

<Rex Johnson's Online Institute>



**Webinar #12:**  
**TAKE OFF THE HANDCUFFS-**  
**A Policy Manual that Really Works!**

*Lending Solutions Consulting, Inc*

**Death of the Credit Union Industry**  
**as of 9/30/06**

Asset Size	% of Total	# of Credit Unions	ROA	Member Growth	Loan Growth	Asset Growth
0-20 Million	60%	5,220	0.64%	-1.07%	4.24%	-1.91%
20M-50M	17%	1,486	0.68%	0.06%	6.10%	1.04%
50M-100M	9%	782	0.70%	0.95%	6.60%	2.64%
100M-200M	6%	519	0.75%	1.85%	7.90%	4.36%
200M-300M	3%	236	0.82%	1.47%	8.65%	5.02%
300M-400M	1%	118	0.89%	3.68%	10.58%	5.98%
400M-500M	1%	84	0.85%	3.65%	10.57%	7.14%
500M-1B	2%	164	0.92%	3.76%	11.48%	5.79%
<b>Total</b>		<b>8,720</b>				

## Credit Union Philosophy

We believe this page is the most important page of our loan policy. Our Board of Directors, our various Committees, Senior Management Team and staff all support this philosophy. All our new employees or volunteers will read and have explained to them what this philosophy means and will subscribe to this philosophy.

It is the philosophy of **(Insert CU Name)** Credit Union to help as many of our members as possible with their credit needs. Our credit union believes in relationship lending. We have strong evidence, based on years of experience, that members pay us when they do not pay others.

**While we will not ignore the fact that others may not be getting paid we also will not solely use that as a reason to deny the loan if it is evident the member has and will continue to pay the credit union.** The credit union will also consider a member's credit score but will not deny a loan due to a credit score. The credit union understands that credit scores are very volatile plus can and will change quickly. Our mission is to counsel our members regarding their credit scores and show them how to dramatically improve their credit scores. **We want to show our members how to pay us less.**

**We believe lending has been and still is a judgment business. While we will instruct our staff to use good judgment in decision making; they are not to judge a member's character.** None of us are qualified to judge someone's character. We realize that bad things happen to good people. We also realize that under enough pressure, our members can and will make mistakes. We also believe our members deserve a chance to get a fresh start. **The only reason we believe a member should ever be turned down is when our loan officers or decision makers believe the member will not pay the credit union.** We expect our employees to be honest with the members in communicating their decisions and then to listen to the member's response. **It is more important that our employees make the right decision than to personally be right.**

## Quality Control of Underwriting

All loan officers will exercise good judgment. Factors including, but not limited to, credit history, payment history, employment and income stability, level of indebtedness, loan type, loan term, and net worth must be taken into account as a part of credit judgment. **The credit union will focus more on the probability the member will pay the credit union and lesser on how the member has paid others.** The credit score is just one of many tools the credit union will use.

The quality control program utilized by this credit union involves a monthly verification of loans produced by employees with lending authority. The actual percentage of loans to be pulled will be determined by the credit manager. The vice president of lending, credit advisor manager, and/or vice president of operations may request additional levels of review if problems are believed to be present. The Board of Directors will receive a summary of all reviews monthly in their board packets. Additionally, the board will receive a quarterly report on the credit quality mix of all non-credit card loans as defined by credit scores.

**It is the responsibility of the credit manager to monitor the gross and net loan yield by product type and grade of paper after charge-offs and cost of collections. The credit union, in an effort to serve all its members, is not trying to avoid risk but manage its responsibility.**

## **Employment and Income Verification**

**The credit union will generally verify income and/or employment if the loan officer has a reason to believe there is a reportable difference or as specified below.** When verifications are obtained, the credit union staff will see a pay stub, W2 form, or other form of proof. However, this will be done on an exception basis. This policy also includes self-employed members.

**(Insert CU Name)** Credit Union will generally, but not always verify income on all applicants who are rated C, D, or E tier paper. Income verification will not be required for consumer loans including pre-approved loan promotions where the members meet A or B quality of credit standards. An applicant's credit rating is determined and assigned based on the credit bureau's credit score listed below:

Example:	730+	=	A+
	680 – 729	=	A
	640 – 679	=	B
	600 – 639	=	C
	550 – 599	=	D
	549 and below	=	E

Generally, real estate loan underwriters will verify income for all Fannie Mae eligible 1st mortgage loans. However, for non-conventional and home equity real estate loans, loan underwriters will verify income if they view the risk associated with the loan merits income verification.

**On indirect lending, the credit union will use more caution in verifying income as car dealers may inflate the income or the loan may be a straw purchase.**

## **Other Household Income**

**Other household income may be used when the member has significant joint obligations that are reflected on their credit bureau report.** Proper documentation is needed in notes. The following information must be listed in notes:

- Name
- Employer name
- Employer phone number
- Length of employment
- Job title
- Date hired; if less than two years previous is needed
- Salary information

The credit union will not ask the joint owner of the debts to co-sign the note if it is apparent the member who is applying for the loan is of good credit quality.

## **Rental Income**

The credit union recognizes that members have rental income that is not always verifiable as members not always report this income. If the member has good credit and it is apparent they have this income and they are making the payments on the rental property, the credit union will include this income, even though it is not verifiable.

## Previous Losses

The credit union will make every effort to recover any losses it has suffered from a member that is legally collectible. **The credit union will not deny services or future loans to a member who was discharged in bankruptcy and caused the credit union a loss.** The member will be given two options if the credit union suffered a loss due to bankruptcy:

- **Option One:** Voluntarily pay the loss at 0% interest and get a new loan at a rate consistent with their credit score before their bankruptcy. The credit union will only honor this on the first loan after bankruptcy and this will be explained to the member. Future loans will be at a rate consistent of the member's credit score. The member will sign a statement that this previous loan is not legally collectible and that the credit union will in no way attempt to enforce collecting the loan. We realize that many members who wanted to pay the credit union were told they could not pay the credit union and that a reaffirmation would not be approved by the trustee, their attorney or bankruptcy judge. This is why no effort will be made by the credit union to collect the loan.
- **Option Two:** Do not pay the loss and pay a rate consistent with their current credit score.



