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# Good Time to Unload Charged-Off Consumer Debt

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With prices for charged-off consumer debt ticking upward in recent months, smart financial institutions are taking a fresh look at selling their delinquent accounts receivables to capture value rather than relying on internal liquidation strategies or third-party agencies.

As an indication of continuing improvements in consumer credit habits, four of the largest credit card issuers - Citigroup, Capital One, Bank of America and Discover - reported their lowest chargeoff rates of the year in December, according to regulatory filings. In addition, prices for delinquent credit card portfolios have risen as much as 50% over the past year, according to Kaulkin Ginsberg, a debt-collection industry adviser.

Against this backdrop of a stabilizing economy, declining chargeoffs and individuals regaining financial stability, debt prices are going up and banks are starting to sell more of their nonperforming assets. In fact, some of the largest banks and credit card issuers are now selling a majority of certain charged-off debt portfolios to debt buyers.

The signs point to debt-buying activity coming full circle. Pre-recession, banks sold outright much of their charged-off consumer debt. During the recession, however, charged-off paper doubled - even tripled - and banks ended up with a lot more volume in declining assets. In this climate, credit dried up and left debt buyers with less capital and loath to purchase charged-off assets declining in value. So they pulled back as chargeoffs ballooned. The situation was tough also for banks: mounting charged-off debt and not enough debt buyers ready to purchase it.

Now, with consumers finding jobs and getting other credit to help pay debts, we are headed back to a pre-recession environment with much more demand for paper and a much better prospect on the value of that paper. The environment for more distressed debt transactions is rapidly improving for banks and debt buyers alike. But will more banks take advantage of this good timing to realize better returns and the cash flow they really need? That depends.

Banking remains a very fragmented sector, with the vast majority of the nation's 8,000 financial institutions unaware of how the debt-selling model can work to their advantage. And of those that are aware, many don't have enough information to implement a debt-selling strategy. They also may perceive too many barriers to the process or worry about putting their brands at risk.

In reality, a bank isn't providing much protection to its brand when placing a debt portfolio with a third-party agency, which is likely to take a temporary view of accounts. By contrast, a debt buyer owns the purchased accounts outright. It has a longer time horizon and a strong incentive to work well with account holders to find solutions for repayment and recovery of assets. A debt-buying firm should be able to prove its protective stance of a bank's reputation through a track record of ethical and sensitive treatment of customers by staff trained in the Fair Debt Collection Practices Act.

So why sell charged-off accounts instead of managing them in-house or sending them to a third-party agency? There are numerous reasons and benefits. Chief among them is that selling the debt allows a financial institution to bolster its bottom line with an immediate cash infusion. Also consider that financial institutions have general and administrative expenses decked against either their in-house efforts or the management of outsourced efforts.

These expenses and the emanating head counts can be more effectively utilized when focused on current/performing assets. In addition, financial institutions have regulatory capital set aside against these non-earning assets, and when the assets are sold, that capital is freed up for allocation elsewhere in the institution or is totally eliminated. This elimination improves important regulatory capital ratios that a bank must report quarterly to the regulatory agencies.

The top 10 credit card issuers and some super-regional and regional banks regularly sell their charged-off assets to debt purchasers. By moving earlier to sell charged-off accounts, banks are able to get a better price from a debt buyer. This is because the liquidation dollars offered to own the account portfolio will differ depending on how many third parties have tried to collect the debt, as well as account demographics, the balance size, and other factors. When a bank moves forward to sell, it is usually paid the full sum in a matter of days, which means a new source of revenue to immediately redeploy into the marketplace.

Even with the current good timing, chief risk officers, lending managers and bank management teams need to be smarter than ever about how they handle their nonperforming receivables. A reputable debt-buying partner needs to have the time and resources to walk a potential client through the process, a track record of protecting a client's brand, highly competitive bids, and quick pricing turnarounds.

The most competitive bids will come from a debt buyer who invests in technology for the strongest asset analysis and modeling capabilities. Banks also should seek out a debt buyer with a strong legal network to ensure recovery of debt in those instances when cooperative payment arrangements are unsuccessful.

While such legal actions by the $100 billion asset recovery and management industry have in recent months come under media scrutiny for a variety of issues, those instances are not the norm. In fact, strong legal support and compliance are integral to the asset recovery process, which benefits not only the financial services industry but also the consumer public by getting money flowing through the financial system.

Now is an opportune time for banks to gain present-day value from those large pools of distressed assets they've been warehousing during the Great Recession. Doing so can be a relatively easy process that will generate a predictable revenue stream, reduce expenses, free up capital, allow the shifting of resources to focus on performing assets and actually protect their brands in the process.