Credit Risk Programme

Module 4

Account Acquisition and Management

Learning Objectives

At the end of this module, you will be able to:

- Understand customer, cost, operations, and risk considerations.
- Understand tactical and strategic considerations, along with operational challenges.
- Demonstrate your understanding of retail-specific tools such as test and control groups, strategy design, and automation of actions.

Underwriting Process

Scenario

Prior to 2003, Hong Kong had negative credit bureau data only. This meant that only when a customer's credit facility reached 90 days delinquency or an impaired status it was reported to the credit bureau. This allowed customers to open up to 50 credit card accounts, using each subsequent card to pay the minimum payments of the prior cards. According to the negative information only credit bureau, those customers did not appear to pose a risk. Weak bankruptcy laws exacerbated the scope of the damage. In 2002 & 2003 a wave of bankruptcy ensued, and the industry wrote off 2.5 Billion USD.

What could have been done prior to the crisis to mitigate losses?

What should be done during and after the crisis to ensure it won't happen again?

What role do credit standards play in this scenario?

What role does lobbying and industry engagement play in this scenario?

Underwriting

Marketing
• Product plan
• Campaign development & implementation
• Communicate benefits
• Application design
• Print Material
Sales
• Training branch staff on product
Credit
• Credit criteria and/or credit scoring
Legal
• Review & sign-off: Compliance with local law, Standard Chartered Policy, regulations

Underwriting

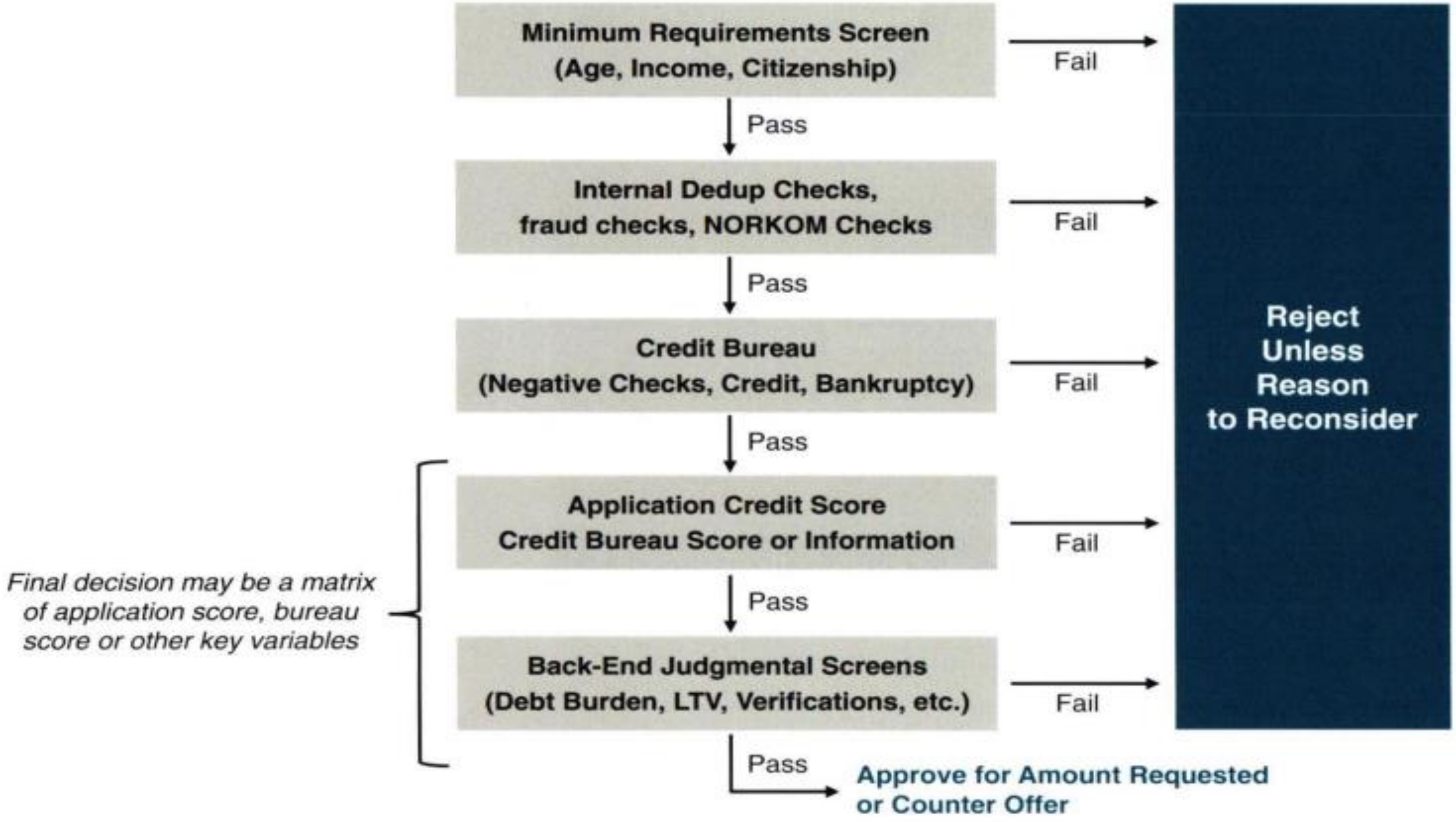
Who is responsible?

