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Abstract

Basel Compliant Modelling with Little or No Data

Traditionally, two types of credit risk models have been predominant in the industry: (a) statistical models constructed on fairly large data samples, generally used for consumer credit and (b) expert models, generally used for corporate credit. With the advent of the Basel Accord the boundary has blurred because lenders have been forced to construct statistical models where numbers of defaulting accounts are low and because it is a regulatory requirement that expert models take account of actual risk experience even if the number of defaults is very small.

This talk describes how models can be constructed and validated for situations where there are few defaulting accounts and few write-offs. It highlights and compares the various approaches available and examines creative examples that have been implemented by lenders. We discuss some of the underlying principles of such modelling, we examine what the Basel regulators have to say on the matter and we suggest areas where more academic research would be useful to assist the credit practitioner.

This talk should be of interest to (a) mortgage lenders who, even if they have a reasonable number of defaulting accounts, may be short of information on property foreclosures, (b) corporate credit lenders, (c) lender who wish to introduce a new product and (e) any other lender who has to model with small samples of accounts or with a low number of defaulting accounts.