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A new normal in consumer debt collections and recoveries

Focusing on compliance while delivering results

*Consumer Finance
Point of View*

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Changes ahead for consumer collections – disruption or opportunity?

The collections and recoveries function (“collections”) plays an important and valuable role in consumer lending. It also is increasingly the focus of regulatory attention. As a result, lenders and both first and third party debt collectors must respond to evolving regulatory requirements and expectations. As they do so, they should use this as an opportunity to take a strategic look at their collections operations. They should consider what additional changes can be made to better align collections with the achievement of the organization’s overall business strategies and objectives including: increased profitability, improved customer experience and regulatory compliance.

The collections function is of great importance to lenders. Over 35 percent of Americans have debts and unpaid bills that have been reported to collection agencies.¹ In light of those numbers, lenders cannot afford to simply write off borrowers with unpaid debts as “bad customers,” nor can they afford to ignore their customer experience. The ability to generate returns by mitigating potential losses and recovering monies is critical to lenders’ profitability.

Collections functions are also of great interest to regulators. Many of those Americans with debts and unpaid bills that have been reported to collection agencies have complained to the Consumer Financial Protection Bureau (CFPB) and other agencies about debt collection practices;² and the CFPB and Federal Trade Commission (FTC) have brought numerous enforcement actions against companies for their debt collection practices. The CFPB is expected to issue rules to bring first party collectors within the scope of the Fair Debt Collection Practices Act (FDCPA), the New York Department of Financial Services (DFS) recently issued its own debt collection rules, and the CFPB and other agencies can be expected to continue to focus on this area going forward.

What this means for collectors is that they will need to make changes to meet evolving regulatory requirements and expectations. This will be inconvenient, time-consuming, and expensive. On the other hand, this disruption also creates an opportunity to voluntarily rethink their collections strategies and operations, as part of the same change process. For example, most collectors underuse available data analytics to target and track the effectiveness of various collections strategies, and to develop new ones. Also, collectors currently underuse the collections customer touch point to improve delinquency rates and maintain borrowers as customers. Both of these are areas ripe for enhancement.

This paper describes some of the regulatory developments that are expected to accelerate the need for regulatory-driven changes in your collections function. It also describes six leading practices that collection functions can employ to make changes that can further collectors’ business strategies and objectives. Finally, the paper concludes by examining asset class-specific considerations and describing ways in which collections functions could be transformed into an industry leader and stay ahead of the compliance curve.

1 A third of Americans face debt collection. Waterloo Region Record. 30 July 2014. Avention.

2 In 2014, collections-related issues were the second most common type of complaint received by the CFPB and debt collectors generate more complaints to the Federal Trade Commission (FTC) than any other industry. See <http://www.consumerfinance.gov/complaintdatabase/>; <http://www.ftc.gov/news-events/media-resources/consumer-finance/debt-collection>

Regulators are focused on debt collections

Regulators are shining a spotlight on consumer collections for all collections operations, including banks, non-bank lenders, debt buyers, and third-party collection agencies and law firms. This heightened regulatory focus is evident from the activity reflected in the Snapshot to the right.

This can have a significant impact across all collectors. A recent study by the Philadelphia Federal Reserve Bank found that stricter regulation of consumer collections operations decreases recovery rates on charged-off assets by approximately 1.1 percent (9 percent of the average recovery rate) for each additional restriction.³ As regulation increases, institutions will likely not only incur higher collections costs, but will also be more limited in their potential collections strategies, potentially impacting their effectiveness.

Moreover, the trend of increased regulatory focus on debt collection is likely to continue. For example, our reading of the tea leaves suggests that the potential regulatory changes in the table below are likely on the horizon.

Collectors should consider acting now to get ahead of these evolving expectations, and be able to make changes on their own schedules rather than on a schedule dictated by a regulatory agency.

Industry timing is right for a double payoff

Recalibrating in the face of economic pressures and regulatory scrutiny isn't a new undertaking for banks and financial services institutions. But this change is different. It encompasses such a broad scope that organizations should consider expanding their compliance reviews and re-examine the entire Collections and Recovery process – not just those aspects impacted by regulatory changes. Improving collections performance can both facilitate compliance and result in significant economic opportunity.

Moreover, to the extent the business-driven improvements are designed to address the customer experience, they also are likely to be viewed positively by regulators as they should reduce the risks of consumer harm. Improving the robustness of your analytics and controls around

your process can not only improve your recovery rate but also promote fair and consistent treatment of customers. Customer-centricity is valuable from a customer experience standpoint, and also aligns with regulatory expectations that collectors work accounts and base their decisions on the entirety of an end-to-end view of all accounts that customer has with the lender. These two drivers create a synergistic opportunity to improve the return on your investment.

Snapshot – regulatory focus on debt collections

- *July 2013 – Senate Subcommittee on Financial Institutions and Consumer Protection held a hearing on supervision of debt collections by the Office of the Comptroller of the Currency (OCC).*
- *July 2013 – CFPB issued two bulletins: Bulletin on Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts and Bulletin on Representations Regarding Effect of Debt Payments on Credit Reports and Scores.*
- *July 2013 – OCC outlined debt sale best practices in Statement Regarding Oversight of Debt Collection and Debt Sales.*
- *September 2013 – OCC issued a Consent Order requiring changes to a broad range of a lender's debt collections practices, as well as borrower remediation.*
- *November 2013 – CFPB issued a Debt Collections Advance Notice of Proposed Rulemaking (ANPR) and began including debt collections in the CFPB public complaints database.*
- *August 2014 – OCC issued guidance on the application of consumer protection requirements and safe and sound banking practices to consumer debt-sale arrangements.*
- *October 2014 – CFPB's Fall 2014 Supervisory Highlights notes that the Bureau's recent examinations identified an unfair practice and several violations of the Fair Debt Collection Practices Act (FDCPA).*
- *December 2014 – New York DFS issued a regulation affecting debt collection in the state of New York.*
- *More than 20 enforcement actions – Since 2008, the FTC has brought more than 20 enforcement actions related to debt collection resulting in over \$165 million in debt collections monetary penalties and restitution.*

