The Models of Personal Bankruptcy in Western Europe

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Abstract

Personal bankruptcy is regulated in all the countries from Western Europe. We selected a group of three countries: France, Ireland and Germany, to analyze the ways in which physical persons are put under bankruptcy law protection, while considering that implementation of the personal bankruptcy law is constantly delayed in Romania. Taking into account some comparative studies, we have found out that in all three countries is applied the principle of "consumer-friendly legislation".

Key words: personal bankruptcy, insolvency proceedings, amicable settlement, judicial settlement
J.E.L. classification: K35, G33.

1. Introduction

The debates provoked by Law of commissioning payment and proximity of the moment when personal bankruptcy law will be applied in Romania constituted a serious impulse to undertake a comparative study on the legislation applied in Western Europe countries in the field of individual bankruptcy. We selected three countries from Western Europe, namely France, Germany and Ireland, which beyond the specific differences, manifest a special care for the economic reintegration of people affected by illiquidity or over-indebtedness. In our opinion the personal insolvency is in direct correlation with the level of financial education of the public (Avram and Avram, 2012, p.95).

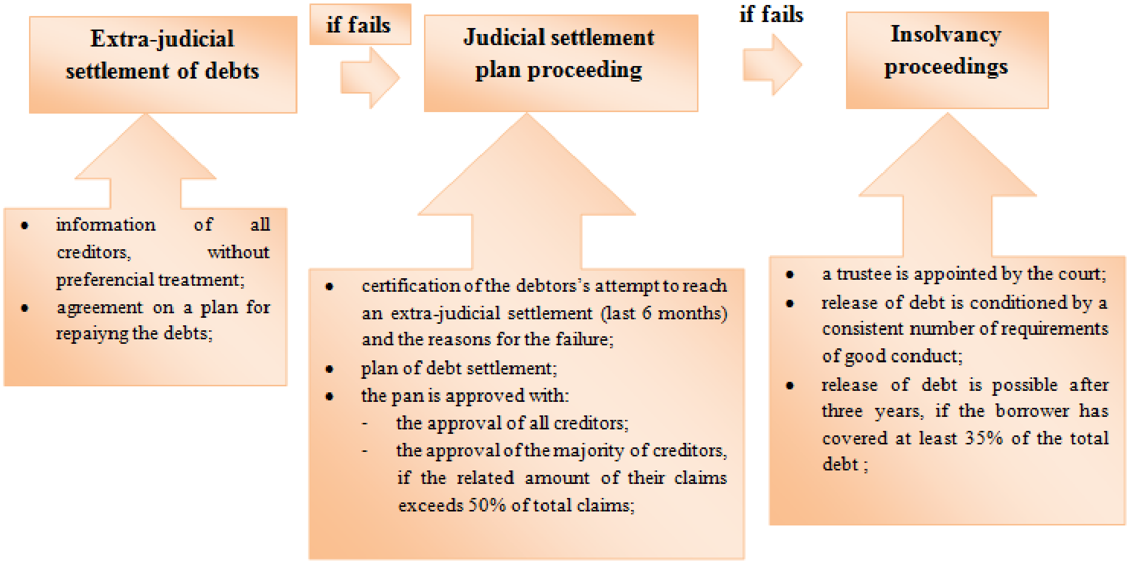
2. Research Methodology

In this study we performed, in terms of methodology, a comparison between the personal bankruptcy legal frameworks applicable in some Western Europe countries. Similarities and differences identified may contribute to assimilation of the best legal practices in this field in Romania. The methodology followed equally to identify basic principles of regulations relating to the personal bankruptcy (Avram and Avram, 2014, p.172).

3. Personal bankruptcy regulations in Germany

German insolvency law is governed by a comprehensive Insolvency Code which entered into force on January 1, 1999 and has been amended from time to time (Busshardt, 2013, p.24). After almost 20 years of discussions, hearings and negotiations the Insolvency Statute (Insolvenzordnung (InsO)) has replaced the Bankruptcy Act (Konkursordnung) and the Settle-ment Act (Vergleichsordnung) in the West German States and the Total Execution Act (Gesamtvollstreckungsordnung) in the East German States. The Insolvency Statute provides special insolvency proceedings for consumers. The provisions include three steps described in Figure no. 1.

