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Title: **Business Models and Best Practices in Debt Recovery Services: an overview of the Italian industry**

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Abstract: Management of distressed receivables for banks and nonfinancial organizations (i.e. utility companies such as energy suppliers) does not normally belong to a firm's core business. In countries such as Italy, where timing and complexity tend to make legal proceedings very inefficient, the credit collection activity becomes very expensive and time consuming.
This paper analyzes the relevant role within the broader credit ecosystem. An outlook over the Italian industry reveals a growth in assets under management and good profitability in recent years. The evolution of business models within debt collection agencies, highlighting the best practices adopted in collection processes, communication strategies and the professional and ethical management of customer service. This demonstrates how an excellent debt collection service is increasingly appreciated by creditors who, thanks to the assignment of the service, can improve their cash flows and their financial stability, and at the same time, concentrate on their main operations. The Debt Recovery Service Market is ripe with opportunities as it adapts to technological innovations and evolving regulations. The integration of data analytics and artificial intelligence for predictive modeling and risk assessment heralds a transformative potential for increasing the efficiency of debt recovery operations.

Type of paper: Qualitative and quantitative analysis based on financial and public data.

Keywords: Distressed receivables, Non Performing Exposures, Credit Management, Debt Collection Agencies, Servicers, Securitizations.

1. Introduction to Debt Collection

Distressed receivables are financial obligations that have become significantly overdue and are at a high risk of default. These receivables originate from various types of transactions. Financial institutions, for instance, offer loans, while companies in the trade sector, such as telecommunications and utilities, issue invoices for services rendered. When the debtor fails to fulfill the repayment obligations as per the agreed terms, the debt transitions into a delinquent state, subsequently classified as non-performing.

The recovery involves intricate, time-consuming, and often costly processes aimed at information gathering and facilitating transaction resolution. Debt resolution typically involves a review of the borrower's ability to repay the debt, determining the terms under which the debt may be settled to the creditor's satisfaction, and collecting the debt, usually through phone or personal contact with the debtor to facilitate resolution.

It is a common practice across various industries, such as insurance, telecommunications, and mail order services, to engage specialized collection agencies for the recovery of distressed receivables.

Similarly, banks often turn to collection agencies in complex cases (Thomas, Matuszyk, & Moore, 2012). Creditors always have the option of an in-house collection, and the decision to use a third-party agency therefore indicates that creditors expect to recover more, on the net, via third-party debt collection than by collecting in-house.

In the fast-paced world of commerce, businesses face more and more issues with unpaid invoices, overdue payments, or bad debts. At present, collection services play a vital role in the financial ecosystem, acting as a critical bridge between businesses and their customers. Collection servicers address these challenges by recovering outstanding debts, thus aiding businesses in preserving healthy cash flow and financial stability.

Given the pivotal role that debt collection agencies have assumed in the current financial ecosystem, it is essential to analyze the determinants that influence their productivity and performance, ensuring their survival in the market.

2. Literature Review

Debt collection serves as an indispensable instrument for creditors to claim overdue debts, and the growth of this practice has garnered significant attention from regulators and policymakers, nevertheless, academic literature on debt collection agencies is not extensive.

Several studies have explored the complex role debt collection agencies play within the broader credit ecosystem, and these analyses converge on the various benefits associated with the growing presence of these non-bank financial institutions in the sector.

As with any debt, the willingness of lenders to provide credit relies on the presence of enforcement mechanisms that allow creditors to pursue a defaulting borrower's income and assets. By limiting the losses of creditors in case of default, debt collection allows for better enforcement of contracts. Theoretical work suggests that this in turn leads to increased supply of credit and lower interest rates, generating economy-wide impacts (Grosman, Hart, 1983), (Djankov et al. 2008).

Because delinquency introduces variability into credit contracts, restricting debt collection practices acts as a form of insurance for consumers, enabling them to mitigate negative financial impacts and potentially improve their financial health. However, limiting debt collection practices also reduces the consequences of default. Consequently, this may lead to more delinquencies due to moral hazard or adverse selection effects. So, new rules restricting the intensity of debt collection effort also can reduce repayment. Creditors will respond by curtailing credit supply and increasing the interest rate. Recent empirical work has found that restricting collection activities leads to a decrease in access to credit and a deterioration in indicators of financial health (Fonseca et al., 2017), (Fedaseyeu and Hunt, 2018), (ViKtar, 2020). A more recent study has found that, however, the welfare effects are ambiguous, as the reduction between perceived and actual consumer welfare on the demand side has to be weighed against a higher interest rate that results from a reduction in the supply of consumer credit (Durbon and Romeo, 2020).

