

NextGen FICO[®] Risk Score Conversion FAQ

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Table of Contents - Short

What You Need To Know About NextGen	1
NextGen Essentials	1
NextGen Design Features	2
Performance Definition Used in Model Development and Odds Charts	3
Alignment	6
Reason Codes.....	7
Inquiry Treatment	7
Minimum Scoring Criteria.....	7
Industry-Specific and Other Applications.....	8
Availability at the Credit Reporting Agencies	10
NextGen Availability at Processors and Within Other Fair, Isaac Products	10
Conversion Plan Considerations	12
Assess Overall Business Impact	12
Decide on Testing Approach.....	12
Determine System Impacts and Changes.....	14
Determine Changes to Strategies	16
Train Staff	18
Implementation Considerations By Life Cycle	19
Prescreening.....	19
Application Processing.....	21
Account Management and Collection Management	23
Fair, Isaac Resources	27

Table of Contents - Extended

What You Need to Know About NextGen	1
NextGen Essentials	1
<i>What is NextGen and why should I convert?</i>	1
<i>Why did Fair, Isaac develop NextGen risk scores?</i>	1
<i>Do the NextGen risk models replace the Classic FICO risk models?</i>	2
<i>Do the NextGen risk models differ from the Classic FICO risk models in what they predict? What's the range of possible scores?</i>	2
NextGen Design Features	2
<i>What are the primary features of NextGen and how do they differ from the features of the Classic models?</i>	2
Performance Definition Used in Model Development and Odds Charts	3
<i>What is the new revised performance definition used in the development of the NextGen models?</i>	3
<i>How do the NextGen odds charts differ from Classic odds charts?</i>	4
<i>How will trade-level odds compare to report-level odds?</i>	4
<i>How does the different performance classification/definition affect my use or understanding of the score?</i>	5
<i>Does the new performance definition used in the NextGen development weigh performance on different types of trade lines differently (e.g., mortgage trades versus bankcards)?</i>	6
Alignment	6
<i>Does a NextGen risk score mean the same thing as a Classic FICO risk score? Is a 700 still a 700?</i>	6
Reason Codes	7
<i>Does NextGen use the same adverse action (score reason) codes as are used in the Classic scores?</i>	7
Inquiry Treatment	7
<i>How is consumer credit shopping behavior treated in the NextGen risk models?</i>	7
Minimum Scoring Criteria	7
<i>Will the NextGen risk models provide scores for fewer or more consumers than does the Classic score?</i>	7

Industry-Specific and Other Applications	8
<i>Is NextGen only for revolving credit? How does it perform on specific industries or product groups, such as mortgage, auto, bankcard, retail, or subprime?</i>	<i>8</i>
<i>If I use the Classic industry options today, should I switch to NextGen?.....</i>	<i>8</i>
<i>Will there be NextGen industry options?</i>	<i>9</i>
<i>How does NextGen do at predicting bankruptcy?</i>	<i>9</i>
<i>For small business scoring, is the added predictive strength of NextGen sufficient to handle small business owners, or do I still need to purchase business info?.....</i>	<i>9</i>
Availability at the Credit Reporting Agencies	10
<i>Where can I get NextGen scores?.....</i>	<i>10</i>
<i>Are NextGen scores more expensive to purchase than Classic scores?.....</i>	<i>10</i>
<i>What differences can we expect with NextGen scores across the three credit reporting agencies?</i>	<i>10</i>
NextGen Availability at Processors and Within Other Fair, Isaac Products.....	10
<i>What is the status of the incorporation of the NextGen score in other F, I products, including CLSO? Small business scores? Liquid Credit? Decision systems? StrategyWare?</i>	<i>10</i>
<i>When is NextGen going to be available in Search?.....</i>	<i>11</i>
<i>Are the processors ready to handle NextGen?</i>	<i>11</i>
<i>How has the secondary market responded to NextGen? What efforts are you making to establish it as the new industry standard?.....</i>	<i>11</i>
Conversion Plan Considerations	12
Assess Overall Business Impact.....	12
<i>Where and how am I using scoring today?.....</i>	<i>12</i>
<i>What’s the quickest way to get started using NextGen with the fewest implementation issues?</i>	<i>12</i>
Decide on Testing Approach	12
<i>Should I do live or retrospective validation testing?</i>	<i>12</i>
<i>When comparing Classic and NextGen validation results, what are some typical pitfalls to avoid?</i>	<i>13</i>
<i>So many of my custom models incorporate the Classic FICO scores. How should I test the value of NextGen vs. Classic and the impact of switching in these models?</i>	<i>14</i>

Determine System Impacts and Changes	14
<i>What implementation information do I need to know to switch to NextGen?</i>	14
<i>What do I need to know about my own bureau interface software and its ability to utilize NextGen?</i>	15
Determine Changes to Strategies	16
<i>Will I need to re-evaluate all of my cutoffs/strategies?</i>	16
<i>What type of score shift can I expect to see in my prescreening population/applicant population/ account management portfolio?</i>	16
<i>How does NextGen handle young and thin populations? Should that impact my strategies?</i>	17
<i>Can NextGen identify more profitable accounts in the Premier (i.e., high-scoring) consumer segment?</i>	17
<i>What kind of repayment performance by NextGen score range can I expect on my own prospects, applicants and existing borrowers?</i>	17
Train Staff	18
<i>How will I explain the NextGen differences to my staff?</i>	18
Implementation Considerations By Life Cycle	19
Prescreening	19
<i>What changes will I need to make to my current system to use NextGen in my prescreening efforts?</i>	19
<i>How should I adjust my prescreen strategies?</i>	19
<i>If I have validation results from a previous prescreen campaign based on the Classic score, what can I actually infer for future campaigns based on NextGen?</i>	20
<i>Are there legal issues to consider before upgrading to NextGen for prescreening?</i> ...21	
Application Processing	21
<i>What changes will I need to make to my current system to use NextGen in my application screening efforts?</i>	21
<i>How should I adjust my application screening strategies?</i>	22
<i>Will I approve more applications at a given score cutoff with NextGen?</i>	22
Account Management and Collection Management	23
<i>What changes will I need to make to my current system to use NextGen in my account management and/or collection management systems?</i>	23

*At our processor, we use the standard joint odds table today, which encompasses the Classic score; will we be able to use the NextGen joint odds in our strategies in the future?*24

*How do I transition to NextGen if I receive my scores through ScoreNet?*24

*How will the switch to NextGen impact my strategy tracking?*24

*How should I adjust my account management and delinquent account queuing strategies with NextGen?*24

*Will I need to change my score cutoffs?.....*24

*How can I determine what score changes to make, if any?*25

*What NextGen research should I keep in mind as I adjust my strategies?.....*25

Fair, Isaac Resources **27**

*How can Fair, Isaac assist with the transition from Classic to NextGen scores using both scoring and business consultants?*27

What You Need To Know About NextGen

NextGen Essentials

What is NextGen and why should I convert?

