Automation and Analytics: Two Levers to Revitalize Retail Debt Recovery

As retail banks strive to revive, they can deploy predictive analytics and other process automation tools to add efficiency and effectiveness to the debt recovery process, thereby increasing recovery rates, reducing costs and enhancing debt salability.
Executive Summary
Retail banks are under relentless pressure to cut costs and meet profit targets amid heightened regulatory scrutiny. But as difficult as these conditions are, they also present opportunities to improve efficiencies. Banks charge-off billions of dollars of retail debt every year, and only later attempt to recover as much as they can from such accounts.

Current debt recovery processes still rely largely on manual effort. Collection and recovery functions have long been treated in isolation, posing challenges to downstream efforts to optimize recoveries from charged-off debts. Other areas of retail banking have so far been prioritized over system upgrades to enable more tightly integrated operational recovery processes. This has undermined seamless data flow within banks (from collections to recoveries) and across various entities (attorneys, external agencies, credit bureaus, etc.) that are part of the recovery process. The result: data inconsistencies and unnecessary delays that erode both efficiency and the ability to derive maximum value from the debt recovery process.

Further, the absence of real-time reporting restricts banks’ ability to monitor agency performance, account status, etc. Elongated turnaround times, the high cost of recoveries, lost cases, customer ire and limited bargaining power in the event of the sale of debt are all manifestations of the challenges associated with existing processes and systems. Revitalizing debt recovery functions is, therefore, an opportunity to create new efficiencies for banks and deliver material business value.

Embedding advanced analytics in recovery solutions will go a long way toward delivering multiple benefits. Banks can analyze the causes influencing customer behavior, identify customers who have the ability or willingness to pay but are currently constrained, and help determine the right recovery strategy. Analytics can also be used to better manage internal recovery teams and agencies.

Automation and real-time enablement should form another vital component of the solution driving down manual intervention, reducing information loss, hastening the recovery process and improving employee productivity. An overall improvement of the recovery function can also increase banks’ chances of winning cases under trial, improve the salability of debt and boost banks’ bargaining power.

These solutions can also be designed to help banks comply with stringent federal and evolving state regulations. Further, large banks that embrace these solutions and gain expertise can subsequently extend this service to smaller banks, thus adding a new line of business to their portfolios.

Remedies for a Tough Business Environment
Even four years after the global financial crisis “officially” ended, the after-effects continue to haunt U.S. and UK retail banks. Net interest margins (NIM) are down due to persistent low interest rates (see Figures 1 and 2, next page). Regulations such as the Dodd-Frank Act and Basel III are increasing costs and requiring banks worldwide to modify existing business practices.
To cope with these challenges, banks are identifying ways to reduce costs and improve efficiencies across various work streams.

**Recoveries to Boost Bottom Lines**

Debt recovery is an area that is ripe for extracting efficiencies. The long overdue improvement of debt recovery processes and systems can result in considerable gains, as every dollar recovered goes directly to the bottom line. The number of charged-off accounts spiked during the financial crisis and then declined (see Figures 3 and 4, next page). However, they continue to pose challenges to banks.

Our analysis reveals an opportunity waiting to be tapped. Consider the fact that total retail debt charge-offs add up to billions of dollars annually. As of the fourth quarter of 2012, approximately $978 billion of the total consumer debt of $11.34 trillion was delinquent, according to the Federal Reserve Bank of New York. Of this, roughly $712 billion was seriously delinquent (defined as 90 or more days past due). We estimate that even a 1% improvement in the recovery rate (currently at 20%) of seriously delinquent debt, and a 10% reduction in recovery costs (currently 15%) can boost the bottom line of U.S. banks by more than $9 billion annually. However, banks’ recovery functions are not equipped to take advantage of this opportunity due to the inherent challenges in their existing recovery processes, which increase costs and induce delays in recovery.

