Study on means to protect consumers in financial difficulty: Personal bankruptcy, *datio in solutum* of mortgages, and restrictions on debt collection abusive practices

Final Report

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Dedication

Dedicated to Frederik Bang-Olsen and H. H. H. Andrup, possibly two of the most influential Danes you've never heard of and without whom, arguably, we would have had very little to write about in this report.

[1] For more information on the FSUG, please refer to http://ec.europa.eu/internal_market/finservices-retail/users/index_en.htm

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Assignment

An **assignment of earnings** is where a consumer gives a lender or a Government administrator the right to remove some fraction of the consumer's income from his salary *before* the consumer receives it, akin to Income Tax.

Attachment

An **attachment of earnings** is where a lender or a Government administrator acquires the right to remove some fraction of the consumer's income from his salary *before* he receives it, akin to Income Tax. Used interchangeably with **garnishment** of wages**.** A **garnishment** or **attachment** can also be applied to benefits.

Bankruptcy

Bankruptcy is a process by which an economic actor reaches a position where they take all available action to repay their debts as far as possible, including a process of asset liquidation to use assets to repay as much debt as possible.

Because of variation of usage within Europe, where in some countries this process is open to private individual or consumers, and some it is wholly reserved for traders and businessmen we are going to, in this study, follow the UK approach, whereby we reserve **bankruptcy** exclusively for the process individual consumers can go through to address their debts. To make a clear distinction we will refer to the situation where firms, traders and businesses cancel their debts as **insolvency**. Where both firms and individuals use the same procedures to cancel debt for clarification we shall refer to **personal bankruptcy** and **corporate insolvency**.

Because this term is used in some countries for a process which leads to cancellation of residual debts, after all steps have been taken to pay, and some countries use it for a process which liquidates assets and attaches earnings, but does not lead to a discharge, for clarity we shall refer to '**debt cancellation**' processes for those mechanisms which lead to a discharge of the remaining debts.

Composition

A commonly used name for a type of **payment plan**. In almost all jurisdictions in Europe **debtors** can emerge from / avoid bankruptcy by entering into a '**composition**' with his creditors, whereby he agrees to repay a fraction of his **debt** and the **creditors** agree to cancel the rest. As such it is a negotiated settlement we in this study classify as **debt relief.** The key difference between **composition** and **bankruptcy** in most countries is that a **composition** requires the agreement of the **creditors**. **Bankruptcy** on the other hand entitles **debtors** to have their **debts** cancelled against the wishes of the **creditors.**

Corporate Insolvency	The legal process where firms, traders and businesses cancel their debts. **Corporate insolvency** is outside the scope of this study. See also **bankruptcy**.
Cram-down	A colloquial phrase used to describe a power sometimes given to a court or administrator to compel dissenting **creditors** to agree to a **payment plan.** Sometimes divided into strong and weak varieties. Weak cram-down is the imposition of the plan on dissenting **creditors**, strong is the immediate imposition of a plan on all creditors without seeking a vote of creditor.
Creditor	The party owed a **debt** by a second party, the **debtor**.
Credit Provider	Another name for **creditor**.
Debt	A **debt** is an obligation owed by one party (the **debtor**) to a second party, the **creditor**; usually this refers to assets granted by the creditor to the debtor. In this study we are going to consider debt as an agreement to lend a fixed amount of money, called the **principal**, for a fixed period of time, with this amount to be repaid by a certain date. In commercial loans **interest**, calculated as a percentage of the principal per year, will also have to be paid by that date, or may be paid periodically in the interval, such as annually or monthly.
Debtor	The party owing a **debt** to a second party, the **creditor**.
Debt Cancellation	**Debt cancellation** is a label we have created for all **debt solutions** which involve the **writing-off** of all remaining outstanding **debt**, as a rule, whether the **creditor** wishes to **write-off** the **debt** or not. **Personal bankruptcy** and **corporate insolvency** are the two predominant types of **debt cancellation** process.
Debt Distress	The situation a **debtor** finds himself in when it has become difficult or impossible for him to pay the **debts** he owes, according to the schedule of payments he agreed in the debt agreement. Also known as **over-indebtedness**.
Debt Relief	**Debt relief** is a label we have created for all **debt solutions** which involve the **writing-off** of a portion of any remaining outstanding **debt.** This includes processes which either require **creditor** agreement to **write-off** the **debt** or not.
Debt Re-organisation	**Debt re-organisation** is a label we have created for all **debt solutions** which involve attempting to reduce the burden of the debt on the

	consumer whilst **writing-off** none of remaining outstanding **debt.** This includes processes which reduce instalments, without changing the principal debt
Debt Solutions	**Debt solutions** are arrangements which take payments or instalments which have become unaffordable to the **debtor** and make them affordable by either re-organising, reducing or cancelling the value of the debt. In scope for this study are all **debt solutions** which address the situation where the debtor is an individual consumer.
Discharge	**Bankruptcy** in many countries is a time limited process, during which the **debtor's** assets and earnings are extracted from him and used to meet **creditor's** claims as far as possible. In some countries this process reaches a conclusion either at a fixed point in time after entering bankruptcy, or when all assets have been liquidated and **creditors** have been as fully satisfied as possible. At this point, in these countries the **debtor** is then **discharged** or released from the **bankruptcy** process and given a 'fresh start' whereby he is allowed to borrow money or start a new business without any remaining **creditors** being able to make any further legitimate claim on him.
Garnishment	A **garnishment** of wages is where a process gives a lender or a Government administrator the right to remove some fraction of the consumer's income from his salary *before* he receives it, akin to Income Tax. Used interchangeably with **attachment of earnings.** A **garnishment** or **attachment** can also be applied to benefits.
Insolvency	The legal process where firms, traders and businesses cancel their debts. **Insolvency** is outside the scope of this study. See also **bankruptcy**.
Interest	The rate of return for the **creditor**; the additional moneys the **debtor** pays the **creditor** in return for the loan of the **principal**.
Mortgage	A loan from a **creditor** to a **debtor** which is **secured** on a property.
Natural Person	A legal term for an individual consumer, as opposed to a legal person / legal personality, which could also include firms, businesses, or traders. Some countries (particularly Italy) also include farmers in the group of firms and businesses.
Over-indebtedness	The situation a **debtor** finds himself in when it has become difficult or impossible for him to pay the **debts** he owes, according to the schedule of payments he agreed in the debt agreement. Also known as **debt distress**.
Payment Plan	An agreement between the **debtor** and the **creditor**(s) under which some compromise is reached relating to the amount of **principal** to be repaid, how **interest** is applied to it, and for how long payments will last.

Personal Bankruptcy	The process whereby individual consumers can cancel their debts. See also **bankruptcy**.
Principal	The sum of money lent by the creditor, which the **debtor** must repay and on which **interest** accrues.
Repossession	The act of taking an asset off the **debtor** by the **creditor** in lieu of a **debt** where the agreed payments have not been made.
Secured Debt	A **debt** which is contractually guaranteed by an asset which the **creditor** can **repossess** / take off the **debtor** if the agreed payments are not made.
Unsecured Debt	A **debt** which is not contractually guaranteed by an asset which the **creditor** can **repossess** / take off the **debtor** if the agreed payments are not made.
Writing-off	The process by which any remaining **debt** is cancelled, so that the **debtor** will not be expected, required or asked to pay it again in the future.

Executive summary

The study's objectives and methodology

The objective of the study is to identify all formal debt reduction solutions which allow consumers to return to a financially sustainable path by eliminating some or all of their debts or reduce their debts significantly, including providing a comprehensive description of:

- the availability and use of personal bankruptcy and *datio in solutum* solutions of mortgages as legal solutions to problems of over-indebtedness faced by a number of consumers in the EU; and,
- the legal framework under which debt collection institutions operate, in particular any restrictions on debt collection abusive practices. General laws and regulations which impact on the tools and approaches that debt collection agencies can use (such, as for example, the right to an unlisted phone number) are outside the scope of this project.

The study details the nature of the solution, the condition the debtor needs to find themselves in to access the solution, the legal, financial and other consequences of having used a particular debt solution, and the effectiveness of such solutions in practice and identifies best practice.

Mechanisms to address consumer debts

By the 1970s, Europe had developed an economic model where credit became widely available to the vast majority of consumers. Whether in the form of mortgages, loans, overdrafts or credit cards, mass consumer credit became common and remains so to this day. But wherever a large amount of any activity occurs, there will be some small fraction where something goes wrong, and in the case of consumer credit, the result is consumer over-indebtedness. European governments have attempted to deal with this problem, which causes a raft of social problems, by creating debt adjustment processes for consumers, often springing out of the pre-existing and long-lived corporate insolvency legislation they already had in place.

In recent years, particularly since the deregulation of credit markets in the 1980s and the following recession of the early 1990s, European jurisdictions took a more pro-active approach in this area. The recession following the credit crunch of 2007/8, however, brought this issue once again, into focus. For example, at the time of writing, the authors can identify six EU members[2] who have announced reforms since we started this project, a period of eight months. We have identified four major trends in the development of debt solutions:

The balance between consumers and lenders

As over-indebtedness has become more common, there has been an increasing recognition that over-indebtedness caused by a change in the consumer's state (i.e. becoming unemployed) has led many countries to move from a position where the law is there to uphold agreed contracts, towards one where lenders who have lent too much are viewed to be as responsible as consumers

[2] In alphabetical order; Austria, Germany, Ireland, Italy, Poland, and Slovakia

who have borrowed too much, and that the law has to achieve a balance between upholding contracts and delivering consumer protection. Only a handful of countries still preserve the concept of *pacta sunt servanda*[3] and attach absolute primacy to ensuring the consumer honour their contractual obligations. This is reflected in the degree of stigmatisation countries deploy in their systems, and how highly they value the moral hazard[4] of allowing someone to negate some or all of their debts without paying. Niemi (2009) and Kilborn in multiple articles, identify three major schools of approach.

- **Nordic model**, which were the first to breach this question of whether it was right to break contractual obligations to relieve over-indebtedness, expose their 'struggle with the very notion of offering formal personal bankruptcy relief' by applying a good faith test whereby consumers cannot access debt solutions if their behaviour is felt to have been in bad faith, for example, by taking out large quantities of debt shortly before seeking a debt solution, or having not made sufficient effort to repay what is owed.
- **Germanic model** (originally implemented in Germany, Austria and Estonia), in contrast allows any consumer in, but then manages a payment plan whose substance is shaped by firm **rules**, whereby they must honour debts as far as practicable.
- **Romance model** Finally there is the approach historically (but no longer) taken in France and the Benelux countries, where voluntary agreements were supported as far as possible, judges had significant **discretion** to define the outcome of the process, but with a general rule that processes were 'hard', payment plans long, and discharge conditions difficult.

The balance between discretion and rules

The Romance school is characterised by judicial discretion to fine-tune the solution according to the particular circumstances of the case, whilst the Germanic school deployed clear, standardised rules, so both consumers and lenders have an accurate expectation of what they are getting into either when they do, or do not agree to a process. There are advantages and disadvantages to both approaches, but the general direction of travel has been away from complete discretion to no discretion (absolute rules). Discretion has been found to be time-consuming and expensive, and often delivered little extra benefit given debtor's limited resources, low income, and high debts. Standardisation also meant that consumers had clarity over what would be expected of them, reducing uncertainty and pressure on consumers going into the process.

Moving from judicially-led to administrative processes

Many countries have moved away from court-based to administrative processes, if only because of the costs associated with judicially-led processes when many clients are unable to meet these costs. However there are more substantive issues also.

[3] The contract must always be honoured.

[4] A moral hazard is an event which, by its existence changes the incentives on individuals, and makes people more likely to commit an action which society views negatively; in this case, if the debt solution is too generous then people may be more likely to risk falling into over-indebtedness. Debt cancellation is the most obvious example of a process which opens the threat of moral hazard. Obviously for those countries which do not have debt cancellation, the view is that the moral hazard of annulling all debts and putting the cost of this onto the creditor is so high that it is not permitted at all. Other countries can impose significant entry criteria.

- Courts are a forum for ensuring that contracts are compiled with as a form of defending property rights. Once the intellectual step has been taken that over-indebtedness is at least partly a problem caused by the lender as well as the consumer, or even in the case of passive indebtedness, where an inability to pay is in effect equivalent to a 'act of god' suffered by the consumer at no fault of his own, such that consumer protection, rather that maintenance of a contract, becomes the over-riding concern, the need for the case to move into the judicial forum, as opposed to other administrative systems, falls.
- As many systems have moved from discretion to rules-based system, the case has developed from being a dispute resolution process, arbitrating between a lender and a consumer, to being the simple application of *a priori* fixed rules the need for judicial involvement has been felt to be lessened.
- As such whether debt solutions retains the need for judicial involvement has become a key question, with some countries moving to only using the courts for appeals against the administrative body, on the grounds they have not followed the published rules and processes. For example, Sweden and France, the most advanced countries in this regard no longer have a role for the judiciary in its debt solutions, aside on appeals of whether the process / law has been correctly applied.

From long processes to shorter, time constrained processes

During bankruptcy the consumers is required to continue to attempt to make payments to debtors. Only on discharge can he finally escape his debts and gain a 'fresh start'. Some countries make this process short; a period of a small number of years, some longer *and som*e have no formal discharge point. The longer the period until discharge the longer the process is not actually debt cancellation, merely debt relief. Many countries have not been willing to leave their consumers in this position, in part because of Council Regulation (EC) 1346/2000.

European countries each have their own laws relating to consumer over-indebtedness, but, aside from Denmark, which has an exemption, all the countries studied here are caught by the European Union Council Regulation on Insolvency Proceedings[5], which had the three goals of:

- Providing legal certainty in matters of cross-border insolvency;
- Promoting the efficiency of insolvency proceedings, by favouring those solutions that facilitate their administration and improve the *ex ante* planning of transactions; and
- Eliminating inequalities amongst EU-based creditors with regard to access to and participation in such proceedings.

This regulation did not attempt to impose a common system on different European countries, but instead to ensure that bankruptcy / insolvency proceedings opened in one Member State would be recognised in all other Member States. It was clearly drafted with corporate insolvency in mind, and from a creditor's perspective, but because the issue of who may be a 'bankruptcy debtor' is determined under national law, and because many countries permit both legal persons (i.e. firms) and natural persons (i.e. consumers) to qualify for their bankruptcy arrangements, this therefore

[5] Council Regulation (EC) No. 1346/2000 of 29.05.2000 on Insolvency Proceedings, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:en:PDF

means that any European consumer[6] who meets the qualification criteria (i.e. residency for set periods etc) of a country which does permit consumer bankruptcy does presently has the ability and right to access this, effectively making their domestic legislative position irrelevant, as the regulation outlines that the domestic law of the country where the case is opened (*lex fori concursus)* is applicable[7], as long as the individual has established a '*centre of main interest' (COMI)* in the relevant jurisdiction.

As a result a trade in 'bankruptcy tourism' has emerged where individuals moves their COMI to a different EU state to gain access to the bankruptcy legislation in place there. Whilst this may appear to be an example of the Single Market at work, the key problem with this is that the consumers participating in this market are often those with the least resources and least ability to move, whilst only a small handful have the capacity to make such a move, and this is fundamentally inequitable. The vast majority of those in over-indebtedness do not have vast debts which overwhelm high incomes, from which they can fund a move prior to declaring bankruptcy, but rather they are citizens with low or negligible incomes and small debts which they nonetheless cannot re-pay, and for whom the idea of moving to another country to live and work is utterly unfeasible. This inequity; one law for the rich and another law for the rest, leaves the current system of debt solutions across the European Union facing a fundamental crisis of legitimacy.

Debt cancellation best practice

We have identified the following model as best practice in relation to debt cancellation:

- Debt cancellation is not, and should not be, an automatic right, but it should be presumed that someone applying should have access to it unless a lender can demonstrate objective evidence of 'bad faith' by the borrower. The application process should give lenders a time-limited opportunity to raise concerns about an applicant's behaviour, so administrators can reject applicants whose behaviour has been found wanting.
- The creditor must be protected when the debtor has acted in bad faith, but in return for this creditors must accept the responsibility where inappropriate lending has helped cause the problem of over-indebtedness they should bear some of the costs of resolving this problem. Best practice requires a compromise between the debtor and creditor; the debtor must pay what he can and the creditor must accept that as the best resolution they can receive, so it is better for them to cut their losses, stop paying legal fees and allow a rapid discharge of unpayable debts.
- The use of stigmatising labels should be ended, and the pejorative term 'bankruptcy' should be replaced with the more neutral 'debt adjustment'.
- Debt cancellation should be delivered by an administrative body without recourse to a judicially-led court-based process except for appeals against the mis-application of the due process, as exists in Sweden and France, transparently applying clear rules quickly and efficiently. Creditors and consumers should have the right to appeal to a court on the grounds of compliance with the process.
- The debt counsellor who leads the administrative process should:

[6] Excluding the Danish.

[7] As long as these are listed in Annex A (insolvency proceedings) or Annex B (winding-up proceedings) of the Regulation, which, between them, give a 'closed-list' of applicable proceedings.

- determine the solution applicable to the case, rather than the consumer or the debtor:
- have the power to attach earnings. There should be transparent rules on exempt income based on social benefit levels, taking account of the number of children and/or a partner, and the impact these have on social allowances.
- only have the right to liquidate assets worth over a substantial threshold.
- have the right to impose a 'cram-down' on creditors.
- have the power to impose a 'zero-plan' where there is no chance of the consumer being able to make payments, with immediate discharge if a consumer cannot over three years repay either 10% of their total debt or €10,000, whichever is lower, in line with recent practice in the Netherlands.

- As in Denmark and the UK, discharge should occur one year into a three year payment plan, aligning discharge at the lowest common denominator whilst still ensuring creditors have access to excess earnings for three years.
- There are some debts which consumers should not be able to escape. Child / dependent maintenance payments deserve inclusion in this exemption. Student loans do not merit exemption from debt cancellation. There is a case that society would benefit most if unpaid taxes were given a priority in payment plans over private debts.
- At the European level, a first step would be to update the list of procedures in Annex A of the Insolvency regulation to keep pace with recent legislation.

Datio in Solutum

This section addresses the research questions concerning the legal instrument of *datio in solutum* in mortgage loan agreements and legal regimes of the Member States. *Datio in solutum* is defined as follows:

'Some jurisdictions may provide that borrowers who cannot repay their mortgage loans are released in full from the underlying debt by handing their mortgaged property over to the lender.

In jurisdictions which do not operate such a regime, the borrower has an unlimited responsibility in relation to their debt, and if there is insufficient collateral in the property must use other income and/or assets to meet the debt and make full repayment of the mortgage loan.

It is worth stating that we view two potential versions of *datio in solutum,* as described below:

- Strong *datio in solutum*: This assumes a hard application of this concept as mandated in the legislation in the country, defining *datio in solutum* as part of the enforcement mechanism of all mortgages.
- Weak *datio in solutum*: This assumes a non-universal application of *datio in solutum* as mandated in law for use with certain types, class or other categorisation of mortgage debt or debtor.

General findings

It is our assessment, in consultation with recognised experts in the field of comparative European mortgage market studies, that:

- There currently exists no European country which has a strong application of *datio in solutum* enshrined in legislation, covering all mortgages in that country.
- Equally, it is our assessment that there exists no country or state in the world which has a strong application of *datio in solutum* enshrined in legislation.
- The only country in the world where we can identify a weak application of *datio in solutum* enshrined in legislation is Spain. This is extremely limited in terms of who can apply to it and the requirements those borrowers must meet before they become eligible to use this solution. In the USA we have found example of non-recourse mortgages, where payment in kind of this type is included in the contract and costed in.
- Most European countries have not considered *datio in solutum* because they have developed systems which preclude the need to have a specific solution for residual debt following enforcement against a mortgage.

We have had strong arguments for and against the concept of *datio in solutum* presented to us in our study, both in terms of whether it is right to so fundamentally shift the balance of power from the lender to the borrower, and in terms of whether it is practicably deliverable as a functional part of the landscape of financial markets. We can see strong reasons why *datio in solutum* appears to present very significant practical problems in terms of delivery and may have large potential impact on lenders, but we also recognise the evidence that the impact on mortgage prices from US studies has been less than would have been expected.

Our review has suggested that *datio in solutum* delivers greater benefits to consumers than no debt cancellation system, but the best practice debt cancellation model described above and a model of mortgage forbearance applied by all lenders appear to deliver even greater benefits to consumers. The best practice debt cancellation approach allows them to address all their debts in a fair way, not just one (potentially large) debt, as over-indebtedness is often a compound problem, where the consumer has more than one problematic debt[8]. Statutory mortgage forbearance has the merit of preventing enforcement against the property for as long as feasibly possible, through using different mortgage designs or some form of payment moratorium to enable the borrower to construct a feasible payment regime which he can honour; it also has the benefit of preventing the losses borrowers, lenders, and the community often face following enforcement or repossession.

However, this argument does not preclude two key points:

- Even if the best practice debt cancellation process, or statutory forbearance may provide better consumer protection, that does not mean that *adding datio in solutum* to these practices may not have benefits, merely that each on their own presents greater benefits that *datio in solutum* on its own.
- Even if *datio in solutum* is not best practice in and of itself, that does not mean we do not have enough evidence from Spain to describe what a best practice *datio in solutum* would look like if one felt compel to use this mechanism.

[8] Whilst it is true that consumers just with problematic mortgage debt are equally supported by *datio in solutum*, we feel it is important that consumers with multiple problematic debts also have a route to address their problems.

Mandatory forbearance and the role of *datio in solutum* in incentivisation

A model to address mortgage over-indebtedness through a general system of forbearance applied by all lenders to achieve an appropriate balance of risk between the creditor and the lenders to facilitate consumers retaining their property would benefit from lenders having incentives to not move to enforcement too quickly. To incentivise this behaviour in such arrangements, one of the following models could be put in place to dis-incentivise lenders opting to proceed to enforcement:

- A best practice *datio in solutum,* as described below.
- The best practice debt solution model described above.
- Limiting consumer liability on enforcement to the property, excluding other assets.

Best practice in using *datio in solutum* to reinforce a debt cancellation mechanism

There is a debate to be held over whether, and in what circumstances, *datio in solutum* may be a useful addition to a universal debt cancellation system, either as an extra lever or mechanism of last resort. Countries with well-developed and well-functioning best practice debt cancellation models are unlikely, in our opinion, to see significant benefits from implementing a *datio in solutum* approach, but those countries where this is not the case would, our assessment suggests, benefit from a strong *datio in solutum* model as the best way to discharge as much problematic consumer debt as possible. The underlying necessity of having a functioning process to cancel debts holds true whether or not a country has implemented a debt cancellation debt solution. In those cases where they have not, they have not done so because the *need* does not exist, merely because some feature of their political economy has prevented the reform being brought into being.

Below we consider what a best practice *datio in solutum* model looks like, which may achieve this aim.

Best practice *datio in solutum* model

The best design for *datio in solutum,* taking into account lessons from Spain, which we can identify has the following characteristics

- We do not see a case for *datio in solutum* prior to the commencement of enforcement, because it should be expected that forbearance should still be being attempted up to this point as the consumer should still be attempting to meet their commitments. At the point where the consumer is informed the lender wishes to move to enforcement, being able to evidence its efforts to agree and deliver a viable re-structuring and the borrower's failure to comply with this, all consumers, irrespective of income, should be able to apply for *datio in solutum* immediately.

The only eligibility criteria should be:

- *Datio in solutum* should only apply on the primary residency of the family, the property in which the household spends the majority of its time. It appears unfair to expect a lender to shoulder this burden in the case of a second property as the purpose of this protection should be for use *in extremis*, when all other efforts have been taken and failed to preserve the household's primary accommodation.

- Similarly, where the consumer has other assets which could be liquidated to help pay-off the mortgage it appears unfair to ask the lender to shoulder the whole burden. Again, this process should only be used when all efforts to preserve the household's primary accommodation have been taken, and the possession of other assets, particularly other property appears to indicate the consumer could have taken further steps if he had wished to address his debt, and if the consumer has chosen to prioritise the protection of these other assets over the mortgaged property, we cannot see why he should not, therefore share the risk of making a loss on the property with the lender.
- We see no reason to consider an exemption based on the consumer's income levels, as this should have been taken into account already in forbearance/ re-structuring attempts. Any consumer who has reached enforcement has already demonstrated that their income is insufficient to maintain the mortgage, so this indicates this consumer is in need of further support, such as the *datio in solutum.* Therefore all consumers who reach enforcement should, except in situations where they make a conscious decision to not liquidate other assets, be able to receive *datio in solutum* on their main residency.

Debt Enforcement

In this study we have identified a wide variety of types of enforcement restrictions affecting everything from the availability of water to the use of social media to communicate debtors. The common underlying principles which almost all these restrictions clearly reveal are the desire of legislators to preserve the debtor's human rights and human dignity, whilst facilitating fair attempts to enforce the payment of late debts:

- To ensure the consumer and his family has access to a sustainable minimum income
- Ensuring the consumer and his family have access to accommodation
- Ensuring compatibility with debt solution processes
- Preventing unfair and non-misleading processes from being used to harass, confuse or use unfair duress to achieve payments by consumers
- Ensuring charges fall onto the lender who has commissioned the enforcement activity
- Ensuring access to utilities
- Respecting the privacy of debtors
- Preventing violence and harassment that may lead to physical or psychological harm
- Ensuring that vulnerable debtors are treated appropriately and in ways that neither exploit nor exacerbate their vulnerability

In general terms we have identified the guidance offered in the UK in relation to debt collection by the OFT[9] as best practice. Whilst it does not cover all the areas we address in the report, its general approach and up-to-date consideration of new areas where restrictions may need to be applied, such as social networking sites appears a good method of communicating what is permitted or not. The model of a lead agency or department with responsibility for the enforcement of debt, requiring that agency to publish and maintain up-to-date comprehensive guidance on what is permitted, and what best practice looks like offers significant benefits in

[9] Office of Fair Trading (2011)

terms of clarity, both for debt collectors and debtors. Equally the model deployed in many countries where those who engage in debt collection are registered to allow the lead agency to ensure that those who should be following this guidance are doing so appears best practice.

To ensure the consumer and his family has access to a sustainable minimum income

There are very different approaches in different countries, but it is unclear why, if the debtor is to have some element of his debts written-off he is deserving of a minimum exempt income, but when he is not looking for a debt discharge, he should not be. **Debt enforcement should therefore take into account a minimum income which is exempt from enforcement activities.** Where assignment / attaching of earnings or benefits are used there should be clear regulation of what limits should be applied, particularly in relation to exempt income, but further research should be undertaken to determine whether these should be used in fewer / more instances. Finally, payments which are made to maintain the children of a previous relationship are often exempted from debt cancellation processes, making these unavoidable, and giving consumers no means of evading this responsibility. This appears to us to be the correct course of action.

Ensuring the consumer and his family have access to accommodation

Eviction and rent arrears are significant areas for the application for restriction on how debts are enforced. Various countries use different types of protection to ensure that families have sufficient time to find alternative arrangements, we consider that it is appropriate that countries ensure that an adequate provision is made in such cases to ensure alternative arrangements can be made, if only to prevent costs falling onto the state, even if the substantial impact on families that eviction can have is disregarded. As this therefore is a classic 'invest to save' we see little difficulty in encouraging countries to ensure the outcome of *'sufficient time'* but recognise that given different systems the mechanism to deliver this, and indeed how much time each country feels is '*sufficient*' is a substantive topic for countries to consider if they have not already done so.

Ensuring compatibility with debt solution processes

Creditors accept three year, or longer, payment plans when cancelling debt, so this may be an interesting lesson for debt enforcement. Any step to prevent debts reaching the point of unsustainability are ultimately likely to provide better value to both the lender and the debtor, and should therefore be assessed as best practice. In relation to taxes, fees, and fines, most countries allow the tax collection office to remit or defer payment, but often exempt these debts from debt cancellation. Tax collection agencies having the flexibility to make this decision appears valuable.

Preventing unfair and non-misleading processes from being used to harass, confuse or use unfair duress to achieve payments by consumers

Best practice catches preventing debt collectors from using official looking documentation, from misrepresenting their authority, preventing the use of wordings which imply the potential to use further processes which may not be available or which are at the discretion of the court, not using Latin phrases, or unhelpful legal and technical jargon, and ensuring information is not to be presented in a way which has the potential to create a false or misleading impression.

Ensuring charges fall onto the lender who has commissioned the enforcement activity

It appears best practice for the cost of enforcement to be priced into the general cost of loans and shared amongst all consumers, as at the point of borrowing all consumers who are lent to must appear to be a 'fair bet' and should all be treated equally in terms of facing a share of the cost of enforcement This also would incentivise to lenders to look to forbearance prior to enforcement.

Ensuring access to utilities

Different European countries have different approaches to this question, for example the UK permits utilities companies to cut-off non-paying clients, whereas France, for example, ensures a minimum allowance of water is supplied. This comes down, we think to whether access to water in this way is a fundamental right, even if they have not paid their bills. This is the principle which needs to be decided on, although in actuality the true issue may be the amount of these commodities which are supplied in the basic requirement.

Respecting the privacy of debtors

Best practice in this area is keeping requirements up to date, such as the use of latest social media, to ensure that requirements not share to information with friends / neighbours / relatives, or to search for debtors by contacting individuals with the same name are complied with.

Preventing violence and harassment that may lead to physical or psychological harm

All countries have ensured that basic standards are in place. Best practice in this space deals with potential harm, specifically in relation to stress and mental health rather than physical harm, which obviously are universally addressed through criminal law. Key here is regulating the debt collector and their staff, looking at both present and previous records.

Ensuring that vulnerable debtors are treated appropriately and in ways that neither exploit nor exacerbate their vulnerability

Best practice is regulation over how debt collection agencies address clients who have demonstrated mental health issues, or who they fear may be demonstrating mental health issues. In the UK, a procedure has been put in place to allow debt collectors to initiate an assessment to then form the basis for how they should deal with the client. It is clearly best practice to ensure that this group is treated sympathetically and with due regard to their state to ensure the process of debt enforcement does not exacerbate their health issues, which of course from a debt collection point of view can only be self-defeating in terms of prolonging a state whereby the likelihood of being paid is lower than standard.

Removal of possessions

Whilst commonly used across Europe, we see two significant issues with using asset liquidation for debt solutions. The first is, as the price of second-hand households electronics falls whether this will continue to be cost effective, the second is if asset liquidation is removed from debt cancellation, as we have identified has already happened in some countries studied, and we have identified as best practice then should this extra severity be imposed at part of debt enforcement?

1 The study's objectives and methodology

1.1 Objectives

To gain a better understanding of the ever-changing picture within the EU, both in terms of practice and legislation, the Internal Markets Directorate General has commissioned London Economics to undertake this study.

The objective of the study is to identify all formal debt reduction solutions which allow consumers to return to a financially sustainable path by eliminating some or all of their debts or reduce their debts significantly, including providing a comprehensive description of:

- the availability and use of personal bankruptcy and *datio in solutum* solutions of mortgages as legal solutions to problems of over-indebtedness faced by a number of consumers in the EU; and,
- the legal framework under which debt collection institutions operate, in particular any restrictions on debt collection abusive practices.

The study details the nature of the solution, the condition the debtor needs to find themselves in to access the solution, the legal, financial and other consequences of having used a particular debt solution, and the effectiveness of such solutions in practice.

Because, in some countries, alternative solutions to formal bankruptcy exist, we include such alternatives in the analysis to provide a detailed overview of all the legally foreseen solutions available to over-indebted consumers. However, we have agreed with the Steering Group to exclude those methods which involve private, bilateral contract negotiated contracts with no formalised process.

To provide a robust picture of such solutions in the EU, we will gather available information and data on their actual use by over-indebted consumers and the problems they encounter in actually accessing the solution.

Regarding restrictions on abusive debt collection practices, we will focus on any legislation and regulation which explicitly addresses this point. However, other, more general laws and regulations which impact on the tools and approaches that debt collection agencies can use (such, as for example, the right to an unlisted phone number, the prohibition of machine-originated calls outside certain hours, etc.) are outside the scope of this project.

1.1.1 Specific Questions

The following points and questions have been addressed:

1) Do the legal and regulatory (including self-regulatory) frameworks of Member States provide for specific regulations on personal bankruptcies, on provisions of *datio in solutum* applied to mortgage credit, and on debt collection activities?

a) In case it does, provide the legislative/regulatory reference and summary of the relevant provisions and indicate the regulatory instrument(s) in which these provisions are set.

b) In case the legal and regulatory (including self-regulatory) framework of Member States does not provide specific regulations; indicate the legal/regulatory provisions that are referring to the three topics, if any. Provide the reference and summary of relevant provisions and indicate the legal/regulatory instrument(s) in which these provisions are set.

c) In case the three topics are not covered in any way by the regulatory framework, summarise and describe the general practice in the respective Member States.

2) For each of the selected Member States a short description should be provided of how the legal framework is applied, through reference to a list of leading case-law and case-studies. Whilst providing such case-law or case-studies, an assessment of cross-border cases of personal bankruptcy to which Council Regulation (EC) 1346/2000 have or would have applied should be provided.

3) Evaluate and select the practices that enhance the protection of consumers in financial difficulty for each area (personal bankruptcy, *datio in solutum* of mortgages and debt collection). The trade-offs of such practices with other objectives and constraints should also be analysed.

1.2 Geographical Scope

We have undertaken analysis to meet the objectives in the following EU member states:

- Austria
- Belgium
- Czech Republic
- Denmark
- Estonia
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Netherlands
- Poland
- Romania
- Slovakia
- Spain
- Sweden[10]
- United Kingdom

[10] Only in chapter 3.

1.3 Methodology

Our study has followed a seven stage methodology:

- Defining the Question Set
- Identifying relevant debt solutions in each Member State
- Identifying interview targets in each country
- Constructing interview materials
- Undertaking Field Work
- Analysis and verification of the collected information
- Development of conclusions and drafting of final report

This methodology is explained in depth in Annex 1. Respondents to our survey are listed in Annex 2. The survey instrument is presented in Annex 3.

1.4 Debt solutions

1.4.1 The definition of different debt solutions

In attempting to categorise debt solutions, to allow us to undertake comparisons and develop best practice, we have looked to map each solution by what it does to the interest and principal of the loans addressed. In the broadest terms, we see four approaches to interest payments which any debt solution can take.

- The interest terms on the debt remain unchanged (even if the amount paid in each instalment, extending the duration of the loan and the overall amount paid back);
- The interest terms on the debt is reduced;
- The interest owed on the debt is frozen so no extra interest accrues on the debt (at least for a period of time); or,
- The interest on the debt is cancelled.

We also see three approaches to the principal which any debt solution can take.

- The principal remains unchanged;
- The principal is reduced; or,
- The principal is cancelled.

Taking these two in combination allows us to create a typology for ***three families*** of debt solution,

- ***Debt Re-organisation:*** The characteristics of the principal and interest terms loan are retained, but instalments may be reduced, increasing the term and overall cost.
- ***Debt Relief:*** Either the principal or interest of the debt is reduced, reducing the instalments.
- ***Debt Cancellation:*** The whole of the principal and any outstanding interest is cancelled following the liquidation of any available assets.

This is presented in the following figure:

Table 1: A typology of debt solutions

	Principal unchanged	Principal reduced	Principal cancelled
Interest unchanged	**1)** Debt Re-organisation: The existing agreement is unchanged, but the debtor either takes out a new debt on lower interest rates or releases liquidity from assets to continue payments.	Debt Relief: Agreements which retain the interest characteristics of the loan, but reduce the payments by reducing the principal.	Debt Cancellation: Agreements which retain the interest characteristics of the loan, but reduce the payments by cancelling the principal.
Interest reduced	**2)** Debt Relief: Agreements which retain the principal characteristics of the loan, but reduce the payments by reducing the interest.	**3)** Debt Relief: Agreements which reduce the principal and interest of the loan, reducing the payments.	Debt Cancellation: Agreements which cancel the principal and interest of the loan, reducing the payments.
Interest frozen	**4)** Debt Relief: Agreements which retain the loans principal characteristics, but reduces payments by freezing the interest.	**5)** Debt Relief: Agreements which reduce the principal and freezes the outstanding interest owed on the loan.	Debt Cancellation: Agreements which cancels the principal and freezes the outstanding interest owed on the loan.
Interest cancelled	Debt Relief: Agreements which retain the principal characteristics of the loan, but reduce the payments by cancelling the interest owed.	Debt Relief: Agreements which reduce the principal characteristics of the loan and cancel the interest owed.	**6)** Debt Cancellation: Agreements which annul both the principal and the interest.

Source: London Economics

As can be seen, four pertinent points emerge from this:

- There are theoretically feasible debt cancellation and relief arrangements which we consider to be unlikely to ever be seen in actuality, which we have shaded out in grey, leaving ***six types of debt solution***;
- ***Debt re-organisation is a single 'type'*** of arrangement;
- ***Debt cancellation is a single 'type'*** of arrangement; and,
- ***Debt relief is a broad family*** which captures many different combinations of treatment of interest and principal.

We can summarise these as follows as, essentially, all debt solutions systems present two choices:

- Whether to preserve the existing contractual obligations and find some way of meeting them, or seek to reform these contractual obligations; and,
- To what degree the preferred approach is taken. This can depend on the level of indebtedness.

Table 2: A simplified typology of debt solutions		
	Contract preserved (principal and interest on original debt remain unchanged)	**Contract re-written**
Moderate	**Debt Re-Organisation:** The existing agreement is unchanged, but the debtor either takes out a new debt on lower interest rates or releases liquidity from assets to continue payments.	**Debt Relief:** Agreements which reduce the instalments by reducing either or both of the principal and the interest.
Severe	**Asset Liquidation:** The existing agreement is unchanged, but the debtor liquidates all assets necessary to clear his debts.	**Debt Cancellation:** Agreements which cancel all outstanding principal and interest of the loan.

Source: London Economics

We will structure our mapping over the next chapter into these headings, bringing together asset liquidation and debt cancellation, as once severe steps have been decided upon it is usual to see both these approaches being taken simultaneously. We will also try to identify where processes straddle more than one type of solution and they form a sequential chain, moving consumers from one to the next as they fail to escape over-indebtedness through application of each process, or whether each process stands alone and apart from other solutions in that country. We also see these steps fitting into a wider dichotomy of how to think about consumer credit and debt:

1.4.2 The debt landscape

The various chapters below each address different questions in slightly different areas of consumer credit and debt. For clarity, in thinking about this project we have identified the following hierarchy to describe how a consumer, in a country which has a full spectrum of credit and debt mechanisms[11], would progress from step to step:

- **Debt compliance:** This describes the state the majority of consumers face; of making the committed repayments against a loan through to the completion of the contract. This is not addressed in our study.
- **Debt enforcement:** This describes the state a consumer finds himself in where he has not complied with making the committed repayments against a loan through to the completion of the contract, and where the creditor has had to go to some additional effort to demand / ensure repayment. This state does not imply that the consumer cannot pay, merely that he has not paid. This state is considered in 5.
- **Debt re-organisation:** This describes a state the consumer may find himself in if he finds he cannot honour his commitments against a loan, but does not feel it necessary to seek to have at least some fraction of the debt written-off, merely to re-negotiate the terms of the loan to make it more affordable and allow him to honour the contract, albeit maybe over a longer time period, or by replacing his present loans with a new loan on cheaper terms. This is considered in Chapter 3.
- **Debt relief:** This describes a state the consumer may find himself in if he finds he cannot honour his commitments against his debts, and feels it necessary to seek to have at least some fraction of the debt written-off. This is considered in Chapter 3.

[11] This is not to imply that a full spectrum of mechanisms is either desirable or necessary; we view this merely as a typology.

- **Debt cancellation:** This describes a state the consumer may find himself in if he finds he cannot honour his commitments against his debts, and feels it necessary to seek to have all of his debts written-off. This is normally accompanied by a *quid pro quo,* in terms of either an **asset liquidation**, or a **payment plan** over a period of time, taking his income and allocating as much of it as possible to his debtor. This is considered in Chapters 3 and 4.

1.5 *Datio in solutum*

Within the wider landscape of debt solutions, it has to be recognised that the larger the overall level of debt the more likely it is that a mortgage, a loan to purchase real estate, will form the largest part of that debt. Debt secured on a property has particular social implications, namely the risk that in the event that the consumer is unable to pay they may ultimately lose their home.

Whilst there is significant variation in the style of enforcement process different European countries use, all countries studied share the characteristic that in the end, the property can be sold, via some mechanism to offer payment in lieu of the consumer meeting his commitments. In this case, there is the threat, if the sale does not raise enough, that the consumer may both lose their home *and* still have residual debt.

This report examines one potential solution to this problem, which is called *datio in solutum*. This is the process whereby the property is surrendered by the consumer to the bank in full payment of the outstanding debt, irrespective of the value raised by the sale.

1.6 Restrictions on debt enforcement

The final part of this report focuses on the legal framework under which debt collection institutions operate, in particular any restrictions on debt collection abusive practices. Consumers facing debt problems can find that the mechanisms which can be employed to pursue their debts exacerbate their situation. Different countries have different conceptions of what is permissible, however, and this report tries to map the limitations placed on debt collection activity in these countries.

2 An overview of the development of debt solutions in Europe

"Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery." Mr Micawber – David Copperfield by Charles Dickens.

2.1 Over-indebtedness

By the 1970s, Europe had developed an economic model, alongside other developed nations, whereby credit became widely available to the vast majority of consumers. Whether in the form of mortgages, loans, overdrafts or credit cards, mass consumer credit became a mainstay of the European economy, and has remained so to this day.

But wherever a large amount of any activity occurs, there will be some small fraction where something goes wrong, and in the case of consumer credit, the end result is consumer over-indebtedness; the state where the consumer can no longer find a way to service his debts from his income, normally because his or her income has fallen for some reason. This report outlines how European governments have attempted to deal with this problem, which by the 1970s was recognised as causing a raft of social problems, through stress and illness, to creating disincentives to work. In response to this debate European countries began to create debt adjustment processes of one form or another for consumers, often springing out of the pre-existing and long-lived corporate insolvency legislation they already had in place.

In recent years, particularly since the deregulation of credit markets in the 1980s and the following recession of the early 1990s European jurisdictions took a more pro-active approach in this area. The recession following the credit crunch of 2007/8, however, brought this issue once again, into focus.

Table 3: Insolvency filings per 10,000 capita 2002, 2008

Country	2002	2008
England and Wales	6	20
Germany	2	12
France	4	11
US	53	38
Canada	38	44
Australia	19	21

Source: Gerhardt M. (2009), Office of Superintendent of Bankruptcy Canada

The movement from the twin objectives of regulating consumer credit and attempting to prevent over-indebtedness to a position where financial de-regulation has occurred and over-indebtedness is a common problem has opened a Pandora's Box which Governments have been forced to react to. Almost all European Governments have re-balanced policy away from just preventing consumers becoming over-indebted, to developing or refreshing mechanisms to address over-indebtedness when it occurs, or at least have actively joined the debate about the level of protection to give to

consumers as well as creditors. For example, at the time of writing, the authors can identify six EU members[12] who have announced reforms since we started this project, a period of eight months.

As such, the flurry of legislation across the members of the EU make this the most important period in terms of reform in the area of personal bankruptcy and other debt solutions in the EU since the abolition of debtor's prisons[13] in the nineteenth century, when modern corporate insolvency legislation was first laid down, and possibly far longer[14]. A list of the most substantial reforms we have been able to identify is given in Annex 4.

Today, consumers in Europe have access to greater numbers of mechanisms to address their debt problems than ever before, including a greater ability than ever before to have some of their debts written-off or discharged. However, there is very significant remaining variation within the EU in terms of the design and availability domestically of debt solutions, with effectively three main groups:

- Those countries which have implemented a full debt cancellation system, with other supporting legislation, which is frequently used and presents a real mechanism for consumers to resolve their problems.
- Those countries which have implemented a full debt cancellation system, but where the courts are not yet permitting people to reach discharge in the numbers necessary.
- Those countries which have not yet implemented such a debt cancellation system, and either are currently developing legislation or have not yet reached this stage.

The countries in the first two groups have introduced legislation which fits with its local policy priorities and its legal system, leaving a confusing array of options before consumers across Europe, particularly bearing in mind Council Regulation (EC) 1346/2000, which provides consumers in EU countries (excluding Denmark), the potential to utilise some of the mechanisms in other EU countries.

There is a substantive debate in the literature as to whether 'bankruptcy tourism' or 'forum shopping' is a positive or negative. Following Council Regulation (EC) 1346/2000 consumers have had some potential to 'shop around' for the best legislation venue for them, depending on the application of the country of main interest (COMI) rule, as the regulation establishes that legal processes in one country will be recognised in others, even if the legislation the judgement is made under is inconsistent with domestic legislation. Whether this is viewed as an example of consumer choice in the internal market, or consumers avoiding their legal responsibilities is a key issue. Europe collectively needs to reach a decision over whether to:

- Accept de facto uniformity from forum shopping,
- Legislate to bring uniformity through domestic legal codes, or
- Reform the regulations which permit forum shopping to restore domestic systems.

Obviously consumers in countries that do not have a debt cancellation mechanism do not just bankruptcy tourism as an option. They also have a variety of voluntary routes which can be

[12] In alphabetical order; Austria, Germany, Ireland, Italy, Poland, and Slovakia.

[13] Such as Mr Micawber, quoted above, found himself in.

[14] In an English context, debtor's prisons only replaced execution in 1542.

negotiated, although the absence of formal routes fundamentally changes the balance of power in such negotiations between the consumer and the lender. For example, where a consumer does not have access to a method to cancel his debts without agreement from the lender he may be unable to negotiate a sufficiently flexible debt re-organisation or sufficiently extensive debt relief to be able to avoid the greatest distress. Obviously, introducing individual bankruptcy into those countries which do not possess this may have significant impacts on the perception of risk run by lenders and increase their potential to suffer 'bad debts', but this needs to take account of the fact that the *formality of the route does not change the debtor's ability to pay*, *merely the form in which lenders end up writing down some or all of unpayable debt*. Formalising individual bankruptcy may actually decrease uncertainty[15].

2.2 Changing responses to over-indebtedness

Becoming over-indebted, being unable to meet the requirements to repay a debt which has been taken out, can be a deeply traumatic experience for consumers. In the past many European countries did not consider this problem greatly except to apply *blame* onto the consumer for getting himself into such a position. In some jurisdictions a difference is explicitly drawn between *active* and *passive* indebtedness[16], where *active indebtedness* is driven by irrational borrowing by the consumer, poor financial management, fecklessness or criminality, whereas *passive indebtedness* occurs when a consumer moves from a position of being able to meet his obligations, to finding this is no longer the case because of a change in circumstances imposed on him against his choice, primarily illness or unemployment.

In a world where consumer debt has ballooned over the last thirty years, many countries feel that contracts cannot be held sacrosanct and that creditors must take a 'fair' share of the burden of over-indebtedness, as over-indebtedness can be seen as being both the fault of the borrower, who has over-stepped their limits, but also the creditor, who has, ultimately, lent unwisely. The Netherlands, in 2008, went so far as to introduce new legislation, whereby debtors are freed from their commitments not because they cannot make contributions, but instead because they could not make *significant* contributions, swinging the system, in this *case even f*urther towards the consumer's benefit and away from the creditors, in so far that going through long, drawn-out and broadly unproductive processes can be seen as being in the creditor's interest[17].

[15] It is worth noting the relatively recent debate in the USA about debt cancellation and 'opportunistic behaviour' by borrowers in the face of increased use of consumer credit and the resultant over-indebtedness, the Bankruptcy Abuse Prevention and Consumer Protection Act (2005) limits full debt cancellation to individuals and households with no real or financial assets and no realistic prospects of future income. See Fay et al (2002).

[16] See Banque de France (1996)

[17] A key issue here is whether this shift has affected the creditor's human rights by violating his right to ownership under Article 1, Protocol 1 of the European Convention of Human Rights. A test case, ECHR *Bäck v. Finland , (*decision 20/7/2004 - Application Number 37598/97 – available at http://www.echr.coe.int/echr) the following general conclusions were reached:

a) The debt-adjustment legislation clearly serves legitimate social and economic policies and is not therefore, ipso facto, an infringement of Article 1 of protocol 1.

b) That in the case of bankruptcy the creditor's claim would have remained legally valid and enforceable at a later stage does not change the fact that, by entering into an agreement with a debtor, a creditor takes upon himself a risk of financial loss.

c) The European Court of Human Rights would not exclude the possibility that a court-ordered irrevocable extinction of a debt, as opposed to the scheduling of payments of a debt over a longer period of time, or the bankruptcy of a private individual, could in some circumstances result in the placing of an excessive burden on a creditor.

The increasing awareness of the existence of passive indebtedness and the role debt solutions have in setting the level of entrepreneurial activity in a society has caused many jurisdictions to deliberately move from attaching stigma or blame towards trying to identify quick, effective and minimally disruptive debt solutions, recognising this is better for the consumer, in reducing the impact on him, better for credit providers, by maximising the amount they ultimately receive whilst minimising the effort the need to exert to get it[18], and the macro-economy, by fostering a climate which encourages entrepreneurial risk taking and incentivises continued effort and productivity from those who otherwise would find themselves in a debt-trap.

This change in approach is easily understood when placed in context of the research evidence available on the drivers of over-indebtedness[19]. We have identified a large number of studies which have analysed the relationship between bankruptcy laws and their application, particularly in relation to discharge and entrepreneurial behaviour. The evidence appears clear that where bankruptcy legislation is perceived as being 'penal' this affects risk-taking behaviour by entrepreneurs and therefore growth. In the current climate this has to be a major consideration when forming policy implications from this report. In the current economic conditions countries increasingly need consumers to be active and productive. Excluding people from economic activity is self-defeating, so many countries are moving from treating bankruptcy as a punitive state towards a mechanism to re-start the consumer as an active economic agent. This however impacts on the force with which contracts are upheld.

Del Rio & Young (2005) is a good example of a class of studies which have found that the most significant relationship with the probability of repayment difficulties is the ratio of debt to income. That is, the more borrowed relative to income, the greater the chance that payment problems may emerge. Rinaldi & Sanchez-Arellano (2006) developed this a step further by identifying that whilst the debt/income ratio is a key driver of payment problems this effect could be cancelled out if accompanied by an increase in available income. In line with this, Bridges and Disney (2004) identify low incomes as the main cause of over-indebtedness. The net result of these is a better understanding that passive indebtedness driven even by small movements in income at low income levels can quickly become a major problem.

However, research has also cast a light on *active indebtedness*, and its causes. Three main causes of non-rational borrowing have emerged:

- Over-confidence bias; the state of over-optimism consumers can have about their ability to service a debt, often caused by under-estimating the likelihood of events like illness or unemployment.
- Availability heuristic; the process of mis-evaluating the probability of negative events such as illness or unemployment based on personal previous experience as opposed to a calculated probability of expectations.
- Hyperbolic discounting; the over-valuing of short-term benefits and costs relative to long-term costs and benefits (see particularly Meier & Sprenger (2007).

d) Whether such a burden was placed on the applicant also depends on whether the procedure applied provided him with a fair possibility of defending his interests as one of some 70 creditors [This last part moves from the general to the specific of the case.]

[18] See, for example, Dye (1986)

[19] A good summary of this material can be found in Vandone (2007).

In short, over-estimating your ability to ride out bad events, and under-estimating the likelihood of these bad things happening exacerbate the risk of *passive indebtedness*, whereas under-valuing long-term costs (repayments) is an example of poor financial management, that is *active indebtedness*. This study looks at the opportunities open to consumers when they reach either of these states.

2.2.1 The balance between consumers and lenders

As over-indebtedness has become more common there has been an increasing recognition that passive over-indebtedness in a major cause of consumer's problems, which has led many countries in Europe to consider whether they should move from a position whereby the law is there to uphold agreed contracts, towards one where lenders who have lent too much are viewed to be as responsible as consumers who have borrowed too much, and that the law has to achieve a balance between upholding contracts and delivering consumer protection.

This is reflective of the degree of stigmatisation countries continue to deploy in their systems, and how highly they value the moral hazard[20] of allowing someone to negate some or all of their debts without paying. Niemi (2009) and Kilborn in multiple articles, for example, identifies three major schools of approach. These three approaches all in their own ways attempt to discourage active indebtedness and accommodate passive indebtedness:

- **Nordic model**: The first to breach this question of whether it was right to break contractual obligations to relieve over-indebtedness, expose their 'struggle with the very notion of offering formal personal bankruptcy relief by applying a good faith test whereby consumers cannot access debt solutions if their behaviour is felt to have been in bad faith, for example, by taking out large quantities of debt shortly before seeking a debt solution, or having not made sufficient effort to repay what is owed.
- **Germanic model:** (originally implemented in Germany, Austria and Estonia), in contrast allows any consumer in, but then manages a payment plan whose substance is shaped by firm **rules**, whereby they must honour debts as far as practicable.
- **Romance model:** Finally there is the approach historically (but no longer) taken in France and the Benelux countries, where voluntary agreements were supported as far as possible, judges had significant **discretion** to define the outcome of the process, but with a general rule that processes were 'hard', payment plans long, and discharge conditions difficult.

2.2.2 The balance between discretion and rules

Over the past twenty years, numerous countries have developed multiple models within these broad schools, some which are aimed to have each case treated individually, with the Romance school characterised by judicial discretion to fine-tune the solution according to the particular circumstances of the case, whilst the Germanic school developed clear, standardised rules, so both

[20] A moral hazard is an event which, by its existence changes the incentives on individuals, and makes people more likely to commit an action which society views negatively; in this case, if the debt solution is too generous then people may be more likely to risk falling into over-indebtedness. Debt cancellation is the most obvious example of a process which opens the threat of moral hazard. Obviously for those countries which do not have debt cancellation, the view is that the moral hazard of annulling all debts and putting the cost of this onto the creditor is so high that it is not permitted at all. Other countries can impose significant entry criteria.

consumers and lenders have a clear expectation of what they are getting into either when they do, or do not agree to a process.

There are advantages and disadvantages to both approaches, but the **general direction of travel has been away from complete discretion to no discretion (absolute rules)**. Discretion has been found to be time-consuming and expensive, and often delivered little extra benefit given debtor's limited resources, low income, and high debts. Standardisation also meant that consumers had clarity over what would be expected of them, reducing uncertainty and pressure on consumers going into the process. In addition, Kilborn (2009) taking one example, points out that '*creditors might have little preference for greater flexibility themselves. Given the choice between a maximally, out-of-court negotiation process and a carefully monitored, in court coercive process with standard demands, Dutch creditors have seemed increasingly eager to choose the latter'.*

2.2.3 Moving from judicially-led to administrative processes

A key question is to what degree processes occur outside court. Many countries have moved down this route, if only because of the costs associated with judicially-led processes when many clients are unable to meet these costs. However there are more substantive issues also.

- Courts are a forum for ensuring that contracts, once met, or compiled with, as a form of defending property rights. Once the intellectual step has been taken that over-indebtedness is at least partly a problem caused by the lender as well as the consumer, or even in the case of passive indebtedness, where an inability to pay is in effect equivalent to a 'act of god' suffered by the consumer at no fault of his own, such that consumer protection, rather that maintenance of a contract, becomes the over-riding concern, the need for the case to move into the judicial forum, as opposed to other administrative systems, falls. As such which types of debt solution retain the need for judicial involvement becomes a key question.
- As many systems have moved from discretion to rules-based system, the case has developed from being a dispute resolution process, arbitrating between a lender and a consumer, to being the simple application of *a priori* fixed rules the need for judicial involvement has been felt to be lessened. For example, Sweden and France, the most advanced countries in this regard no longer have a role for the judiciary in its debt solutions, aside on appeals of whether the process / law has been correctly applied.

2.2.4 From long processes to shorter, time constrained processes

During bankruptcy the consumers is required to continue to attempt to make payments to debtors. Only on discharge can he finally escape his debts and gain a 'fresh start'. Some countries make this process short; a period of a small number of years, some longer and some have no formal discharge point. De facto, all regimes have discharge, after which any remaining outstanding debts are cleared; it is just that for some regimes, this is the point of the consumer's death. The longer the period until discharge the longer the process is not actually debt cancellation, merely debt relief. Many countries have not willing to leave their consumers in this drawn-out purgatory, instead constricting the time to discharge, along with a realisation of the impact of Council Regulation (EC) 1346/2000 has through bankruptcy tourism have triggered a wave of reforms which have fundamentally changed key aspects of many country's debt solutions. For example, Ireland is in the process of concluding a process which has cut the discharge period from twelve years to three.

3 Mechanisms to address consumer debt across Europe

3.1 Debt re-organisation

Debt re-organisation is often the lowest level of entry consumers have into the world of debt solutions. Many of these involve the types of decisions consumers can take before they need to seek to break the contract. The predominant ways to do this are:

- Replacing a contract, or set of contracts, which cannot be afforded with a new consolidating loan which can be afforded.
- Restructuring the contract, such that the overall terms continue to be met in the long-term, but with a reduction in instalments in the short term.
- Reducing debt exposure, particularly on secured loans by selling the secured asset, often a home and 'downsizing', for example into smaller, cheaper accommodation and using any released capital to reduce the debt burden.

This section will therefore summarise for each country:

- Any process which consumers can enter into with lenders which does not rewrite the contract terms in terms of lenders relinquishing on some fraction of the debt, but may include some restructuring of the debt, for example debt 'holidays' whereby payments are reduced or stopped for a period on the understanding that the payments will be made in the future after the holiday.
- Any innovative solutions which are being developed in the country to enable the consumer to replace problematic contracts with something more affordable.

This section deliberately excludes any processes which involve the cancellation of some fraction of the principal, or which freezes interest payments. These are covered in under debt relief.

Because debt re-organisation is broadly a re-negotiation between two parties, or an attempt by a consumer to re-arrange his debts in such a way to make them more affordable without needing to negotiate a change with the lender, there is often little official involvement in this stage, although many countries require evidence that this type of voluntary arrangement has been attempted before giving the consumer access to more formal debt solutions.

3.2 Debt relief

We use debt relief to cover any voluntary or regulated solution in which the lender has to make some accommodation of the consumer's difficulty paying the debt, either through the cancellation of some fraction of the principal, or by freezing/reducing interest payments.

These solutions can either be carried out directly between the consumer and the lender(s), or can take place through an intermediary agent, often offered forward by the state to negotiate a settlement.

A key issue here is whether the solution has the legal force to mandate acceptance of the arrangement on all lenders if the majority accept it, or whether if it is rejected by one or more lenders the consumer is forced to progress to a different solution. A second key issue is the reason for rejection, particularly in those countries where payment plans reached under a court-based

system often heavily reflect the terms which had been negotiated in any out of court debt relief process.

It is worth mentioning that in some countries, at least until very recently, some *bankruptcy* arrangements were not debt cancellation mechanisms, but merely forms of debt relief because the consumer was not discharged from any residual debt upon completing the bankruptcy process. Any such process will be caught in this section.

3.3 Asset liquidation and debt cancellation

For clarity, we look at asset liquidation and debt cancellation solutions for consumers. Within this, bankruptcy is a common phrase, but across Europe there is significant divergence as to its precise definition. There are two dimensions to this divergence:

- **The content of the procedure.** Most bankruptcy proceedings include the liquidation of assets in a final attempt to pay-off the creditors as far as possible. However following this asset liquidation stage, not all countries then permit the writing-off of any remaining debt, a debt cancellation, where the consumer is discharged from bankruptcy. This is because in many countries the original purpose of bankruptcy *is not and was never conceived to be* a means of consumer protection, but the absolute enforcement of the creditor's right to receive as much payment as they could, leaving the consumer in a persistent state of facing calls by his creditors against any new assets he is able to create to pay off old debts.

- **Eligibility**. In the UK bankruptcy is the process by which a private individual or consumer has their debts cancelled when they have reached a position where they can never pay those debts off. In the UK, firms, traders and businesses cannot enter bankruptcy; these instead use insolvency or administration. Many countries allow private individuals and firms / traders to use systems known as bankruptcy, and some countries, such as for example Austria use bankruptcy for firms/traders only and require individual consumers to use different routes. Bankruptcy, therefore, is a route that can either be used only by individuals, only by firms, or by both.

We exclude routes solely available for firms. Therefore when we assert a country does not have a formal debt cancellation route for consumers we will not be asserting it does not have a bankruptcy route or bankruptcy legislation, merely that these do not apply to individual consumers, or that this legislation does not contain a discharge arrangement leading to a cancellation of outstanding debts.

3.4 Austria

Advisory state-approved debt counselling agencies are recognized by the President of the Higher Regional Court[21] in whose district the debt advice centre is located. These agencies help debtors with going through debt solution processes and can also represent consumers in personal bankruptcy in the District Court. State-approved debt counselling is free of charge, although the agencies themselves receive state subsidy. There are also private for-profit debt regulation centres that advertise their services. Officially recognised debt advice centres are entitled to use a specific

[21] *Präsident jenes Oberlandesgerichts*

debt advice label and receive funding from the provincial government and the public employment service. In 2011, 54,324 people sought advice from a debt advice centre, a significant rise from previous years (52,450 in 2010 and 52,613 in 2009)[22]. The presence of passive over-indebtedness in Austria can be discerned from the same research, which shows that the cause of over-indebtedness in 43% of cases was unemployment or a drop in household income, 18% failed entrepreneurship and 12% divorce / separation, compare to only 21% reporting budgeting problems. Debt Advice Centres report that 36% of those who seek advice are unemployed, eleven times higher than in the general population. The average debt has stayed roughly flat over the last three years - €74,473 in 2009, €73,065 in 2010, and €73,108 in 2011.The Land and the AMS do not obtain any information about clients of Debt Advice Centres.

Creditors[23] and debtors can apply for the following proceedings no later than 60 days after the date of insolvency. Debtors must bring the application to the locally competent District Court (in Vienna at the competent district court for execution cases).A debtor who cannot pay court fees in advance must simultaneously submit a detailed list of assets and a payment plan and request the initiation of the absorption procedure (*Abschöpfungsverfahren)*. For all applications and directories are located at counselling centres and courts. The internet[24] provides pre-printed forms.

According to Vadone (2009) the following routes are available in Austria, if a good faith test is met (those found to have caused an irresponsible financial collapse, or to have taken out disproportionately large debts before the bankruptcy submission are barred):

- **Composition:** a debtor may apply for composition proceedings to be opened if he is unable to pay or is over-indebted. Following this the following sub-routes come open:
  - *Amicable settlement*; extra judicial attempt to establish a consensual payment plan between the debtor and the creditors. This is usually rejected by the creditors even if the proposed payment plan is favourable to the creditors as creditors prefer to impose the additional punishment and embarrassment of forcing the debtor to go to court.
  - *Judicial settlement*: This can be resolved either as:
    - **Debt cancellation through a payment plan, without any supervision of the debtor** (*Zahlungsplan*). The creditors and debtor agree on payments, scheduled by arrangement, to be paid to the creditors for a maximum of seven years, based on the current and expected future monetary situation of the consumer (at least equivalent to income over the subsistence level for five years). At the end of this process any remaining debts are cancelled. These payments are not re-assessed if the conditions of the debtor change, unless repayments are missed, in which case the process can be restarted and a new payment plan can be decided upon, with the consent of the creditors. Consumers often offer repayment plans very favourable to creditors in order to avoid the *Abschöpfungsverfahren* below, although creditors must register their interest. This approach requires the consent of the majority of the creditors. Attachment of earnings can be used and is usually

[22] See ASB Schuldenberatungen (2012)

[23] In law, if the consumer demonstrably threatens or diminishes the creditor's possibility of receiving satisfaction by delaying application in filing for bankruptcy, the debtor can be subject to criminal proceedings (*Auch Gläubiger können den Konkurs des zahlungsunfähigen Schuldners beantragen*). The relevant legislation is the Bankruptcy Code (*Insolvenzordnung*), section 25 Debt settlement proceedings (Schuldenregulierungsverfahren), as revised in 1995. However, we believe this to be an extremely rare event.

[24] http://www.justiz.gv.at/internet/html/default/2c94848525f84a6301298974f4f31578.de.html

assumed to last for at least five years. The debtor may also make voluntary payments from the subsistence level of income, if he wishes[25]. All of the debtor's assets are liquidated aside from those viewed as basic requirements, and tools required to practice the debtor's trade. Court costs must be met within three years. Interest payments and other actions brought by debtors are stopped.

– **Debt cancellation with ongoing supervision by a trustee** *(Abschöpfungsverfahren)* A minimum level of income for the next 7 years is determined by the court and any current or future income in excess of this minimum is paid to the creditors by the employer of the consumer as an attachment on earnings, via a trustee. The fact that any potential future employer has to be informed of the insolvency leads many consumers to offer higher repayment plans in the above *Zahlungsplan*, than they would be required to make under the *Abschöpfungsverfahren,* which leaves consumers with the legal minimum income[26]. There are then three routes under this process, dependent on the amount paid, following each of which the consumer has to make an application for discharge, otherwise the entire original debt, including interest on the outstanding amount is reinstated:

  - If the debtor has paid enough to cover court costs and at least 50% of all unsecured claims within three years he is discharged with his remaining debts cancelled, with no discretion for the court to demand more.

  - Otherwise if the debtor has paid enough to cover court costs and at least 10% of all unsecured claims within seven years, the debtor is then automatically discharged and debt cancelled. In both cases the debtor must 'exert' himself to obtain and hold employment.

  - If the debtor has not cleared court costs and at least 10% of the debt in the seven year income assignment period the court can either discharge the debtor or extend his income assignment for a further three years. After this extension, 10% of the debt has to be paid otherwise the entire original debt, including interest on the original outstanding amount, is reinstated.

  The debtor must strive to maximize payments to creditors, and has a duty to earn as much as possible, so that the creditors get paid back as much of their demand as possible. Quotas are minimum quotas. Criminal Fines must be paid in full. The court must at the request of a creditor reject this arrangement under the following circumstances:

  – Evidence of fraud
  – of the debtor favouring a creditor
  – Evidence the debtor has already gone through this process in the last 20 years
  – Evidence of false / incomplete evidence / statements
  – Evidence the debtor has actively taken on excessive debt or squandered assets in the last 3 years.

  The debtor must meet the following conditions to qualify:

[25] www.privatkonkurs.at

[26] The minimum subsistence level is secured by law (execution order) and social support so he can lead his family with a simple but dignified life, although if this implies he will pay back less than the 10% threshold for debt cancellation it is the up to the debtor to decide whether to use some of this exempt income to maximize payments to the creditors to allow the discharge of residual debt.

- He must ensure adequate employment or, if he is unemployed, to seek a job;
- Any gifts and inheritances must be used to pay off the debt;
- Any change in residence or employer) must be reported to the Court and the Trustee (including the receipt of sickness benefit, which represents a garnishee change, because the sickness benefit is paid from the Health Fund);
- He must provide the court and the trustee upon request information on employment and property, and not hide any new acquisitions;
- and
- He must make payments on the debt only to the trustee, to prevent preferential treatment of certain creditors.

- **Debt cancellation through a recovery plan** (*Sanierunsplan*[27]) This process is available to both businesses and private individuals, but it is mostly used by businesses or very wealthy consumers. This procedure was introduced by 1/7/2010 and replaces the "compulsory settlement In practice, this method is, however, scarcely taken by individuals to complete. The minimum amount of debt which must be repaid for both natural and legal persons is 20%. Individuals who do not run a company can take out a payment period of 2-5 years. The adoption of the plan is requires the majority approval of those creditors present at a vote of creditors, including the agreement of creditors owed more than half of the total sum of the demands of those present at the vote. Interest payments and other actions brought by debtors are stopped. This model is very rarely used because of these requirements, with the acceptance rate falling from just 3% in 2000 to 0.5% in 2008[28].

According to Kilborn (2009) the first stage in judicial settlement is a 'weak cram-down' on creditors, a term which refers to the situation where if a bare majority of creditors agree to a scheme then it can be imposed on the others. As he goes on:

'This stage rarely produces a resolution and most cases proceed to the second in-court stage, involving a strong cram-down by the court of a non-discretionary payment plan[29] *without regard to creditor voting.'*

According to the ASB Schuldnerberatungen GmbH, there were 2,159 amicable settlement processes in 2009, and 1,753 in 2010. There were 8,788 judicial settlement processes in 2009, of which 66.5% were payment plans and 32.4% absorption processes, and 8,989 judicial settlement processes in 2010, of which 68.2% were payment plans and 30.1% absorption processes in 2010. Survey respondents from debt counselling agencies reported that the most common complaint from consumers about the amicable settlement process was about creditors not being willing to agree to it.

[27] Previously known, before 2010, as *Zwangsausleich*

[28] Kodek (2012)

[29] *Abschöpfungsverfahren*

If creditors refuse a negotiated settlement (*Zahlungsplan)*, then consumers proceed, as they do under the German regime, into a mandated process (*Abschöpfungsverfahren)*, which unlike schemes historically seen in predominantly French speaking countries involve no element of judicial discretion. Following an asset liquidation led by a court appointed interim trustee of the debtor's non-exempt property, if any, the trustee then receives non-exempt income from the debtor according to a uniform national exemption schedule, for a uniform seven years through an automatic assignment. This means that if the debtor earns more he pays more.

Austria has a system which permits debtors to open proceedings despite having insufficient funds to meet the cost of court and other fees. To do this, debtors must request a *kostenvorschuss* or 'cost advance'. To have access to this, the debtor needs to have unsuccessfully sought an extra-judicial arrangement with creditors, and have made a second, in-court compromise offer[30], as well as being able to meet the standard requirement of being able to repay at least 10% of their debts from their future income.

Austria therefore has a firmly 'rules-based' system with minimal discretion about the application of rules / requirements. Kilborn (2009) sees it as a clear member of the German school of debt cancellation, whereby discretion and innovation have traditionally been down-played against the certainty of clear application of consistent rules.

The Austrian system applies the following impositions on consumers going through these processes:

- The opening of bankruptcy proceedings are published, in the judicial edict (www.edikte.justiz.gv.at). Direct Employers will be notified by the court, creditors and account-holding bank. Sometimes bankruptcy openings are printed in newspapers and other publications.
- All attachable assets go into the bankruptcy estate.
- There is a ban on the debtor disposing of his estate or entering certain contracts without court approval.
- Dropping out of a process can result in the consumer being blocked from starting a new recovery plan (*Sanierunsplan)* or payment plan (*Zahlungsplan)* for 10 years, or 20 years for a absorption process *(Abschöpfungsverfahren).*
- Spouses are not liable for the debts of their automatically wife / her husband. Parents are not liable for the debts of your children, for children not their parents, unless they have acted as a guarantor. A guarantor must pay what the debtor cannot pay, including interest and costs.
- Post is handled by the trustee for a period of around 3-4 months as the processes are put in place to activate either a payment or recovery plan. This ends with the decision of the court that the bankruptcy proceeding is lifted. This is the case when it has come to a decision that should look like the debt repayment (payment plan, absorption procedures, compulsory composition). In practice, a bankruptcy procedure takes on average 3 to 4 months.

Survey respondents from two Austrian debt advice services pointed to the negative knock-on effects of these impositions. As private bankruptcy is often an exclusion criterion for the extension of credit,

[30] *Insolvenzordnung* s.183

it can have the effect of reducing the debtor's access to loans in the future. According to a survey respondent from a debt advice agency, private bankruptcy can also exclude people from employment and they are sometimes confronted with notices of termination. This may derive from the fact that employees are obligated to tell their employer of their involvement in a judicial private bankruptcy process. The survey respondent also reported general problems with access to bank accounts as these can also be terminated as a result of the judicial process.

There was mixed responses in the survey about whether or not debtors that proceed under a judicial settlement generally understand their choice of process. However, respondents from the debt counselling agencies stated that the process did generally work for consumers.

According to survey respondents from debt counselling agencies, the most common complaints from consumers about the judicial settlement process were the minimum payment of 10%, the garnishing of wages, the obligation to tell your employer and the length of the duration. A key cause of failure, according to a respondent, is when the minimum payment cannot be reached. In cases where the consumer breaks the arrangement, debt cancellation does not go ahead and all of the residual debts plus an interest rate is payable by the debtor. According to the ASB Schuldnerberatungen GmbH, this situation can be summarised as:

'Compared to the rest of Europe, Austria comes last, in two respects: on the one hand, as a rule full bankruptcy discharge is granted only after seven years of repayment, and on the other, a minimum of 10% of the debt has to be repaid. This means that it is hardly possible for people with low incomes or people at risk of poverty to get the chance to make a fresh start'.

3.5 Belgium

3.5.1 Debt re-organisation

Respondents noted a number of routes available to consumers prior to moving to a formal debt solution.

Contact the financial institution to find contractual solutions

Respondents noted if the over-indebted borrower is in temporary difficulties, working their financial institution as soon as possible to look together for a solution for their problem is advisable. This solution may take the form of a contractual extension of the credit duration, a temporary suspension of payment on a contractual basis, etc. Respondents noted that the Mortgage Credit Act leaves more room for contractual freedom than the Consumer Credit Act (CCA).

However, the CCA also stipulates that, except for variability of the borrowing rate and the cost of money withdrawal from a cash dispenser, any provision for a change of the terms of the credit agreement will be considered as non-written. However, article 3, § 2, section 7, of the CCA states that agreements under which the lender and a consumer who has not met his original obligations arrange for postponement or redemption lie outside the scope, where

- a default claim may be avoided thanks to those arrangements, and
- this does not cause the conditions for the consumer to be more unfavourable than those in the original agreement,. This exception can be applied only once.

Budget guidance by the Public Centre for Social Welfare

Any person having financial difficulties can call upon the local Public Centre for Social Welfare, which can provide budget guidance, upon the condition that he or she has sufficient financial means, but is not successfully managing these. The adviser, will help the person concerned in paying his invoices and debts by helping re-order his budget so he can manage his expenses. He will help to look for ways (of saving) aimed at monitoring the budget and will see to it that fixed costs are duly paid. If necessary, he can negotiate with creditors if some of the debts have reached unsustainable levels. Budget guidance is free of charges and ends when the person concerned is able to manage his budget by himself.

Non-judicial debt re-organisation

A lenders' association respondent replied that borrowers who have financial difficulties should seek an out of court solution with their lenders as soon as possible. According to this respondent, such a solution may take the form of a contractual extension of the loan duration or a temporary suspension of payments on a contractual basis.

Support is available to individuals with financial difficulties from the Public Centre for Social Welfare (PCSW), which helps borrowers to order their budgets and manage their expenses. If necessary, PCSW personnel can help negotiate with creditors.

The UPC indicated that lenders are generally satisfied with these processes.

Judicial debt re-organisations

From 1997 to 2009, Belgium's three major in-court debt solution procedures; **judicial administration**, **bankruptcy** and the **composition with creditors**[31] were governed by the Law of 17 July 1997, with composition with creditors defined as a preliminary step in a bankruptcy proceeding, during which debtors received some protection from their creditors and were protected from being forced into bankruptcy, although a composition could ultimately lead to bankruptcy. The **bankruptcy** process is governed by the **Law of 8 August 1997** as purely a liquidation mechanism. Bankruptcy has no time limit.

The Business Continuity Act (31 January 2009)[32] (BCA) replaced elements of the Bankruptcy Act of 17 July 1997 on judicial composition with creditors with new flexible tools to facilitate business recovery where debtors can choose and switch easily between a range of out-of-court and in-court options. This process can apply to tradespersons and non-tradespersons.

