



An Experian study on the impact of the economic crisis on scorecards

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About Experian

Experian is the world's leading global information services company. During life's big moments – from buying a home or a car, to sending a child to college, to growing a business by connecting with new customers – we empower confidence. We help individuals to take financial control and access financial services, businesses to make smarter decisions and thrive, lenders to lend more responsibly, and organisations to prevent identity fraud and crime.

We have 16,500 people operating across 39 countries and every day we're investing in new technologies, talented people and innovation to help all our clients maximise every opportunity. We are listed on the London Stock Exchange (EXPN) and are a constituent of the FTSE 100 Index.

The insight contained within this report is prepared using research performed on both Experian data and external data sources, in addition to market research. All sources, unless referenced, are from Experian insight. The information contained within this report is designed to help businesses manage the complexity brought by a national crisis - and is a summary of key areas and capabilities. To understand more about the breadth of market-leading capability Experian has, or to access further detail on the impact of Covid-19 on consumers, business and lending portfolios.

Please contact us or visit our COVID-19 resource hub:
www.experian.co.uk/about-us/covid-19-resources

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Understanding an economy in crisis

With closed businesses, lost jobs and furloughed employees, the COVID-19 crisis has already created an income shock for around 40% of the UK population, and many more remain at risk.

As the situation has developed, customer credit searches have fluctuated, mortgage providers have delayed or withdrawn offers and the auto finance industry has effectively closed, along with the car dealerships it depends on. Some sectors, including aviation, travel, leisure and retail, have been especially hard hit, while many who work in today's gig economy have found themselves out of work, and struggling to find the safety net they so urgently need.

COVID-19 crisis has already created an income shock for around 40% of the UK population, and many more remain at risk.

For firms, it's essential to understand the impact of this income shock, not just on your customers and portfolios, but on the tools you use to make critical decisions, day in, day out. As the effects of the pandemic unfold, it will become increasingly important to assess affordability, credit score and risk, accessing accurate, timely data not just during onboarding, but over the entire lifecycle.

Creating clarity through credit scoring

Here at Experian, we're constantly analysing the situation, and using our insights to help firms pave a way forward. In this document, we explore how the crisis is likely to affect credit scoring, taking an in-depth look at its probable impact on our Delphi for New Business (Delphi NB) score.

Developed to meet logical as well as statistical validity checks, Delphi NB is designed to continue performing despite economic conditions, however extreme they may be. So even if there's a short-term rise in bad rates, as we predict in the coming months, it will continue to discriminate strongly between good and bad risk applicants, informing sound, responsible decision-making.

Over the next few pages, we'll assess the outcomes of various likely scenarios on Delphi NB scoring – and potentially on firms' own scoring systems.

(1) Experian Economics, 31 March 2020.

From emerging trends to powerful predictions

Our research tells us that during the initial pandemic-shock stage, the most vulnerable consumers will pull back from the credit market and overall searches will decrease, creating improved Delphi NB scores.

However, as we move from pandemic shock to more fundamental economic shock, the overall profile of the applicant mix may deteriorate and use of revolving credit may increase, as even customers with previously strong finances face affordability challenges for the first time.

Please refer to our March 2020 Economic report for further details on the four possible scenarios.

While emergency payment freeze measures have already helped many consumers and limited the number of people falling behind with credit payments, these are temporary measures and, once they're lifted, it's likely that arrears rates will rise steeply. These arrears will impact the score profile, although we expect this primarily across the lower bands.

The situation is constantly evolving, as the UK – and the rest of the world – struggles to contain a health and economic crisis on an unprecedented scale. With so many uncertainties swirling, the ability to track evidenced outcomes from probable scenarios is hugely valuable, and we hope this exploration empowers your business to look into, and prepare for, a stronger, healthier future.

Early indications of stress and performance are emerging:

- 01** After a dramatic decline in the first three weeks of lock down, incremental recovery is being seen in credit card and mail-order/retail finance
- 02** Early indications show a rise in CAIS status for lower prime portfolios
- 03** Use of credit is typically higher than pre-Covid. Early trends show change in both lender and consumer behaviours
- 04** April income analysis starts to shed light on the emerging income effects as 6.8 million¹ Brits are furloughed from 800,000 businesses.

Find out more about how Experian are helping to protect credit scores for;

- Consumers
 - Businesses
-

(1) <https://news.sky.com/story/coronavirus-furlough-scheme-now-paying-6-3m-workers-says-government-11983060>

Methodology

This study looks at how scorecards are likely to perform – and inform firms – as the effects of the COVID-19 pandemic ripple through the UK economy, and income shock is felt by a significant proportion of the population.

Built on the trends we're already seeing emerge from the crisis, the study explores a range of possible scenarios. It reveals the potential impact on Delphi NB of varying degrees of decreased searches, increased credit balances and growing arrears rates.

