



Assuring Consumer Protection and Prudent Lending

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Creditinfo – 2014

The Challenge of Balancing Important Factors

Bank Regulation



Consumer Protection



Lending for Economic Growth



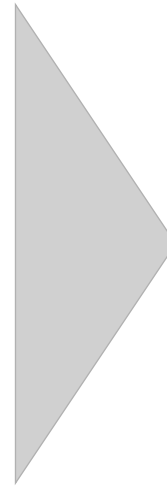
and finding the correct balance



Summary – Debt to Income (DTI) and Affordability

DTI and Affordability are frequently included in Consumer Protection “Guidelines” in Europe and USA.

DTI and Affordability can be inconsistent in calculation and is a poor predictor of real probability of payment



Affordability is useful as it is easily understandable to the public so as supportive recommendation it can be seen as a positive step

For Prudential Regulation and control of portfolios, credit scores prove much more effective.



CONSUMER PROTECTION



BANK REGULATION

Contents

Movements of consumer protection across Europe through Affordability and DTI



What the analysis reveals about comparative methods and how Scorecards will provide greater risk control than DTI

A screenshot of a web dashboard titled "Creditinfo Report Plus" for a user named "Anna Carolina Good". The dashboard includes several sections: "Creditinfo Predictor (CIP)" showing a grade of "B1" and a score of "289"; "Creditinfo Quest (CIQ)" showing "0" fraud alerts; "Contracts" with a "Payments Profile" table showing metrics like "Past Due Amount Sum" (GYD 100,000) and "Outstanding Amount Sum" (GYD 708,065); "Affordability and Over-indebtedness" with a score of "5"; "Relations" showing "0" known relations; "Inquiries" showing "9" inquiries; and "Disputes" showing "4" active disputes. Each section has a "VIEW" link.



Europe / US and Affordability

Two events, in the last 8 years, have triggered regulatory action for consumer protection

Sub prime housing bubble



Pay day loans and Internet Loans Bubble,
providing short term, high cost loans to income groups



Housing Bubble Created
an Initial Focus on Affordability
in UK and USA Mortgage Markets



**Mortgage loans are clearly
a long term burden
on an individuals income
and they should be aware
of the impact**

UK -Office of Fair Trading

DTI and Affordability requirements primarily driven by Office of Fair Trading a consumer protection body

- “Assessing affordability’, in the context of this guidance, is a ‘borrower-focussed test’ which involves a creditor assessing a borrower’s ability to undertake a specific credit commitment, or specific additional credit commitment, in a sustainable manner, without the borrower incurring (further) financial difficulties and/or experiencing adverse consequences.**

Source: Irresponsible Lending - OFT guidance for creditors

USA – Mortgage

Ability-to-Repay rules

On 10 January 2013, the Consumer Financial Protection Bureau implemented a new set of rules designed to address predatory lending practice.

A provision in the rule requires that borrowers' debt should not exceed a total of 43 percent of their gross income.



Lenders have flexibility to make exceptions for buyers with:

- excellent credit scores
- significant assets or
- extenuating circumstances that make it difficult to verify income.

The Baltics Driven by Internet Loans Explosion - Lithuania

Steps and Regulations have been introduced to protect individuals by Central Bank of Lithuania, due to a high proliferation of Internet short term lenders

Step 1	Access to SODRA (State Social Insurance Fund) , the salary tax database
Step 2	Guideline of Debt to Income Net of Financial Obligations ratio of 40%



In reality, short term loan providers, will make a 12 month offer that meets the guidelines, but the customer preferring to have a short term loan will then pay back in 3 months

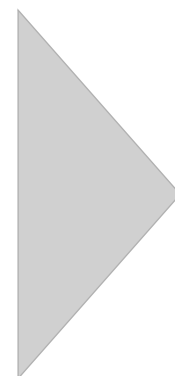
Latvia

Similarly over the last 5 years, an “invasion” of short term lenders has led to concerns about over indebtedness.

There are concerns that this has been fuelled by protectionist measures by the banks.

Thus “Credit Liabilities against Income Ratio” has been introduced by the Consumer Rights Protection Centre (CRPC).

Band 1	minimum income	10% maximum
Band 2	1 – 3 minimum income	30% maximum
Band 3	3+ minimum income	40% maximum



Rules must be enforced unless risk can be demonstrated otherwise, typically done through demonstration of credit scoring cut-offs and identified risk.

Others

Turkey	For consumer protection a loan is generally 30% of take home pay. Maximum indebtedness is 75pct of take home pay. Although, collateral may be used to override these ratios.
Finland	In July 2013 Finland introduced a maximum APR of 51% to reduce the impact of the pay day loan expansion and other short term loans

Prudential Regulation – Scoring Preeminent Approach

For retail lending scoring continues to be the preeminent solution for assessing retail credit.

