

Chapter 4

Debt management

Market participants and products

4.1 There are a number of regulated and unregulated services provided in the debt management sector. They include:

- personal budgeting services
- debt negotiators
- debt agreement managers and
- credit repair agencies.

The details of each are set out below.

4.2 According to ASIC's submission:

The term 'debt management firms' refers to businesses that offer a range of services to consumers in financial hardship, including:

- developing and managing budgets;
- negotiating with creditors, including lenders, telecommunications companies, utilities companies or debt collectors;
- advising and arranging formal debt agreements under Pt IX of the Bankruptcy Act 1966 (Bankruptcy Act); and
- 'cleaning', 'fixing', 'repairing', 'removing or 'washing away' default listings or other information on credit reports.¹

4.3 The first two of these functions replicate what financial counsellors do. This will be dealt with in chapter 6.

4.4 Debt agreement management is a more formal process. A debt agreement is in fact an insolvency, which is overseen by the Inspector-General in Bankruptcy, who is the chief executive of the Australian Financial Security Authority (AFSA).

4.5 A debt agreement is a proposal to pay a percentage of the debt. It is usually submitted by a registered debt agreement administrator, to the official receiver, and is put to a vote of creditors. If it is accepted then the debt agreement is made. Debt agreements now account for around 47 per cent of all personal insolvency administrations.²

4.6 Credit repair involves clearing negative information from credit reports so that a consumer is more likely to get access to credit or other services in the future. These firms operate by challenging credit default listings and making complaints on behalf

1 ASIC, *Submission 21*, p. 27.

2 Mr David Bergman, National Manager, Insolvency and Trustee services, Australian Financial Security Authority, *Committee Hansard*, 24 January 2019, p. 3.

of consumers to external dispute resolution (EDR) schemes.³ As ASIC points out, consumers can access their credit report themselves and challenge an incorrect listing at no cost.⁴

4.7 Debt buyers and debt collectors are not a subject of this inquiry. Debt buyers purchase unpaid debts from creditors at a discount. Debt collectors work for creditors to chase repayments when they have not occurred as scheduled.

4.8 ASIC observes that some firms in this sector offer a mix, or all, of these services. ASIC notes that there is not much data available about the size of the industry because most operators do not require a licence.⁵ The Consumer Action Law Centre also observes:

Given the lack of regulation and oversight, it is difficult to maintain comprehensive information about this industry, with new practices and business models constantly emerging.⁶

4.9 However, the Australian Financial Complaints Authority (AFCA) has noted an increase in recent years of debt management firms working with consumers who are contacting AFCA as well.⁷ AFSA notes that the use of debt agreements has increased markedly as a proportion of personal insolvencies, from less than a quarter 10 years ago to nearly half now.⁸

Impact on consumers

4.10 Community groups suggest that indebted people grasp at any prospect of being helped out of their debt and often do not understand the services being offered or the charges they will incur. Some do not understand that they are dealing with a for-profit entity.⁹

4.11 On the evidence provided to the committee in submissions and public hearings, these services rarely improve a consumer's financial position. The charges for the debt management services increase their debt, and often consumers are referred to inappropriate remedies which may be expensive and cause lasting damage. The committee heard many case studies to this effect.

3 ASIC, *Report 426 Paying to get out of debt or clear your record: the promise of debt management firms*, January 2016, p. 4, <https://download.asic.gov.au/media/3515432/rep465-published-21-january-2016.pdf> (accessed 14 February 2019).

4 ASIC, *Submission 21*, p. 28.

5 ASIC, *Report 426 Paying to get out of debt or clear your record: the promise of debt management firms*, January 2016, p. 5.

6 Consumer Action Law Centre, *Submission 37*, p. 22.

7 Mr David Locke, Chief Ombudsman and Chief Executive Officer, AFCA, *Committee Hansard*, 24 January 2019, p. 2.

8 Mr David Bergman, National Manager, Insolvency and Trustee services, Australian Financial Security Authority, *Committee Hansard*, 24 January 2019, p. 3.