³ <http://www.philadelphiafed.org/research-and-data/publications/working-papers/2013/wp13-38R.pdf>

Potential regulatory changes

FDCPA likely to cover first party debt collectors	The CFPB's Advance Notice of Proposed Rulemaking (ANPR), which seeks public comment on debt collection practices, suggests that the CFPB is considering amending the Fair Debt Collections Practices Act (FDCPA) to cover first party collectors for the first time. ⁴
Further regulation of borrower communications, including more guidance and regulation around the use of text messages, email, and other communications technologies	The CFPB ANPR also suggests that regulators may further regulate borrower contact and require additional validation notices and disclosures when using newer communication technologies. For example, the CFPB may adopt new regulations relating to the use of email and text messaging, including restrictions on the frequency and timing of such messages, and new guidance on written disclosures provided through these formats. While these changes may restrict contact, they may also provide further clarity in what is considered permissible in these new formats, allowing collectors to more confidently rely upon these tools where appropriate.
Increased focus on Management Information Systems' ability to provide an audit trail	The OCC has cited the importance of financial institutions' management information systems' ability to provide timely, accurate, and comprehensive reporting relating to debt sales in Congressional testimony as well as Bulletin 2014-37. ⁵ More broadly, MIS supporting collections should be sufficient to document an audit trail of activities and provide detailed reporting on borrower contact.
Increased focus on third-party management and oversight	OCC examiners have increased scrutiny of the governance and monitoring of third-party service providers, as well as the transfer and accessibility of information upon sale and placement of debt. Both the OCC and Federal Reserve issued new third-party risk management guidance in the fourth quarter of 2013. ⁶
Restrictions on the collection of disputed and time-barred debt	The CFPB ANPR and a recent joint CFPB and FTC Amicus Brief suggest that regulators may require enhanced verification of disputed debt, and may limit collections of time-barred debts (debts that have aged beyond the applicable statute of limitations). ⁷ States including the State of New York have also issued new state-specific regulations to provide additional protections around time-barred debt as well as other areas. ⁸
Increased oversight of federal consumer protection regulations, regardless of a lender's size	The FTC issued a consent order against a smaller subprime lender for violating the FTC Act and for FDCPA practices such as disclosing the existence of debts to third parties, calling consumers at work when not permitted to do so, and calling third parties with the intent to harass. ⁹
Additional governance and compliance requirements	Requirements outlined in an OCC Consent Order may become the new baseline expectation for other collectors as well. Those requirements would require affected collectors to, among other requirements: <ul style="list-style-type: none">• Establish a compliance committee• Develop additional compliance infrastructure in key collections risk areas including Servicemembers Civil Relief Act ("SCRA") compliance, sworn documents, and collections litigation• Incorporate monitoring, testing, and reporting around risk management, governance, and controls• Implement appropriate staffing level metrics and robust employee training programs• Conduct comprehensive internal audit review of collections activities• Have in place comprehensive collections policies and procedures

4 CFPB Advanced Notice of Proposed Rulemaking: Debt Collection (Regulation F), 78 Fed. Reg. 67847 (Nov. 12, 2013).

5 <http://www.occ.gov/news-issuances/congressional-testimony/2013/pub-test-2013-116-oral.pdf>, <http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-37.html>

6 See CFPB Bulletin 2012-03. For analysis of the OCC's Bulletin, see PwC's *Financial Services Regulatory Brief, Managing third-party relationships: It's complicated* (Nov. 2013). See also the Federal Reserve's *Guidance on Managing Outsourcing Risk*, SR 13-19/CA 13-21 (Dec. 5, 2013). For analysis of the Federal Reserve's Guidance, see PwC's *More third-party guidance: When should you just do it yourself?* (Dec. 2013).

7 http://www.ftc.gov/system/files/documents/amicus_briefs/esther-buchanan-v.northland-group-inc.no.13-2523-6th-cir./1403105buchanan6cir-amicus.pdf

8 <http://www.dfs.ny.gov/legal/regulations/adoptions/dfs23t.pdf>

9 <http://www.ftc.gov/news-events/press-releases/2014/05/auto-lender-will-pay-55-million-settle-ftc-charges-it-harassed>

Six leading practices in consumer debt collections

We describe below six practices that organizations can incorporate into the regulatory/business transformation of their collections function to catalyze meaningful improvements both in compliance and in profitability.

1. Align consumer collections strategies and practices with your organizational strategy, structure, and priorities
2. Improve collections decision making with advanced analytics and alternative data sources
3. Increase your customer-centric focus within the collections function
4. Streamline collections workflows and operational structure
5. Effectively incorporate third parties to strengthen your collections performance
6. Enhance debt sale processes, controls, and analytics to support debt sale strategies

The principal objective of a collections function is relatively straightforward: to increase profitability by increasing recovery on bad debt. Therefore, that will necessarily be a prime focus on any rethinking of existing processes, practices and strategies. However, we also recommend identifying and considering opportunities to foster cross-selling, customer loyalty, and providing services across multi-customer households. Collections functions can consider expanding their strategies to also address increasing the lifetime value of customer and household relationships.

