

# HOUSEHOLD



***“LENDING TO THE MIDDLE MARKET  
FOR 125 YEARS”***

***Dave Schoenholz***

*President and Chief Operating Officer*

**January 21-22, 2003**

# HOUSEHOLD

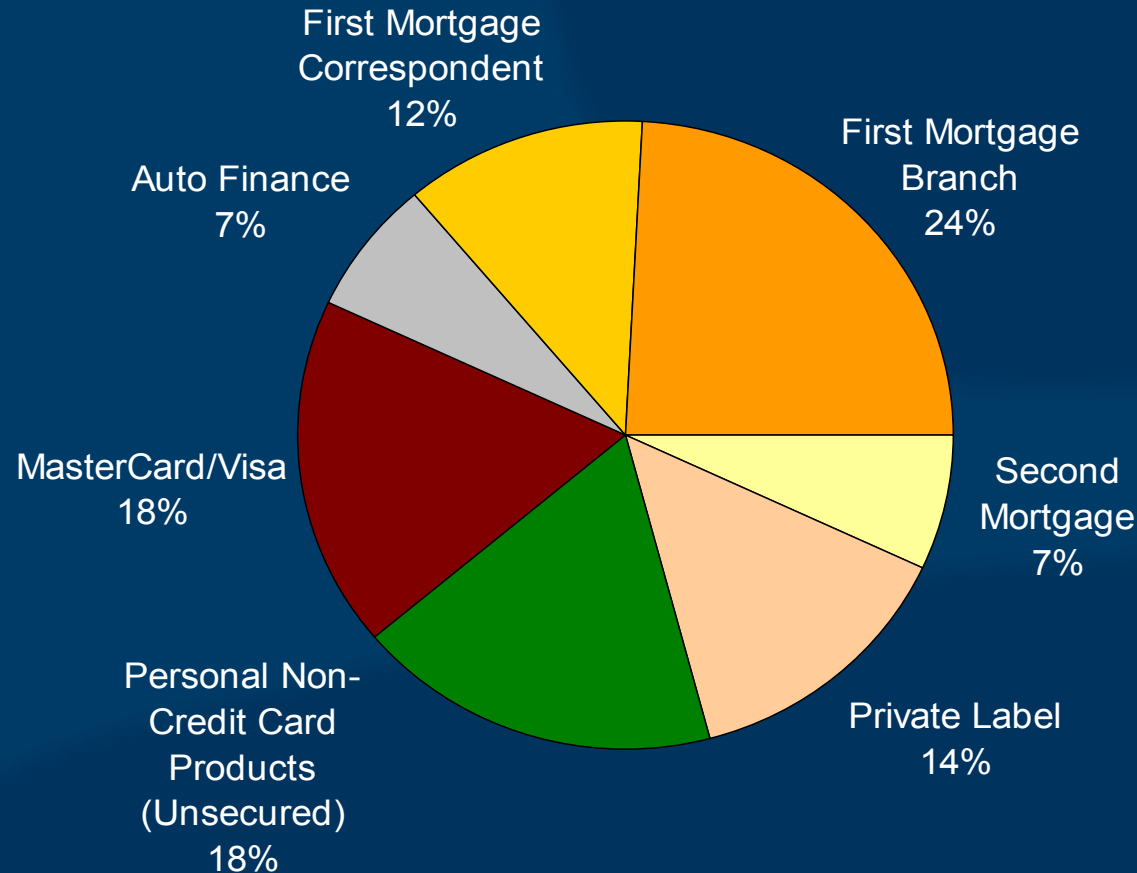
- Established in 1878
- Recognized leader in U.S. consumer lending
  - Leading market share in all businesses
  - Leading brand names in consumer finance
  - Profitable and growing credit card businesses – private label and bank card
- Extensive customer base and distribution network
  - 53+ million customers
  - Nationwide branch network, direct mail and e-commerce
  - Significant distribution through alliances and business partnerships

# HOUSEHOLD

- Consistent financial performance
  - Disciplined and sustainable asset growth
  - Strong margins and returns on a total and risk-adjusted basis
- Leads “Best Practices” in consumer finance

# A DIVERSIFIED CONSUMER LENDER

## *Multiple Products*

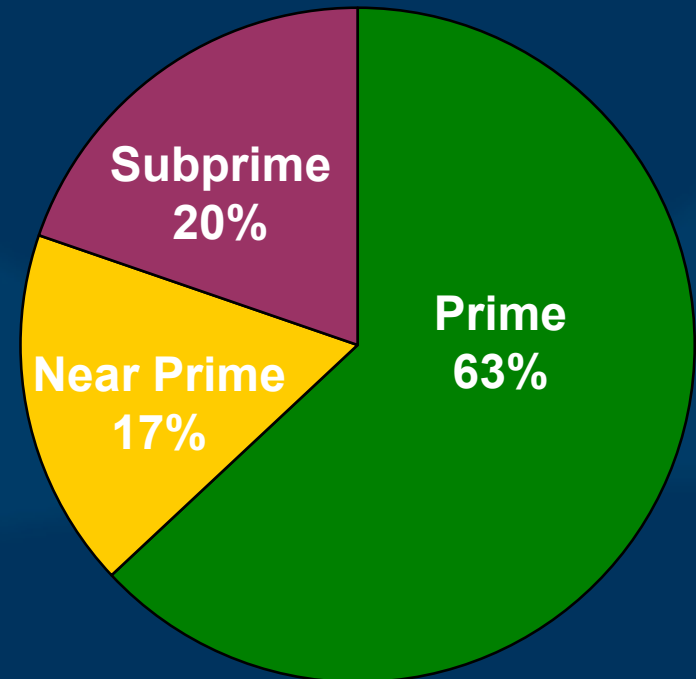


*\$107 Billion in Managed Receivables in U.S., Canada and U.K. at 12/31/2002*

# HOUSEHOLD'S CUSTOMER BASE

*Household's 53 million customers have the following characteristics:*

- Average age between 40–50
- Average household income between \$45,000 and \$60,000
- Average home value\* between \$120,000–\$175,000
- Average auto value\*\* between \$12,000–\$15,000



*Note: Based on outstanding managed receivables as of June 30, 2002.*

\* U.S. real estate secured loan customers

\*\* Auto finance customers

# HOUSEHOLD'S CORE CUSTOMER IS THE MIDDLE INCOME MARKET

Customers can be classified as:

Prime
  Near Prime
  Subprime

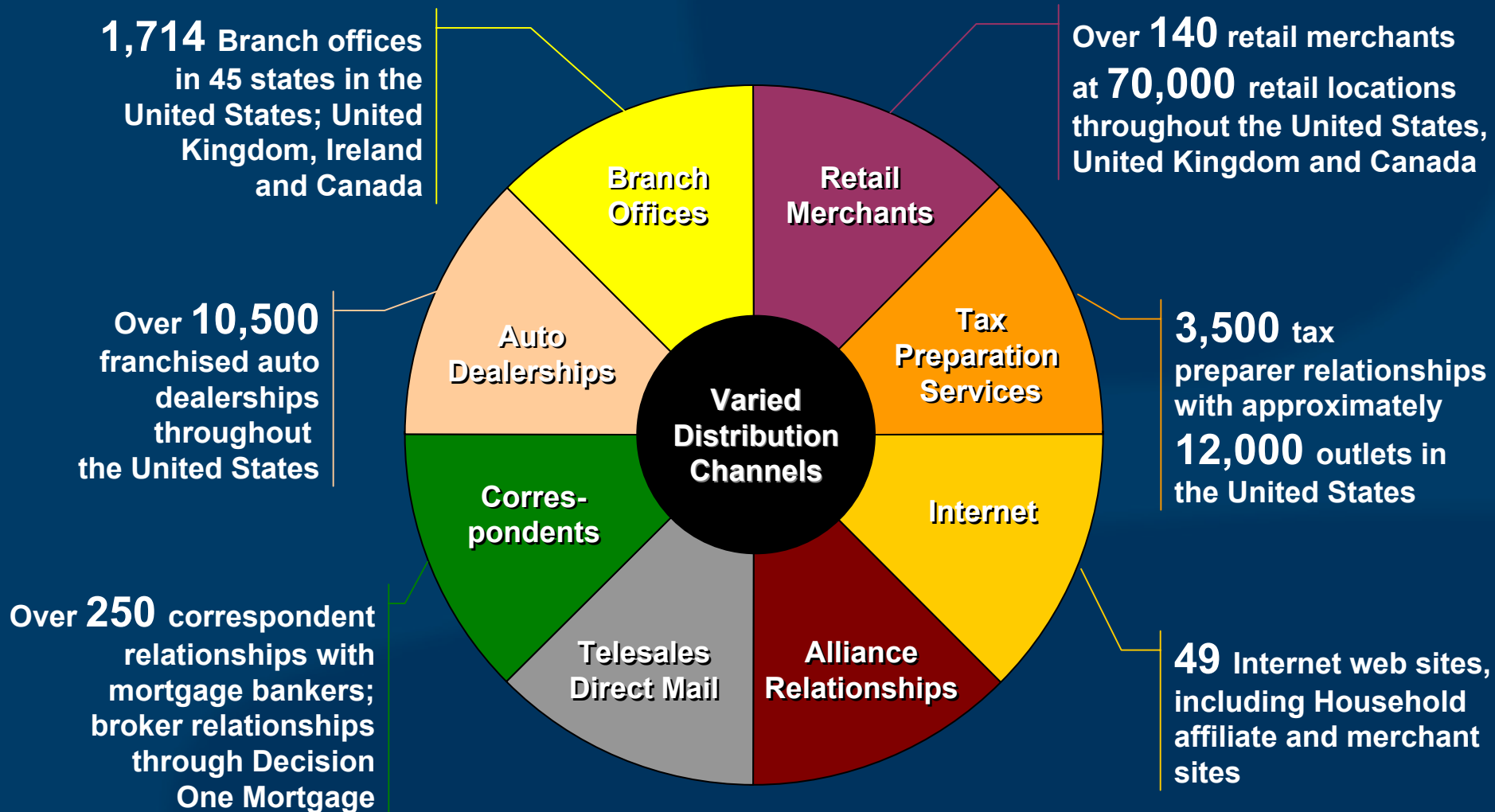
## PROBABILITY OF DEFAULT

		Low	Medium	High
EXPECTED LOSS GIVEN DEFAULT	Low		Real Estate Secured – 1 <sup>st</sup> Lien	
	Medium		Real Estate Secured – 2 <sup>nd</sup> Lien	Auto
	High	Credit Card — GM Credit Card — UP Private Label	PHL; Credit Card – Household Bank	Subprime credit card Branch unsecured

**Probability of Default: Determined by the credit score. General bands are as follows:**  
 Low: >660  
 Medium: 580-660  
 High: <580

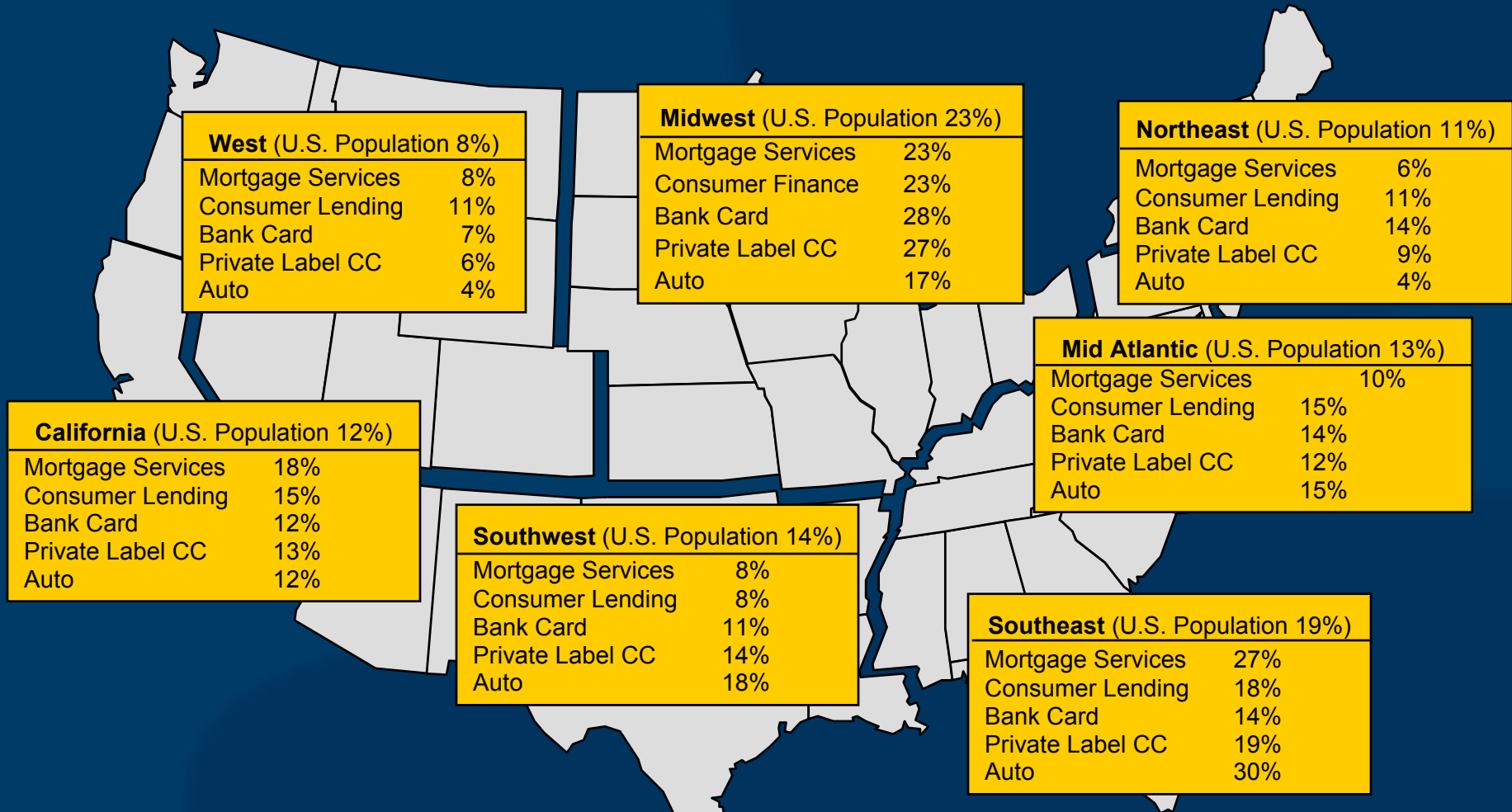
**Expected loss given default: What percent of the loan is at risk given default**  
 Low: <25%  
 Medium: 25% to 75%  
 High: >75%

# HOUSEHOLD'S DISTRIBUTION CHANNELS



# HOUSEHOLD'S CONSUMER LENDING FRANCHISE\*

*Nationwide Coverage, Well-Diversified*



\* Represents % distribution of managed receivables as of December 31, 2002



# CHARACTERISTICS OF HOUSEHOLD'S BUSINESS MODEL

- Centralized approach to business
- Sales skills and culture
- Partnering skills and culture
- Low cost producer
- “Best in Class” technology
- Strong marketing and credit management analytics

**HOUSEHOLD**

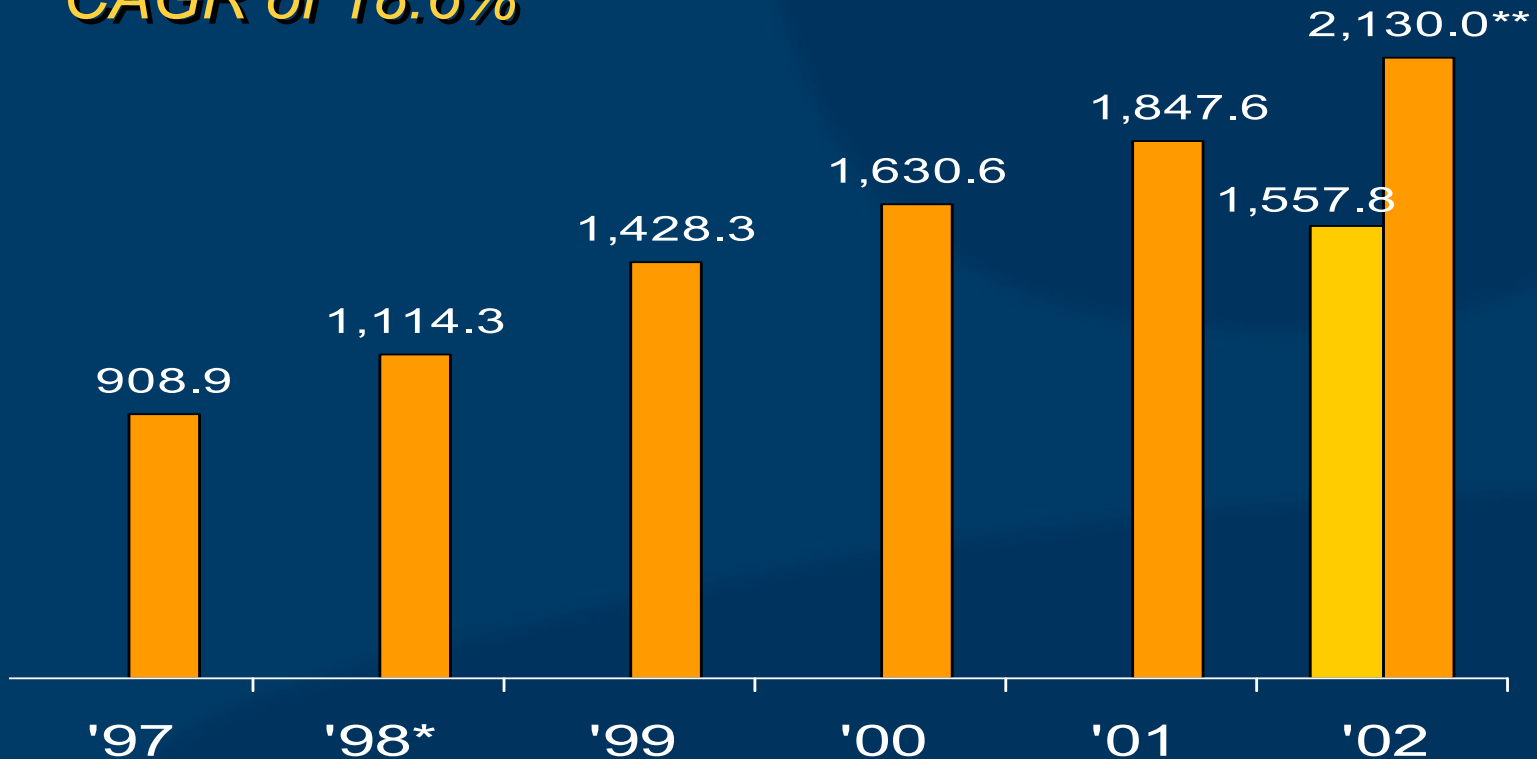


**FINANCIAL PERFORMANCE**

# PROFITABILITY

(\$ Millions)

