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UK Retail Banking Newsletter

So what's new in the Banking industry? In this, the third edition of the PricewaterhouseCoopers 'UK Retail Banking Newsletter', we focus on five diverse, but topical and challenging, issues addressing today's evolving industry.

How can banks embed 'Treating Customers Fairly' into a more informed, dynamic and ultimately profitable approach to customer service? Our opening article examines the issues and approaches to responsible lending. Following this, Sarah Prior looks at why tax risk management is becoming an increasing concern for banking institutions.

Most banking organisations, have, at some point, made attempts to reduce costs without impacting service or improve services without increasing costs. 'Sustainable cost-optimisation' asks whether institutions are managing their costs effectively and outline the challenges faced in delivering a successful cost management programme.

What are the implications of the new accounting standard 'IFRS 7 – Financial Instruments: Disclosure'? In 'IFRS 7 – The strategic disclosure challenge', Harjeet Baura and James Hewer focus on what the new requirements entail and tackle some of the practical and operational challenges facing banks as this comes into effect.

Our final article, 'The collector's collector', provides an insight into the UK debt collection focusing on how dramatically this market has changed to become a sophisticated and commoditised industry.

I hope you enjoy this edition. Please continue to provide me with ideas on topics and issues you would like to see covered in future editions.

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Putting the customer first – Combining compliance and competitive service

By Alastair Noble and Claire Beck

The implementation of 'responsible lending' has highlighted concerns about some banks' approach to treating customers fairly (TCF). How can banks embed TCF into a more informed, dynamic and ultimately profitable approach to customer service?

Responsible lending was introduced by the FSA at the end of 2004 to help ensure that borrowers do not overstretch themselves. On the surface at least, the necessary safeguards would appear reasonably straightforward, with offers based on multiples of income giving way to a broader evaluation of affordability that takes greater account of outgoings and anticipated earnings.

Most lenders have indeed made considerable progress in improving their systems and controls as part of the wider overhaul of mortgage authorisation and regulation. However, in a speech at the Council of Mortgage Lenders Annual Conference in December 2005, FSA Chairman, Callum McCarthy, pointed to a series of failings identified during FSA investigations into responsible lending, ranging from 'the way firms are determining affordability' to 'whether higher risk

mortgage products are reaching customers for which they are not suitable'.

At the centre of the risk radar is the fast-growing sub-prime market. FSA investigators found that most of the firms they visited were failing to gather sufficient information from applicants and in over 80% of cases there was a lack of evidence to demonstrate that the recommendations met the customer's circumstances. Debt consolidation mortgages are a particular concern. For example, do advisors routinely check whether rescheduling existing debts might impair unemployment payment protection?

Comparable problems with documentation, verification of information and the suitability of recommendations also emerged during investigations into lifetime and self-certification mortgages.

Effective leadership is essential in setting the right tone and motivating personnel. In turn, branch satisfaction surveys enable banks to track movements in such factors as staff attitudes and customer loyalty.



As a result, the FSA has sent out letters to a number of prominent firms reminding them of their 'responsibility to treat customers fairly'.

The nature and extent of these failings would suggest that responsible lending is likely to require a strategic response, rather than minor adjustments. Advisors ideally need to be able to put themselves in their customers' shoes by developing a detailed understanding of their individual circumstances. How might market or economic trends such as possible job losses affect their ability to pay, for example? Is the specific product being recommended flexible enough to take account of lifestyle changes such as marriage or children?

Advisors also need to take account of the broader regulatory perspective. For example, would the customer or recommended product be covered by the Consumer Credit Act or Office of Fair Trading's standards relating to vulnerable groups? Companies clearly need to avoid being needlessly intrusive or bureaucratic in the way they gather the necessary information. Is the required data already on the bank's files, for example?

Good business

The cornerstones of TCF are staff competence, systematic controls and effective governance. These attributes can also help to cement the customer

confidence needed to forge enduring and profitable relationships. In short, TCF is good business.

Effective leadership is essential in setting the right tone and motivating personnel. In turn, branch satisfaction surveys enable banks to track movements in such factors as staff attitudes and customer loyalty. In practice, however, the precise experiences and decisive criteria that underlie confidence and satisfaction can be difficult to pin down.