1. Align consumer collections strategies and practices with your organizational strategy, structure, and priorities

Don't let collections become an afterthought

It is easy to forget the strategic importance of consumer collections. After all, if everything goes right, it should never be needed; it is a function no one wants to need. However, the implications of getting collections right can have far-reaching impacts. Could your lending arm broaden its credit underwriting box and attract more origination volume if you could project reduced losses based on improved collections strategies and processes? Might improving your collections operation help your organization meet its overall customer loyalty and retention objectives? Could effective collections even provide an opportunity for the organization to more profitably acquire servicing rights? Effective collections can contribute to the achievement of a broad range of enterprise-level business objectives – if it is considered up-front, rather than after the fact.

Incorporate consumer collections into your overall risk framework

Collections should be viewed as a key component of your risk management framework, so the business change process should include consideration of how business decisions and changes in other areas may affect collections. This can allow you to more accurately align your business activities with your credit risk appetite based on expected losses and to make more informed decisions as you balance the investments you make in collections with other strategic priorities. This risk-based view should inform your collections approach – including key decisions like when to incorporate debt sales into your recovery strategies.

2. Improve collections decision making with advanced analytics and alternative data sources

Make your collections models dynamic and predictive

Many institutions rely primarily on account balances or credit scores to prioritize delinquent accounts and determine collections strategies. But this is only part of the equation. To more accurately prioritize delinquent accounts and determine enhanced collections strategies, lenders should apply analytics that consider both the probability of recovery and the expected dollar amount to be recovered. Leveraging predictive modeling can help determine the loss exposure under a range of collections strategies by forecasting each borrower's likelihood of repayment as a function of each strategy, which in turn can help identify the ideal collections strategy to implement.

Of course, the models should also account for the fact that expected loss may change over time. Contributing factors include depreciation of a vehicle used to secure an auto loan, adjusting the credit limit of a credit card, or declining property values.

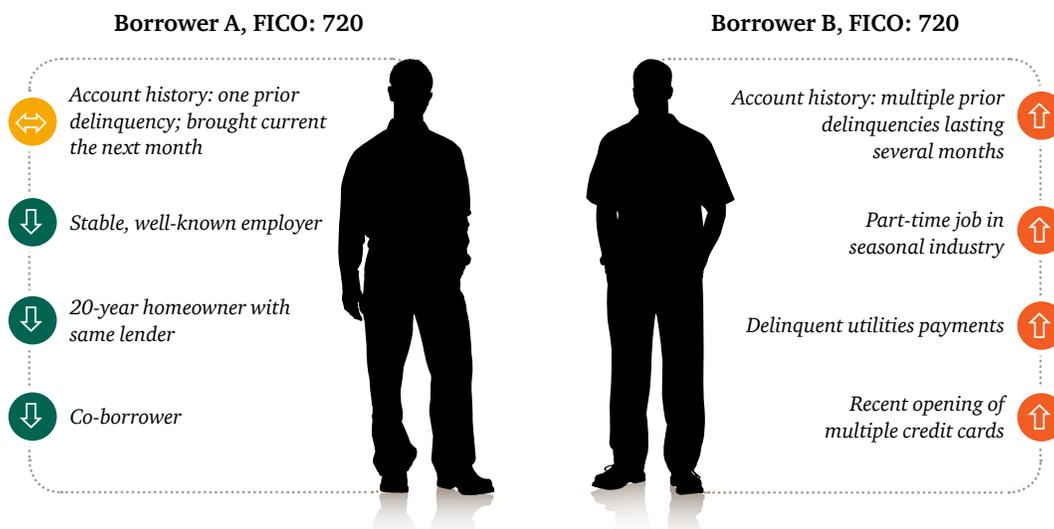
Consider incorporating the following factors into decision models to guide decisions as to collections strategies to apply to individual situations:

- Borrowers' credit profiles
- Historical collections results on accounts with similar characteristics
- Amount of the deficiency, and the total amount of accounts in default for the borrower or household
- Presence of co-borrowers
- Other assets held by the borrower
- Employment status
- Non-traditional data sources including alternative credit scores, vendor-provided collections risk scores, rental and utility records, and legal and public records

Determine collections strategies based on your collectability modeling

The factors identified above can be used to develop a borrower behavioral profile. This can help guide risk tiering for account placement and determine specific loan-level treatment.

