The Value of Negative Credit Bureau Alerts to Credit Card Issuers

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About The International Risk Partnership

The International Risk Partnership (IRP) was founded in 2009 as an independent consultancy to help national credit bureau and lenders compete successfully by maximising the value derived from credit data, analytics and software. Today IRP provide credit bureau experts, consultants and risk management expertise including a wealth of international knowledge to credit bureau and lenders to help them adapt to the constant change in market conditions, to identify new opportunities and to accelerate their growth.

IRP have over twenty associates providing subject matter expertise for all aspects of the foundation, development and operational management of Credit Bureau. The founders have over 60 years of experience in the industry and have worked with 21 credit bureaus in 19 countries across 5 continents and have been responsible for the deployment of over 2000 risk and fraud management solutions in 60 countries across the credit lifecycle. IRP has experience of working with the full spectrum of bureau in established and emerging markets where often micro finance predominates

About The Authors

Chris Slater is a partner of IRP and worked for Experian for thirteen years before leaving to establish IRP with his two partners. Chris is widely regarded as a data and analytics expert in the industry and has worked with both Experian and subsequently with a number of national credit bureaus to develop world class products and services. He has also worked with lenders to maximise the benefits they get from the use of the credit bureau services.

In the last three years Chris has worked extensively in the Australian and New Zealand markets and he is very familiar with the challenges faced in these markets as they try to migrate from a negative reporting environment to a comprehensive (or positive) reporting environment.

Nicholas Gudde is a Solutions Consultant at Veda Advisory Services. He obtained his bachelor of Technology at the University of Queensland in 2002 before joining GE Money where he developed his credit risk management skills. He subsequently joined National Australia Bank where he specialised in portfolio management and behavioural scoring. Nick joined Veda Advisory Services in 2012 and led the case study included in this white paper.

Executive Summary

Credit Bureau data is used in a number of markets to alert credit providers that their customers' circumstances have changed. The strongest take up is among commercial lenders and trade credit providers where the volumes of alerts allow the lender to react on a case by case basis to protect their exposure. In the last decade we have seen more consumer lending businesses taking alert services, tackling the challenge presented by the greater volumes generated by consumer data.

This paper considers the potential for alerts in Australia using negative data based on a Proof of Concept project with one of the main banks. It tackles the challenge of integrating such a service and identifies how the migration to Comprehensive Reporting will further increase the business case for early adoption of alerts services.

Substantial benefits are identified in using negative alerts on credit card portfolios today. In the case study it is estimated that the immediate benefits were 4.2 million dollars per year, with a further 1.6 million dollars in annual operating efficiencies and a decrease of 5.8 million dollars in provisions for annual charge-offs. This is offset by the costs of the alert service and the lost revenue due to false positives for which the combined cost is estimated to be 1.3 million dollars per year. Clearly the business case is strong with negative data alone and will become stronger when the solutions are finessed with Comprehensive Reporting data.

Introduction

The use of alerts services from credit bureaus has become well established in the commercial market and is now becoming more widely used in the consumer markets where the value of the proposition significantly outweighs the added complexity that arises from the volumes of accounts and alerts they generate.

A credit bureau alerts service holds the customers of a lender on file and monitors all the accounts of these customers for specific events on the credit bureau. On a negative bureau typical events monitored include enquiries, defaults and court judgements. Whenever one of these occurs, an alert message is sent to the bank and the bank then executes a strategy based on the customer internal profile and the alert that has been received.

In the markets where Alerts have been successfully used, the credit bureaus have tended to be positive credit bureaus holding the full range of credit data that will be available in Australia under Comprehensive Reporting. There are strong benefits to using Alerts from a negative bureau too, and this paper looks at the benefits that arise with negative data, how they can be integrated into credit

card operations and how early adoption of and familiarity with negative alerts will lay a platform for early mover advantage when comprehensive data starts being reported.

The business case is illustrated through a case study undertaken with a major Australian bank which ensures that the benefits described are directly applicable to Australian credit card issuers.

The benefits of Alerts using negative credit bureau data

Outline Benefits

There are three key benefits that arise from the use of Alerts from a credit bureau on credit card portfolios. These benefits also arise on other portfolios such as mortgages and loans, although the ability to react quickly is less and so the absolute value is lower. The key benefits are:

1. Reductions in exposure by limiting incremental spend once a risk has been identified.
2. Reduction in operational costs for dealing with non-performing accounts.
3. Accelerating remedial processes for non-performing accounts such as arrangements, charge off and debt sale. This brings forward the receipt of the cash that is likely to be recovered.