The studies conducted so far, to analyze the efficiency and performance of debt collection agencies, highlight that there is a significant gap in understanding the factors macroeconomic and industry specific that influence collection. Research by Dermine & de Carvalho (2006), Thomas et al. (2012) and Han & Jang (2013) has explored these factors for bank loans, while Beck, Grunert, Neus, and Walter (2017) have examined them for other goods and services. Additionally, Hoechstoetter, Nazemi, Rachev, and Bozic (2012) have investigated the selection of predictive models. Collection agencies leverage various sources of information to forecast collection recoveries. A crucial distinction exists between the information provided by the original creditors and the data

independently gathered by the debt collection agencies. Earlier empirical studies, including those by Hoechstoetter et al. (2012), Thomas et al. (2012), and Beck et al. (2017), primarily focus on the information initially available. Both Thomas et al. (2012) and Beck et al. (2017) observe that this initial information is often limited.

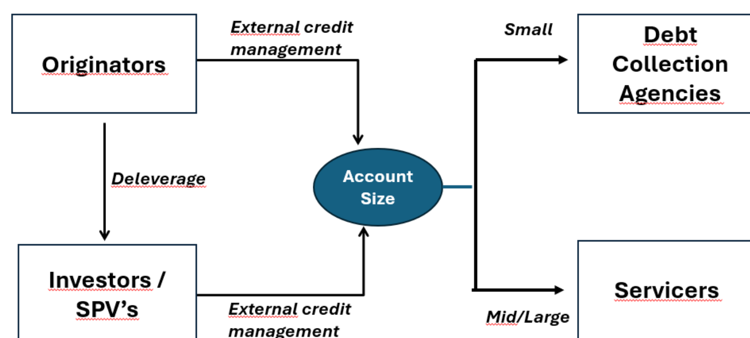
Recent empirical work shows that debt collection agencies play an important role in gathering and processing debtor information. In line with theoretical findings, the initial information is sparse and the information gathered is essential for better-informed predictions. By collecting data on the recovery process, debt collection can elaborate insights into customer behavior in terms of capacity or willingness to repay the debt. Models that have access to information about the recovery process show better performance in predicting recovery rates. (So et al., 2019, Bellotti et al. 2021). Information technology (IT) alleviates informational asymmetries, enabling lenders to focus collection efforts on delinquent borrowers who are statistically more likely to repay. By employing statistical modeling to track the progression of delinquent debt, lenders extensively use large databases to forecast debt collection outcomes. According to industry reports, the implementation of IT-based collection platforms has significantly reduced collection costs and enhanced efficiency. Additional notable advancements include predictive dialers, speech analytics software, internet-based skiptracing, and the provision of collection scores by credit bureaus. (Cfr. Kriebel and Yam, 2020).

This is consistent with the basic observation that today's debt collection technology relies *less* on litigation and more on the use of information.

3. The Debt Collection Business Models

The credit management services (CMS) sector can be broadly categorized into the following areas:

a) Third-party Servicing or Subservicers (Debt Collection Agencies): this model involves the collection and management of debt portfolios on behalf of external entities, such as investment funds, banks, or utility companies, without the servicer having any direct financial stake in the underlying loans.
b) Debt Acquisition and Recovery (Pure Servicers): this approach entails the direct purchase or acquisition of debt portfolios from third-party originators. The acquiring entity then undertakes the collection and management of these portfolios, deriving financial benefits from the recovered amounts. Servicers may grant a mandate to a *Subservicer*, only to perform all debt collection and recovery activities;
c) Hybrid Model of Debt Acquisition, Recovery, and Third-party Servicing: this strategy combines elements of both debt acquisition and third-party servicing. Here, a debt purchaser not only acquires, collects, and manages portfolios for its own benefit but also outsources its specialized debt collection and management services to external clients. This diversified model enhances business stability, allowing purchasers to bid on portfolios they are already familiar with, thereby facilitating accurate pricing and reducing the likelihood of competitive bidding challenges.
d) Pure Investors: this model involves direct investment in or acquisition of an underlying portfolio on behalf of other investors. Pure Investor typically employ the services of one of the above operators to collect and service the portfolios they have acquired and earn management and performance fees from their investors.
e) Special Purpose Vehicles: in this business model, the investor is an SPV that buys credit portfolios via the issue of usually rated asset backed securities. In case of distressed assets, collection services are then outsourced to servicers and debt collection agencies.



