16 February 2018

Committee Secretary
Senate Legal and Constitutional Affairs Committee
PO Box 6100
Parliament House
Canberra ACT 2600

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

Dear Committee Secretary

Bankruptcy Amendment (Debt Agreement Reform) Bill 2018

Thank you for the opportunity to lodge a submission on the exposure draft Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 ('the Bill') to amend the *Bankruptcy Act 1966* (Cth) ('the Act') to make various provisions for debt agreement administrators, debt agreements, and the powers of the Inspector-General in Bankruptcy with respect to debt agreements and debt agreement administrators.

Key points

- Overall, ARITA considers that the measures contained in the Bill will improve trust and confidence in the debt agreement system by 'raising the bar' for registration and practice standards of debt agreement administrators as well as by making improvements to the way in which debt agreements are used;
- We think that two measures in the Bill, namely the doubling of the 'debtor property' threshold and the new, three-year limit on the length of debt agreements could be reconsidered, not in terms of the principle or intention underlying these measures but rather their precise calibration (including consideration of all three thresholds which currently apply to limit the availability of debt agreements)
- We note that the concurrent reform measure of reducing the default period of bankruptcy – by the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 – could impact on the prevalence of debt agreements as an alternative to bankruptcy. It is an open question as to how substantial, concurrent reforms to both bankruptcy and debt agreements will affect existing trends and the popularity of bankruptcies and debt agreements (as alternative procedures).

Should you wish to discuss any aspect of our submission, please contact ,

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents practitioners and other associated professionals who specialise in the fields of insolvency, restructuring and turnaround.

We have more than 2,000 members including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency and restructuring.

Some 84 percent of registered liquidators and 89 percent of registered trustees are ARITA members.

ARITA's mission is to support insolvency and recovery professionals in their quest to restore the economic value of underperforming businesses and to assist financially challenged individuals.

We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large.

The Association promotes best practice and provides a forum for debate on key issues facing the profession. We also engage in though leadership and advocacy underpinned by our members' knowledge and experience.

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1 Increasing standards and professionalism of debt agreement administrators

ARITA broadly supports the measures in the Bill to improve the regulatory framework for debt agreements and debt agreement administrators by 'raising the bar' for both:

- registration requirements of debt agreement administrators; and
- the practice of administering debt agreements.

Overall, ARITA considers that the Bill will improve trust and confidence in the debt agreement system.

ARITA supports the measures in the Bill which will limit the types of practitioners authorised to be debt agreement administrators and modify (raise) standards which debt agreement administrators must satisfy in terms of prerequisites for registration, ongoing obligations and grounds for deregistration. We also welcome the proposed broader powers of investigation of the Inspector-General to support these measures.

ARITA supports the Bill's broad intention to:

- align professional and registration standards for debt administrators with those that currently exist for registered trustees;
- ensure that debtors who are considering the alternative of a debt agreement are properly informed of their alternatives and the consequences of a debt agreement.

Specific measures we have identified in the Bill and which we support are:

- Only permitting registered debt agreement administrators to administer debt agreements;
- Requirements for 'adequate and appropriate' professional indemnity and fidelity insurance, applicable to both applicants for registration and registered debt agreement administrators as an ongoing obligation;
- A 'fit and proper' test to be applied to applicants for registration;
- New Ministerial power to determine conditions of registration (which will serve the same purpose as the existing performance standards for registered trustees in the *Insolvency Practice Rules (Bankruptcy) 2016* – ie, can ground a show-cause notice and potential deregistration under Schedule 2 to the Act);
- New powers of the Inspector-General to cancel registration of a debt agreement administrator (subject to a 'request for written explanation' process) which will support the new 'mandatory insurance' and 'fit and proper person' requirements of registered debt agreement administrators;
- New ability of the Inspector-General to 'bypass the show-cause notice requirement when requiring information on a practitioner's trust account';
- New paragraph 12(1)(bd) in the Act to provide that the Inspector-General's investigation and inquiry powers extend to any conduct of a debt agreement administrator which the draft Explanatory Memorandum states will allow the

Inspector-General 'to investigate or inquire into the registered debt agreement administrator's conduct during the period starting from when the debt agreement administrator and debtor first engage'. We are supportive of measures which will enable the Inspector-General to 'investigate and inquire into a debt agreement administrator's advertising or other methods used to attract debtors';
- Aligning the time for submitting annual returns with registered trustees (ie, 25 business days after the end of the financial year).

2 Improving the use of debt agreements

2.1 Improvements to the use of debt agreements

Subject to the comments below at [2.2], [2.3] and [2.4], ARITA broadly supports the Bill's measures which provide for the types of information the debtor must record in a debt agreement proposal, the certifications the proposed administrator must make, and the standards for how the Official Receiver must handle proposals.

Specific measures we have identified in the Bill and which we support are:

- Prohibiting a debt agreement proposal (or variation) if the total payments under the agreement exceed the debtor's income by a certain percentage to ensure that the debtor has an ongoing capacity to meet the payments;
- Provision for the Official Receiver to be able to refuse to accept a debt agreement proposal (or variation) for processing if there is a reasonable belief that compliance with the debt agreement would cause undue hardship to the debtor;
- Requiring debt agreement administrators to disclose broker or referrer arrangements (and declare whether any affected creditor is a related entity) in the s 185C(2D) certificate signed by the debt agreement administrator;
- Provision that the Official Receiver shall not request (and is able to disregard) a vote from a (proposed) administrator that is an affected creditor, or from an entity related to the (proposed) administrator and similar provisions for debt agreement variations and proposals to terminate;
- Introduction of an offence for a proposed administrator giving, agreeing or offering to give an affected creditor an incentive for voting a certain way on a debt agreement proposal, variation or proposal to terminate;
- New provision for debt agreement variations requiring debt agreement administrators to certify that the debtor is likely to be able to discharge the obligations under the agreement (as proposed to be varied) which will align with the existing requirements under s 185C(2D)(c) of the Act for debt agreement proposals;
- The proposed amendment to s 185T of the Act to broaden the grounds for the Court to void a debt agreement, which will now include a 'breach of duty' by the debt agreement administrator (eg, a defective s 185C(2D)/Reg 9.01 certificate that the debtor was properly informed of alternatives to, and consequences of, entering into a debt agreement);

