Review of the Code of Conduct on Mortgage Arrears

Submission to the Central Bank of Ireland

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Introduction

I welcome the Central Bank's review of the Code of Conduct on Mortgage Arrears and the opportunity provided to offer views on the operation of the Code. I note that the Consultation Paper raises a number of specific issues on which the Central Bank welcomes opinions, but also invites views on any other issues in relation to the operation of the Code of Conduct which should be considered as part of the review. In my submission I therefore comment both on specific proposals outlined in the Consultation Paper and on wider issues relating to the operation of the Code. I focus in particular on the interaction of the Code with procedures under the Personal Insolvency Act 2012 and with other relevant consumer protection legislation.

While my submission therefore does not relate to wider questions of the overall policy approach to the resolution of the mortgage arrears crisis embodied in the Code, I nonetheless begin by outlining the policy context from which my views arise. I work from the assumption that a programme regulating mortgage arrears management and mortgage debt restructuring serves the objectives (briefly described) of:

- Avoiding the social costs for households, losses to lenders, and wider externalities for society, caused by mortgage repossessions.[1]
- Facilitating wider economic growth by reducing excessive household debt burdens in order to increase household productivity both in terms of employment and consumer spending.[2]

The reduction of current household debt service burdens to sustainable levels of regular repayment prevents mortgage repossessions and evictions in the short-term; while the objective of deleveraging households involves a reduction in overall debt burdens of households over a longer-term. [3] These objectives are linked in the (uncertain and contested) extent to which overall debt burdens may influence the sustainability of repayments (based on the assumption that households faced with a debt burden which is unpayable in the long term may have reduced incentives to maintain repayments). I acknowledge that the pursuit of these objectives may be tempered by the additional objective of ensuring the stability of the banking system. Policymakers in other countries have developed means of balancing these objectives through systems for restructuring secured debt, as noted by a recent World Bank report, which observes that:

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[1] *See e.g.* WORLD BANK, REPORT ON THE TREATMENT OF THE INSOLVENCY OF NATURAL PERSONS 26–39 (2013), http://siteresources.worldbank.org/INTGILD/Resources/WBPersonalInsolvencyReportOct2012DRAFT.pdf; Adam J. Levitin, *Resolving the Foreclosure Crisis*, 2009 WIS. LAW REV. 565 (2009); Alan M. White, *Deleveraging the American Homeowner*, 41 CONNECT. LAW REV. 1107 (2008).

[2] *See e.g.* WORLD BANK, *supra* note 1, at 30–39; INTERNATIONAL MONETARY FUND, *Dealing with Household Debt*, *in* WORLD ECON. OUTLOOK 2012 1 (IMF 2012); LAW REFORM COMMISSION OF IRELAND, CONSULTATION PAPER ¶¶ 5.06–5.15 (2009).

[3] As well as the costs to the wider economy of the heavy debt burdens caused by excessive mortgage debt, the social implications of this problem and its potential to engage the humanitarian and human rights commitments of the State should be recognised. For example, in a recent review of economic, social and cultural rights in Spain, the UN Committee on Economic, Social and Cultural Rights (applying Art 11, para. 1 of the UN Covenant on Economic, Social and Cultural Rights 1966) stated it was "deeply concerned about the situation of individuals and families who find themselves overwhelmed by housing costs after taking out long-term mortgages". The Committee recommended that the State "amend its legislation to give borrowers the possibility of surrendering their homes in settlement of their mortgage rather than leaving this option solely to the banks' discretion". *See* UNITED NATIONS ECONOMIC AND SOCIAL COUNCIL, CONCLUDING OBSERVATIONS OF THE COMMITTEE ON ECONOMIC, SOCIAL AND CULTURAL RIGHTS: SPAIN ¶¶ 21–22 (2012).

> "[t]he key to understanding the motivation behind these systems is that policymakers have acknowledged that the financial damage and the losses they fear have already materialized. A properly structured system for relieving insolvency or mortgage distress does not cause losses to the banking sector and does not destabilize the financial sector; rather, these losses already exist, created by the unavoidable fact of debtors' inability to service their debts properly, sometimes exacerbated by chronically depressed collateral values, especially homes."[4]

In the light of these objectives, a number of concerns arise in relation to the operation of the Code thus far. Firstly, approximately half of restructured mortgages are in arrears, either because pre-existing arrears have yet been cleared, or because there has been a default in meeting the terms of the restructured arrangement.[5] This suggests a low success rate in renegotiated arrangements, and that restructurings to date have not involved sufficient reductions in the household debt service burden as to reset mortgage repayments at affordable levels. A related concern is the apparent rising rate of complaints to the Financial Services Ombudsman in relation to mortgages, with complaints rising from 247 in Q1 and Q2 2010 to 599 in Q3 and Q4 2012.[6] This suggests increasing dissatisfaction among borrowers with lenders' practices in relation to mortgages, which is a concern for the operation of the Code of Conduct and its aim of achieving arrangements which reflect the interests of both lenders and borrowers.

