LEGISLATING FOR PERSONAL INSOLVENCY IN IRELAND

THE RATIONALE FOR DEBT SETTLEMENT

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The rationale for debt settlement

Good morning – I'd like to begin with a quote from what seems like another time now - 'With dramatic growth in the extension of consumer credit in recent years and increasing evidence of clients presenting to the Money Advice and Budgeting Service (MABS) with high levels of debt, it is imperative that Ireland put its own (debt settlement) legislation in place' - from 'An End based on Means', Page 123, Free Legal Advice Centres, first published **May 2003**.

Of course, despite our lobbying efforts, the legislation called for never materialised. The good times were rolling and there were no votes in it. Had it been introduced in a timely manner, we believe that it would have prevented a considerable amount of current overindebtedness, by forcing the credit industry generally to adopt a more responsible approach to lending or face losses in the form of write-offs. Thus, debt settlement legislation not only helps to resolve cases of existing overindebtedness, it can also help to prevent its occurrence.

A system would also have already been in place to gradually resolve those cases of chronic over- indebtedness that arose during the boom and that increased as the boom ended and the recession began. Instead, the State now grapples with the introduction of such legislation in a full blown economic crisis, with the prospect of an initial flood of applications and when the availability of funding to set up the required infrastructure is at a premium.

It's a bit like the apocryphal story of the tourist hopelessly lost in the Irish countryside who stops to look for directions and is told by a local - 'Well I wouldn't start from here, if I were you'. But start we must and with consumer and other personal debt, a personal insolvency scheme is where we must begin. For, as Professor Jason Kilborn's comparative work demonstrates , personal insolvency legislation taking a debt settlement approach is the norm right across Europe where consumer and personal credit has been a dominant feature of the economic landscape. Indeed many European countries with a less pronounced personal debt problem have been much more pro-active in this arena than we have been. For example, this afternoon we will hear from Melina Mouzouraki about the 2010 Greek debt adjustment law, which was drafted taking into account the experience of other European countries.

There was something myopic about our attitude that we did not see the need to look outwards for guidance and to benefit from the experience of others, preferring instead to blow our own increasingly grandiose and irrational trumpet whenever the opportunity presented itself. It might also be said that the European Union did not help us here by refusing to put in place any minimum measures that we would have been forced to transpose, the normal default position for progress in Ireland sometimes. With our escalating levels of personal credit, insolvency legislation was always going to be essential to help to reconcile the over-indebtedness that was inevitably going to occur with increasing regularity, even if we had managed the so called 'soft landing' into recession that was promised by many of the cheerleaders of our so called economic miracle.

With credit comes debt as night follows day. In short, the State attempted to defy logic in failing to put in place an infrastructure to resolve personal debt cases. As a result, substantial numbers of people who were encouraged to borrow large amounts of money have been set adrift in a sea of pain and misery. And let's remind ourselves again that most of those who are over-indebted have done little wrong; they are victims of poor financial and economic planning, forelock touching regulation and a culture of unbridled greed.

The lack of political vision that gave rise to this unacceptable delay has also created another 'hostage to fortune'. As the banks were bailed out, expectations were raised and fuelled by intense media speculation, particularly in the course of 2011, that a so called 'debt forgiveness' programme might be introduced. Cue shock and horror at the fear of moral hazard, feeding neatly into the 'divide and conquer' mentality that seems to blind many in our society to the need to find solutions, albeit unpalatable ones, when there are obvious deep-seated problems which have been hitherto neglected by government. With sound bites rather than informed analysis the flavour of the month, a perception grew in some quarters that the settlement of debts is a relatively painless matter, so easy that many unworthy applicants will rush to jump on the bandwagon and offload their debt. However, the reality is that personal insolvency schemes across Europe and throughout the world do not facilitate this.

