Growing Revenue by Focusing on Profitability, Not First Payment Default

An Accelitas™ White Paper for Lenders

ACCELITAS™

Executive Summary

Many non-bank lenders base their lending decisions on predictions about which applicants are likely to incur a First Payment Default (FPD)—that is, which applicants are likely to be late making their first payment on a loan. Lenders assume that by predicting FPD they will be able to predict which applicants are likely to default on the loans entirely, resulting in losses for the lender.

But our detailed analysis of financial results at multiple lenders shows that FPD actually predicts account loss only about 50% of the time. Many customers who incur FPDs end up paying off their loans on time, finishing as profitable accounts for their lenders.

If FPD is an unreliable predictor of profitability, what score or scores can lenders use instead?

Leveraging years of experience in data analysis and financial services, Accelitas has built a highly predictive, highly configurable account-screening web service called AI Verify, which is part of the Accelitas Accelerated Insight® Platform. Lenders can use the AI Verify web service to screen applicants for profitability, improving the accuracy of their lending models and increasing the profitability of their portfolios.

By using AI Verify to screen applicants—including applicants in the 30% of American households that are invisible to traditional account-screening services—lenders can reduce FPD rates to 40% of their current FPD volume while supporting financial inclusion and saying “yes” to more profitable accounts.

Using Data-driven Insights to Grow Profits and Reduce FPD for Lenders

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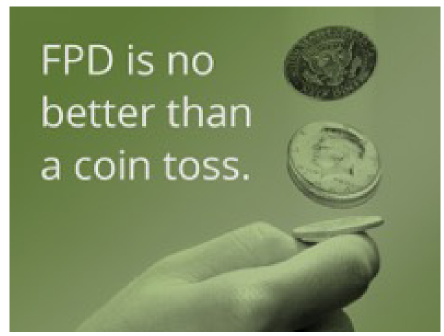
But our detailed analysis of financial results at multiple non-bank lenders shows that FPD predicts account loss only about 50% of the time. When it comes to predicting whether a loan will be profitable, FPD turns out to be no more useful than a coin toss.

In our analysis, we found that:

- For lenders with an FPD rate of 12%, FPDs occurred in about 50% of profitable accounts and 50% of accounts that resulted in losses.
- 26% of accounts that incurred an FPD turned out to be profitable.

As these numbers show, FPD is not as predictive as some lenders assume.



FPD predicts account loss only about 50% of the time.

Why Basing Lending Decisions on FPD Is Risky

Basing a profitability model on a coin toss might seem risky—and it is. By optimizing their data waterfalls for FPD, lenders skew their acceptance rates downward and turn away large numbers of applicants who would actually be profitable.

For example, one lender who had focused their loan-decisioning waterfall on FPD was accepting only about 25% of applicants. Their loss rate was low (about 9%), but they were missing out on a large volume of business.

Our analysis found that by retraining their data waterfall to focus on profitability instead of FPD, they could raise their acceptance rate to nearly 70%. Their loss rate would rise from 9% to 15%, but their overall profitability would jump nearly 50%, more than compensating for any incremental increase in losses. Deal flow would increase and profits would soar.

The key to this transformation is adopting real-time customer identity intelligence focused on profitability instead of FPD.

Growing Profits While Supporting Inclusion and Keeping FPD Under Control

To focus on profitability requires a real-time account-screening service that enables lenders to balance profitability with the risk of FPD, so that FPD rates never rise high enough to create issues with regulators or business partners.

It also requires an account-screening service that can match applicant data for the 30% of American households that are invisible to credit bureaus and traditional account-screening services.

Screening Accounts with AI Verify

Leveraging years of experience in data analysis and financial services, we have built exactly this type of precise, inclusive, and configurable account-screening service. We call this service AI Verify. It's a real-time web service that enables financial organizations to verify the identities of applicants and to assess their financial stability, even if those applicants have little or no financial history.

AI Verify is available through our Accelerated Insight® Platform, a customer identity intelligence solution that leverages data analytics and machine learning to deliver the predictive insights for granting fair, fast, and frictionless access to more customers.

Using AI Verify, non-bank lenders gain:

- Unique scores for account screening
  - FCRA and non-FCRA risk/confidence scores for account segmentation
  - OFAC score
- Predictability even for thin-file and no-file applicants
  - Broad coverage that supports financial inclusion
  - Real-time identity verification and risk assessment
- Insight into waterfall metrics that matter
  - Detailed analysis of which metrics correlate with profitability
  - Clear direction for optimizing data waterfalls for better business results
- Customized analysis and machine learning
  - Scores are trained on the metrics that matter to each institution
  - Scores leverage machine learning to increase accuracy over time

