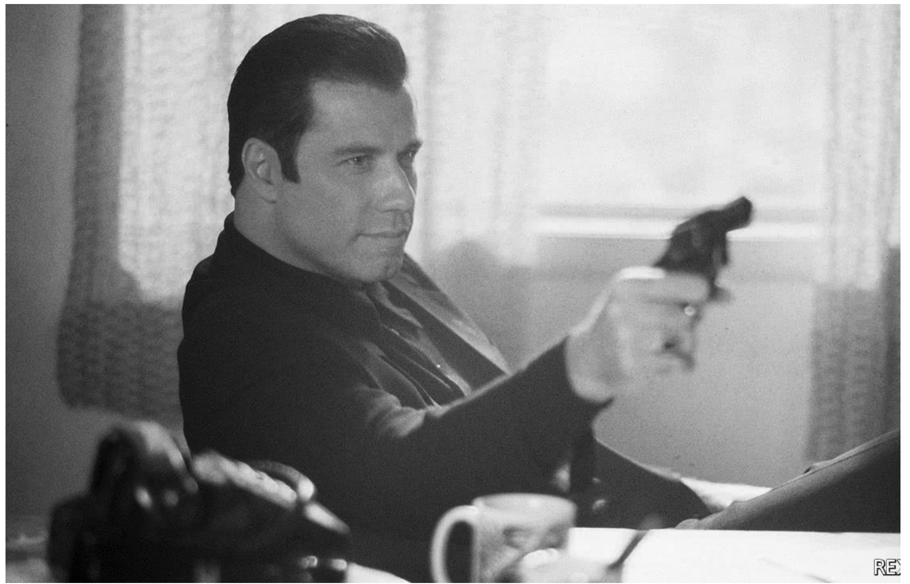

American third-party debt collectors

Bum rap

NEW YORK

Tighter loan-recovery rules make credit harder for borrowers to find.

FEW cheer the rising levels of America's household debt, which reached a record $12.7trn at the end of the first quarter. Nearly 5% of the total, or $615bn, was in some stage of delinquency. One group, however, can barely hide its glee: third-party debt-collection firms, which try to recover mostly consumer loans on behalf of creditors without the resources to chase down bad borrowers themselves.

Business is expanding "at a robust rate", says Keith Kettelkamp, the boss of Remex, a debt collector based in New Jersey whose clients include banks, utilities and musical instrument sellers. Across the country more than 6,000 collection firms contact debtors more than 1bn times a year. One in eight Americans has an account with aa third-party collector. The average amount outstanding is just per $1,300.

Third-party collectors have, it is fair to say, a dubious reputation: they are the target of more complaints from consumers than any other type of financial-services provider, according to the Consumer Financial Protection Bureau, a watchdog.

Their reputedly heavy-handed tactics can largely be explained by their business models. Some operate on a contingency fee basis: their sole remuneration comes from pocketing a percentage of any arrears they recover. Others buy the debts outright. They keep whatever they collect, but lose their whole investment if they fail to recoup what is owed. Both models encourage over-persistence.

Yet Mr Kettelkamp thinks the debt collection industry is overburdened by regulations industry is overburdened by regulations. These govern everything from when debtors may legally be contacted to the manner and content of those communications. They set out licensing requirements and impose hefty financial penalties for bad behaviour.

Consumer-rights advocates would doubtless scoff, but he may have a point. A provocative new paper by Julia Fonseca, of Princeton University, and Katherine Strair and Basit Zafar, of the Federal Reserve Bank of New York, reveals the restrictions on debt-collection legislation at the state level. They find that, after controlling for external factors, such as unemployment and income levels, borrowers in states where debt-collection practices are more strictly regulated find it moderately harder to access credit, because lenders cut back. Borrowers in states where debt collection practices are less intense (owing to stricter rules) received on average $213 less in car loans and $136 less in retail and other personal loans than borrowers in states where debt collectors had a freer hand.

That is because a robust third-party debt collection industry partially insures lenders against excessive losses, in much the same way that personal bankruptcy protects consumers. Without the deterrent effect of third-party collectors, consumers are likely to assume more risk and to over borrow. Default is perceived to come with lower costs. This is likely to lead to higher default rates, forcing lenders to reduce the supply of credit to mitigate losses. Those with low credit scores will bear the brunt, as they become even less likely to qualify for loans. So the debt collectors provide a service to borrowers as well as lenders. It will take more than a well-argued academic paper, however, to burnish the image of an industry neither lender nor borrower deals with by choice.