Analysis sample

The study is based primarily on a sample of 100,000 random banking and finance credit applications made during 2019, including credit cards, personal loans, mortgages and hire purchase agreements.

To enable us to make predictions around bad rates, as we've done in section 5, we've used a similar sample of 100,000 credit applications from 2018, with measured outcomes 12 months later.

Key assumptions

We've analysed each of these samples based on several key assumptions, drawn from the trends we're already seeing emerging. These include:

- Credit searches dropped significantly, and we assume they will remain at this new lower level until after COVID-19 containment measures are lifted.
- Emergency payment freezes on open credit accounts mean that consumers are more likely to hold revolving balances and / or to increase those balances, therefore increasing their balance-to-credit limit ratio.
- A further impact of emergency payment freezes is that there will be a short-term decrease in the number of accounts in early arrears.
- Once the emergency payment freeze period ends, there's likely to be a significant increase in arrears, as well as a reduction in the proportion of collections cases that recover.

Specified scorecard

At Experian, we deliver a broad range of Delphi scorecards to credit providers, including different 'generations' of scores, different vertical markets and different outcomes (i.e. originations, customer management etc.)

This analysis considers the impact of the COVID-19 crisis on the Generation 10 Delphi NB Banking & Finance Scorecard with CII (Consumer Indebtedness Index), which excludes BDS (behavioural data sharing) data.

We've chosen this particular version because it's the most widely used Delphi NB scorecard, so the impact on other Delphi scorecards is likely to be very similar.

You can read more about Delphi NB, CII and BDS in our glossary of terms on page 18, or by visiting our webpages.

This analysis considers the impact of the COVID-19 crisis on the Generation 10 Delphi NB Banking & Finance Scorecard with CII (Consumer Indebtedness Index)

Emerging trends and developments

A key part of our role here at Experian is tracking and evidencing emerging trends and their impact on consumers, businesses and financial firms. This has been especially important in recent weeks, as leaders find themselves in uncharted waters, looking for the answers they need to protect people, organisations and economies.

The impact of payment freezes on credit scores

The situation is changing rapidly, with new government and regulatory guidance being issued every few days. One major change has been that consumers who are struggling to meet credit repayments as the crisis bites can now request a three-month temporary payment freeze. Where this is agreed with a credit provider, no payments will be expected until the agreed period ends.

This is a new set of circumstances and it's important to be clear about what it means for the customer's credit score. On the one hand, the arrears status associated with the account won't increase, so in that way, the credit score will be protected.

However, because the customer's level of indebtedness is a key factor in predicting the likelihood of future payment difficulties and defaults, the score can still reduce during the payment freeze period. This would happen if the customer continued to increase their outstanding balance or use revolving credit – and would negatively impact their Delphi NB score.

We have launched a service which provides timely alerts on customers who may have undertaken an emergency payment freeze as well as highlighting customers who appear to be experiencing income shock. Timely access to these customer level insights enables lenders to identify customers who may be financially vulnerable in order to manage those customers more effectively.

Clare Hollis, Senior Product Manager, Experian UKI

Declining credit searches, applications and quality

We've already seen a significant fall in credit searches and applications across all products since the COVID-19 containment period began back in March.

Increased balances and credit limit utilisation

As the crisis develops and income shock kicks in, it looks inevitable that consumer credit balances will rise and more people than usual will reach the limit of their agreed credit. This will be another measure to understand profile changes and risks of individuals.

Over the next few pages, we'll look at the possible impact on the profile of Delphi NB scores while the COVID-19 containment phase and emergency payment freezes continue.

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Reduced credit searches

To determine how the significant fall in credit searches will impact the Delphi NB score, we've considered two scenarios:

