White Paper

Winning in the Next Era of Collections

As COVID-19 Triggers an Economic Downturn, Leading Creditors Must Respond Rapidly

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Although most banks have constructed recession-readiness plans over the past 1-2 years, the COVID-19 outbreak has forced banks to confront a much sharper and more sudden downturn than even their most severe planning scenario would have suggested. The plans have been predicated on the assumption that the next recession would resemble prior downturns — usually slow to unfold and preceded by a wide array of early warning signals.

Yet the COVID-19 crisis, in very short order, has led to soaring jobless claims[1], an unemployment (or underemployment) rate projected to reach up to 20%, and a U.S. Q2 GDP projected to dip more than 20% from the same period in 2019[2]. With the global economy already in full-blown crisis, financial institutions cannot wait for additional lagging indicators to determine their response. They must act decisively, and they must act now.

The past two weeks have been frenetic, with the situation evolving dramatically day by day. Financial institutions of all shapes and sizes are navigating several existential threats at once, not just related to delinquency and credit losses but also liquidity shocks, potentially severe public-relations problems, and the well-being and trust of their employees. To be successful in such turbulent times, financial institutions need to discard their usual decision making processes in order to react and mobilize in such a highly dynamic environment.

Indeed, the COVID-19 outbreak has brought considerable nuances to "typical" downturns. The crisis is not limited to borrowers but also has significant impacts on the employees of creditors. In the days to come, we will face a scenario in which both the volume of delinquent customers and those inquiring about loan modifications will rise rapidly. At the same time, the number of available agents at both in-house and outsourced call centers is likely to be severely compromised[3]. It is therefore essential that creditors and their suppliers all have robust business-continuity plans. They must agree on how to make the best use of scarce resources; on how to quickly make cross-functional decisions; and on how to scale up digital-collections outreach and fulfillment capabilities to mitigate the impact of severely constrained call-center resources.

[1] In the week ending March 14, the advance figure for seasonally adjusted initial claims was 281,000, an increase of 70,000 from the previous week's unrevised level of 211,000. This is the highest level for initial claims since September 2, 2017 when it was 299,000. Source: https://www.dol.gov/ui/data.pdf
[2] https://www.cnbc.com/2020/03/20/goldman-sees-an-unprecedented-stop-of-economic-activity-with-2nd-quarter-gdp-contracting-by-24percent.html
[3] Agencies are currently operating at ~75-80% capacity

In the collections area, the most immediate challenge so far has been on the employee front, especially concerning in-house and outsourced call centers. Even without any sizable increase in the number of delinquent customers so far, FIs are facing "supply shocks" as call center capacity is diminishing due to COVID-19-related illnesses and work-from-home policies. Work-from-home collections functionality is a nascent capability for most banks, and agent productivity and procedural compliance issues will almost certainly take a hit with any at-scale work-from-home program. Indeed, the state of Nevada has tagged collections agencies as "non-essential," which means the large number of collections centers in the state will be taken off-line[4].

It will be at least a couple of weeks before the inevitable surge in delinquent customers begins. It's as if creditors know that a massive earthquake has taken place offshore, and they know that a tsunami is coming, but the surf conditions at the moment are rather calm. In this environment, collections leaders should be rapidly adapting all aspects of their strategies and operating models. In order to help leaders prepare for the near-term impact on their business, we below take many of the themes from our previous paper, "Preparing Collections for a Recession[5]," and make them more specific and actionable to what the industry faces today.

Many of the most effective debt-collections levers that are workable during normal times will be compromised in the weeks to come. However, we have identified six actions that FIs should adopt immediately during these unprecedented times:

1. Massively shift resources to and within collections. Any competent financial institution has already dramatically cut back on the extension of new credit. Continuing to market new credit cards, new personal loans, or balance transfers to existing customers could have severe consequences. Large teams within banks that previously focused on portfolio growth and new-account marketing find themselves suddenly underutilized. Meanwhile, few heads of collections are content with the level of resources they typically receive from the enterprise shared services. We thus recommend an immediate reallocation of resources toward collections, as well as initiation of other loss-mitigation measures. With collections often run as a cost center, now is the time to reorient its mission toward the ongoing viability of the institution. Indeed, banks should

