Changing dynamics:

Protecting your portfolio as the pandemic plays out

June 2020

EXPERIAN INSIGHTS

Using the power of data to help you

ADAPT, SURVIVE AND THRIVE

Contents

Turbulent economic times

With crashing consumer confidence, a period of enforced business closures and life as we know it very much changed, the coronavirus pandemic has created huge shifts in underlying borrowing characteristics and credit portfolio dynamics. Economic recovery will inevitably take time, and it begins by creating genuine clarity about the challenges ahead.

Whatever sector you're lending in, uncertainty is swirling. The housing market is slowing, emerging from a virtual standstill, car sales have been almost impossible and insurance providers have been riding a months-long rollercoaster of shifting risk, with travel claims soaring but theft and motor payouts taking an unprecedented tumble.

Of course, firms aren't alone in feeling these economic effects. While the crisis is hitting some regions harder than others, wherever you operate, one thing is clear – consumer incomes are changing – quickly, dramatically and in a way nobody had time to predict.

Across many industries, in particular aviation, travel, leisure, retail and hospitality, people have been unable to work for weeks, and millions more in the UK's gig economy are struggling without support. Despite the government's furlough scheme, these significant changes have meant that 40% of the UK population have experienced pandemic-related income shock.

Many more still remain at risk. Throughout the summer, unemployment looks set to reach levels not seen in two decades, and while we believe these numbers will fall as 2020 goes on, they're another powerful way in which the pandemic has the potential to upturn lives, change priorities and destablise portfolios.

Understanding what you're up against

Here at Experian, our economists believe these evolving consumer circumstances will impact credit providers' performance across a multitude of dimensions, including account-related fees, changes to interest revenue, credit losses and higher expenses.

What's inevitable, is that they won't impact all portfolios equally. How hard you're hit will, of course, depend on your sector specialisms, your customer base, and how pandemic recovery ultimately unfolds, but getting ahead of the problem means understanding how things are changing, in as close to real-time as possible. That needs to start now.

41%

INCOME SHOCK

On a sample population of 16m current accounts, 41% showed an income drop of greater than 10% between March and April.

INCOME STABILITY

In May, 8.7m people were reportedly furloughed. Of the 41% of accounts which showed an income drop of greater than 10% between March and April, 57% were in the 'furlough range' of 10-39% income drop.

57%

3.5m

INDEBTEDNESS

Between March and April, 950k accounts deteriorated from current status to 1 cycle overdue. The account holders of these accounts held a further 3.5m current status accounts in April with other lenders.

A closer look at KPIs

When it comes to understanding what the pandemic means for your portfolio, one of the fastest ways to get started is with the data you already have at your disposal.

The KPIs you routinely gather can to tell you what's happening – and help you shape a strategy that takes you forward. These readily available KPIs can reveal more than you might realise, if you analyse them with specific new questions and contexts in mind.

For example, if your most vulnerable customers begin to run into trouble then it could now be a signal that other customers aren't far behind. So, identify them based on immediate economic impact, then monitor their data for signs of stress. These include falls in income, a shift in spending to high-priority items, new or unauthorised overdraft use, greater reliance on savings or an appetite for high-cost loans. It could also include requests for payment holidays, or a slip into arrears.

This data layer will also enable you to iteratively build a fuller view of the economic landscape both during, and in the aftermath of, the coronavirus pandemic.

> When your most vulnerable customers show signs of stress, more traditionally reliable customers may not be far behind.

*Assumptions derived from Experian economic analysis throughout March to June 2020.

Rapid, relevant scenario modelling

Scenario modelling is part of any credit provider's toolkit, but scenarios led purely by macro-economics or traditional credit drivers may no longer enable you to plot a successful path forward. Quite simply, they were built before today's challenges were even imagined.

So, it's time to develop, test and integrate new scenarios, combining macro-economics with the potential progression of the pandemic, the UK's regulatory response, shifting supply and demand, and regional differences in both impact and response.

Our research shows that many firms are struggling to react fast enough in these difficult times and adapt their scenario models to the changes caused by the pandemic. Others are finding it difficult to tap into models reflective of the quality of their own portfolios.

If that sounds familiar and recalibrating your own scenario models feels like a strain on already depleted resources, specialist help is out there – including from our own economics experts.

