FCRC
Financial & Consumer Rights Council Inc.

25 November 2009

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

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

Dear Sir/Madam,

Submission to the Inquiry into the Bankruptcy Legislation Amendment Bill 2009

The Financial and Consumer Rights Council (**FCRC**) thanks the Senate Legal and Constitutional Committee (**Committee**) for the opportunity to make a written submission to its inquiry into the Bankruptcy Legislation Amendment Bill 2009 (the **Amendment Bill**).

We note that the Attorney General (**AG**) has previously sought consultation on the Amendment Bill, and after receiving 17 submissions, has referred the Amendment Bill in its original form to the Committee for inquiry. The referral of the unchanged Amendment Bill indicates the Government's commitment to the Bill's policy objectives to allow consumers who have fallen on hard times, and who have relatively few assets and little income, to make informed decisions and have access to alternative solutions when dealing with debt.

The FCRC supports the general objectives of the Amendment Bill, specifically increased protections for low to middle income debtors. The Government is commended for its proposal to increase the creditor's petition threshold from $2,000 to $10,000, and to increase the stay period following a declaration of intent from 7 to 28 days.

We are concerned about the provisions in the Amendment Bill raising the debt, income and asset tests threshold for debt agreements by 20%, thereby increasing the number of debtors who may be eligible to enter into such agreements under Part IX of the *Bankruptcy Act* 1966 (Cth) (the **Act**). Our comments regarding this and other issues are set out below.

Raising the minimum debt for a creditor's petition from $2,000 to $10,000

Raising the threshold amount

The FCRC strongly supports Schedule 4 Part 1 of the Amendment Bill, which increases the minimum debt for a creditor's petition (or creditor-requested bankruptcy notice) from $2,000 to $10,000.

For consumer bankrupts and their families, the impact of being made bankrupt on a creditor's petition is considerable, with the risk to and loss of family homes, often incredibly disproportionate to the initial debts owed. As can be seen from the below case study, family homes are often lost as a result of creditor petitioned bankruptcy. Although the initial debt may be under the current $2,000 threshold, the addition of interest and late fees push the debt over the threshold enabling the creditor to pursue bankruptcy. The subsequent addition of trustee fee and legal costs eat into the estate's equity, and leave the debtor with very little resources to start fresh.

Sally's Story

Sally (name changed) has an intellectual disability and owns her own home on a large property.

Sally incurred a debt of $700 when she purchased a new alarm system for her home. The initial debt of $700 was pushed over the $2,000 threshold by the creditor with the addition of interest and late fees. Due to her intellectual disability she failed to comprehend the severity of the debt recovery action when her creditors initiated bankruptcy proceedings. The creditor successfully petitioned to bankrupt Sally and a private trustee was appointed to administer her estate.

When Sally was referred to a Financial Counsellor by the courts, the total debt owed had risen dramatically to $30,000. The final debt included the initial debt plus legal costs and trustee fees.

For Sally to repay her creditors she would have no choice but to lose her home. Unfortunately for Sally she is asset rich, yet very income poor.

The above case study illustrates that the use of bankruptcy as a tool to recover small debts is grossly unfair and punitive.

Since the minimum threshold was increased from $1,500 to $2,000 in 1996 the economic climate has changed significantly. The Reserve Bank of Australia (**RBA**) released figures in September 2009 showing that the average credit card debt at the time was $3,100[1], and when multiplied by two - which was the

[1] Alan Porritt, 'Australian's crunching credit card debt', *ABC News Australia*, 17 September 2009.

average number of credit cards per person in 2003[2] - the financial pressure experienced by many households in Australia is more accurately shown. Unfortunately for many consumers, credit card debt is not the sole source of debt, with the rising costs of housing, food and utilities also placing unnecessary strain on households. In a study completed this year, it was revealed that many low income consumers are faced with utility bills that are often as high as credit card debt, with utility bills between $1,000 and $4,500 an unfortunate norm for a third of households in the financial counselling case studies[3].

Increasing financial stress occurring simultaneously with high availability of credit and increasing costs of living is placing many households in a tenuous situation they may have never experienced before. Financial Counsellors are finding that their client base has spread from the 'traditional' low income client, to middle class clients – many of whom own their own home.

