Insolvency Practitioners Association

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IPA – Putting Better Regulation into Practice

Dealing with Debt – A Basic Guide to Alternative Ways of Resolving Debt Problems

If you have debt problems, there are a number of possible alternatives that can help you to manage them. This Guide explains what the alternatives are, how they work and some of the pros and cons of each of them. It can be used by individuals with either consumer or business debts, or a combination of both.

This Guide is not a definitive explanation of the law. Nor is it a substitute for taking independent advice from an insolvency practitioner or recognised advice organisation on which of the alternatives is appropriate for you and your circumstances. You should seek advice early: the worst thing you can do when you are in financial difficulty is to do nothing and hope the problem will go away.

This guide:

- Summarises the key features of each of the main alternative ways of dealing with debt
- Provides an outline of how each of them works
- Explains the pros and cons of each alternative

Key differences between the alternatives

Each of these alternatives can have different outcomes and affect you in different ways. You need to be aware of this when considering which alternative is likely to be appropriate for you.

The most important points to consider are:

- Does the procedure release you (excuse you) from all or part of your debts so that your creditors will have no further claim against you?
- Is it binding on all your creditors?
- Are you protected from further recovery action and/or additional charges by your creditors during the procedure?
- How long will it last?
- Will it affect your employment?
- Will your home be at risk?
- Some of these procedures involve the payment of a fee: where a fee is payable, it may either come out of payments you make towards your debts or it can be payable separately before or after the procedure is put in place: you should be told what the fee will be before agreeing to proceed.
- Some of these procedures may involve prioritising certain types of unsecured debt, for example rent, council tax and gas, electricity and water: it will be more difficult to negotiate reduced payments or write-offs for these kinds of debts.
- Most procedures exclude for example fines, student loans and maintenance payments which you will still have to pay.
- Are you confident that you can keep up the payments you will have to make towards your debts for the period of time required under the alternative you are considering?

The most appropriate alternative in each case will depend on your own and your family's present circumstances and future prospects, and on your own preferences. In all cases the key factors are the amounts you owe and how much you are able to repay from your income and/or your assets, after meeting your own and your family's essential needs. You should be ready to give full details about all your debts and your finances to whoever you seek advice from, and to your creditors. It is essential you give them the complete picture. In making any offer to your creditors you should be realistic about your income and reasonable about your expenditure – insolvency practitioners and recognised advice organisations are able to provide you with guidance about levels of essential household and personal expenditure which can be used to put your case to your creditors.

Features common to all the alternatives

It is important to understand that:

- None of these alternatives can affect the rights of secured creditors, for example a bank or building society that has a mortgage or legal charge over your home. They continue to have the right to take possession of your home if you do not keep up your payments.
- Most debts involving credit and loans, for example credit and store cards and bank overdrafts, are unsecured - that is to say failure to pay this type of debt does not automatically entitle the creditor to take something of yours, such as your home. However in some circumstances they may go to court if you fall behind with your payments and obtain a court judgment; and they may then be able to ask the court to secure the debt on your home through what is termed a charging order.
- All these alternatives may affect your credit rating and will show up on your credit record.
- Entering into a procedure to help with your debt may, in a few cases, affect your employment; and it may, under the terms of your employment, have to be disclosed to your employer.
- If your circumstances change during the time you are subject to one of the procedures, whether for the better or worse, you will be required to disclose the change which may affect what you are paying towards your debts.

The Tables at pages 3-10 contain first the key features and then the detailed Pros and Cons for each alternative.

Note also

- It may be possible in some circumstances to obtain help from a **charity** or **trust fund** to meet certain types of urgent or pressing debt but is unlikely to be the answer to the whole problem - charities are generally not able to help with large credit card and similar debts. You will normally have to fill in a detailed application form or find a recognised advice organisation to apply for you.
- If
  - you do not own your home or have any savings or other assets; and
  - you do not have any surplus income after meeting your and your family's essential needs; and
  - your circumstances are unlikely to improve in the foreseeable future because of for example long term ill health limiting your ability to work or how much you can earn

  your creditors may be prepared to agree to **write off** the whole of what you owe them – that is, release you from having to pay them. A recognised advice organisation may be able to assist you in explaining your circumstances to your creditors and asking them to release you.