Ensuring the portfolios are of controlled risk, as required through Basel II / III Internal Rating Based approach.

Pillar 3 Disclosure



Credit risk

” *Retail businesses - each customer account is separately **scored using models based on the most material drivers of default**. In general, scorecards are statistically derived using customer data. Customers are assigned a score which in turn, is mapped to a probability of default. The probabilities of default are used to support automated credit decision making and to group customers into risk pools for regulatory capital calculations.*

USA – Using Credit Scores for Mortgage Regulation

One of the key regulators is the Office of the Controller of the Currency (OCC) which takes the following approach for mortgage regulation:

Definitions and Methods

The OCC Mortgage Metrics Report uses standardized definitions for three categories of mortgage creditworthiness: prime, Alt-A, and subprime.

These are defined using ranges of credit bureau credit scores at the time of origination, as follows:

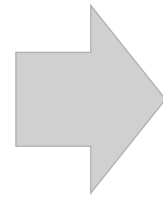
- prime — 660 and above
- Alt-A — 620 to 659
- subprime — below 620



Our goal in supervising banks and federal savings associations is to ensure that they operate in a safe and sound manner

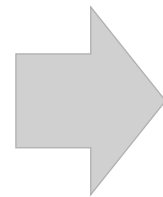
Income Verification – Undermining DTI / Affordability

Income and outgoing data can be fashioned by the applicant to achieve acceptance



Costly face to face interviews and obtaining and analyzing in more detail is an alternative, but it is costly and customers resist it.

Consistency of collection is difficult especially for handling of bonus and irregular payments, unofficial income and calculations of income for self employed.



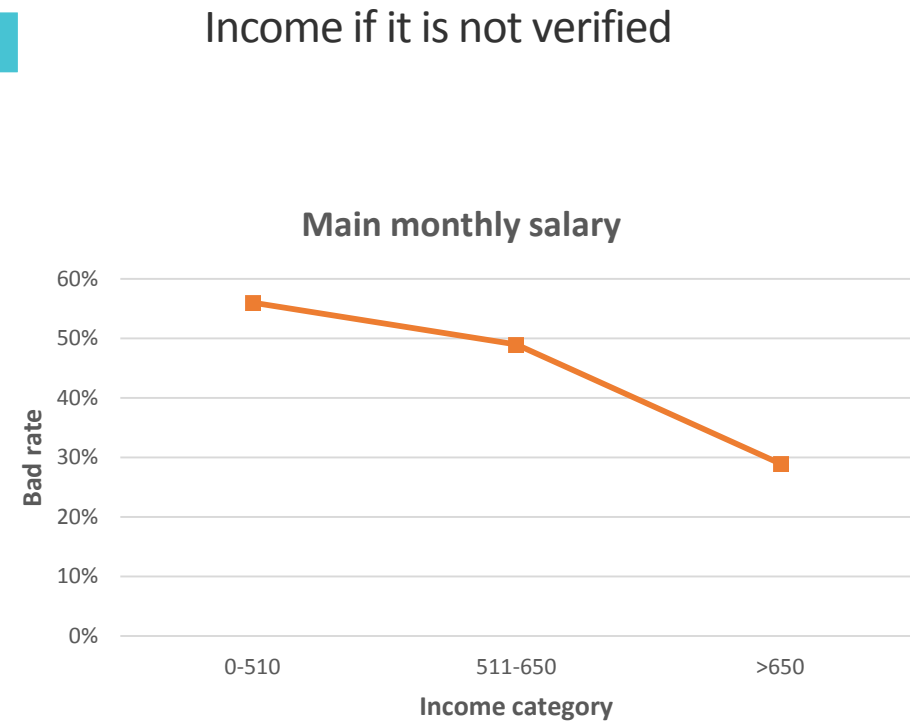
Should the customers word be taken on unofficial income?

Income – Verification Problems

Although validated income is not highly predictive, un-verified income frequently has no predictive power indicating that it has little validity



Income if it is verified



Lithuania – Efforts to Improve Income Validation



STATE SOCIAL INSURANCE FUND BOARD OF THE REPUBLIC OF LITHUANIA
UNDER THE MINISTRY OF SOCIAL SECURITY AND LABOUR

Creditinfo Lithuania lobbied SoDra to eventually provide access to the tax salary data for the benefit of the credit industry

Ability to pay is not the same as willingness to pay.



UK - Current Account Turnover Income Estimates

UK retail banks share credit turnover (CATO) on current accounts through Credit Reference Agencies.

The use of this data is controlled by a British Bankers Association Forum.

The CATO Warning Flag allows income provided as part of an application process to be verified based on current account turnover.

