TransUnion

Challenges, Trends and Innovations

THE STATE OF THIRD-PARTY COLLECTIONS

A research report in collaboration with

Aite

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Introduction

The third-party debt collection industry is confronting a series of challenges and seeing an opportunity to transform itself by using new technology and other innovations to thrive. While these investments are needed, collectors must also make significant outlays to demonstrate compliance, secure sensitive data and maintain a skilled workforce. In addition, consumers are harder to reach than perhaps ever before as they ditch their landlines and reject contact attempts to their mobile phones. Against this backdrop, the Consumer Financial Protection Bureau (CFPB) is in the process of setting new rules to modernize regulations governing the industry.[1]

This report documents where third-party collection firms are today, some of the key challenges they are facing and the extent to which they are investing for the future.

METHODOLOGY

Insights on the Challenges, Trends and Innovations occurring in the third-party collections industry provided in this report are informed by a quantitative survey of third-party debt collection professionals conducted in May and June 2019. Survey results are representative of the market at a 90% confidence level with a nine-point margin of error. Respondents represent a variety of companies in the third-party collections industry, including collection agencies, debt buyers, law firms and business process outsourcers. More information about the firms represented in the survey is available in the Appendix.

As a supplement to the quantitative survey, Aite Group conducted 14 interviews of thought leaders in the third-party collections industry, including regulators, consumer advocates, vendors, advisors and collection agencies. The quantitative survey and qualitative interviews were conducted just after the CFPB released its proposed rules for the third-party collections industry, likely causing many of the topics covered in this research to be top-of-mind for respondents.

This report also contains findings from desk research related to collection industry market size, economic indicators and consumer credit trends as well as a brief survey to understand the prevalence of debt collection activities performed by law firms.

1. The CFPB's rule-making will update Regulation F, which implements the Fair Debt Collection Practices Act.

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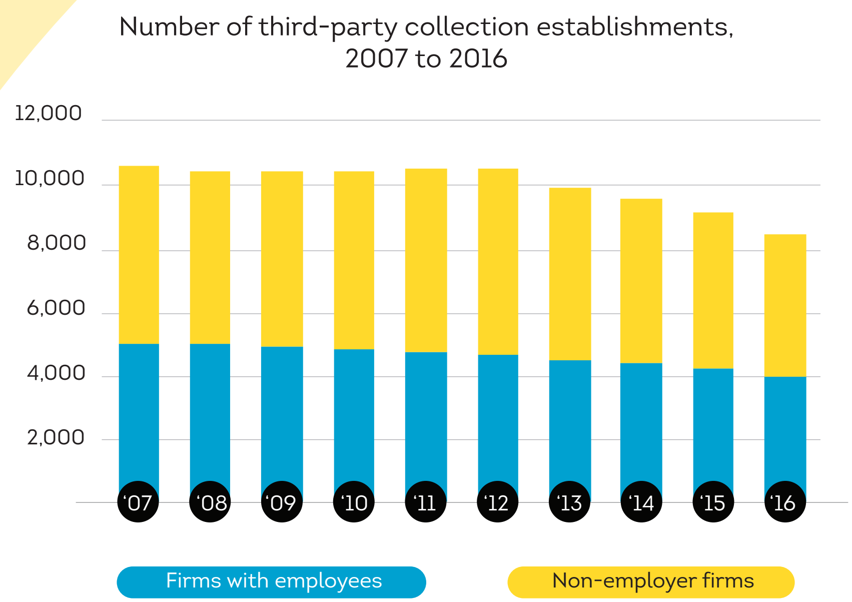
Relevant trends for the third-party collections industry

The market dynamics and challenges facing debt collectors are driven by industry trends, general economic conditions and the extent to which consumers are performing on their debt repayment obligations.

COLLECTIONS MARKET SIZE AND TRENDS

The third-party debt collection industry has experienced a somewhat consistent pattern of decline over the past several years, both in terms of the absolute number of establishments and the people those companies employ. In 2016 (the most recent year for which data is available), Aite Group estimates that there were nearly 8,500 third-party debt collection companies, down from about 10,600 in 2007 (Figure 1). A little over half of these companies do not have employees on the payroll (non-employer firms) but may hire contractors to collect debt or to fulfill other duties.[2]

FIGURE 1: NUMBER OF THIRD-PARTY COLLECTIONS-RELATED FIRMS



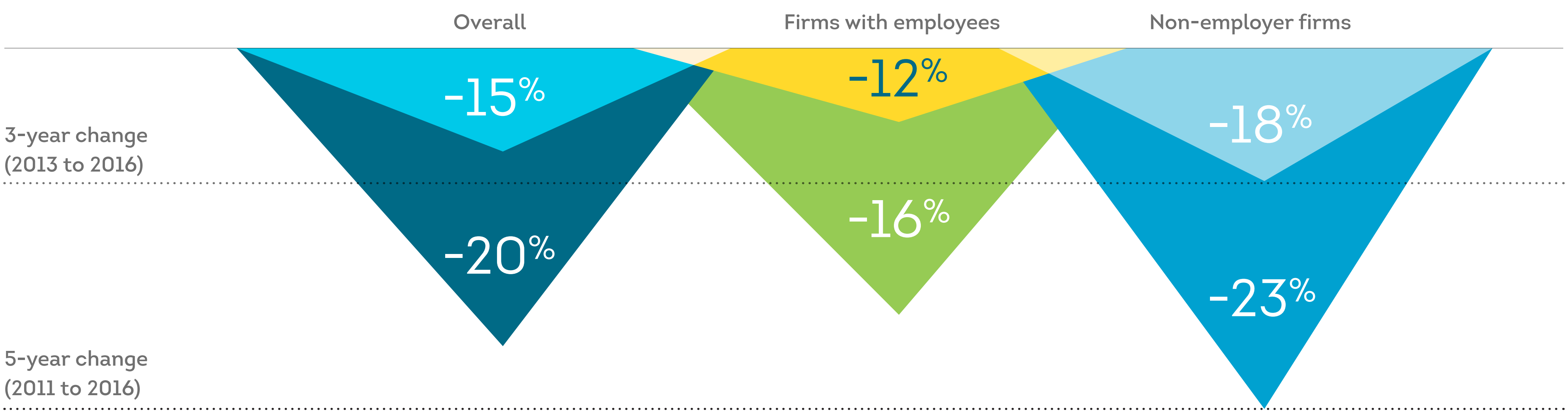
Source: U.S. Census Bureau County Business Patterns and U.S. Census Bureau Nonemployer Statistics for 2012 NAICS Code 56144 (Collection Agencies), Aite Group

2. Specifically, non-employer firms are sole proprietorships, partnerships and corporations that have no paid employees and are subject to federal income tax. These firms may hire independent contractors to conduct their business. For more information, see "Nonemployer Statistics (NES)," U.S. Census Bureau, accessed August 8, 2019, https://www.census.gov/programs-surveys/nonemployer-statistics.html.

COLLECTIONS MARKET SIZE AND TRENDS (cont.)

Overall, the industry has experienced a 15% decline in the number of firms in the past three years and a 20% decline between 2011 and 2016. **The rate of decline has been steeper for non-employer firms than for those with employees on their payroll** (Table A).

TABLE A: PERCENTAGE CHANGE IN THE NUMBER OF THIRD-PARTY COLLECTION FIRMS



Source: U.S. Census Bureau County Business Patterns and U.S. Census Bureau Nonemployer Statistics for 2012 NAICS Code 56144 (Collection Agencies), Aite Group

"Staffing and turnover is a key challenge. A front-line collector is an entry-level position. There is lots of churn because it's a difficult job and you need thick skin. Annual turnover of over 100% a year is not uncommon even in a well-run shop. Reduced commission rates also impact employee retention."

-Third-party collection industry leader

Third-party collection employees

There has been a steady decline in the number of people employed by firms in the third-party collections industry over the past decade. As shown in Figure 2, there were over 141,000 employees in 2007; by 2016, this number had dropped to around 120,000.

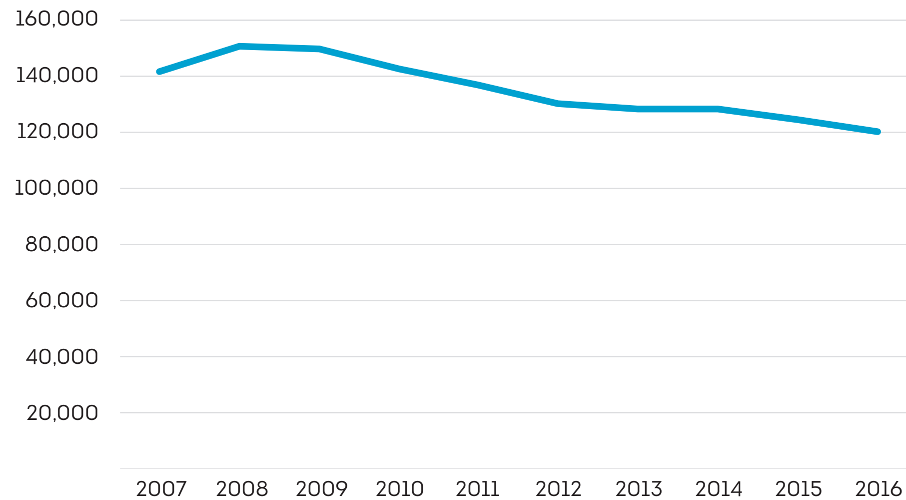
Some of the drivers of this contraction include mergers and acquisitions among firms, the exit of some firms from the market, and automation and other efficiencies within existing firms. For example, when the number of establishments is broken out by size (as measured by the number of people employed by that firm), it's clear that the experiences of firms have varied (Table B). Smaller firms have generally experienced sharper declines than their larger counterparts. Despite these trends, most debt collection firms are still quite small; in addition to the more than half of firms without employees, about 40% of firms with employees have four or fewer.

Number of third-party collection firms with employees by size

While the number of third-party collection firms without employees has declined over time, so too have the aggregate receipts of these companies. However, the receipts generated per non-employer firm have generally increased over time. For example, receipts per firm were up 10% in 2016 relative to three years prior. This suggests that the non-employer firms that persist in the market are those with relatively higher earnings.

FIGURE 2: THIRD-PARTY COLLECTION EMPLOYEES

Number of people employed by third-party collection companies, 2007 to 2016



Source: U.S. Census Bureau County Business Patterns for 2012 NAICS Code 56144 (Collection Agencies), Aite Group

TABLE B: NUMBER OF THIRD-PARTY COLLECTION FIRMS WITH EMPLOYEES BY SIZE

NUMBER OF EMPLOYEES	2012	2013	2014	2015	2016
1 to 4	1,937	1,854	1,797	1,697	1,621
5 to 9	785	802	761	740	694
10 to 19	692	666	679	646	600
20 to 49	605	631	586	577	541
50 to 249	505	478	468	427	416
250 or more	91	94	97	103	103

Source: U.S. Census Bureau County Business Patterns for 2012 NAICS Code 56144 (Collection Agencies), Aite Group

Total receipts per non-employer collection firm

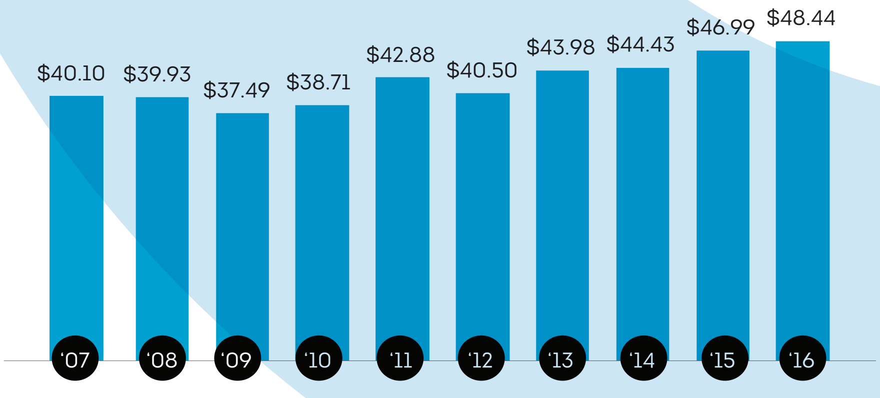
The figures at the right do not include law firms that engage in collection activities. A brief survey conducted on behalf of Aite Group finds that law firms collecting debt are typically small (in terms of number of employees) compared to other collection firms, but law firms that collect debt skew larger than law firms generally.[3] The law firms identified as collecting debt most frequently collect on auto loans, credit cards, government debt or commercial debt. **Over a third (35%) collected fewer than 10,000 accounts in 2008. On the other end of the spectrum, 20% of law firms collecting debt worked over 500,000 accounts in that same year.**

Thought leaders in the industry provided more color on some of the market dynamics at play that are driving some of the trends previously described. First and foremost, collections firms are dealing with increasingly tight margins. Some of this is a result of the perception from clients that collections work functions as a "commodity" with little variation in outcomes across firms, which puts downward pressure on commission rates. **One interviewee notes that 20 years ago, companies had returns of 18% to 20%, while a 10% rate of return is pretty good now. Another concurs, citing dramatically shrinking margins resulting from commission rates reduced by half.**

Pressures on profits are coming at a time when the industry must invest considerable resources to ensure compliance with myriad state and federal regulations. Because these costs are somewhat fixed regardless of the company size, they have a disproportionate impact on smaller firms. Under their own pressure by regulators to only work with compliant vendors, clients are performing intense due diligence and auditing exercises with the collections firms they hire. Because of the effort that clients must undertake to vet third-party collectors, they are placing their accounts across a smaller number of firms and are generally unwilling to contract with a completely new company. For example, one thought leader provided an example of a large financial institution that might have used 50 to 100 debt collection agencies in the past; now it farms out its accounts to only about five to 10 well-established players. Since accounts are distributed to fewer companies and there are high barriers to entry, consolidation and a reduction in the number of debt collection companies may be a natural consequence.

