Individual Voluntary Arrangements: A 'Fresh Start' for Salaried Consumer Debtors in England and Wales?

Abstract

Since the mid-1990s the number of consumer insolvencies in England and Wales has grown exponentially. The UK's Insolvency Act 1986 offers two formal responses to personal insolvency: bankruptcy and individual voluntary arrangements ("IVAs"). While consumers have used both these debt relief mechanisms in increasing numbers in recent years, IVAs − regulated agreements between debtors and creditors facilitated by a licensed insolvency practitioner, usually taking the form of a five-year payment plan − grew faster than bankruptcies between 2003 and 2006. However, the level of new IVA approvals fell back in 2007 and the first half of 2008. This article charts the transformation of the IVA from a bankruptcy alternative originally designed for insolvent traders and professionals into a tool of consumer debt relief. It then seeks to explain both the stellar rise in IVA usage among consumer debtors and the subsequent stalling of IVA growth. The rise of consumer IVAs can be attributed largely to supply side changes in the market for debt resolution − in particular the emergence of volume providers commonly referred to as 'IVA factories' − while a sustained backlash against the procedure and the providers instigated by institutional creditors demanding higher recoveries accounts for the subsequent decline in approvals. The article concludes by considering the near-term prospects for consumer IVAs within the context of the increasingly complex UK debt resolution market.

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Individual Voluntary Arrangements: A 'Fresh Start' for Salaried Consumer Debtors in England and Wales?

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INTRODUCTION

In its seminal report on the state of insolvency law in England and Wales published in 1982 the Cork Committee made the following observations under the heading 'the modern world of credit':[1]

> In the present century, we have witnessed a rapid expansion from the most basic forms of consumer credit, in the shape of pawnbroking, tallymen and moneylending, to instalment credit offered by retailers and the massive

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[1] Report of the Review Committee, 'Insolvency Law and Practice' (Cmnd 8558, 1982) ('Cork Report') 11.

> development in the area of hire-purchase finance. We have lived through a sudden surge in the demand for motor cars, which has spilled over into the market for every kind of consumer goods… Since the mid 1960's, we have experienced the rapid growth of the credit card business in its various forms which has greatly expanded the range of credit available… The increased opportunities for contracting debt have led to the emergence of the consumer debtor, a commonplace today, but virtually unknown in the Nineteenth Century. A wage-earner, with little or no capital assets of any value, can today incur credit to an extent undreamed of a hundred years ago.

Since 1982 the consumer lending revolution has accelerated beyond even the wildest expectations of the Cork Committee in many parts of the world. Its momentum has derived from a number of structural factors: American-led deregulation of consumer lending;[2] globalisation; technological developments that have enabled lenders to perform low-cost, computer-based credit checks on borrowers; and financial innovations such as securitisation.[3] Not only has consumer credit expanded significantly over the last quarter of a century, its social penetration has deepened. Through the development of sub-prime

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[2] Usually traced back to the United States Supreme Court decision in *Marquette National Bank of Minneapolis v First of Omaha Service Corporation* 439 US 299 (1978) which effectively neutralised state law interest rate ceilings on credit cards and thus increased the potential profitability of this type of lending.

[3] I Ramsay, 'Comparative Consumer Bankruptcy' (2007) 1 University of Illinois LR 241, 243 and works therein cited. On the role of information technology and financial innovation in transforming consumer lending (with particular reference to the United States but equally applicable in the United Kingdom context) see D Baird, 'Technology, Information, and Bankruptcy' (2007) 1 University of Illinois LR 305.

markets, the expansion of consumer credit has been accompanied by its so-called 'democratisation',[4] a process whereby mainstream credit has become available to lower income social groups to whom it was not traditionally available. As a consequence of these structural changes many countries, including the United Kingdom, now have 'credit societies' − that is societies in which widespread consumer credit usage facilitated and encouraged by a functioning consumer credit market is seen as an essential pre-requisite of economic growth.[5]

The flipside of the consumer credit revolution is the phenomenon of rising consumer over-indebtedness. Over-indebtedness has been defined and measured in various ways[6] but is generally characterised by a situation in which the debt burden of individuals or households persistently exceeds their capacity to repay over the long term.[7] The problem of consumer over-indebtedness has prompted several jurisdictions to reform their insolvency laws[8] and was a source of political concern in the United Kingdom even

[4] J Niemi-Kiesiläinen, I Ramsay and W Whitford (eds), *Consumer Bankruptcy in Global Perspective* (Hart Publishing, Oxford 2003), 2-4.

[5] J Niemi-Kiesiläinen and A Henrikson, 'Legal Solutions to Debt Problems in Credit Societies – A Report to the Council of Europe' (Umea University, 2005) 7.

[6] European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities, 'Common Operational European Definition of Over-indebtedness' (2007) <http://ec.europa.eu/employment_social/spsi/docs/social_inclusion/2007/edo_summary_en.pdf> 3-4.

[7] *Niemi-Kiesiläinen & Henrikson* (n 5) 7.

[8] J Kilborn, *Comparative Consumer Bankruptcy* (Carolina Academic Press, Durham NC 2007) (chronicling developments in the United States, Europe and Scandinavia); J Ziegel, *Comparative Consumer Insolvency Regimes − A Canadian Perspective* (Hart Publishing, Oxford 2003) (comparing developments in North

before the 'credit crunch' of 2007, compounded by rising commodity prices, raised the spectre of recession or worse.[9] Rising over-indebtedness has generated increased demand for debt advisory and debt resolution services[10] and translated into exponential growth in absolute terms in the numbers of consumer debtors seeking access to formal insolvency proceedings in England and Wales.[11] The upshot is that our insolvency system, which originated as an orderly collection apparatus for the creditors of insolvent traders, has

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America, Europe, Scandinavia and Australia); *Niemi-Kiesiläinen et al* (n 4) (containing accounts from jurisdictions as diverse as China, Israel and Brazil).

[9] The government launched an action plan for tackling consumer over-indebtedness in 2004 and the Department of Business, Enterprise and Regulatory Reform issues an annual report: <http://www.berr.gov.uk/consumers/consumer-finance/over-indebtedness/index.html>. See also the Griffiths Commission on Personal Debt, 'What Price Credit?' (2005) <http://www.niace.org.uk/news/Docs/Griffiths-report-on-personal-debt.pdf> (concluding that personal debt was a problem for roughly three million people in the UK but that increases in household debt to income ratios had left many families, especially those with low incomes, vulnerable to adverse changes in their circumstances or changes in the general economic outlook) and Social Justice Policy Group, 'Breakdown Britain' (2006) <http://www.centreforsocialjustice.org.uk/default.asp?pageRef=180> (describing personal debt as a 'time bomb' which could potentially trigger a 'severe debt crisis').

[10] See eg Citizens Advice, 'Out of the Red – Debt Advice in the Citizens Advice Service' (2006) <http://www.citizensadvice.org.uk/index/publications/out_of_the_red.htm> 2-4 (reporting increase in consumer credit debt problems dealt with by bureaux).

[11] The pattern in Scotland and Northern Ireland has been similar. See Insolvency Service, 'Enterprise Act 2002 – the Personal Insolvency Provisions: Final Evaluation Report' (2007) ('Evaluation Report') <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/Reform.htm> 45-53. On the legal framework for personal insolvency in Scotland which is a devolved matter in respect of which the Scottish Parliament has legislative competence see D McKenzie Skene and A Walters, 'Consumer Bankruptcy Law Reform in Great Britain' (2006) 80 American Bankruptcy LJ 477.

ceased to function primarily as a system for the adjustment of business debts. Talk of a consumer-led 'debt crisis' or 'bankruptcy crisis' is now as fashionable in this jurisdiction[12] as it was in the United States during the mid-1990s.[13]

The main focus of this article is on the formal resolution of consumer debt problems in England and Wales under the Insolvency Act 1986 ('IA 1986'). IA 1986 offers two formal responses to the insolvency of natural persons: bankruptcy and individual voluntary arrangements ('IVAs'). While over-indebted consumers have accessed both of these mechanisms in increasing numbers since the late-1990s,[14] IVAs − which function as a form of debt repayment plan coupled with a partial discharge − grew faster than bankruptcies between 2003 and 2006. On the statute book since the mid-1980s, but little known outside the insolvency profession before the present decade, IVAs acquired a considerable public profile and notoriety as a consequence.[15] However, the period of spectacular growth mid-decade was followed by one of relative stagnation. The number of new IVA approvals fell back during 2007 and 2008. This prompts the question: has the IVA had its day as a consumer 'debt solution'?

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[12] See eg __'Buy now, pay later culture sends personal insolvencies soaring' *Financial Times* (London 6 March 2006); __'Personal insolvency rates at record as "debt crisis" deepens' *The Times* (London 5 May 2007).

[13] See eg E Warren, 'The Bankruptcy Crisis' (1998) 73 Indiana LJ 1079; D Moss and G Johnson, 'The Rise of Consumer Bankruptcy: Evolution, Revolution or Both?' (1999) 73 American Bankruptcy LJ 311.

[14] *Evaluation Report* (n 11) 29-31.

[15] See eg __'Sharp rise in use of IVAs to clear debt' *Financial Times* (London 4 November 2006); __'IVAs are the new face of debt but they mask an age-old truth' *Independent on Sunday* (London 5 November 2006).

After presenting the official statistics on the incidence of formal insolvencies in the period 1998 to 2007 and sketching the legal, institutional and functional characteristics of the main debt resolution options available to over-indebted consumers in England and Wales, this article seeks to cast light on two puzzles about IVAs. Firstly, why did IVA growth outstrip the rate of growth of bankruptcies between 2003 and 2006 and, in particular, why did it continue to do so even after the bankruptcy regime became (so many have claimed) more 'debtor friendly' following the coming into force of the relevant provisions of the Enterprise Act 2002 on 1 April 2004? Secondly, why did IVA growth stall thereafter?

The main threads of the account are as follows. The emergence of IVAs can only be properly understood by reference to the evolution of the consumer IVA market and the role and behaviour of the main actors within that market place. Accordingly, IVA growth has been primarily market-driven rather than law-driven. Moreover, the market transformation of the IVA from a modest bankruptcy alternative used by self-employed traders and professionals to a volume consumer 'debt solution' has occurred within a broadly supportive policy environment. In current policy discourse, the IVA is presented as the best means by which an appropriate balance between the interests of salaried consumer debtors and their creditors can be struck. IVAs offer what may be termed an 'earned fresh start'[16] in which debtors receive a partial discharge of past indebtedness accompanied by the prospect of wider financial rehabilitation in return for repaying what they can reasonably afford from present and future income over a predictable time period. The theoretical attractiveness of this 'earned fresh start' policy is difficult to contest in

[16] *Niemi-Kiesiläinen & Henrikson* (n 5) 45-46.

the conditions of a modern 'credit society'. However, its fate in practice appears to rest upon the outcome of processes of conflict and co-operation between 'repeat players' within the maturing and increasingly complex debt resolution market.

THE CONSUMER INSOLVENCY 'BOOM' IN ENGLAND AND WALES

Official data on the incidence of personal insolvency proceedings

Table 1 and Figure 1 present the official data on the incidence of formal personal insolvencies in England and Wales − that is, bankruptcies and IVAs − for the period 1998 to 2007. Basic details of every new bankruptcy and IVA are required to be entered on a statutory register.[17] As a consequence, both bankruptcies and IVAs are counted in the official data.

