DEPOSIT SCORE℠: How New Deposit Scoring Technology Can Significantly Enhance Your Overdraft Program

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Most financial institutions today have an overdraft or courtesy pay program. These programs automate the decision to pay or return a check when insufficient funds (NSFs) exist in the account up to an OD limit. Further notices and other follow up activities are executed at standard intervals to get repayment of overdraft funds.

Two new scoring factors, not used in overdraft processes today, can substantially improve risk management, revenue and optimize public policy. These two new factors are trends in days to clear up an overdraft and deposit regularity. Let us present what these factors are and why they drive improved performance.

Chart 1 Analysis of NSF/OD Activity

# of NSFs Presented	Precent of Accounts	Precent of NSFs	NSFs/Acct Per Year
0	66%	0	0
1-9	24%	30%	5
10+	10%	70%	30
Total	100%	100%	3.6

Source: SMS Research

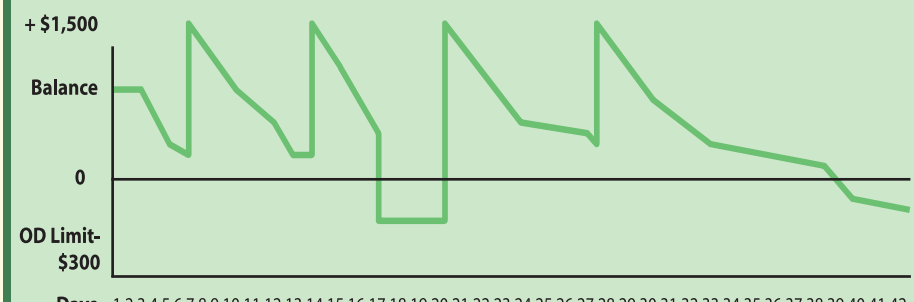
As shown in Chart1, typically 70% of the revenue and risk of NSF/OD activity is related to customers who average 30 or more NSFs annually, or at least about every 12 days. Knowing a customer's history for when they clear up NSFs and make deposits can greatly enhance risk management, revenue and relationship management with the customer. Let us provide an example.

Definition of the New Scoring

In analyzing risk in getting funds back from consumers or businesses, risk managers in financial institutions regularly look at how customers have historically paid back their obligations. However, this information has not been availablewhen analyzing overdraft activity, and as a result, overdraft programs have relied on measures such as age of account, average deposit activity or other related factors. Yet, all of us know from experience with direct deposit customers that deposit consistency lowers risk.

Chart 2 below shows a sample customer account activity over 42 days. This customer has historically made a deposi about every seven days. As checks come in the deposit balance is reduced, and sometimes the customer has a negative balance because of overdrafts. Notice in our example, the matrix score typically pays NSFs into overdraft up to a negative account balance of $300. Further, notice at day 35 the customer did not make a deposit, as was his pattern. Also, this customer presented an NSF that was paid into overdraft based on the existing matrix at day 40.

Chart 2 Sample Customer Deposit and Overdraft Patterns



The logic of using a customer's history in clearing up overdrafts and their history in making deposits to assess risk is driven by how customers present NSFs. At every financial institution we have studied, a consistent pattern exists for NSF activity. As Chart 1 above shows, typically about two-thrids of the customers never present NSFs, 24% present a handful on an annual basis, and about 10% of the customer present more than 10 annually. The customers presenting more than 10 annually generate nearly two thirds of the total volume on NSFs, and average 32 NSFs annually.

Clearly, the risk of paying an NSF has changed for this customer at day 35 when the pattern of deposit activity changed. In all prior cases, this customer had cleared up overdrafts in just a few days, but something has changed.