QUALCO

2019 in Collections Markets

What to expect

QUALCO Experts' take on evolving
NPL & Analytics Trends

2019 INSIGHTS

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INTRODUCTION

Though many are at very different evolutionary stages, both emerging collections markets and mature jurisdictions face common challenges in 2019.

Regulatory intervention and pressure; changing norms in the treatment of customers; and juggling the benefits predictive analytics can offer are just three key themes for the coming year.

In the following pages, QUALCO experts give their views on some of the areas we expect to be topics of conversation in 2019.

Emerging markets

In 2018 countries such as Greece and Cyprus have captured investor interest, with emerging debt sale and specialist collections markets. In Greece, the non-performing loan (NPL) market exploded, with deals in all asset types from the major banks. As the first deal was only concluded in late 2017 this is a new market with huge potential.

Likewise, in Cyprus the country's banks have only just started selling debts, with a backlog of loans to be handled. The government is committed to reducing high levels of NPLs in a bid to put the economy back on the right footing and Cyprus' credit rating depends on tackling the issue.

These markets face challenges previously seen in other jurisdictions – where the surge of investors for initial placement drives prices up, higher than the actual portfolio performance indicates. In these circumstances, discipline and knowledge are required to ensure portfolios are not purchased at prices that are hard to justify at collections level.

State-of-the-art analytics approaches are already being used to transfer knowledge from established markets and better quantify the risks involved. Even where data are not available on specific portfolios, data from similar accounts can be used to model the likely outcomes. These models need to be adjusted for local circumstances and to take account of the way a portfolio will be treated, but none of these challenges lie beyond the capability of today's models.

Other markets, such as Brazil, promise to develop an independent collections industry. The market currently consists mainly of a small number of big banks controlling their own servicing entities. This model is increasingly under scrutiny and it is likely that financial institutions will be forced by regulatory pressure to sell and outsource. The impact of this will be to open the debt collection market and reduce the cost pressure that threatens to suffocate collections businesses, says Fernando Brito Barros. QUALCO's Managing Director for Brazil.

Established markets

Meanwhile, in the UK, the model used by debt collection businesses is also in question, with debt collection agencies (DCAs) feeling the squeeze on their margins while compliance costs have risen significantly. QUALCO UK Managing Director Christian Jacob points to this as a contributory factor in a large European debt purchase company recently deciding to close its UK DCA business.

More positively, an increasing number of creditors, particularly in utilities and financial services, are considering whether to extend the outsourced model to include their internal collections operations. This would take them down a BPO-type route, through external partners delivering services under a white label model.

The UK is also preoccupied with the need to enhance the experience and treatment of consumers in debt, with particular focus on vulnerable customers and the links between mental health and debt problems. This pressure is driving digital innovation and is set against a backdrop of ever-increasing credit being taken by consumers and more Bank of England base rate increases expected through 2019.

That's not to mention the current extreme uncertainty over the form the UK's planned exit from the EU will take. At the time of writing, it was unclear whether a 'no deal' Brexit, negotiated plan or even a second referendum would be taking place. The impact of this on lending and collections businesses will filter through in 2019 as more clarity – hopefully – appears.

REGULATION

"There is no doubt that the introduction of EU General Data Protection Regulation (GDPR) was one of the major challenges for 2018," says Spyros Retzekas, QUALCO's Chief Operating Officer.

The impact of GDPR and the general regulatory scrutiny across Europe affected the whole of the European market in 2018. Attempts continue to be made to deal with the fear, uncertainty and doubt surrounding the legislation. There has been a lot of pushback against innovative ideas in analytics using arguments based on incomplete or incorrect interpretations of the provisions of GDPR, especially regarding the meaning and implications of "automated profiling".

The focus of most GDPR compliance efforts on consent has not helped the credit management industry, where consent is not the primary GDPR-allowed "lawful basis" for processing. Additionally, the lack of a body of case law interpreting the regulation's provisions has contributed to hesitation in rebuffing the precautionary constraints placed by legal and compliance departments.