For Further Information: The Insolvency Service - the government agency responsible for the administration of the insolvency system, which includes bankruptcy, in England and Wales - maintains a website with access to a comprehensive range of publications on all types of insolvency procedure. It also provides a searchable database of insolvency practitioners. The Insolvency Service cannot provide legal or financial advice on individual cases but can provide further information about the alternatives listed here and sources of further advice which can be found at:
http://www.insolvency.gov.uk/otherinformation/supportadvice.htm
Helpline: 0845 602 9848
Opening hours: Monday - Friday 9am to 5pm (except Bank Holidays)
Website: www.insolvency.gsi.gov.uk

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The IPA is a professional body recognised by the Secretary of State for Business, Enterprise & Regulatory Reform under the Insolvency Act 1986 for the purposes of authorising and regulating insolvency practitioners

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Key features of each alternative

	Informally Negotiated Agreement with creditors	Credit Reorganisation/ Consolidation Loan	Debt Management Plan (DMP)	County Court Administration Order (CCAO)	Individual Voluntary Arrangement (IVA)	Bankruptcy	Debt Relief Order (DRO)
Automatic debt release	No	No	No	No, unless the court makes an order to that effect	Yes, when you have completed the terms of the IVA	Yes, when you are discharged, subject to certain exceptions as below	Yes, when you are discharged, subject to certain exceptions as below
Automatically binding on unsecured creditors	No	Only on creditors paid in full	No, but may agree to be bound by plan if you keep up your payments	Yes, on creditors listed in order	Yes, if accepted by creditors owed more than 75% of your unsecured debts who vote on your proposal	Yes	Yes
Automatic protection from unsecured creditor action	No	Only from creditors paid in full	No, but may agree to be bound by plan if you keep up your payments	Yes, on creditors listed in order	Yes	Yes	Yes
Protection from secured creditors action	No	No	No	No	No	No	See below
Length of time	No fixed time	No fixed time	No fixed time	Until last payment made	Usually up to 5 years	Usually one year but you may be required to make payments from your income for 3 years	Usually one year
Effect on employment	Probably none	Probably none	Probably none	Probably none	Possibly	Possibly	Possibly
Home at risk	No, but you need to keep up your mortgage/rent payments	No, unless a secured loan is taken out	No, but you need to keep up your mortgage/rent payments	No, but need to keep up your mortgage/rent payments	Can be avoided if you are able to raise an amount equal to your share of the net worth of your home, for example by re-mortgage or loan from a relative	May be avoided if for example your spouse or partner or a relative is able to pay an amount equal to your share of the net worth of your home	Gross assets must not exceed £300, so you will not qualify for a debt relief order if you own your home even if your mortgage exceeds its value
Minimum or maximum amount owed	No	No	None, but it is unlikely that a DMP would be practical if your debts are less than £5,000	Anything up to £5,000	None, but it is unlikely that an IVA would be practical if your debts are less than £15,000	No minimum if your own petition (£750 if petition is by a creditor)	Anything up to £15,000
Type of unsecured debt allowed	Any	Any	Any, but in practice debts excluded in bankruptcy are usually excluded from DMPs	Any	Any, but in practice debts excluded in bankruptcy are usually excluded from IVAs	Any with certain exceptions e.g. fines, student loans and maintenance payments	Any with certain exceptions e.g. fines, student loans and maintenance payments
Credit rating affected	Probably	Possibly	Yes	Yes	Yes	Yes	Yes

Informally Negotiated Agreement with Creditors

How it works

An informally negotiated agreement can be set up quickly without formalities, and may involve:
(1) Payments from your income and/or
(2) Payments from lump sums you receive for example from an inheritance or from relatives
Creditors may be prepared, at the start or later, to agree to write off part of what you owe them: any agreement to do so should be confirmed in writing.

