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Collections of the Future

Changing Your Debt Collections Program with the Changing Times

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Introduction

Debt collection goes as far back in time as the history of debt. The earliest records of regulations around commercial debt collection come from ancient Babylon – a society that protected debtors' rights but also allowed creditors to recover delinquent accounts. Over the centuries, the process has transformed, from debtors' prisons and specialized collections agencies to a call-and-collect collection process. This method worked quite well until recently, when technology disruptions and digitalization rendered it inefficient. Today, when people use self-serve digital channels for most things, phone calls are not the most reliable or effective channel to reach customers. In fact, according to Hiya's 2021 State of the Call report on global data from more than 150 billion calls processed in 2020, 94% of unknown calls went unanswered. Imagine the number of calls a collections representative would need to make periodically to establish contact with a customer!

As of December 2020, there were nearly 7,000 collection agencies in the US, and the industry's annual revenue stood at more than US$10 billion. Further, according to a Consumer Financial Protection Bureau (CFPB) survey, approximately one-third of customers with a credit bureau file reported being contacted by at least one creditor or debt collector for one or more debts in the previous year. Clearly, the scale of collections operations is vast and vital for lenders.

With recent disruptions in other aspects of lending, such as onboarding and servicing, there is an increasing need to adopt some of these disruptions in the collections space. Both lenders and collectors stand to gain from an efficient, optimized, and hybrid (digital and call/collect) approach to debt recovery.

In this study, we explore the current state of the collections process, examine the challenges of the traditional collections process, and the imperative need to evolve. We also recommend a framework for the collections process of the future and action steps on how to achieve it.

The traditional collections process

Until recently, debt collection was a call center-based process, with collectors cold-calling borrowers who fell behind on their payments. Large files of borrower lists occupied collectors' workstations, and they sequentially called the numbers provided to them. This process was predominantly reactive in nature, with outreach starting once payments had been delayed. More recently, lenders have started modernizing their collections programs, loading them with digital levers and channels, such as emails or phone notifications. The overall strategy largely remains reactive, though some lenders have started utilizing analytics to segment collection accounts based on the age of delinquency and probability of recovery, among other factors. Most collectors still end up cold-calling borrowers, reminding them of missed payments, checking on reasons for missing payments, and taking notes for future follow-ups.

This method is riddled with problems, as the section below shows.

Challenges with the traditional collections mechanism

The biggest problem with a call-based approach is that calls are no longer the primary mode of interaction for a vast majority of the population. Borrowers often do not pick up calls from unknown numbers or from collection agencies, due to a sense of embarrassment or to avoid discussing their personal financial situations with an unknown representative.

Other challenges with a traditional call-based approach, even when aided by digital channels, are:

- **Poor customer experience:** Multiple calls and odd timings of calls create customer stress. Once the debt is repaid, "harassed" customers may not come back to the lender for other products
- **Significant resource requirements:** Collectors spend much time and effort in calling borrowers, with a large proportion of calls going unanswered
- **Complexity and velocity of regulatory mandates:** Regulations around collection mechanisms, government relief measures, and reporting requirements, among others, have increased significantly and continue to evolve
- **Poor data-sharing mechanisms:** Collection teams usually work in silos without real-time data-sharing. Much time is lost in analyzing large data volumes, as legacy collection mechanisms rely on agents' analysis to find critical information to relay to borrowers and sometimes even expect borrowers to understand the liabilities that exist on them
- **Communication breakdowns between borrowers and collectors:** Every debtor's repayment abilities are unique owing to differences in financial backgrounds, which require collectors to create customized collection plans. However, this is not easy due to frequent communication breakdowns, which result in a long, complicated, and incomplete collection process, and hinder collectors from offering a satisfying customer experience

