

# AN EVALUATION OF DEBT AGREEMENTS IN AUSTRALIA

VIVIEN CHEN, LUCINDA O'BRIEN AND IAN RAMSAY\*

## I INTRODUCTION

The year 2016 marked two decades since debt agreements were introduced into the Australian personal insolvency framework. Debt agreements were designed to offer debtors a cost-effective means of making arrangements with their creditors, while avoiding bankruptcy and some of its more serious consequences.<sup>1</sup> Since their inception, debt agreements have grown significantly in popularity. In 2016, they comprised 41.5 per cent of all personal insolvencies in Australia.<sup>2</sup> Yet commentators have expressed concern that debt agreements may be causing harm, particularly to vulnerable debtors on low incomes.<sup>3</sup> These critics maintain that some debt agreement administrators fail to inform debtors of the full implications

\* Vivien Chen is a Lecturer, Department of Business Law and Taxation, Monash Business School, Monash University and former Research Assistant, Melbourne Law School, The University of Melbourne; Lucinda O'Brien is a Research Fellow, Melbourne Law School, The University of Melbourne; Ian Ramsay is the Harold Ford Professor of Commercial Law and Director of the Centre for Corporate Law and Securities Regulation, Melbourne Law School, The University of Melbourne. The authors thank the Statistics team at the Australian Financial Security Authority ('AFSA'), in particular River Paul, for providing the previously unpublished data contained in this article. The authors also thank Dr Malcolm Anderson for carrying out the statistical analysis discussed in Part V and the two anonymous reviewers for their helpful comments. This research has been supported by the Australian Research Council Linkage Grant LP130101022. The partners for this Linkage Grant research project are Consumer Action Law Centre ('CALC'), Financial Counselling Australia ('FCA') and Good Shepherd Youth & Family Service.

On 27 September 2018, and after the final page proofs for this article were approved, the *Bankruptcy Amendment (Debt Agreement Reform) Act 2018* (Cth) received assent. The main parts of the Act commence on 27 June 2019. The matters dealt with in the Act include the types of practitioners authorised to be debt agreement administrators; registration, deregistration and the obligations of debt agreement administrators; formation, administration, variation and termination of debt agreements; protections against debt agreements that cause financial hardship or have other defects; and powers of the Inspector-General in Bankruptcy with respect to debt agreements and debt agreement administrators: Explanatory Memorandum, Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 (Cth) [3]. The consumer protections introduced by the Act include a 'payment to income ratio', which provides that the total payments under a debt agreement cannot exceed the debtor's income by a certain percentage; and a new provision empowering the Official Receiver to 'refuse to accept a debt agreement proposal for processing if ... the debt agreement would cause undue hardship to the debtor': at [73], [80]. Consumer advocates have welcomed these developments but maintain that further reform is necessary in order to address the harmful effects of debt agreements: CALC, Financial Rights Legal Centre ('FRLC') and FCA, Submission No 18 to Senate Legal and Constitutional Affairs Legislation Committee, Parliament of Australia, *Inquiry into the Bankruptcy Amendment (Debt Agreement Reform) Bill 2018*, 21 February 2018.

1 Explanatory Memorandum, Bankruptcy Legislation Amendment (Debt Agreements) Bill 2007 (Cth) 5.

2 This figure is based on unpublished data regarding the Australian personal insolvency system in the financial year ending 30 June 2016. It was provided to the authors by the Statistics team at AFSA. See Part III below.

3 These commentators are described in the last paragraph of Part III and references to relevant publications are set out at nn 76 and 77.

of signing a debt agreement. In particular, they maintain that many debtors do not understand that signing a debt agreement is an act of bankruptcy with long-term legal and financial consequences. They observe that debtors have few legal options for redress when administrators engage in misleading marketing or breach their obligations under the *Bankruptcy Act 1966* (Cth) (*'Bankruptcy Act'*). They also maintain that many debtors derive no tangible benefits from signing a debt agreement, with the majority paying more than 100 per cent of their total debts over the life of the agreement. Critics of the system maintain that many of these debtors would be better off attempting to negotiate repayment arrangements or debt waivers through financial hardship schemes or external dispute resolution (*'EDR'*).<sup>4</sup> Given the increasing importance of debt agreements within the personal insolvency framework, these concerns warrant careful consideration.

This article evaluates the debt agreement system and its impact on Australian debtors, drawing upon three sources of data: statistics published by the Australian Financial Security Authority (*'AFSA'*),<sup>5</sup> a survey of individuals who entered into debt agreements or declared bankruptcy between 2010 and 2015, and interviews with a range of industry stakeholders. The article considers the extent to which the debt agreement system is achieving its objectives and ways in which it could be improved. It re-evaluates the role of debt agreements in light of the considerable expansion of financial hardship schemes and EDR in the years since the system's introduction. It finds 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. At the same time, it finds that fresh measures are needed in order to protect vulnerable debtors from harm and to enhance the efficiency of the system.

Part II of this article provides an overview of the debt agreement system. Part III outlines the methodology, while AFSA's statistics on debt agreements are analysed in Part IV. Details of the survey of debtors are discussed in Part V, and interviews with industry stakeholders are examined in Part VI. Part VII analyses the existing debt agreement system and proposes measures to strengthen the debt agreement framework. Part VIII concludes.

## II THE DEBT AGREEMENT SYSTEM

Debt agreements were introduced as an 'alternative to bankruptcy'.<sup>6</sup> They were intended to provide debtors with a cost-effective means of making arrangements with their creditors, while avoiding bankruptcy and some of its more serious consequences.<sup>7</sup> Debt agreements are binding agreements made between debtors and their creditors in accordance with pt IX of the *Bankruptcy Act*. Under these

4 See below Part VI(B)–(C).

5 Until 2013, AFSA was known as the Insolvency and Trustee Service Australia (*'ITSA'*).

6 Explanatory Memorandum, Bankruptcy Legislation Amendment Bill 1996 (Cth) 32.

7 See, eg, Explanatory Memorandum, Bankruptcy Legislation Amendment (Debt Agreements) Bill 2007 (Cth) 5.

agreements, debtors who are insolvent<sup>8</sup> may propose legally binding repayment arrangements to their creditors. If such a proposal is accepted by the creditors, the debtor is released from the debts owed to these creditors upon completion of the agreed payments. Debt agreements are subject to the oversight of the Official Receiver, AFSA. They are governed by the *Bankruptcy Act*, which imposes restrictions as to persons who are eligible to propose a debt agreement. In order to propose a debt agreement, the value of debtors' unsecured debts, divisible assets and anticipated after-tax income must not exceed specified indexed amounts.<sup>9</sup> Debtors proposing a debt agreement cannot have been bankrupt, nor have had a debt agreement or a pt X arrangement,<sup>10</sup> within the preceding 10 years.<sup>11</sup>

When the debt agreement system was established, it was not expected that private, profit-making debt administrators would assume a prominent role. Under the *Bankruptcy Act*, debt agreement proposals must authorise a specific person to administer the debtor's property in accordance with the terms of the debt agreement. The administrator may be 'the Official Trustee, a registered trustee or another person'.<sup>12</sup> Other parties may administer debt agreements, provided that they pass the Official Receiver's basic eligibility test.<sup>13</sup> The Explanatory Memorandum to the Bankruptcy Legislation Amendment Bill 1996 (Cth) speculated that debt agreements might be administered by a third party or 'one of the creditors on behalf of the others',<sup>14</sup> though it also envisaged that debtors would make payments to creditors directly.<sup>15</sup> It was not 'proposed that there be [any] fees or administrative charges associated with ... debt agreements'.<sup>16</sup> The Explanatory Memorandum noted that 'if fees were charged, debt agreements would in many cases not be viable either for the debtor, or for his or her creditors, which would of course defeat the purpose of creating a further alternative to existing regimes'.<sup>17</sup> In practice, however, many debtors appoint registered debt agreement administrators who provide their services for a fee.<sup>18</sup>

8 A person is insolvent if he or she is unable to pay all his or her debts 'as and when they become due and payable': *Bankruptcy Act* ss 5(2)–(3).

9 *Bankruptcy Act* ss 185C(4)(b)–(d). In October 2018, the maximum amount of unsecured debts that can be subject to an agreement is \$114 478.00. To be eligible for a debt agreement, a debtor cannot have divisible assets exceeding this amount, or an after-tax income exceeding \$85 858.50 per year. These figures are indexed twice a year, on 20 March and 20 September. See AFSA, *Indexed Amounts* (20 September 2018) <<https://www.afsa.gov.au/insolvency/how-we-can-help/indexed-amounts-0>>.

10 *Bankruptcy Act* pt X.

11 *Ibid* s 185C(4)(a).

12 *Ibid* s 185C(2)(c).

13 The basic eligibility criteria are set out in s 186A of the *Bankruptcy Act*.

14 Explanatory Memorandum, Bankruptcy Legislation Amendment Bill 1996 (Cth) 15 [48].

15 *Ibid*.

16 *Ibid*.

17 *Ibid*.

18 See Consumer Credit Legal Service Inc ('CCLS') and Eastern Access Community Health ('EACH'), 'Debt Agreements: Remedy or Racket?' (Report, November 2005). There is currently no data available from AFSA regarding the proportion of debtors who use fee-based debt agreement administration services.

## A The History of Debt Agreements in Australia

Debt agreements were introduced into the Australian personal insolvency framework through the *Bankruptcy Legislation Amendment Act 1996* (Cth). The Explanatory Memorandum to the Bankruptcy Legislation Amendment Bill 1996 (Cth) observed the need for an alternative form of administration that allowed debtors to avoid bankruptcy. Although pt X of the *Bankruptcy Act* already provided debtors with an alternative, known as a ‘personal insolvency agreement’, the cost and complexity of these arrangements rendered them unsuitable for many consumer debtors.<sup>19</sup> Debt agreements were ‘designed to be a low cost alternative to bankruptcy for persons with few if any divisible assets, and low income levels’.<sup>20</sup>

The reforms were premised on the Law Reform Commission’s proposal of a scheme of arrangement, outside bankruptcy, for the regular payment of debts by low income debtors.<sup>21</sup> The Law Reform Commission’s report observed that there was ‘considerable evidence ... of the need to provide debtors, and those who act for them, with an inexpensive and simple means of making suitable arrangements with all their creditors’.<sup>22</sup> The Commission asserted that an alternative to bankruptcy was necessary, reasoning that:

Bankruptcy involves compulsion; the need is for schemes which are voluntarily entered into. Experience both in Australia and elsewhere indicates that rehabilitation of debtors and the successful completion of schemes of [regular debt repayment] depend to a very large degree upon the will and enthusiasm of debtors freely and voluntarily entering into them as dignified and responsible means of solving their debt difficulties.<sup>23</sup>

In his second reading speech, the Attorney-General, Daryl Williams, said that debt agreements would provide debtors with ‘a “breathing space”, during which time they [could] explore opportunities for dealing with debts outside of bankruptcy’.<sup>24</sup> Such arrangements were anticipated to produce better returns for creditors, while

- 19 Explanatory Memorandum, *Bankruptcy Legislation Amendment Bill 1996* (Cth) 14 [44], quoting Law Reform Commission, *Insolvency: The Regular Payment of Debts*, Report No 6 (1977) 14 [31], 17 [38].
- 20 Explanatory Memorandum, *Bankruptcy Legislation Amendment Bill 1996* (Cth) 32. The Law Reform Commission recommended an alternative form of voluntary administration or bankruptcy ‘aimed at stabilising and dealing with the current commitments of insolvent debtors who, either seek to avoid bankruptcy or would find the cost of an administration under Part X prohibitive’: Law Reform Commission, *General Insolvency Inquiry: Summary of Report*, Report No 45 (1988) 27 [80].
- 21 Law Reform Commission, *Insolvency: The Regular Payment of Debts*, above n 19, 14–17, quoted in Explanatory Memorandum, *Bankruptcy Legislation Amendment Bill 1996* (Cth) 14. Sources cited by the Law Reform Commission include debt counsellors, welfare workers and Ronald Sackville, ‘Law and Poverty in Australia’ (Second Main Report, Australian Government Commission of Inquiry into Poverty, October 1975).
- 22 Law Reform Commission, *Insolvency: The Regular Payment of Debts*, above n 19, 14 [32].
- 23 *Ibid* 17 [38] (citations omitted). The Law Reform Commission also observed that measures have been taken in other comparable jurisdictions to provide non-business debtors with simple, inexpensive arrangements with creditors: at 16 [35].
- 24 Commonwealth, *Parliamentary Debates*, House of Representatives, 26 June 1996, 2828 (Daryl Williams).

enabling debtors to avoid the perceived ‘stigma [of] bankruptcy’.<sup>25</sup> It was expected that many debt agreements would involve a reduction in the amount of debt payable to creditors, as well as an extension of time for repayment and provision for periodic payments from the debtor’s future income.<sup>26</sup> Debt agreements were expected to last no longer than three years, with a possible extension of six months to allow for delays in payment.<sup>27</sup>

Since its inception, the debt agreement regulatory framework has been reviewed and amended on several occasions.<sup>28</sup> The *Bankruptcy Legislation Amendment (Debt Agreements) Act 2007* (Cth) was among the most significant of these reforms and responded to concerns that some administrators were promoting unsustainable agreements, resulting in a high termination rate.<sup>29</sup> The 2007 amendments strengthened the regulation of debt agreement administrators through a registration scheme.<sup>30</sup> They required administrators’ fees to be calculated as a fixed percentage of the total debt owed, over the term of the debt agreement.<sup>31</sup> They also stipulated that administrators’ fees could not be prioritised ahead of repayments to creditors.<sup>32</sup> They imposed specific duties on debt agreement administrators, including a requirement that defaults of more than three months be reported in writing to all creditors.<sup>33</sup> Advertising guidelines were released in an effort to curb misleading advertising by debt agreement administrators.<sup>34</sup>

## **B The Life Cycle of a Debt Agreement**

### **1 The Debt Agreement Proposal**

All debt agreements begin with a proposal, put by the debtor to his or her creditors. The proposal must satisfy specific conditions set out in the *Bankruptcy Act* and must be lodged with AFSA using prescribed forms.<sup>35</sup> The proposal must identify

25 Ibid. See also Law Reform Commission, *Insolvency: The Regular Payment of Debts*, above n 19, 20 [44].

26 Commonwealth, *Parliamentary Debates*, House of Representatives, 26 June 1996, 2827 (Daryl Williams).

27 Law Reform Commission, *Insolvency: The Regular Payment of Debts*, above n 19, 36 [79].

28 See, eg, ITSA, ‘Review of Debt Agreements under Part IX of the *Bankruptcy Act 1966*’ (Issues Paper, 2005); Commonwealth Attorney-General’s Department, ‘Review of Debt Agreements under the *Bankruptcy Act 1966*’ (Consultation Paper, July 2011); Commonwealth Attorney-General’s Department, ‘Review of Debt Agreements under the *Bankruptcy Act 1966*’ (Proposals Paper, 2012).

29 See Mary Wyburn, ‘Debt Agreements under Australian Bankruptcy Law: A Successful Experiment?’ (2012) 20 *Insolvency Law Journal* 158, 170; Explanatory Memorandum, *Bankruptcy Legislation Amendment (Debt Agreements) Bill 2007* (Cth) 2 [9]–[12], 3 [15]–[16].

30 See *Bankruptcy Act* ss 186A–186Q.

31 Ibid s 185C(3A)(a).

32 Ibid s 185C(3A)(b).

33 Ibid s 185LB.

34 AFSA, *Inspector-General Practice Guideline 1: Guidelines Relating to Advertising and Marketing of Debt Agreements* (July 2016) <<https://www.afsa.gov.au/about-us/practices/inspector-general-practice-guideline-1>>.

35 These include the prescribed Statement of Affairs in which debtors set out details of their debts, assets, income and other information as required by the Official Receiver: *Bankruptcy Act* ss 185C(2)(aa), 185D.

any property to be applied by the debtor towards settlement of his or her debts and must set out the manner in which this property is to be administered.<sup>36</sup> The *Bankruptcy Act* states that a proposal ‘may provide for any matter relating to the debtor’s financial affairs’.<sup>37</sup> At the same time, it imposes various restrictions on the matters that may be proposed. It requires that all provable debts must rank equally.<sup>38</sup> Creditors are not entitled to receive more than the amount of the debt owed, and debt agreement proposals must not provide for the transfer of property other than money to a creditor.<sup>39</sup> In practice, proposals generally outline regular amounts to be deducted from the debtor’s income, or the sale of specific assets and use of the proceeds to settle debts.<sup>40</sup> Proposals may also request a moratorium on payments for a specified period.<sup>41</sup>

## 2 Lodgement of the Proposal

Once a debt agreement proposal has been lodged with AFSA, the Official Receiver examines the proposal and other prescribed documents to ensure that the eligibility criteria are met and that the proposal is in accordance with the requirements of the *Bankruptcy Act*.<sup>42</sup> A debt agreement proposal will be cancelled if the Official Receiver finds that the debtor has failed to disclose creditors, or has provided incorrect particulars.<sup>43</sup> The Official Receiver has broad discretion to reject debt agreement proposals, including where the Official Receiver considers that the interests of creditors would be better served by the rejection of the proposal.<sup>44</sup> If the Official Receiver is satisfied that the proposal is in accordance with the regulatory requirements and eligibility criteria have been met, the proposal is distributed to creditors.<sup>45</sup> In recent years, only two or three per cent of proposals have been rejected by the Official Receiver at this stage.<sup>46</sup>

The lodgement of a debt agreement proposal has immediate consequences, whether or not it is ultimately accepted by creditors. During the voting period, creditors are precluded from enforcing a remedy against debtors or their property to recover debts<sup>47</sup> and from charging interest on the debts.<sup>48</sup> The proposal

36 *Bankruptcy Act* ss 185C(2)(a)–(c). Debt agreement proposals must not provide for the transfer of property other than money to a creditor: at s 185C(2A).