A further concern is that a large majority of restructurings have involved interest only arrangements and reduced payment arrangements (59% as of end-December 2012). These arrangements may reduce the household debt *service* burden, furthering the objective of preventing repossessions and evictions in the short term. Such restructurings do little to reduce the overall debt burden of the household, however, and in fact in most cases will increase the overall long-term (potentially life-long) indebtedness of the household. Research from the Financial Services Authority on the UK financial sector crisis found that interest-only mortgage loans are associated with increased levels of default and unaffordability,[7] and since these mortgage types have led to such problems it is difficult to see how restructurings based on this format can provide long-term solutions for households already in financial difficulty. The reliance on restructurings based on the capitalisation of arrears (12.2% of restructurings) is also concerning, as this may serve to increase, rather than reduce, a household's long-term overall debt burden. I therefore support the Consultation Paper's acknowledgement of the need for policy to move beyond shorter-term solutions to produce long-term restructuring arrangements capable of achieving the public policy objectives which the system serves.

I acknowledge that these concerns are wider policy issues which do not fall within the immediate scope of this Consultation. They nonetheless reflect the policy background in which I outline a number of issues for consideration in relation to the Code of Conduct and wider arrears management practices of regulated entities. I focus in particular on the relationship between the Code of Conduct and the wider legal system, most notably the Personal Insolvency Act 2012 and relevant consumer protection legislation.

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[4] WORLD BANK, REPORT ON THE TREATMENT OF THE INSOLVENCY OF NATURAL PERSONS ¶ 329 (2013).

[5] Central Bank of Ireland, *Residential Mortgage Arrears and Repossessions Statistics Q4 2012*, http://www.centralbank.ie/press-area/press-releases%5CPages%5CResidentialMortgageArrearsandRepossessionsStatisticsQ42012.aspx.

[6] FINANCIAL SERVICES OMBUDSMAN, FINANCIAL SERVICES OMBUDSMAN: BI-ANNUAL REVIEW 2012, at 12 (2013).

[7] FINANCIAL SERVICES AUTHORITY, MORTGAGE MARKET REVIEW, 56–57 (FSA 2009).

General Issues in Relation to the Operation of the Code of Conduct

The Legal Status of the Code of Conduct

A first important issue not raised directly in the Central Bank's Consultation Paper is that of "the somewhat troublesome issue of the precise legal status of the Code of Conduct."[8] At present considerable legal certainty exists as to the legal status of both the *Code of Conduct on Mortgage Arrears* and the Central Bank's *Consumer Protection Code*.[9] In particular, while it is clear that breaches of a Code issued under section 117 of the Central Bank Act 1989 may be enforced via administrative sanctions or criminal prosecution; it is uncertain of the private law consequences of a breach of the Code by a regulated entity. In particular, it is unclear as to whether a breach of a Code issued under section 117 operates to prevent a court from enforcing a claim for repayment of a breaching creditor. This issue was identified by the Law Reform Commission of Ireland in its 2009 *Consultation Paper* and 2010 *Interim Report* on *Personal Debt Management and Debt Enforcement*; as the Commission noted that the statutory provisions under which the Central Bank issues such codes are silent as to the legal status of these codes from a private law perspective.[10] The Commission recommended that the legal status of the Central Bank codes should be clarified to remove this uncertainty and the potential for inconsistent treatment of the codes by different courts.

In 2010 the Oireachtas Joint Committee on Social and Family Affairs assumed that it is not possible for consumers to take a private law action against a creditor who has breached the Code of Conduct on Mortgage Arrears, with all such breaches to be investigated by the Central Bank itself. [11] The Committee considered that this provided no recourse for individual consumers who have been mistreated, and so recommended that the Code be issued as a statutory instrument and that consumers should be empowered to sue the breaching regulated entity directly for breaches of the code. Similarly, the 2010 *Final Report* of the Mortgage Arrears and Personal Debt Group recommended that the Code of Conduct should be admissible in legal proceedings.[12]

Recent case law has highlighted the legal uncertainty regarding the legal status of statutory codes issued under section 117 of the Central Bank Act 1989. In non-binding commentary in the decision of *Zurich Bank v McConnon*, Birmingham J suggested that a defendant debtor could not rely on a breach of the Consumer Protection Code as a defence to a claim for the sum due under a loan agreement.[13] The court took this view on the basis that the relevant legislation did not specify that a breach of the Code would render a contract falling within the Code's scope of operation void (unlike other legislation such as certain provisions of the Consumer Credit Act 1995). The court also rejected, applying general contract law doctrine, the argument that the provisions of the Code form implied terms of the loan agreement between consumer debtor and regulated creditor. In the 2012 decision of *Stepstone Finance*, however, Laffoy J held that in

[8] Irish Life & Permanent v Duff, [2013] IEHC 43, ¶ 54, per Hogan J.
[9] *See e.g.* Irish Life and Permanent plc. v Financial Services Ombudsman, [2012] IEHC 367, ¶ 55, per Hogan J.
[10] LAW REFORM COMMISSION OF IRELAND, CONSULTATION PAPER, *supra* note 2, paras. 4.179–181; LAW REFORM COMMISSION OF IRELAND, INTERIM REPORT ¶¶ 2.49–57 (Law Reform Commission 2010).
[11] HOUSES OF THE OIREACHTAS JOINT COMMITTEE ON SOCIAL & FAMILY AFFAIRS, HIGH LEVELS OF INDEBTEDNESS IN IRISH SOCIETY 11 (Houses of the Oireachtas 2010).
[12] Mortgage Arrears and Personal Debt Group: Final Report, 6 (Department of Finance 2010).
[13] Zurich Bank v McConnon, [2011] IEHC 75 (2011).

