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Legislating for Personal Insolvency in Ireland:
International Developments and Domestic Issues

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Keynote Address, Session One:
A comparative consumer insolvency perspective:
Key lessons from thirty years of pitfalls and best practices

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Dia dhuit and good morning! FLAC has honored me not only by inviting me to present here, but also by relying generously on my work in its absolutely marvelous and thorough submission on the pending reform bill to the authorities. I agree wholeheartedly with the general and specific FLAC suggestions in its submission, so in my comments here, I would like simply to amplify a couple of key points from a comparative perspective.

Despite a wealth of guidance based on 30 years of hard-fought experience in other European consumer insolvency systems, the Irish bill seems to be based almost exclusively on the unique experience in neighboring England and Wales. My sense is the quite unique and path-dependent model in England and Wales is probably not the best one for Ireland in any event, but whatever one might think of the English and Welsh experience, Ireland would be well advised to consider more carefully some important key lessons to be gleaned from reference to developments in Continental Europe and, a bit, in the United States. The best reform of Irish law will be driven by the state of the art now, taking into account all relevant experience and lessons, rather than simply bringing the Irish law into parity with the state of the art in one neighboring country at a state of development that ended several years ago.

These comparative developments are catalogued in easily accessible writings, including two on which I'll focus here: (1) my own little book on expert recommendations and their reflection (or not) in nearly 30 years of development in consumer bankruptcy in Europe [*Expert Recommendations and the Evolution of European Best Practices for the Treatment of Overindebtedness, 1984-2010* (Deventer: Kluwer, 2011), online at http://ssrn.com/abstract=1663108], and (2) a document sponsored by the World Bank, currently under final revision, which lays out reflections on the purposes and effects of legislative and policy choices in the structure of insolvency regimes for natural persons [World Bank, Insolvency and Creditor/Debtor Regimes Task Force, *Report on the Treatment of the Insolvency of Natural Persons* (forthcoming 2012)].

Many other countries are struggling with these questions, and I personally and the World Bank institutionally have endeavored to provide some guidance, not necessarily on what choices these countries *should* make, but as to the likely consequences of certain choices in light of decades of experience in similarly situated countries and societies. I think and hope our observations can be quite valuable to offer to Ireland in particular . . . as the bill in its current form would lead Ireland directly into some of the worst pitfalls of consumer insolvency policy and practice.

I want to focus on and amplify two main areas of important policy discussion:

First, what policies underlie an effort by Ireland or any other nation to implement more effective solutions for consumer insolvency—what goals are we trying to achieve? Second, what lessons can be learned from empirical studies of on-the-ground consequences of certain policy choices, especially relating to (1) negotiating solutions subject to creditor voting approval, and (2) the key alternative of a bankruptcy system that attempts to extract value from some debtors.

Though the Irish bill is, it must be acknowledged, a great step forward from where Ireland started, I'll observe, I'm afraid, that the current Irish bill seems either to ignore these two groups of comparative lessons, or political choices are steering it directly into an inevitable minefield that will render the new system not only ineffective, but counterproductive—a cure worse than the untreated disease.

Insolvency Policy Goals, Evaluating Proposed Solutions

First and most important, the motivating policy point: Why is Ireland proposing this new system now, why is the IMF so interested in this development, and how then should Ireland evaluate its proposed solutions?

Why now—because of an epidemic of excessive, crushing debt. This is not about a few debtors here and there, but about thousands of debtors across the nation.

Why is the IM interested? Because this is a not a temporary glitch, it's a structural shift in consumer debt patterns that threatens to undermine Ireland's economic miracle. Modern consumer lending practices inevitably produce casualties, and that is a structural phenomenon that is here to stay in a new, global marketplace. Allowing thousands of debtors to remain deactivated by debilitating debt is a serious structural impediment to a maximally healthy, vibrant economy that Ireland could and should have. Allowing value-destroying home mortgage foreclosures to proceed unabated, driven by the illusion of inflated values but which produces further downward pressures on home values, will exacerbate and lengthen the crisis in which Ireland (and the US) finds itself.

