



## A step beyond risk scoring

As banks attempt to better manage price setting for their customers FRANK ROHDE explains where they are deploying price sensitivity scores.

### What is a price sensitivity score?

**Frank Rohde.** The Nomis Price Sensitivity Score is a relative measure of price sensitivity for individual consumers. It ranges from 200 to 800 and a lower score indicates that a customer is relatively less price sensitive than someone with a higher score. Price sensitivity is an important concept that banks haven't yet understood very well. So we developed the Nomis Score to allow banks to accurately and quickly assess the price sensitivity of customers and prospects in addition to their risk score.

### Aren't price sensitivity and risk correlated?

**FR.** There is some correlation between a borrower's price sensitivity and his or her credit risk but it is far from perfect. Banks have always assumed that individuals with very good credit are also very price sensitive and individuals with poor credit are less price sensitive. This is not necessarily true. In fact, in our work with lenders we have found that more than 25 percent of the population has good credit but is not very price sensitive. Alternatively, over 10 percent of the population with poor credit is very price sensitive. We have found four core segments in the market:

First, there is high risk and high price sensitivity: these are consumers who have below average credit scores (less than 700) but Nomis Scores above 500, which indicates that they show above average sensitivity to price. The opportunity for lenders in this segment is to create offers that are attractive in price but limit downside risk through underwriting and product features.

Second, there is low risk and high price sensitivity: these are consumers with credit scores above 700 and Nomis Scores above 500. The majority of the prime market falls into this segment and consumers are conditioned to look for attractive prices. A savvy lender will use price to attract consumers in this segment but limit product feature or functionality to preserve profitability.

Third, there is high risk and low price sensitivity: these are consumers with credit scores below 700 and Nomis Scores below 500. Consumers in this segment care about access to credit more than about price and risk-based pricing is the right strategy in this segment.

***“Marketers often make the mistake of thinking that response and price sensitivity are the same thing”***

Finally, there is low risk and low price sensitivity: this is the most interesting segment with credit scores above 700 but Nomis Scores below 500. About 25 percent of the population falls into this segment. These consumers value brand, product features, and service more than price and smart banks create offers that emphasize those value propositions rather than compete on price.

Of course all of this is not terribly surprising and banks have long known that these segments exist. The innovation that price sensitivity scoring brings to the table is that lenders are now able to quickly and accurately segment consumers at the point of sale or for direct marketing purposes. This has become even more important during the recession as consumers' perceptions of banks, their use of financial services, and their price sensitivity has changed significantly.

#### How is the price sensitivity score different from response scores?

**FR.** Marketers often make the mistake of thinking that response and price sensitivity are the same thing. This is not true. Consumers can have high response to offers that aren't attractively priced and low response to aggressively priced offers. Price certainly plays a part in driving response but savvy marketers understand that disentangling the two effects provides much better overall campaign profitability.

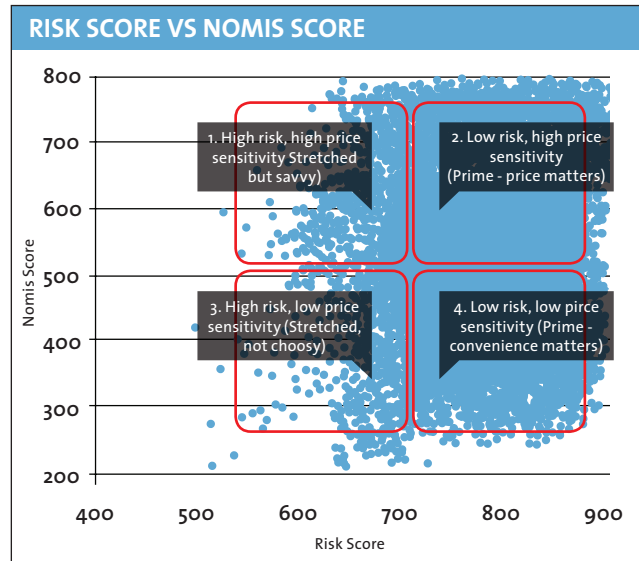
#### How are banks using the price sensitivity score?

**FR.** We are still at the early stages of adoption. In 2009, we scored about six million consumers mostly for direct marketing purposes. Currently, we are working with several lenders on different applications. One of the opportunities we see is in direct marketing, for example batch-scoring of prospects and customers for better targeting of credit offers, such as credit card solicitations, balance transfer offers, loan consolidation, refinance offers. In this case, the price sensitivity score is used in addition to a risk score and a response score. Note that response and price sensitivity are not the same.

Another opportunity is to deploy the Nomis Score in real-time pricing, where loan applicants are scored at the point of sale to determine the optimal price based on the risk score and the price sensitivity score. Furthermore, credit pricing is often negotiated at the point of sale, for example with the finance and insurance manager in a car dealership in the case of an auto loan, with a branch employee in the case of a personal loan, or with a broker in the case of a mortgage. In these cases, the Nomis Score provides the seller with the ability to quickly assess the price sensitivity of the customer and determine what the appropriate discount should be. In this case, the price sensitivity score is pulled along with the credit bureau report and credit score through the application processing system.



Frank Rohde is President and CEO, Nomis Solutions. He leads the company's vision to materially improve the financial and operational performance of companies through the use of best-in-class pricing and profitability management. He has 15 years of financial services domain expertise, including positions at Fair Isaac Corporation and Mercer Management Consulting.



#### Are there uses for price sensitivity scoring in existing portfolios?

**FR.** Absolutely. Lenders are using the Nomis Score to batch-score existing loan customers across the portfolio to understand the relative likelihood of customers prepaying in case of a rate change as well as the relative price sensitivity to refinance offers. In this case, the price sensitivity score is pulled by the portfolio lender alongside a periodic credit score refresh or as part of the behavior scoring process.

#### Where do banks obtain price sensitivity scores?

**FR.** We are working on developing the right distribution partnerships with credit bureaus, direct marketing firms and application processing vendors. Our current customers receive the score directly from Nomis Solutions but our goal is to make the Nomis Score as easily available as credit risk scores.

#### Can banks develop their own price sensitivity scores?

**FR.** No. The key to developing an accurate price sensitivity score is access to a vast array of varying price points offered to consumers across multiple products and multiple brands. We have been fortunate in leveraging our own large research database of pricing data as well as credit bureau attributes, application, and other data to develop the Nomis Score.

#### How do you ensure that price sensitivity scoring doesn't break fair lending laws?

**FR.** Of course the price sensitivity score does not consider or use any prohibited bases in its calculation. As importantly, the concept of price sensitivity scoring should not be used to just increase prices for customers who are less price sensitive. Instead, we work with our banking customers to design offers that emphasize the features those customers care about more than price, such as brand, convenience, customer service and product innovation. Price is always just one component of the overall relationship with the customer – price sensitivity scoring gives banks the ability to quantify and therefore better manage that component. ■