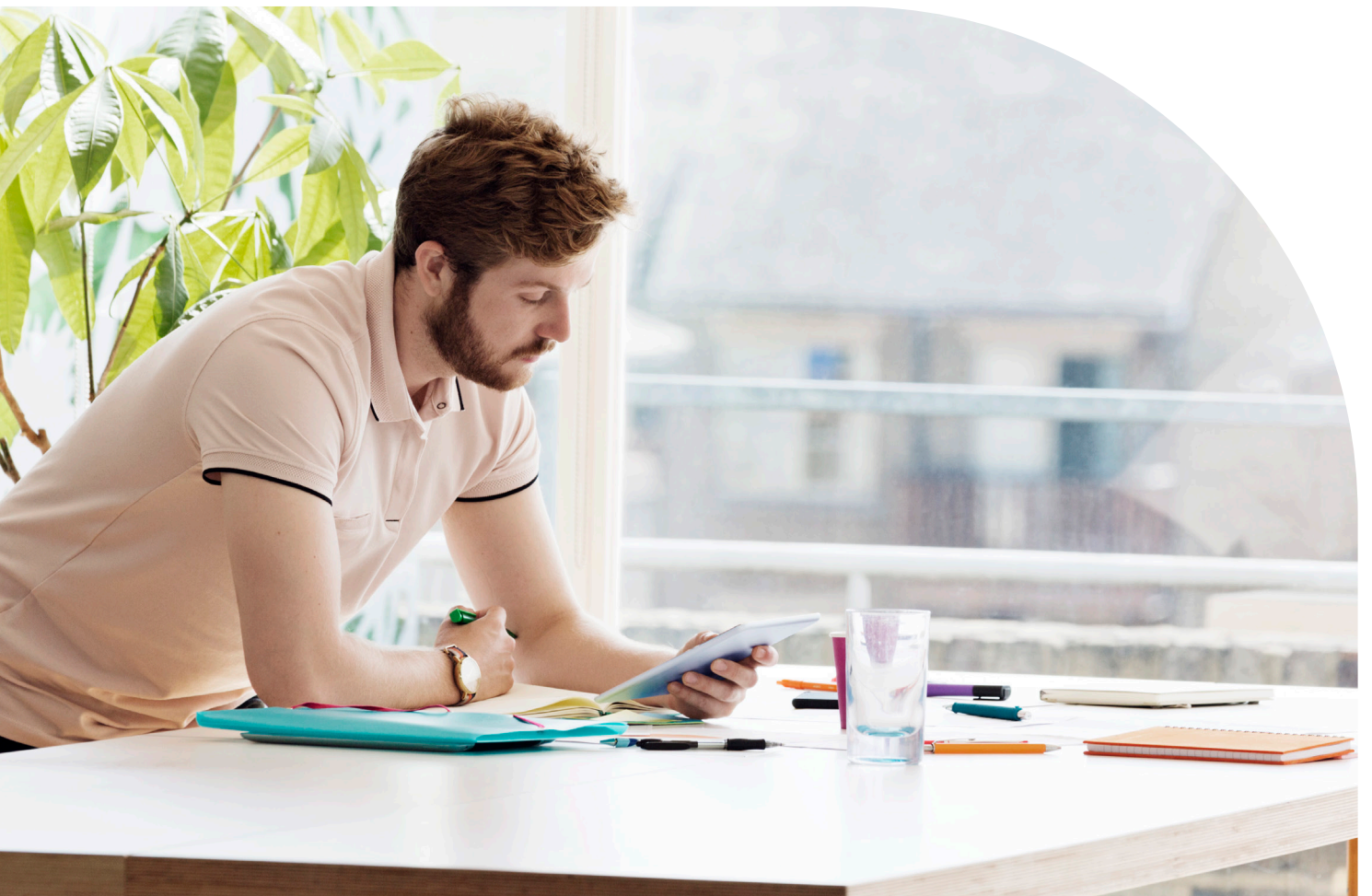
- What happens if the number of searches is reduced by 1 across all search characteristics?
- What happens if the number of searches is reduced by 3 across all search characteristics?

While there may have been a reduction in credit applications since the Crisis emerged, the likelihood is they would have made some applications in the last twelve months. In our scenarios, we've applied the adjustment to credit searches equally to all credit applicants.

In both scenarios around **40%** of consumers see a positive impact to their Delphi NB score. Based on scenario 2 (3 less searches) there are **18% of consumers that gain 26+ points.**

Score Increase	Scenario 1 1 fewer search	Scenario 2 3 fewer searches
0 points	61.6%	58.1%
1 – 10 points	17.5%	16.8%
11 – 25 points	10.1%	7.1%
26 – 50 points	6.3%	9.7%
51 – 100 points	3.4%	5.3%
101+ points	1.0%	3.0%

Table 1: How reduced credit searches impact the Delphi NB score



Increased revolving credit balances

Here, to explore how an increase in revolving credit balances impacts the Delphi NB score, we've considered four scenarios, involving balance increases of £500, £1,000, £2,500 and £5,000. We've applied the increase to all consumers, spreading each person's increase evenly across all of their revolving credit accounts (up to a maximum of 110% of the credit limit).

Score Decrease	Scenario 1 £500	Scenario 2 £1,000	Scenario 3 £2,500	Scenario 4 £5,000
0 points	58.9%	51.9%	42.7%	39.2%
1 – 10 points	2.3%	3.2%	3.3%	2.2%
11 – 25 points	4.9%	4.9%	5.7%	4.8%
26 – 50 points	11.0%	10.7%	8.0%	7.0%
51 – 100 points	12.6%	14.6%	17.8%	17.6%
101+ points	9.1%	13.6%	21.7%	28.7%

Table 2: How increased revolving credit balances impact Delphi NB score

The results we see here are somewhat overstated because they assume all consumers will have an increased balance. However they show that even if a consumer's outstanding credit balance increases by just £500, it can have a relatively significant impact on their credit score.