So how can branch-based lenders ensure that they can meet and exceed customer expectations time in and time out? In our experience, the key differentiator that marks out top-tier operations is the quality of management information. In particular, the use of detailed image profiles that rate tangible sources of satisfaction, such as the friendliness of staff or the ability to respond to customers' needs, enables branch-based lenders to compare performance against their direct rivals. The resulting data can then be used to prioritise and evaluate targets for training and investment. It is also possible to map the touch points that make up the overall customer experience and hence pinpoint the key drivers that can turn an opportunity into a sale and in turn an enduring relationship.

The ability to correlate a variety of feedback, including customer satisfaction, staff satisfaction, service



level measures and monitoring of external attitudes, can help banks to anticipate threats and opportunities. For example, surveys may indicate rising dissatisfaction in a particular area such as response times, which might be difficult to remedy because of poor morale and motivation, identified in the staff surveys. Similarly, a press report may call for early action on an emerging consumer issue such as payment protection insurance.

Clearly, the information is only as good as how it is used. Banks need to be able to respond promptly and ideally, proactively, to their customers' changing expectations. They also need to be able to remedy any possible areas of complaint before satisfaction dips below the decisive tolerance level. Chances are that if a customer takes the time to complain, they care enough about the relationship with their bank to do something about it. If their satisfaction is allowed to drift below the tolerance level, it is already too late, because rather than bothering to complain, they will simply take their custom elsewhere.

TCF the differentiator

Responsible lending is a relatively new regulation and the FSA has been focusing its investigations on the highest risk areas. However, the difficulties experienced so far suggest that some firms may have underestimated the challenge of implementing this important

development in TCF. Following the mortgage endowment mis-selling scandals, lenders cannot afford any further compliance lapses and resulting reputational damage.

Staff need appropriate training and information to help ensure that they can thoroughly assess their customers' circumstances and respond to their particular needs. A better understanding of customers' changing market expectations could also help lenders to target investment where it can be most effective, and stay one step ahead of their rivals. At a time when switching from bank to bank has never been easier, TCF could thus prove to be a competitive as well as compliance imperative.

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Tax risk management

By Sarah Prior

Companies such as BP and Vodafone have received negative news coverage with respect to their tax affairs in the last year. This coverage demonstrates an increasing trend for companies' tax issues to reach the newspapers.

In a UK banking context the readers of newspapers are very interested in the activities of 'their banks', and with taxation an increasingly newsworthy matter, companies' behaviour in relation to their tax affairs is more likely to be subject to public scrutiny. Consequently, tax risk and its management needs to be firmly on the corporate agenda.

So, what has caused this increased focus and what are the particular issues for banks? There are arguably three factors that have caused a brighter light to shine on the tax affairs of corporates.

The first of these is the changing regulatory environment. Sarbanes Oxley and Basel II are, in many instances, subjecting tax controls to external scrutiny, arguably for the first time. Additionally, for some areas of tax risk – operational tax risk for example – it has left some organisations trying to determine who is, in fact, responsible; the tax

department, the settlements function or finance.

The second cause of an increasing focus on tax comes from investors and, as a result, senior management. We have seen two dimensions to this shareholder scrutiny:

- That arising from the corporate social responsibility agenda and the issue of morality around the right amount of tax to pay.
- An increasing interest within the investor and analyst community in the tax numbers in financial statements.

Interestingly in this context, in September 2005 Citigroup produced an Investors Guide to Analysing Tax Risk. This report quite explicitly recognises the fact that tax has been poorly understood and, consequently, inadequately reflected in corporate valuations. More focus like this on tax from analysts will

A first consideration in the management of tax risk is the setting of a tax strategy that is agreed and understood by the Board and the wider organisation.

inevitably mean more questions for management, who will need to have a better grasp of what is going on across their business in relation to taxation.

Last, but by no means least, when looking at the changing tax world is the more robust approach being taken by tax authorities in relation to tax avoidance. In the UK, HM Revenue & Customs are, along with other jurisdictions such as Canada, the US and Australia, making a concerted effort to clamp down on tax avoidance.

David Hartnett, Chairman of HMRC, has stated that its aim is to make tax avoidance not worthwhile by 2008. The HRMC is attacking it in a variety of ways: direct communications with the boards of large businesses; the introduction (and subsequent broadening) of tax-avoidance disclosure as a means of rapidly closing down tax-avoidance arrangements; increasing international cooperation with other tax authorities; and the adoption of a much tougher approach in their dealings with taxpayers.

