Expanding Commercial Lending Into the Hospital Receivables Market

How to Choose a Hospital Receivables Partner

by Mitch Patridge

With the recent downturn in real estate, many lenders now face the challenge of how to diversify into new markets. One new area in the commercial loan market is healthcare receivables. By partnering with a third-party vendor with proven expertise in driving and managing business in this market, banks can meet the diversification challenge and also better serve the community. Additionally, by providing a new product that other banks might not offer, this type of partnership offers a competitive and strategic advantage.

Torrey Pines Bank in San Diego, CA, recently sought a partner for the healthcare receivables market in order to complement the medical marketing plan that it already had in place. Thomas Woolway, senior vice president of corporate banking, explained, “We understood that hospitals need help with providing loans to patients to improve patient relations as well as cash flow, so it was natural for us to look for a partner that could help us buy and manage hospital patient receivables.”

Unfortunately, entry into hospital receivables seems daunting to many lenders because they don’t have staff with expertise in this area. Vince Telles, senior vice

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president and corporate banking manager of the Business Bank of Nevada, has worked in the healthcare receivables market for several years. He explained the bank's dilemma this way: "Healthcare receivables financing is a different animal. It can be difficult for a bank to select a third-party vendor to provide this service. However, given the huge and growing market out there, even banks that have already entered this market can benefit if the vendor allows them to expand their relationships with current hospital clients."

Due diligence for selecting a healthcare receivables partner

The due-diligence process for entering the healthcare receivables market needn't be intimidating. In addition to guidelines from the Office of the Comptroller of the Currency (OCC) regarding risk management of third-party vendors, this article presents insights from banks that have already successfully entered this market.

Step one: Assess the vendor's experience in implementing and supporting the proposed activity. Evaluating a service provider's experience involves asking pertinent questions and thoroughly checking recent and ongoing references. "Ideally, you want to look for a company that has been involved in this market for a long time and knows how to quickly and accurately evaluate a hospital's receivables portfolio as well as identify hospitals with a strong credit profile," said Mr. Telles.

Assessing the vendor's experience "on paper" isn't enough. According to Mr. Telles, it's best to personally interview and observe employees during an onsite visit. "When we had narrowed down our options, I visited both the call center and the headquarters of our first choice. After all, this vendor would be using our bank's letterhead and making calls to patients on behalf of the bank. I felt it was necessary to monitor calls and get a feeling for the professionalism of the staff."

Mr. Woolway added, "We looked for a vendor that had proven it could handle the healthcare receivables operation from start to finish — from assigning risk ratings to hospitals, screening the pool of receivables, and tiering account desirability to finance and managing patient relations and day-to-day administration of the accounts. We were also impressed with vendors that use Standard and Poor's underwriting criteria during portfolio analysis."

Step two: Assess the financial condition, stability and viability of the vendor and its significant principals.

This step involves the same type of scrutiny that a bank would undertake if it were extending credit to the vendor. When selecting a vendor for origination, servicing and collection of self-pay healthcare receivables, a lender should pay particular attention to the financial responsibility of all parties involved.

According to Steve Utt, executive vice president/chief credit officer at RiverBank in Spokane, WA, this step is crucial to reducing third-party risk. "A third-party vendor needs to be able to produce a SAS-70 audit showing they are processing accounts and following procedures in accordance with the law and that the company's operations are in place as represented on paper. To minimize risk further, banks should perform spot audits both during the due-diligence phase and on an ongoing basis."

Step three: Research the vendor's business reputation, complaints, and litigation as well as the sub-contractors that the vendor uses. Vendors that initiate and manage self-pay receivables for hospitals typically "sub out" customer service and direct-mail tasks. Banks should be fully aware of who these subcontractors are and, when appropriate, they must also perform due diligence on these subcontractors.

According to RiverBank's Steve Utt, "A bank cannot afford to associate its name with a vendor that is charging an exorbitant interest rate or that is bullying patients during the collection effort. Most hospitals want their patients to be treated fairly and with respect. A vendor that has an undesirable reputation with hospitals, patients or other lenders is not the kind of vendor that a bank wants to partner with."

