Q&A Session for Webinar #20:
Lending In 2009: See What No One Else Sees
March 6, 2009

Q: How can a small credit union survive by being so lenient at this time?

A: I am not sure what you mean by being so lenient but I think I understand. What you have to do is look at your options. If you choose to not work with the member or insist that the member pays you an amount they are not capable of, the member may just give up and return the collateral to you. If that happened what would you end up losing if you have to sell their collateral? On the other hand, if you can provide the member with a bridge that they need so that their circumstances will improve, what is that going to cost you? When you determine both answers then weigh the costs. Also keep in mind that if you help the member out you are fostering a lifetime relationship with them whereas if you do not help them out chances are you will lose that relationship forever. If you have specific examples please send it over to us and we will show you how this is done.

Q: How do we explain all this to examiners?

A: Have the Board of Directors approve these workout loans or bridge loans and spell it out in your Policy Manual. Make the examiners aware of these new policies that the board has initiated to try and help the members through these difficult economic times.

Q: How do you calculate the AGI?

A: AGI stands for annual gross income. As an example if a member makes $500 a week times 52 weeks their annual gross income would be $26,000. If they had $8,000 in unsecured debt that would equate to 30% of their annual gross income.

Q: Why no references on the application?

A: You only need references if you plan on using them. If that is the case then you need an outstanding reference sheet. If the member is of very high credit quality and will probably never default then don't bother to get references. If the member is of poor credit quality and there is no way you are going to possibly qualify them for a loan don't bother to get references. For the members in the middle then I would recommend having a very good reference sheet.

Q: Do you have experience with payment modification in open-end lending and defending it with the examiners?

A: I don't have personal experience because we never used open end lending. Having said that you should have no problem with the examiners if your policy allows you to modify the payment to an amount consistent with the member's ability to pay. You would like to see that amount large enough that it would cover at a minimum the interest. The member must understand that this is a temporary solution which will be revisited at some point and time when their circumstances improve. Have the board approve this as part of your loan policy manual.

Q: HYLS Scoring factor- how do leases fit into this scoring model?

A: The factors that could possibly involve leases would be number 4 which is only a factor if they over or under finance, number 5 which is direct deposit, number 10 which is the amount the member would owe if they tried to get out of their lease early, number 11 which is the amount of vehicle they are leasing as a percentage of their income, and numbers 23 and 24 which is their prior auto loans including leases as far as their credit history goes. If you have a specific question about one of these factors that you do not understand, please send us an email and we will get it taken care of for you.

Q: Do you suggest that all income be verified?

A: In today's economy with companies cutting out overtime and work weeks being shortened I believe it is a good idea. You must keep in mind that there is income that exists, especially tips, members getting paid under the table, and so forth that is simply not verifiable. I believe you should accept unverifiable income if it is apparent that it exists and the member is not struggling to make their payments. I would put that in my policy manual and use examples such as hairdressers, waitresses, casino workers, and so forth. We are not looking for a way to turn members down.

Q: How is the mortgage cram-down going to affect your recommendations for working with mortgage loans?

A: The cram-down will certainly be a big factor. This bill was introduced by Senator Durbin and it relates to mortgages. I have not seen where the final bill has been passed but you all may know more than I do. Senator Durbin was considering changing his bill so that the following amendments would be in place:

1. It will only apply to existing mortgages

2. Homeowners must show that they attempted to contact their lender before filing for bankruptcy.
3. There has to be a major violation of the Truth In Lending Act to invalidate predator's claims.

CUNA also wants a Sunset Provision on this.

To answer your question now I think it is more important than ever that you work closely with your members and attempt to maintain this lifetime relationship if at all possible. If this new bill is passed, and again it may have already been passed and I am not aware of it, it is going to be devastating to financial institutions because of the power given to the bankruptcy judges.

Q: If the cram-down bill passes what impact will there be on underwriting?

A: If the cram-down bill does pass, financial institutions will most likely all tighten up to an 80% LTV or something of that nature. We are recommending that credit unions charge their unsecured rate for any mortgage loan they grant that is over 90%. You can still record the mortgage. Houses will eventually go back up and you are far better off with this loan than just a signature loan.

Q: In a stable real estate market, with a stable workforce, is it wise to place a restriction on the percentage of total loan in real estate backed loans? Specifically, fixed rate real estate loans?