Systems
• Specification sign-off
• Testing
• Program modifications
• MIS in place
Operations
• Adequate capacity and staffing
Branch
• Marketing/sales

RB Toolkit: Test Cells

Lead Time
• How much is needed?
Testing
• How small ir large can a test be?
• What is being tested? Response? Usage? Credit?
• How and when will the test be evaluated?
• Before or after the roll-out?
Pacing
• Impact on operations?
Seasonability
• Match to customer needs?
• Vacation and holiday periods?

Decision Process for Underwriting



Verification

Final step in extending credit

- Attempts to verify some information supplied by applicant
- important for some products like credit cards, because there is no direct contact with the applicant
- Should be handled by experienced professionals
- Benefits of verification must be weighed against cost
- Should have specific procedures to follow

Verification

For our Hong Kong case, could any of these verifications have enabled mitigation?

What information should be verified?	Why Verify?	When does it make sense to verify?
Identity - Does the applicant exist? - Is the credit being extended to the applicant and not to someone else?	Fraud	Almost always
Employment - Does the applicant work where he or she says?	Credit	When cost-justified on the basis of the balance at risk
Income - Does the applicant earn what he or she says?		
Residence - Does the applicant live where he or she says?	Fraud	When cost-justified
Residence Phone - Is it connected? - Is it correct?	Credit / Collection	
Collateral - Does it exist? - Can lien be perfected if necessary? - What is the value?	Fraud Credit Collections	For shelter products and secured vehicles

Methods of Verification

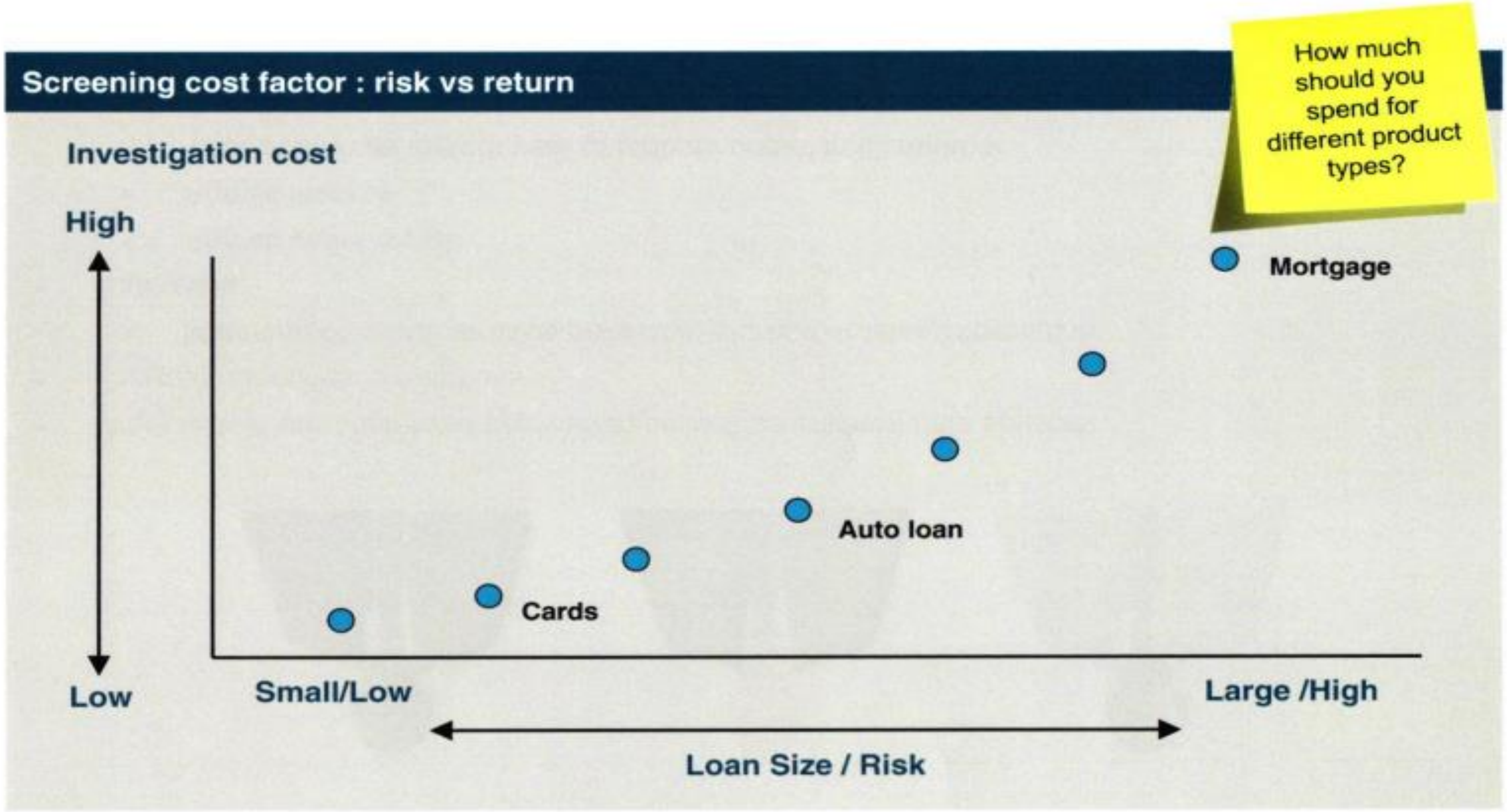
Method	Relative Cost	Used to Verify
Check ID numbers	Low	Identity
Telephone Information	Low	Residence, residence phone
Payroll Stubs	Low	Employment; Income
Tax Return	Low	Income
Credit Bureau report	Moderate	Identity; Residence; Employment
Contact Company	Moderate	Employment
Retail Commodity Check	Moderate	Dealers (for indirect sourcing)
Visit to Residence	High	Residence; Collateral
Visit to Dealers	High	Collateral

