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**REPORT ON**  
**LEGAL SOLUTIONS TO DEBT PROBLEMS**  
**IN CREDIT SOCIETIES**

*by Johanna Niemi-Kiesiläinen and Ann-Sofie Henrikson*  
*Department of Law*  
*Umeå University, Sweden*

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## **1. Introduction: Seeking Legal Solutions to Debt Problems in a Credit Society**

The European Ministers of Justice paid attention to the growing problem of over-indebtedness of ordinary citizens in the Member States of the Council of Europe in their 26<sup>th</sup> Conference *Social Aspects of Justice* in Helsinki, 7-8 April 2005. The Conference adopted the Resolution *Seeking Legal Solutions to Debt Problems in a Credit Society* (MJU-26 (2005) Resol. 1).

As the theme, Seeking Legal Solutions to Debt Problems in a Credit Society, suggests, the member states have entered an era that may be called the Credit Society. The use of credit has become an essential part of the economies of all member states and, as the Conference emphasised, sufficient consumer credit market and effective lending promote economic growth.

The Conference also noted that increase in lending leads to increase in debt problems and, in the worst cases to over-indebtedness, to situations where the debt burden of an individual debtor or a household exceeds its payment capacity in a long perspective. The Ministers of Justice expressed their concern that over-indebtedness can lead to social exclusion of individuals and families. Therefore, the Ministers of Justice underlined the importance of preventing the problems caused by over-indebtedness, seeking measures to prevent debt problems, to proper management of these problems and to enhance the sense of responsibility of both creditors and individual debtors.

The Ministers of Justice recognised that the solutions to the debt problems require a broad variety of measures in the different parts of the society. The Council of Europe should assist member states to find alternative solutions to avoid over-indebtedness such as financial advice, education and the management of debts.

The Conference agreed on the importance of the legal measures as solutions to debt problems. In addition, the Ministers of Justice were convinced that the Council of Europe has an important role to play in this context. Thus, the Conference invited the European Committee on Legal Co-operation (CDCJ) of the Council of Europe to:

- analyse existing legislation and good practices;
- identify the difficulties met;
- prepare an appropriate instrument defining legislative and administrative measures, and proposing practical remedies;
- consider, when preparing such an instrument, the role of competent bodies, in particular courts, administrative authorities, and non-governmental organisations involved;
- consider ways of providing assistance to member states in the application of this instrument and, where necessary, make appropriate proposals to the Committee of Ministers.

To fulfil the tasks given by the Ministers of Justice, the CDCJ commissioned professor Johanna Niemi-Kiesiläinen, Umeå university, to prepare a report on the issues involved and to propose adequate measures. This report has been prepared in cooperation with LLM, lecturer Ann-Sofie Henrikson, Umeå university.<sup>1</sup>

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<sup>1</sup> We thank prefekt Siv Nyquist, Department of Law, Umeå University, for generosity and support and students Mattias Mattson and Suvi Kiesiläinen for help with tables and translations.

For the preparation of an appropriate instrument to alleviate debt problems, it is important to reach an over-all agreement on the nature, scope and reasons of these problems. While there is convincing evidence on the growth of the problem of over-indebtedness in the member states, there is less agreement on what over-indebtedness actually is and how it should be defined or measured. In Chapter two of the report we will discuss the scope of the problems and the concept of over-indebtedness. We will also discuss the most important reasons for over-indebtedness and the relationship between business-related debt and the debt-problems of the individuals.

In this report, we analyse the legislations in the member states of the Council of Europe. While various parts of the legal system directly or indirectly regulate the relationship between the debtor and the creditor, this report deals only with such legal instruments that are directly related to the over-indebtedness. First, we will discuss the role of registration of the data on credit worthiness of the debtors as a means of prevention of over-indebtedness. In addition, attention will be paid to the financial education and advice of debtors. Secondly, the protection of the debtors in the debt enforcement process is analysed as a factor directly contributing to the situation of the over-indebted debtors. Thirdly, the judicial debt adjustment procedures (consumer bankruptcy) are discussed as the means to rehabilitate the debtor.

In the preparation of the 26<sup>th</sup> Conference of Ministers of Justice, the Finnish Ministry of Justice sent to the member states questionnaire concerning the above-mentioned aspects of the laws of the member states. The answers of the member states form an important source of information for this report as well as the memorandum that the Finnish Ministry of Justice prepared for the Conference.

In addition, two studies commissioned by the European Union have been of particular importance for the preparation of this report. In 2001, the European Union contracted a study on the statistical measurement of over-indebtedness in the European Union countries that has been helpful for the analysis of the concept, measurement and scope of over-indebtedness in chapter 2.<sup>2</sup> In 2003, the European Union ordered a Study on the Legislation relating to Consumer Over indebtedness in all European Union Member States.<sup>3</sup> This study has been an important source for the chapters 4 and 5 of the report.

## **2. Over indebtedness: Concept, Reasons and Policies**

### **2.1 Concept and Scope of Over-indebtedness**

#### *Measurements of Over-indebtedness*

While there is convincing evidence on the growth of the problem of over-indebtedness in the member states, there is less agreement on what over-indebtedness actually is and how it should be defined or

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<sup>2</sup> Study of the Problem of Consumer Indebtedness: Statistical Aspects. By Betti Gianni, Dourmashkin Neil, Rossi Maria Christina, Verma Vijay & Yin Yaping. Commission of European Union, 2001. Referred to as EU Statistical Study 2001.

<sup>3</sup> Study on the Legislation relating to Consumer Overindebtedness in all European Union Member States. By Udo Reifner, Nick Huls, Johanna Niemi-Kiesiläinen and Helga Springeneer. Institute of the Financial Services e.V. Hamburg, 2003. Referred to as Refner et al. 2003.

measured.<sup>4</sup>

The European Union Study of the Problem of Consumer Indebtedness: Statistical Aspects (Statistical Study) identified three possible definitions of over-indebtedness: the administrative model, the objective or quantitative model and the subjective model.<sup>5</sup>

*The administrative model* uses the official registration of non-payment in the court or similar procedures as a measure of over-indebtedness. For example, declarations of bankruptcy, filings for debt adjustment by consumer debtors or non-successful debt recovery actions all measure certain type of over-indebtedness. These types of indicators are often used as national indicators of debt problems and as a basis of studies on debtors and on the nature of debt problems. Since they are easy to apply and collect they are often good indicators of changes in the amount of debt problems.

The administrative indicators, however, leave a large amount of debt problems unrecognized since many people seek alternative solutions to their problems and are not registered in the administrative and legal procedures. Legal constraints may leave many or even most over-indebted households outside the scope of bankruptcy or debt adjustment procedures. On the other side, same persons may be registered in different procedures or several times in the same procedure, which also makes these kinds of indicators less reliable as the measure of over-indebtedness. Since different countries at the moment have quite different legal enforcement and insolvency proceedings, these measures can hardly be used in comparative studies on over-indebtedness.

*The objective or quantitative* model uses the information on the economic situation of a household as the measure of its solvency or over-indebtedness. Usually the ratios total debt to (net) income or total debt to assets and income are used as measures of the solvency of the household. This method is often used by the credit institutions and in studies on how households use their income.

The use of the objective model requires detailed information on the composition of the economies of the individual households, which is very onerous to collect. The aggregate amounts of the debts, assets and incomes of all households do not tell anything about over-indebtedness since the debts, income and assets are very unevenly distributed among the population. In other words, even if the total population has enough assets to cover all their debts, it is quite possible that the assets are in the hands of some people, while quite a number of other people have a lot of debt and few assets. Another problem in the use of the objective model is that it cannot accommodate the differences in the life cycles, consuming patterns and ability to adjust among the households. In other words, some households can manage bigger debts than some others with seemingly similar incomes.

Many studies, including the European Union Statistical Study, use *the subjective model* to define and measure over-indebtedness of the households. This means that the household's own perception of its ability to pay back its debts is the criterion for over-indebtedness. A question asking whether the respondent feels that the household is able to pay back its debts when they fall due or whether he or she feels that the household has a higher debt burden than it can manage is included in many household surveys.

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<sup>4</sup> EU Statistical Study 2001 p. 8.

<sup>5</sup> EU Statistical Study 2001 p. 59.

The subjective criterion encompasses debt problems that may not be recognized by the administrative or objective criteria and it tends to give a higher rate of over-indebtedness than the administrative or the objective criteria. Thus, a big portion of debt problems may not show in the official statistics. It is possible that some of the households that have serious problems in paying their debts find some other means, such as borrowing from the relatives or extra income, to cope with the problem. It is also possible that some over-indebted households have been marginalized and cannot be reached. Evidently, some of the over-indebted households make big sacrifices to meet their obligations and decrease their consumption to the minimum. The down-size is that a subjective criterion does not give objective measure for the classification of the households.

### *The scope of Over-indebtedness*

There are no statistics on over-indebtedness that would cover all Council of Europe member states. The only truly comparative European study to our knowledge is the European Union Statistical Study of the 2001 that used data from 1996. Even though the data are old, the study still gives a broad picture of the over-indebtedness in Europe.

Using the subjective criterion as the starting point, the study concluded that 53 million people or 18% of the population of 18 years and over were over-indebted in the EU alone in 1996.<sup>6</sup> This figure confirms the conclusions of national studies, showing that over-indebtedness is a serious and wide-spread problem in Europe.

The European Union Statistical Study also showed differences among the countries in the rate of over-indebtedness. In most of the countries between 11-16 per cent of the households considered themselves over-indebted. Only Denmark (19%), United Kingdom (18%), Finland (21%), Spain (23%), Ireland (21%) and Greece (49%) showed a higher rate of over-indebtedness.

In 1996, the European Union countries also had very different levels of use of credit. Actually, the differences in the use of credit were much bigger than in over-indebtedness. For example, in Denmark almost half of the households had credits other than mortgage but in Spain only one in five households had such credits. Yet, the difference in the rate of over-indebtedness in these two countries was not at all that big (19% respective 23%). The Statistical Study compared the portion of over-indebted households with the portion of households that have credits other than mortgage. The comparison showed that there were big differences in how often these credits led to over-indebtedness. In some countries, like Spain, Greece, Portugal and Italy, over 80 per cent of the households with credits other than mortgage were over-indebted, whereas in Denmark, Luxembourg and France the rate was under 50 per cent.

The report concludes that in those countries where the consumer loan market is well developed the consumer debtors less likely have loan problems than in countries with a less developed consumer credit market. In other words, in a well developed consumer credit market consumers use credit and pay it back in due course. A high level of consumer credit use is not necessarily an indicator of debt problems. In a less developed consumer credit market the credit users are likely to be in the course towards debt problems. In such circumstances, the outstanding consumer credit and the amount of debt

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<sup>6</sup> EU Statistical Study 2001 p. 3.

problems often go together. The conclusions that might be drawn here are, first, that information about the consumer credit market and debt problems are needed and, secondly, that legal policy should promote such legal institutions that enhance the development of well functioning credit markets.

## 2.2 Reasons for and Effects of Over-indebtedness

### *Reasons for over-indebtedness*

Over-indebtedness is only possible when credit is used and, thus, it can be said that credit is the main cause of over-indebtedness. In the understanding of how people become over-indebted, we can distinguish two different approaches.<sup>7</sup>

Some researchers and commentators emphasise the consumer's use of credit and behaviour in the credit market. As an explanation of over-indebtedness is often understood the over-commitment of the consumers. Sometimes also the behaviour of the credit providers is emphasised. For example, The Resolution of the Conference of European Ministers of Justice points out the easy access to credit as an important reason for over-indebtedness. This view approach can be called a market approach and is most pointedly represented by economists.

Another, sociological way of looking at the reasons of over-indebtedness takes its starting point in empirical studies on debtors and analyses the characteristics of the over-indebted debtors. The research is quite unequivocal on that in addition to having credit, most of the over-indebted have experienced some unforeseen event that has weakened their economic situation. Most often this unforeseen event is unemployment, but it can also be sickness, change in the family situation etc.

There seems to be little doubt that especially unemployment and other disruptions in employment are the most common factors leading to over-indebtedness.<sup>8</sup> Big increases in debt problems are almost always related to economic downturns. Even in good times unemployment seems to be the most common factor behind over-indebtedness. Such individual circumstances as illness, illness or death in the family and other family-related changes occur maybe in ten per cent of the cases of over-indebtedness.

Of course all families that face unemployment do not end up being also over-indebted. Some research has been done to identify what types of families are at risk. The overall conclusion of these studies is that this is a problem that can hit very different types of households and that the over-indebted households do not significantly differ from households that do not have problems with their debts.<sup>9</sup> Clearly, over-indebtedness is not a sign or consequence of poverty. Poor people have less access to credit than middle class. This does not protect the poor from debt problems since unpaid rents, electricity and other household bills and alimony payments can lead to over-indebtedness but the amount so accrued are usually not large (except for maintenance debt). Typically, however, over-indebtedness is a problem for

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<sup>7</sup> Niemi-Kiesiläinen 1999 & 2003.

<sup>8</sup> EU Statistical study p. 52, Huls et al. 1993 p. 64, Sullivan, Warren & Westbrook 1989, Sullivan, Warren & Westbrook 2000.

<sup>9</sup> EU Statistical Study 2001 p. 76.

both the middle class and the low income families.

