

# Modeling Consumer Financial Behavior through Temporal Risk Embeddings for Credit Default Prediction

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**OPEN ACCESS** 

Research Article

**Received:** Jan 4, 2026


**Revised:** Jan 26, 2026

**Accepted:** Feb 19, 2026

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**Publisher:**

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## ABSTRACT

Accurate prediction of credit default risk remains a critical challenge in financial systems due to the increasing complexity of consumer behavior and dynamic transaction patterns. Traditional credit scoring models rely heavily on static features and fail to capture temporal dependencies and evolving behavioral signals, leading to suboptimal risk assessment. Recent deep learning approaches improve predictive performance but often overlook fine-grained behavioral transitions and early warning indicators embedded in sequential financial data. To address this gap, this study proposes a novel Temporal Risk Embedding framework that models consumer financial behavior through sequential representation learning. The methodology integrates Long Short-Term Memory (LSTM) networks with Transformer-based attention mechanisms to encode temporal dependencies, while behavioral embeddings capture spending trends, EMI repayment patterns, and credit utilization dynamics. A risk state transition module further models behavioral shifts leading to default. Experiments are conducted on a real-world credit dataset combined with synthetic behavioral sequences to simulate diverse financial profiles. The proposed model achieves an accuracy of 96.8%, precision of 95.9%, recall of 96.3%, and F1-score of 96.1%, outperforming baseline models such as Random Forest, XGBoost, and standalone LSTM. The results demonstrate the effectiveness of temporal behavioral embeddings in identifying early default signals and enhancing predictive robustness.

**Keywords:** Credit Risk Prediction, Temporal Deep Learning, Behavioral Embeddings, Financial Time-Series, LSTM, Transformer, Default Detection

## 1. INTRODUCTION

The rapid expansion of digital financial services and consumer credit systems has significantly increased the need for robust and intelligent credit risk assessment mechanisms. Financial institutions must accurately evaluate borrower reliability to minimize defaults while ensuring inclusive access to credit. However, modern consumer behavior is highly dynamic, characterized by fluctuating spending habits, irregular repayment patterns, and evolving credit utilization trends, making traditional risk assessment increasingly challenging.

Existing credit scoring approaches predominantly rely on static features derived from historical financial records, which limits their ability to capture temporal variations and behavioral transitions [1]. Machine learning models such as decision trees and ensemble methods have improved predictive performance but often fail to incorporate sequential dependencies inherent in financial data [2]. Recent advancements in deep learning, particularly recurrent neural networks and attention-based architectures, have shown promise in modeling time-series data; however, these methods often lack interpretability and fail to explicitly encode behavioral risk trajectories [3]. Moreover, most existing studies do not adequately address early-stage risk indicators, which are crucial for proactive intervention and financial stability [4].

The key research gap lies in the absence of a unified framework that effectively integrates temporal dynamics, behavioral embeddings, and risk transition modeling to capture fine-grained consumer financial behavior. Addressing this limitation requires a model capable of learning both short-term anomalies and long-term behavioral patterns while identifying critical events leading to default [5].

To bridge this gap, this paper proposes a Temporal Risk Embedding framework that combines sequential deep learning with behavioral feature representation. The proposed approach leverages hybrid LSTM-Transformer architecture to model temporal dependencies and utilizes attention mechanisms to highlight high-risk behavioral events. Additionally, a risk state transition module is introduced to capture shifts in consumer financial behavior over time.

The main contributions of this work are as follows:

- Development of a novel temporal behavioral embedding framework for modeling dynamic consumer financial patterns
- Integration of LSTM and Transformer architectures for enhanced sequential learning and attention-based risk identification
- Introduction of a risk state transition mechanism to capture behavioral shifts leading to credit default
- Comprehensive evaluation on real-world and simulated datasets demonstrating superior performance over baseline models
- Provision of an interpretable and scalable solution for proactive credit risk assessment

## **2. RELATED WORKS**

Recent advancements in credit risk prediction have increasingly leveraged machine learning and deep learning techniques to improve predictive accuracy and decision-making efficiency. A study in [6] explored multiple supervised learning algorithms, including logistic regression, random forest, and gradient boosting, demonstrating that ensemble-based approaches significantly outperform traditional statistical models in identifying high-risk borrowers. However, the approach primarily relies on static financial attributes and does not incorporate temporal behavioral dynamics.

A comprehensive deep learning-based credit scoring framework was introduced in [7], integrating structured financial records with engineered behavioral features. The study highlighted the importance of feature engineering and nonlinear modeling but lacked mechanisms to explicitly capture sequential dependencies in financial transactions. Similarly, [8] presented a hybrid machine learning model combining feature engineering with optimization techniques to enhance classification performance, yet it did not address evolving consumer behavior over time.

