Experian viewpoint

Credit risk in a climate of change

Critical disruptions, risks and opportunities to improve credit strategies

February 2021

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Click here to read our consumer credit economy report

Click here to read our commercial credit economy report

Click here to listen to a full review of 2020 and how it will impact this year and beyond

About this paper

This paper has been created by Experian's executive and expert teams to collate a viewpoint of industry trends and requirements. It shares our thinking and findings from a lender view, together with the approaches needed to respond to the realities outlined in our New Credit Economy report.

At Experian, we're continuing to innovate with data, analytics and workflow platforms, to help firms navigate the crisis and unlock new opportunities. We've continued to invest in Covid-19 specific innovations to provide additional clarity into risk management, capital adequacy and credit provisioning. Alongside this, we continually track and analyse trends across bureau data and non-traditional data sources, as well as economic and market conditions.

We were doing this before the pandemic, but the last year has accelerated the need to delve deeper into cause, threat and opportunity. This paper outlines the context and significant themes which will continue to change the credit market, alongside examples of how we're driving solutions to improve process and outcomes.

Economic impact is different for everyone

It's clear that you can't afford to focus on 'the new normal' because normality will mean very different things to different customers, shaped by megatrends that go beyond the pandemic. As we've seen in 2020, the multiple forces driving the economy will continue to evolve customer behaviour and expectations too, and in turn the products and services they need and want from you.

Covid-19 hit at a time where consumers were already exposed, but equally, the post-pandemic landscape isn't just being driven by Covid-19 recovery. Climate risk and new trading conditions post-Brexit will affect different regions, sectors and demographics disproportionately, including ones that fared better in the pandemic.

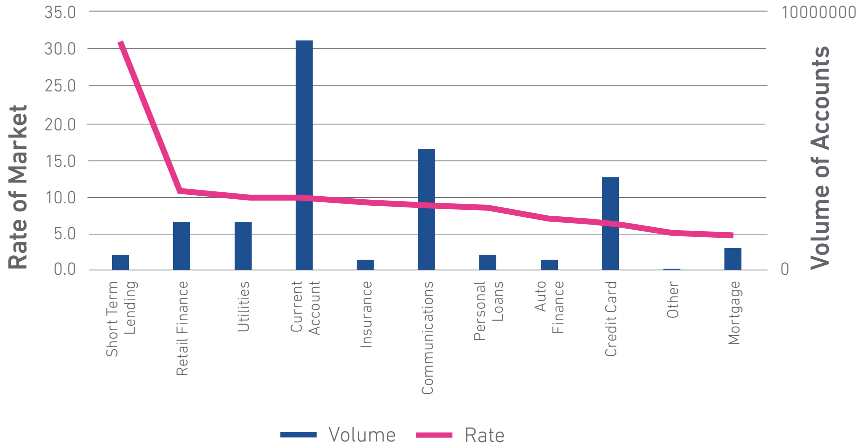
The impact is seen differently

Short-term economic measures during the pandemic, such as Emergency Payment Holidays (EPH) and the furlough scheme, may have masked the full extent of the impact, but it's clear the impact has been different for everyone. Businesses and consumers alike. As the economy recovers, it will take time for financially stressed customers to get back on track. And with the scale and impact of unemployment continuing to be felt, many will continue to struggle. For those with more secure incomes, 2021 could see a return to spending on leisure and hospitality, including holidays abroad.

The lower earners who would typically be hardest hit have been largely cushioned. It's the middle earners, across age bands, who have seen the most significant economic impact.

Consumers with looming potential for hardship

Consumers that have not used a payment holiday, not experienced income shock, and have a good prior risk assessment but that have high possibility for unemployment, may require management as economy continues to struggle.



At the height of the pandemic, we saw 3.5 million people take an EPH. However, a third saw no income change. At this point, delinquency rates on all 'rolled off' EPH accounts is high, and steadily rising. Compared to the pre-Covid-19 average delinquency, we are seeing rates between 3x and 8x higher on rolled-off EPH accounts. For Auto, Cards and Mortgages EPH roll-off accounts are making-up between 25%-35% of all collections stock.

Brexit + Covid-19 paints a very stark economic reality

Brexit uncertainty is set to continue as the UK adapts to a post-Brexit economy and new trading relationships with both EU and non-EU partners.

Source

Brexit + Covid-19 paints a very stark economic reality

When you look at Covid-19 risk, and then overlay Brexit risk, you can see that more people are exposed and the scenarios around affordability, vulnerability and creditworthiness build. Understanding who is economically exposed due to local area risks and employment sectors is critical.

Depending on post-Brexit trading conditions, borrowers will be exposed to a difficult economic period that could slow post-pandemic recovery. It's certain that some businesses and sectors will be more vulnerable than others. Unfortunately, this looks likely to be sectors that have proven their resilience in the face of the pandemic, including construction and manufacturing. With most sectors either facing an uphill recovery from Covid-19, or navigating Brexit, there are very few sectors left unscathed. This will have a clear impact on customers, and lenders' portfolios.

Sector Risk

	Covid-19 Impact	Brexit Risk
Agriculture, Forestry & Fishing	Low risk	Low risk
Extraction & Mining	Mid risk	High risk
Food, Drink & Tobacco	Low risk	High risk
Textiles & Clothing	High risk	High risk
Wood & Paper	Mid risk	Low risk
Printing & Recorded Media	Mid risk	Low risk
Fuel Refining	Mid risk	High risk
Chemicals	Low risk	High risk
Pharmaceuticals	Low risk	High risk
Non-Metallic Products	High risk	High risk
Metal Products	Mid risk	High risk
Computer & Electronic Products	Mid risk	High risk
Machinery & Equipment	High risk	High risk
Transport Equipment	High risk	High risk
Other Manufacturing	Mid risk	Mid risk
Utilities	Low risk	Low risk
Construction of Buildings	Mid risk	Low risk
Civil Engineering	Mid risk	Low risk
Specialised Construction Activities	Mid risk	Low risk
Wholesale	High risk	High risk

	Covid-19 Impact	Brexit Risk
Retail	Low risk	Mid risk
Land Transport, Storage & Post	Mid risk	Mid risk
Air & Water Transport	High risk	High risk
Accommodation & Food Services	High risk	Mid risk
Recreation	High risk	Low risk
Media Activities	High risk	Mid risk
Telecoms	Low risk	Mid risk
Computing & Information Services	Low risk	Mid risk
Finance	Low risk	Mid risk
Insurance & Pensions	Low risk	High risk
Real Estate	Low risk	Low risk
Professional Services	Mid risk	Mid risk
Administration & Supportive Services	High risk	Low risk
Other Private Services	High risk	Low risk
Public Administration & Defence	Low risk	Low risk
Education	High risk	Mid risk
Health	High risk	Low risk
Residential Care & Social Work	Mid risk	Low risk

High risk Mid risk Low risk

Chapter one

Regulation

In this section we explore the regulatory environment, with a particular focus on three key areas. IFRS 9, Climate risk and the recently published Woolard review. We navigate what these look like, and what actions are needed to align with regulatory change – and subsequently improve the process. Highlighting specific areas of our own innovations within these areas too.

