Debt Part 2: Personal Debt and Consequences

No.3 2010

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Editorial

While personal debt is not a new phenomenon in Ireland, the rapidly rising level of debt in recent years is unprecedented. Household debt, including mortgages, in Ireland currently stands at €147 billion. This level of debt has created concerns about levels of over-indebtedness and the potential social consequences which may result.

This *Spotlight* focuses on levels of personal debt in Ireland as distinguished from mortgage related debt. Personal debt is defined in this paper as personal bank or credit union loans, hire purchase agreements or loans from other financial institutions (including sub prime lenders). In particular, the *Spotlight* focuses on rates of over-indebtedness and the consequences, including bankruptcy and likely social impacts. It examines the options available to those in debt here in comparison with other countries.

27th April 2009

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Personal debt

Personal debt has increased rapidly in Ireland. This is reflected in the increase of household debt to income ratio which shows how readily debt can be covered out of current disposable income.

In 1995, Ireland had a household debt (including mortgages) to disposable income ratio of 48. By 2008, this had risen to a ratio of 176, an increase of almost 270%. This rise is much higher than for four other countries (Spain, UK, Canada and France) where similar comparative data sets exist.

Indebtedness and over-indebtedness

The rapid rise in debt can be linked to changes in access to and use of credit. Over the last decade, financial institutions were increasingly willing to lend, even to those who traditionally found it hard to access mainstream credit. Credit was also generally more affordable as interest rates were lower.

The use of credit or being indebted is not a bad thing in itself, provided an individual has the capacity to pay back the debt. Over-indebtedness, however, occurs when someone cannot pay back a debt within a reasonable period of time while maintaining a reasonable standard of living.

Over-indebtedness can be caused by a number of factors such as personal circumstances (e.g. medical emergency), economic circumstances (e.g. loss of a job) and attitudes towards money management.

While much data exists on debt in Ireland, information on the levels of over-indebtedness is more limited. Money Advice and Budgeting Service (MABS) statistics, however, provide some insights into this area as they chart the levels of debt among a group of people who have requested debt counselling.

Analysis shows that from 2008-2009, levels of debt among MABS clients increased across most debt types. In particular, sub-prime and overdraft facilities experienced large rises (>75%).

How Ireland compares?

Notwithstanding comparatively high levels of debt, survey evidence shows that the levels of financial stress among individuals in Ireland are lower than in many other EU 27 countries. Indeed, on many indicators, Ireland is above or close to the EU average.

However, when looking ahead over the next 12 months, survey respondents in Ireland are less confident of their financial position compared to individuals in many other EU countries.

Social impacts

Levels of indebtedness and over-indebtedness in Ireland have raised concerns over the potential knock-on effects for society. Over-indebtedness can have an adverse impact on personal health, access to health care, homelessness, employment and fuel poverty.

Debt problems, for example, can almost double a household's likelihood of experiencing health difficulties. Debt problems can mean that any health issues may not be properly treated. As such, research acknowledges the link between indebtedness and health problems, and highlights that direct and indirect costs to the State can result.

There are also strong linkages between over-indebtedness and employment problems. Some studies, for instance, show that debt problems, among the unemployed, can increase difficulties in finding a job. More broadly, it is highlighted that over-indebtedness can lead to wider social costs such as increased welfare, losses in tax receipts and can also impact on neighbourhood renewal initiatives.

Options when in debt

There are very limited options for those in debt in Ireland in comparison with other countries. In Ireland, there is a lack of formal insolvency schemes and the current bankruptcy system is unsuitable for a majority of current debtors. By contrast, there are personal insolvency options in England and Wales and the US.

Ireland's response to date to over-indebtedness has largely focused on funding MABS which deals primarily with over-indebted clients. Personal insolvency schemes may not be adequate to deal with people who are persistently over-indebted because of low income or bad money management skills.

This highlights the importance of calls by the European Commission, among others, that further steps should be taken to increase financial capability, and to strengthen money management skills to avoid or limit over-indebtedness.

Overall, from reviewing the experience of other countries, it is evident that financial capability skills need to be strengthened in all sectors of society to ensure that people understand the real cost of credit to them, the likely impact of a economic shock on their standard of living and their ability (or lack of) to repay debt within a reasonable time.

Text box 1: Definition of key terms

Debt to income ratio: a debt to income ratio of 176% means that for every €10,000 earned, €17,600 of debt is outstanding.

Indebtedness: a commitment to repay money which the debtor has borrowed and used (Free Legal Advice Centres (FLAC)).

Over-indebtedness: the borrowed money cannot be paid from the debtor's income and within a reasonable time in the future (FLAC).

Financial capability: financial capability is a broad concept and includes people's knowledge and skills to understand their own financial circumstances, along with the motivation to take action. Financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading to greater participation in the financial services market (HM Treasury, 2007).

Financial inclusion: the ability of individuals to access appropriate financial products and services.

Secured debt: a loan secured by an underlying asset or collateral such as a mortgage.

Sub prime: generally this describes loans to borrowers with some sort of credit impairment, due to missed instalment payments or the lack of a credit history.

Unsecured debt: unsecured debt is a loan not secured by an underlying asset or collateral such as credit card debt or personal loans. For this reason, unsecured debt carries more risk for the lender, which in turn makes the loan more expensive

Credit use and access

Many Irish people are indebted because of their use of credit. Use of any type of credit: mortgage, personal bank loan, credit cards or moneylender loans leads to indebtedness.

Credit is often used to smooth out fluctuations in expenditure. Use of credit in itself is not a bad thing and its availability increases spending power which can aid general economic activity.

In the last few years access to credit became easier for almost everyone, including those on lower incomes who were traditionally excluded from mainstream credit. Two key factors contributed to this:

- Credit became more available as financial institutions were more willing to lend.
- Credit was more affordable as interest rates were lower.

While a majority of people are able to manage their debt, any sudden economic shock such as the loss of a job or a medical emergency seriously impacts on the ability to manage and repay debts within a reasonable time.

A person can quickly move from being indebted but with the ability to repay debts, to being over-indebted and in danger of slipping below the poverty line.

