Q&A Session for How to Make Better Loan Decisions... /VantageScore Info

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Q: How would you consider Section 8 housing in a loan application? Would you consider it as income?

A: I would look at it as a subsidy provided by the federal government to assist lower income people with their housing needs. I would want to know how long they had been drawing it and understand the rules as to the likelihood that it will continue. Obviously, these members are going to be more challenged because of their low income in making their payments. If this subsidy is likely to continue for an extended period of time, I would consider it income.

Q: Is there any statistics you can provide on non-repayment of auto loans based upon LTV? In our area, most lenders have a flat rate based upon credit risk, regardless of the LTV.

A: The answer to your question is I have no specific statistics. I have always been a big proponent of common sense lending. I would highly recommend that any credit union should look at its deficiency balances and ultimate losses on car loans and compare them to loan to value at the time of the loan. I would be very surprised that you would find the same rate of loss on an 80% LTV as you would on a 125% LTV

Q: Previously, you indicated in your suggested rate structure different rates for higher LTV's on auto loans. You then mentioned requiring down payments on D/E is costing us loans. Would you please elaborate on this some?

A: You have to be selective on D and E paper loans where you are financing over 100% LTV. I believe there are times when you will want to do this, especially when you are trying to recapture loans from a sub-prime lender where the member has made their payments on time but is upside down. I am willing to take more risk when the member has a relationship with us and has chosen us versus the indirect side where there is absolutely no relationship. I believe collateral risk is a real risk and when you are over-financing and taking more risk you need to be compensated for the risk you are taking.

Q: Sounds like the bureaus are suggesting that we approve and decline based on score with the new Vantage Model--is this true/correct?

A: In talking to the credit bureaus, I haven't seen any indication that the score then and of itself should be used solely to make the decision. I think they still believe as I do that other factors such as length of employment and length of credit history are still very important.

Q: How do we combat the extended term trend on collateral loans?

A: Terms are one of the most important factors when it comes to decision making. Members who make purchases because the terms are stretched out and it makes the payment affordable at that time, often end up getting in trouble. One of the big problems is that credit unions as well as other lenders tend to focus on what the competition is doing and even when it doesn't make sense they follow suit just to get the business. When a product such as car loans starts causing big losses because someone is over-financing and someone is extending the terms way too long and you are not making any money, it is time to look for other ways to loan your money out – therefore maybe you will make more equity loans, signature loans, credit cards, etc. and loan your money out this way.

Q: The breakdown percentages on the VantageScore the rep gave total 106%. Can you go over them again?

A: From TransUnion:

	FICO	**VantageScore**
Payment History	35%	32%
Capacity	30%	23%
Length of Credit History	15%	10%
Accumulation of Debt	10%	15%
Mix of Credit	10%	13%
Available Credit		7%
TOTAL	**100%**	**100%**

Q: In re: score breakdown comparison, what is the difference in "Capacity" and "Availability"?

A: From TransUnion: Capacity is the percent of utilization (balance to credit limit) whereas Availability is the total of all bankcard and revolving credit limits. This type of characteristic proved to be predictive in the model development process. A low total of credit limits indicates a higher level of risk.

Q: Could you have a session with representatives from Equifax and Experian so we could hear their perspectives?

A: The answer is no, we only met with TransUnion and that was only because TransUnion was proactive and wanted to participate in the webinar and share information about VantageScore that all three credit bureaus have created and are selling. We certainly are not endorsing one credit bureau over the others.

Q: What do you recommend for levels of unsecured debt?

A: Since the new BK laws are going to make it somewhat more difficult to file BK plus there will be a lot more chapter 13's than chapter 7's which means the members will have to pay back a substantially larger amount than they have in the past. Therefore I believe you can raise the level of unsecured debt from a high of 30% that we used to recommend up to 35 or 40%. I would be very uncomfortable going over 40%.

Q: Are all default statements legal or enforceable (i.e. upheld in court) that were stated in the member is in default portion?

A: I don't know of any cases where these were not upheld. I believe we took them from CUNA Mutual's loan liner and I am sure their attorneys have done due diligence in writing the form. If there are certain things in this default section you believe would not hold up or your attorney believes would not hold up, please let us know which ones they are.

