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Credit Event Monitoring

More Powerful, Flexible and Easier to Use

When the economy falters, credit managers face trying times—and there's no doubt that this is one of them.

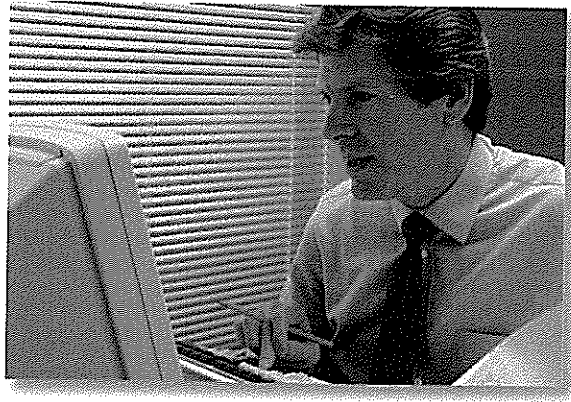
After years of cheap and readily available funding, businesses are finding credit harder to come by. For example, U.S. structured financing—the financing behind financing—went from more than $300 billion per month in June 2007 to less than $50 billion per month in November 2007. Rising prices have put upward pressure on the cost of doing business. Consumers are tightening their belts in the face of a rising cost of living, a decline in home values and fears of a sharp economic slide being stoked by the press.

For the moment, one downturn seems to lead to another, and businesses—large and small, across virtually all sectors of the economy—are feeling the squeeze. While the overall business bankruptcy rate is climbing, small businesses—particularly those whose owners used home equity or personal money to fund their enterprises—are battling for survival and at risk of delinquency or default.

Credit managers face two challenges under such conditions. First, extra vigilance is required both to quickly spot businesses at risk for late payments or failure and to reduce exposure accordingly. Second, it's vital to maximize existing portfolios at a time when new business growth may be stagnating.

The power to customize where and how alerts are delivered is increasingly done by credit managers as interfaces become more user-friendly.

Credit monitoring is a key tool in managing risks and maximizing revenue. Often, being the first to know about financial distress can help creditors ensure collection of their assets from distressed accounts. The converse is also true. Quickly spotting accounts on their way up provides opportunities for growth that may not be there for latecomers. Monitoring systems employ event-based notifications, or triggers. Effective use of triggers can help credit managers partner with



customers who are on the way up and limit exposure to those on the way down.

Like most technological solutions, credit monitoring systems are getting more powerful, flexible and easier to use. On the one hand, credit monitoring systems are delivering more, with an increasing array of alerts, including scores and positive changes indicating accounts on the rise. On the other hand, they are delivering less. Thanks to advancing filtering capabilities, they're providing fewer needless alerts that clog the system and waste resources. Last, the power to customize where and how alerts are delivered is increasingly done by credit managers as interfaces become more user-friendly.

Delivering More

One measure of a monitoring system to consider is the breadth and depth of credit data elements and scores that may be observed—the more, the better.

Very few data elements in isolation are slam dunks in terms of predictive capabilities. Experian case studies show that independently, some triggers don't reveal much about the likelihood of future payments. However, when they are used in conjunction with certain other data elements, they can be powerfully predictive.

For example, say an account in the last three months shows two liens, a derogatory comment and high credit balances that increased by 50%. In isolation, any one of the indicators may mean little. If there's a derogatory comment, it may be the business's fault or it could stem from an error on the part of the business's supplier. But all three indicators around the same time probably indicate trouble, and the need to resolve the matter quickly increases dramatically.

With monitoring tools, it's impossible to overstate the importance of reviewing credit data for changes, particularly among the more volatile small businesses. Data that may be monitored includes:

- Credit scores: significant changes for better or worse
- Credit balance attributes, such as high credit, total balance, percent current or credit utilization
- Payment behavior: paying more slowly or in less time
- Major derogatory events such as bankruptcy, collections, judgments and liens

Advanced targeted trigger systems provide timely alerts so credit managers don't have to wait for problems to occur before acting. They provide a forewarning of potential adverse events and allow risk managers to consider how to treat that receivable.

The best monitoring systems provide continuously updated information rather than snapshots delivered in batches once every few months. It's best to receive notification much closer to real time than quarterly because many changes can occur during that time frame.

A broad set of data to drive alerts also can help reward your best customers while providing up-selling or cross-selling opportunities. Positive alerts might include a score changing for the better, days beyond terms decreasing, indicating bills are being paid in less time, balances going down or balance-to-limit ratios declining.