*Sample letter that the credit union will send to all members who went bankrupt and caused the credit union a loss.*

Dear \_\_\_\_\_,

Welcome back! Your credit union has changed its policies on bankruptcy and our new policy could very well save you thousands of dollars. We understand that in these tough economic times with rising fuel cost, etc., many of our members are being challenged like never before. We also know that bad things happen to good people.

Our previous policy said if you caused the credit union a loss, not only did we deny you any future loans, we also took away all of your services. We understand that most of you were simply following the advice of your attorney. We have rewritten our policies so we can now help you. Many of you were forced to go elsewhere to get credit and you're paying extraordinary high rates. Members who were forced to go bankrupt still need:

- Vehicle loans
- Credit cards
- Mortgage Loans, etc.

Well, we can help. If you have these type loans elsewhere and you're paying a high rate plus you're current with your payments, we'll save you money by lowering your rate and payment. We're so confident that we'll give you \$100 if we can't. You must meet the following simple qualifications:


- You are actively employed
- You have a good job
- Your job will likely continue
- You have the ability to pay
- Direct deposit and payroll deduction are a big plus and entitle you to even bigger discounts
- You're current with your payments since your bankruptcy

We want you back! Our guarantee to you is:

- We'll save you money
- We'll help you drive up your credit score with a free credit analysis that will entitle you to even lower rates
- We'll treat you better than any other financial institution
- Credit union members are family, we borrow together and save together

**Sound too good to be true? Well pick up the phone and call us today...and by the way, "Welcome Back!"**



## Bankruptcy Indicators

 **The credit union will treat members who have been bankrupt the same as any other member.** The credit unions' lending staff generally will avoid making unsecured loans if the following indicators of bankruptcy potential are present:

- **High level of unsecured debt** exists (over 35% of the member's gross annual income)
- **Escalating debt** (a majority of the unsecured debt occurred within the past 18 months)
- **Capacity** (balances are near or exceed limits = over 60% of capacity has been used up)
- **Excessive number of recent inquires**, suggesting the member has not slowed down their spending. **We will use extreme caution when the number of inquiries exceeds the member's age.**

When reviewing a loan requested from a member with a prior bankruptcy, our lending staff will focus on the following:

- When did the member go bankrupt?
- Why did the member go bankrupt?
- What credit has the member established since bankruptcy? (NOTE: **It is not a problem if the member has established no credit since the bankruptcy.** We are far more concerned with the member who has established too much credit.)
- Is the member applying for a secured or unsecured loan?
- **How well did the member pay the credit union before bankruptcy?** (NOTE: This is very important to us, not only how well the member paid us but also everyone else.)
- **How well has the member paid since the bankruptcy?**

  
 **The credit union will actually solicit members who have recently filed bankruptcy**, focusing on how they paid before going bankrupt knowing most of these members are debt free. These members should have the ability to pay and they will need a vehicle or a credit card. Most of these members will get credit somewhere, so why not us.

## Derogatory Items

Those items found on the credit bureau report, which are considered as derogatory items will be addressed and documented by the loan officer as a part of the regular interview process.

 **Proof of payment will not normally be required.**

## Employee Loans

Employees are encouraged to borrow from their credit union and will be treated just like other members. **The credit union believes that if we cannot get our own employees' business, then we will have a difficult time getting the member's business.**

Employees' applications shall be referred to the credit manager. Members of the immediate families of employees require the signature of both a loan officer and a member service officer for approval. Members of the immediate families shall be defined to include parents, children, spouse, or surviving spouse or any other relative by blood marriage or adoption even though such individuals do not reside in the same household. Share secured loans are exempt.

The credit committee is needed for the following employees: executive officers (AVP, VP, and CEO), directors, credit manager, and members of the supervisory, audit, and credit committee. For loans less than \$20,000, the credit committee is not required, only the credit manager. The credit committee can consist of internal employees who are senior management as opposed to volunteers.

**Employees only will be offered a 2% discount on all loans as a benefit of working for the credit union.** If the employee leaves their employment with the credit union, their rate will convert back to the same rate any non-employee would pay at the time the loan was granted, in most cases this would be 2% more.

**Any employee or member will be issued a credit card with a \$500 limit that has direct deposit or payroll deduction were the payment is automatically deducted. The employee or member will be counseled on the importance of not maxing out the card and will understand the limit will not be increased until they demonstrate they can manage their credit.**

## Risk Based Pricing, Managed Risk Lending

### 1. Background

In an effort to expand the ability to make more loans, many credit unions and other financial institutions are pricing loans according to default risk. Risk based pricing involves setting a tiered pricing structure that assigns loan rates based upon an individual's credit risk. Through a carefully planned risk based lending program, lenders may be able to make loans to somewhat higher risk borrowers as well as better serve their more credit-worthy members. **(Insert CU Name)** Credit Union recognizes the importance of managed risk lending.

### 2. Why Risk Based Pricing?

The credit union has adopted risk based pricing to be more able to become the lender of choice for all members by offering the best possible rate based upon each individual's credit history. Less credit worthy members benefit by qualifying for a loan with the credit union instead of resorting to higher cost alternatives such as finance companies. Members with a good credit history may qualify for lower rates rather than seeking other financial institutions offering preferential rates to high quality applicants.

### 3. Advantages

- Loans are available to a broader member base.
- Increased profitability/capitalization and loan volume.
- Allows the credit union to manage versus minimize risk.
- Ability to say "yes" to most members.
- Improves our competitive advantage.

4. **Loans**

The loans ultimately qualifying for risk based pricing include:

- Auto Loans
- Boat Loans
- Recreational Vehicle Loans
- Motorcycle Loans
- Balloon Note Loans
- Signature Loans
- Lines of Credit
- Home Equity Loans
- Portfolio First Mortgage Loans
- Chattel
- Credit Cards

5. **Liquidity Risk**

The credit union has no money to loan out as the demand for loans has exceeded the growth in deposits. The credit union will maintain lines of credit to insure money will always be available for member loans.

