

**Servicing Government Loans**

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Accurate and complete documentation is critical to providing proper servicing of debt, pursuing collection of delinquent debt, and in the case of guaranteed loans, processing claim payments. Once credit has been extended or a financial obligation to repay an administrative debt established, an agency becomes responsible for servicing or controlling the account. This Chapter describes Federal loan and debt servicing requirements as described in Office of Management and Budget (OMB) Circular No. A-129 “Policies for Federal Credit Programs and Non-Tax Receivables,” which may be found online at: [www.whitehouse.gov/omb](http://www.whitehouse.gov/omb) or [www.fms.treas.gov](http://www.fms.treas.gov).

The Federal Government can efficiently meet its servicing responsibilities and reduce its costs in several ways. First, under loan guarantee programs, credit servicing provided by private sector lenders tends to be more efficient and result in lower portfolio management costs than direct servicing by Federal agencies. Second, under certain conditions, an agency may find it advantageous to sell loans or other debts, thus allowing the agency to shift staff resources from servicing to mission critical functions. Finally, an agency may contract with a private sector firm for all or some of its servicing activities, as best meets the agency’s needs.

Basic servicing activities include:

- C billing the debtor;
- C processing and crediting payments;
- C monitoring the account;
- C documenting servicing action;
- C timely responding to borrower inquiries;
- C providing agency management with regular aggregate reports on receivables; and
- C providing central regulatory agencies with required receivables and debt collection reports.

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### Billing the Debtor

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An agency shall ensure that invoices are routinely sent to borrowers/debtors and that efficient mechanisms are in place to collect and record payments. Where appropriate, borrowers should be encouraged to use agency systems established by the Department of the Treasury (Treasury) which collect payments electronically, such as pre-authorized debits, credit cards, and electronic payments via the Internet (see, for example, *www.Pay.gov*). The billing cycle established by a repayment agreement should be the same as that used by private lending institutions for equivalent types of debts, generally monthly. The billing cycle will contain all of the regular mechanisms needed to bill debtors, collect and apply payments to appropriate accounts, and document account activity.

For housing and other long-term real estate loans, an agency or its lender/servicer should establish, at the time of loan origination, escrow accounts to process tax and insurance deposits. Agency servicing systems must process tax and insurance payments through escrow accounts.

For installment loans, the agency or its lender/servicer should initiate the billing process upon the first regular payment due from the debtor. In the case of administrative debt, the agency should initiate the billing process when it determines that the debt exists, e.g., the debtor owes a fine or penalty or has received an overpayment.

The initial billing notice or invoice *for an administrative debt* should include:

- C the amount of the debt;
- C the basis of the indebtedness;
- C the opportunities available to the debtor to dispute the debt, obtain copies of documents related to the debt, and enter into a repayment agreement acceptable to the agency if the debtor is unable to pay the debt in full;

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- C the date on which payment is due, usually 30 days after the date of the billing. The billing notice should also indicate the agency's policies with respect to the assessment of interest, administrative costs, and penalties, and that if payment is not received on or before the due date, the agency will begin assessing such charges as stated;
- C the steps the agency will take to enforce collection, such as reporting a debt to a credit bureau; referring the debt to Treasury for collection actions, including offset; referral to a private collection agency; administrative wage garnishment; and litigation (see Chapter 6, Delinquent Debt Collection). The agency cannot threaten to take collection action it is not authorized or does not intend to take;
- C if not previously provided by the debtor, the request that the debtor provide his/her/its taxpayer identification number, either through the submission of a Form W-9, "Request for Taxpayer Identification Number and Certification" available through the Internal Revenue Service website at *www.irs.gov/formspubs*, or on any payment or returned correspondence if legally authorized to do so; and
- C the name, phone number, and address of an individual to contact within the agency. It is important for a debtor to be able to contact a person knowledgeable about the agency's billing and collection policies and practices and who can respond promptly to the debtor's concerns.

