re:ceeve

3 Key Challenges in addressing Non-Performing Loans

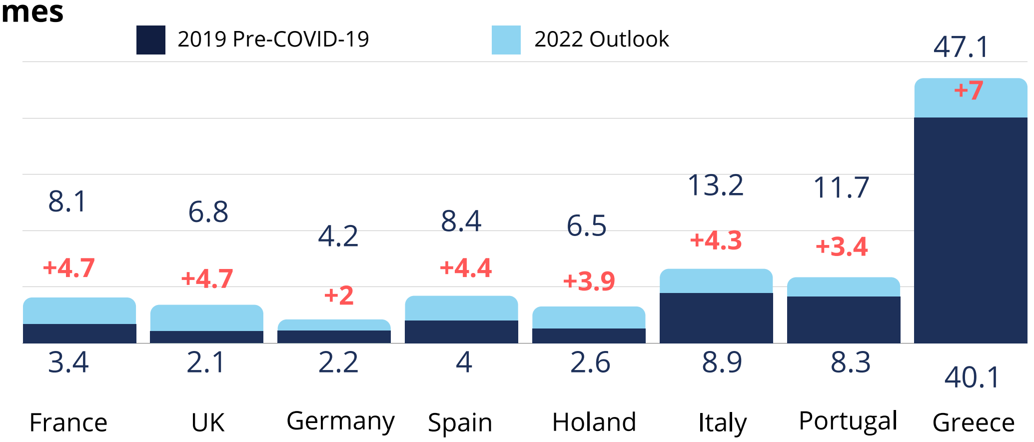
As the European Central Bank states: "The economic crisis caused by the coronavirus pandemic is likely to trigger a sharp increase in non-performing loans: under a severe but plausible scenario they could reach levels as high as €1.4 trillion by the end of 2022."

A significant increase in NPLs

Non-performing loans (NPLs) continue to put pressure on European banks. An analysis of European NPLs done by Oliver Wyman reveals that these bad loans will increase significantly in a post-pandemic world.

For example, NPL ratio in the pre-COVID times were dangerously high in several countries, including Greece (40.1%), Italy (8.9%) and Portugal (8.3%). However, the situation is expected to exacerbate after COVID-19.

NPL ratios (%) in European are expected to increase in post-COVID times



Source: Oliver Wyman analysis; ECB Statistical Warehouse on market structures; scope based on EBA Transparency Exercise (excludes development and smaller institutions)

Banks with a high volume of NPLs would experience a reduction in net interest income, an increase in impairment losses, and additional capital reserve requirements for high-risk weighted assets. Furthermore, NPLs require additional management time and servicing costs to resolve the problem.

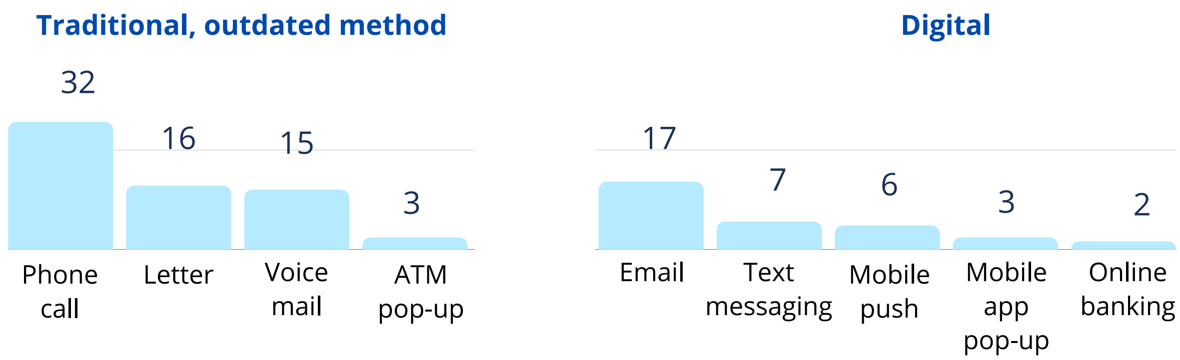
3 key challenges in addressing NPLs

1. Outdated operations

Banks seem to be lagging with their approach towards collections by relying on phone calls and letters. In today's world, digital-savvy Millennials and Generation Z don't have the time to pick up their phone during working hours or sit in long call queues after receiving a letter. They demand the convenience of self-service.

