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# Personal Insolvency

## Introduction

It is a fact of life today that many people are facing debt problems. Britain as a nation, owes over £1 trillion. Credit is all too freely available and can quickly spiral out of control. Problems arise when you are unable to meet the monthly payments and creditors will enviably react to protect their exposure through the courts.

Difficulties in repaying debt can arise from a number of different reasons. Income may be reduced because of redundancy, illness, relationship breakdown, bereavement or a career change. It may simply be that you have taken on too much credit. Whatever the reason, the pressure of being in debt can be overwhelming and professional help is needed.

## Formal insolvency procedures

There are currently three formal insolvency procedures available to people with personal debt problems. The law makes no distinction between people with consumer credit debts (credit cards, store cards and bank loans) and those whose debts arise from their trading as a sole trader or in a partnership. The three procedures are:

- Bankruptcy
- Individual Voluntary Arrangement (IVA)
- Debt Relief Order (DRO)

## Bankrupcy

Generally bankruptcy is an option that should be considered if:

- Your debts are overwhelming with no prospect of you being able to pay any substantial part.
- You are not a home owner or if you do own your own home you have no equity in the property.
- You have no other assets.
- Your job will not be affected by bankruptcy.

For lawyers, accountants, police officers, the armed forces and those employed in financial services, bankruptcy could be a threat to your job. It is important to check with your professional body and also check your employment contract.

A court makes a bankruptcy order only after a bankruptcy petition has been presented. The petition is presented by either:

- The debtor themselves
- A creditor owed money (£750 minimum)
- The Supervisor or anyone bound by an IVA

A bankruptcy order can still be made even if you refuse to acknowledge the proceedings or refuse to agree to them. You should therefore co-operate fully once the bankruptcy proceedings have begun. If you dispute the creditor's claim, you should try and reach a settlement before the bankruptcy petition is due to be heard. Trying to do so after the bankruptcy order is made is both difficult and expensive.

Although bankruptcy has a perceived stigma, it can potentially clear 100% of your debts and you can be discharged from bankruptcy within 12 months or possibly less. As a 'final solution' bankruptcy does provide some sense of closure and peace of mind. Once you enter into the protection of a bankruptcy order, creditors can no longer pursue you for your debts as they are no longer your responsibility.

You can usually keep tools, books, vehicles and other items of equipment that you need to use personally in your employment or business. You can also retain clothing, bedding, furniture, household equipment and other basic items you and your family need in the home. This applies provided that the individual value of these items is less than the cost of reasonable replacement. Any other assets would form part of the bankruptcy estate and would be sold to raise cash to pay your creditors.

Once the bankruptcy order has been made, the Official Receiver will give notice of the order in the London Gazette, which is an official publication that contains legal notices. In addition, the Official Receiver has discretion to advertise the order in any other way, if he or she thinks it is appropriate to do so.

Certain debts are not included in the bankruptcy by law and effectively survive the bankruptcy.  These include court fines, maintenance payments, benefit overpayments and student loans.

### Bankruptcy restictions

Until discharge, there are a number of bankruptcy restrictions which apply. The following are criminal offences for an un-discharged bankrupt.

- Obtaining credit of £500 or more either alone or jointly with any another person without disclosing your bankruptcy.
- Carrying on business (directly or indirectly) in a different name from that in which you were made bankrupt, without telling all those with whom you do business the name in which you were made bankrupt;
- Being concerned (directly or indirectly) in promoting, forming or managing a limited company, or acting as a company director, without the court's permission, whether formally appointed as a director or not.
- You may not hold certain public offices.
- You may not hold office as a trustee of a charity or a pension fund.

## Individual Voluntary Arrangement (IVA)

An IVA is a formal agreement to help you repay your debts. It can freeze interest and charges and reduce the amount you have to pay. IVAs are an alternative to bankruptcy because they are a less severe and less restrictive solution to debt problems. Often creditors in an IVA will receive a greater repayment compared with bankruptcy over the term of the IVA. As the IVA as a legally binding agreement between a debtor and his or her creditors, it has a greater chance of success than an informal solution.

The IVA defines how much money you'll repay to your creditors over a fixed term and allows you to avoid the stigma of bankruptcy and its associated penalties and restrictions. IVAs are typically arranged over a five-year period. Interest and charges on your debts will be frozen during this period and any money that you haven't paid back after five years is then written off. This means that with an IVA, you may well pay back less than the total amount you owe. Your monthly payments will be based on what you can afford, so an IVA will make sure that you have enough money to work and pay essential living expenses.

IVAs are arranged for you by a Licensed Insolvency Practitioner who will help you understand the IVA process and manage your IVA.





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An IVA may be right for you if:

- You're struggling to reduce your debts.
- You owe more than £15,000 to two or more creditors.
- These debts are unsecured eg credit card debts or personal loans. You can still get an IVA if you have a mortgage or secured loan, but these will not be included in the IVA.
- You are a resident of England, Wales or Northern Ireland. (If you live in Scotland a Protected Trust Deed is equivalent to an IVA).'

## The benefits and drawbacks of an IVA

Before you decide if an IVA is right for you, consider the pros and cons.

The benefits of an IVA:

- An IVA is less severe and carries less perceived stigma compared to bankruptcy.
- You may be able to keep assets such as your car or house.
- If you have a business you can continue to trade.
- IVAs are usually limited to 5 years. After 5 years the debts included in the IVA will be cleared.
- Your IVA is tailored to you, so you'll only pay back as much as you can reasonably afford.
- An IVA prevents further legal action from your creditors and stops threatening letters and phone calls.

