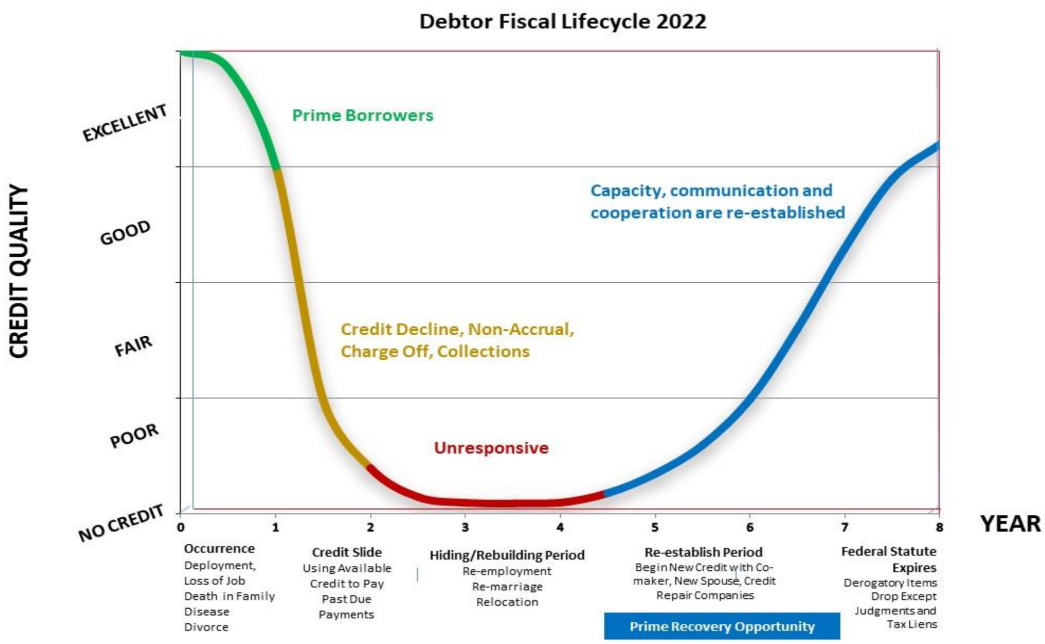
The Best Time to Recover Charge Offs May Be Long After You've Stopped Trying

From the Great Recession of 2008 through the last two years of the COVID-19 pandemic, millions of America's credit union members have experienced a personal financial crisis. Regardless of the cause - whether medical emergency, divorce, prolonged unemployment or under-employment, or something else – the early stages of the 21st century have marked the highest number and dollar amount of consumer charge offs in credit union history. Even today, millions of credit union members have not fully recovered and billions of dollars in charged off loans, credit cards, lines of credit and negative share balances remain uncollected. A significant percentage of those losses have fallen out of the federal reporting statute and are now time-barred from recovery. On the flip side, billions of dollars are still recoverable.

There's an old expression, "bad things happen to good people, and if you leave good people alone long enough, they recover." But how long is "long enough?" When are the right and wrong times to reach out to a charged off borrower? While there is no "one size fits all" answer to these questions, the general recovery strategy to recapture charged off consumer credit losses and rebuild "prior prime" member relationships requires an understanding of the "Debtor Fiscal Lifecycle."



The Debtor Fiscal Lifecycle are intuitive to every credit professional. When a financial crisis occurs, monetary and credit resources become strained or non-existent. In most cases, along with the decline in credit and creditworthiness comes embarrassment and a deterioration of self-respect and self-confidence. The communication between lender and borrower can become strained and may ultimately stop. Collection departments and third-party collection agencies do what they can, but both are limited by available resources. As a result, attention becomes focused on loss mitigation or the recovery of the low hanging fruit in early-stage charge offs; older ones become ignored and eventually abandoned. The result is that billions of dollars of charged off accounts simply fall through the cracks every year.

