

A Guide for Credit Grantors:

Extending Credit, Managing your Company's Delinquent Accounts and When to Hire a Third-Party Debt Collector

Consumer Credit

The extension of credit to consumers and the resulting debt has steadily increased in recent decades. Delinquent accounts are an inevitable part of any business that extends credit, but effective recovery efforts can help reduce losses on these accounts.

As a credit grantor, you need to be aware of two basic principles:

1. Granting credit carries inherent risk.
2. This risk can be mitigated through efficient credit and recovery policies.

Although losses to bad debt are possible, they don't have to be excessive. Establishing and maintaining effective controls over delinquent accounts is a simple way to reduce these losses. While the information in this brochure may not solve all your payment problems, it can help soften the financial burden of bad debt.

Extending Credit

As a credit grantor, you allow consumers to obtain goods and services now and pay for them later. While extending credit increases your sales, it also puts you at risk of some losses due to nonpayment.

Most businesses that "charge-off" a percentage of sales to bad debts have an established rate or procedure for this activity. This rate averages 0.5 percent to one percent on low-profit transactions and up to five percent on high-profit transactions. When your charge-off rate exceeds the limit you set, you must find ways to improve your control over losses to bad debt.

Requirements to keep in mind when you are extending credit include:

1. A clear understanding by both parties of the credit transaction terms.

Unclear repayment terms can be costly for both parties. Neither customer nor credit grantor should agree to terms they don't comprehend.
2. A periodic age analysis of every outstanding account. Categorize accounts by severity of lateness (30 days, 60 days, 90 days or over). Look for patterns that could be used to guide your credit-granting policies (ex: your account balances of \$200 experience delinquency 4% of the time, but delinquency jumps to 8% when the original balance is \$300 – you may wish to require a down payment to compensate for the increased risk of these larger accounts). If necessary, consult an accounting professional to set up an analysis system.
3. Always follow-up. The best method (face-to-face, by phone or in writing) will depend on the situation, but be diligent about communicating with customers who use credit.

Know the Laws

You may be entitled to charge late fees, collection costs, interest and legal fees on delinquent accounts. Interest rate (usury) laws and Truth-in-Lending requirements vary by state. Certain laws apply to some credit situations and not to others.

Identifying Bad Debt

You will have greater success recovering debt if you recognize the problem early. The more time that passes the less likely you are to recover the debt.

Recognizing the Late-Paying Consumer

The following traits may help you identify potential debtors

- Habitually slow in paying
- Financially immature
- Irresponsible about employment and family obligations
- Incapable of handling his or her own problems
- Runs away from debt
- Borrows with no intention to repay
- Tries to reduce debt through unfair complaints

Outside this list are those who experience financial problems due to circumstances beyond their control (job loss, health issues, etc.). A distinction should be made between the delinquency of those who are in a temporary, but difficult, situation and those who repeatedly fail to honor the original payment terms.

Reducing Bad Debt

You should have a written, in-house policy for handling past due accounts that establishes when to call new customers, when to call repeat customers and when to send letters regarding debt situations. Successful in-house policy is consistently enforced and periodically evaluated.

Being consistent means following each step of your collection schedule fully before progressing to the next. It also means that you never move backward or repeat a step in the hope of salvaging accounts.

An example recovery policy:

1. 30 days late: Reselling the Payment Terms – The first step should be to resell the payment terms. Determine the reason for delinquency and emphasize how a new payment arrangement

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benefits the consumer. Be friendly, but firm. When a consumer is non-cooperative, move on to step two.