Figure 1: Same FICO score; different levels of lender risk

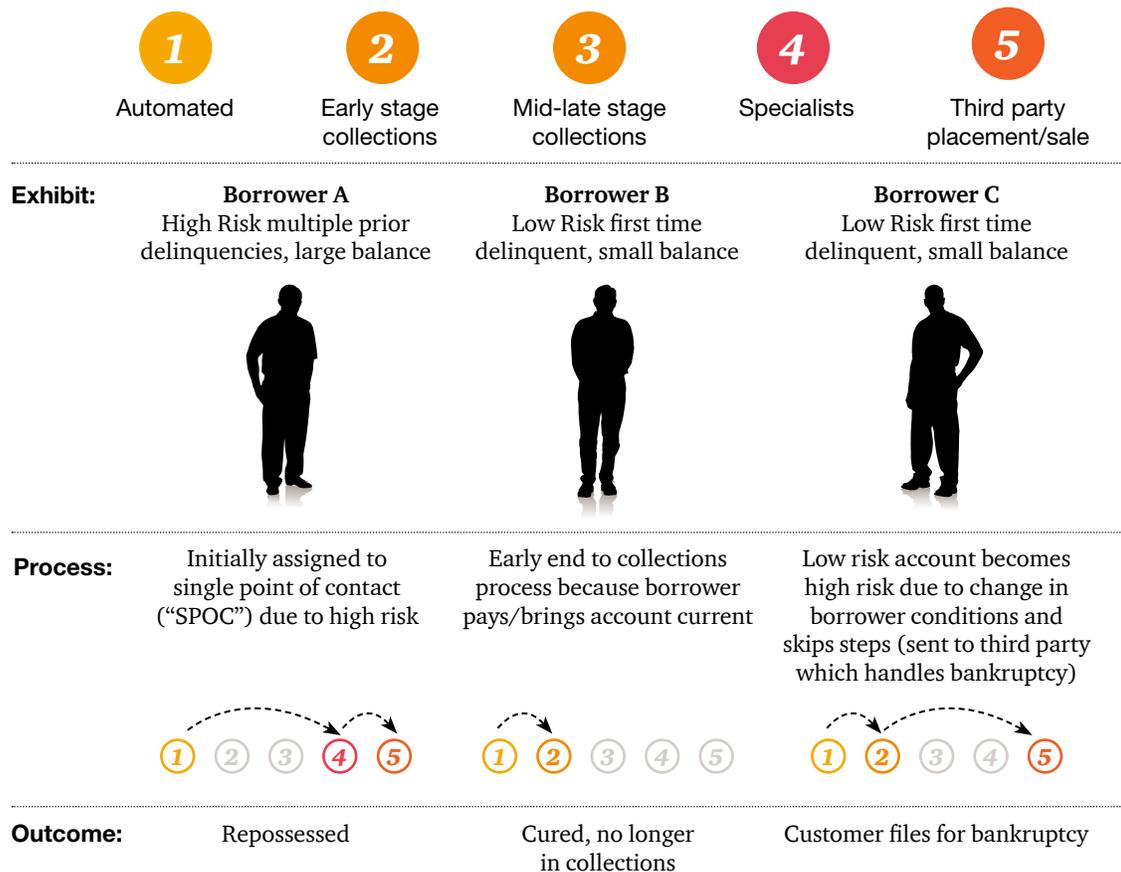


For instance, behavioral analysis could be used to determine whether the borrower is frequently late but responsive to payment reminders, or is never late but now has credit deterioration, each of which would require a different collections strategy. These behavior profiles can help you understand which borrowers are likely to respond to different methods of contact as well as to potential loss mitigation or settlement offers. It may sometimes be advantageous to offer alternatives such as payment holidays, forbearance, forgiveness, partial payments, or restructuring, and you can use analytics based on behavioral profiles to guide these decisions.

that are less likely to be collectible. Targeting the right accounts early can help you to reach borrowers when they are more likely to respond to collections efforts. Effective collections strategies can help minimize the time spent on low-risk or uncollectable accounts in order to improve your efficiency and eliminate unproductive collections costs. Borrowers with different risk profiles may progress through the stages of the collections process differently, as seen in Figure 2.

Develop customer behavior profiles to help predict the likelihood of repayment based on borrower's past payment behaviors and current contributing factors.

Figure 2: The five stages of debt collection



Consider the use of third-party tools and data sources

Third-party vendors can provide valuable data points to serve as inputs for modeling and analytics. Vendors that focus on customers with a “thin file” can often provide access to alternative data sources, such as utilities payments, that give detailed insight into the borrower’s financial situation and improve the quality of data available for that customer. Alternatively, data vendors that focus on wealth products marketing can provide data enabling models to predict the likelihood of collecting from the customer. Vendor-provided risk scores can be an effective supplement to internal data and credit scores. Additionally, validating customer contact data against third-party sources can help correct bad numbers, identify missing information, and improve data quality in order to reduce the need to send a file through costly skip tracing. And third-party systems that provide an online portal for receiving payments can be effective for customers who prefer using the internet channel instead of speaking with a collector.

LexisNexis research has indicated that 40 to 60% of accounts placed for collection do not have a valid phone number for a point of contact.¹⁰

10 LexisNexis Risk Solutions simplifies skip tracing and enhances collections productivity. ENP Newswire. 23 June 2010. [Factiva]

3. Increase your customer-centric focus within the collections function

Service your customers, not just their accounts

It is important to understand your customers’ full relationship with your organization and to assess the overall exposure of that relationship. For customers with multiple accounts, consider their value at an aggregate level – even if not all accounts are in default.

Aligning systems to provide a single customer view provides each product line with consistent customer data. This can help you coordinate your collections decisions based on available data aggregated from each account, including data points obtained during the originations process.

Customer experience may be improved and regulatory risk curtailed by allowing customers to manage multiple account inquiries simultaneously. For example, changes of address or servicemember notifications of active duty status can be handled with a single telephone call.

It is important to understand your borrowers’ full relationship with your organization and assess the overall value of that relationship.

The challenge for many organizations is that products are serviced on different platforms and, while migrating to one platform may be ideal, it is not often feasible in the short-term. Interim steps, such as assigning unique customer IDs, can be adopted that allow for visibility across product lines by servicing and collections personnel.

Once you have an understanding of the borrower’s accounts across the organization, a consistent and unified communications strategy is key. Multiple collections groups that compete for the same funds or send conflicting customer communications can negatively impact overall performance and lead to a poor customer experience. It also introduces the potential risk of borrower harm. Therefore, your organization’s communications should be guided by a broader recovery strategy in which the business results are enhanced through the rules governing payment priority. Employee incentives may then be designed to drive the behavior consistent with mitigating losses and reducing customer risk levels.