In fact, for more than 21.66% of the sample group, it meant a score decrease of 51 points or more. Meanwhile, higher increases in balance had a greater impact, with an increase of £5,000 gave 46.22% of the sample a score decrease of 51 or more.

A realistic, although still relatively extreme, estimation would be that 30% of consumers see an increase in revolving credit balance during the COVID-19 containment phase. We've used this figure to create the graph on the next page.

Overall impact on Delphi NB scores

Combining scenarios in the containment phase

In this chart, we've combined the data from the previous two tables on reduced searches and increased revolving credit balances, showing the overall impact on Delphi NB scores during the COVID-19 containment phase.

The results are based on the following assumptions:

- A reduction of three searches across all search characteristics
- 30% of costumers having an increase in revolving credit balance

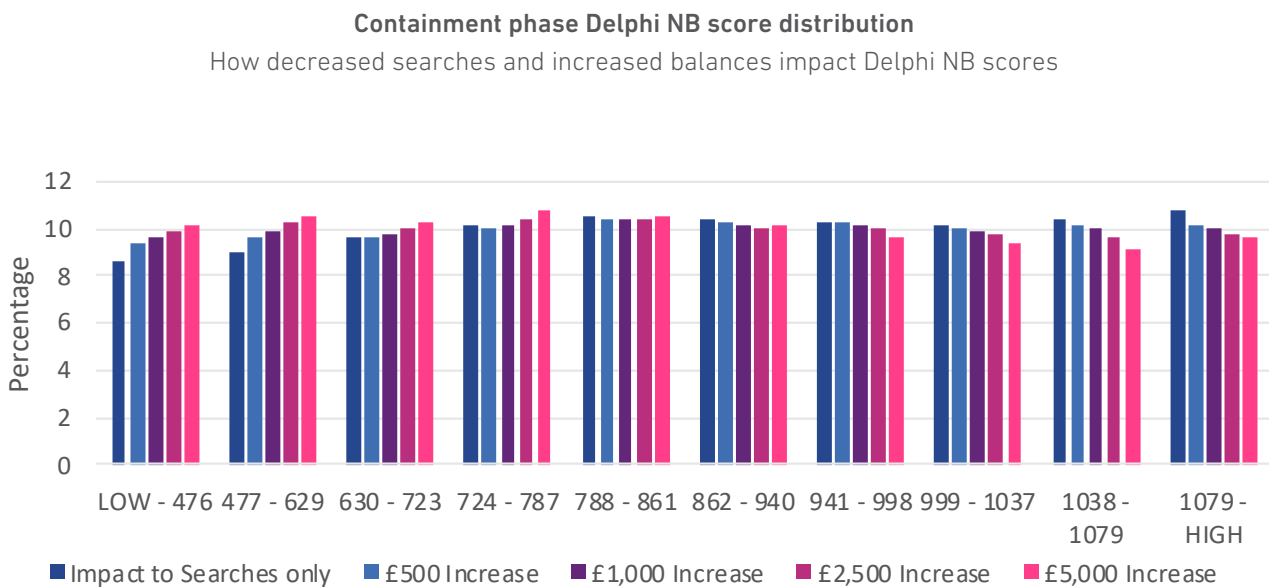
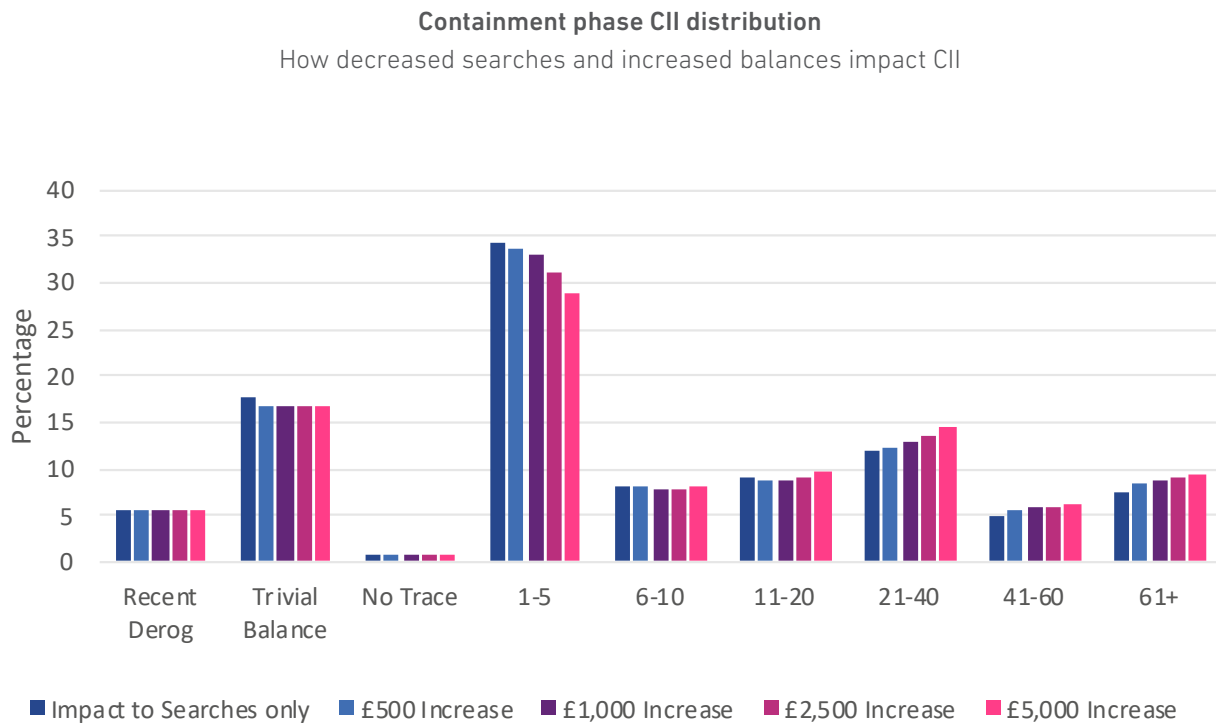