How should we evaluate proposed solutions, then? The key here is whether solutions continue to hew to the tired old slogan that contracts must be fulfilled, "*pacta sunt servanda*," focusing only on the bi-lateral relationship of creditors and debtor, or whether they break free of this and join the many other countries in Europe and elsewhere that have realized that an insolvency solution is not about the bi-lateral relationship between debtors and creditors—it's about the systemic effects of the web of debtor-creditor relationships on broader society and the national economy. Ultimately, an insolvency system acts as a safety release valve to get the economy moving again when the broader benefits of intervention outweigh the narrow and often illusory benefits of allowing creditors to insist on their rights to the detriment not only of debtors, but of society in general and its international competitiveness.

The World Bank document begins with an extended discussion of these ideas because getting us all on the same policy page is key here. Continuing to languish under the pernicious influence of "*pacta sunt servanda*" threatens to repress productive capacity for little reason other than slogans.

Certainly, legitimate debts should be repaid, and no one suggests that "can-pay" debtors should be allowed to evade their obligations, but that's the function of a simple admission-entry criterion like insolvency. Once that simple question is answered in the affirmative—the debtor is insolvent, unable to pay his debts over a reasonably foreseeable period (5 years)—we must accept that an insolvency relief system doesn't deprive creditors of their rights; the FACT of the debtor's hopeless insolvency deprives creditors of their rights. An insolvency relief system does not create mortgage losses and undermine the financial sector, it just *reveals* the losses already "baked into the cake" and forces banks to acknowledge, accept, and confront these losses, rather than continuing to ignore these already existing problems, lying to themselves, society, and regulators about the value of the collateral underlying their receivables and the state of the housing market. Squeeze as they might, creditors will not extract more blood from stones, and if Irish law allows creditors to turn more and more consumers into stones, the entire economy languishes under the dead, demobilized weight of these debtors.

Many other European countries have moved past the historical rhetoric of morality and *pacta sunt servanda*, and Ireland should, too. Why? Because of the societal salutary effects of an insolvency system, which have increasingly and explicitly driven legislative reform in this area across Europe:

Aside from the many and important benefits for creditors and debtors discussed in the World Bank document, we identify a much larger number of benefits to *society*—and these broader benefits are what most commonly and convincingly spur reform in this area. An insolvency system can:

• Encourage responsible lending and reduce negative externalities: When creditors make loans that ultimately default, they incur costs themselves, but they also externalize costs onto others, especially debtors and society. At base, insolvency law is about forcing creditors to re-internalize at least some of these costs, or at least limiting their negative impact on society. Sophisticated institutional creditors are in a far better position than most borrowers to manage the inevitable risks of default and debt distress. An insolvency regime can encourage creditors to engage in more responsible credit underwriting and loan extension by concentrating the risks of overly aggressive credit decisions on lenders themselves.

• Facilitate proper account valuation: Acknowledging the *fact* of account debtor insolvency and swallowing the bitter medicine of an insolvency relief system can put creditors and their troubled industry back on the right path toward healthy financial dealings. Ignorance is not bliss in this context. Delaying this adjustment by treating non-performing loans as potentially performing will likely increase the severity and duration of a housing and general lending industry crisis when the reality of account debtor insolvency can no longer be ignored. This is especially true in the housing sector—it isn't an insolvency relief system that causes trouble for banks, it's the *fact* of housing price declines that won't get better without the insolvency relief. The US continues to be mired in an extended housing price slump largely because of banks' unwillingness to take decisive action to put a bottom on the price drop and acknowledge their built-in losses.

