Debt Sales 101 Mini-Series (Episode 6): After the Close: Compliance, Oversight, and Ongoing Risk

Speakers: Joseph Schuster and Chris Eastman

Joseph Schuster:

Welcome to episode six of our Debt Sales Mini-Series, our final episode. I'm Joseph Schuster, a partner in the Consumer Financial Services Group at Ballard Spahr, and I'm going to let my co-host Chris Eastman introduce himself here momentarily. But before I turn over to Chris, I'll just give a brief overview of what we're going to discuss in this episode. So over the last several episodes, we've walked through what a debt sale is, why companies sell debt, what types of debt can be sold, what the diligence looks like on that debt that's sold, on the buyers, who buys it, how deals are structured, and the regulatory and contractual issues that shape transactions in this practice.

In today's final episode, we're going to pull everything together and we're going to talk about what happens after the contract is signed and the debt is transferred. How sellers manage compliance, oversight, and ongoing risks, and what's expected of them, and also what they can do to run a successful debt sale program over time. Chris, with that, I'll turn over to you to introduce yourself and kick off our discussion.

Chris Eastman:

Thanks, Joseph. I'm Chris Eastman. I'm the founder of Franklin Ross Strategies. We're a consultancy that helps companies with collection and recoveries, specifically among other areas in debt sale. My background, I have both led debt sales from a banker side and a seller side, and then also led a company doing debt buying. So I have perspective on both sides of the transaction, and hopefully I can be of assistance as this group of listeners thinks about debt sales and how to maximize the commercial value to them.

So today, we're talking about post-sale activities. And I really think as we approach that, there's really two things I would highlight from a commercial perspective. First, protecting your brand, and second, being a good partner to your debt buyer. Joseph, I know you're going to provide a lot of great information from a legal and compliance perspective to set debt sellers up for success. From my perspective, a commercial perspective, ongoing responsiveness to outreach from the buyer is the most important thing to protecting your brand and also ensuring you're a good partner.

First, and we talked about this quite a bit in the last episode. Buybacks contractually are likely to be required shortly after the sale, as ineligible accounts are identified and need to be unwound and repurchased by the seller. Working closely with the buyer here to buy back those and refund those accounts quickly. Insurers ineligible accounts are not purchased by the buyer and accidentally collected on. Normally, as I mentioned previously, these accounts are flagged as deceased, but they can also be accounts that paid right before the sale is executed.

Secondly, setting up a framework for monitoring customer compliance and KPIs with your buyer is a great way to protect your brand. I recommend working with them to aggregate complaints, both complaints that they receive and complaints the seller is receiving. Look at credit bureau disputes, tracking counterclaims if you're allowing a legal status and monitoring the debt buyer for the details of ongoing regulatory reviews and audits.

Thirdly, working with buyers to meet reasonable requests for additional documents is really best practice here. These should not be for all accounts, but occasionally a buyer may need additional account details, notes, and so forth, account history, additional account history details to pursue a judgment. Working with them on these positions do well for future sales, and the buyer knows that you're invested in maximizing their recoveries. This can also really help you avoid an adverse ruling in court hearings, a ruling which could have cascading effects on the collectibility of your product going forward. Joseph, I'd love to get your thoughts on preventing adverse court decisions from a legal perspective.

Joseph Schuster:

Yeah, it's a great question in transition, Chris, there, because I'd say that court rulings or adverse court rulings are one of the most underestimated post-close risks in debt sales. From a legal perspective, a single bad decision, even at a trial court level, can have consequences well beyond that individual account. Defense counsel will reuse those arguments. Judges talk to each other. The industry, the buyers see those types of things and they may reprice in certain jurisdictions or not even want to be involved in certain jurisdictions. So avoiding those is really important. So when you're looking at the documentation, standing, charge off practices, that can ripple through jurisdictions and portfolios. It's very important.

I'd say beyond that too, the post-close risk management is a very important aspect of the debt sale, both in terms of a one-time and ongoing debt sale. When you're thinking about risk management, if you're doing ongoing debt sales, even if they're structured as new transactions, you've done a bunch of diligence on the debt buyer, you might be working with that same debt buyer. There is an expectation that you're continuing to do diligence on them. What we generally see in that space is for interim debt sales that are happening regularly, maybe quarterly, monthly, whatever it is, you'll have an abbreviated bring down due diligence questionnaire. Has anything changed since our last one? Do you have regulatory findings, enforcement matters, changes in leadership? Things of that nature that we can ask in the interim. And then you really look at doing a more involved due diligence check-in on a one-year basis to just refresh all the things that are going so that you can have that for your files, you're comfortable where you're placing your debt, regulators are comfortable where you're placing your debt as well.

And so putting aside that due diligence, I also say that post-close risk management really starts with anticipation. Sellers should assume that their debt will eventually be litigated. If not, like Chris has said in previous episodes, that really changes the economics if you say that the debt cannot be litigated substantially. So looking at what you have for documentation, the data, the affidavits supporting the account, that's only going to be extremely important for the debt sale and it's going to be extremely important as their scrutiny later on. That's where I think there's a lot of cooperation between the sellers, with the buyers, especially on that documentation and witnesses for that litigation.

I'd say it's good partnership behavior, it's risk mitigation, but it's also, I think, crucial to these transactions and having them be successful, that you have one successful one that leads to additional transactions. Chris, I'm curious, beyond the specifics that you were talking about as you started, what do you generally see as the involvement of the seller after the deal closes, other than the documentation, the buyback, the putback, all those types of things, just in terms of that partnership?