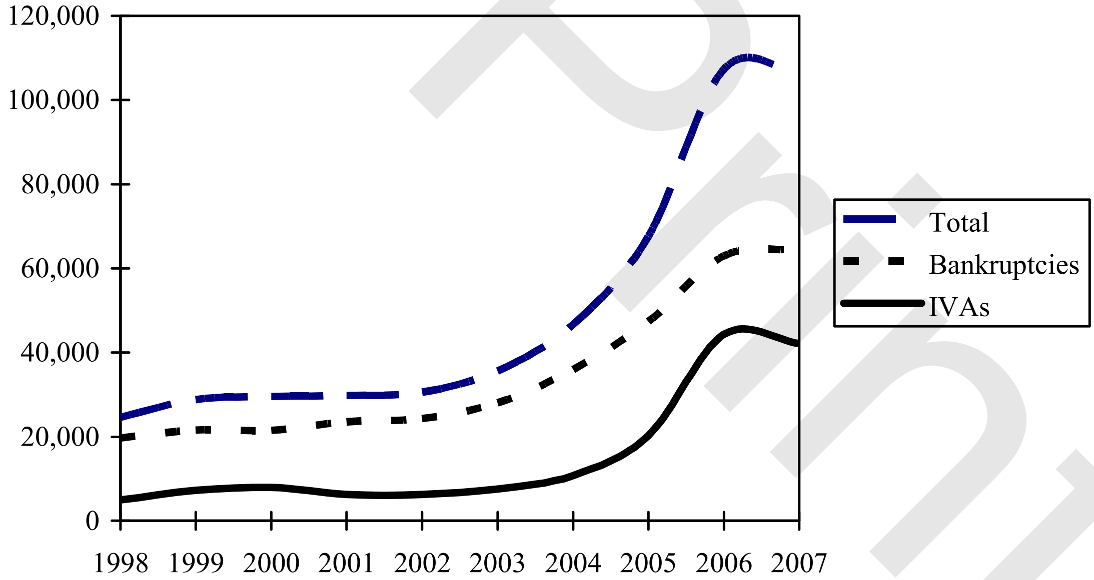
[17] Insolvency Rules 1986 SI 1986/1925 ('IR 1986') rr 6A.1-6A.5.

Table 1: Individual Insolvencies (Bankruptcies and IVAs) in England and Wales, 1998-2007

YEAR	BANKRUPTCY ORDERS	IVAs	TOTAL
1998	19,647	4,902	24,549
1999	21,611	7,195	28,806
2000	21,550	7,978	29,528
2001	23,477	6,298	29,775
2002	24,292	6,295	30,587
2003	28,021	7,583	35,604
2004	35,898	10,752	46,650
2005	47,291	20,293	67,584
2006	62,956	44,332	107,288
2007	64,481	42,166	106,647

Source: UK Insolvency Service

Figure 1: Individual Insolvencies (Bankruptcies and IVAs) in England and Wales, 1998-2007



These official data reveal the extent of the 'boom' in absolute terms. Total numbers of bankruptcies and IVAs were relatively flat at around 25,000 to 30,000 per annum from the late 1990s until around 2002. After 2003 there was a steep acceleration, total numbers exceeding 100,000 per annum for the first time in 2006, before levelling out in 2007. By comparison, at the height of the recession in the early-1990s total individual insolvencies peaked in the region of 37,000 of which the vast majority were bankruptcies. IVA numbers did not break out of a range between 4,000 and 8,000 per annum until 2004.[18]

Since the early-1990s, the demographics of individual insolvency in England and Wales have also been transformed in line with the process of consumer credit expansion described earlier. Using self-employment and salaried employment as proxies to classify individuals as business or consumer debtors, the UK's Insolvency Service has shown that since 1998 the level of bankruptcies based on business debts remained constant at around 10,000 per annum[19] with the implication that consumer debtors account for *all* of the growth in bankruptcy numbers. Similarly, the available evidence suggests that the vast majority of debtors entering IVAs are non-traders in salaried employment[20] whereas during the 1990s IVAs were almost exclusively the preserve of the self-employed.[21]

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[18] For longer run data from 1960 to 2007 see <http://www.insolvency.gov.uk/otherinformation/statistics/historicdata/HDmenu.htm>.

[19] *Evaluation Report* (n 11) 30.

[20] PricewaterhouseCoopers, 'Living on Tick: The 21st Century Debtor' (2006) ('Living on Tick') <http://www.pwc.co.uk/eng/publications/Living_on_tick_21st_century_debtor.html>; Insolvency Service, 'Survey of Debtors and Supervisors of Individual Voluntary Arrangements' (2008) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/policychange.htm> 28.

[21] K Pond, 'The Individual Voluntary Arrangement Experience', [1995] JBL 118; 'An Insolvent Decade: The Changing Nature of the IVA 1987-1997' (1998) Loughborough University Banking Centre Research Paper Series No. 125/98 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139556>.

Per capita incidence of personal insolvency proceedings

The aggregate figures need to be put into context by adjusting for population size. *Per capita* rates of individual insolvencies throughout the United Kingdom are historically low compared to equivalent rates in North America.[22] Within the UK, the *per capita* incidence of individual insolvencies has been consistently higher in Scotland (which in mid-2006 contained only 8.4 per cent of the UK population) than it has been in England and Wales (which in mid-2006 together contained 88.7 per cent of the UK population).[23] Around two in every thousand of the populace entered bankruptcy or an IVA in England and Wales during 2006. In Scotland, the figure for individuals entering sequestration or a protected trust deed (the Scottish equivalents) was nearer three in every thousand. Expressed in terms of overall population, Scots are more likely to end up in a formal insolvency process than inhabitants of England and Wales and, despite the growth in absolute numbers evident from Table 1 and Figure 1 above, the *per capita* incidence of individual insolvency in England and Wales remains stubbornly low compared with that in other jurisdictions. The low *per capita* rate tends to gainsay any suggestion that the absolute numbers are evidence of an 'over-indebtedness crisis' although, it may in part

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[22] For comparable data at least up to 2003 see R Efrat, 'Global Trends in Personal Bankruptcy' (2002) 76 American Bankruptcy LJ 81; *Ziegel* (n 8). See also R Mann, *Charging Ahead – The Growth and Regulation of Payment Card Markets* (CUP, Cambridge 2006) 65 showing that the UK had the lowest *per capita* filing rates in 2002 compared with Australia, Canada, Japan and the US.

[23] Population data is available from the Office of National Statistics: <http://www.statistics.gov.uk/CCI/nugget.asp?ID=6>.

reflect the availability of informal methods of debt resolution (discussed further below). In other words, there may be many more debtors in England and Wales who are *eligible* for formal insolvency proceedings that end up pursuing *informal* resolution outside of IA 1986 and so do not register in the official data. This carries the obvious implication that the rate of formal insolvencies is an incomplete measure of 'over-indebtedness'. It is beyond the scope of the present article to explore any further the reasons behind variations in *per capita* individual insolvency rates across countries.[24]

Changes in the incidence of IVAs relative to bankruptcies

Figure 1 shows that between 2003 and 2006 bankruptcies grew virtually in a straight line. Strikingly, in the same period, as Figure 1 shows and Table 2 below underscores, IVA numbers grew year on year at a significantly faster rate than bankruptcy numbers, albeit from a lower threshold. Year on year, bankruptcies grew steadily while IVA growth sky-rocketed culminating in the more than doubling of IVA numbers in 2006 compared to 2005. Furthermore, a cursory glance at Table 1 shows that by 2006 IVAs had come to account for over 40 per cent of individual insolvencies under IA 1986. However, in 2007, bankruptcies grew year on year by a modest 2.4 per cent whereas IVAs *declined* year on year by nearly 5 per cent. Thus, it was the decline in IVA numbers that

[24] Ronald Mann has suggested that variations may be attributable to a bundle of variables: different levels of indebtedness; different cultural attitudes to financial failure; the accessibility of the legal system as a source of bankruptcy relief; the availability of informal systems of relief. See R Mann, 'Making Sense of Nation-Level Bankruptcy Filing Rates' (4 February 2008) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1090609> 7.

accounted for the small decline in total numbers of individual insolvencies during 2007. The trend of declining IVA numbers as a proportion of total individual insolvencies has continued in the first two quarters of 2008.[25]

Table 2: Percentage year on year increase in individual insolvencies in England and Wales (2003-2007)

YEAR	TOTAL	BANKRUPTCIES	IVAs
2003	16.4%	15.3%	20.4%
2004	31.0%	28.1%	41.7%
2005	44.8%	31.7%	88.7%
2006	58.7%	33.1%	118.4%
2007	− 0.6%	2.4%	− 4.9%

The impact of the Enterprise Act 2002

With effect from 1 April 2004 the Enterprise Act 2002 made several changes to personal insolvency law in England and Wales. These changes − widely perceived to have liberalised the bankruptcy regime − are an important part of the legal backdrop to the rising numbers of formal insolvencies experienced between 2003 and 2006. Perhaps ironically given the prevailing demographics, the policy which animated the Enterprise Act changes was business-oriented. The starting point was the general proposition that fear of failure operates as a cultural disincentive to entrepreneurial activity. Policymakers claimed that personal insolvency law − and, in particular, the law relating to bankruptcy − gave rise to stigma which had the effect of reinforcing the disincentive.

[25] Insolvency Service, 'Statistics Release: Insolvencies in Second Quarter 2008' (1 August 2008) <http://www.insolvency.gov.uk/otherinformation/statistics/200808/index.htm>.

The Enterprise Act therefore introduced structural reforms designed to encourage entrepreneurship by making bankruptcy more accommodating and correspondingly less 'fear-inducing' or 'stigmatising' for entrepreneurs who expose themselves to failure by taking socially desirable business risks in good faith.[26] Firstly, it provides that debtors entering bankruptcy will have their debts discharged automatically after one year (rather than three years under the old law) and allows for the possibility of an even earlier discharge where the official receiver concludes that an investigation of the bankrupt's conduct and affairs is unnecessary.[27]

Secondly, it lifted many of the extensive restrictions, disqualifications and prohibitions that the law had previously imposed on bankrupts the function of which was to castigate bankruptcy as a form of social and moral failure. The English policy of deliberately stigmatising debtors who access the bankruptcy regime through the imposition of legal prohibitions was historically extensive and pervasive in scope. It reflected a deep-seated normative tendency towards the view that failure to pay debts (as

[26] Insolvency Service, 'Bankruptcy: A Fresh Start—A Consultation on Possible Reform to the Law Relating to Personal Insolvency in England and Wales' (2000); Department of Trade and Industry, 'Productivity and Enterprise: Insolvency—A Second Chance' (Cm 5234, 2001); D Milman, *Personal Insolvency Law, Regulation and Policy* (Ashgate, Aldershot 2005); A Walters, 'Personal Insolvency Law After the Enterprise Act: An Appraisal' (2005) 5 Journal of Corporate Law Studies 65; G Wilson and S Wilson, 'Responsible Risk-Takers: Notions of Directorial Responsibility – Past, Present and Future' (2001) 1 Journal of Corporate Law Studies 211.

[27] Official receivers are state officials who act as receivers and managers in all bankruptcy cases pending appointment by the creditors of a private sector trustee and who are statutorily obliged to investigate the conduct and affair of every bankrupt unless they think that an investigation is unnecessary. See IA 1986 ss 287, 289, 399-401 and text to nn 54-58.

evidenced by admission to the bankruptcy regime) casts doubt on moral character and the capacity for financial responsibility and stewardship. A handful of restrictions and disabilities still remain. For example, there are statutory restrictions on undischarged bankrupts acting as company directors[28] or obtaining credit without disclosing their bankruptcy.[29] However, the policy of stigmatising personal financial failure has been significantly relaxed. There is an array of public and private offices to which debtors are no longer denied access simply because they are bankrupt.[30]

Thirdly, the Act not only removed restrictions that previously applied to bankrupts *per se*, it also sought to discriminate more effectively between non-culpable and culpable bankrupts by introducing a new post-discharge restrictions system, modelled on the Company Directors' Disqualification Act 1986. This system is designed to penalise dishonest or irresponsible debtors who, by reason of their past misconduct, are deemed unworthy of a full 'fresh start.'[31] A debtor subject to post-discharge restrictions is prohibited from acting in various capacities (such as a company director or an insolvency practitioner) and from obtaining credit above a prescribed level without

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[28] Company Directors' Disqualification Act 1986 s 11.

[29] IA 1986 s 360(1)(a).

