

Unlocking a new start

Why insolvency alone cannot provide a new start for people in severe financial crisis

In the UK, we believe that people trapped in inescapable debt should be offered the chance to start afresh, and we recognise the importance of having a legal framework that provides this opportunity. Each year, 130,000 people go through insolvency proceedings.¹ Although feedback from those CAP has helped leaves no doubt that insolvency is a powerful way of resetting the clock, many people still remain trapped in the grip of persistent poverty.²

Three in five (57%) of the people CAP helps with debt require an insolvency option to become debt free.³ These solutions are vital and without them hundreds of thousands of people would otherwise face more than four decades trying to repay their debts.⁴ An evaluation of CAP's service by the London School of Economics (LSE) Housing and Communities concluded that there are significant social returns from the relief of being heavily indebted, including from feeling in control of your own life and higher confidence.⁵

Yet, the challenges faced by low-income families go beyond the debt solutions on offer. Addressing these challenges is about tackling the wider issue of poverty. On average, CAP clients' household income is just £1,030 a month (after housing costs) and two in three (64%) live below the poverty line.⁶ In 2016, nine in ten (91%) CAP clients who had become debt free through a Debt Relief Order (DRO) in the preceding five years had remained free of problem debt.⁷ Since then society has changed; welfare reforms have thrown many people into dire financial straits while the benefit freeze has contributed to the erosion of real incomes.⁸

Debt Advisors are now increasingly dealing with broken budgets, where expenditure outweighs people's income, even if they are only spending on absolute essentials. As many as one in three people who seek help from CAP have experienced destitution while in debt, unable to even afford these essentials.⁹ With the depth of poverty faced so severe and persistent, even after debt liabilities are reduced, three quarters (77%) of insolvency clients remain in an unsustainable financial position.

This research explores why insolvency solutions cannot always provide a new start to someone in a persistent debt crisis. It is informed by analysis of the financial circumstances of all 1,953 households supported by CAP's insolvency team in June 2019. This sample includes people living in all parts of the UK who are progressing towards a DRO, bankruptcy or sequestration. In addition, four focus groups with frontline Debt Coaches and Advisors have allowed exploration of the reasons clients can continue to be held back.

Is insolvency a new start? CAP's Debt Advisors say...

'For the vast majority of people, it's a positive thing to go through [an] insolvency. There are so many people for whom it's such a relief and it's life changing.'

'It depends on how you define a fresh start... for a lot of our clients it's that the bailiffs aren't going to knock on their door. They might still only have £10 a week for gas and electricity but that's all they're used to.'

'It's getting to the stage now where I'd say very few really get a fresh chance at life. Debt is one aspect of their financial and social struggles.'

1 | Insolvency Service (2019) *Individual insolvency statistics: January to March 2019*, available at bit.ly/2Pp2TNQ

2 | In this paper insolvency is used to refer to becoming formally insolvent through a statutory insolvency solution. For more details about the different types of insolvencies see page 7.

3 | Percentage of new clients progressing to an insolvency route after debt advice in twelve months between 18 September 2018 and 17 September 2019.

4 | Average estimated repayment term at point of advice of CAP clients choosing an insolvency route is 46 years.

5 | LSE Housing and Communities (2018) *Never just a number: Evaluating the impact of a holistic approach to UK poverty*, available at capuk.org/neverjustanumber

6 | CAP (2019) *Christians Against Poverty client report 2019: Changing perceptions*, available at capuk.org/clientreportpdf

7 | CAP (2016) *The freedom report*, available at capuk.org/freedomreport16

8 | United Nations Human Rights Council (2019) *Visit to the United Kingdom of Great Britain and Northern Ireland: Report of the Special Rapporteur on extreme poverty and human rights*, available at <http://bit.ly/2IGg5Qm>, Resolution Foundation (2019) *The living standard audit 2019*, available at <http://bit.ly/2mGrOyE>

9 | To be destitute is to be unable to afford to buy the absolute essentials needed for basic physiological functioning. CAP clients are deemed to have experienced destitution if they regularly went without two or more of these essentials while in financial difficulty: shelter, food, heating, lighting, clothing/footwear and basic toiletries. See CAP (2019) *Left destitute by debt*, available at capuk.org/destitutionpdf

Key findings

A new start?

