consumer action
law centre

16 November 2012

By email: bankruptcy@ag.gov.au

Dear Sir or Madam

Review of Debt Agreements Under the *Bankruptcy Act 1966* - Proposals Paper

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on Review of Debt Agreements under the *Bankruptcy Act 1966* proposals paper (**the proposals paper**).

Briefly, this submission:

- reiterates our recommendation that the Bankruptcy Act should be amended to introduce a minimum income eligibility threshold for debt agreements to decrease the number of clearly inappropriate debt agreements being entered;
- supports proposal 2 (that debt agreement administrators should be required to certify that a debt agreement is a suitable option for the debtor, not only that it is affordable);
- strongly supports proposal 8 (that the Inspector-General be given powers to impose industry wide conditions) and also recommends that amendments to the Bankruptcy Act be introduced to address the serious and widespread use of advertising by debt agreement providers which we believe to be misleading;
- does not support proposal 10 (which would allow creditors to propose a modification of a debt agreement) because we believe it will create significantly more pressure on debtors to enter unaffordable debt agreements; and
- responds to a number of other proposals in the proposals paper.

Our comments are detailed more fully below.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

The need for a minimum threshold

As we argued in our September 2011 submission on this topic,[1] we strongly believe that the Bankruptcy Act should be amended to introduce a minimum income eligibility threshold for debt agreements.

Our reasons for making this recommendation were explained in detail in our September 2011 submission, but briefly the problem is that large numbers of debtors are being advised to take out debt agreements despite bankruptcy being a clearly better option. In particular, ITSA statistics indicate that 79 per cent of people entering debt agreements have less than $5000 in realisable assets, 69 per cent have no assets at all, 80 per cent do not own or are not purchasing a home[2] and 20 per cent have gross incomes less than $30,000 per annum.[3] This suggests that a significant proportion of people with debt agreements genuinely cannot afford to repay their debts without significant hardship and are at no risk of losing assets were they to petition for bankruptcy. These debtors have taken out debt agreements not because it was in their best interests but simply because there is more money for practitioners in administering debt agreements than there is in bankruptcies.

The overarching purpose of any reform of the debt agreement system should be to ensure that debtors are properly informed of their options and practitioners are directing debtors to the option that is best suited to the debtor's needs, not simply the option most lucrative for the practitioner.

Placing a minimum income threshold for entry into debt agreements will reduce the number of clearly inappropriate debt agreements being sold. We suggest that an individual should be presumed to be ineligible for a debt agreement if:

- their income is below the actual income threshold in the Bankruptcy Act; and
- their only assets could not be accessed by their creditors under Bankruptcy.

The presumption of ineligibility could be displaced where there are clear reasons why a debt agreement would be a better option for a debtor than bankruptcy, for example where bankruptcy would put the debtor's job at risk.

Statistics on termination rates

The proposal paper states that amendments to regulation of debt agreements that commenced in 2007

> appear to have had a positive impact on ... termination rates [which] have decreased from 26.5% to 8.4%....

The same statement was made in the consultation paper released by the Attorney-General's department in July 2011 and is based on statistics presented on page 13 of that paper.[4] This

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[1] Our previous submission can be accessed here: http://consumeraction.org.au/submission-review-of-debt-agreements-under-the-bankruptcy-act-1966/

[2] ITSA *Profiles of Debtors 2009*, p 26, 27.

[3] Attorney General's Department (2011) *Review of Debt Agreements under the Bankruptcy Act 1966: Consultation Paper: June 2011*, p 15.

[4] *Review of Debt Agreements under the Bankruptcy Act 1966: Consultation Paper: June 2011*. Accessed from

statement is incorrect—the statistics in fact suggest that termination rates appear to have *increased* since the 2007 changes. We made the same point in our submission to the 2011 consultation paper. It is a little concerning that the same error could be made again.

To reiterate our point, the statistics in the consultation paper showed that 89 per cent of debt agreements created under the new system (that is, following the 2007 reforms) are still active, compared to 31.4 per cent under the old system.

Under the new system, 603 agreements have been completed (being 2.6 per cent of all agreements made) while 1,977 agreements have been terminated (8.4 per cent of all agreements made)—that is, around 3 times as many agreements have been terminated compared to the number completed.

