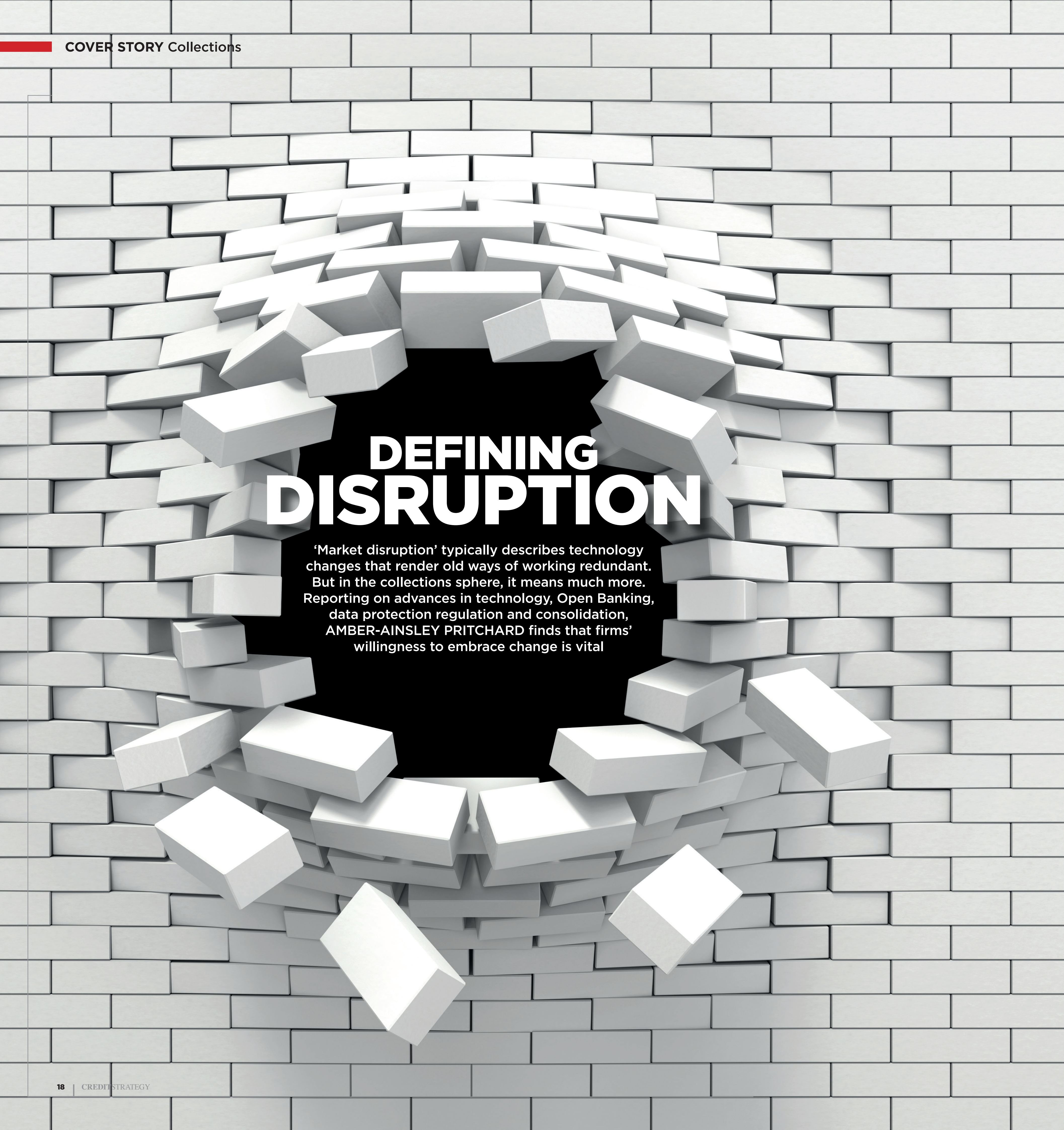

DEFINING DISRUPTION

‘Market disruption’ typically describes technology changes that render old ways of working redundant. But in the collections sphere, it means much more. Reporting on advances in technology, Open Banking, data protection regulation and consolidation, AMBER-AINSLEY PRITCHARD finds that firms’ willingness to embrace change is vital

COVER STORY Collections

Disruption, by its true definition and not just by means of new entrants and technology, is happening everywhere in credit risk and collections.

While automation is becoming ever more prevalent and the rise of machines to do human jobs is well-known - and a well-trodden path in business journalism - disruption stretches quite far beyond technology.

If we really are in the midst of a fourth industrial revolution, perhaps we’re only seeing the beginning of process changes in collections that will continue to evolve at accelerating speed.

