

# Chapter 9 – Loan Collection and Recovery

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## Learning Objectives

What you should achieve after completing this chapter:

- Know the behavioral stance and action to take in handling collections;
- Understand the causes of delinquencies;
- Know the collection process and how to approach the borrower to pay;
- Know how loans and advances are classified;
- Know the remedies available for the financial institution; and
- Know how the process of litigation works.

## 1. Introduction

The **collection** function collects payments from those who are delinquent, i.e. those who make payments later than their contractual due date.

The **recovery** function collects money still owed on accounts after the financial institution has classified the account as non-performing or has written off the account as a loss.

The functions of collection and recovery also help the financial institution measure and evaluate the lending policies. Therefore, these functions help preserve the quality of the consumer loan portfolio and avoid unnecessary loss of revenue.

It is said that lending is a science but collection and recovery is an art. Before pursuing legal action (litigation), it takes the counseling, persuasive and negotiating skills of the lender to collect and recover the monies lent.

## 2. Collection Process

The objectives of a debt collection process involves:

- Maintaining delinquencies within acceptable limits; and
- Manage collection costs efficiently.

The collection function is done either in a centralised manner (one centre for the whole region) or decentralised (branch wise) manner. Whichever method is used, the collection function must be smoothly operated with the following:

- A highly automated system for detecting early delinquencies;
- A system of tracking consumer contacts and following up on repayment promises; and
- The development of adequate information base for the collectors to work on.

The behavioral approach of the collector towards a delinquent borrower goes through a cycle. The cycle can generally be classified into four stages as seen in a delinquent housing loan account (refer to Figure 9.1).

Early stage	One-month's instalment overdue. It is highly automated; computer generated reminders are sent. Phone reminders are another option at this stage.
Personal contact stage	Two months' instalments overdue. The collector becomes more involved in the account to determine why the delinquency is deteriorating and why the borrower is facing difficulty.
Serious delinquency	Three to six months' instalments overdue. The collector's approach to the delinquency should become more serious. The collector will be preparing to proceed with litigation.
Non-performing or write-off	More than six months' instalments overdue. At this point, the collector has decided that the account will be a loss to the FI. The collection will pass on to the recovery function.
<b>Figure 9.1: Stages in a Delinquent Housing Loan Account</b>	

## 2.1 Collection problems

To appreciate the collection process it is helpful to understand what causes the delinquencies. The common causes are:

- (i) Economic downturns. This can lead to closure of factories which in turn leads to loss of employment.
- (ii) Excessive borrowings. It is common to see borrowers having a few credit cards but with reduced capacity to pay. When a borrower has financial problems, he normally adopts a priority order of payment. Though this may sometimes vary, the order is based on needs/collateral as follows:
  - (1) Housing loan instalments or rental payments;
  - (2) Car loan instalments;
  - (3) Credit cards;
  - (4) Unsecured loans; and
  - (5) Unsecured overdrafts.
- (iii) Unexpected problems that change the consumer's income like loss of job or family illness.
- (iv) Poor financial management.
- (v) Marital problems.
- (vi) Intentional fraud.
- (vii) Gambling.

## 2.2 Loan collection methods – reminder system, telephone, etc.

### (a) Early stage – One month’s instalment overdue

#### **First call**

**Delinquency:** One month overdue

**Approach:** Short and simple. This is a mild reminder to the account holder. The script may be as follows:

#### ***Greet***

*Hello, may I speak to Mr David Lee?*

*Good morning Mr Lee. This is Shasha from Afta Asean Bank call centre. I am calling regarding your housing loan account with us.*

#### ***Inform***

*Presently, your housing loan account is overdue by one instalment*

#### ***Find out when payment is expected***

*When can we expect payment, Sir?*

### (b) Personal contact stage – Two months’ instalments overdue

#### **Second Call**

**Delinquency:** Two months overdue

**Approach:** The collector to motivate prompt payment. Slightly more personal:

*Hello, may I speak to Mr David Lee?*

*Good morning Mr Lee, this is Sharlet from Afta Asean Bank call centre. I am calling regarding your housing loan account with us.*

*Sir, our records show that, your housing loan account is overdue by two instalments. Can we expect payment within 3 days, Sir?*

*This will avoid penalty charges on your account. If you have difficulty in calling at the branch to make payment, you can also arrange to set up a standing instruction facility by calling 03-88667889.*

### (c) Serious delinquency – Three to six months’ instalments overdue

#### **Third call**

**Delinquency:** Three months overdue

**Approach:** This requires the collector to be more assertive

*Hello, may I speak to Mr David Lee?*

*Good morning Mr Lee, this is Fabriola from Afta Asean Bank call centre. I am calling regarding your housing loan account with us.*

*We notice that your account has remained delinquent by three instalments. We hope you can settle the instalments within 3 days time. If payment is not received, it will result in the bank demanding the entire loan amount. If you have any queries, you may contact me at 03-77887889.*

**Fourth call**

**Delinquency:** Four months overdue- more serious delinquency

**Approach:** More assertive

*Hello, may I speak to Mr David Lee?*

*Good morning Mr Lee, this is Geo Armani from Afta Asean Bank call centre. I am calling regarding your housing loan account with us. Our record shows that you had promised to pay RM4,000 by 14th February. We have still not received payment as promised and the account is overdue by four instalments. We hope you can settle payment within 3 days time. If payment is not received, it will result in the bank proceeding with a legal notice of demand. If you have any queries, you may contact me at 03-77887889.*

**Fifth call**

**Delinquency:** Five months overdue – Seriously delinquent account

**Approach:** Firm and assertive

*Hello, may I speak to Mr David Lee?*

*Good morning Mr Lee, this is Tanusha Thilo from Afta Asean Bank call centre. I am calling regarding your housing loan account with us. Our record shows that you have not settled your four months' overdue instalments. As a result, the bank has issued a legal notice of demand for the entire loan amount. We hope you can settle payment within 3 days. If payment is not received, it will result in the bank proceeding with further legal action. If you have any queries, you may contact me at 03-77887889.*

(d) **Non-performing or write off accounts**

More than six months' instalments overdue.

