

White Paper

The difficulty with financial difficulties...

- *What the “credit crunch” will mean for repayment of problem debt*

Executive Summary:

- Research just completed by TDX Group for their forthcoming “Financial Difficulties Review” shows the recent “credit crunch” may have a massive impact on solutions for problem debt with a potential doubling of the number of people looking for a repayment solution
- Consumers acknowledge that they don’t shop around for the best advice, with 90% of individuals signing up to a debt solution recommended by the first organisation they contact
- Consumers and creditors need to be aware that the quality of guidance given and service delivered by debt advice companies varies widely, creating opportunities for agreed standards and accreditation.
- The challenge is compounded by a widely varying approach taken by creditors to reviewing and approving customers’ debt solutions

Challenge of problem debt

Tackling problem debt has always been a challenge. UK consumer indebtedness is at an all time high and TDX Group analysis shows problem debt stands at £23bn, with consumer credit write-offs forecast to total £6bn in 2007.

Add to this the ill-winds of forecast higher unemployment and mortgage rates, fixed rate mortgage expiry, higher fuel and food prices, the average UK consumer is under significant pressure to maintain control over their personal finances.

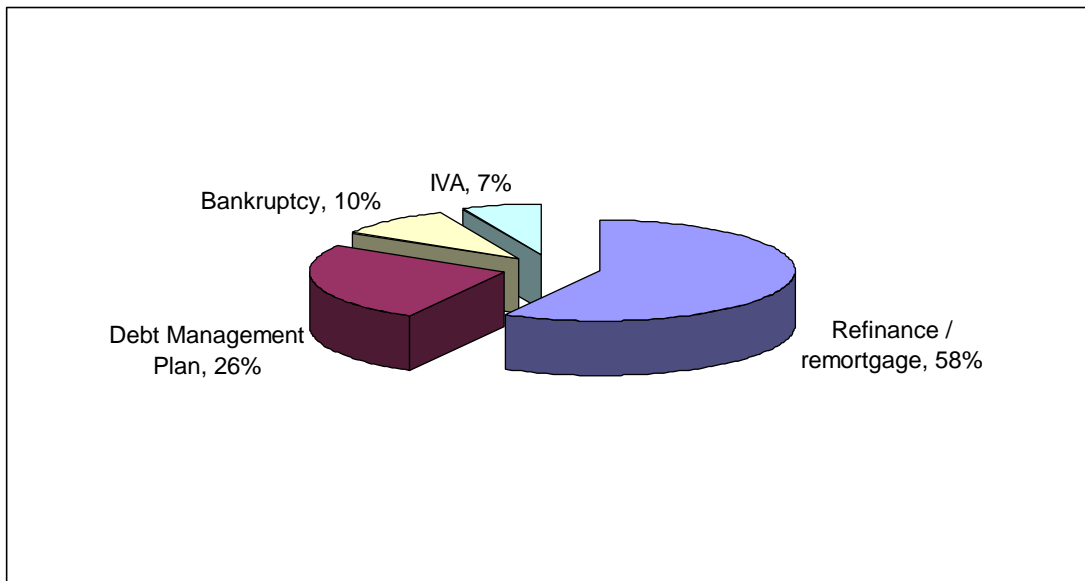
Data processed by TDX Group shows a typical debtor in financial difficulties who propose an IVA has a monthly income of £1855 with monthly outgoings of £1504, leaving only £351 to service their, on average, £48,000 of unsecured debt. This leaves very little margin for error and it does not take much to derail their efforts to service and repay their debts.

Options available for consumers in financial difficulty

TDX Group analysis suggests nearly 700,000 people entered financial difficulty in 2006. Once in financial difficulties a range of options are typically available:

- Refinancing was the “solution of choice” - consolidating of debts through refinancing or remortgaging. With the “credit crunch” this option is all but removed for debtors, meaning a much greater volume the alternative solutions below
- Debt Management Plans (DMPs) – arrangement agreed with lenders often involving third parties to manage the plan. Sets out to make reduced monthly repayments over an agreed term, sometimes with a reduction in fees and interest.
- Individual Voluntary Arrangements (IVAs) – formal arrangement through the courts to repay a percentage of the debt over an agreed term, usually five years.
- Bankruptcy – order made through the courts to share debtor’s remaining assets fairly amongst creditors. Usually considered as a last resort

Chart 1: New debt solutions in 2006:



With the recent “credit crunch” leading banks and building societies to dramatically cut back on the number of customers accepted for new or further lending, the 400,000 customers who would typically have refinanced will now be seeking other options. Compare this to a total of 175,000 customers entering a debt management plan in 2006 and the scale of the potential impact is obvious.