6. **Interest Rate Risk**

Interest rate risk is defined as the credit unions inability to adjust rates in a rising interest rate environment. The credit union will protect against interest rate risk by:

- Having an adequate percentage of re-priceable loan products in the credit union portfolio.
- Using a tiered system on interest rates on signature loans.
- Using a tiered system for interest rates on vehicle loans to offer flexible rates for short and long term loans. The longer the maturity, the higher the rate.

By using a tiered approach and multiple pricing by product, the credit union can maintain margins as rates go up or down.

7. **Default Risk**

Default risk is defined as the chance taken that the member will not pay his/her financial obligation with the credit union. **(Insert CU Name)** Credit Union will always use judgment in granting loans.

8. **Collateral Risk**

Collateral risk is measured by the loan to value of the collateral the credit union is using to securitize the loan.

9. **Rates**

Loan rates will be adjusted periodically for each risk based category.

10. **Discounting Rates**

The credit union will discount its rate to members who represent less risk based on the down payment they make, electing to have an automated payment plan and protecting their loan with the credit union's payment protection plan. The maximum discount will be:

- A+ and A paper: up to 1%
- B and C paper: up to 2%
- D and E paper: up to 3%

### 11. **Determining the Rate to Charge**

When determining the rate to charge:

If two or more credit scores are offered, the credit union will adhere to the following:

- **In the event of two signers (joint borrowers or maker and co-maker) the credit union will use the average of the two credit scores.**

If there is no credit score due to:

- **No Credit:** The credit union will assign a score of C paper
- **Credit but No Activity:**
  - If the credit is good; a score of A paper
  - If the credit is bad; a score of E paper

**The credit union will refinance a member's loan at a lower rate anytime** if the member has improved their credit score by cleaning up their credit. The new rate will be based on the current rates that the member qualifies for at the time of refinance.

### 12. **Mix of Risk Base Priced Loans**

The goal of **(Insert CU Name)** Credit Union is to make safe and sound loan decisions. Maximum limitations of high risk tiers will be established, although it is understood that the mix by category will typically be much lower. Both the Board of Directors and Management acknowledge responsibility of monitoring the quality of the loan portfolio. This will be accomplished through a quarterly report, which will document the current mix of risk base priced loans. Limits exclude credit cards, which cannot be tracked operationally in the same manner as other loans.

**The total amount in higher risk tiers will not exceed the balances as described below:**

- D tier 20% of the total risk based unsecured loan portfolio
- E tier 10% of the total risk based unsecured loan portfolio

NOTE: The credit union can adjust the above based on the type of members we are serving in an effort to truly be able to serve the underserved.

### 13. **Matching Rates**

**The credit union has the authority to match a competitor's rates and terms when it is in the best interest of the credit union.** The credit union will not require proof of rates or terms, simply the **name of the financial institution and the rate** the member was promised and that **the member had applied and been approved.** The credit union will use good common sense on the approval such as we do not believe E paper members were approved for A paper rates. Loans will be lowered by:

- A+ and A paper: up to 1%**
- B and C paper: up to 2%**
- D and E paper: up to 3%.**

Note: The above discounts or matching rates are cumulative and cannot exceed the maximum 3% for D and E paper.

The loans ultimately qualifying for matched rate pricing include:

- Auto Loans
- Boat Loans
- Recreational Vehicle Loans
- Motorcycle Loans
- Balloon Note Loans
- Signature Loans
- Lines of Credit
- Home Equity Loans
- Mortgage Loans

**Term may be extended up to six months if loan contains value added products.**

### 14. **Setting Rates**

**The Board of Directors empowers the CEO to adjust rates as deemed necessary by competitive practices.** A survey of current market rates will be conducted as needed. Loans may not be more than 1% less than the lowest rate or 1% more than the highest rate.

Competitive sources include:

- Banks
- Credit Unions
- Finance Companies
- Businesses offering finance options



# Rate Sheets

The following example demonstrates how rates will be applied and take the following into consideration:

- The type of loan.
- The grade of paper.
- Collateral risk.
- Age of collateral.
- Loan to value.

## SUGGESTED INTEREST RATE STRUCTURE FOR RISK-BASED LENDING AS OF 3/01/07

RANGE	GRADE OF PAPER	RATES All Unsecured Loans	RATES All Secured Non-Real Estate Loans (Autos, Boats, Motorcycles, etc.)					
			24 Mo	36 Mo	48 Mo	60 Mo	72 Mo	84 Mo
<b>Suggested Floor Rate</b>			6.00	6.25	6.50	6.75	7.00	7.25
730+	Platinum	12.25%	7.00	7.25	7.50	7.75	8.00	8.25
680 - 729	A	12.75%	7.50	7.75	8.00	8.25	8.50	8.75
640 - 679	B	13.75%	8.50	8.75	9.00	9.25	9.50	9.75
600 - 639	C	15.75%	10.00	10.25	10.50	10.75	11.00	11.25
550 - 599	D	18.00%	13.50	13.75	14.00	14.25	14.50	n/a
549 or less	E	18.00%	17.50	17.75	18.00	18.00	n/a	n/a

### ADJUST THE ABOVE RATES FOR BOTH LOAN TO VALUE AND VEHICLE AGE

#### LOAN TO VALUE

BELOW 80% LTV	80-94% LTV	95-104% LTV	105-114% LTV	115-124% LTV	125%+ LTV
-1.00%	- .50%	Base Rate**	+ .50%	+1.00%	+1.50%

\*\*Based on A+ Paper for 60 Months - Adjust Rates Accordingly

#### AGE OF COLLATERAL

1. Add 1% to above rates on model years 2004-2005.
2. Add 2% to above rates on model years 2001-2003.
3. Add 3% to above rates on model years 7 years and older.
4. **Note:** Federal Credit Union's cannot exceed 18%