*CAGR of 18.6%*



\* Excludes merger related items

\*\* Excludes non-recurring charges

# 2002 NON-RECURRING CHARGES

## *Thrift Disposition*

- Reduced assets by \$3.6 billion and deposits by \$4.3 billion
- \$240 million after-tax charge in 4<sup>th</sup> quarter
- No longer strategic focus of company
- Help hit capital targets

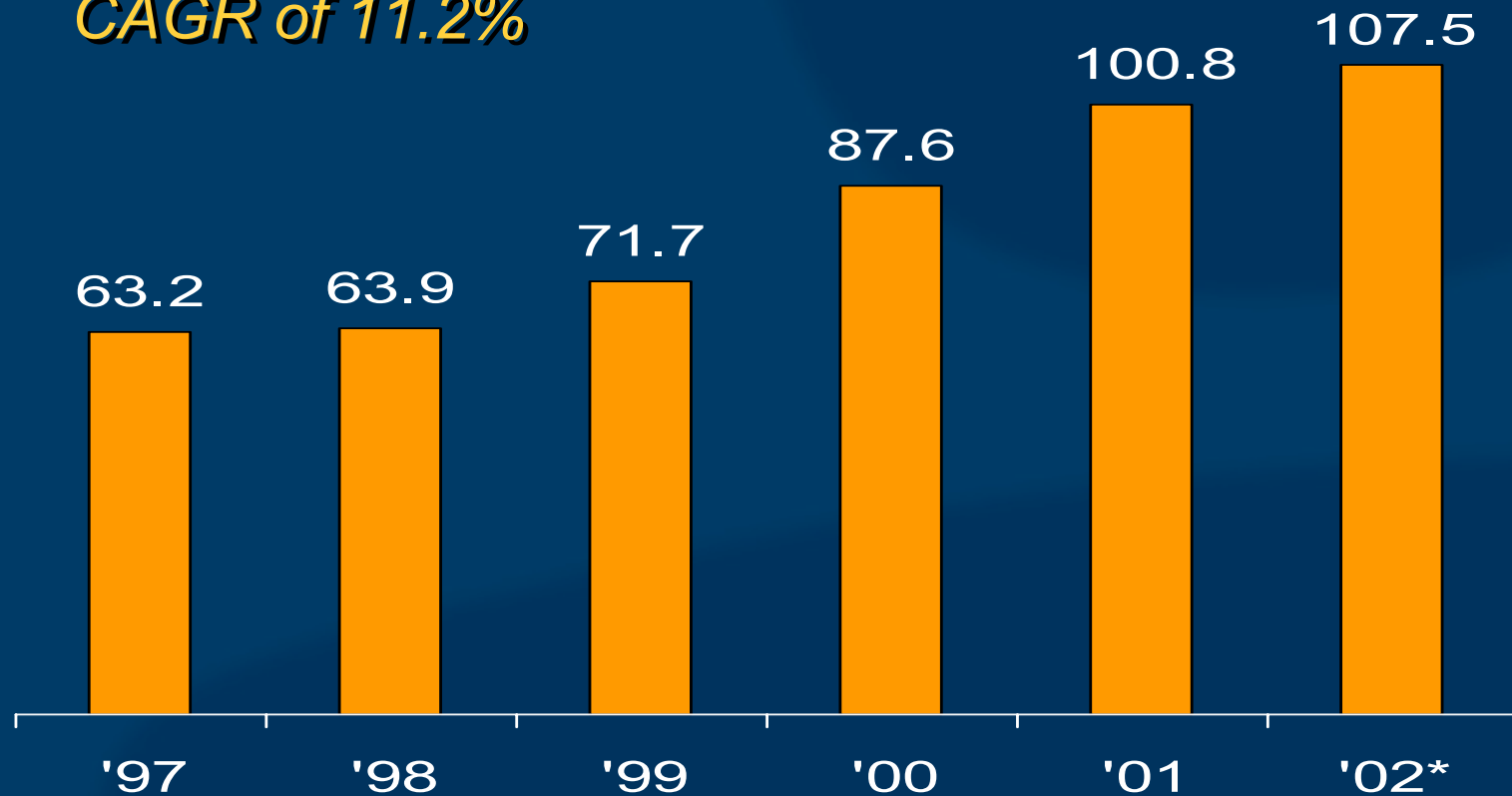
## *Attorneys General Settlement*

- \$333 million after-tax charge in 3<sup>rd</sup> quarter
- Completed in December, 2002

# DISCIPLINED, SUSTAINABLE GROWTH MANAGED RECEIVABLES

*(\$ Billions)*

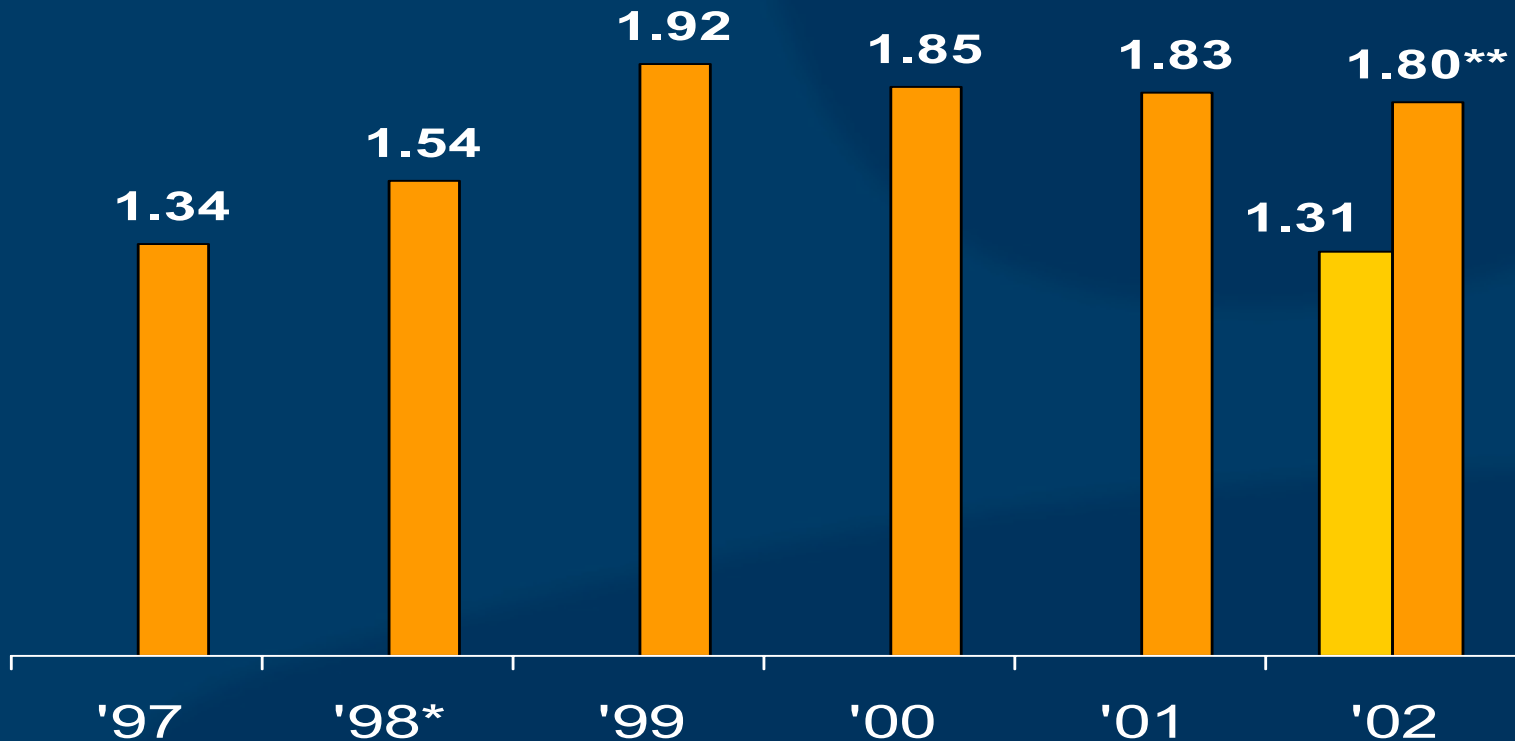
*CAGR of 11.2%*



\* Net of whole loan sales of \$6.3 billion in 2002

# SUSTAINABLE, SUPERIOR RETURNS RETURN ON MANAGED ASSETS

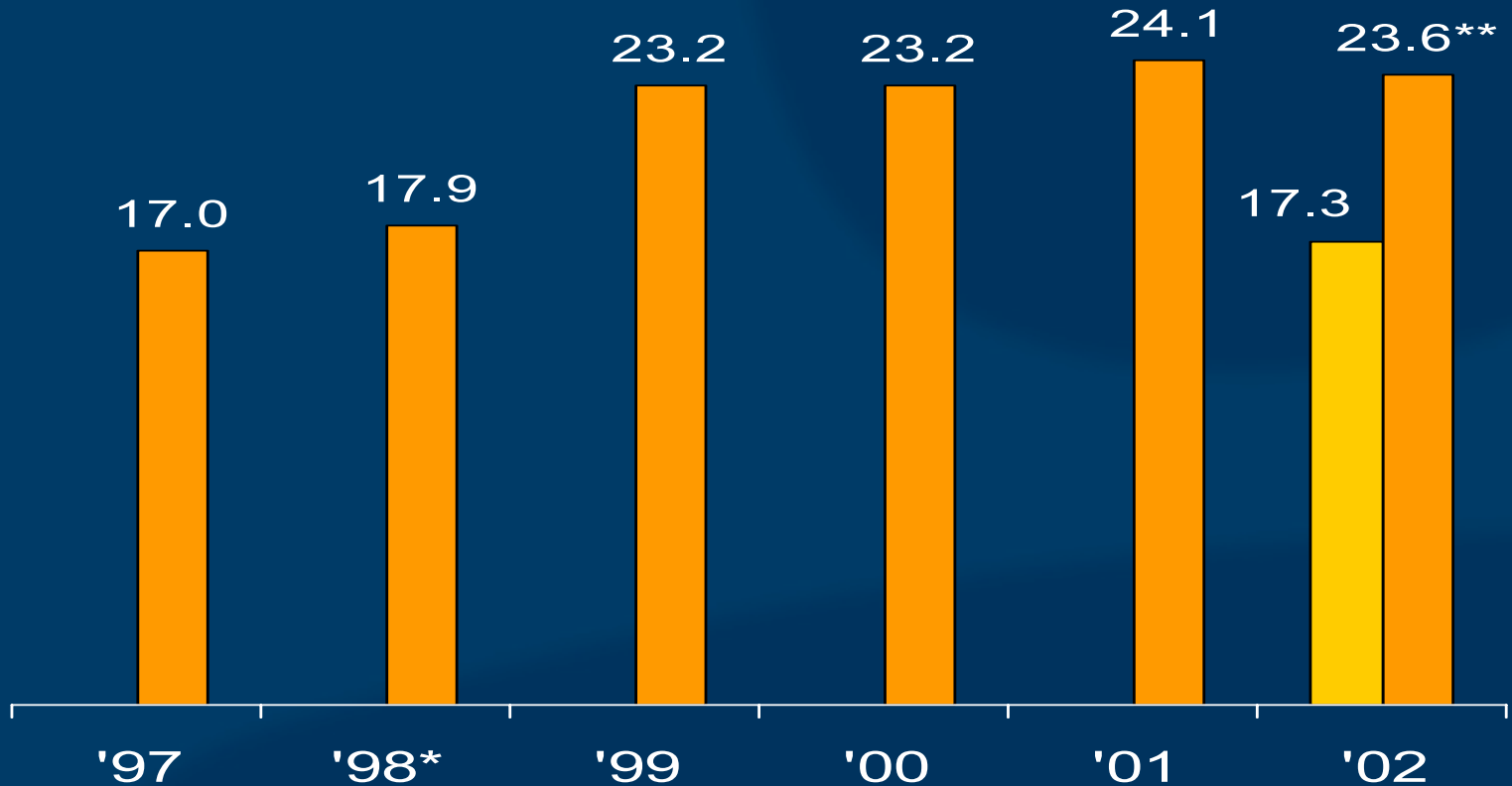
(%)



- *Excludes merger-related items*
- \*\* *Excludes non-recurring charges*

# RETURN ON AVERAGE COMMON EQUITY

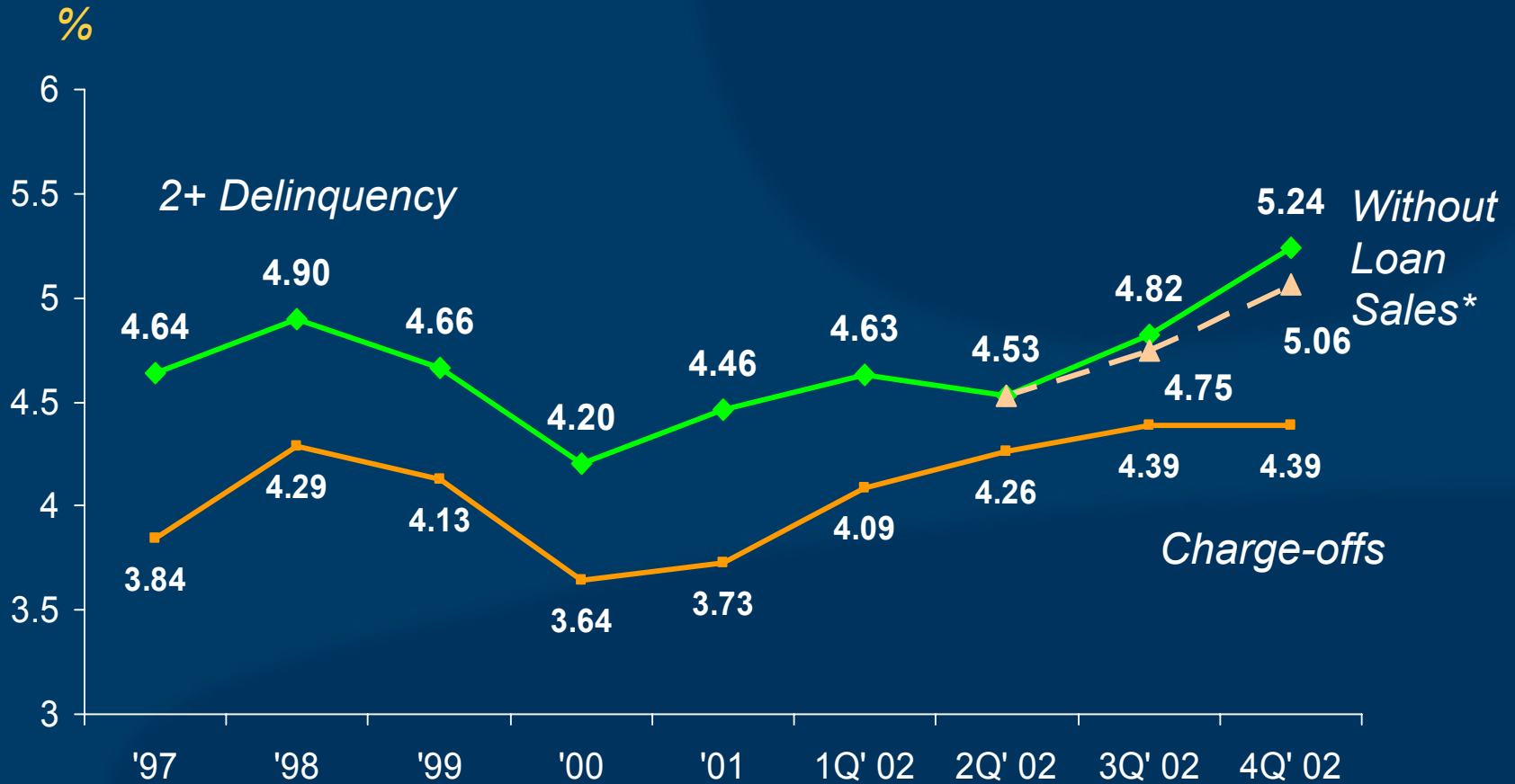
(%)



