Consumer Lender Roundtable Series:

Underwriting Consumer Loans for Borrowers with Poor or No Credit

September 10, 2019

CBA Fund

An emerging CDFI intermediary that supports nonprofits in offering small dollar consumer loans that meet the needs of specific populations in their community.

Levels of Risk

Traditional Underwriting Criteria

CHARACTER*
A borrower's track record (usually measured through a credit report)

CONDITIONS
characteristics of the loan (ex: interest rate, amount of principal, etc.)

TRADITIONAL UNDERWRITING

CAPACITY*
ability to repay

COLLATERAL
assets used to secure the loan

CAPITAL
amount of money a borrower puts towards an investment (ex: down payment on a home)

Finding a Balance

Inclusivity

Risk

Poll Questions

- How do you accept loan applications?

- What information do you collect for underwriting?

- Which underwriting factor is most important to your organization?

- When it comes to underwriting, what challenges does your organization face?

Presenters

Underwriting for Consumers with No or Poor Credit

Andy Posner, Founder and CEO
Laura Rijo, Director of Loan Servicing

Agenda

- Quick overview of Capital Good Fund
- Our underwriting model
- Measuring Ability-to-Pay & Willingness-to-Pay
- When pulling credit makes sense
  - Emergency Loans Cohort Analysis
- Risks
  - Loan Application Fraud
- Toolkit
  - Resources
- Q&A

Capital Good Fund ("Good Fund")

- Founded in 2009
- U.S Treasury-certified Community Development Financial Institution
- Nonprofit "fintech"
- Small-dollar consumer loans and one-on-one Financial and Health Coaching to LMI clients
- Currently operating in DE, FL, MA, and RI; offices opening in IL and TX in the Fall

Our History and Growth

- **Mission is to create pathways out of poverty through equitable financial services**.
- Have financed 4,200 loans totaling $8.6 million (96% repayment rate)
  - Avg. FICO of borrowers is 580; ~20% have no FICO
- Loans of $300 - $25,000
- Financial and Health Coaching – over 1,000 clients served
- 5 Core Loan Products
- 1,600 loans for $4.5 million outstanding; 97% current
- 28 FTEs
- $7.2 million in assets
- $3.5 million budget
- 600% increase in assets and quadrupling of loan volume since launch of scaling plan in 2016

Loan Products Overview

Emergency Loan
- $300–$500
- 10% APR

Other Personal Loan
- $700–$2,000
- 24% APR

Immigration Loan
- $2,000–$20,000
- 15.99% APR

Car Loan
- $6,000–$20,000
- 7%–17.99% APR

Weatherization Loan
- $500–$25,000
- 0% APR

Competition

- **Payday Loans**
- **Pawnshops**
- **Online Predatory Loans**
- **Rent-to-Own Stores**

Example: Payday Loan Alternative							
Institution	Principal	Interest Rate	Term	APR	Monthly Payment	Total Annual Interest Paid	**Total Cost of Loan***
Average Payday Loan	$400	10% for every $100 + $1	14 days	278%	N/A, avg. loan rolled over 8x	$600+	**$1,000+**
Good Fund Payday Alternative	$400	10%	12 months	10%	$35.17	$22	**$422**

The Capital Good Fund Underwriting Model

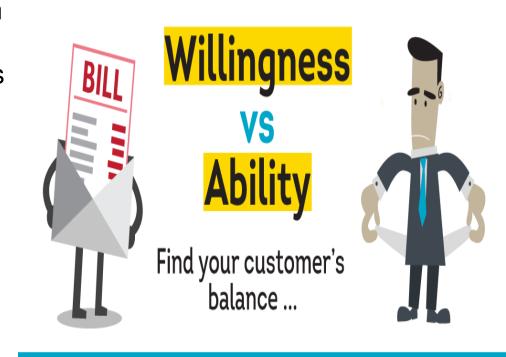- We have underwritten 2,380 applications in 2019
  - An average of 390 applications per month; approval rate of 36%
- Manual underwriting process
- A secondary review from the Credit Manager or Director of the Loan Servicing Department may be required (typically "specialized loans such as immigration bonds or if the underwriter is unsure)
- Speed is essential
  - Guaranteed decision within 48 business hours

