



Credit scoring in the pay day loan sector

Credit Scoring and Credit Control XIII

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Credit scoring in the pay day loan sector

Agenda



- A brief overview of pay day loans (PDL's)
- The impact of PDL's on credit risk scores
- Developing credit risk scores for PDL providers



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A brief overview of PDL's

- PDL's are small value loans, repayable within 30 days which typically charge very high rates of interest.
- The idea behind a PDL is to provide emergency cash injections which carry a consumer through to pay day, possibly to cover some unexpected bill that needs paying quickly.
- Despite this it is not uncommon for these loans to revolve through arrangement plans





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Growth of the PDL market



- PDL's were added to the credit bureau early in 2009 and 4 years later stand at over 14 million
- This product type is growing at approximately 500,000 new loans per month with approximately 900,000 PDL's presently active
- The table below shows expected PDL coverage on a generic application sample for a range of different sample types

Application Sample Type	Expected PDL Coverage
Banking & Finance (Excl Mortgages)	7.9%
Mortgages	1.0%
Retail Credit	3.9%
Mobile Telco's	8.1%



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On what do people use PDL's?

Basic Living

DEBT



- Food
- Vehicle repairs
- High utility bills
- Paying other bills (Credit card etc.)
- Personal / Family emergencies

Want it now



- Clothing
- Gifts
- Towards the cost of holidays



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Why do people use PDL's?

Easy access



- Speed
- Much more easily accessible compared to more mainstream credit facilities

Fewer checks



- Less daunting than approaching a high street bank with fewer questions asked
- For some they have either exhausted existing credit lines or had them frozen due to payment trouble



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Incorporating PDL's into existing credit risk scores

- Generally speaking just the presence of a PDL is a sign of financial difficulty and treating this credit like any other piece of mainstream finance can lead to scorecard irregularities
- Due to the short term nature of PDL's roughly 1/3 of all new accounts supplied to the credit bureau are already settled
- However these cases include consumers consolidating loans or where the lender has allowed the debt to roll over into a new agreement
- This leads to inflated counts for settled credit, which is typically a positive factor in credit risk scores
- If many loans are opened and closed this can also impact age of credit related segmentation / references





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Assessing credit risk from a PDL perspective



- PDL applications typically have been assessed with basic application data and limited credit bureau history
- PDL providers are now using more detailed credit vetting and affordability checks

But...

- Existing credit scores demonstrate limited performance due to the ways in which a PDL differs from mainstream credit



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Assessing credit risk from a PDL perspective

- Application risk scores typically define bad as being customers entering delinquency or default within the 12-18 months after application
- PDL's however are designed to run for up to 1 month and whilst they do frequently rollover, individual loans don't typically do so for more than a couple of months
- The majority of PDL users will already be significantly indebted at point of application, and this differs markedly from a mainstream credit account perspective





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Assessing credit risk from a PDL perspective

Nearly 60% of PDL applicants do not have an active credit card, and for those that do they typically have lower than average limits



Total credit limit	Application type				
	PDL	B&F	Retail	Mortgage	Telco
No Credit Card	58.4%	42.5%	41.7%	31.3%	70.3%
< £250	6.4%	2.7%	2.2%	0.9%	2.2%
£251-£500	6.8%	3.8%	3.6%	2.8%	2.9%
£501-£1000	6.5%	4.2%	4.3%	3.7%	2.9%
£1001-£2000	7.5%	5.9%	5.8%	6.1%	3.2%
£2001-£5000	8.0%	11.7%	11.5%	15.3%	6.0%
£5001 +	6.4%	29.3%	25.1%	39.9%	12.5%



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Assessing credit risk from a PDL perspective

As a result of these lower limits, limit utilisation is significantly higher for a PDL application sample



Card limit utilisation	Application type				
	PDL	B&F	Retail	Mortgage	Telco
No Credit Card	58.4%	42.5%	47.4%	31.3%	70.3%
Moderate	6.3%	33.4%	40.8%	54.4%	20.6%
High CLU	4.2%	7.9%	4.1%	6.3%	2.7%
Very High CLU	5.9%	5.8%	2.8%	3.6%	2.0%
Approaching Limit	11.9%	6.6%	3.0%	3.3%	2.2%
Over limit	13.3%	3.7%	1.9%	1.1%	2.2%



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Developing credit risk scores for PDL providers