**Challenges of Existing Recovery Processes**

While the banking industry has experienced significant technological transformation over the past two decades, the collection and recovery functions at many banks continue to rely on outdated and primarily manual practices and
technologies that bloat cost and turnaround time. The following are challenges currently plaguing the recovery process:

**Ineffective Recovery Methods**

Banks deal with recoveries using rules-based systems and prior experience. They have little analytical help – they lack the necessary infrastructure and analytical abilities to assess accounts and devise optimal treatment strategies based on customers’ ability to pay. To cope with spikes in charge-offs, banks simply augment their recovery efforts by increasing staff and calling customers, both of which usually increase costs. Further, the high level of manual effort involved in collection and recoveries, reporting and workflow management often results in data loss and unnecessary delays, increasing turnaround time, as well as the cost of recovering debt.

**Integration Challenges**

Debt collection and recovery functions at banks operate in silos. Accounts must be moved from collections to recoveries manually when they are more than 180 days due. A lack of integration between these functions puts vast pools of data, such as history, customer behavior, notes, etc., in jeopardy. This data can be misplaced, or errors can creep in during the transfer, leading to data inconsistencies. Further, these functions are not connected to enterprise application systems and, hence, do not provide managers a complete view of a customer.

Recovery involves a series of interactions between the bank and other external entities – agencies, attorneys and debt buyers – to improve payments and reduce losses. Once a charged-off account is identified, the workflow includes account scoring, account segmentation, offer management, collection agency allocation, legal placement, credit bureau reporting, etc.

For a complex process to function properly, data must flow seamlessly within the bank and across the entities in the recovery chain. However, current bank operations are not designed to ensure smooth data flows. Banks share new recovery data with agencies in spreadsheets, often missing key documents and other critical information related to the collection history. Agencies have to, therefore, start fresh rather than continue from the point where the bank ended its recovery effort. This results in unnecessary delays that increase turnaround time.

Given existing data-related issues, recovery managers cannot leverage advanced analytics for real-time decision-making related to recovery strategies, agency management, etc. In addition, internal bank systems are error-prone. Banks that rely on such data in their recovery may be more likely to mistakenly approach the wrong customer, demand the wrong amount or add unnecessary fees and penalties.

Nearly 90% of credit card lawsuits are filed without the proper data, such as payment history, contract agreement, etc., to back allegations about outstanding debt. Furthermore, banks supply the same suspect data when they sell or

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**Charge-off Rates (Consumer-Lending UK Banks)**

![Charge-off Rates Graph](image)

*Source: Bank of England*

*Figure 4*
outsource accounts to external recovery agencies or debt buyers, inviting customer ire and legal challenges.

**Agency Management Obstacles**

Tracking the agencies’ performance, sharing data and data visibility are the primary challenges involved in dealing with collection agencies, according to a 2011 study by SunGard. Banks employ multiple agencies that work on various types of accounts across diverse locations. As such, managing the agencies and tracking and comparing their performance become difficult tasks for recovery managers (see Figure 5).

Further, allocation of accounts to external recovery agencies or internal recovery teams is largely based on personal relationships rather than on their proven abilities and efficacy backed by performance data or analytical insights. Hence, banks need solutions that provide them with real-time information about the agencies’ performance so that business can be allocated to top-performing agencies.

**Declining Agency Efficacy**

Though the debt collection industry has grown in terms of dollars outsourced, the recovery rates for banks and other financial institutions have declined as household wealth dropped and the job market remained weak, according to Marketdata Enterprises Inc. The average recovery rate has fallen to 20% from 30%, and agencies have been forced to work harder and use aggressive tactics to improve their recovery rates. This has resulted in increased customer complaints and caused regulators to impose hefty fines.

**Heightened Regulatory Scrutiny**

The rise in consumer complaints against the recovery practices of banks and debt collection agencies has led to increased regulatory oversight under the newly minted Consumer Financial Protection Bureau (CFPB), the Dodd-Frank Act and federal and state consumer protection laws. The various state laws present additional challenges to banks. These regulations include:

- **Fair Debt Collection Practices Act (FDCPA):** Enforced by the Federal Trade Commission (FTC) to prevent debt collectors from using abusive, deceptive and unfair debt collection. The act prohibits calling customers outside the time window of 8:00 AM to 9:00 PM local time, making repeat calls and other actions considered annoying to customers. While the FDCPA is applicable primarily to third-party debt collectors, some state laws also include the original lender.

- **Telephone Consumer Protection Act (TCPA):** Originally enacted to prevent unsolicited calls by telemarketers using automated dialers and facsimile machines, TCPA was later amended to include the collection industry.