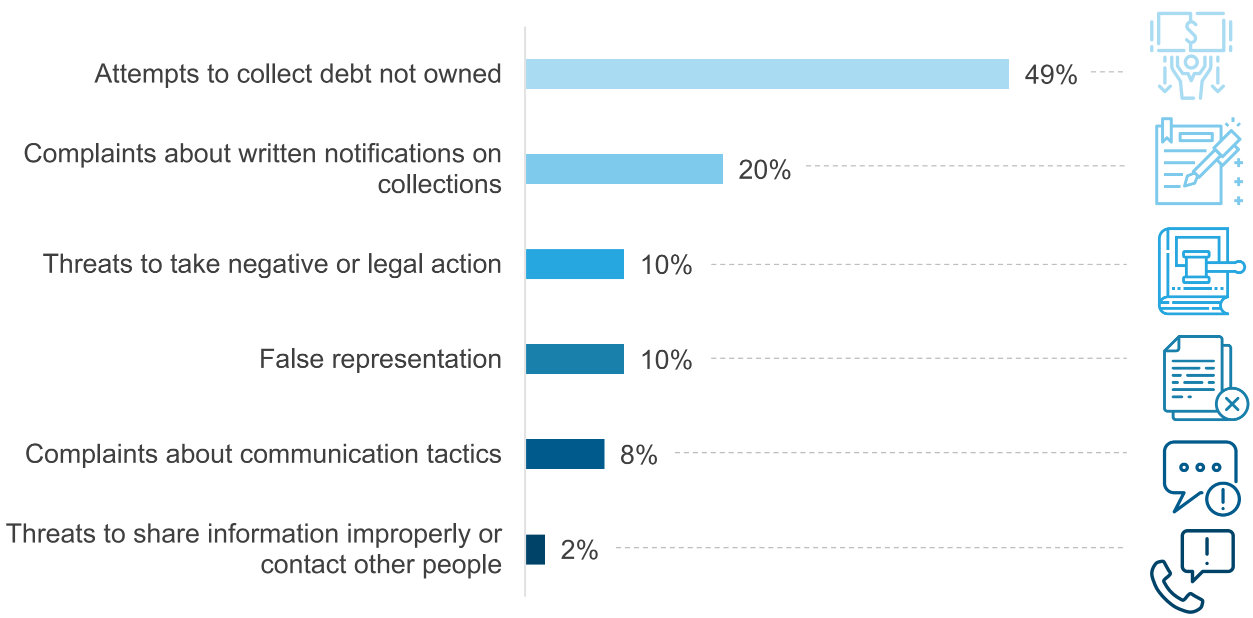
According to CFBP, in 2020, about half the consumer complaints on debt collections were due to errors in borrower records.

In Exhibit 1, we look at the key consumer complaints around debt collection in 2020.

EXHIBIT 1

Consumer complaints on debt collection in 2020

Source: Everest Group (2021); Consumer Financial Protection Bureau



Resolving these challenges requires a change in the overall approach to the collections program – from both collection agencies and lenders. Apart from the major challenges listed above, there are several larger market factors driving the need for change.

The need for collections to evolve

Several industry changes, not to mention the COVID-19 pandemic, have made it difficult to continue with existing processes to achieve high recovery levels and a great customer experience. We explore some of these market changes and their impact on collections in this section.

