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DIGITALLY-ENABLED CREDIT COLLECTIONS

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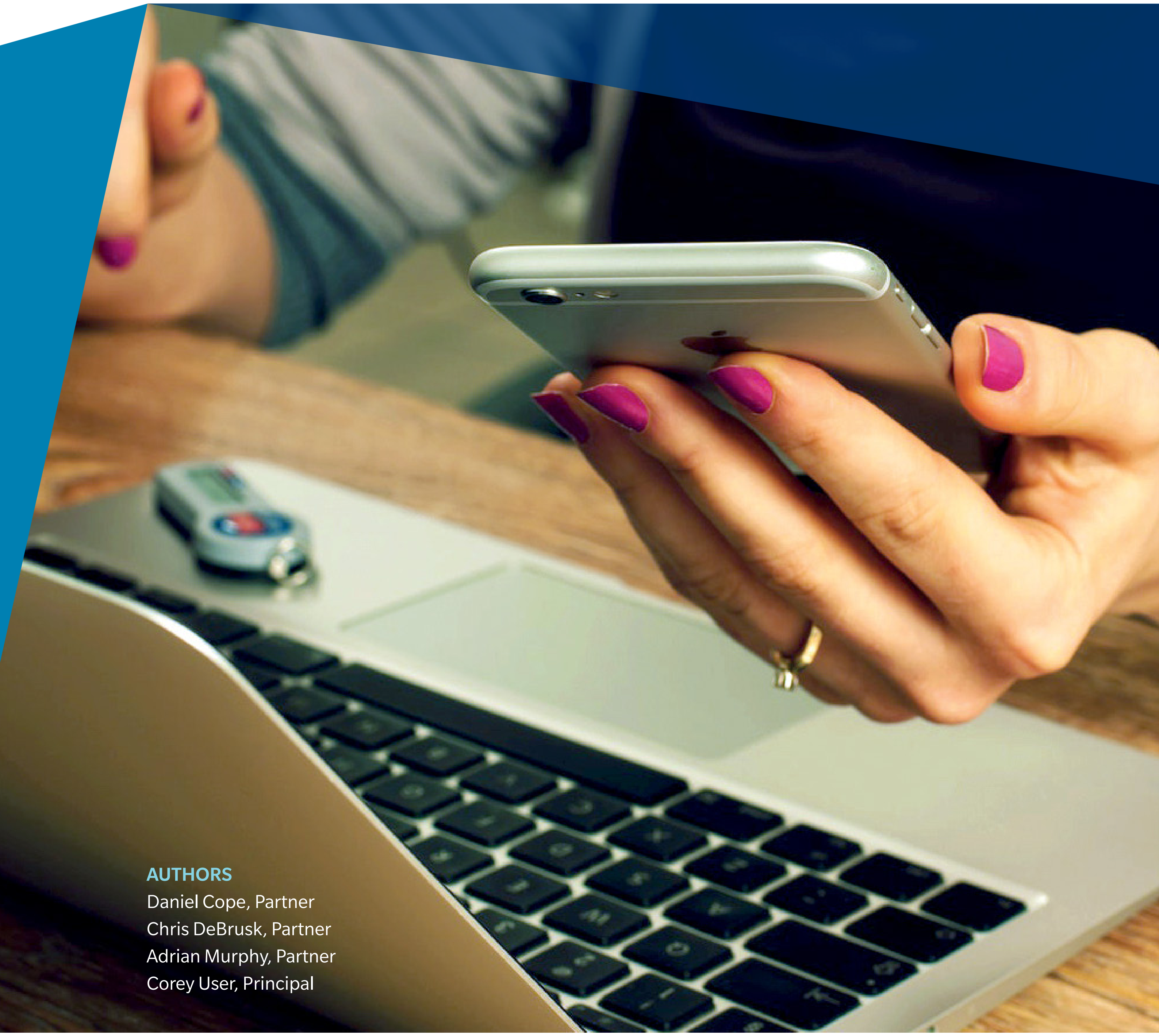

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COLLECTIONS WILL MATTER IN THE EVENTUAL, INEVITABLE, RECESSION

Banks and other consumer lenders must prepare to strengthen collections capabilities and increase capacity in advance of the inevitable recession. In the current environment of strong economic performance, rising equity markets, low unemployment, and generally positive consumer sentiment, it is easy to think that the good times will never end. But the current economic expansion will ultimately come to an end at some point, leading to higher unemployment, tightening household spending, and a corresponding increase in consumer credit delinquencies.