Did you know?
As industry data continues to improve, opportunities to improve verification through automation increase. For example, we can ask an applicant questions about their past credit history based on their credit bureau report, such as details about loan amounts or lender names. This can automate and strengthen the process of identifying verification.

Automated Verification Procedures

- Work with information from the application as well as external data sources
- Program identifies "exceptions"
  - Matching of characteristics predictive of fraud or false information
- Examples:
  - Age vs years on job
  - Age vs income
  - Year of birth as stated; year of birth as coded in ID number
  - Comparison of stated age or address as compared to credit bureau

Cost Benefit Trade-off in Credit Initiation



How can Underwriting Process Mitigate Credit and Fraud Risk?

Scenario

Imagine that identity theft in your country has begun rapid proliferation. Your credit risk policies and standards appear to have been very effective in the past. However, your team says that fraudulent applications are appearing which typically ‘steal’ the identity of customers with good profiles.

How can you ensure you still approve customers with good profiles, yet correctly identify those cases of identity theft, in order to mitigate this risk?

- ❑ Quiz your customer about detailed credit bureau data from their past loans and credit activity.
- ❑ Tighten your credit standards.
- ❑ Apply concentration caps on new to bank customers
- ❑ Add telephone verification to your process

Underwriting Process - Summary

Appropriate approval flow

1. Obtain
• Tools to obtain information
• Signed applications
• Current Credit Bureau Report
2. Evaluate
• Evaluate for credit decision
• Judgemental or Scoring Criteria
• Debt burden analysis
3. Verification
• Verification
• Customer data
• External data where possible
• Collateral existence and value

