

## **ABSTRACT**

**Credit Scoring and Credit Control Conference IX  
September 2005**

**'Impact of UK Regulatory Change upon the Profitable Use of Credit  
Scoring Techniques'**

In three decades credit scoring has become the principle tool for making consumer credit risk decisions. Using objective methods and better data sources, scoring has become the cornerstone of profitable lending.

Scoring now positively influences the design, pricing and delivery of products. The usual 'repayment risk' is aligned to income/costs in more sophisticated ways. Models to forecast likely credit card usage, early settlements, credit protection take-up – and customer income across products – are widely used. Scoring techniques are seen as profit-enhancing mechanisms.

Earlier regulation affecting credit scoring has been benign and led to manageable changes in scorecard construction and use. This has now changed with the press and government taking an active interest in the growth in consumer credit – who gets it – how much is granted – and how much the consumer pays. Consumer groups have become actively interested in 'so-called' over-indebtedness.

The UK consumer credit market is being subjected to an unprecedented level of regulatory change. The stalled Consumer Credit Bill will be carried forward and a final draft of the European Consumer Credit Directive is to be delivered. UK consumer organisations have 'enforcement status' under the Enterprise Act and can challenge 'lending practices'. The OFT is to be given wider powers.

Products, credit reference data and credit decisions are increasingly scrutinised by the Treasury Select Committee, the Financial Services Authority, the Competition Commission, Financial Ombudsman, the DTI and the Data Protection Commission. The Court Service, Home Office and cross-government working parties are covering similar ground. Formulas for calculating the amount of affordable credit to be granted are being developed and may be imposed!

During the passage of the Consumer Credit Bill through Parliament many ill-considered changes from all parties were proposed but not carried. These were conceded as the Minister indicated that any unreasonable activities by lenders would be addressed under the 'fairness test' – a key feature of the Bill.

The 'fairness test' is not defined anywhere and could be very subjective. A defaulter or regulator could present an 'unfairness' defence to a judge as an excuse for non payment. The judge (not a credit scoring expert) will probably decide whether or not the credit was granted fairly but may take into account other factors.

In addition to a statistical decision some form of methodology will need to be applied to the credit decision to meet 'fairness tests'. This could be difficult.

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