An Experian insight report

2020: A year of seismic change

Applying what we've learnt to credit risk strategies

November 2020

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"The current economic crisis is not comparable with the previous one. The speed of change seen in recent months has been faster than anything we've experienced before."

What a year it's been.

In the months since the Coronavirus first hit the headlines we've seen and experienced seismic shifts in the way we live, work and spend. While we all try to adapt to a new normal, the reality is 'normal' continues to evolve at pace.

At Experian, we've been monitoring the behavioural and economic impacts of the pandemic – and the measures the Government has put in place to tackle it – from the very beginning. Alongside our industry research and the ongoing tracking of changes to demographics, this puts us in a unique position to observe and report on emerging trends.

The challenge during this period has been the volatility of those trends. Changes are rapid, and sometimes short-lived. Signs of recovery seen in one month are reversed the next. This unpredictability makes devising appropriate strategies much more difficult.

In this paper, we'll look at how the credit landscape has changed and continues to change; how the industry has responded; and how learnings can be applied to credit risk strategies to ensure they're fit for purpose in a turbulent economy. We'll also consider the other factors disrupting the market, and ways in which the right data, analytics and technology can help you meet those challenges head on.

Our intention is to provide guidance and clarity on the strategies and changes that are needed to manage credit risk throughout 2021 and beyond.

This report is accurate at the time of writing: November 2020.
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The credit market pre-Covid

It's useful to take a look at the state of the credit economy prior to the pandemic to give more context to some of the challenges we're facing now. In fact, despite an extended period of full employment, the UK economy was already showing signs of being stretched. In 2019 household debt was the second highest of the G7 countries; disposable incomes were falling; real wages had remained static for a decade; and we were saving less and less.

Consumer credit was growing at a significantly higher rate than the economy. To meet growing lifestyle expectations, consumers were increasingly borrowing to buy; considering the monthly affordability of credit rather than the overall cost. Higher value loans at low interest rates, over longer terms were making it more affordable. Similarly, we were seeing lending take place later in life, even in retirement. The Bank of Mum and Dad was borrowing or releasing equity to help their children get on the property ladder, rather than using accessible cash.

It's all meant that any spare affordability capacity was already being used up. In some cases exceeded, which is reflected in the slight rise in delinquency rates in 2019. A challenging position for an economy about to face the swift and severe effects of a global pandemic.

What we've learnt from 2020 so far

Seven months on from the first country-wide lockdown, the effects of the Government's measures to mitigate the economic impact of the pandemic are still emerging. But they all demonstrate how important it is to look beneath the headlines and understand change at a granular level.

The legacy of lockdown

The national lockdown of people and businesses in March 2020 had a swift and severe impact on the country's GDP, which dropped by an unprecedented 20% in April.

And while all parts of the economy took a hit, certain sectors – travel and hospitality in particular – were the most significantly impacted during lockdown. Some businesses within these sectors may never fully recover.

As of 31 October 2020, the regional tier system had one in four people in lockdown. As of 5 November 2020, all UK residents are facing a month-long lockdown, bringing the national impacts of these measures back to the fore. While the situation is changing all the time, lockdown – whether regional or national – looks set to become a way of life. That means different and evolving exposure to risk for people and businesses across the country, dependent on the region's lockdown status and concentration of at-risk sectors. Making regional and local analysis even more critical.

20%
drop in GDP in April 2020

4.5%
official unemployment rate

The two sides of furlough

At time of writing 10% of the UK's 27.9 million employees remain on furlough. As with lockdown, there has been significant regional variation – 42% at one end of the scale and 21% at the other – depending on the area's most prevalent sectors. The Government's job retention scheme has undoubtedly stemmed the tide of job losses, but it has had the additional effect of masking people's long-term income prospects, making the job of identifying vulnerability much more difficult.

On 31 October 2020, the Government announced a month-long extension to the Coronavirus Job Retention Scheme, otherwise known as the furlough scheme. This will remain in place until December and will ensure employees receive 80% of their salaries for hours not worked, up to a maximum of £2,500.

Businesses in England will also receive grants if their premises are forced to close. And £1.1bn is being given to Local Authorities to provide broader support to businesses.

These measures have been introduced to mitigate the short-term impact of the current national lockdown. And when they come to an end, new measures are likely to replace them. While they will provide positive short-term relief, they are also delaying the inevitable impact on redundancies and unemployment.

In fact, we're already starting to see unemployment trending upwards. And the largest increases in redundancies since 2008. Income trends are no more insightful. July showed incomes had increased to pre-Covid levels. Swiftly followed by a decline to 19 million people's incomes in August.

