Intellect Article

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Telco Defaults – how relevant are they??

How relevant are telco defaults to determining credit risk. Should you only be concerned about account defaults over a certain value? Should you only assess a deal based on unpaid defaults? Should you ignore telco defaults entirely?

If you looked at the default policy within any two financial organisations, they would be differing.

The Communications Law Centre released some figures related to telco derogatories; these show that the incidences of Telco debts in bankruptcy have increased from 42 to 56% in the last 3 years, and that the average Telco debt per bankruptcy has risen to $1316.00 in the same period.

Several case studies compiled by the Dunn & Bradstreet credit bureau show quite clearly that the relative risk of a telco default, is no different to, if not worse in some case, to other defaults.

The case studies listed below have been sourced by a variety of portfolios and companies, however they all have produced the same result – a default of any source, amount or status has proven to be effective in determining the risk of bad debt.

- Case Study 1 – total defaults versus telco defaults
- Case Study 2 – less than $500 versus greater than $500 telco defaults
- Case Study 3 – unpaid versus paid telco defaults.

The indicator used to compare the cases is the good/bad odds. A 'good' account is defined as an account that is performing satisfactorily and a 'bad' account is one experiencing payment difficulty. It is important to note that the definition of 'good' and 'bad' is specific to the individual client.

The odds are calculated by the number of 'good' applications divided by the number of 'bad' applications. This gives an indicator of how many good applications written for every application that will go bad.

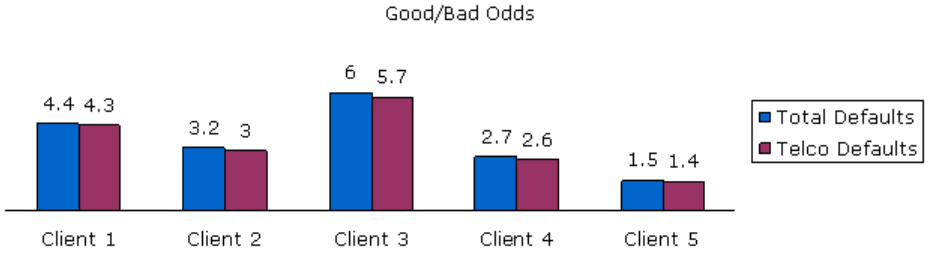
For example, below client 1 shows an applicant with defaults, having odds of 4.4:1, that being 4.4 good applicants exists for every 1 bad applicant in this group. The total population has odds of 8.2:1, that being 8.2 good applicants for every one bad applicant in the total population.

In addition to the odds, another measure of the applicant is the index. The index is a representation of the relationship between any one variable, in this instance – an existing bureau default on file at the time of application, and the odds of the total population. The index for applicants with existing defaults on their bureau file is 187 Bad. This means that, when compared with the total population, these applicants are 1.87 times more likely to be defined as a Bad account within the next 12-24 months. Likewise the index of applicants with no existing bureau is 112 Good. This means that, when compared with the total population, these applicants are 1.12 times more likely to be defined as a Good within the next 12-24 months.

The scenarios for comparison have been extracted from five differing clients, to provide diversity in the outcomes.

Case Study 1

The first case study looks at the outcomes of applications where no defaults exist against where more than one default exists. It then compares the outcomes of applications where no telco defaults exist against where at least one telco default exists.



By combining the below client data, we can ascertain that the odds of an applicant going 'bad' where it contains a telco default actually occurs at a very similar rate to that of the general population. In fact, in all cases, the account performed worse where a telco default existed.

For the five clients, the results show a marginal difference when comparing the type of default, as a result, if credit policy dictated any differentiation in classifying the source of the default as telco and non-telco, it may have led to an increase in bad debt levels.

Client 1

The table below shows the population of all applications, irrespective of the source of the default.

Total Population Defaults	*# Goods*	*% Goods*	*# Bads*	*% Bads*	*% Total Pop*	*Odds*	*Index*	*Index Direction*
>= 1 default exists	1,857	**2.4**	410	**5**	12.3	**4.4**	187	Bad
No Default exists	76,641	**97.6**	7,863	**95**	87.7	**9.2**	112	Good
Total	78,498	**100**	8,273	**100**	100	**8.2**	100	

Here you can see that the odds of an applicant going 'bad' where a default exists are 4.4:1, that being 4.4 good applicants to every 1 bad applicant.