Recovery process through litigation.

## 2.3 Outsourcing collection – debt collection agency

As collection in most FIs is highly automated, it is more economical to outsource this activity to debt collection agencies. The debt collection agency needs only to contact delinquent customers without dealing with the collection of the funds. The customer pays the funds to the branch of the FI directly. Outsourcing collection appears to be more effective than the FI doing on its own and one reason is that collectors are paid on a commission basis for the loans collected. However, this can also be fraught with problems such as the collectors becoming high-handed in their approach and using gangster-like tactics in forcing payment. This is especially so in the case of car repossessioners.

### 3. Recovery Process

The objectives of a debt recovery process involves:

- Maintaining loan losses within acceptable limits;
- Generate loss recoveries at desired levels;
- Counsel clients who are experiencing difficulty handling debt;
- Ensure consistency with the FI's objectives; and
- Manage collection and recovery costs efficiently.

#### 3.1 Classification of loans – current, delinquent, non-performing

The classification of loans and advances is provided for in Bank Negara Malaysia's (BNM) guidelines GP3. As they are guidelines, the classification of individual accounts is determined on a case-to-case basis. Broadly, the classifications are as follows:

- (i) Current
- (ii) Delinquent
- (iii) Non-Performing Loans
  - Sub-standard
  - Doubtful
  - Bad

##### 3.1.1 How term / housing loans are classified as per BNM guidelines

**Current:** Payment of housing loan instalments is up-to-date

**Delinquent:** One instalment not paid

**Non-performing:** More than 6 months in arrears

**Example:** If 7 months in arrears and the customer pays 3 instalments, the loan is classified as delinquent.

If all 7 months arrears are settled, the loan is classified as current.

The non-performing loans are further classified for purposes of provision:

Sub-standard = Period of default is 6 months but less than 9 months.

Provision for write off is '20%'.

Doubtful = Period of default is 9 months but less than 12 months.

Collection is doubtful and there is a high risk of ultimate default.

		Provision for write off is '50% on the shortfall in security value'.
Bad	=	Period of default is 12 months and above. The debt is uncollectible, worthless and recovery chances are nil. Provision for write off is '100% on the shortfall in security value'.

### 3.1.2 How overdrafts are classified as per BNM guidelines

**Current:** Outstanding within limit

**Delinquent:** Outstanding in excess of limit or account

**Non-performing:** More than 180 days excess not settled. These accounts are also termed dormant.

**Example:** If the excess is RM10,000, and the customer has not paid for more than 180 days, the account is classified as non-performing. If the customer pays RM5,000, the account is still classified as non-performing until the entire excess is settled. Once settled, the account is classified as current.

The non-performing overdrafts are classified further for purposes of provision:

Sub-standard	=	Period of default is 6 months but less than 9 months. Provision for write off is '20%'.
Doubtful	=	Period of default is 9 months but less than 12 months. Collection is doubtful and there is a high risk of ultimate default. Provision for write off is '50% on the shortfall in security value'.
Bad	=	Period of default is 12 months and above. The debt is uncollectible, worthless and recovery chances are nil. Provision for write off is '100% on the shortfall in security value'.

### **3.2 Rescheduling of loans**

When a borrower is unable to pay his instalments or meet his payment commitments, the lender should explore the possibility of rescheduling the loan, provided the request appears genuine. A request is considered when a borrower is faced with an unexpected situation like retrenchment. Alternatives that can be explored are:

- Lengthening the repayment period so that the monthly instalments will be reduced to within the repayment capacity of the borrower; and
- Postponing the payment of instalments for a short period.

### **3.3 Restructuring of loans**

This is the first attempt to negotiate a loan workout/restructuring without resorting to legal action.

A borrower unable to healthily operate an overdraft account can be offered the alternative of restructuring the overdraft into a loan with a fixed monthly repayment. Conversely, part of a loan can be structured as an overdraft.

Loan repayments can also be restructured with the instalments being stepped up. This is called a low start-up loan repayment with a gradual increase in the instalment amount.

### **3.4 The cross default clause**

A cross default clause is meant to cover all borrower indebtedness with the FI and other FIs. A default in any of its other loans allows the FI to take necessary action like commencing litigation.

### **3.5 Penalty clause**

Interest is the price of money lent. Failure to pay the price results in a penalty being charged. Failure to pay the penalty and other arrears mentioned below is a trigger to commence collection and recovery.

#### **3.5.1 When and how penalty interest is charged**

Overdraft: Normally 1% above the prescribed rate charged on a daily basis debited monthly. Currently, the rate is BLR plus 3.5%.

Housing loans: Varies with different FIs. Generally, overdue interest is charged on the 15th day from the due date.

Term loans and hire purchase loans: Overdue interest is charged from the due date.

Other situations (unpaid items) causing arrears

- Legal fees
- Fire insurance
- Interest prior to disbursement
- Postal charges
- Other payments

**3.6 Notice of demand issued by the bank**

When a borrower continues to be in default of payment, the FI will proceed to recall the entire advance if the delinquency is not settled. In the case of housing loans, a notice of demand is normally issued when there is a three-month default. A grace period of 14 days is given for the borrower to settle the overdue instalments. Failure to do so will result in the bank issuing a legal notice of demand through the lawyers.

**Recovery via legal means – remedies of charges and assignees, order for sale and order for possession**

When a facility is secured by property, the FI has to determine whether it is with a title or without title before instructing the solicitor to proceed with foreclosure proceedings.

If the property is secured by title, the FI will apply to the court or land office for the sale of the property. This is called **foreclosure proceedings**.