Taking scenario testing to new limits

Scenario modelling isn't the only tool you'll need to sharpen to tackle this current crisis. Your stress-testing strategy is also going to need a comprehensive overhaul if it's to remain useful.

In recent years, stress testing has become a vital way for lenders to assess the vulnerabilities of consumer and commercial lending portfolios. However, whether they've been built by your own teams or independent regulatory bodies, your current stress tests will, once again, be based on scenarios from the pre-COVID world.

The sheer scale of the pandemic has moved lenders into uncharted waters, and you'll now need to rapidly calibrate the outer limits of possible actions with new data. In fact, today's challenges call for stress tests that can quickly adjust to changing economic scenarios, different business mixes and evolving risk profiles.

Effectively re-engineered, they can help you mitigate risk, identify valuable avenues for growth and better protect your credit portfolio. Left in their pre-pandemic form, they'll probably tell you entirely the wrong story.

Creating clarity through credit scoring

Here at Experian, we're constantly analysing the situation, and using our insights to help firms pave a way forward. In a recent study on the impact of the economic crisis on scorecards, we explored how the crisis is likely to affect credit scoring, taking an in-depth look at its probable impact. To read the study, click here.

In exceptional credit conditions, traditional drivers of credit risk, when considered in isolation, tend not to provide a complete picture of how credit risk and losses are evolving.

Access actionable insights, expertise and support

From scenario modelling and stress testing to stronger, sharper IFRS 9 expected credit loss calculations, the tools exist to unlock trends, shape strategies and start safeguarding everything you've built. But with your teams stretched and scattered, we understand that such intensive projects can feel out of reach.

In these difficult times, reams of raw data – however illuminating they might be – often just add to the overwhelming workload firms are facing. Instead, stressed lenders need ready-analysed, actionable data and insights, complete with best next actions, risk analysis and a clear commentary on how all of this flows through to portfolios.

That's why, here at Experian, our experts are working with leading lenders to fight against current uncertainty and pave a way forward. We have a whole range of products and services that offer powerful economic and regulatory analysis. They equip you to assess the impact of the pandemic on your portfolios, meet your regulatory reporting obligations during these difficult times and plan for the future based on reasonable, supportable assumptions.

However you're being impacted, we can also develop appropriate, effective, highly granular models that consider the different variables in play, giving you clearer, more accurate forecasts of what's to come. What we provide goes beyond just insights; offering you the interpretation, consultancy and support you need to put your plans into action, at pace.

Market and portfolio insights

Even under normal, non-pandemic circumstances, protecting and growing your portfolio means getting a clear, objective view of its performance. Our Market & Portfolio Insights team is dedicated to delivering just that, and their work forms a vital part of the support we offer.

They combine CAIS and credit bureau data, benchmarking analysis, granular economic forecasts and data on local economies and households, analysing it against your lending policy and customer profile to forecast the financial performance of your portfolio.

They're also able to confidentially benchmark your portfolio against the rest of the market or a specific peer group, as well as advising on adjustments that can help you mitigate risk or take advantage of opportunities for growth.

To make sure that growth is sustainable, they can even give you quantitative insights into customer risk concentrations across different geographies, life stages and sociodemographic backgrounds, highlighting higher risk concentrations that may require mitigation, as well as opportunities within lower risk areas which could nurture growth within your risk appetite.

How Experian can support you

- **Market and portfolio insights**
- **World-class economic scenario modelling**
- **Portfolio-tailored unemployment curves**
- **IFRS 9 forward looking credit loss modelling**

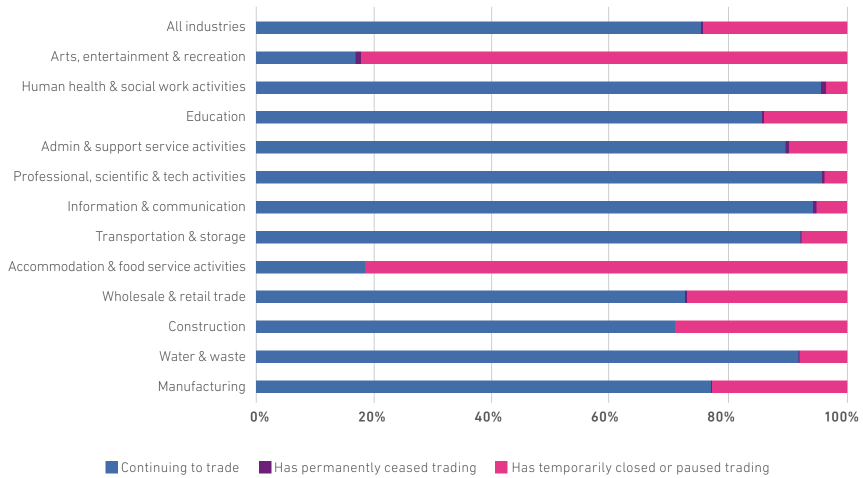
We'll explore these in more depth over the next few pages.

