THE PROCEDURE OF CONSUMER BANKRUPTCY AND THE PROBLEM OF EXCESSIVE HOUSEHOLD DEBT IN POLAND IN THE FACE OF CRISIS TRIGGRED BY THE COVID-19 PANDEMIC

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Abstract

The objective of this article is to analyse the amendment to the act of consumer bankruptcy procedure in the face of crisis triggered by the COVID-19 pandemic. The increase in the number of insolvent consumers may expose credit institutions to losses and deepen the recession, but financial situation of many households will improve. The analysis, based on statistical data and critical interpretation of legal acts, considers the impact of the new regulation in the wider social and economic context.

Keywords: consumer bankruptcy, COVID-19, insolvency

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I. Introduction

In recent years the disposable income of households has increased from PLN 1 369 in 2015 PLN to PLN 1 819 in 2019 (The situation of households in 2019 – based on Household Budget Survey, p.1). Such an increase resulted from the improvement of the economic situation and social benefits for households (e.g. the program "*500 plus*" benefit). However, simultaneously, there has been observed the growth in the number of indebted consumers, who are the clients of financial institutions. The economic situation of households in Poland has visibly improved in the recent years, but gradually, more and more consumers have been suffering from the lack of financial liquidity, unable to clear their arrears. Between 2015 and 2020, the number of insolvent clients of banks has risen from 1 053 125 (InfoDług, 2015, p.5), to 1 259 565 (Newsletter InfoDług nr 14, 2020, p.2). Unfortunately, the debt value of insolvent consumers also increased in 2015-2020, from 29,21 bn to 38,04 bn. In the first three months of the pandemic (March-May), the debt value of insolvent consumers in banks grew by nearly 1 billion (table 1) .

Table 1. Number of indebted clients of banks in 2015-2020, according to statistical data of the Information Economic Office InfoMonitor (BIG InfoMonitor S.A.).

Year / Data	2015	2016	2017	2018	2019	2020*
Consumer debt in billion PLN	29,21	27,69	29,75	33,58	36,79	38,04
Number of indebt consumers	1 053 125	1 010 681	988 025	1 189 488	1 230 880	1 259 565

*Data for the period January-May 2020.

Source: Statistical data of InfoMonitor (BIG InfoMonitor S.A.).

The number of all debtors (credit and non-credit obligations) has increased from 1 977 284 (2015) to 2 833 569 (2020) and the debt value has grown from PLN 40,39 bn (2015) to 80,97 bn (2020). Poles have been significantly losing their financial liquidity because of their inability not only to pay off credits, but also to pay other financial obligations, such as utility bills.

One of the main reasons of the increase in the number of insolvent individuals has been excessive consumption, which is characteristic of all post-socialist countries. Poles have raised their standard of living too rapidly, striving to match the level of richer countries, and they have been financing it with loans and credits and consequently - they lose their financial liquidity to pay instalments, which may lead to insolvency and even financial exclusion.

Over the past decades, proceedings concerning the bankruptcy of consumers have been introduced in most European countries. The exact bankruptcy model differs depending on the country - it can be more conservative (e.g. in Turkey, Italy, Sweden) or more liberal (e.g. in the USA, United Kingdom, Russia). The bankruptcy model is considered liberal or conservative, depending on who, and on what conditions, is allowed to be declared bankrupt and what benefits resulting from a court ruling on debtor's bankruptcy they are. In Europe, it could be observed an influence of the liberal idea of "fresh start", but it is also argued that liberalization of bankruptcy law, may trigger change of consumer behaviour, which result in a growing debt and the number of bankruptcies (Wiśniewska, p. 81).

The consumer bankruptcy procedure was introduced to Polish legal order in 2009. Consumer bankruptcy proceedings, applicable to non-entrepreneur natural persons, were first introduced by the law of 5 December 2008, entering into force on 31 March 2009, as art. 491^{1}–491^{23} of the Bankruptcy and Rehabilitation Law[1]. It was the first, restrictive version for debtors. Debt relief was only available for debtors whose insolvency resulted from extraordinary circumstances beyond their control (Porzycki M., Rachwal A., 2015, p.5).

1 The Act of 5 December 2008 Bankruptcy and Rehabilitation Law (Journal of Laws of the Republic of Poland, 2008, No. 234, Item 1572 with changes).

