Financial "illiteracy" causing bankruptcies

Stewart Free, Jirsch Sutherland Partner

Too many Australians are taking a "head in the sand" approach when it comes to financial literacy – and that's a major reason for many bankruptcies, says Jirsch Sutherland Partner and bankruptcy specialist, Stewart Free.

Commenting on the report Who is making Australians bankrupt, which highlights the large number of people with small debts being bankrupted by debt collection agencies, Free says the major focus should be on financial and legal literacy as a first step. "It's woefully inadequate in Australia," he says. "I've seen people bankrupted for a $12,000 debt – even though they had $50,000 in the bank. That's because they allowed the issue to escalate and didn't communicate with their creditors. People really need to get their heads out of the sand and take action early if they're facing financial difficulties because there are options.

"And unfortunately, too many consumers are freaked out by the thought of bankruptcy, so there also needs to be a mindset change. Bankruptcy isn't the dark cloud many people think it is, it's a legal process designed to alleviate debt."

Free says too many Australians have blinkers on, particularly when it comes to debt collecting companies. "It's rare for a bankruptcy not to include a debt collection company, and where many people get caught out is when a debt is sold to big aggregators of debts (those who purchase the bad debts off others)," he explains. "These companies often have a process that's more likely to lead to a bankruptcy proceeding. And if the individual has previously disputed the debt, they'll have to restart the whole process with the new 'owner' of the debt. It can be a vicious cycle."

In addition to consumers understanding more about their own finances, Free says stronger regulation of debt collection companies is vital. "Of course, there are many reputable agencies out there but there are also some very aggressive companies that are focused on maximising their returns. That's where I think there needs to be stronger regulation," he says.

Lifting the threshold could create more problems

In 2018, the threshold whereby an individual can be sued for bankruptcy for an unpaid debt was lifted from $2,500 to $5,000. And while many consumer affairs advocates are calling for the threshold to be lifted (some suggesting to $50,000), Free says that increasing it could do more harm than good for small consumer debts.

“If the threshold is raised, it could allow a debt to balloon out to something completely unmanageable via a repayment plan. And while this might reduce the number of bankruptcies, it will increase the number of people who get themselves into a debt spiral and not be able to get out,” Free adds.

Common debts

Free says some of the most common debts Free says he sees are unpaid tax, finance company debts and unpaid strata levies. “Being bankrupted over unpaid strata levies is more common than many would think,” Free says. “I’ve witnessed many bankruptcies where a person living in an apartment has lost their job and been unable to pay their fees but rather than alerting the body corporate that there’s a problem or seeking professional help, they’ve allowed it to snowball and then ended up losing their home.

“Communication is so important. People shouldn’t ignore their problems and hope they will go away. If you find yourself in financial strife, engaging with a financial counsellor or a personal insolvency specialist like myself to offer the creditor a deal via a repayment plan can be the difference between paying off the debt or becoming bankrupt. And annulling a debt can be a very difficult, protracted process.”