ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

12 February 2021

Private International and Commercial Law Section
Attorney-General's Department
3–5 National Circuit
BARTON ACT 2600

By email: Bankruptcy@ag.gov.au

Dear Sir/Madam

The bankruptcy system and the impacts of coronavirus

Thank you for the opportunity to lodge a submission in the response to the discussion paper on possible changes to the personal insolvency system to inform the Government's ongoing response to address the impacts of the coronavirus.

Background

Our submission is made with reference to the following background.

A reduction in the bankruptcy period was considered in the Productivity Commission's inquiry into Business Set-up, Transfer and Closure report in 2015 and has been debated periodically since then.

As you would be aware, the Bankruptcy Amendment (Enterprise Incentives) Bill 2017, which included the one-year discharge, failed to pass prior to the last election and stands as 'not proceeding'.

When this legislation was first proposed, as the professional body representing more than 85% of Registered Trustees in Bankruptcy, ARITA took an ambivalent position, as our initial indications were that there was no clear consensus amongst our members as to the proposals.

In 2019, when we became aware that the reduction was still being considered, our position changed. By then it was abundantly clear that our members – those who need to operate under this law – were now almost universally opposed to the reform on the grounds that it would:

- not provide adequate time for investigations into complex bankruptcies
- likely lead to significant scope for abuse by 'well resourced' or high-profile bankrupts
- encourage recidivism
- potentially create links to illegal phoenixing.

ARITA wrote to the Office of the Attorney-General outlining this new position.

Current consultation

We note that the bankruptcy system and the impacts of coronavirus paper covers four elements of the Bankruptcy Act to guide stakeholder consideration:

- the default period of bankruptcy
- debt agreements
- personal insolvency agreements
- offence provisions.

We also note that the department welcomes views on any other areas that stakeholders consider may address the impact of the coronavirus, including the impact that it has had on businesses (eg sole traders and partnerships).

ARITA has circulated the discussion paper to its members who specialise in personal insolvency and their feedback has informed this submission. It is noted that very few of our members have a focus on debt agreements, with registered debt agreement administrator's (RDAA)'s generally being Personal Insolvency Professionals Association (PIPA) members rather than ARITA members, and this submission is consequently limited in its consideration of the questions raised in this regard.

Key points

ARITA's key points in relation to each of the elements covered in the discussion paper are:

Default period of bankruptcy

The default bankruptcy period should not be reduced in responses to the current economic circumstances. It would be more beneficial to conduct a comprehensive review of Australia's insolvency system which establishes a simple, efficient, and effective regime and a clear pathway for those dealing with financial distress. A reduced bankruptcy period should apply as an exception, rather than a rule, and a 'simplified bankruptcy' option is the preferred alternative.

Debt agreements

Other than legislating the same high level of professionalism and competence for registered trustees and debt agreement administrators via academic requirements, no change should be made to the debt agreement system in response to coronavirus.

Personal insolvency agreements

Personal insolvency agreements (PIA) continue to be a valid option for certain debtors, without amendment, however they are costly and other options are available which will result in the same outcome. Creditor support for PIA proposals can be troublesome.

Offence provisions

Should the default bankruptcy period be reduced, amendments should be made to strengthen the objection to discharge regime to ensure the one-year default period for bankruptcy is not abused by serial, non-compliant bankrupts. With a view to reducing the prevalence and harm caused by dodgy pre-insolvency and phoenix advisers, ARITA continues to advocate for all providers of insolvency/solvency advice to be licensed and subject to the same legal duties as insolvency practitioners or lawyers.

As always, we look forward to continuing to work closely with the Attorney-General's Department and should you wish to discuss any aspect of our submission, please contact Ms Narelle Ferrier, Technical & Standards Director, on 02 8004 4350.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

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

We have more than 2,200 members and subscribers including accountants, lawyers and other professionals with an interest in insolvency and restructuring.

Around 80% of Registered Liquidators and Registered Trustees choose to be ARITA members.

ARITA's ambition is to lead and support appropriate and efficient means to expertly manage financial recovery.