[30] Enterprise Act 2002 ss 265-267 lift the automatic prohibition on an undischarged bankrupt being or becoming a Justice of the Peace, an MP or a member of a local authority. See also Enterprise Act 2002 (Disqualification from Office: General) Order 2006 SI 2006/1722 made by the Secretary of State pursuant to powers contained in Enterprise Act 2002 s 268.

[31] A Walters & M Davis-White QC, *Directors' Disqualification and Bankruptcy Restrictions* (Sweet & Maxwell, London 2005) 529-572.

disclosing the existence of the restrictions.[32] Post-discharge restrictions can be imposed by the court on the application of the official receiver or, where the debtor consents, by means of a binding undertaking, for up to fifteen years.[33] Post-discharge restrictions do not affect the entitlement to automatic discharge.[34] As conceived, they restrict the culpable debtor's ability to re-enter and participate in 'credit society', thus confining the scope of the fresh start to discharge of pre-bankruptcy debts. They are noted on a public register and so are matters of public record.[35] The underlying theory was that the combination of a general relaxation of restrictions on undischarged bankrupts and a system of desert-based post-discharge restrictions would improve the information available to credit markets and affect credit scoring by enabling lenders to differentiate more easily between culpable and non-culpable debtors.[36]

Although these changes were primarily intended to remove barriers to entrepreneurship, they were universal in effect. Bankruptcy in England and Wales remains a unitary regime accessible to *all* debtors, not just business debtors. The Enterprise Act is generally perceived as having made bankruptcy more 'debtor-friendly'.[37] Some claimed at the outset that the reduction in the duration of bankruptcy

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[32] IA 1986 s 360(5).

[33] Ibid s 281A, sch 4A. On the official receiver see further text to nn 54-58.

[34] The only ground for suspending discharge is where debtors fail to comply with their statutory obligations to the official receiver and/or to their trustee in bankruptcy: see IA 1986 s 279(3)-(4). There are no grounds for absolute denial of discharge.

[35] IR 1986 rr 6A.6-6A.7.

[36] *Evaluation Report* (n 11) 10, 19, 86, 97-98.

[37] For a balanced view see __'Forgive and Forget?' *The Economist* (London 4 March 2004).

would encourage reckless borrowing and cause or contribute to accelerating numbers of personal insolvencies generally and of consumer insolvencies more specifically. With personal insolvencies now running at over 100,000 per annum, this view still persists.[38]

Of greater significance to the present discussion, it was also widely predicted that, in making bankruptcy relatively more attractive (at least for the non-culpable), the reforms would cause IVAs to wither on the vine.[39] It became commonplace for commentators to contemplate the possible death of the IVA. And yet, as we have seen, while bankruptcies continued to grow fast in the immediate aftermath of the Enterprise Act, IVAs − which were untouched by the Enterprise Act − grew *twice* as fast! This brings me to the central questions of this article. How do we explain the growth in IVAs relative to bankruptcies between 2003 and 2006? Why did IVAs continue to grow exponentially between 1 April 2004 and the end of 2006 in the face of the widely-held belief that the Enterprise Act would have a contrary effect? Why did IVA growth grind to a halt in 2007? As a necessary preamble to the discussion of these puzzles, the next section provides an account of the main options currently available for addressing consumer over-indebtedness in England and Wales explaining their principal legal and institutional features.

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[38] See __‘Lax British bankruptcy rules worsen credit crunch’ *The Times* (London 2 May 2008). The government is more sanguine. Cf. *Evaluation Report* (n 11) 27-30, 45-53 and works therein cited (emphasising the structural relationship between the rate of incidence of personal insolvency proceedings and changes in the credit market).

[39] P Boyden, ‘Individual Voluntary Arrangement’ *Recovery* (Spring 2004) 18; *Milman* (n 26) 136-137; *Walters* (n 26).

DEBT RESOLUTION OPTIONS FOR CONSUMER DEBTORS

Over-indebted consumers in England and Wales are confronted by a diverse and complex matrix of 'options' for dealing with their debt problems in an evolving market populated by a range of public, private and third sector provision. The Insolvency Practices Council, a public interest body that forms part of the regulatory framework for insolvency practitioners, has described the marketplace as 'confused' and 'populated by an "alphabet soup" of debt advisers and "debt solutions" without adequate objective information about their pros and cons and performance'.[40] Against that background, the 'options' considered in this section divide into two groups: formal options under the IA 1986 (ie bankruptcies and IVAs) and informal options available outside the insolvency system, principally debt management plans and various forms of refinancing.[41]

Bankruptcy

Bankruptcy under Part IX of IA 1986 amounts to a statutory bargain which seeks to balance the interests of debtors and creditors. The making of a bankruptcy order stays individual enforcement by creditors against the debtor[42] and so, in theory, should stop

[40] Insolvency Practices Council, *Annual Report 2007* <http://www.insolvencypractices.org.uk/reports/2007/annual_report.htm> 4.

[41] Pt V of the Tribunals, Courts and Enforcement Act 2007 reforms county court administration orders and has added further formal mechanisms – enforcement restrictions orders, debt relief orders and debt repayment plans – but these provisions are not yet in force and are subject to further consultation.

[42] IA 1986 s 285(3). It does not affect the enforcement rights of secured creditors: IA 1986 s 285(4).

creditor harassment. No later than one year from the date of the order the bankrupt is automatically discharged,[43] the effect of discharge being to release the bankrupt from his or her 'bankruptcy debts', meaning the debts or liabilities to which he or she was subject at the commencement of bankruptcy.[44] Discharge is central to the Anglo-American theory of the 'fresh start', the idea in the celebrated language of the United States Supreme Court that bankruptcy law should give 'the honest but unfortunate debtor…a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.'[45]

In return for these benefits, debtors are required to surrender all their non-exempt property. This forms the bankruptcy estate the proceeds of which are used to pay creditors.[46] Tools of trade and basic domestic necessities are exempt property and so fall outside the estate.[47] The policy is that debtors should not be reduced to utter penury or be inhibited from earning a livelihood. Bankruptcy has its most significant impact on debtors who own their homes (whether solely or jointly). The debtor's interest forms part of the estate. The home may therefore have to be sold in order to unlock its economic value for the benefit of creditors, although there are a number of rules that afford some

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[43] Ibid s 279 and text to n 27.

[44] Ibid ss 281, 382. Some debts are treated as non-dischargeable for policy reasons (eg criminal penalties, debts arising from fraud or fraudulent breach of trust, debts arising under a court order made in family proceedings, student loans). Discharge does not affect the enforcement rights of secured creditors.

[45] *Local Loan Co v Hunt* 292 US 234, 244 (1934). See also INSOL International, 'Consumer Debt Report – Report of Findings and Recommendations' (2001) <http://www.insol.org/pdf/consdebt.pdf> 22; *Niemi-Kiesiläinen & Henrikson* (n 5) 45-46.

[46] IA 1986 ss 281(1), 283, 283A, 306-308A, 436.

[47] Ibid s 283(2).

protection to debtors and their families in connection with the realisation of their interest in a dwelling house which is their sole or principal residence.[48]

As well as surrendering assets, debtors who are in receipt of regular income (usually by virtue of salaried employment) may also be required to make payments from income. Strictly, income arising after the making of a bankruptcy order does not form part of the bankruptcy estate.[49] However, the possibility of capturing the debtor's ongoing surplus income for creditors has been a feature of our bankruptcy regime since the Bankruptcy Act 1914. The current position in England and Wales is that debtors can be required to make contributions from surplus income for up to a maximum of three years under an income payments order or agreement.[50] Income payments can only be required if they do not reduce the income of debtors below what appears to be necessary for meeting their and their families' reasonable domestic needs. 'Reasonable domestic needs' is a flexible standard designed to balance the interests of debtors and creditors, the overall policy being to ensure that debtors contribute what they can reasonably afford for a finite period from future income and are not permitted to maintain extravagant lifestyles

[48] Ibid ss 283A (bankrupt's interest in dwelling house automatically ceases to be comprised in the estate three years after date of commencement of bankruptcy if steps not taken to realise interest), 313A (stays order for sale, possession or charge where value of bankrupt's interest in dwelling house is less than a *de minimis*, currently £1,000), 335A (one year stay of order for sale of family dwelling house to protect the interests of the bankrupt's partner and dependants).

[49] Ibid s 307(5).

[50] Ibid ss 310-310A. See further the Insolvency Service's in-house Technical Manual, ch 31.7 and Case Help Manual <http://www.insolvency.gov.uk/freedomofinformation/index.htm>. See also *Evaluation Report* (n 11) 125-138; *Milman* (n 26) 126-129; *Ziegel* (n 8) 116-118; G Miller, 'Income Payment Orders' (2002) 18 Insolvency Law & Practice 43.

at their creditors' expense. In legal terms, it can be seen that there is a *quid pro quo* for bankruptcy's 'fresh start'. Debtors must surrender non-exempt assets, may have to make income payments, are subject to some legal restrictions and, if their conduct is deemed sufficiently culpable, they run the risk of post-discharge restrictions.[51]

Bankruptcy is initiated either by hostile creditors or debtors themselves by means of an application to the High Court or a county court having insolvency jurisdiction.[52] The vast majority of bankruptcy orders are self-initiated: so-called 'debtor own' petitions.[53] All bankruptcies are processed by the official receiver ('OR') attached to the relevant court who initially serves as receiver and manager of the bankruptcy estate.[54]. ORs are state officials employed by the Insolvency Service, an executive agency of the Department of Business, Enterprise and Regulatory Reform, in various locations

[51] On bankruptcy restrictions see further text to nn 28-36.

[52] IA 1986 ss 264-268, 272, 373-374. The threshold for eligibility is that the debtor is unable to pay his debts.

[53] According to Ministry of Justice statistics, 73,270 bankruptcy petitions were filed in 2007. Of these, 53,114 (72.5 per cent) were 'debtor own' petitions and 20,156 (27.5 per cent) were creditor petitions: <http://www.justice.gov.uk/docs/insolvency-bulletin-2007-q4.pdf>. The rise in 'debtor own' petitions has led to increased pressure on the court service and prompted urgent reconsideration of the role of the court in this aspect of bankruptcy process: see Insolvency Service, 'Bankruptcy: proposals for reform of the debtor petition process' (2007) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/Initialstageconsultationpaper.doc>.

[54] IA 1986 s 287.

throughout England and Wales.[55] They are statutory office holders as well as civil servants who handle both bankruptcies and compulsory liquidations of insolvent companies.[56] They have a statutory duty to investigate the conduct and affairs of every bankrupt[57] in the discharge of which they act in the interests of creditors and in the wider public interest. One of the OR's first acts is to publicise the bankruptcy order by advertising it in the press and the London Gazette and by entering the details on the statutory insolvency register.[58]

Once the official receiver has completed an initial enquiry into the debtor's financial affairs, it is open to the creditors or the government to appoint a private sector insolvency practitioner ('IP') to act as trustee in bankruptcy in succession to the OR.[59] In practice, this only happens if the debtor's estate is complex, there are sufficient assets to make the appointment worthwhile taking into account the trustee's expenses and remuneration or there are matters worthy of investigation which may lead to recovery of assets and so increase returns to creditors. A trustee must be a licensed IP authorised to take insolvency appointments under Part XIII of IA 1986 by one of several recognised

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[55] IA 1986 s 287. For the OR network see <http://www.insolvency-service.co.uk/officemap.htm>. The Insolvency Service has both operational responsibility for the ORs and policy responsibility in the field of insolvency law.

[56] On the origins and history of the OR see V Markham Lester, *Victorian Insolvency: Bankruptcy, Imprisonment for Debt, and Company Winding-Up in Nineteenth Century England* (Clarendon Press, Oxford 1995) 170-221. On the nature of the OR's statutory office see IA 1986 ss 399-401; *Re Pantmaenog Timber Co Ltd* [2003] UKHL 49, [2004] 1 AC 158 [43]-[46].

[57] IA 1986 s 289.