proceedings for possession of a primary residence by the enforcement of a mortgage or charge falling within the scope of the Code of Conduct on Mortgage Arrears, a plaintiff must demonstrate to the Court its compliance with the Code.[14] Subsequent to this decision, Hogan J noted the legislative silence as to the legal consequences of a breach of the Consumer Protection Code, but offered no further opinion on the matter beyond stating that the Central Bank statutory codes "are not entirely a species of 'soft' law" and can certainly inform the thinking of regulatory authorities in assessing the conduct of regulated credit institutions.[15] Finally, in the most recent decision of *Irish Life & Permanent plc. v Duff*, Hogan J followed the decision in *Stepstone* in holding that a mortgage lender was not entitled to an order of possession where it could not show that it had complied with the Code of Conduct.[16]

Therefore the case law on the application of the Code of Conduct (and Consumer Protection Code) in private law proceedings demonstrates the existence of diverging views and considerable legal uncertainty. This uncertainty is undesirable from the perspective of both creditors and debtors. It is particularly unfortunate given that mortgage possession proceedings engage the constitutional protection of the inviolability of the dwelling[17] and the human rights protection of private and family life[18] and property rights.[19] This means that any limitation on these protections may be justified only in accordance with clear and precise legal provisions. Parties must be aware of the precise circumstances under which an order for possession can be granted. It is desirable for legislation to be enacted specifying the legal consequences in private law proceedings of breaches of statutory codes issued by the Central Bank.

I suggest that it is appropriate that breaches of these statutory courts should be capable of being sanctioned in private law litigation. The primary mechanism of enforcement of the statutory codes should remain the Central Bank's investigation and administrative sanction procedures. Nonetheless, the auxiliary enforcement of these codes via private law litigation would not only contribute to enhancing compliance levels with the codes, but would also provide redress in individual cases in which a consumer has been harmed by a lender's non-compliance with a code (thus providing just outcomes and attributions of responsibility in individual cases in a manner in which the administrative sanctions procedure cannot). The findings of the High Court in the *Stepstone v Fitzell* and *Irish Life & Permanent v Duff* decisions should be confirmed in legislation, so that creditors seeking an order of possession should be required by law to demonstrate compliance with the Code of Conduct on Mortgage Arrears. Beyond this position, further consideration may be required as to the precise legal consequences of breaches of a statutory code. Options for private law remedies range from the unenforceability of a relevant loan agreement where the creditor has breached a code, to the award of damages (for breach of statutory duty) against a breaching creditor to an aggrieved debtor, to a position under which the creditor is prevented from recovering interest on a loan in circumstances where the creditor has committed a relevant breach of a code. I acknowledge that these matters require legislation, but I suggest that the Central Bank should consider these issues and work with relevant Government Departments in proposing legislative solutions.

[14] Stepstone Mortgage Funding Ltd. v Fitzell and Another, [2011] IEHC 142, ¶ 5.5 (2012).
[15] *Irish Life and Permanent plc. v Financial Services Ombudsman*, *Irish Life and Permanent plc. v Financial Services Ombudsman*, *supra* note 9, para. 55.
[16] *Irish Life & Permanent v Duff*, *Irish Life & Permanent v Duff*, *supra* note 8.
[17] *See* Article 40.5 of the Constitution of Ireland.
[18] *See* Article 8 of the European Convention on Human Rights.
[19] *See* Articles 40.3.2 and 43 of the Constitution of Ireland; Article 1 of the First Protocol to the European Convention on Human Rights.

Transparency in the MARP

I support the Consultation Paper's emphasis that a key principle underlying the mortgage arrears regulatory regime is that of transparency. Vast information asymmetries exist between institutional creditors and consumer debtors. As the mortgage arrears process is based on negotiation and appears to be founded on the belief that private ordering arrangements between debtor and creditor will produce more efficient outcomes than legislative intervention; it is essential that borrowers hold sufficient information and that these information asymmetries are alleviated to the greatest extent possible. Borrowers must not be required to bargain in the dark without any knowledge of the "market" in mortgage restructuring and of the potential outcomes which could be agreed (and which have been agreed in other cases). Transparency in restructurings should therefore be a crucial concern of the system.

In this context, it is worrying that a practice has been described in media reports and Oireachtas debate under which lenders may be requiring debtors entering into renegotiations to sign non-disclosure agreements under which details of negotiations, or even the fact of the existence of such negotiations, are prevented from being disclosed. Regulatory action may be necessary to ensure that such practices do not exacerbate information asymmetries and obstruct the goal of promoting transparency in the system.