The drawbacks of an IVA:

- Your credit rating will be negatively affected.
- You'll either need a lump sum or regular income (such as a salary) to get started.
- You can still go bankrupt if you don't keep up agreed repayments.
- If your circumstances change and your insolvency practitioner can't get your creditors to agree to new terms, your IVA will fail.
- You may need to re-mortgage your home or take out a secured loan against it in order to release equity to pay your creditors at some point during the life of the IVA.

If an IVA is the right choice for you, the insolvency practitioner will guide you through the application process and help you prepare an IVA proposal document, which has to be approved by your creditors.

A creditors' meeting will be held, where creditors can vote either for or against the arrangement. The IVA will only be approved if creditors holding at least 75% of your debt vote in favour of it. Usually this 'meeting' is just a series of phone calls and you don't have to attend in person. The costs of the IVA, including the insolvency practitioner's fees, are met from your single monthly payment in most cases but you need to check.

Rebuilding your credit rating after being in serious debt always takes time. A record of your IVA will stay in your credit history for several years. Getting an IVA does not mean you will be on a 'credit blacklist' - once your IVA is completed, you will be able to start to rebuild your credit history.

## Debt Relief Order (DRO)

DROs were introduced in April 2009 and are intended to be cheaper than bankruptcy to help people who have few assets, little available income and relatively low levels of debt. The courts are not involved with an application for a DRO; instead an approved intermediary will help you complete and submit your application. This application will the either be approved or rejected by the Insolvency Service, the government office which administers insolvencies.

In order to be eligible for a DRO, you must meet certain basic qualifying conditions which include:

- Less than £15,000 debt. Certain debts are excluded; these include student loans, secured loans, CSA arrears and criminal court fines.
- Less than £50 per calendar month surplus income, this is after your household priority bills have been paid.
- Less than £300 in assets, except a car up to the value of £1,000. Assets will include things like savings, shares, expensive cars, antiques and other goods you own.
- You cannot be a homeowner.

Once you have had your DRO agreed, a hold is put on your accounts, this is known as a moratorium period and in most cases will last for twelve months. During this period you should not make any payments towards qualifying debs and you will be protected against further action. At the end of the Moratorium period, you will be discharged from liability for all the qualifying debts listed in the DRO. A mandatory court fee of £90 must be paid before the Official Receiver will consider the application. You cannot apply for a DRO without the assistance of an Approved Intermediary. You can find a list of these on-line.

## Informal procedures

You can also enter into an informal arrangement with your creditors to deal with a debt problem.

## Debt Management Plan

One informal option is a Debt Management Plan (DMP). A professional debt management advisor will calculate the amount you can afford to pay after giving consideration to your priority debts (mortgage, utilities, council tax etc and day-to-day living expenses). Any money left is then deposited with the debt management company as a single monthly payment and then distributed to your non-priority creditors on your behalf.

Using a reputable debt management company to evaluate and administer your DMP will ensure the plan has a greater likelihood of acceptance and success. It may be possible to freeze interest and charges but this is not guaranteed. A DMP will still be noted on your credit reference file which could affect your ability to gain credit in the future.

DMPs are not currently regulated, although there are proposals for legally regulated plans, due to be implemented in 2010.

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## Debt consolidation

In its simplest form, a debt consolidation loan will pay off your existing debts and transfer the balances owed into one loan with one manageable, monthly repayment. You will still have to pay back all the total debt owed, but with a debt consolidation loan you may be able to reduce your monthly outgoings, pay a lower rate of interest, or be able to spread the costs out over a longer time period. However the key point about a consolidation loan is that it must be used to refinance and reduce existing debts and not as an opportunity to increase your debt.

## Full and final settlement

A full and final settlement is an offer to your creditors of partial repayment in the form of a one-off lump sum payment in return for having the remainder of your debt written-off. A full and final settlement offer is a suitable strategy to clear your debts if you have access to a lump sum of money. This could be from selling non-essential assets, from family or friends, re-mortgaging, equity release or redundancy. Again, a professionally worked-out and presented proposal for a full and final offer often has a higher chance of agreement with creditors.

## Practical Issues

No matter how your debts were incurred, everyone with debt problems face similar practical issues:

- What will happen to my home?
- Will I have to make a monthly payment and how will it be calculated?
- What will happen to my bank account?
- Will bailiffs visit my house?
- What will be the effect on my credit rating?
- Will my employer find out I am insolvent – could I lose my job?
- Can I protect my assets?
- What will be the effect on my business?

These are some of the issues you should be seeking to discuss with your professional advisers before you decide which option is best for you. It is vital that you fully understand the implications of the course of action you are being advised to take.

## Summary

This Fact Sheet has summarised the possible options if you are facing a personal insolvency problem.  It is vital to realise that if you find yourself in this position, doing nothing and simply ignoring the problem is not an option.  Reaching an agreementt with creditors which may avoid bankruptcy or an IVA is far more likely if you are proactive in discussing the matter with the banks, credit card companies and other creditors involved. If a formal insolvency procedure is the most appropriate advice for you then you should not delay.

## How Harrington Kelly can help?

- Prepare a summary of your financial position to work out your options.
- Discuss potential options with you and your creditors
- Identify if an informal solution could be right for you.
- Work with you and our insolvency experts and partners to help you find the appropriate solution.
- Put you in contact with experienced Insolvency Practitioners if advice on a formal insolvency solution is needed.

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