



Bankruptcy assets – are they a liability?

We explore the costs and risks for creditors administering bankrupt accounts

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Volumes and losses continue to rise

The latest data released by the Insolvency Service confirmed the number of individuals made bankrupt during 2009 was 74,670, a rise of 11% on the previous year or 28%, if you include Debt Relief Orders (DRO), a bankruptcy style insolvency for those with debts of less than £15,000, no assets and minimal surplus income (see figure 1).

The challenging economic conditions are clearly continuing to have an effect on some peoples' ability to remain solvent – although higher levels of general unemployment does not appear to be a main factor in bankruptcy as the Insolvency Service data shows the proportion of bankrupts who continue to be in paid employment has remained fairly static at around 60%.

Operational costs dwarf potential returns

Administering bankruptcy accounts can be complex and costly – creating an overhead for creditors which is very real but often unseen. Unfortunately much of the bankruptcy process still involves paper-based interactions between creditor, Official Receiver and Trustees.

A recent study by TDX Group estimates the cost of servicing each bankrupt account is £55 over its lifetime, covering post-handling, record keeping, data and systems infrastructure, account management activities, outbound responses, and facilities and storage (see figure 2). Further costs are incurred for supporting infrastructure, a potential drain on future investment priorities incurring costs for maintenance and changes to processes, systems and staff training.

TDX Group estimates the combined cost to creditor organisations to be in excess of £50 million per annum, dwarfing dividend returns received by creditors.

Some creditors try to mitigate the impact of these costs by handing-over responsibility of certain aspects of the bankruptcy process to a nominated trustee firm – who in turn will seek to recoup their own costs by being appointed as Trustee on selected cases. But without clear service guarantees these arrangements may not maximise value to creditors.

In an effort to reduce the cost burden, creditors may unwittingly relinquish some or all of their rights in the bankruptcy. TDX Group research suggest two thirds of creditors fail to exercise their right to vote at Meeting of Creditors and creditors who fail to submit valid Proof of Debt documentation, needed to qualify for any prospective dividends, can even be disqualified from receiving any distribution.

Beware the hidden risks

It is common for creditors to assume bankruptcy accounts are of little value and therefore require little attention – an approach TDX Group advises its clients can be fraught with danger.

Many creditor organisations fail to identify bankruptcy accounts in a timely manner and do not regularly screen their customer base. Consequently creditor records can be inadequate – often leading to mistakes or a failure to properly engage in the bankruptcy process.

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This may create additional financial and compliance risks:

1. Failing to close or restrict the debtor's accounts potentially allowing the debt balance to expand after bankruptcy declaration;
2. Failing to maintain adequate customer data, electronic and physical records;
3. Failing to halt further collection activity and adhere to Treating Customers Fairly (TCF) principles. TDX Group estimates up to 3% of accounts with debt collection agencies may already be subject to bankruptcy proceedings;
4. Failing to adequately support the Official Receiver or appointed trustee in their statutory duty to investigate the affairs of the bankrupt.

Toxic outlook ahead

Bankruptcy volumes will remain high – the numbers of households struggling with their debts and who go on to become insolvent will lag any improvement in the economic climate. Reforms are also being proposed to make bankruptcy easier, where an individual can apply for bankruptcy without the need to go through the courts. The long-term impact of the DRO remains unknown but volumes have risen every quarter since its introduction earlier in 2009.

Returns will likely remain low and difficult to predict – the last two years have seen a halving in the number of bankruptcy cases with asset realisations, largely as a consequence of the fall in house prices. As a result returns to creditors have fallen substantially and are likely to remain depressed and uncertain through to 2012.



Carlos Osorio, Head of Bankruptcy at TDX Group (pictured left), said "Creditors appear to have little to gain and much to lose by administering their bankrupt accounts. With no ongoing client relationship to maintain, creditors are increasingly considering disposing of their bankruptcy assets as a means of extracting some immediate value, removing cost and mitigating risk".