Proceedings in regard to the sale in the **High Court/Land Office** is governed under the National Land Code.

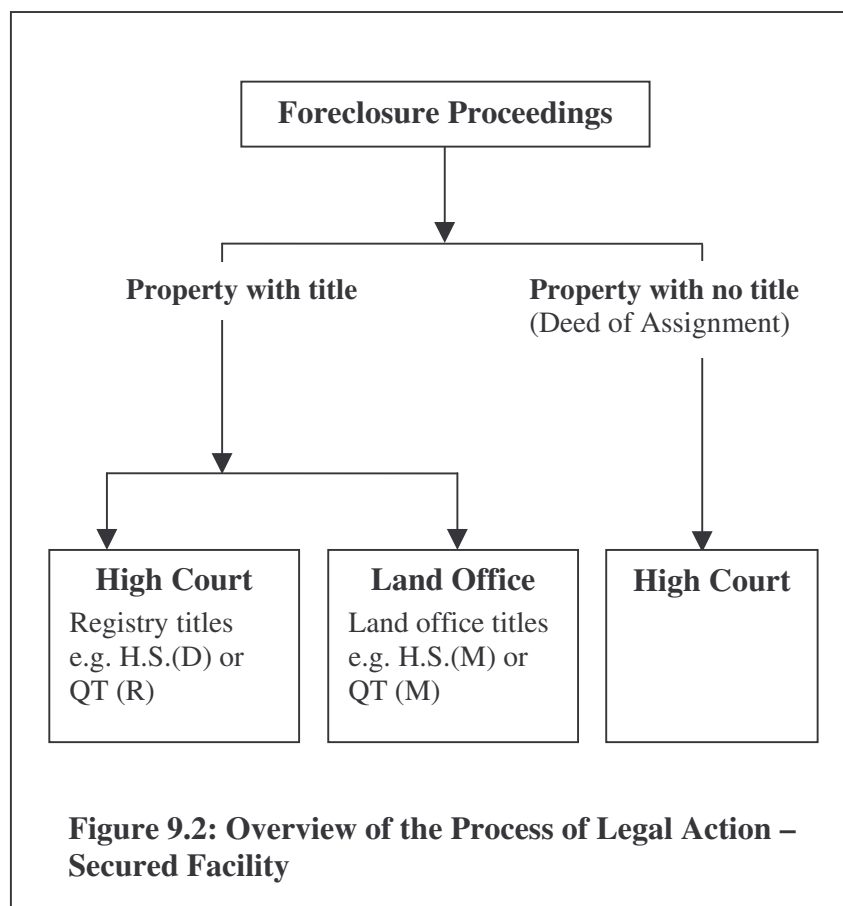
For properties under **assignment**, the terms under LACA will apply.

For unsecured facilities, the FI will proceed with a **civil suit**.

### 3.6.1 Foreclosure proceedings

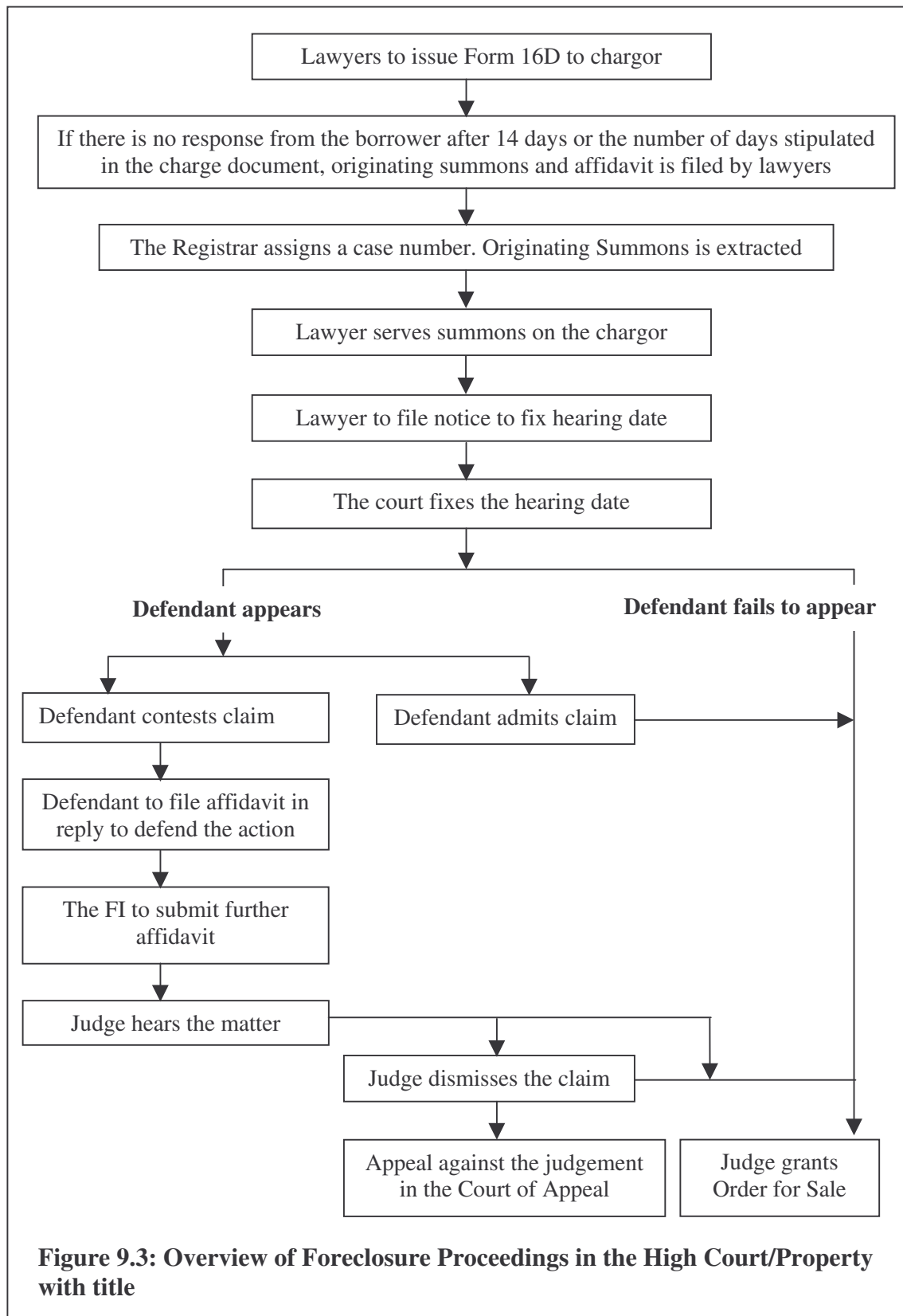
The bank will instruct the lawyer to issue Form 16D also known as *Notice of Default*. This is a statutory notice required under the National Land Code to be issued prior to commencing of any proceedings whether in the High Court/Land Office. The issuance of Form 16D is a mandatory requirement. Failure to issue Form 16D will render subsequent proceedings null and void.

