WELLS FARGO

Credit Decisioning: A Lender's Perspective

Oct 24, 2019

Webinar Objectives

- Explore basic principles of lending
- Review key learnings from the credit score webinar presented by Gigi Ligons of FICO
- Share the 5 primary factors banks consider when making lending decisions
- Review common concepts and ratios considered in lending decisions (DTI and LTV)
- Examine unique considerations by loan product type:
  - Credit Cards
  - Auto
  - Mortgages

Speakers

Navneet Jain

SVP Credit Risk Management, Wells Fargo Credit Cards

Prior experience: Capital One, HSBC, Transunion, Barclays

Stefano Balistreri

Manager of Credit Risk Indirect Originations Policy & Criteria, Wells Fargo Auto Lending

20 years credit risk experience (5 in Credit Card Line Management and 15 years in Auto Originations Credit Risk Strategy)

Mike Schimek

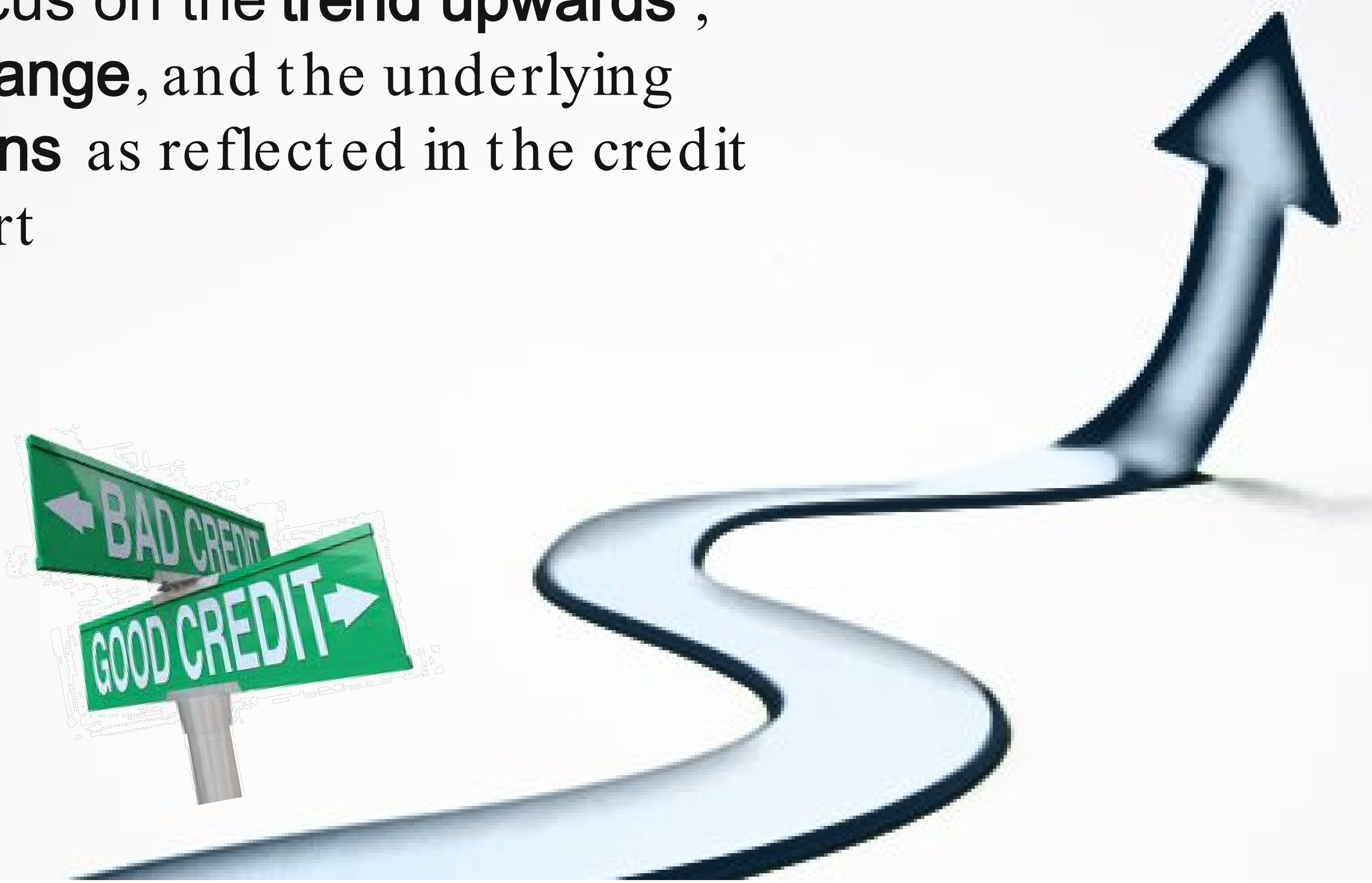
SVP Credit Risk Management, Wells Fargo Home Mortgage

