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Editorial Perspective:
How to Turn Risk Management into a Major Opportunity for Your Credit Union

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by Michael Gulledge

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Whenever credit union credit card portfolio managers discuss their top priorities, they typically tell us that their goals center around growth, increased profitability, and—almost as an afterthought—risk minimization. It seems that many credit unions want to master which levers to pull to increase their card portfolios' upside potential but relatively few realize that they can employ equally specific strategies and tactics to manage and minimize their portfolio risks.

Here at Advisors **Plus**, our Risk Management and Collections team thrives on teaching credit unions that not only are there proven techniques to help them mitigate portfolio risk, but those techniques—used as a matter of course by the Big Banks—can and should be a part of every credit union's toolbox.

Risk Management 101: Moving Beyond Delinquency and Charge-off Rates

When beginning a portfolio risk analysis, it's easy to "jump to conclusions" and head straight to delinquency and charge-off rates as the key metrics for evaluating the credit quality of a card portfolio. While no risk analysis would be complete without them, we believe that taking an overall P & L approach that emphasizes net income and ROA provides a more balanced and nuanced picture of overall portfolio health.

When analyzing the performance of a portfolio, there are a number of attributes that must be carefully evaluated. The key factors that must be examined as part of a credit card P & L statement include three key revenue components:

- **Interest income** is driven by balance and pricing. So for this metric, the questions become: Are balances growing, static or declining? Is pricing producing the appropriate yield for the risk in the portfolio, and is it generating the appropriate level of income? How do these balance and pricing metrics compare to industry benchmarks?

- **Interchange revenue** is driven by volume of purchase transactions. For this metric we look at volume per gross active account and interchange revenue per gross active account. There are industry benchmarks for interchange as well.

- **Credit line management** represents an important element affecting both interest income and interchange revenue. Are credit lines sufficient to give the good accounts the capacity they need to deliver both balance growth and purchase volume?

- **Fee income** is driven predominately by late fees, so the important elements here become the dollar amount of the late fee and the timing of when the late fee is charged.

On the expense side of the income statement, Cost of Funds, charge-offs, accrual for rewards redemption, normal operating expense and overhead are the key components. Our approach at Advisors **Plus** is to apply fully-costed amounts to the credit card portfolio.

Benchmarking the Risks: Are the Metrics in Line with the Market?

Our team uses a variety of tools to help us assess the risk profile of an individual credit card portfolio:

- A **vintage analysis** is an excellent tool to assess the risk profile and segment the credit card portfolio by current credit bureau score ranges, as well as by the year in which the accounts were acquired. Such a matrix approach allows us to evaluate both credit risk within the portfolio and targeted marketing opportunities that may be hidden within the portfolio.

- Credit union industry benchmarking is available through the Advisors **Plus** proprietary database of credit card delinquency and charge-off information that we have developed through various PSCU Member-Owner programs.

- Unique geographic or market area benchmarking is also available, and those analyses can be further refined by peer group analysis based on asset size.

Formulating a Risk Management Roadmap

When the delinquency and charge-off rates in a given card portfolio are revealed to be higher than those of its peer credit unions or the market as a whole, there are a variety of actions that can be taken to address this situation. However, it is important for a credit union to understand that progress is incremental and happens over time. The reality is that it most likely took a number of years for the problem to surface, and it will take some time to correct. The key things to remember are that such situations are correctable and that it is never too late to take immediate action. A comprehensive portfolio review will guide the targeted actions needed, with particular attention to the areas identified below:

- **Underwriting:** Based on a review of current and historical underwriting practices and policies, appropriate adjustment can be made to restrict the amount of risk allowed into the portfolio. This level can then be monitored over time to determine when the more restricted underwriting criteria should be adjusted.

- **Targeted Growth**: High-quality accounts within the portfolio should be identified and specific marketing campaigns targeted to them, with the intent of growing the portfolio's "good" balances, while diluting the negative effects of the higher-risk balances.

- **Targeted Credit Line Increases:** This strategy works hand-in-hand with the targeted growth initiative described above and provides increased capacity for targeted high-quality accounts with the goal of growing them through balance transfers and new purchase activity.

- **Pricing:** The current pricing structure of the portfolio should be evaluated to determine if it is appropriate for portfolio's overall level of risk. A new pricing structure may need to be adopted for existing and/or new accounts to increase the revenue side of the business.

- **Optimize Collection Efforts:** By adding an additional skilled collection resource or outsourcing collections to another institution, the overall collection effort on the portfolio can be ramped up to a more aggressive level. While such increased efforts may only be needed on a temporary basis, they will nevertheless be highly effective in jumpstarting efforts to drive down delinquency and charge-offs.

Ready, Set, Grow: Capitalizing on the Upside of Risk Management

Clearly, no two credit union credit card portfolios are ever alike, which means that the overall level of risk associated with individual portfolio dynamics must be dealt with on a case-by-case basis. In our experience at Advisors **Plus**, however, every credit union—regardless of its precise demographics—can benefit by viewing portfolio risk minimization as a major opportunity.

For More Information

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About Advisors Plus Consulting Services Credit Card Consulting

Advisors **Plus** Credit Card Consulting provides comprehensive credit card portfolio services to credit unions including portfolio reviews, and evaluations of products, marketing practices and financial performance.

Credit Card Consulting is designed to provide a credit union's management team with an in-depth view of its portfolio profitability, credit risk and member usage to help it identify and capitalize upon untapped potential in its credit card product line.

An Advisors **Plus** engagement typically begins with a customized portfolio review which normally includes a P&L analysis, credit card products review, comprehensive scan, and assessment of how the credit card products are positioned and marketed through the client credit union. A comprehensive report is delivered in writing and onsite with analysis, recommendations and proposed actions to improve credit card portfolio performance**.**

In 2014, our average Net Promoter Score was 74 as measured by client surveys.

About Advisors Plus

Advisors **Plus** was established in 2004 to provide consulting and marketing services to credit unions. Our range of services covers the key areas of strategy, credit cards, debit and checking, marketing, contact center, operations, and branch sales.

The experienced consultants at Advisors **Plus** work with a credit union's staff through the entire process from project analysis to implementation and management. Our goal is to ensure that each credit union client achieves sustainable business growth, exceptional member experiences and operational efficiencies.

As of December 31, 2014, Advisors **Plus** has superior NPS Scores of: 74 – Credit; 81 – Debit and Checking; 91 –Contact Center. For more information, please visit **AdvisorsPlus.com.**