Debt Relief Orders

Insolvency procedures exist, primarily, to allow for the rehabilitation of over-indebted individuals and to enable them to re-enter the economic cycle. Each insolvency procedure has different features and requirements, so the most suitable route for each individual will depend on their particular circumstances.

Individual Voluntary Arrangements or Debt Management Plans, for example, require the consent of the individual’s creditors and assets or funds need to be available to distribute to creditors in order to settle at least part of the debt. Bankruptcy, on the other hand, does not require creditors’ consent, but will still involve the distribution of funds to creditors, acquired through the realisation of the debtor’s assets. It also has an entry fee of £700, placing it out of the reach of many indebted individuals.

Debt Relief Orders (DROs), introduced in April 2009 with a much lower application fee of £90, are aimed at people with relatively low debts and, importantly, very little surplus income and few or no assets, meaning that there is little or no prospect of a return for creditors. Like bankruptcy, DROs do not require creditors’ consent. Since their introduction, the number of DROs granted to indebted individuals has been steadily increasing, from just over 25,000 in 2010 to over 31,000 in 2012.

How does a DRO work?

In order to be eligible for a DRO, a person must:

• be unable to pay their debts;
• have unsecured debts of less than £15,000;
• have assets worth less than £300 (excluding a car which can be worth up to £1,000, approved pensions and basic domestic belongings such as clothes, bedding and furniture);
• have a disposable income of less than £50 per month after normal household expenditure.

Other entry criteria include the requirement that the individual must not be involved in, or petitioning for, any other formal insolvency procedure at the time of applying for the DRO and must not have been subject to a previous DRO within the last six years.

An individual can apply for a DRO by completing an application form online through an authorised intermediary. Intermediaries are advisers from the debt advice sector, for example, Citizens’ Advice Bureaux, who have been authorised to assist individuals with the completion and submission of their DRO application. An individual can only apply for a DRO with the assistance of an intermediary.

What is a DRO?

A DRO is a formal insolvency procedure initiated by an individual when they complete an online application form, supervised by an authorised intermediary. Once granted, a DRO will prevent enforcement action being taken against the individual by their creditors. The order will last for 12 months, after which time the majority of the individual’s debts will be written off, although they will remain liable to pay certain debts, such as court fines, child maintenance, student loans, certain liabilities to pay damages and secured debts, which cannot be included within the DRO.

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There is a £90 fee for the application, which can be paid in instalments, although it is non-refundable, even where an application is declined. Once the application is made, the Official Receiver (OR) – a Government official based at the Insolvency Service and an officer of the court – will make a decision on whether to grant the DRO based on the information provided. The OR has the power to decline the order or to delay it pending further information from the individual. They will also administer the DRO after it has been made, looking into the individual’s financial affairs where necessary and in all cases, notifying creditors of the order. Creditors can object to the order, subjecting to fulfilling certain criteria.

What are the consequences of a DRO?

During the period of the DRO, the individual must comply with any requests by the OR for further information about their financial situation. They will also be subject to a number of restrictions, similar to those in bankruptcy, which will apply for the duration of the DRO. For example, they will be unable to obtain more than £500 of credit from anyone without first disclosing their DRO and cannot act as a company director without the court’s consent. Throughout the duration of the DRO, the person must also not make any direct payments to creditors whose debts are included in the DRO.

As in bankruptcy, individuals subject to DROs will have their name placed on a register maintained by the Insolvency Service and an entry will be made on their credit file to record the DRO. The entry on their credit file will last for six years from the date of the order, even after the DRO has come to an end.

If the individual’s circumstances change during the period of the DRO and they no longer meet the eligibility criteria, for example, they become able to make payments to their creditors, the OR will have to consider whether or not to cancel the DRO. If the change in circumstances occurs near to the end of the 12 month period, the OR can decide to extend the DRO period for a further three months to enable the individual to come to an arrangement with their creditors. The individual would be subject to the same restrictions and receive the same protection from creditors during the extended period.

There are civil and criminal penalties in place for people who abuse the system. The OR has the power to revoke a DRO if the individual is found to have failed to give an accurate account of their financial affairs, such as deliberately leaving information out of their application, meaning that they do not meet the DRO eligibility criteria. If the OR revokes a DRO, the individual would once again become liable for all of the debts included under the order and therefore subject to any renewed enforcement action by creditors. If the failure to provide an accurate account of their financial situation is very serious, the individual can also be charged with a criminal offence and/or made subject to a civil action called a Debt Relief Restrictions Order (DRRO) granted by the court, which extends the period of time over which the person is subject to the DRO restrictions for between 2 and 15 years.

