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Collections Outsourcing Trends:
Industry Rethinks Strategies to Include Trusted Partners

Equipment finance companies that team with outsourcing partners on early stage collections are creating the synergy necessary to improve results significantly without stressing internal workloads. An increasing number of companies are extending those benefits to the entire collections and recovery process by opting for one-stop services, bankruptcy expertise, and equipment leasing and finance industry experience when selecting outsourcing partners.

By Ed Castagna and Dan Potts

In early stage collections, it pays to be tactful with customers. That's why equipment finance companies once preferred to handle early stage delinquencies in-house rather than outsource to collections agencies.

Intense competition, mushrooming workloads and new bankruptcy reform regulations are prompting equipment finance companies to rethink their collections strategies. As a result, they are involving trusted outsourcing partners earlier — and more deeply — in all phases of the collections process. Three trends are reshaping the role that collections outsourcing plays in the daily operations of equipment finance companies:

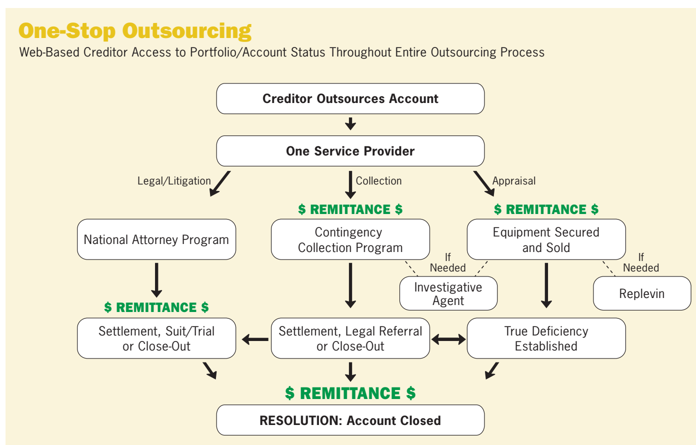
- Growing demand for assistance with early stage delinquencies, which requires outsourcing partners that have the skills, diplomacy and leasing experience necessary to get the job done without straining customer relationships.
- Preference for "one-stop" outsourcing services that reduce delinquency cycles and costs by streamlining pre-charge-off collections, repossessions, commercially reasonable sales, deficiency collections, and legal programs.
- Tightening of U.S. bankruptcy laws amid warnings of a new surge in bankruptcies, which requires outsourcing partners that are staying abreast of the situation and using it to their client's advantage.

Early-Stage Outsourcing

Consolidation within the equipment finance industry and increasing competition are encouraging large-ticket equipment finance companies to consider collections outsourcing services at early delinquency stages. Previously, accounts were outsourced around day-180, but now are more likely to be outsourced between 90-180 days, and in some cases even earlier.

Large and middle-ticket lessors are moving down the market in credit, deal structure and collateral funding, which has increased the labor intensity of their deals. These companies have limited in-house resources to pursue early stage delinquencies but recognize that prompt intervention significantly improves collectibility.

Small-ticket lessors were once reluctant to outsource early stage delinquencies for fear of damaging relationships with lessees — their best sources for future business. Now, small-ticket lessors are stretched thin from handling increasing volume and, consequently, are turning to outsourcing partners capable of managing early stage delinquencies with diplomacy. Many of these lessors are also requiring that their collections agencies demonstrate equipment finance industry experience and review account history thoroughly before making contact with customers to ensure proper handling. They realize an experienced and professional approach often produces the best results and discourages repeat offenders. It also avoids angering lessees who have actually paid but have had their payments misapplied or have experienced billing errors.



The trend toward outsourcing early stage delinquencies is part of the industry's overall strategy to improve the entire collections process.

"Small ticket lessors strive to streamline not only their lease originations, but also their collections," noted the Equipment Leasing Association's

December white paper *Legal Principles Underlying Commercial Businesses' Access to Equipment Leasing and Finance*. "Although delinquency and loss-rates for the industry are generally very low, high-loss levels would not only threaten a lessor's financial viability, but also its ability to offer competitive rates. Because of these factors, small-ticket lessors carefully determine how they employ their resources to collect past-due payments."

Indeed, equipment finance companies of all sizes are searching for ways to expedite the collections process and improve their bottom line. A new study, *Credit Risk: Contract Characteristics for Success*, commissioned by the Equipment Leasing and Finance Foundation, found that 11.1 percent of lease contracts failed between April 2001 and January 2004. That means more than 10 percent of leasing transactions default and will eventually require collections and/or recovery services.