The number of consumers bankruptcies was insignificant : 10-32 per year (Baza Statystyczna Ministerstwa Sprawiedliwości) ; thus, the act of 29 August 2014 introduced a substantial amendment to the provisions on consumer bankruptcy law, liberalizing the access criteria and streamlining the proceedings[2].

In years 2015-2020 the access to bankruptcy procedure for debtors who got into debt intentionally was still restricted. From the beginning, banks have been against liberalization of the law and from their standpoint, bankruptcy procedure shall apply only to debtors who morally deserve this privilege (Kochniak, 2014, p.2-3). In addition, banks may incur significant losses due to unreliable customers. The percentage of declared bankruptcies of bank debtors has increased from 0,20% to 0,55% in years 2015-2018 (table 2).

Table 2. The number of over-indebted individuals, the number of declared bankruptcies and the percentage of declared bankruptcies by debtors.

Year / Data	2015	2016	2017	2018	2019
The number of over-indebted individuals	1 053 125	1 010 681	988 025	1 189 488	1 230 880
The number of declared bankruptcy	2,153	4,447	5,470	6,550	N/A
The percentage of declared bankruptcy	0,20%	0.44%	0.55%	0.55%	N/A

Source: The own study of the author, according to statistical data of the Information Economic Office InfoMonitor (BIG InfoMonitor S.A.) and data of the Ministry of Justice in Poland.

After that second amendment, bankruptcies have increased significantly, yet only a slight percentage of over-indebted people filed for bankruptcy. Therefore, the third amendment to bankruptcy law was introduced[3].

At the beginning of the coronavirus pandemic, the new regulations became valid and have eased the process of declaring consumer bankruptcy, since then the courts have not actually been examining the morality of the debtor. The most important change constitutes the exclusion of the requirement to examine the debtor’s morality (art.491(4) Bankrupcy and Rehabilitation Law), including the debtor's fault in causing or deepening insolvency, assessed by the bankruptcy court at the stage of declaring bankruptcy (Adamus, 2019, p. 10).

The new consumer bankruptcy regulations, which came into force in Poland on 24 March 2020, were not caused by the coronavirus crisis, but were intended to increase

2 The Act of 26 August 2014 Bankruptcy and Rehabilitation Law (Journal of Laws of the Republic of Poland of 2014, item 1306 with changes).

3 The Act of 30 August 2020 Bankruptcy Law (Journal of Laws of the Republic of Poland of 2019, item 1802).

the number of declared bankruptcies. However, these solutions have greatly facilitated the process of failing for consumer bankruptcy. Current solutions alleviate the effects of the crisis on many households, including their financial exclusion and poverty.

The next liberalisation might elicit the significant growth in the number of debtors, as almost every indebted individual is able to go bankrupt. Banks have suffered losses due to the coronavirus crisis, and the rise in consumer bankruptcies may expose them to even additional risk.

Currently, courts in Poland declare bankruptcy if the debtor is insolvent, alike in, so-called, the Anglo-American liberal model. In Anglo-america model (conception of “fresh start”), consumer bankruptcy procedure is open for almost all debtors and procedure is generally fast, aimed at debt relief. The second, European model is based on morality of debtors (conception „earned fresh start”). The European consumer bankruptcy laws differ from the Anglo-American laws, European legislatures generally have not adopted open access to consumer bankruptcy.

On the contrary, access is restricted to those debtors deemed worthy of it. Because of this attitude, there is a tendency in Europe to attach moral attributes to consumer overindebtedness and access to debt adjustment programs. In the majority of countries, the bankruptcy procedure is strict and shall depend on debtors’ morality. Moreover, the discharge is either conditional or is not granted before the completion of the payment plan (Niemi-Kiesiläiem, 1999, p. 475).

The new regulations in Poland include a mandatory repayment plan for all debtors who are able to pay off their debts. The repayment plan lasts between 3 and 7 years and its length depend on the debtor's fault (art.491 (15) Bancrupcy Law). Almost every debtor may file for bankruptcy, but people who borrowed irrationally would have a longer repayment plan.

That solution would be beneficial for both parties, debtors and creditors. If debtors fulfil their repayment plan, reliably and timely, they will take advantage of the redemption of, at least, the remaining part of the debt. From an educational point of view, bankruptcy would improve skills related to managing consumer financial obligations; therefore, debtors would be more rational in the future.