Step four: Check the qualifications, backgrounds, and reputations of company principals. In addition to criminal background checks, each principal's qualifications and background should be scrutinized for ethical practices and possible conflicts of interest. "Management's experience in the healthcare receivables business is extremely important, but so is the culture of the company," said Mr. Telles. "Having a good fit between the way your bank conducts its operations and the vendor's business practices is extremely important."

Step five: Determine the nature of the vendor's internal controls and audit coverage. This step ensures that the vendor complies with applicable consumer protection, fair lending and antimoney laundering laws. Most lenders will want evidence that a qualified CPA firm has audited the vendor's processes and has awarded either a Statement on Auditing Standards (SAS) 70 or a SAS 70 Type II. But a lender should also do a thorough site inspection to observe the vendor's daily business practices firsthand.

Step six: Evaluate the adequacy of the vendor's management information systems (MIS). Banks must be able to prove to regulators that their third-party vendors are managed efficiently and effectively. A key piece of the management process involves setting minimum service-level requirements and remedies for failure to meet these Service Level Agreements (SLAs). Common SLA metrics in the healthcare financing market include deadlines for completing A/R portfolio review, number of data entry errors, and uptime of management information systems.

Mr. Woolway from The Torrey Pines Bank elaborated, "We wanted to enter the healthcare receivables market without hiring full-time staff at the bank, so we focused our due diligence on how well the vendor was set up for initiating and monitoring accounts and keeping our bank informed on a daily basis. We looked for a vendor with strong MIS systems that could keep us informed daily about patient receivables. We couldn't take on the healthcare receivables market with any degree of comfort without this."

Step seven: Assess the adequacy of the vendor's business resumption, continuity, recovery and contingency plans and the technology recovery testing efforts. In the event of a power outage, computer virus, natural disaster, or other event that interrupts or threatens "business as usual," it's crucial that the vendor have a formal plan for resuming operations as quickly as possible with minimal impact.

According to Mr. Utt, "A bank needs to assess business continuity very closely. If something happens to the computer system at the vendor's site, you must be assured there is a way to run the processing software at another site and that data is being backed up on tape that is stored in a safe, secure offsite location."

Step eight: Determine the cost of development, implementation and support that a vendor will require from the bank. It's important for a lender to uncover "hidden costs" of entering into an agreement with the vendor and to determine the lender's full financial obligations. This step is especially important if it will be necessary to integrate a lender's system with one of the vendor's core systems.

Step nine: Assess the vendor's insurance coverage. The primary question during this step: Does the vendor have fidelity bond coverage, liability coverage, fire, data loss, document protection, and other coverage in amounts that are adequate for the services the vendor is to perform?

Step ten: Evaluate intangibles that determine how well the vendor "fits" with the bank's culture, vision and business style. This step involves assessing factors such as the vendor's human resources policies, service philosophies, quality initiatives and policies for managing costs. Lenders may also want to evaluate whether the vendor's business culture, values and business styles are compatible with the bank's culture, values and business styles.

"At the end of the day, your bank will want to be assured that the bank's interests are protected," said Mr. Woolway.

Mr. Telles added, "And you want to make sure that the vendor is offering its patient-financing services — on behalf of the bank — in a compassionate, caring way. For a community bank like ours, it's an absolute prerequisite that the vendor's business style and values match and enhance the bank's standing and image within the community."

Summary

The healthcare receivables market is a realistic and attractive option for banks wanting to grow their business. Banks not well versed in this area can outsource this business to an experienced third-party vendor. As with any third-party agreement, a bank must perform due diligence before making a decision. The depth and formality of the due diligence will vary according to the institution's familiarity with the market and the perceived risk to the bank.

Mr. Telles sums it up well. "With the proper due diligence, as recommended by the OCC and standard banking practices, a comfort level can be achieved. Obtaining that comfort level will allow the respective bank the opportunity to grow and diversify its existing loan portfolio." ▲

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