Euristix

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Hello

Welcome to the January 2009 edition of Euristix Insight, our newsletter which seeks to deliver unique commentary and information in the changing world of credit and portfolio management.

This year promises to be a turbulent one in many ways and we will continue to provide insightful perspectives on the many ups and downs of the industry. Our lead article considers the future of sub-prime lending, which while being an anathema to many is also one of the largest potential areas for growth. In 'Question's Corner' we ask you to consider whether Basel model validation can offer real opportunity for benefit, before ending on a review of how to achieve best practice when considering and using data from multiple bureaus.

Please contact us with any questions. We also welcome any feedback you may have.

Kind regards,

Chris Kemp.

In this edition...

The Future of Sub-Prime Lending - Can sub-prime lending survive and be profitable in today's economic climate? Our lead article discusses the complex issues surrounding this market, which grows ever larger as 'mainstream' lenders tighten their belts.

Questions Corner - Can the regulatory chore of Basel model validation actually provide tangible benefit?

Multi-Bureau Decisioning - As lenders grow increasingly cautious, more and more are turing to multi-bureau solutions for added security. Our 'Achieving Best Practice' article discusses the potential pitfalls of multi-bureau process design, and the steps required to achieve optimum results.

Where Now for Sub-Prime Lending?

The sub-prime sector, vilified and demonised as a primary trigger of the credit crunch in the US, is an unpalatable area for most lenders in today's conservative market. However, as these mainstream lenders restrict their lending, the simple truth is that more and more borrowers can now be considered 'sub-prime'.

This issue's lead article considers the future of sub-prime lending in the UK, given the upheavel that has been seen in both the financial markets and the wider economy. Is sub-prime lending still a viable proposition in today's troubled economic landscape? Does it in fact offer one of the few remaining opportunities for growth and profit? Or is it an out-dated relic of the growth bubble, soon to become extinct?

For a comprehensive review of the sub-prime market, please read the **full article here...**

Questions Corner - Extracting Value from Basel II

Lenders have made significant investment in recent years to comply with the new capital directives as defined by Basel II and the FSA. This ranges from the building of probability of default (PD) models for the calculation of capital to achieving adherence to the use test demonstrating the integration of the tools within the business.

However, are lenders extracting the most value from this investment and utilising the new tool set that exits under Basel II? To answer this, lenders should be asking themselves some of the following questions:

- Are the new models I have such as PD and LGD being used for analytics and forecasting in areas other than capital calculations?

- Is Basel II understood across the business and is the impact on Basel II metrics fully incorporated into the decision making process of management and committees?

- Are the Basel II metrics integrated into existing reports and providing additional insight to what is already available?

- When designing, building and analysing strategies are the new Basel models and tools included in the process to add additional information?

- Is stress testing just seen as a 'tick in the box' exercise, or is it fully integrated into management decisions for planning and budgeting?

- Has the use test been fully adopted across the credit cycle and are strategy changes been made as a result of its roll out?

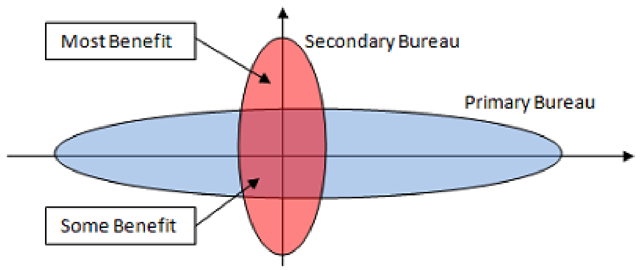
In the next edition of Euristix Insight, we will provide our view on how best to drive value from the Basel II framework by addressing the questions above. In the meantime, if you wish to know how Euristix can help you in this area, then please contact vincent.bordes@euristix.com

Achieving Best Practice - Multi-Bureau Decisioning

Problem - As arrears rise and losses grow, lenders look for more advanced and comprehensive ways to make their lending decisions. One appealing approach which is receiving increasing focus in a number of sectors is the use of multi-bureau solutions. However, multiple bureau calls incur additional cost and if the resulting data is not used correctly and reconciled completely with the application process, then the costs can easily outweigh the gains.

Approaches - Many lenders have become familiar with the content, layout and added-value products of their primary bureau provider and expect additional bureau sources to function similarly. The expectation is that multi-bureau will provide 'enriched' versions of familiar characteristics that can be used in decisioning systems that are structurally similar to their single-bureau predecessors. While this is true to some extent, it is precisely those areas where the bureaus differ that offer the greatest opportunities for deriving additional benefit, and it is of tantamount importance that these are not overlooked. If the new solution does not truly exploit all aspects of the additional bureau data, then the realised benefit will be greatly diminished.

Best of Breed - There are a number of key factors driving the success of a multi-bureau decisioning system. Firstly it is vital to have an excellent understanding of the capabilities and short-comings of all the bureaus involved, including the primary supplier. All three bureaus within the UK have their own strengths, which can be exploited, and their own weaknesses, which can be accounted for in a multi-bureau framework. The true benefit of a multi-bureau process comes from identifying dimensions within the data space that are not covered by the primary bureau, rather than simply adding additional data along existing axes.



Uncovering these additional dimensions requires detailed analysis, whether they stem from unique variable sets, different address matching and data amalgamation, or proprietary bureau scores. Exploring not only the true depth of data, but also the full range of possible applications of that data, will give an accurate understanding of the value-generation opportunities of the multi-bureau solution. This understanding can then inform one of the key decisions in multi-bureau design – what precisely is meant by 'multi'? With the exception of large banking organisations, most lenders will find the added cost and complexity of a tri-bureau solution outweigh the incremental benefit over a dual-bureau process. The choice of which secondary bureau to use is of vital importance and depends on a huge array of factors, from the sector & customer demographic, to the primary supplier & business goals. Thorough analysis of the performance of the data within the decision process is required to ensure a true benefit-maximising decision.

As important as 'how' to utilise the supplemental bureau data is 'when'. While some lenders may find it beneficial to call multiple bureaus for all applicants, many will find the optimal cost-effectiveness is realised through targeted calls. This requires a well-informed strategy driven by the results of the primary bureau call, the appetite of the business, and a clear view of where the additional bureau will deliver value. Using multi-bureau information to enhance decisions around any score cut-off is one obvious application, but maximum benefit can only be realised through the correct selection of the 'marginal' group and careful specification of the override process, again realised through analytical evaluation. Away from the marginal cases, take-up rates can be improved by using positive multi-bureau data to raise loan amounts or limits to match customer requests, beyond the caps set using the single bureau data. Designing a successful targeted strategy relies on identifying those customers where additional data is likely to be found and where that additional data will have a material & beneficial impact on the decisioning process.

Designing and implementing an efficient multi-bureau decisioning process is a complex undertaking requiring detailed and thorough analytics to underpin it. However, the benefits of a well-realised system can be huge, unlocking the true potential of the multi-bureau set-up. Conversely, a sub-optimal implementation which misses the true strengths of the additional bureau can add complexity and cost while leaving the real benefit untapped.

For information on the Euristix approach to this area or for any more general queries, please contact paul.matthews@euristix.com

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