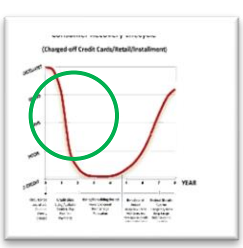
Ironically, this phenomenon occurs at the time when many members have regained their capacity to repay their obligation. Many credit union borrowers would, if given the chance, like to have their membership privileges reinstated by their credit union once their obligation has been repaid. This intangible bond, created on the foundation of member service, is unique to credit unions and virtually non-existent with commercial banks and other types of financial institutions. Therefore, the desire to regain financial credibility, self-respect, and the possibility of reinstated credit union membership privileges creates a strong incentive for the repayment of a charged off credit card balances, direct and indirect loans, HELOCs, mortgages, or negative share account balances. However, as this may occur several years after the date of last payment or date of charge off, all communication between the credit union, its law firm or collection agencies and the borrower has usually stopped and, eventually, the accounts fall out of the federal reporting statute and become time-barred from recovery.

A deeper look into the stages of the Debtor Fiscal Lifecycle.

STAGE 1: **The Event**. The "lifecycle" begins with an event that either slowly or immediately disrupts the financial foundation of a prime borrower. The occurrence may be a divorce, a military deployment to active duty, unemployment, underemployment, a medical emergency or onslaught of a protracted medical condition, death of a spouse or partner…any event or series of events that challenges the borrower's ability to meet his or her timely credit obligations.

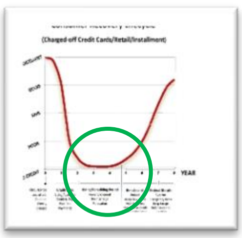
While most "events" are short term and most borrowers recover from them without negative effects on their ability to make timely payments, many credit union members are not as fortunate and the event becomes a slippery slope. A recent and very familiar example from the COVID-19 pandemic is the loss of income over time resulting from the need of an income-producing spouse to quit work in order to care for his or her children. At this point in the life cycle, the borrower is generally unaware of the gravity of the situation and the lender is never aware of the potential delinquency or charge off.

STAGE 2: Credit Slide. A decline in the ability to make timely payments is generally accompanied by a feeling of embarrassment which can lead to desperation. Borrowers begin to prioritize their credit obligations based on immediate need and begin to "borrow from Peter to pay Paul." For example, if the rent or house payment needs to be paid family car is needed to get to work, then the current rent or mortgage payment might be skipped or a credit card advance may be used for the current car payment. And the next month's rent or car payment. And the one after that.

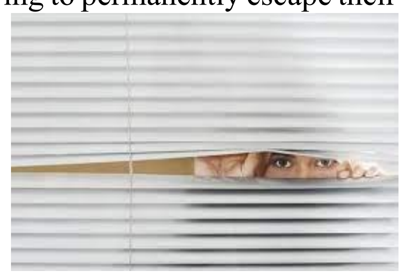


The borrower's financial assets are draining and desperation begins to set in. It is during this stage that delinquency is reportable, collection activities begin and charge offs may occur. It is possible that the Credit Slide stage may last months or even years after the Stage 1 event. This is a time when collection departments are under pressure to prevent credit losses and collection agencies are under pressure to perform. Payments may stop completely and loans, credit cards and lines of credit may be charged off. It is also a time when the borrower is least likely to have the financial capacity to resume payments or repay a charged off balance. It is also the stage where borrowers are likely to seek Chapter 13 or Chapter 7 bankruptcy protection.

STAGE 3: The Hiding Period. This is when borrowers may "go off the grid." Collateral may have been hidden, wireless carriers may have been changed or burner phones may be used. The member may have relocated, gotten remarried, found a new job in another city or state, or moved in with a friend. Your skip tracing efforts have been fruitless and even if the member has been located, he or she doesn't want to talk to you. It isn't time yet.

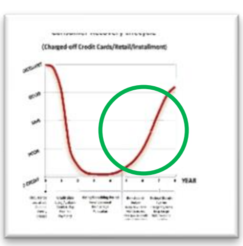


In the vast majority of cases, borrowers go off the grid in order to focus on rebuilding their financial lives. They aren't trying to permanently escape their financial obligations, they're buying time in an attempt to get back on the feet. This may take several months, perhaps several years.