- **Truth in Lending Act (TILA):** The law requires creditors and lenders to disclose information such as terms of the loan and costs to borrower before lending.

- **Credit Card Act of 2009:** This regulation prohibits companies from increasing the rate on an existing balance without notifying the customer 45 days before the effective date. The act also limits the increase in interest rate and fees.

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**Top Challenges Working With Agencies**

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<th>Challenge</th>
<th>Percentile</th>
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<tbody>
<tr>
<td>Tracking Performance</td>
<td>80</td>
</tr>
<tr>
<td>Sharing Data</td>
<td>70</td>
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<tr>
<td>Daily Visibility</td>
<td>60</td>
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<td>Service Levels</td>
<td>50</td>
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<tr>
<td>Disputes</td>
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Base: 189
Source: SunGard, May 2011
Figure 5
Further, many states have also begun to impose stricter standards on the conduct of debt collectors, increasing the challenges for debt recoveries.

Regulators are focused primarily on the recovery activities of external agencies, as banks have outsourced most of their recovery activities. Several states have initiated probes into debt-collection businesses, propelled by the foreclosure crisis and the robo-signing scandal (in late 2010) that cost banks billions of dollars for producing forged and notarized mortgage documents to seize and sell houses. Investigators are looking for organizations following similar practices and to ascertain the quality of data supplied to recovery agencies.

Legal and regulatory authorities say banks sell their charged-off accounts with incomplete or erroneous information to debt collectors and also seek additional payment for more information on the accounts. This has prevented agencies from seeking additional information and caused them to approach customers using insufficient data.

The Federal Deposit Insurance Corporation and the CFPB now require banks with questionable credit card practices to provide customers with documentation of the debt, as well as each transaction for all disputed debts. This can be a major challenge, as the records sought by regulators are more detailed than even those that banks submit in court cases; many banks are not equipped to produce the information consistently and cost-effectively.

Starting this year, CFPB has begun to scrutinize major debt collectors (exceeding $10 million in annual collections). Financial institutions falling under CFPB’s radar must properly identify themselves and document the amounts owed, which puts the onus on banks to provide debt collectors with the necessary details.

With growing regulatory oversight, banks must ensure proper documentation and resolve data-related issues to ensure compliance and avoid fines. Banks must upgrade their recovery systems and use solutions to achieve data consistency and to quickly extract any information requested by regulators.

An Ideal Technology-Enabled Recovery Solution
To overcome the existing challenges and cope with tough business conditions and stringent regulations, banks must seek a recovery solution with the following capabilities.

High Levels of Automation
An end-to-end automated recovery process built on top of a sophisticated workflow engine can streamline the recoveries process and create new operational efficiencies. Automating a workflow with pre-configured rules can considerably reduce the human effort involved in prioritizing workloads and contact channels (agency or attorney), agency allocation, etc.

For instance, rules can be created to automate the monitoring of accounts under recovery. Managers can be alerted as soon as an attorney or agency updates the status of a case, based on which action can be taken. This improves response time and speeds up the recovery process. Employees’ time is freed up, and they can be deployed to more value-adding endeavors, such as analyzing past performance data to create analytical models for improving business results.

The workflow process must be flexible and scalable to accommodate future business requirements.

Predictive and Real-time Analytics
Customer information such as application data, outstanding amount, payment history, customer employment status, etc. can help an institution understand an individual customer’s ability to pay and thus devise an appropriate customer treatment strategy.

Using advanced analytics, banks can segment customers by account type, debt size, etc. so that managers can decide early in the process whether to place an account with an agency or attorney or with an internal team. For instance, internal resources can be used to identify risky customers well in advance so that appropriate strategies can be designed before their debts turn into losses.
used to deal with customers with a higher propensity to pay, while risky customers can be assigned to agencies or attorneys. Customers with a good credit history who are going through tough times can be offered options such as reduced monthly payments, debt restructuring, etc. Predictive analytics can be used to identify risky customers well in advance so that appropriate strategies can be designed before their debts turn into losses.

Analytics can also be used to evaluate the performance of agencies. Not all agencies operate the same way or are consistently effective. For instance, some agencies specialize in high-value debt accounts, while others focus on low-value debt accounts. It is, therefore, important to understand their abilities so that the right agency is assigned the right type of account.