Help borrowers self-cure and avoid collections

“An ounce of prevention” rings true in the collections business. Several methods can help borrowers keep their accounts in good standing, such as allowing customers to select their preferred payment due date that coincides with their pay date or set up automatic payment reminders and past-due alerts through their preferred channels.

Many accounts that reach the early stage of collections despite these pre-emptive efforts may still have the potential to self-cure. Borrowers may simply need reminders or information on the various methods for submitting payments. Also, data analytics may help identify customers that historically self-cure early in the default cycle which can reduce the overall volume of accounts hitting early stage collections queues.

Finally, allowing customers to set up self-cure repayment plans through an easy and intuitive process can result in lower collections costs and a positive customer experience.

Make it easy for borrowers to contact you

Borrowers should be able to easily reach collections staff who have the knowledge and authority to help them. Make sure your communications channels include multiple ways to reach an agent or to make payments. Features such as live online chat and a “call me back” option make it convenient for customers to work with debt collectors and get back on track.

It is important to make sure that borrowers trying to contact you are quickly directed to the right person. Structure your call center so that incoming calls are routed to the appropriate group based on automated workflows. If a borrower has been working on a workout strategy or settlement offer with a particular collections representative, they should also be able to contact that person directly.

For borrowers who have been assigned a single point of contact (SPOC), provide multiple methods of contact and make the SPOC easily accessible. This encourages proactive borrower behavior and decreases the disruption, potential inefficiencies, and compliance risk that can result if borrowers follow up with a different agent who does not have the same knowledge of their account.

Incentivize borrowers based on desired behaviors

Offering borrowers incentives can boost collections results. For instance, consider motivating borrowers to set up automated payment plans by waiving fees if they proactively self-cure, to reduce the cost of collections and achieve quicker results. Data analysis should drive these decisions so the incentives are beneficial to your bottom line. For instance, analytics can help you identify situations where it may be beneficial to negotiate late fee reductions based on expected losses. These targeted fee reductions could increase the likelihood of collecting on the original loan amount.

Allow customers to set up automatic payment reminders or past-due alerts through their preferred channels to encourage borrowers to self-cure.

Train and monitor staff on appropriate customer interactions

It is important for collection personnel to remember that delinquent borrowers are, first and foremost, valued customers. It is not uncommon for customers, especially those in early-stage collections, to quickly cure following a temporary hardship or have other accounts in good standing.

That’s why a customer-centric focus is important throughout all stages of debt collection. The staff member who speaks directly to the customer becomes the representative of your organization. These front-line staff members are key points of contact with customers in what is often a difficult situation for them. Recognizing this and understanding customer concerns are crucial to decreasing any negative impact on customer perceptions.

A customer-centric collections philosophy may also help mitigate potential regulatory risk. As the CFPB and other regulators continue to closely monitor lenders’ collections practices relative to FDCPA, state laws and the Unfair, Deceptive or Abusive Acts or Practices (UDAAP) standard, incorporating these standards into staff training can help prevent the less than favorable behaviors often associated with consumer collections.

Consider borrowers’ preferences

A lender’s collection contact strategies should be flexible and consider customer preferences when communicating with them while maintaining strict compliance with federal consumer protection regulations, including the Telephone Consumer Protection Act (TCPA). Calls to an individual’s place of employment, for example, while permitted in some circumstances, may jeopardize a good relationship by forcing the customer to discuss their account within earshot of their co-workers. For this reason, some lenders leverage predictive modeling to structure a pre-default contact strategy for customers that are at-risk of default to cure those accounts before they become delinquent. Furthermore, today’s borrowers are increasingly tech-savvy; for many, reaching them via mobile phone, email, or text message is easier than and preferable to contacting them via a landline phone. This alone should force many lenders to reconsider their current, outdated contact strategies to increase right-party contacts and recovery rates.

Lenders should also take customer complaint activity very seriously. A strong complaint management program can increase an institution’s issue resolution capabilities and is crucial to customer retention and bottom line profitability. Equally important are complaint analytics capabilities which can help in the early identification of complaint trends and systemic problems adversely affecting customers.