Debt Advisors describe how the release of the pressure and stress that going debt free through an insolvency option can provide is instrumental in improving emotional and financial health. Yet, debt is often just one lock in the prison of complex problems that traps people in persistent poverty. It follows then that many people continue to face constraints on their financial sustainability and resilience. That is why a package of ongoing support, such as that provided by CAP's partner church network, is what truly makes the difference in helping people move forward, break social exclusion and build their self-worth, despite any ongoing financial struggles.

Chronic financial difficulty

For many people, their debt problems do not purely stem from a single life event or short-term crisis from which they can quickly bounce back. The most common causes of debt encountered by CAP clients are chronic and persistent, such as low income or mental health problems, often exacerbated further by a personal crisis such as a bereavement or job loss.¹⁰ People in need of insolvency generally have limited financial means; therefore, debt relief does not always solve the long-term problem. If the root causes, such as unemployment or ill-health, have not been dealt with then a financial new start may be short-lived.

The role of insolvency

There are many factors that impact someone's emotional and social wellbeing. This paper focuses on the role insolvency solutions are expected to play in this mix. Insolvency provides a financial new start to allow someone who is unable to repay their debts an avenue to regain control of their finances. However, in the focus groups, Debt Advisors discussed a wide variety of constraints that keep people locked out of a sustainable and resilient financial position and prevent them from moving forward. The ten most common themes are presented in the table to the right, and those most relevant to regaining financial wellbeing through insolvency are discussed further in this paper.¹¹

CAP Debt Advisors say...



'The whole meaning of insolvency is that they can't repay their debts which means it's likely they can't afford other things as well. Just because their debts are being cleared doesn't mean their circumstances are going to change vastly.'

Realising a new start



Why is an insolvency not always a new start? Top 10 themes from focus groups

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| 1. Low income means people cannot meet basic living costs even when debt issues are resolved | Broken budgets
page 4 |
| 2. Cannot afford to save to build resilience against future shocks | No financial resilience
page 5 |
| 3. Other complex problems such as mental ill health and addictions | |
| 4. Deductions from benefits erroneously continuing post-insolvency | Continuing deductions
page 5 |
| 5. Bank account is closed due to the insolvency | Loss of services
page 6 |
| 6. Impact on credit rating restricting access to affordable products, services and housing | |
| 7. Still feeling or being indebted | Still indebted
page 6 |
| 8. Creditors still chasing payment because of notification delay | |
| 9. Not being able to make significant lifestyle changes | |
| 10. Household budget is not sustainable long-term | |

10 | CAP (2019) *Christians Against Poverty client report 2019: Changing perceptions*, available at capuk.org/clientreportpdf, CAP (2019) *Stacked against*, available at capuk.org/stackedagainstpdf

11 | There were 21 themes identified from the focus groups as to why an insolvency may not be a new start for someone. The ten most relevant to achieving financial sustainability and resilience are presented in this paper and ordered by the scale of impact these have in CAP Debt Advisors' views.

Real lives

Phil and Sharon, CAP Debt Help clients, Midlands



Phil and Sharon shared about their journey in debt at Give Hope Live, one of CAP's fundraising events (Photo by Phil & Sharon).

Phil and Sharon became trapped in a financial prison when Phil's health meant he could no longer work. In 2018 they became debt free through a DRO and were determined to keep carefully to their budget going forward. Like many CAP clients, they did not have enough money to save for the future and soon found themselves in debt again when their disability benefits were unexpectedly stopped.

'I have eye problems through my diabetes, and my kidneys are packing up. I used to be a chef, then I worked in a warehouse. At the time they took my driver's licence off me because of being ill. It's just me and Sharon – I couldn't work and now Sharon is my full-time carer.

It was just never ending – we were getting deeper and deeper. Phone calls, letters, bailiffs at the door. I was suicidal, so was Sharon. We stayed in the house, we didn't go out, we didn't speak to anybody. One day I went for a walk and nearly jumped off a bridge. That's when I decided I needed to do something. It took me a couple of days but I did eventually ring CAP.

It was just a relief getting everything going and having somebody to sort it with us. We had a possession order for the house and Andrew, our CAP Debt Coach, came to court with us to help. We managed to keep the house, and all the debts got written off in a DRO. It was the best thing when I got a card from CAP saying congratulations, I was debt free.

After the DRO it was 100% different for a few months and we made every effort to stick to our budget, but then our PIP was stopped.

