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ARTICLE

Reform of the Personal Insolvency Regime in Ireland

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Introduction

The long awaited reform of the personal insolvency framework in Ireland, as required by the EU/IMF Programme for Financial Support for Ireland, is beginning to take shape following the publication on 29 June 2012 of the Personal Insolvency Bill (the 'Bill'). Although the legislation in still in draft form and therefore subject to amendment by the Houses of the Oireachtas (the Irish Parliament), it is expected to be enacted into law by mid-November 2012. It provides for significant changes to the current personal insolvency regime and introduces for the first time in Ireland, a number of largely non-judicial debt resolution processes designed to offer an alternative to bankruptcy for individuals in certain prescribed circumstances.[1] The proposed changes relate to personal insolvency matters only and have no effect on corporate insolvencies.

The need for modernisation of the current Irish personal insolvency laws, which date back to 1988 and which are archaic when compared to other EU countries, has been brought into greater focus in recent times given the unsustainably high level of mortgage arrears and personal debt existing in Ireland since the economic downturn. Ireland has not previously seen the scale of financial difficulty that has been witnessed over the past five years, reflected by recently released figures from the Central Bank of Ireland which show that just over one in five home loans (over 22% of the 761,533 home loans in the State) were either in arrears or have been modified to help borrowers make some form of repayment. Of further note is the extent of personal insolvency arising from the devastating effect of personal guarantees given, by those working in property in particular, to the banks. Where there is little opportunity for the banks to recover any debt through such instruments, this has created a stalemate.

Proposed changes to the bankruptcy regime

The new personal insolvency and bankruptcy regime proposed by the Bill is seen as a first step towards a second chance for individuals in severe financial difficulty, but is arguably still some way behind the tried and tested working regime in the UK.

The Bill provides for a reduction in the period of automatic discharge from bankruptcy from twelve years to three years. Although this would appear at first glance to be a significant change to the current position, the courts will (if the Bill as currently drafted is enacted) retain a discretion to order the making of payments to creditors from a discharged bankrupt's income for a period lasting for up to five years from the date of the discharge, thus leaving open the possibility that a person may not be free from the shackles of bankruptcy for up to eight years.

In such circumstances, it remains unclear whether the proposed changes will be sufficient to affect the current trend whereby insolvent individuals are moving their centres of main interests ('COMI') to Northern Ireland or Great Britain in order to avail of the possibility of discharge from bankruptcy after one year (subject to a maximum three year income payments order running concurrently from the date of bankruptcy).

Other significant amendments to the current bankruptcy regime contained in the Bill include the raising of the minimum level of debt required for the presentation of a bankruptcy petition from EUR 1,900 to EUR 20,000 and the extension of the period prior to an individual being adjudicated bankrupt in respect of which fraudulent dispositions, fraudulent preferences and fraudulent settlements may be deemed void to three years.

Notes

1 Although court approval is required at the conclusion of these processes, they are largely non-judicial processes. The only formal alternative to bankruptcy currently available is a court supervised arrangement pursuant to ss 87-109 of the Bankruptcy Act, 1988. This is a heavily court controlled, non-user-friendly process which is rarely used in practice.

Introduction of non-judicial debt resolution mechanisms

The Bill provides for three new predominantly non-judicial debt resolution mechanisms. An independent body to be known as the Insolvency Service of Ireland (the 'Insolvency Service') is to be established which will oversee (subject to court approval) three new debt settlement processes contained in the Bill: (1) Debt Relief Notices ('DRN'), (2) Debt Settlement Arrangements ('DSA') and (3) Personal Insolvency Arrangements ('PIA').

The Bill provides for the appointment and regulation of 'Personal Insolvency Practitioners' ('PIPs') who will be tasked with providing debtors with information and advice, assessing appropriate options, and making applications for DSAs and PIAs. Whilst assisting a debtor in preparing an application for a DSA or a PIA, a PIP may apply to the Insolvency Service for 'a protective certificate' which, if approved and issued by the appropriate court, will provide a period of seventy days protection (extendable by a further forty days in certain circumstances) during which time certain enforcement proceedings or bankruptcy proceedings may not be initiated or continued against the debtor or his/her property, except with the leave of the court.