(1) Payments from income: You need to work out how much you can afford to repay, after allowing for your essential household and personal expenditure such as mortgage/rent, heating and lighting, water, telephone, housekeeping, etc. You should offer to share this surplus income among your creditors, based on the amounts you owe them. This means that all your creditors are offered their share of what you can afford. You should also ask that any interest or charges are frozen. Creditors will expect you to provide them with regular updates of your income and expenditure so that they can see whether you are able to increase your payments.
(2) Payments from lump sums: You may make payments towards your debts from a lump sum which you receive and which your creditors may agree to accept in settlement of what you owe – that is, they agree to write off the balance they are owed. If however you do have surplus income, then they may expect you also to make at least some payments from that surplus income.

If your inability to make payments is temporary, as a result for example of a short term illness, creditors may agree to accept no payments or only token payments of say £1 a month, but only for a limited period.

Pros	Cons
• You can make an offer to your creditors and negotiate agreement to accept payment by instalments yourself; but you may find it helpful to have some assistance from a recognised advice organisation in drawing up your budget and drafting letters to your creditors. • Creditors may be prepared to freeze interest and charges for a period or all together, providing you keep up regular payments to them. • You can ask if you can reduce your payments if your situation gets worse or you face unexpected essential expenditure. • Creditors may be prepared to write off the balance of what you owe after a period of time if you have shown that you have made every effort to pay them back as much as you can and have kept up regular payments to them. • You should be able to continue any business you may have or self-employment; but you need to be careful about running up new debts which you cannot meet alongside repayments to your existing creditors.	• Creditors may refuse your offer (but it is always worthwhile asking them to reconsider) or any proposed reduction in payments, although they cannot refuse whatever payments you are able to make to them. • In particular, creditors may refuse unless your offer is made through a recognised advice organisation which will have independently reviewed your circumstances. You can complain to the Office of Fair Trading if this happens. • Creditors may refuse to freeze interest or charges (again, it is worthwhile asking them to reconsider). So, if you can only afford small payments, these may not be enough even to cover interest or charges, and your debts will increase. • There is no debt forgiveness, so you remain liable for your debts until they are paid in full, although you may be able to persuade your creditors to agree to write off part of the debt depending upon your circumstances. • Creditors can still take action against you, for example by obtaining a court judgment and then an order which creates a charge on your home, unless they have specifically agreed not to do so in return for your keeping up regular payments. • You are responsible for administering all the payments yourself and keeping creditors informed of your circumstances.

Debt Reorganisation/Consolidation Loan

How it works

You can apply to a lender for a loan to clear your debts, which are often marketed as "consolidation loans", by which you swap some or all of your creditors for just one creditor. If you own your home, the lender is likely to want to have a charge on it: you should seek independent advice as to whether this would be in your best interests. You should shop around for the best deal from high street and internet lenders. If you have a poor credit rating, loans on the best terms may not be available to you.

A consolidation loan will only be of help if -

- it is used to pay some or all of your existing debts; and
- repayments total no more than those you are already making towards your existing debts, and you can afford to make them.

Otherwise, the new loan will simply add to your debt burden and make your problems worse. You will also need to look very carefully at how long the loan will take to repay; what interest you are going to have to pay compared with what you are currently charged; and what charges or penalties there are, for example for late payments.