Details of the property along with the outstanding and interest chargeable is to be furnished to the lawyers.



### 3.6.2 High Court proceedings

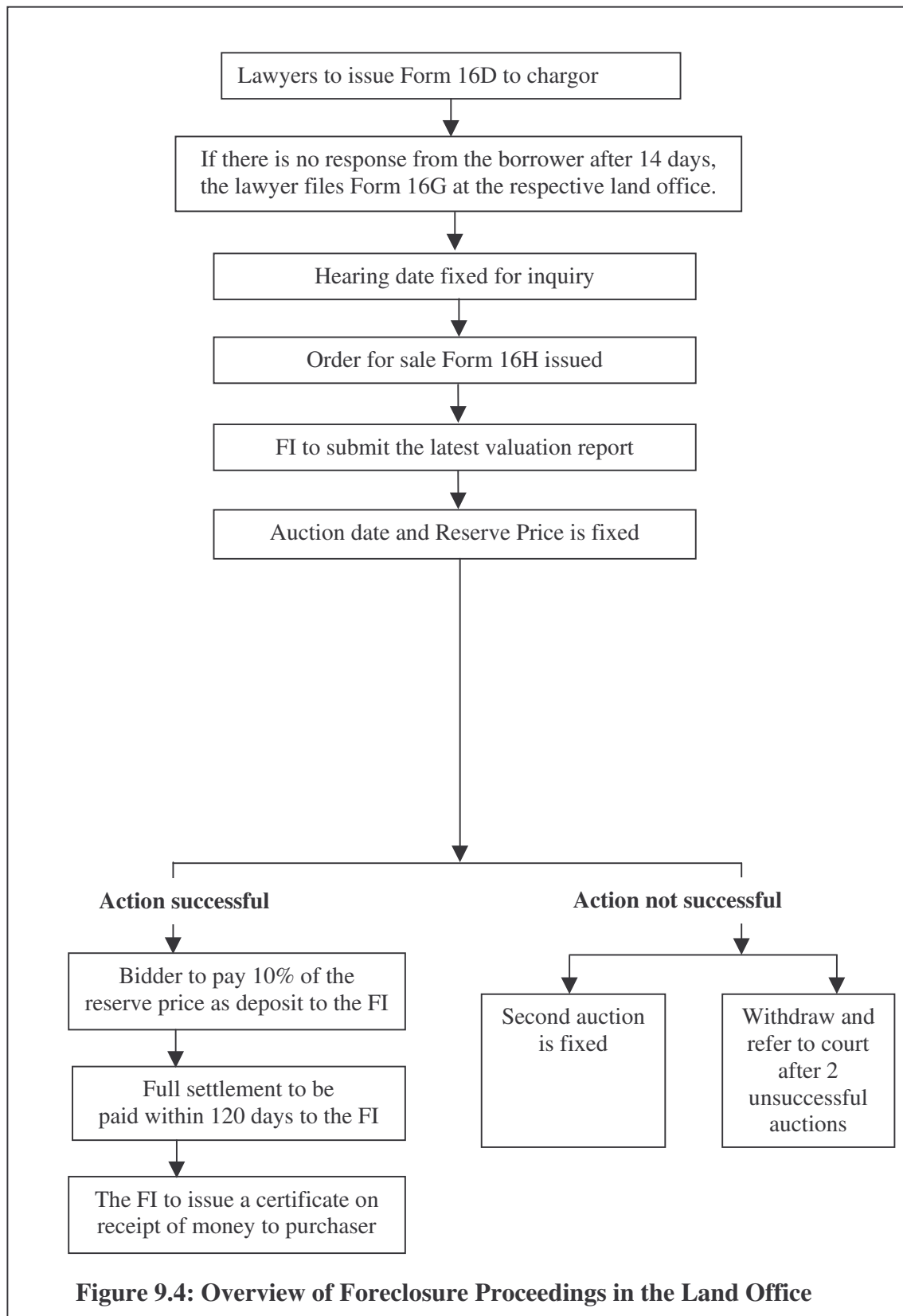
- (1) The proceedings commence with the issue of an originating summons supported with an affidavit. This is a sworn statement by the FI's officer verifying the statement of claim. The amount of advance, amount of repayment, amount of interest or instalments and other amounts remaining due under the charge are stated.
- (2) The lawyer will file the sealed originating summons and the affidavit and then extract it after the Registrar has signed and given the case number.
- (3) Upon receiving the originating summons, the lawyer will serve it on the borrower.
- (4) The lawyer will then file a notice to fix a hearing date.
- (5) The FI then has to file an affidavit stating the new amount owing on the date of hearing.
- (6) If the borrower contests the matter, the judge will hear the argument and decide on the order for sale or dismiss the application.
- (7) If the order for sale is granted, the lawyer will file for summons for directions in order to fix the reserve price and date for the auction. The reserve price is normally fixed by the bank providing the court with the latest valuation report.
- (8) Upon a successful auction, the bidder is given 120 days to pay the balance of the purchase price to the bank. In the event the bidder fails to pay, the advance money will be forfeited and there will be no extension granted.
- (9) The FI can subsequently put the property up for sale again at the same or new reserve price.
- (10) Upon receiving the balance of the purchase price, the FI must, not later than 14 days upon receipt of payment, issue a certification in writing to the bidder.



