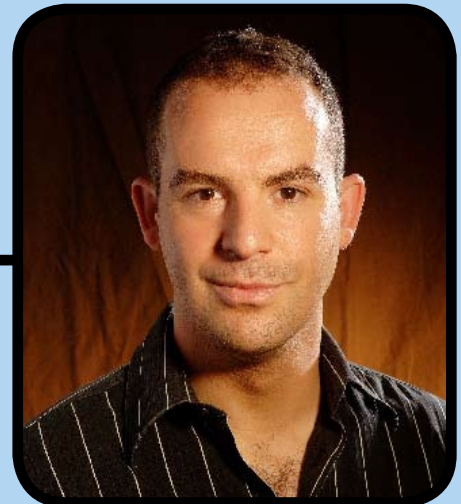


Guide to IVAs

Are they worth it?



Introduction by Martin Lewis, Money Saving Expert

My phone rang. It was a former colleague. She said “just a quick question, I’ve seen these TV ads for IVAs where you can use a loophole to wipe out your debts. There’s no problem is there?”

As she was considering an IVA, I assumed she was in major debt crisis so I asked her how big her debts were. She said, “about £6,000”. At what rate? “Mostly on 0% cards as you usually suggest.”

I was gobsmacked as she earns £40,000 a year plus, so what on earth was she calling me for? The answer’s simple: the adverts say you can write off 75% of your debts with a legal loophole; she’d seen this and thought it was a good idea. What a nightmare! Let me make this plain before we start, in big letters.

“IVAs are not an easy get out of debt. They are an alternative to bankruptcy and should only ever be considered in that light!”

The problem is the IVA industry is incredibly profitable. Take out an IVA and companies often make more than £5,000 from it. It’s no wonder they advertise this as an uber-solution with no catches; they make truck loads of cash from selling it to you.

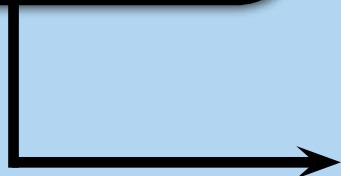
So this is a guide to set the record straight, to show you how IVAs work, who they’re for, and how to get one if you need to. IVAs can be a more than welcome release for some people in the right circumstances, but only those who are in severe debt crisis looking at bankruptcy as the main alternative.

Martin

The Guide to IVAs by Martin Lewis & Jennifer Bailey

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1

IVAs in a nutshell

IVA stands for 'Individual Voluntary Arrangement': a legally binding contract between you and the bank or credit card company. Under an IVA, your debts are frozen and you make a formal proposal to settle your debt within a set period, usually five years. This usually means paying at least £200 a month. After this the rest of the debt is written off.

The main advantage of IVAs over bankruptcy is you're more likely to keep your house and other assets, such as your car. Plus, after the IVA has ended, the restrictions are less severe than they are for someone who has been bankrupt – though they're still tough.

Don't be taken in by the aggressive ads on TV and in the red top newspapers; an IVA is a serious measure, designed for those with limited alternatives. There's been an explosion in the number of IVA firms, making serious cash from the fees they charge. The Office of Fair Trading has been clamping down on them and has ordered several firms to change misleading IVA adverts.

IVAs aren't for everyone. Leading debt help charity the Consumer Credit Counselling Service recommended IVAs to only 3% of people with serious debt problems in 2006. There's a real danger that taking out an IVA unnecessarily will leave you facing the prospect of bankruptcy anyway, despite having laid out £1000s in set-up fees.

This guide will explain in detail how an IVA works, and help you work out if you should or shouldn't think about getting one.

Where can I get help?

If you are struggling to make even the minimum repayments on your debts and think an IVA might be an option you must get personal advice before signing up. Yet equally important is who this advice comes from; you need non-profit debt counselling help, in other words a one-on-one session with someone who is paid to help you, not make money out of you. This is different to 'free': many commercial companies say they're free as you're not charged directly, but you'll still pay somehow.

The three major places are: The Consumer Credit Counselling Service www.cccs.co.uk Telephone: 0800 138 1111, National Debtline www.nationaldebtline.co.uk Telephone: 0808 808 4000, and your local Citizens Advice Bureau www.citizensadvice.org.uk

These counsellors use a variety of techniques; among other methods you may be put on a debt management plan, where they negotiate with your creditors. You may also be recommended an IVA or bankruptcy. They will show you how to prioritise the most important debts to enable you to keep food on your table and the roof over your head.

How Does It Work?

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Who can take out an IVA?

IVAs were introduced in 1986 and were originally designed to offer small businesses with financial problems an alternative to bankruptcy.