FIGURE 3: TOTAL RECEIPTS PER NON-EMPLOYER COLLECTION FIRM

Receipts per non-employer firm, 2007 to 2016 (in US$ thousands)



Source: U.S. Census Bureau Non-Employer Statistics for 2012 NAICS Code 56144 (Collection Agencies), Aite Group

Firms also choose to merge or acquire one another for strategic reasons other than cost containment. For example, firms may merge so that agents are distributed across time zones, or a firm skilled at collecting a particular type of debt may be acquired for greater diversification. In any event, industry consolidation results in fewer overall employees, since merged companies can eliminate redundant management, compliance or other roles that don't necessarily have to scale up at the same rate. Several interviewees believe there is a "sweet spot" for midsize collection firms that are positioned between the smallest and largest players and that can capitalize on economies of scale while still being nimble.

  | 3. However, law firms that collect debt may engage in a host of other activities, with only a portion of their legal staff performing debt collection functions.

> *"Collection firms are trying to understand people better and get the right data. It's a more introspective approach, and probably the right long-term strategy."* -Third-party collection industry leader

Macroeconomic indicators

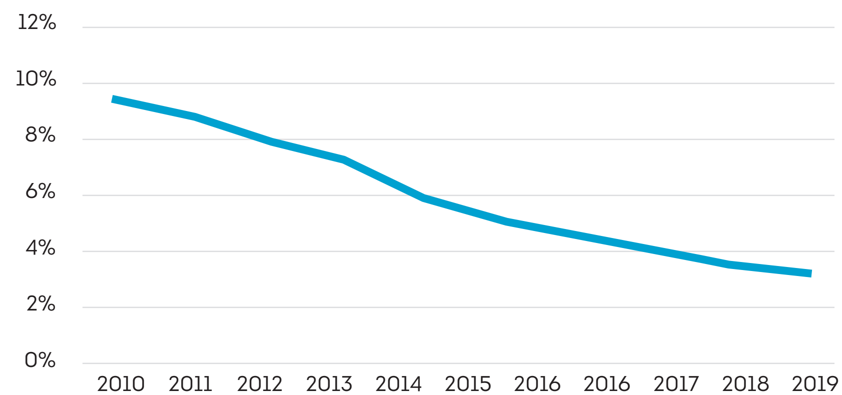
Two important drivers of the collections industry are the overall health of the economy and how well consumers and businesses are managing their debt. Economic and consumer credit trends can help explain the current state of the third-party collections industry and whether a change in the demand for third-party collections may be on the horizon.

As far as the macroeconomic indicators used to gauge economic health, collectors can look to the unemployment rate, interest rates, office vacancy rates (used as a proxy to gauge job market health) and gas prices as key indicators of whether borrowers will be able to afford payments on their financial obligations. In addition, a few indices, such as the Consumer Confidence Index and Consumer Sentiment Index, provide high-level barometers of how consumers feel about the economy and where they believe it's headed. Finally, indices related to housing prices and used car values have implications for those asset classes, specifically, and can be used as additional signs of financial health, generally. For example, the Case-Shiller Housing Price Index, which measures the change in housing values by looking at repeat sales of a given property, may provide an indication of how financially secure a home-owning consumer may feel.

The U.S. economy has generally been on the upswing since coming out of the Great Recession about a decade ago. For example, the unemployment rate has been on the decline since 2010 (Figure 4), and the Consumer Sentiment Index has been on a general upward trajectory over the last 10 years (Figure 5).

FIGURE 4: U.S. UNEMPLOYMENT RATE

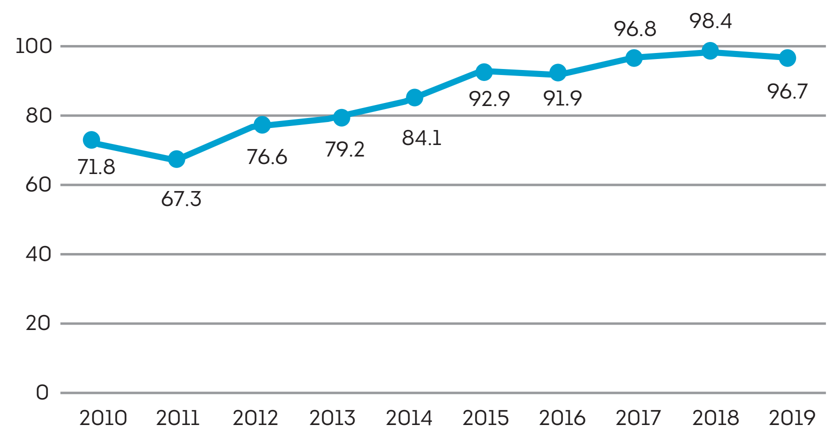
Unemployment rate, Q2 2010 to Q2 2019



Source: U.S. Bureau of Labor Statistics, Second Quarter Civilian Unemployment Rate (seasonally adjusted), Aite Group

FIGURE 5: CONSUMER SENTIMENT INDEX

Consumer sentiment index, 2010 to 2019



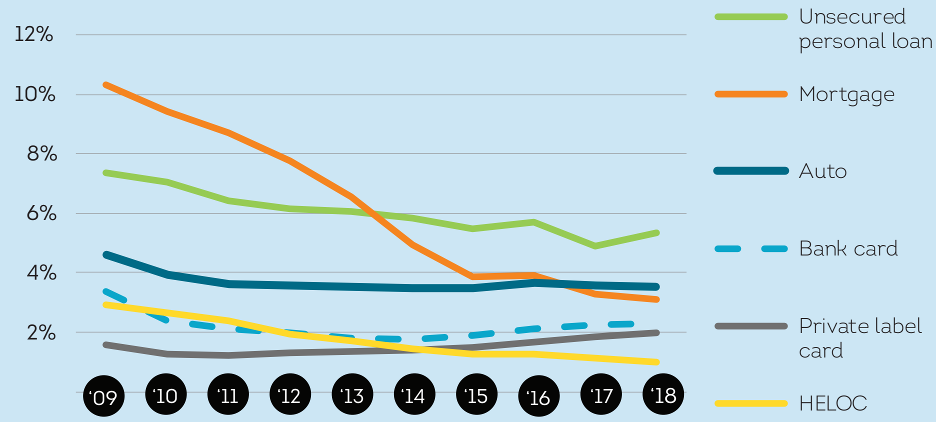
Source: University of Michigan Index of Consumer Sentiment, Aite Group

CREDIT AND COLLECTION TRENDS

While macroeconomic trends are certainly something for collectors to keep an eye on, the overall volume of credit outstanding, delinquency rates and the mix and volume of collection trade lines may be more illustrative for gauging how many accounts are delinquent or in default, potential changes in that volume, and how different asset classes are faring. Delinquency rates on mortgages and HELOCs have steadily declined over the past decade. Bank-issued and private-label credit card delinquencies have ticked up somewhat in recent years, while auto and unsecured personal loan delinquencies are stable overall (Figure 6).

FIGURE 6: 30-DAY DELINQUENCY RATES BY CONSUMER CREDIT PRODUCT

Percentage of accounts, 30-day delinquency rates by consumer credit product, Q4 2009 to Q4 2018



Source: 30-day delinquency rates in the fourth quarter of each year, TransUnion, Aite Group

30-day delinquency rates by consumer credit product

While not all accounts in collections show up as a trade line in a consumer's credit report, looking at the distribution of collection trade lines by debt types, the volume of debt outstanding and number of consumers those trade lines represent can give collectors a full picture of the kind and volume of accounts that they may expect to work. Collection trade lines also enable collectors to see the other types of debt beyond credit products. As shown in Figure 7, over 79 million consumers had at least one collection trade line at the end of 2018. The balance of these trade lines totaled over US$ 211 billion, with over half of the outstanding balances in collection trade lines derived from medical debt.

FIGURE 7: COLLECTION TRADE LINES SNAPSHOT

COLLECTION TRADE LINES, YEAR-END 2018

79 MILLION CONSUMERS have at least one collection trade line

$211 BILLION in outstanding collection balances

TOP THREE TYPES OF OUTSTANDING COLLECTION BALANCES

51% HEALTHCARE/MEDICAL

18% BANKING AND FINANCIAL SERVICES

12% UTILITIES/TELCOM

Source: TransUnion, Aite Group; The banking and financial services category includes automotive, bank, check guarantee, credit union and financial asset classes, year-end 2018

Collection operations and outcomes

The companies represented in the third-party collections survey conducted by Aite Group collect on a wide variety of debts. The type and mix of debts collected impact how they operate and the ultimate results they achieve.

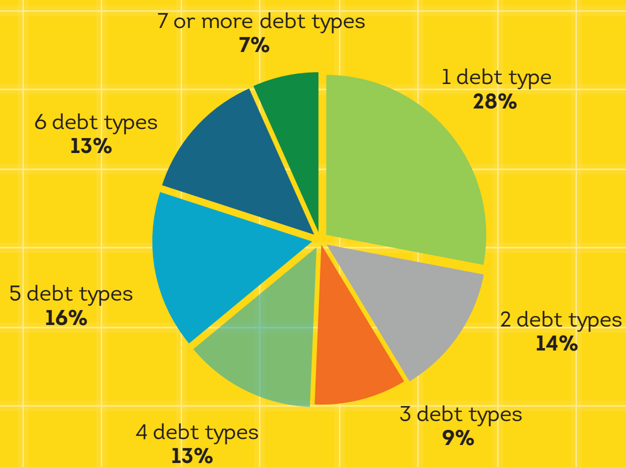
TYPES OF DEBT COLLECTED

Over half of the respondents report that their companies collect commercial and healthcare debt. Following these are utility/telecommunications-related debt and debt from a variety of consumer loan products (including consumer loans, credit cards and auto loans; (Figure 9). Smaller firms are more likely to collect commercial debt, and the larger firms are more likely to collect utility/telecommunications-related debt, private or federal student loan debt, government debt and credit/charge card debt.[4]

Third-party debt collection companies typically collect a mix of debt types. About half of the companies represented (49%) collect at least four kinds of debt (Figure 8).

FIGURE 8: NUMBER OF DEBT TYPES COLLECTED BY COMPANY

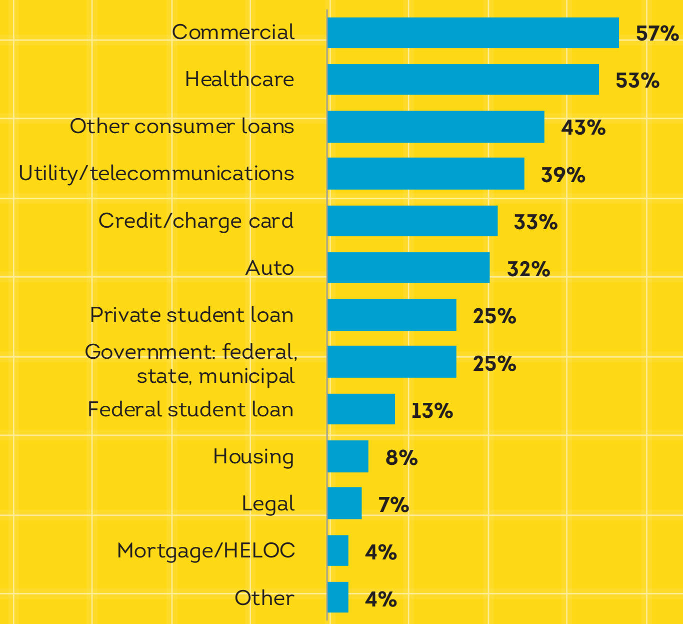
Number of debt types collected per company



Source: Aite Group third-party debt collection survey, May 2019 to June 2019

FIGURE 9: TYPES OF DEBT COLLECTED

Q. What types of debt did your company collect in 2018? (Select all that apply.)



Source: Aite Group third-party debt collection survey, May 2019 to June 2019

Only 28% of the companies represented in the survey collect just one type of debt. Most of the companies that concentrate their efforts on a single type of debt collect either healthcare or commercial debt. Companies represented in the survey with accounts that are substantially all (90% or more) commercial debt are typically smaller collection agencies that worked fewer than 100,000 accounts in 2018. In contrast, for 90% of the larger companies represented in the survey that collect commercial debt, this type of debt makes up a relatively small share (a quarter or less) of their overall portfolio.[5]

Companies represented in the survey with accounts that are substantially all (90% or more) healthcare debt are typically somewhat larger collection agencies (most commonly with 20 to 99 FTE employees) and a wide range in number of accounts worked in 2018.

 | | 4. For the purposes of this survey, smaller firms are defined as those with fewer than 20 full-time equivalent (FTE) employees. | 5. For the purposes of this survey, larger firms are defined as those with 20 or more FTE employees.