### HOME EQUITY PRODUCT (Prime = 8.25%)

SCORE	GRADE	To 80%		To 90%	To 100%	To 125%
730+	Platinum	Prime - 1.50%	6.75%	7.75%	8.75%	n/a
680 - 729	A	Prime - 1.0%	7.25%	8.25%	9.25%	n/a
640 - 679	B	Prime - .50%	7.75%	8.75%	9.75%	n/a
600 - 639	C	Prime + .50%	8.75%	9.75%	10.75%	n/a
550 - 599	D	Prime + 1.5%	9.75%	10.75%	11.75%	n/a
549 or less	E	Prime + 2.5%	10.75%	11.75%	12.75%	n/a

### FIXED HOME EQUITY PRODUCT – 0 to 5 year

SCORE	GRADE	To 80%		To 90%	To 100%	To 125%
730+	Platinum	Prime - 1.50%	6.75%	7.75%	8.75%	n/a
680 - 729	A	Prime - 1.0%	7.25%	8.25%	9.25%	n/a
640 - 679	B	Prime - .50%	7.75%	8.75%	9.75%	n/a
600 - 639	C	Prime + .50%	8.75%	9.75%	10.75%	n/a
550 - 599	D	Prime + 1.5%	9.75%	10.75%	11.75%	n/a
549 or less	E	Prime + 2.5%	10.75%	11.75%	12.75%	n/a

### FIXED HOME EQUITY PRODUCT – 6 to 10 year

SCORE	GRADE	To 80%		To 90%	To 100%	To 125%
730+	Platinum	Prime - .50%	7.75%	8.75%	9.75%	n/a
680 - 729	A	Prime	8.25%	9.25%	10.25%	n/a
640 - 679	B	Prime + .50%	8.75%	9.75%	10.75%	n/a
600 - 639	C	Prime + 1.5%	9.75%	10.75%	11.75%	n/a
550 - 599	D	Prime + 2.5%	10.75%	11.75%	12.75%	n/a
549 or less	E	Prime + 3.5%	11.75%	12.75%	13.75%	n/a

### FIXED HOME EQUITY PRODUCT – 11 to 15 year

SCORE	GRADE	To 80%		To 90%	To 100%	To 125%
730+	Platinum	Prime + .50%	8.75%	9.75%	10.75%	n/a
680 - 729	A	Prime + 1.0%	9.25%	10.25%	11.25%	n/a
640 - 679	B	Prime + 1.5%	9.75%	10.75%	11.75%	n/a
600 - 639	C	Prime + 2.5%	10.75%	11.75%	12.75%	n/a
550 - 599	D	Prime + 3.5%	11.75%	12.75%	13.75%	n/a
549 or less	E	Prime + 4.5%	12.75%	13.75%	14.75%	n/a

### UNDERWRITING GUIDELINES

Maximum Amount	Over \$100,000	\$50,000 - \$100,000	\$50,000 & Under
Appraisal	Full Appraisal	Drive By	Appraisal.com or No Appraisal
Title/Property Ins.	Title Search	Title Search	No Title Search
Fees	No fees of any type, fees are a barrier.		
Draw Down	Member must take initial draw of \$5,000, subsequent advances must be \$500		
Marketing	Market lowest rate, lowest payment, interest only payments, no fees.		

## Terms

The credit union will first and foremost always provide the member a payment the member is most comfortable with. We want our employees to learn to sell to the payment. The payment the member selects must in the best interest of the member and the credit union. A recommended guideline for terms is as follows:

Auto Loans	84 months (exception if approved by level 3 with justification)
Boat and RV Loans	15 years (recommend 15 year amortization with a 5 year balloon)
Motorcycle Loans	84 months
Chattel Loans	60 months
Signature Loans	60 months
Home Equity Loans	15 years (The credit union will guarantee the rate for up to 15 years however if the member is willing to share the risk they can get a lower rate by using a five year balloon.)

# Consumer Loans

## **1. Secured Loan Versus Unsecured Loan**

Loans shall be secured with appropriate collateral when good judgment dictates the credit union needs collateral. We also understand that lots of members prefer to borrow from the credit union with no collateral and will be allowed to do so as the credit union gives up yield by taking collateral when collateral is not needed. The difference in payments will be discussed with the member. The value of collateral will be documented.

## **2. Unsecured Guidelines**

As a guideline, a member's total unsecured debt should not exceed more than 35% of his/her gross annual income. The credit union will generally not loan members more than four times the monthly gross salary including the unsecured debt they have elsewhere unless the credit union is paying off the unsecured debt. See Lending Authority Matrix for approval authority.

## **3. Maximum Loan Limit**

A member's total loan obligation to (Insert CU Name) Credit Union shall not exceed \$ \_\_\_\_\_ for unsecured loans. Secured loans should not exceed \$ \_\_\_\_\_. These limits exclude limits established in the business lending policy.

## **4. Termination of LOC and Credit Card Limits**

Unsecured line of credit loans or credit cards will be revoked by the credit manager or Level 2 Loan Officer or higher when it is determined the credit union's interests are at an unacceptable risk level. We will instruct our employees not to over react to a delinquency or over-limit as the credit union is compensated with fees. Before canceling a credit card or line of credit, we require a new credit bureau report with a complete analysis.

## **5. Annual Review of Revolving Credit**

The CEO will conduct an annual review of all revolving unsecured lines of credit on C, D, and E paper and a two year annual review on A+, A, and B paper.

## **6. Automobile Insurance Requirement**

**Comprehensive and Collision coverage with appropriate deductible is required on loans over \$10,000 only. (Insert CU Name) Credit Union shall be listed as Loss Payee.** The credit union has the option to add Collateral Protection Insurance (CPI) on loans where the member's automobile insurance was dropped or canceled. Recognizing the fact that the member cannot afford their own insurance or that their insurance was cancelled, the credit union believes this could be a sign that the member is having serious financial problems; therefore our policy is:

**Order a new credit report at the time the insurance is added; if the score has dropped substantially and the member is struggling to pay, consider picking up the auto.**

**Since the cost of the insurance is high, the credit union will not add insurance on balances under \$10,000. (NOTE: This amount has to be determined by each credit union and the Board of Directors based on the level of risk they are comfortable with.)**

## **7. Age of Collateral**

**The credit union will finance any vehicle, regardless of age, as long as the credit union can determine the value of the vehicle.**

## **8. Redeeming of Security**

Share pledged loans shall be redeemed with the security when good judgment dictates and when it is determined by the credit manager or the level 2 loan officer or higher that the credit union's interests are at an unacceptable risk level.

