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Hello

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

The various sectors of the industry continue to deal with the fall-out of recent economic upheavals. Our lead article deals with the topical issue of identifying fraud in Buy-to-Let portfolios, much of which had remained hidden in happier times and is only now coming to light. Our achieving best practice section covers the best use of economic stress testing in the debt collections space; any changing environment brings with it opportunities as well as pitfalls! While focussing on the Debt Purchase and DCA space, the techniques applied and the key messages shown can be applied across the credit industry.

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

Kind regards,

Chris Kemp.



In this edition...

Identifying Fraudulent Activity within a BTL Portfolio - Recent months have seen a number of disclosures of fraud issues within leading Buy-to-Let (BTL) lenders. Our lead article considers the optimum framework for identifying this fraud, both to size potential losses and to drive mitigating actions.

Questions Corner - With focus fundamentally shifting from origination to debt collections, we consider some of the key questions involved in the creation of collections or propensity to pay scorecards.

Scenario Testing Wins for DCAs / Debt Purchasers - Understanding the impact of the economy on cash recoveries rates is vital for any DP or DCA wanting to succeed. But the knowledge is just the tip of the iceberg; the real wins come from a best practice approach to using that knowledge to best effect within the organisation.

Identifying Fraudulent Activity in a BTL Portfolio



While the economy may be stabilising and confidence slowly returning to the credit markets, the mortgage sector is facing fresh problems as the dust begins to settle. In the wake of a slew of merger deals, recent months have seen a number of disclosures of fraud problems in the books of leading Buy-to-Let (BTL) lenders.

Given the size of the BTL market in the UK, it can only be expected that further disclosures will be forthcoming from a number of other lenders. The current low interest rate environment may be conspiring to hide these problems, but if interest rates rise or economic hardships continue, through rising unemployment or depressed house values, then these will undoubtedly come to light.

For details on the Euristix approach to identifying and sizing the particular fraud associated with BTL lending, please see the [full article here...](#)

Questions Corner - Scoring for Collections

Collections scorecards are commonly used by Debt Collections Agencies and by lenders to define their collections strategies, both in terms of prioritisation and content. Just as scorecards used for underwriting loans are impacted by previous policy rules, so too collections / propensity-to-pay scorecards are strongly influenced by past collections strategies.

- How are your scorecards impacted by changes that are made to collections strategies?
- Does your model development process incorporate the effect of strategy changes?
- How do you capture the cost of collections strategies within your models?
- Does your propensity model consider full and final settlements separate to payment plans?
- Do you feel that your Analytics team is close enough to Operations?

In a future edition of Euristix Insight, we will provide our view on how best to resolve some of the issues with collection modelling. 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 - Scenario Testing in DCA/DPs

Problem - Cash collection rates within most collections departments have taken a pounding in the last two years. Nowhere has this pain been felt more acutely than within the Debt Purchase and DCA space; settlement revenues collapsed shortly after the 'crunch' and now payment plans are being eroded by the insidious forces of unemployment and low consumer confidence. Anticipating the future, choosing the right strategies and setting the right prices and commission rates has become a minefield in the ever-shifting sands of today's economic climate.

Approaches - As DCAs and DPs belatedly realise just how susceptible they are to the vagaries of the economy, there has been huge focus on updating their cash curve forecasts. These are so fundamental to the business that getting them wrong can spell disaster! With previous curves proving hopelessly optimistic, the challenge now is to derive curves which are not only accurate right now, but which can dynamically adapt as the economy evolves.

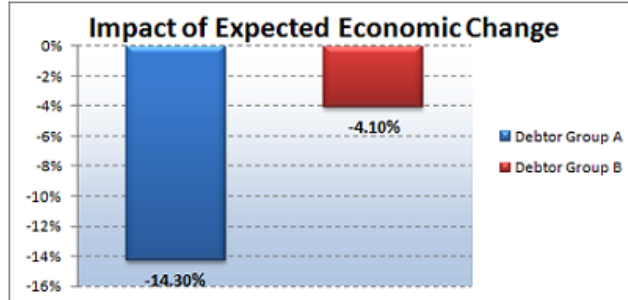
The approaches taken range from the naively simplistic (applying a reduction factor to existing curves, rebuilding curves monthly on the latest data) to the complex (mapping historic macro-economic indices to past portfolio performance), but all have two key things in common. Firstly they are at a portfolio, or at best a segment level, giving information only at a summarized aggregate level. Secondly, they are predominantly backwards-looking and reactive, either adapting to change after it has happened, or using previous (and potentially unrelated) economic shifts to determine performance.

Best of Breed - Armed with forecasts that are not only accurate but which allow for flexible testing of any economic scenario, it is possible to change the fluctuating economy from a thorn in the side to a source of huge returns. The key is to produce cash curves that function at an account level and which accurately capture the impact of any economic projection.

The production of such a scenario testing platform is a hugely interesting topic! Keep an eye on future newsletters for more articles on the ground-breaking work that Euristix has been undertaking in this area. But for now let us assume that the investment has been made and this capability is available – how to use it to the greatest advantage?

Obviously, simply having an accurate view of future performance is in itself a huge boon. Confidence in the figures they are seeing will help both the board and funders buy into the future view of the business and help release the damaging paralysis that has gripped so many DP and DCA players recently. But of course it goes far beyond this; insight into what the future will hold as the economy evolves provides opportunities for significant performance improvements and competitive advantage.

Let us begin with strategies. While no one has an economic crystal ball, some changes seem inevitable. With account level scenario testing it is possible to identify exactly those debtors who will struggle most if unemployment continues to rise; hit these now with a full and final campaign before their value erodes. Other groups may show great stability under the economic changes; avoid the trap of offering payment plans and settlements that are too light here.



Similar ideas extend to pricing and commission rates. Do your economic scenarios show you that home-owners are highly volatile under the likely interest rate hike? Don't be suckered into paying high commission on this previously premium but now risky segment. Have you identified those individuals who are performing badly now but will recover well as the credit market recovers? Price aggressively to pick up bargain debt now and reap the rewards!

The shifting landscape, while a source of woe to many, brings with it great opportunities for those in a position to exploit them. The sector is changing; those with the right tools will emerge stronger from the experience while those who flounder in the dark will undoubtedly fall by the wayside. Euristix will provide more information on this innovative debt collection technology in future editions of Insight, but in the meantime please contact Paul Matthews paul.matthews@euristix.com with any questions.

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