Failure by a debtor and his/her creditors to agree to a suitable non-judicial debt settlement leaves open the option of debt enforcement or judicial bankruptcy. A range of criminal offences are proposed to apply in respect of dishonest conduct by a debtor in connection with any of the new procedures.

The introduction of these non-judicial debt settlement procedures is significant as, for the first time in Ireland, formal debt settlement mechanisms will be available to insolvent individuals as an alternative to bankruptcy. This is a welcome and necessary development in modernising our personal insolvency regime and the availability of such alternative options brings Ireland more into line with the position in the UK at present.

(1) Debt Relief Notice

This procedure proposes that an insolvent individual with debts of EUR 20,000 or less and very limited means (eligibility criteria include having a net disposable income of EUR 60 or less a month, having assets of EUR 400 or less and having no likelihood of becoming solvent within a period of 5 years) may apply, through an approved intermediary, to the Insolvency Service for a DNR. Once the Insolvency Service is satisfied that the application is in order, it will issue a certificate to that effect, and furnish the certificate and the application with supporting documentation to the Circuit Court, which, if satisfied that the appropriate criteria have been satisfied, will issue a DRN. A DRN will provide a three-year 'protection period' during which creditors cannot pursue the debtor in respect of debts specified in the DRN. If the debtor is unable to pay the debt at the end of the protection period, the debt specified in the DRN will be written off, but provision has also been made for a debtor to be removed from the Register of Debt Relief Notices during the protection period if repayment of at least 50% of the value of the specified debts is made to the Insolvency Service.

(2) Debt Settlement Arrangement

The DSA procedure is proposed to enable an insolvent individual to make settlement proposals (through a PIP) in respect of unsecured debts to one or more creditors for payment of debt over a period of five years (with a possible extension to six years). If the proposal is approved by at least 65% in value of unsecured creditors voting at a creditors' meeting and is subsequently approved by the appropriate court on notification by the PIP (i.e. the Circuit Court if the total liabilities of the debtor are less than EUR 2.5m, or otherwise, the High Court), it will become binding on all unsecured creditors and will be registered by the Insolvency Service.

(3) Personal Insolvency Arrangement

A PIA will allow for settlement of both secured and unsecured debt by an insolvent individual over a six year period (with a possible extension to seven years), provided that at least one creditor involved is a secured creditor and the aggregate secured debts do not exceed EUR 3 million (unless all secured creditors agree to waive this limit). A PIA must be approved at a creditors' meeting by at least 65% in value of actual votes cast at the meeting as a whole (whether secured or unsecured creditors) and by (i) more than 50% of secured creditors and (ii) more than 50% of unsecured creditors, and subsequently approved by the appropriate court on notification by the PIP, before it will become binding on all creditors.

Effect on creditors

A creditor may challenge the issuance of a DRN, DSA, PIA or a protective certificate by way of an application to the appropriate court.

Insofar as secured creditors are concerned, it is important to note that only a PIA has the potential to deal with secured debt and the principal owed to the secured creditor cannot be written down to less than the value of the security. Certain protections have been given to secured creditors including a 'claw-back' in the event of a subsequent sale of a mortgaged property where the mortgage has been written down.

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Debts such as wages/salary owed to employees (preferential debts within the meaning of the current bankruptcy laws) cannot be included in a DSA or a PIA and a range of other debts (e.g. taxes, service charge arrears and family law payments) cannot be included unless the relevant creditor agrees in writing to a compromise of the particular debt.