37 *Ibid* s 185C(3).

38 *Ibid* s 185C(2)(d)(i).

39 *Ibid* ss 185C(2)(e), (2A).

40 Ian Ramsay and Cameron Sim, ‘The Role and Use of Debt Agreements in Australian Personal Insolvency Law’ (2011) 19 *Insolvency Law Journal* 168, 176.

41 AFSA, ‘Annual Report 2013–2014’ (2014) 74.

42 *Bankruptcy Act* s 185E.

43 *Ibid* s 185ED(2).

44 *Ibid* s 185E(3).

45 *Ibid* s 185EA.

46 In FY 2014–15, for example, AFSA accepted 12 259 proposals and rejected 256: see AFSA, *Life Cycle of Debt Agreements* (2015) <<https://www.afsa.gov.au/statistics/life-cycle-debt-agreements>>.

47 *Bankruptcy Act* s 185F(1)(a). Nevertheless, creditors may still commence or take fresh steps in legal proceedings, except to enforce judgments, in respect of frozen debts during this period: at s 185F(2).

48 *Bankruptcy Act* ss 9, 185F(1)(a).

becomes a binding debt agreement if enough creditors vote to accept it.<sup>49</sup> Creditors may reject debt agreement proposals for a number of reasons. These include dissatisfaction with the amounts the debtor proposes to pay, concerns regarding the debtor's capacity to make the payments as proposed, or a belief that other measures such as bankruptcy or financial hardship provisions would be more appropriate.<sup>50</sup> When a debt agreement proposal is rejected, cancelled by the Official Receiver, or lapses due to a lack of response from creditors within the voting period, the debtor is no longer protected from enforcement action by creditors.<sup>51</sup> Creditors may recommence charging interest on debts.<sup>52</sup> As the lodgement of a debt agreement proposal is an act of bankruptcy,<sup>53</sup> creditors may also petition the courts for a sequestration order if they are owed a liquidated sum of \$5000 or more.<sup>54</sup> The proposal may constitute an event of default under a consumer mortgage or loan, providing the lender with rights of foreclosure.<sup>55</sup> The debtor's lodgement of a debt agreement proposal will also be recorded on the National Personal Insolvency Index ('NPII') for one year.<sup>56</sup> Debtors are likely to find that this reduces their capacity to obtain credit.<sup>57</sup>

### 3 Acceptance of the Proposal

Following acceptance of the debt agreement proposal, unsecured creditors may not take legal action against debtors or their property to recover the debts which are the subject of the debt agreement.<sup>58</sup> An accepted debt agreement is recorded on the NPII.<sup>59</sup> As a consequence, the debtor's ability to obtain credit is likely to be adversely affected. Debtors must disclose that they are party to a debt agreement if they incur debts over a certain limit, or obtain goods and services on credit

49 These creditors must represent 'a majority in value' of the total debt: *Bankruptcy Act* s 185EC(1). Prior to the reforms enacted in 2007, the requirements for acceptance of a debt agreement proposal were more stringent. Prior to 1 July 2007, it was necessary for 50 per cent of creditors, representing 75 per cent in value of debt owed, to vote in favour of the proposal: Ramsay and Sim, above n 40, 179, citing *Bankruptcy Act* s 185E, as repealed by *Bankruptcy Legislation Amendment (Debt Agreements) Act 2007* (Cth) sch 2 items 25–32.

50 Interview with Matt Angell, Chief Operating Officer, Credit Corp (Melbourne, 19 August 2016).

51 *Bankruptcy Act* s 185F.

52 *Ibid* s 185F(1).

53 *Ibid* s 40(1)(ha).

54 *Ibid* s 44.

55 Ramsay and Sim, above n 40, 175.

56 *Bankruptcy Act* s 185F; *Bankruptcy Regulations 1996* (Cth) regs 13.03, 13.05B, sch 8 ('*Bankruptcy Regulations*').

57 Ramsay and Sim, above n 40, 175.

58 *Bankruptcy Act* s 185K. Creditors may still enforce a remedy against the debtor in relation to maintenance payments or proceeds of crime: at s 185K(2). Secured creditors may also seize assets given as security for debts if debtors default on payments: at s 185XA; Ramsay and Sim, above n 40, 179.

59 *Bankruptcy Act* ss 185H(2)(c), (3)(d); *Bankruptcy Regulations* reg 13.03, sch 8.

above that limit.<sup>60</sup> If the debtor operates a business, the debt agreement must be disclosed to all people dealing with the business.<sup>61</sup>

Even so, debt agreements carry fewer restrictions than bankruptcy. Debt agreement debtors are not subject to restrictions on overseas travel, nor are they disqualified from managing corporations.<sup>62</sup> While undischarged bankrupts are precluded from being chosen or sitting as a Member of the Commonwealth Parliament, these restrictions do not extend to debt agreement debtors.<sup>63</sup> Industry associations and licensing authorities at times impose restrictions on undischarged bankrupts, potentially affecting their employment.<sup>64</sup> The restrictions vary across industries, and differ among the States and Territories, with some regulations requiring debtors who enter into arrangements with creditors, such as debt agreements, to seek the approval of industry bodies in order to maintain their licences.<sup>65</sup>

#### 4 Completion of the Debt Agreement

Once the debtor has completed all payments in accordance with the debt agreement, he or she is discharged from all remaining debts owed to unsecured creditors. The discharge from debts operates in the same way as a discharge from bankruptcy.<sup>66</sup> The debtor is entitled to any surplus assets that were not distributed to creditors.<sup>67</sup> Details of the debt agreement remain on the NPII for five years from the date on which the agreement was made, or the date on which the debtor's obligations were discharged, whichever is later.<sup>68</sup> The discharge from debts is subject to a number of exceptions. Specific debts such as penalties and fines, Higher Education Contributions Scheme ('HECS') debts and child support obligations cannot be included in a debt agreement and thus remain payable after the agreement is completed.<sup>69</sup> Where debts are owed jointly, or backed by a guarantor, the debtor's discharge does not release the other party from his or her obligations to the creditor.<sup>70</sup>

60 This limit is currently \$5726. See AFSA, *Indexed Amounts* (20 September 2018) <<https://www.afsa.gov.au/insolvency/how-we-can-help/indexed-amounts-0>>. This is an indexed figure and is updated quarterly: *Bankruptcy Act* ss 269, 304A.

61 *Bankruptcy Act* s 269(1)(b).

62 Cf *Corporations Act 2001* (Cth) s 206B(3).

63 *Australian Constitution* s 44(iii).

64 See Nicola Howell and Rosalind Mason, 'Reinforcing Stigma or Delivering a Fresh Start: Bankruptcy and Future Engagement in the Workforce' (2015) 38 *UNSW Law Journal* 1529, 1533.

65 For example, the definition of a 'bankruptcy-related event' under the *Legal Profession Uniform Law* (NSW) includes bankrupt and insolvent debtors compounding with creditors or assigning remuneration for their benefit: at s 6. A bankruptcy-related event is an automatic show cause event: at ss 6, 86. Estate agents in Victoria have their licences automatically cancelled if they become insolvent under administration: *Estate Agents Act 1980* (Vic) s 22.

66 *Bankruptcy Act* s 185NA.

67 *Ibid* s 185N(2).

68 *Ibid* s 185N; *Bankruptcy Regulations* reg 13.05A.

69 *Bankruptcy Act* ss 82, 185.

70 *Ibid* s 185NA(3).

## 5 Termination or Variation of the Debt Agreement

If a debtor is no longer able to make payments as agreed, he or she may seek to vary the terms of the debt agreement by lodging a proposal with the Official Receiver. Such a variation is subject to the consent of a majority in value of creditors.<sup>71</sup> A debt agreement is terminated automatically if the debtor defaults on payments for six months or more<sup>72</sup> or becomes bankrupt.<sup>73</sup> Debt agreements may also be terminated by an order of the court,<sup>74</sup> or where the debtor or a creditor proposes that the debt agreement should be terminated and the proposal is accepted by a majority in value of creditors.<sup>75</sup>

### C Controversial Aspects of the Current System

Despite the increasing popularity of debt agreements, some commentators have raised a number of concerns regarding the operation of the system. Organisations such as the Consumer Action Law Centre ('CALC'), the Financial Rights Legal Centre ('FRLC') and Financial Counselling Australia ('FCA') have argued that the current system poses significant risks to debtors, particularly those on low incomes.<sup>76</sup> These organisations maintain that many administrators fail to inform their customers of the full implications of a debt agreement.<sup>77</sup> They assert that administrators' marketing typically 'overstate[s] the differences between [d]ebt [a]greements and bankruptcy, or understate[s] the consequences of entering a [d]ebt [a]greement relative to bankruptcy'.<sup>78</sup> These advocates claim

71 Ibid ss 185M, 185MA, 185MC.

72 Ibid s 185QA. This was introduced in 2007 to ensure that abandoned debt agreements could be expediently managed: Explanatory Memorandum, Bankruptcy Legislation Amendment (Debt Agreements) Bill 2007 (Cth) 26 [191].

73 *Bankruptcy Act* s 185R.

74 Ibid s 185Q.

75 Ibid ss 185P, 185PC.

76 See, eg, CALC, Submission to Commonwealth Treasury, *Improving Bankruptcy and Insolvency Laws: Proposals Paper*, 27 May 2016; FRLC, Submission to Commonwealth Treasury, *Improving Bankruptcy and Insolvency Laws: Proposals Paper*, May 2016; CALC, 'Fresh Start or False Hope? A Look at the Website Advertising Claims of Debt Agreement Administrators' (Report, April 2013); FCA, Submission to Commonwealth Attorney-General's Department, *Review of Debt Agreements under the Bankruptcy Act 1966*, December 2012.

77 CALC has documented these concerns in a number of law reform submissions and policy reports, including a detailed report on the advertising practices of debt agreement administrators: see CALC, 'Fresh Start or False Hope?', above n 76. This report attributes the growing popularity of debt agreements to aggressive and sometimes misleading advertising on the part of debt agreement administrators. It asserts that many administrators' websites overstate the benefits of debt agreements, while failing to provide clear information about their negative consequences, such as their effect on debtors' credit reports, and the fact that signing a debt agreement constitutes an act of bankruptcy. It observes that debt administrators often portray bankruptcy as stressful, and a 'last resort' to be avoided at all costs, whereas in fact many debtors find that bankruptcy alleviates stress. The report notes that administrators' websites provide very little information regarding administrators' fees, with most administrators failing to disclose their fees. Some claim to offer "'free" debt assistance' when in fact they offer a free initial consultation for prospective clients. CALC's report concludes that many debtors enter into debt agreements on the basis of incomplete, inaccurate or misleading information obtained from administrators' websites. See especially at 4, 20, 37.

78 Ibid 3.

that some administrators market their services inappropriately, offering debt agreements to people whose financial problems could be more cheaply and quickly resolved through a hardship variation, negotiated directly with their creditors.<sup>79</sup> They also maintain that some administrators encourage low-income debtors to enter into agreements that are unrealistic or unsustainable.<sup>80</sup> In these cases, they argue, debtors pay large set-up and ongoing fees to administrators, only to declare bankruptcy after their agreements fail. The advocates argue that for many of these debtors, debt agreements only prolong and exacerbate financial hardship, whereas bankruptcy would offer immediate relief from debt-related stress and the opportunity to start afresh.<sup>81</sup> They point out that debt agreement debtors have few legal options for redress when administrators breach their obligations under the *Bankruptcy Act* or the *Australian Consumer Law* ('ACL').<sup>82</sup> Some creditors have also voiced concerns over the current operation of the system, pointing out that high administrator fees result in lower returns for creditors.<sup>83</sup> These creditors also maintain that administrators do not adequately inform debtors of their rights under creditors' hardship schemes. They argue that hardship schemes offer a more affordable, flexible and accessible means for debtors to deal with their debts.

### III METHODOLOGY

This study seeks to re-evaluate the debt agreement system, in light of the concerns raised by consumer advocates and creditors. It draws on three sources of data: AFSA's published and unpublished statistics; a survey of debt agreement debtors and bankrupt debtors conducted by the authors; and interviews with several industry stakeholders also conducted by the authors. In adopting this multi-method approach,<sup>84</sup> the article seeks to supplement existing Australian scholarship, which relies primarily on AFSA data.<sup>85</sup> Building on this earlier work, it seeks to develop a more nuanced and contextualised understanding of debt agreements' impact on both debtors and creditors. AFSA's published statistics on the operation of the system form the basis of discussion in Part IV. These

79 FRLC, Submission to Commonwealth Treasury, above n 76, 12; CALC, Submission to Commonwealth Treasury, above n 76, 6.

80 CALC, Submission to Commonwealth Treasury, above n 76, 6.

81 FRLC, Submission to Commonwealth Treasury, above n 76, 12.

82 *Competition and Consumer Act 2010* (Cth) sch 2 ss 18, 29 ('ACL').

83 Interview with Matt Angell, Chief Operating Officer, Credit Corp (Melbourne, 19 August 2016). For more information on debt agreement administrators' fees see Part IV(A), Figure 8.

84 Laura Beth Nielsen, 'The Need for Multi-Method Approaches in Empirical Legal Research' in Peter Cane and Herbert M Kritzer (eds), *The Oxford Handbook of Empirical Legal Research* (Oxford University Press, 2010) 951.

85 AFSA data has served as the basis of most previous studies of debt agreements in Australia. See, eg, Ramsay and Sim, above n 40; Diana Beal et al, 'Which Consumer Debtors Decide to Enter a Part IX Agreement?' (2004) 32 *Australian Business Law Review* 7; John Duns and Rosalind Mason, 'Debt Agreements Down Under' in Johanna Niemi, Iain Ramsay and William C Whitford (eds), *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives* (Hart Publishing, 2009) 355.

statistics are primarily derived from AFSA's annual reports<sup>86</sup> and its 'Profiles of Debtors'.<sup>87</sup> Much of this data is in turn gathered by AFSA from the Statement of Affairs lodged by each debtor at the commencement of a debt agreement.<sup>88</sup> For more recent data, the authors have consulted AFSA's website.<sup>89</sup> They have also obtained a substantial amount of unpublished data directly from AFSA, including data relating to the financial year ending on 30 June 2016 and data regarding the length of debt agreements. Where no specific source of data is cited, the analysis refers to the unpublished data from AFSA. Part IV outlines and analyses the statistics from AFSA.

Part V describes the results of the authors' survey of debt agreement debtors. This survey was conducted online in 2015, with the assistance of a specialist research company, Pureprofile. Pureprofile draws participants from a database of consumers located around Australia.<sup>90</sup> The survey was open to people who were, in 2015, party to a debt agreement, and those who had been party to a debt agreement within the preceding five years. For the purposes of comparison, the survey was also open to people who were bankrupt at the time of the survey, and those who had been bankrupt within the preceding five years. The survey contained 65 questions addressed to debt agreement debtors.<sup>91</sup> Rather than merely replicating data already gathered by AFSA, the survey sought to gather highly specific information regarding the types of debts owed by these debtors, the sources of their incomes, the nature of their assets and the steps they took to address their financial problems, prior to entering into a debt agreement. The survey asked detailed questions about the causes of debtors' financial problems, their understanding of debt agreements and their knowledge of the consequences of signing a debt agreement. It also sought to gauge the impact of debt agreements, by asking debtors how their debt agreements had affected their physical and mental health, relationships and family life, financial management, ability to meet day-to-day living expenses, careers, access to credit and general quality

86 These statistics are published in the *Annual Reports by the Inspector-General in Bankruptcy on the Operation of the Bankruptcy Act* from 1999 to 2011, and AFSA's annual reports from 2012 to 2014. AFSA's annual reports provide data on matters such as the number of new debt agreements entered into each year, the proportion of personal insolvencies that these agreements represent, and the number of agreements that are terminated and completed.

87 Data relating to the socio-economic characteristics of debtors is derived from AFSA's 'Profiles of Debtors' reports, available at <<https://www.afsa.gov.au/statistics/profiles-debtors>>. See below n 101 for more details.

88 AFSA notes that '[t]he quality and reliability of statistics published [in their Profiles of Debtors] rely on the accuracy of the information provided by bankrupts and debtors in the Statement of Affairs': ITSA, 'Profiles of Debtors 2011' (Report, 2012) 5. They also note that certain categorisations such as the nature of debt 'represent debtors' opinions of the best description of the nature of the debt and not an objectively determined creditor subtype': at 44.

89 Data for 2015 was obtained from AFSA's website: AFSA, *Annual Administration Statistics* <<https://www.afsa.gov.au/statistics/annual-administration-statistics/>>.

