

Dealing with Personal Debt

The SmithAston Brief Guide

Introduction

The law dealing with personal debt and the ways of dealing with it is lengthy and complex. This brief guide can only provide some information regarding the various options available. It should not be relied upon for technical information and in all cases you should seek the advice of an insolvency practitioner or a solicitor who understands insolvency or a Citizens Advice Bureau money adviser before starting any course of action to deal with your creditors. You should be able to obtain free advice from one of these sources. SmithAston always provides free initial advice.

Before we start, creditors are the people to whom you owe money. Debtors are people who owe you money.

What choices are available if you are unable to pay your creditors?

The principal ways of dealing with this are:

1. A Debt Management Plan (“DMP”)
2. An Informal Arrangement
3. Bankruptcy
4. An Individual Voluntary Arrangement (“IVA”)
5. A Debt Relief Order (“DRO”)

The following paragraphs will look at each of the above ways.

What is a Debt Management Plan (“DMP”)?

A Debt Management Plan is where you instruct a firm to agree with your creditors that you will make a certain specified payment to them each month. You need to produce a schedule of your income and expenditure to be able to calculate how much you are able to pay monthly via the DMP. You should make sure that the schedule makes provision for all of your expenditure and that the amount you agree to pay monthly is affordable. The amount of the monthly payment will depend upon your circumstances but will always be less than paying the creditors their normal instalment payments in full otherwise a DMP would not be needed. The Plan is administered by a company on your behalf and the company will charge a fee each month for making the payment.

The principal disadvantages of a DMP are:

1. that it is an informal arrangement with your creditors. This means that at any time any of the creditors can decide that they are no longer happy with the payments that they are

receiving. They can then start or continue with any legal action if they wish or can start any other method of recovery including bankruptcy. It can also be very difficult to get all of your creditors to agree to a DMP. You could then be left with having to try to make normal payments to some of your creditors as well as paying a monthly amount to the other creditors through a DMP.

2. creditors may voluntarily reduce or freeze the charging of interest but there is usually nothing in the plan which means that they have to do so.
3. that, depending on the level of debts, a DMP is unlikely to result in your debts being settled or written off.

A DMP can however provide you with a brief respite if you have temporary problems in paying your debts. The fact that you have entered into a DMP may affect your credit record.

What is an Informal Arrangement?

An informal arrangement is what its name suggests. It can be similar to a Debt Management Plan under which through somebody else you make monthly payments towards your creditors. Alternatively you may deal direct with your creditors in agreeing to make monthly payments to them. If you do it yourself you will obviously not have to pay fees to anyone as you have arranged it yourself. You may find it difficult to get your creditors to all agree to accept reduced monthly payments to them.

As with a Debt Management Plan the creditors can decide at any time not to accept the payments which you are making and may decide that they want to start or continue a legal action or start bankruptcy proceedings.

Also as with a DMP an informal arrangement may not result in your creditors agreeing to stop charging interest or agreeing to write off the balance which you owe to them at any time. The fact that you are paying your creditors through an informal arrangement may be recorded on and affect your credit record.

If they can get their creditors to agree individuals frequently find it difficult to keep an informal arrangement going for a long period of time. One of the main problems can be that such arrangements can result in monthly payments being made for an indefinite period without making any inroads into the amounts due to their creditors.

Bankruptcy

Bankruptcy is a formal insolvency about which there is much misunderstanding and misinformation.

Before dealing with the procedure it is worth dispelling some myths.

Myth 1: Unless you have antiques or the Picasso on the wall, household furniture is excluded in bankruptcy.

Myth 2: As long as you stay within the restrictions imposed by bankruptcy there is nothing to stop you being self-employed or running a business as a bankrupt.

Myth 3: You can have a bank account as a bankrupt although you may not be allowed to have a cheque guarantee card.

Myth 4: If you are living in rented accommodation this should not be affected by the bankruptcy.

Myth 5: If you own or have an interest in a freehold property you will not immediately have to vacate the property and hand over the keys to the official receiver or to a trustee in bankruptcy.

