KPMG Meijburg & Co
Tax & Legal

Cash management and ESG

Collection, debt sales and ESG; an impossible combination?

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Introduction

The debt collection sector has been the subject of debate for years. In recent years, there has been a huge emphasis, partly due to pressure from society and politicians (see in that regard, among others, the publication by Ceder, second MP for the Christen Union) on more social debt collection, preventing stress among debtors and reducing the pressure that debt collection practice puts on the legal system.

This pressure from society has led to stricter rules, for example, regarding costs that may be passed on to debtors. In addition, the Quality of Collection Services Act (Wet kwaliteit incasso dienstverlening, "Wki") is expected to enter into force on 1 January 2024. One of the aims of this act is to further 'make the debt collection industry sustainable', with the scope of these new regulations extending beyond traditional debt collectors to include, by all appearances, factoring companies, servicers and other buyers of debtors and debt collection portfolios.

Less attention has been paid in these discussions to users of collection services and debt collection parties and buyers of portfolios of debtors and debt collection portfolios (including so-called non-performing receivables). And that while one might wonder whether it is not precisely also the behavior and attitude as well as the demand from these users that are (have been) the ultimate drivers for the actions of debt collection agencies.

The rise of ESG means that users of debt collection services and both sellers and buyers of receivables are going to be forced by (inter)national laws and regulations to think about their debt collection and (sales) purchase strategy, to formulate resistant and sustainable policies on the subject of debt collection and then to report on them. This means that a transition will be needed within corporate debtor departments with regard to their debtor and collection strategy.

Impact of ESG

ESG stands for Environmental, Social and Governance, which represents the three domains of non-financial values according to which companies are valued. Well-known examples include CO2 emissions, biodiversity, safe working conditions, fair tax contributions and diversity. But less obvious conditions such as protection of personal data, prevention of slavery, etc., also form part of the overall ESG valuation of companies. Fair, transparent, and proportionate treatment of debtors and other stakeholders can also be considered a non-financial value on which companies are valued and judged.

E Environmental

S Social

G Governance

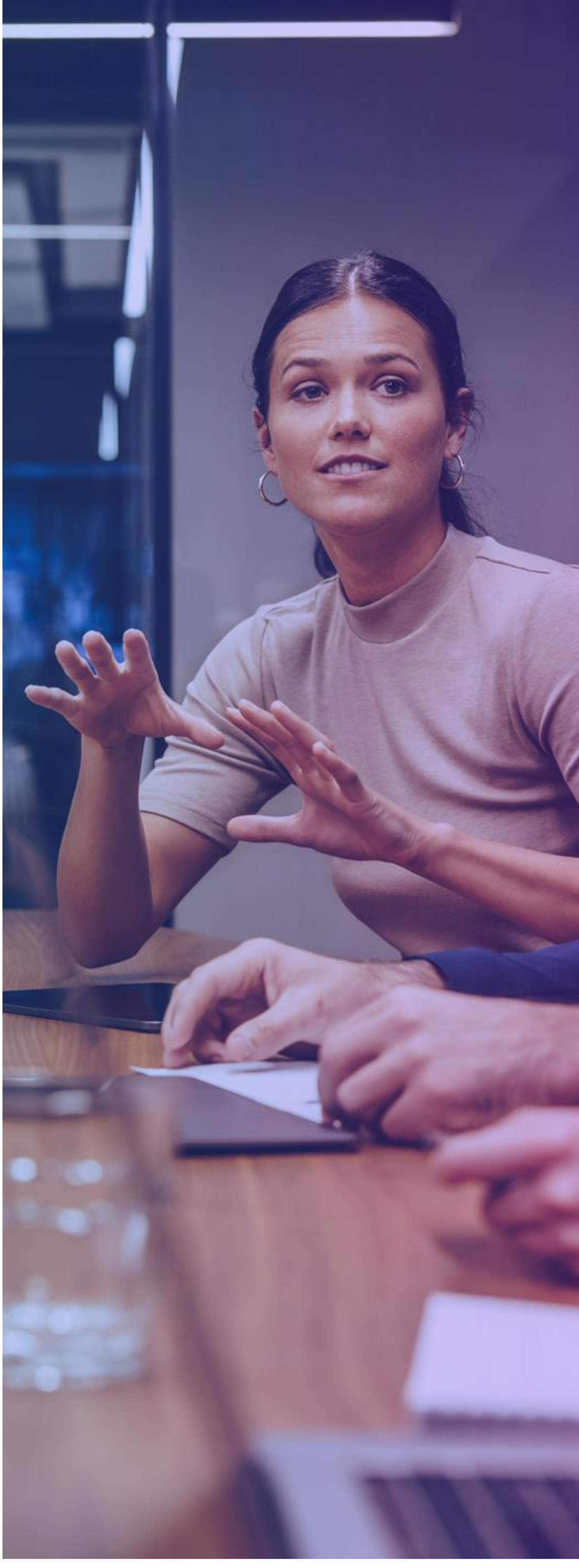
Collection should also be possible within the ESG framework. After all, the starting point is that bills are paid and debts are repaid. There may be situations, however, where the debtor is unable to pay his or her debts due to circumstances, temporary or otherwise. And that is precisely the moment when ESG comes into play in the collection process and the strategy to be followed in the process (which may include a possible sale of receivables). In such a scenario, how does the creditor act, what measures are taken by the creditor, etc.?

