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NEWSLETTER OF A NATIONAL CREDIT BUREAU

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OPTIMISING PRICES FOR RETAIL LENDING

A SERIES ON WHY DIFFERENTIAL PRICES ARE INEVITABLE FOR A BANK

Pricing for consumer credit was once thought of as a relatively simple - Borrow at 3%, lend at 6% and be on the golf course by 3pm. Following the global financial crisis of 2008, it appears that this maxim may have seen its day, just like the universal bank.

Critical to every business's success lies in its ability to identify the potential of the specific customer based on an enhanced understanding of the customer's behaviour. Getting it right with retail lending has become more important today than ever. And here are just some game changing conditions.

Market segmentation to increase market share and profit has seen retail banks segmenting their customer base more finely. Plus, a multitude of new products have also been introduced to retail lending, increasing its complexity.

It would be fair to say that the pricing capabilities at most financial services institutions are continually being challenged to keep pace.

One of the critical contributing factors is the availability of data to better understand the customer's behaviour and their ability to process it. The truth is this - improved decisioning technology has also encouraged lenders to develop and adopt more sophisticated models to predict different customers' profits.

This can only mean that there is a natural tendency for organisations to invest in increasingly more sophisticated analytics, lower service costs and focus marketing, enabling them to make increased profit margins.

The following table from the Tower Group identifies a number of different evolutionary approaches that retail banks have been using to set pricing strategies, starting from the one-size fits all.

Evolution of pricing strategies of retail banks (2006)

Strategy	Explanation
One-price pricing	One size fits all.
Cost-plus pricing	The costs associated with the product (marketing, operations, overhead, risk, etc.) are aggregated with an added markup for profit.
Market-based pricing	Pricing for a product or service is based on what the market will bear. Competitors are surveyed to understand the established pricing of a product or service in the market.
Index-based pricing	The pricing of a product or service is pegged to a moving index.
Risk-based pricing	In this variation on cost-plus pricing, a risk assessment is added to the cost of a product or service based on the customer's credit score. The strategy has a lending orientation.
Adjusted risk-based pricing	In this variation on risk-based pricing, supplemental information is factored in. Multidimensional scoring factors in debt-to-income ratios and other data.
Profit-based pricing	Pricing is based on a profit maximising a combination of cost, risk, and customer price elasticity.



Pricing strategies become more sophisticated and rely on more powerful analytics as the decisioning process increases in complexity.

In reality, there are many different markets - customers have different needs, have different risk profiles and behave in different ways. As a result, there are many different "submarkets," each with its unique theoretical equilibrium position.

Ideally, an organisation should consider the effect of different price offers within the real world constraints. However, managing multiple constraints at multiple levels is complex, particularly when trying to identify optimum profit. The process of optimising strategies should enable an organisation to assess the effect of different actions, decisions, limits or terms on profit and other business metrics. It needs to provide insight into the trade-off between different decision scenarios to enable the business to understand the effect of different constraints on business profitability. Once the business has determined the best trade-off, it is essential that the solution enables the business to implement the results in the minimum time period.

SO HOW DOES PRICE OPTIMISATION WORK?

Well, price optimisation allows a business to develop an overall pricing strategy that generates a high level of profit within its business constraints. The business can assess the best trade-off between competing objectives and then implement individual customer decisions to meet these objectives. In order to manage across different constraints and to choose the best trade-off, it is necessary to predict the effect of different price approaches not only on profit, but also on each of the trade-off dimensions.

To do this, the following is required:

- **Models:** which predict the effect of different prices
- **Data:** past experience, which allows the business to understand the effect of different actions on similar customers
- **Simulation:** the ability to apply models to historical data, simulate the results and generate expected metrics
- **Optimisation:** to determine the maximum profit, within the agreed constraints, and to enable the business to evaluate trade-offs
- Operational deployment through the creation of a rule set
- Ongoing evaluation

Price optimisation encourages lenders to strategize across the entire customer portfolio process.



Next time - Price Optimisation In Practice.



NEWS

THE APATHETIC CITIZEN

More often than not, ambiguity and the diffusion of responsibility contribute to a lower impetus for an individual to take action.

We let policy announcements slide by, assuming that it does not concern us. Or, even if it does, we assume that someone will alert us to it eventually. We then transfer that responsibility of taking action to "someone else", continuing to lead our lives not in the know, without clarity of what is changing and impacting our livelihood.

DP Credit Bureau believes in empowering individuals to take ownership of their finances, which powers lives. What are the recent policy changes that might affect you? In this issue, we take a dive into the land of the plastic – credit.

CREDIT CARD, UNSECURED CREDIT RULES AND ME

On 11 September 2013, the Monetary Authority of Singapore (MAS) announced changes to credit card and unsecured credit rules. This move aims to enable individuals to make better borrowing decisions and avoid getting into debt problems.

The policy changes, to be implemented in stages, increase the importance of an individual's payment behavior and outstanding debts.

What are the key changes that affect us as borrowers?

1



Assessing my borrowing capacity

Before (1) granting me a new credit card / unsecured credit facility or (2) increasing my credit limit...

Banks will conduct credit bureau and income checks to review my total debt and credit limits.

2



Making Decisions

Making more informed credit decisions

If I roll over my credit card debts and revolving credit facilities, banks will disclose to me the potential costs of doing so and how the debt will accumulate.

3



Increasing control

Did I consent to this?

Banks will have to obtain my consent for the amount of each credit limit increase before doing so.

4



Avoiding further debt problems

Banks will not grant further unsecured credit or increase my credit limits if ...

- 1. I have unsecured debts that are more than 60 days past due, till all past due amounts are paid*
- 2. My aggregate interest-bearing outstanding unsecured borrowing across ALL financial institutions exceed 12 months of my income for 90 days or more*

I am also unable to charge further amounts to all existing unsecured cards and unsecured credit facilities, and will be denied new unsecured cards and unsecured credit facilities.

★ Visit www.mas.gov.sg for more information on the changes in MAS rulings. ★

An infographic by



For enquiries about DP Credit Bureau's National Credit Education Programme, contact Geraldine Lee at 6507 2341 or email geraldine@dpgroup.com.sg.

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