Key takeaways

1. Climate risk is one of the silent disrupters of lending decisions, requiring revised and improved strategies that allow for consideration of new variables.
2. During the worst economic crisis on record, being able to continually revise and calculate expected credit losses (provisions) and stress test capital is crucial. To do this, modelling based on more granular economic data is needed, as is ongoing monitoring.
3. The FCA are focusing on better customer outcomes, alongside more sustainable models for personal lending. Understanding the solutions that can aid your compliance, as well as risk strategies, becomes crucial. Done right however, this can support your overall business and market opportunity.
4. In order to provide the best, most suitable customer treatments and decisions, moving to a dynamic decisioning environment will provide vital insight into scorecard performance. Advances in data science, and technology offer the requisite power to monitor model performance and deploy change – fast. As such, you can be assured your models, and decisions, are suitable for the environment at that point in time.
5. There is an immediate need to improve the decision environment to not only continue to monitor, track and change risk strategies – but also allow for more connectivity and 'flow' throughout the customer lifecycle. Therefore offering the immediate opportunity to be able to implement requirements such as continual review of affordability, across the product lifetime. To do this, modular, cloud-managed decisioning will be vital due to its offer of flexibility, speed and intelligence.

1. Expected credit loss needs to be calculated using granular data and enhanced analytical models

From March 2020 onwards regulation focused on helping lenders meet the immediate needs of the pandemic. In 2021, the focus is firmly on managing the long-term impacts. The FCA expect "all firms to have contingency plans to deal with major events and that these plans have been properly tested."

The fundamentals for regulators are protecting consumers, ensuring fair access to credit and making sure customers are treated fairly whilst ensuring stability and sustainability of the financial sector. In an era where customer insight (78%), enhanced customer experience (74%) and improvements in automation and AI (73%) remain firm priorities for firms – it's evident to see all parties are shifting towards a similar goal. Such credence will help the UK continue to lead the financial markets, globally.

IFRS 9

With the looming reality of forbearance and emergency payment holidays ending and likely increases in unemployment levels leading to the inevitable increase in arrears – capital adequacy, stress tests and provisions have also been a firm focus, underpinned by the bedding in and enhancement of IFRS 9 models. In this climate of significant change, managing, monitoring and reporting on expected credit losses and capital has become even more complex. We have invested heavily in all our capabilities to support lenders – including accelerating our IFRS 9 solutions.

Since the pandemic began, we've been building robust, granular and evidenced scenarios that map the likely impact of the crisis on the UK economy.

This includes critical factors such as unemployment, inflation, credit availability and sterling depreciation. Building an in-depth understanding of the implications of various likely scenarios is fundamental to stabilising and protecting your portfolio. We can help you create portfolio-tailored unemployment curves, meet your IFRS 9 modelling requirements and calculate Expected Credit Loss (ECL) forecasts in just a few clicks.

Even before the crisis began, there was evidence that the IFRS 9 models some businesses were using just weren't strong enough to deliver the accuracy needed. Some only factor 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. In addition, a lack of historical or default data, alongside the need to incorporate forward-looking economic scenarios quickly and robustly – all have added complexity to lenders, large and small.

Our latest models and scenarios can help you answer many critical, and timely questions. How many customers have payment deferrals with other lenders, and on what products? How will increases in unemployment impact specific sectors and your portfolio? Are consumers more likely to go into arrears after a payment deferral? The breadth of our data and analytical expertise can help you quickly, at scale, answer many critical questions. Helping you understand the range of outcomes for your customers and plan upscaling of the collection's operation.

2. Climate risk is transforming the economy

Before the pandemic hit, the PRA was regulating the industry to conduct climate-related stress tests on portfolios, with the aim of urging lenders to understand their exposure to climate risk. For example, the volume of housing stock in flood-risk areas, and the individuals vulnerable to job losses in non-green industries. You will need to make the right forecasts and adjustments to mitigate this risk.

Climate risk in 2021 is far more than just a reputational risk, it's the most significant business risk facing lenders. The PRA categorises the risks as:

Physical risks – risks that arise from the impact of extreme climatic events, rises in sea levels and flooding, losses of ecosystem services (e.g., water shortages, degradation of soil, quality or marine ecology), as well as environmental incidents (e.g., major chemical leakages or oil spills to air, soil and water/ocean);

Transition risk – risks that arise from human efforts to address environmental and climate challenges, including changes in public policies, technology breakthroughs, shifts in investors sentiments and disruptive business model and societal shifts;

Liability risks – risks that arise from parties who have suffered loss or damage from physical or transition risk factors seeking to recover losses from those they hold responsible.

Schematic illustration of transmission from environmental risks to financial risks

Environmental and Climate Risks

Transition Risks

- Policy and regulations
- Technology and innovation
- Consumer and societal shifts

Physical Risks

- Chronic risks (e.g. temperature, soil degradation, marine ecology damage, risks in sea levels)
- Acute risks (e.g. heatwaves, flooding, wildfires, storms)

Economic Risk Transmission Channels

Micro

Businesses

- Property damage
- Business disruption
- Stranded assets / Capex requirements
- Legal Liability from failures

Households

- Loss of incomes (weather disruptions / sectoral declines, labour market friction)
- Property damage, loss or value depreciation

Macro

- Capital depreciation and increased investments
- Shifts in prices (due to supply shocks)
- Productivity changes (from severe heat, diversion of investment and higher risk aversion)
- Labour market friction
- Socioeconomic changes (changes in consumption patterns, migrations, conflicts)
- International trade impacts, changes in taxation, fiscal requirement changes, changes in interest rates