[58] IR 1986 rr 6.46(2), 6A.4.

[59] IA 1986 ss 292-296.

self-regulatory organisations which include the main accountancy bodies.[60] In the event that an IP is not appointed, the OR becomes trustee.[61]

Overall then, bankruptcy is administrative rather than judicial in character although it is initiated in court and subject ultimately to judicial oversight. On paper there is a division of labour between the state and the IP profession in running the process. However, it is understood anecdotally that, in practice, there are rarely any significant assets in consumer bankruptcies. The implication is that many of these cases are retained and administered by the OR. The Insolvency Service also has a policy of retaining cases that involve straightforward asset realisations on the premise that these cases can be administered cost effectively in the public sector.[62] The picture of the consumer bankruptcy system that emerges is one in which the state plays the dominant role. In this system, case administration is funded from fees that debtors are charged as a pre-condition to entering bankruptcy and from the proceeds generated from any assets and income payments. The OR charges a flat case administration fee for the work done in the initial enquiry phase and, where a private sector trustee is not appointed, a so-

[60] The licensing framework for IPs which was established in the mid-1980s is set out in IA 1986 ss 388-398. For further background see V Finch, *Corporate Insolvency Law: Perspectives and Principles* (CUP, Cambridge 2002) ch 5; T Halliday and B Carruthers, 'The Moral Regulation of Markets: Professions, Privatization and the English Insolvency Act 1986' (1996) 21 Accounting, Organizations and Society 371, 399-405; A Walters and M Seneviratne, 'Complaints Handling in the UK Insolvency Practitioners Profession' (2008) <http://ssrn.com/abstract=1094757>.

[61] IA 1986 ss 293(3), 295(4).

[62] On the controversy provoked by this policy within the IP profession see L Brittain, 'The disappearance of the OR's rota' *Recovery* (Autumn 2006) 3; G Pettit, 'A level playing field' *Recovery* (Autumn 2007) 3; L Cramp, 'A better deal for creditors' *Recovery* (Winter 2007) 2.

called Secretary of State fee which is calculated as a set percentage of asset realisations. These fees are designed to ensure that, in so far as possible, the OR recoups the full cost of case administration. The fees are calibrated in such a way that cases in which there are assets of value in the estate to some extent cross-subsidise cases in which there are few or no assets.[63] Thus, consumer bankruptcy can be theorised as a service provided by the state the costs of which are largely borne by its users − that is, debtors and creditors. This contrasts with consumer IVA provision which, as we will see, is much more of a private sector concern.

IVAs

For centuries debtors have been able to enter into a composition or an assignment for the benefit of creditors with creditor consent under the general law, although the provision of statutory alternatives to bankruptcy modelled on such techniques goes back only as far as the early nineteenth century.[64] IVAs are binding consensual agreements between debtors and creditors facilitated by an IP within the parameters of a statutory framework. They were first introduced in the mid-1980s to provide an alternative to the little used deed of arrangement procedure. As originally conceived, they were intended to provide a bankruptcy alternative for self-employed traders and professionals. The Cork Committee, whose recommendations led to the enactment of IA 1986, envisaged that the main user groups would be personal guarantors of corporate debts, members of

[63] See further Insolvency Service, *Annual Report and Accounts 2006-07* (HC 752) 13-14.

[64] Lord Eldon's Act, 1825 6 Geo. 4, c. 16. See also *Cork Report* (n 1) 14-35, *Milman* (n 26) 130-137; *Markham Lester* (n 56) 34-36.

professions not permitted to take advantage of limited liability and unincorporated traders with sizeable gross business assets.[65] As bankruptcy restrictions have traditionally impacted through statutory or professional rules on the debtor's freedom to practice various professions, IVAs also offered a method whereby professionals could seek formal debt relief without necessarily having to forfeit their professional status. The idea of debtors and creditors reaching a binding agreement that would enable debtors to avoid bankruptcy was not novel. What was new was the statutory *modus operandi*.

Debtors who wish to achieve a resettlement of their debts through an IVA must start by making a proposal to their creditors. The proposal is usually put forward as a means of avoiding bankruptcy but it is also possible for a debtor who has gone bankrupt to make an IVA proposal with a view to having the bankruptcy annulled.[66] IVAs are flexible. They give scope for debtors to make affordable contributions from assets, ongoing income or third party funds, subject to creditor approval. Ultimately, an IVA stands or falls depending on what the creditors are prepared to accept. This is because an IVA only becomes legally binding if it is approved by in excess of 75% of the creditors by value.[67] Once an IVA is approved it binds all creditors who were entitled to vote by virtue of section 260 of IA 1986 regardless of whether or not they attended the creditors'

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[65] *Cork Report* (n 1) 91-92.

[66] IA 1986 ss 261, 263(A)-(G). There are analogies with payment plan alternatives such as the consumer proposal under Part III 2 of the Canadian Bankruptcy and Insolvency Act and the bankruptcy alternatives in Parts IX-X of the Australian Bankruptcy Act. See generally *Ziegel* (n 8).

[67] IA 1986 ss 257-258, 260; IR 1986 r 5.23. Strictly, the IVA takes effect if it is approved by in excess of 75% by value of creditors who actually cast their vote one way or the other. Creditors who are on notice but choose not to vote are ignored.

meeting or how they voted. IVAs are therefore contracts which are given statutory force so that (in American parlance) dissenting creditors can be crammed down.[68]

There are very few limits on what can be agreed. Creditors can demand modifications to the proposal before approving it.[69] There are no statutory parameters governing the duration of an IVA. However, in practice, in the case of consumer IVAs based on monthly contributions from income, the current market expectation among institutional creditors such as banks and credit card issuers is that the IVA will run for five years.[70] The only statutory controls are on terms which affect the right of secured creditors to enforce their security or the treatment of preferential creditors. Terms of this nature cannot be approved without the concurrence of the affected creditors.[71] Thus, an IVA is primarily a tool for resettling ordinary unsecured debts. Debtors who are home owners must keep up their mortgagee repayments to avoid repossession and those repayments will have to be taken into account in working out what they can afford to contribute into an IVA.

In order to propose an IVA, the debtor must enlist the services of an IP. IPs assist debtors in setting up IVAs and supervise their implementation, services for which they earn fees. The IP profession currently enjoys a statutory monopoly over IVA provision as by law a licensed IP is required to be involved in setting up and implementing an

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[68] *Re N T Gallagher & Son Ltd* [2002] EWCA Civ 404, [2002] 1 WLR 2380 [4].

[69] Ibid s 258(2)-(5).

[70] *Living on Tick* (n 20). A five-year payment plan is the default model under the IVA Protocol: see text to nn 140-141.

[71] IA 1986 s 258(4)-(5). Preferential creditors are unsecured creditors who have statutory priority in bankruptcy over the general body of unsecured creditors: IA 1986 ss 328, 386, sch 6.

IVA.[72] The process as envisaged by the statute is a follows. The debtor contacts an IP who assists in the drawing up of the proposal[73] based on information provided by the debtor about his or her financial affairs. Once the proposal has been drafted, the IP agrees to act in the statutory parlance as 'the nominee'. As nominee, the IP is statutorily obliged to report to the court on whether the proposed IVA has a reasonable prospect of being approved and implemented before then convening a creditors' meeting which votes on whether or not to approve the proposal.[74] The IP is also obliged by professional rules to be satisfied that debtors considering making a proposal have received advice about their available options, including bankruptcy.[75]

If the IVA is approved, there is a change of role: the IP ceases to be 'the nominee' and becomes 'the supervisor'.[76] The primary legal responsibility of the supervisor is to oversee implementation of the IVA, collect and distribute the debtor's payments net of

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[72] IA 1986 ss 388(2)(c), 389. Section 389A (introduced by the Insolvency Act 2000) provides scope for diluting the IP monopoly by allowing the Secretary of State to recognise bodies that could authorise non-IPs to act in relation to individual and/or corporate voluntary arrangements. To date, no such body has been recognised under this provision.

[73] IA 1986 ss 253 (with interim order), 256A (without interim order). The vast majority of IVAs are proposed without an application first being made to court for an interim order (a form of moratorium on collection efforts by individual creditors) under the section 256A procedure which was introduced by the Insolvency Act 2000.

[74] IA 1986 ss 256, 256A, 257.

[75] See Statement of Insolvency Practice 3 (England and Wales), Version 4 (effective April 2007) <http://www.r3.org.uk/publications/?p=80>. The debtor must be provided with a copy of the booklet 'Is a Voluntary Arrangement right for me?' (revd edn, April 2004) <http://www.r3.org.uk/publications/?p=80>.

[76] IA 1986 s 263(2).

his or her fees and ensure that the debtor complies with the approved IVA terms. The supervisor is also required to report annually to the creditors on the progress of the IVA. If the debtor's financial circumstances worsen over the lifetime of the arrangement − if, for example, the debtor becomes ill or loses his or her job − the supervisor may need to broker a variation of the IVA terms. Although, as nominee, the IP is obliged to report to the court on the viability of the proposal and the outcome of the creditors' meeting,[77] the court has no role in the approval process unless there is some irregularity.[78] An IVA is essentially a private deal between the debtor and the creditors with very few legal limits on what can be agreed which is subject to professional regulation[79] and limited oversight by the court.[80]

Advantages of IVAs for consumer debtors

In theory, IVAs have a range of potential advantages for debtors when compared to bankruptcy. Consumer debtors may prefer an IVA to other options, including bankruptcy, for the following reasons:

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[77] IA 1986 ss 256, 256A, 259.

[78] IA 1986 s 262. The decision of the creditors' meeting to approve an IVA can be challenged by a dissenting creditor on limited grounds within the period of 28 days beginning with the day on which the IP reports the outcome to the court in accordance with section 259.

[79] *Statement of Insolvency Practice 3* (n 75). The contents of Statements of Insolvency Practice are agreed by all of the various IP licensing bodies and they therefore govern all IPs.

[80] IA 1986 ss 262, 263.

1. An approved IVA will invariably provide for a stay on individual collection efforts and freeze interest on outstanding debts. These terms are industry standard and have the effect that consumer debtors are no worse off in these respects in an IVA than they would be in bankruptcy.[81]

2. IVAs provide debtors with debt composition and conditional release. Invariably, in approved consumer IVAs, the debtors will agree to repay what they can reasonably afford over a defined period of time in return for the creditors' agreement to accept less than 100 pence in the pound in full and final settlement subject to performance of the IVA terms. It is standard practice to provide that debtors will be released from all the debts within the compass of their IVA provided that they comply fully or substantially with their IVA obligations, compliance to be certified by the supervisor.[82] IVAs therefore offer the prospect of debt relief without the debtor having to petition for bankruptcy, albeit the discharge is partial − only an agreed proportion of the debts are written off − and conditional on debtor performance of the IVA terms. Thus, the 'fresh start' has to 'earned': debtors who fail to comply with their IVA obligations risk being bankrupted.[83]

[81] For the equivalent provisions applicable in bankruptcy see IA 1986 ss 285, 322, 328.

[82] For an industry standard see IVA Forum, 'Standard Conditions for Individual Voluntary Arrangements' (revd 25 January 2008) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/foum2007/plenarymeeting.htm> clauses 6-7.

[83] IA 1986 ss 264(1)(e), 276.

3. IVA debtors avoid the greater publicity and perceived stigma associated with bankruptcy. The fact that a debtor has entered into an IVA is, like a bankruptcy order, a matter of public record in that it must be entered on the statutory insolvency register maintained by the Insolvency Service.[84] It will therefore be picked up by the credit reference agencies. There is, however, no requirement for IVAs to be gazetted or advertised in the press.

4. IVAs provide debtors in certain occupational and professional groups with a debt relief alternative which, unlike bankruptcy, will not impact their ability (because of legal or professional rules) to continue in their occupation or profession.