Figure no. 1 Personal bankruptcy procedures in Germany



Source: Authors, based on legislation in the field

German legal system provides that, prior to the introduction in court of an insolvency declaration, the debtor must inform the creditors about the fact that it is unable to honor payments and must try to reach an agreement with them, giving a plan for repaying its debts. The debtor must contact all creditors, without giving preferential treatment to any of them. This attempt of ***amicable settlement***, can be moderated by lawyers, specialized consulting agencies etc.

If the attempt of amicable settlement fails, the debtor may appeal in the court with a request to open insolvency proceedings. One of the conditions for the admissibility of the request is certification, by a lawyer or a consulting agency, of the fact that, in the last six months, the debtor has tried to reach a settlement out of court with its creditors, without a result, and also the reasons for the failure to reach such an understanding. The debtor must submit a plan of debt settlement, information on its assets and income, a list of creditors and debts incurred. The plan must include all information needed for the debt repayment. At this time, the court will decide if a second attempt to resolve the debts situation between debtors and creditors (***judicial settlement***) could be effective. If the court decides in an affirmative way on this issue, it will submit the plan to the debtor and all creditors. If all creditors agree or do not have any objections against the plan, within one month, the plan is deemed approved. If the majority of creditors approved the plan, and the related amount of their claims exceeds 50% of total claims, the court may replace the objections of other creditors with the approval of the plan. *This will not happen if*:

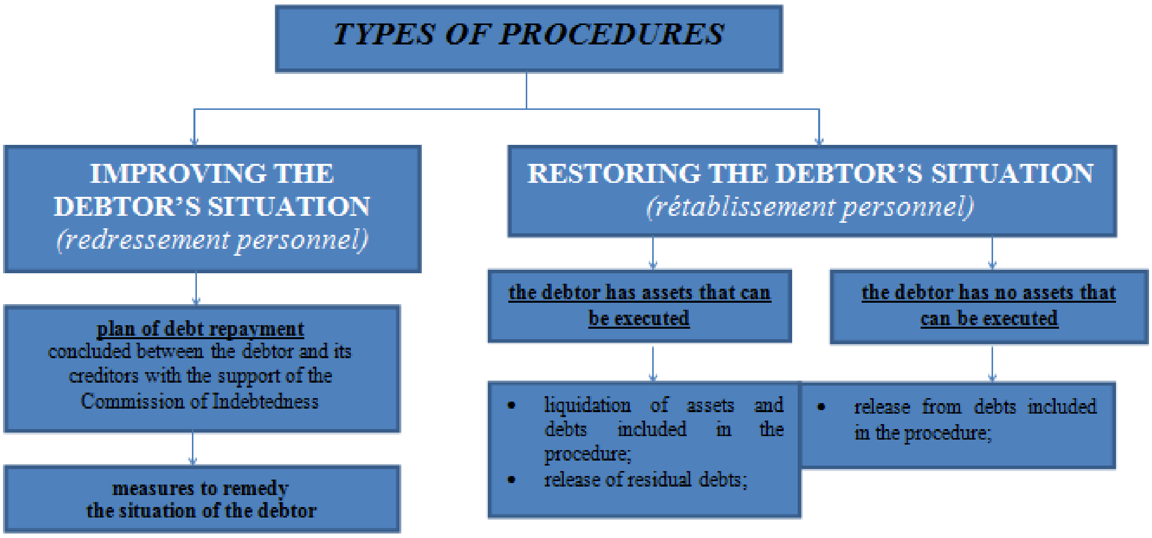
- the creditor who raised objections will not get a fair share relative to other creditors;
- the creditor in question is likely to be placed in an unfavorable economic position as a result of implementation of the plan for the settlement of debts in comparison with the opening of insolvency proceedings or the procedure of release from duty of the debtor.