NextGen scores are the new Fair, Isaac credit bureau risk scores designed to offer the most powerful broad-based risk assessment available. The NextGen models take advantage of the ever-changing credit reporting agency data, and Fair, Isaac's deep analytic expertise and predictive technology innovations to offer all types of lenders superior assessment across the entire risk spectrum. Credit grantors will be able to:

1. achieve substantially better credit quality with roughly the same number of booked accounts or increase booking volumes while maintaining fairly constant credit quality,
2. better set price and other credit terms more appropriately for risk, and
3. more accurately target accounts for both positive and negative customer management treatment. Based on strategy simulations on independent data samples, Fair, Isaac analysts have seen prescreen revenue increase by up to 100%, charge-off rates reduced by 20-25% among those eligible for a line increase in account management, and identify accounts carrying 50% lower profitability for accelerated collections. Such results can translate into substantial bottom-line benefits that can more than justify the effort of conversion to NextGen.

Why did Fair, Isaac develop NextGen risk scores?

The ongoing changes in data reporting and credit usage in the United States have opened the door for advancements in risk prediction. To elevate standards for quality and innovation, Fair, Isaac believed the best way to capitalize on this opportunity was to develop a brand new design for bureau risk scores: NextGen. However, to ensure lenders have a consistent experience with the NextGen scores and to minimize the operational impact of adopting a new score, Fair, Isaac engineered the NextGen models to maintain a “look and feel” consistent with that of the Classic FICO models.

The NextGen models were developed using a *new design blueprint* that capitalizes on the latest Fair, Isaac research into population segmentation analysis, data exploration and predictive variables as well as the ever-deepening credit reporting agency (CRA) databases. Like Classic FICO, the NextGen risk scores rank-order consumer credit risk—serious delinquency, charge-off, repossession, foreclosure and bankruptcy. The NextGen models are a *more advanced tool* with which lenders can evaluate consumer risk, particularly for specialty markets such as loans to emerging credit users, nonprime and premier customers.

Do the NextGen risk models replace the Classic FICO risk models?

The NextGen models provide a choice to lenders who are looking for improvements in risk assessment. The NextGen design blueprint unlocks new depths of predictive power embedded in the CRA databases. However, because many lenders rely on the Classic FICO models for their operation and strategies, we will continue to update and support them. By offering both NextGen risk models and Classic FICO risk models, we are giving lenders a choice between two powerful solutions to meet their credit risk management needs. **The Classic and NextGen models are not designed to be used in conjunction with each other.** For lenders seeking the strongest risk assessment tools available, and who are willing to make the operational and strategic changes required to make the switch, the NextGen score replaces the Classic score.

Do the NextGen risk models differ from the Classic FICO risk models in what they predict? What's the range of possible scores?

The NextGen risk models, like the Classic FICO risk models, are designed to rank-order consumers according to the likelihood of default on credit obligations. Both scores are three digit numbers, with the higher values indicating lower risk; however, due to its refined risk assessment, the range of possible scores is greater for NextGen than for Classic FICO. The NextGen score range is 150-950, compared to the 300-850 for Classic U.S. FICO risk scores and 250-900 for Classic FICO industry option scores.

NextGen Design Features**What are the primary features of NextGen and how do they differ from the features of the Classic models?**

There are 3 key design modifications behind NextGen's sharper risk assessment: 1) significantly more complex predictive variables, 2) an expanded segmentation scheme and 3) a more refined performance outcome for model development.

- Each NextGen model utilizes more than 80 complex predictive variables, including many **multi-dimensional "mini-models"** that capture key interactions within the data. These predictors evaluate the relationship between the various elements of a consumer's credit report. For example, examining payment performance on new accounts (# of new accounts and delinquencies on those accounts) to distinguish between consumers acquiring more debt versus those merely rate shopping. There is more than double the number of predictive variables in the NextGen models compared to Classic FICO models.
- The NextGen models also incorporate an expanded segmentation scheme to analyze consumers across a **broader risk spectrum**. There are now **18 scorecards** in each NextGen model, compared to 10 scorecards for the Classic FICO models. The primary difference between the segmentation schemes is a more refined look

at credit history with NextGen. Classic FICO divides consumers into “derogatory” versus “non-derogatory” categories depending on the presence or absence of serious delinquency or derogatory references in a consumer’s credit history. NextGen groups consumers into various categories—those with very clean credit histories, those with mild forms of prior delinquency and those with more severe derogatory history. The NextGen segmentation scheme also uses some of the traditional splitters found in the Classic FICO risk models such as file thickness and file age, and some new variables such as credit usage.

- Finally, the NextGen models are developed using a ***refined performance outcome classification*** that distinguishes between varying degrees of subsequent credit repayment behavior. In developing the Classic FICO risk models, Fair, Isaac classified consumers as “Good payer” or “Bad payer” based on their worst level of delinquency on *any* credit obligation (or trade line) in the two years after the date of scoring. For each NextGen risk model development, Fair, Isaac classified consumers according to their ***degree*** of positive or negative performance ***across all credit obligations***. For instance, a consumer who went delinquent on two out of eight trades was categorized differently than one who went delinquent on eight out of eight trades.

This new performance outcome classification used in developing NextGen better serves the current lending environment. Many lenders today are more willing to extend credit to applicants with imperfect credit histories, provided they can price their offering relative to the risk. The NextGen risk models will assist lenders in risk-based pricing and will enable more confident decisions across all score ranges.

Performance Definition Used in Model Development and Odds Charts

What is the new revised performance definition used in the development of the NextGen models?

For our Classic risk scores, consumers are classified as “good” or “bad” payers based on their worst delinquency or derogatory status on any credit obligation in the two years after the scoring date. That is, a consumer who went seriously delinquent on two out of ten accounts would be classified as a “bad”; a consumer who went delinquent on all ten trades would receive the identical “bad” classification.

In the NextGen risk score development, consumers were classified by the degree of positive or negative performance across all credit obligations. For example, a consumer who went delinquent on two out of ten trades would be classified differently than another who went delinquent on all ten trades. In each case, the level of delinquency required for “bad” performance at the account level is still 90+ days delinquent.

This new performance outcome classification used in developing NextGen better serves the current lending environment. Many lenders today are more willing to extend credit to applicants with imperfect credit histories, provided they can price their offering relative to the risk. The NextGen risk scores will assist lenders in more appropriate pricing, and will enable more confident decisions across the entire risk spectrum.

For more insight on the benefit and impact of this design change with NextGen, refer to the question, “How does the different performance classification/definition affect my use or understanding of the score?”

How do NextGen odds charts differ from Classic odds charts?

The validation charts (commonly referred to as odds charts) are primarily a way of showing that a score rank-orders risk in a given lending situation. For this purpose, the performance definition shown on the chart need not be the same as the performance definition used in development. In fact, Fair, Isaac has always produced validation odds charts with four different performance definitions, (60+/any derog, 90+/any derog, charge-off/major derog and bankrupt), so that lenders could choose the definition most appropriate for their own performance measurement standard.

The performance measure used for the NextGen development was trade line-based, instead of the report-based performance used for Classic score development. Thus, the new NextGen validation charts include performance (or odds) by both consumer report and by trade line. Providing odds in both ways will allow lenders to easily make comparisons between the more familiar consumer report-based odds and the new approach of trade line-based odds.

