Collections best practices for fintech lenders

Prioritizing key strategies, policies, and infrastructure decisions

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Executive Summary

Over the past couple of years, our Collections practice at 2nd Order Solutions has expanded to not just include large banks and credit card issuers, but an increasing number of fintechs, both in the US and abroad. The fintech sector has grown tremendously over the last 2-3 years, and as their customer bases have grown larger, there is an increasing mandate to focus on default management, especially with delinquencies beginning to rise. This paper highlights emerging trends and recommends immediate focus areas for fintech leaders to quickly strengthen Collections practices.

Relative to large banks and more established lenders, fintechs have the freedom to build their collections capabilities largely from scratch, since they are less beholden to legacy systems and entrenched processes that need to be redesigned. On the other hand, job #1 for almost all fintechs is rapidly growing new customer acquisitions. Dedicating product, data sciences, and tech resources to creating awesome customer experiences and new products understandably leads to Collections falling lower on the priority list.

That tension creates a dilemma for fintech leaders. Clearly one needs Collections capabilities, especially heading into a period of increased delinquencies at best, and an inflation-driven recession at worst. But where to start and how much to invest are the key questions. This whitepaper is a blueprint for how we at 2OS recommend fintechs begin their journey to improve collections.

First of all, good news! You don't need to be great at Collections if you're a fintech. Being great at Collections probably means that you have had severe credit problems or you're not investing enough in growth and new customer acquisitions. Instead, you should focus on being "good enough", to ensure delinquencies are not negatively impacting profitability, liquidity, and funding in case of a credit downturn. However, Collections needs to be an effective extension of the brand (especially in early-stage delinquency) where the customer experience is still paramount and most customers will be able to pay their way out of Collections.

We would recommend viewing Collections as a critical insurance policy since having inadequate collections capabilities sets you up for credit problems, compliance issues, and damaged investor and customer confidence.

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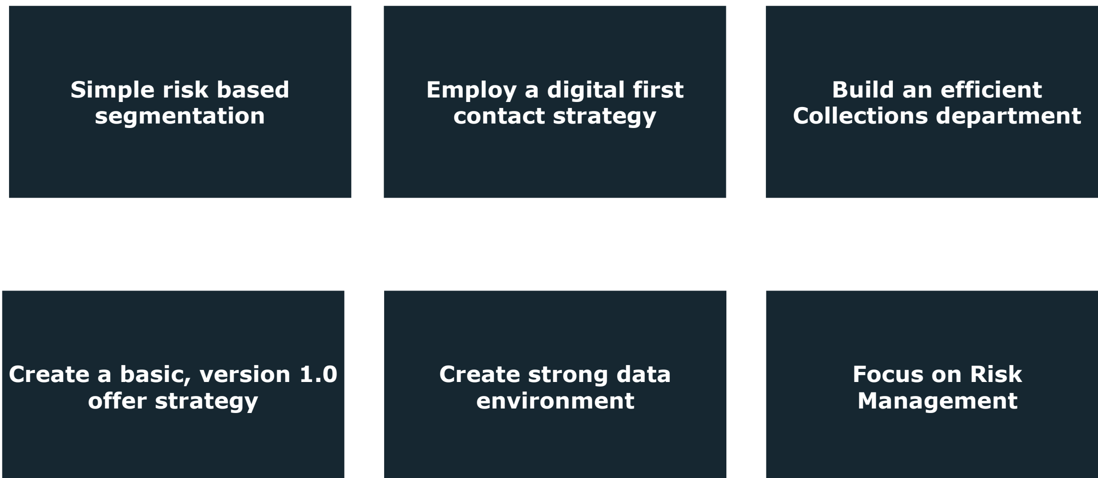
Overview

There are many ways to structure a fintech's Collections agenda to be "good enough", focusing on the following areas:



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- **Simple risk-based segmentation**.
  - Know the difference between low, medium, and high-risk delinquent customers, especially in early-stage Collections, and vary entry timing and outreach frequency accordingly.
- **Digital Collections** (e-mail and SMS outreach, inbound self-service payment portal).
  - Design and develop a "digital-first" (not digital-only) Collections strategy where Collections is an opportunity to reinforce a strong customer experience.
- Build an **efficient Collections department**.
  - Start with outsourcing most Collections phone work to mitigate the need for large call centers. Be aware that while there are many advantages to outsourcing, it can be a source of performance and compliance risk. When using internal call centers, make sure it is for high value or benchmarking

work and that there is a thoughtful approach to goals, pay, incentives, business shift criteria, etc.

