CREDIT CHECK-UP™

A proprietary toolkit that incorporates over twenty years of experience and wisdom, Credit Check-up™ runs through a number of checkpoints and enables us to rapidly zoom in on the capabilities and inadequacies in current credit risk management policies, lending practices, procedures and initiatives.

It is essential that every financial institution undergo an annual check-up and get certified, especially in the light of more stringent regulatory regime and the Basel II Accord.

Basel II is an effort by international banking supervisors to update the original international bank capital accord, which has been in effect since 1988. The Basel Committee on Banking Supervision, which includes the United States, developed the current proposals. They aim to improve the consistency of capital regulations internationally, make regulatory capital more risk sensitive, and promote enhanced risk-management practices.

On August 4, 2003 the four federal bank and thrift regulatory agencies announced the publication of joint Federal Register notices and requests for comment on two interagency documents related to the proposed implementation of the new Basel Capital Accord in the United States.

In the United States, oversight from Federal regulators for the enforcement of *Regulation B* of the *Equal Credit Opportunity Act* makes it highly advisable for a credit grantor to be able to demonstrate that they have an empirically derived and statistically sound credit management system. In the absence of such a system, the onus of compliance is on the credit grantor which, in some instances, has led to lengthy audits of their 'declined applicants'.

Under this new framework, it is important that lenders are able to demonstrate a consistent credit policy that is commensurate with their risk profile; a policy that is understood and followed throughout the institution. Every underwriter must make the same assumptions, use the same metrics, and share the same view of what constitutes a creditworthy customer or impacts risk.

Credit Check-Up™ is a structured methodology (see Fig. 1), based upon a review and validation process that evaluates both automated and manual processes. Our team will

- Custom design and administer a detailed questionnaire
- Interview staff and management
- Collect information
- Evaluate processes
- Review documented policies and guidelines
- Examine override procedures
- Assess the availability of key data
- Evaluate scoring models and scorecards
- Analyze findings
- Submit a comprehensive report.

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CREATIVE BUSINESS DECISIONS

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Even if a model or scorecard has not yet been deployed, the results will

- Pave the way for consistency in lending practices
- Highlight areas of regulatory non-compliance
- Identify areas of concern from the Basel II perspective
- Identify deficient policies and deviations from policy
- Identify the policies, processes and tools (such as models and scorecards) that need to be modified or replaced

Credit Check-Up™ will facilitate closing the gap between policy and practice, and set the stage for consistency in credit decision making. Credit Check-Up™ is accomplished in two stages

Credit Check-Up™ Base: is designed with the objective of determining whether a financial institution is adequately adhering to the current Federal Regulations related to credit application processing and decision making.

The process involves administering a questionnaire, management interviews, policy reviews, analyses, scoring model and scorecard evaluation. Results are documented and actionable recommendations are made. The benefits are

- Assessment as to whether or not the institution is in compliance with current Federal Regulations
- Compliance with the Basel II requirement of an external review of policies and practices
- Independent review and assessment of
    - Lending practices
    - Policies and guidelines
    - Risk controls
    - Model and scorecard evaluation

Credit Check-Up™ Plus: goes beyond the Base analyses and reviews, to assess how well the financial institution is currently managing credit risk. We evaluate plans for immediate and future measures to meet the Basel II requirements, and identify specific areas in which the institution is NOT in compliance with Federal regulations. It usually includes a site visit by one or more of our senior analysts. In particular, we conduct a detailed study of

- **Data**:

    Current Federal Guidelines require that applicant data be stored for *two* years.

    Are records for *approved* applicants being saved as well as the rejects?

    Application processing systems generally store the information, however

    - Some systems encrypt the stored records – can these be retrieved if needed?
    - Some systems only save a “snapshot” of the record – which requires reentry of the data if it is to be used for reporting or modeling.

    The second phase of the Basel II Accord (**Foundation IRB**) requires *five* years of customer data.

    The third phase of the Basel II Accord (**Advanced IRB**) requires *seven* years of customer data.

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- **Reporting**:

  Current Federal Guidelines require accurate and timely reporting on the credit risk associated with each portfolio. Even without a scoring model in place, financial institutions are required to regularly

  - Determine whether individual loans adhere to existing policy
  - Determine whether individual loans and portfolios are classified in accordance with guidelines
  - Examine roll rates and other loss forecasting methods
  - Ensure that account management standards (over limit, line increases, collections) are being followed.

  For institutions that use a scoring methodology (whether judgmental, empirical or behavioral), Federal Regulations require that standard portfolio monitoring reports are accurately and regularly generated and reviewed.

- **Revalidation**

  Scoring models tend to deteriorate over time and lose their accuracy and consequent effectiveness. For this reason, all scoring methods (whether judgmental, empirical or behavioral) must be validated on a regular basis. When was the last time the model was validated?

