QUALCO

THE DEBT PORTFOLIO BLUEPRINT

How to build a strategy to enable effective collections, recoveries, and debt sale

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FOREWORD

"Businesses across all sectors are searching for increasingly sophisticated ways to improve their collection and recovery practices, with the front runners investing heavily in their understanding of customer behavior and the customer journey"

Over the last 10 years, there has been a real focus on more efficient and ethical debt collection and recovery (C&R). This is needed across the full spectrum of business activity, though different sectors and geographies find themselves at different points in the cycle.

Since the credit crisis, financial services firms have drawn much of the limelight as their portfolios of non-performing debts have swelled.

Research by the International Monetary Fund (IMF) found that non-performing loans (NPLs) in the European Union (EU) stood at about €1 trillion (or over 9 percent of the region's GDP) at the end of 2014, more than double the level in 2009.

Rates of default and debt delinquencies experienced by other creditors, such as utility companies, retailers and businesses have also risen, affected by the same economic and political circumstances.

Businesses across all sectors are searching for increasingly sophisticated ways to improve their collection and recovery practices, with the front runners investing heavily in their understanding of customer behavior and the customer journey as a way of doing that. It is no longer sufficient to apply broad strategies to debts. Instead, bespoke solutions are needed to increase efficiency and meet exacting regulatory standards.

Many have found that they need to update their strategy and adapt their operations to meet the new challenges of C&R. They may have discovered that their performance has been inconsistent for managing this growing problem.

Technology plays a vital role. If the right technology can be brought to bear on debt, and those who owe money are approached and engaged in the right way, recoveries and customer experiences can be optimised.

When using state of the art technology to handle the mass of data available on credit accounts, the key focus needs to be on the customers themselves and each individual's circumstances.

Knowing the customer is essential. Once the full details of their circumstances are known, examined and understood, then appropriate measures can be taken to engage with them successfully. This requires a granular approach, using the data innovatively to achieve new levels of understanding.

When this is carried out in the right way, the business can achieve a streamlined and efficient collections process, whether in-house, on an outsourced basis or through debt sale. In all options, the relationship is the key to success.

While financial institutions contend with requirements on capital efficiency and reporting, all sectors face changing expectations on how they handle accounts and individuals in arrears, while wrestling with the best ways to harness and deploy data.

This paper explains how senior management and heads of collections and recoveries can, by using available specialist technology, set a strategy to achieve optimal results.

—

Spyros Retzekas,
Chief Client Officer
Qualco

SPEED READ: EFFECTIVE COLLECTIONS & RECOVERIES

Technology exists to enable creditors to optimise their C&R processes. The key challenge lies in navigating the vast amounts of data available and applying robust analytics.

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Refined data, a carefully designed strategy, and close monitoring lead to a better understanding of customers and their ability to pay. This results in increased efficiencies and a highly-compliant customer approach.

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Once the best strategies are established, whether C&R is performed in-house, by a debt collection agency (DCA) or debt buyer, the likelihood of recovery is more predictable and forecasting accuracy increases.

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As well as choosing the right technology, is it vital to work with an ecosystem of outsourcing partners (DCAs, legal firms, data enrichment agencies) that have the knowledge, skills and experience appropriate to individual customer segments.

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Successful C&R requires continuous monitoring of performance and reevaluation as circumstances change. This achieves a high-quality customer journey, vital to a successful approach in today's environment.

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Establishing bespoke collections strategies by using sophisticated technology and data interpretation is essential to achieving C&R success.

A COLLECTION AND RECOVERY STRATEGY FIT FOR PURPOSE

The need to develop an effective C&R strategy with a clear business case has never been more imperative.

Creditors across Europe saw their rates of default spiral in the years after the financial crisis, from banks and credit card issuers to utility companies, telecoms providers, retailers and debt purchasers.

In some geographies debt sale has become an established method of handling non-performing accounts when in-house collections have been attempted. With the recent number of mergers of debt purchase businesses in Europe and beyond, this option will expand to jurisdictions that have not yet deployed debt sale as a strategy.

