Visa Consulting & Analytics

Rethinking Acquisitions and Approvals

Risk and the COVID-19 pandemic

VISA

The COVID-19 pandemic has brought many challenges to the world of electronic payments, while also accelerating some of the trends that had already been in play.

With global economies still struggling to recover, and a lasting change in consumer behaviors likely, many aspects of electronic payments lending are impacted. In the short term, the sudden shifts in the risk environment are likely to have a profound effect on overall business performance.

Visa Consulting & Analytics (VCA) has investigated the changing face of credit risk management for electronic payments from several angles. In this paper, we consider acquisitions and approvals.

Almost every accomplished risk manager will have some experience working through an economic downturn. Some may also have coped with a full-blown economic crisis, such as the Global Financial Crisis of 2008 and 2009. While we have yet to determine the full extent of this the unprecedented crisis caused by this pandemic, what is remarkable is its impact on everyday consumer behaviors.

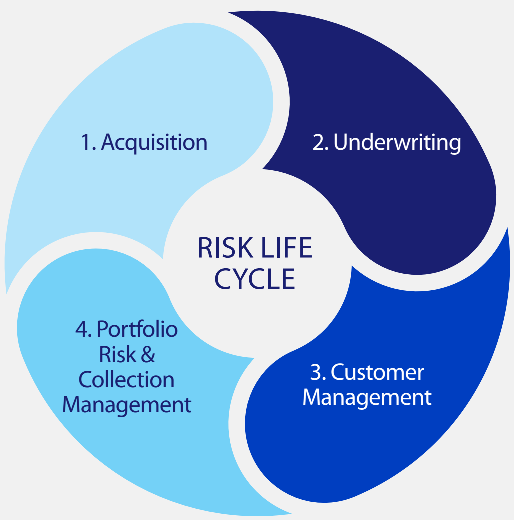
In June, for example, the World Bank said that it envisioned a 5.2% global contraction of the GDP in 2020.[1] Meanwhile, Oxford Economics reported that global household spending had fallen even further and faster than the GDP, and warned that, "when a recovery does come, it is likely to be steady rather than spectacular."[2] Also, the pandemic could cause the equivalent of 195 million job losses worldwide[3], which is increasing consumer concerns about their ability to pay bills and loans, with a wide gap opening up between developed countries (with 66% expressing concern) and developing countries (where the equivalent figure is 88%).[4] On the other side, certain sectors, particularly digital businesses, have been thriving through the pandemic, and there are new opportunities for entrepreneurship.

For credit risk managers, it is a perfect storm that is putting extreme pressure on all phases of the credit lifecycle, all at the same time. To aggravate matters, there is uncertainty as to how the situation will evolve, how long the pandemic might last, or what the recovery could look like.

The COVID-19 crisis puts extreme pressure on all four phases of the risk cycle

With a shift in the economic fundamentals, there is a need to rethink the risk appetite, tighten the acquisition policy, and reduce the cost of acquisitions.

As new risks materialize, there is a need to rework underwriting models, think harder about risk-based pricing, and pay particular attention to origination fraud.



With increased risk across the portfolio, volume is pushed towards the collections function —which is the final back-stop in protecting performance and reputation.

As customer behaviors evolve, customer management practices must follow suit —including credit line management, repayment plans, authorization management, and fraud detection.

1 The World Bank, "The Global Economic Outlook During the COVID-19 Pandemic: A Changed World," 8 June 2020: https://www.worldbank.org/en/news/feature/2020/06/08/the-global-economic-outlook-during-the-covid-19-pandemic-a-changed-world

2 Oxford Analytics, "Coronavirus Watch As restrictions ease, a slow revival," May 4, 2020: http://resources.oxfordeconomics.com/coronavirus-watch-as-restrictions-ease-a-slow-revival?oe_most_recent_content_download_id=0000029&interests_trending_topics=coronavirus

3 International Labour Organization," COVID-19: impact could cause equivalent of 195 million job losses says ILO chief," April 8, 2020: https://news.un.org/en/story/2020/04/1061322

4 TransUnion," Global COVID-19 Consumer Financial Hardship Study Report," April 2020: https://content.transunion.com/v/financial-hardship-global-report

We are therefore experiencing a deep and sudden shift in credit risk. In the short term, this shift can have a profound impact on the overall performance of any credit card business. In this paper, we focus on the very first stage in the credit lifecycle, namely acquisitions and approvals.

