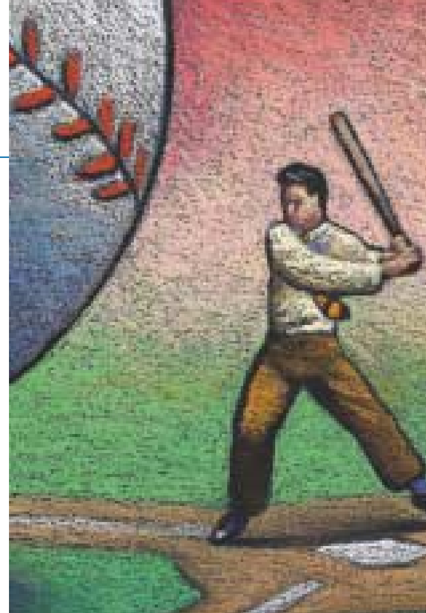

Probate Collections—Managing for the "Two-Minute Drill"

Part 1: Why Lenders Must Get Smarter

by Horace A. Lowe

This article, the first in a series, focuses on statistical trends that tend to support dramatic increases in unsecured consumer debt charge-off figures over the next 35 years. Lenders and collectors must become much smarter about collecting deceased debt to minimize such charge-offs and enhance consumer debt portfolio performance. The author also strongly suggests that lenders/collectors begin to track deceased debt losses as a separate category.

Upon a consumer debtor's death, collection of any account typically is governed by the probate laws of the decedent's domicile. Because the principal purpose of probate laws is to ensure the speedy and efficient settlement of estates, the creditor claims process typically happens very quickly. Thus, when a consumer debtor dies, collectors must act with the precision of a football team in a two-minute drill to have a chance to win the game.

In the first instance, risk management professionals must understand the legal playing field in probate. Under strict historical Islamic law, for example, representatives and heirs of the deceased are to pay the debts of the deceased person as quickly as possible, preferably even before burial. Not so in the U.S. In most states, if not all, unsecured creditors of the deceased person are . . . well, bottom feeders. Far from being paid before burial, in most cases the decedent will have rested through all four seasons before an unsecured creditor collects a dime, if anything at all.

There is precious little uniformity among the 50 states in terms of how creditor claims are handled. Only 18 states, including Colorado, have adopted some variation of the Uniform Probate Code. The result is a smorgasbord of laws relative to the creditor claims process. Thus, lenders and collectors are hard pressed to solve the national deceased debt collection puzzle, as a one-size-fits-all approach simply cannot work. As a result, nationwide lenders and collection houses too often leave the game empty-handed.

As one example, a relatively large and quite complex estate

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was recently in probate under Colorado law. Approximately $300,000 in unsecured claims went uncollected, even though there was a good deal of net asset value in the estate. The case involved more than 20 claiming creditors headquartered across the nation, including one mortgage lender that was secured by an upside-down real property and therefore, given the deficiency, unsecured. Only one major creditor, a local community bank, handled the claims process properly and collected a good percentage of the amount of its claim through negotiated settlement. Most other creditors and collectors (including major credit card issuers, collection agencies, and their lawyers) failed to take timely and appropriate action or made other mistakes and thus lost the opportunity to collect on literally tens of thousands of dollars per claim in some cases. A sampling of these mistakes will be seen in future parts of this series.

If that case is a microcosm of the universe of probate collection practices throughout the nation, then, given current trends in the consumer credit industry, charge-offs will increase dramatically unless lenders and collectors get smarter about probate collections.

While actual statistics regarding deceased debt charge-offs do not appear readily available, the growth trend in overall unsecured debt and the aging of the baby-boom generation make inevitable a significant, gradual increase in deceased debt losses and charge-offs.

The most recent Federal Reserve statistical release on consumer credit reflects that at year end 2003, U.S. consumer debt (excluding debt secured by real estate) stood at approximately $2 trillion, including about $750 billion of revolving debt. A 2003 market research report by Clear of Debt, Inc., a consumer debt counseling firm, states that credit card debt accounted for approximately $400 billion of overall consumer debt.