- Excludes merger-related items
- \*\* Excludes non-recurring charges

# CREDIT QUALITY

## Managed Basis

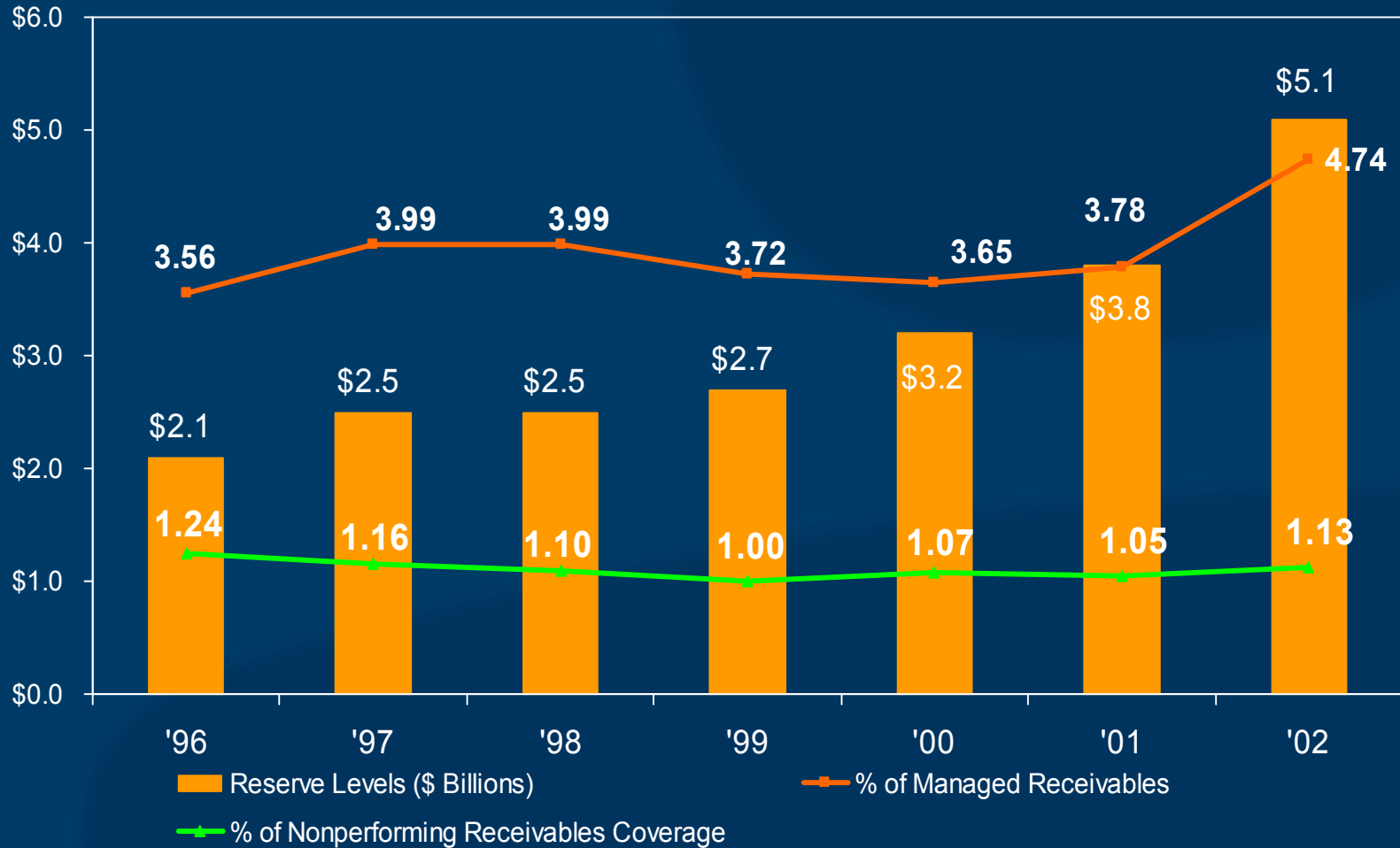


- Excluding loan sales of \$1.6 billion in 3Q'02 and \$3.8 billion in 4Q'02.



# MANAGED RESERVES

## *A Strong Balance Sheet*



# CAPITAL RATIOS

(%)



# ATTORNEYS GENERAL SETTLEMENT

- Settlement primarily addressed loan disclosure issues on branch originated real estate loans
- \$333 million after-tax charge taken in 3rd quarter for AG settlement, other civil litigation and related expenses
- Announced completion on December 19, 2002
- All 50 states and District of Columbia signed
- Settlement:
  - Disclosure
  - Compliance/control
  - Economic issues
- Business model unaffected
- Estimated impact on '03 results - \$50 million (after-tax)

# WHAT IS “PREDATORY LENDING?”

- No clear consensus on the definition of predatory lending
  - “I don’t know how we can hope to address the problem before we have decided what it is...”

*Former U.S. Senator, Phil Graham*

- “The predatory lending story is one of anecdotes; it is very hard to get data.”

*Federal Reserve Board Governor Edward Gramlich*

- Responsible lenders agree that predatory activities include:
  - Making unaffordable loans based solely on the home value rather than the borrower’s ability to repay (“equity stripping”)
  - Inducing the borrower to refinance a loan repeatedly in order to charge high points and fees (“loan flipping”)
  - Engaging in fraud or deception to conceal the true nature of the loan obligation
- Other areas of discussion – points/fees, prepayment penalties, insurance sales, non-standard loan features

# POLITICAL ENVIRONMENT

- Despite no formal definition of predatory lending, over 20 state jurisdictions have instituted high cost mortgage/predatory lending legislation
  - A comparable number of cities and counties have enacted similar local ordinances
  - May result in restricted consumer credit options
  - Raises cost to comply with various state, county and city mortgage lending laws and regulations
- United States Congress has yet to implement a federal, preemptive solution, although such a bill was recently introduced

# POLITICAL ENVIRONMENT

- Activists placed considerable pressure on major players (Citifinancial, Household)
  - Negative media articles
  - Class action litigation
- State Attorneys General and Banking Regulators are responding to public pressure to take action
  - Citifinancial settled with DOJ
  - Household settled with state AG's
  - Wells Fargo currently being sued by California Department of Corporations

# HOUSEHOLD'S UNIQUE OPPORTUNITY

- The company's stringent consumer lending policies, which include provisions agreed to in the recent settlement with state attorneys general, are *industry leading* and are endorsed by state regulatory bodies:
  - *"Household Finance has shown important leadership in this collaborative effort to better inform and protect borrowers."*  
**Utah Attorney General Mark Shurtleff**
  - *"We trust that this settlement will transform Household into a model for other lenders to follow."*  
**Washington Attorney General Christine Gregoire**
  - *"Household should be commended for working to adopt innovative new programs to strengthen compliance and improve disclosure. We anticipate this landmark agreement with Household will set a new standard for the entire subprime lending business."*  
**Delaware Bank Commissioner Robert Glen**

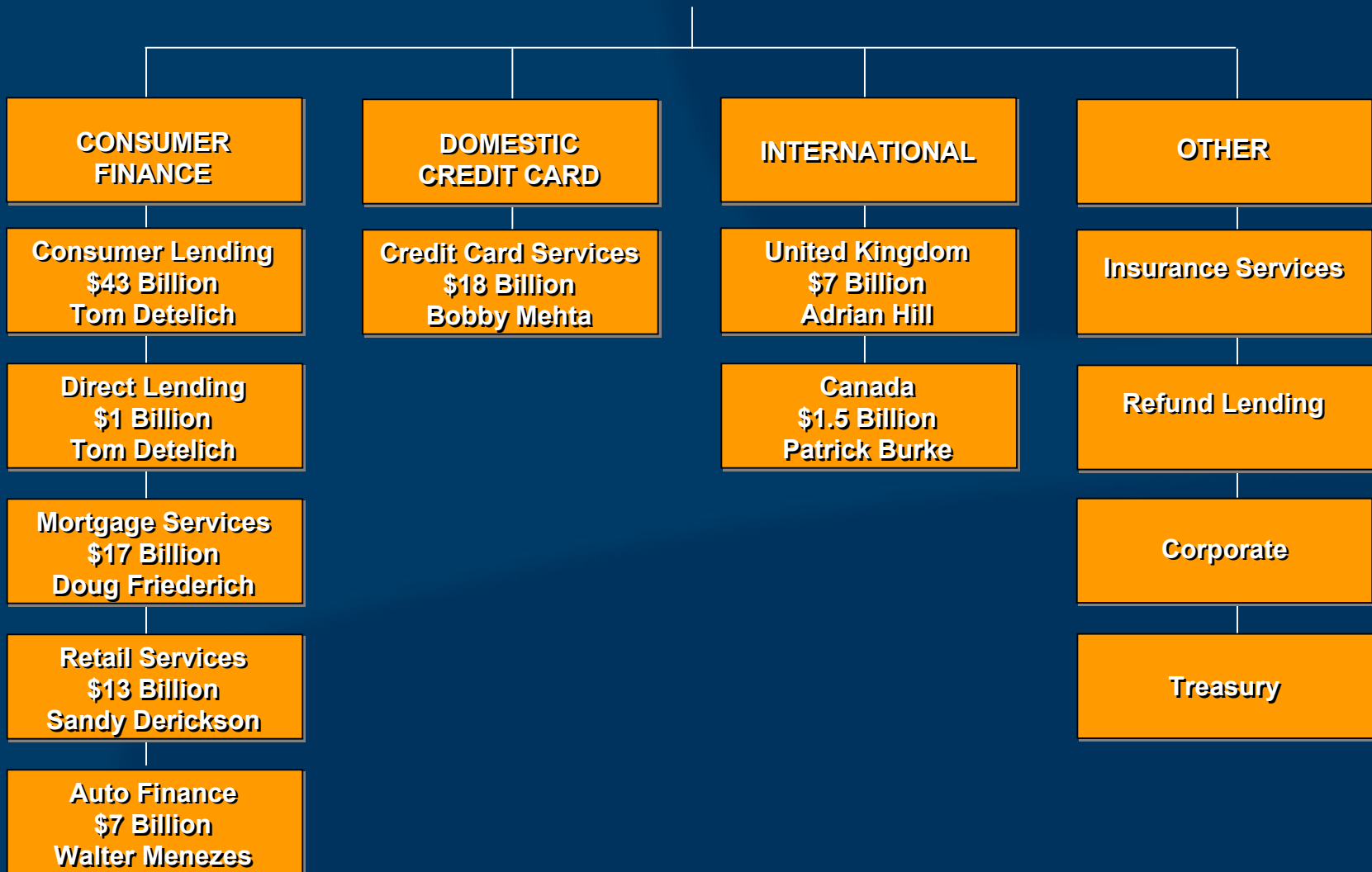
# HOUSEHOLD'S UNIQUE OPPORTUNITY

- Policies are setting the standard
- Low cost producer
  - Centralized capabilities to efficiently comply with various legislative proposals
  - Ability to gain further market share
    - Policies are the most consumer-friendly in the marketplace
  - Capability to advocate for federal legislative solution
    - Existing regulatory dialogue
    - Member of industry coalition pushing for Congressional action in 2003



# ORGANIZATION CHART

## HOUSEHOLD



# HOUSEHOLD



## CONSUMER LENDING

*Tom Detelich*  
*Group Executive*

**January 21-22, 2003**

# OUR OPERATING MODEL

- 1,359 distributed retail branches
- Direct lending channel
- 7 centralized collection, underwriting and customer service sites
- Centralized support functions:
  - Marketing
  - Human resources
  - Credit risk
  - Policy and compliance
  - Financial control

# KEY COMPETITIVE ADVANTAGES

- Operating model
  - Distributed branch network
  - Centralized support
  - Low cost producer
- Lead delivery platform/technology
  - “Next best lead” segmentation
  - Optimization of leads across the branch network
  - Centralized control of the sales efforts
- Proprietary front-end sales engine: Vision

# KEY COMPETITIVE ADVANTAGES

- Credit risk approach
  - Proprietary scorecards and modeling
  - Niche market approach to underwriting
- Direct marketing expertise
  - CIM: data marts for both customer acquisition and relationship management
  - Unique blend of both marketing and credit risk analytical talent: focus is optimization of profit

# QUALITY AND CUSTOMER SATISFACTION APPROACH

- Credit policies are established by a credit committee, which includes key consumer lending executives and Household's chief credit officer
- Proprietary, internally developed scorecards, built on experience with these products, are used to underwrite 100% of our lending
  - No automated decisions occur on secured lending
  - All decisions are handled at a centralized facility
  - Consideration given to credit policy, collateral, ability to pay and verification of title and income
  - Unsecured applications may be manually underwritten or auto-decided

# QUALITY AND CUSTOMER SATISFACTION APPROACH

- Underwriting utilizes an automatic bureau feed to maximize depth of credit file and geographic differences
- There is a centrally controlled appraisal and title ordering process

# QUALITY AND CUSTOMER SATISFACTION APPROACH

- Law records
  - Rate, term, fees, and insurance based upon state requirements
- Safe
  - All form changes are centrally maintained and controlled
  - Checklist of required documents at loan close
  - Bar coding for tracking
  - Loan terms cataloged for post-comparative purposes
- On-line manuals
  - Products
  - Servicing
- On-line training
- Underwriting verification of Customer Benefits Test



# QUALITY AND CUSTOMER SATISFACTION APPROACH

- One page disclosure
- Loan closing video
- Customer survey at loan close
- Third party customer satisfaction survey
- Mystery shopper – branch experience
- Periodic audit of the branch controls
  - Confirmation calls to the customer
  - Branch audits – over 4,000 audits conducted per year

# ORGANIZATIONAL STRUCTURE

Thomas M. Detelich

Group Executive - Household  
President - HFC/Beneficial  
Consumer Lending

Years with Company: 26

Managing  
Director-  
Branch  
Operations

Years with Company: 20

Managing  
Director-  
Operations

Years with Company: 13

Managing Director  
Direct Lending and  
Customer Retention

Years with Company: 3

Managing Director-  
Strategic Planning  
and Development

Years with Company: 14

Vice President  
Marketing

Years with Company: 12

Vice President  
Human Resources

Years with Company: 19

Vice President  
Credit Risk

Years with Company: 26

Chief Financial  
Officer

Years with Company: 19

National Director-  
Business  
Performance

Years with Company: 13

Vice President  
Policy and  
Compliance

Years with Company: .25

General Counsel

Years with Company: 15

Vice President  
Applications - HTS

Years with Company: 23

# BUSINESS MIX

	12/31/02 Outstandings (\$ Billions)	Percent of Total Outstandings
Real Estate		
First Lien	\$23.8	55%
Second Lien	4.2	10
Total Real Estate	\$28.0	65%
Personal Homeowner		
Loan (PHL)	\$ 5.1	12%
Unsecured Loans	10.3	23%
Product Total	\$43.4	

# OUR BUSINESS TODAY

## CUSTOMERS

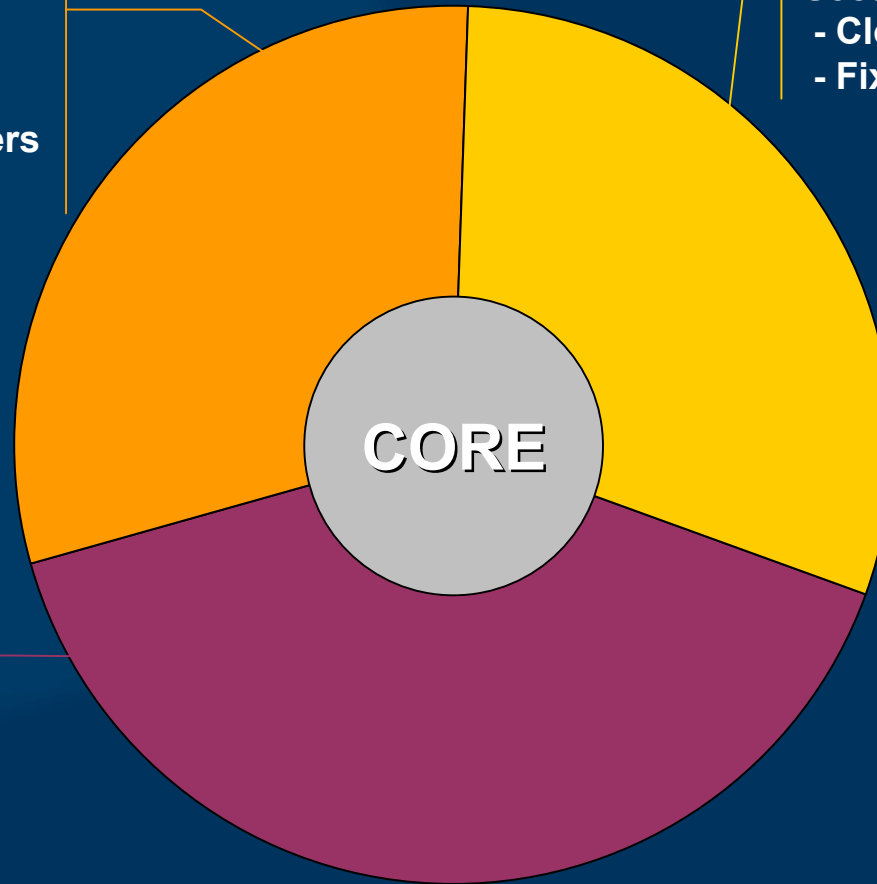
- Subprime and Non-Conforming Homeowners

## PRODUCTS

- Secured & Unsecured Loans
  - Closed-end & Revolving
  - Fixed Rate & Variable Rate

