Ways to clear your debt

Fact sheet no. 35 EW Ways to clear your debt August 2017

Extra advice:

Scottish debts

This fact sheet only applies to you if you live in England and Wales. If you live in Scotland please use the Scottish version of **Ways to clear your debt**.

Use this fact sheet to:

- see the different ways you can deal with your debt and how each one works;
- find out what advantages and disadvantages each different way has; and
- help you to decide which way meets your needs.

Key facts for each way tell you:

- how big or small your debts would have to be;
- what type of debt could be repaid; and
- how long you could expect to wait before you would be clear of your debt.

The detailed sections that follow tell you how that option works, its advantages and disadvantages.

Informally negotiated arrangement

Key facts

How much debt must I owe? There is no minimum or maximum level of debt.

What type of debt? Use this option for credit debts only, after you have dealt with priority debts.

How long will it last? There is no time limit. You may be paying for many years.

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** each 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 our budget tool, but a money adviser will check your budget sheet for you before you send it to the creditors.

See our fact sheet:

CASHflow – an approved way to deal with debts yourself.

- Through an advice agency you can use the Standard 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. A charging order is a court order which secures the debt against your home like a mortgage.
- 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 ability to get further credit will be affected.

Free debt management plan (DMP)

Key facts

How much debt must I owe? No minimum or maximum level of debt. You will need to be able to pay at least **£5** each month to each debt.

What type of debt? Use this option for credit debts only.

How long will it last? You will usually have to be able to repay your debts in less than **10 years**.

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How it works

You need to have at least **£5** each month to pay each of your non-priority debts after you have paid your essential outgoings and any priority debts. You usually have to be able to repay your debts in less than **10 years**.

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

See our fact sheet:

Debt management plans (DMPs).

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

Advantages

- 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 Standard 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.

Disadvantages

- 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.
- Your ability to get further credit will be affected.
- 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.**

Individual voluntary arrangement (IVA)

Key facts

How much debt must I owe? Because of the costs involved, it is better if you owe **£10,000** or more.

What type of debt? Most types of debt can be included, except: secured debts (unless your lender agrees), rent, student loans, magistrates' court fines, maintenance payments or maintenance arrears ordered by a court, Child Support Agency or Child Maintenance Service arrears.

How long will it last? There is no time limit, but they usually last **five years**.

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 balance you owe on those debts which are included in the IVA is written off.

See our fact sheet:

Individual voluntary arrangements (IVAs).

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

- Repayments stop at an agreed date and you will usually pay less than the full amount you owe.
- You may be running a small business which would be difficult to keep going if you were bankrupt.
- You may be in a profession where you could lose your job if you go bankrupt, such as accountancy, the police or the armed forces. But be careful, in some professions your employment may be affected by an IVA. Check with your professional body and check your contract of employment.
- You may have access to a large lump sum and want a formal arrangement with your creditors to accept the lump sum and write off the rest of the debts.
- You will not automatically lose your house or other assets.

Disadvantages

- If you do not keep to the terms of the IVA then the insolvency practitioner (IP) or your creditors can take further action against you, for example by making you bankrupt.
- If creditors do not accept the IVA proposal, you are back to square one and your creditors can carry on trying to pursue you for your debts.
- If you paid an up-front fee for your IVA and it is not accepted, then you will have lost the fee and may be in a worse position than when you started.

Extra advice:

bank accounts

Check the terms and conditions of your bank account to make sure that it cannot be affected by an IVA in any way.

- If you own your house, you may need to re-mortgage your home as part of the IVA. If you are unable to do this you may have to pay extra into the IVA, or in rare cases you may lose your home.
- If you rent your home, check the terms and conditions of your tenancy agreement. It may say that your landlord can end your tenancy if you enter into an IVA. Even if your tenancy agreement does say this, your landlord may choose not to end your tenancy, especially if you are up to date with your rent payments.
- There is a risk that the IVA is agreed on the basis of monthly payments that you cannot afford over a long time. You must be very careful that the payments are set at a realistic amount in the first place.
- If your circumstances change and you can no longer afford the payments, your IVA may end if the IP cannot persuade the creditors to accept a new agreement.
- The IVA will be recorded on your credit reference file for **six years** and can affect your ability to get further credit.
- When you set up an IVA, you will need to open a basic bank account which is separate from all your debts. A basic account does not offer any credit facilities, such as an overdraft. Some banks may not allow you to continue to operate a basic bank account whilst you are in an IVA. **Contact us for advice.**

Bankruptcy

Key facts

How much debt must I owe? A creditor can only issue a bankruptcy petition if you owe **£5,000** or more. You can make yourself bankrupt however much you owe.