Approval rates

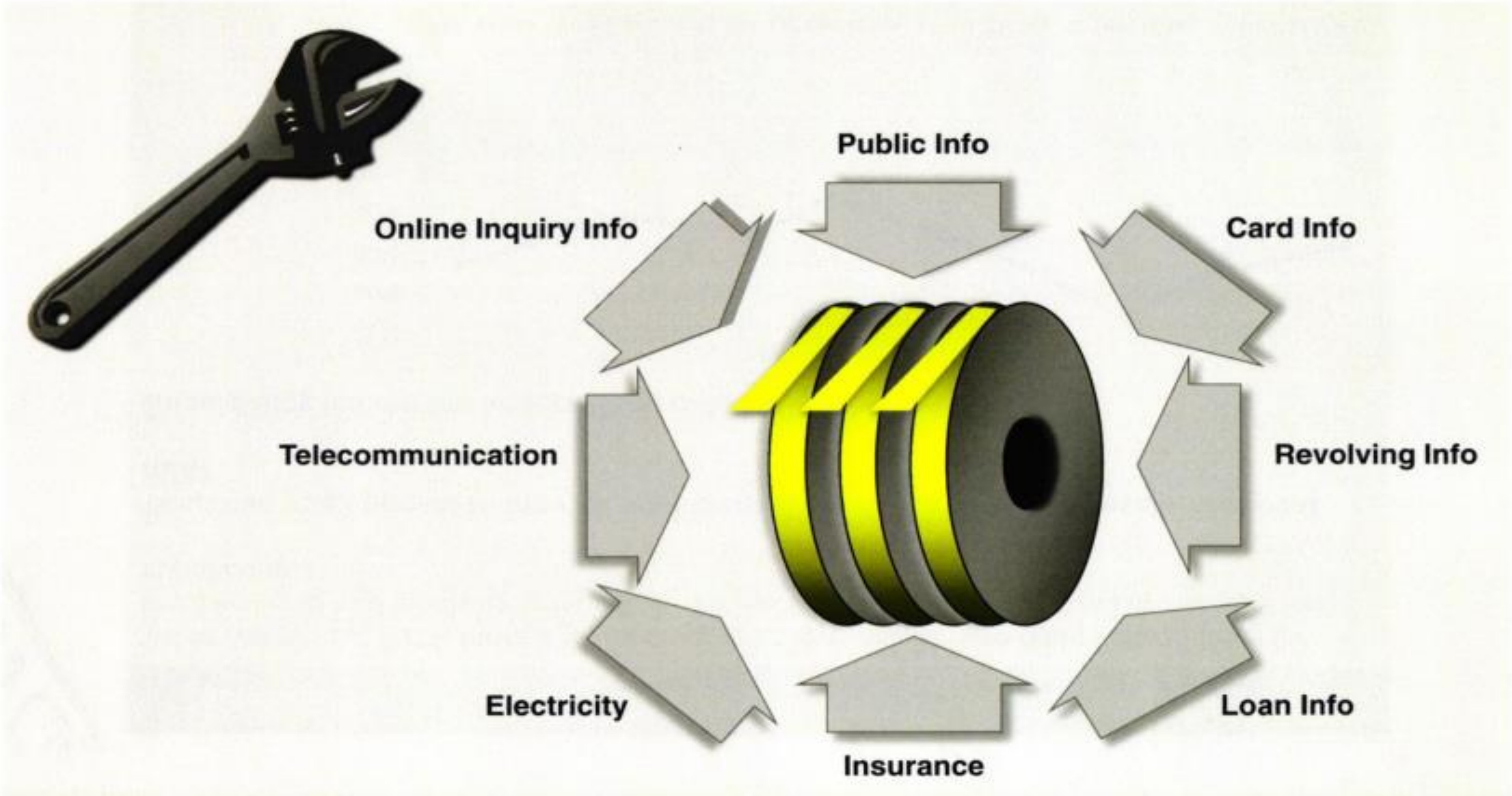
Scenario

Since September 2011, mortgage approval rates in Thailand have been falling. Since the flooding issue had resolved by that time, the risk team is being challenged to increase the approval rate.

What can you suggest to the risk team to lead the conversation about the approval rate?

Should they loosen the underwriting criteria?

RB Toolkit: Credit Bureau Data



Types of Credit Bureau

Negative Information

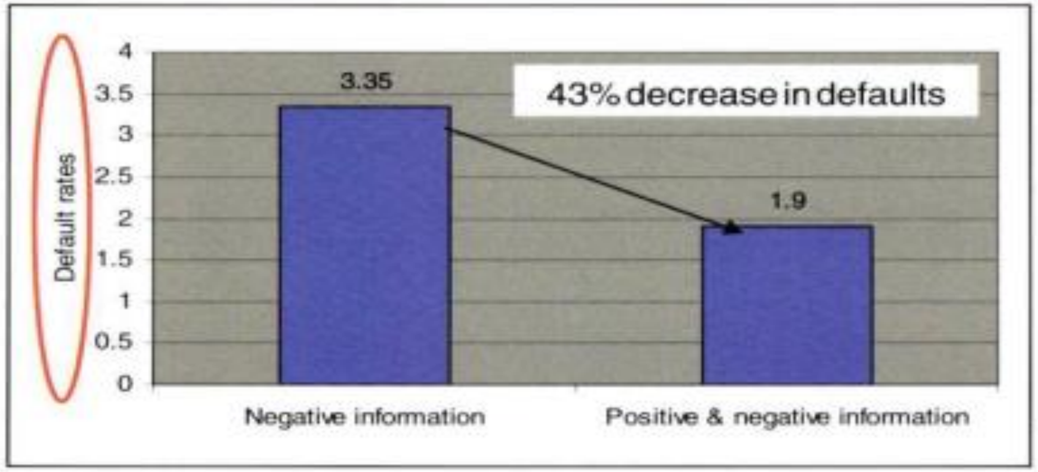
- Credit history only contains information on defaults. (amounts defaulted, outstanding amounts owing and the date of last payment)
- also often relerred to as black lists.