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Relative concentration across debt types

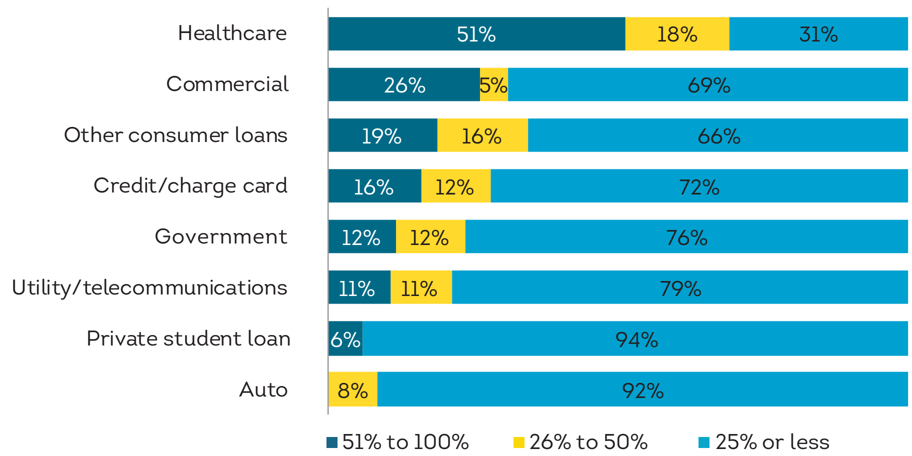
Figure 10 further breaks down the relative concentration of debt types that third-party collectors work. For example, among those respondents whose companies collect healthcare-related debt, a majority (51%) report that at least half of the accounts they work are in that category. In contrast, nearly three-quarters (72%) of respondents whose companies collect credit or charge card debt report that those accounts make up a quarter or less of their overall portfolio.

Companies collecting pre-charged-off and out-of-statute debt

More than two out of five collectors (42%) report that their company collects on pre-charged-off debt. Business process outsourcers were more likely to report that they did so, while law firms were less likely to collect pre-charged-off debt. Far fewer collectors report that their company collects on out-of-statute (i.e., time-barred) debt; only 21% of respondents note that their company did so in 2018 (Figure 11). Companies collecting out-of-statute debt were more likely to be debt buyers or larger firms. Law firms were somewhat less likely to collect out-of-statute debt.

FIGURE 10: RELATIVE CONCENTRATION ACROSS DEBT TYPES

Q. Please provide the approximate percentage of the total accounts worked in 2018 for each of the following categories. (Among companies that collected these types of debt in 2018)



Source: Aite Group third-party debt collection survey, May 2019 to June 2019

FIGURE 11: SHARE OF COMPANIES COLLECTING PRE-CHARGED-OFF AND OUT-OF-STATUTE DEBT IN 2018

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Aggregate average breakdown of major expenses

Looking at the main costs of running a collections business, it's clear that payroll is by far the most significant expense. On average, survey respondents reported that 41% of their total budget was allocated for this purpose in 2018. Thought leaders interviewed by Aite Group confirm that generally about half of revenue goes to employee-related expenses. How costs were distributed among other common expenses in 2018 are detailed in Figure 12 for those respondents who are knowledgeable about their company's expense outlays.[6]

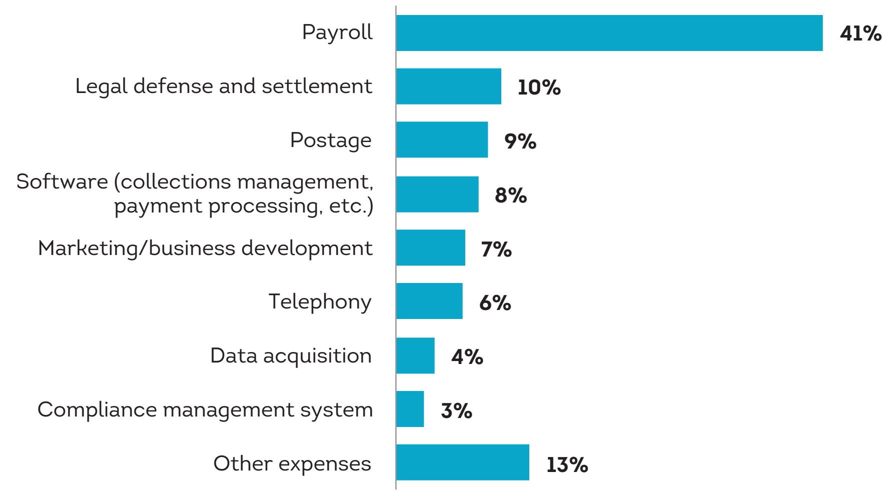
> *"Staffing is the #1 expense of any collections agency, accounting for about 50% of revenue. After staffing expenses, compliance costs, telephony costs, systems costs and letter costs follow."*
>
> *-Third-party collection industry leader*

Share of full-time equivalent (FTE) employees directly involved in collection and recovery work

While payroll makes up a considerable share of expenses, the share of total FTE employees who generate revenue by doing direct collection and recovery work varies across companies. In some cases, this may be the result of companies performing other services in addition to debt collection. On average, just over half (55%) of FTE employees are either collection agents or otherwise doing direct collection and recovery work. However, a quarter of respondents say that 25% or fewer FTE employees do direct collection work. Smaller companies tend to devote fewer of their full-time employees to direct debt collection work than their larger counterparts. On average 45% of FTE employees do direct collection work at smaller companies compared to 61% of FTE employees at larger firms.

FIGURE 12: AGGREGATE AVERAGE BREAKDOWN OF MAJOR EXPENSES

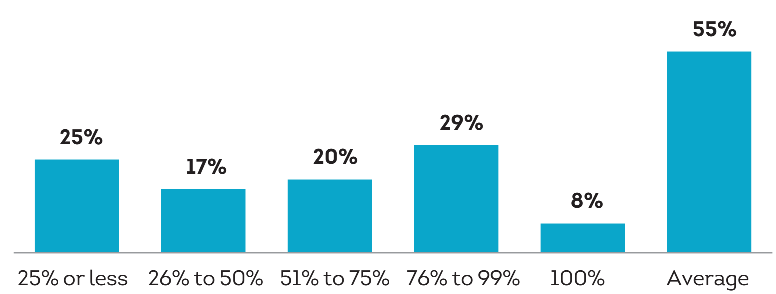
Q. Approximately what percentage of your company's 2018 total budget is allocated for the following areas?



Source: Aite Group third-party debt collection survey, May 2019 to June 2019. Note: The percentage of total budget devoted to legal defense and legal settlement were evenly divided at 5% each.

FIGURE 13: SHARE OF FTE EMPLOYEES DIRECTLY INVOLVED IN COLLECTION AND RECOVERY WORK

Q. Approximately what percentage of total FTE employees in your company are collection agents or otherwise directly dedicated to collection and recovery (versus in an administration, technology or other support role)?



Source: Aite Group third-party debt collection survey, May 2019 to June 2019

 | | 6. The survey did not ask respondents to specify the "other expenses" for which some of their budget was allocated. These expenses may be related to leasing office space, office furniture, hardware, and general supplies.

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Budget allocation comparison

When comparing current budgets to those from last year, nearly two-thirds of respondents noted increased funding for payroll expenses. Not only is staffing the largest single expense for a collections business (as previously described), but many respondents report that this investment is increasing. Increases in 2019 budgets relative to 2018 for postage and software to process payments and manage the collections process were also common (Figure 14).

> *"We are close to full employment… this puts pressure on hiring since people can be more selective of the types of jobs they take on."*
>
> *-Vendor to the third-party collection industry*

Budget expectations for the next two years

Looking out across the next two years, similar trends are expected. A majority of respondents believe that payroll and postage expenses will continue to increase at their companies. Software and marketing or business development-related expenses are expected to rise as well for a significant share of companies (Figure 15). Relatively few respondents reported any areas in which their budgets would decline.

FIGURE 14: BUDGET ALLOCATION COMPARISON

Q. Compared to 2018, how would you characterize your company's 2019 spending in the following areas?

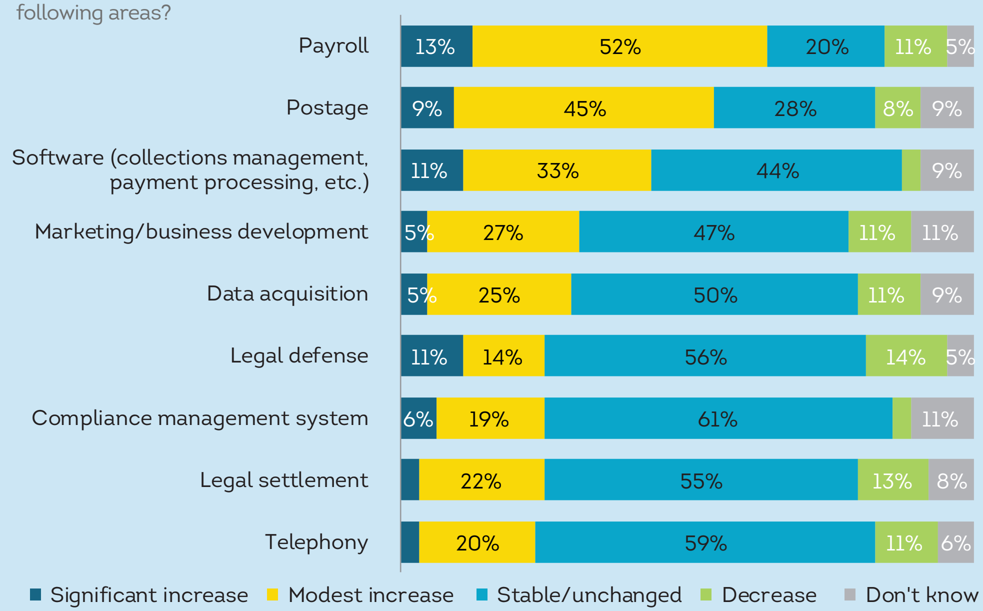
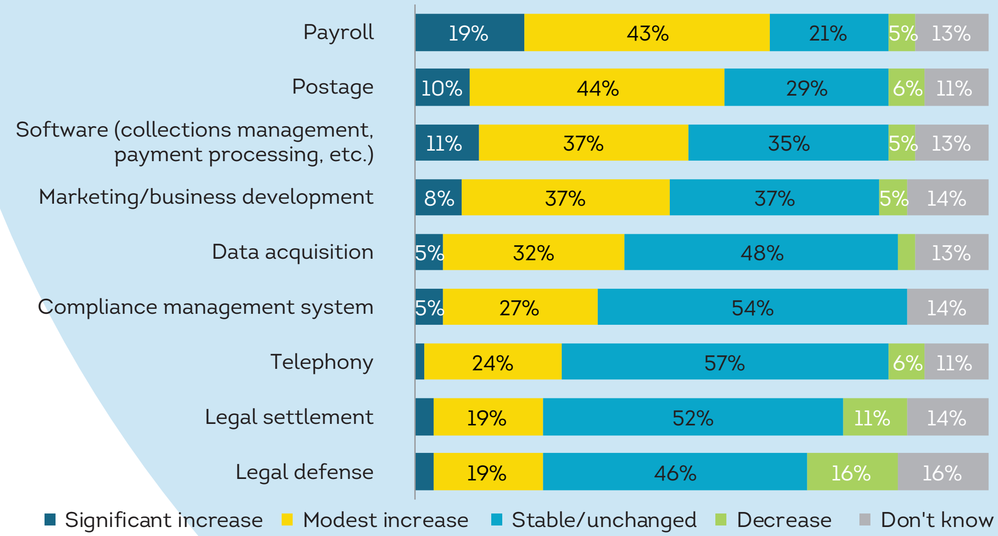


FIGURE 15: BUDGET EXPECTATIONS FOR THE NEXT TWO YEARS

Q. Compared to your company's current budget, how do you expect your company's spending in the following areas to change in the next two years?



 | | Source: Aite Group third-party debt collection survey, May 2019 to June 2019

Aggregate outcomes for accounts worked in 2018

Turning to ultimate outcomes for the accounts collectors worked, respondents were asked to report what share of accounts by their company in 2018 were repaid (either in full, through a settlement agreement, or via partial payment arrangement). Over half (55%) of respondents were either not able to report the breakdown or not willing to disclose their company's performance. The remaining 34 respondents who did provide a breakdown had wide-ranging outcomes. These outcomes may be more favorable than the outcomes experienced by the third-party collections industry overall, as many of the 34 respondents represented companies that collect pre-charged-off debt. Presumably, pre-charged-off debt is more likely to be collected than debt in later stages.