The key to delivering benefits through an alerts service are twofold

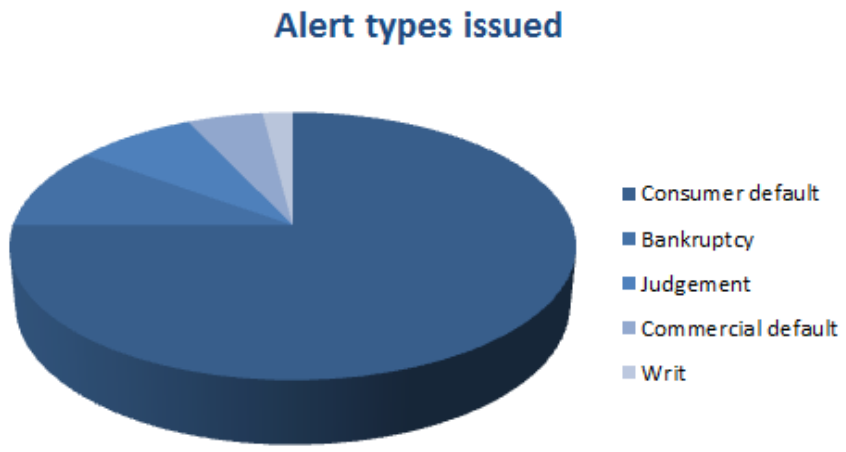
- The earlier the alert is reported the greater the benefits that accrue
- Having a clear strategy for the action to be taken when an alert is received. Simply changing a risk banding is not enough, these alerts should drive immediate positive action.

Case Study: A Major Australian Bank

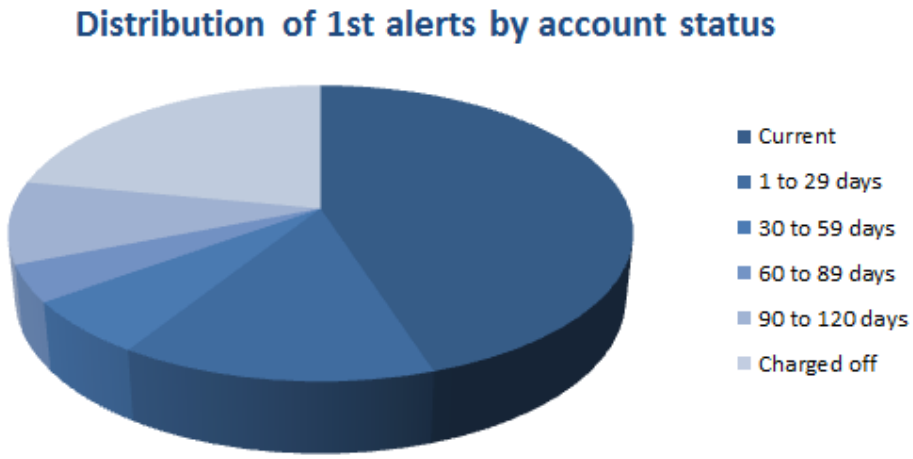
The bank provided a sample of 350,000 randomly selected credit cards for the Proof of Concept study using the Veda consumer Alerts Service. The sample provided was weighted towards higher risk segments and all charged off accounts were present, these being the accounts that are used to determine the value of the Alerts to the bank

Veda then loaded the sample to the Alerts service and retrospectively processed them through an 18 month period and returned the triggered alerts for analysis. On the 350,000 records the system generated 59,677 alerts on 27,853 unique accounts (which are 8% of the accounts).

Of these alerts, about 75% were caused by defaults on other consumer accounts. About 10% of the alerts were bankruptcies and 9% were court judgements. The remainder were a mix of writs, disqualification of directors and commercial defaults.



The average of 2 alerts per accounts show that when customers get into financial difficulties there will be a number of alerts that are generated and it is the first alert that the lender must react to in order to gain the maximum benefit.



