

Thank you for the opportunity to appear before you today. I would like to address certain issues relating to the current review of the 3 year bankruptcy term; in doing this I will refer you to Appendix 3, where we set our position in greater detail. I would also refer you to Appendix 4 where we provide a paper to the Committee on the treatment of the family home in bankruptcy, which includes the results of a recent survey on the subject. I am happy to answer any questions the Committee has in relation to any aspect of these matters.

There are a number of arguments in favour of reducing the current bankruptcy term from 3 years. A reduction would provide an enhanced opportunity for the economic rehabilitation of debtors and specifically a quicker earned fresh start for entrepreneurs. It would assist in our general economic revival by reinserting those debtors who are hopelessly indebted back into society at an earlier stage. It would possibly encourage a greater number of debt restructuring / forgiveness deals by banks and other creditors, due to a likely increase in numbers of bankruptcies. It would also end bankruptcy tourism by Irish debtors travelling to the UK and US, albeit that such numbers are low to begin with.

There are also a number of arguments against the bankruptcy term reduction. These include the moral hazard issue i.e. the easier you make bankruptcy, the more people who will avail of the solution and the fewer number who will seek to pay their debts in full or seek informal or formal debt settlement solutions with their creditors (banks, credit unions, trade creditors and Revenue).

The existing 3 year bankruptcy term and 5 year income payment order term are similar to the standard terms of Debt Settlement and Personal Insolvency Arrangements. The 3 year bankruptcy term is an average bankruptcy term internationally with only the UK, the US and Canada having a 1 year term. The Law Reform Commission in its 2010 Final Report having reviewed the issue recommended a 3 year bankruptcy term as indeed did recently a report commissioned by the European Commission as an upper limit.

In my view, there is no basis for asserting that a reduction in the bankruptcy term will improve the prospects of a bankrupt person retaining his family home. As none of the benefits a bankrupt person derives from the reduction in the bankruptcy period produce

any value for the mortgagee (the bank), its position on adjudication is not affected by the length of the bankruptcy period. What does matter is whether the bankrupt person can pay his mortgage on adjudication? If he can and so wishes, he can retain his family home. If he cannot, he will likely lose his home.

The reduction in bankruptcy term may encourage bankruptcy tourism into Ireland. Many of these cases will be very difficult to investigate with foreign language difficulties, lack of funds in estates, lack of knowledge of processes in relation to registration of title of properties outside this jurisdiction, dealing with companies outside the jurisdiction etc. This would place a heavy burden on ISI resources, and by extension on the Exchequer, to properly administer such estates, as it does in the UK according to the authorities there.

I believe both secured and unsecured creditors would argue for more time within which they say, one will see greater voluntary settlements and even formal settlements. This taken with greater employment prospects in an expanding economy would solve the temporary insolvency difficulties of many individuals, who want to pay their debts in full.

Thank you

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### **1. Introduction**

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- 1.1 Section 9 of the Personal Insolvency Act sets out the functions of the ISI including Section 9(R) which states that the ISI shall “contribute to the development of policy in the area of personal insolvency”. This paper has been prepared by the ISI as a contribution to this Committee’s consideration of the bankruptcy term.
- 1.2 The ISI does not have a firm view on whether the term for bankruptcy should be reduced further. However, it hopes that the points raised in this paper will assist the Committee in its consideration thereof.
- 1.3 This paper attempts to identify the possible effects of any proposed changes to the bankruptcy term, related changes to income payment orders and the impact such changes might have on the principal private residence of the bankrupt. The paper also highlights relevant Irish, European and international studies in this area. Finally, this paper also identifies one technical issue pertaining to the draft bill currently proposed by Mr. Willie Penrose T.D.