At this point in time, we expect incomes to fall further over the next 9 to 12 months, and predict that the peak in unemployment is yet to be seen.

"Our view is that the latest national lockdown will likely lead to another negative quarter of growth in Q4; with more people finding themselves back on furlough in the coming month."

19m
people experienced income decline in August

10%
of the UK's 27.9 million employees currently on furlough

Emergency Payment Holidays (EPH): risk or resilience?

There are some concerning signs of risk emerging amongst the people who've taken an EPH for one or more of their credit products. Particularly when compared to those who haven't taken a holiday and have maintained a stable income.

For people whose EPH have come to an end, delinquency rates are significantly higher than the sector average. And as these EPH borrowers also hold 18 million other credit accounts, the fear is that a potential contagion of delinquency could spread from one account to another.

Much like the furlough scheme, EPH have had a masking effect on the stress indicators that would historically have triggered action. But the flip side of this perspective is that 53% of EPH were, on the face of it, unnecessary. These borrowers' incomes have remained stable throughout the pandemic, begging the question: why take a holiday?

Lenders we've polled are split in their view as to whether it's a cause of concern or not. After all, it could be a proactive measure to build resilience. But almost all agree that the impact of EPH on their ability to assess risk is a worry.

The recent extension of EPH adds further risk and uncertainty into the credit market. Lenders are looking to manage their existing portfolios and onboard profitable new business in a period of unprecedented uncertainty without a clear view of borrowers' true credit behaviours. This is likely to suppress credit market recovery until the effects of Covid on the economy and borrowers are fully visible and understood.

53%

of people didn't need a payment holiday

UK consumers paid off a record

£7.4bn

in credit and loan debt during lockdown.

Source: Bank of England

Learnings from the last credit crisis

The speed and scale of the current economic crisis make comparisons with the crisis of 2008 difficult.

The impact of the pandemic on the economy was greater in just 10 days than during a whole quarter of the 2008 crisis. But there were lessons learned during that credit crunch that have protected the credit market to a certain extent this time round.

The affordability rules introduced in the wake of the last crisis had succeeded in stemming the tide of unsustainable lending we saw going into 2008. That meant the business being written was stronger overall.

The Government and the Bank of England were very quick to introduce measures, like the reduction in interest rates, and the suspension of stamp duty. And that has helped sustain demand and allowed lenders to return a majority of products to market.

However, unemployment does look set to reach similar levels of 8 to 9%. And we know from previous experience that it's likely to be three or four years before that comes back down. So lenders should be primed to understand the relationship between unemployment and delinquency at a regional and sector level to define the right risk strategies and predict propensity to default on payments.

A phased response

As we look back from March, we can see how the industry's response has been phased. The immediate challenges for lenders were largely operational. The first phase of the response (between March and June) could be described as firefighting; customer demand increased fivefold at the same time as branches were closed and staff adjusted to working from home. And manual processes were unable to cope with the volume of consumer and commercial requirements.

The practical impacts of consumer and commercial forbearance measures, and the speed with which they had to be implemented, highlighted the limitations of traditional lenders in particular.

They accelerated the need for automation and insight through artificial intelligence (AI) and machine learning (ML) to make the right decisions during this turbulent time. And firms who had been slow to invest in digital platforms found their ability to engage with, and provide services to, customers severely compromised.

From June onwards, the focus has been on dealing with the fallout of phase 1. Phase 2 of the response has seen lenders taking measures to remain compliant and protect themselves from the volatility in consumer and commercial risk profiles. So business priorities have been:

Accurately assessing affordability and creditworthiness

A key focus for the last couple of years, this has taken on much greater importance now that credit risk is more difficult to understand.

A longer-term view of changes to income, changing use of credit, and income to debt metrics can all be more effective ways to identify an individual's propensity to pay than pre-Covid methods.

