Managing Credit Line Increase Strategies with Opt-In Requirements

In many countries, card issuers are now required to obtain express consent from customers for credit line increases. This opt-in requirement is already in place in countries such as South Africa, Ireland, the Netherlands and Australia, and Canada is next in line. This requirement places a new constraint on issuers, and naturally raises the question: What impact will the opt-in requirement have on my credit line increase program? And: How do I continue to target customers optimally while complying with the new regulations?

This white paper explores the key issues for card issuers bound by opt-in requirements. It discusses:

- Multiple impacts of opt-in requirements on credit line increase programs
- An analytic approach for optimizing line increases in opt-in situations
- Early results from FICO clients who have used optimization to handle this challenge

Summary

FICO has used client engagements to build opt-in requirements into our Credit Line Management Optimization methodology. We can help you identify the impacts of opt-in requirements and develop strategies that can increase the profitability of your credit line increase programs.
In working with issuers across the globe, including those in opt-in countries, FICO has gained insights into the ways in which credit line increases—and the corresponding profit dynamics—change, given the switch from automated to opt-in line increases.

In weighing the impact of credit line increase opt-in requirements, it’s important to consider:

- **Lack of data.** For countries new to the opt-in requirement, or without sufficient data to estimate the response element, there’s no time like the present to implement a test and gather that data. Luckily, response data can be gathered in as little as 1–3 months. FICO can help you design a test that will gather the maximum amount of information for modeling purposes. We also have the expertise to get you started immediately, and in compliance with risk and regulatory requirements, while you are waiting on data.

- **Revenue and profit impact.** Despite lower volumes of line increases, and the corresponding impact on revenue generation, many of the principles of credit line increase targeting still apply. Even with automated line increases, not all customers “respond” by actually using the new line assigned. With opt-in, the customers who accept a line increase are more likely to use that new line. As such, per responder profit is relatively the same between an automated strategy and an opt-in strategy. So, the impact of an opt-in requirement on revenue may be lower than what many issuers might expect. The impact on profit and/or volumes can be offset by targeting more accounts that will respond.

- **Targeting for response.** In addition to the usual targeting of accounts that are most likely to use the new line and least likely to default, we must introduce a new component into our targeting, i.e., who is most likely to opt-in or respond.

- **Possible adverse selection.** Those customers most likely to opt-in can have a higher level of risk, so we must be able to measure this and account for it in our strategies. The fact is that the challenge of adverse selection is not new to credit line increases. Accounts in the past that were more likely to use the new line tended to be of higher risk. The requirement of customer opt-in for line increases does not introduce the adverse selection issue, rather extends it given the necessary new processes to comply with the regulation (making the offer and capturing response).

- **Use of optimization.** Decision modeling and optimization are ideally suited for situations with multiple, often conflicting, goals and constraints. With the added complexities introduced by the opt-in requirement, and the increasingly difficult task of finding good, profitable customers, optimization brings more value than ever before. The FICO approach (outlined below) can help your organization quantify and trade off the potential changes to your credit line increase program, and determine where you want to operate in the opt-in environment. Issuers can, therefore, turn the opt-in requirement to their advantage by establishing better controls over who is offered line increases, and therefore, establishing further control over contingent liability and use of capital.

FICO has experience developing decision models and optimizing strategies for decision areas that require opt-in consent from the borrower. Specifically, FICO has developed both optimal strategies for credit line increase cases requiring opt-in, as well as strategies to cross-sell shadow lines of credit for credit card portfolios. We have developed optimized strategies in the Australian market, where credit line increases require written acceptance by the borrower.

In these cases, the analytic design for the decision model focuses on response analytics as the starting point for the dependent probabilities that capture the borrower’s expected reaction to the specific offer. The following diagram, which represents an example decision model, illustrates the relationships among components of a decision model and highlights the addition of a response component to a typical credit line increase decision model for cases where opt-in consent is required.
The additional response component used to model an opt-in requirement is designed to rank-order accounts using the likelihood that they will respond positively to the increase or offer. The profile of accounts considered for optimal action during the optimization stage is dependent on the likelihood of response. This interaction, therefore, becomes part of a trade-off analysis—optimization problem—alongside other critical components, such as risk and revenue.

