Options for dealing with your debts

Fact sheet no. 35 October 2014

10 ways to clear your debts

In this fact sheet we look at 10 ways it may be possible to clear your debts.

Table One lists each of the options and tells you:

- how big or small your debts would have to be to use each of these methods;
- what type of debt could be repaid using each option; and
- how long you could expect to wait before you would be debt free.

Table Two:

- goes into more detail about each method;
- explains how it works; and
- what the advantages and disadvantages may be.

Table One

Type of arrangement	How much must I owe?	What type of debt?	How long will it last?
Informally negotiated arrangement with creditors	No minimum or maximum level of debt.	Credit debts only.	There is no time limit. You may be paying for many years.
Free debt-management plan (DMP)	Usually over £5,000	Credit debts only.	There is no time limit. You may be paying for many years.
Individual voluntary arrangement (IVA)	None, but due to costs better if you owe over £15,000.	Most debts except: secured debts, rent, student loans, court fines, maintenance and child support.	No time limit, but usually five years.

Bankruptcy	A creditor can only issue a bankruptcy petition if you owe £750 or more. You can make yourself bankrupt however much you owe.	Most debts except: student loans, court fines, maintenance, child support, budgeting loans and crisis loans.	Most people are discharged from all their debts after one year (but there are exceptions to this). If you have spare income you may have to make payments for three years.
Debt relief order (DRO)	Under £15,000.	Most debts except: student loans, court fines, maintenance, child support, budgeting loans and crisis loans.	You will be discharged from your debts after one year.
Administration order	£5,000 or below.	Credit debts and some priority debts.	You can ask for a 'composition order', which means the debts may be written off after a shorter time such as two or three years. Otherwise, there is no time limit. You may be paying for many years.
Consolidation loan	No minimum or maximum level of debt. It will depend upon what the lender is prepared to lend.	Any debts your lender allows you to include.	The length of time it takes you to repay the loan.
Offers in full and final settlement	No minimum or maximum level of debt.	Usually credit debts.	A short time, unless payment is in instalments.
Write off the debt	No minimum or maximum level of debt.	Usually credit debts.	Debts would be cleared.
Charitable payments towards debts	No minimum or maximum level of debt.	Depends on the charity, but usually priority debts.	Debts would be cleared or reduced.

Table Two

Informally negotiated arrangement with creditors

How it works

Normally, you work out your offers of payment based on a pro-rata distribution of your available income, after you have worked out what you have to pay on any priority debts and your essential household outgoings. This means that all your creditors are offered a fair share of what you can afford to pay. You also need to ask that any interest and charges are frozen.

Creditors have to treat you fairly if you are in financial difficulties. They should consider your offer of payment and consider freezing interest and charges if you ask them.

You may need to offer no payments if you have no available income. This is called a 'moratorium'. You may prefer to make token offers of payment of £1 a month to each creditor. Creditors are only likely to accept this for a short time.

Advantages

- Fair and transparent method of distributing payments.
- Recognised by courts and widely accepted by creditors.
- You can alter payments if circumstances change.
- You do not need an advice agency to negotiate these payments for you. Our budget tool **Your budget** shows you how to draw up your own personal budget and make offers to creditors. You can use **sample letters** when negotiating with your creditors. Alternatively, you could speak to one of our advisers about the **CASHflow** service. This is similar to using 'Dealing with your debts', but a money adviser will check your budget sheet for you before you send it to the creditors. You could also use **My Money Steps**, The Money Advice Trust's interactive debt advice tool. All these options involve you taking charge of dealing with your debts.
- Through an advice agency you can use the Money Advice Trust's Common Financial Statement.

Disadvantages

- Creditors may refuse your offers (although it is always worthwhile asking them to reconsider).
- Creditors may refuse to freeze interest and the debt will grow. (Again, it is worthwhile asking them to reconsider).
- You will have to pay your debts off in full. This may take a long time.
- Creditors may refuse offers unless made through an advice agency. (You can complain to the **Financial Ombudsman Service** if this happens.)
- Creditors may take court action. This is a particular risk if you have larger debts and own your own home, as it may be possible for the creditor to get a charging order on your home.
- You are responsible for administering all the payments yourself and keeping your creditors up to date with your circumstances.
- Many creditors will often accept reduced offers for a limited period only and may ask for regular reviews.
- Your credit rating will be affected.