Q: In listening to the webinar I heard a lot of great points to help members who need us, but how do you get around policy when dealing with their debt ratio? If the policy states 45 percent then how do you proceed to help?

A: I would highly recommend you rewrite your policy. In our lending matrix (if you need a copy of this please let David Johnson know) under debt ratios we clearly give the credit union lots of flexibility in approving loans with high debt to income ratios (see Level III approvals). The only other thing I would recommend for you to do is clearly define that the credit union recognizes all income, even when it is not verifiable but its clear the member has it based on how they are currently paying their debts.

Q: You used to preach that people make the payments, not the collateral. You now recommend rate tiering for LTV risk on car loans. Why the change?

A: I am delighted that you remember that I in fact did preach that; basically I still believe that. So many of a credit union's loans are with non-members we don't know and have no relationship with because we are buying contracts from car dealers that are in control. The average deficiency balance has risen dramatically over the last three years because the car dealers are asking us to finance 125%+++. If we are going to take this additional risk, we need to be compensated for it. It is a practice widely used by other lenders.

Q: Do you have a recommendation for establishing retail value on used vehicles? My experience indicates a wide variety in values between NADA, Kelly BB, etc.

A: The very best way to do this is by getting your hands on recent auction guides that shows what cars sold for going through the auction. This maybe difficult for you to do but some credit unions are having success and we are exploring that now. The downside to doing this is those values, while realistic, will always be lower than NADA, Kelley, etc. If you cannot get your hands on the auction guide values, I would look at both NADA, Kelly, the Black Book, and possibly www.edmunds.com, to see the variance in the values and then decide based on past experience whether I wanted to be an aggressive or cautious lender.

Q: Are the GSEs going to accept the new scoring anytime soon?

A: My guess is no, until their comfort level goes up based on their understanding of how VantageScore works I think you should probably continue to use Fair Isaac along with VantageScore – certainly in the short run.

TransUnion had this to add: This will depend upon the test results. All three credit reporting companies have met with Freddie Mac and Fannie Mae, and testing is scheduled to start soon. Results for at least one of the GSEs should be available by the end of August.

Q: Would you suggest using child support as the applicant's income?

A: I would absolutely use child support provided it is going to continue, there is evidence that the spouse providing this support has a good job, and has been diligent in making the payments.

Q: Do you have a sample letter to mail to Bankrupts?

A: Not at this time but it would be reasonably easy to create one. If that is something you would like to see please let us know and we will try to work up one based on Rex's schedule and availability.

Q: We have noticed that home equity loans are included in the revolving debt and causes the score to be lower, do you see this being addressed with the Vantage Score?

A: In my conversations with TransUnion, I don't see this change being made although it needs to be changed.

TransUnion had this to add: This is a data reporting issue that impacts all models. If financial institutions continue to report home equities as revolving, instead of mortgage or installment, then this will continue to be an issue in scoring. Many financial institutions, however, do report home equities correctly as mortgage.

Q: I think Rex is too high on his suggested auto loan rates. We have a successful indirect auto loan program and we find our main competition is the Captive Finance Companies i.e. Ford Motor Credit, Toyota Motor Credit, etc. and they have lower rates.

A: We get a copy of GMAC's rates which we have posted on our website. If you are making good money on your indirect program with the rates you are offering I wouldn't change a thing. We would appreciate seeing what your rates are and an analysis showing by grade of paper and rate you charge minus your expenses what your gross and net loan yield are. I would be happy to share this with other credit unions with your permission. I find it difficult to believe that credit unions still charging in the 5% range, after backing out their cost, such as dealer reimbursement, loan processing cost, and the cost of funds, that there is still substantial profits being made. I have been wrong before and I welcome your analysis. As you can see from the latest GMAC rate sheet we got, they are charging 7.70% for A+ paper for 60 months. Please send us the standard rates you are seeing from the captives that are not being subsidized by the manufacturer. I hope this helps.

Q: What wage earner on a joint report do you use to decide what score to use to determine rate

A: Most credit unions will take the higher of the scores. The reason we do that is that we don't like to create controversy with the member. As credit union earnings continue to dwindle we are starting to see more credit unions take the average of the two scores which you could make a strong argument for and should be easy enough to explain to the member.