We didn't know what had happened until the money just stopped coming in. It's been six months since then. We've appealed but they've said it could take up to twelve months because it has to go to the Crown Court. I've been told to apply again and I'm waiting for my medical. Without PIP our income was reduced by two thirds. They took my mobility car back as well so we have no transport at the moment. I tried walking to the bus last week and it put me in bed for three days. If it weren't for my friends at CAP and church, we wouldn't be going anywhere. They give us a lift to the supermarket and CAP give us foodbank vouchers when we need it.

At the minute, we're only surviving just about.

It's like being back to stage one. I can't pay anything – Council Tax, electric, gas and everything. I don't want to get out of bed. We've said we'll go through bankruptcy because we can't afford to repay but we can't have another DRO for six years.

After the DRO, before this, it was great! We had our heads above water and were surviving better than we had been in a long time. It's how quickly it goes back that scares me. I'd like to get better and get back to work and sort myself out properly.'

Broken budgets

77% of insolvency clients have an unsustainable budget

It is estimated that three quarters (77%) of CAP clients on an insolvency route have an unsustainable budget.¹² On average, households with unsustainable budgets lack £239 a month needed for sustainable household spending. While it may be possible to live on this amount for a short period, emotional and social resources remain under pressure, as people continue to face constant money worries.

However, at the severe end of the scale, Debt Advisors see many people who do not have the income to pay for basic household bills. This means there is a high risk that debt immediately reoccurs after insolvency. Advisors find that people with broken budgets can be disillusioned from the outset and feel their insolvency will not change anything.

Two fifths (39%) of CAP clients on an insolvency route have less than half the income they need for a sustainable budget.¹³ Advisors find this particularly to be the case for single people living on basic benefits, and said they fear the benefit cap and two-child limit are a ‘ticking time bomb’ that will entrap many more families into this situation in the future.¹⁴

Unsustainable budgets
Proportion of CAP clients on an insolvency route whose per person income is less than the sustainable benchmark of £116.80 per week



Weekly per person income (after housing, energy and Council Tax)

Estimated by comparing CAP clients' per person expenditure (after housing, energy and Council Tax) with the average expenditure of UK households at the third income decile. UK average is taken from the ONS Family Spending survey, January 2019 release. The third decile has been used as these households have modest but above poverty line incomes. n=1,953

Housing cost induced poverty

Advisors view housing costs as one of the biggest causes of broken budgets. In these situations, it is common for people to be unable to afford their full rent and so rent arrears reoccur. Moving house is not always a viable option to solve this problem due to not having money for a deposit and to pay other moving costs, as well as poor availability of affordable housing options.

Struggling to pay housing costs is particularly linked to the removal of the Spare Room Subsidy (also known as the bedroom tax) and limits to the Local Housing Allowance (LHA) which means benefits for subsistence living costs must be used to pay the shortfall in someone's Housing Benefit. This also applies to Council Tax bills since Council Tax Reduction schemes were localised in 2012.¹⁵

Case study: broken budget

One CAP client with learning disabilities who cannot read or write went through a DRO in 2018 and is now preparing to make a bankruptcy application less than twelve months later. The client's distress from enforcement activity was lifted through the DRO but her household budget remained unsustainable. She had a Social Fund loan that did not clear in the DRO and £30 continues to be deducted from her Universal Credit. This means that every month she receives £570 but her one bed property costs £572 a month to rent. As a result she was forced back into arrears on her rent, Council Tax and utility bills straightaway.

CAP Debt Advisors say...



‘There's just not enough money to live on so very quickly they fall into [debt], so these types of cases quite quickly come back with rent arrears, Council Tax, energy arrears, so it's not like they've taken [out] loads of credit, they just can't afford to live on the budgets that they're on.’

12 | After taking into account additional disposable income available from debt repayments that will no longer need to be made after they are formally insolvent.

13 | After paying housing costs, energy and Council Tax.

14 | Single adult households with no children are on average the furthest from the sustainable spending benchmark, followed by households with children. On average single adult households on an insolvency route with unsustainable budgets spend £56.29 per week less than the sustainable benchmark of £116.80, and households with children have an average gap of £52.40 per person per week.