McKinsey's research on how customers experience delinquency contact highlighted the banking industry's disregard of the channels that statistically lead to the best customer outcomes. In fact, a staggering 32% of total respondents who hold accounts that are 30+ days past due revealed that the channel of last-contact used by their banks was phone. In contrast, only a small percentage stated highly effective digital channels, such as email (17%), etc.

Method of last-contact channel for accounts 30+ days past due,
% of total respondents



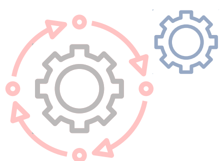
Note: Figures may not sum up to 100%, because of rounding and omission of an inconsequential category ("Other").
Source: McKinsey survey of credit-card customers at North American financial institutions, 2018

To make matters worse, these outdated operations require too many manual processes which are also expensive for the banks. These methods also lack in personalisation and create several ineffective touchpoints which perpetuate an unwelcoming, hands-off approach to customer experience.

A better approach to operations is to use analytics and machine learning to understand behaviours, to apply artificial intelligence to segment customers and to assign the handling of NPLs to the right personnel.

2. Inflexible technology solutions

> One of the biggest challenges in addressing NPLs is the lack of flexibility in current banking collections strategies.



Most technological solutions used by banks to address NPLs focus on automating the collections process. These automated processes cannot recognise patterns of customer behaviour and are insensitive to their need for personalisation.

The collections operating model needs to be flexible enough to allow banks to segment different audiences and change their approach accordingly.

For example, a purely digital approach should be prioritised over phone calls for low-risk customers. Whereas, for higher-risk customers, collectors can use the data and information collected to identify the needs of the customer and create a tailored solution before making contact.

Customer-first

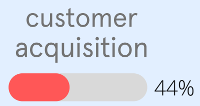
Automating the collections process is customer-centric rather than bank-centric. Putting the needs of the bank first will not bring long term success to your business.

Developing an adaptable system gives banks the room to negotiate effectively and achieve better outcomes, or allocate specific teams to take ownership of certain scenarios. For instance, a bank can set-up a collections team who focus on developing solutions for customers who have just lost their job or are only experiencing temporary payment issues.

3. Prioritising short-term results

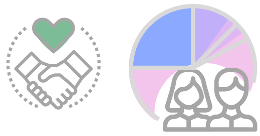
Another reason why NPL ratios remain high in the banking industry is that banks often focus on the short-term results, instead of seeing the long-term value in acquiring more qualified customers. Consumerism and inflation are creating a reliance on loans. It's the duty of a responsible lender to carry out proper credit checks and manage the accounts accordingly.

Bank should focus more on customer retention than acquisition. However, according to Invesp, 44% of organisations place a greater emphasis on customer acquisition versus 18% who focus on retention.



Banks must develop internal credit risk assessment models that analyse the financial and other data of loan applicants, placing a greater emphasis on correctly assessing the default probability. The credit policies in many European banks are centred around making more profit from interest loans with no thought towards retention.

> Yet, it costs five times as much to acquire new customers than to keep an existing one.



This creates a system in which European banks are piling up new bad loans on top of the old ones, thus maximising acquisition but worsening the health of their loan portfolio. This worrying trend is not only causing issues in the collections process, but it's forcing banks to spend more money on marketing and sales to acquire new customers.

Resolving the burden of non-performing loans

> It seems that inflows of new NPLs are still on the high side – not least when you consider where we are in the business cycle. It also seems that some banks with high NPLs are still reporting increasing default rates. We find this somewhat worrying, and we urge banks to stem this inflow by rethinking their underwriting standards and engaging with distressed debtors.
>
> Andrea Enria – Chair of the Supervisory Board of the ECB

With increasing importance given to customer experience, collections practices have changed significantly over the past decade. Using the right tone and the right channel are imperative in effectively helping those experiencing financial difficulty.

The banking industry must ensure they are better equipped to deal with customers, especially those in the collections cycle for a long time. Using advanced technology and harnessing the power of artificial intelligence are more aligned with 21st-century consumer preferences.

While most banks have deployed some sort of proprietary software, bought SaaS software, or have collaborated with a third-party collections agency, very few have started leveraging the technological and analytical opportunities available.