However, the old system showed the opposite trend--more agreements were completed than were terminated. Again using the statistics in the 2011 consultation paper, 4,438 agreements created under the old system have been terminated (26.5 per cent of total agreements entered) while 7,065 agreements were completed (42.2 per cent of total).

As we said in our previous submission, we would be wary of picking trends in the data for new agreements when 89 per cent are still on foot. However, it cannot be argued at this point that the new system is producing less terminations than the old system.

Responses to particular proposals

Proposal 1: Registration as a debt agreement administrator to be made mandatory
We strongly support Proposal 1. There is no reason to continue to allow unregistered administrators to administer debt agreements.

Proposal 2: Statement of suitability to be submitted with debt agreement proposals
We believe that a minimum income threshold for entry to a debt agreement is the best way to reduce the numbers of consumers being directed to inappropriate debt agreements. We also strongly support the proposal that administrators be required to certify that a debt agreement is suitable compared to other options, though this option is only likely to be successful if it is well enforced.

In particular we recommend that:

- administrators be required to provide the statement of suitability to the debtor;
- debtors be given the right to challenge the accuracy of the statement, be released from the agreement and seek compensation if the statement is found to be insufficient;
- administrators should have to indicate why a debt agreement is suitable (as suggested in the proposal paper) especially for low income judgement proof clients;
- ITSA should be empowered to release guidelines for administrators on making the suitability assessment; and

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http://www.ag.gov.au/Consultationsreformsandreviews/Documents/Review%20of%20Debt%20Agreements%20under%20the%20Bankruptcy%20Act%201966%20Consultation%20Paper%20July%202011.pdf

- ITSA must have the ability to randomly audit an administrator's certificates. The statements of suitability will not be effectively enforced if they rely on consumer complaints.

Proposal 3: Certificate to accompany variation proposal

We support proposal 3. Any variation proposal should be accompanied by a certificate from the administrator stating that the that variation is still suitable for the debtor (as compared to other options) and affordable. The debtor should be able to challenge the certificate, seek release from the agreement and seek compensation for insufficient certificates as recommended under proposal 2.

Proposal 8: Power for the Inspector-General to impose industry wide conditions

We support proposal 8. In particular, there is an urgent need for tighter regulation of advertising by debt agreement administrators. As well as giving the Inspector-General power to impose conditions, we recommend amendments to the Bankruptcy Act to address the most serious advertising problems.

There is serious and widespread use of representations in advertisements by debt agreement administrators which in our opinion are misleading, deceptive, or likely to mislead or deceive contrary to section 18 of the Australian Consumer Law. The most common type of misrepresentation are those which deliberately overstate the differences between debt agreements and bankruptcy or understate the consequences of entering a debt agreement relative to bankruptcy.

Websites of debt agreement administrators typically make statements to the effect that a debt agreement is not bankruptcy or is an 'alternative' to bankruptcy. This is exacerbated by the fact that ITSA itself describes debt agreements a 'flexible alternative to bankruptcy'. Despite this, it is our view that in order to not be misleading, debt agreement administrators should clearly state that giving the Official Receiver a debt agreement proposal is itself an act of bankruptcy.[5]

We are particularly concerned by statements on Credit Repair Australia's website that

> A debt agreement is not the same as becoming bankrupt; it is an alternative to bankruptcy, however some people consider a debt agreement to be an “act of bankruptcy”[6]

It is not clear from this statement that debt agreements are regulated under the Bankruptcy Act and do constitute an act of bankruptcy. We believe this is misleading. In particular, Credit Repair Australia's statement suggests that it is open to dispute whether entering a debt agreement amounts to an 'act of bankruptcy' when it clearly is not.

Websites also generally contain strongly worded statements about the effect declaring bankruptcy will have on a debtor's credit report, but give little or no indication that a debt agreement has a very similar impact. For example, Australian Debt Agreements' describe bankruptcy on their 'options for debt consolidation' page in the following terms:

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[5] Bankruptcy Act 1966, s 40(1)(ha).

[6] http://www.creditrepairaustralia.com/content/do/debtagree, accessed 14 November 2012.

> This will mean that your name will be listed on a credit file. Bankruptcy has very serious consequences for the remainder of your life. We strongly advise that you do not take this step without first speaking to Australian Debt Agreements.

