Rekindling success
Uncovering your portfolio’s hidden potential using advanced triggers to prevent risk.
Preface

Experian recently analyzed the performance of 19.8 million commercial triggers over the three-month period from March 2012 through May 2012. In this white paper, we discuss the fundamental components of the study, analyze the most predictive triggers and provide recommendations for increasing portfolio monitoring performance to achieve optimal profitability.

Executive summary

For credit grantors working in the commercial credit industry, having timely and actionable knowledge about customers is absolutely essential to managing risk and increasing profitability. They need to know if a given customer in their portfolio has defaulted on a credit obligation, declared bankruptcy or gone into collections. Many successful credit grantors gain a competitive edge by using tools to help them mitigate risk and uncover areas of opportunity.

Referred to as triggers or alerts, these changes to a company’s credit profile may indicate trouble ahead. Triggers are the stimulus that drives credit grantors to act quickly to avoid a credit problem. Today, a majority of commercial credit grantors accept the need for a trigger-based monitoring program. However, credit grantors must understand the impact and efficacy of triggered events better so they can accurately interpret data and determine what actions should be taken when events are triggered.

As a leader in the business-to-business sector, Experian® recommends that companies put into place a portfolio monitoring program that uses triggers to notify credit grantors when significant negative events occur in their customers’ credit profiles. We will share examples from the Experian study and describe which predictive triggers can help you most efficiently manage your portfolio.

Avoid fire drills by applying better account monitoring practices

Credit grantors often encounter three major obstacles with portfolio monitoring programs.

Not knowing when to act — Credit grantors struggle to determine the impact a triggered event has on a customer. Without performing a true trigger validation, many credit managers won’t know which triggers are the best predictors of risk within their portfolio. Luckily, the results discussed here will help guide credit grantors toward the best triggers to use within a portfolio monitoring program.

Not knowing what action to take — Should they reduce the credit line or close the account? Many credit grantors lack a consistent portfolio monitoring process that defines the treatment strategies for an account if a specific event occurs.

Too many triggers — When credit grantors rely too heavily on the technology, they often get notifications on too many events. This happens because of a lack of understanding of which triggers are most important for managing their portfolio.

Triggers activate so rapidly that, ultimately, credit grantors end up ignoring them all. While having more customer credit data available certainly is better than not having enough data, credit grantors may experience information overload if they don’t apply effective portfolio monitoring practices.

The answer is actionable intelligence that allows credit grantors to take measured actions against potential risks. It is important to use a comprehensive, reliable triggering service to identify problems in a timely fashion.

Having a well-managed risk-based triggering service to rely on is like having a fire alarm system in place. Forewarned is forearmed.

Examining Experian’s commercial triggers analysis

The Experian study analyzed 19.8 million unique commercial triggers from March 2012 through May 2012. The credit data that powers these triggers is drawn from Experian’s robust BizSource℠ database. BizSource℠ is Experian’s business credit database that aggregates all of Experian’s commercial intelligence into a single master database and is largely attributed to the speed and accuracy of the triggers used in Experian’s comprehensive portfolio monitoring product, Account Monitoring Service℠.

To ensure results were unbiased, Experian researchers eliminated trigger records on businesses that exhibited signs of bad payment behavior, delinquency and credit inactivity. As a result, 16 million commercial triggers were considered clean and used for the analysis. Certain triggered events, such as score changes and days beyond terms changes, were aggregated into 30-day periods to summarize the change for each business. Three performance windows were examined to best assess if a business would go bad in one, three or six months. For this white paper, we will discuss the bad rates for the three-month performance window.

Researchers were interested in determining quick business deterioration. Traditional bad definitions tied to credit scoring models look to predict the likelihood of a business becoming more than 91 days delinquent over a 12-month period. Since triggers help to identify rapidly changing payment performance, researchers needed to define what a bad business looks like to effectively measure trigger performance. Two bad definitions were developed for this analysis.

<table>
<thead>
<tr>
<th>Bad trades¹</th>
<th>Bad balance²</th>
</tr>
</thead>
<tbody>
<tr>
<td>This term applies if the percentage of bad trades is greater than or equal to 15 percent and if either of the following is true:</td>
<td>This term applies if the percentage of the total bad balance is greater than 25 percent.</td>
</tr>
<tr>
<td>• The total bad balance is greater than $100.</td>
<td>• The total bad balance is less than or equal to $100, and the percentage of bad balance is greater than 10 percent of the total trade balance.</td>
</tr>
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</table>

¹ This term applies if the percentage of bad trades is greater than or equal to 15 percent and if either of the following is true:

² This term applies if the percentage of the total bad balance is greater than 25 percent.
All 47 Account Monitoring Service triggers were examined to assess how well each trigger performed in identifying a bad account. Some of the events analyzed include lien triggers, judgment triggers, collection triggers, score change triggers, late payment triggers and derogatory comment triggers. Researchers found that certain triggered events were more effective in predicting whether an account will go bad over time. Knowing when to take action will help credit grantors spend more time extending credit and less time fighting fires.