We achieve this by providing 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. In 2019, ARITA delivered 118 professional development sessions to over 5,300 attendees.

ARITA promotes best practice and provides a forum for debate on key issues facing the profession.

We also engage in thought leadership and public policy advocacy underpinned by our members' knowledge and experience. We represented the profession at 15 inquiries, hearings and public policy consultations during 2019.

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1 Default period of bankruptcy

Recommendation 1: The default bankruptcy period should not be reduced in response to the current economic circumstances. It would be more beneficial to conduct a comprehensive review of Australia's insolvency system which establishes a simple, efficient, and effective regime and a clear pathway for those dealing with financial distress. A reduced bankruptcy period should apply as an exception, rather than a rule, and a 'simplified bankruptcy' option is a preferred alternative.

1.1 How do current economic circumstances impact the policy setting for a default period of one year bankruptcy?

ARITA is of the strong view that current economic circumstances should not drive permanent law reform. Any changes in response to current economic circumstances should be temporary in nature or have a sunset built into the legislation.

As noted by one ARITA member:

> The federal government was swift to enact temporary legislative measures and grant concessions to businesses and individuals alike to deal with the fallout from the coronavirus pandemic. The suite of new legislation was needed to ensure that individuals, sole traders, and businesses had breathing room in the height of the pandemic and gave much needed solace that there would be no immediate cessation of their business (in the case of sole traders) or immediate bankruptcy (in all other instances)…
>
> The concessions granted by the federal government with the introduction of the 'omnibus' reforms provide ample opportunity for individuals to navigate economic difficulties, when used correctly. However, the combination of the concessions regarding debts already in place for individuals (including sole traders) and the proposed one-year bankruptcy has the potential to open up space for abuse. Practically, there is concern that individuals/sole traders will incur substantial debts to tide them through the current economic climate, and would be more inclined to do so in the knowledge that they can "dump" these debts within one year.

Law reform should be robust and based on long term learnings rather than reactive to a particular event. Australia's insolvency system has developed in bits and pieces over the last three decades. It is far from broken, but it can be improved to be better suited to our 21st century economy.

We have seen the implementation of the small business reforms for corporate insolvencies; however, the *Bankruptcy Act 1966* (Act) already provides an equivalent process under Part IX, which provides a quick cost-effective process for dealing with low value personal insolvencies, including business related debts. More significant debts can be dealt with under Part X of the Act.

As it stands, Australia's insolvency law is amongst the most complex and voluminous in the world and more piecemeal reform should be replaced with a comprehensive review of Australia's insolvency system. It is high time to set some clear and obvious principles that all insolvency law reform must follow:

SIMPLE – how do we justify having so much disjointed legislation rather than a single 'Insolvency Act' – as the UK has had for the past 30 years?

EFFICIENT – complexity comes at a cost. We need a system that delivers value to creditors and facilitates efficiency for insolvency professionals.

EFFECTIVE – substantial failings in the first two principles – simple and efficient – undermine insolvency practitioners' ability to deliver effective outcomes for insolvency stakeholders.

A simple, efficient, and effective regime will ensure debtors and creditors understand the personal (and corporate) insolvency framework and the pathway they should follow for their specific circumstances.

This knowledge gap is a far greater issue for those dealing with financial distress rather than the term of the bankruptcy.

1.2 Have stakeholder views about the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 changed due to the impacts of coronavirus?

Based on feedback received from our members, it is evident that they continue to oppose the reforms, with some being stridently opposed to a default one year bankruptcy.

Some members have expressed an opinion that a reduced bankruptcy period should apply as an exception, rather than a rule, and propose a 'simplified bankruptcy' option as a preferred alternative.

Following a similar framework as the simplified liquidation process that is now available in corporation insolvency, a bankrupt could access a reduced period of bankruptcy subject to certain eligibility criteria, confirmation by the trustee and possibly agreement by creditors.

Like the simplified liquidation process, eligibility criteria could protect against abuse, including recalcitrant bankrupts, and the Act could prescribe circumstances which trigger ceasing the simplified bankruptcy process where it was in the interest of creditors, without placing significant regulatory burdens on trustees. Similarly, eligibility could be dependent on the lodgement of all outstanding tax returns by the debtor and a statutory 'decision period' for the adoption of the process could be legislated.