9 Mr David Locke, Chief Ombudsman and Chief Executive Officer, AFCA, *Committee Hansard*, 24 January 2019, p. 2.

4.12 Debt managers and debt negotiators are accused of charging large fees for minimal services (some of which are compulsorily provided free to consumers), and failing to tell consumers of free alternatives such as legal aid, or community financial counselling, or contacting a utility company and negotiating an extension of time to pay. Often the fees are not transparent.¹⁰

4.13 The Salvation Army reports a \$1600 set-up fee for a debt agreement that involved only one debt. Legal Aid Queensland offered the following example of a budgeting service:

The client and her friend signed the contract at the meeting without the fees and obligations under the contract being properly explained. These fees included a \$45 charge to move their own money from the company's account back into their own accounts when they requested money for things such as paying car registration. The client was of the view that she and her friend had been pressured into signing a contract to purchase a product of no or little value to them. When she tried to withdraw from the contract, the budgeting service informed her that she was liable for a large establishment fee.¹¹

4.14 Debt negotiators often charge high fees for results which do not solve the consumer's problems:

We've seen quite a few that are a percentage of the amount saved. If you have \$150,000 in credit cards and they reduce it to \$70,000, they'll take 50 per cent, 40 per cent or 80 per cent of the saving or whatever it is...¹²

4.15 Community groups say that debt managers often offer inappropriate products. For example, they may offer a repayment plan that is unaffordable. Consumer Action Law Centre recounts a case:

...the MyBudget representative put together a budget for Claire. It was only at the end of the meeting that MyBudget told her that there would be additional monthly costs....

Claire ran into problems with the budget set up by MyBudget. The MyBudget representative had estimated her credit card repayments to be 2% of her balance. When Claire questioned the representative about this figure, they told her that they had been doing this a long time and they knew. However, her credit card minimum payments were \$65 higher than MyBudget had budgeted for. Claire said when she realised this, MyBudget said, the extra money will need to come from somewhere else but MyBudget did not specify which part of the budget it would come from.

10 See, for example, Good Shepherd Microfinance, *Submission 50*, [p. 6]; Salvation Army, *Submission 9* pp. 12–16; Legal Aid Queensland *Submission 3*, pp. 11–12; Mr David Locke, Chief Ombudsman and Chief Executive Officer, AFCA, *Committee Hansard*, 24 January 2019, p. 2.

11 Legal Aid Queensland *Submission 3*, p. 11.

12 Ms Karen Cox, Chief Executive Officer, Financial Rights Legal Centre, *Committee Hansard*, 12 December 2018, p. 27.

Claire says she had to pay this amount from her personal allowance, which she needed for groceries, which was only \$100 each week. MyBudget had not accounted for other essential expenses, like her car insurance...

After a few weeks, Claire also realised that she would not be able to reduce her debt or save money if she continued to pay the monthly fees to MyBudget and requested MyBudget to cancel the contract. MyBudget told her she needed to go to a website link to cancel the agreement, which took them several days to send. When she received the link and tried to cancel the contract, MyBudget told her that she was required to give a notice period of 28 days. Claire tells us she still had to pay \$790 for the establishment fee.

4.16 Another example was cited at the committee's Melbourne hearing:

An example from our casework is somebody who had a range of expenses, one of which was child care; that was not given priority. The child was subsequently taken out of child care because the fees weren't paid, and that person could no longer work because they had to care for the child. So these consequences can go on.¹³

4.17 The most egregious examples of inappropriate advice were those which advised consumers to enter into a debt agreement. Often the consumer does not understand the full implications of such an agreement—they often believe it is a debt consolidation loan¹⁴—or it may not be a necessary step. The Salvation Army presented this case study on a debt agreement service:

An elderly couple presented to Moneycare stating they had both entered into a debt agreement in March 2017. They advised when talking to the debt agreement service, no other debt reduction options had been mentioned.

The husband worked casually and his wife was on a low income. At the time the debt agreement was entered into, they had \$20,000 arrears on their mortgage. Previous to the debt agreement the husband had been out of work for a long time due to an accident. During this time, he had accessed all his superannuation under hardship to pay down debt - over \$80,000. The house was repossessed in December 2017, and when sold in August 2018 left them with a shortfall of \$90,000.

On assessment, it was clear the debt agreement was not a suitable option because they were servicing a secured home loan that was in arrears. Not being able to keep a secured loan up-to-date is a warning of likely entrenched financial hardship. The debt agreement was not sustainable as the joint income was neither sufficient nor reliable. Being in a debt agreement further exacerbated this couples stress and anxiety as it did not

13 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Committee Hansard*, 12 December 2018, p. 26.

