Reducing loan defaults – A matter of digital communication

White Paper | Banks

Customer Retention Management by Intrum

Management Summary

The global corona pandemic poses enormous challenges for companies in all industries. The second lockdown in Germany will further aggravate the overall economic situation and increase the risks to the financial industry. Many experts fear a significant increase in loan defaults in the coming years. The Federal Association of Loan Purchase and Servicing (BKS) estimates that in the worst-case scenario, the volume of NPLs (non-performing loans) will rise to a maximum of 100 billion euros in the next three years in Germany alone. To prevent loan defaults in the customer environment, financial institutions need to improve their digital processes.

A few weeks ago, Andrea Enria, Chair of the European Central Bank's Supervisory Board, pointed out the challenges resulting from the Covid-19 pandemic and called for an effective risk management. The action plan on NPL management published by the European Commission on 16 December 2020 falls within this context.

Market participants should, on the one hand, find and implement efficient solutions to support bank customers, and at the same time protect the bank portfolio from possible negative effects of increasing credit risks.

The goal: Digital replaces analogue
This enormous challenge must be overcome with foresight, with regard to internal processes, but also in terms of customer approach. On the one hand, banks must improve their credit risk management. On the other hand, the focus should be on the digital transformation of their own organisation. Important drivers for this are an increase in automation and standardisation and an expansion of digital processes. All with the focus on digital replacing analogue for improved customer loyalty.

The solution: One platform, many functions
Customer Retention Management by Intrum
To minimise default risks, Intrum's Customer Retention Management offers a digital customer loyalty and communication solution, as called for by the ECB. The basic idea is an omni-channel platform with many functions. The platform enables the integration of different communication channels. The advantage for banks lies in the complete process handling using the platform. The aim of using the platform is to reduce communication hurdles when approaching customers, to professionalise risk management and to support customer loyalty in the long term.

Quo vadis? Volatility and uncertainties dominate the market.

One look at the current corona pandemic shows a changing world, full of uncertainty, in crisis mode, with serious and profound economic consequences in almost all sectors.

In its June 2020 monthly report, the German Central Bank concluded that the worldwide spread of the coronavirus will lead to a profound global recession.[1] And according to the Munich-based Ifo Institute, Germany is facing "the biggest contraction in gross domestic product (GDP) since World War II. Current forecasts anticipate a 5.2% contraction of Germany's GDP in 2020."[2] As a result of the corona crisis, around 750,000 companies and, at peak times, more than six million employees have registered for short-time work benefits. In addition, according to a quick survey conducted by the Association of German Chambers of Industry and Commerce (DIHK), as early as March 2020 over 90 percent of companies (...) were already experiencing negative effects on their business" and more than 80 percent of companies were expecting a drop in sales.[3]

This will be accompanied by a rise in unemployment to 6.0 percent by October 2020[4] (source: Federal Employment Agency) and possible job cuts – the level of which will vary depending on the sector." On average, 18 percent of companies in Germany have cut jobs."[5] And the figures are likely to continue to rise in most sectors in the financial year 2020 and beyond. In summary, this means that a painful economic avalanche is heading for companies, even if in some cases it is delayed and not yet directly noticeable.

40 percent
of companies plan to cut jobs
(Current as of August 2020)

80 percent
of companies have recorded declines in turnover
(Current as of August 2020)

Risk managers at German financial institutions, for example, expect a significant increase in loan defaults in the coming year. The Federal Association of Loan Purchase and Servicing (BKS) forecasts a massive increase in the NPL ratio (non-performing loans) and expects these to reach a record level.

For Germany this means an increase from currently 33 billion euros (as of 2019 according to the EBA) to an expected 59 billion euros by the end of 2021.[6] Jürgen Sonder, BKS President, puts it even more starkly: „In the worst-case scenario, we are assuming a tripling of the absolute figures to up to 100 billion euros in the next three years."

100 billion euros
NPL volume in the next three years in **Germany**

ECB calls for timely, efficient, and sustainable solutions

The ECB has also sounded the alarm bells. Andrea Enria[7], Chair of the European Central Bank's Supervisory Board, for example, has called on European banks to offer efficient and timely sustainable solutions or support, firstly by supporting financially stricken, viable companies. "This requires that major institutions have procedures in place for an effective risk management to identify, assess and implement solutions that best support these businesses while protecting banks from any negative impact on credit risk," said Enria in his letter to the bank's board members. Secondly, institutions should act in a timely manner to shield banks from possible "cliff effects" when the state Covid-19 measures are gradually phased out. And thirdly, banks should have an adequate risk and portfolio transparency. Banks should "develop an appropriate strategy with short- and medium-term objectives to ensure that solutions for financially stricken, viable borrowers are sustainable", Enria added. This strategy should also ensure that non-longstanding arrears are tackled in a timely manner.

