

How to Use This Manual

The *Credit Scoring Management and Compliance Guide* addresses issues related to implementation and management of a credit scoring system. The guide includes examples of different approaches, a credit scoring system policy and procedures, and a wide range of other management resources to help you and your financial institution management team acquire a credit scoring system, implement it, and maintain a proactive risk management supervisory system. The manual focuses on different scenarios; for example, your situation may involve implementing the initial credit scoring system in your holding company, your institution, functional area, or department. Other situations exist, such as establishing formal guidelines for an existing credit scoring system. This manual establishes basic themes for managing different types of environments.

The manual covers two different philosophical approaches: (1) a bank management team member challenged with coordinating and organizing the acquisition, setup, and management of a credit scoring system, and (2) lending management devising the processes to organize and coordinate the management of existing credit scoring systems. Managing credit scoring systems in a financial services environment involves a great deal more than trying to balance all the corporate and business issues of central vs. departmental stand-alone system costs, systems information compatibility, credit quality, portfolio performance, training, etc. In addition, financial institution regulators have created another significant challenge for each financial institution. Specifically, the regulators are requiring each financial institution management team to address the controls and risks related to credit scoring systems — both safety and soundness issues and compliance concerns. Regulatory issuances underscore the specific regulatory guidelines. What are those guidelines? What should be done to comply? How can you evaluate your organization's level of compliance? What might financial institution regulators consider in their next onsite examination?

The manual offers insights on evaluating the implementation alternatives, assessing risk points, establishing management policies and procedures, and implementing such systems. Also provided are checklists and other tools to help you perform in-depth analyses. Management team members will not only gain an awareness of the various regulatory issuances and examination materials

pertaining to supervisory oversight and risk management processes pertaining to credit scoring systems, they also will receive tips for addressing solutions to regulatory requirements.

Chapter 1 describes how to use credit scoring systems, depending on your particular set of circumstances. Inasmuch as the subject of credit scoring systems in a financial institution environment is not new, many management elements are not new concepts. However, the importance of properly implementing a formal management approach to supervising credit scoring in a financial environment is a growing focus. The chapter outlines issues to consider when developing a credit scoring system, and details important regulatory issuances and regulatory examination materials that will help you assess current credit scoring supervision as well as develop a new credit scoring system. Since many bank officers and directors are still attempting to put much of this process into perspective, a short decision-making questionnaire is provided to help in briefing senior management and/or the board of directors.

Chapter 2 provides insights and guidance on what a credit scoring system is, how a credit scoring system or scorecard is developed, implementing the system, and providing management processes to ensure it performs as designed. The chapter includes several charts to help you understand credit scoring system characteristics, an issue of concern relating to financial regulatory examinations. Furthermore, insights are provided regarding major elements of what constitutes a credit scoring system. Through step-by-step analysis of the financial institution, the management team can develop an approach in recognizing what exists vs. what needs to be developed for a formal comprehensive credit scoring system, including related management policies and procedures. Whether you are adopting a single, all-encompassing policy or writing a section to be incorporated in the credit risk policy, this chapter looks at considerations of managing a credit scoring system.

Chapter 3 outlines a basic management framework in positioning the credit scoring process in your department, institution, or holding company. By careful management of the credit scoring system, through development, implementation, maintenance, and upgrades, many of the operational and related regulatory risk issues can be managed. If your institution has in place numerous well-defined, sound corporate policies already addressing credit risk, then it is possible, through minimal changes of wording or attachments to existing policies to address most of the issues related to managing a credit scoring system. The chapter also contains a management team manual that provides step-by-step guidance — including model policies, procedures, and forms — for implementing and maintaining a credit scoring system.

Chapter 4 provides an example of the credit scoring system manager's information reporting package; the example helps you and your management team take the next step in implementing a formal management process. While written corporate policies are excellent, a management information system is also needed to manage, organize, and supervise the process. In this chapter, sample management reports are provided, with charts or memorandums, plus monitoring analysis grids to help in coordinating the process.

Chapter 5 contains tools you can use to perform your own internal audit or self-assessment of where the process is six months or one year following implementation. Did the process become part of the corporate culture? Are staff members following specific policies requiring certain administrative or security elements? Is your institution ready for an examination by a financial regulatory agency examiner?

Chapter 6 discusses ideas on training and bringing your department, your area, or your bank/branch up to speed on the "newly developed" formal concept of credit scoring systems. Whether designing policy and procedures around an existing system or focusing on acquiring and implementing a new system, this chapter is helpful in providing training workshops for staff and management. The training materials are a starting point, and can be customized to fit your particular situation and requirements.

Chapter 7 profiles regulatory examination approaches to reviewing credit scoring systems. Using existing regulatory issuances, examination materials, examiner training handouts, plus insights from former examiners, this chapter highlights the elements for an examination. A set of sample examination procedures is provided for reference.

The glossary defines terms commonly used with credit scoring systems. The appendix contains copies of regulatory issuances, which represent guidance and, in some instances, suggested minimums required in a financial institution's credit scoring system. While these issuances will require minimal consideration in daily operations, overall, they affect how credit scoring system administration is established, developed, and implemented.

This manual will be updated periodically to bring you current on any regulatory changes pertaining to credit scoring system management. It will also be expanded to give the latest guidance on how to effectively manage your institution with respect to credit scoring systems.

Your institution may not be at risk today; it may not have a credit scoring system or any concern for tomorrow. However, at your next financial institution examination, each aspect of

examination (safety and soundness, regulatory compliance, data processing, etc.) will focus on your management team's techniques and risk management processes. Future examinations not only concern your risk management approach, but also examiners will be correlating risk issues and/or risk exposures as they are detected throughout the organization. Taking time to prepare your credit scoring management techniques, and to review your future plans for automating your credit application decision processes (credit scorecard, risk exposures, and enhancements) will help you reduce your regulatory risk. Seems like the "smart" thing to do!

YOUR COMPANION CD

As part of your subscription to *Credit Scoring Management and Compliance Guide* you receive a companion CD. This disc contains all of the information in your print manual that shows you how to make sure your credit scoring management techniques are being followed and accomplishing what they were intended to do.

Insert your CD into your desktop computer, and the autoplay feature will assist you in navigating the files. You can search quickly and easily for specific guidance and procedures.

Customize Your Program

To manage your credit scoring system, the CD contains sample internal audit procedures, training materials, checklists, examples of documentation, and clear guidelines you can use for your own operation.

You can easily customize the documents on the CD using Microsoft Word so that you keep your management techniques current with the latest compliance issues. Sample documents are provided so that you can easily adapt them to your specific requirements.