The collections landscape has changed quite significantly since the Great Recession. Today, customers interact with their banks in different ways. Digital channels are increasingly becoming the primary mechanism used by customers to manage their finances; this trend applies not only to the millennial generation but also to consumers of all ages, and increasingly to small business customers. Traditional call center-dominated collections operations are unlikely to be sufficient in the future.

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BEING PREPARED WILL PAY OFF

Lenders that preemptively modernize their collections capabilities to scale and become most effective before the next economic downturn will avoid struggling to address rising delinquencies when the economy inevitably turns. This will improve lenders' collections performance today and in the future – significantly increasing recoveries, containing costs, and sustaining returns.

Lenders need to develop an omni-channel digitally enabled collections capability. This will ensure that sufficient capacity is available and that costs are kept under control; and it will be essential to enable lenders to contact customers in a timely manner.

In this paper, we discuss four main areas of focus for enhancing collections capabilities that will have the greatest impact during a time of worsening credit quality, and provide a comprehensive checklist to evaluate collections capabilities against this new reality:

1. **Deploy an omni-channel digitally enabled collections process**
2. **Update collections treatment strategies using analytics**
3. **Implement enhanced portfolio monitoring and management**
4. **Enrich customer information before the delinquency**

Upgrading capabilities will ensure that: customers are able to interact with the bank in the most effective and efficient way possible; that collections treatments strategies are optimized given individual customer circumstances and preferences; that the flow of accounts into collections is minimized; and in cases where this is not possible, the required information is available to determine the best course of action as accounts enter collections.

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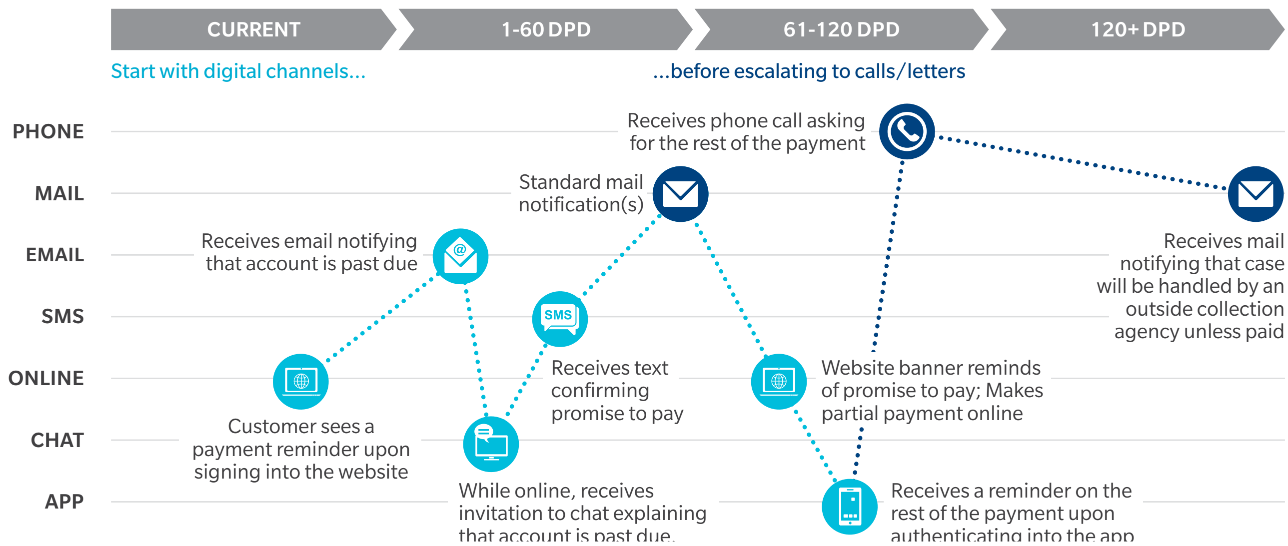
1 DEPLOY AN OMNI-CHANNEL DIGITALLY ENABLED COLLECTIONS PROCESS

The proliferation of smartphones has fundamentally transformed consumers' lives and pushed interactions with lenders into the digital realm. The shift into digital and mobile has been swift and widespread, as over 50% of US homes no longer have a landline[1] and many Millennials do not even use their phones to talk, preferring to communicate via messenger platforms like SMS, WhatsApp, and iMessage.