In enacting the BCA, the Belgian legislature was aware of the existence of foreign legislation enabling struggling debtors to restructure, especially in light of the very broad interpretation of the concept of 'centre of main interest' (COMI) under Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings.

[31] A Composition with Creditors is an agreement among several creditors of a debtor, usually a business. Usually, the agreement involves paying a lessened amount over a period of time.
[32] Loi relative à la continuité des enterprises/Wet betreffende de continuïteit van de ondernemingen

The BCA provides three main options, two of which are two forms of debt re-organisation and one form of debt relief. The two debt re-organisation processes are:

- the conclusion of an agreement with two or more creditors with a view to restructuring the debtor's liabilities; unlike the other two options mentioned below, such an agreement can be concluded either in court or out of court; and
- the conclusion of a re-organisation plan, which must be approved by the debtor's creditors and the court.

The BCA has been very successful, as evidenced by the fact that between 1 April 2009 and 30 November 2010, more than 1,760 restructuring proceedings were opened in Belgium, which is in excess of the total number of composition proceedings opened over the course of ten years under the old legislation.

Suspension of payment

Article 1244 of the Code of civil law provides that the debtor has no possibility of imposing on the creditor the obligation of receiving a partial reimbursement of the debt, even if the debt can be split up. Even when provided otherwise, the judge has the possibility, taking into account the situation of the parties concerned as well as the periods that have already been allotted to the debtor, and using this competence *very cautiously*, to allow a moderate postponement of payment and to impose a suspension of the claims, even when the existence of the debt is proven on the basis of an official deed that is different from a judgment.

3.5.2 Debt relief

Respondents identified the following methods of debt relief.[33]

Payment facilities

The Consumer Credit Act holds the following provision :

Artikel 38 – A justice of the peace has the power to grant payment facilities, as decided by him, to a consumer whose financial situation has deteriorated. If the cost of the credit agreement rises as a result of this granting of payment facilities, the justice of the peace will determine which part of the debt will have to be paid by the consumer. The judge has the power to grant a postponement or rescheduling of the payments that are due when the credit agreement is cancelled, when the duration is cancelled or when there is a simple case of arrears, even if the creditor applies or calls for the application of a provision concerning a cancellation of the duration or an explicit defeasance clause.

Collective debt settlement (collectieve schuldenregeling/ reglement collectif de dettes)

The composition procedure, up to 2009 was governed by the Judicial Code for non-tradespersons. Since 2009, any natural person residing in Belgium who is not a tradesman can apply for a composition if he is durably unable to pay his debts and has not manifested his intention to apply for

[33] See also Kilborn (2006c) and (2009).

insolvency[34]. Insolvency in this case means the debtor is unable to repay his debts to his creditor(s). The BCA aimed to give struggling debtors an opportunity to restructure and recover by temporarily suspending creditors' rights.

For non-tradespersons, **collective debt settlement** (*collectieve schuldenregeling/reglement collectif de dettes*) with creditors is governed by **the Judicial Code** (Article 1675/2, paragraph 1). The request for CDS must be sent to the Court for the settlement of industrial disputes. No charges are payable and the request can be made by the person concerned. In order for a person to be eligible for CDS, they must meet the following conditions:

- the debt must be structural and substantial up to the point that reimbursement within a reasonable period of time has become impossible;
- merchants cannot rely on collective debt settlement, unlike farmers, craftsmen and those with a liberal profession; and
- the person concerned must not be liable of any intentional damage caused to his creditors.

Once a CDS is granted the judge appoints a debt mediator and it is forbidden to continue to apply an interest rate on the debt and any amicable or judicial debt collection must be stopped. Theoretically, the debt-mediator's fees are chargeable to the debtor and paid in priority to all other debts through the payment plan. However, in the event that the debtor is totally insolvent or in the event of the debtor's partial insolvency, on the mediator's proposal, if it is considered legitimate by the court, the mediator's costs and remuneration may be paid in whole or in part by the Fund for Dealing with Over-indebtedness[35].

Initially the debt mediator will attempt to establish an "amicable debt recovery scheme" (i.e. a debt reimbursement scheme to be negotiated with the creditors), which may imply a voluntary remission of part of the debt by some creditors (i.e. there is some degree of debt relief – see next section). The judge will endorse this scheme if it is accepted by both the person who has made the request and the creditors.

If the debt mediator fails to establish an amicable debt recovery scheme, the judge may impose a "legal debt recovery scheme" on the debtor and the creditors, who must follow the decision taken by the judge. A legal debt recovery scheme takes at most five years (although it can be prolonged) and since there is no possibility of reimbursing all of the debt within such a short period it is often the case that part of the debt is remitted.

Provided the equality of creditors is taken into account, the judge may impose a legal debt recovery scheme consisting of the following measures:

- suspension or rescheduling of payment, either in terms of the principal, the interest charged or costs imposed;
- lowering of the interest rate laid down in the contract to the legal interest rate;

[34] Section 1675/2(1) Judicial Code, the Act of 17 July 1997 (*B.S.*, 28 October 1997, err., *B.S.*, 4 December 1997)

[35] This fund was created by virtue of the Act of 5 July 1998 on the collective settlement of debts, amended by the law of 19 April 2002. Its operating procedures were defined in a Royal Decree of 9 August 2002. It is funded by an annual contribution paid by lending institutions which have granted mortgages or consumer loans and which is calculated on the basis of arrears in payment recorded in the Centre for Loans to Private Individuals for each of these institutions on 31 December of the year prior to the year when the subscription is due.

- suspension of the implications of collateral securities, for the duration of the legal debt recovery scheme, without the possibility of the substance being affected by this measure, as well as suspension of the effect of assignment of debts; and
- full or partial remission of interest on overdue payments, compensation and cost.

In 2005[36] Belgium brought in a major reform of the 1997 settlement. This adding a section to the provision on amicable settlements specifically focussed at authorising public body creditors to agree a remission of debt. Previously these bodies had not had the authority to agree settlements involving any remission of debt owed to the public sector.

If those measures turn out to be insufficient for the debtor's financial redress (i.e. allowing him to reimburse his debts as far as possible and making sure that he and his family can lead a suitable life) the judge may decide, at the debtor's request, to impose any other kind of partial debt remission upon the following conditions:

- the debtors assets are liquidated under the supervision of the debt mediator in accordance with the rules governing judicial execution, and the proceeds divided among the creditors in accordance with the equality of creditors, subject to the legal priority reasons;
- once the debtor's assets have been liquidated the balance still to be paid by the debtor will be subject to a debt recovery scheme, taking into account the equality of creditors.

The debt mediator receives all of the income and ensures the repayment of the debts. The person who has made the request is entitled to receive an allowance for daily living (i.e. minimum wages and family allowances) covering the purchase of food, payment of rent, fixed costs, etc. If the debtor does not comply with agreements made in the CDS framework the settlement can be terminated, and they will not be eligible for another CDS during the next five years. The UPC indicated that lenders are generally satisfied with the CDS process.

The BCA and tradespersons

The Business Continuity Act (31 January 2009)[37] (BCA) replaced elements of the Bankruptcy Act of 17 July 1997 on judicial composition with creditors with new flexible tools to facilitate business recovery where debtors can choose and switch easily between a range of out-of-court and in-court options.

The BCA provides three main options, two of which are two forms of debt re-organisation and one form of debt relief. The debt relief process is:

- The court-supervised sale of the debtor's business, or a viable portion thereof, as a going concern. Two years after the entry into force of the BCA, practice indicates that, in most cases, debtors prefer to propose a restructuring plan to their creditors but sometimes have to subsequently adapt their strategy and sell off all or a portion of their business.

[36] Law of 15 December 2005 – *Gerechtelijk Wetboek/Code judicaire* art. 1675/10s. 3 bis.

[37] *Loi relative à la continuité des enterprises/Wet betreffende de continuïteit van de ondernemingen*

3.5.3 Asset Liquidation and Debt Cancellation

Prior to 2009 and the BCA, Belgium was one of the countries whose citizens, as 'natural persons', could not access its debt cancellation / bankruptcy route, as its legal code draws distinction between *tradespeople* and *non-tradespeople*. A tradesman is a person who performs commercial acts for profit as his principal or secondary occupational activity. **Only *tradespeople* can apply for judicial administration to use this route to bankruptcy[38].** These two processes are sequential; judicial administration is preliminary to bankruptcy. During judicial administration the debtor is protected against his creditors and nobody can apply to have him declared bankrupt. 'Bankruptcy' in effect, in Belgium equates to a winding-up process, governed by legislation passed in 1997.

Following a successful composition with creditors, natural persons can then move to having their remaining debts discharged. Discharge is conditioned not only on the debtor's fulfilling a payment plan[39], but on the debtor's material situation not "returning to better fortune" before the end of the plan term. Whilst composition with creditors is therefore classed as a debt relief mechanism, it can lead to debt cancellation.

It is worth saying that the 1997 legislation was not drafted in terms of permitting a complete discharge, but only a partial remission of debts. This 'partial remission' of debts could be a 'quasi-total discharge' leaving a nominal debt of, say a single Franc (at the time). This raised immediate questions, with many courts disagreeing with the Government's interpretation, often imposing the minimum required payout for qualification for a discharge. Finally in April 2003,

'the Belgian constitutional court (the Court of Arbitration) held that limiting relief to those debtors who could pay a substantial portion of their debt violated the equality provisions of the Belgian Constitution. The Court held that insufficient income could not justify refusing to construct a plan that would ultimately discharge all of the debtor's pre-petition debt—despite the language of the law authorizing only "partial" discharge[40]. The Court thus essentially read the word "partial" out the law. It relied instead on the government's insistence in the legislative history about the possibility of "quasi-total" discharges'[41].

Therefore in the law of 15 December 2005, the Belgian legislature brought into place legislation permitting a full discharge, even for debtors unable to pay anything to creditors[42]. As such the completion of a composition can now lead to a full discharge.

[38] After the bankruptcy has been closed, the bankrupt is entitled to 'protection' if he is a natural person, has no criminal record and has acted properly. The 'protection' is that all his debts are definitively extinguished and natural persons who have stood as guarantors free of charge for the bankrupt are released from their obligations. The release given to the bankrupt, being a natural person, is also valid for the spouse if he or she has agreed to be co-debtor (sections 81-82 of the Bankruptcy Act). A bankrupt who is eligible for protection now has the possibility of engaging in a fresh commercial business and is deemed to be rehabilitated (section 110 of the Bankruptcy Act). A bankrupt not declared eligible for protection may apply for rehabilitation if he has paid all the sums he has been ordered to pay (section 109(1) of the Bankruptcy Act).

[39] This is set beforehand, so if the consumer earns more, he gets to keep it.

[40] *See* Order No. 38/2003 (Apr. 3, 2003), *available at* http://www.arbitrage.be/public/f/2003/2003-038f.pdf

[41] Kilborn (2006c) p94

[42] *Gerechtelijk Wetboek / Code judiciare art. 1675/13 bis*

3.6 Czech Republic

3.6.1 Debt re-organisation

Out of court mechanisms used in the Czech Republic, according to survey repondents are:

- *Debt consolidation*, a process of using a new loan to bring together existing debts in a process whereby payments become more manageable.
- *Rescheduling / Restructuring*, a process of negotiated forbearance between the debtor and creditor, whereby lenders agree longer terms but often charge higher APR as a result. Restructuring is individual with each lender and it does not impact the debtor's relations with other lenders. The most common complaint about debt restructuring, according to a survey respondent in the banking industry is that in some cases, at the end of the restructuring process, the amount of the instalments does not decrease as was expected or needed by the consumer due to increase of the APR. The opinion of this respondent as well another respondent from one of the largest Czech banks was that the restructuring process generally worked as intended for lenders. The respondent from the bank also agreed that lenders were generally satisfied by each restructuring process.

The court based 're-organisation' process is a debt re-organisation process through which corporate insolvency can be dealt with. Re-organisation allows firms to gradually meet creditors' claims while remaining in operation. To make use of this method, firms have to meet a number of legal criteria and have the agreement of the majority of their creditors. It is not open to consumers and is therefore out of scope of this study.

The respondent from the Czech bank as well as a respondent from a financial association agreed that debt consolidation worked as intended for lenders and stated that lenders were generally satisfied with this process. When asked to rank the various debt solution processes according to how successful the outcome is for lenders, a bank respondent placed consolidation above restructuring and both above insolvency. The respondent placed bankruptcy above debt consolidation.

3.6.2 Debt relief

The Czech Republic in its legal system does not have mechanisms which are restricted to a partial discharge of debt, so we move directly to the next section. As with many Eastern European and Southern European countries, the Czech Republic had not developed a full debt counselling provision, and this in part explains the absence of pre-court negotiation requirements in the law, leading to a focus on a debt cancellation methodology.

3.6.3 Asset Liquidation and Debt Cancellation

The Czech Republic, amongst Eastern European states moved quickly to address personal over-indebtedness, with the 1991 Bankruptcy and Composition Act[43]. This was replaced by the 2006 Czech Insolvency Act[44], which came live in 2008.[45]

[43] Act 328/1991

[44] Act 182/2006

There are two court-based debt cancellation approaches exist in the Czech Republic.

- Bankruptcy; and
- Discharging the debt.

Bankruptcy

Bankruptcy[46] is the most frequent method of dealing with a debtor's insolvency, catching both entrepreneurs and legal persons, as well as consumers and natural persons. Under bankruptcy assets are sold and the proceeds divided among creditors based on conditions stipulated by law, where the claims of certain creditors are given priority).

Bankruptcy is regulated by the **Insolvency Act**, which stipulates:

- cases in which the debtor becomes insolvent;
- how the debtor settles with creditors;
- individual methods of credit settlement;
- Legal regulations; and
- Exemptions.

You can be declared insolvent if you have creditors whom you are unable to repay. The law specifies under which circumstances the debtor is considered **unable to repay debts**. This is often when the consumer has multiple creditors and when the sum of liabilities exceeds the value of assets. The process can be started by either a debtor or a creditor.

The act also sets out the procedure where there is a threat of bankruptcy, in other words a situation where, in view of all the circumstances, there is reason to expect that the debtor will not be able to service a significant portion of his/her debts duly and on time.

The court may also decide to apply the so-called **minor or petty bankruptcy**, which is a shortened and simplified version of bankruptcy in cases where:

- the debtor is a natural person;
- the debtor is not an entrepreneur; and
- the annual turnover of the debtor does not exceed CZK 2 million and the debtor does not have more than 50 creditors.

Bankruptcy procedure: a step-by-step guide

The insolvency procedure is **started** through the submission of an insolvency proposal to the Insolvency Court (relevant Regional Court).

[45] Richter (2009)

[46] See Šedová (2011) , Richter (2009) and http://europa.eu/youreurope/business/exit-strategy/handling-bankruptcy-and-starting-afresh/

The Insolvency Court will announce the start of the procedure with a public notice which must be published in the Insolvency Register within 2 hours.

After publication of the notice in the Insolvency Register the **creditors** are entitled to **submit applications for outstanding debts**. The Insolvency Register is a public database (accessible also electronically) providing information on insolvent parties, the status of insolvency proceedings and the delivery of court documents. Creditors should regularly monitor the register. Entries in the Insolvency Register are performed by the Insolvency Court and the Insolvency Court appoints the insolvency administrator of a list maintained by the Ministry of Justice.

Lastly, it is possible to submit applications for outstanding debts within a time period stated in the insolvency ruling (the time period may not be shorter than 30 days or longer than 2 months).

An application for outstanding debts may be submitted only on a form which can be obtained on the Internet.

Creditor bodies may also join the procedure. This involves a creditors' meeting, creditors' committee or creditors' representative. If more than 50 creditors apply a **creditors' committee** must be set up. These bodies have a strong position and may influence the course of the entire procedure. Once the procedure starts, there is automatic protection for the consumer from other actions by lenders.

A declaration of bankruptcy brings to the insolvency procedure to the stage where the bankruptcy is resolved through the sale of the bankrupt's assets.

Outstanding debts in return for property of the estate and outstanding debts to property of the estate at a stipulated level are always reimbursed in the course of an insolvency procedure from the property of the estate. This involves, for example, the remuneration of the insolvency administrator and employment-related debts of the debtor's workforce etc.

Secured outstanding debts are met independently of the item against which they are secured.

The bankruptcy includes the **conversion of property of the estate to cash** by the insolvency administrator. At the end of the conversion to cash the insolvency administrator issues a final report, in which he must quantify the amount that has been shared out among the creditors.

After approval of the final report the Insolvency Court at the suggestion of the Insolvency Administrator approves a **distributive resolution**, on the basis of which it then proceeds to **satisfy the various creditors**.

According to a survey respondent from the banking industry, the bankruptcy process does generally work for consumers. Survey respondents representing lenders also agreed that this process worded as intended for lenders and that lenders were generally satisfied by the bankruptcy process.

Discharge of debt (*oddluženi)*

This is a novel recovery method of resolving a bankruptcy, which is **intended only for natural persons who are not entrepreneurs**. The proposal may be submitted only by the debtor. The court will allow discharge of the debt only if the debtor meets the following basic conditions:

- the debtor guarantees to repay at least 30 % of the outstanding debt over a maximum five year period[47];
- the debtor has an honourable intention (good faith test); and
- the proposal is submitted on the appropriate form.

In addition, the court will reject the petition for permission of debt discharge in the case that the petition has been previously submitted and a decision has been made. The court will also reject the petition in the case where the heretofore outcome of the proceedings indicate a frivolous or negligent attitude of the debtor regarding the obligations of the debt discharge process. The court will presume a dishonest intent if an insolvency proceeding or another proceeding addressing insolvency was conducted over the last five years or if the criminal register shows that a criminal proceeding was conducted and ended in an effective and final conviction for a crime against property or economic crime in the five years prior to the instigation of the insolvency proceeding.

While in bankruptcy, all consumer assets can be sold to repay creditors, although in the case of assets against which a loan has been secured, this shall only happen if the secured debtor agrees. Debt discharge can be reached in two ways; either by **conversion to cash of underlying assets** or by the **fulfilment of a maximum five year payment calendar**[48] through an automatic assignment. This means that if the debtor earns more he pays more**.** Following the successful completion of the chosen approach, on application by the debtor the court will order a discharge of the remaining debt[49]. The method of debt discharge is decided on at a meeting of creditors. That means that creditors are forced to choose between the debtor's assets (in which case his income is protected), or his income (in which case his assets are protected). As stated above, whichever method is chosen must deliver 30% of the outstanding debt[50]. After the completion of debt discharge the court may decide that the debtor does not have to pay back the remainder of his/her liabilities. As in the case of bankruptcy, once the procedure starts, there is automatic protection for the consumer from other actions by lenders.

In the case of the payment calendar, the debtor must distribute the agreed amount to unsecured creditors pro rata in the manner stipulated in the court's decision through the hands of an insolvency trustee. in case of discharge from debts by way of payments under a payment schedule insolvency practitioner shall liquidate assets serving as security only if the secured creditor has requested so. As in the case of liquidation of property in the bankruptcy process, if debt discharge is agreed by way of converting the debtor's assets to cash, any property acquired by the debtor after the approval of debt discharge but during the insolvency proceeding does not belong to the property of the estate.

The court can, within three years of the discharge reverse the order if it becomes apparent that the debtor has acted fraudulently, or committed another related crime[51]. Discharge from debts does not apply to pecuniary sanctions or other property sanctions imposed on the debtor in a criminal

[47] Unless creditors agree to accept less: §415 of the 2006 Czech Insolvency Act. Also note this is not 30% of the present value of the debt (i.e. taking inflation or any discounting into account), so the true repayment level is always less than 30% of the debt as valued today. The court can reject applications which fail to meet this criteria, §395(1) of the 2006 Czech Insolvency Act.

[48] See Viimsalu (2010)

[49] §414 of the 2006 Czech Insolvency Act

[50] For more information see Richter (2009)

[51] §417 of the 2006 Czech Insolvency Act

proceeding for an intentional crime, or to claims for compensation for damages caused by wilful misconduct.

This route has proved very popular. Statistics quoted by Viimsalu (2010) show that in 2008, the year of introduction, 1,700 of all 5,300 insolvency petitions (broadly a third) served were for discharge. However, it should be noted that creditors generally preferred the five year payment plan to recover from assets, which is probably broadly reflective of the fact that over-indebted consumers rarely hold large quantities of assets.

3.7 Denmark

3.7.1 Overview

Free and independent debt advice (counselling)[52] is offered to citizens with low incomes who have lost track of their finances and debts, however Denmark does not expect any form of 'forced compromise' (*tvangsakkord)* , which is viewed to be unsuccessful[53]. Outside of the court, the following mechanisms are available to the over-indebted:

- **Reorganisation** without notification to the bankruptcy court; and
- **Voluntary agreements**, depending on consent of both the debtor and the creditors who are affected.

Cases of notified reorganisation, bankruptcy, composition agreements and debt relief are heard by the **bankruptcy courts**, which are connected to the municipal courts. In the Greater Copenhagen area, however, such cases are handled by the bankruptcy division of the Maritime and Commercial Court. There are the following court-based debt solutions available in Denmark:

- **Bankruptcy**
- **Notified reorganisation**
- **Notified composition agreements**
- The bankruptcy legislation also contains rules on any opportunities that a debtor might have for **debt cancellation (Gældssanering)**.

Denmark has an 'old-style' traditional bankruptcy mechanism, which liquidated assets, but leaves the consumer liable for any debts which remain. As such we consider the process called bankruptcy as a debt re-organisation process.

In 1984 Denmark introduced a debt cancellation mechanism which was the first of its kind on continental Europe, cancelling debt after a five year payment plan. This consumer debt adjustment law (*Gældssaneringslov*) originally left significant discretion to judges, which led to significant differences in application in different areas. This was reformed in 2005 to make application more consistent via moving to a more rules-based approach.

[52] Gældsrådgivning

[53] Denmark and Sweden often set the pace in new thinking on consumer debt solutions. In 2007, for example, Sweden joined Denmark in scrapping this requirement, following long delays and wasted effort, with even many creditors viewing such a process as '*nearly meaningless'*. See Kilborn (2009b)

3.7.2 Debt re-organisation

Denmark has the usual range of voluntary debt re-organisation models based on mutual agreement between creditors and lenders, including **reorganisation** and **voluntary agreements.** In addition, bankruptcy, as an old style bankruptcy legislation which does not cancel debt as merely a method of re-organising debt through the liquidation of assets.

Bankruptcy

The aim of bankruptcy is to wind up a company or a personal debtor's assets, so that the values can be distributed among the creditors who have outstanding debts. The bankruptcy procedure is completed by distributing the resources in the estate to the creditors. **A creditor retains his/her rights against the debtor in respect of the part of the debt that is not paid off.**

The Danish **Bankruptcy Act**[54] is based on the following main principles:

- Divestment of the debtor: Control over the estate is taken from the debtor after the bankruptcy decree has been issued, and is transferred to the creditors/administrators.
- Ban against individual prosecution: Bankruptcy moves from individual prosecution in the county court to universal prosecution in the bankruptcy/insolvency court so as to be able to satisfy all creditors' demands equally. Certain dispositions and current creditor proceedings during the period prior to bankruptcy may be annulled under specific conditions.
- Equality: Debts are shared equally among creditors. However, there are many exceptions from this in the 'priority of bankruptcy claims', i.e. the sequence in which claims against the bankrupt estate are covered. The priority of bankruptcy claims means all claims in the same category are treated equally and those in a lower one only receive dividends when the claims in higher categories have been fully paid off, prioritised in the following sequence:
  - 'pre-preferential claims' (for administration costs);
  - other 'privileged claims' (secondary pre-preferential claims);
  - 'employee privilege';
  - 'supplier privilege';
  - 'simple claims'; and
  - 'subordinated claims'.

Bankruptcy proceedings are initiated when either the creditor or the debtor submits a petition to the bankruptcy court. These cases are handled by the bankruptcy/insolvency court.

[54] The unified Bankruptcy Law of 1977 (*Konkurslov*). The law of 9 May 1984, *Gældssaneringslov,* augmented this with a new Part IV (chapters 25-29). The current act is available (in Danish) online at http://www.retsinformation.dk/Forms/R0710.aspx?id=2832. See also Kilborn (2009b)

Immediately after the bankruptcy decree has been issued, the **bankruptcy or insolvency court** appoints **one or more estate trustees**. Once **bankruptcy has been established**, the debtor loses all control of their assets, which now belong to the bankrupt estate administered by the trustee. The trustee has to ascertain the worth of all assets and decide how the revenue will be distributed among the creditors.

If a creditor wants to file a claim, they should notify the trustee within 4 weeks. The invitation to register claims is announced in the Danish Official Gazette and sent to all known creditors. Upon this, the trustee produces a list of registered claims (the **bankruptcy schedule**). They then assess the registered claims using a **"claims test"**.

Once the value of the estate has been established, outstanding credits have been collected and all disputes settled, the trustee draws up draft **accounts** and the draft of the **final distribution** either at the same time or once the accounts have been agreed upon. If there are **only sufficient funds** to cover estate costs, i.e. for the trustee's fee and costs, administration of the estate will be terminated using a Section 143 account. Creditors get no dividends in this case.

Where there are **surplus assets**, the excess is distributed among the creditors following the rules of the 'priority of claims'. Accounts with appendices and allocations are available at the **bankruptcy / insolvency court** for two weeks before the meeting. The bankruptcy / insolvency court confirms the draft, unless it contains errors or omissions which need to be changed. When the bankruptcy / insolvency court has confirmed the draft accounts and allocations and the appeals deadline (4 weeks) has expired with no claims being filed, the dividends are paid to the creditors.

If the trustee **does not agree** with a creditor on the size of the creditor's claim, for instance, the creditor will be informed prior to the meeting. If **agreement cannot be reached**, the creditor may take the case to court. A **petition** needs to be submitted to the bankruptcy/insolvency court no later than 4 weeks following the meeting during which the trustee's claim assessment is announced. If the creditor does not file a petition within a fixed deadline, the trustee's decision will be final.

It is possible to start a new company after bankruptcy. If, however, it is established that the debtor has committed a **criminal offence**, they generally forfeit their right to found the company, be the managing director or sit on the board of directors.

3.7.3 Debt relief

Composition Agreements

A composition agreement must be ratified by the bankruptcy court in order to be valid. A composition agreement may be based on reducing the debtor's debt by a certain percentage (but not less than 10%), distributing the company's assets among the creditors or by extending the deadline for paying the debt. **This normally applies only to businesses.**

Tax Debts

Tax legislation in Denmark[55] makes it possible to grant consumers with *only* tax debts relief without using the procedures available under the more generic processes, under a simplified set of procedures.

3.7.4 Asset Liquidation and Debt Cancellation

Lobbying began for a reform of Danish consumer bankruptcy law in 1972 with articles by Frederik Bang Olsen[56] and H. Andrup[57] which argued that the ills created in society by the universal adherence to fulfilling contractual obligations irrespective of the circumstances, both in terms of health and social costs was illogical when so little of the debt may ever be repaid. By introducing the concepts of a trade-off between consumer protection and contract law (Bang-Olsen) and that, if it was to intervene, the state had a role to play in establishing a universal service to address simultaneously *all* the consumer's debts (Andrup) these two men established the basic principles of the debate in Europe, and subsequently, if almost always implicitly, the form legislation on the continent[58] has taken over the last forty years.

It took Denmark twelve years to convert these first steps into legislation. This consumer debt adjustment law (*Gældssaneringslov* - 1984) added a new Part to the existing 1977 Bankruptcy Act (*Konkurslov*). The debt relief process it put in place had the following features, several of which are quite unusual when compared to those in other European countries[59]. These are highlighted.

- The process is judicially-led.
- *The consumer does not pay a fee, with costs instead covered by the state.*
- *The consumer did not need to provide evidence of using an out-of-court debt counselling service or the out-of-court negotiation with lenders before applying for the formal statutory process[60].*
- The consumer could only enter the process if he was unable, and had no prospect of being off the full value of his debts in the 'near future', which was generally taken as five years. In practice this was taken to imply debts over 250,000 Danish Crowns for those able to work, and 100,000 Danish Crowns for the disabled and retired. As such *temporarily* unemployed able-bodied debtors are often denied entry.
- Exemptions on income which would be levied to meet the debt, for living expenses had to be 'reasonable', subject to the discretion of the court.
- The consumer underwent a 'good faith test' at the initial hearing based on the written application and oral responses to questions, to ensure his '*behaviour and circumstances speak in favour'* of debt adjustment[61], including the following factors:

[55] Act no. 169/2000 on the Collection of Taxes etc (*Lov om opkrævning af skatter og afgifter)* §15

[56] Bang-Olsen (1972)

[57] Andrup (1972)

[58] Excluding the UK and Ireland

[59] See Kilborn (2009b)

[60] Namely because Denmark did not have a debt counselling service, or a desire to pay for one. Neither did Danish legislators believe that those seeking this service would have the income to make such efforts cost-effective, preferring to move directly to a formal conclusion. Denmark continue to not have such a body.

[61] Bankruptcy Act, sections 94, 108, 122 and 126

- The probability that discharge would restore him to an equilibrium whereby he would not descend back into debt,
- The debts were sufficiently old enough to demonstrate a long term problem,
- The majority of debts were 'honest' (i.e. not fines or penalties),
- Evidence of attempts to manage debts well in the past demonstrating prolonged efforts to address these debts rather than passivity, and,
- Good conduct in the case, including supplying all documentation.

This was reformed in 2005 to make application more consistent via moving to a more rules-based approach. The subtle but important change reversed the presumption against giving a debtor admittance unless he could prove good behaviour, as described above, to a presumption of admission unless consideration of the factors above *'suggests decisively against relief,* and oddly led to a *fall* in admission rates, to below 40% of all petitions in 2009[62].

The 'no prospect of repaying rule' became a major area where judicial discretion led to significant variation, but also generally high levels of rejection. For example unemployment for able-bodied consumers was not assumed to be a permanent state, and led to a general assumption that unemployment was not sufficient to claim relief. Equally, courts could take into account of anticipated inheritances[63].

Between 2002 and 2004, according to Kilborn (2009b) of an average 4,700 applications a year, the courts *immediately* rejected between 55% and 60% every year, caused at least in at by the difficulty that many consumers faced filling out the forms without the support of a debt counselling service, leading more than half of those applying back into out-of-court negotiations, without the support of a debt counselling service.

The process then proceeded to a payment plan, whereby proposed payments to lenders are derived from the consumer's income for five years. A neutral trustee (*medhjælper*) collects necessary information (list of creditors, their account numbers and the amounts to be paid to them once a year) and assists the consumer in developing a proposal, which is standardly configured of disposal monthly income after exemptions for the life of the plan. The sum of this indicates the percentage of debts which will be paid. If the court is satisfied the consumer can meet the terms of the plan he is then discharged of the remainder of the debt. This again is unusual, in that the discharge normally occurs at the end of the plan, either to take account of any unexpected (positive or negative) events, and to incentivise completion. To be clear, if the debtor earns more, he gets to keep it. In a final unusual step the consumer is responsible for the plan, although the trustee helps him establish a devoted bank account, and supplies the bank with the collected information. Around 70% of cases admitted result in a confirmed plan.

[62] Kilborn (2009b)

[63] Kilborn (2009b) quotes a case of a man with an 85 year old father, who, the creditors claimed could only be expected to, using Government statistics, on average, to have a life expectancy of 4.7 years, and therefore in the light of this it was 'unclear' whether the consumer could not pay off his debts in 5 years.

- Up to 2005 the judiciary had discretion over the level of exempted income and the length of the plan, although five years was the usual, with few exceptions. Nevertheless, it still led to significant variation despite the original objective of broadly equal treatment. The reform bill was voted for unanimously approved on 24th May 2005, and became effective 1st October 2005[64] to deliver a system that would be simpler, more uniform, and more effective. Standardised rules on exempted income were brought into place and indexed. In 2009, the exempt monthly income levels were 5,170 crowns for singles, 8,770 crowns for couple, with sliding payments for children, from 1,410 crowns (younger children) to 2,600 crowns (older children)[65].
- Claims disputed by the consumer are now discharged in full unless the creditor files a suit within 3 months. This was expected to reduce debt burdens as many lenders may consider the process too expensive and time-consuming to be worth pursuing.
- Claims which are expected to receive less than 500 crowns[66] are automatically discharged as uneconomic to pursue.
- Pension funds could be accessed for fund to pay lenders if they had made large or irregular payments in recent years.

However, early evidence has not suggested a large improvement in successfully completed applications, with completions falling by 2008 to 27.4%. Around 30% of cases failing to progress from the first 'application' hearing to the second 'plan confirmation' hearing.

Finally, one complex area of the Danish law was reformed. Because discharge is awarded *prior* to the completion of the payment plan, this raises the issue of what to do where and when consumers fail to meet the payments. In this case lenders could pursue the debt plan debt for up to twenty years, but could not resurrect the discharged debt unless the consumer has '*grossly neglected his duties under the plan, in which case the court can revoke the plan and reinstate the discharged debt*' (Kilborn 2009b). The original law had restricted revoking or modifying plans by requiring changes were in the consumer's interest (i.e. only reduced the costs), and limited in scale, (so for example, missed payments would lead to a lengthening of the plan, not the increase in monthly instalments.

3.8 Estonia

3.8.1 Debt re-organisation and debt relief

As with many Eastern European and Southern European countries, Estonia had not developed a debt counselling provision, and this in part explains the absence of pre-court negotiation requirements in the law, leading to a focus on a debt cancellation methodology.

3.8.2 Debt cancellation

Estonia carried legislation in January 2003 which has been in force since January 2004[67]. Chapter XI of the Bankruptcy Act (*Pankrotiseadus)* regulates debt cancellation through discharge. There is no

[64] Law no. 365. L10, *Forslag til om ændring af konkursloven og konkursskatteloven (Revision af reglerne om gældssanering),* available at http://folketinget.dk/samling/20042/lovforslag/110/index.htm

[65] With a 7.4 crowns = €1 exchange rate (a typical value in the spring of 2012), the exempt monthly income levels for singles converts to €698; for couples, €1,185; and the child scale from €190 to €351.

[66] €67.

[67] See http://europa.eu/youreurope/business/exit-strategy/handling-bankruptcy-and-starting-afresh/

automatic discharge available, instead consumers must go through a bankruptcy process, five years after which a court can decide to issue a discharge[68].

Through the bankruptcy procedure a debtor who is a **natural person** is given an opportunity to be released from his or her obligations. Bankruptcy is the **insolvency** of a debtor declared by a court judgment[69]. The **debtor or a creditor** can file a **bankruptcy petition with a court**. The objective of the bankruptcy procedure is to **satisfy the claims of the creditors** out of the assets of the debtor. The creditors receive money proportionally to the amount of their claim. As in Germany, the debtor, in an effort to incentivise him, receives a '*motivation rebate´* at the end of each year of between 10 and 25% of the income transferred by the debtor to the trustee during the preceding year is refunded to the debtor[70]. As in Germany again, this is collected through an automatic assignment. This means that if the debtor earns more he pays more.

The hearing of bankruptcy matters is within the competence of **county courts**. The court will decide the initiation of the bankruptcy procedure within 10 days from filing the bankruptcy petition. The bankruptcy procedure is carried out by the **court and the trustee in bankruptcy**. Upon declaration of bankruptcy, the debtor's right to manage and dispose of the bankruptcy estate transfers to the trustee in bankruptcy to satisfy the **claims of creditors.**

The **notices related to the bankruptcy procedure** shall be published in the official publication "*Ametlikud Teadaanded*".

Individuals having experienced bankruptcy are permitted to start a new business, but during proceedings the court may order that they must not act as an undertaking, a member of a management body of a legal person, the liquidator of a legal person or a procurator until the end of the proceedings. Information on the persons, who have received a prohibition on business, shall be published in the Commercial Register. Individuals cannot seek another debt discharge within 10 years of the first, but are not prevented from being eligible for a second discharge after this[71].

However, in April 2010, a new law on personal bankruptcy (for natural persons) began its progress through the Estonian Parliament. The legislation proposed a separate court procedure in which individuals could apply for several debt adjustment procedures, which the aim of the court finding a balance between the rights and needs of both the lender and the borrower, with the aim of preventing individuals being required to end up in bankruptcy. The procedure is similar to that used for corporate debtors, based on the principles for restructuring in the Reorganisation Act (2008)[72], but taking into account the different types of debtors. The Law of Obligations and Debt Restructuring and Debt Protection Act[73] came into force on 17 November 2010. The purpose of this Act is to facilitate the restructuring of the debts of consumers experiencing solvency problems in order to help the consumer overcome solvency problems and avoid bankruptcy proceedings. The regulator of this act is the Estonian Ministry of Justice.

[68] §175 (1) Bankruptcy Act 2003

[69] http://europa.eu/youreurope/business/exit-strategy/handling-bankruptcy-and-starting-afresh/estonia/index_en.htm

[70] §173 (4) Bankruptcy Act 2003

[71] §171 (2) 3) Bankruptcy Act 2003

[72] *Saneerimisseadus.* 4th December 2008 – RT I 2008, 53, 296; 20102, 2, 3 (in Estonian)

[73] http://www.just.ee/10020

According to a representative of an advisory service invited to participate in the survey, indebted consumers are reluctant to admit the problem and usually do not ask for help until problems arise. The representative said that often the parents of the debtor deal with the problem once they start getting notification from debt collectors. He also pointed out that although many students study this area from the point of view of jurisdiction, none study how to actually avoid these problems in the first place.

Another respondent from a consumer agency pointed out that neither governmental nor non-governmental consumer protection organisations were involved in solving the problems of consumers with loans. The ability of these organisations is only to counsel consumers. She said that the documents of indebted consumers are forwarded to the court by the consumer. Either these are processed immediately or the court bailiff initiates the appropriate procedure. She said that although the government has started to show interest in consumer debt, it is difficult to establish to what extent the problem has been acknowledged.

3.9 France

3.9.1 Debt re-organisation

According to survey respondents from a consumer organisation, there are two substantive debt re-organisation methods available to French consumers.

The first is to request for deadline extensions or postponements from the creditor. This procedure is entirely voluntary and a negotiated process with the creditor, which means the most common consumer complaint is that creditors can refuse to cancel the debt and that it occurs too rarely. Depending on the outcome, this process can actually improve the debtor's credit rating by stopping missed payments. Lenders do not generally voluntarily write-off debt, although partial write-offs are sometimes made, particularly where the lender's actions have been called into question.

The second is to request for a debt moratorium from a magistrate for a maximum of two years. There is potential to not pay interest in this period. This procedure does not aim to free the debtor from his debt, but allows him more time to find a more stable financial situation before repaying his debt. It can have positive implications in terms of credit ratings, as it ceases any missed payments by the debtor and creates breathing space for the debtor to, for example, find employment, and find a means to sustain payments, although the debtor is under no obligation to do so unless he wishes to. There are few consumer complaints about this process, except where it is argued that the moratorium is too short. One consumer organisation noted its objectives, providing respite are limited, but respected that was the intention. The relevant legislation is *Loi no91-650 du 9 juillet 1991 – art. 83 JORF 14 juillet 1991 en vigueur le 1er août 1992 and Ordonnance no2006-346 du 23 mars 2006 – art. 38 JORF24 mars 2006*

3.9.2 Debt relief, asset liquidation and debt cancellation.

France has a corporate bankruptcy solution (*faillite*[74]) not open to natural persons. For traders, farmers and small businesses, and all legal persons (with the exception of associations of co-owners of a building) the *faillite* proceedings are initiated when the debtor is in a situation of 'cessation of

[74] Law on restructuring and judicial liquidation of companies (1985)

payments', defined as when it is impossible for him to meet current liabilities with available assets. **Natural persons (consumers) engaged in an independent profession are not eligible for these proceedings[75].**

In terms of consumer bankruptcy, France has tested many of the key issues in designing debt solution systems and provides valuable lessons, having moved fully across the spectrum of possible designs. France's system between 1989 and 1999 came to be seen as an exemplar of the discretion-based 'Romance school' systems of debt cancellation[76] where decision-makers were given the freedom to define exactly how repayment attempts would be made, how much would be paid back, over how long, and how much of their income they would be allow to retain (exempt income). In 1989, a formal mechanism for the private re-negotiation of distressed debts was introduced, giving a prolonged period for the repayment of debt and debt relief, although the latter was only available under stringent conditions, unlike the bankruptcy law which was open to businesses and merchants and wrote-off all unpaid pre-bankruptcy debt. This has undergone repeated reforms which have moved the French system away from a 'Romance' approach including judicial involvement, towards the application of clear rules, and away from compromise solutions between lenders and borrowers to imposed ones, as originally used in more 'Germanic' countries. This movement has resulted in a system which is administratively led, rules-based, with clarity for both lenders and debtors, and which in the author's opinion is, alongside Sweden's probably the nearest to being best practice in Europe.

From 1989 to 1999 discretion was applied differently in different localities, depending on whether the relevant *commissions* and courts took the approach that the maximum possible level of repayments could be made, which led them to impose very tough settlements, whilst others compiled with the statutory income exemption levels as an informal baseline, as suggested by the Government (Kilborn 2009). This led to a revolving door whereby a plan would be worked out then the debtor would return to court for more relief, as the courts at this time could not impose a discharge.

In 1999, this discretionary system was reformed as the Government removed the option of awarding less that the statutory income exemption level, moving the French system more towards a rules-based approach, however some discretion was still allowed as exempt income was treated as only part of the resources necessary to meet expenses[77]. This reform also made more aggressive relief available, with moratorium on debt servicing payments on all debts for up to two years[78], after which if debts could not be satisfied, the court could grant a discharge, after three years, in

[75] In principle, a debtor who has gone through *faillite* and had emerged a natural person is given full capacity and can start a new business following the judgment closing the winding-up. However, it is a different matter if the court decides to impose on him a **prohibition to manage or a personal bankruptcy measure** (lasting five years at least, with no maximum) because he has committed management errors or has performed acts, listed in law, which are damaging to creditors (for instance, having continued with a business in deficit, misappropriated the assets, used ruinous means to obtain funds, paid a creditor after cessation of payments or failed to keep accounts), that is engaged in active over-indebtedness. In this case, or if a creditor proves fraud in relation to him (for instance the fact that the debtor did not inform the liquidator of the existence of a claim) then the debt cancellation may not be complete, leaving residual debts for the debtor to service.

[76] See Kilborn (2005), Kilborn (2009) and Kilborn (2010b), for example.

[77] Code de la consummation Art L.331-2 (2007)

[78] Three years before 2003

'*extraordinary'* measures (being insolvent even after up to three years deferral of all debts) except for non-dischargeable debts, such as child support obligations and criminal fines. Surveys later identified that a quarter of debtors were in this position, yet few debtors were receiving this discharge, the legislature took renewed effort. The 2004 legislation[79] allowed *commissions* to recommend that a debtor was in an '*irremediably compromised'* financial situation and should be allowed access to a *personal recovery programme (rétablissement personnel)* which offered a full and immediate discharge without a rehabilitation plan, but a liquidation of assets. In 2010[80] this was further simplified, by removing the asset liquidation where no assets were available, which offered a full and completely unconditional discharge. This process has been heavily used and appears successful.

Natural persons (consumers) with non-professional debts[81] therefore go through the following process:

A submission is made to an administrative board[82] or *commission,* which assess it against eligibility criteria. The *commission* is a hybrid – part debt counsellor and part administrative tribunal. The criteria are a demonstration of good faith and the manifest impossibility of paying all the debts, due to the scale of the debts. The administrative board then draws up a statement of debts, after having obtained representations from the creditors. Prosecutions, and payments by the debtor are automatically suspended as soon as the board decided that the consumer can have the benefit of the procedure, until the *commission* or, where necessary, a judge, has reached a conclusion.

The board has to determine whether there is a viable prospect of the debtor recovering their financial viability. If it is believed there is, the board proposes a composition with creditors, including measures that postpone, re-schedule or grant remission of the debt. This composition is effectively a debt relief and a debt cancellation mechanism. From 1 November 2010[83], the *commission* has the power to impose this plan on creditors who do not agree through non-judicial 'cram-down'. As such, if creditors do not accept the debt management plan, the administrative board can impose it, without judicial confirmation[84] unless the plan cancels some debt. The judge decides in any appeals against these recommendations. This process has been effective. The rate of success in getting creditors to accept the voluntary plan may have fallen from 70% of all cases in 2000 to 55% in 2008 and 2009, but such a level of success, as noted by Kilborn (2010b) is a positive.

Each case is reviewed individually. Whilst there is no automatic cancellation of all the consumer's debts, and most of the time the consumer must continue re-imbursing at least some of his debts, the debt can in some instances be entirely cancelled. For example, if, in addition to good faith, the person can prove that his situation is irremediably compromised[85], in other words that it is impossible for him to implement the measures mentioned above, the commission may apply to the

[79] See, for example, Freshfields Bruckhaus Deringer (2006)

[80] See Fraisse & Frouté (2012), Kilborn (2012) and Blazy, Chopard, Langlais & Ziane (2012)

[81] Including debts arising from a company guarantee, provided that the guarantee is not a director's guarantee

[82] Run out of the Banque de France

[83] *Loi Neiertz (loi n°89-1010 du décembre 1989)* and *Loi Lagarde du 1er juillet 2010*

[84] Which had been a feature of the system up to this point.

[85] As Kilborn (2009) notes, in recent years the *commissions* and courts have '*adopted an arguably overbroad interpretation of the key password of insolvent and they have found an increasing portion of debtors irremediably compromised and routed them to immediate and full discharge.'*

court for the opening of **personal recovery proceedings**: the creditors are listed and the assets are evaluated. The judge can order the winding-up of the debtor's personal wealth, or since November 2010 the commission can recommend personal recovery proceedings without liquidation of assets in the case where the debtor possesses only household assets that are exempt, or no market value or where the value would be 'manifestly disproportionate ' to the costs of sale. In such cases the commission recommends immediate closure of the case and discharge[86].

Since 1st November 2010, the over-indebtedness commission has a three month delay to decide the admissibility and orientation of the over-indebtedness file. The debt's execution is automatically suspended once the over-indebtedness file is received (and can be as soon as the file is submitted if the commission considers there is a special emergency). The commission, or in the case of urgency the debtor can request the judge to pronounce a suspension of any expulsion procedures from housing.

In normal cases, with asset liquidation, a liquidator is appointed to distribute the income from the assets among the creditors. If it is not possible to meet the debts of all the creditors, he declares the proceedings closed due to insufficient assets, which results in the erasing of the debtor's non-professional debts, with the exception of child support payments, criminal fines or debts paid by guarantor[87]. This is effectively debt cancellation. The debtor is prohibited from administering and disposing of any assets until the proceedings are closed. Full debt cancellation is most likely where passive over-indebtedness is the cause of the problem, or where the debtor is old. The commission can secure an attachment of earnings against the consumer for the duration of any payment plan.

Finally, in relation to taxes, fees and fines to be paid to a public body, in France tax offices retains the power to extend payment periods or cancel debts. Even if a debt cancellation commission proposes debt cancellation, the tax office has to agree to this for tax debts. For other state debts (TV license fees, criminal fines and social security), the commission also has no power to impose payment plans, such as instalments, although it can propose these debts be cancelled. It has been proposed that tax debt be included in consumer bankruptcy arrangements.

This process allows the consumer to re-establish his credit rating by resolving his over-indebtedness, although the consumer is listed for a maximum of five years on the FICP register. This reduces his access to credit as credit institutions have (under the Lagarde law) been required to check the FICP before extending new credit, although the law does not prohibit the extension of credit to a listed person. Around 3% of debtors do not respect their plan and around 10% of debtors appear to have subscribed to new credit, despite their over-indebtedness plan[88].

If the debtor does not comply with the terms laid down by the over-indebtedness commission, the commission can then apply a less favourable treatment. There are some instances of consumers attempting to submit fraudulent files, but it is felt these are generally easily spotted and few such cases are accepted.

There are few complaints from consumers about this process, because it is perceived as quick and relatively painless. However, according to UPC-Que-Choisir, around 40% of files submitted to the

[86] *Code de la consummation* arts. 330-1(1), 332-5

[87] The creditors can always sue in relation to the debtor's guarantees.

[88] Page3, Banque de France (2012)

over-indebtedness commission are from people who have already known over-indebtedness, including those who have gone through the process before, which suggests that the support available to consumers after they have gone through this process is insufficient and that a greater level of aftercare is required to maximise the benefits of the process.

According to Fraisse & Frouté (2012) sixty percent of households are ordered to repay part of their debt. Over a two year horizon, they re-default at an eleven percent rate and reimburse twenty percent of their initial outstanding debt. Banque du France data gives information on the causes of indebtedness, as below or in Banque de France (2011b).

Table 4: Reasons for over-indebtedness/over-indebtedness commissions - France

Reason	2001	2004	2007	2007(PRP)
Too much credit	19.4%	14.6%	13.6%	5.4%
Poor Management	7.7%	6.4%	6%	2.4%
Housing costs	3.1%	1.2%	1.2%	0.9%
Excess charges	2.2%	1.4%	1.3%	1%
Unemployment/Job loss	26.5%	30.8%	31.8%	32%
Separation/Divorce	15.5%	14.7%	14.7%	14.5%
Accident/Illness	9.1%	10.8%	11.3%	18.8%
Lowered resources	6.9%	6.2%	6.2%	7.3%
Death	2.5%	2.4%	2.5%	3.6%
Other	7.1%	11.5%	11.4%	14.1%
Total	100%	100%	100%	100%

Source: Banque de France, quoted in Ramsay (2011)

Table 5: French debt solution usage

	Process initiation		Not irredeemably compromised		Irredeemably compromised	
	Dossiers received	Dossier accepted	Agreed Plans	Recommendation by Commission approved by judge	Personal Recovery Plans	Procedures closed (debt cancellation following failure of PRP)
2003	165,493	144,310	93,012	26,615		20,221
2004	188,176	153,175	94,415	31,927	22,034	20,506
2005	182,330	155,892	97,391	29,514	22,187	19,859
2006	184,866	157,876	95,853	29,991	27,504	19,296
2007	182,855	154,878	84,343	29,836	30,745	19,387
2008	188,485	160,024	87,673	37,668	34,919	18,944
2009	216,396	182,638	95,426	35,515	42,704	20,106
2010	218,102	182,007	86,419	37,386	43,098	18,733
2011	232,493	202,900	73,945	48,797	58,196	

Note: Columns three through seven not mutually exclusive

Source: 2003-2009 Blazy et al (2012), from the Banque de France. 2010-2011, Banque de France (http://www.banque-france.fr/uploads/tx_bdfgrandesdates/Statistiques_Surendettement_2011_01.pdf)

3.9.3 Potential for new legislation.

The Lagarde Law intended, in the view of a consumer organisation respondent to 'sanitise' the distribution of 'consumption' credit, and in particular 'revolving' credit. Consumption credit accounts for around 50% of consumer's debts[89] and appears in most over-indebtedness files. In addition, there are on average four revolving credits in each over-indebtedness file[90]. However, less than a year after its complete application, credit institutions do not appear to be respecting the spirit of the law and making use of certain gaps in the law to continue to give credit to consumers without their being aware of it, for example through the use of 'confused' cards, such as fidelity cards and revolving credit cards. There is therefore, ongoing reflection on two potential reforms:

- Reforming consumer credit laws more generally, in particularly revolving credit. Consumer organisation respondents are in favour of this.
- Creating a register of the debts of individuals. Consumer organisation respondents are not in favour of this.

[89] UFC-Que Choisir response.

[90] UFC-Que Choisir response.

3.10 Germany

3.10.1 Causes of over-indebtedness

As with other European countries, research in Germany confirms that over-indebtedness is mainly driven by factors outside the consumer's control, leading to passive indebtedness.

Table 6: Reasons for over-indebtedness (Multiple responses) – Germany

Reason	Percentage
Unemployment	42%
Lack of financial overview	37%
Divorce/separation	36%
Business failure	22%
Too much consumption	21%
Lack of experience with banks	20%
Family problems	20%
Decrease of income	19%
Lack of experience with money	18%
Low income	18%
Psychological problems	15%
Co-liability	12%
Surety	12%
Own sickness	10%
Others	21%

Source: Backert, Brock, Lechner, Maischatz (2009) in Niemi, Ramsay and Whitford (2009)

3.10.2 Debt re-organisation, debt relief, asset liquidation and debt cancellation

1994 saw a new personal bankruptcy law, *Insolvenzordnung vom 5 Oktober 1994*[91], agreed by the legislature in an effort to '*offer debtors a perspective for their futures, an incentive to remain productive rather than capitulating to a lifetime of [welfare dependency] and essentially involuntary servitude for their creditors*'[92]. It did not come into immediate effect, as it was expected time was need to prepare the court system for a potential influx of work. A five year delay to 1999 was put in place until the Act finally came fully into force. This law requires multi-year payment plans as a requirement for an eventual entitlement to discharge of any residual debt after completion of the plan. The process aims to achieve the best possible, equal satisfaction of the creditors, but it is also intended to allow natural persons a financial fresh start.

This legislation replaced three pre-existing insolvency mechanisms[93].

[91] German Insolvency Regulations (Insolvenzordnung – InsO) See Kilborn (2004), Remmet (2007), Backert, Brock, Lechner & Maischatz (2009), Kilborn (2009), Perakis (2010), and Lechner (2011)

[92] Kilborn (2009). See also Kilborn (2004)

[93] Germany provides a nice example of how bankruptcy legislation evolves. This is described in more depth in Annex 9

- The *Konkursordnung*[94] which came into force in 1879
- The *Vergleichsordnung*[95] of 1935
- The East German *Gesamtvollstreckungsordnung*

In a work which ultimately aims to describe best practice, it is worth reflecting on why neither of these mechanisms were viewed as being successful, and the lessons this implies for those countries which still use similar practices.

Both were court-based, and both were open, in a technical sense, to consumers, albeit not particularly designed with consumers in mind, but were, in practical terms, essentially unavailable or ineffective. Debt cancellation could theoretically occur in both processes, but only with the express permission and condescension of the vast majority of lenders; 75% of claims in monetary terms and a majority of the absolute number of debtors under the *Konkursordnung,* and 75%-80% of claims in monetary terms, a majority of the absolute number of debtors, and repayment of at least 35% under the *Vergleichsordnung.* These constraints effectively locked consumers out of these procedures, even if they could have afforded the high costs, including administration and courts fees which the debtor was expected to shoulder under the *Konkursordnung.* This rule alone led to 75% of all cases, persons and businesses being denied access under the '*sufficient assets'* requirement.

Finally the *Konkursordnung* gave, as is standard in the 'classical' bankruptcy model, no release or fresh start, as at the conclusion of the process, if any debtors had not received full recompense they were provided with a writ of execution which gave them the power to seize any asset or savings the debtor could acquire *for up to thirty years*, a situation described in the German Bundestag as a '*modern debtor's prison.'*[96] This was exacerbated by the '*narrow range of consumer property[that] remains outside the grasp of creditors seeking to execute judgements'*[97] as defined by the Code of Civil Procedure[98], which outlined that only '*clothing, underwear, bedding [and] household and kitchen utensils'* were exempt '*to the extent that they are required for the debtor's modest lifestyle and domestic activity, appropriate to his or her occupational activity and indebtedness',* as well as tools of the trade, although other 'basics', such as a refrigerator, washing machine, furniture, radio, and black-and-white television[99] came to be included in the exempt categorisation. German law also allows the free contractual assignment of future wages as security on a debt, even before financial trouble emerges, but this is balanced by a regime which imposes limitations on the amount which can be garnished in this fashion, ensuring there is an exempt income designed to be sufficient for the debtor to live off of. In the early 1990s, calculations[100] suggest a childless couple in 1992 would have been entitled to an exempt income of about 33,000DM / $16,500, recognising this relied on several simplifying assumptions and the complex nature of the rules for calculating this sum at that time, not a substantial amount.

[94] Literally 'Forced Auction Act'

[95] Literally 'Agreement Act'

[96] Deutsche Bundestag; Stenographischer Bereicht, 94. Sitzung 7770-1, 7775, (June 3 1992). Available at http://www.parlamentsspiegel.de

[97] Kilborn (2004)

[98] Zivilprozessordnung Art 811(1), 95) (2003). See also section 5.8

[99] Colour TV counting as a luxury

[100] Kilborn (2004)

The 1994 legislation

The bill imposed '*strict prerequisites*' on debtors before they could be judged worthy of a discharge. These came in the following forms:

- Firstly, debtors have to attempt to reach an out-of-court agreement with all creditors[101].
- Secondly, if that had failed the debtor had to file a petition[102] to open an insolvency case, including making a second offer, including a payment plan to the creditors[103]. This can be imposed by the court on a dissenting minority of creditors if the majority, including a majority of the monetary value of all debts were agreed[104]. **This could deliver, in our terminology an outcome which is either a debt relief or debt cancellation.**
- Thirdly, if a majority of creditors would not agree to the plan, the debtor would enter an asset liquidation process to extract value from assets to improve the offer[105].
- Fourthly, the creditor would enter a six year[106] payment plan during which '*best efforts*' would be taken to find and retain employment, and all non-exempt income would be handed over to a trustee for distribution, along with the output from the asset liquidation and 50% of any inheritances received in the period, for distribution to creditors.[107] **This results in a debt cancellation.**

To deliver the out-of-court agreement, debtors have the support of a '*suitable person*' determined by the German states (*Länder*), and most commonly choose lawyers and state-sponsored debt counsellors, with the majority of cases handled by the latter and, although there has been experience of long waiting lists, there was significant levels of success, with success rates up to around 45% in some states in some years[108], in terms of plan development and agreement, although of course this does not imply that the debtor was ultimately able to deliver the plan[109].

The in-court payment plan has additional requirements. This is because the court can impose the plan on a minority of dissenting creditors. Specifically the plan needs to offer each creditor an appropriate share of the estate relative to the size of their debt relative to those held by other creditors, and dissenting creditors must not receive less than they would receive if the case proceeded through liquidation and the payment plan. Because this process was so unsuccessful it rapidly lost support, until in 2001 it became optional, with the option exercised by the court[110]. By

[101] §305(1)(1) InsO

[102] Including: the certificate of the suitable person who has been assisting him, a settlement plan, records of his assets and incomes, records of his creditors and his debts to them. The settlement plan contains all provisions required for the appropriate settlement of the debt. The courts can at this point accept a 'zero-plan'. This is where a consumer has no assets or income, and will be unable to meet their debts. If accepted by the courts this implies that either after the creditors have agreed the second offer, or after the payment plan leading to discharge that the debtor can be free of all their debts, even if they have paid nothing to their creditors.

[103] §§305-9 InsO

[104] In the jargon a 'weak' cram-down. §309 InsO

[105] §§311-14 InsO

[106] The payment plan starts when the debtor transfers his assets to the trustee. This payment plan was legally a seven year period, although the time the arrangements are put in place this normally led to a slightly less than seven year payment plan. This was shortened in 20012/2 to a six year duration, leading to a payment plan of between five and six years.

[107] §§286-303 InsO. §295 particularly addresses the inheritance issue

[108] For example, North-Rhine Westphalia achieved 44% in 2001. Kilborn (2004)

[109] Plans which offer more to debtors are easier to agree and harder to deliver, leading to a trade-off.

[110] §306(1) InsO

2003 it was clear that most courts opt-out as a minimal number of these were undertaken from that point on.

If the previous steps have not proved successful (in terms of reaching agreement, not necessarily in terms of the debtor being able to deliver against the agreement), then the case proceeds to insolvency and discharge. The court appoints a trustee to liquidate the estate[111] and manage the distribution of payments to creditors. After this, a payment plan is laid down. Originally designed to be six years long, shortened to six in 2001 and currently under debate in the legislation proposed in 2013, the trustee takes all income over and above the exempt income level as an attachment of earnings, for distribution to creditors. As employment income over and above a set 'minimum subsistence level' is included through an automatic assignment, this means that if the debtor earns more he pays more. However, as in Estonia, the debtor, in an effort to incentivise him, receives a '*motivation rebate´*. At the end of four years the trustee has to refund 10 % of the income transferred by the debtor to the trustee during the preceding year to the debtor, 15 % after five years[112]. This 'carrot' is matched by a 'stick, which is that the debtor must show '*good behaviour'* by holding or actively seeking and not refusing any suitable employment[113], including employment outside one's profession. The end result of a successful completion of a payment plan is a discharge of the remaining debt. Creditors can, however apply to the court to deny the discharge if the debtor has not sought or held down reasonable employment[114]. Creditor can also request a denial of discharge of the debtor is found guilty of a bankruptcy crime[115].

In 2001/2 new legislation made a small number of significant reforms to the personal bankruptcy system:

- Income exemption levels increased by 50%, leading to around 80% of debtors no longer being required to make payments as their income falls below the threshold[116].
- The duration of payment plans was shortened from seven to six years.
- The restriction on entering court proceedings unless court fees could be paid was mitigated, with deferral of payment of the fees introduced.

Usage of this system has increased rapidly since the reforms were implemented, as is shown in the table below.

[111] Like the *Konkursordnung,* the case under the *Insolvenzordnung* gave the court the power to dismiss the petition if the assets were not going to release sufficient resources to cover the court costs. Until 2001, when reforms were put in place to reduce these costs, As Kilborn 2004 notes, this meant that nearly 90% of all insolvency cases did not proceed due to this requirement.

[112] § 292 InsO -*Von den Beträgen, die er durch die Abtretung erlangt, und den sonstigen Leistungen hat er an den Schuldner nach Ablauf von vier Jahren seit der Aufhebung des Insolvenzverfahrens zehn vom Hundert und,[2] nach Ablauf von fünf Jahren seit der Aufhebung fünfzehn vom Hundert abzuführen.*

[113] §295(1)(1) InsO

[114] §296 InsO

[115] §290 InsO

[116] An example of how Germany has worked to strike this balance can be seen in how the legislature reacted to complaints that the income exemptions to which consumers were subject too left them too little income. As such in 2002 these were increased for the vast majority by 50%, an bi-annual indexing was introduced. This led to around 80% of debtors no longer having sufficient income available to cede any to creditors.

Table 7: Number of private bankruptcy cases, 1999-2011 – Germany	
Year	**Number of Filers**
1999	1,634
2000	6,886
2001	9,070
2002	19,857
2003	32,131
2004	47,230
2005	68,898
2006	96,586
2007	105,238
2008	95,730
2009	98,776

Source: Lechner. G., in Consumer bankruptcy in Europe: Different paths for debtors and creditors (2011)

3.10.3 Proposed legislation

On 18th July 2012, the German Federal Government (based on a draft law originally written by the German Federal Ministry of Justice) announced a new revision to consumer bankruptcy law, including the following:

- **Shortening the duration of the discharge procedure** (Restschuldbefreiungsverfahren) from the current six years to three years. To access this, debtors would need to settle within the first three years of the process at least 25% of creditors' claims and legal costs. An early discharge will also be possible after five years if at least the legal costs have been paid, otherwise it will remain at the current time of six years
- **Ability to undertake insolvency plan procedures** In the future, consumers will also be able to undertake insolvency plan proceedings, giving every debtor during the bankruptcy proceedings the possibility of a flexible debt relief agreement with her/his creditors. This includes the removal of priority creditors satisfaction (§ 114 Insolvency Act).
- **Transformation of the out-of-court settlement process** The proposal seeks to improve the efficiency of the out of court settlement process. In future, no more out-of-court settlement attempts should be made when this is obviously hopeless. The intention is to maximise the impact of the limited resources of the debtor and bankruptcy counselling centres.
- **Strengthening of creditor rights** It is proposed that creditors can submit a case for refusing an application for discharge either during the hearing and shall at any time in writing. Such a request must be available no later than the closing date.
- **Protection of member of housing co-operatives**, while ensuring that debtors cannot protect their assets from bankruptcy by transferring them into a co-operative.

The proposed extension of the grounds of refusal (conviction of the applicant for a property or asset offense) is no longer included in the government's draft bill. Likewise, the proposal to incorporate a discharge of residual debt has been dropped. Consumer groups had previously strongly criticised these. The remaining suggestions have also been heavily criticised by consumer groups since they

were published, so in the following section we provide substantive comments about the main areas of contention:

Shortening the duration of the discharge procedure

In the view of consumer organisation respondents, a reform of the length of proceedings in German insolvency law is urgently required, as the existing procedure's duration of six years has been pointed out to be long by European standards. Conversely, The German federation of debt collection agencies (BDIU) and the German Confederation of Skilled Crafts (ZDH) have voiced concerns that the reduction of the discharge procedure from six to three years will damage creditors and will lead to abuse by debtors.

The government bill provides[117] for four options on the length of the discharge period:

- If all costs and all creditors are paid in full the bankruptcy court may decide for an immediate ending of the proceedings.
- The discharge period can be shortened to three years[118] if within this period the debtor has met at least 25% of the claims in addition to all of the legal costs.
- In the case where the debtor only pays the costs of the proceedings, a discharge after five years is possible.
- Otherwise, the debtor is subject to the ordinary period of six years before discharge.

The objective of installing a minimum satisfaction ratio (25% repayment in return for early discharge) is to achieve a reasonable balance between the interests of the debtor through a quicker discharge and the interests of the creditors in achieving the fullest possible fulfilment of their claims. However, as one consumer association respondent noted, from the government bill it is possible to deduce that no valid data on the percentage of satisfaction currently being delivered by debtors are available. However, if on average only 10% of all creditors' claims are actually satisfied over the six year period, consumer associations argue it is unclear how substantial numbers of borrowers are supposed to achieve 25% over only a three year period in the future. The logic of this position is given in the federal government's rationale for this reform, which assumes that the prospect of a shortening of the proceedings can motivate the debtor to make additional efforts beyond any imposed obligations. The debtor could, as contained in the draft justification's reasoning, for instance:

- use exempt income and assets to make additional payments,
- accept a / an additional part-time job to increase his non-exempt income,
- take a loan from relatives[119].
- In this context, the government stated clearly who is mainly expected to benefit from this short-cut: *"In particular, the coalition agreement paid particular attention to failed self-employed workers / entrepreneurs when considering a shortening of the duration of the*

[117] in § 300 InsO-RegE

[118] Following the release of covenant.

[119] Although one has to question the legality of a bankrupt taking on more borrowing during the period of his bankruptcy, unless these 'family loans' have some quasi or in-formal nature. One also has to question what incentive a family may have to support a member in this way, who has demonstrated problematic finances.

remaining debt procedure, as these are often in the position to repay part of their debt within a relative short time period through their new occupation.

In the eyes of consumer organisations it is unfortunate, the government's proposal envisages a shortening of the process *only* in the case of the fulfilment of a minimum satisfaction rate, a model which is not used in many other European states. To justify the minimum satisfaction ratio set, the government's draft refers to similar systems in Lithuania and Austria. However, it is not mentioned that in Austria the minimum quota of 10% is subject to heavy criticism[120], or that Lithuania does not foresee a minimum rate[121]. The Czech Republic currently requires a minimum return of 30%[122].

However, in the view of one consumer organisation respondent, this beneficial re-balancing of interests is unlikely to occur because the logic behind the change fails to recognise a common problem identified in many countries, that a failure to repay is not because the debtor *chooses* not to re-pay, but because he has *no resources* to enable him to re-pay. Indeed the current legislation requires, over the six year period, *all* of the debtor's non-exempt income and assets, *by law*, are used to satisfy the creditor's demands. Thus the reform is likely to leave a large group of consumers and lenders in the to an uncertain period of between three and six years of potential payment, despite the fact that *a priori*, based on an assessment of the consumer's ability to pay, utilising an assessment of their income and assets, an earlier decision could have been reached which is unlikely to give lenders a significantly lower return than they could expect under the current reform proposal. As such, as a consumer organisation respondent notes, it is clear that a three year discharge is not available to those on very low incomes, or who have entered over-indebtedness because of an inability to work (e.g. sickness and other recipients of certain social benefits), leaving many consumers in a position of completing bankruptcy after five to six years, when it is clear from day one that it is unlikely they will be able to contribute effectively in this period. This appears to add unnecessary costs onto lenders and courts, and unnecessary stress onto consumers.

Returning to the idea of encouraging the debtor to make further contributions from their exempt income or assets to repay their debtors, as mentioned above, this appears to the authors to be one of the most interesting and potentially perverse elements of the reforms. Leaving aside whether from a social context this is justifiable, which one consumer association respondent indicated it felt it was not, looking at this in terms of the lessons about effective debt solutions we have identified in many countries, one of the clearest best practices we have identified is the benefits to consumers and lenders of clear, transparent and enforced rules. Germany led the way in learning this lesson, and many countries have replicated this in their legislation. To therefore find Germany reverting to permitting / encouraging ambiguity about exactly how rigorously the rules are to be enforced, appears in some ways to be a bizarrely retrograde step towards a discretionary model of practice which has been widely refuted and abandoned across most European countries which have put in place a formal consumer bankruptcy solution.

Finally, in the view of one consumer organisation respondent the Federal Government is also overlooking the fact that many debtors already voluntarily undertake efforts above what is required of them to successfully complete bankruptcy proceedings, thus the change may deliver little in the way of additional payments.

[120] ASB Schuldenberatungen (2012). See also section 3.4

[121] ASB Schuldenberatungen (2012).

[122] Kilborn (2010b)

Attempting to design the process to incentivise good behaviour such as seeking (additional) employment has to be seen as facet of good policy-making. The rebuke that if a lack of employment is the root cause of the problem then encouraging people to seek employment is insufficient is correct, but does not mean that the attempt is not worth making. However, as one consumer association notes, if the stigma of being involved in insolvency proceedings inhibits the consumer's ability to find employment than incentivisation in the process may not be enough.

One consumer association respondent advocates a general shortening of the discharge procedure for all borrowers to four years to allow debtors to clear debts within the foreseeable future and take part in social life on equal terms.

Transformation of the out-of-court settlement process and strengthening creditor rights

One objective of the reforms is to attempt to strengthen the out-of-court settlement procedure. Based on the amendments, a consumer association respondent argues the opposite seems to be the case. The main reasons given are:

- The funding of public debt counselling looks likely to be reduced, weakening the institutions' ability to undertake the work establishing viable out-of-court settlements
- The abolition of the cram-down (*Zustimmungsersetzungsverfahrens*) process[123], still provided in the draft bill, weakens out-of-court settlements. In the future, the lack of consent from only a few creditors is enough to prevent out-of court settlement. Thus, the number of bankruptcy cases proceeding to the courts will continue to increase. This is a clear example of new legislation in one country failing to recognise best practice in other countries, where this type of cram-down activity has significantly reinforced the capacity of out-of-court settlements to be reached. Consumer organisations in Germany have strenuously argued that the *Zustimmungsersetzungsverfahren* must urgently be reinstated in the bill.

A significant step is the recommendation to permit the abandonment of out-of-court settlements if they are '*obviously hopeless*'[124]*;* when the creditors would receive less than 5 percent or the debtor has more than 20 creditors in total, and in practice the efforts of debt counselling to reach an out-of-court settlement in hopeless cases will no longer be rewarded under the government draft bill. As one consumer association respondent notes '*debtors may have to undergo insolvency proceedings even if there would have been a chance for an extrajudicial settlement and thereby a lengthy debt relief procedure could be prevented*.'

They also point out that Article 10 of the government's draft bill provides for further amendments to the funding of counselling services. The change[125] provides that the remuneration (to be set at 60 euros) for counselling services shall be fulfilled if a certificate attesting the hopelessness of the case to be settled outside of a court is provided. Further remuneration of counselling services in cases where a court settlement is obviously hopeless, is thus to be eliminated. The argument submitted by the consumer association respondent is that debt counselling services do not have less work

[123] The *Zustimmungsersetzung*: A creditors refusal to accept the settlement plan can be substituted with an approval if more than half of all creditors with more than half of the outstanding claims agree to the settlement plan. The creditor who refused the plan has to receive a fair share of the repayments and cannot be made worse off than if the consumer went into insolvency.

[124] The amendment of §305 InsO-RegE provides the definition given above

[125] To the des Gebührentatbestands provision 2502 in the RVG

processing cases which cannot be resolved out-of-court than in cases where an out-of-court settlement is achieved.

Insolvency Code § 305-RegE explicitly states that the finding of apparent hopelessness for the settlement of the case through an out-of-court settlement can only be based on personal consultation and thorough examination of the income and assets of the debtor. In the draft justification, the following is laid down: *"This certificate of previous analysis of the financial circumstances of the debtor has substantial importance for the quality of the certificate. A mere issuance of a certificate without this thorough preparatory work would be worthless for all parties involved. It requires a thorough examination and discussion of the debtor's circumstances to support the request to open insolvency proceedings and create legally sound documents. Finally, comprehensive and expert advice by an appropriate person or agency is best suited to avoid the unwanted revolving doors effect. "*

This requires significant time and effort to be expended by the debt counselling service, including on searches for possible further creditors, organising and filing the documents and the time-consuming submission of all required documents and debtor data for opening legal proceedings. This includes the personal advice as well as a thorough analysis of the causes of indebtedness and budget planning, in order to avoid future liabilities and thus to prevent the "revolving door effect". It is argued this is undeliverable for €60, and as such the workload would be shifted to the courts. This in turn will make court proceedings more expensive. This suggests this proposal may benefit for review. Consumer association respondent's have argued for its removal.

The ministerial draft included not only the elimination of the traditional court debt settlement plan proceedings but also that the debtor could apply to the court for a cram-down if a creditor did not respond to the debt settlement plan or rejected it (§ 305a Inso-RefE). In place of a debt settlement plan, a court approved cram-down was envisioned. The present governmental draft, however, does not provide for a cram-down, either in or out of court. This means *an important tool for supporting and strengthening out of court agreements through measures available to the insolvency court itself, has been dropped*, which in the view of consumer associations would permit a minority of creditors to frustrate out-of-court settlements. Around 20% of cases are currently settled out-of-court, but under the new legislation if only a few creditors refuse an out of court settlement, it will be considered a failure even if many agree. The elimination of the cram-down process will result in a massive increase in insolvency proceedings. Instead of relieving the courts there will be an increasing burden on bankruptcy courts. Consumer associations argue there is an urgent need to resurrect the cram-down procedures to strengthen out-of-court settlements.

In the view of consumer association respondents, additional regulations are necessary to strengthen the out-of court settlement process, including that **cr**editors should be refused permission to initiate enforcement proceedings against the debtor whilst out of court settlement negotiations are in progress. This causes the negotiations to be much more difficult and not infrequently the success of an out-of-court settlement is thwarted.

Equally, in the view of consumer association respondents, it is urgently required to extend the effects of out of court settlements to unknown creditors. Particularly in cases with a long debt history, or after moving or after a divorce, papers may have been lost, that could have otherwise led to identify further creditors. In this case the insolvency procedure is the only way to clear all debt. In order for the out-of-court settlement to also apply to any unknown creditors, it must be ensured that the agreement will also be made known to potential unknown creditors (e.g. by public notice). Within a certain cut-off period, the demands of these creditors could still be taken into account.

Finally, in the view of consumer association respondents, the importance of debt counselling to the whole insolvency process needs to be better recognised. Debt advice is assigned a new task with the power of representation extended to opened proceedings (§ 305 para 4-InsO RegE) but without receiving any corresponding compensation for this. Through exercising the power of representation the debt advice thus becomes part of the bankruptcy proceedings and must be adequately compensated, similar to the (preliminary) liquidator. Consumer association respondents therefore propose an appropriate remuneration policy for debt advice providers in the bankruptcy proceedings which could be included in the Bankruptcy Legal Compensation Regulation.