## CHANNELS

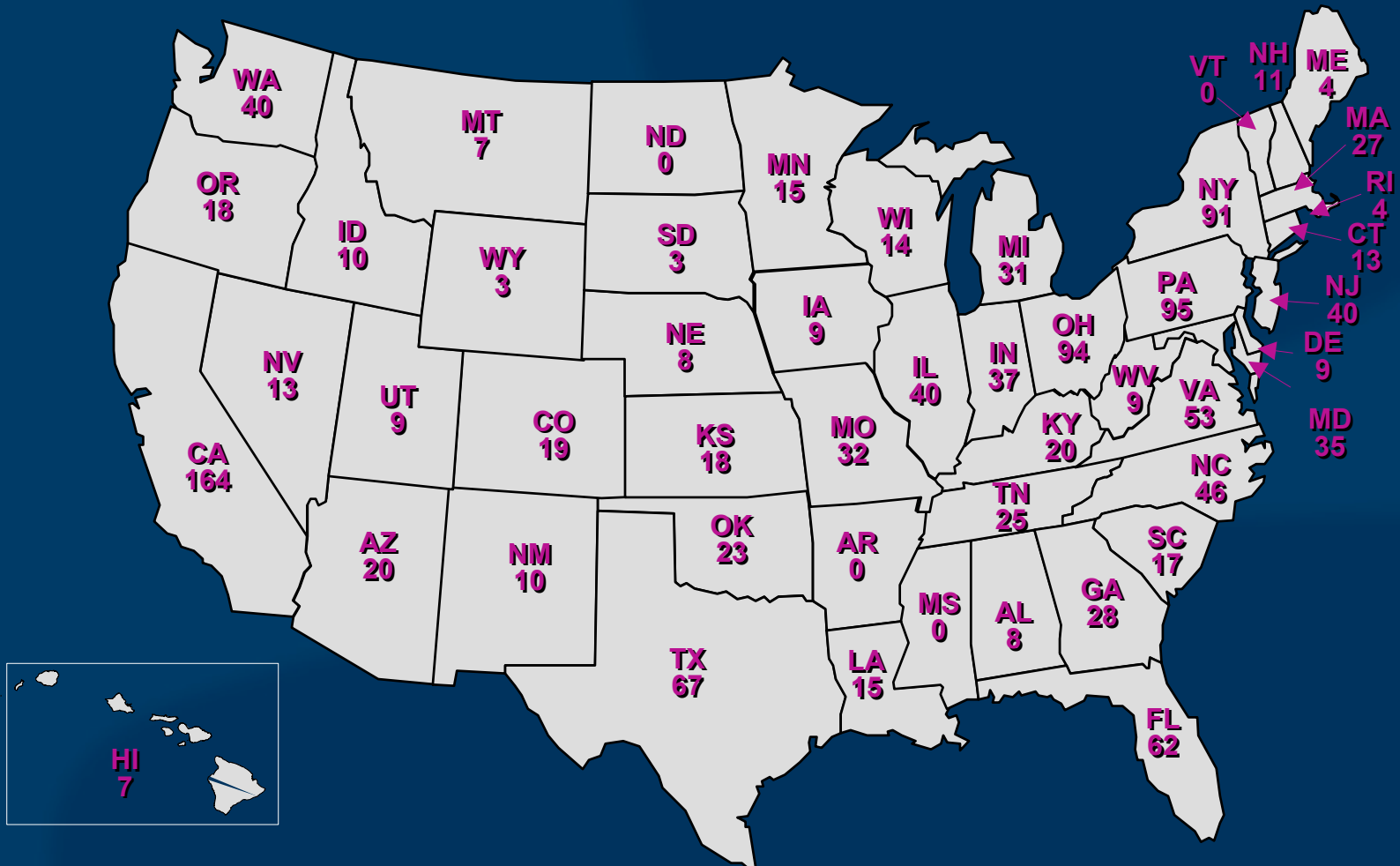
- Branch
- Direct Lending
- Direct Mail
- Internet Sourced



# OUR BUSINESS TODAY

## *HFC & Beneficial Branch Offices Per State*

*(As of November 11, 2002)*



# OUR CUSTOMER \*

<i>Age</i>	43 years
<i>Gross Household Income</i>	\$42,000
<i>Time on Job</i>	6.4 years
<i>Occupation</i>	46% white collar 29% blue collar 25% sales/other
<i>Time at Current Address</i>	6.0 years
<i>Homeownership</i>	79%

\* Data is for all products originated June 2001-June 2002

# OUR CUSTOMER \*

## *Loan Purpose*

assist family

35% debt consolidation

28% current expenses/

17% travel/other

16% home improvement

4% auto purchase/repair

## *Proximity to Branch*

35% live within 5 miles

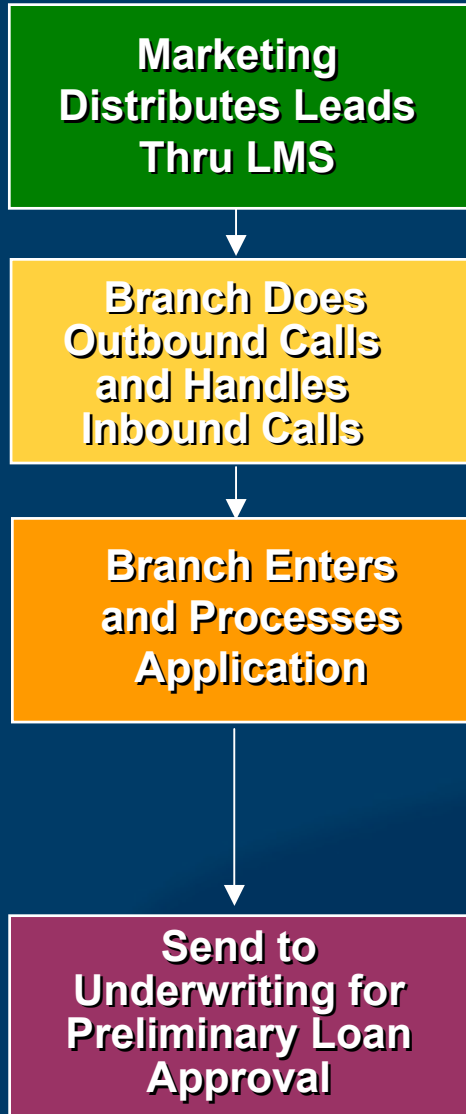
24% live within 5-10 miles

34% live within 10-50 miles

7% live > 50 miles

\* Data is for all products originated June 2001-June 2002

# BRANCH CYCLE – REAL ESTATE

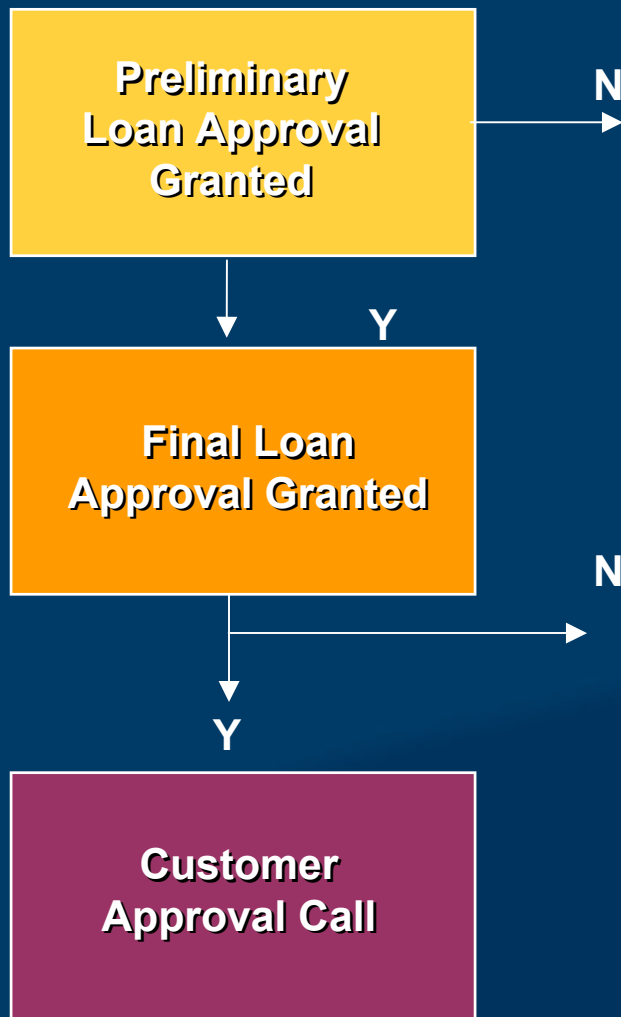


- Branch requests necessary information to complete the application: demographic, employment and earnings
- Request necessary loan documents
- Establish an appointment to discuss loan terms and benefits with the customer
- Complete and mail RESPA documents if applicable
- Underwriting reviews application, credit bureau, income documentation and ability to pay
- Underwriting preliminary grades the customer based on credit policy
- Verify customer meets Net Tangible Benefits and Customer Benefits Test
- Branch Manager orders title and appraisal from our approved vendor



# BRANCH CYCLE

## *Real Estate*



- Contact the customer and explain the turndown
- Determine if additional information needs to be gathered for re-consideration by Underwriting

- Review appraisal, title and income verification

- Determine if additional information needs to be gathered for re-consideration by Underwriting

- Re-grade the loan based on credit policy: ability/capacity to pay, collateral, and title infiractures

- Contact the customer and review the final loan parameters and terms

# BRANCH CYCLE

## *Real Estate*

**Loan Closing**

```
graph TD; A[Loan Closing] --> B[Loan Funding];
```

- Customer watches the loan closing video
- Review loan documents
- Explain rescission and sign loan documents
- Discuss funding date and time

**Loan Funding**

- Cut customer check(s)
- Have customer sign non-rescission notice and collect this document for the file
- Have customer complete customer survey

# 2003 FOCUS

*Quality*



*Customer  
Satisfaction*

*Delivering  
Results*

# HOUSEHOLD



## TECHNOLOGY

***Ken Harvey***

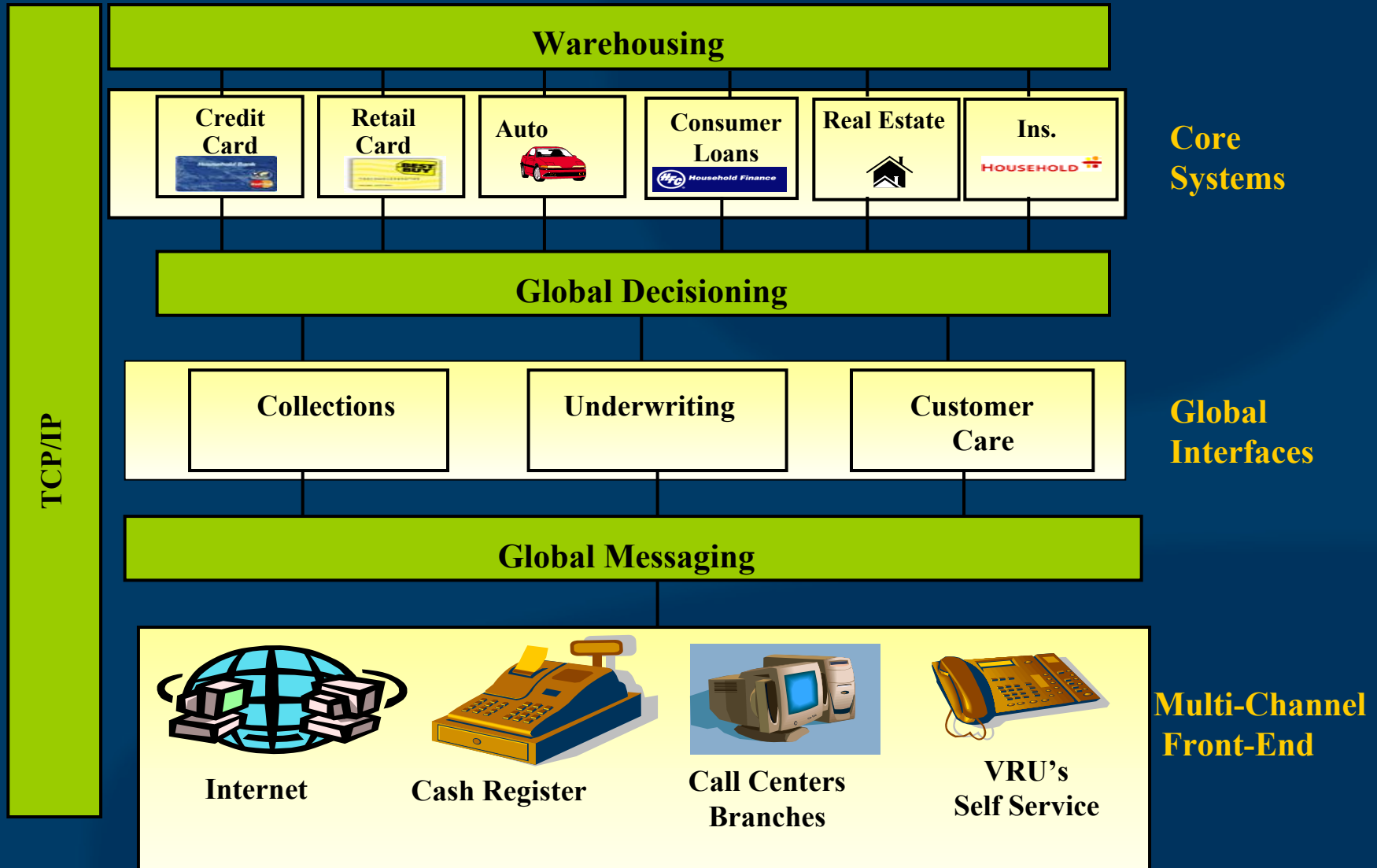
*Group Executive – Chief Information Officer*

**January 21, 2003**

# HOUSEHOLD NORTH AMERICA

- Largest Static Internet Protocol Network
- 800 Million Transactions Processed Per Month
- 25 Ubiquitous Call Centers
- Leader in Neural Networking
- Leader in Point of Sale Technology “VISION”