There is no indication on the same page (or apparently on the entire website), that entering a debt agreement also has significant consequences or that a debtor should seek advice—simply that 'there are some financial criteria that you will need to adhere to in order to qualify'.[7]

Other websites give the impression that a debt agreement is like a debt consolidation loan or is otherwise relatively insignificant. For example, Australian Debt Agreements' say that debt agreements are "a simple answer".[8] Debt Cutter suggests that debt agreements are:

> simply an arrangement to reschedule your unsecured debts into a single payment plan so you can meet your obligations to the best of your ability over a period of time suitable to your budget[9]

Also problematic are:

- statements which misrepresent the debt administration process or what a debt administrator can achieve. Australian Debt Agreements claim that 'a substantial portion of your debt will be written off' and that 'we'll negotiate a lower, affordable repayment'[10]—neither can be guaranteed.

- statements which suggest that a debt agreement covers secured debts. Debt Cutter claims that 'a debt agreement can consolidate and freeze interest on... pending car or boat repossession [and] pending mortgage foreclosure'.[11] This is qualified later by an explanation that 'a debt agreement can free up your cash flow placing you in a better position to address any pending legal action or secured debt commitments'. We do not believe this disclaimer is adequate to remedy the misleading nature of the original claim.

  Debt Fix's website says that one of the benefits of a debt agreement is that 'you keep your property and assets' and that a debtor will not lose their house or car 'as long as the payments are maintained'.[12] It should be far clearer that a debt agreement will not protect secured assets.

- suggestions that debt agreement providers are endorsed or approved by the Government or ITSA, or that the provider will give disinterested advice on the best option for the client. For example, Debt Fix states that it 'is a government registered Debt Agreement Administrator, meaning you will receive the very best advice and most relevant solution

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[7] http://www.australiandebtagreements.com.au/debt_consolidation/options_for_debt_consolidation.asp , accessed 15 November 2012.
[8] http://www.australiandebtagreements.com.au/, accessed 15 November 2012.
[9] http://www.debtcutter.com.au/, accessed 15 November 2012.
[10] http://www.australiandebtagreements.com.au/debt_agreement/benefits_of_debt_agreement.asp, accessed 15 November 2012.
[11] http://www.debtcutter.com.au/how-we-can-help-you.html, accessed 15 November 2012.
[12] http://www.debtfix.com.au/Formal-Debt-Agreements-Sydney.html, accessed 15 November 2012

every time'.[13] Australian Debt Agreements say that a debt agreement 'is backed by Australian Government legislation'[14].

The Inspector-General should have the power to impose advertising conditions which make clear that these kinds of representations are unacceptable. ITSA will also need the range of compliance and enforcement powers that ACCC has in order to effectively enforce those conditions and breaches of the general law. These should include powers to seek:

- declarations;
- injunctions;
- pecuniary penalties;
- enforceable undertakings;
- substantiation notices which require businesses to substantiate the claims made about their products and services;
- infringement notices for less serious contraventions, which take the form of an 'on-the-spot fine';
- public warning notices; and
- redress for consumers who have suffered loss or damage

We also recommend that amendments need to be made to the Bankruptcy Act to address the most widespread and flagrant misrepresentations. The Act should:

- require that all advertisements include a prescribed statement to the effect that entering a debt agreement is an act of bankruptcy and has serious, long term consequences;
- prohibit debt agreement administrators from representing (either in an advertisement or otherwise) that a debt agreement is 'not bankruptcy'; and
- ban the use of representations like 'debt free', 'freedom from debt' or similar phrases. These give the impression that all debts will be included in a debt agreement (secured debts are not) and that an agreement will be successful (creditors may not accept an agreement, or it may not be possible for an affordable agreement to be drawn up).[15]

Proposal 9: Statistics on debt agreements to be published on ITSA's website

We support proposal 9. Providing statistics on fees and acceptance rates on ITSA's website will allow debtors to shop around on price, promote competition by allowing administrators to advertise that they have low fees, and provide information on industry trends to regulators and advocates.

Proposal 10: Changes to voting process for debt agreements

We do not support proposal 10 in its current form.

Proposal 10 would allow creditors to propose a modification of a debt agreement, rather than only being permitted to vote 'yes' or 'no'. While this appears sensible, its effect will be that

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[13] http://www.debtfix.com.au/Formal-Debt-Agreements-Sydney.html, accessed 15 November 2012.

