Carter Clark
Financial Recovery

Briefing Sheet

Personal debt solutions

Which route to go?

Individual Voluntary Arrangements (IVA's) and Bankruptcy have now become popular methods of reducing the burden of personal debt. In recent years, additional options have become available including debt consolidation, debt management plans, debt relief orders and informal arrangements. But what are the merits or pitfalls of these schemes?

Individual Voluntary Arrangement

This is a contract between the debtor and his or her creditors allowing debts to be compromised for less that their full value. Debts are written off upon the satisfactory completion of the IVA.

Advantages

- Flexible. Either a lump sum or monthly voluntary contributions from earnings can be used to clear debts.
- Binding on all creditors once the proposal has been accepted by a 75% majority.
- Regulated. The Nominee and Supervisor of the arrangement must be a licensed insolvency practitioner.
- No restrictions on staying in business or remaining a company director.
- Useful for professional and other regulated persons who may be prohibited from filing for bankruptcy.
- Interest and charges frozen on unsecured debts.

Disadvantages

- Once agreed, the terms of the IVA must be followed.
- Due to the complexity of drafting, the initial set up costs can be prohibitive where the overall debts are small.
- Failure to fully complete the terms of the IVA could result in bankruptcy.

Bankruptcy

Bankruptcy is a Court based procedure. Since April 2004, as a reflection of growth in consumer debt, first time bankrupts may be discharged after 12 months. In cases where there is no prospect of making meaningful monthly contributions, filing for bankruptcy is a quick way of eliminating the stress of debt.

Advantages

- All unsecured debts, with the exception of certain claims relating to matrimonial proceedings and student loans, are written off.

Executive summary

There are now a variety of solutions for individuals with debt problems. The key point to consider is will the chosen approach actually reduce the debt and also be legally binding? In many cases the best option for a debtor remains the choice between an IVA and bankruptcy. Both have certainty, are regulated by licensed insolvency practitioners and can offer guaranteed elimination of debts.

Have a question?

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- Pensions protected together with tools of trade and certain household items.
- The Trustee may seek affordable contributions under an income payments agreement or order usually for a period of three years – typically less than the five years often demanded by creditors in an IVA.

Disadvantages

- All assets of any value will need to be sold.
- Various prohibitions exist whilst undischarged, including such things as being a company director, and seeking credit over £500 without disclosure of bankruptcy status.
- Investigation by the Official Receiver and possibility of a bankruptcy restriction order where a person has acted unlawfully or recklessly in running up debts.
- Extremely difficult to continue to trade due to seizure of assets, restrictions on obtaining credit, and restrictions on use of business name.
- Restrictions on continuing in certain professions and occupations even after discharge.

Debt consolidation

This type of debt restructuring often involves replacing a number of existing loans with a new loan. It is easier to deal with one lender, who may be prepared to advance funds based upon the availability of security, guarantors, and ability to meet monthly repayments. This work is often undertaken by an Independent Financial Advisor.

Advantages

- Possibility of obtaining lower interest rates due to changing market conditions.
- Less paperwork due to reduction in number of creditors and certainty of one monthly repayment.
- Not an insolvency process and credit rating should not be affected as debts will be repaid in full.

Disadvantages

- Full repayment of debt required as debts are not compromised or written off.
- Lack of flexibility as the option of making variable repayments to selected creditors is replaced by the fixed monthly sum to the new lender.
- Insurance may be needed to cover default risk.

Debt management plans

A DMP is a voluntary agreement between the debtor and individual creditors to reduce monthly repayments. A debt advisor or broker will collate details of all debts, calculate surplus funds after provision for living costs and agree a monthly payment plan with creditors. Each month a proportion of the payment, after deduction of fees, is repaid to creditors. This type of plan is often favoured by lenders as their debts are still classed as performing loans.

Advantages

- Sometimes an effective short term solution allowing certainty of reduced fixed monthly repayments.
- No court involvement and not an insolvency

  process. **Disadvantages**

- As debts are not compromised or written off, debts often grow at alarming rates.
- No certainty how lenders will react – some freeze interest, some charge higher rates and others may roll up interest and penalties thereby making the long term situation far worse.
- No fixed period.
- Creditors are not legally bound.

Debt relief orders

A sort of "bankruptcy elite" introduced in April 2009 for persons with debts less than £15,000, assets worth less than £300 and less than £50 per month disposable income. The order is dealt with by the Official Receiver and other debt advisors. It prevents creditors from pursuing debts without permission of court and, after 12 months, the debts listed in the DRO will be written off.

Informal arrangements

This type of debt reduction requires the debtor to write to all creditors explaining his or her position and making proposals for repayment and debt forgiveness by each creditor.

Advantages

- Not a formal insolvency process and therefore a low cost solution.
- Generally only useful over the short term were there are a limited number of creditors who have not commenced recovery action.

Disadvantages

- Not legally binding, with the risk that creditors may demand full repayment at a later date.
- Difficult to implement in complex cases or where there are a significant number of creditors.
- It may trigger formal demand for repayment in full of all sums outstanding.

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