Yet nowadays an IVA can be taken out by anyone who lives in England, Wales or Northern Ireland, with unsecured debts of (usually) at least £20,000. IVAs aren't available in Scotland, where the nearest equivalent is something called a Protected Trust Deed. There's more information about these on the Scottish Executive website www.scotland.gov.uk/Topics/Justice/Civil/17868/10393.

To get an IVA you need a stable income and will usually have assets, like a house or car. Not all debts can be brought into an IVA. The main ones that can are overdrafts, personal loans, credit and store cards, catalogue debts and student loans. You can also include tax or VAT owed to HM Revenue and Customs, though it may be given priority.

However, mortgages and other loans secured on your property can't be part of an IVA. Neither can rent and council tax arrears, magistrates court fines, speeding or parking tickets and maintenance or Child Support Agency arrears. These normally have to be paid, so separate arrangements will need to be made for these.

How can I set one up?

An IVA is a legally binding agreement so you can't set one up on your own. You'll need the help of an Insolvency Practitioner (IP), usually an authorised accountant or solicitor, who'll look at your situation and do a deal with the creditors for you. After the IVA's up and running, it's their job to supervise it.

First the IP will look at your assets and income and work out how much you can afford to pay as a lump sum and/or in monthly payments. Be completely honest about your circumstances. They'll then put together a proposal to show to your creditors; you'll be asked to sign this and confirm it's the best offer you can make. The IP will also explain your other options such as bankruptcy, to make sure that an IVA is the best route for you.

If you decide to go ahead, your IP will apply to the county court for an 'Interim Order'. This stops your creditors from starting bankruptcy proceedings or taking any other action against you without the court's permission.



Since 2003 it's been possible to make an IVA proposal without applying for an Interim Order first. This can reduce costs but means creditors can still take enforcement action against you until the IVA is agreed.

Whether or not your IP has asked for an interim order, the next step is to send the proposal to your creditors who are asked to vote on it at a creditors' meeting. If 75% of your creditors 'by value' vote for the IVA to go ahead, it becomes binding on all creditors, even those who did not agree to it.

'By value' means the creditors to whom you owe 75% of your total debt, not 75% of the creditors by number. Hence if the company which is owed the most money votes against the proposal, the IVA will often fail.

If they do agree, interest is frozen for the duration of the arrangement and creditors are not allowed to contact you about the debts. A standard IVA lasts for five years or 60 months. As long as you make all 60 monthly payments, at the end of the period the rest of the debt is cancelled.



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How much do I have to pay back?

Many adverts for IVAs tout them as “get out of jail free” cards, promising that you’ll be able to wipe out a large proportion of the money owed. The Office of Fair Trading has criticised adverts which falsely claim that ‘up to 90%’ of your debt may be written off, when a more realistic amount is closer to 60%.

The fact is that creditors will only agree to an IVA if they’re convinced that they’ll get back more money this way than by making you bankrupt, so it is important to understand that an IVA’s likely to mean having to stick to a strict budget for five years. For more tips on managing your money go to www.moneysavingexpert.com/budgetplanner.

Under most IVA’s, you pay back 30p per pound owed, although some banks have recently started refusing deals which offer less than 40p to 50p per pound. As a rule of thumb, you should expect to pay at least £200 a month.

Therefore, a bank’s ideal IVA candidate is someone with a stable income, with enough spare cash after ‘essential’ spending to be able to afford this amount.

Yet most banks take a pretty hard line on what counts as ‘essential’. Holidays, clothes, gifts and gym membership are usually regarded as luxuries, so won’t count towards your budget.

What about my car and house or other assets?

Unlike with bankruptcy, as long as you have enough income to make the monthly payments, you should be able to protect your house and other assets.

Yet while you won’t have to sell your home, you may have to give up a big proportion of your ‘equity’, the share of it you own. Creditors can ask you to remortgage and release up to 75% of your share. If you have no equity or are in ‘negative equity’ (that is, you owe more than the property is worth) at the start of the IVA, your creditors may demand that the home is re-valued in the fourth year. After that, you may have to give up a proportion of the equity you then have.

If you have an endowment policy linked to your mortgage you’re likely to be asked to cash it in and add the proceeds to the arrangement. Plus if you have any savings you’ll probably have to hand these over as well.



If you've a car but can show that you need it for work, you are unlikely to have to sell it. Yet if you're in the middle of paying the car off under a hire purchase deal, you can't include this debt in the IVA, as the finance company could just repossess the car. Normally you'll be allowed to keep making monthly payments towards the car (assuming you can afford them), yet when the finance deal ends you'll need to pay the extra money into the IVA instead.

And although an IVA has no impact on your state pension, if you've a private pension it might be affected. In some cases creditors may ask you to stop making contributions over the period, and add the amount to your monthly IVA payment instead. Not all pension schemes will allow you to freeze your payments for five years but if yours does allow it you may have to.

