CREDIT AND FINANCIAL SERVICES TARGETED

at

AUSTRALIANS AT RISK OF FINANCIAL HARDSHIP

Personal Insolvency Professionals Association

PO Box 392

Moorebank NSW 1875

Tel: (03) 9351 0434

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Delivered to: economics.sen@aph.gov.au

INTRODUCTION

The Personal Insolvency Professionals Association (PIPA) is an industry body for those service providers which assist consumers with personal insolvency issues.

Members of PIPA comprise practicing debt agreement administrators, accountants, financial advisors, lawyers and affiliates involved in both personal insolvency work. The role of the PIPA is to inform, educate and assist members who are engaged with consumers affected by personal insolvency issues. Members are required to submit to the Code of Professional Conduct. Its members are predominantly providers of debt agreements.

This submission relates primarily to debt agreements which are one of 3 types of formal personal insolvency – the others are bankruptcy and personal insolvency arrangements (PIAs). All 3 are subject to the detailed requirements of the Bankruptcy Act 1966 (the Act) and Bankruptcy Regulations (Regulations), and regulatory supervision by the Australian Financial Security Authority (AFSA). Bankruptcy and PIAs are not discussed in this submission.

Debt Agreements

For over 20 years, Debt Agreement Administrators have provided a practical and affordable alternative to bankruptcy for debtors struggling with unmanageable debt. During that period, some 100,000 Australian consumers have avoided bankruptcy by proposing a debt agreement to their creditors. In 2017-18, 14,834 Australians entered into a debt agreement[i] and there are currently more than 46, 000 active debt agreements[ii].

Debt agreements account for some 46% of formal personal insolvencies[iii]. Financial management was the main reason identified for insolvency for debtors entering debt agreements (57%), followed by divorce/breakdown of a relationship (36%) and retrenchment/unemployment/business failing (32%)[iv].

As at 30 June 2017 there were 78 Registered Debt Agreement Administrators[v], all of whom are regulated by AFSA and subject to the express requirements of the Act and Regulations[vi]. AFSA investigates complaints against debt agreement administrators, conducts detailed regulatory inspections, and monitors advertising, provides direction and guidance regarding communication and operational matters through the issuance of Inspector-General Practice Directions. Additionally it surveys creditors and debtors and consults widely.

As well as being subject to AFSA's complaint investigation process, many Debt Agreement Administrators, and particularly those granted an Australian Credit License also offer, in addition to an internal dispute resolution process, the external resolutions services of the Australian Financial Complaints Authority. The number of complaints referred concerning Debt Agreement Administrators to external dispute resolution is very low.

It is not surprising that many people call Debt Agreement Administrators seeking information about debt agreements and alternatives. In 2015-16, 15% of Australian households (approximately 1.3 million) were in financial stress[vii].

Debt Agreement Administrators provide information, options, guidance and referral to the many callers who are not eligible to propose; or do not choose to propose a debt agreement. Alternatives to debt agreements include bankruptcy, informal arrangements, debt waivers, consolidation, refinancing and personal budgeting assistance.

The Act requires a Debt Agreement Administrator to undertake a thorough assessment and analysis of a debtor's financial position including household income and expenses[viii]. The declarations made by the debtor must be supported by evidence allowing the administrator to form the belief, based on the evidence and the debtor's declaration, which the debtor is likely to be able to discharge the obligations created by the debt agreement.

It is a requirement that each debt agreement proposal be certified as affordable, sustainable and viable. Further, it must be executed by the Registered Debt Agreement Administrator.

The detailed process required in the preparation of a debt agreement proposal is not well understood by many in the financial and community sectors. The legislative and procedural requirements are onerous. Only insolvent applicants are eligible to seek relief under a debt agreement. Those who are unable to proceed with debt agreement may have little or no other alternative but to file for bankruptcy or remain in a debt trap for a lengthy and indefinite period.

Debt Agreements provide a solution that enables people to retain their dignity without excessive hardship. It is regrettable that there are many financial counsellors and consumer lawyers who fail to understand the benefits of debt agreements, the disadvantages of informal arrangements and the negative impacts of bankruptcy.

