Credit market perspectives and challenges

experian

An Experian research report exploring trends of firms' and consumers

August 2020

EXPERIAN INSIGHTS

Using the power of data to help you

ADAPT, SURVIVE AND THRIVE

Contents

Introduction

The coronavirus pandemic has had a dramatic effect on global economies, driving a comprehensive and lasting shift in consumer behaviours, expectations and values.

The picture continues to evolve rapidly and, as such, lenders of all sizes face the challenge of keeping pace with the speed of change. At this point, we're heading towards the point where the real economic impact of the pandemic hits the credit markets.

In this report, we look at the key trends, evolving attitudes and emerging post-lockdown challenges for both lenders and their customers.

> The pace of change is like nothing we've experienced before – and the need to rapidly accelerate digital transformation has never been greater

Key trends explored within this paper

- **How the market has, and is changing**
- **How have consumers needs changed?**
- **What challenges, and priorities, are businesses facing?**
- **What tactics are being adopted to support immediate needs?**

About our research

During the Coronavirus pandemic we have been continually monitoring datasets to understand how trends are evolving, including uncovering emerging risks. We have closely monitored a series of different datatypes spanning traditional and non-traditional data sources. In addition, we have commissioned B2C and B2B surveys to provide a complete picture of the market.

In June 2020, we commissioned a study by Forrester Consulting. The results cover findings based on more than 1,000 CXOs across the UK and EMEA.

Our research findings are consistent, regardless of industry or country, with the business challenges we see right now across our entire global customer base.

The pandemic has provided a valuable learning experience, helping shine a spotlight on gaps and missed opportunities in risk planning. As we move forward, its clear CEOs and decision-makers are assessing key learnings, insights to factor into business continuity, resilience and management plans from here on. We have supplemented this market-view with qualitative research from across 50 UK decision-makers, of which the paper refers too throughout.

Key outcomes of our business survey

Business performance

80% expect to recover their position within 18 months

56% of firms expect to be trading at pre-pandemic revenue and profit levels within the next 12 months

Challenges

40% struggle to gain a complete picture of indebtedness

Real-time insight remains a barrier, specifically understanding income and expenditure in real-time

Priorities

80% have increased budgets for advanced analytics including AI and ML

4 in 5 are now increasing investment in customer insight

Growth

60% are focusing on growth opportunities

1 in 3 are investing in new products

40% increase in investment to support new, and existing customers

Key trends we have identified through our data analysis

The economy

1 in 8

Britons had no savings before the pandemic began, with 8.3 million people already over-indebted [1]

36-point drop

in consumer confidence

5.7%

real unemployment rate – set to rise to 9%

18%

reduction in spending expected in 2020; 7% reduction in 2021

Financial stability

28%

believe their financial situation has worsened in the last 3 months

34%

of Britain's employees currently on furlough [2]

Indebtedness & delinquencies

41%

have suffered income shock

50%

increase in arrears expected by March 2022 across consumer and commercial credit

Forbearance

If 10%

of payment holidays go bad, arrears will double by 2021 – 70% worse than the peak of the 2008 crisis

20%

of those taking a payment holiday have also applied for credit in the last two months

Commercial credit

56%

increase in time taken for businesses to pay their suppliers

an increase in new incorporations (specifically mid-to end-June)

Consumer need

8m

consumers have sought debt advice from their bank [3]

70%

of consumers welcome online advice during a credit application

Business landscape

80%

of firms expect to be trading at pre-pandemic revenue and profit levels within 18 months (56% within 12 months)

40%

of firms are struggling to gain a complete picture of indebtedness

4 in 5

are increasing investment in customer insight

1 https://www.fca.org.uk/news/speeches/financial-system-support-recovery
2 https://www.statista.com/statistics/1116638/uk-number-of-people-on-furlough/
3 Research conducted by Virgin Money