Maybe the fact that creditors are accessing and analysing more extensive data sets, using chatbots far more widely, and developing online communities of users who can resolve fellow customers’ queries, is just part of a first phase.

Everywhere, and in financial services especially, traditional models are being altered to work better with digitalised systems, but how are collections organisations – both creditors and suppliers – embracing these advances?

Some are able to adapt faster depending on size, agility, risk appetite and investment priorities, but faced with new regulations and industry-wide initiatives, there will be no choice but to change.

For this cover story, we condensed the disruption into five areas (though with such endeavours it’s never an exact science):

- Open Banking and PSD2;
- Automation and digitisation;
- Data protection and financial regulation;
- IFRS 9;
- Market consolidation.

Technology and how it’s used underpins nearly all such changes, and as one expert told *Credit Strategy*, the past 10 years have in some senses been defined by the aftermath of the financial crisis; the next decade will be defined by technology disruption that changes how banks interact with their customers forever.

Open Banking

Open Banking has been referred to as, you guessed it, an industry revolution – and one that must be embraced. It will enable customers to access and share (securely) their bank transaction data digitally through open application program interfaces (APIs).

The reality for customers should be an easier, more convenient way to find out the best account for them and therefore switching becomes more straightforward.

Industry professionals have said the initiative, to be implemented in January 2018, will encourage financial service providers to offer high quality, targeted services, therefore boosting competition.

Another big moment will be the arrival of the second Payment Services Directive (PSD2), also in January 2018, which will transform the way consumers engage with their money; they will be able to share their financial data with third parties, receiving impartial and objective advice that considers all their financial commitments.

Steve Daws, risk and compliance director at PRA Group (Europe), said the key to unlocking the full benefits of Open Banking to collections firms is to build consumer trust and confidence in the security of the technology, as well as in the integrity and reputation of firms involved.

Daws also warned that Open Banking could create risks for the debt collection industry. He said firms that don’t engage with the initiative and instead rely on increasingly outdated methods to keep in touch with customers will fail to connect with them, and be left behind.

This new access does, in fact, come with a few warnings from several experienced minds.

Stephen Jones, chief executive of the new trade body UK Finance, told *Credit Strategy* this month (see p24) that organisations need to be extremely vigilant and work hard to ensure Open Banking doesn’t inadvertently open consumers up to more fraud risks.

He said: “The Financial Conduct Authority (FCA) has a significant responsibility there in terms of its licensing regime, and in terms

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of how it manages the way in which new intermediaries come into the market place and use and protect the customer data that they access."

On a more optimistic note Roger Vincent, head of banking and innovation at Equifax, said: "The ability for transaction data to be used for automated credit-worthiness and affordability assessments, fraud detection and product accessibility is endless."

Automation

Open Banking is just one initiative yet to be implemented, but there's a range of other technology and digital advances already cemented within the collections space.

Stuart Sykes, group customer operations director at online lender MyJar, said technology has helped the industry to understand, in better detail, which consumers are more likely to repay their debts. It has become more about analysing ongoing, transient behaviours and circumstances, rather than a situation at a given point.

He added: "Using data to analyse behaviours of customers will allow us to not waste time and effort on those deemed less likely to pay. It is not an exact science but it will change the industry in how we set our strategy and how we manage our agents' time more effectively."

Sykes pointed to chatbots and the use of voice analytics as the technology that will become more advanced and be used more often in the call centre space – especially because they can operate 24 hours a day.

Nick Cherry, chief operating officer of Phillips & Cohen, agreed that voice analytics will become more widespread in its use, as it enables debt collection agencies (DCAs) to improve the customer experience "in the moment".

The development of voice analytics has also enabled agents to identify vulnerability in real time, helping them to prevent a situation from escalating at an earlier stage. Other technologies have enabled customers to interact through the channel of their own choice.

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> **John Ricketts**
> **President, Credit Services Association**

Rachel O'Connor, senior commercial manager of distressed and vulnerable customers at Barclaycard, said: "Digital provides us with a wealth of data and with this the potential to be much more proactive. Where multiple channels are available to a customer we need to make sure that we don't elevate one channel above another. It's important that there is consistency of experience and outcome across whichever channel a customer chooses to use."

Asked about the most conspicuous change in the industry, O-Connor added: "The most visible is how the industry as a whole now 'gets' vulnerability and is providing a more level and consistent playing field for customers. This now means we can have much more practical debates on how to continue to test, learn and grow, especially in the digital space."

Vulnerability aside, it could be argued that the FCA itself has created a level playing field, among larger debt purchasers at least, and the use of technology has since become part of a differentiation package.

Sykes added: "The secret sauce of DCAs and debt purchasers is not as secret as it used to be. We are all under the same rules with the FCA, so technology specifically targeted at the collections market can really set you aside from the competition."