As mentioned earlier, there are too many manual processes and not enough efficient application of analytics, machine learning, AI and automation to better handle the management of NPLs. A technology-led collections platform which utilises these elements is a long-term solution that will enable banks to:

- **Develop nudges:**
  i.e. introduce payment plans, incentives as well as use certain language tailored to suit a customer's particular circumstances
- **Determine customer preference:**
  i.e. what channel to use to communicate and when to contact them
- **Enhance customer experience:**
  i.e. using data, banks can understand how to communicate and include touchpoints at every stage, including before they enter the collections cycle. Offering self-service capabilities also gives customers the freedom to act when they can and on their own terms

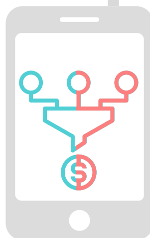
Using common collections metrics and KPIs, such as Right Party Contacts (RPC) and Profit per Account (PPA), are no longer the only way of measuring NPLs.

Nowadays, it's essential to understand the performance of digital communication metrics, which enable banks to address the root of the problem with their collections processes and create a personalised solution.

Using technology-led collections software to lead this kind of granular approach will also give banks more time to strengthen the loan underwriting processes and conduct more rigorous credit risk assessments at the start of the lending process.

Key digital communication metrics

- Email delivery rates/ bounce rates
- Email open rates
- Click-through rates
- Traffic by source or channel
- Landing page views
- Reaction times



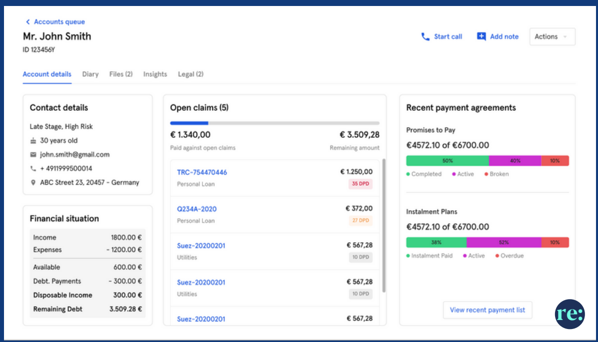
Learn more about the future of banking collections

Deeper analytics and insights will allow banks to develop more detailed client profiling to assess risk, optimise legal services, to reduce expenses and to add more suitable touch points to enrich the customer journey. Banks which embrace the evolution of the global credit environment and open themselves up to the possibilities of technology in collections now have every chance of overcoming the three key challenges in addressing NPLs.

About re:ceeve

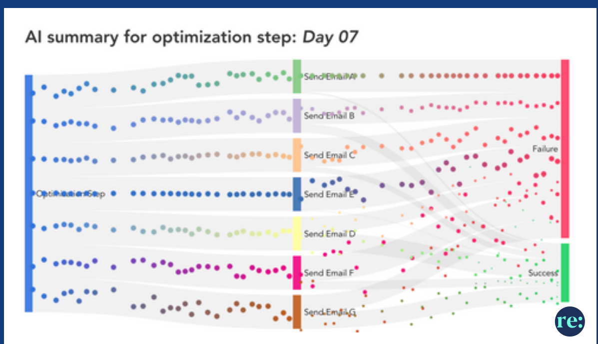
re:ceeve is a revolutionary white-label enterprise software optimising the complete debt collection value chain with AI, data- driven insights, and messaging tools. Our AI-driven approach drives efficiencies and results end-to-end across the collections & recovery ecosystem.

Important information is displayed for you to immediately grasp the context of the debtor during the conversation

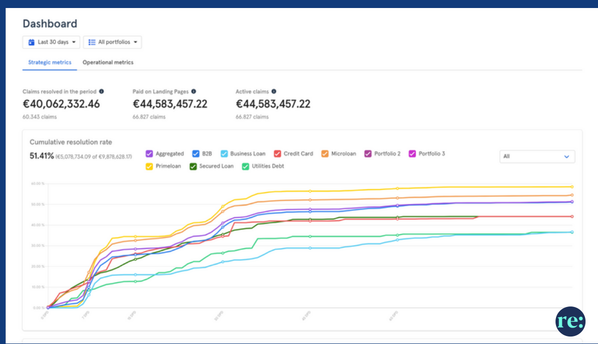


You can easily track customer behaviour via our insightful report and choose your best digital collections strategy

Our software analyses the effectiveness of each messaging and optimises the processes automatically



The performance of your collections rates are shown on the dashboard for you to optimise your approaches



If you want to learn more about leveraging AI to automate collections processes, improve cash flow and create a positive customer journey, schedule a demo with us today.