The benefits for individuals who are accepted into a debt agreement are significant. They include:

- a certain, manageable, fixed term arrangement that immediately freezes interest on all unsecured debt;
- without the stigma of bankruptcy;
- in many cases retaining their home and other assets;
- maintaining their existing home loan, without incurring the higher fees and interest rates typically offered to those who have been bankrupt;
- avoiding the consequences of bankruptcy which may include loss of employment and exclusion from employment in where vocational licensing is required;
- ability to travel overseas without the consent of the trustee;
- ability to operate a company;
- retention of inheritances and windfalls;
- protection from creditor harassment;
- retaining their dignity;
- alleviation of stress and anxiety.

The primary reason expressed by debtors wishing to propose a debt agreement is their desire to pay an affordable amount to their creditors and avoid the consequences of bankruptcy. There is a widespread view in the community at large that bankruptcy indicates a personal, moral and financial failure.

Generally, people will go to great lengths to avoid bankruptcy. On the other hand, there is a conviction that major creditors should "do the right thing" and make reasonable concessions to debtors in financial difficulty.

The rehabilitation of insolvent debtors is a matter that is essential to a healthy society and economy. There are many instances of debtors trapped in unsecured debt for decades leading to health issues such as depression, substance abuse and other harms.

Debt agreements enable individuals to settle their indebtedness, albeit at a compromised rate, within a defined time-line and make a fresh start.

The primary cost associated with establishing a debt agreement is borne by the affected creditors, not by the debtor. Additionally, due to the forced freeze on accruing interest, and the compromised settlement offer, participants in debt agreements repay less to affected creditors than would be required pursuant to the contractual terms.

Debt Agreements have been a significant factor in reducing the number of personal bankruptcies since 1996. Recent legislative amendments which have now restricted the time-line over which a debt agreement may be administered[ix] will inevitably result in many insolvent debtors filing for bankruptcy, who would have previously entitled to apply for a debt agreement. It is surprising that greater consideration was not given to the social and economic impacts of these amendments.

The cost of government regulation of bankruptcy is largely borne by the creditors that support debt agreements. All debt agreement proposals are subject to a government $200 application fee and those approved are subject to a government 7% realization charge[x].

One of the erroneous complaints levelled against debt agreements is that many debtors are paying more than the total of their original debts. In fact, this only occurs in a very small percentage of cases and only when the major creditor demands it or the debtor chooses to offer more than necessary. In one instance a debt agreement proposal was made by a debtor who had ripped off his workmates through gambling and insisted on repaying them 100 cents on the dollar in addition to the administrator's fees because he felt so terrible about what he had done.

AFSA statistics indicate that no more than 1.7% of debt agreement participants would pay back more than 100% of their original debt. If interest were added then it is unlikely that any would pay more than the original amount plus interest[xi].

Inquiries and Reports

There is no need for a further inquiry into debt agreements because they were considered by the *Senate Legal and Constitutional Affairs Legislation Committee* in March 2018, resulting in the recent passing of new legislation[xii]. This has made significant changes and improvements to the regulation and requirements of debt agreements including:

- reducing the maximum length of debt agreement proposals to 3 years *except* where the debtor is a homeowner
- doubling the asset value threshold
- limiting the total payments under a proposal to a percentage of the debtor's income
- restricting eligibility of low income debtors for a debt agreement
- empowering the Official Receiver to refuse to accept a debt agreement proposal for processing if the official receiver reasonably believes that the debt agreement would cause undue hardship to the debtor
- wide powers given to the regulator to reject unaffordable agreements, review advertising
- restricting the category of persons authorized to administer debt agreements

In its March 2018 report on the Bankruptcy Amendment (Debt Agreement Reform) Bill, the Senate Legal and Constitutional Affairs Legislation Committee noted (at 3.16) the submissions demonstrating that the return to creditors will significantly decrease under the new three-year regime by comparison with the five year regime that is currently the most common time-line for debt agreements. The result is that some debtors who are currently eligible for a five year debt agreement will not be able to enter into a three year debt agreement if affected creditors do not accept the reduced rate of return. These consumers may be forced into bankruptcy or left to struggle in the debt collection regime.

AFSA confirmed to the Senate Committee (at 3.20) that on average creditors receive 59.68 cents per dollar owed under debt agreements, compared to 1.15 cents per dollar under bankruptcy.

