

# Consultation – EU Commission Proposed Insolvency Directive

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A submission on the proposal for a Directive on insolvency, debt, restructure and second chance

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## Introduction

MABS National Development CLG thanks the Department of Justice and Equality and the Department of Jobs, Enterprise and Innovation for the opportunity to make a submission in respect of the proposed EU Commission Insolvency Directive. MABS has provided a key policy response to personal debt issues in Ireland for over 24 years. MABS comes under the remit of the Citizens Information Board and since 2013, has undertaken the statutory role of Approved Intermediary for the purpose of processing Debt Relief Notices in accordance with the Personal Insolvency Act, 2012, in addition to providing advice and assistance to debtors in respect of the other statutory personal insolvency options. In 2016, MABS became the ‘Gateway to Debt Advice’, both statutory and voluntary, as part of the Government’s scheme of Mortgage Advice and Assistance.

## Submission

The proposal to harmonise insolvency procedures throughout Member States is a welcome one, and one which would benefit many MABS clients and borrowers generally who may have inter-jurisdictional debts resulting from emigration during the recession years.

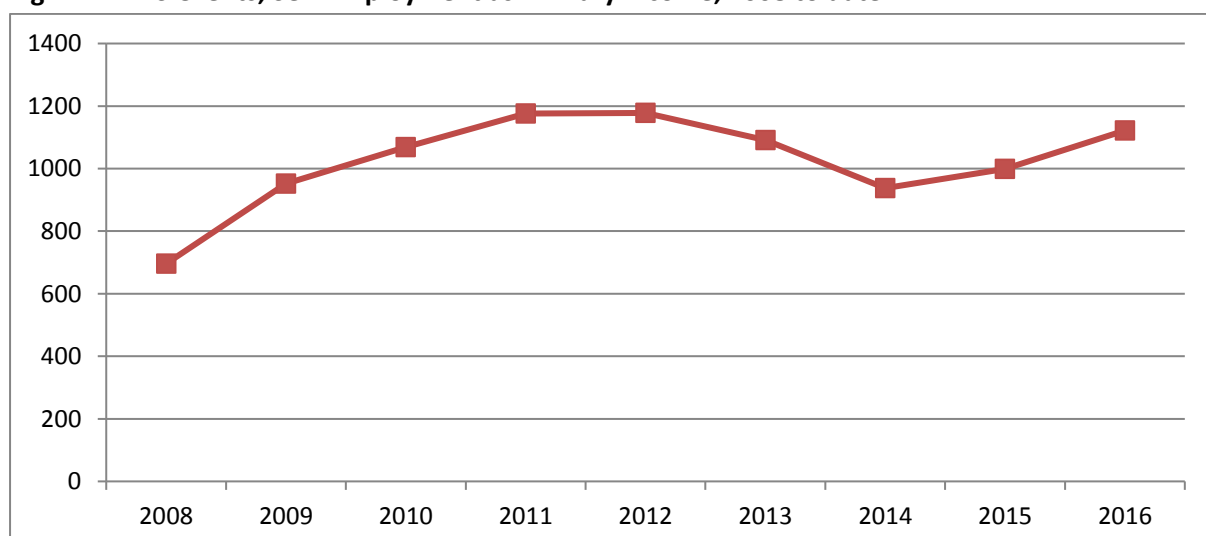
In dealing with this submission, we have set out our submission in two parts:

1. Entrepreneurs; and
2. Natural persons who are not Entrepreneurs.

## Entrepreneurs

The majority of people who approach MABS are dependent on social welfare, some of our clients were previously self-employed but, due to the recent economic downturn, their businesses have now closed. Since 2008, the number of new clients to MABS whose primary income status is reported as ‘self-employed’ has almost doubled. (Fig.1).

**Fig.1 – MABS Clients, Self-Employment as Primary Income, 2008 to date**



Source: MABS' Statistics, 2008 to 2016

At 1,122 clients in 2016, the self-employed represent a relatively small percentage of the overall new clients attending the MABS service (5.7 per cent), however, as the graph shows it is increasing. Business debt, particularly small business and farm debt, has a knock-on effect on family life, not just loss of income but loss of identity when a venture folds due to lack of available funds. MABS does not deal specifically with business debt, particularly debts of limited liability companies, but does work with over-indebted entrepreneurs where the financial difficulties impact on the household. The two tend to be inextricably linked.

In 2012, the Central Bank of Ireland introduced a Code of Conduct for Business Lending to Small and Medium Enterprises (SMEs) which recognised that the situations of SMEs in financial difficulties needed to be considered on a case by case basis by lenders. The term 'Financial difficulties' in this context is defined as already being in arrears of a period of at least three consecutive months, or having continuously exceeded the approval limit of an overdraft for 90 days and without engagement with the borrower<sup>1</sup>. From this definition, it is likely that an SME classified as in financial difficulties is already insolvent. The Code then proceeds to set out broadly how SMEs in financial difficulties should be treated, with an emphasis on alternative repayment arrangements of existing borrowings rather than restructuring or refinancing options. The proposal to enact preventative restructuring procedures for debtors in financial difficulty *where there is a likelihood of insolvency* set out in Article 1 and developed in Articles 4 to 14, is therefore a welcome development.

In the next section of this submission, we provide detail of some of the barriers to accessing the personal insolvency processes currently in place in Ireland, with specific reference to the requirement for judicial approval. A non-judicial preventative restructuring process, which allows the entrepreneur to continue to run their business as a going concern would reduce the number of references to judicial procedures, stimulating economic activity and reducing administrative costs to the State. We further welcome the proposed stay on individual enforcement actions while such preventative action was being taken as set out in Article 6 of the proposal as borrowers should be afforded the time to carefully consider any restructuring or refinancing options presented without the pressure of pending enforcement proceedings.