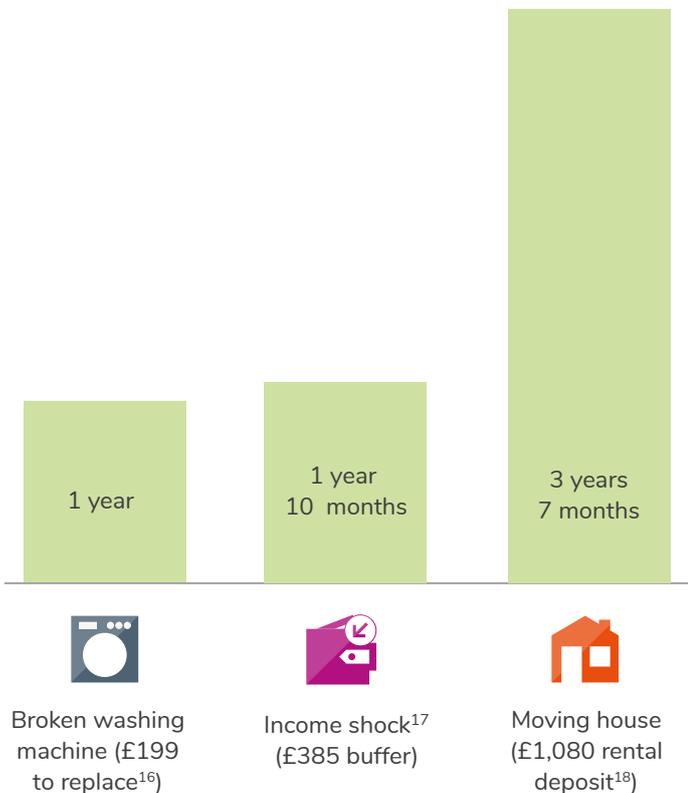
15 | Shelter (2019) *From the frontline: Universal Credit and the broken housing safety net*, available at <http://bit.ly/2nPaJmT>

No financial resilience

Low income also leaves people vulnerable to financial shocks. A strong theme in Debt Advisors' concerns related to people's inability, even post-insolvency, to build savings to ensure they are financially resilient against unexpected expenditures or events. Advisors reported that welfare reforms are a common cause of people returning to them for debt advice after insolvency. As in Phil and Sharon's case (see page 3), moving benefits, such as from DLA to PIP or to Universal Credit, can leave someone without an important component of their income for a period of time.

Building a savings buffer

On average CAP clients on an insolvency route can save just £17.70 each month. This means it would take the following lengths of time to save for:



CAP Debt Advisors say...

 'Most of our clients live on a very tight budget. [The] insolvency has helped them start again but there is little room for manoeuvre if shocks occur.'

16 | Price of cheapest Beko 8kg freestanding washing machine from a highstreet retailer on Google Shopping comparison 11/10/19.
 17 | 48% of households experienced at least one monthly drop in their income in the last year of £385 on average, Citizens Advice (2018) *Walking on thin ice: the cost of financial insecurity*, available at <http://bit.ly/2zrBf7V>
 18 | 70% of the average rental deposit value according to TDS (2019) *Statistical Briefing: UK Tenancy Deposit Statistics 2017-18*, available at <http://bit.ly/2VxA6Gh>
 19 | The two most common issues relating to essential services and DROs are having to make payments towards a benefit or tax credit overpayment and on an energy meter for debts which have been cleared in a DRO, Citizens Advice (2015) *Cutting our losses: the need for good debt collection practice for people with debt relief orders*, available at <http://bit.ly/2L2seZB>

Continuing deductions

We estimate the average client loses **£126** in erroneous deductions after their insolvency is granted

Three in five (61%) CAP clients on an insolvency route have deductions being taken from their benefits or prepayment meter to repay a debt. Most of these debts will be cleared in the insolvency and the deductions stopped once the creditors are notified by the Insolvency Service (or AiB in Scotland) that the insolvency has been granted. It is common, however, for these deductions to erroneously continue for six to seven weeks. With £18 per week being deducted on average, this time lag sees people £126 out of pocket, and Advisors report seeing much longer delays in some instances.

Often someone's vulnerability means they are at risk of not noticing or being able to challenge ongoing deductions, which means a lot of money can be erroneously deducted and often not refunded. This concern is echoed by the experience of Advisors in other organisations and is one of the predominant reasons for an insolvency not having the desired financial impact.¹⁹

CAP Debt Advisors say...

 'There is a big delay for creditors to acknowledge the insolvency has gone through. Especially the DWP... it's demoralising for the client who doesn't see an immediate impact. If they're used to the deductions sometimes they don't notice. You'd hope the client goes into credit and gets refunded but that doesn't happen.'

