



January 2022

Bankruptcy system - options paper

Background

In January 2021, the Australian Government undertook public consultation on possible changes to the bankruptcy system to inform its ongoing response to address the impacts of the COVID-19 pandemic.

As part of this consultation, the government met with key stakeholders and sought public submissions on topics raised in a discussion paper. The discussion paper provided an overview of 4 elements of the *Bankruptcy Act 1966* to guide stakeholder consideration:

- the default period of bankruptcy
- debt agreements
- personal insolvency agreements, and
- offence provisions.

The government received written submissions from a diverse range of stakeholders including members of the public, insolvency practitioners, consumer advocates and peak bodies.

The majority of stakeholders submitted that COVID-19 should not be a driving impetus for reforms to the bankruptcy system, citing the need for a longer-term approach to reform. Notwithstanding this, stakeholders identified a number of reform opportunities of merit.

This options paper outlines the reform opportunities the government is considering to:

- reduce bankruptcy to one year
- promote debt agreements, and
- target untrustworthy advisors.

Reduce bankruptcy to one year

On 19 October 2017, the *Bankruptcy Amendment (Enterprise Incentives) Bill 2017* was introduced to Parliament. The Enterprise Incentives Bill proposed to amend the Bankruptcy Act to:

- reduce the default period of bankruptcy from 3 years to one year
- reduce other time periods associated with bankruptcy to one year including for:
 - disclosing bankrupt status when applying for credit
 - seeking permission for overseas travel, and
 - the attainment of certain licences and entering into certain professions
- extend income contribution obligations for discharged bankrupts for a minimum period of 2 years following discharge or, in the event that a bankruptcy is extended due to non-compliance, to 5 to 8 years.

The Enterprise Incentives Bill lapsed when the 45th Parliament was prorogued on 11 April 2019.

Enhance the Enterprise Incentives Bill

Stakeholder views on the merits of the Enterprise Incentives Bill remain largely unchanged notwithstanding the economic impacts of the COVID-19 pandemic. While many stakeholders support the Enterprise Incentives Bill, some are concerned that a default period of one year will be abused by rogue, reckless and repeat bankrupts.

It is the government's view that the Enterprise Incentives Bill remains fit for purpose subject to modifications to resolve these stakeholder concerns. Accordingly, the government is considering amending the Enterprise Incentives Bill to:

- exclude eligibility for one-year bankruptcy in certain circumstances
- strengthen objections to discharge provisions, and
- strengthen offence provisions.

Exclude eligibility for one-year bankruptcy in certain circumstances

The government is considering excluding bankrupts from one-year bankruptcy who, in the previous 10 years, have:

- been bankrupt
- been banned as a director
- had a bankruptcy extended through an objection to discharge, or
- have been convicted of certain offences.

Bankruptcy in the preceding 10 years

This exclusion will increase the length of bankruptcy from one year to 2 or 3 years depending on whether a bankrupt person has been bankrupt in the previous 10 years.

The exclusion will mean that if a person has been discharged from a one-year bankruptcy and subsequently becomes bankrupt within 10 years, the length of the second bankruptcy will be 2 years. If this person becomes bankrupt again within 10 years of the second bankruptcy, the length of bankruptcy will be 3 years.

The length of bankruptcy will not increase beyond 3 years (the current default length) and will 'reset' to a length of one year if a person has not been bankrupt for 10 years.

This exclusion aims to address the impact bankruptcy has on creditors while decreasing the stigma associated with bankruptcy and recognising that multiple bankruptcies can occur due to circumstances beyond the control of the bankrupt.

A person discharged from a bankruptcy before the Enterprise Incentives Bill commenced would be eligible for one-year bankruptcy if they become bankrupt after the Bill commences, even if this occurs within 10 years of that preceding bankruptcy. The intent of this transitional provision would be to provide a 'fresh start' on commencement so that individuals are eligible for one-year bankruptcy even if they have been previously bankrupt before commencement.

Question – if the default period for bankruptcy is reduced to one year and this proposed exclusion applies, the government seeks stakeholder views on whether a repeat bankrupt that meets certain eligibility criteria (e.g. has satisfied all their tax obligations, has not engaged in voidable transactions, has been cooperative throughout the bankruptcy process etc.) should be able to apply for early discharge from a 2-year or 3-year bankruptcy after the first year.

