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Cash recovery takes on a high-tech twist

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Published: September 18 2007 03:00 | Last updated: September 18 2007 03:00

Professional debt collection agencies are shaking off their "hard man" image and turning to more sophisticated methods as they prepare to handle a sharp increase in late payments and defaults on credit cards and mortgages as the credit squeeze tightens.

Analysts say demand for debt collection services is expected to reach record levels in the coming quarters as borrowers face the dual challenges of higher energy prices and mortgage rate increases, amid falling house prices and turmoil in the financial markets.

But others warn that a downturn also makes debt collection much more difficult and expensive, as borrowers become less likely to pay up, leaving the \$16.7bn debt collections industry struggling to make a profit.

"Whenever there is a downturn in the market, there is more debt to collect, but it's harder to collect," says Ira Leibsker, president of the National Association of Retail Collection Attorneys. There are already signs that the effects of the housing downturn and problems in subprime mortgages are spreading to other types of consumer debt. Credit card companies, which make up the majority of the collection agencies' clients, wrote off 4.58 per cent of credit card debt in the first half of 2007 - a historically low level, but almost 30 per cent higher than in the same period last year.

Creditors in recent years have increasingly relied on professional collectors to collect overdue debt as Americans have taken on record levels of debt.

Collections agencies say they have already felt the impact of higher defaults, but the delay in creditors passing on the bad debts means there is much more to come. Michael Klozotsky, a research analyst at Kaulkin Ginsberg, a consultancy for the debt collections industry, says the full reverberations may not be felt until later this year.

Contrary to the conventional baseball-bat-wielding image, however, collectors are now resorting to more sophisticated methods, using techniques such as automated diallers or "skip tracing" - a method of tracking missing debtors by cross-referencing through electronic databases.

Some collection agencies are hoping that used effectively, these methods could help lift profitability.

A foretaste of the challenge is offered by already acute problems in the subprime mortgage market. Analysts say the scale of late payments and defaults, together with the variety and complexity of home loans in the risky subprime mortgage market mean that mortgage servicers - specialised agencies used by the lending banks - face an uphill battle to collect debts.

Subprime borrowers require more hands-on servicing than borrowers with better credit records, even when the housing market is performing well. But the housing slowdown has increased the workload.

Simply making contact with subprime borrowers can be one of the trickiest elements of the process, say mortgage servicers. Up to half of subprime borrowers who fall behind on their payments are ultimately foreclosed upon without ever returning letters or phone calls. Meanwhile, servicers report that the sheer volume of work has driven up their costs by more than 20 per cent over the past six to eight months.

Like the debt collectors, the mortgage servicers have also started employing new technology to help keep track of elusive borrowers.

Some agencies have started to present the defaulters with mobile phones loaded with hundreds of free minutes, which they can keep if the first call they make is to their lender.

Nevertheless, even when a mortgage has been renegotiated, up to 40 per cent of the borrowers fall back into arrears within a year.

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