Figure 1 shows the overall impact on Delphi NB scores if we combine both factors we expect to see during the containment phase. It's worth pointing out that in the lower score bands, the decrease in credit searches may have a more significant impact than increased balances, while in the higher score band, it's clear that large balance increases are the most significant factor.



The Consumer Indebtedness Index, or CII, includes credit searches, revolving credit balances and credit limit utilisation. Please see the glossary in the appendix for more information on CII.

As you might expect, the distribution of CII is strongly impacted by balance increase, and the increase in CII is much greater for more significant balance increases.

Figure 2 shows how the containment phase will impact CII overall. We can see that primarily, there is a fall in the proportion of consumers with low indebtedness (1 to 5) and a corresponding increase in the proportion of consumers with a CII rating of over 20.

Post-containment predictions

With many consumers, businesses and credit providers keen to look beyond the critical containment stage and map out a plan for economic recovery, over the next few pages we've looked at several key scenarios likely to emerge – and their impact on Delphi NB.

The arrangements put in place to provide an emergency payment freeze to those consumers who need it, mean that very few accounts will go into arrears during the COVID-19 containment phase.

However, for many it will simply be a case of delaying a slide into arrears, so we expect that this delay – combined with lost income as a result of containment and later recession – will lead to a huge increase in arrears once the emergency payment freeze period comes to an end.

Increased arrears will result in significantly more collections cases and have a negative impact on Delphi NB scores.



Increasing arrears scenarios

We've evaluated three potential scenarios based on increased levels of arrears. Each one focuses on 'early' arrears rather than increased delinquent accounts, defaults or public information.

Increasing arrears scenarios

Proportion of accounts in arrears status 1, by decile (10% bands)

	% Applicants with CAIS Arrears	Scenario 1 Moderate Increase	Scenario 2 High Increase	Scenario 3 Extreme Increase
Risk Band 1	61%	80.0%	95.0%	100.0%
Risk Band 2	17.8%	25.0%	42.0%	50.0%
Risk Band 3	5.8%	8.0%	18.0%	25.0%
Risk Band 4	3.0%	5.0%	8.0%	10.0%
Risk Band 5	1.3%	2.5%	4.0%	5.0%
Risk Band 6	1.1%	2.0%	3.5%	5.0%
Risk Band 7	0.7%	1.5%	3.0%	5.0%
Risk Band 8	0.4%	1.0%	2.0%	3.0%
Risk Band 9	0.3%	0.7%	1.5%	3.0%
Risk Band 10	0.1%	0.5%	1.0%	3.0%
Total	9.2%	12.4%	17.6%	20.6%

Based on the figures in **Table 3**, we've gone on to explore the impact of each scenario on Delphi NB scores. **Please note** that some accounts already in arrears don't lose any further points, hence a proportion with zero score increase.

How increased arrears impact Delphi NB score distribution

Score Decrease	Additional Arrears Moderate	Additional Arrears High	Additional Arrears Extreme
% Arrears	12.4%	17.6%	20.6%
0 points	5.4%	5.5%	5.6%
1 – 25 points	0.9%	1.1%	1.2%
26 – 50 points	2.0%	2.7%	2.9%
51 – 100 points	2.7%	4.4%	5.3%
101+ points	1.4%	3.9%	5.6%

Table 4: Even though we haven't considered additional delinquent accounts, defaults or public information, the increased arrears scenarios still make a significant impact on Delphi NB scores, with between 4.1% and 10.9% of scores decreasing by 51 points or more.

