



Retail banking in CEE – Debt collection in times of crisis

Summary of study findings



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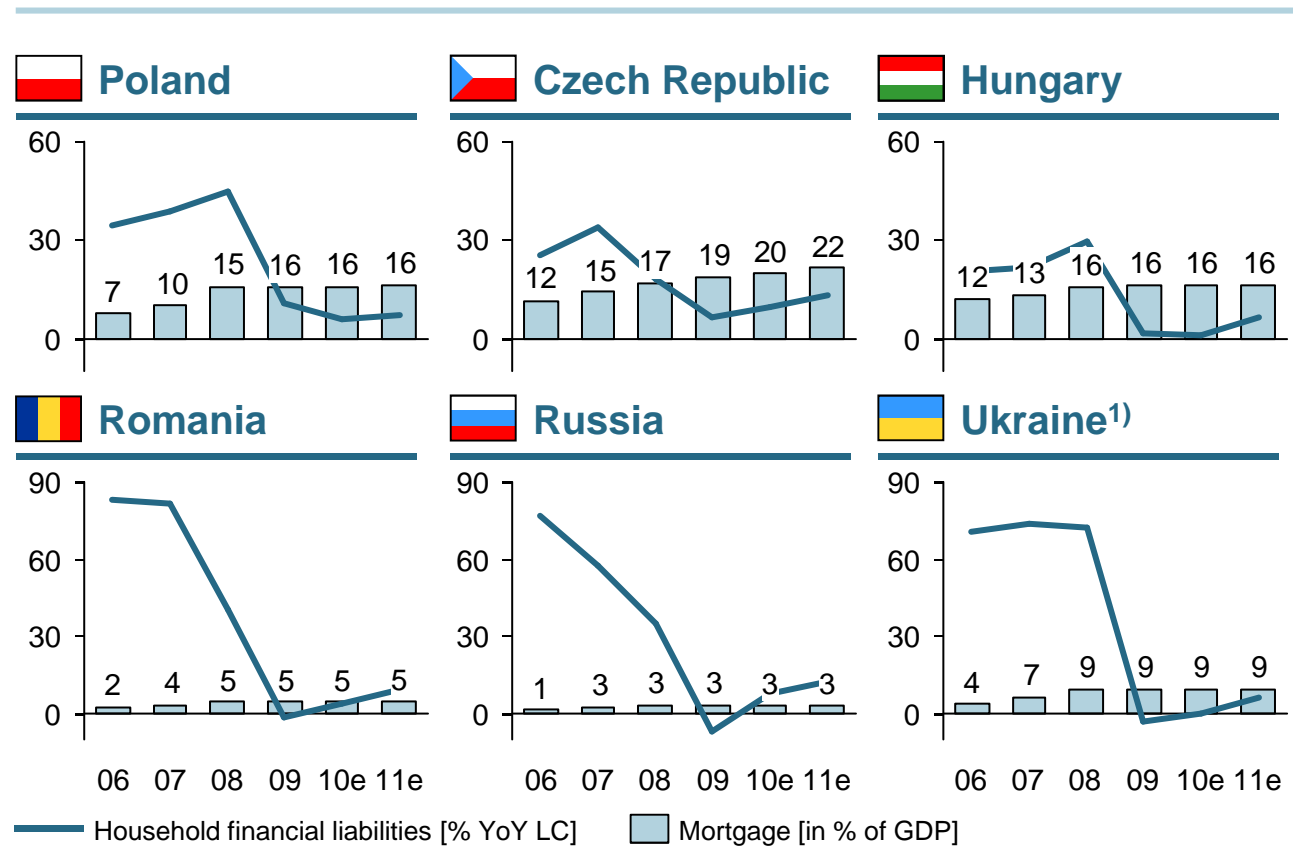
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A. The "Gold Rush" is over – Recent developments & outlook in CEE retail lending

As the financial crisis hit CEE, growth in retail lending dropped drastically – The pre-crisis gold rush appears to be over

CEE – Household financial liabilities growth and mortgage saturation



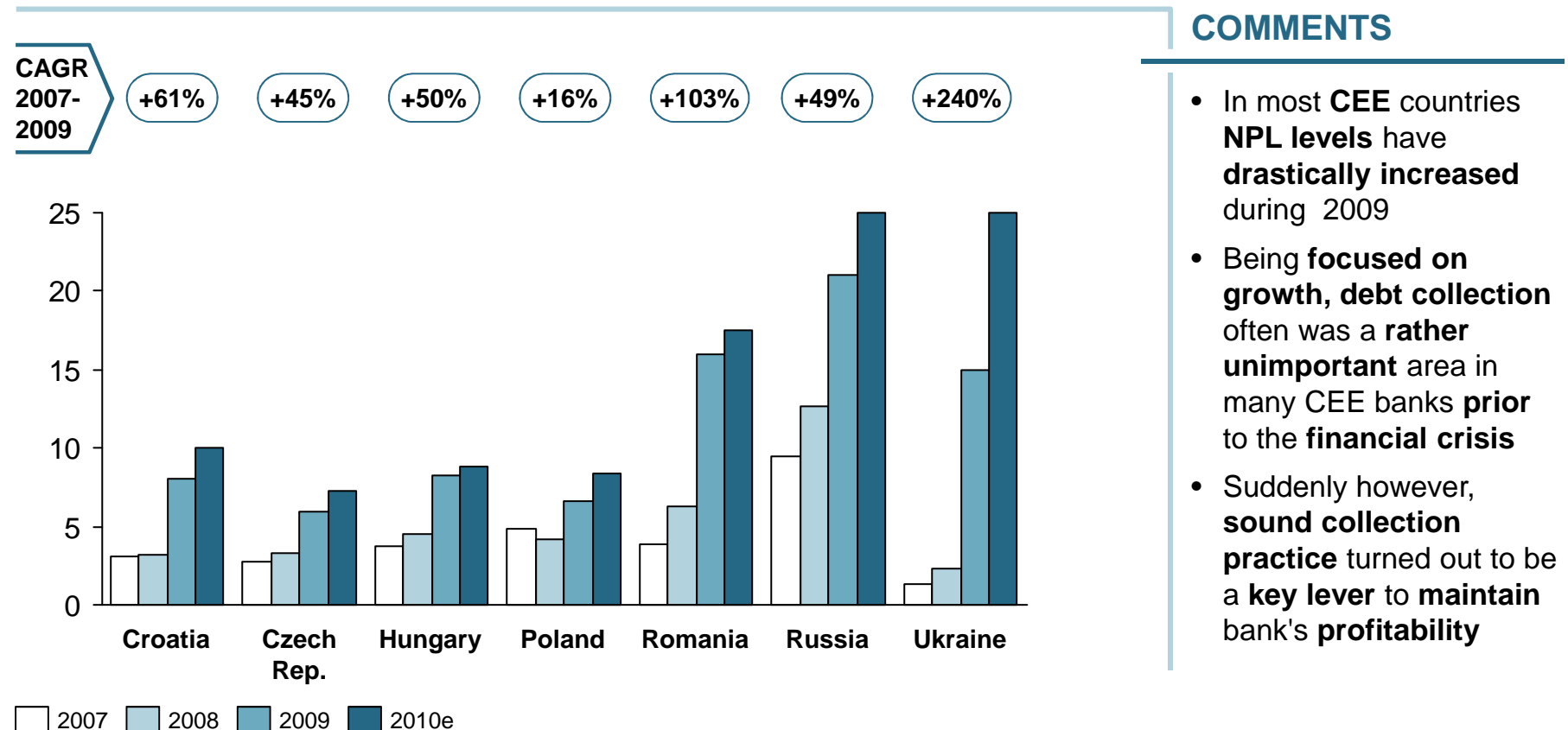
COMMENTS

- In **2009**, following years of rapid credit expansion CEE economies saw **growth in household lending drop dramatically**
- At the height of the crisis, **growth in some countries** (e.g. Romania, CIS) even turned **negative**
- **Lending growth is expected to recover only slowly** – Pre crisis "gold rush" with vastly expanding **retail lending** in CEE seems to be **over**

1) Data reflects total loans instead of household financial liabilities [growth in % YoY];

While credit markets froze, banks across CEE saw NPL ratios soar – Debt collection turned out to be a key lever for profitability

Non-performing loan (NPL) ratios development in CEE 2007-2010e [% of gross loans]

