



08 March 2022

Recipient Position.

Attorney-General's Department

by email: bankruptcy@ag.gov.au

Bankruptcy system

The Australian Banking Association (ABA) welcomes the opportunity to provide feedback to the Attorney-General's Department on the Bankruptcy system options paper.

While the ABA sets out its specific responses to the possible changes below, we encourage the Government to consider these changes in the context of the broad suite of reforms made or proposed in recent years that potentially change the consequences of insolvency for companies and bankruptcy for individuals. This includes small business insolvency reforms, changes to schemes of arrangement and the review of the safe harbour regime.

The ABA also highlights the need for Government and policymakers to consider how these reforms may impact the flow of credit to small businesses and the effect of this on commercial activity with the aim of striking the right balance between creditors and debtors. Consideration also needs to be given to the impact on small businesses trade creditors, the flow-on effect on personal risk-taking behaviour not connected to business activities and, the effect on non-commercial arrangements such as family law settlements.

Key Points

Notwithstanding the impacts of the COVID-19 pandemic, the current economic circumstances have not changed the view expressed by the ABA in February 2018 and 2021 on the proposal to reduce the default period of bankruptcy from 3 years to 1 year. Instead of a broadly applied reduction, the ABA encourages and supports consideration of how the policy aims expressed in the options paper are better achieved while protecting against the downside risks highlighted in our 2021 submission.

The ABA considers there are limited situations in which potential bankrupts should be eligible for a shorter (eg.1-year) period of bankruptcy. We cover these situations in more detail below.

Reduce bankruptcy to one year

The ABA view remains that there are limited situations in which potential bankrupts should be eligible for a shorter (e.g., 1 year) period of bankruptcy.

The eligibility criteria could be designed with the policy aims in mind and in particular, allow those people who engage constructively, positively and transparently with the bankruptcy trustee and their creditors to benefit from a shorter period of bankruptcy.¹

Conditions for a shorter period could also include whether the cause of bankruptcy was due to major events outside the bankrupt's control such as natural disasters, whether the amount / complexity of debt is below threshold levels and, the conduct of the bankrupt both prior to and during the bankruptcy and any prior bankruptcy.

The ABA remains concerned that while the proposed changes might reduce the stigma attached to bankruptcy, it seeks to do so in the context of punishing bad behaviour. The ABA believes better

¹ A letter confirming the trustee is considering a request to reduce the term to 1 year would be appropriate.



outcomes can be achieved by retaining the default three-year period but introducing a framework to reward good behaviour (either with a shorter default period or the ability to apply for an early release).

Finally, and consistent with our February 2021 submission, the ABA strongly recommends a post implementation review period be built into any new legislation to assess the impacts on borrower behaviour, business activity and lending. This should include an assessment of the more far-reaching impacts such as the effect of pressure on trustees to investigate bankruptcies within the 12-month timeframe, and the likelihood of customers adapting their payment behaviour to avoid further financial distress in such a short timeframe.

In response to specific questions raised in the options paper:

- **Bankruptcy in the preceding 10 years** – The ABA agrees that someone who has been bankrupt in the past 10 years should be able to apply for an early release if they have complied with certain eligibility criteria including:
 - a threshold requirement for demonstrating good behaviour prior to the bankruptcy and during the bankruptcy - in addition to the examples mentioned in the options paper, good behaviour prior to bankruptcy should also include payment of all employee entitlements including superannuation (for small business related bankruptcy), and
 - meeting one or more of certain threshold additional eligibility criteria, including whether the cause of bankruptcy was within the bankrupt's control, whether the amount / complexity of debt is below threshold levels, or whether the bankruptcy was in connection with a business or business loan (including a guarantor of a small business loan).
- **Previous offences** – A bankrupt should not be eligible for a one-year bankruptcy if:
 - they have been banned as a director of a company under the *Corporations Act* (except where that is due to being bankrupt),
 - they have engaged in misleading conduct (within section 148 of the *Bankruptcy Act*),
 - the bankrupt has, or is under investigation for, engaging in voidable transactions such as entering into undervalue transactions or making asset transfers to defeat creditors, or
 - investigations are ongoing by a bankruptcy trustee in relation to the conduct of the bankrupt including into offences relating to the concealment of property, failure to disclose property, misrepresentations to or fraud of creditors.
- **Strengthen objection to discharge provisions** - The options paper proposes that certain failures or delays by a bankrupt to provide information will extend bankruptcy by one year. Consideration should be given to:
 - these grounds resulting in an extension of the bankruptcy by two years (instead of the proposed one year), or
 - alternatively, a one-year extension (as proposed), with the ability for the bankruptcy trustee to object to discharge for a further year if the bankrupt has still not complied with their obligations to provide information under the *Bankruptcy Act*, and
 - in addition to the grounds proposed in the options paper, the existing grounds for objection to discharge from bankruptcy set out in section 149D of the *Bankruptcy Act*



