

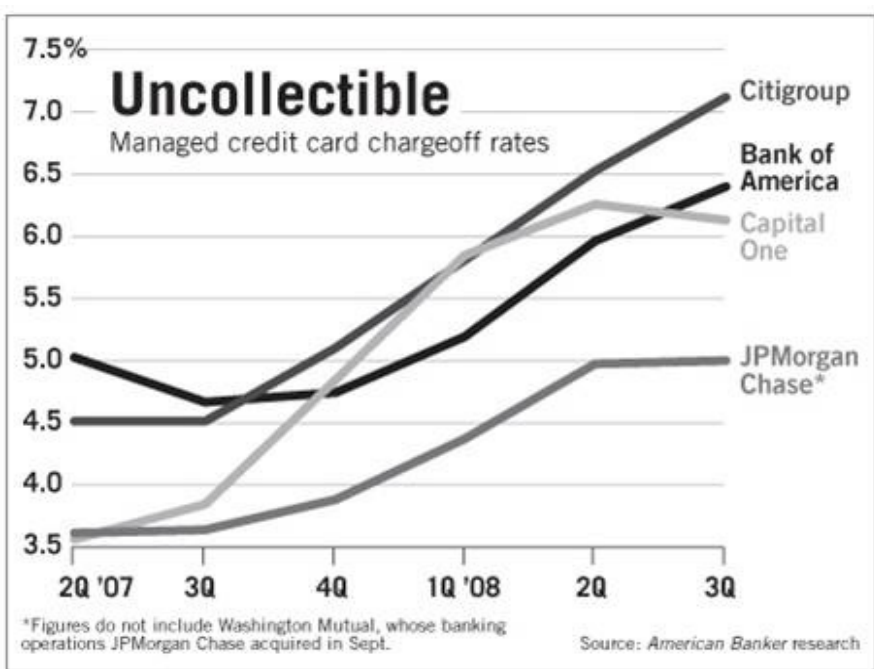
It's time to work harder *AND* smarter

By Bob Landry, Director of Strategy for CGI's Banking & Financial Market Sector
Originally published by FST (Financial Services and Technology) online, February 2009

Given the recent credit market meltdown, much attention has been focused on delinquency and foreclosure problems related to real estate loans. Yet the delinquency problem does not end with real estate. Beginning 3rd quarter 2007, delinquencies began to increase in all segments of the credit market. The financial crisis in September 2008, the attending freefall in economic activity during 4th quarter 2008, and the long expected official pronouncement that the U.S. is indeed in a recession have put in place the conditions for a "perfect storm" of delinquency that has already overwhelmed some financial institutions and threatens more in 2009.

While the more costly delinquency problems are in the real estate secured lending segments, the accelerating economic downturn will continue to create stress across all segments of the credit market, especially those with high volumes of low dollar accounts. Major credit card lenders have continued to revise loss provisions upward as unemployment accelerates; credit card charge-off rates are projected to move past 8% in 2009 (Exhibit 1).

