

***Lessons from managing
consumer lending
relationships in a
downturn***

Martin Tuohey
Consumer Finance Principal
PwC US

Agenda

Introductions

Current Environment

Global Practices in Collections

Lessons Learned from the Global Market

Debt Forgiveness

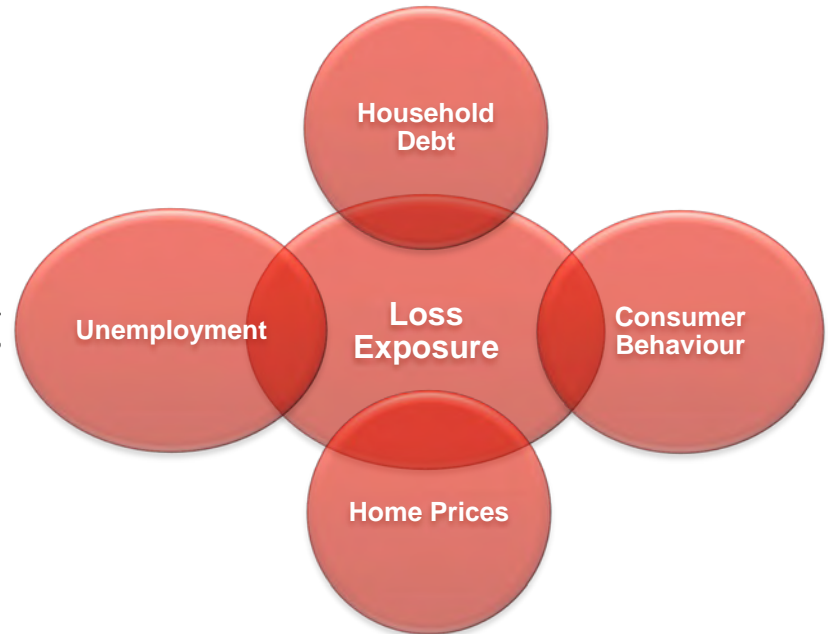
How to Respond

Questions

Global context & challenges

The current economic environment has presented several new challenges to Banks from a Collections perspective.

While some economies are showing signs of recovery, overall consumers remain highly sensitive to “shocks”.



Global context & challenges (cont'd)