Despite this massive shift in consumer behavior, consumer credit collections is often still highly focused on the outbound call center model, with optimization across alternative channels still limited[2]. Unsurprisingly, borrowers are choosing not to pick up calls at increasing rates, influenced by the widespread use of mobile numbers by telemarketers and scammers. If a consumer receives a call from a blocked number, or one they don't recognize, they often just ignore it[3].

In our view it is essential that lenders leverage all potential channels of customer interaction to reach delinquent borrowers. Failing to leverage digital capabilities will dramatically reduce effectiveness and limit access to entire demographic segments. Customer touch points and the journey across channels must be considered, with the trend being towards more intelligent and interactive functionality and consistency of experience. In Exhibit 1, we outline a future-state collections interaction, leveraging the phone, physical mail, email, SMS, the internet, chat and a dedicated mobile (phone and tablet) application.

Exhibit 1: Omni-channel customer interaction



1 National Center for Health Statistics.

2 Source: Oliver Wyman Collections Benchmarking Study (2017).

3 In fact, the Federal Communications Commission (FCC) recommends that consumers let calls from unknown numbers go to voicemail, and subsequently a large number of those are often ignored or simply deleted.

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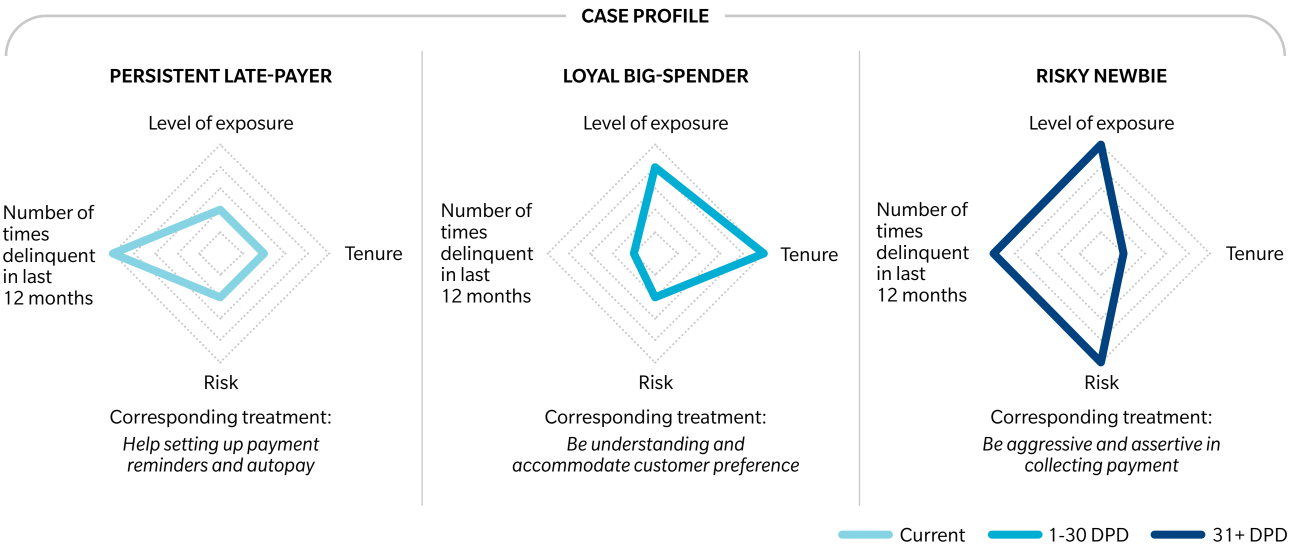
Digital capabilities can also be used to improve the performance of traditional collections channels. One challenge during borrower interactions is to ensure that a collection agent can quickly and effectively evaluate the borrower's situation and present options for remediating the delinquency. One powerful technique for quickly enabling the collections agent to evaluate a wide range of analytical information is to render that information into a "picture" that humans can rapidly and effectively assimilate. In Exhibit 2, we show how collections data can be presented visually using a combination of shape and color to propose the optimal treatment option for particular types of customers.

Exhibit 2: Intuitive presentation of case profile and treatment suggestion



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2 UPDATE COLLECTIONS TREATMENT STRATEGIES USING ANALYTICS

Having put in place the necessary channels, lenders need to embed intelligence into collections processes to ensure that accounts are routed along the optimal path, using the best contact strategy and presenting the best possible treatment options to the customer. The objective is to maximize recoveries while managing costs to a sustainable level, though the precise trade-off may vary according to the individual lender.