Simplified bankruptcy could be specifically targeted towards proactive debtors who are genuinely and honestly wishing to deal with their financial distress and provide full, frank, and transparent disclosure to their trustee.

A simplified bankruptcy approach could also help mitigate mental health issues associated with dealing with these issues on a long-term basis, while preserving integrity in the personal insolvency framework.

Arguably many of the below justifications for the abolition of the early discharge provisions by the *Bankruptcy Legislation Amendment Act 2002* equally apply against one year bankruptcy:

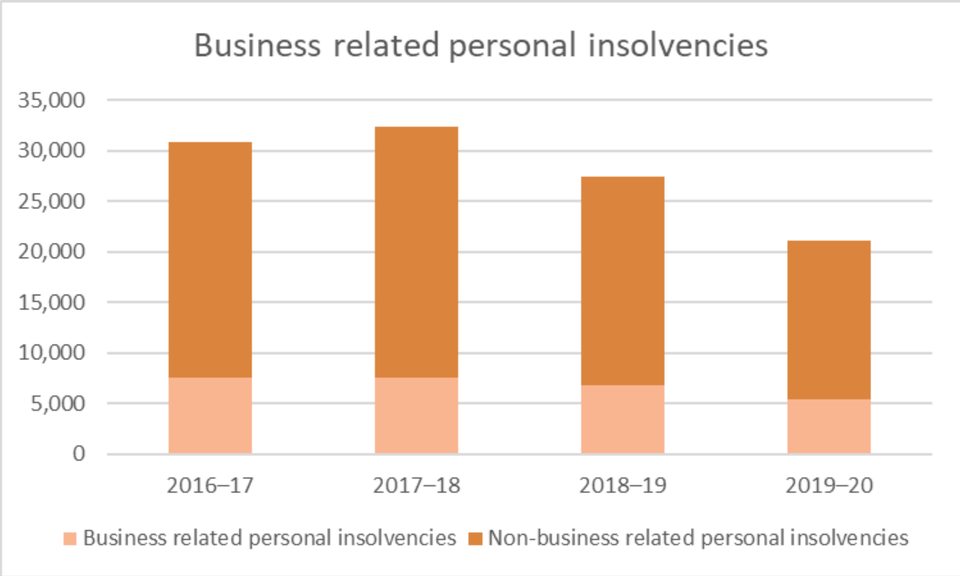
- many creditors feel that the possibility of being released from bankruptcy after six months does not reflect the serious nature of the decision to become bankrupt.
- discourages debtors from trying to enter formal or informal arrangements with their creditors to settle debts, and provide little opportunity for debtors to become better financial managers, and
- they were initially intended to apply to those who became bankrupt out of misfortune (those with few assets and low incomes) rather than misdeed, but it seems inappropriate to thus imply that all those with some assets or income have been guilty of incurring debts in bad faith[1].

1.3 How might a default period of one year benefit debtors with business related debts such as sole traders?

Personal insolvency statistics reported by the Australian Financial Security Authority continue to show that business related personal insolvencies account for 30-35% of all personal insolvency appointments, with the vast majority utilising the bankruptcy process rather than debt agreements (Part IX) or personal insolvency agreements (Part X). This equated to less than 5,500 business related personal insolvencies in 2019-2020, with no present indication of a significant increase in appointments.

The Reserve Bank of Australia also recently highlighted that the economic recovery is well under way and has been stronger than was earlier expected[2].

[1] Bills Digest No. 8 2001-02, Bankruptcy Legislation Amendment Bill 2001, www.aph.gov.au
[2] Reserve Bank of Australia, Statement by Philip Lowe, Governor: Monetary Policy Decision, 2 February 2021



Source: Australian Financial Security Authority personal insolvency statistics

Most of our members do not believe that a default period of one year would benefit debtors with business related debts, such as sole traders, particularly noting that the Act does not restrict a sole trader from running or commencing a business any time during bankruptcy, although some professional, industry and licensing associations may impose limitations.

