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Part 1: Consumer Credit Risk Modelling

Modelling LGD for unsecured personal loans: decision tree approach

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Abstract

The New Basel Accord, which was implemented in 2007, has made a significant difference to the use of modelling within financial organisations. In particular it has highlighted the importance of Loss Given Default (LGD) modelling. We propose a decision tree approach to modelling LGD for unsecured consumer loans where the uncertainty in some of the nodes is modelled using a mixture model, where the parameters are obtained using regression. A case study based on default data from the in-house collections department of a UK financial organisation is used to show how such regression can be undertaken.

Keywords:

Basel II   consumer credit   LGD

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