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| 2022 EDITION

3 Key Challenges in Addressing Non-Performing Loans

"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.

— European Central Bank

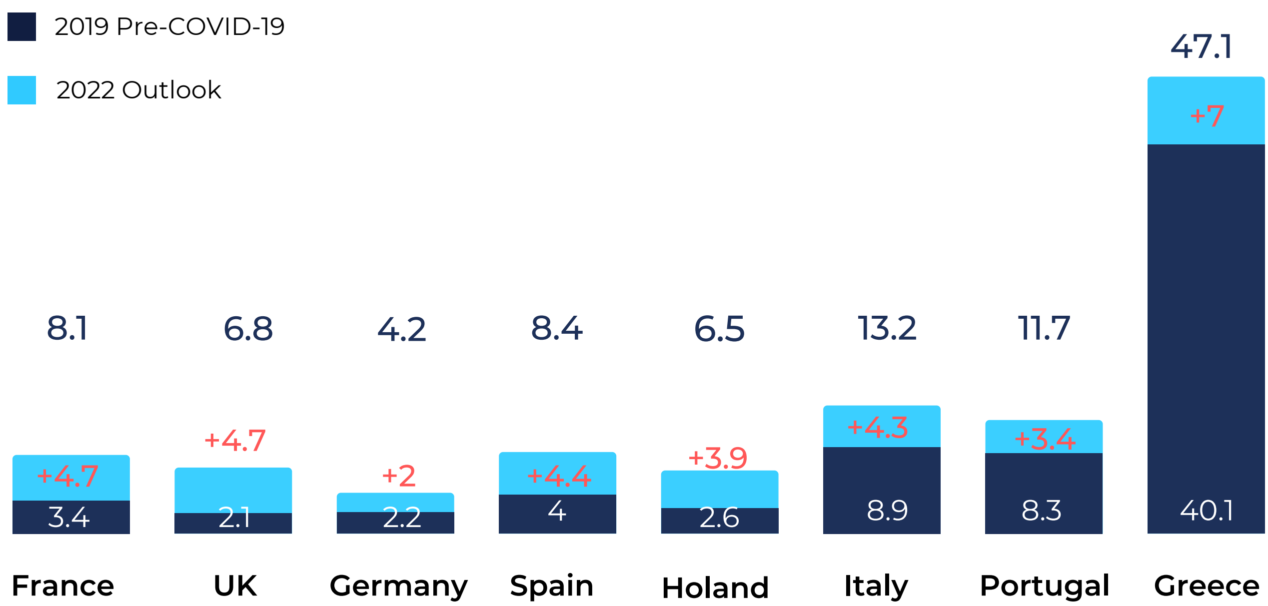
A significant increase in NPLs

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, the NPL ratio in the pre-COVID times was 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

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.

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)

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Outdated operations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.

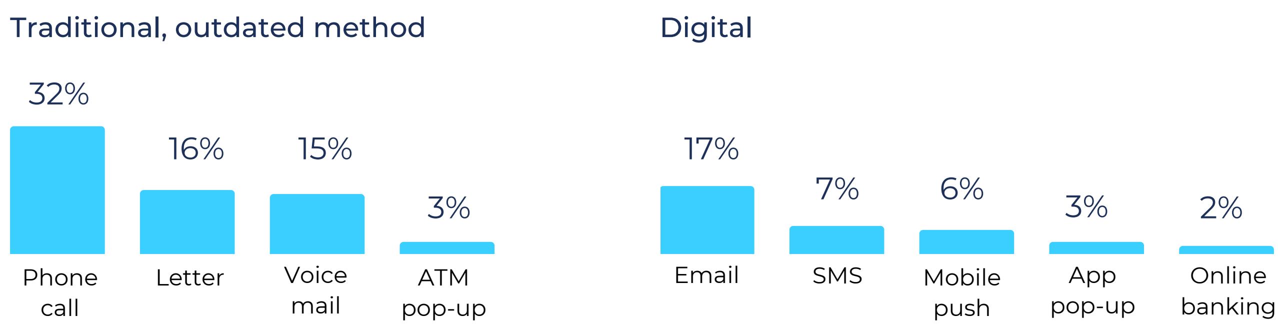
In today's world, digital-savvy Millennials and Generation Z don't have the time to pick up their phone during working hours or sit in long call queues after receiving a letter. They demand the convenience of self-service.

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 the last contact used by their banks was a phone.

In contrast, only a small percentage stated highly effective digital channels, such as email (17%), etc.

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

Method of last-contact channel for accounts 30+ days past due



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

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 have the flexibility 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.

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 that focuses on developing solutions for customers who have just lost their job or are only experiencing temporary payment issues.

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.

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.

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.

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.

It costs five times as much to acquire new customers than to keep an existing one.

44%
acquisition

18%
retention

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.

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.

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.

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 that utilises these elements is a long-term solution that will enable banks to:

Develop nudges
Introduce payment plans, incentives as well as use certain language tailored to suit a customer's particular circumstances

Determine customer preference
What channel to use to communicate and when to contact them

Enhance customer experience
Using data, understand best ways to engage at every stage, including pre-collections.

Using common collections metrics and KPIs, such as Right Party Contacts (RPC) and Profit per Account (PPA), is 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.

Digital communications KPIs to watch for

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

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 receeve

receeve is a fully customisable all-in-one platform for collections & recovery.

The cloud-native, no-code platform is fast to deploy, simple to manage and easy to customise and expand.

> Learn more at receeve.com

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