Australian Government
Australian Financial Security Authority

PERSONAL INSOLVENCY COMPLIANCE REPORT 2017/18

AUSTRALIAN FINANCIAL SECURITY AUTHORITY

Contents

Reader's guide

The purpose of this document is to report on our achievements against our Personal Insolvency Compliance Program for 2017–18.

This report focuses on regulatory outcomes and the performance of personal insolvency practitioners and the Official Trustee (OT) in a transparent manner. It is important that all stakeholders affected by insolvency—including the profession itself—are provided with timely and relevant data and analysis.

This report discusses our compliance, regulatory and enforcement role, and how the compliance program is shaped. This includes:

- key compliance, regulation and enforcement activity outcomes for 2017–18
- outcomes of our compliance program key areas of focus:
    1. remuneration and expenses
    2. law reform readiness
    3. independence
    4. administration funds held on trust
    5. information.

To ensure we deliver data in a timely manner, we provide additional data on our website, which we update quarterly. This includes Regulation and Enforcement data and information about our eight core regulatory activities.

Other reference material such as our Inspector-General Practice statements, newsletters and guidelines are also available on our website.

Our compliance, regulatory and enforcement roles

AFSA's purpose is to maintain confidence in Australia's personal insolvency and personal property securities systems by delivering fair, efficient, and effective trustee and registry services and risk-based regulation.

To achieve that purpose, the Regulation and Enforcement functions support the role of the Inspector-General in Bankruptcy (IG) to regulate the personal insolvency system. We foster confidence in the personal insolvency system through effective risk-based regulation and enforcement activities that are timely, consistent and appropriate.

AFSA's regulatory and compliance activities

AFSA conducts its regulatory work in accordance with its Regulatory Framework (IGPS1) and each annual insolvency compliance program. The following eight core functions support this work:

1. trustee and debt agreement administrator registrations
2. inspections
3. proactive monitoring
4. guidance
5. complaints
6. Inspector-General reviews
7. disciplinary action
8. investigation and prosecution of offences against the *Bankruptcy Act 1966*.

AFSA'S regulatory and compliance activities

1 Registration

2 Inspections

3 Proactive monitoring

4 Guidance

5 Complaints

6 Inspector-General reviews

7 Disciplinary action

8 Investigate offences and refer for prosecution if appropriate

We apply a proportionate risk-based approach to our compliance, regulatory and enforcement activities consistent with the Australian Government's regulatory reform agenda. In accordance with the Regulator Performance Framework, we regularly reassess our approach and develop strategies, activities and enforcement actions to reflect the changing priorities from new and evolving regulatory threats.

Two key aspects of our compliance and regulatory activities are our inspection program and responding to complaints against registered trustees (RTs), the OT and registered debt agreement administrators (RDAAs).

The most common errors detected in the 2017–18 inspection program were:

- property, income and asset errors
- inadequate communication by trustee
- failure to maintain proper records
- unreasonable delays in timely action leading to delays in distribution
- failure to meet performance standards.

There do not appear to be any long-term trends in complaint categories. The most common justified complaints include:

- inappropriate conduct or conflict of interest
- delays in administration or lack of action
- decisions concerning assets
- general administration and accounting
- lack of information or communication.

We address these issues by publishing articles in the quarterly Personal Insolvency Regulator (PIR) newsletter, presenting to the profession at forums, updating our guidance material (as appropriate), and by focusing on various forms of these issues through the compliance program for 2018–19. We counsel practitioners on a case-by-case basis. Some issues identified may lead to disciplinary action.

Practitioners have an obligation under the *Bankruptcy Act 1966* ('the Act') to consider and refer evidence of bankrupts committing alleged offences to the Inspector-General in Bankruptcy. Enforcement assesses these referrals and, where appropriate, commences investigations into the alleged conduct. Investigation outcomes include:

- obtaining compliance through Enforcement intervention
- issuing an Official Caution to an alleged offender
- where appropriate, referring a brief of evidence to the Commonwealth Director of Public Prosecutions (CDPP) to consider prosecution action.

