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Briefing

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Loan Sales: High Court personal insolvency decision differentiates between types of secured creditor

Following a High Court decision of 1 November 2017 , it seems that the High Court will assess an objection by a secured creditor to a personal insolvency arrangement (**PIA**) differently depending on whether the creditor is a bank (or other originating lender) or a loan purchaser that is not a bank.

In the former case, the High Court will look at the future capital costs to the creditor resulting from a proposed PIA. In the latter case, the High Court will view the creditor's position as more akin to that of an investor in a bond.

BACKGROUND

Shoreline Residential DAC purchased the debtors' loans from IBRC which were secured on their principal private residence (**PPR**). Shoreline is not a regulated entity, but had appointed Pepper Asset Servicing (a regulated credit servicer) to service the loans. When the debtors (a husband and wife) encountered financial difficulties, they developed a proposal for interlocking PIAs with a personal insolvency practitioner (**PIP**). Shoreline was the largest secured creditor, owed just over €323,000 with a remaining mortgage term of 18 years and 2 months. The PPR was worth approximately €190,000. Mrs Hayes was in full-time employment, with Mr Hayes in part-time employment and in receipt of social welfare payments.

PROPOSED PIA

Under the proposed PIA:

- the amount owing to Shoreline would be written down to €190,000 (the value of the PPR);
- the remaining mortgage term would be extended from 18 years and 2 months to 27 years; and
- the interest rate would be fixed for the 27 year term at 3.65%.

SECURED CREDITOR'S OBJECTIONS

Shoreline objected to the proposed PIA, and that objection was upheld by the Circuit Court in February 2017.

That decision was then appealed to the High Court. In the High Court, Shoreline's outlined its principal objections to the PIA as being that:

- the fixing of an interest rate for 27 years was "*unheard of in banking practice*";
- the PIA was unsustainable; and
- the PIA was unfairly prejudicial to it.

On 1 November 2017, the High Court overturned Shoreline's rejection of the PIA and allowed the PIA to proceed. Baker J's comments regarding the proposal to fix the interest rate for 27 years are particularly noteworthy, notably the distinction she drew between a creditor that is a commercial bank/originating lender, and a creditor that is a loan buyer structured as a fund (or similar).

FIXED INTEREST RATE

As mentioned above, Shoreline argued that to fix an interest rate at 3.65% for an extended mortgage term of 27 years was "*unheard of in banking practice*" and was unfairly prejudicial to it. It also argued that "*no lender on the open market is offering a fixed rate term even close to the term proposed*" and that it would be impossible for it to borrow an equivalent sum at a 3.65% fixed rate for an equivalent term as it is becoming increasingly difficult to foresee what prevailing interest rates will be.

Baker J started from the position that Shoreline was a fund and not a bank, the terms on which it had purchased (and financed the purchase of) the mortgage debt were not presented to the Court, and it was not clear when Shoreline might need to return to the market to finance its capital needs (in particular as the PIA involved a restructuring of the debt, and not a refinance of the debt).

Baker J noted that:

- the Personal Insolvency Acts allow for interest rates to be fixed, variable, or linked to a reference rate, and do not impose a time limit for this;
- the fairness of the rate need not always be tested against the projected borrowing needs of a mortgage lender, but instead against "*the actual circumstances of the objecting creditor*". She viewed the debtors' loan as an asset of Shoreline, secured on the PPR, offering a long-term return, and commented that it might more accurately be compared to a bond, with Shoreline instead required to demonstrate unfair prejudice by reference to an investment or bond market, and not by reference to interest rates. While an interest rate set by a mortgage lender tends to reflect the lender's ability to borrow, Baker J commented that in the case of Shoreline, the fairness or otherwise of the rate should be tested against the future costs of, or value to, an investor and not a lender.

Expressly taking account of the fact that the mortgage loan was owned by "*an investment vehicle and not a commercial bank*", Baker J did not see sufficient evidence that the 27 year fixed rate caused unfair prejudice to Shoreline.