World-class economic scenario modelling

Since the pandemic began, our internationally renowned economic forecasters and modellers have been building robust, evidenced scenarios that map the likely impact of the crisis on the UK economy, including critical factors such as unemployment, inflation, credit availability and sterling depreciation.

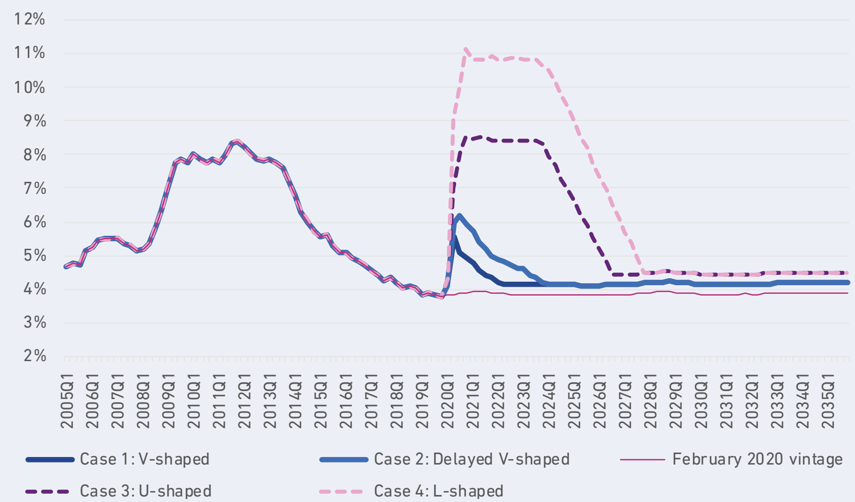
Each scenario is based on the Government views which follow the recommendations set out by the Imperial for managing the epidemic. Each sees a sharp rise in unemployment in quarter two of 2020, which is likely to cause major income shock for British consumers. Figure 1 shows which businesses continued to trade during lockdown.

Figure 1. Percentage of industries continuing to trade, broken down by industry



Together, the scenarios show us that the greater the income shock and the deeper the fall in sterling, the more dramatic and drawn-out the economic implications for the UK will be, including worsening credit availability, rising inflation and longer, deeper levels of unemployment, that impact the financial security of consumers – as well as the stability of portfolios. Figure 2 outlines the projections for UK unemployment rates.

Figure 2. UK unemployment rate (% of workforce) quarterly



The severity of all of these issues depends primarily on how quickly the UK brings down infection rates and reopens its economy – and of course these are unknowns. However, building an in-depth understanding of the implications of various likely scenarios is fundamental to stabilising and protecting portfolios as firms move forward.

As well as using their expertise to model scenarios for the impact of the coronavirus pandemic, our world-class team can model a whole range of more typical economic circumstances and trends. They're also able to assist with strategic decision-making by creating illuminating bespoke models based on your own portfolios, strategies and concerns.