The situation is gradually becoming clearer, and the need to incorporate GDPR "safety valves" and streamline the prescribed human involvement in automated decision making are leading to better processes overall. We believe 2019 will see a rebalancing after misinterpretation and over-reaction to this legislation.

However, central banks will continue to impose heavier regulations and increase regulatory reporting requirements. Regulation and reporting will keep becoming tougher so enhancements in this area should also be considered.

In the UK, banks may have been looking forward to the deadline for reclaiming payment protection insurance (PPI) in August 2019. However, if they were hoping for some respite from the regulatory scrutiny that they have been under for the last 10 years, they are likely to be disappointed. There are already signs that there will be a focus on other regulatory issues such as affordability, documentation and broking.

Meanwhile, according to Gareth Parry-Evans – Global Business Development Director for QUALCO – banks face challenges in digital banking, fraud & cyber-crime, Brexit/recessionary pressures and new challengers to traditional banking models. All of these will affect the way credit is extended and collected.

NON-PERFORMING LOAN REDUCTION

Banks across Europe need to reduce NPLs. Their capacity to do so often depends on regulators, plus investor appetite and pricing.

QUALCO's Chief Operating Officer Spyros Retzekas believes South East Europe (especially Greece and Cyprus) will continue to lead NPL transactions this year as they did in 2018.

The European Central Bank has set aggressive targets for banks to reduce their NPL stock; this inevitably will lead to a number of transactions, but targets also threaten Banks' capital structures and will require new tools and approaches. Small business loans and residential mortgages will require more proactive solutions. It is also important to recognise that initiatives might come from government or central banks that impact overall NPL strategies on a country-specific basis. The prospects for these should be monitored carefully – for example the creation of a central 'bad bank' or Asset Protection Scheme.

In Greece mortgage portfolios will come to the market, followed by SME and corporate portfolios in special segments, such as shipping or tourism. There should be a general improvement in asset quality of the portfolios coming forward in 2019. As the market develops there will be increased opportunities for servicer partnerships and consolidation.

The market will adjust as key investors consolidate their positions and start focusing on profitability. Those keen to establish themselves in emerging markets will need to maintain pricing discipline to avoid overpaying for portfolios in a bid to gain market share.

Italy is a country of special interest for 2019 as it goes through a fiscal transformation programme. The country's stock of NPLs is by far the largest in Europe, standing at €264bn at the end of 2017, according to PwC. The market is fragmented but the banks need to recapitalise and further transactions such as those conducted by Intesa SanPaolo and UniCredit are likely to take place in 2019. In 2017, UniCredit disposed of a €17.7bn portfolio to US private equity firm Fortress. Further opportunities are expected to arise as banks sell loans in earlier arrears as well as those already classed as non-performing.

Meanwhile, Spain will continue attracting attention. Bank asset quality and solvency has substantially improved in the country, with the NPL ratio of Spanish banks 6.4% - less than half its 2013 rate of 13.6%, according to the ECB. Spanish banks have been selling large volumes of loans for some years now, often carving out their servicing platforms to do so. A number of transactions in the secondary market are likely to take place.

Irish banks have been another source of interest to investors. Overall, the average NPL ratio of Irish banks had reduced to 11.2% in the third quarter in 2017, according to ECB data. However, NPL guidelines from the ECB classed those with an NPL rate above 5% as 'high NPL banks'. This affected the main Irish banks, which have NPL rates well above that level. Rules also changed around the classification of mortgage debts, increasing the amounts classed as non-performing and driving the need to continue deleveraging.

CUSTOMERS

Digital Communications

“Self-service systems for both clients and consumers will be a focus in 2019. More and more businesses are offering these capabilities.” Spyros Retzekas – QUALCO Chief Operating Officer.

Across all markets the prevalence of digital channels is becoming more important. For example, the major changes in Brazil relate to the use of digital channels, with around 25% of consumers preferring to communicate via web portals and other digital communications. Views differ on the use of What’s App and social media in collections, with What’s App becoming an accepted and established mode of communication in some markets. This is not the case everywhere.