Banned as a director

This exclusion will ensure that a bankrupt who has been banned as a Director of a company under the *Corporation Act 2001* in the preceding 10 years will have a bankruptcy length of 3 years.

This will respond to concerns about the abuse of a one-year bankruptcy by rogue and reckless bankrupts, as being banned as a director is an indicator of this type of conduct.

The exclusion won't apply to directors who are banned as a director because they become bankrupt. This means they can have a bankruptcy of one, 2 or 3 years depending on whether they have been bankrupt in the previous 10 years (see above).

This exclusion from a shorter period of bankruptcy would apply regardless of whether the director ban occurred before the commencement of the Bill. The intention is that the seriousness of a director ban warrants that individuals subject to the director ban should not be eligible for the 'fresh start' approach that the commencement of the Bill would otherwise provide to bankrupts.

Objection to discharge

This exception will provide that a bankrupt who has had a bankruptcy in the previous 10 years extended due to an objection to discharge will have a bankruptcy length of 3 years.

A bankruptcy trustee can object to the discharge of a bankruptcy on grounds such as the bankrupt failing to provide their bankruptcy trustee with information about property and income.

This exclusion will respond to concerns about the abuse of one-year bankruptcy by rogue and reckless bankrupts as having a bankruptcy extended due to an objection to discharge is an indicator of this type of conduct.

This exclusion from a shorter period of bankruptcy would apply regardless of whether the objection to discharge occurred before the commencement of the Bill. The intention is that the seriousness of

bankruptcies being extended by an objection to discharge warrants that individuals subject to such extensions should not be eligible for the 'fresh start' approach that the commencement of the Bill would otherwise provide to bankrupts.

Previous offences

This exclusion will mean that a bankrupt who, in the previous 10 years, has been convicted of a Bankruptcy Act offence or other offences relating to fraud will have a default bankruptcy length of 3 years.

This exclusion from a shorter period of bankruptcy would apply regardless of whether the bankrupt was found guilty of the offences before the commencement of the Bill. The intention is that the seriousness of the offences warrants this exception that the offending individuals should not be eligible for the 'fresh start' approach that the commencement of the Bill would otherwise provide.

Question – the government seeks stakeholder views on what offence provisions should exclude a bankrupt from one-year bankruptcy.

Strengthen objection to discharge provisions

The government is considering amending the Bankruptcy Act to include new objection to discharge grounds to help ensure bankrupts provide necessary information to their bankruptcy trustee. These new grounds would extend bankruptcy by one year, responding to concerns about bankrupts delaying the provision of information.

The government is considering making a bankrupt's failure to satisfy the following Bankruptcy Act requirements grounds for objection to discharge:

- section 80 - notifying of change in name, address or day time telephone number
- paragraph 77(1)(a)(i) - give the trustee all books (including books of an associated entity of the bankrupt) that are in the possession of the bankrupt and relate to any of his or her examinable affairs
- paragraph 77(1)(ba) - give such information about any of the bankrupt's conduct and examinable affairs as the trustee requires
- paragraph 77(1)(d) - at each meeting of creditors at which the bankrupt is present, such information about any of the bankrupt's conduct and examinable affairs as the meeting requires
- paragraph 77(1)(e) - execute such instruments and generally do all such acts and things in relation to his or her property and its realization as are required by this Act or by the trustee or as are ordered by the Court upon the application of the trustee
- paragraph 77(1)(f) - disclose to the trustee, as soon as practicable, property that is acquired by him or her, or devolves on him or her, before his or her discharge, being property divisible amongst his or her creditors

Strengthen offence provisions

The government is considering increasing penalties for certain offences under the Bankruptcy Act to target abuse of a shorter period of bankruptcy. For example, subsection 265(8) of the Bankruptcy Act, contracting a debt with no expectation to pay, has a current maximum penalty of one-year imprisonment.

Question – the government seeks stakeholder views on what current Bankruptcy Act offences could have penalties strengthened to target abuse of one-year bankruptcy.