Due to its potential to ensure transparency at a systemic level, I support the Central Bank's proposals to require specified credit institutions to publish their performance in relation to the Mortgage Arrears Resolution Targets.[20] In addition to the information to be reported under this procedure (numbers of sustainable solutions proposed, concluded and performing), it would be useful from a public policy perspective if specified credit institutions were also required to publish further additional details of their performance. These could for example include information relating to:

- the number of cases which have reached each of the five steps of the MARP;
- the number of each *type* of restructured arrangement in those cases in which solutions have been reached;
- the number of cases in which the MARP has broken down due to a classification of a debtor as not co-operating (and so have progressed to possession proceedings, personal insolvency proceedings, etc.)
- the number of cases in which the MARP has broken down due to the credit institution's view that no arrangement is possible given the borrower's financial circumstances (and so have progressed to repossession proceedings, voluntary surrender, or various personal insolvency procedures).

The publication of such information would assist in providing transparency to borrowers entering arrangements as to the options available, while also allowing independent assessment and monitoring of the mortgage arrears resolution system and the extent to which it is achieving its public policy objectives.

[20] CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND, MORTGAGE ARREARS RESOLUTION TARGETS 12–14 (Central Bank of Ireland 2013).

Co-Operation and Engagement, Link Between the CCMA and the Personal Insolvency Act

I deal with the issues of Co-operation and Engagement and of the Link between the Code of Conduct and the Personal Insolvency Act together, given the significant overlap between these two topics. As the Consultation Paper notes, the question of the classification of a debtor as "not co-operating" is very significant, not only due to its consequences in facilitating the levying of penalty charges and potential possession proceedings; but also for its impact on the eligibility of the debtor to enter a Personal Insolvency Arrangement under the Personal Insolvency Act 2012. Therefore I support the Consultation Paper's aim of ensuring that the definition of co-operation is appropriate and clear. The proposed clarification of the definition seems unproblematic in this regard. I support the safeguard proposed in the Consultation Paper that any timelines imposed by the lender must be fair and reasonable, so that borrowers are not considered to be uncooperative in cases where it would be impossible or very difficult to comply with a particular lender request. I also support the proposed provision of additional information to the borrower by the lender and the requirement that the lender explain the meaning and consequences of not co-operating in the MARP booklet. The following discussion suggests certain additional information which should be provided to the borrower as part of this process.

The Effect of a Lender's Classification of a Borrower as "Not Co-operating"

A number of points arise as to the nature and effect of the definition of "not co-operating", and particularly its significance for the operation of the Personal Insolvency Act.

First, the Consultation Paper indicates that the Code of Conduct allows a lender to classify a borrower as not co-operating under certain circumstances. A fundamental point is that from a legal perspective, the lender's classification of a borrower as not co-operating cannot be definitive. Any classification by the lender is subject to challenge before the Financial Services Ombudsman and ultimately before the courts. Indeed in the reported High Court cases which have involved the Code of Conduct, a key issue for decision by the courts has been a dispute between creditor and debtor as to whether the debtor should be categorised as not co-operating.[21] Therefore the Code of Conduct should clarify that by "allowing" a lender to classify a borrower as not co-operating where the designated circumstances exist, the Code merely confirms that a lender will not be in breach of its regulatory obligations in proceeding to the next stages of the mortgage arrears case. This does not, however, empower the lender to make finding that the borrower is not co-operating which is definitive for all purposes; as the legal consequences of such a finding (discussed below) mean that such a decision would arguably involve the exercise of a judicial function.[22] The Code should therefore clarify that a classification by a lender of a debtor as not co-operating can be challenged by the debtor before both the Financial Services Ombudsman and the courts. The debtor should also be notified that the creditor's determination is not final on this point, and such a statement could be part of the information provided by lenders to borrowers under Paragraphs 12, 22 and 27 of the Code.

[21] *Stepstone Mortgage Funding Ltd. v Fitzell and Another*, *Stepstone Mortgage Funding Ltd. v Fitzell and Another*, *supra* note 14; *Irish Life & Permanent v Duff*, *Irish Life & Permanent v Duff*, *supra* note 8.
[22] *See* Articles 34 and 37.1 of the Constitution of Ireland; Article 6 of the European Convention on Human Rights.

My position is consistent with the policy apparently underlying the Land and Conveyancing Law Reform Bill 2013, which allows a court to adjourn possession proceedings to allow a debtor to consult with a personal insolvency practitioner for the purposes of formulating a proposal for Personal Insolvency Arrangement. In deciding whether to adjourn proceedings, one of the factors to which the court should have regard is whether the debtor has participated in a Central Bank approved process such as the MARP.[23] A debtor will only be eligible for a Personal Insolvency Arrangement if she has co-operated in the MARP for a period of six months (unless the personal insolvency practitioner is of the opinion that such co-operation would not have led to the debtor becoming solvent within 5 years).[24] Because of this position, and since possession proceedings would most likely take place where the debtor has been classified as not co-operating by the lender;[25] this Bill foresees that it may be possible for a court to find that a debtor is eligible for a PIA and has participated satisfactorily in the MARP, even where a lender has classified the debtor as not co-operating. Therefore the 2013 Bill again affirms that a lender's classification of the borrower as not co-operating under the MARP cannot be definitive, and must be subject to challenge ultimately before the courts. The Code of Conduct should confirm this point, and information to this effect should be provided to the borrower.