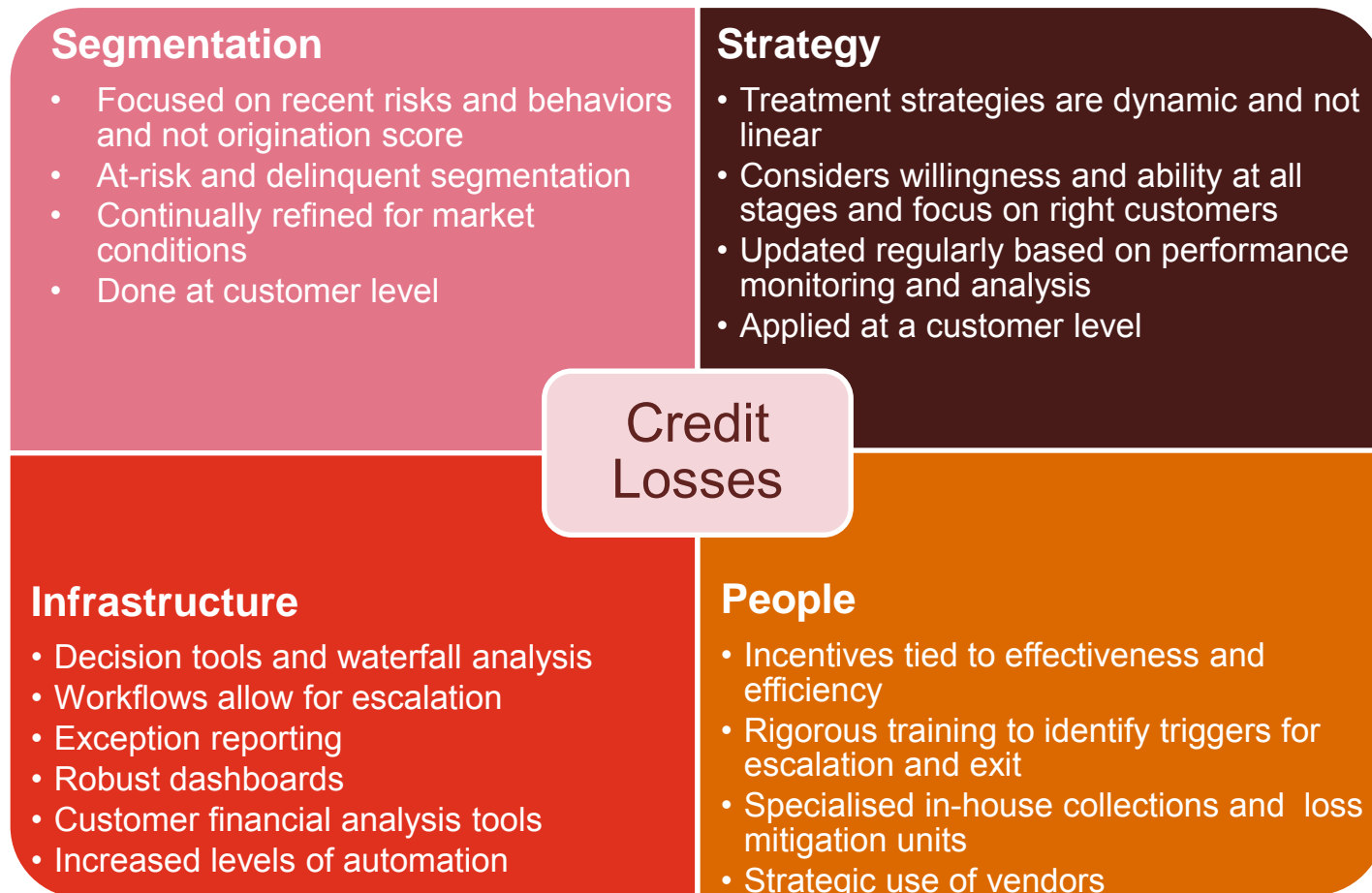
- Consumer leverage remains at a very high levels with many customers one or two pay cheques away from serious distress.
- Payment patterns have changed with the focus shifting from paying secured debt to keeping unsecured debt current.
- In many countries the political environment has become very consumer friendly thereby limiting actions that can be taken against delinquent customers.
- The public stigma associated with default has decreased and the concept of “strategic default” has emerged in several markets. Consumer behaviour has shifted and today’s definition of necessities include cell phones, travel, etc.
- Unemployment and underemployment remain very significant challenges and are adding to consumer distress.

Global context & challenges (cont'd)

- Many Banks are still not prepared for the speed at which a customer's risk profile and financial condition can change.
 - Collections strategies still remain linear and lack flexibility to escalate customers into different strategies and mitigation programs are not designed to handle things such as long term unemployment.
 - Capacity remains a significant challenge for many Banks and while there has been a move to third party vendors to assist with managing this capacity, it has often been without the appropriate performance metrics and oversight.
 - An overreliance on efficiency metrics as opposed to effectiveness metrics.
 - Reaching an agreement with the customer on a loan restructuring is only the first step – on-going servicing is challenging due to continued high debt levels.

Reducing credit losses - the four levers

Although delinquencies are driven largely by origination and economic issues, the business can influence losses through four primary levers; segmentation, strategy, infrastructure and people.