A Martin's Money Moment

If you're in debt you're not alone. MoneySavingExpert.com has a special community of people in various levels of debt (from bankrupts to limited credit card overspending) all working together and supporting each other to get debt free.

The Debt-Free Wannabe board, which is part of the site's forum, has supported hundreds of people through similar situations. The first step is to post your S.O.A (Statement of Affairs) to let others who are also in debt and have been through the same issues, pick through your finances.

I've never yet seen a debt case that isn't solvable; it might not be quick and easy, but there's always a route.



What will an IVA cost?

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IVAs tend to cost less than bankruptcy proceedings.

Your Insolvency Practitioner will charge two fees: a 'Nominee Fee' for preparing and proposing your IVA, and a 'Supervisor Fee' to run it. The nominee fee is usually around £2,500 with an annual supervisor fee of about £1,000 per year that the IVA lasts. In total, therefore, an IVA typically costs around £7,500 – hence why IVA providers try to flog them like crazy and why they're not for people with small debts.

The charges work differently at different companies, yet usually you won't have to pay the fees yourself - instead they're deducted from your monthly payments. This can mean that almost all of the first few years' payments into the IVA are swallowed up by the IP's fees and do not actually go towards paying off any of your debts.

Make sure you understand what and how your IP will charge you for the IVA. Some IPs and debt management firms will offer a free consultation to discuss your circumstances. Take advantage of this if you can. Yet beware that some debt management firms will charge you for this whether or not your application for an IVA is successful.

A Martin's Money Moment

A quick rant about fees

It's worth focusing again on how much IVA companies make. This often means they have a vested interest in trying to set one up, which means the advice you get could be skewed towards getting an IVA again. It's for this reason I revert back to what I said earlier.

If you are thinking about getting an IVA... getting independent advice from a non-profit debt counselling agency is a must. Far too many people go straight to IVA companies, which purport to offer "free debt counselling" and guess what they end up suggesting? An IVA. Big surprise eh?



What if my financial circumstances change during the IVA?

You must tell your supervising Insolvency Practitioner about any changes to your financial situation during the IVA period. They will also reassess your income and expenditure at least every year to make sure that the monthly payments are still the most you can afford to contribute. If your income increases, your supervisor can ask for some of the extra money to be added to your monthly payments.

Sadly, your IVA is likely to have a clause which says any windfalls, such as lottery wins, bonuses, gifts or inheritances, also have to be declared to your supervisor and paid into the IVA. This will happen even if you inherit an amount of cash greater than the amount you're due to pay back. If it meant you could then afford to clear *all* your debts you'll have to do so.

If your financial situation gets worse during the IVA - perhaps because you fall ill or lose your job - you must advise your IP asap. The whole point of an IVA is that you commit to making payments for 60 months - failing to make even one could ruin the agreement.

In an emergency it's possible you might be allowed to miss up to two payments, yet only with permission from your supervisor and your creditors. If you miss payments without their say-so, then you'll be considered 'in default' and could then be made bankrupt, meaning having to sell your home.

If the change in situation is permanent, then in some cases your IP can work out what you can now afford and, if necessary, ask your creditors for a lower payment. There's no guarantee they'll say yes.

Thus it is absolutely crucial that the payment amount agreed when the IVA is set up is realistic. If you don't think you'll be able to keep up payments for the whole period then an IVA's not the right option for you.

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How would an IVA affect my credit file?

There are fewer restrictions with an IVA than there are with a bankruptcy but it's wrong to suggest, as some adverts do, that there aren't any consequences. Details of your IVA will appear on your credit file for six years (i.e. a year beyond the scheduled end of your IVA) and might have an impact for longer, after all not many people want to give credit to someone who's a track record of not paying back all their borrowing.

During the IVA you can't use any existing credit and store cards and you're not allowed to borrow any more cash. You may be able to remortgage, yet are likely to face higher interest rates and be allowed to borrow less money, as the companies you borrow from will credit score you and the IVA will hit that hard.

Yet it's probably a bad idea to try to get a mortgage to buy your first home whilst under IVA; if it fails and you're made bankrupt you risk losing the house. And in any case being able to protect your house is the main advantage of an IVA, so if you're not already a homeowner it's probably the wrong option for you.

You can have a bank account while you have an IVA but in most cases you will only be able to have a basic bank account without an overdraft or cheque book. Some basic bank accounts will also let you have a debit card.

If your current bank's one of the creditors you want to include in your IVA, it's worth opening another account with a different bank before setting it up. Otherwise your existing bank can use something called the "right of offset" to grab money from your account without your permission to help repay the debt.

