INSIGHT GUIDE

Five Key Portfolio Management Strategies: Best Practices for Community Banks and Credit Unions

This document highlights how some TransUnion customers approach portfolio management practices and use TransUnion portfolio review data in the process. Nothing here should be construed as legal or compliance advice, or guidance on lending or portfolio management policies or practices.

Portfolio management in an ever-changing economic landscape

As part of a normal and compliant credit risk program, lenders typically perform regular reviews of their existing loan portfolios (sometimes all of them; sometimes just certain portfolios). For years, these regular reviews consisted of a 'credit score refresh' or other basic tactics. Today's environment warrants more as consumers' responses to shifting market conditions mean risk profiles can change more frequently and drastically.

There are a number of objectives lenders can achieve with a more robust approach to ongoing portfolio management, including (but not limited to):

→ Understand overall portfolio health more completely
A more consistent, recurring empirical analysis of a portfolio enables risk managers to understand trends in the credit quality of their existing borrowers, and helps them more accurately forecast delinquency, losses and profitability.

→ Identify borrowers showing signs of financial stress
Many lenders seek to identify specific borrowers within a portfolio who are showing signs of financial stress. Some will simply flag these accounts for more frequent review; some will proactively contact these borrowers in an attempt to prevent delinquency; and some will make adjustments to line availability to take adverse action on the loan. Many employ some combination of these tactics — all in an effort to ensure better outcomes for borrower and lender alike.

> A lender found its consumers stopped making excess payments on debts anywhere from 6–12 months before a serious delinquency event.
>
> The lender incorporated excess payment behavior algorithms into monthly portfolio reviews to identify those potentially showing signs of early financial stress.

→ Manage existing credit lines
Reviewing portfolios isn't just an exercise to find borrowers who are struggling or might need priority in collection queues, it's also an opportunity to find borrowers who might take advantage of line increases, or those where line decreases or modification of an existing loan make sense.

→ Identify hidden fraud risks
Despite having even the strongest fraud prevention measures in place at origination, fraud schemes like synthetic identity fraud can be sophisticated enough to sneak through upfront mitigations. Many synthetic identities take time to develop, meaning many lenders could be holding outstanding loans that were issued to synthetic identities but have been paying as agreed. Identifying hidden fraud risks and taking action to resolve those accounts is an outcome of portfolio management that should not be overlooked.

> As part of a holistic approach to identity resolution, a lender incorporated synthetic identity scores to regular portfolio reviews and identified three potential synthetics in its portfolio several months after origination. The lender closed the credit line and avoided any additional credit losses.

→ Inform future strategy changes
While consumer credit data used for portfolio management cannot be used to market or cross-sell to consumers, it can certainly be used for internal analysis and segmentation that could inform future marketing or underwriting strategies. Using current consumer data to isolate a weakness or an opportunity when comparing loan performance to initial underwriting decisions can help lenders calibrate criteria or policies to expand or contract their credit 'buy boxes.'

Best practices for portfolio management

Historically, portfolio management consisted primarily of a batch download of updated credit scores for borrowers with existing loan accounts. Advances in data and analytics have enriched that same process, making it easier for lenders to understand portfolios more deeply with ease and speed.

Lenders should consider the following best practices when designing and executing an effective portfolio management strategy:

1. **Maximize the value of portfolio reviews**
   Portfolio reviews are so much more than a 'credit score refresh.' For the same time and level of effort, and with very little additional cost, lenders can incorporate predictive attributes, algorithms, scores and fraud models into portfolio reviews. A best practice portfolio management strategy is one that considers portfolio reviews as a valuable exercise that provides multiple levels of insight into the health of and emerging trends within a portfolio — and not just an updated view of consumer credit scores.

2. **Keep your data fresh and frequent**
   As lenders and data providers continue to refine and improve reporting capabilities with a focus on accuracy and fairness, lenders furnish credit data more often. As a result of this and more dynamic market conditions, consumer credit data changes more frequently today than ever before. Portfolio reviews should be conducted monthly, or at the very least, on a quarterly frequency. This enables lenders to capture emerging trends and potential risks within a portfolio before those risks translate to losses.

3. **Take action quickly**
   Effective portfolio reviews highlight where credit quality may be eroding or accounts may be at risk. They also highlight where consumers are performing well and offer insight into growth opportunities for lenders. In conjunction with more regular and timely portfolio reviews, actions must also be taken in a timely manner. When an account appears to have an elevated level of risk or could potentially be in jeopardy, time is of the essence. Whether its proactive outreach or a fast-tracked collection prioritization, the sooner action is taken, the more likely a lender is to get paid. In terms of growth opportunity, consumers who are rewarded by lenders more frequently with line increases or more favorable loan terms are more likely to grow balances or add additional products in the future.