1. Coronavirus impact modelling
2. Economic trend modelling
3. Bespoke portfolio and strategy modelling

METHODOLOGY

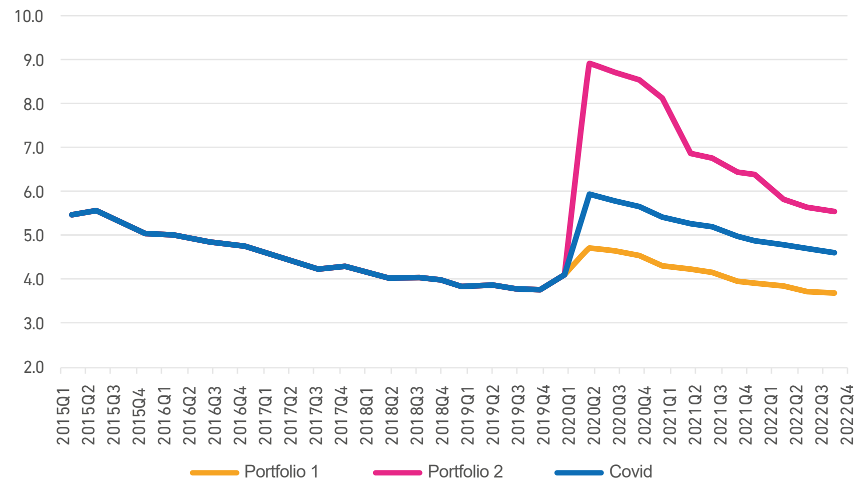
Scenario Assumptions	Are results robust to portfolio changes and lending practices? Are results robust to reasonable changes in scenario assumptions?	SCENARIO AND SENSITIVITY ANALYSIS
Economic impacts	Do economic models accurately predict scenario impacts on economic drivers of credit risk?	STOCHASTIC SIMULATIONS
Credit Risk Components	Do credit risk models accurately predict impacts of alternative economic conditions on credit risk components?	
Capital Requirements	Do capital requirements models accurately predict impact of changes in credit risk components on capital requirements?	

Portfolio-tailored unemployment curves

Rapidly rising levels of unemployment will be one of the greatest challenges to the UK's recovery from the coronavirus crisis – and a major destabilising factor in many credit providers' portfolios.

Based on the four key economic scenarios our experts have modelled, we believe the scale of the pandemic's impact on employment will be less than that of the last recession. However, while that sounds like relatively good news, the reality is that most of the effects will be concentrated in just a few short months – quarter two of 2020. As a result, the hit felt during that quarter will be considerably greater than any single quarter of the 2008 recession. Figure 3 outlines an illustrative view of unemployment curves. Outlining two examples of client portfolios.

Figure 3. Unemployment forecasts may not impact your portfolios equally



Protecting your firm begins with building a clear picture of the specific risk you face, which is why we offer a unique solution to understanding estimated unemployment within your portfolio. By combining our market-leading forecasting with CAIS data, we can map probable unemployment curves against COVID-19 economic scenarios, tailored directly to the customers you serve.

We've developed this capability through rigorous, extensive research, and each of the scenarios we create is stochastically modelled to make sure it remains unbiased and objective. The PRA (Prudential Regulatory Authority) advises that scenario modelling should always be reasonable, robust and supportable, and that's been fundamental to our approach.

Our tailored unemployment curves give you:

- Clarity on most impacted demographics, sectors and regions
- Understanding of the sector concentration within your portfolio
- These tailored unemployment forecasts can be easily dropped into your firms risk and forecasting models simply replacing your macro level unemployment forecasts to give you to give you a uniqueview of your pandemic-related risk exposure
- These tailored unemployment forecasts can also be dropped into your IFRS 9 processes to give you a unique view of your portfolio/s expected credit losses

How our economists helped a major high street bank understand their potential economic exposure

"We asked Experian to develop a range of macro-economic scenarios to help us understand the potential impact of coronavirus on the economy. Experian were quick to support our request and provided a full suite of macro-scenarios; this included a comprehensive narrative explaining the underlying assumptions that used.

The swift response to our request has allowed us to understand the impact that this may have on future losses and has been used to inform the level of mitigating action to be taken. Furthermore, their economists have also made themselves available to explain the rationale behind these scenarios to senior levels within our organisation and to our external auditors, and feedback from them was very positive."

CRO at major high street bank

IFRS 9 forward looking credit loss modelling

Created to measure and report financial assets and liabilities, the international financial reporting standard IFRS 9 can be an incredibly powerful tool in understanding risk and meeting your regulatory responsibilities. However, like so many tools trusted by the financial industry, it needs to be recalibrated if it's to provide accurate, relevant insights in the light of COVID-19.

Even before the crisis began, there was evidence that the IFRS 9 models some firms were using just weren't strong enough to deliver the accuracy needed. Some only factored in economics at macro level, while others weren't sensitive enough to specific portfolio shape or quality, changing risk profiles or the need to make quick, easy management overlays.