2. **Insisting on a Firm Payment Agreement** – This step must involve stronger, more persuasive techniques. Insisting on a firm payment schedule can be done in writing or by telephone, but less time should be devoted to this procedure. The arrangements must be specific and objective. Persuasion will be based on appeals such as fairness, pride and a desire for a good credit reputation. Attempt to set up a definite and clearly understood payment program. This should be done regardless of the circumstances of the individual cases. Long- and short- term extensions can be adjusted in different cases; however, indefinite promises and nebulous payment arrangements have very little value.
3. **Taking Stronger Action** – A consumer who honestly intends to pay a bill is usually not opposed to establishing a definite payment schedule for a delinquent account. Those who are unwilling to cooperate may require stronger action. Therefore, demand payment in full within a specified time. The term “settlement in full” is now often used instead of “payment in full,” because it is more flexible and allows the consumer and the creditor a greater opportunity to negotiate a satisfactory agreement. Whatever term is used, the demand should be firm and concise. Emphasize that you want the payment on or before a certain date. State this briefly and only once. Repetition at this point is counterproductive.

Please note, a common error at this stage of collection is to review the whole history of delinquency with the consumer. The creditor should not do this. It often causes additional arguments and delays payment further.

4. **Taking Final Action** – For some consumers, the older a debt becomes the more excuses they have for not paying it. The value of any efforts at this stage is questionable. Often your time is not very productive and returns are minimal. If you support your final demand with positive reasons for payment you can sometimes get results, but you need to remember all past attempts at collection have failed. Constructive appeals and reasoning were ineffective, now nothing remains to be done except to state that you plan to take decisive action if the debt is not paid.

Further action may be to place the account with a collection agency or take legal action. Do not threaten action you do not intend to carry out, or that cannot legally be taken.

When to Hire a Professional Collector

Business losses from past due accounts and bad checks total billions of dollars each year.

Credit grantors spend millions of dollars attempting to collect their own delinquent accounts. These losses and extra expenses suffered by businesses and professionals are detrimental for consumers too, who are forced to pay higher prices for goods and services.

As an account ages, the chances of collecting on it decrease greatly. It is expensive to carry accounts that you will not be able to collect using the methods at your disposal. It is often a better use of your time and resources to concentrate on other aspects of your business.

A professional collection agency can assist you in collecting accounts that remain unpaid.

Collectors have specialized knowledge of collection techniques, technology and compliance issues. Using a professional collection service will save time and garner better results.

ACA International (ACA) suggests the following signs to look for when deciding on whether or not a collection service is the next feasible step:

- A new customer does not respond to the first reselling notice. For some unknown reason, the consumer will not or cannot pay.
- Payment terms fail. Irresponsible consumers pay when and if they want to. This group is responsible for 25 to 50 percent of the cost of collections.
- The consumer makes repetitious, unfounded complaints. Such consumers are often better handled by trained collection specialists.
- The consumer totally denies responsibility. Without professional help, these accounts are usually written off as total losses.
- Repeated delinquencies can occur with frequent job/address changes. This group is responsible for 90 percent of all “skips.” A skip is a consumer who has moved without informing creditors or leaving a forwarding address. The chances of finding this consumer and collecting the debt will decrease over time, so quick action and collectors skilled in skip tracing are essential.
- Obvious financial irresponsibility is apparent. In such cases, little hope exists for voluntary payments and a quick settlement.
- There is an unauthorized transfer or disposal of goods delivered in a conditional sales contract. Often only prompt professional assistance will yield any recovery.

There are also industry-specific situations that require more prompt collection attention. For example, department store credit managers concerned with unauthorized charges. Healthcare providers whose patients do not understand that most insurance plans have a limit and that collection from the insurance company is a patients’ responsibility.

By working together, credit grantors and collectors can reduce the financial burden on businesses, professions and the vast majority of consumers who must pay for those who don’t.

Selecting a Qualified Service

Choosing a professional collection service to manage delinquent accounts and other related tasks is a wise decision. The agency should represent your organization in a responsible, professional manner and provide a satisfactory rate of recovery while maintaining your public image. Don’t just go with the lowest bidder – your choice should be made with careful consideration.

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ACA suggests the following qualifications and credentials when choosing a collection service.