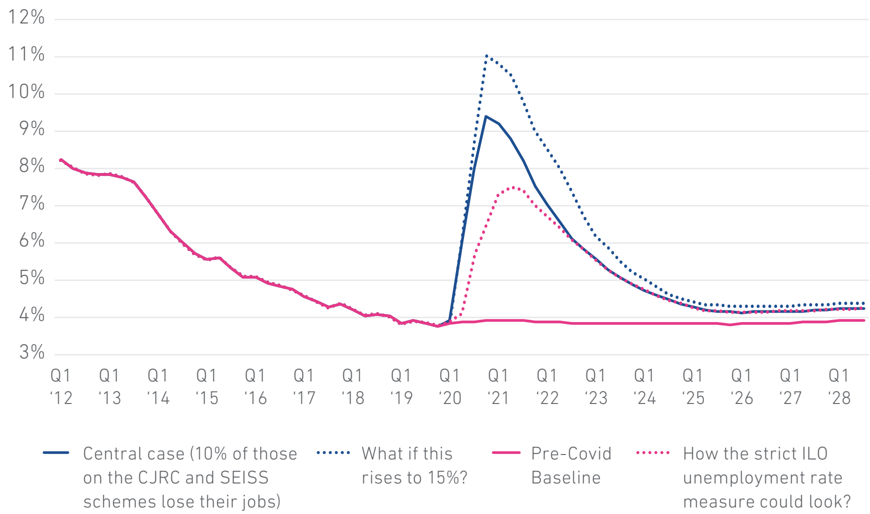
Macroeconomic overview

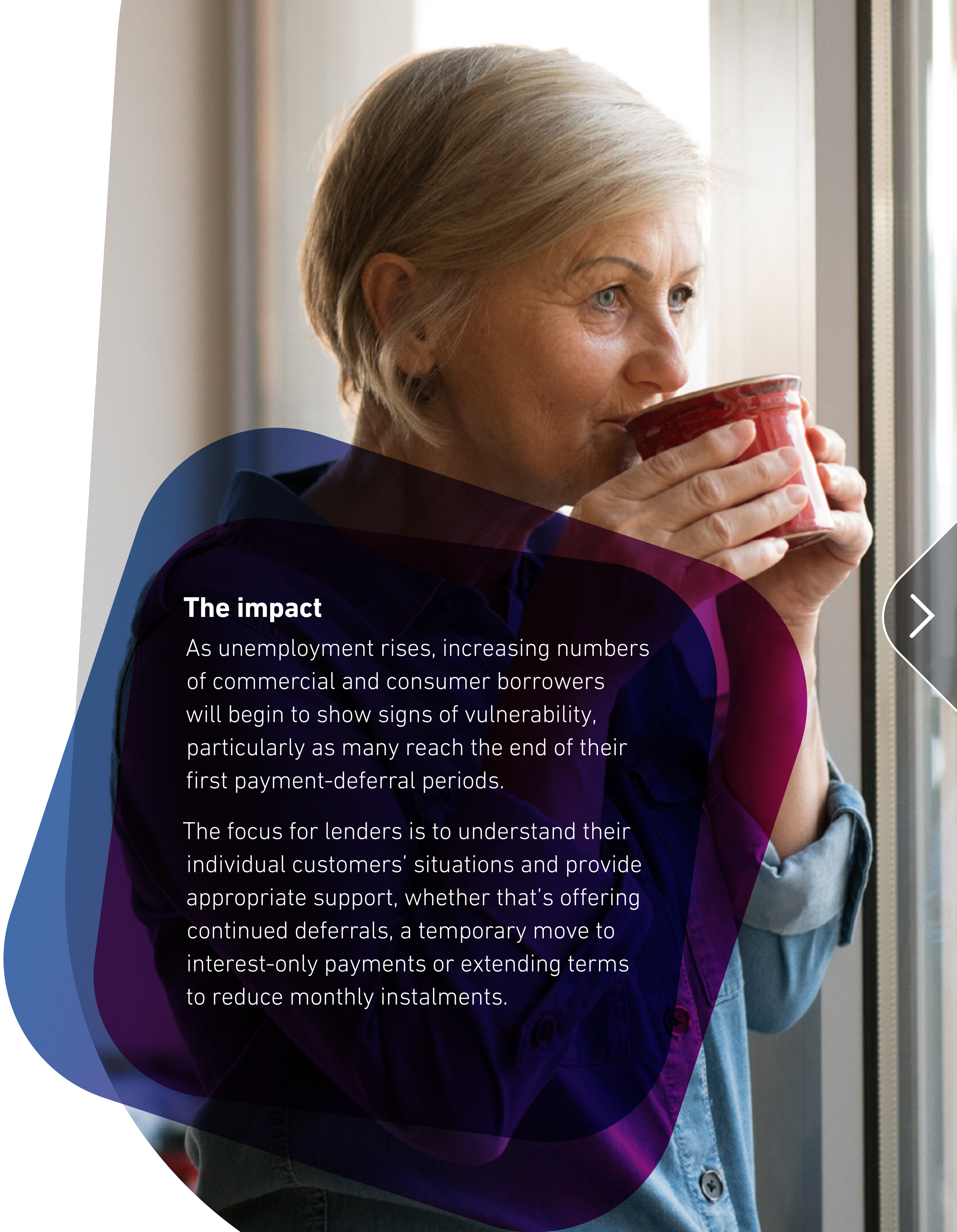
In April this year, GDP dropped by more than 10%. This economic crisis has hit faster and deeper than anything we've seen before – and we're far from being out of the woods.