From an ESG perspective, S(ocial) and G(overnance) will be particularly important within the debt collection process and the sale of receivables. Many organisations use debt collection organisations or the ability to sell receivables to third parties for debt and cash management purposes. Although these debt collection organisations have started to operate in an increasingly social manner in recent years, the ultimate question remains whether the use of debt collection organisations and the sale of receivables by creditors can carry the ESG label in all cases. For instance, are there no other means available and what measures do creditors take in order to prevent the creation of debts?

As far as we are concerned, this is certainly possible. However, a number of starting points need to be taken into account. These assumptions include the following:

- Culture
- Governance
- Stakeholder involvement
- Contracting

Collection and portfolio sales processes have various stages, each with its own dynamics and each with its own points of interest from an ESG perspective. It is important to recognise this and ensure that the right steps and considerations are made and taken at each stage and that the right stakeholders are at the table.



Culture

One of the most important prerequisites for successful implementation of ESG-related transformations is the presence of the right culture within companies. ESG should not just be a 'legal duty', it should actually be intertwined with the company's way of doing business. Becoming interwoven takes time and requires an organisation to be open to becoming interwoven with an ESG culture: at every level.

Specifically, this means that at board level and at all levels below, ESG should be on the agenda and ESG compliance should be pursued. Mind you, there is no one-size-fits-all model within ESG. There are frameworks, but each organisation will have to flesh out these ESG frameworks independently. In our opinion, a tailored model and implementation of ESG is necessary to successfully create an ESG culture within an organisation. Simply imposing ESG obligations and guidelines will, in our opinion, be counterproductive. Organisations should therefore, in our opinion, on the one hand take the time to create an ESG culture (not just saying, but also doing from intrinsic motivation (authenticity)) and on the other hand involve the entire organisation in this process. An organisation-wide ESG journey is the key to success.

Looking at debt collection practice and receivables sales, a culture transition would mean that the mindset towards these topics needs to change in such a way that maximum collection yield and/or return is no longer the sole or main driver. In other words, additional KPIs should be defined that weigh into the assessment of whether a collection strategy or a sale of receivables is successful. Examples include an objective regarding the reduction of the number of legal proceedings, the introduction of debtor-tailored collection procedures, the (partial) waiver of collection costs, offering flexible (not onerous or interest-increasing) payment arrangements or, for instance, an adapted selection process regarding potential buyers of receivables.