4. Streamline collections workflows and operational structure

Automate routine tasks; put more focus on value-add activities

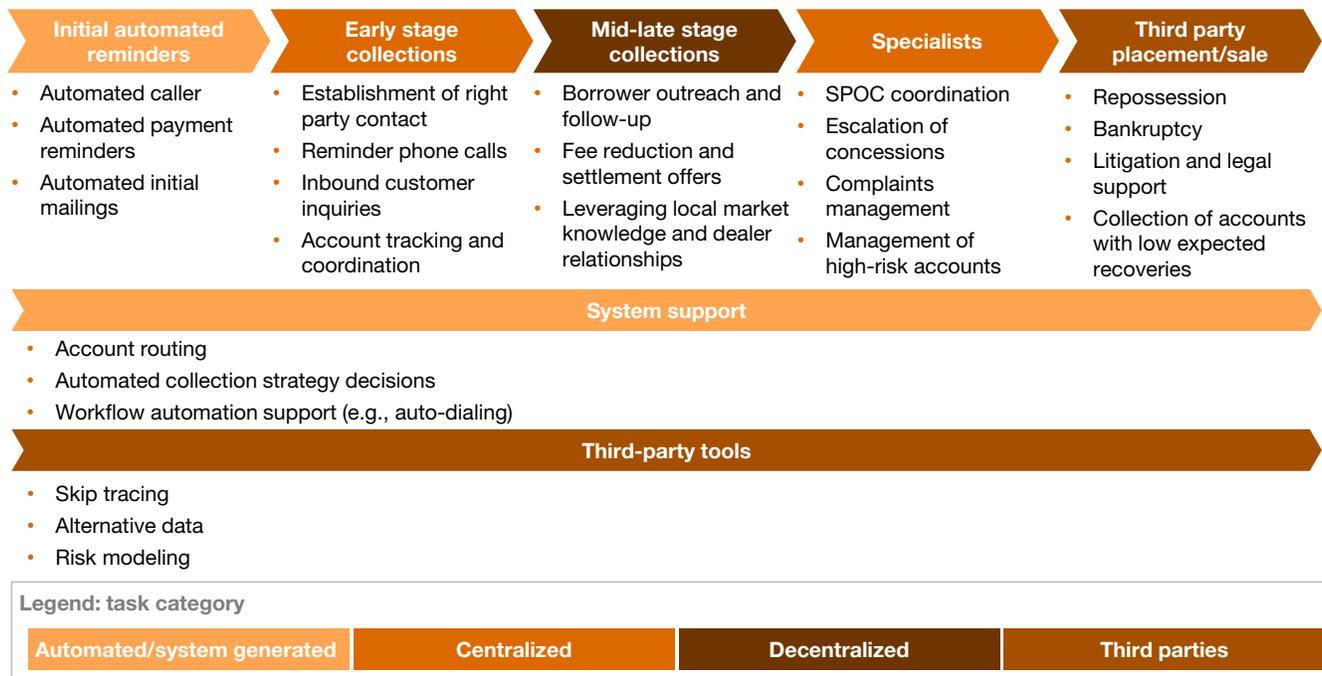
By automating certain components of the collections process, you can achieve even greater efficiencies, freeing up collectors’ time for value-added work. For instance:

- **Provide context-specific scripts with advice tailored to the loan and borrower.** This can help collectors focus on core collections activities and reduce compliance risks by providing standard responses and reminding collectors to provide required disclosures. Standardize scripting can also help promote communications that are aligned with the organization’s policies and procedures for handling specific processes, such as processing multiple, recurring ACH payments, for which compliance with Regulation E is critical.

- **Implement automatic pre-approval of settlements or customer assistance plans based on account characteristics.** For instance, pre-scoring or setting thresholds for the percent of the loan value that must be recouped in an alternative payoff plan based on the customer’s risk level.
- **Determine which processes can be centralized or automated.** Wherever possible, automate standard tasks and low value-add activities throughout the collections process, to allow your staff to focus their efforts on core collections activities. Centralization can be effective for tasks that are consistent and do not require local knowledge, as well as those specialized tasks for which a coordinated approach or special training is required. Conversely, decentralization may be appropriate for more advanced collections activities when you want to make use of local knowledge of the market as well as the ability to leverage dealer or broker relationships.

Third-party tools such as skip tracing can be an effective tool at any stage in the collections process when warranted. You can also consider third parties an extension of your centralized specialists; use them for tasks requiring skillsets which your collections staff does not possess, or for accounts with low expected recoveries which your staff do not have the bandwidth to collect. Figure 3 illustrates how this progression could be applied at each stage in the collections process.

Figure 3: Process centralization and use of third parties across the collections life cycle



Management or a designated independent quality control group should periodically assess the results of the collections and servicing units utilizing such tools as call monitoring and loan level testing. The oversight function can also provide insight into the quality of customer care and immediately address any potential customer risk areas.

Identify accounts requiring special treatment

Recent regulatory changes require aligning borrowers with a SPOC for many delinquent mortgages.¹¹ But assigning a SPOC does not have to be limited to just mortgage loans. Assigning a SPOC capable of managing the customer's entire portfolio of accounts can have benefits beyond regulatory compliance, such as:

- Providing consistency in customer treatment/relationship
- Applying prior knowledge of the borrower's account
- Managing all of the borrower's collections activities for complex accounts
- Focusing on accounts that would benefit from increased attention

Organizations should identify high-risk accounts requiring special treatment early in the collections process and consider whether the accounts would benefit from assigning a SPOC. Although it is ideal to assign a SPOC early in the collections process, this is not always possible. If the status of an account changes to high risk later in the process, a system should automatically route the account to the appropriate specialty group and assign a SPOC.

Bankruptcy and SCRA are but two examples of such accounts that could benefit from a SPOC or specialist treatment. Since both situations provide qualifying customers with protection mandated by federal regulation, having these accounts managed by trained, experienced personnel is paramount. SPOCs should be given both the authority and accountability to properly manage these situations as servicing systems may occasionally lack the functionality to properly adjust these accounts in accordance with regulatory requirements. Finally, lenders should have command over the channels by which these situations may be communicated to them and assign gate keepers responsible for transferring impacted accounts to the appropriate SPOC for timely handling.

Use analytics broadly

Applying advanced data analysis in a collections operation can help enhance performance. Data analysis is frequently used for account segmentation, but there are opportunities to use the same data that is already being collected in a more powerful way.

Many lenders are designing collection scorecards by combining proprietary account and credit bureau data to forecast default trends based on historical payment information. For example, customer contact strategies can be adjusted based on scorecard results – customers demonstrating behaviors indicative of the onset of a financial hardship can be prioritized for contact while those with more favorable payment patterns may not necessarily be contacted immediately upon default.

Collections strategies should strive for right-party contact at the time that has the greatest likelihood of resolution, and analytics can help you design just that. An automated dialing strategy that identifies optimal call times based on a customer's preferences and provides customers an automated phone payment option is one such tool that can both decrease an agent's time on the line and allow customers to avoid a potentially unpleasant discussion.