**In the loan policy manual, the credit union will spell out in detail the following:**

- Who can approve
- Terms and rates
- Down payment requirements
- Unsecured loan limits
- Credit card limits
- So forth of the following: new and used autos, boats, RVs, motorcycles, unsecured and credit cards

**Credit Re-builder**

Credit Re-builder loans are a special loan product set to give members extra cash for the holidays or any other reason, but at the same time help the member improve their credit score. Please note this product can be used anytime throughout the year.

Loan Criteria	<ul style="list-style-type: none"> <li>• The credit score is not a factor, the credit union will market to scores of 639 or below</li> <li>• Current member in good standings</li> <li>• Score enhancement action plan must be completed</li> <li>• Member must have a checking account</li> <li>• Direct deposit-payroll deduction is strongly encouraged</li> <li>• -Payment protection is strongly suggested</li> </ul>
Who Can Approve/Additional Terms	<ul style="list-style-type: none"> <li>• All qualified members are pre-approved</li> <li>• Amounts of \$500 to \$1,000</li> <li>• Member must have a steady income with a strong likelihood that the income will continue</li> <li>• <b>No credit report is required but it is encouraged so that the credit union can look for other opportunities such as a car loan</b></li> <li>• The member cannot be denied due to their credit or credit score</li> <li>• The member will strongly be encouraged not to stop the automated payment plan with the promise that if this loan is handled well, they can add an additional \$500 to their next loan</li> </ul>
Term & Rates	<ul style="list-style-type: none"> <li>• 12 month term</li> <li>• 18% rate (for federal credit unions, state credit union can charge up to 21% if permitted) regardless of credit score since no credit report is required</li> </ul>

# Loan Approval Authority

**Level 1 loan officers** are authorized to approve A and B category loan applications that meet the following criteria:

- **Total Outstanding Unsecured Debt** - Member's total unsecured debt is not more than 35% of their gross annual income. Generally, this will not include limits unless there is an indication that the available balances will be used. The credit bureau report will be used as a tool to determine this tendency. Student loans are not included in the unsecured debt total. However, all unsecured loans and lines of credit as well as credit cards plus an amount the member is upside down on with a car loan will be considered.
- The unsecured amount of the proposed loan does not exceed 35% gross income of the member.
- All vehicle secured loans where total loan does not exceed 50% - 75% of the gross annual income. (75% when that member has little or no other outstanding debt).

**Any loan referred to a level 2 loan officer or higher must be fully developed and include a recommendation by the level 1 loan officer.**

**Level 2 and level 3 loan officers may approve all exceptions to level 1 loan officers. Level 1 loan officers will not have loan denial authority. If a level 1 loan officer wants to approve a member that the level 2 or 3 loan officer want to deny, they must talk to the member as this often can and will change their mind.**

For more information on levels 1, 2 and 3 loan officers please see the Lending Authority Matrix.

## Lending Authority Matrix

Lending Authority Matrix			
Employees are empowered to approve loans or in some cases, deny loans if <u>all</u> of the following conditions are met.			
Condition	Level 1	Level 2	Level 3
<b>1. Risk Score</b>	<b>640 +</b>	<b>550+</b>	<b>Any Score</b>
<b>2. Valid Credit Report</b>	- 4 trade lines	same	N/A
	- 2 yrs. est. credit	same	N/A
	- 1 trade line in excess of \$5,000	same	N/A
<b>3. Max. Loan Amt.</b>	To: \$10,000 not to exceed	To: \$15,000 not to exceed	To: \$30,000 not to exceed
<b>Unsecured</b>	- 3 times mo. gross income on scores of 680+	- SAME	- 4 times mo. gross income on scores of 680+
	- 2 times mo. gross income on score of 640-679	- 2 times mo. gross income on score of 600-679	- 3 times mo. gross income on all other scores
		- 1 times mo. gross income on score below 600	
<b>4. Total Unsecured Debt</b>	With our loan cannot exceed 25% of member's annual income	35% of member's annual income	No restriction on total unsecured debt
Note: Total unsecured debt must include upside down amt on car loans			
<b>5. Max. Loan Amt. on Secured Vehicle Loan</b>	To: \$30,000	To: \$50,000	To: \$100,000
	Not to exceed 75% of members gross annual income	Not to exceed 75% of members gross annual income on score of 600+	On any score 75% of gross annual income Exception: may go over 75% for mbs who make very strong down payment and mbrs who have very little other debt
		- 50% of gross annual income all other scores	

6. Max. LTV on Vehicle Loans	Retail	Retail + 1 month gross income	any score Retail + 1 month gross income
7. Home Equity or 2nd Mtg.	\$50,000 not to exceed 80% LTV	\$100,000 not to exceed 100%	\$300,000 not to exceed 100% LTV
			work out loan (collections) 125% LTV
8. Determining the Value of the Vehicle	must have print out on book value:	Same as Level 1	Same as Level 1
	A) Vehicle being purchased		
	B) Vehicle being traded		
	New cars must have MSRP		
9. Turndown Authority	Cannot Reject any Loan Request	Can Deny any secured or unsecured loans. If Level 2 or 3 rejects a loan they must talk to member.	Same as Level 2
	However, <b>must</b> recommend as if it was their decision		
10. Max. Term on Unsecured Loans	\$5,000 or less (3 yrs.)	SAME	Can set any term provided it is in the best interest of Credit
	\$5,000 to \$10,000 (4 yrs.)	SAME	Union and Member
		\$10,000 to \$15,000 (5 yrs.)	
11. Max. Terms on Secured Loans	60 months on loan	72 months \$25,000 to \$35,000	same as unsecured loan (see above)
		84 months \$36,000 to \$50,000	
12. Debt to Income Ratio	Cannot exceed 45%	Cannot exceed 50%	No restriction on debt to income; however, if it's over 55%, L3 must show the member has the ability to repay.