Financial risks

Credit

- Business defaults
- Household defaults
- Collateral depreciation

Markets

- Repricing of equity, fixed income, commodities

Underwriting

- Increased losses
- Increased indemnity gaps

Operational and Liquidity

- Supply chain disruption
- Forced facility closures
- Increased liquidity requirements and refinancing risks

Financial System Contagion

Environmental and climate effects

Economic and financial system feedback loop

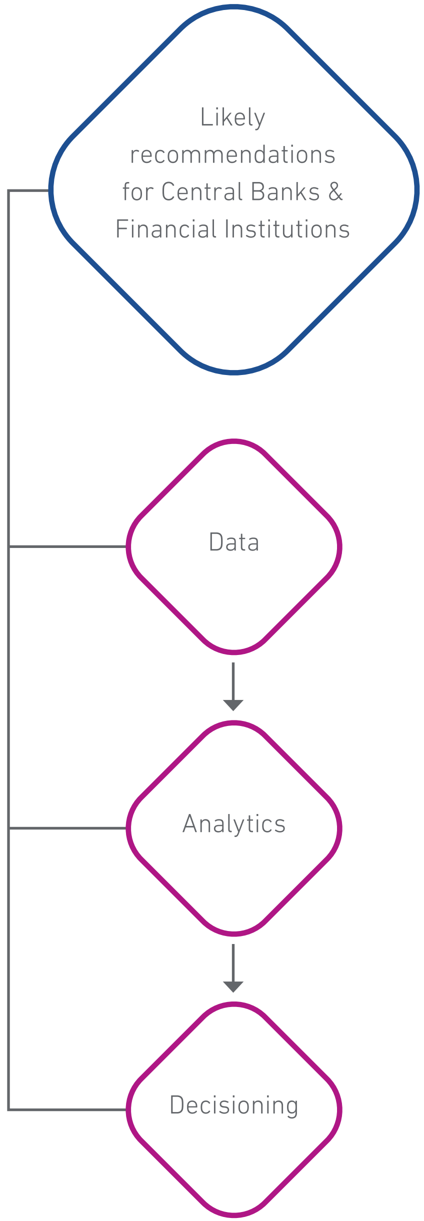
The signs of change and the call to action is visible in the market

As the economy recovers from the near-term impacts of Covid-19, policy makers and industry will turn to the bigger challenge of climate change. Policy makers and central banks will refocus on the effects of climate change and the actions needed to tackle climate risk will have both short term and long-term impacts on the financial sector, and credit markets.

We are beginning to see movements in this sphere. The Network for Greening the Financial System (NGFS), a coalition of 48 central banks and regulators, has recognised climate change as a key financial risk, and is providing guides on integrating climate related and environmental risks into prudential supervision.

Simultaneously, the Task Force on Climate-related Financial Disclosures (TCFD) has recommended climate related disclosures across the Governance, Strategic, Risk Management and Operational Metrics layers within banks. While a recent UN report recommends launching robust climate-related stress tests to scrutinise the impact of climate scenarios on financial institutions and systems.

Lenders will have to build these policy actions into their decisions going forward. As such, traditional scores and data used within decisions, will need augmenting with relevant data – including non-traditional sources such as energy performance certificates and flood risk data. This reinforces the continual need for portfolio and granular customer-level data too. Again, something we are focussed on as we continue to advance our models and scores to accommodate agility, change and future outlook.



Key actions needed:

- Integrate climate related risks into financial stability monitoring and micro supervision
- Integrate sustainability factors in portfolio management
- Bridge data gaps to ensure climate risk coverage
- Build awareness and intellectual capital and encourage technical assistance and knowledge sharing
- Achieve a robust and internationally consistent climate and environmental disclosure
- Develop and implement climate oriented taxonomy of economic activities

At Experian, we have continued to accelerate our innovation to consider the emerging risks, and opportunities, presented by climate risk. Our latest generation of economic models consider climate data within the scenarios, offering improved stress tests and provisioning across your enterprise. Our work extends into revised affordability tests and enhanced scores – for both consumer and commercial lending.

Are you ready for the green economy?

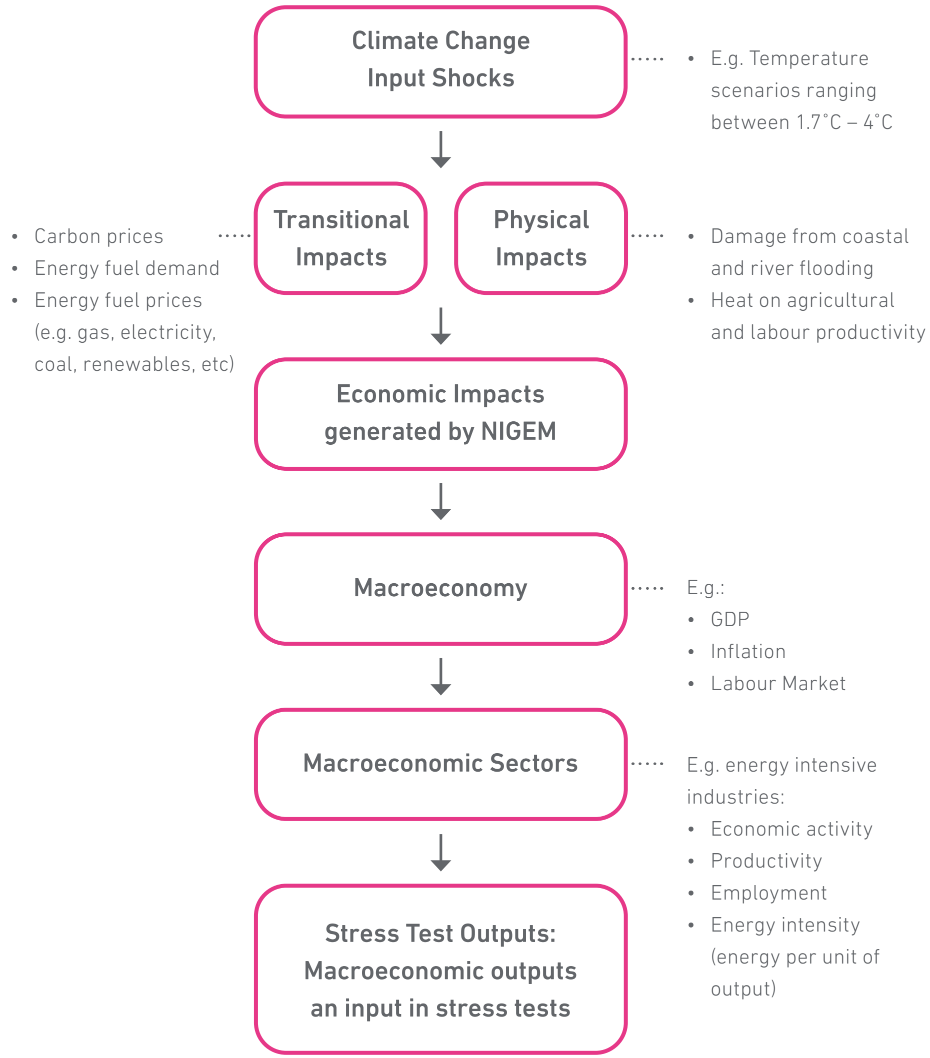
You will need to identify customers and businesses working in at-risk sectors as the UK transitions towards the green economy. For example, polluting industries or sectors under threat from shifting public attitudes, such as meat and dairy as the popularity of plant-based food increases.