Case study: deductions continued for six months

A CAP client who had a DRO approved in January 2018 continued to have repayments (for rent arrears of £60 a month) deducted from his benefits for the next six months. This meant that he needed emergency food aid despite being officially debt free. The client was also unable to afford the bus fare to travel to the Access Course the Jobcentre had arranged for him. It took many attempts by the client and his Council Support Worker to get the erroneous deductions stopped, and the additional payments have not been refunded.

'£60 is one heck of a lot when, after paying bills, I'm not left with a great deal to pay for food and transport. I had to rob Peter to pay Paul at the time when I wanted to concentrate on my course. Each time I or anyone else called we'd be shuffled across to other departments and given vague or incorrect responses. Finally, they stopped taking the money out in June and I was able to be back in control of my finances again.'

Still indebted

1 in 3

clients have an excluded debt they have to repay post-insolvency

Despite an insolvency in theory removing someone's liability to repay their qualifying debts, in practice there are many ways in which people are still or continue to feel indebted after their insolvency. Advisors identified four areas that continue to hold people in the grip of debt: excluded debts, needing to repay rent arrears, a delay in collection letters stopping (especially where the debt is with an enforcement agent) and feelings of guilt about not repaying, especially if money is owed to friends or family.

A third (32%) of CAP clients on an insolvency route have at least one debt which will not clear in their insolvency because it is an excluded debt.²⁰ With an average balance of £807, using all their disposable income after the insolvency, it would take those affected an average of five years and nine months to repay these debts. Most often, Advisors encounter excluded Social Fund loans and overpayments viewed to be fraudulent by the Department for Work and Pensions (DWP) but which are disputed by clients. They attribute the problems these cause to the unaffordability of the deductions that are taken from benefits to repay these debts rather than debt being excluded.

In addition, unlike in bankruptcy, only debts listed on the DRO application are cleared once it is granted. Advisors find this often causes a problem where clients unintentionally omit a debt they do not recollect; the safety net of a credit report does not always provide a complete list of outstanding debts. In addition, benefit or tax credit overpayments can be calculated several years afterwards and suddenly owed after the DRO application has been submitted. This is inconsistent with protections covering consumer credit debts which, if action to collect them is not taken, become statute barred after six years and are non-enforceable.

Case study: excluded debts

CAP helped a client suffering from multiple heart and lung diseases as well as mental health problems apply for a DRO in June 2019. This discharged £947 of non-priority debt but he was still liable for a £2260 benefit overpayment viewed to be fraudulent and a £73 Social Fund loan. The deductions for these two debts were £150 a month which was equivalent to half of his income from Jobseeker's Allowance. After paying minimal household bills he could only afford to spend £40 a month on food, clothing, household maintenance and everything else, and continued to use the foodbank after his insolvency.

Loss of services

People also often lose access to products and services due to insolvency clauses or the impact insolvency has on their credit rating. Advisors particularly find cars bought on hire purchase agreements and rental tenancies to be at risk. Citizens Advice have termed the variety of responses to a tenant's DRO the 'landlord lottery'.²¹

Bank accounts

Yet the most common problem encountered in this area is bank accounts being closed. While this is a certainty where there is debt owed to the bank, Advisors said they find it can happen in up to 50% of cases where there is no debt and it is very difficult to know whether this will happen. Of the nine high street banks that offer basic bank accounts, four banks will not provide one to someone in the first 12 months after their insolvency has been granted, when they are an 'undischarged bankrupt', or those that cannot convert an existing account, requiring a new account to be opened. This can cause a great deal of anxiety, and in some cases it can take clients several months to open a new bank account.

Case study: bank account with no arrears closed

A major high street bank closed the bank account of a CAP client following their bankruptcy, with no prior warning despite the client being in credit. The bank refused to discuss this further with the client or change the account to a basic bank account, and the client had difficulty obtaining the funds that should have been released from the account on closure.

Impact on credit rating

A record of an insolvency remains on someone's credit report for six years, and this can lock people out of cheaper tariffs or certain payment methods. For instance, clients can lose the ability to pay for car insurance in monthly instalments, or get a phone contract. Advisors also have concerns about people only being able to get emergency credit with high interest rates after an insolvency. This means that a debt crisis can be worse the second time round if they have more high-cost lenders and arrears on contracts taken out for them by friends.

Case study: impact on credit rating

A couple with two children under the age of six went through a DRO in 2016. Despite both parents working, they found it incredibly difficult to make ends meet and regularly went without essentials like prescriptions and dental treatment. This was exacerbated when they needed to move house; because of their credit rating the only private landlord that would rent to them was charging a much higher rent. Having to manage their finances very carefully and having no savings still causes a great amount of stress for the family.

