Submission on Draft Personal Insolvency Scheme

FLAC

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1. Introduction

FLAC (Free Legal Advice Centres) welcomes the publication of the heads of the Personal Insolvency Scheme and the opportunity to contribute to the debate in advance of the publication of the actual bill. However, having consistently publicly campaigned for a decade for such legislation, we wish to put on the record that it has been far too long in coming. Untold damage has been done by the inexplicable delay on the part of senior politicians and senior civil servants alike, when the extent of an unsustainable credit boom was staring them in the face. Had such a scheme been introduced when FLAC specifically called for it in 2003, we believe that it would have prevented a significant amount of current overindebtedness, by forcing the credit industry to adopt a more responsible approach to lending or face write-offs through the discharge of insolvent debtors.

However, we must begin somewhere and as of February 2012, the personal insolvency scheme as published is the most realistic place to now start. We are at a critical juncture on a tortuous road to what we hope will be some form of economic recovery. So far on that journey, 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. Indeed, the fact that the International Monetary Fund (IMF) is the main proponent of this legislation suggests that it is driven by an economic rather than a social justice imperative. The recapitalisation of many of our financial institutions and the 2011 stress tests have laid bare the reality of the losses that must inevitably be suffered on the lending books of financial institutions.

Blood will not come from a stone and in finalising this scheme, it is important to focus on that reality and to relieve the human misery of unsustainable indebtedness. It is likely that economic benefits will eventually result from cleaning up this mess with an anticipated improvement in the financial situation of potentially thousands of citizens and therefore the economy generally. However, 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 State must therefore take the lead here in explaining the necessity for collective action as a society from a social as well as an economic perspective.

A number of concerns of a specific nature arise in relation to the more mechanical elements of the scheme with the draft as outlined. In addition, there are a number of broad general concerns about the shape and focus of the legislation. In this submission, we would wish to focus first on our more general concerns and second to concentrate on some of the more technical problems we may have identified in the workings of the scheme itself. As is customary for FLAC, this submission principally addresses the perceived weaknesses of the scheme viewed from the perspective of our central concern – the over-indebted consumer who in turn may or may not have a mortgage on their principal private residence. However, that does not mean that we do not maintain a strong and hopefully objective focus on what is likely to be effective and ultimately workable.

This submission should be read in conjunction with a document already furnished to both the Departments of Justice and Finance and to the members of the Joint Oireachtas Committee on Justice, Defence and Equality, outlining the development of the core principles of personal insolvency schemes across Europe and their potential application to Ireland, in light of the proposals made by the Law Reform Commission in its final report on 'Personal Debt and Debt Enforcement' in December 2010. That document in turn draws heavily on a comprehensive paper prepared by Professor Jason Kilborn, Professor of Law at the John Marshall School of Law, Chicago. This paper, *Expert recommendations and the Evolution of European Best Practices for the Treatment of Overindebtedness, 1984 – 2010*, first published in August 2010, tracks the recent development of debt adjustment schemes across the Member States of the European Union.

2. Issues of general concern across the range of the scheme

2.1 - Creditor Thresholds

The requirement for significant creditor approval thresholds for both the Debt Settlement Arrangement (DSA) and Personal Insolvency Arrangement (PIA), whether 55%, 65% or 75% in value of those voting at a creditor's meeting, without any opportunity for a debtor appeal or independent review by a third party is unbalanced and threatens the effectiveness of the legislation. We have no way of knowing at present whether creditors will act reasonably and pragmatically when proposals from Personal Insolvency Trustees are made but as presently set up we are being asked to 'suck it and see'. We would also emphasise that much of the debate around the necessity to write down or write off debt has focused on 'the banks' but there are likely to be many applicants for these options who will be indebted to a wide range of creditors apart from the licensed banks including: finance houses, credit card, charge card and store card companies, credit unions, licensed moneylenders, utilities, local authorities and providers of goods and services.

Recent Swedish and French initiatives and general European statistical trends of increased resistance to informal out–of–court settlement suggest that if a State is to emphasise informal out-of-court procedures, a strong enforcement agency must be put in place. However, the Insolvency Service as currently proposed appears as an administrative body that will license and regulate private insolvency trustees and will register arrangements but will not have the power to intervene in individual cases, particularly where a creditor or creditors have refused a reasonable proposal. In this respect, it is more akin to the Insolvency Service in the UK, albeit with better powers of supervision. However, it must be noted that the short discharge period in the UK bankruptcy legislation at one year may be seen to act as a major incentive for creditors to agree individual voluntary arrangements.

Our view is that a legislative scheme must be sufficiently robust to give the Insolvency Service express powers to impose reasonable settlements upon creditors, subject to the procedural guarantees of appeal required by the European Convention on Human Rights and Fundamental Freedoms and in the Irish context, Bunreacht na hEireann 1937. Anecdotally, it is apparent that some creditors would regard any attempt to impose debt write-off upon them as a breach of the Irish Constitution in terms of Article 40.3 and Article 43 which in essence both oblige the State by its laws to protect and vindicate the property rights of every citizen and to acknowledges the right to private ownership of external goods. However, critically, Article 43 also provides that the exercise of property rights ought, in civil society, to be regulated by the principles of social justice and may fall to be reconciled with the exigencies of the common good.

The amount of indebtedness of applicants for these two out of court options may vary between €20,001 and €3 million. Given the breadth of these limits, we would also be concerned that something approaching a two-tier insolvency regime will emerge here. Many consumer debtors at the lower end of this debt spectrum may have little to offer by way of asset sale to initially reduce the amount of the indebtedness and will only have their surplus income to offer by way of payments over the duration of the repayment plan. This may be compared with the higher end of the debt spectrum where applicants may be serviced by accountants and solicitors acting as trustees and where they may be assets and property to sell to reduce overall indebtedness and a greater income generating capacity.

It is foreseeable that creditors, particularly the licensed banks, may be more likely to agree plans proposed in the higher end cases. The applicant with little to offer but whose proposal is absolutely the best that can be done in his/her financial situation may find his/her application blocked. The bargaining power of the applicant may also depend upon the bargaining power of the trustee and in turn the fees that may be generated from the insolvency may substantially influence the availability of trustees.

Options exist here to improve the scheme:

- **As an option of preference, we would submit that the Insolvency Service should be given the power, on the application of the trustee whose repayment plan has been rejected, to seek a review of the refusal (especially in the case of Debt Settlement Arrangements) and should be empowered to impose a reasonable settlement on creditors, subject to a creditor right of appeal into the courts as constitutionally required.**

Other European jurisdictions have learned from experience that creditor veto can compromise the effectiveness of a person insolvency scheme. In 2007, for example, Sweden moved from a three step debt adjustment process to one straightforward step. Previously, Step One involved mandatory private negotiation with creditors that would invariably be time consuming and would fail, Step Two saw an application for debt relief then being made to the state Enforcement Agency to be presented for voting to creditors, if (or when) this application was rejected, Step Three saw a court review the proposal and usually impose a 'settlement upon creditors. In effect, the Swedish authorities decided to scrap steps one and three and trust the state Enforcement Agency to make the correct call on the appropriate repayment plan, in light of the fact that courts had up to now upheld the proposed plan in 90-95% of cases. Concerns that the property rights and the European Convention rights of creditors would be affected were allayed by providing for an appeal to the Court against the Enforcement Agency's decisions.

- **The thresholds could be (substantially) reduced in an attempt to ensure, for example, that one creditor does not block an application. However, such a measure is not likely to be effective where a creditor is owed a legacy debt or shortfall on a mortgage where the property has been repossessed and sold by the lender in question and that debt dwarfs other debts in amount and in percentage**

2.2 - What fate awaits rejected applicants?

If creditors in sufficient numbers have a unilateral right of veto, what does the debtor do next? The plan simply falls. It is however worth noting that if in applying for a DSA, the debtor commits an act of bankruptcy, leaving him or her open to bankruptcy proceedings at the election of a creditor. Curiously, a debtor applying for a PIA does not commit an act of bankruptcy. The trustee may of course go back to the drawing board and there are clear dangers here that this will lead to the proposal of a revised repayment plan that will be beyond the debtor's capacity to service.

The most logical step at this point for an insolvent debtor is petition for his or her own bankruptcy. With a three year automatic discharge period, this may seem to be attractive on the surface. However, bankruptcy is still likely to carry restrictions and a significant stigma into the future. In addition, Head 125, proposing to amend Section 85 of the Bankruptcy Act 1988, provides that the (High) Court on application to it may have discretion to make the equivalent of an 'Income Payments Order' for up to five years after the bankrupt is discharged. This provision is modelled on a UK equivalent. However, in the UK the order may only last up to three years in total and is often granted close to the bankruptcy adjudication, meaning it can only last for two years beyond the potential discharge period of one year.

Thus the bankrupt whose assets have all been sold may face the equivalent of an Attachment of Earnings Order for a very lengthy period in the proposed Irish scheme. There is nothing in this provision that makes the granting of the order dependent upon some misconduct by the bankrupt.

- **The provision for potential payment out of income for up to five years is arbitrary and would be likely to impact disproportionately by and large on a person who has only their surplus income to offer to creditors. This provision is unfair and should be removed or substantially diluted.**

- **In addition, far more detailed thought must be given and detail provided as to what happens to rejected applicants, especially in light of the current creditor vetoes and especially considering those on low incomes and their dependants who may be especially vulnerable thereafter.**

2.3 - Licensing and monitoring of trustees

Essentially, the scheme as envisaged proposes to set up a privatised trustee system and this carries huge risks. How long will it take to get the licensing process up and running and how extensive will the vetting procedure be before licences are granted? It is likely that some accountants and solicitors will apply. These potential trustees are already subject to regulation by their regulatory bodies and we would therefore hope that they would act correctly in terms of their functions, but nonetheless this would have to be carefully monitored by the Insolvency Service. It is commonly accepted at this point that mortgage brokers were subject to a very light authorisation scheme under the consumer credit legislation during the boom and some of these brokers lined up borrowers for unsustainable mortgage loans agreements. How will applications from these sources be processed? And what of debt management companies, many of who charge debtors substantial fees both up front and during the course of debt repayment and who, despite persistent calls over a number of years now, have never been licensed at all and other potential trustees such as auctioneers? Finally, what role is envisaged for staff of the Money Advice and Budgeting Service to act as trustees, given their long experience and proud track record as advocates and honest brokers on behalf of indebted people?

It is clear that the scheme as presently outlined imposes some very specific duties on trustees and obliges a number of important and objective assessments to be made that must take into account not just the position of the debtor applicant but also the views of creditors in selecting the most appropriate option. However, in practice, to what extent will trustee performance and conduct be monitored? It is conceivable that a less conscientious trustee will exploit a vulnerable debtor by proposing a repayment plan that may obtain the requisite creditor threshold but will not be sustainable. In this regard, the comparatively high failure rate of Individual Voluntary Arrangements (IVA's) in the UK is of concern.

- **The resources allocated to the Insolvency Service will be critically important in ensuring that trustees act fairly and ethically and propose plans that are financially viable.**
- **Critical to this will be a thorough licensing process that sets a high bar in terms of the appropriate qualifications and experience for the post and establishes clear standards that must be attained in order to retain licensed status**
- **Trustees must be therefore subject to constant monitoring by the Insolvency Service and an accessible and speedy complaints system put in place for debtors (and others) unhappy with the conduct or performance of a trustee**

An alternative here would be for the State to set up a public system whereby an Insolvency Service would employ its own staff as public trustees to assess cases and propose repayment plans to creditors on behalf of debtors, perhaps referred from MABS (and others). This is the essence of the system in Sweden where a state funded debt enforcement agency carries out this work. Fees might conceivably be deducted from the surplus income available from the debtor to creditors and in this way such a service might at least be partially if not fully self funding. Crucially, this is far more likely to lead to consistency of treatment for debtors. **It may be that this would be appropriate only for personal insolvencies of a lower amount, leaving private trustees to carry out the higher end work. Thus, a system that provided for both public trustees and private commercial trustees might be conceivable (see section 2.5 for more detail).**

2.4 - The question of fees for trustees and other costs

The question of the fees for trustees and the other costs of insolvency are not addressed to any extent in the scheme as published and presumably will be the subject of detailed regulations. However, there is universal acceptance across Europe that the costs of access to debt adjustment schemes should be kept to a minimum. The payment of preliminary fees as a condition of entry has been identified as a major obstacle in many of the newer insolvency regimes in Eastern Europe. For example, in Slovakia, a mere 150 cases were opened in the first three and a half years of the legislation, due to the debtor's failure to show that his/her income was sufficient to cover the trustee's fee. These schemes compare unfavourably with the more established regimes in place in Western Europe prior to 2000 where, subject to some exceptions, debtors are not required to pay any upfront fees and the costs of administering payment plans are either absorbed by the State or are paid indirectly by creditors out of the debtor's surplus income that would otherwise be distributed to them.

