



Detail Oriented

Why Lenders Are Using More Regional Economic Data

BY DAVE SCHAFER

Searching for any advantage during an unprecedented economic downturn, Toyota Motor Credit Corp. turned to regional economic data to better understand how its portfolio was performing.

The Torrance, Calif.-based lender had used regionalized data such as local housing prices to gauge performance by branch or region, but in 2009, it started using the data to identify economic pitfalls it might need to overcome. And Toyota has plans to continue bolstering its use of regional data in its risk models.

"That helps us from a forecast perspective and trying to understand where we should focus our efforts," says Reddy Pakanati, chief risk officer. "When we know that losses are likely to be higher in one region, we can put more resources there. Things aren't equally bad all over. They are worse in some areas, and they're OK in others."

Toyota, which ended 2009 with \$61.8 billion of loans, is not alone in realizing the benefits of regionalized data when assessing risk, says Tony Hughes, senior director for consumer credit analytics, Moody's Analytics.

"That's a clear trend in the industry," Hughes says. Moody's did its first regional-data consulting project in the mid 2000s. "People are realizing that the timing of the business cycle — the timing of the credit cycle — is heterogeneous within the United States, and they're interested in taking advantage of that in the risk-assessment process."

Companies need to recognize that geographical boundaries are not based on business considerations, echoes Frank Rhode, chief executive of Nomis Solutions, which uses regional data in the pricing models it sells. "They are political boundaries," Rhode says. "And ZIP codes are designed by the post office, so ZIP plus four is a carrier route that makes sense if you're in a little car slogging the mail around."

Of 25 companies contacted, only a few said they didn't use regional data. State Farm Bank, for example, is looking to incorporate it into its risk-assessment matrix, says Spokesman Dick Luedke.

"It will allow us to match the rate with the risks a little better," he says.

Toyota, for another, looks at local economy, housing prices and aggregated income of consumers within three segments: West, Central and Eastern United States, Pakanati says. The company

obtains the data from the government, among other sources, and once gathered, a consulting company compiles the data, cleans it, and layers it as needed.

Although incorporating the regionalized data went smoothly, the quality of the results has yet to be determined by Toyota. "The outcome of how well this will work out, that's where the rocky road is, and we don't know yet," Pakanati says, explaining it will take one to two years to know the outcome of using regionalized data. Right now, the lender is about about a year into it.

The time requirement is no surprise, as the struggle for the banking industry is the sheer volume of data needed for regionalized assessments, Rhode says.

"If you run the math on a car-loan portfolio where you've got 5% charge off, you've got five observations per 100 loans," he says.

"By the time you'd see a meaningful statistically valid difference between two areas, you need to wait a long time for a number of observations to come through, or you need to make the regional bucketing bigger and bigger, at which point you end up at a state level or something like that. And I think that's generally where most lenders in the United States are ending up."

PANNING FOR GOLDEN INFORMATION

When modeling regional data, Moody's splits the country up into units that have essentially the same statistical or numerical weight, Hughes says, noting the size can be as small as a medium-sized city.

"A regional bank mainly operates in a small number of states, and they'd have to be a little bit more judicious in the amount that they can cut up the territory," he says. "It really depends on the density of the data."

Moving forward, Toyota Credit might drill down to the branch level in forecasting, Pakanati says. But for now, the company is still in the process of discovering how beneficial regionalized data is.

"We'll just have to wait and see how it all pans out," Pakanati says. "But I'm fairly reasonably comfortable this has application."

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