What type of debt? Most types of debts can be included. The main exceptions are student loans, magistrates' court fines, maintenance payments or maintenance arrears ordered by a court, Child Support Agency or Child Maintenance Service arrears, debts you build up through fraud and debts you owe as a result of a personal injury claim against you.

How long will it last? 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**.

How it works

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

See our fact sheet:
Bankruptcy.

Valuable assets are usually sold to raise money to pay your creditors.

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

- 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.

Disadvantages

- Bankruptcy will affect your ability to get further credit.
- If you have equity you could lose your home.
- Secured creditors can still take action against you.
- You have to find the money for the fee and the deposit.
- Your assets may be sold by the official receiver.
- Not all your debts are 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)

Key facts

How much debt must I owe? £20,000 or less.

What type of debt? Most types of debt except: student loans, magistrates' court fines, maintenance payments or maintenance arrears ordered by a court, Child Support Agency or Child Maintenance Service arrears, money owed under a criminal confiscation order, debts resulting from certain personal injury claims and budgeting or crisis loans.

How long will it last? You will be discharged from your debts after **one year**.

How it works

You can apply to the official receiver for a DRO on a special online application form with the help of a money adviser who has been appointed as an approved intermediary.

See our fact sheet:
Debt relief orders (DROs).

You will be eligible if: you are unable to pay your debts; you have **£50** or less spare income each month after you have paid your normal household bills; your total debts are **£20,000** or less; your total assets are worth **£1,000** or less; and, if you own a car, this is worth below **£1,000**. You cannot apply if you have had a DRO in the last **six years**. If you do not live in England or Wales (or have not lived or run a business in England or Wales in the last **three years**), you cannot apply.

If your application is successful, most types of debt 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 an application fee, 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.

Disadvantages

- You cannot apply if you own your home as this would be counted as an asset.
- Not all types of debt are written off.

- If you forget about a debt, you cannot add it in later.
- Details of your DRO will be kept in the Individual Insolvency Register.
- The DRO will be recorded on your credit reference file, which will affect your ability to get further credit.
- 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

Key facts

How much debt must I owe? £5,000 or below.

What type of debt? Use this option for credit debts and some priority debts.

How long will it last? 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.

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.

See our fact sheet:

Administration orders.

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. The court divides this between your creditors on a pro-rata basis.

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 ability to get further credit will be affected.
- If you do not maintain your payments, the AO can be revoked and the creditors can pursue you again.

Consolidation loan

Key facts

How much debt must I owe? There is no minimum or maximum level of debt. It will depend upon what the lender is prepared to lend.

What type of debt? Any debts that your lender allows you to include.

How long will it last? It will last the length of time it takes you to repay the 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 are viewed as a poor credit risk, it is possible that a good deal may not be available to you.

See our fact sheet:

Debt consolidation and credit.

Advantages

- Paying off your debts with a consolidation loan is less likely to have a negative impact on your ability to get further credit.
- 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.

Disadvantages

- If you are viewed as a poor credit risk 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'. If it can change, you could end up paying much more than you expected.
- 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.

Full and final settlement offer

Key facts

How much debt must I owe? There is no minimum or maximum level of debt.

What type of debt? Use this option for credit debts usually.

How long will it last? A short time, unless payment is in instalments.

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.

You may get creditors to agree to you making monthly payments for a set period and then writing the rest off.

See our fact sheet:

Full and final settlement offers.

Advantages

- 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.

Disadvantages

- 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 should 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

Key facts

How much debt must I owe? There is no minimum or maximum level of debt.

What type of debt? You would usually use this option for credit debts.

How long will it last? Debts would be cleared at the time that they are written off.

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 a **sample letter** that you can use to ask your creditors to write off your debts. If they do not agree at first, we have a further **sample letter** that you can use to ask them to reconsider their decision.

