insolvency technical brief

ITB9 Individual Voluntary Arrangement Update

explaining an alternative method of dealing with financial difficulties compared to bankruptcy

introduction

ITB7 for Individual Voluntary Arrangements ("IVA") was issued in 2006 and a lot has happened with IVAs since then.

The IVA process was introduced by the Insolvency Act 1986 to provide an alternative method of dealing with financial difficulties to bankruptcy, principally for sole traders and unincorporated and partnership businesses in order to give them a second chance.

However, since 2006 the IVA process has been "commoditised" and turned into a financial product rather than a rescue procedure, by the so-called IVA "factories": those companies specialising in offering IVA solutions to ordinary individuals with credit card or consumer debt, a so-called "Consumer IVA".

During this period there have been (and to some extent there continues to be) outrageous claims by the IVA factories in the press and other advertisements that people can "…write off 75% of your debt in a little known Government backed scheme…"!! What this doesn't point out is that creditors need to agree to the terms of the IVA!

how do IVAs work?

Essentially an IVA is a deal between a debtor and their unsecured creditors where a proportion of the debt will be paid by the debtor over a period of time (typically 5 years) in return for the debtor avoiding bankruptcy.

The funds needed to provide the agreed return to creditors would be generated by the debtor making monthly payments, or a one off lump sum, (or even both) to their Supervisor. The Supervisor would deduct agreed costs and pay the balance of funds to the creditors. Generally speaking an IVA will provide a higher return to creditors than a bankruptcy would.

Returns, to which creditors must agree, vary from as little as 5% repayment of debts up to the full 100%. However, on average, most IVAs produce between 25% and 45% return to creditors, with an equivalent bankruptcy of the debtor being much less or even nothing.

An IVA also allows the debtor to retain their home, although a large proportion of their equity would usually need to be released at some time during the IVA. Failure to adhere to the terms of the IVA would often result in the bankruptcy of the debtor.

bad advice?

This apparent ability to write off a large proportion of their debt led to many ordinary working people who had got into financial difficulties with their unsecured credit (cards, store cards, loans etc) being "sold" what is essentially a complicated and technical financial solution to restructure their debt, often without the debtor fully understanding what they were getting themselves into.

As the process had been turned into a financial product, many IVA factories set a simple minimum criteria which, providing a debtor could meet these criteria, meant that the IVA factory would propose an IVA for them. The most common criteria was a minimum return to creditors of 25%, hence the "write off 75% of your debt" adverts. This was an informal level generally accepted as the minimum return by most creditors up to around 2004.

Providing the debtor ticked the boxes for the minimum criteria then the IVA factory took their deposit for costs and issued the paperwork to creditors.

In a significant number of cases however, people who entered into an IVA in this way had not been advised properly on the alternatives to an IVA, such as bankruptcy, Debt Management Plan, or a Debt Relief Order. In particular the consequences of failing to maintain their monthly contributions or of achieving the equity release element for their house were not explained clearly. If these didn't happen, then the IVA would fail. On average, up to 40% of consumer IVAs can fail within two years of being set up!!

lenders get annoyed!

As the IVA factories took off, thousands of people proposed IVAs. Between 2004 and 2015, the number of IVAs increased by nearly 400% (10,700 to 40,384). This amounts to a staggering total of 461,000 people over this period entering into an IVA with each owing on average some £25,000: total debt of £11.5 billion! At an average minimum return of 25% there was a significant write-off of debt.

Whilst an IVA should give a better return than a bankruptcy, because so many Consumer IVAs were being entered into, many lenders, particularly the High Street Banks, perceived that an IVA was being used to not only get away with paying back less than a debtor could probably pay but that debtors were avoiding the consequences of bankruptcy when they shouldn't be.

IVA protocol

Unsurprisingly, many lenders were unhappy over this. During the last few years, the Insolvency Profession has worked with lenders to put together a standard IVA Protocol which sets out standard criteria for each IVA. This ensures both the lender and debtor are treated fairly.

IVAs that are not consumer-credit based can still be done outside the Protocol and can be tailored to specific circumstances (e.g. a sole trader who needs to deal with trading liabilities).

the experts!!

At ipd, we have adopted the Protocol going forward but will ensure it is tailored to a debtor's specific circumstances. Generally speaking, our Protocol-based proposals will be drafted to avoid the possibility that the proposals are unworkable or contrary to the Protocol. The proposals will be fair to both the debtor and their creditors and will stand an excellent chance of being approved with very few (if any) changes imposed by creditors.

Our preference is to become involved in the process at the earliest possible stage and to talk to major creditors to obtain their view on outline proposals before incurring the costs of drafting full proposals on behalf of the debtor.