• Reduce wasteful collections costs and destroyed value in depressed asset sales: Part of the panoply of "negative externalities" that creditors foist on society arise from their fruitless efforts to enforce practically uncollectible debts. The enforcement system commonly sustains an illusion that certain debts are enforceable. This phenomenon becomes a problem when creditors engage the official collections apparatus against debtors who have either no assets at all or too few assets to cover anything beyond the costs of collection. In cases where the debtor's assets are seized and sold to no effect other than paying the costs of seizure and sale, the use of the collections process produces little more than a dead-weight loss. If available assets are located, their value is often consumed in covering enforcement costs, much of the real objective value of these assets is wasted in an inefficient piecemeal sale process. This is particularly true in the home mortgage context, where foreclosure sales produce consistent and substantial (≈ 60%) losses for banks, especially in the current home price downturn. Finding negotiated solutions to avoid these fire-sale dead-weight losses is crucial to getting our home value market back to a healthy state. These losses extend beyond creditors and debtors, however, as courts are clogged with ordinary enforcement actions that strain their often already overtaxed resources. Liability in debt collections cases is often not disputed, yet because creditors sustain a sliver of hope of collecting on judgments against insolvent debtors, they engage the scarce resources of the general court system to obtain a default judgment that often proves to be practically uncollectible. Though creditors bear part of the costs of such proceedings, their filing fees do not fully cover the direct and indirect costs of burdening the judicial system with a formalistic and fruitless process

• Reduce the costs of illness, crime, unemployment, and other welfare-related costs: In addition to these direct enforcement costs, creditor pursuit of distressed debtors and properties causes a broad variety of direct and indirect social costs, leaving debtors to languish in a state of perpetual debt distress. Individuals trapped in an endless debt cycle consume precious social benefits, especially but not exclusively in states that provide some measure of social support (welfare). Most obviously, debtors discouraged from working might collect unemployment benefits. Constant harassment by creditors has been identified as the cause of chronic health and medical problems in debtors—the primary impetus for Denmark's path-breaking personal insolvency law in mid-1980s. States that provide medical support thus face an increased burden from greater numbers of patients suffering from stress- and debt-related maladies. Even in states that do not offer direct medical support, emergency rooms and other forms of last-resort health care can be clogged with people suffering from man-made distress, to say nothing of the problem of foregone preventive care by debtors unable to devote resources to avoiding future health problems. At the extreme, financial desperation has driven debtors to engage in crime, or even to commit suicide, thus imposing significant costs on society.

• Increase production of regular taxable income: The flip side of this is a positive—reinvigorating debtors to work for themselves and society, not just creditors. Other European lawmakers have perceived a pernicious competition between creditors and society when creditors continue to pursue insolvent debtors for years on the slim and likely illusory hope of a small payment. For example, policymakers in Sweden and Denmark acknowledged the undesirable but understandable tendency for debtors to go "on strike" and refuse to work to produce regular income if most or all of the fruits of their efforts will be siphoned off by creditors. This lost income harms not only the pursuing creditors, but society as a whole, and the losses to society far outstrip the losses to creditors, especially in light of the fact that continuing pressure from creditors often produces not payment from debtors, but their continued self-exclusion from the regular workforce. By keeping potentially productive debtors under threat of expropriation of any excess income, these creditors for the sake of a relatively small sum rob society of the potentially much larger long-term productive energies of these repressed debtors. An insolvency system can offer debtors the *quid-pro-quo* of release of future income in exchange for a reasonable offering of current income and effort for creditors.

• Maximize economic activity, encouraging entrepreneurship: Along the same lines, when debtors know that they will enjoy most of the value of their creative enterprise, they are more likely to push beyond mere subsistence and maximize returns for themselves and, indirectly, society. Moreover, if potential entrepreneurs know beforehand that the risks of failure are mitigated by an insolvency regime, they are more likely to confront the *risks* involved in entrepreneurship. Small- and medium-sized business is a major driver of many world economies, and a well-functioning insolvency regime can provide a powerful impetus to undertake the risks that necessarily accompany the rewards of starting a business—the motivating idea behind the Enterprise Act reforms to personal insolvency in England and Wales. Enhancing entrepreneurialism and general social engagement maximizes national economic activity and international competitiveness. *Every disengaged citizen is a link in a long chain of now lost economic and social potential.*

The optimal rate of insolvency is not zero if reasonable maximization of economic activity is desired. Risk is an inevitable aspect of pushing an economic system to acceptable limits. An insolvency regime accounts for inevitable miscalculations and casualties of inevitable risks, spreading the costs across society (as discussed below) in exchange for the societal benefits of this approach. It offers individuals a backstop, a safety net, encouraging them to be as economically active as society believes is reasonably appropriate. Identifying the line between reasonably appropriate risk and moral hazard is a challenging task, but one goal of an insolvency system is to signal where the line is and to police access to the recovery system for those who honestly miscalculated its location or who suffered the misfortune of having been pushed beyond it.