As shown in Table C, the average and median percentage of accounts that had some form of repayment are similar. This indicates that the results are not impacted by outliers with especially high or low payment rates. Rather, the results were highly distributed across the spectrum. Simply put, the respondents' companies experienced very different outcomes—from relatively high to relatively low rates of repayment.

Distribution of outcomes for accounts worked in 2018

Figure 16 presents this same data in a slightly different way, comparing the distribution of outcomes reported for the share of accounts repaid to the share of accounts left unpaid. For example, half of respondents report that 20% or more of the accounts worked by their company in 2018 were paid, at least to some extent. Meanwhile, the other half of respondents report that less than 20% of accounts worked by their company had some type of payment made.

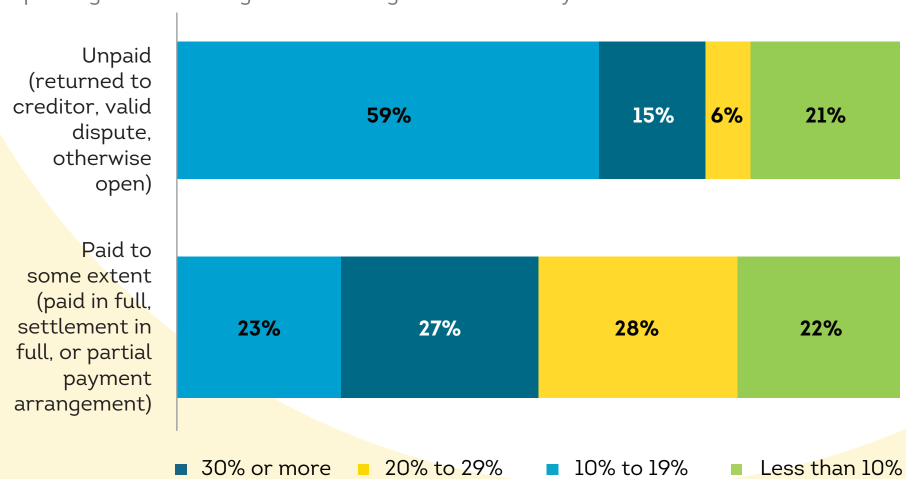
TABLE C: AVERAGE AGGREGATE OUTCOMES FOR ACCOUNTS WORKED IN 2018

	SHARE OF ACCOUNTS PAID IN FULL	SHARE OF ACCOUNTS SETTLED IN FULL	SHARE OF ACCOUNTS WITH PARTIAL PAYMENT ARRANGEMENT	SHARE OF ACCOUNTS REMAINING UNPAID
Average	21%	17%	20%	39%
Median	20%	15%	20%	38%
Standard deviation	17%	12%	14%	28%

Source: Aite Group third-party debt collection survey, May 2019 to June 2019. An additional average 3% of accounts were reported as having an "unknown" status by the 34 respondents to this survey question.

FIGURE 16: DISTRIBUTION OF OUTCOMES FOR ACCOUNTS WORKED IN 2018

Q. Compared to your company's current budget, how do you expect your company's spending in the following areas to change in the next two years?



Source: Aite Group third-party debt collection survey, May 2019 to June 2019

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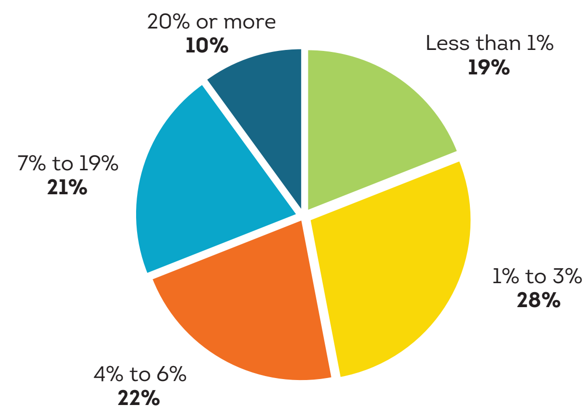
Percentage of accounts disputed by a consumer

One factor in a company's ability to collect is the extent to which those debts are disputed. Upon learning that a debt is in collections, a consumer may dispute that debt by sending the collector a debt validation letter requesting additional details about the account to confirm the collector is pursuing the correct debtor and amount. A large majority (71%) of collectors reports that their company has dispute rates between 1% and 19% (Figure 17). Ten percent of companies have dispute rates of 20% or higher, and—at the opposite end of the spectrum—19% of companies have dispute rates below 1%. Smaller companies tended to have lower dispute rates than larger firms.

FIGURE 17: PERCENTAGE OF ACCOUNTS DISPUTED BY A CONSUMER

Q. Approximately what percentage of accounts worked by your company in 2018 were disputed by a consumer?



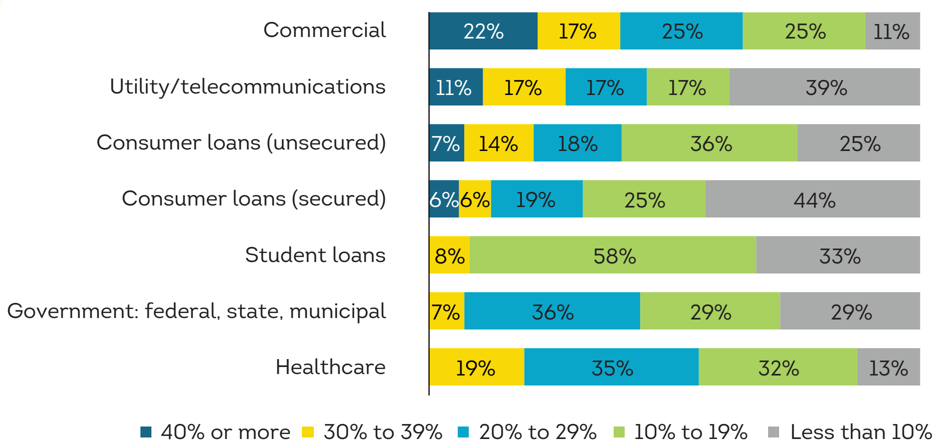
Source: Aite Group third-party debt collection survey, May 2019 to June 2019

Distribution of liquidation rates by debt type

A company's liquidation rate is a key indicator of its ability to collect debt. Liquidation rates are calculated by dividing total amount collected by the total amount of debt placed with that firm. The outcomes a collections business experiences are not only driven by its effectiveness in collecting on that debt but also by the type of debt being collected, the age of the debt and other factors. For example, about two in five respondents reported liquidation rates of 30% or higher for commercial debt, and healthcare debt liquidation rates were relatively high as well (Figure 18). In contrast, liquidation rates for unsecured consumer loans as well as government and utility/telecommunication debts were split somewhat more evenly above and below 20%.

FIGURE 18: DISTRIBUTION OF LIQUIDATION RATES BY DEBT TYPE

Q. What was your company's liquidation rate for 2018 for the following debt type(s)? (Among companies that collected these types of debt in 2018)



Source: Aite Group third-party debt collection survey, May 2019 to June 2019. Consumer loans (secured) includes auto loans, mortgage loans and HELOCs. Consumer loans (unsecured) includes credit/charge cards and other consumer loans. Federal and private student loans are combined into one category.

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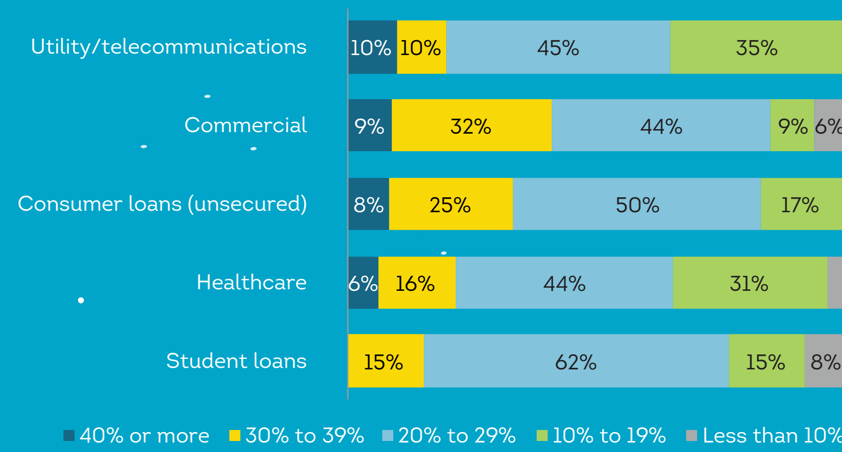
Distribution of commission rates charged by debt type

As with liquidation rates, the commission rates charged by third-party collectors when they collect on accounts vary by the type of debt collected. As shown in Figure 19, the most common commission rates for each debt type are in the 20% to 29% range.

The commercial and consumer loan debt commission rates reported by respondents are distributed relatively higher than other debt types.

FIGURE 19: DISTRIBUTION OF COMMISSION RATES CHARGED BY DEBT TYPE

Q. What was your company's commission rate in 2018 for the following debt type(s)? (Among companies that collected these types of debt in 2018)



Source: Aite Group third-party debt collection survey, May 2019 to June 2019. Consumer loans (secured) includes auto loans, mortgage loans and HELOCs. Consumer loans (unsecured) includes credit/charge cards and other consumer loans. Federal and private student loans are combined into one category.

TransUnion

Tools and technology

Third-party collectors employ a wide range of tools and technologies in their day-to-day efforts to collect on debt. The larger the company, the greater the number of tools and technologies used.

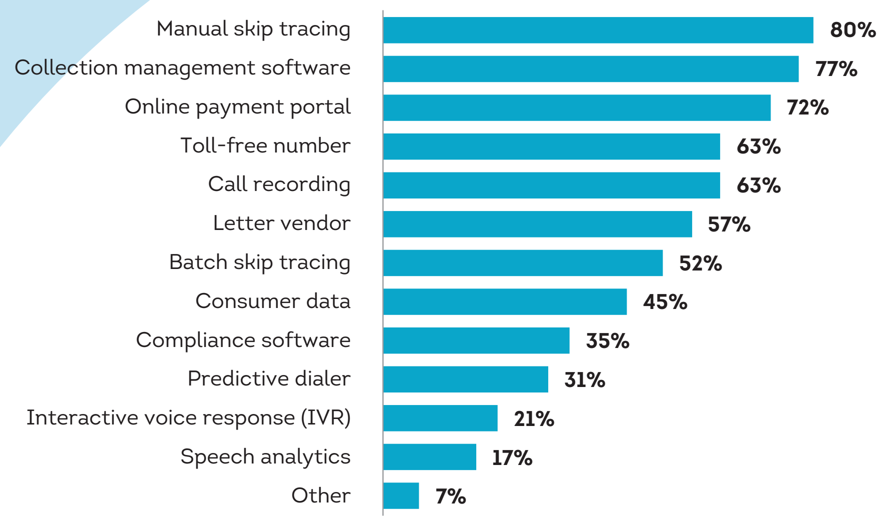
TYPES OF TOOLS USED BY COLLECTORS

As shown in Figure 20, the most frequently cited tool is skip tracing (the process of locating the delinquent consumer) through manual efforts. While 80% of collectors note that their companies engage in this practice, far fewer (52%) use a batch approach in which a high volume of searches can be conducted in a single query via a vendor or other third party. Other common tools and technologies used by collection firms include collection management software; a payment portal in which consumers can make payments on their debts online without the help of an agent; a toll-free number to help facilitate communications; and the recording of calls between agents and consumers to enable training and auditing. Finally, more than half of collection firms employ a letter vendor since, as discussed in more detail in a subsequent section, letters are a primary communication channel.

About one out of six respondents noted that they use speech analytics, an emerging technology in the collections industry that allows companies to take a more automated approach to monitoring calls to improve agent interactions with consumers, ensure compliance, and–ultimately–increase recovery rates. Companies already using speech analytics tend to be those handling the largest number of accounts or those with a greater number of FTE employees. Several thought leaders in the industry are quite bullish on the adoption of speech analytics that can coach agents as conversations evolve with consumers, so that they are as compliant and effective as possible. As it becomes more difficult to reach consumers (as detailed in the next section), making the most of these opportunities when they occur will become paramount.

