressed that his family home in which he has approximately $100,000 of joint equity will be more appealing to creditors to liquidate under the proposed regime through a Creditor Petition filed at the Federal Court.

The tables below highlight the returns under the existing 5-year Debt Agreement regime and the proposed 3-year regime. The next table, Creditor Petition - Bankruptcy - elucidates the returns to creditors after the sale of the family home under 2 common scenarios where the nonbankrupt spouse may or may not contest the sale of the family home.

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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/$*
AFSA - Realisation Charges (7%)	*$2688.00*	*$1612.80*
RDAA Fees (20%)	*$7680.00*	*$4608.00*
Total Return to Creditor	*$28032.00*	*$16819.20*
Net Return to Creditors under a DA	***43.8%***	***26.28%***

Creditor Petition – Bankruptcy	*Scenario 1 – Uncontested sale*	*Scenario 2 – Contested Sale*
Unsecured Debt	*$64,000.00*	*$64,000.00*
Joint Equity in Family Home	*$100,000.00*	*$100,000.00*
Selling and Legal Costs – Approx.	*$25,000.00*	*$35,000.00*
Net Proceeds from Sale	*$75,000.00*	*$65,000.00*
Debtor's Share of Sale Proceeds	*$37,500.00*	*$32,500.00*
Registered Trustee maximum default amount of remuneration (Source: Indexed Amounts – AFSA)	*$5,105.00*	*$5105.00*
Amount available for distribution	*$32,395.00*	*$27,395.00*
Net return to Creditors under a Bankruptcy	***50.6%***	***42.80%***

In order to receive the same return as the existing Debt Agreement regime, it is more conducive for the creditor to liquidate their family home and get a substantial return after paying legal and selling costs almost immediately. This defeats the purpose of the regime (and the proposed increase in asset eligibility threshold) and places the debtor in a precarious position open to legal proceedings and possible sale of their family home.

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<u>Specific to Variations and Terminations</u>: Readers of this paper need to be aware that if a Debt Agreement extends over the time limit and is terminated due to this reason, the current legislation allows creditors and DPC to reinstate all the interest, fees and penalties applicable whilst in the Debt Agreement. The prohibition proposed by the changes to Section 185M fails to recognise the dynamic nature of the industry RDAA work in. Debtors' circumstances frequently change and RDAA 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 information unregulated lengthy debt agreements with DPC. PIPA submits that by limiting the variation period to 3 years, the system will open the regime to abuse and growth of the informal arrangement and other unregulated debt management schemes. It does not serve the best interest of debtors and creditors alike.

<u>Expected rate of return & voting patterns of Creditors/Debt Purchasers</u> - With low returns to creditors by the introduction of this ratio, creditors will be unlikely to accept Debt Agreements thus placing the debtor in a precarious position where there would be no recourse but to declare themselves bankrupt. The ratio does not take into account the demographic status of the debtor or the household dynamics (household income, number of dependants, individual circumstances) of the debtor – with such variables open to interpretation, it would be difficult to justify one predetermined percentage as a 'one size fits all' approach. Further, an upfront application fee with an ongoing realisation fee charged by AFSA will mean reduced returns for the creditors.

<u>Other alternatives to a Debt Agreement</u> - Australia has one of the highest per capita debt levels and a perpetual debt cycle aimed at vulnerable debtors will be created by DPC or by unregistered consultants/advisors with limited knowledge where the only winner would be the unregistered consultant/advisor. This new parallel industry will wreck a havoc to the stability of the Australian Financial system which must be avoided at all cost for the greater good of the economy. The proposed amendments have failed to recognise the 'human element' of its economic agenda.

<u>Enhanced income & debt threshold</u> - This paper also suggests that the income threshold is doubled or removed to make the Debt Agreement regime more accessible to Australians currently reeling under the pressure of increased costs (utilities, fuel and general household) and unemployment in certain sectors of the economy. This will make the DA regime more accessible for those debtors that have higher income but also have significantly higher debts. Further, when calculating the income threshold it is essential that Child Support payments are exempt from this income threshold calculation in line with other section (Part IV) of the Bankruptcy Act. The inclusion of Child Support creates a distortion of the true cash position of the debtor and it is a major obstacle in assessing debtors who are separated from their spouses. Many are disqualified from the debt arrangement regime but in reality their net income should have allowed them to benefit from the debt arrangement regime.

<u>Part 6 of Schedule 1 – Other matters – Item 33 & 38</u>

To obtain protection for the debtor under the debt agreement regime, an administrator often focuses on getting the required administrative and compliance documentation completed at the earliest. In most cases, the administrator accepts some portion of their unpaid fees (including lodgement fees) over the tenure of the debt agreement. In light of this, it is essential that unless there is a legislative change for an administrator's out of pocket expenses and administrative costs to become priority payments (similar to liquidators and trustees), it would be difficult for a RDAA to lodge a proposal without collecting the full amount of the setup fees including the AFSA lodgement fees and any incidental costs associated with the preparation of the proposal. Outstanding balances on debts may change during this period thus adding administrative costs of redoing the proposal.

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Part 1 & Part 2 of Schedule 2 – Length of Debt Agreements & Variations.

As discussed above in Part 4 of Schedule 1 (2), a 3 year tenure for the completion of a Debt Agreement is contrary to the information and statistics available on the success of a debt agreement completed over a 5 year period. Although, a time limit should be imposed to ensure the debtor is given an opportunity for a 'fresh start', a reduced time limit will make the Debt Agreement regime inaccessible for most Australians. The current regime that operates on substance rather than form. The current regime ensures sustainability which means the RDAA must ensure the debtor can meet the obligations under the debt agreement. This is preferred over rigid time frames that do not allow flexibility, result in lower returns to creditors and will result in an increased failure rates of a regime that had proven to be successful.

