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*Hundreds of thousands of U.S. households are in arrears on multiple accounts with various individual banks, confounding product-by-product risk management practices.*

# From Cross-Sales to Cross-Defaults: Dealing with Multi-Account Credit Risk

BY RICHARD TAMBOR AND KENNETH ALVERSON

Retail banks long have aspired to sell multiple products to each customer, hoping to boost relationship profitability and also strengthen ties with households and businesses. But many banks focused primarily on the retailing aspects of cross-selling, including marketing, sales and product design.

Meanwhile, individual product divisions tended to focus on asset growth within their own silos. Seldom did banks look at the big picture of composite household credit risk.

Now this imbalance has come back to haunt as the retail banking market has been rocked by "once in a generation" losses. Nationally, there are hundreds of thousands of households that now are in arrears on multiple accounts with various individual banks.

It is a complicated problem, given that a single customer relationship can present credit exposure across all retail banking product lines, including the first mortgage, the home equity loan, the credit card account, the auto loan and the student loan.

With many billions of dollars of credit extended to multi-account households, banks are in urgent need of comprehensive information and proactive strategies that will help them to deal with a growing mountain of distressed loans and collections activities.

Conceptually most banks would agree that having multiple collections teams from different product areas attempting to individually negotiate with the same household is not ideal. Yet that's exactly the case today in most situations, where product silos unknowingly go into vigorous competition with each other as well as other creditors.

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## THREE STAGES OF RESPONSE

There are three major stages of management response, including: 1) building composite household information; 2) creating new risk analytics that look across multiple product areas; and 3) developing proactive treatments that will help to coordinate workout and collections activities in a balanced manner that works best for both lender and borrower.

**Composite Information.** A complete picture of household credit extension is needed, drawing from the various credit-product silos within the retail bank. Although banks have been pursuing household cross-sell for several decades, many have not yet organized their internal customer information accordingly.

The reasons go beyond winning cooperation from the various credit product silos. Each area typically uses its own specialized technology platform. To compile composite customer information, the bank must build a centralized data warehouse and establish feeds from the various product silos. A further challenge is to go beyond information on individual household members to build a picture of the total household relationship.

Perhaps the biggest impediment is a management perception that robust data integration is a low priority compared with other uses of corporate resources. The current retail credit catastrophe should settle this question, given the disadvantages of pursuing household workouts and collections on a product-by-product basis.

**Risk Analytics.** In pressurized situations, over-indebted households begin to make tradeoffs among various repayment obligations. Traditionally, for example, it was thought that families would almost always prioritize the mortgage payment over other obligations.

More recently, the reverse has held true as sinking housing values eroded the motivation to "hang on" to the principal dwelling. Either way, repayment tradeoffs will have an impact on the institution that faces delinquencies on multiple credit products supplied to the same household.

It is critical to identify this type of risk exposure, along with early signals of household distress. That is why banks need to expand their understanding of composite household repayment patterns, leverage in-house transaction data (for example with checking accounts), and monitor external changes in credit-related behaviors.

**Proactive Outreach.** The ultimate goal is coordinated customer management. Often today, various internal collections teams unknowingly compete with each other for recoveries from the same household. Along with eliminating this counterproductive overlap, banks will need to devise new workout arrangements aimed at addressing the larger household credit picture.

In this more comprehensive approach to multi-account defaults, the borrower's overall circumstance will need to be assessed, including the root causes of distress, overall ability to repay, and ongoing issues that must be considered.

Consolidated workout programs for distressed borrowers are fertile ground for innovation and continuous improvement. The goal is to test various alternative arrangements, analyze the results, and incorporate refinements into new offers that again can be tested.

## LOOKING BEYOND CRISIS MODE

Unquestionably going forward, banks will need to follow up on their cross-sell successes with a coordinated program to manage multi-faceted household credit relationships.

The immediate tactical payoff will be an improved collections operation. In a post-bubble environment where pressured households can easily have a dozen or more different credit accounts to contend with, a nuanced collections process is needed to help the institution make its way to the front of the line for repayment.

Fortunately, one of the intrinsic advantages of cross-sell – relationship "stickiness" – does play to the advantage of the institution in loss mitigation. Customer loyalty, as reflected in multiple account relationships, can be a powerful factor in winning borrower cooperation. Moreover, in-depth customer relationships allow the institution to

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better assess household financial dynamics and respond to signals of impending distress.

Such advantages should not be left to chance. Particularly over the next year or two, there will be substantial opportunities to enhance earnings by assessing risk and managing credit from a total customer relationship perspective.

Perhaps the biggest question is whether this will become of top-of-the house priority. Within many banks today, the various credit product units are severely isolated.

In our view, this means that people such as the head of retail banking, the chief financial officer, the head of risk management, and even the chief executive officer will need to step in – and quickly. Unfortunately, recent experience, no matter how painful, has a tendency to fade quickly when the next growth cycle begins.

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