Free debt-management plan (DMP)

How it works

You will usually need to have £50 or more available income every month to pay your creditors after you have worked out what you have to pay on any priority debts and your essential outgoings.

You must have two or more creditors.

You make the agreed monthly payment to a debt-management company which distributes the payments among your creditors for you.

Make sure you use a debt-management company that does not charge you any fees for their services. **Contact us for advice.**

Advantages	Disadvantages
• This is a fair and transparent method of distributing payments. • The debt-management company will help you work out how much you can afford to pay using the Money Advice Trust's Common Financial Statement. • The debt-management company will negotiate with creditors on your behalf. This means that offers are more likely to be accepted and interest frozen. • You can increase your payments if your circumstances improve. • You may be able to reduce your payments if your circumstances get worse. • The debt-management company administers all payments to your creditors. You just make one monthly payment to the debt-management company. They should pass your payments on within five working days. • The debt-management company should review your plan with you every year and give your creditors regular updates.	• You may not be able to make reduced offers if your circumstances get worse and you cannot afford the minimum £50 a month. • You will have to pay your debts back in full. This could take a long time. • The debt-management company cannot force creditors to accept offers, or freeze interest, so a DMP cannot guarantee that all creditors will take part. • Creditors may still take court action against you. • This will affect your credit rating. • It is very important to make sure you use a free debt-management company. It is not always easy to tell if the service is free when you look at their website. **Contact us for advice.** SEE **Debt-management plans (DMPs) fact sheet**

Individual voluntary arrangement (IVA)

How it works

An individual voluntary arrangement (IVA) is an alternative to bankruptcy. It is a formal arrangement to pay an agreed amount off your debts over a shorter period, such as five years, or through raising a lump sum. The rest of the money you owe is written off.

You will need an insolvency practitioner to set up an IVA. They will charge fees for preparing and running your IVA. The arrangement has to be agreed by the majority of your creditors (75% by value of those who vote).

National Debtline can help you to set up an IVA by referring you to an insolvency practitioner from a list of providers who follow good practice guidelines under the IVA Protocol. **Contact us for advice.**

Advantages

- Usually fewer issues compared to bankruptcy.
- There is less publicity than with bankruptcy.
- You are not bound by bankruptcy restrictions.
- You can continue to be a director of a limited company.
- You can include most types of debt in an IVA (see **Table One**).
- Can exclude assets such as the home if your creditors agree.
- Creditors will be bound by the IVA even if they voted against it; if the required majority vote in favour.
- Usually lasts a maximum of five years.
- Most insolvency practitioners will allow fees to be paid on a monthly basis as part of the IVA. Check this before you agree to your arrangement.
- Some insolvency practitioners follow the IVA Protocol, which provides guidelines for how an IVA should be drawn up and how the insolvency practitioner should behave.
- Creditors will not be able to claim further interest from the date that the IVA is signed.

SEE **Individual voluntary arrangements (IVAs) fact sheet**

Disadvantages

- This will affect your credit rating. Your IVA will be held on the public Individual Insolvency Register.
- You usually need to have high available income, or a lump sum, or asset available to make an IVA possible.
- Costs are high (typically £4,000 plus) and the insolvency practitioner may require payment of fees up-front.
- Some IVAs fail because the payments agreed are too high in the first place. Be very careful that you can afford the payments before you start.
- If your circumstances change, the IVA may be extended if the creditors accept new terms. If the insolvency practitioner cannot get creditors to accept new terms, unless the supervisor releases you from the IVA, you may not be able to consider other options and you could be made bankrupt. See the next section **Bankruptcy** for more information.
- Your IVA may have a built-in requirement to revalue your home and release equity to pay the creditors after a set number of years of payments (usually five).
- There is a growth in companies offering to set up IVAs, even if it isn't suitable in the circumstances. The companies often charge high fees.
- You can still be made bankrupt if the IVA fails.