Key compliance activities for 2017–18

REGISTRATIONS

209 **REGISTERED TRUSTEES**

dropped from 217 (2016–17)

5 new registered trustees **REGISTERED**

13 registered trustees **VOLUNTARILY DEREGISTERED**

75 **REGISTERED DEBT AGREEMENT ADMINISTRATORS**

dropped from 78 (2016–17)

3 new registered debt agreement administrators **REGISTERED**

6 registered debt agreement administrators **VOLUNTARILY DEREGISTERED**

INSPECTIONS

45 personal insolvency practitioners **INSPECTIONS**

10 remote/ eInspections **INSPECTIONS**

increase from 2 in 2016–17

57 Official Trustee administrations **INSPECTED**

COMPLAINTS

247 practitioner complaints received

28 complaints justified

10 Official Trustee complaints received

1 complaint justified

PROACTIVE MONITORING

DEBT AGREEMENT ADVERTISING

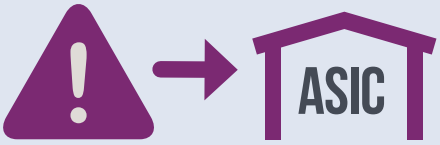
162 advertisements subject to detailed review

72 cases of **INTERVENTION** to correct or remove **MISLEADING OR UNBALANCED ADVERTISING**

63 advertisements relating to registered debt agreement administrators

9 advertisements relating to brokers/ pre-insolvency advisors

2 advertisements referred to the Australian Securities and Investments Commission for potentially incorrect or misleading information



GUIDANCE

ADDRESSED SYSTEMIC AREAS OF NON-COMPLIANCE BY PROVIDING GUIDANCE:

Personal Insolvency Compliance Program 2017-18

quarterly Personal Insolvency Regulator newsletter articles

information sessions for practitioners

review and update of Inspector-General Practice Directions

INSPECTOR-GENERAL REVIEWS

REGISTERED TRUSTEES

319 total registered trustee Inspector-General reviews finalised

149
registered trustee decisions confirmed/ remuneration granted

31
registered trustee decisions cancelled or varied/ remuneration not granted

90
review applications withdrawn/ refused/ substitute lesser amount

49
review applications rejected

OFFICIAL TRUSTEE

18 total Official Trustee Inspector-General reviews finalised

2
Official Trustee decisions confirmed

0
decisions cancelled or varied

10
review applications withdrawn or refused

6
review applications rejected

DISCIPLINARY ACTION

ONE SHOW CAUSE NOTICE SENT
The Committee convened decided the RT should remain registered without condition restriction

INVESTIGATE AND PROSECUTE OFFENCES UNDER THE *BANKRUPTCY ACT 1966*

828
pre-referral enquiries received

812
offence referrals received

616 accepted for investigation

121
briefs sent to Commonwealth Director of Public Prosecutions

128 accepted by Commonwealth Director of Public Prosecutions[1]

137
persons prosecuted

$5.58 million value of fraud proven

up from $2.90 million in 2016–17

[1] Includes a portion of the briefs prepared and referred to the CDPP in the previous financial year.

Report on our Insolvency Compliance Program for 2017–18

1. REMUNERATION AND EXPENSES

A trustee plays a central role in the administration of estates under the Act, Insolvency Practice Rules (Bankruptcy) 2016 ('the Rules') and Bankruptcy Regulations 1996 ('the Regulations'). Trustees are under a general duty to exercise the powers committed to them to enact the intent of the legislation—including equality between creditors and fairness to bankrupts and debtors.

The minimum standard required is the trustee shall handle the assets with a view to achieving the maximum return from the assets to satisfy the claims of the creditors and to provide the best surplus possible for the bankrupt or debtor[2].

A review of complaints, annual estate returns and other information indicated there could be instances of over-servicing and overcharging.

