Canaccede Financial Group

Maximize debt recovery effectiveness.

Insights to Assess your Current Debt Strategies

In combination with the effects of a pandemic, the Canadian economy is being impacted by high consumer debt levels, an unemployment spike, depressed oil prices and shrinking exports.

The question being asked by executives is what will be the duration and severity of a recession.

Given this market volatility, creditors need to have the right strategies in place to optimize recoveries during a recession, without excessive cost build-up. These strategies, well executed, could lead to sustained performance throughout the economic cycles. The key is to strike an appropriate balance between recoveries and overhead, while protecting the customer experience and the company's reputation. We have identified 8 recession proofing strategies;

1 | Problem Scoping

Re-assess your current debt recovery strategies

Take a hard look at your current debt recovery strategy. Your strategy may have been developed during a less volatile economic period. Policies may have been formulated without fully analyzing the impacts of recession cycles, and strategies may need to be updated with current industry best practices. Given current economic factors, we anticipate a heavy surge in debt flow and increased volatility. To scope out any potential problems with your existing recovery strategies, here are 6 key questions to consider:

- Are you set up to manage surging delinquency and charge-off volumes?
- How do you ensure there is sufficient capacity to manage rising volumes, without misdirecting resources if the surge does not materialize?
- How do you strike the proper balance between controlling fixed overheads versus maximizing recoveries?
- Do you have a balanced recovery strategy?
  - Standard 3rd party collection is becoming increasingly specialized – could it be potentially too restrictive as a sole means to properly recover consumer debts?
  - Debt Sale, poorly managed, can be disruptive to customer experience – can debt sale be used as a tool to manage debts and be more adaptable to consumer needs?
- Can you establish capabilities and best practices in debt sale to ensure readiness and reduce inefficiency when you need to?
- Can the risk of a debt surge be externalized to a third party, either completely by selling in forward flows, or partially by outsourcing processing to a leading service provider with sufficient economies of scale?

A sustainable recovery strategy should be regarded as a necessary investment to weather the storm. All creditors should have recession-proof recovery strategies in place to maximize recoveries and mitigate losses.

2 | Analytics and Technology

Lenders need to leverage analytics and technology to optimize their recovery strategies to strike a proper balance between costs and recoveries.

A good starting point in leveraging analytics is to understand your portfolios. Due to economic uncertainty and market volatility, multiple scenarios need to be examined to understand how portfolios will perform under different circumstances. Stress testing scenarios can help to determine how to treat specific segments of customers, as well as identify weaknesses in existing operational strategies.

There are a number of considerations for leveraging your data and analytics into recovery effectiveness:

- Conduct analytics to apply the appropriate collection tactics to relevant customer segments.
- Consider viewing non-performing loans as a portfolio for return optimization.
- Investigate the integration of a data infrastructure across all your product lines with standardized parameters and data format to ensure effective analytics.
- Address any known data gaps. Data integrity is key to maximizing both collections and debt sale proceeds.
- Append additional data from external sources to compare trends between your own inventory versus the market in general.

Coming out of a recession, advanced analytics and technology will continue to help creditors by providing the opportunity to increase lending to top performing customer segments as well as managing customers and their situations through the credit life cycle.

3 | Operations

Operational excellence can be easier said than done, especially in a recessionary environment when cost control is a key consideration.

Insights generated through analytics can be used to inform your operational tactics. It is important to assess your ability and readiness to optimize the value of your non-performing accounts in a cost-effective manner. Consider the following:

- Are you effectively establishing points of contact (e.g. mobile number, SMS, email, bonus programs)?
- What's your charge-off policy and are there any circumstances under which the charge off of an account would be accelerated or decelerated?
- Are your current settlement strategies, effective in optimizing recovery?
- How is your legal recovery strategy structured and how are accounts identified for legal action?
- Does your current allocation between internal and external collection channels optimize recovery, and how are accounts moved between them to minimize friction?
- Have your strategies gone through A/B testing to determine how different factors could optimize results, and scenario testing for performance under stress?
- Is there any scoring methodology that can be deployed to segment your portfolio for determining allocation of recovery strategies?

4 | Customer Experience

Establish a customer contact flow that appropriately reflects your corporate values and mission.

It is important to understand your customer segments and factor these differences into your collection strategies. In a recession, more delinquencies and defaults will be event-driven. Creditors need to craft an optimized treatment plan. This can lead to an improved customer experience and better repayment cycles.

5 | Fraud

As companies engage in remote working protocols and individuals seek financial help, there has been an increased level of phishing, scams and fraudulent activities.

Fraudulent activities spike up during uncertain times. It is critical to monitor your portfolios throughout the lifecycles, and tailor treatment strategies to different types of fraud. It is important to establish an effective early warning system to detect suspicious activities and shut them off on a timely basis. Below are several measures that can be undertaken on revolving products:

- Initiate alerts with defined thresholds to support the detection of large-scale fraud attacks on credit cards (example: BIN, card-not-present, merchant misuse, system failure, POS attacks) .
- Assess daily declined transactions and settlement volumes against historical patterns to identify any emerging patterns.
- Vulnerability scans should be conducted regularly by emulating criminal transaction behavior against authorization network.
- Review fraud decision rules regularly to ensure they are up-to-date and work as intended.