Preventing a surge in collections

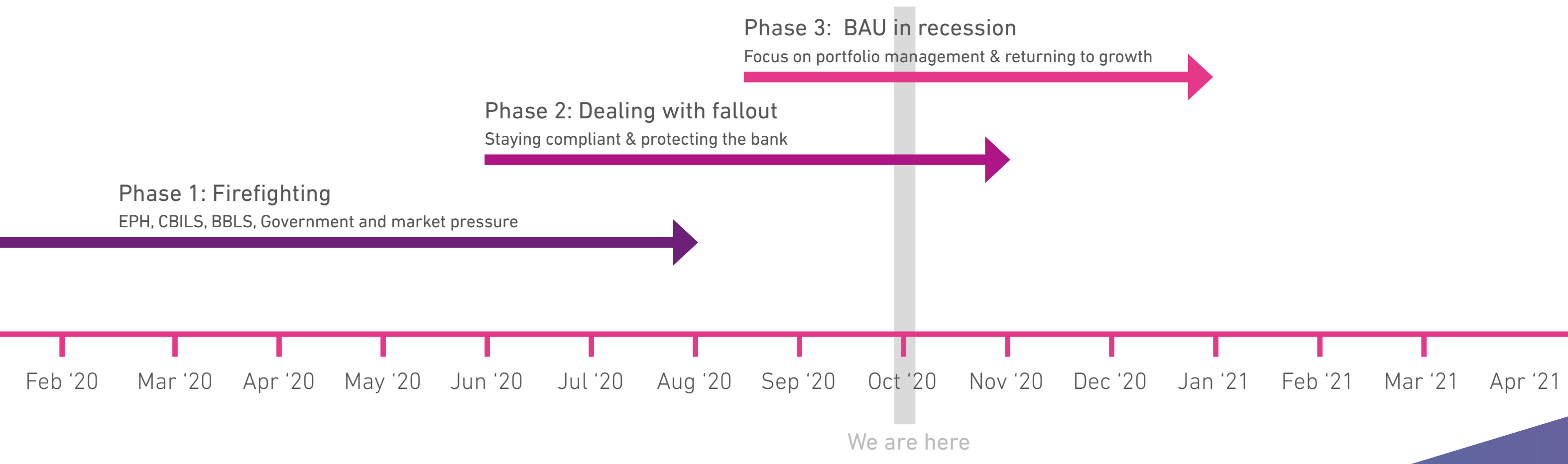
The combination of jobs disappearing, declining income and increased debt means it's essential to be able to identify signs of financial hardship and have early conversations to prevent a bad situation from getting worse.

Our own market research showed that many lenders have been using open banking data as a way to identify which customers have been affected financially by Covid-19, and to help provide the appropriate assistance or forbearance.

Identifying portfolio risk

Managing existing customers and mitigating risk across portfolios is made more challenging by individuals' and businesses' changing risk profiles. Not to mention the variation in risk between different sectors and regions.

Granular data and insight is key to defining customer-centric solutions. As is the ability to model different economic scenarios to forecast potential impacts.



Where are we today?

From a macroeconomic perspective, we're in the midst of the deepest recession on record. And while we expect Q3 to show record levels of growth, Q4 is likely to see another drop and GDP will be significantly lower than pre-Covid. As such, credit providers and risk professionals are moving between phase 2 and a third phase geared towards adapting to business as usual in a recession, and importantly, returning to growth.

That means embedding and automating new risk metrics and alternative data into processes and customer journeys (we'll explore this later in this paper). But it also means recognising how consumer behaviours and demographics have changed, possibly for good.

In the next section we look at three key trends which have changed behaviours.

"Government measures and economic conditions are moving the goalposts continually. However, all that's changing is when the full impact will be felt. In many instances it's delaying the inevitable. We have a long way to go before we are out of the woods."

Accelerated digital engagement

In the week commencing 22 April 2020, three times more 70-year-olds registered for online banking than in the same week in 2019. Similarly, prior to lockdown, online banking registrations hadn't changed much from 2019, but from 16 March registrations amongst people aged 40+ grew significantly.

We saw similar trends in the use of social media and digital channels across the population during lockdown. With access to physical services and outlets severely limited, customers need and expect to be able to engage with businesses online, easily.

Remote working is here to stay

Going to work may continue to mean a two-minute commute to the home office for many people. Analysis of our Mosaic segmentation was already showing a migration of suburbanites to more rural locations as the need to be close to the office was waning. And the enforcement of home working through lockdown has opened many employers' eyes to its potential as a longer-term strategy.

This will have an obvious impact on commuter volumes. And it may be years before people return to public transport in the same numbers as before. That means reconsidering channel strategies that previously relied on out of home advertising. And a renewed focus on social and digital channels, as well as a regional approach to targeting that reflects local lockdowns.

"According to EY, there's been a 72% rise in the use of FinTech apps since lockdown. McKinsey research suggests digital banking usage has accelerated by two years as a result of the pandemic."