# HOUSEHOLD GLOBAL TRANSACTION FLOW



# ENTERPRISE DECISIONING FLOW

## Inbound Channels

Internet

Auto dealers

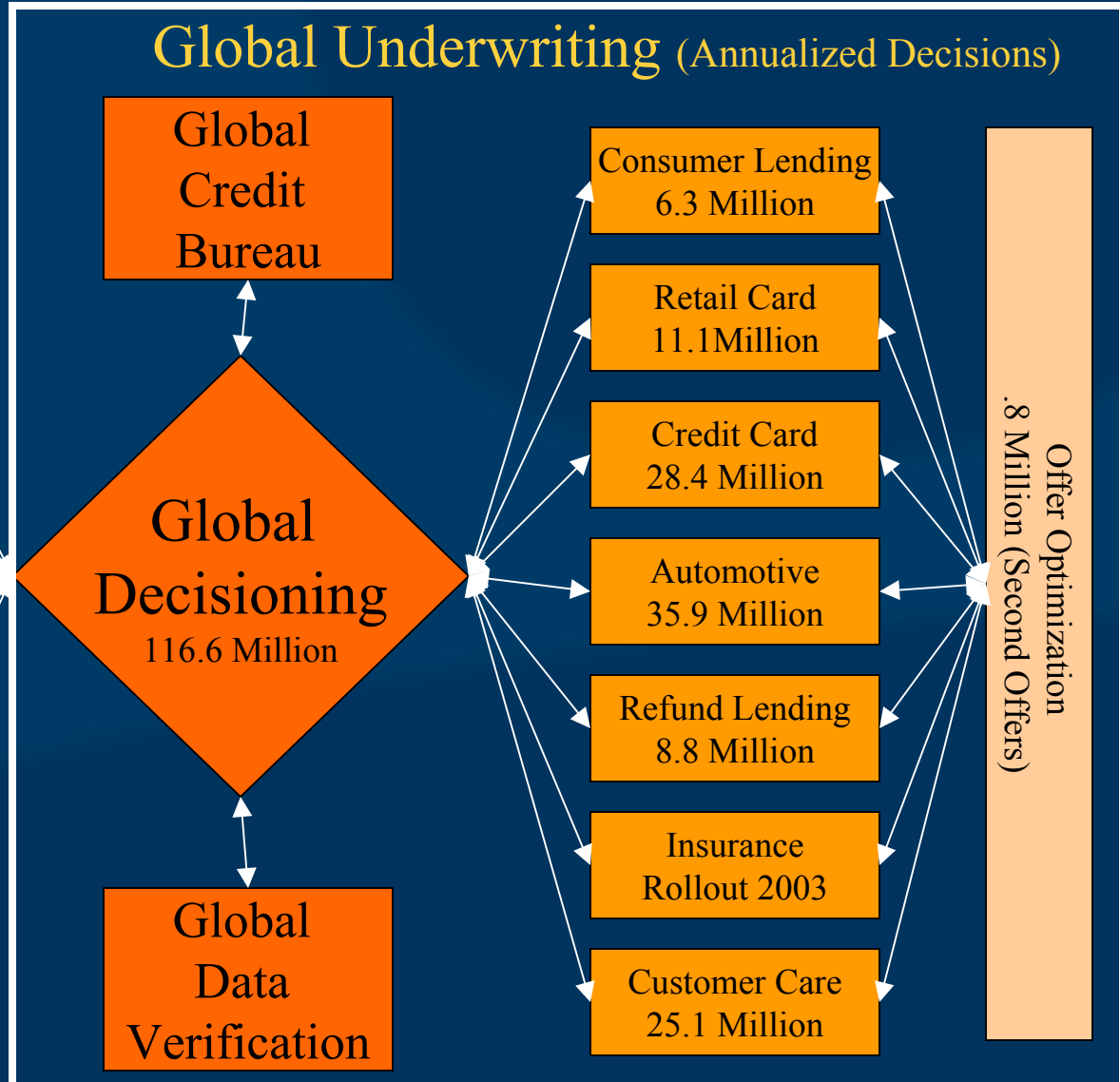
Branch Network

Merchant

Batch Vendor

Third Party

Call Centers



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# VISION METRICS

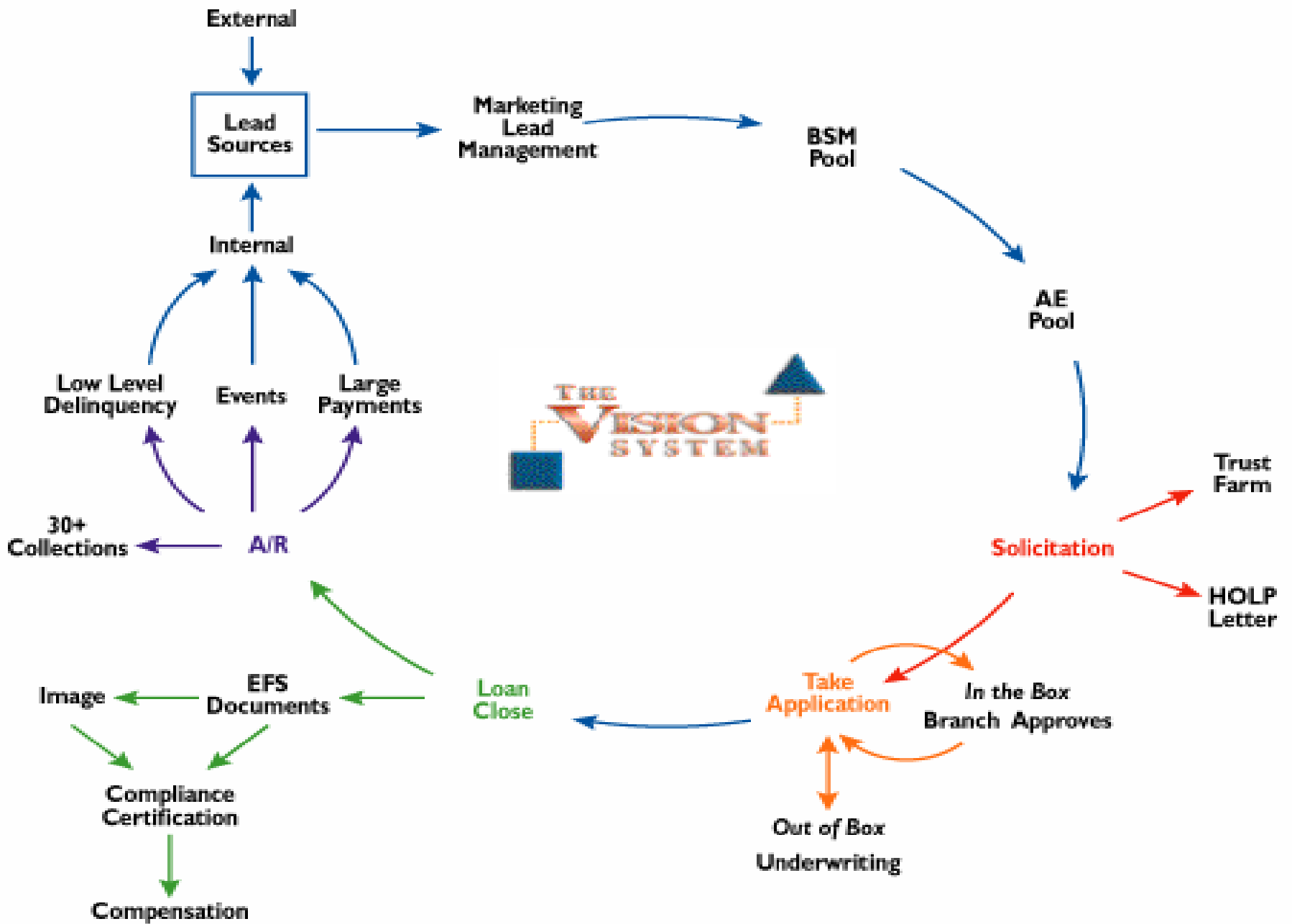
## Servicing

- 7 million outbound calls
- Capacity for 15mm inbound calls
- .5 million leads serviced each week
- 35% average decrease in turn-around time for title and appraisal work

## Efficiency Trends

Total Number of Loans	35% increase
Total Loan Acct Dollar Gain	20% increase
Promotional expense	4% decrease
Cost per \$1,000 originated	20% decrease
Secured cost per LA \$	24% decrease





# HOUSEHOLD



## CREDIT MANAGEMENT

***Paul Makowski***

*Senior Vice President – Chief Credit Officer*

**January 21-22, 2003**

# CREDIT RISK MANAGEMENT

- Credit risk management is a core competency
- Developed and managed company-wide, with common data structure and platforms
- State-of-the-art scoring and segmentation techniques
- Strategic support for batch and real time decisions
- A wealth of technological tools to facilitate implementation of complex strategies

# SKILLS INVENTORY

- 700 professionals with analytic expertise
- Engaged in
  - Scorecard development
  - Customer analytics
  - Strategy implementation
  - Collections analytics
  - Underwriting decision trees
  - Loss forecasting
  - Underwriting and collections support
- Managers all have minimum of 10 years experience; almost all have MBA+

# BUSINESS UNIT CREDIT RISK

## *Underwriting Practices*

- Real Estate Loans
  - No auto decisioning
  - All loans are graded on multiple measurements (i.e., LTV, DTI, etc.)
  - Objective, centralized appraisal process
- Private Label
  - 90% automated
  - Incomplete applications are referred for credit review
- Credit Cards
  - Proprietary prospect database
  - Custom risk attributes and models
  - Screen all responses on back-end

# BUSINESS UNIT CREDIT RISK

## *Underwriting Practices*

- Other Unsecured Products
  - 70% automated
  - Judgmental decisions are made by experienced underwriters at central location
- PHL
  - Judgmental decisions are made by experienced underwriters at central locations
- Auto Finance
  - Decisions are based on a mix of FICO, custom score, judgment and policy rules

# DECISION SUPPORT TECHNOLOGY

## *Common Underwriting Tool*

- Complex strategies in champion/challenger mode
- Can use multiple input sources, not just credit bureau
- Can test logic by analyst at desktop
- Common inputs and outputs company wide, yet allows specific business customization
- Creates outputs ready for future model development
- Supports cross business solicitation
- Offers can be made by multiple businesses with their proprietary strategies with one pass

# CORPORATE CREDIT MISSION

- Provide corporate oversight of:
  - Scorecards
  - Underwriting
  - Account management
  - Promotions and mailings
  - Collections
  - Privacy practices
- Foster best practices:
  - Manage communications and meetings on best practices
  - Work with each business to improve processes and technology
- Manage corporate initiatives:
  - Restructure policy changes
  - Homebase to Datahouse
  - Fraud
  - Scoring utility
  - Collections assessments
  - Cross selling
  - Loss forecasting
  - Strategyware implementation
  - Credit bureau management
  - Privacy
  - Analytic databases



# STRATEGIC CREDIT PROCESSES

- Credit Extension Program Approval for direct mail and other programs with large exposure
- Test and Learn: A culture of controlled experimentation
- Budgeting and Forecasting: Independent forecasting of delinquency and loss for comparison/validation of decentralized business unit projections
- Portfolio Review: Periodic reviews and issue specific reviews
- Risk Assessment: Lower risk tolerance across all areas of business

# FORECASTING APPROACH

- Loss and delinquency is independently forecast by Business Units and Corporate, then reconciled. Process is repeated each quarter.
- Top Down Corporate Forecast - Baseline of constant “Lagged Charge-off Rate” adjusted for economic conditions, mixed seasoning and management actions.
- Bottom Up Business Unit Forecast - Baseline of segmented roll rate and vintage and management consensus adjusted for economic conditions and management actions.
- Reconciled and consensus outlook jointly reviewed with senior management.

# RESTRUCTURE POLICIES

## *Overview*

- Restructure policies are an inherent part of value proposition for our customers, for which they pay above bank prices
- Not intended to defer credit loss recognition or to overstate net income
- Allows customers to recover from “bumps in the road” and to preserve credit bureau information
- Allows collectors to work on higher-risk accounts that have not indicated a willingness and/or ability to pay
- Policies have been consistently applied and are appropriate for each product

# LOAN RESTRUCTURING

## *Restructuring and the Marketplace*

*Wall Street Journal, Friday, November 1, 2002*

- “Fannie Mae... is allowing (customer) to skip some payments”
- “The program’s flexibility may actually help reduce defaults and foreclosures...and helps consumers stay in their homes”
- “Lenders also approve...and see it as benefiting people with irregular income streams or relieving situations in which people are temporarily cash-strapped

# RESTRUCTURING CONTROLS

- Accounts must meet performance criteria to be eligible for restructuring
- Collectors incented on “promises to pay” and dollars collected
- Only experienced collectors may provide restructuring as a collection option/strategy
- Audits to ensure adherence to policy
- Restructuring stock and volume monitoring
- Restructured accounts carry higher reserves

# RESTRUCTURE STOCKS

(\$ Millions)	12/31/02	6/30/02	12/30/01
<i>Total Domestic Portfolio</i>			
Never restructured	84.4%	83.3%	83.1%
Restructured in the last 6 mos.	6.5	7.4	9.0
Restructured in the last 7-12 mos.	4.1	5.1	3.6
Previously restructured	5.0	4.2	4.3
Total Restructured	15.6%	16.7%	16.9%
Total	100.0%	100.0%	100.0%
<i>Total Restructured by Product</i>			
Real Estate Secured	\$8,473.2	\$ 8,778.2	\$ 8,667.1
Auto Finance	1,242.9	1,189.2	959.3
MasterCard/Visa	540.8	535.4	512.5
Private Label	1,255.4	1,237.5	1,332.4
Personal Non-Credit Card	3,768.1	4,195.1	4,191.5
Total	\$15,280.4	\$15,935.4	\$15,662.8

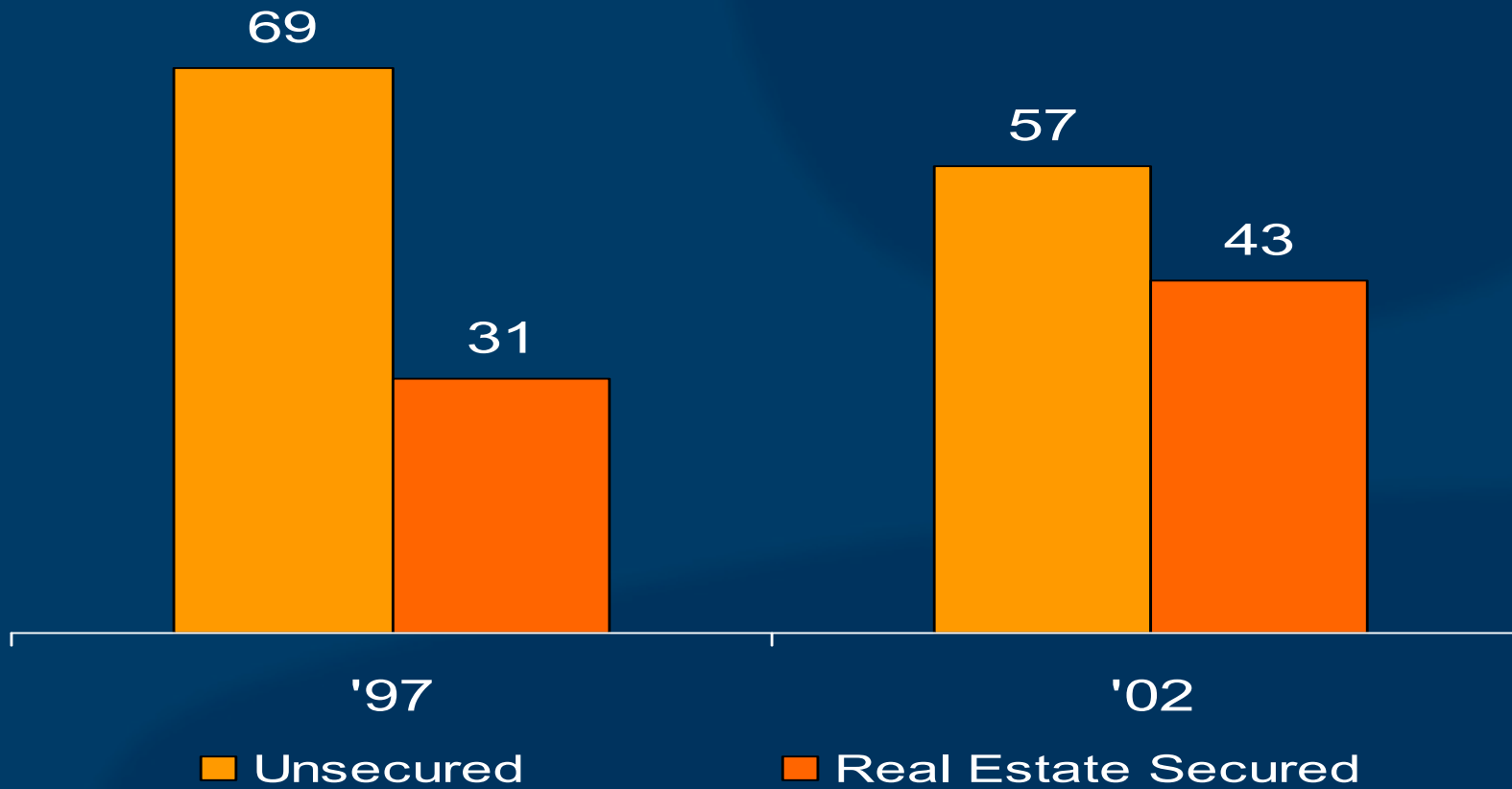
# LOWERING THE RISK PROFILE

*We Have Prepared for an Economic Slowdown*

- Emphasized real estate secured loans
- Increased collectors by 50%
- Tightened underwriting policy criteria
- Reduced credit lines in U.S. credit card businesses
- Eliminated unsecured loans to renters in U.S. branches
- Continuous strengthening of risk modeling capabilities
- Real-time monitoring of account performance

# LOWERING THE RISK PROFILE

(%)





# ACTIONS TAKEN - UNDERWRITING

- Eliminated highest risk populations from credit solicitations (i.e. renters)
- Tightened underwriting policy criteria
  - Increased cutoffs
  - Raised minimum disposable income
  - Reduced initial credit lines
- Tightened lending authority and exception policies
  - Centralized lending authority
  - Reduced exception authority
  - Lowered lending authority
- Significantly improved existing risk models and introduced new ones

# ACTIONS TAKEN – PORTFOLIO MANAGEMENT

- Converted unsecured loans to secured position
- Expanded credit line decrease programs.
- Focused on retaining and up-selling low risk accounts
  - Outbound campaigns
  - Inbound campaigns
- Significantly reduced contingent liabilities in credit card businesses

# ACTIONS TAKEN - COLLECTION

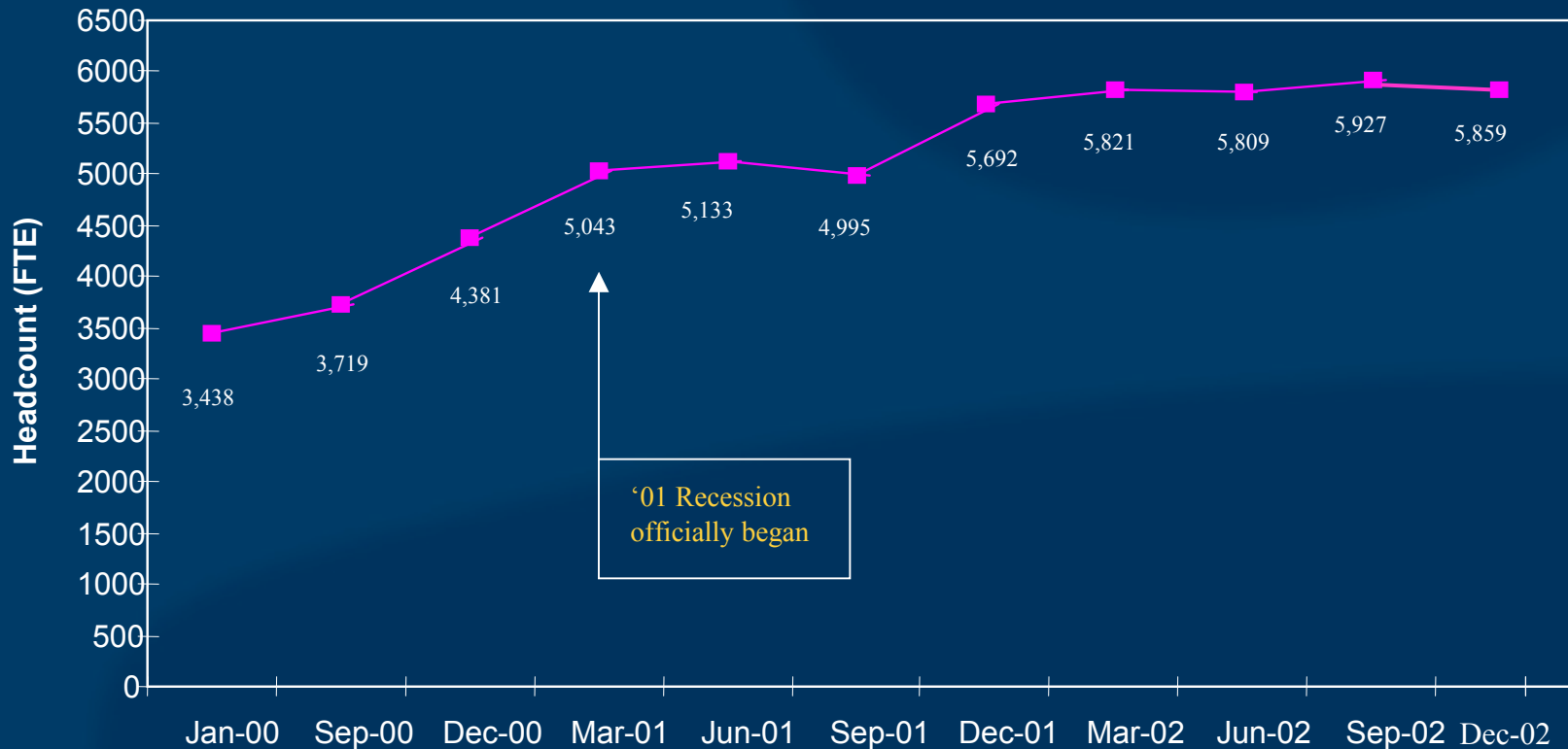
## *Focused on Collections*

- Legendary Performance Incentive Program - sponsored by CEO
- Customer Treatment Decision Tools
  - Best time to call
  - Treatment optimization
  - Adaptive control software
- Contact management database