The need to increase the minimum debt from $2,000 to $10,000 was discussed in detail in the *Homes at Risk* report released by Eastern Access Community Health in November 2007[4]. The findings in this report were significant, and illustrated the enormous impact on consumers and their families when they are made bankrupt on a creditor's petition. The risk to and loss of family homes of consumer bankrupts was in many cases, seriously disproportionate to the size of the initial debts owed. In addition to recommending an increase to $10,000 of the minimum threshold for which a creditor's petition can be issued, the report also concluded that:

> A creditor's petition triggers a process which can significantly impact on the homes of debtors and their families. Mainstream creditors are currently paying more attention to the development and implementation of financial hardship policies for debtors in financial difficulty. Attention to responsible collection of debt beyond this stage would be welcomed by Financial Counsellors. Using the bankruptcy regime to recover small debts should be a last resort.[5]

Bankruptcy action is currently being used as a threat to low income and vulnerable consumers who are experiencing dire financial stress to ensure that they 'pay up'. This is an abuse of the policy objectives of the Act, and it is an abuse that debt recovery practitioners unashamedly admit, with one practitioner stating that:

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[2] Senator Gavin Marshall Wednesday 13 October 2003, Hansard, Matters of public importance, Consumer Debt. Speech. http://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansards/2003-10-15/0145/hansard_frag.pdf;fileType%3Dapplication%2Fpdf on 23 November 2009.

[3] Jessica Murrowood, *Still an Unfair Deal? Reassessing the impacts of energy reform and deregulation on low income and vulnerable consumers*, The Financial and Consumer Rights Council, November 2009.

[4] Jan Pentland, *Homes at Risk: using bankruptcy to collect small debts,* Eastern Access Community Health, November 2007.

[5] As above, p25.

> It is not commercially viable to initiate bankruptcy action against a debtor unless there is a likelihood of a return and thus, the bankruptcy debtors are invariably property owners...[6]

The use of bankruptcy to pressure consumers with the threat of becoming homeless is a callous and punitive tactic used by creditors and debt recovery practitioners. There are other debt collection tools available for creditors to pursue payment for small debts, including judgment debt recovery enforcement proceedings, accepting payment by instalments, and if absolutely necessary; the sale of the debtor's home by the Sheriff by enforcing a judgment debt. These options are far more cost efficient as opposed to the fees charged in bankruptcy proceedings by appointed trustees who consequently strip equity from the debtor's estate.

We strongly believe that both the homes and the equity within homes should be protected from creditors pursuing recovery of small debts. It is unconscionable to send a consumer and their family into further hardship, detriment and vulnerability by forcing them from their home over a debt which - had the creditor have had an understanding of financial hardship and responsible lending policies - could be dealt with in a much more humane way. There is an intrinsic link between financial hardship, responsible lending and bankruptcy, and Government policies on these issues should be in sync.

It should be noted with the passing of the new National Consumer Credit Protection Bill 2009[7] (**NCCP Bill**); creditors will soon be required to ensure that consumers are not susceptible to vulnerability in the event they are unable to fulfil the obligations of their credit contract. Chapter 3 of the NCCP Bill requires that creditors engage in responsible lending conduct to ensure that a credit contract is 'not unsuitable' for the consumer. One requirement of establishing the suitability of the contract is detailed in section 118(3) which states that:

> For the purpose of paragraph (2)(a)[8], it is presumed that, if the consumer could only comply with the consumer's financial obligations under the contract by selling the

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[6] Mendelsons Lawyers and Prushka Fast Debt Recovery, Submission to the Attorney General on the Bankruptcy Legislation Amendment Bill 2009, accessed via http://www.ag.gov.au/www/agd/agd.nsf/Page/Publications_BankruptcyLegislationAmendmentBill2009-ExposureDraft on 24 November 2009.

[7] Senate's amendments passed 23 November 2009.

[8] Paragraph (2)(a) states:

The contract will be unsuitable for the consumer if, at the time of the preliminary assessment, it is likely that:

(a) the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship, or

(b) the contract will not meet the customer's requirements or objectives; or

(c) if the regulations prescribe circumstances in which a credit contract is unsuitable – those circumstances will apply to the contract;

if the contract is entered in the period proposed for it to be entered or the credit limit is increased in the period proposed for it to be increased.

> consumer's principal place of residence, the consumer could only comply with those obligations with substantial hardship, unless the contrary is proved.[9]

Importantly, the same requirement is needed to assess the suitability of *remaining* in a credit contract.[10]

We believe that the policy objectives of the Amendment Bill should be aligned with the overarching policy objectives of the Government. The inclusion of consumer protection policies in the credit market signify a positive step toward recognising the risks and harms associated with financial hardship, especially when there is a threat to the home. To allow consumers to be subjected to further vulnerability because they are unable to meet the demands of creditors over relatively small debts is grossly unconscionable. Creditors remaining allowed to force debtors into bankruptcy with the knowledge that the result would leave the debtor homeless, is in direct opposition to credit reforms which were recently passed in the Senate[11].

