Reduce Exposure With Pre-Delinquent Treatments

The right action at the right time mitigates risk while protecting and even strengthening customer relationships

Rising delinquency rates in many markets around the globe have lenders considering whether they ought to be taking action sooner to reduce write-offs and collections expense. But while the rewards of early action can be substantial, contacting customers who aren’t seriously delinquent can be like walking a minefield—there’s so much potential to damage valuable relationships.

This white paper presents a more precisely timed and targeted approach that delivers the rewards of early action while avoiding the hazards. It examines:

- Pre-delinquent treatment strategies and objectives
- Methods of identifying customers and accounts needing pre-delinquent attention
- Careful targeting of various types of pre-delinquent treatments
- Leveraging existing FICO systems for these new strategies

Precisely timed and targeted pre-delinquent strategies improve risk exposure and protect customer relationships. FICO consultants can help you develop and implement winning strategies for your business.
With card account and loan delinquencies rising in the trail of the global recession, lenders can no longer afford to wait to take action until customers fall behind on payments. Carefully targeted actions initiated early enough can help prevent delinquencies.

Even when delinquencies happen, taking actions prior to their occurrence may enable lenders to reduce write-offs and collection costs. Above all, taking the right actions at the right moments means you’re more likely to receive due consideration from consumers struggling to pay multiple debt obligations. You’re less likely, as the delinquency becomes serious and lenders fight for share of payment, to be left taking the impact from largely uncollectable debt.

Strong competitive advantages like these have spurred interest across financial industry markets in what many refer to as “pre-delinquent collections” strategies. We think this term is a misnomer, however, since it has misled many lenders into thinking that adopting pre-delinquent strategies is basically a matter of making collections contacts with customers sooner.

In fact, what we prefer to call a “pre-delinquent treatment” strategy has a different objective. Effective pre-delinquent treatments enable lenders to avoid contacting customers in all but the most risky cases and, wherever possible, to prevent accounts from needing collections actions altogether.

Making contact is an action that should be used sparingly, and always in a highly targeted manner, since customers who are not yet delinquent may perceive these contacts as intrusive, aggressive and unwarranted. Contacts can even cause customers who had not been fully aware of their financial condition to panic, and reduce or stop making payments.

Fortunately, lenders have a wide range of proactive measures they can take with customers who are not delinquent but whose accounts are showing indicators of rising risk. By taking the right action at the right time—based on precise segmentation and targeting—lenders can manage and reduce their risk exposure without damaging valuable customer relationships. They can spare scarce collections resources while prompting inbound contacts from customers. In some cases, carefully applied pre-delinquent treatments can even increase customer loyalty and contribute to the lifetime value of the relationship.

Pre-delinquent strategies generally have a couple of objectives, which are intertwined and pursued simultaneously:

1. Take well-timed and targeted actions to prevent negative-quality balance build and forestall or eliminate the need for attention from collections.

When customers are experiencing financial difficulty, they often fully utilize every available credit resource while trying to minimally service all of this debt. Months of maximizing credit usage and minimizing payments may go by before the customer’s financial situation improves or they begin slipping into multiple delinquencies. This period before the crisis is prime time for alert lenders to extend assistance while taking measures to curb the runaway growth of indebtedness.

Even when such actions do not ultimately succeed in preventing delinquency, they usually contribute to a more positive outcome. Often they extend the number of months during which payments continue to be made. (Customers may make larger payments for a longer time to the proactive lender, even as they’re missing payments to other creditors.) When accounts do move into collections,
their outstanding balances are therefore likely to be smaller than they otherwise would have been. In addition, as a result of customer information gathered and customer attitudes affected through pre-delinquent actions, collected amounts are likely to be higher and collection expenses lower.

2. Update and improve the quality of contact data in customer records so that if and when collections contacts must be initiated, contact attempts are more productive and less costly.

While it’s important, as we’ve said, not to take premature collections actions, it’s also important not to delay once collections actions are necessary. In markets where customers have multiple credit cards, overdraft accounts or a combination of exposures across a range of issuers and lenders, creditors can find themselves fighting for indebted consumer payment share every bit as much as they fight for market share or wallet share. Under these conditions, slow movers can end up big losers.

Speed depends, above all, on having good contact information. Given the ways technology now enables consumers to evade creditor telephone calls, lenders need to adopt more systematic and sophisticated means of obtaining this vital information. Pre-delinquent treatments are one of the best ways of going about it. Actions taken when accounts are current can greatly improve the odds of being able to interact with customers should their accounts become delinquent.

Effective pre-delinquent treatment depends on careful identification of accounts showing indications of financial stress and rising risk.

To make these identifications, lenders can’t simply rely on event triggers, such as days late on a payment. After all, in some markets, as many as 25% of bankcard accounts are late on any given day—and in this stressed economy, that percentage can swell much higher.

Additional means, including analytics, are needed to differentiate customers with rising risk from others who may have paid late because of temporary factors such as travel, purchase disputes or misdirected statements. More powerful methods are also essential for accurately segmenting identified populations by degree of risk.