While the official unemployment rate sits below 4%, we believe that when you add in broader factors such as payroll data, the real figure – key to understanding the health of the economy – is actually closer to 6%.

Our view is that unemployment will peak at around 9%, an assumption based on a significant drop in the number of self-employed workers.

UK unemployment rate





The impact

As unemployment rises, increasing numbers of commercial and consumer borrowers will begin to show signs of vulnerability, particularly as many reach the end of their first payment-deferral periods.

The focus for lenders is to understand their individual customers' situations and provide appropriate support, whether that's offering continued deferrals, a temporary move to interest-only payments or extending terms to reduce monthly instalments.

Measures of support have been a lifeline to many

Government support

8.9m

jobs furloughed – about 25% of the workforce

£11.1bn

The Job-retention Scheme

£6.1bn

The Self-Employment Income Support Scheme

£31.7bn

Business Bounce-Back Loans

£11.85bn

loaned to SMEs

Support from industry

1.9m

mortgage payment deferrals offered

707,000

personal loans deferred

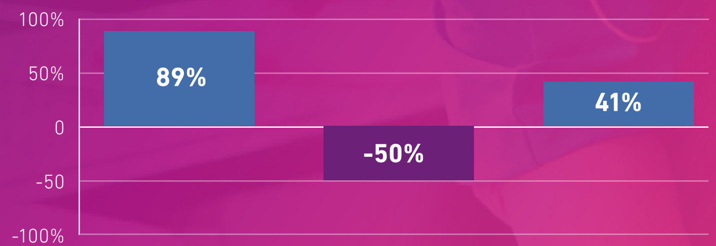
1m

credit card payments deferred

27m

accounts offered 3 months' interest-free on first £500 of arranged overdrafts

Business recovery



of UK businesses are trading again

the volume of published job adverts compared to this time last year

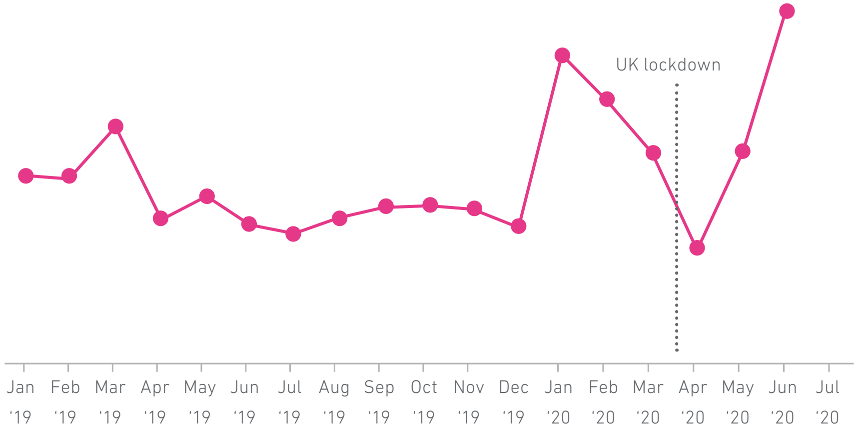
of businesses are providing pay top-ups to the job-retention scheme

Credit trends

Consumer demand

Our analysis shows that enquiries for credit card applications remain low, however enquires for credit have increased. At Experian, we experienced record levels of unique visitors in June – levels that surpass seasonal averages, seen in Figure 2.

Figure 2: Experian Marketplace Unique Form Visits



The number of enquiries for personal loans has improved in recent weeks but In July, was still lower than the pre-Covid norm. However, there has also been a decrease in credit card balances, with £9.1 billion paid off by unstressed borrowers since the start of the year.

