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Three Reasons Why A Score Migration Policy Makes Cents for Credit Unions

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Today's credit unions face unique growth challenges. The financial services marketplace is saturated and highly competitive. The mortgage industry's delinquency rates have caused many financial institutions to tighten their lending practices. Growth through new member acquisition will be difficult in 2008. As a result, reducing attrition and managing portfolio risk will be critical for credit unions to weather the storm. By understanding the dynamic nature of their member's credit risk, how those credit scores can change over time and how those scores impact the credit union's portfolio, credit unions can better address member attrition in three key ways.

1. Positive Reinforcement

The first is when a member's score migrates in a positive direction. Consider a credit union that extends a loan to a member with a 580 credit score. The loan is at an appropriate rate in line with the credit union's risk-based pricing strategy. Provided the member makes on-time payments over time and overcomes their previous financial challenges, their score slowly improves and starts migrating in a positive direction.

As the consumer's credit score improves, other financial institutions hungry for new customers may compete for their business and offer more competitive loan products. However, by recognizing that member's score is migrating in a positive direction, the credit union can preemptively contact that customer and offer him or her a better rate on the existing loan or a new loan based on the consumer's new credit risk and in line with the credit union's credit policy and procedure. Without that knowledge, the credit union could lose that member and subsequently the revenue that member could have generated over time.

2. Watching for Warning Signs

Conversely, the second is when a member's credit score decreases over time. In many cases, understanding this trend is more vital than the first scenario. External factors, i.e. mass unemployment and/or unexpected health issues, can affect a member's credit score and subsequently risk. In this scenario, this member may present a low risk credit score on the surface but in reality may just get by and make ends meet. For many credit unions, this high scoring member is intuitively low risk and will always have the ability to pay their bills. This mindset is dangerous. By adopting a score migration policy, credit unions can not only understand their member's risk but also have a strategy for the delinquency rate the member is charged and a collection strategy.

3. Risk Analysis

Finally, adopting a score migration policy can assist in monitoring the health of specific portfolios by having consistent analysis around the risk associated to each portfolio. A score migration policy can help a credit union in reviewing its underwriting criteria as well as modifying its risk-based strategies to better serve members and provide growth opportunities for the credit union by increasing wallet-share of current members.

In today's economic climate, understanding a member's credit risk and how it impacts the entire portfolio is crucial for credit union's financial success. A member's credit score can evolve, both positively and negatively, and by monitoring the score, credit unions can proactively address it and can subsequently maintain a healthier portfolio during more difficult times.