- Create a **basic, version 1.0 offer strategy**.
    - Focus on key industry standard offers (e.g., re-ages, non-concessionary payment plans, deferrals, fee waivers) and ensure agents have simple rules on when and how to offer.
- **Establish a focus on risk management**.
    - Make sure that your practices (and those of your outsourcers) are fully compliant. As a fast-growing company, the last thing you want is compliance scrutiny related to Collections. Ensure a strong credit governance framework (monitoring and reporting) and an ability to adapt to new laws and regulations such as Reg F.
- Create a **strong data environment and monitoring suite**.
    - Monitoring allows your firm to quickly recognize and diagnose credit or operational performance problems. It is critical to have a strong data environment, not just to enable monitoring and reporting but also to create a longer-term foundation for analytics, modeling, and testing.

Lastly, there is value in implementing a feedback loop back to the product/credit teams. These "upstream" teams have to know how customers are performing in Collections, at a product/segment level.

On the other hand, we would recommend deferring investment in:

- **Internal call centers**. Unless they already exist, the volatility in call volumes, management headaches, and compliance concerns makes this a long-term priority but not an immediate one. Focusing on a strong digital outreach strategy helps to enable this.
- **Advanced Testing and Sophisticated Modeling**. These will be critically important once you're a larger business, but less so as an immediate priority. Use industry-

standard practices early on related to entry timing, call intensity, and offers. Make sure you are capturing the data (see above) to enable analysis and longer-term testing.

- **More advanced offers** – e.g., complex settlements, concessionary payment plans, hardship

In the pages to come, we will dig deeper into each of these recommended areas of investment.

Simple Risk Based Segmentation

At the core of every well-designed Collections strategy is an effective segmentation. Regardless of its sophistication, your segmentation schema should enable differentiated treatments for customers across contact strategy (entry timing, digital outreach, dialing intensity, etc.), call center configuration, and offer strategy. While many large banks and card issuers are using sophisticated machine-learning models to define their segmentation, 2OS does not believe this is necessary for fintechs in early stages of their development. For now, using a simple risk-based segmentation can help elevate your existing strategy and allow you to reduce both losses and operational expenses.

In early stage (1-60 days delinquent) collections the most fundamental issue is being able to clearly distinguish between low and high-risk delinquent customers. This will allow you to delay outreach on your low-risk customers in hopes that they will cure on their own without the need of intervention. The other strategy is to place them in a low touch digital strategy that would not be as expensive as dialing.

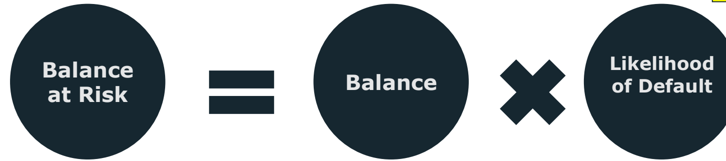
While differentiating risk is also important in late stage (60+ days delinquent), almost all late-stage accounts are high risk and most are hard to get into contact with. We recommend a well-designed digital (e-mail and SMS) contact strategy to connect with late-stage customers at a reasonable cost. Eventually, fintechs will want to invest in a more sophisticated offer strategy (in contrast with the simpler one we describe below), but we do not recommend that as an immediate priority.

For smaller portfolios, we have found simple rules-based decision trees to be effective across all stages of Collections using a few key variables. One big challenge we have found is that not all fintechs are getting full updated bureau data on accounts prior to collections entry. 2OS believes bureau data and understanding performance on other loans can be

highly valuable information for you to have, and we would recommend getting bureau updates on existing customers at least quarterly.

Best practices suggest using Balance at risk to segment your customer base and differentiate treatment

ILLUSTRATIVE



Early Stage Collections Actions (Illustrative)

Balance at Risk	High	Medium	Low
Entry Policy	Begin calling @ Day 5	Begin calling @ Day 10	Begin calling @ Day 15
Calling Intensity (per week)	7 attempts per week	5 attempts per week	3 attempts per week
Email Intensity	10 per month	7 per month	5 per month
Texting Intensity	5 per month	4 per month	3 per month

*Balance can also be used as balance/exposure across number of products

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Employ a Digital First Contact Strategy

Collections is in the midst of its biggest transformation since auto dialers were implemented, and those fintechs that are not actively working towards implementing a "digital-first" collections agenda will find themselves left behind, especially as delinquencies rise. This is especially true for fintechs, who typically acquire most of their customers through digital channels and establish digital communications with the customer at all key points of the customer lifecycle.