Access to credit

Access of a former bankrupt to credit is important to encourage entrepreneurial endeavours and reduce the associated stigma of bankruptcy, however our members do not believe that a reduction of the bankruptcy period from three to one year will address the alleged stigma associated with bankruptcy. No matter what the term of the bankruptcy, and even with a corresponding reduction in the credit restrictions under the Act, many of our members still believe credit providers will require disclosure of past insolvency and assess applications accordingly.

We accept that while the retention of the permanent record of bankruptcy in the NPII may not meet the objective of a fresh start, encourage and facilitate further entrepreneurial endeavours and reduce the associated stigma, it is important that the fact of the bankruptcy remain on permanent record. Bankruptcy has a significant legal impact on the bankrupt and other parties, and a record of its occurrence should not be removed.

Licences and industry associations

Should any amendment be made to the bankruptcy period, ARITA supports the Government working with relevant professional, industry and licensing associations with a view aligning restrictions with any reduced period of bankruptcy, where appropriate. In that respect, from our brief research into the wording of these restrictions, some refer to the period of bankruptcy and others refer to three years.

For example, as to the latter, s 56AC of the *Queensland Building and Construction Commission Act 1991* refers to a person excluded from holding a building licence as an individual who ‘takes advantage of the laws of bankruptcy or becomes bankrupt (relevant bankruptcy event), and 3 years have not elapsed since the relevant bankruptcy event happened.’

As to the former, s 206B(3) of the *Corporations Act 2001* refers simply to a person being under restriction as an ‘undischarged bankrupt’.

1.4 Do stakeholders have views on how the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 could be amended to respond to concerns about the one-year default period being made available to bankrupts for whom such a concession is not a desirable or justifiable outcome?

As noted above, a simplified bankruptcy process based on eligibility criteria could ensure that a reduced bankruptcy period is not available to those for whom such a concession is not a desirable or justifiable outcome.

The requirement to qualify for a simplified bankruptcy process ensures that it is only available to those who meet the eligibility criteria and the obligation to object to an automatic one-year discharge for recalcitrant bankrupts does not pass to the trustee.

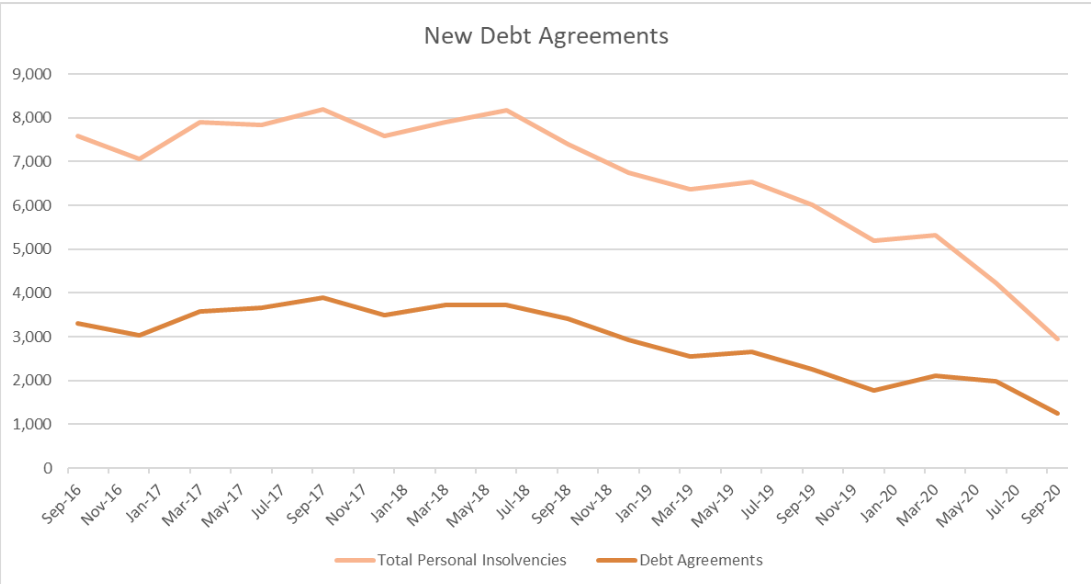
2 Debt agreements

Recommendation 2: Other than legislating the same high level of professionalism and competence for registered trustees and debt agreement administrators via academic requirements, no change should be made to the debt agreement system in response to coronavirus.