This next table shows the population of applications where a telco default exists.

Telco Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
1 telco default exists	948	**1.2**	240	**2.9**	6.5	**4.3**	190	Bad
2 telco defaults exist	44	**0.1**	13	**0.2**	1.5	**4.3**	190	Bad
No Telco Default exists	77,506	**98.7**	8,020	**96.9**	92	**8.9**	108	Good
Total	78,498	**100**	8,273	**100**	100	**8.2**	100	

Here you can see that the odds of an applicant going 'bad' where any telco default exists it is 4.3:1, where no telco default exists the odds are increased to 8.9:1.

Client 2

The table below shows the population of all applications, determine by whether a default exists, irrespective of source.

Total Population Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
>= 1 default exists	356	**0.8**	113	**2.1**	2.9	**3.2**	261	Bad
No Default exists	44,630	**99.2**	5,194	**97.9**	97.1	**8.6**	104	Good
Total	44,986	**100**	5,307	**100**	100	**8.2**	100	

Here you can see that the odds of an applicant going 'bad' where a default exists are 3.2:1, that being 3.2 good applicants to every 1 bad applicant.

This next table shows the population of applications determined by whether a telco default exists.

Telco Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
1 telco default exists	234	**0.5**	85	**1.6**	2	**3**	271	Bad
2 telco defaults exist	5	**0**	4	**0.1**	0.3	**3**	277	Bad
No Telco Default exists	44,747	**99.5**	5,218	**98.3**	97.6	**8.5**	104	Good
Total	44,986	**100**	5,307	**100**	100	**8.2**	100	

Here you can see that the odds of an applicant going 'bad' where any telco default exists are 3:1, where no telco default exists the odds are increased to 8.5:1.

Client 3

The table below shows the population of all applications, determine by whether a default exists, irrespective of source.

Total Population Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
>= 1 default exists	2,204	**4.6**	212	**12.9**	12.7	**6**	307	Bad
No Default exists	45,391	**95.4**	1,428	**87.1**	87.3	**25**	137	Good
Total	47,595	**100**	1,640	**100**	100	**18.3**	100	

Here you can see that the odds of an applicant going 'bad' where a default exists the odds are 6:1, that being 6 good applicants to every 1 bad applicant.

This next table shows the population of applications determined by whether a telco default exists.

Telco Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
1 telco default exists	903	**1.9**	104	**6.3**	5.5	**5.7**	271	Bad
2 telco defaults exist	119	**0.3**	16	**1**	1.6	**5.2**	277	Bad
No Telco Default exists	45,573	**97.9**	1,520	**92.7**	92.9	**21.6**	104	Good
Total	47,595	**100**	1,640	**100**	100	**18.3**	100	

Here you can see that the odds of an application going 'bad' where one telco default exists are 5.7:1 and where two telco defaults it is 5.2:1. Where no telco default exists the odds are increased to 21.6:1.

Client 4

The table below shows the population of all applications, determine by whether a default exists, irrespective of source.

Total Population Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
>= 1 default exists	713	**1.2**	321	**4.1**	7.6	**2.7**	255	Bad
No Default exists	58,297	**98.8**	7,551	**95.9**	92.4	**7.5**	111	Good
Total	59,010	**100**	7,872	**100**	100	**6.8**	100	

Here you can see that the odds of an applicant going 'bad' where a default exists the odds are 2.7:1, that being 2.7 good applicants to every 1 bad applicant.

This next table shows the population of applications determined by whether a telco default exists.

Telco Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
1 telco default exists	263	**0.4**	137	**1.7**	3.5	**2.6**	258	Bad
2 telco defaults exist	8	**0**	3	**0**	0.6	**2.8**	244	Bad
No Telco Default exists	58,739	**99.5**	7,732	**98.2**	95.7	**7.2**	105	Good
Total	47,595	**100**	7,872	**100**	100	**6.8**	100	

Here you can see that the odds of an applicant going 'bad' where one telco default exists are 2.6:1 and where two telco defaults exist it is 2.8:1. Where no telco default exists the odds are increased to 7.2:1.