Bankruptcy is sometimes seen as the easy option but this is not really the case. Bankruptcy proceedings can be started by either one of your creditors or by you.

A creditor which is owed more than £750 can petition for your bankruptcy or if you wish to do so you can also petition for your own bankruptcy. In either case it is worthwhile obtaining specialist advice on your position to check whether bankruptcy is the right course of action for you.

Once a petition has been issued a date will be fixed for a hearing of the petition. You will be notified if a creditor has issued a bankruptcy petition and this will also tell you the date of the hearing. If you wish to oppose the making of a bankruptcy order you should either attend the hearing or arrange for a solicitor to represent you at the hearing. If you do not wish to oppose the making of the bankruptcy order and it is a creditors' petition there is no benefit to be gained by attending the hearing.

The bankruptcy starts with the making of a Bankruptcy Order by a county court where the court is satisfied that there is no alternative. Once the Bankruptcy Order has been made the Official Receiver, a "civil servant" appointed by the Secretary of State, becomes responsible for dealing with your bankruptcy. His job is to deal with your assets and your creditors. The creditors will all be told about your bankruptcy and that they should no longer write to you regarding their debts. An advert will also be placed in the local paper and the London Gazette so that creditors can find out about the bankruptcy even if they were not included in any schedules completed by you for the bankruptcy.

If the Official Receiver wishes to do so he can arrange for an insolvency practitioner to act as your trustee in bankruptcy. If a trustee is appointed he will deal with your assets and creditors whilst the official receiver will carry out any enquires which he considers necessary in to your affairs.

You will no longer have control of your assets. You will generally be able to keep tools of trade and a modest value of equipment needed for your employment, trade or business. You will also be able to keep your household furniture as mentioned earlier.

Whether you will be able to keep a car will largely depend upon its value and whether you need one to get to your place of work. If the car is on hire purchase the Official Receiver can require you to return the vehicle to the hire purchase company and to purchase a cheap car if he agrees that you need one.

You will have to provide the Official Receiver or Trustee with details of your income and expenditure. If he considers that you have a surplus left after you have paid all of your expenses he may require you to make monthly payments to him for the benefit of your creditors. If you do not make the payments that he thinks should be made he can get your employer to make deductions from your wages/salary if necessary. He can obtain a court order which requires you

or your employer to make the payments. The monthly payments will have to be made for three years unless your situation changes and you no longer have a surplus after paying all of your expenses..

If you have a house, which you own or which is jointly owned with someone else, the Official Receiver will have the house valued to see if there is any equity in it of which you have a share. If there is equity the Official Receiver/Trustee will want to take steps to realise your share of it for the benefit of your creditors unless the amount of the equity is fairly small. He will invite your spouse or a relative to make an offer for the purchase of your share of the equity. If necessary he has the power to apply to the court to enable him to take possession of the house and to give him the power to sell it. He will only do this if there is no other way for the equity to be realised.

If you inherit any money or receive any money that was not expected at the date of the bankruptcy you must tell the Official Receiver and he will decide whether that money has to be paid to the bankruptcy for the benefit of your creditors. You would commit an offence if you received the money and did not tell the Official Receiver.

While you are a bankrupt you must not obtain credit of more than £500 from anybody telling them that you are an undischarged bankrupt, you can not act a director of or take part in the management of a limited company nor trade using any name which you were not using at the date you went bankrupt.

The normal length of bankruptcy is twelve months assuming that you have not done anything which the Official Receiver believes justifies your activities being restricted for a longer period of time. The period of bankruptcy can also be less than twelve months if the Official Receiver has completed his enquiries and considers that there is nothing untoward in what you have done.

If the Official Receiver considers that you have not behaved properly he can apply to the court for a Bankruptcy Restriction Order (“BRO”) or ask you consent to one. The effect of a Bankruptcy Restriction Order is that after discharge from bankruptcy you would be subject to the same restrictions as you would have been if the bankruptcy had continued. The length of the BRO can be anything from 2 to 15 years.

There are certain debts which are not written off and which cannot be dealt with in bankruptcy. These are principally student loans, maintenance and fines. Those debts survive bankruptcy.