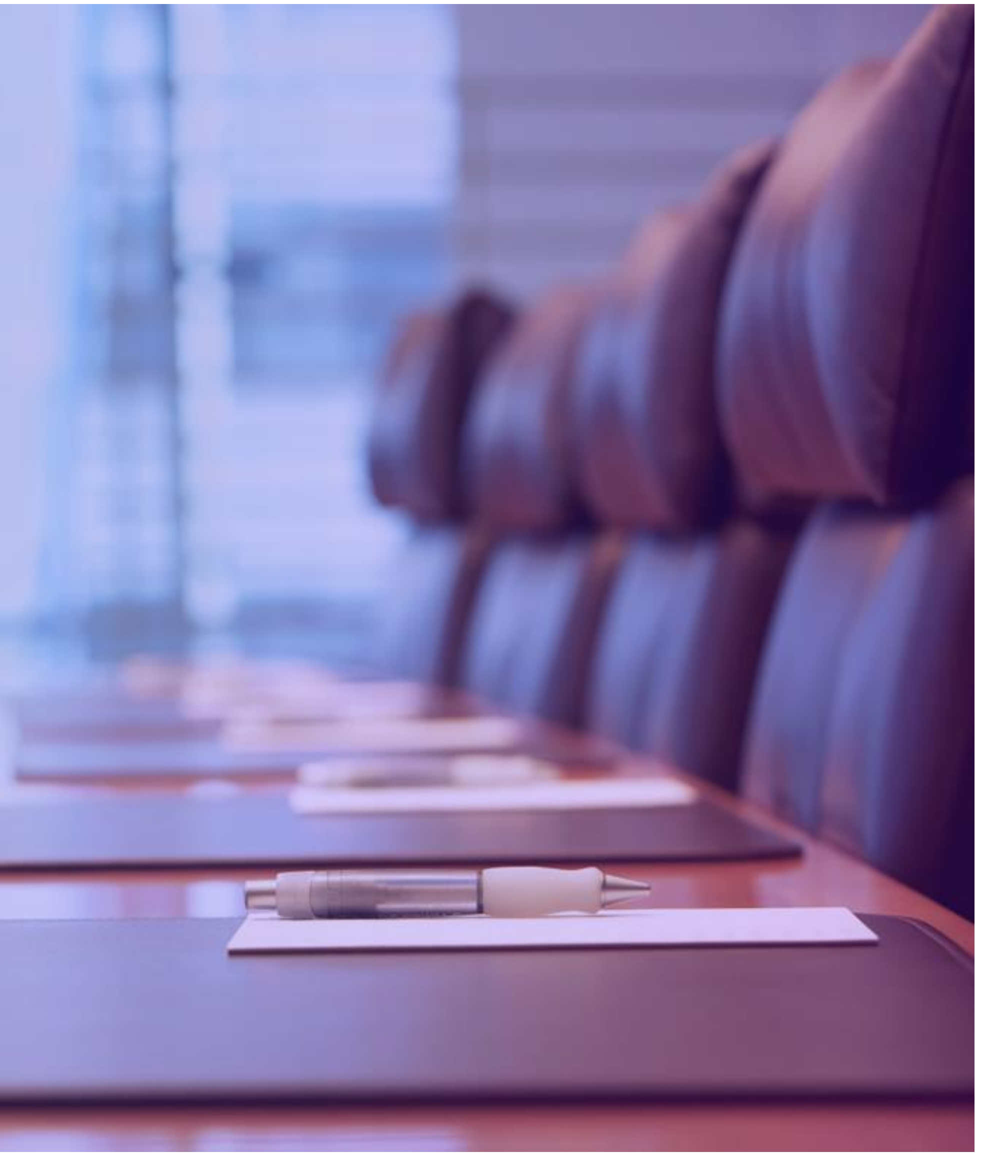
However, a cultural shift does not happen by itself. If organisations want such a change to take place, they need to take a number of steps:

- Determine what the organisation is aiming for, what the objective is and how this fits within the ESG framework, which culture and values are to be integrated into the organisation and lay down the outcome of the above in policy
- Provide a clear communication plan in order to communicate the ESG policy and the desired culture to the entire organisation and ensure buy-in and involvement of all relevant stakeholders (note that these can also be external stakeholders)
- Next, it is important to ensure that the new culture is and remains embedded within the organisation. The ESG policy should be complied with and applied, but it should also be propagated. It is important to continuously ascertain that this is actually happening and if this is not the case, it is important to validate whether the existing policy is still accurate and whether adjustment or adaptation is required

Governance

Governance represents a broad concept within ESG and fulfils a different role for each type of organisation and therefore has a different impact for each organisation. Governance is primarily thought of as oversight and accountability. Supervision from the board and senior management. External supervision from a supervisory board or a supervisory board. But also reporting lines and transparency. In addition, remuneration is also one of the elements of governance.

In order to successfully implement ESG in debt collection practice, it is important that a clear governance system is or has been set up within organisations, with clear and direct reporting lines towards C-level. Ultimately, the board will have to report on all kinds of ESG aspects, including debtor management (collections) and the way external collections are organised. It is therefore important that the board is aware at all times of the debt collection practices carried out on behalf of or by the organisation.



There are two phases that are important (a) the preliminary phase where the collection strategy is set and collection partners are selected and (b) the day-to-day collection practice (whether externally outsourced or not).

In the preliminary phase, the board will have to be involved in the formulation of the debt-collection strategy and should test (or have tested) whether the intended strategy fits in with the broader ESG strategy and standards applied within the organisation. Aspects that could be included in that context are, for instance, how many files an organisation wants to offer for collection on an annual basis at most, when does an organisation proceed to set up a collection process (are there any alternatives, for instance), how much is an organisation prepared to write off 'bad' debts.

We then consider it important that the board remains involved in implementing the collection strategy once it has been adopted. This requires not only board involvement in drawing up the debt collection policy, which will be a matter of course within most organisations, but also involvement in the selection (and periodic assessment) of any debt collection partners and the (permanent review of) the social mode of operation. We recommend making the latter part of the debt collection policy. If there is a supervisory board in addition to the management board, we recommend involving them in this process as well. In this context, use could be made of, for instance, Purpose's Measuring Yardstick for Social Debt Collection .

Governance-related aspects also play an important role in the second phase, the collection phase. Frequent reports to the board and active involvement from the board guarantee proper implementation of the collection strategy and also create better opportunities to identify and subsequently implement areas of concern and/or improvement. In addition, continued board involvement will often lead to better anchoring and acceptance of the collection strategy within the organisation.

In summary, from an ESG perspective, it is important to have debtor and debt collection management as a regular item on the board's agenda and then preferably with a specific focus on the social drivers within the iincasso strategy adopted. This not only allows the board to maintain control over the process, it also allows the board to report on debt collection strategy and practice within the organisation based on its own involvement, and thus knowledge and experience.

Also with regard to the sale of portfolios of receivables, governance plays an important role in the various stages of the sale process.

This starts with the preparations for the sale process. The board should be involved in formulating the sales objective. What does the organisation want to achieve? The highest possible yield or a sale in which perhaps and lower price is achieved, for instance by taking into account the non-selling of receivables such as costs and interest? Clear agreements on the treatment of the claim (and the debtor behind it)? In addition, the board should be involved in determining the intended sales strategy and the role ESG plays within that strategy. Part of this may include drawing up a buyer profile, in which case specific attention should be paid to how they deal with debtors.

After the completion of the preparation process, a selection of potential buyers will take place, who will be invited to participate in a bidding process based on an established buyer profile. The board can play a major role at this stage by being involved in the selection process and actively participating in, for example, discussions with potential buyers. For example, by requiring active involvement of the board on the buyer's side as well, it can be ensured that clear agreements regarding ESG aspects are made during the sales process. The choice will then be made for a buyer with whom further negotiations will take place. ESG aspects should be an important part of the final selection criteria.