Many lenders have established their collections and recovery processes based on the number of days past due (DPD) and a few additional dimensions (e.g., balance, risk). Although this method has been used with a reasonable degree of success in the past, it does not recognize that a contact strategy and treatment that work well for one type of customer may not work for another, and given changes in consumer behavior and interaction patterns, may not work well in the future.

We propose a different approach, where lenders identify the primary dimensions that define different types of customers and collections use-cases. Lenders need to start segmenting customers and collections cases initially by exposure, risk, and behavioral dimensions, along with capacity and willingness to pay, preferred contact method, and preferred channels of interaction. This much more differentiated and tailored approach will ensure that resources are allocated in the best way possible, significantly reducing inefficiencies for the bank.

Analytical techniques can be deployed to develop multiple scores, which then drive improvements in strategies and treatments and cross-channel management. Lenders will need to develop particular treatments for each segment (ultimately drilling down to the individual customer and product level), and deliver these seamlessly across channels, using a test-and-learn based approach to refine and improve offers and response rates. An example of such a "test & learn" collections lifecycle is shown in Exhibit 3.

By way of example, for a large retail bank, Oliver Wyman used machine learning to build customer scores and segmentations to optimize cross-channel treatment strategies. Machine learning techniques analyzed billions of data records and hundreds of variables. Contact strategies and treatments were defined and optimized on a test & learn basis, using real outcomes to measure the effectiveness of different segment-level "treatments". This allowed the bank to collect cash faster and more efficiently. As a result, the bank was able to reduce the number of calls by 35%, with no adverse impact on credit performance.

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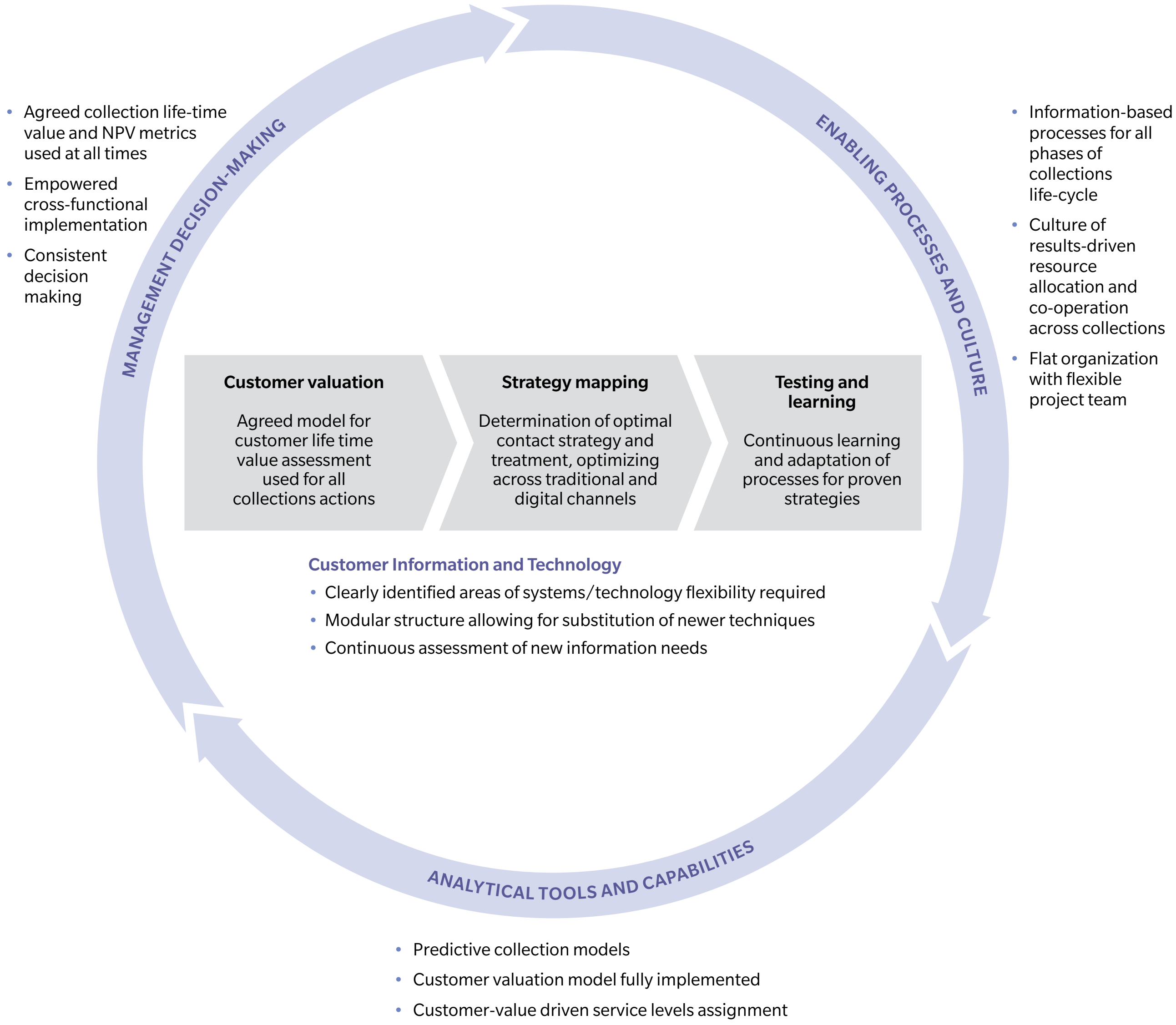
Exhibit 3: Collections and recoveries "Test & Learn" lifecycle