Positive alerts can allow credit managers to identify customers to whom they'd like to extend or increase credit. Perhaps an account with a $5,000 credit line should be increased to $10,000. Perhaps an account's score has risen by 10 points, and the company has been gradually increasing its spending while paying on time. If it's a business that's expanding, that business may be receptive to an offer of improved service or better terms.

For example, a customer paying on net 30 terms could be offered a 2% discount for paying within 10 days, or this customer should not be restricted to terms requiring payment of the net balance within 30 days of delivery or receipt of the invoice. Perhaps the customer should be allowed net 45 terms in exchange for a larger percentage of the business.

Positive alerts also can uncover an opportunity to collect on a delinquent account. If a delinquent customer suddenly shows an increased ability to pay, frequently the first one to attempt collection may be the only one to succeed.

Monitoring systems are growing more robust in how alerts are delivered, often passing along information similar to a credit report's executive summary in addition to the trend over the previous six months. With a more detailed context

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behind an alert, better decisions on how to treat receivables can be made.

Delivering Less

A practical challenge of using triggers has been getting too much information, a constant barrage of data that overwhelms rather than elucidates. In particular, this can be an issue with large portfolios. That's why a monitoring system is sometimes only as good as its filtering capability, allowing for a manageable workload.

One strategy for managing alerts is to assign a priority to each trigger type. Perhaps bankruptcy is a top priority requiring an alert. Judgments, liens and collections might be of secondary importance and so on.

Filters allow credit managers to fine-tune alerts in order to deliver meaningful, actionable information without becoming overwhelmed.

Here are a few trigger types and how filtering might apply to them:

Score Change. A filter might apply to a specific threshold or the magnitude of change. Say a credit manager wants to know when a credit score declines below 77, indicating a transition from low to medium risk. However, if the score drops from 90 to 85, there will be no alert. A filter for the magnitude of change might be tied to any change of five points or more. So if a score moves from 80 to 77, it would not set off an alert, but a change from 80 to 72 or 80 to 87 would. Such filters also could be set to be triggered by a certain percentage change in a score.

Event Thresholds. Rather than generating an alert for every potentially significant event, a filter may help focus on those of the highest magnitude. A threshold may be set for tax liens or judgments of a certain value or greater. A credit manager may not want to be alerted to tax liens or judgments less than $1,000 because such claims will not have much impact on an account's viability. But if a business is hit with a $500,000 adverse legal ruling, that likely will have a large impact on its ability to pay.

UCC Collateral Type. If a business is pledging accounts receivable, that may indicate a risk worth noting. If it's pledging equipment as a normal course of business, that may not be worth an alert.

Cooling Off. After one alert for a collection, a credit manager may not want more alerts for subsequent collections within the next 30 days.

Velocity Alerts. If one inquiry of a certain type comes in, a credit manager may not want to know. But if there are three inquiries, that may indicate something significant, meriting an alert.

Trends. If two months ago days beyond terms was five and today it's 35, it's possible that it declined slowly over time without triggering an alert. But a filter tied to a 60-day period would show the change.

There are other data points that may be targeted with filters, but the point is this: filters allow credit managers to fine-tune alerts in order to deliver meaningful, actionable information without becoming overwhelmed.

Customizing Alerts

The latest credit monitoring systems allow you to use your own parameters to determine notable changes and to adjust those parameters over time.

Modern credit monitoring systems enable credit managers to change filter settings anytime. That's important because over time, credit managers may see what is more predictive, what is less predictive and how certain triggers work together. It's a good practice for credit managers to modify their filter settings on an ongoing basis as portfolio performance and business needs change.

As a starting point, monitoring systems may offer default trigger/filter packages. They may focus on monitoring businesses and their owners for credit risk, prioritizing collections or monitoring for cross-selling opportunities.

For those managing large or decentralized portfolios, the ability to modify and administer alert delivery can streamline the process. For example, a company organized by geographic regions may want to have visibility at the corporate level and within each region. In the past, that type of organizational structure required costly custom programming, but newer, more flexible monitoring systems can handle such demands immediately.

Wrapping Up

Credit monitoring has a proven track record. One large computer maker ran a cost-benefit analysis of deploying credit event-based monitoring and concluded that it would net a benefit of $2.5 million. That's why it's no surprise that we see the use of monitoring growing rapidly year after year—especially in the current economic environment.

Credit managers need every tool at their disposal in times like these to avoid trouble and spot opportunities that others may miss. When success depends on the ability to minimize risk and maximize revenue, credit monitoring can help. ●

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