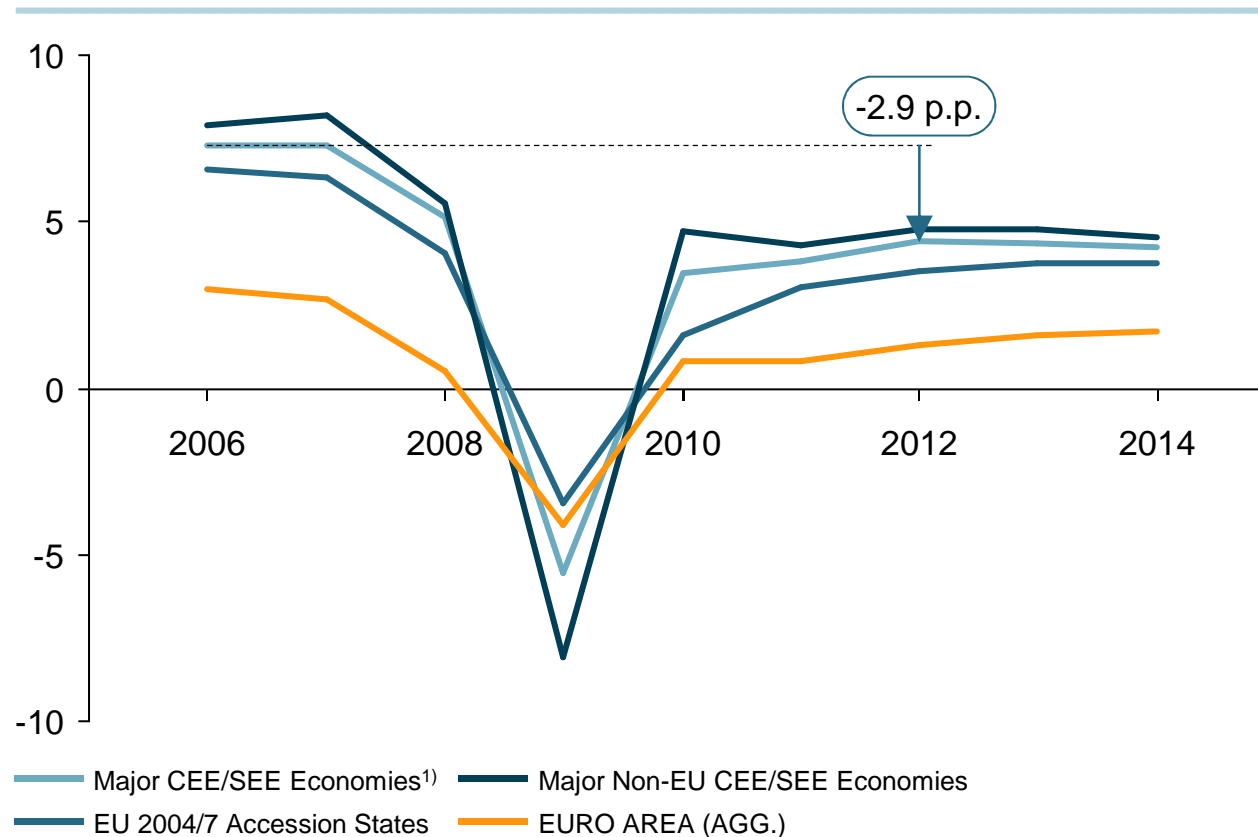


COMMENTS

- In most **CEE** countries **NPL levels** have **drastically increased** during 2009
- Being **focused on growth**, **debt collection** often was a **rather unimportant** area in many CEE banks **prior** to the **financial crisis**
- Suddenly however, **sound collection practice** turned out to be a **key lever** to **maintain** bank's **profitability**

Meanwhile the economic situation stabilized – However, CEE economies' growth rates expected to fall short of pre-crisis heights

GDP growth development in CEE vs. Euro area [% change p.a.]



COMMENTS

After a very tough year 2009 economic recovery is underway but long term economic growth will remain below pre crisis levels

Drivers of convergence still hold but are weaker than in the past:

- **Competitiveness** (but uncertain global outlook and competition from Asia)
- **Capital inflows** (but higher cost of country risk)
- **Convergence** in standards of living (but households sector delays recovery)
- **EU Funds** and infrastructural projects

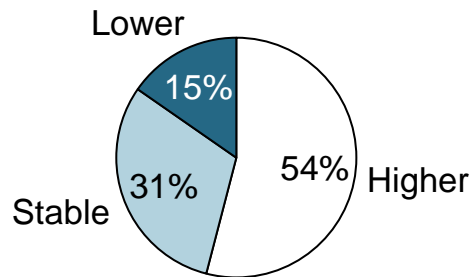
¹⁾ CEE/SEE countries selected (by 2010 real GDP): Russia, Poland, Czech Republic, Romania, Hungary, Ukraine, Slovakia, Croatia, Bulgaria, Serbia

The slowed down economies continue to exert pressure on loan portfolios – Importance of debt collection will remain high

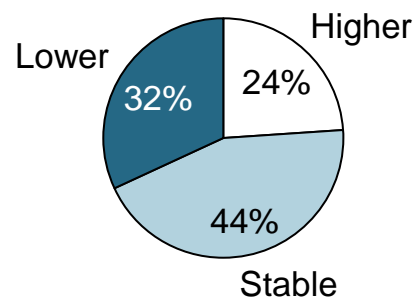
Outlook of credit portfolio quality development in CEE

Banks expectations on development of delinquency rates¹⁾

**Outlook:
Upcoming
12 Months**



**Outlook:
Upcoming
24 Months**



1) As of summer 2010

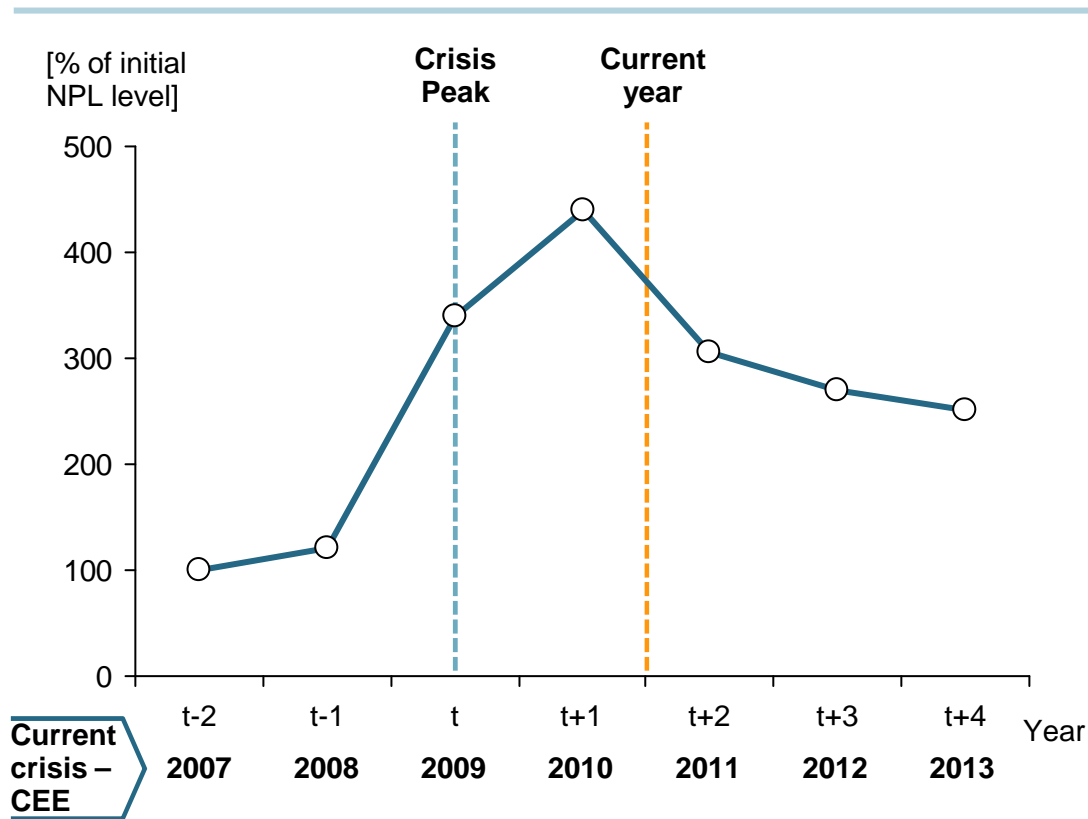
COMMENTS

- As recovery seems slow and growth appears to remain below pre-crisis levels, **85% of banks expect delinquencies** in the retail segment to **further increase** or at least **remain** at the **currently elevated levels** in the **short run** (until summer 2011)
- In the **medium term** (until summer 2012) banks are slightly more optimistic, however, still **two thirds** of banks do **not expect delinquency rates to ease**

Even in **post crisis CEE** collection will remain **key lever** to overall **bank performance**

