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Card Chargeoff Glut Starts to Hit Recoveries

American Banker - By: [Maria Aspan](#)

As credit card chargeoffs climb, the amount issuers can expect to recover quickly on these debts is falling.

The increased supply of charged-off receivables has lowered the prices secondary buyers are willing to pay for the paper. Those buyers are also constrained by liquidity problems. And no matter who holds it, the softening economy has made collecting debt from consumers harder, further depressing prices.

Brokers and buyers of bad debt say the drop in prices has caused many issuers to sell less of their inventory and ramp up internal collection efforts. Despite the pullback by sellers, specialists in the market said that prices will continue to fall well into next year, and that some issuers may eventually feel more pressure to sell.

"Selling chargeoffs in a down market is a little like selling your furniture to make the mortgage payment. It hurts, but you have to deal with today's problem today," said [Sean McVity](#), a managing partner at [Garnet Capital Advisors LLC](#), which brokers sales of bad debt for companies like [Chrysler LLC](#), [Wells Fargo & Co.](#), and [Navy Federal Credit Union](#). "For the banks, it's an agonizing decision."

Lenders that sell their chargeoffs book a small up-front gain, whereas those that hold on to written-off debt can theoretically recover more of it over time, either by collecting the debt themselves or by using third-party agencies. [Dave Ludwig](#), the president and chief executive of the brokerage [National Loan Exchange Inc.](#), said newly charged-off card accounts currently fetch about 7 cents on the dollar, on average.

[Brian M. Greenberg](#), a managing director of [Milestone Advisors LLC](#), who arranges mergers and acquisitions of debt-buying and collections firms, said bankers are "hurting in a lot of places these days," so now is "a very good time out there for buyers who are well funded."

[Brad Bradley](#), the chairman, president and CEO of the Warren, Mich., debt buyer [Asset Acceptance Capital Corp.](#), said during its third-quarter conference call last week, "Sellers are sophisticated in the way that they look at managing their



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charged-off debt, and they look at what their third-party agencies can recover for them."

Nevertheless, "with as much as \$100 billion in credit card debt flooding the market in 2009, ... that's going to put some stress on the capacity to service that charged-off debt throughout the industry," Mr. Bradley said. "And that can help lead to better pricing for debt buyers."

[Sameer Gokhale](#), an analyst at [KBW Inc.](#)'s Keefe, [Bruyette & Woods Inc.](#), said that for the time being "a lot of the banks have put a lot of resources on maximizing their own collections" for the debt in their portfolios. "They're scrubbing and working the portfolios a lot harder than they were in the past, realizing they were leaving a lot of meat on the bones."

[Mr. Greenberg](#) agreed that for bankers, "in the last couple of years we've seen this swing from placing [their chargeoffs] with third-party agents to selling as pricing increased, but in the past year you've seen more of a balanced approach as pricing has come down."

Selling remains a part of most issuers' strategy, he said. "They simply need the liquidity in this market."

[JPMorgan Chase & Co.](#), [Bank of America Corp.](#), [Citigroup Inc.](#), and Wells would not discuss the matter for this story. [Capital One Financial Corp.](#) did not return calls.

[Joanna Lambert](#), a spokeswoman for [American Express Co.](#), said it does not typically sell chargeoffs. "We make that decision by regularly assessing the economics of handling them ourselves versus selling," but "we certainly have invested in the collections area of the business."

[Discover Financial Services](#) also said it prefers in-house collections over sales.

"We do very little sales of charged-off accounts," [Roger C. Hochschild](#), Discover's president and chief operating officer, said last month. That policy "has not changed within the last year" to 18 months, though Discover continues to use some third-party collectors.

Mr. McVity predicted that next month would be the big test of issuers' resolve. "A lot of people are waiting to see if the big banks are going to sell a lot of volume in the December cycle," he said. Some banks typically sell once a month, and others do so on a quarterly basis, but for all issuers, "December is the big Kahuna."

Yearend balance-sheet pressures can affect decisions about whether to sell bad debt, Mr. McVity said.



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"We are seeing more senior management and corporate-level decision-making involved in the collections market, which is typically not the case," he said. "I see a lot of banks struggling, with poor earnings, with loan losses. ... Within collections at banks, collection managers don't want to sell their accounts if they're super cheap, so we see banks having slowed down their sales a lot."

However, "because chargeoffs are a source of cash in earnings, there's kind of a movement to sell chargeoffs to generate earnings," Mr. McVity said. "Collections guys don't want to sell them, but sometimes it's a management decision."

Mr. Bradley said issuers have shown more interest in "forward-flow" selling agreements "to lock in better pricing" as the rising supply of chargeoffs has continued to weigh on pricing.

"Over 90% of our purchases in terms of dollars invested during the third quarter were from forward-flow arrangements, a significant increase from historical rates for us" of 30.3% in the second quarter and 15.4% a year earlier, he said. "Even though the prices are attractive today ... we believe pricing will become even better over the next six to 18 months."

Mr. Ludwig said prices for newly charged-off card accounts have dropped by more than half since peaking at a weighted average of 14.75 cents on the dollar in the first quarter of last year. He predicted that prices eventually will rebound and settle at around 10 cents.

"So far the banks are being somewhat selective in what price they will sell at," he said. "We've seen banks that are not willing to take the market price" and prefer relying on "internal or outside collection efforts."

However, "it'll be interesting to see if they can maintain that philosophy," he said. "If they are heavily involved in subprime mortgages, the bank overall will probably be taking the losses where they have to raise as much money as they can," and their recovery departments "will have the directive to sell immediately to raise the cash now."