Q: Do rates change by region – like auto values?

A: There are some slight changes according to regions. For the most part they are very consistent across the U.S. but it is possible to find certain pockets where someone gets overly aggressive and is determined to get all the dealers business by undercutting everybody else's prices so everybody else follows suit and then they all lose money but the dealer is happy. I think there is a better way – credit unions should charge a good, competitive rate but not give the money away because someone else elected to.

Q: Has any regulatory agencies tested your score card?

A: TransUnion: Not yet. In our discussions with the regulatory agencies, it hasn't been determined what testing, if any, will be necessary. The primary interest of the agencies appears to be a full disclosure of the characteristics used in the development of VantageScore.

To date, we have had at least one formal in-person meetings with the following agencies: Department of Justice, FDIC, Federal Housing Finance Board, HUD, NCUA, OCC, Federal Reserve, Consumer and Community Affairs, Federal Reserve Board of Governors, OTS, and OFHEO.

Q: In the Vantage scoring model, please define what capacity means.

A: TransUnion: Capacity is the percent of utilization (balance to credit limit).

Q: Why the additional available credit, when capacity shows both the available and used portions?

A: TransUnion: In the model development process, we learned that a low total of credit limits on bankcards and revolving accounts indicates a higher level of risk. Measuring Capacity alone did not allow VantageScore to leverage this additional predictive indicator.

Q: How do you view unsecured debt in today's environment?

A: A lot more favorably under the new BK laws than we did under the old laws. This is why we are recommending you take more risk and promote unsecured lending plus credit cards.

Q: Would you base LTV on score and would you finance over 125% on any credit tier?

A: Our recommendations are to loan no more than the retail value plus one months gross income. In order to do that the following conditions have to be in place:

1. The member must have a steady job with a company that is dependable. (Be careful of member's working in trades paid by cash or members who constantly change jobs.)
2. The job is likely to continue. Ask the member if they like their job and how they are rated.
3. Direct deposit or payroll deduction is a must if there is any evidence the member struggles to pay similar type loans on time.
4. The member gets high marks if they have paid similar type loans.
5. Bankruptcy Threat: If the member has 30% or greater of their annual income in unsecured debt, then only loan low book. If they have little or no unsecured debt, loan high book plus 1 month's gross income provided the 1st three factors are in place. Unsecured debt includes all CR/CDs, signature loans, and the amount they are upside down on with their existing or new car loan.
6. On D/E paper, a good guideline for a car loan is 50% of their annual gross income. As an example, if the member makes $20,000 you would prefer to only go to $10,000. On A,B,C paper, use 75% of the member's annual gross income or you would be willing to loan $15,000 on a $20,000 salary.
NOTE: Level 3 can exceed the above with good justification such as:
-Lives at home
-Big down payment
-Car is in great condition, low miles and holds value
7. Inspect the vehicle if at all possible. Focus on:
-Mileage
-Condition

These rules apply to any grade of paper. We have all got to understand that when you are financing over 100% of retail, regardless of the grade of paper, we are taking a lot of risk given how quickly automobiles depreciate. When we finance over 100% and then stretch out the terms we are just compounding the problem. A+ members as a rule have assets, trade-ins, and cash to put down. When they lack all of the above you have to really ask yourself if they are really A+ members. Car loan lending keeps getting pushed to extremes when it comes to taking risk. I guess it will not be too long before we start financing 150 to 200% for 10 years. We have got to stop somewhere.

Q: Why can't we have direct payment as a condition of approval?

A: The reason is because it is a violation of REG E. This regulation clearly states that you cannot make direct deposit or payroll deduction a condition of a loan. Having said that you can clearly show the member the benefits and why it makes a lot of sense and I suspect you will not have any problem in getting payroll deduction.

Q: Should student loan and grant dollars be considered as income when processing a loan request?

A: Absolutely, but you need to know how long they have been receiving it and how long it will continue and it would be helpful to see some evidence that it does in fact exist. My nephew who is a doctor continually got grants all through school, had good credit, and is doing very well today.

