

Increasing the Statutory Demand Threshold

Submission to the Treasury
March, 5, 2021

Overview

The Australian Chamber of Commerce and Industry (ACCI) welcomes the opportunity to comment on the proposed amendments to the statutory demand threshold. ACCI is Australia's largest and most representative business group, comprised of over 70 industry associations and all state and territory chamber of commerce. ACCI is also the voice of Australian business on the international stage with representation on the Business and Industry Advisory Committee at the OECD, the United Nations (UN) and the International Chamber of Commerce (ICC).

ACCI does not support a legislated increase in the minimum statutory demand as it may:

- undermine the debtor-creditor relationship
- increase the costs of doing business
- impact the flow of credit to small business
- led to an increase in intentional debt avoidance

The effect of increasing the statutory demand threshold for companies has gone unamended since its implementation approximately thirty years ago. The statutory demand threshold of \$2,000 is set intentionally low to support trust and the flow of credit among businesses. Statutory demands are generally made by creditors as an act of last resort following unsuccessful attempts at getting paid for a debt that is due and payable.

It is not known what effect the proposed increase in the statutory demand will have on firm behaviour and therefore the economic consequences, as we have not been provided or cited a relevant cost-benefit analysis. The benefit of harmonisation with the personal bankruptcy threshold, as an example outlined in the issues paper, does not necessarily outweigh the costs (real or perceived) of doing so. We recommend as a matter of priority that a comprehensive regulatory impact assessment (RIA) be undertaken before further consideration is made. We propose the assessment consider the viability of three options outlined below:

1. An increase to the statutory demand threshold to \$10,000 effective 1 July 2021, with a sunset provision dated no longer than 2 years from its implementation date.
2. A permanent one-off increase to the statutory demand threshold to the indexed amount or \$4,000 to strike a better balance between the needs of debtors and creditors by addressing

- the changes in the real value of the threshold, the commercial costs of issuing and defending a demand and the reduced pressure and associated costs of accessing courts.
3. Maintaining the status quo while continuing to encourage financial literacy and the accessibility of the new insolvency laws for small businesses.

ACCI does not support a *permanent* increase in the statutory demand threshold of \$10,000 as this will undermine the debtor-creditor relationship, thereby increasing the cost and associated risks of doing business, deteriorating trust in business transactions and impacting the flow of credit to small business. A proposal to permanently increase the threshold requires comprehensive analysis to better determine the costs and benefits. Furthermore, the urgency of these reforms is unsubstantiated.

We anticipate that the proposed reforms will undergo due process including a publicly available cost-benefit analysis.

Policy rationale

Cost-benefit analysis required

The issues paper provides inadequate consideration of factors relevant to the statutory demand threshold and the effects of a permanent increase of the threshold to \$10,000. A regulatory impact assessment needs to consider the following factors:

- the new small business restructuring laws already provide the measures to give small businesses an opportunity to explore an obligation free formal restructure process.
- the accumulation of debt is not a sustainable nor practical means to operate a business and businesses in financial distress should be encouraged to seek services of an insolvency practitioner and other professional services such as accountants to prevent ongoing debt accumulation.
- there is insufficient information available to determine the impact of the proposed reform on credit risk, including low-value BNPL non-ADI lending that small businesses have become increasingly reliant on.
- the amount proposed is substantially higher than the statutory minimum set in international jurisdictions including the United Kingdom (750 pounds) and New Zealand (NZD \$1,000) and the absence in the issues paper of determining whether other jurisdictions have increased statutory demand thresholds and to what effect.

In addition, an assessment of the potential impacts of a permanent increase must account for the following likely outcomes:

- an increase in transaction costs
- impaired trust amongst business-to-business relationships
- the misappropriation and misallocation of capital
- the perpetuation of unviable firms operating with consequences to associated suppliers and customers
- an increase in intentional debt avoidance.

Threshold has decreased in real terms but is intentionally low

The definition of a statutory minimum of \$2,000 has not increased since it was first introduced in the now superseded Corporate Law Reform Bill 1992. The statutory demand threshold is intentionally low to encourage trust and good faith in business transactions.¹ Statutory demands are generally exercised by creditors as an act of last resort following the deterioration of communication and intentional avoidance of debt obligation. ACCI does not support intentional debt avoidance as this deteriorates business relationships.