FIGURE 20: TOOLS AND TECHNOLOGY USED BY COLLECTORS

Q. Which of the following does your company use for debt collection? (Select all that apply.)



Source: Aite Group third-party debt collection survey, May 2019 to June 2019

Types of collection management systems

Collection firms tend to use collection management software developed by third parties rather than developing their own system in-house (Figure 21). Those using vendor solutions are about evenly split between those that license a system from a vendor while keeping their data on company servers and those that use a vendor-hosted system based in the cloud. None of the respondents that have in-house solutions are planning to migrate to a vendor solution in the next two years.

"More agencies are trying to adopt technology and be more efficient and automated." -Third-party collection industry leader

Payment methods accepted

Conventional forms of payments, such as mailing in a check or using a live agent to enable a payment, are the most commonly offered options, but there are a number of companies offering additional options that tech-savvy consumers may find more convenient (Figure 22). **One out of five collection firms offers consumers mobile payment options such as Venmo, Zelle, PayPal or a QR code, and 11% allow consumers to send check images through remote deposit capture as a form of payment.** The types of payments offered seem to drive what payment methods are used by consumers—the most commonly offered options are also the most commonly used.

FIGURE 21: TYPES OF COLLECTION MANAGEMENT SYSTEMS

Q. Which statement best describes the collections management system your company uses?

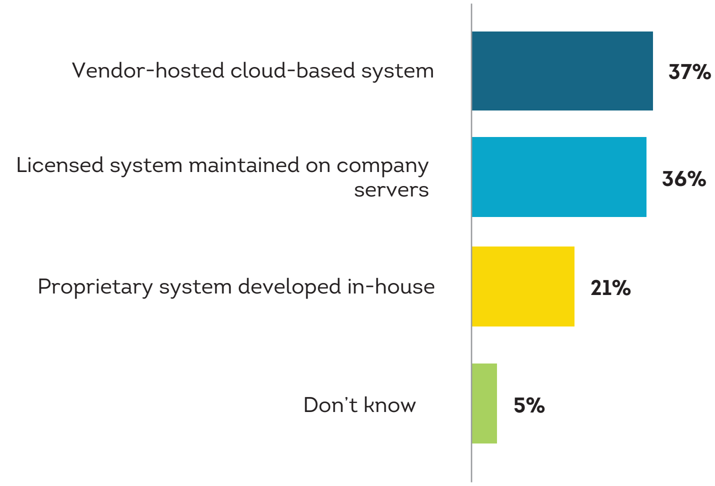
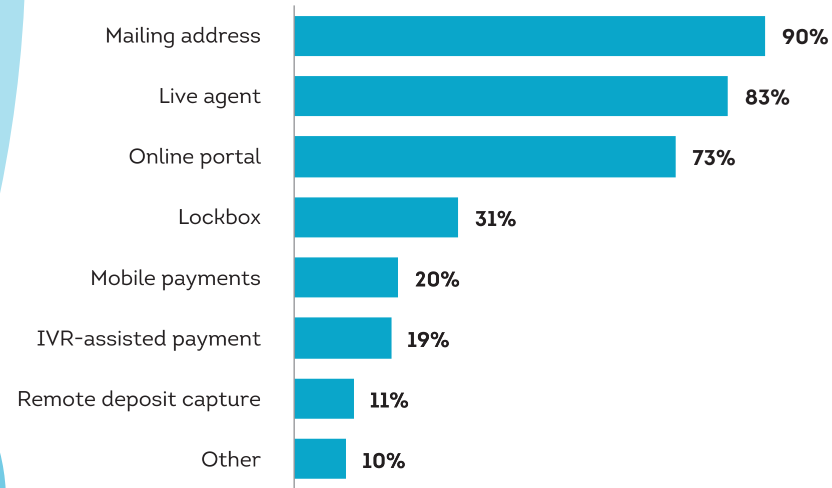


FIGURE 22: PAYMENT METHODS ACCEPTED

Q. Which of the following methods does your company use to accept payments? (Select all that apply.)



 | | Source: Aite Group third-party debt collection survey, May 2019 to June 2019

Communications

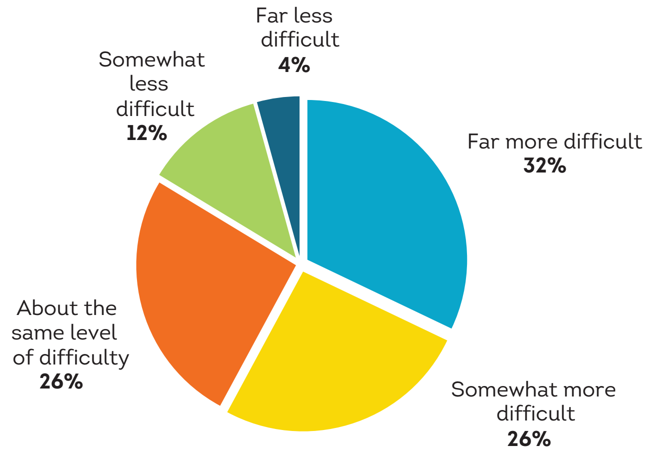
Getting consumers to respond is perhaps the biggest challenge in the industry today.

58% *of survey respondents believe that it is more difficult to contact consumers today than it was five years ago.*

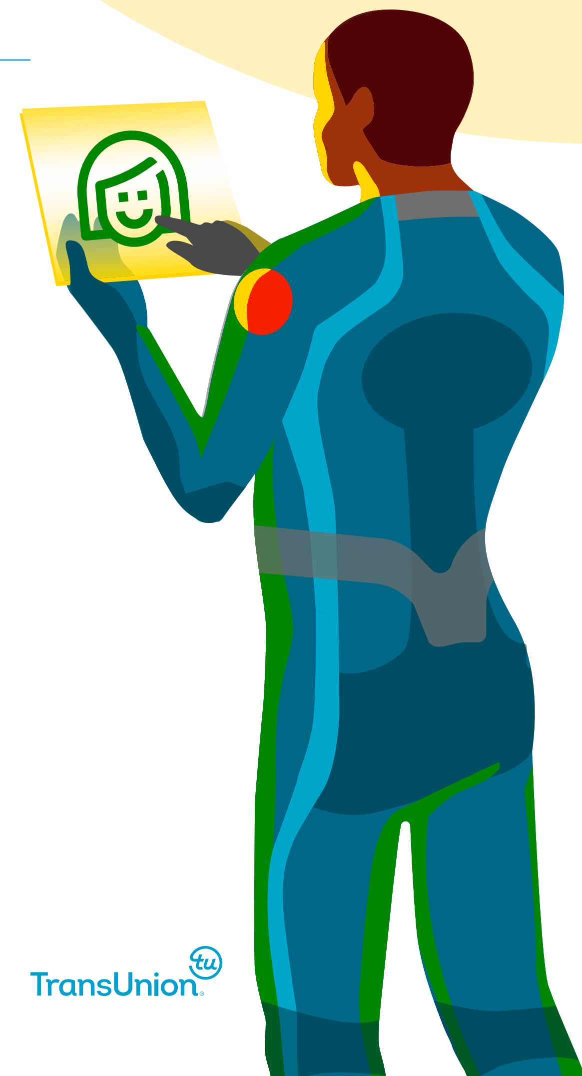
A majority of survey respondents (58%) believe that it is more difficult to contact consumers today than it was five years ago (Figure 23). In contrast, only about one out of six respondents believes it has become less difficult to do so. Discussions with industry thought leaders yield similar findings, with many interviewees noting that contact attempts are viewed by consumers with a high degree of skepticism as to whether the company calling is even legitimate. The "catch-22" of having to ask that consumer for information before revealing details of why the collector is calling is a high hurdle. As one industry leader aptly notes, "right-party contact has fallen off a cliff."

FIGURE 23: DIFFICULTY CONTACTING CONSUMERS RELATIVE TO FIVE YEARS AGO

Q. Compared to five years ago, how would you describe the level of difficulty in contacting a consumer from whom your company is attempting to collect?



Source: Aite Group third-party debt collection survey, May 2019 to June 2019



COLLECTORS USE A VARIETY OF CHANNELS TO ATTEMPT COMMUNICATIONS WITH CONSUMERS

Nearly universal channels are letters and telephones using a manual dialer, with 95% and 89% of respondents, respectively, reporting use of these methods (Figure 24). Emailing consumers and attempting to engage by furnishing information to credit bureaus are common communication strategies as well.

88% *of respondents who use letters as a communication method do so as soon as the account is placed with their company.* (Figure 25)

A few respondents (6%) report that they send a letter only once contact is made by other means, and another 4% note that the timing of a letter depends on the client's preference or the particular collection strategy planned for that account.

FIGURE 24: TYPES OF COMMUNICATION CHANNELS USED

Q. Which methods does your company currently use to engage with consumers regarding a debt? (Select all that apply.)

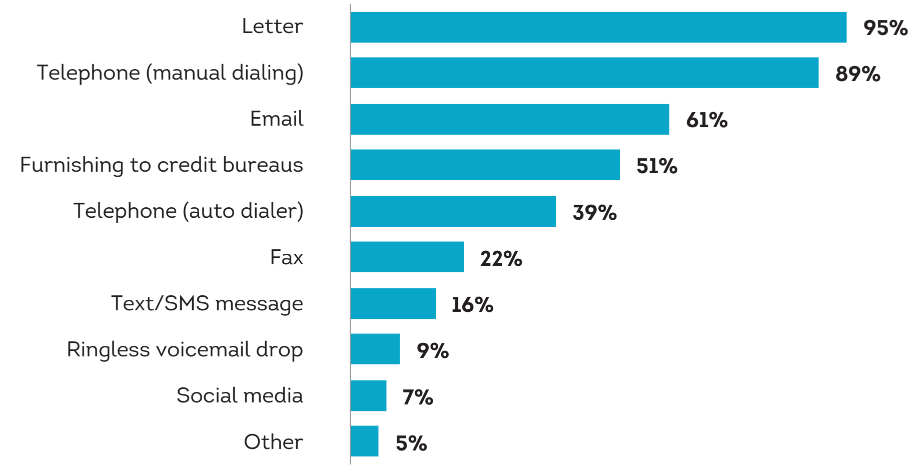
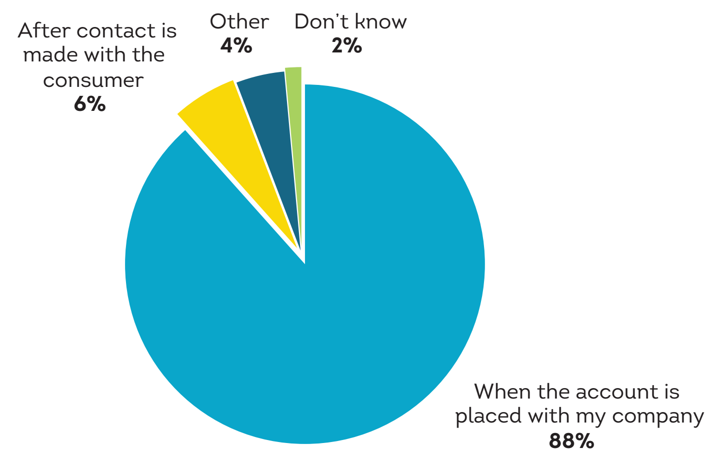


FIGURE 25: TIMING OF LETTER NOTIFICATION

Q. Which methods does your company currently use to engage with consumers regarding a debt? (Select all that apply.)



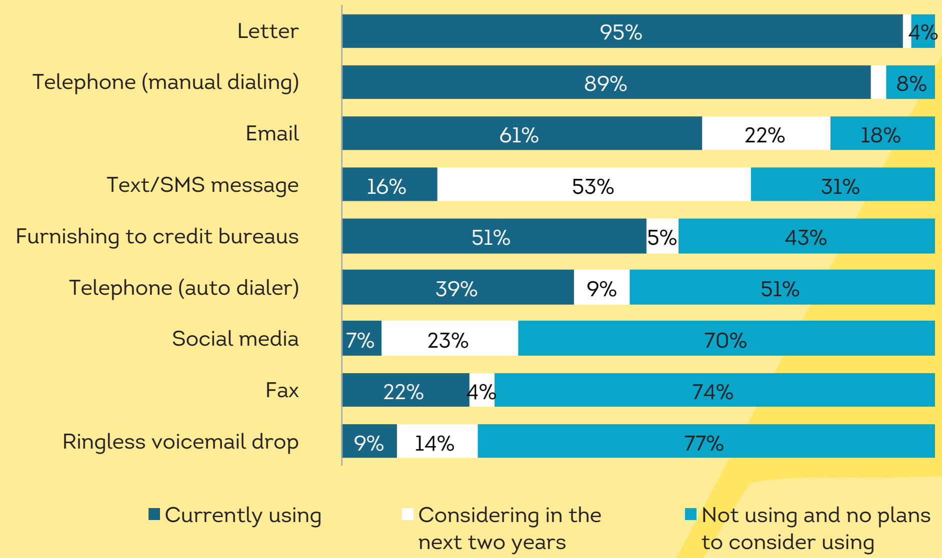
 | | Source: Aite Group third-party debt collection survey, May 2019 to June 2019