Evidence from past emerging market crises confirm expectations that NPL ratios are likely to stay elevated for several more years

Non-performing loan ratio development under GDP shock in year t [% of initial NPL ratio]



COMMENTS

- **IMF analysis of past financial crises¹⁾** in emerging markets reveals **typical pattern of non-performing loan ratios** rising rapidly, peaking one year after the crisis, and then remaining high (> 200% of pre-shock levels) for more several more years
- **Current developments** and simulations for **CEE** markets indicate that **expectations** derived from **historical experience** are met

1) Countries used in IMF benchmark: Argentina, Chile, Colombia, Dominican Republic, Indonesia, Malaysia, Philippines, Turkey and Uruguay

B. Retail debt collection in times of crisis

Roland Berger
Strategy Consultants

The crisis suddenly put collection systems into spotlight – EFMA & Roland Berger conducted a survey to identify key success factors

Debt collection in times of crisis – Survey's objectives & scope

OBJECTIVES

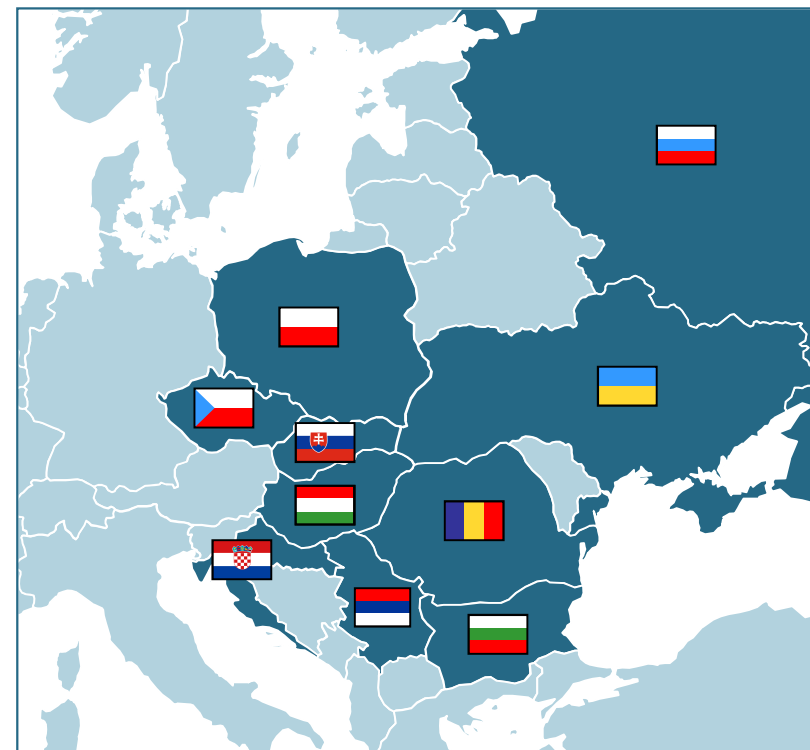
- Provide a **regional insight** on how credit institutions in CEE handle the collection of bad debt in their Retail¹⁾ portfolios, covering topics like:
 - **Impact** of the **financial crisis** on Retail lending and loan portfolio quality
 - **Processes & organizational set up** for managing distressed debt
 - **Outsourcing** of collection activities
- Provide a base for comparison of **regional players** in CEE along specific KPIs and identify **key success factors** and **improvement potential** in managing distressed debt

SCOPE

- **Interviews and statistical data of approx. 50 banks active in the CEE region** regarding their collection activities for distressed retail debt

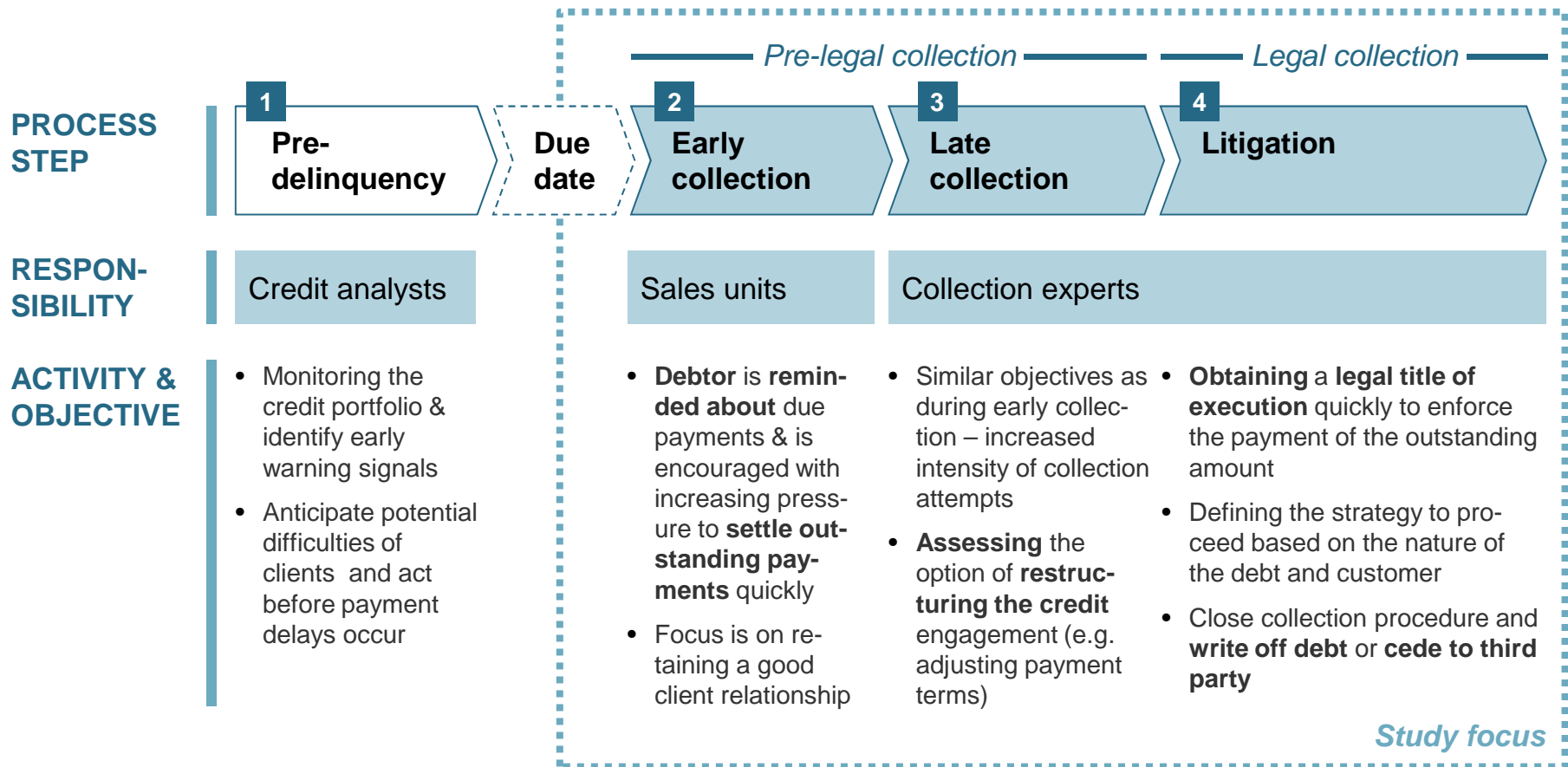
1) Private individuals, professionals & micro enterprises with turnover <EUR 5 m

COUNTRIES IN FOCUS



Our study focused on the collection process starting from due date to legal execution and write-off

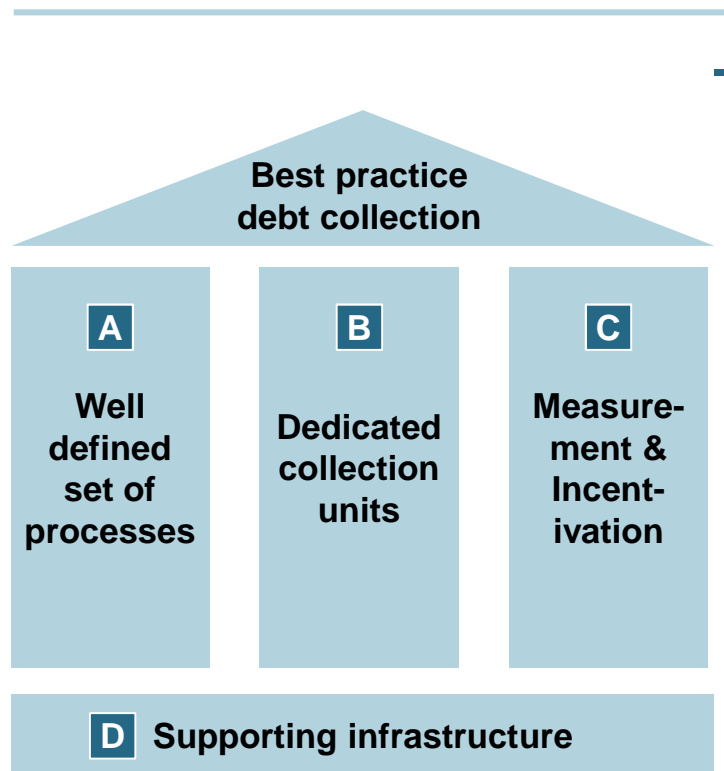
Study focus (schematic collection process)