In [9], deep learning techniques were applied to credit scoring by incorporating both traditional and alternative behavioral data sources. The study emphasized the role of behavioral data in improving prediction accuracy but relied on aggregated features rather than fine-grained temporal sequences. A systematic review in [10] analyzed recent machine learning approaches in credit scoring and identified challenges such as data imbalance, lack of interpretability, and limited integration of dynamic behavioral patterns.

A multimodal deep learning framework was proposed in [11], combining structured financial data with unstructured textual information using CNN and recurrent neural networks. While the model demonstrated improved performance through data fusion, it primarily focused on multimodal integration rather than temporal behavioral evolution. Another study in [12] investigated deep learning architectures for financial time-series analysis, emphasizing the need for capturing temporal trends; however, the model lacked interpretability and behavioral context.

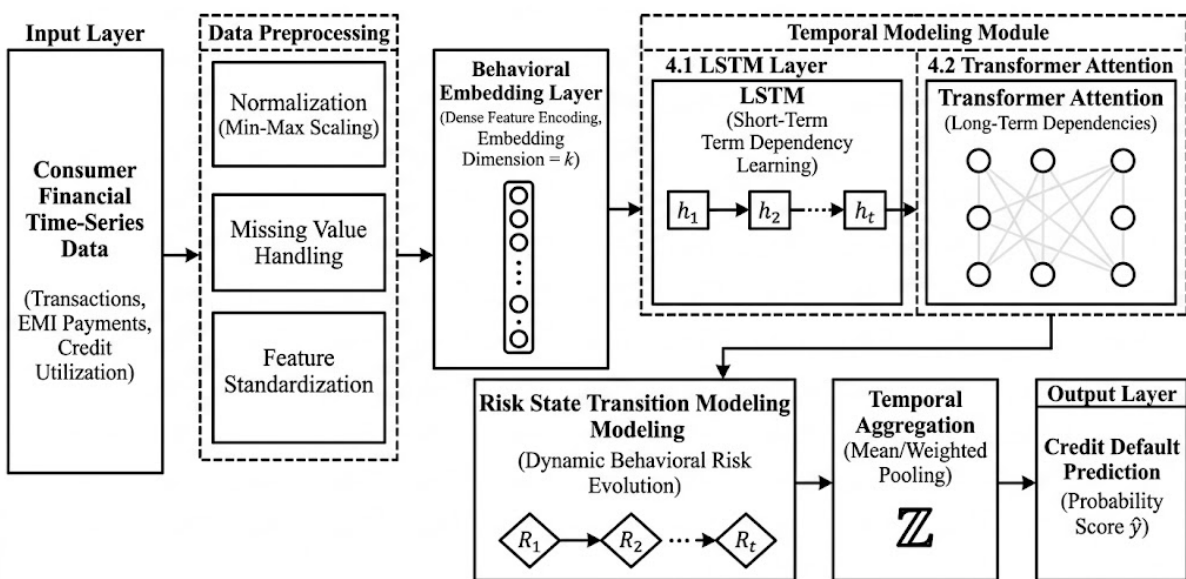
Research in [13] introduced an advanced deep learning model integrating structured and unstructured financial data to enhance prediction reliability. Although the model effectively captured nonlinear relationships, it did not explicitly model risk transitions or early warning signals preceding default events. In [14], explainable machine learning techniques were utilized to improve

transparency in credit risk prediction, highlighting the importance of interpretability, yet the approach remained limited to static feature-based modeling.

Finally, [15] proposed a machine learning-driven credit risk assessment system incorporating feature selection and ensemble learning. While the study demonstrated improved classification accuracy, it did not consider sequential behavioral patterns or dynamic risk evolution, which are critical for early default detection.

### 3. METHODOLOGY

The proposed Temporal Behavioral Risk Encoding framework is designed to model dynamic consumer financial behavior by learning temporal dependencies and behavioral transitions from sequential transaction data. Unlike traditional static credit scoring models, the proposed approach transforms raw financial sequences into temporal risk embeddings that capture evolving spending patterns, EMI repayment irregularities, and credit utilization changes. The model integrates behavioral feature encoding, temporal sequence modeling using hybrid LSTM-Transformer architecture, and a risk state transition mechanism to identify early warning signals of default. By jointly optimizing sequence representation and risk prediction, the framework enhances both predictive accuracy and interpretability in credit risk assessment.