The particular approach adopted in Belgium to ensure that access to relief for low income debtors is not denied is worth noting. Instead of imposing the costs of procedures on either debtors themselves or upon the State, the creditor is forced to take responsibility on a kind of 'the polluter must pay' principle, i.e. that the institutions that in large part caused the overindebtedness by refusing to comprehensively assess the risk of individual debtor default must underwrite the basic costs of the process. Thus, whilst trustees are in general paid their fees out of distributions to creditors, the state has also set up a separate fund financed by a levy on creditors assessed on the portion of each institution's consumer lending portfolio in default at the end of each year. This fund is used to discharge trustee's fees where the debtor has insufficient surplus income to pay such fees. This levy also has the added bonus of encouraging prudent lending as reducing the portion of the portfolio in default will decrease the amount of the levy payable.

The most effective method of ensuring access is to cut out unnecessary formality and complexity and thereby reduce costs. Thus, for example, some jurisdictions have capped trustee's fees on a sliding scale and reduced distributions to creditors to once a year to cut down on administrative expenses. The internet is also being used with greater frequency in order to reduce photocopying and printing expenses. However, lack of means on the debtor's part to cover basic costs persists and may require more drastic initiatives.

The financial contribution that the lending industry will be asked to pay towards administrative costs of the personal insolvency scheme is a key issue. We already have an entirely state-funded money advice service in operation since the early 1990's that, as a side-effect to its work, has indirectly organised the payment of millions of euro to credit institutions that have paid nothing in return. Equally, it can hardly be dispute at this point that a considerable amount of reckless and imprudent lending took place during the boom period. **Those who created the mess should be involved in paying for the clean-up, not just in terms of write-offs arising from debt settlement, but also in underwriting some of the administrative costs of the procedures as a formal recognition of responsibility.**

2.5 – The potential role of the Money Advice and Budgeting Service (MABS) in this scheme

MABS has been in existence now for two decades and has grown to the point that there is now a MABS service in every large town and city across the country, operating with professional paid staff and voluntary management committees to oversee the delivery of services locally. Indeed MABS, though it is perceived to be a national homogenous service, is in fact a number of separate companies limited by guarantee, now operating under the auspices of the Citizens Information Board. Over its existence, MABS has built up an acknowledged expertise in assisting indebted clients to maximise their income, to renegotiate affordable debt payments with creditors and to regain control of their finances. It has acquired considerable knowledge of the range of creditors operating in Ireland and money advisors have undergone a wide range of training in areas of key importance to their work. Money advice personnel also have access to technical and training support from MABS National Development Limited, which also offers a phone line and self help service for people in financial difficulty.

It is reasonably clear from the scheme that MABS is intended to be the intermediary through which applications for Debt Relief Certificates will be processed prior to their determination by the Insolvency Service. In our view, this is appropriate as MABS would have a significant number of clients on low incomes whose average indebtedness may come under the €20,000 threshold. However, there are also an increasing proportion of MABS clients who have secured debt and/or indebtedness levels well in excess of the current threshold for DRC's. A critical question therefore arises – what role is envisaged for MABS in relation to the other out-of-court options outlined in the scheme, the Debt Settlement Arrangement (DSA) and the Personal Insolvency Arrangement (PIA), assuming that the current structure of MABS is to remain the same?

It is clear that in order to propose a DSA or a PIA, a person will have to apply to become a Personal Insolvency Trustee. It is however conceivable that not every MABS money advisor would automatically embrace the role of trustee, in particular given that the scheme as envisaged creates a number of detailed obligations on trustees, including the necessity to consider the interests of creditors as well as the applicant debtor and to make statutory declarations. In addition, if every money advisor became involved in this work, it would undoubtedly distract from the delivery of core front line services to MABS clients whose indebtedness might not be dramatic enough to necessitate the proposal of a DSA or PIA but for whom intervention and assistance is an absolute necessity. It would also be likely to impinge on the negotiation of voluntary debt management plans with creditors; a process that has been and will continue to be a vitally important part of the rescheduling of debt in Ireland, notwithstanding the existence of a legislative personal insolvency scheme. However, on the other hand, some money advisors would be likely to welcome the prospect of becoming involved in such work, viewing it as a natural extension of their current work.

As outlined above, we also believe that with a potential span of indebtedness in order to qualify to apply for a DSA or a PIA ranging from €20,001 to €3 million, there will be some applicants at the lower end of that spectrum with a restricted income and little in the way of assets for sale who may find it difficult to obtain the services of a more commercially orientated trustee. Many of these potential applicants would be likely to seek assistance on their debt problems with MABS services in the first place and so might be a natural fit to have their situation attended to by MABS.

The recent 'Keane' report proposed that an independent mortgage function be resourced by the State and suggested that MABS is not structured or resourced to provide this support and advice[1]. It estimated that over 100 independent advisors would be needed to provide this service and that these advisors would require financial, accounting and legal skills. It suggested that these new advisors might operate in 3 to 4 regional clusters linked to MABS offices and that these clusters could be legally part of MABS but would not have to be. However, it also stressed that it would be important that there was a link to the MABS network to ensure that mortgage holders know how to access the advice.

We are not currently aware of the exact status of the Keane report and this recommendation in particular though it has recently been suggested that an implementation group to give effect to the recommendations of the report has been set up in the Department of Finance. However, in light of the likelihood that a number of debtors with serious mortgage arrears problems who may also have other unsecured debts will try to avail of the Personal Insolvency Arrangement (or indeed the Debt Settlement Arrangement) to reschedule their mortgage and other debts, we would suggest, **for discussion purposes**, that MABS involvement related to the scheme might be structured as follows:

- **MABS staff would receive comprehensive training and ongoing information on the personal insolvency legislation when it is finally passed and will act as a primary source of advice and subsequent referral of clients to insolvency trustees.**
- **MABS money advisors would continue to negotiate and agree voluntary debt management plans with a client's creditors outside of the terms of the Personal Insolvency Scheme.**
- **MABS money advisors would act as the intermediary for application for Debt Relief Certificates.**
- **A significant tranche of the independent advisors envisaged in the Keane report might become the staff of a <u>Public</u> Insolvency Trustee Unit (attached to the Insolvency Service or alternatively the Department of Social Protection) which could be established on a regional basis to deal with referrals from MABS money advisors where the advisor forms the view that a DSA or PIA might be an**

[1] Inter-Departmental Mortgage Arrears Working Group, 30 September 2011, Pages 32 and 33

appropriate solution for his or her clients. This unit could also deal with referrals from other sources in comparatively low value insolvencies.

- **Existing money advisors (as well as others) could apply for these posts either on a secondment or a permanent basis as desired, as the experience and expertise of money advisors would be a useful asset for the role, mindful of the fact that the scheme (as currently outlined) provides that trustees are independent and are not advocates for the debtor.**
- **Licensed <u>Private</u> Insolvency Trustees might focus on higher end cases where they may be significant assets and/or income as well as substantial over-indebtedness and of course potential applicants for any of the options under the scheme would be free to directly approach private trustees as they saw fit.**

2.6 - Minimum Protected Income

The scheme so far provides little concrete detail on the absolutely critical question of protected minimum income, i.e. the income that the household of the insolvent debtor is entitled to retain by law and which cannot be used to make payments to creditors. Slightly vague references are made to ensuring that the debtor has sufficient income to maintain a reasonable standard of living for himself/herself and his or her dependants, with guidelines to be potentially prepared by the Insolvency Service and/or regulations to be made by the Minister for Justice and Equality. Head 132 does however provide 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'[2] 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. Amongst many other issues, this study emphasises that household type, size, location and the age of children (if there are any) are all important variables. The methodology adopted in this study, 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

[2] 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

time for a household to line on a restricted income. It is notable that the Executive Summary to this study concludes by remarking that:[3]

> *"Failure to ground the national minimum wage and social welfare transfers in a tangible measure of adequacy, such as defined in this research, means that poverty and social exclusion will continue to be a reality in Ireland."*

It would be similarly unconscionable if a personal insolvency scheme, designed to relieve debtors of unsupportable debt burdens over time and to act as an aid to economic recovery, impoverished those whom it was designed to help, many of whom have done nothing wrong and finds themselves the victims of circumstances and economic whirlwinds beyond their control.

- **From the perspective of effectiveness, quite apart from the vitally important human rights and anti-poverty perspectives, it is essential that sustainable standards on minimum protected income, <u>consistently applied to all,</u> are put in place. It is vital that this work should begin as quickly as possible and not as a last minute exercise.**

2.7 - Length of repayment plans

The length of the repayment plans under a DSA at five (possibly six) years and a PIA at six (possibly seven years) are arguably too long and may lead to a significant attrition rate for hard pressed families and individuals. It should be said that these exceed the current European trends and are far out of kilter with the proposed three year automatic discharge period for bankruptcy.

In general terms, the practical experience of the feasibility of lengthy repayment plans has by and large gradually led to a reduction of their duration across Europe. Thus many of the newer and revised schemes provide for three years or five years at a maximum, with some of the older ones still sticking to a longer maximum repayment plan, for example, France up to 8 years, Austria at seven years and Germany at six years.

In practical terms, a number of considerations have to be balanced here. Creditors under debt adjustment schemes are inevitably going to have to accept write-offs and in many instances (especially for example in the very difficult economic circumstances in which Ireland finds itself) these write offs will be considerable and conceivably may amount to almost the entire amount of the money owed. To make the repayment period too short may be said to be adding insult to injury, as well as constituting too light a disincentive to incurring high levels of debt in the first place. On the other hand, an overly lengthy repayment plan may risk failure, given that the debtor concerned will have to survive for a long time on a minimum income and may lose heart in the course of what Professor Kilborn describes as a period of 'indentured servitude'.

2.8 - Review of the scheme's effectiveness

This proposed scheme brings the negotiations for the repayment of debt into new terrain. With so many imponderables and variables, it is surprising to see that the scheme does not provide for a rolling review of its

[3] At page 5.

effectiveness. On the contrary, for example, Head 82 in principle suggests that a review of the operation of the PIA system take place not later than ten years from its commencement.

- **In our view, the Insolvency Service should be mandated to review the operation of the legislation on a 'continuous assessment' basis and it should be tweaked and, where it may prove necessary, overhauled as and when required.**

2.9 - Failure to reform the enforcement of judgments system simultaneously

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.**

2.10 - The Insolvency Register and the effect on credit rating

It is currently proposed that information be kept on sub-register s in a Personal Insolvency Register for up to three years in the case of DRC's, and for five years with DSAs and PIAs. This information is to be kept regardless of whether the application was or was not approved from the latest of the dates of either the application, the refusal of the application or the completion, termination or failure of the DSA or PIA or the end of the moratorium in the case of DRC. A number of questions arise in relation to the register and many of these impinge on what is likely to be a key issue for debtors who have completed an arrangement in terms of their future credit rating and subsequent access to credit:

- **What is considered to be the purpose of retaining and making available this information?**
- **Who will be permitted to have access to it?**
- **Why is it proposed that debtors whose applications have been refused be recorded on the system?**
- **Have the views of the Data Protection Commissioner been canvassed in relation to the compliance of what is proposed with the data protection legislation?**

3. Points of a more technical nature on specific aspects of the heads of the scheme

3.1 - Debt Relief Certificates (DRCs)

Introduction

In the UK, Debt Relief Orders, upon which DRCs are clearly modelled, were introduced by the Tribunals, Courts and Enforcement Act 2007 on 6 April 2009. Intended to be a 'poor person's' bankruptcy, it was estimated that 11% of bankruptcies in the UK would have qualified for a Debt Relief Order and this explains the rationale for their introduction[4]. In a number of European schemes of personal insolvency, this function is carried out by system of so called 'zero payment plans'. In some of these schemes, early release where the debtor has no repayment capacity is the norm. With others the repayment plan is allowed to run its course even where no dividend accrues for creditors.