The forecast publication for the Personal Insolvency Bill is the end of April but misconceptions still abound as to what it may involve. The clue is in the language though. You have to be insolvent. Those seeking to take advantage can be winkled out by a rigorous process of financial assessment and penalties for false declarations. Either Mabs in the case of a Debt Relief Certificate (DRC) or a personal insolvency trustee in the case of a Debt Settlement Arrangement or Personal Insolvency Arrangement (PIA) must examine your finances, assemble a Standard Financial Statement (SFS) and certify the financial information as correct before making any proposal to your creditors. Try pulling the wool over the eyes of some of the money advisors, accountants or solicitors in this room and see how far you get!

So that small minority with the gene – the maybe I can ditch my debt which in reality I can afford to pay and get my neighbour to fund it for me gene – should expect no comfort from a personal insolvency scheme. It is important that this is understood loud and clear – personal insolvency legislation should not and will not be a haven for 'cute hoors' and 'stroke pullers' – have we not had enough of that in our society which has contributed significantly to where we now find ourselves?

But nor should 'moral hazard' be allowed to muddy the waters and be used as a further excuse to do nothing. The school that says 'Let's not introduce such legislation because some people might try to abuse it' is more of the same type of hand wringing. You may as well say let's not have a public health system because not everyone is sick. If you are medically ill, a doctor assesses your condition and you receive medical treatment (eventually!). If there is little or nothing wrong with you, you will be politely told to go away.

Help must firstly be provided to those who need it most, those households and individuals who are the most financially ill if you like and desperately require their financial situation to be resolved in a structured and sympathetic manner, before their situation further deteriorates with longer term costs and consequences for society. Witness, for example, the spiralling costs of mental health care in Ireland as reported in last Saturday's Irish Times newspaper. These cases must be fast-tracked and we must move on from there. Considerations of fairness and justice demand it and as we will hear from Tom McDonnell of TASC later on, so does our economic recovery.

Basic structure of the scheme

- **The options**

Moving on to the structure of the scheme, I think firstly that its authors deserve much credit for tackling and completing a very difficult task. However, in our view there are certain critical weaknesses in general terms in the scheme as currently proposed. Time does not permit an exhaustive analysis but in essence the scheme proposes a suite of four options for insolvent debtors as follows:

- **A Debt Relief Certificate** – to apply to specified unsecured debts up to a maximum of €20,000 and for so called no income, no assets debtors. After a one year moratorium, the relevant debts will be written off if the debtor's circumstances remain unchanged.

- **A Debt Settlement Arrangement -** to apply to unsecured debts generally to an amount over €20,001. Payment will be made for five years (with a possible extension to six) and remaining debt will be written off at the end of the repayment period

- **A Personal Insolvency Arrangement -** to apply to both secured and unsecured debts between €20,001 and €3 million. Payment will be made for six years (with a possible extension to seven)and unsecured will be written off with payment resuming in general terms on secured debts

- **An application for Bankruptcy –** to ground a creditor's application, a debt of at least €20,001 must be owed to that creditor. A debtor petitioning for his or her bankruptcy must show that he or she has already made reasonable efforts to reach an appropriate arrangement with creditors, including the other three options outlined above.

- **Personal Insolvency trustees**

Apart from the Debt Relief Certificate application which will be processed by an intermediary and made to the Insolvency Service, the other applications must be made on behalf of an insolvent debtor to his or creditors by a Personal Insolvency Trustee. What is currently envisaged is essentially a privatised system. Trustees will have to undergoing a licensing or authorisation process but it is not clear from the scheme what form it will take. However, it is obvious that many over-indebted people are extremely vulnerable and must be protected from unrealistic payment proposals and by a comprehensive monitoring process. Trustees will obviously have to be paid for this work but it is neither clear from the scheme so far how. However, generally speaking, trustee's fees come out of the sale of debtor's assets and the distribution of debtor's surplus income, subject to the payment in some case of initial upfront fees to process an application. It is to be hoped that the work to prepare for this infrastructure has already begun. If not, it must begin as soon as possible.

The threshold of total indebtedness to apply for a DRC is already too low in our view and should be increased to at least €30,000. However, we believe that there will still be substantial numbers of applicants (many of them current Mabs clients) who will not qualify for a DRC but who will have little to offer by way of asset sale or surplus income, particularly when minimum protected income is taken into account. It is conceivable that these clients may be of limited interest to more commercially minded trustees. Thus, a system of public as well as private trustees might be introduced.

