

The New Normal for Collections & Recovery



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Contents

COLLECTIONS & RECOVERY FACES A NEW NORMAL.....	3
CLASS OF COVID 19: COLLECTING STUDENT LOANS IN A PANDEMIC.....	4
CONSUMERS HIT THE BRAKES ON AUTO LOANS.....	6
COVERING CORONAVIRUS EXPENSES WITH CREDIT CARDS.....	8
MANAGING COLLECTIONS IN A PANDEMIC.....	10

Collections & Recovery Faces a New Normal

You have heard it so often recently that it sounds cliché – we are living in unprecedented times. Unfortunately, the cliché is also truth. The coronavirus pandemic has impacted global health, and measures taken to contain the spread of the virus have shaken the foundations of the global economy.

In the United States, the economic impacts of our national lockdown have been both swift and severe. Tens of millions of Americans have filed for unemployment since March, and the economy is sputtering as states ease their restrictions on businesses and residents.

Before Covid-19 hit, Americans and American businesses were enjoying a huge economic expansion. Twelve years of uninterrupted growth had consumers spending more, and in many cases accumulating more debt. By the end of Q3 in 2019, Americans were holding nearly \$14 trillion in debt.¹

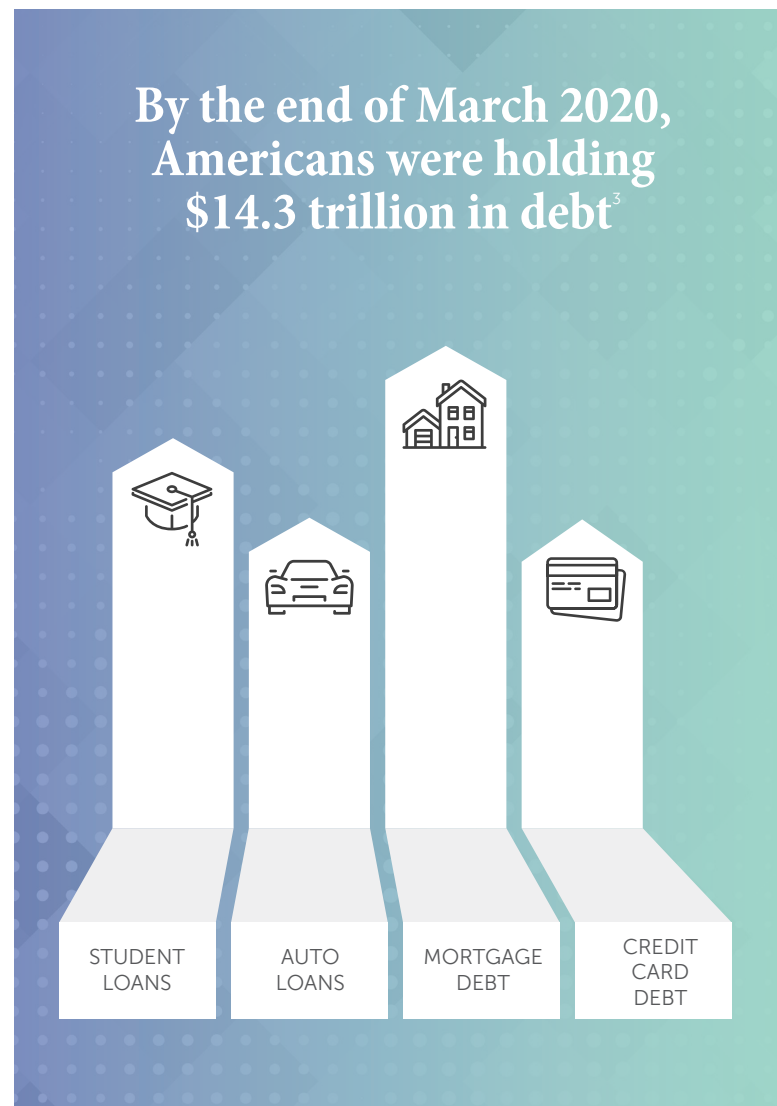
Nearly two thirds of that was mortgage debt, “a level that has remained relatively stable in the last few years.”² Student loans accounted for the second largest category of debt, followed by auto loans and credit card debt.