3.11 Greece

3.11.1 Debt re-organisation and debt relief

According to Ekpizo, a consumers' association, other than the three stage[126] bankruptcy process described in section 3.11.2, there are two processes consumers can use to address over-indebtedness:

1) Seek an "individual amicable settlement".
2) Debt counselling (governed by Law 3869/2010) by consumers' associations, Hellenic Consumers' Ombudsman and the Bank & Investment Ombudsman, with out of court settlement.

Ekpizo indicated that:

- Both processes relate to both secured and unsecured debt.
- Both the consumer and the lender can apply for the consumer to start the process of seeking an individual amicable settlement, whereas only the consumer can apply to start debt counselling.
- Neither process has any implications for the credit rating of the consumer (but, in practice the debtor cannot obtain new loans), the consumer's employment, or the consumer's civic rights.

According to the Hellenic Banking Association (HBA), in view of the current financial circumstances in Greece, since 2008 HBA members have concluded a significant number of voluntary agreements with their customers with the intension of making the repayment of outstanding loans considerably easier for the consumer. However, according to Ekpizo, consumers generally understand their choice of process, but neither process generally works for consumers, not because of customer intransigency, but rather because of the unrealistic proposals of lenders, which are felt to not cater sufficiently take into account the debtor's needs and capacity to pay, including other financial commitments, with some plans containing interest rates of 20-22% for credit cards and 12-16% for consumer loans.

[126] One out-of-court amicable agreement, an in-court amicable agreement, and then a judicially imposed solution.

3.11.2 Asset Liquidation and Debt Cancellation

Up to 2010, in Greece, there were four mechanisms for court-based corporate insolvency and personal bankruptcy:

- bankruptcy,
- special liquidation only for companies,
- temporary administration, management and administration by the creditors, and
- placing the company into receivership so that a compromise can be reached with its creditors.

Both individuals and companies can be declared bankrupt, but only companies can be placed in special liquidation, temporary administration by the creditors or receivership. We shall therefore only consider bankruptcy.

In 2010[127] a consumer debt adjustment law (Law 3869/3.8.2010) was put in place in response to credit expansion to Greek households which had become a material problem. Credit to households[128] had expanded from €24bn in 2001 to €117bn in 2008, and consumer credit rising from €2bn in 2003 to €35bn in 2008, with loan and credit card debt reaching 15.1% of GDP, the highest in the Eurozone. Mouzouraki also argues that '*misleading advertising, poor competition, lack of transparency, and all kind of profit driven and improvident credit expansion by unskilled and scrupulous personnel'.*

According HBA, it is "standard practise" for Greek credit institutions to offer cancellation of debts arising from credit agreements "for reasons of social solidarity on a case-by-case basis" (e.g. severe health issues or chronic unemployment), although whether such settlements succeed is questioned with consumer organisations voicing strong concerns that having '*examined the settlements, they are doomed to failure*.'

The law was shaped in light of the experience of other European countries, specifically the German laws, but also added some new ideas, particularly the exemption from asset liquidation of the debtor's home. In 2011 the Greek Government also drafted some further minor, technical amendments, although these were not passed into law.

In order to be declared bankrupt, the individual[129] must demonstrate he has become permanently insolvent for reasons other than fraud, although there is no minimum debt level to gain entrance to the system, or minimum amount of debt which must be repaid to earn a discharge. Under the existing legislation he also had to go through a three stage process (as noted by Ekpizo, a consumers' association, in their survey response):

- Out-of-court negotiation with debtors,
- Court-based settlement

[127] See Perakis (2010) Mouzouraki (2012a) and Mouzouraki (2012b)

[128] Mouzouraki (2012a)

[129] Both consumers and professionals can apply. Traders are exempted and can make use of corporate insolvency mechanisms . However, former traders who have closed their businesses at a time when they were not insolvent can also apply.

- Court-based 'debt adjustment' procedure.

Out-of-court mechanism

The law as originally passed in 2010 includes a preliminary stage before debtors can have access to the courts. This stage consists of negotiations with creditors in a fairly classic '*composition with creditors'* style arrangement. As usual the aim of two stages was to resolve as many cases as possible out of court, with court used as a lever to aid debtors encourage creditors to a speedy out-of-court resolution. As usual this optimal outcome failed to materialise.

As part of this compulsory step, creditors are informed of the overall financial position of the debtor, and given the opportunity of agreeing a payment plan without needing to go to court, saving time and expense. The law provides two opportunities to reach a compromise payment plan. The first occurs via the Consumer Ombudsman (free) or a consumer association (low cost) or an attorney at law. The quality of this service depends on the level of expertise in the organisation. This process requires unanimous approval of the proposed payment plan by creditors to proceed. Very few plans were agreed in this way.

Access to the courts and a discharge is not permitted unless the debtor can demonstrate to the court's satisfaction that he has gone through this process.

Court-based settlement

The first stage of the in-court process is to again attempt to find an amicable settlement. Within two months of filing a petition, one last attempt at a compromise solution had to be made. In his petition the debtor presents a payment plan, on which creditors have two months to offer comments. If they do not offer comments there is an automatic presumption of agreement. If comments are received, the debtor has fifteen days to reply. Creditors then have twenty days to comment on the revised plan. If creditors with claims exceeding 50% of the total sum of claims consent, the court cram-down on the other creditors.

Court-based 'debt adjustment' procedure.

If an amicable agreement cannot be reached then the judge decides on the settlement. The process is based around two court judgements, the first which establishes asset liquidation, for which a trustee may be appointed, and a payment plan[130], and a second which grants a discharge of debt if the payment plan has been adhered to.

It is worth noting that, unlike in many other countries, entering this process in Greece does not prohibit other enforcement proceedings automatically. The debtor must request the court to suspend other proceedings via an intermediate rapid procedure.

The law as originally proposed and implemented had the consumer submitting a petition to the court, which had to be heard within six months to be valid and continue.

[130] The payment plan can contain zero payments if the debtor is unemployed, or suffers from a severe health condition, or if his income falls below the exempt income level. However, in this case the court has to check every five months whether he has attained a level of income from which payments could be made.

Payment plans are set to consume all income over a set level to maintain a socially acceptable standard of living. Following this, as part of the second judgement, he received a discharge of the remaining debt not accounted for via the payment plan, however because of the mandatory payment plan this was couched in terms of 'debt adjustment' rather than consumer bankruptcy. Finally, the payment plan is set in advance, so if the debtor earns more he keeps it. The court also has discretion over the level of exempted income.[131]

As noted above, this process exempts the main residence of the debtor, in light of the evidence from other countries that debtors could be discouraged from seeking discharge in jurisdictions whereby their properties, as part of their estate, could be liquidated to pay their debts (this is confirmed by Ekpizo who noted in their survey response that not all consumer assets can be sold to repay lenders). The conditions on this exemption are that:

- only one property can be exempted,
- other properties must be liquidated,
- the value of the preserved property must be less that €300,000 and,
- the debtor is obliged to pay a payment plan over up to 20 years, on a mortgage-loan type interest rate, *up to* the value of 85% of the property.

One piece of relevant case law was identified by Ekpizo in their survey response, namely the 161/2012 Kavala County Court decision which cancelled all debts, with no obligation to pay up to 85% of the commercial value of the main residence.

As the present economic crisis in Greece has led to falling house prices, mortgages are often higher than the value of the property. This provision provides to the debtors the possibility not to abandon the mortgage, as in most cases the mortgage will be the vast majority of outstanding debts.

Decisions may be appealed, but the decision and any enforcement action are not halted by this, so the debtor can gain at least respite where necessary.

A failure to have declared all assets can be punished by the court, either through penal sanction or the annulment of the discharge. Honesty is required throughout the process, and any significant change in circumstances must be revealed. The unemployed must seek employment. Any default of more than four months in the payment plan results in cancellation of the process. Creditors are allowed to confirm the debtor's income through accessing tax records and the employer.

Ekpizo also reported that the process has no "official" implications for the credit rating of the consumer, although a debtor's data are preserved for 3 years after discharge, and that consumers generally understand their choice of process and it has no implications for their employment or civic rights. In addition, according to Ekpizo, the process does generally work for consumers, although consumer groups have recently lobbied for reform.

The result of this was that 12,000 extra judicial payment plans were submitted to creditors by October 2011[132], with 7,800 petitions subsequently submitted to courts in 2011, with anticipated quantities for 2012 being in the region of 12,000. This number is higher than anticipated, not least

[131] See Article 8(2)

[132] According to data from the General Secretariat for Consumer Issues, referred to by Mouzouraki (2012).

because there were temporary provisions governing the first year of operation which prevented auctions for claims of credit institutions against debtor's property of up to €200,000. This suggests there may be another step-change following December 2012 when this provision sunsets.

More than 3,000 judgements have been made by courts, with a 60% acceptance of the debtor's petition. Most rejections (which at around 40% appear substantial) are posited by Mouzouraki to be caused by 'bedding-in' issues, such as errors in the petition (e.g. traders applying to the wrong process), or lawyers and judges getting up to speed with the new arrangements. The key issue identified from the consumer's perspective is that the income exempted from the payment plan, on which the consumer has to live for the life of the plan, is felt to be low, with the judiciary taking a hard line about continuing to maximise the honouring of the debts. With minimum salaries falling from €720 to €520 this has also impacted. Ekpizo note in their survey response that the most common complaints from consumers about the process are "court fees and expenses, distant hearings, [and] severe court decisions with high instalments".

This process has been basically abortive, with Mouzouraki noting that only 15 cases were resolved in this way of the 12,500 recorded in consumer association data. Lenders fail to take this opportunity, often, according to Mouzouraki, by failing to engage with the debtor and his circumstances, with comments issued in a '*pre-formulated, standardised way, with no reference to the data of the specific debtor….either mak[ing] reference to their general policy or… ask[ing] for documents regarding the personal and financial situation of the debtor.'* It is therefore no surprise that the 2011 amendments to the Greek law proposed abolishing the compulsory nature of the out-of-court procedures, leaving these to be entirely optional to the debtor.

Proposed amendments

According to Ekpizo, draft amendments were to be introduced to Greek parliament before the elections of 6 May 2012, but were withdrawn. The amendments included (among other things): a) the increase of the payment period to 5 years, which would count from the notification of the application to lenders; b) the increase of the term of the mortgage payment to 35 years; and c) the out of court procedure would become optional.

The main reasons for the introduction of this legislation (according to Ekpizo) were, respectively: a) the very distant day of trial (up to 5 years in some courts); b) high instalments for mortgage payments over a 20 year term; and c) almost none of the out of court procedures were successful.

The impact of these amendments would have been so that when a case proceeded to the first hearing at the Court of Peace in the district of the debtor's relevance[133], a judgement would be made, and following the first judgement, providing that the debtor serviced their debts for a period of 48 months, to a schedule defined by the court, based on their income and the amount of the debt, the debtor could earn a discharge of a significant part of their debts. Debts to any institution or individual could be discharged, but those owed to Government through unpaid taxes, fees, and state insurance premiums would not have been.

The major difficulty to be addressed was that payment plans were activated as part of the second judgement, but the courts were unable to handle the weight of submission, with some local courts

[133] No judicial costs are charged to the debtor, whatever the result of the proceedings, although there is no provision for free legal advice, or free debt advice, therefore the costs can be considerable, including court administration costs.

scheduling first hearings through to 2015, with examples out to 2020 reported by a consumer organisation, up to eight years after submission. Therefore in 2012, the Greek Government proposed that the payment plan period of 48 months would run from the date of petition, requiring debtors to propose their own payment plan up to the date of the first hearing.

The amendment also proposed that, in instances where the hearing, when finally held, required a higher level of contribution than the consumer had inflicted on himself, the difference would be made up within one year of the conclusion of the payment plan, on a very low interest rate, extending the discharge period under these conditions to five years. If a court hearing is not arranged within five years, then the consumer wins an automatic discharge as long as they have honoured the payment plan they put in place. However, in all circumstances, Greek law is clear that discharge can only be received once in a lifetime, and discharge also exempts taxes and fees owed to federal and local governments[134].

The draft amendments also allowed the exceptional application of a three year discharge for consumers whom the court note to suffer from personal and financial circumstances which prevent him making any further payments in the future.

The draft amendments proposed in 2012 also proposed extending the term of this payment plan to 35 years.

3.12 Hungary

Whilst Hungary did not, in 2010, have personal bankruptcy legislation, putting it in a similar position to Spain and Romania, there have been active discussions about the introduction of such legislation. A proposal was submitted in February 2009 which suggested procedures individuals could use to try and settle issues of over-indebtedness with creditors. The proposal contained two mechanisms. According to Viimsalu (2010), these were:

- *A regulated process that aims to establish a compromise between the debtor and his creditors – in such a procedure, the supervision of the debtor's financial decisions is secured; and*
- *A procedure (also aimed at securing a compromise between the debtor and the creditor) initiated by the request of the debtor or creditor but that does not assume an agreement with the other party.*

3.13 Ireland

3.13.1 Debt re-organisation

As with most countries, Ireland has a number of voluntary debt re-organisation processes, such as loan consolidation, down-sizing (releasing equity in property, or merely to reduce the amount borrowed) or forbearance (interest holidays, loan duration extensions, moving to interest only mortgages).

[134] Kilborn (2010b)

Free debt counselling is provided by the state-funded Money Advice and Budgeting Service (MABS) who negotiate affordable repayments and in some cases partial write-downs or write offs with creditors. According to Free Legal Advice Centres (FLAC), despite the voluntary nature of the negotiations, MABS advisors do manage to achieve many voluntary repayment arrangements and the process does generally work for consumers, although it has "become more and more difficult". On the other hand, the Central Bank of Ireland (CBoI) reported that the process does not generally work for consumers or lenders. FLAC also notes that the voluntary nature of the negotiations leaves it open to any individual creditor to sue if it is not happy with the pro rata payment offer being made.

Views are divided over whether consumers generally understand the debt counselling process, with MABS National Development Limited and the Financial Services Ombudsman Bureau (FSOB) reporting that consumers do understand the process, and FLAC and the CBoI reporting that they do not.

According to FLAC, being in negotiations to repay debt in affordable instalments may adversely affect a consumer's credit rating, although the CBoI reported that it will only be shown on the credit register in so far as debt payments are restructured. In theory there should be no implications for the consumer's employment, although both FLAC and the CBoI reported that in practice in some professions – e.g. finance – the existence of unmanageable debt may have an impact on continuing employment (although this is of course subject to the protection of employment laws[135]).In the summer of 2011 the Government's Economic Management Council tasked an Inter-Departmental Group (IDG) to consider further action to '*alleviate the increasing problem of mortgage arrears and to report back to it by the end of September*'. This report[136] made several recommendations of which the most important, in the context of this study, was that:

'...existing forbearance arrangements will not always be appropriate and the Group is looking to the industry to extend the range of alternative solutions. In this regard, the Group recommends that specific proposals be developed by the mortgage lenders, including trade-down mortgages, split mortgages and sale by agreement. Importantly it will not be the case that the distressed mortgage holder will be entitled to a particular solution and all solutions carry consequences'.

The study noted in relation to mortgage debts that there are three fundamental issues:

- '*Affordability: Changes in people's ability to meet their monthly mortgage obligation due to changes in things such as employment, salaries, tax, is the key driver of mortgage arrears.*
- *Negative Equity: Negative equity has not of itself given rise to mortgage arrears. However it does influence the scale of loss that the mortgage holder and the bank face and, as a result, the potential solution.*
- *Future prospects: While the scale of the problem can be estimated for each mortgagee now, the bigger difficulty is in determining how their income, interest costs, [and] house value will fare in the future. Age, and how many future years of earning capacity an individual has, is also a very important consideration'.*

[135] If an individual is an undischarged bankrupt there is a prohibition on acting in certain professions e.g. solicitor

[136] Available at http://www.finance.gov.ie/viewdoc.asp?fn=/documents/Publications/Reports/2011/mortgagearr2.pdf

The key new proposals of this report are addressed in section 4.12.2. The following outlines the existing mechanism identified.

Voluntary forbearance continues to offer useful solutions where, in the long-term the creditor can see some potential to ultimately be paid. As the IDG correctly implicitly note, situations where it is unlikely the debtor has enough future years of earning capacity, or where negative equity is of such a size that were the debtor to defer the resultant unpaid debt post-repossession would be substantial then forbearance looks dangerously like a one-way bet with no benefits.

The **Deferred Interest Scheme** (DIS) was recently introduced as an advance form of 'forbearance', and for our purposes counts as a form of debt re-organisation. Under the DIS interest payments are 'deferred' or delayed, although they are still in existence. The IDG understood that '*lenders representing appropriately 70% of the mortgage market have indicated that they will offer a DIS, [but as] the scheme was only recently introduced it is too early to assess its effectiveness*'.

3.13.2 Debt relief

In Ireland, prior to a bankruptcy case being brought before the case, the debtor can submit a '**petition for arrangement'** to the Court for protection from bankruptcy proceedings so that he can put an offer of composition to his creditors. If the offer is accepted by three-fifths in number and value of his creditors and approved by the Court then it is binding on all his creditors. If the offer is not accepted or not approved by the Court then the Court itself may adjudicate the debtor bankrupt.

Ireland has also introduced a direct form of debt relief for certain mortgage holders in difficulty. The **mortgage interest supplement** (MIS) can be applied for by debtors, and effectively subsidises debtors by contributing to mortgage interest payments. The latest estimates[137] are that over 18,700 households are receiving payments, which raises questions about how long support should be available for, whether long-term MIS is just a bank subsidy, and whether it in effects is a 'welfare trap' as those moving into employment become ineligible.

Finally the IDG proposed '**sale by agreement'** which is essentially a voluntary form of some degree of *datio in solutum* where, in a position where it is in the interest of both the debtor and creditor to sell the property and reach a '*reasonable and appropriate agreement regarding the shortfall taking account of the borrower's circumstance, [where] such agreement should be more economically advantageous than formal bankruptcy for all parties*'.

3.13.3 Asset Liquidation and Debt Cancellation

Bankruptcy is a law for the benefit and the relief of creditors and their debtors, in cases in which the latter are unable or unwilling to pay their debts. Bankruptcy law applies only to debtors who are individuals. It is contained in the **Bankruptcy Act, 1988**[138]. To be adjudicated bankrupt the debtor must have committed an "act of bankruptcy"[139], of which the most commonly cited are:

[137] Referenced by the Inter-Departmental Working Group.

[138] Some reforms were introduced in Part 7 of the Civil Law (Miscellaneous Provisions) Act 2011. Further reforms are currently being introduced.

[139] Defined in Section 7 subsection (1) of the 1988 Act.

- "if execution against him has been levied by the seizure of his goods under an order of any court or if a return of no goods has been made by the sheriff or county registrar whether by endorsement on the order or otherwise"[140]
- a 'bankruptcy summons'[141] has been issued which demands payment of the sum due within 14 days in default of which the debtor will have committed an act of Bankruptcy.

Formal Insolvency Proceedings proceed on receipt of a Petition[142] grounded on Affidavit[143], from either the debtor or a creditor, if the following conditions[144] are met:

- Commission of an Act of Bankruptcy as set out in Section 7 (1) of the Bankruptcy Act, 1988
- The Debt must be a liquidated amount and not less that €1,900
- There are conditions as to domicile/residence within the State (Section 11 of the Act)
- The Petition must be served personally on the debtor.

If the debtor is adjudicated Bankrupt notice of Adjudication must be published in the *Iris Ofigiuil* (The Official Gazette), A national daily newspaper and, where applicable, a local daily newspaper.

When someone is adjudicated bankrupt their property is transferred[145] to the Official Assignee in bankruptcy[146]. The Official Assignee deals, subject to the approval of the Court (Section 61 (7)), with all practical aspects of the day-to-day running of the bankruptcy - such as disposing of the bankrupt's assets and certifying to the Court who the creditors are. Among other duties, the debtor is required[147] to disclose all property[148] to the court; to deliver up to the Official Assignee all property in his/her custody or control, including all books and papers relating to his/her estate. According to FLAC, if the bankrupt fails to co-operate their property vests in the Office of the Official Assignee, and there are also certain criminal offences prescribed under the legislation for non-cooperation.

Claims are dealt with in order, with payment made pro-rata within each category:

- The costs of the bankruptcy rank in priority to all claims[149].

[140] Section 7(1) (f).

[141] Section 7 (1) (g).

[142] Which must issue within three months of the commission of the act of Bankruptcy.

[143] The Petition, Affidavit and all other forms required in Bankruptcy proceedings can be found in appendix O of the Rules of the Superior Courts Statutory Instrument no. 79 of 1989.

[144] Section 16 of the Act sets out a procedure whereby a Bankrupt may "show cause" against the validity of the Adjudication Order. Showing cause basically consists of asserting to the satisfaction of the Court that one or more of the required conditions above have not been met. If a Bankrupt succeeds in showing cause then the Court is required to annul the Bankruptcy. If the Bankrupt fails in an application to show cause there is a right of appeal to the Supreme Court

[145] Section 44 (1) of the Act

[146] The powers, duties and functions of the Official Assignee are set out in part III of the Bankruptcy Act, 1988.

[147] Section 123 of the Bankruptcy Act, 1988 sets out 16 separate offences commissable by a Bankrupt all of which fall under the broad heading of failure to co-operate with the Court in the administration of the Bankrupt's estate.

[148] ""Property" includes money, goods, things in action, land and every description of property, whether real or personal and whether situate in the State or elsewhere; also obligations, easements, and every description of estate, interest, and profit, present or future, vested or contingent, arising out of or incident to property as above defined" - Section 3 of the Bankruptcy Act, 1988.

[149] Section 80 of the Act.

- Preferential Claims including rates, taxes and social insurance contributions[150].
- Non Preferential Claims.

An undischarged bankrupt suffers certain statutory disabilities such as being prohibited from being a Company Director or in any way concerned with the management of a company[151]; being prohibited from being a member of Parliament or of a local authority.

According to FLAC, an adjudication of bankruptcy prevents the bankrupt from accessing any more than €650 in credit without disclosing the fact of bankruptcy. Any person adjudicated bankrupt is listed on a register and, even when discharged, the register continues to disclose the fact of the person's former state of bankruptcy.

Implications for employment (FLAC): If an individual is an undischarged bankrupt there is a prohibition on acting in certain professions, such as a solicitor. However, the Bankruptcy legislation has been very rarely used and is even rarer for people working under contracts of employment.

Implications for civic rights (FLAC): In practice a registered bankrupt should inform the Official Assignee if s/he intends to travel abroad. The Official Assignee on behalf of the High Court may appropriate salary or even pension for the benefit of creditors.

To be discharged from Bankruptcy the debtor must meet one of the following conditions:

- (i) Discharge after payment of debts in full: This is where the bankrupt's creditors are paid in full. If the High Court so allows, interest may also be payable. Normally, interest is only paid where surplus funds are available[152].
- (ii) Discharge with the creditors' consent: This is where all of the bankrupt's unsecured creditors consent to the discharge[153].
- (iii) Discharge after making composition with the creditors: This is where unsecured creditors agree to accept payment of a certain percentage of their debt in settlement of the full amount. This must be supported by at least sixty per cent in number and value of those creditors who vote at a sitting of the High Court for this to be accepted. The bankrupt must provide the Official Assignee with sufficient funds to make this settlement and pay his/her unsecured creditors. This is called an Offer of Composition.
- (iv) Discharge after paying fifty cent in the Euro: This is where all of the bankrupt's property has been fully sold or disposed of and his/her creditors have received fifty cent in the Euro on their debts[154].
- (v) Discharge after five years: This is where the bankruptcy has lasted for five years and all of the bankrupt's property has been fully sold or disposed of. The court must be satisfied that the bankrupt has disclosed any property acquired since his/her bankruptcy and that it would be reasonable and proper to discharge the debtor from bankruptcy[155].

[150] Section 81 of the Act
[151] Companies Act, 1963 Section 183
[152] Section 85 (3)(a)(i)
[153] Section 85 (3) (a) (ii)
[154] Section 85 (4) (a)
[155] Section 85 (4) (b)

- (vi) Automatic discharge after twelve years: Discharge is automatic on the twelfth anniversary of the order of adjudication. Unrealised assets will also revest in debtor on that anniversary or on such date thereafter when all costs, court fees, expenses and preferential debts of bankruptcy are paid[156].

Part 7 of the Civil Law (Miscellaneous Provisions) Act 2011 made substantive amendments to the Bankruptcy Act 1988 including:

- Bankruptcy will be automatically discharged after 12 years (it is estimated that this has terminated more than 300 legacy bankruptcies);
- The minimum period before a bankrupt can seek a discharge from bankruptcy, where the debts have not been paid in full, is decreased from 12 years to 5 years;
- It provides for a petition be presented where a person ordinarily resided in the state or carried on business in the state in the period of three years prior to the date of its presentation (rather than the current period of one year);
- It allows the Revenue Commissioners to furnish information to the Official Assignee or a trustee in bankruptcy; and
- It increases the period of time before adjudication in which dispositions may be deemed fraudulent or may be set aside to one year.

However, Irish bankruptcy law continued to be the subject of sustained criticism both regarding the complexity of the process and the minimum length of time (12 years, until amended in 2011) taken to purge bankruptcy where all of the debts of the bankrupt have not been discharged.

Both the CBoI and FLAC reported that consumers do not understand the bankruptcy process, and the process does not generally work for consumers (neither does it work for lenders, according to the CBoI). FLAC argue that Ireland's bankruptcy legislation "is seldom used in consumer debt cases because of its cost, ineffectiveness and outdated procedures". In response to our survey FLAC wrote that the existing bankruptcy legislation:

> *"...is an entirely inappropriate mechanism to deal with the chronic over-indebtedness of so many consumers and small business people in Ireland. Proper debt settlement legislation has been desperately needed for some time. It is perhaps ironic that the imperative to introduce this legislation stems from a commitment given to the troika in return for the financial bailout, rather than any domestic initiative".*

Following the bursting of the Irish property bubble, commentators have noted the appearance of bankruptcy tourism - Irish debtors move to other jurisdictions to use more lenient bankruptcy laws. The most prominent cases of alleged 'bankruptcy tourism' are those of David Drumm, former chief executive of Anglo Irish Bank, and property developer John Fleming. Fleming, who had personally guaranteed much of the €1 billion debt of Tivway and associated companies in Ireland, was discharged from bankruptcy in the UK on 10 November 2011, the first anniversary of the date on which he was declared bankrupt there. Former government minister Ivan Yates, who described the Irish bankruptcy regime as '*purgatory*', publically announced that he was contemplating moving to the UK to use its bankruptcy regime.

[156] Section 85 (4) (c)

Unsurprisingly, given the criticism it receives, consumer groups have recently lobbied for reform of the bankruptcy law.

On 24 January 2012, therefore, the Department of Justice and Equality published the Draft General Scheme of a new personal insolvency bill[157]. The proposed bill would, among other things, reduce the minimum period of bankruptcy to discharge to 3 years and introduce three different non-judicial mechanisms to deal with debt. The bill was published on 29 June 2012 and is due to be implemented by the end of 2012 (according to the survey response from MABS National Development Limited). The three routes are:

- A Debt Relief Certificate to allow for the full write-off of qualifying unsecured debt up to €20,000, after a three year supervision period – which would be an alternative form of **debt cancellation**;
- a Debt Settlement Arrangement (DSA) for the agreed settlement of unsecured debt of €20,001 and over – a **debt relief** mechanism;
- a Personal Insolvency Arrangement (PIA) for the agreed settlement of secured debt of between €20,001 and £3m and unlimited unsecured debt – a **debt relief** mechanism.

Both the DSA and the PIA processes rely on agreement by creditors, which experience in other countries strongly suggests will not be forthcoming, unless the offer is so generous that it is almost certain to fail. France, for example changed its system precisely because debtors were being forced into unworkable plans whilst in the UK IVAs fail in around a third of cases, and in the US, the comparable Chapter 13 provisions to the PIA fail in around two-thirds of cases. Without a strong 'threat' of quick and unconditional discharge, many creditors have exhibited in the past their willingness to 'kick the can down the road'[158] and delay a conclusion, and even in the case of quick and unconditional discharge being available, many creditors prefer to force the debtor into court to 'punish' them. As such, it is to be anticipated that Ireland may be forced to re-legislate again relatively soon, if this law in this form is past, as it breaches several of the best practices identified below.

3.14 Italy

3.14.1 Debt re-organisation and debt relief

In their survey response *Conciliatore Bancario Finanziario* (CBF), a consumer complaints institution, named two processes consumers can use to address over-indebtedness:

- The law for the repression of usury (Act 7 March 1996, n.108)[159] introduced a cap on interest rates on lending beyond which the same would be deemed usurious. Any clause setting usurious rates is void and no interests are due in the presence of usurious rates (and the sums already paid must be paid back by the lender)[160]. The penalties for breaking the

[157] See http://www.justice.ie/en/JELR/Pages/PR12000198

[158] Kilborn (2012).

[159] Available, in Italian at http://www.bancaditalia.it/vigilanza/contrasto_usura/Normativa/L108-1996

[160] A fund for the prevention of usury especially dedicated to households was also established (not explicitly mentioned by the stakeholder). In order to access the fund consumers need to meet the following criteria: they need to be in a state of over-indebtedness; the various debts must have been contracted for serious reasons and for non-commercial purposes; the total amount of the debt needs not to exceed €26,000 (excluding the house mortgage); consumer need to be able to repay the loan given by the fund.

law originally included six years in jail and fines of up to 30m lire. Interest rates were deemed to be usurious when they are more than 50% higher than the average over the previous three months, although this caused problems for fixed rate mortgages set in the early 1990s as interest rates fell in the early 2000s[161]. To address this, in terms of assessing whether the rate on a loan is usurious or not, it is now necessary to refer to the time when the interest is promised or agreed, regardless of the time of payment, as defined by Law 28 February 2001, n.21[162] The CBF reported that consumers do generally understand their choice of this process, and it does work for them. However, an implication of this process is that the consumer has no access to further bank credit (the CBF stated that there are no impacts on the consumer's employment or civic rights), and there are concerns that this law failed to impact on 'loan-sharks' effectively. Law Decree No.70, 13th May 2011, to encourage '*the development and growth of the economy*'[163] amended the usury legislation to change the method for calculating the interest rate thresholds, increasing the thresholds before an interest rate is judged to be usurious for mortgages and to a degree other loans, although it was argued[164] that this new calculation still failed to take into account consumer's risk profiles or the nature of the financing. The change was implemented to protect lenders and facilitate loans in the face of low interest rates which were anticipated to change upwards, which may be preventing lending to consumers.

- Debt counselling associations, which consumers do generally understand, and do work for consumers.

3.14.2 Asset Liquidation and Debt Cancellation

The Italian Government initiated a process of change in its *corporate* insolvency arrangements in 2005 with the Act of May 14, 2005, and the Government decrees of January 9, 2006 and September 12, 2007. The legislation has been in complete force since January 1, 2008[165]. Before this legislation dated back to 1942[166], and had been identified as breaching European legislation[167]. Whilst the 2005, 2006, and 2007 legislation contained a number of substantive reforms, they still did not contain the creation of a mechanism for the cancellation of consumer debt. *Fallimento* continued to be a corporate insolvency procedure restricted to commercial enterprises, exempting farmers[168].

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[161] On November 18th 2000, the country's highest court of appeal ruled that the fixed rate of interest attached to a bank mortgage contracted in 1993 was usurious. When, in September 2000, the Treasury Ministry announced average rates for house mortgages of 6.6%, the usury rate for such loans was automatically set at 9.9%, a rate far below the going rates in the early 1990s, and hence below the rates on fixed-rate mortgages entered into (legally) at that time. The appeal court's decision upset the banks, with the ABI, the Italian banking association, complains of sloppy legislation and a perverse legal system. One consumers' group reckoned at the time that around 1.5m mortgages are illegal. See http://www.economist.com/node/432022.

[162] Available, in Italian at http://www.bancaditalia.it/vigilanza/contrasto_usura/Normativa/l-2001-24.pdf

[163] Clifford Chance (2011)

[164] Clifford Chance (2011)

[165] Other amendments came into force in 2012 through the Government Act 22 giugno 2012, n.83, but these do not refer to natural persons bankruptcy.

[166] Albeit with the introduction of 'extraordinary administration in 1979 in the Prodi Act, which was itself reformed in 1999.

[167] Including Article 87 of the European Community Treaty on state aid.

[168] To quote Justice Panzani – *'Among commercial law experts nobody understands the reason for this exemption. In Italy there has always been a policy of farmer sustenance, and Parliament did not change this traditional exemption.'* (Panzani 2009 – p317).

Therefore, in Italy, until 2012 corporate entities and private persons who were commercial entrepreneurs but not corporate entities could become bankrupt through the corporate insolvency process.

In their survey responses, a sectoral expert at the the Tribunale di Torino (TdT), and the Bank of Italy named a significant reform which increased the availability of debt cancellation to a wider pool of individuals. The Law 27 January 2012, n.3 'Regulation on usury and extortion, as well as on the composition of over-indebtedness crises'[169] sets out new rules for the over-indebtedness crisis of small and medium enterprises **but does not cover consumer debts**. Essentially private persons who are not commercial entrepreneurs can now use this mechanism, which required the approval of at least 70% of the creditors, **and any lender that does not agree to the plan would have to be fully reimbursed**,. This process relates to both secured and unsecured debts and **writes off some of the debt (potentially up to 100% of the debt although the law doesn't state a maximum percentage**). Finally, the Law 27 January 2012, n.3 has been amended by article 18 of law decree 18 October 2012 n. 179. This now determines that only 60% of the creditors need to give approval, reducing this from 70%.

In March 2012 a government bill proposed to extend the effects of the law to consumer. This bill has not yet been passed into law yet, so the following describes the system which could be implemented.

Under the proposal the process requires the approval of at least 70% of the creditors, according to the Central Bank. The respondent at the Bank of Italy also pointed out that there is no fixed length of the procedure as it requires the separate and consequential agreement of the lenders and the Court. The respondent said that this process would take a few months but less than a year.

The process would be started by the consumer, who would goes through a public sector intermediary. It would involve negotiation with the lenders regarding the terms of the loan. It prevents lenders from seizing the consumer's assets (they are not at risk of losing their home), and there would be automatic protection for the consumer from other actions by lenders during the course of the process. However, the respondent from the Bank of Italy pointed out **that any lender that does not agree to the plan would have to be fully reimbursed and that the process doesn't have any impact on the right of creditors regarding any jointly liable debtor.**

In order to leave the process the consumer would need to fulfil the agreement reached with creditors and approved by a judge. According to the TdT, if the consumer broke the arrangement the agreement could be revoked and they would have to completely pay all their creditors.

It should be noted that the debtor "must not be an entrepreneur subject to the bankruptcy proceeding and must not have asked to be admitted to the over-indebtedness proceeding in the last three years". There is no relevant case law at present.

According to the TdT, if consumers cannot cancel their debts any creditor may ask for foreclosure and generally can ask the Court to seize debtor's goods, except the few that cannot be seized as part of the home's furniture. These goods can then be sold through an auction. The "insolvency collective

[169] Legge 27 gennaio 2012 , n. 3 *Disposizioni in materia di usura e di estorsione, nonché di composizione delle crisi da sovraindebitamento.*

procedure" is reserved for entrepreneurs. However, the TdT also reported that lenders regularly voluntarily write-off unpaid debts (except mortgage debt). The TdT also wrote that:

> *"...the recent Act (2012) on the natural persons' over-indebtedness provides only a mechanism enforced by the Court to approve an agreement between the debtor, who must be a natural person and not an entrepreneur, and his creditors. The agreement is binding when approved by 70% of unsecured creditors. All the secured creditors must be paid completely. The creditors who don't participate to the agreement must be paid completely also if the law permits a short delay in the payment. During the proceeding, the debtor may ask for the stay, binding also for creditors who don't participate to the agreement.*
>
> *"The Act provides also that public institutions may create special bodies for crisis resolution. These entities may act on debtor's behalf helping him to reach the agreement with creditors, receiving the creditors' vote and informing the Court of the vote result. At the end of the proceeding such entities survey the agreement execution.*
>
> *"The Act, as approved by the Parliament, doesn't provide a liquidation proceeding for the cases, absolutely frequent, when it's not possible to reach an agreement with creditors, and discharge at the end of liquidation. But the Government is oriented to amend the law, providing such new rules and also reducing the percentage of favourable votes asked for the debtor's petition approval, however it may be very difficult, as affirmed publicly by senators, for the Government's amendment to become law before the end of the legislature in 2013.*
>
> *At the moment the scholars' majority think that the on force discipline will not have real influence on the natural person over-indebtedness. The same people think that the law, as amended, will work.*
>
> *"One question more is if private legal entities, i.e. consumers' associations, must be authorized to act as crisis resolution bodies. The mediation Act, recently approved by Parliament, provides a double regime with private and public institutions who can deal with the mediation and arbitration proceeding. Probably part of these private organizations could operate also in the indebtedness field".*

3.15 Netherlands

3.15.1 Introduction

The Netherlands has both statutory and voluntary debt solutions[170]. There are two voluntary mechanisms and three statutory mechanisms.

The voluntary mechanisms are:

- Debt rescheduling (*schuldsanering*) – this is a debt cancellation solution.
- Debt conciliation (*schuldbemiddeling*) – this is a debt cancellation solution.

[170] See Kilborn (2006b), Von Bergh, Lalta & Vriesendorp (2009), Vandone (2009,Jungmann & Huls (2009), and Kilborn (2010b)

The statutory mechanisms are:

- Bankruptcy – this is a debt re-organisation solution.
- Moratorium – this temporary solution only applies to businesses and is excluded, although a 'light' version for natural persons under consideration for the future which would bring this into force, although information is not available on when this is likely to proceed.
- Statutory debt settlement – this is a debt cancellation solution. From 1999 to 2005, the number of debtors admitted to this process increased from 6,528 to 17,780[171].

There are two main pieces of legislation which govern the statutory mechanisms; the 1896 Dutch Bankruptcy Act governs two of the processes: bankruptcy and moratorium. This act applies to entrepreneurs and private individuals, although only entrepreneurs have access to a full debt moratorium. There is a 'light' version for private individuals which differ in how the main moratorium model operates. This is laid out in the 1998 '*Law on Debt Rehabilitation of Natural Persons*'[172] *(WSNP)*. Statutory debt settlement is a relatively new process, brought in from 1998, in the WSNP. This introduced a new debt cancellation mechanism, but only for natural persons.

3.15.2 Debt re-organisation

Bankruptcy

In an unusual twist, the Netherlands is the only country we can identify which has one or more debt cancellation processes and which uses the terms bankruptcy, but *does not* use bankruptcy to describe a debt cancellation process. The bankruptcy process (*faillissement*), whilst it was available to those who have ceased to make payments[173], has the sole objective of liquidating assets to distribute among the creditors, not cancelling any outstanding debt. After completion of a bankruptcy the claims not paid survive and can therefore become collectable again for creditors[174], after the final distribution of the sum of liquidated assets. It is therefore a pure asset liquidation process, which in the typology we have established means it is an (extreme) debt re-organisation process.

Bankruptcy is open to both natural persons and corporate bodies. Bankruptcy is available to those who have ceased to make payments[175] and has the sole objective of liquidating assets to distribute among the creditors, but does not imply the cancellation of any outstanding debt. As such, it is a form of debt re-organisation.

The Bankruptcy Act does not require any (judicial or extra-judicial) preparatory proceedings. The Court does however require a well-founded petition. Bankruptcy can be applied for by the debtor himself (own declaration) or by a creditor, or by the Public Ministry for reasons in the public interest.

[171] Jungmann and Huls (2009).

[172] *Wet schuldsanering natuurlijke personen (WSNP).*

[173] According to Section 1 of the Bankruptcy Act (BA). This means that there is at least a due debt and a claim for support (Section 6 BA).

[174] Section 195 BA.

[175] According to Section 1 of the Bankruptcy Act (BA). This means that there is at least a due debt and a claim for support (Section 6 BA).

The Clerk to the Court should publish in the State Gazette a number of key items of data from the pronouncement of the Court including the name and full address of the debtor, the name of the acting supervisory judge and the appointed receiver.

The Court takes the most consequential decisions in bankruptcy, such as admission or refusal of the proceedings and granting discharge in debt restructuring, or a levy from the bankruptcy. The Court may also dismiss the receiver or administrator if he neglects his legal duties.

An acting supervisory judge is appointed from the Court for the numerous decisions of management and supervision of the estate during the term of the proceedings. This individual supervises the receiver or administrator, grants permission for some transactions and decides on possible complaints from interested parties.

As soon as the Court has opened bankruptcy proceedings, it appoints both a supervisory judge and an administrator (in bankruptcy) or receiver (in moratorium or debt restructuring). The tasks of the administrator and receiver are described as follows in the Act: supervision of compliance by the debtor with the obligations arising from the law, and managing and liquidating the estate. These tasks apply regardless of whether the debtor is a private person or an enterprise.

A bankruptcy is sometimes declared on the debtor's own initiative, but this is generally done on the initiative of a creditor. If this is rejected the creditor has the right of higher appeal if it is admitted that the debtor has a right of higher appeal. On behalf of the creditors the administrator can nullify certain legal transactions conducted by the debtor up to one year before the bankruptcy that have resulted in creditor disadvantage, for example a sale of valuable property well below market value. The verification meeting offers creditors the chance to have their say. Creditors may submit a complaint about the administrator to the supervisory judge (Section 69 BA).

The estate incorporates all of the debtor's property at the time of the judgement that admits him to the arrangement, as well as all property that he obtains during the bankruptcy[176]. The possessions that are not excessive remain outside of the estate – together with certain other goods[177]. The occurrence of bankruptcy means that the legal position of everything involved in the estate becomes fixed. However, in bankruptcy a mortgage holder can conduct himself as if there was no bankruptcy[178].

Due to the judgement in which the debtor is admitted to the bankruptcy or debt restructuring arrangement he lawfully loses authority to have his goods at his disposal: from that time onward these goods belong to the estate that is managed by the administrator or receiver. He also loses the authority to conduct and to allow actual transactions in respect of these goods. He is obliged to surrender all goods that belong to the estate on the request of the administrator or receiver. The debtor must obtain permission from his administrator or receiver for some legal transactions, such as entry into a credit transaction.

[176] Goods delivered under ownership proviso do not fall into the state of bankruptcy, see Sections 20 and 295 BA, but may well be affected by any judicial order in which a cooling off period is proclaimed. The supervisory judge in bankruptcy may at the request of each interested party specify by order a cooling off period that applies to each third party competence to recover goods belonging to the estate.

[177] Described in Section 21 and in paragraph 4 of Section 295 BA.

[178] See Sections 57, 58 and 59 BA.

No obligation exists for the creditors to submit all claims to the receiver or administrator, however anyone wishing to share in the income, which is paid out via what is referred to as a distribution list to known creditors, should submit his claim.

The bankruptcy proceedings focus on liquidation of the available equity. In bankruptcy the main rule is public sale, unless the supervisory judge allows private sale[179]. The administrator is authorised to progress to liquidation[180].

In bankruptcy the supervisory judge may specify at the request of each interested party that a third party recovery competence may not be exercised for a maximum of one month, to be extended by a maximum of one month: the so-called cooling-off period. The administrator can form a picture of the estate. This cooling off order can therefore also involve the mortgage holder or pledge holder, or the individual with an ownership proviso.

Registration of all current insolvency proceedings takes place in the Central Insolvency Register (CIR) at the Court for Jurisprudence in The Hague[181]. ; A verification meeting is not always held in bankruptcy proceedings. The Court judges whether following such proceedings is worthwhile in view of the situation of the estate – generally at the request of the administrator or receiver – or whether simplified completion can be followed. If a verification meeting is planned, the administrator or receiver communicates this to all known creditors. Creditors may submit their claims along with the associated evidence to him. The verification of all claims progresses as is the case in bankruptcy in accordance with Sections 110 to and including 116 BA. Creditors with a recognised claim are placed on a list of recognised claims.

Under bankruptcy preferential creditors are ranked first and receive twice the value in the euro from liquidated assets as competing creditors[182].

If before the bankruptcy the debtor conducted voluntary legal transactions that he knew or should have known would disadvantage the creditors, the administrator or receiver can call on the *'actio pauliana'*, and can reverse these transactions to benefit the estate[183].

The law does not specify the term of a bankruptcy. Most bankruptcies are completed within eighteen months, generally with a lack of revenue and based on the simplified proceedings without verification. Complicated major bankruptcies often take longer. The supervisory judge monitors the progress made by the administrator, so that completion remains within the reasonable period required by the EVRM.

As a rule the administrator only distributes once to the creditors, this being at the end of the proceedings. The bankruptcy formally end when the final distribution list becomes binding. The administrator informs creditors of this. Creditors may object to (oppose) this list.

[179] Section 176 BA.

[180] Section 68 BA.

[181] This may be consulted via www.rechtspraak.nl/registers.

[182] in accordance with Section 349 paragraph 2 BA.

[183] Sections 42 and 43 BA.

Simplified proceedings exist in debt restructuring. These are proceedings without a verification meeting. In bankruptcy it is required that there is insufficient income to satisfy the competing claims.

A bankruptcy ends by means of an agreement, or by means of a simplified completion (removal in the case of a lack of income) or by means of a distribution to the creditors following verification of their claims.

An entrepreneur who has significantly contributed to the bankruptcy through apparently improper administration of the enterprise may be held liable by the administrator on the grounds of the Civil Code. The Penal Law Code contains provisions concerning threatened bank breaking. No specific sanctions exist for employers/non-corporate bodies if they do not adhere to their debt restructuring obligations.

According to a Dutch financial information organisation, the process itself does not have any direct effect on the debtor's employment status. The respondent does note, however, that an organisation named BKR (*Bureau Kredietregistratie*) collects information on whether a consumer already has a credit agreement with other organisations and whether the client has paid his obligations in a timely manner. It calculates a score based on this information and categorises consumers by the score. Any consumer in one of the debt solution processes will have a negative BKR but this disappears five years after the consumer has paid off the debt. According to the financial information organisation, a negative BKR score is likely to lead a lender to refuse a loan to the consumer.

The financial information organisation also estimated that 2,354 consumers used the bankruptcy process in 2009-10 based on figures from the Dutch Bureau for Statistics. Although the financial information organisation agreed that consumers who use the bankruptcy process generally understand their choice of process, they said that this process did not generally work for consumers, particularly because the process did not allow the consumer to get out of debt and because it allowed the lenders to keep asking for repayment.

3.15.3 Debt relief

The full **moratorium** proceedings are reserved for entrepreneurs, and are not granted to a natural person who does not practice an independent profession or business. Under moratorium proceedings the debtor must foresee that he will not be able to continue paying his due debts[184]. The moratorium proceedings have a restructuring objective rather than liquidation in order to prevent the latter. Moratorium is not in scope of this report.

Debt restructuring was introduced from 1998 under the '*Law on Debt Rehabilitation of Natural Persons'*[185] *(WSNP)* only for natural persons. However, whilst this includes the potential for debt relief, it is ultimately a debt cancellation process and described in the debt cancellation chapter.

3.15.4 Asset Liquidation and Debt Cancellation

The Netherlands has both statutory and voluntary debt solutions. There are two voluntary mechanisms and three statutory mechanisms.

[184] Section 214 BA

[185] *Wet schuldsanering natuurlijke personen (WSNP).*

The voluntary mechanisms are:

- Debt rescheduling (*schuldsanering*) – this is a debt cancellation solution.
- Debt conciliation (*schuldbemiddeling*) – this is a debt cancellation solution.

The statutory mechanisms are:

- Bankruptcy – this is a debt re-organisation solution.
- Moratorium – this only applies to businesses and is excluded.
- Statutory debt settlement – this is a debt cancellation solution.

The landscape

The Netherlands passed its original Bankruptcy Act in 1896, which gave firms the option of a moratorium process which offered debt relief, and an asset liquidation process called bankruptcy, open to firms and natural persons. This was legislation very much in the 'old-European model' whereby the primary aim was to see the contract compiled with and the debt honoured. The consumer was at fault and was punished appropriately by losing his assets to cover his debts, and if his assets were not sufficient to clear the debt the responsibility on him to make further payments to cover the residual meant there was no escape from debt, aside from death.

A technical law (known as *Wbleu*) change in 1989[186] provoked the legislature to consider reform. The *Wbleu* was proposed to deal with what was viewed to be an inequity in the application of attachment of earnings between those earning salaries and those receiving benefits. Prior to *Wbleu*, whilst attachments of earnings could be applied to salaries, they could not be attached to benefits payments. *Wbleu* imposed parity between wage-earners and those in receipt of benefits so those with the same income, irrespective of source would be treated similarly. *Wbleu* was not challenged politically but raised the issue of how to treat over-indebtedness now those entitled to benefits were no longer protected, and was amended to request the development of new legislation.

In 1998, the '*Law on Debt Rehabilitation of Natural Persons*'[187] *(WSNP)* introduced a new debt cancellation mechanism, statutory debt settlement, but only for natural persons. Importantly the intent of the legislation was to influence the behaviour of creditors to make them prefer voluntary debt settlement arrangements outside of court by making the likely settlement for the statutory route less attractive that the voluntary arrangements. Although the *WSNP* was refined by further legislation which came into force in 2008, this is the landscape in the Netherlands today. The following sections will run through the three debt cancellation methods:

- Voluntary debt rescheduling (*schuldsanering*)
- Voluntary debt conciliation (*schuldbemiddeling*)
- Statutory debt settlement

[186] *Wet beslag loon, sociale uitkeringen en andere periodieke betalingen (Wbleu) – Parliamentary Documents II, 1982/83, 17,789.*

[187] *Wet schuldsanering natuurlijke personen (WSNP).*

According to a survey respondent from a Dutch financial information association, the voluntary and statutory processes themselves do not have any direct effect on the debtor's employment status. However, an organisation named BKR (*Bureau Kredietregistratie*) collects information on whether a consumer already has a credit agreement with other organisations and whether the client has paid his obligations in a timely manner. It calculates a score based on this information and categorises consumers by the score. Any consumer in one of the debt solution processes will have a negative BKR but this disappears five years after the consumer has paid off the debt. According to the financial information organisation, a negative BKR score is likely to lead a lender to refuse a loan to the consumer.

Voluntary debt settlement

Local debt counselling organisations supervised by municipal authorities carry out voluntary debt settlements. Over-indebted consumers apply for help and are interviewed to establish the details of their case, including any mitigating factors. The debt counsellor then develops a debt adjustment plan, which consists of a voluntary debt settlement plan and access to any support which may be available and for which the applicant may be eligible[188]. Around 10% of the debtor's income after exemptions was top-sliced to fund the debt counselling service. If the creditors all agree to a voluntary plan, this is then activated. At the end of the plan all remaining debts are discharged.

According to a survey respondent from a financial information institution, the law relating to voluntary debt settlement only states an obligation for municipalities to help people in debt. It does not include an obligation for the lender. The respondent also said that a consumer can only apply for the statutory process if they have followed the voluntary process first.

It is worth noting there are several reasons why a creditor may not agree to a voluntary plan, ranging from attitudes, to incentives, to it being prohibited:

- Public organisations, particularly social services, the National Social Institute (*Landelijk instituut sociale verzekeringen / Lisv)* and the Social Insurance Bank (*Sociale verzekeringsbank / Svb*) are prohibited from agreeing to voluntary agreements by statute[189].
- The statutory settlement route can be perceived by lenders to be more punitive, particularly where it, for example, requires the re-directing of the consumer's post to the administrator, to ensure he is not trying to hide any assets which could be liquidated.
- Many lenders find statutory settlements less time consuming as responsibility for checking the quality of the plan falls on the debt counselling organisations instead of the lenders.
- Whereas the only alternative to voluntary agreements used to be the drawn out bankruptcy process, which offered creditors little, the creation of the statutory route made them less likely to agree to voluntary schemes.
- Whilst originally designed to be less financially attractive than voluntary plans, statutory plans are often very similar, both because given the low incomes there is not much scope

[188] Many municipalities held funds which were used to guarantee payments and maximise the probability of getting voluntary agreements with lenders. However, following the WSNP legislation in 1998 many municipalities read this as a replacement for their systems and abolished these support systems, a small example of how statutory debt settlement, which by design was meant to be inferior to voluntary settlement weakened voluntary settlements through the simple fact of its existence.

[189] The NVVK brokered an agreement with the Central Fine and Collection Agency (*Centraal Justitieel Incassobureau – CJIB)* after it identified that one third of unsuccessful negotiations failed because of their rejection by the CJIB. Sucess rates subsequently grew to 18% in 2006, 22% in 2007, 33% on 2008 and 30.5% in 2009 – statistics and other information available at http://www.nvvk.eu.

for variation but also because the system has moved to a uniform rules-based approach in recent years which are often commonly applied across both voluntary and statutory plans.

- Some consumers, when lenders do not agree to a voluntary plans do not push on to a statutory plan because of feelings of 'shame'[190] which allows the lender to continue to collect instalments as previously, given them to at least delay any reduction in income.
- Dropping out of a statutory plan by a consumer gives lenders access to attachments of earnings and sustaining at least some repayments, which is not guaranteed under a voluntary plan.
- Creditors can access more information in a statutory plan than a voluntary one.

According to Jungmann and Huls (2009) '*between 50 and 75% of all debt counselling services follow... the NVVK Debt Rescheduling Code of Conduct*'[191]. This lays down a three year maximum length for plans and equitable treatment of all creditors[192], sets exempt income at the social minimum and requires a full discharge at the end of the plan. Within these limits, debt counsellors have access to two mechanisms for establishing voluntary plans.

According to the respondent from the Dutch Institute for Family Finance Information, in cases where a debtor just gets an income allowance, he or she has no direct access to his or her income. If a consumer breaks the voluntary arrangement, the process stops. In some municipalities, a new arrangement can be organised.

This respondent stated that 78,986 consumers applied for the voluntary process in 2010 based on figures from an annual report from an association of debt counsellors. However, the respondent suggested that this number is likely to be higher since not all debt counselling organisations are members of this association. The respondent estimated that about 50% of these applications would have been successful. The respondent also said that 30% of people in the voluntary settlement process broke it, using figures from the annual report from an association of debt counsellors.

The most common complaint from consumers about the voluntary settlement process is that it is hard to live on such a low level of allowance, according to the respondent. However, the respondent said that the voluntary process does generally work for consumers. The most common complaints from lenders are that they get a low percentage of the money back in most cases, that the process takes too long and that there are few guarantees that it will succeed.

A respondent from a lending association also agreed that the process generally worked for lenders and that lenders were generally satisfied with the process. The respondent said that the most common complaints from lenders concerned the process leading up to the relief programme, based on its members' experiences. The respondent from the lending associated also said that the most common complaint from consumers about the voluntary process was that there was no clear concept of the seriousness of the administrative process.

Voluntary debt rescheduling (schuldsanering)

This method uses a consolidating loan to replace existing loans. The repayments are calculated according to the debtor's income. The creditors receive their payment up front, although if the consumer can only pay off a consolidating loan which is less than the total value of their debts then

[190] See Jungmann and Huls (2009) for more on this and other factors.

[191] *Gedragscode Schuldregeling.*

[192] As opposed to offering those who initially refuse a greater return in terms of cents in the Euro, to attempt to 'buy' their agreement.

this is only a part payment. Should the consumer's income go up during the period of the plan the consumer benefits from this as their repayments on the new loan are fixed. If income falls, however, then the loan is extended for a longer period with lower instalments each month.

Voluntary debt conciliation (schuldbemiddeling)

This method uses a calculation based on the consumer's income to inform lenders how much is expected to be repaid each month, and therefore an estimate of the fraction of the debt which they can expect to recoup over the life of the plan. If they agree and the plan goes ahead, if the consumer's income goes up the creditors will be repaid more, but if it goes down they receive less.

After 1 January 2008, an additional provision on *dwangakkoord* (forced agreement) allows the debtor to request that the court force a creditor to accept the debtor's proposed out-of-court plan *'if the creditor could not have reasonably have refused'* to accept the compromise plan '*in light of the imbalance between the [creditor's] interest... and the interest of the debtor and the other creditors who will be injured by the rejection'*[193]. This *dwangakkoord* was requested in only about 1,000 cases in the first two years of its availability, compared to 18,000 WSNP cases initiated, or which around one-third were granted,[194] compared to successful use in around 1% of cases in the first two years of the Dutch law, before the 2008 reform. This was also the piece of legislation which introduced the small moratorium for natural persons.

Statutory debt settlement

From 1998, the '*Law on Debt Rehabilitation of Natural Persons'*[195] *(WSNP)* introduced a new statutory debt cancellation mechanism, but only for natural persons. Only the debtor can apply for statutory debt settlement. The following applies when applying for debt restructuring:

- An incurable debt burden must be involved; in other words there is no prospect of repayment.
- The debts must have arisen or remained unpaid in good faith. The Court will interpret this open criterion in each case. Debts from criminal acts are not regarded as arising in good faith. In accordance with jurisprudence from the Supreme Court and the Directives of judicial policy it is important here that no attempts have been made to disadvantage creditors. It is also important that the debts have not arisen or remained unpaid very recently and that where in any way possible there has been partial repayment along with its frequency. In other words there is no consequent pattern of incurring debts without demonstrable improvement.
- The debtor must enclose a model statement with the restructuring application, completed by the municipality and signed by him in person, and must also submit a complete petition to the Court as described in Section 285 BA, demonstrating that voluntary debt settlement had been attempted and had failed as a requirement for accessing the court-based system. The core problem with this, as outlined in Kilborn (2006b) was that:

[193] *Faillissementswet* art 287a (*cf, id.* Art. 332, the in-court *akkoord* procedure)

[194] See von Bergh et al (2009) – in Dutch.

[195] *Wet schuldsanering natuurlijke personen (WSNP).*

> *'The process of structuring and negotiating a voluntary payment plan with creditors* [imposed] *significant delays on Dutch consumer debtors' obtaining needed relief. Delays* [varied] *considerably depending on local conditions and the complexity of debtors' problems, but debtors often face[d] two types of delay: First estimates suggest[ed] that in two thirds of Dutch municipalities, consumers face[d] waiting periods of two to six months just to get appointments with local debt counsellors. Second creditors understandably d[id] not view responding to debt arrangement proposals as an issue of urgent necessity'.*

The WSNP increased the pressure on counsellors, and success rates were low[196]. Nevertheless, the attempt to assemble such a plan was a pre-condition of accessing court-based debt re-structuring, with application requiring consumers to file a certificate issued by a debt counsellor attesting that the voluntary out-of-court negotiations had failed.

If accepted by the court debt re-structuring operated using trustees to administer the estate, paid for from the estate to make payments agreed under a plan set by the court. This form of paying for the trustee was used, as with many countries, as an incentive to encourage lenders to agree out-of-court solutions which did not drain value from the estate to pay the trustee that could otherwise be paid to the lender. The debt restructuring proceedings in Court have a double objective: liquidation of the available equity and restructuring of the debt burden. However, in principle the debt restructuring arrangement does not work in respect of claims covered by pledge or mortgage[197].

Entering a statutory plan puts a stop to creditors exercising the law. Attachments already imposed lapse and executions already started are suspended[198]. Legal or contractual interest also stops running from that time[199]. If a consumer completed a debt re-structuring plan, they could be awarded a "remission of debts" which would[200], apply to all creditors, even those who have not submitted their claim to the receiver. Therefore debt re-structuring, which in many countries is, in the terminology of this report, a debt re-organisation process, was in the Netherlands a debt cancellation mechanism. There is an important restriction here: the debt restructuring arrangement only works in respect of claims that exist at the time of the pronouncement in which the debtor is admitted to the arrangement[201]. Claims arising after the date of the admission judgement are new debts, do not therefore fall under the debt restructuring and the discharge also cannot involve them.

Formerly the Clerk to the Court should publish in the State Gazette a number of key items of data from the pronouncement of the Court including the name and full address of the debtor and the name of the acting supervisory judge. This no longer takes place.

The Court takes the most consequential decisions in the debt restructuring arrangement, such as admission or refusal of the proceedings and granting discharge in debt restructuring, or a possible interim termination of debt restructuring.

[196] Only 26% of voluntary plans were successful in 2001.

[197] See Sections 57, 58 and 59 BA.

[198] Section 301 BA.

[199] Section 303 BA.

[200] Section 284 '*Debt Restructuring for Natural Persons act*'.

[201] Section 299 BA, the fixation principle.

An acting supervisory judge is appointed from the Court for the numerous decisions of management and supervision of the estate during the term of the proceedings. This individual supervises the receiver or administrator, grants permission for some transactions and decides on possible complaints from interested parties.

As soon as the Court has opened insolvency proceedings, it appoints both a supervisory judge and an administrator (in bankruptcy) or receiver (in moratorium or debt restructuring). The tasks of the administrator and receiver are described as follows in the Act: supervision of compliance by the debtor with the obligations arising from the law, and managing and liquidating the estate. These tasks apply regardless of whether the debtor is a private person or an enterprise.

The debtor should exert maximum effort for his creditors for a period of three years, so that as much money as possible comes into the estate. For three years he will have to make his capacity to repay available to his creditors up to 95% of the applicable support level.

A debtor (but also a creditor or the receiver) can place the debt restructuring matter before the Court for interim termination[202]. The most frequent causes are interim termination on the grounds that excessive new debts have arisen, or that the debtor is attempting to disadvantage his creditors or is informing his receiver incorrectly or incompletely. The legal consequence is that in that case the debtor is immediately placed in a state of bankruptcy afterwards.

A creditor cannot institute higher appeal against the judgement in which a debtor is admitted to debt restructuring. The creditor may also have a say during the verification meeting, or submit a complaint about the course of affairs to the supervisory judge. It is also possible that creditors can go into higher appeal of the judgement in which the debtor is provided with a clean sheet on expiry of the debt restructuring term[203]. The creditor has to respect a clean sheet judgement, even if he was not involved in the debt restructuring proceedings[204].

The estate incorporates all of the debtor's property at the time of the judgement that admits him to the arrangement, as well as all property that he obtains during debt restructuring[205]. The possessions that are not excessive remain outside of the estate – together with other goods described in Section 21 and in paragraph 4 of Section 295 BA. The occurrence of debt re-structuring means that the legal position of everything involved in the estate becomes fixed.

Due to the judgement in which the debtor is admitted to the debt restructuring arrangement he lawfully loses authority to have his goods at his disposal: from that time onward these goods belong to the estate that is managed by the administrator or receiver. He also loses the authority to conduct and to allow actual transactions in respect of these goods. He is obliged to surrender all goods that belong to the estate on the request of the administrator or receiver. The debtor must obtain

[202] Section 350 BA.

[203] Section 355 BA.

[204] Section 358 BA.

[205] Goods delivered under ownership proviso do not fall into the state of restructuring, see Sections 20 and 295 BA, but may well be affected by any judicial order in which a cooling off period is proclaimed.

permission from his administrator or receiver for some legal transactions, such as entry into a credit transaction.

According to a survey respondent from a Dutch financial information association, a consumer in a statutory settlement has no direct access to his or her income and receives an allowance instead. All of his or her post goes to the administrator.

No obligation exists for the creditors to submit all claims to the receiver or administrator, however anyone wishing to share in the income, which is paid out via what is referred to as a distribution list to known creditors, should submit his claim.

There may be provisional admission to the debt restructuring arrangement in anticipation of a final judicial judgement. This legal facility is seldom used by the Court and only in acute emergency situations such as a threatened house eviction.

As soon as debt restructuring is provisionally or finally declared applicable, an overall moratorium applies against creditors as far as legal exercise is concerned. Attachments already made will lapse and executions already started will be suspended. Legal or contractual interest likewise stops from that time onwards. In debt restructuring the supervisory judge may also specify a cooling off period by order at the request of each interested party.

A verification meeting is not always held in the debt restructuring proceedings. The Court judges whether following such proceedings is worthwhile in view of the situation of the estate – generally at the request of the administrator or receiver – or whether simplified completion can be followed. If a verification meeting is planned, the administrator or receiver communicates this to all known creditors. Creditors may submit their claims along with the associated evidence to him. Creditors with a claim, the existence and size of which are recognised, are placed on a list of recognised claims.

Registration of all current insolvency proceedings takes place in the Central Insolvency Register (CIR) at the Court for Jurisprudence in The Hague; this may be consulted via www.rechtspraak.nl/registers.

Under debt restructuring preferential creditor and competing creditors are ranked equally and receive the same the value in the euro from liquidated assets[206].

If before debt restructuring the debtor conducted voluntary legal transactions that he knew or should have known would disadvantage the creditors, the administrator or receiver can call on the '*actio pauliana'*, and can reverse these transactions to benefit the estate[207].

This system was generally discretionary, with courts theoretically entitled to freely design payment plans. The main freedom was over the amount of exempted income. The legislation required debtor's to be allowed to retain at least 90% of the social assistance minimum, but judges could increase this. This was in part because of the way the social assistance minimum was calculated in relation to children, such that houses with multiple children may be relatively hard-pressed. This

[206] in accordance with Section 349 paragraph 2 BA.

[207] Sections 42 and 43 BA.

90% was hard-fought in the legislature, with significant pressure to increase it, although this was finally defeated, with 90% explicitly set as the floor in law.

However, from 2000 judges rejected this discretion in preference of standardised amounts of income to be exempted for use by the consumer based on a 30 page guide developed by a working group of judges (*Recofa*), which was eventually accepted as standard in nearly all courts. This was updated annually, with on-line calculator tools made available, de facto turning the Dutch system from the discretionary Romance model it had been legislated to be, into a rules-based model of the Germanic school it had not been legislated to be, and deliberately set rules which were more generous than the 90% of social assistance minimum. The Recofa guide set limits of 95% of the social assistance minimum for those receiving benefits, and 100% for those working at least 18 hours a week. In addition Recofa made allowances for health insurance premiums, monthly housing rental charges, childcare costs, and the costs of transportation to work, bringing exemptions broadly into line with those applied in the out-of-court negotiated settlement phase.

These steps by the judiciary to effectively completely recast Dutch debt cancellation law led to the Dutch legislature in 2007 codifying this approach in a simplified and streamlined process and formalised a rules-based model of the Germanic school which has been in operation from 2008 onwards. This abandoned judicial discretion, except over plan length and the amount of income exempted, with discharge after one year possible, although three years was standard. One year plans were permitted in cases where the trustee had '*no expectation that the debtor* [could] *satisfy his obligations in such a way that the continuation of the proceedings could be justified*'[208]. This was broadly an attempt to avoid the administration costs of plans where there was little progress being made, where the legislature indicated that expected contributions of less than 2% of outstanding debts would trigger this new provision, which brings into play a new dimension, whereby debtors are freed from their commitments not because they cannot make contributions, but instead because they could not make *significant* contributions, swinging the system, in this case even further towards the consumer's benefit and away from the creditors, in so far that going through long, drawn-out and broadly unproductive processes can be seen as being in the creditor's interest.

In this system, a trustee would take on the consumer's non-exempt assets to liquidate these to pay outstanding debts. In addition, the debtor must '*exert maximum effort for his creditors for a period of* [standardly] *3 years during which he will have to make his capacity to repay available to his creditors up to 95% of the applicable support level*' (Vandone 2009). In other words, the trustee has access to non-exempt income for one to five years to contribute to meeting unpaid loans. The standard period, however is three years.

The debt restructuring proceedings focus on liquidation of the available equity. The receiver in principle always needs authority from the supervisory judge to progress to liquidation, but as a rule a public sale is once again unnecessary. Liquidation of the available assets may also take place in the debt restructuring agreement.

As a rule the receiver only distributes once to the creditors, this being at the end of the proceedings. Debt restructuring formally ends when the final distribution list becomes binding. The receiver informs creditors of this. Creditors may object to (oppose) this list.

[208] Faillissementswet Art 354a(2008)

The essential difference between bankruptcy and debt settlement is that after completion of a bankruptcy the claims not paid survive and can therefore become collectable again for creditors (Section 195 BA). This happens at the time when the final distribution list becomes binding, in other words when opposition against this by a creditor is no longer possible. A bankruptcy ends by means of an agreement, or by means of a simplified completion (removal in the case of a lack of income) or by means of a distribution to the creditors following verification of their claims.

Debt restructuring is completed positively or negatively:

- If a debtor keeps properly to his debt restructuring obligations (fully informing the receiver, getting as much money into the estate as possible for three years, going to work or as the case may be staying at work) the Court will grant him a "clean sheet" in the final judgement. This implies (see Section 358 of the Bankruptcy Act) that the remaining debts may no longer be legally collected for creditors.
- If a debtor does not adhere to his debt restructuring obligations, debt restructuring may be terminated in the interim with no clean sheet. Now the debtor will be lawfully in a state of bankruptcy (see Section 350 of the Bankruptcy Act). For example, this can happen if the debtor allows excessive new debts to arise during the term of his debt restructuring, or if he tries to disadvantage his creditors. According to the survey respondent from the financial information association, a debtor who breaks a statutory settlement arrangement cannot return to the arrangement for the next 10 years.

The survey respondent stated that 16,643 consumers used the statutory process in 2010 based on figures from the Dutch Bureau for Statistics. The respondent also estimated that 30% of people in the voluntary settlement process broke it.

The most common complaint from consumers about the statutory settlement process is that it is hard to live on such a low level of allowance, according to the respondent. However, the respondent said that the statutory process does generally work for consumers and that most consumers in the statutory process did understand their choice of process. The most common complaint from lenders is that they get a low percentage of the money back in most cases.

A respondent from a lending association also agreed that the process generally worked for lenders and that lenders were generally satisfied with the process. The respondent said that the most common complaint from lenders about the statutory process was that there was little or no choice on the format. The respondent from the lending associated also said that the most common complaint from consumers about the statutory process was about the loss of control over the process.

3.16 Poland

3.16.1 Debt re-organisation and debt relief

Free debt advice can be found on the internet[209], although it is not always clear who is providing the advice. As with many Eastern European and Southern European countries, Poland had not developed a debt counselling provision, and this in part explains the absence of pre-court

[209] For example http://forumprawne.org or http://www.eporady24.pl.

negotiation requirements in the law, leading to a focus on a debt cancellation methodology. Parties' participation in the pre-court mediation process is voluntary.

In complaints addressed to the Polish Financial Services Authority, consumers often point to their problems with repayment of their debts. However the main function of the PFSA is to protect deposits. The PFSA may only take preventive actions to protect the customers of the financial markets.

In accordance with article 138 section 7 of the Polish Banking Law the measures undertaken by the Polish Financial Services Authority cannot violate the agreement concluded between the bank and the client.

3.16.2 Debt cancellation

Poland passed personal bankruptcy legislation on 31st March 2009[210]. The aim of the Act is to re-organise the debtor's obligations and to satisfy the creditors in part as well as to return the debtor to financial liquidity in order to allow them to return to a normal life.

Under this legislation only the debtor, not the creditor, may file for bankruptcy, although individuals cannot file more often than once every ten years, and in order to do so must meet certain conditions, particularly that the over-indebtedness must have occurred under exceptional circumstances beyond their control, such as sudden or severe illness, natural disasters or exceptional events, and they can cover the administrative costs.

The process liquidates assets, of which the liquidator is obliged to provide a comprehensive list to the court, with the creditors paid off as far as this allows from the proceeds. This process is usually managed by an approved liquidator, although the debtor can do this personally under the supervision of the liquidator. This liquidation includes property and other belongings, even those of sentimental value, although article 829 of the code of civil procedure does exclude some items. A spouse's assets will not be liquidated, but joint assets will be. The court has discretion of the level of exempted income[211]. Equally the law provides no guidance to the judge in determining how much, or when the debtor must pay creditors, or how much of the debtor's obligations will be discharged. The payment plan are set in advance, however on the debtor's petition, the court may mitigate the payment plan's requirements either by postponing the payment deadline or by reducing the amount of the debtor's payment. Upon the creditor's petition the court may also amend the payment plans if the financial situation of the debtor has improved for any reason other than the debtor's remuneration for work[212].

The objective of regulating the consumer bankruptcy is to [213]carry out the restructuring of the debtor's obligations and to pay off partially the creditors. For this objective the plan to repay the creditors is established by the court after it has determined which part of the debtor's liabilities will not be paid off from the liquidation of their assets. The plan sets out the amount of the debtor's obligations and the period, not exceeding five years, within which the debtor is obliged to pay off the

[210] Articles 491^{1} – 491^{12} of the Polish Bankruptcy and Reorganisation Act (dated 28th February 2003 and amended by the Law of 5th December 2008. See also Filipiak (2009), Lesniewska-Drwiega (2009), Viimsalu (2010), and Kilborn (2010b),

[211] Article 491(7) is in the view of Kilborn (2010b) '*particularly vague*'.

[212] Kilborn (2010b), p41.

[213] Section 13, Polish Bankruptcy and Reorganisation Act, as quoted in Kilborn (2010b)

creditors. The plan also specifies what part of the debtor's obligations will be annulled after carrying out of the repayment plan[214].

However, it should be noted that costs are a problem, as the law requires debtors to pay the petition fee or face immediate case dismissal[215], as it will if the debtor does not observe the terms of the payment plan. The case will also be dismissed[216], if

- In the previous ten years the applicant has gone through either bankruptcy or another proceeding which led to an annulment of the debtor's obligations, either in whole or in part, or led to an arrangement with lenders.
- There was conducted a bankruptcy but neither the sale value of the debtor's assets satisfied the creditors' claim nor the creditors' claims were satisfied after the completion or discontinuation of the bankruptcy proceedings.
- There was conducted a bankruptcy which was subsequently discontinued and the discontinuation was caused by any other reason except for a request of all the creditors.
- The court in its final ruling assessed the legal transaction of the debtor to have a detrimental impact on the creditors' interests.

Unusually the Act puts in place arrangements to protect debtors from the threat of homelessness. After asset liquidation the debtor receives financial aid to cover rent for a period of one year. The sum depends on the debtor's income, and an assessment of need, including the number of dependents.

Within the first three months of personal bankruptcy being brought into force there were around 450 court applications, or which only two succeeded[217], in both of which cases the debtor was able to secure their spouses' businesses, which both went bankrupt later. From 31st March 2009-31st March 2010, the first full year of operation, only 14 of 1,000 petitions were accepted[218]. Regulation appears in this context to have been '*too strict in respect to both the material and the financial prerequisites for filing of an effective consumer insolvency petition.*[219]. The legislation only permits entry to debtors whose over-indebtedness was a result of *'exceptional circumstances entirely beyond their control'*[220].

Driven by this *'meagre number of declared consumer bankruptcies as well as the decline in debtor's requests for declaring the consumer bankruptcy (both causes by the over-restrictive present rules)'*, there is new legislation planned in Poland for adoption in 2013. To quote the Polish Ministry of Justice, the new legislation will:

[214] It should be noted that, according to the Polish Ministry of Justice, in cases where the lender is not capable of recovering the full value of their claims within the bankruptcy proceedings, they have the right to bring a legal action in civil proceedings under the terms of the Polish Act of 17 November 1964 – the Code of Civil Practice. In other words, the bankruptcy process does not compel other litigation against the debt to stop.

[215] Polish Bankruptcy and Reorganisation Act s.13.

[216] Article 491(3) of the Polish Bankruptcy and Reorganisation Act.

[217] See Viimsalu (2010)

[218] Kilborn (2010b).

[219] Viimsalu (2010) and Filipiak (2009).

[220] Kilborn (2010b).