Your credit rating is adversely affected for six years as a consequence of bankruptcy.

Individual Voluntary Arrangement (“IVA”)

This is a formal insolvency process in which creditors can be legally bound into an agreement under which they accept an offer to pay them less than 100% of the amounts owed to them.

A licensed insolvency practitioner is required in order to be able to propose an IVA. The insolvency practitioner will usually be a qualified accountant or a solicitor.

The offer to the creditors is set out in the proposal which is the formal legal document which provides details of your assets and liabilities. It also provides details of your income and expenditure.

There is no set format for the offer which is proposed to creditors. This can consist of contributions from your income, the sale or remortgage of the matrimonial home in order to release the equity for your creditors, and/or the introduction of money from third party (such as a relative).

When the proposal has been signed by you and confirmed as being true to the best of your knowledge and belief by means of a sworn affidavit, an application can be lodged in the county court for an interim order. The interim order prevents any creditor taking or continuing any legal action against you while the order is in force.

The insolvency practitioner has to report to the court whether he considers that a creditors' meeting should be held. If he thinks that there should be a creditors' meeting. Following an extension of the interim order papers are sent to creditors including the proposal and a schedule which compares what the creditors would get paid in an IVA with what they would get paid in bankruptcy. An IVA will have no chance of being approved unless the amount paid to creditors is more than they would get in bankruptcy.

The creditors' meeting is usually held in the office of the insolvency practitioner unless it is likely that a number of creditors will attend or will be represented at the creditors' meeting. In the majority of cases creditors do not attend creditors' meetings. They can vote by post or by fax using a proxy form which says how they want to vote at the creditors' meeting.

Creditors can vote in favour of the proposal or vote against the proposal. Alternatively they can vote in favour of the proposal with modifications which the creditor puts forward. For the IVA to be approved 75% or more of the value of the creditors voting on the day have to vote in favour. If the required majority in favour is obtained all of the creditors are legally bound by the IVA even if they did not exercise their right to vote.

If the IVA is rejected creditors are advised of this and your position goes back to how it was before the IVA procedures were started.

If the IVA is approved you need to make sure that you do what the IVA says. Subject to what the IVA says there is no reason why any business operated by you cannot continue whether this is as a sole trader or through a limited company. It is also usually possible to retain a vehicle in an IVA unless it is worth so much that it would be unreasonable to keep it. If, for example, there was a Rolls Royce with personalised number plates which was worth in excess of £50,000 the creditors would not regard that as a reasonable vehicle if the business was as a self-employed electrician.

Where the proposal says that monthly payments will be paid into the IVA from surplus income then these must be paid regularly or there is a risk that the IVA will fail.

A house will have to be valued for the purposes of the IVA when putting together the proposal and this will show the equity in the property. It must also be set out as to what is to happen to the value of the equity. If it is fairly small it may be possible to exclude the property from the IVA altogether. This is a complex area of law and you should discuss the position with the insolvency practitioner before the proposal is drafted.

An IVA is not advertised, unlike bankruptcy, and only your creditors will be sent papers relating to the IVA.

If the IVA has been approved and its requirements complied with, your creditors accept the amount(s) paid to them from the IVA in full and final settlement of the amounts due to them.

Debt Relief Order (“DRO”)

A Debt Relief Order is a recently introduced procedure to help debtors who have amounts due to their creditors of less than £15,000 in total. To be able to enter into one you must not own your own home and must have surplus monthly disposable income of no more than £50 per month. A Debt Relief Order can be arranged through an authorized intermediary. The one which most people will want to use is the Citizens Advice Bureau. A DRO if obtained will last for twelve months and the debt are written off in total with no contributions being required from your income.

Conclusion

The area of insolvency law is complex. No particular solution works for everybody. It is therefore very important that you do seek advice before starting to do anything. It should be possible to obtain free advice on your circumstances which can give you an independent view of your situation. This brief guide has been prepared by SmithAston to briefly outline the various routes open to people suffering from debt pressures. SmithAston always provide free initial advice and can be contacted on 01603 283630.