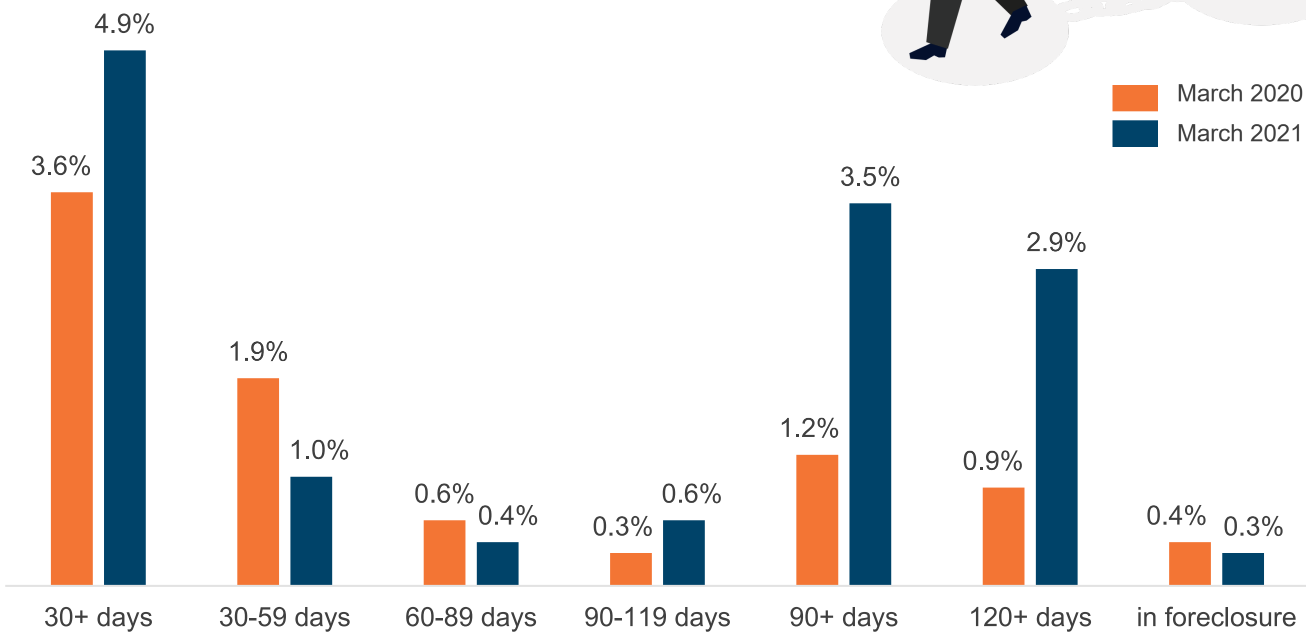
COVID-19-induced challenges

COVID-19 brought with it a tsunami of debt delinquencies in all debt types. Most lenders were not prepared for this surge from a collections-management perspective. They struggled to keep up with smaller teams, uprooted operations, extended moratorium, and rapidly evolving government regulations. In fact, COVID-19 put under the scanner the outdated and inflexible collection management operations that several lenders still use, while emphasizing the pressing need for more flexible and efficient processes. Exhibit 2 depicts the scale of delinquent debts in the US during COVID-19 and the rates shooting up as the government's support programs phase out.

EXHIBIT 2

Scale of delinquent debts in the US – delinquency rate, percentage

Source: Everest Group (2021); CoreLogic (2021)



Business challenges for lenders

In fact, even before the pandemic hit and made matters worse for lenders and collectors, multiple business challenges plagued the industry, such as:

- Net Interest Margins (NIMs) for lenders had been reducing even though costs improved, resulting in a lookout for other areas to improve profitability. Collection costs present a significant opportunity to reduce costs and add to the bottom line, along with improved recovery rates
- A prolonged low interest-rate environment increased lending volumes, but also meant that lenders were not earning as much from interest and needed to look at other means of income to maintain profitability
- Recessionary prospects cast uncertainty over lenders' future credit health and their liquidity requirements. The increase in delinquencies and defaults, coupled with mandates from the government on prolonged moratorium periods, only made things worse for lenders

The continuously evolving regulatory landscape and its specific clauses on collection mechanisms are other significant challenges.

The regulatory environment and its impact on collections

The collections process today is characterized by a constantly evolving regulatory landscape, with extremely specific changes and requirements around aspects such as repayment procedures and communication methods. Regulators aim to create a fair process for all stakeholders involved – the lender, the borrower, and the collection agencies. The CFPB's recent changes regarding compliance to the Fair Debt Collection Practices Act (FDCPA) are bringing long overdue and significant changes to the collection process in areas such as:

- Restriction on the mode and frequency of communications
- Time and place of communication
- Abusive conduct
- Sale and transfer of debt
- Disputes and litigation
- Information retention

These changes require significant effort in terms of maintaining documentation, technology, programming communication trails, process changes, data retention, and staff training to maintain compliance.

Other critical factors impacting collections

Besides the broader challenges that impact the overall collections industry, there are several factors that impact the debt collection process, as discussed below. These factors could impact some lenders and collectors more than others and are also dependent on lenders' lending portfolios.

- **Debt size:** Debt size has a direct relation to collection costs, as the larger the debt size, the more the lenders spend on recovering the amount. In fact, collection costs (across the life cycle) are almost 10% of the debt size, making larger debts costlier for lenders to recover. The cost also varies based on the type of loan, for example, a student loan may cost a lender up to 20% of the loan size
- **Number of days past due (aging accounts):** As a loan account in the collections stage gets older, the probability of recovering it starts to decrease. Exhibit 3 showcases that the probability of recovery is inversely proportional to the number of days past due. Current mechanisms to identify which outreach mechanisms work best at what stage of the collections timeline are fairly limited
- **Borrower profile:** Presently, there is no differentiation in the borrower profile based on behavioral and historical financial activity. An effective collections mechanism would consider the risk associated with the borrower, past defaults, and propensity to repay with support and flexible options, among other factors, before devising a plan. Segmentation-based plans help offer operational benefits and help mitigate future losses
- **Lender type:** Different lenders have different criteria for loan eligibility, as they are exposed to varying degrees of risk from their portfolios. Exhibit 4 illustrates that financial services institutions have the highest share of debts in collections, closely followed by telecom, which makes an efficient collections program even more critical for these lender types