Chris Eastman:

Yeah, Joseph, I see a really wide range of involvement with different sellers. I'll see everything from a very low touch, low ongoing oversight, highlighting the items you were just mentioning, all the way to exercising full audit rights and going in and wanting to do an audit of the debt buyer on an ongoing basis. So I really think it comes back to the risk appetite of the seller, their comfortability with the buyer.

I also see a lot of best practices on the commercial side really touching base with the buyer on a regular basis just to see how the sales performing and getting a sense of is the recovery liquidation curve matching what the buyer expected? Have things occurred that were unexpected in the process? And that really gives the seller a heads up on could anything be changing with the next, whether it be the next one-time debt sell or the next forward flow contract coming up for rebid? Getting an early indication of where pricing might go based on the performance. It may take a few months to get that, but I think it's a really good habit and best practice to utilize, just keeping the lines of communication open on performance as well. But Joseph, what do you see from a regulatory perspective?

Joseph Schuster:

Yeah. Thank you, Chris. And I think that what you talked about from the commercial side is very important. From a regulator or from a regulatory side, what we see is that regulators are viewing debt sales as a managed activity. It's not a clean exit. It's not that you sell the debt in Europe. That may have been the case maybe prior to 2010 and earlier, that's not the case anymore. Sellers are expected to have some level of oversight. They're expected to have done that due diligence that we talked about earlier. Sellers are not expected to control buyer's day-to-day operations, and that is not something that we want. That would create risk for both parties involved.

What the sellers are expected to do is have reasonable oversight, particularly where consumer harm could result. This could include monitoring complaints, understanding litigation trends, and responding appropriately if there are issues that surface. It may also affect how the seller's doing things with their remaining portfolios. They look at improvements to their practices for debt that they may sell in the future. We do regularly see regulars ask about that due diligence that was performed before sales, before those interim sales I was talking about. They'll ask about the contractual protections that are in place, what monitoring has occurred afterwards, what audit rights do exist, and not having answers to these questions is problematic.

I'll touch on just a couple of these in more detail, I think which might be helpful, maybe complaints and buybacks. Complaints, in that space, you can think about complaints, credit bureau disputes, and counterclaims, they're all early warning systems. The mistake I see is treating them as isolated events, as opposed to looking at if there's trend data that can be evaluated. From a legal standpoint, patterns matter. If there's a spike in litigation or with respect to counterclaims, you need to know that. It can signal a systemic issue that needs to be addressed before it turns into an enforcement or really a widespread litigation risk as well. I'd say strong sellers use post-closed data to refine the eligibility criteria going forward, their documentation standards, and even future contract terms too. So having that feedback loop is valuable.

I'll touch on buybacks too. Buybacks, they're inevitable, but you have to manage the process. Unmanaged buyback processes is where there's really a risk here. From a legal perspective, I'd say clearly defined buyback windows, pricing mechanics, and dispute resolution processes are critical. Allowing buybacks to remain open indefinitely can create accounting uncertainty, creates operational drag, there's regulatory questions about ownership. It's a whole mess. So well-run programs really treat buybacks as a short-term cleanup mechanism as opposed to an ongoing contingency. And that's what sellers want too. They don't want that ongoing contingency. Yeah, those are some of the high level pieces I touch on here. Chris, any final thoughts from your perspective?

Chris Eastman:

Yeah, I think Joseph, what it really comes down to is a debt sale, whether it be a spot sale or a forward flow, really is a long-term relationship with the buyer. This is a ongoing 7 to 10 year type of relationship that needs to be well thought out on the front end with the contracting, and then well executed on the backend. And I think you've brought some of these key items to light here today. So thanks for sharing this.

Joseph Schuster:

Absolutely. Thank you. And with that, I'll just wrap up this episode and say, I think the through line across all of this is that debt sales work best when they're treated as a program, not as a transaction. Sellers that succeed long-term have the lessons that they learn. They standardize post-close processes and continuously recalibrate based on regulatory and litigation trends and what works from a contract perspective. This approach reduces risk, it strengthens those buyer relationships, and Chris, as you were talking about, it's ultimately going to improve pricing. To wrap up this final episode, what I'd say, is that debt sales don't end at closing, they evolve afterwards, as we've been discussing. Compliance, oversight, responsiveness are what protect the brand, the value and the regulatory posture over time. That's crucial to the transaction as a whole. With that, Chris, do you want to close out our series and maybe share a little tidbit about a bonus episode that we're planning?

Chris Eastman:

Absolutely, Joseph. I hope our listeners have really understood that debt sales can really be a great source of P&L for the business. They can help companies generate significant value to the bottom line, but as with anything else, this needs to be well-managed. The risks need to be understood, both from a regulatory and a commercial perspective, and a framework and having the right people advising and helping through the process can really generate additional value financially and prevent additional risk from a legal and compliance perspective.

So I hope our listeners found this beneficial as we walk through the Debt Sales Series, but I do want to say we're not done yet. And as Joseph and I have been talking here, one of the big items we're hearing a lot about lately, the buzzword in the industry, if you will, is AI. And so we're going to be doing a bonus episode on AI in the debt sales space. We'll be coming back to you with the latest what's evolving in the AI space and how we're both sellers and buyers thinking about AI as they process debt sales. So we're looking forward to that bonus episode coming up next time.