MABS money advisors who are still likely to deal with the bulk of indebted clients and voluntary debt settlements on the ground should have a clear referral route into this service. If it were to be part of MABS, effective Chinese walls would be required. Equally, it could be part of the Insolvency Service and indeed existing money advisors could be seconded to it upon application. However, it is clearly envisaged to be a different role from that of a money advisor – less of an advocate and more of a professional mediator – and this must be clearly understood.

- **Creditor approval**

Whoever becomes a trustee will face what is by far the most obvious obstacle to reaching an agreement - a requirement for significant thresholds of creditor approval. These are currently:

- 65% for a DSA,
- 75% (or alternatively 100%) for secured creditors in PIA, and
- 55% for unsecured creditors in a PIA

The scheme also proposes to allow any individual creditor to appeal to the Circuit Court against the approval of a repayment plan on the grounds that it may prejudice that creditor - a further obstacle. We do not know how the credit industry will react to this scheme, particularly in cases where the applicant debtor will not be in a position to make any significant payment over the lifetime of the repayment plan.
Will they be pragmatic? Will they be resistant? If it is the latter, the legislation is effectively doomed to failure and the government will have to report back to the troika and go back to the drawing board.

Or we can do the sensible and pragmatic thing and build in independent oversight of creditor refusal. A number of options exist here: for example, the Insolvency Service can be empowered to impose a plan where it deems creditor refusal to be unreasonable with a creditor having a right to appeal this into the courts. Alternatively, a debtor whose plan has been rejected may present that plan to a court who may impose a settlement. As it stands, unless there is creditor acceptance, the application falls. As we will hear from Professor Gerry Whyte, there may be well be constitutional difficulties in imposing out-of-court debt write-offs upon creditors and the government is said to be concerned about this. Again, however, this should not be allowed to provide another excuse to do nothing. As you know, a bill may be referred to the Supreme Court for its constitutionality to be tested.

- **Minimum income**

The question of the minimum income that a debtor is entitled to retain under a repayment plan is absolutely critical to the fairness and success of this scheme. At present, the scheme is vague on this issue providing that the debtor should have sufficient income to maintain a reasonable standard of living for him or her and dependants. It suggests that guidelines might be prepared by the Insolvency Service and/or regulations to be made by the Minister for Justice and Equality. Head 132 provides a list of matters that the Insolvency Service shall take into account in preparing and publishing guidelines. It is at least encouraging that this suggests that essential income should be above social welfare rates; that a debtor should be allowed to retain a significant proportion of any increase in income and that reductions in payment amounts may occur for debtors when they reach certain milestones in the repayment plan.

However, calculating minimum protected income for a household is far from a straightforward application of a slide rule. In this regard, the recent publication of 'A Minimum Income Standard for Ireland' the latest work on this subject from the Vincentian Partnership for Social Justice, published by the Policy Institute in Trinity College should be examined very closely[1]. This study emphasises that household type, size, location and the age of children are all important variables. The methodology, adapted from similar work carried out by the University of Loughborough in the UK, consists of a number of focus groups who exhaustively review each other's work before arriving at the expenditure required for a minimum standard of living for a variety of household types. The amount of income that must be earned in order to meet this minimum standard of living, taking onto account income tax, PRSI and other charges must then be calculated. The issue of protected income is particularly important given the envisaged durations of the two out-of-court schemes at five (and possibly six) years for DSAs and six (and possibly seven) years for PIAs. This is a very long time to survive to line on an overly restricted income. In summary, it would be unconscionable if a personal insolvency scheme, designed to relieve debtors of unsupportable debt burdens over time further impoverished those whom it was designed to help.

- **Factoring in mortgage debt**

At the end of 2011, there were over 70,000 residential mortgages in arrears for 90 days or more (over 70% of these for over 6 months). Close to a further 40,000 have been rescheduled but are not in arrears and it is estimated that at least another 40,000 are in arrears but for less than 90 days. This is one in five of mortgages on principal private residences in the State, not counting the large but seemingly unquantified number of buy-to-let (or investment mortgages) in difficulty, some of which are secured by principal private residences upon which there are also mortgages not of themselves in arrears.