This article is an extract from a TDX Group briefing note. For a free copy, e: info@tdxgroup.com

Figure 1. Number of individuals made bankrupt Q4 2007 to Q4 2009

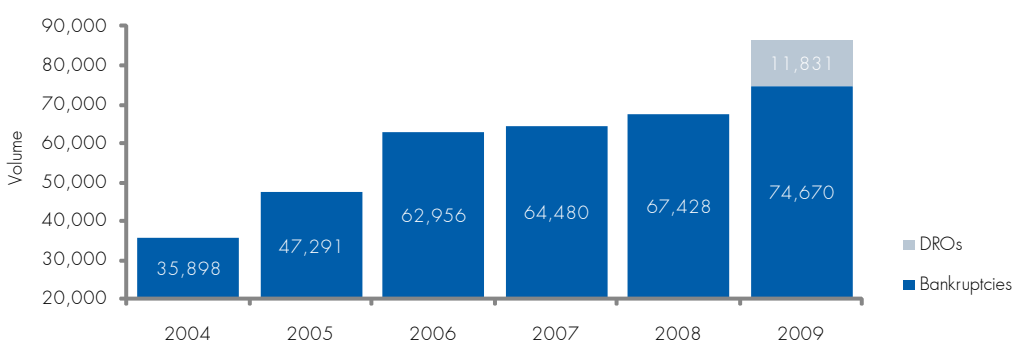
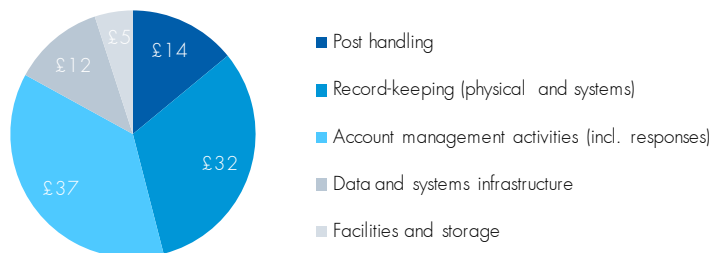


Figure 2. Costs per account



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How might the Government more effectively manage the collection of public sector debt?

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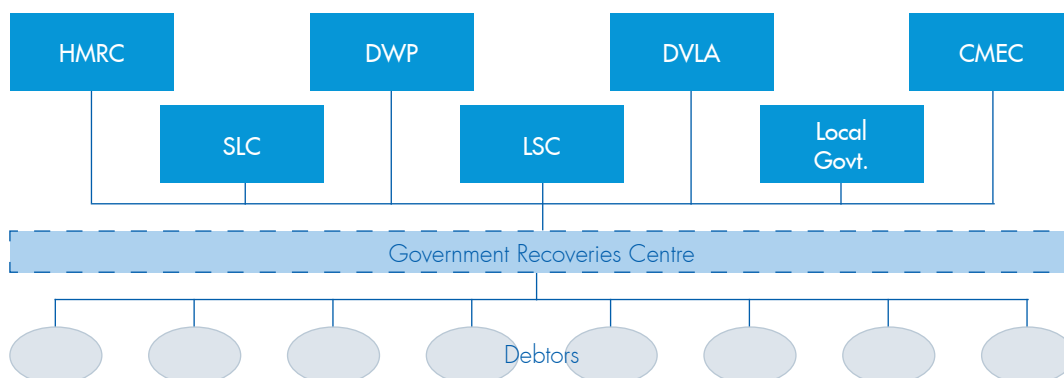
Money owed to the UK Government in the form of unpaid tax, benefit overpayment, fines and so on currently stands at over £30 billion. The way in which government accounting operates means that the majority of this £30 billion is already committed through spending plans and, in order to provide cover for it, the Government must either bridge the deficit with further borrowing or make cuts elsewhere.

Therefore the question must be: with all the resource and information available to the government both nationally and locally, why is there such an issue in collecting debt?

A key issue is that debt is spread across government departments and local councils, and debtor data is not effectively shared. This is partly due to restrictions resulting from Data Protection legislation and also a fear that data will become "lost in transit" or leaked to a newspaper, as has happened in the past. Having spoken to many government departments over the past year, the risks – however small – are a significant reason why data is not shared. The impact is that there is no single government view of a debtor.

ID cards aside, one solution to this problem is a system that works as a cross-departmental clearing house for government debtors, providing a collaborated view of all known data about a debtor into a single profile. The effect would be the facilitation of debt collection from the point of view of the collection agency and a reduction in confusion for the customer as they are only contacted once for all their debts. In addition, a single government recoveries' centre would massively reduce the risk associated with transferring and sharing data.

Notwithstanding inevitable privacy issues, the system does have flaws: Who has the highest priority on debtors' money? How would this 'body' be funded? Under whose remit would it sit? However when done responsibly, creating a single view of customers is the logical and sensible step.



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