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Briefing on the Personal Insolvency Bill

Overview

The Personal Insolvency Bill published on 29 June 2012 represents a radical overhaul and modernisation of Ireland's personal insolvency law. The Bill introduces a comprehensive and balanced regime to address personal insolvency as required by Ireland's IMF country programme.

The Bill envisages the creation of an Insolvency Service of Ireland to oversee the legislative regime. Under the Bill, creditors will continue to hold the whip hand over debtors:

- Creditors holding 65% by value of debt must approve any Debt Settlement Arrangement (DSA) or Personal Insolvency Arrangement (PIA);
- Secured creditors must get the value of their security;
- Criminal and civil penalties are provided for failures to disclose assets by debtors;
- There is a reinstatement of debts if a debtor fails to honour a PIA or DSA;
- There is a "triple lock" to get into the main processes of DSA or PIA requiring an insolvency practitioner, the Insolvency Service and the court to be satisfied that the debtor qualifies; and
- There is a touchstone test that a PIA, DSA (but oddly not a Debt Relief Notice) cannot be unfairly prejudicial to a creditor.

A critical role is envisaged for the Insolvency Service to determine what is a reasonable standard of living for a debtor and his dependents. All security rights (not just the family home) can be affected by a PIA. This may impact on banks' appetite to lend to unincorporated businesses such as doctors, dentists, accountants and lawyers.

The Insolvency Service of Ireland ("the Service")

The Bill provides for the establishment of the Insolvency Service of Ireland, an independent body, which will have a key role in the delivery, monitoring and execution of the new personal insolvency arrangements provided for in the Bill. The Service will have all powers necessary to ensure its ability to exercise the delivery of the functions provided for in the Bill.

The principal functions of the Service include:

- Monitoring of arrangements relating to personal insolvency;
- Consideration of applications for Debt Relief Notices ("DRNs");
- Processing of applications for protective certificates relating to Debt Settlement Arrangements ("DSAs") or Personal Insolvency Arrangements ("PIAs");
- Maintaining registers of DRNs, protective certificates, DSAs and PIAs;
- Providing information to the public on workings of the legislation; and
- Developing policy.

The Bill contains a number of provisions which deal with the Service's planning, reporting, fee generation and accounting obligations.

In relation to a DRN, the Service must consider and, if appropriate, certify to the court that an application for a DRN is in order. The Service also has a role in liaising with creditors and other parties as regards the DRN process generally, in making payments under the DRN process, in investigating relevant matters, in seeking to extend the DRN process, and in bringing the DRN process to an end if necessary.

In relation to a DSA, the Service must consider and, if appropriate, certify to the appropriate court that the application for a protective certificate is in order. The protective certificate operates as a moratorium from creditor action (save for secured creditor enforcement).

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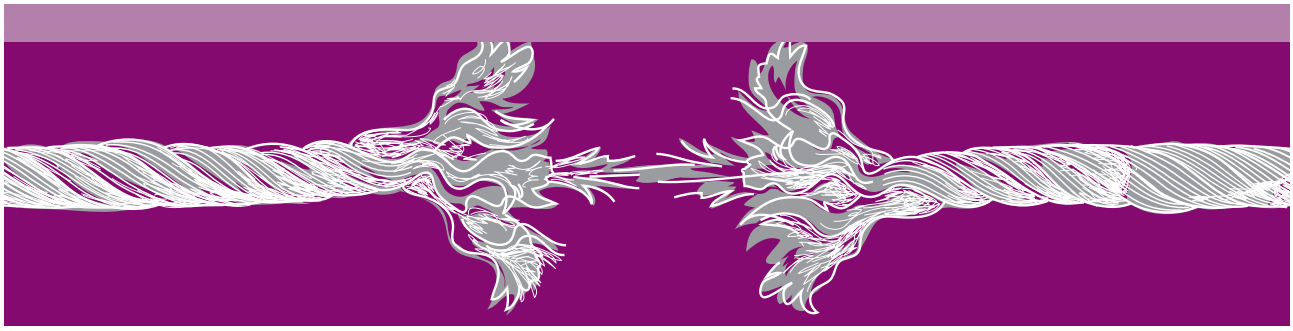

In relation to a PIA, the Service must also consider and, if appropriate, certify to the appropriate court that the application for a protective certificate is in order.