5. Debtors who have non-exempt assets and relatively stable incomes may be able to protect assets that they would have to surrender in bankruptcy by offering creditors a

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[84] IR 1986 rr 6A.1-6A.2. In a recent survey, over 70 per cent of a sample of debtors gave answers that indicated a continuing perception of stigma attaching to bankruptcy. See J Tribe, 'Centre for Insolvency Law and Policy: Bankruptcy Courts Survey 2005 – A Pilot Study' (2006) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/personaldocs/BankruptcyCourtsSurvey.pdf> 104-107. See also two reports prepared by the Insolvency Service, 'Attitudes to Bankruptcy' (2005) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/attitudes/report-attitudestobankruptcy1.pdf>; 'Attitudes to Bankruptcy Revisited' (2007) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/ABrevisited/ABrevisitedMenu.htm>. These report findings from surveys of various groups, including bankrupts, which corroborate Tribe's findings. In particular, bankrupts identified the publicity given to bankruptcy orders through advertisement and the signal that bankruptcy sends about debtors' inability to meet their obligations as stigmatising factors.

higher proportion of their income by way of monthly contributions. Thus, the intuition is that consumer debtors with assets and relatively higher incomes should, in theory, favour a bankruptcy alternative such as an IVA whereas consumer debtors with few assets and relatively lower incomes should favour bankruptcy.[85]

6. Following on from the previous point, IVAs, in theory, provide salaried homeowners with a mechanism for protecting their homes. In bankruptcy, the debtor's interest in the home is at risk as it vests in the trustee for the benefit of creditors. In an IVA, the debtor's interest does not vest by operation of law in the supervisor; it remains with the debtor. Thus, so long as debtors can maintain their mortgage repayments, their home is not at risk. There is, however, a powerful creditor expectation that debtors who are salaried homeowners will release a portion of any equity that may accrue during the course of the IVA in addition to making monthly payments from income.[86] The industry standard requirement is an obligation on the debtor to re-mortgage towards the end of the IVA in order to release capital for the benefit of unsecured creditors who are bound into the arrangement. In theory, if allowance is made for the debtor to continue paying the mortgage, this can be expected to reduce the amount of the debtor's disposable income available for contributions towards repayment of unsecured debt. Equity release provisions are therefore designed to compensate

[85] *Ziegel* (n 8) 48.

[86] This creditor expectation is now enshrined in the IVA Protocol on which see text to nn 140-142.

unsecured creditors for accepting lower monthly contributions during the life of the IVA which enable debtors to maintain in full their repayments to secured creditors.[87]

IVAs also have theoretical advantages for creditors over bankruptcy:

1. They offer the prospect of better returns than bankruptcy.[88] It is understood anecdotally that consumer bankruptcy cases produce little by way of return to creditors. In the case of salaried debtors IVAs should produce higher realisations from ongoing income because creditors can demand contributions from income for a longer period than the three years permitted in bankruptcy.[89] In practice, IVA proposals are invariably drafted on the assumption that debtor contributions net of the IP's costs and fees will generate more for creditors than bankruptcy. The government's current policy is to reinforce this assumption by engineering a reduction in the fixed costs associated with the IVA approval process with the aim of increasing net returns to creditors.[90]

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[87] Who enjoy statutory protection by virtue of IA 1986 s 258(4). See text to nn 70-71.

[88] For historic evidence, see *Pond* (n 21). See also M Green, 'IVAs, Over-indebtedness and the Insolvency Regime: Short Form Report' (2002) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/ivapolicyresearch/shortformreport.doc>.

[89] The industry standard is five years for IVAs: see text to nn 69-70, 140-141.

[90] See further text to nn 111-113 on the forthcoming introduction of the simple IVA.

2. There may be reputational advantages for institutional creditors in supporting IVAs rather than resorting to bankruptcy as a collection device.

Options for consumer debtors outside of IA 1986: informal debt resolution

There is nothing to preclude consumer debtors from entering into informal arrangements for the rescheduling of debts with their creditors[91] and a considerable market for non-statutory debt management plans ('DMPs') has emerged in which there is a mix of private sector and third (voluntary) sector providers.[92] DMPs are simply rescheduling agreements which extend the contractual period for repayment. The standard pattern is that the debts are consolidated and the debtor pays an affordable monthly contribution to the provider who, in turn, distributes the payment among creditors. DMPs usually provide for repayment in full over time or repayment on the terms of the DMP until such time as the debtor has sufficient resources to meet the repayments as originally contracted. Costs vary according to the provider. Some providers pass their costs onto the creditors while others charge the debtor but spread the cost over the lifetime of the arrangement.[93]

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[91] *Cork Report* (n 1) 92.

[92] See I Ramsay, 'Bankruptcy in Transition: The Case of England and Wales' in *Niemi-Kiesiläinen et al* (n 4) 214-217.

[93] To illustrate, say that Debtor needs to pay £200 per month for five years to pay off her debts and the DMP provider's costs are 10 per cent of the total repayments (£1,200). If the creditors bear the cost (as is the case with DMPs offered by some of the voluntary sector providers that are credit industry funded) the provider will distribute the proceeds to creditors net of the 10 per cent but this will be treated as payment in

DMPs may have advantages for some debtors, such as homeowners, as they can be entered into without assets having to be surrendered. However, compared with bankruptcy and IVAs, they have several disadvantages. They do not stay individual collection efforts (they are informal and no more legally binding than a unilateral promise to forbear). Unlike IVAs, they do not provide a 'cram down' mechanism for dealing with dissentient creditors. There is no guaranteed interest freeze and no debt relief. The object of the exercise is simply to reduce monthly payments by stretching out the repayment period. Ultimately the whole debt together with interest remains repayable and it follows that the higher the debtor's debt to income ratio, the longer the DMP will need to last. Anecdotally, it is understood that DMPs have been entered for periods of upwards of 10 years. DMPs and their providers have hitherto been largely unregulated.[94] A form of statutory DMP has now been enacted although the relevant provisions have not come into force.[95] These provisions would not prevent debtors from continuing to enter non-statutory DMPs.

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full. If Debtor is required to pay the costs, the repayment term would need to be extended by a further six months to cover the costs and return one hundred pence in the pound to creditors.

[94] There is a requirement under the Consumer Credit Act 1974 for providers to hold a standard consumer credit license from the Office of Fair Trading if they carry out 'ancillary credit business' involving debt adjustment, counselling, collecting or administration relating to debts due under regulated consumer credit or consumer hire agreements. DMP providers need a license because the average consumer's debts are likely to include advances made under regulated agreements. Moves have been made in the direction of greater self-regulation through the establishment of the Debt Resolution Forum: see <http://www.debtresolutionforum.org.uk/index.php> and text to n 137.

[95] See Tribunals, Courts and Enforcement Act 2007 ss 109-133 and text to nn 144-145.

There are no reliable statistics indicating over time how many debtors have opted for DMPs. The Insolvency Service has estimated that around 72,500 debtors signed up to DMPs in 2004 accounting for 59 per cent of debtors who entered a debt resolution process in that year (the figures for bankruptcy and IVAs were 29 per cent and 9 per cent respectively and the balance was made up by the lightly used county court administration order process).[96] As these debtors are not counted in the insolvency statistics and are therefore hidden from view there is every reason to believe that the *per capita* rates for bankruptcies and IVAs do not accurately capture the full extent of consumer over-indebtedness in England and Wales.[97]

Aside from DMPs, the other route to informal resolution is some form of refinancing by way of consolidation loan or home equity release. Refinancing involves the taking on of new debt to repay old debt – in the popular jargon the old is 'rolled over' into the new. Refinancing solutions are therefore only viable for debtors who can realistically afford to service the new debt. In the light of the 'credit crunch' it seems likely that sources of funds for refinancing will be scarcer and therefore more expensive especially for borrowers with impaired credit histories.

[96] Insolvency Service, 'Improving Individual Voluntary Arrangements' (2005) ('Improving IVAs') <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/improvingIVAs.pdf> 11.

[97] See text to nn 22-24.

THE RISE OF IVAs 2003-2006

Recall the story recounted earlier based on the official statistics. Bankruptcies grew steadily between 2003 and 2006: 15.3% year on year in 2003 followed by straight line annual growth of roughly 30 per cent between 2004 and 2006). However, IVAs grew much faster: 41.7 per cent in 2004; 88.7 per cent in 2005; 118.5 per cent in 2006. Debtors therefore opted for IVAs in ever increasing numbers, and yet, from 1 April 2004, this growth took place against the background of an apparent easing of the bankruptcy regime. Although a streamlined procedure for consumer IVAs is now very much on the reform agenda,[98] there have been no legislative changes of comparable significance to the IVA regime since it was introduced in the mid-1980s.[99] So, not only did IVAs grow faster than bankruptcies between 2003 and 2006, they did so against a background in which the IVA regime did not change but the bankruptcy regime was (on one view) substantially liberalised. This then is our first puzzle: why did IVAs suddenly become more popular during a period (especially from the second quarter of 2004) when many believed that bankruptcy would become more popular relative to IVAs?

In the previous section, I considered a number of factors which may be thought to give IVAs an edge over bankruptcy for certain classes of debtor. To reiterate, the main advantages of IVAs are: (i) debtors can avoid the greater publicity accorded to

[98] See text to nn 111-113.

[99] Some changes were made by the Insolvency Act 2000, notably removal of the previous mandatory requirement for the debtor to apply to the court for an interim order (a form of stay) before making an IVA proposal to creditors. Applications for an interim order are now optional: see IA 1986 ss 252-253, 256A. In practice, the majority of consumer debtors propose an IVA without first applying for an interim order.

bankruptcy; (ii) debtors within certain occupational groups can avoid the impact of bankruptcy on their occupational or professional status; (iii) debtors with assets (especially homes) and relatively stable incomes have some prospects of protecting their assets by proposing an IVA. All of these advantages were available to debtors *well before 2003* and at a time when bankruptcy was considered to be less liberal. And yet IVA numbers were stable relative to bankruptcy numbers between 1999 and 2003 and actually *declined* in 2001 and 2002 while bankruptcy numbers were steadily growing.

Did the sudden increase in the popularity of IVAs perhaps have something to do with the profile of debtors? One possible theory is that there was a rising trajectory of financial distress among people for whom IVAs appear to be a natural solution: higher income debtors with assets to shelter; debtors in occupational or professional groups most impacted by bankruptcy. However, this still begs the question why these 'natural constituents' would suddenly opt for IVAs rather than DMPs which can also be used to shelter assets and avoid the residual legal restrictions applicable to bankrupts.

Furthermore, an analysis of over 6,000 IVAs entered into between July and November 2005 carried out by accountancy firm PricewaterhouseCoopers suggests that the average IVA debtor is likely to be 'unskilled, earning less than £30,000 per annum and living in rented accommodation'.[100] Although that evidence provides at best a statistically significant snapshot of IVA debtor profiles for five months in 2005, it offers some support for the view that IVAs have increasingly been populated by non-home-owning salaried debtors as well as by 'natural constituents'. These debtors − salaried debtors who have little by way of assets to protect − *may* make candidates for IVAs if

[100] *Living on Tick* (n 20).

they can afford a sufficient monthly contribution to satisfy the demands of creditors. However, from their standpoint, the *economic* choice between bankruptcy and an IVA does not obviously favour the IVA. It is not immediately clear why such debtors would voluntarily opt for a five-year payment plan (in accordance with prevailing creditor expectations) coupled with a long-term conditional discharge rather than a maximum three-year payment plan coupled with an automatic discharge after one year in bankruptcy. Moreover, an IVA debtor who defaults on the IVA payments risks bankruptcy in any event. A further point is that the credit industry does not appear to treat IVAs any more favourably than bankruptcy on the debtors' credit histories at the point of entry. The credit reference agencies simply classify entry into any formal insolvency procedure as 'default' though there may be some positive adjustment to the debtor's credit history in the event that an IVA is successfully completed.[101] It is true that debtors who go bankrupt are subjected to more intensive scrutiny and publicity than is the case with IVA debtors. It is also true that debtors risk the imposition of post-discharge restrictions in bankruptcy, although in practice the risk is less than 5 per cent because of practical constraints on the capacity of the Insolvency Service to investigate and process cases.[102] Thus, on balance, there seems to be a clear case for saying that

[101] See *Is a Voluntary Arrangement Right for Me?* (n 75).

