



Credit risk and the COVID-19 crisis

Considering collections

The COVID-19 crisis represents one of the biggest disruptions in the 80-year history of the credit card sector.

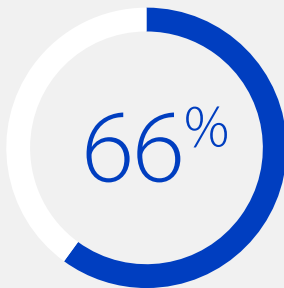
With GDPs falling, a global recession looming, and a change in consumer behaviors likely, many aspects of credit card lending will be impacted. Most importantly, there is significant risk of increase in credit losses.

Visa Consulting & Analytics (VCA) has investigated the changing face of credit risk from several angles. In this paper, we consider collections.

Almost every accomplished credit manager will have some experience of working through an economic downturn. Some may also have coped with a full-blown economic crisis, such as the global financial crisis of 2008 - 2009. However, no one will have experienced anything like the COVID-19 crisis.

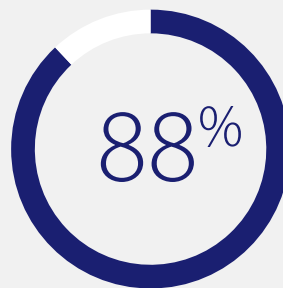
In early-May, for example, Oxford Economics reported that global household spending had fallen even further and faster than GDP, and warned that, "when a recovery does come, it is likely to be steady rather than spectacular"¹. Meanwhile, the pandemic is expected to wipe out the equivalent of 195 million jobs worldwide², which is increasing consumer concerns about their ability to pay bills and loans, with a wide gap opening-up between developed countries (with 66% expressing concern) and developing countries (where the equivalent figure is 88%)³.

