



National Innovation & Science Agenda

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Improving Bankruptcy & Insolvency Laws

Submission

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Submitted: 18 May 2016

Table of Contents

| | |
|---|----|
| Introduction | 4 |
| 1.0 Reducing the default bankruptcy period | 5 |
| Background | 5 |
| 1.1 Misconduct..... | 5 |
| 1.2 Ongoing Obligations for bankrupts..... | 6 |
| 1.2.1 Requirement to assist trustee..... | 6 |
| 1.2.2 Income contribution | 6 |
| 1.3 Restrictions | 6 |
| 1.3.1 Access to credit | 6 |
| 1.3.2 Overseas Travel..... | 7 |
| 1.3.3 Licences and industry associations | 7 |
| 2.0 Safe Harbour | 7 |
| 2.1 Background | 7 |
| 2.2 Safe Harbour Model A..... | 7 |
| 2.2.1 The restructuring adviser | 7 |
| 2.2.2 Other features of safe harbour | 8 |
| 2.2.3 Where safe harbour is not available | 8 |
| 2.3 Safe Harbour Model B..... | 8 |
| 3.0 Ipso Facto clauses | 8 |
| 3.1 Background | 8 |
| 3.2 The Ipso Facto Model..... | 8 |
| 3.2.1 Anti-Avoidance..... | 8 |
| 3.2.2 Exclusions | 8 |
| 3.2.3 Appeal | 8 |
| 4.0 Summary | 9 |
| 4.1 Rehabilitation..... | 9 |
| 4.2 Small Business Enterprise | 9 |
| 4.3 Household Debtors | 9 |
| 4.4 Willingness to effect a compromised settlement..... | 9 |
| 4.5 Unwillingness to effect a compromised settlement..... | 10 |
| 4.6 Creditors..... | 10 |

| | |
|----------------------------------|----|
| 4.7 Debt Agreements | 10 |
| 4.8 Categories of Bankrupts..... | 10 |
| 4.9 General..... | 11 |

Introduction

SRMC Limited is a Registered Debt Agreement Administrator (720) operating nationally from offices located in Bundall, Queensland. The Company was incorporated 20 June 2003 but operated in an unregistered capacity as a sole trader from 2000. Registration became a requirement from 1 July 2007.

Our Group also includes a wholly owned subsidiary in Credit Counsellors Australasia Pty Ltd, trading as Credit Counsellors Australia, which operates on behalf of SRMC Limited in the capacity of marketing facilitator. The management and employees of the Group are well trained, highly educated individuals dedicated to personal insolvency law and practice, issues and processes.

During the course of normal business officers and employees of the Group interact with both financially distressed individuals, including small business owners and, with creditors both large and small deriving from all areas of industry and commerce.

As a direct result of its operations the Group believes that it has a comprehensive understanding of the moral, social and commercial aspects of personal insolvency in Australia together with the impact of insolvency legislation on both debtors and creditors borne from direct contact.

SRMC Limited is a founding member of the Personal Insolvency Professionals Association.

SRMC supports the proposals identified in the executive summary but has reservations concerning the suggestion to reduce the bankruptcy default period to one (1) year insofar as that proposal, if implemented, will impact on the Part IX and Part X personal insolvency regimes.



Clifford Mearns RITP

Director

1.0 Reducing the default bankruptcy period

Background

Modern Australian bankruptcy legislation has a number of purposes:

- Relieve the debtor from burdensome indebtedness
- Fair and equitable distribution of the debtor's assets to affected creditors
- Protection of the debtor from creditors' demands
- Financial rehabilitation of the debtor by enabling a 'fresh start'
- To investigate a bankrupt's affairs for improper dealings.

Since inception of the statute¹ the bankruptcy default period has been three (3) years however bankrupts could be discharged, on application, after six (6) months until early 2000.

There are two (2) routes to bankruptcy:

- Voluntary – filing a debtor's petition – no threshold
- Involuntary – sequestration order – minimum \$5000 indebtedness

In 1996 legislation was introduced² allowing financially distressed consumers to submit an offer of settlement to affected creditors albeit by compromise and subject to thresholds. The Part IX Regime has worked extremely well in culling consumer bankruptcies and providing substantial returns to creditors.

Filing a Debtor's Petition is a voluntary act undertaken by a consumer who may or may not have the ability to return some monies to affected creditors. Administratively, filing a petition appears prima facie to be a simple, unquestioned procedure, although the Official Receiver is empowered to reject a petition in certain circumstances.³

The introduction of Part IX to the statute⁴ offered debtors a legally binding option to protect their assets whilst making an effort to settle their indebtedness upon terms that were affordable and acceptable to relevant creditors.

1.1 Misconduct

It is our view that not every bankrupt should be discharged on the expiration of the first anniversary of filing a debtor's petition. Rather, the legislation should revert to an application for discharge by the debtor and such discharge should be considered subject to the recommendation of the trustee based upon:

- The level of loss sustained by creditors as a result of the bankruptcy;
- Full compliance of the bankrupt with his or her legislated obligations;
- If the bankruptcy is a first or subsequent bankruptcy;
- All asset issues have been resolved by the trustee;
- Contributions have been met in a timely manner, and continue to be met;
- Steps taken to compromise the indebtedness prior to bankruptcy.