14 Salvation Army, *Submission 9*, p. 12: Consumer Action Law Centre, *Submission 37*, p. 26.

fully resolve their financial problems and the transition to bankruptcy was not something they were expecting.¹⁵

4.18 Many witnesses believed that debt management firms do not act in the best interests of their clients:

They go to see a debt management firm. The firm have made all sorts of promises up-front about how everything will be fine and they're going to fix everything, and often the first thing they say is, 'Please stop paying your creditors; instead you pay that money to us.' That money may be paid to them as being saved up towards their up-front fees, or it could be to put together a fighting fund to negotiate with, but the result of it is always that the client is then pressured by their creditors because they've stopped paying, and sometimes that goes on for six or eight months, because that's how long it takes for people to accumulate enough money to pay the up-front fee. What happens over that time is that the person becomes quite frantic. At the beginning they may have been asking the right questions, but, by the time they get to the point where they're under severe pressure, it's them writing to say: 'Have you put that thing together yet? Has it gone through? Has it gone through?' So it's a very interesting dynamic. I have seen so many people sucked in by it that I find it hard to believe it's not a very common behavioural trait where, no matter what we say people should do, this is what people will do in practice. They are very vulnerable in those circumstances.¹⁶

4.19 ASIC points out that consumers can, at no cost, receive help from financial counsellors or community legal services; and, again at no cost, they can have an independent ombudsman scheme help resolve disputes with lenders, telecommunications and utilities providers.¹⁷

Conduct of providers

4.20 ASIC's view is that:

The business models of debt management firms create a risk of abuse or exploitative conduct, particularly where:

- consumers are charged fees irrespective of the quality of the services provided by the debt management firm; and
- consumers do not need these services because of the availability of free alternatives.¹⁸

4.21 Sometimes there seem to be deliberate attempts to mislead consumers, or at least obscure the fees they will pay:

15 Salvation Army, *Submission 9*, p. 13.

16 Ms Karen Cox, Chief Executive Officer, Financial Rights Legal Centre, *Committee Hansard*, 12 December 2018, p. 32.

17 ASIC, *Submission 21*, p. 28.

18 ASIC, *Submission 21*, p. 27.

At this meeting, I was told there was a problem with their printer, so I couldn't receive a hard copy of the contract. I was made to digitally sign it on a tablet. I wasn't able to read it before I signed because it was over 40 pages long...At this meeting I again asked about the fees, and I was told there are only two sets of fees: a fee to set up the agreement to liaise with the creditors and a fee to use the budget. On checking the budget, I found there were other fees embedded there.¹⁹

4.22 Credit repair firms tend to use the industry dispute resolution schemes, and the creditor pays for each lodgement. AFCA noted that debt management firms charged 'sometimes not insignificant fees' to get financial firms to cease enforcement action, when in fact what they do is pass the matter to AFCA. The consumer could have come to AFCA in the first place for no cost.²⁰

4.23 AFCA suggested that debt management firms prey on consumers' ignorance of the system:

If consumers actually bring a financial hardship matter to AFCA then, whilst the matter is being considered by AFCA, the financial firm is not able to—is excluded from—enforcing that debt. Yet we see situations where debt management firms are actually charging fees, sometimes not insignificant fees, to get the financial firm to stop the enforcement action...²¹

4.24 AFSA observes that debt management firms may have a conflict of interest:

Several of the larger players for registered debt agreement administrators have a larger business with a larger offering to consumers, and debt agreement firms will be a part of that broader offering that they provide.²²

4.25 AFSA's submission gives an example, referred by the Consumer Action Law Centre, of a debtor who wanted to obtain his credit file. He rang a credit report provider who also had a debt agreement arm:

The debtor was confused and unwittingly agreed for the company to prepare a debt agreement proposal for him, something he would be charged for.

When the debtor realised what he had allegedly agreed to he attempted to cancel the agreement.

It was only with the help of the Consumer Action Law Centre that the debtor could extricate himself.²³

19 Henry, *Committee Hansard*, 12 December 2018, p. 24.

20 Mr David Locke, Chief Ombudsman and Chief Executive Officer, AFCA, *Committee Hansard*, 24 January 2019, p. 9.

21 Mr David Locke, Chief Ombudsman and Chief Executive Officer, AFCA, *Committee Hansard*, 24 January 2019, p. 9.

22 Mr Paul Shaw, National Manager, Regulation and Enforcement, Australian Financial Security Authority, *Committee Hansard*, 24 January 2019, p. 7.