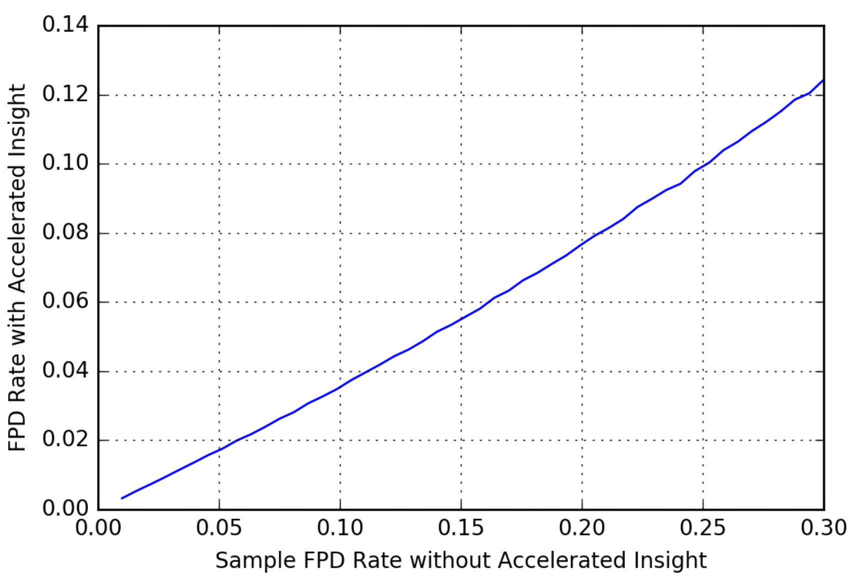
The 40% Rule: Growing Profits While Reducing FPD

In our studies of multiple online lenders, we have found that tuning AI Verify to predict profitability for an organization's customer population enabled organizations to open more accounts while reducing FPD.

Once this optimization was in place, FPD rates fell to about 40% of their previous levels—proof that lenders can focus on profits without experiencing spikes in FPD rates that cause trouble with regulators or business partners.

The chart below summarizes our analysis of FPD rates across multiple vendors. To read this chart, a lender should find their current FPD rate on the X axis, then consult the Y axis to learn what their new FPD rate would likely be once they adopted AI Verify and tuned scores to focus on profitability.

By optimizing for profitability, lenders saw their FPD rates drop to 40% of their previous levels.

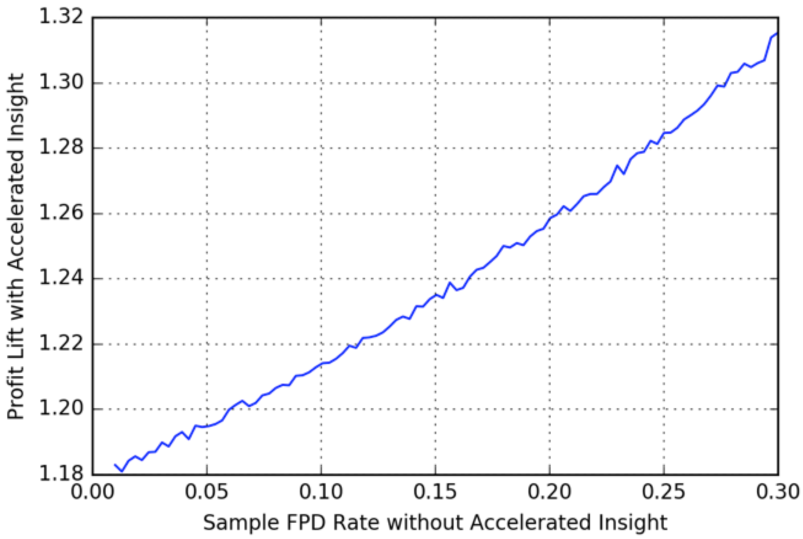


For example, by adopting our AI Verify service, a lender with an FPD rate of 15% would see its FPD rate drop to about 5.5%. Similarly, a lender with an FPD rate of 25% would see that rate drop to 10%.

Growing Profits While FPD Falls

The analysis above shows how much FPD rates decline when lenders decide to focus on profitability. Basing lending decisions on profitability also increases profits, but by how much?

The chart below summarizes our analysis of growth in profits achieved by using AI Verify to focus more on profitability and less on FPD.



To read this chart, a lender should find their current FPD rate on the X axis and then find the multiple by which profit would increase on the Y axis. For example, a lender with an existing FPD rate of 15% would see profits grow about 23.5% by focusing on profitability. A lender with a current FPD rate of 25% would see profits grow about 28.5% by focusing on profitability rather than FPD.

Using AI Verify, it's possible to reduce FPD rates over 50% while growing profits 26%.

The table below summarizes sample results combining these two charts.

Current FPD Rate	New Rate with AI Verify	Additional Profit
5%	1.9%	19.5%
10%	3.9%	21.5%
20%	7.5%	26%

Conclusion

The market for small-dollar loans is more competitive than ever. To grow profits, lenders need to make the most of the applicants they already have.

By using the AI Verify service in Accelerated Insight to screen applicants for likely profitability, lenders can optimize their loan decisioning, reduce FPD rates, and grow profitable accounts for financially underserved consumers.

To learn more about AI Verify and Accelerated Insight,
please contact Accelitas:
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Accelitas is a leading provider of identity intelligence services that help companies identify and say "yes" to more customers.

Our Accelerated Insight® platform includes four real-time web services that provide a faster, smarter way to seamlessly open digital accounts, quickly authenticate IDs, verify profitable customers, and revive previously rejected applicants. The resulting decreases in abandonment, risks and charge offs, and rejection rates can deliver an ROI as high as 30:1.

For more information, please:

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