Promote debt agreements

The debt agreement system has been a vital part of Australia's consumer finance framework since its introduction in 1996. A debt agreement offers a statutory alternative to bankruptcy and a solution for managing personal debt.

The debt agreement system was the subject of significant reforms introduced by the *Bankruptcy Amendment (Debt Agreement Reform) Act 2018*, which commenced in June 2019. The intent of these reforms was to boost confidence in the professionalism of administrators, deter unscrupulous practices, enhance transparency between the administrator and stakeholders, and to expand the accessibility of the debt agreement system.

Since the introduction of these reforms, there has been a decline in the average volume of new debt agreements which could raise question about whether the current accessibility of the debt agreement system remains appropriate. In the 2018–19 period, there were 11,549 debt agreements, a fall of 22.1% compared to 2017–18. In the 2019–20 period, there were 8,147 debt agreements which was the lowest annual level for the formation of new debt agreements since 2010–11. There has been a further decline since then, with only 3,731 new debt agreements made in the 2020–21 period. It is important to acknowledge that the personal insolvency landscape (and the reduction of debt agreement volumes) is likely to have been impacted by temporary government measures, such as JobKeeper, to respond to the financial impacts of COVID-19, and the policies of major lenders (such as the six-month deferrals on debt repayments).

Noting this context, the government considers there is scope to promote debt agreements by:

- improving access to the debt agreement system, and
- minimising the consequences of debt agreement system.

Improving access to the debt agreement system

The government is considering improving access to the debt agreement system by:

- extending the default term limit for debt agreements to 5 years, and
- increasing the eligibility thresholds for debt agreements.

Extend the default term limit for debt agreements to 5 years

Stakeholders have raised concerns that the 3-year default term limit has significantly restricted the formation of new debt agreements. To address these concerns, the government is considering extending the default term limit for debt agreements to 5 years. The effect of extending the default term is that the home ownership exception provided under section 185C(2AA)(b) of the Bankruptcy Act would no longer apply; and the option of a 5 year debt agreement will be available to all debtors.

The aim of extending the default term is that debtors will have access to a sustainable debt agreement with a defined term limit, while providing creditors with reasonable prospects to receive a commercially acceptable return.

Question – the government seeks stakeholder views on whether the default term limit for debt agreements should be extended to 5 years.

Question – the government also seeks stakeholder views on whether the home ownership exception should remain to allow a debtor with a real interest in property to propose a longer debt agreement beyond a 5-year default term.

Question – Section 185M of the Bankruptcy Act gives debtors the flexibility to vary their debt agreement to up to 5 years if they suffer a substantial and unforeseen change in circumstances. The government seeks stakeholder views on what form this variation exception should take if the default term for debt agreements is extended to 5 years.

Increase the eligibility thresholds for debt agreements

The government is considering increasing the debt and income thresholds to match the asset threshold. At the time of publication, the debt, income and asset thresholds are \$121,030.00, \$90,772.50, and \$242,060.00, respectively. The dollar amounts for the debt, income and asset thresholds are indexed.

Increasing the debt and income thresholds will mean the debt agreement system is more accessible to a wider range of debtors with higher incomes and levels of debt, giving them another formal insolvency option (including a PIA) to avoid the restrictions and consequences of bankruptcy.

Minimising the consequences of the debt agreement system

Reduce exclusion period for proposing debt agreements

A person cannot lodge a debt agreement proposal if they have been bankrupt, in a debt agreement or a PIA in the previous 10 years.

The government is considering reducing this exclusion period from 10 years to 7 years. This reduction would allow a cohort of debtors who have been subject to one of the formal insolvency options under the Bankruptcy Act (i.e bankruptcy, debt agreements or PIA), the ability to access the debt agreement system, rather than being channelled towards bankruptcy or a PIA as the only formal insolvency options available to discharge their debts.

Question – the government seeks stakeholder views on reducing the exclusion period for lodging a debt agreement proposal from 10 years to 7 years.

Question – for debtors who have previously been party to a debt agreement only, the government also seeks views on providing a specific exclusion period of 5 years (rather than the proposed 7 years which would still apply to the other insolvency options (bankruptcy and PIA)).