## 2. International Comparisons and Report References

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2.1 Set out below are the current bankruptcy terms that apply in a number of other jurisdictions:

Country	Term of Bankruptcy in Months	
USA	12	
UK	12	
Australia	36	After filing of Statement of Affairs
Netherlands	18	No set term 18 months average
Germany (1/7/14)	36	If 35% debts & all costs paid (60 if only costs paid)
Canada	9/36	(First/Second bankruptcies)
New Zealand	36	After filing of Statement of Affairs
Israel	0	No set term in cases of little assets discharge immediate, most cases within a few months
France	60 minimum	Not automatic – Court
Sweden		No discharge unless repayment plan in place (60 minimum)
Austria	84	Not automatic – Court
Poland	60	Not automatic – Court
Hungary		No discharge unless repayment plan in place
Czech Republic		No discharge unless repayment plan in place

## 2.2 Three studies covering this area are worth highlighting

- 2.2.1 The Law Reform Commission published a report entitled "Personal Debt Management and Debt Enforcement" (LRC 100- 2010)" in 2010<sup>1</sup>. It includes a review of bankruptcy practice internationally and recommended the current 3 year automatic discharge period.
- 2.2.2 The European Commission Expert Group Report entitled "A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start" was published in 2011<sup>2</sup>. It recommends a bankruptcy term not exceeding 3 years. Key extracts from the report are set out below.

"A modern system for discharge is paramount to reduce the stigma of bankruptcy. In this system discharge should be as automatic and as reasonably limited in time as possible. In principle one to three years could be a good target to aim for. Contribution beyond the period of discharge is not reasonable and all debts should be discharged after this time." (page 11)

"Discharge is key for second chance: a 3 year discharge and debt settlement period should be a reasonable upper limit for an honest entrepreneur and as automatic as possible. It is fundamental to send a message that entrepreneurship may not end up as a "life sentence" in case things go wrong. Otherwise it acts as an effective deterrent to entrepreneurship." (page 12)

- 2.2.3 The World Bank published a report entitled "The World Bank, Working Group on the Treatment of Insolvency of Natural Persons Report" in 2012<sup>3</sup>. The report did not recommend any optimal discharge period stating that, the insolvency of natural persons is intertwined with social, political and cultural issues that present too many differences to be treated uniformly. Key extracts from the report are set out below.

"There is general consensus that it would be premature to identify a single approach (or "best practice") for the legal treatment of the insolvency of natural persons not engaged in business activities. The insolvency of natural persons is intertwined with social, political and cultural issues that present too many differences to be treated uniformly. It would be difficult for a uniform approach to emerge out of this effort. Policymakers should be aware of the social, legal and economic peculiarities that

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<sup>1</sup> [Personal Debt Management and Debt Enforcement \(Law Reform Commission\)](#)

<sup>2</sup> [A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start \(European Commission Expert Group\)](#)

<sup>3</sup> [Working Group on the Treatment of Insolvency of Natural Persons Report \(The World Bank\)](#)

may affect the functioning of a regime for the insolvency of natural persons.” (paragraph 12)

“The development of a legal regime for the insolvency of natural persons requires careful consideration of many issues unique to the context of treating the insolvency of natural persons, whether or not such debtors are or have been engaged in commercial activity. It is also necessary to consider that the system of insolvency of natural persons is intertwined with the basic rules for consumer and commercial credit.” (paragraph 403)

“If a single standard term is to be chosen for all plans, what might be the optimal length of time? Unfortunately, very little uniformity can be observed in existing systems. The most common repayment terms tend to fall between three and five years, with a notable congregation of laws with a standard five-year term. The rationales for these decisions, however, are seldom clear or particularly convincing. The choice of five years in one country, for example, was based on a scattered sampling of comparable practices, including existing norms for forgiveness of social assistance repayment debts in and general offer-in-compromise practice by tax authorities, as well as the evolving norms in other countries’ laws. The most empirically meaningful basis for selecting one term over another appears in the legislative history of another insolvency law, in which policymakers concluded that accumulated experience with voluntary workout arrangement indicated that expecting debtors to live longer than three years at a subsistence level would be “from a social point of view not responsible”. (paragraph 268)

“Practice in many countries has indicated that plans longer than three years produce more failure than success. In one large system, for example, a consistent two-thirds of all payment plans fail before they reach the end of their five-year term. Unfortunately, very little empirical evidence exists on plan performance in most countries, so strong conclusions on the results of longer plan periods are not well supported by data. Existing evidence and widespread anecdotal reporting, however, consistently indicate an inverse relationship between plan length and plan success. Particularly in developing countries with economies marked by high levels of volatility and uncertainty (especially rampant inflation), rapidly changing economic conditions can make successful planning for even a short period all but impossible.” (paragraph 269)

### 3. Automatic Discharge Period

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3.1 Set out below are some of the arguments in favour and against a further reduction in the bankruptcy term.