A more thorough description of how and why we are evaluating odds by report and by trade is included in a leaflet entitled “How to read Fair, Isaac risk score validation charts” which is provided with every NextGen validation odds chart. Please ask your Fair, Isaac representative for copies of the validation charts for the specific industries and applications in which you are interested. You may choose from the entire library of validation charts available at www.fairisaac.com/pagesupport.htm.

How will trade-level odds compare to report-level odds?

The new validation charts provide a direct comparison of trade-level odds and report-level odds for a specific given industry or “base category”. On any given validation chart, trade odds may be higher or lower than report odds depending on the relative number of good performing trade lines and poor performing trade lines.

In addition, the difference between trade odds and report odds will be greater in some industries than in others. For industries where consumers tend to have only one or two trade lines in the base category (such as real estate or auto finance), trade odds

will look very similar to report odds. For those industries where consumers often have multiple accounts (such as bankcard), the difference will be greater.

While neither measure of odds on the validation charts will provide a precise prediction of actual odds for a given lender's portfolio, lenders now have two choices as to what to use as a starting point. Fair, Isaac expects that trade-level odds are more likely to be closer to the actual odds observed by a lender in practice, than are the report odds. The latter have been made available on the NextGen validation charts for lenders accustomed to report odds on the conventional Classic model validation charts.

How does the different performance classification/definition affect my use or understanding of the score?

By now you know that the Good vs. Bad performance measure used for the development of the Classic risk scores is based on a consumer report level, while performance classification used for the development of NextGen risk scores is trade line-based. The new validation charts provide a side-by-side comparison of the two types of performance. Note that the NextGen trade line-based performance measure will more closely mirror the account performance tracking experience of a particular lender. To understand why, consider a consumer with two bankcards, who pays one account on time while going delinquent on the other. Naturally, the two lenders in question will concern themselves only with the repayment performance of this consumer on *their particular* account; i.e., the consumer is a Good payer for one lender, but a Bad payer for the other. This mirrors the way performance is generated when developing the NextGen score. (In contrast, this consumer would be classified as a Bad payer in developing the Classic model.)

One consequence of the performance classification scheme used for developing NextGen is that the file thickness tends to have a greater impact on score than it did under the Classic model. Consider two consumers with no history of delinquency indicated on their credit files; Jack has three trades on file, while Jill has ten trades. With their clean repayment histories, Jill and Jack are probably good risks for the future. However, it's reasonable to estimate that Jill, with a greater number of successfully paid accounts under her belt, is a better risk (all other factors being equal). And even if both Jack and Jill were to go delinquent on one account in the near future, the odds of a particular lender experiencing delinquency on *their own* account are less with Jill (1 out of 10) than with Jack (1 out of 3). These notions suggest that, all other factors being equal, Jill (with her thicker file) should probably score higher than Jack. In fact, our research shows that NextGen does tend to push thicker files upward in the score distribution, while pushing thinner files downward.

Does the new performance definition used in the NextGen development weigh performance on different types of trade lines differently (e.g., mortgage trades versus bankcards)?

In answering this question, it's important to make a distinction between how the model scores credit files in practice, vs. how credit reports in our development sample are classified (i.e., "Good" vs. "Bad") for model development purposes.

First, when a credit report is scored under NextGen, it is possible that *prior* missed payments will impact the score differently depending upon the type of account that went delinquent. This is because some of the variables in the model measuring delinquency focus on particular types of trade lines (e.g., bankcards vs. installment loans vs. all revolving accounts, etc.) Note that other delinquency-related variables may consider all trades on an equal footing. The particular types of delinquency variables contained in a given NextGen scorecard depend upon which types were found to be the most predictive of future risk for the subpopulation in question.

Second, consumers in our development sample are classified (i.e., "Good payer" vs. "Bad payer") for model development purposes according to their repayment performance during the 24-month period *following* the scoring date. For this purpose, delinquency on trades from different industries is treated on the same footing. This is because the NextGen credit bureau risk score is designed to be a general credit risk assessment tool, for use by lenders in a wide variety of industries.

Note that all of the statements above regarding the NextGen model also apply to the Classic model.

Alignment

Does a NextGen risk score mean the same thing as a Classic FICO risk score? Is a 700 still a 700?

The NextGen risk scores have been aligned so that a NextGen score of 700, for example, represents the same level of risk as a Classic FICO score of 700. This consistent odds-to-score relationship means that the odds at a specific score range are designed to be the same for NextGen vs. Classic. However, because the NextGen models are a more advanced scoring system with a broader score range, score distribution shifts should be anticipated. Also, it is very possible that an individual consumer's NextGen risk score will be different from their Classic FICO risk score (either higher or lower).

Reason Codes

Does NextGen use the same adverse action (score reason) codes as are used in the Classic scores?

While the Classic scores used two-digit numeric reason codes to identify a reason statement, the NextGen model uses two-digit *alphanumeric* reason codes. The list of reason codes required for the NextGen models expanded beyond the limits of a two-digit numeric code. Thus, the existing reason codes were mapped to a new alphanumeric system, and many new reason codes were also added for use with NextGen. An example of a new score reason code is: “Amount owed on recently opened accounts is too high”. The additional reason codes applicable to NextGen are not more complex to explain to applicants, but were merely required, given the expanded characteristics included in the NextGen models.

The NextGen reason codes are identical across all three of the major US credit reporting agencies. To request a copy of the new, expanded list of NextGen reason codes, contact the Fair, Isaac Credit Bureau Score Helpline at 1-800-777-2066 or cbhelp@fairisaac.com or the Client Support Website at www.fairisaac.com/pagesupport.htm. The existing list of numeric reason codes is still used for the Classic scores.

Inquiry Treatment

How is consumer credit shopping behavior treated in the NextGen risk models?

When a consumer actively shops for credit, an inquiry is posted to the CRA database. The inquiry treatment for the NextGen risk models is consistent with that of the Classic FICO risk models. Only consumer-initiated, credit-related inquiries can impact a score. All mortgage and auto-related inquiries occurring within 30 days of the time of scoring are bypassed. In addition, auto and mortgage-related inquiries occurring over a 14-day period are treated as a single inquiry.

Minimum Scoring Criteria

Will the NextGen risk models provide scores for fewer or more consumers than does the Classic score?

No, because the NextGen risk models use the same minimum scoring criteria as the Classic FICO risk models. The purpose of minimum scoring criteria is to avoid returning a score for files with data that is too outdated or insufficient for sound credit risk assessment.

Industry-Specific and Other Applications

Is NextGen only for revolving credit? How does it perform on specific industries or product groups, such as mortgage, auto, bankcard, retail, or subprime?