Bankruptcy

How it works
You can petition for your own bankruptcy or a creditor can make you bankrupt. Your financial affairs will be dealt with by the official receiver.

Valuable assets are usually sold to raise money to pay your creditors. Your bankruptcy usually lasts one year, but you may have to make payments for three years.

At the end of your bankruptcy most debts are written off. Bankruptcy may be a good option, particularly where you rent your home and have no assets.

Advantages	Disadvantages
• It relieves stress and anxiety. • It allows you to make a fresh start after a year. • Your debts are written off if you have no assets. • Most creditors cannot take further action against you unless the debts are secured on your home. There are some exceptions to this. • You may need to make monthly payments for a maximum of three years. • You may be able to avoid selling your home if your partner or a relative can buy out your share of its value. SEE **Bankruptcy fact sheet**	• Bankruptcy will affect your credit rating. • If you have equity you could lose your home. • Secured creditors can still take action against you. • You have to find a fee and deposit totalling £705. • Your assets may be sold by the official receiver. • Not all your debts are written off (see **Table One** for details of main debts not written off). • Your employment may be affected. Check your contract. • If you run your own business, you may find it difficult to continue to trade. • Details of your bankruptcy will be held in the public Individual Insolvency Register and published in the London Gazette. • You may have a 'bankruptcy restrictions order' made against you for dishonesty or 'unfit conduct'. • In some cases the official receiver can take criminal action against you: for example, if you have committed fraud.

Debt relief order (DRO)

How it works

You can apply to the official receiver for a debt relief order on a special on-line application form with the help of a money adviser who has been appointed as an approved intermediary.

You will be eligible if: you are unable to pay your debts; you have less than £50 a month spare income after you have paid your normal household bills; your debts are under £15,000; your assets are worth less than £300; and, if you own a car, this is worth below £1,000.

If your application is successful, most of your debts will be written off after 12 months. A DRO could be a good option if you rent your home, have few assets and little spare income.

Advantages

- It relieves stress and anxiety.
- There is no court hearing.
- It allows you to make a fresh start after a year.
- Your debts are written off if they were included in the DRO.
- Most debts can be included in the DRO, including priority debts such as energy debt and council tax.
- Creditors included in the DRO cannot take further action without the court's permission, once you have a DRO.
- You have to find a fee of £90, but you can pay this in instalments and this is much cheaper than **bankruptcy**.
- You do not have to make monthly payments on your debts while you have a DRO.

SEE Debt relief orders (DROs) fact sheet

Disadvantages

- You cannot apply if you own your home as this would be counted as an asset, or if you have had a DRO in the last six years.
- Not all debts are written off. For example, you cannot include: magistrates' court fines, student loans, maintenance, CSA payments, budgeting loans and crisis loans.
- If you forget about a debt, you cannot add it in later.
- Details of your DRO will be kept in the Individual Insolvency Register.
- A DRO will affect your credit rating.
- You may have a 'debt relief restrictions order' made against you for dishonesty or 'unfit conduct'.
- In some cases the official receiver can take criminal action against you: for example, if you have supplied false information.

Administration order (AO)

How it works

You must have a county court or High Court judgment. Your debts must be no more than £5,000. You must have at least two debts.

An application is made to your local County Court on a **form N92**.

An administration order (AO) is a county court order which allows you to make a single payment every month to the court. This is divided among your creditors on a pro-rata basis by the court.

Advantages

- None of the creditors listed on the AO application can take further action against you without the court's permission.
- The court deals with your creditors and makes the payments for you.
- Interest and other charges are stopped.
- There is no up-front fee, although the court takes 10p from every £1 paid in.
- You can apply to make payments for a time-limited period such as three years using a 'composition order'.
- You can increase payments where your circumstances improve.
- You can apply to the court to make reduced payments if your circumstances get worse.

