

ADVANTAGES, DISADVANTAGES AND RISKS OF DIFFERENT DEBT SOLUTIONS

The most common options available to individuals who are unable to pay their debts are:-

- 1 Do nothing.
- 2 Obtain an unsecured debt consolidation loan.
- 3 Release equity by way of re-mortgage or secured loan.
- 4 Informal arrangement (no assistance).
- 5 Debt management programme.
- 6 Individual Voluntary Arrangement
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1 **DO NOTHING**

Many people try to avoid dealing with their problems because they don't know what to do for the best. However, doing nothing is never an option that we would recommend. Doing nothing increases the likelihood of your creditors taking recovery action against you usually by contacting you directly in writing and by telephone instructing debt collectors and culminating in court action, bailiffs, attachment of earnings orders, charging and property sale orders and even bankruptcy. This can be very stressful. If you fail to make payments on secured loans repossession proceedings could be commenced.

2 **UNSECURED DEBT CONSOLIDATION LOANS**

Again, this is not an option that we would usually recommend. In theory a debt consolidation loan allows you to combine numerous credit commitments into one monthly payment. You will need to carefully consider what you can afford to repay realistically each month before the debt consolidation loan is applied for. Unless you can borrow sufficient funds to clear all your existing debts you may find yourself in a worse position.

Advantages

- If you are able to consolidate all of your unsecured debts, then you can have one monthly payment each month.
- Low impact on your credit rating if you can maintain the required contractual repayment.

Disadvantages

- The consolidation loan will cost considerably more in the long term as it will be repayable over a longer period of time and will increase the level of the debt by the new creditors' interest and charges.
- Most people keep their previous credit cards for "emergencies" and over a period of time the balances on those credit cards build up again.

3 **RELEASE OF EQUITY & SECURED LOANS/RE-MORTGAGE**

This is a debt solution offered by loan companies and banks to home owners in financial difficulty, on the basis that by consolidating unsecured debt in the form of a re-mortgage, the re-mortgage monies can be used to repay all existing unsecured debts and reduce the required monthly repayments by taking advantage of lower interest rates which can be obtained with secured borrowing. Again, the level of the required re-mortgage would need to be ascertained so that sufficient money could be raised to clear all of the outstanding unsecured debt.

Advantages

- If it pays off all of your unsecured debts, then you can have one monthly payment.

Disadvantages

- It will cost more in the long term as the secured loan will be repayable over a longer period of time with substantial arrangement fees and interest charged for the duration of the loan.
- If you default on the repayments of the secured loan you may lose your home if the lender commences repossession proceedings.
- With falling house prices if you secure further borrowing on your house you may find yourself trapped in a negative equity situation. It is unlikely that you will be able to sell/move out of your property if this were to occur without allowing the mortgage company to sell as mortgagee in possession. In effect this means your house would be repossessed and you would be liable for any unsecured balance.
- Banks are now reluctant to approve secured loans for consumers in financial difficulty.

4 INFORMAL ARRANGEMENT (DEALING DIRECTLY WITH YOUR CREDITORS)

If you have a small number of creditors and a low debt level and there is no immediate threat of legal action you could try to come to individual arrangements with each of your creditors by offering them reduced repayments.

Disadvantages:

The difficulty with trying to resolve your issues in this way is that it may be difficult to reach individual agreement with all of your creditors. Those refusing to accept the informal payments proposed could commence legal action against you at any time making the arrangement unworkable. In addition it would only be suitable for people whose financial circumstances are about to change for the better thus increasing what would be made available to creditors in the near future.

Advantages:

- 1) There would be no arrangement fees or management fees to pay.
- 2) You remain in complete control (subject to your creditors rights) of your own affairs

5 DEBT MANAGEMENT PROGRAMME

A debt management programme is an informal procedure under which a commercial debt management company or advisory body seeks to negotiate on your behalf an agreement with your creditors as to reduced repayments. The debt management company will usually charge an arrangement fee for setting the programme up (usually spread over the first six months of your programme) and a management fee (charged from month seven of your programme onwards) for managing the programme and distributing payments to your creditors each month some advisory bodies provide this service free of charge. The debt management company with your help will prepare an up to date financial statement regarding your financial situation and agree with you and your creditors a monthly repayment that you can afford to pay your creditors each month. Making allowances for the debt management company's fees your creditors will be offered a pro rata payment out of your surplus income each month. You would make monthly payments to the debt management company usually by standing order and they will distribute that payment once their costs have been deducted. Debt management would not always be an appropriate solution in our opinion if it would take you longer than 10 years to become debt-free.