The young, and the old show signs of stress

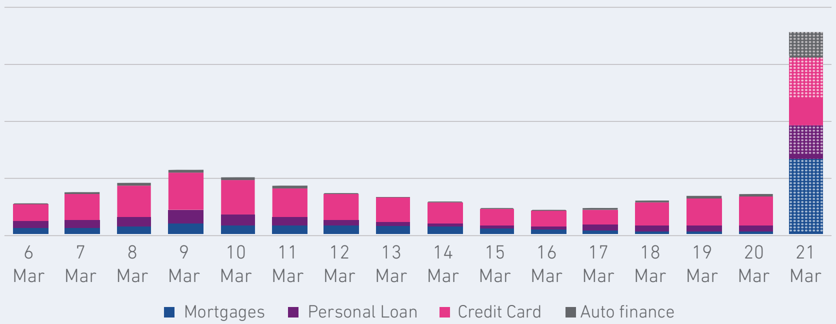
The number of customers moving into collections is rising, with those up to the age of 25 the hardest hit. This is evidenced in not only our data-analysis, but also backed-up through consultative research we have done across lenders. This is consistent across all products except mortgages and auto-finance. These are the products this age group is less likely to be able to afford in the first place, so unsurprisingly it's older customers who are starting to show signs of stress here.

The volume of arrears correlates closely with the segments most at risk, such as single earners. The big concern is that emergency payment holidays are masking a significant element of risk arrears, and industry is rightly concerned about how best to support customers as and when those holidays end.

This crisis could be 200% greater than the last

If 10% of customers with emergency payment holidays fall into arrears, it will more than double the number of people who have missed three or more payments – a figure 70% worse than at the peak of the 2008-09 credit crisis. If 20% of customers with emergency payment holidays fall into arrears, the levels in 2021 will be more than triple what we see today, around 200% higher than the last crisis.

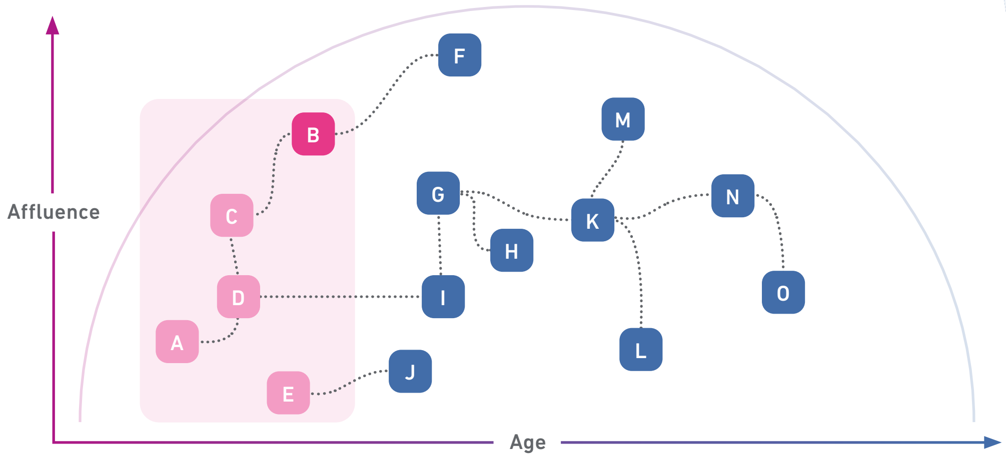
Accounts 3 payments in arrears, EPH 20% forecast



Importantly, not everyone is experiencing financial hardship

One of the striking things about this pandemic is that not everyone is struggling. Through June, a third (30%), of consumers have seen an increase.

Figure 1: Some young groups have seen a positive income shock



So, while lenders need to concentrate on those who are struggling, it's also important to be able to identify those businesses and individuals minimally impacted by the crisis. By doing so, you can strengthen those customer relationships and offer new and better products to support their futures.