It is sometimes argued that the young people are especially prone to debt problems.<sup>10</sup> According to the European Union Statistical Study this is not so. This study found no obvious observable relation between age and debt problems.<sup>11</sup> The family form, to the contrary, seems to matter. According to this study, single adult households with children were the most likely to face debt problems.<sup>12</sup> It has to be pointed out, however, that since the portion of single parent households is low in all societies, this group is only a small group of all over-indebted households. As the American researchers Elizabeth Warren and Amelie Warren Tyagi emphasise, a two income family is not protected against over-indebtedness. Most young families today have loans for home and car and the loss of income for just one of the spouses may lead to trouble.

The most common uses of credit households are housing, education, cars and consumption. Increasingly, individuals are also indebted for the personal guarantees for business loans, both for their own businesses and those of their family members. Most households use credit for completely legitimate purposes. From the point of view of legal regulation, some comments are in place.

Housing loans are almost always protected with a collateral and, thus the risk to the creditor is limited. However, excessive housing cost sometimes lead to use of credit for consumption and sometimes even to over-indebtedness. Especially if the housing cost increase unexpectedly because of reconstruction costs, purchase of new apartment, rise in fuel prices etc. Usually debtors and creditors can sort out these situations by themselves but in difficult cases it can be of importance how laws on debt enforcement and debt adjustment protect the home.

Like housing loans, educational loans spread the costs of investment over the life cycle. Therefore, many countries have special regulations concerning educational loans also in situations of over-indebtedness.

The business loans are a big part of the debt problems of households. Even if unemployment is the most common reason for over-indebtedness, the former employment may have been the debtor's own small business. If the debtor has run the business in his or her own name, the debtor is responsible for the loans. The banks often require that the owners of small companies give personal guarantees for loans. Especially during a financial down turn, the business loans may be a more common reason for over-indebtedness than is usually thought.

The most difficult issue to regulate is the personal guarantees for business loans. On the other side, it is argued that the personal guarantees of loans by the entrepreneur and his or her family members enhance small businesses. If such guarantees were somehow restricted, small entrepreneurs' access to credit would be limited and such regulation would not benefit them or their families. On the other side, it is argued that especially the family members are often in a situation where they cannot properly protect their own interests and freely decide whether to commit themselves. In the same way problematic is the use of jointly owned family home as a collateral for a business loan. In addition, ex-spouses sometimes

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<sup>10</sup> For example Ramsay 2003 p. 21.

<sup>11</sup> EU Statistical Study 2001 p. 75.

<sup>12</sup> EU Statistical Study 2001 p. 71, Huls et al. 1994 p. 65.

end up paying consumer card debts that the other spouse has incurred after separation. These problems concern the civil and family law but they also concern the regulation of over-indebtedness.

The argument that the debtors may blame themselves for over-indebtedness if they have over-committed themselves is most easily made concerning consumer debts. In practice, however, it is difficult to judge whether the over-commitment has been the result of strategic behaviour or a desperate attempt to get over difficult times. Often the debtor already has considerable debt when the difficulties start. For many families, consumer debt is a means of getting over a hard time.<sup>13</sup> If the situation gets worse instead of improving, the debtor ends up being over-indebted.

Interestingly, the European Union Statistical study found that a high percentage of those households that have loans have difficulties with repaying them. The situation was similar in almost all countries and in all age groups.<sup>14</sup> In addition, the only thing that made a difference between over-indebted and other households was that the over-indebted presented a lower consumption/income ratio than other comparable households. This means that the over-indebted households had decreased their consumption to repay back their debts.<sup>15</sup> This finding is confirmed by surveys and interviews of debtors in many countries; over-indebted debtors tell about incredible sacrifices they have made to pay their debts.

These are very important findings also for the legislative point of view. As a conclusion, the research shows (1) that the over-indebted households are not much different from other households, (2) that single parent families have a higher risk of becoming over-indebted, (3) that over-indebtedness is often, but not always, partly due to unforeseen events in the household's economy and (4) that over-indebted households have made considerable sacrifices to pay back their loans.

When these conclusions are considered together with the finding of the Statistical Study that in countries where the consumer loan market is more developed the consumer debtors are less likely to run into problems with their loans than in other countries, we can conclude that the development of the consumer credit market *can* be beneficial *both* for the economic growth *and* for the individual debtors. There is no reason to say that the consumer credit as such would be a "dangerous" product. Instead, it should be of importance how it is regulated, both generally and more specifically in situations of over-indebtedness.

#### *Effects of over-indebtedness*

Over-indebtedness is a serious problem that affects the whole household. Over-indebtedness is, besides a serious economic problem, also a psychological problem, leading often to exclusion from the social settings. As was explained above, the over-indebted families have cut down their consumption. The situation of children in over-indebted families is both economically and psychologically a serious

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<sup>13</sup> Especially in the United States many researchers have started to call consumer bankruptcy the last safety net. When the social security system does not protect people in case of unemployment or illness, consumer credit may be the only way to finance a crisis situation. See for example Jacoby 2003.

<sup>14</sup> EU Statistical Study 2001 p. 75.

<sup>15</sup> EU Statistical Study 2001 p. 76.

concern. The over-indebtedness may put children's basic needs at risk. Because over-indebtedness is a long-lasting problem, many children suffer also from the hopeless atmosphere in the family.

Over-indebtedness often leads to economically and socially unwelcome behaviour. A hopeless debt burden gives to the debtor little incentive to work more than is needed for survival. Some over-indebted debtors are tempted to work in the black market, which means a loss of taxable income for the society. Over-indebted debtors also cause unproductive costs to the creditors who pay in vain for the collection of their claims. In many cases, the costs of over-indebtedness are paid by other than the debtor or the creditors. Often the debtor's family has to support his or her and sometimes the family members make great sacrifices to pay the debts. Equally often the costs are borne by the welfare system and, thus, the whole society.

### 2.3 Prevention and Rehabilitation

#### *Priority of Prevention*

The legal response to over-indebtedness can be divided into three categories; *prevention, alleviation and rehabilitation*. There seems to be a European consensus about the priority of the prevention of over-indebtedness through legal means and seeing the rehabilitation of over-indebted debtors as a means of last resort. This view is reflected in the Resolution of the European Ministers of Justice, which emphasises the importance of the prevention of debt problems but uses very cautious language about the "management" of the actual debt problems.

The authors of this report share the European view on the *importance of the prevention* of debt problems through legal means as far as it is possible without unnecessarily curbing the access to credit. While the preventive means are various, both legal and social measures, parts of the general social and economic policies, their concrete impact on the amount of debt problems is very difficult to estimate. The preventive effects are often hidden in the shadow of the bigger effects of the changes in the national economy and in the credit market. However, comparing the American and the European situation indicates that preventive measures, particularly consumer credit legislation, have some impact on the level of debt problems. In the United States, the credit card use is more wide spread, the households have more debt and debt problems than in Europe. As a last resort, about 1,5 million American households file for bankruptcy each year.

#### *Social policies*

What are the most important preventive policies and measures? First, it has to be notified that general social security programs, such as unemployment benefits, and the public health care have a remarkable effect on debt problems. Many American researchers hold consumer bankruptcy as the last safety net because people use consumer credit to finance a decline in income or big medical bills in the lack of adequate unemployment and health care programs.<sup>16</sup> The European public health care, unemployment benefits and social security programs have effectively protected the Europeans against over-indebtedness.

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<sup>16</sup> Sullivan, Warren & Westbrook 2000, Jacoby 2003.

### *Financial education and debt advice*

Lately, financial education and debt advice have received increased attention and they are also mentioned in the Resolution of the European Ministers of Justice. Financial education already at school should be a good way to decrease debt problems in the younger generations. In addition, a view that financial education should be attached to the judicial debt adjustment schemes has gained popularity, for example, in Canada and United States<sup>17</sup>.

In many European countries, consumer agencies, social services and non-governmental organisations have developed programs of debt and budget advice for over-indebted consumers.<sup>18</sup> Financial education and debt advice are further discussed in chapter 3 of this report.

### *Civil law*

In the field of legal policy, the most important regulations that have a preventive effect on debt problems concern the consumer credit law. Even though the European consumer credit market was to a large extent deregulated in the 1980s, both European Union law and national laws include important rules that enhance sensible use of consumer credit. For example, the regulations of interest rates, default interests and the terms of cancellation of a consumer credit contract as well as the laws on usury have a direct bearing on the processes of over-indebtedness.<sup>19</sup>

In the deregulated credit market, the most important legal guarantees for the functioning of the market concern information, both in marketing of credits and at the time of concluding the credit contracts and during the contract relationship. Also these aspects are regulated in detail in the national consumer credit laws and in European Union consumer credit directive. The reform of the consumer credit directive is pending and it will lead to a more harmonised regulation in the European Union countries.<sup>20</sup>

Besides the regulation of consumer credit, also general contract law and regulations of specific types of contracts have a bearing on the processes of over-indebtedness. As Udo Reifner has pointed out, also principles of general contract law, such as adequate information at the time of concluding the contract, information duties during the performance, loyalty, the balance between the contract partners, the right to cancellation in case of default, are important for the process of becoming over-indebted.

As was mentioned above, the personal guarantees for loans are a frequent cause for over-indebtedness. Therefore, the regulation of the liability of spouses for joint debts and guarantees both during the

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<sup>17</sup> Braucher 2003, Gross 2003.

<sup>18</sup> Niemi-Kiesiläinen 1999b.

<sup>19</sup> Many of these aspects are regulated by the Consumer Credit Directive (87/102/EEC Council Directive of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit). A summary of the national legal regulations in the EU member states is presented in Study of the EU legislation (Reifner et al. 2003) at p. 73-144.

<sup>20</sup> See Credit for consumers: harmonisation of the laws of the member states COD/2002/0222, Commission/Council: initial legislative document COM(2002)0443 and Commission: modified legislative proposal COM(2004)0747.

marriage and in divorce need careful consideration.<sup>21</sup>

Moreover, the access to basic utilities, such as electricity, heating, water and phone can help households to avoid over-indebtedness and help to alleviate its consequences when already in trouble.

#### *Credit data*

The use and registration of data about individual debtors is believed to have a more direct preventive effect on over-indebtedness. The creditors file huge amount of data on their debtors and also the public registers contain a lot of information about the debtors. Both public registers and commercial data banks collect information on debtors who default on their loans and the commercial creditors frequently check these registers before they grant new loans.

At the moment international human rights law, protecting the privacy of individuals, and more specifically, the convention on data protection (1981)<sup>22</sup> as well as national data protection laws regulate the use and storage of personal data. The international conventions do not specifically restrict the storage of economic information as such. Today most countries allow registration and automatic procession of data on debtors who default on their loan. The attitude towards the registration of data on other loans, that is, loans that are not in default has been more restrictive. The issues concerning debtor data are discussed in chapter 3.2.

#### *Alleviation of enforcement*

Even though the prevention of over-indebtedness is a good goal both for the sake of individual debtors and for the sake of well functioning credit market, the total elimination of debt problems is not possible, nor desirable. The commercial creditors do not count on that all debts are paid back but try to maximise their profits. In order to do that they market their products also to groups of high risk debtors, knowing that some of the loans will turn out to be losses. A policy that would aim at eliminating over-indebtedness would probably mean less profit to the creditors and less economic well being.

According to the traditional way of looking at the relationships between the society, the creditor and the debtor, the duty of the society is to provide a debt enforcement system that guarantees the payment of debts if they are not paid voluntarily. The right to a fair trial according to the European Convention on Human Rights covers also a right to enforcement of the given judgement. The Conference of the European Ministers of Justice has paid attention to this aspect of enforcement in its Resolution No. 3 in 2001 and the Council of Ministers has given a Recommendation on enforcement.<sup>23</sup> While the focus of these recommendations is on the efficiency of the enforcement, they also recognise the need of protection of the basic needs of the debtor and the need to strike a proper balance between the creditor's and debtor's interests.

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<sup>21</sup> Reifner et al. 2003 p. 67, 91.

<sup>22</sup> Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data ETS 108 (1981). See also the European Union Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

<sup>23</sup> Rec(2003)17.

Also, the national laws traditionally include important protections for the debtor's basic needs in their enforcement legislation. The Finnish Ministry of Justice gathered information on these regulations from the member states of Council of Europe before the Conference of Justice Ministers in April 2005. The results of this survey are reported in chapter 4. The survey shows that the member states have a fairly consistent view on the protection of the debtor's and his or her household's items in the enforcement situation. Also, the member states protected part of the debtor's income in enforcement situation, even though the percentages varied.

In addition to the legally regulated enforcement of the judgements, also the less formal credit collection procedures often play a big role in the process of over-indebtedness. These debt-collection procedures have not been investigated in this report.

### *Rehabilitation*

Overwhelming debt causes the debtor and his or her family great suffering. When the household has no possibility to meet its obligations in the future, the situation has often serious consequences to its economic productivity and motivation to work. Often hopeless over-indebtedness leads to marginalisation and social exclusion. Then the society often bears the final costs.

The bankruptcy laws of the in the European Union did not contain any rehabilitative measures until the late 20<sup>th</sup> century. In the 1990s, when the economic down turn in the Western Europe led to a remarkable increase in the over-indebtedness of ordinary households, many European governments started to look for new measures to combat the situation. They found inspiration in the American bankruptcy law, which allows ordinary debtors to file for bankruptcy and get relief from their debts.

During the 1990s several European countries enacted debt adjustment laws, according to which a hopelessly over-indebted debtor may file for an insolvency procedure. In this process, the debtor's economic situation is examined and the debtor is obliged to pay his or her debts according to payment plan of usually five years. After this, the debtor is relieved from the outstanding part of the debts.