90 Pureprofile pays these individuals for each survey completed. Payments are calculated according to the amount of time taken to complete a survey. Panellists were paid \$1.50 to complete this survey.

91 The survey included a separate set of questions for those respondents who were, or had previously been, bankrupt.

of life.<sup>92</sup> It offered respondents the chance to provide extended comments on any aspect of their debt agreement.<sup>93</sup> The survey remained open for four weeks and was closed at the request of the authors, upon receipt of 400 complete responses. Of these, 233 complete responses were received from debt agreement debtors and 167 from bankrupt debtors.

Part VI describes the results of a series of interviews with industry stakeholders, also conducted by the authors. In 2016 the authors carried out extended interviews with a Melbourne debt agreement administrator, consumer solicitors and policy experts at CALC, and a senior executive of Credit Corp, a major debt-buying firm.<sup>94</sup> The debt agreement administrator was the director of a debt management and insolvency firm based in suburban Melbourne, with over 10 years' experience in administering debt agreements. CALC is a Melbourne not-for-profit community legal centre specialising in consumer law.<sup>95</sup> Credit Corp is a major Australian debt purchaser and debt collection agency. In June 2015, it was party to approximately 21 000 current debt agreements, representing more than half of all debt agreements in operation in Australia at that time.<sup>96</sup> Prior to the interview, Credit Corp supplied the authors with a paper setting out its concerns regarding the current debt agreement system. The paper contained detailed statistics drawn from Credit Corp's database of current and completed debt agreements and debt agreement proposals.<sup>97</sup> The discussion in Part VI incorporates statistics provided by Credit Corp.

#### IV ANALYSIS OF AFSA DATA

This section provides a detailed overview of the debt agreement system in Australia, drawing upon data published by AFSA between 1998 and 2015. From 1998 to 2011, the data is derived from the *Annual Report by the Inspector-General in Bankruptcy on the Operation of the Bankruptcy Act* from 1999 to 2011.<sup>98</sup> From 2012 to 2014, AFSA's Annual Reports provide the data, while the data for 2015 is derived from AFSA's website.<sup>99</sup> Statistics on the number of debt agreements,

92 The survey did not define 'ability to manage finances', 'ability to meet day-to-day expenses', or 'general quality of life'. Respondents were allowed to make their own interpretations of these phrases. In relation to each of these factors, respondents were asked to indicate whether bankruptcy had made things 'better' or 'worse'. Respondents were offered a third option: 'Neither — I haven't noticed any change'.

93 This final question read: 'Please add any other information you would like to share regarding your experience of bankruptcy.'

94 Credit Corp Group Limited ('Credit Corp'), 'Part IX Debt Agreement Insights' (Paper, June 2016). According to its website, Credit Corp 'is Australia's largest provider of sustainable financial services operating in the credit impaired consumer segment'. It 'provide[s] repayment solutions to consumers who, for various reasons, have found themselves in default of their credit obligations': Credit Corp, *Frequently Asked Questions* (2018) <<https://www.creditcorp.com.au/customers>>.

95 CALC, *About Consumer Action* (2012–17) <<http://consumeraction.org.au/about/>>.

96 Credit Corp, 'Insights', above n 94, 1; AFSA, *Annual Administration Statistics* <<https://www.afsa.gov.au/statistics/annual-administration-statistics/>>.

97 Credit Corp, 'Insights', above n 94.

98 Statistics relating to monies administered and incomplete debt agreements were only reported from 2003 onwards, while statistics on dividends paid to creditors were reported from 2004 onwards.

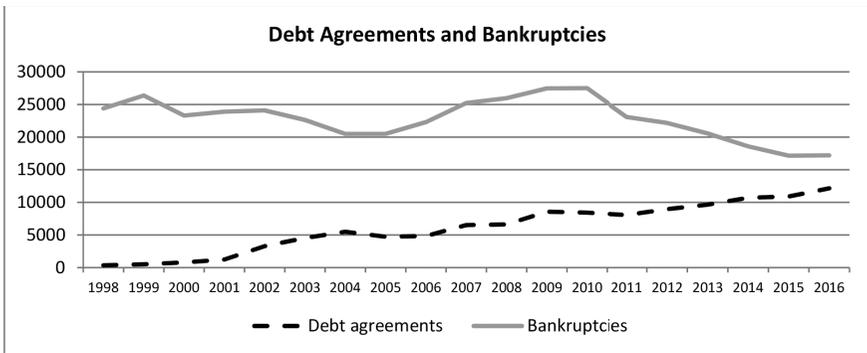
99 AFSA, *Annual Administration Statistics* <<https://www.afsa.gov.au/statistics/annual-administration-statistics/>>.

bankruptcies and total personal insolvencies for the 2016 financial year were obtained from AFSA’s website.<sup>100</sup> The remaining data cited for 2016 has been provided to the authors directly by the statistics staff at AFSA. The data regarding the length of debt agreements, cited in Part IV(A)(8), was also obtained directly from AFSA. Data relating to the socio-economic characteristics of debtors, in Part IV(B), is taken from the ‘Profiles of Debtors’ reports published by AFSA from 1998 to 2012,<sup>101</sup> AFSA’s website<sup>102</sup> and data provided to the authors by AFSA’s staff.

## A Debt Agreement Trends

### 1 Growth of Debt Agreements as a Form of Personal Insolvency

There has been an overall increase<sup>103</sup> in the number of new debt agreements established each financial year between 1998 and 2016.<sup>104</sup> In 2016, there were 12 150 new debt agreements, the highest number of new debt agreements in a year since their introduction in 1997. This represents growth of 51 per cent from 2011 to 2016 and 151 per cent from 2006 to 2016. Figure 1 indicates the number of new debt agreements and bankruptcies entered into each financial year from 1998 to 2016.



**Figure 1**

100 AFSA, *Personal Insolvency Statistics* <<https://www.afsa.gov.au/statistics/personal-insolvency-statistics-0>>.

101 AFSA published Profiles of Debtors for the calendar years 1997, 2002, 2003, 2005, 2007, 2009 and 2011.

102 AFSA, *Social Characteristics* <<https://www.afsa.gov.au/statistics/social-characteristics>>.

103 This has been noted in several previous studies. See, eg, Ramsay and Sim, above n 40, 172–4.

104 In 2011, AFSA ceased reporting according to calendar year and began reporting according to financial year. While the statistics analysed in Part IV(A) are based on financial years, commencing 1 July and ending 30 June of the following year, the statistics on demographics are based on calendar years. For ease of reference, this article cites financial years according to the year in which the period ends. For instance, the financial year from 1 July 2014 to 30 June 2015 is referred to as 2015.

In contrast with the overall increase in debt agreements since 1998, bankruptcies have declined on the whole, particularly since 2010. Figure 2 shows that the annual number of personal insolvencies<sup>105</sup> in Australia peaked in 2009 and 2010 and subsequently declined, though numbers rose again slightly in 2016.

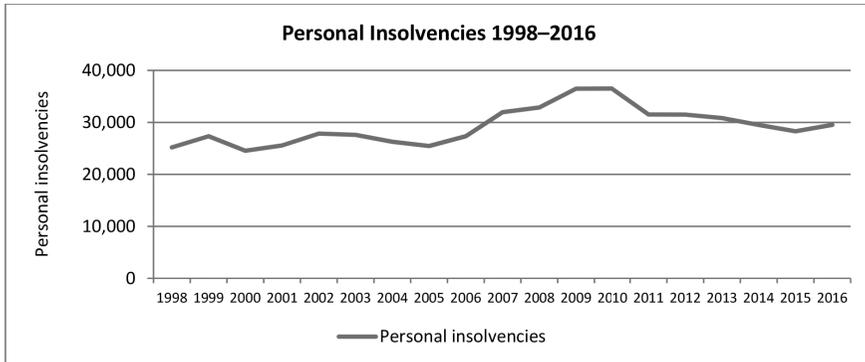


Figure 2

The number of debt agreements established annually has continued to rise, despite the decreasing overall number of personal insolvencies since 2011. This means that, as a proportion of personal insolvencies, debt agreements have increased substantially over the period 1998 to 2016. Debt agreements as a proportion of personal insolvencies were at their highest in 2016, constituting 41.5 per cent of personal insolvencies, representing growth of 80 per cent since 2011 and 133 per cent since 2006. Figure 3 shows the growth in the percentage of debt agreements as a proportion of personal insolvencies from 1998 to 2016.

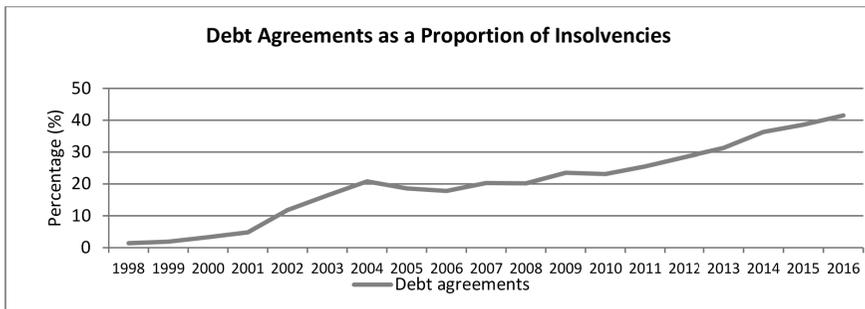


Figure 3

105 This represents the total number of personal insolvencies each financial year, comprising bankruptcies, debt agreements and personal insolvency agreements.

## 2 Increasing Number and Rate of Acceptance of Debt Agreement Proposals

Consistent with the growth in new debt agreements, the number of debt agreement proposals has increased considerably. The highest number of debt agreement proposals lodged in any one year was 14 317, in 2016. In 2015, 12 515 debt agreement proposals were lodged by debtors. Figure 4 indicates the number of debt agreement proposals made from 1998 to 2016, and the proportion accepted for processing by the Official Receiver as well as the proportion accepted by creditors.

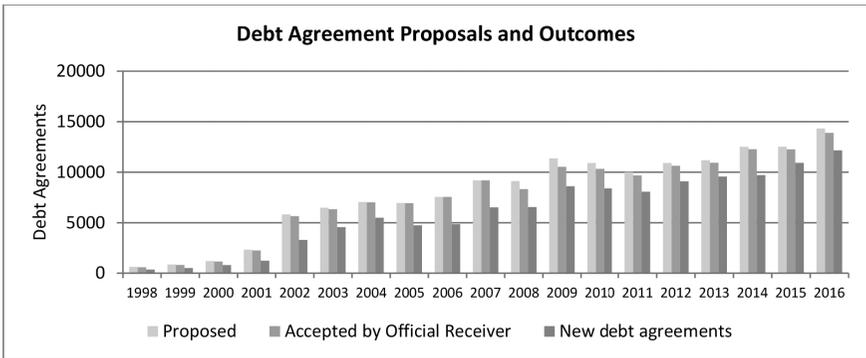


Figure 4

The proportion of debt agreement proposals accepted by creditors from 2012 to 2016 ranged from 77.6 per cent to 87.2 per cent.<sup>106</sup> An average of 16.3 per cent of debt agreement proposals did not materialise into debt agreements during the five most recent years of available data, largely as a result of debt agreement proposals being rejected by creditors. Nevertheless, a higher proportion of debt agreement proposals have been accepted by creditors in recent years, following the reforms in 2007. While an average of 65.4 per cent of debt agreement proposals were accepted by creditors from 2000 to 2006, an average of 80.4 per cent of debt agreement proposals were accepted from 2008 to 2016. The proportion of debt agreement proposals which materialised into debt agreements each year from 1998 to 2016 is shown in Figure 5.

106 In 2016, for example, 97 per cent of proposals were accepted by AFSA for processing and 84.9 per cent were approved by creditors. In 2014, AFSA accepted 98 per cent of proposals for processing and 77.6 per cent were accepted by creditors.

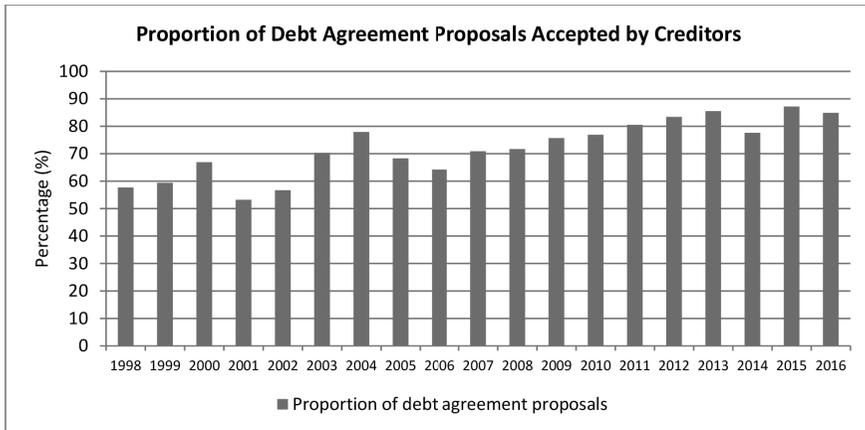


Figure 5

### 3 Increase in Monies Administered under Debt Agreements

Consistent with the growth in the number of debt agreements each year, the funds administered<sup>107</sup> by debt agreement administrators have increased between 2003 and 2016. In 2016, a total of \$242 121 406 was received by debt agreement administrators pursuant to debt agreements. Of this total, \$167 456 491 was paid to creditors as dividends, comprising 69.2 per cent of the monies received. Figure 6 shows the monies administered by debt agreements administrators from 2003 to 2016.

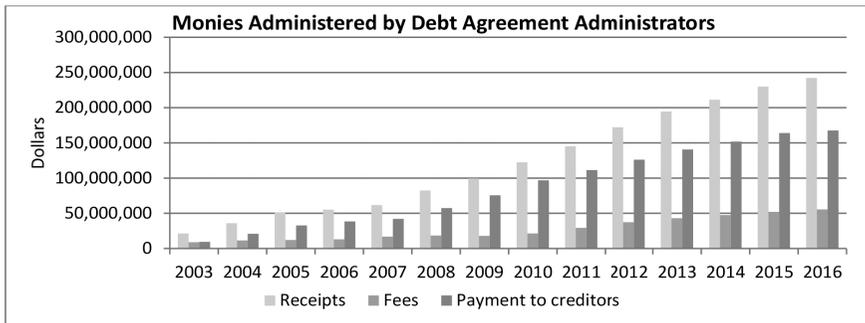


Figure 6

107 These include amounts received, amounts paid to creditors and fees paid pursuant to debt agreements.

#### 4 High Rate of Dividends Paid to Creditors

Dividends received by creditors pursuant to debt agreements were much higher than the dividends received under bankruptcy administrations. Between 2012 and 2016, creditors were paid an average of 60 cents per dollar owed. The average dividend paid to creditors from 2007 to 2011 was 67 cents per dollar. By contrast, the average rate of return for unsecured creditors in dividend-paying bankruptcy administrations was 6.54 cents per dollar. The average rate of return for unsecured creditors in *all* finalised bankruptcy administrations was 1.04 cents per dollar in 2016. Dividends paid under debt agreements were also higher than dividends paid under personal insolvency agreements (‘PIAs’). In 2016, the average rate of return for unsecured creditors in dividend-paying PIAs was 3.86 cents per dollar, while the average rate of return for unsecured creditors in *all* finalised PIAs was 2.01 cents per dollar.<sup>108</sup> The average dividend paid to creditors under debt agreements from 2004 to 2016 is shown in Figure 7.

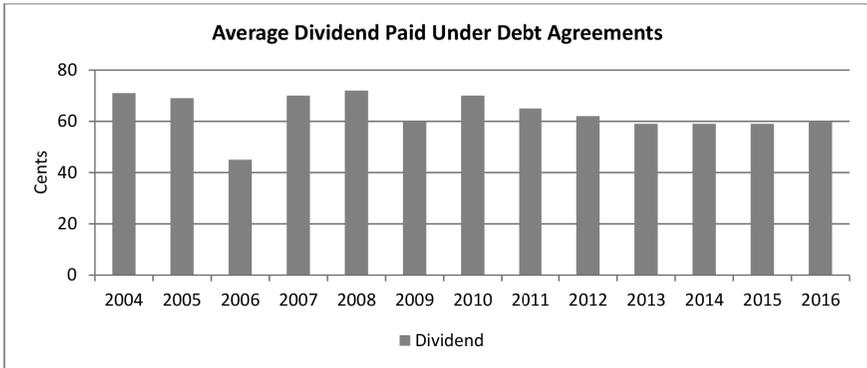


Figure 7

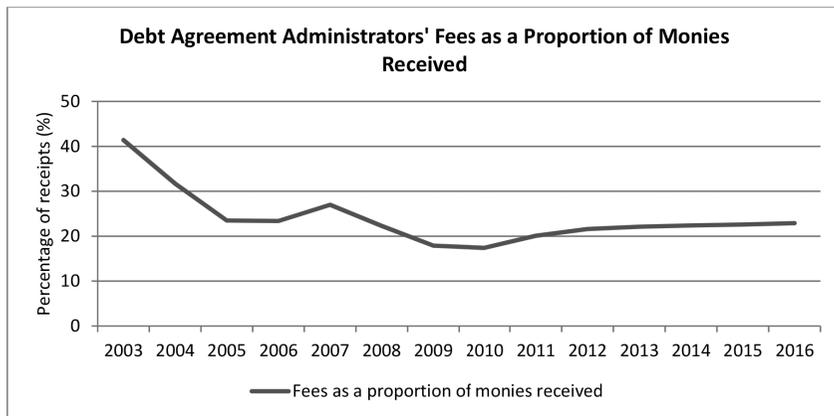
#### 5 Fluctuation in Fees Paid to Administrators

A significant proportion of funds administered under debt agreements are retained by administrators as fees. These fees have fluctuated over time, as a proportion of total funds administered. Between 2003 and 2010, administrators’ fees decreased sharply as a proportion of total monies received under debt agreements, from 41.4 per cent in 2003 to 17.4 per cent in 2010. This may in part be attributable to the reforms instituted in 2007, which prevented debt agreement administrators from prioritising their own fees over payments to creditors.<sup>109</sup> Since 2010, however,

108 AFSA, *Personal Insolvency Statistics*, above n 100. Likewise, the rate of return for unsecured creditors in dividend paying personal insolvency agreements in 2011 was 2.47 cents per dollar, while the average rate of return for unsecured creditors in all finalised personal insolvency agreements was 1.17 cents per dollar: ITSA, ‘Annual Report 2011–2012’ (2012) 129.