Effect on debtor

Neither a DSA nor a PIA can include a requirement that a debtor cease to occupy or dispose of his/her principal private residence unless the debtor agrees to such proposal or if the PIP, having discussed the issue with the debtor, forms the opinion that the costs of the debtor continuing to reside there are disproportionately large bearing in mind his/her financial circumstances.

Furthermore, neither a DSA nor a PIA may include terms which would leave a debtor with insufficient income to maintain a reasonable standard of living for the debtor and his dependents. The parameters of what constitutes a 'reasonable standard of living' are not specified in the Bill. However, the Insolvency Service is empowered to publish a code of practice on such standards which PIPs must have regard to when formulating arrangements, and the content of this code is likely to influence how many people will look to avail of the procedures. It will inevitably fall on the courts to interpret the phrase and such interpretation is likely to have a major influence on the effectiveness of the legislation and the quality of life of debtors subject to the arrangements.

It is worth also noting that the protections afforded under the Central Bank Code of Conduct on Mortgage Arrears (which apply to loans secured by a borrower's 'primary residence') will continue to be available to cooperating borrowers.[2]

A person who is subject to a DRN, DSA or PIA is prohibited from applying for credit above a specified amount (EUR 1,000) for the duration of the protection period without informing the creditor as to existence of the insolvency procedure in place. Furthermore, a person is only permitted to avail of a DRN, DSA or PIA once in his/her lifetime and never in combination with or within a prescribed period of time of availing of another insolvency procedure.

Commentary on proposals

There has been broad agreement amongst interested parties that the proposed changes envisaged by the Bill are a welcome improvement on the current position. However, certain potential shortcomings have been identified, including the absence of a formal appeals process for disgruntled debtors in respect of arrangements which are rejected by creditors. As a secured creditor effectively has a veto in respect of a PIA, it has been suggested that an independent mechanism should be incorporated into the process to ensure that if an arrangement is deemed to be reasonable, it can be implemented notwithstanding a secured creditor unreasonably refusing to approve it.

It is suggested that, given the innovative new arrangements and the introduction of a whole new profession to Ireland in the form of PIPs, an annual review of the operation of the new law by the Oireachtas would be a welcome amendment to the Bill, rather than the proposed review after five years of operation of the PIA provisions of the Bill only.

Furthermore, the absence of detail in the Bill as regards the regulation of PIPs is a cause of concern. The lack of information in the Bill as regards the qualifications or training required by such individuals and the absence of a code of conduct or audit or disciplinary processes to deal with misconduct or malpractice by PIPs has been criticised.

Some predict that, despite the proposed reduction in the bankruptcy term to three years, individuals will continue to be enticed to move their COMI to the UK in order to declare bankruptcy there and be discharged after one year, especially if the provisions regarding retention of a discretion to order the making of payments to creditors from a discharged bankrupt's income for a period lasting for up to five years from the date of the discharge are to be enacted into law.

Conclusion

The three new debt settlement options are likely to be of some benefit in dealing with personal insolvency outside of the bankruptcy process as they will at least allow qualifying insolvent individuals an opportunity to try to deal with their debts in a structured manner. Heretofore there has not been a culture of restructuring or dealing with personal debt in Ireland, and it remains to be seen to what extent people who have been through a PIA, a DSA or a bankruptcy will be afforded a genuinely fresh start and how the banks will perceive them once they go through the process. As creditors retain a power to veto an unfavourable DSA or PIA, debtors will be forced to be realistic and reasonable in their proposals to creditors. Similarly, creditors will be encouraged to take a pragmatic approach as to reject a proposal would leave open the possibility of a debtor being freed from all debt within three years if declared bankrupt.

Notes

2 The Central Bank Code of Conduct on Mortgage Arrears is published at <www.centralbank.ie>.

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Whether the proposed changes will be of genuine benefit to struggling debtors is a question of having to 'wait and see', however, it is nonetheless widely agreed that the personal insolvency issue in Ireland requires to be addressed and that the Bill is a step in the right direction.

It is envisaged that the Bill will be passed into law by mid-November 2012.

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