Exhibit 1



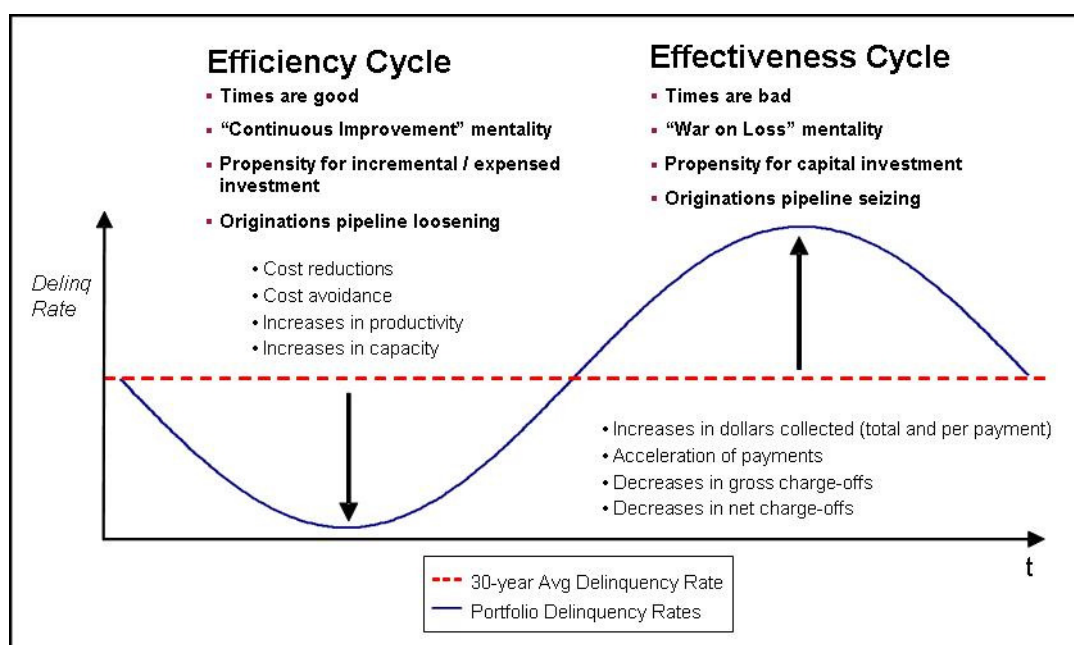
Source AB Monday, October 20, 2008

In order to keep pace with the rapidly expanding volume, collections operations are already working harder than they have ever worked. As the flood of delinquencies swells, we will not only have to work harder, but smarter as well.

Moving from efficiency to effectiveness

Collections has always been a feast or famine business, but in the reverse of the term's usual meaning (Exhibit 2). During good economic times collections organizations operate in famine mode choosing small incremental expensed investment in capabilities focused on cost reduction and increased productivity. Ineffective collections performance is easily masked when net charge-offs are level or decreasing. Marginal creditors can usually find other sources of credit to pay off debts in a "borrow from Peter to pay Paul" scenario. Believing losses are under control, institutions focus on increasing revenues through cross-sell and new customer acquisition.

Exhibit 2



Source: AITE Group. "Managing Delinquencies and losses in Tough Economic Conditions." August 2008

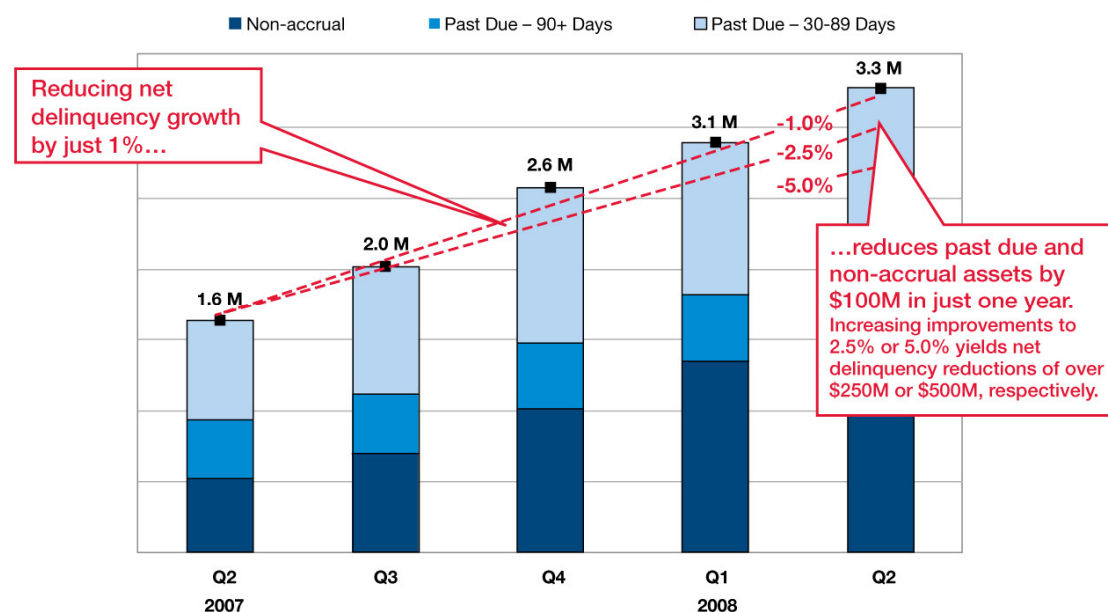
As competition heats up in the attractive low risk segments, the seeds of later losses are sowed as many lenders move to riskier segments to maintain volume and adopt various strategies such as risk adjusted pricing to maintain revenue momentum.