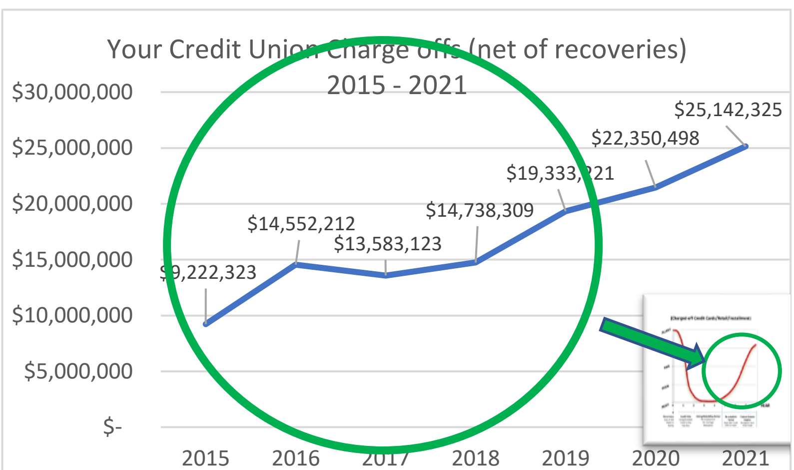
This is also the time period when most loans, lines of credit, credit card balances and negative share balances are charged off. Attempting to harvest the "low hanging fruit" of freshly charged off credit obligations, internal recovery departments and third party collectors aggressively attempt to make contact which frequently has the negative effect of driving the borrower deeper underground.

STAGE 4: Re-establishment. Generally speaking, it is now several years since the event that caused the initial credit default and the member (yes, even though charged off, the borrower is still a member-owner of the Credit Union) has recovered from the medical condition, remarried, gotten a new job, or otherwise has regained his or her financial footing. Now capable of paying the rent and feeding the family his or her primary goal is to once again become credit-worthy. In addition, most members want to re-establish a positive relationship with their credit union. This intangible bond between Credit Union and member often remains intact after a financial crisis. After years of member service have been shattered by a temporary financial crisis, long-time members express their desire to be able to walk into the Credit Union without feeling embarrassed. This simple fact has been proven to be a critical recovery tool. If, during the first three stages of the Lifecycle the member has been treated with empathy and respect and not treated like a financial criminal, the Re-establishment Stage is by far the most opportune time for a Credit Union to recover both the charged off credit balance and a "prior-prime" member.



According to Anthony Joplin, President of CU Revest, an award-winning multiple Credit Union-owned special asset management CUSO that has recovered millions of dollars of “unrecoverable”, “cold-case” charge offs while helping more than 4,000 “prior prime” members regain their borrowing privileges, “Our unique loss recovery strategy is built on the foundation of the Debtor Fiscal Lifecycle. By monitoring the financial activities of borrowers from behind the scenes, using our predictive analytics to determine which borrowers have the highest probability of repayment, and rewarding our collections team for their empathy and respect for member-borrowers during the first 3 stages of the Debtor Fiscal Lifecycle, when we contact a borrower we reach out at the right time with potential solutions to help him or her re-establish a positive relationship with their Credit Union. Timing is everything. By waiting through the Credit Slide and Hiding periods until the borrower is in the Re-establishment Stage, we can see how he or she is regaining the capacity to repay. Then we reach out with a solution rather than a demand.”

Let’s put all this into perspective: The following illustration is typical of Credit Union charge off trends during the past seven years. Most collection departments and third-party collection agencies focus their efforts on the “low hanging fruit” in the most recent charge offs such as those from 2019, 2020 and 2021. They rightfully assume that the older charge offs generally require more time and effort to locate, contact and liquidate. As a result, a significant percentage of older charge offs – even though they are still within the 7-year federal reporting statute – become ignored and eventually time-barred from recovery.



However, following the strategy of the Debtor Fiscal Lifecycle, those borrowers whose credit obligations were charged off in 2019, 2020 and 2021 are the LEAST LIKELY to be able to repay, while borrowers whose credit obligations were charged off from 2015 through 2018 are the MOST LIKELY to be able to repay, and are motivated to re-establish a positive relationship with their Credit Union.

In other words, timing is everything, and the best time to recover charge offs may be long after you’ve stopped trying.