If the statutory minimum were to increase, then that amount should increase to no more than the rate of inflation. According to the Australian Bureau of Statistics, the indexed amount equivalent in purchasing power today is approximately \$4,000.² A *one-off* inflation adjusted increase to this amount may address some of the concerns expressed by the commercial costs of issuing and defending a demand and reducing pressure on the courts allowing for informal settlements up to this amount. An increase even of this amount will need to be considered as part of a cost-benefit analysis.

The Statutory demand for payment is a mechanism of last resort

Debtors seeking relief of obligation are encouraged to engage with creditors by working on an appropriate payment plan where possible. We actively promote financial literacy and encourage our members to seek the services of financial advisers, restructuring professionals, and accountants. The serious nature of a statutory demand is generally an act of last resort for a creditor and the threshold is largely an irrelevant factor when trust and communication has broken down. By increasing the threshold, this will allow businesses to accumulate debt and provide goods and services when it may be inappropriate to do so.

Potential impact to credit for small business

In ACCI's submission on insolvency reforms to support small business on November 24, 2020, we expressed caution over potential adverse consequences for creditors, many of which are small businesses to pursue monies for goods and services provided. Reducing the ability of creditors, including other small business owners, to take action may lead to unintended consequences, including creditors managing their risk of non-payment through dealing with the company on less generous terms, such as higher interest rates on loans, a shorter payment period or by requiring cash on delivery. This will have the effect of exacerbating access to credit issues, reducing flexibility in the serviceability of loans, and worsening the impacts of choppy cash flow experienced by seasonal businesses.

Lenders may respond with tightening of credit to small business

The significant number of small business owners that have given personal guarantees secured by personal assets (including their primary residence) in order to obtain financing for their company's liabilities is a genuine and ongoing concern for our members and requires the attention of government. The Australian Prudential Regulation Authority (APRA) currently applies a single risk weight (of 100%) to all SME lending not secured by a residence, with no delineation allowed for the

¹ Please refer to the policy rationale of the [Harmer Report](#)

² <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release>

size of borrowing, the form of borrowing or the risk profile.³ This is above the recommended amount proposed by the Basel III Accord. Consequentially, for an SME loan that is not secured by a residence, Australia's smaller banks need to hold up to twice as much capital as the major banks. This means that small banks are required to pay up to twice as much to be able to offer loans to their customers. This has led to suboptimal competition in small business bank lending, with high interest costs, fewer lenders, and strict serviceability requirements.

Increasing the statutory demand threshold will not resolve the ongoing banking competition issue that has led to (and continues to lead to) a greater number of small business owners giving personal guarantees secured by personal assets as a condition to obtain finance. Consultation with our members in the finance industry have expressed a worsening of the issue following the proposed increase in the statutory minimum. An increase in the intentional avoidance of debts will:

- reduce creditors ability to pursue unresolved debts
- reduce creditors ability to identify and mitigate high risk exposures and,
- increase barriers to accessing credit.

A non-viable business is easily identifiable when payments of \$2,000 or thereabouts are avoided. The proposed increase to \$10,000 will eliminate the ability of creditors to identify these businesses and these businesses may carry on employing staff, offering goods and services when there is no economic rationale for doing so. A worsening of debt obligations with multiple creditors may lead to more preserve outcomes, such as non-payment of wages and superannuation with the associated penalties attached.

Increase time to resolve disputes

There is a need to provide greater resources and accessibility to a dispute resolution process for small business. A company that is in dispute of an issuance of debt may require more than 21 days to seek the assistance of legal and associated professional advisers – given the general waiting times and preparation of work required. This period should be amended to at least 21 business days to factor in the waiting period in currently seeking professional services from financial services and accounting firms.

Conclusion

ACCI does not support the proposed increase in the statutory minimum. The statutory minimum is intentionally set low to encourage trust and good faith in business transactions. The impact of any proposed increase requires further evidence through a rigorous cost-benefit analysis. The proposed permanency of the increase may lead to significant perverse impacts on the business community by increasing the cost of doing business, deteriorating trust in business transactions, impacting the flow of credit to small businesses and exacerbating access to finance issues. We are genuinely concerned that without a thorough cost-benefit analysis, the overall impact of this reform on the economy remains unknown.

³ Productivity Commission, Competition in the Australian Financial System No.89, 29 June (2018)