Failure of a debtor to respond to the billing notice or indicate a desire to negotiate a reasonable repayment agreement or compromise should lead the agency to renew the demand for payment and proceed into the full collection process described in Chapter 6, Delinquent Debt Collection.

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### Reporting Account Information to Credit Reporting Agencies

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An agency or its lender/servicer must be able to identify and report *non-delinquent* and *delinquent* debts to credit reporting agencies (also known as “credit bureaus”) in accordance with the requirements of 31 U.S.C. 3711(e), OMB Circular No. A-129, and the “Guide to the Federal Credit Bureau Program” published by the Treasury’s Financial Management Service (FMS). Copies of the statute, OMB Circular, and guide are available on FMS’s web site at [www.fms.treas.gov](http://www.fms.treas.gov).

- C **Credit extension by lenders.** Under the Debt Collection Improvement Act of 1996 (DCIA), an agency must, as a condition for insuring or guaranteeing any loan, financing, or other extension of credit under any law to a person, require that the lender provide information relating to the extension of credit to credit bureaus. Credit extension reporting provides a true picture of the borrower’s outstanding obligations with respect to Federal direct and indirect loan assistance.
- C **Federal agency debts.** OMB Circular No. A-129 **requires** agencies to report to credit bureaus all non-tax, non-tariff commercial accounts (current and delinquent). In addition, the DCIA requires agencies to report all delinquent non-tax, non-tariff consumer accounts. Agencies may report current consumer debts to credit bureaus as well and are encouraged to do so. The reporting of current debts (in addition to any delinquencies) provides a truer picture of a borrower’s outstanding indebtedness while simultaneously reflecting accounts that the borrower has maintained in good standing.

There is no minimum dollar threshold below which debts cannot be reported, i.e., accounts for as low as \$5 may be reported to a credit bureau. For detailed information on credit bureau reporting, including information concerning the required agency procedures for reporting delinquent consumer debts, agencies should refer to FMS’s “Guide to the Federal Credit Bureau Program.”

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### Account Monitoring

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An agency or its lender/servicer is responsible for monitoring each of its accounts. As a primary means for monitoring account activity for administrative debts in particular, the billing system should enable the agency to "flag" or "mark" overdue payments for special attention. With overdue payments, the agency should contact the debtor by telephone or letter, in accordance with its collection procedures and strategies.

A loan classification (or risk rating) system is designed to assist an agency in monitoring and assessing loan performance. Such a system allows the agency to mark for special monitoring those loans which have been identified as potentially or actually weak. Any loan classification system established by the agency should be the same as, or comparable to, the system established by the Comptroller of the Currency.

Systematic monitoring of individual accounts provides an agency with a mechanism for:

- C identifying and correcting potential problems before accounts go into default;
- C evaluating the overall quality of its portfolio; and
- C identifying trends, such as deficiencies in account documentation.

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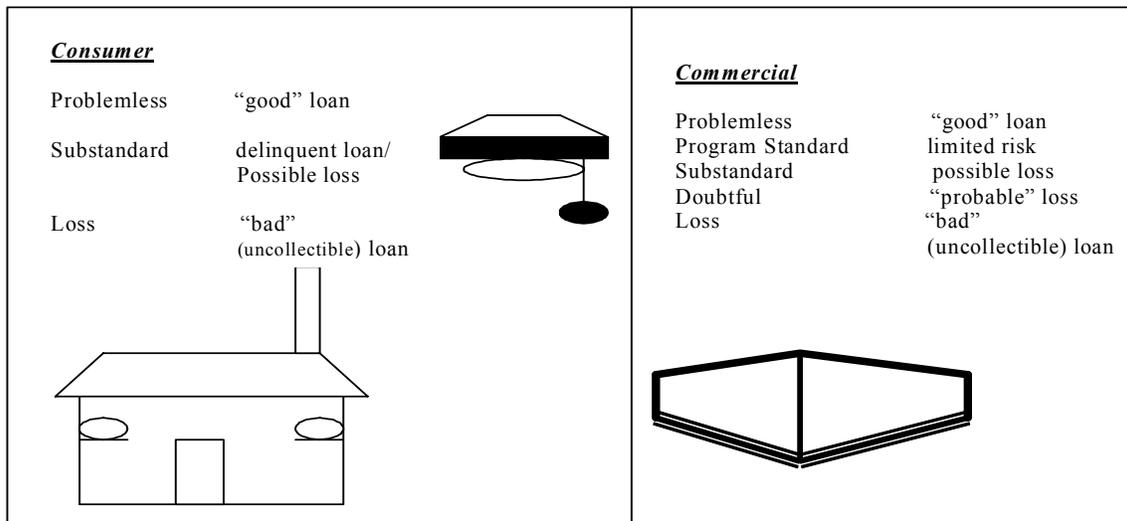
### Loan Classification

