

# Personal Bankruptcy Regulations in Central and Eastern Europe

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## Abstract

*Countries from Central and Eastern Europe are in different stages of development and implementation of personal bankruptcy legislation. Austria has regulations comparable to those in Western Europe, while the Czech Republic and Poland have recently developed regulations regarding the bankruptcy of individuals. The solutions identified in countries that have followed a similar path, namely the abandonment of a centrally planned economy and transition to a functioning market economy, which consequently led to the problem of individual bankruptcy, can also be applied selectively in Romania in the next period.*

**Key words:** personal bankruptcy, judicial procedure, amicable settlement, recovery plan.

**J.E.L. classification:** K35, G33.

## 1. Introduction

In Central and Eastern Europe there are both countries that are members of the euro zone (Austria, Slovenia, Slovakia) and countries with derogatory status (Poland, Hungary, Czech Republic, Romania etc). For our study we chose three countries, namely Austria, Czech Republic and Poland. Austria is a country with rich experience in market economy and has already regulated bankruptcy of individuals to the existing standards in North America and Western Europe, while the Czech Republic and Poland have returned to the market economy after 1990 and implemented gradually the legislation on bankruptcy of commercial companies and subsequently on bankruptcy of individuals (Sak and Schiffman, 1994, p.927). The personal bankruptcy of interest to a number of important actors in the economy, in our opinion, credit institutions are most concerned about the legal regulation of the personal bankruptcy (Avram and Avram, 2010, p.47). Basic principles of personal bankruptcy can be found in different forms in each country's legislation being influenced by a number of elements of the nature of economic, social, cultural and religious related with accounting rules (Avram and Avram, 2014, p.174)

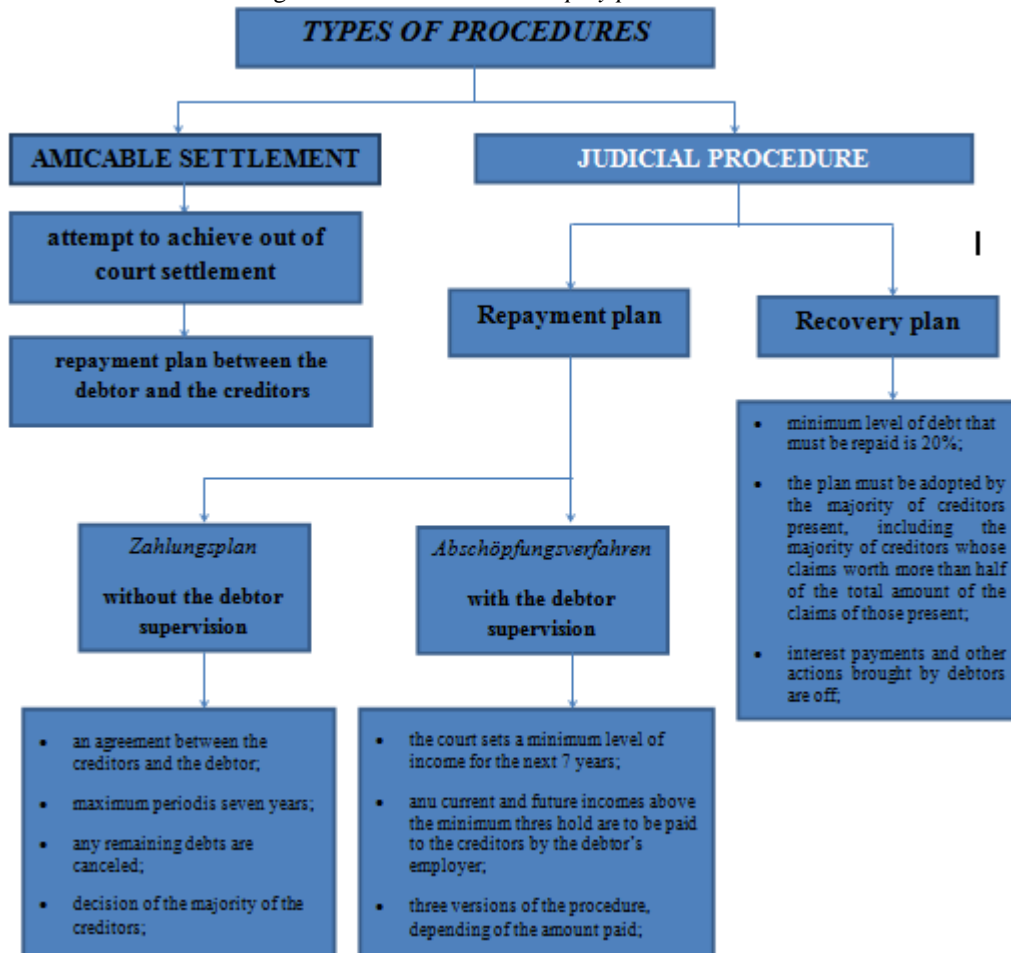
Our comparative study aims to identify how personal bankruptcy is regulated in Austria, Czech Republic and Poland.