3.1. Third-party debt servicers

Third-party debt servicers act on behalf of the original creditor, typically the debt originator, to recover outstanding debts. These servicers are generally compensated through a fee structure tied either to the nominal value of the debt portfolios they manage or to the amount collected, contingent on the portfolio's characteristics. This service model is also applicable to performing credit originators. Contracts in this domain are frequently multi-year arrangements, incorporating base fees alongside variable fees based on specific milestones or key performance indicators (KPIs).

Outsourcing both nonperforming and performing debt collection serves various strategic purposes, primarily centered on cost efficiency. Original lenders often lack specialized expertise in recovering nonperforming loans and the necessary infrastructure, economies of scale, and experience that dedicated service providers possess.

The decision to engage an external partner for recovery management must not only be made by considering direct costs, such as commissions, but also indirect costs (e.g., coordination costs) that may be borne by the assignee, provided that outsourcing leads to greater effectiveness in recovery actions and an absolute increase in gross operating margin.

The evaluation of the convenience of outsourcing must carefully consider the potential risks it entails. Among the major risks to highlight are:

- Loss of control over strategic decisions in the recovery activity;
- Loss of know-how and difficulty in making timely and efficient strategic choices;
- Reduction of available recovery data and challenges in monitoring the portfolio.

The occurrence of such conditions could result in a recovery rate for the managed credit portfolio lower than what the assignee could have achieved through internal management. Underperformance can stem from various causes, such as the interface between the assignee and the recovery agency, the IT system, the timing of onboarding recoverable credits, documentation deficiencies, recovery organization, and the volumes of NPLs managed by the agency.

To safeguard the interests of the assignee, it is crucial to establish:

- A precise periodic monitoring system;
- Access to all recovery data from the platform;
- A provision for constant review of recovery policies.

Furthermore, it may be prudent to include clauses in the contract to protect the assignee. These could include defining minimum recovery rates for each cluster of the managed portfolio and imposing penalties when recoveries do not meet these thresholds. In cases of less severe underperformance, a reduction in servicing commissions could be considered. In more severe cases, penalties could be imposed on the servicer, and in the worst cases, the dissolution of the joint venture could be contemplated.

The contractual terms and fee structures for servicing agreements are influenced by factors such as the performance status of the loan, the loan type, the presence of collateral, and whether the debtor is a corporate entity or an individual consumer.

3.2. Servicing contracts

The servicing contract must be structured based on the elements of the operation, considering the expected recovery rate for the different clusters of loans, the expected recovery times, the duration of the mandate, and the definition of the delegations assigned to the Servicer. The tariff structure defined in the contract, which typically includes both variable and fixed commissions, is of considerable importance.

The variable commissions aim to incentivize the servicer to optimize activities, thereby maximizing recovery rates and minimizing recovery times. These commissions are often structured as success fees and are paid only if the servicer achieves a recovery rate exceeding predefined thresholds stipulated in the contract. To establish an appropriate commission structure, it is necessary to conduct a preliminary due diligence activity on the NPL portfolio subject to the contract and to cluster the positions based on variables determining the expected recovery (such as size, type, collateral, etc.).

The commission structure, specifically in its variable component, must take into account the regulatory limits to avoid potential distortive incentives that may encourage undesirable behavior by individuals who have direct contact with debtors. Fixed commissions are usually determined based on the size and volume of the credit portfolio entrusted for management. These commissions should be designed to remunerate the agency for the costs incurred in structuring the operation (such as those necessary to define the IT architecture that must interface with the bank's information system, the costs associated with data transfer, documentation management, etc.).

