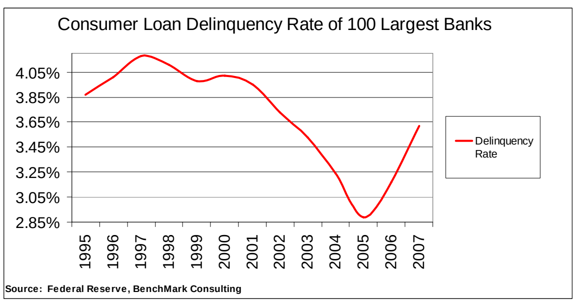
How to Navigate Successfully through the Current Collections Challenge

Brian King
BenchMark Consulting International

Changing state of consumer collections

For 10 years, the Federal Reserve reported a declining trend in consumer debt-based delinquencies. The 2006 Consumer Banker's Association (CBA) Collections and Recovery Report researched by BenchMark Consulting International confirmed those numbers and most Collections shops posted similar results. At the 2006 CBA Consumer Collections Conference, many attendees anticipated a "Perfect Storm" for Collections and Recovery professionals and, as anticipated and illustrated in the figure below, delinquencies began to rise.



The time has come for financial services providers to re-focus on balancing the strain of the increased delinquency volume with the benefits of aggressively managing Collections. Streamlining Collections processes based on industry best practices positions lenders to actively leverage both early stage and late stage collections and to reduce operational and credit loss expenses which impact the bottom line.

There is an old saying, "You don't know what you don't know" and it fits aptly with some lenders' abilities to optimize their current operations. Many Collections managers and executives responsible for these areas have good intentions of driving improved performance, but they are constrained because their frames of reference are limited to their own experiences. The optimal way to drive top performance is to implement best practices which are gleaned by working with hundreds of banks and lenders to validate the proper alignment of people, process, policy, and technology. For example, when in uncharted waters or rough seas, traveling with an experienced, seasoned navigator dramatically improves the odds of arriving safely and soundly. During this challenging economic environment, partnering with experienced, seasoned professionals who know what you may not know ensures the desired outcome.

Collections impacts entire organization

Employees, customers, and shareholders are all feeling the impact of the current credit cycle. Unfortunately, many lenders feel there is little they can do to improve the circumstances. Delinquencies are rising, losses are increasing, and reserves are now a main focus for each quarterly earnings call. With a critical focus on Collections, some lenders feel like they are rowing the boat with a broken paddle. Sure, it works and it will eventually move them from point A to point B, but is it really the most effective way to navigate through a storm? When time is money and lenders need to assertively manage Collections, why reach for a broken paddle?

In most organizations, there are processes that are working well and others that require improvement. There is often misalignment of policy that creates inefficient and redundant work. Sometimes workflows are not optimized, creating negative client and employee impact. And just about every lender could more effectively use their existing technology. With so much opportunity and such a critical and time-sensitive demand on results, where is a Collections manager or consumer lending executive to turn? Who can help in this challenging time? Where do they start? There is a substantial negative impact on those institutions with ineffective Collections processes. The time for change is now.

How to best navigate the challenge

The best approach to navigating this challenge is to conduct a high-level process review, then to establish rational performance goals by comparing methodologies and technologies to industry high achievers.

This approach, called process benchmarking, is a proven methodology that allows financial services providers to learn from the experience, successes, mistakes, information, and revelations of others in the industry. This process encourages providers to

- Understand the performance levels of other financial organizations
- Easily identify the differences using actual process workflows
- Understand the drivers of high performance
- Establish reasonable performance goals
- Validate the strategies and required changes needed to achieve established goals

Today's essential collections strategies

While many Collections departments have deployed workflow management; decision analytics; and predictive dialers, the ideal strategy for improving Collections is a proactive, best practices approach. Some of these best practices include contacting borrowers for early intervention when delinquencies first occur, deferring selected accounts for collection where appropriate, automated messaging, and collaboration across product lines. Once a proactive, best practices Collections approach is established, technology may be used to automate and reduce expenses.