Insolvency test

Inability to pay his or her debts in full as they fall due is one of the decisive criteria in terms of qualification for a DRC. This is a quite a general criterion and the question must be posed as to whether further detailed guidelines will be developed and published to provide clarity on the parameters of such inability, particularly in the context of the Standard Financial Statement (SFS). This goes for the other forms of out-of-court settlement as well.

A fear has been expressed by some, most notably creditors and those who are not indebted, that those with capacity to pay but who will not do so ('won't pays) will attempt to use these schemes to offload debt. FLAC is also anxious to ensure that this does not happen, principally because it may undermine the effectiveness of the scheme for those who really need to access it. In our view, there are enough opponents of a formal personal insolvency scheme in Ireland without further ammunition being provided. **We would suggest that the drafters of the legislation therefore give some more thought to framing more detailed and precise insolvency tests for the guidance of debtors, trustees and creditors alike.**

Exclusion of secured debts

It should be noted that 47% of clients now contacting MABS have a mortgage but secured debts are not qualified for a DRC by virtue of H.22 (4). We assume therefore that having a secured debt such as a mortgage will not automatically exclude the debtor in question from applying for a DRC but obviously cannot be included in it. However, it is hardly a holistic approach to over-indebtedness to permit a person or household to apply for relief from their personal debts but still be faced with a chronic mortgage arrears problem and in practice this exclusion of secured debt may exclude those with mortgages entirely.

Low debt threshold

Assuming that the sum of €20,000 referred to is calculated as the total amount of indebtedness of the applicant as opposed to the total of arrears currently being suffered, our view would be that the threshold is too low and may exclude many 'no income, no assets' cases for whom a debt settlement or other form of arrangement may not be appropriate as their financial situation is so compromised that little or no dividend can be created for their creditors. Although it is on a par with the UK threshold of £15,000, that figure was first set in April 2009 and was specifically introduced as an alternative to bankruptcy. Bankruptcy in Ireland as envisaged under this scheme, with a three as opposed to one year (UK) discharge period and a five as opposed to (in practice) two year (UK) Income Payments Order is not a comparable equivalent to a DRC.

In practice, this threshold is likely to exclude many Money Advice Budgeting Service (MABS) clients, even though it would appear that Mabs are clearly being targeted as the 'intermediary' that will make applications to the

[4] See debtrelieforder.org.uk.

Insolvency Service for DRCs on behalf of clients. Our understanding is that it has recently been estimated that the average indebtedness of a MABS client is approximately €19,000. If this is an average figure, it follows that a substantial number of clients will exceed this threshold and some of these will be 'no income no assets' cases. **In this regard we would urge the government to examine the available statistics on the MABS client base in detail with a view to determining a more appropriate debt level and to consider revising the threshold upwards to a more realistic figure, not less than €30,000.**

Financial criteria and minimum income standards

The applicant's surplus income must not exceed €60 per month after payment of 'normal household expenses' and payments in respect of excluded debts (H.23). These excluded debts include court fines, child or spousal maintenance as well as periodic payments, if any of these are applicable. However, for the purposes of **H.50** - 'monthly surplus income' is the amount by which a person's monthly income exceeds the 'amount necessary for the reasonable domestic needs of him or her and family'. It is arguable that normal household expenses and reasonable domestic needs are not the same criteria. Equally, there is no guidance presently provided as to whether minimum retained income will differ depending on the option applied for. So, for example, will the amount allowed for in respect of 'normal household expenses' when applying for a DRC differ from the amount allowed for in a Debt Settlement Arrangement (DSA) in order to ensure that there is sufficient income for the debtor to 'maintain a reasonable standard of living' (H.66 (2) (f)).

A further point occurs and it is one that will no doubt occur particularly for creditors. If normal household expenses is intended to cover all the essential costs of that debtor's household (and the applicant has none of the excluded debts listed), is he or she really insolvent if there is a surplus of up to €60 per month to the extent that no payments can be made and all qualifying debts must be written off after a year should his or her financial situation not change? **We pose this question not to potentially exclude worthy applicants from the process but because it indicates a lack of clarity that may serve to undermine the scheme and thus the swift resolution of genuine no income, no assets cases.**

As set out above in our general concerns, we believe that the fairness, effectiveness and integrity of any of the mechanisms outlined in the scheme depends largely upon the speedy adoption of well researched, consistent and realistic minimum protected income standards. The scheme empowers the Insolvency Service to issue codes and the Minister to propose regulations. These need to be worked on immediately.

Financial criteria and assets

The applicant's assets and savings must not exceed a value of €400 (apart from the applicant being entitled to be the owner of a vehicle that must be worth no more than €1200). We cannot find any provision that fixes responsibility on anyone to value assets for the purposes of the application for a DRC. Is it to be the intermediary (clearly envisaged to be MABS) as part of the assembly of the Standard Financial Statement? If so, this has not up to this point been a core part of money advice work and will need training and resources. Perhaps, this function could be carried out by the Insolvency Service but again resources would be an issue here.

A more troubling question is the current list of 'assets' that are not counted for the purposes of the €400 calculation. These include 'household equipment such as bedding, clothing and furniture' and 'tools, books and items of equipment used by the debtor in his/her job or business'. However, domestic appliances such as white goods and basic leisure items are not specifically listed. If therefore, for example, an applicant has a TV, a DVD player, a personal computer, a washing machine, and a microwave oven that are bound to be collectively worth more than €400, will he or she be excluded from applying for and obtaining a debt relief certificate? If this is the case, there will be very few applicants who will qualify. **Far more detail is needed here on what will and will not be considered to be 'assets' and items that are standard in the vast majority of households across the country should be exempted.**

Effect of existing court orders and 'legally binding' agreements

A DRC will have 'no effect on the enforcement of any order of a court that is in force for the payment of money' (**H.32**). This is likely to refer to existing Instalment Orders, for example, which the debtor must continue to pay and which may not qualify for the DRC. However, a less clear issue is whether it will allow a creditor to apply for an Instalment Order for the first time on an existing judgment even where it concerns a debt that could come within the ambit of the DRC? **In other words, is what is excluded from the DRC simply an existing order or judgment that has already been enforced or any existing order of the court, i.e. a judgment for a liquidated sum that is capable of being enforced? This should be clarified.**

A related question concerns the status from an enforcement perspective of judgments obtained since the announcement of the scheme. There is likely to be a substantial time gap before the legislation is finally passed, at least into the autumn and already there is some anecdotal evidence of creditors obtaining judgment in anticipation of it. It would appear that there is nothing right now to stop this happening. Clearly, if a judgment creditor having obtained judgment then obtains an Instalment Order before the legislation is commenced, this debt will be excluded from the scope of any DRC. **Could some control over this be exercised by inserting a provision that allows the Insolvency Service to examine judgments post January 25th when the detail of the scheme was first announced in order to determine whether the judgment was obtained in order to frustrate the intent of the scheme?** Criteria might include an examination of previous negotiations and payments on the debt. So for example, if the creditor had been accepting staged payments and then suddenly brought legal proceedings, the Service might be able to draw an inference from this in deciding whether or not to apply the DRC to the debt.

Legal action during the moratorium

A creditor to whom a specified qualifying debt is owed may not bring legal proceedings during the one year moratorium **(H.33).** However, a court may give permission to do so on such terms as it sees fit to impose. **Why is this? Surely, if a court was to exercise this power and it currently appears to have complete discretion to do so, it completely undermines the purpose of this part of the scheme and may cause the DRC to fail.** At the very least, specific limitations should be imposed on a court here and only in extreme circumstances should this be allowed. Even at that, it is hard to envisage what these might be, short of the debtor's misconduct in some shape or form in which case the DRC would be likely to be revoked anyway.

Similarly, in respect of qualifying debts, a court may stay existing proceedings on the date the moratorium is to begin or allow them to continue on such terms as it sees fit. Again why is this? Surely if the DRC is approved, the moratorium should apply to all qualifying debts. **If a court is empowered at its own discretion to make exceptions to this, it would surely undermine the effectiveness and consistency of this part of the scheme.**

Potential exclusion where legally binding arrangement in place
H.23 (5) (viii) (albeit in square brackets) excludes a debtor from applying for a DRC if he or she is subject to any form of legally binding arrangement or composition, other than a DSA or PIA, with one or more creditors. The reference here to 'any form of legally binding arrangement' here is confusing and wide open to interpretation. **We presume it is intended to refer to any such arrangement or composition pursuant to the existing Bankruptcy Act 1988. If this is the case, it should be explicitly stated.**

Treatment of Hire Purchase agreements
H.22 (3) leaves the question of hire purchase or conditional sale agreements qualifying as a debt for the purposes of a DRC open (i.e. in square brackets). In our experience many people on low incomes entered into HP agreements during the boom and now find the payments unaffordable. **It is our view that many of those with no income and no assets should be able to terminate these agreements and return the goods and this is already provided for under Section 63 of the Consumer Credit Act 1995.** The remaining debt should then qualify under the DRC. However, there may be limited instances where the suggested obligatory return of goods on HP may not be appropriate (H.25), for example where the hirer only has a few payments left to make on the agreement and where with a rescheduling of the agreement s/he will may be able to complete the agreement and acquire title. However, even at that, the vehicle would have to be worth less than the €1200 value limit suggested under the scheme.

Approved Intermediaries
The implication in H.48 (3) – that the Authority might only approve persons of a particular description - suggests that MABS might undertake this role. If this is envisaged, it is vitally important that it does not sidetrack the work of MABS. We note that under 48 (7) the approved intermediary may not charge the debtor any fee in connection with a DRC application. This should ensure that no commercial operators will want to get involved in this aspect of the scheme.

Appeals
There does not appear to be any mechanism for the debtor to seek a review with the Insolvency Service of its refusal to grant a DRC. Why is this, given that the applicant debtor will generally have no means to mount such an appeal? If the debtor can only appeal to the Circuit Court appeal against a refusal of a DRC, will publicly funded legal representation be available to him or her for that hearing? By contrast, creditors are entitled to object on a range of grounds (including the issuing of the DRC or the inclusion of a particular debt in the DRC) to the Insolvency Service within 28 days under **H.37**.

Disclosure during the moratorium
Under **H.36**, the debtor has a number of disclosure obligations. One of these, where a DRC has been made, is to notify the Insolvency Service as soon as is reasonably practicable of any increase in his or her income, any property he or she acquires or any material error discovered in relation to his or her application. **What will the effect of such a notification be as the scheme seems to be silent on its implications? The fear would be that such a disclosure may potentially affect the discharge at the end of the moratorium and so in the absence of clarification; it may affect decision to disclose?** Where is the incentive if, for example, disclosure is likely to adversely impact on the debtor's right to a write off at the end of the one year moratorium?

Conceivably, the change in circumstances could be a dramatic one – for example, being left a significant sum of money in a will – to the extent that it might have a profound effect on the DRC. It could also happen quite far into the one year moratorium period. At that stage, presumably some form of review would have to take place but in principle the debtor and his or her qualifying creditors would have been preparing for a write-off. The payment of an agreed percentage of the qualifying debts might be an option here, but it would seem unfair that the DRC would fall in its entirety. However, the scheme must attempt to provide some guiding rules for such an occurrence

Criminal offences
H.42 provides for a range of criminal offences to be prosecuted by the Insolvency Service for debtors making false representations or omitting important information in connection with applications. So do H.43, 44, 45, 46.