That said, the means available for performing pre-delinquent identification and segmentation vary across markets and lines of business. FICO consultants can help you make maximum use of all available means to achieve sharp differentiation:

In markets where credit bureau scores (e.g., FICO® score, FICO® Bankruptcy Score and FICO® Credit Capacity Index™) are available, lenders can segment portfolio populations using both the commercial score and their own behavior risk score. Combining bureau score and behavior score to calculate joint odds will improve definition of high-risk segments. In addition, credit card and other revolving portfolios can gain segmentation precision by adding a transaction score and/or using various transaction-indicated thresholds. Transaction scoring provides supplemental analytic insights for separating customers who have similar behavior scores, but different levels of risk, revealed in day-to-day transactional behavior patterns not evident in activity summaries. It provides immediate alerts to patterns that indicate rising risk, enabling lenders to implement intra-cycle pre-delinquent actions.

In markets without bureau scores but with bureau records and permissible purpose for account management reviews, a check for negative bureau indicators can take the place of the bureau score check. (This can be considered an external “knock-out” rule or disaster check.) In some cases, credit...
reporting agencies offer services indicating when customers exhibit specific credit behaviors that show rising risk or when their activity patterns or scores cross pre-defined thresholds.

Where there is neither a bureau score nor accessible bureau data, a behavior risk score should be used to identify and segment pre-delinquent customers.

In conjunction with these analytics, other segmentation criteria can be used:

- **Balance amount**
- **Habitual delinquency and balance building patterns**
- **Recent activity, including:**
  - Out-of-pattern large purchases
  - Sudden use of cards or lines of credit after long account dormancy, or change in cash usage pattern tied to cards or lines of credit
  - Increased time since last payment
  - Increase in number of payments (i.e., partial payment several times throughout the month rather than single full payment at due date)
  - Shift to payment of minimum due rather than balance in full or payment received progressively later in each billing cycle

FICO consultants can assist you in developing behavior scores, transaction scores and other decisioning elements for precise pre-delinquent segmentation.

Pre-delinquent treatments aimed at preventing negative-quality balance build and forestalling or preventing delinquency should be cautiously assigned based on the segment’s level of risk. All segments, at minimum, should also be targeted for collection of updated customer contact information.

**Timely actions**

For those accounts identified for pre-delinquent treatment where the risk is still relatively low, the best strategies usually expend minimal resources. Lenders may choose to implement unobtrusive automated account monitoring or to take measures that encourage customers to self-correct and/or to initiate contact.

Such measures aim to present the institution as a friendly, educational lender. They might include adding general credit management messages to account statements (“In this difficult time, many people are looking for help to maintain a good credit history...”) and pointing to your own customer service representatives (“We’re here to help”).

Institutions may also want to make consumers aware of third-party credit education resources, budgeting tools and credit counseling services, particularly those offered for free in their geographic region. Consumers in the US can be directed to myFICO.com to obtain their FICO® score, gain a better understanding of their credit standing and obtain free educational information about good credit behaviors. FICO® ScoreView Program, which enables creditors to provide consumers with free monthly access to their FICO® scores online, may provide another pre-delinquent education mechanism. Through services like FICO ScoreView, financial institutions benefit from more educated consumers who are more likely to engage in credit-building activities and become current on payment obligations.
Similar treatments can be applied to medium-risk customers, but exchanging the generalized message with a more personally directed one. (“We’ve noticed that you’re having problems making payments. Find out if there’s been an impact on your credit score and, if so, how to correct it.”)

Other actions that can prompt customers to initiate a timely inbound contact — while reducing the lender’s risk exposure — include lowering credit lines. For this treatment, we strongly recommend the use of line optimization analytics to pinpoint the most profitable point within what the organization determines to be an acceptable range of risk. Line decreases should still allow for the accumulation of potential interest and penalty fees, under the assumption that the current balance may not be paid on a timely basis. Other accounts held by the customer could also be examined as part of the exposure review, if this is permissible under local regulation and the credit agreement with the customer.

Creditors with revolving accounts also have the option of blocking authorizations of future purchases and cash requests for higher-risk customers. When implementing this kind of treatment, assume that customers will attempt to reach the call center at the moment their next potential purchase or use of credit is prevented. These callers should be promptly connected with a human being rather than handled by a Voice Response Unit (VRU) or presented with a menu of telephone numbers. The customer service or collections area into which the call is routed should be equipped with talk tracks and training for discussing the reasons these actions have been taken and investigating the risk potential of the customer.

In general, apart from the specific pre-delinquent treatments being applied, we can’t emphasize enough the need for well-prepared call center staff. We know of some institutions that have lost opportunities to head off delinquencies because when customers called in for help, they were told “You’re not delinquent at this time, so there’s nothing I can do to help you.” All staff taking or making calls should therefore be trained in pre-delinquent strategies and treatments. They should be able to collect critical contact data (discussed further in the next section), and provide informational and educational assistance to customers. Where necessary, they should be able to negotiate extended or alternative payment plans, or quickly connect the customer with someone who can. Creditors may also wish to provide customers with anonymous means by which to make payment arrangements, including web portals.