Underwriting Model - Continued

- Underwriting criteria is based on three basic principles:
  - Applicant's **ability to pay** as evidenced from their recent bank statements and an analysis of their income against their current obligations (DTI, RTI, ETI)
  - Applicant's **willingness to pay** as evidenced from their past and current credit repayment history from the credit report
  - **Loan Purpose**

Ability to Pay

- Also known as financial capacity, this is the borrowers' ability to sustain and make good on their loan obligations and support their existing debts.
- Income
  - Income and Housing Stability
- Important ratios - (Typically don't set min or max ratios)
  - Expenses-to-Income
  - Rent-to-Income
  - Debt-to-Income
  - Payment-to-Income
  - Rent-to-Income
- Bank Statements

Income   Expenses

Reading Bank Statements

Important Metrics

- Daily Running Balances
- Average Daily Balances
- Income Verification
- Red Flag Transactions
- Cash flow
- Beginning and Ending Balances
- Account Usage -- Recurring Transactions vs Cash Transactions
  - Overdraft and NSF fees

Limitations

- Access to Consistent Data
- Documentation Fraud
- Limited Technology Usage
- Time and Employee Resources Invested
- Fraud

Willingness to Pay

- Considers the applicant's past and current payment history on trade accounts
- Credit Report - Beyond the FICO Score
- Credit Repayment History
  - Trending credit usage
  - Root of credit issues and corrective measures
- Bankruptcies, unpaid public records, tax liens, and past due child support
- Collections
  - Size vs. Recency
  - Medical Collections
- Credit Utilization
- New Credit vs. Old Credit
- Identity Verification

Emergency Loans - Cohort Analysis

- $300 - $500
- 10.00% Interest Rate
- 12 Months Term
- Alternative to payday lenders
- 2017 Cohort Analysis
  - Found no correlation between credit repayment history and loan performance for this product
  - Having better credit did not translate to better loan repayment
  - A better indicator for assessing loan performance was the borrowers' ability to pay and banking history
  - Credit review is no longer part of the underwriting process for Emergency Loans
    - Cost of a credit pull was also an important factor

Loan Application Fraud

- Application fraud is the most common type of fraud in lending. It can be in the forms of using someone else's identity, adding misleading or false information to the loan application, submitting false or tempered underwriting and loan closing documents, etc.
- Prevention is Key
  - Bank statements, proof of address and proof of identity are amongst the most falsified pieces of documents
  - Develop a procedure for determining when applications may be fraudulent and how to process them
  - Routinely train your underwriting and loan origination staff on these procedures
- However, prevention is not always possible
  - Determine expected losses on your portfolio and set a cash reserve to help mitigate their impact
  - Loan fraud insurance policy - could not be cost-effective

Session II

- Underwriting Policy and Procedures
  - Regulations
  - Planning for Growth
    - Staffing Needs
      - Staff Training
    - Technology
      - Automated Credit Pulls
      - Automated Bank Pulls
      - Score Cards
      - Automated Loan Decisioning
- Sample Documents
- Additional Resources
- Analyzing Trends -- Underwriting Criteria vs. Loan Performance
- Interest Rates and Risk and Defaults
- Utilizing Conditional approvals and Requesting Co-applicants
- Your Questions and Concerns

Poll

- **What resources would be helpful for developing or strengthening your underwriting criteria?**

Resources

- **CBA Products in a Box Toolkit**

- **Innovations in Underwriting** (Wells Fargo and Opportunity Finance Network)

Questions? Thoughts?

- **Type in your chat box!**

Thank you!

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