



TRANSUNION WHITE PAPER

Portfolio Reviews:
Monitor for Risk, Catalyst for Action

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A portfolio is simply the aggregate sum of the individual debt instruments it contains— accounts, loans, credit cards, lines of credit or other instruments. As individual accountholders move through different life events, the creditworthiness and risk level of their accounts constantly change. And, because the level of risk contained in your debt portfolio is a function of the risk presented by these individual accounts, your portfolio constantly fluctuates too. Your portfolio’s performance, including both profitability and loss rates, directly correlates with how well you identify, anticipate and manage these fluctuations in individual risk.

Clearly, the ability to understand and manage risk fluctuations is an essential part of any effective credit risk management strategy. One of the best ways to do this is by conducting regular portfolio reviews, which can provide both point-in-time and longitudinal statistics. This information gives you the ability to assess both overall portfolio risk and individual account-level risk, making it a key foundation for developing effective business rules and organizational strategies.

This paper explains four ways in which your business may benefit from the use of portfolio reviews:

Better risk quantification

Improved trend monitoring

More precise portfolio valuations

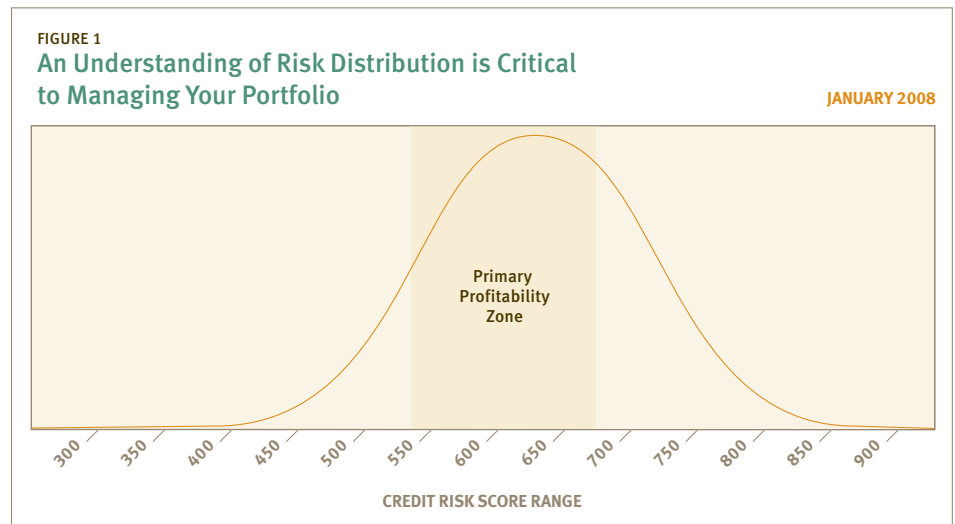
Enhanced account management

Use a Portfolio Review to Quantify Risk in Your Portfolio

A portfolio review can quickly and objectively quantify the level of risk contained in your portfolio at any given time. It provides insight into your current balance of high-risk accounts against those that are low-risk.

Based on this empirical data, you can better determine how a portfolio's risk profile fits your business rules and risk appetite, including organizational objectives, board directives and investor expectations.

Quantitative knowledge of your portfolio is a vital component in satisfying examination and regulatory demands. Empirical results provide examiners with an objective foundation against which your account management strategies can be compared and validated. As such, an empirical, verifiable knowledge of your portfolio's risk profile is integral to a comprehensive safety and soundness review. For example, in completing a soundness opinion, it is necessary to attest to the sufficiency of your reserves to compensate for uncollectible accounts. Simply measuring the raw numbers of accounts that are 30, 60 or 90 days past due has limited predictive ability. It doesn't tell you the likelihood that any sub-segment of accounts will further degrade or improve. It offers no insight into what estimated proportion of accounts can be rehabilitated and which have the potential to be sold or



This portfolio distribution is in line with management goals.

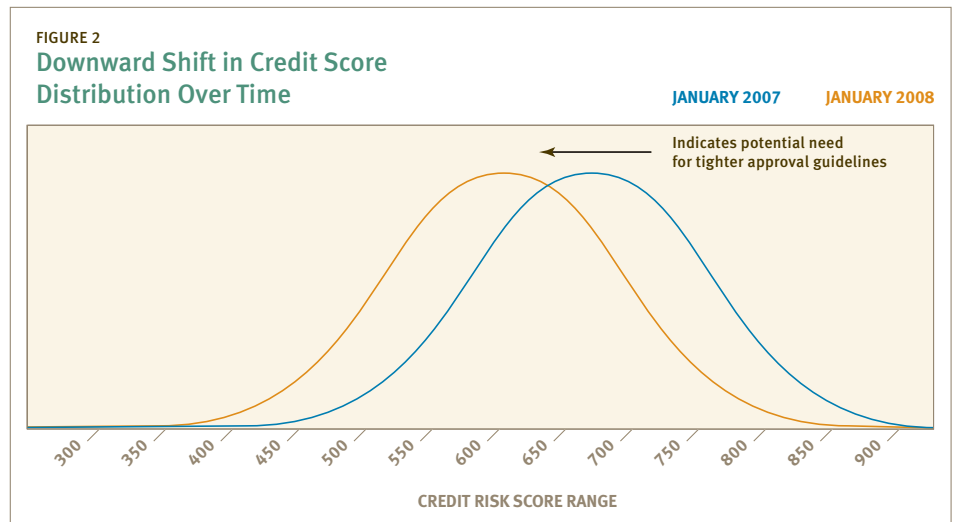
outsourced for collection. In contrast, by conducting a portfolio review you can quantify the probability of different account behaviors, thereby getting more statistically valid insight into these issues. With this insight, you can make more considered decisions about any further action you might need to initiate to control risk in your portfolio.