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One-Stop Outsourcing

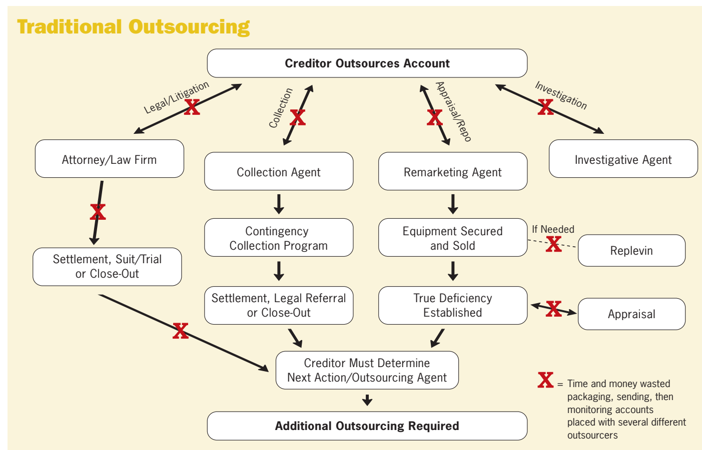
Most equipment finance companies still rely on the traditional "divide and conquer" approach to asset management outsourcing. They outsource part or most of their collections, repossessions, remarketing, and legal activities to as many as four or more different companies. Because these outsourcing companies are independent from one another, it is usually the equipment finance company's job to coordinate the various relationships and make sure the companies involved report critical information in a timely manner.

However, a growing percentage of equipment finance companies are opting instead for "one-stop" outsourcing services that can streamline the entire continuum of collections, repossession, legal activities, and remarketing for their businesses. As noted in recent Industry Future Council Reports by the Equipment Leasing and Finance Foundation, factors fueling this trend are industry consolidation and an increased emphasis on returns, efficiency and process improvements.

One-stop outsourcing partners typically have specialists on board that can handle a range of services, including: collections prior to charge-off; appraisal of leased assets before or after charge-off; voluntary and involuntary repossessions; full condition reports and appraisals on-site; asset location and skip tracing; equipment remarketing; post charge-off and deficiency balance collections; and legal services through nationwide attorney networks.

Equipment finance companies that are using one-stop outsourcing services have reported a number of measurable and anecdotal benefits, such as:

- Shorter collection/recovery cycles — By eliminating communication delays among multiple outsourcing partners, one-stop outsourcing services are reducing communication delays by days, and in some cases, weeks for individual equipment finance companies.
- Greater lessee cooperation — When collections are backed with repossession expertise, lessees who repeatedly drag their feet on payments are more likely to comply with collection efforts. Additionally, lessees that cannot afford to lose a piece of equipment, or have a significant amount of equity paid into a lease that allows for a buyout option, will likely work toward resolving their past due balances if collectors can initiate a repossession with little or no forewarning.
- Improved collectibility through early intervention — Resolving past due balances while still early in the delinquency cycle enables the lessor's delinquency to remain in line with targets and objectives set, thus preventing the more ominous risk of slipping too far behind into severe delinquency.
- Reduced expenses by decreasing in-house staff — Most one-stop outsourcing services work on a contingency-based collection arrangement, for a percentage of the payment recovered rather than charging specific fees.
- Faster return on assets — Revised Article 9 provisions allow remarketing to take place simultaneously with deficiency balance collections. This shaves weeks, if not months, off the overall recovery process.
- Minimal equipment depreciation — Shortened collection cycles speed up remarketing efforts. Plus, remarketing and deficiency balance collections can occur simultaneously.



Bankruptcy Savvy

The U.S. Senate passed long overdue bankruptcy legislation in March that tightens repayment requirements for debtors. The Associated Press reported on March 11 that the legislation was scheduled to reach the House of Representatives in April and, assuming passage, would later be signed into law by its chief supporter, President Bush.

Traditionally, it has been the judge's prerogative to determine which chapter of the bankruptcy code applied in each case and, consequently, whether the debtor must repay some or all of the debt. Under the legislation's new income-based test for measuring repayment ability, debtors with insufficient assets or income could still file a Chapter 7 bankruptcy, which if approved by a judge, erases debts entirely after certain assets are forfeited. But those with income above the state's median income who can pay at least $6,000 over five years would be forced into Chapter 13, whereby a judge orders a repayment plan.

To leverage the new law and ensure compliance, more equipment finance companies are insisting that outsourcing partners demonstrate knowledge of changing bankruptcy regulations and proof that they can manage situations in accordance with laws governing collection and asset recovery.

Bankruptcy expertise may become an even more important requirement for collections-related outsourcing services in the near future, according to news sources. *The Financial Times* on March 13 reported that bankruptcy advisers were adding staff amid fears that an end to the global credit boom could spark "a surge" of business failures.

The Financial Times noted: "Unusually loose lending conditions have encouraged record borrowing by speculative-grade companies, with leveraged buy-outs and debt refinancing on both sides of the Atlantic generating more than $100 billion of deals in the past eight months. But last week's fall in the price of [U.S.] Treasury bonds, coinciding with signs that bankers are struggling to complete riskier corporate bond issues, has added to a sense of nervousness in some quarters. Although corporate default rates remain low, some fear the legacy of recent private equity buy-outs and hedge-fund investments in distressed debt will be a swath of overleveraged companies, ill-equipped to survive in less benign conditions."

Conclusion

Equipment finance companies that team with outsourcing partners on early stage collections are creating the synergy necessary to improve results significantly without stressing internal workloads. An increasing number of companies are extending those benefits to the entire collections and recovery process by opting for one-stop services, bankruptcy expertise, and equipment leasing and finance industry experience when selecting outsourcing partners. **m**

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