There appears to be a technical problem with H.42 (5) (a) in that it purports to fix liability on a debtor for an offence committed after the DRC stand discharged. What offence could be envisaged here, apart from discovering after the event that there was some kind of material error in the information used to grant the DRC in the first place and failing to subsequently disclose it? If this is the case, how practical is this when the DRC has run its course?

H.44 (1) (a) purports to retrospectively fix upon an applicant criminal liability for any gift or transfer of his or her property during the two year period immediately preceding the application as well as during the moratorium itself. **Logically, the approved intermediary or the Insolvency Service would therefore have to ask every applicant for a DRC if he or she made such a transfer in that two year period and must exclude a person if he or she did.** It should be clarified what range of property gifts or transfers is envisaged here? Equally, is there not a problem of remoteness of time here? A person could, for example, gift a family heirloom to a child two years before he or she runs into severe financial difficulty and needs to apply for a DRC and could still face a prosecution at which it appears that the onus would be on him or her to prove his or her innocence.

H.52 (transactions at undervalue) and 53 (preferences) also render unlawful conduct that has occurred two years before the application for a DRC is made. Although it is understandable that the State would want to impose stringent conditions on an application that potentially involves the entirety of qualifying debts being written off (albeit currently only up to €20,000), is this realistic or fair? **Will some of these clauses provide creditors with spurious grounds to object to applications for DRC's?**

Fees
There is a €90 fee to be paid by the debtor applicant. Is this likely to be a significant disincentive for some applicants **and is it envisaged that there may be some form of subsidisation or waiver available in particular cases of hardship?**

3.2 - Debt Settlement Arrangements (DSAs)

Introduction
The Debt Settlement Arrangement as proposed would appear again to be primarily modelled on a UK procedure first introduced under the Insolvency Act 1986 – the Individual Voluntary Arrangement (IVA). The maximum length of the envisaged repayment period is similar, 5/6 years for the DSA, 5 years for an IVA. Both systems

involve a private trustee proposing an arrangement between the debtor and his or her creditors for the (partial) repayment of debt over a fixed period, with the prospect of a write-off. Both involve periodic reviews of the applicant's financial circumstances and both are an alternative to bankruptcy with less serious present and long term consequences.

However, it is important to note that the IVA system in the UK has not been an unqualified success. For example, from 1990 to 2007, an approximate average of 30% of IVA's terminated without being completed each year[5]. Detailed research data breaking down the reasons for such failure does not appear to be available but it is speculated that a combination of factors are at play here. These include unsustainable repayment proposals, poor regulation of and poor quality of insolvency practitioners (some of whom request up-front payments) and persistent economic distress for applicants. It is also a factor that the length of these arrangements can be very demoralising from the debtor's perspective and human nature being what it is, there are times when the debtor is tempted to take time out, in addition to those times when additional expenses aggregate for unforeseen reasons and must be met.

In short, though issues of so called moral hazard are important public policy considerations when designing a personal insolvency scheme, an overly moralistic attitude that results in too much rigidity and inflexibility risks compromising the effectiveness of the legislation. Once a failure occurs, the debtor and his or her dependants and society in general risk greater perils and costs as uncertainty replaces a formal system. As suggested above, it is our view that the scheme as presently outlined does not give sufficient thought to what happens to the debtor whose application is rejected.

Insolvency test

As with the DRC, the applicant must be insolvent and this is construed as meaning the inability of a person to pay his or her debts as they become due. As outlined above, whether this is a sufficiently detailed definition is certainly open to question and the vagueness of the definition arguably leaves creditors room to undermine the cogency of the DSA option. Without stretching the point too far, it could for example be argued on a literal interpretation that inability to pay debts as they fall due is not conclusive proof of insolvency but an indication of financial difficulty. **H.65** does go on to require the Insolvency Trustee, when preparing an application, to state in his or her opinion both that the value of the debtor's assets is less than the value of liabilities and will be so for five years and that it is unforeseeable that the debtor will be able to pay his or her debts [in full] over the same period. This is at least a more precise test.

It is worth noting that other jurisdictions have taken a more definite view of insolvency. The Scandinavian countries are among the most restrictive, with Denmark (the first jurisdiction to introduce debt adjustment/settlement in 1984) specifying that the debtor must be in a state of qualified insolvency with <u>no prospect</u> of being able to pay off debts in full in the near future, i.e. five years. The 1993 legislation in Norway provides that an applicant for debt settlement must be <u>permanently unable</u> to meet his or her obligations.

In summary, the essence of an insolvency test is that it distinguishes between those individuals (or households) who with more time and access to the assistance of debt counselling services will be able to pay all or the bulk of

[5] From the UK Insolvency Service, May 2010

their debts over a longer period and those whose overindebtedness is chronic. This is far from easy and involves a wide ranging examination not just of current financial circumstances but also future prospects and projections of income, far from an exact science.

In the scheme as currently designed, this assessment initially falls on the trustee but given the creditor veto that applies in the form of thresholds, ultimately a creditor or creditors have the power not just to decide whether to accept a repayment plan but also effectively to determine the question of insolvency. It is worrying from our perspective that the Insolvency Service appears has no oversight on the insolvency question.

Applicant for DSA commits act of bankruptcy

We note that **H.55** provides that in proposing a debt settlement arrangement, a debtor commits an act of bankruptcy, potentially leaving him or her open to a creditor's petition if his or her application is refused. On the other hand, an applicant for a Personal Insolvency Arrangement (see below) does not commit such an act. We are not aware of the rationale for this and no explanation is provided for it. We can see no logic behind this when under the Bankruptcy Act 1988, a creditor must issue a Bankruptcy Summons demanding payment of a liquidated sum and that sum must remain unpaid after 14 days before an act of bankruptcy is committed and that creditor can file for that debtor's bankruptcy. **This proviso should be removed.**

Payment in full under a DSA

We note in **H.57** that the proposal for a DSA may, inter alia, include the payment of a lump sum, an ongoing payment arrangement, an asset sale or a transfer of assets or combination of these, following which will result in creditors being paid or satisfied in part <u>or in full</u>. Given that it is a condition of application that the trustee warrants as to the debtor's insolvency, how is it generally conceivable that creditors will receive full payment? **The wording here is unclear and runs counter to the general intent of the scheme and may create an unrealistic expectation from the creditor's perspective. The reference to payment in full should be deleted or reworded.**

The creation of a charge or guarantee in a DSA

We note too that **H. 57(3)** provides that the proposal may also include the creation of a charge or a guarantee for the benefit of creditors. Given that the DSA purports to concern itself exclusively with unsecured debt (although it is conceivable that the debtor might continue his or her mortgage, even on a rescheduled basis during the course of the DSA), **is it not contradictory to provide that the DSA might potentially allow for unsecured debt to become secured in some form?**

Application for a Protective Certificate

H.58 provides that an application for a Protective Certificate be made by the debtor and that it must name the trustee who has agreed to act in relation to that PIA. When applying for this certificate, the debtor must submit the draft terms of the proposed PIA to the Insolvency Service. Surely this application should be made by the trustee on the debtor's behalf, given that it must include financial information which the debtor would be well advised to consult the trustee in relation to?

Presumably, the Insolvency Service will use this information to vet the application to decide whether it is well founded or not under **H.59**. **Is it not ironic that the scheme as presently constituted imposes an obligation on**

the Insolvency Service to vet the application before the debtor is granted protection from legal action by his or her creditors, yet it has no power to review creditor refusal of the debtor's proposal, having at least in principle approved the intended application?

Duration of a Protective Certificate

According to **H.59 (2) and (3)**, the Certificate is to lasts 30 working days, i.e. 6 weeks, with the possibility of an extension of a maximum of two weeks. **H.60 (4)** allows the trustee to apply for an extension of time to the protective certificate in order to prepare his or her report for the debtor and creditors. Is this an additional different extension to the two week extension provided for **H.59 (3)** or part of it?

In any case, although it may be argued that the bulk of the work in preparing a proposal has been done before the Certificate is granted (although that remains to be seen in practice), is this sufficient time to assemble in full all the required information and to conduct what may be difficult and protracted negotiations with creditors on the proposal, including the holding of the creditors meeting? What if a creditor is obstructive and delays the process or documents are not available. It should be borne in mind too that the finances of some applicants may be very complex involving multiple creditors and that the trustee may have a multiplicity of applicants to assist at any particular time. **Provision for a longer period in the first place may therefore be preferable.**

Debtor's obligation to prepare documents

Under **H.60**, the trustee is to prepare a report for the debtor and creditors for the purposes of the creditor's meeting. In turn the debtor is obliged to submit information and documentation for the trustee in order for him or her to prepare this report (note: this is not specifically referred to as a Standard Financial Statement (SFS) in this head but the term subsequently appears in Head 62). The sequencing of these actions in the heads is confusing. Surely, in order to prepare a draft proposal in order to obtain the Protective Certificate in the first place, the debtor will have already supplied this information. **The sequence of steps under this process should be clarified**.

Trustee as an independent actor

H.61 obliges the trustee to advise the debtor of the general effect of initiating and entering into a DSA and of the other options available. **These options should specifically include entering into negotiations to agree voluntary debt management plans with creditors**. Amongst other things, **H.62** obliges the trustee to consider the likely viability of a proposal, its fairness to all parties involved and whether it is otherwise fit to be considered by creditors. He or she then has to seek to register the proposal prior to a creditor's meeting and vouch that it has a reasonable prospect of being accepted by creditors. In summary, these and similar obligations reinforced in H.65 suggest that the trustee must work with an objectivity that may not necessarily put the interests of the debtor first. If this conclusion is correct, it becomes of huge relevance what role MABS (and other services) will play in explaining processes to debtors and assisting their decision making. If it is not the trustee's principal task to consider what may be in the best interests of the debtor, albeit in the context of what is feasible and reasonable, then someone should be charged with this function. Otherwise, there is a danger that debtors may become locked in some instances into unsustainable arrangements that may ultimately fail as so many IVA's in the UK appear to do.

In essence, it would appear that the trustee as currently envisaged is not an advocate for the debtor but an independent actor with statutory obligations, yet there appears to be no onus placed upon the trustee to explain this to the debtor. This should be provided for.

Trustee's ongoing obligations and the effect on fees

It is notable that trustees are charged with ongoing obligations under the terms of DSAs under **H.63**, for example the handling of money and the keeping of accounts. From what we can see, the scheme is silent on the question of the fees that may be charged by trustees for the service that they provided. However, it is evident that these obligations are likely to impinge on the question of cost, a question that will have to be considered in more detail when it comes to regulations concerning trustee's fees.

Maximum duration of debt settlement arrangement

H.66 (2) provides that the maximum duration of the DSA shall be five years but with the express agreement of creditors may last no longer than six years. Again we are uncertain about the thinking behind this particular provision. At the risk of being simplistic, why would creditors not wish to extend the arrangement for another year if it meant that they would receive more money? **The key question that arises here and appears unanswered is whether creditors individually or collectively are entitled to come back on a DSA proposal made on the basis of a five year repayment period and insist that it last six years, potentially using their veto as leverage. This uncertainty should be clarified.**

Tools of the trade

H.66 (2) also provides that a DSA shall not contain any terms requiring the debtor to sell assets that are necessary for his or her employment, business or vocation. What will be the scope of this exemption? **For example, will it include a vehicle that the debtor uses for domestic purposes but also requires to get to and from his or her place of work? The regulations that are provided for sub head (3) will have to clarify this issue.**

Preferential status of the Revenue Commissioners

H.67 preserves the priority of preferential creditors currently provided for in Section 81 of the Bankruptcy Act 1988 for the purposes of a DSA unless such creditors agree otherwise. The implications of this are particularly notable where the applicant for a DSA has a failed business leaving significant Revenue debt. We have no idea the attitude of the Revenue will be to such applications. However, if the Revenue were to insist upon its preferential status and in a particular instance this would mop up a significant portion of the applicant's available assets or income, this is likely to cause the application to fail due to creditor veto and undermine the purpose of this option**. Has the view of the Revenue Commissioners been canvassed here and should this status not be reviewed?**

Dealing with secured creditors in debt settlement arrangements

H.68 rules out the participation of any secured creditor in a DSA arrangement and specifically provides that nothing will affect the right of a secured creditor to enforce his or her security against a debtor who is participating in such an arrangement. Putting it baldly, this will specifically allow and may even facilitate the repossession of the principal private residence of a debtor in a DSA, an event that would be likely to fundamentally and perhaps fatally undermine the security and confidence of the debtor in the arrangement. **We note that no cross reference is made here to the necessity for mortgage lenders to comply with the terms of**

the Code of Conduct on Mortgage Arrears (CCMA) and the general policy objective of avoiding the repossession of the family homes wherever possible. These should be inserted.

