



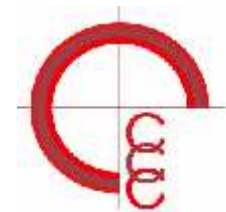
# Credit Scoring and Credit Control XII

## Credit Scoring and Credit Risk Management – Some Regularly Occurring Challenges

David Edelman

ThreeCs Limited

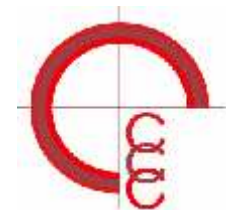
August 2011





# Challenges

- 1. Who should develop scorecards?
- 2. Who should own and manage the rules engine?
- 3. Who should own and manage the credit risk data warehouse?
- 4. Who should produce the monitoring and validation reports?
- 5. To what extent should the organisation be educated / informed about scoring?
- 6. What criteria should be used to select characteristics for a scorecard?



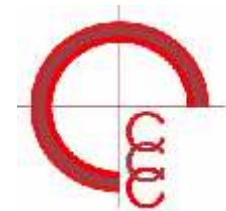


# Challenge 1:

## Who should develop scorecards?

### Three Options:

- Internal team within credit risk
- Dedicated model building team within the organisation
- External development



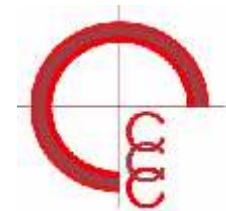
# Challenge 1:

## Who should develop scorecards?

Some of the key considerations:

Those involved in the development should

- 1. Have a good understanding of the organisation's lending processes and be able to interpret the data
- 2. Be aware of industry trends
- 3. Understand the scorecard implementation



# Challenge 1:

## Who should develop scorecards?

	1	2	3
Internal	✓ ✓ ✓	XXX	✓ ✓ ✓
Dedicated	???	XXX	???
External	XXX	✓ ✓ ✓	XXX





# Challenge 1:

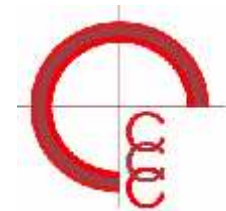
## Who should develop scorecards?

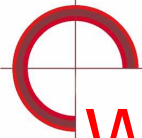
Suggested conclusion:

Build most scorecards using internal credit risk team

Build a small proportion at regular intervals externally to

- Understand what is happening in the market
- Benchmark techniques
- Understand how the developers are interpreting laws and regulations
- Help to manage peaks and troughs of scorecard development projects



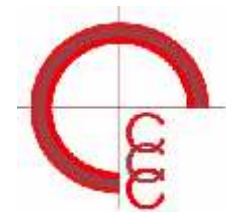


## Challenge 2:

# Who should own and manage the rules engine?

Again, there are three broad solutions to this:

- External third party
- Internal IT department
- Credit risk

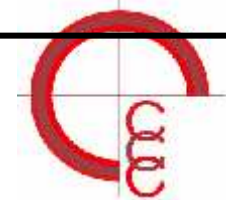




## Challenge 2:

Who should own and manage the rules engine?

	Economies of scale	Protocols / Controls	Flexibility / Speed
External	✓ ✓	✓ ✓ ✓	XXX
IT		✓ ✓ ✓	XXX
Credit Risk		???	✓ ✓ ✓



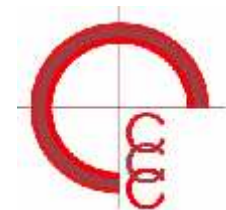
## Challenge 2:

### Who should own and manage the rules engine?

Suggested conclusion:

If we can overcome the organisation's policy about IT owning and managing all systems, then if credit risk can introduce and impose suitable levels of protocols, and change control, and security,

Then the organisation will be comfortable with credit risk ownership.



