Choosing the Right Debt Buyer

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As bad debt continues to rise in the healthcare industry threatening already slim profit margins, hospitals and health systems are searching for options that bring more dollars to the bottom line. Increasingly, providers are finding that one very practical solution is selling their bad debt.

Generally, when a hospital chooses to sell its bad debt, the decision is not one made quickly, but comes after much careful consideration and attempts to collect the debt have been exhausted. Once the decision to sell is made, it's natural for a provider to feel relief at the thought that, after perhaps years of uncollected revenue, the accounts will finally turn into cash.

Not so fast, notes attorney Leslie Bender. The debt selling process in the healthcare industry is far from simply turning over accounts and receiving a check. That transaction is only the start of an arrangement that, just like any relationship, can sour very quickly should the wrong partner be chosen. Success in the debt selling process, therefore, depends on the buyer, or partner, that is chosen to take over the debt. For the hospital or health system, the buyer can be the reason for a smooth process or the source of complaints regarding unwarranted collections practices.

"The manner in which the portfolio is serviced post sale could have a dramatic impact on the hospital," says Bender, CIPP, a Timonium, Md.-based attorney who often represents sellers in such transactions. "Relationships with patients are ongoing, so it is especially important that a hospital sells to someone who shares its philosophy on collection practices and will act in a way that supports its reputation in the community."

Of course, paving the way for a successful relationship only begins with finding a qualified buyer.

Put Them to the Test!

Hospitals working with a debt purchaser for the first time often will select one or two blocks of debt to start. If the experience is successful, then they will consider expanding the program to all debt of a certain age. This way, the hospital can test the relationship and examine the effects, if any, that the strategy will have on its business office, such as changes in patient call volume.

The provider must also structure a fair contractual agreement and institute a monitoring process to gauge how well the relationship is going. In the end, how much due diligence the hospital or health system has put into choosing its partner, along with its efforts in building a solid partnership, often will mean the difference between success and failure. So while being choosy may lengthen the selection process for finding a debt buyer, it's also the key to making sure a provider finds the right one.

Setting the Criteria

It may sound basic, but the No. 1 criterion for selecting a debt purchaser should be experience with buying healthcare debt. Asset purchasers may have stellar records with other kinds of debt, but health care is a unique area that requires sensitive techniques because the service that was performed was so personal.

"Healthcare receivables are very idiosyncratic as compared with credit card or automobile charge offs or other types of financial portfolio classes," says Bender. "I think it would be foolish to believe that somebody who is great at collecting and servicing credit card portfolios will necessarily have a similar business skill in collecting healthcare receivables."

Bender says that buyers that don't have experience in health care should be crossed off the provider's list of candidates because the risk of damaging a hospital's reputation through inappropriate collection practices is too high. Accounts that are sold in a bad debt transaction traditionally are very old, and this can present problems from patients who may question being contacted perhaps several years after receiving the service.

In addition to healthcare experience, another criterion commonly used when selecting debt buyers includes involvement in both the debt buying and healthcare professional associations, says attorney Barbara Sinsley, with Barron, Newburger, Sinsley & Wier, PLLC, and general counsel for DBA International, a debt buyers association based in McLean, Va.

Along with being a member of DBA, Sinsley recommends debt buyers belong to ACA International, a Minneapolis-based association of credit and collections professionals, along with local and national healthcare trade associations. "Having this background is a good start," she says.

A long list of criteria for a qualified buyer, in fact, can be found within the statement of principles and guidelines for the collection, purchase, and sale of healthcare debt, developed by ACA International.

"It's a wonderful tool for the hospital to use when determining if the particular asset buyer matches the culture of the particular healthcare provider," says Rozanne Andersen, executive vice president and general counsel for ACA.

The principles and guidelines were developed by ACA with the support of the American Hospital Association and the Healthcare Financial Management Association in order to identify and address key concerns of those providers contemplating the sale of healthcare debt and to clarify the roles of all parties to the debt-sale transaction, Andersen says. The guidelines include voluntary practices designed to support fair collection and payment practices for ACA debt buyer and collections agency members to follow.

