Credit Scoring for Risk Managers: The Handbook for Lenders

Elizabeth Mays and Niall Lynas (2010)

Reviewed by Michel Aratan

“You know you’re a golf fanatic when you save all your scorecards—well, at least the good ones.”

In that context, Elizabeth Mays and Niall Lynas, in their updated handbook *Credit Scoring for Risk Managers*, demonstrate practical ways to construct good consumer scorecards. Not only does this book contain sound statistical approaches, but even more importantly, it delivers practical advice, presented in multiple formats, for assessing risk in consumer portfolios.

To begin with, the authors do not hesitate to evaluate the performance of scorecards during the recent economic crisis, and they conclude that scores continued to rank-order potential defaulters well—at least outside the mortgage product. The culprits, they assert, were management of the scorecards and policies for their use. Lessons can be learned from the perils of simultaneously introducing new products and targeting new customers, along with relying excessively on generic bureau scores rather than custom scores.

The statistical material is presented at a level that is technically robust but requires only a very basic background in statistics. For example, the authors use graphs to develop building blocks that cement an intuitive appreciation for what the Kolmogorov-Smirnov (K-S) test is designed to measure. No one should be afraid to pick up this book, even with a weak background in mathematics.

But it is on the practical side that risk managers will find this book invaluable. Mays and Lynas describe strategies for dealing with data problems arising from merged banks and lack of available historical information. They offer recommendations for how to use business experts to identify potentially useful but omitted variables, such as the effect a plant’s closing could have on default rates in a particular geographic region. They even discuss the financial incentives that vendors could have to create elaborate segmentation schemes.

In each chapter, whether describing how to use a particular statistical technique, how to construct a scorecard development project, or how to use and manage scorecards in a regulatory environment, it feels as if the authors are looking over the reader’s shoulder and saying, “Watch out for this” or “Try that.” And if that watchfulness isn’t sufficient, they have a chapter entitled “Ten Scoring Mistakes to Avoid.”

To be sure, this book does not present a simplified version of scorecard development and use. It covers data, project management, model specifications, variable selection, evaluation of performance, statistical analysis, sample-selection bias, the use of scores for loss forecasting and capital, fair lending issues, model governance and validation, reports, and the nature of independent reviews.

Some advice is offered when there are significant impediments to overcome. An example would be sample-selection bias, where “through the door” clients are censored or truncated so that they are not booked and therefore cannot be used to judge performance. To their credit, the authors do not gloss over this troublesome topic. However, readers should recognize that it is quite difficult to infer or extrapolate how the filtered customers would have performed.

In future editions, the chapter on loss forecasting and capital could be expanded to include more detail on how economic capital modeling can be accomplished. And it might also be helpful to package a CD with the book or refer readers to a website where data sets are stored. Readers could then download the data and follow the instructions for scorecard construction and statistical analysis.

In short, all risk managers operating in the consumer credit world should have this text on their bookshelves. They will undoubtedly find a need to reference it frequently.

Michel Aratan is managing director at JPMorgan Chase. He is also a member of The RMA Journal Editorial Advisory Board. He can be reached at michel.aratan@jpmchase.com.

This book is available on Amazon.com.