For the credit risk manager, there are four key points to consider.

1 The risk profile of acquisitions has shifted dramatically

A percentage of consumers will be facing real financial hardship. Many of them may be tempted to game the credit card system. Along with several other strains of COVID-inspired fraud, you may see an increase in application fraud.

2 Many of the tools used to assess new applicants are rendered less useful

The types of checks used by most issuers in most markets will require some additional scrutiny and validation. For example, given the shifts in consumer circumstances and behavior, traditional risk and credit scores may have lost some of their predictive power. Similarly, you should view the traditional methods for verifying income (such as pay slips or bank statements) with more caution.

3 The shift to digital acquisition channels has been accelerated

While many risk managers may prefer the additional certainty that comes from face-to-face acquisitions, the pandemic is accelerating the shift to digital. Given the potential efficiency savings of digital, you should embrace this change, along with the enhanced risk defenses that can protect it, such as biometric checks and device fingerprinting. Risk managers can also take comfort in the fact that, with more people going down the digital channel, the risk mix will improve accordingly.

4 There will be some definite opportunities to grab market share

Many issuers will choose to close their doors to new applicants. Many others will limit themselves to the very safest of safe bets. Under these circumstances, there are bound to be some opportunities to win market share, especially for those issuers who are ready and prepared to strike now as the tide begins to turn towards a recovery.

The specifics of the response will be determined by several factors including the issuer's circumstances, the size and characteristics of its portfolio, the fraud environment in which the issuer operates, and the severity of the crisis in its home markets. VCA has compiled seven imperatives that, we believe, are relevant to any issuer operating anywhere.

Seven imperatives for acquisitions and approvals in the COVID-19 crisis

#1

Proceed, but proceed with real caution

Continue acquisitions, but do so with prudence.

Tighten up your underwriting criteria. Focus on measured bets. Also, be sure to construct your credit card propositions in a way that optimizes your credit risk exposure and effectively balances risk with anticipated profitability. For example:

- Optimize credit limits – perhaps by reviewing the income multipliers you usually use, especially on lower scores
- Reduce cash advance limits – to address the biggest risk area in a tough economic climate (20-25% of the existing credit line is a good rule of thumb)
- Be extremely cautious with balance transfers – it may be best to de-prioritize them for the time being
- Enhance your authorization processes – perhaps by adding in behavioral scores and spend insights
- Be careful with usage-based promotions – to help keep cardholders on an even keel
- Tighten up your application fraud screening processes – to weed out a likely rise in fraudulent applicants who will ultimately default

One thing you should NOT do is set the credit line too low when reviewing income multipliers. If you have the confidence to originate an account, you should also have the confidence to assign a realistic credit limit – one that is useful to and sufficient for the customer.