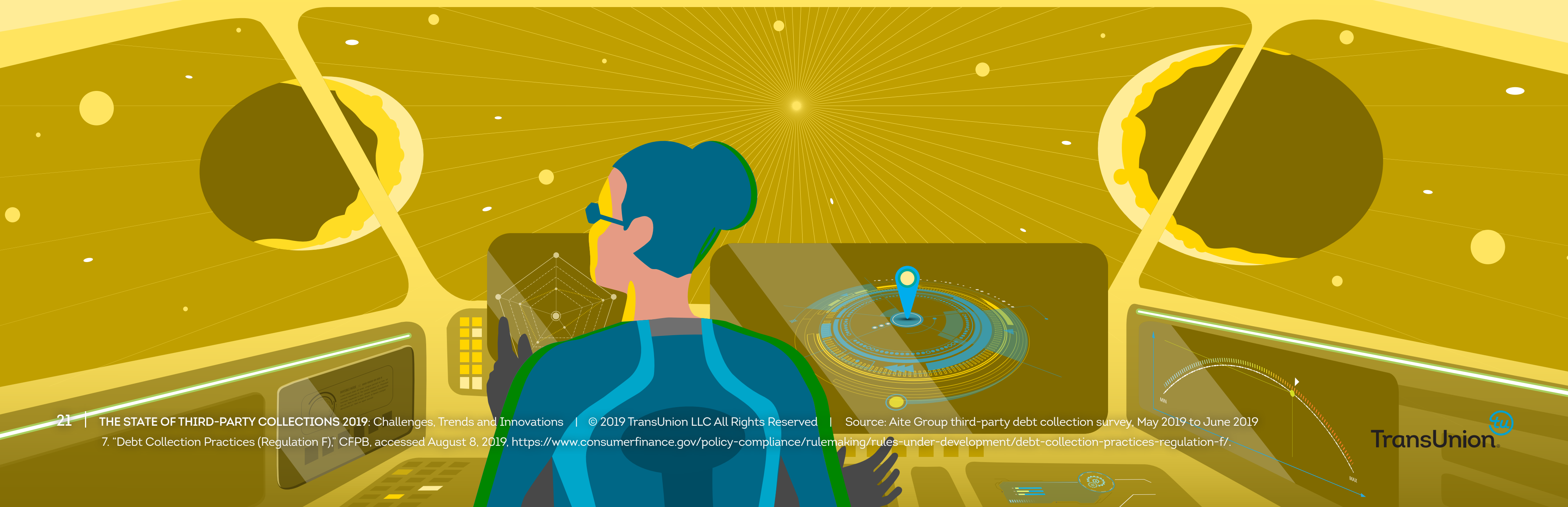
Looking to the future, emerging strategies such as text messages, ringless voicemail drops and communicating through social media platforms may be growth areas.

As shown in Figure 26, many respondents not using text messaging or social media currently are considering adding these as communication channels in the coming years. While more respondents already use email as a communication channel, over half of those that don't are considering adding this capability. Many industry thought leaders believe new communication channels hold promise and have seen good results among companies adopting them. For example, they report that consumers prefer quick calls to action that direct them to a portal where they can view their information and make payment arrangements at a time of their choosing, but current rules and regulations may hinder this. The proposed rule under consideration by the CFPB would set parameters for email and text communications, providing greater certainty of how to use these channels in a compliant manner.[7]

FIGURE 26: NEW COMMUNICATION CHANNELS UNDER CONSIDERATION

Adoption of and interest in debt collection methods





 | | Source: Aite Group third-party debt collection survey, May 2019 to June 2019

7. "Debt Collection Practices (Regulation F)," CFPB, accessed August 8, 2019, https://www.consumerfinance.gov/policy-compliance/rulemaking/rules-under-development/debt-collection-practices-regulation-f/.

Initial contact method

When collectors first attempt to contact a consumer, they are most likely to do so through a letter, rather than a call, email or other method of communication (Figure 27). Two-thirds of respondents report a letter being the first method by which they try to reach a debtor. Most of the remaining respondents (31%) first attempt contact through a telephone call, though a few respondents report their initial contact is attempted via email. This finding of how collectors first attempt contact is consistent with the finding in Figure 25 regarding when in the collections process letters are typically sent.

> *"We have changed our focus to make the best of the first contact. This changes the way we collect and modifies strategies."*

-Third-party collection industry leader

Number of attempts made before contacting the right person

Across communication channels, collectors most commonly report that they make two to four attempts before connecting with the debtor for the account. Nearly three-quarters of respondents (73%) can make right-party contact with seven or fewer attempts, while 8% typically need more than 10 attempts to do so (Figure 28).[8]

FIGURE 27: INITIAL CONTACT METHOD

Q. By which method do you typically first attempt to make contact?

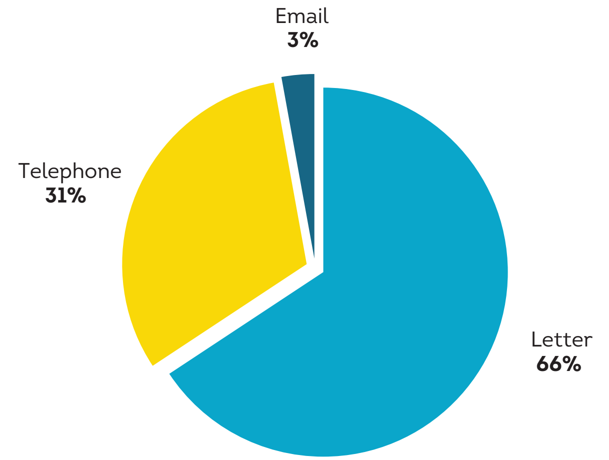
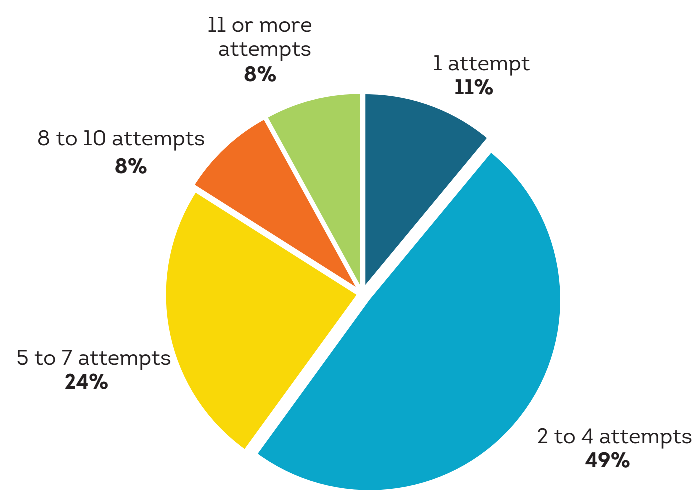


FIGURE 28: NUMBER OF ATTEMPTS MADE BEFORE CONTACTING THE RIGHT PERSON

Q. Based on your experience at your company, about how many attempts are typically made before the correct party is contacted?



  | Source: Aite Group third-party debt collection survey, May 2019 to June 2019 |

8. The phrasing of this survey question likely implied to respondents that they should report the number of attempts made before successfully reaching the debtor, assuming that right-party contact was established. Thus, these findings likely exclude scenarios in which right-party contact was never made.

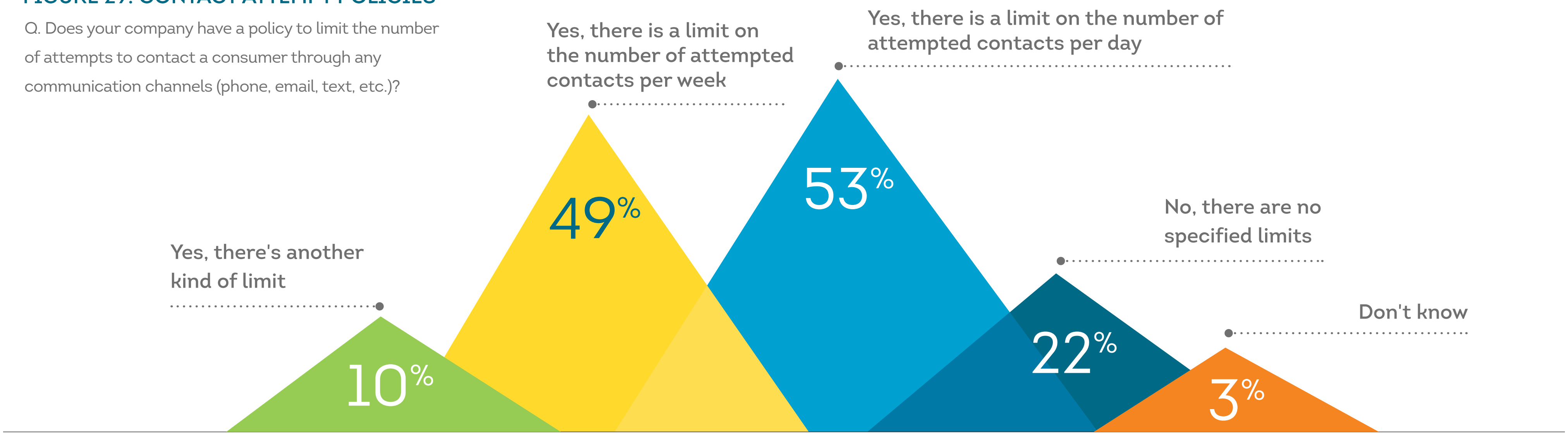
THE FREQUENCY OF CONTACT ATTEMPTS AND TYPE OF CHANNEL ARE TOP-OF-MIND ISSUES IN THE COLLECTIONS INDUSTRY.

The CFPB is proposing to limit the number of calls made to a consumer as part of its rule-making but would allow for unlimited emails and text messages as long as a consumer does not opt out of those communication channels.

About half of respondents note that their company imposes limits on the number of attempted contacts per day, per week or both (Figure 29). Twenty-two percent of respondents report that there are no policies limiting the number of contact attempts, and an additional 3% were not sure if such policies existed at their company. Smaller companies and companies handling fewer accounts were less likely to have policies limiting contact in place.

FIGURE 29: CONTACT ATTEMPT POLICIES

Q. Does your company have a policy to limit the number of attempts to contact a consumer through any communication channels (phone, email, text, etc.)?



"Communications has been a key challenge in the past 20 years. [We have to] balance restrictions from different legal perspectives, different agencies, what information to include, what's required [and] what will have the biggest impact" *-Third-party collection industry leader*

  | Source: Aite Group third-party debt collection survey, May 2019 to June 2019

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Key challenges

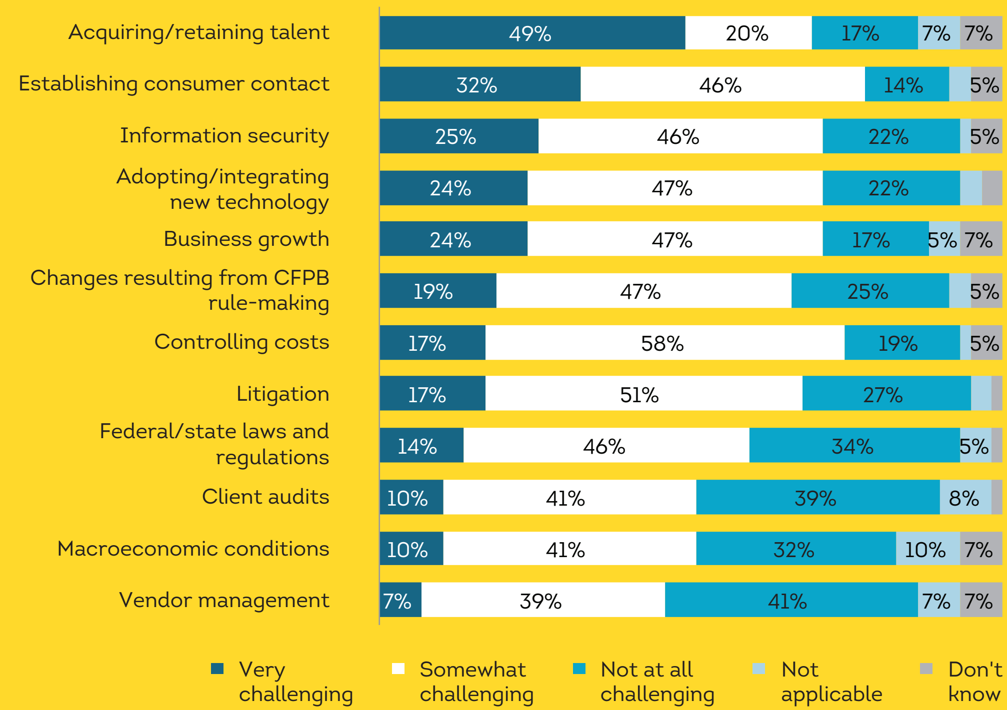
The third-party collections industry is experiencing a wide variety of challenges. Well over half of respondents describe the potential issues presented in the survey question detailed in Figure 30 as either somewhat or very challenging. The top challenges for third-party collectors are acquiring and retaining talented staff, communicating with the consumers from whom they need to collect, ensuring that proper information security protocols are in place, deploying the right technology and—fundamentally—growing the business.