Ability to pay bills and loans



DEVELOPED MARKET

US, UK, Canada, Hong Kong



DEVELOPING MARKET

Colombia, South Africa, India

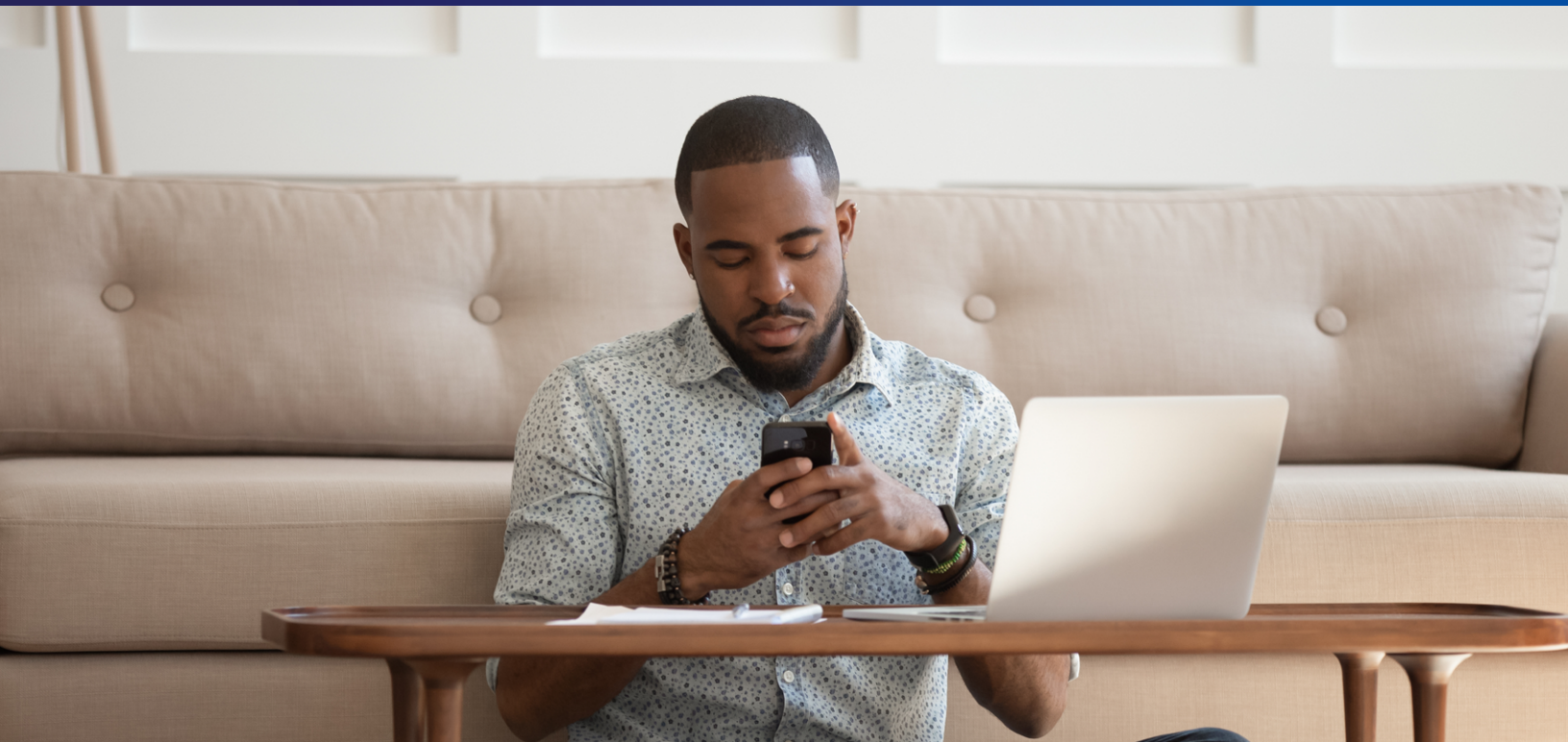


There is a **wide gap between developed and developing market**³ concerns about their ability to pay bills and loans.

¹ Oxford Analytics, "Coronavirus Watch As restrictions ease, a slow revival", May 4, 2020: http://resources.oxfordeconomics.com/coronavirus-watch-as-restrictions-ease-a-slow-revival?oe_most_recent_content_download_id=0000029&interests_trending_topics=coronavirus

² International Labour Organization Body, "COVID-19: impact could cause equivalent of 195 million job losses, says ILO chief", April 8, 2020: <https://news.un.org/en/story/2020/04/1061322>

³ TransUnion, "Global COVID-19 Consumer Financial Hardship Study Report", April 2020: <https://content.transunion.com/v/financial-hardship-global-report>

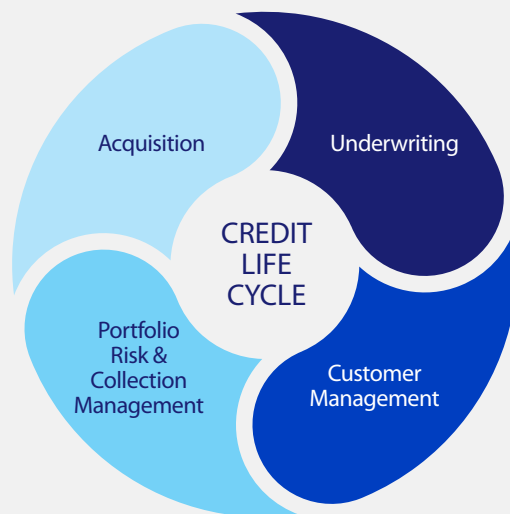


For credit managers it is a perfect storm. It is putting extreme pressure on all phases of the credit lifecycle, all at the same time. To aggravate matters, there is real uncertainty as to how the crisis will evolve, how long it might last, or what the recovery could look like.

The COVID-19 crisis puts extreme pressure on all four phases of the risk cycle

With a shift in the economic fundamentals, there's a need to re-think the risk appetite, tighten the acquisition policy, and reduce the cost of acquisitions.

With increased risk across the portfolio, volume is pushed towards the collections function—which is the final back-stop in protecting performance and reputation.



As new risks materialize, there's a need to re-work underwriting models, think harder about risk-based pricing, and pay particular attention to origination fraud.

As customer behaviors evolve, customer management practices must follow suit—including credit line management, repayment plans, authorization management, and fraud detection.

We therefore anticipate a deep and sudden shift in credit risk. In the short-term at least, this shift is likely to impact the overall performance of any credit card business. At VCA, we believe that issuers should be prepared for increased delinquencies.

This is the "make or break" for two reasons:



Profitability

Fast and accurate work is required to predict the risk of defaults, lookout for signs of stress across the portfolio, and intervene as required to minimize the bottom-line losses.



Reputation

Many cardholders have begun to face real financial hardship. Under these circumstances, even the best laid financial plans could unravel quickly, resulting in public backlash against a bank.