Like the Classic score, NextGen is for use with all credit products. Our research has found excellent results from NextGen in nearly all industries and groups. Following are some of the results from our tests on millions of credit records:

- The NextGen risk scores showed a 10-18% improvement over the Classic risk scores in the number of future “bad” accounts scoring below a given score cutoff.
- The subprime market is one of many areas in which you will find that NextGen does a superior job over the Classic models; it does a finer job of distinguishing risk levels in the lower score ranges. Among a subprime population—credit files with prior serious delinquencies or charge-offs—a lender using the NextGen risk scores in lieu of the Classic risk scores could increase the number of approved loans by 6-10% while still lowering losses.
- Among the lowest-scoring 10% of consumers with revolving bankcard balances of \$3,000 or more, the NextGen risk scores identified 23% more future bad payers than the Classic scores.
- By switching from Classic FICO scores to the NextGen risk scores, a decrease in bad rates of up to 20% is possible for lenders in various industries, such as bankcard, auto, mortgage, retail, personal finance, and others.

Industry-specific validation charts exist for a variety of industries to enable lenders to examine the performance of NextGen for their specific types of portfolios. To see more specific results, please contact us at the Fair, Isaac Credit Bureau Scores Helpline at (800) 777-2066 or cbhelp@fairisaac.com.

If I use the Classic industry options today, should I switch to NextGen?

NextGen outperformed all of the Classic industry options for all account originations we studied. This may be surprising because the industry option models are particularly created for specific industries. NextGen far outperformed even the industry option models in terms of predictive ability.

For example, we compared the ability of the applicable Classic industry option vs. NextGen to identify the future poor paying accounts on our development sample. In the lowest scoring 10% of accounts, we found the following:

- On newly opened bankcard accounts, NextGen identified 39% of accounts that would prove to be poor paying accounts, while Classic bankcard industry option identified 33%. This represents an 18% increase for NextGen.

- For new department store retail accounts, NextGen identified 41% of accounts that would prove to be poor paying accounts in the future, while the Classic bankcard industry option identified 36%. This is a 14% increase for NextGen.

In the lowest scoring 30% of accounts, we found the following:

- For new auto loans, NextGen identified 58% of accounts that would prove to be poor paying accounts in the future, while the Classic auto loan industry option identified 53%. This is a 9% increase for NextGen.
- For new subprime mortgage loans, NextGen identified 61% of accounts that would prove to be poor paying accounts in the future, while the Classic installment loan industry option identified 55%. This is an 11% increase for NextGen.

Thus, to take advantage of the most predictive credit bureau broad-based risk model available, upgrade to NextGen.

Will there be NextGen industry options?

Our research has shown that the NextGen models offer superior risk assessment than both the Classic base models and the Classic industry options. At this time, no industry-specific NextGen models have been planned.

How does NextGen do at predicting bankruptcy?

Although NextGen is a general risk assessment tool and not designed specifically to predict bankruptcy incidence, it does an excellent job at predicting bankruptcy and offers significant improvement over the Classic FICO scores. On a national consumer sample, NextGen identified over 6% more bankrupts in the lowest 5% of all accounts than the Classic score did, and identified over 12% more bankrupts in the lowest 10% of all accounts than the Classic score.

For small business scoring, is the added predictive strength of NextGen sufficient to handle small business owners, or do I still need to purchase business info?

While the NextGen score offers more predictive power than the Classic score on a consumer file, the Vista and Venture scoring services provide you with more predictive, more actionable, information about your small business customers than a consumer bureau risk score does. Vista and Venture incorporate data from both consumer and business bureau reports. In addition, Fair, Isaac research has shown that small business owners, as consumers, exhibit different behavior than average consumers. Those differences have been taken into account in the Vista and Venture models, so these models are more predictive in evaluating small businesses.

Availability at the Credit Reporting Agencies

Where can I get NextGen scores?

The NextGen scores are called PinnacleSM at Equifax, the Experian/Fair, Isaac Advanced Risk Score at Experian, and PRECISIONSM at TransUnion. Pinnacle, the Experian/Fair, Isaac Advanced Risk Score, and PRECISION are now generally available for prescreening, account review, and on-line in the U.S. The NextGen scores are also available through Fair, Isaac's PreScore[®] Service and ScoreNet[®] Service at Equifax, Experian, and TransUnion. The NextGen scores are not available in Canada.

Are NextGen scores more expensive to purchase than Classic scores?

Please contact your credit reporting agency representative or your PreScore or ScoreNet representative for specifics on NextGen pricing. Fair, Isaac does not set pricing for FICO scores distributed directly through the credit reporting agencies, but as NextGen provides greater value, the price will likely be higher. On average you can expect to see a small increase in price above the Classic risk score, such as 15-20%. Case studies have shown, however, that this increase is far outweighed by the increased profits possible resulting from switching to NextGen.

What differences can we expect with NextGen scores across the three credit reporting agencies?

The NextGen scores were calibrated to the same odds-to-score relationship observed with the Classic risk scores. This means that for a given score range, expected odds for the NextGen risk scores should be similar to those for the Classic scores. The consistent calibration holds across all three bureaus. As with the Classic FICO scores, the NextGen scores take advantage of the unique data available at each credit reporting agency.

The NextGen score reason codes (previously known as adverse action codes) are identical across all three of the major U.S. credit reporting agencies.

NextGen Availability at Processors and Within Other Fair, Isaac Products

What is the status of the incorporation of the NextGen score in other F, I products, including CLSO? Small business scores? Liquid Credit? Decision Systems? StrategyWare?

NextGen can be used as an input to CLSO. NextGen scores are not currently available in Liquid Credit. NextGen is also not currently available in the small business services Vista and Venture, nor SBSS. NextGen can be used in Decision Systems and StrategyWare.

When is NextGen going to be available in Search?

Pinnacle and PRECISION are already available through a Search mid-release upgrade (4.2a). The Experian/Fair, Isaac Advanced Risk Score will be available in Spring 2002 in an additional mid-release upgrade (4.2b)

Are the processors ready to handle NextGen?

Pinnacle, PRECISION, and the Experian/Fair, Isaac Advanced Risk Score are available for account management purposes at FDR and TSYS.

All three scores are also available through the ACE system on TS1. On TS1 for the ACE Advantage system, and for the ACE and ACE Advantage systems on TS2, Pinnacle and PRECISION are currently available, and the Experian NextGen score is not yet available. For more detail or a current update, please call us at (800) 777-2066.

How has the secondary market responded to NextGen? What efforts are you making to establish it as the new industry standard?

We have presented information on NextGen to the ratings agencies and investment banking community to great interest. Also some of the more progressive mortgage lenders are already using NextGen. Ultimately, we believe that any lender seriously studying the issue will conclude that the improvement in profitability from NextGen far outweighs the operational and strategic investments required. As more and more lenders adopt NextGen, it will inevitably become the industry standard.

Conversion Plan Considerations

Assess Overall Business Impact

Where and how am I using scoring today?

As part of the longer-term conversion process, you should determine all aspects of how you are currently using credit bureau risk scores, including specific decision areas, functional areas, and portfolios. But to get up and running quickly, you should decide which area of your operations, such as a certain portfolio or life-cycle area, is most business-critical and where you might immediately want to apply the value of NextGen to mitigate risk or boost profits. To assess how your organization uses credit bureau risk scores today, you may need to initiate discussions with other departments across your organization. Changing scores will also impact your structural systems (e.g., underwriting systems, prospect and customer databases, collections), as well as your relationships with outside stakeholders (e.g., rating agencies, investors, securitizers).