## Requirements for Level 1, 2, & 3 Loan Officers

The credit union wants to develop their decision makers so level 1 loan officers can become level 2 and level 2 loan officers can be level 3. To help with the development, it has to be clearly understood that when the employee takes the application, it is theirs from start to finish. A level 1 loan officer cannot see the score and just pass it on to a level 2 or 3 loan officer. They must handle it as if they were level 2 or 3, interview the member, go over the member's credit bureau report, clear up any issues and build the loan if possible. They must then present it to a level 2 or level 3 loan officer with a recommendation as to what they would do, including signing off on the loan. If the level 2 or level 3 loan officer disagree with the level 1's decision, they must then talk to the member and advise the member that they disagree with the level 1 and the decision is ultimately theirs and why they disagree. The rationale behind this is we want level 1 to start thinking like level 2 and 3 instead of just passing the application off. They will never become level 2 or 3 unless they start thinking like them.

Length of time required to advance.

### **Level 1**

Any MSR, FSR, teller, etc... who has attended the University of Lending (U of L) would be eligible to be level 1 within 60 days of completing the course and making loan recommendations provided the recommendations are consistently good.

### **Level 2**

A level 1 can move up to level 2 within 12 to 18 months as long as management is comfortable with their decisions.

### **Level 3**

A level 2 employee can become a level 3 employees within 24 months provided their decisions are consistent and management is satisfied with their performance.

To summarize:

Level 1 = Completion of University of Lending plus two months of solid performance.

Level 2 = Level 1 plus 12 to 18 months experience and good performance.

Level 3 = Level 2 plus 24 months with good performance. This would equivalent to three to four years of good decision making.

•NOTE: As employees are promoted through the perspective levels, they should be entitled to a raise.

## Decision Making Guidelines Are Expected to Follow for Marginal Loan Approvals

The credit union believes it is critical to find out why the member chose the credit union. We call this motivation. We define motivation as why members do what they do when they do it.

### **Secured Loans**

Questions and analysis employees are expected to use:

#### **1. Motivation**

- What motivated member to come to the credit union today and apply for loan?
- Why now?

#### **2. Good job** – Is it likely to continue?

- Is the employer reputable?
- Professionals (include schooling)
- No seasonal or part-time
- Professional trades with longevity looked at very favorably. This includes those in management, supervisor, foremen positions or those who obtain a license or certification (AC, Mechanic, Electrician, etc.).

#### **3. Probably will continue** – job satisfaction

- Ask "Do you like your job?"
- "Do they like you?"
- "Looking at retirement?" (If older their salary will probably will be no more than 65% of today's salary.)
- "What kind of benefits do they provide there?" if none, really push payment protection, etc.
- Longevity plays a factor here too

#### **4 Payroll deduction**

- Whole checks preferred, over 50% acceptable. Nothing less than 50%
- Either we set up with known employers or the payroll must be coming in to set up the loan
- No transfers
- Payment frequency must match payroll frequency

#### **5. Evidence pays car loans/mortgage**

- Mostly current payment pattern on autos or mortgages
- If current member over 5 years, must pay the credit union loans

#### **6. If bankruptcy threat** – (35% of gross income is unsecured) – loan trade-in value or invoice on new car

- If not bankruptcy threat – loan retail plus 1 months gross income (only Level 2 and Level 3 employees an approve

7. The credit union will generally loan no more than 50% of the member's annual gross income for marginal loans exceptions to this will require level 3 approval.

#### **8. Inspect car** when possible – must document in notes

### Unsecured Loans

#### **1. Motivation**

- What motivated member to come to the credit union today and apply for loan?
- Why now?

#### **2. Good job** – Is it likely to continue?

- Is the employer is reputable?
- Longevity – 5 years or more
- Professionals (include schooling in longevity)
- No seasonal or part-time
- Professional trades with longevity looked at very favorably. This includes those in management, supervisor, foremen positions or those who obtain a license or certification (AC, Mechanic, Electrician, etc.).

#### **3. Probably will continue** – job satisfaction

- Ask "Do you like your job?"
- "Do they like you?"
- "Look at retirement?" (If older their salary will probably will be no more than 65% of today's salary.)
- "What kind of benefits do they provide there?" if none, really push payment protection, etc.
- Longevity plays a factor here too

#### **4. Payroll deduction**

- Whole checks preferred, Over 50% acceptable. Nothing less than 50%
- Either we set up with known employers or the payroll must be coming in to set up the loan
- No transfers
- Payment frequency must match payroll frequency

5. If bankruptcy threat – (35% of gross income is unsecured) plus debts are escalating and the member has used up most of their capacity, then the loan should be denied without collateral that would have made the loan bankruptcy proof.

6. Total unsecured up to 35% gross income, includes upside down amount on autos. Not to exceed 2 month gross income for level 2 approval. No limitations for level 3.

#### **7. Loan terms:**


under \$1000	12months
\$1000-\$2000	24 months
\$2001-\$3000	36 months
\$3001-\$5000	48 months
\$5001-greater	60 months

## Overdraft Privilege Policy

The following will be covered in your loan policy manual:

- Why the credit union should offer this.
- Amount will pay on overdraft items.
- Employees are eligible.
- When members will not be eligible.
- Suspension/Removal of Privilege
- Monitoring and Reporting
- Transactions Covered by Overdraft Privilege
- Charge-Offs
- Marketing and Disclosures
- Payment Order of Items
- Fee Limits
- Repayment Plans
- Loss Allowances (Reserves)
- Program Usage
- Additional Disclosure Language
- Waiver

## Debt Ratios



**The credit union will use a debt to income ratio as a tool in decision making. A debt ratio will not be a reason in of itself to deny a loan.**

The credit union will use the lending matrix in administering a debt ratio. The Lending Authority Matrix calls for the following:

- Level 1 up to 45%
- Level 2 up to 50%
- Level 3 has no restrictions; however, if it's over 55%, level 3 must show the member has the ability to repay.