[102] The Service secured 1,867 bankruptcy restrictions orders and undertakings in its financial year ended 31 March 2007. See Insolvency Service, *Annual Report and Accounts 2006-07* (HC 752) 18. There is a time lag between a debtor being made bankrupt and being made subject to post-discharge bankruptcy restrictions. But on a crude approximation based on a conservative bankruptcy rate of say 50,000 per annum and a generous bankruptcy restrictions rate of 2,000 per annum, only around 4 per cent of debtors

these debtors would be financially better off in bankruptcy. That they have opted for IVAs instead tends to imply that non-economic factors − perceptions of stigma associated with bankruptcy, concerns about additional publicity and scrutiny or even a moral impulse to repay as much as possible − may outweigh economic factors in influencing debtor behaviour.[103]

So far I have presented the choice between bankruptcy and IVA on the assumption that debtors will calculate the relative costs and benefits and act accordingly. But this rational choice calculus, which prioritises human agency-based explanations of behaviour over structural explanations, ignores the point that the 'choice' of option is very likely to be influenced by the debtor's interactions with the wide range of intermediaries in the public, private and voluntary sectors that offer debt advice and 'debt solutions'. The role of intermediaries is likely to be particularly significant where the 'choice' is complex and finely balanced as appears to be the case for salaried debtors who do not own their homes, have few or no high value assets and for whom bankruptcy poses no threat to occupational or professional status. Thus, we cannot arrive at a complete understanding of what happened between 2003 and 2006 without an account of how the market has developed on the supply side. Even assuming that IVAs have a natural constituency of debtors, there needs to be provision in the market to meet rising demand. It follows that institutional explanations of the rise of IVAs on the supply side

entering bankruptcy can expect to have to suffer post-discharge restrictions. At the current bankruptcy rate of over 60,000, the percentage is likely to be even lower.

[103] See *Insolvency Service* (n 84) suggesting that bankruptcy is perceived as being stigmatising precisely because it indicates failure to pay debts. Of course, IVA providers in the private sector have good incentives to 'talk up' the stigmatising effects of bankruptcy through the advice they offer.

are at least as important as (if not more important than) behavioural explanations on the demand side. Indeed, it is arguable that the significant changes in the market for debt resolution outlined below were the single most critical explanatory variable on the assumption that supply-side actors not only *meet* demand but also help to *create* it.

Explaining the rise of IVAs: the role of IVA factories

The exponential growth in IVA numbers occurred against the background of significant changes in the market for debt resolution characterised by the emergence of powerful new players offering commoditised volume 'debt solutions' to hard pressed consumer debtors. These players − sometimes pejoratively referred to as 'IVA factories' − have constructed business models which enable them to process high volumes of debtors through IVAs. A number of volume providers controlling between them high levels of market share established themselves rapidly.[104] Some of these leading firms acquired stock market listings. It is essentially this shift towards volume provision that drove the transformation of the IVA from a restructuring tool for self-employed debtors and professionals into a 'debt solution' for salaried consumer debtors.

The emergence of the factories amounted to a second stage in the evolution of volume provision of consumer debt resolution within the private sector. The first stage was the emergence of the unregulated debt management sector. Fee charging debt

[104] Based on an analysis of the individual insolvency register (on file with author), Michael Green of the University of Wales, Bangor has established that between 1995 and 2005 the market share captured by the top 20 firms by volume of IVAs arranged increased from less than 39% to around 82%. Moreover, nearly half of the top 20 firms by volume in 2005 had only entered the market in 2001.

management companies offering DMPs grew strongly during the 1990s as an alternative source of provision to third sector debt advisory services offered by organisations such as Citizens Advice and the Money Advice Trust. This was a period in which IVAs were stuck in a range of around 4,000 to 5,000 per annum, were still being used primarily by self-employed traders and professionals as was originally intended, and were being set up, more often than not, by small independent firms of insolvency practitioners.[105] Notwithstanding its statutory monopoly, it appears that the IP profession was not well geared up to exploit increasing demand from consumers for debt resolution through the medium of IVAs. There were a number of structural barriers. IPs have traditionally tended to operate along professional service lines with the vast majority of their fees deriving from corporate insolvency and restructuring work. Their principal sources of referrals are banks, accountants and solicitors, a referral network that works well in generating corporate case loads but does not connect with the public at large. A further barrier was that IPs were (and remain) subject to professional restrictions on advertising and on paying commissions to introducers of business with a view to securing appointments.[106] It has been argued that the IP profession's failure to capitalise on the rising tide of consumer over-indebtedness amounted to a failure of entrepreneurship.[107]

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[105] *Pond* (n 21).

[106] In seeking publicity for and/or advertising his or her services an IP must act consistently with 'the dignity of the profession' and 'should not project an image inconsistent with that of a professional person bound to high ethical and technical standards'. See Insolvency Service, 'A Guide to Advertising and Publicity' (1999) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/iparea/iparea.htm>. Payments or commissions offered to introducers of business are also considered unethical because they may compromise the integrity and objectivity of the IP in taking the insolvency appointment. See

The gap in the market was exploited by entrepreneurial new entrants who learned from the success of the early debt management companies. These entrepreneurs realised that IVAs could be offered to the public much in the same way as DMPs through a combination of high profile advertising and volume business processes. Some of the new providers were set up specifically to offer IVAs as a main service line while others were established by existing debt management companies.[108] In some cases there was explicit targeting of groups whose occupational status would be threatened if they opted for bankruptcy.

Given the IP profession's statutory monopoly, the new providers could not offer IVAs unless they could bring IPs into the business to act as nominees and supervisors. The business model which emerged is one in which a handful of IPs are employed by the provider to process high volumes of IVAs after initial screening has been carried out by low paid staff in a call centre or over the internet using a financial template designed to identify whether an IVA is a viable solution appropriate to the debtor's circumstances. Each element of the process is handled by different teams of staff in order to create an

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Insolvency Service, 'Guidance on Ethics and Professional Conduct' also available via the previous web link.

[107] *Green* (n 88).

[108] An example of the former is Debt Free Direct and of the latter is Blair Endersby which was established by the leading DMP provider Baines and Ernst: see <http://www.debtfreedirect.co.uk/history.php> and <http://www.blairendersby.co.uk/who-are-we>.

efficient division of labour.[109] Once the initial contact, known in the industry as a 'lead', yields the possibility of an IVA, one team verifies the financial information provided by the debtor and generates a draft proposal for consideration and review by an 'in house' IP, another team handles the approval process and yet another team supports performance of the IP's supervisory and collection functions post-approval. By around 2003 volume providers generating IVAs on this kind of platform had gained a foothold in the market alongside the debt management companies, the free advice sector and lenders offering consolidation loans and equity release.

The growth in high profile volume provision of IVAs appears to have had at least two effects which go a long way to explaining the increase in take up between 2003 and 2006. Firstly, it provided a more visible alternative to bankruptcy for consumer debtors who wished to avoid bankruptcy. Secondly, it seems to have attracted debtors who might otherwise have entered DMPs or who were already in long dated DMPs with many years still to run. In other words, on the balance of probabilities, there was not only an impact on the overall composition of formal insolvencies but debtors also switched from *informal* to *formal* debt resolution. In the absence of reliable data on DMP volumes it is not possible to measure the size of any switching effect. However, it does seem likely that the expansion of volume IVA provision stimulated a switching effect from DMPs to IVAs as the latter acquired media profile and became more widely available.[110]

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[109] For consideration of the kind of business process models that IVA firms use see *Walters & Seneviratne* (n 60) 30-34. Naturally, IVA firms do not operate on the model of a traditional provider of professional services.

[110] *Living on Tick* (n 20). See also *Ramsay* (n 92) 223 on the possibility of a 'substitution effect' away from long-term DMPs towards debt-relief mechanisms.

Government policy

These developments on the supply side of the consumer debt resolution market have occurred in a broadly supportive policy environment. Government policy rests on the premise that IVAs are the best instrument for balancing the interests of debtors and creditors within the context of a credit society. In other words IVAs are thought of as a 'win, win': good for institutional creditors who over a run of cases should generate better returns from IVAs than from bankruptcies; good for debtors who in return for a defined period of financial discipline will get some measure of debt relief in contrast to DMPs, which offer no such prospect, and may last indefinitely. Indirectly, IVAs may also promote financial responsibility and financial rehabilitation as they require debtors to commit to a strict budget: the 'fresh start' has to be earned. The following extract from a 2007 government consultation document reflects these various strands of current policy:[111]

> The IVA provides a flexible solution to a debtor's financial problems, balancing a debtor's need for certainty of reasonable payments over a set, planned timetable, against the need to maximise returns to creditors. An IVA is less punitive on the debtor (in terms of the restrictions imposed) than bankruptcy but it is not a soft

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[111] Insolvency Service, 'A consultation document on proposed changes to the IVA regime' (2007) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/proposedchangestoIVA.pdf> 3, 9.

option. An IVA requires commitment from the debtor as it is legally binding, publicly recorded and if it fails, the debtor can still be made bankrupt.

This policy thinking has been translated into reform. The government is expected to introduce a new 'simple' IVA ('SIVA') − a streamlined IVA designed for consumer debtors who have undisputed unsecured debts of £75,000 or less − in late-2008 or early-2009. The current IVA procedure will be retained for debtors (business or consumer) whose debts exceed £75,000.[112] The SIVA is an interesting example of contemporary law reform in that the Insolvency Service derived much of its content from the deliberations of a working group the members of which included representatives from the credit industry and from the volume providers. The aim of the reform is to reduce fixed costs associated with the current procedure that have to be incurred regardless of the size of the debtor's liabilities. So, for example, it is proposed to replace the current mandatory requirement for a 'real' creditors' meeting with the use of voting by correspondence and to remove several of the IP's existing reporting requirements. Some dilution of creditors' rights is also contemplated. Creditors will no longer be permitted to seek modifications of the proposed IVA terms − it will be a case of 'take it or leave it' − and the threshold for approval of IVA proposals will be reduced from the present level of in excess of 75 per cent of creditors by value to a simple majority by value. The theory is that by reducing fixed costs that are currently unavoidable there will be a corresponding increase in net returns to creditors.

[112] Ibid. For further background, see *McKenzie Skene & Walters* (n 11); *Improving IVAs* (n 96).

Public choice theorists[113] will probably not be surprised by the government's championing of consumer IVAs and its attempts (with stakeholder input) to streamline provision. If there were a substitution from IVAs into bankruptcy this could see bankruptcy numbers edging closer to the 100,000 per annum mark. Higher bankruptcy numbers would require a considerable further expansion of state provision and infrastructure through the OR network which could well stretch the Insolvency Service to breaking point.[114] Equally, a substitution from IVAs back into DMPs would increase demand for greater regulation of debt management companies. In present conditions, the promotion of a market for private bankruptcy serviced by licensed professionals (albeit within a model of volume provision) may be seen as a means of achieving an optimal balance between public and private sector provision of the 'fresh start'. The financial discipline of the IVA (as the extract above suggests) also offers a useful riposte to arguments that generous provision of debt relief engenders 'moral hazard'. Thus, it is suggested that developments on the supply side of the market have driven the growth of

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[113] See generally, D Skeel Jr, 'Public Choice and the Future of Public Choice-Influenced Legal Scholarship' (1998) 50 Vanderbilt LR 647.

[114] Further administrative burdens are already in the pipeline for the ORs. First, the Tribunals, Courts and Enforcement Act 2007 introduces debt relief orders, a form of administrative bankruptcy for *in pauperis* debtors who satisfy defined financial eligibility criteria. Secondly, proposals to remove the involvement of the court from debtor self-initiated bankruptcies are well advanced: see Insolvency Service, 'Bankruptcy: proposals for reform of the debtor petition process' (2007) <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/registerindex.htm>. These proposals would transform debtor-initiated bankruptcy into a largely administrative process under the aegis of the ORs.

the IVA market[115] within a policy environment in which the government has had no obvious incentive to hold the market back.