# ACTIONS TAKEN - COLLECTIONS

*Dramatically increased the number of collectors both prior to the actual recession and after 9/11.*

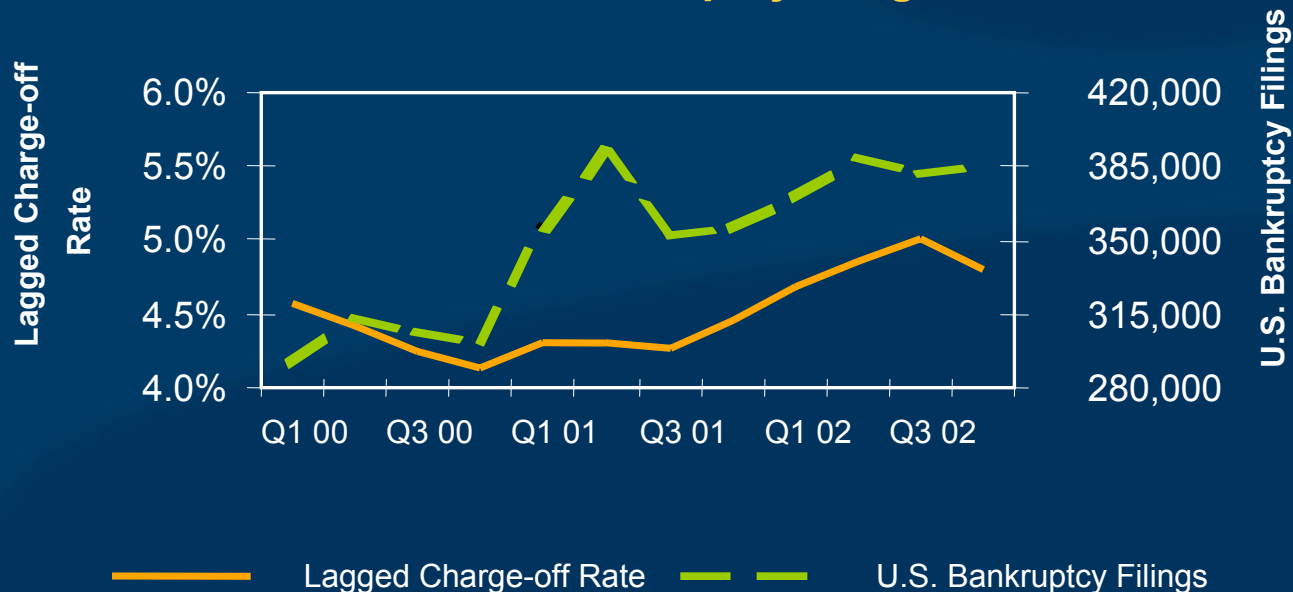
Collectors - Headcount All Businesses



# MANAGING THROUGH THE RECESSION

- However, losses rose less than the benchmark – U.S. bankruptcy filings
- Resilient performance was the result of preemptive management action

**Comparison Lagged Charge-off rate and U.S. Bankruptcy filings**



# SUMMARY

- Credit risk management skills, practices and technologies are “best in class”
- Accurate loss forecasts have enabled the company to prepare for the weak economy
- The company has continued to outperform the industry

# HOUSEHOLD



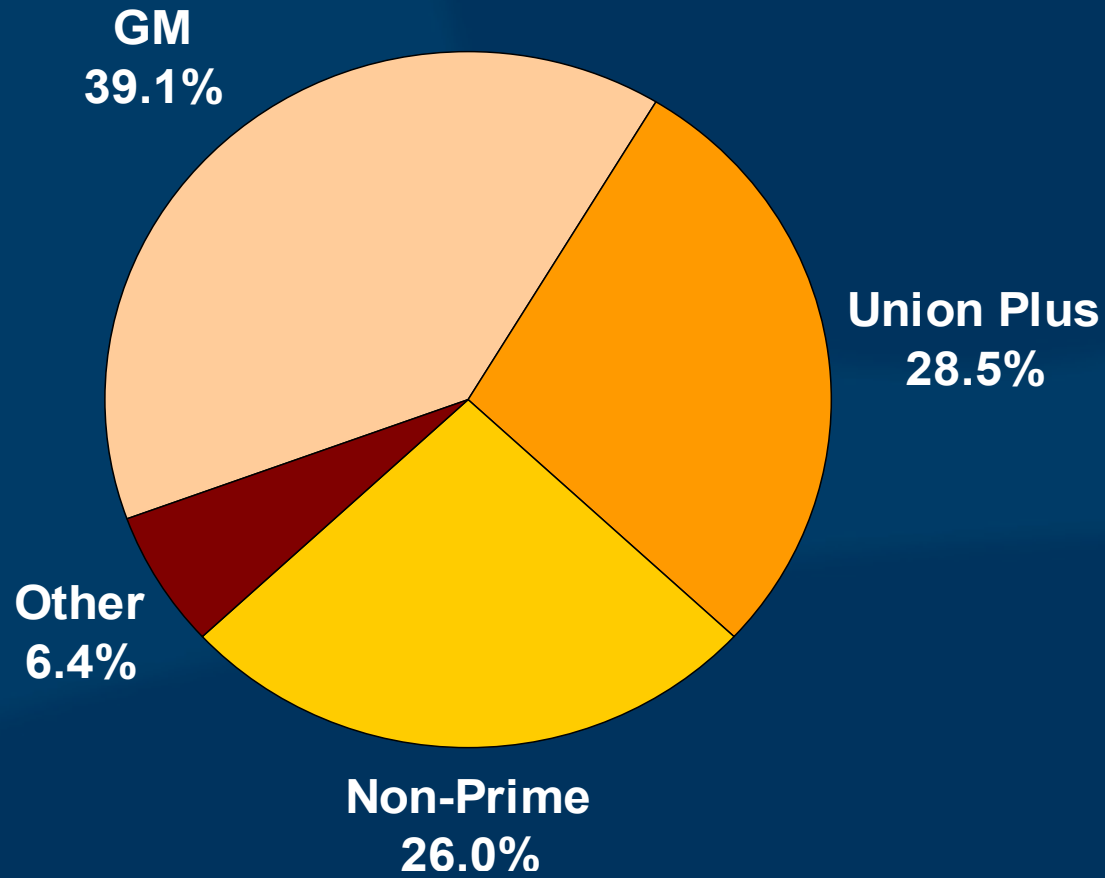
## CREDIT CARD SERVICES

***Bobby Mehta***  
*Group Executive*

**January 21-22, 2003**

# CREDIT CARD SERVICES

*Receivables As of December 31, 2002*





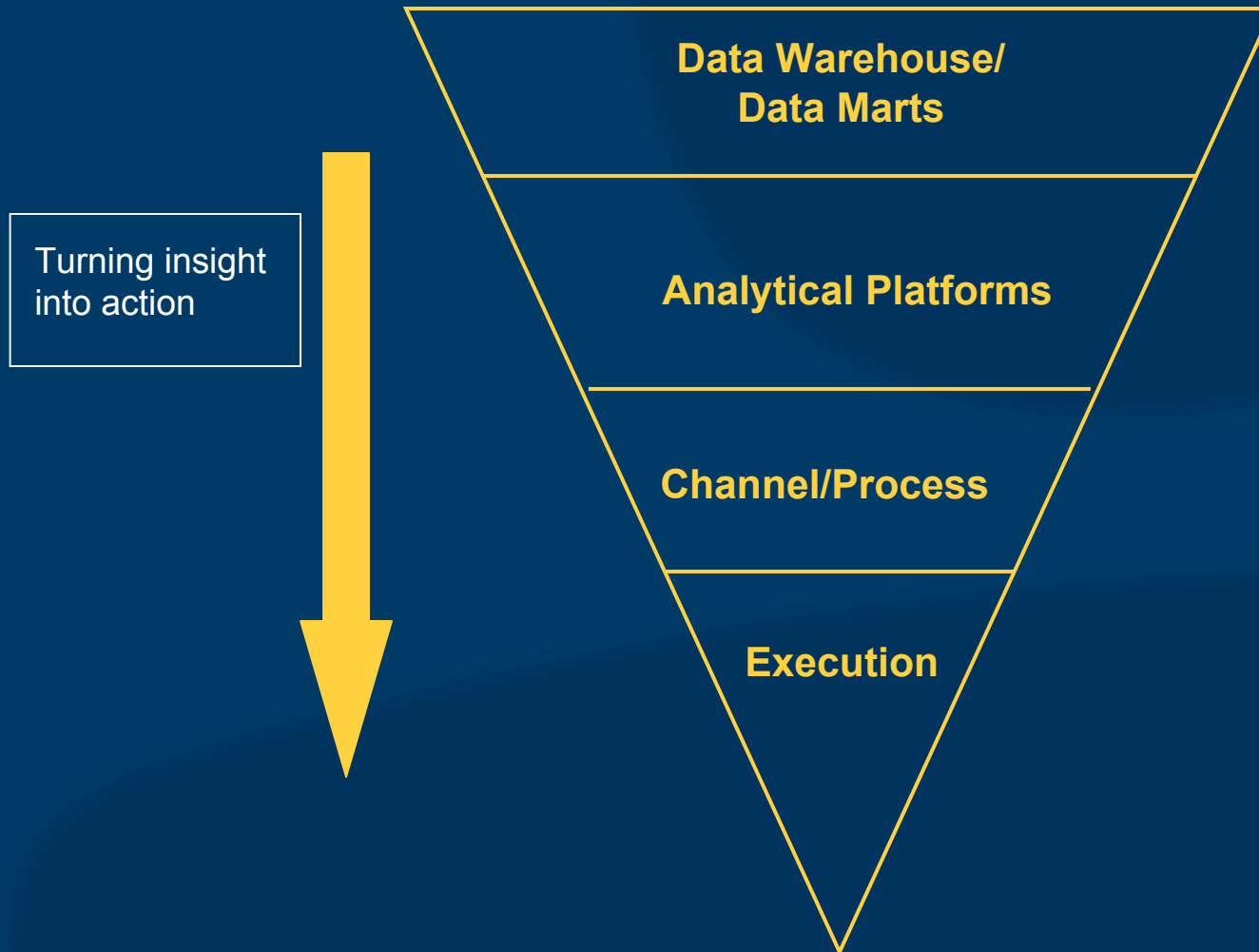
# STRATEGY FOR PROFITABLE GROWTH

- True partnership approach
- Full spectrum lending
- Leverage of Household franchise
- Customer care orientation (Sales and Service)
- Analytically driven decision making (Marketing, Risk, Collections)

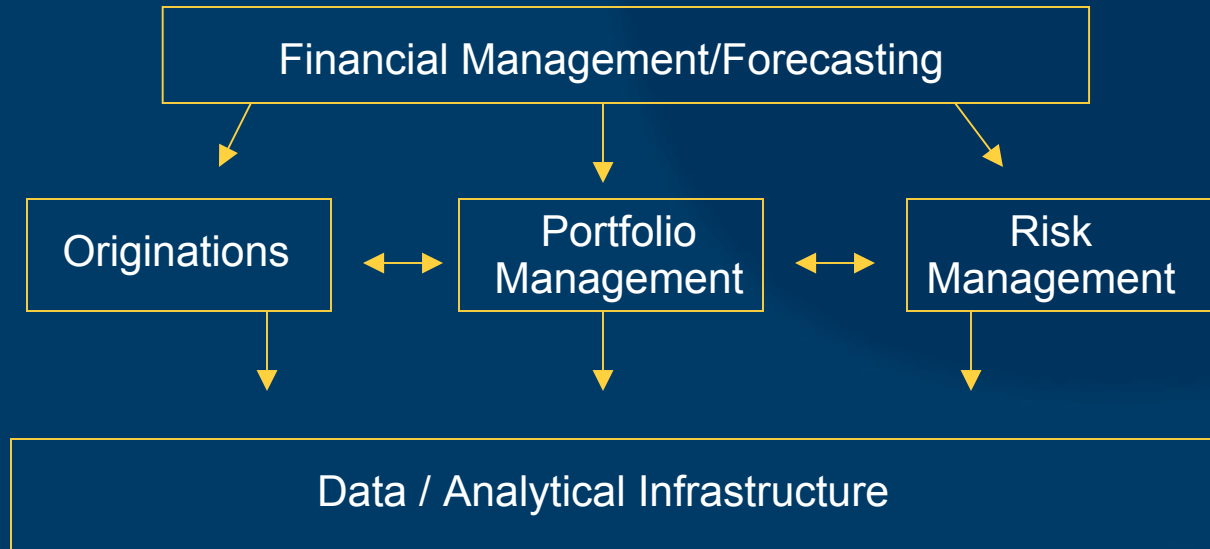
# LEVERAGING DATA AND ANALYTICS FOR PROFITABLE GROWTH

- Data and analytics are the foundation for decision-making
- Analytics and execution are aligned to turn insight into actions
  - Focused teams support each critical business function
- Teams leverage a common data infrastructure
  - Analytics are balanced with experience and judgement
- Test and learn approach

# FRAMEWORK FOR ANALYTICAL DECISION MAKING



# EXECUTION: TURNING INSIGHT INTO ACTION



# STRONG FINANCIAL MANAGEMENT PROCESS UNDERPINS RISK MANAGEMENT

- Originations, investment decisions and results tracking
  - Pro formas (5 year) utilize recent performance of “like” marketing cells
  - Risk-weighted capital based on portfolio
  - Vintage tracking on portfolio mailings
- Loss forecasting process
  - Joint process with Finance, Risk and Collections
  - Roll rate models
  - Vintage models
  - Econometric modeling and economic overlays

# STRONG FINANCIAL MANAGEMENT PROCESS UNDERPINS RISK MANAGEMENT

- Financial forecasting process
  - Full P/L monthly by major portfolio
  - Common data infrastructure
  - Produce 18-month rolling forecasts
  - Continuous improvement of process (cost analysis/drivers, capital, treasury, etc.)
  - Recession and other scenarios
- Monthly business reviews
  - Focus on risks and opportunities to financial forecasts
  - Initiatives and trends

# MODELS ARE CONTINUOUSLY VALIDATED WITH EXPERIENCE

*Over 150 scorecards are in production today*

- Leverage a suite of custom models
  - Risk and response models
  - Bankruptcy prediction models
  - Behavior scores
  - Transaction-based models
  - “Purpose-built” models
- Strict, well-documented control process governs the model development/validation process
  - Ensures statistical validity and legal/regulatory compliance

# ORIGINATIONS

## Data

Credit bureau

Demographics

Customer

Suppression

Campaign history

Response history

Vertical lists

## Analytics

Risk

Marketing

Finance

## Business Processes

Monthly mailings

Offer optimization

Underwriting  
(Strategyware)

## Results

Response rates  
above industry

Cost per account flat  
while volume of new  
accounts rising

Risk-adjusted returns  
stable

Increased frequency  
of mailings to  
monthly

Leading direct mailer  
(300M originations  
pieces mailed)



# PORTFOLIO MANAGEMENT

## Data

Transaction

Account

Customer

Household

Offer

Response

Application

Behavior

Demographics

Models/Scores

Telephone

Points (GM)

## Analytics

Risk

- Line management

- Risk-based pricing

Marketing

- Balance build

- Spend

- Retention

- Enhancement Services

Financial Forecasting

## Business Processes

Data integration

Risk focused

Marketing focused

## Results

Program execution  
(700+ campaigns annually)

Growth of inbound sales

Intelligent call routing

Monthly processes for all key actions

# LOSS MITIGATION

## Data

Falcon (fraud)  
Bust-outs  
Suspicious merchants  
Transactions  
Authorizations  
Collections

## Analytics

Current account  
- Line management  
- Repricing  
- Authorizations  
Delinquent accounts  
- Collections treatment optimization  
- Collections support (champion/challenger)

## Business Processes

Collections analytics  
Current account loss mitigation

## Results

Collections  
- Efficiency  
- Effectiveness  
- Optimization of treatment (CTO)  
  
Fraud losses among lowest in industry  
  
Current account loss mitigation provides substantial charge off savings

# SUMMARY

- Results
  - Have improved consistently since 1998
  - Have proven highly predictable
- Overall portfolio growth has been prudent and controlled
- Underwriting and account management strategies have been appropriately conservative
- Collections and loss mitigation efforts have been very effective
- All strategies have a strong empirical and statistical foundation
- Rigorous review and control processes ensure sustainability of results