- *'mitigate the restrictive conditions under which the consumer may apply to the court for a declaration of his/her bankruptcy.*
- *'The amended rules will allow the consumer to negotiate an agreement with lenders/creditors'.*
- *'Abolish the obligation to put the debtor's immovable property up for sale'.*

3.17 Romania

Romania does not have a debt discharge process. However, Romania has made some steps to aid consumers, particularly by revising and refreshing regulation[221] applying to lenders granting loans to individuals, which focus on attempting to ensure that over-indebtedness does not occur. The regulation stipulates tighter rules for banks when setting the maximum amount that the consumer can borrow, in an effort to prevent the consumer reaching the point of over-indebtedness.

It is also important to note that the NBR regulation recently put in place is prospective only, applying only to future loans and does not stipulate any solution for existing borrowers who are facing difficulties. It is clear these regulations have been drafted in the light of the experience of Hungary and mortgages denominated in foreign currencies, but it is a key reflection that over-indebtedness either requires feckless borrowing, feckless lending, or great misfortune, and whilst this report focuses on what happens in event of the first and the last of these, it is only correct, in the current climate that appropriate regulation and controls on lenders are maintained and routinely updated and refreshed. In the opinion of the authors, such regulations on lenders are a necessary precondition for a stable financial system but are not a substitute for good debt solutions.

3.17.1 Debt re-organisation

The Romanian Banking Association (RBA) reported that there are three processes consumers can use to address over-indebtedness:

- Refinancing
- Rescheduling
- Restructuring

According to the RBA, none of these processes work as intended for lenders, although lenders are generally still satisfied with them. From a lender's perspective, the most successful process is rescheduling, followed by restructuring. Refinancing, rescheduling and restructuring are, at all times, agreed upon by both the lenders and the borrowers. The most common complaints from lenders in 2009/10, concerning all of these processes, were the lack of predictability/stability of the legal system and court practice, and the legal restrictions in the area of consumer protection with unclear and overlapping legal provisions.

Studies from the National Bank of Romania have shown several times that restructuring models used by banks have not worked effectively as only small numbers of clients actually benefited from debt relief solutions, or have been discouraged by the NBR:

[221] NBR Regulation no.24 from 28.10.2011 on granting loans to individuals.

'In terms of structure, restructuring is more resorted to for the corporate portfolio than for the retail portfolio… For the households segment, one of the most resorted to restructuring methods was the rescheduling of loans, but most probably the measure was not efficient enough, postponing generally the materialisation of risks without eliminating them. As concerns rescheduled exposures (in individual amount of over RON 20,000) that were in banks' portfolios in 2011 and the first half of 2012: (i) the recovery rate of non-performing loans does not differ significantly from that of loans which did not undergo contractual changes, while (ii) the recovery rate of loans posting delays between 1-90 days is higher in the case of loans which did not undergo contractual changes.'[222]

'The rescheduling of loans was another solution identified by banks for improving[223] *the portfolio's quality, but this procedure was less resorted to in the first months of 2012, including at the request of the NBR.'* [224]

'The share of restructured loans to households and non-financial corporations in the loan stock reached 9.6 percent in September 2010 from 6.6 percent in December 2009... According to information supplied by credit institutions, subject to restructuring were particularly non-financial corporations. The efficiency of restructuring was relatively low in the light of the adverse economic environment, so that restructured exposures might in the future put pressure on non-performing loan ratios.'[225]

We have also been supplied case studies where restructuring only offers temporary relief, in the form of cutting interest rates for limited periods of time, where the lender can withdraw their offer at any time, moving to an *increased* interest rate, as compared to the original loan.[226]

3.17.2 Debt relief

According to the RBA, unless agreed by the lender (in the sense of "taking a haircut") the only process that can lead to cancellation of outstanding debt is "hardship". Hardship has been recently introduced in the Romanian legislation and refers to "*the situation where, due to extraordinary circumstances, the contractual undertakings become too burdensome; in such cases, the debtor may ask the court [to make] a reassessment of such undertakings (by distributing on [an] equitable basis the losses and the benefits under the relevant contract*)". In the view of the RBA, hardship may have negative implications for the lenders (since, for example, it is a new concept, there are no "objective elements embedded in the law" for interpretation, etc). However, equally, a consumer organisation respondent noted that he had not yet seen any evidence this had been applied yet by courts and did not believe that consumers were aware of it, or how easy it may be to implement in practice due to the phrasing of the law.

[222] NBR (2012), p137, Box 11

[223] The NBR have been quoted in the past that restructuring is a means of cleaning lenders' portfolios of loans, rather than helping consumers. See, for example: http://www.conso.ro/citeste-comentariu/51/info/BNR-suspecteaza-ca-bancile-isi-ascund-neperformanta-.html

[224] NBR (2012) p143

[225] NBR (2011) pp107-8, Box 5

[226] See, in Romanian: http://www.conso.ro/citeste-comentariu/117/cons/Ajutor-de-criza-in-varianta-Raiffeisen--4-la-dobanda-la-credit.html

3.17.3 Asset Liquidation and Debt Cancellation

No personal bankruptcy legislation exists in Romania. According to a consumer organisation respondent, attempts to legislate have occurred, with the initiative on such a law being taken in 2010 by a barrister specialised in insolvency, leading a professional organisation in the area (Mr Piperea), together with another lawyer who is a member of the Senate (Mr Urban). Another 12 senators joined the initiative[227]. The basic content of the proposal was that a debtor in good faith who files for personal bankruptcy may be fully or partially discharged of their debt, after a process of asset liquidation and the completion of a payment plan. The proposal was that, if the debtor, through the payment plan can repay a minimum of 75 per cent of the debt, then he would discharged of the remainder and the procedure would be closed, with all the legal consequences of the insolvency erased from all public records and advertisement registers, thereby offering a discharge of 25 per cent of the loan principal owed by the bankrupt debtor. The law's sponsors from the left-of-centre Social Democratic Party argued the banks should share more of the pain with debtors struggling on account of devaluation and collapsing house prices in 2009, after the banks had disbursed loans far too freely during the credit boom that pumped up growth during the noughties[228].

The draft was approved in the Senate and several commissions of the Chamber of Deputies, but Parliament has not taken 'into deliberation' the draft as a number of voices strongly argued against passing this proposal into law:

- The National Banks Association was strongly opposed, considering that the "degree of criminality" is higher in Romania than in the rest of the member states, making equivalent treatment of over-indebtedness inappropriate. For example, Mihai Dudoiu[229] of Tuca Zbarcea attorneys-at-law, a leading Romanian law firm, defined '*excusable bankruptcy*,' as the situation, acknowledged by a court of law, of a bankrupt debtor who became bankrupt as a result of adverse economic or social conditions, but excluding gross negligence, bad faith or fraud of the bankrupt debtor, but went on to say that "*although this concept may limit attempts from bad faith debtors to go under the protection of the law, in real life things may not work just as well and activities in bad faith cannot be excluded*'.
- Radu Ghetea, CEO of top-five bank CEC and president of the Romanian Banking Association, was quoted in media sources[230] as follows: '*The immediate negative impact will be that the credit institutions will be forced to a higher volume of provisions and probably also to capital increase*.'
- There is a school of thought that Romania would do better in terms of re-invigorating growth by focussing on business regulation, including corporate insolvency. To quote the US Commercial Service[231], the international view of Romanian insolvency procedures: '*the lack of specialization of judges and lawyers in the bankruptcy field makes it difficult to bring such cases to court, and to obtain consistent outcomes*.'

[227] Draft bill available, in Romanian, at http://www.cdep.ro/pls/proiecte/upl_pck.proiect?cam=2&idp=10900

[228] http://www.bne.eu/story2058

[229] http://www.bne.eu/story2058

[230] http://www.bne.eu/story2058

[231] US Commercial Service (2012)

- Credit-ratings institutions, such as Moody's issued warnings that '*the personal insolvency law, which went through the Senate last week, could have some significant negative consequences on the banking system in Romania, adding that credit institutions might need to supplement their capital by 10 per cent, in an optimistic scenario.*[232]' Moody's continued: '*Supposing, conservatively speaking, that the bad loans in late December 2009 alone were to be devalued as such, we estimate the banking system will need an additional capital of 10 per cent. As consumption loans account for 36 per cent of the overall loans given out by Romanian banks, the figure would be a lot higher if the persons who are not in a truly difficult financial situation try to take advantage of the new law*.' At first glance, the law being passed appears to be negative for the financial situation of the Romanian banking system, as it appears to harshly punish commercial banks,' Moody's report states, 'as it might promote a moral haphazard among debtors, who could opt to dodge loan rates taking advantage of the legislation.' '*The debtor who made use of the personal bankruptcy law not being listed as a debtor who defaulted on his payments might encourage the excessive use of defaulting.*' However, not even all opponents of the bill agreed with this frequently quoted analysis. For example, Steven van Groningen[233], CEO of Raiffeisen Romania, while equally opposed to the law, saw Moody's figures as unduly pessimistic. '*This calculation results from a double worse-case scenario in which not only all overdue debtors would be declared insolvent, but also all of them would have the possibility to come up with 75% of the value of their debts in order to benefit from the 25% write-down. This is very unlikely to happen*.' Van Groningen, however, also identified the potential moral hazard issue. '*Given the experience with the insolvency law for companies, there is a real risk that the law will be abused by people who are not in real financial distress and want to exploit the possibilities the law offers to reduce their debts. Here we should also take into account that the courts are already overloaded and that this might make it more difficult to prevent abuse*.'
- Van Groningen[234] saw two major impacts. '*The first one is on the cost of lending; since credit losses for banks are likely to increase, cost of credit will go up as well. This means it will become more expensive to borrow money, which will have a negative impact on the banks' lending activity and on the economy*.' Secondly '*banks might finance smaller amounts for mortgage loans because the collateral value of an apartment or house will be lower as result of the bill, which stipulates that defaulting homeowners can remain in their houses for two years*.'
- Government was not supportive of the personal bankruptcy law. Various reasons were mentioned, the main one being the opposition of the International Monetary Fund (Romania having an accord with it). The IMF denied such a position. But the country reports on the accord in 2012 present interesting evidence. The April 2012 report[235] including a statement by the Romanian authorities, states that 'We will continue to consult with the IMF and EC staff before introducing or amending other aspects of the regulatory framework and avoid adopting legislative initiatives, such as the current draft of the personal insolvency law or proposals for the debt collecting law, which could undermine debtor discipline.' The June 2012 report similarly stated that 'We will continue to consult with IMF

[232] All Moody's quotes available at http://www.seeurope.net/?q=node/19401. See also http://www.pecob.eu/flex/cm/pages/ServeBLOB.php/L/EN/IDPagina/1550. For an alternative pro-reform view, see http://florincitu.wordpress.com/2011/12/14/personal-bankruptcy-law-will-jump-start-the-lending-market-in-romania/

[233] http://www.bne.eu/story2058

[234] http://www.bne.eu/story2058

[235] IMF (2012a)

and EC staff before introducing or amending the regulatory framework and avoid adopting legislative initiatives which could undermine debtor discipline.'

- Other Government reasons were more vague according to one consumer association respondent who quoted a government official: '*The Government is not taking any risk'*. In October 2012 the Government publicly stated that it did not support the passing of the personal bankruptcy legislation without further explanations (besides those published in the IMF reports quoted above.
- The National Bank was also against this initiative, speaking about the fragility of the banking system. For example, BNR Councilor Adrian Vasilescu is quoted in media reports[236], for example as saying that personal bankruptcy law might force banks into seeking further guarantees for funding and restricting credit access. '*On the face of it, [the] personal bankruptcy bill is a generous one. Basically, we might wake up to some law provisions that would put strong pressure on the banking system which has already been bearing a loan slowdown. We might see banks seeking more and more guarantees in order to give out loans*.', The Central Bank conveyed to Parliament its unfavourable view of the bill. Consumer organisation respondents, did however note that, in its favour the National Bank acted strongly and very early (before the subprime crisis in USA) against banks lending money without enough analysis of the debt position this would place consumers in, in an effort to prevent the need for personal bankruptcy legislation through preventing over-indebtedness occurring[237].

A second legislative attempt[238] was proposed by a single deputate (Eugen Nicolescu), whio currently chairs the Parliamentary Committee of Budget, Finance and Banks in the Chamber of Deputies. This attempt was rejected by the Senate and is awaiting a final vote in the Chamber of Deputies.

Both proposals were rejected by the Government in October 2012. In short therefore, the reforms have faltered in Romania because of opposition from lenders based on the following four summary concerns:

- That the legal system in Romania may not be able to cope with the influx of work.
- That the level of criminality in Romania, building on experience from corporate insolvency cases may be higher than in other European countries, leading to more attempts to defraud banks than other countries may have experienced.
- That the general weakness of the Romanian banking system meant it may not be able to withstand the losses which some commentators argued may occur. '*Following the economic crisis and the application of more prudential requirements to ensure the viability of the banking sector*... the *adoption of the personal bankruptcy law is seen with reluctance*[239]*.'* Of course, if on the basis only unpayable debts would be written off, then this would not 'worsen' bank's balance-books, merely expose their true position and losses to the markets and their shareholders, as the basis for the Romanian legislation, as described by one commentator was 'excusable' or passive over-indebtedness, which causes the same issue that many other countries have found, which is that without resources to repay the debt

[236] http://www.seeurope.net/?q=node/19401
[237] See for example,footnote221.
[238] Draft bill available, in Romanian, at http://www.cdep.ro/pls/proiecte/upl_pck.proiect?cam=2&idp=10555
[239] Romanian Competition Council description of the views which led to the rejection of the legislation. The Romanian Competition Council supported the legislation.

'*you cannot take the shirt from a naked man*,' and whether a bankruptcy law exists or not does not change this fact.

- That allowing debtors to default may cause banks to incur losses, restrict lending and increase interest rates, all slowing economic growth, although this point of view of course fails to take account of the fact that over-indebtedness can, in effect, lock workers out of productive labour as it is not worth their while to participate as a active member of the economy.

One respondent did not consider that the industry's concerns are justified, citing evidence from the example in Greece, which, whilst suffering very significant financial problems, successfully managed to implement a debt cancellation / personal bankruptcy law at the beginning of 2011. The respondent noted there had been no evidence that Greek economy had suffered further detriment from this reform nor that Greek financial sector was strongly affected.

3.18 Slovakia

3.18.1 Debt re-organisation and debt relief

As with many Eastern European and Southern European countries, Slovakia had not developed a debt counselling provision, and this in part explains the absence of pre-court negotiation requirements in the law, leading to a focus on a debt cancellation methodology. As the Ministry of Finance of the Slovak Republic notes, however, this does not prevent consumers using various restructuring methods to re-organise their debts and make them more sustainable. Such processes are delivered directly between the consumer and the lender. Key examples are prolonging the date of maturity, extending payment periods, taking payment holidays and postponing some instalments of the debt, transforming either one debt or several debts by replacing these with one larger debt with better conditions. Within this, replacing a single debt with another debt, often a secured debt, such as a mortgage, is regulated by Act No. 483/2001. For example, Article 75 para. 6 gives consumers the right to pre-pay the mortgage without fees when a fixed interest rate period comes to an end, to facilitate people moving to loans with better conditions.

However, financial sanctions such as default interest may make it difficult to access new credit to use these methods, as these are noted in the debtor register.

3.18.2 Debt cancellation

In Slovakia, debt solutions are available when the consumer falls into insolvency (*úpadok*), where the debtor is unable to pay all its creditors, either because of insufficient cash-flow or assets. The Bankruptcy and Restructuring Act (Act 7/2005, which came into force in 2006)[240] defines an insolvent debtor as an entity that has more than one creditor and is not able to perform more than one monetary obligation for at least 30 days after the maturity date[241]. As such, there are two main forms of insolvency under Slovak law:

[240] See Sandor & Seman (2006) Marek & Majer (2009), and Kilborn (2010b)

[241] Monetary obligations that a debtor does not recognize or refuses to settle for some other reason do not count as overdue obligations. On the other hand, the fact that a debtor is settling some of its obligations in a timely manner does not mean it cannot be declared insolvent for failing to settle other obligations. (Sandor & Seman 2006).

- Cash-flow insolvency (*platobná neschopnost*), where there is more than one creditor and the debtor is unable to pay due debts for at least 30 days. In this situation either the debtor or the creditor may apply for bankruptcy.
- Over-indebtedness (*predlženie*), where there is more than one creditor and the value of debtor's due debts exceeds the value of the debtor's assets. In this situation only the debtor may apply for bankruptcy. Only due debts are taken into consideration – there is no 'balance-sheet insolvency'.

In Slovakia there are three mechanisms for addressing corporate insolvency and personal bankruptcy. The objective of the Bankruptcy and Restructuring Act is the fair distribution of the limited resources of the debtor between the creditors by selling off the assets of the debtor or by gradually satisfying the creditors of the debtor. Administration of the bankruptcy and restructuring process is carried out by the **Ministry of Justice of the Slovak Republic.** The three mechanisms are:

Bankruptcy is the commercial failure of a company.

- Bankruptcy (*konkurz*) - an independent bankruptcy trustee liquidating a debtor's assets and proportionally satisfying creditors from the proceeds of the liquidation. This process is out of the debtor's control with an important role of creditors in the proceedings. It can be either voluntary (petitioned for by the debtor) or involuntary (petitioned for by a creditor – this rarely happens in Slovakia), in which case the creditor must meet the following requirements:
  - The debtor must be in a situation of cash-flow insolvency
  - The creditor must prove:
    - its enforceable/acknowledged claim;
    - the enforceable/acknowledged claim of another creditor (as the definition of insolvency requires there to be at least two creditors);
    - additional written reminder of both; and
    - advance payment of €1,660 for the costs of the proceedings
- Restructuring (*reštrukturalizácia*) – a collective proceeding consisting in restructuring debts and partial or entire satisfaction of creditors from the proceeds of continuing to operate the debtor's business under the debtor's control, as the trustee is chosen by the debtor. The trustee may recommend proceeding with restructuring of the debtor if:
  - the debtor performs a business activity;
  - the debtor is threatened by bankruptcy or is bankrupt;
  - it is reasonable to presume that it is possible to keep at least an essential part of the debtor's enterprise operations; and
  - restructuring can be reasonably presumed to lead to a greater recovery for creditors than bankruptcy.
- Withdrawal procedures – a process for natural persons whose estate is insufficient to pay off creditors through bankruptcy, which allows them to withdraw from bankruptcy (like a discharge), albeit with a three year requirement to pay up to 70% of annual income to an administrator towards meeting debtor's claims.

Of these, *restructuring* is purely for corporate insolvency. *Bankruptcy* is primarily for businesses, but is the mechanism to gain consumer's access to *withdrawal.*

A debtor is in a state of failure if he has a number of creditors and he is unable to discharge his liabilities to them within 30 days. A bankruptcy petition may be filed by a debtor, creditor, the liquidator of a debtor, or another legally appointed person. Petitions are submitted to the relevant court. The court provides the supervision stipulated by the law throughout bankruptcy proceedings, and supervises the activities of receivers.

Bankruptcy

A **bankruptcy petition** may be filed by a creditor, debtor or liquidator. Proceedings are held under court supervision. A debtor who is bankrupt must file a bankruptcy petition within 30 days of discovering that he is bankrupt. The process prevents lender's seizing the consumer's assets or pursuing other legal routes to assert their claims.

A bankruptcy petition may be filed by a debtor, creditor, the liquidator of a debtor or another legally appointed person. If a **creditor** files a petition, its claim is considered probative if it is certified by the debtor on the document together with the debtor's officially certified signature or a judgment from a court or other body.

The debtor's property is taken over by the **receiver** (*správca konkurznej podstaty*) who is selected at random using an electronic system, who acts to dispose of the assets subject to bankruptcy and for the bankrupt in matters related to these assets.

The bankruptcy procedure has two phases: the **start of bankruptcy proceedings** and the **declaration of bankruptcy**, where the actual proceedings start. If the court determines that the bankruptcy petition satisfies the particulars required under the law, it will decide on starting bankruptcy proceedings within 15 days of receiving the petition.

Bankruptcy is considered officially declared once the bankruptcy order is published in the Trade Journal (Obchodný vestník)[242].

Creditors must submit an **application for claims** together with supporting documents in duplicate to the receiver's office, with one copy also going to the court. The application must be received by both the trustee and the court within 45 days of the bankruptcy declaration. The receiver prepares a schedule of assets for liquidation. Proceeds from liquidation of the assets subject to bankruptcy proceedings are allocated to creditors who have registered their liabilities. The Slovakian system gives the court autonomy to define the amount of income exempted from this process for the debtor to live off. The law refers to '*the amount specified by the court'* , which the debtor must cede to the trustee limited to '*up to 70% of his total net income*'[243]. In order to realise the assets, the administrator/trustee may:

- publish a public tender;
- entrust an auctioneer with the sale of the assets;
- entrust a securities trader with the sale of the assets;

[242] www.zbierka.sk

[243] Slovak Insolvency Act s. 168(A).

- organise an auction, competitive bidding or any other competitive procedure aiming at the sale of the assets;
- sell the assets using any other appropriate method.

A secured claim of a secured creditor should be satisfied, to the extent established, from the proceeds of the realisation of the assets constituting the separate, individual estate of the secured creditor that remained after the claims against the estate linked to the inventory items of the assets constituting the separate estate had been deducted. Where a secured claim of a secured creditor cannot be satisfied in full, the remaining part should be satisfied as an unsecured claim.

Unsecured claims should be satisfied, to the extent established, from the proceeds of the realisation of the assets constituting the general estate that remained after the claims against the estate linked to the inventory items of the assets constituting the general estate had been deducted. Where unsecured claims cannot be satisfied in full, they should be satisfied proportionately.

The court may halt or suspend bankruptcy proceedings if it discovers that the assets of the bankrupt are insufficient to satisfy the claims against the estate, that is the remuneration and the costs of the administrator to be paid from the debtor's assets, and the costs of the bankruptcy proceedings, otherwise the case is closed after the final distribution of the proceeds has been made, on the administrator's motion. Obviously, the court will also suspend the process if the debtor demonstrates, before the resolution on the declaration of bankruptcy has been issued, that he has paid all claims due to the creditors that are parties to the bankruptcy proceeding or is, the debtor demonstrates his solvency after a creditor launches proceedings. If the debtor breaks the arrangement, the three year period is cancelled and he loses the opportunity to discharge his debts

On the date of cancellation of the bankruptcy proceeding, the administrator should close the books of account and draws up a separate financial statement pursuant to specific legal provisions. The administrator should also hand over to the bankrupt or, if appropriate, to the liquidator, all required documents and the remaining assets, and ensure that any further action related to the cancellation of the bankruptcy proceeding be taken. Once the action has been taken, the court should dismiss the administrator from his office.

Where a natural person dies during the bankruptcy proceeding, his heirs assume his role in proportion to the assets subject to bankruptcy; where there are no heirs or where they refuse the inheritance, the bankrupt's role is assumed by the State.

Withdrawal

Discharging of debts by consumers is novel in Slovak law. As part of the bankruptcy proceedings, an individual[244] may, at the end of a post-bankruptcy probation period, petition for the discharge of any remaining amounts payable on all creditor claims arising prior to the declaration of bankruptcy that were duly evidenced to the court within 45 days of such declaration. This is carried out by the debtor petitioning the court after the suspension of bankruptcy proceedings under the conditions laid down by the law for clearing his debts under the terms of *withdrawal*. An individual filing for bankruptcy may, at the same time or at any time prior to the closing of the bankruptcy procedure, also petition

[244] A debtor who is a natural person. This option is not available to corporate insolvencies.

for an eventual discharge of his or her debts. That petition must contain certain general prerequisites as well as a well-founded statement of the intent of the debtor to exert reasonable efforts to satisfy the creditors. Applications for a *withdrawal* permit must be submitted before the suspension of bankruptcy proceedings at the latest. The court will permit the withdrawal of the debtor provided that the debtor has duly fulfilled his obligations during the bankruptcy proceedings.

The court will then appoint a trustee for the debtor for the duration of a three-year probation period that commences on the valid and effective date of a court's resolution of the discharge of debts. All legal acts of the debtor during this probation period are subject to the written consent of the trustee to the extent specified by the court. The trustee is obliged to decide immediately whether it approves of a given legal act of the debtor. The trustee is entitled to approve a legal act of the debtor only if the value of the debtor's assets increases as a result of such legal act.

Permission for withdrawal marks the start of a three-year trial or probation period. During this period the debtor must provide the receiver with a sum of money specified by the court at the end of every trial year for allocation to creditors. Only claims that were duly filed within 45 days of the declaration of bankruptcy and properly evidenced in the bankruptcy proceeding can be satisfied in this manner during the probation period. However, the maximum amount is 70% of his entire net income for the trial year just ended. After deducting his or her remuneration, the trustee will distribute these funds on a pro rata basis to the debtor's creditors. Upon the expiration of the probation period, the court will finally decide whether to discharge the debtor from his debts.

Claims that arose prior to bankruptcy but were not evidenced to the court (and thus were not on the schedule of claims that were paid down in part by the debtor during the probation period) are rendered unenforceable, together with the remaining portion of the properly evidenced claims, upon publication in the Commercial Journal of a resolution on the discharge of debts. Claims that arose during the probation period are not affected by the discharge and remain enforceable in full.

However, it should be noted that costs are a problem, as the law requires debtors to pay court fees or the trustee's fees or face immediate case dismissal[245]. According to several respondents, the withdrawal procedure is recognized by law, but is very rare in practice. Most of the debt collection practices take place well in advance before the natural person is by legal definition over-indebted. In Slovakia, according to Kilborn (2010b) under 150 cases were opened in the first three and a half years of the Slovak Insolvency Act, with this cost being a likely cause of this.

As such the Ministry of Justice has informed the authors that new legislation is planned which is planned to be implemented in 2014, on the basis that the process to attain a discharge is presently insufficiently flexible to meet requirements. This legislation shall liberalise the process of gaining a discharge and make it available to more debtors.

[245] Slovak Insolvency Act s.171(A).

3.19 Spain.

3.19.1 Debt re-organisation

Legal framework[246]

The principal Spanish rules relating to insolvencies are found in the relatively recent Insolvency Law 22/2003 of the 9th of July. Main aspects of the law are:

- The 2003 Act contemplates a single insolvency proceeding, "bankruptcy" (*concurso de acreedores*) which is applicable to all types of debtors (legal entities and individuals)[247].
- The proceedings can conclude either with the approval of a settlement by creditors or with the liquidation of the company (or of the assets of the individual).
- A new type of Courts is created (*Juzgados de lo Mercantil*) so as to ensure the correct application of the bankruptcy law.

This law has been the object of a recent reform by way of the Royal Decree Law 3/2009 of the 27th of March. The 2009 changes made the two over-indebtedness proceedings ("quiebra" – which means bankruptcy and "suspension de pagos" – which means insolvency), which previously were only for businesses, accessible to natural persons. However, the procedures themselves were not re-designed with the view of adapting them to the particular needs of consumers[248].

The present situation is therefore one where all cases of insolvency and bankruptcy from individuals to multinationals are included in the same process denominated "concurso de acreedores".

Through this "Concurso de Acreedores" a debtor is declared by a Court as unable to pay their creditors. When it is the debtor who files for insolvency the procedure is called "concurso voluntario" (voluntary proceeding) otherwise when the creditors are filing the proceeding in order to recoup part of the debt, the procedure is called "concurso necesario" (necessary proceeding).

Act 38/2011, of 10 October has aimed to further the reforms started in Royal Decree Law 3/2009, trying to adapt the rules of insolvency to the corporate realities triggered by the current financial climate. This new Act introduces a series of significant changes for businesses, especially in relation to refinancing, but no significant changes in legal provisions for personal bankruptcy.

A Decree-Law from March of 2012 dealing specifically with mortgage debt but of limited applicability is discussed in more detail in the last section of this chapter.

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[246] REFERENCES: El Consumidor Ante La Crisis Económica: Análisis Y Soluciones, 2011, Eugenio Ribón Seisdedos; Blanquer Uberos, R. Efectos del concurso sobre los derechos de la persona del deudor, familia y sucesiones, en La nueva ley concursal –Estudios de Derecho Judicial nº 59-, Madrid, 2005; Cuena Casas, C. y Colino Mediavilla, J.L. (Coords). Endeudamiento del consumidor e insolvencia familiar. Cizur Menor (Navarra), 2009; Fernández Carron, C. El tratamiento de la insolvencia de las personas, físicas, Cizur Menor, 2008.

[247] Before 2003 there were four bankruptcy proceedings, two for commercial debtors (*quiebra* and *suspension de pagos*), and two for non-commercial debtors (*concurso de acreedores* and *quita y espera*).

[248] In Spanish the terms for Insolvency and Bankruptcy are, respectively "insolvencia" and "quiebra". Insolvency is a legal proceeding that, if accepted by court, protects the company or the individual from its creditors and in most cases normal commercial activities will continue. Bankruptcy is another legal proceeding that involves the cessation of commercial activities and the final liquidation of the debtor's assets in order to repay creditors.

Procedural aspects

Insolvency must be declared by a court. Filings should be made with the Mercantile or Commercial Court located in the jurisdiction of the debtor's headquarters. The party filing for insolvency will have to nominate a lawyer and prepare a file that will include financial accounts for the last three years including if possible: an accounting audit, a list of creditors with all the amounts owed and a detailed inventory of the debtor's assets.

Declaring insolvency at court will thus require the collection of a substantial amount of information. The court can decide to accept or reject the proceeding. If the Judge adjudges the debtor bankrupt, the next step will be the appointment of the bankruptcy trustees, which will analyze and determine the bankruptcy estate (*activos*) and the existing debts (*pasivos*). This stage is concluded with a report drafted by the bankruptcy trustee panel (*administración concursal*), which includes the patrimonial situation of the bankrupt, as well as the inventory of the bankruptcy estate and the list of creditors .Once the inventory and the list of creditors have been fixed, two alternative stages can follow: i) the settlement of creditors, which implies reaching an agreement between the debtor and the creditors for the payment of the credits, or ii) the liquidation of the bankruptcy estate in order to pay the debts. The liquidation stage will be initiated if no agreement is reached or in case of non-compliance by the debtor with the agreement.

Implications for the over-indebted consumer

While the legal figure of 'settlement of creditors' is nominally applicable to situations of personal bankruptcy, it is in reality a very unlikely outcome of the proceeding. Traditionally, the creditors of over-indebted consumers opt for liquidation because liquidation brings many advantages over settlement since liquidation obliges consumers to continue meeting outstanding unpaid debts with future incomes, often for many years after liquidation. The details of this process are further discussed in the asset liquidation section.

3.19.2 Debt relief

There is no mechanism for debt relief of over-indebted consumers.

3.19.3 Asset Liquidation and Debt Cancellation

In the current state of Spanish law, the liquidation of the debtor's assets as a result of a bankruptcy proceeding does not cancel the amount of debt that remains unpaid. The debtor will continue to be responsible for repayment should new assets enter into their estate until the total of the debt is fully repaid[249].

In Spain, personal insolvency and the personal bankruptcy process lead to severe consequences for the debtor. In particular, the legal framework seems designed with the protection of businesses in mind and with almost complete disregard for the needs of over-indebted consumers.

[249] Even when a bankruptcy proceeding ends with an agreement to cancel outstanding debts, it is possible, according to some legal opinion, that creditors ignore the partial waiver granted in the event that the debtor's estate subsequently increases significantly. This may mean in practice the indefinite subjection of the overindebted debtor's assets and therefore a burden that prevents the consumer from rebuilding his financial independence in the future.

One indication of this is the non-applicability to individuals of the suspension of enforcement of debt interest payments. The law provides for the suspension only if continuity of business activity is at risk. Since many of the applications from natural persons are based on the inability to cope with mortgage loan payments, this condition rarely applies to personal over-indebtedness.

The bankruptcy process can in principle end in an agreement with creditors or liquidation. Of these two only the first is adequate to overcome the insolvency problems of the debtor. The law recognises under art. 136, these agreements and when they are reached they replace the old debt with a new contract for partial and/or deferred repayment.

However, it is not easy for consumers to reach an arrangement with creditors. Creditors are most often financial institutions and the debts have associated collateral (homes, vehicles) which together with the favourable legal status of creditors make it unappealing to them to reach an agreement. Instead creditors opt for liquidation which pays a portion of the outstanding debts immediately and on-going small payments from the debtors often for many years into the future.

Liquidation, therefore, is unlikely to produce the effect of overcoming the situation of insolvency because liquidated values will generally be below the value in debt and because by law debtors continue to be responsible for the unpaid remainder of the debts after liquidation of all assets. Part of the debtor's future income is protected (*rendimientos inembargables*) and the remainder is used to the repayment of the outstanding portion of the debt. This leads often to a very long period, often many years, of periodic payments to creditors. The process, according to ADICAE is '*ineffective'*, demonstrated in their argument by the National Statistics Institute in 2011, which revealed there were only 953 bankruptcy proceedings by individuals without businesses, compared to 77,854 bankruptcy proceedings for those with businesses. ADICAE argues forcefully that '*it is essential to reform [to] ensure consumer debtor's rights, especially in two areas....making the [process] a safe destination... and [allowing a] 'fresh start''.*

In the case of legal persons, the law allows the extinction of the legal person after a bankruptcy process where it is determined that this legal person does not have any assets. This equates to an implied waiver of liability for the non-satisfied portion of the debts after the conclusion of the bankruptcy process. In the case of natural persons, the absence of assets does not change the outcome of the process in any way and there is no release from debts due to inexistence of assets. So at the end of the personal bankruptcy process the debts that are not paid remain active. The debtor is left financially marginalised with no access to the credit market and either effectively prevented or at least strongly discouraged from starting any new economic activity.

3.20 Sweden

Although we were not requested in include Sweden in our study, we have found several relevant sources[250] in relation to its debt cancellation process, which we have included. This section has not been reviewed at the national level in the same way as for other countries.

[250] McGregpr, Klingander, & Lown (2001), *Konsumentverket* (2003) Kilborn (2006), Kilborn (2010b)

Prior to 1994, bankruptcy law in Sweden (konkurslagen) did not contain a debt cancellation mechanism. Swedish legislation in 1994, called the *Skuldssaneringslag*, introduced reforms, predicated on a three stage process:

- Stage One – an informal process of attempting to reach a voluntary agreement, led by an official administrator (the debt collector, *Kronofogdemyndigheten*, or KFM) to which all creditors had to agree. Refusal by a creditor to agree, or collapse of the agreement led to Stage Two. The KFM had discretion over exempt income, and plan length. To tailor plans to individual conditions, although the original rule on plan length was that these should run for five years as standard, although longer and shorter were permissible. As in the Netherlands, this level of discretion was effectively rejected by the KFM, with plan design becoming rapidly standardised, with the general exemption rules accepted as standard and plans length rarely deviating from the five year norm. There was occasional variation in the 'buffer' for unanticipated expenses added to the exempted income, but even here the Tax Service, which controlled the KFM pressed for greater consistency of application.
- Stage Two – was a formal submission for entry into the formal system. This process included a screening by the *Kronofogdemyndigheten* (KFM), who would test it against the eligibility criteria:
  - The debtor was expected to have been attempting to address his over-indebtedness for some time, generally three to four years, before they become eligible for formal debt relief.
  - The debtor was not eligible if he is felt to have engaged in active rather than passive over-indebtedness. Reckless risk-taking, 'luxury consumption and acts of bad faith before requesting formal debt relief would exclude the debtor. Similarly he is expected to have attempted to maximise his earnings, liquidated any non-property assets and sought other alternatives, such as informal debt re-organisation.

  These requirements led to high rejection rates. Between mid 1994 and 2001 rejection rates averaged around 40% of all petitions. From 2001 to 2003 this fell to 30%[251]. This reflects a continuing reticence to recast existing contracts wherever possible.

  The KFM would then propose a settlement based on guidelines set out by the Tax Service, generally over a five year period. If any creditors opposed this plan, the case transferred from the KFM to the local general district court for Stage Three.

- Stage Three – a judicially led process to agree a repayment plan[252]. On conclusion of this any remaining debts would be cancelled and the debtor discharged.

This process is exceedingly close to that put in place in the USA in 2005. It is therefore interesting that the perceived failures of this system led to Sweden radically reforming its legislation again, with the Swedish Debt Adjustment Law, effective January 1st, 2007. The major reasons for this were:

- **Misuse of Stage One** – Many disordered debtors who were not in a state of over-indebtedness used this process and the municipality-funded debt-counselling services, so that in 2002 and 2003 creditors accepted 40-45% of proposed informal payment plans. In

[251] A further12-145 of petitions were also withdrawn, meaning that less than half of all petitions continued to the next step.

[252] Normally formally imposing the KFM's previous proposals.

cases where the outstanding debts were more significant[253] the Consumer Agency, the *Konsumentverket*, reported that Stage One was 'often a formality' (*Konsumentverket* 2003).

- **Uncertainty over the level of completion of voluntary payment plans –** Whilst voluntary plans were often, perversely, more likely to be successful, because they could draw on income the KFM and courts had to treat as exempt, and could extend longer than the mandatory period of five years, and that ten year durations were not unusual, but that the failure rate was up to 70%[254].
- **Low levels of take-up of Stage Two** – Legislators has expected around 12,000 petitions a year. Between 1997 and 2003 they ranged between 3,200 and 3,500, rising to 4,200 in 2005, suggesting unmet need, which was the suspicion of the Consumer Agency and the Tax Service, in part driven by the eligibility criteria which prevented some individuals progressing to Stage Two, despite their levels of indebtedness.
- **Low payments to creditors under KFM payment plans** – The KFM was designed to be creative in setting income exemptions, based on legally set guidelines. Instead the KFM took the guidelines as de facto rules, the only major difference being the addition of a 'buffer' for unexpected costs. Debtors whose income was less than this level were set *nullförslag,* or 'zero-proposals.' It is estimated[255] that around a quarter to a third of KFM payment plans were *nullförslag* with, in 2002 and 2003, more than half of plans *accepted by creditors* offering payments of 10% or less of the outstanding debt, and only a quarter offering 20% or more. Kilborn's estimate is that 70% of plans gave less than 1,500 crowns (c$175) per month to share amongst all creditors.
- **Low numbers of case using Stage 3** – Only 1,600 debt adjustment cases reached court in each of 2001, 2002, and 2003, just over half of which were mandatory, caused by creditors refusing the KFM's proposed plan, many of which were seen as frivolous. Given the court upheld the KFM's plan in around 90-95% of these mandatory cases, stage 3 became a '*pure formality*'[256]. The other half were appeals of one sort or another, suggesting either compliance with the KFM plan by debtors or creditors ceasing pursuit.

The major reforms proposed in 2004, debated in 2006 and brought into force in 2007[257] abolished both stages one and three as wastes of time. Stage one delayed support to debtors in hardship, often without achieving a positive result, or without debtors '*showing personal initiative to work something out themselves to avoid bankruptcy if they could*'[258]. While voluntary payment plans were still supported and counsellors still provided, it was no longer mandatory to go through this process to access the formal system. In the new legislation the KFM apply binding payment plans and also administrate any proposed modifications. There remains the potential for appeals to the courts in cases of fact and application of legal process, but otherwise **debt cancellation in Sweden is now a non-judicial process.**

In 2009, the Swedish government proposed to reduce the five year repayment period to three years.

[253] Over 200,000 crowns, worth circa $37,500 at the time.

[254] See MacGregor et al (2001).

[255] See Kilborn (2006), p453.

[256] Swedish government report quoted in Kilborn (2006) – p 451.

[257] Using the same name as the 1994 legislations.

[258] See Kilborn (2006) p 459.

3.21 United Kingdom

3.21.1 Causes of over-indebtedness.

Looked at over time it is clear that passive indebtedness has become a major component of the UK over-indebtedness landscape. Whilst legislation has changed little in relation to processes to address debt solutions, there has also been clear Government effort to prevent consumers from becoming over-indebted in the first place, focussing on ensuring responsible lending, debt advice and financial education[259].

Table 8: UK reasons for financial difficulties 1989, 2002

Reason	1989	2002
Loss of income	26	45
Redundancy	-	19
Relationship breakdown	-	5
Sickness or disability	-	7
Other loss of income	-	14
Other changes in circumstances	7	-
Insufficient (1989)/Low(2002) Income	25	14
Over-commitment	24	10
Increased/unexpected expenses	10	12
Overlooked or withheld payment	12	8
Third party error	-	5
Debts left by former partner	-	4
Other reasons	12	3

Source: Berthoud and Kempson, "Credit and Debt – The PSI Report" (1992), Kempson (2002)

Table 9: Reasons for individual bankruptcy as recorded by official receiver, 2006-7

Reason	Percentage
Living beyond means	30%
Unplanned change of circumstance	43%
Business failure	16%

Note: Unplanned change of circumstance includes 'life events' such as illness, an accident or a relationship breakdown, and the loss or reduction of income (either of the bankrupt or his/her household.

Source: Insolvency service, England and Wales (2008) study

3.21.2 The debt solution landscape

The United Kingdom, particularly England and Wales as analysed in this section, has a system which could be described in some ways as very particular within the landscape of European models. There

[259] Skene & Walters (2006)

are a number of key differences between how the English and Welsh system operates compared to the direction Europe as a whole has taken, but there are underlying common themes which are worth keeping in view.

- The English and Welsh system is predicated on the UK system is designed with multiple routes which attempt to deliver two main objectives:
  - Stabilisation of debt for a period so a schedule of payments can be established and met, often with the capacity for a short-term freezing of interest, and
  - Cancellation of debts after the conclusion of this process if the terms of the agreement have been met and outstanding debts remain.
- The English and Welsh system puts little emphasis on negotiated settlements, instead imposing plans on creditors in many cases.
- The English and Welsh system has looked to move activity out of the courts via the creation of alternative arrangements.

The areas where England and Wales are distinct are:

- **The speed with which consumers can move to discharge their debts.** As opposed to European standard payment plan durations of three to five years, and in some cases longer, the UK has by far the shortest period to discharge, namely one year in the case of the bankruptcy process. The English and Welsh system is designed to focus on the consumer and achieve results quickly to encourage rehabilitation and entrepreneurial activity. This leniency has knock-on effects on neighbouring countries who find themselves having to compare their systems against the UK when bankruptcy tourism facilitates inequality in outcomes in their system.
- As with most of Western Europe, **the existence of debt counselling services to encourage debt re-organisation** as well as helping consumers navigate through debt relief and debt cancellation processes. This is in contrast with Eastern Europe, in the main, who have never had this type of facility, and as such have focussed more on formal routes to solutions.
- **The multiplicity of types of arrangement.** As opposed to say Germany, Sweden, or France where one system, albeit comprising of a number of steps, is deployed to solve over-indebtedness, the English and Welsh system contains a number of discreet processes, many of which lead to the same end-point, discharge, but are only applicable in certain cases.

Taking this last point, the following table provides a breakdown of the methods identified by the Insolvency Service which are available to consumers.

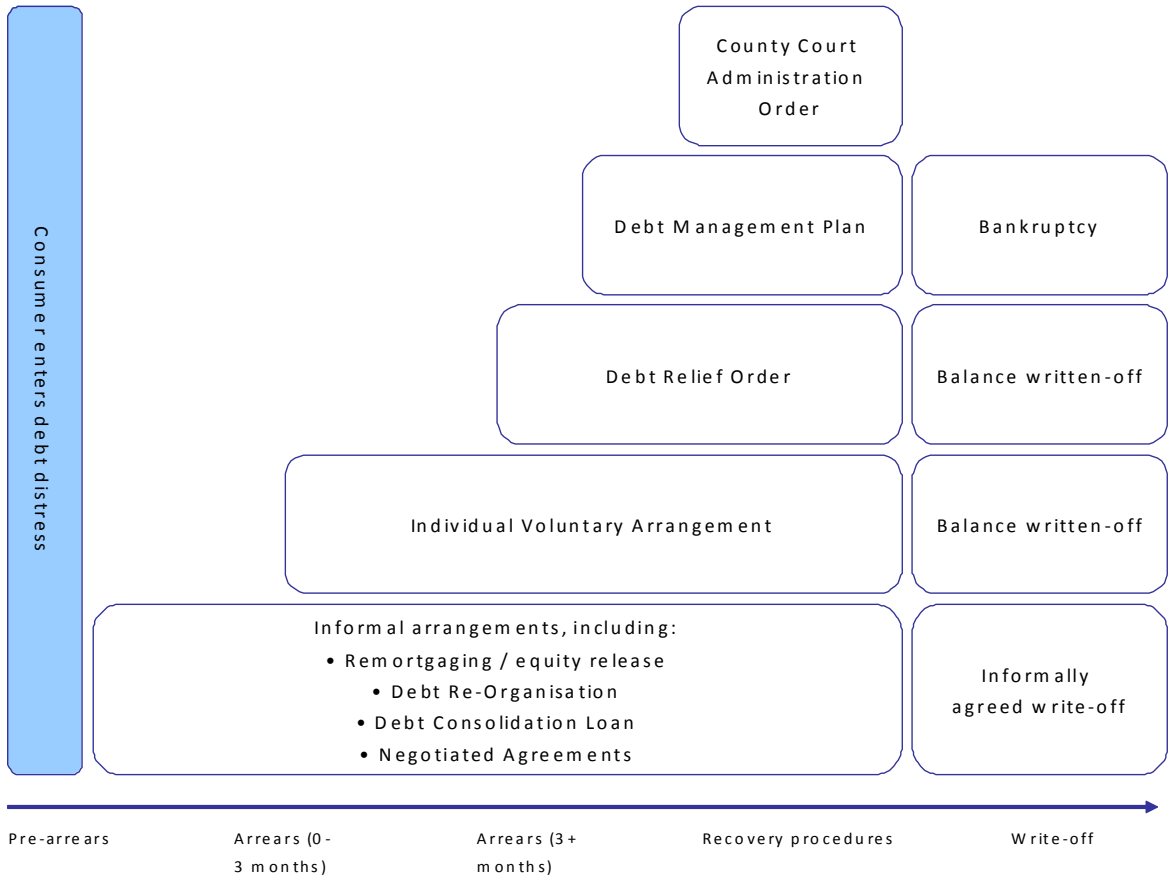
Table 10: UK debt Solutions

	Negotiated Agreement	*Debt Re-Organisation / consolidation loan*	*DMP*	*CCAO*	*IVA*	*DRO*	*Bankruptcy*
Automatically free of debt?	No	No	No	No, unless court orders this	Yes, when IVA completed	Yes, except see below	Yes, except see below
Automatically binding on all unsecured creditors?	No	Only on creditors paid in full	Only on creditors paid in full	Yes	Yes, if 75% (by value) of creditors accept	Yes, those in application form	Yes
Automatic Protection from unsecured creditors	No	Only on creditors paid in full	No	Yes	Yes	Yes	Yes
Protection from action by secured creditors?	No	No	No	No	No	No	No
Length of time?	Any	Any	Any	Until last payment made[260]	Up to 5 years	Usually 1 year	Usually 1 year, but payments may last 3 years
Home at risk?	No, if mortgage payments made	No, if mortgage payments made	No, if mortgage payments made	No, if mortgage payments made	If you cannot raise an equivalent amount to your share of the property	No, home-owners do not qualify for a DRO	Not if spouse / partner / relative can buy you out
Minimum or maximum amount owed	No	No	No	Up to £5,000, including one qualifying debt	No	Up to £15,000	No minimum
Types of unsecured debt affected	Any	Any	Any	Any	Any, but usually exclude fines, student loans and maintenance payments.	Excludes fines, student loans and maintenance payments	Excludes fines, student loans and maintenance payments

One of the key differences amongst all these system is that they can be applied at different points in time from problem debts emerging, as demonstrated in the following figure.

[260] The Citizen's Advice Bureau consider this to be up to three years normally.

Figure 1: UK debt solutions



Similarly we can map these onto the six families.

Table 11: UK debt solutions in the nine families

	Principal unchanged	Principal reduced	Principal cancelled
Interest unchanged	**1)** Debt Re-organisation		
Interest reduced	**2)** Debt Re-organisation / Consolidation Loan / Debt Management Plan	**3)** Debt Management Plan	
Interest frozen	**4)** Debt Management Plan / County Court Administration Order	**5)** Debt Management Plan / Individual Voluntary Arrangement / County Court Administration Order	
Interest cancelled			**6)** (After completion of) Individual Voluntary Arrangement / Debt Relief Order (after one year) / Bankruptcy

We can also see a clear hierarchy in usage between the different types of process.

Table 12: English Insolvency Alternatives - 2009	
Alternative	**Number**
Individual bankruptcy	72,480
Individual voluntary arrangement	47.641
Debt relief order	11,831
Administration order	1,948
Debt management plan	100,000-150,000 (estimate)

Source: Insolvency service, Ministry of justice, Judicial and court statistics (2009)

3.21.3 Debt re-organisation

The broad objectives of resolving difficulties at the simplest level and providing consumers with the time to get back onto a firm footing without necessarily needing to enter a formal solution which may lead to debt cancellation has led to a wide variety of 'recognised' techniques in the UK credit system.

- Re-mortgaging – with many debts being related to housing, the plethora of mortgage models in the UK market encourages consumers to look here first when trying to resolve debt problems, particularly with the Financial Services Authority's focus on lender's obligation to think in the round to avoid pushing borrowers into foreclosure. More information on this is provided in section 4.19. The options are:
  - Looking for a better rate – simply shopping around is the first option available to consumers.
  - Extending the contract time period – extending duration of the mortgage increases the total sum paid, but also reduces individual payments, making the mortgage more affordable.
  - Using an 'Interest Only' product – again this reduces individual payments but only delays the consumer's need to find a way to pay off the capital element.
  - Equity release – renewing a mortgage to basically re-finance problematic debts by increasing the amount borrowed and using this to offset more expensive loans, decreasing the overall cost of servicing debts. This is similar to a consolidation loan.
  - Capitalising the debt – taking payments which have fallen into arrears and any charges and adding these to the capital borrowed. This may be helpful, and gives the loan the appearance of being functioning, but the FSA do look to lenders to only use this appropriately, where it helps the loan become more sustainable.
  - Using other products, such as lifetime mortgages. A lifetime mortgage rolls up the interest and instead of paying this sets the capital accrued against this, so that at the end of the consumer's life the capital is used to pay-off the interest, up to the value of the capital; i.e. there is no possibility of negative equity, so the lender takes the risk that property prices will allow full payment.
- Debt re-organisation / consolidation loan – Debtors bring all their debts into a single new loan on more manageable terms to replace their original loans; however the availability of this may depend on how their previous payment problems have affected their credit rating.
- Negotiated agreement with creditors – Debtors contact creditors directly, in an ad-hoc fashion, and negotiate an agreement to repay all or some of their debts. We will exclude

this from the rest of our study as it is too informal; there is no standard methodology and creditors agree to a wide variety of outcomes, from writing off the debt to just making payments more manageable.

- Debt Management Plan (DMP) – Debtors find a licensed debt management company who contacts creditors and commences negotiation on an agreement to repay all or some of their debts. The process is less formal than those listed below, and is not binding on lenders. Interest may or may not be frozen. Neither does it offer the debtor any protection from any further action by the lender. The outcome may include some element of writing-off, but equally it may only include the negotiation of some degree of forbearance. As such, we have placed this under debt re-organisation. The opinion of this process, according to one survey respondent from an association of lenders, was that this process did generally work for lenders and that lenders were generally satisfied with this process. If the DMP does not succeed, then the debtor moves on into one of the more formal routes which does offer protection from prosecution and halts interest accruing on the outstanding debt.

3.21.4 Debt relief

In the UK there are multiple routes which can lead to a discharging of debt. The main distinction between whether a process offers in our terminology debt relief or debt cancellation is whether or not the process compels some degree of payment. In short, if the process cannot be completed without making some form of payment, so *a priori* the whole debt cannot be cancelled, it is a debt relief process. If the consumer can go through the whole process without contributing anything (e.g. like a zero-plan in other jurisdictions), it is a debt cancellation methodology[261].

In the UK there is one process which requires some positive payment for the consumer to become eligible for having the remainder of their debt written-off or discharged.

- **County Court Administration Order (CCAO)** – CCAOs were established in the County Court Act (1984), to offer a '*limited means of dealing with over-indebtedness to facilitate the recovery of small debts while protecting the debtor from creditor harassment*'[262]. Debtors wishing to use this mechanism must have total debts not exceeding £5,000, including at least one judgement debt[263]. They must file a request in the geographically relevant court, where a court official then considers whether the debtor has sufficient means to fulfil a series of instalments over a '*reasonable time period*', setting the instalment value and the time period and makes an order establishing this routine of payments, pro-rated amongst creditors, under which creditors cannot take further action against you. The debtor and creditors are informed of the proposed payment plan. If there are no objections in the prescribed period the CCAO is made as proposed. If the debtor or a creditor raises an objection then, or if the official believes the debtor has insufficient funds to make full recompense to the creditor(s) in a '*reasonable time*' then the case proceeds to a District Judge. The District Judge can then define a plan which does not lead to full recompense to the creditors; a CCAO '*may provide for the payment of the debts of the debtor by*

[261] It is fair to say that the distinction can be fuzzy, especially in processes which include asset liquidation. In practice, we have worked on the basis of assessing what would happen to no-income, no-asset (NINA) consumers.

[262] Skene & Walters (2006). No enforcement action by creditors can be taken against the debtor or their property whilst the CCAO is in place. However, if payments are not kept up with the court can revoke the CCAO.

[263] This is a debt which a creditor has sought to have enforced in the courts, where a judgement has been made that the debt must be paid. Judgement debts appear on credit rating assessments unless they are paid quickly.

instalments or otherwise, and either in full or to such extent as appears practicable to the court under the circumstances of the case'[264]. If the debtor therefore provides sufficient payment to cover the court fees and meet the Judge's payment plan, he can then earn an entitlement to have any remaining debts written off[265]. As such there is no potential to have all costs written-off, so we have listed this process as debt relief. This process does not require asset liquidation as it is designed for low income / relatively low debt households which are not expected to hold significant assets to liquidate.

According to a survey respondent from an organisation that offers advice to consumers, the Court may impose an attachment of earnings order on the consumer to ensure that the payments are made[266]. This process has a negative impact on the credit rating of the consumer, according to the respondent, and has a negative impact on the consumer's future access to mainstream credit. The respondent said that, in most cases, involvement in the process would not have an effect on the consumer's employment but it could in the case where a consumer's employment is conditional on the consumer not having any county court judgements against them.

The respondent also stated that a consumer would lose the protection of the administration of the order if they broke the terms of the arrangement. This could lead to additional interest and charges and the consumer could face court action by creditors.

The respondent estimates that about 3,000 consumers used this process in 2009-2010, based on figures from the Ministry of Justice.

The most common complaint from consumers about the CCAOs, according to the respondent is that so few people are eligible for them because they require a county court judgment and a debt of under £5,000. Despite this, the respondent felt that the process did generally work for consumers.

3.21.5 Asset Liquidation and Debt Cancellation

The United Kingdom passed a major piece of insolvency legislation in 1986, the Insolvency Act. This laid down the framework within which the variety of debt solutions operates. The Insolvency Act created two routes through which debt cancellation can be achieved:

- **Bankruptcy**
- **Individual Voluntary Agreement (IVA)**[267]

In addition, further legislation in 2009 introduced a third debt cancellation process:

[264] §112(6), chapter 28, County Courts Act 1984.

[265] §117, chapter 28, County Courts Act 1984.

[266] Preston Borough Council v Riley is an example of case law which has affected the application of this legislation as far as it relates to County Court Administration Orders.

[267] In January 2008, the Latvian Insolvency Act established a new procedure in that jurisdiction which is very similar to the English IVA. The purpose was to give a natural person an opportunity to renew his payment arrangements or be released from the debt, following the sale of property and efforts to satisfy creditor's claims without the stigma of the consumer being labelled 'bankrupt'. To apply, the consumer must not have the means to meet payments for which the date has passed and where the total commitments exceed either the minimum wage monthly income by fifty times or the consumer must not have the means to meet payments for which the date will pass in the next year and where the total commitments exceed either the minimum wage monthly income by one hundred times. See the Latvian Insolvency Act Part D Chapter XXIV, §149 (1) & (151).

- **Debt Relief Order (DRO)**

Respondents felt that the processes did generally work well for consumers and lenders despite each of these processes having a negative impact on the credit rating of the consumer and the consumer's future access to mainstream credit. The respondent said that, in most cases, involvement in the IVA process would not have an effect on the consumer's employment but it could in the case where a consumer's employment is conditional on the consumer not having any county court judgements against them. In the case of bankruptcy and DROs, the process could impact employment if the consumer works in the financial services sector, the armed forces, the police or as a solicitor, an accountant, as a local councillor or as a Member of Parliament.

The respondent estimates that 50,693 consumers used an Individual Voluntary Arrangement, 25,179 used the Debt Relief Order and 135,045 used the bankruptcy process in 2009-10, according to figures from the Insolvency Service.

Bankruptcy

Bankruptcy[268] is a full asset liquidation and debt cancellation process established under Part IX of the Insolvency Act 1986. It is a judicially-led process under which assets are sold and regular payments are required for up to three years if the debtor has surplus income. Residual debts outside the payment plan are discharged after one year. Debts which cannot be written off are student loans, fines and debts arising from family legal proceedings. Creditors holding secured debt can still take action (e.g. repossession) during the bankruptcy period, otherwise alternative enforcement proceedings are halted.

In the UK, where financial deregulation has been most expansive, and where comparisons are more often drawn with the USA than European models, bankruptcy legislation has more been perceived as an instrument of enterprise / entrepreneurial policy than legal / financial policy[269]. The aim is to restore economic actors to full effectiveness as quickly as possible, which is why discharge rates from bankruptcy in the UK are only one year. As seen, this decision has knock-on implications for other countries. Ireland in particular has found it necessary to revise its legislative code in reaction to this.

Either the debtor or a creditor can apply to the High Court or the relevant County Court to initiate a Bankruptcy Order[270]. Debtors must submit a written statement which demonstrates their inability to meet their debts[271]. All bankruptcies are administered by the Official Receiver (OR), through the Insolvency Service. Creditors can request a private sector trustee succeed the OR[272], if the estate is large enough to make this worthwhile. The debtor must submit to the OR's investigation and co-operate with the OR or subsequent trustee[273].

[268] Bankruptcy in the UK explicitly and only means personal bankruptcy. Corporate insolvency is a completely different process. The bankruptcy discharge conditions were revised in 2004, tellingly in the Enterprise Act which came into force on 1st April 2004.

[269] See Green (2009)

[270] §§264-8, 272, 373-4, c.45 Insolvency Act 1986.

[271] §272 c.45 Insolvency Act 1986.

[272] §§292-6 c.45 Insolvency Act 1986.

[273] §§291 & 333 c.45 Insolvency Act 1986.

The debtor surrenders all non-exempt assets to the OR or trustee. Exemptions are tools of the trade are basic household items. Housing is not exempt, although any property can only be held in the estate for three years, a rule implemented to prevent trustees holding property in hopes of a rising market[274]. Secondly the OR establishes a payment plan drawn from surplus income, that is income over and above the exempt income level, via an income payments order or agreement[275].

Discharge was revised by the Enterprise Act 2002, and was effective from 1st April 2004. This give an automatic one year discharge[276], unless the OR considers following investigation of the debtor's conduct and affairs delay is redundant. This was counter-balanced by permitting surplus income to be captured before and after discharge for up to three years, and is restricted from taking new debts over £500 or serving as a company director. These restrictions can last from two to fifteen years[277].

According to a survey respondent from a consumer advice organisation, the Insolvency Service has recently consulted on reforming the petition process for bankruptcy to take the court out of the process. The aim is to cut costs and streamline the process. The outcome of this legislation is not known at the time of publication.

According to the respondent from a consumer advice organisation, in the case of a bankruptcy process in which the official receiver requires the consumer to make payments under an income payment agreement, if the consumer stops paying, then the official receiver can take actions to recover the missed payments and can apply to the Court to suspend their discharge from bankruptcy. The Court could also find the consumer in contempt of court in this situation, in which case the sanction is imprisonment. According to the same respondent, the most common consumer complaints about bankruptcy in the UK are that the fee for bankruptcy (£700) is beyond the reach of some consumers on low incomes with substantial debts and that homeowners are in danger of losing their homes. The respondent also pointed out that this process may not work properly in the case where the receiver requires the consumer to pay substantial sums under income payment arrangements or orders.

Individual Voluntary Agreements

IVAs are the formal alternative to bankruptcy, established in Part VIII of the Insolvency Act 1986. It is instantly recognisable as what would be known in the rest of Europe as a '*composition with creditors.'* The UK, in fact has had *composition with creditors* style legislation for nearly two hundred years[278], initially implemented, as usual with indebtedness legislation in part response to the recessionary consequences of the Napoleonic Wars, and the perceived weaknesses of bankruptcy legislation which forced the sale of assets, often at significantly less than market value[279].

The court has little role in the IVA process, aside from a fairly standard[280] supervisory role, in that dissatisfied creditors[281] can appeal approved IVA plans to the courts.

[274] §§283, 307-308A c.45 Insolvency Act 1986.

[275] §§310-310A c.45 Insolvency Act 1986.

[276] §256, c40 Enterprise Act, replacing §279 c45 Insolvency Act 1986.

[277] §360(5) c.45 Insolvency Act 1986.

[278] Lord Eldon's Act 1825, 6 Geo 4, c.

[279] This is not an isolated example of recessions leading to reform, see for example German legislation from 1935, or the waves of legislation following the recessions of the late 1970s and early 1980s, early 1990s and the Great Recession of 2007-present.

[280] See also Sweden and Franc.

[281] §§256A(3), 262, 263(3-5), chapter 45, Insolvency Act 1986. One presumes dissatisfied debtors may have a similar right, but we cannot provide assurance of this.

Debtors find a licensed 'insolvency practitioner' who negotiates a deal with creditors, often freezing interest. The creditors vote and if they give their approval, the nominated administrator becomes the IVA administrator[282], with responsibility for ensuring implementation and making sure the debtor pays. If 75% of the creditors[283] by value do not agree, the debtor and the supervisor must re-write the proposal and re-submit it. Creditors can demand changes before giving approval. At the completion of the IVA (often five years), any outstanding balance is written off.

One point which is worth noting is that IVAs should be assumed to give better returns to creditors than bankruptcy.

- IVAs can require some asset liquidation, including requiring equity release from any share of a property.
- IVAs can require payment plans for up to five years.
- IVAs have lower costs than bankruptcy, because no use is made of the official receiver, court costs are lower and the administration is less time-intensive than for a bankruptcy.
- IVAs are based on agreement by the creditor, who can therefore ask for more if he desires it, however as bankruptcy takes all income over an exempted level, asking for more when no more exists can appear intuitively pointless, except that consumers may be willing to pay more out of their exempted income to avoid the stigma of bankruptcy, including the greater publicity. This needs to be traded off against the risk that the debtor agrees a plan they cannot deliver, in which case the risk of failure increases.

The survey respondent from a consumer advice organisation that offers advice to consumers stated that consumers in the Individual Voluntary Arrangement process do not generally understand their choice of process.

The most common consumer complaints about Individual Voluntary Arrangements, according to the respondent, are that the process is costly and that some private companies sell them to consumers who will never be able to benefit from them. According to the respondent, this process may not work properly in the case where the credits reject reasonable offers and where consumers are required to make payments that they cannot afford.

Debt Relief Order

A one year process through an approved intermediary for debts up to £15,000 for those with low assets (£300) and disposable income (£50) after which any outstanding balance is written off, except student loans, fines and debts arising from family legal proceedings. This route is not available to homeowners. Creditors cannot apply for a DRO.

According to the respondent from a consumer advice organisation, if a consumer in the Debt Relief Order process breaks the arrangement, the supervisor can force the consumer into the bankruptcy process.

The most common complaint about the Debt Relief Order process is about the eligibility criteria which require the debtor to have less than £50 per month available income for creditors, less than £15,000 debt and less than £300 in assets, making it very hard to access.

[282] §263, c.45, Insolvency Act 1986.

[283] §§257-8, c.45, Insolvency Act 1986.

4 Mortgage solutions and *datio in solutum*

4.1 Datio in solutum

This section addresses the research questions concerning the legal instrument of *datio in solutum* in mortgage loan agreements and legal regimes of the Member States. *Datio in solutum* is defined as follows:

'Some jurisdictions may provide that borrowers who cannot repay their mortgage loans are released in full from the underlying debt by handing their mortgaged property over to the lender'.

In jurisdictions which do not operate such a regime, the borrower has an unlimited responsibility in relation to their debt. If there is insufficient collateral in the property the debtor must use other income and/or assets to meet the debt and make full repayment of the mortgage loan.

It was the Financial Service' User Group's concern that this latter state, especially in the face of falling house prices may push thousands of citizens into being '*materially condemned to long term social exclusion and poverty*'. This view is reinforced by the fact that for many borrowers the mortgage forms the lion's share of their debts. As Hayre et al (2010) note, following unemployment, other losses of income, or illness in the family, a mortgage can become challenging to meet, even without any increase in cost, for example through a rise in interest rates.

As such this chapter identifies and maps the respective legal and regulatory (including self-regulatory) frameworks as well as practices in the sample countries of provisions of *datio in solutum* applied to mortgage credit. In cases where *datio in solutum* is not present we summarise and describe the general practice.

It is worth stating that we view two potential versions of *datio in solutum,* as described below:

- Strong *datio in solutum*: This assumes a hard application of this concept mandated in the legislation in the country, defining *datio in solutum* as part of the enforcement mechanism of all mortgages.
- Weak *datio in solutum*: This assumes a non-universal application of *datio in solutum* as mandated in law for use with certain types, class or other categorisation of mortgage debt or debtor.

It is our assessment, in consultation with recognised experts in the field of comparative European mortgage market studies, that:

- There currently exists no European country which has a strong application of datio in solutum enshrined in legislation.
- There exists no country or state in the world which has a strong application of datio in solutum enshrined in legislation.
- The only country where we can identify a weak application of datio in solutum enshrined in legislation is Spain. This is extremely limited in terms of who can apply to it and the requirements those borrowers must meet before they become eligible to use this solution. In the USA we have found example of non-recourse mortgages, where payment in kind of this type is included in the contract and costed in.

- Most European countries have not considered *datio in solutum* because they have developed systems which preclude the need to have a specific solution for residual debt following enforcement against a mortgage.

Whilst enshrining strong *datio in solutum* in legislation is an exceedingly high bar, it is of interest to note that no country has cleared this bar and only Spain has met this for a weak *datio in solutum*.

Setting the bar slightly lower we can consider those instances which mirror *datio in solutum* through **particular contractual arrangements which include clauses which permit the handing of the property to the lender in complete payment of their debt, irrespective of the value of the property**. Known generically as 'non-recourse' mortgages[284] such instruments achieve the same fundamental aim as *datio in solutum* for those individuals who take out such a loan, but does not achieve the wider aim of providing all consumers in a Member State with a *datio in solutum* means to relieve mortgage over-indebtedness.

We have discovered examples of non-recourse mortgages in the US states of Arizona and California, and in Spain.

4.2 Key questions arising

In this chapter, it is our intention to attempt to map, for each country, a basic description of their enforcement system, including, as far as possible answers to these key questions:

- Do consumers have access to a mandated *datio in solutum* solution?
- Do consumers have access in practice to frequently used voluntary *datio in solutum* solution or non-recourse mortgages, i.e. do lenders accept property as full payment of outstanding debts ?
- If *datio in solutum* is not available, what processes do they face?

4.3 Austria[285]

Enforcement is delivered, under the law through public auction through a publicly commissioned authority[286], or after the start of enforcement procedures through alternative procedures if agreed. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

The legal consequence of an enforcement initiated by a lender is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key

[284] As opposed to 'recourse' mortgages, where the lender has a means of gaining by requiring lenders to use other income and/or assets to meet the debt and make full repayment of the mortgage loan.

[285] All materials in the following sections of this chapter are extracted from Stöcker & Sturmer (2010), except for Spain, Belgium, the UK.

[286] In all cases this commonly refers to courts, but may also refer to a notary.

question of whether in this jurisdiction this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration, property related taxes, other taxes and maintenance costs for children.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended in the event of exceptional personal circumstances (e.g. heart attack).

A valuation is mandatory before the forced sale which occurs within the enforcement proceedings.

At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

In this system, the creditor does not have the right to take over the property (*lex commissoria*) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above, and discharged through a bankruptcy procedure.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements.

4.4 Belgium

Consumers may be able to prevent the loss of their property by using different mechanisms. Re-financing the existing mortgage credit (re-mortgaging), rescheduling and 'globalisation' of existing credits are possible. There is an expectation that the creditor who is approached by the defaulting debtor should take the principles of responsible lending into account.

In Belgium, *datio in solutum* or non-recourse loans don't exist. There are no examples of mortgage products in Belgium, which the consumer can choose, whereby the contractual terms prevent the lender pursuing any residual debt which has not been covered by the sum raised from selling the property following enforcement.

In this system, the creditor does not have the right to take over the property (*lex commissoria*) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the

house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property.

4.4.1 The enforcement procedure in Belgium

Enforcement[287] is delivered, under the law through public auction through a publicly commissioned authority, or after the start of enforcement procedures through alternative procedures if agreed. The Mortgage Credit Act holds the following provision:

Article 59, § 1. Any execution or distraint in pursuance of a judgment or other official deed, must be preceded, within the framework of this law, under pain of being declared void, by an attempt to reach an amicable solution before the judge in charge of imposing distraint, which will be mentioned on the court minutes.

Any request for payment facilities made by the borrower, the surety and the provider of a personal security, if any, must be addressed to the judge in charge of imposing distraint. Therefore the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

The legal consequence of an enforcement is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key question of whether in this jurisdiction this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration.

Preliminary measures/actions

There are no legal differences between how enforcement activity by the lender which has resulted in the sale of the property are applied to first and additional mortgages, or between the main and any additional residence(s).

When creditors wish to proceed with the seizure of a property belonging to their debtor, they must be in possession of a writ of execution (see below). Although such a document allows them to proceed with the enforcement without having to go before a trial judge, it is necessary to precede any such action or seizure carried out by virtue of a mortgage loan enforceable order for private purposes, on pain of nullity, with an **attempt at reconciliation before the judge dealing with seizures**, that has to be recorded in the hearing papers. Moreover, the seizure must be preceded by an **order to pay**, with notice served by a court bailiff to the debtor in person, at his domicile or elected domicile, election of which is made in the deed that will be enforced. The creditor may transcribe this order to pay at the mortgage registry in order to render *ab initio* the procedure opposable to third parties.

[287] Stöcker & Sturmer (2010)

The order to pay must be followed within six months by a writ of seizure, with notice served by a court bailiff. This document must contain the following references:

- identification of the basic deed on which the seizure is based;
- a precise indication of the property to be seized in accordance with the land register descriptions or other property title;
- indication of the Judge dealing with seizures who will decide on the appointment of a notary;
- the writ of seizure must be transcribed within two weeks in the mortgage registry of the district in which the property is located. This transcription remains valid for 3 years only, unless it is renewed on the basis of a request signed by a court bailiff or a lawyer.

Within a month of transcription of the seizure, the creditor must ask, unilaterally, **the Judge dealing with seizures** at the court of first instance of the place where the seizure took place to **appoint a notary responsible for the sale of the property and operations regarding the ranking**.

The order to pay must be followed within six months by a writ of seizure, with notice served by a court bailiff. This document must contain a copy of the order appointing the notary is sent to the latter within two weeks of the judgement, with an advice of receipt. When the order is served on the judgment debtor, a period of one month shall begin in which the judgment debtor may apply opposition to the judgment by challenging the party appearing before the judge who ordered the seizure. This procedure may be carried out at the same time as the formal notice mentioned below but the authority of the final decision of the order will not be confirmed before one month has elapsed. This opposition is intended to show the judge that the creditor does not have a specific liquid and demandable claim or any other reason which might implicate the nomination of a notary (for example non-compliance with the preliminary conciliation proceedings or even the lack of impartiality on the part of the ministerial officer appointed).

A valuation of the property only takes place in special cases, e.g. with a private sale, within the enforcement proceedings. The valuation is irrelevant however in determining whether the best offer at an auction is accepted.

The sale (first session) of the assets must take place within six months from the order. The **notary first of all draws up the general articles and conditions of sale**. At least one month before the sale, the creditors who requested transcription of an order to pay and the debtor, are **summoned by a court bailiff to take note of the conditions of sale** contained in the specifications drawn up by the notary. Within eight days of the last notification, the order to pay is mentioned in the margin of the transcription of the seizure at the mortgage registry.

***Forced Sale: form and conditions*:**

The **sale is organised by the appointed notary**. The auction takes place in accordance with local custom, to the highest bidder and in principle in a single session. The adjudication always allows for a higher bid, and any person has the right to place a bid within 15 days of the adjudication for a minimum of 1/10th of the price with a maximum of €6,200. This sum must be placed in the hands of the notary, after which a session will be fixed. The mortgage registrar must mention the adjudication in the margin of the transcription of the seizure.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, with a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is written-off, which is essentially a *datio in solutum* solution in terms of the impact on the consumers debt

position, but utterly dissimilar to a *datio in solutum* solution in that the bank has to proactively make the decision to purchase the property, rather than the consumer unilaterally deciding to end his interest in the property and compel the bank to take the property.

Subsequent measures

Following the adjudication, the buyer must pay the purchase price in the manner indicated in the specifications. In most cases, it is stipulated that the payment is made to the notary appointed for the auction. The acquirer may nevertheless, notwithstanding any opposition or opposition clause, pay the purchase price, interest and other costs and fees of the appointed notary, into the hands of the notary responsible for the ranking procedure (in fact in the event of there being more than one asset in different local areas the judge may appoint several notaries who will carry out the auctions, but only one of them will be responsible for the ranking procedure) or to the *Caisse de Dépôts et Consignations*.

One month at the latest after the auction is definitive (there may be opposition up to fifteen days after the notification of the auction to the debtors), the notary must draw up his report of the ranking. In it he must note the mortgages and privileges cited by the various creditors. The notary must summon the inscribed creditors and the debtor to tell them within one month of the draft report, in order to allow them to express their grievances. In the event of opposition to the report, the notary must submit the dispute to the Judge dealing with seizures. In the absence of a dispute or after the Judge has ruled definitively on the dispute, the redemption of the property is carried out at the initiative of the notary.

Consumer protection rules in the context of a procedure of seizure

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended with the consent of the court based on social protection reasons.

Protection is given to the consumer by the fact that he can challenge the creditor's writ of execution before the Judge (see above). So the creditor will not have a writ of execution when the notarial deed (of mortgage charge) states that the conditions for a private agreement are to be applied and that this agreement is not attached to the notarial deed.

In the majority of cases the Judicial Code stipulates the periods that have to be respected on pain of nullity. It also stipulates the possibilities of enforcement, including those of the debtor, during the procedure of seizure, and there must have been an attempt at reconciliation before the Judge dealing with seizures and concerning the order to pay. The order to pay informs the debtor that, failing payment, his property will be seized and any private offer to purchase the building may be transmitted to the Judge within one week of notification of the writ of seizure. The wording concerning the possibility offered to the debtor to transmit to the Judge, on pain of inadmissibility, within one week of serving notice of the procedure of seizure, any private offer to buy his property, is repeated in the seizure notification.

If the value of the buildings to be seized is more than sufficient to settle the debt, the debtor may request that the effects of the transcription of the order to pay do not extend to all of his properties.