Pros	Cons
• While you may be assisted in getting a consolidation loan, you will be responsible for paying your existing debts from it and negotiating with any of your existing creditors who are not repaid in full. • You make a single payment each week or month on the consolidation loan, rather than a number of payments to different creditors (unless any of your existing creditors have not been repaid in full). • Your monthly payments may be lower, or at least should not be any higher. • You should be able to continue any business you may have or self-employment; but you should be careful about running up new debts.	• You can expect to have to pay fees in connection with the arrangement of the loan: always ask for full details in writing of what those fees will be. • If you have a poor credit rating you may not be able to get a loan or you may be offered poor terms and conditions, for example at a high rate of interest. • If the loan is secured on your house or other asset, then it could be repossessed if you do not keep up the payments. • Interest rates often change over the loan period, making it difficult to work out what the total cost of the loan will be: check if the interest is fixed or variable. • Consolidation loans are often offered over a longer time than your existing credit card/ store card/overdraft/loan repayment periods. That means that even if the interest appears reasonable, the length of time you have to repay can significantly increase the overall cost of the loan and you end up paying more. • If you don't clear all your existing debts, then the new loan is likely to make your debt problems worse, and you may find it more difficult to make all the repayments to which you are committed. • Creditors who are not paid in full can still take action against you, for example by obtaining a court judgment and then an order which creates a charge on your home.

Debt Management Plan (DMP)

How it works

If you have surplus income after meeting your essential household and personal expenditure, such as your mortgage/rent, lighting and heating, water, telephone, housekeeping, etc, and you would like someone to negotiate with your creditors and manage your payments to them, then you might consider a more formal debt management plan.

Creditors will also want details of your assets, including your home where you own it, so that they can consider whether your offer is reasonable or whether they expect any of those assets to be sold so that they will receive a larger payment towards their debt.

The individual or company you choose to manage your plan is required to be licensed and regulated under consumer credit legislation. Some will not charge you a direct fee for their services but instead receive it from your creditors, for example out of the payments made to your creditors. Others may make an initial charge for preparing, negotiating and administering your plan and then take the remainder as a proportion of your monthly payments. In either case, before you sign up, you should be provided with details of the fees it is proposed to charge for managing your plan and how they are to be paid.

A plan can last for 5 years or more depending on what you owe and how much you can pay each week or month: your debt management company should give you an estimate of how long the plan will last. Creditors will expect to be provided with regular updates of your income and expenditure so they can see whether you are able to increase your payments.

Some debt management companies may not be prepared to accept you for a plan if you owe less than £5,000 or your surplus income is less than £100 a month since it would not be economic for them to undertake the work involved.

Pros	Cons
• The debt management company will assist you in preparing your plan, including agreeing the level of your expenditure based on guidelines which are acceptable to creditors. • The debt management company will negotiate with creditors on your behalf, including freezing interest and charges: your plan is more likely to be accepted than if you try yourself to negotiate separately with each of your creditors. • Some debt management companies do not charge you a fee. • You make a single payment each week or month to the debt management company which is responsible for administering payments to your creditors. • You can ask if you can reduce your payments if your situation gets worse or you face unexpected essential expenditure. • Creditors may be prepared to write off the balance of what you owe after a period of time if you have shown that you have made every effort to pay them back as much as you can and have kept up regular payments to the debt management company. • You should be able to continue any business you may have or self-employment; but you need to be careful about running up new debts which you cannot meet alongside repayments to your existing creditors.	• Creditors cannot be forced to accept your plan or freeze interest and charges. A plan is not binding on creditors who refuse to take part in it although they cannot refuse to accept whatever payments you can make to them. • Creditors may be prepared to accept a reduction in payments for only a limited period. • If your situation improves, you can be expected to be asked to increase your payments. • There is no debt forgiveness, so you remain liable for your debts until they are paid in full, although you may be able to persuade your creditors to agree to write off part of your debt depending upon your circumstances. • Creditors can still take action against you, for example by obtaining a court judgment and then an order which creates a charge on your home, unless they have specifically agreed not to do so in return for your keeping up regular payments. • A plan can last for a number of years. If interest and charges cannot be frozen for the full length of the plan, then the total amount you end up paying under the plan could substantially exceed the original amount of your debts, and extend the lifetime of the plan.