In its submission to the Senate Committee, PIPA (at 3.26 and 3.27) also highlighted the importance of flexibility to vary a debt agreement rather than forcing termination. Where a debtor's circumstances change, the debtor may still be able to complete the debt agreement subject to it being varied. Creditors generally are understanding and supportive of variations where there are good reasons. Restricting variations results in debtors being unable to complete their debt agreement.

Research by Monash University[xiii] academics of the experiences of 233 participants in debt agreements and 167 consumer bankrupts noted *that "most respondents who left extended comments at the end of the survey were positive about their experiences."* Unfortunately, only the negative side of this report has been reported. The authors concluded that *"to some extent, the debt agreement framework has succeeded in providing heavily indebted Australians with a means of dealing with their financial problems, without resorting to bankruptcy."*

Debt Management

Debt agreements should be recognised as a type of formal insolvency administration, not as a type of informal debt management. Debt agreements are subject to strict regulatory controls and oversight by AFSA.

Debt management usually involves an informal agreement between creditors and the debtor. There is a wide variety of providers of products and services. Regulation is minimal compared with formal types of insolvency such as bankruptcy or debt agreements.

PIPA strongly supports practical and effective regulation that will ensure that all service providers in the debt management field provide a satisfactory level of customer service and are accountable to their customers and to the wider community. Companies that buy debts and collect debts should be recognised as part of the debt management process and be regulated on a national basis.

ASIC should be given the resources to set and enforce minimum benchmarks for all debt management providers. These should include provision of information to consumers and avenues of complaint.

Consumer Credit

Australians have a very high level of consumer debt by world standards. The Royal Commission into the Banking Industry highlighted some significant problems regarding irresponsible lending. However, there are many forms of credit available to consumers and excessive lending is a widespread problem.

Although some progress has been made in promoting financial literacy, the impact on consumer borrowing practices is not widely apparent. Clearly there is an urgent need for stronger protection for consumers who may be unable, or unwilling, to exercise self-restraint in their borrowing.

High interest credit exacerbates debt problems. Many of the insolvent debtors that apply for debt agreements through PIPA members have high interest loans. The freeze on interest offered by debt agreements is a significant benefit.

The recent proliferation of “buy now, pay later” credit has hastened the journey to insolvency for many. Purchases are usually of a discretionary nature, such as white goods or household furniture; and on occasion personal clothing. The availability of additional credit encourages consumers to spend more than they would otherwise spend if they had to wait until their pay was deposited into their account. Although the amount of credit provided is small, there are now many companies offering this service through retailers so that the cumulative total available to a consumer who accesses “buy now, pay later” credit through multiple providers can be significant.

It should be noted that “buy now, pay later” credit is not a new product, as it has been available in various forms for larger purchases such as furniture and electrical goods for many years. However, in the past, lenders were more careful in approving “buy now, pay later” credit for larger purchases.

When PIPA members are reviewing the overall financial situation of consumers with payday loans and “buy now, pay later” credit, it is often difficult to see how the lender considered the credit to be affordable at the time of approval. When debtors apply for assistance, the “buy now, pay later” credit is often the most recent debt, obtained at a time when the debtor was already struggling with other loans, indicating that the debtor was an insolvent borrower.

Case study

Mr C was struggling with payments on a car loan, personal loan, two credit cards and two payday loans. He went shopping to cheer himself up and bought an expensive new outfit with “buy now, pay later” credit. Because he did not make payments on time, a number of late payment fees were charged. Mr C then applied for a Debt Agreement. The company *that provided the "buy now, pay later" credit voted against the Debt Agreement, claiming that the length of time to receive their dividend was too long as the credit was interest-free.*

We recommend that "buy now, pay later" lenders and other short-term credit providers be required to review the customer's current indebtedness and undertake an assessment of the customer's ability to service additional debt before advancing credit.

Informal Arrangements

Informal arrangements are typically agreements between the debtor and each creditor for the payment of some or all of each debt at a rate that is affordable. Interest may continue to accrue at the contract rate or the court judgment rate. Alternatively, the creditor may agree to remit some or all of the interest charges.