Digitisation

PRA Group (Europe) pointed to other advances in the digital sector, such as machine learning. Daws said the continued development of this technology is important to help make pricing, performance and customer interaction more predictive, reliable and seamless.

More generally, Eddie Nott, UK managing director of 1st Credit, explained that the empowerment of individuals to take control of their accounts and repay online has, in turn, enabled support teams to dedicate their time to helping those customers with more complex needs, or those who prefer to speak to a human being.

Cherry said further advances within this area, such as apps to help debtors budget for collection payments, where developers could work directly or in partnership with DCAs or collections departments of creditors, will become more widespread.

Randolph McFarlane, head of sales and partnerships at Intelligent Environments, a digital collections specialist, made the point that digital messaging means customers can deal with an awkward situation in private, without the embarrassment of being forced to take a debt collection phone call at work or with friends.

He said the collections industry is notoriously traditional but things are beginning to change – but he believes modern technologies shouldn't transform the collections industry beyond recognition.

A spokesperson from Lloyds Banking Group added: "We'll continue to see diversity of options for engagement, including more choices in the digital space, such as self-service. This will enhance the customer experience and will not replace the human touch that many customers value."

The human touch is an important point here too. The increased use of chatbots and automation has caused a level of uncertainty around how agents will be deployed in the long-term future.

Many seasoned professionals believe, however, that robots cannot and never will have the same emotional responses needed to support customers in a highly sensitive area like collections.

John Ricketts, president of the Credit Services Association (CSA), said it is inevitable that the number of collections agents will decrease as the industry adapts to a changing world.

"Self-serve will continue to grow as the customers' preferred choice of interaction, particularly as Generation Z becomes the next customer. Automation has the power to enhance human abilities, removing the repetitive and mindless aspects of a job, freeing up staff to work more intelligently."

A slightly more positive impact of fewer agents means DCAs can save money.

McFarlane said: "The increasing cost of call centres means it is no longer efficient to employ large numbers of people to complete outbound calling."

However, Roger Lucas, managing director of Lucas Credit Services, said the function of a collections agent is irreplaceable – a point Nott agreed with.

Cherry added that sometimes a personal conversation with an agent is best to help resolve a consumer's issue because humans have "patience, understanding, empathy, and the ability to think outside of the box".

One pattern we can say with a degree of certainty that will continue, however, is automation of simpler interactions.

Pini Yakuel, chief executive of SaaS product developer Optimove, said: "Automation tools which reveal what value looks like to each customer will be the secret weapon to help banks succeed in this environment."

Data protection

Some industry professionals argue that the constant development of technology brings with it new risks to the collections space, such as the introduction of new, more challenging regulation to comply with.

Lucas said: "A threat is the compliance industry. Not, I stress, compliance per se, but the industry that has grown around it. We don't have the margin available to sustain this industry as well as our own."

Ricketts added that upcoming regulation such as the Senior Managers & Certification Regime and GDPR will also be a compliance challenge the collections industry must deal with.

Daws agreed it will be a challenge: "GDPR is impacting every system, process and control within business and the complexities of informed consent and data transfers makes Open Banking particularly vulnerable to its impact."

He explained how consumers need to have confidence that a dispute resolution process exists, one which assures enforceability of their rights under data protection laws in the case of a data breach through the use of APIs, in the context of Open Banking.

The industry, meanwhile, awaits clarity from the Information Commissioner's Office (ICO) in terms of guidance. It won't happen imminently – the ICO needs clarity itself from Brussels.

Speaking at the CSA's UK Credit & Collections Conference in September, Jo Pedder, head of policy and engagement at the ICO, said: "We are working hard on domestic guidance for UK firms. It's a real challenge. We don't want to give bad guidance, and produce it too soon. We want to add value and give clarification. We also can't complete a comprehensive guidance (document) until we have certainty on what the final provisions (of GDPR) will be. We are going as fast as we can; we're making progress but there's more to do."

Pedder also tried to address the fact that DCAs face challenges in some areas, in that complying with FCA rules could mean non-compliance with data protection rules: "There's a misunderstanding here. We spend time with other regulators like the FCA to avoid those tensions. We are committed to reducing conflating requirements, but data protection should not prevent you from treating vulnerable customers fairly."

Part of the challenge for the ICO is establishing clarity from the European data protection board on GDPR. The board's role is different and it will have the ability to make binding decisions. For the moment though, final guidance is yet to emerge.

Creditor contracts

Potential disruption ahead in the form of the

FORWARD THINKING

Experts' views on collections technology that will become critical to firms' success in the future

Stuart Sykes, MyJar: *"Machine learning of propensity to pay models is moving in the right direction; it will allow collections managers to train models to really segment the book to establish good, medium and bad payers.*

"It's not fully reliable but it is starting to drive better collection techniques."