- Due to the expected lifespan for a PDL and the typically financially stressed nature of applicants a more tailored score is needed
- From previous analytical assessments, PDL companies have tended to define 'bad' as accounts not paid up in full by the original due date, yielding bad rates usually in excess of 50%
- Many of these cases though repay in full, and end up being profitable for the lender.
- For the purpose of developing a generic PDL score we focussed on account default as the definition of bad to identify the very worst cases
- On average most PDL's which do default, typically do so within 6 months yielding a bad rate of around 5-6%





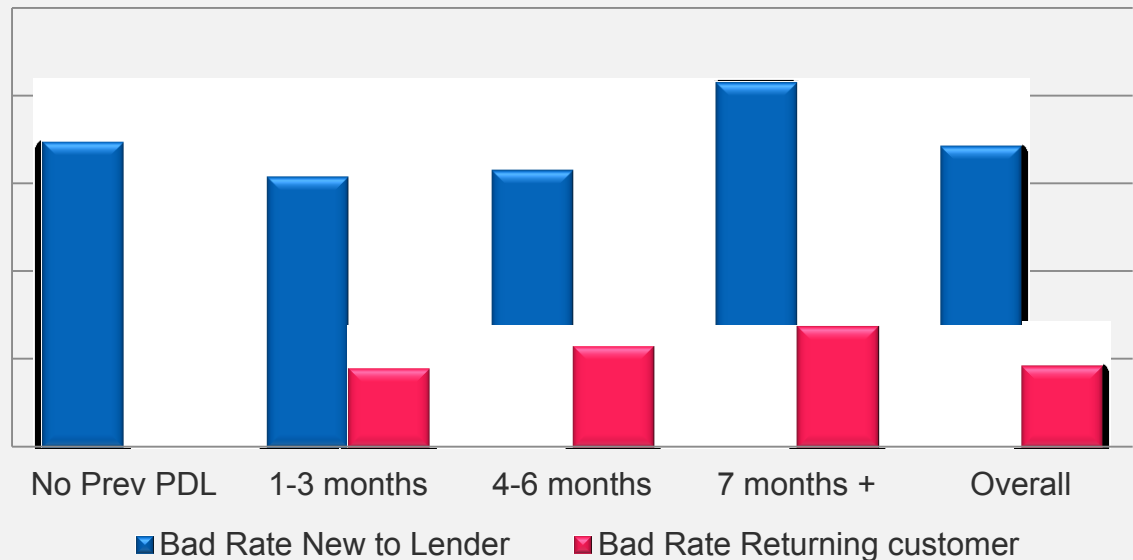
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Developing credit risk scores for PDL providers



- PDL accounts opened over a three month period were selected for analysis and split into two distinct populations
 - ▶ New to lender applications & Returning customers
- Initial analysis on the combined sample demonstrated a clear difference in trend for previous PDL history when dealing with repeat custom

Bad rate by time since last PDL





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Developing credit risk scores for PDL providers

Best 'New to lender' predictors

- Number of active CAIS with current status = 0 and open >12M ago
- Total monthly payment including mortgages
- SP Voters confirmation
- Average age of CAIS
- Number of active revolving CAIS with a balance > £0



Best 'Returning customer' predictors

- WCS on active / defaulted PDL's
- Number of searches L6M
- SP-PDL-Number of payday loans
- Number of finance house searches L3M
- Average age of CAIS





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Developing credit risk scores for PDL providers



The table below details the improvement (in Gini) between the best available bureau score and the PDL specific scores.

New to Lender

Best previous bureau score	New to lender score	Improvement
27.2 %	52.2 %	91.9 %

Returning Customer

Best previous bureau score	Returning customer score	Improvement
34.2%	57.9%	69.3 %



Independent client validations

Lender	Best available bureau Score GINI	New to Lender GINI	Returning Customer GINI	% Improvement
Lender A	27.1	38.3	39.4	45.4
Lender B	25.6	39.3	35.7	53.5
Lender C	15.6	33.1	28.9	112.2
Lender D	9.6	19.8	19.3	106.3

- We can see from the above table how much more effective PDL specific scores are relative to typical credit bureau scores an a range of PDL samples
- The benchmark GINI's start low which reflect the high risk nature of the population and that typical credit bureau scores do not provide the right focus
- But also because the client performance typically uses a basic definition for bad, where the consumer has missed the initial payment deadline
- For a significant volume of cases in a PDL environment though this is expected, the consumer repays in full with additional interest, remaining profitable for the lender



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Summary



PDL's are significantly different to traditional forms of credit

The PDL market has grown considerably in recent years and whilst the landscape is changing, the volumes are still increasing

PDL data should be incorporated into traditional credit risk scores with care

PDL specific scores work much better than traditional scores on PDL applications