Where it is in the interests of the parties concerned, the Judge dealing with seizures may order a private sale. In the event of the disposal of the building serving as the main residence of the debtor, the judge may also appoint as acquirer, any person who allows the debtor to use his home. Inscribed

mortgage or privileged creditors, those who transcribed an order to pay or a writ of seizure, the debtor and, where appropriate, the third-party holder of the building, must be heard or duly summoned by judicial letter. The order of the Judge must indicate the reasons for the private sale (and, where appropriate, the name of the acquirer), serve the interests of the creditors and the debtor and, where appropriate, the third-party holder. Any creditor of the seizure may also request authorisation for a private sale.

After enforcement activity has been taken by the lender which has resulted in the sale of the property, the consumer is not automatically free of all mortgage debt. If the value of the property sold is not enough to pay off the debt, there will still be an unsecured debt and the lender becomes an unsecured / simple contract creditor and all legal and judicial means pertaining to this kind of creditors to recover its claim will be available. Either the debtor is able to pay the residual debt or he is not and in this case, he may call for a collective settlement of the debt. In the case where enforcement activity by the lender has resulted in the sale of the property and where the value received from the sale is less than the remaining debt lenders never take the sale value as full settlement of the debt, however, where it is clear from the very poor situation of the file that nothing further can be recovered, the creditor may decide to record the remaining debt as a loss in its accountancy books. It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements.

If the consumer is not automatically free of all mortgage debt following enforcement activity by the lender which has resulted in the sale of the property, generally the consumer is liable for interest payments on the remaining balance of the debt. Equally, the consumer is generally liable for any costs incurred by the lender for the enforcement and sale procedure. These are taken by priority from the sale proceeds.

4.4.2 Writ of execution

In the field of mortgage loans, writs of execution can have the following form:

- Judicial decisions (judgements by a Magistrate of the Peace, Commercial Tribunals (in case of bankruptcy), Courts of First Instance (Judge dealing with seizures), as well as judgements from the Court of Appeal), that are definitive or declared expressly or legally enforceable by provision. Where appropriate these will be consent judgments between the parties or conciliation records.
- Writs from ministerial officers (principally from notaries) invested with an executor formula. This means that the mortgage creditors may carry out the procedure of seizure without procedure on the merits.

Conditions to be fulfilled to render a deed (or a judicial decision) enforceable

In addition, in the case of a notarial deed, the latter must respect the conditions stipulated by the '*loi de ventôse*' in order to become enforceable: the parties and the notary must sign the deed, the notary must read it in full (in principle; under certain conditions, partial reading is sufficient), the notary must comment on the deed and the deed must mention the fact that the notary read it and commented on it.

4.4.3 Carrying into effect of the mortgage deed

Who has the right to initiate the procedure for a forced sale

Creditors with a writ of execution. If they do not have one, they must go before the court to obtain a definitive judgement on the merits.

The stage at which this procedure can be demurred on third parties

Creditors may transcribe the order to pay in the mortgage registry in order to render *ab initio* the procedure opposable on third parties.

Legal means available by which any other creditors with mortgage guarantees can claim their rights, especially in respect of the valuation of the mortgaged asset.

The creditor (of the seizure) has the benefit of several guarantees assuring him of a sale at a fair price:

- In the case of voluntary sale, the creditor may object to the sale.
- It may be a private sale ordered by the judge dealing with seizures when the interests of the parties so require. The creditors have an opportunity to state their case before this. The order must state the reasons why a private sale is in the creditors' interests. The judge may fix a minimum price. This has the effect of redeeming the mortgage inscriptions. The reason for this is that the law provides that the sale *ipso iure* assigns the payment in favour of the mortgage creditors.
- It may be a private sale requested by the creditor of the seizure himself and authorised by the judge. The creditors have an opportunity to state their case before this. The order must state the reasons why a private sale is in the creditors' interests. The judge may fix a minimum price. This has the effect of redeeming the mortgage inscriptions.
- During the seizure proceedings the creditor of the seizure himself may purchase the asset being sold if a sale by auction does not appear sufficient with regard to the value of the assets. Other types of private sale can be arranged under the supervision of a judge. This is the sale of a building belonging to a bankrupt debtor or the sale of a building as part of a collective settlement procedure.

4.5 Czech Republic

Enforcement[288] against property is delivered, under the law, through public auction. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration.

The legal consequence of an enforcement is that all debts of lower, equivalent, or higher rank are cancelled, meaning the new purchaser would not inherit responsibility for the old mortgage.

[288] Stöcker & Sturmer (2010)

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended in the event of exceptional personal circumstances (e.g. heart attack).

A valuation of the property is mandatory within the enforcement proceedings. At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

In this system, the creditor does not have the right to take over the property (lex commissoria) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above and discharged in a bankruptcy procedure.

According to the Association of Czech Building Societies when the value received from the sale is less than the debt owed, lenders rarely voluntarily take the sale value as full settlement of the debt. In this case, payment of the remaining part of the debt would be enforced, either in or out of court.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements.

4.6 Denmark

Restructuring an existing mortgage is done only on an individual basis, and normally requires the financial difficulties suffered by the borrower to be considered of only a temporary nature and requires a realistic reconstruction plan for the borrower's finances to have been produced and accepted by the mortgage lender.

After enforcement activity has been taken by the lender which has resulted in the sale of the property, the consumer is not automatically free, under the legislative framework in place in your country, of all mortgage debt.

In Danish mortgage contracts there will always be a provision for the borrower to fulfil his/her outstanding obligations personally. This means that the borrower is personally liable to any residual debt after the property is sold on a forced auction. There are no examples. Therefore of mortgage products, which the consumer can choose, whereby the contractual terms prevent the lender pursuing any residual debt which has not been covered by the sum raised from selling the property.

Enforcement is delivered, under the law through public auction through a publicly commissioned authority, or by private sale under the control of a publicly commissioned authority. It should also be

noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

Following enforcement activity by the lender which has resulted in the sale of the property, generally the consumer is liable for interest payments on the remaining balance of the debt and any costs incurred by the lender in repossessing the property.

There are no any legal differences between how enforcement activity by the lender which has resulted in the sale of the property is applied to first and additional mortgages, or between the main residence or any additional residence(s) except that if the property involved is the main dwelling of a family the social authorities are alerted in order to make sure that the family is housed elsewhere.

In a situation where enforcement activity by the lender has resulted in the sale of the property and where the value received from the sale is less than the remaining debt. lenders rarely voluntarily take the sale value as full settlement of the debt. In the opinion of the Danish Mortgage Banks´ Federation this is '*probably the case in 99 % of cases*' but there is the possibility the settle the outstanding debt if the debt is deemed impossible to settle, such as the case where the estate of a deceased borrower is declared insolvent.

The legal consequence of an enforcement[289] is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key question of whether in this jurisdiction this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended in the event of exceptional personal circumstances (e.g. heart attack).

A valuation of the property only takes place within the enforcement proceedings in special cases (such as a private sale). The valuation is irrelevant however in determining whether the best offer at an auction is accepted.

In this system, the creditor has the right in principle to take over the property (lex commissoria) but this is rarely practiced, in which case compensation is paid if the value of the property exceeds the debt, however the question of how this is calculated, when a valuation of the property may not have been carried out is a key one, as the *value* of a property transferred in a *datio in solutum* solution would need to be resolved to be compatible with this system.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but

[289] Stöcker & Sturmer (2010)

having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements. However, the consumer is pursued for the remainder of the debt by the mortgage lender making a claim to the borrower with a proposal for a repayment scheme. If the borrower accepts and adheres to the repayment scheme payments are made until the debt has been paid. More often the borrower doesn't react to the claim. The lender can then either wait for some time and put forward his claim once again, or have the claim tried at the bailiff's court. Here the borrower will probably declare insolvency and this will stop the lender from further legal actions via the bailiff's court for 6 months. In practice, according to the Danish Mortgage Banks´ Federation the lender will rest the claim for some time and then make a new attempt later. The limitation period for mortgage loans is 10 years.

4.7 Estonia

Enforcement[290] is delivered, under the law through public auction through a publicly commissioned authority, or before the start of enforcement procedures through alternative procedures if agreed. It should also be noted that the lender can have the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, if he has obtained an executor title for such measures in a court procedure.

The legal consequence of an enforcement is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key question of whether in this jurisdiction this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended in the event of exceptional personal circumstances (e.g. heart attack).

A valuation of the property is mandatory within the enforcement proceedings. At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

In this system, the creditor does not have the right to take over the property (lex commissoria) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the

[290] Stöcker & Sturmer (2010)

house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone, although the lender must obtain an executor title for such measures in a court procedure.

4.8 France

It is important to note in relation to the market for loans related to property in France, that, as one consumer association noted to us; '*most home loans are not mortgage credits but personal loans not secured by a mortgage on real property*,' and that as such, loans are given on a loan to income ratio, not loan to value ratio, which was viewed as making them responsible lenders in this regard, indicated by home loans only being present in 7% of over-indebtedness filings[291].

As such, the enforcement mechanism as described below must be considered in these terms, as to a great degree, the loans under consideration are unsecured, not secured loans. As such *datio in solutum* would be particularly problematic to apply in the standard French context, because of the lack of a formal relationship between the property and the loan. It is in this context that the consumer association also noted that '*there is no debate [in France] on datio in solutum'.*

4.8.1 Avoiding enforcement

France has a number of different processes which consumers can use to prevent lenders launching an enforcement procedure. The most significant are:

Amicable process: French lenders engage in a permanent practice which relies on an amicable approach with a view to dealing with the difficulties the borrowers may face. This covers debts secured on an asset, although, of course such secured loans are rare in France given the distinct design of loans for housing which are not secured. This procedure is entirely voluntary and a negotiated process with the creditor, which means the most common consumer complaint is that creditors can refuse to cancel the debt and that it occurs too rarely.

The first step of this practice consists in assessing the causes of the default, and proposing personalised measures adapted to the borrower's personal circumstances. Within this framework, more than 80% of the files are solved on an amicable basis. Even when a foreclosure procedure is initiated, it is still possible to reach an amicable solution. As a result, the number of forced sales

[291] Banque de France (2011b)

remains very low in France. Depending on the outcome, this process can actually improve the debtor's credit rating by stopping missed payments.

Legal procedure: Enforcement can be delayed or prevented by the debtor entering into one of two legal processes.

The first is to request a debt moratorium from a magistrate. This gives a maximum of two years with possibility to not pay interest in this period. Technically this covers debts secured on an asset, although, of course such secured loans are rare in France given the distinct design of loans for housing which are not secured. This is described in greater depth in section 3.9.1.

The second is the over-indebtedness commission process. The debtor can resort to such proceedings when he is obviously unable to meet "either all of his personal debts due now and in the future or fulfilling an undertaking he has given to guarantee or jointly and severally settle the debt of an individual contractor or a company when he was not a de facto or de jure executive thereof." The admissibility of the debtor's case involves the suspension of the enforcement proceedings instituted against the debtor and relating to debts (such as mortgage credits) other than those relating to alimony. In addition, when the *commission de surendettement* declares the case admissible, it can refer the case to the *Juge de l'exécution* for the purposes of suspending the measures aiming at the eviction of the debtor from his/her home. The commission can even refer the case to the *Juge de l'exécution* before it has been declared admissible.

In the event of the compulsory sale of the debtor's principal residence encumbered by a mortgage in favour of the credit institution which provided the funds for its purchase, the *commission de surendettement* can recommend the reduction of the proportion of the mortgage which remains due to the credit institution after the sale and after application of the proceeds of the sale to the principal amount outstanding, in a proportion such that payment thereof, combined with rescheduling calculated as indicated above, is compatible with the debtor's income and expenditure.

The same provision shall apply in the event of a sale by private treaty on terms and conditions determined by mutual agreement between the debtor and the credit institution in order to avoid foreclosure. In any event, the benefit of the present provisions cannot be invoked more than two months after a demand is made for payment of the proportion of the mortgage still owing, unless the matter has been referred to the commission during that period.

4.8.2 *Datio in solutum and non-recourse mortgages*

After enforcement activity has been taken by the lender which has resulted in the sale of the property, the consumer is not automatically free of all mortgage debt.

There are no examples of mortgage products which the consumer can choose, whereby the contractual terms prevent the lender pursuing any residual debt which has not been covered by the sum raised from enforcement.

4.8.3 Enforcement processes

There is no legal difference between how enforcement activity by the lender is applied to first and additional mortgages, but there are difference between enforcement processes for the main residence as opposed to any additional residences. In the case the main residence has been sold, social measures exist with a view to accommodating consumers.

Enforcement is delivered, under the law through public auction through a publicly commissioned authority, or before the start of enforcement procedures through alternative procedures if agreed. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

The legal consequence of an enforcement is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key question of whether in this jurisdiction this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

In a situation where enforcement activity by the lender has resulted in the sale of the property and where the value received from the sale is less than the remaining debt, lenders rarely voluntarily take the sale value as full settlement of the debt. The circumstances under which the sale value would be taken as full settlement are essentially when the consumer is totally insolvent.

Following enforcement activity by the lender which has resulted in the sale of the property, the consumer is generally liable for interest payments on the remaining balance of the debt and any costs incurred by the lender in repossessing the property.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended with the consent of the court based on social protection reasons.

A valuation of the property only takes place within the enforcement proceedings in special case. The valuation is irrelevant however in determining whether the best offer at an auction is accepted.

In this system, the creditor only has the right to take over the property (lex commissoria) with previous agreement as part of the contract, in which case compensation is paid if the value of the property exceeds the debt, however the question of how this is calculated, when a valuation of the property may not have been carried out is a key one, as the *value* of a property transferred in a *datio in solutum* solution would need to be resolved to be compatible with this system.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements. In general, according to BNP Paribas however, if a mortgage

lender enforces the sales the property, but does not raise enough from the sale to cover the outstanding debt, the consumer is pursued for the remainder of the debt through mortgage lender using mainly wage garnishment or/and foreclosure of others assets unless an agreement on monthly payments of the remaining debt has been concluded with the consumer.

According to the French Banking Federation, following enforcement leading to the sale of the property, where the value received from the sale is less than the debt owed, lenders rarely voluntarily take the sale value as full settlement of the debt. If the sale value does not cover the outstanding debt, the lender can bring an action over all the borrower's assets in order to recover the total amount of the debt. The sale value will be taken as full settlement of the debt only in cases where the excessive debt commission (*commission de surendettement*) or a judge requires them to do so. Under a personal recovery procedure, when the assets realised are insufficient to pay off the creditors, the judge shall declare the procedure closed on account of insufficient assets. Closure entails the writing off of all the debtor's non-commercial debts, with the exception of any which were settled on the debtor's behalf by a surety or joint debtor.

4.9 Germany

Enforcement[292] is delivered, under the law through public auction through a publicly commissioned authority, or before the start of enforcement procedures through alternative procedures if agreed. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

The legal consequence of an enforcement is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key question of whether in this jurisdiction this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration, property related taxes, other taxes and maintenance costs for children[293].

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended in the event of exceptional personal circumstances (e.g. heart attack)[294]. This allows for the abandonment of proceedings if this would represent *contra bonos mores* hardship to a debtor, including where the value extracted by the enforcement threatens to *'squander the debtor's assets'*, for example where there is a stark disparity between the market value of the asset and this highest bid. The Court draws the line at about 30-35% of the market value of the asset.

[292] Stöcker & Sturmer (2010)

[293] This is not to imply that maintenance is standardly to be paid from real estate capital, merely that if there were outstanding maintenance payments these would have a claim on the collateral of the debtor, in the same way as other debts such as taxes.

[294] §765a ZPO

In addition §30a ZVG[295] allows, at the request of the debtor for the temporary suspension of proceedings for up to six months, as part of a large suite of legal remedies which allow the debtor to appeal decisions to the highest levels of the judiciary.

A valuation of the property is mandatory within the enforcement proceedings. At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions[296], although these subsequent auctions may set a lower benchmark, in terms of share of the valuation, but only if an effective bid has been submitted in the previous auction. This is to prevent asset squandering. In Germany's case, this threshold is 70% of the valuation in the first auction, falling in subsequent auctions[297]. **Over this limit any outstanding debt is automatically cancelled if the creditor is the winning bidder at the auction.** For example, if before an enforcement auction, a valuation assessed a property as worth €100,000, with an outstanding debt of €80,000, and the creditor submits a winning bid of €70,000, because this is over 70% of the valuation then any outstanding debts, in this case €10,000 is written off. If, however, anyone else wins the auction, this cancellation does not apply.

In this system, the creditor does not have the right to take over the property (*lex commissoria*) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property. Neither does the debtor have the right to demand that the creditor takes over his property with the consequence that the creditor becomes owner of the property and that all secured debt is extinguished.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale, requiring however further formal requirements.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, with a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and a significant fraction, if not all of any residual debt is written-off, which is essentially a *datio in solutum* solution in terms of the impact on the consumers debt position, but utterly dissimilar to a *datio in solutum* solution in that the bank has to proactively make the decision to purchase the property, rather than the consumer unilaterally deciding to end his interest in the property and compel the bank to take the property.

4.10 Greece

The HBA indicated in their survey response that, after enforcement, the consumer is not automatically free of all mortgage debt, and is liable for interest payments on the remaining balance of the mortgage.

[295] Section 30a: Law on Compulsory Auctions and Forced Administration (*Gesetz über Zwangsversteigerung und Zwangsverwaltung – ZVG)*

[296] §85a ZVG and §74a ZVG

[297] §74a: Law on Compulsory Auctions and Forced Administration (*Gesetz über Zwangsversteigerung und Zwangsverwaltung – ZVG)*

Enforcement[298] against property is delivered, under the law, through public auction. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

The legal consequence of an enforcement is that all debts of lower, equivalent, or higher rank are cancelled, meaning the new purchaser would not inherit responsibility for the old mortgage.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration, property related taxes, other taxes, maintenance costs for children, salary claims of employees within limits and/or alimonies.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended in the event of exceptional personal circumstances (e.g. heart attack).

A valuation of the property is mandatory within the enforcement proceedings before the auction. At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

In this system, the creditor has the right to take over the property (lex commissoria) but only after an unsuccessful attempt for a forced sale, in which case compensation is paid if the value of the property exceeds the debt, based on the mandatory valuation.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above and discharged through a bankruptcy procedure.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements.

According to the HBA, since 2008, through a number of consecutive legislative acts, the initiation of foreclosure proceedings against a debtor's main residence has been suspended for debts of up to €200,000 owed to credit institutions and other credit providers. The current suspension began on 1 January 2012 and will end on 31 December 2012.

There are no legal differences in terms of how processes are applied to first and additional mortgages, but there are legal differences depending on whether the mortgage is on the main residence or on an additional residence. Pursuant to article 14 par. 11 of Law 2251/1994 on consumer protection as it currently stands, credit institutions and credit providers may not initiate

[298] Stöcker & Sturmer (2010)

foreclosure proceedings against a debtor's main residence for debts arising from consumer credit contracts and credit cards, provided that the consumer has filed a complaint against the title initiating the proceedings and one of the following conditions apply:

- the unpaid balance owed to the foreclosing credit institution does not exceed €20,000 in total;
- the debtor's main residence has not been mortgaged by the debtor in order to secure the credit institution's claim; or
- the debtor proves that he/she is unable to meet his/her obligations as they fall.

4.11 Hungary

Enforcement[299] is delivered, under the law through public auction[300]. The lender can have the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, if he has obtained an executor title for such measures in a court procedure.

A valuation of the property is mandatory within the enforcement proceedings before the auction. At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

Entering into legal procedure is sometimes possible without prior warning to the debtor. However, all courts are trying to mediate between creditor and debtor, and in order to shorten the amiable phase of the legal proceedings, they may ask for proof that all pre-court efforts did not reach a conclusion, and will ask to see all prior correspondence in order to reach a fast and final judgement.

This is the standard procedure where the bailiff visits the debtor to take away movable goods he can liquidate in favour of the creditor. The bailiff cannot seize goods necessary for the debtor's basic daily life or that enable him to maintain his business activity.

The legal consequence of an enforcement is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key question of whether in this jurisdiction this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended with the consent of the mortgagee.

[299] Stöcker & Sturmer (2010)

[300] Section 141, LXXX, 1994 – 'Unless otherwise provided by law, immovable property shall – on general principle – by sold by way of auction.' Auctions are scheduled by bailiffs by way of auction notice.

In this system, the creditor does not have the right to take over the property (*lex commissoria*) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to *take* the property. However, the creditor and the debtor may agree that the creditor may take over the property. One respondent indicated that there is a common practice where commercial banks have developed their own property management companies and purchase properties from debtors.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank (or more likely its property development company[301]) can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt[302] but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in wider debt solutions, as described above, although, of course, there is no route to a discharge of this debt in the Hungarian system, although at this point, one respondent suggested that creditors are likely to re-structure the debt.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone, as permitted under the law, although the lender must obtain an executor title for such measures in a court procedure.

4.11.1 Foreign currency mortgages

Hungarian households[303]' hold the highest levels of foreign currency denominated debt in Eastern Europe, with this debt concentrated into roughly 800,000 households (or 20 percent of the total), mainly held in the form of mortgages in foreign denominations. Although total household debt peaked at a relatively modest level, (40 percent of GDP), the severe depreciation of the Hungarian forint after the start of the global financial crisis led to private consumption falling as a greater share of family incomes was devote to meet mortgage repayments, which, in forints, were growing as the forint depreciated. This compelled the authorities to step in and assist foreign-currency-indebted households. The government introduced a compulsory debt restructuring program in September 2011[304]. During a relatively short period of roughly five months, banks were forced to allow customers to repay their mortgages at a preferential exchange rate, roughly 30 percent below market rates. All losses from the implied debt reduction would be borne by the banks alone.

The compulsory debt restructuring program appears to have achieved high participation based on preliminary estimates—about 24 percent of all mortgage debtors in foreign currencies. However, it has three main effects on the whole economy:

- Because households with higher levels of savings could afford to pay off their mortgages with a one-off lump sum payment in forints, and households with relatively high savings

[301] Which may be a cheaper way to complete the purchase.

[302] If the creditor does not wish to write this off.

[303] IMF Report - World Economic outlook April 2012.

[304] Act LXXV of 2011 on Anchoring the Exchange Rates for the Repayment of Foreign Exchange Loans and on the Forced Sale of Residential Properties.

rates have relatively low rates of spending on consumption[305] and therefore this reduced the impact this policy had on driving demand back into the economy, because a relatively large share of this input into the economy can be expected to leak straight back out into savings.

- Second, the compulsory nature of the policy put the full burden of the losses on the banks, some of which were already suffering in the financial crisis and were therefore poorly placed to absorb such losses. This could therefore threaten further bank deleveraging and a deepening of the credit crunch may result, with associated exchange rate pressure.
- The retroactive revision of private contracts impacted on lender's confidence on investing in Hungary vis-à-vis other neighbouring countries, again affecting Hungary's relative economic performance, although foreign exchange exposure has, of course, improved.

This process effectively wrote-off a share of mortgage debt, but not in a *datio in solutum* type fashion because; a) the provision was not universally available[306], b) it is not permanent, and c) unlike say the Spanish system, which was targeted at those who were over-indebted and in the deepest overall financial distress, this system aided those who were relatively affluent, and whose misfortune sprung from borrowing to gamble on making gains from exchange rate movements, a clear example of what many jurisdictions in Europe would classify as 'bad faith'.

The Hungarian Financial Supervisory Authority provided us with the following detailed explanation of how this policy works. As such, this section recites the materials provided as a best illustration of this aspect of the Hungarian mortgage market.

Mortgage relief

Debt relief on mortgages in Hungary can be achieved through exchange rate fixing for foreign currency loans, interest rate subsidisation for home purchases and the combination of conversion of mortgage loans in a foreign currency to Hungarian forints and 25% remittance. The exchange rate fixing and interest rate subsidisation processes will close on 31st December 2012 and the last option closes on the 31st August 2012.

Most of these processes allow for some of the debt to be written off. Although the interest rate subsidisation process is not about writing off some of the debt, it is a state aid for the people in default of payment in order to help them retain their property, or those who propose to buy a new one. All of these processes can only be applied to mortgages.

In the case of exchange rate fixing on currency loans, the interest rate is covered by the state and the financial institution and the financial obligation above the highest exchange rate is waived. This process lasts for 5 year. If the consumer tries to leave the process before this, the exchange rate fixing ends. The conditions for entering into this process are as follows:

[305] If one saves a high share of one's income, one cannot also spend a high share of your income. Of course, if your income is very large you may spend more in total on consumer goods and consumables, but this will still only represent a smaller share of your income.

[306] It was available for those who applied and who agreed to pay off any bridging loan or any outstanding debt from an omnibus account that existed in a way directly related to the foreign exchange-based loan to which the note of intent for loan pay-off pertained, at the time of submission, and who wcould pay off the loan within sixty days from the date of submission, where the exchange rate on the loan was not higher than that specified in the relevant law, and for loans the creditor had not cancelled before the Act came into force.

- the value of the original loan cannot exceed 20 million forints (almost €70,000)[307];
- the debtor has not been in default for over 90 days;
- the debtor is not already under any debt rescue programme
- there is no on-going foreclosure on the coverage; and ,
- in the case of a financial leasing contract, the entering into the leasing contract was before 15th December 2011.

There are four types of interest rate subsidisation options, each with different conditions. The level of subsidisation depends on the type of interest rate subsidisation options, the government bond yields, and the past year(s). The value of the coverage[308] should not be over 15 million forints (almost €52,000) in Budapest and 10 million (almost €35,000) in other cities and towns. The value of the new loan in forints should not be over 10 million forints in Budapest and 7 million (just over €24,000) in other cities and towns. In order to be eligible for this process, the debtor cannot have been in default for over 90 days, with a floor for the level of the default (small debts exempted) or the loan is cancelled. The debtor cannot hold another property. This process lasts for 5 year. If the consumer breaks the arrangement before this, the subsidy has to be paid back to the Treasury.

For the **combination of conversion of mortgage loans in a foreign currency to Hungarian forints and 25% remittance** (or write-off) of the loan, the value of the residential coverage should not be over 20 million forints in Budapest and 15 million forints in other cities and towns. In addition, the debtor cannot have been in default for over 90 days since 30th September 2011 and the debtor cannot be under on-going foreclosure. The debtor must have at least one child. If the consumer leaves the process, then they continue to repay the foreign currency loan on the current exchange rate.

The processes all require financial obligations from the debtor and all of the debtor's assets can be sold to repay lenders. There is no automatic protection for the consumer from other actions by lenders while they are in these processes. However, the consumer is not at risk of losing their homes in the process.

Exchange rate fixing was established in 2011 under Act LXXV of 2011. Interest rate subsidisation for home purchases was established in the same year under Government decree 341/2011. The process consisting of conversion of mortgage loans in a foreign currency to Hungarian forints and 25% remittance was established under both of these pieces of legislation.

Only the consumer can start each of the processes and the consumer enters the process directly – not with an intermediary. There is no involvement by a judge in any of the processes. The Hungarian Financial Supervisory Authority reported that, when it comes to these mortgage relief processes, consumers don't generally understand their choice of process, and that the most common complaint from consumers about the exchange rate fixing was that consumers who have loans combined with home insurance or home saving funds are in a better position. Some problems can also arise because the definition of residential property does not cover holiday homes or farm buildings.

The most common complaint about the interest rate subsidies was that most financial institutions did not know whether the disbursement fees had to be counted or not under the rule that the value

[307] Exchange rates as of 13 July 2012. Source: xe.com.

[308] Mortgage loan, effectively.

of the original loan cannot be over 10 million forints in Budapest and 7 million in other cities and towns. The respondent also said that neither consumers nor financial institutions really know the details of this particular process since the regulatory environment is so complicated.

According to the Hungarian Financial Supervisory Authority, the most common complaint about the currency conversion of mortgage loans and 25% remittance process was that financial institutions did not give appropriate information. However, the Hungarian Financial Supervisory Authority has not received any complaints where the process does not work for consumers.

The respondents said that these processes did generally work for consumers and lenders, and that lenders are generally satisfied with each process.

Debt cancellation for mortgages

There are two processes which free the consumer from all debts including mortgage debt, preventing lenders from pursuing consumers further. These are the use of the National Asset Management Company and the final repayment of mortgages nominated in foreign currency. All consumer assets can be sold in these processes to repay lenders. There is no involvement of a judge in either case.

With the involvement of the **National Asset Management Agency**, it takes 2 years for debts to be cancelled so that the consumer can no longer be pursued by lenders. Either the creditor or the lender can initiate the process, and all lenders must agree. The lender does not have to mark the coverage as saleable, only make a contributing statement that the coverage is saleable by the National Asset Management Company, who buys the coverage and makes a purchase price allocation plan. According to this purchase price allocation plan, the financial institution gets the price ratio and releases the debtor from their on-going financial obligation.

The process prevents lenders from taking the consumer's assets. However it does not automatically protect the consumer from other actions by lenders and the consumer could be at risk of losing their home in the process. This can happen if the National Asset Management Company buys the property but allows the original owner to stay as a tenant but the original owner fails to pay rent.

The consumer has the option to redeem the property form the first day of the sixth month following the date of entering into the sales and purchase contract to the end of the twenty-fourth month. If the consumer breaks the conditions of the arrangement, foreclosure of the property will continue.

The value of the residential coverage cannot be over 15 million forints in Budapest and 10 million in other cities and towns. The debtor cannot own another property. The debtor has to be socially disadvantaged, but the definition of this is regulated; the debtor must have at least one child, must receive either alternative employment benefit, housing benefit, nursing allowance or regular social support. This process was established in 2011 under Act CLXX.

Under the **final repayment of mortgage scheme**, the debtor does not have to pay the amount between the current and the fixed value of the exchange rate. After the application is submitted, the consumer has 60 days for the final repayment of the mortgage. The process does not prevent lenders from taking the consumer's assets. If the consumer breaks the terms of the process, the consumer will have to continue to repay the foreign currency loan at the current exchange rate.

The process can be initiated by the consumer only and the consumer cannot use an intermediary. One of the restrictions on this process is that the foreign currency exchange at the disbursement

date had to be below a fixed exchange rate of 180 forints /CHF, 250 forints /EUR or 200 forints /100JPY. Only mortgages can be part of the final repayment process. The debtor cannot have been in default for over ninety days, and the creditor must not have withdrawn the contract before 30th June 2011.This process was established in 1996 under amendment 200/B§ to Act CXII. This process was in force from between 30 September 2011 and 1 March 2012.

The Hungarian Financial Supervisory Authority reported that, when it comes to these processes, consumers don't generally understand their choice of process.

The most common complaint about the final repayment of mortgages nominated in foreign currency process, according to the respondent, was that financial institutions did not give appropriate information and that financial institutions eliminated unreasonable costs. An example that the respondent gave of where the process did not work was when borrowers with loans in Euros above the fixed exchange rate entered into the mortgage loan contract.

Despite these complaints respondents did feel that the processes did generally work for some consumers and lenders. Respondents also said that lenders are generally satisfied with both processes.

4.12 Ireland

As with most countries, Ireland has a number of voluntary debt re-organisation processes, such as loan consolidation, down-sizing (releasing equity in property, or merely to reduce the amount borrowed) or forbearance (interest holidays, loan duration extensions, moving to interest only mortgages).

However, in the summer of 2011 the Government's Economic Management Council tasked an Inter-Departmental Group (IDG) to consider further action to '*alleviate the increasing problem of mortgage arrears and to report back to it by the end of September*.' This report[309] made several recommendation of which the most important, in the context of this study, was that:

'...existing forbearance arrangements will not always be appropriate and the Group is looking to the industry to extend the range of alternative solutions. In this regard, the Group recommends that specific proposals be developed by the mortgage lenders, including trade-down mortgages, split mortgages and sale by agreement. Importantly it will not be the case that the distressed mortgage holder will be entitled to a particular solution and all solutions carry consequences'.

The study noted in relation to mortgage debts that there are three fundamental issues:

- '*Affordability: Changes in people's ability to meet their monthly mortgage obligation due to changes in things such as employment, salaries, tax, is the key driver of mortgage arrears.*
- *Negative Equity: Negative equity has not of itself given rise to mortgage arrears. However it does influence the scale of loss that the mortgage holder and the bank face and, as a result, the potential solution.*

[309] Available at http://www.finance.gov.ie/viewdoc.asp?fn=/documents/Publications/Reports/2011/mortgagearr2.pdf.

- *Future prospects: While the scale of the problem can be estimated for each mortgagee now, the bigger difficulty is in determining how their income, interest costs, [and] house value will fare in the future. Age, and how many future years of earning capacity an individual has, is also a very important consideration'.*

The following outlines some of the key debt re-organisation mechanisms available or proposed:

4.12.1 Mechanisms available

A Central Bank Code of Conduct on Mortgage Arrears (CCMA) obliges mortgage lenders to consider a range of alternative repayment arrangements for borrowers in difficulty with the mortgage on their principal private residence.

Voluntary forbearance continues to offer useful solutions where, in the long-term the creditor can see some potential to ultimately be paid. As the IDG correctly implicitly note, situations where it is unlikely the debtor has enough future years of earning capacity, or where negative equity is of such a size that were the debtor to defer the resultant unpaid debt post-repossession would be substantial then forbearance looks dangerously like a one-way bet with no benefits.

The **Deferred Interest Scheme** (DIS) was recently introduced as an advance form of 'forbearance', and for our purposes counts as a form of debt re-organisation. Under the DIS interest payments are 'deferred' or delayed, although they are still in existence. The IDG understood that '*lenders representing appropriately 70% of the mortgage market have indicated that they will offer a DIS, [but as] the scheme was only recently introduced it is too early to assess its effectiveness*'.

Every mortgage lender must have a **Mortgage Arrears Resolution Process** (MARP) in place. Although both FLAC and MABS agreed that the processes does generally work for consumers (referring to the CCMA generally in the case of FLAC, and the MARP in particular in the case of MABS), the most common complaint from consumers about the CCMA, according to FLAC, is that lenders are not legally obliged to offer a borrower in arrears an alternative repayment arrangement. FLAC wrote:

"The CCMA has bought some breathing space for borrowers in arrears in many instances but as a long term measure, it does not and will not work on its own".

Furthermore, MABS noted in their survey response that consumers do not understand the MARP, although FLAC reported that they do understand the CCMA generally.

According to the CBoI, under the new Personal Insolvency Bill, which was recently published and is expected to become law in late 2012, a **loan term extension** plan can be imposed on lenders, without negotiation with the lenders regarding the terms of the loan, including (but not limited to) secured debt such as a mortgage. This process can be applied for by either the consumer (through an intermediary) or the lender, with a judge involved from the start. It takes around six months, and does not prevent lenders seizing the consumer's assets. The CBoI indicated that consumers do not understand their choice of this process and it does not generally work for them and. Furthermore, lenders are not satisfied with the process, since it does not work as intended for them.

The Personal Insolvency Bill also contains 'personal insolvency arrangements (PIAs)', under which specific provisions are included whereby, if a PIA requires the sale of a property and **the realised**

value is less than the amount due to the secured creditor, the remaining balance will abate in equal proportion to the unsecured debts covered by the PIA and shall be discharged with them on completion of the PIA.[310] This is very close to the concept of *datio in solutum* in terms of presenting a mechanism to address residual mortgage debt. A debtor cannot be forced to leave a principal private residence ('PPR') under a DSA or a PIA, but may opt to do so

What is interesting is the protections the PIA gives secured creditors, which look to ensure that a minimum amount is payable to secured creditors. This is aimed at ensuring that any write-down does not reduce the principal below the lesser of (a) the value of the security or (b) the amount of the debt secured thereby. It also provides for a clawback if the property is subsequently sold, unless agreed otherwise. Regarding the valuation of security, this is to be determined by agreement between the debtor (via the Insolvency Practitioner) and the relevant secured creditor. Where the Insolvency Practitioner does not accept the secured creditor's estimate, both sides must endeavour to agree a market value having regard to certain factors. In the absence of agreement, the valuation will be performed by an independent person.

Where a PIA relates to PPR mortgage debt, it is interesting to note that all secured debt (mortgages over PPRs and buy to-let properties, and second charges) are treated the same. Judgement mortgages will also be treated as secured debt. This could produce unfair results at PIA creditors' meetings in respect of holders of PPR mortgages.

4.12.2 Proposed mechanisms

Mortgage to rent schemes: The IDG recommended the introduction of new types of mortgages which allowed debtor's to remain in their property and move from paying a mortgage to a creditor to paying a rent to a social landlord or local authority. This scheme has been designed in the light of the following arguments:

- Were debtors lost their homes, the state would need to provide them with social housing.
- Transferring the property to a social landlord or local authority, as long as the property is suitable to act as social housing, would prevent unnecessary lengthening of the social housing list and would keep people in their homes.
- Housing stock and bank funding would be brought into the social housing market, increasing the supply of social housing in the longer term.

The first scheme would operate in the following way:

- Debtors sell their home (at a discount[311] because the mortgage lender has not has to pay for re-possession and associated costs) to an approved housing body (AHB), and would use the income generated to pay / part-pay the creditor / mortgage lender.
- The mortgage lender would provide the AHB with a mortgage of up to 75% of the value of the property. The Department of the Environment, Community and Local Government (DECLG) would pay the AHB a 25% equity stake for the property. Any gap is funded by the mortgage lender.

[310] See, for example, http://www.mondaq.com/x/184860/Personal+Insolvency+Bill+July+2012

[311] An equivalent scheme in the UK set this value at 90% of current market value.

- The debtor / tenant would pay an agreed means tested rent to the AHB to remain in the property. The DECLG would pay up to 80% of the market rental value to the AHB. The AHB would use these two income streams to pay the mortgage.

The second scheme would operate in the following way:

- Debtors would return their home to the creditor, who then provides the local authority with a long-term lease. The local authority would pay up to 80% of the market rental value to the mortgage lender.
- The debtor / tenant would pay an agreed means tested rent to the local authority to remain in the property. The DECLG would pay the local authority the difference between the rent it receives and the rent it is paying the mortgage lender, up to 80% of the market rental value.

Trade-down mortgages: The basic design of this instrument would allow a debtor to trade-down to a cheaper / smaller property, despite negative equity by allowing him to take the negative equity value in his debt with him. The cost of this is an increased Loan to Value ratio, although the IDG argued that '*as long as the mortgage holder could afford the new mortgage and the ratio is nor so high to be a disincentive to the mortgage holder, it is a secondary factor*'.

The IDG provide two numerical examples, '*Customer A'* showing a successful application of a trade-down mortgage and second '*Customer B',* which illustrated some of the key concerns and led to them arguing that, despite the quote above, a maximum LTV and other parameters would need to be agreed between lenders and the regulator, the Central Bank.

Table 13: Inter-Departmental Working Group Trade-down Mortgage Example

	Customer A		Customer B	
	Current Home	New Home	Current Home	New Home
Mortgage	€400,000	€270,000	€400,000	€307,000
Comprised of:				
• Current value of property	€320,000	€180,000	€220,000	€120,000
• Negative equity	€80,000	€80,000	€180,000	€180,000
• Selling costs	n/a	€10,000	n/a	€7,000
Loan to Value	125%	150%	182%	256%
Approximate monthly payment	€2,100	€1,400	€2,100	€1,600
Affordability gain		33%		23%

Note: Assumes 4% interest rate and a 25 year term in all cases. The affordability gain is the percentage savings in mortgage debt servicing costs.

Source: Inter-Departmental Working Group (2011)

Split mortgages: The IDG documents that it received *'several suggestions'* concerning splitting existing mortgages into two parts, a live part and a 'warehoused' element, which would include a share of the principal and would 'roll-up' interest payments on the overall mortgage for the term. The basic design suggested required mortgage lenders to hive off a fraction of the principal and stop expecting payments against it. This would cause the debtor's monthly instalments to fall. However, the model suggested is that the debtor would pay this back faster than the equivalent mortgage under normal conditions. Warehoused debt would return to the live account as and when household income grew, based on a formula that only up to 40% of additional net disposable income would be required to pay the extra instalments resultant from the debt which has left the warehouse.

At the end of the mortgage the debtor could then pay-off the warehouse by:

- Selling the property / trading down to a smaller property and repaying the warehouse from the proceeds
- Using other assets / pension lump sums to pay off the warehouse
- Agreeing a 'life interest' in the property, where the creditor will receive a payment when the house is sold on the debtor's death.

However, the process of rolling-up the interest payments still leaves the potential to find the value of the property may be insufficient to pay-off the warehouse at the end of the term, although the gap should be less than would be experienced today if the property was re-possessed, depending on housing markets becoming buoyant once again.

The IDG proposed **'sale by agreement'** which would essentially a voluntary form of some degree of datio in solutum where, in a position where it is in the interest of both the debtor and creditor to sell the property and reach a 'reasonable and appropriate agreement regarding the shortfall taking account of the borrower's circumstance, [where] such agreement should be more economically advantageous than formal bankruptcy for all parties'.

4.13 Italy

At an enforcement auction[312] of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

In this system, the creditor does not have the right to take over the property (*lex commissoria*) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above, although there is no mechanism for it to be discharged in the Italian system.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone, although the lender must obtain an executor title for such measures in a court procedure.

[312] Stöcker & Sturmer (2010)

There is one exception to this, relating to the case of bankruptcy of construction companies. Let us take the example of a block of flats built by a construction company using finance raised through a mortgage on the block of flats. Here the law provides an insurance system to protect the buyer.[313] In this case, buyers can request the division of the mortgage into parts, (i.e. pro-rated between the flats in the block). They then become responsible for their share of the mortgage, but with the proviso that the mortgage is considered part of the auction price, which leads to discounting of that price.

4.14 Netherlands

In the Netherlands, some of its credit union and social banking members are experimenting with the idea of taking over 'bad mortgages' for a fixed period of time from commercial lenders. The mortgage would then be sold back to the original lenders as soon as the crisis situation has been resolved.

According to a Dutch lending association, a consumer is not automatically free of all mortgage debt after enforcement and eventual liquidation of the property. Instead, the consumer is liable for interest payments on the remaining balance of the mortgage and for any costs incurred by the lender in repossessing the property.

Enforcement[314] is delivered, under the law through public auction through a publicly commissioned authority, or by private sale under the control of a publicly commissioned authority. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement. There are differences in how the processes are applied to first and additional mortgages and how they are applied to main and secondary residences.

The legal consequence of an enforcement is that all debts of lower, equivalent, or higher rank are cancelled, meaning the new purchaser would not inherit responsibility for the old mortgage.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended with the consent of the mortgagee.

A valuation of the property only takes place within the enforcement proceedings in special cases, such as a private sale. The valuation is irrelevant however in determining whether the best offer at an auction is accepted.

In this system, the creditor does not have the right to take over the property (lex commissoria) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property.

[313] Comments from Justice Panzani.

[314] Stöcker & Sturmer (2010)

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above and discharged through a bankruptcy procedure.

In cases where the amount recovered by enforcement does not cover the remaining debt, lenders rarely voluntarily take the sale value as full settlement of the debt, according to the source. They would take the amount as full settlement of the debt in the case where the sale of the property is an integral part of a debt settlement to which the lender specifically agreed. If this is not the case, then the lender has the right to confiscate part of the consumer's income or valuables to meet the remainder of the debt.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements.

4.15 Poland

In addition to enforcement, under article 518 of the Polish Civil Code an alternative process named *cession legis* is available, under which there can be a cessation of a debt through a third party paying the debt of the debtor and acquiring the rights of the creditor, and then not pursuing the debt.

Enforcement against property is delivered[315], under the law through public auction. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration, property related taxes, other taxes, maintenance costs for children, salary claims of employees within limits and/or alimonies.

The legal consequence of an enforcement is that all debts of lower, equivalent, or higher rank are cancelled, meaning the new purchaser would not inherit responsibility for the old mortgage.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended with the consent of the mortgagee.

A valuation of the property is mandatory within the enforcement proceedings before the auction. At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

[315] Stöcker & Sturmer (2010)

- In this system, the creditor has the right to take over the property (*lex commissoria*) but only after two unsuccessful attempts for a forced sale, in which case compensation is paid if the value of the property exceeds the debt, based on the mandatory valuation.
- It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, with a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is written-off, which is essentially a *datio in solutum* solution in terms of the impact on the consumers debt position, but utterly dissimilar to a *datio in solutum* solution in that the bank has to proactively make the decision to purchase the property, rather than the consumer unilaterally deciding to end his interest in the property and compel the bank to take the property.[316]

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements[317].

4.16 Romania

Enforcement[318] is delivered, under the law through public auction through a publicly commissioned authority, or before the start of enforcement procedures through alternative procedures if agreed. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, but only if he has obtained an executor title for such measures in a court procedure.

The legal consequence of an enforcement is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key question of whether in this jurisdiction this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration.

It is only possible for the owner to have enforcements proceedings which have started for reasons of social protection.

A valuation of the property is mandatory within the enforcement proceedings. At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

[316] Stöcker & Sturmer (2010)

[317] Stöcker & Sturmer (2010)

[318] Stöcker & Sturmer (2010)

In this system, the creditor does not have the right to take over the property (*lex commissoria*) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property (and possibly, if the bank has taken this step, other assets too). Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above, although, of course, there is no route to gain a discharge of this debt in the Romanian system.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone, although the lender must obtain an executor title for such measures in a court procedure.

According to the RBA, unless agreed by the lender (in the sense of "taking a haircut") the only process that can lead to cancellation of outstanding debt is "hardship". Hardship has been recently introduced in the Romanian legislation and refers to "the situation where, due to extraordinary circumstances, the contractual undertakings become too burdensome; in such cases, the debtor may ask the court [to make] a reassessment of such undertakings (by distributing on [an] equitable basis the losses and the benefits under the relevant contract) or to terminate the contract at the time and conditions as the court establishes". The court will be asked to make a distinction between burdensome [case in which the court will adapt or terminate the contract] or onerous obligation [case in which the debtor will execute the contract as it is. In the view of the RBA, hardship may have negative implications for the lenders (since, for example, it is a new concept, there are no "objective elements embedded in the law" for interpretation, etc).

4.17 Slovakia

The Ministry of Justice notes that consumers can try to re-structure the loan by taking out new loans on more sustainable rates to replace a loan which has become unaffordable.

Enforcement is delivered, under the law through public auction through a publicly commissioned authority but the owner may choose private sale. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement.

The legal consequence of an enforcement[319] is that all debts of lower, equivalent, or higher rank are cancelled, meaning the new purchaser would not inherit responsibility for the old mortgage.

[319] Stöcker & Sturmer (2010)

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended with the consent of the mortgagee.

A valuation is mandatory before the forced sale which occurs within the enforcement proceedings, and the forced sale is not concluded if the valuation is not achieved.

In this system, the creditor does not have the right to take over the property (*lex commissoria*) from the consumer. This obviously again has a fundamental impact on the ability of the bank to take the house as collateral in a *datio in solutum* solution, as the bank would be acting illegally to take the property.

A key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer, leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property. Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above. In the opinion of the Ministry of Justice, lenders almost never take the sale value as full settlement of the debt, although, as the Ministry of Finance has confirmed there is no legislation which prevents this. The consumer is obliged to pay any remaining debt after the auction.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements.

4.18 Spain

4.18.1 The general framework

As reported in the Financial Times of Tuesday, November 12th 2012, the number of Spanish properties repossessed since 2007 had reached 350,000, with 3.1% of all mortgages in default, with total outstanding mortgage lending of €600bn. This combined with the suicides of two struggling homeowners in the past two weeks has made housing and mortgages a major issue in Spain, with the Association of Spanish Banks calling for a freeze on all evictions of vulnerable homeowners for two years, although a spokesperson for PAH, a pressure group fighting evictions said 'we distrust the announcement made by the AEB because it only speaks about moratoriums on those evictions for people in extreme need' adding that 'extreme need' needed to be defined.

There is no general legal provision of *datio in solutum* in Spain, although there is an application of *datio in solutum* for very extreme cases of destitution. Otherwise, the mortgage system works as in other countries, with the debtor responsible for meeting their commitments. The recently introduced Royal Decree Law 6/2012 of 9 March, on urgent measures to protect mortgage holders without resources, can be viewed as quite a limited step in the direction of *datio in solutum*.

4.18.2 Mortgage enforcement in Spain

Enforcement[320] is delivered, under the law, through public auction through a publicly commissioned authority, or by private sale under the control of a publicly commissioned authority. It should also be noted that the lender has the right to take enforcement measures against other assets of the debtor *before* the forced sale of the property, generally secured as an option within the loan agreement. After enforcement activity has been taken by the lender which has resulted in the repossession sale of the property, the consumer is not automatically free of all mortgage debt.

Although legislation does not give a general entitlement to a writing-off of residual mortgage debt, there are examples of mortgage products, which the consumer can choose, whereby the contractual terms prevent the lender pursuing any residual debt which has not been covered by the sum raised from selling the property. In accordance with Article 140 of the Spanish Mortgage Law[321], it can be agreed that the debtor's liability is limited solely to the amount of the mortgaged property and not affecting the rest of the personal liability (in effect a non-recourse mortgage). However, this product is rarely used in the market and theoretically interest rates would be higher.

Where the consumer is not automatically free of all mortgage debt following enforcement activity by the lender which has resulted in the sale of the property, the consumer is normally liable for interest payments on the remaining balance of the debt, and is generally liable for any costs incurred by the lender in repossessing the property.

There is no legal difference to how enforcement activity by the lender is applied to first and additional mortgages, or to the main residence versus any additional residence(s).

The legal consequence of an enforcement is that all debts of lower or equivalent rank are cancelled, but if the lender taking the enforcement action is a subordinate mortgagee that a higher ranked mortgage would continue to exist. That is the new purchaser would still be responsible for paying off the first ranked mortgage. This clearly normally acts to cause a discounting of the purchase price of the asset, but in the case of *datio in solutum* raises the key question of whether this higher ranked mortgage would be included in the write-off or whether it would just be ported to the next purchaser of the property.

It is also important to note that some costs have claim on the collateral released by enforcement over and before the mortgage. These are the costs of the proceedings and administration, property related taxes, other taxes, maintenance costs for children, salary claims of employees within limits and/or alimonies.

It is only possible for the owner to have enforcements proceedings which have started and are adjudged lawful temporarily or permanently suspended in the event of exceptional personal circumstances (e.g. heart attack).

[320] Stöcker & Sturmer (2010)

[321] The Spanish legal system already reflects the existence of a mortgage limited to delivery of the mortgaged property. Indeed, Article 105 of the Mortgage Law expressly establishes that the responsibility of the debtor is unlimited whereas under Article 140 the obligation is only concerning the subject of the mortgage, and this is limited.

A valuation of the property is not required within the enforcement proceedings as it has been set within the mortgage agreement when signed. At any auction of the property if a certain fraction of this valuation is not achieved the proceeding is prolonged but not suspended, through repeat auctions, although these subsequent auctions may set a lower benchmark, in terms of share of the valuation.

Lenders rarely voluntarily take the sale value as full settlement of the debt where the value received from the sale is less than the remaining debt. The circumstances where the sale value may be taken as full settlement are not regulated. It is optional for the credit institution and will depend on the socio-economic circumstances of the debtor. In pursuit of the remainder of the debt, the debtor's liability is 'universal', and the mortgage guarantee does not prevent debtors from also responding with the rest of their personal assets. The only limitations are time-related, because the general prescription period in Spain is 15 years and, for mortgage action, 20 years.

In this system, the creditor has the right to take over the property (*lex commissoria*) but only after an unsuccessful attempt for a forced sale, in which case compensation is paid if the value of the property, agreed in the contract, exceeds the debt.

It is important to note that a key feature of this market is that the lender can bid in the forced auction and acquire the property this way, but without a full or partial settlement of the remainder of the debt. In other words, the bank can purchase the property and any debt over this value is still owed by the consumer[322], leaving the consumer in the worst of positions, of still having the debt but having lost his asset, the property (and possibly, if the bank has taken this step, other assets too). Without an asset this debt becomes an unsecured debt and can be treated as such in a wider debt solution, as described above, although, of course, there is no route to gain a discharge of this unsecured debt in the Spanish system.

It is usual practice for mortgage contracts to include clauses which permit the lender to pursue enforcement action against other assets once the property itself has gone through a forced sale without further formal requirements.

According to the *Confederación Española de Cajas de Ahorros* (CECA), the high rate of unemployment and the general economic conditions in Spain are some of the factors which explain the decrease of income that has reduced the capacity of mortgage loans holders to meet their payments.

Despite that, the percentage of non-performing loans (NPL) in the home loans portfolio currently stands at 2.74%[323], with the percentage of unemployed people who hold a mortgage loan 7.9% of

[322] It is worth asking oneself at this point why this may prove to lead to a problematic situation for the consumer. There are five main reasons why this process may lead to significant out-standing debt.

- The property has significantly dropped in value, so the auction price is significantly below the purchase value.
- The bank has purchased the property at a very significant discount compared to the original loan value.
- The consumer took a mortgage with a greater than 100% loan to value (LTV) ratio.
- The *hypotec* has caused the resultant value of outstanding debts being enforced against to be greater than 100% LTV.
- The consumer has engaged in cross-guarantees with other mortgagors which have left them unable to address their outstanding debts and guarantee commitments.

[323] Figures from the *Confederación Española de Cajas de Ahorros* (CECA)

total mortgage loans contracted by households. The unemployment rate, in comparison, was 24.4% in March 2012.

All credit institutions[324] have practices and debt refinancing products to adapt to the new socio-economic circumstances of the debtor.

Credit institutions systematically offer solutions for borrowers in financial problems so they can afford the repayment of their mortgage loans according to their financial status, through different mechanisms, such as, among others:

- the creation of grace periods in interest and/or capital payments,
- deferred due dates,
- interest rate modifications,
- including alternative repayment formulae (diverting a part of the principal to the final due date of the loan, applying repayment formulae with payments in progressive growth, etc),
- in some cases, more seldom, credit institutions acquire the property. Later on, it can be rented to the former owner, even with a buying option.

Although these measures have been applied more frequently during the crisis, they already existed before the crisis.

4.18.3 Recent reforms

In response to the current crisis, several modifications have been introduced in the Spanish legal framework governing foreclosure to mitigate the economic effects of these.

There have been three significant attempts to reform the mortgage market and address problematic mortgage over-indebtedness:

- **Mortgage Moratorium:** Royal Decree 1975/2008 of 28 November, on urgent measures on economic, fiscal, employment and access to housing.
- **Consumer Protection:** Royal Decree-Law 8/2011, 1 July 2011, establishes measures in order to increase consumer protection:
- **Mortgage re-structuring, mortgage relief, and *datio in solutum:*** Royal Decree Law 6/2012 of 9 March, on Urgent Measures to Protect Mortgage debtors without resources

Mortgage Moratorium

The previous Government issued by Royal Decree 1975/2008 of 28 November, on urgent measures on economic, fiscal, employment and access to housing. This introduced a moratorium via *Instituto de Crédito Oficial* (ICO), a state-owned bank attached to the Ministry of Economy, which provided credit lines, such as *Linea Moratoria Hipotecaria*, which was aimed at unemployed people, with a

[324] According to the Spanish Mortgage Association (*Asociación Hipotecaria Española*)

temporary and partial deferral of the obligation to pay 50% of the amount of mortgage instalments between 1 March 2009 and 28 February 2011, with a maximum of €500 per month.

In addition, since 2008, However, as ADICAE note, this was 'ineffective' and 'an utter failure' as access was quite restrictive, as evidenced by the fact that whilst €6,000m was set aside for this scheme, only €73m (1.3%) was used), in part because of the voluntary nature of the arrangement on the part of lenders.

Consumer Protection

Royal Decree-Law 8/2011, 1 July 2011, establishes measures in order to increase consumer protection:

- In the case of **debtors who have lost their property but still have residual debt**, the debt can be collected via an attachment on earning. The Royal Decree-Law 8/2011 increases the minimum amount exempted up to 150% of the official minimum wage and an additional 30% for each member of the household who are not receiving income above the minimum wage.
- Also, where the auction has been unsuccessful (there are no bidders and the lender has therefore foreclosed and take possession of the property), with the aim of cancelling as much of the debt as possible, it raises the reserve (or floor) for the sale of the mortgaged property (it could not be less than 60% of the valuation price). In other words only bids which paid more than 60% of the value would be accepted.
- It reduces the deposit required from third-party bidders.

Mortgage re-structuring, mortgage relief, and *datio in solutum*

In March 2012 the *Royal Decree Law*[325] *6/2012 of 9 March, on Urgent Measures to Protect Mortgage debtors without resources* introduced measures to enable the restructuring of mortgage debt and the easing of the foreclosure process, all aimed at a social group of debtors in a position of special vulnerability, defined as those below the 'threshold of exclusion'[326]. The introduction of this law also implicitly recognises that in spite of several legislative initiatives adopted in recent years for the protection of the mortgagor, all seem to have been insufficient to mitigate the effects of the current economic context, especially on those most vulnerable, who find themselves in a situation where, in addition to being deprived of their property, they still have a duty to satisfy the debt not covered by its liquidation. These include:

[325] It is of note the fact that this rule is promulgated by a Royal Decree-Law, an instrument constitutionally reserved to the executive, generally for situations of extraordinary and urgent need), which is indicative of the perceived seriousness of the current situation of economic crisis in Spain.

[326] People considered to be on the threshold of exclusion are those who are under the following circumstances:

- When all members of the household and co-debtors do not have an income to meet their financial obligations.
- When the mortgage payment is more than 60% of net income received by all members of the household and co-debtors.
- When the mortgage affects the residence of the debtor and the mortgage was granted for its acquisition.
- When the loan has no other guarantees.
- When there is a guarantee, but guarantors lack sufficient assets and the mortgage payment is more than 60% of their net income.

- The Sustainable Economy Act (Act 2/2012)
- The Consumer Credit Law (Law 16/2011) transposing Directive 2008/48/EC
- The Order of transparency and customer protection for banking services
- (EHA/2899/2011, 28 March) and Circular 5/2012 of Bank of Spain.

This Royal Decree-Law contained two significant areas of reform:

- General Provisions
- Voluntary Provisions

General provisions

The Royal Decree-Law makes significant amendments to taxes on revisions to contracts and to out-of-court foreclosure proceedings under the Mortgage Law and its implementing regulations with a view to bringing the rules on out-of-court auctions into line with those on court auctions under the Civil Procedure Law. Out-of-court foreclosure proceedings have been simplified by requiring a single auction and an upset price.

The rules on out-of-court foreclosure proceedings contained in the Royal Decree-Law will apply where the proceedings are conducted against the debtor's principal residence:

- The value of the property will be realized in a single auction in which the starting price will be that stipulated in the mortgage deed. If, however, bids are submitted for 70% or more of the value at which the property would have been auctioned, the property will be deemed to be awarded to the highest bidder.
- If the highest bid is lower than 70% of the starting price, the debtor may submit, within ten days, a higher third-party bid which exceeds 70% of the appraisal value or which, if less than that amount, is sufficient to pay off the whole of the foreclosing party's claim.
- If the debtor does not take the step mentioned the previous paragraph within the time limit, the lender may, within five days, request that the property or properties be awarded in exchange for a sum equal to or exceeding 60% of the appraisal value.
- If the lender does no exercise that right, the property will be deemed to be awarded to the highest bidder, provided that the bid exceeds 50% of the appraisal value or, if less, that it at least covers the amount claimed in respect of all items.
- If there are no bidders at the auction, the lender may, within twenty days, ask for the property to be awarded in exchange for an amount equal to or exceeding 60% of the appraisal value.
- If the lender does not exercise that right, the notary will deem the foreclosure proceeding to be at an end and will complete and file the notarial certificate, which will clear the way for the appropriate court proceeding.

Voluntary Provisions

Adherence to the Code of Practice is voluntary for lenders, who communicate whether they plan to adhere to the Code to the Spanish Treasury. Once communicated, the Code becomes mandatory for a period of 2 years (renewable). All Savings Banks adher to the Code. The measures outlined in the Code will apply to debtors who are on the 'threshold of exclusion' and where the acquisition price of the house does not exceed certain values. The measures including three successive key phases of activity, which must be gone through in sequential order, adding a further delay before *datio in solutum* can take place:

- **Measures to restructure the debt prior to foreclosure**. Debtors who are on the threshold of exclusion may request, and obtain, from the credit institution a restructuring of their mortgage, provided that there has been no announcement of the auction. The conditions for this restructuring include a lower interest rate spread, longer period for repayment and two years under an "interest only" payment scheme. In addition there is a moderation of interest rates charged on arrears applicable to mortgage contracts[327], such that the default interest does not exceed the amount resulting from adding to the stipulated interest payable on the loan, at 2.5% over the outstanding loan principal. This limit applies as soon as the debtor evidences that he falls within the exclusion threshold. Thus, if the mortgagor so far had to deal with late payment penalties of up to 25%, with the entry into force of this rule, if the debtor is below the threshold, the interest on arrears shall be limited to a maximum of 2.5 percent of the outstanding principal of the loan. This rule also reduces the penalty interest that often weighed on mortgage borrowers who could not cope with their debt and made their financial situation even more difficult.
- **Accompanying measures consisting of a haircut on the outstanding principal.** The debtor could ask for such a measure when the above mentioned restructuring plan is non-viable because the amount to be paid is still too high. The credit institution may accept or reject the haircut. This measure may also be requested by debtors who are in foreclosure proceedings in which there has been the announcement of the auction, and those who despite being included in the threshold of exclusion, have failed to qualify for *datio in solutum.*
- **Alternatives measures to foreclosure, consisting of *datio in solutum*[328] of the main residence.** This alternative measure is applicable to those debtors who cannot benefit from the measures mentioned above. **In this case, the lender is obliged to accept it.** After the house is received in payment of debts, the debtor may remain in the house as a tenant for a period of 2 years, renewable with the agreement of both parties, paying an annual rent of 3% of the outstanding debt at the time of the *datio in solutum*. It is also established rent subsidies for people affected by foreclosure proceedings concluded after January 1, 2012. Those debtors who sign leases as a result of the implementation of the Code of Good Practice on *datio in solutum* may also obtain assistance.

ADICAE argue that the *debt re-structuring* proposition is not a solution for many of the cases it has seen because it still involves repayments when to qualitfy the household has no income.

Simialrly ADICAE argue that as the second measure, *debt relief*, is voluntary for banks its take-up has been too low to be considered a success. In fact, ADICAE have informed us they have seen no (zero) cases in which a bank has agreed to apply it, so, in effect this stage does not exist.

Finally ADICAE argue that *datio in solutum* is not having a favourable effect because, under the Code, to be eligible for this process borrowers must have gone through the two preceding processes, which is likely to take around a year, so in many cases the home may already have been lost. In addition, ***datio in solutum* suffers the significant weakness of involving the loss of the property to the consumer, with the consequences that implies**. Therefore, ADICAE advocates the adoption of a moratorium to stop problem mortgages moving to enforcement proceedings.

[327] Article 4.

[328] The precise definition of d*atio in solutum* in this case is a mechanism to solve the foreclosure by giving the property to the bank in satisfaction of the debt, which limits the principle of unlimited liability of the debtor set out in Article 1911 of the Civil Code.

It is important to point out, however, that **this Decree-Law has a very explicit intent of assisting only those consumers who are at the very extreme lower end of financial difficulty.** The requirements for meeting the conditions of the law are such that a vast majority of over-indebted consumers are not be able to avail themselves of the protection offered

Following the approval of Royal Decree-Law 6/2012 of 9 March, on urgent measures to protect of mortgagors without resources, ADICAE's immediately launched the Observatory, designed to extract data that allow us to analyse the success or failure of the measure approved by the Government.

From the March 15, 2012, information has been collected from 8,726 consumers who attended an ADICAE office on mortgage matters, and who were potential beneficiaries of the measures implemented by the Good Practices Code.

Firstly ADICAE asked a series of questions to each consumer to determine if they did or did not meet the requirements of the Royal Decree. The summary of the data extracted from the attentions made is as follows;

- Only 12.8% of the mortgaged attended met each and every one of the requirements to adhere to the Good Practices Code.
- The 87.2% did not meet the necessary requirements broken down the reasons for failure as follows;
  - In 5.8% of cases the problem was not with the family residence.
  - In 17.4% of cases the family had too many household assets.
  - In 47.8% of the cases not all the members of the household were unemployed.
  - In 32.2% of cases the mortgage payment did not exceed the 60% of the total income of the family unit.
  - In 40.2% of cases there were guarantors on the loan. These only met the requirements set in 44.1% of the cases involving guarantors.
  - 58% of the cases did not meet the maximum price set for the home purchase.

As the large majority of consumers do not meet the requirements, we analyse why below:

- **Strict requirement that all family members are unemployed:** The Good Practices Code states that one of the requirements to meet it may be that 'all members of the household must have a lack of income from work or economic activities'. The Observatory has detected that in many cases that do not meet this requirement, the salaries earned were generally low and unstable that did not provide the solvency required to meet mortgage payments. In many cases the only income was from a single member of the household, who may only be in part-time employment for a single household member, leaving little over after basic expenses like food, water, and energy.
- **Definitional problems with the calculation of problematic mortgage debt:** Another requirement is '*That the mortgage payment is greater than 60 % of the revenue after taxes received by the wider membership of the family unit*'. However, consumers facing difficulties may not meet this requirement. The two main circumstances a family can find themselves in which do not meet the requirement are:
  - Families who have small mortgage payments, but a minimal income preventing them from meeting their mortgage obligation do not fall within the requirement (e.g. mortgage payments of €400 and income of €600).

- Families whose incomes are not enough to keep the number of people in the household (e.g., a family of five who has an income of €1,250 per month and a fee of €700 euros). This is because the Royal Decree does not take into account the number of people living on that income, which distorts the eligibility rules. Many other countries take account of the number of children when calculating exempt income, for example, which appears to be a relevant lesson for this application.

- **Areas of discretion in application:** Among the conditions that potential recipients must meet Code measures are is that of 'That all members of the family unit lacks any other property or proprietary rights sufficient to deal with the debt'. This requirement introduces a subjective judgment as 'sufficient' is not defined, leaving the bank free to decide who is eligible.
- **Restrictions on eligibility based on what the mortgage was used for:** The Code requires that the '*mortgage fall[s] upon the unique home ownership granted to the debtor and the acquisition of the same*'. While it is true that in most cases handled by ADICAE's Mortgage Observatory the problem with the residence met this requirement, in determining that the mortgage was granted for purchase, rather tan renovation or to release equity, ADICAE frequently found examples who were excluded under this rule, for example;
  - Borrowing to buy the house but also must reform or to buy furniture for it.
  - Loans that were requested to meet other debt or a need for liquidity. (Example, home ownership is paid on a mortgage is secure funding for the small family business).
  - Consumers who have another home that has little or no value as it is in a rural area.
- **The existence of complicating guarantors and represents a further limitation:** 40.3% of consumers, according to the ADICAE Observatory have their mortgage guaranteed by guarantors. Among such guarantors, 55.9% did not meet the requirements through owning another home that could be considered sufficient to pay the debt. However, in these cases, guarantors often do not have sufficient financial capacity to address the troubled mortgage they guaranteed and their own personal obligations. This is a general problem of the guarantor model failing through its mis-application whereby guarantors did not have the resources to make such a commitment. Given this, it is exceedingly difficult; on one hand the bank should be able to have an expectation that the guarantor's guarantee means something, but equally, if the guarantor system is fatally flawed then punishing people in difficulties by preventing them being eligible for relief because the guarantor has, in effect, let them down seems harsh on them too, particularly as a common phenomenon appears to be cross guarantees, allowed by the bank at the time of the housing boom and consisting of two strangers endorsing each other's mortgages with guarantees to reduce the interest chargeable. In such instances it is not unknown for the boorrower to not even be aware who his guarantor is. This is a major problem in its own right as consumers have been sold mortgages which, in reality were unsuitable for them because they should not have been able to include stranger third-party guarantors. As such, *datio in solutum* is not be a solution for this very different problem, which requires its own bespoke response.
- **The maximum mortgage amounts to access the Good Practices Code:** Article 5.2 of the Code states that its application covers '*mortgages as security for loans or credits granted for sale of homes whose purchase price had not exceeded the following values:*

  a) for municipalities with more than 1,000,000 population: €200,000;

  b) for municipalities with between 500,001 and 1 million inhabitants or integrated into areas metropolitan municipalities of over 1,000,000 inhabitants: €180,000;

  c) for municipalities with between 100,001 and 500,000 inhabitants: €150,000; and

d) for municipalities to 100,000: €120,000.

For the purposes of the above will be considered the latest population figures resulting from the Revision of the Municipal Register'.

58% of consumers who have come to ADICAE do not meet the requirement that the value of your property purchase does not exceed the limits. According ADICAE experience, most mortgages that are currently problematic were taken out during the boom years, so that in many cities the values set out in the Code are overly restrictive. Furthermore, using population as a general rule misses property 'hot-spots', such as coastal and privileged areas.

Given these data raised ADICAE argues the Royal Decree has been 'a vague attempt by the government', that the measure is not an effective solution, similar to the moratorium reforms of 2008.

4.18.4 Assessments of *datio in solutum*

The *Confederación Española de Cajas de Ahorros* (CECA) supplied us with an analysis of the impact of *datio in solutum,* having noted this change has generated a lot of social, legal and political debate in Spain. The analysis looks to identify the potential impact of the effects that could be produced if a legislative amendment should establish mandatory *datio in solutum*. The conclusions they reported indicate that the change would be unfavourable for both financial institutions and citizens. Should this action retroactively apply, in the words of CECA, 'the consequences would be magnified and the negative impact would be much more relevant, jeopardizing access to mortgage credit and the stability of the mortgage market'.

Specifically, the main impacts CECA, a lender association, identifies from the research it has reviewed would be:

- **Increase in mortgage default rates** (up to levels above 8.0% in the worst case scenario, compared to 2.3% is in the first quarter of 2011);
- **Increased capital requirements of lenders** (up to €4.5bn in the case of retroactive application of the legislative amendment), with the consequent impact on the credit flow in the economy;
- **Significant increase in fees on mortgage loans** and savings necessary to qualify for a mortgage loan (lower LTV);
- **Reduction in mortgage lending to individuals** (up to 40% in the case of retroactive application), which would have knock-on effects on the recovery in the construction sector, and, if one anticipates a return to increasing property prices, an impact on mortgage borrowers ability to acquire an asset which may appreciate over time[329];
- **Destabilisation of the securitisation market**: much of the mortgage loans are securitised. As it represents an important source of financing for banks, the alteration of the legal regime of the mortgage loans would affect the rating of asset-backed securities and covered bonds issued by Spanish banks and backed by such loans, increasing the cost of financing the financial system. On top of that it would more than likely add a negative effect on the risk premium of Spanish debt[330].

[329] Although, as the last few years has shown, relying on this type of asset value growth / bubble is not necessarily wise.

[330] See Annex 6.

These effects could negatively impact the sovereign risk premium and the cost of financing company's face.

Therefore, CECA suggest that, were *datio in solutum* mandatory, it would benefit very few people (around 2.5% of defaulters) and could be detrimental for many consumers through higher borrowing rates, shorter terms and lower Loan-To-Value mortgages. These results align with our general understanding of the potential impact of *datio in solutum,* which is that *datio in solutum* is a way for lenders and borrowers to share the risk of over-valuation of properties, although we cannot vouch for the numbers calculated here, which appear noticeably higher than those calculated by Levitson, for example.

ADICAE, also identified that this particular model of implementation, which they feel fails to address the problems of Spanish consumers, at least in in part because of the drafting of the legislation and the degree of discretion it gives to lenders. The key issues ADICAE raise are listed below:

- There seems to be a contradiction in article 3, which lists circumstances that must be met in order to be included within this protected group. Article 3.1 a) states that *'all members of the household must have a lack of income from labour*'. However on Article 3.1 b) indicates that the amount due on the loan has to be more than 60% of income (after taxes application) received by all members of the family unit. This therefore suggest the cut-off is set at 60% of social welfare payments, but it is not immediately clear, especially as unemployment benefits, which are taxed in the same way as salaries through income tax, appear to be considered as 'earned income' The phrase '*after taxes application*' is also unusual in this setting, when all agents in the household are meant to be unemployed, especially as no mention is then made of any element of exempt income to cover the family's living costs.
- The definition in Article 3.1 d) of the family unit, incorporating spouses, civil partners and children, is less clear on how to define their income.
- Article 3.1 c) requires '*that all members of the family unit lacks any other property or proprietary rights sufficient to deal with the debt*.' However, there is no clear definition of how 'sufficient' is defined, or who makes this determination. ADICAE raise a concern that without the establishment of minimum criteria then discretion with appraisal ultimately appears to rest with the bank.
- As stated in the Article 3.1 d) and Article 5.2[331], to benefit from this Royal Decree, the mortgage must have been taken out with the purpose of purchasing the property. Mortgages which released equity, or were used to finance renovation and extensions to the property[332] are excluded, as are, under Article 3.1 d) mortgage loans exceeding the value of the house. Similarly we assume this means legal fees (registration and notary, tax, etc.) are excluded.
- Article 3.1 e) requires the guarantor to also meet these strict assumptions for the '*family unit*' to be included within the threshold of exclusion and access *datio in solutum*.

[331] Article 5.2 reads 'The implementation of the Good Practice Code will cover the mortgages as collateral for loans or credit granted for the sale of homes whose purchase price had not exceeded the following values.'

[332] And special dispensations for farm debt.

- Article 4 on moderating default interest states '*the applicable default interest from the time the debtor satisfies the entity that is in such circumstances, shall not exceed, the result of adding the interest on the loan agreed remunerative by 2.5 per cent on the outstanding principal of the loan.* ' This article is obligatory but it is not clear when to begin to calculate default interest; from the point where the consumer presents the documentation referred to in Article 3.2 or when the entity 'evaluates' whether borrowers qualify. Under Articles 5.4 and 7, and Article 1 b) of the Annex, it appears that the entity must assess and confirm explicitly the borrower is within the threshold, which implies that the earliest possible start date for default interest charges is upon submission of documentation, not apply retroactively from the time of default. Moreover, in the case of floating rate loans, it not stated what the specific applicable annual rate is (within the meaning of '*agreed remunerative interests*' referred to in Article 4.1). One assumes it should be understood that the rate prevailing at the time of default, but this is not explicit.
- Section 5. 4. says: '*once the debtor is accredited as meeting the threshold, the provisions of the Code of Good Practice must be applied. Notwithstanding this, either party may compel the other to a formalised deed of novation of the contract correcting for the provisions contained in the Code of Good Practice. The costs of such formalisation are borne by the party requesting it*.' Therefore, it is not necessary for the bank to respond formally and expressly to consumers about whether or not they are included in the 'threshold of exclusion'. Completing the accreditation of Article 3.2 (certified) is enough to implement the content of the Annex. This can produce significant uncertainty for debtors.
- According to Article 5.4 '*lenders will be mandated to apply the provisions of the Code of Good Practice*', however, this is inconsistent with paragraph 2 a) of the Annex, which says '*debtors for whom the restructuring plan provided for in the preceding paragraph is impractical, given their economic and financial position may request a rebate on the capital amount outstanding under the terms provided in this section, and the institution shall have power to accept or reject*.' Ultimately, the choice of the haircut is not mandatory for the company, but optional, which undermines the effectiveness of the Code and makes *datio in solutum* virtually unattainable.
- Article 5.6 states that: '*lenders shall be covered by the Code for two years, automatically renewable for periods of one year, unless expressly denounced in notification to the General Secretariat of Treasury and Finance with a minimum of three months notice*.' However, there is no specific reference to giving information to consumers to inform them the company will not continue subscribed to the code of good practice. Given the importance of this reform to consumers it is clear to us that this notice should be disseminated properly and at the same time the lender notifies to the Secretariat General of the Treasury and Financial Policy.
- Article 6.1. says that '*compliance with the Code of Practice by the member institutions will be supervised by a supervisory committee constituted for that purpose*,' but the term 'supervisory' is misleading, since such "supervision" as the law requires is purely for information purposes with no possibility of punishment and rectification obligation[333]. Despite being explicitly regarded as 'mandatory' for code enforcement (section 5.4) and application of Article 4 (reduction of default interest), Royal Decree Law 6/2012 does not contain any express sanction for breach of such provisions whereas other similar laws, such as the Law amending Law 26/1988 of Discipline and Intervention of Credit Institutions,

[333] This commission simply collects and disseminates information and 'standard models (Article 6.4) and does not have the power to resolve contentious issues arising from the application of Articles 3, 5 and Annex.

established a specific offence for noncompliance[334]. Article 6.2 completely excludes consumer organisations specialised in this issue from the supervisory committee. Whilst Article 6.6, says '*claims of alleged failure by the banks to comply with the Code of Good Practice may be sent to the Bank of Spain, and will receive the same treatment as other claims that were processed and resolved by the Bank of Spain'*, it is unclear if they are subject to the specific procedure for claims on financial matters, which first requires bank's customer service function. In addition, the Bank of Spain's resolutions are not binding and there is no express mentioned in the Royal Decree of the possibility of recourse to the courts.