The Central Bank estimates that non-mortgage related debt amounts to 18% of all debt in Ireland (Kelly and Reilly, 2005). Central Bank figures show that:

In 1995, the ratio of household debt to disposable income in Ireland stood at 48% (for every €48 borrowed, €100 was being earned); this is in sharp contrast with 2010 where €176 was owed for every €100 earned.

Looking more closely at levels of debt in Ireland, Table 1 (overleaf) charts the rise in outstanding debt to credit institutions from 2000 to 2010. The table shows that with the exception of instalment credit / hire-purchase, levels of outstanding debt among Irish residents increased over the 2000-2010 period across all types of credit to institutions.

In particular, other loans and securities repurchase agreements, residential mortgages and term/revolving loans, experienced the largest percentage increases (>200%).

Over the last two years, however, the levels of outstanding debt decreased in six of the nine types of debt to credit institutions. Only overdrafts, other loans and securities and credit cards increased from 2008-2010. The decline in some types of debt could be due to greater difficulties in accessing credit and an increase in individuals' willingness to pay-off loans.

Credit, indebtedness and over indebtedness

There is no one definition of over-indebtedness (see Text box 1, previous page, for definitions of the financial terms used in this *Spotlight*). According to FLAC, over-indebtedness can be defined as the 'imbalance or shortfall between income and expenditure. Borrowing to bridge that gap, without having the necessary means to service the debt within a reasonable timeframe, is the point at which an individual becomes over-indebted.'

Various definitions of over-indebtedness have been recently reviewed by a consortium of researchers appointed by the European Commission (2008) and a

Table 1: Aggregate amounts outstanding to credit institutions by Irish residents 1999-2010 (€ millions)[1]

	2000	2002	2004	2006	2008	2010	% change (2000 to 2010)
Overdrafts	7,798	7,632	6,966	7,389	8,104	8,770	12%
Repurchase agreements	172	752	921	457	1,615	763	344%
Loans up to and including one year	23,651	21,933	19,834	32,381	58,679	55,789	136%
Term/ revolving loans	38,009	60,440	67,510	95,382	137,345	130,434	243%
Instalment credit/hire-purchase /leases	3,337	4,720	3,595	3,659	3,651	2,461	-26%
Residential mortgages	31,816	40,647	61,460	92,765	118,984	109,770	245%
Other mortgages	5,535	7,520	9,875	11,974	17,862	14,996	170%
Other loans and securities issued to other residents	3,901	3,027	3,723	3,861	10,440	40,748	945%
Outstanding debt on credit cards	1,079	1,461	1,898	2,407	2,820	3,034	181%

Source: Central Bank Quarterly Bulletins

number of common features of over-indebtedness identified, as follows:

- **Lack of payment capacity** (an inability to meet debt-related repayments and other commitments).

- **Persistency** (a prolonged as opposed to a once-off problem).

- **Problems with a range of contractual financial commitments** (defined broadly to include mortgages, household bills and consumer credit).

- **An inability to maintain a reasonable standard of living** (i.e. an inability to live reasonably and to repay debts).

[1] All figures are not nominal.
Final column includes figures for credit unions for the first time.
The first column relates to data for end of Dec 1999. All others are end of Jan.

- **Illiquidity** (an inability to realise assets to discharge outstanding debts).

Greater access to credit has not been matched by increased financial capability. Financial capability relates to understanding the concepts of responsible borrowing and lending, and includes having the skills to be able to see how economic events such as interest rate rises would affect you.

The National Adult Literacy Agency, however, has found that 'people may find the moneylenders' repayment schedules easier to understand than an annual percentage rate (APR) even if the APR costs less'.[2]

A survey, conducted by the Financial Services Regulatory Authority (FRSA, 2008), also highlights shortcomings in relation to financial capability. Some of the key findings include the following:

- 75% of consumers find written information on financial products too complicated and difficult to understand.

- 63% of consumers do not shop around because they do not fully understand what they should look for in a financial product or service.

What causes over-indebtedness?

The European Commission has identified a number of key characteristics as being associated with over-indebtedness in the EU. They are as follows[3]:

- **Personal circumstances**: particularly being young, single and having children.

- **Economic circumstance**: low income, economic inactivity, renting a home and having little or no savings.

- **Attitude towards money management**: spending, paying bills and use of credit.

Over-indebtedness for a person living on a low income can easily be triggered when an adverse event occurs. Specific triggers from the Money Advice and Budgeting Service (MABS[4])/OPEN study included separation/relationship break-up, disability/illness, redundancy or a new baby. However these triggers would not have been so detrimental if those surveyed had not been living on low incomes to begin with.

Other factors can cause almost anyone to become over-indebted. These include adverse shocks such as illness or unemployment or money mismanagement and over-borrowing.

The changing demographic profile of over-indebtedness

Access to credit is linked to affluence, economic stability and housing tenure. For example, homeowners rather than tenants would generally find it easier to access credit from mainstream financial institutions. The use of credit, however, is more closely linked to need. Different demographic groups use credit differently. Very generally, those on lower incomes use credit to pay for day to day expenses such as rent or utilities or to ease financial hardship. People on higher incomes use credit to improve their standard of living.

Using MABS data, the demographic profile for over-indebted people in Ireland has been largely consistent since 1992 (when MABS was established).