2.1 What reforms, if any– either on a temporary basis or more permanently – should be made to the debt agreement system to respond to coronavirus?

As noted above, ARITA is of the strong view that current economic circumstances should not drive permanent law reform. It would be more beneficial to conduct a comprehensive review of Australia's insolvency system which establishes a simple, efficient, and effective regime and a clear pathway for those dealing with financial distress.

As noted in the discussion paper, the *Debt Agreement Reform Act 2018* amended the Act and imposed, among other measures, a default limit of three years on the length of debt agreements and doubled the asset threshold for access to the debt agreement mechanism. Notwithstanding these amendments, only 8,147 new debt agreements were entered into in 2019-20, representing 39.2% of total personal insolvencies.



Source: Australian Financial Security Authority personal insolvency statistics

2.2 Are there changes that could be made to the debt agreement system to make it more useable for those with business related debts such as sole traders?

The *Debt Agreement Reform Act 2018* introduced new qualification and registration requirements for debt agreement administrators, however while there are now qualification requirements set out in the Bankruptcy Regulation 1996, there is no requirement for specific insolvency education.

The *Insolvency Law Reform Act 2016* (ILRA) increased the competence and capability of the profession and was enacted in response to two decades of reviews into the regulation of insolvency practitioners including the Australian Law Reform Commission; the Working Party to review the regulation of corporate insolvency practitioners; the Parliamentary Joint Committee on Corporations and Financial Services; and the Senate Economics References Committee (Senate Committee) in 2010.

The explanatory memorandum to the ILRA's predecessor bill noted:

> The insolvency profession must be skilled, honest and accountable in order for the insolvency regime to operate efficiently. …. Regulation that promotes a high level of professionalism and competence of insolvency practitioners is therefore essential to retaining confidence in the insolvency system as a whole. [5.5]

This same high level of professionalism and competence applies equally to registered trustees and debt agreement administrators and both levels of registration should be subject to the same academic requirements.

2.3 Should the income, debt, and/or asset threshold amounts for debt agreements be increased? Eg the income and/or debt threshold could be increased to match the current asset threshold of $236,126.80.

The income, debt and asset threshold amount for debt agreements were increased in 2018, including the ability to hold twice as many assets as debt (increased from $111,675.20).

Given the Act provides for Personal Insolvency Agreements (PIAs) to facilitate arrangements for higher value personal insolvencies, and subject to our below comments below regarding PIAs, we do not believe the income, debt or asset threshold should be increased.

2.4 Does the impact of the coronavirus give rise to the need to re-consider the term limit of a debt agreement?

Consistent with the above, ARITA does not believe that the impact of the coronavirus should give rise to the need to re-consider the term limit of a debt agreement.

2.5 What are the possible consequences (unintended or adverse) to making reforms to the debt agreement system in response to the impacts of the coronavirus?

Law reform should be robust and based on long term learnings rather than reactive to a particular event. More piecemeal reform should be replaced with a comprehensive review of Australia's insolvency system.

2.6 If you support reforms to the debt agreement, should there be a transition period before any reforms take effect?

ARITA does not support reforms to debt agreements beyond the implementation of specific insolvency education for registration. We believe that such education should apply to all new RDAAs and those seeking to renew their registration.

3 Personal insolvency agreements

Recommendation 3: PIAs continue to be a valid option for certain debtors, without amendment, however they are costly and other options are available which will result in the same outcome. Creditor support for PIA proposals can be troublesome.

3.1 Could personal insolvency agreements play a greater role – either on a temporary basis or more permanently – in settling debts for individuals, including those who have business-related debt (eg sole traders), who are in financial distress due to the impacts of coronavirus?