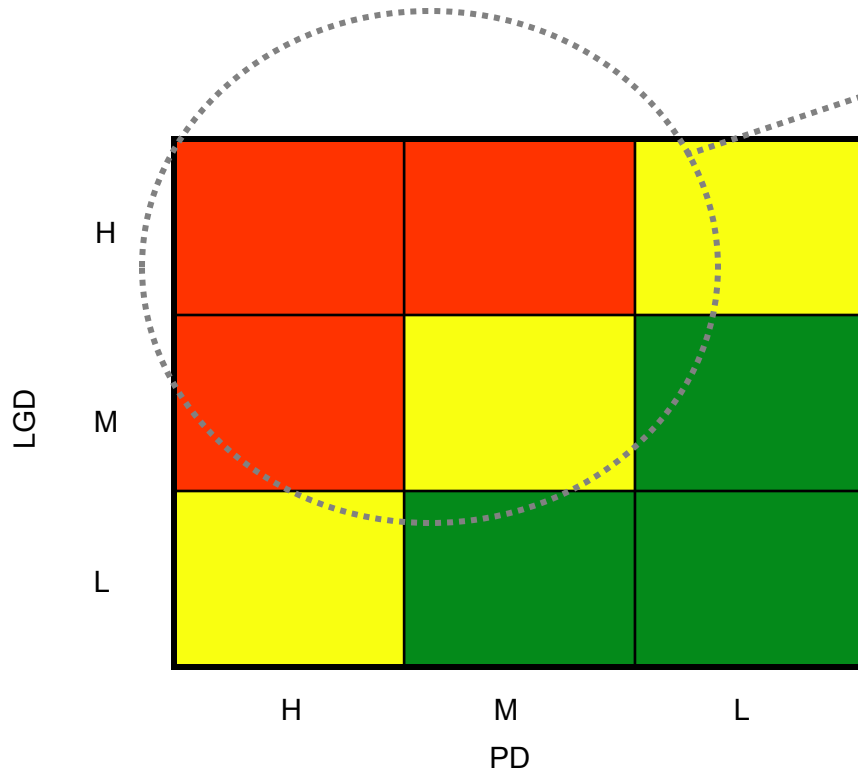
Summary of leading global collections practices

- There are no "silver bullets" – those who have been successful have a variety of programs to address the nature of the underlying cause of the default.
- Applying the right strategy requires a detailed understanding of the underlying cause of default which requires investments in training.
- Regardless of the strategy or programs selected, operational simplicity is critical - this was the downfall of many of the initial programs in the U.S. Market.
- Pre-delinquency strategies are increasingly applied in the global markets - getting to a customer before default occurs has proven to be very effective in rehabilitating the consumer.

Identifying at-risk customers

- Identifying pre-delinquent distressed customers has taken on a greater focus in the recent downturn. As an example, we have seen the following behaviours used as risk indicators of future default:
 - Changed or ceased direct deposit into current account
 - Increase in credit card or home equity line balance
 - Changed or ceased auto debit feature
 - Change in payment patterns, i.e. lower payment, payment received closer to due dates
 - Change in credit score
 - Increases to late fees / penalties
 - Subject Property Location - depending on the location the risk for default can vary
 - Borrower Profession - certain professions may have higher risk for lay-offs

Identifying at-risk customers



This type of risk based analysis would suggest immediate focus on this population with tailored products for each loan status.

However, there is considerable discussion regarding “imminent default” criteria for performing borrowers.

Risk indicators are used to estimate probability of default (“PD”), e.g. using a risk ranking to determine impact of change in credit score. Once PD is estimated, determine loss given default (“LGD”) by utilising valuation and other Models to identify underwater loans or second loans (secured only) to determine loss.

Contact strategies – a marketing mindset

Historically contact strategy and capabilities were heavily focused on a dialer based strategy with referrals to branches for distressed clients. Best in class strategies incorporate alternate contact and outreach strategies in order to increase pull through rates in the current mitigation programs.