Nick Cherry, Phillips & Cohen Associates: *"In the short term, real-time integration of existing systems is going to be key. Consumers rightly expect that if they communicate with an organisation through one channel, that the business will be technically capable of reflecting that communication across all of its systems and processes immediately.*

"This can be tough. In many businesses, system updates and processes run through batches or overnight processes and this is simply not going to be fit for purpose in future, as consumers expect joined-up, accurate responses and instant interaction regardless of channel choice."

Jan-Michael Lacey, Qualco: *"The most important thing is data and analytics. With no data (or inaccurate/incomplete data), there is no collections process.*

"To optimise a collections operation, it is now vital to deploy analytics, ideally prescriptive or predictive. In the case of pure collections technology, a fully functional and interactive customer website (optimised for mobile) is a necessity moving forward."

FCA's new areas of scrutiny, also emerged at the CSA's annual conference.

In a keynote speech Philip Salter, director of retail lending supervision at the FCA, said the regulator has some concerns about the collections industry relating to the quality of data passed on in contractual arrangements between lenders and debt purchasers/DCAs.

Salter said the FCA has seen circumstances where arrangements have fallen short of their expectations and worries if "creditors are working collaboratively enough on access to data and if sales arrangements are limiting access to data."

This note would appear to be significant – it's the first time, as far as *Credit Strategy* can establish – that the regulator has made a public notice of contractual requirements.

Perhaps disruption for creditors could mean extra efforts to clean and update data passed on to third parties. They can't say no to the FCA, not without good reason.

IFRS9

Other more macro pieces of regulation are on the horizon for the collections industry – of which IFRS9 is probably the most significant.

Two key themes came up when *Credit Strategy* contacted sources about IFRS9. One was a question over capacity to deal with higher volumes on the market, the second was an increased likelihood of even greater volumes of non-performing loans (NPLs) being sold earlier in the cycle.

Bruce Curry, director at analytics software provider FICO, said IFRS9 may bring a huge change to collections and recoveries strategies, as well as operating models.

He said: "There is speculation in some markets that IFRS9 adoption will be delayed. That's because the adjustments it will drive are just not sustainable by some institutions and that in itself is a worry - especially if these institutions include any of the 127 systemic banks across the EU. IFRS9 should not stop creditors doing the right thing for the customer but it does mean the cost of forbearance will change and every cost has a

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>
> **Philip Salter**
> **Director of retail lending supervision**
> **FCA**

ceiling. We will move into a world where we help a customer establish appropriate repayment arrangements and then pass many of them to another organisation (such as a debt purchaser) to manage the customer through that new plan. That's going to be a big shift."

For consumer credit organisations to be prepared for IFRS9, Curry said they should have addressed a range of questions including:

• What is the value of the performing debt portfolio for sale and who will we sell to/buy from?

• Do the contingent DCAs have the capacity to work our placed debt and the debt they service for the purchasers?

Curry explained that, added to these considerations, firms will have to layer in a £200bn debt bubble, persistent indebtedness, rising interest rates and many other factors affecting how firms manage vulnerable customers going forward.

Consolidation

With the development of so much technology, and various abilities to absorb extra costs while margins are squeezed, it begs the question of what the future holds for independent DCAs, and if more consolidation is simply inevitable.

Dewi Fox, managing director of ARC Europe, believes so - although the types of business being acquired may change.

"Most of the recent deals have involved large businesses buying other large businesses to achieve even greater scale", he said, adding: "There are also signs of larger agencies now looking to buy in specialist providers delivering more bespoke/specialist services, and this is often where independent DCAs are involved."

Fox emphasised that there is "definitely still a role for independent DCAs", with their principal advantage being that they tend to be faster movers and early adopters of new techniques, technologies and thinking.

Lucas echoed this point, adding that technology creates many opportunities for independent DCAs because they are best placed to exploit them with creative and reactive teams.

But an issue that may cause trouble for independent DCAs, according to Jan-Michael Lacey, head of UK sales at Qualco, is that more creditors will begin to reduce their outsourced panels and gravitate towards the larger servicers, offering a 'one-stop-shop' approach. He said: "The independents will be compressed to a point whereby it could be impossible to maintain operations."

Lacey said this could be further compounded by the minimum standards some creditors now insist on, which ensure continuing a pure 'no win, no fee' commission model is tantamount to commercial suicide.

He added that the exponential increase in the cost of collections, enhanced compliance costs and IT security costs, will be untenable for many smaller agencies.

However the future plays out for independent DCAs the market appears to be, in the main, embracing and driving change through the use of technology.

But as larger creditors continue to look for ways to drive costs out of their businesses, one wonders which department will take the first hit. CS