For customers who have demonstrated a preference to pay on-line or via their mobile device, lenders can incorporate analytics to push secure payment reminders before delinquency. These payment reminders can leverage the banking institution information previously provided to allow customers to make a payment from their laptop or hand held device at the click of a button.

5. Effectively incorporate third parties to strengthen your collections performance

Collections agencies can be a valuable asset: They can provide specialized services in areas requiring specific expertise, such as states with unique requirements, as well as an opportunity to recover otherwise uncollectable accounts. But there are risks involved when using third-party service providers, and in the current regulatory environment, it is important to revisit your third-party risk management practices. It is also important to assess what functions you want performed by third parties and how they complement your internal team.

11 <https://www.federalregister.gov/articles/2013/02/14/2013-01248/mortgage-servicing-rules-under-the-real-estate-settlement-procedures-act-regulation-x#p-1928>

Begin by considering each stage of the third-party engagement process, including choice of third-party partners, account placement, and third-party monitoring and account management, as shown in Figure 4.

Companies should maintain high standards for their third-party collections partners. Vendors should be expected to:

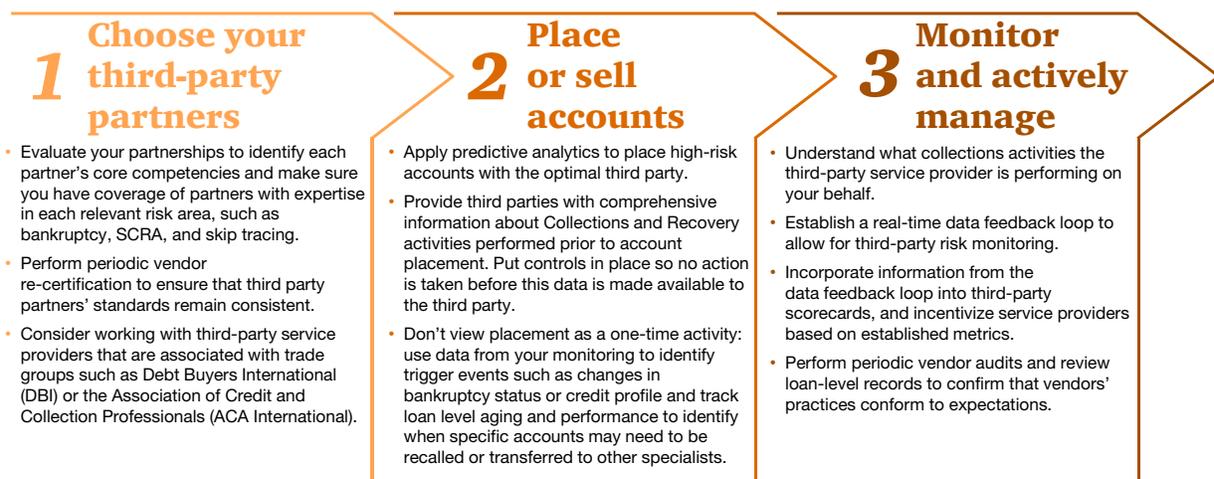
- Document collections activities in a single location that provides an end-to-end view of all communications with the borrower (an effective audit trail).
- Refrain from initiating contact with borrowers until the collections agent has reviewed the borrower’s history.
- Have a compliance monitoring program in place, including testing and monitoring of the control environment and monitoring of agent calls for compliance with regulatory and debt collector policy. Assessment of the third party’s Compliance Management System (CMS) should include provide management with insight into the effectiveness of the third party’s governance and oversight, written policies and procedures, risk assessment, monitoring programs and plans for corrective action. The results of this analysis should be considered in the risk-based analysis that drives the scope and frequency of remote and onsite reviews.
- Provide prompt communications to the debt owner regarding consumer complaints.¹²

6. Enhance debt sale processes, controls, and analytics for debt sale strategies

Debt sales can be an effective tool for certain accounts, especially those with low expected recoveries. Many institutions sell charged-off accounts to third-party debt buyers as part of their overall recovery strategy. Monthly sales are typically executed through either forward flow agreements or ad hoc sales of bulk transactions, based upon portfolio and account characteristics. Sellers of debt to third-party buyers should assess their processes, systems, risk management functions, control environment and reporting for accounts sold to or repurchased from a third-party debt buyer. Portfolio analytics should be leveraged to further align debt sales strategies with recovery objectives. Lenders should review strategies and operational processes for the following, to increase the return on debt sales and strengthen governance and oversight of third party debt buyers and related control structures.

- **Recovery scores:** Recovery scores can help to prioritize higher cost channels by identifying accounts to pursue with higher probability of a greater return. Accounts with suboptimal recovery scores could benefit from an accelerated debt sale strategy, as debt that has not aged significantly tends to yield improved pricing, leading to greater recovery.