4. The Debt Collection Process

The profitability of debt collection agencies hinges on their ability to maximize recoveries of managed accounts in the shortest possible time, while incurring the lowest possible costs associated with attempting to collect from borrowers who lack the means to repay their debt. Modern systems utilize Markov models to track the progression of delinquency, allowing for a statistical cost-benefit analysis of debt collection strategies at specific times and in specific ways. This approach is commonly referred to in the industry as segmentation and prioritization.
The use of IT in debt collection has been associated with major savings and large gains in efficiency (Makuch et al., 1992). (Chin and Kotak, 2006).
The approach to debt recovery varies significantly depending on whether the positions are secured or unsecured. In managing secured positions, the focus is on the asset pledged as collateral, which needs to be assessed, valued, and marketed.
Immediately after the servicer takes over, all activities related to gathering information are carried out to appropriately route the distressed position towards the most suitable management method, either extrajudicial or judicial.
Regarding the management of unsecured NPLs, especially small accounts, the process is typically mass and standardized. Extrajudicial management primarily involves initiating debt recovery through the debtor's signing of promissory notes or voluntary repayment plans. These activities are usually

conducted by phone and home collections to attempt partial recovery of the owed amount without resorting to legal procedures.
Judicial management is typically initiated when extrajudicial efforts fail to reach an agreement and when the expected recovery justifies the legal costs. This process aims to execute movable assets at the debtor's premises or through third parties and involves several legal steps to obtain an enforceable title, including obtaining an injunction, precept, movable property seizure, and, in the case of third-party seizure, an assignment order.

Typical costs associated with debt recovery via collectors include salaries, commissions, and operational and infrastructure expenses (e.g., electricity, office space, furniture, desktop equipment and support, phone equipment and support, personnel and accounting services). Salaries and commissions are necessary not only for the act of collecting debt but also for investigating the borrower and assessing their ability to pay.

Debt collection is usually carried out by entities that did not originally extend the credit but instead purchase the debt for a specific amount. These entities operate exclusively for debt collection and are subject to particular rights and restrictions. When these entities attempt to collect a debt, the delinquency period is critical as interest fees and penalties accumulate, increasing the debt amount. However, the likelihood of successful recovery diminishes over time. A significant portion of debt may become legally unrecoverable, or "out of statute," after seven years. Therefore, contacting debtors and settling accounts must be done within specified time frames. Additionally, debt buyers and sellers may not actively pursue accounts during the purchase, holding, and sale processes of a debt portfolio, further complicating timely recovery efforts.

A structured approach could ensure efficient handling of debt resolution processes, leveraging technology to enhance communication, data analysis, and personalized financial solutions for debtors based on their credit profiles. The process can be explained in sequential phases:

1. Communication: this phase initiates the process by transmitting a communication to the debtor, prompting them to contact the server arrangement through various communication channels available. One significant challenge in debt collection today is the frequent changes in contact information, which complicate the process of reaching debtors effectively.
2. Credit Information Seeking: upon the debtor's contact arrangement with the servicer, it is necessary to retrieve the debtor's credit history information.
3. Rules-Based Engine: by utilizing rules established by the creditor, this engine analyzes the obtained debtor debt account information. It extracts pertinent data aligned with the established rules to determine multiple tailored transaction settlement offers specifically designed for the debtor, taking into account the debtor's creditworthiness.
4. Memory Storage: the apparatus includes a memory component to store information pertaining to the debt transaction and the rules applied by the rules-based engine.
5. Offer Provision: the servicer arrangement delivers the customized transaction settlement offers to guide the debtor towards resolving the transaction based on the rules and the debtor's creditworthiness.
6. Credit Score Impact Estimate: additionally, a model could estimate the debtor's credit score and could potentially increase chances of resolution of the debt transaction. This estimate is provided to the debtor, offering insight into the positive impact on their creditworthiness.

The Debt Recovery Service Market is brimming with opportunities, driven by technological advancements. Harnessing data analytics and artificial intelligence for predictive modeling and risk

assessment offers a remarkable chance to significantly improve the efficiency of debt recovery processes.

5. Unlawful practices in debt collection

Effective debt collection requires debt collectors to be familiar with the economic circumstances of the borrower, which is one of the reasons why the debt collection industry is geographically disperse and consists mostly of small firms.
The collection process is a human-intensive effort that requires debt collectors to constantly communicate with borrowers. As described earlier, this communication is usually established over the telephone and by mail, or by face-to-face contact.
Most debt collection agencies work on commission, in which case, they return net proceeds to the original creditors and retain a collection fee proportionate to the collected amount. Therefore, they have incentives to be persistent. Being persistent is not illegal, unless debt collectors violate the law. Examples of debt collectors using unlawful practices are not uncommon; however, it is hard to establish their frequency relative to the total volume of the debt collection activity. At the same time, the large number of consumer complaints and lawsuits against debt collectors implies that the instance of illegal practices is not trivial.