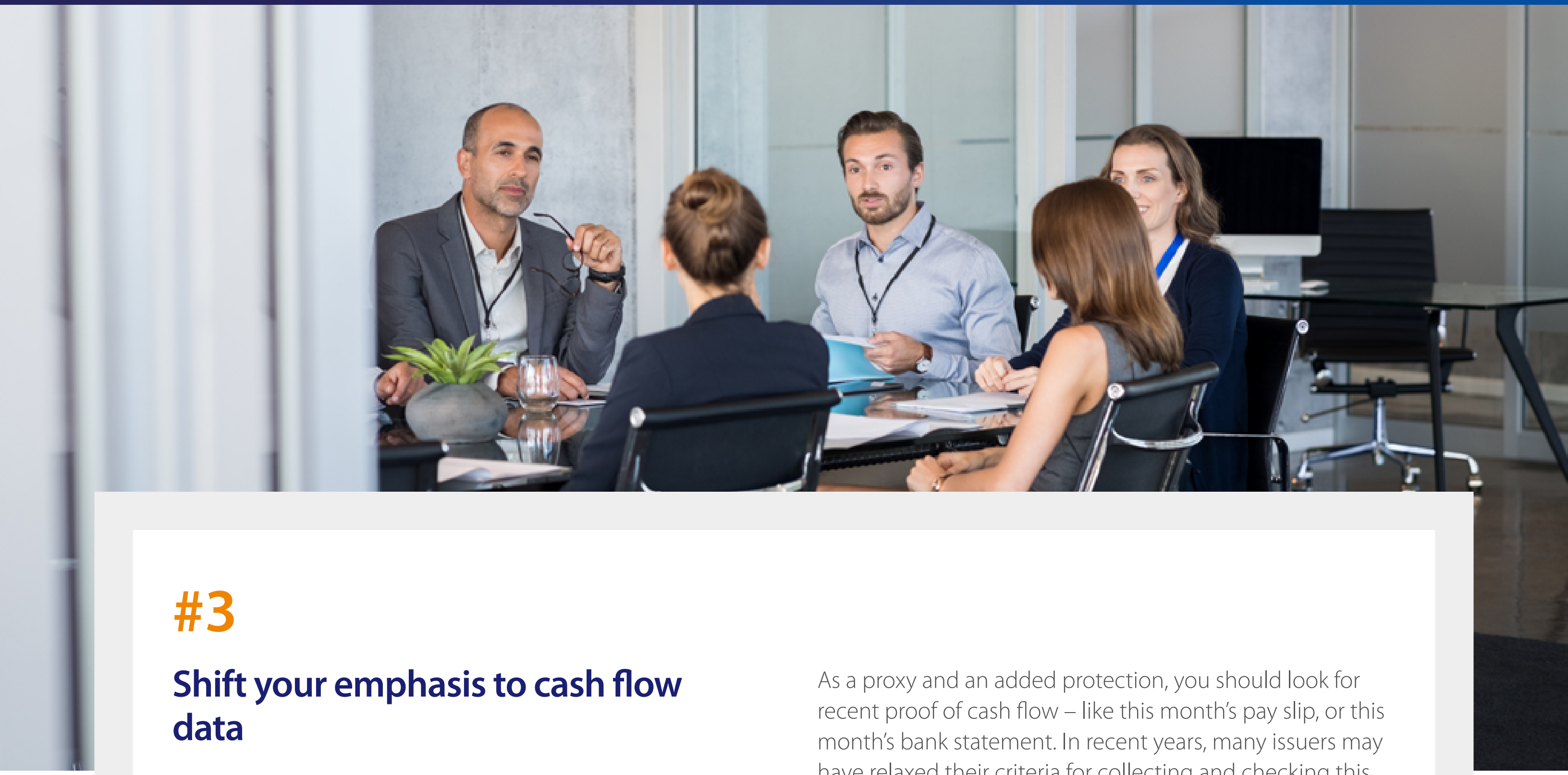
#2

Rethink and rework your traditional approach to decisioning

Many issuers rely almost entirely on automated tools and decisioning criteria to approve new customers and assign credit lines. However, strategy assumptions based on an environment of economic growth may no longer be applicable, and could introduce unacceptable risks.

You should therefore re-evaluate your approach to decisioning, question the validity of your models, and interrogate the data that underpins them, in order to ensure that your risk tolerance is correctly reflected in the way that customers are decisioned in the current environment.

It would also make sense to conduct strategic reviews on a more frequent basis, and give yourself the flexibility to take any corrective measures that may be necessary.



#3

Shift your emphasis to cash flow data

Given the shifts in consumer behaviors, the rapid changes in the circumstances of individual consumers, and the payment moratoriums announced by regulators, traditional risk scores should be subject to additional scrutiny and validation, and cut-offs should be tightened.

As a proxy and an added protection, you should look for recent proof of cash flow – like this month's pay slip, or this month's bank statement. In recent years, many issuers may have relaxed their criteria for collecting and checking this type of documentation. Now is the time to tighten things right back up again.