A DRRO can also be imposed on individuals where the OR determines that they have been dishonest before or during their DRO or are otherwise blameworthy for their financial position, such as incurring debts which they had no reasonable chance of repaying, gambling, fraud, giving away assets or selling them at less than their value. The individual can also voluntarily sign a Debt Relief Restrictions Undertaking (DRRU) which has the same effect as a DRRO without the need for a court process.

Increasing the scope of DROs – a solution to the bankruptcy barrier

To petition for their own bankruptcy, individuals are currently required to pay an up-front fee of £700, made up of a court fee (£175) and a case administration fee (£525). The court fee can sometimes be waived in certain circumstances but the case administration fee is never waived as this income enables the OR to administer bankruptcy cases.

By definition, many people facing bankruptcy do not have access to significant sums of money. It is therefore counter-intuitive that people who are hugely indebted can find £700 to apply for bankruptcy, unless they go further into debt and/or avoid paying other creditors. For many people, an up-front fee is therefore a significant barrier to entering bankruptcy; even when it may be the most appropriate debt solution for their circumstances. A survey of R3 members revealed that 29% had seen debtors unable to afford to go bankrupt, even though bankruptcy would be the most appropriate solution, and when asked what the debtor tended to do next, 58% said that ‘the individual does not address their debts’.

As a result of not being able to afford bankruptcy, many individuals may be pushed towards inappropriate debt solutions, possibly making their situation far worse.

Case Study

Due to ill health, an individual and his wife in the North West got into serious debt, which further exacerbated their health problems. Having recently sought advice from a debt adviser after suffering a serious breakdown, they were advised to go bankrupt due to their age and ill health. Despite bankruptcy being the most appropriate solution for their circumstances, they are unable to find £1,400 to pay for their bankruptcy fees (£700 each). Their debt problems are getting worse, including visits from bailiffs, which has led to further health issues and severe depression. As they cannot afford to go bankrupt, they are now being forced to seek alternative debt relief solutions.
R3 believes that DROs have a vital part to play in assisting individuals to access debt relief in appropriate circumstances without the significant financial barrier associated with bankruptcy. Increasing the debt and asset thresholds for DROs would make them an option for many more individuals who have no significant assets from which to provide returns to creditors but who are currently unable to access either bankruptcy, due to cost, or a DRO due to the current entry thresholds. R3 therefore suggests that the asset threshold could be increased to £2,000 and the debts threshold to £30,000 in order to widen entry into the DRO procedure.

In view of the increase in personal debt in the UK over the past decade, the £15,000 debt limit is actually fairly low. The median unsecured debt of those who enter bankruptcy, for example, was just over £38,000 in 2012/13. Given that over 50% of bankruptcies involve individuals with few or no assets, it is reasonable to assume that a significant proportion of financially distressed individuals have few assets but debts of between £15,000 and £30,000. It is also reasonable to assume that, given their low level of assets, this is precisely the group most likely to be locked out of debt relief by the up-front bankruptcy fee cost, or a DRO due to the current entry thresholds. R3 therefore suggests that the asset threshold could be increased to £2,000 and the debts threshold to £30,000 in order to widen entry into the DRO procedure.

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on the one hand and the current DRO debt threshold on the other. Raising the DRO debt threshold to £30,000 would enable these debtors to access debt relief at a more feasible cost.

R3 also believes that the asset threshold for DROs should be raised to £2,000. As well as further helping to increase access to debt relief, this could also be beneficial for the public purse. For example, administering bankruptcies carries a cost for the OR. As mentioned above, more than 50% of bankruptcy cases are said by the Insolvency Service to have few or no assets, which they define as cases where the assets are insufficient to cover the OR's cost of administering the bankruptcy, let alone provide a return to creditors. In order to subsidise these cases, the OR applies a ‘Secretary of State’ fee to cases with assets of over £2,000. By increasing the DRO asset threshold to £2,000, cases in which there is no distribution to creditors and which are a net loss to the state could, subject to the DRO debt threshold, be transferred into the cheaper DRO procedure. If, as expected, this led to a significant decline in the number of nil or low asset cases being dealt with through bankruptcy, this would also allow for the possibility of a reduction in the Secretary of State fee, thereby improving returns to creditors in those bankruptcy cases that do have realisable assets.