4. **Sometimes the best action is no action**
   For most lenders, net losses at or below 1% of average balances are fairly common. Even if a lender carried a 30-day delinquency ratio of 5% (which is relatively high), 95% of that lender's loan portfolio is paying as agreed. In portfolio management, especially when looking for accounts with an elevated risk profile, doing nothing is more often than not the most common action — and that's OK. This simply means front-end underwriting processes are working mostly as intended.

   Nevertheless, portfolio management isn't entirely about finding brewing troubles. There are several additional and valuable outcomes that can be achieved. And while there are some general best practices, understanding which data can do what and how creates a more impactful approach to portfolio management.

Making sense of it all: Understanding the data

With a wide and deep catalogue of predictive risk scores and other insights — in the form of attributes and calculated algorithms — TransUnion credit data enables lenders to get an unmatched, holistic view of a consumer's credit and identity risk profiles at scale.

In general, TransUnion customers have access to the following types of data in the portfolio management use case:

Traditional credit risk scores	A variety of traditional risk scores built using point-in-time credit data and developed both by TransUnion and third parties. Available scores include new account risk scores, account management scores (designed to predict risk on existing accounts) and collections scores.
Alternative credit risk scores	Scores developed using alternative credit data. These scores routinely score over 98% of US consumers and incorporate data like short-term lending performance, utility bill performance and rental data where available.
Fraud risk scores	Scores developed to identify specific fraud risks, such as synthetic identity fraud, rapid default and early pay default fraud risks. Developed using trended credit data and consumer identity data.
TruVision™ trended attributes	A catalogue of trended credit attributes designed to capture trends over time in a consumer's financial position, such as changes in revolving balances, total debt and income estimates, or payment behaviors.
TruVision premium algorithms	A collection of summarized or calculated values (similar to a score) using a series of attributes derived from TransUnion's trended credit data. Algorithms help make deeper sense of trends in consumer behaviors like excess payments and balance growth velocity.

Desired outcome	Need to know	Data to use	Actions to take
Understand overall portfolio health	Risk distribution and segmentation	• Scores • Enriched attributes	• Adjust future pricing • Adjust future underwriting policies • Optimize allowance funding
	Changes to consumer liquidity	• Liquidity algorithms	
	Changes to capacity	• Income estimator • Debt-to-income estimator	
Identify borrowers showing signs of financial stress	Changes to consumer liquidity	• Liquidity algorithms	• Proactive outreach • Collection prioritization • Optimize allowance funding
	Changes to capacity	• Income estimator • Debt-to-income estimator	
	Velocity of balance growth	• Balance and utilization magnitude algorithms	
Manage existing credit lines	Open credit card balances and usage	• Open trade line attributes • Utilization attributes	• Credit line increases • Credit line decreases • Credit line suspensions • Collection prioritization
	Line management changes from other lenders	• Credit line increase and decrease attributes	
	Changes to individual capacity	• Income estimator • Debt-to-income estimator	
Identify hidden fraud risks	Emergence of potential synthetic identities	• Synthetic fraud model	• Escalate for investigation • Proactive outreach • Collection prioritization • Optimize allowance funding
	Emergence of early or rapid payment default risk	• Early pay default model • Rapid default model	
	Identify consumers that pose other potential identity risks	• Fraud alerts	
Inform future strategy changes	Identify maturing portfolio segments	• Loan term expiration attributes	• Build criteria strategies for future marketing campaigns • Adjust future pricing
	Estimate off-us interest rates	• APR estimator suite	
	Loss post-mortem	• Enriched attributes	

Pulling it all together: Taking action

You've designed your portfolio management strategy, and decided which data you want to include and why. You've ordered your portfolio review file and it's in your hands. Now, it's time to execute. The examples here are illustrative and may provide ideas on how you wish to use the insights at your disposal.

→ Benchmarking

If you've captured scores or attributes in the past, one method of finding borrowers you want to focus on is comparing your last portfolio file to this one. For example, you may have an existing file of borrowers you're keeping a closer eye on. By comparing that file to a new one, you can find borrowers who seem to be improving (their credit scores have increased by X points, or they're no longer showing as being delinquent on any accounts). Or, you can do the inverse and find borrowers who have changed materially from the last review.

→ Single file review

You may also wish to just work off of one file and narrow in on borrowers who meet certain criteria. What follows are examples of how a lender could identify borrowers within their portfolios.