By the time the virus was a full-blown pandemic in March of 2020, Americans had added hundreds of billions of dollars to their outstanding debt, bringing the total to \$14.3 trillion.³ That level of debt is higher than the GDP of every country on earth other than the US,⁴ leaving debtors holding a very heavy load.

For those facing financial hardship from pandemic-related unemployment, that debt is even more burdensome. Many people saw income disappear overnight as mandatory business closures went into effect. That impacted their ability to pay for essential goods like gas and groceries, much less make payments on outstanding debt.

Many banks and other financial institutions (FIs) recognized the magnitude of this situation early on, and began offering forbearance, delayed payments and fee forgiveness for outstanding loans and lines of credit. Debt collection activities have also been reduced or suspended in many cases, but the stark reality is that sooner or later, payments will come due.

When FIs do resume the business of collecting debt, they will be in the unenviable position of holding cash-strapped consumers to the terms of their credit. For companies that will be collecting on student loans, auto loans and credit card debt in default, what are the implications? Are they in the best position to adapt to the new normal and compassionately and fairly pursue collections?



Class of Covid 19: Collecting Student Loans in a Pandemic

Student loans represent a tremendous amount of debt in the United States. As of February 2020, total student loan debt stood at \$1.59 trillion, passing auto loans and credit cards to become the second largest category of debt in the country.⁵

More than 44 million Americans hold student loans, owing on average between \$20,000 to \$25,000.⁶ Borrowers between the ages of 18-39 owe about \$860 billion, or 57% of the total outstanding loan amounts.⁷ Clearly, student loan debt is a significant economic factor for borrowers, lenders and the economy at large.

FEELING THE PRESSURE

For many student loan holders, the last 15 years have been particularly challenging. The Great Recession in the late 2000's dealt a hard blow and pushed national unemployment up to more than 15 million individuals.⁸ During that time, the job market was thin and did not offer much reprieve from the weight of debt.

Today, we are in uncharted territory. Many of the same people who weathered the financial crisis of 2008 are now facing an even larger financial crisis. And those people are still holding that same student loan debt, with bleak prospects to find and start the work desperately needed to make payments.

It is a sobering reality for individuals who invested in their education. Not only are people holding heavy debt – their earnings potential is facing a squeeze. As an article in The Atlantic notes:

“Every 1-percentage-point bump in the unemployment rate costs new graduates 7 percent of their earnings at the start of their careers, and 2 percent of their earnings nearly two decades later.”⁹

That is a toxic combination, especially since federal student debt was not in great shape prior to the pandemic. At the end of 2019, the US Department of Education reported “that about 20 percent of borrowers are in default—typically defined as having gone at least 270 days without a payment—millions more are behind on their payments, and more than a million loans go into default each year.”¹⁰

Private student loans are another matter, but still face many of the same issues. Outstanding private student loans in deferment stand at 18.34%, while those in forbearance and default sit at lower rates than federally backed loans (2.25% and 1.46% respectively).¹¹ Lenders will also often provide options for refinancing, and they benefit from the fact that private student loans cannot be excused in a bankruptcy.

But borrowers are still facing tremendous debt, soaring unemployment and a looming wave of default. Is there good news?

ENTER THE CARES ACT

In a word, yes. When the pandemic flared up in March, the government quickly drafted and passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). Under the terms of this legislation, payments and interest accrual have been suspended for federally-held student loans through September 30, 2020.¹²

For federal loan holders, no action is necessary as the payment suspension is automatic. The law further states that collections efforts for federal loans already in default must be halted, effectively meaning that “wages, tax refunds and Social Security benefits will not be garnished during this period to pay for federal student loans.”¹³

That is welcome information for any borrowers who found themselves in default, although it doesn't mean loans are forgiven. The law also does not apply to private student loans, although many lenders are working with folks to provide options for those impacted by this pandemic.