Credit Check-Up™ has many benefits, and they all result in a more consistent, efficient and compliant lending business that is under proactive control.

- ☑ Ensure that current judgmental approaches are incorporated into any new automated credit evaluation environment in the most efficient and effective way
- ☑ A business intelligence tool that highlights deficiencies and facilitates the deployment of remedial processes
- ☑ Improve effectiveness of training resources, by clearly identifying who, what and when to train
- ☑ Validate control processes and practices for internal auditors and credit review
- ☑ Demonstrate the observance of fair lending principles in policies, practices, procedures and initiatives
- ☑ Show external auditors and regulators that actual practice supports the policy and that control processes are in place to ensure this.

For more information, please contact:

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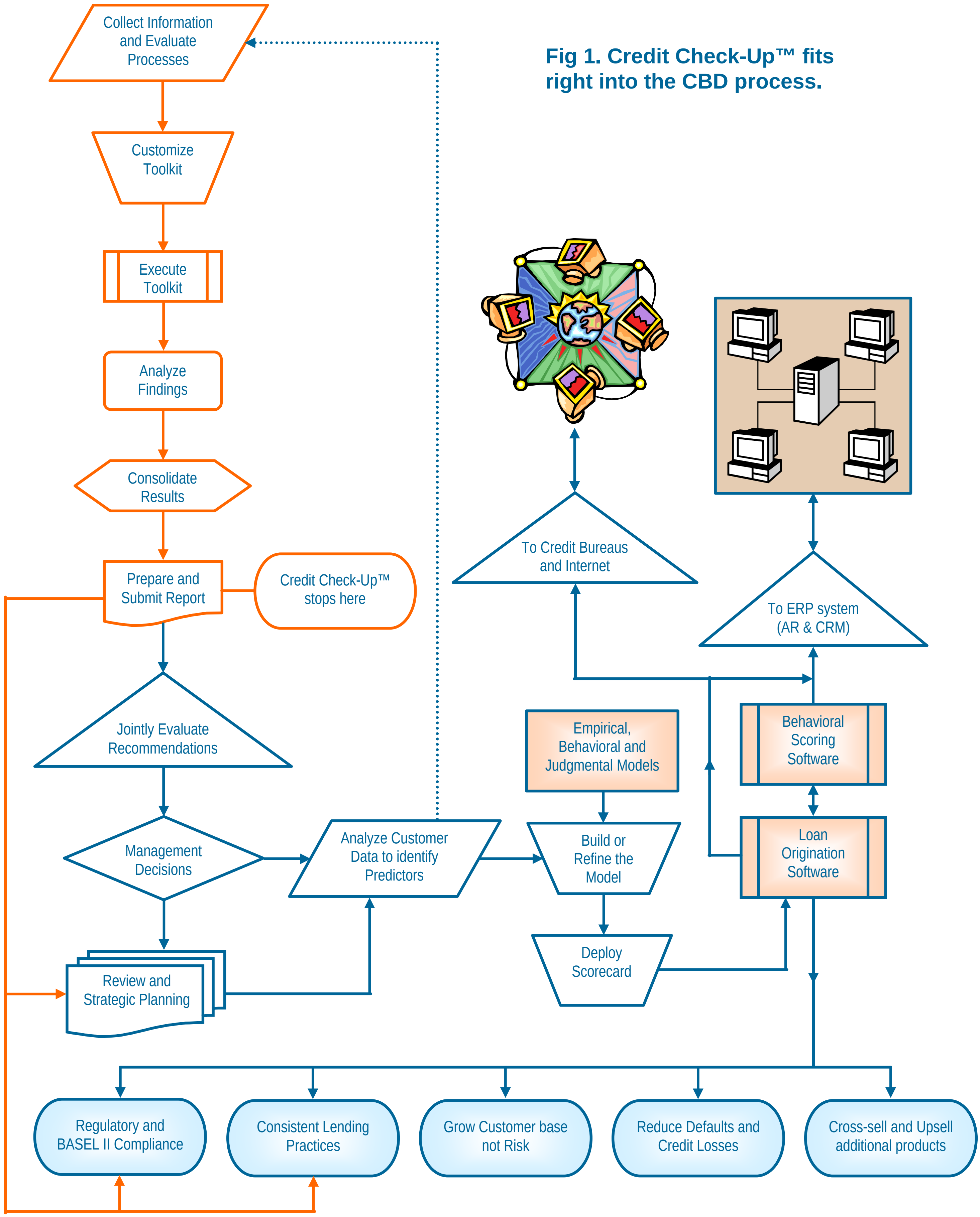
Fig 1. Credit Check-Up™ fits right into the CBD process.



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