#4

Double-down on the people who you already know

A sound and relatively safe strategy is to focus on cross sales by identifying and targeting those people who already have another product with your organization (and, ideally, hold their main bank account with you, too).

The great benefit with these customers is that you already know them, you already know something about their circumstances, and you probably know more than you think.

As well as having access to their hard demographic data (such as age, income bracket, educational qualifications and residential status), you also have access to something that is equally valuable: softer behavioral data that could tell you more about the true risk characteristics.

You can use a combination of propensity modeling and segmentation to identify those customers who are most likely to respond to a cross-sell campaign, and to offer the type of product construct that is most likely to appeal to them.

By using a combination of this type of data and analysis, and adding in behavioral scores, it becomes possible to improve the accuracy of your risk assessment models. By targeting the right customer, with the right product, on a pre-approved (or near pre-approved) basis, you improve the efficiency of your digital onboarding and acquisition funnel.

Meanwhile, do not be sidetracked from the need to protect your most engaged customers. Be sure to identify those customers for whom you have already achieved a high share-of-wallet and put a robust protection strategy in place.

#5

Take a segmented and sectoral point-of-view

This downturn, like any downturn, will be selective in its economic impact.

Indeed, a few sectors have been performing relatively well, like the big digital players, some grocery retailers, healthcare players, home delivery firms, and so on. Similarly, some occupations are experiencing heightened demand, such as so-called essential workers, information and communication-based workers, cybersecurity professionals, and so on.

This type of information is not robust enough for you to build your entire strategy around it, but it certainly helps inform your acquisition and approval decisions.

#6

Look to new and alternative data sources

Much of the recent innovation in the financial services industry (as typified by the rise of the Fintech community) came as a response to the 2008/2009 financial crisis – and some innovative approaches to post-COVID credit risk scoring are already surfacing.

Examples include psychometric credit scoring solutions (which assess an applicant's true character), open banking-powered solutions (which use data from existing accounts), and mobile behavior solutions (which use artificial intelligence to evaluate credit risk based on mobile data and app usage).

Of course, these solutions are not yet fully proven. However, they are certainly worth engaging and experimenting, if only in preparation to move quickly when the upturn comes.

