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## Hello

Welcome to the March 2010 edition of Euristix Insight, our newsletter which seeks to deliver unique commentary and information in the changing world of credit and portfolio management.

In the last edition we presented the benefits of outsourcing as a cost-effective means to enhance risk management capability. We follow that up this month in our lead article; a case study illustrating exactly how such a relationship has benefited one of our clients. Also following on from the last edition, our 'Achieving Best Practice' piece presents some of our advances in the field of economic stress-testing. Finally, our 'Questions Corner' highlights some key considerations in the management of successful funding relationships, an area of vital importance in the current economic climate.

As ever, please contact us with any questions regarding any aspect of risk management or with feedback regarding our articles and newsletter.

Kind regards,

Chris Kemp



## In this edition...

**Outsourcing Case Study** - Buy As You View have engaged with Euristix to enhance their risk management capability through the use of best practice risk analytics components. Our lead article is a case study highlighting the benefits of this outsourced engagement.

**Questions Corner** - Funding is at the forefront of considerations for many at the moment. Here we consider some key questions in the area of managing investor relationships.

**Economic Stress-Testing Using Customer Susceptibility** - Last edition's lead article outlined some of the reasons why stress-testing can be considered to have failed in light of the recent economic downturn. As a positive counterpoint to this, our 'Achieving Best Practice' article presents some of our recent research in this area and a new cutting-edge methodology that bypasses many of the issues.

## An Outsourcing Case Study



Last edition's 'Achieving Best Practice' article (available [here](#)) discussed the potential benefits of an outsourcing partnership as a means to achieve analytical and risk-management excellence. This type of engagement can provide access to tools, skills and knowledge not available internally and drive a real step-change in risk management capability.

Buy As You View, the asset-based specialist lender have engaged Euristix to provide key risk management components and help them drive secure business growth. A more detailed case-study presenting the structure and benefits of the engagement can be found [here...](#)

## Questions Corner - Funding Relationships

Funding considerations are absolutely critical to business success and now more than ever funders are scrutinising every aspect of their investments. Businesses need to support their funding relationships with the right information and insight presented in the right way. Consider the following quick questions:

- Do you fully understand what information funders like to see to understand the risk profile of your assets, and how that information should be presented?
- Is the credit risk information you regularly present designed especially for investors, or do you re-use existing reports and MI?
- Do you feel that your funders really understand your portfolios of assets and where the value is generated?

- Who in the business provides risk inputs to the funding relationship? Are they fully aware of their roles and responsibilities with respect to managing this investor relationship?
- When meeting potential funders, do you know what they expect to see from a risk perspective to give them the confidence to invest?

In a future edition of Euristix Insight we will discuss some of the key issues surrounding funding negotiations and investor confidence. In the meantime, please direct any questions to [vincent.bordes@euristix.com](mailto:vincent.bordes@euristix.com)

### Achieving Best Practice - Economic Susceptibility

**Problem** - One side-effect of the recent economic downturn has been to highlight the flaws in many lenders' stress-testing frameworks. The standard methodologies tended to involve using historical portfolio and economic trends to develop link models between portfolio performance and the macro-economic climate. But what these models really capture is the mechanics of past recessions; they function poorly when applied to a new downturn driven by different factors.

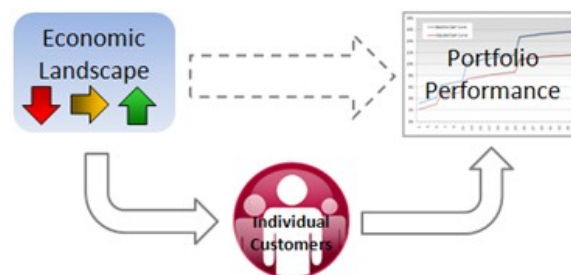
So the credit industry finds itself in a situation where the importance of stress-testing is more clearly understood than ever before, but there is little confidence in the stress-testing approaches that have commonly been used in the past.

**Approaches** - Many are taking a far more heuristic approach of the whole stress testing problem, placing greater reliance on expert judgement. Certainly it is the case that stress testing needs to be broader and more encompassing of a range of potential shocks, both to the economy and the market. The difficulty with such approaches of course is that there is limited experience available on which to build the expert knowledge required.

Others are beginning by stressing not outside factors such as the economy and the market, but their own business. What is the impact of changes in costs, sales, bad rates, funding costs and so on - all internally tracked components of the business. This is the first step in the new regulatory favourite of reverse stress-testing; understanding what level of performance drop will 'break' the business. The same complications arise however when it comes to understanding what external factors could drive the internal stresses being analysed.

**Best of Breed** - While the broadening of the scope for stress-testing and the introduction of an heuristic component within the process are to be lauded, is it really sensible to turn away from real data? Historic economic data has proved to be of limited usefulness, but there are alternative data-driven approaches that can be highly effective in economic stress testing and Euristix has developed one such customer-centric methodology.

The crux of the Euristix approach is that portfolio performance is not driven directly by the economy, but by the customer base. This is true for any consumer based credit business, from specialist mortgage or sub-prime lenders through to debt collection agencies. The reason that economic changes impact the portfolio is because those economic changes are having a direct effect on the individuals in the portfolio, changing their situations and resulting behaviour.



Understanding the susceptibility of individuals to different economic shocks is key to developing a stress-testing framework, and not just at portfolio or segment level, but at customer level. Homeowners are more susceptible to interest rate increases as variable rate mortgage payments shoot up; rising CPI will hit the man supporting a family of three far more than the 20 year old youth still living at home.

Not only does this approach allow for the development of a robust economic stress-testing framework, it provides a better understanding of customers and the drivers of behaviour. Using this insight in an operational situation can allow mitigating actions to be taken on accounts flagged as particularly susceptible to the prevailing economic climate. From marketing to pre-delinquency account management and collections, this can be invaluable information for risk management.

For the full article on the Euristix approach to economic stress testing through understanding customer susceptibility, see [here](#). If you have any questions or would like more information on the Euristix offerings in this area, please contact [paul.matthews@euristix.com](mailto:paul.matthews@euristix.com)

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