Debt Management Plans

R3 believes that Debt Management Plans (DMPs) have a place in the range of insolvency options, offering a short term solution for individuals who can afford to pay off their debts if they are granted an extended payment timetable or reduced payments. To find out more out how the industry is operating, R3 has commissioned and conducted research exploring the experiences of individuals in DMPs, and the views of Insolvency Practitioners who are experts in personal insolvency. Our research indicates that while most DMPs seem to operate to an acceptable standard, there are certain worrying practices in the system. This paper highlights our key concerns and our main recommendations.

R3's concerns about DMPs

A lack of impartial advice

According to the Office of Fair Trading debt management guidance, all DMP providers should provide advice in the best interests of consumers. Evidence suggests that people enquiring about a DMP may not always receive advice about the various debt and insolvency options available to them:

- 35% of individuals in a DMP say that other options for dealing with their debts, such as an IVA or bankruptcy, were not discussed with them before they started their DMP.
- 84% of Insolvency Practitioners have seen debtors who agreed to a DMP without having received impartial advice about the alternative options available to them.

Unfeasible, unworkable DMPs

DMPs should be a manageable, short-term solution for individuals who can afford to pay back their debts. There is evidence to suggest that certain DMPs are unfeasible, unrealistic and unworkable:

- 57% of Insolvency Practitioners have seen individuals whose DMP had failed because the amount of debt they were in was just too high to make a DMP a feasible option,
- 46% have seen individuals whose DMP had failed because the monthly payments were simply unaffordable, and
- 40% have seen individuals whose DMP had failed because the repayment timescale was too unrealistic.

Key information

What is a Debt Management Plan? A Debt Management Plan (DMP) is one of the range of solutions available to people struggling to pay their debts. Operating outside formal insolvency procedures, DMPs are a formalised - but not legally binding - agreement between an individual who is in financial difficulty and their unsecured creditors. DMPs are usually negotiated by a third party (either a private company or a not-for-profit organisation). As DMPs are not legally binding, their characteristics vary. They can include debt forgiveness, but often allow people to pay off their debts in full by extending the repayment period. There is no limit on the amount of debt included in a DMP or the length of time a DMP can last.

How do DMPs work?

Individuals in a DMP make regular payments to the organisation that established and administers their DMP. The organisation then distributes the money between the individual's various creditors. If the organisation providing the DMP is a private company, they will charge for this service.

How many people are in a DMP?

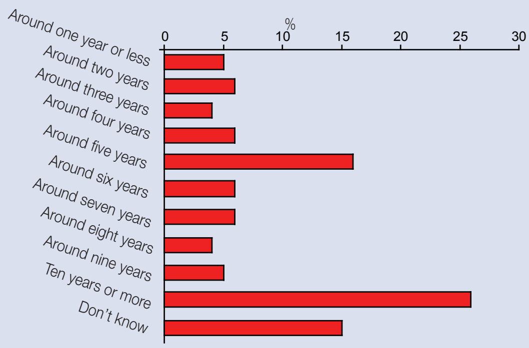
Unlike formal insolvency procedures, there are no records of the numbers of individuals on DMPs. Even taking a conservative estimate, the numbers of people on DMPs dwarf the numbers in all formal insolvency procedures put together – lower estimates suggest 300,000 individuals in DMPs, and higher estimates put the number at over 700,000. By way of comparison, there are around 130,000 people currently in an Individual Voluntary Arrangement and around 70,000 people who are currently bankrupt. The lack of available records means that the true picture of personal insolvency in the UK is somewhat hidden – the available data is likely to represent the tip of the personal debt iceberg.

What kind of information do we have about DMPs?

Although there are no official records of the numbers of DMPs, R3 has commissioned research which indicates that:

- The average (mode) amount of debt individuals are in when they enter into a DMP is between £10,000 and £50,000
- The average length of a DMP (mean) is about 8 years, though the mode is 10 years or more.

How long does a DMP usually last?



Source: R3/ComRes Personal Insolvency Research Project January 2010

- On average, individuals in a DMP have a take-home salary of around £1,400 a month
- On average, individuals in a DMP pay back approximately £250 into their DMP each month.

Our research suggests that around half of people in a DMP pay a fee to the company that set up and administers their DMP. The average amount of money individuals in a DMP pay to the company is around £50 a month, and the average amount paid to the company for setting up the DMP in the first place is around £430 (a one-off payment).

- Over a quarter of individuals in a DMP say it is due to last ten years or more (10% say their plan is due to last more than fifteen years and 16% say it is due to last between ten and fifteen years). We suggest that the sheer length of these plans indicates that the amount of debt is too high for a DMP to be an appropriate and effective option.
- Around one in three (30%) individuals currently in an IVA were previously in a DMP, as were the same proportion of undischarged bankrupts. This may suggest that, in certain instances, DMPs can prolong distress rather than solving the problem – another solution would probably have been more suitable from the start.
- Approximately one in five people (22%) in a DMP say the organisation that set up their plan did not ask to see proof of income or expenditure before the plan began. If this kind of information is not asked for or verified, monthly payments may be unaffordable and the DMP doomed from the outset.