Overall impact on Delphi NB scores

As we move into the post-containment phase

Here, we've mapped out the potential overall impact on Delphi NB scores once the UK moves beyond the containment phase and emergency payment freezes are no longer in place. Our results are based on the following key assumptions:

- A reduction of three searches across all search characteristics
- 30% of costumers having an increase in revolving credit balance of £1,000

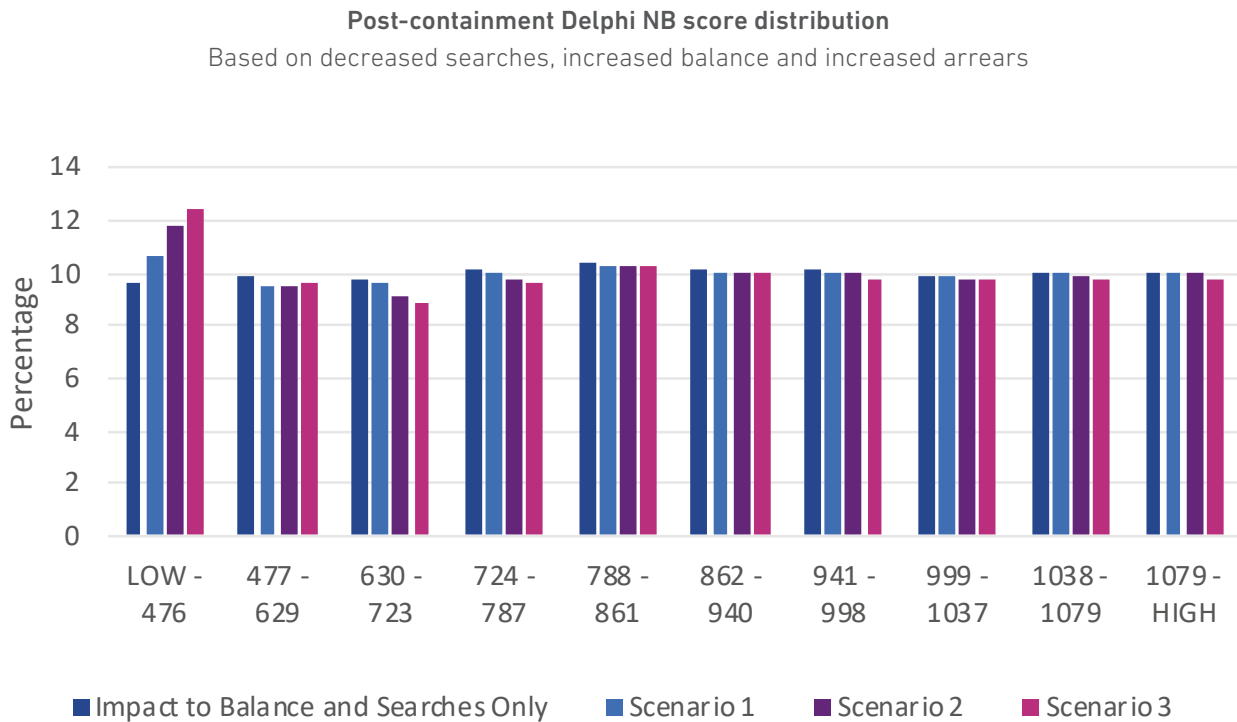


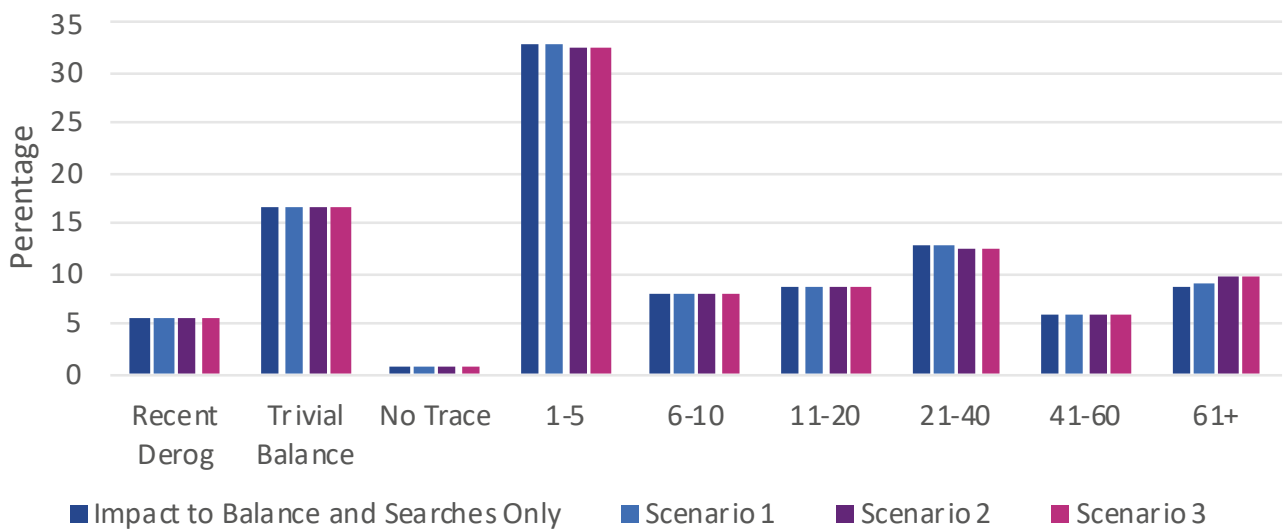
Figure 4 shows how this combination of factors, as well as the different arrears scenarios outlined above, come together to impact Delphi NB scores.