Subsequently, the agreements regarding the sale, including specific agreements on ESG-related subjects, must be laid down in an agreement. Examples of ESG-related subjects that need to be laid down are agreements on collection methods, treatment of debtors and the possibility of reselling. But also reporting obligations to and inspection rights for the seller. This offers vendors (and their boards) the opportunity to monitor compliance with the obligations included in the sales agreement and thus also the opportunity to test whether ESG targets are met. Incidentally, it is important that sales agreements provide for possibilities for the seller to intervene if agreements are not met. This immediately clarifies the role of governance after a successful sale. By keeping an eye on the receivable and debtor after the sale, and having opportunities to intervene if necessary, a sale of receivables can be cooperated with in an ESG worthy manner.

Finally (and without pursuing completeness), from a governance perspective, remuneration policy could contribute to the creation of an ESG worthy debt collection and receivables sales policy. By drawing up a remuneration policy in which the achievement of ESG-related KPIs, focused on debtor and debt collection management or the sale of receivables, leads to a higher variable remuneration, for example, instead of a system in which a higher remuneration depends purely on the collection result or return, it can be ensured that the focus is placed on elements that are important for ESG.

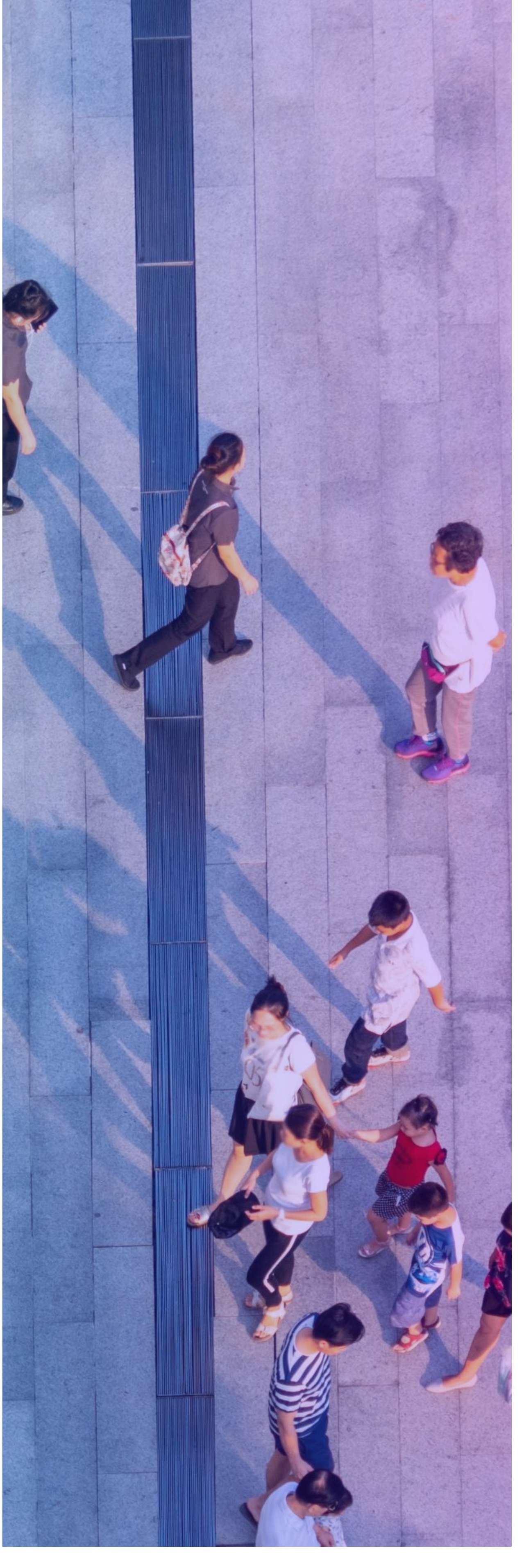
Stakeholders and the debtor's position

Involvement of all stakeholders in making debt collection practice and the sale of receivables ESG worthy is of great importance. By stakeholders, we include debtors, debt collection agencies, buyers of receivables, umbrella industry associations and regulators in addition to the organisation itself.