EXHIBIT 3

Falling probability of debt recovery with the number of days past due

Source: Everest Group (2021); Commercial Law League of America

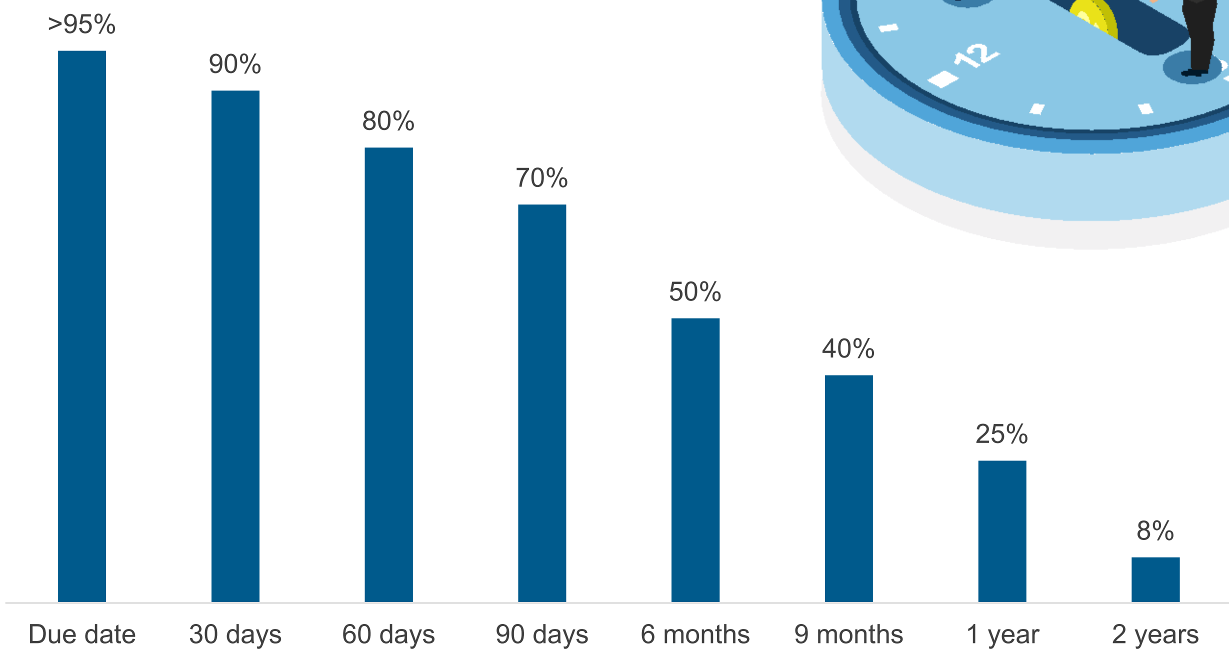


EXHIBIT 4

Share of debt by lender type, percentage share

Source: Everest Group (2021); IBIS World (2019)

Financial services	Telecom and utilities	Others	Healthcare	Retail	Government
37%	20%	13%	11%	10%	9%

With the need for an evolved collections program having been established, the industry needs to come up with a collections mechanism that is ready for the future. Having said that, future-ready collection programs need not be rip-and-replace models; in fact, aspects that will form the foundation of a successful collections program are already present today.

Collections of the future

COVID-19 has exacerbated the need to overhaul systems and processes in the broader lending industry. At a time when lenders need to continuously monitor their portfolios, create personalized repayment plans, build dynamic and agile collection strategies, and relook at borrower segmentations, traditional collection processes fail to deliver. We thus recommend a futuristic collections model, which considers all existing disruptions from a market and technology perspective, as well as prepares collectors and lenders for any unplanned events in the future.