3x

more 70-year-olds registered for online banking during w/c 22 April than in the same week in 2019

5.2%

of the UK's workforce reported working primarily at home prior to Covid-19

46.6%

of the UK's workforce were working from home in April 2020

A perfect storm for young people

Already squeezed from an affordability perspective and struggling to get onto the property ladder, the economic impacts of the pandemic have particularly disadvantaged younger groups. New lending in mortgages is down by 18% on 2019 (YTD) and nearly half of that decline is made up of younger population groups (up to 35).

Young people are more likely to work in the sectors most adversely affected by the pandemic, which is reflected in the fact that unemployment is higher amongst the young than middle-aged and older people.

And as they're also more likely to rent than own their own homes, they're committing proportionately more of their household incomes to accommodation, further decreasing their discretionary spending allowance.

Nearly **50%**

of the decline in new mortgages is made up of younger people (up to 35)

c.13%

the unemployment rate for people aged 16 to 24 (versus c.3.5% for people aged 25 and above)

Looking forward:

The longer-term effects of Covid-19 on the credit sector

The impact of the virus on the way we spend our time and money is affecting, and will continue to affect, demand for credit. Consumers are spending less and prioritising essential items over luxuries, making day-to-day trade-offs to stay afloat. They're also getting more savvy and taking more control of their personal finances, showing a greater propensity to shop around and switch to the best deals.

Changes to the way people pay are also pointing to a longer-term trend. Not only are we seeing a rise in digital and cashless payments – it's estimated that the pandemic has accelerated internet spending by five years. New payment methods such as 'buy now pay later' and 'basket finance' continue to increase in popularity, paving the way for new models of accessing credit at the point of need, rather than via credit cards, for example.

The reality is that much of the population will become more financially stressed for a longer period. As unemployment rises, disposable income will decline further. Many will experience financial hardship for the first time. We're also likely to see a drop in retirement savings and long-term security. So the affordability squeeze we saw prior to the pandemic is only going to intensify as people see more pressure on their income and savings.

The other forces disrupting the market

There's little doubt that Covid-19 will continue to challenge the credit economy, but it's just one of several macro forces impacting the market as we look to 2021 and beyond. The others aren't new, but they're moving back into view.

Climate change

Prior to Covid-19, the PRA was regulating the industry to conduct climate-related stress tests on portfolios with the aim of understanding their exposure to climate risk. For example, the volume of housing stock in flood areas and individuals vulnerable to job losses in non-green industries. Credit providers will need to make the right forecasts and adjustments to mitigate this risk.

Brexit

The prospect of a no-deal Brexit is one that brings both uncertainty and risk. Not only will borrowers be exposed to a difficult economic period if there's no deal, but certain sectors will be more vulnerable than others. Unfortunately, these look likely to be industries that have proven their resilience in the face of the pandemic – like manufacturing and construction – leaving very few sectors unscathed by one or the other. This will have a clear impact on lenders' portfolios.

Regulation

To help firms respond to the pandemic and focus on immediate needs, some pending regulatory changes were delayed. Changes to regulatory reporting were also implemented by the FCA. But now, the FCA has updated its guidance to make it clear to firms that they should be focusing on long-term impacts, rather than their immediate response to the pandemic.

They expect "all firms to have contingency plans to deal with major events and that these plans have been properly tested. Such plans were outlined in their operational resilience consultation paper published late last year, which sets out proposals for how firms can strengthen their resilience so as to be able to supply their most important services with minimal interruption, even during severe operational events such as Coronavirus."

This is an economy we've not operated in before. And these factors will all play into lenders' ability to identify and nurture the business they want, and extend credit with confidence.

At Experian we believe regulation is a force for good. From our analysis we can see this coming through, with 4 in 5 (78%) of firms stating regulatory frameworks has improved their resilience to disruption and economic distress, it has also increased most firms' investment in risk management.

Planning credit risk strategies for 2021 and beyond

So what does all this change mean for your credit risk strategies beyond 2020? What learnings can you apply that will help you strike the fundamental balance between mitigating risk to your organisation and supporting your customers through this turbulent period? And critically, how can they help you return to profitable growth.

We believe these are the key focus areas:

1

Develop a better ongoing understanding of affordability and creditworthiness

Pre-Covid methods of understanding affordability are no longer reliable because they can't reflect the rate at which things are changing. A longer-range, real-time and granular view of income and expenditure is needed to truly understand an individual's ability to pay. The sort of view afforded by open banking, which can be deployed on an ongoing basis to monitor change. It's not about adding more checks, but rather making sure they're taking place in the right place, at the right time and at the right frequency.