109 The practice commonly resulted in the debt agreement administrator ‘being the only person to have received any payments’ when debt agreements were terminated early, leaving the debtors worse off: Explanatory Memorandum, Bankruptcy Legislation Amendment (Debt Agreements) Bill 2007 (Cth) 3 [16].

fees have once again begun to rise: they accounted for 20.1 per cent of funds received in 2011, 22.1 per cent in 2013 and 22.9 per cent in 2016. The fees paid to debt agreement administrators are examined in Figure 8 as a proportion of the monies received during the financial year.



**Figure 8**

## **6 Proportionate Decrease in Unsuccessful or Terminated Agreements**

As already noted, the reforms in 2007 sought to address concerns over the high rate of prematurely terminated debt agreements. The number of terminated or unsuccessful debt agreements increased from 18 in 1998 to 1968 in 2007. Since then the number of terminated debt agreements has remained between 1617 and 1853 debt agreements each year from 2008 to 2015. In 2016, 1973 debt agreements were terminated. While the number of terminated debt agreements has remained relatively stable, successfully completed agreements have increased in number. The number of successfully completed agreements has increased from 55 in 1998 to 2633 in 2007 and 6774 in 2016. This means that proportionately fewer debt agreements are now terminated prior to successful completion.<sup>110</sup> Figure 9 shows the number of debt agreements completed, and debt agreements terminated, annually from 1998 to 2016.

<sup>110</sup> AFSA's statistics on the variation of debt agreements were published only up to 2012 and, as such, are not shown in Figure 9. Nevertheless, the statistics reflect that a significant number of debt agreements were varied each year. In 2012, 1261 debt agreements were varied, while in 2011 there were 1178 variations of debt agreements.

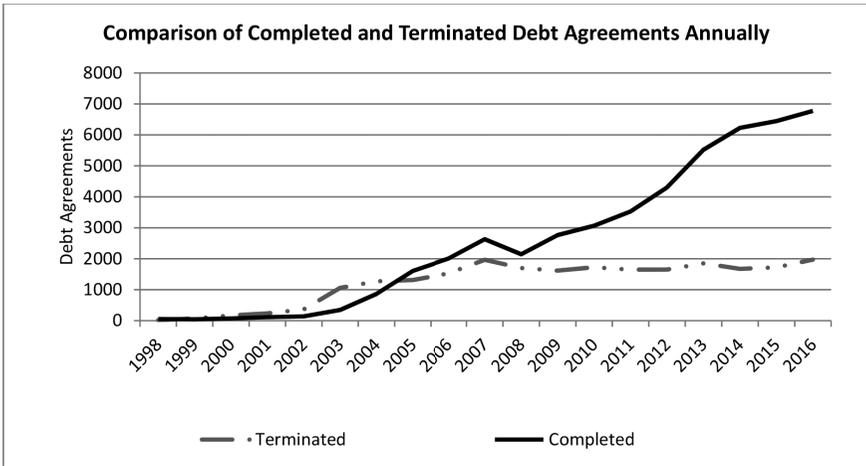


Figure 9

### 7 Increase in Number of Incomplete Agreements

Despite the increase in successfully completed debt agreements, a growing proportion of debt agreements remain on foot but incomplete. The number of incomplete debt agreements has increased at a higher rate than the number of new debt agreements each year.<sup>111</sup> The number of incomplete debt agreements increased from 1.7 times the number of new debt agreements in 2003, to three times the number of new debt agreements in 2010. By 2016, the number of incomplete debt agreements was 3.5 times the number of new debt agreements for the year. Figure 10 shows the number of incomplete debt agreements for each financial year in comparison with the number of new debt agreements each year.

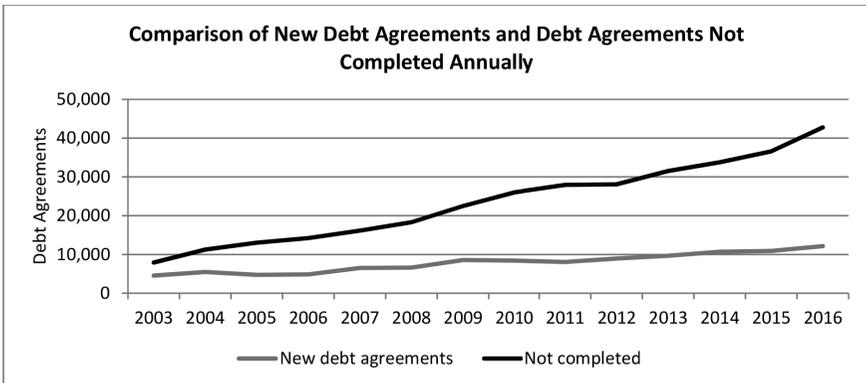


Figure 10

111 In 2003, there were 4550 new debt agreements created while 7915 debt agreements remained incomplete. In 2010, there were 8428 new debt agreements created while 26 014 debt agreements remained incomplete. In 2016, 6774 debt agreements were completed, however 42 756 remained incomplete.

## 8 Increasing Length of Agreements

This sharp increase in the proportion of incomplete agreements may be attributable to the increasing length of agreements proposed by administrators. In 2010, 10.5 per cent of proposed agreements were intended to run for three years. 31.2 per cent were scheduled to run for four years, while 53 per cent were scheduled to run for five years. Since this time, three-year agreements have steadily declined as a proportion of total agreements, while four and five-year agreements have become more common. In 2013, 6.9 per cent were three-year agreements, 17.1 per cent were four-year agreements and 72.3 per cent were five-year agreements. In 2016, only 3.4 per cent of agreements proposed were expected to complete within three years while 9.2 per cent were expected to complete within four years. The vast majority, 84.6 per cent, were expected to run for five years. Figure 11 shows the proposed length of debt agreements from 2009 to 2016.

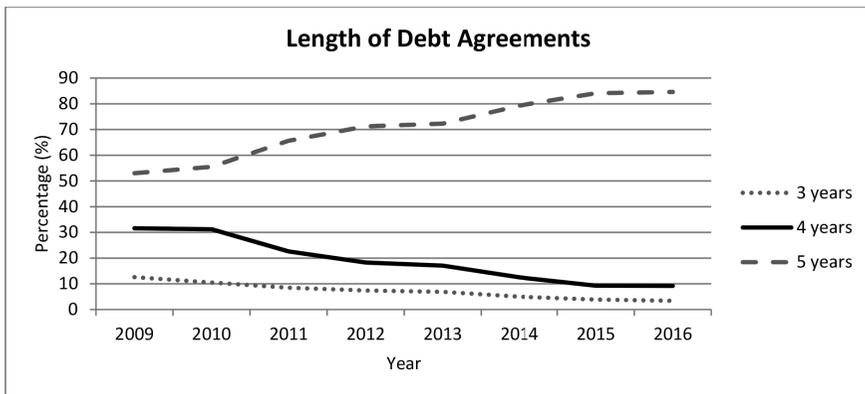


Figure 11

## B Socio-Economic Characteristics of Debtors

This section analyses the socio-economic characteristics of debt agreement debtors, drawing on AFSA's most recently published data.<sup>112</sup> It examines features such as the age, employment levels, income and occupation of debtors, their assets, unsecured debts and causes of personal insolvency, as well as their family circumstances and gender.

<sup>112</sup> Several previous studies have examined the socio-economic characteristics of debt agreement debtors. In 2004, Beal, Delpachitra, Mason and Troedson's study found that debt agreement debtors had several characteristics which indicated that they were better able to meet repayment obligations than bankrupts. These included findings that debt agreement debtors were, on the whole, younger, more likely to be employed and had more assets than debtors who declared bankruptcy: Beal et al, above n 85, 15. Similarly, in 2011, Ramsay and Sim found that debt agreement debtors were generally younger, had a higher rate of employment and higher incomes than debtors in bankruptcy, though they also observed that the majority of debtors in both categories had no realisable assets and low levels of property ownership: Ramsay and Sim, above n 40, 184–7.

## 1 Age

Figure 12 shows the total number of personal insolvencies compared with debt agreements and bankruptcies in 2016 according to the age of debtors.

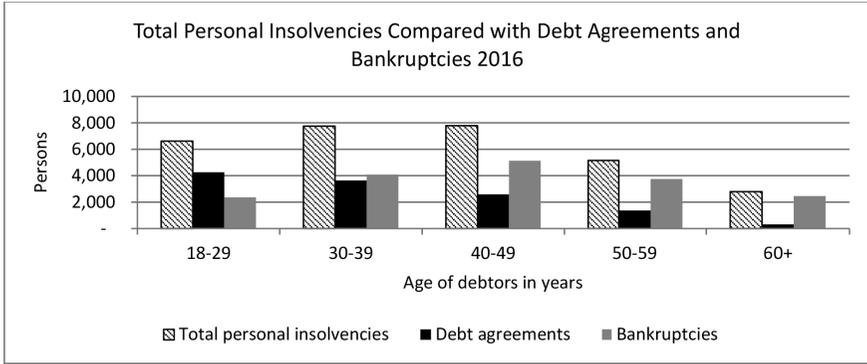


Figure 12

AFSA’s statistics confirm the popularity of debt agreements among younger debtors. Data from 2011 to 2016 consistently indicates that debtors aged 18 to 29 years were the highest users of debt agreements, comprising 29.7 to 35 per cent of debt agreement debtors each year. Debtors were more likely to enter into bankruptcy, rather than a debt agreement, as their age increased. While 57.2 to 64.9 per cent of debt agreement debtors were under the age of 40 years, bankrupt debtors were on the whole older than debt agreement debtors, with the most common age being 40 to 49 years. The average age of bankrupts has increased since 2003.<sup>113</sup>

## 2 Employment Rates, Income and Occupation

Statistics from 2005 to 2011 consistently indicate that over 90 per cent of debt agreement debtors are employed.<sup>114</sup> By contrast, employment levels for bankrupts remained between 51 and 56 per cent throughout this period.<sup>115</sup> Figure 13 indicates employment levels for debt agreement debtors and bankrupts biennially from 2003 to 2011.

113 ITSA, ‘Profiles of Debtors 2011’, above n 88, 7.

114 In 2011, 91 per cent of debt agreement debtors were employed. 92 per cent of debt agreement debtors were employed in 2009 and 2007. Nevertheless, employment levels for debt agreement debtors were slightly lower in 2005, at 86 per cent.

115 In 2011, 53 per cent of bankrupts were employed. 51 per cent of bankrupts were employed in 2009, 56 per cent in 2007 and 54 per cent in 2005.

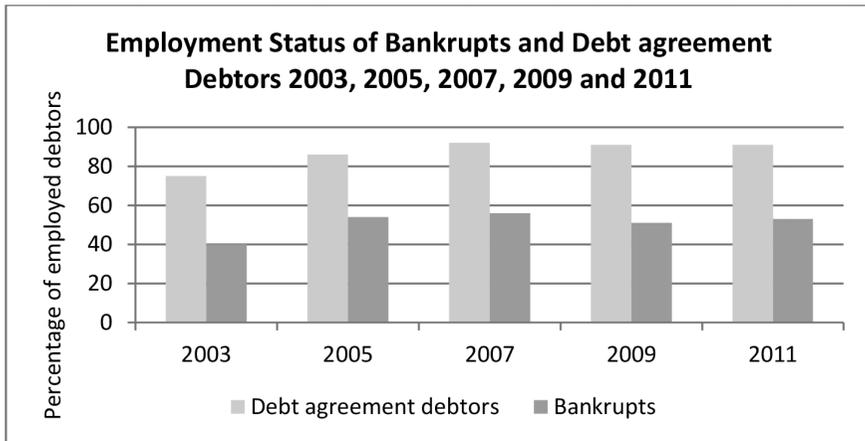


Figure 13

Figure 14 indicates the value of debt agreement debtors’ expected after-tax income for 2016. The majority of debt agreement debtors had expected after-tax incomes of \$30 000 to \$49 999 from 2011 to 2016, with 54 to 59 per cent of debtors falling within this income range. In 2016, 54 per cent of debt agreement debtors had expected incomes of \$30 000 to \$49 999. Twenty-six per cent cited after-tax incomes of \$50 000 to \$69 999, while another 13 per cent cited incomes in the \$10 000 to \$29 999 range. Notably, from 2011 to 2016 one to two per cent of debtors stated that their expected after-tax income was \$0 to \$9999, raising questions as to their capacity to meet payment obligations under their debt agreements.

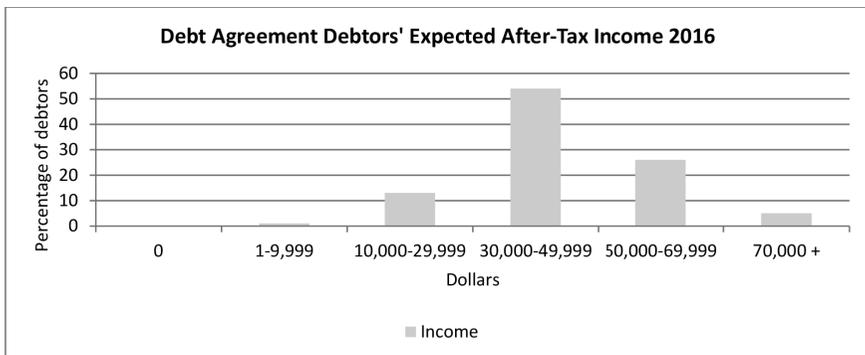


Figure 14

The information on income of debt agreement debtors in AFSA’s reports is not directly comparable with the information on bankrupts’ income, as there are differences in the requirements for the reporting of income between these groups. The Statement of Affairs for debt agreement debtors requires the disclosure of expected income for the year, while those declaring bankruptcy must disclose their income in the previous 12 months. Despite differences in the reporting of

data, the income levels of debt agreement debtors are clearly higher than the income levels of bankrupts. From 2011 to 2016, bankrupts most commonly had incomes of \$10 000 to \$29 999 in the previous 12 months, with 31 to 41 per cent of bankrupts within this category. 24 to 25 per cent of bankrupts had incomes of \$30 000 to \$49 990, and 12 to 16 per cent of bankrupts had incomes of less than \$10 000 in the previous 12 months.

Between 2011 and 2016, the most common occupation among debt agreement debtors was a clerical or administrative role, with technicians, trade workers, labourers and community or personal service workers also strongly represented.<sup>116</sup> In bankruptcy, the most common occupational group consisted of technicians and trade workers. The second highest occupational group was the miscellaneous category, 'other'. This category includes a wide variety of debtors such as students, retirees, pensioners, those performing home duties, unemployed people and others who did not fall within any specific occupational category. Labourers were the third most common occupational group among bankrupts.

### **3 Ownership of Assets**

The majority of debt agreement debtors owned realisable assets valued at less than \$5000 when their debt agreement commenced. From 2011 to 2016, 58 to 67 per cent of debt agreement debtors had realisable assets of less than \$5000. Of these debt agreement debtors, 13 to 18 per cent had realisable assets of less than \$1000. Eleven to 15 per cent of debt agreement debtors had realisable assets worth between \$5000 and \$9999, while six to eight per cent owned realisable assets worth between \$10 000 and \$19 999. Eight to 12 per cent of debt agreement debtors owned realisable assets worth between \$20 000 and \$49 999, and five to seven per cent had realisable assets worth between \$50 000 and \$99 999.

Patterns of asset ownership among bankrupts were more varied. Bankrupts commonly had realisable assets of less than \$1000, with 17 to 25 per cent of bankrupts falling within this category. Nevertheless, it was also fairly common for bankrupts to hold realisable assets of higher value. For instance, in 2016, 17 per cent of bankrupts had realisable assets worth \$20 000 to \$49 999, 12 per cent had realisable assets of \$50 000 to \$99 999 and 18 per cent had realisable assets of \$100 000 to \$499 999.