23 AFSA, *Submission 4*, p. 3.

4.26 Credit repair agencies in particular are accused of over-promising and under-delivering, at a high cost to the consumer:

We're definitely seeing debt management firms offering cleaning, fixing, repairing, washing away of default listings on credit reports, which consumers can do themselves. And we're seeing fees charged, sometimes concerning levels of fees charged, with regard to some of these sorts of services as well. The issues that we are most concerned about really are the charging of high up-front fees for services that provide little or no value.... Poor, inappropriate services...can leave consumers worse off in terms of actually negotiating a settlement.²⁴

4.27 Credit repair agencies have also been accused of taking fees for no service:

...They don't have enough money to pay for the service up-front, so they enter into a direct debit arrangement, and the money starts coming out of their account. Often no action will be taken, because the company is waiting for enough money to accumulate for the up-front fee to be paid. In the meantime, life goes on, and quite often these people will find out that actually this isn't the way to go, or they just won't have enough money and they'll stop paying, and then we see them sued down the track. In a couple of their cases, we've seen that the money demanded by the lawyers later on is between \$4,000 and \$6,000.²⁵

4.28 There are limited circumstances in which a default can be removed from a credit record, and those can be pursued free of charge.²⁶ The committee was told:

Many times the default listings and credit listings on people's reports are actually listed properly, appropriately, and they can't be removed. So, even with the assistance of a credit repair provider, the ultimate service isn't delivered.²⁷

4.29 ASIC suggests that many debt management firms market their services to consumers in financial hardship as an appealing way to transfer responsibility for their difficulties to a third party.²⁸

4.30 AFSA monitors the advertising of debt agreement administrators and it too observes that they market to people in financial difficulty and offer 'a form of welcome relief'.²⁹ The Consumer Action Law Centre made the same point:

24 Mr David Locke, Chief Ombudsman and Chief Executive Officer, AFCA, *Committee Hansard*, 24 January 2019, p. 9.

25 Ms Karen Cox, Chief Executive Officer, Financial Rights Legal Centre, *Committee Hansard*, 12 December 2018, p. 26.

26 Legal Aid Queensland, *Submission 3*, p. 11.

27 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Committee Hansard*, 12 December 2018, p. 25.

28 ASIC, *Submission 21*, p. 28.

29 AFSA, *Submission 4*, p. 3.

A key [method] is online advertising. If you were to type 'debt help' into Google, the key listings up-front will, unfortunately, not necessarily direct you to a free and independent financial counsellor but will direct you to a debt management firm...³⁰

4.31 The Financial Rights Legal Centre had noted predatory behaviour using sophisticated technology:

I've even heard of people having used the screen-scraping technology that payday lenders used to pass on information about when accounts are empty so that people are at their most vulnerable when they get the advertising...payday lenders will on-sell the details of people who they've rejected for loans...³¹

Nature and adequacy of the current regulatory arrangements

Current regulation

4.32 AFCA observed that:

In areas such as the debt management firms, where there is no code of conduct, there is almost no framework there.³²

4.33 Most operators in the industry are not required to be licensed. Nor are they:

... required to satisfy threshold requirements (such as 'fit or proper' persons tests), satisfy competence standards, meet conduct or disclosure obligations, manage conflicts of interest or belong to an EDR scheme to resolve consumer complaints.³³

4.34 A consumer advocate put it colloquially:

...Debt vultures and credit repair firms do not fall under any regulatory framework, and staff who work at these firms are not required to meet any training or professional or ethical obligations.³⁴

4.35 If a debt management firm also provides credit, this aspect of its operations is regulated under the National Credit Act, as described in the chapter on payday loans.

4.36 Debt agreement administrators are regulated by the Personal Insolvency Regulator (AFSA) under the *Bankruptcy Act 1966*.

30 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Committee Hansard*, 12 December 2018, p. 27.

31 Ms Karen Cox, Chief Executive Officer, Financial Rights Legal Centre, *Committee Hansard*, 12 December 2018, p. 27, p. 28.

32 Mr David Locke, Chief Ombudsman and Chief Executive Officer, AFCA, *Committee Hansard*, 24 January 2019, p. 7.

33 ASIC, *Report 426 Paying to get out of debt or clear your record: the promise of debt management firms*, January 2016, p. 5.