Advantages

- 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.

Disadvantages

- 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.

Equity release

Key facts

How much debt must I owe? There is no minimum or maximum level of debt. However, it's more likely to be a suitable option if you have debts that you can't afford to clear through your existing regular income.

What type of debt? You can use this option to clear any type of debt.

How long will it last? There is no time limit. Different equity release schemes can give you money in different ways and at different times. For example, some may give you a cash lump sum. Others may give you regular payments over time.

How it works

You consider all options to deal with debts and raise funds. You identify that you would like to release money from your property to help clear debt.

You get independent financial advice and independent legal advice to help you understand the advantages and disadvantages of equity release.

There are two main types of scheme available.

- Lifetime mortgages give you funds in a single lump sum or smaller instalments over time, or a combination of both. You remain the owner of your home. The lifetime mortgage is repaid when you die or go into long-term care.
- Home reversion plans allow you to sell part, or all, of your property to a home reversion company. They give you a lump sum or regular smaller payments. When the property is sold, the home reversion company gets their share of the sale proceeds.

Advantages

- Equity release can give you a cash lump sum or regular monthly payments. This can help with regular bills, home improvements, care costs and so on.
- You can usually stay in your property for as long as you need to.
- You may be able to move, as long as the new property is acceptable to the equity release firm.
- You can set aside part of your property value as an inheritance for your family members.
- You do not have to pay rent to the equity release provider.
- For lifetime mortgages, you may be able to choose whether to pay back interest or let it build up.
- The loan is usually only paid back when you die or when your property is sold.
- For some lifetime mortgages, interest rates are either fixed or can't rise above a set level.
- For some equity release schemes, there is a guarantee that the total amount you owe cannot be greater than the value of your property.
- You will not have to pay tax on the equity released from your main home.

Disadvantages

- Your equity immediately becomes less.
- You may leave a smaller inheritance to other people when you die.
- A lifetime mortgage means that you are securing further borrowing against your home.
- For home reversion schemes, home reversion companies will usually pay a lot less than the full market value of their share of your property. Also, you will no longer be the sole owner.
- If you die or sell your home shortly after taking out an equity release scheme, you could lose money. There may also be early repayment charges if you decide to repay what you owe within a short time of taking out the deal.
- If house prices fall, you may owe a greater percentage of your home's value.
- With a lifetime mortgage, if you live long enough, you could end up owing 100% of your property's value.
- The money you get from equity release could affect the amount of benefits you are entitled to.
- You may need the provider's permission for someone else to move in, such as a relative or carer.
- You usually need to get your provider's permission to move to another property.
- You usually have to pay costs for arranging the transaction, for your property to be valued and for legal fees.
- You will still be responsible for paying all the usual bills such as council tax, gas and electricity. You may also need to pay for buildings insurance.
- You will usually be responsible for repairs and maintenance. So you may need to regularly set aside some money for this.

Pension release

Key facts

How much debt must I owe? There is no minimum or maximum level of debt.

What type of debt? Any kind of debt

How long will it last? This depends on how much money you take from your pension fund and how often you take it.

How it works

The rules governing **defined contribution pensions**, sometimes called 'pension funds' or 'pension pots', have changed. If you are **55 or over**, you now have access to your pension fund. This affects many personal and workplace pensions, but not defined benefit pensions such as final salary schemes. If you are considering moving money from a final salary scheme pension or a defined benefit pension, get specialist pension advice from an independent financial adviser first.

Warning:

think carefully

Think very carefully about whether you use your pension fund to pay off your debts or not. Take your time to decide. Making a hasty decision could mean that you lose a lot money because of the tax or benefit rules. Taking money from your pension pot now will reduce your income later in retirement and might reduce the amount of benefits, tax credits or financial support from your local council that you get in the future.

If you have a defined contribution pension, you might be able to use some of your pension fund to deal with your debts. You can choose to take up to 25% as a single, tax-free, lump sum.

You can do this in five different ways:

- buy an annuity;
- get an adjustable income (called 'drawdown');
- take cash in chunks;
- cash in the whole pension fund in one go; and
- mix any of the options.