You will need to revisit risk models and apply scenarios specific to climate risk to understand the changing face of affordability, vulnerability and creditworthiness in the green economy. Have you made specific provision for unemployment in these sectors? On the flip side, the green economy could also see some sectors booming, and new ones emerging, representing new opportunities.

Depending on the level of government support available, consumer incomes and savings could also be hit by transitioning to a low-carbon economy. For instance, having to make energy efficiency upgrades to their property could strain already stretched finances for some.

> "As the economy recovers, policymakers and industry will return to the bigger challenge of climate change. The actions needed will have short and long term effects on the sector, and will need to be built into your decisions going forward. Traditional scores and data will need augmenting with sources including energy performance certificates and flood risk data - at both a portfolio and granular customer level. We're continually investing in innovation and advancing our models and scores to accommodate agility, uncertainty and the affordability implications - to help you prepare for the changes ahead."
>
> **Mohammed Chaudhri, Chief Economist, Experian UK&I**

Illustrative example of Experian's Climate Change Model



3. The Woolard review highlights a number of key issues

Earlier this month (February 2021) we saw the publication of the long awaited Woolard Review. The review recommends a more holistic approach to regulation in the new credit economy. The report was commissioned by the FCA Board with the aim of exploring the unsecured credit market in-depth, and asking whether more needed to be done to ensure a healthy, sustainable market. They believe the short answer is yes.

"Credit is part of most people's lives in the UK. Used well it can be a helpful tool, but can also cause consumer harm when out of control. Unsecured credit can come in many forms, and the market has seen some recent rapid innovations. The market has also been changing, as a result of regulation and the impact of Covid-19. Achieving change and delivering outcomes will also depend on working in partnership with HM Treasury, a range of other government departments, other regulators, consumer groups and the third sector along with the active cooperation of the industry."

The Woolard Review highlights a number of key issues:

- To have a long-term, healthy market certain new credit products that are currently unregulated need to be brought within the regulatory framework as a matter of urgency.
- The economic effects of the pandemic will drive demand for debt advice. A well-functioning debt advice sector is essential to support a healthy credit market. Providers of free debt advice need access to secure, long term sources of funding and debt solutions must be suitable.
- For the good of consumers and firms there needs to be a more outcomes-focused approach to regulating the credit sector that looks at how products are used in the real world and consistently regulates on that basis. Regulation should focus not just on affordability, but on conduct across the lifetime of the product. Learning from the experience of Covid-19, there also needs to be a more consistent approach to forbearance across firms.
- Greater emphasis needs to be placed by the FCA, but also the government and other stakeholders on ensuring a holistic approach to key issues – ranging from long term debt advice strategies, boosting the availability of alternatives to high cost credit, and the treatment of the very poorest when they need help.
- There are significant opportunities to build a better credit information market to the benefit of consumers and lenders.

As The Woolard Review makes clear, the focus going forward should be on helping customers to make better financial decisions and more sustainable models of personal lending. The review has also made it clear that it will need to collect the right data and join it up with a cross-organisational intelligence strategy to intervene more promptly, as it looks towards a more end-to-end system of regulation and supervision.

Of course, this is not something new from a lender view. The focus on a single customer view, or enhanced digitisation that digitally connects a business' portfolio is identified as a critical requirement in the next 2 years.

At Experian, we believe that by working together, with industry and regulators alike, we can drive innovation throughout Financial Services which will bring long-term benefits to all. To do this, continued collaboration and innovation will be key.

Chapter two

Affordability and scoring: creating strategies to manage risk and opportunity

In this chapter we explore the link between affordability and vulnerability, we look at what's needed to gain a real-time view of an individual's affordability position, as well as how evolved scores can support your understanding and decisions.

Analytics are evolving fast, giving you the opportunity to continually optimise your decisions, strategies and customer journeys. By harnessing data and analytics, you can evolve decision-making based on optimal models that are continually advancing in real time, based on actual customer behaviours. That means you can focus on optimising customer experiences and relationships throughout customer management, not just around originations or at the point of default. From an affordability perspective, understanding employment risk and verifying income source is more important than ever in 2021. We're investing in new data sources to make it easier for lenders to automate this step and assess affordability and employment stability quickly and easily.

Our investments allow for you to understand your current position, as well as likely future scenarios. Offering the ability to model future delinquencies, along with groups prime for new lending.

Key takeaways

1. Affordability across the lifecycle becomes even more crucial in being able to support customers in times of need, as well as understand who has the capacity for further lending.
2. Lenders must be more transparent and accountable for their risk decisions. They must be able to demonstrate their understanding of credit and affordability data and how this is applied to inform risk to protect themselves and consumers.
3. Scores and bureau data are no longer enough – supplementary analytics and data sources, including indicators, can vastly improve your knowledge of what's affordable and where risks are present in your portfolio.
4. Scoring needs to be agile and responsive, consider economic change, and be built in an environment that is continually optimising in line with economic conditions.
5. The advent of Open Finance and consumer consented sharing of financial information is set to grow as part of the UK government's agenda to maintain the UK's reputation as a global leader in Fintech innovation.