B.1 Main pillars of successful retail debt collection

The study identified main pillars of successful debt collection practice – Not all of them are fully developed in CEE

Main pillars of debt collection



COMMENTS

A Well defined set of processes

- **Processes, responsibilities** and **competences** need to be **clearly defined** to minimize time lost on case handling
- Processes need to be differentiated to account for differences in client segments, products and risk

B Dedicated collection units

- Collection **units** need to be **specialized** to account for **differences** in approach for **different client segments**
- **Staff** needs to be **specialized** and **understand key levers of recovery** – Fluctuation should be kept low to build **required experience**

C Measurement & Incentivation

- **Efficiency of processes** and **performance of units** and **staff** need to be **transparent** and **tracked** down to individual staff level – **Performance** should **ultimately** be used as **part of incentive scheme**

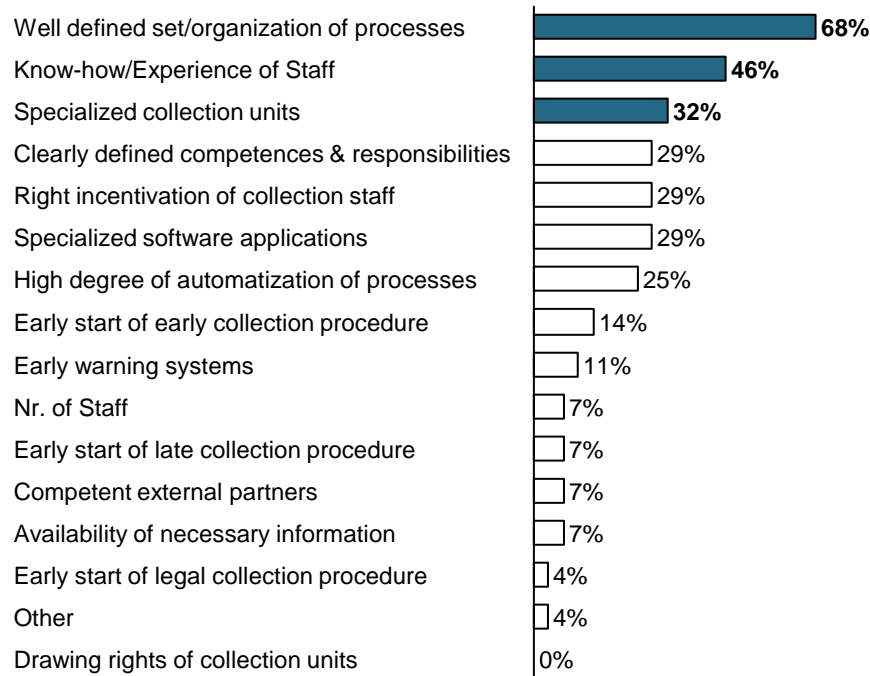
D Supporting infrastructure

- **Sufficient collection functionality** and **integration of IT Systems** is **crucial** to **enable efficiency** of operations and **enable effective controlling**
- **Frequent and standardized process steps** should be fully **automated**

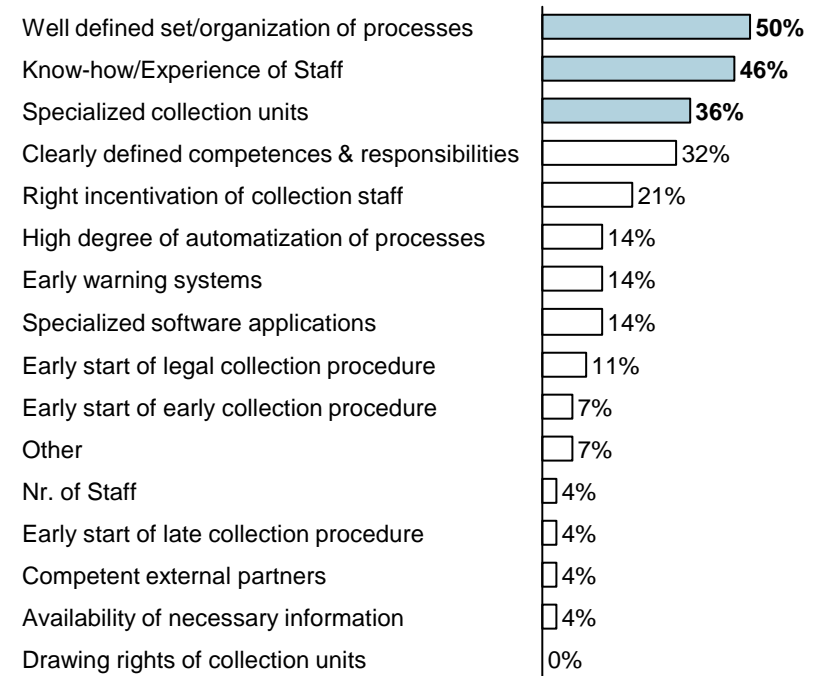
Key in retail collection: well defined processes & competences, specialized units with capable staff & sufficient system support

Key success factors (KSF) in retail debt collection [% of banks]

KSF in debt collection – Individuals segment



KSF in debt collection – Micro segment



Top 3 KSF individuals segment
 Top 3 KSF micro segment

Banks in CEE have tried different approaches to collection – some are highly recommendable, others should be better avoided

Do's and Don'ts in retail debt collection – Experience of CEE banks

+ Do's

- Use **'personal assignments'** (requires experienced staff) for **selected clients** (with higher exposures) – banks achieved up to 50% better RoI than with pure mass approach
- **Segment delinquencies & strategies:**
 - e.g. use **automated reminders** for **low risk accounts** while **focus personal contacts on risky exposures**
 - **Test different strategies & evaluate** using **champion/challenger** approaches (comparison groups)
- Constantly **monitor** your **portfolio** – if e.g. delinquencies increase in a client segment/product category quickly **adjust strategy** (e.g. **give higher priority, intensify treatment**)
- **Measure & reward individual performance** of staff – make results transparent (e.g. ranking system by weighted KPI's)
- **Follow up on payment promises tightly** – **educates** the **customer** that **payment behavior** is **closely monitored**
- **Outsource** collection activities **selectively** – cases where **expected recovery** is **low** or **unlikely** (particularly **late collection & intense measures** like field visits or litigation)
- **Use several** collection agencies, **benchmark** against each other and **distribute accounts based on their performance**

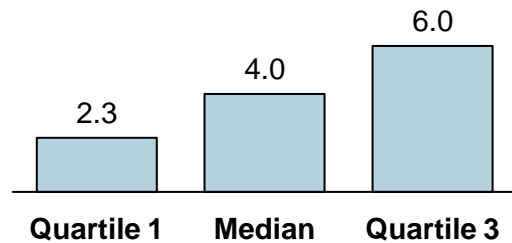
– Don'ts

- **Use sales staff** for retail collection – activity can be **more efficiently performed in central collection departments** and **sales staff** might have **difficulties getting tough on their customers**
- **Use too individualized process for every client** – after all, **retail collection** is a **mass business** and requires an **industrialized approach**
- **Attempt to contact low risk delinquent accounts starting from 1 day past due** – Many **accounts self-cure** within the **first few days** of **delinquency**
- **Go to court** before all other options have been exploited – Legal collection **costs time & money** and **recoveries are low**
- **Outsource all your collection activities** – **particularly in early collection** a well run **in-house** department can be considerably (in some cases 3-4 times) **more cost efficient** than using the services of external collection companies

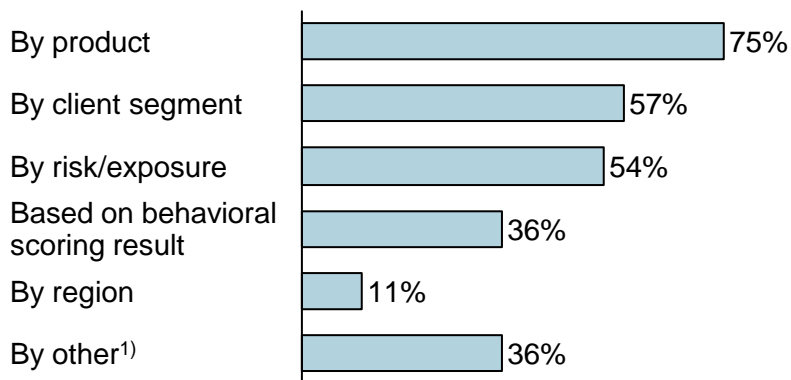
"One size does not fit all" – Collection processes need to be differentiated to optimize handling of different cases

Differentiation of collection processes in CEE banks

Nr. of collection procedures used [Nr.]