In computing the debt ratio, we will allow our employees to use unverifiable income as long as it is apparent the income exists based on the member's assets and payment history. In addition, payments will not be counted that a spouse or someone else clearly makes.



## Credit Committee

### Option One

The credit union does not use a credit committee.

### Option Two

The credit union utilizes a credit committee to oversee all lending practices such as rate and policy changes. The credit committee will only get involved in decision making when a member is not satisfied with the credit union's decision. **If the credit committee is not trained in decision making, then the credit union should provide them training and certify they are capable of making good loan decision.** If the credit committee is going to make decisions, they must not only be trained but also be available.



## Home Equity Lending

The Home Equity Loan program for **(Insert CU Name)** Credit Union will consist of open-end and closed-end second mortgages including extra equity loans. Home Equity Loan files shall contain all legally required forms and disclosures approved by legal counsel and the bonding company

### Compliance

All Home Equity Loans shall comply with all credit union Statutes; NCUA Rules and regulations; and other applicable Rules, Regulations, or guidelines affecting real estate, credit, or financial institutions in general; Credit Union Bylaws and Policies; and sound management practices.

### Home Equity Loans

**(Insert CU Name)** Credit Union may offer home equity loans to members as follows:

- **Closed-End:** This loan may have up to a 100% loan to value (LTV) ratio.
- **Terms:** Closed-end home equity loans shall be offered for periods up to 180 months. The Chief Executive Officer shall set interest rates for these loans monthly. Interest rates shall be offered on a fixed and variable basis.
- **Variable Rate Index:** All variable rate loans offered by **(Insert CU Name)** Credit Union fluctuate according to **(Insert CU Name)** Credit Union policies and a Variable Rate Index. The Index used by **(Insert CU Name)** Credit Union shall be the prime rate of interest quoted in the Wall Street Journal on the last day of the month. Interest charged by **(Insert CU Name)** Credit Union shall be the prime rate plus an adjustment factor and shall be adjusted monthly on the first day of each month. The maximum shall be the lesser of 18.0% or the Usury ceiling. The maximum yearly rate increase caps at 2% and the loan lifetime cap is generally 6%. At no time shall the minimum monthly payment amount on a variable interest loan be less than \$25.00.
- **Open End:** The open-end home equity line of credit is an open-end loan with a recorded mortgage against the property. This loan may have up to a 100% loan to value (LTV) ratio.
- **Terms: Home Equity Line of Credit** loans and interest-only loans shall be offered for a period of 180 months with a 15-year mortgage recorded. Payments shall be amortized over a 180 month draw period at maximum. At the end of this period, any balance shall be amortized over the remaining 180 month. Interest rates shall be offered on a variable basis.



## **Fast Equity Home Equity Program**

The Fast Equity Home Equity Program is a closed or open-end mortgage loan **designed for a low credit risk member who wishes to close their home equity loan in an accelerated timeframe. The loans will be made to our best members and will not require a title search. These loans will be for \$50,000 or less, are expected to be approved in 30 minutes or less and closed within one week. We will market these loans with "as easy to get as an auto loan."**

### **Eligible Property – Quick Close**

Only a member's primary residence or secondary with not more than one outstanding mortgage loan.

### **Documentation**

The Fast Equity Home Equity loan is a mortgage loan and will be made in accordance with all laws and regulations including documentation as current credit union home equity loans are made with the exception of the appraisal. (In lieu of the appraisal, **(Insert CU Name)** Credit Union will use the following to determine value):

**Method I – Automated Valuation Model (AVM):** Automated valuation model as accepted by standard secondary market requirements.

**Method II – Tax Assessment Based Property Value:** The tax assessed appraised value (just value) is used for determining market value by using a factor of 1.20 as a current market multiplier.

No Title Search Required



## **Extra Equity Loan**

The Extra Home Equity Loan Program is a closed-end loan designed for members with little or no equity in their home, and is primarily for, but not limited to, consolidation of current loans, credit cards, or other outstanding debts. **This loan is a signature loan with a mortgage filed against the property as additional security. The purpose of the mortgage filing is to protect the credit union from Chapter 7 and Chapter 13 bankruptcy filings.** Under a bankruptcy filing, real estate loans are not subject to cram downs and have to be paid in full. By contrast, signature loans are generally totally discharged, especially in Chapter 7 filings. This additional security feature allows the credit union to make loans to individuals, not possible on an unsecured basis due to bankruptcy. Primary markets for the loan will be bill consolidation and home improvement.

### **Documentation**

The Extra Equity Loan is a mortgage loan and will be made in accordance with all laws and regulations. It will be documented in the same manner as current the credit union closed-end second lien mortgage loans.

### **Eligible Property- Extra Equity**

Only a member's residence with, not more than one, outstanding mortgage.

### **Terms**

The Extra Equity Loan shall be in an amount up to 125% of the appraised value, or 125% of the current tax value. The minimum amount financed will be \$5,000.00 with a maximum repayment period of 180 months, and shall be secured by a recorded mortgage. The maximum unsecured portion will not exceed \$40,000. Extra Equity loans will be priced like consumer loans and not like real estate loans.



## **Workout Loans**

**This type of loan would be processed only when it is in the best interest of the credit union.** This loan will be used to improve the credit union's position when the collectability of a loan is in doubt. This would include delinquency, deterioration of ability to repay, or high potential for a bankruptcy. The collection manager will recommend to the manager or AVP of Lending when it is in the credit union's interest to securitize its position. All such loans will need to be approved by the credit manager or AVP of Lending. No new monies in excess of what is currently owed to the credit union, except closing costs, may be added to the loan. Loan to value ratios will not be used in this situation as the funds are already owed to the credit union. The situation when this plan would be used is if a member's unsecured debts with the credit union are outside credit union guidelines, and the possibility is high that a member may file bankruptcy. The times when the collection manager may use this plan would be when the outstanding balance on the credit union loans may be delinquent or the member may file bankruptcy. Clear documentation must reflect the reason we are granting the workout loan secured by a mortgage. The collection manager must make a recommendation to the credit manager or AVP of Lending for approval. The member's remaining unsecured debt after a workout loan may not exceed our unsecured lending limits excluding the Extra Equity Loan. In the case of bill consolidation, checks will be made payable to the member's creditors.