# HOUSEHOLD



## AUTO FINANCE

***Bobby Mehta***  
*Group Executive*

**January 21-22, 2003**

# AUTO FINANCE

- We finance primarily late-model used vehicles through franchised new vehicle dealers
- 10% direct lending through internet, direct mail and alliance partners
- Tremendous success of HAFC Superhwy.com
- \$7 billion in managed receivables

# UNDERWRITING TRENDS

## *Improving Collateral and Borrower Profile*

	2002	2001	2000
<i>Borrower</i>			
Monthly Disposable Income	\$1,709	\$1,706	\$1,613
Home Ownership	45%	40%	37%
FICO Score	598	587	576
<i>Collateral</i>			
Odometer Mileage	27,770	26,529	24,253
New Cars	24%	24%	29%
Loan Amount	\$16,677	\$15,938	\$16,226
Wholesale Value of Car	\$14,814	\$14,704	\$14,958
Average Term	63.5	63.1	64.0

# KEY ISSUES

- Losses increased in late 2001 and 2002 due to:
  - A slow economic growth environment creating higher unemployment rate (frequency)
  - Zero percent manufacturers' programs creating declining/weak used car prices (severity)
- Used car prices have softened and likely to result in low recovery rates for the foreseeable future
- 4<sup>th</sup> quarter 2002 chargeoffs are higher due to weak used car prices, some of which is seasonal

# HOUSEHOLD



## RETAIL SERVICES

***Sandy Derickson***

*Group Executive*

**January 21-22, 2003**



# RETAIL SERVICES BUSINESS OVERVIEW

- Second largest third-party private label provider
- \$12.6 billion managed receivables
- Nearly 11 million active cardholders
- 70 active merchant relationships
- Approximately 2,300 employees in 7 locations

# THE PRIVATE LABEL MARKET IS SIGNIFICANT

(\$ Billions)



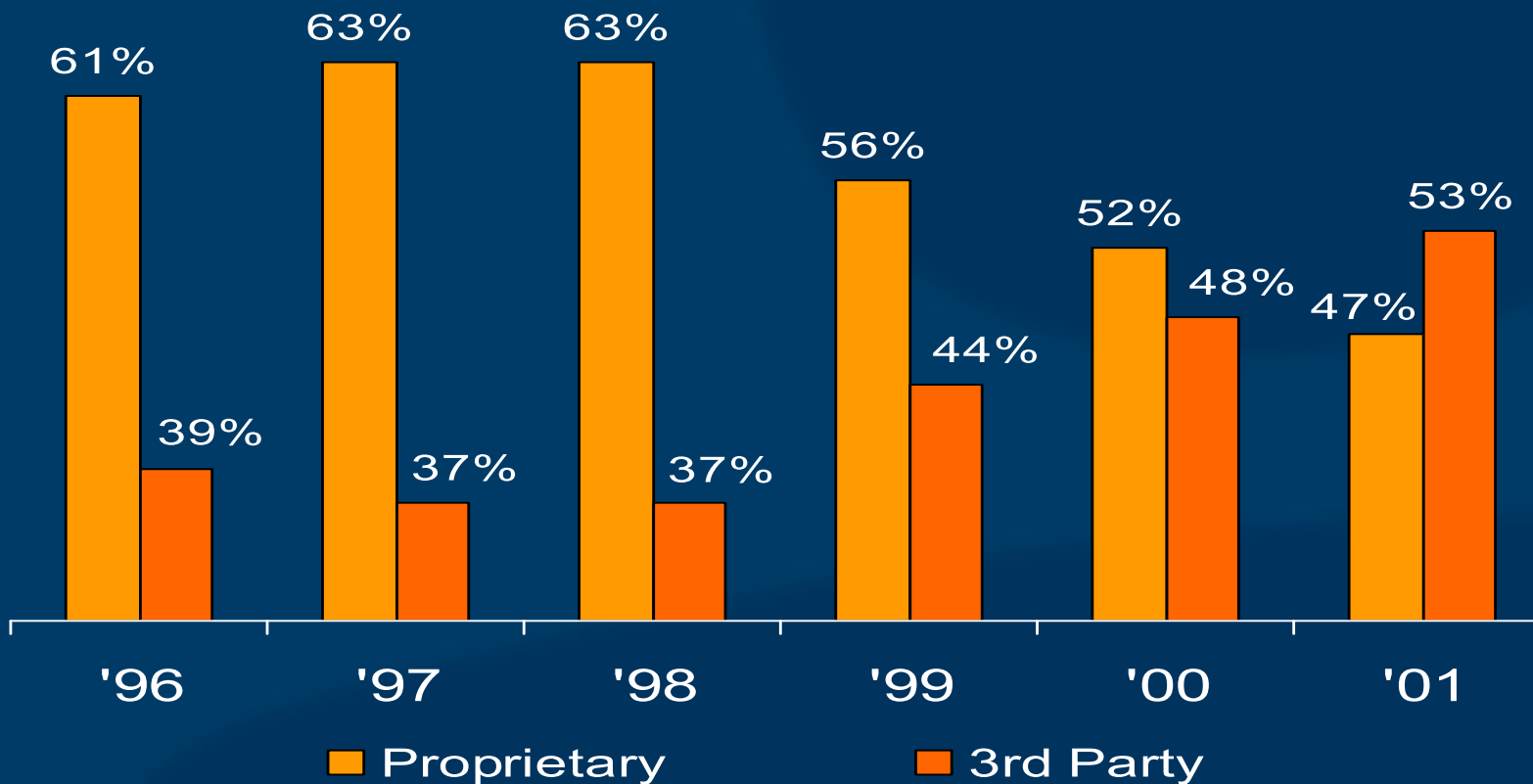
SOURCE: *The Nilson Report*

# PRIVATE LABEL CREDIT IS ESSENTIAL TO RETAILERS

- Customers receive a distinct line of credit which increases buying power
- Merchant has greater flexibility in the design of credit promotions and structure of program economics
- Private label program provides valuable customer data for future marketing campaigns
- Customer loyalty is enhanced through formal rewards programs and targeted marketing
- Outsourcing allows retailer to leverage third party scale and expertise, minimize financial investment and risk, yet maintain key customer data

# MARKET SHARE IS SHIFTING TO THIRD PARTIES

(%)



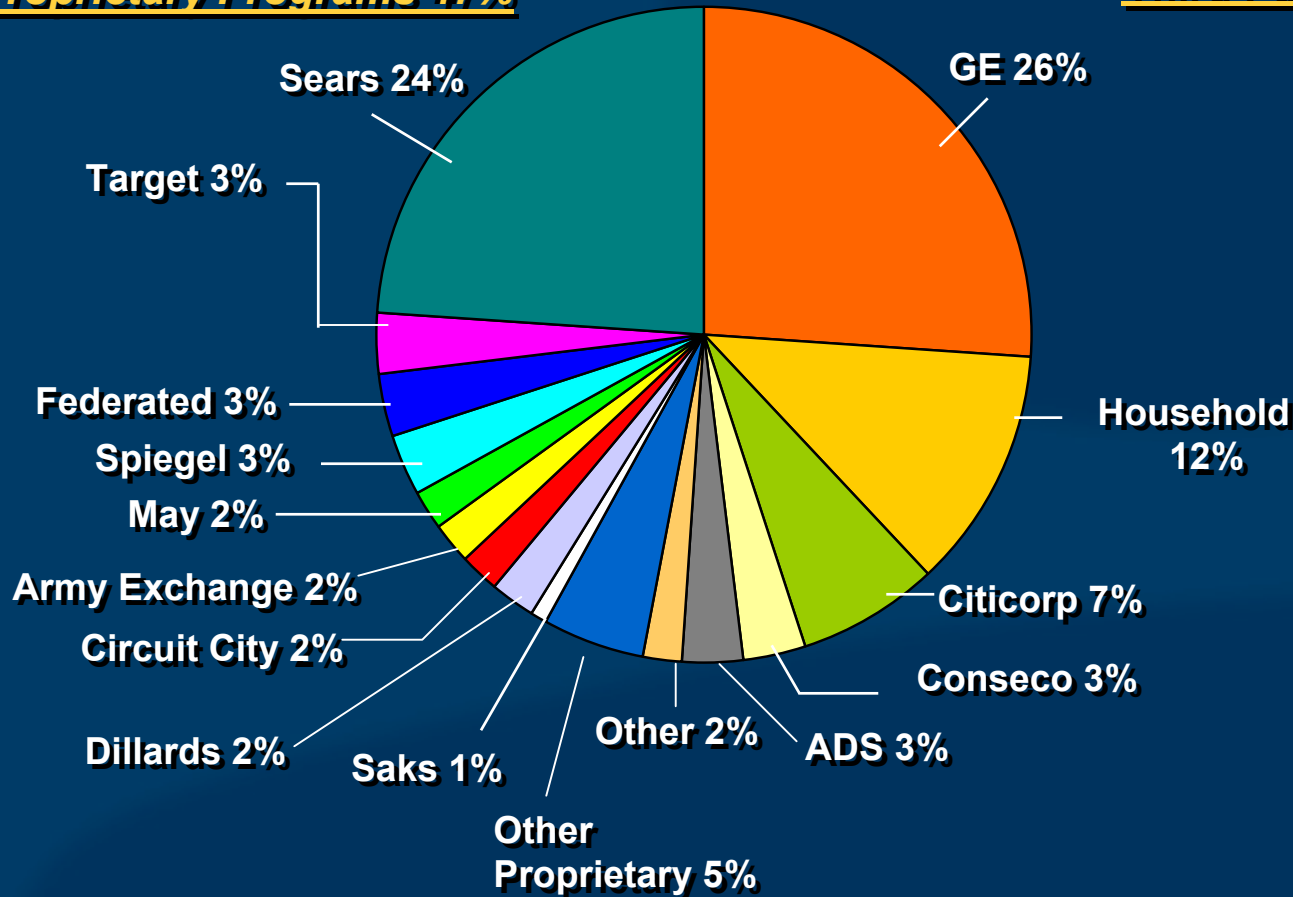
*Private Label Receivable Share*

*SOURCE: The Nilson Report*

# THE PRIVATE LABEL MARKET REMAINS ATTRACTIVE

Proprietary Programs 47%

Third Party Providers 53%



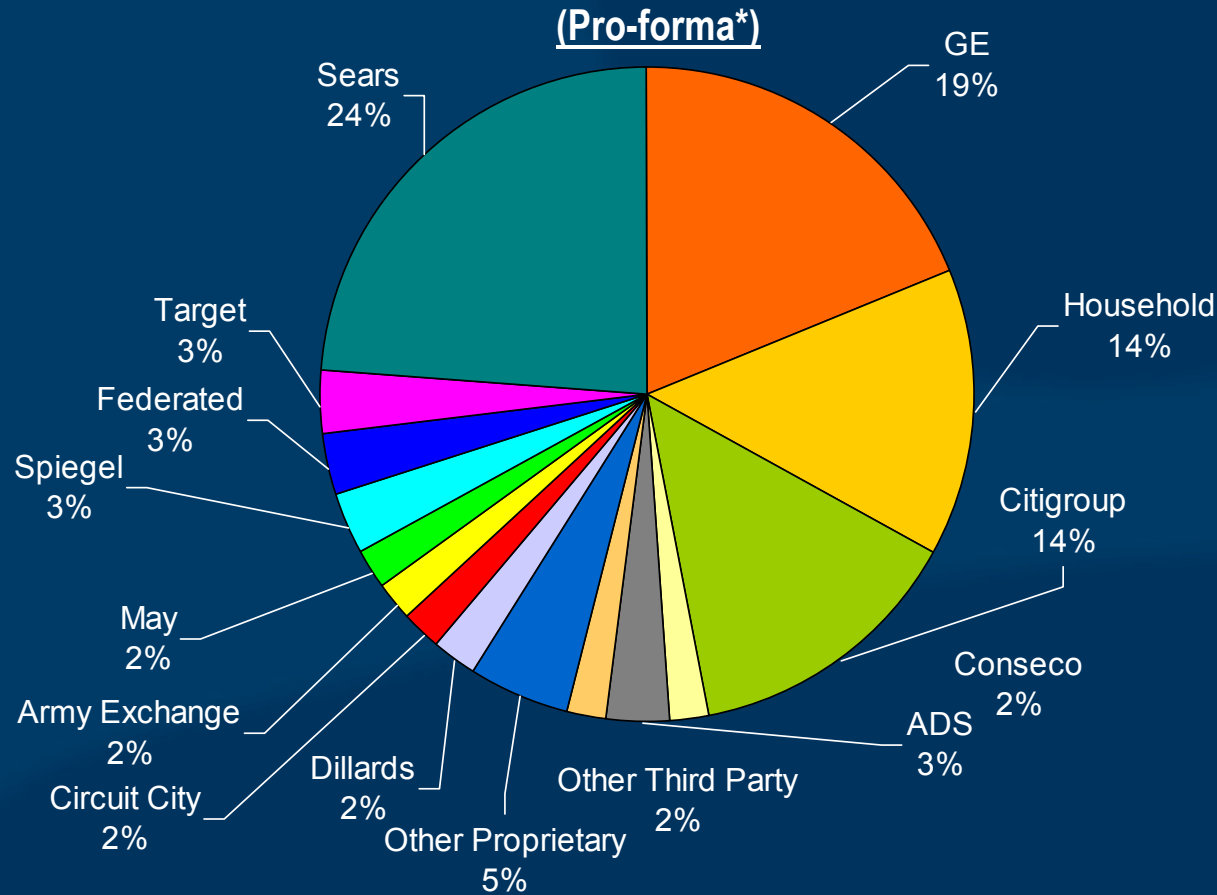
**2001 - \$91.6B MARKET**

SOURCE: The Nilson Report

# MARKET SHARE IS CHANGING

Proprietary Programs - 46%

Third Party Providers - 54%



\* Pro-forma adjusted to reflect transfer of Home Depot from GE to Citigroup and Retail Services' proposed acquisition of Saks and Menards

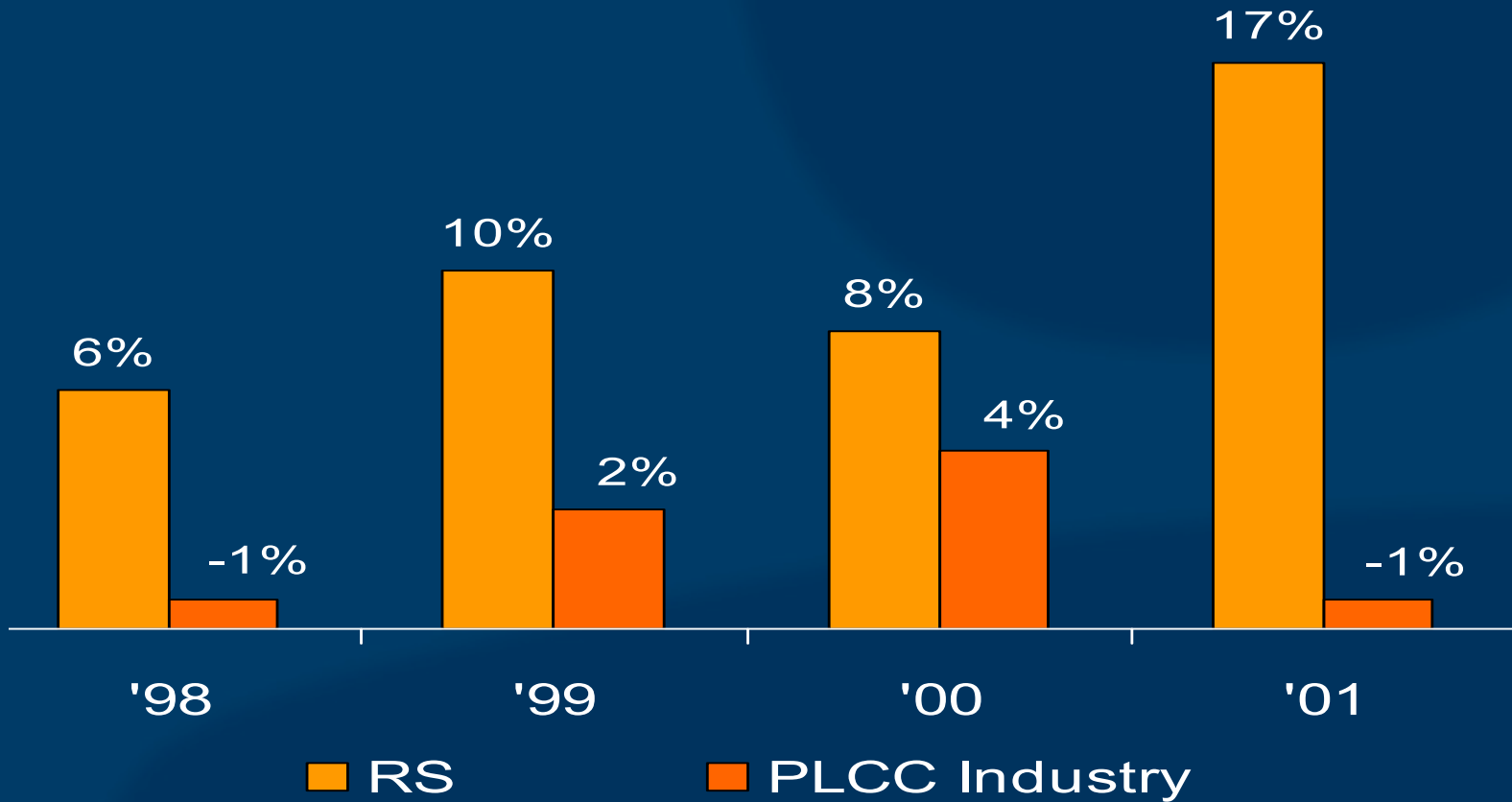
*SOURCE: The Nilson Report*

# OUR BUSINESS MODEL FOCUSES ON OUR PARTNERS' NEEDS

- Partnership focus provides alignment of interests
- Flexible program structuring meets financial needs of merchants
- Operational efficiency enhances price competitiveness
- “Home grown” system vs. outsourcing allows greater speed and flexibility
- Multiple origination channels promote merchant sales
- New commercial platform provides industry leading capabilities
- Recent initiatives have improved competitive position