What's the quickest way to get started using NextGen with the fewest implementation issues?

Prescreening is a great way to get started immediately with NextGen. As our research has shown, the potential for universe expansion and loss reduction is hard to resist. A short-term solution for immediate prescreen use involves decisioning with NG on the front end, but pulling the Classic score on both the front- and back-end screens. This allows you to take advantage of the tremendous power and predictive ability of NG in the front-end selection process, but you can use the Classic score as an indicator of any file deterioration between the front-end and back-end screens. We feel this would allow compliance with FCRA, though we also recommend that you check with your own legal group. This is a transition solution until your account origination system is able to accept the new reason codes that accompany NextGen. For more information or if you have questions, refer to the Fair, Isaac Resources listed at the end of this document.

Decide on Testing Approach

Should I do live or retrospective validation testing?

While a retrospective validation can be helpful in determining performance of any new score in your lending environment, it can often be a costly, time-consuming, and resource intensive undertaking. Doing a live test of NextGen and Classic scores can offer a faster, cheaper alternative to a retro validation and allows you to immediately capture the competitive advantage of NextGen while you gather performance results. For more information about how to conduct a cost-effective live test with the purchase of NextGen and Classic together, please contact the Fair, Isaac Credit Bureau Score Helpline at 1-800-777-2066 or your bureau representative. From our

Helpline you can also request a copy Fair, Isaac's booklet "Evaluating & Comparing Predictive Models: Eight Questions to Help You Better Measure & Interpret Model Performance."

When comparing Classic and NextGen validation results, what are some typical pitfalls to avoid?

As you would when comparing the performance of any two predictive models, it's important to ensure you're making an equivalent and fair comparison. To assist in this effort, Fair, Isaac has produced a booklet titled, "Evaluating and Comparing Predictive Models", which provides details to help you better measure and interpret model performance. This booklet is available through the Fair, Isaac Client Support Website at www.fairisaac.com/pagesupport.htm.

In general, you should ensure you're performing an apples-to-apples comparison of the two models. Following are several pitfalls to keep in mind.

- **Not examining cumulative vs. marginal odds.** The Classic and NextGen models are scaled to the same odds-to-score relationship, yet also have different score distributions. Thus, the marginal odds at a specific score break will be similar for the two models. However, due to the different distributions of applicants or accounts, the *cumulative* odds at a score break – or the odds of all accounts above a score break – will be most often higher for NextGen than for Classic.
- **Not comparing scores by impact to revenue or profit.** If comparing bad rates or charge-off dollars in a validation, note whether the comparison is being made on equally sized groups of accounts. Even if a similar score break is used, the differing distribution of accounts between the two models would likely result in a different volume of accounts passing the score cutoff. For example, if there is an increase in overall bad or charge off rates with NextGen, it is likely that the volume of accounts included increased significantly, and revenue and overall profit as well.
- **Not examining swap sets.** When a population is scored on the Classic and NextGen scores, the resulting score distributions are likely to be different. We know that the NextGen score enjoys a broader score distribution. In some cases, the change in score from Classic to NextGen for an individual consumer may be quite large. Not surprisingly, with any cutoff in any strategy, there will be a large number of consumers who score above the cutoff on both Classic and NextGen, and a large number who score below the cutoff on both scores. On the other hand, those consumers who score above one cutoff and below the other will represent the area of key importance for a lender. The two groups of consumers will form swap sets: those who score below a cutoff on Classic and above the cutoff on NextGen, and vice versa. The majority of our research on the development sample showed that the odds of the swap set which NextGen scored above the cutoff

while the Classic score scored it below cutoff was higher than the reverse. If you seek to understand further the composition of these swap sets, a retro analysis can be beneficial.

So many of my custom models incorporate the Classic FICO scores. How should I test the value of NextGen vs. Classic and the impact of switching in these models?

All of the studies that Fair, Isaac and our clients have done thus far indicate that NextGen’s predictive power is superior to the Classic score when comparing the scores in a head-to-head test. In addition, we are seeing increased profitability result from swapping in NextGen for Classic in both prescreen and account review strategies. Also, when looking at application screening examples, NextGen has been shown to be more predictive than the Classic score in head-to-head tests.

If you’re planning to include a the FICO bureau score within a custom application or risk score, then using NextGen instead of Classic scores will also provide increased predictive power. We recommend including NextGen when developing those custom cards.

Some clients have said, “But I just went through an application score development and put Classic into the scorecard—can I simply swap in NextGen for Classic and see the improved predictive power?” Fair, Isaac’s research has shown that, for custom scorecards developed with the Classic score in the model, swapping in NextGen results in approximately the same predictive power. Although NextGen is more predictive than Classic when examined head-to-head, the fact that the custom score was optimized to the Classic score (plus the other variables) often compensates for the difference in strength of the two bureau scores.

In some cases, even though the custom model was optimized on the Classic score, a switch to NextGen will still yield more predictive power. If possible, we recommend testing the NextGen model versus the Classic model within your custom score to see if yours is such a case.

Lastly, we fully expect that a custom model built including NextGen will outperform a custom model built with Classic. Consequently, we recommend including NextGen when developing custom scorecards in the future whenever possible.

Determine System Impacts and Changes

What implementation information do I need to know to switch to NextGen?

As with any new scoring product, changes to bureau access for the on-line inquiry will be required. Contact your CRA representative(s) for such information. In addition, application systems and account management systems will need to be modified to accommodate new score reason codes and letter generation systems will need to translate the appropriate code into the narrative explanation. The development

of new score reason codes and associated explanations was necessary due to the large number of predictive variables that were utilized in the NextGen models. We have exceeded the number of 2-digit *numeric* code numbers and have therefore switched to 2-digit *alphanumeric* codes. This change should result in fairly minimal programming for most application and account management processors. An example of a new score reason code is: “Amount owed on recently opened accounts is too high.” For more detail, please see the “Implementation Considerations by Life Cycle” section of this document.

What do I need to know about my own bureau interface software and its ability to utilize NextGen?

There are several important questions regarding the ability of your bureau interface software to receive NextGen that should be investigated.

- Can the interface software read and store a new three-digit score and the four associated alpha-numeric reason codes?
- Can the interface software accept a score with a value outside of the stated range of 300-850 for the Classic scores? What changes are required to adjust it to the NextGen possible score range of 150-950?
- If the application processing software generates letters based on reason code values, is the software ready to read and convert the new two-character alpha-numeric NextGen reason codes into the appropriate reason code verbiage?
- Is the software ready to receive the new NextGen product codes for each appropriate credit bureau?

Changes to bureau access for the on-line inquiry will be required. The NextGen scores can be requested as follows:

- at Equifax – Pinnacle® (model number 02531)
- at TransUnion – PRECISIONSM (algorithm #227)
- at Experian – Experian/Fair, Isaac Advanced Risk Score (keyword “RM-M”)

Contact your CRA representative(s) for more information.