Differentiation of collection procedures [% of bank using criteria]



1) E.g.: Credit bureau score, relationship history, collateral type

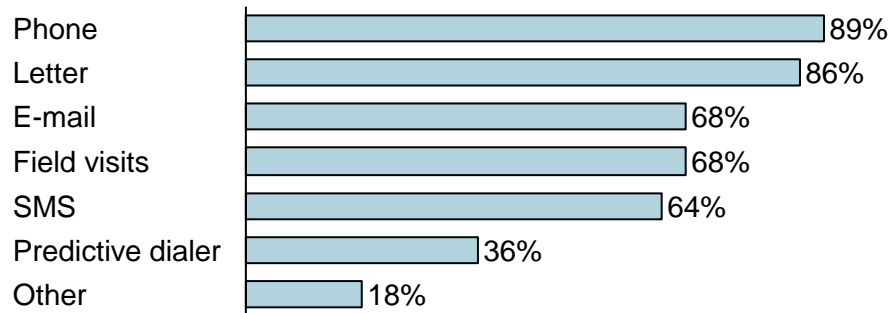
COMMENTS

- **Collection processes** need to be **differentiated** to enable **efficient** and **effective handling** of delinquent debt
- However, cases should not be treated completely individually – cases with **comparable characteristics** should be clustered into **groups of critical volume**
- **Ideal collection strategy** (best practice banks measure effectiveness of processes and adjust) should then be **defined for each group** – e.g. some clients are merely forgetful and only need a reminder, others are unable or unwilling to pay and require adequate handling, etc.
- In **CEE banks**, practices **range** from **almost no differentiation** to large **sets of processes & sub-processes**
- Most **common criteria** to **differentiate** processes are **product** and **client segment** – behavioral **analytics** are often **difficult** for CEE banks, due to **limited availability** of reliable **historical data**

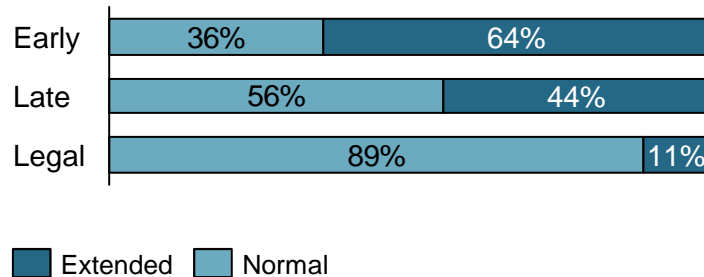
A multi channel approach combined with flexible contact timing can prove effective particularly in early stage collections

Communication channels and operating hours of collection departments

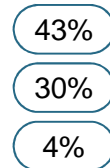
Communication channels used [% of banks]



Operating hours of collection departments by phase [% of banks]



Weekend operations



COMMENTS

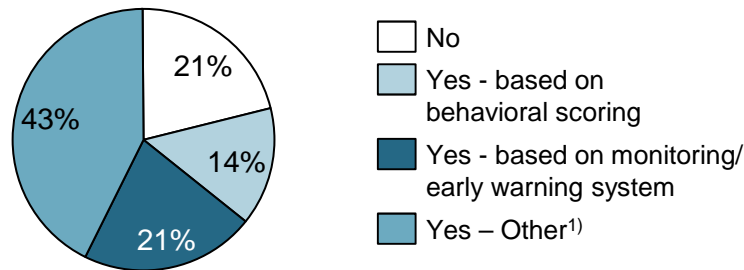
- **Establishing client contact** should take **minimum effort** – Particularly in early stage collection this can be effectively **achieved by use of different communication channels**
- **Phone** and **letter** are the **most commonly** used means of communication, however, **advanced call center technology** is **only used by roughly one third** of the banks
- **Cost effective** new tools like **SMS & e-mail** are used by **two thirds** of the banks

- **Accessibility** of clients is often **limited** during **regular business hours** – In early & late collection, strongly depending on client contact, collection **departments operating hours & capacity planning** needs to be **adjusted**
- In **Early** collection **~60%** (**~40%** in **Late**) of **CEE banks** operate collection units **also outside business hours**, **~40%** (**~30%**) also on **weekends**

When in doubt, it is better to start collections earlier than later – However, the right timing helps balance effort and effect

Preventive measures & timing of collection activities

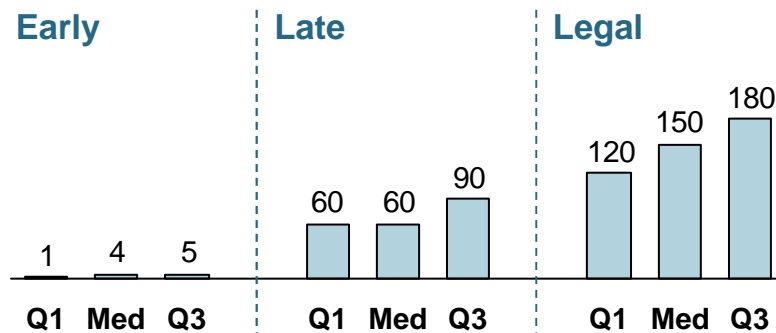
Preventive measures



COMMENTS

- **Identifying potential problems early** on can help to **prevent** an account go **delinquent** or at least increase **recovery**
- **Roughly 80%** of banks thus **take** some sort of **preventive measures**
- Out of these, **43%** use **mostly standardized reminder** letters/SMS
- **Banks using monitoring or scoring (35%)** also send reminders but **additionally call identified risky clients**

Average start of collection phases [dpd]



- In **early** and **late collection timing** is very **comparable** in CEE banks – Majority starts early collection at 0-5 days past due (dpd), Late collection is initiated mostly between 60 and 90 dpd
- **Right timing** can **increase effectiveness** of collection:
 - **Many delinquencies resolve** themselves **automatically** within few days after falling past due, so do not start too early
 - Collection **attempts** can be **more successful** at **certain points in time** (e.g. Monthly after receiving salary – these data are often available for the bank)

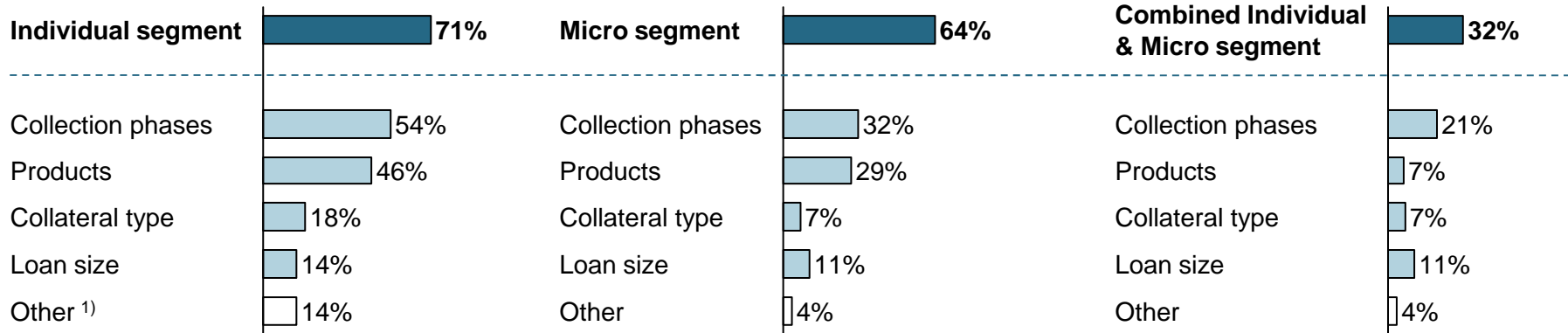
Q1 – Earliest quartile; Q3 – Latest quartile

1) e.g.: Based on product/exposure, by default for clients using SMS service, previous delinquencies

Collection requires specific skills & know how – Banks specialize units by client segment & further by collection phase or product

