INSTITUTE OF
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Submission to Attorney-General's Dept : Possible reforms to the Bankruptcy system

February 2022

26 February 2022

The Manager
Bankruptcy Proposals
Attorney-General's Dept

By email: bankruptcy@ag.gov.au

Dear Sir/ Madam

Possible reforms to the Bankruptcy system

The Institute of Public Accountants (IPA) welcomes the opportunity to comment on the possible reforms to the Bankruptcy system as part of the ongoing reforms to the insolvency regime.

In preparing this submission, we have undertaken consultation with members who specialize in insolvency. In particular, we acknowledge the contribution of Adrian Hunter of Brooke Bird.

The IPA is one of the three professional accounting bodies in Australia, representing over 47,000 members and students in over 80 countries. Three-quarters of the IPA's members work in or are advisers to small business and small to medium enterprises (SMEs).

The IPA fully supports the policy objective of encouraging entrepreneurial activity by destigmatizing business failure; and to encourage and enable entrepreneurs to continue starting up businesses. However, we note that over 75% of bankruptcies relate to consumer debt rather than entrepreneurial activities. We are aware that some of this debt may relate to small business people who have been unable to access commercial finance. More detailed data would be useful for further analysis of the nature of bankruptcy related debt.

Our comments follow the questions in the options paper and are detailed below.

If you have any queries or require further information, please don't hesitate to contact Vicki Stylianou at either vicki.stylianou@publicaccountants.org.au or mob. 0419 942 733.

Yours faithfully

Vicki Stylianou
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Comments on questions in the options paper:

Question – if the default period for bankruptcy is reduced to one year and this proposed exclusion applies, the government seeks stakeholder views on whether a repeat bankrupt that meets certain eligibility criteria (e.g. has satisfied all their tax obligations, has not engaged in voidable transactions, has been cooperative throughout the bankruptcy process etc.) should be able to apply for early discharge from a 2 year or 3 year bankruptcy after the first year.

The government is considering excluding bankrupts from one-year bankruptcy who, in the previous 10 years, have:

- been bankrupt
- been banned as a director
- had a bankruptcy extended through an objection to discharge, or
- have been convicted of certain offences.

The IPA's view is that further amendments to the Bankruptcy Act should not be undertaken until there is a comprehensive review of Australia's insolvency system. Currently the system is complex, legalistic, and challenging to navigate when dealing with individuals whose affairs are complex or who are otherwise uncooperative. A review to develop a new framework which is simple, efficient, and effective should be the approach adopted by the Government. This new framework should provide a clear pathway for those dealing with financial distress. Such a review would also have the opportunity to consider whether a one year bankruptcy regime is appropriate or that perhaps a 'simplified bankruptcy' option like that recently introduced into the *Corporations Act 2001* could be introduced.

It is also the view that, in the absence of a full review of the personal insolvency regime being undertaken, that rather than a one year bankruptcy becoming the default, there should be the option for a person to have their bankruptcy reduced from three years to one year in certain circumstances. This would provide an effective mechanism for a targeted approach which restricts such a benefit to those assessed as appropriate by the Government (through legislation) and validated by the Official Trustee (following a recommendation made by the Debtor's Trustee).

Notwithstanding the above, in response to the question provided, IPA responds as follows:

Been bankrupt

According to statistics collected by the Australian Financial Security Authority (AFSA), in the December quarter 2021, 37.3% of bankruptcies were business related, which is a rise from 35.5% in the December quarter 2020.

In addition to this data and other data provided by AFSA, it would be beneficial to know the exact number of repeat bankrupts. However, we expect the number of repeat bankrupts as a representation of the whole would be marginal. Accordingly, it would appear unnecessary to develop laws and waterfalling criteria to assist individuals who have repeatedly gone bankrupt to access the option of reducing the bankruptcy period from the current three year term.

It should also be queried why the legislation should reward basic compliance responsibilities/duties of an individual who has gone bankrupt. Accordingly, the IPA is of the view that penalties for non-compliance should be imposed (like the objection to discharge regime that presently exists) with the existing compliance regime remaining without a 'reward' for doing what should be done.

To generally incentivise good behaviour by a bankrupt, it is open to the legislature to provide the power to Trustees to enable early discharge to an individual in certain circumstances. That is, the base (or default) period of bankruptcy should remain at three years but a one year bankruptcy could be introduced as an exception.