22 years credit risk experience; responsible for the creation and implementation of credit strategies and credit policies

Whatis your perception of borrowing money?

Scores are important but are only part of the credit story

…focus on the **trend upwards** , the **range**, and the underlying **actions** as reflected in the credit report

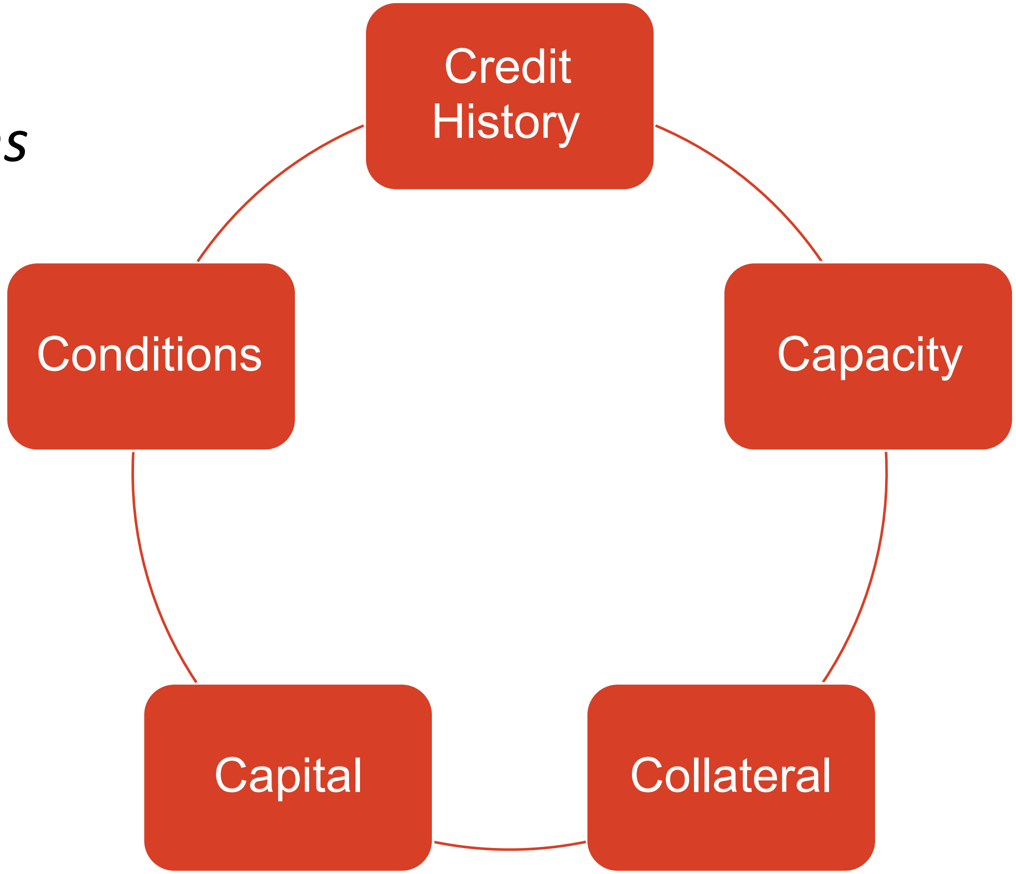


Lenders use several inputs to reach a decision and provide a rate

Bureau Score	Custom Score	Lender Policy	Decision and Rate
Considers only the information on the credit report	Generated by the lender. Considers characteristics specific to the asset class or loan type	For example: Type of residence Length at residence Type of employment Length employment Income Relationship	Credit approval Risk-based pricing Credit line or loan amount

The 5 C's of Credit

Lenders typically use the 5 C's of credit as the core considerations for making a lending decision



A key input to the decision process is the credit report

- The same items that drive the FICO score are used by lenders as input to their decisioning

- Lenders pull select information from the credit report into their systems and decisioning models for both automated and judgmental processes

- Lenders leverage elements of the report differently based on their models and experience

Red Flags
- Recent late payments and missed payments
- Mortgage default
- Bankruptcy
- Shopping for credit
- High balance on a credit card
- Using too much of available credit (utilization)

The type of credit requested influences the decisioning process

Revolving vs Installment Credit

Revolving Credit

With *revolving* credit, as you pay the money back, your credit becomes available for you to use again and again. Credit cards and other lines of credit are called revolving credit.