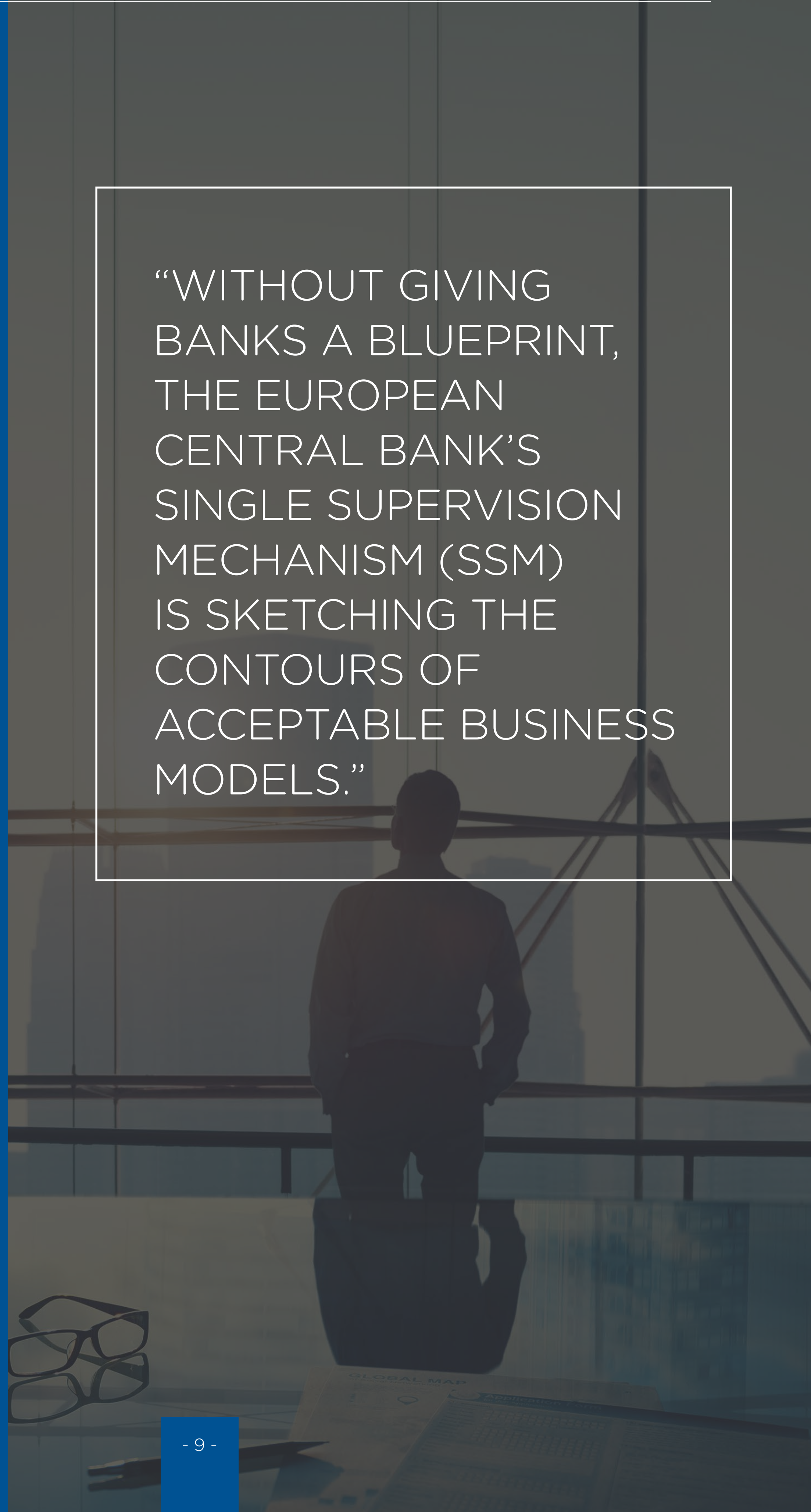
There are plenty of debts that could be purchased by specialist organisations. For example, research from Deloitte found that "…major European banks have over EUR 800 billion of NPLs on their balance sheets…"

At the same time, new regulation of credit institutions has forced them to hold high levels of capital and circumscribed how banks should operate, as Marcus Evans, Partner, KPMG European Central Bank Office, Frankfurt has noted:

"Without giving banks a blueprint, the European Central Bank's Single Supervision Mechanism (SSM) is sketching the contours of acceptable business models. It will challenge banks in 2016 to prove that they can generate capital, even in an environment of low-yields, high NPLs and rising risk weights. For some banks the 'math' will not work, prompting a re-think of their pricing, products and portfolios."

