

06 February 2018

Mr Tim Watling  
Committee Secretary  
Senate Legal and Constitutional Affairs Legislation Committee  
Parliament House  
Canberra ACT 2600

By email: [legcon.sen@aph.gov.au](mailto:legcon.sen@aph.gov.au)

Dear Mr Watling

## Bankruptcy Amendment (Enterprise Incentives) Bill 2017

The Australian Bankers' Association (to be re-named Australian Banking Association) is pleased to have this opportunity to provide some views about this Bill.

### Introductory remarks

The ABA has reservations concerning the government's decision to reduce the default period of bankruptcy from three years to one year, including the transitional arrangements for bankruptcies in train once the legislation commences. It is acknowledged that certain obligations of a bankrupt would continue beyond the one year bankruptcy period such as income contributions and providing assistance to the bankrupt's trustee.

The government's intention behind this reform is to remove a potential barrier to innovation and business start-ups, encouraging entrepreneurial behaviour and reducing the stigma associated with bankruptcy.

We observe that first, the majority of personal bankruptcies are not business-related (see insolvency statistics below). For this reason, reducing the default period for all bankruptcies may go further than necessary to achieve the policy aim.

Further, it is questionable whether reducing the period of bankruptcy alone would lessen or remove a stigma of bankruptcy in any case. Arguably, reducing the discharge period alone would have no effect on the numerous restrictions (for example, barriers to entry to professions) which currently exist, which add to the stigma of bankruptcy in employment and business.<sup>1</sup>

Finally, it is the ABA's view that reducing the business related bankruptcy period would create risks for the broader business community. These should be carefully considered.

### Personal insolvency statistics

The Explanatory Memorandum to the Bill states that in reducing the default period for bankruptcy from three years to one year:

As part of the National Innovation and Science Agenda these reforms aim to foster entrepreneurial behaviour and to reduce the stigma associated with bankruptcy. Reducing the automatic discharge to one year will reduce stigma, encourage entrepreneurs to re-engage in business sooner and encourage people, who have previously been deterred by the punitive bankruptcy laws, to pursue their own business ventures.

<sup>1</sup> The Conversation "Reducing bankruptcy to 12 months ignores realities of insolvency" June 2016 <https://theconversation.com/reducing-bankruptcy-to-12-months-ignores-realities-of-insolvency-60382>



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As noted above, personal insolvency statistics provided by the Australian Financial Security Authority (AFSA) show that in 2016–17, only 18.4% of debtors entered a personal insolvency due to business related causes. In the 2016-2017 year some 12416 debtors became bankrupt for non-business related reasons, primarily due to unemployment, excessive use of credit, domestic discord or relationship breakdown and ill health.

Further, it may not be the case that many business related personal insolvencies today involve entrepreneurship or starting of a business. According to AFSA, the most common usual occupations of debtors who entered a business related personal insolvency in 2013–14 were:

- Construction trades workers 669 debtors with economic conditions the most common cause of insolvency.
- Road and rail drivers 353 debtors with economic conditions the most common cause of insolvency.
- Hospitality, retail and services managers 289 debtors with economic conditions the most common cause of insolvency.
- Other technicians and trades workers 282 debtors with economic conditions the most common cause of insolvency. These occupations include: Hairdressers, Printing trades workers, Textile, clothing and footwear trades workers and Wood trades workers. It could be argued that this lack of representation by entrepreneurs in personal insolvency statistics today indicates that the 3-year default bankruptcy period could be discouraging entrepreneurship and innovation. But on the other hand, it is evidence to show that a more targeted reduction of the period is warranted (rather than reducing the default period for all personal bankruptcies).

According to AFSA, for business related causes of personal insolvencies, “in 2016–17, where a debtor cited a specific cause, the most common business-related causes of debtors entering personal insolvencies were:

- *economic conditions (1,779 debtors)*
- *personal reasons including ill health (471 debtors)*
- *excessive drawings (310 debtors).”*

“Economic conditions” was the most common cause cited by debtors for entering a business related personal insolvency in every year from 2007–08 to 2016–17.<sup>2</sup>

## Further considerations

### 1) Role of trustee

According to the Explanatory Memorandum, the Bill contains measures to implement significant reforms to Australia’s bankruptcy laws by reducing the default period of bankruptcy from three years to one year. Other time periods associated with bankruptcy will also be reduced to one year. These include disclosure of bankrupt status when applying for credit, seeking permission for overseas travel and the attainment of certain licences and entering into certain professions.