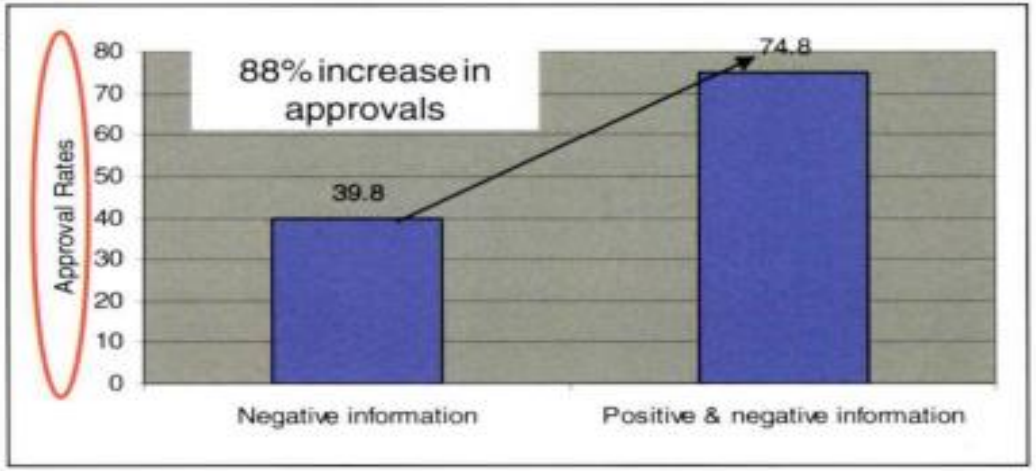
Positive Information

- Credit history contains information on all open and closed credit accounts. (amount approved, as well as the information on repayments)
- If a borrower has defaulted on payments, but eventually paid it off, the default information remains on lile and is not deleted for a defined period of time.

Impact of Positive Credit Bureau data

* Effect on Default rates from including positive information (simulation using U.S. data)





* Effect on approvals from including positive information (simulation using U.S. data)

Usage of Bureau Data in a Credit Cycle

Product Strategy	Underwriting	Account Management	Collections & Recovery
• Customer profiling • Pre-screening • Marketing models • Prospect databases	• Authenticate • applicant identity • identify potential risk • borrowers • Select valuable customers • Confirm borrowers • ability and willingness to repay • Establish the current total indebtedness of a borrower	• Line management • Credit concerns • Line increase • Line decrease	• Collections strategy • Skip tracing

Credit Bureaus: Industry Engagement as a Success Factor

Scenario

In 2003, Thailand enacted legislation which could penalize the members, management, and board of directors of a credit bureau for any information found to be recorded incorrectly. Since the penalty included up to five years of incarceration, both credit bureaus immediately suspended operations for three months.

If a positive credit bureau suspends operations in a country where SCB calculates IRB scorecards and probability of default, what would be the impact on reporting and capital allocation?

What would be the impact on daily operations, such as underwriting and account management?

Can you think of strategies for regulatory interaction which would be proactive, rather than reactive?

Account Management

Scenario

When SCB moved from Basel I to Basel II IRB in Hong Kong, regulatory capital for credit cards suffered a material increase. Under Basel II IRB, we need to reserve capital for most of the unused (OFB) portion of the credit line. In Hong Kong, we had low overall utilization rates due to inactive cards and a high proportion of transactors instead of revolvers.

What levers are available to reshape this type of portfolio?

What is the danger of cutting credit lines of our customers?

If we want to de-risk, what key indicators can be used to identify the correct segments for de-risking?

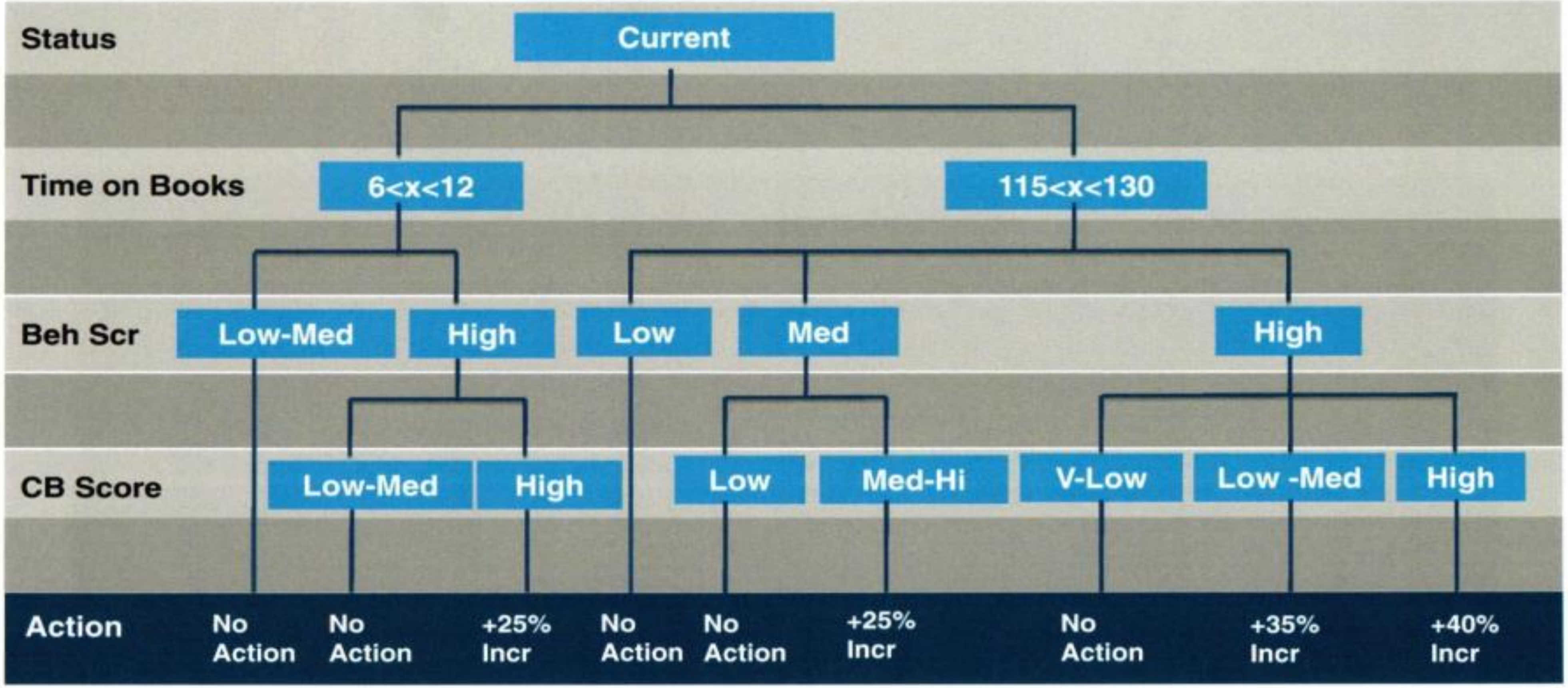
Example Account Management Actions for Retail