Scores and bureau data will no longer be enough

For a long time, open banking has been poised to provide better insight. This promise is now being realised as organisations deploy ML and data science-based engines to automatically categorise transaction behaviour to inform decisions. At Experian, we're investing in innovation and non-traditional data sources on a global scale, to design new products and services. Cloud based data aggregation and new predictive features enabled by ML mean that products can take many forms; and through the ability to aggregate scale of data fast, you can innovate in ways you could only previously imagine. By creating an intuitive decision environment, you can interact and understand your customers, anytime, anywhere, and modernise both your offer and your relationship with individuals.

Our focus is on data innovation and advanced analytics to solve complex problems, and we're exploring a wide spectrum of alternative data types. The next era of consumer-consented data sharing has already been defined in the FCA's Open Finance roadmap, and the government's UK Data Strategy. Both of which focus on extending the role of consumer-consented data sharing. This will see other sources of open data come to market, including payroll, savings, investment, pensions and utilities data. Practical examples of consumer-consented open data in action include Experian Boost, which uses bank transaction data to help consumers improve their credit score and access better financial services. Another is the automated sharing of payroll data to verify gross and net income during a credit application.

At Experian, we are constantly looking at what new, and alternative data sources can bring consumer value. Our latest addition of salary data offers a valuable, alternative source that can be easily ingested into decisions - relieving friction, yet improving accuracy.

Open Finance is here to stay

Open Banking was the first step in a wider agenda that will see consumer's consenting to automatically share a variety of other important data such as their pay slip, credit transactions, savings and pensions information. This is likely to be bolstered by an emerging Open Data ecosystem where organisations charge to share a customer's data – with their consent – with Third Parties and organisations creating new value propositions for customers which improve the financial literacy and provides quicker and more convenient access to services.

It's long been known that automation can remove friction and reduce cost, but with greater trust in data comes the opportunity to automate decisioning, without the need for manual underwriting or oversight. In a climate of change and new opportunities, that means going beyond traditional sources of data like bureau data, to align decisions and strategies that feed from reliable golden data sources.

The vulnerability hypothesis

The concept and challenge around vulnerability is nothing new, but the approach is sporadic and differs across firms. The pandemic has accelerated the need to review and improve the means by which organisations classify, capture, and share details relating to financial vulnerability.

The FCA has said they expect firms to exercise particular care with vulnerable consumers. Currently, the FCA definition of a vulnerable consumer is someone who, due to their personal circumstances in four areas (health, life events, resilience and capability) is especially susceptible to harm, particularly when a firm is not acting with appropriate levels of care.

These customers are not easy to identify and 83% of lenders felt under increased pressure to understand non-financially vulnerable customers[1].

With continued uncertainty around economic recovery, post-Brexit trading conditions, and the transition to a green economy, it's more important than ever to look at what strategies and processes are needed to standardise and improve insight around vulnerability. Doing so will result in various benefits to consumers and businesses, while helping you to comply with evolving, customer-focused regulation.

It will support customers with being treated fairly, appropriately and consistently, while also mitigating impact and exposure, through the ability for firms to introduce early and effective intervention measures.

The affordability scales

Nurturing lifelong relationships with new and existing customers is key in a period of change and uncertainty. No consumers' circumstances are the same. By producing a standardised, unbiased classification, a calculative measure can be created which gives you a clear understanding of the scale, or extent of the individual's exposure. By having a scale, or score approach, you can apply relevant treatments, or strategies, that appropriately reflect the scale of vulnerability.

Equally, it also crucial to understand who is vulnerable through exclusion.

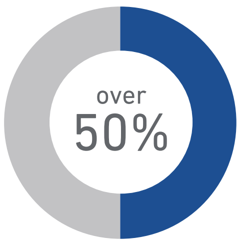
[1] Research conducted through December 2020, across 123 Financial Services and Banking decision makers.

You should be:

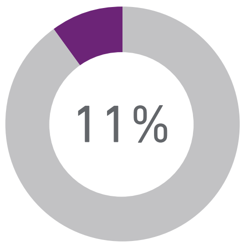
- Including income risk in credit and affordability assessments
- Factoring individuals' needs into forbearance strategies
- Identifying signs of stress through an aggregated view: a fall in income combined with a shift in spending to high priority items, new or unauthorised overdraft use, greater reliance on savings, or an appetite for high cost loans
- Supporting consumers in building financial literacy to promote better behaviours

Enhancing credit assessment with Consumer Consented Data

Experian have always invested in data and scores and we're proactively driving innovation around both dimensions. Being able to harness new data sources, alongside having effective strategies and scores in place, that advance what we have today, is crucial to weather the ongoing storm.



of consumers who used Boost improved their score in the first week of its launch



moved up a typical score band

Experian Boost: enriching Delphi scores through additional indicators and characteristics, to enable greater insight, and access

Our most recent innovation is Experian Boost, which benefited 100k consumers in less than a week of its launch - as of February 2021, this figure has quadrupled to 400k. Boost enriches the Delphi score through additional indicators and characteristics derived from current account transaction data, allowing consumers to improve the data available to lenders assessing their credit standing. The Boost score is provided in addition to the Delphi score, at no additional cost. Open Banking characteristics used within the score are also available for scorecard monitoring, or for clients to use within their own risk strategies.

For our scores, Boost acts as a medium to incorporate richer data sets for risk scoring and analytics. We expect more than 1 million boosted customers by 2022, and to incorporate a larger number of highly predictive data categories and new data sources.

Crucially, what Boost also provides is the ability to support an inclusive lending strategy. Through the integration of new data, Boost can help provide previously 'thin' file customers with a lifeline as it helps them build a credit history profile. In the first week, we saw over 50% of consumers who used Boost improve their score. 11% moved up a typical score band. At full capacity, these percentages translate into millions of consumers. Improving their chances, but also your insight and understanding, leading to better lending decisions overall.

Macro stability credit scoring will offer greater economic resilience

We're also exploring incorporating and layering macroeconomic datasets into Delphi scores, to model financial resilience in consumers. By doing so lenders will gain deeper insights into the risk attributes of individual consumers and their ability to cope with volatile macro-economic circumstances. These new scores are being designed specifically to help firms fully function during adverse macroeconomic events.

The difference between Delphi scores and macro stability scoring

A customer's Delphi score today is 878 and predicts the probability of default in 12 months. The score equates to GB odds of 4:1 or a 20% bad rate.