County Court Administration Order (CCAO)

How it works	
If you owe not more than £5,000 to at least two creditors and have a court judgment entered against you by one of your creditors which you are unable to pay in full, you can ask the court to make an administration order. Under that order, you are required to make weekly or monthly payments from your income to the court which distributes them to your creditors in proportion to the amounts you owe them. The court may, if there are difficulties in obtaining payments from you, make an attachment of earnings order which is sent to your employer directing that amounts be deducted from your wages and paid to the court for distributing to your creditors. On completion of the terms of the court's order, any amounts still owed to your creditors is written off.	
Pros	**Cons**
• You can prepare your own application, although a recognised advice organisation or the court may be able to assist you where needed. • Creditors will be notified by the court. • None of the creditors listed in your application can take further action against you without the court's permission. • Interest and charges are stopped. • There is no up-front fee – the court takes 10p in every £1 you pay in. • You make a single payment each week or month to the court which is responsible for administering payments to your creditors. • You can ask the court if you can reduce your payments if your situation gets worse or you face unexpected essential expenditure. • You can apply to make payments for a time-limited period such as three years using a 'composition order', and any amounts still owed to your creditors would then be written off. • You should be able to continue any business you may have or self-employment; but you need to be careful about running up new debts which you cannot meet alongside repayments to your existing creditors.	• Creditors can make objections to the court and ask to be left out of the order (although the court may not agree to this). • If you do not keep up your payments the order can be revoked; you may be made subject to the same restrictions as if you were bankrupt; and the creditors can pursue you again. • If the court makes an attachment of earnings order, your employer will become aware of your financial difficulties. • If your situation improves, you can be expected to be asked to increase your payments.

Individual Voluntary Arrangement (IVA)

How it works

If you have surplus income after meeting your essential household and personal expenditure, such as your mortgage/rent, lighting and heating, water, telephone, housekeeping, etc, and/or have assets which can be used to pay your creditors and/or have access to a lump sum from for example a relative, then you might consider entering into an individual voluntary arrangement which will protect you from action for recovery that might be taken by your unsecured creditors and will usually involve creditors writing off part of what you owe them. A proposal for an IVA has to be approved by creditors owed more than 75% of your debt and who vote on whether to approve it or not.

The individual you choose to supervise your IVA is required to be licensed and regulated under insolvency legislation as an insolvency practitioner.

The insolvency practitioner will charge fees for preparing, negotiating and administering your IVA: you should be provided with details of the fees it is proposed to charge and how they are to be paid – whether as a lump sum or from the payments you make into the IVA – before you are asked to sign up to an IVA.

Some insolvency practitioners may not be prepared to accept appointment to supervise your IVA if you owe less than £15,000 since it would not be economic for them to undertake the work involved.

Pros	Cons
• The insolvency practitioner will assist you in preparing your proposal, including agreeing the level of your expenditure based on guidelines acceptable to creditors, and submit it to your creditors. • Creditors who vote against your proposal are still bound by it if it is accepted by those owed more than 75% of your debts . • Creditors who are unsecured cannot take any further action against you. • Many insolvency practitioners will allow their fees for preparing your proposal to be paid on a monthly basis as part of your IVA. • You make a single payment each month or quarter to the insolvency practitioner who is responsible for administering all payments to your creditors. • You can ask if you can reduce your payments if your situation gets worse or you face unexpected essential expenditure. • The terms of an IVA will usually enable you or your spouse or partner or a relative to make arrangements, for example a re-mortgage or loan, to purchase your share of the net worth of your home or to make additional payments, rather than your home having to be sold. • On completion of the IVA, the balance of what you owe to your creditors is written off.	• Your IVA is entered on a public register. • The insolvency practitioner may require payment in advance for preparing your proposal and getting agreement of your creditors. • If there is some equity (value) in your home after taking account of the mortgage(s) on it, you are likely to be required to pay for your share, usually in the fifth year of your IVA, by remortgaging it: if you cannot obtain a re-mortgage, you may be required to continue making monthly or quarterly payments from your income for up to a further year. • Creditors may not be prepared to agree to you reducing your payments where your situation gets worse, or may agree but only for a short period. • If your situation improves, then you can be expected to be asked to increase your payments. • If your fail to keep up your payments or to comply with other terms of the IVA, the IVA is likely to fail and you may be made bankrupt. • You would usually be able to continue any business you may have or self-employment; but you need to be careful about running up new debts which you cannot meet alongside repayments to your existing creditors and to deal properly and promptly with your tax affairs which may be a condition of creditors' agreement to an IVA.

