Lending and Collections Working Together to Maximize Net Income

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Southwest Lending & Collections Conference


We are in the business of
people helping people

What it can feel like…

Teamwork is Dreamwork

- Good collections begins at the application
  - Who is taking applications at your CU?
- There is risk associated with making loans
  - There are no bragging rights for 0% DQ or C/O
- The requests should be commensurate of the risk
- Without Lending there is no Collections
- Without Collections we can’t Lend

GREAT Reasons to Lend in all Credit Tiers

- Your low-credit members are your members with the greatest need
- Living the Credit Union Mission
  - Serving the under-served
- If you help D and E-Paper Members they will be very loyal
  - Can the same be said of A-Paper Members?
- An aging population requires you buy deeper to maintain loan growth
- Aggressive dealer finance will cause you to lose many of your top tier borrowers
- When done well, you can make good money on lower credit tier loans

Credit Unions have a natural bias towards A/B Paper Loans

- Conservative A-Paper mindset among Boards and Senior Management
- Lack of Reporting and Risk Mitigation
- Overreaction to Loan Losses without Context
- Risk Adverse
- Oversensitivity to Regulator Comments
- Weak Collections Effort

Keys to Successful D and E Paper Lending

- Do these loans on the Direct side of your business
- Start with a secured loan (i.e. the car that drives this member to work)
- Use the loan interview to build a performing loan
- Ensure your loans are priced correctly
- Underwriters must be able to distinguish between high-risk and low-risk loans in your lower credit tiers
- Higher-risk loans must be collected more aggressively
  - Starts at the interview and close
- Management and Boards cannot FREAK OUT when some of the lower credit tier loans go bad

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6 Most Costly Underwriting Mistakes

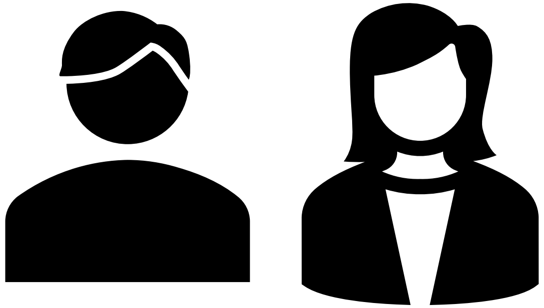
1. Not recognizing bankruptcy risk
2. Incorrect Loan-to-Value decisions
3. Too much car = too much payment
4. Being too aggressive with young borrowers
5. Too aggressive with unsecured loans
6. Denying good loans

Let’s Define High-Risk

- Low Credit Tiers Scores
- Thin Files
- New Member/Crappy Job

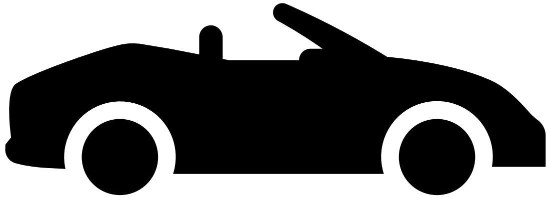
Understanding the Type of Risk

Borrower Risk



- Stability
- Ability

Collateral Risk



- There is a time when the car makes the payment

Bankruptcy Risk: Your ACE in the Hole

(A)mount of Unsecured	(C)apacity	(E)scalating Debt
>30% Unsecured DR	**<30% Revolving Available**	**# of new accounts in the past 18 months**
Sum Amount US/Annual Income	Balance in relation to limit	# of payments

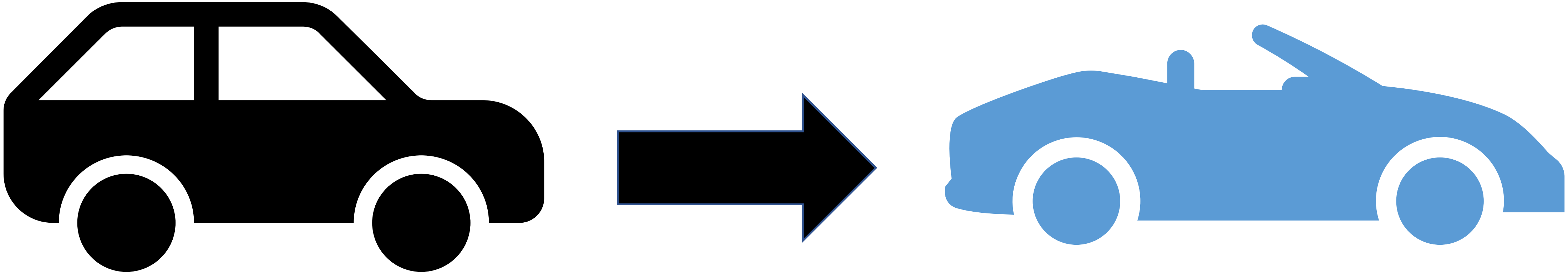
On their own, these factors are not necessarily risky. Combined together, they represent a significant risk. Declining a secured loan request for these reasons is appropriate – even if the loan meets DTI criteria

The Importance of Payment

- Your members carry payments in their pockets not rate
- How many loans where bad the day we made them?
- Are we asking members what a comfortable monthly payment is during the interview AND including it in the notes?
- Payment-to-Income (PTI)
  - 10—15% PTI is a good guideline for your auto lending
  - According to Edmunds.com the average consumer pays 11% PTI for an auto loan payment

Payment Shock

Are you willing to trade payment for payment?



- 30 months payment history @ $350/month
- New car payment @ $315/Month
- 30 months payment history @ $350/month
- New car payment @ $565/Month

What Changed?

Common Collections Mistakes

- Waiting 30-60 days before contacting delinquent members for payment arrangements
- Not hiring enough collectors
- Collectors that spend more time doing paperwork than calling on delinquent member accounts
- Not providing clear performance expectations
- Not tracking collector performance
- Outsourcing collections (pre charge-off)

Successful Collections Strategies

- Have collections report to a senior lending manager
  - Us vs Them Mentality
- Prioritize
  - Higher-Risk
  - Higher Dollar
- Understand the risk that is being taken in the loan department
  - Aggressive indirect, debt consolidation, D & E paper, etc.
- Communicate common underwriting mistakes to lending manager or VP of Lending
- Track the FICO score on delinquent accounts
  - Collecting is different for good credit members with an isolated problem than for poor-credit members that are habitual late payers


YOU GET A CAR!
EVERYBODY GETS A CAR!
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Lessons Learned from Repossessed Auto

- Blessing a member with a payment
- Not asking for cash down
- Not understanding the importance of job quality
  - High friction to get, high friction to loose
- Underwriting Direct and Indirect the same
- Using Co-Signers as a Safety Net
- Appropriate payment and collateral for young borrowers
- Not effectively balancing borrower risk and collateral risk
- Cross-Selling into larger losses on Higher-Risk Members

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Looking for more tips, tools, and best-practices?

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Questions?

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