THE STALLING OF IVA GROWTH IN 2007-2008

This brings me to the second puzzle about IVAs. After the stellar growth of IVAs in the period 2003 to 2006, the overall rate of individual insolvencies dropped away slightly in 2007, a decline attributable entirely to a 5% fall in new IVAs. IVA numbers have continued to decline in the first two quarters of 2008.[116] If personal insolvency rates are simply a function of the amount of credit in the economy subject to a time lag then it could be that the numbers have simply peaked and are now on their way down correlating positively to credit conditions that were already tightening even before the onset of the 'credit crunch' in Autumn 2007.[117] However, 'macro' explanations of this kind speak only to the aggregate number of personal insolvencies. They do not explain the decline in new IVA approvals as a proportion of personal insolvencies.

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[115] See PricewaterhouseCoopers, 'Precious Plastic 2007 – Consumer credit in the UK' <http://www.pwc.co.uk/eng/publications/secure/precious_plastic_2007_consumer_credit_in_the_uk.html>: 'Our analysis indicates that cyclical factors alone would not have resulted in the sharp rise in insolvencies. The consumer credit boom has created a fertile environment in which debt advisers have been able to promote the IVA. The industry that has developed around this arrangement has certainly played an important role.' See also __'IVA factories fuel insolvency boom' *Guardian* (London May 4, 2007).

[116] In Q1 new IVAs were down 22% on Q1, 2007. In Q2 new IVAs were down 12.4% on Q2, 2007. See <http://www.insolvency.gov.uk/otherinformation/statistics/insolv.htm>.

[117] See __'Sounding the Retreat' *Economist* (London 13 July 2006).

It appears that much of the explanation for declining IVA numbers during 2007 and the first half of 2008 lies in the behaviour patterns of repeat players within the credit industry. Under the current law an IVA can only take effect if it is approved by in excess of 75% of the creditors who cast a vote. Ultimately, the consumer IVA market functions on the basis of continuous interaction between the providers and credit industry repeat players, principally banks, credit card companies and the intermediaries whom they appoint to represent their interests in the IVA process.[118] Institutional creditors or intermediaries who can control or co-ordinate up to a maximum of 25% of debt by value, are in a position to determine the outcome.[119] Credit industry repeat players are therefore a powerful and concentrated source of discipline within the market for IVAs. They are in a position to influence the outcome of many consumer IVA proposals and to dictate overall industry standards. It follows that if the credit industry loses faith in the providers and the IVA 'product' to deliver what are considered 'acceptable' returns, the number of IVA approvals is likely to go down all other things being equal.

[118] A leading intermediary is TiX which is part of the TDX group: see <http://www.tdxgroup.com/TIX.html>. The major credit providers have tended to outsource management of IVAs proposed by their customers to intermediaries such as TiX who act both as voting agents (analysing and deciding whether to accept proposals) and collection agents (monitoring the progress of IVAs post-approval and managing recoveries).

[119] This assumes that all creditors who are eligible to vote will vote one way or the other. If creditors do not all take an active interest in the approval process then, in practice, a creditor holding significantly less than 25% by value of the overall debt will often be in a position to determine the outcome as approval depends only on achieving the required threshold of votes in favour as a proportion of votes actually cast rather than as a proportion of total debt.

Against a background of increasing bank write-offs on unsecured lending to individuals during 2005 and 2006, which coincided with rising numbers of IVA approvals,[120] it is clear that there was a very considerable loss of faith on the part of the credit industry during 2007. Two leading volume providers announced profits warnings to the stock market in January 2007 citing 'creditor posturing' as the main reason for downwards pressure on IVA approvals and therefore on earnings.[121] Later in the year, a third large provider (one that had been in the top three by volume of new IVAs set up during 2003 to 2006) put its IVA business up for sale.[122] These developments were born out of a concerted backlash against the volume providers that had already begun before the end of 2006.

The first stage of the backlash was a sustained call by the credit industry for greater government regulation of the IVA providers.[123] Concerns were voiced about misleading advertising,[124] quality of advice,[125] IP costs and the reliability of the

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[120] See Bank of England, 'Monetary and Financial Statistics' (July 2008) Table C2.1 <http://www.bankofengland.co.uk/statistics/ms/current/index.htm>. See also __'Prudential blames IVAs for losses at Egg' *Financial Times* (London 19 October 2006).

[121] __'Their pain, your gain' *Investors Chronicle* (London 23 February 2007); __'Accuma shedding reliance on IVAs' *Financial Times* (London 19 October 2007).

[122] 'Intermediaries under strain as banks cut cost of rescheduling' *FinanceWeek* (Bristol 14 February 2008); __'IVA shares plunge amid profitability concerns' *Guardian* (London 2 October 2007).

[123] 'More regulation of IVAs rejected' BBC News (13 October 2006) <http://news.bbc.co.uk/1/hi/business/6047070.stm>.

[124] This prompted regulatory action by the Office of Fair Trading over IVA advertising. See __'OFT warns IVA providers over misleading adverts' (Press Release 8/07, 17 January 2007) <http://www.oft.gov.uk/news/press/2007/8-07>. The main target was the false claim made by some

providers' due diligence processes for verifying the financial information upon which IVA proposals are based. In short, institutional creditors appear increasingly to have lost confidence in the providers to put forward IVAs that would stand the test of time, complete successfully and deliver better net returns than bankruptcy (discounting the present value of projected returns over the life of the IVA to reflect the risk of debtor default prior to successful completion).

The second and more decisive stage in the creditor assault on IVAs was a determined attempt by creditors through their intermediaries to stiffen the criteria on which they were prepared to vote in favour of IVAs. In particular, creditors began increasingly to insist on 'hurdle rates' and ceilings on fees.[126] Hurdle rates are minimum projected rates of return. So, for example, a group of banks might insist on a projected rate of return of at least 40 pence in the pound as a pre-condition for approving IVAs regardless of the individual circumstances of debtors. Several of the large banks also insisted that the provider's fees should not exceed prescribed levels expressed as a percentage of the debtor's projected monthly payments. Proposals that did not meet the

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providers that an IVA could wipe off 'up to 90 per cent of your debt'. *Living on Tick* (n 20) suggests that the average *projected* dividend is around 37 pence in the pound which, assuming successful completion of the IVA, would mean only a 63 per cent write-off. Assuming a normal distribution of values with a low standard deviation, IVAs leading to write-offs of 75 per cent or more are likely to be outliers.

[125] The volume providers have responded to doubts over quality of advice and conflicts of interest by pointing to industry conversion rates of around 5 per cent – that is only 5 per cent of 'leads' (debtors who are referred to the providers or who contact them for advice) converted into approved IVAs. They argue that if there were widespread 'misselling', the conversion rate would be much higher.

[126] The prime mover was TiX. See eg __'Insolvency rule changes set to cut practitioners' fees' *Financial Times* (London 18 July 2007).

hurdle rate or comply with the fee cap became liable to rejection out of hand. This approach appears to have had a number of consequences. Firstly, it reinforced a rising trend of outright rejections by creditors without any consideration of the merits of the individual debtor’s proposal.[127] Secondly, it increased the prospect that some debtors would accede to creditor pressure to contribute more than they could reasonably afford leading to approval of unsustainable IVAs and the likelihood of early failure with little or no benefit to debtors or creditors. Thirdly, it imposed significant downward pressure on fees (hence the profit warnings alluded to above) with implications for providers’ margins and business models and for debtors for whom an IVA might have been appropriate but who had insufficient income to meet and sustain the levels of contribution demanded by creditors. Fourthly, it threatened to drive lower volume operators among the traditional IP community out of the market altogether. Indeed, those in the IP community who felt most squeezed by the stiffening of creditor approval criteria cried foul, launching attacks on the volume providers and the banks accusing them both of rigging the market.[128] Debtors whose IVAs might otherwise have been affordable and viable were caught in the crossfire as the creditors’ grip on the market effectively raised the barrier to entry. These debtors were restricted to a choice between bankruptcy or a DMP or left at the mercy of the increasingly aggressive collection efforts of some banks

[127] See __‘Northern Rock accused of bullying debtors’ *Observer* (London 30 September 2007); ‘Debtors deserve a choice’ *Recovery* (Summer 2008) 22.

[128] This is reflected in a members’ update issued by the Association of Business Recovery Professionals (R3), the IP trade association on 29 August 2007: see <http://myvesta.org.uk/articles/articles/3942/1/R3-Takes-TIX-Desire-to-Control-the-IVA-and-Insolvency-Practitioners-Seriously/Page1.html>.

under ordinary debtor-creditor law.[129] Consumer organisations and professional networks of IPs have added further to the pressure on the volume providers by questioning whether they provide appropriate advice and whether bankruptcy (which the volume providers have no economic incentive to promote) may not a better option for debtors than an IVA in many cases.[130]

Understanding creditor behaviour

It is clear then that conflict between institutional creditors and the volume providers accounts for the stalling of the IVA market in 2007. The question this begs is: why were creditors prepared to risk forcing consumer debtors who might otherwise have entered viable IVAs into bankruptcy which would be projected to generate lower returns even assuming three years' worth of income payments?

One theory is that the imposition of hurdle rates and fee caps was a hard-nosed attempt by institutional creditors to channel debtors away from the volume providers, and more generally from debt solutions delivered by licensed IPs, towards their own direct

[129] See the articles referred to at n 127.

[130] See concerns voiced by the UK Insolvency Helpline, a network of accountants and lawyers specializing in money advice: <http://www.insolvencyhelpline.co.uk/news/topnews1.htm>. A new breed of unscrupulous operators who, using personal data recorded on the statutory insolvency register, write advising debtors to default their IVAs and then charge fees to assist them in filing bankruptcy has also emerged. See reference to the so-called IVA Council: <http://www.debtquestions.co.uk/debt_forum/viewtopic.php?f=4&t=21367>; <http://www.insolvency.gov.uk/IVACouncilMessage.htm>; <http://www.cleardebt.co.uk/cd_press_1.php > and the account of its activities in *Mond v Mason* [2008] EWHC 1649 (QB).

collection functions or towards preferred intermediaries that they control and fund within the debt management sector. This may be thought of as a process of *disintermediation* in which the major banks and consumer credit providers reassert direct control over their over-indebted customers in order either to pursue aggressive recovery through ordinary debt collection methods supplemented by enforcement techniques such as charging orders[131] or to cross-sell informal resolution options such as debt management or loan consolidation without incurring the additional costs associated with IP intermediaries. There is anecdotal evidence that certain banks have used their votes to reject their customers' IVA proposals and then followed up with the offer of a consolidation loan shortly afterwards. It has also been suggested that banks have perverse incentives to prefer DMPs to IVAs because the former receive a more favourable accounting treatment. Apparently, debts subject to a statutory insolvency solution such as an IVA must be written off in full at the point of entry whereas the same is not true of debts subject to DMPs.[132] In these troubled times for the banking industry, DMPs may therefore have less impact than IVAs on the bottom line, at least in the short term.

[131] __'Creditors want your money, or your home' *The Times* (London 20 March 2008); __'Homes at risk as banks seek more security for credit card debt' *The Times* (London 22 March 2008). See also articles cited at n 127.

[132] See http://myvesta.org.uk/articles/articles/3942/1/R3-Takes-TIX-Desire-to-Control-the-IVA-and-Insolvency-Practitioners-Seriously/Page1.html.

CONCLUSION: FUTURE PROSPECTS FOR CONSUMER IVAs

This article has sought to demonstrate that the rise of the IVA to the status of a prominent 'debt solution' for consumers was predominantly market-driven and that the subsequent failure of the market to expand further can be explained by the conflict between its main participants − volume providers and institutional creditors − over quality of advice issues and approval criteria. In the present economic climate − which in England and Wales is characterised by rising inflation, rising credit costs, falling house prices and the legacy of rapid consumer credit expansion over the last fifteen years − there is every reason to believe that demand for consumer debt resolution will increase in the short term.