Group B

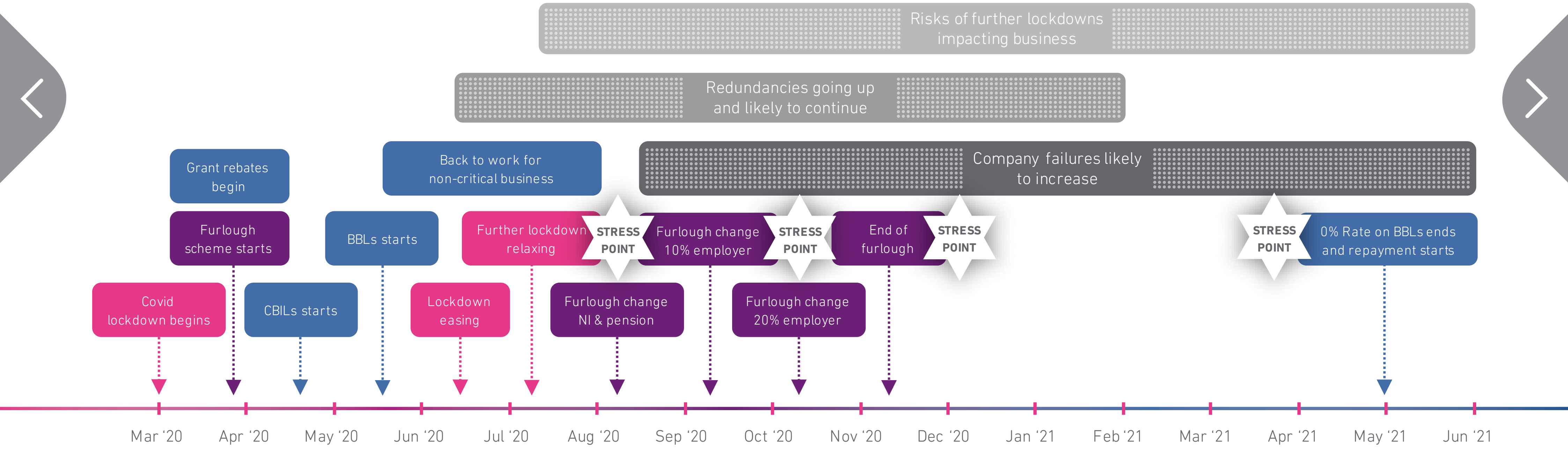
High income households who are in the process of accruing assets, despite high expenditure, to give financial security

- Works in financial services
- No dependents
- Acquiring assets
- Lives in South East
- No commute costs
- Lower mortgage payments

Commercial credit trends

The anticipated shock to businesses is yet to be seen, but by analysing stocks, payment performance and bounce-back loan applications, we are starting to see an emergence of the risks coming through.

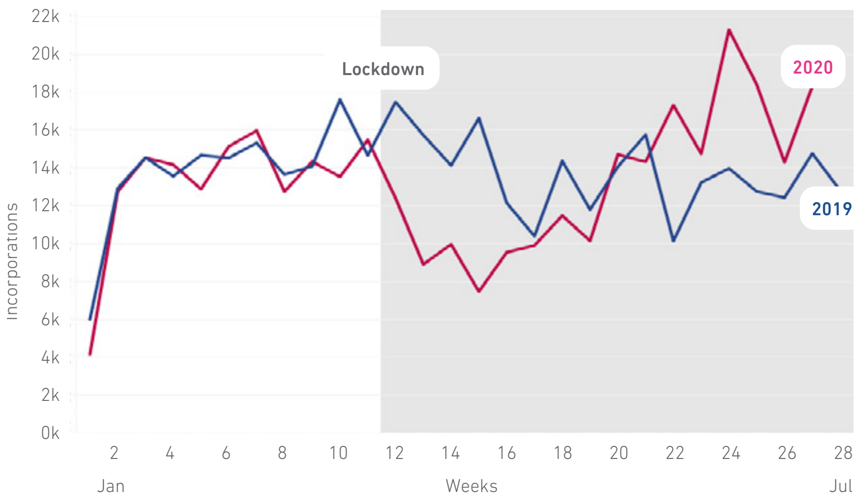
Despite the collapse of one or two high-profile businesses making media headlines, the number of limited companies calling in the administrators or closing completely actually remains consistently low. This is in large part due to the government's various economic support schemes. However, it's clear that there is a significant number of companies who would have otherwise folded and thus remain at risk. Figure 4, provides an example outline of how commercial credit trends will play out within the next twelve months.