A key issue is that under a PIA, a debtor cannot be required to make payments of such an amount that the debtor (and his dependents) would not have a reasonable standard of living. The Bill envisages that the Service will publish guidelines on reasonable expenditure and essential income which should clarify what constitutes a reasonable standard of living. Such guidelines will be of key significance.

Personal Insolvency Arrangements ("PIA")

A PIA is a process which allows a debtor to pay creditors a portion of what is due to them over a six or seven year period and then be discharged from further liability.

A debtor can enter a PIA with his creditors if a majority of creditors representing 65% in value of the debtor's obligations vote in favour of the arrangement. In addition, 50% of the value of secured creditors and 50% of the value of unsecured creditors must vote in favour of the proposed arrangement.

A debtor wishing to enter into a personal insolvency arrangement can do so once only. In order to enter into the arrangement, the debtor must engage a personal insolvency practitioner and provide sworn details of their assets and liabilities. The process is only available where the aggregate of the debts of the debtor which are secured debts is less than €3 million.

To commence the process, the personal insolvency practitioner applies for a protective certificate from the Service. If the Service is satisfied, it will certify to the court that the application for a protective certificate is in order. If the court is satisfied that the debtor meets the prescribed criteria, it must issue a protective certificate. Accordingly, there is a triple lock on the process namely the satisfaction of the personal insolvency practitioner, the Service and the court.

The protective certificate gives a debtor protection from creditor action for a basic period of 70 days which can be extended for a further 40 days.

During this protective period, creditor action against the debtor is effectively prohibited. Critically, secured creditors are prohibited from taking steps to enforce security. This may prejudice secured creditors holding security other than real property, for example shares or other tradable instruments. A party prejudiced by the granting of a protective certificate can apply to have it set aside on the grounds of unfair prejudice to that creditor.

The protective certificate does not prevent creditors from taking action against guarantors or other co-obligors.

During the protection period, the personal insolvency practitioner seeks to formulate a PIA. That PIA can include a lump sum payment from the debtor's own resources or from the resources of other persons or a variety of other provisions to ameliorate the debt burden faced by the debtor.

Critically, an arrangement may not include terms which would mean that the debtor would not have sufficient income to maintain a reasonable standard of living for the debtor and his dependents. The Service is empowered to publish a code of practice giving guidance on such standards and the personal insolvency practitioner must have regard to any guidelines on reasonable expenditure and income for debtors published by the Service. Where the threshold of a reasonable standard of living is set will be critical to the take up and functioning of the envisaged PIA process.

A PIA shall not require that the debtor sells his home unless the personal insolvency practitioner forms the view that the costs of continuing to reside there are disproportionately large.

A PIA can provide that secured property is sold but if it does, the secured creditor must get the value of the security at the date of issue of the protective certificate. There are detailed provisions for the valuation of security.

A PIA does not have to provide that security be sold. It can also provide for variations of repayments. It can stipulate interest only payments or no payments at all. It can extend the period of a loan or it can defer payments for a period of time. It can also change the applicable interest rates and mandate debt for equity swaps.

Even if a PIA is approved by the requisite number of creditors, any creditor who believes they have been unfairly prejudiced by the PIA, can apply to court to set it aside.

Where a PIA becomes operative it will bind the debtor and creditors and must be reviewed at least annually. If there is a change in the debtor's personal circumstances, payments to creditors can be increased although it appears that only 50% of any new assets acquired by the debtor after the coming into effect of the arrangement would be made available to creditors.

If a debtor fails to meet his obligations under the PIA for more than 6 months, the PIA stands as terminated and all debts covered by the arrangement are reinstated unless the court otherwise orders. This is a powerful incentive for compliance by debtors.

Where the term of a PIA expires, all unsecured debts stand discharged but secured debts are not discharged unless that is specified in the terms of the PIA itself.

There is a comprehensive range of offences created for dishonest behaviour by debtors regarding the provision of information to the personal insolvency practitioner, the Service or the court.

