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# What Is Risk Management

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A common question that is asked today is, "What is Risk Management" and what processes can be implemented to mitigate risk. At GDS Link we can help companies with functions such as "Portfolio Management" and "Decision Analysis" by using proven techniques such as building custom Scorecards, or Score Models for any Risk Management function, including Originations, Collections, Account management, even Basel II. GDS Link uses advanced software for everything required to implement sound Risk Management policies, including Application Processing Software, Data Aggregation software and a Decision Engine for effective Business Rules management.

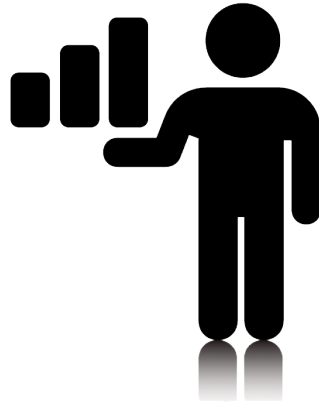


The primary objective of a sound risk management strategy for lending institutions has not changed over time. In its simplest form the goal is to increase market share and profitability without taken on an amount of undue risk. While the basic purpose is the same the challenges faced by those responsible for risk management today continues to grow. Whether it is adjusting to ever changing and increasing regulations, a dynamic competitive landscape, mergers, acquisitions and consolidation or worsening economic conditions risk management staff, must be equipped with the tools and techniques to effectively manage risk throughout the lifecycle of a customer, be it a consumer or business, from the point of acquisition though potential collections, recovery and write off. In order to manage risk effectively lenders must invest in qualified personnel and proven technology that will allow them to implement the appropriate risk analytics, procedures and policies that align with a company's tolerance for risk and works to maximize ROI.

#### Loan Origination:

Effective Loan Origination software today must provide the capability to easily access and test new data sources, implement new scorecard models and implement and test new risk strategies. Existing legacy applications often lack the flexibility and technical foundation to support these requirements in an affordable and efficient manner. Risk Management must secure access to the tools that allow them to meet these objectives without placing a heavy demand on the workloads of IT personnel.

## Customer Data:



One result of the recent consolidation in the financial services sector, for some organizations has been an increase in the number of relationships per customer. With expanded relationship data risk management has the opportunity to enhance its analytics and credit strategies to effectively leverage the wealth of information that is available. Unfortunately, this data often sits in product silos making it difficult to secure real time access. The data can typically be easily exported to a data warehouse for analytical purposes but accessing it as part of the real time decision process is problematic.

Technology that can easily interface to existing legacy applications via web services to support real time access to the disparate customer data may be required to ultimately implement the new strategies developed by risk management.

## Alternative Data

Over the past decade the number of data bureaus offering products and services for assessing risk, both identity risk and credit risk, has increased exponentially. Often seen primarily as a way to more effectively target the unbanked or under banked, lending institutions are finding value in augmenting full file consumers with third party data sources not available by accessing the traditional credit bureaus alone.

After testing these alternative data sources and finding they can deliver a positive return on investment, business users are often confronted with full IT workloads preventing rapid access and integration to these new data sources.

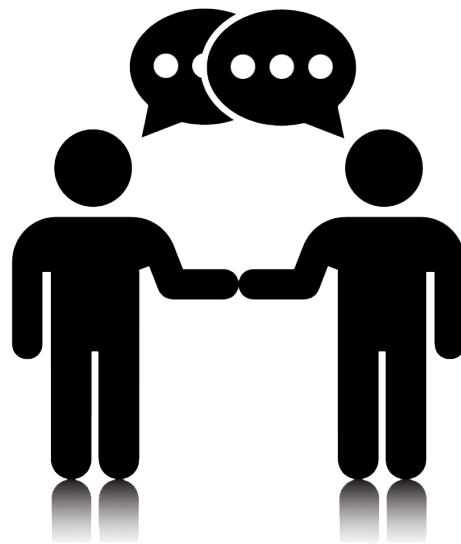
Access to affordable technology that can support not only the integration to the data sources but the incorporation into new models and risk strategies is critical. Here to, oftentimes, legacy applications do not provide the flexibility to easily leverage the new data that is available. Once again identifying technology that can provide the required level of flexibility to leverage these new data sources is paramount.

## Decisioning:

Current economic conditions and new legislation has resulted in a need for risk management to revisit their existing scorecard models and credit strategies to ensure they properly address the

profiles of new applicants. To be effective, risk management must have access to tools that allow them to efficiently evaluate, test and implement new policies. Risk software that supports the ability to develop new strategies in an off line mode and run historically data through them is required to support the needs of the risk group. Once new strategies have been tested, the ability to test them in production in a controlled manner, ie, Champion/Challenger strategy is necessary. System that support the ability to easily assign a defined percent of applications to pass through the new strategy will help to mitigate the risk associated with the big bang approach.