Steven S. Poloz, chief economist at EDC (Export Development Canada), states in a 2003 article, "Consumer Debt Not So Worrisome," that the current annual rate of increase in U.S. consumer debt is 9-10%. This figure is consistent with the Federal Reserve release. And Poloz writes:

> *. . . consumer indebtedness has been rising for 50 years simply because credit has become more available. Consumers have more financial flexibility today than ever before, flexibility that allows them to choose to carry debt when in the past they may not have had the option. Even loyalty points have added to debt: to accumulate points, people use credit cards for ordinary spending and pay the balance monthly, but that means they carry a debt load, on average.*

There is every reason to expect a continued increase not only in overall consumer debt levels, but also in the annual rate of consumer debt charge-offs. Federal Reserve statistics show that over the past 15 years or so, the annual consumer debt charge-off rate has increased gradually, particularly for unsecured credit card debt. For 1988, the annual charge-off rate for credit card debt held by the largest 100 banks was 3.48%. For 2002, the charge-off rate was 5.94%. For all other banks, such as community and mid-sized banks, the charge-off rates were 3.01% in 1988 and 8.7% in 2002. And there is nothing to indicate a reversal of this trend, even without the more or less predictable impact of baby boomers over the next 35 years.

Lenders and collectors must

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According to the Consumer Credit Insurance Association, one-seventh of all consumer debt is insured by consumer credit insurance.

consider the potential impact of baby boomers (those Americans born from 1946 to 1964) on the trend toward ever-increasing consumer debt charge-offs. As a group, the approximately 78 million baby boomers are the heaviest users of credit cards. According to the Clear of Debt report, so-called "first wave" baby boomers (age 49 to 57) have the highest average monthly credit card balances of all age groups, about $628. A note of interest is that the decedent in the example provided in this article was a baby boomer.

The oldest of the baby boomers are now approximately 57 years of age. Assuming a median life expectancy of about 73 years across all demographics, we reasonably may expect that within about 15 years and continuing for an approximate 20-year period thereafter, baby boomers will begin to die in increasing numbers—the "baby boomer-ang." Add to this the fact that, as consumers have become more sophisticated and the consumer credit insurance industry has become more heavily regulated, fewer consumers are purchasing credit insurance "to protect their loved ones" in the event of death. According to the Consumer Credit Insurance Association, one-seventh of all consumer debt is insured by consumer credit insurance.

However, while the foregoing factors portend increasing rates of consumer debt charge-off, the stars appear well aligned to favor enhanced collection of debt in probate in the coming decades. A 1999 study prepared by Boston College's Social Welfare Research Institute (SWRI), "Millionaires and the Millennium: New Estimates of Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy," predicts that some $41 trillion will be transferred through deceased estates from 1998 through 2052.

In a paper published last year, "Why the $41 Trillion Wealth Transfer is Still Valid: A Review of Challenges and Questions," authors John Havens and Paul Schervish defended their estimate and confirmed their view that $25 trillion of the $41 trillion total will pass to heirs through inheritance, the remainder going to fund charitable bequests and to pay estate taxes and estate settlement expenses. Of the $25 trillion figure, SWRI predicts that about $7.2 trillion will pass to baby boomers, while the majority of that amount will pass to subsequent generations. SWRI thus concludes: "As the baby boom generation ages and dies during the 55-year period, their role in the wealth transfer process will be far greater as benefactors than as beneficiaries."

Thus, the typical baby boomer's estate will have sufficient assets to pay at least a reasonably acceptable percentage of outstanding pre-death debt. Viewed thusly, the most significant impediment to enhanced deceased debt portfolio performance during the baby boomer-ang period will be the failure of lenders, collectors, and their legal counsel to properly posture themselves for the future.

As amply demonstrated in the example, probate laws can be a trap for the unwary creditor or collector. It is therefore imperative that lenders and collectors get smarter about collecting debts in probate, and the effort can begin by tracking deceased debt losses as a separate category. Unless the lending and collection industries develop appropriate management philosophies, systems, strategies, and techniques, otherwise collectible dollars will slip through their fingers as probate lawyers take advantage of laws that tend to favor heirs and devisees over creditors. ❐

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In the next article, "Understanding the Legal Playing Field," the author describes the pertinent rules of the game under the Uniform Probate Code and other state probate laws, compares the probate claims process to the general process of pre-death collections, discusses the extent to which the current laws are simply inappropriate to the current realities of the consumer credit industry, and exposes typical traps that creditors can easily avoid. The goal of this series is to prepare lenders and collectors to better focus their operations and apply their human and other resources to win in the "two-minute drill."