You can also decide to leave your pension fund untouched. Creditors should not pressurise you to use your pension to pay off debts. Contact **The Pensions Advisory Service** on 0300 123 1047 for free, impartial information and guidance about your pension choices.

You may be able to get a Pension Advice Allowance of up to **£500** from your pension fund to help pay for financial advice about your pension options. You will need to write to your pension provider to make the request. Not all pension providers will offer this. The allowance is paid directly to a **regulated financial adviser**. It is not given to you. You can get an allowance up to three times, but not more than **once** in any tax year.

Advantages

- Using the money in your pension fund might make it possible for you to deal with your debt in a way that otherwise you could not afford.
- If a creditor issues a statutory demand and is threatening to make you bankrupt, you may prefer to use money from your pension to deal with this instead of trying other options, like offering a charge on your property.
- You will not have to take out credit that you cannot afford to deal with your debt.

Disadvantages

- Taking money from your pension now will reduce the money you and your family can get from your pension fund later.
- If you are getting any benefits or tax credits, or if you get financial support from your local council, you should inform the Department for Work and Pensions (DWP), HM Revenue & Customs or your local council of any money that you take from your pension fund, so that you are not overpaid. Your benefit may be reduced or stop once you have done this.
- If you take money from your pension fund, the DWP, HM Revenue & Customs and the local council will consider whether you have spent the money to try to get more in benefits or tax credits later. If they decide that you have done so, you may be given less in benefit or tax credits than you would otherwise have received.
- You may need to pay for advice about what option to take.
- If you take money from your pension fund without getting advice, you could lose a lot of money.
- Your pension provider may charge you a fee for leaving your pension early.

- Taking a lump sum greater than the tax-free amount from your pension would mean that some of the money would be taken in tax.
- If you take money from your personal pension, it may affect whether you are able to use some other options for dealing with your debts.
- If you take money from your pension while you are in some other debt options, it may be taken off you.

Selling assets

Key facts

How much debt must I owe? There is no minimum or maximum level of debt. It's more likely to be a suitable option if you have debts that you can't afford to clear through your regular income.

What type of debt? You can use this option to clear any type of debt.

How long will it last? There is no time limit. It may take you longer to sell some assets than others. It depends on the asset and the method you use to sell it.

How it works

You consider all available options and decide that you want to sell an asset to help clear your debt. **Contact us for advice** before making this decision.

You choose which assets you want to sell and how you want to do this. You explore all the costs involved in the method of sale you choose.

There are many ways of selling assets yourself, such as online auctions and advertising in local newspapers. There are also legally binding ways of using assets to pay debts, such as entering into an individual voluntary arrangement.

You consider how you want to use the money you raise. If you cannot pay all your debts off, you could consider making smaller offers to settle each debt and ask the creditors to write off any remaining amounts. It is important to take into account how you can treat creditors fairly. This is because if you consider some other options to deal with your debt in the future, how you have previously treated creditors can be taken into account when deciding whether further restrictions should be applied to you.

Advantages

- It can help to relieve pressure from creditors who may be chasing you for payment or threatening legal action.
- It can help to stop priority creditors taking legal action to take away an essential service or an essential item.
- You may be able to pay off those creditors who charge interest at a higher rate so that your other debts are easier to manage.

Disadvantages

- You would have less financial security for the future. For example, depending on which assets you sell, it may mean you have less money and security for your future and retirement.
- You may leave less inheritance to other people when you die.
- If emergencies occur in the future, you may be less likely to have the funds to deal with them.
- In some situations, you could still be treated as having money you have used to clear debts when the Department for Work and Pensions or your council look at your benefits.
- You may need to get professional advice to make sure that selling your assets does not affect your tax position.

Charitable payment

Key facts

How much debt must I owe? There is no minimum or maximum level of debt.

What type of debt? It depends on the charity, but usually priority debts.

How long will it last? Debts would be reduced or cleared by the payment.

How it works

Apply for financial help from a suitable **charity** on the Turn2us website **www.turn2us.org.uk**.

Get information about trust funds you can apply to for financial help by going to the Auriga Services website **www.aurigaservices.co.uk**. Click on the link **Download booklet Help with Water and Energy** at the top of the page.

Advantages

- 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.

Disadvantages

- 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.