Getting to the right solution

The key challenge is to ensure that once a debtor recognises that they can’t service or repay their debts they are steered towards the most appropriate debt solution, ideally tailored to their specific needs. Recent TDX Group consumer research uncovered the stark reality - 90% of individuals signed up to a debt solution recommended by the first organisation they contacted.

Professional advisors are investing hundreds of thousands of pounds in advertising their services on TV, radio, print and the internet. However, as an example, 57% of consumers were unaware that payments they were making would go first to the provider of the plan to cover these costs rather than to paying off their debts if the plan failed.

Whilst prepared to offer advice on specific debt solution products, many professional advisors are unable to offer the full range of solutions – so it is no surprise to see that failure rate of the solutions can be high.

Mark Onyett, CEO of TDX Group “It is a reality of the credit environment and this summer’s “credit crunch”, that borrowers are experiencing a tightening in their ability to service their debt and in the availability of credit. As a result, we could see a doubling in the number of people being advised to enter into financial difficulty solutions. The quality of advice and service offered by companies in this sector varies widely with some good and some poor providers, so there is a real risk that a large number of consumers will end up with the wrong solution”

Improving standards in IVAs in the last 12 months

During the last 12 months much attention has been focused on the use of Individual Voluntary Arrangements (IVAs) as a debt solution, intended for larger debtors with a sufficient regular income to repay a minimum of £200 a month.

TDX Group’s Insolvency Exchange (TIX) reviews 80% of the UK’s IVAs on behalf of creditors and estimates the total number in 2007 will be nearly 50,000 – slightly more than in 2006, with balances totalling £2.3bn.

Significant changes have been happening in the IVA industry during the last 6 months, with creditors, TIX and Insolvency Practitioners driving improved standards and changes to fee structures. TIX has led the development and agreement on an “approved IVA” standard which, combined with audit and accreditation of providers, will deliver a quality IVA solution to debtors in difficulty.

Mark Sanders, UK Managing Director of TDX Group said “All these changes have helped to drive a new equilibrium in the IVA market, with creditors taking a greater interest in the IVA as a solution for insolvent debtors and many of the solution providers working to raise the standard of advice and service being given. As the hub for the IVA industry, TIX has available a vast breadth of data on IVAs which has enabled creditors to much better understand the solution”

More progress is still required to improve the quality of advice and the ongoing TIX Audit and Accreditation programme will define the set of standards for best practice in the industry and allow firms who offer IVAs to be recognised for achieving these.

Debt management plans could become a bigger phenomenon than IVAs

An alternative option for some debtors is to enter into a formal Debt Management Plan (DMP). Usually negotiated through a professional debt advisor an average DMP will be for a total of £25,000 and requires negotiation between six to eight lenders. TDX Group estimates that there are currently 370,000 active Debt Management Plans, managing a total debt of £9.2bn.

TDX Group is seeing evidence that varying policies are being adopted by the lenders to DMPs - with some taking the view that ‘he who shouts loudest’ gets paid, others taking a more moderate approach. This behaviour can be driven by internal targets and different approaches to provisioning and loss recognition standards. A lack of data, such as that now available on IVAs, compounds the challenge.

But with an estimated 60% failing to complete the agreed term, there is plenty of opportunity to improve the effectiveness of DMPs. TDX Group analysis suggests that if the average life of a DMP can be extended, each month could be worth up to an additional £100m for the credit industry.

A different approach is needed

Professional advisors have an important role to play but are often hindered by an inability to offer access to the full range of solutions. The cost of advice varies from free services to up to 18% of the agreed monthly repayment, the higher of which will naturally hinder the debtor’s ability to repay the underlying debt. The opportunity exists for a greater awareness of the choices available to debtors struggling to cope with their debts, supported by professional advisors able to offer the full breadth of solutions.

Inconsistent treatment by lenders also creates confusion for the struggling debtors who feel alienated and disincentivised to settle debts with finance providers who are, in their eyes, being unreasonable and unhelpful. Given the oncoming wave of debtors looking for repayment solutions to their financial difficulties, it will be critical for lenders to have a consistent, data based decision making process for review and support of their customers seeking the right course of action.

If this happens then creditors, debt management advisors and the UK’s many struggling debtors all stand to gain.

By Mark Hover, Director of TIX, TDX Group

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