Advantages

- Relatively cheap to set up and manage.
- You continue to control your assets.
- Your creditors may freeze ongoing interest and charges, but this can not be guaranteed.
- Once the programme is implemented i.e the creditors are receiving regular repayments from you they will usually stop further action against you.
- Where creditors approve a debt management programme this avoids the need for formal insolvency proceedings.

Disadvantages

- Your creditors are not legally forced to freeze interest and charges on your accounts and even if they do it is usually only for a limited period of time. Some creditors will continue to charge interest albeit at a reduced rate. Creditors will require ongoing information and can change their minds about freezing interest. In some instances if creditors refuse to freeze the interest and charges at all it is possible that the size of your debt will continue to increase during the term of the programme so far from resolving your debt problems the debt will continue to increase in spite of regular payments.
- You have no court protection from your creditors who can at any time break ranks and decide to issue court action or other legal process for the recovery of the debt. Creditors who are unhappy with what

they are being paid on a debt management programme could also issue a bankruptcy petition against you at court which could ultimately result in you being made bankrupt.

- Not all of your creditors may agree to the programme. Those creditors are likely to continue in recovery proceedings against you escalating the size of the debt all the time. Some creditors may even try to get security for their debts over any assets you may own by use of the bailiffs/High Court Enforcement Officers (they will usually secure charges over personal items eg furniture or your car) or by way of charging order proceedings usually over your house. In both cases assets can be sold to repay debts.
- Creditors would expect payment in full in respect of the outstanding debt. No part of the debt would be written off.
- Some creditors have minimum repayment requirements for example if an individual creditor feels that what is being offered to them is low they may require individual increases. This again could make the programme unworkable.
- A financial management programme would have an adverse effect on your credit rating as your creditors would log with the consumer credit reference agencies the offers of reduced payments under the financial management programme.

6 INDIVIDUAL VOLUNTARY ARRANGEMENT

An Individual Voluntary Arrangement (hereinafter IVA) is a formal agreement between you and your creditors and an Insolvency Practitioner under which you agree to make monthly payments or make available to creditors your assets or both in full and final settlement of your debts. As people who avail themselves of this procedure are insolvent creditors will usually agree to part of the debt being written off. However, creditors will expect to receive more than they would in the event of your bankruptcy. If such an arrangement is accepted/approved by your creditors and successfully concluded, they are not entitled to apply interest or any changes thereafter and thus the level of the debt will be frozen. Essentially if agreed this would form the basis of a new contract between you and your creditors.

An IVA is managed by a licensed Insolvency Practitioner. Whilst the terms of the proposal may vary typically you will be required to make an affordable monthly payment to your Insolvency Practitioner out of your surplus income over a period of usually five years sometimes six. In addition, if you own your property and there is equity in it you may be required to introduce a lump sum either by way of re-mortgage or sale of the property at the end of the arrangement. As long as you make the required repayments and do what is necessary you will be debt-free within the time specified in the arrangement. The unpaid balance of what you owe once the IVA has been concluded will be written off by your creditors.

Advantages

- If you successfully complete your IVA, you will not lose control of your assets as you would in a bankruptcy situation.
- If you are a director of a Limited company or self-employed it is easier for you to remain in business. In other words, you would not automatically be disqualified from acting as a Director and similarly your business partnership would not automatically be terminated. Statutory restrictions on obtaining credit would not apply.
- There is quite a lot of flexibility in the preparation of proposal documents and in particular what assets are offered to creditors. Some assets can be excluded.
- As long as over 75% of the creditors voting at your creditors' meeting vote in favour of the proposal then all of your creditors will be bound by its outcome. This avoids the necessity of securing every creditor's specific agreement (as would be required in a debt management programme).
- If approved the IVA gives you security and comfort in knowing that once you have fulfilled your obligations under the arrangement it will effectively bring the IVA to an end and your creditors will not be able to pursue you for any unpaid balances. This is guaranteed.

