Portfolio Quality WG call May 14

The Portfolio Quality WG's objectives were to give a progress report from Loss/Default and Collection Efficiency Subcommittees, discuss remaining challenges for Portfolio Quality KPIs including ancillary metrics, determination of relevant thresholds, and analytical tools, and set tasks/goals ahead of next call.

1. Loss/Default Survey #3 results

PAR-based vs collection rate-based RAR

The name of the PAR metric changed to RAR.

In the survey, most participants favored the PAR-based approach. This is the most common approach that most companies are using. However, the collection-rate based RAR could be very useful. Explanation for the collection-rate might have been less clear.

The advantages of a collection rate based RAR:

1. You can cover the same information that you would get from the PAR-based approach (setting CR = 0% for period of evaluation is same as using a PAR-based approach).
2. Ability to move the toggle and include lower paying customers.

With the PAR-based approach you would miss some customer accounts that are at risk as some customers only pay 1 time in 30 days.

No comments from the group.

Conclusion:

The name of the KPI is now RAR. There is a possibility to use both for internal purposes; for external purposes, we will select one. We will confirm with data whether the collection-based approach is the way to go.

Write-off ratio

Comments from the group, suggesting an alternative:

Concern whether you also account for extending credit and receivables from the customer if you would only do write-off ratio. You would need to account somewhere what the e.g. PAR30/RAR30 means for the ultimate loss on the balance sheet.

Write-offs from an accounting perspective occurs far after the initial default. Provisioning when a customer is showing signs if getting into trouble (given historical/statistical analysis), would be a better measure as it is forward looking.

Challenges are (1) difficult to compute when changing business model, and (2) provisioning would not be a 100% as it would be 100% - cost to put asset into market again. IFRS 9 is providing some guidelines around provisioning.

Conclusion write-off ratio vs provisioning:

The two metrics RAR (PAR-based or collection-based) and write-off ratio should be looked at side by side. The RAR functions as a forward-looking metric, what receivables are at risk and what do we expect to lose. The write-off ratio is a backward-looking metric and should indicate what happened. As the RAR metric already fulfills the purpose of the proposed provisioning, this will not be considered.

Comments from the group write-off ratio:

1. We should consider renaming it to avoid confusion with the accounting definition.
2. Outstanding question whether it should be a device-based view or a customer-based view.
3. Outstanding question how to account for units that are repossessed multiple times. Overall goal of the write-off ratio should be defined more as well as who will be the stakeholder that will use this ratio. Important to focus on what has actually happened when defining the write-off ratio overall goal.
4. Write-off ratio should likely to be value based.
5. No consensus yet for the measurement period.

Conclusion:

Further thinking process required for the write-off ratio and proposition of some other suggestions.

Repossession ratio

The repossession ratio should be compared with a 'write-off ratio'. Subcommittee recommended a unit-based repossession rate due to its simplicity and practicality, although a value-based measure would provide additional information.

Comments from the group:

1. Remaining challenge is the difficulty to calculate as the kit is sometimes not fully redeployed. We might have to write some guidelines on how we define redeployment.
2. Concern whether we are moving slightly from Portfolio Quality and to the cycle of the asset.
3. Topic repossession ratio is very operational, but complements "write-off" ratio especially if "write-off" is customer or receivables based.

Conclusion:

Overall, the 'repossession ratio' is a good metric to have. The ratio should be tested with some data. To adopt this ratio, we should think through more hedge cases and come up with guidelines.

2. Collection Efficiency Survey results

Collection rate

The headline KPI for the collection rate:

$$\frac{\$\, receivables\ payments\ collected\ [t, t+1]}{\$\, total\ customer\ payments\ due\ [t, t+1]}$$

- The focus for the KPI is on the active contracts.
- Due = contractual and not expected (considering free days given, "due" changes when payment terms and value of receivables stream is changed)
- Deposits should not be included in payments due in the headline KPI as it can distort the metric.

It is crucial to look at the collection rate in comparison to the 'write-off' ratio to measure whether the overall collection has improved; i.e. in the case where the collection rate has improved and the write-offs have gone up, the overall collection efficiency has not improved. However, if the write-off ratio remained stable, this indicates that the collection efficiency improved.

No comments from the group

Conclusion:

Adopt the collection rate and keep the current definition/formula.

Cohorts

The relevant cohorts depend on several factors. The respondents on the survey indicated that it might make sense to include a geographical or product/systems cohort. Some tiers have been proposed for the system (refer to presentation).

No comments from the group

Conclusion:

The tier definition can be taken forward. The conclusion is to provide recommendations and considerations but not imposing a certain number of cohorts as it would be difficult to reach consensus.

WALR

We will leave WALR aside for now as it average credit period (both actual and nominal) can be used as proxies and are easier to understand.

Average credit period

The average nominal credit period and the average actual credit period are both relevant and should be adopted. Need to get some more feedback from young companies to estimate where the issues lie with calculating the Average Actual Credit Period. We would need to work further on the definition and exact formula.

Disclosure

The collection rate is a commercially sensitive figure. Question was asked to the group whether they see any major biases or limitations to hide bad results especially when it comes to the collection rate.

No comments from the group

Conclusion:

Recommendation to look at the collection rate in comparison with the write-off ratio. We should try this with real life data and test whether the output of the collection ratio represents fairly the collection efficiency. If not, we can redefine the metric or add ancillary KPIs.

3. Recommendations

Refer to slide 27 and 28 for a summary of the recommendations.

4. Ancillary metrics

Ancillary metrics up for discussion would be (1) Growth, and (2) FX-Exposure.

5. Next steps

1. Test the KPIs with actual data and conclude on:
    a. Thresholds
    b. Periods of measurement
    c. Outstanding challenges/selecting between options
2. Likely one more working group call, bringing all 3 WGs together.
   Sign up for the PAYGo PERFORM workshop