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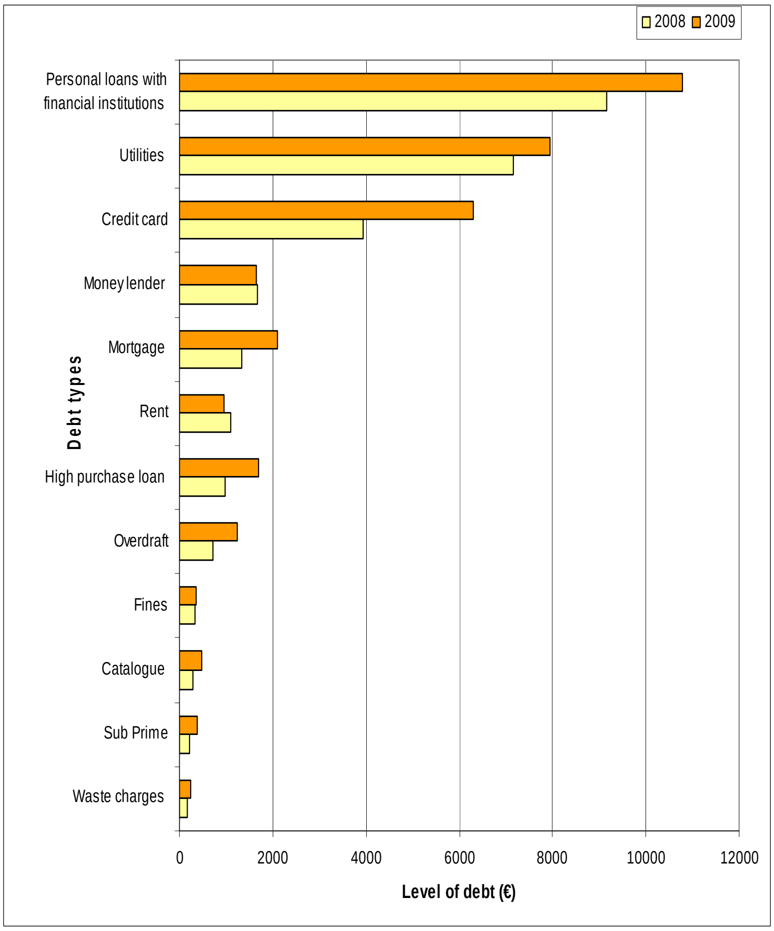
[2] *Irish Times* 30th March, 2010.
[3] Please note individuals may have one or more of these attributes.

[4] MABS is an independent community based non-profit debt counselling organisation which receives State funding.

Analysis of MABS clientele shows that in the main, MABS clients tend to be in receipt of social welfare payments (averaging 63% over time) with the majority being female aged between 26 and 40 and 60% have dependent children. Over half of all MABS clients live in either private rented or rented local authority accommodation, and have a number of relatively small debts.

In recent years, however, rising levels in unemployment (among other issues as noted above) have led to a growing number of 'new' over-indebted people. Traditionally MABS clients generally have a number of small loans but MABS has now pointed out a rise in clients with 'bigger, more complex debts'. In 2007, for example, around 2% of MABS clients had a mortgage, compared to 35% of clients in 2010.[5]

Figure 1: Change in level of debt by debt types 2008-2009



Source: MABS

Levels and types of over-indebtedness

This section looks at the type of debts owed **(excluding mortgages)**, at who owes the money and, where possible, highlights the amounts owed.

While much data exists on debt in Ireland, information on the levels of over-indebtedness is more limited. MABS statistics, however, provide some insights into this area. Although these statistics do not relate to all levels of over-indebtedness across the population, they do chart the levels of debt among a group of people who have requested debt counselling from MABS.

Analysis shows that from 2008-2009, levels of debt among MABS clients increased across most debt types. Figure 1 highlights that while personal loans with financial institutions, utilities, and credit cards form the largest proportion of debt, four types of debt experienced increases of over 70% from 2008-2009 These include the following:

- Sub-prime[6] (82.5%)
- Overdraft (75.4%)

[5] *Irish Times* 1st April, 2010.

[6] This was introduced as a category in 2008 and includes both mortgages and other loans at sub-prime level.

- Hire purchase loan (72.1%)
- Catalogue (70.8%)

From 2008-2009, utilities and fines experienced much smaller increases of 10.9% and 3% respectively, while two types of debts decreased, money lenders (1%) and rent (15%).

The Combat Poverty Agency has also conducted analysis of MABS statistics from 2006 which relates to the type of debts owed in relation to the primary income source of the debtor. This includes those on social welfare only, wage only or social welfare plus other.

The analysis is based on 4,212 MABS clients and the findings are detailed in Table 2. The fact that a person may have multiple debts is reflected in the data. This data from 2006 shows that:

- Social welfare recipients owe almost twice as much on utilities as those on wages. Almost 30% more wage earners are in credit card debt as opposed to social welfare recipients.
- Wage earners are more than twice as likely to be in debt because of a personal loan.

Table 2: Percentage of debts owed by first income source 2006

Type of debt	% of all those on social welfare only	% of all those on social welfare plus other	% of all those on wage only	% of all those on wage plus other	% of all clients
Personal loan	26.0	27.4	63.7	63.2	38.6
Moneylender	13.2	17.4	15.2	16.6	15.1
Credit card	15.0	20.0	41.7	43.8	25.2
Local authority rent	10.3	11.9	7.7	8.1	9.9
Credit union	24.9	31.0	38.0	42.3	31.2
Fine	2.3	1.9	1.5	0.75	1.8
Other	23.3	28.7	40.3	30.2	28.9
Hire purchase	6.7	7.8	12.8	13.0	9.0
Catalogue	1.8	3.5	2.6	2.3	2.4
Waste charges	1.5	3.5	1.2	1.7	1.9
Private rent	2.5	2.3	1.4	1.3	2.1
Utilities	61.3	66.2	31.2	37.7	53.6

Source: Stamp (2009)

Ability to repay debt

Debt is generally a manageable problem when a person has the means to service or repay the debt. An economic or financial shock such as unemployment or major life event such as a new baby, however, can have a huge impact on the ability to repay debt.

These shocks can create short-term impacts and can be seen through the difficulties people face in meeting day to day expenses. Longer-term social consequences may also result and these are discussed in the next section.

The Financial Regulator conducted research on levels of financial capability in Ireland between October 2007 and January 2008. This research involved interviewing over 1,500 adults. This is a wider sample of Irish society than MABS clients but some similar trends emerge.

In regard to having the capability to pay bills, the study found that while 60% reported they had little problem keeping up with all bills and commitments, 37% said they had some degree of difficulty. The report showed that this 37% can be broken down into:

- 28% who struggled from time-to-time.
- 7% who found it a constant struggle
- 2% who responded that they were falling behind and having real difficulties with keeping up with bills and commitments.

The report also found that those who reported difficulties in keeping up with bills and commitments were more likely to be lone parents with dependent children and those on lower incomes. This generally matches the profile of MABS clients.

How Ireland compares?