To put this in context, recent Treasury figures show that while the financial services sector accounts for only 10% of national income, it pays over a quarter of all corporate tax revenues. The sector, a key source of tax revenues, must expect that HMRC's focus will be on maintaining, if not seeking to increase, the level of these revenues.

What are the implications of this dynamic and increasingly risky environment for banks operating in the UK? What does it mean for tax risk management, and what are the particular challenges to be faced?

A first consideration in the management of tax risk is the setting of a tax strategy that is agreed and understood by the Board and the wider organisation. Such a strategy is a means through which there can be a dialogue on tax risk between the Board and the tax function, and may cover such issues as target tax costs, acceptable tax planning, responsibility for different areas of tax risk management and communication with the Board and shareholders.

Once a strategy has been set, banks face a number of particular issues:

- A significantly higher level of operational tax risk than other organisations, having a wide range of tax-deduction and reporting obligations. In the UK, for bank borrowing and lending alone, there are at least 10 different tax reporting and accounting obligations, both domestic and international. With custody, brokerage and investment management, the number doubles. With the wide scope for more to go wrong, and the cost of failure being potentially very significant, banks need to know that controls are strong. To do this there needs to be clarity on who is responsible for this area of tax risk



Complex VAT recovery methods, a steady flow of new businesses, and almost constantly changing case law from Europe make strong controls imperative.



management. This responsibility is in many instances not clearly identified, with elements of it spread across both tax and operations management.

- Banks are unusual in that many of them have tax structuring and tax specialist staff embedded within their front-office, whether as part of structured finance teams or, more generally, ensuring tax efficiency of products. This raises issues for the banks as to who is responsible for these areas of tax, who has the ultimate sign-off on their activities, and how the organisation is monitoring their activities in an increasingly challenging environment.
- As partially exempt businesses, VAT is a real cost for banks. Complex VAT recovery methods, a steady flow of new businesses, and almost constantly changing case law from Europe make strong controls imperative.
- Finally, another important issue for banks, albeit that it is not a unique one, is the need to manage the tax risk associated with employees. Banks have a significant proportion of highly paid executives and often significant inflows and outflows of expatriates. This increases the cost of getting things wrong, and when it comes to individuals' pay (particularly when it is creatively delivered) is an area carrying higher reputational risk.

The current environment for tax is most certainly becoming more challenging. Tax is no longer an area that can be left as a mystery to everyone other than the tax department. Senior management need to know what is going on and the tax function needs to show that it is in control. Consequently, it needs a clear mandate and structured dialogue with senior management. It is more challenging for banks to achieve control than for other organisations, not least because of the way tax is threaded right through the organisation, from front-office products or business lines to back-office settlement functions. The breadth of tax issues within a bank, coupled with HMRC's more aggressive approach to collecting tax revenues, makes a sensible tax risk management policy a priority.

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Sustainable cost-optimisation

By Andrew Gray and Keith Webb

Every organisation strives to maximise the return on its investments, be they in people, technology, premises costs or other services. A perennial question is: Can we get greater value from the money we spend?

Most organisations have made attempts to reduce costs without adversely impacting service and to improve service without increasing costs. While there are undoubtedly many great success stories, there are many more examples of failure. Even where an organisation is recognised by the market as being efficient, there is continual need to ensure further opportunities in cost-optimisation are exploited to maximise the benefits available to the various stakeholders. In businesses where cost-efficiency is already part of the management culture, opportunities for further cost-reduction are continually talked about.

The effect of continual incremental changes in business, due to internal as well as external drivers, usually result in costs ratcheting upwards. This is often compounded where revenue growth hides an underlying deterioration in profitability. Furthermore, experience demonstrates that, as previous cost-efficiency programmes bed

down, additional opportunities to access some of the untapped cost-savings become possible.

In well managed organisations the changes required to reduce costs are especially challenging because they require a comprehensive analysis to be undertaken, which frequently reveals a package of relative small measures to improve organisational effectiveness. By definition, well-run organisations should have already identified and addressed any individually large cost-saving opportunities. While these opportunities can be small and on a case-by-case basis may not be worthy of significant management effort, collectively, they can be substantial, in many cases amounting to 15–25% of the total cost-base.

Driving the changes necessary to further optimise cost-efficiency generally requires a cultural shift, although care must be taken as decisions for short-term gain can

Driving the changes necessary to further optimise cost-efficiency generally requires cultural shift, although care must be taken as decisions for short-term gain can damage the cultural fabric which has taken years to build.