The following are examples of some selected best practices:

1. **Collector Effectiveness**
Collector effectiveness measures what the collector accomplishes during a customer contact and, generally, reflects the quality of the collections staff; associated training; and tenure. Effective collectors focus customer calls on the following critical actions:

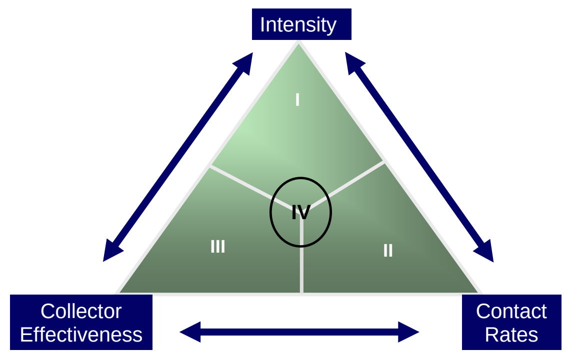
   - Define the reason for delinquency
   - Reach a mutually agreeable solution to the delinquency
   - Update customer information
   - Discuss future payments

   In the scorecard below, Lender B's collectors clearly are the most effective. Well-trained collectors can score high points in this area with a high-touch, customer-focused model. Since this approach is the most staff-intensive, it is often the hardest to improve in a cost effective manner. While a high effectiveness rate is generally positive, when not carefully managed, an organization that invests in excessive collection time with each customer can experience diminished returns.

Sample Collector Effectiveness Scores

	Lender A	Lender B	Lender C	Lender D
Reason for delinquency	43%	88%	66%	33%
Solution	50%	85%	86%	71%
Arranged future pmts	0%	100%	33%	36%
Updated customer info	25%	100%	66%	75%
Average score	30%	93%	65%	54%

Successful Collections require balancing collector effectiveness with call intensity and contact rates.



A well-designed Collections process and prioritized Collections goals are the key drivers that technology enables and supports. However, the automation of ineffective processes simply generates ineffective results more quickly.

2. **Behavior Scoring** While customer credit scores predict a customer's propensity to repay, there are additional data points that are important to consider. Many best-in-class financial institutions use behavioral scoring models built from portfolio data. This data allows financial services providers to tailor collection processes to each account based on its behavioral score. Using scoring, lenders can defer many accounts that would have been introduced into early stage collections. This deferment generates significant cost savings that reduce expenses by freeing the Collections staff to focus on more critical accounts to help lower credit losses. By contrast, some lenders

– depending on the portfolio credit quality, geography, and collection staff may elect to call all customers on the first day of delinquency. As with any recommendation, there is no one-size-fits-all scenario; each strategy is highly customized based on the individual lender and associated portfolio.

3. **Automated Messaging**Newer technology that automates communication and payment reminders lets providers reach more customers and reduce the expenses associated with Collections. Used on accounts that are less than 30 days past due, as well as on those that are 31-60 days past due, automated messaging is an effective delinquency prevention approach. According to a Tower Group report, "debtors perceive the reminders generated automatically to be less 'judgmental' than calls from live agents."[1] Additionally, at some lenders the number of return calls actually increased because the borrower preferred the option to self-service the cure process.

4. **Effort Consolidation** If a borrower has a credit card; auto loan; and mortgage with the same institution, he or she might receive separate collections calls for each product. Often the tasks, skills, and work hours are similar for these different Collections areas. By consolidating collection information and processes, collectors can support the different product types' collection requirements and substantially reduce collection costs. While the long-term goal would be fully integrated systems and processes, some lenders have taken the initial steps with a more extensive migration over time.

   Successful institutions place a high value on the customer relationship by providing the collector with access to the overall relationship and allowing additional latitude in the collection process based on customer value to the organization. While investing in a process that supports an overall customer relationship is important, the ultimate focus still should be on the goal of repayment.

5. **Early Stage Outsourcing** Another very effective strategy implemented by financial institutions is early stage outsourcing. This effective measure represents the outsourcing of very early past due accounts to a third party provider. The third party provider will then message reminders to borrowers to address their delinquency without additional intervention. Not only is this an effective strategy to minimize later stage past due accounts, early stage outsourcing allows for a more effective allocation of internal resources. Being able to redirect efforts of internal trained resources will allow the bank to focus on collections activities that will bring the bigger "bang for the buck" of staff resource dollars.

6. **Interim Environment Management** Creatively managing the gap between today's operations and long term plans that are "in-process" challenges many managers. The time gap involved is often not trivial, especially in today's turbulent environment as organizations consider technology enhancements and other long term projects. Managers need to explore non-permanent options including temporary staff and other third party solutions that can be quickly deployed to add, enhance, or replace current operations or technologies until the long term solution is fully implemented. With the continued growth in both the number and breadth of services provided by third parties, it is prudent for managers to continually explore opportunities to improve their bottom lines.

Measure the Success

Once a lender has decided which strategies to implement – it is important to measure Collections performance before a change, after a change, and continuously thereafter. Review existing metrics to ensure they remain relevant. External economic influences, internal credit policy modifications, as well as other changes will ultimately have a downstream impact on the Collections area. Periodic, timely, and accurate management reporting is vital to navigate successfully in turbulent times.