We distinguish "digital-first" from "digital-only". We do feel that inbound and outbound phone outreach will have a role in a winning collections strategy for the foreseeable future. But prioritizing digital outbound and inbound improvements over incremental improvements to phone-based strategies is the right course of action.

Historically, Collections outreach strategy has been based on outbound phone and steering customers to call back via inbound. But over the last 10 years outbound dialing effectiveness has plummeted, driven by the role that mobile phone usage and caller ID play in all of our lives. Furthermore, with the implementation of Reg F, which among other restrictions puts caps on outbound phone calls, we have seen this shift towards digital

accelerate. Phone channels, while not obsolete, are being utilized to complement digital first contact strategies vs. acting as primary methods to obtain payments.

One of the key changes we are seeing is that as companies begin to go digital-first they are doing so while coordinating with their phone channels. You can create an omni channel contact strategy which is catered to specific customer segments.- Channels that are important in a digital first contact strategy include:

- **Email** - 2 way preferred
- **SMS** - 2 way preferred
- **Robust self-service** - website, mobile, app, VRU, IVR
- **Chat** – live chat preferred
- **Letters** - primarily for customers who do not have valid email addresses or phone numbers with no phone contactability

Adoption of email and SMS in collections has become widespread over the past few years. Well-constructed e-mail and SMS strategies can be superior to phone outreach in terms of effectiveness, efficiency, and customer experience.

Foundational steps to build a winning digital contact strategy include:

- Creating an extensive creative library which varies with specific risk segments and delinquency buckets
- Varying subject lines, pre-headers, and messaging content
- Ensuring tone and content build upon each other as the customer progresses in delinquency, while also being consistent with the organization’s brand standards.
- Matching creative content with agent talk-offs in both inbound and outbound
- Continuous testing to determine highest open rates, click through rates, drivers of inbound calls, and payment rates

Additional best practices in maximizing the effectiveness of a digital collections strategy include ensuring valid contact information at origination and through website prompts, and maximizing opt-in and cell phone consent rates. These “upstream” processes are

critical to setting up the Collections department for success, since obtaining this information is much less likely once a customer goes delinquent.

Create a Version 1.0 Offer Strategy

In early-stage delinquency, right party contact rates are usually high and self-payers and customers with only short-term issues begin to cure. However, once the customer hits 60+ days of DQ, it not only becomes harder to get in touch with the customer, but even harder to get a payment when you do get in touch with them. This is where an offer strategy becomes important to implement on the following dimensions:

- Suite and structure - focus on key industry standard offers both concessionary and non-concessionary e.g., re-age, settlement, fee waivers, payment plans, etc.
- Eligibility - focus on determining which offers you want to provide to different risk segments, when you should provide them, and in what order (i.e., have an offer waterfall)
- Focus on agent level training e.g., if the system does not allow it, ensure the agents know the offer waterfall and how to communicate and present the offer

...we would also recommend some best practices:

- Make sure you understand your objective function e.g., NPV maximization, liquidity, loss mitigation, number of customers saved, etc. Collections strategies can be "tuned" to optimize for NPV or credit loss minimization, so being explicit about the top financial goal for Collections is critical.
- In a credit downturn, it is important to be flexible by moving eligibility earlier, providing multiple options, and focus on getting as much principal as possible
- Keep the offers basic in an Offer 1.0 strategy, but consider more compelling, innovative, and targeted offers for customers with short- and long-term hardships in an Offer 2.0 strategy
- Be aware of changing situations and adapt quickly e.g., tax season, government stimulus programs, etc.

Build an Efficient Collections Department

Building an efficient and effective Collections department allows you to maximize dollars collected while minimizing operational expenses. We would suggest that for most fintechs a winning call center strategy starts with a primarily outsourced agent footprint.

