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The Impact of the Personal Insolvency Act on Loan Portfolio Purchasers

Introduction

The decision of the High Court in *Re Hayes (a debtor) ([2017] IEHC 657)*, illustrates the impact that the Personal Insolvency Act 2012 (as amended) (the "**Act**") may have on secondary purchasers of loan portfolios.

Baker J. held that when determining whether any personal insolvency arrangement ("**PIA**") would be unfairly prejudicial to a creditor regard shall be had to the particular financial profile of the creditor. As the creditor in *Re Hayes* was an investment fund, and not an originating lender, Baker J. held that unfair prejudice should be assessed by reference to the return on that creditor's investment, rather than by reference to its future funding needs.

Background

Jacqueline Hayes and her husband, James Hayes, had difficulties in repaying a loan secured by a mortgage over their family home. The loan was part of a portfolio that had been bought by Shoreline Residential DAC from IBRC Limited (in special liquidation).

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The borrowers, who were in financial difficulties, engaged a personal insolvency practitioner to formulate PIAs in relation to their debt. The PIAs outlined certain proposals for the repayment of the Shoreline loan, including that: (i) the balance of €323,626 be written down to €190,000 (the value of the family home); (ii) there would be interest-only payments for the 6 year period of the PIA; (iii) the term would be extended from 18 years and 2 months to 27 years; and (iv) the interest would be fixed for the entire term at a rate of 3.65%.

The PIAs were rejected as unsustainable in the long term by Shoreline at the creditors' statutory meeting. This objection was upheld by the Circuit Court. The borrowers then appealed the Circuit Court decision to the High Court.

High Court Decision

Baker J. in the High Court allowed the appeal and confirmed the proposed PIAs.

Section 115(9)(b) of the Act provides that a court may confirm a PIA only where it is satisfied, amongst other things, that: (i) the debtor is reasonably likely to be able to comply with the terms of the PIA; and (ii) the proposed arrangement is not unfairly prejudicial to the interests of any interested party.

Sustainability of the PIA

Baker J. held that the PIAs were, in the circumstances, sustainable and that the Act does not require the Court to assess the likely circumstances of a debtor after the six-year term of a proposed PIA. On this basis, she dismissed Shoreline's argument that the PIAs were unsustainable as they could result in the borrowers living below the prescribed level of reasonable living expenses from year 18 onwards. She did acknowledge that where presented with evidence, the Court could not disregard the likely circumstances that might exist after the six-year period, but went on to say that the weight to be attached to such evidence would depend on the specific facts of each case.

Unfair Prejudice?

Shoreline adduced evidence that the proposal to fix an interest rate of 3.65% "*represents a radical departure even from the most competitive rates available on the open market*" and argued that the borrowers would not be able to avail of a comparable rate in the Irish market. However, Baker J. placed emphasis on the fact that Shoreline was not a lender, but an investment fund and that the Shoreline loan was being restructured and not refinanced. She said that the fairness of the rate should be tested against the position of the objecting creditor and went on to describe the loan as an asset of Shoreline, secured over real property, which offers a fixed return on Shoreline's investment, with repayments proposed at a set amount over the term. She said that the asset value of the loan would be more accurately compared to that of a bond and therefore in order to establish that the return on the investment was unfairly prejudiced, a comparison would need to be made by reference to the bond markets and not the domestic lending market.

Baker J. further observed that Shoreline had not provided evidence that it would need to return to the market to meet its capital needs in order to fund the investment, nor had it provided evidence of the terms on which the loan was purchased and how it was financed. On that basis, she held that there was insufficient evidence on which to conclude that the proposal to fix the interest rate for the proposed extended period was unfairly prejudicial to Shoreline, having regard to its status as an investment fund.

She held that a comparison between the likely return on bankruptcy and that under the PIAs was an appropriate consideration in determining whether the PIAs were unfairly prejudicial. She found that on a comparison between the two, the return on the PIAs were more favourable.

In this regard she held that the test for unfair prejudice should not be considered purely on a mathematical basis; consideration should also be given to whether the proposed PIAs would enable the borrowers to continue to live in their principal private residence and whether a creditor could recover the amounts owing to it, insofar as reasonably possible, without the need to resort to bankruptcy proceedings; both questions being specific factors for consideration under the Act. Baker J. concluded that the proposed PIAs were not unfairly prejudicial solely by virtue of the fact that the likely return on bankruptcy would be marginally better.

Context and Implications

The decision *in Re Hayes* creates uncertainty for potential buyers of non-performing loan (“**NPL**”) portfolios, such as investment fund and private equity vehicles and may potentially have an adverse impact on the pricing of proposed future deals in this area.

As a significant proportion of NPLs in Ireland are secured on real estate, including principal private residences, the availability of the personal insolvency regime and the decision may make debt and collateral enforcement over NPL portfolios more difficult.

Given that Baker J. held that there was insufficient evidence to conclude that the proposal to fix interest rates was unfairly prejudicial to Shoreline having regard to its status as an investment fund, it may be advisable for secondary purchasers of loans that are involved in PIA applications to provide evidence of how the loan was priced when it was initially purchased and details of any loss of anticipated investment return as a result of the fixing of such rates.

Conclusion

The case illustrates the potentially significant impact of PIAs on the terms of mortgage loans and the weight that may be placed by the Irish Courts on the financial profile and investment strategy of a creditor when deciding whether or not to sanction a PIA.

Should you have any queries or require any further information on this topic, please do not hesitate to contact Conor Houlihan, Kate Curneen or your usual Dillon Eustace contact.

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