Collection systems need to offer an increasing amount of functionality through mobile/web channels. Therefore, mobile applications and web interfaces will have to become richer in function in 2019 and be able to handle larger volumes securely. This is a key part of planned product development by QUALCO in 2019.

Customer Experience

The trend of treating customers with more empathy: establishing a long-term relationship and providing solutions that meet their ability to pay, is certainly set to continue, as it is a major regulatory focus across all territories.

In more mature markets regulation and campaigns are already in place to improve the treatment of consumers in debt. In the UK this is moving further from financial services ‘regulated’ debts to public sector and utilities debt, which are not currently subject to the same level of regulation.

We expect both central and local government in the UK to realise that using bailiffs as a tool to collect debt early in the process is no longer acceptable. Instead they will turn to using more traditional DCA-type models and implementing practices that have long been standard in the private sector.

Likewise, some of the unregulated debt types (utilities, some mobile operators) will aim to treat their accounts with the same standards as regulated debt. We expect a number of other industry regulators in the UK to introduce measures to align with the Financial Conduct Authority and this trend will accelerate.

QUALCO UK’s Christian Jacob says there will also be more sharing of Income & Expenditure (I&E) information between collections organisations. There is increased recognition that sharing I&Es is in the best interests of the customer in a number of ways: such as reducing the length of multiple creditor calls and ensuring that there is one version of the individual’s situation.

There will be moves to a more central repository-type model, provided that those models recognise that the original provider of the data should not be commercially disadvantaged. Having a central bank of income and expenditure information would significantly cut the time it takes collections teams to gather financial information on individuals and restructure their accounts. This development has the potential to cut costs for collections businesses while benefiting customers who will not have to go through the same details with multiple firms.

Open Banking

Open banking will be a hot topic in the coming years, with banks in the UK already required to open up their APIs and the rest of Europe to follow in 2019 when technical standards around the EU's second Payment Services Directive (PSD2) are finalised.

Initially this is likely to focus on front-end customer acquisition and cross-selling. However, the potential of open banking to transform many different sectors is acknowledged and much depends on the innovation of Fintech operators and their clients.

Open Banking will lead to a greater focus on customer experience and we expect systems to evolve to be more customer-focused, including the ability to hold and share customer I&Es. This could transform the way collections teams amass the information they need to set up payment plans with indebted consumers. There will likely be greater interest in API connectivity to both client platforms and DCAs, enabling real-time data access and sharing.

Additional self-serve tools for customers will be more prevalent. In the UK and beyond, we expect customers will gradually exhibit wider acceptance of 'Open Banking' in line with PSD2, which will lead to an increased adoption moving into 2020. Gaining consumer confidence is a key step for Open Banking advocates as progress relies on persuading people to share their information.

We expect this to follow a similar trajectory to when direct debits were first introduced to an initially sceptical public and it will depend in part on the innovation and benefits offered by this technological change – if consumers can see the benefits they will adopt it more rapidly. The burden for individuals of providing their income and expenditure information to multiple firms is one area ripe for a solution.

ANALYTICS IN 2019

Technology can be deployed in all environments and the trends we see coming there are:

Productisation of analytics

In 2019 we will see a continuation of the trend of productising analytics – making it easier for both origination and collections ends of the chain to use analytics and data, for example through simpler user interfaces.

Issues such as GDPR have contributed to this push towards standardising and "productising" analytics processes, as the added overhead of ensuring GDPR compliance in every ad hoc, non-reusable analysis, as well as in every data feed escaping central control, has proven to be very costly as well as exposing data processors to a high degree of compliance risk.

However, analytics productisation can only go so far without affecting the business processes requiring analytics input, and the requisite process reengineering has lagged behind.