6. A Market Insight into Collection Servicers in Europe

The need to deal with NPLs to ensure financial stability as a consequence of the 2008 financial crisis became particularly acute across Europe. While until 2008 the NPL ratios to total loans stood at manageable levels, the crisis seriously jeopardized lenders' financial statements and underlined their inadequacy in dealing with distressed debt. As a matter of fact, the NPL ratio had reached 8% in the Europe area in 2014 for a total amount of 1 trillion euros, the highest level reported since the sovereign crisis. In response, the European Banking Authority (EBA) issued guidelines as a first step to account for the change in accounting practices for loan loss provisions and the launch of a comprehensive Council Action Plan on NPL for the purpose of reducing existing distressed receivables as well as preventing the build-up of new distressed assets. The action plan proposed measures in three areas: on supervision, on the development of secondary markets, and on the reform of insolvency frameworks, most of which were already in place by 2019. Specifically with regards to the development of secondary markets, sales and securitisations were a key driver of their reduction in Member states; leaving aside regulations that dealt with securitisations (i.e. Regulations EU 2401/2017 and 2402/2017) the new Directive on Credit Servicers and Purchasers (Directive EU 2021/2167), which entered into force in 2021, introduces the regulation and supervision of credit servicers, including a regulatory passport to operate across the EU, while ensuring a consistent level of consumer protection. The latter point is important since the Directive also applies to NPLs of retail consumers, who need to be protected consistently and with high standards in the entire EU. As a result of all the actions taken by supervisors and regulators, the NPL ratio continued decreasing since 2014; in December 2022, according to the latest EBA figures, EU banks showed a ratio of NPLs of 1.8% of total loans.

The European market for debt collection and management services originated in the Nordic countries in the 1990's as a result of the real estate and banking countries; indeed, some of the largest European Debt Collection Agencies (DCA's) such as Intrum and Lindorff are headquartered in the Nordics with branches throughout Europe. The 2008-2010 financial crisis fostered the development of the servicers industry in the UK, in Spain and Italy.

Quite often, especially in the past, debt collection has come along with malpractices put into place to recover amounts due; this has happened, and still happens, across many European countries. A recent report by Finance Watch shines a light on how sometimes such malpractices tragically worsen the cycle of personal over-indebtedness, leaving consumers vulnerable to harassment, abuse, privacy

violations, as quite often debt collectors make use of deceptive, aggressive and obscene language and misleading representations. Indeed, debtors sometimes confront personal bankruptcy, social and financial exclusion, public shame, family or relationship hardship or psychological issues while, at the same time, creditors deal with business disruptions and insolvency; this might lead them to engage in abusive practices in order to maximize collection (Stanescu, 2021). The Finance Watch report therefore highlighted a vacuum in European legislation and the need to enhance consumer protection.

Directive 2167/2021 is therefore meant to regulate debt collection across Europe in order to protect consumers from aggressive collectors, although abuses still occur. Debt collectors who violate the rules can be sued. Article 10 of the Directive provides that, in the relationship with borrowers, credit servicers should:

- act in good faith, fairly and professionally;
- provide information that is not unclear, false or misleading;
- respect and protect privacy and personal information of borrowers;
- communicate in a way that does not constitute harassment, coercion or undue influence.

Further provisions of the Directive concern transparency. The credit servicer should provide the borrower, by a durable medium, with all information related to the purchaser of the receivables and to the purchase agreement, including contact details. Also, a breakdown of the amount due by capital, interest, fees and other permitted charges shall be produced and delivered to the borrower. The above communication shall be written in a clear and understandable language.

The infringement of provisions in article 10 is liable to administrative penalties and remediation actions by the national supervisory authorities. Most importantly, in transposing the Directive into national legislation, all Member States should ensure that the competent authorities are given all supervisory, investigatory and sanctioning powers, necessary for the exercise of the functions and duties set forth in the Directive,

Hence, the Directive imposes constrains on third-party debt collection firms, by *de facto* declaring certain debt collection practices unlawful and in some cases may constitute a criminal offense. Such restrictions, in those countries where similar legislation is already in place, make it more difficult for third-party debt collectors to operate and this has led to a reduction in their number (Viktar, 2020).