The challenge for the credit risk manager is to balance these two priorities. On the one hand, there is a need to protect the profitability of the portfolio. On the other, there is a need to help customers to bridge the gap. The sweet spot is to find a way to align their respective interests.

A critical success factor will be early engagement with the customer for three key reasons:

1

So that the issuer understands the customer's situation and what is affordable for them

2

To increase the cure rate
(so that a difficult situation is not left to spiral out of control)

3

To maintain loyalty
(so that an at-risk customer values the help they are given, feels good about the issuer, and sticks with it well into the future)



Shifting gears and changing direction

As issuers deploy portfolio strategies such as proactive line management to limit exposures, or shut down balance transfers and instalment plan propositions, another important consideration is the transformation of collections in the face of the COVID-19 crisis.

In good times, the collections function addresses core credit risk. However, during a global pandemic, customer hardship will likely occur in unexpected and challenging new ways. These two sets of circumstances are very different, and so too should be the way an issuer deals with them.

In the chart below, we establish the various phases of the collections process, and outline the approaches which could be pursued.

CREDIT STRATEGY

Collection action: optimize collections

Build a proactive collections strategy & action plan to minimize loss; keep a watch on collection operating costs



Build a **pre-delinquency management strategy**:

- Daily monitoring reports
- Real time risk triggers at account level segmentation
- Payment reminders linked to risk assessment of customer and exposure contribution.

Identify segments that are facing an **affordability issue**:

- Offer instalment program pro-actively
- Enable the front line staff with customer information to resolve cases

Collection recoveries take longer to resolve during stress period, determine **collection effort based on return on investment**.

Provide option to **customer to settle** - settlement strategies ensure faster resolution, upfront collection payments and lower collection operating cost.

Have a special **watch out for** early vintage, first payment default accounts – creeping **fraud losses**.

Build a **Champion/Challenger** strategy for **case allocation**. For similar collection cases agencies provide different collection resolution/recovery capabilities.

Build process of **regularly updating customer contact details** e.g. prompt to update information while customer logs into internet banking.

Skip tracing recoveries from customer with contact details and contactable are much higher; use external sources to enrich information about SKIP accounts e.g. credit bureau, telecom, social media are some of the common data points that banks are using to trace SKIP accounts.

Use **self-serve channels** to resolve incoming customer queries. As delinquency rises operational capability to manually service customers will be limited. Consider using **collection chat bot**, internet banking and mobile to address low severity & customer query related enquiries, letting other channels focus on high severity cases.

Explore **non-performing asset sell down to Debt collection agencies (DCA)**; ensures bank is focused on core lending capabilities and not stretched on recoveries.

Operational challenges impact collection efficiency; build automated process to reduce manual intervention in areas of case allocation, customer detail updates, feedback capturing; **digitize collection payment** receipt to reduce reconciliation efforts.

Use **predictive & prescriptive analysis** to segment customer base, determine case allocation, collection path & collection treatment.

The specifics of the response will be determined by the issuer's circumstances, the size and character of its portfolio, and the severity of the crisis in its home markets. We have outlined ten imperatives for all issuers.

Ten imperatives for collections teams in the COVID-19 crisis

#1

Build leading indicators and forecasting capabilities

Existing collections resources and processes may be unable to optimally manage increased delinquency volumes. Robust forecasting tools will help operational planning by increasing visibility into expected collections volumes by bucket, risk segment, and customer profile.

This type of analysis can drive improvements in queuing/routing strategies and staffing plans.

#2

Emphasize affordability – with a view to bridging the COVID-19 gap

Some of your customers will have difficulty managing their credit card balances. That is inevitable. In time, most will recover. What they need from you right now is the help to bridge the gap.

Consider implementing relief measures such as fee waivers, relaxed payment schedules, and flexible repayment options.

#3

Bring your collections window forward

The quicker you can engage with an at-risk customer, the higher the cure rate is likely to be. Do not wait for days or weeks to pass.

Galvanize all the indicators you can find. Given the environment, the fact that you are reaching out should reflect well on your organization, irrespective of a customer's true circumstances.

Create a **champion/challenger** strategy to deduce which rules work the best – and keep on testing-and-learning to optimize your approach.