A surge in new businesses opening

Interestingly, the last few weeks have seen an increase in new corporations. There could be a number of reasons for this, including furloughed or newly redundant employees starting out on their own. Another possibility could be an increase in phoenix companies – typically those organisations over-exposed to risk and restarting under a new name. Lenders need to display extra vigilance where these types of companies are concerned.

New incorporations by week



And a slowdown in payments

More worrying are trends that see a rise in credit-agreement terms and show businesses taking longer to pay their suppliers, which has a knock-on effect in the supply chain. Both of these trends need to be carefully monitored by lenders to understand emerging risks.

Bounce-back loans spark an increase in demand

Although new credit agreements declined significantly in March and April this year, the introduction of government bounce-back loans sparked a large increase. Because this type of loan is not bound by the ordinary credit and affordability checks of a typical credit application, we've witnessed a varied pattern of applicants and agreements compared to what we would normally see. Normally businesses taking out unsecured loans (85%), would have previously taken some form of commercial credit, however for bounce-back loans only 55-60% have previously had a commercial credit account.

With these many of the loans being applied for by a high number of companies we consider maximum-risk, many will be unable to pay them back, leading to a high number of closures.

The view across Europe

In June 2020, we commissioned a study by Forrester Consulting, which spoke to more than 1,000 credit management CEOs across the UK and EMEA regions. We discovered that a large proportion of firms remain confident they will recover their economic position – yet customer insight remains a significant barrier. Firms; are accelerating investment in insight, alongside AI and automation.

80%
expect to recover their economic position within 18 months

40%
are struggling to gain a complete picture of indebtedness or identify financially at-risk customers

4/5
are increasing or retaining investment in customer insight

1 in 4
are finding the lack of automation across all commercial functions an acute challenge

80%
have increased budgets to invest in advanced analytics and expect to invest more in machine learning and AI over the next three years

40%
have increased investment to better support new and existing customers

60%
are pursuing aggressive growth initiatives

1 in 3
are planning to invest in new products and services

How Covid is impacting UK lenders

Throughout our analysis we have also conducted qualitative insight. Through the research we are seeing four key trends emerge – and reoccur. A summary of these include:

1 Emergency payment holidays (EPHs)

- The number of customers on EPHs is holding steady for many firms
- The percentage of customers with EPHs varies depending on the product: 1%-6% credit cards; 7%-10% loans; 10%-15% auto-finance; 15%-20% mortgages
- There have been very few new EPH applications, despite the government extending the EPH start deadline to 31 October
- Most initial EPHs are now coming to an end. Lenders expect 20%-30% of customers will need to continue with an EPH, reduce their repayments or have their terms extended
- Auto-finance lenders anticipate that up to 50% of customers will need further support when their EPH ends
- Lenders are still concerned that they need to really understand their customers in order to offer appropriate support and treat customers fairly. The inability to access clear data on customers' current positions, particularly EPHs with other lenders, continues to inhibit their decision making

2 Collections

- The anticipated large volume of customers entering collections hasn't materialised
- Most lenders have experienced a modest increase of 5%-10% of customers in collections. Some are reporting no change, or even a reduction.
- There's a firm belief that the reason for this is the continued use of EPHs
- Lenders now anticipate a "massive" increase in collections in late summer and autumn
- To prepare, lenders are increasing staff numbers in collections or pre-collections activities by 25%-40%
- Organisations have identified three main challenges in managing collections: having the required resources; having the data to understand their customers' financial position (particularly when they're 'off-book') and having the ability to forecast, specifically in terms of customers rolling into collections

3 Portfolio impacts

- Understanding economic exposure, and revising stress tests and capital provisions, remains a key need for most lenders – regardless of industry.
- Lenders remain convinced they have the tools to track and monitor areas such as payments, spend, utilisation, delinquency and forbearance in order to inform their forecasts
- Although lenders say they have good internal data, they remain concerned about not having reliable up-to-date income and expenditure data, off-book data, data to track economic changes and data on EPHs

4 Emerging trends

Lenders have identified three key topics:

- Having the digital capabilities to manage customers in EPHs and collections, so they can reduce their need for additional staff
- Having access to Open Banking and data categorisation so they can better understand affordability and income
- Having better insight into spend, searches, post-deferral trends and other areas so they can reinvigorate credit decision-making and shape new lending strategies

1/4
of businesses were strategically investing in the security of their mobile and digital channels prior to Covid-19