## Challenge 3:

### Who should own and manage the risk warehouse?

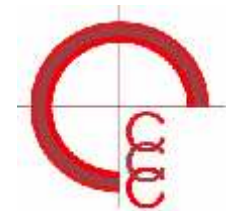
Once again, there are three broad solutions to this:

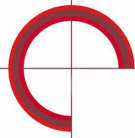
- External third party
- Internal IT department
- Credit risk

and the broad criteria relate to

Control

Flexibility

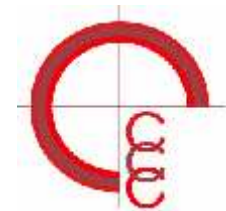




## Challenge 3:

Who should own and manage the risk warehouse?

	Control	Flexibility
External	✓ ✓ ✓	XXX
IT	✓ ✓ ✓	XX
Credit Risk	??	✓ ✓ ✓



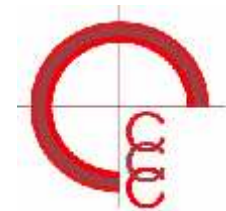
## Challenge 3:

### Who should own and manage the risk warehouse?

Suggested conclusion:

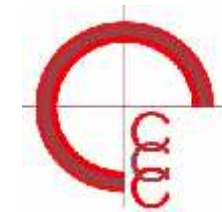
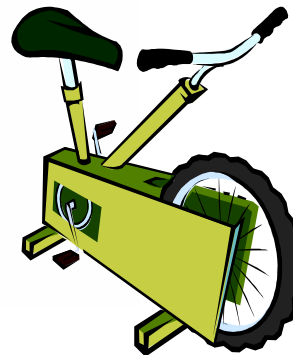
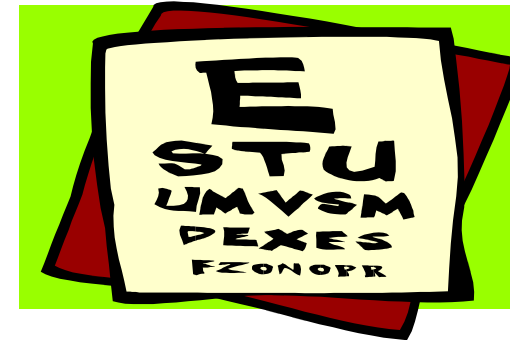
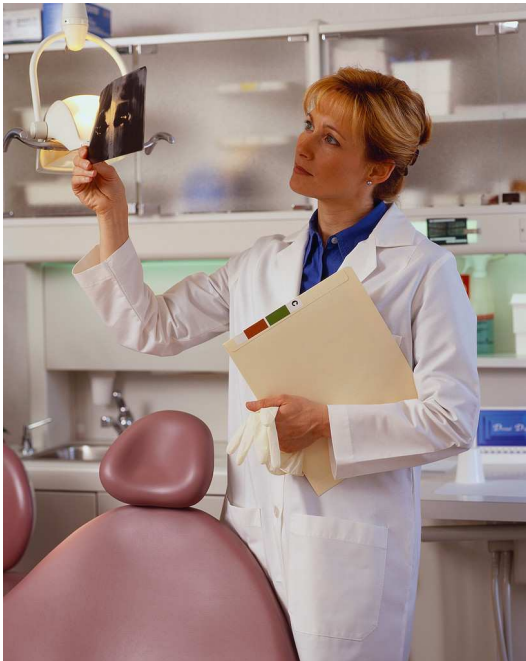
As with the risk engine, if credit risk can introduce and operate the organisation's required levels of controls, protocols, and security,

Then the organisation will be comfortable with credit risk ownership and management of the data structure.



# Challenge 4:

Who should produce the monitoring, tracking, and validation reports?

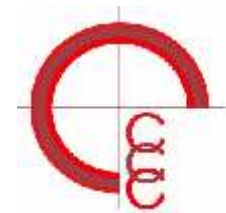


## Challenge 4:

### Who should produce the monitoring, tracking, and validation reports?

When we see something unexpected in the reports -

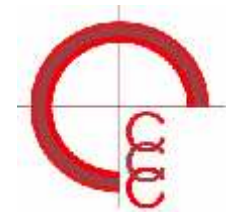
- What is it?
- What has caused it?
- How long has it existed?
- How long will it last for?
- What is the impact?
- What should we do about it?



## Challenge 4:

Who should produce the monitoring, tracking, and validation reports?