As stated previously, business and household debts are linked for entrepreneurs. For those that are insolvent, we welcome the approach proposed in Article 23(1) of the proposal whereby all debts are treated in a single procedure for the purpose of obtaining a discharge.

## Natural Persons who are not Entrepreneurs

Ireland, through the enactment of the Personal Insolvency Act, 2012 (the Act), has adopted many of the provisions provided in the proposed Directive relating to natural persons who are not entrepreneurs. The Act introduced three procedures leading to a discharge of debts incurred by over-indebted persons, and amended the pre-existing bankruptcy legislation, with a view to returning over-indebted persons to solvency within a relatively short period of time. In 2013, the

<sup>1</sup> Code of Conduct for Business Lending to Small and Medium Enterprises, 2012, p.5

World Bank issued a Report on the Treatment of the Insolvency of Natural Persons<sup>2</sup> in which it states that ‘one important function of a formal insolvency system is to encourage informal negotiation and resolution’<sup>3</sup> and refers to legislators giving priority to preventing insolvency proceedings in favour of negotiated solutions. While MABS has many years experience of negotiating voluntary arrangements and settlements with a range of creditors, and has seen an increase in the willingness of creditors to engage in such negotiations in preference to formal insolvency processes, it is our contention that this should not be one of the objectives of the personal insolvency system and it is likely that this objective has contributed to the lack of clarity in the drafting of insolvency legislation resulting in a burdensome process for debtors and creditors, and the intervention of several stakeholders including insolvency practitioners (such as Approved Intermediaries and Personal Insolvency Practitioners in the Irish context) and the judiciary.

The World Bank statement is further at odds with the statement of the Task Force in launching the World Bank Report that an ‘effective regime for the insolvency of natural persons is of crucial importance for economic development and financial inclusion’<sup>4</sup>. It is vitally important that personal insolvency legislation be drafted, and where necessary, amended with the aim of returning insolvent borrowers to solvency in the shortest possible timeframe in order that they may participate fully in the economy and society generally.

While being aware of the necessity to have regard for the social, political and cultural peculiarities of Member States, there is a need for harmonisation of personal insolvency legislation that meets that aim. In an Irish context, the insolvency processes for Debt Relief Notices, Debt Settlement Arrangements and Personal Insolvency Arrangements are, in MABS experience, relatively onerous both on practitioners and borrowers ( particularly, when comparison is made to the UK’s insolvency regime). Verification of debts poses a particular problem in the area of Debt Relief Notices due to the lack of availability of a comprehensive credit register which includes bank and non-bank debt. The Central Bank of Ireland is currently working to introduce a Central Credit Register; however this is unlikely to be of great benefit in the majority of applications where non-bank debt presents as an issue. Another barrier to accessing the current Irish insolvency regime is the approval of the application by the Circuit Court. For many over-indebted borrowers, a court hearing for debt is too deeply entwined with enforcement and committal proceedings and so this step prevents the process being as effective as similar non-judicial processes in other jurisdiction.

While the Act endeavours to return insolvent debtors to solvency within specified timeframes, there are exceptions for secured creditors who retain the right to deal with their security after the expiry of the arrangement term<sup>5</sup>. This may leave the debtor with a residual debt which remains to be paid

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<sup>2</sup>

[http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport\\_01\\_11\\_13.pdf](http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf)

<sup>3</sup> p.44

<sup>4</sup> Statement on the Report of the Treatment of Insolvency of Natural Persons, the World Bank Insolvency Law Database, December 2012 available at

<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTLAWJUSTICE/EXTGILD/0,,contentMDK:23329898~pagePK:4789622~piPK:64873779~theSitePK:5807555,00.html>

<sup>5</sup> Sections 35(9), 46(5), 68(1)

after the security has been sold. The introduction of non-recourse security, such is the case in the United States, would greatly enhance the efficacy of personal insolvency legislation. Accordingly, we suggest the removal of secured debts as an exclusion from automatic discharge as set out in Article 22(3) of the proposal, as secured creditors could invoke longer discharge periods as provided for in Article 22(2) to recoup their debt as part of an extended arrangement.

It is MABS' experience that early intervention is key to addressing debt problems. Where mechanisms have been put in place to support borrowers to manage their finances and come to affordable, sustainable repayment arrangements with their lenders, borrowers have been empowered to deal with their financial difficulties and engage meaningfully in society. When interventions are only implemented as a 'last resort', the negative effects of over-indebtedness, be it financial, psycho-social or physical, are more difficult to deal with. Accordingly, we submit that the preventative restructuring procedures afforded to entrepreneurs within the proposal be extended to natural persons who are not entrepreneurs when there is a likelihood of insolvency. In an Irish context, enhancing the Consumer Protection Code 2013 to provide for responsible lending and restructuring to borrowers at risk of insolvency, and strengthening the pre-arrears provisions of the Code of Conduct on Mortgage Arrears, together with placing both on a statutory footing, would go a long way to achieve this.

## Conclusion

The proposal, which seeks to support SMEs in financial difficulties (as defined therein) to restructure and continue as a going concern, is a welcome development in debt management. Extending this proposal to natural persons who are not entrepreneurs, with relevant prudential lending criteria to avoid over-borrowing or reckless lending, would greatly aid borrowers at risk of becoming over-indebted at an earlier stage and return them to active participation in the economy. The enhancement and streamlining of insolvency procedures in tandem with preventative measures would ensure that those procedures work for those most in need, providing them with a fresh start and enabling them to return to a productive role within the economy.