We would like to address the arguments made by our opposition, who call for the minimum threshold to only be raised to $5,000 and not the preferred $10,000.[12] The minimum debt amount has not been raised since 1996 when it increased from $1,500 to $2,000. Further, if the original minimum debt about of $500 set in 1966 was indexed in accordance with inflation, the current values would equate to over $5,000. To increase the minimum debt to $5,000 would not adequately reflect changes in the current economic environment, or be cognisant of the realities faced by consumers in trying to navigate their way through debt and rising household costs. As we discussed earlier, given that average credit card debts equate to over half of $5,000, to advocate for the minimum debt level to merely be raised to $5,000 is irresponsible and does not adhere to the spirit of the amendments, or wider Government policy.

Clarifying what amount the threshold applies to

We note that the Amendment Bill proposes to raise the minimum debt to $10,000 however does not make any clarification on what the $10,000 consists of. We strongly recommend that the increase in the minimum debt be done so in addition with an amendment to clarify that the minimum debt of $10,000 must only relate to the amount of the *original* debt owed and not to the debt owing at the time the creditor's petition is issued.

[9] NCCP Bill.
[10] NCCP Bill section 119.
[11] NCCP Bill 2009
[12] Australian Bankers' Association and Association of Building Societies and Credit Unions, Submission to the Attorney General on the Bankruptcy Legislation Amendment Bill 2009, accessed via http://www.ag.gov.au/www/agd/agd.nsf/Page/Publications_BankruptcyLegislationAmendmentBill2009-ExposureDraft on 24 November 2009.

As we illustrated in the case study of **Sally's Story**, an original debt amount increases over time as the creditor applies interest, late fees and other charges – such as collection costs. In Sally's case, although her original debt was only $700 and under the minimum threshold, the addition of late fees and interest by the creditor allowed them to petition for Sally's bankruptcy. Sally would not have lost her home or be placed in situation of high vulnerability had the minimum debt level only apply to her original debt level of $700.

In addition to ensuring that the minimum debt threshold only apply to the original debt owed (without creditor applied interest and fees), we also strongly support a review of bankruptcy trustee remuneration and costs, and we fully support the arguments made by the Consumer Action Law Centre in relation to the review of trustee remuneration and costs in their submission to the Committee.

Increasing the stay period that follows the declaration of intent to file a debtor's petition from 7 to 28 days

We support Schedule 4 Part 2 item 5 of the Amendment Bill, which increases the stay period in relation to a declaration of intention to present Debtor's Petition from 7 to 28 days. We agree that the current 7 day period does not provide debtors with enough time to assess their options properly and perhaps negotiate with creditors. The filing of a declaration of intention is an act of bankruptcy, thus it has serious consequences and is not merely a way for a debtor to avoid the payment of debts.

Increasing the debt, income and assets thresholds for eligibility for debt agreements by 20%

Whilst we are generally supportive of the Amendment Bill, we have concerns about the proposal to expand eligibility to enter into a debt agreement under Part IX of the Act, given our concerns about the administration of debt agreements under Part IX of the Act.

In August 2005 the Attorney General and the Insolvency and Trustee Service Australia (**ITSA**) conducted a review of the operation of debt agreements under Part IX of the Act. In response to the review, the FCRC voiced its concern regarding the administration and regulation of debt agreements and debt agreement administrators. We remain concerned, and we anticipate further review and reform of debt agreements and their administrators, in conjunction to the Amendment Bill.

Of the 9118 debt agreements proposed for the 2007-2008 financial year, 6542 of these proposed agreements were accepted by creditors and only 27 were completed. Further, the success of these agreements in recovering debts for creditors is very low, with a mere 1.1% of accepted debt agreements completed over the financial years of 2005-2006 to 2007-2008.[13] The rate of completed debt agreements has declined markedly since 2002-2003.[14]

Financial Counsellors have reported that many of their clients have been lured into unrealistic and unsustainable debt agreements, and we are concerned that the large number of unsuccessful agreements is driven by the large fees retrievable by debt agreement administrators under the agreements. Debt agreements must be administered in a manner that realistically assesses the debtor's capacity to pay their debts. However, a 2005 report on Part IX debt agreements, *Debt Agreements: Remedy or Racket?*, found that many debtors failed to comply with their debt agreement after being unable to maintain payments that were unlikely to have been sustainable from the start.[15] A copy of this report is attached to this submission.

We are very concerned about the occurrence of unsustainable debt agreements, and since the release of the *Debt Agreements: Remedy or Racket?* report in 2005 Financial Counsellors continue to work with clients who have felt trapped into debt agreements. Below is a recent case study which illustrates our concern.

Nick's Story

Nick (name changed) is receiving treatment for clinical depression, and since entering into a Part IX debt agreement, his relationship with his wife deteriorated and they are now separated.