- It is worth noting is that the Code of Good Practice is divided into three different measures which are only available on demand or consumer application, and are successive stages, in the sense that you cannot apply one of the measures without first applying or being evaluated as being unsuitable for the previous measure. Therefore, it is not possible for the consumer to request *datio in solutum* (last of the measures) if there is no evidence of the infeasibility of the other two earlier actions.
- Restructuring may be requested by those debtors for whom execution procedures have not yet been commenced. Debtors defined as meeting the threshold of exclusion may apply to the lender to restructure their mortgages and create a viable payment regime. That plan should include a moratorium on capital depreciation charges for four years, the expansion of the payment period up to forty years and reduced interest rate charges of Euribor + 0.25 points. Article 7.1. c) states that restructuring is only applicable when the '*restructuring is viable'*, including the requirement that the new payments do not exceed 60% of the household income[335], or otherwise at the lender's discretion, leaving this a very restrictive and limited approach. Of course, if the lender feels that permitting this may prevent applications for stages two and ultimately three (*datio in solutum*) then they may allow the debtor to access an inappropriate re-structuring solution to prolong the period before proceeding to a stages two and three.
- In determining the capital removed under *datio in solutum*, the lender uses certain calculations, but the decree-law does not say anything about the choice of a calculation method. This is a key gap as the calculation method can significantly impact on the borrower and his ability to to evaluate the objectivity of the decision of the credit institution.
- According to 'Alternative measures' point 3 c), the debtor may stay a minimum of two years as a tenant paying an annual rent equivalent to 3 % of the amount of outstanding debt. For example, if left to pay a € 200,000 loan, 3% would be €6,000 a month or €1,500 per week for a household with no sources of income, with late rent interest charges of 20%, suggesting the rental idea is untenable for the vast majority of households who do use the *datio in solutum* route.
- Datio in solutum shall not apply if the enforcement procedure is completed or if the property is encumbered with subsequent mortgages.

In addition, ADICAE has questioned whether the warnings of lender's associations, that *datio in solutum* will inevitably drive up the price of mortgages will not be counter-balanced by a drop in

[334] Articles 3-7.

[335] Which given no member of the family can be in employment must surely imply restructuring is unfeasible in the vast majority of cases.

demand caused by consumers being forced to exit the housing market (purchasing, not rental), driven in part by the fact that these consumers will not be able to access mortgages, but also through the buying power of the Spanish consumer falling, they would not be able to borrow as much as they once did. We consider this argument in greater depth in section 6.2, but also want to note ADICAE's recognition that if this is the best that *datio in solutum* can offer, it may be necessary to consider other options.

4.18.5 ADICAE's proposed solutions

ADICAE has developed a number of proposals to these problems:

1. Mortgage moratorium for three years

ADICAE argue for moratorium on mortgage payments as the most effective method to stave off foreclosures; a variant of the argument we present in section 6.2, that well-organised and universally available mortgage forbearance arrangements which are designed to put consumers onto a sustainable repayment schedule to honour their commitment is the most effective response to mortgage over-indebtedness, from the point of view of both lenders and borrowers. Given the urgency of a concrete and effective intervention ADICAE propose a mortgage moratorium to temporarily avoid mortgaged families facing enforcement proceedngs and any potential loss of housing, along the lines of, and using the language of the Real Decree Law moved by the previous Government.

This would give debtors defined periods without payments to allow them rebuild their finances such that they can complete the course of their loan. This has the inescapable strength over *datio in solutum* that all forbearance models possess, which is that the ultimate aim is that the consumer does not lose their home.

2. Proposed mortgage law reform

Whilst urgently required, a moratorium would only give some respite; it would not solve some of the underlying issues which have led to the current levels of problematic mortgage debt in Spain. As such, essential reforms are needed to mortgage legislation, which has remained basically unchanged for over 60 years generating various imbalances against users in a the Spanish mortgage market. In particular, ADICAE propose:

a) Ability to defend against enforcement proceedings or Foreclosure: There should be an identification of bad practices in existing contracts to permit consumers to defend themselves against abusive contracts and pevent the advent of enforcement proceedings when these would not be merited by a fair contract

b) Share of valuation which must be met for a valid mortgage: Changes to auctions to amend the share of the appraised value to not less than 80% is proposed to reduce residual debts owed by the consumer on losing his home.

c) Limitation of default interest, With current default lebels of interest ranging from 24 to 29%, at a time when the official rates are around 1% even the Ministry of Economy has described the situation as potentially abusive, and potentially even falling in scope of usury laws.

d) Regulation of disproportionate legal costs, Presently lenders are allowed to pass their legal costs onto borrowers, levering up the level of debt after enforcement. This imposes an additional burden, and regulation should be used to constrin the potential for this burden to become abusive.

e) Limiting consumer's liability for secured debt to just the secured asset. This would mean that a lender who carries out enforcement against a mortgaged property, and who raises less than the mortgage value cannot then pursue the debtor for the residual. This idea, we believe has great merit for three reasons:

- It achieves the same limitation of liability as *datio in solutum*, in that the lender cannot receive more than the value of the property from a secured debt, but without raising many of the awkward practical and legal questions we capture in Annex 7 which occur in a *datio in solutum* system, because the lender is forced to make the decision to take the property under the common enforcement procedures.
- This would incentivise the lender to not foreclose but instead seek preferable forbearance models of resolving problematic over-indebtedness, as he would now need to cost in a potential significant loss into his assessment of whether to launch enforcement procedures is going to deliver him a benefit or not.
- This would incentivise the lender to lend responsibly, as losses incurred in the property market, either from a collapsing bubble or driven by an economy-wide recession would be borne by the lender.

3. Proposals on personal bankruptcy

Finally, the creation of a specific bankruptcy process that would give consumers a 'second chance' to renegotiate, postpone or discharge unrecoverable debt, is clearly required.

It is the opinion of the authors that these models deserve further consideration, presenting interesting alternatives over a weak *datio in solutum* such as is currently in operation in Spain.

4.19 United Kingdom

Enforcement is delivered, under the law through private sale, including auctions, through the creditor.

The UK has a number of mechanisms available to consumers to help prevent repossession. Lender forbearance has played a key role in keeping first charge mortgage possessions under forecasts since the financial crisis. In 2011, the Financial Services Authority issued detailed guidance[336] to lenders to set out their findings from a review of firms' '*mortgage forbearance and impairment provisions processes and .... the action [the FSA] want[s] firms to make'* on the basis that *'arrears and forbearance support provided with due care by firms has a beneficial impact both for the firm and the customer, in that it can reduce the number of repossession and lower realised losses'*. The guidance's conclusion was that *'forbearance based on sound conduct principles provides for sound*

[336] To support the relevant existing Handbook material such as Principle 6, chapter 13 of the Mortgage and Home Finance: Conduct of Business sourcebook (MCOB).

prudential management. However....where support or forbearance is provided without careful consideration of the customer's individual circumstances it can place them in an even worse position. In some cases this can lead to the mortgage moving permanently onto non-sustainable terms'.

The guidance states that the '*primary aim of providing a forbearance facility to a customer should be to enable the complete recovery of the mortgage through the full repayment of arrears... where the circumstances of the customer mean that the primary aim cannot be achieved, the secondary aim would be recover the customer into a sustainable terms position on the mortgage. In all events, the provision of forbearance should aim to minimise the risk of the customer ultimately losing their home'.*

One of the tenets of mortgage regulation prescribed under the FSA's MCOB rules is that a borrower's individual circumstances must be taken into account when considering alternatives to possession [MCOB 13.3.4AR(1) in the application of MCOB 13.3.2AR(6)]. The guidance outlines that the determination of a repayment period which is reasonable will depend on the individual circumstances[337], and is affordable and sustainable for the consumer, that the consumer has been made aware of the options before them and that firms should not capitalise a payment shortfall except where no other option is realistically available to assist the customer[338]. This will include considering whether a term extension, a change in the type of mortgage or a government-led forbearance initiative is appropriate. The lender will need to assess the nature of the financial difficulty, its expected duration and how any forbearance measure works in the interests of both the lender and borrower in returning the mortgage onto sustainable terms. One-size-fits-all forbearance approaches are identified as poor practice in the guidance.

Possibly the most important element of the best practice identified for this study is the customer-focused assisted voluntary sale (AVS) scheme where homeownership may prove unsustainable for some borrowers, despite the best efforts of the borrower and lender, or independent debt advice and government initiatives. AVS occurs when and where moving out of home ownership or downsizing has been agreed with the customer. This provides the consumer help to manage expenses and associated processes. Under this arrangement consideration should also be given to allow the customer to '*remain in possession for a reasonable period to effect a sale'.* In complying with MCOB 13.3.2AR(6), some lenders with higher incidence of arrears/impairment on their book may choose to offer a structured approach to assisted voluntary sales. However, lenders need to balance the challenges of incentivising a borrower to stay on any such 'scheme', whilst ensuring that it is not being used by a borrower to buy time, either through not clearing their arrears or not having any intention of selling.

Government operates a 'mortgage rescue scheme' for borrowers at high risk of repossession, which allows them to stay in their home through either mortgage-to-rent or an equity loan.

Mortgagees that wish to take possession, irrespective of whether they are first or subsequent charge holders, should adhere to the mortgage pre-action protocol before going through the courts. However, first and subsequent charge mortgages are subject to different regulations. First charge

[337] MCOB 13.3.4A R (1).

[338] MCOB 13.3.4A R (1)(d).

mortgages are regulated by the FSA under the Financial Services and Markets Act 2010; subsequent charge mortgages are regulated under the Consumer Credit Act 1974.

Where a lender wishes to commence possession proceedings, Civil Procedure Rule 55.10(20)(c) enables better information sharing between lenders with charges over the property - but it is not unheard of that the first a lender knows of proceedings are when the subsequent charge mortgagee has instigated possession.

Buy-to-let mortgages are unregulated and the mortgage pre-action protocol does not apply. Where a mortgage was once on a main residence, but now has an unauthorised tenant in occupancy, the Mortgage Repossession (Protection of Tenants etc) Act 2010 would apply, to provide protection for unauthorised tenants.

After enforcement activity has been taken by the lender which has resulted in the sale of the property, the consumer is not automatically free of all mortgage debt. Regulations in the UK recognise the distinct differences between secured and unsecured credit and the need for secured lenders to pursue shortfall debt post-sale. Any automatic right for the consumer to be free from such debt would create significant unintended consequences.

In the UK, there are no examples of mortgage products which the consumer can choose, whereby the contractual terms prevent the lender pursuing any residual debt which has not been covered by the sum raised from selling the property.

However, following enforcement activity by the lender which has resulted in the sale of the property, the consumer is not generally liable for interest payments on the remaining balance of the debt. Lenders may also exercise discretion taking into account individuals' circumstances.

Following enforcement activity by the lender which has resulted in the sale of the property the consumer is generally liable for any reasonable costs of possession incurred by the lender in repossessing the property, which the lender can recover either by way of an express order from the court or through provisions contained in the mortgage contract.

When enforcement activity by the lender has resulted in the sale of the property on which instalments have not been met by the consumer, and where the value received from the sale is less than the remaining debt lenders rarely voluntarily take the sale value as full settlement of the debt. This would be assessed on a case by case basis and a lender would only write off all of the shortfall in exceptional cases.

The most likely scenario whereby the sale value might be taken as full settlement is an *assisted voluntary sale*. This is where the lender has consented to the borrower selling at a shortfall as an alternative to possession (i.e. the lender has not necessarily commenced possession proceedings).

In the case whereby the consumer, following enforcement by the lender still has outstanding debt, under the Financial Services Authority (FSA) rules that govern lenders' mortgage conduct of business, the lender has the right to pursue the customer for the post-sale shortfall provided that it notifies the customer of its intention [MCOB 13.6.4R(1)] and within six years (or five years in Scotland) of the date of sale [MCOB 13.6.4R(2)].

Such shortfalls can be pursued by the lender directly, or outsourced to other debt recovery agencies. There are OFT guidelines on debt collection.

The view, expressed in a joint submission, of the Council of Mortgage Lenders (CML) and the Building Societies Association (BSA) is that '*there are significant market and macro-economic risks in the EU adopting a model similar to foreclosure in the US. It would pose a moral hazard where borrowers with little 'skin in the game' are incentivised to walk away from their obligations, even if there is prospect of clearing the arrears. Lenders would become more risk averse, would be less likely to lend at higher Loan-To-Values and would be more likely to charge higher interest rates to recover the higher probability of default and expected/realised losses. This would constrain the mortgage market yet further, with non-delinquent borrowers and savers (both new and existing) picking up the cost of lenders not being able to recover post-sale shortfall debt*'.

There is a nascent insurance market against negative equity in the UK, which is looking to operate broadly as follows:

- Consumers who purchase mortgages also purchase an insurance policy against negative equity, making monthly payments as per any mortgage protection insurance.
- Consumers draw down the insurance in the circumstance that they wished to sell their property whilst in a period when the property has negative equity, for example to move location to find a job. Note there is no incentive to sell a property because this insurance is in place because there is now a floor in the value to the consumer of this asset; the amount paid for it. Therefore there are still incentives to hold the property until such time as house prices rise again.
- In such a case, selling the property and cashing the insurance policy would allow the complete payment of mortgage debt, allowing the consumer to purchase a new property at an affordable price.
- In such a case, datio in solutum becomes an unnecessary solution because there will always be sufficient resources available to clear the mortgage.

5 Restrictions on abusive debt collection practices

5.1 Overview

Debt collection and enforcement suffers from a similar trade-off to that raised for debt solutions; how far to compromise enforcing a legal contract to protect the consumer? What efforts can be taken to compel a citizen to honour the contractual obligations he has agreed to and which are viewed as being inappropriate, too intrusive or too aggressive.

For clarity, in this section we review restrictions on 'bad practices' in the area on debt collection and enforcement, not to provide a full mapping of the debt collection and enforcement systems in the seventeen countries.

We have reviewed available evidence from Europe, and also looked to the USA, who in 2006 passed a significant piece of legislation in this space, the Fair Debt Collection Practices Act[339].

Whilst almost every country applies some form of restriction on some element of the debt enforcement landscape, we feel that when considering whether a restriction is appropriate, we need to consider the reasons for applying a restriction of some form. To the authors, the primary areas where restrictions should be applied are:

- Preservation of human dignity:
  - To ensure the consumer and his family has access to a sustainable minimum income. It serves society no purpose if such a large share of his income is directed at paying existing debts that he either runs up new debts or finds himself in ill-health through stress etc.
  - To ensure the consumer and his family have access to accommodation upon eviction following debt enforcement of unpaid rent / mortgage payments.
  - To ensure compatibility with debt solution processes which have been determined to give a sufficient length of payment plan to permit a fair reimbursement of the lender and a finite period of burden at the end of which the consumer can look forward to a discharge of remaining debt.
  - To prevent unfair and non-misleading processes from being used to harass, confuse or use unfair duress to achieve payments by consumers when they may have other options.
  - To ensure charges fall onto the lender who has commissioned the enforcement activity, so that this can be priced into the general cost of his loans and shared amongst all consumers, as at the point of borrowing all consumers who are lent to must appear to be a 'fair bet' – for who would lend to someone clearly unable to meet the payments – and as such should all be treated equally in terms of facing a share of the cost of enforcement against those who find themselves in such a position.

[339] Although the scope of this study did not cover the USA, we provide a short summary of the key facets of this Act at Annex 8.

- Many debts which consumers struggle to pay come from utilities where different European countries have different approaches, particularly in relation to whether consumers have a fundamental right to access certain commodities, such as water, even if they have not paid their bills. A principle needs to be determined to assess best practice as to which approach is appropriate.
- The role for removal of possessions when most assets (TVs, DVD players etc) have exceedingly low re-sale values. Is removal of possessions carried out to liquidate these assets for cash or because the irritation value is sufficient to force the consumer to pay his bill.

- Protection of rights

  - Privacy – debt enforcement should respect the privacy of debtors and not share information with friends / neighbours / relatives, nor should they search for debtors by emailing / writing to all individuals with the same name to try and hunt down the debtor.
  - Safety – obviously violence and harassment that may lead to physical or psychological harm must be prevented.
  - Health including mental health – Debt enforcement, when done correctly, should not cause ill-health, but it also needs to recognise that it may exacerbate existing problems. Specifically there needs to be assurances that vulnerable debtors, such as those with mental health issues, need to be treated sensitively and appropriately.

5.2 Austria

Licensed debt counsellors have to work for free and have to fulfil strict quality criteria. This prerogative is regulated in the bankruptcy law. The label "licensed" is issued only to non-profit organizations by the Ministry of Justice. Advisory state-approved debt counselling agencies are recognized by the President of the Higher Regional Court[340] in whose district the debt advice centre is located. These agencies help debtors with going through debt solution processes and can also represent consumers in personal bankruptcy in the District Court. State-approved debt counselling is free of charge, although the agencies themselves receive state subsidy. There are also private for-profit debt regulation centres that advertise their services. Officially recognised debt advice centres are entitled to use a specific debt advice label and receive funding from the provincial government and the public employment service. These bodies do not, however, receive any information about the consumer. Fraudulent debt counselling services, not to be confused with their officially certified counterparts, and fraudulent credit institutions are known to be a problem in Austria. The Austrian chamber of labour (*Arbeiterkammer Österreich*) has published a list of such institutions on its website and instructs consumers how to avoid these scams. [341] Similar lists have also been published

[340] *Präsident jenes Oberlandesgerichts.*

[341] http://www.arbeiterkammer.com/online/anlage-und-kreditberatung-54462.html.

by regional chambers of labour[342] and also the federal ministry of labour, social affairs and consumer protection warns of these services on their website[343].

Amongst other things, common tactics are to keep consumers on expensive customer hotlines, often resulting in bills in excess of €1000. In a case study undertaken by the chamber of labour, the company www.austriakredit.at, for example, kept the experimenter on the line for 182 minutes leading to a telephone bill of €672. It is often implied, or even explicitly stated, that the consumer will be awarded a quick loan at the end of the process, something which never actually materializes.

Austria does not have specific regulations to prevent low income and vulnerable consumers against having utilities (including water and telecommunications) cut-off as a result of non-payment (Reifner et al 2010).

In relation to rent arrears Austria has light-touch protections, only requiring the landlord to provide written advance notice to the tenant and then file an action for possession before eviction (Reifner et al 2010).

When it comes to chasing debtors electronically for non-payment of debts, there are restrictions on cold calling. In some cases, personal property can be taken in order to satisfy a debt but it is only allowed in the case of legal authorities and it is not possible to take items necessary for daily living. There can be, however, some debate about whether some items – for example, a television – are necessary for daily living. Revealing information about indebtedness to a person's family or neighbours is prohibited by data protection legislation.

In relation to the assignment of wages, assignment for demands *not yet due*[344] is forbidden[345], however this is sometimes circumvented by the bank obtaining contract attachments of the wages from the debtor, in other words the bank does not own the claim on the wages, but rather the wage claim is contractually attached to the creditor as security for the credit. Employers are able to make payments under such a contractual attachment only if the creditor has a 'requirement on utilization' which has been indicated to the employer.

Information from survey respondents reveals that generally, the process for debt collection in Austria consists of notice from the creditor, a private debt collection agency or an attorney. In case of notice from the creditor, the most common complaints from consumers, according to an Austrian debt advice organisation, were the high interest rates on arrears and the tendency to use payments to pay off interest ahead of capital. In cases where private debt collectors and attorneys were involved, the most common complaint was the level of fees.

[342] http://www.ak-salzburg.at/online/page.php?P=245&IP=57617. See also http://wien.arbeiterkammer.at/online/vorsicht-bei-finanzsanierung-38188.html and http://m.sbg.arbeiterkammer.at/bilder/d131/Listeneu.pdf.

[343] http://www.bmask.gv.at/site/Konsumentenschutz/News/Vorsicht_vor_dubiosen_Kreditvermittlern.

[344] I.e, unlike a garnishment of wages.

[345] §12, para 1 Consumer Protection Law (*Küngdigungsschutzgesetz).*

5.3 Belgium

Belgium does have regulations relating to the cutting-off of utility supplies in instances of non-payment. Consumers can request providers to maintain a minimum level of electricity supply, as a contribution towards a minimum standard of living (Reifner et al 2010).

In relation to rent arrears Belgium requires the landlord to file an action for possession before eviction, although the landlord must also give prior notification to the appropriate social welfare organisation, and the tenant can be granted a prolongment of the term of payment on the tenant's request. An evicted tenant has to exit the property within one month (Reifner et al 2010).

Pay-roll withholding

In Belgium, in cases of pay-roll withholding, the debtor will agree on a voluntary basis, whereas in case of distraint on wages, the creditor must have the approval from the judge beforehand. There is a legal limit as for the part of the wages that can be subject to withholding. A bailiff has to send a notice of withholding to the Central Register of notices pertaining to distraint, delegation, withholding and collective debt settlement.

According to article 1411bis of the judicial code, salaries, social wages and other protected wages paid on bank account must mention a specific code in order for the bank to identify them as protected from seizure.

According to the Law of 12 April 1965 on the protection of the employees' wages, the pay-roll withholding must be executed, under pain of being declared void, by means of a deed that is separate from the deed stipulating the principal agreement guaranteed by the pay-roll withholding. This deed must be drawn in as many copies as there are parties concerned on their own behalf.

Assignment of wages requires documentation whereby the consumer empowers the creditor to obtain payments direct from the employer. This does not require a judicial order, unlike attachment of earnings, which does require a judicial order. According to the UPC, since assignment of wages is no form of execution by sale of the debtor's personal property there is no need for a mandatory and prior attempt to reach an amicable solution.

Most lenders require borrowers to sign an assignment of earnings as a guarantee[346], which they can activate directly with the employer in the case of default. For the assignment to be valid[347] it requires:

- A separate document forming a distinct part of the agreement
- Lenders, consumers and, if applicable, the guarantor must have copies of this document and

[346] This does not apply when the withholding has been laid down in an official (authentic, notarial) deed. In case of withholding stipulated in an official deed, which consequently is governed by the common law rule for a transfer of a claim, as laid down in the Code of civil law, the employer must carry out the withholding either when notice of the order is being given to the employer, regardless of the means of notice (process-server's writ, registered letter, ordinary letter), or at the moment when the employer agrees with the withholding in an official deed, in the withholding deed as such or in an separate deed.

[347] Under the Law of 12 April 1965 on the protection of worker's incomes.

- The document must cite the relevant articles of the law which outline the process enabling the consumer to object, if the purpose of the assignment is to guarantee a loan.

To activate an assignment, the creditor must:

- Notify, by registered letter or via a *deurwaarder/huissier*[348], the consumer of his intention to bring the assignment into effect.
- Notify the employer.
- Within 24 hours of notifying the employer send a notice to the *griffie/greffe*[349] of the consumer's local court, so it can be entered on a centrally held register.
- Wait a further ten days (in case an objection is raised), before sending the employer a certified copy, confirming to the assignment document to commence payment.

The consumer can object, by sending a letter to his employer. The employer must inform the creditor, again by recorded letter, within five days of the receipt of the consumer's letter. At this point the employer is no longer bound by the assignment. Consumers can also object after the ten day period, but they cannot then reclaim any payments which have been made. The consumer must then justify opposition to the assignment to the *vrederechter/Juge de Paix*. In practice, this is mainly either to give the consumer a chance to raise the necessary funds, or because the documents are incorrect or incomplete.

Under assignment the law[350] outlines exempt income which cannot be made subject to assignment. These rules also apply to attachment of earnings:

- Holiday pay, substitutes for income (pensions, unemployment benefits and disability benefits) and maintenance payments are exempt. Family allowances, disability allowances, minimum income, guarantees income for retired people, and social security paid by CPAS are also exempt.
- Payment levels vary by gross monthly income, in bands for which payment levels vary from 0% to 100%. These are set broadly annually.

Artikel 24 of the Mortgage Credit Act stipulates as follows: If pay-roll withholding has been agreed upon as supplementary credit guarantee, the withholding can cover only up to the amounts that can be claimed by virtue of the mortgage credit deed at the moment of notice giving. The amounts that have been gathered as a result, must be spent, upon their gathering, on the payment of the amounts due at that moment.

In relation to debt collection, in Belgium all attempts to secure recovery of a debt on an amicable basis must have advance written notice setting out the details of the debt. Legislation[351] prohibits practices designed to mislead the consumer or affect their private life or '*human dignity*' (Reifner et al 2010). It particularly prohibits:

[348] An enforcement authority or agent.

[349] Court clerk.

[350] Articles 1409 and 1410 of the *Code Judiciaire.*

[351] The Law of 20 December 2002.

- Providing false information about the consequences of not paying
- Exposing that a letter relates to an unpaid debt on the outside of the envelope
- Applying additional charges which were not in the loan agreement, including fees for the recovery office
- Approaching the debtor's neighbours, family, or employer
- Recovering payment in the presence of a third party, unless agreed to by the debtor.
- Deliberate harassment of a consumer who disputes the debt
- Using procedures designed to obtain acknowledgement by the consumer of the debt, a bill of exchange or an assignment of wages
- Telephone or home visits between 10pm and 8am.

Debt recovery agents must provide the consumer with:

- A document stating
  - The debt recovery agent's name
  - A warning that the consumer is not compelled to agree to the visit and may bring it to an end at any time.
- A receipt for any payments received.

5.4 Czech Republic

Debt enforcement is governed in the Czech Republic by the Execution Code[352], the Notarial Code[353] and Civil Procedure[354]. Consumers are empowered to take a legal action to Financial Arbitrator and the subject matter can be often connected to the financial difficulty. The Financial Arbitrator exclusively decides disputes and declares whether the brought claim is in accordance with law or not. The finding does not lead to cancelling consumer's debts or their re-organizing.

One example of the restrictions on debt enforcement in the Czech Republic includes a ban on contacting a debtor during the night. Similar to Austria, it is forbidden for debt collectors to discuss a person's debt with anybody else for personal data protection reasons. It is also prohibited to take an individual's property if it has a disproportionately higher value than the debt itself.

Interest rates should be specified in the contract between supplier and buyer. If it is not, the buyer can charge an interest rate on late payment based on the law. The interest rate is the same for all business relations and is prescribed by Civil law. It is calculated as the semi-annual amount of the repo-rate set by the Czech National Bank, plus seven percentage points[355]. The general prescription period in Czech Republic is after 4 years of sending the original invoice for business-to-business claims, and after 3 years in business-to-consumer claims. The prescription period doesn't run from the moment of the exercising of creditor's rights during the proceedings (the point the creditor starts legal procedure), and the prescription period can be interrupted if the creditor's right was

[352] http://portal.gov.cz/app/zakony/zakonPar.jsp?page=0&idBiblio=51202&nr=120~2F2001&rpp=15#local-content.

[353] http://www.nkcr.cz/doc/rady/Not_rad_akt_od_1.7.2010.pdf.

[354] http://portal.gov.cz/app/zakony/zakonPar.jsp?idBiblio=30398&nr=99~2F1963&rpp=15#local-content.

[355] http://www.atradiuscollections.com/private/countryinfo/czech-republic.html

awarded by a final and conclusive decision of the court or other authority or if the creditor proves written debt acknowledgement[356].

In case a debtor is not able to satisfy a claim in a speedy manner, we can request the debtor to secure the debt in favour of our client. This can be done amicably and cost effectively by providing an acknowledgement of debt - authenticated by a notary and immediately enforceable in case the agreed payment terms are not honoured. Corresponding costs have to be carried by the debtor. The debtor is also able to offer other means of security like mortgages, assignment of debts or assets[357].

Legitimate court judgements and arbitration awards that go unpaid by debtors can be executed by a court or by private executors in an execution proceeding. Execution proceedings comprise of two parts. The first part takes place in a court and determines the question of formal execution and nominates a particular executor. The court always follows the suggestion of the entitled party in nominating any particular executor. For the second part, either a court or a nominated private executor carries out the execution proceeding. Execution proceedings commence on the presentation of a motion. An execution can only be ordered on a motion by the entitled party or by anyone who can prove that the entitlement was transferred to him. The entitled party may lodge a motion for an execution warrant if the obligated party does not voluntarily comply with the requirement, which the execution title imposes on him (see above for execution titles). The execution proceedings end when all claims are fully paid, including all charges, partly paid, or for reason of tax reduction in case of negative end of execution proceeding.

Enforcement of decisions imposing payment of a sum of monies can be carried out by means of attachment of wages/salary and other income, compulsory debit, the sale of movable goods or the sale of a business. These means are the same for both the court execution proceedings and for the private executor. In the case of a secured claim, a decision can be enforced by the sale of the of movable assets, bulk assets, groups of assets and residential or non-residential premises under ownership that have been given as security in accordance with specific legislation or by compulsory debiting of a money claim that was given as security or by recovery against other property rights given as security. Enforcement of decisions can be carried out by means of the sale of immovable assets also.

5.5 Denmark

In Denmark, the cutting-off of utilities in instances of non-payment is supervised by the Danish Energy Authority, as part of its general regulation of energy utility providers, which has imposed special notice requirements to enforce what is viewed as acceptable standards (Reifner et al 2010).

In relation to rent arrears Denmark requires the landlord to provide written advance notice to the tenant before proceeding to court and eventual eviction (Reifner et al 2010).

In Denmark wages cannot be garnished for private debts, but can be garnished for public debts, public law or family law purposes. Assignment of wages is also forbidden.

[356] Ibid

[357] Ibid

Interest charges on overdue debts are defined by The Act of Consolidated Law on Interest on Overdue Payment 743 of 04.09.2002. There are two alternatives:

- To calculate the interest rate as agreed between creditor and debtor.
- To calculate the interest rate according to Danish regulation based on the reference rate fixed by the National Bank of Denmark (+ 7 % p.a.). This rate is fixed twice a year on 1st of January and 1st of July. The second rule will always occur if the interest rate is not agreed between the creditor and the debtor.

The general prescription period in Denmark is 3 years starting from the due date of the invoice[358].

For debts below 100.000 DKK cases go directly to the Bailiff's Court. If the debt is undisputed, the Bailiff will issue a payment order, which equals a judgement. This procedure is the cheapest method of legal action as the court costs will be 700 DKK or 1,350 DKK plus lawyers' fees. It is also the quickest procedure, taking up to 6 - 12 months on average. If a debtor disputes the debt, the file is always assigned for trail handling, no matter how serious the situation is[359].

For debts above 100,000 DKK, always requires an external lawyer to file a claim form with the court. A judgement has to be obtained before enforcement proceedings can be carried out. If a judgement is obtained and the debtor does not pay accordingly, the file will be handed over to the Bailiff's Court for execution. The Bailiff will investigate if the debtor has any assets that can be taken as security for the debt and can be sold by creditor following specific rules. The Bailiff will try to establish a payment arrangement with the debtor. Debtors can try to delay the process by not attending the meeting in Bailiff's Court. In such cases the Bailiff requests the police trace the debtor so a new Bailiff's Court meeting can be held. The cost for enforcement proceedings depends on the size of the debt. It will cost 300 DKK + 0.5% of the amount above 3.000 DKK plus lawyers' fees. The timeframe is up to 6 - 12 months on average[360].

In Denmark no regulations exist on debt collection.

5.6 Estonia

The enforcement of court judgments is delivered by professional judicial officers. They exercise a monopoly on the enforcement of judgments and enactments and writs of execution in Estonia. They may likewise proceed to the service of writs and to the enforced sale by public auction of the debtor's possessions. They are also authorized to formulate findings and observations. The judicial officers are empowered to enforce execution against the entire debtor estate, be it immovable or movable, tangible or intangible. The judicial officers assume responsibility for carrying out the enforcement procedure. In agreement with the creditor, they organise procedures of enforcement as adapted to the circumstances. In case of trouble, they can take recourse to assistance from the public enforcement authorities.

[358] http://www.atradiuscollections.com/private/countryinfo/denmark.html.

[359] Ibid.

[360] Ibid.

The judicial officers must adhere to a fixed rate. The debtor is responsible for the costs of the execution. In the event of default by the debtor, the creditor shall assume the expense of the execution. A graduated collection fee is in place, this being at the charge of the applicant.
the judicial officer May arrange for sales by public auction[361].

5.7 France

In France the consumer can request the responsible Departmental Solidarity Commission, (or some other relevant social bodies) to decide whether the cutting-off of utilities in instances of non-payment is just and reasonable, as a contribution towards a minimum standard of living. The consumer can gain access to the prolonging of payments or other forms of arrears payment, and can be granted a 'stay of execution' before eviction of up to three years. (Reifner et al 2010).

In relation to rent arrears France requires the landlord to file an action for possession before eviction. The tenant can be granted a prolongment of the term of payment on the tenant's request of up to two years, upon the tenant's request. (Reifner et al 2010). In the opinion of these authors, Frances provides '*the most comprehensive protection against eviction*'.

In relation to taxes, fees and fines to be paid to a public body, in France tax offices retains the power to extend payment periods or cancel debts. Even if a debt cancellation commission proposes debt cancellation, the tax office has to agree to this for tax debts. For other state debts (TV license fees, criminal fines and social security, the commission also has no power to impose payment plans, such as instalments, although it can propose these debts be cancelled. It has been proposed that tax debt be included in consumer bankruptcy arrangements.

In relation to attachment of earnings, the French system requires a conciliatory hearing before a judge as a precursor. The judge may grant the debtor more time to make payments before attachment. If the judge is satisfied that the debt cannot be paid immediately, and does not give more time, attachment can begin the next week, and the employer is informed of the percentage of income to be garnished. This is sent to the court clerk's office. The percentage is calculated on a scale which takes account of the number of dependent children.

In relation to debt collection, there are two possible processes: amicable agreements[362], and judicial recovery via a bailiff with an enforcement title[363]. The requisition of property can only happen following a judicial process granting the creditor permission to recover it.

Debt collectors must register[364]. The costs of the debt collection agent[365] are also regulated[366], although the consumer may be exempt if he informs the *huissier* he has already filed with the over-indebtedness commission. If there are legal proceedings the consumer is normally responsible for the costs, but judges can reduce or write these off if they are viewed to be unjustified of excessive.

[361] http://www.uihj.com/en/ressources/10148/58/estonie-en.pdf.

[362] *Articles R124-1 à R124-7 du Code des procedures civiles d'exécution (CPCE) and Décret 96-1112 du 18 décembre 1996*

[363] *Articles R124-1 à R124-7 du Code des procedures civiles d'exécution (CPCE)* and *Décret 96-1112 du 18 décembre 1996*

[364] *Décret 96-1112 du 18 décembre 1996*

[365] *Huissier.*

[366] *Décret of 12 December 1996.*

Creditors have to leave a minimum sum, called the elusive bank balance on the account of the person in debt. This exempt income corresponds to the level of RSA, the minimum in France (€47,493). To this sum can be added some further credits to cover costs such as maintenance costs etc. This exempt income is considered insufficient by most consumer and family associations. Some property belonging to the creditor also cannot be seized; goods essential to everyday life and work, such as clothes, bedding, linen, hygiene products, food, kitchen utensils, heaters, table and chairs, furniture for clothes and linen, washing machines, study objects, children's objects, personal souvenirs, tools and a telephone.

Instances of deliberate non-payment of loans granted to natural persons can be documented in a national register, under the French Consumer Code. However there are restrictions on interacting with or revealing the debt to the consumer's family or neighbours for privacy reasons.

There are restrictions on chasing debtors electronically, such as by phone or email. Following *l'article 1139 du Code Civil*¸ one email is viewed as sufficient. Multiple contacts can lead to a claim for harassment. For example, in the case of multiple telephone calls the consumer can assert *l'article 222-16 du Code Pénal.* Similarly, if the creditor uses envelopes which mention the recovery procedure, they can be prosecuted by the consumer, either for public function usurpation if he receives his mail through a bailiff acting within the execution procedure (*l'article 433-13 du Code Pénal*), or for moral harassment in other cases (*l'article 222-13-2 du Code Pénal*). If the creditor attempts to contact the family or friends of the debtor he can be sanctioned for moral harassment (*l'article 222-13-2 du Code Pénal*), damage to privacy (*l'article 226-1 du Code Pénal*), or abuse of weakness.

The most common complaints from consumers reported[367] by consumer organisations were about:

- Multiple reminders by menacing telephone call or mail.
- Illegal invoicing of penalty fees or bailiffs fees (despite these being forbidden by legal mandate)
- Attempts to levy contentious sums on the consumer's account

5.8 Germany

Debt collection activity in Germany is subject to legislation[368] and licenses[369] of agencies, which are granted by the courts, and covers out-of-court debt recovery. The agencies also have to be registered at the Trade Supervisory Office. Lawyers working on this area of work have their fees set by the Federal Code of Lawyers' Fees[370]. Under the Civil Code[371] creditors have to absorb collection costs, including fees and charges, unless the collection has been proper and been able to produce more than sufficient funds.

[367] Source: letters to UFC-Que Choisir

[368] The Legal Advice Act (*Rechtsberatungsgesetz*).

[369] § 1.1.1(5) Legal Advice Act.

[370] *Bundesgebührenordnung für Rechtsanwälte*.

[371] Art. 254 BGB (Civil Code).

In relation to the assignment of wages, this is captured by a regulation[372] which was designed to cover assignment of claims. Therefore this regulation does not outline the rights and obligations on the consumer or the creditor. However, consumer credit contracts do regularly contain a standardised assignment of wages clause. The requirements for this was laid down by the Federal Court of Justice in 1989, which determined the clause had to be objective and clearly state the amount which would be assigned, include a release declaration, and give clear terms and conditions for realising the assignment. The consumer however can prevent an assignment is he can show it is 'contrary to good morals[373]' (Reifner et al 2010). Some collective wage agreements prohibit employees from using assignments.

In relation to attachment of earnings, Germany imposes limitations designed to ensure a minimum income[374] which is exempt from attachment, although after this 100% attachment is permitted, except child maintenance or housing benefit which are exempt, along with Christmas bonuses and overtime pay, up to certain limits. This provision is deliberately designed to prevent debtors sliding into poverty. If the consumer applies to court the exemption can be increased, particularly if this prevents the consumer becoming reliant on social security benefits, or if there are specific personal or work-related needs.

In recent years a number of bogus financial intermediaries, money collection firms and debt counselling services have appeared in Germany[375]. The Federation of German Consumer Organizations studied the complaints against debt collection services, in relation to internet fraud and gambling, and determined that in 84% of the cases even the main claim for debt repayment was unwarranted. In a further 15% it was unclear and in only 1% of the cases was the repayment demand clearly justified[376].

Further, payment obligations are often greatly inflated by the addition of nebulous charges and interest fees. The same internet fraud and gambling study undertaken by the Federation of German Consumer Organizations found that the average increase in repayment obligation is 52% (258,511.03 Euro) and in the case of debt counselling services even 266%. Such firms appear to operate by threatening consumers with legal action, worsening of their credit ratings and even visits to their homes. The largest firm of this kind in Germany, for example, even hired private detectives to be able to assess the consumer's financial situations. These existing grievances are being addressed by a legislative initiative of the Federal Ministry of Justice against dubious business practices.

In Germany, there are different arrangements relating to the cutting-off of utilities in instances of non-payment depending on whether the utility provider is a public or private body. Public bodies cannot cancel a contract as cutting-off supply would be viewed as disproportional, taking the consumer below a minimum standard of living, whereas the general terms and conditions of private suppliers do not contain a similar restriction (Reifner et al 2010).

In relation to rent arrears Germany requires the landlord to provide written advance notice to the tenant and then file an action for possession before eviction through a proper judicial process, at the

[372] Art.398 *Bürgerliches Gesetzbuch* BGB (Civil Code).

[373] Art. 139 BGB (Civil Code).

[374] See art 850c-f Zivilprozessordnung (Code of Civil Procedure).

[375] http://www.polizei-beratung.de/themen-und-tipps/betrug/kredit-und-anlagebetrug/kreditbetrug.html.

[376] http://www.vzbv.de/cps/rde/xbcr/vzbv/Inkasso-Auswertung-vzbv-2011.pdf.

end of which an eviction title may be obtained. Tenants, however, can be granted a 'stay of execution' of one year plus upon request, for example through a stay of execution. (Reifner et al 2010).

In relation to mortgages, in the past non-banks could purchase (non-performing) loans and then perform debt enforcement. In Germany there were no wrongful cases in relation to this, nevertheless, restrictions in law were brought in by the Risk Reduction Act of 2008. This law introduced further debtor protection regulations into German law, such as an extended dismissal protection regarding demands against real estate loans, a strict claim for indemnity (irrespective of level of liability) against unauthorized execution of enforcement, more transparency with assignment of claims, a closer connection between Grundschuld (land charge) and debt demands, as well as cancellation periods for the Grundschuld (land charge).

In relation to taxes, fees and fines to be paid to a public body, in Germany various regulations in Federal and Land Law provide some protections for consumers. In general if the payment of the debt would 'constitute an unreasonable hardship[377], then the debtor may claim to:

- Agree a settlement with the relevant agency; essentially seeking some form of negotiated debt relief or debt cancellation[378] or
- Prolong the payment period or introduce payment by instalments,

A survey respondent from the a German association representing lenders noted that there are restrictions on chasing consumers electronically in Germany but that notices are usually given in written documents and foreclosure measures are never done electronically. According to the respondent, there are no restrictions concerning the repossession of real estate. However, concerning private equity of the debtor, income thresholds may apply[379]. Restrictions may also apply in the case of property needed for daily life or for professional use.

5.9 Greece

The HBA described three primary debt collection processes in Greece:

- written notices sent out to the borrower by post with information on their outstanding debt owed to the credit institution;
- phone calls by the credit institution or an affiliated "debt-information company" informing the consumer of their late or outstanding debts; and
- written notices served to the borrower by a bailiff, calling upon the borrower to meet their obligations from the credit agreement.

According to the HBA, the first two are governed by Law 3758/2009 (Official Gazette 68/A/5.5.2009) on companies that inform debtors of late or outstanding debts, whereas the latter is governed by Code on Civil Procedure.

[377] Reifner et al 2010.

[378] For example, with tax arrears, release from these would occur under section 227 of the Tax Code (*Abgabenordnung)*. For fines, the courts may review fines under section 459a of the Code of Criminal Procedure (*Strafprozessordnung)*. For fees arrears various Federal and Land Budgetary Regulations give different treatments.

[379] Pfändungsfreigrenze see http://www.rechtsrat.ws/gesetze/zpo/anlage.htm.

Greece does not have specific regulations to prevent low income and vulnerable consumers against having utilities (including water and telecommunications) cut-off as a result of non-payment, but utility companies have tolerance towards households in arrears. The major Greek telecommunications companies maintain their service as long as the outstanding debt is less than €1,000 (Reifner et al 2010).

In Greece, no regulations exist on the assignment of wages, and attachment of earnings is prohibited[380] *except* where maintenance claims to contribute to the income of the family, in which case up to 50% of the wage can be taken, dependent on the level of income, the financial obligations created by marriage and the number of persons eligible for maintenance.

The HBA indicated in their survey response that there are restrictions on how consumers can be chased. According to the HBA, under article 4 par. 2 of Law 3758/2009 companies engaged by credit institutions to inform debtors of their due or outstanding debts may only provide relevant information to the debtor and negotiate the time, place, manner and other conditions for the repayment of the debt. Furthermore, credit institutions may not engage more than one debt-information company in relation to the same debt.

The HBA also noted that, according to article 4 par. 4, before the debt-information company undertakes any action towards the debtor, the credit institution should inform the debtor of their outstanding debts by any available means, confirm the debtor's identity, and also inform the debtor that their data have been given to the debt-information company. Debt-information companies are required to communicate with the debtor once every two days at most. Communications with debtors may only commence ten days after the debt has fallen due and may only take place between 9am and 8pm and only during working days. Telephone communications with the debtor at their place of work are allowed, provided that the debtor has only given the credit institution their work number in their contact details..

In their survey response the HBA also reported that there are restrictions on interacting with or revealing the debt to the consumer's family or neighbours. According to the HBA, under article 4 par. 1 of Law 3758/2009 "debt-information companies are required to carry out their activities exercising professionalism, decency and directness in their transactions. Furthermore, they are required to exercise honesty in their communications, transparency and respect towards the debtor's personality, privacy, health, security, confidentiality of banking transactions and his/her freedom to transact".

Companies that inform debtors of their late or outstanding debts are prohibited from visiting the debtor's residence or place of work. Visits to other places of a strictly personal character, such as hospitals, are also prohibited (article 5 par. 8 of Law 3758/2009). Insulting behaviour towards the debtor or members of the debtor's family is prohibited (article 5 par. 3 of Law 3758/2009). Defamation or threat of defamation of the debtor to his family or working environment is prohibited (article 5 par. 4 of Law 3758/2009). Harassment of the debtor's family members is not allowed, within the meaning of the above paragraph 4 (article 5 par. 9 of Law 3758/2009).

[380] See Art 982, para 2 of the Code of Procedure in Civil Cases.

Despite the provisions described above, Mouzouraki (2012) identifies concerns that debtors are vulnerable to '*unprofessional or even corrupt debt counsellors*'. She argues for a professional independent debt counselling arrangement to be established, with appropriate licensing.

Finally, according to the HBA, once foreclosure proceedings have been initiated, the general provisions of the Code on Civil Procedure apply. Companies that inform debtors of their late or outstanding debts towards credit institutions are prohibited from taking any kind of judicial action, initiating or participating in foreclosure proceedings against debtors or engaging lawyers or bailiffs to pursue repayment of the debtor's debts (article 6 par. 5 of Law 3758/2009). Restrictions set out in articles 4 ("Principles governing the information of debtors on their debts that fallen due"), 5 ("Unfair and misleading practises of debt-information Companies towards debtors") and 8 ("Protection of confidentiality") of Law 3758/2009 are also binding for creditors, according to article 9 par.6 of Law 3758/2009 as it stands.

More recently, in February 2012, amendments to Law 3578/2009 were adopted according to which:

- Debt collectors are now obliged to keep for 1 year data with all the calls they make to debtors and to provide these data to him/her upon request.
- The same data obligation applies to every conversation with the debtor.
- Debt collectors call only from 9.00 in the morning to 20.00 in the evening.
- The Law now also covers debtors and law offices (law offices are excluded from the obligation to keep data).

5.10 Hungary

In Hungary debt collection costs are chargeable, but there is no regulation fixed by the local law. The basis of any charges must be proven by contractual documents signed by the debtor. From a cultural point of view, Hungarian debtors are not used to paying debt collection costs, and these costs are considered a matter of negotiation[381].

Interest charges on late payments to economic organisations are fixed by Article IV of 1959 on the Hungarian Civil Code section 301/A. The rate is always the Hungarian National Bank's base rate plus 7 % on a daily basis unless the creditor has agreed a higher interest rate through contractual documents[382].

The general prescription period in Hungary is 5 years starting from the due date of the claim[383]. The limitation period can be suspended according to rules of the Hungarian Civil Code by amicable collection steps, the debtor's acknowledgement of the claim or payment agreement and starting the legal or arbitration process[384].

[381] In the opinion of an international debt collection agency. http://www.atradiuscollections.com/private/countryinfo/hungary.html.

[382] Ibid.

[383] Section 327, Hungarian Civil Code.

[384] Ibid.

Entering into legal procedure is sometimes possible without prior warning to the debtor. However, all courts are trying to mediate between creditor and debtor, and in order to shorten the amiable phase of the legal proceedings, they may ask for proof that all pre-court efforts did not reach a conclusion, and will ask to see all prior correspondence in order to reach a fast and final judgement.

This is the standard procedure where the bailiff visits the debtor to take away movable goods he can liquidate in favour of the creditor. The bailiff cannot seize goods necessary for the debtor's basic daily life or that enable him to maintain his business activity. In fact, the Act on Enforcement strictly stipulates that the order for enforcement is:

1) Wages
2) Financial assets
3) Movable goods, and
4) Property.

This is the standard procedure if enforcement is not successful in debt and in movable goods. If the debtor owns real estate, it is possible to receive a record of the claim in the land register and to then either force the attachment, and sale or in case there are tenants, the sequestration of the real estate by court order.

In May 2012, the Hungarian Financial Supervisory Authority published a report[385] in which it stated, using the term 'receivables management' for 'debt enforcement' that:

'several consumer-related anomalies (consumer protection risks and violations of consumer interests) derive from the fact that receivables management is not regulated properly and sufficiently regarding consumer protection considerations… It is obvious that the rules on payment defaults and receivables management set out in the code of conduct for financial organizations engaged in retail lending (Code of Conduct) are not sufficient. ***Legal regulations are missing concerning the minimum requirements of conduct with consumers, the scope of information to be provided to them, and the settlement obligations.***

Owing to under regulation, the principle of fair and cooperative ***conduct*** *is breached on several occasions in the receivables management and receivables trade market****.*** *In addition to professional players, the market is witnessing* ***unethical practices and conduct that verges on the criminal, and receivables managers that often harass debtors.*** *These claims are supported by submissions to the HFSA and its civil consulting network about overdue debt.* ***The growing number of claims also underscores the need for consumer protection regulations****: in 2010 and 2011, the quantity of these claims doubled*[386]*.'*

The HFSA therefore submitted a detailed legislative proposal in March 2012 to establish regulation based on the concepts that lending and borrowing should be legally secure activities, and that a predictable legal environment is necessary for economic growth, with three main 'cornerstones':

- protection of rightful debtor (consumer) interests (transparency, fair procedure, fair information, etc.),

[385] Hungarian Financial Services Authority (2012)

[386] P22, Hungarian Financial Services Authority (2012)

- respect of lender interests, sustaining guarantees for prudent lending (the enforceability of undisputed, overdue receivables on signed contracts is a fundamental lender interest),
- regulations must suggest contracts are obligatory and that the parties must comply with the conditions set out therein ("pacta sunt servanda" principle).

The HFSA's proposed regulations had three main components:

- The legal concept for receivables management, for the sake of market cleaning, redefines the scope of receivable buying and receivables management as financial activities; it would introduce mandatory HFSA licensing and stricter operational requirements for receivables management companies.
- A consumer protection chapter setting out rules of conduct for receivables management companies in order to eliminate consumer anomalies, requiring regular and thorough information being provided to consumers. The proposal also called for the extension of provisions set forth in the Code of Conduct and their elevation to legal provision status. It sets out consumer protection requirements for receivables management institutions **from the moment a default occurs to the collection of receivables, keeping in mind the requirements of gradation and proportionality**. This component had two parts**:** rules of conduct and rules on information.
    - The **rules of conduct** set out requirements to receivables management institutions concerning their conduct with customers. In particular, these rules cover:
        - the ways and frequency of contacting customers,
        - the recording of telephone conversations
        - the requirement on institutions to keep records of the receivables management process in order to enable tracking and subsequent control.
        - The requirement to provide a 15-day grace period to the debtor following the sale of receivables to pay the debt without any additional costs. Foreclosure could only be initiated once this grace period is over without success.
        - The requirement on institutions to examine[387] the possibility of bridging solutions in the case of mortgages. The proposed rules would allow the receivables management institution to decide on the bridging solution based on a check of the customer's income and financial position.
        - The requirement on receivables management institutions to carry out settlement with the customer. Accordingly, the proposal sets out the detailed rules for settlement during the receivables management process, specifying the minimum contents of the settlement notice and the obligation to reimburse the customer for the residual value.
        - The requirement to publish the rules of keeping contact with and informing customers along with the fees and costs charged during the procedures.
    - **Rules on information** are intended to help consumer **decision-making**. According to the concept, once default occurs, the receivables manager would provide the debtor

[387] Whilst it did not mean that institutions would be required to provide bridging solutions, they were required to examine whether they can provide such facilities.

(and other consumers concerned) with the necessary information step by step through the entire process. These rules cover:

- The requirement on the receivables manager to send to the debtor *several notification letters during the default period.* E.g. the first letter should go out within 15 days after the occurrence of the default, then before the termination or after the transfer of the contract. These rules could ensure that the debtor regularly receives information on the debt through the life of the default, to allow the debtor to track changes and make informed, responsible decisions on how to manage the default. The law would only set the minimum content of notification letters.
- The requirement on the receivables manager to inform the debtor on any related charges, the rules of accounting for debts, the legal consequences of termination, the expected receivables management steps, the bridging options available to the customer (including government-backed programmes), and the potential sale (transfer) of the receivables and settlement.
- The requirement on the receivables manager to inform the debtor on the outcome of the examination regarding the availability of a bridging solution. For mortgage contracts, the law should require the receivable manager institution to inform the customer on the option to sell the collateral property alone / jointly (where consent can be reached between the parties).

- Proposals on improving the effectiveness of judicial foreclosure proceedings by making them faster, more effective and more cost efficient through amending Act LIII of 1994 on Judicial Execution and the related provisions, accordingly.

The scope of the proposed regulations encompassed all receivables manager institutions, including

- Financial institutions that perform receivables management on their own right regarding the loans they provided,
- Receivables managers that perform receivables management based on a service contract for the lender financial institution, and
- Receivables buyers that carry out receivables management on their own right following the transfer of receivables.

These consumer protection regulations would apply to the management of overdue receivables from financial services contracts[388], including retrospective application to existing loans, noting that in some cases stricter consumer protection rules apply to the management of receivables from mortgage contracts.

Whilst waiting for legislation to be passed, the HFSA moved to publish detailed rules along these lines to impact on the market as quickly as possible. Until the point this legislation passes, the main consumer protection legislation is:

- Act XLVII of 2008 on the Prohibition of Unfair Commercial Practices against Consumers; this prohibits businesses from applying misleading or aggressive commercial practices against consumers

[388] At the same time, keeping its mandate in mind, the HFSA also called to the attention of legislators that it was necessary to regulate the management of receivables deriving from non-financial services, preferably along similar guidelines.

- Act LVII of 1996 on the Prohibition of Unfair Trading Practices and Unfair Competition[389]; this contains a general provision prohibiting the misleading of consumers.
- Act CXII of 1996 on Credit Institutions and Financial Enterprises[390]
- Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds
- Act CLXII of 2009 on Consumer Credit[391]

5.11 Ireland

Ireland does not have specific regulations to prevent consumers against having utilities (including water and telecommunications) cut-off as a result of non-payment (Reifner et al 2010).

In relation to rent arrears Ireland has light-touch protections, only requiring the landlord to provide written advance notice to the tenant and then file an action for possession before eviction (Reifner et al 2010), although local authority housing rents are subject to a hardship clause[392], which requires that '*local authorities should ensure that their differential rent scheme includes a hardship clause which makes provision for the acceptance of a lower rent than that required under the terms of the scheme, in exceptional cases where payment of the normal rent would give rise to hardship'.*

In relation to taxes, fees and fines to be paid to a public body, in Ireland, local authorities can give means tested exemptions to low-income households for refuse collection charges. The Post Office has also voluntarily agreed with the Money Advice and Budgeting Service (MABS) to grant 3-6 month moratoriums on TV license purchases, where they are contact by MABS on behalf of the consumer. On fines, individuals need to submit petitions to the Ministry of Justice for the cancellation or reduction of criminal fines.

According to MABS, the main pieces of legislation that govern debt collection in Ireland are: the Consumer Protection Act, 2007; the Consumer Credit Act, 1995; the Data Protection Acts, 1988 and 2003; the Enforcement of Court Orders Acts, 1940 and 2009; and the Non-fatal Offences against the Persons Act, 1997. The Statute of Limitations 1957 outlines the time limit within which a creditor can chase a debtor for outstanding debts. Creditors are given a fixed period of 6 years to chase their debtors, which is outlined in the Statute of Limitations 1957, and after this time it is no longer possible to pursue their debt.

In Ireland no regulations exist on becoming a debt collector, however, harassment of debtors is covered by separate legislation[393] which states that:

Any person who makes a demand for payment of a debt shall be guilty of an offence if:

[389] http://net.jogtar.hu/jr/gen/hjegy_doc.cgi?docid=A0500164.TV

[390] http://net.jogtar.hu/jr/gen/hjegy_doc.cgi?docid=99600112.TV

[391] http://www.mhk.hu/mhknew/i_online/Cache/330720286523495095399319890252 64/001697400000.htm

[392] See '*The Guidelines for Local Authorities on Rent Assessment, Collection, Accounting and Arrears Controls'* Housing Unit, Department of Environment.

[393] The Non-Fatal Offences against the Person Act 1997.

a) *the demands by reason of their frequency are calculated to subject the debtor or a member of the family of the debtor to alarm, distress or humiliation, or*
b) *the person falsely represents that criminal proceedings lie for non-payment of the debt, or*
c) *the person falsely represents that he or she is authorised in some official capacity to enforce payment, or*
d) *the person utters a document falsely represented to have an official character.*

A person guilty of an offence under this section shall be liable on summary conviction to a fine.

In addition, according to MABS, for cases under the Code of Conduct on Mortgage Arrears and Consumer Protection Code unsolicited contact is restricted to three times per calendar month, outside of the contacts permitted under the Codes. There are also restrictions on interacting with or revealing the debt to the consumer's family or neighbours under the terms of the Data Protection Acts (1988 and 2003).

Following judgment a creditor may choose to lodge the Judgement Order with the Sheriff in the area where the debtor resides or conducts his business. The Sheriff will visit the premises to try and collect the monies. The normal enforcement procedure is via collection by the Sheriff, but the Judgment itself can also be published in Stubbs, a publication that is readily available to all and contains details of all judgments issued. If the debtor is not able to make any payments then the Sheriff can seize goods relating to the business as payment towards the debt through a notification of seizure, followed by the seizure itself. Goods are sold by the Sheriff to realize funds, however, any costs involved in making the sale are deducted from the monies recovered. If the debtor owns property then the creditor can apply for a Judgment Mortgage. This means that the property cannot be sold without first discharging the debt. There can be several judgment mortgages against a single property.

5.12 Italy

In Italy in relation to the cutting-off of utilities in instances of non-payment, public suppliers of utilities have to maintain their service if the consumer's default is not '*severe'* or if cutting-off the utility would be an '*act of bad faith'*. Public Authorities (such as Autorità Energia, AGCOM) control the practices of private utility companies in this regard to enforce what is viewed as acceptable standards and a minimum standard of living (Reifner et al 2010).

In relation to eviction for rent arrears, the Italian system offers a system of protection under which the tenant can have a nine month 'stay of execution' prior to eviction, to allow alternative arrangements to be reached. This can be granted either automatically, or on the tenant's request.

In relation to assignment or attachment of earnings, up to one fifth of an individual's wages can be assigned or attached[394].

[394] See d.p.r 5.1.1950 n.180.

The Italian juridical system adheres to a civil law system. Credit collections are gathered by the Italian Civil Code (*Codice Civile*), which contains and implements all the rules of commercial law and the Civil Action Code (*Codice di procedura Civile*) that govern civil trials in Italy.

The ordinary Civil Action is rarely used to collect credit founded on a written document, such as an invoice. The proceeding is very long and can last for several years. It is also expensive due the lawyer's fees, witness examinations, and evidence analysis involved in the case[395].

The main purpose of the ordinary Civil Action is to determine the existence of the credit that is due and the relations between parties. If the credit is based on documents, the law allows a faster and cheaper procedure called the summary judgement (*decreto ingiuntivo*) that requires only limited intervention from a judge unless the debtor opposes to the petition. These are the most common ways of collecting credit in Court.

In relation to debt collection agenize *di recupero crediti*, or debt collect agents are subject to regulation[396] and have to apply for a license, although Reifner et al (2010) report that few checks are made of them. In response to this a trade body *unirec* have launched an ethical code of practice. There are no maximums relating to fees for debt collection, but they have to be publicly disclosed, and cannot be claimed back in court, as there is no jurisprudence which permits this[397]. The prescription period of a credit is 10 years (art. 2946 Civil Code), which can be interrupted by the creditor notifying the debtor about the interruption of the prescription and asking for payment. Once this has been received, the period of prescription would be calculated again[398].

Debt collectors are prohibited from using force or otherwise constraining debtors. The enforcement in debt requires an act of the creditor to be signed by the bailiff, who will notify the debtor and the third party. This document has to confirm the details of the creditor and the credit, the list of goods or monies subjected to the enforcement (the debtor cannot dispose of them), and the domicile election of the creditor in the city of the Court. The enforcement can refer to different types of credit like bank accounts, goods located at a third party and, on the basis of limits fixed by the law, any salary and retirement pension.

The bailiff visits the debtor at his address to find out if goods can be seized. It is foreseen by the law that:

- The execution cannot be made against certain goods (unseizable goods).
- The bailiff can visit the debtor only during the time fixed by the law, i.e. between 07.00 and 21.00.
- The bailiff cannot proceed during holiday periods.
- The goods that can be taken by the bailiff are money, jewellery, and credits. The other goods must be given to the official receiver.

[395] According to an international debt collection agency. http://www.atradiuscollections.com/private/countryinfo/italy.html.

[396] See art. 1, para 1, a) d. Lgs. N. 374/1999.

[397] http://www.atradiuscollections.com/private/countryinfo/italy.html.

[398] Ibid.

According to CBF, the main legislation that governs debt collection in Italy is Italian Law 7th March 1996 n.108.

According to a consumer organisation, in relation to the payment of electricity bills, the Electricity regulator has proposed the creation of a database for the clients who are late in paying to provide firms more information. Consumer associations are strongly fighting against this proposal.

In 2005, the Italian Data Protection Agency (*Garante per la protezione dei dati personali*) brought into line the processing operations related to debt collection with the provisions concerning personal data information. Irrespective of any commitments with other third parties, creditors must now comply with certain principles related to specific activities performed in relation with debt collection.

It is illegal for personal data operators to disclose information about the subject to third parties without any justification. Moreover, the use of pre-recorded telephone messages to urge payments and posting default notices (or payment injunctions) on the debtor's door is unlawful, since both may reveal relevant personal data to other entities.

Activities that may affect the debtor's dignity are also prohibited. For example, mail or certain documents sent bearing "debt collection" or similar words on external labels. It is also necessary to ensure only the debtor receives payment reminders and injunctions, which requires closed envelopes to be used and only reveal data to allow the necessary identification of the sender.

The processing of personal data within the framework of debt collection must take place in compliance with relevance, purpose specification, and data quality principles (Section 11 of the Data Protection Code). Therefore, only the necessary data must be processed for the relevant task. Additionally, if certain data must be retained for longer, suitable mechanisms must be implemented to prevent access from other third parties.

5.13 Netherlands

According to a respondent from a lending association in the Netherlands, the main pieces of legislation that govern debt collection are the Burgerlijk Wetboek for the voluntary process and Wetboek van Rechtsvordering and Beslagrecht for the statutory settlement process. The respondent said that this legislation protects the rights and interests of all parties.

In the Netherlands, in relation to the cutting-off of utilities in instances of non-payment, utility suppliers may grant a respite and consumers are entitled to reach a payment settlement[399] (Reifner et al 2010).

In relation to taxes, fees and fines to be paid to a public body, in the Netherlands, individual cities can grant remissions from taxes and fees for the poorest[400].

In relation to attachment of earnings, up to 90% of an employee's income is exempted, but above this percentage attachment in unrestricted[401].

[399] *Algemene Voorwaarden voor de Levering van Elektriciteit 2002 voor Huishoudelijke Verbruikers, Article 4.*

[400] *Leidraad invordering 1990, Algemene wet inzake rijksbelastingen.*

In relation private debt collection is not specifically regulated by Government, relying on self-regulation instead.

According to respondents from a Dutch financial information organisation and a Dutch lending organisation, there are no restrictions for lenders on chasing debtors electronically. The respondent from the financial information organisation said that there are no restrictions on interacting with or revealing the debt to a debtor's family or neighbours. They also said that, in order to take property in lieu of debts, either the debt must be mortgage debt or else a court order is needed to confiscate property. According to the respondent from the lending organisation, certain possessions cannot be confiscated such as those protecting a minimum income or necessary personal belongings.

The respondent from the financial information organisation said that debt collection companies and lenders sometimes send letters to the consumer threatening to get a court order for the confiscation even though, in the Dutch system, it is only bailiffs that can confiscate income or assets. According to the survey respondent, consumers can find these actions threatening.

The respondent also pointed out that there is a professional organisation of bailiffs. Additionally, the Dutch Association of Debt Collection Companies has a code of conduct.

5.14 Poland

In general, a creditor or debt collector gives up their right to collect a debt after three years from the due date of the debt. Debts under sale contracts become prescribed within two years and one year for transport invoices. For services that require periodic invoicing, such as rental, telephone and internet agreements, the time period is 3 years.[402] Lenders most complaint is that the process is excessively long and insufficiently effective[403].

The Polish Code of Civil Procedure, as laid down in the Polish Act of 17 November 1964, defines that the specific terms of the statute of limitation of debt depends on the type of contract. After the expiration of the statute of limitation, the creditor can file against the debtor but the debtor can ask the judge to dismiss the suit on the grounds that the statute of limitation has expired. The prescription period can be interrupted if a creditor starts legal procedure or proves written debt acknowledgement[404].

In general the execution of a debt collection activity is universal across consumers and other types of borrowers. There is no special legal framework in relation to consumers. Debt collection is enforced by bailiffs on the request of the lender on the basis of the executor document with a writ of execution. In the request, the lender should determine the way in which the execution shall be enforced (according to the Polish Code of Civil Procedure), and his decision is binding on the bailiff. However, some execution acts are reserved for the competence of the court.

[401] Art 475c-d, RV.

[402] http://www.atradiuscollections.com/private/countryinfo/poland.html.

[403] From lender's complaints sent to the courts and the Ministry of Justice, as relayed by the Polish Ministry of Justice. However the Ministry of Justice do not collect statistics on consumer's complaints.

[404] http://www.atradiuscollections.com/private/countryinfo/poland.html.

Bailiffs are allowed to auction debtor's assets in lieu of payment, and sell occupied property not earlier than seven days from taking it over[405]. Bailiffs can only conduct the execution proceedings on weekdays and Saturdays between the hours of 7am and 9pm.

Enforcement against moveable goods is the procedure where the bailiff visits the debtor to take away movable goods he can liquidate in favour of the creditor. Consumers defaulting on their loans can face a bailiff intervention. 2% of households faced this in 2008[406]. The court places restrictions on what assets the bailiff can remove from the debtor in payment for outstanding debts. Those assets which can be taken are salaries, pensions, savings in a bank account, and real estate. The quickest way for bailiffs to enforce payment is via an attachment on earnings (either salary or pension), or by removing cash directly from a bank account. Assets can also be seized, including valuables within the property, cars, appliances or equipment for hobbies. However under article 829 of the Code of Civil Procedure, bailiffs cannot take everyday use items of the debtors and their family members, such as household items and appliances[407], bedding, everyday clothing, one month's worth of food and fuel, tools necessary for the debtor's job, items necessary for learning, scholarships, maintenance allowances, welfare benefits, personal papers or awards/trophies. In the event that a bailiff takes an item not identified by the coach the debtor can make a formal complaint to the court[408].

If the debtor owns real estate, it is possible to receive a record of the claim in the land register and to then either force the attachment, the attachment and sale or in case there are tenants, the sequestration of the real estate by court order. All of these processes are more expensive than those mentioned previously, and it can be a long process to get a copy of the record. Afterwards, it can also take time to sell or sequestrate the land and real estate[409].

There are also limitations on bailiffs in relation to execution against a person's salary, of which no more than 50% can be taken (60% if it concerns the execution of maintenance obligations), and on taking cash from a bank account, in which case a sum equal to a maximum of an average monthly salary according to the Polish law has to be left in the account and only the remaining sum may be attached[410].

If the debtor is married, bailiffs have the right to carry out the execution of a joint bank account of the debtor and his/her spouse. In such a case, the creditor does not need to release a separate clause against the spouse[411].

Under existing laws on the protection of the rights of tenants, it is not possible to evict tenants in rent arrears who are unemployed, pregnant or disabled, nor is it allowed to evict any person between the dates of 1st November and 31st March unless there is suitable accommodation

[405] Dziennik Gazeta Prawna (2012c).

[406] UOKiK (2008).

[407] The Polish Act on civil procedure does not provide examples. Court and bailiff practice is therefore restrictive in applying this exemption.

[408] Dziennik Gazeta Prawna (2012b)

[409] http://www.atradiuscollections.com/private/countryinfo/poland.html

[410] Article 890 §2 of the Polish Act on civil procedure. The 'average monthly salary' refers to the average over the past three months, established by official announcement by the President of the Polish Central Statistical Office.

[411] Dziennik Gazeta Prawna (2012a)

available. However, these rules are often abused[412] by debtors due to black market employment. Municipalities particular feel this system does not work. New rules therefore suggest that people 'in need' will be given a council flat when evicted, with the court deciding whether a particular person is 'in need'.

In Poland debt collection costs are charged to debtors[413], and collected with the claim. If the enforcement is carried out by the bailiff they establish the cost of execution in an issued order. A common complaint from bailiffs is that for each concurrent instance of administrative (recovering public law charges, such as unpaid taxes) and judicial execution proceedings being required, a separate court ruling is required.

The creditor can block the bank account of the debtor or block the debtor's claims against tax offices, life insurances, the debtor's employer, and shares in a business, corporate shares, or any possible claim the debtor may have against any third party. This usually proves effective[414].

There are no restrictions on pursuing debtors via electronic means, such as by telephone, text or email, or on interacting with the debtor's neighbours or family.

5.15 Romania

The RBA named three primary debt collection processes:

- Enforcement over real estate;
- Enforcement of movable asset;
- Wage, account or other income garnishment.

According to the RBA, the main pieces of legislation governing these debt collection processes are the Civil Code, the Code of Civil Procedure, and Mortgage Loan Law. The most common complaints from lenders in 2009/10 concerning these processes were the "lack of legislation for soft collection process (pre-enforcement)" and the "lengthy enforcement process (claims may be filed against each and any procedural step, with no sanction for overuse of legal rights)".

The RBA reported that are no restrictions on chasing consumers electronically and on restrictions on taking the consumer's property in lieu of debts. However, in case of real estate enforcement there are restrictions in connection with eviction individuals during winter season provided certain conditions are met.

An Enforcement Bailiff costs 300-1000 euro. If a debtor does not pay voluntarily after receiving the judgment sentence from the court, a lawyer will have to file for a new legal procedure. A Forced Execution Proceeding or enforcement, is needed for searching the debtor's assets or banking accounts, and is performed only by a legal executor, which can be an individual person or specialized office.

[412] According to Dziennik Gazeta Prawna (2012d)

[413] Article 770 of the Polish Act on civil procedure

[414] http://www.atradiuscollections.com/private/countryinfo/poland.html

- **Enforcement in movable goods:** These are done after a Bailiff evaluation and a local expert's help.
- **Enforcement in immovable goods:** These are done after a Bailiff evaluation and a local expert's help.
- **Expected timeframe:** Most procedures last a few months, depending on the assets[415].

An example case study we received from one respondent outlined the case of a teacher being pursued for a debt:

'The last payment for the loan was made in March, and the amount was 300 lei. I believed that this would lower the debt those gentlemen had calculated on my account. The phone calls started. Every day, the same conversation, different individuals. The minimum amount: "at least 100 lei".

I politely asked them to accept a payment agreement until the end of the month, hoping that in this way I would not be called 10 times a day. Big mistake! "Even if my colleagues have phoned you, you have to talk to me too".

On 3rd of June 2011, a day I will not forget easily, a young lady called me at 8 a.m.! Same speech. I asked her not to call me anymore because I was at work and I hang up. She then called me at my work office, at school.

I hang up again. She called the secretary and asked to speak with someone from the management board. The secretary transferred the call to the chief accountant. She had a conversation with my colleague, with the same "civilized" tone. She requested an income deduction (through the phone!), she asked for the net amount of my income.

My colleague let the young lady know that a deduction can be established only through a court order and hung up. Of course, the young lady returned. She questioned my colleague, she wanted to know who he was, why he hung up, she let him know that I will pay until the final cent, and the school where I work will be held accountable. Just thinking of that day makes me sick!

Then she called again; the secretary transferred the phone call to my office, the same speech. To get rid of the nightmare and of the situation I had been put in, I told the lady that I have 50 lei and that I would pay this amount after 16 o'clock, when I get out of work. "NO, 100 lei is the minimum amount", she said, "And I will call you at 16:15, after the payment".

I was in front of the bank at 16:15, and the phone rang again. I froze! I answered and let the lady know that I am on the way to put the money in their account! "Well, I will wait on the phone with you to make the payment!" I was speechless. Hey, how do you expect me to make a payment while talking to you on the phone? "You can use one hand for payment", the answer came.

[415] http://www.atradiuscollections.com/private/countryinfo/romania.html

Then, I told the lady that I would not pay one single lei until they had clarified the amount they claimed I owed them and that from that moment on I would not talk to them anymore. She started to scream on the phone: "Money, you have the money? You have the money in your hand and you won't pay?".

In 2011 the APC received more than 1,500 complaints from consumers regarding one or several aspects of their credit agreement(s). However, the APC also noted that in 2012 the European Court of Justice decided that the National Authority for Consumers Protection correctly applied Directive 2008/48/EC on consumer credit: that consumers have the right to direct recourse to a consumer protection authority to limit the number of commissions, etc (case C-602/10).

According to the Authority for Consumers Protection, Romania does not have legislation to protect consumers against abusive practices by debt collectors, and the Government has indicated in their intention letter to the IMF[416] that they do not propose to legislate in this area. In 2010 19 senators did prepare a draft bill to regulate debt recovery procedures. This was improved by the Government taking advice from the National Authority for Consumer Protection, which transposed various elements from UK[417] and US[418] legislation. This was adopted by the Senate but was rejected by the Chamber of Deputies.

