



.....from the CEO's desk

We are back with the third edition of our news letter – News & Views. If last quarter was dominated by rising crude oil prices (which I had hinted earlier as being speculative), this time it is the fall of Wall Street giants which has rocked the world. If the collapse of these giants is an aftermath of the subprime crisis, the after effect of this collapse will be felt across the world, across sectors and in consumer confidence and spending. There is likely to be shift of focus, especially in countries like India, from managing growth to maintaining profitability. The need for more discipline and robust analysis in the business decisioning process will be felt even more during these testing times.

With the background of calamities on Wall Street, this issue has a telling article by our COO, Anunay, on the complex nature of today's banking environment and the need for a more robust risk management system.

This issue we are introducing Raja, who is one of our early associates. Raja has deep expertise in Risk & Marketing analytics, and with a 'can-do' attitude, stops short of nothing to get things done.

As always we are on a constant improvement process and would like your feedback on this issue.

Roy K Cherian

Meet some of our associates.....

Raja Abhishek

Raja Abhishek is involved in Analytics Consulting and Business Development for Marketelligent. He specializes in designing customer level structure and strategy based on business rules, segmentation and predictive modeling.



He has been involved in various Analytic Consulting projects in different sectors like Marketing and Branding, Risk Management, Collections, Liability Portfolio Management, Real Estate etc. and has worked in variety of Industries including Banking, Insurance, Retail and Real Estate.

His achievements include designing and implementing Decision Control System for the Sub-Prime Loans Market in US, and designing customer level structure and strategy for Standard Chartered.

Prior to joining Marketelligent, he was with Global Analytics and Standard Chartered. He holds a B.E. degree from BIT Sindri, India.

His hobbies include Travelling, Sports and Reading. He is interested in learning new things in any field. He is a good sports person and was the captain of college cricket team.

Q3 2008 Highlights

- Partnering with a leading global Software Company on building and implementing a Sales Potential Realization framework
- Working with a US-based leading Online Auto exchange on Marketing Analytics
- Marketelligent completes 1 year of successful operations

The 100-year Flood ? !

Anunay Gupta, Head of Analytics, Marketelligent

The 100-year flood event that we all read about when calculating capital requirements for Banks as they relate to unexpected losses seem to be happening with alarming frequency and regularity. Its almost as if the hundred-year cycle has been replaced with a much hastened and monstrous 5-year deluge. Global Financial Warming? And to top it all no amount of current regulatory oversight in the form of exotic names and lengthy text book procedures (Basel II, lognormal distributions with fat tails, VaR to the second decimal, etc) has prevented some of the world's largest commercial and consumer banks from going under or from being in dire straits. Who is to blame for this; but more importantly what have we learned that will help prevent such events from happening in the future. Or are we doomed to repeat past mistakes forever riding on the shoulders of fear and greed. Interestingly enough, the above parallel has some striking similarities to natural disasters of late; witness Katrina, Gustav, Ike, Kosi, etc. Both a definite consequence of human actions.

Getting back to the basics, first and foremost, banks - consumer or commercial - are a vital link in any economy; developed or developing. They provide an avenue for folks to deposit their hard-earned money thereby earning real interest and escaping the threat of inflation; and they allow the same money to be recycled back into the economy to fuel growth and consumption. The recycling can happen in various ways – banks can make loans so consumers can fulfill their immediate aspirations on the back of future earning power; be it buying a plasma TV, a new car or that Victorian mansion. Banks also make loans so that companies – small and big – can continue to churn out widgets and grow; in turn providing employment to the depositors whose money was being used to finance their employers growth. This cycle of consumption and deposits and loans can accelerate leading to a heating economy; or slow down leading to a recessionary environment. In the end the Central Bank has power to control the pace of expansion or contraction; primarily by controlling short-term interest rates and/or the money supply.

These banks in turn can either elect to hold loans they make on their books; or choose to 'securitize' them. The process of securitization is exotic and fanciful – it allows banks to package the loans they made into various 'tranches', or 'risk classes' and then sell these tranches to various investors with varying risk-appetite, thereby freeing up their own balance sheet to make even more loans and feeding the consumption frenzy. Investors in this case are most likely you and me; holding a portion of these securitized loans in our retirement portfolios. And the banks or broker/dealers that are involved in the securitization process are some of the more familiar names of late – Bear Stearns, Lehman Brothers, etc.

A few important themes emerge in the preceding discussion – (1) the process by which money flows is definitely complex and involves access to, and the exchange of sensitive information between many counter parties, be it consumers and banks, banks and other banks, rating agencies and banks, banks and investors, etc; (2) there are many steps, parties and counter-parties by which money and corresponding risk transfer happens. This also implies a fragile financial ecosystem wherein a sneeze in say the coffee room of Citigroup headquarters in New York can and will have an effect in the boardroom of HSBC in Canary Wharf (the so-called Butterfly Effect), and (3) the global inter-connectedness of the financial system means that the lowest tranche of a securitized loan made from a pool of subprime mortgages in Bergen County, New Jersey can wind up, knowingly and unwittingly, many steps and various counter-parties later, in the retirement portfolio of a well to do professional in Bangalore, India.

All this leads to a few fundamentals that have to be present to ensure the orderly functioning of increasingly fragile and global Capital markets. First and foremost is regulatory oversight. Parties involved in transactions have to conduct business within the confines of well established and closely supervised controls and restraints; something that has largely been missing for a vast swath of the capital markets. It is easy to leverage yourself 30X when the going is good only to discover that you were swimming naked when the euphoria tide recedes. Regulatory oversight also includes transparency; which implies that parties have to be contractually open in their dealings with each other. The second important need is the pursuit of sound risk management practices. Sub-prime mortgages are not bad; as long as they are underwritten and priced appropriately. They also encourage home ownership across society. The Credit Card industry has done well here; having learnt over the past 15 years the virtues of risk-based underwriting, and in the process has developed an internal mechanism of calculating and managing risk across the risk spectrum and in spite of an ever-changing macro-economic environment. Besides the presence of external rating agencies (like Fair Isaac in the US), sophisticated consumer banks have developed internal risk expertise that is more often than not superior to external rating agencies. And the final need of the hour is the elevation of Risk Management to a core function across all Institutions that deal with credit in any form. After all, banks are fundamentally in the business of managing risk across various dimensions; and with the past few years spent in the pursuit of revenues and assets, risk has been delegated to a back-office role. No doubt, the next few decades (or at least till the current flood waters recede) will see the rise of seasoned Risk Managers into leadership roles.