Other lifelines for student debt holders are the absence of a negative impact on credit scores for non-payment of federal student loans, and the ongoing public service loan forgiveness program. Some states have added their own debt relief items as well; Colorado, for example, is offering “options [that] include providing a minimum of 90 days of forbearance; waiving late payment fees...and working with borrower to enroll them in other assistance programs, such as income driven repayment plans.”¹⁴



Consumers Hit the Brakes on Auto Loans

In recent months, "auto loans [have been] emerging as one of the hardest-hit categories of credit amid the coronavirus pandemic."¹⁵ Total auto sales are down, with a 39% year-over-year drop in March.¹⁶ That reduction marks "the lowest volume in March for over a decade"¹⁷ and shows no signs of slowing.

With fewer vehicles leaving the lot and consumers grappling with lost income, are auto lenders facing a bump in the road or a full-blown crisis?

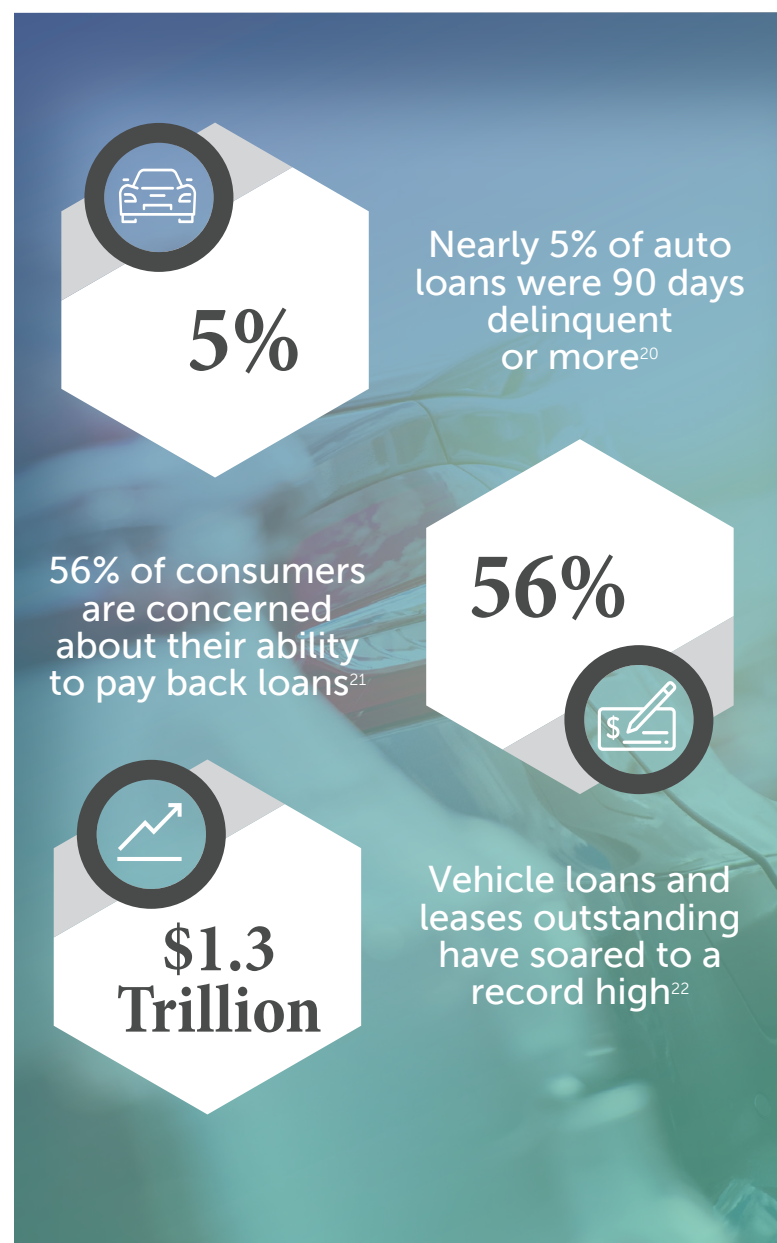
DANGEROUS CURVES AHEAD

The auto loan market had already flashed some warning signs as 2019 came to a close. A recent article from the American Banker's Association¹⁸ noted that Q4 delinquencies in both direct and indirect auto loans were rising. While the direct auto loan delinquencies were still below pre-recession levels, indirect loans "rose 13 basis points to 2.56 percent of all accounts, above the pre-recession average of 2.03 percent."¹⁹