The debt adjustment laws have been object to lively legal policy discussion in many countries. The European legislators have been critical towards the liberal American consumer bankruptcy laws and added to the laws special precautions conditions. Today, we already have several years of experience from the functioning of debt adjustment laws from several European countries. A review of the existing legislation is presented in chapter 5.

## **3. Prevention: Credit Registration and Debt Counselling**

### **3.1 Introduction**

As was discussed in chapter 2, a wide range of social policies are indirectly important for the prevention of over-indebtedness. In this chapter, we will discuss two legal policies that have a more direct bearing on the situation of individual debtors who are in the risk of becoming over-indebted; the policies on registration of credit data and on financial education and debt counselling.

In recent discussions it has been argued that an effective measure against over-indebtedness would be a comprehensive register on all loans that the prospective debtors would have. By checking that register, the creditors could see which debtors already have so much credit that they will not be able to cope with new credits and deny the debtor new credit. This kind of positive registration of loans is already possible in some countries. As appealing as this suggestion is, it is not a solution to the problems with over-indebtedness nor quite unproblematic in itself, as will be discussed in 3.2.

Financial education and debt counselling are two distinct way of approaching debtor's cognitive abilities to live in a credit society (see 3.3). Many European countries have been first to develop debt counselling programs. Financial education both in schools and for the general public are also discussed here because of their close connection to debt problems.

### 3.2 Registration of Default and Credits

Information has always played an important role in credit. A well-informed decision to grant credit would be based on adequate information on the debtor's ability to pay back. In case of non-payment, information about the debtor's assets and income is of crucial importance for the creditor.

The nature and role of information in credit relations has undergone considerable transformations during the past decades. While the basis of granting of credit used to be based on the debtor's tangible assets, which still play an important role as securities for home mortgage etc., today the most important forms of information concern intangible assets, which may be in the form of income, different forms of capital, money transfers etc., and especially debts and obligations of the debtor.

The development of information technology has changed the way information is used, filed and processed. IT makes it possible to collect, transfer and analyse huge amounts of information. In the field of credit data, information of debtors who default on their credits has been used and collected for a long time. The collection of information on debtors who are not in default is a more recent trend. In addition, the data banks have started to analyse data to classify debtors according to their creditworthiness.

Quite naturally, the use of information technology to collect information on individuals rises important issues of protection of privacy. Right to privacy is one of the fundamental human rights protected, for example, by Article 8 of the European Convention of Human Rights and Article 17 of UN Convention on Civil and Political Rights. While these conventions do not specifically mention right to information, this aspect has been specifically taken up in the convention on data protection,<sup>24</sup> which has been prepared under the auspices of the Council of Europe and signed already in 1981. Later on in 1995, the European Union has given a directive on data protection.<sup>25</sup> These international instruments set out criteria for the reliable and confidential use, processing and storage of data. They also include important restrictions to the collection of sensitive personal data, such as information on race, ethnicity, religion and political opinion. Many European countries have enacted national data protection laws that implement the above mentioned international instruments.

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<sup>24</sup> Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data ETS 108 (1981).

<sup>25</sup> 95/46/1995.

The international conventions do not specifically restrict the storage of economic information as such. The national data protection laws and specific laws on credit data, however, include specific regulations on what kind of economic data on individuals may be collected and filed. This is necessary, since most people experience that information on their economic affairs is private information that they should have control over. In addition, the commercial interests involved make possible huge data banks in which information from different sources may be combined in different ways.

The credit data is usually divided into two categories, negative and positive. These terms are somewhat misleading, but they are generally used. Negative credit data means information on default with payments. Positive credit data is data on loans that are not in default.

Negative credit data is collected both in public registers and by private data banks. In many countries, the court data on insolvency, including bankruptcy and debt adjustment procedures, is public data and some countries have a central national register in which the opening of such procedures is registered in the purpose of protecting the creditors and third parties in insolvency. Also information on enforcement of money judgements is usually non-confidential information that can be registered.

In many countries, credit data is collected by private companies. These companies are often cooperatives of or owned by institutional creditors, such as banks and credit companies. Since they are commercial companies, they sell their data to their owners and others who give credits.

The credit data companies collect publicly registered information on insolvency and defaults. For example, information on judgments and enforcement of judgements is commonly collected from the administrative files and registered to the data banks. In addition, the credit data companies may also register default that has been confirmed by their members. The national data protection laws and laws on credit data include detailed regulations on what kind of defaults may be registered, how long the information may be filed in the register and to whom it may be disclosed and for what purpose. The national laws differ from each other in details. For example, the general time limit after which information has to be erased from the register varies between three years in Sweden and ten years in Spain. The general rule is that anyone who is registered has a right to access to any information concerning him or herself. However, the national laws differ on how this access in practice guaranteed.

The national markets for credit data tend to be dominated by one or two big companies, which are able to collect information from a wide range of members or owners. In some countries, credit data is registered under the national bank and has, thus, a more official character. This seems to be the case in France, Belgium, Italy and Portugal. Some east European countries, such as Bulgaria, Azerbaijan, Latvia and Romania, have also central governmental registers, which may be a suitable solution for a developing market.

The recent discussions on credit information have been about so called positive data, that is, whether registration of loans and credits that are not in default should be allowed. To our knowledge, at least seven European countries already allow registration of such positive data (Austria, Czech Republic, the Netherlands, Norway, Portugal, Romania and Russia). In Greece and Ireland positive information may be registered if the debtor consents, which limits the registration considerably. In Italy, the central bank may register positive information, but not private companies. Belgium has plans to allow positive data.

The registration and use of positive credit data most likely has a preventive effect on over-indebtedness. There is some reason to be cautious about new forms of information gathering about the individuals. The basic issue is whether the intrusion into the privacy of the debtors is in a reasonable relation to the end, that is, to the prevention of over-indebtedness. The running and operating of such data bases is costly and all debtors pay the bill in the end.

It is sometimes noted that some creditors grant credit even if the existing data shows that the debtor already has so much credit that default is likely. Some creditors offer credit contracts without any control of debtor's credit worthiness. A positive register is not likely to deter these creditors from taking risks and does not necessarily lead to as strong decrease of debt problems as was expected.

An important question is, should the creditors be obliged to consult such a data base. What are the consequences if the creditor grants the credit even if the debtor already has over-committed him- or herself according to the data bank?

The credit data banks are regulated in national laws because this information can also be abused. The risks of abuse increase when more information is registered. The European Union study on legislation gathered also information on problems with the use of credit data.<sup>26</sup> It was reported from some countries that the debtors who have the right to check what data about them is registered seldom know that they have this right or can use this right. It was also reported that registers contain sometimes errors and that it is not always easy to correct these errors – it may even take time before the debtor realises that an erroneous data gives him or her difficulties. Also a concern that credit data may be slipped to inappropriate purposes, such as excluding the debtor from job opportunities or rental of apartment, was expressed.

Even though serious abuses were not reported, these examples show that credit data can have very strong effects on peoples lives and, therefore, its appropriate regulation and processing are very important concerns for the whole society.

### 3.3 Debt Counselling and Financial Education

#### *Financial Education*

The contemporary society requires that ordinary people have considerable financial skills. Ordinary life requires comparison of prices, financial planning and follow-up of incomes and expenses. Many households want to improve their position by investing and using credits, which again require improved financial skills.

In an ideal world, everyone would learn the necessary financial skills in the school. Unfortunately, the education system has not necessarily woken up to this new reality. Even though some courses and classes are introduced in many countries, the financial skills have not got the same, self-evident lot in the curriculum as, for example, geography or foreign languages.

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<sup>26</sup> Reifner et al. 2003 Part II Answers to question 22.

Even if the school system fulfils its role satisfactorily, many immigrants and refugees arrive to the European countries each year, some of them from societies, which have very different economies. This is not to label immigrants as a special risk group. On the contrary, immigrant households often have excellent budgeting and other financial skills. Rather, there is need to stress that notwithstanding educational system, there is always need for adult financial education. Adult financial education may be directed to people who already have difficulties with their debts or to those who are already over-indebted, as will be discussed later on. In addition, also courses that are open to anyone, but especially for young households, should be offered. There seem to be modest development and experimental projects in some European countries, but overall this seems to be an area where a lot of development work is still needed.

### *Debt Counselling*

Apart from general financial education, case based, individual debt counselling is needed. Actually, many European countries had developed debt-counselling programs long before consumer debt adjustment was even heard of. Today, fifteen member states of the Council of Europe report that they have some form of debt-counselling programs (see Table 3.1). Many of these countries are the same that have enacted debt adjustment laws. Some of the countries, especially Sweden, Germany and the Netherlands had debt-counselling programs in place already in 1980s. Also in Ireland, in a country still without a debt adjustment law for consumers, debt advice network is well developed. In many other countries the counselling has been introduced in connection with the debt adjustment procedures.

Debt advice and counselling are prime examples of activities that can be organised by the third sector. As is shown in Table 3.1, there is no uniform pattern on how debt counselling is organised in the member states. New forms of organising debt counselling pop up constantly and therefore the picture that is given in Table 3.1 should be understood as examples of different way of organising debt's counselling

Some countries, especially the Nordic countries, rely on state and municipal authorities, either on consumer protection offices or on social services. Many countries have a long tradition of third sector agencies working with financial and debt advice. Here should be mentioned especially Money Advice and Budgeting Services (MABS) with 50 offices over the country in Ireland, several organisations in the United Kingdom, which among other things keep a National Debtline, and consumer protection organisation DECO in Portugal. In Germany many third sector organisations, including consumer organisations, religious welfare organisations and labour unions, have added debt counselling to their activities when they have seen the debt problems arise. In the Netherlands, the municipal banks have had a long tradition of debt counselling, debt rescheduling and consolidating loans to the consumers before the debt adjustment act of 1998 was enacted.

When the debt problems have a political concern, the states have allocated funds to counselling. Many third sector organisations are now partly funded from state contributions. The organisation of debt counselling has become a mixture of state, municipal and third sector actors in many countries. This plurality should be seen as a blessing, which gives creative examples of different and flexible ways of organising a new activity.

With the legal regulation of debt adjustment, discussions about the need to regulate also the profession of debt counselling have started. According to the European Union Study on Legislation,<sup>27</sup> Austria, Belgium, Finland, France, Germany Luxembourg, the Netherlands and Sweden have some regulation of debt counselling services. The regulations are quite different, tough. For example, in Austria, Belgium, Germany and Luxembourg the counsellors have to get a license for their practice. France prohibits certain kinds of consultation work.<sup>28</sup> In Finland the law obliges the municipalities to arrange debt counselling either by its own officials or by purchasing the service from the private or the third sector. Generally, the counselling services are free of charge for the debtor.<sup>29</sup>

The content of debt counselling has undergone transformations with the emergence of debt adjustment laws. In the absence of such laws, debt counselling used to focus on the household budget and on the negotiations on payment of debts with individual creditors. With the emergence of debt adjustment laws, the counselling tends to transform into advice and help with the filing for the debt adjustment procedure.

The European Union Study on Legislation has identified different tasks for debt counselling as follows:<sup>30</sup>

- budget analysis and advice, focusing on the expenditure and income of the debtor household
- financial planning
- debt settlement, drafting and bargaining with the creditors
- monitoring of legal claims
- social work
- mobilisation of social security
- supervision of repayment
- financial literacy.

The transformation of counselling has meant, first, that debt settlement negotiations have either disappeared or become a formal and required pre-stage for a filing for debt adjustment procedure. Monitoring of creditors' claims and disputing them have virtually disappeared. The household budget is the central starting point in debt counselling both in the absence of legal debt adjustment and in the preparation for such. The traditional debt counselling paid much attention to the ability of the debtor's household to follow a budget. The counsellor was expected to give psychological support, to direct the debtor to appropriate services, to give advice on available social security benefits and to monitor the payment plan. As the European Study on Legislation notes this social work aspect of debt counselling has diminished as the preparation for filing has become more central. Some counsellors have become semi-legal advisors on the debt adjustment procedure. This development has been necessary, but it bears with it certain problems. There is evidence that the payment plans are not easy to keep. Many debtors make big sacrifices to fulfil the plans but many debtors fail to fulfil the plan. There are probably many reasons for failures. As is discussed in chapter 5, payment plans are often quite onerous. One

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<sup>27</sup> Reifner et al. 2003 p. 200.

<sup>28</sup> Reifner et al. 2003 p. 201.

<sup>29</sup> Reifner et al. 2003 p. 202.

<sup>30</sup> Reifner et al. 2003 p. 197 ss.

contributing factor to failures may be that the debtors do not get enough support in the necessary behaviour modification, both during the preparation and the fulfilment of the plan.

The demand for debt counselling exceeds the available resources, especially when a new debt adjustment law is enacted, the demand for counselling increases. Individual debt counselling is time-consuming. Individual work is needed for the preparation of filing for judicial debt adjustment and for that work a counsellor is not as costly as a lawyer. Other tasks of debt counselling, on the contrary, could be learned in groups. Actually, education in peer groups has proved to be a very efficient way to change certain behaviours, such as addictions and aggressions. In the USA and Canada, the debtors in consumer bankruptcy are now required to participate in financial education, which is in most cases organised for groups.<sup>31</sup> This is a field where the general adult education in financial literacy and the rehabilitation of over-indebted debtors could meet. In conclusion, the development of financial education should be a priority in the European countries.