Mortgage	
• Top-up / equity add-on product	• Cross sell
• Re-pricing where possible	• Payment holiday
• Tenor extension	• Re-financing
• Tax Return	• Conversions
CCPL	
• Credit Card purchase block at x days past due - what is this?	• Cross sell
• Credit Line increase and decrease	• Payment holiday
• Re-pricing	• Tenor extensions
• Debt restructuring	• Balance transfer to revolving line
• Credit Card reissue strategy	• Installment on card product (DAC, LOC etc)
• Usage strategy - revolvers vs transactors	• Promotion / reaser rates
• Instant upgrade - gold to platinum	• Debt consolidations
• Instant approval	• Top ups to original loan amounl
• Temporary line increase	• Performance metrics to use for opening/closing segments eg. RORWA, RLM

Example Account Management Actions for Retail

Behaviour Score	Low Bureau Score	Medium bureau Score	High Bureau Score
Low Score (High Risk)	Reduce credit limit	Retain current limit or reduce limit	Retain current credit limit
Medium Score (Marginal Risk)	Retain current limit or reduce limit	Betain current credit limit	Marginal increase
High Score (Low Risk)	Retain current credit limit	Marginal increase	Larger increase

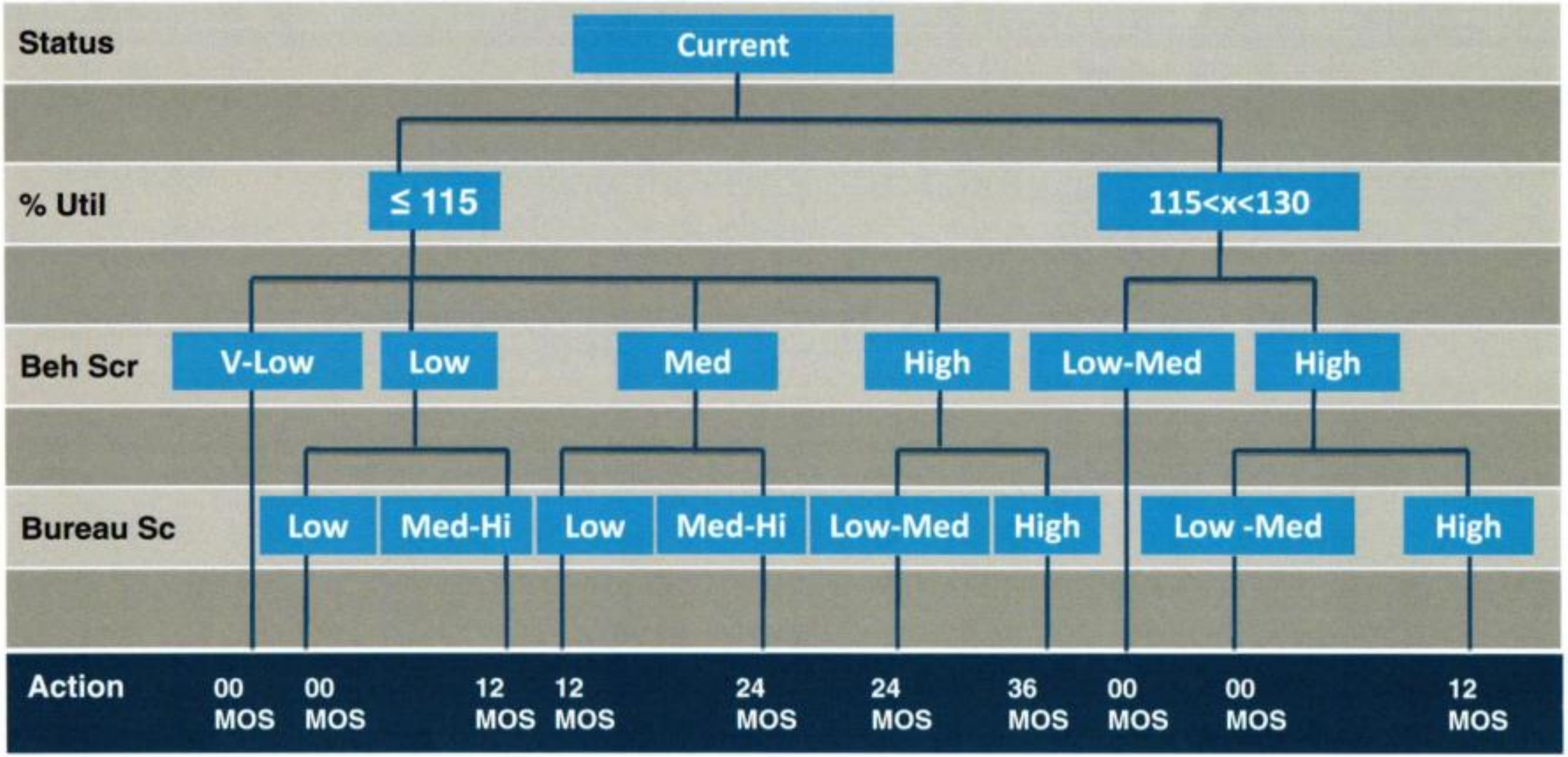
Credit Line Increases: Example of Segmented Approach