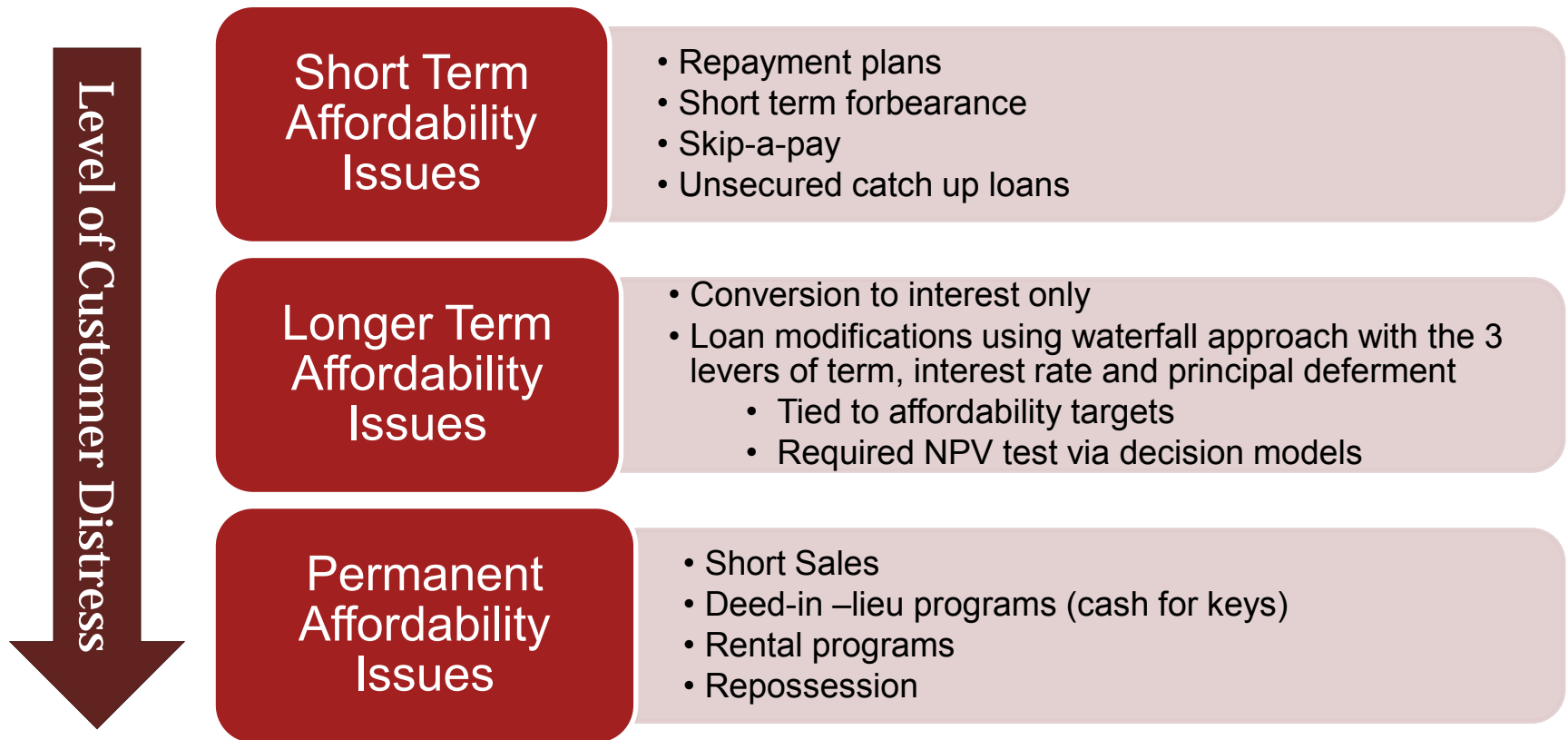
Customer Contact Evolution



- Basic outbound campaigns (30,60,90)
- Engaging technology to route calls through local area codes
- Use of cell phone prefixes
- Linkage to Customer Service (warm hand offs, empowering Customer Service to make offers, etc.)
- Increased focus on component servicing strategies
- Mailing of pre-approved loss mitigation offers to customers overnight
- Local office or point of sale network (existing or newly created)
- Door knocking companies
- Best time to call software
- Behavioral modeling
- Focused calling campaigns by workout type (multiple campaign strategies)
- Gas card, consumer electronic cards, prepaid cell phones
- Borrower needs to call to activate cards
- Pre-paid cell phones can be ongoing requiring a monthly call and activation
- Home visitation to borrowers without contact or refusing offers
- Borrowers made aware of local presence
- Door hangers

Summary of leading global collections practices (cont'd)

- Loss mitigation solutions are tailored to the level of customer distress



All requests for relief are assessed within the context of ability and willingness