Why focus so much on the moral hazard and fear of abuse here, as the Irish bill does? The fear of abuse reflected here is, as I've written elsewhere, "still chasing chimeras"—pursuing an unreal fear not based on reality. Empirical studies have established quite conclusively that the incidence of "abuse" in existing systems is vanishingly small, as most debtors are struggling to keep their heads above water.

If failure to fulfill obligations were solely a function of debtor irresponsibility or immorality, redistributing the consequences of undesirable behavior onto the debtor's neighbors would itself be undesirable. But default is rather seldom solely the consequence of factors within the debtor's control.

Economic cycles take their toll on debtors' borrowing decisions, especially home purchases regardless, and often despite, debtor's careful planning. Unemployment can strike like a tornado, and debtors are not situated to avoid these kinds of tragedies through prudent planning.

Debtors in modern financial societies are at the mercy of swings in currency valuations and actions taken by finance houses seemingly far removed from the debtors' lives. The globalization of world economies like that in Ireland has placed debtors at the mercy of forces in far-flung areas of the globe whose influence is neither anticipated nor controllable (e.g., risky investments by US Wall Street banks in residential mortgage-backed securities that then bring down the world economy!).

Debtors in all societies are at the mercy of potential health problems, divorce, childbirth, and all manner of life events that strain an otherwise manageable budget to the breaking point. Life is risky, and if we want healthy levels of economic and financial engagement by our citizens, we need to provide some sort of backstop for the inevitable casualties.

• **The insurance function of insolvency relief: Concentrating losses on more efficient and effective loss distributors**: One tragedy concentrated on a few debtors is likely to destroy these individuals. But dividing and dispersing the burden of tragedy among all members of society produces an equitable and solidary solution. Everyone contributes a little in exchange for the promise of salvation from devastating demands.

An insolvency regime fills a similar function to mandatory auto insurance in redistributing the inevitable casualties of expected but unpredictable financial distress. No one can accurately predict where financial distress will strike, but the lenders in charge of a substantial portion of the debts behind any given instance of financial distress are able to factor aggregate losses into their business model and incorporate the costs of such casualties into the rates they charge all borrowers.

For "honest but unfortunate" borrowers who fulfill the entry requirements for an insolvency regime, a natural role for lenders is to concentrate and redistribute the increased costs of inevitable financial distress among all borrowers. All borrowers benefit from the availability of credit despite the risk of default, all borrowers benefit from the variety of positive effects that flow from the availability of a safety-valve insolvency regime, and so all borrowers can fairly be expected to share in the widely distributed costs of default and rehabilitation.

Some continue to argue that this approach imposes an unfair penalty on "responsible" borrowers who would never default. "I work hard and make sacrifices to pay my debts—why should my loafing neighbor get his debts written off for nothing?" This perspective, though, is akin to equating mandatory auto insurance premiums with a penalty on safe drivers who would never experience an accident. It's not "unfair" that your neighbor whose car was totaled in a road accident gets a new car from the insurance company, while you, a "safe driver," are forced to pay premiums for insurance without any casualties and still continue to drive your old jalopy (banger). No matter how carefully one drives, one never knows when, through forces beyond one's control, an auto casualty will occur. Likewise, no matter how carefully and responsibly one manages one's finances, one can never be sure when financial distress will strike unexpectedly as a result of distant and perhaps unexpected forces. Both of these systems are here to protect all of us when we need it, likely through no fault of our own (as discussed above).

Some element of "moral hazard" will always be present in systems like this. Some people will choose to drive in a riskier way, and some people will consume credit in a riskier way. But the answer to these hazards is not to eliminate either auto insurance or insolvency relief. The answer is proper administration and enforcement of the credit/insolvency and driving/insurance systems. Proper enforcement of driving rules will isolate and punish those who drive in an excessively risky way, and careful entry and exit requirements for an insolvency regime will isolate and exclude debtors who engage in excessively risky or irresponsible credit behavior.