'Life is still really difficult for me and my husband. Finances are still extremely tight and we struggle with every penny. High interest credit cards are thrown at you from every direction and it is hard to resist when you are still struggling.'

20 | This includes a Social Fund loan (22%) or a court fine (15%). Other debts that do not clear in an insolvency include secured loans and other debts secured with a charging order, student loans, maintenance payments and child support payments. Note: Social Fund loans are not an excluded debt in Scotland.

21 | Citizens Advice (2015) *Cutting our losses: the need for good debt collection practice for people with debt relief orders*, available at <http://bit.ly/2L2seZB>

Recommendations

While insolvency can make a substantial difference, CAP's twenty three years of experience has shown it is the holistic and community aspects of our service that truly sees clients' wellbeing transformed. It is a package of holistic support that truly makes the difference in helping people move forward, break social exclusion and recover from the whole-life-effects of problem debt. CAP's Debt Advisors view insolvency solutions as a vital part of achieving positive client outcomes. However, to unlock a new start for more people post-insolvency, we make the following recommendations:

For Government

- Reform housing policies so low-income households are not required to use 'subsistence benefits' to cover Housing Benefit shortfalls.²²
- DWP and HMRC need to ensure benefit and that Tax Credit deductions stop immediately after receiving notification that an insolvency has been granted.

For creditors

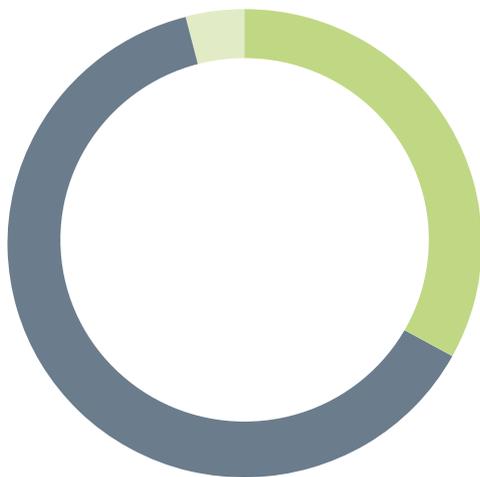
- Guarantee banking facilities will be offered to people post-insolvency, including in the twelve-month discharge period, and develop processes to transition existing accounts to a new basic account if needed.

For the Insolvency Service

- Bring DRO rules on omitted debts in line with bankruptcy, so all debts within the £20,000 limit incurred before the application are covered, including historical benefits and Tax Credit overpayments.

Most common forms of insolvency proceedings

Breakdown of the type of insolvency applications made by CAP on behalf of clients



- 63% DRO
- 33% Bankruptcy
- 4% Sequestration

Bankruptcy

In England and Wales a debtor can make a bankruptcy petition online if they are unable to pay their debts. In Northern Ireland debtors must present their application at a bankruptcy hearing at the Royal Courts of Justice in Belfast. If granted, the debtors' liability to pay eligible debts will be discharged and any assets they have may be sold and the proceeds distributed to their creditors. The cost to apply for a bankruptcy is £680 (or £669 in Northern Ireland). The debtor may also be ordered to pay a proportion of their income to their creditors for a period of time. Creditors can also petition the court to make someone bankrupt if the debtor owes them more than £5,000 in total.

Debt Relief Order (DRO)

A form of debt relief similar to bankruptcy which was introduced in 2009 for debtors who have a low income, less than £20,000 of debt, and less than £1,000 of assets. Applications must be made through an approved DRO Intermediary and debtors must pay a £90 fee to the Insolvency Service. DROs are available to debtors living in England, Wales and Northern Ireland.

Sequestration (Scotland)

In Scotland bankruptcy is known as sequestration. A debtor has to pay a £200 fee to apply for sequestration. Under Scottish law a creditor can petition for a debtor to be declared bankrupt if they owe them £3,000 or more. There is also a minimal asset process (MAP) which is for people with a low income, less than £17,000 of debt and few assets for which the fee is £90.

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always hope.

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22 | 'Subsistence benefits' refers to basic allowances such as JSA, Universal Credit Standard Allowance and ESA which are intended to cover all basic living costs, other than housing, and are deemed by the Government to be the minimum amount someone needs to live on.