Client 5

The table below shows the population of all applications, determine by whether a default exists, irrespective of source.

Total Population Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
>= 1 default exists	437	**2**	312	**4.8**	19.3	**1.5**	195	Bad
No Default exists	21,763	**98**	6,145	**95.2**	80.7	**3.4**	121	Good
Total	22,200	**100**	6,457	**100**	100	**2.8**	100	

Here you can see that the odds of an applicant going 'bad' where a default exists are 1.5:1, that being 1.5 good applicants to every 1 bad applicant.

This next table shows the population of applications determined by whether a telco default exists.

Telco Defaults	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
1 telco default exists	172	**0.8**	114	**1.8**	9.7	**1.5**	193	Bad
2 telco defaults exist	6	**0**	2	**0**	2	**1.5**	194	Bad
No Telco Default exists	22,022	**99.2**	6,341	**98.2**	87.7	**3.2**	111	Good
Total	22,200	**100**	6,457	**100**	100	**2.8**	100	

Here you can see that the odds of an application going 'bad' where one or two telco default exists are 1.5:1 and where two telco defaults exist it is 1.4:1. Where no telco default exists the odds are 3.2:1.

Case Study 2

Given that the first case study has proven that there is no differential in credit risk for telco defaults, the next scenario we will investigate is whether the amount of the default makes any difference to the odds of an application going bad.

The above graph combines the client data below to depict the good/bad odds of all defaults, irrespective of source, determined by the default amount. It also includes the total odds where a default exists, irrespective of amount. This data is derived from the first case study.

From the scenarios, all three clients show limited or no difference where the default is less than or equal to $500. Meaning that irrespective of the amount of the default, it is useful in predicting the risk of an applicant going bad.

Client 3
This next table shows the good/bad odds for applications by the amount of the default.

Default Amount	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
<= $500	1,124	**2.3**	104	**6.4**	5.2	**6.6**	278	Bad
>$500.00	939	**2**	89	**5.4**	7	**5.7**	320	Bad
No Default exists	45,532	**95.7**	1,447	**88.2**	87.8	**24.7**	135	Good
Total	47,595	**100**	1,640	**100**	100	**18.3**	100	

This shows a slight difference in the risk of an application relative to the amount of the default. However, comparatively to the odds for the total population, this differential is not varied enough to warrant differing credit policies.

Client 4
This next table shows the good/bad odds for applications by the amount of the telco default.

Default Amount	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
<= $500	342	**0.6**	173	**2.2**	3.6	**2.6**	256	Bad
> $500.00	239	**0.4**	90	**1.1**	3.7	**2.8**	245	Bad
No Default exists	58,429	**99**	7,609	**96.7**	92.7	**7.5**	110	Good
Total	59,010	**100**	7,872	**100**	100	**6.8**	100	

This shows no difference in the risk of an application relative to the amount of the default.

Client 5
This next table shows the good/bad odds for applications by the amount of the telco default.

Default Amount	# Goods	% Goods	# Bads	% Bads	% Total Pop	Odds	Index	Index Direction
<= $500	204	**0.9**	126	**2**	8.6	**1.5**	197	Bad
>$500.00	139	**0.6**	66	**1**	9.8	**1.5**	191	Bad
No Default exists	21,857	**98.5**	6,265	**97**	81.6	**3.4**	119	Good
Total	22,200	**100**	6,457	**100**	100	**2.8**	100	

Again, this shows no difference in the risk of an application relative to the amount of the default.

We specialise in understanding and advising on the correct processes to assist companies manage their credit decisioning process. We also provide comprehensive analysis of existing solutions to ensure optimal processes are maintained. Our vast experience in this market coupled with our in depth knowledge of the bureau, allow us to provide unbiased and comprehensive advise to companies in relation to their credit risk assessment.

Contact us to discuss how we can assist you with managing your credit decisioning process.