The write-off tsunami we now face has refocused collections professionals away from incremental cost reductions for improved efficiency towards solutions that will improve the effectiveness of their collections operation. The best solutions will enable them to keep up with increased collection volumes and utilize their best collections staff on accounts that will generate maximum returns. Now that rising charge-offs has garnered management's attention, adding seats is not the problem; filling seats with effective collectors that can convince borrowers to pay them first is the greatest challenge. Using these resources effectively is paramount to meeting collection goals.

The key to effective collections is influencing the behavior of a borrower at the lowest cost for the maximum return. Small improvements in effectiveness can have a big dollar impact. For example, at a major regional bank with approximately \$1.6B in non-accruing debt, decreasing delinquency growth by just 1% can reduce past due and non-accrual assets by over \$100mm in just one year. Net delinquency reductions of up to 5% are possible, providing benefits of over \$500mm (Exhibit 3).

Exhibit 3

Example: Major US Regional Bank Past-Due and Non-Accrual Assets, in 000s



Source: CGI

Techniques to increase effectiveness

The foundation of collections effectiveness is the well trained collector. The keys to leveraging this precious resource during this period of rapidly increasing volumes are improved customer knowledge and self service treatment tools. Improved customer knowledge provides insights on which accounts to focus collections activity, and which collections treatments provide the most effective results; it also supports a test and learn environment with which to tune strategies as the market evolves. Advances in technology and evolving attitudes towards self service, primarily in younger customer segments, are opening the way for new treatment tools such as Internet-based self-resolution and automated phone contact and resolution messaging.

Pre-collection analysis provides early warning

Real estate business lines are having a major impact on customer behavior and have set in motion some unique trends not seen in earlier downturns. According to the MBA National Delinquency Survey for 3rd quarter of 2008, the number of loans for one-to-four-unit residential properties that are 30 days or more past due or in foreclosure is 9.96%. The report projected that recession related job losses will likely increase delinquency rates well into 2009.

Lenders must get out in front of this problem and identify customers who are at risk before they are significantly delinquent and in a hopeless situation. It is important to proactively engage customers to take remedial action quickly; once a mortgage is delinquent, many borrowers are already behind on other payments. At that point, collection efforts often return little value to the lender and loan modifications can not sufficiently ease the financial pressure on the borrower. In areas such as California and Florida, where home values have collapsed and the borrower is "under water", many borrowers are prepared to walk away from the home. As a result, they have reversed traditional payment priorities and, rather than paying their mortgage first, they are paying it last.

Pre-collection analysis is the proactive identification of customers likely to fall into bad debt before they start to default, enabling institutions to determine how to profitably manage these accounts, and to tailor specific and appropriate strategies to them. This approach can afford the bank time to have a significant impact on customer behavior and as a result, many accounts will avoid moving into collections, leading to reduced collection costs and increased profits.

There are a number of factors that can be evaluated in order to predict imminent delinquency. Scoring models use transactional and behavioral customer data to predict future outcome. Institutions may also evaluate additional factors such as locations with significant home value declines, unemployment and job losses, erratic and repeating payment delays, revolving and installment debt ratios, and other financial and market indicators that help identify accounts or customer segments that are susceptible to delinquency. The predictive models are then applied to the customer base, resulting in a score, or likelihood of default, for each account. Strategies are segmented based on risk factor, balance, product type, or other logical account groupings

Even if you are not the holder of a customer's delinquent real estate secured loan, it is still valuable to identify clients who have the potential of falling into delinquency and reduce risks by taking measures to limit your exposure. Preventive strategies can include modifying open line balances and exclusion from future sales and marketing campaigns. Treatment can change if future evaluations indicate a change in propensity for delinquency.