Given the lack of consistent and up-to-date data, it is difficult to compare levels of personal debt in Ireland with the position in other countries. Some data, however, is available on the levels of household debt as a proportion of disposable income. While this data includes mortgages and only provides information to compare Ireland across a small selection of countries, it offers one international benchmark - as outlined in Table 3.

Table 3: Household debt to disposable income ratios - percentage change 1995-2006

Country	1995	2008	% increase
Ireland	48	176	267
UK	106	173	63
France	66	72	9
Spain	59	130	120
Canada	103	130	26

Source: Goodbody (cited by Amárach)

Figures show that while Ireland's household debt (including mortgages) to disposable income ratio of 48 was the lowest recorded among the selection of other countries, this position was reversed in 2008. In 2008, Ireland had the highest ratio of household debt to disposable income (compared to the selection of other countries) and experienced the largest percentage increased from 1995-2008 of 267%.

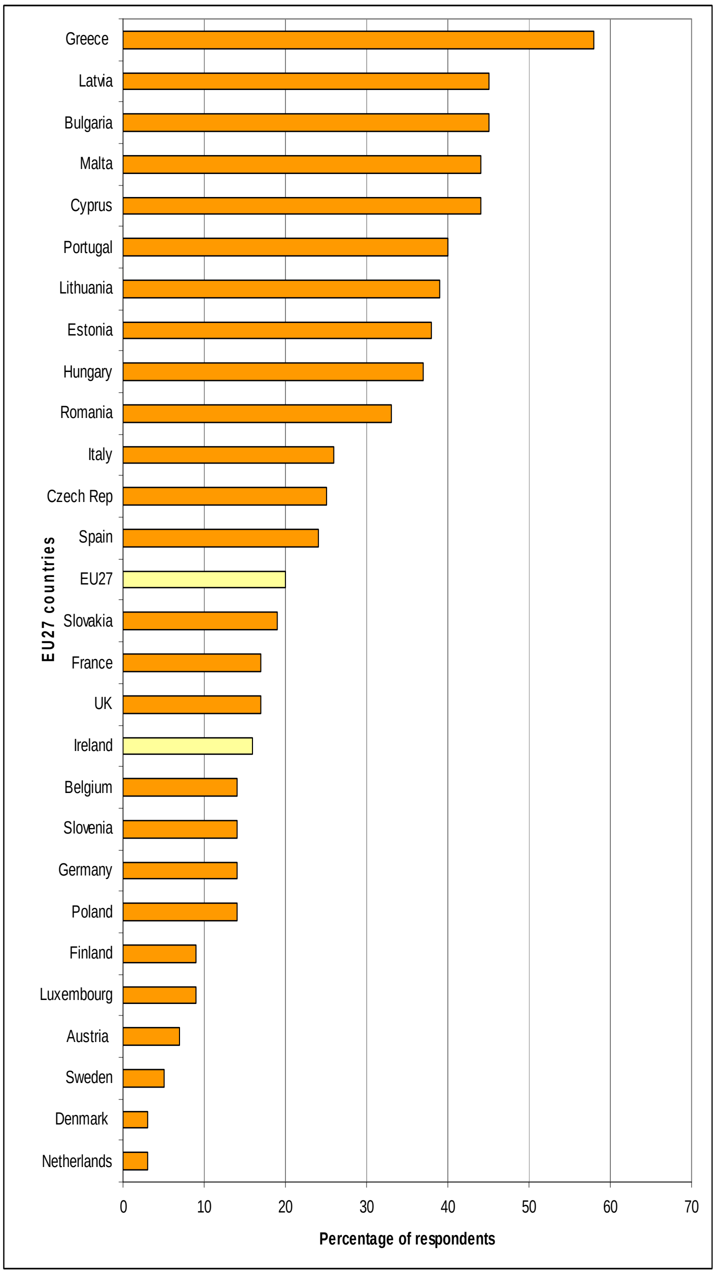
Further to this, Eurobarometer survey research (conducted by Gallup, 2010, towards the end of 2009) can show the practical impact of debt and offer some insights into relative levels of personal financial stress in Ireland compared to other EU countries.

In assessing the degree of financial difficulty in households, the survey evidence shows that the levels of financial stress among individuals in Ireland are lower than in many other EU 27 countries. Indeed, on many indicators, Ireland is above or close to the EU average. However, when looking ahead over the next 12 months, survey respondents in Ireland tend to be less confident of their financial position compared to individuals in many other EU countries. To illustrate this, the extent to which individuals in Ireland can keep up with household bills is examined below.

Keeping up with household bills

According to the Eurobarometer research, 16% of respondents in Ireland stated they had problems keeping up with household bills and credit commitments (this includes 5% who stated that they had fallen behind with some or many bills and 11% who stated that this was a constant struggle). This figure places Ireland 11th out of 27 countries (when ranking them from those which have the lowest percentage of respondents stating they had problems keeping up with household bills and credit commitments) and below the EU27 average of 20% as shown in Figure 2, overleaf.

Figure 2: Percentage of respondents who stated that they had fallen behind in keeping up with household bills and credit commitments or that it was a constant struggle.



Source: Eurobarometer, Gallup (2010)

Respondents to the survey from Ireland, however, were less positive about the level of risk they would experience if they faced an unexpected expense. In Ireland, 49% of respondents stated that they would be placed in high or moderate risk in terms having to cope with an unexpected expense of €1,000 over the next 12 months.

This placed Ireland 14th out of 27 countries (when ranking them from those which have the lowest percentage of respondents stating they would be placed in high or moderate risk) and below the EU average which recorded that 45% of respondents would be placed in high or moderate risk.

Social consequences of over-indebtedness

It is difficult to distinguish the social consequences of over-indebtedness from the social consequences of poverty. Over indebtedness means that people may be falling below the poverty line for the first time. This has a major impact on the lives of individuals, families and on society in general. Some of the impacts are explored in more detail below.

Paying priority debts

Priority debts are those that have a serious consequence for non-payment attaching to them. For example, failure to make mortgage repayments may put the family home at risk and failure to pay rent can result in eviction. Similarly, failure to pay utilities may result in their disconnection and failure to pay a fine or a civil debt may result in a prison sentence. The necessity to prioritise debt, particularly secured debt over unsecured debt may result in the debts with the highest interest rates being paid last. This may mean that it will take longer overall to exit from debt.