→ Identifying borrowers whose overall credit risk profiles are deteriorating

Borrowers showing signs of being overextended or struggling may warrant stepped-up monitoring or special handling. Examples of how to find these borrowers could include:

- Identifying borrowers who have a below prime trended credit score and have had more than one recent delinquency
  - TRUVISION ACCOUNT MANAGEMENT SCORE <= 660
  - NUMBER OF TRADES 30 OR MORE DAYS PAST DUE IN LAST 3 MONTHS > 1
- Identifying borrowers who have a high number of recent inquiries and have close to full utilization across revolving accounts.
  - NUMBER OF INQURIES IN LAST 6 MONTHS > 3
  - AVG OF MONTHLY AGGREGATE BANKCARD UTILIZATION FOR THE LAST QUARTER > 50%
- Identifying borrowers who have received credit line decreases from other lenders over the last quarter
  - NUMBER OF CREDIT LIMIT DECREASES OVER THE LAST QUARTER >= 1

→ Identifying borrowers whose excess payment levels are declining

You may wish to engage borrowers who are showing early, predictive signs of potential financial stress. Some institutions will proactively offer loan modifications, while others may simply engage in "courtesy calls" to check on the borrower and assess their needs. Examples of how to do this could include:

- Identifying borrowers who have experienced a sharp decline in average excess payments on all accounts and sharp increase in their bankcard utilization over the last three months
  - PERCENT CHG IN AGGREGATE EXCESS PAYMENT FOR ALL ACCOUNTS FROM T+3 TO T <= 25%
  - PERCENT CHG IN AVG AGGREGATE BANKCARD UTILIZATION FROM T+3 TO T >= 25%
- Identifying borrowers who have rapidly increased minimum monthly payments and an estimated debt-to-income of greater than 50%
  - TOTAL MONTHLY OBLIGATION MAGNITUDE >= 500
  - TRUVISION TRENDED DEBT-TO-INCOME ESTIMATOR > 50%
- Identifying borrowers who have a low ratio of actual to minimum payment due, are rapidly building bankcard balances and have rapidly utilized their available bankcard lines
  - AVG PAYMENT RATIO FOR REVOLVING ACCOUNTS IN PAST 3 MONTHS <= 1.00
  - BANKCARD BALANCE MAGNITUDE >= 500
  - BANKCARD UTILIZATION MAGNITUDE >= 500

Identifying borrowers who have additional capacity

While finding those borrowers showing signs of risk, you may also wish to identify those who are low risk and show additional potential. Line increases or other strategies may help drive additional utilization from these borrowers or point to other opportunities. Examples of narrowing in on these borrowers could include:

- Finding those with good credit scores and low debt-to-income ratios, high aggregate excess payment and relatively high bankcard spend
  - VANTAGESCORE® 4.0 >= 680
  - TRUVISION TRENDED DEBT-TO-INCOME ESTIMATOR < 40%
  - AVG AGGREGATE EXCESS PAYMENT ON ALL ACCOUNTS OVER THE PAST 3 MONTHS > 250
  - AVG PAYMENT RATIO FOR REVOLVING ACCOUNTS IN THE PAST 3 MONTHS > 1.50
  - AGGREGATE BANKCARD SPEND OVER THE PAST 3 MONTHS >= $5,000

- Finding creditworthy existing borrowers who could benefit from a line increase based on their experience with other cards in their wallets
  - VANTAGESCORE® 4.0 >= 680
  - TRUVISION TRENDED INCOME ESTIMATOR >= $65,000
  - CURRENT CREDIT LIMIT OF TOP-OF-WALLET BANKCARD > [THEIR LIMIT WITH YOUR F.I.]
  - ANNUAL SPEND ON TOP-OF-WALLET BANKCARD >= [THEIR ANNUAL SPEND WITH YOUR F.I.]

Identifying potential hidden fraud risks

Unfortunately, and despite strong fraud controls in origination experiences and underwriting practices, fraudsters still sneak through exterior defenses. Many times those fraudulent loans go unseen until it's too late and losses hit. Identifying these loans enables lenders to take action to resolve fraud concerns sooner, potentially saving them from unforeseen fraud losses. Examples of narrowing in on these borrowers could include:

- Identifying potential synthetic identities on book
  - TRUVALIDATE SYNTHETIC FRAUD SCORE >= 600

- Identifying borrowers who have potential to default rapidly or "bust out"
  - TRUVALIDATE BANKCARD RAPID DEFAULT SCORE <= 640

- Identifying borrowers who have potential to default on new bankcards in first 180 days of account opening
  - TRUVALIDATE BANKCARD EARLY PAY DEFAULT SCORE <= 640

Additional tactics

Some lenders will combine information from portfolio reviews with their own in-house data as part of their review and decision-making processes. This often includes deposit account balances, other relationship indicators like direct deposit or bill pay, or other activities. Other lenders may choose to run a subset of their portfolios for specific portfolio review routines based on internal criteria, such as one specific product type or only loans below or over a certain age.

Summary

Lenders have many choices and considerations related to data and how to use the right data in their portfolio analytics strategies. Ultimately, the decision on which data and criteria to use in portfolio management should be driven by empirical evidence, a sound business strategy, and the lender's individual appetite for and understanding of generally accepted risk management principles. This guide is intended to highlight potential use cases and logic structures using TransUnion's products and solutions. Be sure to consult with your institution's legal, compliance and risk departments with any questions surrounding your individual institution's policies and procedures.

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