Organizational setup of collection units

Availability of specialized collection units for different client segments [% of banks]



- More than two thirds of CEE banks have collection **units dedicated** to **individual clients**
- Most banks **further differentiate** their collection units **by at least one more criteria**, mostly by phases

- Almost two thirds of surveyed banks have **dedicated collection units** for **micro clients**, further **specialization** however is **less** than in the **individual segment**

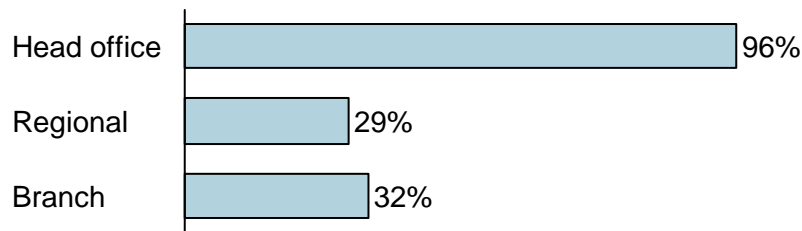
- One third of banks has **combined units** for micro and individual banks and **overall** shows **less specialization of collection units**

1) E.g. Behavioral score, credit bureau score, functions

Collection needs to be steered by central units to ensure consistent quality and efficiency of operations

Organizational setup and capacity of collection units

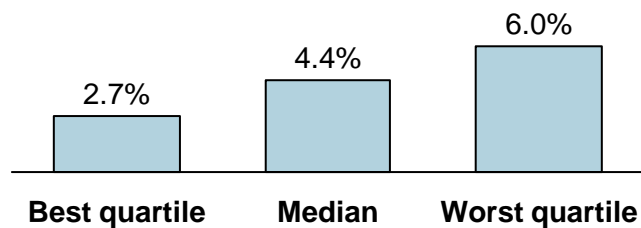
Positioning of Collection units within the organization [% of banks]



COMMENTS

- Almost all banks have **steering** and **most collection activities centralized** in the head office
- Collection **units on regional and branch level** are each used by **30% of the banks** – they are mostly used for **field collection, collection of certain loan volumes** or from **specific customer segments** (affluent individuals/micro)

Capacity of collection units 2009 [FTE in% of total]

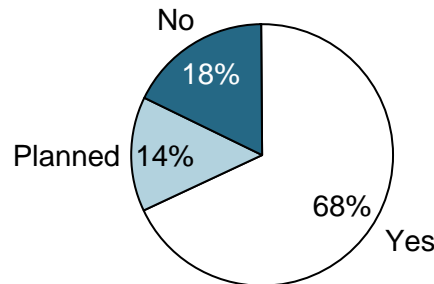


- **Staff capacity differs** strongly **between banks**, depending on level of automation and outsourcing, 50% of banks however have a **2.7% to 6.0% share** of their **staff in collections**
- Generally, share of **collection staff** strongly **increased during the crisis** – most banks increased collection Staff, often while reducing other staff

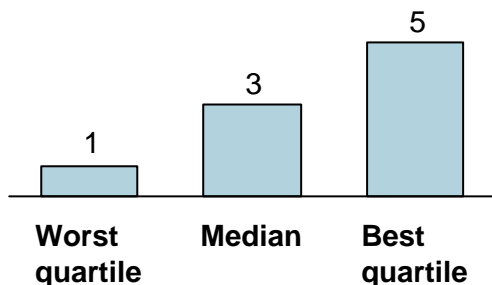
"What you measure is what you get" – Collection units and staff should be measured & rewarded based on collection specific KPI's

Performance measurement and staff incentivitation in CEE banks

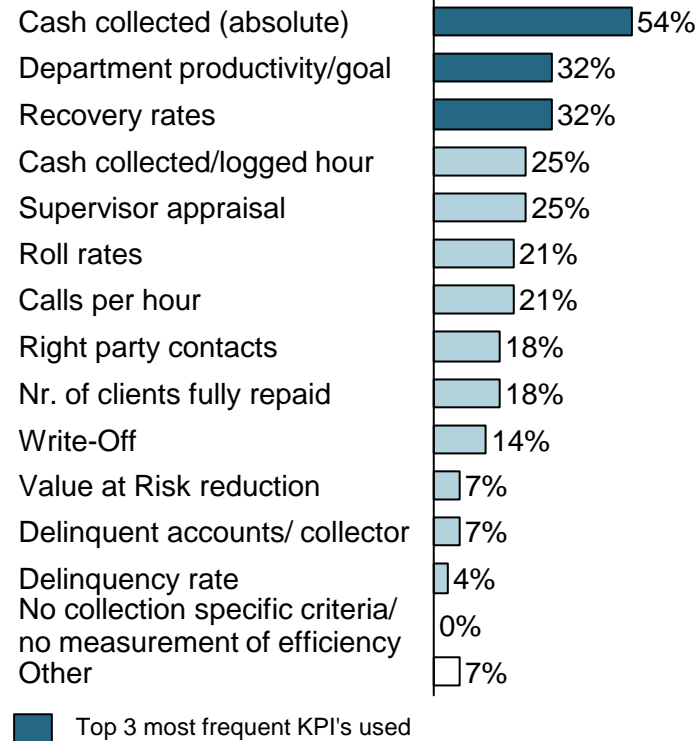
Usage of variable compensation [% of banks]



Nr. of KPI's used to measure performance [Nr.]



KPI's used to measure performance [% of banks]



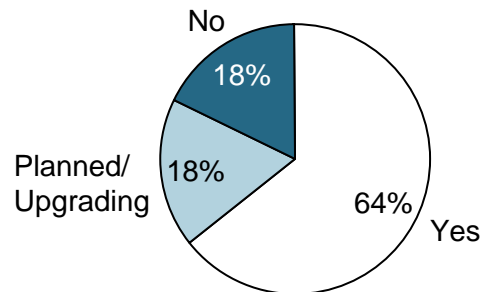
COMMENTS

- Adequate performance measurement and incentive systems a key driver for improving collection performance
- Staff performance needs to be measured and rewarded on individual level and based on pre-defined set of collection specific KPI
- Already 90% of CEE banks use or plan to use variable compensation as incentive for collection staff – however criteria and Nr. of criteria used differ strongly
- Level of variable compensation on most cases is capped, while ideally, there would be no upper limit

Specialized IT provides required information & analytics – Standard procedures can be automated for staff to focus on key issues

Usage and functional scope of collection software

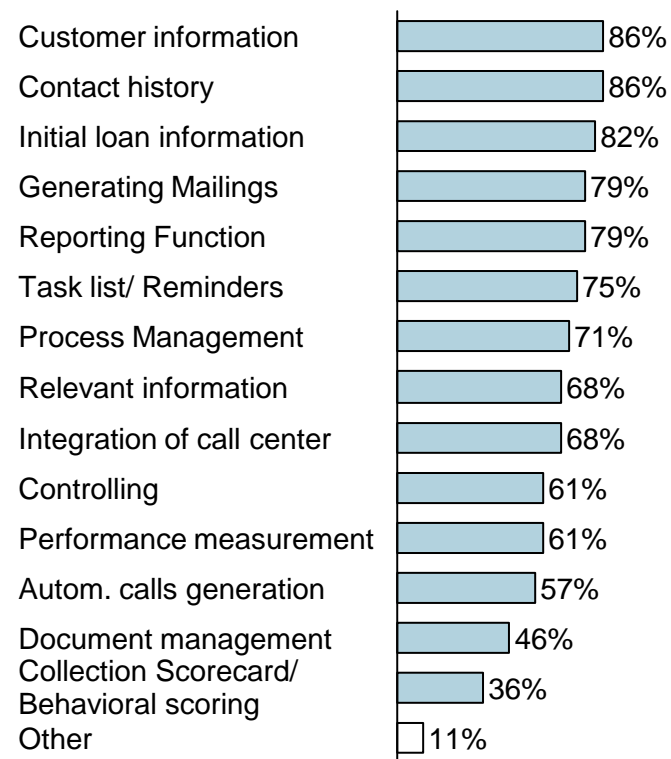
Share of banks using special collections software [% of banks]



Examples of systems used in collection:

- CACS
- Capone
- CDC
- Credex
- Debt manager
- Fasma
- GEMA
- IMX
- Oracle Sibel
- Tallyman
- Various In-house developments

Functional Scope of IT support [% of banks]