7. The Debt Collection Industry in Italy

The activities carried out by debt recovery services are particularly crucial in certain countries where, due to inefficient legal systems, it is particularly difficult and costly to recover defaulted credits. Notably, the Italian justice system is very inefficient, and the excessive length of civil proceedings has a significant impact on businesses, potential investors and economic growth. The legal literature on the subject quantifies the impact of this inefficiency on the country's GDP at around 1%. Based on data from the 2022 Justice Scoreboard, the estimated time needed to settle legal disputes varies considerably by country. Amongst the 23 member states with data available this time ranges from just over 100 days in Lithuania, to almost 700 days in Italy. The estimated time exceeds 200 days in 12 countries. For this reason, Italy stands out as the European country where debt collection has reached its greatest scale.

Italian debt collection agencies are ruled by specific regulations that depend upon the type of license obtained. A license granted pursuant to article 106 of the Italian Consolidated Law on Banking (Legislative Decree 385 of September 1993) allows financial intermediaries to perform acquisition and servicing of assets and to be registered as a Master Servicer, holding all legal and accounting responsibilities versus supervisors and regulators. A license granted under article 115 of the

Consolidated Law on Public Security (TULPS) allows firms to execute debt collection activities on behalf of third parties (including a Master Servicer) and to purchase receivables, pursuant to article 2.b of the Ministerial Decree 53/2015. Lastly, debt collection agencies can hold a license under article 134 of the Consolidated Law on Public Security, which allows firms to detect and provide information on debtors. Debt Collection Agencies may hold one or more of the licenses mentioned above.

The method of disposing of overdue debt is influenced by the requirements and balance sheet strategies of debt originators. In the wake of the financial crisis, there was an urgent necessity for financial institutions to rapidly reduce leverage on their balance sheets, resulting in the sale of NPLs through substantial one-time transactions. Over the last 15 years, as banks have systematically reduced their leverage and regulatory bodies have enforced stricter lending standards, the proportion of delinquent or non-performing loans has significantly declined from the peaks observed in 2008.

Presently, the European Banking Authority (EBA) recommends maintaining a non-performing loan (NPL) ratio below 5% to ensure a bank's balance sheet remains robust. Should this threshold be exceeded, it is advised that banks formulate a strategy to reduce NPLs. European banks now have an average NPL ratio of around 1.8%, significantly below the EBA's recommended limit.

The gross NPL ratio in Italy, on the other hand, has slumped from 17% in 2015 to 2.8% as at December 2023 (CEIC data, 2024). Despite the contraction in the NPL ratio, however, there still remain 306 bn as at December 2022 (Banca IFIS, 2023) of outstanding non performing loans to be processed in future years in Italy.

This study provides an insight into the evolution of the Italian distressed asset management industry from 2019 to 2023 and its future developments, based on the data provided by the annual UNIREC (the Italian association of the most representative 142 debt collection agencies, accounting for approximately 71% of the total industry turnover) reports.

The UNIREC surveys make a distinction between the following types of collection firms:

- *Own account (OA)*, where the originator is also in charge of collection;
- *Third Party Account (TPA),* which in turn can be:
    - *Originator,* when the third party collection agency acts on behalf of the originator;
    - *Purchaser,* where the third party collection agency acts on behalf of the purchaser. This category includes *Servicers and Subservicers*.

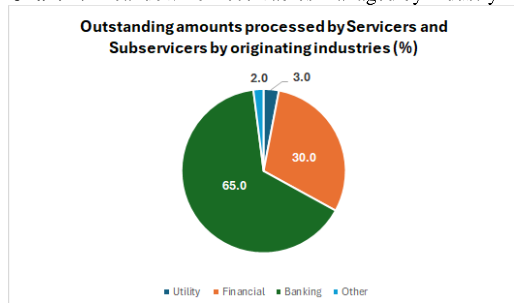
In the first place, the analysis of UNIREC data highlights the consolidation process under way within the Italian credit servicing industry, with the number of debt collection agencies declining to 1,031 in 2023 from over 1,300 in 2017, the size of which is very diverse depending upon the underlying business model.

If we consider the entire distressed receivables industry, total revenues were in the amount of € 2.3bn as at the end of 2022, with a CAGR (Compound Annual Growth Rate) of 10% over the previous five years (revenues soared by 42% between 2020 and 2021). It should also be noted that 90% of the total industry revenues are only produced by 15% of the debt collection agencies operating on the Italian market.