**Figure 9.3: Overview of Foreclosure Proceedings in the High Court/Property with title**

### 3.6.3 Land Office proceedings

- (1) Application is made under Form 16G to the relevant Land Office after the issuance of Form 16D. Upon receipt of this application, the Land Administrator will fix a date for the inquiry.
- (2) At the inquiry, the representative from the FI is required to give the balance amount outstanding to the Land Administrator.
- (3) At the inquiry, the Land Administrator will grant the order for sale in Form 16H.
- (4) In the event of no bid being received, the Land Administrator can put up for auction on a subsequent date at the same or new reserve price. Alternatively, reference can be made to the High Court after 2 unsuccessful auctions.



**Figure 9.4: Overview of Foreclosure Proceedings in the Land Office**

### 3.6.4 Enforcement of the assignment

The Federal Court in *PhileoAllied Bank (Malaysia) Bhd v Bupinder Singh Avatar Singh & Another* has now allowed a bank to dispose of the property either by public auction or private treaty without the necessity for an order of sale from the court. This is done pursuant to the powers of sale and the power of the attorney provided for under the Loan Agreement cum Assignment.

## 3.7 Repossession

Repossession is appropriate when the consumer is uncooperative and the FI stands to recover some or all of its investment by selling the collateral that secures the loan.

### 3.7.1 Hire-purchase (procedures are as per Hire-Purchase Act 1967)

- (1) When any two successive instalments are overdue, Schedule 4 (Notice of intent to repossess) is sent by the owner (FI) giving the hirer 21 days to settle the default. When the hirer is deceased, an owner shall not exercise any power of taking possession of goods comprised in a hire-purchase agreement arising out of any breach of the agreement relating to the payment of instalments unless there has been four successive defaults of payment.
- (2) However within the 21 days but 14 days later, a notice to physically repossess is sent.
- (3) On the 21st day, the repossession order is sent.
- (4) The owners normally appoint repossessors to exercise its rights of taking possession of goods on hire-purchase. The job of repossession requires some degree of force and tact as resistance from the hirer can be expected.
- (5) Within 21 days of repossession, an acknowledgement is sent for the goods repossessed by sending Schedule 5.
- (6) After 21 days of Schedule 5, the goods are sold.

### 3.7.2 Leasing (Laws of the Contracts Act, 1950 apply)

When a lessee is in default, the lessor may repossess the equipment/assets or institute legal proceedings. Although there are no set procedures for repossession in leasing, the issue of the notices follow closely to hire-purchase.

In addition, the following can also be the cause of legal action:

- Bankruptcy;
- The lessee being the subject of any writ of execution; and
- The lessee being subject entering into any compromise or settlement with his creditors.

### **3.7.3 Repossession – for hire-purchase**

Where the owner has taken possession of the goods, he must not sell the goods without the written consent of the hirer until the expiry of 21 days after the date of service of the Fifth Schedule notice.

### **3.7.4 Civil proceedings**

Civil proceedings or a civil suit is a procedure whereby the suit is commenced by way of summons in the High Court or summons in either in the Sessions or Magistrates Court.

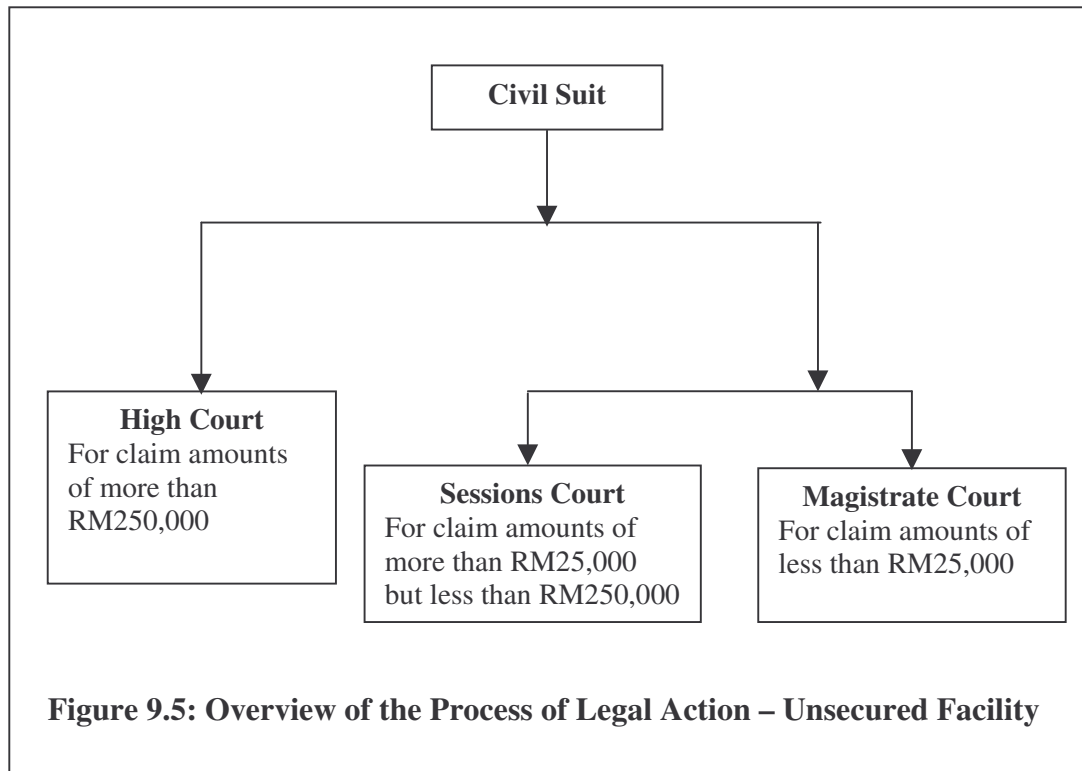
**(a) Legal action**

After the bank's notice of demand is issued, the legal notice of demand is issued, followed by summons.

