Euristix

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Hello

Welcome to the November 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 edition's lead article looks at the important topic of scoring models for collections. As consumer debt grows and affordability wanes, ensuring the right tools are being used in the collections management process is vital. The right tools are equaly important for underwriting, and as mortgage lenders look to re-open their doors we look at the best practice in bringing underwriting processes up to date and incorporating the learnings from the recession. Finally our questions corner asks how analytics can best be utilised in your business to balance value against cost.

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

Kind regards,

Chris Kemp.

In this edition...

Successful Collections Scoring - The use of scoring models is widespread throughout the financial services industry, and collections is no exception. Our lead article looks at some of the tricks and considerations that you should consider when building scoring models for a collections function.

Questions Corner - Take a moment to consider the role of analytics within your business. Does it provide true value for money in terms of the benefit it brings? Do you use your analytics team optimally?

Mortgage Underwriting in a Brave New World - As signs begin to emerge that the freeze on mortgage lending may indeed be thawing, we look at best practice policies in updating and reconciling underwriting practices to match the current climate.

Successful Collections Scoring

With the debt collection environment having changed dramatically recently, many collections teams are taking the opportunity to review or rebuild their analytical tools to more accurately reflect the current climate. However, beyond a simple refresh of development data to capture the most recent behaviours, this is a time to question and improve the methodologies and thinking underpinning the models.

With this in mind this issue's lead article takes the opportunity to discuss some of the issues and considerations that arise in the development of collections scoring models. To read further please see the **full article here...**

Questions Corner - The Cost-Benefit of Analytics

Analytics is a powerful tool that can and should be transformational in a business, in terms of both management and performance. But analytics is a fast moving and potentially expensive business, where yesterday's optimum solution can be obsolete today. Consider the questions below and try to evaluate the cost-benefit position of your own analytics processes:

- Are you confident that the knowledge and tools available within your internal analytics team are best in sector?
- Are analytical tools and models updated regularly, or do resource constraints and BAU tasks interfere?
- Are any of the analytics tasks which occupy your team suitable for automation or out-sourcing?

- How much value generation in the last 12 months is directly attributable to new analytical initiatives?

- Does your analytics team spend more that a third of their time producing standard reports?

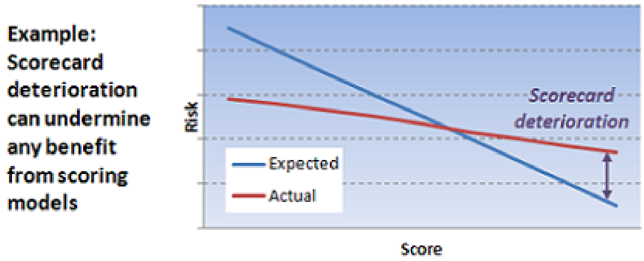
In a future edition of Euristix Insight we will look in more detail at the best options for optimising the use of internal and external analytics resource, from outsourcing and automation to team structure and road map creation. In the meantime, please direct any questions to paul.matthews@euristix.com

Achieving Best Practice - Mortgage Underwriting

Problem - In recent months there have been tentative signs in the mortgage market that lenders are starting to expand their lending again. As those organisations with the risk appetite and the capital look to further increase this lending into 2010, it is vital to review underwriting processes in light of the learnings from the recession. The problems facing lenders are numerous:

- Customer risk: unemployment is expected to continue to rise through to 2010, how can a lender mitigate the impact of this on new originations?
- Customer affordability: customers may appear to have head room in their monthly disposable income, but what will happen if rates rise?
- Asset Valuation: House price volatility has increased and with HPI flattening, can lenders be confident in their valuation so that they have sufficient equity if problems occur?
- Third Parties: how do lenders decide which brokers, intermediaries and solicitors to do business with?
- The FSA Mortgage Market Review: the new proposals could mean big changes in the way affordability is assessed. Can lenders act now to limit the effect of any new regulation?

Approaches - A simple approach to facilitate a quick re-entry into the market with minimum overhead is to overlay some basic policy changes on to existing underwriting processes. However, even this 'light touch' plan should go beyond simply adjusting maximum loan values, LTVs and affordability ratios. Any scorecards should be reviewed to ensure they are not misaligned or show undue deterioration. While certainly powerful tools, sub-optimal or misleading scoring models can be at best useless and at worst downright damaging to the business!



Affordability assessments need to be adjusted to match not just the changed environment, but also any new regulatory stipulations. Any policy changes will also need to filter through to the underwriter mandate and discretion to reflect recognised changes in the applicant risk profile. Additionally, fraud prevention rules need to be updated to incorporate new learnings from recent internal investigations and the list of approved third parties must exclude and identified banned or suspicious firms.

This basic approach may function adequately in the short term and give lenders the opportunity to grow their book. However there are serious risks in operating with such a 'light touch' review of previous processes and underwriting policy.

Best of Breed - A successful and long-term growth strategy can be best achieved through a thorough and robust re-evaluation of lending policy. Presenting an exhaustive list of required tasks here would be beyond the remit of a simple newsletter, but it is vital that lenders scrutinise their systems and underlying assumptions and focus efforts on the areas that are key to their business.

The first task is to clearly understand the consumer base on which the growth plans are based. Has similar business been written in the past? What are the performance expectations and which factors - economy, regulation, market - will have the largest impact on this? Clearly defining the customer base and assessing the businesses strengths and weaknesses in light of this will steer any process review to the key areas.

How is the business to be acquired? Is it through direct channels only, or is there a broker element to the business? These considerations should supplement a review of internal fraud investigations to create an updated fraud screening process, with all fraud detection rules verified and third party exclusions updated. Many key considerations for fraud avoidance in the mortgage market were covered in **last edition's article** on buy-to-let mortgage fraud.

It is undoubtedly the area of risk underwriting that will require the most scrutiny. From the analytical tools to the affordability assessment, no stone should be left unturned when testing for any weak link in this decision chain. Scorecards need to be tested and monitored. Do they still work in the new climate? What level of confidence do I have in these models? Is the data on which they were built and are being tested reliable? Affordability checks should be re-considered, especially in light of the possible introduction of new guidelines from the FSA. Are affordability levels varied by customer and income types? Is all available expenditure data from bureaus and other sources used optimally? And what level of scenario-testing is required to safeguard the business in the event of any future downturns?

With mortgage losses intrinsically linked with property value, the valuation process should also undergo review. It is important not only to value the property correctly, but also to understand volatility around that valuation, which may vary from area to area even in a stable economic climate. Factoring this into a calculation which also captures concentration risk and the impact of further economic upheaval is not an easy task, but this is required to truly understand the risk associated with any new lending.

Lenders are justifiably wary about expanding their lending again, but for those that do so in a careful and considered manner the rewards could be great. The tasks to undertake are many, requiring a well thought out, analytical and robust approach, but it is vital to build success on secure foundations. For a more detailed discussion, please see the full article on **best practice mortgage underwriting**, or contact richard.pinch@euristix.com with any questions.

Web: www.euristix.com Phone: +44 (0)20 7043 4700 Email: insight@euristix.com