These factors coincide with increased consumer protection legislation that prescribes how customers can be treated by those seeking to recover money owed to them. In the UK, for example, debt buyers have invested heavily in achieving customer satisfaction levels that exceed even the lenders' own records. Some have achieved net promoter scores as high as +44%.

There is growing pressure on creditors to work more efficiently and more compliantly, yet across Europe many lack the tools and expert staff to successfully navigate these changes.



"WITHOUT GIVING BANKS A BLUEPRINT, THE EUROPEAN CENTRAL BANK'S SINGLE SUPERVISION MECHANISM (SSM) IS SKETCHING THE CONTOURS OF ACCEPTABLE BUSINESS MODELS."

It is time for organisations to take a more thorough approach to C&R and adopt customer-centric, efficient strategies.

This is significantly worthwhile because the benefits of putting effective processes and procedures in place are clear to see. Success ensures:

- MORE ACCURATE FORECASTING
- REDUCED LOSSES
- HIGHER LEVELS OF CUSTOMER SERVICE
- LOWER RATES OF DELINQUENCY
- LOWER PROVISIONING / OPTIMISED BALANCE SHEET
- BETTER CUSTOMER EXPERIENCE AND SUSTAINABLE LONG-TERM PAYMENT ARRANGEMENTS
- MORE EFFICIENT USE OF CAPITAL
- HIGHLY-COMPLIANT APPROACH

Harnessing powerful technology to clean and refine debt portfolio-related data is an important first step. This includes examining data available from within and outside of the debt portfolio.

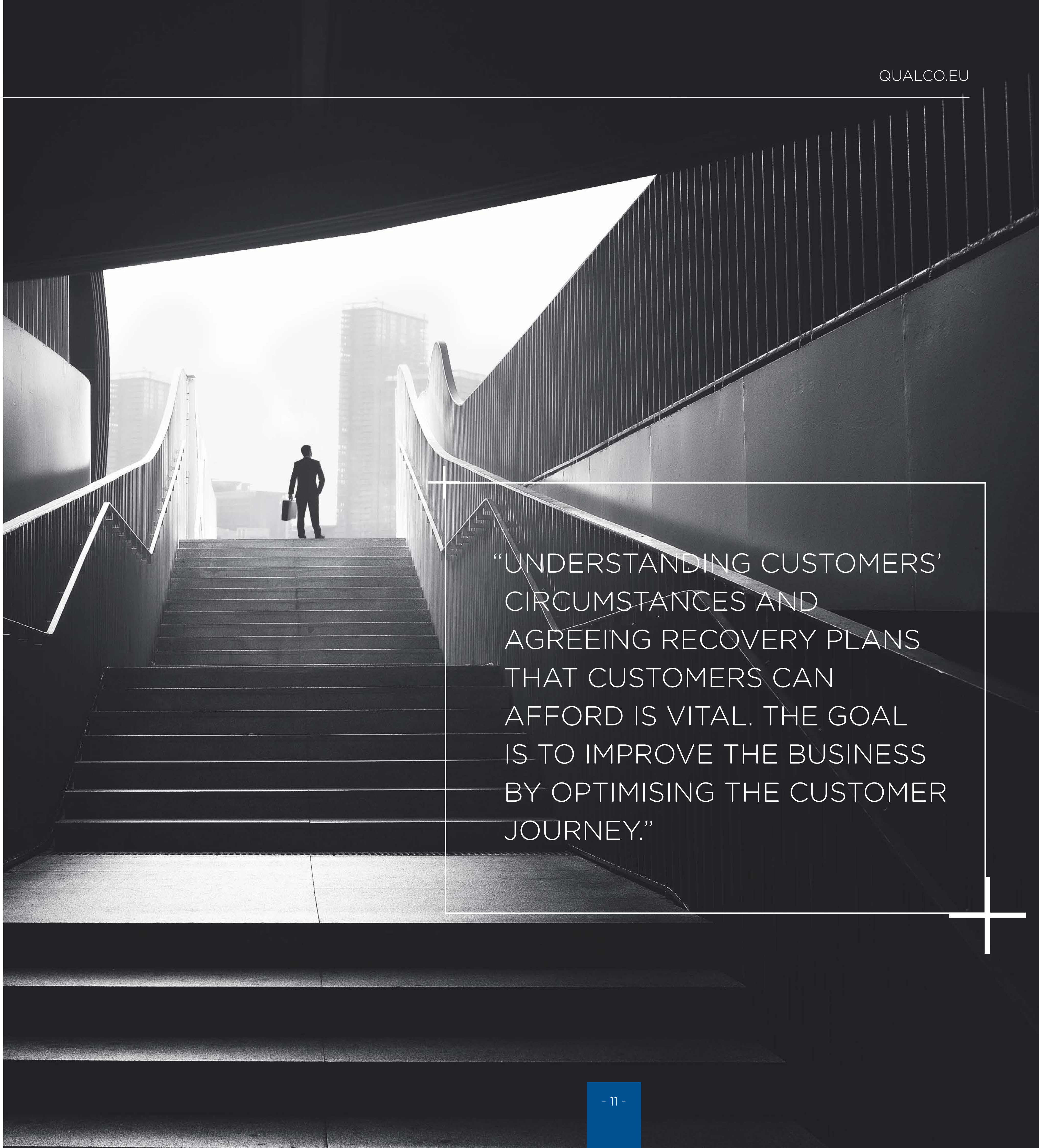
Employing the best skilled DCAs from a panel of service providers to work with different segments of a portfolio requires an understanding of the strengths and capabilities that those DCAs possess. Once appointed, the manner of approach and the ongoing relationship with customers is of primary concern. This is true for both in-house and external collections.