Auto accidents and distressed debt could both be almost entirely avoided by never driving or borrowing against future earnings. A modern country like Ireland doesn't want to eliminate driving or borrowing—overreaction and over-deterrence deprives a country of the many benefits of these inherently risky activities. Ireland has embraced the benefits of lending; e.g., smoothing consumption and reducing the volatility of financial supply and demand over time. Borrowing and driving each carry inevitable risks and casualties, and some form of loss spreading is a healthy way of maximizing and smoothing the benefits for all.

An insolvency regime thus represents a sort of trade-off for deregulation of consumer lending. If natural persons are to be exposed to inevitable risks that they do not—and likely cannot—understand or avoid, insolvency restores fair equilibrium by offering insurance against those risks, with the "premiums" financed through small and appropriately distributed increases in the cost of credit.

Just as an insolvency relief system carries a risk of undermining payment morality, there is an equally significant risk in losing the many benefits of an insolvency system by failing to provide effective relief. To achieve these goals, we want more hopelessly financial distressed people in this system, not fewer. Some danger of moral hazard will be present in any system, but these slippages should not overshadow the substantial benefits of providing relief in the overwhelming majority of cases involving debtors who have tried and failed due to factors largely or entirely beyond their control. Care should be taken to avoid sacrificing the great good of such a system simply because perfection cannot be assured.

Comparative Lessons on Negotiated Alternatives

On to the second major topic: the notion of encouraging negotiated alternatives to bankruptcy and the long and frustrating struggle with that in other countries.

The World Bank document draws an important contrast with business reorganization practice in this regard: Informal workout negotiations with creditors are just as common among natural person debtors as they are in the corporate context, but for a variety of reasons, creditors often find natural persons less trustworthy than corporate managers. Also, creditors' perspectives and expectations in the context of natural persons often differ markedly from the corporate context with respect to reasonable sacrifices and the moral compulsion to fulfill obligations. A settlement proposal that creditors might accept as a reasonable business measure for a corporation tends to be viewed in much more moralistic and judgmental terms when advanced by an individual. Questions of appropriate personal sacrifices and standards of living make the process of deciding whether to pursue an individual debtor all the more complicated.

In the business context, renegotiation of distressed debt is regarded as a normal issue of private contracting, rather than social planning. The limited liability of business entities offers powerful inherent leverage to debtors in such situations, and the state might well have little specific interest in preventing creditors from simply demanding that the debtor-company liquidate and go out of existence. Natural person debtors most often occupy a substantially weaker bargaining position than their business debtor counterparts. Once the situation has deteriorated to the point where a natural person debtor would seek formal insolvency relief, natural market forces and free contract negotiation are no longer sufficient safeguards of the public health and welfare.

The bargaining over a negotiated solution has to occur in the shadow of something less attractive for creditors if they are to have any incentive to accept negotiated solutions. In England and Wales, on the other side of a 5-year IVA stands a one-year bankruptcy discharge with maximum of 3 years of income payments (imposed in only about 20% of cases), and in much of Europe, the other side of a compromise arrangement is an illusory payment plan that offers creditors nothing. Yet even in these situations, negotiated solutions have been the frustratingly rare exception.

In the Irish bill, juxtaposing a 6- or 7-year negotiated plan against a 3-year bankruptcy discharge and 5 years of income payments hardly compels the choice in favor of negotiated solutions. The tri-partite approach of the bill falls directly into serious and obvious traps, and I hope the drafters of this bill can revise it before the dragonfire begins to reign down on the doomed system it sets up.

Other countries with these same problems, especially mortgage debt, are watching (esp. Spain, the Netherlands). Ireland can make some bold choices to move forward and lead, but it has to make some different choices than those appearing in the bill at present. Ireland has to begin from the current state of the art, the latest stages of development and reform of personal insolvency systems in neighboring countries. Unfortunately, the current bill does not reflect this kind of learning, and as a result, in the tri-partite approach of the bill, "there be dragons . . ."