Installment Credit

With *installment* credit, you borrow the money once and repay the lender in equal amounts over a fixed period of time. Examples include auto loans, student loans and mortgages.

Secured vs Unsecured Loans

Secured Loans

Secured loans and credit cards are credit products backed by an asset such as a home, car, or savings account. The asset is collateral, which means it may be claimed by the company issuing the loan or card if the account holder fails to make the necessary payments.

Unsecured Loans

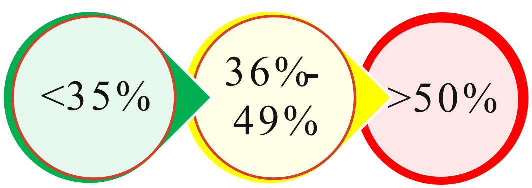
Unsecured credit cards and loans do not require collateral. *Secured* credit is typically easier to obtain and will have lower rates than *unsecured* credit because there's less risk to the lender.

Important to understand a few commonly used metrics

Debt to Income Ratio (DTI)

Canyou afford to take on another payment?
Canyou afford to borrow more?

Monthly debts/ obligations	÷	Monthly gross income	=	Debt-to-income ratio
$1,100	÷	$2,600	=	42%



Percentages provided for illustrative purposes only; acceptable DTI level will differ by lender and product

Loan to Value (LTV)

How much are your borrowing compared to the value of the asset that will secure your loan?

$$\text{LTV Ratio} = \frac{\text{Loan Amount}}{\text{Asset Value}}$$

- Indicates risk to the lender; high LTVs are riskier than low LTVs
- Influences the approval rate; low LTVs are more likely to be approved
- Often impacts the interest rate; low LTV loans may receive a lower rate than high LTV loan

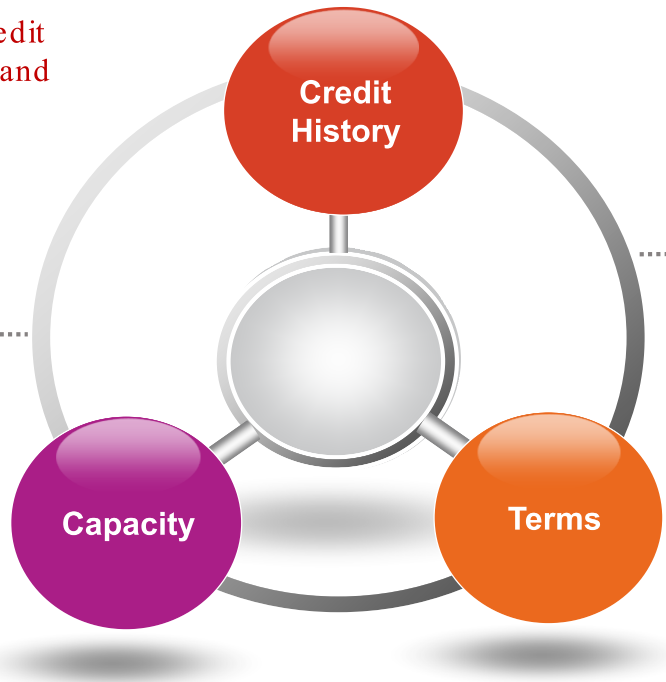
Credit Card Considerations

Credit Card Considerations

Key credit extension decisions over the credit card lifecycle

Credit & Fraud Review → APR Assignment → Initial Credit LIne → Balance Transfer → Credit Line Increase → Product Upgrades

- Willingness to pay
- Breadth, depth and quality of credit experience (with both revolving and installment credit)
- FICO and custom credit scores
- Propensity to use



- Ability to pay
- Emphasis on stable income and disposable income
- Existing financial obligations and non-discretionary living expenses
- Regulatory requirement (CARD Act)