These are appropriate reforms which may help to reduce the stigma of formal bankruptcy.

On the other hand, there is a significant risk with a one year bankruptcy period, particularly for business related bankruptcies, because a trustee may not have sufficient time to investigate the circumstances of the debtor. In the administration of a business related bankruptcy or where there is added complexity or lack of a bankrupt’s co-operation, one year is unlikely to be sufficient time for a competent trustee to conduct the necessary work.

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<sup>2</sup> <https://www.afsa.gov.au/resources/statistics/socio-economic-statistics/causes-1/causes-business-related>



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This would include identifying any antecedent transactions or restructuring of the debtor's assets to determine whether any uncommercial or other questionable dealings had taken place by the debtor to avoid or lessen the consequences of the bankruptcy for the debtor.

If the necessary preference claims or uncommercial transactions related investigations are not completed in the year, the trustee will not be in a position to decide to extend and, if so, how longer, the bankruptcy should continue.

These investigations are an important protection for the business community if the debtor is to be released prematurely from bankruptcy to resume a business career which could expose future creditors of the debtor to risk of loss. For example, AFSA's statistics (footnote 2) show that prior to bankruptcy a debtor may have:

- engaged in making excessive drawings on the business,
- failed to account for taxation,
- failed to keep proper books of account,
- engaged in gambling or speculation,
- displayed a lack of business ability including a failure to assess the potential of the business,
- had a lack of initial working capital to support the business, and
- had other (non-specified) other business reasons.

This risk would be avoided if the first alternative option (see alternatives below) submitted by the ABA is adopted in the Bill.

## **2) Future bankruptcies numbers**

Further, the ABA understands that the experience in the United Kingdom after the bankruptcy period was reduced from three years to one year saw an exponential increase in bankruptcies that later fuelled increases in other personal insolvency arrangements other than bankruptcy.

If this experience were to be repeated in Australia this would present a substantial increase in the number of bankruptcies to be overseen by AFSA with consequential resourcing, costs and budgetary implications.

The ABA believes that development of an entrepreneurial culture would be better focused on constructive measures for avoiding bankruptcy such as better preparation and training for business proprietors, especially new starts.

Further, it should be noted that banks have played a role in the preventative aspects of bankruptcy through working out financial difficulties with their financially troubled personal and small business customers and their guarantors, including under the Code of Banking Practice's pre-contractual disclosures for guarantors.

If a result of the proposed reduction in the discharge period of bankruptcy is that more debtors seek the apparent simplistic relief in bankruptcy without understanding fully its implications rather than working with their banks (or other creditors) to achieve relief with their credit facilities, this would be counterproductive to the assistance which banks might be able to offer them.

The ABA trusts that this submission is of assistance to the Committee in its deliberations on the Bill and that its alternative suggestions are worthy of consideration by the Committee.

## **Alternative suggestions**

If the Bill is to proceed without a deeper consideration of the nature of business failure and the stigma of bankruptcy, the ABA submits four alternative approaches aimed at achieving the government's policy aims and which are reasonable given the lack of clear statistical information, and the identified associated risks for industry.



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The ABA suggests these alternative options that could achieve the government's objective in preference to a general reduction in the bankruptcy period:

- 1) Confine the reduced, default one year period of bankruptcy to business related bankruptcies with an expeditious right for the trustee to extend the bankruptcy period for up to another two successive twelve months' periods balanced with a right of the bankrupt to seek to contest the extension in the court provided there is an indemnity from whatever source for the trustee's costs.
- 2) For the default period of bankruptcy to be reduced to two years (instead of one year) with corresponding reductions of other time periods associated with bankruptcy as set out in the Bill i.e. disclosure of bankrupt status when applying for credit, seeking permission for overseas travel and the attainment of certain licences and entering into certain professions. Corresponding reductions in other time periods are necessary whatever the default period of bankruptcy is set.
- 3) For the law to provide for an early release mechanism for those business related bankrupts who have clearly demonstrated sound business acumen and responsibility and who for circumstances not under their control, for example due to adverse economic conditions, illness or family disruption, have been unsuccessful in their business ventures, on application to the court by the bankrupt with the onus of proof to rest with the bankrupt.
- 4) Create two thresholds: one for non-business related bankruptcies with a default period of bankruptcy of one year; the other for business related bankruptcies retaining the current default period of three years to take account of, for example, the more complex bankruptcies particularly those where a large corporate failure or where phoenix activity has occurred .

Yours faithfully

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