What we said we'd do

We will focus on early identification and, where possible, remedy instances of overcharging or over-servicing by insolvency practitioners. This will be identified and handled through a number of functions including our inspection program, targeted campaigns, complaint handling process and own-initiative Inspector-General reviews of remuneration (from 1 September 2017). We will review dealings with property—particularly strata title property—to ensure petitioning creditors costs and conveyancing costs are paid appropriately. We will review the expenses taken in debt agreements to ensure they have been paid appropriately.

What we did

Trustee remuneration and potential overcharging or over-servicing

In addition to responding to requests for review of trustee remuneration, we analysed administrations commencing after 1 July 2016 that were annulled under section 153A of the Act. During our analysis, we identified 12 registered trustees' administrations that met the relevant risk criteria for potential overcharging.

In March 2018, we sent CIR letters to these trustees. The trustees were asked to provide the following information (12 administrations in total):

- copies of the account of receipts and payments, and cashbook for the estate
- a brief summary of main issue(s) in the estate
- copies of all reports to creditors issued to date for the estate.

Based on the trustees' responses and the information they provided, we found that none of the 12 administrations displayed signs of overcharging.

[2] Re Carolyn Nancy Mannigel; Gunther Henry Frederick Mannigel; Heinrich Oswald Herman Mannigel v Lindsay Robert Aitken [1983] FCA 183.

Although there were several different criteria in the administration analysis, the criterion that we considered most important and indicative of potential overcharging was where trustee remuneration exceeded $50,000. Six of the 12 administrations met this criterion. However, the responses and information we received indicated that the remuneration was necessary and reasonable for those six administrations.

Another important risk criteria and an indicator of potential overcharging, was where it took more than 12 months (from the date of bankruptcy) to annul the estate. Six of the 12 selected administrations met this criterion. However, based on the evidence provided by the trustees, we found that none of the delays for these six administrations were caused by the trustees, but rather other parties, such as the bankrupt.

Two of the 12 administrations had been subject to full inspections in the preceding months, as part of our inspection program, with no issues with the remuneration identified during those inspections.

Eleven of the 12 bankrupts owned property with sufficient equity for annulment. However, as it was their residential property, most of these bankrupts wanted to avoid selling and sought funding for annulment through other sources such as relatives or re-financing their mortgages. This contributed to the delays in annulling some of the administrations as the bankrupts were often slow in obtaining funding and, in some cases, the trustees had to eventually sell the properties as alternative funding was not provided. In these administrations, the trustees gave the bankrupts sufficient opportunity to keep their property in order to reduce costs and stress for bankrupts. This approach is consistent with the expected level of conduct for practitioners.

Strata title property dealings

Our 2016–17 inspection program highlighted two perceived issues with how trustees deal with residential apartments—particularly when the petitioning creditor was the owners' corporation. These issues were:

- trustees not complying with orders of the Federal Court fixing the petitioning creditor's costs
- trustees engaging the solicitor for the owners' corporation to act on the conveyance at an excessive cost.

We published our concerns, along with appropriate guidance, in the March 2017 edition of the PIR. In April 2018, we sent CIRs to 15 trustees who have administered matters in the last two years where an owner's corporation (i.e. strata body) was the petitioning creditor. The purpose was to check whether the trustee had overpaid the petitioning creditor its debt and costs, and to ascertain if the trustee engaged a solicitor for the owners' corporation.

The results were positive with no serious or significant overpayments identified. We will continue to monitor fees about strata property dealings, drawing on intelligence such as annual estate returns and complaint data.

Expenses taken in debt agreements

In August 2017, we sent CIRs to the three RDAAs with the highest expenses during 2016–17. These RDAAs were asked to provide confirmation that the expenses paid in debt agreements administered in the 2016–17 financial year have been paid in accordance with:

- Inspector-General Practice Direction 3 – *What constitutes an expense recoverable in a debt agreement by an administrator*
- the relevant debt agreement proposal approved by creditors
- a breakdown of the total amount of expenses taken to show the nature and amount of each expense category.

All RDAAs responded to the CIR and were able to demonstrate how expenses were directly attributable to the debt agreement and how the actual expense for a particular matter was calculated. The responses indicated that expenses were paid in accordance with IGPD 3 and the relevant debt agreement proposal approved by creditors.