As for the **Personal Insolvency Arrangement (PIA)**, my New York friends would offer a one-word response: *fuhgeddaboudit!* In the Irish experience, as in the US and elsewhere, one mortgage bank will hold at least 26%, and probably closer to an absolute majority, of all secured debt—that's the primary reason why Ireland finds itself in its current economic trouble—and one creditor holding 26% of secured debt is enough to scuttle any negotiated deal. As FLAC has pointed out in its submission, the bill provides for no review of creditors' unreasonable refusal to accept a "best-efforts" plan, and this is clearly what will happen.

The PIA doesn't change anything from the status quo: mortgage banks can already agree to modify unserviceable secured debt today, and they're often asked, but they don't, for a variety of mostly legitimate reasons related to future risk and uncertainty. They want closer, more careful investigation and monitoring of debtors, which they can't get effectively in a private negotiation. They can't trust that many debtors will have the wherewithal to make ongoing payments over 6-7 years (they've defaulted already, after all)—their short-term risk model forces them to dump their losses on the market (and externalize them onto society, the housing market, etc.) now, report them in the current quarter's earnings report, and move on to better days. They also simply refuse to accept the notion of providing welfare aid to distressed consumer borrowers, as that's the government's job—these are business people, tied to shareholder expectations!

This is parallel to US experience of asking mortgage banks to agree to a modification deal. Our administration has suggested, then asked, then begged and pleaded, all but demanded that banks offer mortgage relief to right our economy and housing market, yet banks and other lenders have steadfastly refused to accept workable solutions in more than a handful of cases, even in the worst housing and economic crisis in world history. I see no reason whatsoever to expect a different result in Ireland.

The PIA introduces what my esteemed colleague Katie Porter (California, Irvine) calls a "pretend solution" that's worse than the problem unaddressed. With no mechanism to override "bad faith" refusals to accept economic rationality, the PIA is DOA. Indeed, note that banks' resistance to this PIA is just a charade—they know it will be completely ineffective without their acquiescence, but they want to avoid taking the first step down the slippery slope toward real intervention. The PIA doesn't even represent a half-measure, it represents no measure at all to move away from the status quo.

As for the **Debt Settlement Arrangement (DSA)**, a similar fate doubtless awaits the notion of negotiating with unsecured creditors, in light of a long history of struggles with negotiation and utterly irrational, unprincipled rejection of solutions by creditors in England and Wales, France, Germany,the Netherlands, Sweden, etc. We don't have enough time to get into the details of all of these systems here, but suffice it to say that the problems with the negotiated stage of the consumer insolvency systems everywhere in the world have been severe, and relatively few workable plans have emerged from this desire for negotiated out-of-court solutions

As policymakers in Germany observed, even allowing a plan to be crammed down on a dissenting minority just won't happen, it's a "pure formality" in light of the depressed payment abilities and high debts of these debtors and the irrational resistance of creditors who insist on a moralistic view that *pacta sunt servanda.* Sweden finally threw in the towel on this utterly formalistic process in 2007 after years of observing creditors rejecting reasonable plans out of spite, irrational principle, or even disinterest!

One major reason for abandoning this burden on negotiating agencies (credit counselors) was the distraction of credit counselors imposed by these doomed negotiations. If we hope for that system to function properly for the cases that represent good candidates for a workout, we can't burden it with pointless negotiation in the majority of cases with no hope of a successful workout.

Recipes for Success with Negotiated Solutions?

Where negotiated solutions have had some success, the success is relatively clearly attributable to the intervention of a **neutral, trusted intermediary** in brokering arrangements—trusted by the creditors and having perhaps some *gravitas* with them.

France has had a specific consumer insolvency regime since 1990, and a negotiated payment plan is the result for a majority of debtors there still, though this is attributable to two major factors.

First, this system serves anyone who is "overindebted," which includes far more than just "insolvent" people. The French system is like credit counseling and an insolvency system combined, so the high success rates for negotiated plans reflect the bulk of debtors with temporary liquidity problems, not long-term insolvency. The longer-term insolvent debtor in France has had access to more and more aggressive forms of relief over the years, leading to a situation now where about 25% of filings in the French system are routed immediately to a full and immediate discharge, with or perhaps without a liquidation of assets!