## 2. Personal bankruptcy regulations in Austria

In Austria, personal bankruptcy is a form of judicial repayment proceedings that were established in 1995 and include a set of procedures and provisions laid down in Austria's

Bankruptcy Act. The goal of these proceedings is to give 'righteous and motivated' persons who have run into debt a realistic chance to start again (economically). According to a study conducted by London Economics (London Economics, 2012, p.15), the debtor may request the opening of proceedings if cannot meet payment so rover-indebtedness, but only if they acted in good faith. Subsequently, are available two ways of action, **amicable settlement** (out of court) establishing are payment plan between the debtor and creditors (less used in practice) or **judicial procedure**, which may involve debt cancellation by fulfilling are *payment plan* (with or without the supervision of the debtor) and cancellation of the debt by applying a *recovery plan* (Figure no. 1).

Figure no. 1 Personal bankruptcy procedures in Austria



Source: Authors, based on legislation in the field

In the case of *debt cancellation procedure by fulfilling a repayment plan, without the supervision of the debtor*, the creditors and the debtor are supposed to agree on there payment schedule through an agreement, for a maximum period of seven years. At the end of this process any remaining debts are canceled. Repayment plan is not reevaluated under changing conditions of the debtor, but only when payments are not done, in which case the process can be resumed and may be set a new repayment plan with creditors' agreement. This approach requires the majority of creditors. The debtor may also make voluntary payments from the subsistence level of income. All the debtor's assets are liquidate with the exception of those seen as basic, and legal expanses must be paid within3 years.

According to the *debt cancellation procedure by fulfilling a repayment plan, with the debtor supervision*, the court sets a minimum level of income for next 7 years and, any current and future incomes above the minimum threshold are to be paid to the creditors by the debtor's employer, through a trustee. Any potential future employers hold be informed of the insolvency of the debtor. Subsequently, there are three versions of this procedure, depending on the amount paid, and after each of them, the debtor must make a request to discharge the debt, otherwise the entire original

debt is restored, including interest on the outstanding amount.

Versions of the debt cancelation procedure(with the debtor supervision)		
<ul style="list-style-type: none"> <li>• If the debtor has paid enough to cover legal expenses and at least 50% of all unsecured claims, within three years, remaining debts are erased and the court can not order more;</li> </ul>	<ul style="list-style-type: none"> <li>• if the debtor has paid enough to cover legal expenses and at least 10% of all unsecured claims, within seven years, the debtor is discharged automatically and the debt is erased;</li> </ul>	<ul style="list-style-type: none"> <li>• if the debtor did not cover legal expenses and at least 10% of the debt, within seven years, the court may liberate the debtor or to extend the proceedings for another three years;</li> <li>• after this extension, 10% of the debt must be paid, otherwise the entire initial debt, including interest on the outstanding initial amount, is restored;</li> </ul>
Conditions the debtor must meet in order to be eligible		
<ul style="list-style-type: none"> <li>• it must be employed or, if unemployed to seek a job;</li> <li>• gifts and inheritances must be used to pay debt;</li> <li>• any changes related to the home address or employer should be reported to the court or the legal representative (including sickness);</li> <li>• the court shall provide, upon request, information on heritage and work relations;</li> <li>• debt – related payments are made only through a trustee to prevent preferential treatment of certain creditors.</li> </ul>		