The pandemic has brought these shortfalls into sharp focus and presents the industry with an opportunity to address these weaknesses while adjusting for a post-pandemic world.

We're here to help you do that, using the latest insights to make sure your IFRS 9 results are as reliable, robust and supportable as PRA guidance recommends, while reducing the time your own team spends generating them. Our world-renowned economists have realigned and updated our own unique, transparent software to provide all the analysis, agility and accuracy you need.

IFRS 9 Tailored Solution Suite

This agile Experian product suite helps you address your specific IFRS 9 challenges, including data, reports, software and modelling. Experian can meet your IFRS9 modelling requirements with our traditional audit proven bespoke solutions. We can combine our extensive CAIS data coverage, with our industry leading probability weighted economic scenario forecasts, with your internal view of your portfolio to suit your requirements providing all the elements of expected credit loss forecasting under IFRS 9 and helping you move confidently forward.

Our approach explicitly builds the relationship between the performance of each segment of your portfolio and the changes we're seeing in the economy, improving accuracy and aligning with your risk appetite.

As well as helping you meet regulatory requirements in these challenging times, this enables you to make profitable decisions at strategic and tactical levels. You'll receive data-driven insights into the resilience of your portfolio under a variety of strategies and economic scenarios, empowering you to adapt your lending policies and product offerings to changing market conditions.

IFRS 9 Credit Loss Insight

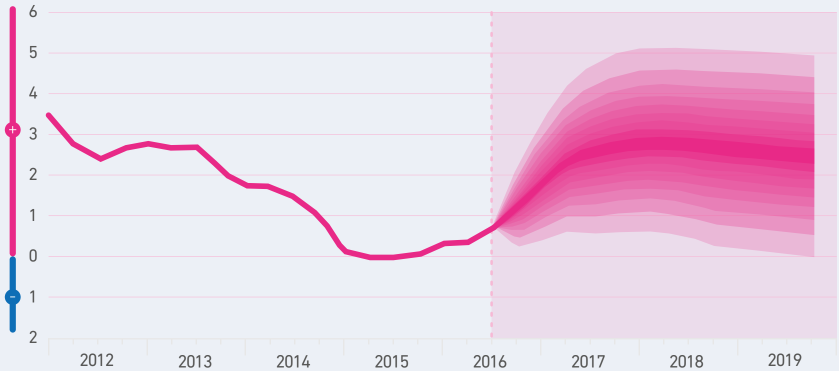
Alongside the bespoke elements of our IFRS 9 Tailored Solution Suite, Experian are developing a powerful, flexible, on-demand software tool that calculates Expected Credit Loss (ECL) forecasts in just a few clicks - IFRS 9 Credit Loss Insight (ICLI).

Based on CAIS data and industry-leading, forward-looking, probability-weighted scenarios, it enables you to quickly generate and evaluate your own ECL models. Models can be generated automatically or you can control the shape and content of the models. We ensure the underlying data and scenarios are kept up to date, giving you the confidence that your calculations are timely and accurate.

To explore specific questions about your portfolio, you can input key components by risk bands, as well as flexing various elements and parameters to give you targeted insights and answers.

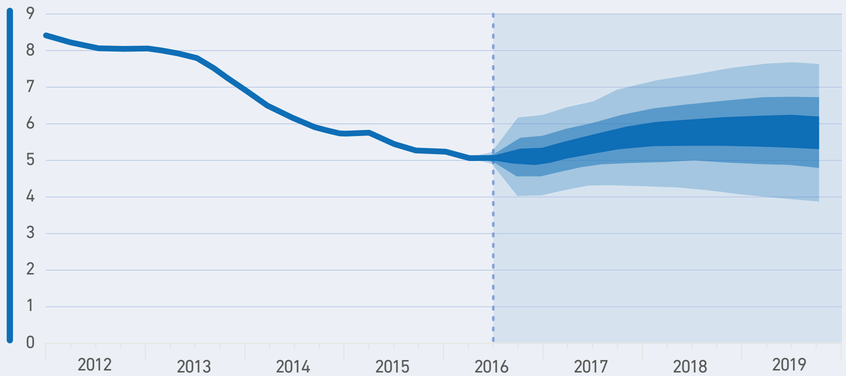
IFRS 9 ECL calculations include forward looking probability weighted economic scenarios