Of the first alerts generated the majority (45%) were on accounts that were up to date. This immediately shows the risk that is present accounts showing no immediate internal evidence of problems. The customer is up to date with the credit card being monitored but can be in default, court or being declared bankrupt elsewhere. About 15% of alerts were on accounts that were between 1 and 29 days past due, again indicating that the delinquency was not random but part of a wider problem. Taking action to limit the exposure on these accounts becomes critical.

Of all the accounts that went to charge-off, alerts were triggered on 49% of these accounts identifying problems the customer had with other institutions before they reached this status with the bank.

- Alerts were generated on 20% of charged off accounts while they were still overdue on the first cycle
- Alerts were generated on 10% of charged-off accounts while they still current
- Alerts were generated on 7% of charged-off accounts at least 7 months before charge-off

Essentially there are three key segments that lead to cost savings to the lender. The table below shows them in terms of the performance of the accounts with alerts on them segmented by their status at the time the alert is issued.

Status when 1st alert received	Status at end of observation period			
	Current	Early Delinquent	Late delinquent	Charged Off
Current	70%	16%	4%	10%
Early delinquency	25%	30%	15%	30%
Late delinquency	7%	4%	19%	70%

Segment 1 – accounts that are currently up to date

When alerts are received on up to date accounts they represent the greatest opportunity to limit any growth in exposure as they will still have a positive risk profile internally and a full shadow limit in most lenders.

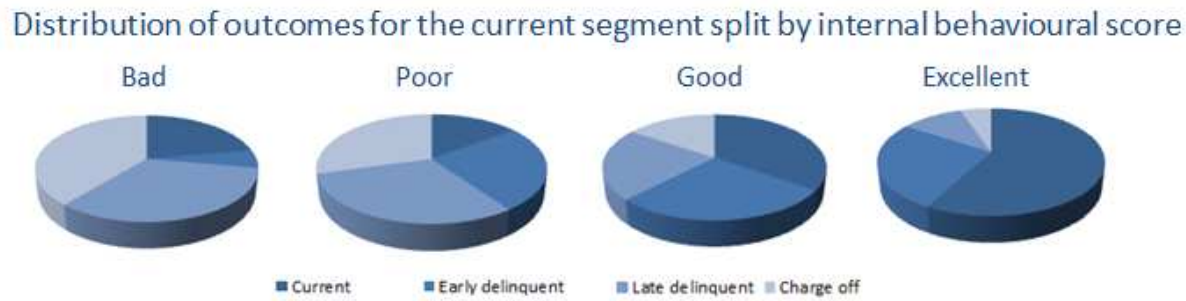
The value of the alerts in this segment is dependent on understanding how balances might change between the alert and the charge off point. The table below shows the change in balance for those accounts that were up to date from the time that the first alert was triggered to the end of the exercise.

Change in balance at end of observation period							
Current	1 to 30 days	31 to 60 days	61 to 90 days	91 to 120 days	121 to 150 days	151 to 180 days	Charged off
+$245	+ $835	+$400	+$922	+$1,172	+$1,666	+$1,741	+$1,295

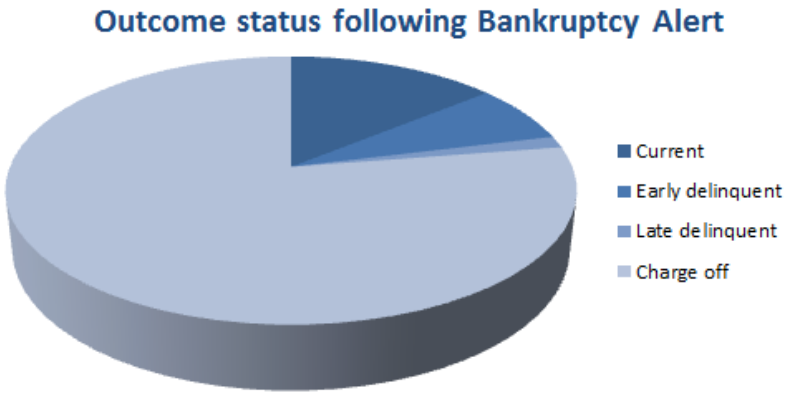
What the table shows us is that, if preventative action is taken when the initial alert is received, the exposure to this growth in bad balances can be avoided.

However not all accounts go bad, so there can be a number of false positives. Indeed a majority of up to date accounts (circa 70%) will either stay up to date or will self-cure in the following months. There can be both a lost opportunity cost associated with taking action with this segment and also an element of reputational damage.