- For Collections the key requirements are process reliability as much as value optimization
- Priority fixes to bridge the gaps should address reliability, establish value and, then, how to optimize

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3 ENHANCE PORTFOLIO MONITORING AND MANAGEMENT

Ideally lenders should proactively manage their portfolios to minimize the flow of accounts into collections in the first place. In practice, they monitor and manage their credit portfolios using methods of varying degrees of sophistication. At the most basic level, they monitor changes in observable risk metrics across key segments and sub-segments of the portfolio and take actions in case of rising delinquency. Many lenders now also have at least some form of behavioral scoring and early warning systems in place.

We propose a more proactive approach, where the lender uses a suite of sophisticated risk and behavioral scores to monitor the portfolio and harnesses analytics to initiate engagement with customers to improve performance. In order to achieve these goals, lenders must develop more extensive data sets, including both non-traditional and unstructured data, as well as leverage advanced analytical techniques including different types of machine learning. Lenders also need to build more accurate and expansive sets of metrics; for example, cash-flow predictive scores, integrated customer scores, and sentiment-based early warning indicators.

Lenders can use these more advanced models to accurately identify risky customers at an early stage and proactively restrict risk exposure by adjusting credit limits and improving authorization and pricing strategies. Interestingly, improving understanding of credit-worthy customers' risk profile may also help identify opportunities to improve penetration and cross-sell of credit into the portfolio. To accomplish this, lenders will need to apply a suite of tailored treatments to clients and products across the portfolio, depending on the risk-return profile and susceptibility to stress. We provide an overview of such portfolio management treatments in Exhibit 4.

By way of example, Oliver Wyman successfully improved risk costs and revenue through the use of analytics and improved portfolio management. Specifically, we used advanced modelling techniques to develop and deploy multiple customer and product level risk scores and transaction-level analytics in a consumer credit portfolio. This included limit decreases and no-pay strategies, in addition to selective proactive limit increases and cross-sell/up-sell strategies. The effort resulted in a 30 basis points (bps) improvement in risk costs and a 20 bps improvement in revenue, equivalent to an increase of over 350 bps in returns for the portfolio.

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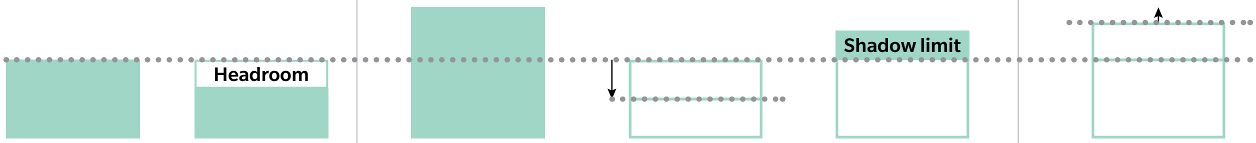
Exhibit 4: Overview of portfolio management treatments



SET CREDIT LIMIT

Contractual limit

- Amount of credit previously extended to the customer as a result of a credit decision

Utilized limit (balance)