Bankruptcy

How it works	
Bankruptcy is a formal court procedure which you can start or which can be started by one of your creditors owed not less than £750. Your assets (with certain exceptions) are sold towards paying your creditors: you retain necessary personal effects, contents of your home and tools of trade (which may include your car) unless they are of high value in which case they will be replaced by ones of reasonable cost: you will be required to make payments out of your income for up to three years if you have surplus income after meeting your essential household and personal expenditure, such as your mortgage/rent, lighting and heating, water, telephone, housekeeping, etc. Your assets and income are dealt with by a licensed and regulated insolvency practitioner or by a government official called the official receiver. Bankruptcy usually lasts for one year: on your discharge from your bankruptcy, you are released from your debts (with certain exceptions).	
Pros	**Cons**
• You can prepare your own application, although a recognised advice organisation or the court may be able to assist you where needed. • Creditors are notified by the official receiver. • Creditors who are unsecured cannot take further action against you. • It may be possible to avoid the sale of your home if your spouse, partner or a relative is able to arrange to buy your share of its net worth. • The balance of what you owe your creditors, after your assets have been realised and you have completed making any payments required from your income, is written off, with certain exceptions explained opposite. • It allows you to make a fresh start, usually after a year.	• Your bankruptcy is entered on a public register and may be advertised. • If you apply for your own bankruptcy you will have to find a court fee and deposit totalling £510. • You will remain liable for certain debts - in particular student loans, fines, maintenance payments and under other orders made in family proceedings. • Any business you have will almost certainly be closed down. • You can continue in self-employment, subject to restrictions about for example obtaining credit. • Any employment may be affected. • Certain professionals are barred from practising if they are made bankrupt. • You commit an offence if you incur credit of £500 or more without disclosing that you are bankrupt. • You cannot act as a director of a company or be involved in its management unless the court agrees. • You may have a bankruptcy restrictions order made against you for a period of 2 to 15 years if you are found to have acted irresponsibly, recklessly or dishonestly.

Debt Relief Order (introduced April 2009)

How it works	
If - • your total assets are worth not more than £300 excluding necessary personal effects, contents of your home and tools of trade together with a motor car worth not more than £1,000; • your debts do not exceed £15,000; and • your surplus income, after meeting your essential household and personal expenses, such as your rent, lighting and heating, water, telephone, housekeeping, etc, does not exceed £50 a month then you can apply to a government official called the official receiver for a debt relief order through an approved intermediary. The official receiver may not grant your application if you have given away any of your assets or sold any assets at less than their value. A DRO lasts for one year when you are released from your debts (with certain exceptions).	
Pros	**Cons**
• An approved intermediary will assist you in preparing your application. • Creditors are notified by the official receiver. • Creditors who are unsecured cannot take any further action against you. • Your debts are written off, with certain exceptions explained opposite. • It allows you to make a fresh start, usually after a year.	• Your DRO is entered on a public register. • You will have to find a fee of £90 paid to the official receiver • You will remain liable for certain debts - in particular student loans, fines, maintenance payments and under other orders made in family proceedings. • You can continue in self-employment, subject to restrictions about for example obtaining credit. • Any employment may be affected. • You commit an offence if you incur credit of £500 or more without disclosing that you are subject to a DRO. • You cannot act as a director of a company or be involved in its management unless the court agrees. • You may have a DRO restrictions order made against you for a period of 2 to 15 years if you acted irresponsibly, recklessly or dishonestly.