If the procedure of judicial settlement mentioned earlier fails (most creditors oppose the plan submitted to the court), next step is to open the ***insolvency proceedings*** (Remmert, 2007, p.2). In this case, the court will appoint a trustee who will liquidate the debtor's assets and will distribute the proceeds to creditors. The debtor may ask in court the admission of release of debt. If the court approves the request of the debtor, it must meet a consistent number of requirements of good conduct (a considerable part of its income will be distributed to creditors and the properties may be subject to seizure, the debtor must perform paid activities for being able to make the necessary payments to creditors). After a period of six years, the court decides if the debtor is discharged of debts. Since 1 July 2014, release of debt is possible even after passing a period of three years, if the borrower has covered at least 35% of the total debt due (acts as an incentive for the borrower, as well as in the interests of creditors).

4. Personal bankruptcy regulations in France

French legal regime applicable to an individual indebtedness provides two different procedures: improving the situation of the debtor and restoring the situation of the debtor as in Figure no. 2.

Figure no. 2 Personal bankruptcy procedures in France



Source: Authors, based on legislation in the field

Debt repayment plan (Blazy and Chopard and Langlais and Ziane, 2011, p.6) aims to establish measures to remedy the situation of the debtor, such as the timing of payments, debt forgiveness, interest reductions or suspensions, consolidating debt or substitution of collateral. The plan may impose the fulfilling of these measures on condition that the debtor will act to facilitate or guarantee payment of debt. They can also be conditioned by the debtor refraining from committing acts that would exacerbate insolvency. If the parties involved in the negotiation procedures of Approved Plan, *do not reach an agreement*, or if, analyzing the situation of the debtor, the Commission finds that it is not possible to reconcile because the debtor's assets would not permit to cover all debts, the Commission shall notify the debtor and creditors. Commission, by analyzing the situation of the debtor, may require some or all of the following special *mandatory measures* and may propose the court some *special recommended measures*:

Mandatory measures	Recommended measures
• rescheduling or postponement of any kind of debt for a period which may not exceed eight years; • attributing priority to the payments of principal; • amounts carried over or rescheduled to bear lower interest rates (in justified cases to a level even lower than the statutory rate); • suspension of the claims chargeability, other than food, for a term not exceeding 2 years.	• residual debt reduction, resulting from a housing loan (owed to credit institutions or financial institutions that financed the purchase of a building), after selling the property encumbered by mortgages. This reduction can or cannot be associated with a rescheduling of the remaining payment; • partial deletion of the claims against the debtor, in combination with special mandatory measures imposed by the Commission.

When the implementation of the recovery plan expires, the creditors and the debtor return to the previous situation (except where certain claims were paid / deleted entirely) so, if there are more debts to be paid, they will again be subjected to the common procedure of payment.

If it considers that the financial situation of the individual concerned is compromised, the Commission will refocus the case to a ***restorative procedure*** of the debtor, with or without liquidation, which involves referral to court. The procedure envisages *two situations*: where the debtor has assets that can be executed, the liquidation of assets and debts included in the procedure, accompanied by the release of residual debts (except certain categories of debt) or where the debtor has no assets that can be performed, release from liabilities included in the procedure (except certain categories of debt).