Nick sold what was once the family home to try and repay his debt, however after mortgage repayments he was left with very little to repay his debts. As a result, Nick is now homeless, and relies on the help of family to seek shelter.

Nick sought the advice of a finance company who advised him to enter into a debt agreement to repay his debt of $66,000. The company did not offer Nick advice on any other options available to him, such as bankruptcy. The company brokered the debt agreement for Nick, and arranged for a debt agreement administrator to handle the agreement. The company charged Nick a fee for brokering the debt agreement, which consisted of six payments of $400 *prior* to the commencement of the debt agreement. This equated to a total fee of $2,400.

The debt agreement administrator negotiated payments to be made in the amount of $350 per week, and did not ask Nick any detailed questions about his living and other expenses. Nick was left with $50 per week once he began making payments toward the debt agreement.

Nick later terminated the debt agreement as it was too difficult for him to make the payments. He is now bankrupt.

[13] Inspector-General in Bankruptcy, *Annual Report by the Inspector-General in Bankruptcy on the operation of the Bankruptcy Act 2007-2008*, p42.
[14] As above.
[15] Consumer Credit Legal Service Inc and Eastern Access Community Health, *Debt Agreements: Remedy or Racket?*, November 2005. See Appendix 1

It is also important to recognise that many debtors enter into debt agreements under the false belief that they will avoid the consequences associated with bankruptcy. For example, entering into a debt agreement will be recorded on a person's credit information file in a similar manner to bankruptcy and the person's name will be recorded permanently on the National Personal Insolvency Index. It is also generally considered an 'act of bankruptcy' under clauses in typical consumer lending arrangements such as mortgages, triggering default or foreclosure options for lenders. After the Australian Competition and Consumer Commission (**ACCC**) had concerns that Australia's largest debt agreement administrator, Fox Symes, was not providing consumers with this information it started legal action against the company in 2004.[16] The matter was settled on 10 June 2006 when Fox Symes and its directors gave enforceable undertakings to the Federal Court on the basis that they did not admit that they engaged in conduct in contravention of the Trade Practices Act 1974. The undertakings given by Fox Symes, still in force today, were that for a period of five years it:

- will not make certain statements to customers or potential customers in respect of debt agreement proposals and debt agreements;

- will use its best endeavours to inform customers and potential customers that details of a debt agreement proposal or debt agreement are highly likely to be recorded on a person's credit report as maintained by credit reporting agencies;

- will explain the nature and effect of all documents provided to customers and potential customers by Fox Symes; and

- will bring to the attention of customers and potential customers the amount of all fees payable in respect of a debt agreement.[17]

We remain concerned that, in the absence of further provisions better regulating the conduct of debt agreement administrators and fees payable for these agreements, the Amendment Bill will merely expand the number of potentially very vulnerable consumers who will be at risk of entering into inappropriate and unfair agreements. We therefore recommend that the Government revisit the recommendations of the *Debt Agreements: Remedy or Racket?* report and review the operation of debt agreements over the last three years before making any amendments to this part of the Act. As the Explanatory Memorandum to the Amendment Bill notes, the 2007 review of debt agreements decided to retain the thresholds at their current levels until the next review of debt agreements scheduled for 2010 (§144). We strongly recommend that Schedule 4 Part 2 item 11 of the Amendment Bill, which

[16] Australian Competition and Consumer Commission, 'ACCC alleges unconscionable conduct by debt administrator', *ACCC website*, http://www.accc.gov.au/content/index.phtml/itemId/518507/fromItemId/465054 .
[17] Australian Competition and Consumer Commission, 'Fox Symes & Associates Pty Ltd', website, http://www.accc.gov.au/content/index.phtml/itemId/585988/fromItemId/684968 .

raises the threshold amounts for debt agreements, be postponed for consideration during the more comprehensive review of debt agreements which should take place next year.

About the FCRC

The FCRC is the peak body for Financial Counsellors and community based organisations in Victoria who are concerned with the rights of low income and vulnerable consumers.

The FCRC is an independent not-for-profit organisation which is primarily funded by the Department of Justice and has been in operation since 1996.

Amongst other things, the FCRC provides a support network for 200 member Financial Counsellors, primarily through ongoing training, education and professional development seminars and policy development. Additionally, the FCRC is active in promoting the rights of consumers and seek to achieve this by the provision of consumer information and community education, as well as effective casework support and advocacy.

We again thank the Committee for the opportunity to provide input to its inquiry into the Amendment Bill. Should you have any questions regarding this submission, please contact Kristen Gobbo at the FCRC

Yours sincerely

Richard Foster
Chief Executive Officer

Kristen Gobbo
Policy Officer