

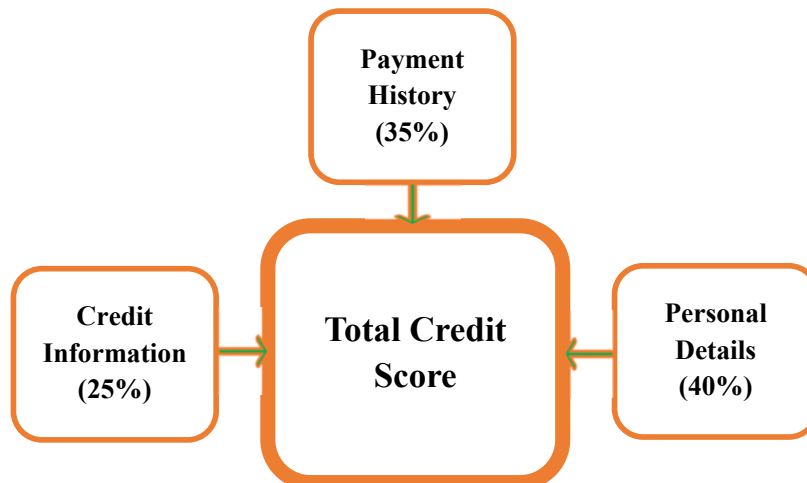
PERSONAL CREDIT SCORING METHODOLOGY

1.0 OVERVIEW AND SCOPE

This article represents National Credit Ratings' (NCR) methodology for calculating Personal Credit Score, the numerical representation of creditworthiness of an individual. Personal Credit Score is a number that depicts the ability of the borrower to pay back the borrowed amount. According to this methodology the number will range between 300 to 900. The higher the score, the better the borrower's ability to repay the loan portraying lesser credit risk. Though Personal Credit Score is derived from different quantitative and qualitative information of a person, NCR guarantees that the privacy of the person will not be disturbed in any way.

2.0 FRAMEWORK

Three main factors are evaluated while enumerating Personal Credit Score. The factors along with their weights are depicted in the following diagram:



2.1 PAYMENT HISTORY

Past payment behavior of a person can be evaluated by the payment history. This is the most important factor in calculating the total credit score. Making on-time payments help one to improve his score while missing payment hurts the score. Payment history is further categorized in three segments:

2.1.1 LOAN REPAYMENT HISTORY

Loan repayment history is the most significant constituent of payment history. Regular payments with faultless records generate the highest score. Length of payment history provided by a person is also considered during the process. Longer history results into better score. Score will be hampered for the person who provides the payment history of a limited period instead of having a longer history of credit usage. A single score is generated in combination with the payment pattern and the provided length of loan repayment history.

2.1.2 TAX PAYMENT

Though taxes are owed to the government, regular tax payment indicates a good payment behavior of a person and thus included in the calculation.

2.1.3 UTILITY BILLS PAYMENT

Despite having a low weight, payment behavior of utility bills is also considered during the calculation of score of payment history as part of evaluating a person's attention to payments of insignificant amounts.

2.2 CREDIT INFORMATION

NCRL considers several credit related information to obtain the overall score on credit information. The factors are:

2.2.1 CREDIT CARD UTILIZATION

Having credit cards and owing money on them does not necessarily indicates high risk with low credit score. Increasingly high credit card utilization increases the risk of default and decreases the score. High utilization indicates that a person is overextended and is more likely to make late or missed payments. On the other hand, very low utilization indicates an excess limit compared to the capacity of the borrower. Low utilization also decreases the credit score. Between these two extremes, no or low utilization and high utilization, a balanced score is generated for each percentile.

2.2.2 NEW CREDIT IN LAST 01 YEAR TO TOTAL CREDIT

Opening several credit accounts within a short period indicates greater risk. NCRL considers the last 01 year as the period. Percentage of sanctioned loan limit within this period to total credit limit is calculated. A high percentage indicates the lack of longer payment history for most of the credit accounts and results in a lower credit score since payment pattern for those accounts cannot be evaluated with greater certainty.

2.2.3 LENGTH OF CREDIT USAGE

Length of credit usage is the period between the opening of a person's first credit account to the date of recent approval of loan. A person with a longer credit usage has a longer payment history which in turn assist to identify the payment behavior of that person be that good or not. Besides, longer credit usage may indicate, to some extent, a smooth payment behavior of the person since he might have not provided with new credits having faulty records in the past. However, longer credit usage does not necessarily guarantee a smooth payment behavior and should be dealt with commensurately. That is why NCRL considers the payment pattern or behavior in conjunction with provided payment history which has been discussed in the earlier section of this article.