Equally, as outlined in more detail , the prospect of an increase in the repossession of family homes that are the subject of unsustainable mortgages, brought on by the introduction of a personal insolvency scheme, is an imminent threat that must concentrate the minds of government is developing greater social housing options and a more expansive mortgage to rent scheme.

This head would also appear to mean that other forms of secured creditor (as defined in **Part 5, H.80**), such as the holder of a judgment mortgage, is also precluded from participating in a DSA. Equally, these secured creditors cannot be precluded from enforcing their security. This all potentially adds up to bad news for the debtor in a DSA. **For example, if the holder of a judgment mortgage decides to apply for an Instalment Order against a debtor who is the subject of a DSA, this could cause the DSA to come crashing down as the repayment capacity of the debtor will be altered by a court order.**

On the more positive side, this head also allows for the provision of relevant information, including the SFS, to secured creditors of the debtor. It also mentions the possibility of varying the terms of a secured debt even though it is not part of the DSA, but which, for example, might result in a rescheduled payment being paid on the mortgage for the duration of the DSA.

The treatment of secured creditors parallel to a DSA is an extremely important issue and has major ramifications for the effectiveness of such arrangements. Our sense from this head is that insufficient thought has been given as to how secured debt might bed down in a DSA and there is too little protection here for the debtor and the integrity of the process.

Variation and termination of a debt settlement arrangement by creditors

H.73 and **H.74** allow for the variation or termination of a DSA where **65%** of the votes cast at a creditor's meeting so agree. First, it is not clear from these heads who would call the meeting in question. Would it be for example the creditors themselves or the trustee? Second, whilst we accept that the provisions on variation would allow and could be intended to allow for a variation downwards, it would however appear that the decision to vary the arrangement upwards or to terminate it completely can be an entirely unilateral decision at any time during the course of the DSA on the part of the creditors concerned and does not have to be linked to any misconduct, failure to make agreed payments or other action or inaction of the debtor concerned. If this is the case, it is not only deeply unfair but in breach of the debtor's right to fair procedures. In theory, this would seem to allow a threshold of creditors who have accepted a proposal from a trustee and acted upon it, including accepting payments and even the proceeds of asset sale, to change their minds in the middle of the DSA, ask for greater payment or even call a halt to the arrangement without having to account for it in any way. It would also appear that only a <u>creditor</u> is entitled to appeal such a variation or termination to the Circuit Court and the debtor has no such right of appeal. To top it off, **H.75** seems to also entitle a creditor (or more curiously the trustee) where a DSA has come to an end because of termination by a threshold of creditors at a creditors meeting to file for the debtor's bankruptcy.

Perhaps we are missing something here but the uncertainty inherent in these provisions seems to undermine the whole process. Trustees would have to explain to debtors, even where proposals are accepted, that there is no guarantee that the DSA would last, even if the debtor stuck to his or her side of the bargain. **H.73, H.74, H.75 must be reviewed and revised in order to ensure that arbitrary and unfair decisions by creditors that adversely affect a debtor who has acted in good faith are not permitted.**

Powers of the Court concerning debt settlement arrangements

H.76, 77 and 78 deal with the powers of the Court. As far as we can see the Court in question is not named in this part but we are assuming that the Circuit Court is what is intended, apart from references to bankruptcy applications where we assume the High Court is intended.

A creditor is entitled under H.76 and H.77 to object to the grant of the DSA or to challenge the actions of the trustee or the Insolvency Service in the Court. However, it would appear that the respective heads referred to concerning hearings on creditor objection are incorrectly and/or inconsistently numbered.

Under H.78, a creditor (or a trustee) is entitled to the court to have a DSA terminated at any time during its course on specific grounds. This would appear to be in addition to the right of a 65% threshold of creditors under H.74 above to unilaterally terminate the DSA without reference to a court.

What is fundamentally missing here is any right for a debtor to appeal into the Court. Specifically, the debtor has no right to appeal:

- **The refusal of creditors to accept a proposal**
- **The actions or the conduct of a trustee, the Insolvency Service or a creditor**
- **The decision of a threshold of creditors to vary or to terminate the DSA**
- **The decision of the court to terminate the DSA**

The provisions in relation to appeal are unbalanced and require to be reviewed.

Failure of a debt settlement arrangement

H.79 currently provides that a DSA shall be deemed to have failed and shall terminate where three months arrears default has occurred. From a technical viewpoint, there appears to be a superfluous use of the word 'either 'in sub head (3). In any case, the principal issue that arises here is whether a three months arrears default justifies the termination or automatic termination of the DSA, without any further discussion or examination. A DSA can run for up to six years and this is a long time to be devoting one's surplus income to the benefit of creditors. Default can occur for a multiplicity of reasons, from illness and family emergency to loss of income and plain old fashioned loss of will which may be recoverable. **At the very least, termination should not be automatic in these circumstances and should be subject to a review process, where ideally the Insolvency Service examines the reason for default, the point in the DSA where the default occurs and other relevant considerations before deciding on termination. Appropriate rights of appeal for all parties could also be provided for.**

3.3 - Personal Insolvency Arrangements (PIAs)

Introduction

The PIA is the most innovative measure in the scheme and provides, at least in theory, for a method whereby the debtor applicant may, though technically insolvent and in arrears on his or her mortgage, stay in his or her principal private residence for the duration of the repayment period of six years and then resume paying the mortgage in full after unsecured debt is written off. **How this mechanism under the PIA system as envisaged works or does not work is critical to the prospects of success of the personal insolvency scheme in general.**

Some commentators, including the Irish banking Federation (IBF) have said that dealing with mortgage debt in the context of a personal insolvency scheme is unprecedented. However, this is not universally true. The Norwegian debt adjustment law of 1993 and the recent Greek insolvency law of 2010 both provide for potential retention of the family home for an insolvent debtor. There follows an explanation of the Norwegian scheme in some detail and a very brief synopsis of what is intended in the Greek legislation in this regard for the purposes of comparison.

Comparative schemes

- **Norway**

Norway experienced a major credit boom in the late 1980s with borrowing by private households increasing dramatically. A recession followed in the early 1990s leaving an increasing number of households unable to meet their credit obligations. According to Egil Rokhaug, *"property prices slumped and people had to sell at prices – sometimes far – below the sum borrowed*[6]. Sound familiar?

What is different was the response of Norway to its predicament. Rokhaug explains that "*the authorities had to deal with the problem – and it had to be dealt with without delay. One major problem was that the different problem areas were the responsibility of different ministries. Solving the debt problems among private households therefore would not be possible without co-operation between the different ministries. So this was the first step that had to be taken – to recognise indebtedness as a national problem, and to put in place a National Plan involving various ministries".* It is this example amongst others that led to FLAC[7] and others, most notably Stamp[8], to call for a national strategy on overindebtedness to be put in place in Ireland, as the full extent of the personal debt crisis began to manifest itself in 2009.

The Norwegian authorities in turn quickly realised that the most important measure that had to be adopted was a legal mechanism for compulsory debt reduction or debt settlement and as a result the Debt Reorganisation Act entered into force on 1 January 1993[9]. The stated purpose of this Act is to *'give persons with serious debt problems an opportunity to gain control over their finances'.* It attempts to achieve this by enabling debtors to

[6] Egil Rokhaug, Ministry of Children and Family Affairs, Oslo, speaking at Money Advice and Budgeting Service Annual Conference, Ormonde Hotel, Kilkenny – March 2002

[7] See Joyce – 'Consumer Debt in Irish Society', Law Reform Commission Annual Conference, Dublin Castle, December 2009.

[8] See 'A Policy Framework for Addressing Over-indebtedness', Combat Poverty Agency, 2009. Available online at http://www.combatpoverty.ie/publications/APolicyFrameworkForAddressingOverIndebtedness_2009.pdf

[9] July 17. 1993 nr.99.

file a petition of debt settlement in order to obtain a debt reorganisation arrangement, either agreed with creditors (non-compulsory debt reorganisation) or imposed by a court of first instance (compulsory debt reorganisation). This two tiered system follows the classic approach, adopted particularly in the Scandinavian countries, of encouraging creditors to reach a settlement with over-indebted debtors or face the prospect of having a settlement imposed by a court.

It should also be noted for those in Ireland who are particularly exercised by the prospect of moral hazard that access to the Norwegian debt settlement system is dependent upon a debtor being permanently unable to meet his or her obligations. This is defined as occurring "*when it has to be assumed that he is unable to do so to the full* (i.e. meet his obligations) *within a period that is reasonable for him seen in light of the nature of the obligations and other circumstances, or without undue sacrifice".* Essentially, this amounts to the necessity to pass the equivalent of an insolvency test at the point of entry, and in turn the legislation empowers locally based 'Enforcement Officers' to make a decision on this and other questions relevant to the debtor's petition.

Specific provisions in relation to mortgage debt: The Norwegian authorities also understood that in a nation with a very high level of home ownership (currently for example up to 80 %), protection of the family dwelling was a very important issue that would be likely to frequently arise in debt settlement applications. Three specific provisions in the legislation are of particular importance on this issue.

Section 4-4 - The debtor's obligation to sell his dwelling

'The debtor is obliged to sell his dwelling if doing so will give the creditors best satisfaction, and the value of the dwelling exceeds the debtor's and his household's reasonable needs. The assessment shall be based on the dwelling's market value, cf section 4-7 first paragraph, and the cost to the debtor of obtaining for himself and his household another dwelling which meets reasonable needs in terms of location, size, price and other conditions'.

Section 4-7 - Valuation of property items to be retained

'If the debtor is to retain a dwelling he owns, the dwelling's market value shall be fixed by the enforcement officer together with two court witnesses who are specially qualified to participate in the valuation who shall be appointed by the enforcement officer.
If the debtor is to retain other items in which a security interest has been granted, and if it is necessary to determine the extent to which the security interests exceed the property's market value, the value shall be determined by the enforcement officer. The enforcement officer may appoint one or two court witnesses who are specially qualified to participate in the valuation if deemed necessary'.

Section 4-8 - Distribution between the creditors

(a) Claims secured by mortgage on a dwelling
If the debtor is to retain a dwelling he owns, claims secured by mortgage on the dwelling within the dwelling's market value with an addition of 10 per cent shall carry agreed interest during the debt

reorganisation period. Instalments shall not be paid during the debt reorganisation period, but the principal shall subsist.

Other claims secured by mortgage on the dwelling shall be satisfied on a par with other unsecured claims. Claims become void once the debtor has fulfilled his obligations in accordance with the debt reorganisation arrangement.

Section 4-4 contains the criteria on which the dwelling can be kept under a debt settlement. According to this provision, the debtor is only obliged to sell his dwelling if doing so will give the creditors the best financial result ("best satisfaction"), and the value of the dwelling exceeds the debtor's and his household's reasonable needs. Rokhaug explains that although this is formulated in theory as an obligation to sell, in reality it is more like a "right to keep". The implementation of this section in practice has meant that the significant majority of the house owners can continue to live in their houses during the debt settlement and remain after the debt settlement repayment period has been completed. It is very rare that a sale will give "best satisfaction" to creditors because in the Norwegian experience, renting a house will normally cost more. In 2002, Rokhaug estimated that as a result of this rule, close to 90% of applicants where a debt settlement application had been processed were allowed to keep their family home.

