Loss/Default Subcommittee Call April 17

The Loss/Default Subcommittee is part of the PQ Working Group. The meetings objectives were to discuss and select a set of Loss / Default indicators with basic definitions to further refine in subsequent calls/meetings in preparation for the next broader Portfolio Quality Working Group call.

1. PAR/ RAR

Value to include and name

PAR should be rebranded to RAR. It makes sense to include this as a KPI. However, it does depend on the audience. The metric can be very complicated for the field staff and they would rather look at the number of customers/units at risk. From an investor perspective, you would rather look at the value of receivables.

Definition

The definition and/or formula is slightly unclear, it should convey the following:

$$\frac{Total\ future\ expected\ payments\ that\ are\ at\ risk}{Total\ future\ payments\ due}$$

Further comments on definition of the formula:

1. Are we looking at the whole outstanding balance or only one period?
2. Adding the word future to the definition to a couple of places would help clarify.
3. Explain that the idea is to include all accounts with excluding those that had no billing in the last 90 days (defaulted). Out of those, you measure the accounts at risk (ones that haven't paid for 30 consecutive days). [PAR-based RAR]

Comments on definition of "default":

1. is it repossession and redeployment + write-offs?
2. Companies have different "default" definitions. This changes the level of risk of the companies for investors.
3. In general, "default" is someone who hasn't paid for 90 – 120 days.
4. Not a term that accurately reflects potential to reclaim and recoup payments from new client.
5. Get rid of the name "default" and replace with low utilization or another terminology and/or mention repossession policy.

Comments on other definitions:

1. Written-off if it is repossessed and after 180s consecutive disabled.
2. Expected future cashflows = contractual
3. It is out of gross receivables outstanding with the numerator as the amount at risk.
4. You should aim for always including all units in the formula to avoid hidden risks. If you reclaim a unit, there is still a value to it.
5. Inclusion criteria – how long do you keep non-payers in the denominator?
6. Total value receivable, proportion:
    1. Active
    2. Recollected (outstanding and repossessed)

3. At risk/ default

Cohort analysis could complement RAR. Could be useful when explaining it to an investor. However, you do need one headline number that can be comparable within the industry.

Thresholds

The options for thresholds are 30, 45, 60, and 90. It is unclear yet in the industry what is the best one to use. In the future, the group is expecting that investors will ask you what your RAR30, RAR45, etc. are.

The risk of non-payment increases after two weeks but there is a significant percentage of customers that recover. However, when you look at 60 days, the performance decreases dramatically.

- 30 days consecutive days of non- payment:
  At risk (potentially bad client long term, maybe repossess, maybe still good)
- 60 days consecutive days of non-payment:
  Very little likelihood that client comes back.

RAR 30 is sufficient to look at. Yet, it might be beneficial to look at 45 and 60 as you must consider seasonality, harvest, etc. In general, it should be flagged when someone hasn't paid for 30 days, but % customers that have not paid 30/60 days do start paying again after a while. It seems that 60 days is a tipping point where the slight majority will default.

It might make sense to break into buckets:

1. Cash received
2. Outstanding and active
3. At risk (30 -120 days)
4. Written-off receivables

2. Alternatives for RAR

An alternative way to identify future receivables payments at risk is to use the utilization rate – customers who have sufficiently low utilization rates (and have had a sufficient number of pay periods that have come due) would have their future receivables considered "at risk." This would be more cumulative in nature than the current PAR-based method of identifying receivables at risk.

In general, utilization rate could be a more stable number to look at and is more comparable in the industry. It is important here to keep all the units in the denominator.

Determining appropriate thresholds here and linking them to outcomes will be very important (same as would be the case with a PAR-based metric going forward)

3. Churn

1. Hard to interpret, esp. if denominator growing
   Not really used.

4. Write-off
    - One PAYGo rep said they look at this but have active repo policy (those not repossess able?)
    - Units 30d @risk consider reclaim; hope to redeploy quickly before 120d, at 120d write-off (operational not accounting)
    - One PAYGo rep said they have found write-off confusing for investors given this is not a standard loan, they uses 180d
    - Snapshots at 50/100/150% of contract life for cohorts and lifetime headline number both useful
5. Repo Rate
    - Gross repo and net repo
6. Default rate
    - Overlap with other terms
    - Not necessary
    - "default" doesn't make sense for industry
    - Repo/(repo+write-off), will give you a sense of how many put back into play

Growth – useful to indicate if cohort/nearer term analysis needed for headline figures for company that is experiencing high growth