CPI inflation projection (narrow bands)



Percentage increase in prices on a year earlier

Unemployment rate protection (narrow bands)



Unemployment rate, per cent

From CAIS data the software can generate IFRS 9 model components by risk bands for example:

- Lifetime definition (where appropriate)
- Probability of default over 12 months
- Probability of default over lifetime
- Exposure at default
- Significant increase in credit risk (SICR)
- IFRS 9 Stages 1, 2 & 3

Data that is unique to your portfolio can be input by risk bands directly:

- Loss Given default
- Time to charge off
- Effective interest rates

Flex your analysis to...

- Explore the impact of using different historic timescales
- Manually override components to reflect known variances for your portfolio
- Reweigh samples to reflect expected or desired profiles
- Sensitivity test different components of the models e.g. probabilities of default, EADs, LGDs
- Amend the economic scenario probability weightings
- Add bespoke economic scenarios

You can find out more about our **IFRS 9 solutions by clicking here.**

Conclusion:
From clarity to opportunity

Nobody in living memory has ever faced a situation like the one we're living through. There are no footsteps to follow, roadmaps to roll out or protocols to implement. In such uncertain times, we need to create clarity, interrogating the phenomenal amount of data that now exists in new ways, and with new tools, to understand the challenges ahead.

Experian is here to help. We know that for many firms, credit portfolios will be fluctuating, evolving and showing signs of stress. We also know that having the resources in house to understand those changes, identify patterns and create new strategies may be unrealistic when teams are depleted, dispersed and dealing with huge new pressures.

That's why we don't just provide the latest data, market insights and recovery scenarios – we offer you in-depth support, consultancy and strategic problem solving. We're ready to create bespoke models that assess your customers' probability of default, your organisation's exposure and your likely losses in the face of today's unprecedented challenges. At the same time, we have the tools to identify new, sustainable avenues for robust, responsible growth.

Together, we believe these capabilities are exactly what you need – not just to find clarity, but to create stability and opportunity – adapting your provisioning, protecting your portfolio and carving a clear path towards a stronger future.

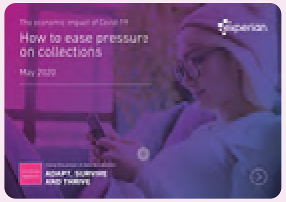
Experian's experts in Economics and Market Insight use a unique approach to making credit decisioning tools 'forward looking'

Whether this is initiated from Market and Portfolio analysis or competitor benchmarking, our services are used daily by the financial sector globally.

We provide you with comprehensive commentary and analysis of trends and forecasts allowing you to anticipate future movements in factors affecting your credit portfolios and markets.

These forecasts for credit markets are based on our UK macroeconomic forecasts and cover the economic drivers of default on your secured and unsecured loans, together with net lending forecasts, projections of new lending, write off rates and repossessions.

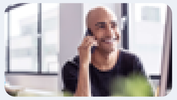
Read our supplementary content:



Download paper

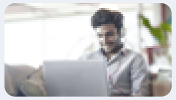
Visit our continually updated Covid-19 content hub to see how we can help:
www.experian.co.uk/about-us/covid-19-resources

Why good quality data is even more critical right now



How can Experian help you manage credit risk in a turbulent economy?

Managing increased risk in your commercial lending portfolio



Commercial resilience in an uncertain world

Contact us:
Business.Enquiries@uk.experian.com

Stay up to date with our latest thinking,
by bookmarking our thought leadership portal:
www.experian.co.uk/latest-thinking

The insight contained within this report is prepared using research performed on both Experian data and external data sources, in addition to market research. All sources, unless referenced, are from Experian insight.

The information contained within this report is designed to help businesses manage the complexity brought by a national crisis - and is a summary of key areas and capabilities. Experian are actively striving to help firms' understand the breadth of change and requirements needed in order to better support, and protect, consumers and businesses nationally.

To understand more about our market-leading capability Experian has, or to access further detail on the impact of Covid-19 on consumers, business and lending portfolios - please contact us.

Registered office address:
The Sir John Peace Building, Experian Way,
NG2 Business Park, Nottingham, NG80 1ZZ

T: 0844 481 5873
www.experian.co.uk

C-00714