Each stakeholder has its own ESG concerns and it is important for the organisation to recognise these during discussions and when making agreements. In addition, stakeholders are experiencing more and more guidance from (new) laws and regulations, in which ESG aspects play an important role, as is the case with the Wki. Think of the 'Customer First' principle as it has become a guiding concept within consumer credit.

From an ESG perspective, we believe that the most important stakeholder is the debtor. After all, all actions of the other stakeholders are valued, at least from an ESG perspective, on the basis of the impact those actions have on the debtor.

Having debts usually has quite an impact on a debtor. Of course, there is a financial impact. However, the impact that stress caused by debt (and debt collection) has on the mental and physical state of a debtor (and often his/her environment) is enormous and often leads to a worsening of the situation. Active and aggressive debt collection usually leads to a magnification of this effect and a debt burden that increases rather than decreases.



Social debt collection allows a debtor to be heard, helped and more likely to escape a problematic debt situation.

But what is social debt collection and when is social debt collection actually worthy of the ESG designation? As far as we are concerned, social debt collection is tailor-made collection that takes into account the debtor's specific circumstances. This requires customisation, which initially sounds like something costly. In our opinion, however, customisation will lead to a better debt collection result and will thus pay for itself.

So what does customisation look like?

• Personal approach and regular personal contact (not only in case of non-compliance with agreements) without creating unnecessary pressure (as much as possible everything digital, but not purely automatic actions, at all times a human consideration from the creditor or debt collection organisation)

• Realistic solutions and agreements in consultation with the debtor and tailored to the debtor's (financial) situation, e.g. by (temporarily) stopping repayment obligations.

• Transparency: what we want to achieve with debt collection, but also providing real-time insight into the debtor's position

• No problem-increasing measures such as extra costs and interest

• Creating a safe environment in which there is room for the debtor to indicate if agreements cannot be met temporarily or in full

• Limiting the number of files that end up in the judicial phase, for example by applying minimum amounts with regard to going to court

• Looking beyond debt collection itself, cooperation with other stakeholders and social organisations. Are there other problems the debtor is struggling with that lead to financial problems and how can the creditor help with that (create room in the debtor's life to pay debts), think of coaching in the area of finding work, budget coaching, health-related issues (assisting in the search for medical help): in summary, offering a total solution.

ESG proof collections

We believe that even within the ESG frameworks it is possible to collect receivables and use collection partners. It is important to consider the following aspects in order to bear the ESG worthy debt collection designation:

• Change the collection culture within the organisation: collect with an eye for the debtor: personal solutions, room for deviation and prevention of stress, offer a total solution

• Collection strategy is not only aimed at the highest possible collection result within the shortest possible time frame (quick wins), other KPIs play an equally important role: think about unburdening the legal system and also be prepared to weigh up cost-benefit and do not always go to extremes

• Digitalization is the future (and the practice), but human contact is even more important if possible. Stay in touch, but in moderation and use digitalization especially to provide insight