One review identified a minor system coding error relating to joint applicants. As a result, a refund of $1,174 out of $176,066 in expenses taken was reimbursed.

Interestingly, we observed that a majority of expenses were due to Direct Debit fees or dishonour charges.

CASE STUDY

AFSA INTERVENES IN RDAA SET UP FEE OVERCHARGING

A debtor contacted a RDAA seeking relief from unmanageable financial burden. The RDAA assessed the debtor's financial situation and began collecting a 'set up fee' prior to submitting a debt agreement proposal to the Official Receiver.

The debtor continued to pay the RDAA for over nine months, assuming payments were being made towards their debt agreement. By this time, $2,728.15 had been paid in set up fees only.

After nine months, the debtor, who was of the belief that the debt agreement proposal had been submitted, enquired on its progress with AFSA. They were advised that it had never been lodged. The debtor complained to AFSA, alleging that in the intervening time, their debts had blown out from approximately $7,300 to $10,000. A refund of the set up fees was sought.

AFSA undertook an enquiry into the RDAA practices—requesting a full inventory of matters older than four months where no DAP had been lodged, to ensure that the issue was not systemic. Further enquiries were also made into the RDAA's systems and internal controls to reduce the risk of this practice occurring again.

As a result of AFSA's intervention, the RDAA refunded the entire amount of the set-up fee collected from the debtor.

2. LAW REFORM READINESS

What we said we'd do

We will focus on ensuring that trustees understand and comply with the new provisions of the *Bankruptcy Act 1966* and Bankruptcy Regulations 1996 introduced by the *Insolvency Law Reform Act 2016* and the Insolvency Practice Rules 2016, which took effect on 1 September 2017.

What we did

To reduce the regulatory burden on trustees while we assessed their *Insolvency Law Reform Act 2017* (ILRA) readiness, we used information already available to us, such as lodged annual trustee returns (ATRs), notices of significant and other events (NOSOEs) and reports to creditors for part X/section 73 proposals, remuneration determination requests and pro-active inspections. Based on this data, we were able to verify that:

- all trustees had lodged an ATR (or otherwise provided adequate evidence) showing they held current professional indemnity insurance and fidelity insurance
- 23 trustees (11%) had lodged a NOSOE showing that they were aware of their duty to notify the IG of certain events under the new ILRA provisions
- 74 trustees (35%) had demonstrated that they were aware of their duties to provide a declaration of relevant relationships and interest, initial remuneration notice and a remuneration approval report (RAR) under the new ILRA provisions.

For the remaining trustees where AFSA did not have information to validate compliance with ILRA, we sent an email asking them to provide the information needed to verify compliance. All trustees replied with sufficient information to verify their ILRA readiness.

Overall, we found that trustees and their staff had an appropriate level of ILRA readiness. There were a small number of instances where the trustees' RAR didn't include a reference to the right of the debtor and creditor to elect to receive a remuneration claim notice within 20 business days. This has since been resolved through direct practitioner engagement.

3. INDEPENDENCE

The legislative framework that regulates the conduct of personal insolvency practitioners is found with the Act, the Regulations and the Rules. The framework imposes a range of duties on personal insolvency practitioners that require their independence. Inspector-General Practice Direction 1 (IGPD1) outlines the IG's expectations relating to the importance of personal insolvency practitioners ensuring they maintain real and perceived independence. This is important, as a lack of independence can lead to practitioners failing to act honestly, impartially or avoid conflicts of interest.

We continue to observe the presence of untrustworthy advisors operating in the personal insolvency industry. There is a risk that practitioners may be influenced by these advisors.

What we said we'd do

We will focus on compliance with the trustee standards under the new Insolvency Practice Rules 2016, IGPD 1, and the ARITA and PIPA codes of professional practice to ensure practitioners remain independent and are not influenced by pre-insolvency advisors.