MABS points out that people in debt will usually pay the person who puts the most pressure on them, for example, a debt collection agency or any creditor who send a legal letter. This may also be to the detriment of paying the debt with the highest interest rate first.

Health

The Law Reform Commission notes that 'indebtedness has been shown to have a detrimental impact on health, with debt problems almost doubling a household's likelihood of experiencing health difficulties within the next year. Irish research has highlighted both the negative mental and physical implications of debt. Over-indebtedness was shown to lead to intense pressure and stress'.[7]

A Women's Health Council report in 2006 entitled 'Women, Debt and Health[8]' found that 81% of women mentioned their mental/emotional health during their consultation with MABS money advisers with stress, depression and anxiety the most common problems. In the study, 40% of the women surveyed mentioned physical health problems and 27% said that debt affected the health of their family members.

In Edwards's (2003) survey of more than 900 over-indebted clients of Citizens Advice Bureaux in the UK, 62% mentioned that they were suffering from stress, anxiety or depression. A quarter of debt clients were already seeking treatment for stress, depression and anxiety from or via their GP and just under half of those who were receiving medical treatment for their depression felt their symptoms were caused by debt problems.[9]

The need to pay priority debts is likely to affect spending on healthy and nutritional food. This in turn may lead to increased health problems.

Debt causes health problems but also means that the problem may not be treated. Stamp notes that preliminary analysis from an ongoing study by the ESRI (Layte *et al*, 2006) found that 50.7% of the population studied had an unmet medical need as they could not afford the medical examination or treatment for the health problem. It is also established that indebted individuals are more likely to skip a recommended test, treatment, follow-up or specialist visit (Plax and Seifert, 2006; Doty *et al*, 2005).

Given recent financial pressures, research suggests that many patients, who would previously have seen GPs privately, are now not attending surgeries. 63% of GPs surveyed by the *Irish Medical Times* (January 2010) felt that patients were delaying visits due to financial pressures, with one GP stating that "private patients do not get sick anymore." 47% of the GPs surveyed said that they were seeing fewer private patients.

This analysis is also supported by the findings from the Eurobarometer survey research. This survey identified that in December 2009, there was almost a 6% increase in the numbers of respondents in Ireland who stated that they found paying for healthcare was more difficult or somewhat more difficult since July 2009.[10]

Stamp (2009) also notes the number of people who go further into debt in order to pay for medical treatment.

[7] Consultation Paper on Personal Debt Management and Debt Enforcement (LRC CP56-2009), page 13.

[8] http://www.mabs.ie/publications/reports/Health_WHC_MABS.pdf

[9] Citizens Advice (2003) *In Too Deep: CAB clients' Experience of Debt*.

[10] http://ec.europa.eu/public_opinion/flash/fl_276_en.pdf

The Irish League of Credit Unions reported that €30 million was given in loans to members in 2004 in order to pay for necessary medical treatment such as heart surgery, hip replacements, eye surgery and MRI scans.

Over-indebted people have a more frequent health problem which leads to an increase in the continued use of health care services.
The Institute of Public Health in Ireland (PHI) also notes that local socio-economic circumstances affect the prevalence of chronic conditions such as hypertension, stroke, coronary heart disease and diabetes and that these conditions occur more frequently among the poor and vulnerable.

Based on figures from the Department of Health and Children, it is estimated that three quarters of the healthcare expenditure in Ireland is allocated to the management of chronic diseases. This includes approximately 80% of GP consultations and 60% of hospital bed days which are related to chronic diseases. Chronic diseases also account for two thirds of emergency medical admissions to hospitals. The PHI also predicts a rises of up to 40% in incidences of chronic disease from 2007-2020.

Research from Sweden (Ahlstrom, 2000) also acknowledges the link between indebtedness and health problems and points out the direct costs (hospitalisation, treatment and medication) and indirect costs (loss of production and rehabilitation) to the State. For one type of heart surgery, for example, Ahlstrom calculated this in 2000 as costing £55,000 over the first five years.

Homelessness

In 2009, 24% of all new MABS clients were living in private rented accommodation, with a further 20% renting local authority housing. Buy-to-let investors who have difficulties with their mortgages may be particularly reluctant to tolerate arrears in payment. Rent arrears can lead to eviction, which would lead to a huge burden on the State to provide for emergency accommodation. Homelessness could also occur when an over-indebted landlord's property is repossessed by a financial institution.

The Capuchin Day Centre for Homeless People in Dublin, for instance, currently distributes 1,000 parcels of basic food stuffs a week to anyone who is in need of food. It is reported that this is a 285% increase since November 2008 and represents the highest demand in the 40 year history of the centre. The centre has also doubled the numbers of free meals it provides. The changing profile of the clientele has been noted by Brother Kevin Crowley, the centre's director, who stated that:

'We are meeting a lot of people who are coming here for the first time. A lot of people who have lost their jobs and, even though they can make ends meet, are finding it difficult to meet their mortgage payments. We have a new poor in this country.'[11]

Figures from the UK Government show that 3% of all homelessness cases in 2009 were as a result of mortgage arrears (repossession or other loss of home). This figure is down from 4% in all quarters of 2008. During the 1991 downturn, mortgage arrears resulted in 12% of all homelessness cases. A further 11% of homelessness cases in 2009 were caused by the end of an assured short hold tenancy in private rented accommodation.[12]

Employment

The Law Reform Commission notes that recent research resulting from

[11] *Sunday Business Post* 22nd November 2009
[12] http://www.communities.gov.uk/documents/statistics/doc/34561795.doc

European Community Household Panel (ECHP) statistics shows that 'over-indebtedness was shown to have a very significant impact on employment, with arrears increasing the likelihood of unemployment even up to four years after arrears first occurred'. The study showed that householders who are currently employed are much less likely to remain employed if they have recently incurred arrears. In addition, the study, which used statistics over a seven year period, found that:[13]

- Repayment arrears increase the difficulty of finding a job for those workers not currently employed.
- The existence of arrears has a negative effect on a household's chance of owning its own home.
- While indebtedness does not have a significant effect on the likelihood of an individual starting a business and becoming self-employed, the existence of debt problems among those already self-employed can make such entrepreneurs less likely to remain self-employed.