In 2019 we expect the combined pressures of regulatory compliance and the need for high degrees of automation in advanced analytics to lead to some business processes starting to be reengineered to deeply incorporate the results of analytics, not just as one-off initiatives but as an ongoing, established business practice.

Starting with relatively uncontroversial analytics predictions such as probability to collect or redefault, and with the more flexible, but relatively well-provisioned actors in the market – servicers, rather than banks or DCAs – we will see analytics input becoming a part of everyday processes.

This change will be evolutionary rather than disruptive, contributing to, but not singlehandedly causing, efficiency and effectiveness improvements.

Improved user interfaces

As a result of this productisation of analytics, we expect to see more integrated facilities for using the results of analytical processes within operations systems. This is unlikely to be a fundamental change in the way collections systems operate on a technical level, as most state-of-the-art collections systems already encompass the breadth of configurability needed.

Instead, given the ever-increasing complexity of the automation and configuration facilities involved, the evolution we would expect to see is towards simpler interfaces. These will hide the complexity necessary to deal with local special cases, analytical input and the breadth of asset classes, offering more intelligent, unified front ends that just do what the user wants.

Servicing sector development in emerging markets

In 2019 there will be a focus on increasing sophistication and the establishment of a servicing sector in emerging markets, including legislation allowing foreclosure, access to data etc.

Emerging markets that are establishing a collections servicing industry will be able to leverage analytical and operational advances from other jurisdictions, applying them to portfolios and accounts that have not previously been treated in this way.

Such an approach has the potential to bring collections processes and performance up to speed faster. Perhaps more significantly, leveraging and adapting analytics models from established markets can limit the risk of over-pricing portfolios and contribute to the elimination of the uncertainty for investors in new markets. Combining academically successful (but unproven in practice) “transfer learning” approaches with traditional empirical underwriting processes will be key in reaching consistent valuations based on fact rather than hunches. The automated, repeatable application of best practices in analytics can then guarantee that actual performance meets expectations.

In Brazil, for example, the use of better database mining tools is important, alongside organisations that are amalgamating consumer information from different sources. Using this information in a predictive way to decide how to allocate resources and tailor approaches to individuals is the next stage.

A further common theme in some markets is that of integrating tools for dealing with real estate – such as identifying total costs, valuation and finding potential buyers. Often there is limited servicing experience in these segments and banks may have limited ability to sell secured portfolios due to their capital structure.

However, multiple servicer platforms emerging in places such as Greece create acute competition for resources and drive fees down. Some of the servicers are moving towards achieving critical mass in their assets under management.

The danger is that opportunities are being missed – both in analytics and in operations – in the rush to get things under way, says Panayis Fourniotis Pavlatos, Intelligent Decisions Director for QUALCO.

Faced with the unknown, and depending on their past experience, most new servicers have tended to fall back on banking or DCA approaches to portfolio management, thus missing the right balance of flexibility, rigour and innovation necessary to succeed in the servicing space.

This effect has tended to get lost in the market’s overall immaturity, but we expect it to become more evident as the market evolves and the measures of success become more evidence-based.

Alternative models and BPO structures in established markets

There is often a debate in mature markets about the way collections teams are remunerated. In the UK there is growing discussion about whether a commission-only model is appropriate in an environment where DCAs are now measured on the right customer outcome rather than the amount of money collected.

A number of creditors are already trialling models which remunerate DCAs on the best customer outcome and we expect them to become more common in 2019, particularly in financial services.

In the meantime, DCAs continue to face margin pressure so harnessing advances in technology, better data & analytics and providing more self-serve options for customers, will be vital to optimise operations.

There will be continued consolidation of the industry – both in terms of M&A activity or closures. In the UK there are still a number of independent DCAs who have key positions in some sectors or with some creditors which may be attractive for the larger DCAs and debt purchasers.

Other areas of focus

Investment & underwriting

Rising sophistication in operational analytics will increase the scrutiny placed on investment and underwriting analytics.