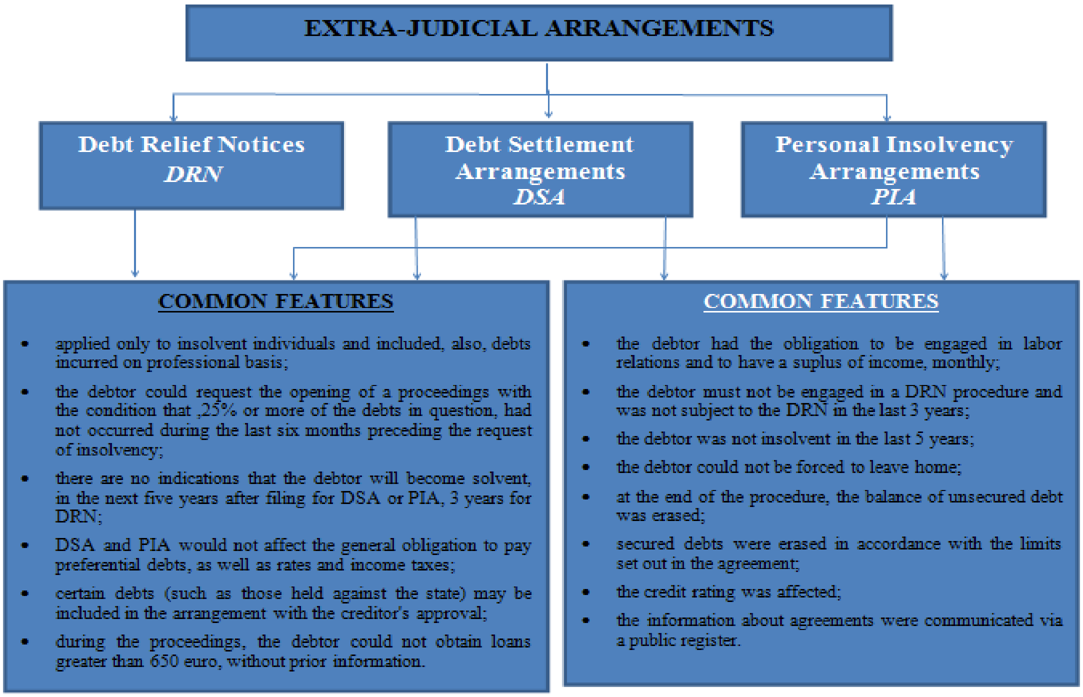
Prior to the decision to initiate the procedure, at the debtor's request, the Commission may request the court to suspend any enforced execution measures against the debtor. If the court pronounces the suspension, it will take effect on the same conditions mentioned in the table below. Another effect of opening the procedure is to suspend any interest and late payment penalties, suspension which will operate under the same terms mentioned in the table below. Also, after the procedure is opened, the Commission may, if appropriate, refer the matter to the court asking it to suspend any evacuation procedures of the debtor from home.

With the opening of a restorative procedure of the debtor's situation through liquidation, enforcement proceedings are suspended. Will also be suspended a measure of home evacuation, with the exception of evacuation measures initiated following the implementation of foreclosures. At the same time, the debtor cannot dispose of his assets without the trustee appointed by the court or, where a trustee was not appointed, without the consent of the court. If the court finds that the debtor no longer owns assets that can be executed in the process of liquidation, it may close the fund liquidation procedure for failure, in which case the borrower will benefit from the release of all residual debts.

5. Personal bankruptcy regulations in Ireland

In **Ireland**, the **personal insolvency law (2012)** reduced the period of bankruptcy proceedings from 12 to 3 years and provided three forms of extra-judicial arrangements for the redressing of the debtor, as in Figure no. 3.

Figure no. 3 Personal bankruptcy procedures in Ireland (2012



Source: Authors, based on legislation in the field

The Debt Relief Notices (DRN) (Dorly, 2013, p.18) had as a result relief of unsecured debt up to 20,000 euro, after passing a 3 years supervision period. The debtor was eligible if: didn't hold a house in property, didn't hold goods worth more than 400€ or had a lower income of 60 Euros / month. However, the borrower could hold household items, books, tools and equipment related to his professional activity (≤ 6.000 euro), personal jewelry (≤ 750 euro) and a motor vehicle (≤ 2.000 euro). A debtor was not eligible for DRN if, within two years prior to the insolvency request, made undervalued transactions or a preference right was given to one person, which substantially reduced the amount available to fulfill other obligations. The eligible debts were: liabilities related to credit cards, overdrafts, unsecured loans, rents, bills on utilities, phone bills, and guarantee liabilities of other persons. In this list were not included: court fines, child alimony, expenses related to marriage.

