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Submission to Consultation on Statutory Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act.

Thank you for the opportunity to comment on the consultation paper. My comments concern consumer insolvency. By way of background I was a member of the Canadian Personal Insolvency Task Force, and a drafter of the World Bank Report on the Insolvency of Natural Persons[1]. I have written extensively on comparative analysis of personal insolvency systems.

Many of the issues raised in the consultation paper pose questions which cannot be adequately addressed in the absence of empirical evidence. Much consumer insolvency policy making in Canada has not been evidence driven. Several current provisions derive from the Personal Insolvency Task Force in the early 2000s. It conducted however no empirical studies on the consumer insolvency system. The OSB has attempted to remedy some lacunae in our knowledge of the Canadian system through its programme of research. I assume that the Minister of Industry will present a more evidence-based report to Parliament.

Canada has a high rate of consumer bankruptcy compared with other 'Anglo' jurisdictions. The US has a higher rate, but a significant number of US bankruptcies were related to medical debt because of limited public health care provision. If these cases are taken away then Canada may have the highest level of consumer bankruptcy in the developed world. This was also the conclusion of Ronald Mann in 2009.[2] A high consumer bankruptcy rate is not bad since it may suggest that Canada has a more accessible system of insolvency than jurisdictions such as England and Wales. Canadians also have among the highest household debt to income ratios in the world.

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[1] J Garrido, J Kilborn, J Niemi, I Ramsay C Booth *World Bank Report on the Treatment of the Insolvency of Natural Persons*. <http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNatu

[2] See R Mann, Making Sense of Nation-Level Bankruptcy Filing Rates, in J Niemi, I Ramsay & W Whitford (eds) *Consumer Credit Debt and Bankruptcy: Comparative and International Perspectives* chapter 11 at 233 (Oxford, Hart).

It is important to view consumer bankruptcy as part of the ground rules of the consumer credit market. The current moves to modernize Canada's consumer credit regime to bring it in line with international best practices should therefore be linked to consideration of the role of consumer bankruptcy.

1. The role of consumer proposals

The consultation paper indicates a significant increase in consumer proposals. According to OSB statistics they now represent 42 percent of all consumer insolvencies. The 2009 reforms continued the thrust of the 1997 amendments intended to push individuals towards proposals by making straight bankruptcy less attractive to individuals with surplus income and providing greater incentives for trustees to recommend consumer proposals. The 2009 amendments which increase the consumer proposal limit to $250,000 may also have attracted more self-employed and higher income debtors.

Given this policy preference by government for encouraging proposals it would be useful to know how successful are proposals in meeting the needs of debtors. Evidence does not currently exist which answers this question. Existing studies indicate that proposals are used more by homeowners who hope to stay in their home while paying down unsecured debt and that this use may be related to the variations in provincial home exemptions[3]. Proposals are therefore part of a safety net for homeownership. However a significant number of these plans appear to fail (average 30 percent). No studies exist of debtors' experiences of proposals or their long-term impact on rehabilitation. The study by Janis Sarra[4] provides some interesting information on pre-2009 proposals but does not answer the questions above.

Further quantitative and qualitative analysis (e.g. through study of individuals who have gone through a proposal) are necessary on how effectively consumer proposals function in the overall context of insolvency alternatives and safety nets for homeownership. These issues were raised over ten years ago both by myself and Professor Ziegel in our comments in the Personal Insolvency Task Force report.

2. **The role of the trustee and the delivery of bankruptcy services**

Trustees in consumer bankruptcy wear several hats. They advertise their services widely to debtors, counsel the debtor and at the same time are also an impartial representative of the creditor and an officer of the court. The current description of their appointment in s49(4) states that they are chosen by the official receiver by reference to the wishes of the most interested creditors. This does not describe the reality of consumer bankruptcy where a consumer generally approaches a trustee and the trustee files the bankruptcy on behalf of the debtor. At a minimum this provision should be reformed, as proposed by the PITF report.

Both Professor Jacob Ziegel and myself raised in the Personal Insolvency Task Force Report the issue of the conflicts of interest faced by trustees and

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[3] See J Sarra, Economic Rehabilitation: Understanding the Growth in Consumer Proposals (OSB,2008); Karen Duncan, Janet Fast and Phyllis Johnson, Profiles of Canadian Households Undertaking Insolvency Procedures Pre and Post Recession (OSB,2012).

[4] J Sarra, Economic Rehabilitation: Understanding the Growth in Consumer Proposals (OSB, 2008).

whether the current system, which serves individuals who are often in a vulnerable position and without access to legal advice, is optimal. Over the last decade since that report there has been a growing 'over-indebtedness industry' in Canada of counseling agencies etc. as well as trustees in the market for advice. A recent study [5] raises disquieting questions about the impartiality and accuracy of advice given by some agencies. There should therefore be a review of this industry from an economic and access to justice perspective.

3. **Addressing the needs of the 'no income no asset' debtor**

The vast majority of consumer bankruptcies appear to produce little in the way of a dividend for creditors. This has been the case for many years. These are effectively the 'no income no asset' bankruptcies. This group constitutes a significant percentage of bankruptcies in North America and Europe. They pose a challenge for public policy because individuals in this group may have difficulties in raising funds to finance bankruptcy. Several countries have developed low cost procedures such as the Debt Relief Order in the UK, the New Zealand procedure, government processing in Australia, or the French *rétablissement personnel.* The summary administration process is the Canadian response but individuals must still pay a 'fee' of approximately $1500 to access the procedure. This may prove a barrier to access for low-income debtors with no assets. I do not know if the Bankruptcy Assistance Programme continues to function but it has been criticized as failing to provide an adequate low-cost bankruptcy programme for the poor.[6]

An assessment should be undertaken as to whether the current insolvency options meet the needs of no-income no asset debtors.