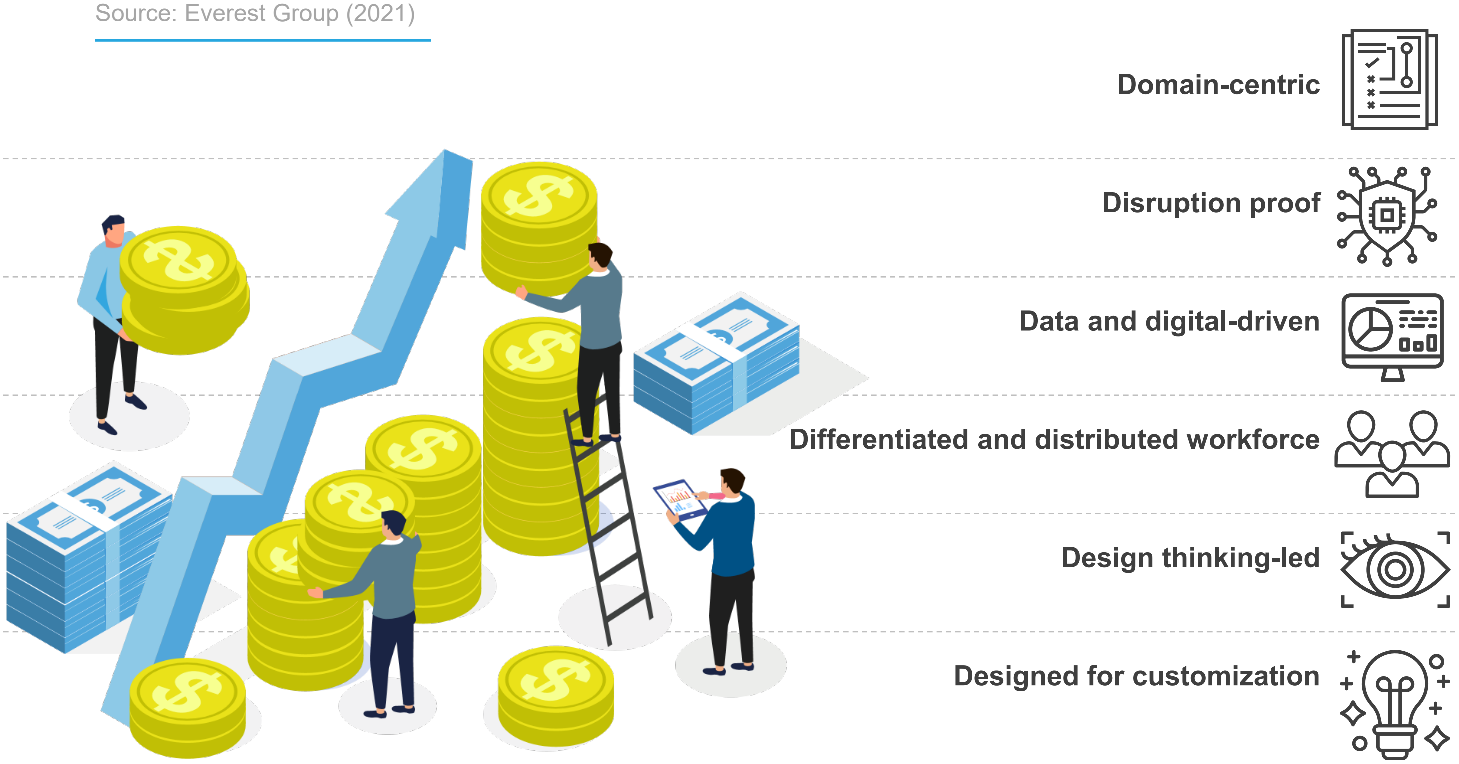
Characteristics of future collections

The future-ready collections model will include all features of existing collection programs and leverage them to create a transformed and streamlined program that factors in customer experience and effectiveness to measure performance. We explore one such model in Exhibit 5 and discuss each of its dimensions in detail.