When organisations are managing costs effectively, it should be easy for them to answer yes to the following list of questions:

1. Do you understand the real cost-drivers in the business?
2. Do you understand how costs support revenue (customers products and channels) and the variability around volume dynamics?
3. Do other managers have a common understanding of cost-drivers in the business?
4. To what extent can management control their costs vs the level of allocated costs for which they have limited control?
5. Is there a consistent view of why costs did not come in on budget/target (both for over and underspend)?
6. Are costs increases always targeted at areas of greatest strategic importance?
7. Are areas which the business regards as least important identified as key areas for cost-savings?
8. Is there a regular challenge process on the level of expenditure?
9. Do efficiency programmes target the real cost-drivers?
10. Is cost-analysis linked into service quality?
11. Do other efficiency programmes (e.g. straight through processing or six sigma) look at costs of the underlying activities they impact?
12. How do incentive programmes drive behaviour around costs?

damage the cultural fabric which has taken years to build. While some of the savings will, with the benefit of hind sight, be obvious; others will be less visible. Frequently, change may be resisted by individuals due to vested interests or misplaced belief of the costs or benefits of performing certain activities.

A particular challenge is that the greatest opportunities for cost/service optimisation rarely come from within a single functional area, but requires different functional silos to work together in new ways. This necessitates greater transparency and a better understanding of the interdependencies between functions, which in turn provides the opportunity to challenge the cost vs benefit of activities, looking at an end-to-end process. This is particularly the case for functions that directly support revenue generating business units (e.g. divisional finance, HR, IT), but also for corporate and group functions which provide the framework within which the rest of the business operates.

Understanding the organisation from the customer perspective and what these customers value in how the organisation services their requirements is critical. Empirical evidence consistently shows that an organisation's own management frequently has different views from

the customer of the cost compared against the value of certain activities. Consequently, some cost-savings can end up negatively impacting customers and damaging longer term profitability.

All of the above require a shift in behaviours that may need to be supported by changes to the ownership model within the organisation as well as organisational hierarchy, reward metrics and methods.

In our view the optimal approach for conducting such studies is to start with an understanding of the activities within an organisation and how those activities support the strategic goals of the organisation. Gaining a common view of the costs and values associated with those activities often helps management focus on areas for improvement. Challenges faced will include the need to recognise and deal with the difference between various costs, such as discretionary vs nondiscretionary, marginal, semi-variable and fixed costs. As indicated above, many potential cost-savings only become apparent when looking across organisational structures.

Management reporting lines often result in the real cost of activities becoming opaque, and provide incentives that frequently support a status quo or



drive costs up, rather than enable the organisation to make decisions to optimise costs in line with its strategic and operational goals. Examples include product launches that did not fully understand the cost of processing new products and marketing initiatives that assumed a certain level of data quality. Consequently, in order to optimise costs, changes to reporting lines may be necessary.

In addition to traditional analysis of management information and benchmarking, a variety of techniques can be employed to identify potential areas for cost-savings including interviews, prioritisation sessions and workshops with cross-functional teams. Once cost-savings have been identified a straw man for management actions required to deliver them is required for validation and obtaining management buy-in and sponsorship. Implementation is key; a great many cost-reduction programmes identify substantial potential savings that are never realised.

There are a great many challenges in executing and achieving the benefits of a successful cost-management programme. The specific challenges and the way they manifest themselves will generally be unique to each programme;

however, a number of areas that always require particular attention within organisations include:

- Communication – all levels of staff across the organisation will develop their own views as to the nature of the exercise and possible consequences. Getting the level of communication right is critical. Telling people nothing generally results in dissatisfaction or abdication of their responsibility and role in the programme; too much communication, especially too soon, can lead to unnecessary anxiety.
- Buy-in from key stakeholders – when opportunities are identified, a sufficient amount of time must be given to agreeing the change with key stakeholders; failure to do so frequently results in objections being raised during implementation, which often significantly undermine the ability to deliver the planned benefits.
- Define the target, based on business requirements – in all cases it is essential to ensure that the future state is defined on what the business needs, and not on what can easily be delivered. This is particularly important where changes in roles are required.