Disadvantages

- The IVA may impose more onerous obligations over a longer period than bankruptcy.
- Creditors may suggest modifications which may alter the original scope of the proposal for example require higher repayments over a longer period, assets included in the IVA are held by the Supervisor on trust for the benefit of your creditors.
- If your IVA is approved and you fail to comply with what is required of you in accordance with the terms of the proposal for example if you fail to make the monthly repayments into your proposal

without prior arrangement your Supervisor may be forced by creditors to issue a bankruptcy petition against you.

- There are restrictions in obtaining credit whilst you are in an IVA.
- You are released from your IVA only when you have complied with all the conditions of your IVA and your creditors have been notified.
- If you were required to re-mortgage your house at the end of the arrangement you would be left with a higher mortgage.
- If you are unable to secure a remortgage the term of your IVA may be extended (this will require your creditors approval) If not your IVA may fail.
- Debt write off and the freezing of interest and charges only applies on the successful completion of the IVA.
- The Insolvency Service maintains a register of bankruptcies, IVA's and Debt Relief Orders. There are similar provisions applicable to orders made in Scottish courts for Scottish residents. These registers are accessible not only to lenders but also to other members of the general public. There is a public register of financial management programmes for those living in Scotland. This is restricted to use by lenders only at the present time. Judgements and decrees are recorded by credit agencies for six full years from the date of Judgement.

7 BANKRUPTCY

Bankruptcy is a formal insolvency procedure used where someone's financial affairs are such that they owe more money than the value of their assets and their income cannot cover the monthly contractual payments due to creditors. Bankruptcy can come about either by a creditor who is owed more than £5000 making a creditors' application to the Court or the debtor making their own application. Either way once a Bankruptcy Order is made your affairs would be dealt with by the Official Receiver or an appointed Trustee in Bankruptcy. Any assets that you own at the time of your bankruptcy will vest in your Official Receiver or your Trustee in Bankruptcy and consequently if you own your own home the Trustee would seek to realise any value that you have in it if necessary by applying to the courts for your house to be repossessed and sold. The Trustee in Bankruptcy would also seek to sell any investments or shares and will also take control of any savings accounts that you may have. If you receive any assets during your bankruptcy such as a lottery win or an inheritance this will have to be paid to your Trustee in Bankruptcy and such sums would be distributed to your creditors. In addition, having taken into account your income and expenditure the Trustee in Bankruptcy may try to reach agreement with you as to the level of a monthly payment for an Income Payments Agreement. In the event of him not being able to agree a suitable level of income payment, he will seek to make an application to the Court. Such payments usually last for 36 months from the date of any Order and unless the court determines otherwise. The Trustee in Bankruptcy under bankruptcy legislation is now required to investigate your conduct and the circumstances giving rise to your financial predicament. Relevant conduct can include such matters as borrowing money from creditors when you knew you had no way of repaying it, giving assets away or selling them for less than their value, paying some creditors (usually family members) before others, gambling or fraud. Such conduct could give rise to grounds for your Trustee in Bankruptcy to make an application to the court for a Bankruptcy Restriction Order. The effect of this would be for the duration of your bankruptcy to be extended for a period of up to 15 years. This depends very much on the conduct in question.

Advantages

- It gives you an opportunity of a fresh start. It prevents your creditors making any further claims against you or demands for direct repayment of the debts whilst you are bankrupt and cannot pursue you for repayment once you have been discharged from bankruptcy.
- Relative peace of mind. All legal action against you is stopped in relation to the bankruptcy debts.
- The level of an income payments order may be lower than those required in an Individual Voluntary Arrangement and unless the Trustee in Bankruptcy applies to the Court for a Bankruptcy Restriction Order would only last for 36 months.
- Many bankrupts are discharged after 12 months.

