

IVA's

THE DEBT CRISIS –MADE WORSE BY BIG BANKS' OFFICE POLITICS

A few days ago the Insolvency Service published statistics for the second quarter of 2007, showing the largest-ever quarterly drop in the number of IVAs approved, whether compared to the previous quarter¹ (461 or 3.5%) or the same quarter of the previous year. This was the first quarter-on-quarter drop since the fourth quarter of 2003, which showed a drop of 0.6% but a rise on a seasonally-adjusted basis, and the first year-on-year drop since the 0.4% drop in Q2 of 2002. Almost simultaneously the Council of Mortgage Lenders revealed that repossessions had risen by 30% year-on-year rise in the first half of 2007.

This is not entirely coincidental. Both are a result of initiatives by credit card companies and "The Insolvency Exchange" aka TIX, to reduce fees collected by Insolvency Practitioners. TIX has set itself up to represent the interests of the creditors but its recent behaviour seems to be increasing their losses by rejecting too many IVAs, which will inevitably result in an increase in bankruptcies and, where the insolvent individual is a homeowner with a mortgage, in repossessions.

One might expect a rise in Insolvencies swiftly following the rise in interest rates but there is usually a 6-9 month delay before repossessions rise, due to the mortgagor's desire not to foreclose if the mortgagee has any chance of repaying the loan and the time taken to go through the legal processes.

The Debt Resolution Forum published a statement yesterday condemning Capital One and TIX for unilaterally blocking debtors' applications for IVAs when these are in the best interests of creditors.

TIX is said to be aiming to improve returns to creditors by reducing fees charged for IVAs, but DRF mention that the fees payable to TIX average around £1,000 per case (for very little work compared to that done in order to earn the £750 that ClearDebt charges for setting up an IVA for smallish debts).

An IVA gives someone who is over-indebted a chance to work their way back to solvency through effort and an acceptable degree of self-sacrifice. Many observers consider it to be morally preferable to bankruptcy.

Also all IVAs result in a better return for the creditors than bankruptcy. In an IVA the debtor repays his/her available income for (usually the next five) years as well as any net current assets to his/her creditors. We cannot measure the national benefit from debtors working their way out and learning how to manage their finances instead of taking the easier path of bankruptcy, but athletes do say "No gain without pain". However it should be obvious that collecting a share of the debtor's future income increases the return to creditors.

TIX has apparently acted more reasonably in Scotland after Invocas explained to them that they collected higher fees from sequestration (the Scottish equivalent of bankruptcy) than from Protected Trust Deeds (the equivalent of IVAs).

¹ *The Insolvency Service claims a 15% reduction on a seasonally adjusted basis but I do not believe them as their numbers are invariably revised to flatter the government.*

Unfortunately TIX's English executives do not seem to have received the message. Of course I think Accuma was unwise to claim that it had a 70% profit margin on its supervision fees, but the creditors' response is not in the interests of the shareholders of HSBC, RBS, Barclays, Lloyds TSB, HBOS etc.

Some people think that the blocking of IVAs is to delay the impact of recognition of loss by the banks (all major credit card companies are owned by banks). If you delay recognition of loss by waiting for a bankruptcy/sequestration instead of accepting an IVA/PTD, you actually *increase* both the total amount and current value of the loss: shareholders suffer, but the individual executive may gain by transferring blame for the losses from bad loans to his/her successor (instead of to the credit card salesman).

If the fee reduction across the IVAs accepted matched the drop in receipts from those potential IVAs rejected that opted for bankruptcy instead and TIX charged no fees, then the creditors would break even: however we do not believe that either is true.

As we have said before, some proposals by the BBA (such as limiting fees paid to the IP to a percentage of the amounts received by creditors) are reasonable but to ignore the cost of work done in England, while recognising it in Scotland, is not.

We just do not have enough data to precisely measure the cost to the banks of this "toughening" of policy although any sensible estimate must be in excess of £25m per quarter or £100m per annum. We can, however, say that bank shareholders are losing money while TIX benefits.

I certify that this report represents my own opinions
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