# OUR GROWTH CONTINUES TO EXCEED THE INDUSTRY

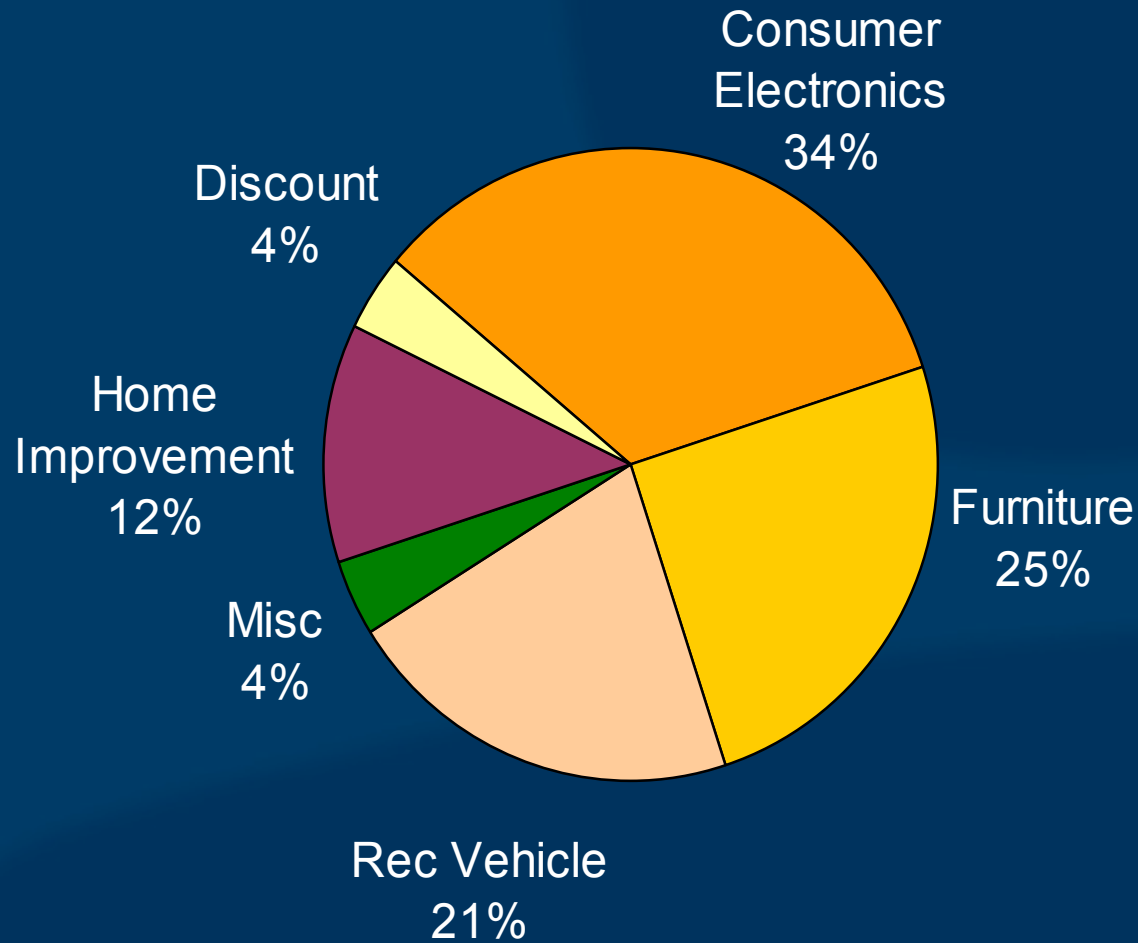
(%)



SOURCE: *The Nilson Report*

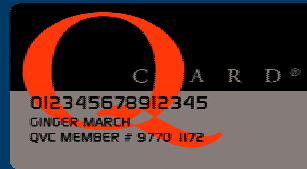


# OUR PORTFOLIO IS DIVERSIFIED



*December 31, 2002*

# Our Partners Include Some Of The World's Largest And Best Retailers And Manufacturers



- Our 45 retailer partnerships include industry leaders such as Best Buy, QVC, Costco and Menards
- Our 17 manufacturer partnerships include great brands such as GM, Mitsubishi and Yamaha
- Our 8 commercial partnerships include both retailers and manufacturers such as Costco, Best Buy and Microsoft
- The acquisition of the Saks program provides strategic entry in the department store market

# WE ARE MORE THAN JUST A CREDIT PARTNER

## *Household's Marketing Capabilities*

### **Marketing Strategy/Consulting**

- Customer needs/channel analysis
- Business strategy development
- Product innovation, eMarketing

### **CRM/Analytics**

- Tailored/targeted Customer Relationship Management
- Loyalty program design and execution

### **Program Development/Execution**

- Campaign design and execution
- In-house creative services
- Insurance/Enhancement services

### **Infrastructure Support**

- Prospect data warehouse
- Loyalty program management
- Database and information management



**Retailer**

## **Maximizing Sales and Profitability by:**

- Retaining and growing the existing customer base
- Identifying and attracting new customers
- Driving value for all stakeholders
- Leveraging key marketing strengths of retailers and Household

***Household complements retailers in-house marketing capabilities***

# RISK CONTROL UTILIZES SIGNIFICANT ANALYTICS

- Credit underwriting uses proprietary scorecards and decision rules
  - Customer scorecards developed for specific merchant or industry programs
  - Scorecards revalidated periodically to maintain predictive value
- Proprietary bankruptcy models and internal fraud scorecards provide additional risk mitigation
- Custom models are complemented by the use of external credit and fraud tools
- Loss targets established for each merchant program to achieve approval rate consistent with program economics
- Experienced credit risk team (average 12 years industry experience) with additional support provided by Corporate Risk resources

# OUR USE OF TECHNOLOGY PROVIDES ADDITIONAL CONTROL AND EFFICIENCY

- Online credit application procession ensures appropriate risk control yet provides positive point-of-sale experience
  - Credit risk tools and credit bureau interface incorporated in decisioning system
  - Over 90% of all credit decisions are automated
  - Response received within 8 seconds
- Best in Class call center technology ensures quality, efficiency and service
  - Champs
  - Geotel
  - Witness
  - Skill based routing
  - Expanded VRU capabilities
- Technology can ensure efficient and effective collections
  - Davox Dialer
  - Call tech (Austin Logistics)
  - Par 3
  - CHAMPS

# HOUSEHOLD



## TECHNOLOGY

***Ken Harvey***

*Group Executive – Chief Information Officer*

**January 22, 2003**

# ENTERPRISE DECISIONING FLOW

## Inbound Channels

Internet

Auto dealers

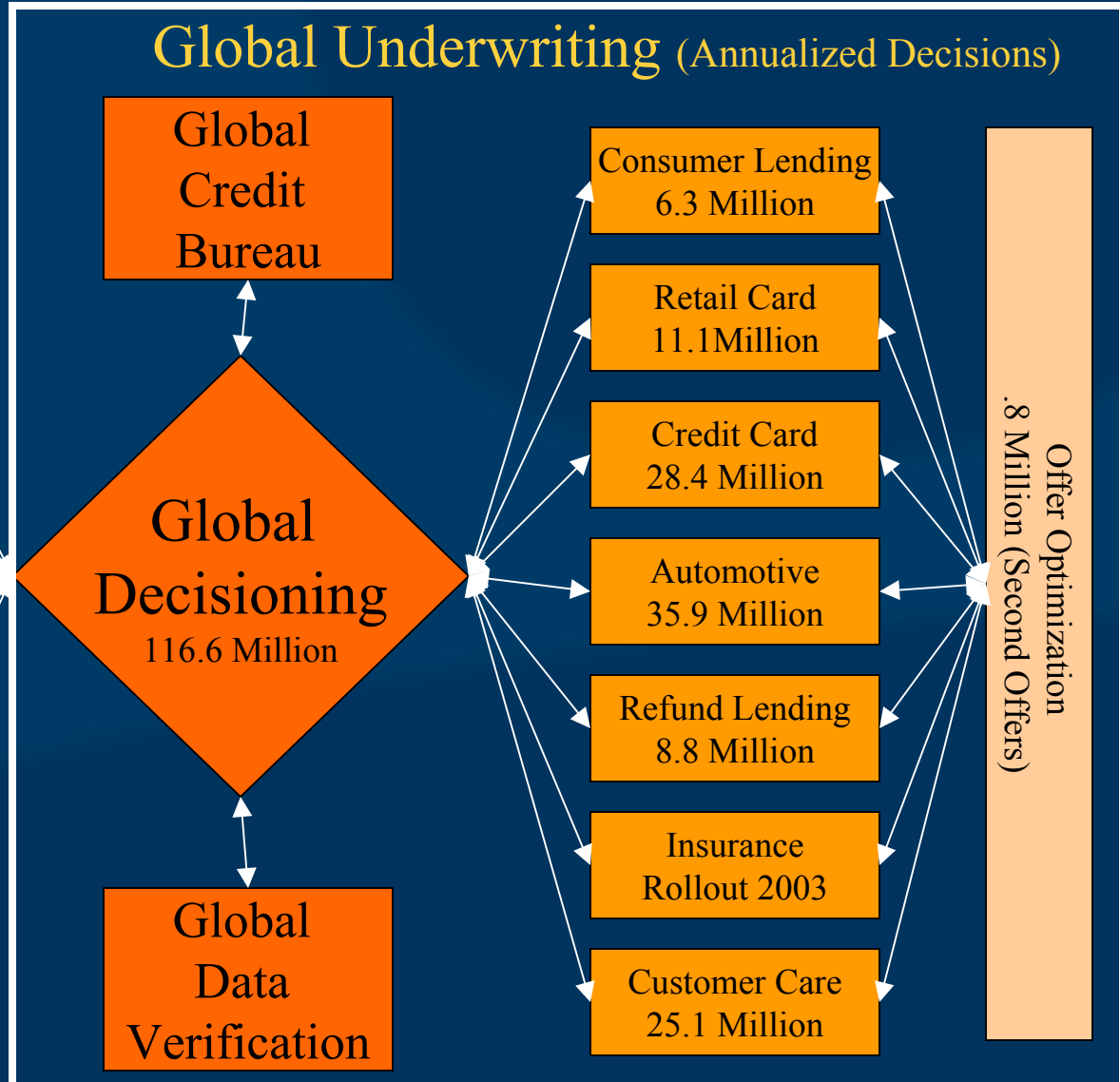
Branch Network

Merchant

Batch Vendor

Third Party

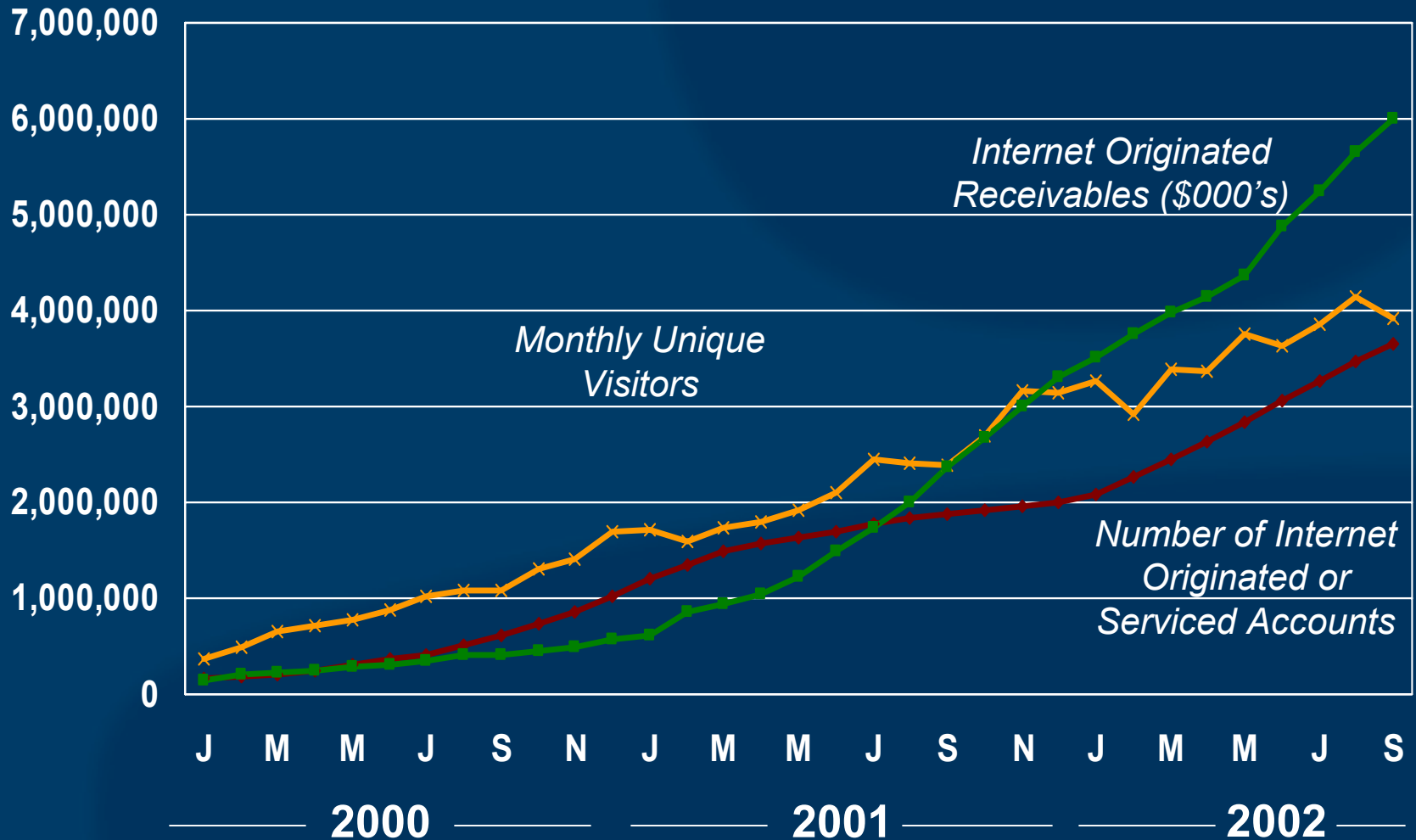
Call Centers



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# EMETRICS – ONLINE VISITORS, ACCOUNTS & LOANS

*eCommerce – 2002, 2001 & 2002*





# CREDIT CARD SERVICES

## *eCommerce*

### *Account Origination and eCare for Six Portfolios*

#### *2002 eCare Highlights:*

- 1,542,779 new enrollees, Total = 3,213,287 Registered Customers
- 1.2 M Registered Bill Pay users made 8.9M payments totaling \$2.667 B.

#### *2002 Online Application Highlights:*

- 767K Pre-selected Offer applicants, 500K Approved (65%)
- 906K “Walk-in” Applicants, 198K Approved (22%)

# HOUSEHOLD



**“BALANCING RISK AND REWARD  
IN CONSUMER LENDING”**

***Walt Rybak***

*Vice President - Credit Risk*

**January 21-22, 2003**

# CONSUMER LENDING

## *Credit Risk Management*

- Responsibilities include:
  - Score card development
  - Underwriting analytics
  - Underwriting decision trees
  - Collection analytics
  - Loss forecasting
  - Credit risk system implementation
- Staff of 55 Analytical Specialists
  - Managers have 12+ years of experience

# SCORECARD DEVELOPMENT

## *Consumer Lending*

- Manager has 17 years experience
  - 6 scorecard development professionals on staff
  - Plans to expand group
- We believe in proprietary scorecards
  - Scorecards are product specific
  - Scorecards capture extensive data
    - Application
    - Prior payment history with Household
    - Credit bureau attributes

# SCORECARD DEVELOPMENT

## *Consumer Lending*

- Scorecards are rebuilt at least every 2 years; or sooner if needed
- Corporate credit must approve model development
- Scorecard performance is validated on a regular basis
  - Scores and approval rate monitored monthly
  - Delinquency forecasts validated quarterly

# UNDERWRITING ANALYTICS

## *Consumer Lending*

- 13 analysts review underwriting
  - Portfolio performance is reviewed every month
  - Regular review meetings with underwriting on policy and practices
  - Test and amend cutoffs
  - Decision trees developed with underwriting

# UNDERWRITING ANALYTICS

## *Consumer Lending*

- For real estate loans we believe in the “3C’s”
  - Credit: Probability of default as predicted by our scorecard
  - Capacity: Ability to repay the debt measured as debt-to-income and disposable income
  - Collateral: Quality of the property
- We rely on our scorecards to evaluate credit, however underwriting personnel
  - Evaluate income and ability to repay loan
  - Reviews appraisals
  - Make judgements on exceptions to policy

# COLLECTION ANALYTICS

## *Consumer Lending*

- 12 Collection Analysts are responsible for:
  - Collection strategy development
  - Strategy analytics
  - Direct mail campaigns
  - Database development and maintenance
  - System implementation



# COLLECTION ANALYTICS

## *Consumer Lending*

- Strongly believe in “test and learn” approach
  - Accounts randomly assigned to groups
  - Different actions applied
  - Different offers made
  - Tests are tracked up to one year after installation
- Restructure policies are used to:
  - Maximize cash flow
  - Retain customers