FICO’s experience to date, from live strategy tracking, has shown response rates to credit line increase offers meet and exceed the expectation set during strategy development. Typical response rates for countries optimizing credit line increases with opt-in requirements range between 15% to 30%, depending on the frequency and type of offer campaign. The fact that our optimization solution has achieved the expected accuracy for response is reassuring given the nature and focus of the optimization—to maximize profit by selecting those accounts that will respond to the line increase offer and generate revenue as a result. With response rates and other key metrics meeting or exceeding expectations, we are confident the expected ROI will be achieved.

Furthermore, internal analysis by FICO has shown that the addition of a response component to the decision model does not substantially affect the profile of accounts being targeted. Our decision models still target the most profitable accounts (accounts with profiles that show a balance between risk and revenue potential) when each account’s response rate is accounted for in the decision model.

Based on FICO’s experience, the following are expected outcomes of having an opt-in requirement for credit line increases:

1. **Impact to Penetration Rates**

   *There will be fewer increases taken up by borrowers when they are required to explicitly opt-in, which leads to lower penetration rates.* This creates an opportunity for an optimization environment to target customers who are likely to opt-in. The objectives of the credit line increase strategy are therefore transformed to obtain the set of actions that yield maximum returns while accounting for each account’s likelihood of response. Penetration, or acceptance of a credit line increase offer, is only the first step in realizing the benefit of a line increase. The efficiency rate on credit line increase offers, a measure of how much of the offered credit line increase is actually used, becomes an increasingly relevant metric with opt-in requirements; optimization is ideally suited to achieve higher increase efficiency rates.
2. Impact to Profit per Increased Account

Profit returns from an increase program can suffer, given the lower volumes of increases expected to be taken up. In reality, however, the drivers for profitable line increase programs remain relevant despite the lower penetration rates, and opt-in requirements do not have strong adverse effects on profit per increased account (accounts that received an increase and used the additional line). FICO has observed an average incremental profit over business as usual strategies of USD$8 per increased account resulting from strategies delivered to clients across the globe. We expect this per account average to hold steady in cases where opt-in is required, subject to volume targets and operational constraints.

The fundamental driver of profit, therefore, remains targeting increases at accounts that will achieve the right balance between risk and reward for a credit line increase strategy. As mentioned above, adding a response component to the decision model serves to refine FICO’s methodology and allow for modeling of response rates, but does not significantly change the profit profile of accounts being offered a credit line increase.

3. Impact to Offer Cost

As a result of the opt-in requirement, additional costs may be incurred to process the credit line increase offer, to capture the opt-in response, and to comply with any policy requirements. This will result in operational cost pressures to the overall line management program bottom line. For the purposes of optimization, FICO considers this cost pressure a constraint that can be neutralized in a trade-off assessment. By targeting accounts that have a high likelihood of response, our methodology will yield high increase efficiency ratios while controlling the cost pressures to process the actions taken.

FICO believes that having a response component helps further refine the process of optimally selecting accounts for action. The true value of an optimized credit line increase program comes from those account holders who actually use the increase in credit lines. Adding this opt-in response component to the line increase offer is a natural extension of an increase program. The response component is implemented in a way such that we do not substantially alter which accounts are targeted for a credit line increase; we continue to target the accounts that drive profit.

In countries where opt-in to credit line increases is required, FICO not only has been able to apply its optimization methodology to accommodate this requirement, but has also observed positive results during early live tracking. We invite card issuers to discuss their programs and goals with us.

Visit www.fico.com/insights for more white papers, including:

- A Recipe for Right-Sizing Credit Facilities
FICO (NYSE:FICO) transforms business by making every decision count. FICO’s Decision Management solutions combine trusted advice, world-class analytics and innovative applications to give organizations the power to automate, improve and connect decisions across their business. Clients in 80 countries work with FICO to increase customer loyalty and profitability, cut fraud losses, manage credit risk, meet regulatory and competitive demands, and rapidly build market share. FICO also helps millions of individuals manage their credit health through the www.myFICO.com website. Learn more about FICO at www.fico.com.