JobCentre Plus (Wales) has also found that debt is a major barrier to employment for a number of reasons. This includes the 'benefit trap' with some believing that they are better off on benefits and would find it difficult to repay debt if they started work. Other reasons include the fact that starting work will mean the repayment of loans currently covered by insurance, and the fact that work is not seen as a priority due to the impact that debt has on people's health and personal relationships.[14]

Under Danish debt management law people on social welfare are not expected to repay debts, but become liable as soon as they get a job. This has been acknowledged by the Ministry of Social Affairs as a serious disincentive to finding employment.[15]

Fuel poverty

Fuel poverty is defined as paying over 10% of net income on fuel costs (including spending on water heating, lights, appliances and cooking). It impacts on the standard of living of householders and fuel poverty can have serious impacts on health. Fuel costs average €1,015 p.a. for an 'average' house and €1,525 p.a. for houses with poor insulation standards (MABS).

MABS figures for 2006 show over 50% of clients were in arrears for utility bills and identify a strong relationship between fuel poverty and debt. Indeed, in one study, over 40% of 1,430 MABS clients were found to be affected by fuel poverty, more than twice the estimated national average (17.8%), as outlined in the Table 4.

Table 4: Fuel poverty

Group	Percentage experiencing fuel poverty
General population	17.8
MABS clients	40.5
Mobs Clients with social welfare as first income	55.7
MABS clients with wage as first income	13.7

MABSIS/ Sustainable Energy Ireland

A smaller 2003 study by MABS staff in midland counties in Ireland highlighted a significant problem with fuel poverty among MABS clients. Although the

[13] LRC 2009 commenting on http://www.bos.frb.org/bankinfo/qau/wp/2008/qau0803.pdf

[14] JobCentre Plus submission to Welsh Assembly Government 2005.

[15] Niels Rasmussen from the Ministry of Social Affairs http://ec.europa.eu/employment_social/spsi 2007

survey sample was very small (29), the problems identified were significant.[16]

- 93% of respondents surveyed restricted the amount of heat used in winter because of cost.
- 66% borrowed money for fuel.
- 81% of respondents reported ill health and a general lack of well being.
- The average amount spent on fuel in any one week ranged from €10 to €70.

A carbon tax on heating fuels due to be introduced in May 2010 may lead to increases in fuel prices which could add to these difficulties.[17]

Loss of credit rating

MABS has pointed out that being in debt may result in the loss of a good credit rating. This may make future credit more uncertain and more expensive, and consequently may also result in debtors resorting to licensed and unlicensed moneylenders or to sub prime lenders as their only option. Anne Marie O'Connor, Business Manager of MABS, has stated that 'in the absence of mainstream alternatives there could be a growth of high-cost credit forms such as loans from licensed money lender and the use of catalogues as a form of credit.'[18]

Wider cost to society

The Law Reform Commission notes that 'the negative effects of over-indebtedness are not only detrimental to indebted households themselves, but also to society in general, which suffers financial loss. The cost to society includes increased social welfare expenses, losses in income tax receipts, higher medical costs, and the costs of accommodating evictees.'[19]

The Welsh Assembly Government (2005) highlights how over-indebtedness inhibits the effective delivery of the Assembly Government's economic and social policies and strategies such as improving health in Wales, the national housing and homelessness strategies and helping more people into jobs.

The Social Exclusion Unit of the UK's Office of the Deputy Prime Minister (2004) also acknowledges the effect debt can have on neighbourhood regeneration and urban renewal. It noted that 'predatory lending is stripping out money from poor communities. People are paying off interest rather than using their benefits or limited income for their own good, or in local shops.'[20]

Current supports for the over-indebted

While a number of State initiatives are available to support those on lower incomes such as rent supplements, clothing and fuel allowances, to date, Ireland's response to over-indebtedness has largely focused on funding MABS.

A 2004 EU peer review of MABS praised its people-oriented approach and cohesive nationwide strategy. The review, however, also pointed out that work around debt in Ireland was reactive in nature, occurring generally when an individual was already over-indebted. From this analysis, the review highlighted the advantage in insolvency legislation and suggested

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[16] http://www.mabs.ie/publications/current_accountmag/currentaccount_09.pdf
[17] *Irish Times* 20th April 2010
[18] *Irish Times* 1st April, 2010.

[19] Consultation Paper Personal Debt Management and Debt Enforcement (LRC CP56-2009).
[20] Social Exclusion Unit (2004) Action on Debt: Why it Matters and What Can You Do, April 2004.

that Ireland should undertake a more proactive approach to tackling problems of debt. This means placing greater emphasis, among other things, on increasing financial capability and strengthening individuals' money management skills.[21]

Options when in debt: international comparative analysis

There are very limited options for those in debt in Ireland in comparison with other countries. Imprisonment for non-payment of debt remains a threat. The imprisonment is not for the debt per se but for failure to show the court that the court-ordered payment of debt was not paid due to 'wilful refusal' or 'culpable neglect'[22]. This issue will be the subject of the forthcoming May *Spotlight*. Unlike some other jurisdictions, there is no distinction between 'won't pay' rather than 'can't pay' debtors.

Court-based insolvency procedures are expensive and are unsuitable for a majority of debtors, but there are no formal or statutory alternatives in Ireland.

Current formal insolvency options in Ireland

The renewed programme for Government includes a commitment to 'create a new system of personal insolvency regulations allowing for a statutory non-court-based debt settlement system'. The Government will also seek to establish a 'central Debts Enforcement Office to remove as many debt enforcement proceeds from the courts as possible'.[23]

Businesses have a number of formal insolvency options such as examination, recovership, receivership and liquidations (both voluntary and court ordered). Individuals have much more limited options with bankruptcy and a voluntary scheme of arrangements (which is depends on the circumstances of the debtor) currently the only avenues available for insolvent individuals.

Bankruptcy

Bankruptcy is a serious and expensive process which has long-lasting consequences for individuals, and is a process[24] whereby the property or assets of a debtor is transferred to a person given charge of the property by the High Court (called a trustee) to be sold. This includes the sale of a family home where the High Court permits. When the property or assets are sold, the costs, expenses, court fees[25] and certain priority debts are paid. After this, the net proceeds are distributed to other creditors.