60%
are expecting to increase their fraud detection budgets in the next 12 months

Nearly 25%
of businesses lack confidence in the effectiveness of their analytical models for determining creditworthiness since Covid-19

80%
agree lack of historical data is the biggest challenge

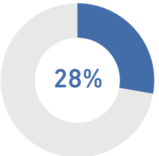
51%
of businesses say they're asking customers to contribute more information/data **to solve for the lack of economic precedent**

49%
say their exploring new or alternative data sources

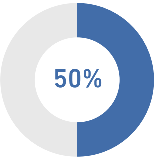
Consumer trends and attitudes

Alongside the research into lenders, we also carried out analysis of consumers in order to understand the impact Covid-19 has had on their households.

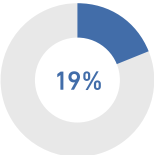
We found that



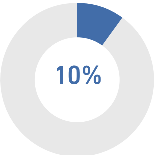
say their household income has declined since the Covid-19 outbreak



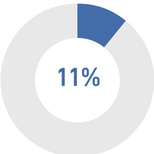
anticipate their online spending to remain the same over the next year



are reducing discretionary spending

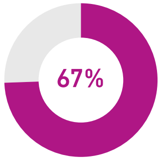


are drawing on their savings

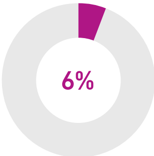


are struggling to pay their credit card bills, with another 11% struggling to pay their personal loans

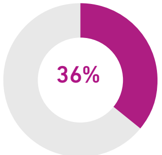
We also found that



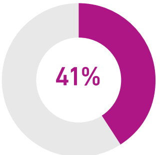
believe the UK will be in a recession in 12 months' time



believe the UK economy will grow in 12 months' time



believe their financial situation will worsen in a year



are concerned about not being able to meet their financial commitments.

Segmentation analysis

When we performed analysis against Mosaic, we found that it's Mosaic groups I (Family Basics) and J (Transient Renters) – the lower income groups – who are most concerned about not being able to pay their bills.

Conversely, E (Senior Security) is the least concerned. The latter group is most likely to be retired and living with a healthy pension fund.

It's clear from the segmentation analysis that both younger and older generations are at risk. But the story is more nuanced than that. Both cohorts show positive signs of growth and resilience. Half of young people and half of older tiers don't believe their finances have been impacted by Covid-19 – underscoring the need for lenders to have a detailed understanding of their customers.

How can Experian help?

Our research shows that the majority of lenders expect to return to normal levels of business within the next 18 months. But as payment holidays come to an end, there is considerable concern in the UK that this will trigger huge numbers of customers to fall into arrears. Lenders are now preparing support strategies, while also looking at ways they can restart lending.

What's clear form the customer insight is that while there are large numbers of people and businesses who are struggling to pay their bills and their suppliers, there are many who have been largely unaffected. We've seen a surge in those paying off their credit card debts and an uptick in new businesses being launched.

Having a clearer understanding of customers – those who are at risk and those who are open to new products – has never been more important. Yet lenders have expressed serious concern that they lack the right data and tools to truly build a clear picture.

As we cautiously move into a new era, Experian is here to support you with access to a comprehensive range of insights and analytical tools that will help you navigate the months to come.

Using data differently to navigate the crisis

Our data and expertise can unlock future credit strategies to help you succeed – providing real-time insight, that provides the ability for action. Helping you understand if your existing data is providing clarity into capital adequacy and credit provisioning that's required.

	Board reporting	Forecasting	PORTFOLIO MANAGEMENT: Credit	PORTFOLIO MANAGEMENT: Financial vulnerability	Credit strategy	Modelling
1 Economic Confidence Index	✓	✓				
2 Company Failures	✓	✓				
3 Tailored Unemployment Curves	✓	✓	✓	✓	✓	✓
4 Household/Local Insight	✓	✓	✓	✓	✓	✓
5 CAIS Market insight	✓	✓				
6 CATO Income Shock	✓	✓	✓	✓	✓	✓
7 Modelled EPH	✓	✓	✓	✓	✓	
8 Indebtedness Index	✓	✓	✓	✓	✓	✓

We have continued to invest innovation, creating a suite of covid-19 tailored solutions that can help with your many varied needs

If you need...