Borrower Non-cooperation and the Personal Insolvency Act 2012

This position becomes important when one considers the relevance of the Code of Conduct to the procedures contained in the Personal Insolvency Act. The Consultation Paper correctly notes that the debtor's co-operation with the Code of Conduct is a criterion to be considered by a Personal Insolvency Practitioner when considering whether a borrower is eligible for a Personal Insolvency Arrangement (PIA). Under section 52(3) of the 2012 Act, when advising a debtor on the appropriateness of entering either a Debt Settlement Arrangement (DSA) or a PIA, the practitioner shall have regard among other things to whether the debtor has co-operated in a Central Bank process such as the MARP.[26] This provision only relates to the provision of advice to the debtor regarding the appropriateness of these insolvency procedures, and does not create a *condition* for accessing the insolvency procedure. In contrast, section 91(1)(g) creates a substantive eligibility requirement (subject to section 91(2)) for entering the PIA procedure which requires the debtor to declare that she has co-operated for at least 6 months in the MARP. Again, it is important that it is recognised that a classification by a creditor of a debtor as "not co-operating" under the conditions foreseen in the Code of Conduct cannot be determinative of the debtor's eligibility to enter the PIA procedure. Such a position would make a debtor's access to the PIA procedure dependent on a determination by a creditor, and so would potentially infringe the debtor's right of access to justice. Rather, any determination as to the debtor's eligibility to enter the procedure, and so of all eligibility conditions including that of the debtor's cooperation with the MARP, are to be made only by the Insolvency Service, and ultimately the Circuit Court (or High Court, in certain exceptional cases), under sections 94 and

[23] Land and Conveyancing Law Reform Bill 2013 § 2(3)(a).
[24] Personal Insolvency Act 2012 §§ 91(1)(g), 91(2) (2012).
[25] This was the position, for example, in the cases of *Irish Life & Permanent v Duff*, *Irish Life & Permanent v Duff*, *supra* note 8; *Stepstone Mortgage Funding Ltd. v Fitzell and Another*, *Stepstone Mortgage Funding Ltd. v Fitzell and Another*, *supra* note 14. I acknowledge, however, that possession proceedings could also be commenced where a borrower has cooperated in the MARP but has rejected an alternative repayment arrangement offered by a lender; or where a lender has deemed a mortgage to be unsustainable and has not offered a repayment arrangement.
[26] Personal Insolvency Act 2012, *supra* note 24, § 53(3)(c).

95 of the Act.[27] Where the debtor disputes the creditor's classification of her as not co-operating, it should be open to the debtor to declare under section 91(1)(g) that she indeed cooperated; and the Insolvency Service and court should then adjudicate upon the question of whether the debtor can be considered to have co-operated for the purposes of section 91, taking into account all the circumstances of the case in interpreting this section (and not necessarily just the definition of "not co-operating" outlined in the Code of Conduct, as the Code in its present legal status cannot alter substantive law[28]). Therefore the Code of Conduct should clarify that a classification by a creditor of a debtor as not co-operating cannot be determinative of the debtor's eligibility to enter a Personal Insolvency Arrangement and that a debtor who has been so classified may (with the advice and assistance of a Personal Insolvency Practitioner) proceed to apply to enter such an arrangement. The Code should also provide that the debtor be notified that the creditor's determination is not final on this point, and a statement to this effect could be part of the information provided by lenders to borrowers under Paragraphs 12, 22 and 27 of the Code.

In addition, for the successful operation of the PIA procedure in such cases, it is essential that creditors accept any finding of the Insolvency Service and Circuit Court that a debtor has in fact cooperated in the MARP. Therefore in cases in which the creditor has classified the debtor as not co-operating, but the Insolvency Service and court have reached an alternative conclusion, it is important the creditor accepts this finding and does not vote against a debtor's reasonable PIA proposal on this ground.[29] The Code of Conduct should therefore clarify that a creditor is bound to accept any determination of the Insolvency Service and Circuit Court as to the debtor's cooperation in the MARP process prior to her PIA application, and may not reject a PIA proposal on the ground that the creditor had previously classified the debtor as not co-operating.

Regulating Creditor Participation in Personal Insolvency Procedures

This leads to a wider issue of the good faith of creditors in participating in the DSA and PIA procedures and in voting on debtor proposals. The Law Reform Commission noted that a significant problem under voluntary arrangement insolvency procedures in other jurisdictions is the practice of creditors demanding overly high repayments in order to vote in favour of a debtor proposal, without regard to the actual means of the debtor in an individual case.[30] The Commission identified this practice as having the effect of excluding over-indebted individuals from accessing debt relief procedures, and so frustrating the public policy objectives behind the establishment of such procedures. In order to counter this risk, the Commission recommended that the Central Bank should publish regulatory rules (in the Consumer Protection Code) to prevent lenders from operating in bad faith in this manner and voting against debtor

[27] Similarly, the debtor's eligibility to enter the Debt Settlement Arrangement is to be determined by the Insolvency Service and the Circuit Court under sections 60-1: Personal Insolvency Act 2012, *supra* note 24, §§ 60–61.

[28] *See Irish Life & Permanent v Duff*, *Irish Life & Permanent v Duff*, *supra* note 8, para. 59.