Bankrupts cannot act as a director, auditor, manager, liquidator or receiver of a company or hold elected representative office in local authorities or in the Dáil or the Seanad.

A person can remain a bankrupt even after death unless their bankruptcy is discharged by the High Court. There is

[21] http://www.peer-review-social-inclusion.eu/peer-reviews/2004/money-advice-and-budgeting-service

[22] Section 28 of the 1926 Act as amended by Section 6 of the 1940 Act

[23] http://www.taoiseach.gov.ie/eng/Taoiseach_and_Government/Programme_for_Government/Renewed_Programme_for_Government_October_2009.shortcut.html.

[24] The main provisions of bankruptcy law are contained in the Bankruptcy Act, 1988, the Bankruptcy rules and forms, Order 76 and Appendix O of the Rules of the Superior Courts, the Deeds of Arrangement Act, 1887 and the decisions of the courts.

[25] The court fees payable in bankruptcy and arrangement matters are contained in the Supreme Court and High Court Fees Order.

no right to automatic discharge after a certain period of time. No bankrupt can be discharged unless there are enough funds to pay the costs of the Official Assignee, High Court fees, the costs of the petitioning creditor and other preferential debts of the bankrupt. Discharge from bankruptcy will generally occur when:

- The High Court is satisfied that the debts (and any interest in certain cases) are paid in full the creditors consent to the discharge.

- Where a 60% majority of unsecured creditors agree to the payment of a certain percentage of the debt (composition).

- Where all of the bankrupt's property has been fully sold or disposed of and his/her creditors have received fifty cent in the Euro on their debts.

An application for discharge can also be made after the bankruptcy has lasted for twelve years and all of the bankrupt's property has been fully sold or disposed of. The court must be satisfied that the bankrupt has disclosed any property acquired since his/her bankruptcy and that it would be reasonable and proper to discharge the debtor from bankruptcy.

Bankruptcy is not a viable option for people on low incomes and with little assets. Even if a person on a low income had the assets to become bankrupt it is unlikely that they could afford to discharge the bankruptcy at a later date unless their circumstances changed dramatically.

A range of personal insolvency options could be explored as different approaches to reasonably small debts and very large debts should be taken, as in other jurisdictions. It is also important to note that insolvencies schemes may not address many of the problems associated with long-term debt, particularly debt caused by a persistently low income.

Informal debt resolution options in Ireland

In 2002, the Irish Banking Federation (IBF) and the MABS introduced a pilot debt settlement scheme for MABS clients. This encouraged negotiation and mediation between debtors and creditors and sought to minimise court proceedings. The scheme lasted until 2006 but it has not been possible to find an evaluation of the scheme or information as to its success or otherwise.

In June 2009, the IBF and MABS introduced an Operational Protocol*: Working Together to Manage Debt*[26] which is a voluntary protocol for financial institutions. The protocol recognises that each case of indebtedness is unique, needs to be treated differently and is likely to require different solutions. It also recognises that MABS Advisers aim to 'support clients to protect a standard of living for themselves which is acceptable and, at minimum, is above the poverty line including the prevention of homelessness or fuel disconnection, the loss of essential goods or services or the loss of liberty, the retention of social welfare payments'.

In addressing customer/client debt problems, IBF/MABS agree to prioritise secured debt over unsecured debt and thereafter on the basis of consequences for non-payment. They also will give priority to payment for essential utilities such as heat and light and other basic necessities. Any alternative repayment measures will need to be explained clearly to the

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[26] http://www.welfare.ie/EN/Press/PressReleases/2009/Documents/IBF-MABS%20Protocol%20FINAL%20June%2009%20Logo.pdf

customer including details of any new interest or administration charges, and the consequences of not following the repayment plan.

This protocol does not relieve debtors of their contractual duties until such time as the debt is settled in full or otherwise agreed by the IBF Creditor, which can include debt settlement where the actual final payment may be less than the full amount of the debt owed.

Proposed personal insolvency law reform

MABS is strongly in favour of an out of court debt settlement programme which would include a finite period for an agreed debt repayment programme, the freezing/reduction of interest and the write-off of residual debt on successful completion of the programme.

Other elements of a debt settlement programme would be unrestricted access (except in fraud cases), a compulsion on lenders to cooperate with the system, realistic payment levels that leave the debtor with an adequate standard of living and time limits on the payment plan. MABS also recommends that ideally there should be a link to a programme of money management and budgeting to help with rehabilitation and to prevent further problems.

The Law Reform Commission (LRC) has undertaken a major review of personal debt management and debt enforcement. It recommends the creation of a new system of personal insolvency law in Ireland including a statutory non-court-based debt settlement scheme to supplement (though not necessarily replace completely) the court based scheme in the Bankruptcy Act 1988. The key principles of the new system envisaged by the LRC would be:

- Earned debt discharge.
- Open access for honest and long-term insolvent debtors.
- Legally binding debt settlement.
- Preserving a reasonable standard of living for debtors.
- A discharge period of reasonable length (shorter than the 12 years in the Bankruptcy Act 1988).

FLAC also strongly advocates an alternative approach to resolving problems of over-indebtedness which would include finding a solution outside the court through debt rescheduling and mediation service. Insolvencies schemes should attempt to ensure that their terms are not too punitive. Ahlstrom notes that indebted individuals in Sweden in 2000 who were part of a formal insolvency scheme could not have any kind of credit and this extends to renting a car or a video, or signing up for life insurance.[27]

Formal insolvency options in other countries

England and Wales

There are a number of insolvency options for individuals in England and Wales such as bankruptcy, administration orders, enforcement restriction orders, individual voluntary arrangements and debt relief orders.

For example, an **Individual Voluntary Arrangement (IVA)** is a legally binding arrangement drawn up by a certified insolvency professional between a debtor and creditors. The arrangement protects the debtor from interest charges on debts and the threat of enforcement. The debtor agrees to maintain agreed payment for a specified period, normally over five

[27] MABS National Conference 2000

years. However, a debtor must have a certain amount of disposable income to be eligible for an IVA.