5.16 Slovakia

Creditors, according to the Ministry of Justice, use private collection firms which are '*very active and in some cases also buy the claims*' from the debtors. Whilst there is no legislation specifically governing debt collection, there is a code which has been put together by a trade body; the Code of the Association of Slovak Collection Companies (ASINS)[419]. When launched, the President of ASINS, Martin Šoltes, said that:

'*vaguely formulated legal conditions for operation of collection agencies in the market leads some collection agencies to use unfair practices when collecting receivables. ASINS wants to make the situation in the market for receivables more transparent and especially prevent operation of unqualified companies using such unfair practices*'[420].

Interest rates should be specified in the contract between supplier and buyer. If it is not, the buyer can charge an interest rate on late payment based on the law. The interest rate is the same for all business relations and is prescribed by Civil law. It is calculated as the semi-annual amount of the

[416] www.imf.org/external/np/loi/2012/rou/091212.pdf Paragraph 1.

[417] See section 5.18.

[418] See Annex 8.

[419] Five international collection agencies operating in Slovakia founded the Association of Slovak Collection Agencies (ASINS) in mid October 2010. Its primary goal is to represent the interests of professional companies active in collection of receivables and secure their proper operation in the market. The founding members of ASINS are EOS KSI Slovensko, Intrum Justitia Slovakia, Coface Slovakia Credit Management Services, Creditre form and Transcom Worldwide Slovakia,

[420] Press release, quoted at http://spectator.sme.sk/articles/view/42800/16/association_of_collection_agencies_launched_in_slo.html.

repo-rate set by the European Central Bank, plus eight percentage points[421]. Debt collection charges are not recognised in Slovak law.

Reminders for payment are usually sent to the debtor before court proceedings start but are not necessary according to law. If the claim is not covered legal action is issued. The contracting parties are also allowed to negotiate an arbitration clause or a particular court's local competence clause. If these clauses are not agreed upon, legal actions are handled by the District Court of the debtor. The courts always award the interest that is required on condition the basic claim is accepted. The losing party also has to pay court fees and lawyer costs[422]. Under article 53, paragraph 7 of the Act No. 40/1964 Coll. Civil Code, in consumer contracts, securing the debt by transferring the ownership of immovable property to the lender is forbidden.

Debt collectors often, in the report of the Ministry of Justice, use email, sms (text messages) and letters to communicate their requests to consumers, on which there are no restrictions, however '*very often they use aggressive commercial practices.'* There is also a concern that arbitration is used to push through an unlawful execution.

There are general complaints from debt collectors, lenders and consumers about the system. Debt collectors concerns that the legislation is not clear enough, or understandable in places has caused ASINS to develop its own guidance; lenders (according to studies from business associations reported by the Ministry of Justice) are uncomfortable with the length (time-wise) of the civil proceedings, and consumers have concerns about the application of execution and arbitration , usury, unfair terms in consumer credit contracts, and unfair commercial practices.

There are no restrictions on debt collection practices on taking property in lieu of payments, nor on interacting with, or revealing the debt to the consumer's family or neighbours.

5.17 Spain

In Spain, the cutting-off of utilities in instances of non-payment is prohibited without prior notice (Reifner et al 2010).

In relation to taxes, fees and fines to be paid to a public body, in Spain, the General Taxation Act permits the extension relief or deferment of payment, but generally with interest charges applied for any delay in payment. This is at the discretion of the Department of Tax, who takes the financial situation of the individual into account. However, guarantees, normally from banks, are required.

Exclusions of assets that creditors cannot liquidate and incomes that creditors cannot collect from the debtor are enunciated in articles 605 to 609 of Law 1/2000, of 7th of January, Law of Civil Procedure (*Enjuiciamiento Civil*):

- furniture and household utensils and clothing of the debtor and his family, which cannot be considered superfluous. In general, those goods such as food, fuel, etc. which in the opinion of the court prove essential for the debtor and his dependents to live with reasonable dignity;

[421] http://www.atradiuscollections.com/private/countryinfo/slovakia.html.

[422] Ibid.

- books and tools necessary for the exercise of the profession, trade or occupation, when their value is not commensurate with the amount of the claim;
- sacred goods and goods dedicated to the worship of legally accepted religions;
- amounts expressly declared by law not be seizable;
- goods and amounts declared unseizable by treaties ratified by Spain;
- wage, salary, pension, other professional compensation, are unseizable up to the amount of the minimum wage;
- wages, salaries or pensions that are higher than the minimum wage are seized according to this scale: (1) for the additional amount up to twice the minimum wage, 30% (2) for the additional amount up to three times the minimum wage, 50% (3) for the additional amount up to four times the minimum wage, 60%. (4) for the additional amount up to five times the minimum wage, 75% (5) and for any amount exceeding the above amount, 90%.

In response to the needs of dependents of the debtor, the court may allow the debtor to keep an extra 10%-15% of the incomes above.

These measures, however, do not solve the problem of indebtedness and subsequent insolvency of consumers but simply prevent the debtor from being rendered destitute.

5.18 United Kingdom

According to the survey respondent from the organisation that offers consumer advice, in the case where a consumer does not meet his or her financial obligations, the primary debt collection processes work as follows:

- The creditor will attempt to contact the debtor to make arrangements for payment.
- The creditor may pass the debt to a third party.
- The creditor may initiate country court action. In the case that a judgment is attained, the debt repayment may be enforced by bailiffs, by a charging order, by AEO, by TPDO or by bankruptcy.

Debt collection is governed by the Consumer Credit Act of 1974, the County Courts Act of 1984, the CPRs of 2008, the Charging Order Act of 1979 and the Insolvency Act of 1986. The main complaint by debt collectors in 2009-10 about the legislation, according to the respondent, was that it should be easier to get a county court judgment and to enforce it. The respondent said that the most common complaint by consumers related to harassment by creditors, particularly that they took court action too quickly and in inappropriate circumstances.

The United Kingdom does not have specific regulations to prevent consumers against having utilities (including water and telecommunications) cut-off as a result of non-payment, however Government has targets to minimise the problem of being disconnected for vulnerable households by 2020 (Reifner et al 2010).

In relation to rent arrears the United Kingdom has very light-touch protections, only requiring the landlord to file an action for possession before eviction (Reifner et al 2010).

Child maintenance payments are exempt, along with student loans from debt cancellation processes.

In the UK any attachment or assignment of earnings requires either the prior written agreement of the employee or a court order. Court orders can be obtained in relation to an attachment of earnings to pay a criminal (payable to the state) or civil order (payable to the state or a private debtor). Deductions from wages (for example by an employer in response to a stock shortage in a retail environment) must be in writing and signed by the employee, and is subject to restrictions for how large the deduction can be.

Private collection must be in line with the agreed contract. If the matter reaches the court, the court retains discretion on whether to uphold any contractual obligations.

Debt collection in the UK is governed by codes of practice issued by trade bodies, and specific guidance issued to the Office for Fair Trading (OFT). All businesses engaged in the recovery of consumer credit related debts[423] must hold an appropriate standard consumer credit license issued by the OFT, and are required to meet the 'section 25' test[424] as outlined in section 25 of the Consumer Credit Act 1974. In considering whether a firm is fit to be a debt collector, the OFT has to look at their skills, knowledge and experience in the consumer credit business, and '*have regard to any matters which appear to it to be relevant and in particular any evidence tending to show that an applicant, licensee, or its employees, agents, or associates, past or present, have:*

- Committed offences involving fraud or other dishonesty or violence
- Failed to comply with the Act or any other enactment regulating the provision of credit to individuals or other consumer protection legislation
- Failed to comply with the requirements of Part 16 of the Financial Services and Markets Act 2000 so far as they relate to consumer credit jurisdiction operated by the Financial Ombudsman Service
- Practised discrimination in connection with the carrying on of their business
- Engaged in business practices appearing to the OFT to be deceitful, oppressive or otherwise unfair or improper, whether unlawful or not.

The OFT therefore expects debt collectors to

- Treat debtors fairly
- Be transparent in their dealings with debtors
- Exercise forbearance and consideration, particularly to debtors facing difficulties
- Act proportionately
- Build and apply transparent, effective and suitable policies and procedures for employing with debtors and other relevant parties (for example, parties participating in the debt recovery process)
- Establish and implement clear, effective and appropriate policies and procedures, particularly around vulnerable debtors, defined as those who are '*significantly constrained*

[423] Including those firms who recover their own debts, not just those whose business activity is the collection of debt.

[424] The factors the OFT considers when assessing fitness are outlined in (OFT 969) 'Consumer Credit Licensing – General guidance for licensees and applicants on fitness and requirements', available at http://www.oft.gov.uk/shared_oft/business_leaflets/credit_licences/oft969.pdf .

in terms of their ability to engage appropriately with those pursuing them for the repayment of debts owed. Debtors with mental health issues... may fall into this category[425]*'*.

- Account for differences that may arise when dealing with debtors in a different jurisdiction to ensure there is no significant impact on the debtor's rights.

The areas of unfair or improper business practices which the OFT considers under s25(2A)(e) of the Consumer Credit Act are:

- **Communication**: whether communications are clear and accurate. Businesses must not:
  - include Latin phrases, or unhelpful legal and technical jargon, and information must not be presented in a way which has the potential to create a false or misleading impression.
  - leave out or present information in such a way that it exploits a debtor's lack of knowledge.
  - fail to provide debtors with information on the outcome of query or dispute investigations.
  - fail to provide information to debtors on the status of their debts. For example, not providing balance statements when requested.
  - contact debtors at unreasonable hours or ignore reasonable requests in respect to when, where and how to make contact with debtors. For example, a shift worker may ask not to be contacted at certain times during the day.
  - contact family or friends of the debtor, or use methods which may easily reveal the debt to others, such as postcards, answer-phone messages, or messages on social networking websites. For example, leaving a contact number at a debtor's address, which states or implies that the debtor has missed a delivery and encourages him to make contact.
- **False representation of authority**: Businesses should not:
  - misrepresent their authority or status or the legal position they have in regard of the debt and debt recovery. For example, using official-looking documents to mislead debtors, or claiming to work for a court[426], or claiming that a warrant of execution *will* ensue if the debtor does not comply, when this is a decision for a court to make.
  - take or threaten to take court action in the wrong jurisdiction. For example, taking action against a debtor based in Germany in English courts.
  - pursue third parties for payment when they are not liable.
- **Physical/psychological harassment**: Businesses should not engage in physical or psychological harassment of debtors of third parties. Businesses cannot:
  - falsely imply that action can or will be taken (such as implying the debtor could be forced into bankruptcy as a result of not paying, when the debt is below the threshold, or claiming a right of entry when a court has not granted one).
  - apply pressure onto the consumer to sell assets to satisfy the debt, and multiple businesses cannot pursue the same debt. Consumers must be informed when responsibility for pursuing a debt has moved to another organisation.

[425] p9, OFT (2011).

[426] Including using logos or business names which imply government backing, public body status, or a connection to the courts.

- pressurise debtors to pay more than they can afford without undue difficulty or expect payments within an unreasonable time period. Moreover, businesses must not continue to pursue a debt if they believe the debtor has mental health issues, without going through the relevant processes. In this matter, the OFT regards the use of the standard Debt and Mental Health Evidence Form (DMHEF) as a reasonable means of collecting evidence. The DMHEF has been formed to assist creditors in order to extract relevant information from health/social care practitioners.

- **Deceptive and/or unfair methods**: Businesses should not mislead or trick debtors into making payments. This includes:
  - asking debtors to use premium rate[427] telephone numbers to contact them. Businesses cannot imply that failure to pay will be seen as a *criminal* rather than *civil* action, and that criminal proceedings can be brought.
  - refusing to engage with an appropriate third party, such as a debt advice counsellor or centre.
  - passing on debtor's details to third parties, such as lead generators, debt management firms and brokers. Although it may be lawfully possible to pass such personal data to an appropriate third party without the debtor's consent, the OFT believes it is good practice to seek the approval of the debtor before doing so.
  - investigating or providing details for a debt query or dispute and providing a timely response to the debtor; since failure to do so may result in the wrong person being pursued, the person being pursued not existing at all or a person being pursued for an incorrect amount.
  - requiring a person to prove they are not the actual debtor who owes the outstanding debt. For example, by asking for a proof of identity such as a driving license or passport, or by signature verification.
  - failing to terminate debt recovery activity when investigating a queried or disputed debt when the debtor has, or appears to have, valid grounds for the query or dispute.
  - Misusing a continuous payment authority. For example, debiting lesser or greater amounts than those agreed.
- **Charging for debt recovery**: Charges should not be levied inappropriately or unfairly, particularly including:
  - misleading debtors into believing they are legally liable for these payments when they are not.
  - claiming recovery costs in the absence of contractual provision to be able to do so.
  - not giving a clear indication in credit agreements of any default charges.

  The OFT believes that creditors should consider reducing or stopping interest and charges when there is sufficient evidence that the debtor is in financial difficulty and will be unable to meet repayments.
- **Debt collection visits**: visits must not be carried out in a threatening or unclear manner, including:

[427] Higher than standard charges.

- not revealing what the visit is about. For example, not providing a reason for the field agents visit.
- visiting at a time when the debtor may be vulnerable. For example, when a doctor's certificate has been provided stating the debtor is unwell.
- entering the debtor's property without their consent and failing to leave when asked to do so.
- Visiting the debtor at an inappropriate location, such as a hospital where the debtor is a patient.

- **Statute barred debt**: This applies to the pursuit of debt regardless of age. In this regard, the OFT:
  - accept that statute barred debt still exists in England, Wales and Northern Ireland and is therefore recoverable. On the other hand, once a debt has entered the statute barred period in Scotland, where is it extinguished, businesses should not use unfair methods, such as misrepresentation, to recover it.
- **Data accuracy**: Data must:
  - be accurate, to ensure the debtor is only pursued for live debts, and that only the correct person is pursued, complying wherever necessary with the Data Protection Act.
  - not be shared with inappropriate third party businesses. Collected funds *must* be passed on to the creditor. Continuous payment authorities, such as permission to debit a bank account must not be misused[428].
  - be processed fairly and lawfully and only for specific purposes. Under the Data Protection Act (1988), it is a criminal offence to obtain or disclose personal data by unlawful means.

  The OFT considers that businesses should ensure that they have accurate and adequate data by carrying out reasonable verification steps, before pursuing a debtor for any outstanding debts.

The OFT are likely to prevent a business from holding a consumer credit license if it views the business plan to have a negative impact on consumers. The OFT can impose fines of up to £50,000 per instance of non-compliance, with an additional possibility of varying the license to limit the activities for which the business is licensed to carry out or alternatively, reduce the life of the license.

According to a survey respondent from the UK Citizen's Advice service, there is no restriction on taking the consumer's property in lieu of debts.

[428] Misuse is defined as taking large single payments, as opposed to small repeated payments to cover a debt.

6 Best practice models for consumer debt cancellation, *datio in solutum,* and restricting abusive debt collection practices

6.1 Consumer debt cancellation

6.1.1 Previous best practice studies

The authors are not the first to have attempted to have identified best practice in Europe in relation to consumer bankruptcy. Several key papers are worth mentioning, and were this paper to be considered the basis for further reform we would strongly encourage the re-reading of these documents as well, to at least understand the evolution of 'best practice', but also to better understand the key debates and the different points of view that can and have existed on this issue over the past twenty years.

- **Huls et al: 'Over-indebtedness of consumers in the EC Member States' (1993)** – Commissioned by the Directorate General of the Consumer Policy Services of the EC in 1991. Major conclusions were:
  - Whilst the practice principle should be that everyone ought to pay back their debts, measures needed to be put in place to protect consumers from '*undue demands and harassment'.*
  - Debts should be discharged after a limited period in which best efforts are made to repay all that the consumer reasonably could, except alimony / support criminal fines and liabilities resulting from crime or '*gross negligence'*. Taxes should be discharged.
  - '*Good faith is supposed, bad faith must be proven'.*
  - Debt counsellors should help address over-indebtedness outside the courts as far as possible, with the ability to impose or 'cram-down' agreements on dissenting creditors if 75% of creditors were in favour.
  - In-court arrangements should primarily exist to leverage acceptance of out-of-court arrangements.
  - '*Costs should not prevent the consumer seeking relief'.*
  - The maximum period for repayment plans should be four years before discharge, and a preference was expressed for three years.
- **International Federation of Insolvency professionals (INSOL International): 'Consumer Debt Report: Report of Findings and Recommendations (2001)** – Independent and massively influential report. Major conclusions were:
  - There should be fair and equitable allocation of consumer credit risks between lenders and borrowers, and allow consumers a '*reasonable standard of living'.*
  - There should be some form of discharge available to give consumers a 'fresh start'. This should take the form of either immediate discharge where no hope of repayment exists, or a payment plan followed by discharge.
  - Payment plans should not extend for longer than a maximum of seven or eight years before discharge.
  - Discharge should exclude maintenance agreements, court fines, taxes, and student loans.

- Extra-judicial rather than judicial proceedings should be preferred when equally effective options were available.
- '*Debtor[s] should have easy access to the procedure without costs being an obstacle...and without numerous or complicated formalities*'.

- **Reifner, Kiesiläinen, Huls and Springeneer (iff): 'Consumer Over-indebtedness and Consumer Law in the European Union: Final Report.' (2003)** – Commissioned by the Directorate General; Health and Consumer Protection of the EU. Major conclusions were:
  - The INSOL report from 2001 was '*the international consensus about sound law and policy in insolvency matters'.*
  - There should be rehabilitation by way of a broad discharge; *'exceptions for taxes, fines, and damages are not recommended'*.
  - There should be an earned fresh start through an 'onerous' payment plan, to avoid public resistance to the discharge and reflect '*the European moral attitude towards payment of debts*'.
  - Noted that five years was the median length for payment plans before discharge, but that three years was preferable.
  - There should be open access in terms of affordable costs, but that there should be a 'good faith test.
  - There should be budget and debt counselling available to consumers.
  - There should be a preference for out-of-court and opposed to in-court processes.
  - There was so much variation it was '*impossible to say at the moment that one system was better than the other.*'
- **European Commission: Enterprise Directorate General 'Best Project on Restructuring, Bankruptcy and a Fresh Start, Final Report of the Expert Group (2003)** – commissioned by DG Enterprise as part of the Lisbon Agenda. Main conclusions were:
  - A public campaign to change mindsets on financial failures and fresh starts needed to be undertaken.
  - Early discharge should be open to debtors who had not acted fraudulently.
  - Identified court costs as an obstacle.
  - Recognised Finnish five year discharge and UK one year discharge, subject to a payment plan of up to three years, as best practices.
- **European Commission, DG Employment, Social Affairs and Equal Opportunities: 'Amnesty of debts: Amicable agreement and Statutory Solution, Minutes' (2006**) – Main conclusions were:
  - '*Need to give people a fresh start after a reasonable short time, rather than after seven years or more as in some countries*'.
  - Considered whether shorter discharge should be balanced with lower level of exempt income.
  - Emphasised importance of considering the 'good faith' of the creditor as well as the debtor, as a way of balancing creditors' and debtors' rights.
- **Niemi-Kiesiläinen & Hendrickson: 'Report on Legal Solutions to Debt Problems in Credit Societies' (2005)** – Commissioned by the European Committee on Legal Co-operation, a committee of the Council of Europe
  - Conclusions based on the iff report (2003), to which one of the authors had contributed.

- **Council of Europe ' Final Activity Report of the Group of Specialists for Legal Solutions to Debt Problems (CJ-S-DEBT)' (2007)** – Recommendations adopted by the Council of Europe in June 2007 included:
  - A broad working definition of 'over-indebtedness'
  - Measures to prevent excessive consumer debt
  - Measures to protect citizens from aggressive debt enforcement
  - Measures to facilitate rehabilitation including:
    - Encouraging effective financial and social inclusion of the over-indebted
    - A broad discharge, although only where '*other measures have proved to be ineffective*'
    - Debtors should fulfil their obligations as far as possible
    - Discharge is a privilege that should be a carefully guarded last resort
    - Out-of-court arrangements to be preferred to in-court
    - No 'good faith test' as impossible to define 'good faith'
    - Payment plans should not '*deprive the debtor and or his family of the ability to satisfy their basic needs with due regard to their human dignity*.'

6.1.2 Best practice summary

Best practice – Summary key elements

- Debt cancellation is not, and should not be, an automatic right, but it should be presumed that someone applying should have access to it unless a lender can demonstrate objective evidence of 'bad faith' by the borrower. The application process should give lenders a time-limited opportunity to raise concerns about an applicant's behaviour, so administrators can reject applicants whose behaviour has been found wanting.
- The creditor must be protected when the debtor has acted in bad faith, but in return for this creditors must accept the responsibility where inappropriate lending has helped cause the problem of over-indebtedness they should bear some of the costs of resolving this problem. Best practice requires a compromise between the debtor and creditor; the debtor must pay what he can and the creditor must accept that as the best resolution they can receive, for in the end there is no more funds for them to access, so it is better for them to cut their losses, stop paying legal fees and allow a rapid discharge of unpayable debts.
- The use of stigmatising labels should be ended, and the pejorative term 'bankruptcy' should be replaced with the more neutral 'debt adjustment'.
- Debt cancellation should be delivered by an administrative body without recourse to a judicially-led court-based process except for appeals against the misapplication of the due process, as exists in Sweden and France, transparently applying clear rules quickly and efficiently. Creditors and consumers should have the right to appeal to a court on the grounds of compliance with the process.
- The debt counsellor who leads the administrative process should:
  - determine the solution applicable to the case, rather than the consumer or the debtor:
  - have the power to attach earnings. There should be transparent rules on exempt income based on social benefit levels, taking account of the number of children and/or a partner, and the impact these have on social allowances.
  - only have the right to liquidate assets worth over a substantial threshold.
  - have the right to impose a 'cram-down' on creditors.
  - have the power to impose a 'zero-plan' where there is no chance of the consumer being able to make payments, with immediate discharge if a consumer cannot over three years repay either 10% of their total debt or €10,000, whichever is lower.
- As in Denmark and the UK, discharge should occur one year into a three year payment plan, aligning discharge at the lowest common denominator whilst still ensuring creditors have access to excess earnings for three years.
- There are some debts which consumers should not be able to escape. Child / dependent maintenance payments deserve inclusion in this exemption. Student loans do not merit exemption from debt cancellation. There is a case that society would benefit most if unpaid taxes were given a priority in payment plans over private debts
- A good first step at the European level would be to update the list of procedures in Annex A of the Insolvency regulation.

Building on the works listed in section 6.1.1, and our research into the current processes available in the countries analysed, the authors have constructed a best practice regime based on the following criteria:

- **Fairness:** We have identified systems which deliver an appropriate balance between the benefits to the debtor and the lender as best practice. This principle attempts to ensure that where a potential reform has additional benefit which can be created without additional hardship being inflicted on another that this reform is proposed as part of the best practice solution. In essence, we view that it is fair for the debtor to receive debt relief as quickly as possible, if the borrower has a chance to recoup all funds that are available for repayment. A system is viewed as unfair if it tries over prolonged periods to extract more funds than are ever realistically going to be available as this counter-productively, as this puts undue pressure on the borrower and unrealistically raises the lender's hopes. This will help achieve a '*power balance'* to prevent future reform
- **Functionality**: We have looked to identify aspects of debt cancellation systems which deliver efficient and successful case resolutions for both debtors and lenders, based on experience across Europe, particularly noting where features of systems have been abandoned and replaced. Within this we have identified a large number of reforms which have been driven by legislators coming to understand the perverse incentives or unintended consequences, which previous laws have created and which have prevented the achievement of their stated objectives. A functional process is one where we cannot identify any pressure for further significant reform because of a failure to meet one of the other arguments in this list.
- **Coherency**: We have looked to ensure the best practice described is internally consistent and coherent. Included within this we have sought to ensure that where a system logically leads to a specific conclusion that we include this and ensure this is reflective of the other principles.
- **Responsiveness**: Is the system responsive to the needs of borrowers and lenders, or does it impose structures on them which they find burdensome, or restrictive?
- **Affordability**: We have looked to identify best practice which allows the tax-payer, or the agents in the case to reach an affordable conclusion to the case.
- **Equity:** We have chosen to identify processes as best practice where they deliver equality of outcome for all consumers who wish to enter them, without discrimination.
- **Observed preference by consumers**: We suggest that a system is best practice where it can clearly be seen that where the agents (creditors and debtors) involved in this type of process have an option and consistently choose one model over another to their common benefit, rather than where they are seeking to use that choice to disadvantage the other.
- **Accessibility**: Does the system provide a mechanism which is openly available to borrowers, which we view as an advantage or does it put up barriers which segregate and discriminates between borrowers without clear, transparent rules.

Using these criteria, we believe the following description is best practice, reflective of the very latest developments in the field. However we are also aware that our arguments are based on three key assumptions:

- We have taken the latest evidence from across Europe and looked at its impact on lenders and borrowers. From this perspective the results below are valid, but obviously different

countries have different legal systems, and what may be feasible in one may causes another fundamental problems in terms of application. This is why our best practice model is described in terms of the outputs and outcomes we suggest legislation should be designed to achieve, rather than precise definitions of procedural steps.

- We have described best practice from a neutral and, we hope, objective position which looks at the costs and benefits of different scenarios and tries to reach an optimal balances between the rights and responsibilities of both lenders and borrowers. In several instances we argue that best practice is not that which maximises benefit for consumers, but rather that which best reflects a fair balance of costs between the lender and the borrower. We recognise however that this is very much an 'economic' approach. There are others. Different countries have had very different perspectives on how their debt solutions systems should or should not work based on cultural, political or even moral perceptions of the sanctity of the contract and the rights of the lender to have his property returned intact. These factors, and the systems they have led to, need to be taken into account as it is the author's opinion that they are the root cause of the variation which already exists in Europe and any move towards harmonisation will fail if it does not take these into account.
- Almost all systems across Europe are very 'path dependent', in that change is usually in small steps, taking explicit note of what the previous regime was and often only making marginal changes to that system. In short, reform in countries which have a consumer bankruptcy system are normally incremental, whereas reforms in countries which do not have a consumer bankruptcy system either take the existing corporate insolvency practice or perceived best practice in other European countries as the basis for reform. This means that we should not expect legislators to rapidly move to fundamental large scale reform, when this has rarely been evidenced in the past. Discharging debt *is* controversial. It may appear to be a blinding glimpse of the obvious that in a modern consumer credit system a method for addressing the errors of lenders and borrowers is simply unavoidable, but history shows us clearly that any political act which takes from one group to give to another is always controversial, at least with those from whom the reform takes. Debt solution reform in Europe will always be subject to political reality, and the reality is that almost every European country which has introduced a debt cancellation system found it politically hard. The best practice we describe, therefore, is the best of what we have seen; but it may not be possible for a country to move straight to such a system in one step as no country ever has.

The following sections present our assessment of best practice.

Rules versus discretion

Probably the most important decision to make in deciding on best practice is in the fundamental debate between rule-based systems and systems which contain a degree of judicial discretion, to allow the tailoring of solutions to the individual circumstances of the case.

Many countries in Europe launched their first system with a discretionary model with laudable aims to maximise consumer protections, and most have moved away from these, because of six major arguments which have empirically emerged to make a strong case that rules-based systems are superior and offer greater protections and benefits to consumers:

- **The cost argument:** There is little doubt that a system which presents opportunities for highly paid professionals to spend significant periods of time deliberating over the precise

terms of often fairly standard cases is more expensive than the simple application of a set of rules.

- **The timeliness argument:** Again, the quick resolution of cases presents greater benefits to consumers and lenders than the marginal adjustments to their treatment which may occur under a discretionary system.
- **The certainty argument:** It is a sad reflection on the circumstances in which many consumers who enter debt solution processes find themselves that the fact a judge has discretion over their eventual solution is seen as more of a potential threat that introduces uncertainty over what they will have to ultimately pay, rather than a chance to get a better solution applied to them. This may appear counter-intuitive but has been noted in several jurisdictions. Equally, creditors deserve certainty too. A system which includes judicial discretion is a system which includes sufficient uncertainty for creditors to be unable to accurately forecast losses and build these into the prices of their products.
- **The inequality argument:** Discretion allows for variation in the solutions given to different people. In some contexts this can be viewed as a positive but it can equally be seen as a negative. Inequality of outcome bas**ed on geography, the identity of** the judge, or some other essentially irrelevant factor is the most important reason to oppose discretion in the debt solutions systems.
- **The parsimony argument:** When judges and other administrators are left to their own devices, they often subject debtors to budgets that are totally unreasonable and unworkable.

For these reasons, it is clear to the authors that **best practice must be the transparent application of clear rules through the quickest and most efficient process necessary.** We will consider the characteristics of such a system below, but before we do we feel it is also necessary to address the other major debate within European debt solutions systems, namely, should debt solutions be a mechanism of consumer protection, which aims to resolve difficulties individuals face, or should it retain its original character of a system of punishment to enforce the contracts made in law between lenders and creditors to preserve creditors property rights and prevent other consumers believing they may be able to avoid honouring their commitments.

Accessibility

How accessible should debt solutions be is a fundamental which European legislators have grappled with since Bang-Olsen published his seminal paper in 1972. In essence this boils down to the simple question of whether in a modern consumer credit economy, consumers who find themselves suddenly and unexpectedly facing over-indebtedness, not because of fecklessness or bad behaviour, but rather because of unemployment, family breakdown, or illness, should be judged and stigmatised in relation to their resultant debts when they simultaneously receive universal entitlements to state support and welfare in relation to these root causes of this debt problem?

European legislators have repeatedly looked at the trade-off between remedying these social ills against the costs to creditors of loss of property through discharging of debts. Consideration of the case, in line with the fairness principle described above has almost always led to the same conclusion, which is that the marginal benefits of accruing additional cents in the Euro is barely sufficient to merit the costs to lenders of trudging through the thankless requirements of taking legal action to enforce their claim, let alone the impact of immiserating debts on consumers and their consumption of public services, however, that is not to disregard those consumers who do take on debts to spend recklessly and then seek those debts' annulment. Any best practice regime must

recognise the claim of the vast majority of consumers to fair treatment, but also must be able to handle the minority who bring the indebted a bad name.

In line with the fairness principle therefore, **debt cancellation is not, and should not be, an automatic right, but it should be presumed that someone applying should have access to it unless a lender can demonstrate objective evidence of 'bad faith' by the borrower.** There is evidence from several countries that 'good faith tests' are problematic[429] as it is trying to prove a negative, whereas a 'bad faith test' can be simpler – the need to prove the consumer did do something, as opposed to having not done something. The bar for behaviour to be classified as 'bad faith' should be set high, capturing clearly deviant behaviour, not merely living beyond one's immediate means, to allow as many consumers access to debt cancellation as possible. **The application process should give lenders a time-limited opportunity to raise concerns about an applicant's behaviour, to minimise administrative cost and allow consumers quick access to relief and administrators will need to be able to reject applicants whose behaviour has been found wanting.** This defends the rights of the creditor, protects those who need protecting, and allows society to punish those who deserve punishment.

The trade-off between creditors and debtors

There is an important corollary to the presumption of good faith, which is that those who go through the process are by definition defined as those who acted in good faith. It therefore appears perverse that we should 'label' such people as '*bankrupts*' and stigmatise them when we would never consider doing so to '*benefit receivers*', or the '*long-term unemployed*', or the '*divorced*'. Therefore the logical conclusion, in terms of the coherency principle, the harm minimisation principle and the fairness principle, is that **the use of stigmatising labels should be ended** particularly where this prevents the consumer finding employment or a second job, which would increase their income and allow them to repay more of their debts, as has been identified by consumer associations in response to the 2012 proposed reform in Germany. **As such, we should remove the pejorative term 'bankruptcy' from debt solutions for consumers and replace it with the more neutral 'debt adjustment',** in an effort to break the association with mis-behaviour, fecklessness and criminality.

The rights of the creditor mentioned above are an important aside we need to ensure we have addressed at this point. **The creditor must be protected when the debtor has acted in bad faith, but in return for this it is only fair creditors must accept the responsibility that where their inappropriate lending has contributed as a cause to the problem of over-indebtedness they should bear some of the costs of resolving this problem.** The authors recognise that this statement is necessary to say but is also too simplistic. *If we argue that many consumers fall into over-indebtedness through no fault of their own, because of life-changing life events, it would appear perverse to somehow insist that we should expect the creditor to bear the costs when, in lending, they also acted in good faith.* The argument we present is merely an articulation that **best practice requires a compromise between the debtor and creditor; the debtor must pay what he can and the creditor must accept that as the best resolution they can receive, for in the end there is no more funds for them to access, so it is better for them to cut their losses, stop paying legal fees and allow as rapid a discharge of unpayable debts as possible.** This underlying lesson, we would argue has driven almost all reforms in Europe since the 1990s, that it is better for both the creditor and the debtor to accept the reality of the situation they seek as quickly as possible, and write off as

[429] See Kilborn (2010b)

unpayable those debts which are not, in all likelihood ever going to repaid, even if the debtor is put through a long and onerous process[430]. This logic is supported by the fairness, functionality, and affordability arguments, in delivering a fair solution to both lenders and borrowers, which operates effectively and efficiently.

The role of the judiciary

Returning to the characteristics of a best practice rules-based system, the next aspect of best practice we have identified emerges from the following considerations:

- Court based solutions are almost inevitably, due to the present of highly trained and paid legal professionals, more expensive than out of court solutions.
- Out-of-court solutions are seen as being preferable in many countries because they are quicker and simpler to understand than going through court.
- There is evidence from numerous jurisdictions which have attempted to have out-of-court regimes co-exist with judicially-led, court-based solutions, that this model is intrinsically unsustainable. The major issue is that if an out-of-court regime is to work it must have one of two defining characteristics:
  - It must be able to impose a settlement (through a cram-down on either creditors or debtors) on all agents.
  - It must have no alternatives that agents who are unhappy with the settlement can flee to and seek a better settlement.

  The first of these leaves no work for a court-based system to do, and the second identifies the existence of a court-based option as a major reason why agents choose not to accept the out-of-court settlement, which is the preferred outcome.
- If you have a sufficiently transparent rules-based system, designed to remove conflict and dispute from the process by giving all agents clear sight of the treatment they can expect to receive, is there then a remaining judicial role, that is essentially a dispute resolution forum for complex issues where ambiguity and different points of view exist? By making debt cancellation a rules-based procedure the case for having a judicially-led forum playing a role which goes beyond adjudicating on appeals on the application of the process and mis-administration no longer appears justifiable, both on grounds of logic and on grounds of cost.

Therefore, **best practice appears to be an administratively led debt cancellation process without recourse to a judicially-led court-based venue except for appeals against the mis-application of the due process, such as already exists in Sweden and France.** This has the benefit of correcting the incentives facing lenders who go into out-of-court, administrative processes with the deliberate aim of resisting whatever compromise or offer is made to force the debtor to go to court and be publicly shamed and stigmatised. In a system without recourse to public, court-based shaming, or the stigmatisation of labelling, and where the feckless do not have access to the solution anyway, we hope the creditors would better focus on the case in hand rather than trying to scare other potential 'bad-faith borrowers' who may be potentially about to face the problems of over-indebtedness.

[430] As one interviewee colourfully put it; '*you cannot take the clothes from a naked man*.'

The powers of the administrative body

To be effective, we consider that the powers of this administrative body need to be clearly articulated. The powers which are most important are:

- **The debt counsellor who leads the administrative process should determine the route / solution applicable to the case, rather than the consumer or the debtor:** This argument is driven by two points. Firstly, the counsellor will have greater experience to know which route is likely to be most efficient and effective. This would give the benefit of fewer solutions collapsing because the consumer cannot meet their requirements. Secondly, the more we see debt cancellation as a part of the consumer protection / welfare system, the more we should treat it as such. We would not expect consumers to pick and choose which benefits they should be entitled to, and we should not give them this choice in this area either. Debt cancellation is not a right and it can be painful. Removing stigma does not imply this should be a process without pain, merely that this pain should be managed and not excessive, on both the consumer and the creditor.
- **The debt counsellor should have the power to attach earnings:** The debt counsellor should administer a payment plan, using attachment of earnings to remove excess earnings from the debtor to collect funds to reimburse the creditors as far as possible. This appears the most efficient way to run a large body handling large numbers of payments, permitting as much automation as possible. **There should be transparent rules on exempt income based on social benefit levels, taking account of the number of children and/or a partner, and the impact these have on social allowances.** This issue also raises the issue of partner's income into a family where an individual is in debt and seeking relief. This is an interesting area rarely directly addressed in the literature we have reviewed, and is obviously closely intertwined with similar issues in terms of family finances such as the treatment of tax and tax allowances in terms of transferability between spouses. Whether debt solutions should be targeted at the individual or the partnership is a question which also veers closely to corporate insolvency issues within limited partnerships. In almost all situations it appears that the usual approach is to address the individual as, particularly business partners, may have other income / assets which may mean they are not insolvent even if their partner may have reached this state. Clearly the earned income of the partner/spouse is entirely separate (the fruit of their own labours) from the income of the debtor, the key issues are whether the debt is shared and any assets are shared, and how much the partner can be looked to, either in terms of committing their income or shared assets to the payment plan. Generally we do not see partner/ spouses being looked to, if the debtor has claimed sole authority for the debt, and this appears at first blush to be appropriate, leaving the question of how assets are treated, in terms of who owns them between the debtor and their spouse, and this spurs us to our next consideration.
- Administering an estate, and liquidating assets which are often worth very little is a pointless and expensive process which demeans the citizen and gives little back to the creditor. **The debt counsellor should only have the right to liquidate assets worth, on their own, over a substantial threshold.** The authors suggest this should be at the £2,000 /€2,500 level in 2012 prices.
- **The debt counsellor must have the right to impose a 'cram-down' on creditors:** To make the system work, if the debt counsellor has concluded the payment plan which sets out what will received by which creditor is the best available, and complies with the clear rules already laid down, and that it is in the interest of debtors, creditors and society to see that payment plan taken up, then it is hard to see why creditors, either together, or on their own, should have the right to reject the package. To preserve the fine balance of rights and

impositions on consumers and creditors we can see the logic in permitting creditors or consumers to appeal to a court if they believe the process through which the payment plan has been created has not complied with the rules then there should be a right to appeal on these grounds, as in Sweden, but not on the contents of the plans, except insofar that the process was flawed and did not reveal some source of income which should have been included in the plan, or that the plan does not comply with the rules. **Creditors and consumers should therefore have the right to appeal to a court on the grounds of compliance with the process.**

- Debt counsellors should discharge any debts which will not be paid by the end of the agreed payment plan. Payment plans should be of a common duration across Europe. The question of how long this discharge period should be is a fraught. Many learned contributors to this debate over the years have argued that three years is a sufficiently short enough period to benefit consumers whilst still giving creditors some recompense. The authors have sympathy with this argument but regretfully note it is a theory which fails the obvious empirical challenge that England and Wales have operated a one year discharge for ten years and it would be inequitable for one group of consumers to be eligible for this and their children to face harsher conditions. **As with countries such as Denmark and the UK where payment plans occur post-discharge, discharge should occur one year into a three year payment plan. This has the merit of aligning discharge at the lowest common denominator whilst still ensuring creditors have access to excess earnings for three years**. This gives consumer faster relief from their debts, but counter-balances this with a remaining responsibility to continue to make payments in good faith on the threat of having the discharged debt re-established if the terms of the payment plan are not complied with. In this case, debt counsellors would need to have the power to amend the payment plan in years two and three if the consumer faced another life-changing event, which made meeting the original terms impossible, which was not their fault.
- **The debt counsellor should have the power to impose a 'zero-plan' where there is no chance of the consumer being able to make payments. Zero-plans should include immediate discharge**, as there can be no justification for prolonging the process for a consumer who have been independently assessed as incapable of making payments. The key decision here is the cut-off point for eligibility for a 'zero-plan.' In the Netherlands, for example, payment plans can already be terminated if the debtor cannot make a 'significant contribution' towards meeting their debts. Again, **in terms of efficiency, the authors see the merit of this, and would argue that if a consumer cannot over three years repay either 10% of their total debt or €10,000, whichever is lower, then a 'zero-plan' should be imposed, as the case for employing a public official to resolve cases smaller than this appears to be poor value for money.**

The authors also note that many countries have some debts which consumers are not able to escape, and there are good reasons for this. **Child / dependent maintenance payments appear to obviously be deserving of inclusion in this exemption. We cannot see a case for student loans to merit exemption from debt cancellation.** Taxes, the authors feel, as they represent a 'membership-fee' towards the society which has remitted the consumer's debts should be honoured in theory, but clearly where taxes represent a large share of their over-indebtedness, it is a bridge too far to expect these to be exempted. **There is a case that society, which has established the debt cancellation system, would benefit most if unpaid taxes were given a priority in payment plans over private debts, and we offer this forward as a provisional best practice.**

Best Practice at the European level

In addition to the above we also considered the application of the European Insolvency Regulation, which whilst originally designed to help creditors, because it caught processes to which natural persons can avail themselves, has opened the door to the trade in '*bankruptcy tourism*.'

The European Union Council Regulation on Insolvency Proceedings and cross-border issues

European countries each have their own laws relating to consumer over-indebtedness, but, aside from Denmark, which has an exemption, all the countries studied here are caught by the European Union Council Regulation on Insolvency Proceedings[431], which had the three goals of:

- Providing legal certainty in matters of cross-border insolvency;
- Promoting the efficiency of insolvency proceedings, by favouring those solutions that facilitate their administration and improve the *ex ante* planning of transactions; and
- Eliminating inequalities amongst EU-based creditors with regard to access to and participation in such proceedings.

This regulation did not attempt to impose a common system on different European countries, but instead to ensure that bankruptcy / insolvency proceedings opened in one Member State would be recognised in all other Member States[432].

The regulation was clearly drafted with corporate insolvency in mind, and from a creditor's perspective[433], but because the issue of who may be a 'bankruptcy debtor' is determined under national law (article 4.2 (a)), and because many countries, such as the UK and Ireland, permit both legal persons (i.e. firms) and natural persons (i.e. consumers) to qualify for their bankruptcy arrangements, this therefore means that any European consumer[434] who meets the qualification criteria (i.e. residency for set periods etc) of a country which does permit consumer bankruptcy does presently has the ability and right to access this, effectively making their domestic legislative position irrelevant, as the regulation outlines that the domestic law of the country where the case is opened (*lex fori concursus)* is applicable to the proceedings which then follow[435], and their conclusions, as long as the individual has established a '*centre of main interest' (COMI)* in the relevant jurisdiction.

Of course, the differences across Europe, in relation to whether natural persons can receive debt cancellation, and in terms of the frequency of reform, combined with this capacity for individuals to move COMI to gain access to different systems, and the fact that in some countries creditors as well as debtors can open proceedings, makes this a very complex field and gives rise to potential outcomes, for example '*bankruptcy tourism*', more detail on which is given in Annex 10.

[431] Council Regulation (EC) No. 1346/2000 of 29.05.2000 on Insolvency Proceedings, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:en:PDF.

[432] It also covered issues of conflict between jurisdictions and assets held in other Member States.

[433] All three goals relate to creditors, not debtors.

[434] Excluding the Danish.

[435] As long as these are listed in Annex A (insolvency proceedings) or Annex B (winding-up proceedings) of the Regulation, which, between them, give a 'closed-list' of applicable proceedings.

A further issue is that the regulation does not prevent proceedings being opened in different countries. Whilst the primary (i.e. first) proceeding has primacy and is the 'insolvency proceeding', further 'winding-up' proceedings can be opened in other countries. This causes the greatest confusion where countries have proposed the same proceeding to be both an 'insolvency' and a 'winding-up' proceeding, as in for example Spain, where *concurso* is in both Annex A & B, or Germany, where *Insolvenzverfahren* is in both Annex A & B, which may raise problems in other countries as to the exact roles being performed.

This, in the opinion of Kilborn (2010b) is '*not likely to be a problem for those countries where debt cancellation is just one aspect of a general insolvency procedures (e.g. Germany, Austria, Estonia, Poland, Portugal, Slovenia, Slovakia), or who have mentioned their specific debt adjustment procedure in Annex A (e.g. Belgium, the Netherlands, the Czech Republic, Latvia). In France, Finland, Luxembourg, [Greece,] and Sweden on the other hand, where debt adjustment is the subject of a separate non-insolvency law, these procedures are not mentioned in Annex A... and so the cross-border portability of a discharge in these states is at least unclear, If not doubtful*'. Similarly, Denmark currently opts out, although the authors are unclear what advantages this gives Denmark.

Therefore whilst this regulation in theory allows any European citizen access to the most liberal of bankruptcy laws, it requires citizens to move country, establish a 'centre of main interest' and live in that country for some months. In other words, it has created one system of bankruptcy for the rich, who can afford to move, and another for the poor. This inequality appears unacceptable. **A good first step would be to update the list of procedures in Annex A of the regulation to include relevant processes where these are missing[436].**

6.1.3 Comparing our best practice model with the most recent proposed legislation

At the conclusion of the data-collection phase of this study, Germany announced a proposed reform to its system, which contained a number of reforms which conflict quite markedly with our proposed best practice model, in particular:

- Abandoning out-of-court settlements in 'hopeless' cases
- Removing 'cram-downs' to give creditors more rights.
- Creating ambiguity about the official view of how exempt 'exempt income and assets' really are.
- Permitting a complex menu of discharge options including:
  - an immediate discharge in cases where it is impossible to see any payment,
  - a three year discharge if costs plus 25% of outstanding debts have been re-paid,
  - a five year discharge if costs have been repaid, or
  - a six year discharge where the debtor has been unable to even cover court fees.

[436] This, in the opinion of Kilborn (2010b) is '*not likely to be a problem for those countries where debt cancellation is just one aspect of a general insolvency procedures (e.g. Germany, Austria, Estonia, Poland, Portugal, Slovenia, Slovakia), or who have mentioned their specific debt adjustment procedure in Annex A (e.g. Belgium, the Netherlands, the Czech Republic, Latvia). In France, Finland, Luxembourg, [Greece,] and Sweden on the other hand, where debt adjustment is the subject of a separate non-insolvency law, these procedures are not mentioned in Annex A... and so the cross-border portability of a discharge in these states is at least unclear, If not doubtful*'. Similarly, Denmark currently opts out, although the authors are unclear what advantage this gives Denmark.

Given that almost all reforms we have identified have moved in the direction of compliance with the best practice model we have identified, and which sees its clearest examples in Sweden and France, to find an example of a major economy moving in the opposite direction of travel.

We have sought further evidence from Germany and whilst we do not have absolute clarity over why this approach has been chosen over others, it is clear to us that the fundamental difference is not the objectives which are being targeted by the German Government, which appear very close to those we have used to define best practice, but rather a set of assumptions concerning judicial involvement in the process.

At its simplest, both our model and the German model attempt to re-invigorate out-of-court settlements as the preferred method of dealing with bankruptcy cases, which we both recognise are not working fully effectively in many countries. We seek to do this through abolishing alternatives (i.e. the court-based route) and giving the administrative body responsible for delivering out-of-court plans the key tools necessary to impose plans where necessary and force a resolution. The German model appears to take a different route, of attempting to maintain out-of-court settlements as a consensual mechanism where creditors and lenders can reach common agreement, where it is not necessary to impose a settlement through a cram-down, by attempting to remove from out-of-court agencies responsibility for those cases where they most obviously fail to reach a consensus agreement. The German model clearly sees out-of-court and judicially-led court-based solutions operating in tandem to resolve cases, with out-of-court processes having a subsidiary role to the courts to achieve what they can in the cases they can and pass the rest to the court as the appropriate place to resolve disagreement between agents in terms of what is a fair settlement.

In short, the German proposals are predicated on the implicit assumption that whilst preferable, out-of-court mechanisms are failing and cannot be repaired sufficiently to deliver the tasks they were originally designed to carry out, and the best response to this is to use the existing court-based mechanisms to replace the out-of-court process where it has proved itself unable to resolve those cases.

Conversely our proposals are predicated on the implicit assumption that whilst preferable, out-of-court mechanisms are failing because they currently do not have the tools to do the job required of them, and also because as long as a court based solution exists lenders have incentives to refuse to agree and force the case into the courts, at the least as a form of punishment for debtors. As such, we consider the best response to this is to remove the existing court-based mechanisms, and give the out-of-court administrator powers to force cases to a successful out-of-court resolution.

This difference of assumptions is based on clearly differing assessments of the existing evidence. We have looked to Sweden, France, Denmark, the UK and the Netherlands to deliver us the main building blocks of our proposals in terms of the design of the best practice regime. The most important of these in this respect is the Netherlands, which has moved to offering ‘zero-plans’ / immediate discharge when a ‘significant contribution’ cannot be made by the debtor, so that a full discharge is offered even if some small fraction of the debt could have been repaid. German proposals reference the Austrian and Lithuanian systems, despite the Austrian system being criticised by its domestic consumer associations, particularly in terms of the hard 25% minimum repayment requirement before a three-year discharge is offered.

This variation in approaches across Europe is clearly in part driven by a second implicit assumption that we can discern under the German proposals, which is where is the appropriate balance between creditors and debtors to be struck: the German proposals look to reinforce creditors rights

when it is arguable that, with a standardized six year discharge, confiscation of assets, payment plans and incentives to work harder in the form of payments back to the debtor of set percentages of his contributions to the trustee in the later years of his bankruptcy period, German creditors already have far more significant rights than their counterparts in many other countries. As such the bankruptcy tourism issues identified above, of some relevance to Germany, are unlikely to be fully resolved by this reform.

As such, we can see that differences in a very small number of key assumptions can fundamentally change the model implemented. We recognise that the best practice model as described above is a very challenging one, but for the reasons we have argued we consider it to be the model most likely to deliver a fair, functional, affordable solution which meets the needs of both debtors and creditors.

6.2 *Datio in solutum*

This argument which has been applied to debt solutions in previous chapter of this report, reflects the fact that in a modern consumer credit society, where large portions of the population have taken out significant debts, moral hazard runs in both directions;

- Consumers need to expect to be required to pay their loans back, as routes which make them eligible to not make payments (i.e. debt solutions) may encourage others to not pay.
- Credit providers face the trade-off that they need to ensure that they have lent to those who can repay, but under the need to make profits have incentives to push the boundary and lend to consumers who may be less likely to be able to keep up with repayments. Therefore solutions need to be put in place to prevent reckless or inappropriate lending by ensuring the lender will make losses if they do so.

The primary supporting benefits for consumers from *datio in solutum* is that those who face large mortgage debts and whose property asset is worth less than the debt can have the residual debt cancelled by transferring the property to the lender, in full payment of the debt. As such, consumers who have found themselves in such a position are able to benefit, in much the same way as a consumer benefits from any debt solution which cancels an unpayable debt. *Datio in solutum* is one method achieving this aim.

As concluded in Chapter 4, in consultation with recognised experts in the field of comparative European mortgage market studies:

- There currently exists no European country which has a strong application of *datio in solutum* enshrined in legislation, covering all mortgages in that country.
- Equally, we have not been able to identify any country or state in the world which has a strong application of *datio in solutum* enshrined in legislation.
- The only country in the world where we can identify a weak application of *datio in solutum* enshrined in legislation is Spain. This is extremely limited in terms of who can apply to it and the requirements those borrowers must meet before they become eligible to use this solution. In the USA we have found example of non-recourse mortgages, where payment in kind of this type is included in the contract and costed in.

- Most European countries have not considered *datio in solutum* because they have developed systems which preclude the need to have a specific solution for residual debt following enforcement against a mortgage.

In Spain neither lenders nor consumer associations are satisfied with the current legislation and the particular design of the *datio in solutum* model in use. CECA suggest that were *datio in solutum* mandatory, it would benefit very few people (around 2.5% of defaulters) and could be detrimental for many consumers through higher borrowing rates, shorter terms and lower Loan-To-Value mortgages. Meanwhile ADICAE, a consumer organisation, feel that the current rules are over-restrictive and fail to help many consumers in difficulty and point out that a solution which involves the consumer losing their property is not necessarily the best option to help consumers. Reviewing cases of those who have asked ADICAE for assistance, only 12.8% met all the requirements necessary for eligibility for *datio in solutum*. The 87.2% who did not meet the necessary requirements failed for the following reasons[437];

- In 5.8% of cases the problem was not with the family residence.
- In 17.4% of cases the family had too many household assets.
- In 47.8% of the cases not all the members of the household were unemployed.
- In 32.2% of cases the mortgage payment did not exceed the 60% of the total income of the family unit.
- In 40.2% of cases there were guarantors on the loan. These only met the requirements set in 44.1% of the cases involving guarantors.
- 58% of the cases exceeded the maximum price set for the home purchase.

The terms of reference require us to review the application of *datio in solutum* and considers it in relation to the impact on consumers, particularly whether and how it can deliver benefits to consumers. Given the limited evidence our primary assessment agrees with the responses from Spain that the model being currently used in Spain, which has such restrictive criteria that only a small fraction of *those seeking help with problematic mortgage debt,* and which requires consumers to lose their home in exchange for relief is not best practice.

Given this, we can still consider *datio in solutum* from a conceptual point of view, in comparison to the other models identified in this study in paper to see if a less restrictive / better designed *datio in solutum* model could deliver benefits to consumers.

To do this we have broken our analysis into the following parts:

- The gross benefits to consumers[438], comparing these to other policy instruments
- The net benefits to consumers, taking account of any costs *datio in solutum* and the other policy instruments may impose
- The net social benefit taking account of the costs and benefits falling on agents other than consumers.

In doing so we assess whether *datio in solutum* delivers benefits compared against[439]:

[437] Many failing against multiple criteria.

[438] Throughout this section we assume no mis-selling of mortgage products. We do this on the logic that the best method for addressing the impact on consumers of mis-selling is through regulation and policing how mortgages are offered, rather than through a debt cancellation solution.

- **A country with a full, best practice debt cancellation / personal consumer bankruptcy mechanism, as described in section 6.1.2:** This would be a fast, cheap system, involving a payment plan, which does not stigmatise those who use it, with clear results for both lenders and debtors based on the application of rules, without entry restrictions unless a lender can prove a debtor took out debts in bad faith.
- **A country with a traditional debt cancellation / personal bankruptcy mechanism:** This is a slow, relatively expensive system, involving a payment plan and asset liquidation, applies some degree of stigma to those who use it, with some degree of judicial discretion and 'good faith' entry restrictions.
- **A country without a debt cancellation / personal bankruptcy mechanism:** This is a system which does not provide a mechanism for consumers to cancel debts, placing long-term burdens on consumers to do what they can to service their debts for life.
- **A mortgage market with statutory forbearance requirements laid down in legislation:** This compares *datio in solutum* to a proposal from ADICAE not to a generic debt solution, as above, but instead to an alternative mortgage market specific reform, where legislation is laid down to require lenders to allow borrowers who run into difficulty access to a forbearance mechanism, such as a moratorium on payments, extended terms, a temporary shift to interest-only mortgages or similar arrangements.
- **A mortgage market with borrower's liability limited only to the asset/property secured to the debt in the case of borrower-led enforcement against the property:** This again compares *datio in solutum* to a proposal from ADICAE, which applies strictly just to the mortgage market. Whilst a lender with a secured debt has additional rights over unsecured lenders through the association of the property with the loan, he does not currently share the risk the consumer faces on the property, in that if the value of the property falls below the outstanding loan, the consumer continues to be liable for this residual, to be funded from future income or other assets. *Datio in solutum* shares this risk with the lender by allowing the borrower to transfer the property in full payment of the mortgage, irrespective of the value of the loan or the property. This option transfers the decision-making power to the lender, such that, if he enforces / forecloses / repossesses the property, he has to take it in full payment of the loan, and cannot hold the consumer liable for any residual. The key difference here to *datio in solutum* is that this changes the incentives on lenders to enforce against the property as the bank would automatically take over the risk on the property.

[439] Although we have not directly compared it to *datio in solutum,* there is a concept being considered in the UK, of insuring against negative equity based on the numerous papers written by Robert Shiller on this topic (see particularly Shiller and Weiss 2001). This would make *datio in solutum* unnecessary for those who held such insurance which would re-imburse the residual debt. The key questions are:

- Should the insurer insure the full value of the negative equity, or should he only insure up to some share, such as 90%? This means the consumer would still lose out were he to incur a negative equity debt, incentivising him to make payments as far as possible, and delay moving until the property has increased in value, if at all possible, and to not accept low bids on the property to facilitate a quick move, knowing the shortfall will be refunded through the insurance.
- An event which has already occurred cannot be insured. As such, negative equity insurance would not benefit these people. There is a case to argue that in some parts of Europe insurance may be too little, too late.
- There is a risk of mis-selling. Which consumers should take out such insurance? What advice should they receive to make the decision whether it is right for them and their circumstances?

6.2.1 The gross benefits of *datio in solutum* to consumers.

In this section we compare datio in solutum in turn to the other options to test which deliver**s greater benefit to consumers in relation to the following areas:**

- The right to cancel mortgage debt
- The right to cancel non-mortgage debt
- The speed of debt cancellation
- Transaction costs faced by the consumer
- Whether the consumer loses their property
- Whether the consumer has to meet a payment plan
- Whether the consumers other assets are liquidated
- Whether there is stigma attached to consumer from using the process
- Whether there is clarity for the consumer in terms of the expected outcome
- Whether there are entry / eligibility restrictions

Comparing benefits to a full, best practice debt cancellation process.

- **Right to cancel mortgage debt:** In this system the debtor would already has the right to cancel the residual mortgage debt. Once the property has been enforced against, or handed over to the lender, if there is a remaining debt it is no longer a *secured* debt as there is no asset to secure the debt against. As such, the residual debt becomes an unsecured debt, and is eligible for the debt cancellation process. There is therefore no additional benefit to *datio in solutum* for debtors in this circumstance over this solution.
- **Right to cancel non-mortgage debt:** *Datio in solutum* does not permit the cancellation of non-mortgage debt, so therefore presents lower benefits for debtors who have more than just mortgage debt than this solution.
- **Speed of cancellation:** Because the debt solution is fast, and does not have prolonged discharge periods, the additional benefit of an instantaneous process such as *datio in solutum* is real but low.
- **Transaction costs:** In both debt cancellation and *datio in solutum* the transaction costs (the cost of going through the process) is low, although *datio in solutum* is effectively free at the point of transfer, giving an additional benefit to the debtor.
- **Loss of property**: The property is lost in both, so *datio in solutum* presents no additional benefit.
- **Payment plan:** The best practice debt cancellation process involves a three year payment plan, whereas *datio in solutum* makes no such requirements, so *datio in solutum* presents a benefit for consumers.
- **Asset liquidation:** Neither process requires other assets to be liquidated, so there is no additional benefit to *datio in solutum.*
- **Stigma:** Because both processes are designed as being non-stigmatising, there is no additional benefit to *datio in solutum*.
- **Clarity of outcome for consumers:** In terms of gross benefits both *datio in solutum* and debt cancellation present clarity of outcome, so there is no additional benefit to consumers of *datio in solutum*.

- **Entry restrictions:** A weak form of *datio in solutum* would have tighter entry restrictions that a best practice debt cancellation process, and therefore lower benefits to debtors than the debt cancellation process. A strong *datio in solutum* would have the same open-access as the debt cancellation approach, and therefore no additional benefits.

Comparing benefits to a traditional debt cancellation process.

- **Right to cancel mortgage debt:** Again, in this system the debtor already has the right to cancel this debt through pre-existing methods. There is therefore no additional benefit to *datio in solutum* for debtors over this model.
- **Right to cancel non-mortgage debt:** *Datio in solutum* does not permit the cancellation of non-mortgage debt, so therefore presents lower benefits for debtors for debtors who have more than just mortgage debt than this model
- **Speed of cancellation:** Because the debt solution is slow, normally involving court hearings etc, and may have prolonged discharge periods, there are clear additional benefits of an instantaneous process such as *datio in solutum*.
- **Transaction costs:** In debt cancellation, the costs may be quite high compared to *datio in solutum,* therefore *datio in solutum* gives additional benefits to the debtor.
- **Loss of property**: The property is lost in both, so *datio in solutum* presents no additional benefit.
- **Payment plan:** The best practice debt cancellation process involves upto a seven year payment plan, whereas *datio in solutum* makes no such requirements, so *datio in solutum* presents a benefit for consumers.
- **Asset liquidation:** The debt cancellation process requires other assets to be liquidated, the avoidance of which is a key rationale for *datio in solutum*, so this is an area of additional benefit from *datio in solutum.*
- **Stigma:** Because this model can be stigmatising, there is an additional benefit to *datio in solutum*.
- **Clarity of outcome for consumers:** Because judicial discretion creates potential uncertainty, there is additional benefit to consumers from *datio in solutum*.
- **Entry restrictions:** A weak form of *datio in solutum* would have tighter entry restrictions that a traditional debt cancellation process, if we use the Spanish model as our template, and therefore lower benefits to debtors than the debt cancellation process. A strong *datio in solutum* would have easier access, as there is no 'good faith test' to overcome and therefore gives consumers additional benefits.

Comparing benefits to no debt cancellation process.

- **Right to cancel mortgage debt:** In this system the debtor does not already has the right to cancel this debt through pre-existing methods, therefore *datio in solutum* presents additional benefits for debtors.
- **Right to cancel non-mortgage debt:** *Datio in solutum* does not permit the cancellation of non-mortgage debt, so presents no additional benefits for debtors for debtors who have more than just mortgage debt over this solution.
- **Speed of cancellation:** Because there is no debt solution, *datio in solutum* is faster and gives consumers additional benefit.

- **Transaction costs:** There are no transaction costs in either circumstance, so *datio in solutum* presents no additional benefits to the debtor.
- **Loss of property**: In this situation, it is highly likely the secured lender will foreclose if the debtor is unable to maintain his payments, as he will have first claim on the secured asset, and if he is operating a *hypotec*[440] he is likely to be able to promote his other claims against the debtor other those of other lenders. As such, the property is best assumed to be lost in both, presenting no additional benefit.
- **Payment plan:** Neither includes a payment plan, so there is no additional benefit from *datio in solutum*.
- **Asset liquidation:** Neither includes generic asset liquidation, so there is no additional benefit from *datio in solutum*.
- **Stigma:** This situation leaves debtors in debt and facing adversity. Insofar as this produces stigmatisation, there is an additional benefit to *datio in solutum*.
- **Clarity of outcome for consumers:**I In the absence of a mechanism to address debt consumers have great uncertainty, so the clear cut-off which *datio in solutum* delivers is an additional benefit to consumers of *datio in solutum*.
- **Entry restrictions:** A weak form of *datio in solutum*, which permits only some people to cancel debts is still better for consumers than no process for cancelling debt, so there are additional benefits for both strong and weak *datio in solutum*.

Comparing benefits to statutory forbearance.

- **Right to cancel mortgage debt:** In this system the debtor does not have the right to cancel this debt, but would be able to attempt gain relief on their mortgage debt through re-designing their mortgage to better live within their means. As such we argue that statutory forbearance presents equivalent benefits to *datio in* solutum
- **Right to cancel non-mortgage debt:** Neither *datio in solutum* or statutory forbearance permits the cancellation of non-mortgage debt, so presents equivalent benefits.
- **Speed of cancellation:** Because statutory forbearance does not cancel debt, *datio in solutum* presents additional benefits.
- **Transaction costs:** There are no transaction costs in either circumstance, so *datio in solutum* presents equivalent benefits to the debtor.
- **Loss of property**: Forbearance which delivers a viable re-structuring of debt means the debtor does not lose their property, which is a consequence of *datio in solutum.* This model therefore presents an additional benefit over *datio in solutum*.
- **Payment plan:** Neither includes a payment plan, so there is no additional benefit from *datio in solutum*.
- **Asset liquidation:** Neither includes asset liquidation, besides the property, so there is no additional benefit from *datio in solutum*.
- **Stigma:** This situation leaves debtors in a position of being able to handle their debts without losing their home, and therefore gives additional benefits compared to *datio in solutum*.

[440] For the importance of this, see section 6.2.2.

- **Clarity of outcome for consumers:** Statutory forbearance could have several options within it, so the clear cut-off which *datio in solutum* delivers is an additional benefit to consumers.
- **Entry restrictions:** Statutory forbearance would be open to any consumer, which is a benefit compared to a weak form of *datio in solutum*, which permits only some people to cancel debts. There is no additional benefit over strong *datio in solutum*.

Comparing benefits to consumer limited enforcement liability.

- **Right to cancel mortgage debt:** In this model the debtor does not have the right to cancel this debt, unless the lender has started enforcement proceedings against him, in which case the residual debt is cancelled. This is a directly equivalent effect to *datio in solutum*, the only difference being the agent who activates this cancellation. As such this provides equal benefits to *datio in* solutum
- **Right to cancel non-mortgage debt:** Neither *datio in solutum* or limited enforcement liability permits the cancellation of non-mortgage debt, so therefore presents no additional benefits for debtors who have more than just mortgage debt compared to each other.
- **Speed of cancellation:** *Datio in solutum* is faster than limited enforcement liability so presents additional benefits.
- **Transaction costs:** There are equivalent transaction costs in either circumstance, so *datio in solutum* presents no additional benefits to the debtor.
- **Loss of property**: Because these processes are equivalent this presents equivalent benefits to *datio in solutum*.
- **Payment plan:** Neither includes a payment plan, so there is no additional benefit from *datio in solutum*.
- **Asset liquidation:** Neither includes asset liquidation, so there is no additional benefit from *datio in solutum*.
- **Stigma:** This model leaves debtors losing their homes, exactly as they do in *datio in* solutum, so both give equivalent benefits.
- **Clarity of outcome for consumers:** Because these processes are equivalent this presents equivalent benefits to *datio in solutum*.
- **Entry restrictions:** Because this limitation would have to be written into contracts, one assumes it would be open to any consumer, which is a benefit compared to a weak form of *datio in solutum*, which permits only some people to cancel debts. There is no additional benefit over strong *datio in solutum*.

Transferring these results into tabular form for ease of comparison, we can see that in terms of gross benefits, with the five most important benefits, in our assessment highlighted in blue.

Table 14: Gross Benefits of *datio in solutum*

✔ = *datio* presents greater benefits than option	Best practice debt cancellation		Traditional debt cancellation		No debt cancellation		Statutory Forbearance		Limited borrower liability in enforcement	
X = *datio* presents fewer benefits than option	Strong *datio in solutum*	Weak *datio in solutum*	Strong *datio in solutum*	Weak *datio in solutum*	Strong *datio in solutum*	Weak *datio in solutum*	Strong *datio in solutum*	Weak *datio in solutum*	Strong *datio in solutum*	Weak *datio in solutum*
Right to cancel mortgage debt	-		-		✔		-		-	
Right to cancel non-mortgage debt	X		X		-		-		-	
Loss of property	-		-		-		X		-	
Clarity of outcome	-		✔		✔		✔		-	
Entry restrictions	-	X	✔	X	✔	✔	-	X	-	X
Speed of cancellation	✔		✔		✔		✔		✔	
Transaction costs	✔		✔		n/a		-		-	
Payment plan	✔		✔		n/a		-		-	
Asset liquidation	-		✔		n/a		-		-	
Stigma	-		✔		✔		X		-	

Comparing on the five main benefits above, we can see that strong and weak *datio in solutum* has benefits over some options and weaknesses compared to other options.

Table 15: Gross Benefits of *datio in solutum*		
	Strong *datio in solutum*	Weak *datio in solutum*
Best practice debt cancellation	Fewer benefits	Fewer benefits
Traditional debt cancellation	More benefits	Fewer benefits
No debt cancellation	More benefits	More benefits
Statutory Forbearance	Equal benefits	Fewer benefits
Limited borrower liability in enforcement	Equal benefits	Fewer benefits

In summary:

- *Datio in solutum* appears to have generally fewer benefits that a best practice debt cancellation method,
- Strong *datio in solutum* has many advantages over traditional debt cancellation methodologies.
- *Datio in solutum,* in terms of gross benefits, is unambiguously better than no debt cancellation.
- Weak *datio in solutum* appears to generally have fewer benefits than any alternative which includes putting a solution in place.
- Forbearance has equal benefits to strong *datio in solutum* and greater benefits than weak *datio in solutum,* as it does not involve the loss of the property. ,
- Limited *enforcement lia*bility is directly equivalent to strong *datio in solutum* except it is not the consumer's choice as and when to use it. Asuming it would be universally available, it presents greater benefits than weak *datio in solutum.*

On the basis of gross benefits, we therefore conclude that, for consumers, that strong *datio in solutum* presents greater benefits compared to the alternatives than weak *datio in solutum*, but that some of the alternatives present greater benefits to consumers than strong *datio in solutum.* We now assess the whether there are any costs to consumers which these models may introduce which we need to take into account.

6.2.2 The net benefits of *datio in solutum* to consumers.

In this section we outline any costs of *datio in solutum* to consumers which may mitigate the benefits which we outlined in section 6.2.1. The combined aggregate of these two sections presents therefore the total net benefits which fall on consumers from a possible implementation of a *datio*

in solutum solution[441]:

- **Uncertainty over further reform discouraging take-up:** *Datio in solutum* is a partial solution which does not solve the more general issue of over-indebtedness. Therefore implementating *datio in solutum* may create uncertainty, particularly as most European countries have demonstrated an iterative approach to debt solutions, with repeated rounds of new legislation being introduced. This may have the effect of discouraging those eligible for *datio in solutum* from taking it up in the hope that a more generous solution may shortly become available.
- Whilst *datio in solutum* present benefits to consumers in financial difficulty there is empirical evidence that **banks fund *datio in solutum* by increasing the cost of mortgage products**[442]. As such, there is a large benefit for a small set of consumers (albeit those in the greatest difficulty), and a small loss for another, larger set of consumers. We should consider this in greater depth:
  - **It is highly likely that *datio in solutum* makes mortgages more expensive for all consumers**[443]**,** however the evidence suggests that the additional cost is often lower than may be *a priori* assumed[444]. Because at the point of purchase all borrowers must have been assessed[445] as being safe enough to lend too, this means that *a priori* neither consumers nor lenders know who the cost of mortgage default will fall on, so it appears fair for it to be shared more equitably. Equally, any model which transfers risk or cost from the borrower to the lender is likely to have an impact on the cost of borrowing. The key issue is how distorting this effect is between the interest rate available on different types of loan:
    - A full debt cancellation regime, when introduced in a country which has no such system already in place, will have such an impact on all loans
    - A forbearance scheme will have such an effect on mortgage loans, although there should be hope for some return to the lender over time.
  - **Higher prices are to the detriment of consumers trying to access mortgages,** creating an 'access to the property market' argument against *datio in solutum* relating to those consumers who are not at risk of negative equity because of the type or location of the property being purchased, but who could not afford the higher fee level. Equally, it is possible that lenders may cease to offer mortgages or secured loans and move to a model more like one sees in France, whereby loans to acquire property are guaranteed unsecured loans, rather than mortgages, in which case *datio in solutum* would become ineffective.
  - *Datio in solutum* is a mechanism to impose on lenders and a wider pool of borrowers the true cost of over-valuation and poor lending decisions. Whilst this is a first order cost for consumers, who will have to face higher borrowing costs, **there is a second order benefit if this price increase and sharing of this risk acts to inhibit property price bubbles and leads to more rational property purchasing** decision

[441] And its cousin, the non-recourse mortgage
[442] This is because *datio in solutum* is effectively an additional insurance element built into a mortgage product. See Annex 5 and Levitin & Goodman (2008) and Levitin (2009) for evidence from American non-recourse mortgages.
[443] For two reasons; the first is the simple pricing of risk, outlined in detail in Annex 5, and secondly because of the impact on equity holdsing, as explained in Annex 6.
[444] Possibly because lenders already write-off a number of residual mortgage debts, particularly when the cost of pursuing them through the courts is close to, or greater than, the debt outstanding, meaning this cost is already built into loans.
[445] On the assumption that mis-selling is not in evidence. We consider better regulation of the mortgage market to be a better policy lever for addressing mis-selling issues than *datio in solutum*, because it better addresses the question in hand.

making through the internalisation of what, at the moment is to a degree an externality; a cost which is a result of a decision taken by the consumer which falls onto others.

- ***Datio in solutum* may increase the price of non-mortgage loans to consumers.** Banks have multiple relationships with clients, through loans, overdrafts and mortgages. This network of relationships led to the creation across Europe of 'all money charges', '*hypotecs'* or 'maximum amount mortgages'[446] which allow all the debtor's debts to the bank to be bundled into the first rank of claims[447], through the claim on the secured property. Effectively in cases of *hypotecs* allow other debts to become 'secured' on the property and eligible to be treating as a risk reducing factor in equity calculations[448]. *Datio in solutum* may therefore have a wider impact on the price of many types of loan, not just mortgages. However, this point again could be made for the other options described above.
- There would be a cost of consumers if lenders found a way to turn this tool back onto the consumer and use it to lever them into accepting things they otherwise would not; most obviously the risk that creditors may encourage a debtor with a range of debts to apply for *datio in solutum* rather than seeking cancellation of all their debts.
- The European Commission and European Parliament have both in recent years brought significant pressure to bear on the bundling of goods and services into financial products, as this is viewed as being to the detriment of consumers by reducing choice and competition. If *datio in solutum* is effectively an insurance product bundled into a mortgage product, guaranteeing no losses if the mortgage is enforced against, it would appear to breach this principle, and as with any bundled product of this nature, there is the risk of mis-selling, which would act to the detriment of consumers.

In summary, therefore, it appears that whilst there is a generic cost to consumers in terms of the impact on the price of loans, particularly mortgages, this effect may be shared by many of the options to a greater or lesser extent. Equally there may be some additional benefit from reducing irrational lending and some additional costs from the bundling of an insurance product into the mortgage. Due to the difficulty of weighting the value of these benefits and costs, it appears these costs and benefits identified in this section may net-off against one another, allowing us to focus on the benefits identified in section 6.2.1.

The next section looks at costs and benefits falling on agents other than consumers in the economy.

6.2.3 The net social benefits of *datio in solutum*

In addition to the costs and benefits identified here, which fall mainly on communities, Government and lenders there are a number of questions we have identified concerning exactly how a *datio in*

[446],See Annex 7 for more information.

[447] In enforcement procedures against a debtor, whether against an unpaid mortgage, or otherwise, in many countries, creditors are put into ranks. Creditors in the second rank only begin to receive payment after creditors in the first rank have been fully paid off. Because a mortgage is secured against a property, it is a first rank claim. For example, if a debtor cannot pay his mortgage and other bills, enforcement action is taken against him. The property is sold, and enough is recouped to pay off the outstanding mortgage and leaves some left over. The mortgage creditor receives full payment and the other creditors, in the second rank, receive payment in shares based on the relative size of their debts and the amount of capital available. Having a debt in the second or lower rank makes that debt more risky to the bank, because the chance of recouping that money falls as other debts are paid off first.

[448] See Annex 6.

solutum regime would work, which are given in Annex 7 which do not address the question 'is *datio in solutum* desirable', but rather 'is *datio in solutum* deliverable?' These are excluded from this section but are well worth consideration were this policy to be taken forward. It is also worth noting that debt cancellation and forbearance will also incur some of these costs, particularly the first.