COMMENTS

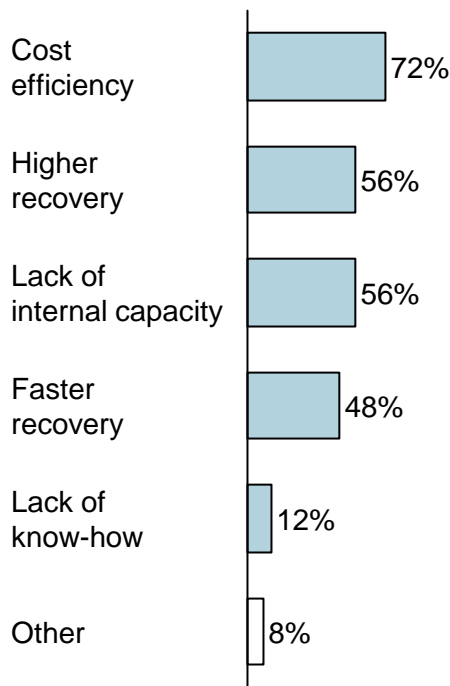
- **Data systems** are the **backbone** of **collection** – providing key data and analytics, enabling automation of processes, controlling and reporting and supporting workflow management
- Banks **CBS** however **usually do not** provide **adequate support** of collection activities **special modules** or **programs** required
- In the crisis **IT systems** **often proved** to be a **weak spot** – roughly **20%** of banks **currently introducing or upgrading** their collection **software**

B.2 Alternatives to own debt collection? – A view on outsourcing & debt sale

Banks do not necessarily need to handle collection themselves – 3rd parties can compensate lack of capacity & increase efficiency

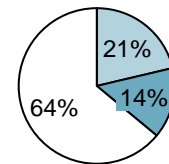
Usage of debt collection outsourcing in CEE

Main reasons to use outsourcing [% of banks]

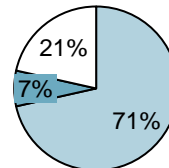


Share of banks currently using outsourcing in different collection stages

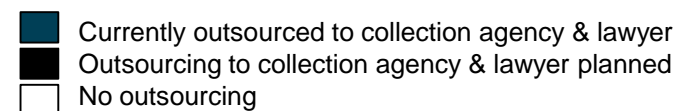
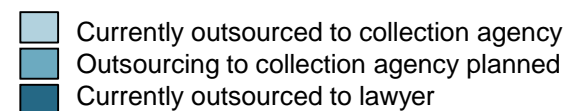
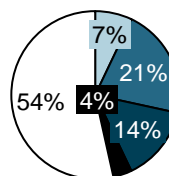
Early Collection



Late Collection



Legal Collection



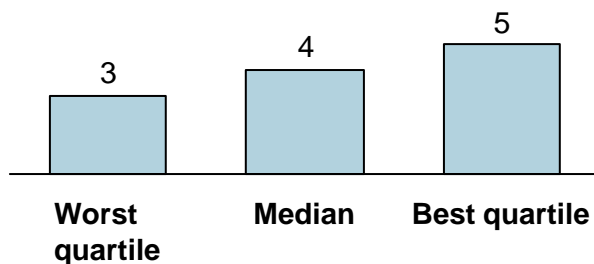
COMMENTS

- **Early collections**, containing most of the **easy to solve cases**, are **mostly handled inhouse** – only 35% of banks use or plan to use support of collection agencies
- **More than two thirds** of banks however **outsource late collection** (at least partially)
- 3rd parties mainly used due to **higher efficiency** or to **bridge internal capacity** restraints
- While banks **try to avoid legal collection** (long procedures & limited recovery) **more than 50%** handle **legal collection inhouse**
- As delinquencies increased, **nr. of banks considering outsourcing legal collection** however **increased by more than 60%**

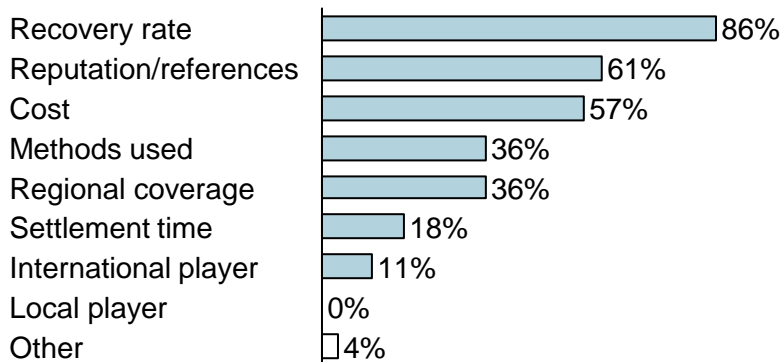
Using several outsourcing partners allows banks to benchmark both internal and external performance

Working with collection agencies

Nr. of collection agencies worked with [Nr.]



Selection criteria for collection agencies [% of banks]



COMMENTS

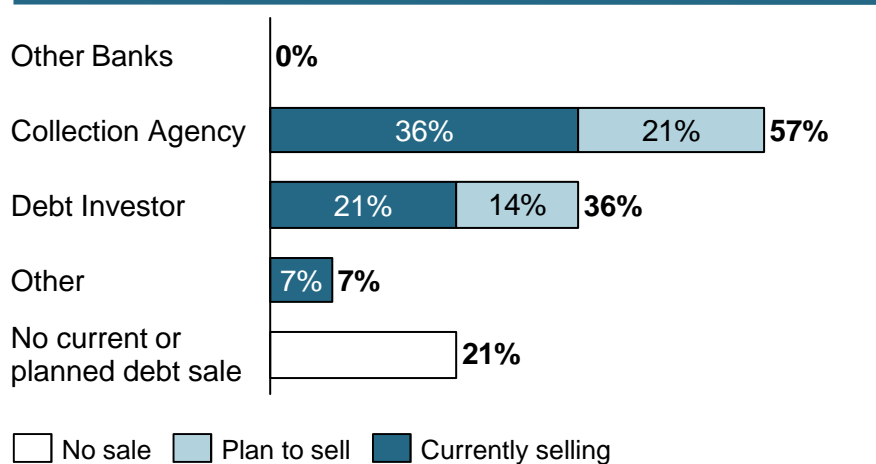
- Out of those banks actually outsourcing their collection activities at least partly the majority works with 3-5 agencies (or lawyers)
- Using several external collection agencies for comparable activities allows banks to benchmark costs/performance of the services provided – some banks even openly communicate performance among their agencies to foster competition
- Additionally, external agencies can serve as benchmarks for internal collection to assess internal performance as well

- In selecting agencies for outsourcing most banks refer to Recovery rate as selection criteria
- Outsourcing however bears significant reputational risk as banks have limited control over 3rd parties activities
- Selection should therefore be based additionally on several qualitative criteria and e.g. also take into account reputation and references of the external provider – currently considered by 61% of the banks

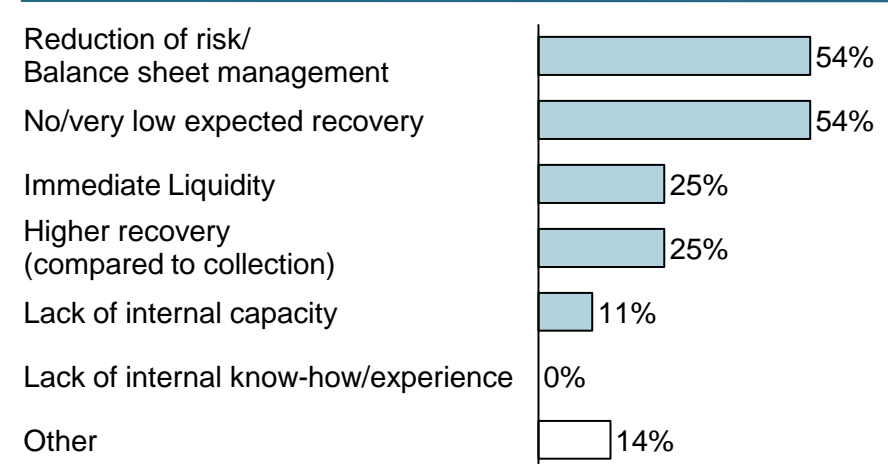
Selling delinquent debt can be an option to free up resources fast – As a result from the crisis plans to sell debt are on the rise