[29] For the voting procedure in respect of a proposed Personal Insolvency Arrangement, see Personal Insolvency Act 2012, *supra* note 24, §§ 108–10. The creditor under a mortgage loan secured against a debtor's residence will in most cases hold a dominant position in the voting process, as its obligations under the mortgage loan will most likely represent more than 35% in value of all debts and over 50% of all secured debt. This holding of debt would allow such a secured creditor to block a debtor's proposal for a Personal Insolvency Arrangement. Only in scenarios in which the debtor has multiple mortgage loans (but yet has aggregate secured debts of less than €3m - see section 91(1)(a)) would this not be the case.

[30] LAW REFORM COMMISSION OF IRELAND, REPORT ¶ 1.297 (Law Reform Commission of Ireland 2010).

proposals merely due to the repayment sum offered not meeting a "threshold" level, where the debtor's means would not allow such a level of repayment to be met.[31] The Commission's recommendations were made even in the context of the Commission's proposals for more open access to the judicial bankruptcy procedure than has been provided under the Personal Insolvency Act 2012, which would have improved debtors' bargaining positions.[32]

In order for the DSA and PIA procedures to achieve their public policy aims, it is essential that creditors cooperate in the negotiation process and exercise their voting rights reasonably and with regard to the public interest, rather than solely in furtherance of their own financial self-interest. The recently published World Bank *Report on the Treatment of the Insolvency of Natural Persons* notes that personal insolvency policymakers' "wish for voluntary settlements will not… be fulfilled automatically or by the order of the law; some institutional support and incentives are needed."[33] The Report continues to state that one of the conditions which has led to the success of voluntary personal insolvency arrangements in other countries is where the negotiations between creditors and debtors are "overseen or even facilitated by a particularly persuasive government regulator – such as a central bank".[34] This is the position under the French consumer over-indebtedness system, in which the French Central Bank has played an important role in ensuring that lenders cooperate in the negotiation process in order to advance the public policy objectives of the legislation.[35]

The Central Bank could play a crucial role in ensuring through regulatory rules that creditors act in the public interest by requiring creditors to negotiate in good faith and with regard to the public policy imperatives of the personal insolvency regime. It would be appropriate, therefore, for the Central Bank to amend the Code of Conduct on Mortgage Arrears and/or the Consumer Protection Code[36] to extend regulated entities' arrears handling obligations to their participation in procedures under the Personal Insolvency Act. Lenders should be obliged to consider and vote upon debtor proposals in good faith and with regard to the public policy objectives which the personal insolvency procedures were designed to achieve. Regulated entities should be obliged to reject debtor proposals only where there are reasonable grounds for so doing, and to notify the debtor of these reasons. Therefore creditors should be expected not to reject proposals merely on the grounds that a debtor has not offered a sufficiently high level of repayment, if the debtor's means do not permit greater payments to be made while maintaining a reasonable standard of living and reasonable levels of economic productivity and social participation of the debtor in society. Regulated entities should also be required, when voting upon any proposal, to consider the collective nature of insolvency proceedings and the principle of equality of creditors. A further means of encouraging creditor engagement with the personal insolvency regime would be for the Central Bank to require regulated entities to publish details of their participation in personal insolvency procedures, such as the numbers of debtor proposals entities have accepted and rejected.

Non-cooperation and Default Charges, Penalty Interest, etc.

[31] *Id.* paras. 1.299–1.300.
[32] *See e.g.* LAW REFORM COMMISSION OF IRELAND, CONSULTATION PAPER, *supra* note 2, para. 5.120; LAW REFORM COMMISSION OF IRELAND, REPORT, *supra* note 30, paras. 3.120–129.
[33] WORLD BANK, *supra* note 1, para. 134.
[34] *Id.* para. 135.
[35] *See e.g.* Jason J. Kilborn, *Responsabilisation De l'Economie*, 26 MICH. J. INT. LAW 619 (2004); Iain Ramsay, *A Tale of Two Debtors*, 75 MOD. LAW REV. 212 (2012).
[36] See Consumer Protection Code, Chapter 8: Arrears Handling.

The Code of Conduct on Mortgage Arrears should be considered in the context of other relevant legislation applicable to mortgage contracts and mortgage possession proceedings. In this regard, the Court of Justice of the European Union has recently issued a judgment[37] on the matter of the relationship between mortgage possession proceedings and the Unfair Contract Terms Directive.[38] The Court of Justice held that, where a consumer debtor challenges the compatibility of a contractual term with this legislation, national law and procedural rules must allow for mortgage possession proceedings to be stayed while the unfairness or otherwise of the relevant contractual terms are considered by a court. The Court reaffirmed its previous finding that, given the need to compensate for the imbalance between a consumer and a seller/supplier, a national court is obliged to consider *of its own motion* whether a contractual term falling within the scope of the directive is unfair.[39] If the court then finds a term to be unfair, it must not apply the term, unless the consumer opposes its non-application. In this case, the clauses in question which were to be assessed for fairness consisted of a penalty interest clause,[40] an acceleration clause,[41] and a clause permitting the creditor to quantify unilaterally the amount owed under the mortgage contract. These clauses were to be tested for fairness due to their potential to fall within the Directive's "grey list" of terms which may be regarded as unfair; particularly as "terms which have the object or effect of requiring any consumer who fails to fulfil his obligation to play a disproportionally high sum in compensation".[42]