Another option is for one year and two year periods to be introduced, with, for the sake of simplicity, the Trustee having the discretion to determine the most appropriate period.

It is envisioned that the Official Receiver could provide oversight to this discharge process. Such circumstances could be where:

- The trustee is of the view that there would be little merit in having the individual remain bankrupt for three years
- The individual went bankrupt due to circumstances beyond their control (eg lost their job due to the pandemic)
- Became bankrupt as a result of a business failure (liquidation) where the liquidator did not detect any offences
- The bankrupt appears to be a person of good character and remorseful of their circumstances
- A ceiling on the level of debt that caused the bankruptcy, with the intention of capturing bankrupts that really were no fault bankruptcies, or circumstantial
- The legislation needs to ensure that at all times the Trustee's ability to extend the bankruptcy period in case of misconduct is preserved.

Banned as a director

The IPA agrees with this exclusion to ensure that a bankrupt who has been banned as a director of a company under the *Corporation Act 2001* in the preceding 10 years will have a bankruptcy length of three years.

Objection to discharge

The IPA agrees with this exception to provide that a bankrupt who has had a bankruptcy in the previous 10 years extended due to an objection to discharge, will have a bankruptcy length of three years.

Offences

Where a person has been convicted of an offence that involves fraud or dishonesty, they should be excluded from being able access a one year bankruptcy.

Question – the government seeks stakeholder views on what current Bankruptcy Act offences could have penalties strengthened to target abuse of one-year bankruptcy.

The objection regime (which provides for a 1, 2 and 5 year objection period) when overlayed with a range of bankruptcy default periods (1, 2 or 3 years) can produce a number of potential discharge dates. Such a diverse range of discharge dates will create administrative issues for Trustees and potential uncertainty for individuals and stakeholders in the system.

The current regime is already complex and the increased administrative burden upon Registered Trustees should be avoided. The aim of improvements in the legislation should be to make the regime simpler and easier to understand, not more complex.

Again, a remedy to such a position would allow those 'good' bankrupts or those who qualify with a reduced bankruptcy period to one year, while all others remain at three years subject to any objections as per the existing offence regime.

A reduced bankruptcy period for only those who qualify would also allow sufficient time to investigate those bankrupts whose affairs are contentious and, where applicable, collect sufficient evidence to support an objection to discharge for those individuals who breach the law or otherwise are non-compliant. Such a 'reward' period of one year would stop bankrupts from attempting to frustrate the efforts of their Trustee during the initial one year period in an effort to diminish the ability of a Trustee to lodge an objection to discharge.

Question – the government seeks stakeholder views on whether the default term limit for debt agreements should be extended to 5 years.

Firstly, with respect to debt agreements, the IPA makes the point that debt agreements should only be used or promoted once the person contemplating bankruptcy is also advised to try all other avenues with their creditors to resolve their debts (payment plans, more time to pay, compromise the debt with a smaller lump sum payment) before they enter a formal agreement. They should be made aware of the long-term consequences to their credit rating in both entering into a formal debt agreement, or bankruptcy.

There is a role for regulated insolvency practitioners to assist individuals to make informal arrangements with their creditors. Our members advise that often creditors will respond to Registered Liquidators whereas individuals approaching on their own do not have the same outcomes. Further feedback from IPA members is that many people experiencing financial distress just bury their head in the sand, don't seek help, then when they do it is often too late, they have already 'burnt their bridges' with creditors. For this reason, the IPA has strongly advocated for government assistance in this pre-insolvency/ restructuring phase.

The IPA refers to the options paper which notes that the changes in the debt agreement system are being considered to increase the admission thresholds to the debt agreement system. However, a response was not sought to this change. Currently, the debt agreement process provides for a quick, cost-effective outcome for dealing with low value personal insolvencies, including business related debts.

The IPA is concerned that the suggested changes to the eligibility thresholds for debt agreements to those with debts/ income/assets of more than $242,260 will, while achieving the result of making these more accessible to the population, result in more complex affairs needing to be administered for which the legislation is not equipped to deal with. These larger administrations will no longer be 'quick and easy' to administer and will likely lead to creditor dissatisfaction with the process.

Individuals who currently don't qualify to access the debt agreement process require their affairs to be adequately investigated by a Registered Trustee who can appropriately report to creditors on their investigations. For the protection of the system, those individuals who have incurred significant debt require an investigation into their affairs to be undertaken.