3.2 Arguments in favour of a further reduction in the bankruptcy term

- Beneficial to debtors in that restrictions that apply to undischarged bankrupts would last for a shorter period (i.e. cannot be a company director or manager, notification requirements if seeking credit, on changing name and address or if they acquire property post adjudication of bankruptcy). It would accordingly allow them to economically rehabilitate themselves in less time.
- Also beneficial to debtors if there was a proposed corresponding reduction in the period within which the Official Assignee can seek income payment contributions
- A reduced term is likely to see an increase in the numbers of debtors seeking bankruptcy and an increase in those willing to 'hand back the keys' crystallising the negative equity in properties. This might increase the willingness of secured creditors to do deals with debtors short of bankruptcy to avoid such crystallisation of negative equity.

3.3 Arguments against a further reduction in the bankruptcy term

- The easier you make bankruptcy, the more will avail of the solution and possibly the fewer who will seek to pay their debts in full or seek informal or formal debt settlement solutions (DSAs, PIAs) with their creditors. With increased bankruptcies, unsecured creditors such as Credit Unions, the Revenue Commissioners and trade creditors will have greater amounts of debts owed to them written off.
- There is no basis for an assertion that a reduction in the bankruptcy period will improve the prospects of a bankrupt retaining their family home. As none of the benefits a bankrupt derives from the reduction in the bankruptcy period produce any value for the mortgagee (i.e the bank), its position on adjudication is not affected by the length of the bankruptcy period. What matters on adjudication is whether the mortgagor (i.e. the borrower) has the capacity to make his mortgage payment in whole or in part in a manner acceptable to the mortgagee and then whether such payment agreed between them, is acceptable to Official Assignee as a reasonable accommodation expense within the Reasonable Living Expenses Guidelines of the ISI.
- Ireland may experience the same pattern as the UK with persons from within Europe and wider afield, applying for bankruptcy in Ireland. Many of the cases

will be difficult to investigate with difficulties with foreign languages, lack of funds in estates, lack of knowledge of processes in relation to registration of title of properties, companies etc, which will place a burden on the ISI, and indirectly the Exchequer, to properly administer such estates as it does in UK as per authorities there.

- Break in linkage to Debt Settlement Arrangement and Personal Insolvency Arrangement term. Currently the 3 year bankruptcy term and, normally concurrent, 5 year Income Payment Order term is similar to a Debt Settlement Arrangement and Personal Insolvency Arrangement term which is for a maximum of 5 / 6 years respectively. To be declared bankrupt, an applicant must demonstrate to the Bankruptcy Judge that they have undertaken all reasonable steps to secure a Debt Settlement Arrangement or Personal Insolvency Arrangement. Certain debtors may not favour a Debt Settlement Arrangement or Personal Insolvency Arrangement if the terms are no longer similar to bankruptcy.

## 4. Income Payment Order (IPO)

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4.1 Currently an Income Payment Order (IPO) can last for up to 5 years. The Official Assignee currently adopts the following policy approach.

- IPO sought as early as possible so as to run concurrently with bankruptcy term.
- IPO calculated with reference to disposable income after allowing for ISI Reasonable Living Expenses.
- Credit given for periods where no disposable income available
- IPO limited to 4 years with full cooperation from bankrupt.

4.2 In the event that a reduction in the bankruptcy term saw a corresponding reduction in the IPO payment period, the following arguments in for and against apply.

4.3 Arguments in favour of a reduced IPO period

- It will allow a Bankrupt an earned new start as they will now face a reduced maximum income payment contribution period, rather than the 5 year maximum period at present.
- It will enable the Bankrupt to economically rehabilitate themselves a lot quicker thereby contributing back into the economy, which will assist general economic revival.

4.4 Arguments against a reduced IPO period



- If this recommendation is followed, with most assets in bankruptcy in negative equity, the prospects of a dividend in bankruptcy for unsecured creditors will greatly diminish.
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