The optimal collections process in a regulated environment

Experian Webinar Academy
14 June 2018

Before we start…

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Today’s speaker

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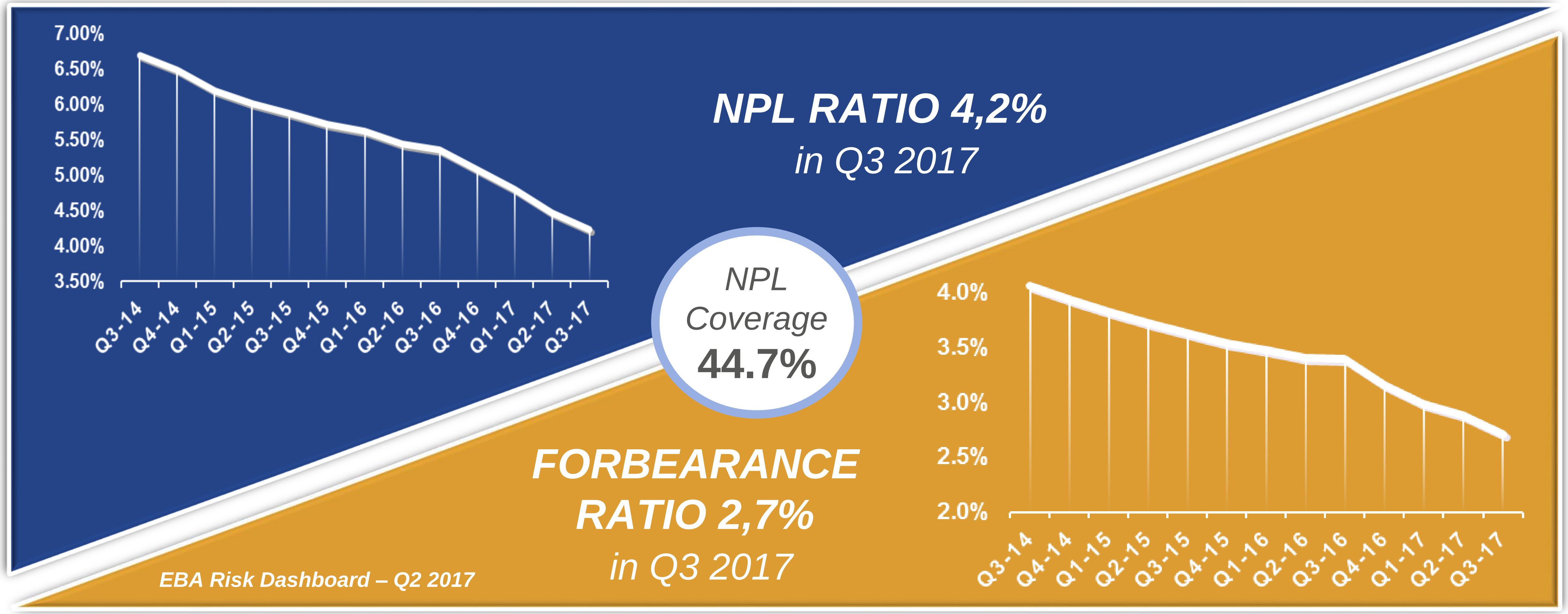
Agenda

1. IFRS 9 impact on the business, NPL regulations
2. NPL management process
3. Early Warning Systems (EWS)
4. The future of Information
5. Benefits for the Business
6. Q&A

Non-performing loans in EU



Any exposure that is at least 90 days past due, or unlikely to be repaid without realization of collateral, is considered to be non-performing. Additionally, exposures which have been restructured, or forborne, may be classified as non-performing

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IFRS 9

Changes

Impacts on credit process

Credit Policy

- **Definition of credit strategies** taking into account a potential transition of the positions from stage 1 to stage 2
- Portfolios have to be simulated for **multi-year periods,** considering the new absorbed risk

Credit Monitoring

- **Early Warning system** evolution
- Inserting in the monitoring dashboard of a series of indicators in order to **prevent the migration from Stage 1 to Stage 2**

Price Origination

- Coherence between **lifetime risk parameters** used for the purpose of risk-based pricing and provisioning purposes. The idea is that the price should cover the associated risk

Governance & Reporting

- **Align IFRS9 impairment process** with other key related areas – e.g. Capital calculation; ICAAP (Stress test)
- **Enhanced reporting** to accommodate additional complexity and flexibility e.g. impairment staging

Recommendations

The fundamental idea of IFRS 9 is the relevance between the risk and the price, i.e. the interest rate

When disbursing the loan, the lifetime risk should be considered for the right decision and pricing

Responsible lending – affordability and using all available information (may include even WEB for legal entities)

Restructuring and pricing – best practice is to re-estimate affordability on household level

ECB's guidance

NPL Comprehensive approach

Strategy
- ✓ Assessing
- ✓ Developing a strategy
- ✓ Defining an operational plan
- ✓ Embedding the strategy

Operations
- ✓ Role of the management body
- ✓ NPL operating model
- ✓ Monitoring and early warning

Forbearance
- ✓ Affordability assessments
- ✓ Forbearance options
- ✓ Forbearance processes

Detection
- ✓ Regulatory default definition
- ✓ Forbearance
- ✓ Additional definition issues

Collateral
- ✓ Governance
- ✓ Valuation approach
- ✓ Foreclosed assets

Provisioning
- ✓ Individual estimation of provisions
- ✓ Collective estimation of provisions
- ✓ Late collection process

ECB guidance on NPL is currently non-binding, although banks should explain and substantiate any deviations upon supervisory request

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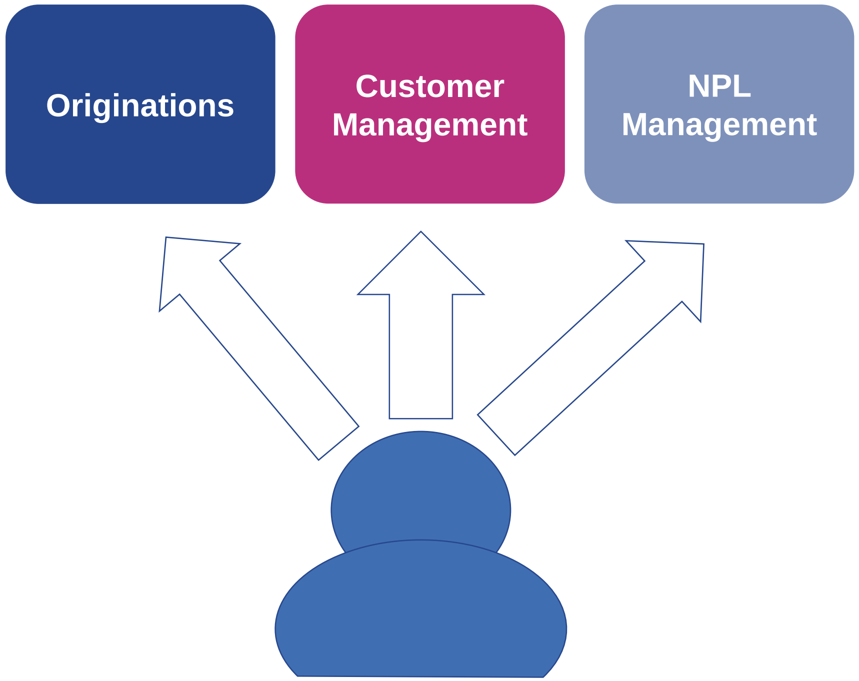
NPL management as part of the lifecycle

One customer across the lifecycle – it's all about the customer!



How NPL affects the customer and other functions:

- Helping a customer **get back on track** results in higher customer loyalty and **longer term revenues** in customer management
- NPL prevention **saves on losses and provisions**, so affects the P&L

How other parts of the lifecycle affect the customer and NPL:

- There are customers that will be **accepted at origination** but will eventually **get into delinquency, default** and legal stage **no matter how well the collections process works**
- **Proper Customer Management** can help prevent significant losses and risk costs

Ultimately it is **all about the customer** – what **they need** (services, convenience) and **what they could afford** (income vs. expenses) and it all starts with **data and insights**

NPL Management – Experian solution

Early Warning Systems

- Forward looking
- Machine learning
- Account and portfolio level triggers
- Up-to-date and forborne accounts

- Reduction of flow rates into higher delinquency stages
- Reduced provisioning levels

Forbearance Measures

- Affordability models
- Forbearance models
- Net Present Value models

- Higher customer loyalty through efficient forbearance measures
- Reduces provisioning levels

LGD for defaulted assets

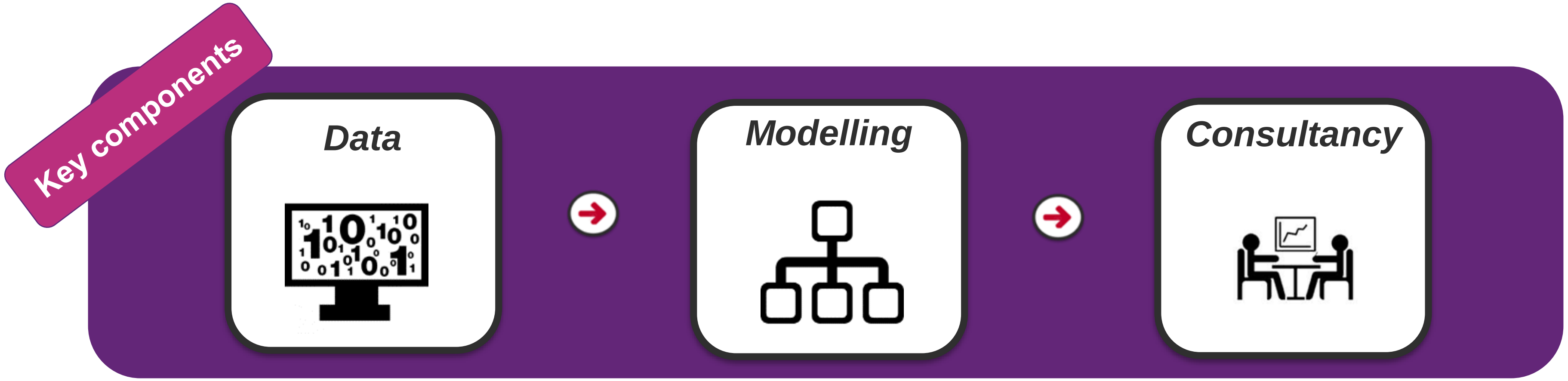
- LGD models for defaulted assets

- Accurate estimation of provisions
- Improved collections process

What is an Early Warning System?

Experian's Early Warning System (EWS) is a comprehensive solution that enables lenders to:

proactively **identify customers** who are currently up-to-date or just past due, but have a **predicted high risk** of becoming (seriously) delinquent in the very near future and **prevent them from doing so**



Internal and external data

Statistical Models and triggers to predict short outcome periods behaviour

PRE and Early Collection strategies and their implementation into the live environment

Early Warning System

Part of the Customer Life Cycle

An EWS delivers early information on expected deterioration of the client’s financial situation and integrates internal data as well as external data to increase its effectiveness.

The role of EWS within the customer life cycle

Underwriting	Customer Management	Pre-default Management	Default Management
✓ Mainly strategic perspective aimed at preventing future delinquency	✓ Identify changing behaviour patterns	✓ Control exposures and product offerings	✓ Contact to offer advice and guidance

Early Warning System

Data Sources for High Risk Prediction

Usually available

- **Loan-specific and client specific data**
- **Credit Accounts data**
- **Revolving Credits data**

Additional data

- **Current Accounts and Savings Data**
- **Credit bureau and Other External data (Trade Register, etc.)**

Advanced/ New data

- **Web Data**
- **Internal Log data from comm., Web-apps, Online banking**
- **Voice Data**

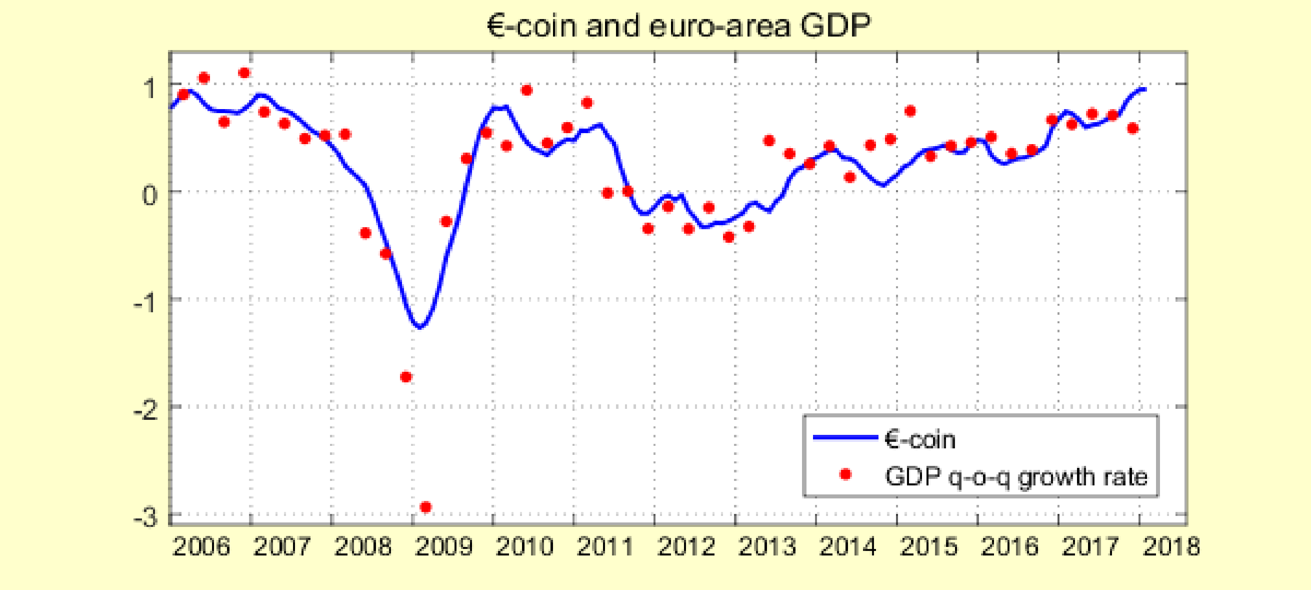
Design of Early Warning Indicators

Nowcasting

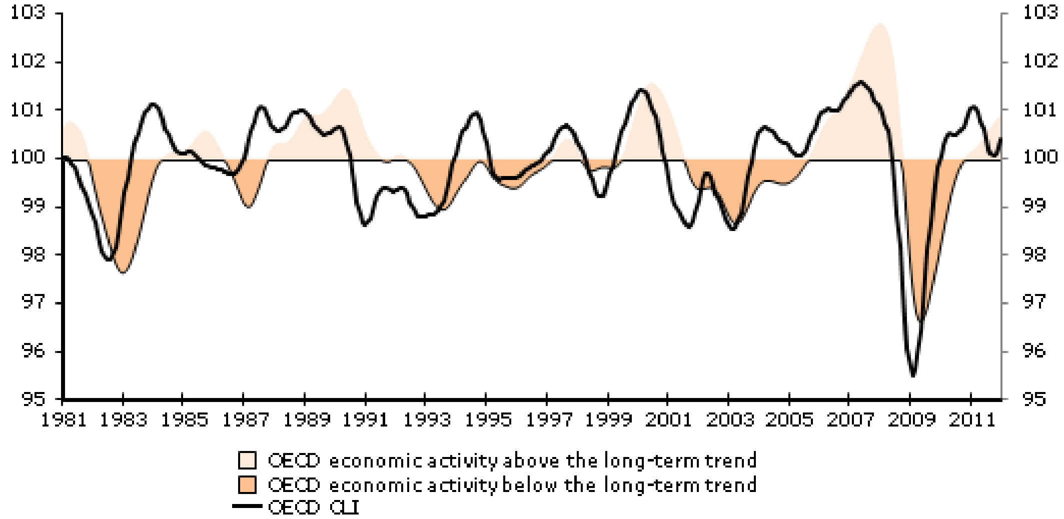
Leading

Forecasting

Altissimo et al. (2008)



OECD's Composite leading indicator on economic activity validation report



Sound forbearance process

Affordability assessment

The affordability assessment of the borrower should be based on the borrower’s current and conservatively assessed prospective future servicing capacity for all borrowings

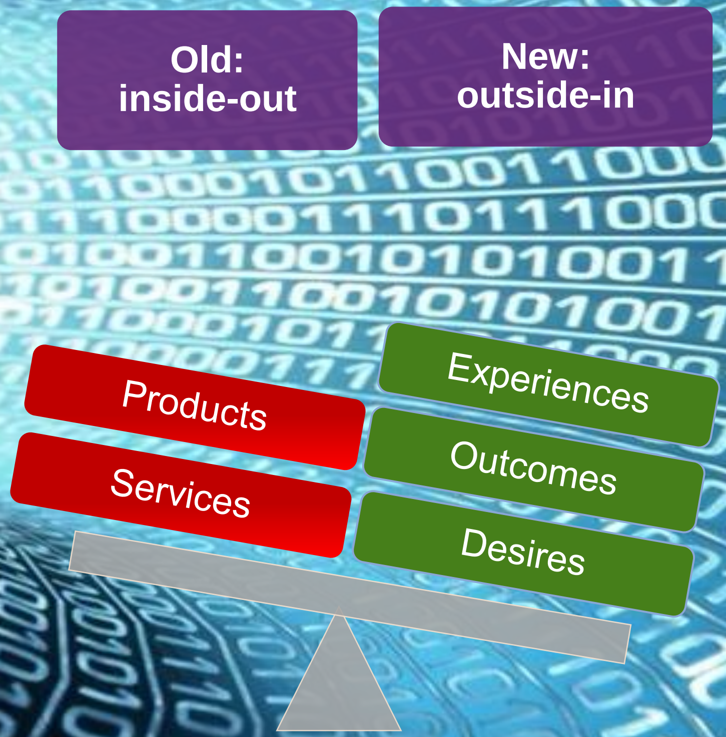
Standardized forbearance products

Identify a wide range of sustainable and effective forbearance solutions for the borrower

Comparison with other NPL workout options

Detecting the most suitable and sustainable workout option for borrowers

We’ve entered the digital era



Web Data Analytics (WDA)

WDA is a complete solution for the measurement, collection, analysis and reporting of web data to have a much better knowledge of your customers within the credit lifecycle

Assessing the customer behaviour through on-line presence measurement

WDA uses new sources of data for individuals and companies to go over the credit data knowing consumer preferences and how they interact with companies on the web

Although Web analytics can be very powerful when used to gather information about private customers, due to different legislations and restrictions on private data, this tool is more commonly used to get data about legal entities, i.e. SMEs and Corporations

Transactional Data Insight

TDIS is a complete solution to extract value from credit card or current account transactions

Knowing Your Customer on a transactional level

TDIS uses historical payment data and credit card data for modelling of income estimation, enhancement of customer insights and detection of early warning and fraudulent transactions.

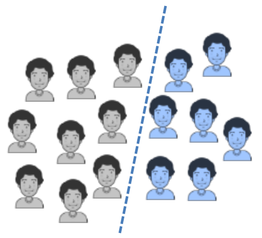
- Segmentation
- Retention and spending stimulation
- Notification, spend alerts and anomalies detection
- Look-alike spending patterns
- Fraud alerts and fraud detection
- Income estimation

Applying machine learning as an Early Warning Trigger

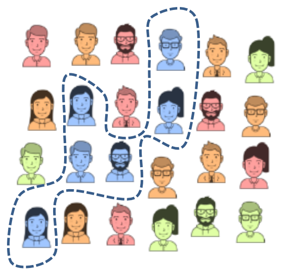
Collections and recoveries

Machine learning in collections and recoveries helps to predict risk better and more dynamically and to manage the collections team's performance. The advantages of the use of this technology is to identify potential problems beforehand and becomes a much less daunting task with powerful monitoring tools.

Traditional Approach



Machine Learning Approach



Benefits

- ▶ **Efficient customer recovery and loss reduction** through more risk sensitive treatments
- ▶ **Pre-collection signals** through deeper insights from external web and internal web log data
- ▶ **Collection process** streamlining
- ▶ Deeper understanding of reasons for both **payment and default cases**

Voice of Customer Analytics (VoC)

A complete solution to extract value from different communication sources

Turning voice calls into predictive models

VoC uses information such as voice calls converted into text and several text data sources (e.g. contact centre logs, text reports) for the development of predictive models for collections, fraud detection, regulatory and customer insights.

Customer Insights

- Churn prevention
- Cross selling Up selling
- Leads identification

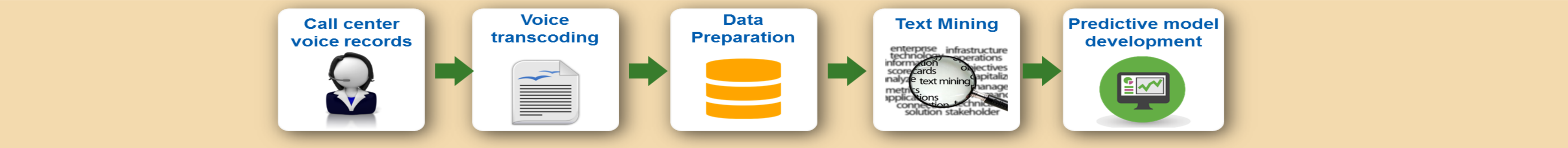
Collection

- Predict risk better and more dynamically
- Manage collections teams' performance with language insights
- Monitor and control compliance and call quality

Fraud Detection

- Prevent/detect fraud on Insurance Claims
- Prevent/detect fraud on call center

Text into data – Natural language



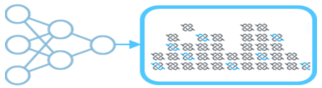
Development overview

«I am having a **problem with my boiler** and I would like to fix really soon. I would like to have **priority**? Please schedule it **in the mornings**, I am working from home at that time»

Calls extracted among contact center agents

Voice Conversion & Natural Language Processing based on keywords and spoken behavior from clients

Text Mining used to find patterns and create new variables based on the full conversation



The results are used to:

- Enrich the segmentation and predictive models
- Evaluate contact centre performance
- Improve/update contact centre scripts

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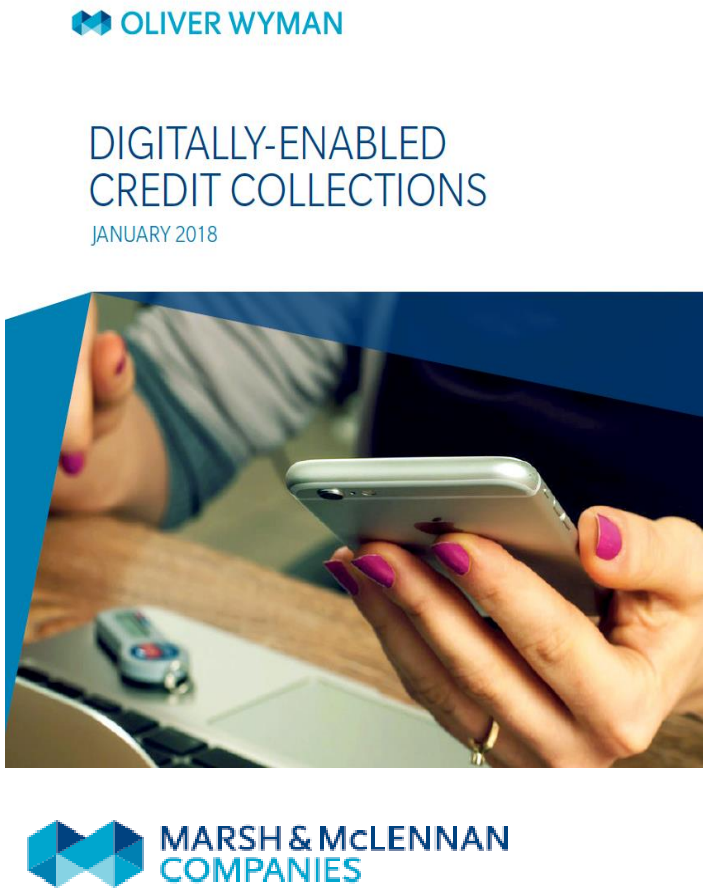
Future of collections
Digitalisation



Checklist to evaluate collections against the new reality

- ✓ Deploy an omni-channel digitally-enabled collections process
- ✓ Update collections treatment strategies using analytics
- ✓ Implement enhanced portfolio monitoring and management
- ✓ Enrich customer information before the delinquency

Establishing an optimal collections process

Early Warning System and Collection Analytics

An international banking group implemented an Early Warning System and strategies to reduce the number of cases to be treated in the recovery process and the overall collection costs

Methodology

- Development of specific forecasting models by product / bucket (from 0 to 1)
- Portfolio segmentation combined with specific actions
- Assessment of the economic benefits

The challenge

- Creating a coherent approach between the commercial strategies and preventive actions to control risk
- Being customer-centric and products-driven
- Implementation of models, business rules and segmentation in a decision engine

Business Benefits

25%
improvement in flow rate from bucket 0 to bucket 1

20%
decrease in cost to collect in 6 months

15%
reduction of number of delinquent accounts

Optimisation
of Customer care process and Attrition level

Implementing a pre-collections process

Profiling and segmentation

An Italian banking group wanted to implement a process of pre-collection based on the prediction of the probability to recover

The challenge

- To reduce the number of accounts allocated to external collection agencies
- To improve the quality of the exposures
- Early entry of a portion of the portfolio to debt recovery phase (about 70% of the portfolio is also exposed to other institutions)
- Containment of the entry to debt recovery during peaks of the financial crisis

Methodology

- Creation of risk profiles based on two levels of segmentation:
  - Credit bureau scores
  - Internal behaviour data
- Identification of products based on risk profiles to be managed in pre-collection phase

Business Benefits

$130m of outstanding amount moved back to regular

25% decrease in cost to collect in 4 months

$4m reduction in losses on an annual basis

Improved customer experience

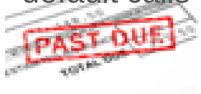
Voice of Customer in action

Natural Language Processing and Machine Learning

A large retail bank aimed to reduce both the number of cases to be treated in the recovery process and the overall collection costs

Methodology

Payment and default calls



Operator evaluation + Compliance + Call centre evaluation + Voice collection score

Natural Language Processing and Machine Learning

The challenge

- Lack of understanding for reasons for both payment and default calls
- Low collection score performance
- The need to analyse call centre performance

Business Benefits

15% increase in the collected amount

10% increase in accuracy of collection models

Reduced collections costs and optimisation of contact centre resources

Improved operational performance New collections insights based on natural language processing and comparison of collector performance

References & Case Studies
Collections

Experian developed behavioural collection scorecard for early and mid collections

Business **Challenge**

- Reduce credit risk exposure by increasing recovery and reducing the volume of accounts rolling into later collection stages
- Reduction of collections operational costs
- Improved customer service and retention rates

Experian's **Solution**

- **Behavioural collection model** for early and mid collections
- **Customer level segmentation** strategies for strategic collections for the personal loans and combo customers
- **Regular monitoring and fine-tuning**

Key **Benefits**

Reduction in roll-forward rates for buckets 31-60

10%

Reduction in outbound calls costs over 6 months

22%

Reduction in outbound letter costs over 6 months

26%

- Increase in ROI by focusing the collection actions on customer segments providing the highest recovery to costs ratios
- Control and reduction in collection costs through automation and optimisation of processes

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Any questions?

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We employ approximately 17,000 people in 37 countries and our corporate headquarters are in Dublin, Ireland, with operational headquarters in Nottingham, UK; California, US; and São Paulo, Brazil.

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