- External third party
- Internal MI department
- Credit Risk

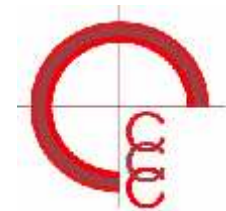


## Challenge 4:

Who should produce the monitoring, tracking, and validation reports?

Utilising credit risk resource may allow

- More specialist software to be used
- The analysts to carry out quick assessments as they produce the reports to identify areas for further investigation
- The further investigations to be carried out immediately



## Challenge 4:

# Who should produce the monitoring, tracking, and validation reports?

Suggested conclusion:

For a small organisation

For an organisation making significant changes in its appetite or market position

- it may be better and more efficient and more effective to have credit risk people producing the reports

For a larger organisation or one with some stability, where many reports are simply “company medicals” with few things to be investigated

- report production by an internal MI function may be better



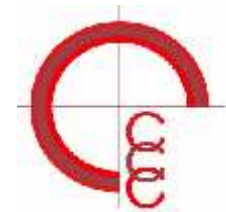
## Challenge 5:

To what extent should the organisation be educated / informed about scoring?

### Benefits

Helps to anticipate problems

Reduced “CSN Syndrome”

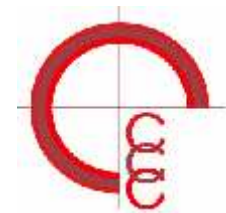


## Challenge 5:

To what extent should the organisation be educated / informed about scoring?

Need to recognise

- Different functions and levels have different needs
- Many people will not acknowledge the benefit to them or to the organisation
- “Debate” about whose budget pays

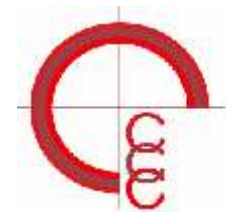


## Challenge 5:

To what extent should the organisation be educated / informed about scoring?

Some functions

- Sales / Call Centre staff
- Underwriting
- Collections
- Marketing, IT, and Product Development
- Finance
- Legal and Compliance
- Senior Management



## Challenge 5:

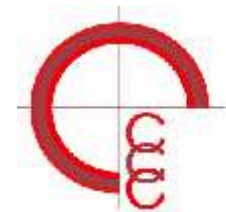
To what extent should the organisation be educated / informed about scoring?

Suggested conclusion

Mount a range of courses with

- different content
- different length
- different levels
- different objectives

Happy to discuss this further with any interested parties



## Challenge 6:

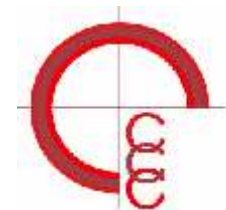
**What criteria should be used to assess characteristic inclusion in a scorecard?**

Scorecard development includes

- Selection of the sample window and observation point
- Coarse and fine classing
- Reject inference
- Verification of our interpretation of the data
- Research into No Response's

Eventually, we reach the point where we select the characteristics to appear in the scorecard

How do we make that selection?



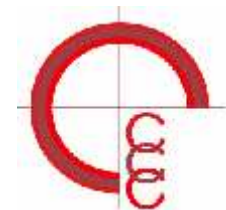
## Challenge 6:

What criteria should be used to assess characteristic inclusion in a scorecard?

Power / Information Value

Select characteristics that, on their own or in combination with others, separate low risk cases from high risk cases.

But you may need to consider other criteria



## Challenge 6:

What criteria should be used to assess characteristic inclusion in a scorecard?

Legal

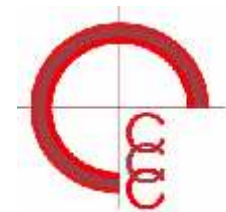
Stable

Make Intuitive Sense

Simple to Obtain

Clear and Unambiguous

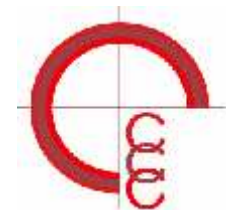
Verifiable





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# Credit Scoring and Credit Control XII

## Credit Scoring and Credit Risk Management – Some Regularly Occurring Challenges

- Review
- Are we biased?
- Discussions

David B. Edelman