The Economy Aware score = 800 and predicts a higher bad rate than above
The reason the bad rate is higher is because macro-economic conditions have been deteriorating and are going to be worse than the clean-weather macro conditions the Delphi score assumes. We anticipate that there will be a moderate increase in credit defaults across most of the population. Traditional Delphi scores don't include macro-economic conditions, and unless arrears and defaults start appearing, there will be no change in a customer's score.

The Impact Stability score = "RED" or "3 out of 10" or "30 out of a 100"
which means that if a big step-like shock to the economy arrives, then the customer will actually be behaving not like an 878 Delphi or an 800 macro-Delphi, but as a 600 or 500 Delphi. We predict that this person isn't adequately resilient and should be treated with caution if applying for credit, and with special care if they've been granted a loan.

The Impact Stability score = "GREEN" or "8 out of 10" or "80 out of a 100"
which means that if a big step-like shock to the economy arrives then the person will, for the most part, still be behaving like a 878 Delphi or an 800 macro-Delphi. We predict that they're adequately resilient and can be trusted with credit, even if the possibility of a big macro shock looms on the horizon.

Chapter three

Digitalisation

In this section, we explore digitalisation from a consumer view, but also digitalisation from a process and enterprise viewpoint. We explore how new tools and strategies can be improved – and adopted at a faster rate – exploring what outcomes this will enable against business priorities. Critically, looking at how firms can deploy new data and advanced analytics into decisions, alongside a constant ability to monitor performance, test scenarios and models – and deploy change at pace.

It goes without saying that the world is digital. And today, it is not about having a digital agenda, but an agenda that is digital. Yet, for many businesses the transition into a dynamic, digitised decisioning environment is hindered by legacy systems. This is not new. Today, the advances in cloud-managed software, the opportunity to tailor and design decision strategies that can be easily integrated into your commercial models, are all in easy grasp. Without the need for a complete IT overhaul, or significant investment either.

While data is of significant value, it's what you do with it that matters. The requisite power of data, analytics and technology allow for more meaningful insight, and action. Enabling a virtuous cycle, lenders can all benefit from greater market share, by accelerating growth.

Key takeaways

1. Cloud technology offers ability to respond, as well as seamlessly integrate and orchestrate advanced processes.
2. Being able to identify, and act on, trends at a granular level, sector or local area insight for example, will provide the ability for more personalised and responsive decisions.
3. Journeys should be friction-right, not frictionless. To do this, intuitive architecture is imperative.
4. Disruption is coming from non-traditional sources. Being able to pivot to side-step disruption will support future growth.
5. Decisions need to be made without bias, in an explainable way. Ensuring your technology and analytical tools can accommodate such reporting and auditing is crucial.

Digitalisation is changing the way consumers use credit

With more people managing their finances and spending online and via mobile, 2020 saw digital engagement improve significantly. Digital and cashless payments have become the norm, with internet spending accelerated by five years. As a result, accessing credit at the point of need, via models like 'buy now pay later' have significantly increased in popularity, offering consumers an alternative to credit cards.

"Our latest advances to our decisioning platform (PowerCurve) accelerate new model deployment by using our ACE framework. It enables analytical models to be directly imported into the decisioning environment. From there they support the associated process flows that apply across multiple channels including customer portal, AI Virtual Assistant ("AIVA") and your own in-house execution channels."

The financial services and banking sectors are also under pressure from major cloud service providers including Amazon and Alibaba, as they provide consumers with financial products, cash services and credit cards. Digital devices like Alexa, Siri and Google Home will revolutionise how people manage their finances, enabled through the ability to deliver highly personalised advice to individuals. Embracing the cloud is vital for lenders to survive in a climate shaped by innovation, disruption, new competition from fintechs and platformification, and consumer demand for fast, simple, personalised, digital experiences.

As we head into 2021, it's more important than ever to consider these shifts, and customer-centric product design and digital experiences with affordability built-in, in the risk environment. Competition needs to be continually assessed. Beyond your traditional sectors, do you fully understand the threats, disruptions and influencers?

Cloud hosted platforms can provide critical insight into your market opportunity for new product development and launch – alongside other valuable factors such as where you're over-indexed or exposed in your current base. It will also make responding and reacting to market shifts and disruption much quicker, enabling you to keep pace with future change.

Click here to read our paper: The future of digital onboarding

Decisions need to be informed by granular customer-level insight, that's continually monitored

Accelerated digitalisation, from customer engagement to Artificial Intelligence (AI), Machine Learning (ML) and automated technologies, all contribute towards a myriad of complex threats and opportunities.

Today, automation has become a critical business need, and enabler, not just in scaling decisions, but as a way of boosting resilience. With a digitally accelerated world, having the right infrastructure that can support virtual channels and engagement is critical to success and risk mitigation – it can reduce cost, improve productivity and speed up sales cycles. Such resilience comes from agility, which is enabled by cloud technology.

There are multiple ways to assess, understand and manage risk at speed and scale, enabling you to adapt quickly and lend confidently. Beyond this, you will also need to understand the links between risks and their cumulative impact. Data alongside digitalisation will underpin everything.

Granular, local and sector-level data, analysed alongside many other data sources, traditional and non-traditional (for example bank account transaction data, or employment and salary data), will give you the insight you need to devise better, more agile risk strategies – and test, refine and action them. But, of course to do this, the tools and infrastructure that provides the connectivity and intelligence - is a crucial step.

With existing tools and approaches no longer in step with the pace of change, having the right technology in place to pinpoint accurate, actionable insights is vital, and possible. And, of course, the ability to consume new data, modelled indicators and processes into your decision strategies.

Continuous monitoring and benchmarking will help you control change, optimise risk management and identify new opportunities for growth – across your portfolios, and from prospects. Additionally, being armed with continuous intel on how your rejected applications have performed when trading with a competitor, will give you clarity and assurance in your risk strategies and policies.

Test, learn, monitor and deploy

To further enhance your confidence, risk and resilience, adopting new platforms that can improve your monitoring and policy adjustments becomes another pivotal step towards effective response.

We're continuing to invest in digital platforms that empower lenders with the data, analytics and models that can provide insight and foresight – both in live and test environments. Crucially, we're also creating an environment where this insight and foresight can be acted on, deployed, and monitored. This approach requires little intervention and can simply be consumed via the decision environment – to mitigate risk, increase opportunity and manage customers fairly and appropriately.