Debt Settlement Arrangements ("DSAs")

A debtor who owes over €20,000 in unsecured debt to one or more creditors will have the option of proposing a Debt Settlement Arrangement. If the arrangement is accepted by the creditors and adhered to over 5 years by the debtor, the balance of the debtor's debts covered by the arrangement will stand discharged.

Eligibility

The debtor must make the proposal through a personal insolvency practitioner. The debtor must be domiciled in Ireland or ordinarily resident here or have had a place of business in the State, within one year of the application. He must be insolvent and must make full financial disclosure in a sworn statement.

There is no financial ceiling on the level of debt which can be included in a DSA.

A debtor may enter into a DSA once only.

Procedure

If the personal insolvency practitioner is satisfied that the debtor qualifies, the personal insolvency practitioner makes

an application to the Service for a protective certificate. If, in turn, the Service is satisfied that the debtor qualifies, it so certifies to the court. If the court is satisfied that the debtor qualifies, it must grant the protective certificate.

Powers are given to the Service to carry out enquiries regarding both the personal insolvency practitioner and the debtor, including power to obtain information held by banks, government departments and the Revenue Commissioners.

The certificate protects the debtor from legal action by his unsecured creditors for 70 days (extendable by 40 further days), subject to a creditor's right of appeal. During this time, the debtor and the personal insolvency practitioner prepare the proposed arrangement. In preparing the DSA, it is envisaged that the Insolvency Practitioner will liaise with and obtain submissions, information, and where necessary proof of debt, from creditors.

Terms of a DSA

Any DSA should contain provisions setting out how creditors will be paid, in whole or in part, which may involve lump sum payments or phased payment arrangements and/or the disposal of assets, although without requiring the debtor to sell his principal private residence.

Unless a DSA provides otherwise, payments to creditors of the same class are to be made on an equal basis.

Preferential debts, such as tax, must be paid in full.

A DSA will not affect the right of a secured creditor to enforce or otherwise deal with its security. The DSA process involves unsecured debt only.

Creditors' Meeting

The personal insolvency practitioner must convene a creditors' meeting to consider and vote on the proposed DSA. To approve the proposed DSA, 65% in value of the creditors present and voting must vote in favour of it.

If not approved, the DSA procedure and the protection period come to an end, leaving the debtor exposed to creditor action and possible bankruptcy. A creditor may object to a DSA by application to court if the creditor contends it is unfairly prejudiced by the terms of the DSA.

If approved, the DSA must then be put to the court which must confirm it if there is no valid objection and if the eligibility criteria have been met.

Effect of DSA

When a DSA is in effect, no unsecured creditor bound by it (including those who voted against it) may take action against the debtor.

The terms of the DSA must be reviewed by the personal insolvency practitioner at least once a year and are capable of being varied if the debtor's circumstances change.

Payments under a DSA are made through the personal insolvency practitioner and there are on-going obligations on him to ensure compliance.

If the debtor complies with the arrangement for the 5 years, the debts covered by the DSA will be discharged. However, if the debtor defaults in his obligations or is in arrears for 6 months, the DSA is terminated and the debtor becomes liable in full for all debts covered by the DSA, to include arrears, interest and charges that might have been otherwise foregone. This is a significant incentive to the debtor to comply with the terms of a DSA.

Debt Relief Notice ("DRNs")

This procedure allows for the write-off of qualifying debts up to €20,000 either by paying half of them or following a three year supervision period.

Eligible debtors must have qualifying debts of €20,000 or less; net disposable income of €60 or less per month; assets or savings of €400 or less; and must be insolvent and have no realistic prospect of being able to pay their debts within 5 years of the application date.

Qualifying debts include credit card debt, an overdraft or unsecured bank loan, bills in respect of utility bills or rent. Critically they may include secured debt. However, when the DRN ceases to have effect, the secured creditor retains the right to enforce his security. Taxes and sums due to various State bodies, domestic support payments and damages awarded by a court cannot be subject to a DRN.

Only one DRN per lifetime is permitted and a person may not enter into the DRN process within 5 years of completion of a DSA or PIA.