In relation to the default term limit, the IPA agrees that the default term should be extended to five years as this provides additional flexibility to those individuals who seek to address their debt issues and take responsibility for the loss suffered by others. The incurring of debt and the inability to repay is a serious matter and should have consequences. Balanced against this should be the ability of an individual to come to an arrangement with their creditors which would see them repay some (if not all) of these borrowed funds. The legislation should consider including flexibility relating to a repayment program over five years that is desirable by both the individual and their creditors.

Question – the government also seeks stakeholder views on whether the home ownership exception should remain to allow a debtor with a real interest in property to propose a longer debt agreement beyond a 5 year default term.

The IPA does not believe that a repayment program should extend beyond the five year default period on the basis that an individual has an interest in real property. The default period of five years is already a significant period of time (when contrasted with a potential one year bankruptcy period). In the event that a suitable agreement cannot be reached as a result of the debtor having an interest in a home within a five year period then other legislative mechanisms are available and should be considered.

Question – Section 185M of the Bankruptcy Act gives debtors the flexibility to vary their debt agreement to up to 5 years if they suffer a substantial and unforeseen change in circumstances. The government seeks stakeholder views on what form this variation exception should take if the default term for debt agreements is extended to 5 years.

The IPA does not support the view that a five year default period should be able to be extended in the event the individual suffers from a substantial and unforeseen change in circumstances. The current legislation allows for the variation of an agreement with the consent of their

creditors. Should the individual suffer such a trauma then their creditors can consider, if appropriate, amending the agreement in light of such circumstances. Should the creditors be unsympathetic then other legislative mechanisms can be considered.

The role of the administrator in a debt agreement is to be largely administrative. The introduction of further complexity into an agreement where the administrator would need to become involved in the affairs of the individual for the purpose of assessing whether they have indeed suffered an unforeseen change in circumstances should be avoided.

Question – the government seeks stakeholder views on reducing the exclusion period for lodging a debt agreement proposal from 10 years to 7 years.

The IPA does not have any data available on the number of individuals that would be impacted by the reduction of debt agreements from 10 years to 7 years. However, we would expect that the number of such individuals would be few and therefore question the need to vary such a term.

Question – for debtors who have previously been party to a debt agreement only, the government also seeks views on providing a specific exclusion period of 5 years (rather than the proposed 7 years which would still apply to the other insolvency options (bankruptcy and PIA)).

The IPA does not have any data available on the number of individuals that would be impacted by the reduction of the exclusion period from 7 years to 5 years. However, we would expect that the number of such individuals would be few and therefore question the need to vary such a term.

Question – the government seeks stakeholder views on what other existing Bankruptcy Act offences should include an offence to advise, instruct, assist or counsel any person to commit or attempt to commit those offences.

The prevalence of Untrustworthy Advisors (UAs) within the Australian insolvency market continues to be of concern to the IPA. Such UAs operate both in the corporate and personal distressed debt space. It is the view of the IPA that all providers of insolvency/ solvency advice should be licenced by a government regulator and be subject to the same legal duties as existing Registered Trustees and Registered Liquidators.

Under the current proposal it would appear that, rather than the government require individuals to be registered to provide this advice and thereby fall within the purview of the regulators, that the proposal is instead seeking to place the onus upon existing Registered Trustees to identify UAs. The IPA is aware that the involvement of UAs in an individual's estate can result in that estate being denuded of assets prior to their bankruptcy, resulting in the work of the appointed Registered Trustee to be largely unfunded. Accordingly, it would appear the Government's intention to require these unfunded Trustees to undertake further unfunded work on behalf of the regulator. Such a proposition is unacceptable to the IPA's membership.

It is also unlikely that the impact of UAs is limited to bankrupt estates. It would not be unreasonable to assume that UAs may also seek to exploit the debt agreement legislation due to the lower investigative thresholds that exist therein. Accordingly, any requirements imposed upon Registered Trustees to identify and report UAs should also extend to Debt Agreement Administrators.

The IPA is aware that legislation was recently introduced to combat UAs in the corporate environment via *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* (Cth) (the Act). This introduced offences for persons who procure, incite, induce, or encourage a company to make a phoenix disposition. Similar legislation should be introduced into the Bankruptcy Act.

Our members frequently report incidences of phoenix activity, especially in certain sectors, and this remains a major concern. We are keen to see what impact the Act will have on such activity.

Such criminal offences combined with the requirement for all advisors operating in this industry to be registered, regulated, and professionalised should greatly assist in removing UAs from this space.