#### **4. Alleviation: Social Aspects in Enforcement**

##### **4.1 Introduction**

When a debtor has financial difficulties and becomes unable to pay his or her debts, the creditors proceed to recovery and enforcement. First the creditors usually send a reminder of the bill, then they may remind the debtor by telephone or letters. These steps are subject to some restrictions in many countries but, in principle, the creditor can choose among different procedures.

The next step is to start legal debt recovery. The legal process is divided into two parts, the confirmation of the debt by the court or other equivalent body with legal capacity to give a binding decision or judgement and the enforcement of the judgement.

The enforcement system is a condition for a well functioning credit market and, thus, there has been considerable emphasis on the creating of the enforcement system in the legal development of the former East European countries during the past decade. Also the Committee of Ministers of the Council of Europe has paid attention to the importance of enforcement procedures by giving a Recommendation on Enforcement Rec(2003)17.

The enforcement law is often looked at from the perspectives of efficient enforcement and the protection of creditors. The enforcement of judgements is considered to be part of the legal proceedings and, thus, subject to the requirements of fair trial in the Article 6 in the European Convention of Human Rights. The European Court of Human Rights has, indeed, in several decisions confirmed that the right to a fair trial has been violated when the trial has not been conducted in a reasonable time, counting the time that enforcement has taken into the length of the trial.<sup>32</sup> It can be said that the right to enforcement of judgements is part of the right to the fair trial according to the ECHR.

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<sup>31</sup> See Braucher 2003 and Gross 2003.

<sup>32</sup> See *Silva Pontes v. Portugal* 23.3.1994, *Scollo v. Italy* 28.9.1995, *Di Pede v. Italy* 26.9.1996, *Zappia v. Italy* 26.9.1996, *Immobiliare Saffi v. Italy* 28.7.1999, *Lunari v. Italy* 11.4.2001, *Hornsby v. Great Britain* 19.3.1997 and *Sabin Popescu v. Romania* 2.3.2004.

Also the Council of Europe Recommendation takes the claimants right to enforcement as its point of departure. However, the Recommendation emphasises the balance between the interests of the claimant and the defendant in enforcement.<sup>33</sup>

In international procedural law, the cross-border enforcement of judgements has been facilitated by European conventions since 1968 as will be discussed in 5.6.

The protection of debtors against inhuman and harsh enforcement through the courts and legal enforcement agencies has not been, as far as we know, under recent discussions in international law. It has to be noted, however, that human rights instruments forbid imprisonment for a failure to pay a debt.<sup>34</sup> Also, different forms of modern debt-bondage exist in many parts of the world in breach of workers' rights and, in the worst cases, are a violation of the prohibition of slavery.

The legal forms of enforcement, which are discussed here, have not been under discussion in international law. The most common form of enforcement is the garnishment of wage and salary. In its regulation it has to be recognised that the international human rights instruments guarantee the worker's right to fair working conditions and reasonable remuneration for work. For example, the European Social Charter of 2002 protects the working conditions in articles 2-4 and, more specifically, gives the families economic, legal and social protection in article 16. The same guarantees are found in the UN Covenant on economic, social and cultural rights of 1966. Article 6 of the last mentioned Covenant summarises the right to earn one's living by work as follows:

*The States Parties to the present Covenant recognize the right to work, which includes the right of everyone to the opportunity to gain his living by work which he freely chooses or accepts, and will take appropriate steps to safeguard this right.*

The enforcement in the form of garnishment of the debtor's wage and salary should only be possible as long as it does not violate the right of the debtor to get a just standard of living out of his or her earnings. Special attention should be paid to the rights of children who live in over-indebted households. In the Convention of the Rights of the Child, almost all states have recognized the right of every child to a standard of living adequate for the child's physical, mental, spiritual, moral and social development (art 27). While it is the parent's primary responsibility to secure these rights, also the states have undertaken the obligation to assist parents and others responsible for the child to implement this right.<sup>35</sup> Thus, it is argued that the enforcement of debt should be regulated to that it does not endanger children's right to development.

#### 4.2 Organisation

A system for the enforcement of payment judgement has proved to be necessary for a functioning market economy. Especially in the beginning of the 1990s, the lack of an enforcement system seemed to

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<sup>33</sup> Council of Europe Recommendation Rec(2003)17 III 1 g.

<sup>34</sup> 4<sup>th</sup> Protocol of European Convention of Human Rights 18.5.1990 Article 1.

<sup>35</sup> The Children's rights are also recognised in several other human rights instruments in more general terms. See for example the European Social Charter art 13 and The European Union Constitution art 84.

be one of the problems for the developing market economies. The Council of Europe paid attention to the role of enforcement agents in its Recommendation Rec(2003)17. The recommendation emphasises that the powers, responsibilities, role and status should be prescribed by law. It further includes guidelines for the regulation of training, working conditions, disciplinary procedures etc. The recommendation also sets a high ethical and professional standard to enforcement agents:

*Enforcement agents should be honourable and competent in the performance of their duties and should act, at all times, according to recognised high professional and ethical standards. They should be unbiased in their dealings with the parties and be subject to professional scrutiny and monitoring which may include judicial control.*

To get information about how enforcement is organised in European countries a question on the organisation of the enforcement process was included in the questionnaire the Finnish Ministry of Justice presented to the member states.

According to the answers to the questionnaire, all member states seem to have taken steps towards ensuring the enforcement of judgements. There seem to be two or maybe even three different ways of organising enforcement.

About two thirds of the countries reported that the courts are mainly responsible for the enforcement of judgements. This group of countries included, for example, Austria, Germany, Poland, Portugal, Russia and the United Kingdom. As was noted in the answer by Italy, the bailiffs who carry out the enforcement are attached to the courts and work under their supervision.

The second group of countries report that the bailiff is a liberal profession but a licensing by a court or other state agency is required to act as a bailiff. These private bailiffs seem to work under the supervision of the courts. This group consists of Estonia, France, Greece, Lithuania, Romania, Slovakia and the United Kingdom. There seems to be an on-going tendency to privatise the bailiff profession in many Eastern European countries.

In yet a third group of countries the enforcement is carried out by a specific state agency. This organisational form is popular in the Scandinavian countries as well as in many Eastern European countries. Also Belgium, Ireland and Switzerland are mentioned here.

#### 4.3 Beneficium

Beneficium is an old Latin term used to define what assets are protected from execution for debt payment. There seems to be a fairly broad consensus among the member states about what assets should be protected, which is also reflected in the Council of Europe Recommendation on enforcement<sup>36</sup> according to which

*h. certain essential assets and income of the defendant should be protected, such as basic household goods, basic social allowances, monies for essential medical needs and necessary working tools.*

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<sup>36</sup> Recommendation Rec(2003)17 of the Committee of Ministers III 1 h.

The member states have indeed followed the recommendation. All of them have laws that protect the personal items and ordinary household objects, tools and educational material of the debtor. It may, of course, vary a great deal from country to country how the protected household are defined and in practice applied. What is considered as ordinary in one country may be considered as luxury in another. Also, the law defines in many countries what specific tools of trade and educational materials the debtor may keep. However, the general rule is uniform in that such items are protected.

Differences among the countries became obvious when they were asked whether the transportation vehicles are protected from enforcement. While most countries replied with a straight “no”, about one third of the countries replied that under certain conditions a transport vehicle, usually a car, can be protected against enforcement. The car could be protected in several West European countries but also Slovakia, Slovenia, Turkey and Ukraine allowed the debtor to keep a car in some cases. In general, the car must be necessary either for work or going to work, taking children to child care or other necessary transports and it may not exceed a reasonable value, for example, in Belgium 2.500 euros.

A cultural difference between the Western and Eastern European countries appears concerning food and agricultural equipment, which are offered a better protection in the East European countries. In many of these countries, the law defines that the debtor is allowed to keep food supplies and fuel, coal or firewood for a period that varies between one and six months to support his or her family. Several countries also protect agricultural production for the maintenance of the family by excluding seeds, machinery and some animals from enforcement. In most cases only one cow, two goats or three sheep are protected as in Poland, which shows that the purpose is to protect the basic needs of the debtor's family rather than agricultural production as such. In Bulgaria and Croatia, even some agricultural land is protected from enforcement.

The debtor's home seems not to enjoy special protection from enforcement in most countries. The notable exceptions are Bulgaria and Moldova.

This summary of the beneficium rules in the European countries shows that the rules protecting the debtor's household objects, tools and educational material rely on fairly similar principles. This summary could not go into the economic values of protected assets, which may differ according to the circumstances in the respective countries but also depending on the attitudes towards debt payment and enforcement. Also the scope of protected assets may vary in practical interpretation of the laws. To make an assessment on the level of protection one should go deeper into the values and scope of protected assets. In principle, at least, the protection of household and personal items seems to be fair.

#### 4.4 Protection in Garnishment

##### *The results of the questionnaire*

In the contemporary society, most people get their livelihood in the form of wages, salary, pension or other regular income. With the exception of those who run their own business or agricultural cultivation, also most debtors are dependent on their income from employment or pension. At the same time, the regular income is for most people the most important source to repay their debts. Consequently, it is a very delicate and difficult balance that has to be drawn between the protection of livelihood of the debtor and his or her family and the repayment of debts.

The questionnaire sent to all member states of the Council of Europe made an inquiry into how national legislators have solved this dilemma. The answers show that the problem is recognised in all member states and the balance is struck by regulating how big portion of the wage and salary may be garnished in debt enforcement. Also the garnishment of a pension is allowed in all countries.

The usual mode of regulation is that a certain percentage of the debtor's regular income is allowed. There is, however, usually a basic line that defines how much is the basic subsistence that always is left to the debtor. We have compiled the different garnishment percentages in Table 3.2., which shows that the regulations vary from country to country.

The *most common way of regulating the garnishment* is that one third or one half of the income can be garnished. One half of the income has been chosen in several Eastern European countries and two of them allow even two thirds to be garnished. One third of the income can be garnished in Austria, Finland, Bosnia, Croatia, Macedonia and Slovakia.

Many of these countries allow a bigger garnishment when the creditor is someone to whom the debtor is obliged to pay maintenance, such as a spouse or child, or someone who is entitled to compensation for damage to health or for a death of a provider. To pay to such creditors, even 60-70 percentage of the income can be garnished in several countries.

A *progressive scale* for garnishment is used in Belgium, Bulgaria, France, Latvia and Spain. In these countries, the portion to be garnished at the lowest level on income is one fifth or one third. The progression can be very steep, leading to garnishment of all or 75 per cent of income above a certain level.

Surprisingly, some wealthy countries with a good social security allow that all income above a certain level may be garnished. Sweden, the Netherlands, Norway and Switzerland belong to this group. In this group the debtor's *households may keep the same amount notwithstanding income*. As far as we know, the level above which garnishment is allowed is fairly reasonable in these countries. Some of these countries also limit the time under which income may be garnished.

In three countries, Cyprus, Ireland and the United Kingdom, *the court has discretion* over how much can be garnished in each case.

Very few countries limit the period of garnishment. Finland and Norway have a limitation of five years for garnishment of taxes and fines. Sweden has a limitation of one year, but the garnishment can be renewed. Norway has a general limitation of two years. Finland has recently introduced a limitation of 18 years after which a debt can not be enforced.

A special mention has to be made of Denmark and Greece. In these two countries *only maintenance debtors and public authorities* with their claims are allowed to garnish regular income.

### *The assessment of the situation*

To conclude, there is a variety of ways to regulate garnishment of income. The assessment of the level of garnishment, which can not be fully made here, is dependent on the level of basic minimum level of subsistence, which can not be garnished at all. Since this level was not studied, we can not compare the basic minimum standard the debtor may keep in enforcement. However, my study of the Finnish garnishment system showed that since many debtors have low incomes this level is quite essential for the survival of the debtors. Even if this level is higher for every family member that the debtor has to support, especially families with children were extremely distressed in the garnishment situation.

Considering that most debtors have fairly low incomes, also the different percentages used in garnishment seem to lead to quite low living standard for the debtor and his or her family. Especially a garnishment of two thirds or half of income leaves debtors with average income under what is often considered as poverty line (60 percent of average income).

The positive signal in the use of percentages is that such a system gives the debtor, at least in theory, an incentive to try to increase his or her income. It can be asked, however, whether the incentive is big enough if two thirds of the income is garnished. The incentive profile has not been found to be a problem in those few countries that leave all debtors the same income or that have a progressive scale for garnishment. These kinds of systems are based on a certain concept of equality among the debtors.

Both high percentages and flat level of protected income lead to efficient enforcement at the first sight. We think, however, that the incentive problem is quite serious. A hard enforcement may lead to black market behaviour, which is probably much more detrimental to the economy than occasional losses to creditors.

Very few countries reported limitations in the period of garnishment, even though that might be market conform way of regulating the enforcement. In the market economy the credit is given with an assessment of the ability to pay back in a certain frame to the future. Therefore, it would be consistent with the market logic that the state facilitates the enforcement of credit only for some reasonable time.

A quite surprising finding is that two countries, Denmark and Greece, do not garnish at all for the payment of commercial debt. As far as we know, this has not caused special problems for the Danish or Greek economy. These countries would, indeed, deserve a closer study. At this point we can point out them as curiosities, which indicate that a market economy can find other ways than enforcement to guarantee payment of debt.

In an ideal case, the garnishment system would successfully balance the need to protect the basic living standard of the debtor and his or her family, the efficiency of debt repayment and give the debtor incentive to try to increase his or her income.