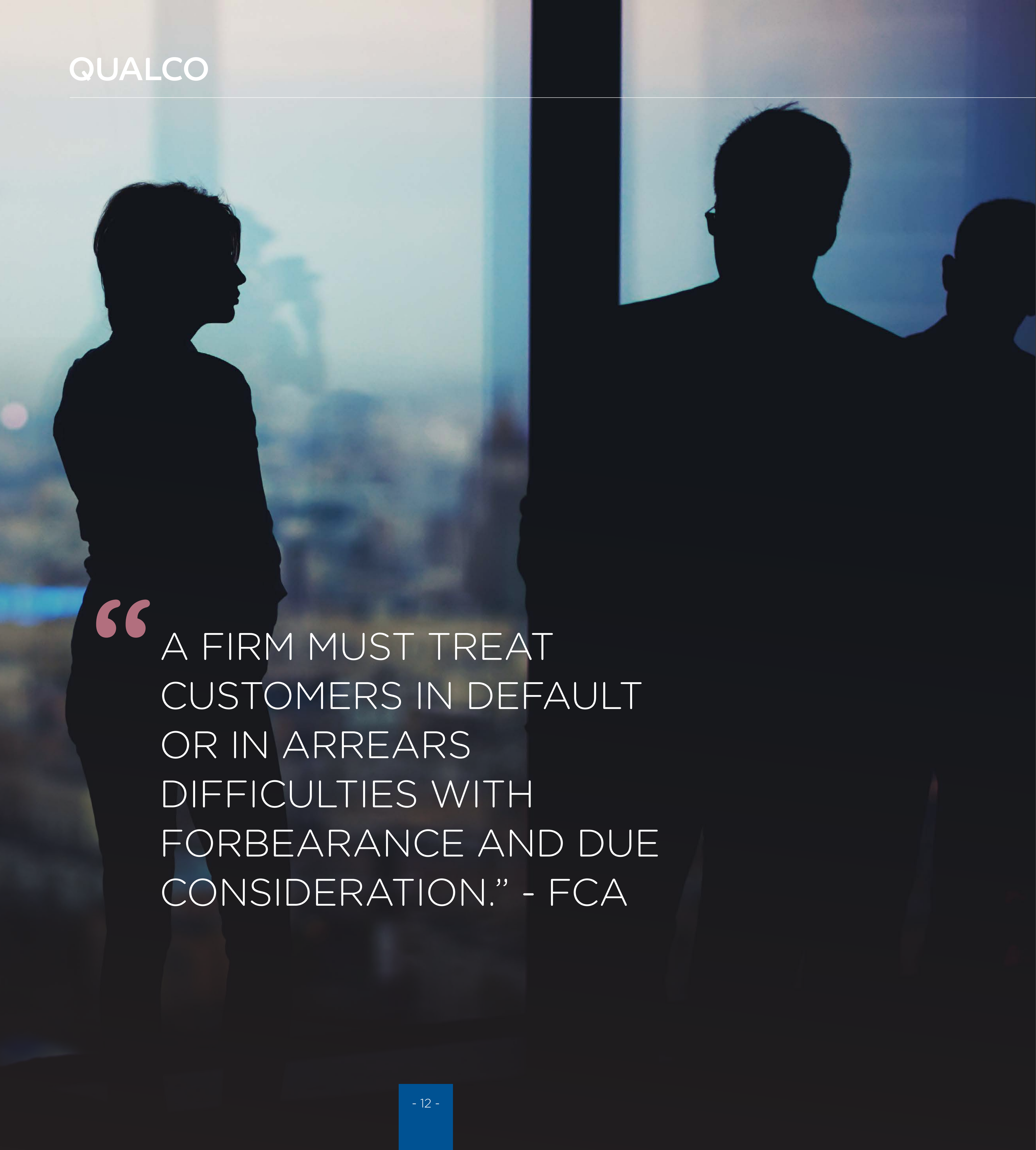
It is therefore important to use technology to monitor the collections process and determine if forecasting is accurate and behaviour compliant. Likewise, selling debts for optimal returns requires data, forecasting and pricing expertise, as well as confidence in the quality of customer journey provided.