[1] Egan, Bob. "Navy Federal Credit Union and Proactive Alerting: An Early Adopter's Results with Automated Outreach." TowerGroup May 2005

Following are key Collections metrics that institutions should monitor on a continuous basis:

1. **Delinquency** The delinquencies – both the number of accounts and the dollars are key metrics reported as

# of Days	# of Accounts	$ of Accounts
15 – 30		
> 30 & < 60		
> 60		

2. **Monthly Gross Loss Rate** The numerator is represented by the dollars that are charged-off for that month, only. The denominator is the total outstanding portfolio dollars. There are no adjustments made in calculating this metric.

$$\frac{\textbf{Dollars Charged Off at Month End}}{\textbf{Portfolio Dollars Outstanding at Month End}}$$

3. **Monthly Net Loss Rate** When calculating the monthly net loss rate, the numerator is derived by subtracting the dollars recovered for that month from the dollars charged-off for that same month. The denominator is the same as for monthly gross loss rate which is the total outstanding portfolio dollars.

$$\frac{\textbf{Dollars Charged Off at Month End minus Dollars Recovered at Month End}}{\textbf{Portfolio Dollars Outstanding at Month End}}$$

4. **Account Roll Rate** For each 30 day delinquency stage, the number of accounts in the older bucket at the beginning of the month is divided by the total number of accounts in the immediately preceding (earlier) bucket at the beginning of the prior month.

Delinquencies	Month 1	Month 2
Roll Rate	$\frac{\text{Delinquencies End of Month 1}}{\text{Delinquencies End of Month 0}}$	$\frac{\text{Delinquencies End of Month 2}}{\text{Delinquencies End of Month 1}}$

5. **Dialer Intensity** This metric is represented by how often each past due account is called per day. Another way to calculate this metric is the number of dialer attempts divided by the number of accounts in the dialer download.

$$\frac{\textbf{Dialer Attempts}}{\textbf{\# Accounts in Dialer Download}}$$

6. **Contact Rate** The contact rate is calculated by determining the number of "right party contacts" (the borrower, co-borrower, or guarantor) divided by the number of dialer attempts for the month.

$$\frac{\textbf{\# of Right Party Contacts}}{\textbf{\# of Dialer Attempts}}$$

When developing metrics, it is important to understand how the metrics will affect the Collections operation's performance levels. Once a clear understanding is achieved, then refine the strategies and the work processes in order to improve the overall operation's performance. It is critical to take care in refining your strategies. It is often a careful 'balancing act', since increasing activities will eventually reach a point of diminishing returns, as mentioned earlier.

Once an effective systematic approach is employed with regards to measuring and refining, a lender will be able to optimize the performance of the Collections area.

Conclusion

During a time when delinquency rates are increasing, a poor or inefficient Collections process leads to disappointing results. Successful institutions focus on a best practice, proactive approach for addressing Collections. This approach includes deploying appropriate early intervention action and ensuring the organization collaborates on logical and well-planned customer communication. Implementing meaningful performance metrics and refining processes for continuous improvement will yield meaningful results.

J. Brian King is Senior Vice President and Consumer, Mortgage, and Retail Practice Executive at BenchMark Consulting International. He has extensive background in mortgage and consumer lending, strategic planning and product development.

BenchMark Consulting International has specialized in improving the financial services industry since 1988. The company is a management consulting firm that improves the profitability of its financial services customers through the delivery of management decision-making information and change management services to realize the benefits of business process changes. BenchMark Consulting International's expertise is in the measuring, designing, and managing of operational processes.

The firm has worked with 39 of the top 50 (in asset size) commercial banks, all 14 automobile captive finance corporations, several of the largest consumer finance corporations and many regional and community banks throughout the United States. Internationally, BenchMark Consulting International has worked with the five largest Canadian commercial banks, more than 40 European organizations in 11 different countries, in addition to financial institutions in Latin America, Australia and Asia.

The company is a wholly owned subsidiary of Fidelity National Information Services, Inc., with clients in more than 50 countries and territories, providing application software, information processing management, outsourcing services and professional IT consulting to the financial services and mortgage industries. BenchMark Consulting International has dual headquarters in Atlanta, Georgia and Munich, Germany.

For more information please visit www.benchmarkinternational.com.

BENCHMARK CONSULTING INTERNATIONAL
14 Piedmont Center NE, Suite 750
Atlanta, GA 30305
(404) 442-4100
www.benchmarkinternational.com