## **5. Rehabilitation: Consumer Debt Adjustment**

### **5.1 Background**

The expansion of debt-problems in the late 20<sup>th</sup> century led several European countries to look for new remedies. The growth of debt problems occurred after the deregulation of the credit markets in the 1980s and the subsequent economic downturn in Europe in the early 1990s. The political pressures to help those who had become over-indebted due to an unexpected event increased since many middle class households faced serious debt problems in these circumstances. In many countries, the researchers and legislators became interested in the insolvency legislation as a possible cure for over-indebted individuals.

Traditionally, the European bankruptcy laws did not contain any alleviation from the debt burden. A bankrupt debtor was legally liable for all his or her debt after he or she had been declared bankrupt and also after all his or her assets were sold in the bankruptcy and the bankruptcy case was closed. Of course, in the latter half of the 20<sup>th</sup> century most bankrupts were companies with limited liability and, thus, dissolved after a bankruptcy. Still, quite a number of bankrupts were private persons, small entrepreneurs in various fields, such as construction and commerce. Most of the over-indebted individuals, however, never filed for bankruptcy since it would not have helped them in any way.

Insolvency law may, however, offer alleviation of the debt burden. Some insolvency laws included provisions of composition or accord, in which the majority of creditors grant the debtor a partial relief of debt against the payment of some percentage of the debt. Such laws were, either according to the letter of the law or in practical terms, only accessible for commercial debtors. The compositions were very rare, because a qualified majority of two thirds or more of unprivileged creditors had to vote for the composition. Since the 1980s, the business bankruptcy laws have been reformed in many countries so that both reorganisation of the business and the rescheduling of debts, including partial relief of debt, have been made an accessible option for viable businesses.

In the Anglo-Saxon countries (except in United Kingdom and Ireland), bankruptcy has been an option also for consumers and other individual debtors. Bankruptcy has included the regulation of discharge of remaining debt. In the United States, the debtor has in principle had a choice. In ordinary, "straight" bankruptcy all debtor's assets have been sold and the debtor has been relieved of remaining debt straight after the bankruptcy. In the other alternative, the debtor has paid the debts according to a payment plan for three years. Since most consumer debtors have no assets to sell, straight bankruptcy has been the dominant form of bankruptcy.

Each year about 1,5 million households file for bankruptcy. The great number of bankruptcies has been the object of heated debate lately. Therefore, the law has been recently changed to require that the debtor pay his or her debts according to a five-year payment plan if the debtor's income exceeds the national average income. The payment plan is mandatory when the debtor can in five years pay at least \$ 10.000 or over \$ 100 per month and 25% of the unsecured debt.<sup>37</sup> Other Anglo-Saxon countries have already before had modest requirements to pay part of debts in bankruptcy, but the principle of discharge of outstanding debt has been a fundamental principle for example in the bankruptcy laws of Canada, Australia and New Zealand.<sup>38</sup>

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<sup>37</sup> The issue has been discussed in the Senate and the Congress since 1998, and the amendment was finally signed into law by the president on April 20, 2005. It will enter into force 17.10.2005.

<sup>38</sup> See Ziegel 2003.

Modern insolvency law may, thus, include three different procedures; (1) bankruptcy either with relief of pre-bankruptcy debt or not, (2) business reorganisation including rescheduling of debt payment and (3) a separate procedure for consumers. In the English-speaking world, the last mentioned procedure is generally called consumer bankruptcy and regulated in the general bankruptcy law. The European languages often used equivalents of consumer debt adjustment or debt rescheduling (skuldsanering, Schuldenregulierung) and the procedure of debt adjustment differs from bankruptcy proceedings.

In the 1990s, several European countries have enacted laws on consumer debt adjustment. Even though the European legislators have looked at the United States for inspiration, the European laws differ from the Anglo-Saxon consumer bankruptcy laws so much in important respects that we prefer to use the term *consumer debt adjustment*. The word consumer is used here as an opposite to commercial entrepreneur and to underline that the over-indebtedness is an issue of consumer protection law rather than business bankruptcy law. The use of word consumer does not indicate that the debtor had become indebted by consuming.

## 5.2 Status of Legislation

In 2005, fourteen European countries have a consumer debt adjustment act in force. That is almost one third of the member states of the Council of Europe. Most of these countries are in the old Western Europe and can be characterised as developed or mature credit societies. Also some Eastern European countries have already enacted consumer debt adjustment laws or have plans to do so.<sup>39</sup>

The first country to introduce such a law was Denmark in 1984. In 1989, France enacted its law for the prevention of over-indebtedness. This law allowed regulation and prolonged payment period of debts but gave relief of debts only under very stringent conditions. This was in contrast to bankruptcy law, which in France is only accessible to debtors who are merchants or engaged in some kind of business. Since 1985, the debtor is relieved from debt after bankruptcy. The French law on consumer over-indebtedness was changed towards a more relaxed adjustment of debts in 2003 and a bankruptcy for private individuals was added to law, allowing for discharge of all debt.

Other Scandinavian countries followed Denmark in the early 1990s and enacted debt adjustment laws. These laws contain a comprehensive insolvency procedure designed for the individual, non-commercial debtor leading to a payment plan and relief from remaining debt. The Norwegian law (1992) gives preference to voluntary settlements between the debtor and the creditors before the case goes to the court. This model was also accepted in Finland and Sweden. The Finnish law (1993) has been amended in 1997 and 2002. The somewhat cumbersome procedural arrangement of the Swedish debt adjustment law (1994) is under review and will probably be simplified in the near future.

In Germany and Austria the relief from debt is regulated in bankruptcy law. In Germany a procedure for relief of remaining debts (Restschuldbefreiung)<sup>40</sup> was incorporated in the new Insolvency Act in 1994, which became effective in 1999. Even though the debtor is, in principle, required to go bankrupt before the relief procedure, the bankruptcy for non-commercial debtors is very simple. The procedure has been

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<sup>39</sup> The laws are compiled in Table 5.1.

<sup>40</sup> Insolvenzordnung (5.10.1994 BGBl 1994, 2866, in force 1.1.1999) 8 Teil §§ 286-30.

reformed in 2001. In Austria, the debt adjustment was introduced in 1993 and became effective in 1995.<sup>41</sup>

The Netherlands (1998), Belgium (1998)<sup>42</sup> and Luxembourg (2000)<sup>43</sup> have enacted laws on collective insolvency procedures for individuals, leading to partial relief from debt. All countries put emphasis on the preventive measures and voluntary agreements between the debtor and the creditors.

Recently, Estonia (2003) and Portugal (2004) have amended their bankruptcy laws to include a debt adjustment procedure for individuals.

In the United Kingdom, a debt adjustment procedure titled Administration Order has been regulated since 1881 in the County Court Act. This procedure, however, is accessible only to debtors with fairly limited amount of debt and creditors. The payment requirements are also quite stringent, making the remedy unattractive or not possible for many debtors. Notwithstanding, the procedure has helped some debtors who have got adequate advice about it.

The British bankruptcy law has been changed towards a more debtor-friendly direction during the past decades. The 1986 Insolvency Act introduced an automatic discharge of debts three years after the bankruptcy. In 2002, the law<sup>44</sup> was amended so that the debtors who have failed through no fault of their own and who cooperate with the bankruptcy administration can have discharge already after one year. Even other debtors may be granted discharge later. There is no formal prohibition for consumer debtors to use this procedure to get discharge but in practice the high fee for the administration and court procedure (total of £370) is an effective barrier for individual debtors.

In Ireland, the debtor in bankruptcy is relieved from liability of pre-bankruptcy debt when 12 years have passed after the bankruptcy. This is hardly an option for indebted households, even if they are not legally excluded from the bankruptcy.

Albania has taken a step toward debt adjustment in the regulation of loans from state owned banks.<sup>45</sup> This law allows for decrease in interest and continuation of payment periods but it is not a comprehensive insolvency law covering all debts.

In several other European countries, it has been discussed whether a consumer debt adjustment law should be drafted. In Czech Republic and Lichtenstein a draft proposal has already been presented and is under discussion. Also Slovenia reports that a concrete plan for the preparation of the law already exists. The need for a debt adjustment law has been discussed, for example, in Italy, Greece, Portugal and Spain.

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<sup>41</sup> Konkursordnung-Novelle 1993.

<sup>42</sup> Loi sur le règlement collectif des dettes 5.7.1998, in force 1.1.1999. The law has been amended 16.7.2004.

<sup>43</sup> Loi la prévention du surendettement 8.12.2000, in force in 2001.

<sup>44</sup> By the Enterprise Act, which came into force 1.4.2004. For more about the law in UK see Ramsay 2003 (England and Wales).

<sup>45</sup> Law on establishment of the agency for treatment of credits Law No. 8339, 30.4.1998.

### 5.3 General Principles

The purpose of the debt adjustment is to re-establish the debtor's economic capability, in other words, *economic rehabilitation*. Rehabilitation can be said to include two elements. First, the debtor has to be freed from excessive debt. Secondly, the debtor should be able to avoid ending up in debt again in the future, which may require some behaviour modification.

In the English usage, the term *fresh start* is often used but it is associated with the straight discharge, which has been possible in the American bankruptcy law and even after the recent amendments will be an option to people who earn less than the average Americans. In the United States, the concept of fresh start can be identified with the ideology of the country of immigrants, many of whom started a new life after having left everything, including debts, in their old home countries.

The European countries have not accepted the straight discharge. All European countries set as a condition for discharge a partial payment of debts according to a payment plan that lasts usually five years. Thus, the debt is only reduced to such an amount that is considered reasonable for the debtor to pay.<sup>46</sup> Instead of fresh start we could speak of a delayed or *earned new start*.

For rehabilitation it is important that the debtor's all debts are included in the discharge. As will be discussed in 5.4.4, a general principle of the European debt adjustment laws is that all debts, except maintenance payment to the debtor's child, are included in the discharge.

The other dimension of rehabilitation, *behaviour modification* is not consistently regulated in the European debt adjustment laws. Nevertheless, several institutions in these laws aim at promoting behaviour modification if such is needed. For example, the debt counselling is, as a rule, connected to the debt adjustment procedure. The counsellors should help the debtor in the making of the household budget, advice on reduction of costs and supervise the fulfilment of the plan and the budget. The counsellors are also expected to give psychological support to the debtor and have good knowledge of social services (see chapter 3.3). The individual counselling has an important role in the rehabilitation of the debtor.

Equally important, the whole debt adjustment process and especially the payment plan are deemed to have an educational effect. The fulfilment of the payment plan is, in a way, proof of the debtor's capacity to control his or her financial affairs. In some countries, such as Austria and Germany, the debtor has also a special obligation to "good behaviour" during the plan. That is, the debtor is obliged to work during the plan or look for a job if he or she is unemployed. This obligation is a legal one, the creditors may claim that the debtor has not fulfilled it and ask for denial of discharge in the end of the payment plan.

The principle of *good faith* is present in the regulation of access to debt adjustment and in the obligations during the payment plan. The idea of the law is to help unfortunate, but honest debtors. In principle all laws require that debtors, who abuse the system, are denied discharge. In the Nordic countries, the debtor's circumstances and the way he or she became indebted are screened quite rigorously as a

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<sup>46</sup> As mentioned above, the fresh start has not been a principle of European business bankruptcy law. In some new bankruptcy laws, however, the debtor is discharged of pre-bankruptcy debt. This is the case in France and in the United Kingdom one year after the bankruptcy.

precondition of admissibility to the debt adjustment procedure. Elsewhere, for example in France, a more generous test of *bonne foi* is applied.

Finally, the principle of *non-discrimination* should be mentioned. Actually, discrimination issues have not been discussed in this context and there seems to be no explicit prohibitions against discrimination in any of the European consumer debt adjustment laws. The data protection regulations, however, usually prohibit the registration and use of information about completed payment plans, which is in effect a prohibition against discrimination. Since the plans last for several years, discrimination both during the plan and after its completion may be a problem that warrants more attention in the future.

## 5.4 The European Model

### 5.4.1 Introduction

The European countries that have enacted a law on consumer debt adjustment have in no way harmonised their laws. To the contrary, the regulations differ widely in their details. With the exception of the payment plan, which is mandatory in all countries, the institutions that will be presented in this subchapter differ over Europe. This is good to remember when we make generalisations in the following presentation. We think, however, that the laws are based on a set of common values, such as the goal of rehabilitation, the principle of good faith and the equality principle, and, therefore it is a worthwhile attempt to analyse whether there are more concrete common characteristics in the regulations.

We can distinguish three broad groups among the countries that have debt adjustment legislation. First, the *Nordic countries*, following the Danish example of 1984, pay a lot of attention to the *good faith –test* in their regulation of access to debt adjustment. The courts have the power to deny access to debt adjustment procedure from debtor's who have incurred the debts in an irresponsible manner, who have not made enough attempt to pay back the debts or who have incurred big debts right before filing for debt adjustment.

In the second group, the *German and Austrian model*, implemented also in Estonia, puts emphasis on the *payment plan*. The debtor earns the discharge by fulfilling the payment obligations of the plan. The debtor has also an obligation to respect the creditor's rights by behaving well, that is, working and looking for a job during the plan. The debt adjustment is regulated in the general bankruptcy codes of these countries. In the bankruptcy context, it is natural that the access to the procedure is a matter of economic terms (insolvency), not one of moral control of past behaviour.