[4] Collection agencies holding a license or certificate under Nevada and located out-of-state must cease collection efforts with Nevada consumers/residents effective until April 16, 2020
[5] https://www.linkedin.com/feed/update/urn:li:activity:6645279538295173120/

add direct-marketing talent, analysts, supplier managers, data scientists, and tech resources to the one “growth business” they have at the moment, and make similar shifts among call-center agents. For example, take that tele-sales unit down the hall that does outbound marketing of balance transfers: welcome to collections! If FIs start cross-training such agents now, they will be largely up-to-speed in their new roles by the time delinquencies begin to surge. Even if these newly re-allocated resources are only 70% to 80% as effective as their longer-tenured colleagues, they will still be critical to stemming the flood of collections activity.

2. Clarify decision making. As discussed in our previous paper, there is often a co-management model used to lead collections, most often between the 1st line-of-defense (LOD) credit department and operations. This model can lead to misalignment of goals and slow decision making in the best of times, but can lead to very costly inaction in times such as the present. We recommend creating a cross-functional collections “war room” — ensuring social distance using Zoom or Webex, of course — that not only includes 1st LOD credit and operations leaders, but also representatives of the important staff functions needed to make immediate decisions. These include HR, compliance, and public relations, which should not be steering the ship but whose rapid response to strategic and operational changes is imperative. Having each of these functions come together will also ensure nimble decision making in response to customized strategies necessitated by quick-moving legislation (e.g., avoiding making calls to hot-spot areas).

3. Prepare for a world of severely constrained outbound dialing. As discussed, this downturn is remarkable for having both demand shocks (more delinquent customers) and supply shocks (fewer in-house and outsourced call-center agents). When combined, these forces will severely curtail creditors’ outbound dialing capabilities. They therefore need to use a combination of analytics and judgement to create tiers of expected value from outbound dialing campaigns, so that as needs arise to reduce dialing by 25%, 50%, or even 75%, it is clear how the creditor will react as capacity tightens up. The exact changes will vary by portfolio, but should include consideration of varying entry logic, sloping the amount of calling dramatically based on risk and exposure, on the use of outbound interactive voice response (IVR) campaigns, and on skill-based routing. For example, those tele-sales agents who are now collectors should not be focusing on late-stage, high-balance customers.

We know of several banks who have stopped or scaled back outbound dialing on delinquent borrowers due to reputation risk. Our recommendation is to continue outbound dialing, with several important adjustments. Our first suggestion is to develop more customer-friendly scripting, knowing the severe challenges facing many of their customers. Second, if the creditor gets in touch with the customer, and are told the customer can't pay, extend the period where that customer is automatically taken off of the dialer (known in the industry as a Right Party, No Arrangement (RPNA) Hold) relative to current practices. Finally, make sure that daily calling limits are reasonable, and are set at both the customer level not the account level, in case a customer has multiple delinquent loans with the creditor.

4. Make no-regrets increases in non-phone outreach. To offset the constraints on outbound calling, creditors should increase the amount of e-mail and SMS outreach that drive inbound phone calls. Most creditors send out one to four e-mails per month, but we would suggest increasing that significantly. We have done extensive test-and-learn about the optimal entry date, frequency, and messaging of digital communications —but barring the time to do that, sharp increases are now more useful than ever. Communications should be rapidly developed to be more compassionate and more focused on hardship plans, as well. Snail-mail collections letters have fallen out of favor for most creditors due to their relatively high cost, but there’s a risk that as more creditors send out more collections e-mails, that channel will become as saturated as outbound dialing is today. To counter that, creditors should spend the money to launch a strong letter campaign in addition to ramping up digital channels.

Moreover, an effective way to reduce call volume further and allow for self-service is to allow for online servicing and fulfillment capabilities for past-due customers. We know of some banks that exclude delinquent customers from their online servicing systems, which is counterproductive during these times. While most lenders are not able to offer their full suite of offers online, having the ability to direct customers to a landing page from email and SMS will help reduce inbound call strain on the network. This page, at a minimum, should allow the customer to view balances, chat with an agent, and submit payments.