2

Define joined-up risk strategies across the customer lifecycle

A proactive and holistic approach to customer management is needed to monitor signs of persistent debt and other stress within your portfolio and act on them in good time. While you may need to be prepared for increased collections, a strategy that allows you to intervene with measures before a customer automatically rolls into collections, is a better way to minimise your exposure. Our polls show that 83% of lenders feel they are under increased pressure to identify non-financial vulnerability in their customers, and ongoing monitoring can help. Equally, it will highlight those customers whose financial situation is improving, allowing you to tailor the right solution to them at the right time.

3

Harness automation as a means to adapt at speed and scale, whilst controlling costs

As we have seen, decisioning has become much more complex, prompting the need for more granular data and insight, and non-traditional indicators. As well as stress testing, models and analytics that consider wider data sets to increase accuracy and foresight into opportunity and risk. Marrying this combination of new and traditional data with the technical ability to action insights into your processes is key to performance and agility.

Our cloud-based decisioning platforms allow you to quickly harness automation by easily integrating decisioning strategies into your commercial models. They also let you manage and control those strategies as you need to; adding and amending as you choose. You can access specific modules that let you design and implement your own tech stack and make sure it's fit for purpose in volatile circumstances like these.

4

Deploy digitisation to improve customer management, engagement and communication

Covid-19 has accelerated the focus on digital transformation from one to three years, to one to three months. Despite past investments, many decision-makers admit they're not keeping pace with customers' expectations in terms of online engagement. Investment in digital platforms is critical to growth. With the right strategies you can better manage your contact and communications strategies too. Identify people through a more effective single customer view, and orchestrate decisions across channels, to increase engagement and improve response rates.

5

Accelerate adoption of AI/ML and data to optimise customer insight and better inform strategic decisions

More than ever, insight is central to business performance. And tools like AI and ML help you make the most of your own and third party data to improve customer experience, build a more accurate picture of indebtedness and affordability, and protect yourself against risk. They can also help to ensure you maintain fairness in your decision-making, and aren't inadvertently introducing bias to your decisioning processes as a result of having to make changes so quickly. Our platforms allow for the interconnection of all available data to ensure you're making insight-led decisions throughout the customer lifecycle.

"Experian's platforms are uniquely placed to bring together the many different components in the credit process (from fraud checks, to affordability assessments), allowing you to make changes and continually optimise your processes."

6

Test and learn to optimise risk strategies

As well as monitoring credit conditions in your own sector and across the market, applying a test and learn approach is essential to stay agile and responsive.

Our analytics-on-demand platform allows for easy integration of an analytical sandbox that lets you access whole of market insights to test certain scenarios. For example, understanding the impact of change on a segment, or at a portfolio level. Seeing how risk will change if you revise credit risk strategies and rules. Most importantly, you can quickly deploy any changes you have tested into your live systems. Giving you the ongoing ability to make informed changes that will reduce risk and improve resilience.

A final word

Uncertainty is the prevailing theme going into 2021. The worst impact of the pandemic on the labour market is still ahead of us. Any deal made with the EU will deliver different trading conditions to the ones we've been used to. Climate risk is certain but unpredictable. So we're operating in an economy that will test our abilities to manage risk and lend confidently.

But there are ways to assess, understand and manage that risk at speed and scale. Continuous monitoring and benchmarking will allow you to control change and optimise strategies so you can identify the risk in your portfolios and, critically, identify new viable opportunities for growth.

Granular, local and sector-level data, analysed alongside supplementary data and your own portfolio assessments will give you the insight you need to devise, test, refine and action agile risk strategies. And deliver more accurate indicators of stress and vulnerability than traditional sources that can no longer keep up with the pace of change.

Strategies should look to make use of all the data assets available to help you make the best credit risk decisions. And crucially, they should marry that data with the technology that will deliver insights you can act on.

Sign up for the latest data insights

This year we've been hosting monthly webinars, which unearth useful insight from unrivalled data sources.

These webinars provide the latest economic trends and forecasts, delivered by our in-house, award-winning economics team, along with the latest consumer and commercial credit trends. We've seen over 70% repeat attendance from more than 800 industry leaders so far, each benefiting from a monthly and future perspective. For 2021 we'll be launching a new series of insight webinars, which you can register for now.

These monthly sessions will consider data, sector and industry trends, to ensure the content is insightful, helpful and, more importantly, current and relevant.

With so many different areas of focus and the pace change, we supplement the monthly sessions with additional topic-specific deep-dive sessions. Register now for the sessions currently available and make sure you opt in to receive communications from Experian to get the latest invites for future sessions.

Click here to see the agenda, and register

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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.

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