**NOTE:** Workout loans will be coded differently than other loans so the credit union can track the results. The credit union realizes that many of the loans would have been charged off had the credit union done nothing. We also understand we can expect higher delinquencies and charge offs than with other loans but overall our losses will be lower than if we had done nothing.

## **Indirect Lending**

**The policy will cover the following:**

- General Policy Statement
- Dealership Eligibility and Investigation
- Dealer Reserve Accounts
- Indirect Dealer Contracts
- Membership Eligibility
- Underwriting Standards
- Loan Contract Assignment
- Rates and Fees to Dealership
- Line of Credit – Liquidity
- Marketing
- Monitoring and Audits
- Collection Practices
- Loan Interest Rates
- Discontinuance of Dealer Relationship
- Fraternalization between credit union employees and dealers should be restricted.
- Sample Dealer Agreement



**Step 1. GET DEALERS TO BUY IN IF YOU HAVE GOOD RELATIONS WITH THEM**

**Step 2. MARKETING CAMPAIGN  
TARGET MARKET**

- C,D,E Paper members
- 1st time buyers
- Members who are upside down
- Members who don't want a hassle

**PROMISE MEMBER**

- Free Credit analysis
- Food
- Draft Package to carry to dealers
  - Check
  - Instructions
  - Pre-Approved Amount
- (5) \$1000 drawings to be used as down payment (MUST be financed at credit union)

**Step 3. EDUCATE MEMBERS**

- Dealers, UNDER NO CIRCUMSTANCES, are they to allow the dealer to pull their credit report
  - The members are not to discuss financing insurances or add ons
  - They are not to act like they are desperate
  - They are to explain to the dealers they want the best price.
- REMEMBER:** Most of these members think about just getting financed and a car to drive back and forth to work. As a result, because they feel desperate, they get a bad deal and make a mistake. We want to eliminate financing mistakes and instead finance a good deal.
- Once they negotiate the price, they immediately call the credit union so we can make sure they're getting a good deal.
  - The credit union will show the audience a couple of examples of impulse buying, buying a car just to get transportation back and forth to work and what happens to their credit when the car is repossessed. We want to educate them on how they are being set up for failure and how to get a good vs. bad deal.



**Step 4. EXPLAIN CREDIT UNION'S NEW PLAN TO HELP THEM GET THE SAME GOOD PRICE AN A+ MEMBER GETS.**

THE MEMBER WILL UNDERSTAND:

- Get pre-approved before coming to the seminar
- How the draft package works and how they can drive away with the car and hand the dealer the draft in one easy step.

**Step 5. INVITE PARTICIPATING DEALERS TO ATTEND AND POSSIBLY SPEAK.**

ESTIMATED TIME NEEDED: 1 1/2 TO 2 HOURS.

**WHEN MARKETING TO THE MEMBER, LET THEM KNOW THE SIMPLE QUALIFICATIONS LISTED BELOW:**

- Must be actively employed or have a steady continuous source of income such as retirement or social security.
- Must have the ability to pay.
- Direct Deposit
- Pre-Approved draft amounts will be consistent with their income and no greater than 50-75% of their annual income.
- Pre-Approved drafts will be for franchise dealers, enterprise, Hertz, Avis, National or CarMax. Private party or other deals must be approved by the credit union first.



**Vehicle Qualifications:**

- Vehicle must be model 2000 or newer
- Odometer reading cannot exceed 65,000 miles.
- Loan to value is limited to 110% of invoice on new vehicles and 110% of NADA trade value on used vehicles.
- Minimum Loan Amount: \$5,000
- Maximum Loan Amount: \$ \_\_\_\_\_

**Estimated Payment:**

The credit union will allow you to pick your own payment as long as it's in the best interest of you and the credit union. We encourage you to select a payment you can afford, however we expect the payment that you select will pay off your loan in a timely manner. (The credit union must approve the payment you select).

**Contract and Sales Agreement**

Please read this entire agreement before endorsing the check.

**NOTE:** You can substitute your own note and security agreement. What is important is to make sure you include the default section, which may read as follows:

**The Member is in Default if:**

1. I fail to make any payment when it is due.
2. I break any promise, covenant or agreement or statement I have made to the Credit Union under this agreement or in any other agreement I have made with the Credit Union now or in the future.
3. Any statement (oral or written) I make under this agreement or in connection with the agreement or in connection with any other agreement I have with the Credit Union is not true.
4. I or any guarantor dies, becomes insolvent, files a petition for relief under any chapter of the Bankruptcy Code or for any reason is unable to pay their debts when due.
5. I for whatever reason, discontinue, dissolve or otherwise leave my usual business activity or employment.
6. A judgment is entered against me or any guarantor in any court.
7. A writ of attachment, a lien, a writ of garnishment or any similar legal process is issued against me or any guarantor.
8. Any loss, theft, or damage to any collateral given under this agreement should occur.
9. If I fail to keep in force any insurance which is required under the terms of this agreement or any other agreement I have with the Credit Union now or in the future.
10. Any collateral used to secure my payment of this agreement or any other agreement I have with the Credit Union now or in the future is moved to another county without the Credit Union's prior written consent.
11. I am in default under the provisions of any other security agreement given to the Credit Union.
12. Anything else happens which gives the Credit Union any reason to believe that my ability or willingness to pay the Credit Union is impaired or that any other loan account with the Credit Union is not adequately secured. If I am pledging property as an Other Owner of Collateral, I will be in default if anyone who signed the Note is in default.

## Member Business Lending

**The policy will cover the following:**

- Purpose
- Definitions
- Limitations and Exclusions
- Type of Business Loan
- Maximum Amount of Business Loans
- Maximum Loan Amounts
- Who Shall Sign
- Acceptable Collateral/Trade Area
- Unacceptable Collateral/Loans for Any Loan Amount
- Method(s) to Secure Collateral
- Loan Terms
- Loan Rates
- Approval Authority
- Required Documentation
- Qualified Personnel Involved in Business Lending: (NCUA)