- Introduction of a requirement that debt agreement administrators refer evidence of offences (to align with the duties of registered trustees under ss 19(1)(h) and (i) of the Act);
- Increasing the threshold by which an administrator is obliged to report to creditors a 3-month arrears default to instances where the value of the arrears exceeds the higher of either 20% of the payment due for the period or $300 (the intention being to only require notification if the amount is significant having regard to the value of the payments due and the cost of reporting);
- Alignment of offences with those which currently exist for registered trustees in bankruptcy (funds handling, keeping sufficient records).

2.2 Doubling the ‘debtor property’ threshold

The Bill proposes to double the debt agreement access threshold which applies to a debtor’s property (currently set at $111,675.20).

The draft Explanatory Memorandum states that the decision was made to raise this threshold amount due to ‘the recent rises in Australian property prices’ which ‘prevents a significant proportion of Australians from accessing the debt agreement system.’ However, the extent and degree of this measure begs the question as to why the other two relevant threshold amounts for debts and income remain unchanged.

In our view, a proposal to double one threshold while leaving the other two thresholds unchanged warrants reconsideration of the current settings of all three thresholds which limit debt agreement access.

The intention appears to be to allow debtors to propose debt agreements where their unsecured assets are well in excess of unsecured debt. While it would ultimately be up to creditors to consider accepting a proposal in such circumstances, we query what message or signal this sends regarding attitudes to consumer debt and personal financial management.

2.3 Capping the length of debt agreements to 3 years

ARITA supports the intention behind this measure, namely to prevent debtors entering into debt agreements which provide for payment plan terms that are excessively lengthy and prevent insolvent debtors from obtaining a ‘fresh start’.

That said, we are not sure that it is necessary to have total alignment of debt agreements with the length of income contributions in bankruptcy (three years). The draft Explanatory Memorandum states that ‘debt agreements are frequently running for longer than five years’ (in part due to variations), but the timeframe ‘cap’ introduced by the Bill is set at three years.

While acknowledging the detrimental effects of not having any limit, it should be remembered that debt agreements are an alternative to bankruptcy and need not necessarily align with every aspect of bankruptcy.

A maximum five-year timeframe for example, might still address the current problems of the unlimited length of debt agreements while retaining some of the flexibility that the debt agreement alternative is intended to provide.

2.4 Debt agreements versus 'one-year bankruptcy' (incentives and disincentives)

As observed in our earlier submission on the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 (reducing the default period of bankruptcy to one year), debt agreements are used as an alternative to bankruptcy. The 2015 Productivity Commission's Report into *Business Set-up, Transfer and Closure* ('the PC Report') recognised that the alternative procedure of debt agreements had 'increased to unprecedented levels' and that agreement alternatives to bankruptcy 'are becoming more popular.'[1]

More recent statistics reported by AFSA demonstrate that:

- In 2016/17, the number of debt agreements was the highest on record (13,597) which was 45.1% of total personal insolvency activity (new personal administrations under the Act) and there were 16,320 bankruptcies (54.1% of personal insolvency activity). This reinforces the trend of increasing popularity of debt agreements: around the time of the PC Report in 2014/15, the respective numbers and proportions were 10,911 (39%) debt agreements and 17,163 (61.3%) bankruptcies;[2]

- In both the June and September 2017 quarters, around 24% of bankrupts entered a business-related bankruptcy, around 6.5% of debt agreement debtors entered a business-related debt agreement, while around 16% of all new debtors entered a business-related personal insolvency.[3]

In our view, Parliament should reflect upon the fact that the statistical prevalence of bankruptcies and debt agreements is unlikely to remain static following substantial, concurrent reforms to both procedures (as is currently contemplated).

It stands to reason that a reduction in the default bankruptcy period (to one year) could see a decline in the popularity of debt agreements when the two procedures are compared and assessed by financially distressed debtors and/or their advisors (though such a trend may be offset if the debt agreement access threshold for the value of debtor's property is raised by the passing of the Debt Agreement Reform Bill in its current form).

When considering the possibility that a reduction in the default period for bankruptcy may provide disincentives for the uptake of debt agreements, it is worth noting that the PC Report

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[1] Productivity Commission Inquiry Report 'Business Set-up, Transfer and Closure', No.75, 30 September 2015, p 332.
[2] AFSA personal insolvency statistics at https://www.afsa.gov.au/statistics/personal-insolvency-statistics-0.
[3] AFSA business and non-business statistics at https://www.afsa.gov.au/statistics/commentary. Focussing on the minority of business-related personal administrations, statistics for both these quarters also suggest that bankruptcy, as a procedure, accounts for around 78% to 80% of these business-related personal insolvencies.

identified that debt agreements are devoid of many of the restrictions imposed upon bankrupts (those restrictions in bankruptcy being the very things that a reduction in the default period is intended to ameliorate).

In terms of the uptake or popularity of these alternative procedures, it is difficult to predict with certainty the impact of the concurrent implementation of these two sets of personal insolvency law reform measures.

It might be that considered and careful reflection is warranted as to the outcomes – in terms of the future uptake of alternative procedures – sought by the concurrent introduction of these Bills.