> "From an affordability perspective, there is currently a pressing need to understand employment risk and income, and validate the source. We realise this is an additional manual step and we're investing in new data sources to help build employment verification. We're also making it easier for lenders to assess affordability and employment stability on an automated basis."

Frictionless or friction right?

Lenders and regulators alike are focused on driving better customer experiences and outcomes through innovation at every stage of the customer journey. Customers expect quick decisions across multiple channels, but a smooth journey shouldn't be at the expense of accurate checks for affordability and fraud, for example. It's not about frictionless, it's about friction right.

The right technologies underpinned by the right data will enable you to redesign digital customer journeys in the new credit economy

Automation has long been known to remove friction but it requires more data than bureau data alone to truly align decisions and strategies to golden data sources. You need data you can trust to automate decisioning and remove the need for manual underwriting or oversight.

Crucially, to design the right journey different forms of data remain necessary – as explored already, salary data, affordability, biometric and many other sources become a valuable aid in reducing risk, without the expense of a slick customer journey. To harness this opportunity, and maximise new, non-traditional data sources, you need the infrastructure to consume it – in multiple forms. Data also needs to be of high quality, and continually managed and aggregated to ensure you are always working on the best base of information.

Thanks to significant advances in cloud, software-as-a-service and continually advancing AI and ML capabilities, this is possible, without the burden of an IT overhaul or months to build. Access to augmented decisioning can be rapidly deployed and optimised in weeks. Which means you can tackle the challenges and embrace the opportunities of 2021 with tools that are fit to respond, and scale or change as you choose.

The reality of automation is that consumers get decisions in seconds and are able to access what they want, and what's fair and appropriate, fast. It also enables more connectivity between each step of the journey. For example, eligibility or affordability calculators will be more accurate, and by assessing a customer's eligibility upfront, they'll get the outcome they were expecting. Leading to greater customer satisfaction and less churn. Process augmentation is critical, and it should enable you to onboard the same number of customers, but with lower risk and less chance of delinquency later in the life of the loan. Even if volumes are lower, the potential for value could be greater – as you can benefit from the opportunity to increase 'share of wallet' and subsequently, lifetime value. Giving you a greater ROI and the ability to meet your growth trajectory.

Our latest edition of PowerCurve helps you adopt the most effective decision-management strategies across the entire customer lifecycle. PowerCurve takes your customers' information and enhances it with credit, fraud, Open Banking and internal data, then uses predictive scoring models and policy rules to trigger instant automated decisions.

Click here to read our frictionless digital journeys whitepaper

Tools for change

It's important to ensure all areas of your decisions are optimal. With uncertainty the new normal, you can't rely on affordability at the point of application. You need to continually assess whether lending will be affordable for individual customers as their circumstances evolve and test scenarios to accurately assess exposure and loss. You also need the ability of foresight into when affordability has changed and what will happen if it changes – to your individual customer and your portfolio. That's why effective, ongoing scenario modelling is crucial.

By harnessing the power of AI enriched software, you can be assured that not only are your decisions optimal – from pricing to limits - but also ensure you are constantly making decisions relevant for that point in time, and economic environment. Such capability can also give you the advantage of supporting provisioning and portfolio risk – in parallel.

We believe that enabling businesses to leverage their current technology investments to support future growth is key to ensure they get the full benefit of their commitment to innovation.

At Experian we have accelerated our investment in innovation significantly in the last few years. Our latest Decisioning capabilities allow custom plug-ins to be added at any time to support the next generation of technology and decision-making strategies, while ensuring consistent, precise and personalised experiences that satisfy consumers' demands over time. This enhanced flexibility means you can get value from your current data and technology investments today, and keep pace with the latest and most effective decision management strategies across the entire customer life cycle.

Alongside many enhanced features, our improved cloud-hosted decisioning platform is continually advancing and adaptable – which means you will always be privy to, and able to use, the latest updates and techniques. Enabling you to design decisions, against your rules, as and when you choose.

Increase flexibility in your analytical tools

Maintain and increase relevance

Improve customer experience

Our software is designed to help you architect your IT for the needs of today, while being responsive and adaptive to tomorrow's demands. With the inbuilt ability to consume data and integrated analytics you can not only make effective decisions, but ensure they are always built off accurate, timely, relevant data. Our advanced capabilities also bring the additional opportunity for firms to continually monitor performance, test and learn from new models and scenarios - and deploy change at rapid pace. The cloud-nature of our solutions gives you continuous access to the latest updates, giving you peace of mind that you're always using the latest technologies, techniques and insights to build decisions.

We're continuing to invest in digital solutions that empower lenders with data, analytics and models that provide real insight, and foresight. Crucially, we're also creating an environment where you can act on that insight and foresight, quickly and easily deploy it into your decision environment to mitigate risk, increase opportunity and manage customers fairly and appropriately, and monitor the impacts to keep optimising.

In the data analytic environment, trust, explainability, transparency and ethics become critical considerations

A question of ethics

As we continue into the 5th industrial revolution, and the liberalisation of data becomes every day, ensuring data is used appropriately, stored securely, and protected becomes an imperative for us all. Equally, data needs to be used fairly and ethically, and data-driven decisions need to be explainable. Open Finance raises a range of ethical issues, which need to be anticipated and planned for, if lenders are to protect consumers and build their trust.

Explainability

As the proliferation of data continues and more industries use advanced techniques to develop more predictive models, there is a need to explain these new models and verify they are performing correctly, and for regulatory purposes. Reports show that lack of explanations are a major factor that hampers uptake of advanced ML models. This is becoming a top priority for financial institutions making high impact decisions in regulated markets.

Through PowerCurve, we've created an AI-augmented decisioning platform that enables explainable models and decisions, providing transparency across the decision process. Through our technology, we have developed a solution that aims to solve the ultimate problem of determining and fixing algorithmic and decision bias. It applies to any stage of modelling, allowing you to train, evaluate, and improve your models.

Fairness-as-a-Service

In order to help tackle this issue holistically, Experian has developed a commercial means of identifying and remedying bias in models. Our Fairness-as-a-Service platform (FAAS) launched in 2020 and uses our own proprietary algorithms to help analyse discrimination and bias in ML models. We've packaged and commercialised these tools in such a way that they are tailored to the specific use cases of the financial services industry. In addition, by integrating our 'normative' representative datasets, our clients are able to measure fairness against multiple dimensions (e.g. religion, ethnicity) that were previously unattainable, due to lack of measured data.