- Secured vs. Unsecured
- Private label vs. Co-branded vs. General Purpose Bank-branded Cards
- Rewards (redeemable points), Platinum No-Rewards (lower rate)
- Balance transfers to enable lower rate debt consolidation
- APR – Promotional, Purchase, Cash
- Credit Line – Purchase, Balance Transfer, Cash, Over limit Authorizations

Auto Lending Considerations

Channels of Auto Lending

Obtaining an auto loan is generally done one of two ways:

1. **Indirectly,** through a dealership with the help of the finance manager or dealership employee. This is the most common approach.
2. **Directly** through a bank branch or financial institution either in person or online. This is less common and may require a current relationship with bank/financial institution.

Indirect Auto Loan Process (most common)

– Customer enters the dealership to look for a car
– Dealership employee will ask what car/type/price range customer has in mind
– Dealership employee will ask how the customer intends to pay for the car (cash or if they need financing)
– If financing needed, will get signed permission to pull credit bureau
– Credit application is filled out by the customer
– The dealership has relationships with multiple lenders. Based on the credit characteristics and loan structure, the dealer will send same application to lenders of their choosing
– Decision, rate terms and stipulations are returned back to the dealership from the lenders
– Customer signs contract and leaves with their new car

Unique Risk Considerations of Auto Lending

Credit Experience	Ability to Pay	Loan Structure	Collateral
• In addition to custom and FICO scores, other specific credit experience is considered • Relative credit depth • Prior Auto/Installment history (comparable credit) • Time since derogatory event	• Although it is quite often that auto loans are booked based on stated income, the higher the credit risk the increased likelihood for proof of income is needed • Loan payment to income is an important measure, in addition to the overall debt to income • Cash down (commitment) • Payment amount compared to prior auto payment amount	• There are wide ranges of loan structures which greatly change the risk of the loan • Loan term (36-72 months) • LTV – lenders typically use wholesale value (the amount you'd get by trading in the car or at an auction) • Total $ amount financed • Backend products (typically vehicle service contract) • Negative equity – the amount carried over from previous auto loan	• The reliability of the auto and how well it holds its value are important • Make/model • New/Used • Year/age • Mileage • Dealership (Franchise vs Independent)

Other Considerations:

- The number of open auto trades is considered, a requirement to trade in an open auto may occur
- Having a co-applicant to supplement the credit risk and increase ability to pay is common
- A phone interview may be required by some lenders

Home Lending Considerations

Home Lending Considerations

Credit History

Established with a demonstrated ability to manage credit

- Credit report
  - Traditional credit - mortgage payments, auto loans, credit card payments
  - Non-traditional credit - rental payments, utilities, insurance payments
  - Adverse credit - late payments, bankruptcy, foreclosure (waiting periods/additional documentation)
    - One-time event or history of delinquency

Ability to Repay

Employment/Income - stability (regular, verifiable, reasonable expectation of continuance)

- Primary and second job
- Non-wage earner (Public assistance, child support, pension)
- W2's, paystubs, tax returns, awards letters

Capacity – analysis of monthly liabilities relative to monthly income

- Two principal metrics:
  - Ratio of housing payment to monthly income
    - Principal/interest/taxes/insurance/association dues (PITIA), Mortgage insurance
  - Ratio of total debts to monthly income
    - Credit cards, auto loans, student loans
- Liabilities not evaluated - Cell phone, auto insurance, installment debt < 10 payments remaining

Assets – source and demonstrated ability to save

- Down payment - minimum down requirement varies between products
- Own funds - bank/brokerage statements, retirement accounts, second mortgages
- Gift funds/gift of equity, down payment assistance, grants
- Reserves - assets available after closing

Considerations related to income types and capacity are illustrative and may differ by lender

Home Lending Considerations

Collateral

Determines lendable value of property

- Generally required to be completed by a licensed appraiser
- Property specifics – number of units, condition, location, style
- Automated valuations

Settlement Costs

Additional costs beyond down payment when obtaining a mortgage

- Escrows- taxes/insurance
- Title insurance - verify liens, encroachments,
- Discount points, seller paid closing costs

Products / Programs

Various products, loan terms and features available

- Conforming, Non-Conforming, FHA, VA, USDA
- Maximum LTV varies per product
- Fixed rate and adjustable rate

Q&A

Thank you