Use Serial Portfolio Reviews to Monitor Risk Trends

Portfolio reviews provide snapshots of a portfolio’s current risk distribution. By repeating the review at frequent intervals over a sustained period of time, such as on a monthly, quarterly or semi-annual basis, you can better identify changes and determine trends.

Not only is such historical trend data more predictive of future behavior, it also provides an effective means of monitoring the impact of time-sensitive or staggered operational changes.

Most portfolios have a specific range of credit risk where accounts are usually quite profitable. As a general rule, this range—commonly known as the sweet spot—is not at the high-risk end of the spectrum because excessive charge-off rates would overwhelm any revenue streams. Lowest-risk customers are also unlikely to be profitable, since they generally do not carry large balances from cycle to cycle and usually make consistently on-time payments. This makes the near-prime risk segment generally the most profitable group for the majority of banks and credit unions. The near-prime group carries balances, makes reliable payments and generates occasional fees for minor delinquencies or services. Wherever the sweet spot is in your portfolio, it is important to understand how accounts move in and out of your most profitable risk range.



Unlike a one-time analysis, portfolio reviews over time can track and identify changes in your risk composition that could impact profitability—either adversely or positively.

Disproportionate growth in the number of lowest-risk customers could signify overly conservative business rules and lending practices, which may be diminishing returns on your portfolio.

Increases in the proportion of highest-risk customers can indicate red flags for your policies, such as inappropriately low approval standards or a disproportionate number of accounts deteriorating.

Greater numbers of accounts with an upward trend in credit score may indicate opportunities to increase profitability by increasing credit lines/changing the product pricing structure to better accommodate these customers.

In essence, portfolio reviews give you greater insight into portfolio behavior, not just composition. So, instead of simply knowing how your portfolio is performing today, you can better evaluate past performance, predict future trends and changes in behavior, and set strategies to take maximum advantage of that knowledge.

Use Portfolio Reviews for Valuation

In any financial services business, a portfolio is one of your most basic, valuable assets. It's vital that you know how much your portfolio is worth at any given time.

Portfolio valuations are complex undertakings that need to answer two fundamental questions:

What is the book value of my accounts?

How much of that value am I likely to actually be able to collect?

With a portfolio review, you can more precisely estimate the worth of your accounts and calculate more appropriate discount rates to account for the risk of loss. As a result, you can get a much better estimate of how much a portfolio is worth so that you neither overpay as a purchaser nor accept too low a price as a seller.

FIGURE 3
Portfolio Review Can Help in Estimating the Value of a Portfolio

	Volume of Loans on Books	Probability of Serious Default (90+ DPD)	Estimated Volume Generating Returns
894 - 925	\$6,294,505,401	0.57%	\$6,258,626,720
868 - 893	\$7,226,841,600	0.97%	\$7,156,741,236
857 - 867	\$7,421,956,630	1.43%	\$7,315,822,650
847 - 856	\$7,480,167,758	1.31%	\$7,382,177,560
835 - 846	\$7,396,487,455	1.60%	\$7,278,143,655
825 - 834	\$7,202,604,662	1.97%	\$7,060,713,350
814 - 824	\$6,870,089,228	2.13%	\$6,723,756,327
804 - 813	\$6,474,051,395	2.51%	\$6,311,552,705
793 - 803	\$5,956,259,713	3.00%	\$5,777,571,922
781 - 792	\$5,322,497,879	3.43%	\$5,139,936,201
768 - 780	\$4,593,660,010	4.35%	\$4,393,835,800
756 - 767	\$3,916,906,148	4.70%	\$3,732,811,559
742 - 755	\$3,161,122,210	5.48%	\$2,987,892,713
728 - 741	\$2,474,224,699	6.15%	\$2,322,059,880
711 - 727	\$1,763,420,201	6.84%	\$1,642,802,259
692 - 710	\$1,144,882,595	8.23%	\$1,050,658,757
665 - 691	\$562,391,372	9.58%	\$508,514,278
624 - 664	\$153,689,199	12.15%	\$135,015,961
Credit Risk Model Score Band			
TOTAL BOOK VALUE:			\$85,415,758,153
ESTIMATED TRUE VALUE:			\$83,178,633,535
% OF BOOK VALUE:			97.38%

In conjunction with a loss odds chart—easily obtainable from most scoring model vendors—portfolio review data lets you assess the odds of bankruptcy or other credit loss, such as an account going more than 90 days past due. Odds of these credit “events” are calculated for each band of the scoring model used to evaluate your portfolio.