Level of selling debt to external parties

Share of banks selling debt to third parties



Main reasons to sell debt to third parties



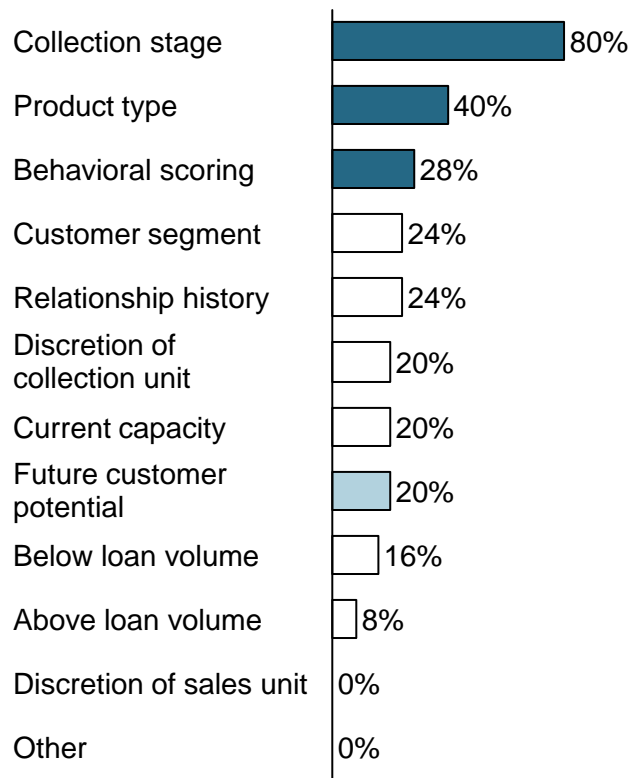
- Today **already 79% of banks sell or plan to sell delinquent debt** – In the course of the **crisis share of banks considering debt sale** has considerably **increased**
- At the same time, with high insecurity in the market, achievable **prices for distressed debt portfolios** have been **relatively low** (e.g. 10% of face value or less in Romania and Ukraine)

- **Selling debt** for most CEE banks is mainly used to **reduce risk/manage the balance sheet** or as a **measure of last resort** if **no or only low recovery can be expected** – if they still see potential banks collect themselves or refer to outsourcing

Outsourcing and debt sale can be used to the benefit of the bank – If used selectively and based on sound analytics

Criteria for deciding on outsourcing collection or sale of delinquent debt

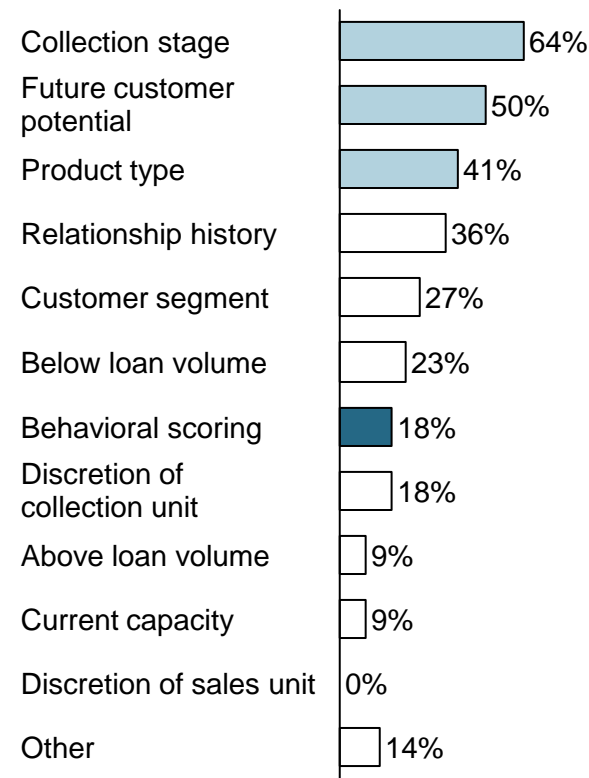
Criteria for outsourcing [% of banks]



■ Top 3 criteria outsourcing

■ Top 3 criteria debt sale

Criteria for debt sale [% of banks]



COMMENTS

- **Outsourcing and debt sale** of CEE banks is currently mainly based on **rather static criteria** like collection stage and product type
- **Selection of cases to outsource/sale** however should be **based on additional analysis**, e.g.:
 - Future **customer potential**
 - Probability/ **ease of recovery**
- Additionally, good **data systems** are **basis** to assess adequate **pricing**

Sound **analytics** are **pre-requisite** to reap full **benefits** from **outsourcing/sale** – improvement potential at CEE banks

C. Collections after the crisis – Conclusions for CEE banks

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Even after the crisis banks will need to keep an eye on their debt collection capabilities

Outlook: Debt Collection in CEE after the Crisis

Economic development in CEE stabilized but long term prospects below pre-crisis levels

Credit portfolios remain under pressure – NPL ratios are expected to stay elevated also mid-term

Debt collection will continue to be a substantial lever for banks profitability

Competition among collecting banks increases due to increased capacities & structural improvements

**Establishing/
Maintaining best
practice collection
capabilities will be
a differentiator of
winning banks, both
in recovery of the
loan and client
relationship**

Some CEE banks used technology to increase productivity and efficiency of their collection staff

Case Studies

CE: Using predictive dialer technology to increase Call Center productivity

- By introducing **predictive dialer technology** a bank in Serbia could **increase its call center productivity by 40%**
- Predictive dialers **systems call a list of telephone numbers in sequence**, screening out no-answers, busy signals, answering machines and disconnected numbers while **predicting** at what **point** a **human caller** will be **able to handle the next call**, thus minimizing idle time of the phone collectors
- The **bank's collectors work in shifts** to also **cover non business hours in the evening** – **shifts are rotated** every 2 weeks to **evenly distribute the peak times** across the collection teams and **decrease staff attrition**

CE: Increasing Efficiency through process automation & differentiation

- Through high level of **process automation and differentiation**¹⁾ a bank in Slovakia succeeded in running its retail collections with a **share of only ~1% of its FTE** (Median share of collection FTE in total ~4,4%) **even during the crisis**
- Based on **client segment, product and risk different collection processes** are initiated using **low cost communication channels** (automated SMS, e-mail & letters through central print center, Internet (Pop-up) implementation is currently being thought of) **for early stage & low risk cases**
- Also **loan restructuring offers** are **sent automatically** – if client starts to pay the new installment the system **automatically sets back delinquency** and **updates loan parameters** – personal follow up only if clients do not react

1) Combined with selective outsourcing & prudent risk management prior to the crisis

A SEE bank evaluates new procedures with "Champion-Challenger" principle – others "bought" experience from outside the industry

Case Studies

SEE: Experimenting and assessing new strategies using "Champion – Challenger" principle

- **Striving to continuously improve its collection practice** a SEE bank keeps **experimenting** and **adjusting its collection strategies** & approaches (e.g. adjusting segmentation & processes, personal assignments, outsourcing, etc.)
- To **assess the impact of changes** the Bank uses the **"Champion – Challenger" principle**. It sets up **two different groups** – **one operating** according to the **current procedure** ("Champion") while the **other group works with the new approach** ("Challenger")
- **After a while of running both approaches in parallel**, the **results are compared** and the **best alternative** is then **selected** – the **new "Champion"** is then **challenged again** by new alternatives

SEE: Recruiting experienced staff from mobile phone operators

- In the context of strong **economic growth** and double digit **increase of real wages**, **collection** was only of **minor concern** to most Romanian banks, **despite the retail lending boom** of the past years
- As the **crisis** brought significant financial stress on households, many Romanian **banks** found themselves **lacking capacity to cope** with rapidly **rising defaults**
- With the new **priority of developing internal collection capabilities** and too few experienced collection staff available, some **banks referred** to collection **experts from outside their industry**
- Being **known** for having **strong collection**, banks **recruited staff** from the **leading mobile phone operators** Vodafone and/ or Orange to **rapidly build capable collection teams**

The crisis has exposed the weaknesses in collection systems – Many CEE banks have started to adjust but still have a way to go

Conclusions for CEE banks

A Well defined set of processes

CEE **Best practice** banks use **diversified processes linked with analytics** to handle collection efficient & effectively – **Many banks** however are **not that far** yet and **first** need to **establish the analytical infrastructure (IT) & reliable data sets** in order to do so

B Dedicated collection units

Banks have **mostly** built **centralized** and **specialized units** for retail debt collection – and in many cases have **increased capacities** during the crisis – large **differences** in Staff **capacities** however **exist** and might **indicate room for efficiency improvement** – e.g. by **use of current communication technology, selective outsourcing or staff training**

C Measurement & Incentivation

Use of measurement and incentives nowadays is **common** in CEE retail collections – **still about 30% of banks consider** measurement and incentives one of their **weaknesses**. Banks should thus **review** their **measurement practice** and **consider** introducing **uncapped incentive systems**

D Supporting infrastructure

Many CEE banks **IT systems** collection **functionality** have proved to be a **weak spot** in the course of the crisis - reducing efficiency and effectiveness of operations and preventing use of advanced analytics. Today **one fifth** of the banks is already **upgrading** – **others** might be **well advised** to **review functionality** of their IT system **with a long term view**



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