Financial Rights LEGAL CENTRE

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Productivity Commission
by email: BusinessDynamismInquiry@pc.gov.au
Submitted via www.pc.gov.au

Reducing barriers to business dynamism

Thank you for the opportunity to comment on the **Reducing barriers to business dynamism discussion paper.** This short submission focuses on the experience of debtors who access our services when dealing with unsurmountable debt.

The Financial Rights Legal Centre (Financial Rights) strongly submits that long-overdue reforms to the personal insolvency system will reduce barriers to business dynamism. We refer the Commission to previous submissions we have made on various aspects of insolvency including:

- Attorney Generals Department, Minimal Asset Procedure Discussion Paper, August 2024 (advocating for a one-year insolvency option for low-income debtors);
- Attorney General's Department Personal insolvency Discussion paper, October 2023 (advocating for reforms to existing bankruptcy laws which would reduce stigma for debtors); and
- Legal and Constitutional Affairs Legislation Committee Bankruptcy Amendment (Enterprise Incentives) Bill 2017, January 2018[1] (advocating for a reduction of the bankruptcy period to one year).

Bankruptcy is not an easy option – and a 3 year discharge period is too long

Demand for financial counselling and consumer credit legal advice increases as challenging economic circumstances arise. And yet as AFSA statistics show, personal insolvency rates remain remarkably low – as are the returns from bankrupt estates.

[1] Previous submissions are all publicly available on our website under https://financialrights.org.au/submissions/

There are myriad reasons individuals end up over-indebted and contact our services. Sometimes they have borrowed beyond their capacity; at other times their personal circumstances have changed. Sometimes in unpacking the debts, it becomes apparent the client is the victim of financial abuse and has, accrued debts for which they have received no benefit. Others have found themselves with tax debts beyond their capacity to repay. They contact our services seeking to understand their options and the consequences attached to those options.

While the level of knowledge about the consequences of bankruptcy varies, typically people are trying to avoid bankruptcy, no matter the level of personal stress and financial hardship they are experiencing.

We regularly talk to people in terrible financial stress who are being chased for debts they have no ability to pay. Financial stress and mental health are closely related and can directly affect one another. Financial stress can have a negative impact on a person's mental health, and at the same time, poor mental health can exacerbate financial stress by impairing the person's ability to take restorative action or to make logical decisions.

Bankruptcy can and does help people reconcile and move on from unmanageable debt. Empirical research from leading Australian bankruptcy scholars has concluded that "for many Australian debtors, bankruptcy results in genuine improvements to financial stability, health, relationships and general well-being[2]. And yet the people we speak to gravely fear bankruptcy and its consequences. Going bankrupt carries great stigma for Australian consumers, and our clients are often experiencing feelings of shame, embarrassment and guilt.

The fresh start offered by bankruptcy is life changing, but 3 years is a long time to be prevented from being a company director as well as be locked out of credit and the ability to rebuild credit worthiness and economic participation. For the people who contact our service, there can be little doubt that a shorter bankruptcy period would allow financial rehabilitation and return to full participation in economic activity.

Financial Rights and other consumer groups were involved in government consultations to reform bankruptcy in 2023. Our arguments in favour of a shorter discharge period were not supported, though there was some interest in the concept of an express discharge for people with small debts and no capacity to make contributions, which formed the basis for our advocacy for a Minimal Asset Procedure. Given we know that the majority of

[2] Paul Ali, Lucinda O'Brien & Ian Ramsay, Bankruptcy And Debtor Rehabilitation: An Australian Empirical Study, Melbourne University Law Review , Vol 40:688 ; pp688-737. https://law.unimelb.edu.au/__data/assets/pdf_file/0009/2494269/01-Ali,-OBrien-and-Ramsay.pdf

bankruptcies are initiated by individuals with relatively low debts and very low rates of return, we think it time to revisit the benefits of a reduced discharge period. A modern Australian bankruptcy system needs to move on from penalising people for a perceived moral failing of not repaying their debts.

Responsible lending obligations are a bulwark against misuse of the personal insolvency system

Invariably discussions of bankruptcy reform invoke concerns about bad actors who seek to game the system without a strong deterrent.

The reality is that access to credit is strong regulated. Responsible lending obligations are embedded into Australia's consumer credit framework and serve as an important bulwark against the misuse of the personal insolvency system. Lenders are obliged to ensure a loan is not unsuitable for the person seeking credit, which provides an important friction where people seek access to credit that may be unaffordable to them.

In recent years, regulatory gaps that facilitated ongoing access to unaffordable credit through small and medium amount credit contracts, and buy now pay later facilities, have been closed. This, coupled with a reckoning in financial services industry culture after the Hayne Royal Commission into Financial Services, has helped to keep the numbers of people accessing the personal insolvency system remarkably low, particularly given the high levels of personal debt in Australia.

Responsible lending provides significant protection against over-indebtedness. This, in conjunction with the credit reporting framework in place, means that a reduced bankruptcy period can be safely considered.

Credit reporting

When considering the efficacy of the bankruptcy regime, it is necessary to also consider how the credit reporting regime can better support the return to productivity, given they are inextricably linked.

At present, bankruptcy is retained on a person's credit report for the longer of 2 years from discharge or 5 years from the date of bankruptcy – so effectively a minimum of 5 years. Five-year credit listings are unnecessarily punitive and extend beyond the agreed penalty period of bankruptcy.

People we assist are very concerned about their perceived creditworthiness and the impact of any potential decision, such as bankruptcy or applying for a hardship variation, on their credit report. Financial counsellors report that, when advising on the consequences of a potential insolvency, people are far more concerned about the impact on future borrowing than the stigma of disclosing that they are an undischarged bankrupt for the period of bankruptcy.