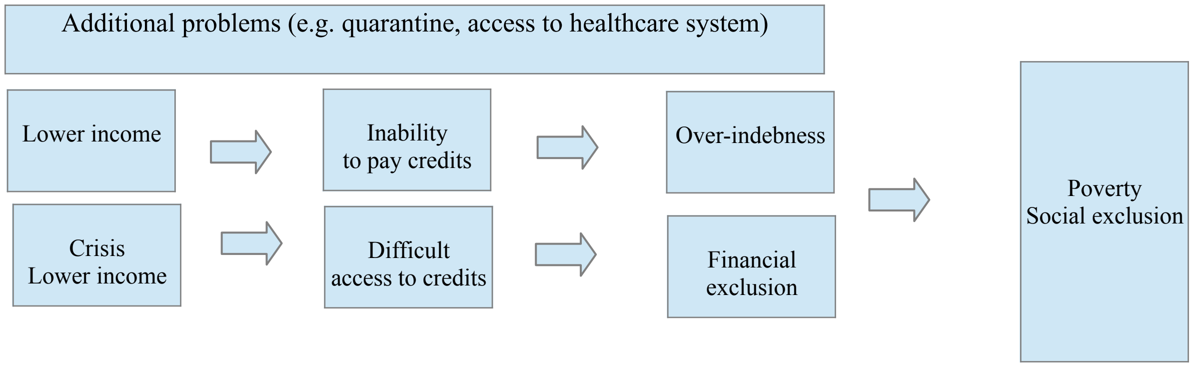
Currently, the trends in the crisis are still vague. The Polish economy might bounce back in a few months. On the other hand, the crisis and stagnation might also preserve, resulting in a long-term decrease in GDP, lower household income or higher unemployment rate.

II. Economic crisis and situation of households

Current financial crisis caused by COVID-19 has resulted in lower household income and higher unemployment. Most likely, there will be a further increase in the number of people insolvent from loans in the near future. There may also be issues in the access to healthcare or education systems or labour market. Restrictions in the pandemic time, such as quarantine, closing schools and necessity to provide round-the-clock care for children might further deepen social gap and exclusion.

The crisis has brought two main threats for households (Figure 1). Firstly, households with lower income may struggle with paying their instalments, and hence, they may lose liquidity and become insolvent. Secondly, households may have limited access to credits due to more restrictive bank policies. Households affected by the crisis may need financial resources. If they lack such resources in formal financial institutions, they will be more likely to use the services of shadow banks.

Figure.1 Process of social exclusion of debtors.



Source: The own study of the author.

Taking into consideration these obstacles, households are vulnerable to be exposed to greater risk of financial exclusion, which may worsen their poverty and social exclusion. On 18 March 2020 the Polish government announced the legislative package called "Anti-crisis shield". The Polish government has introduced the solutions to improve the standard of living for families, but this can only partially mitigate the effects of the crisis. The solutions implemented by the government are mainly aimed at stimulating consumption, e.g. monthly gross allowance in the amount of PLN 2,000 (approx. EUR 500) per person hired on the contract of mandate (*Coronavirus COVID-19 outbreak in the EU Fundamental Rights Implications,* 2020, p.6).

As the consequence of COVID-19, the Monetary Policy Council decided to cut the NBP reference rate by 0.50 percentage points to 0.50% (Monetary Policy Couciul, 2020) . Moreover, on 28 May 2020 the Council continued to cut the NBP reference rate further, by 0.40 percentage points, i.e. to 0.10%. *"In order to mitigate the negative economic effects of the pandemic, fiscal measures have been introduced to alleviate the fall in households' and enterprises' income, as well as to stimulate economic activity. At the same time monetary policy has been eased by – inter alia – lowering interest rates and pursuing asset purchases. As the restrictions related to the pandemic are lifted, a recovery in economic activity could be expected. This would be supported by economic policy measures, including monetary policy easing by NBP, that mitigate the fall in employment, supporting incomes of households and financial situation of enterprises. The scale of the expected recovery could be – in turn – curbed by uncertainty regarding the consequences of the pandemic, lower incomes and weaker sentiment of economic agents than in previous years."* (Monetary Policy Couciul, 2020).

Due to restrictions in the access to bank credits, households may search loans in different financial institutions. However, as part of coronavirus and household protection restrictions, the interest rates of loans have been reduced. Therefore, such financial institutions may reduce lending money to people without an appropriate income level. Hence, even two million poor people may be deprived of the access to credits from such institutions. On the one hand, such people might benefit from this deprivation, as they would not run into debts. On the other hand, in the face of the economic downturn such deprivation may worsen the situation of households, who may suddenly lose their jobs and income and have no option to provide their families.