However the losses associated with the charged-off accounts will outweigh the opportunity costs of acting to limit balance growth on the accounts that remain good. To minimise the lost opportunity costs of the false positives, international lenders will use their internal risk segmentation to vary the strategies that are applied when the alerts are received. For example, for the lowest risk segments, there may be no action until a payment is missed, for the medium risk segment, shadow limits may be reduced, while the highest risk segments will have the full action taken against them.



The pie charts above show how the various internal risk segments perform after an alert for a default account is received. It is no surprise that the higher risk accounts tend to go to charge off while the low risk accounts tend to self-cure. It is very easy to see how the actions can be varied by the internal risk segmentation to minimise the opportunity costs of false positives.



Naturally, with the bankruptcy alert the likelihood of the account moving to charge off after the alert is received is very high and so the lender should always implement their full defensive strategy.

Segment 2 – accounts that are in early delinquency (1 to 60 days)

Accounts that are already in early delinquency show the strongest correlation between the receipt of alerts and ultimately being charged off. However, as they are already showing signs of delinquency their balances are usually being managed down by the lenders so the net benefit of the alerts is lessened.

Change in balance at end of observation period							
Current	1 to 30 days	31 to 60 days	61 to 90 days	91 to 120 days	121 to 150 days	151 to 180 days	Charged off
-$572	+ $370	+$113	-$573	-$48	+$530	+1,545	+$613

The table shows how those that self-cure (25% to 35%) will also reduce their balances as they do so, whereas there is still moderate growth in the average balances of those that worsen.

With this segment the value of the savings from increased exposure at charge off far outweighs the lost opportunity costs of the actions on those that self-cure and there is far less ill- feeling from those that do self-cure as they have clearly been delinquent. As a result most lenders will tend to action all alerts fully.

Segment 3 – accounts that are over 60 days

The accounts that are already over 60 days should already be under strong balance reduction strategies, the key use of the alerts information is to target the best accounts to sell as bad debt early and so get an improved price by selling a younger debt.

The likelihood of an account already over 60 days being charged off when an alert is received increases by 50 to 60% depending on status, so early sale of these accounts can have a significant return.

Action strategies

The value of alerts is all created by taking action. If you receive an alert and do nothing what was the value of the alert? Summarising the simplest actions for the segments that this paper has looked at produces the following table:

Segment	Risk Segment	Action Strategy
Current	Low Medium High	Block on bankruptcy alert, else no credit limit increases Block on bankruptcy alert else remove shadow limit Block on bankruptcy alert else Decrease credit limit
1 to 29 days	All	Block and accelerate default collection actions. Negotiate remedial repayments
30 to 59 days	All	Aggressively fight for cash and establish arrangement for repayments
60 days plus	All	Debt sale for significant balances and alerts connected with significant balances Accelerate default actions and establish arrangement.

This basic set of actions delivers business benefits that justify the use of an alerts service from a credit bureau. In this case study this strategy delivered the following estimated annualised business benefits over an 18 month proof of concept study.

Segment	Strategy	Business Benefit
Accounts less than 30 days	Decrease credit limits Reducing shadow limits Preventing credit limit increases	$1.36 million $2.53 million $0.37 million
30 to 60 days in arrears	Improved collections prioritisation	$0.46 million
60 to 90 days in arrears	Improved late collections strategies	$0.35 million
90 plus days in arrears	Early sales prices	$0.71 million
TOTAL		$5.71 million

The costs of implementing the service would be:
Credit Bureau costs - $300,000 per year
Lost opportunity costs cause by reduced credit limits on self-cure accounts - $1.01 million

The business case is further improved by the reduction in provisions for charge-offs. In combination this gives a substantial pay back that would overshadow the systems implementation costs.

The challenges of implementing Alerts Services

Customer Experience

The customer experience is a key aspect of making the adoption of an alerts service successful. By its very nature, an alerts service leads to actions that can be perceived as negative by the customer, even though the actions may well ultimately be for the best for the customer in the long run.

The best users of alerts aim to treat their customers fairly and ensure that actions that are taken are explained clearly when necessary. The most sensitive group is the up to date group, who the case study above shows has a reasonable chance of recovery. While the removal of shadow limits for example may not require communication, stronger action does and the best lenders ensure that they treat this as an opportunity for the customer to communicate with them. The communication strategy for up to date customers who show problems elsewhere should be constructive and aim to strengthen the relationship with the customer by seeking to see if the bank can provide wider support for the customer than a simple credit card limit change.