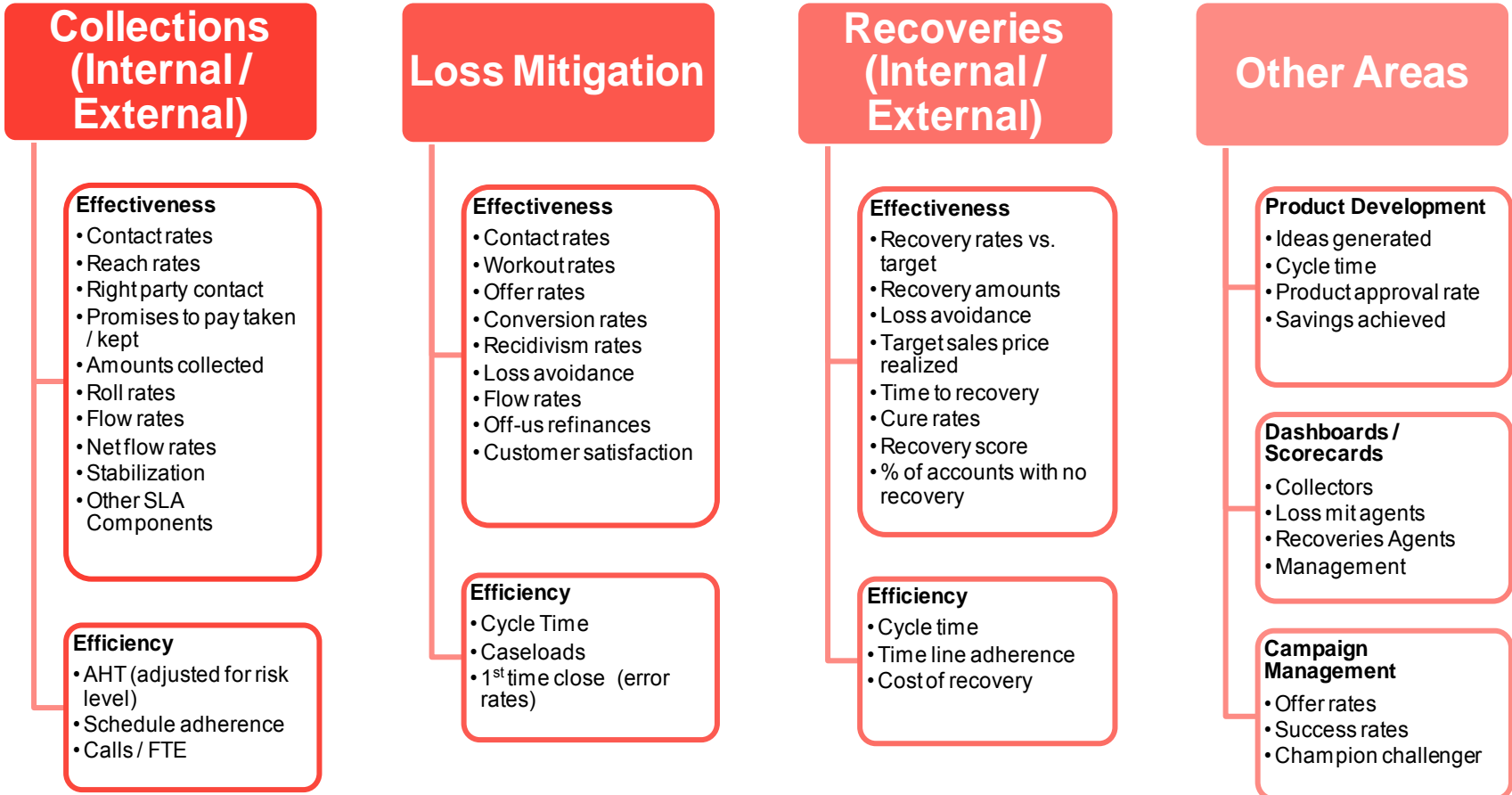
Lessons learned from global experience

- Early and broad regulatory intervention under the veil of consumer protection is not seen as being overly successful in any market.
- Develop Collections strategies that are dynamic, aligned to risk and are non-linear in nature - know when to escalate and always factor in ability and willingness.
- Collections has to adapt and take on a "marketing" mindset - have both push and pull strategies related to customer engagement.
- Without understanding the underlying cause of the default the chances of establishing an effective strategy are very low.
- Have clearly established affordability targets for loss mitigation programs and analyse customers in the context of affordability and economic return to the Bank (may be a lower loss).
- Assess any restructures in the context of the overall relationship and not simply on a product by product basis.