- Amount of the actual limit utilized by the customer
- Equal to the actual limit for a fixed payment product
- The utilized limit might exceed the actual limit in the case of a decision to pay an over-limit transaction

MANAGE RISK

1 Pre-approved limit

- Amount of credit bank is willing to extend to customer due to customer characteristics and behavior

2 Limit decrease

- Reducing limits for high-risk customers pre-default

3 Authorizations (pay/no pay)

- Shadow limits are standard mechanism for automating pay/no pay decision
- Shadow limits are not communicated to the customer
- Shadow limits are not the only mechanism for pay/no pay decision

4 Back-book re-pricing

- Increasing of margins on existing business to ensure that risk costs are covered
- Subject to product terms and conditions and consumer protection regulation

5 Loan restructuring

- Restructuring of debt prior to customer default
- Reducing debt burden through extension of term for fixed-term loans, consolidation of unsecured and secured debt, reduction in effective rates and use of repayment plans or similar mechanisms

CREATE VALUE

Limit increase, further advance or top-up

- Increasing limits to credit-worthy customers
- May increase beyond pre-approved limit if the updated application data warrants

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4 ENRICH CUSTOMER INFORMATION BEFORE THE DELINQUENCY

It is difficult to optimize collections if the customer cannot be contacted or profiled, no matter how sophisticated the strategies or treatments that have been implemented. Many lenders struggle with the availability and quality of information on borrowers, often including basic contact information. In some cases, this data deficiency is a symptom of a siloed organizational structure, where servicing functions do not focus on the data needs of collections, while in other cases, the lack of borrower data is simply due to a lack of a robust data management strategy. Limited borrower data forces collections teams to attempt to locate information on the borrower post-delinquency, when information could be more easily and accurately collected prior to the delinquency.

Lenders need to be deliberate in defining their data needs and proactive in collecting and enriching data through the course of normal customer interactions. They also need to leverage the full suite of internal and external third-party data sources available to augment and validate existing customer information. Implementing this strategy requires clear definitions of critical data elements and data validation rules for collections as a part of an enterprise-wide customer data strategy. Servicing has an opportunity to leverage each and every customer interaction to proactively gather, verify, and update customer information, on a prioritized and iterative basis (also known as a "drip feed" data collection process). This approach ensures that critical data items are in place when a borrower becomes delinquent, while also ensuring the process is not overly onerous for the customer.

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IMPACT

There are several notable benefits of modernizing collections:

1. Ensure that digital channels are properly equipped and available in collections, allowing customers to interact how and when they want, in the most efficient and effective manner for the bank
2. Reach customers with the right offer at the right time, and hence collect more effectively and efficiently (which is particularly important for more indebted, multi-banked customers)
3. Identify at-risk customers early and facilitate proactive treatments by leveraging comprehensive and accurate information on borrowers
4. Ensure that accurate contact information is available at the time of delinquency and increase the lender's chances of collecting when competing with other lenders

The impact will be to allow the lender to maximize recoveries whilst managing costs to a sustainable level, consistent with the defined objective function. Financially the payout from initiatives in this space is normally large, with pay-back ratios of 5 or even 10 to 1 not being uncommon, not to mention the avoidance of adverse impact on reputation or share price effects in cases of not getting this right.

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PERFORMING A SELF-ASSESSMENT

We have created a seven-component framework to conduct a high-level self-assessment of a lender's capabilities, and suggested areas for investment. This framework outlines the typical state of collections operations today, what is currently best-in-class, and predicts what the future might look like as lenders continue to invest in their capabilities.