The Federal Reserve Bank of New York noted that in Q4 2019, "[n]early 5% of auto loans were 90 days delinquent or more in the fourth quarter of 2019 — the highest 90-day loan delinquency rate in more than seven years."²⁰ And a May 2020 survey by Lightico "found that 56% of consumers are concerned about their ability to pay back loans in the coming months."²¹ Factor in the economic impacts of the novel coronavirus, and auto loans could well be one of the most significantly delinquent categories of debt.

It is not just the delinquency rate that is concerning lenders; it's the total amount of outstanding debt held in auto loans. According to a recent Experian report, vehicle loans and leases outstanding have soared to a record high of \$1.3 trillion, and auto loan balances have grown by 81% since 2009.²²

Compound all that news with the fact that "subprime borrowers account for 22% of outstanding automobile-loan debt"²³ and you can see why auto lenders are concerned about the future.





LENDERS ARE SHIFTING GEARS

While lenders may feel like they are barreling towards a blind curve, many are taking proactive steps to help mitigate potential fallout from loan delinquencies. One of the first steps: offering forbearance for loan customers.

The Wall Street Journal recently reported that lenders are seeing increases in auto loan forbearance, with “the median amount of lending in forbearance reported after the first quarter ... at 7.5% for auto loans”.²⁴ Ally Financial reported that a quarter of its auto loan customers requested forbearance, and of those “more than three-quarters have never asked for a deferral before and 70% have never had a late payment with Ally.”²⁵

Other steps that lenders are taking include offering new borrowers deferred payment options, giving them up to 90 days to make the first payment on a new loan. Some are extending lease agreements and loan terms, to allow consumers more time to meet their financial obligations. But in general, auto lenders are gearing up for a significant increase in delinquencies and defaults as the economic impacts from the pandemic continue.

Covering Coronavirus Expenses with Credit Cards

As of May 2020, almost “half of US adults (47%)...have credit card debt, up from 43%...in early March.”²⁶ Not only are more consumers holding debt, they are holding more of it – current estimates for outstanding credit card debt are approximately \$1.07 trillion, with an average of just over \$7,000 owed per household.²⁷



47%

In May 2020, nearly half of US adults had credit card debt²⁶



\$1.07 Trillion

Estimates for outstanding credit card debt (May 2020)²⁷



\$7,000

Average credit card debt owed per household (May 2020)²⁷

Not helping matters is the fact that many people who lost their jobs are turning to credit cards to cover essential expenses, further adding to their outstanding debt. Nearly a quarter of “U.S. adults with credit card debt have added to it during the pandemic”.²⁸

This reality is weighing heavily on people. A recent survey indicated that 45% of debtors are stressed about credit card debt, and 15% are “very” stressed about it.²⁹ That stress is particularly acute in younger Americans; 34% of millennials with credit cards “say they went more deeply in debt because of the pandemic” as compared to only 23% of Generation Xers and 15% of baby boomers.³⁰



How are card issuers reacting?



Short & long-term payment plans

Waiving fees



Allowing payment delays of 2-3 months

PAYING IT BACK?

As consumers rack up credit card charges and the related stress, they are faced with hard choices, including when and how to deal with the additional debt. 60% of recent survey respondents are planning to make more than their minimum payments, while others are looking to transfer balances to lower APR cards. Some will make the minimum payments, some will look for credit counseling, but a worrisome minority (13%) “either don’t plan on paying anything (9%) or don’t have a plan at all (4%).”³¹

Fortunately for debtors, card issuers are also taking proactive steps to help. Many are offering payment deferral or forbearance, giving consumers some much-needed breathing room. Issuers are also offering cardholders different short- and long-term payment plans, waiving fees, and allowing payment delays of two to three months.