It's possible that once you are in an IVA your bank may downgrade your account to a basic bank account or even close it altogether, in which case it would make sense to have another account ready. You don't have to tell your new bank that you have an IVA, yet make sure your new bank is not linked to your existing bank or they might still use the right of offset. For instance, Nat West and Royal Bank of Scotland are part of the same group, as are Halifax and Bank of Scotland, and HSBC and First Direct.

At the end of the period, you must make sure that the UK's three credit reference agencies Experian www.experian.co.uk, Equifax www.equifax.co.uk and CallCredit www.callcredit.co.uk are notified that your IVA is now 'complete'. The easiest way to notify them is to send each a copy of the letter from your IP.

In addition, all IVAs and bankruptcies are listed on a publicly available court register www.insolvency.gov.uk/bankruptcy/bankruptcysearch.htm which holds your name, address and details of the arrangement. For IVAs taken out since 1 April 2005 it also includes your date of birth and occupation.

Checklist: Advantages and disadvantages of IVAs over bankruptcy

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Checklist: Advantages

The amount you pay is based on what you can realistically afford.



You won't normally have to sell your house.

Once your IVA has been agreed, all your creditors are bound by the terms. As long as you make the payments as agreed, your debts are frozen, you are protected from any further court action by your creditors and they can't contact you about your debts.

At the end of the IVA the rest of your debts will be written off and you'll owe nothing.

In most cases your job won't be affected. Becoming bankrupt excludes you from many professions including accountancy and being a solicitor. It also means you cannot join the police and the armed forces or become a company director or a local councillor.

Although an IVA will appear on your credit file for six years, there are fewer restrictions in terms of access to financial products and credit than with bankruptcy.

Checklist: Disadvantages

In most cases you are locked into making monthly payments for five years.

Although you should be able to keep your house, you may have to release a significant share of your equity –either at the start or towards the end of the IVA.

You will be expected to give up any endowment linked to your mortgage and hand over savings.

If you do not keep to the terms of the IVA your creditors can make you bankrupt and you'll lose everything anyway and will have paid £1,000s to do so.

If your income improves during the period of the IVA your monthly payments will normally increase to reflect the extra amount, and you must declare and contribute any windfalls, inheritances or bonuses you receive.

You cannot take out any more unsecured credit while the IVA is in force.

IVAs are recorded on a publicly available register.



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How to choose an IVA provider

Remember the best thing to do is see a non-profit debt counselling agency first, to see if an IVA really is for you. Because an IVA's a legally binding agreement it must be set up by an Insolvency Practitioner (IP). Most IPs are accountants or lawyers, but whatever their background they must be licensed by one of the chartered accountancy bodies; the Law Society, the Insolvency Practitioners Association or the Department of Trade and Industry.

Some debt management companies offer to put you in touch with an IP for a fee, but steer clear. You can contact an IP directly and there are many ways to find one; and then you'll only pay one set of fees.

Your local county court and Official Receiver's office should be able to give you a list of IPs. Look in the phone book for details or contact the Insolvency Service Central Enquiry Line by ringing 0845 602 9848 or emailing Central.Enquiryline@insolvency.gsi.gov.uk. Alternatively go online to the Insolvency Service at www.insolvency.gov.uk Tel: 0845 602 9848 or the Northern Ireland Department of Enterprise Trade and Investment at www.detini.gov.uk Tel: 028 902 51441.

Your local reference library should also have a copy of an Insolvency Service publication called "The Directory of Authorised Insolvency Practitioners" which lists IPs by area.

The following bodies can provide details of their member IPs only:

The Association of Business Recovery Professionals www.r3.org.uk Tel: 020 7566 4200

The Insolvency Practitioners Association www.insolvency-practitioners.org.uk Tel: 020 7623 5108

The Law Society www.lawsociety.org.uk Tel: 0870 606 2555

You may decide to contact a debt management firm instead - which will either refer you to one of its in-house IPs or to an external company.

Whichever route you take, you should speak to a number of different IPs before committing yourself. Make sure you understand how much support you will get. Ask how many IPs the company employs, and how many IVAs each supervises. What proportion of IVAs proposed by the firm are successful? Can you have face to face meetings with your IP? What will the IVA cost? How are the fees paid? Will you have to pay any money upfront? What happens if your IVA proposal fails?

Some debt management companies and IPs offer a free initial consultation. Take advantage of this if you can.

The money advice charity the Consumer Credit Counselling Service www.cccs.co.uk also has its own IVA. It has been designed to deal mainly with IVAs for CCCS's own debt clients, but it says its fees are several thousands Pounds cheaper (typically £5,000 rather than £7,500) than the market average and is therefore likely to prove very popular. It's hoped this will help bring fees down across the market place, yet even in this scenario £5,000 isn't cheap. So always think carefully before starting an IVA.