[1] A Minimum Income Standard for Ireland - A consensual budget standards study examining household types across the lifecycle, - Collins, McMahon, Weld and Thornton, the Policy Institute at Trinity College Dublin

We do not know to what extent these households also have unmanageable unsecured debt, though anecdotal evidence would indicate a substantial majority. In that regard, a recent snapshot survey of 50 callers to FLAC centres with mortgage problems revealed that 33 had other personal debts and 29 of these 33 were in arrears with those other personal debts. Recently, Matthew Elderfield, Deputy Governor of the Central Bank of Ireland announced that as part of the Bank's ongoing research on the mortgage market, a Household Income Survey is to be conducted to provide a more accurate picture of the financial position of a representative sample of mortgaged households - an admission that such an accurate picture does not exist.

It is astonishing that on the cusp of introducing personal insolvency legislation, we still have little idea of the exact extent of that problem across the range of credit agreements. However, given the domination of mortgage credit during the boom, it might be said that personal insolvency legislation that does not factor in mortgage debt would be like trying to fuel a rocket with diesel oil.

A key priority for FLAC with the draft scheme is the maintenance wherever possible of the family home, though we do unfortunately have to accept that some mortgages are unsustainable, because the arrears are now so deep and the capacity to pay anything remotely resembling the contractual instalment so impaired. What does the scheme propose here? Firstly, Debt Settlement Arrangements (DSA) can include unsecured debts only though Head 68 suggests that a secured creditor might, without specifically participating in a DSA, reschedule the terms of that secured debt. This may be designed to encourage mortgage lenders to take less money for the duration of the DSA repayment period of five years whilst unsecured debt is being paid and then written off. The maintenance of the family home may therefore be achieved here. However this head is also careful to say that nothing '*affects the right of a secured creditor of the debtor to enforce or otherwise deal with his or her security'.* Thus, a mortgage lender may sue (assuming that it has complied with the terms of the Code of Conduct on Mortgage Arrears) and seek to repossess a family home. However, if that home is in substantial negative equity as so many are, the mortgage lender will generally face a large shortfall. However, the debtor may then propose a DSA in respect of that shortfall as an unsecured debt together with other debts.

The second way that mortgage debt may be stitched into the draft scheme is through the Personal Insolvency Arrangement (PIA). It is notable that a trustee when proposing a PIA must generally prioritise the retention of the debtor's principal private residence unless the costs of doing so are disproportionately large relative to income and accommodation needs of the debtor. The trustee may propose a write down of the outstanding principal on the mortgage to the current market value of the property (with a potential clawback for the lender in the event of sale) and may also propose that the mortgage be rescheduled during the six (or seven year) repayment period, freeing up any surplus income for distribution to unsecured creditors.

At the conclusion of the PIA, unsecured debt is written off and the debtor may resume paying his or her mortgage. In design, this infrastructure is not a million miles away from the Norwegian system of factoring in mortgage debt that Egil Rokhaug will explain early this afternoon. However, a number of obstacles appear in the Irish scheme that do not apply in Norway – not least the significant creditor thresholds of approval for both secured and unsecured creditors for a PIA proposal in Ireland already referred to. This compares to Norway where a court may impose a settlement upon creditors where it is considered appropriate. In addition, the definition of secured debt in Ireland is extremely broad and includes those creditors who have registered judgments as judgment mortgages against the family home of the debtor concerned. In our view it is pure fantasy to call these creditors secured when that property is in negative equity and including them in the voting mechanism may further dilute the prospects of agreement.

Why is retention of the family home so important? Quite apart from considerations of social justice, there are 100,000 people on local authority housing lists and little by way of social housing available. A fledgling small-scale mortgage-to-rent scheme is currently starting but otherwise there are few accommodation alternatives for families whose homes have been repossessed, apart from applying for Rent Supplement from a pressurised social welfare budget.