[14] http://www.australiandebtagreements.com.au/debt_agreement/how_a_debt_agreement_can_help.asp, accessed 15 November 2012.

[15] Note that the section 923A of the Corporations Act 2001 currently prohibits the use of the terms 'independent', 'impartial' or 'unbiased' by financial service providers who accept commissions or similar payments.

considerable pressure will be applied by debt administrators on the debtor to agree to pay a higher amount than offered in the original debt agreement proposal—the only modifications creditors will ever suggest will be to increase the amount to be repaid. In our experience, there is usually no extra room in a debtor's budget after debt agreement repayments are made and we are dubious that many modified proposals would be sustainable.

Additional debtor protections would need to be introduced to respond to this risk, including at a minimum that the administrator must make a fresh certification that the modified proposal is suitable and affordable for the debtor. The Bankruptcy Act would also need to provide that creditors could not take steps to recover a debt while modification process on foot.

We do not agree that this proposal allows large creditors to send 'a market signal' to administrators (as suggested by the proposals paper), unless the creditors are seeking to modify the proposal purely to reduce the administrators fees. We suspect that most proposals will instead seek to increase the amount the debtor repays. We would not have concerns with allowing creditors to propose a reduction in administration fees as long as the payments made by the debtor are not required to be increased.

Proposals 11 and 12: Powers of the Inspector-General to obtain information concerning accounts

We support both proposals 11 and 12, which would give the Inspector-General additional powers where they believe on reasonable grounds that proceeds of debt agreements are not being handled correctly.

Proposal 16: Declaration of relationships

We do not oppose proposal 16, but we very much doubt whether simply declaring relationships will reduce the risk of debt administrators offering conflicted advice or debtors paying excessive brokerage fees. Indeed, these kinds of declarations have been shown to create perverse effects, including that a person disclosing a conflict can be seen as *more* trustworthy by their client because they appear to be going out of their way to be transparent[16].

We recommend that conflicted remuneration should simply be prohibited, as it has been for financial advisers through the Future of Financial Advice reforms. If the Government is not willing to prohibit conflicted remuneration for administrators, ITSA should investigate the type and extent of conflicted remuneration in the industry and impose more targeted conditions.

Proposal 17: Increase income, assets and unsecured debt thresholds for debt agreements by 20 per cent

We do not oppose proposal 17, however we reiterate our earlier point that there should also be a minimum income threshold. While there may be value in increasing availability of debt agreements, the Government's focus should be on ensuring they are available where they are an appropriate option rather than simply making them available in all cases.

Proposal 23: Fit and Proper Person Test

[16] See Daylian M. Cain, George Loewenstein and Don A. Moore (2005) *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, Journal of Legal Studies (University of Chicago), vol 34 (see in particular pp 5-6). Accessed from http://sds.hss.cmu.edu/media/pdfs/loewenstein/DirtOnComingClean.pdf.

We support the introduction of a general 'fit and proper person' test as part of determining whether a person is eligible to become a debt administrator. As the proposals paper notes, a general test will allow the Inspector-General to reject an application where an applicant meets specific requirements of the eligibility criteria but is not otherwise fit and proper for the role. Without a general 'fit and proper' test, it is also likely that practitioners that are rejected from practicing in other areas of the financial services industry for poor conduct will be attracted to debt agreement administration.

Proposal 25: Alignment of offences

We support proposal 25 which would align offences and penalties for debt agreement administrators with those which apply to the administration of bankruptcies.

The requirements in question (keeping a separate bank account, keeping books and making accounts and records available for inspection) reflect a minimum standard of professional conduct for debt agreement administrators and bankruptcy trustees. It is sensible that the penalties should be aligned across both professions. Aligning penalties also (slightly) reduces the incentives for practitioners to direct debtors into debt agreements where bankruptcy is a more appropriate option.

Proposal 28: Debt agreements and the NPII

We support proposal 28, which would remove listings regarding debt agreements from the NPII rather than recording them permanently. In our view there is no reason why records relating to a debtor's use of a debt agreement (or bankruptcy) need to be recorded permanently. This kind of record is presumably of very little value in assessing creditworthiness if many years have passed and the debtor's circumstances have changed. We also agree that there are benefits in aligning the time that debt agreements are listed on the NPII with the time they are recorded by the credit reporting system.

Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

CONSUMER ACTION LAW CENTRE

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