

CREDIT SCORING AND CREDIT CONTROL X EDINBURGH 2007

Monitoring and Forecasting Bad Rates

Abstract

Credit strategy is typically defined based on score distributions and related reports that are produced as part of a scorecard development. However, these reports are static and changes in the economy can quickly make predictions on future bad rates inaccurate.

Experian Decision Analytics (EDA) has developed The Consumer Credit Monitor (CCM) reporting service to monitor credit industry trends and use this information in conjunction with significant macroeconomic trends to forecast future consumer bad rates.

On a quarterly basis EDA selects a large sample of individuals that have made a credit application within the previous three months. Credit bureau data and Delphi scores are then attached to these individuals as at the application point, and then subsequently on a quarterly basis.

This quarterly information is used to measure changes in bad rate over time by 'risk segment' i.e. Delphi score band. These trends are then extrapolated forward to provide 'expected' bad rates by score. As a further step, 'expected' macroeconomic indicators are overlaid on these extrapolated results to provide a set of additional bad rate forecasts.

The CCM therefore produces reports detailing expected bad rates for different account types over a 12-month period. Initially the economic forecasts will be limited to Experian's view of the economy over the next 12 months, however in the future this will be extended to consider different economic scenarios such as an economic downturn or a significant increase in interest rates.

This talk describes the data used to generate the bad rate time series, the approaches used to forecast future bad rate trends and the applications of these forecasts. Clearly a more accurate understanding of future bad rates enables more accurate provisioning. In addition, it should be possible to adjust any score-based strategies employed in order to reflect the bad rate prediction.

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