**Debt cancellation procedure by applying a recovery plan** is applicable to businesses and individuals. The minimum level of debt that must be repaid is 20%. The plan must be adopted by the majority of creditors present, including the majority of creditors whose claims worth more than half of the total amount of the claims of those present. Interest payments and other actions brought by debtors are off. This model is rarely used because of these requirements, the acceptance rate falling from 3% in 2000 to 0.4% in 2014 (Wessing, 2015, p.1)

The Austrian system allows borrowers to open legal proceedings even if they do not have sufficient funds to cover legal costs and fees. In this regard, the debtor must have tried unsuccessfully an out of court settlement with the creditors, have made a second offer of compromise in court and to repay at least 10% of debts. In addition, *for all procedures are provided some general measures:*

- initiation of the bankruptcy procedure is published and shall be notified directly by the court;
- all assets of the debtor are recorded as belonging to the bankruptcy proceedings;
- debtor cannot dispose of his assets or engage in certain contracts without court approval;
- waiver of a process may result in the debtor's failure to start a new recovery plan (*Sanierungsplan*) or a repayment plan (*Zahlungsplan*) for 10 years, or an absorption process for 20 years (*Abschöpfungsverfahren*);
- husbands / wives are considered responsible (s) for the debts of their wife / husband;
- parents are not responsible for their children's debts, unless they acted as guarantor;
- the guarantor must pay what the debtor cannot pay - the principal plus interest accrued;
- the correspondences is managed by an insolvency administrator for a period of approximately 3-4 months, until are started the procedures for payment by a recovery plan.

According to *Wessing (2015)*, 8,414 bankruptcies were opened on private and formerly self-employed persons in Austria during year 2014. This is a decrease of 6.7% compared to 2013 (9,022 bankruptcies). The estimated insolvency liabilities were amounted in 2014 to EUR 1,098 million and in 2013 to EUR 1,137 million. After 20 years of practice, it is clear that the *debt settlement proceedings* provide a lot of *benefits*, which the execution proceedings were not able to provide:

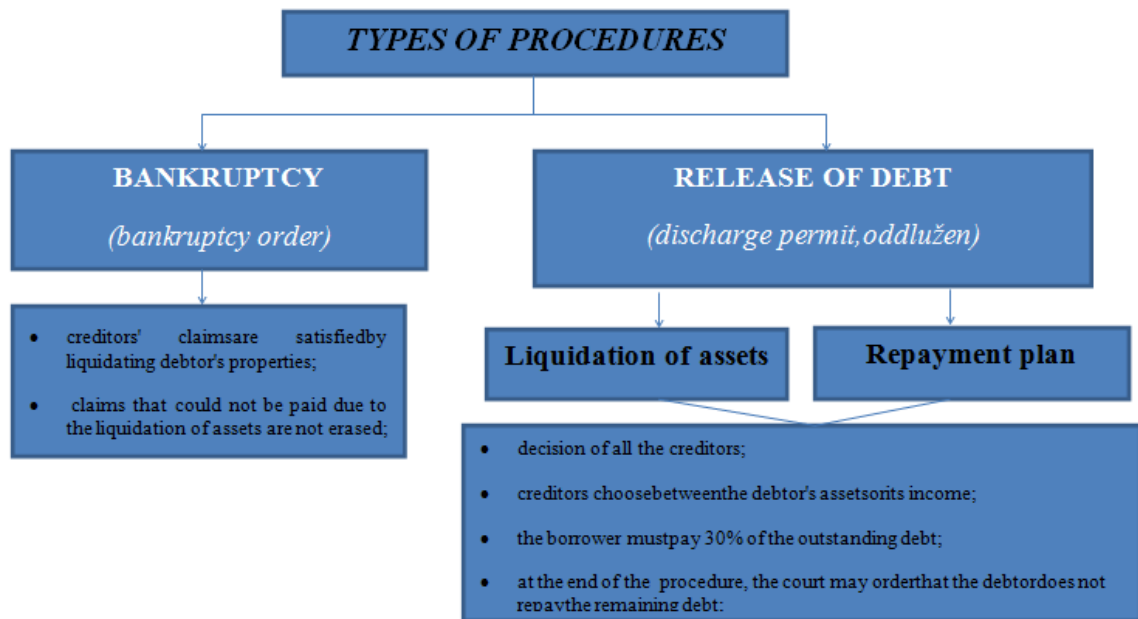
- regular payments over a longer period of time, without constant petitions or additional costs for creditors;
- effective equal treatment of creditors;

- interest stop and no further prosecution costs for the debtor;
- financial rehabilitation after a period of financial strain.

### 3. Personal bankruptcy regulations in Czech Republic

In the case of **Czech Republic**, the bankruptcy law, entitled "Act on Insolvency and Its Resolution" (Lewis, 2009, p.3), became effective on January 1, 2008. The Act introduced the idea of consumer bankruptcy law and accompanying discharge of debt into Czech law. More specifically, regarding the individuals bankruptcy, two separate procedures are regulated: **bankruptcy** and **release of debt**, as in Figure no. 2.

Figure no. 2 Personal bankruptcy procedures in Czech Republic



Source: Authors, based on legislation in the field

**The bankruptcy procedure** is the common procedure applicable to individuals and legal entities and may be triggered either by the debtor or by a creditor. *Effects of opening the proceedings* are:

- acts of management or disposal concerning the debtor's assets, included in the procedure, made by the debtor after the bankruptcy decision was taken, are not opposable to creditors;
- the act by which the debtor refuses wholly or partly a donation or inheritance is null;
- as a rule, creditors' rights regarding enforcement of claims arising after the opening of proceedings are suspended;
- unilateral acts of the debtor regarding the assets included in the procedure (e.g. delegations, orders, etc.) cease as law;
- if the debtor has entered into a loan agreement as lender, the insolvency administrator has the right to request the return of the asset even if the deadline for returning the item has not yet expired;
- the loan contracts or lease agreements that the debtor has concluded as borrower or tenant cannot be terminated by the co-contracting part for the unpaid due amounts;
- disputes related to the debtor's assets included in the proceedings shall be suspended with the exception of: criminal cases, cases involving inheritance, cases concerning the maintenance of minor children, proceedings in which the debtor acts as a single part .

As a measure of social protection for individuals, the legislation provides that, by analyzing the situation of the debtor, creditors will decide on assets that the debtor and his family will be able to keep for covering their daily needs. This decision will be taken following the request of the debtor or any member of his family.

The bankruptcy procedure is initiated by submitting a motion for insolvency to the Insolvency Court. Insolvency Court announces the commencement of the proceedings by public notice, which is published in the Insolvency Register within 2 hours. After publication of the notice, creditors may submit their applications for the recovery of claims within the period specified in the court decision-limit cannot be less than 30 days, nor more than two months. Insolvency Court appoints a judiciary administrator from a list administered by the Ministry of Justice. With the onset of the procedure, the individuals are protected from other actions filed by creditors.

Initiation of *debt relief proceedings* has basically the same *effects* as those generated by the opening of insolvency proceedings (e.g. suspend any enforcement proceedings against the debtor's assets, suspension of administration right if the court decides so, etc.). The legislation does not provide a suspension of the interest/penalties for late payment accrued prior to the initiation of the procedure, which can be satisfied during the procedure. However, any interest /penalties accrued or payable after the court decision approving the release mode, although it will be suspended, will be paid after the procedure. Regarding *the request for debt relief*, it must contain the following:

<b>The request for debt relief</b>	
<b>Content</b>	<b>Situations for rejecting</b>
<ul style="list-style-type: none"> <li>• indication on the debtor and the person authorized to act on its behalf;</li> <li>• list of all assets and liabilities or a statement about any modification in the list previously submitted in the insolvency proceedings;</li> <li>• proof of income in the last 3 years;</li> <li>• estimated revenue e for the next five years;</li> <li>• a proposal on debt discharge or a statement that the debtor made no such proposal;</li> <li>• unsecured creditors' agreement on release of liability if the amounts they receive as a result of the release procedure will be less than 30% of the claims held against the debtor (this agreements hall also state the minimum amounts accepted for payment using release procedure).</li> </ul>	<ul style="list-style-type: none"> <li>• it seeks an unlawful purpose;</li> <li>• amounts to be repaid to the unsecured creditors hall be less than 30% of their claims, except where these creditors have agreed to receive less;</li> <li>• in the past, the debtor was subject of other insolvency proceedings and demonstrated negligence.</li> </ul>

The release of debt can be done in the following *ways*:

- liquidation of assets (all acts of capitalization for the debtor's assets and payment of creditors are made by the insolvency administrator appointed by the court);
- repayment plan for a maximum period of five years - amount of payments provided by the repayment plan will increase proportionally with the income earned. At the end of the repayment plan, at the debtor's request, the court orders to discharge the remaining debt.