This enormous challenge must be met with a view to internal processes, but also regarding customer approach. On the one hand, banks must improve their credit risk management – either with the help of an optimised credit rating system or thanks to new forecasting models. On the other hand, the focus must be on the digital transformation of their own organisation in order to improve processes and save costs. Important tools in this respect are further automation and standardisation as well as an expansion of digital sales and communication channels in all banking processes.

For decision-makers and risk management it is therefore essential to focus on the customer and actively create change.
On the following pages we will show you how this can be achieved with our new concept of optimised customer communication in the financial environment and the solution behind it. After all, the goal is to minimise default risks and at the same time improve customer relations in the long term. In terms of sustainable customer communication and customer loyalty and ultimately for your business future.

First of all: Our approach is called Customer Retention Management by Intrum – one platform, many functions – digital and interactive. Because your customers are important to us.

Banks in digital transformation

The traditional banking environment has long been under intense pressure from new digital players in the financial environment. In addition to the search for new business models and more digitalisation, especially established banks are facing high costs of their branch networks, high staff requirements and a zero-interest policy.

Many banks are also struggling to improve customer communication and loyalty. Simply put, this means that many affiliated banks often lag behind in today's requirement for transparent and proactive customer loyalty – with disastrous consequences.

Especially in times of crisis, such as the current corona pandemic, it is essential for banks to have a well-developed customer communication. With the difficulties of the economy increasing, so do worries and hardships of customers. Short-time work, redundancies and massive business collapses of many entrepreneurs mean that loans can no longer be serviced. For banks, this increases the risk of loan defaults and insolvencies by customers. For example, the German Central Bank is most concerned about credit risks, especially because of the time delays in possible loan defaults.[8]
Not to forget the high estimated number of potential insolvencies, as the current deferrals and suspensions of insolvency applications mask the real scale of the problem.

Close coordination, credit risk management, customer communication and loyalty
At this stage, customers require close coordination with their financial institution to detect possible payment difficulties at an early stage and look for viable solutions. This requires consistent communication with the customer from the early stage. "For banks, this means improving their credit risk management and establishing more digital solutions in the organisation and in the exchange with the customer," explains Florian Wöretshofer, CEO of Intrum Germany. He adds: "At the same time, automated and standardised processes must be in place to improve customer communication and ultimately customer loyalty."

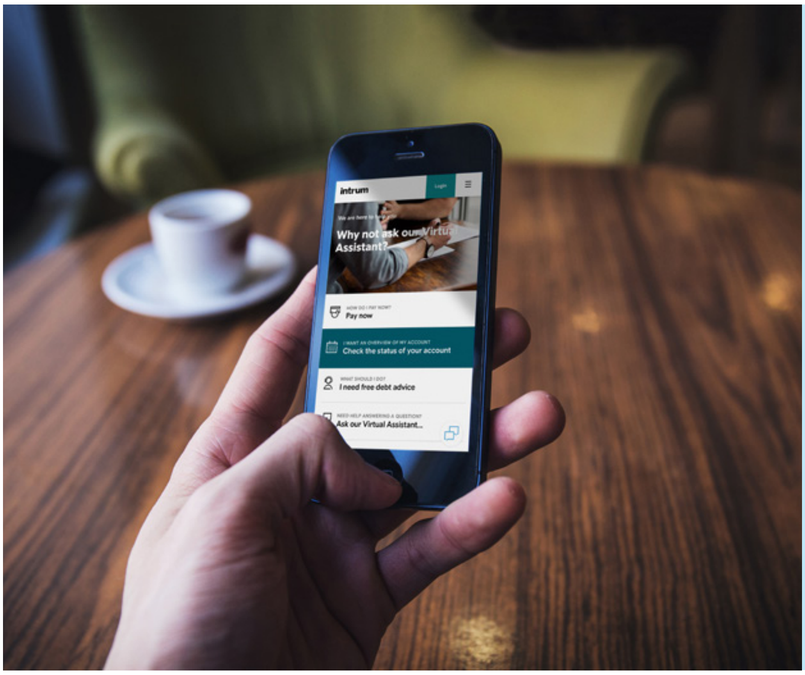
It is advisable to tackle the digital transformation soon. After all, the Fintech competition never sleeps, and today's customers can choose from a wide range of financial institutions. And once a customer is lost, they usually do not return. The Oliver Wyman consultancy formulates this in its study on "Managing existing customers" like this: "If a customer decides to change banks, they usually close their accounts, and the value of the banking relationship is eroded to almost zero in the long term."[9] This must be prevented – with a modern, timely, and above all, digital approach.

One platform, many functions: Interactive Communication Service

The fact that the world of communication and finance is undergoing fundamental changes due to digital structures is not entirely new. And yet, in many organisations, there is an apparent gap between the analogue activities of yesterday and the new digital possibilities of today.