People who would be deprived of the possibility to take loans from banks and financial institutions due to too low income may be forced to borrow money from shadow banks which operate in the ”grey zone”. Such loans can be expensive and deepen the debtors' poverty and social and economic exclusion. It may even lead to homelessness if such an expensive loan would be secured by a mortgage on their house.

There is yet another issue of “grey zone” as a labour market for insolvent consumers. In the informal sector of economy, people may earn income without law enforcement. Eventually, people excluded from the labour market may also be excluded from the financial market; in particular, they are not able to take credits due to the lack of legal income. From this perspective, a more serious problem is insolvency and inability to pay debts, because such problems may lead to financial and social exclusions in the future. Such situation is especially dangerous for young people - without credits, constituting a stable household for young people may be extremely difficult, because they do not possess financial resources for education or the purchase of flats for a new household (Reczuch, 2015, p.7).

III. Indebted and bankrupt consumers and financial situation of banks

Financial institutions were critical of any changes to the bankruptcy procedure, which aimed at facilitating bankruptcy. Bankruptcy should only be allowed for people who have lost their liquidity without their own fault. In addition, insolvent consumers gain excessive social benefits which cause banks to lose and upset the balance in the financial service market, as customers gain an unjustified advantage over banks and other financial institutions (Kochniak, 2014, p.2-3).

The first restrictive insolvency regulations in Poland entered into force during the period of economic stagnation caused by the global financial crisis that began in the USA in 2007. That crisis had been caused by the boom of insolvent consumers due to mortgages. Hence, the number of insolvent households led to bankruptcies in American banks, including Lehman Brothers, and caused the major recession in many other countries. That collapse resulted in the perils for households which had to face significant drop in their income and the increase of unemployment. The crisis triggered remodelling of the entire economic system which was supposed to prevent such situations in the future. Many economists called nonperforming loans as “financial pollution” due to their strong, negative economic consequences on consumers, banks, and even whole economies (Korol, p.135).

One of the goals which are assumed to secure the financial system against any crisis is responsible financing and that idea is popularized by experts from the World Bank. It is based on responsible granting loans and credits to households based on their creditworthiness assessment. In the recent years banks in Poland sometimes granted loans regardless of this concept, unethically offering the loans to clients without proper income. For that reason, experts of World Bank take into consideration such problem as financial capability, education and consumer protection (*Global Financial Inclusion and Consumer Protection Survey,* 2017. p.11-55). During crisis trigged by COVID-19, that idea is especially important, because ensuring the safety of financial system.

The situation reversed again due to the coronavirus crisis and the reduction of interest rates by the National Bank of Poland. Banks have found themselves under a serious threat, because, on the one hand, there is a risk of lower profits as a consequence of lower interest rates; on the other hand, lower household income may cause an increase in the number of insolvent customers and bank losses.

The crisis is likely to change the behaviours of consumers, who will make more responsible financial decisions, in particular the ones associated with new loans. Uncertainty, protracted stagnation, and restrictions may strengthen such economical consumer behaviours and these changes may impact the whole economic system.

IV. Summary

As a consequence of lower incomes, households must balance repaying debts with keeping up rational level of consumption. For households at risk of poverty, without any savings, such reduction of consumption, may face difficulties and became insolvent, which may lead to financial and social exclusions.

The liberalization of bankruptcy is not associated with the crisis but has arisen from the difficulty in access to this procedure and the lengthy process. Nevertheless, the legal provisions came into force just at the time of the economic downturn caused by the coronavirus. Although the rise in bankruptcies may improve household situation, it will also have a negative impact on the banking sector and ultimately the entire financial system. Probably financial institutions, taking into consideration experiences of the last crisis, started in 2007, will take steps to ensure financial stability. The increasing number of bankruptcies may change the policy of credit institutions and reduce access to loans, especially during that crisis.

Moreover, many over-indebted people will be able to declare bankruptcy and their economic situation will improve. New regulation would be beneficial for people, who face risk of poverty, financial and social exclusions (e.g. elderly people, pensioners, single parents). In addition, more employees will work legally and pay taxes, instead of avoiding debt enforcement procedures and working in "grey zone".

The institution of consumer bankruptcy is only one of the instruments of mitigating poverty or financial exclusion of households and its effectiveness requires also ensure an appropriate standard of living in various spheres of socio-economic life, such as healthcare system, access to labour market, financial services or education, during current crisis.

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