EXHIBIT 5

Collections of the future model

Source: Everest Group (2021)



- **Domain-centric:** The collections-related domain developed by agents over the years is rich and relevant even in an evolved model. Domain expertise will always be at the center of evolution and provide the much-needed solid ground to build the model up. Collectors need to be highly trained to answer borrowers' queries, offer repayment programs, elaborate on liabilities, and utilize the insights generated from different tools and solutions. Collectors need to be thorough with the legal and regulatory aspects of communicating with borrowers too, as a failure will lead to much larger consequences than a bad loan.
- **Disruption-proof:** The model of the future will be built on a digital foundation, with clear mechanisms for regulatory compliance and process adherence, to easily transition into a Business Continuity Program (BCP) model that can withstand disruptions
- **Data-driven and digitally enabled:** In recent years, lenders have started leveraging data to profile customers and predict loans that would need collections support in the near future. Data can also help understand and plan the right approach for borrowers' timely intervention and determine the most efficient outreach channel. Self-help channels, borrower dashboards, and timely reminders via channels of choice for borrowers do exist, but they often do not use them. Similarly, collectors should be armed with efficient CRMs and critical data on their fingertips to maximize lender returns
- **Differentiated and distributed workforce-enabled:** After the government's stimulus packages and moratorium end, collections agencies will need to segment and prioritize the long lists of accounts they need to call, as against those that can be reached through cost-effective channels, such as text or emails. A limited workforce, long borrower lists, and the mounting pressure to reduce costs are driving collections agencies to revamp their operating models quickly and test new strategies faster. Such challenges draw attention to the need for lenders to continuously upskill collectors with digital solutions to fast-track work and invest in infrastructure that offers a secure environment for collectors to work remotely with sensitive borrower information
- **Design thinking-led:** A design thinking-led approach can be incorporated in collections by following a repayments model that relies on predictive and behavioral analytics to create more personalized debt solutions. Leveraging analytics to formulate risk-based collections and using existing capabilities to design more robust processes based on risk, probability of repayment, flexible payment options, etc., will also bring about a more holistic transformation in collections
- **Designed for customization:** Historically, collections mechanisms were based on either the amount due to lenders or the number of days past the due date. However, the pandemic, which affected different industries differently and led to a sharp rise in the gig economy, has demonstrated that this approach needs to change. Borrower segmentation and continuous strategy updates based on past communications will be key in designing a borrower-centric collections program that not only delivers successful returns, but also fosters long-term engagement with borrowers. Exhibit 6 depicts a streamlined approach to collections, with distinct plans based on borrower personas

Historically, collections mechanisms were based on either the amount due to lenders or the number of days past the due date. Today, the model is shifting to an experience-oriented program.

EXHIBIT 6

A streamlined approach to collections with distinct plans based on borrower profiles

Source: Everest Group (2021)

Customer Profile 1	Customer Profile 2	Customer Profile 3
Amount due: **>US$100,000**	Amount due: **<US$50,000**	Amount due: **>US$100,000**
Days past due: **30 days**	Days past due: **45 days**	Days past due: **90 days**
Risk exposure: **low**	Risk exposure: **medium**	Risk exposure: **high**
Age bracket: **30-45**	Age bracket: **25-30**	Age bracket: **>50**
Digital propensity: **high**	Digital propensity: **high**	Digital propensity: **low**
Number of reminders already sent: **<5**	Number of reminders already sent: **>10**	Number of reminders already sent: **>15**
Primary channel: **email**	Primary channel: **app notification**	Primary channel: **call**
Category: **low alert**	Category: **medium to low alert**	Category: **high to medium alert**
Strategy review period (days): **30**	Strategy review period (days): **15**	Strategy review period (days): **immediate**

Note: These profiles are only representative, and individual customers may vary

Leverage of digital tools and operations in the collections of the future model

An amalgamation of the right digital levers and operations is critical for the futuristic collections model to succeed. Different digital levers can help bring in vital components individually; however, orchestrating all of them together seamlessly will spell success. We explore each of these digital levers and the ways in which different interventions can be introduced in the collections program.

Analytics

Analytics is the backbone of an evolved collections program. Robust data-sharing mechanisms between lenders and collection agencies are vital to implement successful analytics solutions that are capable of generating insights on dimensions such as the probability of recovery, efficiency of outreach, and risk exposure. Organizations will need to relook at mechanisms around data collection to gather rich and insightful data, rather than just bare-minimum data on income and KYC in predictive analytics.

Automation

Data extraction and classification is the biggest area of intervention, where digital interventions can reduce collectors' processing times by more than 90% in certain cases. Digitalization helps increase collector productivity as well, by providing borrower data intelligently and extracting important data points. Automated rule-based programs that flag up aging accounts, prioritize accounts, calculate risk exposure to the lender and recovery probability, fetch historical collections communications, and assist in sending broad distribution messages will only increase the overall efficiency of collection programs.

