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Hello

Welcome to the latest edition of Euristix Insight, where we continue to provide insight, information and assistance in the changing world of credit and portfolio management. This edition's lead article focusses on the changes affecting the UK mortgage market and how best to thrive in these challenging conditions. We also discuss the best approach for exploiting the expanding 'near prime' market, whilst our 'Questions Corner' asks you to consider the impact of recent economic changes on your scoring systems. We welcome any feedback you may have and please contact us with any questions.

Kind regards,

Chris Kemp



In this edition...

Thriving in a Challenging Mortgage Market - our lead article gives the Euristix view on the issues faced by today's mortgage lenders and discusses how to turn a time of turmoil into one of opportunity.

Questions Corner - In this edition we ask how the recent economic changes will have impacted your scoring and decision models.

Exploiting 'Near Prime' Opportunities - Both prime and sub-prime lenders view the 'near prime' sector as an area for potential growth. Our 'Achieving Best Practice' article discusses the pit-falls and the best approaches to derive value in this important market segment.

Thriving in a Challenging Mortgage Market



The recent economic upheaval has had a profound impact on the mortgage market. This traditionally stable area is seeing significant changes happening at a bewildering pace, from rising arrears and falling house prices to increasing capital constraints amid evaporating funding.

In this altered market, established models may no longer function, making choosing the correct actions much more difficult. Pursuing out-of-date strategies can be disastrous, but over-conservatism leads to lost opportunities and sub-optimal use of precious capital.

Survival and success in this new environment requires the clearest insight and the best tools applied in the optimal way. Marrying detailed portfolio understanding with account-level forecasting and stress-testing will provide the clarity and vision required to reassure Product, Risk and Finance Directors alike. For more details please read the [full article here...](#)

Questions Corner - Decisioning Deterioration

As the economy changes and consumer behaviours shift, many lenders are slow to assess how this may be impacting their scoring models. To understand whether the decision tools in your business could be hemorrhaging value, consider the following questions:

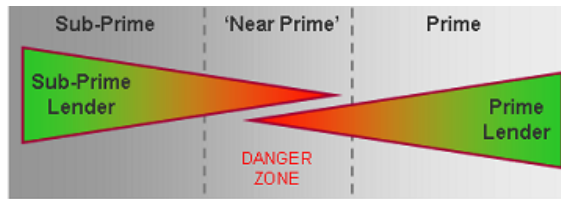
- Most statistical models are based on an assumption that the future will be like the past. Have you seen any shifts in consumer behaviour or account performance recently?
- How many statistical models are used within your business and how many of these were created more than 12 months ago?
- Are your models monitored regularly and efficiently and do you have an accurate view of current vs expected model performance?

- Are the decision strategies which overlay these models, such as score cut-offs, still optimal or do they need updating?
- All models deteriorate over time, but most lenders will find that deterioration has accelerated recently. Do you understand the effect of this deterioration on value and its impact on the profitability of the business?

For more information on the problems associated with out-of-date scorecards and what Euristix can do to help, please [link to this article](#). If you have any questions on this matter, please contact paul.matthews@euristix.com

Achieving Best Practice - The 'Near Prime' Market

Problem - In an effort to secure market share and drive growth, both prime and sub-prime lenders often turn to the so-called 'near prime' segment, albeit from different directions. In both cases, these lenders are commonly surprised that performance is very different to expectation, and their endeavours can incur significant losses.



Approaches - The key reason for the problems lenders encounter in 'near prime' is that they approach the segment as a simple extension of their existing market, applying the same business model and expecting to simply extrapolate customer performance. Prime lenders often just lower their cut-offs and are surprised when the resulting losses are much greater than predicted in the business plan. Similarly, sub-prime lenders find that the strategies that work well in their traditional space function poorly in 'near prime', with collections being a common issue. 'Near prime' customers are often more transient than their sub-prime counterparts making recovery of debts far harder than anticipated.

Best of Breed - To truly exploit the 'near prime' segment, it is necessary to implement a responsive and robust business model, specifically tailored to this market.

The start point is to build an accurate and comprehensive business case which forecasts not just expected losses, but the individual PD, EAD and LGD components. Perhaps even more importantly, these measures should be extensively stress tested to give a true indication of possible business performance; both prime and sub-prime lenders are often wrong-footed by the levels of volatility shown in this transitional zone when compared to their own relatively stable sectors.

Forecasts for these key components can be translated into detailed performance forecasts for customers and the business. Tolerances need to be set around these expected performance metrics, with pre-defined action plans being triggered in case of significant deviation.

Pre-defined tolerances and actions help to achieve one of the key ingredients for success in this space - responsiveness. The ability to not only quickly recognise deviations from base-line, but to swiftly take appropriate actions is vital here. The importance of monitoring all aspects of customer performance cannot be over-stated, with the production of timely, accurate and detailed management information being imperative.

It is necessary to forecast not only customer performance, but also any increased costs incurred by entering this sector. Prime lenders in particular may find it necessary to overhaul their collections processes to succeed. Pre-delinquency activities to prioritise their payment above others and more extensive late-phase collections actions such as field visits, are important but expensive aspects of near-prime business. These costs need to be accurately captured and incorporated into the business plan.

Entering into a new area of the market with insufficient preparation and insight can lead to big losses and significantly damage an unwary organisation. However, with the correct business model in place, and with robust processes installed to support it, the 'near prime' sector can provide excellent opportunities for growth and profit. For information on

the Euristix approach to this area or for any more general queries,
please contact martin.rowe@euristix.com

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