Applying those odds against the aggregate dollar amount in each scoring band provides for a precise estimate of the value of the portfolio (EVP). Put into practice, this information helps risk managers make better decisions. If your calculated EVP for a given portfolio were 84% of face value, why would you sell for 68% or buy for 93% of face value?

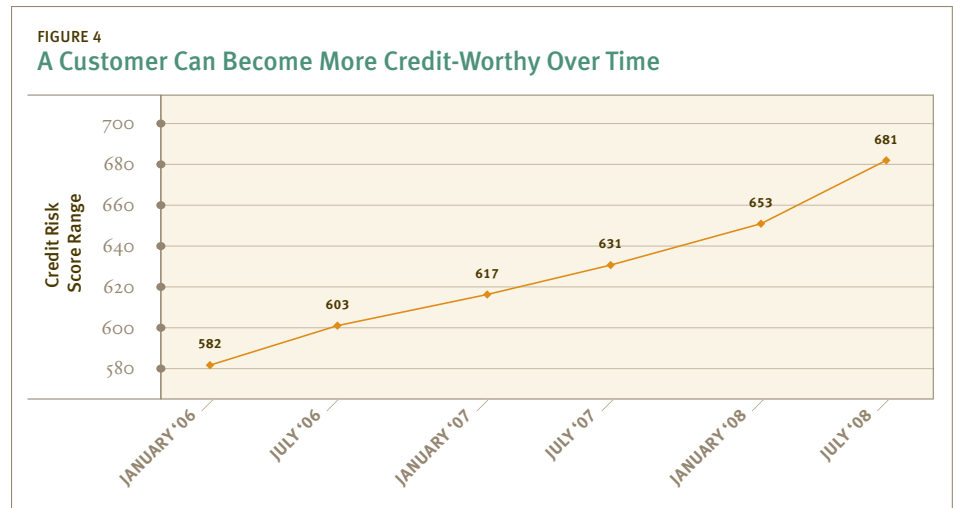
A single debt portfolio represents a tiny fraction of the overall debt burden of the population. However, generic credit scores use experience data from a vast number of similar accounts to predict performance within any given loan type (i.e., credit cards, auto loans, etc.). By using these analytically derived credit scores, you can value a portfolio against other similar portfolios with more quantitative rigor and determine a much more statistically valid value. In essence, a portfolio review incorporates open-market forces into a private transaction.

Use Portfolio Reviews for Individual Account Management

In an increasingly competitive market, relationships are essential for customer retention. Portfolio reviews enable you to see beyond your own limited lending relationship with particular individuals and provide insight into each consumer’s overall financial profile.

Whether on a one-time basis or as part of a portfolio trend analysis, this insight can help you determine the most appropriate offers and strategies to retain your most profitable accounts, decrease surprises and reduce attrition.

When an individual changes his or her credit behavior—whether adversely or positively—this change in behavior is not always distributed equally across all accounts. For example, due to an affinity with a credit union or preference for one account, a consumer may continue to perform well on certain accounts while others deteriorate. By the time the situation is recognized, it may be too late—the opportunity for an institution to make corrective changes may be gone. This can lead to unanticipated losses, particularly for credit unions and community banks. With regular portfolio reviews, you can noticeably reduce the possibility of such scenarios. A review can uncover changes in performance outside your own relationship and help you identify downward trends in other accounts held by that consumer. This gives you the opportunity to review the consumer’s account more thoroughly and, if



warranted, make pre-emptive changes to limit your exposure to loss—such as tightening limits on revolving lines, adjusting interest rates to compensate for the consumer’s new higher-risk standing, or using more aggressive collection strategies for early stage delinquency. Conversely, for consumers whose credit standing has improved since you made your original underwriting decision, there is a higher likelihood of competitors targeting them with attractive offers. This can act to trigger your own account retention strategies, such as offering improved account services or more favorable terms.

It should be noted that, because portfolio reviews are conducted pursuant to the account management permissible purpose, they cannot legitimately be used for cross-sell purposes. Nonetheless, portfolio reviews provide a wealth of information at the account level to help you tailor your treatment strategies to improve retention of profitable accounts while mitigating the impact of unprofitable ones.

Portfolio reviews are a significant way for mid-market banks and credit unions to monitor, manage, and act upon their portfolio credit risk and enhance overall portfolio returns. Beyond this, they can deepen accountholder relationships and build the foundation for loyalty and continuing business growth.

Large financial organizations have long been using custom tools and credit reporting company data to perform these credit risk analyses, but few options have been available for mid-tier institutions. TransUnion Express Portfolio Review is a new risk management offering designed with the needs of this market in mind. While still useful for the largest of banks and card issuers, the combination of performance and value makes Express Portfolio Review particularly attractive to mid-market banks and credit unions.

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