Improved segmentation to reduce risk, increase collections and improve staff utilization

Leading collections systems are workflow enabled and decision driven. The key to using this power and flexibility is to establish a strong database for analysis and a proactive test and learn environment that will enable you to implement and maintain an effective segmentation strategy. In addition to selecting the appropriate strategy for each step in the collection process, the various treatment strategies should be controlled via decisioning to maximize their effectiveness and facilitate customer level customization.

You must be able to change your customer treatment strategies quickly and easily in order to react to changing market conditions and increasing account volumes. To speed the collections of impaired accounts, decision applications and processes must be constructed so that business owners have the flexibility to modify key decision points quickly without the need for programming support. With this flexibility you can apply targeted and dynamic strategies, including:

- Optimize treatment strategy for each account, or groups of accounts, according to business strategy and resource constraints
- Focus collection efforts on accounts with high balances and/or high probability to pay
- Automatically assign accounts to collectors, third-parties and automated treatments when these can have a major effect
- Rapidly evolve and implement strategies based on "test and learn" capabilities
- Automate policy and regulatory compliance
- Provide dynamic scripting for new collectors
- Review customer-level information to better inform account-level decisions and improve customer relationships and retention

Use the Internet to help your customers self cure

The effectiveness of traditional telephone channels is in long-term decline. It's an expensive way to collect money, and with caller ID consumers can easily avoid answering unpleasant collections calls or solicitations from unregistered or unknown numbers.

As a collections channel, the Internet is virtually untapped; the web is being used successfully for many other areas of credit and customer service—why not collections? The Internet can offer an effective way to collect money for a targeted set of customers. From the organization's perspective, the web can deal with high volumes of collections efficiently and cost effectively and can scale without little or no specialized staffing. From the

consumer's perspective, a web collections channel interacts the way they want it to: on their own timetable, without confrontation, via a self service portal they can easily use.

These new solutions help establish a web channel that allows customers to self-cure their delinquency via a contact method aligned with their preferences. Clients can take action when they want, which often is outside the legal "window" of collection activity by phone. The leading solutions include most aspects of debt negotiations, commitments, payments and settlements. The tool gives consumers a comfortable avenue to exchange pertinent information and with business rule screening you can offer flexible payment alternatives, leading to higher rates of debt repayment. With a relatively low capital outlay, this tool can be standalone or integrated into the corporate web site in as little as two months. Payback can vary depending on how aggressively the capability is deployed but full repayment can typically be achieved in less than one year.

Automated contact and resolution messaging

Strategies to enhance early stage collections can pay significant benefits. Typically, a small minority of delinquent customers avoid payment for a particular reason. Most consumers have simply overlooked your bill in the blizzard of direct mail they receive on any given day, or have overlooked the pay-by date. Improved analytics will help identify these customers and enable you to convert what could be perceived as a harassing collections contact into a relationship building contact.

The new automated contact systems can deliver a positive customized message to these customers. Unlike letters, the automated message can be delivered on timely basis with up-to-date information on payment receipt. Most messages are received and reviewed by the customer the same day, unlike mail which can pile up for a week or more before it is reviewed.

Automated systems can go beyond delivery of customized reminders and accept promises to pay, collect payments from various sources and, when necessary, connect the client directly to your collectors to resolve problems immediately. The automated agents convey no judgment, reduce compliance concerns by never varying from approved scripts and the conversations and associated transactions/promises are fully auditable. Automated contact systems can also pre-screen calls to deliver more "right contacts" to your collectors, improving utilization and time spent with clients by up to 20%.

Smart moves for big gains

The widespread deterioration of the housing and mortgage market has caused unprecedented delinquency levels across all segments of the credit market. As collections volumes swell, it is imperative for collections operations to work smarter, focusing on solutions that will improve the effectiveness of the collections operation. How you weather today's turbulent credit environment can well determine future profitability. Solutions that incorporate customer information, risk-based segmentation, self-service tools and automated treatments will help ensure effective operations and more dollars collected for each dollar of effort.