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When using a loan classification system, the agency will reassess and reclassify each loan in its portfolio annually. It should periodically examine all accounts within each classification to ensure that they meet the standards for that classification. It should further ensure that each classification accurately reflects the agency's historical experience with accounts in that program area.

The following factors should be evaluated in classifying an account:

- C the debtor's ability to manage an income-generating activity (particularly relevant for some types of commercial loans);
- C the debtor's financial position and history, including employment history and financial responsibility;
- C the type of business and ability to generate profits (for commercial entities only);
- C the structure of the loan and its purpose; and
- the condition and adequacy of the loan's collateral.



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### Consumer Loan Classification

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An agency will use a three-tiered classification system for consumer accounts. Substandard and loss categories are adverse classifications with respect to potential or actual loss to the Federal Government. The classifications are:

- C **Problemless** - a loan on which payments are consistent with the terms of the agreement. Thus, it does not pose an abnormal credit risk to the Federal Government.
- C **Substandard** - a loan which is 90 to 119 days delinquent. If the deficiencies are not corrected, there is a distinct possibility the Federal Government will sustain some loss.
- C **Loss** - a loan which is 120 days or more delinquent. This class of loan is judged uncollectible and of such little value that continuing to record it as a loan receivable is not warranted even though partial recovery may be possible in the future.

Agencies should consider using the following more stringent criteria when classifying single family housing loans:

- C **Problemless** - a loan which is less than or equal to 30 days delinquent;
- C **Substandard** - a loan which is 31 to 90 days delinquent; and
- C **Loss** - a loan which is more than 90 days delinquent.

The reason for using more stringent criteria for single family housing loans is because the amount of the monthly mortgage payment must be considered when determining the risk of these loans. The size of typical mortgage payment is usually about 25 to 30 percent of the household's disposable income. When a borrower becomes delinquent by more than 30 days, the likelihood of full repayment under the original loan terms decreases significantly; the agency may wish to move such loans into the substandard category earlier than other types of loans.

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### Commercial Loan Classification

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Commercial loans will be classified using the categories defined below. Substandard, doubtful, and loss categories are deemed adverse classifications with respect to potential or actual loss to the Federal Government.

- C **Problemless** - a loan which is performing as expected. Payments are current; the borrower is in general compliance with the terms of the loan; and projected receipts and expenses show that repayment is very likely. The loan does not pose an abnormal credit risk to the Federal Government.
- C **Program Standard** - the loan does not presently expose the Federal Government to a sufficient degree of risk to warrant an adverse classification; however, it poses sufficient credit risk to deserve more attention than a problemless loan. Included in this category are loans with inadequate collateral, inadequate written agreements, or other deficiencies indicating deviations from prudent lending practices which expose the Federal Government to a higher than normal credit risk.
- C **Substandard** - a loan in which the borrower's paying capacity and/or the collateral pledged, if any, jeopardizes payment of the debt in full. If the deficiencies are not corrected, there is a distinct possibility the Federal Government will sustain some loss.
- C **Doubtful** - a loan in which liquidation of an asset(s) for full value is improbable and the possibility of loss, based on currently known facts, is highly probable. However, certain conditions exist that may positively affect the asset(s) and increase the possibility of recovery.
- C **Loss** - a loan that is uncollectible and of such little value that continuing to record it as a loan receivable is not warranted even though partial recovery may be possible in the future.