Lessons learned from global experience

- Keep loss mitigation programs as operationally simple as possible
- Focus on effectiveness of collections operations and less on efficiency - effectiveness drives efficiency and lowers the amount of accounts that are "churned" through collections.
- In some cases the best solution for the customer is to not be in a property - know when to help a customer exit a property.
- Support and relief is a two-way street - customers who fail to demonstrate willingness should be escalated to recoveries.
- Effective collections programs have robust capacity models that allow them to anticipate volume demands to drive workforce strategies.
- Skills sets have shifted – underwriting and analytical skills are critical especially in loss mitigation units.

How to respond - focus on effectiveness



Debt Forgiveness as a Collections Strategy

There is significant debate in the Irish media about Debt Forgiveness as it relates to residential mortgages. In terms of the global context there are several factors to consider:

- Debt Forgiveness has not been widely pursued as a strategy to provide relief to mortgage customers due largely in part to moral hazard considerations and future impacts on financial contracts and capital markets.
- Significant challenges exist in trying to draw the line as to who gets relief and who does not - many people who are “underwater” continue to service their debt.
- There are other strategies which can be very effective in providing relief to those who have issues with affordability such as loan modifications with principal deferment.

How to respond – migrating to a leading model

Moving from a traditional collections strategy to a more sophisticated approach is not an overnight transformation. There are specific items a company needs to analyse, assess, and incorporate into sequencing and implementation plans so as not to negatively impact operations. Items to consider include:

- Performing a gap analysis of current vs. target state processes and technology, and then developing sequencing and implementation plans to address gaps;
- Capacity modelling to drive staffing levels, determine training needs and infrastructure requirements;
- Designing the appropriate incentive based compensation strategies both internally and for external collection agencies to drive desired outcomes;
- Developing collections and loss mitigation reporting dashboards that take into consideration key performance and risk indicators;
- Outsourcing or co-sourcing - identification of opportunities to leverage vendors and develop robust vendor assessment and oversight capabilities;
- Establishing risk and behavioural based modeling capabilities to support targeted campaigns and risk based collection strategies;
- Campaign strategies - development, implementation, on-going management and assessment.

Sequencing of change is critical

Contacts

Ireland

Chand Kohli
Dublin chand.kohli@ie.pwc.com
+ 353 1 792 6519

Ciaran Kelly
Dublin ciaran.kelly@ie.pwc.com
+ 353 1 792 6408

Ronan Doyle
Dublin ronan.doyle@ie.pwc.com
+ 353 1 792 6559

Jane Conroy
Dublin jane.conroy@ie.pwc.com
+ 353 1 792 6041

Oonagh Carroll
Dublin oonagh.carroll@ie.pwc.com
+ 353 1 792 8163

Feilim Harvey
Dublin feilim.harvey@ie.pwc.com
+ 353 1 792 8631

Contacts

Americas

Scott Dillman
New York
scott.dillman@us.pwc.com
+1 646 471 5764

Michael Shearer
New York
michael.a.shearer@us.pwc.com
+1 646 471 5035

Jonathan Riva
New York
jonathan.riva@us.pwc.com
+1 646 471 5668

Steve Josephthal
Charlotte
steven.josephthal@us.pwc.com
+1 704 344 7864

Kunal Mehta
New York
kunal.mehta@us.pwc.com
+1 973 236 4362

EMEA

George Stylianides
London
george.e.stylianides@uk.pwc.com
+ 44 (0) 20 7804 3364

Symon Dawson
London
symon.k.dawson@uk.pwc.com
+ 44 (0) 20 7804 1225

Denis Bavay
Brussels
denis.bavay.rbr@be.pwc.com
+ 32 2 710 7104

Asia-Pacific

James Chang
Beijing
james.chang@cn.pwc.com
+ 86 (10) 6533 2755

Rick Heathcote
Hong Kong
rick.heathcote@hk.pwc.com
+ (852) 2289 1155