- **Lender costs:** In the current climate, it is clear that such a fundamental reform of the mortgage market would require some expenditure by financial service providers to implement the reform. It is impossible at this stage to estimate this cost.
- **Taxes, fees and costs:** A transfer of ownership of property is in many European countries a process which includes the paying of taxes and fees to Government. Each jurisdiction defines who pays these. Where the bank is not already the '*owner*' of the property and there is a change of title, such as on a French guaranteed loan *datio in solutum* raises the question of, if the consumer can unilaterally decide his interest in the property is over and he transfers ownership of the property to the bank in full cancellation of his debt then who pays these taxes[449] and fees , particularly if the consumer has simultaneously entered a consumer bankruptcy process.
- **Informing and updating the land register:** Assuming the contractual form has not been designed such that the bank is the owner of the property until the borrower has paid off the mortgage, who is responsible for informing the Land Registry or equivalent agency to update records of ownership under *datio in solutum?* This may impose a cost either on Government or lenders, one of whom will need to put in place administrative systems to manage this system. This is not a cost one sees in US non-recourse mortgage markets where the laws on registration of property are different and less reliance is placed on an up-to-date register.
- **Social costs:** When considering *datio in solutum* the findings from much of the empirical literature on failing mortgages[450] show that the costs on debtors, creditors *and the surrounding area* are significantly lower if a mortgage does not require enforcement or something like *datio in solutum* deployed against it. It has been argued, for example by Levitin & Goodman (2008) and Levitin (2009) that forbearance and negotiation to moderate the terms of a mortgage contract so the borrower can meet a revised instalment schedule has the best possible outcomes, for the consumer, the lender, and the community. The consumer benefits by being able to continue to make what contributions he can, for example moving to an interest-only mortgage for a period, without being at risk of losing his home. The creditor benefits from being able to continue to extract some value from the loan, not being required to fund expensive and often pointless enforcement efforts, and the community does not run the risk that foreclosure / enforcement may have a detrimental effect on house prices on surrounding properties, impacting on the viability of recovering mortgage collateral in the case of these mortgages moving to enforcement. It is worth noting that in Levitin & Goodman (2008):

[449] Or even, strictly, whether these taxes apply. For example, the UK applies a stamp duty on the contract, but in this case whether such a contract would exist is not a moot question. If the terms of the exchange were written into the initial mortgage contract, would the stamp duty need to be paid on this contract and would it be re-imbursed when the mortgage was eventually paid down. This would make mortgages massively expensive for consumers compared to today, as in effect consumers would need to pay two stamp duty payments at the point of purchasing a property, one on the actual transfer and another on the potential *datio in solutum.* transfer. On the other hand, the bank could become the owner, and pay the stamp duty, adding this to the mortgage debt and giving the consumer a refund at the end of the mortgage. This would again cost many consumers out of the mortgage market.

[450] E.g. Case & Shiller (1996)

> *'Everybody losses in foreclosure. Lenders are estimated to lose 40% - 50% of their investment in a foreclosure situation, and debtors lose their homes, which disrupts families and communities'.*

Being a new system, there would be costs that would need to be incurred to establish *datio in solutum,* potentially falling wider than just on lenders, reflecting the transfer of cost and risk from the borrower to the lender and some of the knock-on effects passed on to Government and communities by transferring property in such a way. In the broadest sense it is hard to see these costs also being incurred by some of the alternative models. However, from the consumer's perspective it is likely that any impact would be marginal beyond those already discussed.

6.2.4 Best practice summary

Most European countries have not considered *datio in solutum* because they have developed systems which preclude the need to have a specific solution for residual debt following enforcement against a mortgage. *Datio in solutum* delivers greater benefits to consumers than no debt cancellation system, but the best practice debt cancellation model described in section 6.1.1 and a model of mortgage forbearance applied by all lenders appear to deliver even greater benefits to consumers. However, this argument does not preclude two key points:

- Even if the best practice debt cancellation process, or statutory forbearance may provide better consumer protection, that does not mean that *adding datio in solutum* to these practices may not have benefits, merely that each on their own presents greater benefits that *datio in solutum* on its own.
- Using the evidence from Spain it is possible to describe what a best practice *datio in solutum* would look like.

Best practice in reinforcing a forbearance system

To incentivise good behaviour in a forbearance system, one of the following models should be put in place to dis-incentivise proceeding to enforcement:

- The best practice debt solution model described in section 6.1.1
- Limiting consumer liability on enforcement to the property, excluding other assets
- A best-practice *datio in solutum*, as described below.

Best practice in using *datio in solutum* to reinforce a debt cancellation mechanism

Countries who put in place a best practice debt cancellation model are unlikely to see significant benefits from implementing *datio in solutum,* but in those countries where a best practice debt solution model cannot be implemented, our assessment suggests that a best practice *datio in solutum model* would deliver benefits to consumers, and would be preferable to a traditional debt cancellation model.

Best practice *datio in solutum* model

We have considered the Spanish example and have identified the following model as being likely to be best practice. This model does not exist anywhere in the world, but does not suffer the weaknesses of the current Spanish model:

- *Datio in solutum* should not be used prior to the commencement of enforcement, because forbearance should still be being attempted. When the consumer is informed the lender wishes to move to enforcement, being able to evidence its efforts to agree and deliver a viable re-structuring and the borrower's failure to comply, all consumers, irrespective of income, should be able to apply for *datio in solutum* immediately. The only eligibility criteria should be:
  - *Datio in solutum* should only apply on the primary residency of the family, the property in which the household spends the majority of its time.
  - Where the consumer has other assets which could be liquidated to help pay-off the mortgage it appears unfair to ask the lender to shoulder the whole burden. This process should only be used when all efforts to preserve the household's primary accommodation have been taken.
- We see no reason to consider an exemption based on the consumer's income levels, as this should have been taken into account already in any forbearance efforts. .

We have had strong arguments for and against the concept of *datio in solutum* presented to us in our study, both in terms of whether it is right to so fundamentally shift the balance of power from the lender to the borrower, and in terms of whether it is practicably deliverable as a functional part of the landscape of financial markets. We can see strong reasons why *datio in solutum* appears to present very significant practical problems in terms of delivery and may have large potential impact on lenders, but we also recognise the evidence that the impact on mortgage prices from US studies has been less than would have been expected.

Our review has suggested that *datio in solutum* delivers greater benefits to consumers than no debt cancellation system, but the best practice debt cancellation model described in section 6.1.1 and a model of mortgage forbearance applied by all lenders appear to deliver even greater benefits to consumers. The best practice debt cancellation approach allows them to address all their debts in a fair way, not just one (potentially large) debt, as over-indebtedness is often a compound problem, where the consumer has more than one problematic debt[451]. Statutory mortgage forbearance has the merit of preventing enforcement against the property for as long as feasibly possible, through using different mortgage designs or some form of payment moratorium to enable the borrower to construct a feasible payment regime which he can honour; it also has the benefit of preventing the losses borrowers, and the community often face following enforcement or repossession.

However, this argument does not preclude two key points:

- Even if the best practice debt cancellation process, or statutory forbearance may provide better consumer protection, that does not mean that *adding datio in solutum* to these practices may not have benefits, merely that each on their own presents greater benefits that *datio in solutum* on its own.
- Even if *datio in solutum* is not best practice in and of itself, that does not mean we do not have enough evidence from Spain to describe what a best practice *datio in solutum* would look like if one felt compel to use this mechanism.

Mandatory forbearance and the role of datio in solutum in incentivisation

A model which aims to prevent enforcement happening in the first place by instilling a general principle / right to forbearance in the first instance may come in several forms:

- a right to move to an interest-only[452] mortgage,
- a right to move mortgage providers, particularly if a social bank could be found offering better terms[453].
- a right to extend the duration of the mortgage, at least up to retirement age, or to convert the mortgage into a lifetime[454] mortgage,

[451] Whilst it is true that consumers just with problematic mortgage debt are equally supported by *datio in solutum*, we feel it is important that consumers with multiple problematic debts also have a route to address their problems.

[452] This occurs where the consumer ceases to pay the capital down, but maintains the interest payment to reach a position whereby the mortgage is sustainable. In the long-term the consumer either has to find a way to pay off the capital, or take out a new mortgage at the end of the present one.

[453] As long as that new lender is willing to accept lower interest rates, if that is sufficient to make the payments sustainable.

- a right to payment holidays / moratoria up to a maximum number of years,
- a right to automatic capitalisation[455] of unpaid debt,

All these give consumers a period within which to get back on their feet, and give banks a viable means of getting back at least some of the loan. This appears preferable to the consumer losing their property and the lender incurring the costs of liquidating this asset. Some countries have focussed their efforts in this area[456].

However, there is a substantial difference between putting in place arrangements for encouraging forbearance and making both borrowers and lenders want to make any such restructuring succeed. The key issue here is that if forbearance does not succeed there is still the potential to move to enforcement of the debt, and at this point it is worth asking whether having *datio in solutum* in addition to mandatory forbearance would incentivise the behaviour we wish to encourage, which is both lenders and borrowers making all efforts to make restructuring / forbearance work. To do this there has to be incentives to avoiding enforcement. These of course already exist:

- Borrowers lose their property and go through a stressful process.
- Lenders, evidence suggests, lose value.

These incentives do not, however, appear to be sufficient to prevent enforcement happening, either because borrowers are already resigned to losing the property, or because the loss is not sufficient to make the lender feel that what he gains from enforcement, in terms of sending a message to other borrowers that he will enforce if they do not keep up repayments, is sufficient to overwhelm the loss. At least in those countries where the lender can still pursue the borrower and any other assets or income he has for the residual debt this may even be a profit maximising strategy once you have accepted that enforcement is required.

There is therefore a question to be asked as to whether *datio in solutum* has a role to play in addition to mandatory forbearance, as the stick as opposed to the carrot of restructuring. If *datio in solutum* can make enforcement look even less attractive that can incentivise the behaviour we wish to encourage; that of lenders and borrowers working together to re-design failing mortgage loans such that they can create a viable schedule of instalments and complete the mortgage without needing to recourse to enforcement or surrendering the property.

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[454] A lifetime mortgage is a loan, available in some countries and by practice normally used by people aged over 55, which allows them to release equity from their home by means of a secured loan, and only requires paying back (together with any interest rolled up if applicable) once the property is sold on their (or in the case of joint applications - their surviving partner's) death or permanently moving into care. A lifetime mortgage doesn't involve selling any fraction of the legal ownership in return for money raised and allows the consumer to remain living in the property for the rest of your life. Either the capital is paid off and the interest is rolled up and paid off as a lump-sum from the equity built up in the property, or the interest payment effectively acts as a rent, and the equity built up in the house is used to pay off the capital. Either way, the debt is only repaid when the property is sold. As no ownership of the property is lost under a lifetime mortgage, the property is sold when required by consumer or their family, whereby the debt paid off and any balance retained by the consumer or their heirs.

[455] Capitalisation takes place where the recovery of arrears or monies due is not possible, so the outstanding balance is added to the capital borrowed, and interest is charged on this as part of the standard instalment, following an assessment has been made to the affordable value of the instalments, ensuring these are sustainable in the long-term. In effect the consumer pays less down each month, increasing the total overall price. This may include a temporary transfer to an interest only mortgage.

[456] See for example FSA (2011).

Datio in solutum could carry out such a role, however, we should note that two alternative proposals would deliver the same function:

- A full best practice debt cancellation regime, as described in section 6.1.2, which has the advantage of relieving other debts as well as problematic mortgage debt, but requires a longer term payment plan where the consumer can afford it.
- Limiting consumer liability on enforcement to the property, excluding other assets, delivering the same outcome with fewer practical barriers, and only requiring a slight alteration to existing rules rather than the creation of a new mechanism such as *datio in solutum.*[457]

General debt cancellation; is there a role for datio in solutum?

When comparing strong or weak *datio in solutum* with a full best practice debt cancellation approach, the authors consider that the full best practice debt cancellation approach gives greater benefits to the consumer, however, the picture is more mixed when comparing to traditional debt cancellation, and it is clear that *datio in solutum* is preferable to no debt cancellation at all. This point is key, because it is essential to understanding why Spain has a *datio in solutum* solution, and why ADICAE have argued to move towards introducing some form of personal bankruptcy arrangement in Spain. Because mortgage debt is often the largest single debt that consumers have, *datio in solutum* has been introduced in lieu of a wider solution for unsecured debt.

However, there is a debate to be held over whether, and in what circumstances, *datio in solutum* may be a useful addition to a universal debt cancellation system, either as an extra lever or mechanism of last resort. Countries with well-developed and well-functioning best practice debt cancellation models are unlikely, in our opinion, to see significant benefits from implementing a *datio in solutum* approach, but those countries where this is not the case would, our assessment suggests, benefit from a strong *datio in solutum* model as the best way to discharge as much problematic consumer debt as possible. The underlying necessity of having a functioning process to cancel debts holds true whether or not a country has implemented a debt cancellation debt solution. In those cases where they have not, they have not done so because the *need* does not exist, merely because some feature of their political economy has prevented the reform being brought into being.

Below we consider what a best practice *datio in solutum* model looks like, which may achieve this aim.

The best practice datio in solutum model

The best design for *datio in solutum,* taking into account lessons from Spain, which we can identify has the following characteristics

- We do not see a case for *datio in solutum* prior to the commencement of enforcement, because it should be expected that forbearance should still be being attempted up to this point as the consumer should still be attempting to meet their commitments. At the point where the consumer is informed the lender wishes to move to enforcement, being able to evidence its efforts to agree and deliver a viable re-structuring and the borrower's failure to

[457] Proposals currently under debate in Ireland also consider whether this limit should be 100% or partial.

comply with this, all consumers, irrespective of income, should be able to apply for *datio in solutum* immediately.

The only eligibility criteria should be:

- *Datio in solutum* should only apply on the primary residency of the family, the property in which the household spends the majority of its time. It appears unfair to expect a lender to shoulder this burden in the case of a second property as the purpose of this protection should be for use *in extremis*, when all other efforts have been taken and failed to preserve the household's primary accommodation.
- Similarly, where the consumer has other assets which could be liquidated to help pay-off the mortgage it appears unfair to ask the lender to shoulder the whole burden. Again, this process should only be used when all efforts to preserve the household's primary accommodation have been taken, and the possession of other assets, particularly other property appears to indicate the consumer could have taken further steps if he had wished to address his debt, and if the consumer has chosen to prioritise the protection of these other assets over the mortgaged property, we cannot see why he should not, therefore share the risk of making a loss on the property with the lender.
- We see no reason to consider an exemption based on the consumer's income levels, as this should have been taken into account already in forbearance/ re-structuring attempts. Any consumer who has reached enforcement has already demonstrated that their income is insufficient to maintain the mortgage, so this indicates this consumer is in need of further support, such as the *datio in solutum.* Therefore all consumers who reach enforcement should, except in situations where they make a conscious decision to not liquidate other assets, be able to receive *datio in solutum* on their main residency.

6.3 Debt enforcement

6.3.1 Restrictions on debt enforcement

In this study we have identified a wide variety of types of enforcement restrictions affecting everything from the availability of water to the use of social media to communicate debtors. The common underlying principles which almost all these restrictions clearly reveal are the desire of legislators to preserve the debtor's human rights and human dignity, whilst facilitating fair attempts to enforce the payment of late debts. Because there are so many varied approaches to debt enforcement, we have determined to address best practice in reference to each of the points outline in section 5.1:

- To ensure the consumer and his family has access to a sustainable minimum income
- Ensuring the consumer and his family have access to accommodation
- Ensuring compatibility with debt solution processes
- Preventing unfair and non-misleading processes from being used to harass, confuse or use unfair duress to achieve payments by consumers
- Ensuring charges fall onto the lender who has commissioned the enforcement activity
- Ensuring access to utilities
- Respecting the privacy of debtors
- Preventing violence and harassment that may lead to physical or psychological harm
- Ensuring that vulnerable debtors are treated appropriately and in ways that neither exploit nor exacerbate their vulnerability.

6.3.2 Best practice summary

In this study we have identified a wide variety of types of enforcement restrictions affecting everything from the availability of water to the use of social media to communicate debtors. The common underlying principles which almost all these restrictions clearly reveal are the desire of legislators to preserve the debtor's human rights and human dignity, whilst facilitating fair attempts to enforce the payment of late debts:

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- Ensuring charges fall onto the lender who has commissioned the enforcement activity
- Ensuring access to utilities
- Respecting the privacy of debtors
- Preventing violence and harassment that may lead to physical or psychological harm
- Ensuring that vulnerable debtors are treated appropriately and in ways that neither exploit nor exacerbate their vulnerability

Before addressing best practice in terms of dealing with restrictions on debt enforcement, it is probably a good point to argue that, of course, one of the best ways of avoiding consumers being faced with difficult debt issues is to try and mitigate the risks being run by consumers in terms of over-extending themselves. This report has argued that much over-indebtedness is passive; driven by a change in circumstance beyond the debtor's control, but it is worth pointing out that ensuring that consumers have good, transparent, impartial advice about money issues is surely a prerequisite to ensuring the debt market operates effectively, minimising the threat to creditors of active over-indebtedness, and making clear to consumers the risks they run in terms of falling into passive over-indebtedness and trying to ensuring that they have taken a level of risk which they are fully aware of, or taken some appropriate steps to mitigate.

This clearly falls in two camps, the provision of money advice services which consumers can use before they take out debt, but also systems to support consumers who have fallen into over-indebtedness to support them and prevent them falling into such debts again. This could take the form of information on budgeting and money management, lectures, or a more general advice service of some form.

Whilst not in the scope of this work, we have considered whether this sort of system would be a best practice, as a plank in a wider debt management strategy for consumers. The provision of good quality advice does appear to us to be imperative, but whether this is delivered through advice or transparent rules on the information about the debt and what the repayment schedule will mean for the consumer is obviously a wide and complex question and firm conclusions would require a deeper analysis than we are able to carry out, but our assessment has not identified any compulsory services provision in this area, although several countries have been taking steps in recent years to support their consumers in this area. This move, at the country level, to review again the provision of support and advice appears to be a best practice.

Moving back to the core question to be addressed in this section, we consider the guidance offered in the UK in relation to debt collection by the OFT[458] to be best practice. Whilst it does not cover all the areas we address below, its general approach and up-to-date consideration of new areas where restrictions may need to be applied, such as social networking sites, are key strengths. best practice therefore appears to be **for each country to identify a lead agency or department with responsibility for the enforcement of debt and to require that agency to publish and maintain up-to-date comprehensive guidance on what is and is not allowed, and what best practice looks like.** To support this we also consider it to be best practice that debt collectors are registered to allow the lead agency to ensure that those who should be following this guidance are doing so.

To ensure the consumer and his family has access to a sustainable minimum income

Where one draws the distinction between a process which a creditor uses to enforce a debt which has not been paid and one where the debt cannot be paid, which to the authors appears to be the key distinction between processes one may call enforcement and others one may call debt solutions, is a key issue, especially as at their heart they are simply parts of the same spectrum. As such, many of the findings from section 6.1.1 need to be re-examined to test whether they are applicable for debt enforcement as well as debt solutions. Primary amongst these are what limitations should be placed on debt collectors in respect to how much income they should leave the consumer to live on. There are very different approaches to this in different countries, but it is unclear to the authors why, if the debtor is to have some element of his debts written-off he is deserving of a minimum exempt income, but when he is not looking for such a boon as a debt discharge, he should not be. We will not repeat all the arguments put forward above for minimum income guarantees, but we will identify that our second identified best practice is that **debt enforcement should be forced to take into account a minimum income which is exempt from enforcement activities.**

Equally, many countries limit the use to which assignment / attachment of wages / benefits can be used, or require judicial hearings beforehand, and where it is not limited there are often limits imposed to ensure a minimum income after assignment. Given the variety of usage which such methods are put too, with some countries forbidding assignment of wages to private debts whereas others use them frequently to secure loans (often with clear regulation in place) it is clear this is an area with 'path dependence' – the present system relies heavily on decisions made in the past – which means it is very difficult to find a '*one-size-fits-all'* model. We consider that where assignment / attaching of earnings or benefits are used there should be clear regulation of what limits should be applied, particularly in relation to exempt income, but beyond that we consider that a deeper assessment needs to be carried out specifically into this issue to see whether greater use should be made of it .

Finally, payments which are made to maintain the children of a previous relationship are often exempted from debt cancellation processes, giving consumers no way of evading this responsibility. This appears to us to be the correct course of action.

Ensuring the consumer and his family have access to accommodation

Eviction and rent arrears are significant areas for the application for restriction on how debts are enforced. Various countries use different types of protection to ensure that families have sufficient

[458] Office of Fair Trading (2011)

time to find alternative arrangements, with protections ranging from advance notice and prolonged stays of execution before eviction can occur. Broadly the range of protections available are:

- An advance notice
- A conciliation procedure, such as a payment plan
- A prolongment of payment periods
- Stays of executions

We consider that it is appropriate that countries ensure that an adequate provision is made in such cases to ensure alternative arrangements can be made, if only to prevent costs falling onto the state, even if the substantial impact on families that eviction can have is disregarded. As this therefore is a classic 'invest to save' we see little difficulty in encouraging countries to ensure the outcome of *'sufficient time'* but recognise that given different systems the mechanism to deliver this, and indeed how much time each country feels is '*sufficient*' is a substantive topic for countries to consider if they have not already done so.

Ensuring compatibility with debt solution processes

In a similar vein, if creditors can accept a three year payment plan, or in some present cases even longer when in a debt solution situation, why such forbearance cannot be shown when debt enforcement is in play and the consumer has not made any request for debt relief is a key question. We recognise that the enforcement of a contract which has not been called into doubt at the point in question is different to the situation implicit in a debt relief or debt cancellation process where the debtor has implied that the creditor must share some blame for a debt which has turned bad, but we would wish to point out the general rule which has become apparent to us through this process, which is ***any step which can be taken to prevent debts reaching the point of unsustainability are ultimately likely to provide better value to both the lender and the debtor than enforcement, of whatever form.***

As such we consider that the issue of the exact arrangement which should be standard for an unpaid debt should balance this key factor with the second general rule; ***that the moral hazard created by arrangements which allow debtors to avoid repaying their debts need to be mitigated as far as possible.***

Bringing these two together, it is worth stating that debt enforcement is, by definition, a halfway house between a contract which the consumer is able to honour, and one which the consumer is not able to honour, being in the territory of a contract the consumer is still trying to honour, but finding it difficult to do so, on the current terms, a situation not dissimilar to that we have described as debt re-organisation above. It is worth considering whether if at this juncture, more serious thought should be given to forbearance which allows the full completion of the contract, either over a longer time period or even through some limited re-negotiation may be an attractive and beneficial requirement for both lenders and borrowers. Defining the length of an enforcement payment plan is a possibility here.

In relation to taxes, fees, and fines, most countries allow the tax collection office to remit or defer payment, but often exempt these debts from debt cancellation. We have addressed this question in section 6.1.1, but here feel that, from the consumer's perspective, tax collection agencies having the flexibility to make this decision appears valuable.

Preventing unfair and non-misleading processes from being used to harass, confuse or use unfair duress to achieve payments by consumers

Some form of regulation of what is and is not acceptable here is a basic building block of any regulatory regime around debt enforcement. Best practice catches several obvious matters; preventing debt collectors from using official looking documentation, from misrepresenting their authority, preventing the use of wordings which imply the potential to use further processes which may not be available or which are at the discretion of the court, not using Latin phrases, or unhelpful legal and technical jargon, and ensuring information is not to be presented in a way which has the potential to create a false or misleading impression.

At this point we also want to mention that an EU wide law came into effect on 7 August 2002 to combat usury in late payment in commercial transactions. Penalty interest will become payable if payments for commercial transactions are not met within 30 days, unless otherwise specified in a contract or agreement. The new Regulations state that, unless otherwise specified in an agreed contract, the interest rate will be the European Central Bank main refinancing rate plus 7 percentage points.

Ensuring charges fall onto the lender who has commissioned the enforcement activity

It must surely be best practice for the cost of enforcement to be priced into the general cost of loans and shared amongst all consumers, as at the point of borrowing all consumers who are lent to must appear to be a 'fair bet' and should all be treated equally in terms of facing a share of the cost of enforcement against those who find themselves in such a position. This also removed the pressure which the over-indebted would face in trying to meet this additional payment over and above their existing debts. This also would act to provide a further incentive to lenders to look to find forbearance approaches prior to initiating enforcement.

Ensuring access to utilities

Different European countries have different approaches to this question, for example the UK permits utilities companies to cut-off non-paying clients, whereas France, for example, ensures a minimum allowance is supplied. There is clearly a trade-off between the time and effort it takes to turn the after supply on and off, and the value to consumers to having access to sufficient water for basic human dignity. This comes down, we think to whether access to water in this way is a fundamental right, even if they have not paid their bills. This is the principle which needs to be decided on, although in actuality the true issue may be the amount of these commodities which are supplied in the basic requirement.

Respecting the privacy of debtors

Again, this is a basic building block of any regulatory structure, and the best practice in this area, in our eyes is how well these requirements are kept up to date, for example by keeping guidance up to date with the latest media, to ensure that requirements not share information with friends / neighbours / relatives, or to search for debtors by contacting individuals with the same name to try and hunt down the debtor are complied with.

Preventing violence and harassment that may lead to physical or psychological harm

Once again, almost all countries have ensured that basic standards are in place. Best practice in this space deals with the spectrum of potential harm, specifically in relation to stress and mental health rather than physical harm, which obviously are universally addressed through criminal law. A key facet here is regulating the debt collector and their staff, looking at both present and previous records.

Ensuring that vulnerable debtors are treated appropriately and in ways that neither exploit nor exacerbate their vulnerability

Best practice in this area is seen in those countries where there is regulation over how debt collection agencies address clients who have demonstrated mental health issues, or who they fear may be demonstrating mental health issues. In the UK, a procedure has been put in place to allow debt collectors to initiate an assessment to then form the basis for how they should deal with the client. *A priori* we cannot see a reason to exempt all debtors with mental health issues from their debts, because 'mental health' is a wide spectrum, not all of which is inhibiting and not all occurrences of which are permanent or long-term. However, it is clearly best practice to ensure that this group is treated sympathetically and with due regard to their state to ensure the process of debt enforcement does not exacerbate their health issues, which of course from a debt collection point of view can only be self-defeating in terms of prolonging a state whereby the likelihood of being paid is lower than standard.

Removal of possessions

In section 6.1.1 we identified that best practice in terms of asset liquidation for debt solutions suggest that this exercise is not one which can be expected to deliver sufficient equity to make the exercise worthwhile, in terms of the resale value of household electrical products. If one argues that something is not worthwhile in one context, it is obviously beholden on us to consider whether it is worthwhile in another. Debt enforcement, especially if it relates to a single debt, rather than the totality of a consumer's debts, may well address smaller values, in which case it may be more feasible, and of course, asset repossession has the added merit of having an irritant value, helping to make debt enforcement a sufficiently unattractive prospect to deter voluntary late or non-payment of debt. Of course, if the consumer is in the position of not being able to pay, rather than not paying for some other reason, then the prompt of asset repossession may be sufficient to encourage the consumer to enter debt solutions procedures, but whilst this sounds intuitively unattractive 'up-tariffing' from one level of addressing debt to another, we should consider that for a consumer who has so little that losing their TV is sufficient encouragement to force them to move into a more stringent system, than these are likely to be the type of consumers we should look to protect. It is also worth mentioning that once the precedence of asset liquidation is removed from debt cancellation whether this extra severity should be imposed at part of debt enforcement is still appropriate. For this reason and the limited value in terms of generating returns for creditors, we advise that serious consideration of whether asset liquidation, albeit with the provisos outlined in section 6.1.1, is still part of a best practice model. We are no longer convinced it is.

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Annex 1 Methodology

A1.1 Step One: Defining the Question Set

For each of the available debt solutions in a Member State we agree to attempt to collect the following:

- Is the consumer automatically free of all unsecured debt? If not, what are the remaining obligations of the consumer?
- Is the consumer automatically free of all mortgage debt? If not, what are the remaining obligations of the consumer and/or his/her guarantor?
- Is the arrangement automatically binding on all unsecured creditors? If not, which creditors are not bound?
- Is the arrangement automatically binding on the mortgage lender?
- Does the arrangement offer automatic protection from actions by unsecured creditors? If not, which creditors can continue to take actions?
- Does the arrangement offer automatic protection from actions by mortgage lender(s)? If not, is there a difference between first and second mortgages on a given property. If not, is there a difference if the mortgage in on principal residence or a second home, or any other type of property owned by the consumer for non-business purposes.
- For how long is the consumer in the arrangement? Can the consumer break the arrangement? If yes, what are the consequences?
- Is the consumer's home at risk under the arrangement?
- By how is the debt reduced under the arrangement?
- Does the arrangement result in-going financial obligations, albeit at a reduced level? How does the consumer discharge the on-going financial obligations? Directly, or through an intermediary?
- Who can impose the arrangement on the consumer? Only the consumer her/himself, the creditor(s), or both?
- How does the consumer access the arrangement? Directly or through an intermediary?
- Does the arrangement have any implications for the credit rating of the consumer?

A1.2 Step Two: Identifying relevant debt solutions in each Member State

The processes in scope are those which are open to the consumer to address a debt that he can no longer afford to pay. As such it includes any process the consumer can voluntarily enter, or can be compelled to enter after the standard mechanism by creditors to get their money back have been carried out.

For example, a process where the original principal and interest terms of the debt are retained, but a court or other body compels the completion of instalments, for example, in the UK a civil

action in the County Courts to compel payment of an unsecured debt by initiating enforcement procedures, such as repossession of assets, for example by bailiffs is not in scope as it is creditor driven and there is no *a priori* reason to assume the consumer *cannot* pay; he just *has not* paid. However, if the consumer was not able to pay and had no assets which could be seized, the processes available to him at this point would in scope.

In the case of secured debt, repossession is in scope as we have a particular interest in what happens to the debtor after repossession if outstanding debt remains.

Whilst we have a preliminary mapping from the literature, we used the telephone interviews with the lead public institution responsible for consumer protection in each of the 17 Member States to ensure complete coverage. We used this contact to gain a core understanding of the range of debt solutions available, so we could target questions at other interviewees building on this information.

Telephone Surveys operated as follows:

- On Day t, the survey manager contacted by phone all the targets for the in-depth interviews, explaining the study, its rational and the reason the target is contacted. If the target agrees, a date for the in-depth interview will be mutually agreed on between the survey manager and the target.
- The actual in-depth interview took place on Day t+x, with x typically ranging from 2 to 4 weeks.
- Once the interview was completed, the interviewer wrote up the interview and sent the write-up to the project manager for dissemination to the relevant project team member. This typically took 2 to 3 days.

We aimed to complete this process within a period of about 6 weeks, allowing a staggering of the in-depth interviews.

A1.2.1 Identifying interview targets in each country

Stakeholders will be listed in the final report following the completion of the interviews. These have been identified with the support of the Steering Group. The telephone survey with the lead public institution was also used to identify other interviewees to be caught in the email survey.

A1.3 Step Three: Constructing interview materials

We have constructed questionnaires and interview guides to allow consistent collection of data primarily through an email survey, with telephone follow-ups where necessary. Questionnaires were tailored for each sector according to the following scheme.

Table 16: Mapping questions to shareholders					
Module and number of questions	**Responsible institutions**	**Financial sector regulators**	**Consumer complaints institution**	**Consumer Associations**	**Credit Provider Associations**
Process Names (1)	✔	✔	✔	✔	✔
Basic characteristics (7)	✔	✔		✔	
Bankruptcy (8)	✔	✔		✔	
Debt re-organisation and debt relief (15)	✔	✔			
Mortgages (10)	✔				✔
Implications for the consumer (6)			✔	✔	
Use, understanding, and satisfaction (9)		✔	✔	✔	
Provider satisfaction (6)		✔			✔
Any other Issues (1)	✔	✔	✔	✔	✔
Debt enforcement (8)			✔	✔	✔

A1.4 Step Four: Undertaking Field Work

We appointed a dedicated survey manager to manage fieldwork, address any questions from survey and interview participants about the nature of the work, ensure that interviews are scheduled and take place at agreed date/time, and ensure that survey participants are appropriately chased as necessary.

All providers were asked to name an accurate list of debt solutions in their country, although we looked to the lead public institution to confirm the list in the country level report. We consulted public institutions responsible for the framework around debt solutions, consumer associations, financial sector regulators and institutions responsible for addressing consumer complaints about debt solutions and the behaviour of debt collection agencies. We consulted national associations of unsecured and secured credit providers to obtain the views of the creditors, especially as regards the problems they see with the different debt solution methods available.

Email Surveys operated as follows:

- Day t-7: circulation of an email to survey targets announcing the survey and providing the rational for the survey
- Day t: circulation of the survey with response deadline of day t+21. The survey will be accompanied by a Frequently Asked Question note addressing some of the most likely questions survey participants may have
- Day t+14: circulation of email reminder that survey is due by day t+21
- Day t+25: circulation of email reminder to non-respondents
- Day t+30: phone call to non-respondent
- Day t+35: second phone call to those who are still non-respondent

- By Day t+40 we expect all completed survey responses to have been completed.

The survey questionnaire indicated clearly the deadline and the survey manager actively "chased" non-respondents along the following schedule. We subsequently coded the responses and quality-assured the coding independently against the completed survey questionnaires.

A1.5 Step 5: Analysis and verification of the collected information

We processed and analysed the information gathered during the fieldwork, and to validate the findings, we wrote up specific country files for each Member State which describes the various debt solutions that exist in the Member State and their key characteristics. We asked the main public institution responsible for consumer debt solution in a Member State to review and approve the country file. Any legal material collected as part of the project was provided in an annex.

A1.6 Step 6: Development of conclusions and drafting of final report

During the last step of the project, we developed our conclusions and recommendations for discussion with the FSUG and prepared the draft final report before taking on board comments.

Annex 2 Survey Respondents

The following organisations were contacted to take part in this study. We thank all those who provided us their expertise, time, materials, and survey respondents. Our thanks to all respondents:

Pan-European Organisations

- European Federation of Building Societies
- European Mortgage Federation

Austria

- Schuldnerberatung Wien gem. GmbH
- Arbeitkammer Wien
- ASB Schuldnerberatungen GmbH

Belgium

- Union Professionelle du Crédit x2

Czech Republic

- Czech National Bank
- Association of Czech Building Societies
- Komercni banka a.s.
- ČSOB
- Ministry of Justice
- Financial Arbitrator

Denmark

- Real Kredit Foreningen (Danish Mortgage Banks Federation) x2
- Competition and Consumer Authority
- Denmark Consumer Council

Estonia

- Consumers Advice Centre of Tallinn
- Ministry of Justice
- Association of Consumer's Protection Ugandi
- Estonian FSA

France

- BNP Paribas

- French Banking Federation
- Banque de France
- Ministère de l'economie, des finances et de l'industrie
- UFC Que Choisir

Germany

- Association of Private Bausparkassen
- Verband Deutscher Pfandbriefbanken (VDP)

Greece

- EKPIZO – Consumers Association
- Hellenic Bank association

Hungary

- Hungarian Financial Supervisory Authority

Ireland

- Free Legal Advice Centres
- Money Advice and Budgeting Service
- Financial Service Ombudsman Bureau
- Central Bank of Ireland

Italy

- Conciliatore Bacario Finanziario (Banking Ombudsman)
- Justice Luciano Panzani, First Instance Court, Torino
- Banca d'Italia

Netherlands

- Association for debt and social banking (NVVK)
- National Institute for Family Finance Information (Nibud)

Poland

- Ministry of Justice

Romania

- Romanian Banking Association

Slovakia

- Ministry of Justice
- Ministry of Finance

Spain

- Asociación Hipotecaria Española
- ADICAE (Association of Consumers and Users of Banks, Savings Banks and Insurance of Spain)
- CECA (*Confederación Española de Cajas de Ahorros)*
- Banco de España
- Judge José Maria Fernández Seijo – Asociación Jueces Para La Democracia (Judges for Democracy Association)

United Kingdom

- Council of Mortgage Lenders
- Citizen's Advice Bureau
- Insolvency Service
- Office for Fair Trading
- Financial Services Authority
- British Banking Association

Annex 3 Survey Questions

SECTION ONE: PROCESSES TO ADDRESS CONSUMER OVER-INDEBTEDNESS

1. Please name all processes consumers can use to address over-indebtedness, including any which cancel part or all of outstanding debts.

SECTION TWO: DEBT CANCELLATION

2. Do any of the processes you listed in Question 1 cancel all unpaid consumer debts (except mortgage debt), preventing lenders from pursuing consumers further?
3. Please describe what happens to consumers if they cannot cancel their debts; in particular what claims lenders can place on their income, and any assets consumers may acquire.
4. Do lenders regularly voluntarily write-off such unpaid debts?
5. What, in your opinion, are the main reasons your country does not have a mechanism for writing-off problem debt for individual consumers?
6. Does this include debt secured on an asset, such as a mortgage?
7. Is the consumer automatically free of all debt from going through this process, or can financial obligations be imposed?
8. Can all consumer assets be sold to repay lenders?
9. What period of time does it take for debts to be cancelled so that the consumer can no longer be pursued by lenders?
10. Additional comments?

SECTION THREE: BASIC CHARACTERISTICS AND LEGISLATION

11. Please name the legislation which established each process you have previously mentioned.
12. Please give details of any relevant case law which has affected the application of this legislation.
13. Does the process relate to unsecured debt or secured debt (borrowed against an asset) or both?
14. Who can apply (either to a court or other relevant authority) to have the consumer start the process?
15. Is any new legislation currently planned to reform or introduce debt solutions in your country?
16. Please describe any new legislation, including likely implementation date.
17. Please give the main reasons for the introduction of this legislation.
18. What are the main reasons for not introducing legislation? Please choose only one of the following: Happy with current system / Not been raised as an issue/New legislation recently passed /Legislation proposed but not passed into law/Other.
19. Additional comments?

SECTION FOUR: SOLUTION CHARACTERISTICS

This section asks questions about processes consumers can enter to either change their debt through renegotiating or taking out new loans, or where the lender writes off some or all of the debt. This may apply to multiple lenders simultaneously. When we refer to lenders in this survey,

this also includes government agencies who may be owed money by consumers in the form of taxes or levies.

20. Please state any financial limits above or below which consumers can NOT use this process?
21. Please describe the eligibility criteria (including any 'Good Faith Test') which affects whether the consumer can use each process.
22. Does the consumer go directly or through an intermediary to enter the process(es)?
23. Please select the point in each process when a judge becomes involved.
24. Does the process involve negotiation with the lender(s) regarding the terms of the loan?
25. Please select the type of lender agreement necessary for each process: All lenders must agree/majority of lenders must agree/plan is imposed on lenders.
26. Does the process write off some of the debt?
27. Please state the maximum percentage of the debt (e.g. 25%) which can be written off.
28. What length of time does each process take?
29. Please describe the conditions the consumer must meet to leave each process?
30. Please describe any implications for the consumer of breaking the arrangement.
31. Does the process prevent lenders seizing the consumer's assets?
32. Is there automatic protection for the consumer from other actions by lenders?
33. Please select the type of lenders or other agencies (such as government agencies), who still have the right to pursue the consumer separately for the debt, despite the consumer entering the process:
    a. Lenders of secured debt
    b. Lenders of unsecured debt
    c. Other agencies.
34. Is the consumer at risk of losing their home in the process?
35. Additional comments?

SECTION FIVE: IMPLICATIONS FOR CONSUMERS

36. Please describe any implications each process has for the credit rating of the consumer.
37. Please describe any implications for the consumer's future access to credit.
38. Please describe any implications it may have for the consumer's employment.
39. Please describe any implications for the consumer's civic rights. (Implications may include losing the right to vote, losing access to particular government welfare payments, imprisonment, restrictions on leaving the country, the court being able to remove money directly from the consumer's wages via their employer before the wage is received by the consumer).
40. Please describe any implications for the consumer of breaking the arrangement.
41. Additional comments?

SECTION SIX: CONSUMER USE, UNDERSTANDING & SATISFACTION

42. Do consumers generally understand their choice of process, if they have a choice?
43. Please enter the number of consumers who used each process in 2009-10 and give the data source.
44. Please enter the number of consumers who broke the arrangement in 2009-10 and give the data source.

45. What are the most common complaints from consumers about each process?
46. Have consumer groups recently lobbied for reform of any of the processes?
47. Do the processes generally work for consumers?
48. If a specific process does NOT work as intended for consumers, please give example(s) of how it does not work.
49. Please give any common examples of consumers misusing the process(es).
50. Additional comments?

SECTION SEVEN: LENDER SATISFACTION

51. Do the processes work as intended for lenders?
52. Are lenders generally satisfied by each process?
53. Please rank each of the processes according to how successful the outcome is for lenders.
54. Please list the most common complaints from lenders in 2009 - 2010 and give the data source.
55. How many complaints did lenders make in 2009-10? Please also give data source.
56. Additional comments?

SECTION EIGHT: MORTGAGES

Repossession of a property following a failure by the consumer to pay back a mortgage can have a major impact on the lives of the consumers and their families. This section looks first at mortgage repossession / enforcement and then at any other processes which solve problems related to repaying mortgages.

57. After repossession / enforcement is the consumer automatically free of all mortgage debt?
58. If the consumer is not automatically free of all mortgage debt, is the consumer liable for interest payments on the remaining balance of the mortgage?
59. If the consumer's property is repossessed / has enforcement action taken against it, is the consumer liable for any costs incurred by the lender in the process?
60. Is there any legal difference to how processes are applied to first and additional mortgages?
61. Is there any legal difference if the mortgage is on the main residence or if it is on any additional residence(s)?
62. Imagine a situation where a mortgage lender repossesses / takes enforcement action and sells / compels the sale of a property on which instalments have not been met by the consumer. The value received from the sale is less than the remaining debt. Which of the following statements best describes your national system?:
    a. Lenders ALWAYS voluntarily take the sale value as full settlement of the debt
    b. Lenders RARELY voluntarily take the sale value as full settlement of the debt
    c. Lenders NEVER take the sale value as full settlement of the debt.
63. Under what circumstances might the sale value be taken as full settlement?
64. If a mortgage lender repossesses and sells the property, but does not raise enough from the sale to cover the outstanding debt, how is the consumer pursued for the remainder of the debt?
65. Sometimes consumers may be able to prevent repossession / enforcement by using different mechanisms, such as re-mortgaging. Some countries / lenders are developing innovative new models. If this is the case in your country, please describe these new models, or provide references if this is easier.

66. Additional comments?

SECTION NINE: DEBT COLLECTION

As part of this study we are also collecting information on the legal framework under which debt collection institutions (debt collectors, such as bailiffs or private debt collection firms) operate when they collect debt from individual consumers. In particular we are interested in identifying and understanding any restrictions on 'abusive' debt collection practices, including actions which are threatening to the consumer or which overly intrude into their lives, such as the prohibition of machine-originated calls, texts or emails outside certain hours. We are not concerned about other, more general laws and regulations which impact on the tools and approaches that debt collection agencies, amongst other firms (such as marketing firms) can and cannot use (such, as for example, the right to an unlisted phone number).

67. Please describe the primary debt collection processes in your country if a consumer does not meet their obligations.
68. Please name the main legislation that governs debt collection for each process.
69. What were the most common complaints from debt collectors in 2009 - 2010 about the legislation?
70. What were the most common complaints from lenders in 2009 - 2010 for each process? Please also state the data source.
71. What were the most common complaints from consumers in 2009 - 2010 about each process? Please give the data source.
72. Are there restrictions on chasing consumers electronically (e.g. by phone calls or emails)?
73. Please describe these restrictions.
74. Are there restrictions on taking the consumer's property in lieu of debts?
75. Please describe these restrictions.
76. Are there restrictions on interacting with or revealing the debt to the consumer's family or neighbours?
77. Please describe these restrictions.
78. Are there any other restrictions on debt collection practices we should be aware of?
79. Please describe these restrictions.
80. Additional comments?

Annex 4 Major debt solution legislation

A broad chronology of reform is given below, outlining where countries have either revised or introduced legislation around addressing consumer debt, and key examples of where legislation was proposed but not passed into law.

- Denmark – 1984 – Denmark enacts the first bespoke personal bankruptcy legislation in continental Europe.
- UK – 1984 – County Courts Act introduces County Court Administration Orders; a debt relief mechanism.
- UK – 1988 – Personal bankruptcy introduced, with discharge after 3 years.
- Ireland – 1988 – Personal bankruptcy introduced, with discharge after 12 years.
- France – 1989 – introduced a formal mechanism for the private re-negotiation of distressed debts, giving a prolonged period for the repayment of debt and debt relief, although the latter was only available under stringent conditions, unlike the bankruptcy law which was open to businesses and merchants and wrote-off all unpaid pre-bankruptcy debt.
- Netherlands – 1989 – Parity between attachment of earnings and garnishment of benefits, as previously someone earning a salary would see an attachment whilst someone on equivalent benefits would not be garnished. Bringing those on benefits into scope by legalising garnishments provoked the 1998 reforms.
- Netherlands – 1990 – Cities given the power to remit local taxes and fees for the poorest
- Czech Republic – 1991 – Bankruptcy and Composition Act. Replaced in 2006.
- Norway – 1992 – Law on debt adjustment, effective from 1st January 1993
- Austria – 1993 – new personal bankruptcy law amendment to older corporate insolvency law. Came into force in 1995.
- Germany – 1994 – new personal bankruptcy law. Came into force in 1999, as it was expected time was need to prepare the court system for a potential influx of work.
- Sweden – 1994 – introduces debt cancellation in a three stage process akin to law enacted in the USA in 2005.
- The Netherlands – 1998 – introduced third mechanism to the 1896 Bankruptcy Act, offering partial relief / debt cancellation for individuals (WSNP).
- Belgium – 1998 – introduced partial relief from debt for individuals, effective from 1st January 1999.
- France – 1999 – Extended court mandated deferral and extensions from five years to eight years.
- Luxembourg – 2000 – introduced partial relief from debt for individuals. In force from 2001.
- Denmark – 2000 – introduced a simplified system under tax legislation to provide debt relief when all outstanding debts relate to tax debts.
- Germany – 2001/2 – Income exemption levels increased by 50%, leading to around 80% of debtors no longer being required to make payments as their income falls below the threshold. Income surrender duration shortened from seven to six years. The restriction

on entering court proceedings unless court fees could be paid was mitigated, with deferral of payment of the fees introduced.

- UK – 2002 – Personal bankruptcy reformed, with discharge after 1 year.
- Estonia – 2003 – introduced partial relief from debt for individuals. Effective from 2004.
- Poland – 2003 – Polish Bankruptcy and Reorganisation Act. Later amended in 2008 to permit personal bankruptcy.
- France – 2003/4 – relaxed rules on debt relief and introduced debt cancellation for private individuals. Extended court mandated deferral and extensions from eight years to ten years. Immediate debt cancellation made available, by-passing the payment plan / moratorium stage altogether. Moratorium on debt payments reduced from three to two years.
- Spain – 2003 – New individual bankruptcy legislation which did not include debt cancellation provisions for individual consumers.
- Portugal – 2004 – introduced partial relief from debt for individuals.
- USA – 2005 – New system introduced similar to Swedish approach.
- Denmark – 2005 – Minor revision to bankruptcy legislation to reverse the presumption against qualification towards a presumption that debtors would be admitted into the debt cancellation process.
- Germany 2004/5 – Consideration was given to revising the consumer bankruptcy legislation to remove optional in-court negotiated settlement process, which had been proved by this time to be futile.
- Slovakia – 2004/5 – Completely new bankruptcy law for consumers and businesses. Came into force in 2006. Creates novel 'withdrawal mechanism' for consumer bankruptcy.
- Belgium – 2005 – First major reform of the 1997 settlement, adding a section to the provision on amicable settlements, specifically authorising public body creditors to agree a remission of debt, and bringing legislation in line with Constitutional Court ruling that full discharge should be permitted, even for debtors unable to pay anything to creditors.
- Czech Republic – 2006 – individual discharge law carried. In force from 2008.
- Latvia – 2007 – individual discharge law carried. In force from 2008.
- Slovenia – 2007 – individual discharge law carried. In force from 2008.
- Sweden – 2007 – Radical reform of the 1994 law, abolishing two of the three stages as a 'time-consuming waste of effort' and 'a pointless formality'460. Strict limitations on payment plans of longer than five years imposed.
- The Netherlands – 2007 – Debt cancellation through debt settlement reformed. Applied from 1st January 2008, with discharge falling to one year, rather than three. Introduced an additional provision on dwangakkoord (forced agreement) allowing the debtor to request that the court force a creditor to accept the debtor's proposed out-of-court plan
- Poland – 2008 – individual discharge law carried. In force from 2009.
- Italy – 2008 – Personal bankruptcy reforms considered, but, at this time we believe not carried forward.

[460] Kilborn (2006)

- Belgium – 2009 – Law reformed again. Structures remain broadly the same.
- United Kingdom – 2009 – Debt Relief Orders introduced.
- Sweden – 2009 – Proposal to reduce discharge from five to three years.
- Lithuania – 2009 - Legislation proposed and rejected by the legislature.
- France – 2010 – Introduction of non-judicial 'cram-down', compelling creditors to accept the proposed payment plan from the commission, and introducing a personal recovery procedure without liquidation of assets, effectively opening the door to immediate and unconditional discharge.
- Greece – 2010 – Personal bankruptcy reformed, introducing non-judicial debt negotiation, judicial debt relief, and discharge for consumers. Out-of-court elements effective from September 2010, with in-court provisions effective from 2011.
- Romania – 2010 – Legislation proposed and rejected by the legislature.
- UK – 2010 – Legislation to establish Money Advice Service.
- Ireland – 2011 – Personal bankruptcy reformed, with discretionary discharge after 3 years.
- Greece – 2011 – Amendment to the 2010 law to allow the payment plan period to start with submission of petition, rather than data of first judgement, to address backlog in court.
- Italy – 2012 – New legislation on consumer indebtedness which permits discharge of debt (theoretically up to 100% of debt).
- Ireland – 2012 – Proposed personal bankruptcy reform, mandated 3 year discharge plus five year payment plan.
- Germany – 2012 –Personal bankruptcy reform reducing discharge to three years.
- Austria – 2012 – Proposed personal bankruptcy reform.
- Poland – legislation planned for 2013 – to remove barriers to applying to the discharge process, to facilitate negotiated settlements and remove obligation to sell property.
- Slovakia – legislation planned for 2014 – to make discharge more flexible and more widely available.
- Countries which have all produced recent drafts of individual discharge laws, where this does not currently exist:
  - Romania
  - Lithuania
  - Hungary
  - Italy
- Countries which have not produced drafts of individual discharge laws, where this does not currently exist:
  - Spain
  - Bulgaria
  - Cyprus
  - Malta

Annex 5 Estimating the impact of *datio in solutum*

The key issue here is the treatment by the credit provider of the costs they incur. Our expectation is that it is likely that credit providers will wish to take account of these costs through the charges they make on the mortgage. The following simple model explains our thinking in more detail.

Let us take a generic mortgage, which charge interest on the principle loan. Let us consider the composition of that interest charge. At time t the interest on the principle will typically be a percentage i_t of the outstanding principle of the loan L_t. The composition of i_t is the question of interest.

From first principals, we should assume that i_t is composed as follows[461]:

$$i_t = i_{bt} + (c + \pi) + r_t \quad (1)$$

where:

i_{bt} = the base rate of interest / the cost of money (the cost to the lender of accessing the funds lent)

c = the costs to the lender of administrating the loan, taking into account the term of the loan

π = the profit margin the lender wishes to make on the loan, and,

r_t = a risk premia (the extra reward the lender needs to receive to neutralise the risk he will not receive the principle back)

In effect the risk premia is the risk to the lender of a default. The larger this risk, we can presume the greater the premium which will be charged by the lender. In simple terms, if we were to consider the case of negative equity, a far too prevalent experience in many EU countries at the time of writing, then we can see that **the existence of negative equity has converted this 'safe' secured debt into an unsecured debt, fundamentally changing the risk portfolios of lenders and the benefits they derive from repossession procedures.** In short, the asset no longer retains the value to recompense the lender in the case of default. The higher the probability of default and repossession, and the lower the value of the property, the greater this risk will be. As such, the risk premia in equation (1) can be decomposed as follows:

$$r_t = f(p_{rt} . E(L_t - V_t)) \quad (2)$$

where:

[461] This is obviously a simple representation of the key principles in play here, because we are trying to present a theoretical argument about the values of the risk premia under different scenarios, not a detailed academic paper about mortgage rate setting. As such, we have not presented this with the full rigour which would be necessary to actually estimate i_t. If we were to do this we would need to undertake an inter-temporal optimisation and solve for i for all time periods t and thereby take account of any discount factors applied to income /risk in future time periods. This would also need to take account of any credit constraints which would act in this instance as budget constraints. Finally, we would classically make assumptions that lenders wish to optimise profit and assumptions that they would wish to smooth profit through time. All of this would detract from the flow of the argument being presented so it is excluded.

p_{rt} = the probability at time t of repossession.

V_t = the value of the property at time t

L_t = the outstanding principle of the loan

$E(L_t - V_t)$ = the expected value of the loss that would be made if the property was re-possessed[462], and,

f(....) = a function to allow the fact that this risk is actually going to be the average of the sum of these risks for each time period[463]. This is a positive function; as p_{rt}. $E(L_t - V_t)$ increases the risk premia r_t can be expected to increase accordingly. We can also assume f(....) = 0 when (p_{rt}. $E(L_t - V_t) = 0$

Substituting (2) into (1) gives us

$$i_t = i_{bt} + (c + \pi) + f(p_{rt}.\ E(L_t - V_t)) \quad (3)$$

from which we can discern the following conclusions:

- As the risk of repossessions increase, interest rates go up.
- In a market where *datio in solutum* applies and where house prices are going up it is potentially possible for $E(L_t - V_t)$ to become negative. Because i_t is fixed, at least in the short term, this will increase profit, and in the long term[464] drive down interest rates, as lenders are, in effect taking one-way bets on house prices.
- In a market where *datio in solutum* applies and where house prices are going down and negative equity has been reached, it is likely that $E(L_t - V_t)$ will become positive and large, significantly decreasing short-term profits and in the long-term driving up interest rates.
- In a market where *datio in solutum* does <u>not</u> apply, $E(L_t - V_t) = 0$, because even if the property is repossessed and sold, the residual debt is not a loss for the lender because it remains a valid loan, which the debtor is expected to repay. As such, assuming f(....) = 0 when p_{rt}. $E(L_t - V_t) = 0$ this would change (3) into:
  - $i_t = i_{bt} + (c + \pi)$ (4)

  This suggests that in markets where *datio in solutum* is not a feature we could theoretically expect to see lower interest charges to consumers.

This final point is exceptionally important, because with *datio in solutum* in place we now see winners and losers compared to the alternative:

- Consumers purchasing mortgages, but not defaulting, can expect to see higher interest rates charges in place than would otherwise be the case.

[462] This could also include any additional costs (e.g. court costs) incurred by the lender. We have omitted these from the formula for simplicity.

[463] Otherwise i_t will fall over time. In reality this is a key feature of this equation which will be smoothed through time.

[464] Depending on the terms of the contract. A fixed rate or tracker mortgage puts this risk on the lender's profit, a flexible rate mortgage puts it on the consumer.

- Consumers purchasing mortgages and finding themselves in the position of debt distress face lower costs than would otherwise be the case.

In effect the risk which those who are repossessed pay is spread across the whole community of mortgage purchasers. This pooling effectively operates as a form of insurance, and because consumers are usually risk averse we can therefore suggest that pooling this risk to reduce individual exposure will result in great consumer gain than detriment due to the higher prices.

This aspect of risk-sharing amongst the population is important when one considers the asymmetric information involved in this type of rare purchase. Most consumers will purchase property no more than a handful of times in their lives, whilst major lending institutions will approve mortgage applications in their thousands every year. As such banks are far more informed than individual consumers about the risks being run and their value. Sharing this risk therefore would appear expedient in reducing the value of this asymmetry of information and any market power it gives lenders over consumers. Strong competition in the mortgage market should also work to erode the value of this asymmetry between consumers and lenders if lenders have to actively compete on price between themselves for custom.

Annex 6 Basel and equity calculations

To ensure that banks are stable institutions; a key requirement in a modern capitalist economy; supranational regulations have been defined which all lenders must comply with. One of the most fundamental is bank equity calculations, that is the amount of cash a bank must hold per Euro leant. When credit institutions lend money, the risk profile is shaped by the type and size of the loan and the soundness of the collateral it is secured upon. In 1974, to develop common minimum requirements for the supervision of credit institutions with international operations to promote stability in international finance markets, central banks and supervisory authorities of the G10[465] convened the Basel Committee, which, although without any legal competence has great influence on national legislatures around the world.

In 1988, the Basel Committee adopted the Basel Capital Accord (**Basel I**), which was largely incorporated into EU and national law within the EU. **Basel I** is key to understanding the potential impact of *datio in solutum* because it established the principle that banks must hold equity capital to cover at least 8% of their *risk weighted assets,* and defined risk weightings of 0, 20%, 50% and 100% for different types of asset. In short, the lower the percentage the less risk weighted asset was held, and the less equity was therefore required. In this system, residential mortgages had a weighting of 50%.

A simple example of this is to imagine a loan of €100,000 with a 100% risk weighting. This loan would be a risk weighted asset of €100,000 requiring the lender to hold €8,000. However, if that loan was a mortgage, this would have a risk weighting of 50%, leading to a risk weighted asset of €50,000 requiring the lender to hold €4,000.

However, it was identified that the risk weightings defined in **Basel I** often failed to reflect reality adequately well, and therefore **Basel II** delivered very significant changes, including two methods for risk assessment.

- The **modified standard approach** replicated the broad risk categories, but fine-tuned them, with weightings either defined by statute, or by the credit rating of the borrower. In the case of real estate, an assessment of the value of the property would be carried out, for inclusion into the risk category of retail lending (for which external credit ratings are not available), using the 35% risk weighting[466] defined in statute.
- The **internal ratings-based approach** (IRB) determines the risk weighting through a combination of the four factors; the probability of default (PD), the loss given default (LGD), the maturity (M) and exposure at default (EAD). Again the LGD ratios are stipulated by the relevant authorities, expressing the relationship between the bank's losses after realisation of the real security and the loan amounts in defaults (effectively what share of losses can be re-couped via the sale of the property in the case of a mortgage).

[465] Belgium, West Germany, France, Great Britain, Italy, Japan, Canada, the Netherlands, Sweden and the USA.

[466] The related capital requirement is therefore 2.8% of the loan value, which equates to 8% of the risk weighted asset.

Basel II was implemented into law in Europe via the EU Capital Requirements Directive[467]. This specifies[468] that a reduction in the capital requirement on the basis of real estate collateral is only possible if the mortgage is enforceable and that enforcement is legally verifiable, such that the credit institution is able to realise the value of the mortgage within a reasonable period of time, irrespective of which method of risk assessment is used.

As such, *datio in solutum,* which by definition transfers the risk of losses from the consumer to the lender affects the risk weighting of mortgages. Even in the Spanish context where the use of a *datio in solutum* instrument has been restricted to a small group of individuals, because there is no way to ascertain *a priori* who may eventually end up in this group[469] then *all mortgages in the Spanish market are likely to share the common impact of the risk that the bank will not be able to recover the full value of the loan,* changing their risk weighting ratio and driving up the amount of equity they would be required to hold would be significant and expensive.

It is a key question whether we would wish to increase bank equity requirements at this time, when the European banking sector is facing its current difficulties. The result of this, which appears to be a cost on lenders is clearly ultimately a cost on consumers who may find mortgages more expensive to access, or even not available at all, as certain products may be withdrawn from the market.

[467] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006

[468] In Annex VI Number 48. c) and Number 54. c), in each case I conjunction with Annex VIII Part 2 Number 8, which states that: '*For the rocgnition of real estate collateral the following conditions shall be met: a) Legal certainty – The mortgage or charge shall be enforceable in all jurisdictions at the time of the conclusion of the credit agreement, and the mortgage or charge shall be properly filed on a timely basis. The arrangements shall reflect a perfected lien (all legal requirements for establishing the pledge shall have been fulfilled). The protection agreement and the process underpinning it shall enable the credit institution to realise the value of the protection within a reasonable time frame.*

[469] And indeed, if it was possible to identify this group, by definition they would not be adjudged suitable for a loan of this type.

Annex 7 Questions on the practical application of *datio in solutum*

This section outlines briefly some of the practical concerns a country may wish to take into account where it to attempt to implement a *datio in solutum* policy.

- **The principal of unilateral decision-making** It is not a usual feature of European legal codes that one party in a contract can unilaterally transfer an asset of the size and complexity of a property without the agreement of the receiving body. This either means that European legal codes would need to be fundamentally re-written, or that the fundamental question of ownership before the point of transfer would need to be resolved.
- **Fundamental question of ownership.** The USA has a property market which has been shaped by its labour market, which encourages flexibility of labour and ease of movement, with the application of many legal processes occurring at the state-level. Therefore, if an individual moves between states it can be hard to enforce against that individual. This problem led to innovative solutions being developed to try and simplify processes and accelerate them. Enforcement mechanisms are written into contracts. One of these is the taking over of the real estate property, either directly, (e.g. California), or via an enforced private auction. From this springs two options.
  - The first is that a court could be called on to decide what to do with any outstanding debt, however this was rarely used when house prices were on an upward trajectory, as why go to the effort and cost of a court action when the house would appreciate and neutralise any bank losses over time?
  - **In California and Arizona a second process was designed, which made the taking over of the real estate property a very quick process, but in return for this, the banks gave up the right to chase any outstanding debt in the contract. This is a non-recourse mortgage, whereby the returning of the keys to the bank was sufficient to declare that the consumer's interest in the property had concluded and could not be resurrected, bringing the contract to a close.** This process is in part dependent on the model of mortgage contract used in these jurisdictions. It is important to note **that in these states, the Bank owns the property through a Deed of Trust until the mortgage is paid off, as opposed to Europe whereby the property is owned by the consumer and is pledged against the mortgage as a form of security.** As such, handing over the keys does **not** constitute a change in ownership, because the ownership is already in the hands of the bank. As such, handing over the keys terminates a contract, it does not result in a change in ownership of the property. In Europe, such a process as *datio in solutum* would require a fundamental re-writing of mortgage law whereby either the bank would need to become the owner, *or* legislation would need to resolve many of the other issues mentioned in the bullets below.
- **How can real estate be used as collateral when the owner and the debtor are different persons?** For example; a young family with a low income whose parents assist with the mortgage, using the parent's property to secure a loan on a new property. Second example: a trader uses his home as collateral on a loan for commercial

expansions. In these cases, in many countries in Europe, particularly Germany, the courts limit enforcement in these special cases.

- **If the mortgage loan has been securitised, who would the consumer 'hand the keys over' to?** The key question here is once the mortgage has been securitised, who becomes the owner of the debt, is it still the lending bank, an intermediary (or special purpose vehicle – SPV) or the owner of the security. In this case, therefore, who would the consumer contact to hand over their property as a *datio in solutum* solution? This may be further complicated in the UK context if the bank has retained ownership but has transferred the mortgage equitably to the SPV, in which case there is now a legal owner and an equitable owner of the debt.
- **Charges:** There may be charges or court costs the lender incurs in taking on the property.
- **Negative property values:** It is possible that property can incur significant pollution / flooding / fire damage, such that the costs of rectification are greater than the current value of the property. Let us take the example of a semi-detached property which has burnt down, leaving its neighbour intact, but maintenance work required to maintain the integrity of that property. Would it be right for the lender to be forced to take this property on? Normally both parties need to agree to such a transfer; for example, on the death of an individual whose debts exceed their assets the inheritors can refuse to accept the inheritance. In this case, whereby the mortgage contract has been terminated, does the bank have any right to refuse to take on ownership of the property, and if they do, who does take on ownership, as it cannot be the current owner, who otherwise would have reneged on his interest in the property, cancelled his debt, and then received the property back.
- **Compensation to the consumer.** A key question is when part of the debt has been paid off, what compensation the consumer should receive for this, and what charges the bank can impose. Clearly if the banks are at liberty to charge sufficient charges they could neutralise the *datio in solutum* benefits to the consumer, but equally it is clear there would be costs on the bank from the administration of the taxes, costs and fees which spring from the transfer, which should be applied.
- **Compensation to other mortgage lenders.** Let us imagine a consumer who wishes to use *datio in solutum*, but there are multiple mortgages with multiple lenders on the property. This then raises the question of whether he has to surrender the property to all mortgage holders in parts, of whether the banks become joint owners, or whether one bank becomes owner and has to somehow compensate other mortgage holders.
- **Banking structures and licensing:** If banks were to receive property via a *datio in solutum* transfer, they would need to establish internal structures and guidance to facilitate this and ensure they comply with the requirements of their banking licenses. This would require banks to invest time and effort.
- **Opportunities to 'cool off':** What would occur if a consumer made a *datio in solutum* transfer, and then regretted the decision and wished to change their mind. Unlike other financial transactions taxes and charges would have been immediately incurred, and the bank may even have moved to immediate auction and disposed of the asset within a normal cooling-off period. As such, systems would need to be put in place to help consumers ensure that they were making the right decision.

Annex 8 The US Fair Debt Collection Practices Act

This annex gives a brief summary of the contents of the US 2006 Fair Debt Collection Practices Act, and the main restrictions it applied.

A8.1 Acquisition of location information:

To acquire location information from any person other than the consumer, the debt collector must identify himself, not state that the consumer owes any debt and not communicate with any such person more than once unless requested to do so. Additionally, there should be no communication by post card, or use of language/symbols that indicates that the debt collector is in the debt collection business.

A8.2 Communication in connection with debt collection:

The debt collector may not communicate with the consumer in relation to the collection of any debt:

- At any unusual time or location which is inconvenient to the consumer
- If the debt collector knows the consumer is represented by an attorney and has their contact information

The debt collector may not communicate with any other person than the consumer, his attorney, a consumer reporting agency if otherwise permitted by law, the creditor, the attorney of the creditor, or the attorney of the debt collector.

The debt collector must not communicate with a consumer if they notify the debt collector in writing that they refuse to pay a debt or wish to cease further communication, except in certain circumstances, such as to notify the consumer that the debt collector or creditor may invoke specified remedies.

A8.3 Harassment or abuse:

A debt collector must not harass, oppress, or abuse any person in connection with the collection of a debt.

A8.4 False or misleading representations:

A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of debt.

A8.5 Unfair practices:

A debt collector may not use unfair means to collect or attempt to collect any debt. For example, taking or threatening to take any non-judicial action.

A8.6 Validation of debts:

The debt collector may send the consumer a written notice within five days after the initial communication with a consumer in connection with the collection of any debt, containing:

- The amount of the debt
- The name of the creditor
- A statement that the debt will be assumed valid unless the consumer, within thirty days after the receipt of the notice, disputes the validity of the debt
- A statement that the debt collector will obtain verification of the debt or a copy of a judgement against the consumer and a copy of such verification or judgement will be mailed to the consumer by the debt collector, unless the consumer, within thirty days notifies in writing that he disputes the validity of the debt

A8.7 Multiple debts:

A debt collector may not apply a single payment for multiple debts to any debt that is disputed.

A8.8 Legal actions by debt collectors:

A debt collector who brings any legal action on a debt against a consumer must bring such action only in a judicial district or similar legal entity in the case of an action to enforce an interest in real property securing the consumer's obligation.

A8.9 Civil liability:

Any debt collector who fails to comply with any provision of this title with respect to any person liable to such person in an amount equal to the sum of:

- Any actual damage sustained by such person as a result of such failure
- In the case of any action by an individual, such additional damages as the court may allow, but not exceeding $1,000
- in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

Annex 9 Germany bankruptcy legislation and change: 1879-1994.

Debt solution laws are generally re-written at times when the effects of recession to push large numbers of individuals into over-indebtedness. This explains the flurry of activity seen in the system in response to the Great Recession of 2007-present, the waves of reforms following the recession of the early 1990s, another wave in response to the recession of the early 1980s, and in Germany a law enacted in the 1930s in response to the Depression.

Germany's first modern bankruptcy legislation was the *Konkursordnung*[470], enacted in 1877 and coming into force in 1879, and remaining essentially unchanged until 1999. This legislation had proved itself unable to meet the challenges of a modern consumer credit society, being essentially a 'classical' bankruptcy legislation as one still sees in force in Spain and the Netherlands today, in that assets were liquidated and payments made to creditors, in so far that consumers could use this legislation as opposed to entrepreneurs, but at the end of this process of asset liquidation there was no accompanying release for debtors in the form of a debt discharge or debt cancellation. This, in effect, was an extreme form of debt re-organisation, giving the debtor no form of relief, merely other means to make the payments required for which he was now in arrears.

The *Vergleichsordnung*[471] of 1935 was a law designed to prevent debtors being forced into the compulsory auctions of the *Konkursordnung,* which even in the 1930s were recognised to destroy value by allowing the purchase of the debtors' assets at significant discounts to their actual value. This law fell into the class of what would come to be known as '*composition with creditors*' processes, being a renegotiation of debt based on a majority vote amongst creditors.

Alongside the relevant East German legislation[472], both these laws were replaced in 1999 by the legislation which was passed in 1994.

Attempts to reform this landscape begun in 1978 when the West German Justice Minister appointed, in the light of similar steps being taken in Denmark, a commission to review the bankruptcy laws and recommend any necessary change. Two reports, in 1985 and 1986, were delivered. The first focused solely on corporate insolvency, but the second looked to personal bankruptcy and discharge for consumers. It concluded that discharge was '*out of the question'*, and unanimously declared that negotiated agreements with creditors were the only way that consumers could have some of their debts written off, and that protection against further enforcement post -*Konkursordnung* was '*a problem of consumer protection, especially in connection with consumer credit, which has no immediate relationship to insolvency law reform';* positions which the Government at the time disregarded. By 1988 further research into the impact of over-indebtedness had been commissioned, on the back of which led to a Bill being submitted to the Bundesrat in January 1992 and being finally passed in 1994.

[470] Literally 'Forced Auction Act'

[471] Literally 'Agreement Act'

[472] The *Gesamtvollstreckungsordnung*, or literally the 'Total Execution Act'

Annex 10 Bankruptcy Tourism

'Bankruptcy tourism' occurs where an individual moves their COMI to a different EU state to gain access to the bankruptcy legislation in place there, as this will be advantageous to them over the solutions available to them in their home country.

Clear examples of this trade in 'bankruptcy tourism' have been mentioned above, for example in relation to the Irish experience where long durations until discharge in Ireland compared to one year in the UK have led to well publicised cases of Irish bankrupts having their cases heard in London.

The most prominent cases of alleged 'bankruptcy tourism' are perhaps those of David Drumm, former chief executive of Anglo Irish Bank, and property developer John Fleming. Fleming, who had personally guaranteed much of the €1 billion debt of Tivway and associated companies in Ireland, was discharged from bankruptcy in the UK on 10 November 2011, the first anniversary of the date on which he was declared bankrupt there.

The most likely flows of 'bankruptcy tourism' as these snap-shots suggest are for relatively wealthy citizens with extremely large debts to move into those jurisdictions with the lowest barriers to enter the legal process and the most lenient rules. In both cases this appears to be the English and Welsh system in the UK. For example, one internet financial comparison and news-site[473] recently noted that:

'It has recently been revealed that the Kent towns of Tunbridge Wells and Greenhithe have been invaded by bankruptcy tourist[s…] coming from Germany, making the area, the hub for 'bankruptcy tourism'. A German insolvency expert has set up a branch in the Kent location and is charging thousands of pounds to relocate German citizens, who are in financial difficulty, in the UK [and] stated that he has helped more than 150 Germans resettle since the company was founded in 2007'.

Similarly, a firm in Leicester claims to have helped Irish consumers cancel €1.2bn of debt, including negative equity[474], including producing a 'handy' seven point guide:

- *Step 1: Temporarily emigrate to the UK in face of mounting debt in Ireland.*
- *Step 2: Hand back the keys of properties and other assets to banks, building societies, financial institutions in the Irish Republic.*
- *Step 3: Move to the UK and establish a COMI – a 'centre of main interest' where you rent property, register to vote, create an address for utility bills, find work etc.*
- *Step 4: Fill in a 26-page form applying for bankruptcy in the UK. This can be done after at least six months of residency at a COMI in the UK.*

[473] http://www.onlyfinance.com/Debt/Bankruptcy-tourism-leading-people-to-the-UK.aspx.

[474] http://www.guardian.co.uk/world/2012/may/27/irish-dodge-debts-uk-bankruptcy-tourism.

- *Step 5: Remain in the UK for up to nine months or beyond to secure your bankruptcy order.*
- *Step 6: Go through county courts processes, which is some cases has been a formality lasting as little as 35 seconds in a rubber-stamping exercise.*
- *Step 7: After residing as a bankrupt in the UK for nine months or more you can return to the Republic of Ireland fully protected in terms of your debts being written off. You may not be able to open a bank account in Ireland for up to 12 years under the current regime but there is nothing to stop you opening up a parallel account in the UK after only 12 months in financial purdah[475], an account whose funds you can draw from while in Ireland.*

The single biggest problem with this state of affairs is not, in the eyes of the author, the fact that Member States have lost their autonomy to act and set the rules for their own citizens when this may well never have been their intent, but rather that the situation as seen at the moment is fundamentally inequitable. The vast majority of those in over-indebtedness do not have vast debts which overwhelm their high incomes, but rather they are citizens with low or negligible incomes and small debts which they nonetheless cannot re-pay, and for whom the idea of moving to another country to live and work is utterly unfeasible. This inequity; one law for the rich and another law for the rest, leaves the current system of debt solutions across the European Union facing a fundamental crisis of legitimacy. As noted by Reifner, Kiesilainen, Huls and Springeneer (2003):

'These differences in the scope of application are quite illogical and the present state of regulation [across the EU] can hardly be defended. It seems clear that both a review and a reform of the Regulation of the recognition of the consumer debt adjustment schemes[476]and discharge provisions are necessary'.

Even if this is not happening in practice, it is nevertheless happening in fact. Whilst the twenty years since the early 1990s recession have seen reform of corporate insolvency / personal bankruptcy legislation in all but a handful of states the drive is still towards moving into alignment with the most lenient systems, moving beyond attaching stigma to bankrupts and moving towards their rapid rehabilitation back into normal economic activity. Ireland, being geographically closest to the UK has clearly felt this pressure intently, in June 2012 announcing its *third* major revision of its 1988 legislation on discharge periods in the last *two* years.

In Belgium, the Belgian legislature was sufficiently aware of the existence of foreign legislation enabling struggling debtors to restructure, especially in light of the very broad interpretation of the concept of 'centre of main interest' (COMI) under this EC Regulation ,that it revised its Bankruptcy Act of 17 July 1997, through the Business Continuity Act (31 January 2009)[477], which replaced elements of the old regime and introduced new flexible tools to facilitate business recovery where debtors can choose and switch easily between a range of out-of-court and in-court options.

[475] An enforced period of inactivity.

[476] Their term for personal bankruptcy.

[477] Loi relative à la continuité des enterprises/Wet betreffende de continuïteit van de ondernemingen.

This pressure to revise legislation, often quite recent legislation, is clearly not just, however, the result of Member States identifying that they were significantly different from the most lenient systems. Two other reasons play significant roles:

- the Great Recession since 2008 has placed new pressure on consumers. Unparalleled levels of over-indebtedness have forced Member State Government's to consider more lenient personal bankruptcy processes.
- In an environment where economic growth is desperately required punitive regimes that punish past failure rather than incentivise future effort clearly are no longer an optimal policy and are counter-productive to the growth agenda.

Finally, it should be noted that as long as 'bankruptcy tourism' exists, countries which import this business and charge fees for using their courts will benefit financially from this process as long as those fees cover the cost of administrating the bankruptcy, and may even be able to cross-subsidise other services.