Analytics enable faster and more informed decision-making by allowing managers to get reports on agency performance, on-demand. Managers can monitor agency performance based on key criteria, such as channel type, account type, amount recovered, geography, etc., and analyze fees and performance. Based on this, accounts can be added, deleted or swapped; agencies can then be paid accordingly, which will help financial institutions optimize costs and improve recovery rates.

**Tight Integration and System Consolidation**

An integrated collection and recovery solution will improve information accuracy and consistency. Further, integration of the solution with enterprise systems will provide managers with a 360-degree view of customers and their payment histories. The solution should facilitate integration of the interfaces with agents, attorneys and external data providers with the internal recovery systems, and provide a faster and easier process for on-boarding new entities. This will facilitate a smooth data flow across various entities and provide managers with all the details about account status, the actions taken by the assigned parties, etc.

In many banks, different lines of business (mortgage, credit cards, student loans, auto loans, etc.) develop localized recovery practices. Further, various channels (call centers, e-mail, Web, ATM, etc.) that interact with customers operate in silos, resulting in the same customer being contacted numerous times, with each channel unaware of the actions taken by another.

A recovery solution should support data consolidation across various lines of business and provide automatic, synchronized multichannel integration to deliver one version of the truth regarding customer information. Collectively, this will help banks approach customers with appropriate details and propositions under the right debt management strategy, as well as offer them the option to extend payment flexibility if appropriate.

**Regulatory Compliance**

In the wake of heightened regulation, banks must pay close attention to federal and state laws that differ from state to state, relative to debt type.

The solution must provide a configurable and flexible architecture that enables organizations to quickly update their compliance requirements to deal with all the key facets of evolving regulations, as well as a host of state laws and rules created by banks. It must allow banks to quickly prepare and serve statutory and regulatory reports when required.

**Intelligent BPM**

An ideal solution must extend beyond business process management (BPM) services and include intelligent functionality that enables banks to develop personalized recovery strategies. This will allow them to make smarter and better allocation decisions.

**The Business Case for Modernizing Recovery Activities**

We consider two drivers that can lead to the business case for deploying a new technology-enabled recovery solution: the ability to increase recovery rates and reduce the overall costs associated with recovery. A more process- and cost-efficient recovery process will significantly improve retail banks’ bottom lines. Further, large banks can offer technology-based recovery capabilities to affiliated and smaller banks to create a new revenue channel.
Increased Recovery Rates
We believe banks can generate higher recovery rates on the strength of improved data flows, process optimization, integration and availability of analytics-driven insights from customer data and agency performance data. Banks can also expect to improve their ability to win lawsuits, thereby raising the recovery rate. The salability of debt and pricing power are also enhanced.

Reduced Recovery Costs
An overall increase in process efficiency, automation, resource optimization and compliance - accompanied by a reduction in manual effort - would reduce the cost of recovery, bolstering profitability.

Looking Ahead
The growing complexity of the debt recovery market requires banks to take a hard look at their existing processes and the entities supporting them. Banks must leverage recent advancements in technology to streamline their recovery processes, optimize costs and improve recovery rates.

An integrated collections and recovery solution that is connected to enterprise applications will provide a complete picture of customers and mitigate data loss during the moving of accounts. By combining automation and advanced analytics, banks can create a potent duo that can significantly impact recoveries by creating new efficiencies in the form of improved workflow, internal and external communication through a seamless flow of data, documentation, agency management and reporting. All of these can increase recovery rates and optimize operational costs.

Footnotes


6 In the year 2012, the Federal Trade Commission received 199,721 unverified complaints about debt collection, compared with 180,928 in 2011, 140,03 in 2010 and about 14,000 in 2000. Of the total, 178,009 were related to third-party debt collection, while the rest were focused on creditors’ internal debt collection practices.

7 In February 2012, five banks reached a $25 billion settlement with state attorneys general and the federal government in February 2012. In January 2013, 10 banks reached an $8.5 billion agreement with the Office of the Comptroller of the Currency and the Federal Reserve to end a case-by-case review of foreclosures from 2009 to 2010 by independent auditors.


9 Ibid.
About Cognizant

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