Section 4-7 provides that for the purpose of making a decision on the retention of the dwelling, the relevant enforcement officer will have access to independent expertise to assist in the valuation of the current market value of the property concerned. The necessity for this provision is explained by
Section 4-8. This section sets out the extent of the amount the applicant must pay towards his/her mortgage, where retains his/her dwelling during the debt settlement period (in the Norwegian legislation generally five years).

Part (a) of the section provides that the applicant may only be obliged to pay interest on the market value of the property plus 10% during the debt settlement repayment period (generally five years). No principal is payable during this period. Claims in respect of any amount over 110% of the market value line up with other unsecured debts for payment on a pro rata basis during the repayment period and critically are written off at the conclusion of that period. Essentially, therefore, at the conclusion of the debt settlement period, the borrower who has been allowed to retain their dwelling is likely to resume paying a more affordable mortgage, with the market value of the house and the outstanding principal on the mortgage at an approximate level, especially where the property may have appreciated in value during the debt settlement repayment period.

It is clear that in negative equity situations, there will of necessity be a write-off of a portion of the principal involved and a loss for the lender under the Norwegian system. For example, if a property is now worth €200,000 following a steep decline in property values and €300,000 capital is owed on the mortgage, the Norwegian system would see agreed interest being paid on €220,000 for five years (i.e. 100% of the market value plus 10%), the remainder of €80,000 being treated as an unsecured debt which the applicant pays to the best of his/her ability in tandem with other unsecured debts over five years from his/her disposable income (after a minimum income is assured for the household). All unsecured debts are written off at the conclusion of the repayment period and the debtor is left with a mortgage of €220,000 which s/he must resume paying.

Rokhaug reports that the essence of the system is that it is unlikely that most debtors can find a cheaper dwelling by renting, and therefore they fulfil the conditions in section 4-4, which gives the right to keep their dwelling. Given the constraints on payments imposed by section 4-8 – interest only payment on market value plus 10% of the dwelling - the debtor will normally have a low payment obligation during the debt settlement period. This frees up residual income to be paid to the unsecured creditors (including the mortgage lender beyond 110%) during the repayment period. Rokhaug describes the system as functioning very well and reports that both debtors and the creditors seem to be satisfied with it. Creditors do not normally lose any more money than without debt settlement and the debtor gains a fresh start.

The underlying principle that appears to guide this scheme – that unsecured creditors are afforded a reasonable opportunity to recover some of their money before writing off what remains and moving out of the picture – would appear to allow the debt settlement applicant who has a mortgage to then refocus on ensuring that the full mortgage instalment is paid. Access to credit during the debt settlement repayment period may be effectively ruled out by Section 3-5 (d) of the Norwegian legislation which obliges the debtor "not to incur new debt without the creditors' consent, or carry out other dispositions liable to harm the creditor's interests" so that no fresh credit commitments are taken on board during debt settlement, leaving the disposable income earned by the debtor when the repayment period comes to an end to be devoted to paying the full mortgage instalment. Thus, although the mortgage lender sustains a loss, it occurs only once and all things being equal, a viable mortgage with payment capacity for the remainder of its duration may follow. A further restriction on access to credit without the mortgage lender's consent might help to enhance the security of the mortgage.

Contrast this with the forced repossession or voluntary surrender of a home in negative equity in the Irish context using the figures in the example outlined above. The borrower owes €300,000; the market value of the property is €200,000. The lender in the course of repossessing the property may incur substantial legal costs, will have to secure the property once it is vacated or find a tenant pending sale and will also have to avail of auctioneering, advertising and conveyancing services for the purposes of sale. Let us suppose that this costs 5% of the current market value of the property - €10,000 in this example. This leaves a shortfall of €110,000 that the lender will find very difficult to recover from a borrower who no longer has a vested interest in the property. At least in the Norwegian system, €220,000 in capital and the associated interest will be paid after debt settlement and in addition, the mortgage lender may be paid a portion of the remaining €80,000 in capital (the portion above 110% of market value) during the debt settlement repayment period.

Perhaps most critically of all, the borrower and his/her household do not have to be rehoused by the State, either in subsidised private rented accommodation or in public housing, at a time when there are close on 100,000 on waiting lists for local authority housing in Ireland and the only alternative plan at present is a pilot mortgage-to- rent scheme whose success in terms of outcome for the household and the costs to the State would have to be critically evaluated before it could be rolled out in any significant manner. Lastly, it is important to emphasise again that this kind of option will not be available to every mortgage holder in negative equity or in arrears. An applicant would have to pass an insolvency test in terms of being permanently unable to meet his or her obligations in order to avail of the debt settlement option and this would generally involve significant mortgage arrears and significant arrears on other personal debts.

- **Greece**

Greece's new law on debt adjustment and debt discharge (Law 3869/2010) was introduced in 2010. According to Mouzouraki, Greece have the highest ratio of consumer credit loans (personal loans and credit card loans) to gross domestic product (GDP) in the Eurozone and the highest rate of interest on such loans[10]. Against a backdrop of poor information provision, the lack of a debt advice infrastructure and unscrupulous selling of credit, it was inevitable that widespread indebtedness would occur and in the face of intransigent treatment of debtors by credit institutions, the Greek administration moved to introduce a personal insolvency law.

Mouzouraki reports that as the legislation is the most recent of the consumer bankruptcy laws in Europe, it has tried to make good use of the experience of other countries whilst simultaneously trying to introduce some new ideas. Access to debt adjustment is available to those citizens who 'have a proven and permanent inability to service their debts', quite an onerous insolvency test and again indicative of the lengths that legislation can go to avoid 'moral hazard'. As is standard in countries across the European Union, discharge from debt must be earned by paying residual income to creditors, over and above a minimum income retained for necessary living expenses, over a period of four years.

It is worth noting that there is no minimum amount of debt that must be paid, with the Greek government deciding that it was preferable not to fix a set repayment amount but to distribute surplus income to creditors over and above minimum income, whatever that may be, for the duration of the 4 year repayment period. The legislation also allows for zero payment plans, if the debtor is unemployed, suffers from severe health or has no income for distribution. A zero payment plan must be reviewed every five months at a minimum to see whether the debtor's financial circumstances have changed. Debts to the State and debts arising from a fraud or other wrongful act are excluded from discharge. A debtor may only obtain one debt adjustment in his or her lifetime.

The legislation takes a fairly standard two-tier approach to debt resolution. A compulsory extra-judicial phase involves voluntary negotiation to reach a settlement that is both less time consuming and less expensive for creditors. In this phase, the Consumer Ombudsman, a consumer association or an attorney on the debtor's behalf presents the debtor's financial situation to his or her creditors. However, unanimous approval of the out-of-court settlement is required by creditors. Unsurprisingly, the need for complete agreement has led to very few extra-judicial plans being approved, a point that is clearly relevant in an Irish context. The second and therefore almost inevitable phase involves the debtor petitioning a court to ratify the debt adjustment and a creditor/s has two months to object to the proposal. If there is no objection, the proposal is automatically ratified. If there are objections but 51% of creditors accept the settlement, the court has the power to bind the remainder. The court procedure is free but again the lack of a legal aid and advice infrastructure means that fees for private legal advice and representation can be considerable.

The extra -judicial phase of the scheme came into effect in September 2010 and the judicial phase from January 2011. In terms of the volume of applications, as of October 2011, 12,000 extra-judicial applications had been made, close to 1,000 per month. In the first six months of 2011, 3,200 debt adjustment petitions were made by

[10] Melina Mouzouraki, Attorney-at-Law, 'Legal developments regarding debt adjustment in Greece' – European Consumer Debt Network (ECDN) Conference, 29-30 November, 2011, Gdansk.

debtors to the courts and this number is rising all the time. It is estimated that 60% of these cases result in acceptance by creditors.

Specific provisions in relation to mortgage debt*:* In summary, the Greek legislation allows the insolvent debtor as part of the scheme to apply to the relevant court to exempt the repossession and sale of the family home. The debtor must in general only own one home and its value must be under €300,000 (although this may vary depending on the family circumstances of the debtor). The debtor must be in a position to show that he or she will be in a position to pay 85% of the current market value of the dwelling over a period of 20 years. Critically, the applicable interest rate for this extra payment option will be tied at a rate above but linked to the European Central Bank base rates.

Rationale for the Personal Insolvency Arrangement option

H.81 helpfully sets out a rationale for the PIA option and it is useful to have a stated policy objective within which to contextualise the proposals. In particular, we note **H.81 (1) (c)** which states that the purposes of this part include:

> '*To set out the conditions that apply where a debtor enters into the Personal Insolvency Arrangement procedure and to provide that debtors who successfully complete a repayment plan under a Personal Insolvency Arrangement may obtain under this Part (i) a discharge of their remaining unsecured debt and (ii) a discharge and/or restructuring of their remaining secured debt, thereby providing them with an alternative to bankruptcy'*

and **H.81 (1) (e)** which aims to:

> *'to provide for a fair balancing between the interests and rights of debtors and those of creditors in connection with Personal Insolvency Arrangements consistent with principles of social justice and the exigencies of the common good'.*

We note the reference to the potential restructuring of secured debt in (1) (c) and the reference to the principles of social justice and the exigencies of the common good in (1) (e). We believe that prevention of the loss of the family home whilst unsecured debt is resolved, insofar as this can be achieved, is a vital social policy objective of this scheme. Without such a focus, it is likely that the number of repossessions of family homes will substantially increase in the coming years beyond what is necessary or desirable, though unfortunately it would appear that the repossession of some family homes is inevitable, simply because the financial capacity is simply not there to sustain these mortgages. Ultimately the interests of creditors must indeed be 'fairly balanced' with those of debtors and we submit that this has not happened up to date. The public interest demands that it should do now.

Protecting the family home in a Personal Insolvency Arrangement proposal

According to **H.97**, a PIA in principle may not include terms that would require the debtor to cease to occupy his principal private residence or to disposes of an interest in it. When formulating a PIA, a trustee is under a duty to do so on terms that will not require the debtor to cease to occupy his or her principal private residence. These are very important protections.

This duty does not apply where the debtor confirms in writing that he or she does not wish to remain in occupation he or she wishes to do so or where the costs to the debtor of remaining in such occupation are, in the opinion of the trustee, disproportionately large relative the debtor's financial circumstances and reasonable accommodation needs.

In turn, according to **H.96A**, a PIA must provide that a secured creditor is paid at a minimum the (current market) value of the security or the amount of debt secured by the security as of the date of the granting of the protective certificate that enables the PIA proposal to be formulated, whichever is the lesser. In turn a PIA may not propose a write-down of the amount owed on the mortgage to below the value of the security (with a possible clawback of the uplift if the property is subsequently sold for a greater amount)

Finally, under **H.96,** a PIA may propose that alternative repayment arrangements are put in place for the payment of secured debt (such as a mortgage) for the duration of the PIA, that might include one or a combination of the following :

- payment of interest only,
- payment of interest and a portion of capital,
- a change in the type or rate of interest
- a deferral of payments for a specified period
- an extension of the term
- a debt for equity swap to reduce the principal
- a reduction of the principal with uplift
- capitalising of arrears and interest
- reduction of principal
- in the case of a principal private residence – mortgage to rent, deferred interest, trade down mortgages, or split mortgages or other options set out in the Keane Report

The architecture set up under these respective heads is innovative and is reminiscent of the Norwegian system outlined above in two critical respects; first the potential reduction of the principal (which can conceivably be permanent) and second the payment of interest only for the duration of the PIA. However, in providing for a wider range of methods of rescheduling secured debt, it may potentially provide greater flexibility than the Norwegian scheme. However, unlike its Norwegian counterpart, where a court of first instance ultimately has the power to approve a debtor's proposal without seeking creditor approval, the Irish scheme as proposed appears entirely dependent upon significant thresholds of creditor approval.