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The classification of commercial loans involves a more detailed analysis than that for consumer loans since commercial loans have different characteristics such as:

- C     unstable repayment due to heavy impact of economic factors;
- C     potential for large dollar loans; and
- C     shorter repayment periods, with larger monthly payments.

In making a loan classification decision, there are a number of significant factors which should be considered when evaluating the potential viability of a business:

- C     cash flow and budget projections;
- C     past income performance; and
- C     future economic conditions.

Delinquency, however, remains a key indicator when classifying a commercial loan. (See **Appendix 3** for a list of early warning signs of potential problems.)

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## Allowance Accounts

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An agency shall recognize and record its projected debt losses by setting up allowance accounts, such as a "loan loss reserves" account. Separate accounts should be established for accounts and loans receivable. The agency should establish the amounts in the allowance accounts based on any one of the following:

- C     **Portfolio condition and composition.** For loan portfolios, the aggregate totals of all loans classified in the "loss" category and a percentage of those considered to be in the "doubtful" and "substandard" categories should be placed in the allowance account. The agency should determine what proportion of its "doubtful" and "substandard" loans can be reasonably projected as a loss.

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For administrative debt, the agency should consider the type of debt (e.g., fines, fees, penalties, etc.) and its experiences with collecting a given type of debt, such as the likelihood of the courts enforcing repayment of punitive charges.

- C **Historical experience with losses.** Using past account records, the agency should determine the number and percentage of its accounts that can reasonably be considered uncollectible.
- C **Actual write-offs taken in the preceding year or groups of years.**

By accurately estimating its potential losses and putting that amount in its allowance accounts, an agency is recognizing that it is unlikely to effect recovery on a portion of its portfolio and that the estimated uncollectible amount constitutes a "bad debt" expense to the Government. The agency must subsequently recognize amounts it deems uncollectible as write-offs against the allowance account.

## Servicing Documentation

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To monitor its accounts successfully, the agency needs to maintain and update, in each account file, all information pertaining to an account. During the account servicing phase, the agency or lender/servicer servicing a loan account should simply build upon the documentation generated during credit extension.

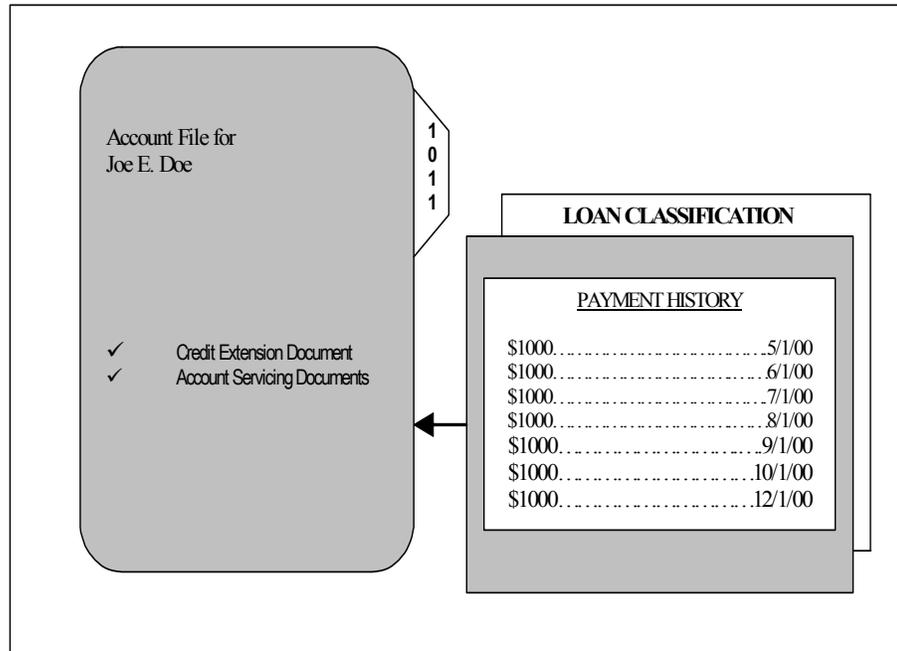
The agency which is servicing an administrative debt begins its process of documenting account activity in the account servicing phase. It is, therefore, critical that the agency document any contact with the debtor since such contacts may be needed to support the legitimacy or legality of the debt.

