Advanced Underwriting Skills for Consumer Loans

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Today’s Presenter:

Bruce Hull, Consultant, Lending and Collections Specialist

Team Resources

Bruce Hull has more than 30 years’ lending experience. His knowledge and ability to communicate have made him a sought-after speaker in the areas of lending, collections, and sales. Bruce has served in several capacities, including: C.O.O. for a 1.5 Billion Credit Union, the VP of lending for two other large credit unions; the director of collections; a lender in two banks and a savings and loan; a lending professional with one of the nation’s top credit union audit firms; and an expert witness in loan fraud and bond claim cases.

Bruce has been a frequent presenter at conferences around the country for 20+ years. He attended the University of Nevada in Reno and earned a Retail Banking Diploma from the American Institute of Banking.
What is underwriting?

Underwriting is:

“The process by which a lender decides whether a potential borrower is credit worthy and should receive a loan.”
What is advanced underwriting?

Advanced underwriting is:

“An extension of basic underwriting utilizing underwriting tools and techniques refined from the basic principles of underwriting that focus on key aspects of the underwriting process to increase the effectiveness, efficiency and timeliness of decisioning a loan.”
First, let’s start with a question:

How is the process of making loans changing today and, to be competitive, what advanced underwriting skills must today’s loan officers possess and employ?
Borrowers are still emerging from the devastating financial consequences of the economic recession. This has caused a greater demand for credit resulting from consumers that had previously postponed their borrowings until their confidence in the economy returned.

The types of loan products borrowers are looking for and how fast the borrower’s want to obtain those loan products has changed.
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Borrowers are also looking to their financial institutions for a better borrowing relationship: “You really are interested in me and you really are “looking out” for me!

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Many borrowers experienced financial hardships during this past recession, including many borrowers that never had any financial problems before the recession, that might negatively affect the decision on those borrower’s loan requests.
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Big financial institutions including banks are well aware of this and they had already prepared for the “pent-up” demand for credit that the economic recession caused with new products and training for lending personnel to maximize their lending personnel’s abilities to capture every consumer loan possible.

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Competition for every consumer loan has become fierce!
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WHAT HAS YOUR FINANCIAL INSTITUTION DONE TO PREPARE THIS?

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Credit unions need to adopt and implement an advanced underwriting philosophy and perspective that permeates all consumer lending operations ensures that their membership “looks to their credit union first” – not some other financial institution.
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The advanced underwriting concepts we will discuss today will assist credit union’s with accomplishing just that.

To ensure that members look to the credit union first for their borrowing needs, we must understand that “time” has become the primary ingredient to borrowers.

• How long will it take to get my loan?
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Also, advanced underwriting focuses on ensuring that the borrower’s perception will be that the Credit Union is “looking out” for the best interests of the borrower by the credit union looking at the borrower’s whole financial picture to see where there are other credit opportunities that will both benefit the borrower and save the borrower money.

• What else can you do for me?

Please note:

There is a separate handout included with this presentation with notes and additional details that further describes many of the concepts we will discuss in this session.
The most important advanced underwriting skills a loan officer must possess are the abilities to quickly “read” and understand a loan application and credit report and the “story” these documents tell about a loan applicant and to see, not only the opportunity the borrower is applying for, but also other possible opportunities to assist the borrower with additional credit products.
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This webinar will discuss the following advanced underwriting skills for consumer loans that will assist consumer loan underwriters to:

- Refine the credit factors being focused on to quickly and efficiently decision consumer loans.
- “Read between the lines” to better decision a loan request.
- Increase consumer loan opportunities by appropriately approving additional loan products for applicants and answer the question: *Is there a consumer loan “magic bullet” that will bring in more consumer loan volume?*
- Know how to consider and analyze the effects of the economic recession and how these effects have affected consumer’s financial conditions.

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...and:

- Consider how the economic recession has affected the adequacy of borrower credit scores and credit reports
- Draw a connection to the borrower’s credit behavior before the economic recession and today.
- Refresh underwriting factor considerations to the five “key” underwriting criteria that need to be considered in every consumer loan request.
- Adequately consider negative credit conditions for borrower/consumers that did not have negative credit prior to the economic recession.
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...as well as:

• Know when to use “deep-dive” (full investigation) underwriting techniques to consumer loan underwriting and when a less investigative underwriting approach should be applied.

• Retain existing member borrowers, recapture members that have used other financial institutions for consumer credit needs and increase consumer loan volume.

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Today’s session is not going to focus a lot of attention on the “slam-dunk, gold plated” borrower.
Instead, this session is focused on the more “marginal” level borrower that requires more skill to quickly and effectively underwrite.
And, though today’s session is not primarily an analysis of underwriting criteria for automated underwriting products or tools, the information herein can act as a refresher for those institutions that employ an automated consumer loan underwriting tool/product which can assist with the periodic validation of automated consumer loan underwriting products/tools.

Let’s Begin...
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The key elements to acquiring the skill to be able to “read” a borrower’s loan application and credit report and to also being able to then understand the “story” that these documents tell consist of many criteria and attributes.