In effect, at least three obstacles have to be cleared before a PIA can come into operation.

- First the trustee must be satisfied that such an arrangement is viable before it is put to creditors. Bearing in mind the objectivity that the scheme as currently drafted demands of trustees, there is no guarantee that a trustee will form this view in a significant number of cases.

- Second, a threshold of [75% at present] of secured creditors must approve such a proposal. In this regard, **it is very significant that the definition of security in relation to a debt is very wide and includes solicitor's undertakings and judgment mortgages**. Thus, an unsecured creditor who obtains a judgment and registers it as a judgment mortgage against the family home of a debtor will rank equally with the original lender in terms of decision making in the PIA process and may conceivably block a PIA application even if the original lender is prepared to accept it. Given that in many instances the property against which the judgment is registered will be in negative equity, to classify these judgment mortgages as secured is a legal fiction. This definition should be amended so that a judgment mortgage can only be classified as secured where the security has a realisable value

- Third, 55% of unsecured creditors must also approve the proposal for a PIA. Depending on the debtor's general financial situation and how much of the debtor's monthly income a mortgage lender demands in payment towards a mortgage on the principal private residence, in some cases there may be little incentive for unsecured creditors to agree a proposal even where it has been approved by the requisite percentage secured creditors.

- Fourth, a debtor may conceivably have to survive a challenge to the PIA from an individual creditor in the Circuit Court. For example, under H.105, any creditor may argue that it has been unfairly prejudiced by the PIA

The more complicated the debtor's financial situation, for example if he or she has a number of secured as well as unsecured debts, the more difficult it will be to reach agreement. **How likely is it that these respective obstacles can be successfully negotiated with the voluntary agreement of creditors? There is a significant danger that without any independent review powers being provided to the Insolvency Service in the event of creditor rejection; one of the main purposes of the PIA - to maintain the family home while unsecured debt is being partially paid – will fail. It is therefore essential for the potential success of the scheme that independent oversight of creditor refusal should be provided for.**

Mortgage to rent/Social housing provision where the family home is repossessed

The Irish Banking Federation (IBF) has recently stated that the current Mortgage Arrears Resolution Strategy (MARS) being conducted by the Central Bank with lenders has focused the minds of its members on unsustainable mortgages.[11] In our view, the processes of the personal insolvency scheme are also likely to focus more attention on a number of cases where the mortgage of the applicant may be unsustainable. Such cases unfortunately exist but are currently being masked by a comparatively low level of legal action. This is principally caused by negative equity and the reticence of lenders to repossess dwellings and crystallise a significant shortfall on the capital amount owed.

What will happen to an applicant if a trustee in proposing a PIA forms the view that it is not feasible from a financial perspective for the debtor to remain in the family home or if creditors reject proposals that are framed

[11] IBF conference on the future of the mortgage market, 18 January 2012, Radisson Blu Hotel, Dublin.

to maintain the family home? This is clearly envisaged in the scheme as **H.96 (4)** provides for the sale of property secured by a debt in a PIA and specifies that any shortfall (for example where the property sells for less than the sum owed to the lender) should rank as an unsecured debt like any other.

It is likely therefore that due to a combination of factors including the introduction of the new legislation, a rise in the repossession of family homes will occur. The rapid development of measures to complement the personal insolvency regime is therefore urgently required. We understand that a strategy is in preparation for the implementation of some of the measures in the Inter-Departmental Report on Mortgage Arrears or 'Keane' Report. However, it is worrying that the mortgage to rent scheme is only just commencing and on a very small scale and that some 100,000 people/households are on local authority waiting lists. Equally, NAMA seems to have created little so far by way of a 'social dividend' in the form of the release of housing units for public purposes. Where will people who lose their homes as a result of chronic mortgage arrears be rehoused? **The Personal Insolvency Scheme must be accompanied by other measures across a range of other departments, particularly the Departments of Housing Affairs (Environment) and of Social Protection, that focus on providing accommodation for former mortgage holders who may lose their homes.**

Personal Insolvency Arrangement and joint debtors

H.83 (3) provides that two or more debtors may jointly propose a PIA, but only if both are insolvent and are joint parties to <u>all</u> of the debts. It is submitted that this eventuality is unlikely in a substantial number of cases but it could apply to spouses/partners who have debts arising from a business together and are also joint borrowers on their home and other personal debts.

However, this provision does raise broader questions in relation to applying the options under the scheme to households where one partner is insolvent but the other partner is not. In relation to the former, could the partner who is not personally insolvent and/or who is not personally responsible for all or any of the debts voluntarily agree to a declaration that the <u>household</u> is insolvent for the purposes of the relevant option taking into account the overall financial situation of the household, having received full legal advice as to the consequences of his or her action?

The very complex question of the interaction between family law and indebtedness may also be relevant here, particularly what happens where the parties are in dispute on the question of the ownership of the family home in the course of separation or divorce proceedings. Could it for example be provided that a PIA might be proposed and agreed through a family mediation process, in order to ensure that dependent children might continue to reside in the family home? Family law legislation, in turn, currently allows the courts to make property adjustment orders or to defer of the sale of the family home while children remain dependent and provides for maintenance and pension adjustment orders. How the division of property takes place depends on a number of factors which take into account the past contributions of the partners and the needs and capacities of dependent parties. These orders are binding on parties other than those in the proceedings, notably pension trustees. Similarly, the law permits a spouse to seek a declaration that a lender who gets an order for sale must recognise that a certain portion of the property is the property of that spouse. Might it be possible in such cases where the mortgage on the family home is in arrears and the property is in negative equity to propose a type of PIA to the court on terms that might for example defer sale, reschedule the mortgage payment or relieve one spouse from liability for the debt? Creditors could be heard in such proceedings.

Insolvency test
As with the DRC and the DSA, an applicant for PIA must be insolvent and this is again defined as meaning that a person is unable to pay his or her debts as they become due. **H.85 (1) (e)** further provides that having regard to the debtor's financial circumstances as outlined in the Standard Financial Statement (SFS), it is unforeseeable that the debtor will become solvent over the course of the five period of the plan and the application of this test is further outlined in **H.85 (2)** where due regard must be had to matters such as the applicant's contingent and prospective liabilities and prospective assets and income.

We reiterate our comments above that the insolvency test must be sufficiently robust to ensure that creditors do not use it as an excuse to refuse reasonable repayment plans. We would also suggest that the opportunity be taken to review the Standard Financial Statement (SFS) developed for the purposes of the Code of Conduct on Mortgage Arrears (CCMA) in order to simplify it where possible.

H.85 (1) (f) further provides that a DSA must not be a viable alternative to a PIA and **H.85 (3)** in turn provides detail of the factors to be taken into account here. These include the value of secured as against unsecured debts, the debtor's compliance with voluntary and regulatory codes and whether secured creditors have indicated to a trustee their willingness to vary the terms of a secured debt for the purposes of allowing a DSA to proceed.

There are a significant number of assessments and criteria in **H.85.** Although it is not specifically stated, the trustee will have to carry out these assessments and some of these may be quite difficult to apply and quite time consuming, with implications for cost. For example, how will the trustee objectively assess the debtor's co-operation with the Code of Conduct on Mortgage Arrears (CCMA)? **We would be concerned that the posing of so many requirements will give creditors too many opportunities to cast doubt on the veracity of proposals.**

Protective Certificate
H.88 (3) provides that Insolvency Service must confirm that the debtor meets the criteria under Head 85 and subhead (4) sets out the relevant criteria it must consider. It may then issue a Protective Certificate under **H.89** to last for eight working weeks with a possible extension to 12 weeks and a further possible extension on application of another two weeks. **Again, we would question whether this is enough time to formulate and process an application?**

H.90 provides that any creditor on notice of the Protective Certificate must, if issuing new proceedings or already in the course of proceedings, notify the court of the certificate, which may then make an order staying the proceedings. **First, a creditor on notice of a Protective Certificate should not be permitted to issue new legal proceedings against the relevant debtor. Second, why is the court given the discretion to stay legal proceedings? Surely the stay should be automatic where the Insolvency Service has confirmed that the debtor meets the criteria for a Protective Certificate in order to apply for a PIA.**

Duties of Personal Insolvency Trustees
The list of the trustee's duties prior to the application for a Protective Certificate is exhaustively outlined in **H.86,** including the necessity to make a statutory declaration under **86 (1) (f)**. This declaration must disclose that the trustee has reasonable grounds to believe there is a reasonable possibility that a PIA would be capable of making the debtor solvent within six years. '**Reasonable grounds that there is a reasonable possibility' is very**

vague but once again may provide a given creditor with another stick to hold up the process or file an appeal that will bog down the application and defeat the object of the exercise – settlement of the debts of insolvent debtors.

H.91 sets out the duties of the trustee in preparing the application including considering the views of creditors and as already noted requires an objectivity of the trustee that may not always accord with the interests of the debtor.

H.92 (d) (i) again places the trustee in 'crystal ball' territory, whereby he or she must assess that the PIA has a reasonable prospect of being accepted by creditors, in that it may be liable to provide a better financial outcome than bankruptcy. He or she must also give opinion that the debtor is reasonably likely to comply with its terms. **Without wishing to labour the point, this series of speculative assessments may provide uncooperative creditors with an opportunity to undermine the process and it is hard to see what they achieve.**

Duration of the Personal Insolvency Arrangement

H.93 (2) (a) provides that the maximum duration of PIA shall be six years but may provide for an extension to seven years within its own terms. Quite apart from the six year period being arguably too long, what is intended by the one year extension to seven years and in what kind of circumstances is it envisaged that it will apply? **Without some kind of clarity that this should be the exception rather than the rule, is it not conceivable that creditors will automatically look for a seven year repayment period in the terms of the PIA?**

Tools of the trade

H.93 (2) (e) also provides that a PIA shall not contain any terms requiring the debtor to sell assets that are reasonably necessary for his or her employment, business or vocation. What will be the scope of this exemption? **For example, will it include a vehicle that the debtor uses for domestic purposes but also requires to get to and from his or her place of work?**

Reckless lending

Head 94 (4) (d) provides that the Minister or the Insolvency Service, in framing regulations and/or codes that may provide guidance to trustees in the preparation of repayment proposals, may take into account the circumstances in which the credit was advanced to the debtor, including whether the creditor acted prudently at the time the credit was advanced. This potential reference to reckless lending is a welcome inclusion in the scheme as some applicants for a PIA will have received excessive loans with little by way of due diligence in terms of assessing capacity to repay. **However, we would question how useful this provision will be in practice. First, it requires regulations or a code to come into being. Second, the Insolvency Service appears to have no role in overseeing its application. Third, any proposals framed in order to take the reckless lending of a creditor into account would have to get past the creditor veto. It might usefully strengthened to allow the Insolvency Service to play a role is assessing the responsibility of creditor lending.**

Preferential status of the Revenue Commissioners

See comments in relation to DSAs on page 21.

Extra costs for debtors
Under **H.96** (1) creditors are to value their security in good faith and also get to express a view as how they would wish that security to be treated. **H.97A** suggests that the value of the security be agreed between the debtor's trustee and the creditor, but that in the absence of agreement between the two that an independent assessor be used by the trustee for the purposes of preparing the PIA. **How will the costs of that independent assessment be met? Will this be the responsibility of the debtor?**

H.97 provides that a debtor must obtain independent legal advice if it is proposed that his or her principal private residence is to be disposed of in a PIA. **From whom will this advice be sought and will it be cost free or at nominal cost for the debtor, for example, civil legal aid from the Legal Aid Board?**

Where a creditor's meeting approves an application for a PIA, **H.100** allows any given creditor 30 days to object to the PIA in the Circuit Court. **Will the debtor be entitled to legal representation to oppose the creditor's objection and if so, who will provide it particularly if the trustee is not a practising lawyer? Should trustees who are not practising lawyers be allowed to appear on the debtor's behalf in the Circuit Court?**

Trustee's ongoing obligations and the effect on fees
See comments in relation to DSAs on page 23.