A review of the industry profitability shows evidence of an overall EBITDA rate of 17.0% in 2023, bearing witness to the high overall profitability of the credit collection industry in Italy; the EBITDA rate has now reached the pre-pandemic levels. The EBITDA is affected by the size of the collection agency; as a matter of fact, in 2023, the rate ranges from 20% for larger debt collection agencies (turnover above € 20mln) to a mere 8.3% for smallest servicers (below € 1mln turnover). Average

fees earned per processed account by TPAs in 2023 were 4.1%, a percentage that varies widely according to the type of Servicers: while *Originator TPA's* fees were 2.8%, *Servicers'* and *Subservicers'* fees were 8.4%, a figure that once again confirms the higher profitability of the credit collection services provided by *Purchaser TPAs*.

Chart 1: Breakdown of receivables managed by industry



Source: *Our estimates based on the XIV UNIREC Annual Report, 2023*

As illustrated Chart 1, the banking industry is by far the most relevant in terms of outstanding amount, since it originates 75.5mln (65.0%) of the € 116,1mln of distressed asset managed by *Servicers* and *Subservicers*. Financial services account for 30%, with € 34.9mln managed, while the remaining 5% stem from the Utilities and Other (i.e Insurance, etc.) industries.

The total number of accounts processed in 2023 by the DCA's that are members of UNIREC were 37mln (70% by *Originator TPAs* and 30% by *Purchaser TPAs*), down 15% as compared to 2022 (43.8 million). The number of recovered accounts was 13.7mln (37% of accounts processed), up 6% against 2022, 89% of all recovered accounts were collected by *Originator TPAs*, while the remainder 11% was collected by *Servicers* and *Subservicers*.

Table 1: Summary of accounts and amounts under management and recovery rates in Italy by DCAs

NUMBER AND AMOUNTS OF ACCOUNTS PROCESSED		# OF ACCOUNTS (MLN)			OUTSTANDING AMT (€ BN)		
		2022	2023	% Variance	2022	2023	% Variance
Own Account		10.1	10.3	2.0	41.4	30.4	-26.6
Third Party Account	Processed	43.8	37.0	-15.5	158.4	173.9	9.8
	Recovered	12.9	13.7	6.2	15.6	17.2	10.3
	Recovery rate	***29.5%***	***37.0%***	***25.7***	***9.8%***	***9.9%***	***0.4***
- Originator TPAs	Processed	28.0	25.9	-7.5	53	57.7	8.9
	Recovered	11.3	12.2	8.0	12.2	13.3	9.0
	Recovery rate	***40.4%***	***47.1%***	***16.7***	***23.0%***	***23.1%***	***0.1***
- Purchaser TPAs	Processed	15.8	11.1	-29.7	105.4	116.2	10.2
	Recovered	1.6	1.5	-6.3	3.4	3.9	14.7
	Recovery rate	***10.1%***	***13.5%***	***33.4***	***3.2%***	***3.4%***	***4.0***

Source : Our estimates based on *XIV UNIREC Annual Report* - 2023

Specifically with regards to *Servicers* and *Subservicers* (i.e. *Purchaser TPA's*), the vast majority of processed accounts stems from the Utility industry (42% out of a total 11.1 million accounts in 2023), followed by financial services (31%) and banking (26%).

If we look at the outstanding amount of € 174bn of distressed receivables processed in 2023 by all TPAs, the weighted average success rate stays stable at about 10% (€ 17bn recovered), a figure that reaches a peak with *Originator TPAs* (23%) and a low in the case of *Purchaser TPAs* (3.4%). Such success rate has proved to be stable over the past 6 years.

The average outstanding amount per distressed account processed is quite different according to the type of industry and collection business model. Overall, the average amount per account in 2023 was € 4,696, up 19% against 2022. The average account size for *Servicers* and *Subservicers* rose to € 10,486.

Debt Collection Agencies may implement one or more of the following business models for their collection activity:

- *phone collection*, where the agency contacts debtors by phone/email;
- *home collection*, in which case the agency pays visit to the debtor;
- *master legal*, which involves legal proceedings.

The judicial management recovery activities account for 42% of outstanding amounts under collection in 2023, (average account size of € 36,460), while extra-judicial activities account for the remaining 58%, of which home collection stands at 27% and phone collection at 31% of outstanding amounts (average account size at € 7,186 and € 1,871, respectively). As regards collection via judicial practices, it should be noted that the slowness of legal proceedings in Italy dramatically contributes to low recovery rates, for this reason, judicial management is only activated eventually.