34 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Committee Hansard*, 12 December 2018, p. 23.

Changes under way

4.37 The *Bankruptcy Legislation (Debt Agreement Reform) Act 2018* commences in June this year. It includes a number of changes which are aimed at ensuring that the only proposals given to debtors are affordable, sustainable and protect those for whom a debt agreement may result in greater hardship. Debt agreements would generally be limited to three years unless the debtor owns or has an equitable interest in their principal place of residence. There will be a new test to compare the debtor's payments against their income, which is setting up a more rigorous affordability test, and there will be an additional discretion for the official receiver to reject a proposal where the circumstances show that it would cause the debtor hardship.³⁵

4.38 It also includes some significant regulatory changes. Registration as a debt agreement administrator will be made mandatory, allowing for an enhanced oversight of the industry by the Inspector-General in Bankruptcy. Further, the Inspector-General's powers will be extended to enable investigation of the conduct of a registered debt agreement administrator to include conduct prior to the signing of a debt agreement proposal. This will facilitate investigation into administrators who may inappropriately influence debtors who are considering entering a debt agreement. The law reform will also enable industry-wide conditions to be established for registered administrators.³⁶

Other proposed changes

4.39 The Consumer Action Law Centre recommended that debt managers and credit repair firms be regulated more robustly, either by being brought under the National Credit Act or with stand-alone legislation. Such regulation should include a licensing regime, with membership of AFCA, a ban on upfront fees, and a duty to act in the client's best interests.³⁷

4.40 ASIC supported the extension of the product intervention power (in legislation before the Parliament at time of writing³⁸) to all products covered by the definition of 'financial services' under the ASIC Act. However, this would mean that PIP would apply to some, but not all, debt management services. Some services come under the provisions of the Australian Consumer Law, regulated by the Australian Competition and Consumer Commission (ACCC). The government could consider extending the power beyond the ASIC Act to cover all debt management services.

4.41 ASIC considers that the flexibility provided by the product intervention power makes it a better solution than a licensing regime. It notes that it is questionable

35 Mr David Bergman, National Manager, Insolvency and Trustee Services, Australian Financial Security Authority, *Committee Hansard*, 24 January 2019, p. 3.

36 Mr Paul Shaw, National Manager, Regulation and Enforcement, Australian Financial Security Authority, *Committee Hansard*, 24 January 2019, p. 3.

37 Consumer Action Law Centre, *Submission 37*, p. 5, p. 33.

38 Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018.

whether having many of the services available, even by licensed providers, is desirable, given the existence of free alternatives.³⁹

4.42 The proposal for a general requirement of fairness proposed by AFCA and discussed in Chapter 3 is also relevant here. That is, AFCA considers that treating consumers fairly should be made a standalone and enforceable standard for financial services entities and individuals working for them.⁴⁰

Compliance with, and enforcement of, current regulation

4.43 Consumer groups noted that they had successfully used Ombudsman services in this space⁴¹. There has also been litigation by ASIC, and litigation sponsored by consumer groups, but that is expensive and time consuming.⁴²

4.44 The marketing and advertising of debt agreements continues to be of concern to AFSA. In 2017–18, 165 advertisements relating to debt agreements were subject to detailed assessment by AFSA, with correction, action and/or removal of content occurring in 79 instances. Three registered debt agreement administrators and one adviser were referred by AFSA to ASIC for potential enforcement action for misleading and deceptive conduct in 2017–18.

4.45 AFSA has concern about untrustworthy advisers who operate in the insolvency sector. Such people are seen by AFSA insolvency practitioners and stakeholders as a key threat to the integrity of the insolvency sector, and these concerns are reflected in the submission to this committee from the professional association the Australian Restructuring Insolvency and Turnaround Association.⁴³

39 ASIC, qon 1, Additional Information, 5 February 2019.

40 AFCA, *Submission 58*, p. 4.

41 For example, Legal Aid Queensland, *Submission 3*, p. 13.

42 Consumer Action Law Centre, *Submission 37*, p. 5, pp. 30–32.

43 Mr Paul Shaw, National Manager, Regulation and Enforcement, Australian Financial Security Authority, *Committee Hansard*, 24 January 2019, p. 3; Australian Restructuring Insolvency and Turnaround Association, *Submission 12*, p. 1.