- Early-warning indicators to understand levels of bad debt
- To quickly spot and react to emerging risk trends
- To identify areas of interest/ concern for further analysis

Market impact insights

Gain whole-market benchmarking analysis with a deep dive by product, including application volumes, conversion rates, new lending, lending terms, market share, full stock view and stock delinquency by value and volume.

If you need...

- Insight into how a portfolio will be impacted by economic change
- To segment and identify potential vulnerability for fast-track/review
- Marketing segmentation for customer retention

Economic insights

- Gives you a forward-looking view of four different economic scenarios, showing which sectors are likely to be worse hit by unemployment
- Helps you identify towns and groups that will be most or least resilient to Covid-19, using sectoral and household forecasts

If you need...

- To identify vulnerable clients who appear to be suffering income shock or instability, and profile their emergency payment holidays for reactive or preventive treatment
- To inform new lending decisioning strategies / campaigns
- To support retention, pre-delinquency and collections strategies

Bureau data insights

Give you regular data insights into on- and off-book behaviour and affordability, as well as metrics from analysis of CAIS data provided by lenders, including:

- **Emergency payment holidays:** Insight into number, total balance and payment value of EPHs.
- **Income shock:** Red / amber / green flags to highlight income dropping below pre-defined thresholds in the last three months
- **Turnover stability flags:** Red / amber / green flags to highlight changes in account turnover across different time periods
- **Special instruction variables:** Spot unusual or significant changes in indebtedness or utilisation, such as a debt management programme or voluntary termination

If you need...

- To identify vulnerable customers and assess risk across a portfolio
- To inform new lending decisioning strategies / campaigns
- To support retention, pre-delinquency and collections strategies

Transaction data insights

Gives you the ability to unlock timely and relevant data insights from current account transaction data and categorise it into income and expenditure blocks and additional metrics such as:

- Income KPIs
- Employment sectors
- Financial behaviour
- Balance behaviour
- Consumer liquidity

If you need...

- To digitise processes to support customers in financial difficulty

PowerCurve Customer Assist Portal

Gives you an automated and consistent process to achieve compliance with FCA guidelines around Treating Customers Fairly (TCF) and forbearance for customers in financial difficulty.

If you need...

- Access to up-to-date, high-quality income and expenditure data
- To improve application decisioning time, efficiency and approval rates
- Reduce time to collate and analyse income and expenditure within collections and make better decisions to support customers

Affordability passport

- Customer-consented data and categorisation to get a near-real-time view of a customer's financial position, which supports affordability assessments and helps underwriting decisions
- Gives you market-leading aggregation and categorisation of income and spending across 186 categories including basic, essential, committed and discretionary, over 12 months
- Offers low-touch integration, with standalone underwriting portal

About the authors

Mohammed Chaudhri
Chief Economist
Experian UKI

Andrew Oldham
Director of Banking Consultancy
Experian UKI

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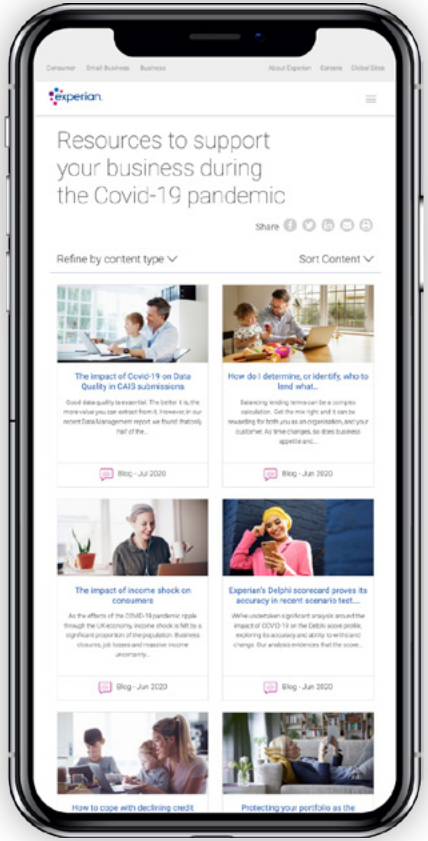

Contact us:
businessuk@experian.com

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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.

Registered office address:
The Sir John Peace Building, Experian Way,
NG2 Business Park, Nottingham, NG80 1ZZ
T: 0844 481 5873
www.experian.co.uk

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