Typically areas for cost-reduction would include:

1. Product consolidation, requiring a solid understanding of product profitability
2. Process/platform consolidation
3. Process improvement (usually approaches to simplification, automation or elimination)
4. Product/process development vs Greenfield development
5. Project costs
6. Sourcing decisions including off shoring and outsourcing
7. Corporate entity consolidation
8. Property consolidation
9. Service based cultural change



- Be practical – a level of compromise is always required, but don't give in too much or too soon.

If these considerations are taken on board, financial services organisations can finally move towards improving cost-management and, in particular, their cost-income ratio that are so carefully scrutinised by the analysts. This is, by far, one of the most challenging current hot topics facing the UK retail banking sector.

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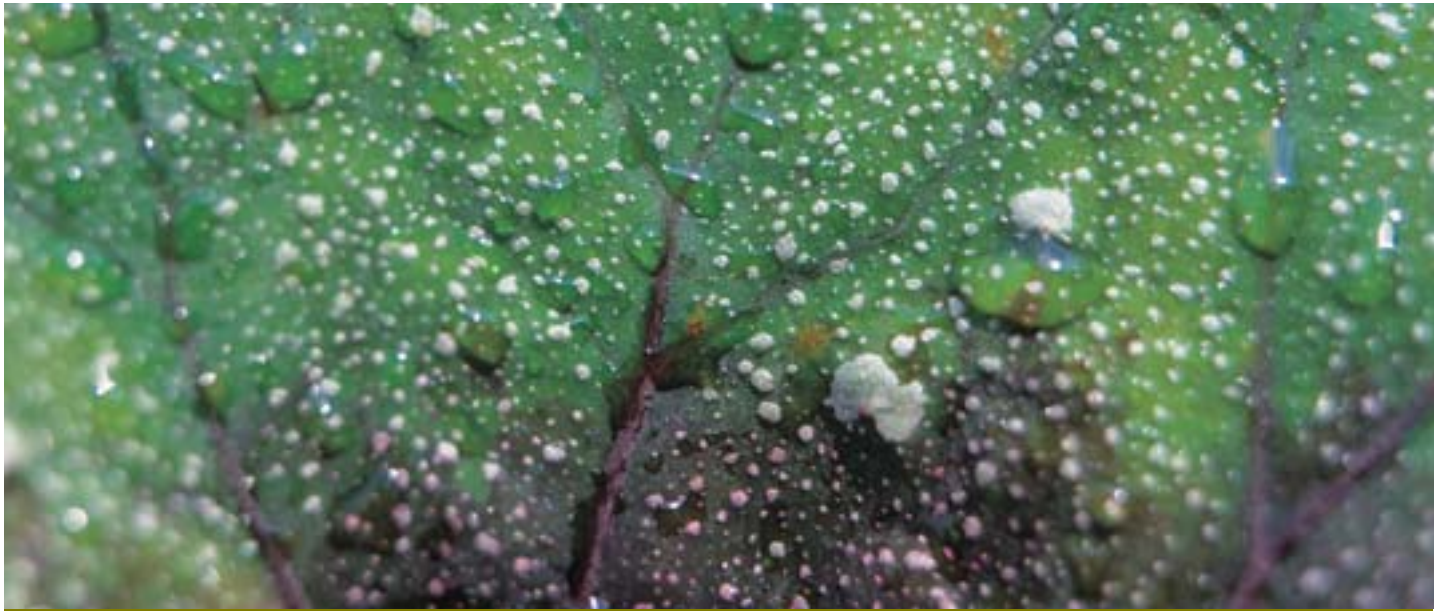
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IFRS 7 – The strategic disclosure challenge

By James Hewer and Harjeet Baura

The International Accounting Standards Board (IASB) has recently issued a new standard that consolidates and adds significantly to the current requirements for disclosures in relation to financial instruments. 'IFRS 7 – Financial Instruments: Disclosures', aims to improve the information on financial instruments provided in companies' financial statements, to enable users to evaluate better the significance of financial instruments on a company's financial position and performance. It replaces two previous standards: 'IAS 30 – Disclosures in the Financial Statements of Banks and Similar Financial Institutions' and the disclosure requirements of 'IAS 32 – Financial Instruments: Disclosure and Presentation'.

While the release of a new accounting standard and particularly one purely on disclosures is not normally something to get CFOs and CEOs tremendously excited, this one could be different. The new standard, in line with recent trends from the IASB, focuses on improving information for the users of the accounts by requiring companies to publish potentially sensitive management information and hence takes a rather different approach to that of the historical financial instrument disclosure standards.