Twenty-five per cent of debt agreement debtors owned or were purchasing real estate at the time of entry into a debt agreement in 2011.<sup>117</sup> Real estate in this context includes a residential home or commercial property and may comprise houses, units or land, but excludes timeshares. In comparison, 16 per cent of bankrupts disclosed ownership of real estate or were purchasing real estate at the date of bankruptcy. Since 2003, there has been an increase in the ownership of real estate by bankrupts and debt agreement debtors. Ownership of real estate by

116 AFSA reports this data using the Australian and New Zealand Standard Classification of Occupations ('ANZSCO'), a system developed by the Australian Bureau of Statistics for the collection, publication and analysis of occupation statistics used across government agencies in Australia.

117 ITSA, 'Profiles of Debtors 2011', above n 88, 47.

debt agreement debtors has increased at a higher rate. In 2003, five per cent of bankrupts and five per cent of debt agreement debtors owned or were purchasing real estate. By 2009, 20 per cent of debt agreement debtors and 12 per cent of bankrupts disclosed ownership of real estate at the time of insolvency.<sup>118</sup>

#### 4 Gender

AFSA’s statistics consistently indicate that more men enter into debt agreements each year than women. Nevertheless, the difference is relatively slight. From 2003 to 2016, between 52 and 54 per cent of those who entered into debt agreements were male. This imbalance was more pronounced among bankrupt debtors. In 2016, 60.9 per cent of bankrupt debtors were male, while only 39.1 per cent were female.

#### 5 Value of Unsecured Liability

From 2011 to 2016, close to 40 per cent of debt agreement debtors had unsecured liability of \$20 000 to \$49 999. Nineteen to 25 per cent had unsecured liability of \$50 000 to \$99 999, while 13 to 14 per cent had unsecured debt of \$10 000 to \$19 999. One to two per cent had unsecured liability of \$5000 to \$9999. In comparison, bankrupts on the whole had debts of higher amounts, with 27 per cent having unsecured liability of \$100 000 to \$499 999 in 2016. Figure 15 shows the amounts of unsecured debts owed by debt agreement debtors to various creditors in 2016, in comparison with bankruptcy.

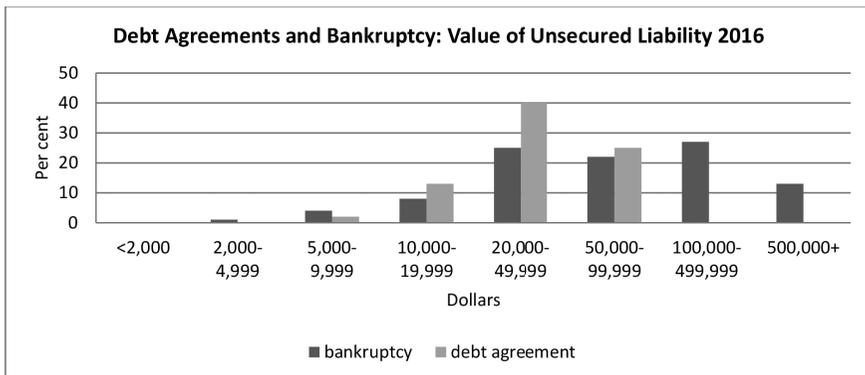


Figure 15

118 Ibid 25, 47.

## 6 Nominated Causes of Personal Insolvency

AFSA obtains data on the causes of personal insolvency from the Statement of Affairs lodged by each debtor. Overall, most debtors state that their personal insolvencies are not business-related.<sup>119</sup> In 2016, debt agreement debtors most commonly attributed their personal insolvencies to excessive use of credit.<sup>120</sup> The second most commonly cited cause was unemployment or loss of income, while the third was domestic discord, and the fourth was ill health.<sup>121</sup> By contrast, the most commonly cited cause of bankruptcy was unemployment or loss of income,<sup>122</sup> while excessive use of credit and domestic discord were the second and third most commonly cited causes of bankruptcy.<sup>123</sup>

## 7 Sources of Information

Debt agreement administrators are the primary source of information for most debt agreement debtors, as indicated by data gathered from the Statement of Affairs.<sup>124</sup> In 2016, debt agreement administrators were the primary source of information for 92 per cent of debtors who entered into debt agreements.<sup>125</sup> A similar trend is also evident in earlier years with 94 to 96 per cent of debtors relying on debt agreement administrators as their primary source of information prior to entry into debt agreements in 2013 to 2015. Figure 16 shows debt agreement debtors' primary sources of information.

119 In 2016, 93.5 per cent of personal insolvencies were not business-related. In a business-related bankruptcy, the debtor's insolvency is 'directly related to the debtor's proprietary interest in a business': ITSA, 'Profiles of Debtors 2011', above n 88, 7.

120 In 2014, 43.8 per cent of debt agreement debtors attributed their personal insolvency to excessive use of credit. AFSA observed in 2011 that '[t]he proportion of debtors nominating "excessive use of credit facilities" as the primary cause of non-business related insolvency has increased since 2003 and reached a record 45% of non-business related debt agreements in 2011': *ibid* 31.

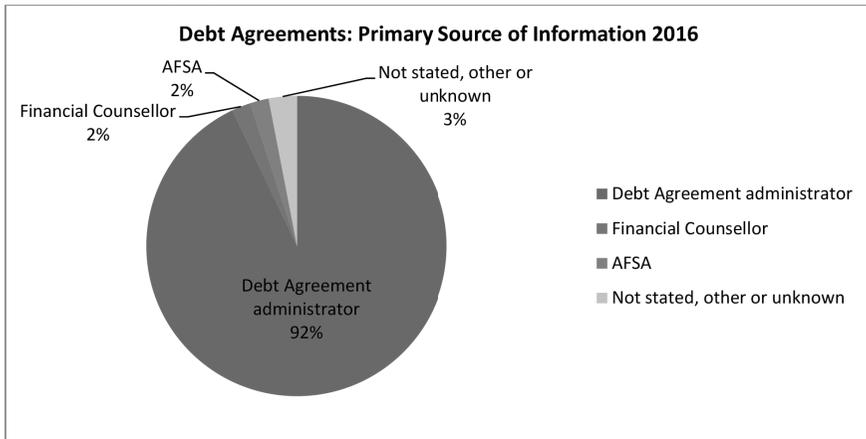
121 Unemployment or loss of income was nominated as the primary cause of insolvency for 34 per cent of debt agreement debtors in 2014, while 13.2 per cent attributed their insolvency to domestic discord. Eight per cent of debt agreement debtors indicated that ill health was the primary cause of insolvency.

122 This is consistent with previous statistics that highlight 'unemployment or loss of income' as the highest cause of non-business related bankruptcy since 2003: ITSA, 'Profiles of Debtors 2011', above n 88, 7. In 2014, 43.9 per cent of bankrupts indicated that unemployment or loss of income was the primary cause of bankruptcy.

123 Excessive use of credit was nominated as the primary cause of bankruptcy by 23.6 per cent of bankrupts in 2014. Bankruptcy was attributed to domestic discord by 15.3 per cent of bankrupts, while ill health was stated as the primary cause of bankruptcy for 11.7 per cent of persons in 2014.

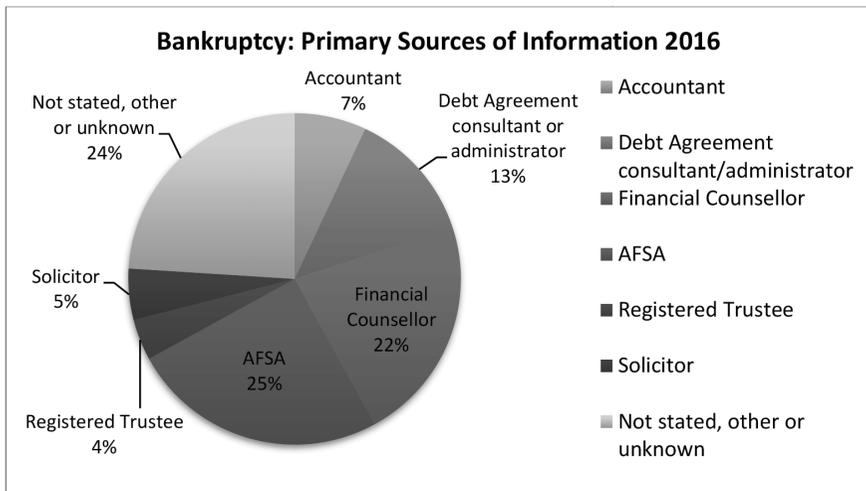
124 Although debtors may have had access to multiple sources of information, they are required to identify one source of information, being the primary source from which they obtained information regarding debt agreements.

125 Two per cent of those who entered into debt agreements cited financial counsellors, while two per cent cited AFSA as their primary source of information. Three per cent cited 'other' as their primary source of information.



**Figure 16**

By comparison, primary sources of information for bankrupts were more varied, as indicated in Figure 17. In 2016, 25 per cent of bankrupt debtors cited AFSA as their primary source of information. Financial counsellors were the primary source of information for 22 per cent of bankrupts, while other primary sources of information included professionals such as debt agreement administrators, accountants, solicitors or registered trustees.



**Figure 17**

**C Summary**

This analysis of AFSA data points to several important differences between the debt agreement system and the bankruptcy regime. Some of these differences appear to have changed little over time. The dividends received by creditors under

the debt agreement system are consistently far higher than the dividends received under bankruptcy administrations or personal insolvency agreements. At the same time, administrators' fees account for a relatively large proportion of the total funds collected from debt agreement debtors. The debtors who enter into debt agreements are demographically quite different from those who declare bankruptcy. Debt agreement debtors are younger, earn higher incomes and are more likely to own real estate than those who declare bankruptcy. Whereas men outnumber women in both bankruptcy and the debt agreement system, this imbalance is far less pronounced in the debt agreement system, with women representing almost 50 per cent of such debtors. Debt agreement debtors are more likely to cite the excessive use of credit as the cause of their financial problems, while bankrupt debtors are more likely to cite unemployment. Debt agreement debtors are also more likely to rely on a single source of information, namely, debt agreement administrators, for advice on how to deal with their financial problems, whereas bankrupt debtors obtain this information from a much wider range of sources.

In some respects, however, the debt agreement system has changed considerably in recent years. The number of new agreements formed each year has grown, while the rate of acceptance by creditors has also increased. Administrators' fees decreased as a proportion of total monies administered under debt agreements from 2003 to 2010. Nevertheless, they remain relatively high, making up at least 20 per cent of all monies received from debtors. Since 2010, they have once again begun to rise. The number of agreements that are terminated annually has remained steady, despite the substantial increase in the overall number of agreements. This means that terminated, or unsuccessful, agreements now constitute a far smaller proportion of total agreements in the system. At the same time, debt agreements are becoming longer, with the average length of new agreements increasing significantly in the last decade. As a consequence, there has been a significant increase in the proportion of agreements that remain on foot but incomplete.

## **V SURVEY OF DEBT AGREEMENT DEBTORS AND BANKRUPT DEBTORS**

This section outlines the results of the authors' survey of debt agreement debtors and bankrupt debtors.

### **A The Sample**

Reflecting the experiences of 233 debt agreement debtors, and 167 bankrupt debtors, the survey conducted by the authors cannot be viewed as representative of the overall population of Australian debt agreement debtors. Still, in many respects, the debt agreement debtors who responded to the survey were broadly comparable to the wider population of debtors, portrayed by AFSA's statistics. Consistent with AFSA's statistics, the debt agreement debtors were younger than those who had declared bankruptcy,<sup>126</sup> with most aged under 40.<sup>127</sup> They were

126 See also Part IV(B)(1) above.

127 See also Part IV(B)(1) above.

more likely to be in paid employment<sup>128</sup> and more likely to own real estate.<sup>129</sup> As in the wider population of debtors, women constituted a higher proportion of debt agreement debtors than bankrupt debtors.<sup>130</sup> Consistent with AFSA's statistics, the debt agreement debtors were less likely than bankrupt debtors to have contacted a financial counsellor for advice on their financial difficulties.<sup>131</sup>

Statistical analysis of the survey data showed that the debt agreement debtors were relatively socio-economically advantaged compared with the bankrupt debtors. When measured according to the Socio-Economic Indexes For Areas ('SEIFA'), developed by the Australian Bureau of Statistics, debt agreement debtors were consistently better off than the bankrupt debtors in the sample.<sup>132</sup> Debt agreement debtors had fewer debts at the time of their insolvency than the bankrupt debtors in the sample. They were less likely than bankrupt debtors to say that they owed money through credit cards,<sup>133</sup> car loans,<sup>134</sup> a personal loan or overdraft,<sup>135</sup> a hire purchase contract<sup>136</sup> or loans from family or friends.<sup>137</sup> They were also less likely to say that their debts included debts for utilities,<sup>138</sup> school fees,<sup>139</sup> rent arrears<sup>140</sup> or medical bills.<sup>141</sup> Debt agreement debtors were less likely to report that, at the time of their insolvency, their main source of income was

128 See also Part IV(B)(2) above.

129 See Part IV(B)(3) above. See also ITSA, 'Profiles of Debtors 2011', above n 88, 74.

130 See Part IV(B)(4) above.

131 15.5 per cent of debt agreement debtors said that they contacted a financial counsellor prior to their insolvency, compared with 26.3 per cent of bankrupt debtors. This difference was statistically significant at the 0.01 level. Henceforth, two asterisks (\*\*) indicate significance at the 0.01 level, while one asterisk (\*) indicates significance at the 0.05 level. See also Part IV(B)(7) above.

132 These indexes measure the relative advantage and disadvantage of each Australian postcode, drawing upon Census data. Respondents to the survey were allocated a SEIFA score based upon the postcode in which they lived. In each index, the lowest percentile is the most disadvantaged and the highest percentile is the most advantaged. When measured according to the SEIFA Index of Advantage and Disadvantage, debt agreement debtors were, on average, in the 49<sup>th</sup> percentile, while bankrupt debtors were in the 45<sup>th</sup> percentile. Measured according to the SEIFA Index of Disadvantage, debt agreement debtors were, on average, in the 49<sup>th</sup> percentile, while bankrupt debtors were in the 44<sup>th</sup> percentile. Measured according to the SEIFA Index of Education and Occupation, debt agreement debtors were, on average, in the 51<sup>st</sup> percentile, while bankrupt debtors were in the 46<sup>th</sup> percentile. Measured according to the SEIFA Index of Economic Resources, debt agreement debtors were, on average, in the 47<sup>th</sup> percentile, while bankrupt debtors were in the 42<sup>nd</sup> percentile.

133 46.4 per cent of debt agreement debtors reported credit card or store card debt, compared with 68.3 per cent of bankrupt debtors (\*\*).

134 21.9 per cent of debt agreement debtors reported car loan debt, compared with 28.7 per cent of bankrupt debtors (not statistically significant).

135 20.6 per cent of debt agreement debtors reported a personal loan or overdraft, compared with 39.5 per cent of bankrupt debtors (\*\*).

136 6.4 per cent of debt agreement debtors reported owing money under a hire purchase contract, compared with 16.8 per cent of bankrupt debtors (\*\*).

137 8.2 per cent of debt agreement debtors reported owing money to family or friends, compared with 14.4 per cent of bankrupt debtors (\*).

138 27.0 per cent of debt agreement debtors reported owing money for utilities, compared with 43.1 per cent of bankrupt debtors (\*\*).

139 7.7 per cent of debt agreement debtors reported owing money for school fees, compared with 11.4 per cent of bankrupt debtors (not statistically significant).

140 7.7 per cent of debt agreement debtors reported owing money for rent, compared with 15.6 per cent of bankrupt debtors (\*).

141 6.4 per cent of debt agreement debtors reported debt relating to medical expenses, compared with 13.2 per cent of bankrupt debtors (\*).

a Centrelink payment.<sup>142</sup> In other ways, they also appeared to be in less acute financial distress at the time of insolvency. Compared with bankrupt debtors, fewer debt agreement debtors reported experiencing harassment by creditors.<sup>143</sup> More reported that, at the time of their insolvency, they ‘had the capacity to raise \$2000 in an emergency’.<sup>144</sup> Debt agreement debtors also reported better overall wellbeing at the time of their insolvency than bankrupt debtors in the sample. Fewer reported experiencing physical illness,<sup>145</sup> mental illness<sup>146</sup> or difficulties in their relationships or family life,<sup>147</sup> at the time of their insolvency. Table 1 sets out key socio-economic characteristics of the debt agreement debtors and bankrupt debtors surveyed.<sup>148</sup>

**Table 1 Socio-Economic Characteristics of Debt Agreement Debtors and Bankrupts**

Socio-economic characteristics	Debt agreement debtors	Bankrupts
Average age (years)	41.8	46.1
Wages were the primary source of income (%)	53.6	34.1
Owned a home or investment property (%)	47.2	28.2
Owed money through credit or store cards (%)	46.4	68.3
Had a personal loan or overdraft (%)	20.6	39.5
Owed money for utilities (%)	27.0	43.1
Centrelink payment was main source of income at the time of insolvency (%)	24.0	33.5
Harassed by creditors (%)	55.9	72.4
Could raise \$2000 in an emergency (%)	26.9	17.4

142 24.0 per cent of debt agreement debtors reported that their main source of income at the time of their insolvency was a Centrelink payment, compared with 33.5 per cent of bankrupt debtors (\*).

143 55.9 per cent said that at the time of their insolvency, they were being harassed by creditors, compared with 72.4 per cent of bankrupt debtors (\*\*).

144 26.9 per cent said that they could have raised \$2000 in an emergency at the time of their insolvency, compared with only 17.4 per cent of bankrupt debtors (\*).