Each of the three credit reporting agencies has published a list of score reason codes.

- Equifax published codes in a systems-to-systems manual in Fall 2000.
- TransUnion listed the codes in *General Announcement #18* on December 7, 2000.
- Experian included the codes in the June 1, 2001 issue of Vendor News.

Determine Changes to Strategies

Will I need to re-evaluate all of my cutoffs/strategies?

As noted before, the NextGen risk models have the same odds-to-score relationship as the Classic FICO risk models. Therefore, lenders choosing score cutoffs based on marginal risk (or marginal odds) should not need to adjust score cutoffs or strategies to maintain the same level of risk.

The difference between the scores will be seen in the score distribution shifts that result from the more refined risk assessment. Lenders choosing score cutoffs based on volumes may need to make adjustments to their score cutoffs to maintain consistent volumes.

Fair, Isaac recommends that lenders monitor the impact of converting to the NextGen risk scores on their portfolios and make any necessary adjustments. Monitoring will be especially important for lenders who set cutoffs based on volumes.

What type of score shift can I expect to see in my prescreening population/applicant population/account management portfolio?

On a national consumer sample, we compared score distributions between Classic versus NextGen on a number of different populations. Following are some of the findings.

- For all consumers, 57% scored higher with NextGen than with Classic, while 42% scored lower with NextGen than with Classic
- On the population of consumers with a Classic score less than 550, 33% scored higher with NextGen, and 66% scored lower with NextGen.
- On the population of consumers with a Classic score greater than 750, 79% scored higher with NextGen, and 20% scored lower with NextGen.
- On a population of thin files (consumers with only one or two trade lines), 14% scored higher with NextGen, and 85% scored lower with NextGen.

These figures represent the findings on our development dataset, and results may differ on different populations. Lenders can perform this analysis on their own data to understand what will occur in their own populations of interest. After converting to NextGen, ensure that proper tracking is in place through scorecard management reports.

How does NextGen handle young and thin populations? Should that impact my strategies?

Expect to see superior rank-ordering of risk with NextGen, in part due to the new segmentation scheme. The young and thin populations are, in general, likely to distribute lower with NextGen than they did with Classic. Consumers in these groups that do score higher with NextGen indeed represent lower risk.

Up to this point, some prescreeners have treated young and thin file consumers differently than other consumers, even at the same score range. When building your NextGen strategies for these groups, you can be confident that the marginal risk level at a specific cutoff is the same for them compared with the remaining consumers. Therefore, a single strategy can be put in place that address the entire population, rather than creating separate strategies to address these unique groups.

Can NextGen identify more profitable accounts in the Premier (i.e., high-scoring) consumer segment?

Our NextGen research compared score distributions of consumer files from a number of large, national bankcard issuers. This study determined that not only does NextGen place more accounts in the highest score ranges, but also that those accounts generate more revenue per account than similarly scoring accounts under the Classic score. Specifically, on our sample we found that twice as many accounts scored at or above 780 with NextGen, and these accounts contributed 25 – 100% more revenue per account. This discovery should be exploited in your strategies for high-scoring consumers across all stages of the account life cycle.

What kind of repayment performance by NextGen score range can I expect on my own prospects, applicants and existing borrowers?

As with the Classic score, the bad rate by NextGen score will be unique for every portfolio. Thus, we recommend calibrating the NextGen score on your own portfolio to assist in making decisions and revising strategies. Approaches for calibrating include:

- Scoring accounts with NextGen and monitoring their subsequent performance for a period of time,
- Performing a retrospective validation,
- Creating a calibrated validation chart.

The last option uses an industry validation chart in conjunction with your own score distribution and observed rates of bankruptcy, charge-off and delinquency. For more details on calibration techniques please contact Fair, Isaac.

Train Staff

How will I explain the NextGen differences to my staff?

As the NextGen score is used within your business, it will be necessary to train and educate your customer-facing personnel about the new NextGen score. Many experienced personnel may be confident that they understand what a 680 “looks like” for the Classic score. It’s critical that they understand that the NextGen model is a superior predictor of risk, and that the models are scaled to the same odds-to-score relationship. Thus, although the risk associated with a 680 is similar between the two models, the type of consumer profile that scored 680 with the Classic score may be different from the consumer profile that will score 680 with NextGen.

In addition, the range of scores in the NextGen distribution is much broader than that of the Classic distribution. Thus, your customer service personnel may see a higher volume of accounts scoring in the 800s than they did with Classic. These higher scoring consumers are also more likely to be more profitable than the highest-scoring consumers under the Classic model, as our research has shown. Please see the ‘Fair, Isaac Resources’ section of this document for additional support that can be provided by Fair, Isaac.

Implementation Considerations By Life Cycle

Prescreening

What changes will I need to make to my current system to use NextGen in my prescreening efforts?

Using NextGen in your prescreening efforts is one of the easiest ways to start using the score as the prescreening effort takes place at service providers such as credit reporting agencies, list processors, and 3rd party prospect database providers. If you use a prospect database, you'll need to ensure the database is ready to accept NextGen. In the criteria to the provider, specify the use of NextGen.

How should I adjust my prescreen strategies?

- **Review low-end score cutoffs.** Depending on the operating region and objectives relative to risk tolerance and volume, an adjustment in the low-end score cutoff may be needed. Generally there is a shift upward in the score distribution.

Although the marginal odds are similar at a cutoff for both Classic and NextGen, the cumulative odds will likely be higher for NextGen because of the upward shift. If the same score cutoff is maintained, a decrease in the loss rates will likely be seen on the approved population. Depending on the cutoff score, there will likely be more approved good accounts but similar number of bad accounts, or a similar number of good accounts but a decrease in the number of bad accounts. Volumes can be increased by lowering the cutoff, resulting in more approved accounts while, for example, maintaining cumulative population good/bad odds. Please note this involves accepting some accounts at a lower marginal odds level than previously accepted.

Due to the broader score distribution with NextGen, a shift downward in the score distribution may occur in the lower score operating regions more typical of the sub-prime area, or when targeting offers to potentially higher risk prospects.

- **Review high-end score cutoffs.** High-end cutoffs are often used to screen out consumers who are unlikely to respond, or who historically produce lower revenue. The shift upwards in the NextGen score distribution means many more accounts are scoring in the higher ranges. Research on a pooled bankcard sample has shown that these higher scoring accounts also produce higher average revenue per account. Leaving the high-end cuts unchanged could unnecessarily eliminate many profitable, low risk accounts. Consider increasing the high-end score cutoff by 20-40 points.
- **Review initial line assignment strategy.** Re-examining the current approach is recommended, as research has indicated that higher scoring accounts with NextGen are also tending to be more profitable and generate more revenue. More

favorable credit line assignments can be made to some of the higher-scoring consumers that traditionally might have had the initial line limited, because they are thought not to produce significant revenue. Better offers should result in improved response and activation, and subsequent increased revenue and profit. If the initial line is set in back-end application processing and NextGen is not available there, consider determining the potential line during the front-end prescreening process—thus creating a shadow line to pass for a basis in setting the final line.