A large proportion of the additional information that companies will be required to report is internal information they use to identify and manage the risks associated with their financial instrument exposures, including interest, currency, credit and equity market risks. The new requirements also apply to all companies and there is no longer any differentiation between the requirements for banks and other institutions as there was with IAS 30 which only applied to banks.

Some of the new requirements will require the disclosure of information that management would previously have considered as commercially sensitive, but will now need to be shared with the outside world.



The biggest area of change for retail banks is likely to come from the additional disclosures required on credit risk. New disclosures required by the Standard include:

- Quantitative disclosures for each type of credit risk – In practice, this will not only require the disclosure of risk concentrations that are used by management to run the business, but also a clear description of the basis upon which management has determined these concentrations.
- Information relating to credit quality on performing assets – Examples of this information include analysis of the portfolio by credit rating or, of more relevance to retail banks, loan to value ratio and credit risk score bandings, nature of counterparties, historical information on counterparty default rates and any other information used by the business to assess credit quality.
- Carrying value of loans that would otherwise be past due or impaired if they had not been renegotiated – Many institutions are unlikely to have this data because current management information systems have not been designed to capture and store such information.
- Additional disclosures on loans that are past due or impaired – The Standard requires: an analysis of the age of loans that are past due at the balance sheet date, but not impaired; an analysis of

loans identified as impaired on an individual basis and a description of the criteria that were considered in determining that they were impaired; and a description of the collateral held as security (or other credit enhancements) for both these categories, together with an estimate of their fair value.

- Repossessed assets – Disclosures on the nature and carrying amount of assets that have been repossessed or credit enhancements that have been called on are also required. Policies for disposing of these repossessed assets will also need to be disclosed.

These additional requirements are likely to present retail banks with a number of interpretational, practical and operational issues. These will include:

- Disclosure of commercially sensitive information – Some of the new requirements will require the disclosure of information that management would previously have considered as commercially sensitive, but will now need to be shared with the outside world. This would include those disclosures that relate to credit quality of loans that are neither past due nor impaired.
- What does 'past due' mean? The definition of past due continues to be a subject of debate for lenders. Although the Standard defines past due as the failure to make a contractual



payment, in reality, one missed payment is not a true indicator of risk for most types of retail lending and books are not managed on this basis. Consequently, there is a risk of a disconnect between the disclosures included in financial statements and how credit portfolios are actually managed.

- Disclosures for loans that are past due or impaired – Lenders will need to be able to distinguish and report collateral fair values on those loans that are past due or impaired, rather than performing. For some lenders, this will require developments on how data is currently captured. In addition, information is currently likely to be only captured on either a past due or impaired status, not both. Management will need to be comfortable with the new definition and be satisfied that such data is available.
- Extent of disclosures in subsidiary companies – Under IFRS 7, there are no exemptions available for subsidiary entities where the Group has made all the necessary disclosures, resulting in all companies in the Group having to make the disclosures required by the Standard. This is likely to be particularly difficult for a number of lending groups that have subsidiary companies with loan assets, because management and risk reporting is generally performed on a group or divisional, rather than

company basis. Hence data may not currently be available in the required form.

- Balance-sheet classifications – Banks were able to take advantage of an exemption in IAS 30 to avoid having to disclose financial assets as either current or non-current (as required by IAS 1). However, this exemption has not been carried forward into IFRS 7 and, consequently, this is another area where information may not currently be available and will need to be sourced.

It is clear that retail banks will need to understand the implications of the Standard and identify what additional information needs to be disclosed. They will then need to review their management information systems to make sure they are able to provide the necessary data as required by the new Standard. The data requirements arising out of the disclosures required by IFRS 7 are intended to be consistent with those of Pillar 3 of Basel II, with the ultimate objective that banks prepare, and users receive, a single coordinated set of disclosures about financial risk.

Retail banks will also need to review the supporting systems, data flows, and processes and related internal controls, because the resulting data will have to be externally reported for the first time and will be covered by the annual audit process. For SEC registrants, these


processes and controls will also need to pass the threshold as required under section 404 of Sarbanes Oxley.

Although the IASB has encouraged early adoption of this standard, IFRS 7 will not be mandatory until 2007. Given the sensitivity of some of the information and the data challenges that are likely to be faced collating the information to an auditable standard, it may be just as well. However, companies should not take false comfort from the 2007 date; there is much to do and early indications are that market practice may well be to adopt early. Hence, pressures from the market and investors may require companies to adopt IFRS 7 in their next financial statements, which does not give companies very long to address the challenges outlined above.