Process for applying for a DRN

A debtor must apply to the Service through an approved intermediary. A debtor must firstly submit a written statement of his or her financial affairs to the Intermediary. The Intermediary must then advise the debtor whether he satisfies the eligibility criteria; the general effect of a DRN; and alternative options open to the debtor.

The debtor must then confirm in writing to the Intermediary that he wishes to proceed with the application, following which a Prescribed Financial Statement must be completed. The application is then made by the Intermediary to the Service on behalf of the debtor. If satisfied that an application is in order, the Service shall issue a certificate to that effect and furnish same to the appropriate court. If the court is satisfied that all the eligibility criteria are satisfied, it must then issue a DRN.

Effect of DRN

The DRN remains in effect for a period of 3 years. While it is in force a creditor subject to the notice cannot take any steps to recover his debt, including seeking the return of goods held by the debtor but owned by the creditor. This prohibition also applies to secured creditors.

However, creditors can seek leave of court to take action against the debtor or his property. Secured creditors may choose to avail of this option.

Creditors may also take action against any guarantor or any person jointly liable to the debts specified in the DRN.

During the 3 year period, the debtor must inform the Service of any material change in his circumstances and must hand over to the Service 50% of any gift or payment he receives worth €500 or more and 50% of any increase in income worth more than €250 or more (after all deductions). The Service must distribute any such receipts amongst the creditors pro rata to their debts.

If the debtor pays 50% of the debt covered by the DRN to the Service, he will be relieved of the balance of his liability.

A creditor can object to the inclusion of his debt in a DRN by application to court. However, the grounds for objection do not include unfair prejudice. This is in contrast to the position regarding creditor objections to DSAs and PIAs.

Termination of a DRN

The Service may apply to court to terminate a DRN if there has been dishonesty or non-compliance by a debtor. If a DRN is terminated, the debtor is liable in full for all debts specified in the DRN.

Cessation of a DRN

When the 3 year period passes, the debtor is discharged from all the unsecured debts specified in the DRN. However, a secured creditor may then enforce his security.

Bankruptcy

The Bill discourages the use of bankruptcy in general. It shortens the period for automatic discharge from bankruptcy to 3 years. However, the Bill also increases to 3 years the period before bankruptcy in respect of which transfers of property may be void.

The Bill makes significant amendments to the Bankruptcy Act including:

- Shortening the period in which a bankrupt will be discharged to 3 years, unless an application is made alleging that the bankrupt has not cooperated with the Official Assignee or has hidden or failed to disclose assets, where the court may extend this period to up to eight years;
- Permitting the court to adjourn bankruptcy proceedings if the court takes the view that a debtor's situation could be better dealt with by a DSA or a PIA, to allow a debtor time to use one of those arrangements;
- Raising the level of debt required for a petition to be presented to €20,000;
- Making an award of costs to the petitioner discretionary (it is currently automatic) and conditional on the court's view of the reasonableness of the behaviour of the petitioning creditor with regard to any refusal to accept a DSA or a PIA;
- Increasing the period prior to the court determining a debtor is bankrupt in respect of which fraudulent dispositions, fraudulent preferences and fraudulent settlements will be deemed void against the Official Assignee to 3 years from 3 months;
- Repealing the law providing for court supervised arrangements. The new procedures of PIAs, DSAs and DRNs will take the place of this process. It is unclear what effect this will have on any such arrangements currently in being;
- Requiring the court in making any on-going payment order against the bankrupt to have regard to the reasonable living expenses of the bankrupt and his family, in which respect it may have regard to guidelines published by the Official Assignee or the Service.

In short, the amendments that the Bill proposes to effect to the Bankruptcy Act include:

- Discouraging creditors from bringing petitions by for bankruptcy by making the award of costs to the petitioning creditor discretionary;
- Effectively forcing creditors to consider PIAs and DSAs prior to petitioning as otherwise the court may simply adjourn matters;
- Improving the position of creditors where assets have been fraudulently transferred; and
- Inserting a degree of subjectivity with regard to "reasonable" living expenses.

The amendments appear to strike a reasonable balance between the rights of creditors and debtors. The increase in the period in respect of which fraudulent transfers may be set aside may make bankruptcy more attractive to banks and judgment creditors seeking to enforce against such assets.

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