The changing face of consumer credit

The impact of credit and the over indebtedness of consumers in developed economies has received significant focus globally due to the recent recession led by the credit crisis. Despite the fact that the recession has officially ended, consumer lobby groups and the media have been critical of fees, interest rates and practices applied by lenders.

According to PIC Solutions, a leading specialist credit risk solutions company in the EMEA region, the US and UK governments are actively looking to introduce legislation that regulates the granting of credit, lending criteria and communication. Proposed legislation will require the lending institution to assess the indebtedness of each potential customer, prevent lending to over-indebted individuals and refrain from predatory marketing practices.

According to Simon Trupp, one of the PIC Solutions directors, South Africa's National Credit Act has led the way when it comes to protecting the rights of the consumer and more advanced economies, such as that of the US and UK, are now following in SA's footsteps.

There is currently debate in US congress on how to restrict certain credit and debit card issuer lending practices. Fees such as interchange fees, which are levied when a credit or debit purchase occurs, are under scrutiny and there is a high level of consumer attention on credit and debit card practices.

Legislation was recently enacted in the US regarding controlling credit practices such as pricing of a credit product. In advance of the implementation of this legislation, banks and other lenders have been increasing rates and fees, as they will be unable to do so once the legislation comes into effect.

Key statistics in the US indicate that fees have been increased to counteract the reduction in both credit cards and credit limits:

- In the 12 months that ended in September 2009, the number of Visa, MasterCard, American Express and Discover card accounts in the United States fell by 72 million, according to David Robertson, publisher of The Nilson Report, an industry newsletter. There are currently 555 million accounts still in the marketplace.

- Over roughly the same time period banks lowered credit limits by 26%, to US$3.4 trillion (about R24.242 trillion), from US$4.6 trillion (about R32.798 trillion), according to an analysis of government data by Foresight Analytics.
- Interest on credit card accounts increased to an average of 13.71%, up from 11.94% in the previous year, according to federal records.

One outcome of this increased attention on consumer credit is that consumers are becoming increasingly credit aware. Lenders are now obliged to make decisions at the individual consumer level rather than the previous practice of broad based policy implementation across portfolios. This requires accurate decision technology and flexibility in their processes to cater for this new function.

South Africa introduced the National Credit Act in June 2007 and the lending practices that were prevalent internationally were restricted. The lead up to the introduction of the act saw many lenders advance high risk credit in anticipation of the legislation. The impact of the legislation and subsequent recession has resulted in high levels of consumer debt and credit bureau statistics report that nearly half of the 18.2 million credit active consumers listed have impaired records and are struggling to meet debt commitments. Lenders have naturally reacted by constricting lending and rather focusing on debt collections. The results from this collection focus are that over the past year early stage (one and two payments in arrears) collection results have improved and are no longer deteriorating; however, the volume of late stage collections (three or more payments in arrears), defaults and write-offs is high relative to the total portfolio. These high bad debt levels are still affecting the profitability of lenders and will continue to roll through the credit portfolios.

Some retail credit portfolios have shrunk or experienced no growth. This is partly due to restrictions in lending criteria, emanating either from legislative requirements (such as the NCA) or strategic credit policy changes by the organisation, designed to curb the levels of bad debt. A second aspect that has contributed to the stagnation in credit is consumer appetite and capacity for credit.

PIC Solutions has observed four distinct trends in consumer credit lending and portfolio management against the current economic and credit background:

1. Account acquisition

Significant budgets are now being allocated to acquisition campaigns and processes as lending criteria become more relaxed. There is also a renewed focus on both above the line and below the line marketing, with key requirements being efficiency and sophistication. Direct acquisition channels are being further developed, such as cell phones, electronic banking, checkouts, and person-to-person approaches. Advertising on TV, commuter transport and social networks are also being expanded. Measurement of each of these channels is becoming more refined, with the ability to track responses by the use of different response numbers or campaign codes, enabling sophisticated breakdown of the alternative elements to increase response.

Predictive modelling is being applied to determine probability of response by channel, together with estimates of future usage and bad debt. Marketing campaigns are now routinely measured across response, usage and risk to determine the effectiveness and longevity of each campaign.

Lenders are looking to improve direct marketing approaches with "test and learn" champion/challenger approaches being adopted as the norm. Leading edge techniques such as "experimental design" combined with predictive modelling and optimisation are being implemented in order to maximise bottom line profit. External data sources are now also being adopted to augment internal data and drive decisions.

2. Credit application decisions

Additional attention and funding is being allocated to the calculation of the initial credit limit given to customers through the implementation of sophisticated tools and strategy design methodologies. This has resulted in a gradual increase in the credit limit of existing customers as the high cost and risk associated with acquiring new clients is becoming an influencing factor.

For revolving credit products such as store cards, the flexibility of account management processes to adjust credit limits has been reduced by legislation (NCA).

Organisations are investing in technology such as "flexible decision engines" (Blaze Advisor) to assist with complex application decision making. This has come about through a need for more complex segmented strategies and decision processes; using more data fields in order that lenders can give appropriate terms and conditions based on the individual customer profile.

As an example, pro-active affordability modelling is being used by leading institutions to meet the multiple objectives of making sound and consistent decisions. This is married with being compliant in terms of reckless lending requirements of the NCA, while at the same time balancing these requirements with a desire to minimise customer 'annoyance' factors.

3. Late stage collections and recoveries

Due to the slow-down in customer payment in many credit portfolios over the last two years, many portfolio managers are faced with increasing late stage collection and recovery portfolios. A majority of organisations use external agencies to collect these debts and there is an increasing trend for organisations to review and update the systems and processes used to manage these external agencies. Activities around the debt counselling process have been given special attention and debt sale is being given more focus, using external data and analytics to maximise the value of these portfolios.

4. Use of external data sources

External data such as payment profile data held at the Credit Bureaux, is being widely used across the credit life cycle to improve the decisions made at each point. Organisations are also looking to centralise the regular update of this data on their customers to enable all credit decisions across the business and generate a holistic view of the customer. Organisations are also testing the frequency and format of data updates to optimise the benefit that this data gives to credit decisions across the credit life cycle.

In summary, the face of credit has been brought into sharp focus through legislation, media and consumer lobbying groups, which is in turn increasing the level of customer awareness. In addition, economic forecasts predict a slow recovery from the recession. It is within this environment that credit issuers are looking to stabilise and build credit portfolios. Competitive advantage exists for lenders who lead the way in these four areas - acquisitions, credit application decisions, late stage collection and recoveries and use of external data sources.

About PIC Solutions

The company, one of the leading specialist credit risk solutions companies in the EMEA region, provides consumer finance solutions to a wide range of blue-chip organisations across the entire credit life cycle and are leading experts in the fields of credit, risk and software.

The company has offices in Cape Town, Dubai and Johannesburg, and delivers integrated analytics, consulting and software solutions to over 150 companies in more than 30 countries.