When managing a small network of outsourced agencies, there are key factors to consider to optimize overall business performance:

- **Key Performance Indicators** - it's essential to define the right set of performance metrics, both at the agent and agency level. These include:

    (a) business performance metrics, e.g., delinquency rates, number / dollar inventory by bucket by batch, bucket-to-bucket roll rates
    (b) operational metrics, e.g., outreach (dials, connects, RPC's, etc.), inbound (service levels, speed to answer, abandon, occupancy, etc.)
    (c) agent level metrics, e.g., productive to paid, average handle and wrap time, dollars collected, quality scores, associate satisfaction scores, etc.
    (d) compliance and customer satisfaction metrics, e.g., complaints, escalated calls, net promoter scores

- **Agent compensation** - how are agents and outsourced agencies paid, which includes both base pay and incentives
- **Business shift approach** - when, how often, and what metrics (usually a combination of performance and cost) are utilized to move business between suppliers or between internal and external
- **Call flow** - create a structured approach through training, quality, and coaching to hold managers and agents accountable to performance.
- **Reporting and monitoring** - create consistent reports for managers and associates to know how they are performing and for the business to assess overall performance both internally and with outsourced agencies
- **Coaching and management routines** - develop clear action plans and specific management routines to ensure ownership and accountability

Establish a Focus on Risk Management

As Collections inventory grows and becomes a larger part of the overall business, organizations need to create roles and responsibilities focused on ensuring adherence to credit risk management and complying with relevant laws and regulations. Some best practices include:

(a) Create a strong **credit governance framework**

- Create frameworks to understand and review financial and credit impacts of significant Collections decisions
- Focus on execution matching intent
- Strong partnership between credit/analytics teams and operations
- Systematically review performance of key Collections metrics and the incremental impact of key decisions

(b) Build **flexibility** to react quickly to current and future **regulatory changes**

- The CFPB continues to aggressively expand its supervision to include nonbank financial companies which highlights the importance of a strong compliance team able to identify and prevent findings before they occur

- Reg F has changed the landscape of the Collections industry as financial companies react to the limitations in calling, both calling frequency and best time to call
- As phone outreach becomes more highly regulated, building out digital inbound and outbound capabilities is essential
- To allow for continued flexibility, organizations must ensure infrastructure and technology can meet compliance and regulatory requirements

Build a Strong Data and Monitoring Suite

(a) Build strong oversight and monitoring

- Monitor all KPI's through a consistent reporting framework and review with senior credit and operations executives
- Ensure each metric has controls and limits to understand when performance is below expectations
- Create escalation points and mitigation strategies in advance for when metrics are outside of guardrails

(b) Develop a solid data environment

- Data should be comprehensive and easily accessible
- All fields, terms, and corresponding metrics should be clearly defined and understood universally
- There should be a known expert responsible for answering questions and stewarding teams through the correct utilization of the data
- Clear change management processes should be adopted for any data logic changes or enhancements to ensure all key stakeholders are aware in a complete and timely manner

While not an immediate priority for most fintechs, it is important to start thinking about a testing agenda so that your infrastructure can support any testing you may want to perform in the future. The testing agenda should focus on the highest leverage areas of your business, with the goal of driving improved performance across loss metrics, efficiency and customer satisfaction. All tests should have a clear outcome they are trying to read, have a robust monitoring plan, and be time-bound to force decisions. Most testing starts out as simple A/B tests, but we have seen more complex designs at some lenders - these lenders are typically more advanced and are able to have dedicated resources focused on testing. In our experience the highest leverage areas to test are: entry timing, outreach intensity, and channel preference.

Conclusion

While it is an exciting time to be a fintech, the current credit-related uncertainties will likely make for some sleepless nights. But being thoughtful about how to invest in your Collections department now can end up paying huge dividends down the road and even

allow you to accelerate future growth. Having the following in place will allow you to be prepared for any possible risk environment:

- Implement a simple risk-based segmentation
- Design and develop a “digital-first” (not digital-only) Collections strategy
- Create a basic, version 1.0 offer strategy
- Create a strong reporting and monitoring suite, to quickly recognize and diagnose credit or operational performance problems.
- Build an efficient Collections department
- Ensure that your practices (and those of your outsourcers) are fully compliant.

Please feel free to contact us if you’d like to see some examples or additional details of anything we discussed during the white paper. We welcome the opportunity to discuss Collections with you in further detail!

About the Authors

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About 2OS

2nd Order Solutions (2OS) is a boutique credit risk advisory firm that specializes in solving the world's most challenging credit problems. 2OS was founded 12 years ago and consults to a wide range of banks, card issuers, fintechs, and specialty finance companies in the US and abroad.

2OS has deep experience with lending businesses across Card, Auto, Small Business, and Personal Loans, at all points in the credit lifecycle. 2OS partners have vast expertise in all aspects of Collections, both as operating executives and as consultants.