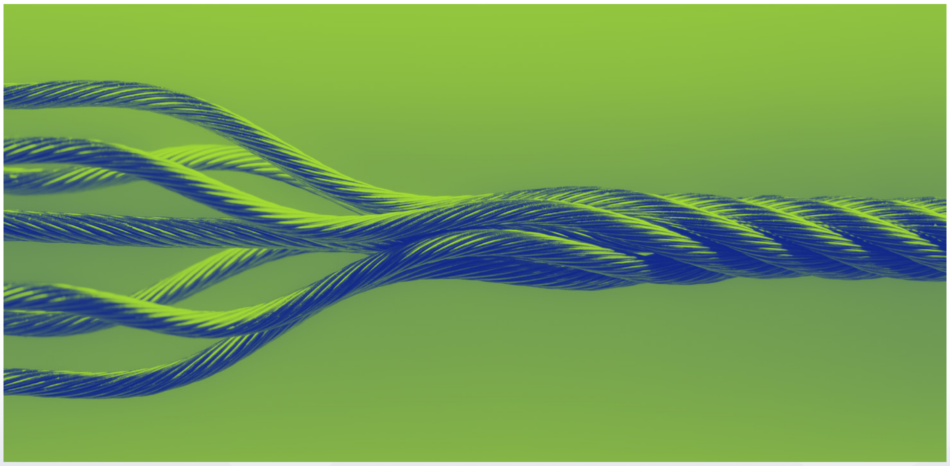
6 | Flexible Capacity

Establish a flexible operating structure that can adjust to accommodate the ebb and flow of shifting debt sales.

Establishing a flexible operational model allows you to manage volatile debt volumes by adjusting resources to meet your needs and reduces the potential cost impact of more rigid fixed overhead models.

Flexible capacity is the ability to process units at different rates by varying resource levels. In a recession, you need to assess whether there is risk of being unable to manage surging non-performing volumes with limited internal resources or external agencies without sufficient scale, especially since it may not be easy to hire experienced staff quickly. This risk can be externalized to a third party, either completely by selling in forward flows, or partially by outsourcing processing to a leading servicer provider with sufficient economies of scale.

Flexible capacity can include the integration of an outsourcing solution from a service only to a service-and-sale model to provide the most comprehensive solution. This model blends the economics of multiple functions to optimize recovery value for the creditor.



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7 | Debt Sale

The strategic use of debt sales can accelerate recoveries in a cost-effective manner, especially in the face of surging defaults.

A lender must ensure its debt sale strategy is sustainable and can be deployed flexibly according to its loss provision and capital needs. Here are the key points to think about in any debt sale to help ensure capitalize on opportunities to optimize returns in the long run.

Preparations

- Identify loan segments based on age and identifiable pre-treatment strategy
- Perform non-conforming scrubs to remove ineligible accounts – fraud, deceased, commercial, etc.
- Generate net free-cash flow estimates for the inventory based on historical experience
- Generate anonymized historical liquidation data for comparable account segments to share with buyer
- Prepare a standardized purchase and sale agreement for buyer review, or have buyers supply a sample
- Determine the bureau posting and logging in local system of records related to sold accounts
- Leverage vendor management systems in the provision of operational delivery items:
  - Receipt and distribution of direct payments received by the bank through online banking
  - Media and documentation request fulfillment required to prove claims

Sale Process

- While sale price is a key factor, you should also carefully consider the execution capabilities of your buyer such as operational capacity and financing wherewithal, especially for forward flow arrangements.
  - Consider whether the debt buyer has the right procedures and infrastructure in place to manage debtor relationships, protect your reputation and even potentially refer customers back to you once credit is rehabilitated.
- Debt sale could vary between auction and direct sale, with important considerations for an auction such as number of rounds, minimum price threshold, bidding mechanism etc.
- The more transparent your disclosures, the more sustainable the sale price that is established.
- Important disclosures include your pre and post charge-off treatment and sale file selection criteria, which could greatly impact the remaining value of the file.
- Can you redeploy lump sum sale proceeds effectively, or would you rather receive proceeds in installments to optimize returns according to your capital deployment schedule?

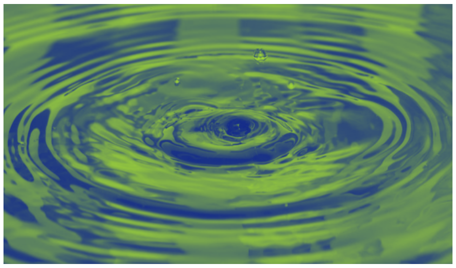
Evaluation

- Execute sale and monitor on an A/B testing basis to see performance of sold vs retained receivables
- Evaluate success based on:
  - Receipt and distribution of direct payments received by the bank through online banking
  - Media and documentation request fulfillment required to prove claims

8 | Impact on Returns

As IFRS and Basel rules require default accounts to receive full equity allocation on a Bank's financial statements, recoveries need to be discounted at the lender's return on equity levels for current valuation.

When evaluating strategies for default accounts, the discount factor applied against free cash flow is the Bank's equity return. As a result, recoveries associated with non-performing receivables are net dilutive to financial results, making it advantageous to capitalize on discount rate arbitrage and divest in the accounts rather than realize on them.



Canaccede Financial Group is the largest multi-asset acquirer in Canada and we are part of the global Jefferson Capital Systems team. We are a debt servicing and purchasing solutions provider that helps companies accelerate corporate cash flow.

Our expert valuation team will work with you to size the debt recovery potential for your organization. If you, or someone in your organization, would like us to set up a review meeting, please contact Canaccede at **1.844.846.0440** or at partnership@canaccede.com.