The third group consists of France, Belgium, The Netherlands and Luxemburg. In these countries debt adjustment is more closely connected with the idea of *prevention of debt problems* which is apparent even in the names of the laws. The laws strongly *favour voluntary settlements* and give them considerable institutional support. Conditions for a discharge in the judicial procedure are hard and payment plans long.

In this subchapter we will discuss the preference for voluntary settlements, the mandatory payment plans and the regulations and problems with different types of debt in debt adjustment procedure.

#### 5.4.2 Preference for voluntary settlements

The priority for the prevention of debt problems in the European countries is apparent in the preference for “soft” measures, that is, for institutionalised debt settlement by an agreement between the debtor and the creditors.<sup>47</sup>

According to the preparatory works for the debt adjustment laws, the merits of such voluntary debt settlements are obvious. First, the debtor avoids the stigma of bankruptcy and the registration in credit information data banks that follow from an officially recorded insolvency procedure. Secondly, the costs of a court procedure are higher than those of informal settlement negotiations. Thirdly, the debtor may have an incentive to make a higher offer to creditors to avoid the inconvenience of the court procedure, which would benefit the creditors.

This preference for voluntary settlement has in many European countries led to two-stage procedure in the debt adjustment laws.<sup>48</sup> The debtors are required to make an effort to reach a voluntary settlement with their creditors before they are allowed to file for judicial debt adjustment in the court. A debt counsellor is usually available and obliged to assist the debtor in the negotiations for a voluntary settlement. In some countries, the attempt to reach a voluntary settlement is regulated in a more formal framework, such as the French and Luxembourgian Commissions for over-indebtedness and the filing to the debt enforcement agents in Norway and Sweden.

In practice, it is not easy to reach voluntary settlements between the debtors and all their creditors. In countries, where debt counsellors had experience of preparing such settlement before a debt adjustment law was enacted, a portion of cases is still settled voluntarily. In Germany about ten per cent of cases that come to the counsellors have been voluntarily settled. In the Netherlands, where the counsellors had a long tradition of working out voluntary settlement with the help of the municipal banks before the debt adjustment law was enacted in 1998, the low number of voluntary settlements after 1998 has been a disappointment. Compared to other countries, the Dutch figure of 28 per cent of voluntary settlements seems to be very successful, however.

There are several reasons for the low rates of voluntary settlements. Just one of several creditors may make the settlement impossible by a veto. Some creditors trust a court procedure more than a settlement proposal. Public creditors, such as the tax authorities, have often been reluctant to accept voluntary settlements. Sometimes the rules for accounting give preference to a formal court decision, which makes possible an easier process for writing down the losses. Some creditors are quite difficult to locate and some others remain passive when a proposal for voluntary settlement is presented to them. Unless the law stipulates that passive creditors are bound by a settlement, they will not be bound. The passive creditors are bound by a settlement according to the laws of, for example, Germany and Sweden. This kind of regulation seems to be a condition for a meaningful debt settlement program, but it requires that the institutional setting in which the proposals are prepared is well regulated and supervised.

As a formal insolvency procedure, the debt adjustment can only be a court procedure because this procedure concerns the rights of both the creditors and the debtor. Already the opening of a debt

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<sup>47</sup> This subchapter is based on European Union Study on Legislation, Reifner et al. 2003 p. 170-175.

<sup>48</sup> A more detailed comparison is presented in Reifner et al. 2003 p. 171-172.

adjustment procedure by the court curtails the debtor's right to freely dispose of his or her property and rights to other economic disposals. At the same time, the opening of the debt adjustment procedure imposes a stay on the creditor's right to collect the debt. Even though these rights can in concrete cases seem to be illusory as there is nothing to collect and the debtor has no property to dispose, these are core elements in the constitutional and human right to property. Without due process guarantees these rights could be abused. The final decision to confirm a payment plan and discharge also encroaches strongly on the creditors' rights, and such a decision can hardly be invested to any other body than a court. In addition, the decisions in the insolvency procedure bind also "unknown" creditors, that is, creditors whom the debtor has not reported and who have not given notice themselves. Only a court can make such binding decisions in a regulated insolvency procedure.

A voluntary settlement has considerable advantages. In addition to what has been said above, there is also room for some flexibility in voluntary settlements. The need for flexibility has become apparent with the implementation of the judicial debt adjustments. For example, the guarantors of loans can be included in the settlements in a flexible way, which is not possible in judicial debt adjustment (see below 5.4.4). Also if the debtor is a homeowner, the home can sometimes be better protected in a voluntary settlement than in judicial debt adjustment.

Therefore, the preference for voluntary settlements is worth preserving. The wish for voluntary settlements will not, however, be fulfilled automatically or by the order of the law, but some institutional support and incentives are needed. First, professional, low-cost or cost-free assistance has to be available and the advisor should have experience in negotiations with creditors. The counsellors or mediators have to have credibility in both debtors' and creditors' eyes. Secondly, the negotiations proceed better if they can be carried out without a threat of debt enforcement. The court should be able to stop enforcement while the negotiations are pending. Thirdly, the creditor passivity should not prevent the acceptance of the settlement, which should be binding on all creditors who have been notified.

#### 5.4.3 Payment plan

##### *Mandatory plan*

The European debt adjustment laws require that the debtor pay his or her debts according to a payment plan. According to the plan, the debtor is required to pay all his or her disposable income to the creditors. The debtor has the right to deduct from his or her income the necessary living costs of the family. The methods of calculating the necessary living costs vary from country to country, but the general impression is that the debtor households are required to acquiesce in a quite modest living standard, the standard of which is often compared to the minimum social security.

##### *The duration*

The length of the payment plan is usually five years. While this is the maximum duration according to the laws in most countries, the maximum is usually also the standard length of the concrete plans. Three-year plans are generally used in Denmark and the Netherlands. Longer plans are allowed and also used in practice in Austria, Germany, France and Luxembourg (see Table 5.2).

*Fixed or flexible plans*

The plans can be fixed or flexible. A fixed plan remains the same during the whole time unless there is a radical change in the debtor's income or other circumstances. Normal raises in salaries or changes in the expenses of the household do not affect the plan. Flexible plans adjust constantly to the changes in the debtor's income. The payment plans are flexible, for example, in Austria, Germany and Estonia. In those countries the plan is also progressive so that the debtor may keep a bigger percentage of his or her income during the later years of the plan.

The length of the plan and the rules on how it is adapted to changes in debtor's situation have important incentive effects on the debtor's behaviour. A fixed plan gives the debtor an incentive to improve his or her lot, but it is generally believed that if the debtors do too well during the plan, the credibility of the debt adjustment system in the eyes of the general public is in danger. The rules on changing the plan and the progressive regulation of the plan are attempts to solve this dilemma.

*Hardship cases*

The debtors who have no payment capacity at all, no assets and no income above the necessary living costs (no-asset cases) present a special problem for the system. The general rule seems to be that the plan is mandatory and the debtors are legally under the plan for the five years. Some countries put these cases under special screening by requiring that the hardship must be permanent as a condition for discharge without payments.

If the hardship is permanent, the treatment can be in some ways more lenient. In France, the debtor can in hardship cases be granted a discharge after a two-year grace period. In Austria all debtors have to pay a minimum of 10% of their debts but in equity (hardship) cases discharge can be granted without any payments. In Luxembourg a special fund may pay part of debts in hardship cases.

5.4.4 Relief of all debts – the content of fresh start*All debts included*

As an insolvency procedure, the debt adjustment procedure covers all debts and all assets of the debtor. Unlike in bankruptcy, also the future income of the debtor is drawn in to the debt adjustment procedure.

By all debts is meant pre-filing debts, that is, debts that are incurred before the insolvency procedure is started. If the debtor takes new debts during the court proceedings and the plan, these debts have to be paid in full and according to the agreed conditions. Because of the stringent conditions of the payment plan, most debtors should be very careful not to take new credits before the plan is completed. It has to be reminded, however, that a rescheduling loan, which is used to pay off an agreed part of the debts, is a very useful tool in debt rescheduling. Its legal status, however, depends on the national law.

### *Business debt*

The debt adjustment covers generally also debts from the failed and ended business activity of the debtor. Only in France commercial debt seems to be excluded, but in France a merchant can be discharged from commercial debt in bankruptcy. Luxembourg has set a clear dead line for commercial debt, since the commercial activity must have ceased six months before the filing for debt adjustment.

The social and economic situation of a small entrepreneur is not necessarily much different from that of an employee. On the other side, the legal obligations of an entrepreneur towards his or her contract partners and employees and the society are so complicated that they are difficult to accommodate in the same, fairly simple debt adjustment procedure that is fit for the consumer. Most countries exclude even small entrepreneurs from the debt adjustment procedure, but some countries regulate the debt adjustment for (very) small entrepreneurs in the same law and legal procedure as for consumers. This is the case in Finland, in the Netherlands and in Portugal and also in the Czech draft law. All these laws set conditions on how big the business may be or how much business debt the debtor has. In the Netherlands small entrepreneurs have made 15 per cent of the filings for debt adjustment.

### *Maintenance*

The rehabilitation of the debtor is hampered if some debts are excluded from the discharge. As a general principle, all the debts of the debtor are included in the procedure and discharged. The most important exceptions are maintenance payments, which are generally excluded from the discharge. Either all maintenance is excluded, also alimony to a former spouse, or only child support.

### *Exceptions*

Quite common is also the exception of *finis* and other liabilities that are a consequence of a crime or other *damage to another person*.

A *privilege for taxes* and other liabilities towards the state has been quite common but seem to be abolished in more and more countries as the time goes by. It exists still in some countries. Since taxes are not excluded from discharge, their privilege means that the debtor's payments according to the plan go to the tax collection first and other creditors get what is left. This sounds quite unfair against other creditors and is one of the reasons why the privilege for tax is disappearing also in bankruptcy law.

Quite few countries exclude *educational loans* from a discharge, even though this is an issue that has been discussed at times. We have no evidence in Europe of newly examined professionals, such as medical doctors and lawyers, filing for debt adjustment to discharge their study loans in order to make a profitable carrier afterwards. The general good faith tests have been sufficient in most countries to stop such behaviour. On the other side, some debtors with no prospect of huge incomes have serious problems with study loans. Therefore, a complete exclusion seems hardly the best solution.

### *Secured debt*

Debt that is secured by a collateral in the debtor's property is usually not touched by debt adjustment and discharge. If the collateral is part of the ordinary household goods and furniture, it may be

protected even against the secured creditor. Otherwise the creditor may use the collateral to get payment for the secured debt. The outstanding debt, however, is treated as any other debt in debt adjustment.

The most important secured debts for a household is those, which have a collateral in the house or apartment of the debtor. Since the debtors who file for debt adjustment are very seriously over-indebted, the idea in many countries is that they do not own their homes or that even if they do, they will not be able to keep the home in the debt adjustment. Therefore, for example, the Austrian report simply states that the debtor's home is sold in debt adjustment.

Only a few countries have special regulations on home mortgage in debt trouble and even those regulations usually concern situations other than the debt adjustment. For example, Albania has a regulation on rescheduling of debts, in particular debts to the state owned banks. In this rescheduling, the debtor should be able to keep the home, even if it is collateral to the debt. In Denmark and Sweden, the law on debt adjustment is silent on home and home mortgage but the attitude is that the debtor may keep his or her home if that alternative is not economically less favourable to the creditors than selling the home.

According to the Finnish debt adjustment law and the Czech draft law, the debtor can keep the home but he or she has to pay the secured debt as far as it is covered by the value of the collateral. The unsecured part of the debt can be adjusted, but a liquidation test is used. The liquidation test means that the debtor has to pay at least as much of the unsecured part of the debt as he or she could have paid in a bankruptcy in which the home would have been sold.

In France the keeping of the home and rescheduling of the secured debt is a preferred solution in the voluntary settlements in front of the commissions. In judicial debt adjustment the home is sold.

#### *Guarantees, co-debtors and third party collateral*

Over-indebtedness is always a problem for the whole family. Sometimes the family members and others close to the debtor are drawn into the economic crisis because they have personally guaranteed the loan of the debtor or given their property as collateral for a loan. Since the payment can be quite easily demanded from the guarantor or from the value of the collateral if the main debtor does not pay or is insolvent, the guarantors often face their responsibility in the eve or after the opening of debt adjustment procedure. The legal position of the guarantor has been found to be quite hard in many countries.

There seems to be very little qualitative information or legal research on such guarantees in the member states. The questionnaire by the Finnish Ministry of Justice collected information on the legal position of the guarantor in the context of consumer debt adjustment. The legal situation seems to be fairly similar in all member states and can be summarised as follows.

Personal guarantees and collateral in the property of the family members are accepted as guarantees of loans in most states and, as far as we know, very few legal restrictions apply. The laws on debt adjustment contain no provisions on the effect of the filing for debt adjustment by the main debtor on the guarantor's legal position. Because the payments are at that point usually late, the creditor may collect the debt from the guarantor or from the value of the collateral that a third person has given for the loan. After the guarantor has paid the loan he or she has the same right against the debtor as the

creditor had before the payment. In practice the guarantor will be one of the creditors that receive a partial payment according to the plan. A co-signer of a loan is treated in the same way as the guarantor. When a third person has given property as a collateral, the same applies up to the value of the collateral. To summarise, the debt adjustment has no effect on the liability of the guarantor.

In a voluntary debt settlement the rules may be the opposite. According to the private law of many countries, a voluntary agreement on the paying of the debt, including partial forgiving of the debt, is valid against the guarantor as well.