The guidelines, for example, state that debt purchasers should abide by such regulations as the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, and the Health Insurance Portability and Accountability Act of 1996 [HIPAA], in addition to state requirements for charity care and consumer protection laws. The statement also addresses such business relationship issues involving reselling of the debt and operational issues such as maintaining a quality assurance program.

Buyers should have particular acumen regarding the importance of complying with HIPAA, Andersen says. Some buyers of healthcare debt even go so far as requiring their collection employees to complete special training offered through ACA International for the collection and servicing of healthcare debt that discusses compliant activities because it is such a sensitive area, she says.

Know What You're Selling

Remember that successful selling of hospital debt truly begins with choosing the right portfolio. Optimal candidates for sale typically are "warehoused" accounts, or those that have made their way through an internal process and one or more collections agencies and are not receiving much, if any, attention. Avoid sale of receivables that may have inaccurate patient data due to age or that have not been appropriately "scrubbed" to remove accounts of those to whom collection communications would be inappropriate, such as patients who have declared bankruptcy, are deceased or incarcerated, or are eligible for charity care. It also is in the best interest of the hospital to retain those accounts where a payment plan with the hospital or agency has been arranged or where the hospital or its agency has filed a complaint in a court of law. Reputable debt buyers often are willing to work with the hospital on identifying accounts suitable for sale.

What to Expect from the Buyer

Once a hospital or health system has established its criteria for a debt purchaser, it can produce a request for proposal. One of the requests will be for the prospective buyers to value the accounts the hospital wishes to sell. "The value of the accounts often depends on the age of the accounts, the accuracy and completeness of the patient records or documentation associated with those accounts (subject to the limitations imposed by HIPAA), and the willingness of the provider to release such information and documentation to the seller. This is important for the seller of healthcare receivables to understand because the more documentation regarding a debt that the healthcare provider can provide, the more likely it is the debt will be collected," Andersen says. "Documentation is a very important part of the discussion between the healthcare provider and the asset buyer when they are negotiating the sale."

Andersen says it is common for a buyer to work with a provider, especially one with little experience in selling receivables, to help identify those accounts suitable for sale. "Providers may consider the asset buyer as an informal partner at the front end," she says, adding that more experienced sellers can make their own determination of those accounts appropriate for sale.

Buyers should have a standard way to request data elements regarding the prospective portfolio to be sold, and they should be able to run some reasonable analytics against the portfolio characteristics in order to be able to value the accounts, says Leslie Bender. Buyers should also be able to provide some explanation for how they price the portfolio and expect it to liquidate, along with their strategies for receiving payment.

Providers need to be particularly concerned with how prospective buyers intend to handle the accounts, Bender adds—for example, whether they will service the accounts internally or hand them over to another firm for collection, or even whether they intend on flipping the portfolio and selling the accounts outright. In the latter situation, the buyer wouldn't have the same concerns about the collections process as it would if it kept ownership of the accounts itself. Bender says there have been a number of transactions where she believes the seller thought it was receiving such an advantageous deal, but it didn't realize that the portfolio wasn't going to be held by the buyer.

"If a buyer is simply acting as a broker, then it can potentially lead the seller in the same position as having done no due diligence on the buyer," says Bender, noting that these kinds of transactions should be avoided.

On the other hand, selling to a buyer who is going to use a service company is not necessarily reason for unease, providing the servicer has experience in healthcare collections. "If the prospective buyer comes to you with a team of competent people with healthcare experience in place, then I wouldn't be concerned that an investing buyer was a problem," Bender says. "But if someone comes to you and is planning to sort it out after the deal closes, then that is reason to take pause."

Whose Offer Is Best?

In addition to price, criteria when evaluating bids should include the buyer's willingess to accept contractual allowances granting the hospital necessary control. No matter the arrangement, the purchase and sale contract should specify the collection methods allowed by the debt buyer, such as whether the buyer can place liens or send accounts to a credit-reporting bureau, and how the buyer will respond to questions from patients regarding the accounts.