2.2.4 CREDIT MIX

The types of credit one has are known as the credit mix. They can include a mix of accounts from credit cards, retail accounts, installment loans, finance company and mortgage loans. The risk of lending money is assessed through a variety of factors, one of them being the ability of a person to successfully manage different types of credit. For creditors, it stands to reason that the better a person manages different loans and lines of credit, the lower their risk when lending him money. However, a person having different types credit with unsuccessful management would ultimately hurt his score by having higher risk. So, mix of different types of credit may not be mandatorily translated into a better score. However, if a person is striving to bring his score to the highest level, credit mix can play a part.

2.3 PERSONAL DETAILS

Several personal factors are considered by NCRL during the scoring process. Unitarily these factors don't carry higher weights to affect the overall score significantly but may turn out to be robust in combination. Individual factors may not be strong enough to bring down the total score but may add an extra topping for the person thriving to a higher score. Factors considered in personal details are as follows:

2.3.1 AGE OF THE PERSON & AILMENTS

Though age of the person is not of that much importance to the creditor for younger people, age comes to play an important role for the aged persons. Life expectancy is uncertain at any age but becomes more certain for the aged people. That is why, age of a person after a standard age puts negative pressure on his score. However, permanent ailments due to deadly diseases is also considered by NCR since, a young person with permanent ailment will have shorter life expectancy. An aged person without any permanent ailments may have a higher score than a younger person with permanent ailment. That is why, a single score is generated by considering the age of the person and presence of permanent ailments simultaneously.

2.3.2 PERSONAL NET WORTH TO AVERAGE CREDIT LIMIT

Personal Net Worth (PNW) of a person is calculated by subtracting the liabilities of that person from his total assets. A positive PNW is always good but raises a question – to what extent? Here comes the average credit limit to provide a solution. A person is expected to further increase his credit line somewhat by the amount close to his previous individual credit limits. If a person's PNW remains positive after increasing the credit limit for once or more, that indicates a stronger financial position of the person and thus supports the score.

2.3.3 ANNUAL INCOME

Persons with higher annual income are expected to supplement their payables more smoothly than those of with lower annual income and consequently gets a better score.

2.3.4 SAVINGS AND INVESTMENTS

Individuals having savings and investments along with credit accounts are better than those without any savings and investments. Because, in case of any difficulties in payments in the credit accounts they may use their savings and investments to keep the payments regular.

2.3.5 OCCUPATION

Occupation may somewhat explain the financial condition of a person which in turn explains the capacity of that person to repay the borrowed amount. For example, a jobholder's earnings are more certain (irrespective of amount) than the earnings of a businessman.

2.3.6 LIFE INSURANCE

Life insurance helps the nominee of a person to get a handsome amount after the demise of that person. This amount could be, not necessarily, used to repay the amount owed by the person.

2.3.7 COMPLIANCE OF COVENANTS (PAYMENT RELATED)

Compliance with the covenants in the loan agreement indicates that the person is disciplined and exposes lesser risk to the creditors. An in-compliant person has the highest possibility to miss payments.

2.3.8 ENTITY RATING

Persons involved with businesses may have entity ratings for the business. Entity rating indicates the creditworthiness of the business. A good entity rating may be translated into a good score since financial condition of the person may be related, directly or indirectly, with the performance of the entity.

2.3.9 STRENGTH AND QUALITY OF GUARANTOR

In most cases creditors of personal loans takes personal guarantee as security. Financial strength and quality of the guarantor depicts the quality of the security. Good security means better score as it reduces credit risk.

2.3.10 LOANS IN WHICH CLIENT PROVIDED GUARANTEE

NCRL also considers the amount of loan in which the client has provided personal guarantee. The person for whom personal guarantee has been provided may default and the guarantor may become liable for the amount and consequently may become unable to repay his loans.

2.3.11 POLICE CLEARANCE CERTIFICATE

Objection in the police clearance certificate raise questions regarding the obedience of a citizen to the laws of the state. Such a person may become financially unstable at any time upon steps taken against him by the state and thus exposes a higher credit risk resulting into lower score.

Disclaimer:

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