PIAs can play a greater role in settling debts for individuals, including those who have business-related debt (eg sole traders), who are in financial distress due to the impacts of coronavirus, however debtors need to have access to the right advice to understand their options.

There are some significant barriers to the uptake of PIAs, as noted below, and a simple, efficient, and effective regime would ensure debtors and creditors understand the right pathway for their specific circumstances.

This knowledge gap is a significant issue and extensive and, at times, aggressive marketing by some registered debt agreement firms and ambulance chasing by unregulated pre-insolvency advisors creates confusion for those dealing with financial distress.

3.2 Are there barriers to the uptake of personal insolvency agreements?

Cost of compliance

The Part 5.3A Voluntary Administration process in the *Corporations Act 2001* is based on the PIA regime.

Like voluntary administrations, as the investigation and reporting obligations on the controlling trustee are significant, PIAs are best suited to debtors who have a reasonable level of assets and resources available to enable a return to be paid to creditors.

The duties and functions of a controlling trustee can make the up-front cost involved prohibitive or a deterrent for some debtors, with it often being cheaper to proceed into bankruptcy and then consider a composition or arrangement pursuant to section 73 of the Act.

We also understand that the Australian Financial Security Authority also takes particular interest in PIA proposals and such regulatory interest can be a deterrent for some debtors and controlling trustees (noting that it can also increase costs).

Section 73 Composition or arrangement

Except for very few debtors, a section 73 composition or arrangement is an alternative to a PIA. This avenue avoids the upfront cost of a PIA however, the same outcome may be achieved. Creditor support may also be more forthcoming following what may be perceived as a more rigorous and independent investigation of the debtor's affairs.

Support of creditors

Several ARITA members have expressed concerns that in their experience PIAs fail due the actions of consumer creditors, notably credit card providers, who require high return thresholds (upwards of 50%) before supporting a proposal.

We have also received mixed feedback about the Australian Taxation Office's support for PIA proposals, with the below actual experiences demonstrating this variance:

- "Both of the PIA's we have put up in the past two years has been knocked back by the ATO. The last two that we have had were [director penalty notice] related debts. The debtors were not related and were about 12 months apart so not the same tax officer. The ATO knocked both PIAs back, did nothing and then relied upon their ability to set off every future tax refund the [tax payer] was going to get against the [director penalty notice] debt"
- "The last one I did last year, the PIA proposal was actually offering only a return to priority [superannuation guarantee charge] creditors (ie the ATO for unpaid super). There was nothing for unsecured creditors. In that case the ATO voted in favour on the basis that there was going to be a return to employees for their super, even though underlying tax debt wasn't going to see a return. It got up. They were playing the good corporate citizen."

The tight investigation and reporting timeframes can also leave creditors wondering how much investigation work has been done and if the debtor's affairs have been fully identified.

3.3 Could the processes for establishing personal insolvency agreements be streamlined to make them more attractive or more accessible, particularly for individuals with business-related debt?

We have no comment on this question.

4 Offence provisions

Recommendation 4: Should the default bankruptcy period be reduced, amendments should be made to strengthen the objection to discharge regime to ensure the one-year default period for bankruptcy is not abused by serial, non-compliant bankrupts. ARITA continues to advocate for pre-insolvency advisers to be licensed and subject to the same legal duties as insolvency practitioners or lawyers.

4.1 What new or expanded offence provisions could respond to concerns about the abuse of a one-year default period of bankruptcy?

Should the default bankruptcy period be reduced, amendments should be made to strengthen the objection to discharge regime to ensure the one-year default period for bankruptcy is not abused by serial, non-compliant bankrupts. Draft amendments in this regard were circulated by the Attorney-General's Department in September 2018 and we reiterate ARITA's feedback to the proposals.

While ARITA supports the inclusion of the proposed amendments to mitigate the abuse of the new reduced bankruptcy period, the key concerns are:

A. the timing requirement imposed on trustees to raise the new ground for objection; and
B. the cumulative nature of the factors for which a trustee must form reasonable grounds.

Requiring trustees to prove that there are reasonable grounds to deny discharge after the one-year period will be practically difficult, places a significant burden on trustees and creates circumstances which are likely to be open to manipulation by those seeking to abuse the new regime.