It is also important to remember that DROs should not be considered a ‘lighter’ option compared to bankruptcy and should not be viewed as a way in which people can easily get rid of their debts. Although there is no debtor's estate in a DRO, meaning that there are no payments to creditors because there are no assets from which to make such payments, individuals subject to DROs are still subject to the same restrictions as bankrupt individuals and similar criminal or civil actions if they are found to have been dishonest, fraudulent or in some way blameworthy for their financial circumstances.
17,441 DROs were granted, over half of which were obtained by individuals who were unemployed and just over 20% of which were granted to employed or self-employed people. There is therefore potential, in view of the number of individuals who are unemployed and seek DROs, for the potential revocation of a DRO to act as a deterrent for a significant proportion of individuals, effectively dissuading them from seeking new employment or improving their employment status. The Insolvency Service’s report6 also recognises that, whilst economic and psychological barriers to seeking employment may exist before debt relief is sought, for example where individuals may believe that any financial gain or extra money will only be available to pay off debts, following a DRO the disincentive to seek employment may persist, as individuals are concerned about becoming ineligible to continue with their DRO and therefore losing the benefit of the debt relief afforded by this procedure.

In order to remove such a disincentive, R3 believes that a mechanism should be introduced whereby individuals who declare a change in circumstances enabling them to make a contribution to creditors are able to do so, without losing the benefit of their DRO. This would recognise the difference between individuals who do the right thing in declaring extra income or assets whilst retaining the deterrent of revocation for those who seek to cheat the system.

One way of achieving this might be to enable individuals who declare a change in circumstances during their DRO to be given the option to transfer into bankruptcy, thereby making them subject to a bankruptcy order and the protection from creditors afforded by that order. Recognising that bankruptcy involves a higher entry fee than a DRO, one way in which the burden of any requirement to pay the increased fee could be alleviated would be to allow the debtor to pay by instalments over the term of their bankruptcy or, for example, postponing the individual’s discharge from bankruptcy until they had made all of the required payments. In this way, the debtor would still benefit from debt relief over the period of their bankruptcy whilst the requirement to pay the bankruptcy fee would also be met, albeit over a longer period of time.

Bringing DRROs into line with Bankruptcy Restrictions Orders (BROs)

The OR may also revoke a DRO where the individual deliberately left out information on their application form in order to falsely demonstrate that they met the entry criteria, or provided false information to the OR about their eligibility for a DRO. This situation is distinct from what could be termed an ‘innocent’ change of circumstances involving an income increase or obtaining new assets during the period of the DRO. In circumstances where the debtor has provided false information or deliberately lied or left out information on their application form, R3 believes that the effect of revocation of their DRO should apply retrospectively without any limitation period. This would mean that if, for example, a debtor held an undeclared asset worth more than £300 at the time of obtaining their DRO but this fact did not come to light until after the DRO had come to an end and their debts had been written off, the OR would still be able to pursue revocation of the DRO, the relevant date for revocation being the date on which the debtor lied or provided the false information. In R3’s view, the prospect of being made liable for all of their debts once again, even in cases where the DRO has already ended, may act as a strong deterrent to those debtors who consider lying or withholding information on their application forms. In cases where the DRO is revoked in such circumstances, other debt relief procedures, such as bankruptcy, would still remain available for the debtor.

R3 believes that where an individual declares a change in circumstances during their DRO, such that they no longer meet the DRO entry criteria, they should be able to make a contribution to their creditors and continue to be afforded debt relief. This could be achieved through the option of a transfer into bankruptcy.
R3’s recommendations

- R3 believes that the debt and asset thresholds for DROs should be increased in order to allow more indebted individuals who cannot currently afford to go bankrupt to access an alternative debt relief procedure at a significantly lower cost.

- R3 believes that where an individual declares a change in circumstances during their DRO, such that they no longer meet the DRO entry criteria, they should be able to make a contribution to their creditors and continue to be afforded debt relief. This could be achieved through the option of a transfer into bankruptcy.

- R3 believes that the effect of revocation of a DRO in circumstances where the debtor has deliberately withheld information or provided false information on their application should apply retrospectively without any limitation period.

- R3 believes that DRROs should only be granted where the individual is still subject to a DRO in order to provide symmetry with the current bankruptcy process.

Unlike BROs, however, a DRRO can be applied to an individual who has had their DRO cancelled. This would leave them subject to all the DRO restrictions for up to 15 years, but affords them no debt relief at all – they would still be liable for all their existing debts which had been included under their DRO prior to its revocation. Whilst either revocation or a DRRO might be appropriate in certain circumstances, it seems an inequitable discrepancy within the current DRO system that both could be applied simultaneously. Whilst this discrepancy may only have occurred infrequently since DROs were first introduced, R3 believes that it should be addressed in order to bring the DRO system into line with the bankruptcy process.

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