**(b) Modes of execution**

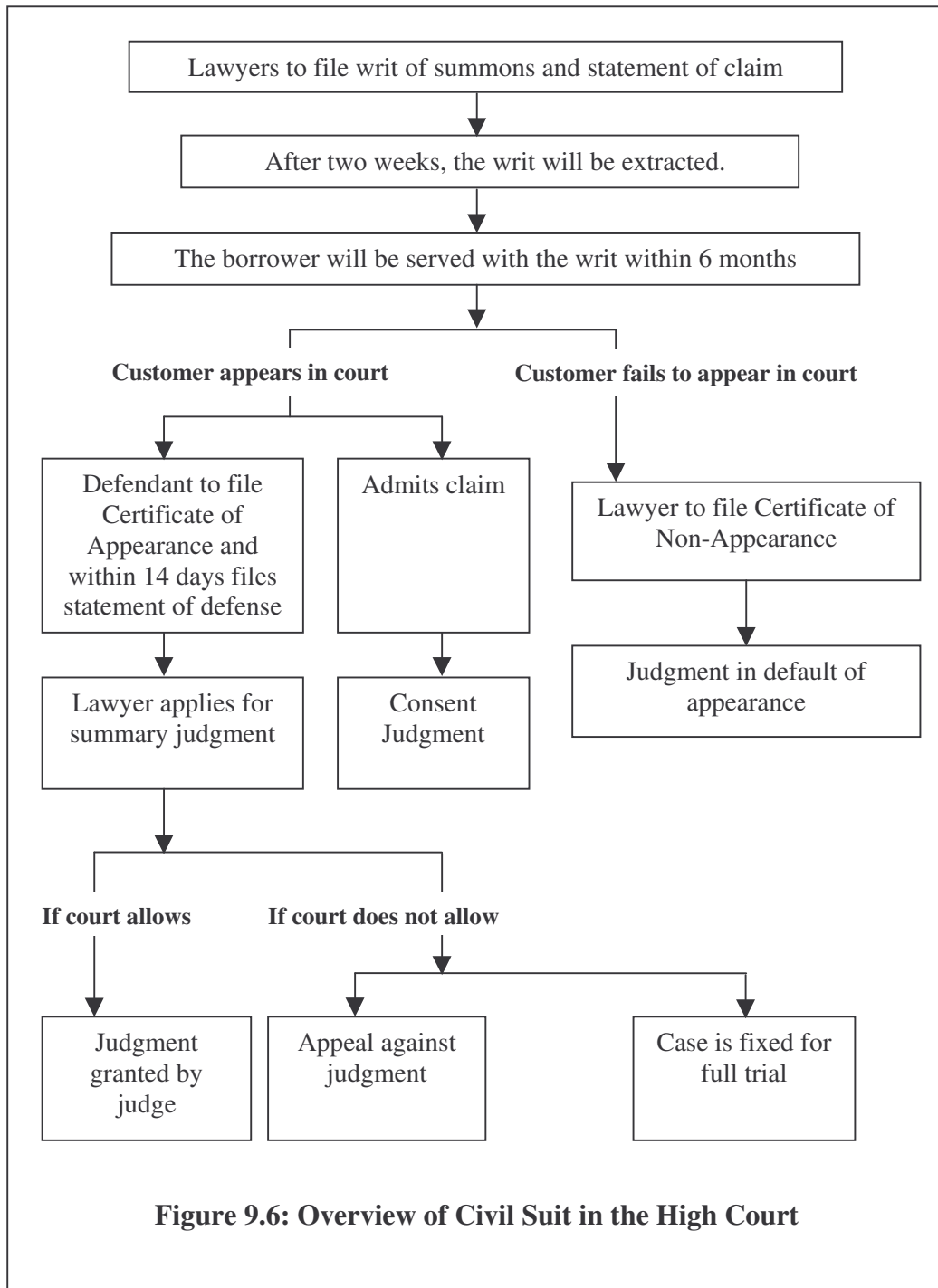
After judgement is obtained, execution proceedings commence vide Judgment Debtor Summons, Garnishee Order, Writ of Seizure and Sale and finally, bankruptcy.

The procedure is to enable the FI to obtain judgment against the customer or guarantor. It would then enable the FI to proceed with the execution process to enforce the judgment, i.e. to force the customer to pay failing which the FI by way of bankruptcy proceedings, garnishee order, writ of seizure and sale and judgment debtor summons.