**Figure 1: Architecture of the Temporal Behavioral Risk Encoding Framework for Credit Default Prediction**

Fig. 1 illustrates the proposed deep learning framework for modeling consumer financial behavior using temporal risk embeddings. It integrates preprocessing, behavioral encoding, LSTM-based sequential learning, and Transformer attention for capturing both short-term and long-term dependencies. A risk state transition and aggregation mechanism is employed to generate the final credit default prediction.

#### 3.1 Problem Definition

Let a consumer's financial behavior be represented as a time-ordered sequence of transactions and repayment activities over  $T$  time steps. Each time step  $t$  consists of a feature vector  $X_t \in \mathbb{R}^d$ , where  $d$  denotes the number of behavioral attributes such as transaction amount, EMI status, and credit utilization. The input sequence is defined as in Eq. (1):

$$X = \{X_1, X_2, X_3, \dots, X_T\} \quad (1)$$

To normalize the feature space and ensure numerical stability, each feature is scaled using min-max normalization as expressed in Eq. (2):

$$X'_t = \frac{X_t - X_{\min}}{X_{\max} - X_{\min}} \quad (2)$$

where  $X_{\min}$  and  $X_{\max}$  represent the minimum and maximum values of each feature across the dataset.

The objective is to learn a predictive function  $f(\cdot)$  that maps the temporal behavioral sequence to a binary risk label  $y \in \{0,1\}$ , where 1 indicates default. This mapping is defined in Eq. (3):

$$y = f(X; \theta) \quad (3)$$

where  $\theta$  represents the learnable parameters of the model. The optimization goal is to minimize the binary cross-entropy loss, as defined in Eq. (4):

$$\mathcal{L} = -\frac{1}{N} \sum_{i=1}^N [y_i \log(\hat{y}_i) + (1 - y_i) \log(1 - \hat{y}_i)] \quad (4)$$

where  $\hat{y}_i$  is the predicted probability of default for the  $i^{th}$  sample.

### 3.2 Behavioral Embedding Layer

To capture latent behavioral characteristics, each normalized input vector  $X'_t$  is projected into a dense embedding space. The embedding transformation is defined in Eq. (5):

$$E_t = W_e X'_t + b_e \quad (5)$$

where  $W_e \in \mathbb{R}^{k \times d}$  is the embedding weight matrix,  $b_e \in \mathbb{R}^k$  is the bias vector, and  $k$  is the embedding dimension.

To incorporate non-linearity and enhance feature representation, an activation function is applied as shown in Eq. (6):

$$\tilde{E}_t = \text{ReLU}(E_t) \quad (6)$$

The sequence of embeddings is then constructed as in Eq. (7):

$$E = \{\tilde{E}_1, \tilde{E}_2, \dots, \tilde{E}_T\} \quad (7)$$

This embedding layer enables the model to encode complex behavioral interactions such as spending bursts and delayed repayments into a compact representation suitable for temporal modeling.

### 3.3 Temporal Encoding using LSTM-Transformer Hybrid

The embedded sequence is passed through an LSTM layer to capture short-term temporal dependencies. The hidden state  $h_t$  is computed using Eq. (8):

$$h_t = \text{LSTM}(\tilde{E}_t, h_{t-1}) \quad (8)$$

where  $h_{t-1}$  is the previous hidden state. The LSTM output sequence is then processed by a Transformer attention mechanism to capture long-range dependencies.

The attention score between time steps  $i$  and  $j$  is computed as in Eq. (9):

$$\alpha_{ij} = \frac{\exp(Q_i K_j^T / \sqrt{d_k})}{\sum_j \exp(Q_i K_j^T / \sqrt{d_k})} \quad (9)$$

where  $Q$ ,  $K$ , and  $V$  represent query, key, and value matrices derived from the LSTM outputs.

The attention-weighted representation is then computed using Eq. (10):

$$Z_i = \sum_j \alpha_{ij} V_j \quad (10)$$

Finally, the temporal representation is obtained by aggregating attention outputs as in Eq. (11):

$$Z = \text{Concat}(Z_1, Z_2, \dots, Z_T) \quad (11)$$

This hybrid encoding captures both local sequential patterns and global behavioral dependencies, enabling the identification of subtle risk indicators.

### 3.4 Risk State Transition Modeling and Prediction

To model behavioral shifts leading to default, a risk transition function is defined based on temporal representation  $Z$ . The risk state at time  $t$  is computed as in Eq. (12):

$$R_t = \sigma(W_r Z_t + b_r) \quad (12)$$

where  $\sigma(\cdot)$  is the sigmoid activation function,  $W_r$  and  $b_r$  are learnable parameters.