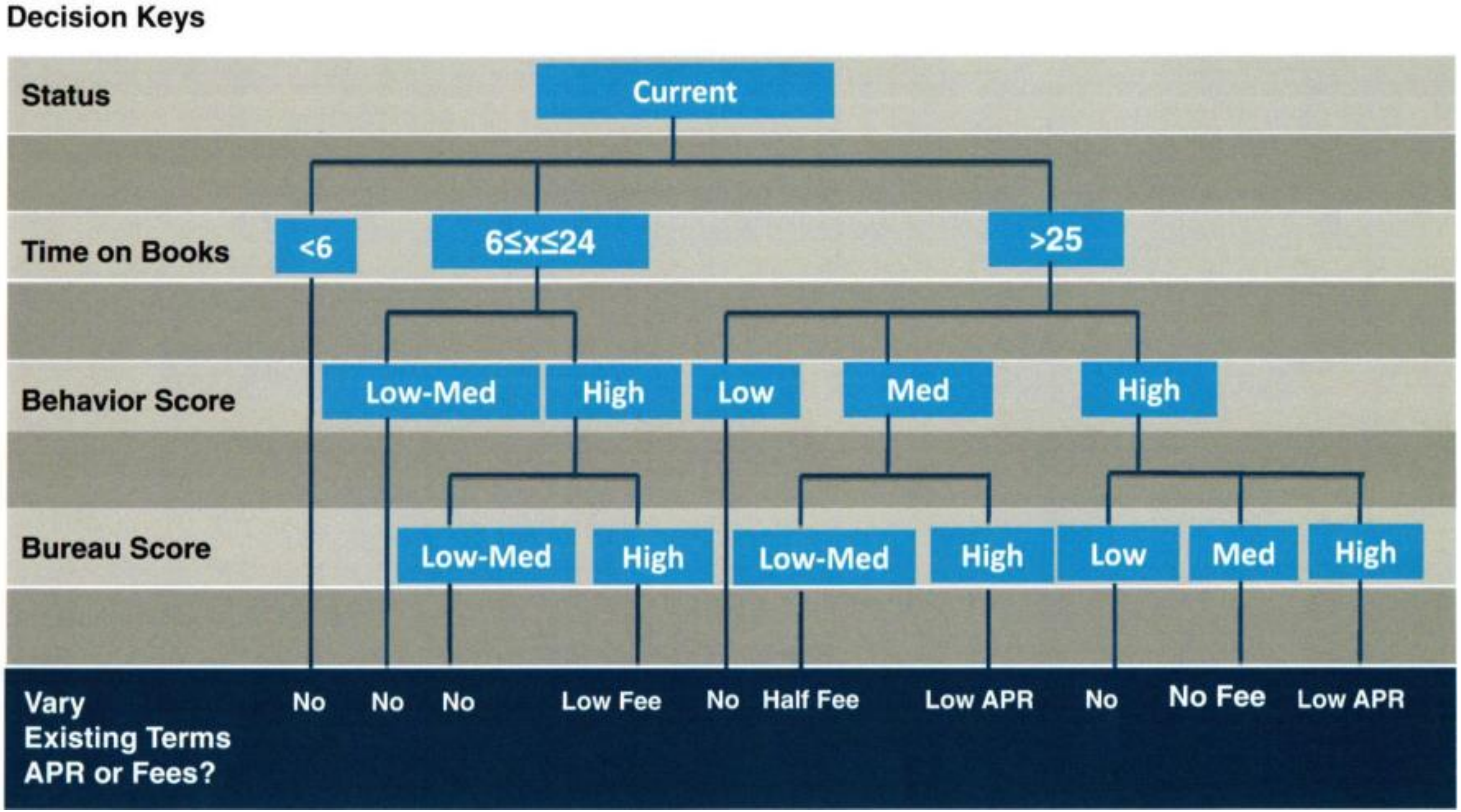
Note: *All of these segmented strategies can be done in a test & learn (champion / challenger) context. We can test new strategies on test cells and measure the results prior to using it as our main strategy.*