What we did

Targeted investigation into inappropriate behaviours

In 2016–17, Enforcement proactively targeted bankruptcies where we identified the potential involvement of a known untrustworthy advisor. Investigations were determined by analysing the data we hold involving existing referrals and information held by the Official Receiver. These investigations were finalised in 2017–18. We referred six matters to the CDPP for consideration of prosecution action.

Of the six matters, the CDPP accepted four matters with the view to commence a prosecution. One matter was rejected and another was pending assessment at the end of the financial year. Of these, one prosecution was finalised in the reporting period. The others are still active with the CDPP.

Through Enforcement activities, a number of referrals and investigations highlighted inappropriate behaviour of untrustworthy insolvency advisors. This behaviour included the provision of pre-bankruptcy advice with the view to inappropriately protect assets and obtain quick annulments during bankruptcy.

Where appropriate, this information was provided to Regulation so it could be considered in the context of independence and future proactive regulatory activities.

Regulatory intervention at creditors' meetings

During 2017–18, we continued to monitor trustee independence by attending and intervening at creditors' meetings where appropriate. Attendance at a sample of meetings provides us with an opportunity to monitor the standard of the trustee, including observing the independence of the trustee.

During 2017–18, we reviewed 439 out of 459 Part X and s73 proposals received and attended 44 meetings. Of the 439 proposals reviewed, we intervened or took corrective action in 37 instances.

CASE STUDY

AFSA DISRUPTS CREDITORS MEETING

A married couple who declared bankruptcy received pre-insolvency advice from an untrustworthy advisor about how to structure their financial affairs (including interest in a family self-managed superannuation fund and discretionary trust). Both debtors had an interest in two properties with substantial equity and were guarantors on another property owned by the discretionary trust.

The couple claimed to have debts owing to two related creditors and two secured creditors. A section 73 proposal was made offering $15,000 to creditors, which was payable in instalments. This amount was sufficient to cover the costs for holding the meeting and the trustees' remuneration. One of the secured creditors was in the process of finalising a sale of the trust property but had not established the value of the shortfall on the property.

AFSA expressed concern that the annulment of the bankrupts' administrations from only the votes of related creditors would deny the institutional creditor the opportunity to receive a dividend if the bankruptcy continued and realisations were made.

AFSA reviewed copies of proofs of debt and supporting documents, and attended the meeting of creditors during which Regulation and Enforcement staff raised concerns about the evidence obtained to support the related party debts. The trustee adjourned the meeting. Prior to the re-convened meeting, Regulation and Enforcement conducted further enquiries and raised their concerns with the trustee. At the reconvened meeting, the proposals were withdrawn by the bankrupt.

As a result of AFSA's monitoring activities, remedial action occurred at the meeting of creditors. The bankrupts withdrew their original proposals and ultimately submitted new proposals for $290,000 and $250,000. This will provide creditors with a dividend.

4. ADMINISTRATION FUNDS HELD ON TRUST

It is imperative that a personal insolvency practitioner maintains funds held on trust in a bank account that is reconciled on a regular basis.

What we said we'd do

We will seek assurance that administration trust funds are reconciled under the relevant provisions and standards. This will be carried out by remote targeted campaign as well as the inspection program.

What we did

The 2017–18 inspection program identified the minimum number of practitioners that were inspected either onsite or remotely. All practitioners subject to an inspection formed part of this targeted campaign, as trust accounts are part of the standard inclusion in inspections.

We conducted 45 practitioner inspections. During these, we tested the practitioner's systems and controls and, importantly, tested whether funds held on trust were properly accounted for. Of these, only one debt agreement administrator's bank reconciliations were not properly carried out and were consequently difficult to comprehend. We are continuing to make further enquiries of this debt agreement administrator.

5. INFORMATION

It is important that the right information is available throughout the decision making process for those who are considering informal and formal debt management options. As practitioners play key roles in the personal insolvency system, it is vital they provide accurate, relevant and comprehensible information to their clients. This expectation is in accordance with the legal requirement for practitioners to act honestly, impartially and independently.

What we said we'd do

We will focus on ensuring that information provided by practitioners is accurate, relevant and comprehensible, thereby enabling informed decisions to be made by debtors, creditors and all relevant stakeholders.