We expect to see a degree of convergence between the two – initially as part of more rigorous attempts to reconcile them and set more realistic targets for both, and eventually (although probably not in 2019) with the aim of unifying them into overarching analytical monitoring and validation frameworks.

Small creditors

In the UK, smaller creditors will recognise the value of an intermediary panel management service, continuing a trend from 2018. Previously these clients thought that it was easier to use one or two DCAs.

In reality, their accounts span a number of debt types that require specialist treatment (i.e. vulnerable, deceased, insolvent, statute-barred, low balance, etc.) Using an intermediary can consolidate the accounts of several smaller creditors to generate economies of scale and increase cost effectiveness.

CONCLUSION: Hopes for the future

Next frontiers of analytics: Automation, Fairness, Causation

The names of exciting new analytics approaches continue to change over the years – from "predictive analytics" to "machine learning" to "artificial intelligence". Their substance remains the same: extremely useful techniques with great potential, just not in the areas most people expect.

Seen as part of the general business domain of "innovation", these techniques are kept separate from operations processes (which are viewed as revenue-generating, therefore sacrosanct). They are not given the support they need to integrate with the business integration. They thus remain the "next big thing", just as they have for the past decade or so.

As analytics acceptance and adoption improves, we expect more nuanced issues to come to the fore. We do not expect these to be fully addressed in the following year, but we should see at least the beginnings of attempts to deal with them:

Automation of prescriptive analytics, i.e. the further codification and streamlining of ever-finer-grained responses to analytics findings.

Incorporating the constraints imposed by regulations like GDPR as valuable checkpoints in business processes, rather than trying to avoid or work around them.

Ensuring ***fairness*** (and avoiding further regulatory pitfalls) by adopting processes to check for and control analytics biases.

More rigorous ***investigation of the causal processes*** behind analytics findings, whether using controlled empirical trials or more formal approaches based on the principles of causal inference. This will lead to simplified operations processes and the elimination of non-scientific approaches to portfolio management.

When it comes to the expansion of analytics opportunities and increasing analytics maturity, banks and DCAs, which lie at the two "edges" of the credit portfolio management space, are constrained by this fact in ways that servicers are not.

Banks are originators – they control the original selection of customers and credit parameters, but when they sell the debts may no longer have much say in how those accounts are managed. They face mounting regulatory pressure to divest, potentially losing the opportunity to go for long-term treatment approaches. DCAs, on the other hand, receive time-limited placements, making it very hard for them to build a relationship with customers, whether for practical or for analytical purposes.

Servicers occupy a "sweet spot" allowing them to leverage data on relatively long-term portfolio treatment cycles with comparatively little regulatory pressure and reap comparatively large benefits from analytics.

The challenge in analytics will be to leverage their unique positions to improve their analytics situations. In the case of banks, as the ultimate decision makers on who the customers are, and in the case of DCAs, as the frontline communicators.

For banks, this will mean focusing on much longer-term analytics – overcoming the complexity of dealing with credit cycles and reconciling it with shorter-term balance sheet concerns. Optimising processes on a scale of multiple years to decades will require synergies between analytical and strategic decision making that has been non-existent in the past.

For DCAs, it means finding ways to exploit the short-term but voluminous data collected to extract additional efficiency improvements. They will be able to introduce variation in processes that are currently seen as monolithic – e.g. by making fine-grained decisions on who to call and when, or on which communication channel to employ.

According to QUALCO Client Operations & Support Director Nikos Argyrakoulis: "We will encounter a trend of collection systems moving towards a SAAS (software as a service) model. Especially for large organisations with many jurisdictions, this model makes sense." He adds: "Such a change poses a lot of challenges regarding architecture, security and development models."

QUALCO

QUALCO is an expert provider with more than 15 years' proven experience in enabling clients to take control of customer data across the entire credit lifecycle. Whether you are looking to modernise your internal collections platform, delve deep into the analytics of your entire debt portfolio to drive future strategy, or harness the power of external service providers, QUALCO has a solution to help you drive efficiencies and streamline your collections and recoveries operations.

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