Structuring the Contract

Most purchase and sale contracts between providers and buyers of their bad debt include a business associate agreement. The buyer maintains a direct relationship with the hospital for a period of time and is acting on behalf of the hospital, so the collections process is subject to the HIPAA privacy rules.

Some transactions may be structured where the information that passes between the buyer and seller is more limited. There is also no ongoing relationship once the sale has occurred. Although such arrangements are still subject to HIPAA, Bender says they're not recommended because the provider has no control over the accounts once they've been sold.

In some cases, however, a hospital may simply not have the resources to oversee a relationship with its buyer, "In which case they would have to be extra careful that under absolutely no circumstances would the buyer ever be able to come back to the seller to traipse through medical records to obtain additional data," Bender says.

The principal concern of the hospital in a business associate arrangement, therefore, is maintaining an appropriate amount of control within the relationship, in terms of the accounts that have been sold, the types of collections methods that will be allowed, and the ability to terminate the relationship if necessary. These points should be addressed specifically in the contract.

Also, the contract should include language that addresses how the portfolio will be serviced (whether internally or externally) and whether accounts can be resold to another buyer. The provider should also maintain the authority to repurchase accounts. For example, if accounts that shouldn't have been sold were unintentionally included in the portfolio or if there are problems with the way the accounts are being serviced, the provider will want to ensure the right to buy back those accounts at a predetermined value, Bender says.

In addition, the contract should explain a buyer's collection practices, in terms of how a debtor will be contacted and how payment will be received, and the process for handling issues. For example, if there is an incident that affects a debtor's privacy or if a debtor requests information on the healthcare service that was provided, then there should be a certain time frame in which the buyer must notify the provider, Bender says.

The provider also may want to specifically identify those methods that may or may not be used by the asset buyer or its servicer. For example, the contract may state whether the buyer can initiate litigation or garnishment of wages. It is important to note, however, that the number and degree of restrictions on collection methods can affect the value of the portfolio. Providers need to balance controls that align with the organization's collection practices with the pricing for the portfolio.

Obtaining a higher percentage of revenue for your receivables isn't always of top interest, notes Drew Pallas, CFO of New Island Hospital, Bethpage, N.Y. The 223-bed community hospital sold $7.7 million worth of its aged receivables for the first time this past summer.

"If an organization chooses to sell its receivables outright and let the agency have little restriction in collection tactics—allowing the purchaser to affect debtors' credit reports or even take them to court—then it will get a much higher percentage than organizations that restrict these activities because the collectability of the accounts is easier," notes Pallas.

New Island Hospital restricted such collection methods from its purchaser, and so the organization settled for a lower percentage on the dollar for its receivables. Pallas notes that it was very important for his organization to be sure the contract restricted the buyer from allowing legal proceedings unless given hospital approval.

Monitoring the Collections Process

Although hammering out a thorough contract is critical, it is just as important to follow up on the sale with specific controls to help ensure that the relationship is working as it was intended to by contract.

"I think where things can really go wrong is if a seller has the perception from the day the transaction closes that it will have no further worries or cares about what occurs with the portfolio," Bender says. "It's risky to think of it as a cut-and-run transaction."

Hospitals may request periodic reports (often monthly or quarterly) detailing any disputes that arise with patients, for instance. Providers may want to review any form letters or other forms of written communication used in the collections process, as well.

Principles and Guidelines for Successful Debt Sales

What can the hospital and debt purchaser expect from one another? See **www.acainternational.org** for principles and guidelines that identify and address key concerns of those providers contemplating the sale of healthcare debt and clarify the roles of all parties to the debt-sale transaction. The principles and guidelines were developed by ACA International, the Association of Credit and Collection Professionals, with the support of the American Hospital Association and the Healthcare Financial Management Association.

Rozanne Andersen points out that any controls designed to monitor the relationship should not be overly burdensome such that the oversight unreasonably drives up the cost of collecting the receivables. "The controls simply need to be reasonable," she says.