Hardship arrangements under the National Credit Code are a form of informal arrangement. However these are intended to only be a form of temporary relief. In some cases creditors allow informal arrangements to continue indefinitely, requiring the debtor to provide periodic updates on their financial circumstances, and using that information to vary the amount of payments required.

Informal arrangements have advantages and disadvantages. They can be easily negotiated and are not subject to government regulation and government charges. They may provide a good return to the creditor and provide a significant discount to the debtor. There is no public record other than an entry on the debtor's credit report.

However, there are a number of disadvantages. There is usually no limit on the length of time that may apply to an informal arrangement, meaning that the debtor could be locked into payments for an extended period. Missing a payment or two may result in the agreement being revoked, and any discount on interest or principal being lost. Hardship arrangements may not incorporate a freeze of interest, resulting in the balance of the debt rising over time.

There is a common misconception that the Limitation Acts offer some finality to informal arrangements. In fact, these laws provide that debts continue indefinitely until they are paid in full as long as the debtor continues to make payments or acknowledges the debt. The debt collection industry has adopted modern methods of debt collection in order to extract the maximum financial return from each debt. Debts are frequently sold by the original creditor to debt buyout companies which may then acquire other debts owed by other creditors enabling them to manage individual debtors with individual payment plans that vary according to each debtor's personal circumstances.

The temporary relief afforded by an informal arrangement may tempt the debtor into obtaining further credit from other sources, thus exacerbating their debt problems and ultimately resulting in a financial crisis.

Case Study

Ms A was 23 when she borrowed $23,000 from a finance company in 2009. She made irregular payments on the loan until 2016 when the loan was sold to a debt purchase company. She has continued to make payments to the debt purchase company and her payments total $17,000 since 2009, but the balance of her debt has grown to $32,000. Ms A is now 33 and in a permanent relationship with three young children. She has a part-time job and continues to make payments on the debt. However, interest accrues at a greater rate than her payments so the debt continues to grow. The couple lives in rented accommodation with no significant assets. The debt purchase company has now issued court process so it will have many more years to collect the debt. It is possible that Ms A could be paying off this debt for the rest of her life.

Financial Counsellors

Financial counsellors provide a significant role in assisting the most financially disadvantaged individuals in the community. PIPA members refer many debtors to financial counsellors each year and speak to debtors who have previously consulted a financial counsellor.

Some debtors are reluctant to seek help from the charities and welfare organisations that predominantly operate financial counselling services. There is a perception that consulting a financial counsellor is receiving a form of welfare or handout. These debtors often prefer to seek assistance from professionals in the private sector such as PIPA members.

It is appropriate that adequate government funding be allocated to ensure that free financial counselling is available for those who are truly unable to afford to pay for any form of financial assistance.

Financial counsellors have been granted a licensing exemption by ASIC in respect of the financial services they provide.[1]

Whilst most financial counsellors appear to provide a professional and ethical service to their clients there have been a number of debtors who have reported receiving a service that was not considered professional.

[1] **ASIC Corporations (Financial Counselling Agencies) Instrument 2017/792**

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Case study

Mr B was eligible for a debt agreement that would have cleared all his unsecured debt in five years. He spoke to a financial counsellor who advised him against the debt agreement and said that he should enter into an informal agreement with his creditors. His creditors agreed to reduce repayments but most did not freeze the interest. At the end of five years Mr B still had a large amount owing to the unsecured creditors and felt overwhelmed by the pressure of debt collection activity. He went to a different financial counsellor who assisted him with bankruptcy. He was disappointed with the advice he had received from the first financial counsellor.

Government funding bodies should take a more vigorous approach to ensure the quality of financial counselling services that receive government funding. There is a lack of evidence regarding the nature and quality of advice offered to clients. Financial counsellors should be required to collect data for every client that includes the nature and amount of indebtedness, the options presented to the client, the advice provided to the client and the outcome of financial counselling. This should include the agreed return to unsecured creditors for each informal arrangement. Data concerning bankruptcy and other outcomes should also be collected and reported.

The data collected by financial counsellors on every client should be reviewed by an external body and analysis should be made of what the outcome was and the actual return to creditors.