- Check references. Does the agency have a good reputation in the community? Contact other credit grantors, local lawyers, the Better Business Bureau and the Chamber of Commerce.
- Has the agency complied with both federal and state regulations? In addition to federal rules, many states have their own statutes requiring that an agency is bonded, licensed or both.
- Does the agency make regular reports to the creditor? It is a good idea for an agency to update you on the status of your accounts on a specified date each month.
- Is the agency a member of a national trade association?
- Is the agency prepared to give the best possible service? An agency cannot guarantee results on a specific date, but will often estimate an average expected recovery rate.
- Does the agency have modern tools such as collection software and skip tracing technology?
- Will the agency be sensitive to the debtor's individual situation? The agency should promptly notify you when it discovers a consumer with a hardship case as well as recommend proper procedures for you to follow.

Working with a Collection Agency

ACA suggests the following steps to help you get maximum returns from a collection agency:

- Document the account. Accurate information about the account will improve collection results. At minimum, you should provide the collection agency:
 - The correct name, address and telephone number of the consumer.
 - Name of the consumer's spouse.
 - Whether mail has been returned.
 - Consumer's occupation or last known occupation.
 - Names of relatives, friends and trade references.
 - Details of any disputes over the debt
 - Any information about the filings of a bankruptcy petition or the possibility that the consumer may file one.
 - Date of last transaction (charge, credit or adjustments)
 - Cellular phone and/or pager number
 - Nicknames or aliases

- Cooperate with the collection service. Rely on the experience, diligence and judgment of your collection service for the best and quickest results. Promptly refer any developments on the assigned accounts to the collector.
- See that your collection service is fully acquainted with the nature of the goods and services involved. If the collection service understands your industry, it will be better suited to handle the issues specific to your business that may impact collection of the account.
- Make sure the collection service is familiar with your record system. The collection service should be given a fair understanding of your accounting system, so the collectors can maintain mutually acceptable records. The better the collector knows your individual requirements and specialized field, the more fully he/she can serve you.
- Do not place an account with more than one collection service. Make sure that if you change collection agencies, the account is being worked on by only one agency. As a potential violation of the Fair Debt Collection Practices Act (FDCPA), placing an account with more than one collector can create legal problems. Also, communication between you and the various parties can easily become uncoordinated, causing accounting problems and reducing the likelihood of successful collection.
- Make sure you completely understand the contract or arrangement made with the collection service. Commission rates and regular account updates should be understood and agreed upon by both parties, preferably in writing.

Professional Collectors Services

Collection agencies use vast experience and extensive resources to provide professional accounts receivable management services for numerous industries. Some collection agencies provide billing services including coding, processing, printing and mailing while other agencies offer business administration and accounting services. Some agencies also provide "early out" services (collectors start working on the account before it becomes past due).

You can be confident you will receive the services of a qualified professional collector if you select a member of ACA International, the Association of Credit and Collection Professionals (ACA).

Professional collection agencies can offer skiptracing services to locate consumers when they can no longer be reached at the addresses or phone numbers listed on the accounts.

All ACA members have access to ACA's Membership Directory, which allows them to locate member agencies and forward accounts if necessary.

Along with serving creditors, professional collectors assist consumers, including helping them solve payment problems, maintaining good credit reputations and reestablishing good credit ratings.

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Laws, Rulings & Decisions

It is essential that creditors know about the federal and state laws, rulings and decisions related to the debt collection industry. Listed below are some general guidelines creditors should be aware of regarding what can and cannot be done when collecting on past-due accounts.

How Can Credit Grantors Help Themselves and Their Collectors Comply with the Fair Debt Collection Practices Act (FDCPA)?

Concerning Interest – If credit grantors add charges, such as interest or late fees on accounts, the collection service should be made fully aware of this by being provided with a detailed breakdown of the principal amount of the debt and all additional charges.

Under the FDCPA, collectors are allowed to add interest and other charges to the past due account if the agreement creating the debt allows it or if it is permitted by state law.