Barbara Sinsley suggests conducting audits of the buyer's collections practices, specifically with regard to complying with HIPAA regulations and testing the security of the information technology system. She says an experienced compliance staff knowledgeable of HIPAA rules can perform the audit; otherwise, an external auditor can be used.

Some fairly obvious warning signs that the collections process is not going so smoothly include a high volume of consumer complaints either directly to the hospital, the state attorney general's office, or the Better Business Bureau. Complaints by themselves, however, don't necessarily mean that the buyer's collections practices are inappropriate; they may simply represent consumers who are angry about receiving notices for their unpaid bills.

"Frequently, patient concerns are labeled as complaints when in fact the patient is simply making an inquiry about his or her bill, payment history, or rights under the law. In the healthcare debt sale space, a common question posed by patients may be as basic as: 'Why is somebody else collecting my debt? Why isn't the hospital collecting my debt?'" says Andersen.

"Debt collector communications are by definition fraught with emotion and anxiety from the perspective of the patient," she adds. "As such, there may be a host of reasons, unrelated to the debt collection process, that may drive a patient to the point of frustration and to consequently file a complaint. Those complaints do not necessarily mean that a law violation occurred or that there is even a problem. The solution is to retain debt collection companies to collect purchased healthcare debt that understand the delicate nature of the healthcare collection process."

Words of Wisdom

Because hospitals provide such necessary and personal services for their patients, they must take more steps than other kinds of organizations would to ensure that any debt-selling transaction is not only financially successful, but also publicly acceptable. Even though a transaction may bring in immediate cash, in the long run the results may negatively affect revenue if improper collection practices harm a hospital's reputation. Hospitals must both do more to construct a good transaction and expect more from a buyer, which is ultimately seen as a long-term partner.

Providers should especially concentrate in the areas of performing due diligence on the buyer and ensuring HIPAA and charity care regulations will be followed.

For example, Sinsley says, providers should make on-site visits to the prospective buyer's facility to see for themselves how that candidate conducts business. "Ask questions, look at the compliance procedures in place, look at the information technology safety and security procedures, and ask about any prior complaints or lawsuits," she says.

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Sinsley also suggests inviting the prospective buyer to the provider's facility to see how the business office is run and how collections are handled. All collectors should be cognizant of the culture of the organization for which they are collecting debt—its mission, tax-exempt status, position within the community, and commitment to its patient population. It is incumbent on the debt collector to understand the healthcare provider's culture and attitude about its patients in order to carry that through to the collection conversation. "Basically, you want to ensure a certain level of alignment around management of the receivables. Visits to both facilities help each party understand how the other's approach works," she says.

For smaller hospitals with fewer resources, New Island Hospital's Drew Pallas advocates the use of an auction when selecting a buyer. When trying to choose a collection agency, for example, Pallas says he visited the company, but felt he really couldn't make educated judgments about what he saw. "I couldn't get into the nuts and bolts of exactly what they were doing and how well they were doing it," he says.

In the auction process, providers give out information on their accounts, which prospective buyers use to value those accounts and then bid on them. A company that acts as the "auctioneer" vets the prospective buyers. The highest bidder able to meet the particular requirements wins. "Coming from a small hospital, I don't have the resources to be able to vet a large number of competing purchasers like that," he says. "Some of the bigger hospitals that have appropriate types of resources can actually accomplish this process on their own."

Because patient privacy is such a sensitive area and one where hospitals can face substantial fines or other serious consequences for violating rules, providers should also make sure their debt buyers have a solid understanding of HIPAA regulations. One requirement, for instance, is that buyers of bad debt notify the provider of certain situations, such as when a debtor requests an amendment to his or her healthcare record.

Finally, providers should be particularly careful about determining who is going to be responsible for sharing information about charity care programs with the patient-debtor, says Andersen. Some states have laws that govern

OUR SPONSOR SPEAKS

Understanding the Sale Environment

Jim Richards, CEO and president, Capio Partners, Deluth, Ga., describes the role of debt sale in a hospital's receivables management strategy and ways to position the organization for a successful transaction.

