

In a precarious market, traditional risk defenses need to be fortified with new analytical approaches that better identify – and anticipate – key patterns of customer behavior.

Credit Crisis: New Lines of Defense

BY RICHARD TAMBOR

Will tried-and-true risk defenses be enough this time around? It's a critical question at a time of rising credit card delinquencies and the most difficult collections environment in recent memory. Already, issuers are rushing to traditional defenses such as tightening approvals, paring credit lines and expanding collections staff.

These basic measures definitely are in order. Yet there are compelling reasons to adopt progressive new approaches as well. For one thing, a changed lending atmosphere has weakened the applicability of traditional measures. And new sources and uses of customer information have surfaced which, in the hands of skilled practitioners, promise new levels of precision in dealing with varying types of problems and customer profiles.

The fundamental opportunity is improving risk management by gaining customer insight beyond credit scores. Credit card issuers can develop a far richer picture of risk exposure by

expanding their analyses to include more detailed credit bureau information and the customer's total relationship with the financial institution. The payoff is precision modeling of likely customer responses to various initiatives.

There are at least four major applications of advanced risk analytics, including:

- ◆ Modeling customer responses to delinquency-instigated re-pricing;
- ◆ Curbing losses by anticipating impending borrower distress;
- ◆ Competing for collections in a world of multi-creditor defaults; and
- ◆ Finding pockets of attractive growth in a tight market.

To be sure, new Federal rules on credit card practices will limit issuer flexibility in using new techniques. Both the speed and the extent of permitted changes in account relationships will be restricted when the Fed guidelines become effective in July 2010.

Significant opportunities remain, however, given all the new possibilities for segment-based customer responsiveness. In marketing, issuers long have known about consequential differences between various customer groups, or segments.

And progressive executives also are familiar with test-and-learn programs that scientifically measure the degree to which various customer segments respond to changes in various details

AS SEEN IN

CardsPayments

of an offer. Increasingly, these same principles can be applied in refining various types of risk mitigation initiatives.

We see this as an urgent priority. Under current approaches that fail to distinguish among differing categories of borrowers, lenders risk misdirecting their efforts with large numbers of customers and prospects who are unreceptive to blanket treatments and offers – or were never good candidates in the first place.

For example, issuers can hurt repayment prospects and salvageable cardholder relationships by over-aggressive default repricing; tightening or extending credit sub-optimally among various current customers; and failing to consider unique borrower circumstances in overall collections strategy and individual negotiations.

By contrast, a more progressive segment-based approach to default repricing should include an investigation of the extent to which sounder borrowers react by taking their business elsewhere. It is also useful to consider the extent to which the most distressed borrowers might react by ceasing all attempts at repayment.

Similarly, a segment-based approach recognizes that credit scores and monthly payment trends may

“Lenders risk misdirecting their efforts with large numbers of customers and prospects who are unreceptive to blanket treatments and offers – or were never good candidates in the first place.”

not provide adequate guidance on credit extension to current customers. In some cases, an analysis of risk-adjusted account profitability reveals stretched-but-solid borrowers who may actually warrant credit line increases. In other cases it reveals the need for active intervention with households having clean payment histories but teetering at the brink of financial crisis.

Even among delinquent borrowers, understanding variations in segment responsiveness is invaluable in guiding negotiating tactics and specialized workout programs. Troubled borrowers with substantial remaining assets, few credit lines and deep ties to the institution, for example, surely

differ from debtors in the opposite condition.

Certainly, issuers should continue with traditional risk defenses. With the benefit of new analytical guidance, however, segment-based strategies offer substantial additional opportunities to interact more effectively with borrowers.

Richard Tambor is a managing director in the New York offices of Novantas LLC, a management consultancy.

NOVANTAS

Novantas LLC

485 Lexington Avenue
New York, NY 10017
Phone: 212-953-4444
Fax: 212-972-4602
www.novantas.com

Novantas LLC

311 South Wacker Drive
Chicago, IL 60606
Phone: 312-924-4444
Fax: 312-924-4440
www.novantas.com