Our FAAS platform is currently being trialled with major banks and we expect to roll out the service across multiple industries going forward. We've also worked closely with regulators to ensure FAAS reflects their views of fairness, to provide the most relevant service to our clients. Digitalisation and the proliferation of alternative data sources, including open data, makes data accuracy and fairness an increasingly important sustainability topic. Historically, it's been argued that algorithmic decision-making reduces incidences of human bias, but our research shows AI can perpetuate, exacerbate, and even mask discrimination if the underlying data on which the model is trained and run is erroneous or biased.

FAAS has four key functionalities

1

Evaluate fairness

How fair is your data and model

2

Explaining models

Do you understand your model's predictions globally and also at an individual basis

3

Training fair models

So they are both predictive and fair

4

Applying fairness

So you can update your models to make them fair, as well as amend your model's decisions, to make those decisions fair

Conclusion: 2021 or 2031: the future relies on resilience and response

In a climate of change and uncertainty, insight, monitoring and testing across the credit lifecycle will be essential. Not only to manage risk and exposure, but to identify new opportunities and meet evolving regulatory responsibilities.

The structure of the economy has radically changed in the last decade, and we expect it to change in the next. The next two years will sustain a period of uncertainty as we transition fully from pandemic to economic shock, with the expectation that unemployment will peak at a little under 8% (the highest level since 2008) alongside a continued slowdown in spending and investment.

Crucially, the economy has actually faired resiliently at large, despite the significant economic, health and socio-economic impacts facing the nation. But it has been helped significantly by continually advancing Government support measures. How can the economy continue to be as resilient without them?

The economic position is influenced by many factors, many of which we've covered in this report and others. The speed with which people move jobs and control their own lives, alongside the speed of change, creates an environment that is already fluid and reactive. The need is to be responsive to this.

The last few years has seen the nature of financial services shift significantly, with draconian debt collection replaced by a softer, more customer-centric approach to arrears and affordability designed into financial products and services. Lender response could also help to soften the economic outcome, with the continued and heightened approach to due diligence and affordability in customer strategies.

The reality is, that not everyone is impacted in the same way and economic trends aren't nationally or regionally balanced. It's not until you drill down into income shock analysis, to household income shock, that you can see where the stress points are. While one income lost will likely cause an impact on daily life, it may not cause a stress point which is impactful on sustaining livelihoods or outgoings. Drilling down is crucial, alongside the inclusion of additional insights into your risk models to understand impact fully. Having an individual view will be imperative to understanding risk and applying remedies and strategies to help your businesses' exposure, your customers and the economy as a whole.

It's all about early warning indicators. We can help you understand which parts of your portfolio are likely to be impacted. We can help you develop robust 'what if' scenarios to help you prepare for alternative realities without having to wait for them to become reality. We can also help you identify stronger segments, to which you can lend confidently.

It's going to be a case of learning as you go and recognising uncertainty as the new normal. We have the tools, models, and techniques to solve the most complex problems and improve your insight and foresight. Providing you with solutions and support for today and tomorrow.

2021 is set to be another challenging year for the financial sector, but it could also be the beginning of a fundamental shift towards a fairer, more ethical, more sustainable, customer-focused credit economy.

About Experian

Experian is a global innovation company with a simple mission to transform people's lives and help shape the societies we live in.

Our world is built on data; it's everywhere, growing in power and influence. At Experian we have always believed that data has the potential to transform lives and create a better tomorrow. To do this, data needs to be understood, interpreted and acted on. We work to do just this: unlock the possibilities that data holds and help people and organisations realise the opportunities within.

We are continuing to innovate with data to help you navigate the crisis. We have continued to invest in Covid-19 specific innovations which provide additional clarity into risk management, capital adequacy and credit provisioning.

Our latest innovations enable you to understand your customer circumstances, and plan for potential spikes in arrears. Allowing you to allocate the right resources to combat such spikes. While we are focussed on developing new capabilities that can help you with understanding, and action – whether it be analytical models that consider economic variables, or tools that can enhance your outcomes, throughout your decisioning – we are in a unique place of being able to help you across the entire value chain.

Experian's platforms focus our expertise centrally, while delivering specific capabilities to our customers

One specific area where we have invested significantly, is through our four platforms. By doing so we are uniquely placed to be able to provide a consistent and flexible way for you to access our products and services.

The benefit of Experian platforms is greater integration and interoperability between products making it easier to deploy and much faster speed to value from the exciting new functionality and features. The inherent flexibility of the platforms design and architecture provide the basis for multiple use cases and so you can extract significant potential and return on your investment.

Designed to work independent, or as a connected architecture, the platforms are uniquely designed to offer you an environment that can support your decisions end to end, across all lifecycle stages. Configured to your needs, or available as preconfigured use cases, our approach to product design and provision is one that's based on flexibility and agility. To find out more about how we can help you understand your exposure, opportunities and priorities – please contact us. Our expert consultants can work through your needs and provide unbiased views on areas where you can reduce risk, and boost resilience.

To understand more about our Covid-19 response, watch our short video.

Experian are perfectly placed to support an end to end strategy for 2021 and beyond

Core Data Platform

Open Data Platform

Data Analytics Platform

Decisioning Platform

Core Data Platform

- Detailed and high quality data on ~50m UK adults
- Available in real-time
- Continually updated from thousands of independent sources

Open Data Platform

- A real-time view of customers' financial well-being
- Categorises 90% of bank transactions in under 1 sec
- Access to confirmed identities for 71% of UK adults

Data Analytics Platform

- Powerful, big data and analytics on-demand environment, linking data, advanced analytics and deployment
- Analytics and ML through Cloudera Data Service Workbench
- Scorecards and models integrate into our Decisioning Platform; enriched by Challenger and Pulse technologies

Decisioning Platform

- A robust future-proof platform proven to deliver faster more accurate decisions with greater flexibility in designing strategies
- Integrated decisioning across all phases of the customer lifecycle; any level of customisation; any hosting preference
- Unrivalled data, analytical and local expertise
- Commitment to innovation

Business benefits

- Enhanced provisioning, exposure, market and portfolio insights
- A clearer customer lens for more accurate lending decisions
- Great opportunity for growth, confidently
- Fair treatment and customer-centric approach to collections - including early intervention strategies
- Data-led, insight rich decisions - fast

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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 making this information available, in the public interest, 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 the breadth of 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.

Sources:

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