This paper strongly opposed the move to reduce the tenure to 3 years without having any opportunity for recourse after a debtor has paid over 50% of their proposed debt agreement and there have been circumstances beyond the debtor's control which put the future payments in jeopardy and renegades the debtor a fair chance for a 'fresh start'.

Example: Using the same example on Page 3, *Mr. John Citizen (with 3 dependants) is a construction worker earning $72,000 annually, enters into a Debt Agreement for $94,000 under the new proposed legislation paying 60c/dollar over 36 months to all the affected creditors. His wife is an administration assistant who shares the household expenses. One unfortunate morning after being the Debt Agreement for over 20 months, he gets knocked by a semi-trailer while unloading freight. Badly injured and advised bed rest with heavy medication, he calls the RDAA after 15 days of the incident to advise that he will not be able to meet his monthly commitments and is unsure how long it will take for him to recuperate fully. Although there is a work safe claim lodged, he is unsure of the pay out and the timelines. Further, even if he goes back to work, he will be assigned lighter duties which will not pay him as much as he did previously and that a variation of the original proposal will be imminent.*
Mr. Citizen is stressed that he has been denied natural justice short of 2 years of being in a Debt Agreement. He is also worried that his debts will be reinstated with interest, fees and penalties applicable for the period he was in the debt agreement. He now has to succumb to mental stress along with a physical injury that makes matters worse. He is confident that the 6 month extension to complete a debt agreement is unviable and will undo the payments made for the previous 20 months.
Instead of providing a 'fresh start', the proposed debt agreement regime has hindered social justice, put him under immense mental stress and voided the opportunity to make good on a proposal which he could afford until uncontrollable circumstances changed his situation. With no legislative recourse, he has no option but to declare bankruptcy, something which could have been done at the start of the Debt Agreement and saved the debtor from paying out over $30,000.00 to creditors.

Part 3 of Schedule 2 – Proposals to terminate debt agreements.

In legislating a change, the debtor's interest must be paramount. This paper would like to highlight the fact that in most cases, affected creditors do not vote on a termination of debt agreements. Having a termination open for 2 weeks for voting and not having a single creditor vote, creates uncertainty for the debtor where the next course of action is unclear until the agreement is automatically cancelled by the AFSA.

Part 5 of Schedule 2 – Voiding debt agreements.

Although the proposed change is positive, this paper would recommend a provision to annul a debt agreement similar to the provisions in bankruptcy under Part IV of the Bankruptcy Act.

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Other concerns and suggestions

1. Value of debt listed in a Debt Agreement – As known, a debt purchasing company does not pay the face value of the debt at the time of purchase. To ensure transparency, integrity of the Bankruptcy Act and in line with other sections (Part IV & Part X) of the Bankruptcy Act, it is imperative that other affected creditors know the purchase value of the debt to ensure fair and equitable voting on a debt agreement proposal. Without this provision, the vote is heavily influenced by the debt purchaser and skews the voting pattern, much to the detriment of the debt agreement regime.
2. Zero votes received at the initial proposal – If by the deadline date, zero votes are received by the AFSA, this paper suggests that the debt agreement proposal be accepted as proposed.
3. Automatic Approval for Debt Agreements with an assured return to creditors – If a debt agreement proposal can pay above a certain percentage, it would be beneficial for the debtor and all affected creditors to avoid administrative costs in reviewing and voting on a debt agreement. This fast-track methodology would alleviate most of the stress a debtor experiences over the 5 week voting period.
4. Opportunity to include civil penalties and fines – Often a debtor, due to financial hardship, is unable to pay civil fines such as tolls, parking and other penalties passed on to a specific department of the state government (Sheriff, Fines Victoria, SPERS, State Debt Recovery etc.). This paper suggests that such fines be included in the Debt Agreement to allow fair and equitable distribution as an affected creditor. Fines originating through the unpaid use of a tollway or parking spot must have the same classification as an unsecured creditor.
5. Removal of the household Budget as part of the Proposal – A debtor often provides a budget based on the average amount spent on household expenses. Occasionally, there is unallocated money seen by creditors which leads to the rejection of the proposal by a creditor. This paper suggests that the budget be removed from the Proposal or the debtor be allowed to have a small surplus up to a percentage of their income. Although this fund would have a negligible impact on the returns to creditors, some creditors have a strict 'no surplus policy' which costs the debtor significant time and money.
6. Arrears based reporting – The proposed changes have introduced the concept of arrears based reporting ($300 or 20% - whichever is higher). However, it has still kept the 3 & 6 month arrears reporting requirement in situ. Having multiple reporting requirements will lead to creditors receiving multiple reports for the same debtor, create bottlenecks in processing these reports. Most RDAA's have arranged their software programs to allow for 3 and 6 months arrears reporting to creditors and believe this should remain unchanged.

Conclusion

With the exception of very low debt, asset and income thresholds, the Debt Agreement System in its current form has worked very well and has been very successful for many debtors who have been unable to pay their debts when they fall due.

Many of the proposed changes to the Part IX Bankruptcy Legislation will make Debt Agreements unviable and open to more bankruptcies, unregulated arrangements or the debtor just trying to maintain minimum payments forever.

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Disclaimer: The views expressed in this submission are of PIPA as the peak industry body and are not personal views of the author of the submission. The submission was constructed following consultation with PIPA's members who were asked to consider the welfare of the industry, interest of creditors and protection of debtors under the Act. The author is not a debt agreement administrator.