Figure 4: Key considerations for third-party management



12 For insights into additional steps that may be appropriate, see PwC’s *Financial Services Viewpoint, Significant Others: How financial institutions can effectively manage the risks of third-party relationships* (Sept. 2013)

- **Vendor management:** The OCC¹³ is requiring that banks perform due diligence on debt buyers before a sale, including the assessment of the debt buyer’s record of compliance with consumer protection laws and regulations. Third-party surveillance programs should include processes for initial and ongoing debt buyer due diligence, including the use of debt buyer scorecards.
- **Accuracy of information:** The list of media and information that organizations must provide to debt buyers has grown to include signed customer contracts, account numbers, copies of prior account statements, source and amount of the last payment, itemized account of all amounts claimed to be owed, information about all unresolved disputes and fraud claims made by the debtor, information about Collections efforts (both internal and third party efforts, such as by law firms) made through the date of sale. Strong quality standards and quality control over the accurate and reliable transfer of hard copy and electronic account information to debt buyers, is critical to operational performance. The use of “data scrubs” and transactional sampling can help ensure that account data are complete and accurate before accounts are transferred to the buyer.
- **Sale agreement contracting:** Debt sale contracts should include restrictions on debt sales, limits on debt resale, and rights to review debt buyer litigation strategies.
- **Policies and procedures:** Policies and procedures for debt sale should include clear roles and responsibilities, financial analysis of sale versus internally collecting the debt, debt sale approval and sign-off, document retention standards, restrictions regarding accounts that should not be sold, accuracy and timeliness of credit bureau reporting, and compliance with merchant requirements and regulatory standards.
- **Restrictions on selling certain debts:** Regulatory guidance forbids banks from selling certain categories of debt that “fail to meet the basic requirements to be an ongoing legal debt” such as debt that has been otherwise settled or is in process of settlement, debt of deceased account holders, debt of account holders currently in litigation with the institution, and debt incurred as a result of fraudulent activity. Additionally, banks should also closely examine debt sale strategies for the exclusion of certain additional types of debt that may pose greater potential compliance and reputational risk, such as accounts eligible for SCRA protections and accounts close to the statute of limitations.
- **Repurchase analysis:** For repurchases, lenders should evaluate why the accounts were returned, determine whether additional quality controls need to be implemented, and, if necessary, whether they should perform look-back reviews to determine whether they or the debt buyers engaged in practices that hurt consumers.

13 <http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-37.html>

Specific considerations by asset class

While collections operations have many similarities across asset classes, certain nuances exist. Differences in loan size, collateral, and available loss mitigation tools should be incorporated into modeling, decision making, and workflows. Figure 5 breaks down some specific considerations by asset class.

Figure 5: A closer look at auto finance, mortgage, credit card, and student loan collections

Auto finance considerations

- Skip tracing is more significant for auto finance due to the mobile nature of the asset, which requires tracing for repossession as well as for borrower contact
- The reliance on dealers to provide initial borrower information at the time of application introduces additional risk for indirect lending
- Indirect lenders' risk models should incorporate the impact of recourse through dealer reserve "clawbacks" in the event of early payment defaults
- Repossession agencies should be managed carefully due to the potential negative customer impact

Mortgage considerations

- A broader range of loss mitigation options is available due to the size and nature of the underlying residential asset
- Mortgage servicers may need to develop more sophisticated models to project the impact of loan modifications and other loss mitigation strategies
- Deficiency judgments may be considered, as potential losses may be sufficient to justify the cost and complexity
- Mortgages are subject to significant regulatory scrutiny as well as data collections and loss mitigation requirements from the Federal Housing Finance Agency and government-sponsored entities

Credit card considerations

- As an unsecured lending product with 100% value-at-risk and frequent transactions, proactive monitoring and predictive analytics are important tools for risk management
- Transaction monitoring can be used to manage the "open to buy" (the difference between the credit limit and the balance drawn) and block high-risk accounts
- Fraud detection models should balance potential losses against the potential negative customer impact of "false positives" resulting in declined transactions that are not actually fraudulent

Student lending considerations

- Student loans are non-dischargeable in bankruptcy providing collections operations with the opportunity to employ longer term recovery strategies
- High co-signer rates on private student loans (>90%) provide collections operations with a second borrower with whom to attempt to cure the loan
- Student loan collections practices are receiving tremendous scrutiny from the CFPB and strict adherence to all regulated collections practices is highly recommended

14 20 U.S.C. §1078-6(a)(1)(A); 34 C.F.R. §§ 682.405(a)(2) and 685.211(f)(1)

Conclusion

The considerations discussed in this paper provide an outline of industry practices that can help enhance your collections operation, from strategy and organizational alignment to specific tactical improvements. While greater regulation may be the most popular impetus driving enhancements, benefits available to the organization go well beyond just the mitigation of regulatory risk.

Aligning your collections platform with your organizational strategy, structure, and priorities can help you look past the current status of the customer's account, recognize the future value of the overall relationship, and drive toward a customer-centric philosophy.

Considering the manner in which the use of advanced analytics, alternative data solutions, and third-party relationships in critical areas can be leveraged will provide perspective necessary to streamline workflows and drive cost-effective operational improvements.

And finally, efficiently incorporating debt sales into your overall Recovery strategy can help free up valuable resources or generate a source of revenue from charged off accounts not yielding an acceptable return.

Whether all or just a few of these considerations ring true with your organization, one thing is for certain – today's consumer collections strategy cannot just be approached with strictly a regulatory lens but must be woven into the overall competitive fabric of the organization.

How we can help

As your organization considers potential enhancements to its Collections and Recovery operations, we can provide industry insight and subject matter specialists across asset classes. Whether you are looking to enhance targeted aspects of your operations, perform an end-to-end assessment and process re-design, or explore new opportunities related to third party vendor tools and Collections management systems, we can support you through any stage of your enhancement efforts. Our experience includes helping clients:

- Customer and risk segmentation and scoring
- Developing and assessing Collections strategies
- Comparing current debt collections practices to global and industry standards and Federal regulatory guidance
- Developing “as is” and target operating models
- Building new capabilities or significantly reengineering existing processes and operations
- Assessing staffing levels, training needs and infrastructure requirements through capacity modeling
- Developing Collections and loss mitigation reporting dashboards that consider key performance or risk indicators
- Creating vendor assessment frameworks for outsourced consumer collection partners

Contacts

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