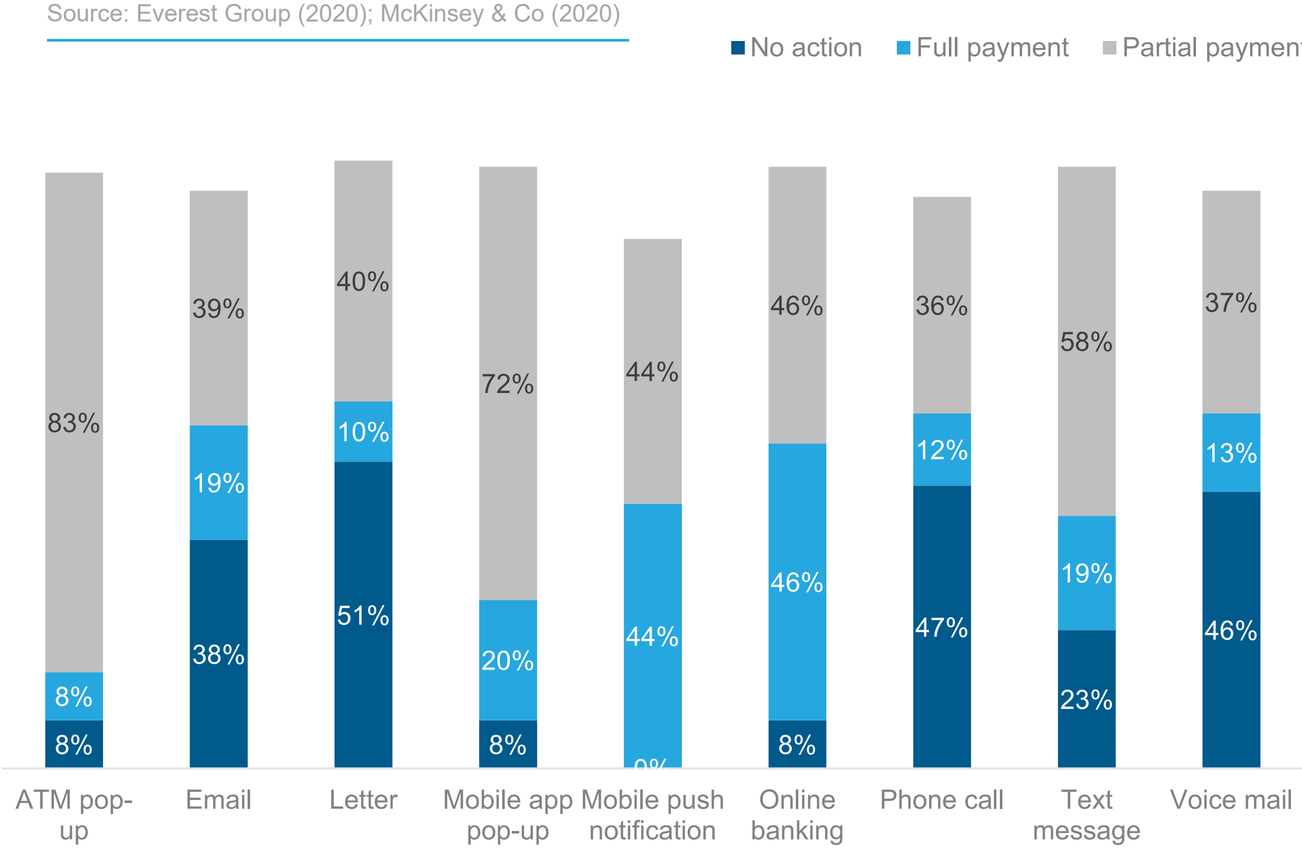
Artificial Intelligence (AI) / Machine Learning (ML)
Intelligent automation can help extract customer information from different bank systems and create a unified customer view. It can segment borrowers based on historical financial activities and channel usage, calculate the efficiency of different channels at different stages, create customized outreach plans based on borrower profiles, and suggest repayment options for different profiles of borrowers and loan types. Such types of interventions enhance the borrower's experience and increase the probability of recovery of a particular debt in its entirety or in part.

Digitally comfortable borrowers prefer self-serving online channels and applications. Lenders need to identify the right mix of channels, such as email, text, and banking applications, to improve borrowers' experiences. For the not-so-digitally savvy customer, offline channels should be leveraged, but the experience should be similar to online channels. Leveraging automation, AI/ML, and analytics is key to achieving this customer-focused channel strategy. Exhibit 7 illustrates the effectiveness of different channels in collecting debts due for more than 30 days.