- **Review knock-out rules.** Given the increased risk prediction strength of NextGen, consider relaxing or eliminating some of the criteria used to exclude consumers before the credit bureau risk score ever comes into effect. Allow NextGen to help refine the offer population.
- **Review targeting and segmentation strategies.** NextGen provides superior risk assessment even for specialty areas such as young and thin files, and is powerful at identifying low risk consumers who will actually want and need credit. Prescreen strategies can be streamlined by allowing young and thin files to be evaluated through a more general criteria. A more compelling offer that may include a lower APR, larger credit line, product upgrade or other enhancement can be confidently directed toward the most credit worthy prospects.

If I have validation results from a previous prescreen campaign based on the Classic score, what can I actually infer for future campaigns based on NextGen?

Ideally, a sample of booked, non-approved, non-responded and non-mailed should be included in a retrospective validation performed on a previous prescreen campaign. This will provide the closest representation of the prospect NextGen score distribution. However, all of these may not be available. The sample will be truncated if only prospects that pass the Classic score cutoffs are provided. Of those prospects not passing the Classic cutoff, the NextGen scores would not be available to determine their score distribution. Thus, accounts that could have been swapped in using NextGen cannot be considered. Without knowing the potential number, it is not viable to conjecture the cumulative impact of swapping those in with NextGen.

Also, performance measures will only be generated on actual booked accounts. Looking at the score distribution of the non-booked accounts would give an indication of those that could be approved using NextGen. Although performance measures will not be available on the non-booked, the results of booked accounts with the same NextGen score can help in gauging the quality. Nevertheless, within the sample, the effectiveness of NextGen over Classic to rank order risk on consumers likely to respond and go delinquent will be evident. The ability of NextGen to identify the more profitable accounts and the high loss accounts will also be quite apparent.

Are there legal issues to consider before upgrading to NextGen for prescreening?

When a consumer is scored on the two different models, Classic and NextGen, we expect that the scores will most likely be different. When moving from a Classic score to the NextGen score, some files will move up in score, and others will move down. Across all score ranges, we will see a wide variety of changes in scores. We can be sure, however, that NextGen is a superior score, and thus is a better predictor of risk.

A lender may be tempted to use NextGen for the selection process on the front end and then use Classic on the back end screen to determine if the file still meets the front end criteria, utilizing the Classic score reason codes. While this may seem to be a plausible approach, Fair, Isaac would recommend against this screening method. While the Classic and the NextGen models are scaled to the same odds-to-score relationship, the shifts in score that will occur by scoring a file on one model, and then the other, may be significant. For this reason, merely utilizing NextGen for the front end screen, and then Classic for the back end screen may result in declines of consumers on the back end which did not exhibit a deterioration in file condition, but merely have been scored on a different model. That is, certain responders may exhibit the same credit criteria and risk level that was initially used to select them, and declining them on the back end is potentially a conflict with the FCRA.

Due to the score shifts, a lender using solely the NextGen score on the front end and the Classic score on the back end may be at a great risk of non-compliance with the FCRA. As a solution, we recommend that for near-term purposes, until you're prepared to incorporate NextGen into your back-end screen, you capture the Classic risk score on **both** the front end and the back end. Comparing the Classic scores on the front end and the back end will allow you to accurately determine if there has been a deterioration in the credit file while the more powerful NextGen score is used for the critical front-end selection process.

As in all cases, you should check with your own legal counsel before instituting a new prescreen process. Of course, once you begin using the NextGen score for both front end and back end screening, you will no longer need to rely on the Classic score to identify any change in file condition.

Application Processing**What changes will I need to make to my current system to use NextGen in my application screening efforts?**

- Program new alphanumeric Reason Codes for use in application processing and/or adverse action
- Update letter writing systems to accept new alphanumeric Reason Codes

- Determine underwriting system impacts
- Determine changes to voice response system if necessary
- Determine changes to customer service system if necessary
- Determine changes to the application web page browsers if necessary

How should I adjust my application screening strategies?

- Review final credit decision cut-off strategies
- Review credit line assignment strategies
- Review knock-out rules
- What if I want to maintain my booking volume and lower losses?
- What if I want to increase my booking volumes while controlling losses?

Although the marginal odds are similar at a cutoff for both Classic and NextGen, the cumulative odds will likely be higher for NextGen because of the general upward shift in score distribution. If the same score cutoff is maintained, a decrease in the loss rates will likely be seen on the approved population. Depending on the cutoff score, there will likely be more approved good accounts but similar number of bad accounts; or a similar number of good accounts but a decrease in the number of bad accounts. Volumes can be increased by lowering the cutoff, resulting in more approved accounts while, for example, maintaining cumulative population good/bad odds. Please note this involves accepting some accounts at a lower marginal odds level than previously accepted.

Will I approve more applications at a given score cutoff with NextGen?

Lenders will have many options when setting NextGen score cutoffs to better meet their business objectives, whether it is to increase booking volume, reduce risk, or some combination of both. Some applicants scoring below the Classic FICO risk score cutoff will score above cutoff with NextGen, and some with a Classic FICO risk score above the cutoff will score below the cutoff with NextGen. Because NextGen is the superior risk predictor, those applicants swapped above the cutoff will have better odds (lower bad rate) than those swapped below.

The actual numbers of consumers migrating above or below a specific cutoff will vary by lender and by portfolio. The impact to score distributions (the number of consumers scoring above or below a given cutoff) will likely be larger than what is typically seen following a Classic FICO model redevelopment. Therefore, lenders seeking to maintain their booking volume will need to evaluate (at a minimum), the score distributions on their own portfolios, to determine whether cutoff changes are necessary.

Account Management and Collection Management

What changes will I need to make to my current system to use NextGen in my account management and/or collection management systems?

Several changes are required to fully utilize the NextGen score in your account management and collection management systems. Institutions that process at First Data Resources or Total Systems will find that many of these are already addressed. However if you process your accounts internally and utilize a collection management system to execute delinquent account strategies, then the following is a list of modifications to each system that should be considered:

- Ensure the new alphanumeric Reason Codes are implemented in your system and are linked to your letter-writing platform and decision system, where necessary, so the new reason code statements can be used in adverse action notifications.
- Determine any reporting impacts and considerations. The NextGen score encompasses a broader score distribution than the Classic score. To capture the full spectrum of risk levels for the accounts scoring at the higher and lower ends of the distribution, your reports would likely benefit from a redefinition of score breaks in the ends of the score ranges. For example, if a distribution report used today for the Classic score ends with a score range of 750+, you may want to adjust the ranges to separate this into several more score ranges, to observe the broader distribution of accounts in these higher score ranges.
- Determine if your database accommodates separate score fields for both the Classic and NextGen score. If you plan any side-by-side testing, or if you are seeking to examine any distributions of the two scores on a portfolio, you will need to capture and house the two scores in separate locations.
- If the NextGen score will be housed in a new location, make sure this score field is tied in and ready to be used as an input into each and every necessary process. Determine how this will affect your MIS.
- Ensure any third party marketing vendors or agencies you work with for cross-selling activities can accept and/or receive NextGen.
- If you are using the NextGen score in your prescreening or application screening processes, is the score then accessible by your account management system? Is the score accessible by your collection management system?
- Ensure that your collection management system can accept the NextGen score as a decision key in the delinquent account routing and queuing function.