Concerning Skiptracing – The law permits a collector to contact a third-party in order to locate a skip. When the collector has good initial information from the credit grantor, it is easier and faster to locate the missing debtor.

Concerning reassignment of past-due accounts – Credit grantors can assist collection services by helping comply with the law when accounts have been reassigned. For example:

A credit grantor assigns an account to Collector A. Unable to locate the debtor, or told by the debtor that communication by the collector should cease, or being unable to collect for some other reason, Collector A returns the account to the credit grantor who then reassigns it to Collector B.

The credit grantor should inform Collector B that this is a reassigned account and explain what Collector A did on the account. For example, Collector B should know if Collector

A located the debtor, communicated with the debtor, sent a validation notice or received information that the account was disputed. This is important information if a collector is to collect an account for a credit grantor successfully and legally.

Concerning payments made directly to credit grantors by debtors – When credit grantors receive a payment directly from the debtor on an account that has been turned over to a collection service, the credit grantor should immediately notify the collector. A collector who continues collection efforts on an account that already has been paid could be vulnerable to charges of harassment or use of false representation by the debtor. The credit grantor can be held jointly responsible.

How Must Credit Grantors Comply with the FDCPA?

Credit grantors must comply with the FDCPA when they collect their own debts using a name other than their own. Some examples include:

- Best Finance Company uses the name “The Best Collection Service” to collect its own debts. They must comply.
- Several hospitals join in a “shared hospital services” concept and collect their own debts through a collection service they set up and give a name other than that of the hospitals, for example, The Best Medical Collections. They must comply.
- XYZ Department Store collects its own debts on the name of ABCD Division. They must comply.
- A credit grantor mails a series of collection letters that carry a business name other than that of the company, and they are not clearly designed as being affiliated with the creditor. They must comply.

Financial institutions, such as banks and credit unions, become debt collectors under some circumstances, including reciprocal or forwarding arrangements. Some examples include:

- A bank regularly collects debts for unrelated institutions in which no common ownership is shared. Under such an arrangement, the bank solicits the help of another bank in collecting a defaulted debt of a customer who has relocated. The second bank must comply.
- A credit union sends a past due account for collection to an unrelated credit union. The receiving credit union must comply.

What are the penalties for violating the FDCPA?

Debt collectors can be fined up to \$1,000 plus actual damages, for violating a provision of the law, along with reasonable attorney fees as determined by the court. Class action lawsuits have higher penalty limits. A class of debtor-plaintiffs can be awarded the lesser of \$500,000 or one-percent of the net worth of the collector, along with reasonable attorney fees as determined by the court.

Steps to Take to Reduce/Eliminate Liability

As a credit grantor you should familiarize yourself with the requirements of the FDCPA and adopt procedures to avoid any potential liability arising from your in-house collection activities. Specifically, you should train your in-house accounts receivable staff on FDCPA issues; maintain a separate and documented independent contractor relationship with collection services; and avoid any direct recovery efforts after referring an account to a collection service.

When the time comes to turn late accounts over to a professional collector, businesses can be assured that members of ACA will give the finest collection service available. All ACA members are required to comply with federal and state laws and regulations, as well as the ethical standards and guidelines established by the organization.

Conclusion

After reading this material, you may want to review your present collection program and make some changes depending on your individual needs. Members of ACA will be happy to discuss with you

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the contents of this booklet or any phase of your credit-collection operation.

ACA membership status is also available to credit grantors, and provides access to many association benefits. ACA produces informative publications about the credit and collection industry including the award-winning *Collector* magazine and *Consumer Trends*, a monthly newsletter specifically for creditors. ACA also offers educational resources and training, legal and legislative support, annual conventions and meetings, and business discounts.

For more information on ACA's Creditor Membership, or to locate an ACA member collection service in your area, please contact ACA by phone at (+1952) 928-8000. For more information about ACA or the credit and collection industry, please visit ACA's Web site at www.acainternational.org.

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