If the implementation of new scorecards is required, here too, risk management must have access to tools that allow them to implement the new models without having to engage IT personnel. Tools that support the ability to easily program new data attributes through an easy to use scripting language will accelerate the implementation time required to push new scorecards models into production increasing their overall value. Once the attributes are coded, the ability to easily implement the model(s) assigning the points to the defined intervals and incorporating expected values to drive adverse action reasons is required. An easy to use graphical interface for supporting this effort will accelerate the implementation time and provide a more immediate benefit to the organization.



## Custom Model Development Services

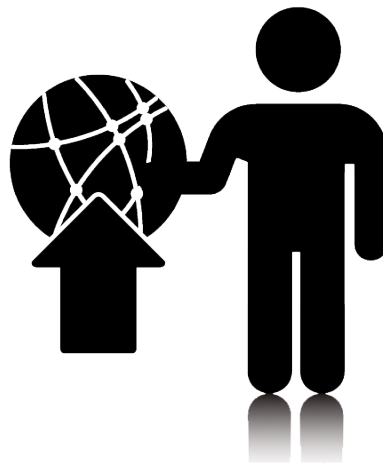
**Lead Purchasing Models** Models that will help determine which leads should be purchased and which data sources should be used and in what order. These models usually focus on predicting First Payment Default or some other classification of a ‘bad’ account.

**Origination Models** An extension of Lead Purchasing Models, these models would take other data into consideration that may not have been used during the lead buying process due to time constraints or operation constraints. These models usually focus on predicting First Payment Default or some other classification of a ‘bad’ account.

**Conversion Models** Evaluate the likelihood that a purchased lead will actual turn into a loan accepted by the consumer:

**Profitability Models** A focus simply on first payment default can be short sighted. The “holy grail” in payday lending modeling is a Profitability Model that will accurately predict the amount of revenue a customer will produce during the life of their relationship. A loan that is classified as a first payment default can become a very profitable customer to the lender. If the customer is able to clear the first payment default and then move forward to enter into a certain number of renewals or consecutive loans they can become quite profitable. A consumer that takes a loan and pays in full on their first pay date will be very unprofitable for a lender. The key is to identify applicants that will not only pay, but more importantly execute a stream of renewals that will more than offset the cost of the lead, risk assessment cost, on-going operations, etc.

This is analogous in the credit card world where the most profitable customer is one that pays the minimum payment each month accruing the maximum interest fees possible. To extend this, if a model was also able to predict those consumers that would go over limit from time to time, generating over limit fees, and go late with self cure from time to time they would represent the greatest profit to the card issuer ( actual size and amount of card charges aside).



**Cross Sell Models** As payday lenders look to expand their product offerings there will be a need to develop models that identify applicants that can be sold additional products and services. An example of this would be migrating from a payday loan consumer to an Installment Loan.

**Behavior Models** These models are used to evaluate current active customers. Typically used in the credit card environment to initiate changes in a cardholder's terms and conditions, in the payday world these type of models could be used to determine when it is time to start requiring a consumer to pay down a portion of their principal. Behavior scores can leverage internal data as well as data triggers or alert data from third party data bureaus. As an example, the bureaus offer various Account Monitoring programs that can provide triggers based on changes to a cardholders information ( related to competitors accounts) on their credit file, such as an increase in delinquency from 30 to 60 days. This data can be leveraged to drive account treatment strategies.

**Collection Models** These models can be used to help drive collection strategies. If a lender has a current policy of working accounts until 90 days and then placing it with an agency, a Collection Model can be leveraged to potentially accelerate the placement of certain accounts as their profile aligns with other consumer who were deemed to be uncollectable after 90 days of internal collection activity. Collection staff would be better allocated to accounts that have the highest probability of being cured. Similar to Behavior Models, collection models would benefit but the use of credit bureau data.



## Risk Management Services

**Credit Policy Development and Management** In this capacity GDS can offer various levels of credit policy support to lenders that don't have the in-house skills to effectively develop risk management strategies that are required to help them fully realize their business objectives. This would include leveraging various data sources and various score models (as documented above) and to implement credit policy strategies. This would also include the on-going monitoring of portfolio performance in order to make the changes necessary to react to shifts in applicant profiles, economic conditions and regulatory changes. In this role, GDS would leverage the risk technology licensed by the lender.

**Credit Systems Integration** Related to the above topic, in this capacity GDS personnel would be involved with the integration of best in class Risk Management Technology (GDS Link's DataView360). GDS involvement could be limited to the initial implementation of the lenders risk strategies and the training necessary to make the lender and its risk staff self sufficient or it can extend into the on-going management of risk management strategies as outlined in the section on Credit Policy Development and Management.

**Scorecard Model Monitoring Reports** Touched on in the section on Credit Policy Development and Management, scorecard model monitoring requires the implementation of standard reports which should be evaluated on a on-going basis to determine if some action is required, such as an adjustment to the scorecard, due to shifts in the 'through the door' applicant population. Two examples of these reports include:

**Population Stability Report** Compares the score distribution of recent application to standard population that is usually based on the development sample. This report is used to assess how the "through the door population" compares to the development population.

**Characteristic Analysis Report** This report compares the distribution of attributes or variables across each scorecard characteristics. This report helps to high light what is causing the new population to score differently than the model development sample population.