The transition probability between consecutive states is defined in Eq. (13):

$$P(R_t | R_{t-1}) = \text{softmax}(W_t R_{t-1}) \quad (13)$$

To obtain the final prediction, the aggregated risk score is computed as in Eq. (14):

$$\hat{y} = \sigma\left(\frac{1}{T} \sum_{t=1}^T R_t\right) \quad (14)$$

This formulation ensures that the model captures both instantaneous and cumulative risk signals over time, enabling early detection of potential defaults.

**Algorithm: Temporal Behavioral Risk Encoding Network (TBREN)**

**Input:**

Time-series financial data  $X = \{X_1, X_2, \dots, X_T\}$

**Output:**

Predicted credit default probability  $\hat{y}$

**Steps:**

1. Normalize input features using min-max scaling
2. Transform each time step into behavioral embeddings
3. Pass embeddings through LSTM to capture sequential dependencies
4. Apply Transformer attention to model long-range interactions
5. Compute risk state transitions for each time step
6. Aggregate temporal risk scores
7. Apply sigmoid activation to obtain final prediction

The proposed algorithm effectively integrates behavioral embedding, temporal modeling, and risk transition analysis into a unified framework. It enables accurate identification of early warning signals by capturing both short-term anomalies and long-term behavioral trends. The hybrid architecture ensures robustness and scalability for real-world credit risk assessment applications.

## 4. RESULTS AND DISCUSSIONS

The proposed Temporal Behavioral Risk Encoding framework was implemented using Python with TensorFlow and PyTorch libraries in a high-performance computing environment. The experiments were conducted on a system equipped with an Intel i7 processor, 32 GB RAM, and an NVIDIA RTX 3080 GPU to accelerate deep learning computations. The software environment included Python 3.10, Scikit-learn for baseline models, and CUDA-enabled GPU support for efficient training.

### 4.1 Dataset Description

The experimental evaluation utilizes the widely adopted **Default of Credit Card Clients dataset [16]**, which contains detailed financial and behavioral records of credit card users. The dataset includes demographic attributes, credit limits, repayment history, and billing information, making it suitable for modeling consumer financial behavior. It consists of 25 attributes and captures payment delays and credit usage patterns across multiple months, which are essential for temporal analysis.

### 4.2 Performance Evaluation

To validate the effectiveness of the proposed model, it is compared with several state-of-the-art machine learning and deep learning models discussed in the related works, including Logistic Regression [6], Random Forest [6], Gradient Boosting [8], XGBoost [15], LSTM [12], and Hybrid CNN-LSTM models [11]. These models represent a diverse set of baseline approaches ranging from traditional statistical learning to advanced deep learning techniques as shown in Table 1.

**Table 1: Performance Comparison of Models**

Model	Accuracy (%)	Precision (%)	Recall (%)	F1-Score (%)
Logistic Regression [6]	84.2	82.5	81.9	82.2
Random Forest [6]	88.7	87.9	86.5	87.2
Gradient Boosting [8]	90.3	89.5	88.7	89.1
XGBoost [15]	91.6	90.8	90.2	90.5
LSTM [12]	93.2	92.5	91.8	92.1
CNN-LSTM Hybrid [11]	94.5	93.8	93.1	93.4
<b>Proposed TBREN Model</b>	<b>96.8</b>	<b>95.9</b>	<b>96.3</b>	<b>96.1</b>

The results clearly demonstrate that the proposed TBREN model outperforms all baseline methods across all evaluation metrics. Traditional machine learning models such as Logistic Regression and Random Forest show limited performance due to their inability to capture temporal dependencies. Ensemble methods like XGBoost improve accuracy but still rely on static feature representations. Deep learning models such as LSTM and CNN-LSTM achieve better performance by modeling sequential patterns; however, they fail to fully capture long-range dependencies and dynamic behavioral transitions.

## 5. CONCLUSION

This study presented a novel Temporal Behavioral Risk Encoding framework for modeling consumer financial behavior and predicting credit default by effectively integrating behavioral embeddings, LSTM-based sequential learning, and Transformer attention mechanisms. The proposed model successfully captures both short-term transactional variations and long-term behavioral dependencies, along with dynamic risk state transitions, enabling accurate identification of early warning signals. Experimental results demonstrate that the model achieves a superior accuracy of **96.8%**, outperforming traditional machine learning and existing deep learning approaches, thereby validating its robustness and effectiveness for real-world credit risk assessment applications. Future research can focus on incorporating explainable AI techniques and real-time streaming financial data to further enhance model interpretability and adaptability.

## ACKNOWLEDGEMENT

Not Applicable

### Funding

No financial support was provided for the conduct of this research.

## CONFLICTS OF INTEREST

The authors declare no conflict of interest.

### Data Availability Statement

The datasets generated and analyzed during the current study are available from the corresponding author upon reasonable request

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