MARKETING WITH A RISK PROXY SCORE

by Dave Kelly, AnalyticsIQ, Inc.

Many direct marketers are keenly aware of the trade-off between risk and response – individuals with the highest credit risk tend to respond best to offers of credit, while individuals with perfect credit are typically unlikely to respond to offers of credit. Combined with a recent trend away from doing pre-approved offers of credit, the need to determine an individual's likely credit profile is more important than ever when executing effective marketing campaigns.

BACKGROUND

There are several leading risk proxy ("RP") scores available on the market. The major compliers (such as Acxiom) each have a proprietary RP score, and Fair, Isaac, & Co. ("FICO") has a version of its popular credit risk score available for use in 'non-firm offer' applications (i.e. in situations where live credit data is not used). This paper will attempt to compare and contrast our proprietary RP score ("Risk**IQ™**") with these market leading scores.

HOW SHOULD YOU USE A RISK PROXY SCORE?

The fundamental assumption behind the concept of using a risk proxy score is that it is significantly correlated with a real credit score. With that assumption in place, the typical use of an RP score is to stratify, or carve out, an appropriate marketing universe in which to execute marketing campaigns. For example, a given lender may not generally approve applicants with a credit score below 640. So, while prospects that score below 640 will likely respond at a high rate to an offer of credit, it is not beneficial to either the lender or to the prospects for prospects to reply to this offer only to be turned down. In this case, the lender could use an RP score to 'purify' the target audience and greatly increase the odds that offers are going out to prospects that will pass credit screening.

PROTECTED CLASSES AND REDLINING

Given that lenders will likely utilize RP scores to exclude part of the universe, should there be some concern about the possibility of 'redlining'? It is our position that absolutely no demographic information that directly describes a protected class of consumers should be used in an RP model. For that reason, RiskIQ is wholly derived from summarized credit data.

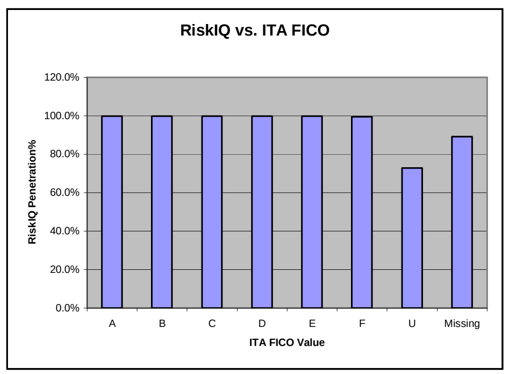
COMPARING THE RISK PROXY SCORES

We have had the opportunity to validate RiskIQ on several occasions (and have had third parties assess it on numerous occasions).

<u>Test A: Large Marketing File</u>

We had the opportunity to apply RiskIQ to a large file extracted by a large data compiler for an end-user client.

ITA_FICO	Count	Pop%	Mean RiskIQ	Penetration RiskIQ
A	2,633,620	14.8%	76	99.8%
B	4,194,178	23.5%	64	99.9%
C	2,976,003	16.7%	47	99.9%
D	1,717,771	9.6%	31	99.9%
E	810,712	4.5%	20	99.9%
F	225,438	1.3%	15	99.6%
U	994,639	5.6%	55	72.9%
Missing	4,288,066	24.0%	43	89.2%
Total	**17,840,427**	**100.0%**		**95.8%**



Here is what this test tells us:

- When there is a valid ITA_FICO score (A-F), there is a valid RiskIQ score 99.8% of the time
- When there is a missing or invalid ITA_FICO score (U, missing), there is a valid RiskIQ score 86.1% of the time
- When there is a valid ITA_FICO score, RiskIQ is highly correlated (A=76, F=15)
- RiskIQ is valid on 96% of the file, ITA_FICO on 70%

Test B: RiskIQ Score vs. Subsequent Credit Decision

In this case, a lender has a specific score cut applied to responders. Historically, 32% of responders pass the credit screening, resulting in a 'net response' rate of 0.20%.

	Total Sample		Above Cutoff		Below Cutoff
RiskIQ Score Cut	None		>33		<33
Mail Pop%	100%		67%		33%
Response Rate	0.62%		0.54%		0.78%
Screening Pass Rate	32%		48%		10%
Net Response Rate	0.20%		0.26%		0.07%

Here is what this test tells us:

- Removing the bottom third of the prospect file had the effect of removing a population that was highly responsive, yet had little chance of passing credit screening
- A strategy incorporating RiskIQ resulted in a diminution of response rates by 13% while, at the same time, the screening pass rate increased by 50%
- Net response rates increased by 30%

CONCLUSION

Used correctly, a risk proxy score can allow marketers to market to a purer group of potential prospects, where the likelihood of each responder to pass credit screening is greatly increased. A savvy lender will want to make sure that the risk proxy score that they are using does not use demographics that single-out protected classes of consumers, which could result in a 'de facto' form of red-lining.

RiskIQ has a number of benefits:

- Scores more records (25%+ when compared with ITA FICO)
- Highly correlated with traditional credit risk scores
- Derived from summarized credit data

RiskIQ is available for testing through selected resellers, or directly from AnalyticsIQ, Inc.

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