Debt relief orders (DRO) were introduced in 2009 and are an option for people with total unsecured liabilities under £15,000; total gross assets not exceeding £300; and a disposable income, following deduction of normal household expenses, of less than £50 per month. An Official Receiver can make the DRO without the need for court involvement. During the period that a DRO is in force, the debtor will be protected from enforcement action by creditors included in the application and the debtor will be free from those debts at the end of the period (usually 12 months). The debtor is expected to make arrangements to repay their creditors should their financial circumstances improve.

A debtor who is the subject of a DRO is tied to certain restrictions including an obligation not to obtain credit of £500 or more without disclosing the DRO to the lender. The debtor may not be involved (directly or indirectly) with the promotion, management or formation of a limited company, and may not act as a company director, without the court's permission. The debtor will only be able to obtain a DRO once every six years. As with other forms of personal insolvency, a DRO debtor's credit rating will be affected and there will be civil and criminal penalties for those who abuse the system.

Q3 2009 figures in England and Wales show a 28.2% increase in individual insolvencies from Q3 2008. However there was a slight decrease in individual insolvencies in Scotland (-4.2%) and Northern Ireland (-1.3%) during the same period.

United States

Bankruptcy in the US is better suited to individual debtors than in Ireland, and is sometimes used in a strategic way. The American Journal of Medicine found that 62.1% of all bankruptcies in 2007 were because of medical bills. The majority of debtors in the study were well educated and middle class; three quarters had health insurance. However, 92 % of these medical debtors had medical debts over $5000, or 10% of pre-tax family income.[28]

Bankruptcy in the US is governed by both federal and state law. States can be divided into recourse and non-recourse States and this impacts on how bankruptcy affects individuals. Non-recourse debt is a loan secured by a pledge of collateral, typically real property, but for which the borrower is not personally liable. If the borrower defaults, the lender/issuer can seize the collateral, but the lender's recovery is limited to the collateral. If the value of the property is insufficient to cover the outstanding loan balance, the difference between the value of the collateral and the loan value becomes a loss for the lender.

In recourse States, an individual is more likely to apply for Chapter 13 bankruptcy. Recourse loans are based on collateral which can be seized but further legal action can also be taken by the lender to recover debt. Chapter 13 bankruptcy is a repayment plan for individuals with regular incomes and unsecured debt less than $336,900 and secured debt of less than $1,010,650. It requires applicants to repay debts in full, or in part, over several years. The debtor keeps his property and makes regular payments to the Chapter 13 trustee out of future income to pay creditors over time (3-5 years). Repayment in Chapter 13 can range from 10% to 100% depending on the debtor's income and the make-up of the debt. Certain debts that

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28 http://www.amjmed.com/webfiles/images/journals/ajm/AJMMedicalBankruptcyJun09FINAL2.pdf

cannot be discharged in Chapter 7 (see paragraph below) can be discharged in Chapter 13. Chapter 13 also provides a mechanism for individuals to prevent foreclosures and repossessions while catching up on their secured debt. In 2009 there were 1.47 million bankruptcy filings, up 32% from 2008 (Office of the U.S. Courts), while Chapter 13 filings were up just 12% from 2008.

Chapter 7 is the most common form of bankruptcy[29] in the US and is used for non-secured consumer debts including credit card debt. It is a liquidation proceeding in which the debtor's non-exempt assets, if any, are sold by the Chapter 7 trustee and the proceeds distributed to creditors according to the priorities among creditors established in the Code.

Chapter 7 is available to individuals, married couples, corporations and partnerships. Individual debtors get a discharge within 4-6 months of filing the case. If there are assets which are not exempt, the trustee takes control of those assets, sells them and pays creditors as much as the proceeds permit. Creditors have no claims to any wages the debtor ends after the case has begun. Applications for Chapter 7 bankruptcy rose 41% in 2009 from 2008. In May 2010 amending legislation will be introduced to limit Chapter 7 bankruptcies to once every 8 years in an attempt to limit the numbers granted.

While personal insolvency procedures will assist certain over indebted individuals with their immediate problems, it will not solve the problem of how people become over indebted, or is unlikely to ensure that people do not return to over indebtedness. The European Commission has proposed six building blocks to provide an effective response to consumer over-indebtedness. These deal with both the availability and the consumption of credit, as follows:

- Responsible borrowing.
- Responsible lending.
- Responsible arrears management.
- Debt counseling.
- Personal insolvency law.
- Comprehensive court-related enforcement procedures.

This approach suggests that financial capability skills need to be strengthened in all sectors of society to ensure that people understand the real cost of credit to them, the likely impact of an economic shock on their standard of living and their ability (or lack of) to repay debt within a reasonable time.

Recent initiatives to manage over-indedtedness

As well as measures to try combat over indebtedness, other options are available in some countries to allow those in debt to pay off their debts as swiftly as possible. For example, recent legislation in the UK and the US as outlined below will have a positive effect on those paying off credit card debt.

Current measures in the UK and US: Right to repay

Current Irish credit card industry practice is that debts attracting the highest level of interest payments (usually cash advances) will not begin to be paid off until any balances attracting a lower rate of interest (for example, those arising from a 0%

29 http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter7.html

balance transfer deal) have been paid off in full. This obscures the real cost of borrowing for consumers.

New legislation in the UK will introduce a right to repay for customers. This means that customers' repayments will always be put against the highest rate debt first. Consumers in the UK will also be able to reject increases in credit card interest rates as banks must inform clients 60 days before an increase will be enforced. Customers will then have 60 days to close their accounts and pay off outstanding debt. The legislation also provides that consumers at risk of financial difficulties will be given guidance on the consequences of paying back too little.

The US introduced a similar right to repay measure in through the Credit Card Accountability Responsibility and Disclosure (CARD) Act[30]. Introduced in May 2009, it enforces fair interest calculation: credit card companies will be required to apply excess payments to the highest interest balance first as consumers expect them to do. The Act also ends the confusing and unfair practice by which issuers used the balance in a previous month to calculate interest charges on the current month, or the 'double-cycle' billing.

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30 http://www.whitehouse.gov/the_press_office/Fact-Sheet-Reforms-to-Protect-American-Credit-Card-Holders/