Many guarantors and co-debtors have been bitter over their legal position in debt adjustment. They have felt that it is unfair that they have been obliged to pay the loan back in full when the debtor is discharged and the guarantor only gets a meagre portion of the payment back according to the main debtor's payment plan.

The rationale of the personal guarantees or a collateral is to ensure that the creditor gets paid in case the main debtor turns out to be insolvent. When the debtor files for debt adjustment (or for bankruptcy, for that matter) he or she is obviously insolvent and, thus, the guarantor's liability comes into the picture. If the guarantor's liability would be adjusted in such a situation, the creditors would be less protected and less willing to give credit.

The difficult situation of family members as guarantors has given reason to consider the economic argumentation anew. The problems have often emerged in the courts when the creditors have claimed payment from the guarantors who have argued that they have given the promise under duress or without adequate information or that the guarantee is simply unreasonable. The courts have in some cases had sympathy with the guarantors, which in some countries led to more stringent duties for the creditors at the time of signing the contract have been strengthened. Especially, the creditor has a responsibility to give adequate and detailed information to the guarantor in many countries. In Germany, the Constitutional Court has even given some restrictions on what kinds of guarantees a spouse, a child or other dependent person can validly give. It is argued that the persons who are dependent or have strong emotional ties with the debtor need some protection against exploitative contracts.

The information rights of the guarantors and restrictions on the use of guarantees by the family members are to be recommended. As long as guarantees are used, however, the guarantor's position in the debtor's debt adjustment remains a problem. This may be a problem for which there is no good solution. We want to point out that the debt adjustment procedure could include some regulations that might give some time for the parties to adjust and negotiate in the situation. This would mean that the guarantors, co-debtors and those who have given collateral for the debtor would be drawn into the debt adjustment.

Here we give some examples of what this could mean. First, the opening of debt adjustment procedure imposes a legal stay on debt enforcement measures against the debtor but not against the guarantor. This rule could be changed. The stay on enforcement would give all parties time to negotiate a reasonable settlement. If the guarantor hides property, the court could give the creditor the right to enforcement. Secondly, the guarantor's and the debtor's liability could be divided in the debt adjustment. For example, the guarantor could be made liable only for that part of the debt that exceeds

what the debtor pays according to the plan to the creditor. This could give the debtor an incentive to pay more. Thirdly, the guarantor's payment could also be adjusted in the main debtor's debt adjustment procedure, for example, into instalment payments. Fourth, the courts could be given discretion to favour the regress claims of individual guarantors in the payment plan if the guarantor has made big sacrifices to pay the debt. This may sound unfair to other creditors but is not necessarily so. If the guarantor has lost his or her home to pay the debt and the other creditors are institutions to favour the guarantor in the payment plan is not unjustified.

These proposals mean that the guarantor's liability would not be equal to that of the debtor. Interestingly, the European Union has in its draft for the Consumer Credit Guidelines made proposals that go to the same direction. According to that proposal, the creditor could take action against the guarantor only after the debtor has been in default for three months. In addition, the proposal aims at furthering rescheduling agreements on the payment of debt. These proposals are in line with a greater flexibility we are proposing for the guarantor's position in the debt adjustment.

#### 5.4.5 Costs

There is an attempt to keep the costs of debt adjustment low. As was discussed in 3.3, the debt counselling programs that have been developed in the European countries aim at giving cost free advice to debtors in trouble.

Even if the costs of debt adjustment are low, these procedures are not always cost free. The costs of debt adjustment usually consist of three different posts, the assistance with filing, the court fees and the administrative costs of drafting and supervising the plan. There seems to be a variety of ways how these tasks are organised in different European countries.

The assistance with filing is most often available from the debt counsellors for free. The debtor may also use an advocate if he or she has funds. In some countries and in some situations free legal aid may cover costs of a lawyer but legal help may also be subsidiary to the debt advisor's help. In many countries, such as Sweden, France and Belgium, the debtor is not, as a rule, considered to need help with filing because the government or municipal agency that prepares the case also has the responsibility for the guiding of the debtor through the procedure.

The court fees for debt adjustment are usually low or nonexistent. In Germany, where the route to debt adjustment goes through bankruptcy, the court fees are paid according to the plan and a credit to pay them is prioritised.

The drafting and the supervision of the plan are also organised in different ways. When a state agency takes care of these tasks, such as the debt enforcement agency in Sweden and Norway or the Commissions for Over-indebted in France and Belgium, the debtor is not liable for the costs. In most countries these tasks are allocated to private trustees. Their fees are usually collected from the payment plan as prioritised payments.

## 5.5 International insolvency law

### *The development of international insolvency law*

For an international organisation, such as Council of Europe, the cross-border effects are of special interest, also in the field of over-indebtedness. The credit markets, indeed, have become global during the past decades. For Europe, the internationalization of credit markets developed already in the 1980, and a huge expansion of markets took place in the 1990s as former East European countries joined the European markets.

The internationalisation of credit markets concerns consumers in several ways. By using credit cards consumers become part of the international credit market both at home and abroad. More obviously, credit and purchases in internet and by post-order from out-of-state companies tie consumers to the international market. Also, people move after work or work on the other side of the border and, thus, have economic interest, including credits, in several countries.

In international private and procedural law, the enforcement of judgements across borders has been an issue for international conventions. Especially the arbitration awards, that is, judgements in international commercial disputes can be enforced in several countries according to the New York Convention of 1958.<sup>49</sup>

In the European Union, enforcement of judgements in civil and commercial matter has been possible according to the Brussels Convention since 1968.<sup>50</sup> States that were members of the European Free Trade Association were included in this area of “free movement of judgements” by joining the Lugano Convention of 1988.<sup>51</sup> Brussels Convention has now been replaced by a EU Council Regulation. Regulation (EC 44/2001).<sup>52</sup>

The EU regulation covers jurisdiction and enforcement of judgements in commercial and civil matters, including consumer credit, sale of goods to consumers and insurance contracts. Consumers, insurance beneficiaries and employees are treated as weaker parties in the relationship and special provisions for their protection are designed (preamble 13). According to the regulation, court action against a consumer or an action by a consumer against a commercial creditor, as a general rule, takes place in the home country of the consumer.

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<sup>49</sup> Convention on the recognition and enforcement of foreign arbitral awards, June 10th, 1958.

<sup>50</sup> Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters, signed 27 September 1968 in Brussels (Brussels Convention). All member states were parties to the Convention before new member states joined to the Union in 1995. The Brussels Convention still has relevance in relations with Denmark, which opted out of the Council Regulation.

<sup>51</sup> Lugano Convention was signed 16 September 1988. The material provisions of Lugano Convention are virtually identical with the Brussels Convention and Lugano Convention still has relevance in relation to countries that have not joined the Union but are members of the EFTA (Iceland, Norway, Switzerland).

<sup>52</sup> Council Regulation (EC) No 44/2001 of 22.12.2000 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters (OJ L 12 of 16.1.2001); [http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/l\\_012/l\\_01220010116en00010023.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/l_012/l_01220010116en00010023.pdf).

The development in international bankruptcy and insolvency law has been more modest, even though business bankruptcies with wide cross-border effects are known since the middle ages. Companies have often both assets and creditors abroad and the legal complication when such a company goes bankrupt are widely known. Yet, there have been very few international conventions on international bankruptcy law, the Scandinavian Bankruptcy Convention of 1933 and Latin American regional conventions being rare exceptions.

A European bankruptcy convention has been a goal for the European cooperation for a long time. Preparations for such a convention started in the European Union in the 1960s but the Council of Europe was the first to succeed in presenting such a convention. The European Convention on Certain International Aspects of Bankruptcy was signed in 1990 under the auspices of Council of Europe.<sup>53</sup> The convention was signed by eight member states but it was not ratified by so many states that it would have entered into force. This Convention, however, had an important influence on the development of the European Union law.

In the auspices of the European Union, preparations for an insolvency convention started in the beginning of the 1990s<sup>54</sup> and the European Union Convention on Insolvency Proceedings was opened for signatures on 23 November 1995. This convention again never came into force<sup>55</sup>, but an essentially identical Council Regulation on Insolvency Proceedings was passed 29 May 2000.<sup>56</sup>

The basic principle of the Regulation is that a bankruptcy proceeding opened in one Member State is legally recognised in all other Member States. In addition, the Regulation contains a comprehensive regulation of conflicts of laws concerning assets situated in another member state than where the insolvency proceeding is opened.

The Regulation was drafted with business bankruptcies in mind and its scope of application is designed accordingly. Its implications for consumer debtors and debt adjustment procedures are not consistently regulated.

In principle, both legal persons and natural persons can be debtors under the Regulation. The Regulation shall apply to collective insolvency proceedings which entail partial or total divestment of a debtor and the appointment of a liquidator (art 2). These qualifications as such do not preclude insolvency proceedings concerning private and consumer debtors from the scope of the Regulation. Concretely, the issue who may be a bankruptcy debtor according to the Regulation is a matter determined under national law (art 4.2 (a)). While member states have different insolvency proceedings

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<sup>53</sup> European Treaty Series No. 136, signed 5.6.1990.

<sup>54</sup> About its history, see for example Fletcher Ian F., Historical Overview: The Drafting of the Regulation and its Precursors. In: Niss, Fletcher & Isaacs (eds.) The EC Regulation on Insolvency Proceedings. A commentary and Annotated Guide. Oxford University Press 2002.

<sup>55</sup> It was signed by all Member States except United Kingdom.

<sup>56</sup> Council Regulation (EC) No 1346/2000 May 29, 2000 on Insolvency Proceedings [http://europa.eu.int/eur-lex/pri/en/oj/dat/2000/l\\_160/l\\_16020000630en00010018.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2000/l_160/l_16020000630en00010018.pdf) is binding on all member states, except for Denmark (preamble 33).

concerning different debtors and slightly different purposes, the regulation applies to specific proceedings which are enumerated country by country in Annex A to the Regulation. Each member state has notified the European Union, which procedures are included in the Annex A.

The member states have chosen different positions concerning the application of the Regulation to the existing debt adjustment proceedings for consumers. The first group of countries, consisting of Belgium and the Netherlands, has decided that the Regulation is applied to their consumer debt adjustment proceedings, which are mentioned in Annex A. For the second group, German and Austrian Restschuldbefreiung proceedings are not specifically mentioned in Annex A but since they are a (possible) stage in the respective insolvency and bankruptcy proceedings, mentioned in Annex A, they come under the scope of the Regulation.<sup>57</sup> The third group of countries, including France, Finland, Luxembourg, and Sweden do not mention their consumer debt adjustment proceedings in Annex A and since these proceedings are regulated in specific laws and do not fall under the proceedings mentioned in the Annex, the Regulation can not be applied to them.<sup>58</sup> As more and more member states are drafting their consumer debt adjustment law, it is expected that the last mentioned group of countries will grow in number.

#### *A concern for the international community*

For the rehabilitation of an over-indebted consumer, it is important that the creditors in other countries can be drawn into the debt adjustment procedure and that the debt adjustment is respected in other countries. This is especially important when the debtor can work abroad. If the debtor's income can be garnished in another country after he or she has been granted debt adjustment in one country, the over-indebtedness may become an obstacle to the movement of labour.

From the creditors' point of view, it is important that the debtor's all income and all assets can be drawn to the debt adjustment procedure. It is not acceptable that the debtor's car or house in another country could be used in enforcement for the benefit of one creditor when other creditors participate in the debt adjustment. Cooperation across the borders is also important to hinder abuse of debt adjustment procedures. The court or the trustee in debt adjustment should have a possibility to get information about assets located in other countries. According to the debt adjustment laws, the debtor is obliged to cooperate with the trustee as a condition for the discharge, which means that the debtor must surrender his or her assets even from other countries to the debt adjustment, but the debtor can not protect assets against the enforcement by single creditors.

These concerns make the regulation of cross-border recognition of debt adjustment procedures and confirmed payment plans a serious concern for the international cooperation. At this moment, the situation is largely unregulated. The international community has not been active in this area. The national debt adjustment laws lack rules on international recognition of debt adjustment plans and discharge confirmed in other countries. Since some countries grant discharge in bankruptcy procedures and others in special debt adjustment procedures, reliance on national legislations can lead to arbitrary

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<sup>57</sup> Specifically, both countries mention in Annex C Treuhänder (trustee) as a liquidator mentioned in the Regulation Article 2(b). According to the laws of both these countries, Treuhänder is the trustee in discharge proceedings concerning natural persons.

<sup>58</sup> From the point of view of discharge, it has to be mentioned that France, Great Britain and Ireland, unlike Finland and Sweden have a discharge provision in their commercial insolvency law which comes under the Regulation.

outcomes. Therefore, this should be an area where international cooperation within the auspices of Council of Europe could lead to sound development of law. Council of Europe could persuade its member states to the recognition of debt adjustment decisions given in other countries by soft law instrument, such as resolutions and recommendations. Even the feasibility of an international convention in this area might be worth consideration.

## **6. Recommendations**

Over-indebtedness of households is a wide-spread problem in all member states of Council of Europe. With the internationalisation of the credit market, it is also a problem that crosses the borders. Over-indebtedness causes a lot of suffering, social and health problems and exclusion for the families. A special concern is children whose basic needs cannot be fulfilled because they have lived all their lives in over-indebted households. In addition, over-indebtedness is a serious problem for the development of market economy. Over-indebted individuals are often excluded from ordinary labour market and from starting their own businesses. The costs are often borne by the society or by the families of the over-indebted individuals.