In this climate, IVAs would appear to have a useful role to play, especially as a debt relief mechanism for consumer debtors who are both salaried and propertied. Indeed, the attractiveness of the consumer IVA in policy terms seems unassailable. IVAs strike a balance between debtors and creditors. They offer debt relief in return for a considerable *quid pro quo* in terms of financial contribution and discipline: the fresh start − a clean slate and an opportunity to rejoin the 'credit society' − has to be 'earned'. To borrow a phrase from Jason Kilborn, IVAs can be theorised as 'a responsible reaction to the challenges of the open credit economy'.[133] Moreover, there are potential 'spill over' benefits in the form of financial responsibility and rehabilitation: the possible educative value of working to a managed budget; the scope for debtors who successfully complete their IVAs to repair their credit histories and engage in financial planning for the future.

[133] J Kilborn, 'Mercy, Rehabilitation, and Quid Pro Quo: A Radical Reassessment of Individual Bankruptcy' (2003) 64 Ohio State LJ 855, 890.

On this last point, some of the providers have grasped that debtors who succeed in IVAs make good prospective customers for savings and pensions products and there are signs that a market in financial services for IVA 'survivors' may be emerging.

Even if we accept that the policy is enlightened and the IVA is a socially desirable means of resolving consumer over-indebtedness in our version of the 'credit society', the present conflict between the main players in the market threatens to undermine provision. There remain concerns that IVAs are being 'missold': in other words, that unscrupulous providers are persuading debtors to enter into inappropriate and unsustainable IVAs that may generate sufficient contributions to cover the nominee's fee but ultimately leave the debtor still owing the original debts, exposed to bankruptcy or some other form of recovery process and therefore worse rather than better off. The risk of 'misselling' is, however, mitigated by a number of factors:

1. Providers that wish to remain in business have powerful economic and reputational incentives to set up viable IVAs in order to maintain market credibility and cash flow.

2. The market has undergone a process of consolidation which has led to convergence on a 'one-stop shop' model of debt resolution provision. Most of the major volume providers have become what I have termed 'integrated solutions providers'[134] offering a range of different debt resolution options, not just IVAs or debt management. This to some extent mitigates the risk that quality of advice could be undermined by conflicts of interest.

[134] See D Milman (2007) 20(6) Insolvency Intelligence 93.

3. Integrated solutions providers are regulated by the Office of Fair Trading under the consumer credit licensing regime. The OFT issued guidance in 2001 setting out the minimum standards to be met by debt management companies if they are to be judged fit to hold a consumer credit licence.[135] In January 2007, the guidance was clarified to make it clear that licensees who offer advice and assistance with the setting up of IVAs are regarded by the OFT as 'debt management companies' falling within its regulatory ambit. With effect from 6 April 2007, debtors can bring complaints about providers − which could include complaints about 'misselling' − to the Financial Ombudsman who has extensive powers to order redress.[136]

4. Several of the leading integrated solutions providers have joined together to promote self-regulation through the establishment in October 2006 of the Debt Resolution Forum to 'provide a voice for the industry and… set best practice standards for members.'[137] These players have commercial interests and market share to protect. It is therefore in their interests to commit to self-regulation for all the usual reasons:

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[135] OFT, 'Debt management guidance' OFT 366 (December 2001) <http://www.oft.gov.uk/shared_oft/business_leaflets/credit_licences/oft366.pdf> 8. A good illustration of the operation of the regime in practice was provided recently when the OFT flexed its muscles in relation to 17 IVA providers because it considered that their advertising material and websites contained statements likely to mislead consumers (n 124).

[136] See further *Walters & Seneviratne* (n 60) 43-46.

[137] Insolvency Practitioners' Association, 'Debt Resolution Forum founded as an industry voice and regulator' (Press Release, November 2006). See also the DRF's website: <http://www.debtresolutionforum.org.uk/index.php>.

management of reputational risk; maintenance of confidence among consumers and creditors; raising the bar for new entrants to the market.

5. The IP licensing bodies have also customised their approach to monitoring the fitness to act of IPs involved in volume provision.[138] They now assess the whole advice process from initial contact through to approval. They also monitor conversion and early failure rates. The conversion rate measures the proportion of people seeking advice from a provider that actually end up doing an IVA. A low conversion rate − and historically across the industry the rate has been well under 10% − tends to imply that IVAs are, on the whole, being appropriately targeted. The early failure rate measures the proportion of a provider's IVAs that fail in the first year. Needless to say, the higher the rate, the greater the cause for concern about the quality of the advice that debtors are receiving.

These factors notwithstanding, the view persists in some quarters that bankruptcy may often be at least as good, if not a better option, than an IVA especially for salaried debtors who own few assets. Those that subscribe to this view would point to the providers' lack of powerful financial incentives to recommend the bankruptcy option.

The risk of market failure does not arise solely from the risk of possible 'misselling' by the providers. The market rests on an interdependent relationship between providers (who desire to earn fees) and institutional creditors (who desire to

[138] Insolvency Service, 'Guidelines for Monitoring Volume IVA Providers' <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/iparea/iparea.htm>.

maximise net recoveries).[139] The stance taken by creditors on fees and hurdle rates is consistent up to a point with their desire to maximise recoveries. However, it may lead some debtors to offer more than they can realistically afford in order to secure approval, thus increasing the risk of early failure, while denying other debtors access to a sustainable and sensible solution that is projected to deliver 'better than bankruptcy' but 'lower than hurdle rate' returns. In this way, the market may operate to constrain debtor choice and frustrate public policy unless its participants can be persuaded that co-operation, rather than conflict, is in their mutual interests.

Given its policy commitment to consumer IVAs, the government through the Insolvency Service has taken steps to promote co-operation and build trust between the key players. In November 2007, industry participants including representatives of the providers and the British Bankers Association agreed an IVA Protocol for straightforward consumer IVAs. This is a voluntary industry code brokered by the Insolvency Service which establishes a standard framework for dealing with consumer IVAs.[140] If the debtor's proposal is put forward in accordance with Protocol processes and on agreed standard terms, the creditors are expected to approve it. The Protocol is designed to embrace both homeowners and non-homeowners. It requires providers to (i) comply with Office of Fair Trading guidance on advertising; (ii) ensure that debtors

[139] On the regulatory implications of this kind of organisational interdependence in markets see L Hancher and M Moran, 'Organizing Regulatory Space' in L Hancher and M Moran (eds), *Capitalism, Culture and Economic Regulation* (Clarendon Press, Oxford 1989).

[140] The Protocol and accompany documents can be accessed at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/foum2007/plenarymeeting.htm>.

receive full information on the advantages and disadvantages of *all* available debt resolution processes (which information is to be standardised across the industry); (iii) follow prescribed due diligence processes as regards verification of the debtor's income and expenditure; (iv) calculate contributions using standard form financial statements and agreed guidelines on allowable expenditure. It also entrenches as the default model a five-year IVA with homeowners to release equity above a £5,000 *de minimis*, but within specified limits, during the fifth year of the arrangement. No provision is made in the Protocol for dealing with fees as it was considered that any attempt to negotiate a fee cap or parameters for fees would render it susceptible to challenge under competition law as a price-fixing agreement.[141] Creditors are not bound to approve a Protocol compliant IVA but they have agreed to disclose their reasons for voting against such IVAs to the provider. However, there is an expectation that creditors will generally approve Protocol IVAs without modification 'wherever possible'. The Protocol is a deft attempt by the Insolvency Service to intervene in support of its policy in the hope that more drastic legislative intervention − which would be costly and troublesome to achieve − can be avoided. The government's approach, expressed in more ideological language, is well captured by the following extract from a public statement made by the Insolvency Service's chief executive:[142]

> What governments try to do is create markets that work; they don't take a commercial position…The protocol should give the customer more clarity and

[141] Competition Act 1998 s 2.

[142] S Houghton, 'Interview with Stephen Speed' *Recovery* (Autumn 2008) 59.

improve trust in the process. In this way, government can lubricate a market without having to regulate it. My hope and expectation is that as the protocol starts to take effect financial institutions and creditors will start to see that excessive hurdle rates are not in their interest.

It remains to be seen whether a voluntary code will successfully 'lubricate' the market. The operation of the Protocol is being kept under review by a standing committee populated by representatives from the credit industry, the providers and the IP community. The creditors appear to be hedging their bets. Another interesting feature of the Protocol is that debtors are required to disclose previous attempts to deal with their financial problems and explain why these were unsuccessful. The implication is that debtors should pursue informal solutions to their problems by speaking directly to their main creditors first instead of jumping straight into an IVA. This sort of approach − in which the banks strive to maintain control over their own customers − is in keeping with the process of informal resolution through bank-customer dialogue envisaged in the recently revamped Banking Code.[143]

The impression that the consumer IVA market is at a crossroads is reinforced by two other developments the consequences of which are difficult to predict. The first one is the simple IVA reform discussed earlier.[144] This is expected to make it onto the statute book in late 2008 or early 2009. In theory, the SIVA reduces the providers' costs therefore making SIVAs more palatable to creditors who also have less scope to block

143 The Banking Code (March 2008) <http://www.bankingcode.org.uk/home.htm> 24-27.

144 Text to nn 111-113.

them because of the change to simple majority voting. The second is the introduction in sections 109-133 of the Tribunals, Courts and Enforcement Act 2007 of a statutory debt management framework. This reform has been promoted separately by the Ministry of Justice. It will enable debtors to propose a statutory debt repayment plan with facility for partial repayment and discharge as long as the debtor keeps to the plan. The debtor will benefit from a stay and an interest freeze at the point of entry. Strikingly, there will be no creditor approval mechanism, although creditors will have limited rights to apply to court to challenge the inclusion of their debt or the plan terms. It will only be possible for approved operators to offer statutory debt repayment plans. Assuming these provisions are brought into force, statutory debt repayment plans will offer a functional substitute for IVAs that can be offered to the public without the involvement of IPs. This further expansion of consumer 'choice'[145] may therefore have considerable future implications for IVAs and SIVAs. On the other hand, there are reasons to be sceptical about the long term prospects for this latest initiative given that it involves a significant erosion of creditor rights.

It is clear that the future prospects for IVAs and SIVAs are for the most part in the hands of institutional creditors many of whom are under pressure in the current economic climate. As I have sought to demonstrate, these creditors appear to have good incentives to pursue alternative strategies beyond the pale of insolvency law for managing their recoveries. Consolidation among the providers coupled with the re-establishment of trust

[145] See Ministry of Justice, 'Tribunals, Courts and Enforcement Bill – Detailed Policy Statement on Delegated Powers' (2007) <http://www.justice.gov.uk/docs/TCEbill-policy-statement-delegated-powers.pdf> [238]-[239].

through the Protocol may lead to a period of relative stability and permit a further steady expansion of IVA numbers. However, were IVA (SIVA) numbers to creep up towards 50,000 per annum against a background of increasing write-offs, it seems realistic to suppose that creditors would once again threaten to desert the process. The likelihood of such a prospect would increase further if IVAs brokered in the more benign economic conditions of 2005 and 2006 turn out to have high early failure rates. Given the rising cost of living, creditors will also have to temper their expectations as regards rates of return if the market is to generate affordable and sustainable IVAs.

No doubt, the government will be praying that the Protocol sticks. The fear otherwise is that increasing numbers of consumer debtors will be forced into bankruptcy or onto the treadmill of long term debt management. More bankruptcies will put the OR network under severe strain and could prompt a creditor backlash against the 'debtor friendliness' of the Enterprise Act reforms. In the longer term, it will be interesting to see what impact the introduction of SIVAs and statutory debt repayment plans have on the overall picture. The only thing that seems certain is that powerful market actors − principally institutional creditors − will continue to play a critical role in shaping the increasingly complex choices that insolvent consumers face in dealing with their financial problems.