#4

Build an empathetic customer communications strategy

The effects of COVID-19 will have a profound impact on the ability of customers to make payments. As issuers reach out to their cardholders, it is vital to display empathy, listen closely, and adopt the right tone for communication.

That also means being prepared for more inbound volume from distressed customers. And successful issuers will be prepared with compliant, reasonable, and flexible deferral options for those customers making a good-faith effort to make payment arrangements.

Letting customers know you care, and that you are ready to support them through the crisis, will go a long way in protecting and building valuable relationships – for both the short-term and the long-term.

#5

Focus on your most valued customers

Increased collections volumes will likely strain current resource levels. It will be necessary to focus attention where you can expect most benefit.

By developing a response strategy tailored to your most valued customers, you can mitigate the credit loss impact in the short-term, and also provide long-term benefits as they rebuild their credit profile.

#6

Stick with the tools you know

They say that extreme times call for extreme measures. However, our strong advice would be to stick with the tools you know and only begin to test new capabilities once a reasonable baseline has been established for incremental losses.

Yes, you should flex your approach. But you should also carefully weigh the risk-reward of devoting time to new solutions (which can be time-consuming), versus relying on what is at-hand.

Your existing toolset may not work perfectly, but you do know its shortcomings. You have enough to deal with right now – without adding more uncertainty into the mix.

#7

Actively engage with the credit bureaus

If ever you needed some additional insights, the time is now.

So, catch up with your credit bureaus and quiz them about the services they can offer to collections teams. What level of granularity can they give you about your customers' broader repayment behaviors?

For example, is a good repayment record at your bank obscuring any wider warning signs? Conversely, are they missing your repayments but honoring everyone else's?

The more you can discover about your customers' willingness and ability to pay, the better chance you have of reaching a mutually satisfactory payment arrangement.

#8

Talk to your analytics teams about leading indicators and collection scores

If a customer is getting into difficulty, some telltale signs should appear in your internal data.

For example, are there any sudden surges in out-of-pattern spending? Have recent billing cycles and repayment behaviors differed from historical norms? What lessons can be learned from previous economic crises?

If a customer has a wider relationship with your organization, and you can access data from current or savings accounts, the picture will be even clearer. For example, is there evidence of loss of income? Are they dipping into savings accounts? Could this compromise their ability to make payments?

With this type of intelligence (combined with granular credit bureau data), you can create collection scores that will help you prioritize. For customers who are likely to self-cure, you could use low-cost channels to reach out. For those with higher exposure, you can actively approach to offer a more tailored solution.



#9

Keep an eye on your operational efficiencies, and automate where you can

Explore virtual channels to reach your customers, and give them a self-service tool so they can choose the best option to suit their needs.

Your teams are going to be working flat-out – dealing with the everyday realities of the crisis and attending to high-severity cases.

So, find ways to lighten the load. Force yourself to find new efficiencies, emphasizing non-human touchpoints.

One good approach is to build an automated process to reduce manual intervention in areas like case allocation, customer detail updates, feedback capturing, and so on. Another useful tactic is to digitize collection payment receipt to reduce reconciliation efforts. You can also explore the use of self-service channels to resolve incoming customer queries - such as collection chatbots, and new internet and mobile banking functionality.

#10

Understand and take full advantage of any regulatory assistance

Governments everywhere are scrambling to respond to the crisis.

Many have introduced a battery of consumer credit management and debt relief measures, and more may be on their agenda. The regulatory response may impact workflows and controls for sensitive/high-touch customer interactions, such as bankruptcy, cease and desist, and hardship enrolment/eligibility.

It is critical to engage with your regulatory relations teams to understand the regulatory environment, ensure you have a deep grasp of new or planned measures, and understand how they can benefit your customers and your organization. The aim is to ensure collaboration across the organization.

No one could pretend that the COVID-19 crisis is good for business. However, opportunities to provide better customer service / to connect with your customers can arise from challenging situations. At Visa Consulting & Analytics, we can support your response to the COVID-19 crisis as the recovery unfolds. To have a more in-depth discussion with VCA on this topic, please contact your Visa account representative.

About Visa Consulting & Analytics

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- 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 help addressing any of the ideas or imperatives above, please reach out to your Visa Account Executive to schedule time with our Visa Consulting & Analytics team or send an email to VCA@Visa.com. You can also visit us at [Visa.com/VCA](https://www.visa.com/VCA).

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