Credit Card Reissue Strategy: Example Segmented Strategy

Decision Keys



Risk-based Pricing Example: By Segment

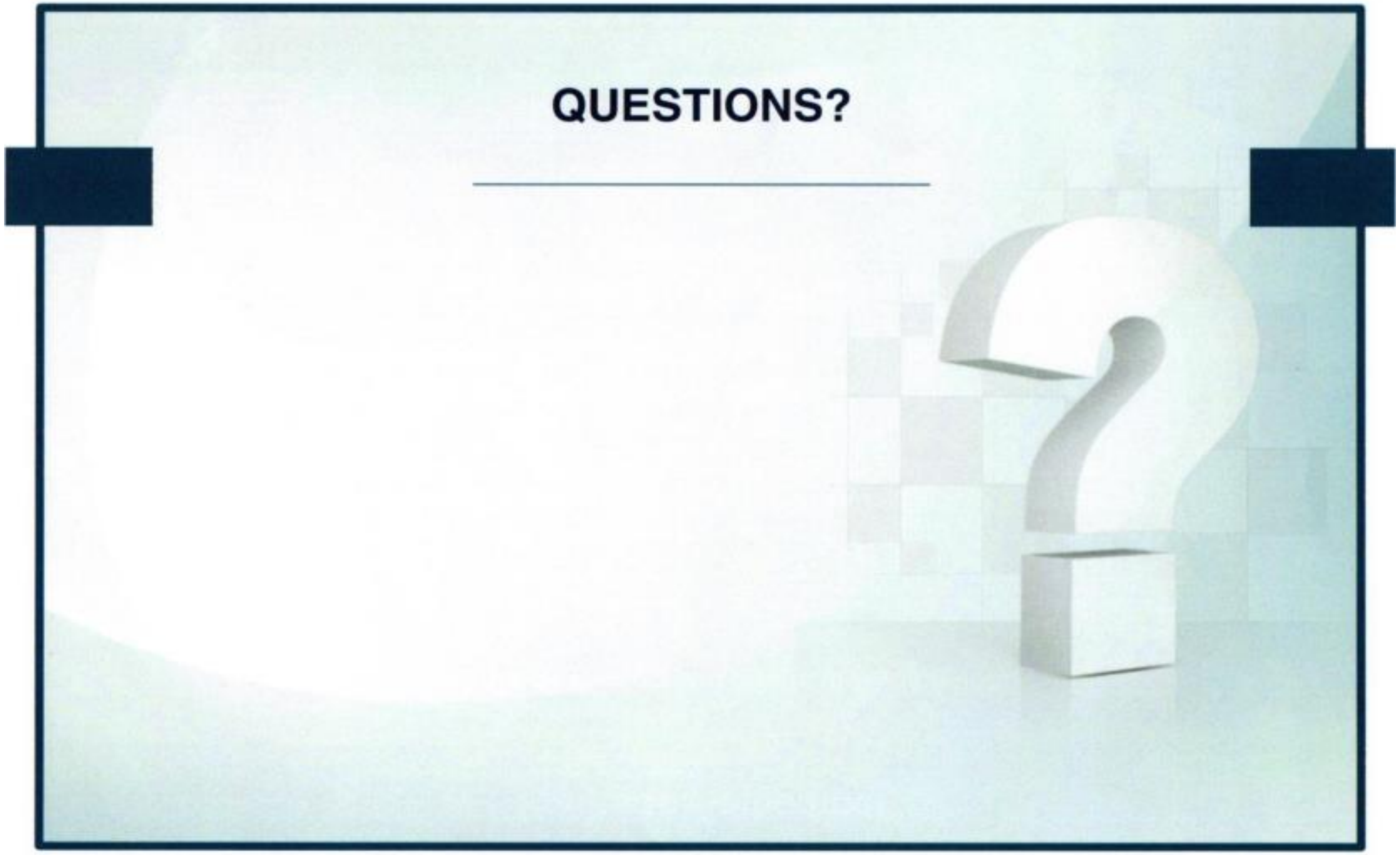


Points to Remember

Let's revisit some of the most important points in this sections

- Getting the right information, its verification, and evaluation is critical in the underwriting process.
- As the quality of available data improves, verification, and evaluation processes can be automated.
- Credit bureau data is used in every stage of the credit cycle, for account and portfolio management actions through a segmented approach.

Questions



Notes