Disadvantages

- If you are to apply for your own bankruptcy you would be required to pay a substantial court fee although you can now pay for this in instalments. Please visit

www.gov.uk/bankruptcy/overview for the current fee amount. If you apply to obtain credit of more than £500 during your Bankruptcy and prior to discharge you must bring this to the lender's attention.

- Any assets that you own at the time of your Bankruptcy will automatically transfer to your Trustee in Bankruptcy.
- You have a duty to provide full information as to your assets and liabilities, income and expenditure and fully co-operate with your Trustee in Bankruptcy. Failure to co-operate may result in the Trustee in Bankruptcy applying to the Court to suspend time running in respect of the duration of your bankruptcy and extending its duration.
- The Trustee may make an application to the Court or reach an agreement with you for you to be subject to an Income Payments Order and may require monthly repayments for a period of at least 36 months (unless the Court orders a longer period).
- You would be automatically disqualified as acting as a Director of a Limited Company or taking part in the management of a company except with the Court's prior permission. You may also be prejudiced in your employment if you work in the financial services industry, police or other related areas or perform a management role.
- Certain debts are not provable in bankruptcy eg student loans, arrears of maintenance, fines and child support agency payments. These will need to be paid even if you are bankrupt.
- As the Official Receiver has to investigate the circumstances giving rise to your present financial predicament if this has been the result of reckless, blameworthy or dishonest conduct, the Official Receiver/Trustee in Bankruptcy appointed by him may apply to the court for a bankruptcy restriction order eg building up credit card debt that you realistically could not pay back.
- Certain conduct in bankruptcy may result in prosecution and can be punishable by imprisonment of a maximum of two years for example defrauding creditors, concealing assets or destroying books and records.
- Bankruptcy orders are advertised in the London Gazette and depending on the official receiver may be advertised in local newspapers.
- It may be difficult for you to operate a bank account during bankruptcy.

8. Debt Relief Orders (DRO) * *please note the monetary thresholds referred to below are subject to change in June 2024 and this document will be updated then to reflect those changes*

A DRO is an alternative to bankruptcy that can help people deal with certain types of debts. You can apply for a DRO if you do not own your own home, have little disposable income and assets worth less than £2,000 and/or a car worth less than £2,000 and cannot realistically see your situation improving.

A DRO is issued by the Official Receiver (OR) who is an officer of the bankruptcy court via an approved intermediary. The OR will write to your creditors to explain:

- They can not take any action to recover their money without the permission of the court
- You are not able to make any payments towards your debts
- You will be discharged (freed) from your debts when the DRO ends, usually after twelve months. However, a DRO can be amended or cancelled if your financial situation improves.

In order to qualify for a DRO you must:

- Owe less than £30,000 to your creditors.
- Have less than £75 a month disposable income. This is the amount left after you have paid essential bills such as rent, utilities, council tax and all necessary living costs.
- Have less than £2,000 worth of assets; you can own a motor vehicle valued at no more than £2,000.
- You must not have been subject to another DRO within the last 6 years.
- You must not be involved in another formal insolvency procedure at the time you apply.
- You must tell your bank or building society that you have a DRO, they can decide if you can continue to use your accounts. It is a criminal activity to break any of the following DRO restrictions:
- Borrow more than £500 without telling the lender about the DRO
- Act as a Director of a Limited Company
- Create, manage or promote a company without the Court's permission
- Manage a business with telling those you do business with about your DRO
- Work as an Insolvency Practitioner.

You can contact your local citizen's advice bureau (CAB) or the Money Advice Service (MAS) who will be able to help you if you feel a DRO may be suitable for you. They will be able to advise you regarding the online application process and any fees which you will need to pay.

Advantages

- All unsecured debt is written off.
- A DRO is completed after just 12 months.
- It serves to prevent creditor harassment. Any form of creditor harassment is illegal once a DRO has been entered.
- You are not required to make a monthly payment as debtors aren't expected to contribute towards their debts because there is no surplus income available from which payments can be made.
- Simplicity. An Intermediary, rather than the Official Receiver, will deal with the case. This means that if you do have financial difficulties you will have someone to consult and take care of the more complex aspects of a DRO.