145 35.8 per cent said that at the time of their insolvency, they were suffering from physical health problems, compared with 49.1 per cent of bankrupt debtors (\*\*).

146 46.3 per cent said that they were suffering from mental health problems, compared with 57.7 per cent of bankrupt debtors (\*).

147 45.8 per cent said that they were ‘having problems in [their] relationships and family life’, compared with 54.0 per cent of bankrupt debtors, though this difference was not statistically significant.

148 The results of statistical tests are set out in the footnotes to the text in this Part.

In this context, it is notable that the debt agreement debtors were broadly similar to the bankrupt debtors with regard to the 'causes of their financial problems'.<sup>149</sup> Compared with bankrupt debtors, debt agreement debtors were less likely to attribute their problems to 'business losses or failure'.<sup>150</sup> They were also more likely to link their financial problems to 'high housing costs'.<sup>151</sup> In a slight deviation from AFSA's data, bankrupt debtors were more likely than debt agreement debtors to nominate 'excessive use of credit' as the primary cause of their financial problems.<sup>152</sup> In other respects, however, the two groups were strikingly similar. In both groups, 'loss of my job' was most frequently nominated as the leading cause of respondents' financial problems.<sup>153</sup> In both groups, physical illness, relationship breakdown and 'poor financial management' were more commonly nominated causes,<sup>154</sup> while mental illness, gambling, substance abuse and the 'cost of raising and supporting children' were less commonly chosen.<sup>155</sup> These results suggest that the primary difference between the two groups was not the underlying cause of their financial problems, but rather, the extent of their indebtedness.

## **B Reported Impact of Debt Agreements**

Debt agreement debtors generally reported some improvement in their lives after personal insolvency, but these were less marked than the improvements reported by bankrupt debtors. Debt agreement debtors were less likely than bankrupt debtors to report that they had been 'treated differently' or 'disapproved of' as a result of their insolvencies.<sup>156</sup> In other respects, however, they were more ambivalent. Debtors in both groups were asked about the impact of insolvency upon their physical health, mental health, relationships and family life, ability to manage finances, ability to meet day-to-day living expenses, career, access to

- 149 Respondents were invited to choose from the following list of causes: 'loss of my job', 'relationship breakdown', 'physical illness', 'mental illness', 'substance abuse', 'high housing costs', 'giving a personal guarantee on a loan', 'excessive use of credit', 'poor financial management', 'gambling', 'cost of raising or supporting children', 'being on a low income', 'high utilities costs (eg electricity, water)', 'business losses or failure' and 'other causes'. Respondents who selected 'other causes' were invited to supply further information. Respondents could select any number of causes from this list.
- 150 3.4 per cent of debt agreement debtors attributed their financial problems to 'business losses or failure', compared with 10.2 per cent of bankrupt debtors (\*\*).
- 151 6.9 per cent of debt agreement debtors attributed their financial problems to 'high housing costs', compared with 1.8 per cent of bankrupt debtors (\*).
- 152 9.0 per cent of debt agreement debtors attributed their financial problems to 'excessive use of credit', compared with 14.4 per cent of bankrupt debtors, however this difference was not statistically significant. See also Part IV(B)(6) above.
- 153 21.0 per cent of debt agreement debtors and 26.9 per cent of bankrupt debtors nominated 'loss of my job' as the primary cause of their financial problems. This difference was not statistically significant.
- 154 In both groups, each of these causes was nominated as the primary cause of financial problems by seven to 12 per cent of respondents. Differences between the groups were not statistically significant.
- 155 In both groups, each of these causes was nominated as the primary cause of financial problems by zero to five per cent of respondents. Differences between the groups were not statistically significant.
- 156 When asked if anyone had 'disapproved of' them or 'treated them' differently as a result of their insolvency, 93.1 per cent of debt agreement debtors answered, 'No', compared with 76.6 per cent of bankrupt debtors (\*\*).

credit and ‘general quality of life’. In all but two categories, between 40 and 60 per cent of debt agreement debtors reported an improvement.<sup>157</sup> Table 2 sets out some of the key impacts of personal insolvency, as reported by the debt agreement debtors and bankrupt debtors surveyed.

**Table 2 Reported Impact of Debt Agreements and Bankruptcy**

Reported impact	Debt agreements	Bankruptcy
Access to credit worse (%)	30.9	41.9
General quality of life worse (%)	20.6	10.2
Physical health better (%)	41.6	55.1
Mental health better (%)	45.5	64.1
Relationships and family life better (%)	43.8	58.1
Ability to manage finances better (%)	59.7	78.4
Ability to meet day-to-day living expenses better (%)	52.5	74.9
General quality of life better (%)	49.8	71.3
Careers better (%)	36.1	38.3

Like the bankrupt debtors in the sample, very few debt agreement debtors reported that these aspects of their lives had grown ‘worse’ after insolvency.<sup>158</sup> Yet compared with bankrupt debtors, debt agreement debtors were less emphatically positive.<sup>159</sup> In contrast to the marked improvements reported by bankrupt debtors, many debt agreement debtors reported that they simply ‘ha[d]n’t noticed any

157 The two exceptions were ‘access to credit’ and ‘career’. 27.0 per cent of debt agreement debtors reported an improvement in their access to credit, while 36.1 per cent reported an improvement in their careers.

158 There were few statistical differences between the two groups in this respect. In most categories, between 8 and 21 per cent indicated that the relevant aspects of their lives had grown ‘worse’. The exceptions were ‘access to credit’ and ‘general quality’ of life. 41.9 per cent of bankrupt debtors reported that their access to credit had grown worse, compared with 30.9 per cent of debt agreement debtors (\*). Conversely, 10.2 per cent of bankrupt debtors said that their ‘general quality of life’ had grown worse, compared with 20.6 per cent of debt agreement debtors (\*\*).

159 55.1 per cent of bankrupt debtors said that their physical health was ‘better’, compared with 41.6 per cent of debt agreement debtors (\*\*). 64.1 per cent of bankrupt debtors said that their mental health was ‘better’, compared with 45.5 per cent of debt agreement debtors (\*\*). 58.1 per cent of bankrupt debtors said that their relationships and family life were ‘better’, compared with 43.8 per cent of debt agreement debtors (\*\*). 78.4 per cent of bankrupt debtors said that their ability to manage their finances was ‘better’, compared with 59.7 per cent of debt agreement debtors (\*\*). 74.9 per cent of bankrupt debtors said that their ability to meet day-to-day living expenses was ‘better’, compared with 52.5 per cent of debt agreement debtors (\*\*). 71.3 per cent of bankrupt debtors said that their ‘general quality of life’ was ‘better’, compared with 49.8 per cent of debt agreement debtors (\*\*). The outcomes regarding career and access to credit were much less pronounced: 38.3 per cent of bankrupt debtors said that their careers were ‘better’, compared with 36.1 per cent of debt agreement debtors. 29.9 per cent of bankrupt debtors said that their access to credit was ‘better’, compared with 27.0 per cent of debt agreement debtors. These differences were not statistically significant.

change'.<sup>160</sup> These results might indicate that debt agreements are less effective than bankruptcy as a remedy for financial distress. Alternatively, they may reflect the fact that the debt agreement debtors were in less acute distress, prior to insolvency, and that they were therefore less likely to notice a pronounced improvement in their circumstances after insolvency.

### **C Extended Comments**

Most respondents who left extended comments at the end of the survey were positive about their experiences. Some stated that their debt agreements facilitated affordable and flexible payment arrangements, thus reducing their financial stress. One said, 'it has made my life easier because I was able to arrange an agreement of how much I can pay back per fortnight that would suit me', while another explained, 'while I was working I paid \$200.00 a month and ... agreed to pay \$40.00 a month if I was unemployed, was very happy with this result'. 'The company seem fairly flexible if I struggle to make my repayment on time', another commented. One referred to the benefits of having an intermediary to negotiate with creditors:

I think that a third party should always be involved as I know it was difficult for me going through the breakdown of a relationship, physical illness and a change in financial circumstances to clearly negotiate and understand the process of negotiating my debt agreements.

Another described relief at escaping the harassment of creditors: 'When I signed up they told me that the creditors and debt collectors could no longer harass me and I was so glad as the bullying from them was really stressing me out.' Some respondents indicated that signing a debt agreement had prevented the loss of their homes. One alluded to 'threats to take my home of 45 years because I am on a pension'. Another said, '[it] was a relief not having to worry about utilities and not being forced into bankruptcy for the bank resume [sic] of my house'. One respondent said, 'it is a life changing agreement, a relief on the burden on my shoulders and it is done legally'.

Even so, several respondents expressed dissatisfaction with the debt agreement system. One expressed concerns regarding 'hidden costs and surprises', saying that a debt agreement 'helped at the time but I would seriously look into it more thoroughly if I had to use a similar service again'. Another suggested that his or her debt agreement had involved unrealistic repayment obligations, stating that it 'ha[d] been very difficult to make the specified payments'. A number of respondents left comments indicating that they had signed a debt agreement without a clear understanding of the consequences. 'I assumed as I had paid it

160 The proportion of debt agreement debtors who responded that they 'ha[d]n't noticed any change' was as follows (with the proportion of bankrupt debtors choosing this response indicated in brackets): physical health — 39.9 (31.1) (not statistically significant); mental health — 35.6 (20.4) (\*\*); relationships and family life — 39.5 (30.5) (not statistically significant); ability to manage finances — 28.3 (13.2) (\*\*); ability to meet day to day living expenses — 30.5 (13.2) (\*\*); career — 44.2 (40.7) (not statistically significant); general quality of life — 29.6 (18.6) (\*).

all without any hitches it would be ok on my record', wrote one. 'I wasn't told at the time the repercussions of it being on my record.'<sup>161</sup> Another said that she had 'recommended the debt agreement to a few people', but '[t]he problem is that some banks think we were bankrupt but we weren't'. While several respondents compared debt agreements favourably with bankruptcy, none compared them with other debt management options, such as financial hardship schemes or assistance from financial counsellors. It is therefore unclear whether or not they were aware of these options.

## **VI INTERVIEWS WITH INDUSTRY STAKEHOLDERS**

This section outlines the results of the authors' interviews with several key industry stakeholders: a debt agreement administrator, a group of consumer solicitors and policy experts and a major creditor.

### **A A Debt Agreement Administrator**

The authors' interview with a debt agreement administrator broadly confirmed the findings of the debtor survey. Unsurprisingly, the administrator strongly believed that debt agreements offer real and unique benefits to many Australians in financial difficulty. The administrator stressed that bankruptcy is not a suitable option for all debtors. She pointed out that some people genuinely want to repay their debts, while many have assets they wish to protect, particularly real estate. She observed that for those who have the capacity to repay their debts, a debt agreement offers substantial benefits. For example, it will only be listed on the NPII for five years. This means that its long-term impact on access to credit is less severe than a bankruptcy, which is listed permanently. In most cases, a debt agreement does not affect a debtor's capacity to work in his or her profession and does not entail any restrictions on travel. Importantly, it does not involve the vesting of all assets in a trustee, meaning that debtors can retain ownership of their homes. The administrator pointed out that debt agreements also allow homeowners to remain with their existing mortgage providers, avoiding the higher fees and interest rates that usually accompany 'non-conforming' loans offered to people who have been bankrupt. The administrator pointed out that debtors' obligations under debt agreements are 'set in stone', meaning that, unlike bankrupt debtors, debt agreement debtors can retain windfall gains such as pay rises, redundancy payouts and inheritances. She also noted that debt agreements can be arranged relatively quickly, by telephone and email communication, without the need to meet in person. She stated that this is preferable for many debtors, who might find face-to-face meetings inconvenient or stressful. She said that, in her experience, debtors with assets to protect usually complete their agreements as they have a strong motive to do so.

161 Here and in subsequent quotations, some minor errors in grammar and punctuation have been silently corrected.

The administrator acknowledged that there are some problems with the existing debt agreement framework. She expressed concern that some administrators offer debt agreements to individuals who have no assets, low incomes, or only one debt, when in many such cases it might be possible to negotiate a debt waiver. She expressed the view that such practices are not ‘in the spirit’ of the system. She conceded that some administrators establish agreements that require debtors to repay more than 100 per cent of the debts they originally owed. The administrator believed that this practice should be prohibited by legislation. The administrator expressed concern at the increasing length of debt agreements, and the increasing prevalence of ‘stepped’ agreements, in which debtors are required to increase the size of their repayments over time. In both these respects, however, the administrator stated that the industry is simply responding to pressure from creditors, particularly debt purchasing companies. She maintained that for the most part, debt agreements offer significant benefits for people in financial distress.

## **B Consumer Advocates**

By contrast, consumer advocates expressed deep concern regarding many aspects of the debt agreement system.<sup>162</sup> In their interview with the authors, solicitors and policy workers from CALC maintained that debt agreements are often unsuitable to the needs of the people who sign them.<sup>163</sup> They pointed out that some debt agreements are manifestly unsustainable based on the incomes and future earning prospects of the debtors. They also maintained that a significant proportion of debtors are not in fact insolvent at the time they sign their debt agreements. They argued that for many debtors, other solutions such as debt waiver, hardship variations or EDR are far more appropriate than a debt agreement. In the case of debtors who are clearly insolvent, the advocates maintained that many would be better off declaring bankruptcy, particularly if they have no significant assets to protect.<sup>164</sup> They also maintained that many debtors enter into debt agreements on the basis of inaccurate or incomplete information, most commonly derived from administrators’ websites and internet advertising. They acknowledged that prior to creating an agreement, administrators are required to give debtors a ‘Prescribed Information’ notice, setting out the implications of a debt agreement

162 Interview with CALC (Melbourne, 12 October 2016); CALC, Submission to Commonwealth Treasury, above n 76, 5–6. See also FRLC, Submission to Commonwealth Treasury, above n 76; CCLS and EACH, above n 18; CALC, ‘Fresh Start or False Hope?’, above n 76.

163 See also CALC, Submission to Commonwealth Treasury, above n 76, 5–6. In an earlier study, the CCLS found in a survey that 85 per cent of debt agreements were unsuitable due to unaffordable payments, a lack of information regarding other options for managing debt, or high fees of which debtors were often not aware. The survey involved 145 debt agreements and 24 financial counsellors: CCLS and EACH, above n 18, 22.

164 See also CALC, Submission to Commonwealth Treasury, above n 76, 5. Advocates note that there are some debtors who may benefit from a debt agreement despite having no significant assets to protect. These include company directors and others whose employment would be compromised by bankruptcy: FRLC, Submission to Commonwealth Treasury, above n 76, 10.

and alternative options for dealing with unmanageable debt.<sup>165</sup> The information briefly canvasses options such as talking to creditors and personal insolvency agreements, and suggests sources of further information. However, the advocates regarded this notice as a highly ineffective means of advising debtors of suitable options for managing debt.<sup>166</sup>

The consumer advocates argued that the system must undergo sweeping change in order to protect the interests of debtors, particularly those on low incomes. They argued strongly for the introduction of minimum income and asset requirements as a pre-condition for entry into debt agreements.<sup>167</sup> They argued that administrators' fees must be more strictly regulated, maintaining that these fees are often excessive and serve to exacerbate debtors' financial distress.<sup>168</sup> They observed that some administrators charge a fee for presenting a debt agreement proposal to creditors, even when the proposal is not accepted or when the debtor elects not to proceed with the agreement.<sup>169</sup> Under the current framework, debt agreement debtors have very few options for redress if they are misled, deceived or provided with inadequate service by a debt agreement administrator.<sup>170</sup> While administrators are bound by the *ACL*, which prohibits misleading or deceptive conduct in trade or commerce,<sup>171</sup> they are not currently subject to an EDR scheme of any kind. In order to obtain a remedy under the *ACL*, a debtor must initiate legal action in the Federal Circuit Court.<sup>172</sup> Advocates pointed out that this complex, costly and time-consuming process is unlikely to be viable for most low-income, financially distressed debtors.

### C Credit Corp

As noted above, Credit Corp was party to more than half of all debt agreements in force in Australia in June 2015.<sup>173</sup> Credit Corp possesses a unique insight into the operation of Australia's debt agreement system due to its market share and the size of its database. The authors' interview with a Credit Corp senior executive drew upon data derived from this database. This data identified high administrator fees as a striking feature of the current system. Credit Corp's records revealed a number of proposals in which debtors offered to pay up to 196 per cent of the value of

165 The Prescribed Information notice is available from the AFSA website at <<https://www.afsa.gov.au/insolvency/how-we-can-help/forms/prescribed-information>>.

166 Interview with CALC (Melbourne, 4 May 2016).

167 See also CALC, Submission to Commonwealth Treasury, above n 76, 8; FRLC, Submission to Commonwealth Treasury, above n 76, 13.

168 See also CCLS and EACH, above n 18, 21.

169 See also CALC, Submission to Commonwealth Treasury, above n 76, 7.

170 For example, even if a debt agreement administrator engages in credit activities as part of their work, they are exempted from the requirement for those who engage in credit activities to hold a credit license: *National Consumer Credit Protection Regulations 2010* (Cth) reg 20(3)(j). This means that debt agreement administrators are not required to be a member of an EDR scheme.

171 *ACL* s 18.

172 *Competition and Consumer Act 2010* (Cth) s 138A.