Although there is no direct mention in the paper concerning a debtor's bankruptcy by way of a creditor's petition it is presumed that the same processes, as outlined, are likely to apply.

¹ Bankruptcy Act 1966 (Cth).

² Part IX, Bankruptcy Act 1966 (Cth).

³ Bankruptcy Act 1966 (Cth) s55.

⁴ Bankruptcy Act 1966 (Cth).

We perceive that a one year bankruptcy default period will invite an avalanche of filings from the lower socio-economic groups and those consumers who show little or no regard for personal indebtedness. Gamblers will perceive the proposals as a wind fall. Multiple filings during a prescribed period, by an individual, should involve penal consequences. Alternatively, as in the United Kingdom, the bankrupt should be subjected to a:

- Bankruptcy Restrictions Order; or
- Bankruptcy Restrictions Undertaking⁵

The grounds of objection that may be set out in a Notice of Objection⁶ appear to be substantial and sufficient.

1.2 Ongoing Obligations for bankrupts

It is the view of this submission that those consumers seeking relief under the proposed reduction in the bankruptcy discharge period will possess few, if any, assets of consequence.

1.2.1 Requirement to assist trustee

1.2.1 The requirement that a discharged bankrupt give assistance⁷ is well expressed in the current legislation with an appropriate penalty.

1.2.1a The obligation on a bankrupt to continue with contributions is considered a primary obligation and should continue.

1.2.1b The obligation to pay contributions should be enforced by mandatory garnishee of income.

1.2.2 Income contribution

This submission supports the proposal, as expressed.

1.3 Restrictions

Bankrupts retain the ability, in the majority of circumstances, to obtain credit from last resort lenders albeit at a premium interest rate. This practice should be eliminated by legislation particularly if repayment of such loans hinders the payment of contributions.

1.3.1 Access to credit

If the purpose of the proposals is to engender greater innovation and boundless risk taking by those wishing to embark on business ventures it would be a futile proposition to reduce the bankruptcy discharge period to one (1) year whilst retaining five (5) years annotations on credit files. If credit file annotations remained at five (5) years then the intended purpose of unlocking available credit will be lost.

⁵ Insolvency Act 1986, Sch 4A, para 7(1).

⁶ s149D; s152; s178 Bankruptcy Act 1966 (Cth).

⁷ s152 Bankruptcy Act 1966 (Cth).

1.3.1a This submission supports the proposal, as expressed.

1.3.1b The NPII is anachronistic and other than its commercial value to credit reporting agencies it serves no real function beyond gathering statistics.

If the purpose of the proposals are to assist consumers to be innovative and to 'take more risks' then NPII annotations should be extinguished after a prescribed period of time.

1.3.2 Overseas Travel

This submission supports the proposal.

1.3.3 Licences and industry associations

This submission supports the proposal

2.0 Safe Harbour

This submission supports the concept of a safe harbour for directors.

2.1 Background

This submission supports the concept of introducing a safe harbour to the current insolvent trading offences.

2.2 Safe Harbour Model A

This submission offers no comment.

2.2.1 The restructuring adviser

As the restructuring of a business is essentially the preserve of the company directors, we see no reason for regulatory guidance from ASIC. Failure will most likely result in liquidation.

This submission advocates for accreditation by way of specific 'turnaround' licencing through ASIC and submits that those accredited should include members of:

- CPA Australia;
- Chartered Accountants Australia;
- Institute of Public Accountants;
- ARITA.

Additionally, a corporation which has directors qualified to undertake the role of adviser should be included. Example:

- Director 1. Certified Practicing Accountant
- Director 2 ARITA Qualified
- Director 3 Lawyer

We do not agree that a member of the Law Society, acting in the capacity of a solicitor, is qualified to undertake restructuring of a company unless aided by a qualified accountant with insolvency qualifications.

We believe that the methodology outlined as a test of viability would be adequate.

The dynamics of a restructuring should be left with the adviser in consultation with the directors, as there may be numerous issues to be considered that will influence an outcome.

This submission supports the obligations and protections expressed for the role of a restructuring adviser.

2.2.2 Other features of safe harbour

This submission offers no comment.

2.2.3 Where safe harbour is not available

This submission offers no comment.

2.3 Safe Harbour Model B

This submission offers no comment.

3.0 Ipso Facto clauses

This submission offers no comment.

3.1 Background

This submission offers no comment.

3.2 The Ipso Facto Model

This submission offers no comment.

3.2.1 Anti-Avoidance

This submission offers no comment

3.2.2 Exclusions

This submission offers no comment.

3.2.3 Appeal

This submission offers no comment.