The procedure lasted three years, during which the debtor was obliged to notify the Insolvency Service about any significant changes on its financial situation or inaccuracies / omissions in completing the financial statement. If the debtor's income increased by 400 Euros or more per month, it had to deposit at least 50% of this increase to the Insolvency Service. The debtor could make repayments at least 50% of the debt, in which case the balance of the debt was cleared. At the end of 3 years, the debts were erased without affecting the rights of secured creditors to enforce collateral.

The Debt Settlement Arrangements (DSA) was applied to unguaranteed debts, regardless of their value. The debtor had to give a written statement on its financial situation to an insolvency practitioner. Subsequently, the insolvency practitioner was the one to organize the DSA procedure (including the application for insolvency required by the Insolvency Service) and to negotiate with creditors on behalf of the debtor. Insolvency Service notified the court, which acted by issuing a certificate of protection for the debtor. This certificate was valid for 70 days, extendable by another 40 days.

Creditors, holding at least 65% of the debts, could decide on DSA approval or could block it. The agreement reached by creditors was notified to the Insolvency Service and, in the next step, DSA was approved by the court and entered into force on the date of registration in the corresponding registry. By DSA, parties could agree to pay a percentage of the total debt through monthly installments. Unless there was a direct specification, payments were made equally to the creditors involved in the DSA and, it could be stipulated, that the debtor or another person, to provide collaterals.

Acting as an agreement (obligatory), DSA terms could not be changed without the consent of both parties. During the arrangement, the debtor was entitled to a reasonable standard of living, including food, clothing, education, medical assistance and a modest amount for savings. DSA was considered favorable to creditors, because it provided them the recovery of a part of their debts. In practice, 3 of 4 creditors agreed on DSA. The procedure had a period of 5 years (with the possibility of extension for another year), during which creditors could not initiate other legal proceedings. At the end of this period, the debtor was released from the debts referred to in arrangement.

The Personal Insolvency Arrangements (PIA) (Insolvency Service of Ireland (ISI), 2016, p.26) was applied both in the case of secured debt in favor of creditors (< 3 mil. Euros, or more, with the agreement of all creditors) as in the case unsecured debts (without maximum value). The debtor had to provide a financial statement and to obtain a declaration from an insolvency practitioner confirming, inter alia, that the borrower was eligible for PIA and there are indications that PIA could recover its financial position, within time 5 years. The proposal on PIA had to be approved by creditors, with secured debts or unsecured debts, representing at least 65% of total debt, the creditors representing at least 50% of the debt guaranteed, and by the creditors representing at least 50% of the unsecured debt. At the end of the procedure (within 7 years), the debtor was released from secured debts in favor of creditors within the limits specified by the agreement (so that, the value affected to a mortgage, could not be entirely deleted). All PIA agreements contained a claw back clause for any debt erased, applicable for 20 years. Thus, in the case of selling a property at a high price, some of the surplus had to be assigned to debt repayment.

The Bankruptcy (Amendment) Act 2015, which was signed into law on 25 December 2015, provides for several changes to the rules on bankruptcy. It includes the following provisions, which came into effect on 29 January 2016:

- reducing the normal duration of bankruptcy from 3 years to 1 year (up to December 2013 it was 12 years);
- returning ownership of the bankrupt person's home to them after 3 years (subject to any outstanding mortgage) unless it must be sold to pay creditors;
- reducing the maximum duration of bankruptcy payment orders from 5 years to 3 years, except in cases of non-co-operation or concealment of assets;
- extending the duration of bankruptcy in cases of non-co-operation or concealment;

6. Conclusions

Our research has highlighted that in France, Germany and Ireland it can be talked about the principle of "consumer-friendly legislation" and the concern for debts' recovery and return to work of the people affected by insolvency. Even if procedures are lengthy and expensive, in terms of economic system's health we face some incurred costs. If we add the authorities' efforts for the public financial education and the prudential supervision exercised by the national central banks, we understand that personal bankruptcy must be prevented and highly regulated in the situations where is necessary.

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