For these reasons, it is important that the international community shares the responsibility for the policy development concerning over-indebtedness. It has to be recognised that the legal development in this area has been very different in different member states of Council of Europe. The different legal policies concerning over-indebtedness in the member states are partly due to the differences in circumstances, but another reason may be that there has not been sufficient knowledge, exchange of information and cooperation in this field among the member states.

For the above mentioned reasons, the Council of Europe should take initiative in this field.

The Council of Europe should act as a facilitator of policy development in the European area concerning prevention of over-indebtedness and human and fair treatment of those who are already over-indebted. An appropriate instrument for the Council of Europe would be a Recommendation on the policies in the field of over-indebtedness.

The Council of Europe should coordinate the policy development

- Respecting the human rights of those who have debt problems, especially the rights of children in over-indebted families;
- Observing the right and interests of the creditors;
- Promoting good practices in the use of credit data and in the enforcement of debts;
- Promoting programs for the development of financial education both in the school curriculum and in adult education;
- Promoting development of advice and debt adjustment procedures for honest, but unlucky debtors;
- Recognising the need of recognition and enforcement of judgements and insolvency procedures, including consumer debt adjustment, across the borders.

The Council of Europe should

- Establish an observatory to gather information and to follow the development of debt problems and related legislation in the member states;
- Facilitate the development of international law in the recognition of debt adjustment orders.

The Council of Europe should recommend the member states to

- collect information and statistics on the debt problems and analyse the situation of over-indebted households in their countries;
- include financial education in the curriculum of the general school system and of the adult education;
- promote financial, social and legal advice and counselling that is free of charge to those who have problems with and questions about their debts;
- promote responsible lending practices, responsible use of debtor data and responsible marketing of credits, especially to young people;
- respect the dignity of the debtors in debt enforcement;
- protect especially the right to development of children who live in over-indebted families;
- promote good practices in debt enforcement taking into account the creditor's rights and the economic effects of enforcement to encourage the debtor to be a productive and law-abiding member of the society;
- consider legal and social solutions to those over-indebted debtors who have been unlucky but honest;
- recognise payment judgements, debt adjustment decisions and payment plans confirmed by the courts in other countries.

Those countries that decide to enact a law on judicial debt adjustment for consumers should take into account the following recommendations:

- the debt adjustment should be accessible to debtors who have acted in good faith towards the creditors;
- the debtor should have access to cost-free assistance in the procedure;
- the debt adjustment procedure should be cost-free or low cost;
- the payment plans in debt adjustment should be reasonable both in payment obligations and in length;
- the debt adjustment should cover the debtor's all debts, excluding the maintenance payments to a debtor's child;
- the debtor and creditors should be encouraged to make a voluntary agreement on the payment of the debts and passive creditors should not be allowed to hinder such an agreement;
- the rights of the private guarantors of the debtor's debts should be recognised in the debt adjustment procedure.

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**TABLE 3.1 THE MAIN PROVIDERS OF DEBT COUNSELLING<sup>59</sup>**

Member state	Main Provider(s)
Austria	Independent, non profit-making organisations; local municipalities Accreditation of counseling
Belgium	Centres publics d'Aide Sociale, non profit organisations; Advocates, Notaires and enforcement
Denmark	Consumer organisations
Finland	Municipalities
France	Consumer associations; non-profit organisations (e.g. Debtors Anonymous, Society of St Vincent de Paul) social workers; (Attention is drawn to the fact that the Over indebtedness Committees are not regarded as debt counselling agencies.)
Germany	Local authorities (e.g. social welfare authorities, youth welfare departments); Caritas / Diakonisches Werk; Deutscher Paritätischer Wohlfahrtsverband; German Red Cross; Workers' welfare; Consumer organisations
Ireland	Money Advice and Budgeting Services (MABS) with 50 offices state funded organisation in cooperation with the free legal aid
Liechtenstein	Social services
Luxembourg	Service d'Information et de Conseil en Matière de Surendettement (administered by the Ligue Luxembourgeoise de Prévention et d'Action Médico-Sociales); Service d'Information et de Conseil en Matière de Surendettement (administered by Inter-Actions); Ministry for Family Affairs and Social Solidarity
Netherlands	Municipal Credit Banks; Social services; Private organisations; Attorneys
Norway	Municipalities, social services
Portugal	DECO (consumer protection organisation); CIAC (municipal information centres for consumers)
Sweden	Municipalities
Switzerland	Municipalities Private organisations (state funded)

<sup>59</sup> The information in this Table is based on the Questionnaires to the member states of Council of Europe by the Finnish Ministry of Justice in 2004 and Reifner et. al 2003 p. 203.

United Kingdom	Consumer Credit Counselling Service; National Debtline; Citizens Advice Bureau with its local branches; Commercial debt management services; Money Advice Trust; Money Advice Association
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**3.2 GARNISHMENT OF REGULAR INCOME**

Member State	Portion garnished	Maintenance	Comment
I			
Serbia Montenegro	2/3		
Slovenia	2/3		
Austria	70 % of income above MS		MS is 650 e/single person (2005)
Albania	1/2		
Armenia	1/2	3/4	
Azerbaijan	1/2	7/10	
Moldova	½		
Poland	1/2	3/5	
Austria			
Russian Federation	1/2	7/10	
Ukraine	1/2	7/10	
Bosnia and Herzegovina	½ wages 1/3 pension		
Finland	1/3	1/3	MS
Croatia	1/3	1/2	
Czech Republic	1/3	2/3	all above 150% of MS
Macedonia	1/3	½	
Portugal	1/3		MS
Romania	1/3 - 1/2	½	MS
Slovakia	1/3	2/3	
Lithuania	1/5 - 1/2 minimum monthly wage (MMW) 7/10 income exceeding MMW	1/2	Court has discretion
Turkey	1/4 of MS		
Italy	1/5		
II			
Belgium	Progressive scale		MS; court has discretion
Bulgaria	1/5 - 1/2		
France	Progressive scale	Scale not applied	MS
Latvia	1/5, special cases 1/2		MS
Spain	30-90% of income above MS		MS
III			
Luxembourg	Progressive scale 10% - all above 1750 e/month		MS

Netherlands	All income above 90% of MS		
Norway	All above MS		time limit 2-5 years
Sweden	All above MS		
Switzerland	All above MS		one year limit
III Cyprus	Court decides		
Ireland		x	
United Kingdom / England and Wales	Court decides		Reform pending
IV			
Denmark	1/5		creditor must be a public authority
Greece	1/2	x	creditor must be a public authority or maintenance creditor
V			
Estonia			MS
Georgia			MS
Germany			MS which is 930 € /month /single
Hungary			
Iceland			
Liechtenstein			MS 1800 CHF/month

Maintenance = There is a special regulation for certain payments, usually maintenance payments to a child. In several countries also compensation for damage to health or for the death of provider are garnished according this special rule.

MS = The law regulates the minimum subsistence level that always has to be left to the debtor. When the debtor's income remains under this level, it is not garnished.

**TABLE 5.1 CONSUMER INSOLVENCY REGULATIONS IN THE MEMBER STATES**

<b>Member State</b>	<b>Status</b>	<b>Year</b>	<b>Law</b>
Albania	Yes	1998	On establishment of the agency for treatment of credits
Austria	Yes	1993	Konkursgesetz
Belgium	Yes	1998/2004	Loi sur le règlement collectif des dettes
Czech Republic	Draft		
Denmark	Yes	1984	Konkurslov
Estonia	Yes	2003	Bankruptcy Act
Finland	Yes	1993	Velkajärjestelylaki/Lag om skuldsanering för privatpersoner
France	Yes	1990/2003	La loi sur le surendettement/Outline and Programming Act no. 2003 -710
Germany	Yes	1994 (in force 1999)	Insolvenzordnung
Liechtenstein	Draft		
Luxembourg	Yes	2000	Loi la prévention du surendettement; Civil Procedure Code
The Netherlands	Yes	1998	Consumer Bankruptcy Act
Norway	Yes	1992	Act relating to voluntary and compulsory debt settlement for private individuals
Portugal	Yes	2004	Code relatif aux procédures d'insolvabilité et au redressement de société
Slovenia	Plan		
Sweden	Yes	1994	Skuldssaneringslag
United Kingdom	Yes	1881	Administration Order

**TABLE 5.2 PAYMENT PLAN**

Member State	Duration	Administration during the plan	Notes
Austria	7 yrs	trustee	3 yrs more if payment less than 10%
Belgium	5 yrs		credit agreements ½ of remaining time
Czech Republic	5 yrs		
Denmark	3-5 yrs	debtor	
Estonia	5 yrs	trustee	
Finland	5 yrs	debtor	2 yrs more for private creditors
France	10 yrs	commission	Bankruptcy for private persons leads to immediaty discharge
Germany	6 yrs	enforcement	before 1.12.01 7 yrs
Liechtenstein			-
Luxembourg	7 yrs		
Netherlands	3 to 5 yrs	debt manager, trustee	normally 3 yrs
Norway	5 yrs	enforcement agent	
Portugal	5 yrs		
Slovenia			-
Sweden	5 yrs	debtor	some discretion up and down by the judge
United Kingdom	7 and more yrs 1, 3 yrs	debtor	Administration Orders: no maximum / Bankruptcy 1 or 3 years

**TABLE 5.3 DEBT THAT CANNOT BE DISCHARGED IN DEBT ADJUSTMENT** <sup>60</sup>

Member State	Maintenance debts	Taxes	Fines	Torts, damages	Study Loans	Other Exceptions , Comments
Albania		no				judicial expenses; employment relations
Austria	no		no	no		wage assigned sustains for two years; social security contributions; debt to employer
Belgium	no			no		living costs
Czech Republic			no			
Denmark						equality principle
Estonia				no		
Finland	privilege					alimony to child privileged; living cost debts privileged if the court decides so; trustees fee privileged
France	no		no	no		no commercial debt court discretion in allocation of payments
Germany			no	no		wage assignment two years; credit for court fees privileged
Luxembourg	no	privilege				
Netherlands		privilege	proposal	proposal	no	cost of insolvency process privileged
Norway	*		*	*		* = not discharged but subject to more strict consideration
Portugal	no	no	no	no		
Sweden	no				no *	* subject to the discretion by the court
United Kingdom	no		no		no	drug related confiscation etc, gambling debts, debts that are more than 6 yrs old

<sup>60</sup> The information in this Table is based on the Questionnaires to the member states of Council of Europe by the Finnish Ministry of Justice in 2004 and Reifner et. al 2003 p. 185. The Table should not be considered as a statement on the laws of the respective countries, but rather as a illustration of different possible regulations. It is possible that we have missed some exceptions and priorities.

**APPENDIX**

MJU-26 (2005) Resol. 1 Final

*26th CONFERENCE OF EUROPEAN MINISTERS OF JUSTICE*  
(Helsinki, 7-8 April 2005)

**RESOLUTION No 1**  
**on**  
**Seeking Legal Solutions to Debt Problems in a Credit Society**

THE MINISTERS participating in the 26th Conference of European Ministers of Justice (Helsinki, 7 and 8 April 2005):

1. Having examined the Report of the Minister of Justice of Finland on seeking legal solutions to debt problems in a credit society as well as the contributions made by a number of delegations;
2. Underlining that a sufficient consumer credit market and effective lending promotes economic growth and that it is important to strike a balance between the interests of the debtor and the creditor in a credit relationship;
3. Concerned about the problems arising in today's credit society due *inter alia* to the easy access to credit that can in some cases result in the over-indebtedness of households creating social exclusion of individuals and their families;
4. Underlining the importance of preventing problems arising from over-indebtedness and, where necessary, seeking solutions to enhance the proper prevention and management of debt problems, as well as the sense of responsibility of creditors and the individual debtors;
5. Convinced that the Council of Europe has an important role to play in this context, and a responsibility to assist all member states to find alternative solutions to avoid over-indebtedness through various means such as financial advice and education, as well as management of debt;

6. Being aware of the various legal means, institutions and good-practices that already exist in certain Council of Europe member states, aiming at avoiding over-indebtedness and providing alternative means of dispute resolution, and of debt enforcement measures;
7. Bearing in mind the European Convention on Human Rights and Fundamental Freedoms and the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data (ETS No.108);
8. Recalling Resolution No. 3 on "The general approach and means of achieving effective enforcement of judicial decisions", adopted at their 24th Conference in Moscow in October 2001 and the Committee of Ministers Recommendations Rec(2003)16 and Rec(2003)17 on this subject;
9. Recalling the increasing attention paid in the European Union to the principle of responsible lending in the consumer credit market and to the other minimum harmonisation of consumer credit provisions (COM (2004) 747);

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10. AGREE on the importance to take measures to seek legal and practical solutions to debt problems encountered by citizens in a credit society;
11. RECALL the necessity to pay particular attention to prevention and proper management of debt problems, as well as the role of statutory institutions and non-governmental organisations involved;
12. INVITE the Committee of Ministers to entrust the European Committee on Legal Co-operation (CDCJ), in co-operation with other competent instances of the Council of Europe to:
  - analyse existing legislation and good practices;
  - identify the difficulties met;
  - prepare an appropriate instrument defining legislative and administrative measures, and proposing practical remedies;
  - consider, when preparing such an instrument, the role of competent instances in particular courts, administrative authorities, and non-governmental organisations involved;
  - consider ways of providing assistance to member States in the application of this instrument and, where necessary, make appropriate proposals to the Committee of Ministers.