RECRUITMENT AND RETENTION CHALLENGES

Industry thought leaders interviewed by Aite Group echoed many of these challenges. As noted previously, the agents and other staff in a collections company are its greatest expense. At many companies, managers have more agents reporting to them than ever before and generally a larger scope of responsibilities, adding to their stress levels. The collection agent role, often an entry-level position, is especially hard to fill for several reasons that build off one another. First, the job of a collection agent can be unpleasant, as they spend hours each day having difficult conversations with financially distressed consumers. As a result, annual turnover rates of over 100% are common in even the strongest of companies. Staff turnover can be quite costly for companies, since companies must ensure that newly onboarded agents stay compliant with regulations and any additional requirements of their clients, and are fully trained on their collections software. Finally, the turnover problem is exacerbated by several years of low unemployment rates, which make it more difficult to find replacements for agents leaving a company.

FIGURE 30: RELATIVE CHALLENGES FOR THE THIRD-PARTY COLLECTIONS INDUSTRY

Q. To what extent does your company feel that the following are challenging?



 | | Source: Aite Group third-party debt collection survey, May 2019 to June 2019

TransUnion

CONSUMER CONTACT CHALLENGES

The challenge at the top of thought leaders' minds was the increasing difficulty of connecting with consumers in a world where robocalls and scams run rampant. While some collectors' calls may not even reach a consumer's phone if their mobile carrier blocks it, calls that do go through are likely to go unanswered. One vendor to the industry notes that right-party contact is harder to establish and predicts that within two years, the voice channel will no longer be useful. This vendor wonders what will be left for collectors who are accustomed to the "call bombardment" approach and believes companies that want to survive this shift will need to develop differentiated, compliant communications strategies with consumer preferences in mind. Another vendor with a bird's eye view of the industry agrees, noting a shift in mindset from threatening to penalize a consumer that does not engage with the collector, to framing the repayment of a debt owed as the first step on a path to better financial health. A collector concurs with the need for this shift, noting that collections agents have been taking a softer approach in their communications, putting the consumers' needs first and finding that "you attract more bears with honey."

> *"Collection firms are trying to understand people better and get the right data. It's a more introspective approach, and probably the right long-term strategy." -Third-party collection industry leader*

Some of the greatest challenges in connecting with consumers stem from how the third-party collection model operates and would require significant help from original creditors to address. For example, third-party collectors may not have relevant consumer contact information or feel that they lack the proper consent to use certain forms of communications. Collectors note frustration with the incomplete flow of information from clients for accounts on which they are attempting to collect. While several interviewees believe this is a critical issue, none felt it would be addressed unless collection rates substantially plummet. If this were to occur, original creditors might be more incented to provide such information. Another possible way this dynamic could change is if lawmakers or regulators required that original creditors provide this information to those collecting on their behalf.

TECHNOLOGY AND INNOVATION CHALLENGES

The third-party collections industry is generally slow to innovate and adopt new forms of technology, according to those interviewed by Aite Group. This lagging pace results from regulatory concerns and the thin margins felt by many companies, which make it difficult to find resources to invest in transformative innovations.

As noted previously, a majority of companies use collection management systems provided by vendors; however, many of these systems have antiquated functionality and may not have the option to be offered through the cloud, an option many companies prefer. Companies with the wherewithal to invest are building their own systems or using vendor-provided software that is quickly scalable, highly configurable, and cloud-based, with features that allow accounts to be segmented and fed through a strategy engine to determine the appropriate treatment. As noted earlier, some companies are looking at the use of speech analytics that enable agents to be coached in real time on how to respond to a particular consumer's situation and how to improve the tone and pacing of the conversation. The future also includes greater use of artificial intelligence-fueled chatbots that will converse with consumers to free up agents to focus on the most complex accounts.

One particularly innovative collection firm has already implemented machine learning and other AI techniques to build collection strategies from a deep understanding of consumer preferences. This company believes that its innovative techniques to customize collection journeys—along with its focus on providing information about the company transparently to consumers from whom it's seeking to collect—will result in better outcomes.

Another issue related to technology and innovation that survey respondents mention as a key challenge is information security. As clients provide collection firms with consumer information—and firms supplement that with data of their own—ensuring this sensitive data remains secure is paramount. As one thought leader notes, "There's not a client out there that will give [a collector] precious consumer data if you can't show you are spending big bucks to protect that data." According to that interviewee, information security is becoming more of a focus, with the associated costs and challenges potentially serving as a barrier to innovation. Another thought leader agrees, noting that information security "certifications and requirements are onerous, but not optional."

The companies with this ability to invest for their technology needs several years out are midsize to large; smaller firms have more limited revenue streams from which to draw. As a result, the challenge related to adopting new technology and transforming the collections business is a key driver of the consolidation occurring in the industry.

"Bigger companies are focusing on artificial intelligence to assist in debtor engagement. There is a challenge to practically apply this technology in the real world and for it to be effective. It will happen at some point and hopefully reduce expenses."

-Third-party collection industry leader

REGULATORY AND LEGAL CHALLENGES

While regulatory considerations did not rise to the top of the list of challenges, about three-quarters of survey respondents believe that changes resulting from the CFPB's rule-making to modernize debt collection regulations will be challenging for their companies to implement. While the industry generally welcomes the rule-making because of the regulatory certainty it will eventually provide, opinions vary on the some of the rule's substance, particularly related to call caps and provisions related to email and text message communications, as detailed in a previous section.

Several thought leaders interviewed by Aite Group questioned why caps were proposed for phone calls without similar limitations on email and text messages. They also questioned whether the proposed cap of seven calls over a seven-day period was too high, especially considering a consumer may have multiple accounts in collection. If finalized as proposed, however, many in the industry believe the rules would have a major impact on how business is conducted. As one interviewee notes, "It would be an earthquake to the way collections is done ... and kill phone calls as a major channel for collections."

Other legislative and regulatory initiatives at the state and federal level will create ongoing challenges as well. For example, California recently enacted the California Consumer Privacy Act (CCPA), which provides more consumer protections regarding the collection of personal information.[9] While debt collection should largely be exempted from this new law, there may be certain practices that are implicated by the regulations, once finalized by the California Attorney General. In any event, other states may be interested in creating similar types of legislation to deal with how consumers' personal information can be used, and the collections industry must continue to monitor these types of developments and weigh in when necessary.

Litigation risk is a pain point highlighted by industry and consumer advocates alike, albeit for very different reasons. Consumer advocates deplore the use of lawsuits when used as a tactic to obtain a default judgment against consumers who may not have the resources to hire an attorney, the documentation needed to effectively mount a defense, or the ability to appear in court. These consumers face a large imbalance of power, and the ripple effects of these lawsuits cause a significant degradation of their financial security. On the flip side, industry thought leaders note that the number of lawsuits against collections for technical violations of the law has spiked in the last several years. According to one interviewee, there were around 2,000 of these lawsuits in 2008, and this has grown to 14,000 a year now. These lawsuits are often brought by "frequent filers," with one out of every three such lawsuits brought by someone who has sued at least once before. Nearly three-quarters of survey respondents note that litigation is either "somewhat" or "very" challenging.

Key challenges facing the collections industry

EMPLOYEE RECRUITMENT AND RETENTION

- Low unemployment rate results in smaller hiring pool
- 100% annual turnover

ESTABLISHING CONSUMER CONTACT

- Usefulness of phone channel decreasing
- Account hand-off needs improvement, more information

TECHNOLOGY AND INNOVATION

- Thin margins and regulatory concerns result in lagging pace
- Ensuring information security is paramount

REGULATORY AND LEGAL LANDSCAPE

- Implementation of future CFPB rules and compliance with myriad state laws
- Ongoing litigation risk for industry and debtors

  | Source: Aite Group third-party debt collection survey, May 2019 to June 2019

9. For an overview of CCPA, and the potential implications for third-party debt collectors, see Lauren Valenzuela and June Coleman, "California's Fifth Consumer Privacy Act Public Forum in Review," InsideARM, February 12, 2019, accessed August 5, 2019, https://www.insidearm.com/news/00044735-californias-fifth-consumer-privacy-act-pu/ and Aki Estrella, "Collecting in the Wild West: Impacts and Updates for Collection Operations in the Face of Emerging Privacy Regulation in California and Washington State," Business Law Today, May 15, 2019, accessed August 5, 2019, https://businesslawtoday.org/2019/05/collecting-wild-west-impacts-updates-collection-operations-face-emerging-privacy-regulation-california-washington-state/.

TransUnion

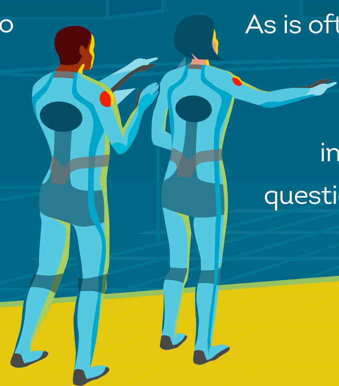
Conclusion

The third-party debt collection industry comprises a diverse group of collection agencies, business process outsources, debt buyers and law firms. While the industry as a whole is contracting, larger firms are losing ground more slowly than their smaller counterparts, and many firms are strategically merging or acquiring others to achieve economies of scale and diversify their offerings. The need to demonstrate compliance, protect sensitive data, and use technology that enables collection strategies often places smaller firms that must make these investments regardless of their size or number of accounts worked at a disadvantage.

THE INDUSTRY IS DESCRIBED BY MANY THOUGHT LEADERS AS BEING AT A CROSSROADS, WITH TWO POSSIBLE FUTURES ON THE HORIZON

Some companies may fail to innovate and have their collection services viewed increasingly as a commodity by clients. This will likely spur greater pressure on margins, making new investments even less feasible.

Other firms seem to be on a different, more transformative path. These companies are already embracing new technologies and communication channels or are considering doing so in the near future. These changes include communicating via text, email or other more nascent channels; investing in cutting-edge speech analytics software; or allowing debtors to self-serve via an online payment portal. Many are also taking a more consumer-centric approach to collections than one that is strictly punitive. The CFPB's rule, once finalized, will hopefully provide a clearer path forward for these firms that are differentiating themselves and moving the collections industry forward.



As is often the case with this type of research, survey responses and thought leader interviews not only provide insights but also raise additional questions that TransUnion hopes to probe further in the future. For example, half of the firms in the third-party collections industry are classified as non-employer firms. TransUnion plans additional research to determine how these firms operate, how they are similar to and how they differ from firms with employees, and the extent to which they rely on contractors. In addition, TransUnion would like to learn more about the collection of commercial debt—the types of firms that are heavily involved in this activity and any unique challenges or opportunities in the collection of this type of debt. TransUnion will continue to study the third-party collections market to provide a deeper understanding of market conditions and where the industry is heading.

TransUnion

APPENDIX 1: RESPONDENT AND COMPANY PROFILE

Most quantitative survey respondents report having senior roles at their companies and a high degree of knowledge about their company's debt collection activities and outcomes (Figure 32 and Figure 33).

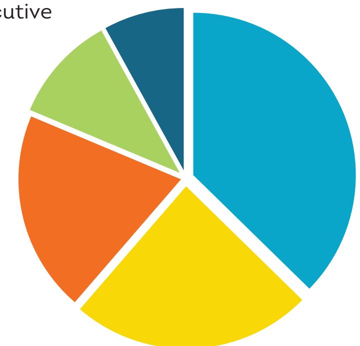


FIGURE 32: RESPONDENTS' ROLES AT COMPANY

Q. What best describes your role in the company?

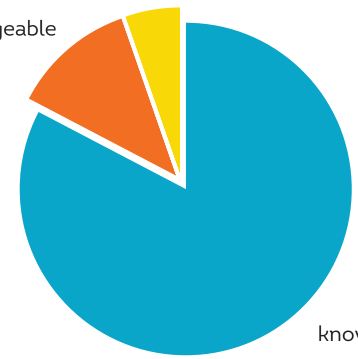


FIGURE 33: RESPONDENTS' KNOWLEDGE OF COMPANY'S DEBT COLLECTION ACTIVITIES AND OUTCOMES

Q. How knowledgeable are you about your company's debt collection-related activities and outcomes?

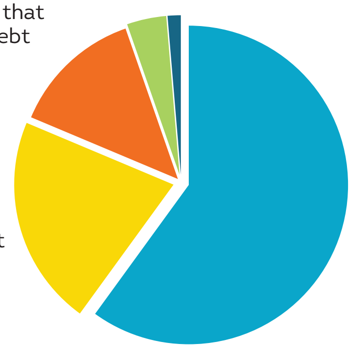


FIGURE 34: TYPE OF THIRD-PARTY COLLECTION COMPANIES REPRESENTED

Q. Which of the following best describes your company?

Respondents to the quantitative survey represent collection agencies, law firms collecting debt, business process outsourcers and debt buyers. Figure 34 provides a breakdown of respondents by company type. The companies represented in the survey were geographically dispersed, with headquarters located across 28 states.