In some instances, it appears that financial counsellors lack sufficient understanding of the consequences of bankruptcy and insolvency alternatives such as debt agreements. There does not appear to be any independent assessment of the competence of, or skill level of financial counsellors. It is important that financial counsellors attain and maintain an appropriate level of skill and reliability to ensure that disadvantaged consumers will receive a professional quality service. This should be made a condition of ongoing funding agreements.

Financial counsellors need to be recognized as financial service providers and should not be allowed to provide a service of unknown quality simply because no charge is made to the consumer. There is no avenue of complaint for consumers who may have suffered loss as a result of a financial counsellor's negligent advice. Dissatisfied consumers of financial counselling services should be able to access an external dispute resolution process such as the new Australian Financial Complaints Authority. We understand that State and Commonwealth financial counselling associations are unable to take disciplinary proceedings against individual financial counsellors and are not equipped to conduct investigations into consumer complaints.

The availability of financial counselling services is inadequate to meet the needs of all Australians in financial distress. Currently, financial counsellors tend to assist the most financially disadvantaged consumers, who may be unable to afford to pay for assistance. However, there are many ways in which the private sector can provide an affordable and effective form of assistance to this group, at no cost to the taxpayer. Debt agreements are an effective response to financial distress that is funded by creditors, at no cost to government.

Commonwealth and State governments both contribute increasing amounts to financial counselling without undertaking the same manner of assessment of outcomes that would apply to private sector providers. We submit that governments must establish that financial counselling services achieve superior outcomes to other debt solution advisors before commitment of further funds.

When an organization is publicly funded, it is tempting for it to ignore the consequences of payment default upon creditors. Some organisations appear to advocate that debtors should avoid paying their debts if they can. An expansion of financial counselling could simply result in more people defaulting on their debts and more bankruptcies.

The value for money offered to government by financial counselling services should be assessed. Consideration should be given to a wider tendering process for financial counselling services that would enable private sector providers to tender for services currently the exclusive preserve of the not-for-profit sector. Investigation should also be made into alternatives to public funding such as a self-funding model where financial counsellors receive a percentage of payments made to creditors under informal payment arrangements.

Some overseas funding models are worthy of consideration. In the USA, credit counselling is largely funded by creditors, through the creation of Debt Management Plans which provide for a percentage of payments to be retained by the service. In the United Kingdom, there are services funded by a levy on financial institutions as well as independent organisations funded by a charge imposed on debt management plans.

Conclusion

We welcome the opportunity to provide information to the Committee and other key stakeholders. We can be contacted on [redacted]

Richard Symes

PIPA Chairperson

References

[i] AFSA, Provisional annual personal insolvency statistics 2017-18
[ii] AFSA submission to the Senate Legal and Constitutional Affairs Legislation Committee, 15 February 2018 noted that there were 46,651 debt agreements under administration at 30 June 2017.
[iii] 14,834 debt agreements out of 31,859 total personal insolvencies - AFSA, Provisional annual personal insolvency statistics 2017-18
[iv] AFSA submission to the Senate Legal and Constitutional Affairs Legislation Committee, 15 February 2018
[v] AFSA, Personal Insolvency Practitioners Compliance Report 2016-17
[vi] Bankruptcy Act 1966, Part IX, Division 8
[vii] Australian Bureau of Statistics; "*Financial Stress and Spending",* Household Expenditure Survey, 2015-16
[viii] S. 185C Bankruptcy Act 1966
[ix] *Bankruptcy Amendment (Debt Agreement Reform) Act 2018*
[x] Bankruptcy (Estate Charges) Act 1997
[xi] See table 3: "Rate of dividend to creditors estimated by debtor on debt agreement proposal" in the AFSA submission to the Senate Legal and Constitutional Affairs Legislation Committee dated 15 February 2018. That table shows that only 1.7% of debt agreement proposals provided a dividend to creditors of $0.81 or more. It is only in this group that it would be possible for a debtor to pay more than 100 cents in the dollar on the original debt.
[xii] *Bankruptcy Amendment (Debt Agreement Reform) Act 2018*
[xiii] Chen V., O'Brien, L. and Ramsay, I. *An Evaluation of Debt Agreements in Australia* 2018 44(1) *Monash University Law Review*