What we did

Debt agreement advertising

Reviewing the accuracy and relevance of advertisements by RDAAs, brokers and others who promote debt agreements and their related services is vital to ensure financially vulnerable debtors have access to the right information at the right time.

As such, we prioritised resources to review the advertising of debt agreements and related services to ensure compliance with Inspector-General Practice Guideline 1—the guideline relating to advertising and marketing of debt agreements. We procured the services of a media monitoring company to monitor paid advertising of the personal insolvency sector. This media monitoring activity resulted in an increase of detailed advertising reviews finalised from 18 in 2016–17 to 162 in 2017–18. Of the 162 advertisements reviewed, 72 required some level of regulatory intervention to ensure false, misleading or unbalanced elements of advertisements were corrected.

We continue to monitor for potentially misleading advertising practices and refer matters to the relevant regulatory authorities, such as the Australian Securities and Investments Commission (ASIC), where appropriate.

Inadequate information

During the course of the 2017–18 inspection program, it became evident that 'inadequate communication' continues to be one of the primary errors identified. This class of error can take many forms, but quite commonly relates to a need for greater clarity and the use of plain English in all forms of communicating with debtors and creditors.

To support practitioners to be in the best possible position to provide the right information at the right time, AFSA continued to provide guidance through different media such as:

- offering information sessions on technical areas of interest
- publishing guidance in the quarterly PIR newsletter
- providing practice guidance through IG practice directions, statements and guidelines.

Appendix A: Insolvency Compliance Program 2017–18

1. Overarching ethos

We foster stakeholder confidence in the personal insolvency system through effective regulation and enforcement activities that are timely, consistent and appropriate.

Statements of principle

AFSA's regulatory approach focuses on early resolution of systemic issues by adopting a proactive and preventive approach wherever possible.

The IGPS 1—Regulatory framework outlines the core of AFSA's regulatory ethos.

IGPS 1 and AFSA's compliance program is agile and continuously under review in line with market conditions affecting stakeholders.

Whole of industry approach and international best practice focus

AFSA promotes a regulatory environment where all stakeholders play a part in maintaining best practice standards. AFSA will continue to engage with:

- financial counsellors
- creditors
- debtors
- the CDPP
- ARITA
- PIPA
- ASIC
- other professional associations and government agencies.

This broad level of engagement ensures all necessary intelligence is available and facilitates the best outcomes for those affected by insolvency.

AFSA will also continue to actively engage with the International Association of Insolvency Regulators to facilitate appropriate benchmarking against developments and advances in insolvency regimes in comparable jurisdictions.

2. Strategic focus areas in 2017–18

In the financial year to 30 June 2018, AFSA will focus on the following five areas in its compliance program. These areas have been identified following consultation with the profession.

Remuneration and expenses

We will focus on early identification and where possible remedy instances of overcharging or over-servicing by insolvency practitioners. This will be identified and handled through a number of functions including our inspection program, targeted campaigns, complaint handling process and own-initiative IG reviews (from 1 September 2017).

We will review dealings with property, particularly strata title property to ensure petitioning creditors costs and conveyancing costs are paid appropriately.

We will review the expenses taken in debt agreements to ensure they have been paid appropriately.

Law reform readiness

We will focus on ensuring that trustees understand and comply with the new provisions of the Bankruptcy Act, Bankruptcy Regulations introduced by the ILRA and Insolvency Practice Rules.

Independence

We will focus on compliance with the trustee standards under the new Insolvency Practice Rules 2016, IGPD 1—independence (currently being finalised) and the ARITA and PIPA codes of professional practice to ensure practitioners remain independent including with pre-insolvency advisors.

Administration funds held on trust

We will seek assurance that administration trust funds are reconciled under the relevant provisions and standards. This will be carried out by remote targeted campaign as well as the inspection programme.

Information

We will focus on ensuring that information provided by practitioners is accurate, relevant and comprehensible, thereby enabling informed decisions to be made by debtors, creditors and all relevant stakeholders.