Q: What do you think of Experian's Fast Start scoring model?

A: Fast Start can be a helpful tool to assist your employees with their decision making. I would not let Fast Start make the decision for me because I believe lending is a judgment business and there is a lot you can learn from talking to the member. Fast Start should never be used for pricing – only to assist you in decision making. Credit unions that have used Fast Start for pricing have found that many members who are C or D paper with Fair Isaacs suddenly become A paper with Fast Start. As a result, credit unions are not getting compensated for the risk they are taking.

Q: Do paid collections count differently than unpaid collections on the new scoring

A: TransUnion: Yes. Dollar amount of the collection is also taken into consideration.

Q: Once you assign a member to a scorecard, how long do you predict a member will remain on that particular scorecard?

A: TransUnion: We haven't studied this over time yet. We do know that general changes in the credit profile are not significant enough to shift a consumer to another scorecard, so our untested expectation is that this will hold up over time.

Q: Will the new scoring also include a bankruptcy score?

A: TransUnion: VantageScore's scorecards all assess the level of bankruptcy risk, however, we expect validations to show that greater accuracy in bankruptcy prediction is achieved when VantageScore is used with a bankruptcy model. In general, bankruptcy models are more accurate than delinquency models in predicting bankruptcy risk, because a bankruptcy model is developed strictly on a population of bankrupt consumers.

Q: Should we put a heavier weight based on a particular scorecard into our risked based lending model?

A: TransUnion: No. However, if the applicant's score is marginal (i.e. in a review range) you could consider approving if the scorecards used were either the "previous bankruptcy-low risk" or "no previous bankruptcy-low risk scorecards.

Q: How does Rex feel about the BNI?

A: The BNI should never be used to price loans. It can be a useful tool in helping you predict BK. The main components of the BNI are capacity, accumulation of debt, and mix of credit all of which are contained in the Fair Isaac model. If you really understand the Fair Isaac, you probably don't need BNI. BNI will cost you additional money, it does have value and if it helps you then please continue to use it.

Q: How do you propose using your system of asking questions for indirect loans when you do not have access to the member?

A: You have identified the main reason why credit unions can take more risk with *direct* versus *indirect* lending. Unless you have a unique relationship with the dealer where the dealer will make the member available to you then you will not be able to do it and therefore you will not be able to take the same risk. You simply cannot take as much risk with indirect lending as you can with direct lending because you often don't know these people and you are not in control.

Q: On your new approach to bankruptcy, how could we justify serving a member that has cost a $10,000 loss and possibly more if we give them a new loan?

A: Your question is a good question and I fully understand where you are coming from. Let's look at it from a different angle. These members, by law, do not have to repay the debt. They have been advised of this by their attorney and the courts. In the member's mind they are simply doing what they were advised to do by legal council. If we cut off the relationship with the member and refuse to make them additional loans because we suffered a loss, then there is no chance we will ever earn additional income on this member. Somebody is going to make your member a car loan, mortgage loan, or credit card and will earn income. The member is going to need all of these products after a BK. The member often thinks they have done no wrong, that they are following the law and the advice of their attorney. I believe this new approach over time will help many credit unions recover their loss with the interest they will earn on the new loan and the future loans you might grant them. They are not getting away scot-free – most of these members will be E paper after the BK and will end up paying 17 to 18% interest on the new loan which is going to be substantial income for somebody, why not you?

Q: Rex mentioned we should waive the requirement for verification of income/employment for high quality members; we had a stay at home mom who wanted an overdraft loan. The loan officer turned her down because she was not employed. I think the loan should have been approved, but how do we justify this to the auditors?

A: It starts with your policies. Simply rewrite your policy and have the board approve it. The policy should read, "The credit union will verify employment on an exception basis only when the credit union has reason to believe the member has overstated their income or misrepresented where they work. This policy pertains to all of our self-employed members as well. Income does not have to be verifiable as long as it exists. We will focus more on the members overall qualifications including how they have handled their credit and how long they have had credit. We recognize members who have outstanding scores (A+ and A paper) can get credit with any of our competitors without showing proof of income."

This should give you a lot of flexibility in making loans and you should be able to justify them to the examiner with the members qualifications and credit history.