"Adaptation will be huge. We need more leadership to acknowledge the challenges of the industry. The collections industry helps the market and economy work, but needs help." *-Third-party collection industry leader*

  | Source: Aite Group third-party debt collection survey, May 2019 to June 2019

TransUnion

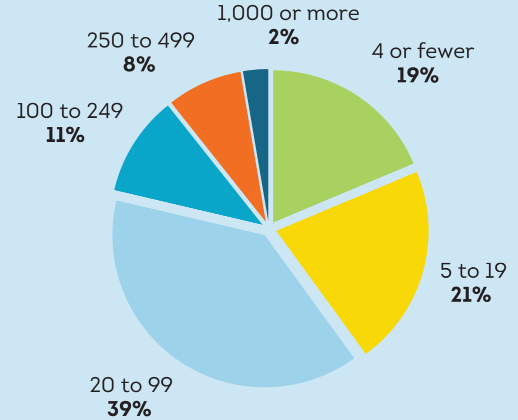
Number of FTE employees at respondents' companies

Those respondents to the survey whose companies purchase and collect on debt were split between companies that collected on relatively few debts they purchased and companies that mostly collect on purchased debts. A large majority of debt buyers purchased prime debt, and half reported purchasing seconds and out-of-statute debt. Fewer of these respondents reported that their companies purchased tertiary, quads or midprime debt.

A large majority of the companies represented in the survey have fewer than 100 FTE employees. Ten percent of companies have 250 FTE employees or more (Figure 35).

FIGURE 35: NUMBER OF FTE EMPLOYEES AT RESPONDENTS' COMPANIES

Q. Approximately how many full-time equivalent (FTE) employees does your company have?



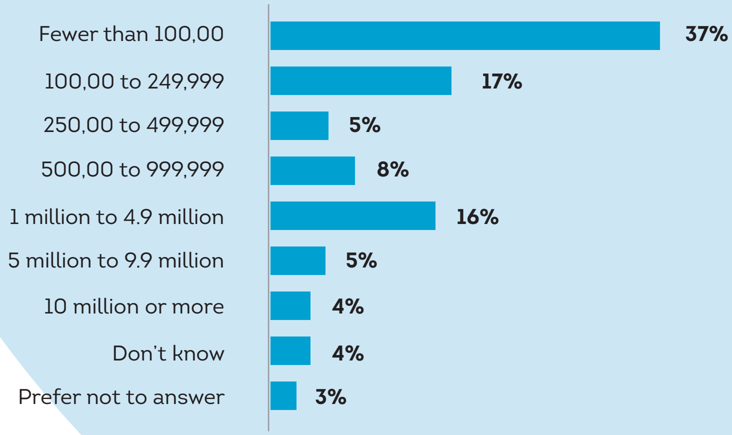
Source: Aite Group third-party debt collection survey, May 2019 to June 2019. Note: No respondents indicated that their companies had 500 to 999 employees.

Number of accounts worked by respondents' companies in 2018

Another way to measure the relative size of a company's operations is by the number of accounts worked. About 4 out of 10 respondents are from companies that worked fewer than 100,000 accounts in 2018, while about a quarter of respondents represent companies that worked 1 million or more during the same time period (Figure 36).

FIGURE 36: NUMBER OF ACCOUNTS WORKED BY RESPONDENTS' COMPANIES IN 2018

Q. How many accounts did your company work in 2018?



APPENDIX 2: RELEVANT SUPPLEMENTAL DATA

This section provides more details on the makeup of the collections industry, additional macroeconomic indicators and trends in consumer credit and collection trade line data.

Establishment and payroll trends

The number of third-party debt collection establishments and employees has decreased in recent years. Additional data on the scale of the third-party collection industry is provided for firms with employees (Table D) and non-employer firms (Table E) over the most recent five-year period for which data is available.

"There is lots of conversation about the CFPB proposed call caps, but it may all be for naught. Within a year or two, the voice channel will not be useful."

-Third-party collection industry leader

TABLE D: NUMBER OF THIRD-PARTY COLLECTION FIRMS WITH EMPLOYEES, NUMBER OF EMPLOYEES AND PAYROLL

	2012	2013	2014	2015	2016
Establishments	4,615	4,525	4,388	4,190	3,975
Employees	130,192	128,150	128,115	124,282	120,089
Annual payroll (in US$ thousands)	$4,689,880	$4,771,633	$4,878,549	$4,881,039	$4,761,031

TABLE E: NUMBER OF NON-EMPLOYER FIRMS AND RECEIPTS

	2012	2013	2014	2015	2016
Establishments	5,935	5,469	5,240	4,980	4,497
Annual payroll (in US$ thousands)	$240,381	$240,505	$232,826	$234,027	$217,819

Source: U.S. Census Bureau County Business Patterns for 2012 NAICS Code 56144 (Collection Agencies), Aite Group

MACROECONOMIC INDICATORS

As noted in the main report, interest rate trends and gas prices are examples of additional indicators of overall macroeconomic health. Rising interest rates cause the cost of borrowing to increase (Figure 37), and gas prices impact the ability of consumers to afford loan payments and other household expenditures (Figure 38).

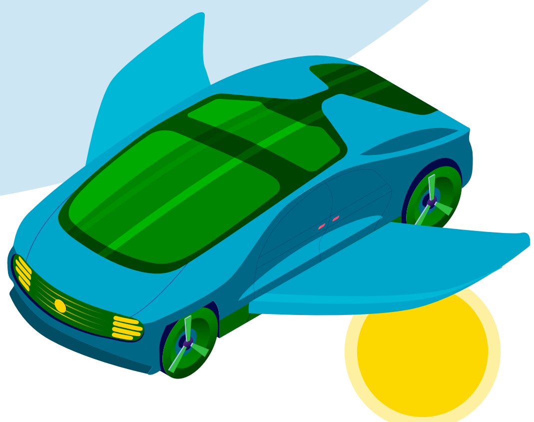
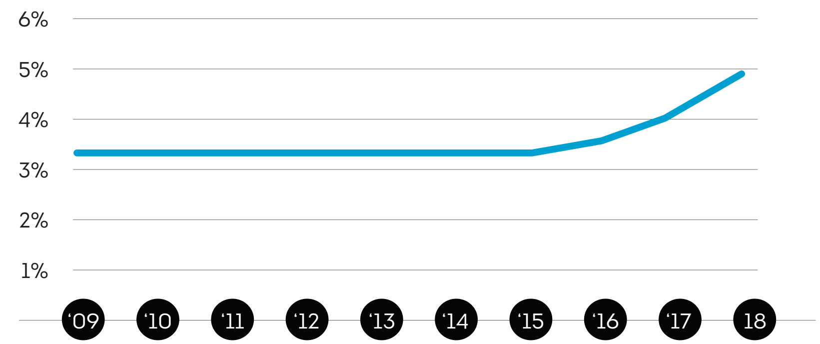


FIGURE 37: BANK PRIME LOAN RATE

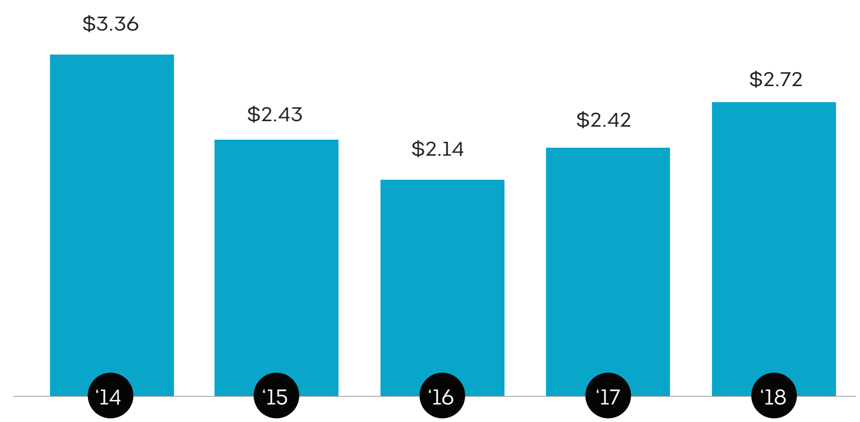
Average annual bank prime loan rate, 2009 to 2018



Source: Board of Governors of the Federal Reserve System, Aite Group

FIGURE 38: AVERAGE NATIONAL PRICE FOR A GALLON OF REGULAR GASOLINE

Average annual cost per gallon of regular gasoline, 2014 to 2018



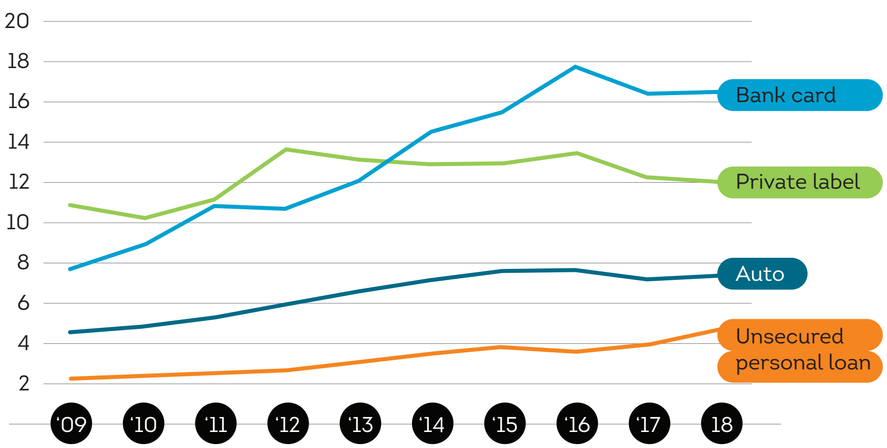
Source: Energy Information Administration, Aite Group

CONSUMER CREDIT AND COLLECTION TRADE LINE DATA

Finally, changes in the number of loans originated and lines of credit opened can impact the potential number of accounts that business collectors may eventually work (Figure 39), and the number of consumers with one or more collection trade lines provides a general sense of the scale of debtors engaged with the collections industry (Figure 40).

FIGURE 39: NUMBER OF LOAN ORIGINATIONS BY TYPE

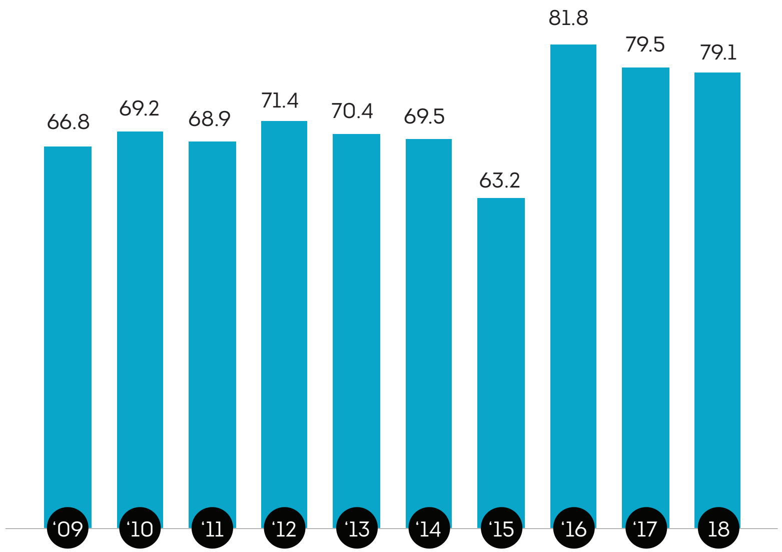
Loan originations, Q4 2009 to Q4 2018 (in millions of loans)



Source: TransUnion, Aite Group

FIGURE 40: CONSUMERS WITH ONE OR MORE COLLECTION TRADE LINES

Number of consumers with one or more collection trade lines, year-end 2009 to year-end 2018 (in millions)



Source: TransUnion, Aite Group. Note: The increase in the number of consumers with one or more collection trade lines starting in 2016 is due in part to a change in reporting standards. See www.nationalconsumerassistanceplan.com for more information.

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