		CONVENTIONAL METHOD	BEST-IN-CLASS TODAY	POTENTIAL FUTURE
1	**Strategy**	• Limited segmentation of collections cases and differentiation in treatments • Ad-hoc test-and-learn efforts • Collector skills are only broadly considered in case assignment	• Broad segmentation of collections cases • Treatments are differentiated by several dimensions • Continuous test-and-learn efforts limited to certain channels • Collectors are segmented by skillset and assigned cases accordingly	• A holistic collections strategy that determines all aspects of borrower segmentation and interaction (timing, intensity, collector assignment, etc.) • Treatments are differentiated by all dimensions as analytically proven effective and continuously refined through test-and-learn • Collectors' skills and performance are individually managed and considered in case assignments
2	**Data footprint**	• Standard customer data gathering during onboarding and new product applications • Skip trace efforts if contact information is inaccurate	• Collections data strategy, where critical data is identified and drip-feed techniques are leveraged • Collaboration with other functions to improve availability of accurate critical data prior to delinquency	• Enterprise-wide data strategy to gather, verify, and update data across the customer lifecycle and across channels • Big data capabilities in line with the enterprise-wide strategy
3	**Operating model**	• Use of off-shore collections teams • Use of collections agencies as necessary • Limited collaboration to optimize collections agencies' capabilities	• Selective off-shoring of labor-intensive collections functions • Limited collaboration and data exchange with collections agencies • Champion/challenger collections teams	• Strategic use of collections agencies (based on case type and skillset) and seamless integration • Collaboration and integration with collections agencies to democratize best practices where appropriate • Fluid exchange of information and joint task force with other functions in the bank
4	**Processes**	• Processes and policies defined at a very high level • Limited automation • Most decision making done by managers	• Detailed processes and policies covering more cases • Increased automation and workflow support • System-guided decision making and offer suggestions	• Highly automated processes and workflow support • Extensive use of automation technologies • Fully integrated collections systems • Decision making supported by advanced analytics
5	**Personnel**	• Skills sought for collections agent recruitment are fairly basic • Standard classroom and on-the-job training • Title/pay-grade based career progression	• More nuanced skills sought for agent recruitment • Standard classroom training, more intense on shadowing and on-the-job training • Skill-based career planning • Complex, commission-based compensation	• Skills sought for agent recruitment are in line with their specialized case assignments (e.g., soft vs. hard approach) • Brief classroom training, more intense on shadowing and on-the-job training, periodic refresh of training, and e-learning capabilities • Skill-based career planning with a strategy to retain best talent • Commission-based compensation aligned with lender's overall collections strategy
6	**Channels**	• Collections mostly through outbound and inbound calls and letters • Use of predictive dialers • Non-integrated collections agent screens containing limited borrower information and few analytics	• Additional channels are available for collections, including e-mail, online, SMS, mobile app, and chat • Channels operating largely independently and have limited self-serve functionality • Fewer collections agent screens containing borrower information with policy-based (static) guidance for decision making	• Self-serve channels capable of delivering customized treatments and offers • Omni-channel integration (e.g., single collection process flows seamlessly across channels) • Single collections agent screen that offers critical borrower information, which can be consumed quickly via visual aids • Systems provide real-time guidance for decision making (treatments/offers updated based on customer response) • Use of self-serve 'robo' based collections agents to support negotiation, offer generation and performance monitoring
7	**Analytics**	• Periodic reporting on standard collections metrics • Ad-hoc hypothesis testing	• Data analytics focus to test strategic hypotheses • Continuous test-and-learn efforts, but limited to certain channels	• Advanced analytical capabilities that surface intelligence to inform portfolio management and collections strategies and leverage a wide set of information from internal and third party sources • Strong machine learning capabilities to support test-and-learn across all channels • Predictive delinquency/default analytics that allows preemptive/early interaction with the borrower

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CONCLUSION

Lenders may realize meaningful benefits by proactively enhancing their credit portfolio management and collections capabilities prior to the next recession. We believe that lenders should seek to build these capabilities by deploying a straight forward, three-step approach:

1. **DIAGNOSE**
   Evaluate the current state of your capabilities and identify areas of improvement:
   - Use Oliver Wyman's seven-component framework to guide you through a comprehensive analysis of your current capabilities
   - Include in the diagnosis relevant capabilities outside of the collections domain (e.g., test-and-learn capabilities in Marketing)
   - Evaluate your position against your peers and against your own potential

2. **STRATEGIZE**
   Formulate/revisit your credit portfolio management and collections strategy:
   - Define your aspirations for collections, being specific on what could happen in an economic downturn and how you will need to react to ensure your losses do not exceed risk thresholds
   - Consider you customer habits as they relate to where and how they want to interact with you, and the capabilities to direct that interaction that the current technology environment makes possible
   - Pay particular attention to the four high-impact areas presented in this paper as you consider areas for investment

3. **IMPLEMENT**
   Implement the required capabilities and supporting technology to enable required capabilities:
   - Determine improvements and investments required for each "enabler" using our seven-component framework and express them in terms of initiatives and investments
   - Identify and implement "quick-win" initiatives to build momentum from the start
   - Define a longer-term, multi-year roadmap to reach the target state

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