Accounts with the highest risk should be reviewed with the understanding that they are very likely to become delinquent or require adverse action. These are the cases where the best pre-delinquent treatment may actually be to accelerate a collections-like contact. Calls should be made by collections representatives with particular training in pre-delinquent actions and strong negotiation skills. If messages are left for the customer requesting return calls, use of toll-free numbers should be considered, and calls should be routed directly to the collections group specializing in pre-delinquency.

**Contact information collection**

All accounts identified for pre-delinquent treatment should be flagged in customer service so that whenever one of these customers initiates contact, a systematic effort is made to update their contact information. This information should include traditional telephone number and address, as well as mobile phone, email address and other online points of contact. Customers should also be asked for their contact preferences.

Such measures are important even for institutions that have regular data update processes, since in some locations as much as 25% of early-stage delinquencies are related to disputed purchases or
customers not receiving their statements properly. Lenders should therefore have processes in place to determine if there have been return statements or other undeliverable mail sent to the current mailing address for the customer. In such cases, it is also appropriate to check telephone numbers for viability. Should no working means of contact exist, closing or blocking the existing account(s) may be appropriate. Skip tracing action should occur as soon as the lack of contact viability can be determined and where the balance at risk justifies this resource expenditure.

Consider using a dialer system to efficiently check contact viability for all accounts identified as needing pre-delinquent treatment. Dialers determine only whether or not the telephone numbers provided are working numbers (i.e., result in a ringing phone). They allow lenders to confirm current contact information without intruding into the customer’s home or business by trying to engage them in conversation.

Where customers have nonworking phone numbers, take steps to update contact information. For low-risk accounts, most lenders will simply flag the account in customer service, as described above, for updating during inbound contacts. Medium risk may justify accessing services such as credit bureau information and electronic telephone directories to fill in the gaps. High-risk accounts will likely warrant skip trace or location services.

Remember that whatever measures you take to obtain current, reliable contact information, it’s far better to take them in advance of a delinquency rather than after the account is in collections. Agile lenders with good information at hand can move faster than other creditors to obtain as large a share of payment as possible.

Another advantage of confirming contact information ahead of delinquency is the possibility of detecting first-party fraudsters masquerading as legitimate customers. As much as 10% to 30% of all delinquencies are actually fraud. When contact information update efforts turn up no viable means of reaching the customer, there’s no need to wait until balances mount and delinquencies develop. Moving these no-points-of-contact accounts promptly into a fraud queue reduces losses, increases the odds of apprehending criminals and saves collections expense.

Lenders can gain additional competitive advantage and value from investments they’ve already made by using their existing FICO systems to develop and implement pre-delinquent treatment strategies.

Creditors with FICO TRIAD

Use FICO® TRIAD® Customer Manager to segment accounts for pre-delinquent treatment. You can also create effective pre-delinquent treatment strategies using Collections Decision Area or Client-Configurable Decision Area in TRIAD 8. Measure and continually improve the impact of your strategies on delinquencies, delinquent balances, payments, write-offs and other performance indicators through systematic champion/challenger testing. TRIAD strategy consultants can explain how population segments identified for pre-delinquent treatment can be moved into specific contact queues, and file details passed into the dialer for customer contact viability confirmation or for actual customer contact.

TRIAD 7 and earlier versions do not allow management of accounts that are not delinquent within the Collections Decision Area. If you have one of these TRIAD versions, however, you can manage these account in the Overlimit Collections Decision Area or, if you haven't licensed that module, in
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Record delinquencies, debit and prepay cards, recessionary stress and new regulations are damaging card profitability. Issuers are reevaluating every aspect of their card operation, business model and strategies, in order to hold onto portfolio profitability. FICO has developed a program for Reengineering Card Profitability that can help issuers in three critical ways:

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» Reduce losses through precise segmentation

We bring issuers more than 30 years of experience in helping card issuers in every global market, coupled with new analytic tools that you can use to rebalance risk and reward with “scalpel” precision.

To learn more about our program, speak with your FICO representative or contact us at info@fico.com.

Pre-delinquent treatment is a systematic, precise method of reducing write-offs and collections expense by identifying and mitigating at-risk balances earlier. Carefully targeted and timed treatments help prevent some delinquencies while minimizing the impact of early intervention on valuable customer relationships. When delinquencies occur on accounts that have received pre-delinquent treatment, collections actions are swifter, more productive and less costly.

As lenders fight for share of payment, your ability to manage your risk exposure and move out in front of trend lines to offer proactive assistance to your customers is an emerging source of competitive advantage. FICO consultants will help you apply best practices, and leverage your existing systems and all available tools for your market and line of business to excel in this new area of critical business performance.

Conclusion

Pre-delinquent treatment is a systematic, precise method of reducing write-offs and collections expense by identifying and mitigating at-risk balances earlier. Carefully targeted and timed treatments help prevent some delinquencies while minimizing the impact of early intervention on valuable customer relationships. When delinquencies occur on accounts that have received pre-delinquent treatment, collections actions are swifter, more productive and less costly.

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