

2 November 2018

Mr Dipen Mitra
Australian Financial Security Authority

By email: Dipen.mitra@afsa.gov.au

Dear Mr Mitra

Consultation regarding proposed amendments to the Statement of Affairs and Application for Bankruptcy

We welcome the Australian Financial Security Authority's decision to review the *Statement of Affairs and Application for Bankruptcy* form. We are currently in the final stages of completing a major empirical study of Australia's personal insolvency system, supported by the Australian Research Council (details available at <https://law.unimelb.edu.au/centres/cclsr/research/major-research-projects/personal-insolvency-project>). To date, this research has produced nine scholarly publications, with several further articles currently in development. The research has drawn upon a large data set, provided by AFSA, containing the de-identified records of nearly 29,000 individual bankruptcies initiated between 2006 and 2017. This data set has afforded a unique insight into the social and financial characteristics of Australian debtors. AFSA's statistics team has provided ongoing assistance with the interpretation of this data and has also provided us with up-to-date data regarding various aspects of the debt agreement system, supplementing the information published on AFSA's website.

We are extremely grateful for AFSA's support over the course of our project. We wish to offer our comments on the revised *Statement of Affairs*, drawing on the results of our research, in case they may be of assistance to the current review process. These comments draw in particular upon our article, 'The Hidden Dimension of Business Bankruptcy in Australia'. This article will appear in Volume 46, Part 5 of the *Australian Business Law Review*, scheduled for publication in late 2018.

Our findings

Our forthcoming article presents an empirically based analysis of business bankruptcies in Australia. This analysis has two principal objectives: to identify

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key differences between debtors who declare business bankruptcy and those who declare non-business or ‘personal’ bankruptcy; and to explore the extent to which business and personal bankruptcies overlap, including the extent to which there might be a ‘hidden’ population of business debtors among those formally identified as personal debtors.

Our statistical analysis of the large data set has identified some potential flaws in AFSA’s ‘causes of bankruptcy’ data, as it is currently collected through the *Statement of Affairs* and subsequently used to classify all bankruptcies as either ‘personal’ or business-related. Our analysis suggests that a substantial proportion of debtors whose bankruptcies are classified as ‘personal’ have in fact engaged in business activity prior to bankruptcy. It finds, for example, that in our sample of 22,517 debtors in ‘personal’ bankruptcy, just over 20 per cent were either directors of a company, members of a partnership or sole traders in the five years prior to bankruptcy. Since 98 per cent of business debtors report that they have held at least one of these roles, in the five years leading up to bankruptcy, we consider that they are reliable indicators of business activity.

We believe that the existence of a ‘hidden’ business bankruptcy cohort may reflect debtors’ uncertainty regarding the definition of a business-related bankruptcy. At present, the *Statement of Affairs* provides no guidance to debtors on this point, leaving individual debtors to decide which category more accurately describes their circumstances. It is also possible that some debtors are unable to identify a single cause of bankruptcy, perceiving that their bankruptcies are due to a number of causes, some business-related and others personal in nature. At present, debtors completing the *Statement of Affairs* are required to choose a single cause from a list of ‘business-related’ or ‘non-business-related’ causes, with the option of citing a further ‘reason not listed’ in a free text box. In practice, however, some debtors select multiple causes, while others make no selection from the list provided, preferring to use the free text box to provide information about the causes of their bankruptcies. These bankruptcies are recorded by AFSA as being due to ‘other business reason[s] or reasons unknown’ or ‘other causes or causes unknown’. In making this assessment, AFSA draws upon information from other parts of the *Statement of Affairs*. However, in some cases, there may be insufficient information to enable AFSA to identify the cause of bankruptcy. Some debtors may provide conflicting information, suggesting that both business and personal factors played a part in the bankruptcy.

In these circumstances, it is conceivable that some bankruptcies might be classified by AFSA as personal, when they are in fact partly or wholly business-related. We have been informed that at present, if a bankruptcy cannot be identified as business or personal, it is attributed to a third category, ‘not stated’. This third category, ‘not stated’, is treated as a sub-category of personal bankruptcy, for statistical purposes. This has the effect of making personal bankruptcy the default classification for those bankruptcies that have no identifiable cause.

Our recommendations

We believe that it is necessary to clarify the ‘causes of bankruptcy’ section of the *Statement of Affairs*, so that the extent of business-related bankruptcy in Australia can be more accurately measured and reported. A redesigned *Statement of Affairs* should enable debtors to select more than one cause of bankruptcy from a list of possible causes. This list should be reformulated, with clearer and more specific causes, such as ‘loss of a job’, ‘inadequate working hours or wages’, or ‘loss of spouse’s income’. This redrafted *Statement of Affairs* would not require debtors to state categorically whether their bankruptcies are ‘business-related’ or ‘non-business-related’. Instead, the form could include two new questions, asking debtors whether or not they have engaged in business activity and whether or not they consider that this activity played some role in their bankruptcies.

Following this change, it may be desirable to amend AFSA’s reporting methods, to include a new category of ‘partly business-related bankruptcy’. This change would recognise the fact that bankruptcy can be the result of several factors, some commercial and others more personal in nature, and that some debtors might find it difficult to identify a single or pre-eminent cause.

Specific comments on the revised *Statement of Affairs*

We note that in the revised *Statement of Affairs*, circulated for comment, Question 6 regarding the ‘main cause’ of bankruptcy has been redrafted. We welcome the fact that the form no longer explicitly requires debtors to choose between ‘business-related’ and ‘non-business-related’ causes of bankruptcy. We also welcome the fact that the listed causes have been rephrased. We believe that the revised list of causes is simpler and more accessible. To cite one example, the phrase, ‘I borrowed more than I could afford to repay on my income’, is much clearer than the equivalent phrase in the current *Statement of Affairs* (‘Excessive use of credit facilities including losses on repossessions, high interest payments and pressure selling’). We believe that this revised wording will make the form easier for debtors to understand and complete accurately, resulting in more reliable data.

We note, however, that the revised question still requires debtors to select a single ‘main’ cause of bankruptcy. For the reasons outlined above, we believe that it would be useful to allow debtors the opportunity to identify more than one cause of bankruptcy, if appropriate. We suggest therefore that the revised *Statement of Affairs* be amended, so that debtors are no longer required to ‘select one cause only’ when completing Question 6.

Thank you for offering us this opportunity to comment on the revised *Statement of Affairs*. Should you have any queries regarding any aspect of this submission, or our research more generally, please do not hesitate to contact Lucinda O'Brien via email at lucindao@unimelb.edu.au, or by telephone on (03) 8344 7096.

Yours sincerely

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