### 3.7.5 Civil suit in High Court

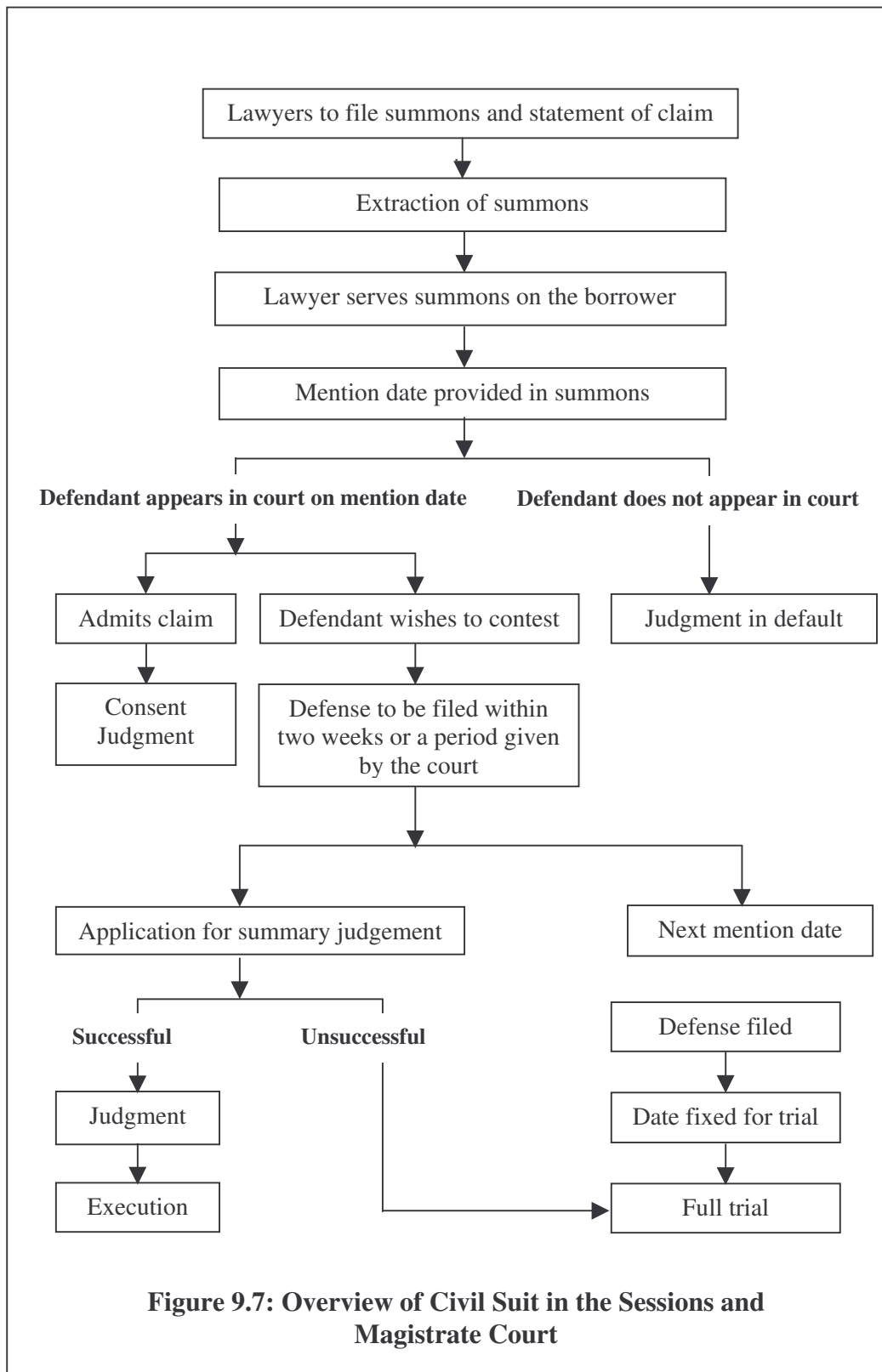
- (1) A writ of summons and a statement of claim is filed in the high court for amounts above RM250,000. The writ is valid for six months and must be served on the defendant.
- (2) Upon receipt of the summons, the defendant has eight to 12 days to respond.
- (3) If the defendant wants to contest the matter, he responds by filing the memorandum of appearance.
- (4) The defendant then has to file a statement of defense.
- (5) If the defendant does not contest or respond by filing the Certificate of Appearance, the solicitor proceeds to file Certificate of Non-Appearance and Judgment-in-Default of appearance.
- (6) In the event the defendant admits claim, a consent judgment is recorded.
- (7) Upon receiving the statement of defense by the bank, and upon perusal of the defense by the bank, and there is no defense to the claim of the FI, the FI can proceed to file for a summary judgment.



### **3.7.6 Overview of civil suit in the Sessions and Magistrate Courts**

Civil suits commence by way of a statement of claim.

- (1) The court will fix a date known as a mention date.
- (2) If the defendant does not admit the claim and intends to contest the matter, he has to:
  - appear in court on the mention date; or
  - appoint a solicitor to appear on his behalf.
- (3) The court will then grant a time period to enable the defendant to file his defense.
- (4) Upon the defendant filing the defense, the court will then fix a hearing date.
- (5) If the defendant does not appear in court on the mention date, judgement-in-default is obtained. If the defendant admits the claim, consent judgment is recorded.



### 3.7.7 Execution

Execution is the process of enforcing the court's decision. Once the judgment is delivered, a draft copy of the judgment is extracted by the lawyers and sent for approval by the court. The approved draft is filed again to obtain a fair copy. This process takes between 4 to 6 months. The judgment is valid for 12 years. However, in the event execution cannot be levied within 6 years, the court's permission must be obtained before any execution proceedings (except bankruptcy notice) are commenced against the defendant.

### 3.7.8 Procedure for bankruptcy

Bankruptcy is pursued when the judgment sum is above RM30,000.

- (1) A bankruptcy notice valid for three months stating the judgment sum outstanding is issued.
- (2) The notice is served personally or by substituted service through posting at the defendant's premises, advertisement and posting at High Court.
- (3) Once served, a Creditor's Petition is to be filed within 6 months from the date of commission of the Act of Bankruptcy
- (4) Hearing of the Creditors Petition and adjudicating and receiving order is granted
- (5) Proof of debt is to be filed.

### 3.7.9 Garnishee order

A garnishee order is a court order obtained by a judgment creditor attaching funds held by a third party (garnishee) who owes money to the judgment creditor.