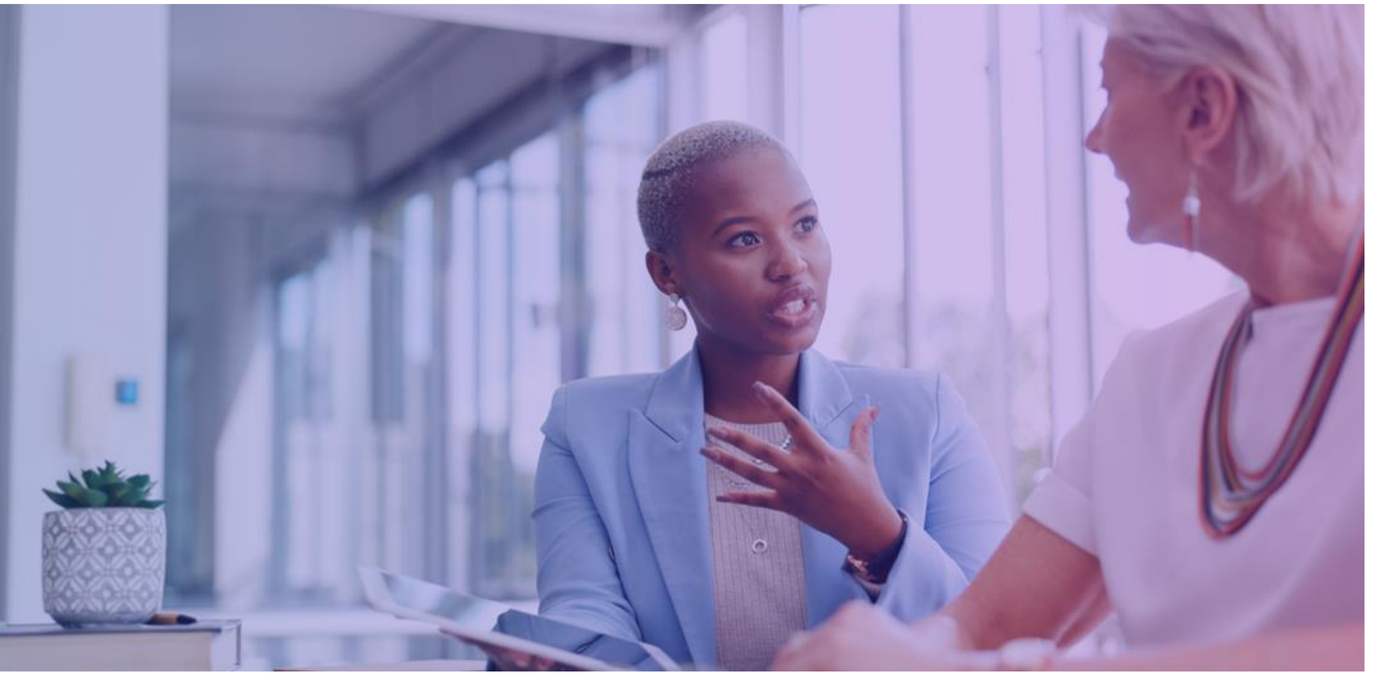
• Involve C-level in setting debt collection strategy, including ESG principles, selecting debt collection partners and determining debt collection methods, as well as organising this involvement throughout the debt collection process

• Make debtor and debt collection management a fixed item on the management board's agenda

• Report to board, pay specific attention to ESG and debtor management

• When using a collection partner, include ESG standards and reporting in agreements, for example reporting obligations to the organisation and audit and information rights for the organisation (and actually monitor social treatment). It is important to include termination options in agreements if (ESG) agreements are violated

• Link fees to collection partners to dealing with ESG-related KPIs



ESG proof debt sales

Selling receivables should also be possible for organisations, in our opinion, without violating ESG policy. However, even then it is important to properly regulate and record a number of matters. These include:

• C-level involvement in determining sales strategy, sales process and profile and selection of buyer (ESG principles form the basis)

• What to sell: only receivables or interest and costs in addition to the principal?

• Active involvement and monitoring by/reporting to board after successful sale

• Clear agreements are laid down in the purchase agreement with regard to collection of the sold receivables, reporting obligations of the buyer to the seller, audit rights for the seller, agreements with regard to resale and servicing of receivables on a social basis, rights for the seller to ensure compliance or to be able to intervene in case of non-compliance

Debt collection and the sales process remain an important part of organisations' cash and debt management strategies even in the ESG era. As long as organisations take the right measures prior to, during and (where relevant) after a debt collection process or a sale of receivables, it is very well possible to conduct these activities in an ESG worthy manner. and there within organisations The implementation of a clear monitoring and reporting structure with regard to these topics is then a requirement.

Meijburg Legal, in collaboration with the various multidisciplinary teams within KPMG, can assist you in making your cash management organisation ESG proof:

• Strategic advice on cash management optimisation and ESG

• Preparing your organisation for modern cash management

• Implementing and structuring governance system, including legal documentation

• Training and communication

• Reporting, auditing and assurance

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