As a final remark, it appears that despite the 10% annual growth in the debt collection industry's turnover over the past five years, significant further boosts to *Servicers'* and *Subservicers'* profitability could stem from IT investments aimed at alleviating informational asymmetries on borrowers and streamlining the collection process. However, the amount of capital expenses required, in addition to the potential legislative constraints that are expected to fall upon DCAs, could bring about further industry consolidation.

8. Best Practices in Debt Collection

Back in 2017, way before the approval by the EU Parliament of Directive 2021/2167 UNIREC, the largest Italian association of DCAs, together with the biggest consumers' associations, had set forth a Code of Conduct that all of its associate must comply with in the course of their credit collection activities. Such Code constitutes one of the most exemplary self co-regulation by the credit collection industry throughout Italy and across Europe. The Code of Conduct has been granted numerous awards in different European countries and has been identified as a reference ethics code by the European Federation of Credit Collection Servicer in drafting the new Pan-european Code of Conduct.

The obligations set forth by Article 10 of the Directive seem to be in line with UNIREC's Code of Conduct: in addition, the Code provides specific indications on how to communicate with borrowers and on the information to be provided both in written communication and in face-to-face meetings. Specifically with regards to written communication, the Code of Conduct provides that:

- in all emails and letters by which payment is requested, detailed description of the amount due must be provided;
- the servicer must clearly and correctly describe the consequences of further payment delay;
- all payment details should be accurately provided;
- a gentle reminder clause should be written in all communication stating that *"in case payment has already been settled, please ignore this notice and, only for the purpose of accounting registration and to avoid further insolvency communication, please provide evidence of the payment made"*;
- no threats of legal actions should be unduly reported;
- payment terms should be at least 10 days.

With regards to face-to-face meetings, the Code of Conduct requires debt collectors to act professionally and respectfully, avoiding harassing or coercive behavior, and to collaborate with borrower to identify an acceptable path to collect all payments due.
The Code of Conduct also lays down week days and hours on which the borrower can be contacted by phone.

9. Conclusions

The traditional methods of collection and recovery are no longer adequate in today's rapidly evolving landscape. Customers now utilize a plethora of channels for borrowing, paying, and communication, spanning across numerous devices. Moreover, customers often hold multiple debts or credit obligations with various institutions, which complicates the process of collection and recovery.

Instead, a comprehensive, technology-driven, and multichannel approach is essential at every stage of the credit cycle, from origination to write-off. Data serves as the cornerstone for modernizing collections and recovery efforts.

Debt collection servicers' profitability can be enhanced by massive IT investments aimed at alleviating informational asymmetries and at enabling lenders to focus collection efforts on delinquent borrowers who are statistically more likely to repay, thus reducing collection costs at the same time. Further profitability improvements can stem from innovative borrower-information gathering technologies, such as Internet-based skiptracing, predictive dialers, speech analytic software, by also using artificial intelligence tools.
By implementing the appropriate systems, processes, and practices, collection departments can gain deeper insights into customer behaviors, risk profiles, revenue opportunities, as well as enhance their own efficiency and performance.

Specifically with regards to the Italian credit collection industry, it has been a bonanza over the most recent six years with a CAGR of 10% per annum, also in the aftermath of the 2008 financial crisis and the COVID 19 pandemic. However, the slump in NPL banking ratios from over 17% in 2015 to a mere 2.8% in 2024, emerging legislative constraints imposed on the DCA's collection process, combined with macroeconomic uncertainties, pose new threats to the collection industry that, albeit it confirms its vital role as a key element in the credit collection cycle, now needs to restructure in order to face up to the challenges ahead.

The adoption of the Directive on Credit Servicers and Purchasers (Directive EU 2021/2167) Europe-wide will certainly bear an impact on the collection industry. However, as a result of the Code of Conduct already implemented by Italian credit servicers since 2017 for a more effective protection of borrowers, any impact on their operations should be very limited.

Still, the consequences of the highest market pressure due to the reduction in outstanding amounts of non performing loans shall force credit servicers into operational strategies aimed at improving their efficiency and effectiveness in the collection activity, via IT investments, process improvements, new technologies. The substantial IT capital expenses required, however, may not be borne by smaller firms and might lead to further industry consolidation, to the benefit of bigger and better structured servicers.

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