I have not attempted to cover all aspects of this planning period as this depends largely upon the circumstances of the individual. If you or any of your clients require any further advice, please contact me. Please see the flow chart on the last page.

there is no substitute for expert advice

I have been advising individuals and businesses suffering financial distress since 1986, a substantial part of that time having been spent within the Insolvency and Business Recovery practices at two of the "Big Four" UK accountancy firms.

In that time I have come across many instances where an IVA has proven to be a blessing in disguise for individuals who may have no idea of what they can do, or who to turn to.

As a Fellow of the Association of Business Recovery Professionals (also known as "R3" - Rescue, Recovery and Renewal) you can be assured that I am an expert in my field and will be able to help with an individual's needs.

Get in touch

Please call me for further information or to arrange a free initial meeting.

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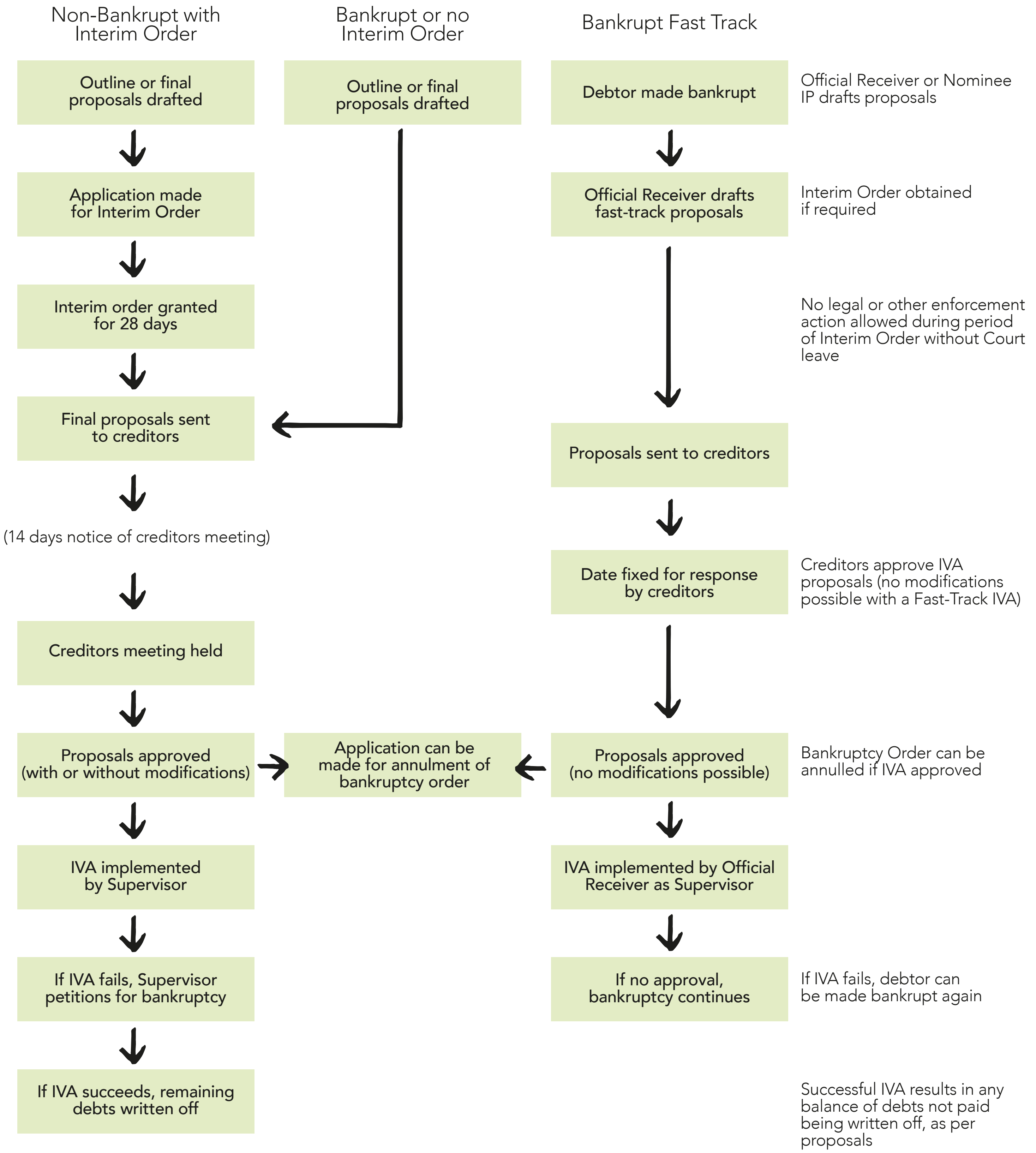
the IVA process



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