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Great Burden

Britain's personal debt is increasing by £1 million - $1.9 million - every four minutes. That spells growth opportunities for domestic and foreign collection agencies and debt buyers.

By Corinna C. Petry

Almost 300 Britons are becoming insolvent each day, according to Richard Talbot, author of a recent report from Credit Action, a national educational non-profit in the United Kingdom. Local and national newspapers have run screaming headlines for months about citizens' personal finances being in such disarray.

Higher interest rates on mortgages – which are not fixed but rise and fall with the Bank of England's moves – and higher interest rates on credit cards and other loans have been the main drivers that have sent a growing number of borrowers to fall three months or more in arrears on their payments.

Approximately 80% of the delinquent consumer debt outstanding consists of secured assets, primarily homes. The average mortgage debt per capita is £92,851 ($182,693) for the 11.7 million households who hold mortgages. The average annual interest paid by each household on its total debt, as of March, was £3,425 ($6,740). That's up over 6.1% just from December. (See chart, page 36.)

The value of UK consumer debt currently overdue is estimated to exceed £50 billion ($98.39 billion), having risen by more than 46% in just five years, says Kevin Still, senior vice president of Credit Professionals Limited (CPL), a credit management services provider and consultancy.

Of 25 million households in the UK, about 875,000 have outstanding loans on which they're at least three payments behind. CPL estimates this will increase by 40% within the next three years.

Members of the Credit Services Association – comprising 270 creditors, debt pur-

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chasers and agencies – handle more than £5 billion in debt or 20 million accounts a year. The face value of accounts placed with collection agencies ranges from £2.7 billion to £3.5 billion, according to a recent market analysis performed by CPL.

What all these numbers mean is there is a lot of delinquent debt to collect in Britain and there will be much more in the months and years ahead.

That could spell opportunity for buyers and agencies that can learn the market quickly. At least two major U.S. players already have done just that and are active there. The UK collection industry remains fairly fragmented: There are up to 500 agencies, mostly contingency collectors that don't buy their own paper.

The U.K. debt-purchasing sector is smaller than that of the U.S. but matches it in vigor and growth. There is a good deal of American capital invested so far and probably room for savvy newcomers as well. The secondary market has yet to develop in earnest.

Those thinking about getting into the Great British debt race should be well capitalized and consider partnering with existing buyers and agencies that are reputable and well established.

U.K. Debt Crisis – Salient Statistics

As of January 2007 / top 5 figures in billions of pounds

	£	% change from Jan.'06
Total UK personal debt	£1,300	11.3%
Total secured lending on homes	1,087	11.5%
Total consumer credit lending to individuals (January 2007)	213	10.2%
Total credit card debt	5,490	-3.6%
Total lending growth (January 2007)	10.6	0.95%
Average outstanding mortgage	£92,851	NA
Average household debt (excluding mortgages)	8,795	12.5%
Average household debt (including mortgages)	53,701	13.6%
Average consumer borrowing (January)*	4,526	9.2%
Average annual interest payment per household	3,425	45.7%
Average loan approval in January 2007	146,700	15.7%
Secured and unsecured debt as a percentage of disposable income (3rd quarter 2006)	152%	

*per average UK adult, via credit cards, motor and retail finance, overdrafts and unsecured personal loans

Sources: Credit Action (www.creditaction.org.uk), Credit Professionals Ltd., NCO Europe

The Debt Buyers

Debt sellers in the UK include all the major banks and card issuers, telecommunications and mobile phone providers, utilities, finance companies, retail credit and home entertainment providers (cable, satellite, Internet).

Bank loan and credit card debts represent the largest asset classes by value. Auto loans, known as motor finance, represent a common asset class that's favored by niche buyers. Student loans and healthcare debt sales are very rare, says Still.

Portfolio sales in the UK over the past five years have gone from virtually zero to 50% of all delinquent debt being sold, according to Kenneth Maynard, chief executive of debt purchaser Cabot Financial Group. He predicts the level of activity will eventually approach that of the U.S.

Still concurs, noting that sales growth has been rather dramatic since 2004: 300% from £1.5 billion in face value debt sold to £6 billion in 2006. He projects a further increase to £7 billion this year.

The Credit Services Association has a subsidiary, Debt Buyers & Sellers Group, comprising 52 members. Established in June 2004, "this group is well represented by leading debt buyers and leading creditors," Still says, citing Capital One, HSBC, Lloyds, Citigroup, GE Money and others.

Recent research by TDX Group – a broker that UK market experts say transacts 40% of the deals on British soil – showed that debt buyers last year owned over 50% of defaulted consumer debt.

"There are 19-20 debt buyers that routinely bid on UK portfolios. Of these, the top six players probably acquire 75% of the books [what Americans call portfolios]," Still says.