UNFAIR PREJUDICE GENERALLY

Regarding a broader argument by Shoreline of unfair prejudice, Baker J noted that any debt write-down is prejudicial to a creditor, with the key assessment being whether the prejudice is actually unfair. Emphasising that this should not be a purely mathematical assessment, and that the statutory objective (per the Personal Insolvency Acts) of keeping debtors in their PPRs should be considered, Baker J commented that:

- even if the return to the creditor on a bankruptcy would be marginally better (that was not the case in this particular scenario), that does not necessarily mean that the PIA is unfairly prejudicial to the creditor; and
- notably, the test of unfairness in this case should be by reference to investment returns and not the cost of capital, as Shoreline was not a lender.

In examining the question of fairness by reference not only to the financial profile of the debtors, but also that of Shoreline, Baker J held that the proposed PIA was not unfairly prejudicial to Shoreline.

SUSTAINABILITY OF PIA

Shoreline argued that:

- the debtors would not be able to service capital and interest payments under the PIA once its 6 year term had expired (the PIA proposal involved interest-only payments for that 6 year period);
- the PIA was unsustainable as it would require mortgage payments to be made until Mr Hayes was 79 years old and Mrs Hayes 68 years old; and
- as Mr Hayes was likely to retire around year 18, he would then be in receipt of a pension only, leaving him with a monthly shortfall. While the debtors argued that they could choose to live below the Insolvency Service of Ireland's Guidelines on a reasonable standard of living and reasonable living expenses, Shoreline argued that the Court could not approve a PIA that allowed this to happen.

In approving the PIA and finding in favour of the debtors, Baker J held that:

- a proposed PIA must be shown to be "*reasonably sustainable during its currency*" i.e. during its 6 year term. The Personal Insolvency Acts do not require the Court to assess the debtors' likely circumstances once that 6 year term has expired (but it cannot disregard the circumstance that are likely to exist at the end of that term if presented with evidence on that point);

- the terms of the proposed PIA showed that the debtors' current income could sustain the payments needed under the proposal;
- while the debtors may have to live below the current guideline figures from year 18 onwards, she could not safely assess the sustainability of the repayments from year 18 onwards against 2017 salary figures and social welfare entitlements, as any scenario would be overly based on conjecture; and
- should the debtors decide to live below the applicable guideline figures from year 18 onwards, they are entitled to do so.

COMMENT

This decision reflects the tendency of the Irish courts to encourage arrangements which enable debtors to remain in their family homes, and to encourage secured creditors to approve PIA proposals. In the context of loan portfolio sales, the distinction drawn between creditors that are banks, and loan purchasers that are not, is troubling. It remains to be seen whether, in future cases, this distinction is limited to matters such as funding costs and interest rates, or whether it is applied more widely, and the impact that would have on the value of banks' NPL books.

POSTSCRIPT

A debtor's ability to appeal to Court to have a secured creditor's veto of a PIA proposal overturned received considerable coverage when it was introduced with effect from 20 November 2015. For further information, read our August 2015 briefing here.

Earlier cases dealing with the secured creditor's veto have been covered in our previous briefings (Resolving the Mortgage Arrears Crisis Vol 1/2016, Resolving the Mortgage Arrears Crisis Vol 1/2017 and Resolving the Mortgage Arrears Crisis Vol 2/2017).

However, in addition to the Shoreline case, the other recent case which attracted a considerable amount of coverage was the High Court decision handed down on 5 October 2017 by Baker J in Reilly & Personal Insolvency Acts 2012-2015 [2017] IEHC 558. In her decision, Baker J confirmed that only a PIP can appeal a secured creditor's rejection of a PIA to the Circuit Court, and if the Circuit Court rejects that appeal, only a PIP can appeal that decision to the High Court. That decision reportedly presented issues for PIPs who are concerned about the risk that they may not be able to recover their costs in taking these cases on behalf of clients.

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