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### Account Servicing Documentation



Information to be incorporated into the account file should include:

- C the basis for the creation or establishment of the debt, including any loan documents; or, for administrative debt, assessment of a fine or penalty, a copy of the invoice that was overpaid, the supporting payment schedule, and/or any other documentation that would substantiate and support the debt;
- C payment history and schedules, including delinquencies and defaults and subsequent deferrals, rescheduling, or refinancing, if any;
- C loan classification or risk rating, if any;
- C documentation of each contact between the servicing official and borrower/debtor including demand letters; and
- C reports submitted to the agency for monitoring the account, such as financial statements for commercial loans.

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Agencies should maintain the originals of any documents generated which indicate that the debtor was aware of the loan or debt obligation, such as the loan commitment or repayment agreement, since such documents may be required in any future actions involving litigation to enforce collection. The agency may use an automated system to maintain the account and create the account history and documentation as the account ages (see Appendix 2 for servicing checklist).

## Contract Servicing

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Depending upon the size of the portfolio and the cost of automating its functions, it may be cost effective for an agency to have a cross-servicing agreement with another Federal agency or contract out its account servicing functions. If the agency contracts out its account servicing, it is also responsible for developing standards consistent with its needs and with the reporting requirements of OMB and FMS.

Each agency should establish penalties for any contractor that fails to conduct operations in accordance with the established standards. For example, the agency can require a contractor to absorb any delinquencies caused by negligent servicing.

The agency must ensure that the contractor fully documents all servicing undertaken and require the contractor to promptly communicate information on delinquent accounts so that the agency may initiate action. The agency must establish a means to move and store the servicing information for delinquent accounts into its debt collection activities.

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## Account Servicing

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### Treasury Report on Receivables

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Federal agencies are required to regularly provide information concerning their non-tax receivables and delinquent debts to FMS for inclusion in the “Treasury Report on Receivables” (TROR). See 31 U.S.C. 3719.

The TROR is the Treasury’s only comprehensive means for periodically collecting data on the status and condition of the Federal Government’s non-tax debt portfolio. The information contained in the report is disseminated to Congress, OMB, agency Chief Financial Officers, the Federal Credit Policy Working Group, other officials and representatives of Federal and state organizations, private sector organizations, and the public.

The TROR serves as a management report which informs Federal decision-makers of the **gross book value** of the debts held by the Federal Government and the actions taken to enforce collection of the Government’s receivables. Thus, the debt amounts listed in an agency’s receivables report are not necessarily identical to the amounts reported on an agency’s financial statements, which are presented in accordance with Credit Reform guidance, i.e., using net present value. Agencies are, however, required to reconcile their TROR reporting with the receivables data reported on their financial statements.

To assist agencies in properly reporting receivable and debt information to FMS, FMS has published an “Instructional Workbook for Preparing the Treasury Report on Receivables.” The workbook and contact information are available on FMS’s website at [www.fms.treas.gov/debt](http://www.fms.treas.gov/debt).

For further information on this chapter, please contact the Agency Enterprise Solutions Division, Federal Finance, at 202-874-6875. For information on the TROR, please contact the Agency Liaison and Reporting Division, Debt Management Services, at 202-874-6660.