He lists the leading buyers, in no particular order, as Cabot Financial Group, 1st Credit, Capquest, Lowell Group, Aktiv Kapital/Thames Credit and Link Financial.

"The major players recognize the dramatic growth in the UK debt purchase sector and now have the financial, operational and analytical resources to manage large single placement and forward flow portfolios," he remarks.

Still and Maynard each say that many purchases by the top buyers are supported by financiers such as Barclays Capital and U.S.-based CarVal Investors.

U.S. investment banks like Goldman Sachs and Lehman Bros. also have entered the UK debt-purchasing market, several sources say.

"They are buying portfolios and taking the equity risk themselves, placing the accounts with contingency collection agencies or reselling the portfolios," Maynard says.

Maynard contends there is no true secondary market for debt yet. "Banks sell paper to buyers and it stays with the buyers," he says. When banks start to loosen restrictions about how long agencies must work the accounts – typically two to three years – he believes the secondary market will develop.

The Collectors

Besides purchasing portfolios, Cabot Financial places accounts with 23 agencies. "Cabot places as much debt with agencies as banks do," Maynard says.

A director of the Credit Services Association and chairman of its Debt Buyers & Sellers Group, Maynard names the largest UK collection agencies as Intrum Justitia, Westcot Credit (owned by credit bureau Equifax), Legal and Trade (owned by Outsourcing Solutions Inc.) and NCO Europe.

More recent U.S. entrants include Arrow Financial Services LLC, which also operates in central Europe.

"Everyone is much more professional today, compared with the industry's former grubby, nasty reputation," Maynard says, adding that collectors are more readily perceived by creditors and consumers as "a natural part of the credit cycle."

As consumer credit volume grew, banks did more outsourcing and demanded competition between agencies, which has had the effect of reducing commissions. "Margins on collecting early [first-stage] debt are quite thin," Maynard says.

Commission rates vary widely, according to Still, citing 8% to 50% and more on consumer accounts, depending on factors such as the age of debt, asset class, balance, previous treatment, location, debtor score and residential status.

"It is usual for a leading creditor to have a panel of agencies that are benchmarked by a number of factors; commission rate would be one," Still says. "Netbacks remain the key driver, though protection of [the creditor's] reputation is becoming increasingly critical as the UK media focus on credit and debt."

One great determinant for fees is the level of delinquency, says Spencer Locke, operations director for NCO Europe. "For prime credit card or telecom paper 90-180 days outstanding, the contingency fee ranges from 7% to 12%," he offers. Commissions also depend on what the creditor has already done in-house, such as scoring and litigation work, and vary with the overall liquidation expectation, adds Locke.

Collection Costs

The major costs of collection work in the UK mirror those in the United States: analytical models, data warehousing, collections and skip tracing systems, call center infrastructure and training, postage and legal work.

"Salaries are not dissimilar except at the upper end of the ladder, where the U.S. is higher," Still says. A chief credit and collection executive in the U.S. can earn $135,539 (£69,030) per year, according to *CCR*'s Salary Survey, published in April. "The reward mechanisms for collectors and skip tracers are very similar," Still says.

Skip tracing in the UK is expensive, says NCO's Locke, due to restrictions under privacy laws and because no central telephone directory exists. The choice that remains is to trace a debtor through credit bureau information, but

Lenders Become Target of Politicos

A number of card issuers used to reject a high proportion of all card applications but now, "practically everybody is waved through," says Kevin Still, senior vice president of Credit Professionals Ltd., a credit management services provider.

Throughout the card industry, standards were lowered when more applications were automated online, requiring less documentation than before. Specifically, some card issuers are not necessarily verifying applicants' income, he charges.

An early 2006 study by uSwitch highlighted "serious failures" in the lending practices of UK banks when issuing credit cards. According to uSwitch's survey, nine out of 10 credit card borrowers were issued cards without the lender verifying that the borrowers could afford to repay the debt, and it found that 88% of applicants who received a credit card during 2005 were not asked for proof of their annual income beyond what was written on the application.

This practice has caused major headaches for U.S. subprime mortgage lenders.

In addition, consumers were, until recently, being offered credit limits up to £20,000, while the average Briton's annual salary is £23,000 ($45,257).

Kenneth Maynard, chief executive of debt buyer Cabot Financial Group, agrees: "The banks haven't been responsible enough in their lending criteria, especially if a consumer is not in arrears."

As a result, consumer debt is now a political issue in the country.

The Office of Fair Trading (OFT) – a national government agency that promotes and protects consumer interests while ensuring that businesses are fair and competitive – has began several inquiries into card issuers' practices, such as default fees and interest rates.