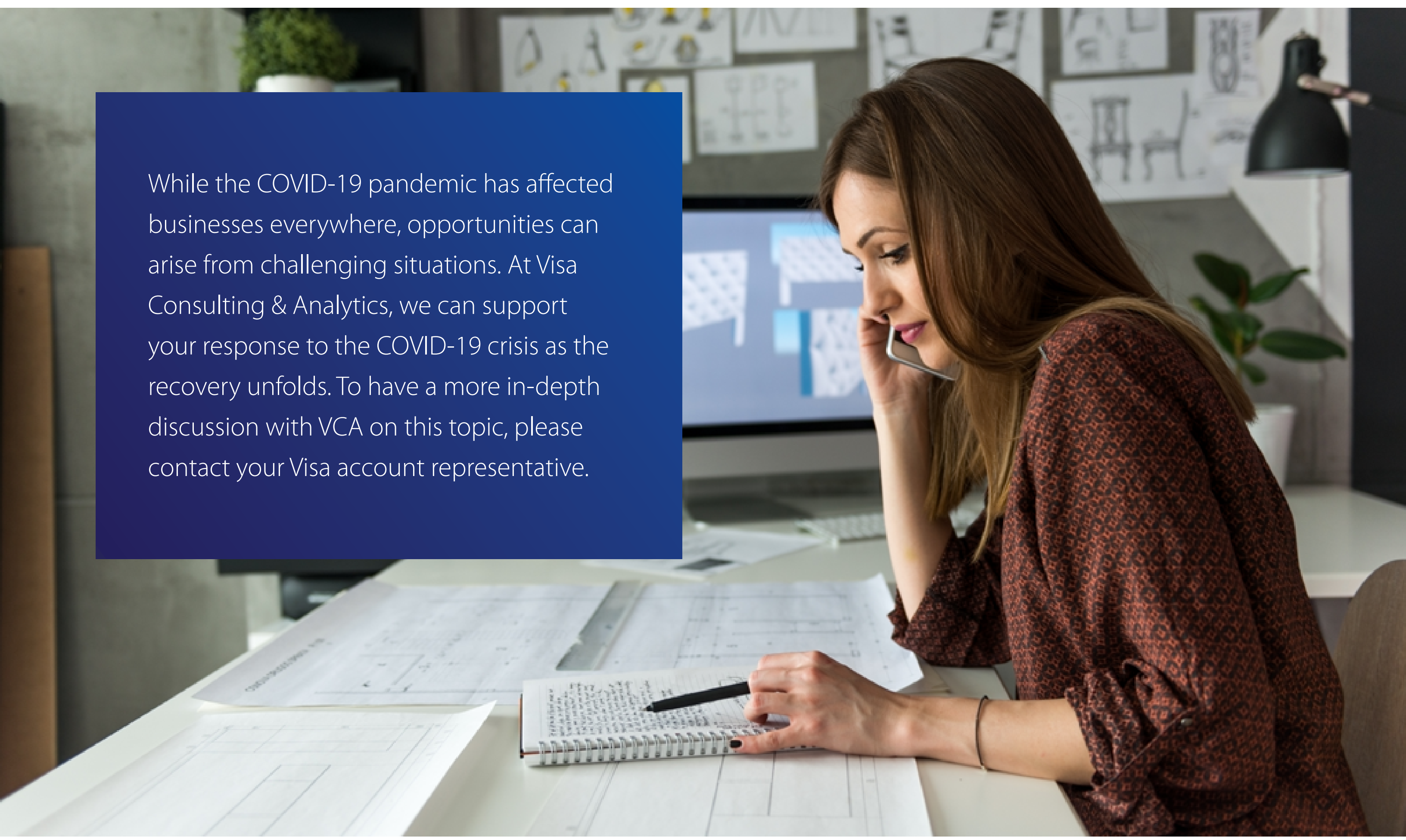
#7

Think about making a land grab – but do so carefully

There will still be plenty of good opportunities out there. Many players will have backed down from acquisitions, so competition will be less fierce. For perceptive issuers, there will be definite potential to grab market share, and the closer we get to some form of a recovery, the less risky this will become.

Through scenario modeling and forecast modeling, you should be preparing for the upturn. Thanks to your credit card transaction data, you will have a real-time time view of emerging spending trends (one that is many weeks ahead of the official economic numbers). The golden moment to strike will be just before the inflexion point.

For example, you could conduct a comprehensive review of your acquisition strategy by geographical location, consumer segment, product type, and so on. You should also perform a profitability analysis under different recovery scenarios to identify areas of stress and opportunity. Armed with this type of analysis, you can prepare to exit segments that are not profitable under the different scenarios of recovery, and grow in those that hold the most promise.



While the COVID-19 pandemic has affected businesses everywhere, opportunities can arise from challenging situations. At Visa Consulting & Analytics, we can support your response to the COVID-19 crisis as the recovery unfolds. To have a more in-depth discussion with VCA on this topic, please contact your Visa account representative.

About Visa Consulting & Analytics

We are a global team of hundreds of payments consultants, data scientists and economists across six continents.

- Our consultants are experts in strategy, product, portfolio management, risk, digital and more, with decades of experience in the payments industry.
- Our data scientists are experts in statistics, advanced analytics and machine learning with exclusive access to insights from VisaNet, one of the largest payment networks in the world.
- Our economists understand economic conditions impacting consumer spending and provide unique and timely insights into global spending trends.

The combination of our deep payments consulting expertise, our economic intelligence and our breadth of data allows us to identify actionable insights and recommendations that drive better business decisions.

For help addressing any of the ideas discussed in this paper, please reach out to your Visa Account Executive to schedule time with our Visa Consulting & Analytics team or send an email to VCA@Visa.com. You can also visit us at Visa.com/VCA.