Lastly, automation of parts of the portfolio management process ensures that team members are deployed where they can be most effective, for example in dealing with vulnerable customers and complex accounts instead of routine payments.

Technology can be used to ensure customers are contacted through their preferred channels. This benefits both customer and creditor – for example in reducing the cost of collections through the use of online portals for individuals to manage their accounts.

Applying the correct strategy ensures consistency and compliance in portfolio management. Technology tools enable debt owners to pursue their C&R strategies while at the same time remaining sensitive to individual customers' circumstances.





“A FIRM MUST TREAT CUSTOMERS IN DEFAULT OR IN ARREARS DIFFICULTIES WITH FORBEARANCE AND DUE CONSIDERATION.” - FCA

PORTFOLIO DATA

Streamlining an end-to-end debt rehabilitation system relies on the agile application of powerful, specialist and scalable technology. Data capture is the first step.

In the UK, where the industry has experienced massive change in the way collections teams operate, the Financial Conduct Authority’s Consumer Credit Sourcebook sets out conduct standards for them to follow. “A firm must treat customers in default or in arrears difficulties with forbearance and due consideration,” it says.

This means collections professionals are obliged to consider waiving interest on accounts, allowing customers to defer payment of arrears and accepting token payments for a reasonable time.

In this changed environment, working with the customer and thoroughly analysing and segmenting data on outstanding debt is essential.

Once clean, the data can be segmented in a variety of ways. For example, by size, duration, nature – whether secured or unsecured, consumer loan or overdue credit card receivable, where customers live geographically, their occupation, gender and any other data available, including economic and behavioral information. This enables the customers to be carefully profiled in relation to the debts that they owe.

In addition, external data can be brought into the analytics. For example, economic data, market rates of recovery, county court judgements and deceased records.

GOAL SETTING

When creditors have a clear picture of customers, their debts and circumstances, accurate recovery forecasts can be agreed with collections teams and external partners.

Rates of recovery will vary, depending on the age and nature of the account, as well as the economic and regulatory environment in which the team is operating. However, effective analysis of the best method of collections for particular account segments will maximise success rates.