Meanwhile, the House of Commons is looking to rewrite the Consumer Credit Act of 1974. Overseen by OFT, the law requires certain businesses to obtain consumer credit licenses and protects individuals receiving credit up to £25,000. The lower house of Parliament is also expected to consider tightening regulations for the financial services industry, especially with regard to credit cards, says Still.

this can cost £7-£8 per account, depending on how many pieces of information have to be searched. If the normal recovery rate for a portfolio is 20%, buyers have to consider that skip tracing will cut that rate down to 10-11%, and price the portfolio accordingly, he notes.

Bulk mail collection letters typically cost 30 pence apiece. U.K. collectors, including NCO Europe, typically send out four to six letters per account to make contact.

About 5% of accounts in the UK are suitable for litigation. The point is to go after can-pay or can-pay-more accounts, says Locke, referring to debtors who refuse to pay or who won't pay an appropriate amount relative to their financial wherewithal.

"You have to balance where you stop spending" – when the effort has become unproductive – "and analyze where you should spend more, based on the expectation of liquidity," he says.

Recovery Expectations

Speaking of liquidity, recovery rates in the UK can vary broadly depending on the asset class and the individual creditor, Still at CPL says.

"The trend is for creditors to work cases harder and harder in the initial phases," he says. "As a rule of thumb, expected collection rates at month 12 on bank debt would be 8%-14%; telecom, 30%-50%; utility, 10%-22%; and mail order [retail catalog], 10%-16%." Often, a primary agency will be allowed to retain an account for only six months and must obtain a promise to pay within that time or the account will be removed to a second agency or sold, Still notes.

Typical collection practices can help to liquidate consumer and commercial accounts anywhere from 2% to 80%; the range is almost meaningless, Locke admits. But a normal liquidation range for prime credit card paper over 12 months is 5%-15%.

The UK debt purchasing market – like that in the U.S. – is marked by a high level of competition and "very tight" margins, says Glen Crawford, managing director for Cabot Financial.

"We have come up the learning curve quickly. We constantly evaluate the cost of borrowing" to pay for debt portfolios and "we have use very sophisticated pricing models."

Two hundred percent of the purchase price over five years was the previous broad goal for return on investment, Crawford says. These days, "returns depend on how fast we can liquidate. Sometimes it's 1.5 times; sometimes it's 2.5 times."

Challenges and Predictions

The "feeding frenzy" for portfolios in the UK has abated somewhat, according to Locke. Prices had topped those in previous cycles, "but are starting to rationalize a bit."

The future of the market in the UK, he predicts, may include earlier collections in-house – that is, beginning work on paper in the 30- and 60-day buckets, and moving 60- to 90-day paper more quickly to contingency agencies.

Locke and Still both predict that more portfolios will be sold earlier in the cycle, too, perhaps at 180 days. "[UK] creditors won't necessarily wait to sell until charge-off, as most have in the past," says Locke.

Still believes more portfolios will contain performing along with delinquent accounts, which he says will "increase secondary sales of accounts that are not performing."

Growth in household debt is a major factor that will affect creditors, debt buyers and collection agencies alike in the immediate future. The country's average mortgage rate is "the highest it has been since May 1991, while housing prices continue to rise," Locke says. "This affects people's ability to pay. Something has got to give at some stage."

If interest rates rise 1%, a lot more consumers will be in trouble, Maynard at Cabot Financial says. If the UK economy holds steady and unemployment is low, the fallout should not be severe. If the economy gets into trouble and people lose their jobs, he predicts the debt crisis will worsen.

Between 2000 and 2004, there was 13% annual growth in unsecured account balances; that has since come down to the 8-9% range, Maynard notes. "People are trying to make a dent in their debt load," he says. Meanwhile, "Our industry has flourished. Higher interest rates equal more debt sold."

And that will mean a steady stream of collection work going forward. ■

Will Door Knockers Go the Way of the Ice Man?

One collection practice that has faded into the American past but still exists in the United Kingdom is door-to-door collections by what is called a field agent, also known as a door knocker.

Field agents are typically employed as a last resort, after a debtor has failed to respond to numerous letters and phone calls.

Spencer Locke, operations director for NCO Europe, admits that using a field agent is highly inefficient "but very necessary" – particularly for consumers who don't have savings or checking accounts or credit cards and who must pay cash.

On reaching a debtor at his home, a field agent will ask the debtor to agree to a small weekly or monthly payment in cash, and he'll regularly visit the debtor's home to collect payment, sometimes as low as £5 or £10.

Says Locke, "If a door knocker collects £5 a week, it adds to the recovery rate and adds maybe 2-3% to the value of the portfolio." Many financial institutions continue to endorse the use of door knockers, "but it may be a dying business."