To facilitate the return of productive people back into the economy faster, any reduction in the discharge period for personal bankruptcy should be accompanied by a reduction in the corresponding duration of bankruptcy information being listed on consumer credit reports.

Minimal Asset Procedure

Financial Rights provide services a cohort of people living with the stress of having unaffordable debt that is draining their productivity, often as a result of servicing high-cost credit. Often callers to our services have been paying off credit cards or personal loans for many years at incredibly high interest rates and are trapped in a cycle of indebtedness that they are not able to navigate out of themselves. Financial counsellors can assist them with understanding their options.

As discussed above, the punitive nature of bankruptcy is a disincentive to people who would benefit from using it. If the discharge period for all personal insolvencies is not reduced, then a simplified alternative to personal insolvency that reduces the economic penalty, through a reduced bankruptcy duration and reduced listing on the NPII, is needed.

We have been advocating for a Minimal Asset Procedure for several years now. The concept of a MAP was explored in a AGD consultation paper in 2024 and with few self-interested exceptions was broadly agreed as an idea of merit. Responsibility for policy reform was shifted in March 2025 to the Treasury. Financial Rights has closely followed this issue and is disappointed that nearly 2 years past the original consultation there is no sign of progress on this issue.

We envisage the MAP as effectively a fast-track bankruptcy option, for people with relatively low debts, no assets, and a low income. This would be a bankruptcy option that would strike a balance between the interests of creditors and ensuring that bankruptcy enables a fresh start for debtors, whilst not being needlessly punitive.

It would be a cheaper, faster option for people becoming insolvent with no prospect of repaying their debts. It would benefit not only this cohort of debtors, but also registered trustees and taxpayers who would not be wasting time and money seeking money that simply does not exist. Similar insolvency options exist in several other jurisdictions and have significant uptake, including New Zealand.

A Minimal Asset Procedure strikes an appropriate balance between the interests of creditors and ensuring that bankruptcy enables a fresh start for debtors, whilst not being needlessly punitive. Reducing the discharge period to 12 months is likely to have a minimal effect on the amounts recouped by creditors from bankrupt estates, but significantly improves the bankrupt's opportunities for early financial rehabilitation and participation in economic activity.

For-profit debt businesses flourish where bankruptcy is too punitive

The ongoing stigma of bankruptcy and effect of a 3-year discharge period has not only created a barrier to business dynamism, it has helped create a harmful product offering marketed to people as an 'alternative' to bankruptcy. ASIC is presently undertaking a market study of debt management firms, and we expect the findings may be relevant to this inquiry.

Typically, debt management firms offer – for a very high upfront fee – to negotiate informal repayment arrangements over a longer term to avoid debt enforcement action. In our experience, they are poor value for the fees incurred – achieving minimal if any overall debt reduction and repayment arrangements the client is unable to meet.

Regulated Part IX debt agreements offer genuine protection from bankruptcy but the people we speak to fear the consequences - such as their credit reports being impacted, loss of access to future credit and of course permanent listing on the National Personal Insolvency Index.

These services are thriving in Australia because people want to pay their debts – even when the circumstances of the debt are questionable. We have spoken to many clients who pay loans that have been accrued under financial abuse situations. We speak to people who have taken out loans with fringe lenders who have made the decision to offer credit where it appears to have been unaffordable.

Priya's story*

Priya is in receipt of Centrelink payments and is a single parent to 2 teenagers. Late last year she was diagnosed with cancer and has been very unwell.

Priya has been in an informal debt agreement for over two years. Prior to her illness, she had not missed a payment.

Under the agreement, she was required to pay approximately $5,000 more than the debt she owed to her various creditors. This was due being required to pay a flat fee for the agreement, as well as a 20% administration fee. Her contract showed there was no debt reduction achieved for Priya in using this expensive service.

We assisted Priya to seek hardship from the debt management firm. The firm unexpectedly ceased making repayments to Priya's creditors, and did not attempt to negotiate hardship or debt waivers for Priya. They claimed this was because a financial counsellor was now acting on her behalf, which was incorrect.

The debt management firm then advised that negotiating with Priya's creditors would be beyond the scope of services it was contracted to provide, and sought to terminate the agreement. They denied a request for a fee refund, but agreed to waive charges that would have applied had they not terminated the agreement.

(**Name and identifying details changed*)

We suspect there are a significant number of people for whom bankruptcy would provide an appropriate release of insurmountable debt. Instead, debt management businesses can profit from people's financial stress and divert money that could be repaid to creditors.

A less punitive bankruptcy procedure with a shorter discharge period would help reduce barriers to business dynamism and allow people to get on to being a productive member of the economy.

Delay in legislating announced bankruptcy reforms is prolonging harm

Finally, it is important to note that we are still waiting for legislation to enact the substantial bankruptcy reforms announced by the government in July 2024.

This is incredibly frustrating for the consumer sector, who continue to assist people with relatively small debts, no assets, who are fearful of the consequences of 3 years bankruptcy and permanent listing on the National Personal Insolvency Index.

Unnecessary bankruptcies over small debts do not benefit families, creditors or the broader community.

Recommendation

1. **Financial Rights recommends that the discharge period for personal bankruptcy be reduced to one year. If there is strong evidence this would do more overall harm than good, a new insolvency option with a one-year discharge should instead be added to the Bankruptcy Act, namely a Minimal Asset Procedure.**

Concluding Remarks

Thank you again for the opportunity to comment. If you have any questions or concerns regarding this submission please do not hesitate to contact Financial Rights on (02) 9212 4216.

Kind Regards,

[redacted]

Sarah Wilson
Financial Rights Legal Centre
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About Financial Rights

Financial Rights is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters.