Visa Consulting & Analytics

Risk Series

Re-thinking Collections

Trends, challenges and actions for post-pandemic collections

As the pandemic recedes, collections teams face an unfamiliar context – and an opportunity to implement a new, high-performance operating model.

In 2020, near the start of the COVID-19 pandemic, Visa Consulting & Analytics (VCA) released a series of papers investigating the changing face of credit risk – including the implications for collections and recoveries.

A year later, we re-visit the topic, looking at how the risk environment has changed, what should be expected in the coming months, and where collections teams should focus their attention going forward.

Taking stock – the credit risk context one year in

When the pandemic first hit, there was a sense of impending doom across the finance sector. Anticipating that the global economy would go into a deep recession, lenders braced themselves for a surge in loan defaults.

Although 2020 was a tumultuous year, default rates did not increase as anticipated. In the U.S. for example, credit card defaults fell to the lowest levels on record[1] as many consumers took the opportunity to pay down their balances, and many others were supported by extended government benefits. Other countries around the world implemented similar support programs. In the UK, the government offered a three-month payment holiday on mortgages.[2] In Germany, the government extended their Kurzarbei pay-check protection program[3].

The possibility of increased defaults, however, appears to be an issue that may have been delayed rather than averted.

1. American Bankers Association, Consumer Credit Delinquency Bulletin, January 2021, https://www.aba.com/about-us/press-room/press-releases/aba-report-delinquencies-improved-in--second-and-third-quarters-of-2020
2. Help with mortgages to continue for homeowners affected by Coronavirus, May 2020, https://www.gov.uk/government/news/help-with-mortgages-to-continue-for-homeowners-affected-by-coronavirus
3. How Germany is saving jobs during the pandemic, May 18, 2020, https://nymag.com/intelligencer/2020/05/germanys-paycheck-protection-program.html

Across the world, household debt rose in both mature and emerging markets, increasing by an estimated US$2.6 trillion in 2020[4]. Global GDP, meanwhile, fell by 3.5 percent, and the slow economic recovery is continuing to place hardship on consumers[5].

Consequently, more people are requesting support from their financial institutions – in the U.S., for example, more than 2.7 million homeowners are in forbearance[6]. With government assistance programs set to expire in September 2021, further difficulties are likely to emerge – as more than 12 million people in the U.S. have been covered by the Pandemic Unemployment Assistance program[7].

In the coming months, we are likely to see the potential for cardholders to face new challenges in paying their debts on time, as well as increased focus from regulators in reviewing how financial institutions engage with consumers.

4. Institute of International Finance, Global Debt Monitor, February 2021, https://www.iif.com/Portals/0/Files/content/Global%20Debt%20Monitor_Feb2021_vf.pdf
5. International Monetary Fund, World Economic Outlook, January 2021, https://www.imf.org/en/Publications/WEO/Issues/2021/01/26/2021-world-economic-outlook-update
6. Mortgage Bankers Association, Share of Mortgage Loans in Forbearance Decreases to 5.37 Percent, January 2021, https://www.mba.org/2021-press-releases/january/share-of-mortgage-loans-in-forbearance-increases-slightly-to-538
7. The Century Foundation, 2 Million Workers Facing Jobless Benefit Cliff, December 2020, https://tcf.org/content/report/12-million-workers-facing-jobless-benefit-cliff-december-26/?agreed=1

Three key trends

Based on our analysis and client discussions, from a collections perspective, the months ahead will be characterized by three trends.

1 **Continued volatility in volumes**

Ongoing peaks and troughs in defaults and forbearance volumes.

2 **Increased regulatory attention**

Public concern for those most affected by the pandemic reflected in increased interest from regulators.

3 **Accelerated demand for digital**

New behaviors have accelerated an expectation among consumers for access to secure digital experiences and expanded digital services – including, from a collections perspective, omni-channel communication channels and self-serve facilities.

Three key challenges to overcome

Given the context and the trends outlined in this paper, post-pandemic collections will have three key challenges to overcome:

1 **Expectation**

As seen in the wake of previous crises, attention on financial institutions will increase, particularly in how to best help consumers facing financial hardships. Regulators, consumer protection groups, the media and the public will expect to see the fair and consistent treatment of borrowers. It will be key for financial institutions to anticipate possible regulation and ensure a proper framework of internal controls.

2 **Execution**

Many collections teams face the challenge of working with legacy systems and platforms, which are specific to each line of business. In today's environment, financial institutions will need to ensure they have effective workflows that offer data integrity, a complete view of cardholders, cost efficiencies and provide an optimal customer experience.

3 **Experience**

Consumers are expressing a clear preference for online channels and digital platforms[8]. To meet shifting consumer behaviors, financial institutions will need to ensure they can offer new digital experiences and services such as self-serve options.

8. McKinsey & Company, The customer mandate to digitize collections strategies, 2019, https://www.mckinsey.com/business-functions/risk/our-insights/the-customer-mandate-to-digitize-collections-strategies

Key questions

From a collections perspective, financial institutions should formulate compelling responses to these key questions.

THE RIGHT SEGMENTS

Do you understand where and why cardholders are likely to get into difficulties?

How will you identify those who do?

THE RIGHT CHANNELS

Have you viewed your business through the eyes of your cardholders? Do your interactions with them measure up to their needs?

THE RIGHT MESSAGING

Do you truly understand the circumstances your cardholders face?

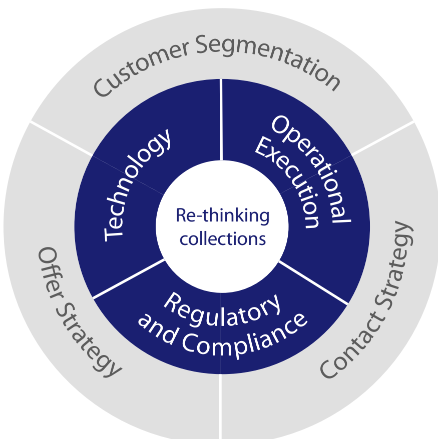
Is the way you speak with them relevant, empathetic, and effective?

THE RIGHT OPERATING MODELS

Are you working with the right capabilities, skills and technologies, while also ensuring regulatory compliance?

Re-thinking collections –implementing a double-layered model

The most effective financial institutions organize themselves around an inter-dependent, two-layered operating model that includes:



An inner core of operational excellence – to maximize efficiencies and minimize costs

At the center of the model is the enabling inner core, which utilizes a combination of digital technologies and clearly defined processes, enabling the collections team to improve its efficiencies, minimize human errors, and enhance compliance and accountability. The three main components are:

Regulatory and compliance

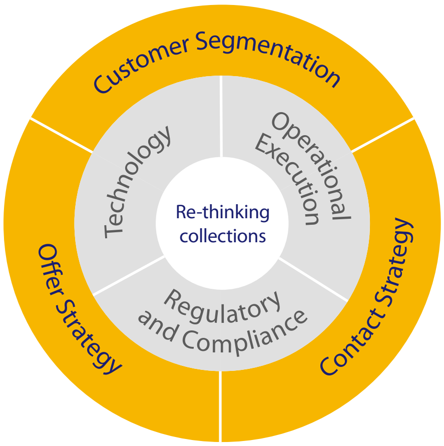
A standard framework of internal controls enabling enhanced traceability and accountability, which mitigates risks, and brings greater transparency from intent through to execution. Driven by automation and backed by comprehensive documentation, it also reduces operating expenditure. It also means that the collections function can be prepared for an audit or regulatory review.

Technology

An integrated case management and workflow platform, bringing improved data integrity and data consolidation, and enabling the automation of scheduled tasks. With a rationalized IT application base across different business units, modern platforms also lead to lower credit losses and significant cost savings. It also brings the opportunity to acquire new data sources to feed refreshed analytical models and augment the existing credit bureau and servicing data.

Operational execution

Armed with comprehensive data, accessible cardholder data and simplified processes, the employee experience is vastly improved, and productivity is increased. With a single source of truth for all cardholders, products, and processes, the risks of human error are minimized. With the use of advanced analytics and artificial intelligence, decisioning is progressively improved. And, with digitized cardholder-facing functions, the user experience is also improved.



An outer layer of consumer focus – to minimize reputational risks and maximize the ability for cardholders to pay their debts

Enabled by the inner core of operational excellence, it becomes possible to deliver a superior cardholder offer which is responsive and relevant to cardholder circumstances. The three main components are:

Effective segmentation strategies

A nuanced understanding of cardholders in various stages of defaults becomes the foundation of collections optimization and prioritization.

Optimized contact strategies

Successfully contacting cardholders – at the right time and through the right channel – unlocks the overall success of the collections function.

Customized offer strategies

Armed with cardholder segmentation, it becomes possible to create a personalized offer strategy that works for the financial institution and is more likely to be accepted by the cardholder.

As indicated in the table below, with this approach, it becomes possible to make progressive improvements to the cardholder focus – testing and optimizing for industry leading practices (see below).

	GOOD	BETTER	BEST
Effective Segmentation Strategies	• Segmentation based mostly on cardholder risk • Cardholder behavior management models using old behavioral data • Similar treatment to all cardholders	• Use of at-risk calculation to prioritize cardholders with the highest balances and risk • Divert low-risk cardholders away from live calling and toward digital-first solutions • For late-stage cardholders, develop proxies for likelihood to contact and willingness to pay • Cardholder behavior management models using new behavioral data	• **Model based at-risk assessment**, using Artificial Intelligence/ Machine Learning methods • **Multiple models using new data**, e.g., early/late stage probability of cardholder advancing in default, contactability, channel preference • Implement **performance management approaches** using active response models so that agents can address outliers • Review predictive modeling in place and factor in **pandemic-level disruption data** to better predict defaults
Optimized Contact Strategies	• Some use of digital channels, including email • Digital channels utilized in early stages of collections • All collections work done in-house	• Multi-channel contacting, including email, calling, SMS and self-service, with high adoption of mobile phone channel • Digital channels utilized in all stages of collections • Varying the frequency of calls, email and SMS toward high at-risk cardholders • Personalizing messaging (instead of generic notices of collections) and training staff to have effective conversations based on cardholder needs in lieu of standardized scripts	• Maximize the use of self-service through **targeted digital campaigns** • Shift staff to a **more personalized cardholder relationship**, in particular with high-risk cardholders • **Outsource** lower value accounts if needed to maintain sufficient calling focus • Use a range of cardholder capabilities to enhance outreach, capture situations, and **enable cardholder predictive capabilities** such as: Machine Learning and Natural Language Processing
Customized Offer Strategies	• Agents have one-size-fits-all offers • Settlements focused on late-stages collections • Limited use of enrollment in a payment plan	• Additional offers to ensure agents have an option for all cardholders, especially high at-risk ones • Prioritize settlement offers by likelihood to pay and likelihood to contact • Allow all eligible accounts to automatically enroll in a payment plan • Waive late payment fees in earlier stages of collections	• Offer cardholders an option to pay in **installments** • **Consumer-appropriate settlements** to cardholders who are riskier and deeper into late-stage collections • Provide **self-service access** to all personalized payments plans and treatment solutions through a collections platform • Proactively contact cardholders in collections to go on a **payment plan** and make several consecutive payments on time, so that their status can change to current

The bottom line: significant financial benefits, plus reputational safeguards

From a financial perspective, the benefits of this approach can be significant. Based on our experience and analysis, a financial institution that adopts a double layered model can expect to realize:

Efficiency gains of **4-7 percent**[9] over three years

Based on:

- Rationalized IT application base across business units to realize cost savings
- Reduced manual processing through applying automation and workflow management solutions
- Reduced human involvement and decisioning through the use of artificial intelligence, advanced analytics and digital solutions

Increase in collection performance of **1-3 percent annually**[10]

Based on:

- Better predictive capabilities
- More sophisticated segmentation
- More relevant and effective cardholder servicing

By adapting to the public sentiment, ensuring regulatory compliance, and maintaining the loyalty of at-risk cardholders, a financial institution can reap financial benefits and safeguard their reputation.

Visa recommends deploying a double-layered model to serve cardholders and drive positive business outcomes. Reach out to your Visa Account Executive to see how we can help.

9. Visa analysis, 2020
10. Visa analysis, 2020

About Visa Consulting & Analytics

We are a global team of over 1,000 experts, including payments consultants, data scientists and economists across six continents.

- Our consultants are experts in strategy, product, portfolio management, risk, digital and more with decades of experience in the payments industry.
- Our data scientists are experts in statistics, advanced analytics and machine learning with exclusive access to insights from VisaNet, one of the largest payment networks in the world.
- Our economists understand economic conditions impacting consumer spending and provide unique and timely insights into global spending trends.

The combination of our deep payments consulting expertise, our economic intelligence and our breadth of data allows us to identify actionable insights and recommendations that drive better business decisions.

For more information, please contact your Visa Account Executive, email **Visa Consulting & Analytics** at **VCA@Visa.com** or visit us at **Visa.com/VCA**

Visa Consulting & Analytics is a global team of industry experts in strategy, marketing, operations, risk and economics consulting, with decades of experience in the payments industry. Using analytics from the payment network with the most purchase transactions worldwide, our team of subject matter experts can provide you with proven strategies and data-driven insights that support your business objectives.