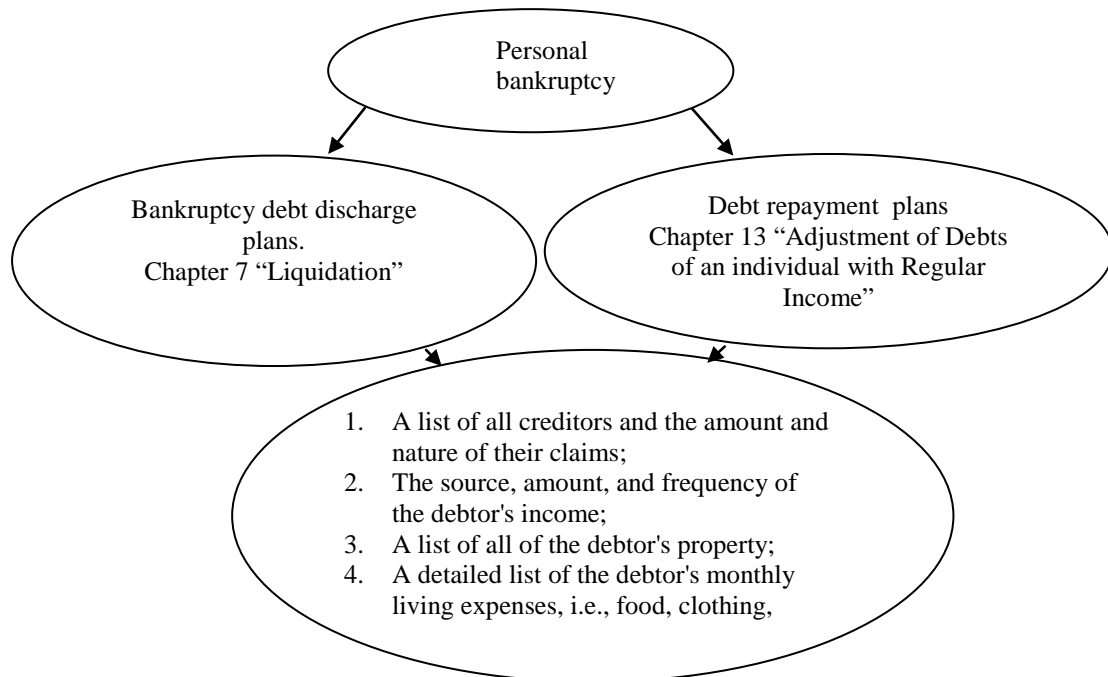
The method of debt relief is decided by all the creditors. Creditors are forced to choose between the debtor's assets or its income. As mentioned above, regardless of the method chosen, the borrower must pay 30% of the outstanding debt. After completion of the procedure, the court may order that the debtor does not repay the remaining debt. With the commencement of the proceedings, the debtor is protected by other actions that can be initiated by creditors. In the case of the repayment plan, the debtor must distribute proportionally the agreed amount to unsecured creditors, as established in the court decision, through the administrator. Insolvency practitioner will perform to the foreclosure process only at the request of a secured creditor. If the release of debt is established through liquidation, the properties acquired by the debtor after the approval of proceedings, but during the insolvency procedure, shall not be included in its heritage.

#### **4. Personal bankruptcy regulations in Poland**

Polish bankruptcy proceedings were based on the 1934 law which was amended in 1990 (Szlczak 1994, p 110). In **Poland**, since April 2009 has been extended the law of bankruptcy (Bankruptcy and reorganization Law) and from individuals, the procedure being strict and limited,

individuals can benefit only once in 10 years of bankruptcy law protection.

Figure no.3 Personal bankruptcy procedures in Poland



Source: Authors, based on legislation in the field

## 5. Conclusions

The maturity and soundness of the Austrian economy are reflected eloquently in the quality of regulations on individual bankruptcy. The examples provided by the Czech Republic and Poland are proof of the authorities' courage to adopt a legislation that was, however, controversial in the ex-Communist space.

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