4. Responsible Lending

The concept of responsible lending is increasingly becoming an international principle of consumer lending. The G20 High-Level Principle of Financial Consumer Protection[7], which Canada is committed to implement, recognize it and the EU has most recently enacted in the Mortgage Lending Directive[8] a responsible lending framework. This principle generally requires that lenders assess whether individuals are likely to be able to repay over the life of the credit contract (and not merely whether lenders will recover their money) and that lenders treat borrowers fairly and consider their interests throughout the credit relationship. The main policy issue is how to effectively implement a principle of responsible lending.

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[5] See S Ben-Ishai and S Schwartz, Credit Counselling in Canada: An Empirical Examination (2014) 29 Canadian Journal of Law and Society (1) 1-20.

[6] See S Ben-Ishai & S Schwartz 'Bankruptcy for the Poor?' (2007) 45 Osgoode Hall LJ 471.

[7] http://www.oecd.org/daf/fin/financial-markets/48892010.pdf

[8] Directive 2014/17/ EU of the European Parliament and Council on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

Bankruptcy could be one site for raising issues of responsible lending[9]. Trustees are already under an obligation to verify and in appropriate cases disallow a claim. An amendment could be introduced to permit a trustee to either disallow a claim if it arises from irresponsible lending or to notify the OSB.

The OSB has established a 'debtor compliance' programme to address bankruptcy abuse. Trustees advise the OSB if they are aware of non-compliance using an electronic referral form. A similar programme of creditor referral could exist in cases of potential irresponsible lending, or other contraventions of consumer credit legislation such as truth in lending or debt collection requirements. One variation could be a programme which focused on credit advanced in a designated time period before insolvency. These measures could have a modest impact in ensuring compliance, supplementing *ex ante* regulation of responsible lending. Trustees would not be expected to go on fishing expeditions nor make final decisions on creditors' conduct. Bankruptcy is often the 'canary in the mine', which identifies potential emerging problems in the marketplace and the OSB may be in a better position to detect patterns or issues which deserve further sanction. The OSB should have power to seek penalties and restitution in the event of contraventions. Trustees could have a power to disallow claims based on irresponsible lending through an amendment to section125 of the Act. In the US the US Federal Trustee has been involved in action against abuses by mortgage servicers.

Trustees may argue that this role is inconsistent with their role as impartial representative of creditors. But this position 'lacks credibility' given the extent to which trustees encourage debtors to seek advice from them. Moreover creditors in general have an interest in ensuring that irresponsible lending or other contraventions do not occur. The role is not inconsistent with the role of the trustee as impartial representative of all creditors.

A concern will be raised about the costs of such a programme which conflicts with the routinized processing of many consumer bankruptcies. Trustees are paid a modest sum for counseling services so that a similar sum could be payable to trustees where they have a reasonable basis for suspecting creditor misconduct.

5. Reaffirmations

The recommendations of the PITF should be considered along with a study of the extent of use of reaffirmation agreements in Canada. At a minimum re-affirmation should not occur through mere conduct by the debtor.

6. Federal Exemptions

Given the political difficulties of reform in this area, analysis might focus on whether there should be a minimum Federal level of exemption for a debtor's residence, given the economic and psychological importance of the home. Provinces with higher exemptions could retain them. The existing Provincial exemptions represent partly historical accident and path dependency.

7.Modernisation

Section 173-Facts for Which Discharge will be suspended etc.

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[9] The following section draws on suggestions made by Jacob Ziegel in 'Consumer Insolvencies, Consumer Credit and Responsible Lending' (2009) Annual Review of Insolvency Law 343 at 391-393.

The grounds for opposing a discharge in the Canadian BIA replicate generally those in the English Bankruptcy Act 1914 (now repealed) with a few modern additions (s173(1) (m) (n) and (o). Sections such as 173 (1) (a) do not fit the contemporary reality of the great majority of consumer debtors who have no assets. In updating section 173 it would be useful to have some sampling of data on the percentage of cases where opposition to discharge is made, who initiates the opposition (trustee, creditor, OSB) and the reason for the opposition. The broad discretion given to a judge under section 172 is likely to result in substantial variations within and between provinces. Some data on these practices would be useful. Given the move towards bright-line rules in consumer bankruptcy, analysis should be made of the future role of objections to discharge both in terms of the overall objectives of the section and who should be able to lodge an objection.

Other anachronisms

Most modern bankruptcy statutes (e.g. England, US, Australia, Hong Kong) have abolished 'acts of bankruptcy' as a requirement for bankruptcy petitions. Canada still uses the concept. This is generally regarded as an outmoded approach to determining entry to bankruptcy since it focuses on the wrongful conduct of the debtor, rather than the financial situation of the debtor.

Section 48 was originally intended to protect wage earners against involuntary bankruptcy. Its limitation to individuals earning under $2500 a year is outdated. There may be a case for limiting the use of involuntary bankruptcy against consumers, particularly when used as a debt collection device by a single creditor. However this section could be reworked.

It is not clear why a modern statute should continue the distinction between a 'petition' for a creditor initiated bankruptcy and an assignment for a debtor initiated bankruptcy.

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