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Once these criteria and attributes are studied, understood and put into use, the skill to being able to interpret the “story” being told will be acquired.

This takes focus and there are no shortcuts.
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• Every loan application and every borrower is different and not all of the criteria and elements we will discuss here apply to each and every loan.
• Understanding all of these criteria, elements, the borrower and how they relate is the essential principle to advanced consumer loan underwriting.

PLEASE NOTE:
The criteria and elements we will discuss below are not “entry-level” concepts.

The criteria and elements being discussed below assume that the loan officer already has:
• A full understanding of the basic principals of lending.
• A full understanding of the credit unions loan policies/procedures.
• A full understanding of the credit union’s lending software program.
FOR TODAY’S SESSION:
ADVANCED UNDERWRITING SKILLS INCLUDE BUT ARE NOT LIMITED TO:

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Being able to refine the credit factors being focused on to quickly and efficiently decision consumer loans:

• What are the most important credit factors a consumer loan underwriter needs to know to be able to decision a consumer loan?
• The nature of the borrower(s) and the nature of the credit request (Who are the borrowers and what is the loan for?)
• Does the loan request make sense – does the loan request fit the nature of the borrower?
• What is the probability of repayment? (Borrower’s past history of paying debts)
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Being able to “read between the lines” to better and more quickly decision a loan request:

• In today’s credit world, the amount of time for making a loan decision and informing the borrower of that loan decision has been significantly reduced.
• Immediacy, “I want it now”, speed-speed-speed is putting pressure on the time for decisioning a loan.

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What does “read between the lines” to better and more quickly decision a loan request mean?
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It means that in a “glance” the loan officer/underwriter can determine:
• The loan applicant has the capacity to repay the proposed debt without undue burdening of the overall financial condition of the borrower.
• The borrower has sufficient credit experience to demonstrate the probability that the proposed loan will be repaid.
• Collateral (if any) will be sufficient to securitize the loan.
• The loan “makes sense”.

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To ensure that this advanced underwriting skill is adequately developed and consistently applied requires that consumer loan officers have had sufficient prior and ongoing training to understand the concept of what to focus on including these essential factors:
• Our member for many years
• Previous loans with us with no serious derogatory pay history
• Reasonable credit history
• Stability factors (job, residence, etc.)
Within this element also is the need and requirement for loan officers with advanced underwriting capability to increase consumer loan opportunities by appropriately approving additional loan products for qualified borrowers.

Here is a question:

*Is there an advanced underwriting consumer loan “magic bullet” that will bring in more consumer loan volume?*
YES:

The magic bullet is: “Ask for the business” at every touch point with every member. And the knowledge and skill to successfully “cross-offer” in-house credit union loan products to members.
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To be able to cross-offer effectively, the loan officer must have a thorough knowledge of the borrowers full financial condition and a thorough knowledge of the loan products offered by the credit union.

Both of these require the skill of being a good listener and training.

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• Listening – must listen to be able to determine what the borrower is asking for and to perceive what the borrower needs and how the credit union’s loan products can help the borrower.

• Training on how to match members with the institution’s loan products: Do what is right for each member!

• Above all: Ask for the business.
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Advanced underwriting skills include being able to know how to consider and analyze the effects of the economic recession and how these have impacted consumer’s financial conditions.

- How has the recession affected the member’s borrowing habits?
- Some borrowers may still be in a “wait-and-see” mode.
- Proactive contact – create a report that lists loans about to pay off and contact those borrowers - show the borrower value.
- Comparing the member’s current credit accounts to the institutions credit products to see where the institution can save the borrower money – again, show the borrower value.
- Offer to do the work to move the member’s credit accounts from where they are to your institution.

Consider how the economic recession has affected the adequacy of borrower credit scores and credit reports.

- All consumers credit scores and credit reports have been affected.
- Most consumer’s credit scores have decreased – even if the consumer changed nothing.
- This can (and usually does) affect the interest rate the borrower is going to pay for their loan(s)
- Design discount programs that assist the borrower without being discriminatory (discount for using services that all members are eligible for such as automatic loan payment)
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Advanced underwriting skills includes being able to draw a connection to the borrower’s credit behavior before the economic recession and today.

• If the borrower did not have credit problems before the recession and the credit report remains similar to the borrowers credit report prior to the recession, even though the credit score may have decreased, loan officers can conclude that the borrowers changed credit profile is not the result of negative credit behavior.
• Take this into consideration in underwriting, asking for supporting documentation, etc.

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Advanced underwriting skills require the use of a concise narrative to describe how any negative credit conditions affected the loan decision. (How negative conditions were not “held against the borrower”, etc.)

More later on tools that assist with making these determinations...
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Advanced underwriting does not rely on a credit score to decision a loan.

- Other than situations where a financial institution may have a credit score minimum requirement for a loan product, relying on the borrower’s credit score as the primary factor for decisioning a loan is not underwriting.
- Credit score models today are struggling to stabilize – the recession seriously damaged the odds probability and other credit score criteria matrices.
- Credit scores are basically a general indicator only.