- **Bankruptcy changes**

The scheme also proposes to amend and update the much criticised Bankruptcy Act 1988. The most significant change is the introduction of an automatic discharge period of three years. However, it is perhaps not as automatic as it looks when you realise that a further five year 'Income Payments' Order may be imposed by the High Court at its discretion on the application of a creditor or trustee. At present no criteria to guide the court as to the circumstances in which such orders might be granted are set out but in principle this is far too penal a provision. It is likely that this provision is modelled on a UK equivalent but my understanding is that such an order in the UK applies from the date of the bankruptcy, not the date of discharge and can apply only for three years. Three versus eight years is quite a disparity.

It should also be noted that an application objecting to automatic discharge from bankruptcy may be made by the Official Assignee or by a trustee on grounds of lack of co-operation, dishonesty or other wrongful conduct of the debtor. If there is sufficient evidence of this, the period of bankruptcy may be extended up to eight years.

Otherwise, there is a clear problem in terms of the comparative lengths of the DSA and PIA at five and six years as opposed to three years for bankruptcy. Although a debtor filing for his or her own bankruptcy must show that he or she has pursued the out-of-court options, there is a significant danger that these will be bypassed in favour of the comparative certainty of outcome of bankruptcy, not to mention the availability of a much shorter discharge period in the UK and Northern Ireland.

Imbalances

Looking at the proposed scheme in its entirety, our overriding conclusion is that it is significantly imbalanced in favour of creditors in many respects. Please see our submission for more detail but some examples, in addition to those already outlined, might include the following:

- New or pending legal action against a debtor during the one year moratorium for a Debt Relief Certificate may be approved by a court, which may serve to undermine the whole purpose of the mechanism
- Existing Debt Settlement Arrangements already approved can be brought to a unilateral end by a majority vote of creditors even where the debtor has acted in good faith

- A Debt Settlement Arrangement will not preclude any secured creditor, even the holder of a judgment mortgage, from enforcing its security which may serve to undermine the DSA itself
- A debtor who applies for a DSA commits an act of bankruptcy and little thought has gone into what happens to rejected applicants generally
- Two or more persons (such as a couple) can only propose a PIA if they are joint parties to all the debts. There is no provision for a household to declare insolvency
- Debtors have very few rights of appeal under the scheme compared to creditors
- A wide range of potential criminal offences may be brought against debtors under the scheme. There appears to be no criminal liability envisaged for creditors, even those who may have impeded the scheme's operation
- It is proposed that an Insolvency Register will be kept that will record applications that have been refused as well as accepted.

Reforming methods of debt enforcement

The processes for enforcing a debt judgment in the legal system in Ireland remain in many instances ineffective and out-of date for the 21st century as FLAC has noted in detail in both its reports on debt enforcement. The Law Reform Commission too in its comprehensive report on Personal Debt and Debt Management in December 2010 not only proposes the introduction of personal insolvency legislation but also the overhaul of many of the standard forms of debt enforcement such as the Instalment Order system and the system of seizure and sale of goods by City Sheriffs and County Registrars.

This part of the reform process appears to have been put on the back burner. This should be remedied as soon as possible as these reforms are also an essential part of the modernisation of the debt enforcement infrastructure in Ireland.

Conclusion

So far, on the tortuous road to what we hope will be some form of economic recovery, the plight of the over-indebted consumer has been of peripheral importance to policy makers and by and large, sympathetic noises but little by way of concrete action has been the norm. In finalising this scheme, it is important to focus on relieving the human misery of unsustainable indebtedness. Economic benefits will eventually result from cleaning up this mess but it is also critically important that this scheme rebalances rights and places the welfare of the insolvent debtor and his or her dependants at the heart of the matter. There are many in Ireland not over-indebted or who are fully servicing their obligations and who are deeply suspicious of what is proposed. In our view, the government must therefore take the lead in explaining the necessity for collective action from a social justice as well as an economic perspective. Most crucially of all, it must not lose its nerve. Unfortunately, years of failure to act cannot be undone at this stage. However, this failure must not be compounded now by further failure to take decisive action at this most difficult yet vitally important time.

Thanks very much for your attention.