Variation of a Personal Insolvency Arrangement
It is notable that with a PIA under **H. 104 (2)**, a debtor must consent to any variation of a PIA, although if consent is withheld unreasonably, this may be challenged. We assume that this consent is intended to apply where the variation is to involve an increase in payment. This is However, where a debtor is proposing a variation which presumably will involve a reduction in payment, the same creditor thresholds apply again. Why is the bar set so high here? **If the debtor's financial situation has deteriorated and he or she can no longer service the agreed repayments, should the variation not be automatic. Otherwise, the minimum protected income for that household may be affected.**

Creditor challenge
H.105 provides a very broad range of grounds for a creditor to challenge a PIA. **It should be noted again that these may conceivably be used by any creditor even where the requisite creditor thresholds have been agreed.** How widely will a challenge to a failure to follow the procedural requirements in the scheme be allowed to go? How will unfairly prejudicing the interests of a creditor be interpreted?

Transactions at undervalue and preferences that have occurred at any time during the two years prior the application for a PIA is made are also grounds for challenge. Quite apart from a problem of remoteness in terms of time from the transaction to the application, **the trustee should be under a legal obligation ask every applicant for a PIA if he or she been involved in such a transaction in that two year period and must exclude a person if he or he did.**

H.106 allows a creditor to apply to terminate a PIA in the Circuit Court on a range of grounds, again in stark contrast to DSAs where creditors appear to be able to terminate simply by voting at a creditor's meeting. **However, where such an application is made, who will represent the debtor's interests in court? Will civil legal aid be available or will this be yet another function that the trustee will be asked to carry out?**

Failure of a Personal Insolvency Arrangement
H.107 currently provides that a PIA shall be deemed to have failed and shall terminate where six months arrears default has occurred and the Insolvency Service is notified by a creditor or a trustee of such default. Adjudication in bankruptcy may then follow at the election of either a creditor or the debtor, according to **H.108** and the full amount of the debts covered by the PIA, including any arrears, charges and interest become due according to **H.109**. The consequences for the debtor are therefore very serious. Should a six months arrears default justify the termination or automatic termination of the PIA, without any further discussion or examination? A PIA can run for up to seven years and this is a long time to be devoting one's surplus income to the benefit of creditors. Default can occur for a multiplicity of reasons, from illness and family emergency to loss of income and plain old fashioned loss of will which may be recoverable. **At the very least, termination should not be automatic in these circumstances and should be subject to a review process, where ideally the Insolvency Service examines the reason for default, the point in the PIA where the default occurs and other relevant considerations before deciding on termination. Appropriate rights of appeal for all parties could also be provided for.**

Debtor appeal
H.110 allows a debtor (as well as creditors) to apply to Circuit Court if he or she is dissatisfied with an act of his or her trustee and the Court may make appropriate orders as it sees fit. As far as we can see, this is the only provision that allows the debtor object to anything under the scheme. Even at that, how will the debtor make this reference? It is unlikely to be at the behest of the trustee concerned. **Again will legal assistance be available to the debtor to facilitate this application?**

Criminal offences
H.111 provides for a list of debtor offences and even for the potential criminal liability of a trustee. **Notably , there is no liability of any kind envisaged under this head for creditors, for example who may have impeded a trustee in the course of his or her work or who may failed to provide relevant documentation to enable the trustee to make an application on a debtor's behalf within the appropriate time limit.**

It is also worth noting that the Insolvency Service is given express power under this head to prosecute offences summarily but again has no power to review creditor veto.

Regulations and codes
H.112 provides for the passage of regulations and/or codes to facilitate the purposes of part 5. We note that **112 (2) (c)** refers to the need to protect the interests of debtors generally whereas **112 (2) (d)** refers to the need to protect interests of creditors generally <u>including their property interests</u>.

It is also worth noting that in preparing such regulations or codes, the Minister for Finance must be consulted with, particularly with regard to the State's economic situation. This suggests that the interests of debtors may be sacrificed to what may be perceived as the greater economic good.

3.4 – Amendments to the Bankruptcy Act 1988

Introduction
It is commonly accepted at this point that the bankruptcy legislation is not fit for purpose for the 21st century, particularly insofar as it concerns consumer over-indebtedness and the low number of bankruptcy petitions

whether brought by creditors or debtors themselves reflect this. Clearly, the out-of-court debt settlement approach favoured by many European jurisdictions is the main thrust of the new personal insolvency scheme but it is also necessary to overhaul the court bankruptcy option as part of the 'calibration' of the new scheme. In particular, because of the likelihood of creditor veto being applied in a number of cases, it is critical that debtors have recourse to a more accessible bankruptcy system. There has been much speculation about the need to choreograph the discharge period with that of the UK, given the advent of so called 'bankruptcy tourism'. However, insofar as it concerns those who are over-indebted and who may be in the low to middle income earning bracket, potentially uprooting a family and moving one's centre of interest to the UK is not a great option, unless emigration is contemplated in any case.

In our view therefore, what is required is a viable bankruptcy option in this jurisdiction and this must be one that simultaneously encourages creditors to reach accommodations outside of the courts. **In this regard, as stated in Section 2.2 of this submission, the three year discharge period followed by a potential five year Income payments Order on the application of the creditor is simply too prohibitive and manifestly unbalanced against the interests of debtors but also arguably against the integrity and the potential effectiveness of the entire scheme.**

Debt threshold and notice periods

Both **H.115** and **116** provide that in order to petition for a debtor's bankruptcy, a creditor must be owed €20,001 or more and this threshold is consistent with the current cut off point for Debt Relief Certificates and entry point for Debt Settlement or Personal Insolvency Arrangements. **We have suggested at Section 3.1 of this submission (see page 11) that the threshold for DRC's is too low and should be raised to a minimum of €30,000. Any such increase should also be reflected in a revised bankruptcy threshold.**

We wonder whether there is some confusion in these heads in relation to the notices required. **H.115** provides that a creditor must give at least 14 days notice of his or her intention to apply for a Bankruptcy Summons. **H.116** provides that the creditor must give the debtor 14 days notice in writing of his or her intention to seek a petition. Is this two separate periods of 14 days? **In any case**, **it is submitted that these timelines are too short for an application with such serious consequences as bankruptcy and might usefully be extended to 28 days apiece to allow the debtor to seek a full review of his or her financial situation and for negotiations to take place to avoid the bankruptcy.**

Debtor's petitions

According to **H.116 (3),** a debtor petition may only petition for his or her bankruptcy if he or she can meet an insolvency test. At present the choice is [unable to meet engagements] or [unable to pay debts as they fall due]. We reiterate our previous remarks about the need to establish an insolvency test that will stand up to creditor scrutiny and would also suggest the need for consistency across the range of solutions in the scheme.

Critically, under **H.116 (4),** the petitioning debtor must also present a statement of affairs and must make a sworn statement or a statutory declaration that reasonable efforts have been made to reach an accommodation with creditors, including exploring the other options under the scheme, but that he or she has reasonable grounds for believing that these would not be viable or acceptable alternatives to bankruptcy.

There does not appear to be any such corresponding onus on a creditor to make such a statutory declaration, prior to being allowed to present a creditor's petition. Why not? Is it not preferable that the out-of –court option is emphasised at all times and that there is an onus on creditors to use it, especially in light of the significant creditor vetoes at present?

It is also worth noting that there is no mention of the personal insolvency trustee having an input in showing that the debtor made such reasonable efforts. Surely, the vast majority of debtors will have consulted a trustee prior to filing for their own bankruptcy. Should the trustee not be called upon to corroborate the debtor's statutory declaration?

Under **H.117**, the High Court, when considering the question of costs in relation to a creditor's petition, may have regard to a creditor refusing appropriate alternatives to bankruptcy. **Should the Court not have a similar power in the case of a debtor's petition as well and could a trustee again play a useful role in clarifying the petitioning creditor's attitude to alternatives for this purpose?**

Excepted articles

Under **H.120**, the value of goods that a bankrupt shall be entitled to retain as excepted articles under S.45 of the Act, such articles of clothing, household furniture, bedding, tools or equipment of his trade or occupation or other like necessaries for himself, his wife, children and dependent relatives residing with him, is increased to **€5,000** from **€2,500**. It is presumed that the rest of his or her goods are therefore to be taken by the Official Assignee and potentially to be sold as part of the realisation of the bankrupt's estate. **As such €5,000 is a very low threshold especially if a family car is factored into the valuation. It is submitted that at a minimum €10,000 is a more realistic basic amount, with provision for the bankrupt to apply to the Court for this amount to be increased in individual cases presumably to be retained**

Fraudulent and voluntary conveyances

H.121, 122 and 123 respectively extends the relevant time limits for declaring void fraudulent preferences and the sale of property at under value from one to three years prior to the adjudication of bankruptcy and for the settlement of property from two years to three years. **Might there not be a problem of remoteness here, in terms of the connection between the potentially void transaction and the adjudication of bankruptcy. To provide a concrete example, some lenders have in recent times offered to consolidate arrears on loan facilities (such as for example overdrafts and credit cards) into new personal loans. If this were to happen in the three years prior to an adjudication of bankruptcy, would it be considered a fraudulent preference?**

Objection to automatic discharge

H. 126 introduces a new section 85A to the Bankruptcy Act 1988 entitling the Official Assignee or a trustee (at the request of a creditor or on their own motion) to apply to the court to object to discharge on grounds of the bankrupt's lack of cooperation, dishonesty or other wrongful conduct. Where there is sufficient evidence of this, the bankrupt's discharge may be extended up to eight years in total. If the bankrupt has previously been made bankrupt, a presumption of dishonesty will exist which the debtor will have to rebut.

A number of questions occur here. **First, why would a previous adjudication of bankruptcy lead to a presumption of dishonesty? Is this not a conclusion that the debtor has in principle being guilty of some misconduct in being previously adjudicated bankrupt and should this be assumed? Second, does this**

conclusion apply only to a previous bankruptcy in Ireland? Third, this is a very serious allegation with very serious consequences for the debtor. Will he or she be entitled to legal representation in the form of civil legal aid to defend his or her position? Finally, an issue not specifically addressed is whether the potential for a five year Income Payments Order provided for in H.125 (5) may also apply on top of eight years of bankruptcy leading to a potential effective total of 13 years (unlucky for some) of attachment of income.

Early discharge before three years
H.127 purports to create a new section - S.85B - to provide for earlier discharge in certain circumstances, for example where the bankrupt's estate has been realised, costs and preferential payments have been made and a fixed percentage in the euro has been paid. **Is this not a replacement Section 85 as opposed to a new Section 85B?**

Protection with a view to arranging a composition
H.129 proposes a new sub-section (7) to Section 87 to the effect that where a debtor seeks the protection of the Court in order to propose a composition with his or her creditors, the Court may take into account previous reasonable efforts by the debtor to negotiate appropriate alternatives arrangements (including a DRC, DSA or PIA) where the debtor has reasonable grounds for believing they are not viable. **Again the potential evidence of a trustee might be a useful addition here.**

3.5 Miscellaneous

The Standard Financial Statement (SFS)
H.133 provides that a SFS be completed by a debtor for the purpose of assessing his or her financial position and that this should be a mandatory requirement for any of the three out-of-court applications under the Act. Whilst it makes sense that a universally accepted SFS be put in place for all matters concerning personal debt, **there have been some suggestions that the SFS in use for the purposes of the Mortgage Arrears Resolution Process (MARP) of the Code of Conduct on Mortgage Arrears (CCMA) is unnecessarily complex. Perhaps this would be a good time to review it.** Point (v) also provides that the SFS shall be recognised as a legal document in any court proceedings. **Are we to assume that it will also to be used therefore in cases of bankruptcy?**

/ENDS