At our processor, we use the standard joint odds table today, which encompasses the Classic score; will we be able to use the NextGen joint odds in our strategies in the future?

The joint odds tables in use at the processors today are based on the Classic score. Clients are advised that these joint odds are derived on pooled data. The most accurate approach for score cutoff determination is to use your own data.

Fair, Isaac has prepared NextGen joint odds tables for potential implementation at FDR and TSYS. The availability of the NextGen joint odds table will depend upon the ability of each processor to implement it—either in tabular form or in a formula. You are encouraged to contact your Fair, Isaac strategy consultant for further guidance in the use of the joint odds tables.

How do I transition to NextGen if I receive my scores through ScoreNet?

To begin receiving NextGen scores through ScoreNet, contact your Fair, Isaac ScoreNet consultant. If you don't receive credit bureau risk scores through ScoreNet and have questions about this process, please call Mark Chapman at (415) 492-5383.

How will the switch to NextGen impact my strategy tracking?

The impact will likely be influenced by the extent to which:

- you adjust or change your strategies to account for the different score distribution of the NextGen score, and
- the credit bureau score is leveraged in your strategies to apply different actions or queue assignments to your accounts.

See the Strategy section immediately below for more details on possible impacts to strategies.

How should I adjust my account management and delinquent account queuing strategies with NextGen?

This complex question can be divided into a short set of questions, as follows:

- **Will I need to change my score cutoffs?** As noted before, the NextGen risk models have the same odds-to-score relationship as the Classic FICO risk models. Therefore, lenders choosing score cutoffs based on marginal risk (or marginal odds) should not need to adjust score cutoffs or strategies to maintain the same level of risk.

The NextGen score has a broader distribution than the Classic score. A NextGen score and the associated Classic score on a single account can be quite similar—or quite different. Thus, it's likely that once you're using NextGen, a strategy cutoff may have more or fewer accounts that pass over it, depending upon where the cutoff is and the type of portfolio. Lenders choosing score cutoffs based on

volumes may need to make adjustments to their score cutoffs to maintain consistent volumes.

- **How can I determine what score changes to make, if any?** If it is possible to receive and store both the Classic and NextGen scores on the same accounts for a short period, and if this information would be available through your estimator facility, then carefully executed strategy estimators would provide you with critical information about the distribution of your accounts on the NextGen score. This information could then be used as direct input into revising your strategies, under NextGen.

If you are unable to run this type of estimator before using NextGen in your production strategy environment, then implementation of NextGen, followed by careful and immediate tracking, is recommended.

- **What NextGen research should I keep in mind as I adjust my strategies?** Evaluate each type of strategy and determine if adjustments are necessary. As you go through this process, please keep in mind the significant findings from our NextGen research on our development sample, including:
 - The NextGen distribution has more accounts scoring in the highest score ranges, and these accounts generate more revenue per account than a similarly scoring group of accounts under the Classic score
 - Across all industries, the NextGen risk scores showed a 10-18% improvement over the Classic scores in the number of future “bad” accounts captured below a given cutoff score.
 - Among consumers with total revolving bankcard balances of \$3,000 or more, the NextGen risk scores identified 23% more future bad payers than the Classic scores within the lowest-scoring 10% of this group.

Fair, Isaac Resources

How can Fair, Isaac assist with the transition from Classic to NextGen scores using both scoring and business consultants?

Fair, Isaac provides a wide variety of materials and services available to help you better understand and implement the NextGen scores. Feel free to phone the Fair, Isaac contacts below to learn more about what services are available to you.

Fair, Isaac Credit Bureau Score Helpline at (800) 777-2066 or cbhelp@fairisaac.com

The Credit Bureau Score Helpline experts are available to Fair, Isaac clients by phone or email to answer questions about FICO scores. Contact us to receive marketing collateral, including brochures, pamphlets, and other documentation, or to receive research results or validation charts. You can also refer to the Client Support Website at www.fairisaac.com/pagesupport.htm.

Prescreening Consulting

For prescreening clients, Fair, Isaac can provide consulting services in the areas of retrospective validations, live testing, and system transitioning. If you are a PreScore Service client, consulting hours and analytic projects are available for conversion support needs. Specialized consulting services are also available for bureau direct and PreScore Service clients. With further questions, contact Barbara Dalmau at (415) 446-6287.

Account Management Consulting

For account management clients, speak with your TRIAD or ACS strategy consultant to help you transition to NextGen as smoothly as possible. If you process at FDR or TSYS and are unsure who your consultant is, contact Linda Heger at (415) 491-5244. If you're not currently working with a strategy consultant, contact Edmund Tribue at (410) 933-7531 for more information.

Systems Integration Consulting

For assistance with systems integration concerns or questions, contact the Credit Bureau Score Helpline at (800) 777-2066 or cbhelp@fairisaac.com. Your question will be routed to the appropriate people to assist you.

General Business Consulting

For clients who require additional risk management consulting support beyond the resources listed above. For questions regarding all phases of the credit life cycle including solicitation, account acquisition, account management, and performance tracking and interpretation, contact Edmund Tribue at (410) 933-7531 for guidance.

Print Materials available through Credit Bureau Score Helpline at (800) 777-2066 or cbhelp@fairisaac.com

White Paper

NextGen—More Predictive Power In Account Management

Case Studies

- *Bankcard account management results: Top bankcard issuer boosts account management results*
- *Prescreening: Prescreeners get a better tool for targeting high-profit, low-risk accounts*
- *Mortgage loans: NextGen FICO Scores for Mortgage Lending*

Article Reprints

- “NextGen Risk Scores Coming to Equifax”: Spring 2000 *Bureau Scores Today*
- “Pioneering the NextGeneration of Bureau Risk Scores”: Spring 1999 *Bureau Scores Today*
- “Research Shows How New Risk Scores Increase Bottom Line Results”: Fall 1999 *Bureau Scores Today*
- “New Risk Scores Reduce Charge-offs, Shine in Key Account Management Segments”: Dec. 2001-March 2002 *VIEWPOINTS*

User Guide

NextGen User Guide

Brochure

NextGen Credit Bureau Risk Scores

Reason Code List

Fair, Isaac US Credit Bureau Risk Score Reason Codes

Validation Materials

- Validation Charts (formerly known as odds charts) (Validation charts for both the Classic score and the NextGen score are available for a variety of industries, so you can compare the trade odds and report odds for the appropriate industry for your portfolio)
- *Pamphlet: How to Read Fair, Isaac Risk Score Validation Charts*
- *Booklet: Evaluating & Comparing Predictive Models: 8 Questions to Help You Better Measure & Interpret Model Performance*
- *Booklet: Calibrating Credit Bureau Scores*

Software Demo

The NextGen Return on Investment Calculator



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