Raising objection within 6 months

The proposed amendment places a high burden on trustees by requiring them to form the requisite opinions very early in a bankruptcy, and possibly in circumstances where only limited information is available and the bankrupt may be non-compliant in assisting the trustee.

Further, to the extent the requisite opinions are to be based on matters arising from previous bankruptcies (which at the moment there is no limit in number) there is also a need to obtain information from prior trustees concerning the conduct of a bankrupt in any previous bankruptcies. Depending on the number of bankruptcies involved and their complexity, this could be a time-consuming task in practice.

In fact, the specific feedback from an ARITA board member who is a registered trustee, is that it:

> "would almost be unworkable to make that decision [as required for the new ground under the proposed amendment] in the first 6 months, particularly for the complex matters…"

Given objections under the current provisions can be registered on the National Personal Insolvency Index (NPII) any time up to discharge, and noting the significant practical challenges presented by the inclusion of a requirement to raise the objection within the first six months, ARITA considers the existing position (being no time limit for raising an objection) should also apply to the new objection criteria in the proposed amendment.

Any limitation of the right to object to discharge places increased obligations on the trustee and provides an advantage to a bankrupt who may seek to abuse the provision.

We therefore strongly disagree with the proposed amendment including a requirement that such an objection must be lodged within a reduced timeframe.

Cumulative requirements for reasonable grounds

The cumulative nature of the requirements for the proposed amendment also places a high burden on trustees in terms of the materials which must be assessed to form a defensible view that the objection to discharge should be lodged.

The proposed amendment provides that the breaches to be prescribed as being a required part of the trustee's assessment should be "objectively ascertainable" and accessible to the trustee taking into account privacy considerations - the scope of the requirement remains significant.

This is particularly the case in circumstances where the proposed list of offences under the consideration of breaches by the bankrupt of the Bankruptcy Act require convictions to have been recorded.

It is further noted that the indicative list of prescribed breaches of the Act, while comprehensive, further highlights the broad scope of the assessment which the current form of the proposed amendment obliges trustees to undertake.

4.2 What new or expanded offence provisions could respond to concerns about the behaviour of untrustworthy advisors, including pre-insolvency advisors?

ARITA has long taken the position that illegal phoenix activity, facilitated by dodgy pre-insolvency advisers, is undermining the effective operation of the market and strips assets from other rightful creditors in external administrations. These same advisers assist debtors to circumvent the personal insolvency laws and remove assets from the reach of creditors.

This was one of ARITA’s key points in its Financial Recovery 2020 8-point plan to improve Australia’s business rescue culture, better help indebted individuals back onto their feet, and ensure that creditors get a fairer deal from insolvency.

Insolvency practitioners continue to be concerned about the rise of the largely unregulated ‘pre-insolvency’ advice market.

Not to be confused with qualified professionals giving lawful advice, these ‘pre-insolvency advisors’ counsel their clients on how to avoid paying their debts and meeting their legal obligations.

They are ambulance chasers who prey on people and businesses in financial distress. They claim to be able to remove the worry of a dire financial situation, but they often encourage unlawful conduct such as hiding or stripping assets and illegal phoenixing.

These pre-insolvency advisors are not Registered Liquidators or Trustees. They aren’t lawyers or tax practitioners and don’t hold Australian Financial Services Licences. This means they are totally unlicensed and operate without scrutiny from any regulator.

The lack of regulation also means that there is no accountability and no recourse. They are generally not members of any professional bodies, hold no professional registrations and therefore do not have any indemnity insurance should things go awry.

We need effective enforcement action to shut down these dodgy advisers. We believe the advice being offered by pre-insolvency advisers should be considered corporate or personal insolvency advice. Therefore, pre-insolvency advisers should be licensed and subject to the same legal duties as insolvency practitioners or lawyers.

ARITA has made a submission to the Treasury supporting reforms to Australia’s consumer credit laws to facilitate more timely access to credit for small businesses and consumers, whilst retaining and strengthening a number of consumer protections by licensing debt management firms.