Proposing a debt agreement will not be an ‘act of bankruptcy’

Stakeholders have raised concerns that it is not appropriate that the mere act of proposing a debt agreement should be a potential legal trigger for bankruptcy, particularly since a debt agreement proposal may not be accepted by creditors.

The government is considering amending subsection 40(1) of the Bankruptcy Act so that the lodgement of a debt agreement with the Official Receiver cannot be relied upon as precondition for a creditor to commence involuntary bankruptcy proceedings as an ‘act of bankruptcy’.

Target untrustworthy advisors

Stakeholders have expressed concerns about the provision of pre-insolvency advice by untrustworthy advisors (UAs), particularly those that are unregulated. In response, the government is considering strengthening detection of UA activity, and introducing new offences targeting UA activity.

Strengthen detection and referral of UA activity

To improve the detection of UA activity, the government is considering requirements for the collection of information about pre-insolvency advisors and advice by requiring that:

- bankrupts disclose details of advisors who have provided pre-insolvency advice to them
- registered trustees make preliminary enquiries about pre-insolvency advice a bankrupt has received, and
- registered trustees provide information about these enquiries to the Inspector-General in certain circumstances.

These requirements will assist to detect whether the bankrupt has received pre-insolvency advice aimed at defeating the legitimate interests of creditors.

It is expected that the requirement for the bankrupt to provide information about pre-insolvency advisors will be prescribed in section 77 of the Act and that the requirement that registered trustees make preliminary enquiries about pre-insolvency advice will be prescribed in section 42-30 of the *Insolvency Practice Rules (Bankruptcy) 2016* (Insolvency Practice Rules).

It is expected the requirement that registered trustees provide information about their enquiries about pre-insolvency advice to the Inspector-General in certain circumstances will be prescribed in Division 70 of the Insolvency Practice Rules.

Due to the wide ambit of pre-insolvency advice, the government considers that requiring registered trustees to provide the Inspector-General with all information about enquiries they have made would be burdensome. Accordingly, the requirement will be limited. For example, registered trustees will be required to provide certain information to the Inspector-General when the bankrupt has engaged in certain conduct such as acting with an intent to defraud or making a false claim or declaration.

In addition, the government is considering expanding insolvency practitioner duties to include consideration of whether any party connected to a bankruptcy or debt agreement has committed an offence against the Bankruptcy Act and referral the possible offence to the Inspector-General or relevant law enforcement authorities. These duties are currently limited to considering the actions of bankrupts and debtors.

New offences targeting UA activity

The government is considering adding to existing Bankruptcy Act offences and including new offences to target UA activity.

The government is considering adding to existing Bankruptcy Act offences to make it an offence to advise, instruct, assist or counsel any person to commit or attempt to commit the existing offences. It is expected that these offences will generally contain fault elements of intention or knowledge such as:

- subsection 263(1) of the Bankruptcy Act – concealing a bankrupt’s property with the intent to defraud creditors
- subsection 267(2) of the Bankruptcy Act – making a false declaration or statement which the person knows to be false, and
- subsection 268(3) of the Bankruptcy Act – making a false representation or committing any fraud when executing a personal insolvency agreement with the intention of obtaining the consent of creditors.

The addition of these new offences will accurately reflect the serious risk and impact of such conduct on the personal insolvency system. They will facilitate the Australian Financial Security Authority (AFSA)’s investigation and prosecution of UA behaviour.

Question – the government seeks stakeholder views on what other existing Bankruptcy Act offences should include an offence to advise, instruct, assist or counsel any person to commit or attempt to commit those offences.

The government is also considering creating provisions in the Bankruptcy Act analogous to those contained in the *Corporations Act 2001* targeting creditor defeating behaviour. These new provisions will define the concept of a creditor-defeating disposition for the purposes of the Bankruptcy Act and create offences for a bankrupt engaging in a creditor defeating disposition as well as an offence to advise, instruct, assist or counsel any person to commit or attempt to commit the conduct.

The new provisions target UA activity by ensuring that both the bankrupt/debtor and any third-party advisor is adequately penalised for any creditor-defeating disposition.