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The collector's collector – An insight into the UK debt collection market

*By Graeme Johnston,
Anurag Verma and Omar Kayat*

The UK landscape for the management of delinquent debt has changed dramatically over the past 20 years. As access to credit has increased, so has the number of consumers falling into arrears – moving debt management higher up the boardroom agenda.

Historically, debt management was viewed as a core competence by retail credit institutions that were keen to keep customer management in-house. However, as the reputation of debt collectors improved, these institutions found that outsourcing collection to third parties freed up valuable resource and improved collection efficiency.

The early 1990s were typified by the large UK credit institutions outsourcing the collection of delinquent debts to third parties on a contingency basis (where the third party does not take any principal risk and earns a percentage of debt collected). By the end of the 1990s, these institutions, predominantly banks

and credit-card companies, became comfortable with using third parties for collection and began selling chunks of their delinquent debtor books to a new breed of debt collector – the debt purchaser.

Debt collection on a contingency basis became a commoditised product, with collectors competing on price, earning thinner margins than were once available.

Debt purchasing, however, had higher barriers to entry and required capital and sophisticated pricing systems – for those companies that got the pricing right, healthy returns were available, typically breaking even on portfolio acquisitions within 24 months.

The strong growth seen in the industry over the past five years when augmented by the expectation of further growth, has led to significant interest in the sector from external investors.

Selling debt offered the seller an opportunity to dispose of parts of their book that were becoming unprofitable to chase, instantly producing a positive effect on the balance sheet on debt, which typically had been written down to zero. For managers of debt who were rewarded on this basis, selling debt became de rigueur – in 2005, it was estimated that debt with a face value of over £3 billion was sold in the UK, much of it timed to impact in the right financial year, bonus year, or both.

Today, the market for debt sales has become increasingly sophisticated. More debt is being sold and it is being sold at an earlier stage in the invoice cycle. Sellers are experimenting with auctions and with brokers to try and increase the prices for books. Forward flow contracts are being put in place with purchasers who agree to acquire future books at set prices or on a set formula.

As debt sale becomes an integrated part of the debt management strategy for lenders, we expect more sellers to be selling larger amounts of debt, at an earlier stage.

Attracting investment

The strong growth seen in the industry over the past five years when augmented by the expectation of further growth, has led to significant interest in the sector from external investors.

Since 2004, there have been seven private equity transactions that have taken place in the UK with over £650 million invested (in terms of enterprise value). The most recent of these transactions was the largest ever in the UK, with Nikko Principal Investments acquiring Cabot Financial for £275 million.

These acquisitions have taken place against a backdrop of imminent cross-border expansion and the potential of IPOs on the horizon. In terms of market development, the UK has lagged behind the US by about seven years. While there are six quoted debt collectors/purchasers in the US, there are none in the UK – pointing towards a potential exit route for the private equity community. Significant M&A have also taken place in the US and while this is increasing in Europe, the market is still highly fragmented (an estimated 25,000 companies across Europe).

Looking to the future

We expect to see continued growth in the market, especially on a pan-European basis. As the market matures in the UK, players will be looking abroad to sustain their growth levels. Given the fragmentation in the European market, we expect consolidation to take place with the larger UK players leading the charge on acquiring European assets.





We also expect to see further interest in debt purchasing from hedge funds and investment banks. Through innovative funding these institutions are able to extract greater value from books of debt than traditional debt purchasers. These companies are likely to enter this market either by acquiring stakes in debt purchasers or funding the acquisition of portfolios of debt through joint ventures. The added sophistication of these investors leaves the door open for securitisation of purchased debt portfolios.

The market has come a long way from the traditional door-to-door debt collector, but as the market changes and the country's indebtedness grows, only the sophisticated debt collector will flourish.

PricewaterhouseCoopers Corporate Finance has been an active advisor in the UK receivables management sector. In April 2006, PwC advised Nikko Principal Investments on its acquisition of Cabot Financial. Previously, PwC has advised: Intrum Justitia on the acquisition of Dun and Bradstreet's European Receivables Management business; Bridgepoint on the acquisition of 1st Credit; and Royal London Private Equity on the acquisition of Equidebt. PricewaterhouseCoopers was recently asked to speak at the Debt Buyers and Sellers annual conference on pricing pressure in the sector.

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