Therefore as a requirement of EU law, mortgage possession proceedings must permit the consideration of the fairness or otherwise of contractual terms which are potentially incompatibility with the Directive and transposing Regulations. A duty arises under EU law for Irish courts in such proceedings to consider, of their own motion, whether clauses falling within the scope of the Directive (including those of the type considered in this case), are unfair. The courts are then obliged not to apply a term found to be unfair. In order that Irish law complies fully with this duty, it is appropriate that information is provided both to consumer debtors and to judges regarding the application of the Unfair Terms Regulations.[43] Therefore the Code of Conduct on Mortgage Arrears should clarify expressly that it is subject to any relevant provisions of European Union law, most notably the Unfair Terms in Consumer Contracts Directive (but also, for example, the Unfair Commercial Practices Directive). The Code should state that, even where the MARP has come to an end and court proceedings have commenced, a court is obliged to consider the fairness of terms falling within the scope of the Directive of its own motion, even where a consumer has not raised an argument to this effect. Also, the Code should provide that the information to be supplied to borrowers under Paragraphs 12, 22 and 27 should include notice that any charges or penalty interest may be capable of being tested for fairness before a court under the Regulations.

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[37] Mohamed Aziz v Catalunyacaixa, CASE C-415/11 (14 March 2013).

[38] EU Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts (1993). This Directive is transposed into Irish law in the European Communities (Unfair Terms in Consumer Contracts) Regulations, S.I. No. 27 of 1995 and the European Communities (Unfair Terms in Consumer Contracts) (Amendment) Regulations 2000, S.I. 307/2000.

[39] *Mohamed Aziz v Catalunyacaixa*, *supra* note 37, paras. 41, 46–48.

[40] This clause provided for annual default interest of 18.75% which was automatically applicable to sums not paid when due, without the need for any notice to be provided: *Id.* para. 20.

[41] This clause permitted the creditor to call in the total amount owed under the loan on the expiry of a specified time-limit in the event of the debtor failing to fulfil her obligation to pay any part of the principal or of the interest on the loan: *Id.* para. 21.

[42] EU Council Directive 93/13/EEC on unfair terms in consumer contracts, *supra* note 27, Annex, para. 1(e).

[43] Note in this regard the recent recommendation of the Law Commissions of Scotland and England and Wales that, in order to bring the obligation to the attention of the courts, legislation should state expressly that courts are under a duty to investigate of their own motion the fairness of clauses falling within the scope of the Directive: *see* LAW COMMISSION & SCOTTISH LAW COMMISSION, UNFAIR TERMS IN CONSUMER CONTRACTS: ADVICE TO THE DEPARTMENT FOR BUSINESS, INNOVATION AND SKILLS ¶ 7.90 (2013).

Possession Proceedings, the Personal Insolvency Act and the appropriate Notice Period

The Consultation Paper calls for views on whether, where a borrower has rejected an offer of a repayment arrangement or where the lender has refused to offer an arrangement to the borrower, the 12-month moratorium should be replaced by a 30-day notice period before legal action will be commenced. The aim of the 30 day notice period would be to provide time to a borrower to consider her options, and in particular to consult a Personal Insolvency Practitioner with a view to preparing a proposal for a DSA or PIA.

In this regard it is important to note that the Personal Insolvency Act has not been commenced, and that the new system is not yet operational. The system for the licensing and regulation of Personal Insolvency Practitioners is not yet in place. In this context, it is impossible to estimate how much time will reasonably be required by a debtor to contact a Personal Insolvency Practitioner and to work on preparing a DSA or PIA proposal. It is unclear as to how many Personal Insolvency Practitioners will be available to provide services to debtors, and whether there will be long waiting periods for access to such services. Therefore in the absence of this information, it is advisable that the Central Bank errs on the side of caution in establishing timeframes for permitting debtors to consider their options and consult a practitioner if required. Therefore more, rather than less, time should be allocated to debtors for this purpose. If an overly short notice period was established, this could be counter-productive in that it could merely result in large numbers of proceedings being adjourned by courts under the proposed Land Law and Conveyancing Bill 2013 in order to provide debtors with more time to work on preparing a PIA proposal.[44]

Therefore if the retention of the 12 month moratorium generally leads to a period of longer than 30 days being available to the borrower to explore alternative options before possession proceedings may commence, then this is the preferred option.

Contact between Lender and Borrower

Interaction with Primary Legislation and EU Law

In relation to the its provisions on contact between lender and borrower, I suggest that the Code should clarify that any requirements it specifies in relation to debt collection practices are subject to other legislation, and particularly to relevant provisions of EU law. Therefore in addition to following any provisions of the Code relating to contact between lender and borrower, lenders must also comply with relevant provisions of the Consumer Credit Act 1995 and the European Communities (Consumer Credit Agreements) Regulations 2010, as well as section 11 of the Non-Fatal Offences against the Person Act 1997. The requirement of the Code that contact should be proportionate and not excessive must at the very least establish a level of consumer protection equal to that provided under these provisions.