Consumers also got some help in the form of Federal stimulus checks earlier this year. For many individuals, though, that money would better used to pay for essentials like groceries and gas. Ted Rossman, analyst from Credit Cards.com, recommends holding on to the stimulus funds versus paying down card debt: “You’ll want to have cash on hand just in case. Don’t use all of it.”³²

POST-COVID REALITY

For the last 12 years, card issuers have been on the leading edge of an economic expansion – and have not had to fundamentally change much about collections. That is all shifting as a result of the pandemic and subsequent economic fallout, and issuers very well may be facing a tsunami of delinquent accounts.

An April 2020 forecast from UBS posits that “[u]p to \$110 billion in credit card debt...would reach delinquency” if national unemployment rate reaches 12.6% by the end of 2020.³³ While the current national rate is in flux, the rapidly changing employment landscape leaves a lot of questions unanswered.

Managing Collections in a Pandemic

For lenders facing the potential for significant loan defaults, there is seemingly little to cheer. As accounts potentially move into collections, issuers will have to navigate new federal and state legislation, changing customer expectations and different contact channels than they did in 2008.

Without a modern, flexible collections system, they may face challenges like segmenting portfolios and not reaching customers through their preferred channels. Moving too quickly, and pushing too hard, could have negative consequences for both lenders and borrowers.

Companies that embrace a proactive, strategic approach – supported with a flexible, enterprise-level collections and recovery solution – can take control and work with their customers to improve loss mitigation. They can also create seamless experiences for their customers, which can have a significant impact on retention. Borrowers are “[a]ccustomed to effortless digital services in all other aspects of their lives...[and] they expect the same from their...lenders.”³⁴


Unfortunately, many of the systems supporting collections and recovery today are limited and rigid, forcing companies to use a single approach that does not necessarily work for their entire portfolio. These companies need an alternative – a nimble solution that can quickly adapt and empower users to automate processes and explore different contact and collections strategies.

Those that have invested in the right technology will be able to employ more flexible pursuit plans, use different outreach channels and adapt to unique individual circumstances. Collections and recovery professionals will need the ability to bring in the best data, tie to multiple outreach channels and enable their teams to use all the tools at their disposal to work carefully and empathetically with borrowers in default.

With a Zoot collections and recovery solution, companies can have total control. They can segment their portfolios and prioritize recovery efforts. They can target different cohorts based on customer and loan characteristics, identify and test new collections and contact strategies, and limit access based on user groups to manage risk.

Using Zoot, FIs can create an environment that supports their unique workflow. Zoot is committed to making it easy for our clients to enhance and automate collections, from pre-delinquency through recovery.

Ready for a solution that will grow and adapt with you? You're ready for Zoot.



The right technology will empower lenders to employ flexible pursuit strategies, use different outreach channels and adapt to unique individual circumstances.

ABOUT ZOOT


For over 30 years, Zoot Enterprises has been a global provider of advanced origination, acquisition, and decision management solutions. Our customer-centric tools and services enable Zoot's clients to add value and differentiation, while providing nimble, scalable solutions for specific business objectives.

A leader in the fintech industry, Zoot's cloud based secure processing environment delivers millisecond real-time decisions accessing hundreds of cutting edge data sources to help reduce risk and increase conversions.

Our international client base includes major financial institutions, retailers and payment providers. Zoot's network is distributed across three world-class data centers and provides unmatched security, redundancy and flexibility.

At Zoot, our promise is simple: To make our clients successful. We work closely with the top financial institutions in the world to deliver state-of-the-art solutions that satisfy the most demanding decisioning needs.

Contact Zoot today to learn more about how our proven solutions solve the most complex credit decisioning and loan origination needs and deliver ROI, while helping mitigate risk.

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