Especially in times of crisis, such as the current corona pandemic, digital and interactive solutions can help to minimise losses, save costs, and keep your own bank on the road to success. Active communication with the customers is of vital importance in this respect, to prevent financial losses and to establish and expand sustainable and long-term relationships with the customers.

Income crisis due to corona
According to the Hans Böckler Foundation (HBS), the coronavirus crisis is exacerbating social inequality. The HBS writes: "More than a quarter of the working population has already lost income in the crisis, and social inequality is increasing."[10] Younger generations are affected financially by corona to a higher degree. This has been confirmed by current surveys. For example, the University of Vienna, Faculty of Social Sciences, came to the conclusion: "Young adults aged 25 to 34 years experienced a very rapid increase in unemployment during the lockdown in mid-April; the group of 25 to 29 year-olds was also in short-time work more frequently than the average". It goes on to say that "The financial situation of households had deteriorated by mid-April at a higher rate for 25-34 year olds than for 35-50 year olds compared to February; the financial cutbacks were still evident in mid-June in the sub-group of 25-29 year olds."[11] The Intrum white paper on the "European Consumer Payment Report 2020"[12] also reveals economic pressures on households in 24 European countries.



More and more customers feel understood in their daily communication behaviour and are prepared to go along with solutions due to digital approaches. This in turn avoids possible cancellations and the ensuing high costs of processing former customers and acquiring new clients. The danger of image loss caused by former customers making negative comments about the bank in forums, on social media or to friends and acquaintances, must not be underestimated. Often "shitstorms" have erupted which even large companies could only partly recover from with difficulty.

Clearly younger generations are particularly affected. They are expressing concerns about their financial situation due to the coronavirus pandemic. In the age group of 22 to 37-year-olds, 53 percent of those surveyed cited the current coronavirus crisis as the reason for a financial deterioration of their personal situation. And the Hans Böckler Foundation points out: "Respondents are increasingly feeling the consequences of the crisis in their own wallets: In April 2020, 20 percent said the epidemic had already had a negative impact on their personal income, in June it was 26 percent."[13]

Digital before analogue
The above-mentioned income crisis of many people needs to lead to a change in thinking for banks. This means preventing possible default risks, picking up more customers and contacting them digitally. This means taking advantage of the changing communication behaviour of many people in the digital age and using digital communication channels and "smart" solutions to retain them.

And not every customer who is in default is principally unwilling to pay. The reasons for the arrears are as varied as the people themselves. The best way is therefore to initiate a proactive dialogue with the customers, i.e. before a late payment has even occurred. In this way, banks can interact with customers as sparring partners at eye level.

Sustainable customer relations with just one click
Intrum offers this type of customer loyalty and communication solution thanks to the Interactive Communication Services platform as part of the certified Customer Retention Management overall process. The service is intended for customers with payment difficulties within a period of up to 90 days from the due date, but before cancellation. The underlying idea is an omni-channel platform with many functions. The solution allows for the integration of various communication channels – from web portal to (interactive) SMS and e-mail systems. A payment site is also integrated into the solution. And that in several languages!

The aim of using the platform is to mitigate communication hurdles when approaching customers. In that way, payment difficulties, for example, can be addressed early on to find a solution for payment by instalments together with the customer. The idea is to create a basis of trust through timely interaction via different channels – precisely because customers are met where they interact digitally. "Ultimately, the aim for banks is to establish and strengthen a sustainable customer relationship in order to pre-empt a possible cancellation by the customer," explains Florian Wöretshofer: "And all this with just one click."

One for all: Intrum platform and many years of experience
The advantage it offers for banks is the handling of the entire process by using the platform – starting with a direct integration of cases into the Interactive Communication Services solution and the file transfer of the data into the Intrum platform. From here, cases are processed, and the results made available to the client via digital reporting. In addition to an improved digital customer loyalty and approach, organisations can concentrate on their core business, based on an active problem-solving for payment delays. The platform also offers an important component for payment processes thanks to the white label function.

Financial institutions can rely on Intrum's many years of experience throughout the entire process of implementing the Customer Retention Management digital customer retention and communication solution.

For this purpose – and ultimately to prevent default risks – over 500 specialised employees are available in Germany. With 80,000 clients worldwide and thus over 250,000 customer meetings every day, we know what matters when it comes to customer retention. Flanked by further digital processes, by using artificial intelligence and process certification for customer loyalty (TÜV ProfiCert/certified 2018), we offer a complete package to solve possible default risks in good time. With our Customer Retention Management solution, we are paving the way for your digital transformation with up-to-date communication for a sustainable customer retention.

Our digital presentation:

Interactive Communication Service by Intrum

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