should continue to form the basis of a trustee's ability to object to discharge from bankruptcy.

- **Strengthen offence provisions** - The options paper seeks stakeholder views on what current bankruptcy offences could have penalties strengthened to target abuse of one-year bankruptcy. Consideration should be given to whether the following offences in particular are appropriate or could be strengthened:
 - offences relating to the concealment of property or failure to disclose property (sections 263 and 265(1) and (4) of the *Bankruptcy Act*;
 - making false representations or fraud of creditors under section 265(3) of the *Bankruptcy Act*, and
 - obtaining credit without disclosing a debt agreement or bankruptcy (section 269 of the *Bankruptcy Act*).

However, better outcomes might be achieved by retaining the default three-year period with strict eligibility criteria for applying for early release or confining the default one year period to stricter eligibility criteria e.g., business related bankruptcies.

Promote Debt agreements

At an overall level, the proposed changes appear to be in the context of assisting a debtor to discharge their debts. The ABA notes that there are a number of stakeholders significantly impacted by bankruptcies, debt agreements and personal insolvency agreements (PIAs), including creditors of the debtor.

The impact on those stakeholders should be considered for any changes in relation to the promotion of debt agreements. In response to specific questions raised in the options paper:

- **Extend the default term limit for debt agreements to 5 years** - The ABA supports the proposal the proposal to extend the default term limit for debt agreements to 5 years. Further, removing the home-owner exemption in section 185C(2AA)(b) will simplify the default term limit and will also avoid imbalanced outcomes for stakeholders.

In recognition that debtors can suffer a substantial and unforeseen change in circumstances, the existing framework of section 185M of the *Bankruptcy Act* could be amended to permit a maximum variation by reference to the existing period for the debtor to make payments, rather than a maximum overall period.

For example, permitting an extension by no more than a percentage of the existing period could produce balanced outcomes for all stakeholders in debt agreements with shorter payment periods, while providing assistance to a bankrupt who has suffered a substantial and unforeseen change in circumstances.

- **Reduce exclusion period for proposing debt agreements** – The ABA agrees that reducing the exclusion period from 10 years to 7 years might improve access to debt agreements.

On the question of providing a specific exclusion period of 5 years (rather than the proposed 7 years which would still apply to the other insolvency options such as bankruptcy and PIA's), the ABA believes that creating different exclusion periods for different processes may introduce unnecessary complexity.



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Target untrustworthy advisors

In relation to the proposed changes, the ABA believes the pre-insolvency advice space needs to be more specifically regulated and, that industry standards including advisor education and / or accreditation be considered to improve stakeholder outcomes.

Specific offences targeting untrustworthy advisor activity should include hiding or stripping assets and illegal phoenixing. Further, penalties for offences should reflect the seriousness of the misconduct.

The options paper also notes it is expected that new offences “will generally contain fault elements of intention or knowledge”. Given the standards which should be expected of professional advisors, consideration should be given to whether actual knowledge should be required or, for example, wilful blindness or negligence may be sufficient.

Thank you for the opportunity to respond to this important consultation and we welcome further discussion as the process continues.

Yours sincerely

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers.

We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.