> Persistently high NPLs hold down credit growth and economic activity. High NPLs tie up bank capital that could otherwise be used to increase lending, reduce bank profitability, and raise funding costs, thereby dampening credit supply. Reducing NPLs expeditiously will therefore be crucial to spur credit growth, especially to small and medium-sized enterprises (SMEs) that are more reliant on bank financing.
>
> IMF

Creditors should optimise portfolio performance by considering all collections options, whether that be in-house expertise, specialist agencies or a debt sale process.

Recognising when to pursue a debt sale strategy instead of deploying scarce in-house resources is sensible. Likewise, careful placement of account segments with specialist agencies suited to their nature will result both in better business and customer experiences.

“REDUCING NPLS EXPEDITIOUSLY WILL THEREFORE BE CRUCIAL TO SPUR CREDIT GROWTH, ESPECIALLY TO SMALL AND MEDIUM-SIZED ENTERPRISES (SMES) THAT ARE MORE RELIANT ON BANK FINANCING.”

APPROACHING THE CUSTOMER

Having a clear picture of the debt determines how the customer is approached, whether by an in-house team or external partner. For example, when a creditor has an understanding of the DCA market and the capabilities of a wide variety of service providers, it can match groups of debts to in-house teams, DCAs and other service providers who have appropriate skills and expertise.

Some providers will cover particular geographical areas, regions or countries. They may have experience in particular types of debt collection, perhaps by the nature of the debt, the industry sector or its duration. Likewise, in-house teams may specialise in categories such as vulnerable customers.

Armed with refined customer data, a collections professional will be far more likely to establish a positive dialogue and achieve successful recoveries than if they are handed a random assortment of unsegmented, miscellaneous data. They will be able to contact the customer more quickly with a more accurate and intelligence-led collection plan.

In some cases, it may be appropriate to provide a DCA with instructions that are pre-defined, including a degree of scripting for communications, to align with the client's own culture. In other cases, the partner may have the expertise to advise on the best course of action.

In any event, two forms of communication are important at this stage. For regulated accounts the customer contact must be in line with Financial Conduct Authority guidelines on the "Treatment of customers in default or arrears (including repossessions): lenders, owners and debt collectors." This methodology is increasingly transposed into non-regulated sectors and is often viewed as best-practice.

The second form of communication is between the DCA and debt owner to monitor progress and report back. It may be appropriate to adjust the collections approach and process to achieve optimal results based on updated information relating to the individual customers' circumstances.

It is vital to ensure that the recovery plan agreed with the customer is both affordable and sustainable. If a repayment plan is agreed that the customer cannot adhere to, their experience will be poor and time and effort will be wasted.

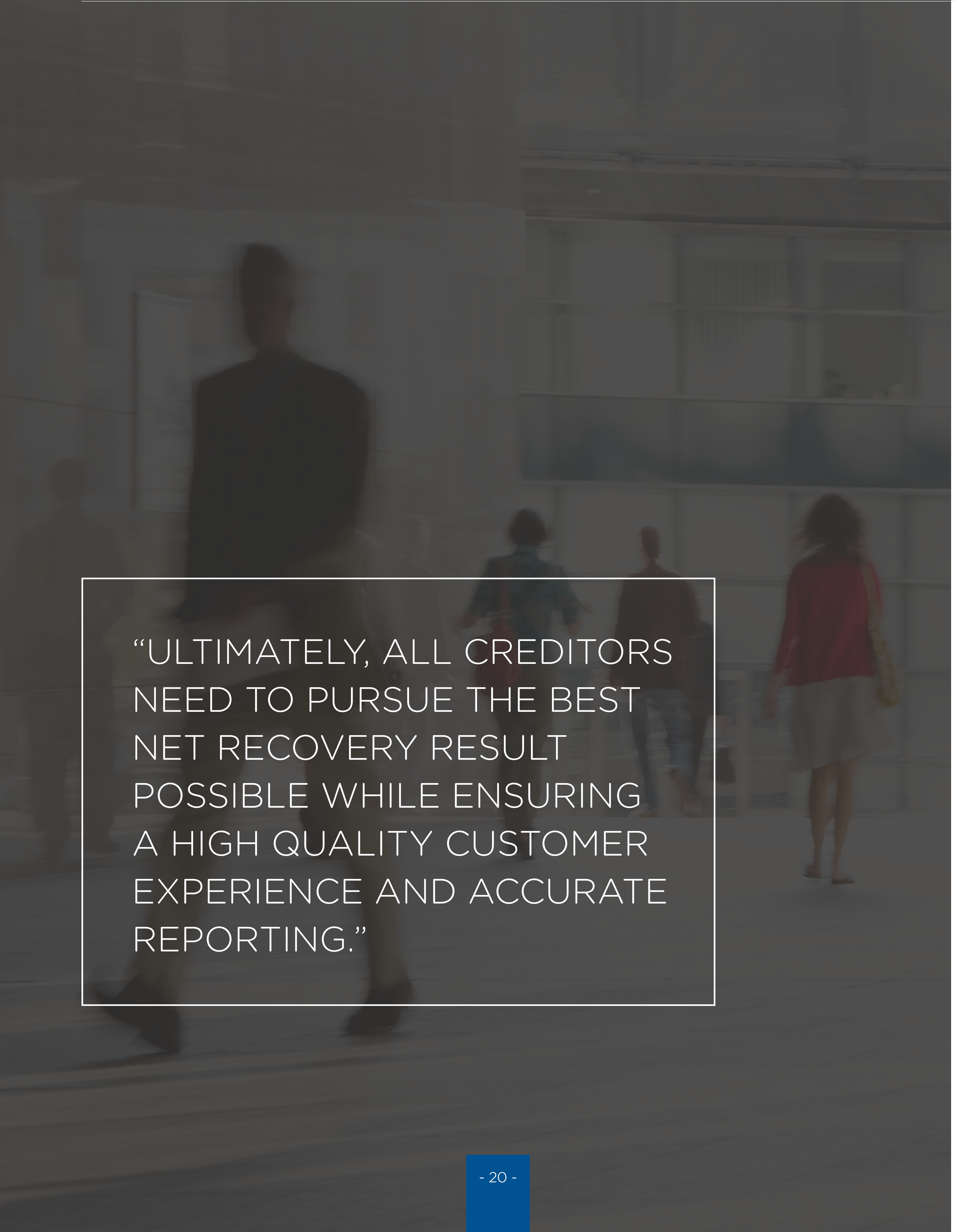
A plan that produces the best possible result for both the customer and the debt owner will be a far more effective one and will result in a better outcome. The likelihood that the creditor will retain the customer will also be increased. Over the longer term, this offers more successful new business while saving on customer acquisition costs.

STRATEGY AND MONITORING

Debt owners need to use accurate data to define their strategies and monitor the performance of collections teams and external partners.

Different debt owners will require different strategies. For all, daily monitoring of progress made in the collection process is best practice. Using reporting technology to measure the amount and quality of contact with customers, plus the success of those interactions, is no longer an optional extra given the highly-regulated markets in which many are operating.

This monitoring will determine whether the collections team is the right one for the task and allow adjustments to be made quickly if necessary. Increasingly, banks operating in highly-regulated markets such as the UK are adopting these best practice standards globally, requiring all jurisdictions to adhere to stringent standards of behavior when interacting with customers, regardless of local legislation.



"ULTIMATELY, ALL CREDITORS NEED TO PURSUE THE BEST NET RECOVERY RESULT POSSIBLE WHILE ENSURING A HIGH QUALITY CUSTOMER EXPERIENCE AND ACCURATE REPORTING."

According to the IMF, reducing European NPLs requires a comprehensive approach based on three key pillars:

- Enhanced prudential oversight to incentivize banks to write off or restructure impaired loans, including efforts to foster more conservative provisioning and imposing time-bound restructuring targets on banks' NPL portfolios. In EU countries the Single Supervisory Mechanism (SSM) and European Banking Authority (EBA) should spearhead this effort, while national regulators will need to take the lead in other jurisdictions.
- Reforms to enhance debt enforcement regimes and insolvency frameworks. Effective out-of-court restructuring frameworks and improved access to customer information should be encouraged.
- Development of distressed debt markets by improving market infrastructure and, in some cases, using asset management companies (AMCs) to jump-start the market.