I have witnessed cases in the UK where the communication is handled well and the customer exclaims “thanks, I didn’t think anyone cared” when they find that the customer facing staff are

willing to listen to their issues (exposed through the alerts) and pleased to engage in a constructive approach to solving the customer's problems. Not unsurprisingly, the customer support staff also report that they get a sense of wellbeing from these calls as a change to the usual collections negotiations.

Operations

Alerts deliver business benefits in a number of aspects of the credit card operations. Ideally a card issuer will integrate the alert data as a feed into its behavioural scoring solution and allow the data to be used to drive strategies in the different areas of the business. The ideal customer management or behaviour scoring solution combines and exploits both internal and external data and re-evaluates the customer's position and set the most appropriate and up to date strategies such as exposure limits and customer service actions.

As an initial tactical implementation some lenders create manual processes around the alerts data that they receive, focusing on their collections processes where they can accelerate early delinquency issues manually. However the benefits in the up to date population can be hard to implement manually as manual changes based on the alerts sitting outside a behavioural scoring system can easily be over-ridden by the automatic updates from the behavioural scoring system which is still basing its updates on the internal up to date view or the customer.

Technology

Integrating the alerts into a behavioural scoring system is a significant project that requires the new source of alerts to be set up as data feeds. The data then has to be set up on the scoring engines input data blocks and then the new strategies have to be designed, tested and implemented. On customer level behavioural scoring systems the lender should supply the lender's customer identification number should be supplied to the bureau when the file is supplied for the alerts service. This makes the integration of the results much simpler.

On an account level behavioural scoring system, the lender can use the alerts service to effectively create a partial customer level system by ensuring that the credit bureau returns the alerts generated by its other portfolios (most bureaus allow alerts from specific own company portfolios to be supressed).

Looking forward to Comprehensive Reporting

With comprehensive reporting now becoming a near term reality in Australia, the benefits of early adoption of alerts are significant. When banks start supplying positive data the flow of positive will be too uneven for sophisticated behavioural scoring for the first months, but any company that has

already got an experience in Alerts and strategy for using the major positive alerts will be able to extract value far sooner than their competitors.

When positive data becomes available, the major alerts to look for will be

- 90 days past due
- 60 days past due
- 30 days past due in the first three months of opening an account
- 30 days past due

Just adding strategies to deal with these 4 alerts will allow lenders to make significant improvements to the strategies that they have established under negative reporting.

Experiences from around the world

Case studies from around the world show that reacting to a customer that goes 60 days down with another lender gives by far the biggest return.

Anecdotal evidence tells us that people go 30 days from time to time and recover the next month, usually because they have forgotten to pay a bill. The people who are struggling are those that miss payments on more than one account (ie you receive 2 different 30 day alerts) or go 60 days down. When they have missed two payments there is usually a problem and if you do not react it will be coming your way.

The selection of 30 days down within 90 days of opening an account is a reflection of those customers who take out a new loan or card and finds that it just tips them over the edge. They make the first payment, maybe the second but then their finances start to tumble down like a pack of cards and you need to react quickly.

The 90 days alert is a strong predictor, but you should have reacted to preceding 60 day alerts and saves a month's exposure. However the 90 day alert does confirm your need for action and some banks have an escalation action for this alert.

The change of address alert that is enabled by comprehensive data is an operational opportunity for most lenders, but does not usually predict a change in risk assessment.

Recommendations

The International Risk Partnership recommends that lenders adopt an alert service as a pre-comprehensive reporting project and embeds a number of strategies to make use of the three key alerts:

- Default at another bank

- Court judgement
- Bankruptcy

We recommend for credit card portfolios that the alerts service is used across the entire portfolio. For other products we would recommend taking the service on certain key risk segments.

For those cards that are current when they receive a default alert we recommend that the lender uses their internal risk segmentation to drive the response. IRP recommends that there is always a response; action is the key to getting value from alerts. If you don't react to an alert, it was a waste of money taking the alert in the first place.

We recommend that experience in this service is gained before comprehensive reporting is introduced as those lenders who can make use of this service and have the experience to finesse their strategies around alerts from Comprehensive data will gain a significant competitive advantage.