A: The NCUA has always been reluctant to allow a credit union to have the majority of their loans in fixed rate mortgages because of interest rate risk. The problem is more so the interest rate risk than it is default risk. I have always been a big proponent of credit unions making non-conforming mortgages where they get a good yield, especially if those loans can be re-priced. There are many good non-conforming loans that are not necessarily high risk but they are non-conforming because they are not sellable on the secondary market. You have to make sure that the Board of Directors approves a policy that will allow you to serve your members with both conforming and non-conforming loans. I suggest long term fixed rate mortgage loans, unless you are getting a good return be sold to the secondary market. You don't want to take that kind of interest rate risk.

Q: In regards to the scoring system, why would we not add points for home ownership and years of ownership and subtract points for renters?

A: We attempted to reward home owners by giving them points for having equity in their home (see factor number 3). There are a number of members who now have considerable negative equity that would like to walk away from their home, so we also accounted for that. In today's economy being a home owner can both be positive or negative however we reward stability (see factor number 2).

Q: What are the guidelines for the final score?

A: If you are looking for specific guidelines, if the adjusted score is higher due to more positive factors than negative then that should influence to look hard at finding a way to grant the loan and vice versa if more factors are negative than positive. Now, when we have tested the model with lots of applications, and this has been impossible up until now as most credit union applications are incomplete then it is our intention to tell you when you can take substantially more risk because the adjusted score is (blank) number of points higher than the FICO score. More testing has to be done before we can do that. There is no question that your decision makers will take better loan applications and will be more focused on the right factors if you start using this model immediately. We would love to get your feedback.

Q: Does deposits in other institutions add to this score?

A: No as we have no way of verifying those deposits and we are encouraging you to get those deposits moved over to your credit union so you can count them.

Q: Is LSI using this model?

A: Not at this point and time because it is brand new and LSI will probably also have to modify their loan application. However it is certainly being discussed

---

Q: We frequently find members that have filed bankruptcy have higher scores than members who missed some payments but continued to make their payments. Should we get excited to take applications from those that filed bankruptcy and have very little debt? Or, should we be more excited to lend to members that struggled but continued to pay their bills? Shouldn't the FICO scores penalize those that filed bankruptcies more and shouldn't the FICO scores penalize those that made payments less?

A: I am glad that you are observing these things and asking questions. As a rule, a member's score will go up after their bankruptcy. It will go up faster if the member reestablishes a payment pattern that is positive. When you see a reasonably high score on a member that has a higher bankruptcy, it usually suggests the member's bankruptcy took place some time ago. Member's who are currently missing payments but have not been bankrupt, are doing so because they are on a tight budget or they lack the discipline. It is better that they are paying and not going bankrupt, however bankruptcy might be right around the corner. You must focus on their level of unsecured debt. Finally, if they lack the discipline to pay every month on time even though they have the ability then that should encourage you to make sure you get any loan on direct deposit or payroll deduction if at all possible.

Q: Are there any credit unions that are currently using the HYLS Scoring Factors and what are their loss results? If the questions were asked of the members the lenders would have a more comprehensive knowledge of the members and perhaps be able to loan more money to the member or to not loan at all.

A: The HYLS Decisioning Model is brand new and we concur with you that if the loan officers or decision makers will take a more in-depth app as we have suggested and use these factors then there is no question you will be able to make more performing loans and you will deny loans that you may be currently making because the model will point out the areas you should be focusing on.

Q: One of your suggestions was marketing loans that are charged off. If we have already charged off a loan and taken the loss, why wouldn't a member think he/she could get away with not making payments on the new loan since we took a loss and continued to loan him/her money? Maybe it's the collector in me but a loss is a loss and it may be easier for the member not to pay us the 2nd time around since they already failed to pay us once. Is there statistical data to validate the member paying the 2nd time around?

A: We primary want you to market to members who have caused you a loss for two reasons.

1. The first is those members who filed bankruptcy who were told they could not reaffirm with you because your debt was unsecured or they were way upside down on the collateral. By ending the relationship you will not have an opportunity in the future to recover any money you lost and remember if they are paying you a higher rate now you can ultimately get part of your money back. You are correct with your observation that they may not pay you in the future as 25% will file bankruptcy again but 75% do not.
2. The second is if other members, who did not file bankruptcy but you lost money anyway, reapply then you should get a new application with as much information as you can get and make the member aware that you have suffered prior losses with them. Some of these members may not even be aware that they still owe you money and you might be able to work out some sort of settlement with them plus grant their new loan request because their circumstances have changed over the last 4 or 5 years. I personally love collections so I know where you are coming from but ending the relationship is not the answer.