Second, even for the first group who are able to propose a decent compromise plan, those plans were rejected by creditors until an 800-pound gorilla stepped in—the *Bank of France*. Its intervention was the turning point in achieving a marked rise in plan acceptance—and the courts always stood ready to impose reasonable Banque-formulated compromise arrangements on recalcitrant creditors. After 2010, the BdF-headed commissions themselves can impose most compromise arrangements, because creditors have proven themselves over and over to be incapable of negotiating in this context rationally and in good faith.

The central bank's pivotal role lent crucial legitimacy to the radical new law in the eyes of lending establishments, and the bank's participation was instrumental in overcoming the initial reticence of many creditors toward the new system. In the face of obstructionist attitudes from many institutional creditors during the first few years of the new system, working groups constituted by the Banque de France successfully lobbied their constituent credit organizations in support of the new law. This lobbying effort produced a strong upsurge in creditor cooperation and an increase in the success rate of out of-court plan negotiations from only about 30-40% to about 65%, having later fallen back to just over 50% in light of new alternatives.

A particularly instructive example of the importance of a trusted intermediary in the plan negotiation process comes from the unique system in the **Netherlands**:

The Netherlands have a long and impressive history of debt negotiation supported by a well-developed credit counseling infrastructure with a historical relationship with the banking sector: the national coordinating association for credit banks (*Nederlandse Vereniging voor Volkskrediet* or *NVVK*), which focuses on counseling now. The historical success of that quasi-banking counseling system had fallen to disappointing lows after the adoption of the formal personal insolvency relief law, the *Wsnp*, in 1998. Within only a few years, only 9% of proposed out-of-court workout arrangements were accepted by creditors. After a long struggle to raise this success rate, in the past few years the plan acceptance rate has climbed to back up around 30% based on a coordinated and concerted effort by the NVVK—the key trusted intermediary—on two fronts:

First, rather than treating every case as a suitable candidate for an out-of-court solution, counseling agencies implemented a sort of triage system. History had shown that the most financially overwhelmed debtors were clearly destined for the formal debt adjustment system, so NVVK counselors stopped resisting that inevitable result. Such debtors were simply prepared for and routed directly to the formal *Wsnp* system, with a certificate attesting that any attempt at a voluntary arrangement would be pointless. With fewer resources diverted to such hopeless cases, counselors could concentrate their efforts and enhance success rates in cases where an extra-judicial workout was a realistic objective.

Second and even more important, the NVVK had observed that one-third of unsuccessful negotiations failed as a result of rejection by one major creditor: the collections bureau for fines and penalties (*Centraal Justitieel Incassobureau*, generally called by its acronym, CJIB). The NVVK concentrated on convincing this one key creditor to support more out-of-court arrangements, a tactic that seems to have paid off.

Unless MABS is to be the centre of the Irish system, and creditors trust it as a neutral intermediary (which doesn't seem to be the case, as MABS seems explicitly to represent debtors), creditors just won't have a solid basis for accepting plans proposed by debtors, even represented ones. The long struggle in England and Wales with debtors represented by lawyers and accountants, leading to the "TIX-compliant IVAs" process is instructive. We need neutral, trusted brokers, not advocates, to have any success with negotiated solutions.

Without some serious incentive or compulsion for creditors to accept these negotiated solutions, Ireland will be in a worse position than England on IVAs and the Netherlands with its pre-*Wsnp* negotiations, with no "stick behind the door" (as the Dutch say, *stok achter de deur*) of a truly worse bankruptcy option for creditors. As we'll see in a moment, the bankruptcy alternative proposed in the Irish bill is much better than its predecessor from the debtors' perspective, but it still isn't particularly menacing for creditors. If creditors don't trust the plan proponent, and they have no real negative incentive to avoid the alternative of a bankruptcy, there can be virtually no hope of successful workout plans along the lines of PIA or DSA. We've seen this over and over in Europe and the US for decades.

Worse yet, if debtors are able to propose a DSA or PIA Draconian enough to attract supermajority creditor consent, experience all over the world suggests these plans *will fail*. We've seen this in France, which amended its system precisely because debtors were pressed into unworkable plans, and we've seen it in the few places that actually monitor failure rates for plans: IVAs in the UK fail at a rate of at least 30%, and for plans that add secured debt, Chapter 13 plans in the US fail at a rate of at least 66%. This cure here will be worse than the disease, kicking the can down the road.