Disadvantages

- Bad Credit. A DRO will result in bad credit being registered at all the major credit reference agencies. This will show on your personal credit reports for a period of 6 years. However, if you have been struggling with personal debt problems and financial difficulties it is quite likely that your credit file has already been impaired.
- Existing debt solutions. A DRO is not suitable if you are an un-discharged bankrupt, have a Bankruptcy Restriction Order (BRO) or are already in an Individual Voluntary Arrangement.
- Only covers debts up to £30,000. If you are seeking to write-off debt above £30,000 you will need to look into an alternative debt solution such as going bankrupt, debt management or an IVA.
- Unsuitable for homeowners. Your assets must not exceed £2,000 (if you have a car the values must not exceed £2,000). If you are a homeowner with personal debts of over £30,000 you may wish to consider an alternative debt solution, such as an Individual Voluntary Arrangement or a debt management programme.
- Windfall payments. Should you win or inherit money, it is expected that this will form part of the Debt Relief Order.
- Insolvency Register. A DRO will appear on the publicly available government Insolvency Register. However, very few people will ever access unless they have reason to search for an individual.
- You can apply for a DRO once in any six-year period.
- There is no cost associated with applying for a DRO

More information can be found at <https://www.gov.uk/government/publications/getting-a-debt-relief-order/getting-a-debt-relief-order>

9. Administration Order

If any of your creditors have already issued a judgement against you and your debt does not exceed £5,000 you can apply to the County Court for the court to take over the administration of payments to your creditors. You will be required to make monthly payments to the Court who will distribute payments on your behalf.

Advantages:

- An Administration Order prevents any of your creditors from enforcing the judgement without obtaining permission from the Court. The making of an administration order will ensure that all a person's debts are processed together.
- You will make one monthly payments to Court.
- All debts if below £5000 can be included including council tax arrears and fines.
- These Orders are usually decided by Court Officers without the necessity of a court hearing. Creditors will be given notice of your application setting out what they will receive. A District

Judge's involvement will become necessary if your offer of repayment is insufficient to repay your debts in a reasonable time (usually 3 years)

Disadvantages:

You would be liable to pay the Court Costs in administering the order, usually 10 pence in the pound. If your debts are in joint names a couple cannot apply together and individual applications are required. Social fund loans and benefit overpayments cannot be included in Administrations Orders.

- Once approved the Court will make an Attachment of Earnings Order for the monthly payment into the Administration Order to be deducted from earnings. (if you do not wish for this to happen then you will need to let the Court know).
- If you are not making an offer that will discharge your debt in a reasonable time a District Judge may propose a longer repayment period.
- If a Court hearing is required, you and your creditors will be given notice and the opportunity to attend in order to make representations to the Court.
- Once the terms of the Order have been determined by the Court details of the terms are circulated to your creditors who have 14 days to object to the level of installments as well as whether they want to be included within the Order.
- If creditors object the Court will list your case for a hearing so that the creditors objections can be considered.
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10. Breathing Space

The Debt Respite Scheme (Breathing Space) will give someone in problem debt the right to legal protections from creditor action.

There are 2 types of breathing space: a standard breathing space and a mental health crisis breathing space. A standard breathing space is available to any client with problem debt. It gives legal protections from creditor action for up to 60 days. The protections include pausing most enforcement action and contact from creditors and freezing most interest and charges on their debts.

A mental health crisis breathing space is only available if you are receiving mental health crisis treatment. If an Approved Mental Health Professional (AMHP) certifies you are in mental health crisis treatment, you or someone else might ask for a mental health crisis breathing space on your behalf. The mental health crisis breathing space has some stronger protections than the standard breathing space. It lasts as long as your mental health crisis treatment, plus 30 days (no matter how long the crisis treatment lasts).