In every loan application situation, advanced underwriting skills require the application of five “key” underwriting criteria that must be considered in every consumer loan request:
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1. Capacity to repay the debt
2. Credit history to support the nature of the prospective debt
3. Collateral value (If collateralized)
4. Stability (Time on job or in job field, length of time at residence, etc.)
5. Reasonableness of the credit request

In advanced underwriting, the loan officer or underwriter that understands these five concepts and how they all relate to each other has all the skills needed to effectively underwrite any loan application or credit request quickly and efficiently and to see opportunities to offer the borrower additional services that can not only help the borrower with their financial needs but to also save money!
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Remember, we are not referring to the “slam-dunk/gold-plated loan situations here.

• All of this requires timely and effective communication with the borrower.
• Ask questions – do not assume, especially if there is negative credit in the loan equation.

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For advanced underwriting, adequately consider negative credit conditions for borrower/consumers that did not have negative credit prior to the economic recession.

For borrower’s with negative credit:
• Consider whether the negative credit is very current or not.
• Consider whether the negative credit could be a result of the recession.
• Consider the permanence of any situations that are causing the negative credit.
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Advanced underwriting skills enables the loan officer/underwriter to quickly clarify any and all of these conditions by asking the borrower for explanations and then document the explanations.

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Advanced underwriting considers that temporary negative credit conditions or other conditions that have impaired the financial condition of a borrower be considered from that point of view.

- Developing the ability to determine if the negative credit conditions were/are or are not temporary is a fundamental advanced underwriting skill.
- To be able to employ this skill, the loan officer must take the time to understand the entire credit history and financial condition of the borrower.
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Advanced underwriting enables the loan officer/underwriter to know when to use a “deep-dive” (full investigation) underwriting approach or when a less investigative underwriting approach should be applied.

• Marginal Borrowers.
  • Loan officer’s most important job is to find a way to take a marginal conditions borrower and make it into a successful credit.

• But how?

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Advanced underwriting differentiates marginal borrowers from the “gold-plated” borrowers. For most, if not all, marginal borrowers a “deep-dive” approach will be used and these conditions require more extensive due diligence and investigation.

• The key is to make a “good” loan.
  • Not many shortcuts are available for marginal credit conditions... and there shouldn’t be.
  • Go the “extra-mile, check it out”.
  • The extra effort contributes to success for the borrower... setting the borrower up to succeed.
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Use of the advanced underwriting concepts will result in greater retention of existing borrowers, recapture borrowers that have used other financial institutions for consumer credit needs and increase consumer loan volume.

• Use the credit report to determine where “cross-offering” opportunities exist.
• Pre-calculate the payment/savings before cross-offering and use that to initiate the contact.
• “Everybody wants it for less – everybody want to pay less – everybody wants more for less.”
• Do the work for the borrower, make it easy.

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Strategically, advanced underwriting tells us that perhaps the best source of good loans that will assist with increasing the institutions loan portfolio is to consider pursuing the institutions existing borrowers that have started to borrow elsewhere.
• Much of the information the loan officer needs to decision a loan already exists and can be updated quickly and efficiently.
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Advanced underwriting Tools:
• Veteran (and new) loan officers can and do use tools to assist with the underwriting of loans.
• However, for advanced underwriting: These tools assist the loan officer in focusing on key elements of the loan application that create consistent approaches to considering loan applications that generally result in stronger and more effective loan decisions.

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Some loan underwriting software programs have these features built-in but some do not. In any case, advanced underwriting tools include, but are not limited to:
• Check lists of key underwriting elements and attributes.
• Reminder sheets of solutions to common underwriting questions.
• Example cross-offering situations and the language to use to approach a borrower with a cross-offer.
• Short list of the benefits of each consumer loan product
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Advanced underwriting checklists that include sections for quickly establishing:

- The borrower’s capacity to repay the debt.
- Quick summary of the credit report (# of trades paid as agreed, high credit, previous on us loans paid as agreed, etc)
- LTV if collateralized.
- Job stability (Time on job or in job field)
- A conclusion as to the reasonableness of the credit request.

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Narrative Tool:

Narrative template that may or may not include “check the box” type sections for :
- Recency of any negative credit.
- Nature of negative credit (caused by irresponsible use of credit or caused by circumstances not of the borrower’s making.)
- Conclusion as to the potential that negative credit will or will not continue.
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Cross-offering Tool:

List of loan products with boxes to check to assist the loan officer with selecting the loan products that could benefit the borrower and improve the borrower’s financial condition.

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“Reasonableness” Tool:

Boxes to check to assist the loan officer with answering the following:

• Does the loan make sense for this borrower?
• Does the loan increase or decrease the financial burden to the borrower?
• If collateralized, is the LTV less than 100% or not?
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“Thank-you” Tool:

After making every loan to a borrower, send the borrower(s) a “thank-you” card or thank you letter.

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CONCLUSION:
• Advanced underwriting is a proficiency comprised of many skills.
• Know the criteria and concepts discussed and how to employ them effectively.
• Communicate with the borrower to better understand the borrower’s full picture.
• Look for opportunities to better serve the borrower with your institutions loan products.
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QUESTIONS?

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Thank you!
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