As for the alternative, on the Continent, the real "cram-down" solution is an imposed debt adjustment plan—often zero payment, but some number of years of monitoring—while in Ireland (as in England and US) the "stick behind the door" is a **bankruptcy** filing . . . and this could work but bear in mind two crucial things:

First, the overwhelming majority of debtors will (be able to) seek relief only in bankruptcy, though expect lots of whining later about debtor "moral hazard" and debtor's "not trying hard enough" to fulfill responsibilities with utterly unworkable 65% and 75% creditor acceptance hurdles!

Second, the new, shorter 3-year discharge period is a vast improvement over what Ireland has now, but it's not short enough, especially in light of the 5-year income-payment period. These payment provisions don't set up a sufficiently distasteful alternative for creditors. In any event, the key here will be how realistic the payment order provisions will be applied, since most debtors will have little or no reasonable excess capacity. A five-year payment period after a three-year moratorium in the new Irish bankruptcy provisions is far less reasonable than the English model of one-year discharge co-extensive with the three-year payment plan imposed in only about 20% of cases.

Goodness knows whether the "income payment order" rules will be applied rationally and constructively here given the guidelines proposed in one of the final Heads of the Irish bill. One final clear lesson is that leaving this to the case-by-case discretion of judges is a recipe for problems, as described in both my own reflection on 30 years of European experience and the World Bank document—these guidelines had better be closer to the Dutch *Recofa* guidelines than to some "reasonable needs" standard, as in England and Wales.

Conclusion

Unfortunately, the Irish bill is comprised of a series of half-measures that seem to have missed the purposes/motivations/salutary effects not only to debtors and creditors, but to *society*, as discussed in World Bank document.

You can't solve a collective action problem by a negotiated, contract solution!

Parroting the cobbled-together raft of disjointed provisions in the English model is likely not a good solution. A much more efficient and effective series of models is just across the English Channel on the continent: One portal, one solution, based on public policy, not creditor negotiation and English path dependency. Don't leave Ireland's public policy to England's path, much less to banks and their shareholders. Look where they got Ireland.

Strike out on a new path based on genuine goals: If you want to encourage cheaper, more amicable solutions, accept that many big creditors will be obstructionist, and imposed solutions will benefit other creditors, debtors, and society. If you want to maximize responsible fulfillment of debts, why offer a bankruptcy *choice*? Just put everyone in a standard income-expropriation plan with a reasonable amount and a reasonable time—and 8 years is probably not reasonable, but experience elsewhere indicates that this is a fool's errand, enormously wasteful to extract a few pennies from a few "can-pay" debtors while spending many pounds administering the multitude of "can't pay" cases. In Germany, 80% of cases extract no return for creditors beyond debtors' subsistence budgets, and this is not an isolated example.

Better to simply identify those who can pay, extract a reasonable payment from them, and have that be that . . . with others routed to an immediate discharge and re-insertion into the healthy economy, as in France. Any other model imposes waste and expense on every actor in the system, especially the state and its taxpayers, to subsidize creditor avarice and an irrational desire for punishment of debtors, who are not *malefactors*, but *victims* of local financing risk-taking by banks and global economic forces beyond consumers' control and probably beyond their comprehension.

No one benefits from accepting the moralistic fairytales of creditors. Stop listening to the shrill warnings of "hordes of sharpies" taking advantage of the system—a handful of creditors are keeping productivity and society under their thumbs in the current system due to their illusion of collectability against legions of otherwise productive, healthy people.

Especially from the IMF's perspective, I presume, this is about macro-economic competitiveness in the global marketplace, not morality—and lectures from international banks about morality ring particularly hollow. This is about healthy risk-taking, and being a consumer today, especially a homeowner, is an inherently risky proposition—and banks ought to accept this and get out of the way.

Stop capitulating to illusions and empty threats and rhetorical allusions to morality, and take the necessary bold steps to liberate the economic productivity and vitality of the Irish people!

Go raibh míle maith agat!