4.0 Summary

We recognize that reform in the area is long overdue, however the likely consequences to other personal insolvency regimes as a direct result of the adoption of the proposal to reduce the bankruptcy discharge period from three (3) years to one (1) year is concerning. Specifically, the impact this proposal may have on the willingness of consumer debtors to seek a compromised settlement arrangement with their affected creditors, even if they have a diminished capacity to honour their obligations. This will also result in implications for major lenders.

4.1 Rehabilitation

Historically, it has been a cultural obligation for a debtor to repay monies borrowed, or at the very least (in Australia) to offer creditors a compromised settlement. Bankruptcy Law has been diluted over the years in Australia and elsewhere leaning toward an emphasis on rehabilitation of the debtor. Bankruptcy has always been viewed as an option of last resort.

4.2 Small Business Enterprise

It is government's stated aim to allow consumers greater flexibility to be innovative and to take greater risks. We support this view but question if the proposed legislation will achieve its goal or end up a nightmare.

Only 17% of bankruptcies are due to sole trader business failures. The balance of 83% relate to households. If the possibility of bankruptcy acting as less of a deterrent than it does, it remains to be seen if that will have a positive impact on entrepreneurial behaviour or if it will encourage risk taking by those with business aspirations but no business acumen. Although we support the concept that entrepreneurs do, and will fail in ventures, we express concern that this could force major lenders to be less willing to advance loans.

Current business culture tends toward incorporation rather than sole trader and partnership arrangements thereby circumventing bankruptcy legislation unless personal guarantees are involved.

4.3 Household Debtors

This group is the major filer of debtors' petitions and a substantial portion of individuals in this group are government beneficiaries. Those in the higher income brackets filing debtors' petitions have generally suffered a major event in their lives that has drastically curtailed their ability to meet creditors' demands.

4.4 Willingness to effect a compromised settlement

Many financially distressed consumers, for whatever reason, find the prospect of bankruptcy to be abhorrent and willingly enter into compromised debt settlement arrangements with affected creditors. Subject to thresholds, Part IX⁸ has proven to be a mechanism that, in the main, satisfies creditors and delivers substantial returns. This may not be the case if the proposals are implemented.

⁸ s185 Bankruptcy Act 1966 (Cth).

4.5 Unwillingness to effect a compromised settlement

It is perceived that a one (1) year bankruptcy discharge period will be misunderstood by many distressed consumers as 'the easy way out' of their financial problems irrespective of any side-effects that may be incurred. Such an attitude may lead to communal disrespect for incurring indebtedness and result in consumers preferring bankruptcy to any form of debt settlement.

4.6 Creditors

How creditors react to the proposals is unknown, but it would not be unreasonable to assume that the losses they will incur will be substantial and uncollectable. The cost of such losses will ultimately be borne by consumers at large.

4.7 Debt Agreements

Since the introduction of debt agreements in 1996 under Part IX,⁹ consumers have been able to offer a compromised settlement to affected creditors, at an affordable rate, retain assets that they could afford to keep and not be subjected to many of the consequences of bankruptcy. This regime has operated very successfully over the years.

Reducing the bankruptcy discharge period to one (1) year places those who have chosen to settle with creditors; and those who may choose to make offers in the future, at a clear disadvantage.

- Debtors are making efforts to honour their indebtedness.
- The majority of proposers have asset-less estates.
- In the main, debtors enter into five (5) year arrangements to repay.
- There are consequences to bear under bankruptcy legislation.
- Declarations concerning their insolvent state are required to be made in certain circumstances.
- Sole traders cannot operate under a business name without personal identification.

An asset-less bankrupt, on the other hand, simply walks away from indebtedness (irrespective of the losses to creditors), subject to the liability to pay contributions – which is unlikely in the majority of cases, and it is proposed that after one (1) year they will have the ability after discharge to seek further credit, irrespective of the financial hardship that may have been caused to lenders, small businesses or individuals.

There is a clear inequity in the proposals, as they relate to filing for bankruptcy and being prepared to honour one's obligation to some extent.

4.8 Categories of Bankrupts

Consideration should be given to categorizing bankrupts in legislation and dealing with their discharge according to prescribed regulation.

- First or subsequent bankruptcy;
- Cause of bankruptcy;
- Attempts to compromise creditors prior to bankruptcy;
- Cooperation with trustee;
- Timely contributions;
- Financial awareness.

⁹ Bankruptcy Act 1966 (Cth).

As there is no threshold on the amount of debt discharged under bankruptcy such regulations should have regard for the level of indebtedness at the date of bankruptcy. In monetary terms 'writing off' \$1,000,000 or more from business failure has a far greater impact on the economy than does house-hold debt of \$30,000. However concerns are raised regarding the likelihood of household debtors who will file for relief under the one (1) year proposal.

4.9 General

We perceive that the number of consumers seeking relief under Part IX or Part X will decrease with individuals opting to file a debtor's petition. The proposed changes will therefore have far reaching consequences in the industry; particularly, it is likely consumers already accepted into compromise arrangements with creditors will apply to terminate those agreements and file for bankruptcy. It remains to be seen if that will have a positive impact on entrepreneurial behaviour, however, it is clear it will have far reaching consequences for lenders.