5. Strengthen proactive and reactive hardship responses. While many customers will be only indirectly or mildly impacted financially by COVID-19, it is clear that a large number will lose their employment and income indefinitely. Banks generally have hardship programs in place that are made available under special circumstances — such as natural disasters and government shutdowns — to help borrowers by reactively offering fee refunds or waivers, options to skip payment(s), and/or cessation of aging — and by delaying litigation and repossession activities.

We recommend that banks make options such as those illustrated below available to impacted customers. Banks should also set clear guardrails for qualifying customers based on the recognition that they are experiencing hardship in different ways. For example, credit card customers could be offered:

Impact	Description	Action
Short Term Impact	Temporary loss of income, stemming from a temporary need to care for an infected family member, or provide child care given a school closure.	Waive past due fees for 1-3 months until the situation passes.
Long Term Impact	More structural income loss, perhaps stemming from job loss in a disproportionately impacted industry.	Offer 0% APR for up to 12 months
Severe Impact	Customers who become infected and hospitalized themselves or have an immediate family member severely impacted.	Maintain current aging, set minimum pay to $0, and waive past-due fees until the situation passes

In addition, banks should find ways to identify hardships even before the customer enters delinquency — for example by monitoring checking-account inflow activity to see if the customer is getting regular paychecks, and by looking at macro-economic indicators at the MSA level to model local-level shocks.

On March 22nd, the major US banking regulators produced interagency guidance clarifying the hardship concessions that can be made before triggering a total debt restructuring (TDR) for customers impacted by COVID-19[6]. The important COVID-initiated clarification is that short-term (e.g. six month) payment deferrals, fee waivers, extensions, and other short-term actions can be taken without triggering TDR as long as the customer is less than 30 days delinquent as of when the loan modification is established. Relative to pre-COVID guidance, this gives banks clarity and additional latitude in working with customers during this crisis. But notably the customer must be less than 30 days delinquent per the guidance, which will drive how creditors best react to the clarifications. Taking decisive, creative approaches to working with customers at a time of distress will allow creditors to distinguish themselves positively, not negatively, in the weeks to come.

6. Look at all collections actions through a customer-fairness and reputation lens. Any recession serves as a moment of truth for financial institutions, and this downturn will be no different. Because of the unique dynamics of COVID-19, however, this particular moment of truth is not just about financial survival but also about the fairness with which the creditor treats its customers and employees. COVID-19 is not just a macroeconomic issue—it is a *public health issue that is creating* a macroeconomic issue. Companies finding themselves in a situation where illness has spread among their employee base will face "20/20 hindsight" scrutiny on their human resources policies. And creditors who are negative outliers on treating impacted customers with empathy will face outsized brand risk and customer loyalty problems.

Many banks have already made headlines in the last week by suspending foreclosures and auto repossessions. But we know of one large bank that has taken the step to suspend dozens of foreclosures while continuing to send out thousands of pre-litigation letters. It is essential for banks to look at their practices through a lens of reputation risk that is unique to this crisis. Litigation, in particular, will not only bring reputation risk—but its effectiveness will be reduced as courthouses are either closed entirely or triaging significant felony cases over those related to unpaid debt. A holistic view that incorporates both expected financial impact, as well as reputational risk and the future ability to attract and retain customers, is imperative in such a delicate situation.

[6] https://www.fdic.gov/news/news/financial/2020/fil20022.html

Conclusion

These are unprecedented moments in the lives of all financial institutions. For many FIs, this is the first economic downturn in the history of the organization, and it has been over ten years since lending executives have had to confront a crisis approaching this magnitude—and certainly not of this speed. Collections is the last line of defense that FIs have at the moment, and well-run collections functions can contribute meaningfully to the survival of the organization. Now is the time to immediately increase the focus on this area, and CEOs and CROs should be making sweeping strategy changes and reallocations of resources to this "growth business."

To better engage customers, banks should reach out proactively and frequently with the right tone and messaging. The goal should be to keep the relationship trusting and open in case hardship hits, knowing that this will be the case for many customers. To the extent that banks can prompt regular communication from borrowers, even if just to confirm that they're on solid ground at the moment, a positive pattern can be set that will potentially make any later hardship or delinquency more manageable.

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