As you can see, the addition of increased arrears in the post-containment phase results in a significant increase in the proportion of applicants in the lowest score decile (10% bands).

In Figure 5, we move on to look at CII distribution beyond the containment phase. While arrears aren't explicitly included in the CII, they're incorporated into the score to index calibration.

Post-containment phase CII distribution

Based on decreased searches, increased balance and increased arrears

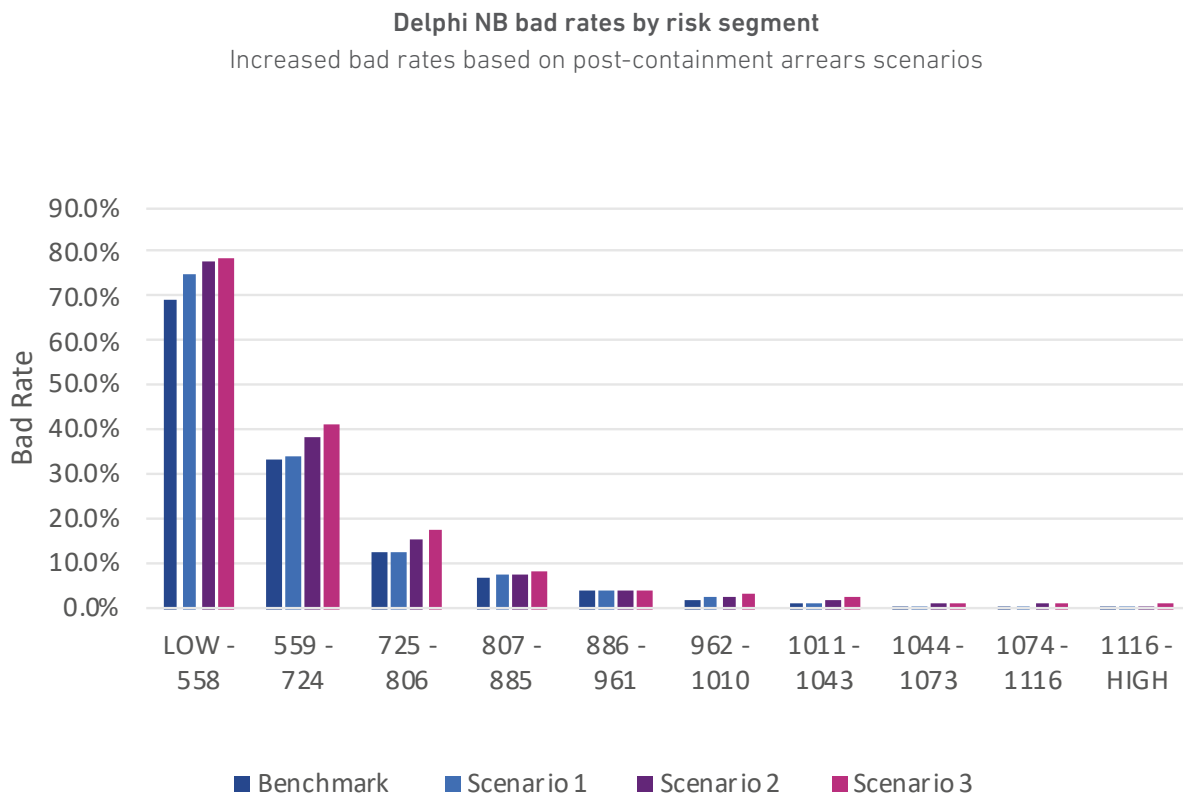


The chart shows the overall impact to CII in the post-containment phase. As you can see, arrears have a limited impact in comparison to the increased balances, when considered as part of the containment phase.

Resulting impact on bad rates

It appears inevitable that the UK will move into a very deep recession following the COVID-19 containment period. This makes it very difficult to estimate future bad rates by score band. However, bad rates tend to be relatively stable based on point-in-time variables, so although external factors will clearly have an impact, we firmly believe that the Experian Delphi NB score remains the best indicator of future credit risk.