**Actionable insights — predictive triggers revealed**

Triggers attract your attention and help you to make a quick decision. When comparing the most active triggers (events with the highest frequency of occurrence), the most predictive trigger was the derogatory trade payment trigger, which reported a business paying 61 to 90 days past due. When it occurs, this event indicates that a business has a 15.37 percent likelihood of going bad in the next three months. Even derogatory trade payment triggers, which reported a business paying 31 to 60 days past due, had significance, showing a 9.11 percent bad rate. When implementing triggers into a portfolio monitoring program, credit grantors should include and act on derogatory trade payment triggers to avoid becoming the next late-paid account.

The lien trigger also was used frequently. Credit grantors often put heavier emphasis on lien triggers, but as research shows, the trigger has only a modest ranking among other triggers, with a 7.22 percent bad rate. When the significance of lien balances was reviewed, even small liens with a balance between $1 and $3,200 showed relevance over a three-month performance window. As researchers observed lien triggers over a six-month performance window, liens within the same balance range steadily increased to 11.60 percent.

When analyzing derogatory comment triggers, researchers found the "derogatory comment — not paying as agreed" trigger to be most predictive in this category. Such a comment can be reported to the bureau by a data contributor and helps describe the account status. While this trigger had a lower frequency of occurrence, when it did appear, the likelihood of the business going bad was 12.50 percent. This was the most predictive trigger across all derogatory comment triggers observed. Furthermore, when observed over a six-month performance period, business performance deteriorated further, ending up with a 17.95 percent likelihood of the business going bad. While this event may infrequently occur in your portfolio, if it does, the customer should be treated like a brushfire that needs to be contained.

For credit grantors that need to get a handle on trigger volumes, perhaps the first place to start is with score change triggers. With more than 1 million score triggers analyzed, these events produced the highest volume of notifications and showed various bad rates, depending on how the business scored prior to the drop. For example, when declines in credit score were examined, a business whose score was 70 (low to medium risk) and dropped by 15 points had a bad rate of 1.15 percent when observed over a three-month period. However, if the business credit score was 40 (medium risk) and dropped by 15 points, the bad rate increased to 6.51 percent. To control trigger volumes, use robust filters provided by monitoring programs and set score thresholds appropriately for the greatest impact.

<table>
<thead>
<tr>
<th>Score</th>
<th>0-10</th>
<th>11-20</th>
<th>21-30</th>
<th>31-40</th>
<th>41-50</th>
<th>51-60</th>
<th>61-70</th>
<th>71-80</th>
<th>81-90</th>
<th>91-100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score drops by 15 points</td>
<td>24.82%</td>
<td>13.80%</td>
<td>6.51%</td>
<td>3.55%</td>
<td>1.85%</td>
<td>1.15%</td>
<td>0.91%</td>
<td>0.68%</td>
<td>0.62%</td>
<td></td>
</tr>
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</table>

When ranking all 47 triggers evaluated in this study based on bad rate, eight out of the top 10 commercial triggers analyzed are ones built around trade data contributed by credit grantors as part of the monthly reporting process. Such triggers include the derogatory trade payment triggers and derogatory comment triggers, as noted in the observations above. This emphasizes how critical it is for credit grantors to share the payment behaviors of their customers with others through trade contribution.

Unfortunately, many credit organizations don’t have an analytics department to perform a full trigger validation against their own portfolio of customers. Luckily, other independent trigger tests performed by top financial institutions showed corroborating results with this study. As Experian researchers also reported, when compared across multiple client portfolios, the late payment triggers ranked highest in predicting risk.

Based on the research, credit organizations need to take action on the triggers that display the highest likelihood of a customer going bad over time and develop strategic actions based on the severity of risk. Alternatively, they should leverage filters on score change triggers to reduce alert volumes and increase productivity.

1A bad trade means the tradeline is more than 91 days past due or is marked as being in severe derogatory status, such as a write-off, a foreclosure or a collection.

2A bad balance is the balance from a tradeline that is more than 91 days past due or is in severe derogatory status.
Conclusion
Rather than relying solely on credit reports, sophisticated credit grantors have realized the value of having ongoing portfolio monitoring programs in place to uncover a portfolio’s hidden potential. For best results, using predictive triggers such as the late payment triggers or derogatory comment triggers can dramatically increase a credit grantor’s efficiency and ability to identify future risk. With added intelligence, credit grantors now can develop definitive strategies on how to treat customers who pose a significant threat.

As researchers continue to analyze the data from the study, their observations have sparked the development of new products and services that will give credit grantors greater clarity for making more informed credit decisions.

Looking forward, sophisticated monitoring programs will continue to evolve and help credit grantors address their struggles of what to do and when to act. Until then, look for sparks, avoid the flames, and try not to get burned.

About Account Monitoring Service
Powered by Experian’s robust BizSource database, Account Monitoring Service relies on refined data processes and intuitive matching technology to provide comprehensive insights on businesses of all sizes. With 47 triggers and robust filter capabilities, Account Monitoring Service is well-positioned to deliver timely and reliable information to clients daily.

About Experian Business Information Services
As a leader in providing data and predictive insights to organizations of all sizes, Experian’s Business Information Services team is committed to helping organizations mitigate risk and improve profitability. Experian provides market-leading tools and consulting services to assist clients in making real-time credit decisions throughout the Customer Life Cycle.

For more information about Experian’s advanced business-to-business products or this study, visit www.experian.com/b2b or call 1 800 520 1221.