173 Credit Corp, 'Insights', above n 94, 1; AFSA, *Annual Administration Statistics* <<https://www.afsa.gov.au/statistics/annual-administration-statistics>>.

their original debts over the life of the agreement. These payments represented a combination of repayments to creditors, AFSA's charges and administrators' fees. In some of these proposed agreements, administrators' total fees were equal to or greater than the debtors' initial debts.<sup>174</sup> The executive advised that Credit Corp's policy is to vote against debt agreement proposals where administrators' fees are manifestly excessive.<sup>175</sup> When confining its statistical analysis to agreements that were accepted, and either on foot or completed on 30 June 2015, Credit Corp calculated that 13 per cent of these agreements required debtors to pay more than 120 per cent of their original debts in the form of administrators' fees, AFSA's charges and payments to creditors.<sup>176</sup> Thirty-five per cent required debtors to pay more than 110 per cent of their debts.<sup>177</sup> Sixty-four per cent required debtors to pay more than 100 per cent of their original debts.<sup>178</sup>

The Credit Corp executive identified several other problems with the current debt agreement system, drawing on Credit Corp's database and anecdotal evidence. He pointed out that many debt agreements involve relatively few creditors. He observed that more than one in 10 proposals received by Credit Corp involve only one, two or three creditors.<sup>179</sup> A further 13 per cent involve four creditors. He suggested that in many such cases, it would be 'more efficient and appropriate for ... debtor[s] to seek to resolve the[ir] debt[s] through direct engagement with the creditor [or creditors]', through financial hardship schemes or EDR,<sup>180</sup> thus avoiding administrators' and AFSA's fees. The executive also observed that Credit Corp often receives debt agreement proposals from debtors who have not made any attempt to negotiate with their creditors, either to seek payment extensions or other variations through hardship schemes or EDR.<sup>181</sup> He noted that it is 'commonplace' to see supporting statements, prepared by administrators, in which debtors claim to have sought hardship assistance when this has 'never occurred'.<sup>182</sup> He asserted that debtors should be required to make meaningful attempts to negotiate with creditors, either through internal hardship schemes or mandatory EDR, prior to proposing a debt agreement.<sup>183</sup> He pointed out that, at

174 Credit Corp cites a proposal it received in which the debtor's original debts were \$4677, while the fees sought by the administrator would have amounted to \$5821, with AFSA charging a further \$494 to register the agreement. In another proposal, the debtor's original debts amounted to \$6520. Over the life of the agreement, the administrator sought fees of \$6067. Including AFSA's fee of \$377, the total monies payable by the debtor would have amounted to 196 per cent of the original debt. In another example, the debtor's original debt was \$8820. The administrator sought fees of \$6995, while AFSA would have charged \$851 in fees. The debtor would have paid 185 per cent of his or her original debt over the life of the agreement. This case involved only one creditor (presumably Credit Corp), excluding the debt administrator: Credit Corp, 'Insights', above n 94, 8.

175 Interview with Matt Angell, Chief Operating Officer, Credit Corp (Melbourne, 19 August 2016).

176 See Credit Corp, 'Insights', above n 94, 3.

177 *Ibid.* 1.

178 *Ibid.*

179 For the purposes of this discussion, administrators are not included as creditors, though Credit Corp advises that many do in fact list themselves as creditors and include their own fees in the debtor's total debts: *ibid.*

180 See *ibid.* 6.

181 See *ibid.* 7.

182 See *ibid.*

183 See *ibid.* 6.

present, creditors are ‘paying twice’. They bear the costs of operating hardship schemes and EDR, while also losing money when debtors’ funds are absorbed by administrators’ fees — funds that could otherwise be used to defray their debts.<sup>184</sup>

## VII ANALYSIS AND REFORM PROPOSALS

### A Benefits of Debt Agreements

This study reveals that the objectives underpinning the debt agreement system<sup>185</sup> have to some extent been achieved. AFSA’s data shows that a substantial number of debt agreements are completed successfully and that completion rates have been increasing over time. The authors’ survey offers further evidence that the system is, in some ways, succeeding. While based on a small sample, the survey suggests that debt agreements are being taken up by people who are generally in less severe financial distress than those who declare bankruptcy. They are less likely to be unemployed, less likely to be reliant on Centrelink benefits and less likely to be experiencing harassment from creditors. This suggests that, on the whole, the debt agreement system is serving its intended purpose by offering a ‘breathing space’<sup>186</sup> for people who have genuine prospects of repaying their debts, as distinct from those whose problems are irreparable. The authors’ survey and interview with a debt agreement administrator also indicate that debt agreements can confer benefits on debtors in this situation. These include flexible payment arrangements; the right to keep unexpected windfall gains, such as inheritances; the chance to retain significant assets, such as a home; and the ability to maintain existing home loans, thus avoiding the higher fees and interest rates typically offered to those who have been bankrupt.<sup>187</sup> The authors’ survey also illustrates other less tangible benefits associated with these agreements. Many respondents to the survey stated that entering into a debt agreement served to alleviate stress and helped them to negotiate with creditors.<sup>188</sup> The administrator maintained that debt agreements offer psychological benefits to those who have a strong desire to repay their debts. There is also evidence that debt agreements offer some benefits

184 See *ibid.* The executive also observed that, according to Credit Corp’s data, the likelihood of an agreement being terminated increases the longer an agreement is on foot. He pointed out that of all the agreements in Credit Corp’s database commencing or on foot in June 2014, 72 per cent were ‘paying’ or complete in June 2015, while 16 per cent were in arrears and 10 per cent had been terminated. By contrast, of all the agreements commenced or on foot in June 2012, only 68 per cent were still ‘paying’ or complete by June 2015, while five per cent were in arrears and a further 22 per cent had been terminated. The executive suggested that this phenomenon reflects the ‘declining economic incentive’ for administrators to ensure that debtors meet their payment obligations, as a debt agreement ‘ages’. Since administrators’ fees are calculated as a proportion of debtors’ outstanding debts, their fees reduce as debtors get closer to completing their agreements.

185 Commonwealth, *Parliamentary Debates*, House of Representatives, 26 June 1996, 2827 (Daryl Williams).

186 *Ibid* 2828 (Daryl Williams).

187 AFSA’s statistics show that 25 per cent of debt agreement debtors owned or were purchasing real estate at the time of entry into a debt agreement. See Part IV(B)(3) above.

188 See Part V(B) above.

to creditors. AFSA's statistics show that creditors receive much higher dividends through the debt agreement system than they do through the bankruptcy system.<sup>189</sup>

## **B Problems with Debt Agreements**

Despite the benefits described above, this study identifies a number of areas in which the debt agreement system requires reform. These are discussed below.

### **1 Unsuitable or Unsustainable Agreements**

The data examined in this article suggests that some debt agreements are being offered to debtors for whom they are unsuitable or unsustainable. Compared with bankruptcy, a debt agreement involves significantly higher costs to the debtor, over a longer period of time.<sup>190</sup> If debtors are unable to sustain the required payments and their debt agreements are terminated, bankruptcy may be the result. Such debtors will be left worse off financially than if they had opted for bankruptcy in the first place. Debtors who rely primarily on Centrelink benefits are among the clearest examples of people unsuited to debt agreements. Centrelink benefits are meant to provide a basic standard of living, and diverting a portion of income towards debt agreements is likely to cause significant hardship to any Centrelink recipient. In particular, people receiving a disability or aged pension are unlikely to increase their incomes over time, and may in many cases be better off declaring bankruptcy, or seeking other forms of debt relief, such as a financial hardship variation or debt waiver.<sup>191</sup> The consumer advocates interviewed in this study maintain that they have seen many instances of debt agreements being offered in these circumstances. Credit Corp also advises that it has seen debt agreements proposed in inappropriate contexts, for example when a debtor has only one creditor and that creditor may be willing to enter into an informal payment plan or hardship variation.

### **2 Misleading Marketing and Poorly Informed Debtors**

AFSA's statistics show that a very large proportion of debtors rely upon administrators for information about their debt agreements.<sup>192</sup> Research conducted by CALC indicates that much of the information provided by administrators to debtors tends to 'overstate the differences between [d]ebt [a]greements and bankruptcy, or understate the consequences of entering a [d]ebt [a]greement relative to bankruptcy'.<sup>193</sup> The authors' survey confirms that some debtors are unaware that signing a debt agreement constitutes an act of bankruptcy. It also

189 See Part IV(A)(4) above.

190 While bankruptcy entails a period of three years, the duration of debt agreements is often five or more years, as noted above: see Part IV(A)(8).

191 FRLC, Submission to Commonwealth Treasury, above n 76, 12.

192 See above Part IV(B)(7).

193 CALC, 'Fresh Start or False Hope?', above n 76, 3.

indicates that some debtors are poorly informed regarding other, cheaper options for dealing with debt, such as financial hardship schemes and EDR. The authors' interviews with consumer advocates and Credit Corp reinforce this finding, confirming that many make no attempt to contact their creditors to negotiate variations to their payment obligations prior to proposing a debt agreement. Given that such arrangements are usually far cheaper and more flexible than debt agreements, this suggests there is scope to improve the information provided to debtors prior to their entering the system.

### **3 Excessive and Unwarranted Fees**

This study indicates that some debt agreement administrators are currently charging excessive or unwarranted fees for their services. AFSA statistics indicate that in 2014, administrators' fees comprised 22.4 per cent of the monies administered under debt agreements.<sup>194</sup> Credit Corp data shows that a large proportion of debt agreement debtors agree to pay more than the full amount of their unsecured debt, while some proposals dedicate up to half of all debtors' payments to fees, rather than to the repayment of creditors.<sup>195</sup> Consumer advocates also maintain that high administrator fees are a source of significant detriment, particularly for low-income debtors who are at the greatest risk of failing to complete their agreements and who would, in many cases, be better off declaring bankruptcy.<sup>196</sup> If a debt agreement is terminated prior to completion, the debtor's fees cannot be recovered, but the debts to creditors remain. These debtors are in a worse position than they would have been had they simply made their payments directly to creditors. Similarly, if debt agreement proposals are rejected by creditors, debtors are considerably worse off than before, having incurred additional debt in the form of administrators' fees and committed an act of bankruptcy.<sup>197</sup> AFSA's statistics suggest that approximately 15 to 23 per cent of debt agreement proposals have failed annually over the past five years.<sup>198</sup> There appear to be no regulatory safeguards to deter administrators from charging fees to draft agreements that have little chance of succeeding.<sup>199</sup>

### **4 Lack of Redress for Debtors**

Debt agreement debtors have very few practical remedies against debt administrators, even when administrators clearly breach their legal obligations

194 AFSA, 'Annual Report 2013–2014', above n 41, 76.

195 Credit Corp, 'Insights', above n 94, 1.

196 FRLC, Submission to Commonwealth Treasury, above n 76, 12.

197 See above Part II(B)(2).

198 Statistics on the proportion of debt agreement proposals accepted by creditors are shown in Part IV(A)(2) Figure 5 above.

199 The Personal Insolvency Professionals Association's Code of Professional Practice for Members states broadly that debt agreement practitioners are fiduciaries and that '[m]embers must exhibit the highest levels of integrity, objectivity and impartiality in all aspects of administrations and practice management': see Personal Insolvency Professionals Association, 'Code of Professional Practice for Members' (1 July 2014).

under the *Bankruptcy Act* or the *ACL*. As the consumer advocates noted, debtors who cannot resolve such problems through negotiation currently have little alternative but to issue proceedings in the Federal Circuit Court. This complex, time-consuming and expensive process is likely to be impracticable for most debtors. EDR schemes are more accessible than the court system, since they are usually free for consumers and do not involve legalistic processes or terminology.<sup>200</sup> In many cases, they facilitate resolution of disputes much more quickly than litigation,<sup>201</sup> something that is often critically important to debtors in immediate financial distress. Having no access to such a scheme, debt agreement debtors are at a significant disadvantage when compared with consumers of other products and services, such as insurance, banking and finance, energy, water and telecommunications.<sup>202</sup>

### **C Proposed Measures to Strengthen the Debt Agreement System**

This study suggests that debt agreements pose significant risks to some debtors, particularly those on low incomes. This section considers a range of measures, many of which have the support of consumer advocates. If implemented, it is likely that these measures would protect the interests of debtors and improve the efficiency of the debt agreement system.

#### **1 Stricter Eligibility Requirements**

Stricter eligibility rules would better target the debt agreement system towards those who can afford to repay their debts, while reducing the potential harm that debt agreements pose to low-income and vulnerable debtors.<sup>203</sup> In practical terms, many low-income debtors have little or nothing to lose from bankruptcy, since they have no assets to protect and would not be required to make contributions to their creditors if they were to go bankrupt. In many cases, such debtors are incapable of fulfilling their obligations under a debt agreement, meaning that

200 Care Inc Financial Counselling Service and the Consumer Law Centre of the ACT et al, Submission to Commonwealth Treasury, *Review of the Financial System Dispute Resolution Framework*, 10 October 2016, 2.

201 Ibid.

202 All of these industries are subject to the jurisdiction of EDR schemes, such as the Financial Ombudsman Service ('FOS'), the Credit and Investments Ombudsman ('CIO'), the Energy and Water Ombudsman Victoria and the Telecommunications Industry Ombudsman. From 1 November 2018, the FOS, CIO and the Superannuation Complaints Tribunal ('SCT') will be replaced by the Australian Financial Complaints Authority (AFCA): *Treasury Laws Amendment (Putting Consumers First — Establishment of the Australian Financial Complaints Authority) Act 2018* (Cth). The establishment of the AFCA is a response to Commonwealth Treasury, 'Review of the Financial System External Dispute Resolution and Complaints Framework' (Final Report, 3 April 2017).

203 CALC, Submission to Commonwealth Treasury, above n 76, 6; FCA, Submission to Commonwealth Attorney-General's Department, above n 76; FRLC, Submission to Commonwealth Treasury, above n 76, 13. FRLC proposes that Part IX of the *Bankruptcy Act* should be repealed or at least subject to a comprehensive review to address the high incidence of inappropriate debt agreements. They emphasise the need for debtors to have a material divisible asset as a condition for entry into debt agreements.

they will eventually become bankrupt in any event. It is arguable that for such debtors debt agreements only serve to aggravate and prolong financial stress. A legislated *minimum* income threshold would protect low-income debtors from entering into agreements that offer them little or no benefit. Consumer advocates suggest that debtors should be presumed ineligible for debt agreements if their incomes would be entirely protected in bankruptcy — that is, that they could not be legally required to make contributions to their creditors if they were to go bankrupt.<sup>204</sup> The current minimum income threshold for payments to creditors is \$57 239.00, net of tax, for a bankrupt debtor with no dependants.<sup>205</sup> If this became a minimum income threshold for all debtors entering the debt agreement system, it would disqualify most of those who currently access the system.<sup>206</sup>

While it may be impracticable to exclude such a large proportion of debtors from the system, there are strong grounds for establishing a minimum income threshold of some kind, in order to protect low-income debtors from financial harm. The minimum wage might serve as an appropriate threshold, though this threshold may need to be varied according to the number and nature of the debtor's dependants.<sup>207</sup> Minimum wages are formulated with the 'living standards and the needs of the low paid'<sup>208</sup> in mind and are intended to guarantee a modest but adequate standard of living. This would have the effect of disqualifying most individuals who are reliant upon Commonwealth benefits from the debt agreement system. Alternatively, debtors could be presumed ineligible for a debt agreement if they do not have any realisable assets that would be lost in bankruptcy. In either case, the presumption of ineligibility could be open to rebuttal where a debt agreement would confer demonstrable benefits upon the debtor. For example, a debtor without relevant assets could still be considered eligible for a debt agreement if his or her employment would be adversely affected by bankruptcy. Similarly, some debtors on low incomes, such as age pensioners, could still be considered suitable candidates for a debt agreement if they had significant assets to protect, such as a family home.

## 2 A Suitability Statement

As noted above, AFSA currently accepts around 98 per cent of the proposals submitted to it by administrators.<sup>209</sup> Though AFSA is required to reject a proposal

204 CALC, Submission to Commonwealth Treasury, above n 76, 8.

205 AFSA, *Indexed Amounts* (20 September 2018) <<https://www.afsa.gov.au/insolvency/how-we-can-help/indexed-amounts-0>>.

206 AFSA's statistics discussed in Part IV(B)(2) above indicate that 68 per cent of debt agreement debtors who entered into debt agreements in 2016 earned less than \$50 000. See Figure 14.

207 On 1 July 2018 the Australian minimum wage was \$37 398.40 per annum. This is based on the minimum wage of \$719.20 per 38-hour week before tax. The minimum wage is reviewed annually by the Fair Work Commission: Fair Work Ombudsman, *Minimum Wages* (July 2018) <<https://www.fairwork.gov.au/how-we-will-help/templates-and-guides/fact-sheets/minimum-workplace-entitlements/minimum-wages>>.

208 *Fair Work Act 2009* (Cth) s 284(1)(c).