**Example:** Mr Harjit Singh has an overdraft account which is in excess for more than 180 days. Afta Asean Bank (Judgment Creditor) has obtained judgement against Harjit Singh (Judgment Debtor). Afta Asean Bank has come to know that Mr. Harjit has a credit balance in his account at Beta Banco bank (garnishee). A court order (garnishee order nisi) is obtained and served on Beta Banco Bank. Beta Banco Bank will freeze the account and inform Mr. Harjit Singh. The amount mentioned in the garnishee order is then forwarded to the Afta Asean Bank judgment creditor.

### **3.7.10 Writ of seizure and sale**

Writ of seizure and sale is applicable when the defendant has properties (movable and immovable) in his own name and which are unencumbered.

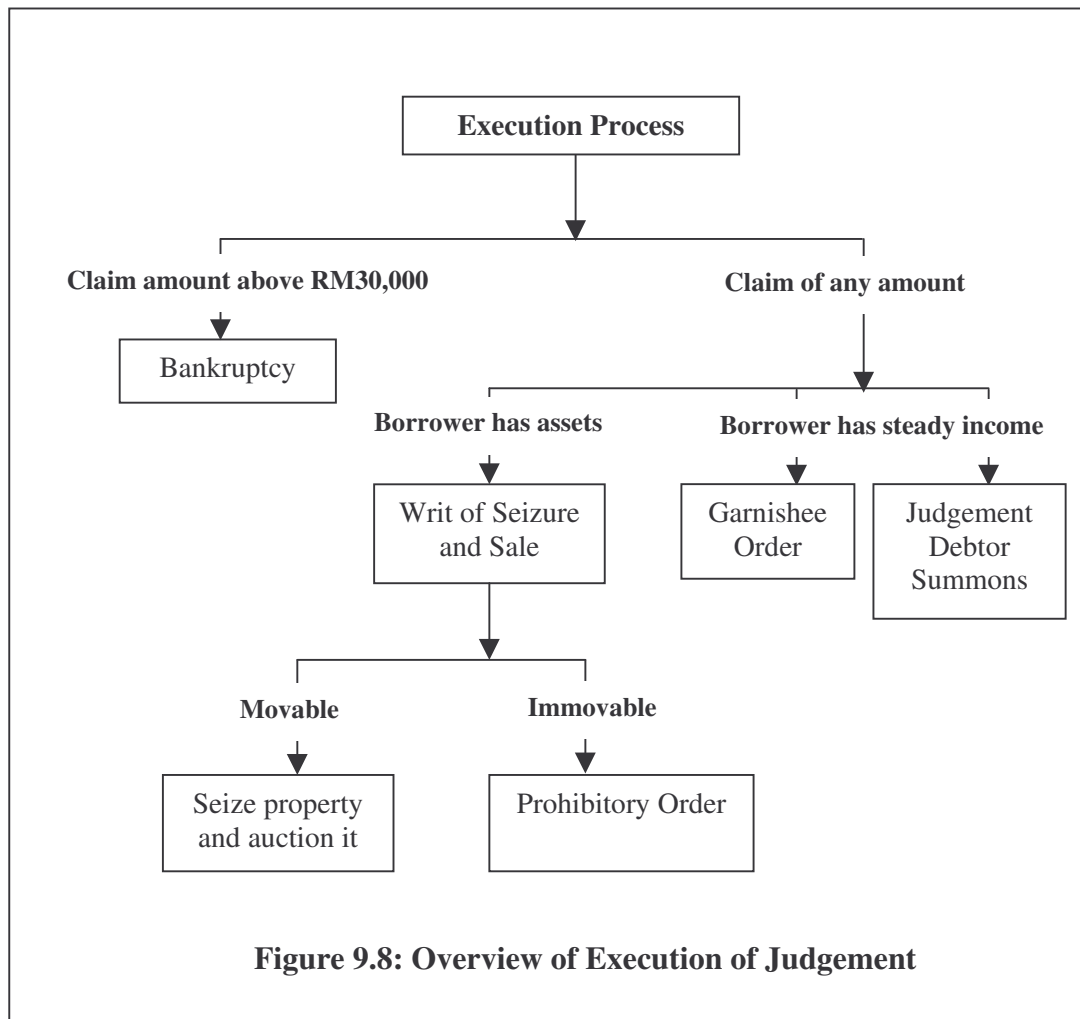
### **3.7.11 Movable properties**

Once the order has been granted, the court bailiff would go to the defendant's premises and seize all the movable properties except clothes, bedding and tools of trade and take all inventory of them. The defendant is given 14 days to pay in order for the attachment to be lifted.

In the event the defendant fails to pay within the stipulated time, the properties attached will be auctioned off.

### **3.7.12 Immovable properties**

The FI applies for a prohibitory order, which is registered in the Land Office. To do this, one must have the title number and lot number of the property. The prohibitory order prohibits the landowner/defendant from disposing of the land. The bank applies for an order to dispose of the property through the court. The prohibitory order is valid for 6 months.



**4. Summary**

A sound consumer credit operation depends on the success of the collection and recovery function. Well-trained and motivated collectors make the difference between retrieving a profitable asset and writing it off as a loss.

Delinquency results from many causes including unexpected changes in the consumer’s financial position.

The collection process may be either centralised or decentralised and is a four-stage process.

The recovery function acts in a less formal structure. Lawyers acting on behalf of the bank mainly handle this.

**Practice Questions**

1. What are some of the objectives normally established for the bank's collection function?
2. List some of the stages of a collection cycle.
3. What are some of the primary causes of delinquency?
4. Give an example of how a housing loan is classified as per BNM guidelines.
5. List some ways to reschedule and restructure a loan.
6. What is the procedure for repossession of a car?
7. What is Judgment Debtor Summons?
8. What is the legal process to initiate recovery of a loan against property without a title at the High Court?
9. What is a Garnishee Order?
10. Explain the litigation process an FI will pursue for recovery of an unsecured overdraft of RM12,000.