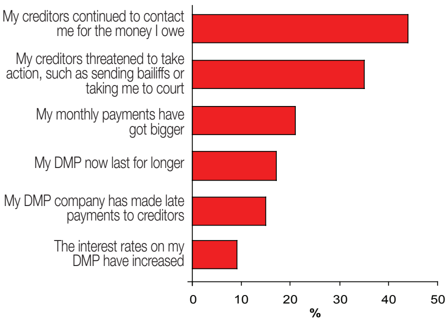
Conditions changing for the worse

By definition, DMPs are flexible which, can have advantages as well as drawbacks. One of the key drawbacks is creditors' to make changes to DMPs after they have started. This can elongate the plan or make the debts harder to pay off.

- 17% of individuals in a DMP say the length of their plan has increased since it began;
- 21% say their monthly payments have increased in size;
- 9% say the interest rate has increased.

What kinds of worrying practices happen once a DMP starts?

The following graph shows the percentage of individuals in a DMP who have experienced each of the following since their DMP began:



Source: R3/ComRes Personal Insolvency Research Project January 2010

Creditors continuing to contact or threaten debtors

As DMPs are not legally binding, creditors are free to continue to contact debtors. There is evidence to suggest that this kind of highly distressing contact can continue to occur, which seems extremely unfair given that the creditors gave their agreement to the DMP.

- Since starting their DMP, 44% of indivudals in a DMP say they have been contacted by their creditors for the money they owe;
- 35% say their creditors have threatened to take action such as sending bailiffs round or taking them to court, even though the plan is in place and they are abiding by its conditions.

Possible 'strong-arming'

We suspect that certain banks may be effectively 'pushing' debtors towards a DMP even though a different option would be more suitable. We believe they may do this as a result of their accounting procedures - debts covered under a DMP can be classed in a preferable category to debts covered under formal insolvency procedures.

- 52% of Insolvency Practitioners who work on personal insolvency have seen debtors being 'pushed' into a DMP by their creditors;
- 53% have seen creditors refusing an IVA even though it was a viable option because the creditors wanted the individual to go into a DMP.

Providers making late payments

DMP providers are bound by the OFT guidance, to pass on the payment they receive from the debtor to creditors as quickly as possible. There is evidence that this does not happen as frequently as it perhaps should:

- Since starting their DMP, 15% of individuals in a DMP say the company arranging their plan has made late payments to the people they owe money to, even though they have made the agreed payment at the right time.

A lack of information about fees

We do not see any reason why companies should not be able to charge a fee for administering a DMP. However, there is evidence to suggest that individuals can enter into a DMP without being told that they would be paying a set up or administration fee.

- 10% of individuals in a fee charging DMP say they were not told that they would be paying a fee until after they had started their plan;
- Only half (49%) were told that a fee would be charged when they first had a conversation with the company.

It is worth reiterating that our research suggests that the majority of DMPs are operating well, but there are some worrying practices in the industry.

R3's recommendations

1. We are calling for the Government to keep records of the number of people in a DMP.
2. We want to limit creditors' ability to change conditions of DMPs already in existence if this is detrimental to the debtor (i.e. making it harder to pay back the money owed), to prohibit creditors pursuing individuals who are abiding by an agreed DMP, and to prevent creditors vetoing a DMP without good cause.
3. Our members would like to see overall caps on the length of DMPs, as well as restricted access to DMPs so that individuals with extremely excessive debt cannot enter into a DMP which will inevitably be very lengthy or unmanageable.
4. We are calling for organisations offering DMPs to be much more upfront about the options available to individuals struggling with their debts and to provide individuals in DMPs with regular updates on the progress of their DMP. DMP providers should be obliged to verify proof of income and expenditure before producing a DMP.
5. We believe fee-charging companies should make their fees clear on their websites and provide individuals who approach them for help with information on the average fees in the industry so that they can make as informed a decision as possible.

A statutory solution?

There have been calls to introduce statutory DMPs, outlined in the Government's 'Debt Management Schemes' consultation in late 2009. The particular brand of statutory DMPs outlined in this consultation is highly flawed. They would add to the existing maze of solutions open to individuals in financial distress and do little to tackle bad practice.

Conclusion

DMPs have an important role to play in offering a short-term solution for individuals struggling with their debts. As with any new product, it will take time to iron out any creases, curb bad practice and find the right balance between the needs of creditors, debtors and providers. The challenge will be to retain and develop the best aspects, while addressing bad practice. A combination of mandatory recording of DMP numbers, improved self regulation and increased OFT action should enable DMPs to rightfully take their place as a useful tool to tackle personal debt.

About R3

R3, the trade body for Insolvency Professionals, represents over 97% of Insolvency Practitioners. R3 members are trained and regulated accountants and lawyers who have extensive experience helping individuals in financial distress.