209 See AFSA, *Life Cycle of Debt Agreements* (30 June 2015) <<https://www.afsa.gov.au/statistics/life-cycle-debt-agreements>>. See also Part IV(A)(2) above.

that is not in the creditors' best interests,<sup>210</sup> this high acceptance rate suggests that there is relatively little scrutiny of the merits of individual agreements, either for creditors or debtors. As a safeguard for vulnerable debtors, administrators could be required to submit a statement with each debt agreement proposal certifying that a debt agreement is a suitable option for the debtor in light of his or her specific circumstances. In the statement, the administrator could be required to explain why other options, such as bankruptcy or a hardship variation, are not suitable. Such a statement would assist AFSA in determining whether or not to accept a proposal for processing. This reform has the widespread support of consumer advocates.<sup>211</sup> FCA proposes that such a statement of suitability should specify all the debt management options that have been considered and discussed with the debtor.<sup>212</sup> FCA also proposes that the *Bankruptcy Act* should be amended to provide that it is a breach of an administrator's duties to state that a debt agreement is a suitable option, where a reasonable person would consider a debt agreement to be clearly unsuitable.<sup>213</sup> Consumer advocates argue that debtors should be entitled to release from their debt agreements, and to compensation, if it can be shown that the statement of suitability lodged by the administrator contained incorrect information.<sup>214</sup> Based on the results of this study, particularly the authors' interview with Credit Corp, it seems likely that this reform would benefit creditors as well as debtors.

### 3 A Key Fact Sheet

As noted above, debtors are currently provided with a Prescribed Information notice prior to proposing a debt agreement.<sup>215</sup> Nevertheless, consumer advocates argue that this Prescribed Information notice is ineffective as a form of consumer protection. An examination of the Prescribed Information notice suggests that these claims have some force. Studies indicate that disclosure documents using plain, everyday language, and presenting information in a readable format, are most effective in facilitating debtors' understanding of risks.<sup>216</sup> Technical terms have a tendency to undermine rather than promote risk awareness, while visually

210 *Bankruptcy Act* s 185E(3).

211 In its 2012 Proposals Paper, the Commonwealth Attorney-General's Department suggested this as a potential reform: Commonwealth Attorney-General's Department, Proposals Paper, above n 28, 4–5. See also CALC, Submission to Commonwealth Attorney-General's Department, *Review of Debt Agreements under the Bankruptcy Act 1966*, 16 November 2012; FCA, Submission to Commonwealth Attorney-General's Department, above n 76.

212 FCA, Submission to Commonwealth Attorney-General's Department, above n 76, 3–4.

213 *Ibid.*

214 *Ibid* 4; CALC, Submission to Commonwealth Attorney-General's Department, above n 211, 3. CALC also proposes that a copy of the statement should be given to the debtor.

215 AFSA, 'When a Debt Agreement Proposal is Acceptable for Sending to Creditors for Their Vote' (Official Receiver Practice Statement No 12, 9 February 2017) 4. The prescribed information sheet is available at AFSA, *Prescribed Information* <[https://www.afsa.gov.au/sites/g/files/net1601/f/forms/prescribed\\_information.pdf](https://www.afsa.gov.au/sites/g/files/net1601/f/forms/prescribed_information.pdf)>.

216 See Andrew Godwin, 'The Lehman Minibonds Crisis in Hong Kong: Lessons for Plain Language Risk Disclosure' (2009) 32 *UNSW Law Journal* 547; Andrew Godwin and Ian Ramsay, 'Short-Form Disclosure Documents: An Empirical Survey of Six Jurisdictions' (2016) 11 *Capital Markets Law Journal* 296.

cluttered documents with dense, small text are harder to read and understand.<sup>217</sup> The Prescribed Information notice is printed in a small font, without clear headings that identify the sections relevant to debt agreement debtors. Large portions of the document are inapplicable to debt agreement debtors, diverting attention from the relevant sections. More than half the document describes the consequences of bankruptcy, while the section on debt agreements comprises only a few paragraphs. The notice uses technical terms and presumes a great deal of legal and financial knowledge. For example, it explains that a debt agreement will be recorded on the NPII, but does not explain the implications of this. This section of the document refers readers to a subsequent paragraph on the ability to obtain credit, located further down the page. However, this latter paragraph is part of a separate section on the consequences of bankruptcy and makes no explicit reference to debt agreements. Importantly, the Prescribed Information notice does not clearly state that proposing a debt agreement is, of itself, an act of bankruptcy. The vast majority of debtors who enter debt agreements are financially stressed and are likely to find this document difficult to navigate and comprehend.<sup>218</sup>

To improve debtors' understanding of the legal and financial consequences of a debt agreement, administrators could be required to give all debtors a simplified, well formatted Key Fact Sheet prior to lodging a debt agreement proposal.<sup>219</sup> This document would set out the most important risks and adverse consequences of debt agreements, and would not include irrelevant information about bankruptcy.<sup>220</sup> FCA proposes that a Key Fact Sheet should set out the length of the debt agreement, the amount to be repaid, details of fees paid to the debt agreement administrator and the consequences of default.<sup>221</sup> The adverse consequences of debt agreements, and their practical implications, should be clearly brought to the debtors' attention. The Key Fact Sheet should inform debtors that proposing a debt agreement is an act of bankruptcy, that the record of the debt agreement will remain on the NPII and credit agencies' listings for five years or longer, and that it may result in debtors having difficulty obtaining loans, credit cards, utilities and rental accommodation.<sup>222</sup> Likewise, it should advise debtors of the restrictions imposed upon debt agreement debtors by the *Bankruptcy Act*,<sup>223</sup> including the requirement that they disclose the debt agreement if they incur debts of more

217 Godwin and Ramsay, above n 216, 302; Godwin, above n 216, 558–9.

218 CALC, Submission to AFSA, *Draft Revision of Inspector-General Practice Guideline 1: Debt Agreement Administrators' Guidelines Relating to Advertising*, 31 January 2014, 2.

219 FCA, Submission to Commonwealth Attorney-General's Department, above n 76, 2.

220 The Australian Securities and Investments Commission's ('ASIC') Regulatory Guide emphasises the importance of considering the needs of consumers in preparing disclosure documents: see ASIC, 'Disclosure: Product Disclosure Statements (and Other Disclosure Obligations)' (Regulatory Guide No 168, October 2011) 25.

221 FCA, Submission to Commonwealth Attorney-General's Department, above n 76, 2.

222 See Paul Ali, Lucinda O'Brien and Ian Ramsay, 'A Quick Fix? Credit Repair in Australia' (2015) 43 *Australian Business Law Review* 179, 179; Tenants Union of Victoria, *Applying for a Private Rental Property* (September 2011) <[https://www.tuv.org.au/articles/files/resources/AL\\_applying\\_for\\_private\\_rental.pdf](https://www.tuv.org.au/articles/files/resources/AL_applying_for_private_rental.pdf)>.

223 CALC, FRLC and FCA, Submission to AFSA, *Revised Inspector-General Practice Guideline 1*, 21 August 2015, 5.

than \$5726 or obtain goods and services on credit above that limit.<sup>224</sup> Debtors should be informed that if they have a business, they must also disclose the debt agreement to all people dealing with the business. In addition, the Key Fact Sheet should include information about other options for dealing with debt, such as financial hardship variations, and advise debtors of the availability of free financial counselling services.<sup>225</sup>

#### **4 Greater Transparency Regarding Fees**

This study highlights the need for debt agreement administrators' fees to be more transparent and more strictly regulated. As a first step, it would be helpful if AFSA could gather and publish data regarding debt agreement administrators' fees.<sup>226</sup> Comprehensive, publicly available information about administrators' fees would afford some protection to debtors by enabling them to make a realistic assessment of the benefits and costs of a debt agreement, compared with other solutions for managing debt. It would also promote competition in the sector by enabling debtors to compare the fees of different administrators prior to entering into an agreement.<sup>227</sup> This study also illustrates the need for legislative reform in relation to administrators' fees. It indicates that debtors are exposed to high up-front fees whether or not their proposals are ultimately accepted by creditors. It also shows that many debtors are being charged excessive fees, sometimes equalling their original debts. To protect debtors from excessive fees, the *Bankruptcy Act* could be reformed to provide that administrators' fees cannot exceed a certain proportion of debtors' original debts. The Act could also be amended to provide that administrators' fees only become payable after a debtor's proposal is accepted by creditors. This would create a strong incentive for administrators to conduct a rigorous assessment of debtors' capacity to repay their debts before lodging a debt agreement proposal on their behalf.

#### **5 External Dispute Resolution and Remedies for Debtors**

The availability of free and independent dispute resolution mechanisms is important for vulnerable and financially stressed debtors and critical to the enforcement of consumer protection laws such as the *ACL*. Debt agreement administrators should be required by the *Bankruptcy Act* to establish clear and consistent internal dispute resolution processes and ensure that all debtors are aware of these proposals.<sup>228</sup> All administrators should also be required to join an EDR scheme approved by ASIC in line with the requirements imposed upon

224 The credit limit is an indexed amount which is updated quarterly: see *Bankruptcy Act* ss 269, 304A. The credit limit stated above is from AFSA's latest release of indexed amounts: AFSA, *Indexed Amounts* (20 September 2018) <<https://www.afsa.gov.au/insolvency/how-we-can-help/indexed-amounts-0>>.

225 Interview with CALC (Melbourne, 12 October 2016).

226 See Proposal 9 in Commonwealth Attorney-General's Department, *Proposals Paper*, above n 28, 8.

227 FCA, *Submission to Commonwealth Attorney-General's Department*, above n 76, 6; CALC, *Submission to Commonwealth Attorney-General's Department*, above n 211, 6.

228 See FOS, 'Operational Guidelines to the Terms of Reference' (1 January 2018).

providers of financial services and consumer credit.<sup>229</sup> Remedies administered by the EDR scheme should facilitate debtors being restored to their position prior to entering the debt agreement.<sup>230</sup> These include rescission of debt agreements, the refunding of fees, the removal of debt agreements from the NPII, annulment of bankruptcies and, where appropriate, financial compensation.<sup>231</sup>

## 6 Further Enhancement of Financial Hardship Schemes

The objectives of the financial hardship provisions of the *National Credit Code Protection Act 2009* (Cth) sch 1 ('NCC') are similar to those of the debt agreement system. Both seek to facilitate repayment arrangements with creditors in order to provide debtors respite from financial stress.<sup>232</sup> The financial hardship provisions of the NCC give consumers a statutory right to seek a variation of their credit contracts on grounds of financial hardship.<sup>233</sup> Similar rights are available in relation to essential utilities under state regulations.<sup>234</sup> As with debt agreements, a hardship request provides debtors with temporary respite from enforcement action as credit providers are precluded from bringing enforcement proceedings until notice requirements are met.<sup>235</sup> Credit providers may refuse to vary contracts, for example when they do not believe that there are reasonable grounds for the debtor's inability to pay.<sup>236</sup> Still, debtors may challenge such a refusal through EDR.<sup>237</sup> These financial hardship schemes are designed to be the first recourse for debtors in financial stress. By resolving their financial problems by these means, debtors have an opportunity to avoid the higher costs and long-term consequences of a debt agreement. As noted above, Credit Corp believes that the majority of debt agreements require debtors to pay more than 100 per cent of their debts when AFSA's fees and administrator fees are taken into account.<sup>238</sup> Moreover, as noted above, creditors receive on average approximately 63 cents per dollar under debt agreements, while 35 to 40 per cent of debtors' payments accrue as fees

229 *Corporations Act 2001* (Cth) s 912A; *National Consumer Credit Protection Act 2009* (Cth) s 47. The most appropriate scheme would be the new AFCA: see above n 202.

230 Interview with CALC (Melbourne, 12 October 2016).

231 It is proposed that the *Bankruptcy Act* be amended to facilitate the provision of these remedies.

232 The Explanatory Memorandum to the National Consumer Credit Protection Bill 2009 (Cth) cites illness or unemployment as examples of situations in which variation of the terms of credit contracts were intended to provide consumers relief: at 242.

233 NCC s 72.

234 Paul Ali, Evgenia Bourova and Ian Ramsay, 'Responding to Consumers' Financial Hardship: An Evaluation of the Legal Frameworks and Company Policies' (2015) 23 *Competition and Consumer Law Journal* 29, 34–41.

235 NCC s 89A.

236 *Ibid* s 72(3).

237 Voluntary codes of practice in some industries such as banking, finance and insurance impose specific requirements on credit providers to assist customers in financial hardship: Ali, Bourova and Ramsay, 'Responding to Consumers' Financial Hardship', above n 234, 34–6.

238 Credit Corp was a creditor party to 53 per cent of debt agreements in force in Australia as at 30 June 2015. 64.6 per cent of debt agreements required debtors to pay more than 100 per cent of amounts owed, while 35.4 per cent of debt agreements required payment of over 110 per cent of amounts owed: Credit Corp, 'Insights', above n 94, 1.

to debt agreement administrators and AFSA.<sup>239</sup> By contrast, under a repayment arrangement negotiated through a hardship scheme, all payments flow directly to creditors, reducing the debtor's liabilities. In this respect, compared with debt agreements, financial hardship variations can provide better outcomes for both creditors and debtors. Yet despite this, the present study indicates that many debtors enter into debt agreements without fully exploring their options under the relevant financial hardship schemes.<sup>240</sup>

It is likely that both debtors and creditors would benefit if more debtors sought to negotiate directly with their creditors through hardship schemes prior to proposing a debt agreement. There is currently a lack of available information on the extent to which debtors seek hardship variations before proposing debt agreements. In view of the significant benefits of financial hardship provisions, it is important to gather data on debtors' attempts to negotiate hardship variations. One method of obtaining such information is for AFSA to systematically collect details from debtors who propose debt agreements as to whether they have attempted to negotiate hardship variations with creditors and to obtain details of such negotiations.

At the same time, it is important to note that financial hardship arrangements do not, at present, offer viable solutions for a significant group of debtors. Many creditors are willing to allow payment by instalments or short-term extensions of time for payment, but are unwilling to reduce debts on grounds of hardship.<sup>241</sup> Consequently, financial hardship arrangements are best suited to debtors facing short-term financial difficulties. Debtors facing long-term financial hardship are often unable to afford the payment plans offered under financial hardship provisions.<sup>242</sup> Recent research highlights other challenges faced by debtors in obtaining hardship arrangements. These include unsympathetic attitudes among staff who lack understanding of the difficulties encountered by debtors living in financial hardship.<sup>243</sup> Debtors who attempt to navigate financial hardship schemes themselves often obtain poorer outcomes than those who are assisted by professional advocates, such as financial counsellors.<sup>244</sup> In order for financial hardship schemes to be a viable alternative for a broader group of debtors, creditors need to offer more affordable payment plans and work to make these schemes more accessible and navigable for all debtors, whether or not they have access to advocates' assistance.

239 Data from Credit Corp indicates that upfront and ongoing fees to debt agreement administrators commonly amount to 30 to 33 per cent, while AFSA's fees comprise 7 per cent, of payments under debt agreements: *ibid* 5–6.

240 CALC, Submission to Commonwealth Treasury, above n 76, 6; *ibid* 6.

241 For instance, Ali, Bourova and Ramsay indicate that extensions of time for payment in relation to water and energy tend to be short, with some creditors limiting extensions to periods of one to four weeks: see Paul Ali, Evgenia Bourova and Ian Ramsay, 'Financial Hardship Assistance Behind the Scenes: Insights from Financial Counsellors' (2017) 52 *Australian Journal of Social Issues* 241, 248–9.

242 *Ibid* 6.

243 *Ibid* 38.

244 *Ibid* 33.

## VIII CONCLUSION

This evaluation of the debt agreement system finds that in its first 20 years of operation, the debt agreement system has, to some extent, achieved its aims. It indicates that debt agreements offer tangible benefits to some debtors, particularly those who have assets to protect, such as a home. Nevertheless, this study also finds that the debt agreement system has deviated from its initial objectives, in so far as it is now dominated by private, for-profit debt agreement administrators charging substantial fees. Many debtors now pay more than 100 per cent of their total debts under the terms of their agreement when AFSA's charges and administrators' fees are taken into account. At present, more than 20 per cent of total funds administered are retained by administrators as fees. These fees have the potential to cause significant detriment to some debtors, particularly those on low incomes and those who are unable to complete their agreements due to changes in their circumstances. This study finds that many such debtors will be left worse off after using the debt agreement system than they would have been if they had simply made their payments directly to creditors under a repayment arrangement. Importantly, this study indicates that some of these debtors may not be aware of less costly avenues for negotiating such arrangements, for example, those offered by financial hardship schemes and EDR.

The study concludes that several reforms are required in order to ensure that the debt agreement system provides adequate safeguards for debtors. These include stricter eligibility requirements for debtors entering into debt agreements such as a minimum income threshold or a requirement that the debtor have assets to protect; a more rigorous, legally binding assessment of debtors' suitability on the part of debt agreement administrators; the provision of clearer information to debtors in the form of a Key Fact Sheet; and regulated limits on administrators' up-front and ongoing fees. It is important that debt agreement debtors gain access to an EDR scheme, offering redress where administrators have breached their obligations under the *Bankruptcy Act* or the *ACL*. There is also a need for more information on the extent to which debtors negotiate directly with their creditors prior to considering a debt agreement. It is also vital for creditors to continue to improve their financial hardship schemes to ensure they are genuinely accessible and that they offer realistic, long-term solutions for people in financial difficulty. If such reforms are initiated, the debt agreement system could play a still more valuable role in the personal insolvency system, providing a useful alternative to bankruptcy for Australians in financial distress.