EXHIBIT 7

Effectiveness of different channels in collecting debts due for more than 30 days, percentage of total respondents by last-contact channel; N = 300+

Source: Everest Group (2020); McKinsey & Co (2020)



Note: Percentages do not add up to 100% because of rounding and omission of an inconsequential category ('other')
Source: McKinsey survey of credit card customers in the US

Several lenders have already started relooking at their collection programs. We examine one such successful case study from a bank.

Case study

A large global bank customized its collections program to gain efficiencies through data

Objective

A large global consumer bank was looking to modernize its collections program to embed more customization and improve the overall program efficiency.

The solution

The bank partnered with a collections-focused third-party provider to address the issues impeding its collections program. The solution involved:

- The partner team worked to address the customization and efficiency-related issues using digital levers, particularly automation and analytics
- The team designed a dynamic outreach plan by leveraging channel-effectiveness data, risk-based profiling, and payment-rate data to reduce reliance on phone contacts in late-stage categories and redirect to external agencies on a contingency basis
- The partner worked on customized strategies for the bank by designing an AI- and ML-based platform that could adapt to borrowers' changing situations, changing macroeconomic conditions, and changing business policies
- The platform also provided insights on customer needs and preferences to customize communications, select preferred channels, and determine the time and frequency of outreach

Impact achieved

- The bank was able to achieve benefits worth more than US$50 million through efficiency gains across portfolios
- The cost of recovering a debt through collections went down by 4-6%
- The bank also experienced a 10% increase in its borrower satisfaction score within a year of implementing the new strategies

Considerations for lenders as they design a future-ready collections model

While lenders need to transform their collection processes to ready themselves for the future and implement successful and customer-centric debt collection programs, they also need to consider certain factors before embarking on such a transformation program:

- The **siloed nature of data and operations** has been one of the biggest impediments to transformation initiatives. Data-sharing and collaboration are key to a successful transformation project and a smooth, long-term transition to new mechanisms, making it imperative for lenders and collection agencies to break silos
- **Talent crunch** is another obstacle that hinders transformation projects and the digitalization of programs. Without suitable skills to use the tools and solutions, the projects are akin to costly adventures without providing the desired return
- **Apprehension to change** is another impediment to achieving the full potential of digital transformation projects. Processes that have worked for years have set in an inertia, hindering the shift to new processes and mechanisms. Digital tools and solutions also make employees apprehensive of potential job losses due to automation
- Creating attractive **business cases for investments** in such initiatives is also difficult, as direct measurement of RoI using traditional KPIs is difficult until new processes mature and start showing results
- **Overhauling legacy systems and processes** is a herculean task for any organization and any evidence of failure when organizations have tried to replace systems and processes only adds to challenges. Data and workflows from legacy systems need to be cleaned, standardized, and reformatted for new systems, with any errors leading to potential breakdowns

However, these challenges can be overcome with a well-thought-out, right-fit strategy. Every lender must choose a transformation plan based on its unique needs and considerations. Some lenders might be comfortable in opting for a rip-and-replace transformation, while others may opt for a modular approach. Lenders should also factor in their investment appetites and leverage avenues of partnership with third-party providers that specialize in collections. These partners can bring in the right expertise, best practices, and flexible models of engagement that lenders can leverage for greater returns on investment.

We believe that, to succeed, lenders need to focus on three aspects:

- **Technology**
  - Invest in the right kinds of solutions and capabilities, either through partnerships or in-house developments
  - Upgrade internal legacy infrastructure and systems to ensure compatibility with digital solutions

- **Talent**
  - Train and upskill collectors for more complex conversations and to provide alternative solutions to borrowers’ challenges

  - Undertake continuous learning and development initiatives to leverage digital solutions to their advantage and, in turn, increase productivity
  - Hire and nurture talent for the new roles created by digital transformation
- **Change management**
  - Educate and create awareness about the benefits of a customer-centric, digital-first approach
  - Involve impacted stakeholders through proactive communication
  - Allow adequate time for the organization to absorb changes and stabilize the new mode of operations

Such an evolved and focused collections program will help both the borrower and the lender meet their objectives, while providing a superior experience to all stakeholders involved.

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