Q Why is sale becoming a part of so many hospitals' receivables management strategies?

A Rising self-pay activity is leading to increasing bad debt, and many hospitals simply don't have the resources to effectively manage the complexity and sheer number of these accounts. Selling aged receivables—usually one to five years old—provides immediate cash flow and a clear end to the hospital's revenue cycle management activities. Such immediate cash flow is becoming particularly important as the economic times continue to squeeze hospitals' budgets and resources.

It's also important to note that aged receivables that make their way to sale typically have already been through the hospital's internal process and one or more collection agencies and are not receiving much, if any, attention. So by pursuing this option, many hospitals are able to realize greater revenue than they would have been able to receive from these accounts over time. It is revenue that is, in essence, "found money."

Q What are some key issues hospitals should discuss with debt purchasing companies to improve their understanding of the processes and best position themselves for a successful transaction?

A Good buyers should be willing to walk you through the process and answer your questions. Just a few key aspects relating to process that we typically discuss include:

- Goals for the relationship among hospital, debt buyer, and patient
- Ways the sale may result in reduction or reassignment of human resources for the hospital
- An analytical breakdown of the portfolio and how value is determined
- Types of arrangements (one-time sale versus forward-flow options) and how they work
- Contractual obligations

With such information, hospitals are best empowered to make a sales decision. It also affords them the comfort of knowing that the company buying the debt understands that the patient is to be handled with the same patient-centered culture as the hospital.

Q Overall, what is the most important thing hospitals should look for in a buyer?

A The most important thing a hospital executive can do is to choose a buyer that understands the culture of a healthcare provider and its patients and the provider's unique collection philosophy.

The buyer must understand that healthcare receivables are different than other types of bad debt. This is partially due to the fact that healthcare debt is not voluntarily incurred, as opposed to credit card, automobile charge-offs, and other types of financial portfolio classes. The value of an experienced healthcare debt purchaser cannot be overlooked.

Also, a good buyer will understand that one healthcare debt portfolio is not the same as the next. Many variables affect ability to collect, including account type, region and demographics, multiple billing sources, and the hospital's practices regarding registration, charity care enrollment, determination of Medicare/Medicaid eligibility, and collection of copays. The buyer should understand not only the amount of debt owed, but also all of the factors that may affect the many processes relating to its collection.

Selecting a buyer with such an appreciation is the best way for the hospital to ensure its patients will continue to be treated with the dignity and respect they deserve.

how and when patients will be notified of charity care programs. In other instances, the providers may have well-defined internal policies that control the manner, timing, and delivery of information about their charity care policies. In either situation, charity care rules need to be addressed by the seller and buyer of healthcare receivables, and the responsibility for adhering to such rules or guidelines should be detailed in the transactional documents underlying the sale. For example, in Minnesota if a hospital has not provided the required information about charity care to a debtor, it can be investigated by the attorney general's office, notes Andersen. So the provider should determine whether it has satisfied all such charity care requirements before the debt is sold, and whether the buyer should be providing such required information. "It's just good business," she says.

Andersen adds that, while not always possible, the relationship may benefit from a familiarity between the two parties. "In the best-case scenario, the asset buyer is a company that the healthcare provider perhaps has had some history with. It's possible that it is actually one of the collection agencies used in the past."

As bad debt continues to increase and becomes harder to simply write off, sale of aged receivables is an increasingly attractive option for hospitals. A strong contract and monitoring process with the right partner cannot only bring in immediate cash flow for the hospital, but also add peace of mind from knowing accounts are in the hands of another with the necessary high-level collection resources and expertise.

"The asset buyer selection process is not necessarily an easy one, particularly for the first-time seller of healthcare receivables. However, the importance of taking the time to understand the business, compliance, and patient service philosophy of any potential buyer of healthcare receivables cannot be understated," notes Andersen. Hospitals should seek a buyer that is socially responsible, has a patient-friendly infrastructure, understands the nuances of the market, and is credible. Says Andersen, "At the end of the day, it really comes down to trust."