- Breathing Space lasts up to 60 days with a review between day 25 and 35
- Needs at least one qualifying debt
- Full co-operation is required from the debtor
- Ongoing liabilities must be paid – this is not a payment holiday
- No additional credit to be obtained above £500
- Priority bills must be paid
- Can only apply for once in a 12-month period
- Details are held with the Insolvency Service – but not Public Record
- Provides protection from creditors from enforcement in most cases.
- Freezes going interest and charges

Breathing space is only a temporary solution. Once the Breathing space period has come to an end (60 days if not before), a suitable alternative solution/updated advice will be provided to you.

If you live in Scotland the following options are also available to you:

SCOTTISH DEBT SOLUTIONS

11. Debt Arrangement Scheme (DAS) – Applicable and available to those living in Scotland.

A Debt Arrangement Scheme (DAS) is a government-run debt management scheme which allows someone in debt to repay/make repayments through a Debt Payment Programme (DPP.) The DPP allows the debtor an extended period of time in which to repay their debts whilst giving them protection from their creditors taking action against them to recover the debt in the DPP. The scheme can last for any reasonable length of time and, if approved, will ensure that all interest and charges frozen on all outstanding accounts and will protect your ownership of any assets.

There are five parties involved in the setup and ongoing management of the DAS:

- The debtor – the person owing the money
- DAS approved money advisor – the person who provides the advice
- Creditor – the company that is owed the debt
- DAS administrator – the individual responsible for the setup and management of the DAS
- Payments distributor – the individual who distributes the clients' payment to their creditors on a monthly basis.

When a debtors DAS is approved there are conditions, specified by law, that they must comply with. The debtor must:

- Make the first payment to a DPP within one month of approval
- Make all payments that are due under the DPP
- Make no further direct payments to any creditor
- Not apply for, or obtain, credit unless approved by a DAS advisor.
- Notify their advisor of any change in circumstances

A DPP may be subject to further conditions set out by a DAS advisor, subject to approval. If any of the conditions are breached it may result in the DAS being revoked.

Once the DPP has been completed all of the debtor's details are removed from the DAS Register and the creditors will be informed that their debt in the DPP have been repaid. If the DPP is being paid directly from the debtors' wages, the DAS Administrator or the money adviser will contact the employer.

If you live in Scotland and are struggling to repay unsecured debts, a Trust Deed, Debt Arrangement Scheme or Sequestration might well be the solution to your debt worries.

12. Trust Deeds

A Trust Deed is essentially an agreement between a debtor and his or her creditors. It's a legally binding agreement and is made with the help of a Licensed Insolvency Practitioner, known as a Trustee. Essentially, a Trustee will put together a repayment proposal for your creditors, based on what your income and your assets would realistically allow you to afford. The repayment period is agreed to run over a set period of time, most commonly four years, at the end of which your debts are considered to have been settled in full. Once the Trust Deed has been 'protected,' your creditors are legally bound to it and can no longer contact you directly. Some debt write-off may be possible. The minimum level of debt required is £5000.

13. Sequestration.

Sequestration is the Scottish legal term for personal bankruptcy. Sequestration can only be granted by authorised persons or defined under regulation 3(1) of the Bankruptcy (Certificate for Sequestration) Scotland Regulations 2010. It is one way of dealing with debts you cannot pay. In order to apply for sequestration there would be an application fee of £200 to pay in order to apply for sequestration. The sequestration proceedings free you from overwhelming debts so you can make a fresh start, subject to some restrictions, for example if you do have a surplus income you would be required to make payments for a specified duration towards your debts.. It also makes sure your assets are shared out fairly among your creditors. To apply for sequestration your total debt must be over £3,000, and you must be either living in or have lived in Scotland during the last year. Also, a creditor must have either agreed to make you bankrupt, or you are an apparent insolvent (this means that you are unable to meet payments as they fall due). Your creditor will usually have taken some form of legal action in the Sheriff Court against you.

14. Minimal Assets Process Sequestration

You would qualify for a Minimal Assets Sequestration if:

1. You have no surplus disposable income, or your income is derived entirely from benefits or part time income supplemented by benefits and
2. You have a minimum debt of £1500 but not exceeding £17,000
3. You own no land or assets exceeding £2000

For a one of payment off £50 once approved you will be discharged from your debts completely within 6 months without having to make any further contribution towards the payment of your debts.