In addition, the Unfair Commercial Practices Directive is a maximum harmonisation measure of EU law, meaning that national laws may not provide for either less or more restrictive or prescriptive consumer

[44] *See* Land and Conveyancing Law Reform Bill 2013, *supra* note 23, § 2.

protection measures in the area harmonised.[45] Under Article 3(9) of the Directive, national laws may, however, provide for *more* restrictive or prescriptive measures in relation to financial services and immovable property. Consequently, provisions of the Code of Conduct may go beyond the provisions of the Directive in providing increased protection to consumers. The level of protection cannot drop below the minimum established by the Directive, however. Certain provisions of the Directive are relevant to the current context, most notably Paragraphs 25 and 26 of Annex I, which identify certain debt collection measures as prohibited aggressive commercial practices. Therefore any provisions of the Code of Conduct relating to contact between lender and borrower must meet the standards set in the Directive, including any future interpretation of these provisions in decisions of the European Union courts.

Regulation of the Debt Collection Industry

In a related issue which nonetheless falls outside of the scope of the Code of Conduct, the debt collection industry remains unregulated in Ireland. This is a problem which has been identified by the Law Reform Commission in proposing detailed recommendations for the establishment of a licensing and supervision system for debt collection undertakings.[46] The Commission noted that the potential for consumer harm is great in the area of private commercial debt collection, in which dubious practices have traditionally been known to be deployed.[47] The Commission also noted that Irish law is out of line with the laws of its European counterparts, as a licensing and supervision regime exists to regulate this industry in most of these countries.

Recent High Court litigation of *Sullivan v Boylan & Others* has highlighted once more the deficiencies of Irish law in this area,[48] in which the court awarded damages to a debtor whose constitutional rights (personal rights and right to the inviolability of the dwelling) had been violated by aggressive debt collection practices.[49] The High Court held that it was justifiable to award damages for a breach of constitutional rights by a private party in this case because the Irish private law (of torts) was "basically ineffective" to protect these rights. This finding is a severe indictment of Irish law as it applies to debt collection, as the law has been exposed as being ineffective to protect constitutional rights of individuals subjected to abusive debt collection practices. Thus it is imperative to introduce laws regulating debt collection practices in order to vindicate adequately constitutional protections. If a system for the licensing and supervision of debt collection undertakings had existed, the practices described by the court as "contemptible, irresponsible and outrageous", which caused "extreme distress" to a consumer debtor in this case, could have been more readily prevented. [50]

While I acknowledge that the wider issue of the regulation of the debt collection industry lies outside of the scope of this Consultation, I wish to highlight the potential for serious consumer harm raised by the lack of regulation in this area. I therefore call upon the Central Bank to support the introduction of

[45] EUROPEAN COMMISSION STAFF DOCUMENT, GUIDANCE ON THE IMPLEMENTATION/APPLICATION OF DIRECTIVE 2005/29/EC ON UNFAIR COMMERCIAL PRACTICES 17 (2009).
[46] LAW REFORM COMMISSION OF IRELAND, REPORT, *supra* note 30, Chapter. 6.
[47] LAW REFORM COMMISSION OF IRELAND, CONSULTATION PAPER, *supra* note 2, para. 4.223.
[48] Sullivan v Boylan & Others, [2012] IEHC 389 (2012); Sullivan v Boylan & Others, [2013] IEHC 104 (2013).
[49] *Sullivan v Boylan & Others*, *supra* note 48.
[50] *Sullivan v Boylan & Others*, *supra* note 48, paras. 10, 18.

legislation for the comprehensive regulation of the debt collection industry, and to work with relevant Government Departments towards the introduction of such legislation.

Information on other Options

I support the Consultation Paper's proposals to expand the requirements for lenders to provide information on alternative options such as voluntary surrender of a mortgaged property or trading down. I recommend that the information provided to the borrower should include the matters suggested in the Consultation Paper, but that further additional information should be supplied relating to the implications of these alternative options for the borrower's participation in an insolvency procedure under the Personal Insolvency Act 2012. Information should, for example, be provided as to how a surrender of the mortgaged property to the mortgage creditor could be effected under a Personal Insolvency Arrangement,[51] or via the bankruptcy of a debtor. This information would be particularly relevant in cases in which a debtor contemplating voluntary surrender is in financial difficulty in relation to unsecured loans as well as a mortgage loan. It would also be relevant where the value of the debtor's mortgaged property is lower than that of the remaining balance owed on the mortgage loan (negative equity), as an insolvency solution may be necessary to address the (potentially large) unsecured debt which would still be outstanding after the surrender of the property.[52]

I thank the Central Bank for the opportunity to offer my views on the Code of Conduct, and I hope that they are of some assistance. Given the limited time period within which this submission has been prepared, I have sought to keep my comments as brief as possible. I am happy to elaborate upon them if required.

Joseph Spooner

[51] Personal Insolvency Act 2012, *supra* note 24, § 102.

[52] The Personal Insolvency Act provides expressly for such a situation in relation to the Personal Insolvency Arrangement procedure, where it envisages the deficiency obligation owed after the sale or disposal of the mortgaged property being addressed alongside other unsecured debts in an Arrangement: *see Id.* § 102(5).