Some financial institutions are now highly prescriptive about the level of contact their in-house and external teams have with customers, limiting the number of calls or other contacts they make. The principles-based nature of the new regulatory regime in the UK, for example, means there is no hard and fast set of rules to follow. Lenders interpret the guidance themselves, leading to different interpretations of the same regulation that partners must be able to demonstrate adherence to.

In advanced collections markets few, if any, heads of collections now incentivise their teams primarily on cash collected. Instead they have designed systems that value call quality and compliance as their key metrics for staff success and reward.

Monitoring expenses involved in debt collection is also important. The net collection outcome needs to be considered in light of the expense of achieving it, as it may not be economic to keep pursuing an account.

This is where the power of the data and the agility with which it is handled comes into its own. Whether the debt owner chooses to retain the C&R process in-house or to use an external agency, the process and application of technology is similar.

Some debt owners may prefer to directly continue the relationship with their borrowers, at least initially. Others may find that using one or more external agencies to assist them with early arrears or paying accounts is a more efficient route. Debt sale is also an important consideration and one that requires data sophistication and accurate forecasting.

Ultimately, all creditors need to pursue the best net recovery result possible while ensuring a high quality customer experience and accurate reporting.

INVEST FOR AN EFFICIENT AND COMPLIANT COLLECTIONS PROCESS

Debt portfolio management and collections preoccupy businesses across the spectrum. The wealth of data available and the ability to analyse that data in innovative and predictive ways can transform returns, efficiency and customer relationships.

Today, a large amount of raw data covering every aspect of the debt, the customer and the available collection methods is within reach.

Creditors need to take advantage of the technological capability that exists to capture, refine and interpret that data through advanced analytics.

This means accounts can be matched with appropriate methods of collection, either internal to the organisation, through outsourcing to service providers who can adopt the most appropriate approach, or using a debt sale strategy.

Continuing communications with both the customer and external partners is of vital importance in monitoring effectiveness. It is not good enough to continue using unsuccessful standard or legacy methods of dealing with customers whose accounts are overdue – the move to customer-friendly regulation threatens those businesses that fail to adapt.

Using up-to-the-minute reporting from the technology platform immediately highlights which approaches are successful and which ones need to be adjusted. Agile, flexible, scalable technology will grow and change with the demands of the data it is required to work with, ensuring that any new trends in debt performance are immediately factored into collection methods.

> "USING UP-TO-THE-MINUTE REPORTING FROM THE TECHNOLOGY PLATFORM IMMEDIATELY HIGHLIGHTS WHICH APPROACHES ARE SUCCESSFUL AND WHICH ONES NEED TO BE ADJUSTED."

Regulation has had a distinct impact on the debt collection process:

- Firstly, by setting levels of capital adequacy, solvency and provisioning, regulators have forced financial services organisations to address collections performance and safeguard portfolio quality.
- Secondly, new regulatory measures designed to protect consumers from poor debt collection practices have transformed the way we approach and relate to customers.

For all of these reasons debt collection is becoming increasingly sophisticated and reflective of a business's overall culture. It is an integral part of good business administration, requiring a coherent strategy, regular, ongoing monitoring and accurate forecasting.

The business case for investing in C&R technology and processes is clear from financial, regulatory and customer perspectives. Failure to invest is no longer an option if businesses are to survive and thrive in a data-driven, highly-regulated environment.

STEPS TO C&R STRATEGY SUCCESS

1. RESOLVE TO DEVELOP A PROACTIVE AND REALISTIC COLLECTIONS STRATEGY
2. EMBRACE TECHNOLOGY AND INVEST IN USING IT TO ITS FULL POTENTIAL.
3. USE DATA TO GET TO KNOW YOUR CUSTOMER IN DETAIL.
4. ADOPT THE MOST APPROPRIATE APPROACH FOR EACH CUSTOMER'S CIRCUMSTANCES TO ENSURE... SUCCESSFUL COLLECTIONS AND RECOVERIES.

SHARE THIS BLUEPRINT

Are you ready to take our **Debt Portfolio Maturity Audit** and discover how we can help you build a more cost-effective C&R strategy? Find out now.

FILL OUT THE AUDIT

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