Disadvantages

- You must have total debts below the £5,000 limit.
- Creditors can make objections to the court and ask to be left out of the order (although the court may not agree with this).
- Your credit rating will be affected.
- If you do not maintain your payments, the AO can be revoked and the creditors can pursue you again.

SEE **Administration orders fact sheet**

Consolidation loan

How it works

Apply to a lender for a loan to clear debts. These are often advertised as ‘consolidation loans’. The lender may want to secure the new loan on your house if you own property.

It is very important that you shop around for the best deal from high street and internet lenders. If you have a poor credit rating, it is possible that a good deal may not be available to you.

Advantages	Disadvantages
• This won’t affect your credit rating unless you fall behind on payments. • You will be making one monthly payment on one loan, rather than many payments to different creditors. • Your new monthly payment should be lower, but you must check that you can afford the new payments.	• If you have a poor credit rating you may not be able to take out a consolidation loan, or you may be offered one on worse terms and conditions, for example at a higher interest rate. • If the loan is secured on your house, then it could be repossessed if you do not keep up with the payments. • Interest rates often change over the loan period, making it impossible to work out what the total cost of the loan will be. Check if the interest is ‘fixed’ or ‘variable’. • Loans are often offered over a longer time than your original loans. This means that, even if the interest appears reasonable, the length of time you have to repay can increase the overall cost of the loan significantly. This means that in the end you pay more. • If you don’t clear all your existing borrowing, then you may struggle to make the payments. • If you keep your credit cards it may be tempting to use them again. • If you did not use **Your budget** to make a full budget, listing your income and outgoings, you may not have worked out if you can realistically afford the new payments.

Offers in full and final settlement

How it works
If you have a lump sum available that will pay off part of your debts, you can ask your creditors to accept a part payment and write the rest off.

Alternatively, you may get creditors to agree to you making monthly payments for a set period and then writing the balance off.

Advantages	Disadvantages
• You clear your debts in full but only pay part of the debt back. • It relieves stress and anxiety. • It allows you to make a fresh start. • This gives you a goal and means you are more likely to make the payments. SEE **Full and final settlement offers fact sheet**	• You lose your lump sum or asset which you could have used elsewhere. • It is vital to get agreement in writing from your creditors before paying the lump sum to them. • You may need to ask for help from relatives or friends. • The debts will still show up on your credit file and affect your ability to get credit in the future, but your file will be marked to show you have made a 'partial settlement'. • A creditor could refuse your offer and try to recover the whole debt by taking court action.

Write off the debt

How it works

It may be possible to ask your creditors to write off the debts if you have no available income to make any payments and have no savings or assets.

You need to convince the creditors that your circumstances are unlikely to improve in the future.

Your circumstances may need to be exceptional; for example, you have a severe illness.

You need to convince your creditors that it is not worthwhile trying to collect the debt.

We have **sample letters** that you can use to ask your creditors to write off your debts.

Advantages	Disadvantages
• It relieves stress and anxiety where you are in an exceptionally difficult situation. • It allows you to make a fresh start. • Your creditors accept that it is not appropriate to take any further action because of your situation.	• Creditors do not normally agree to write off the debt. • It will still show up on your credit file and affect your ability to get credit in the future. • Some creditors choose not to pursue the debt but do not put this in writing. • There is no guarantee they won't chase you for the debt in the future. • Some creditors may refuse whilst others agree.

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Charitable payments towards debts

How it works
Apply for help from a suitable **charity** or **trust fund**.

Advantages	Disadvantages
• It relieves stress and anxiety where you are in an exceptionally difficult situation. • A charitable payment may pay off a particularly urgent or pressing debt.	• Most charities are unlikely to be able to help with large credit debts. • You must fit the charity rules to apply in the first place, so it may be hard to find a suitable charity. • Charities are only likely to help with an emergency or priority debt, not the whole problem (assuming you have more than one debt). • You will normally have to fill in a detailed application form or find an advice agency to apply for you.