In order to understand how an increase in arrears could potentially impact Delphi NB performance, we considered bad rates based on the arrears scenarios outlined on page 11. Figure 6 shows the Delphi NB score based on the observed bad rate (outcome after 12 months) and how this would be impacted by the three arrears scenarios.



Although bad rates are expected to increase across the entire score range, a majority of the total increase in bads will come from the lower score bands. However, the extent of the increase in bad rates is clearly very dependent on the arrears scenarios and may vary significantly by lender.

How Experian can help

As the UK battles to bring the health and economic fallout of the COVID-19 pandemic under control, these are hugely challenging times for consumers, businesses and credit providers alike.

Here at Experian, we believe in the power of data to reveal possibilities, empower decisions and help organisations build stronger, more robust futures. Now more than ever, we're using that data to support firms in shaping strategies, allocating resources and tapping into effective tools.

As new credit applications decline, it will be essential to nurture your existing customer base, re-evaluating strategies to understand evolving levels of affordability, as well as balance appropriate support with your current appetite for risk. The new lending applications that do continue look likely to decrease in quality and mark a shift in demand from prime to sub-prime credit, requiring an ever-sharper understanding of consumers' behaviours and challenges.

With circumstances rapidly changing for both existing and new customers, it's critical to recalibrate your own scorecard and customer segmentation systems to make sure they're still relevant and accurate in a much-changed world. Systems that performed powerfully just weeks ago may no longer be able to effectively protect your organisation, or help you accept the right new customers as you move beyond the crisis.

If that feels like a stretch of already reduced resources, we're here to help. Or economics experts can work with you to review your existing systems and strengthen them with bureau data, bespoke analytics and insights into likely, evidenced economic scenarios. It's about making sure the data you're analysing is absolutely relevant, and the changes you make are the right ones.

As consumers emerge from the payment freeze period and arrears and collections spike rapidly, we can also help you triage new cases and make a more accurate estimate of demand. By using CAIS data extracts, we can provide granular data on which customers have suffered income shock or taken a payment freeze, updated twice a month to make sure you always have an up-to-date picture of your customer base, and a solid platform for moving forward.

Here to help you get through this

If you'd like to talk through your specific challenges and find out more about our powerful package of recovery support, please contact your account manager or visit our resource hub:

www.experian.co.uk/about-us/covid-19-resources/

We can also be contacted by email Business.Enquiries@uk.experian.com

Appendix:

Glossary of terms

BDS

Behavioural data sharing refers to credit card payment data. This is subset of CAIS that's provided by a majority of credit card providers. All CAIS members can obtain this data providing they either provide BDS data to Experian or don't operate a credit card.

CII

The Consumer Indebtedness Index is a score-based index developed to identify consumers who may not be experiencing payment difficulties currently, but are likely to experience them in the near future because of their level (and type) of credit commitments.

Delphi NB scores can be provided with or without CII included. There are three different versions of CII: with BDS, without BDS, and Enhanced CII. The Enhanced CII option includes a number of debt-to-income ratios not included within the other models.

Delphi NB

Delphi for New Business (Delphi NB) is a suite of highly predictive, generic credit scorecards that can be used within UK consumer credit application processing to assess the credit risk of new customers. Our Delphi NB scoring models maximise the predictive power of all elements of the Experian Credit Bureau in order to predict the likelihood that a new applicant for credit will become a good payer if accepted.

We provide a whole range of new business Delphi scorecards to credit providers, including different generations of score (the latest being generation 11) and different vertical market versions. The most commonly used is our Banking & Finance option.

Emergency payment freeze

This is a three-month freeze on credit repayments, made available to consumers by credit providers in order to ease the financial burden of the COVID-19 crisis.



Using the power of data to help you
ADAPT. SURVIVE. THRIVE.

EXPERIAN
INSIGHTS



Helping you manage the turbulent economy

To help you navigate the complex landscape, and fast-paced environment we are living in, we have created a dedicated insight series designed to help you adapt, survive and thrive. As ever, we believe data has the power to help – with insight being ever more crucial to monitoring and responding at speed and scale.

Visit our dedicated resource hub to sign up to our latest webinars and insight reports, as well as content exploring the complex problems that are unravelling because of the turbulent economy and unprecedented environment.

[View the resource hub here](#)

[Sign up to our June webinar.](#)

3rd June 2020 exploring the credit landscape

Authors:

Chris Curtis

Head of Bureau Analytics
Experian UKI

Michael Joyce

Lead Analyst
Experian UKI



Registered office address:
The Sir John Peace Building, Experian Way,
NG2 Business Park, Nottingham, NG80 1ZZ

T: 0844 4815 888
www.experian.co.uk

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