Value	Description	Applicant Supplied Income As % of Income Estimates
1	Supplied Income Significantly Overstated	> 150%
2	Supplied Income Overstated	111% - 150%
3	Supplied Income Consistent with CATO income estimate OR Supplied Income lower than CATO income	0 – 110%

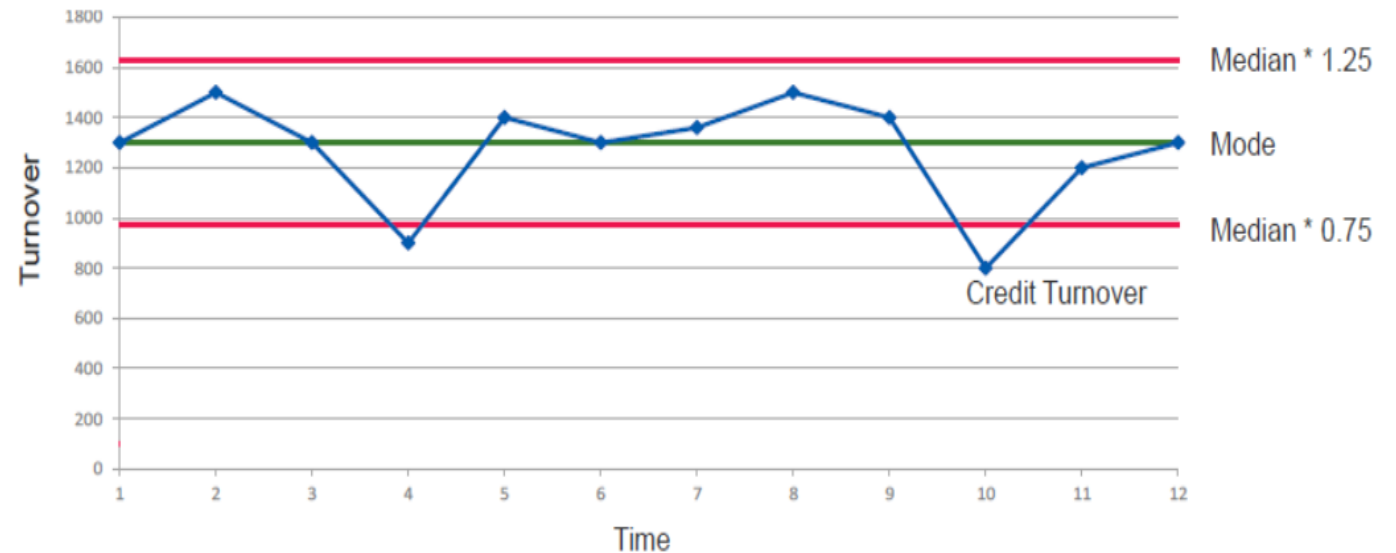
UK - Current Account Turnover Income Estimates

Individual banking relationships can be complicated and this means that income estimation is not trivial.

Algorithms defined for several key segments to account for:

- Single / multiple accounts
- Sole / joint accounts
- Stable/fluctuating/irregular credit turnover (not stable for around 40-50% of accounts)

CATO income estimates available for main applicant, joint applicant/SPA and family economic unit (FEU)



Georgia - Income Estimates Validation

In Georgia, the credit bureau on behalf of the financial institutions hold a shared database of incomes provided by customers in applications.

New applications are compared against historic applications.

Where there is a substantial difference this is highlighted as likely to be an exaggeration.

CREDIT BUREAU GEORGIA CREDITINFO QUEST ALERT			
Date of validity	5/15/2012		
CURRENT SUBJECT DATA			
Personal information			
National ID	02021202	Date of birth	10/21/1980
First name	Justin	Date of last update	1/2/2012
Surname	Timberlake	Borrower classification	Individual (physical person)
Gender	Male		
Marital status	Single		
CIQ ALERT SUMMARY INFORMATION			
Input salary		Summary	Fraud Alert
	12,000.00 GEL	Difference against latest salary	60%
DETAILED INFORMATION			
Salary record			
Previous salary	7,500.00 GEL	Date registered	5/14/2012
Record type	CIQA history information	Information source	B01
Salary record			
Previous salary	7,500.00 GEL	Date registered	5/14/2012
Record type	CIQA history information	Information source	B01
Salary record			
Previous salary	7,500.00 GEL	Date registered	5/14/2012
Record type	CIQA history information	Information source	B01
END OF CREDIT REPORT			
Date of issue:	5/15/2012		
JSC `CreditInfo Georgia` 13, Mosashvili str. 0162, Tbilisi, Georgia; Tel/fax: (+995 32) 262 35 55; Email: info@creditinfo.ge			

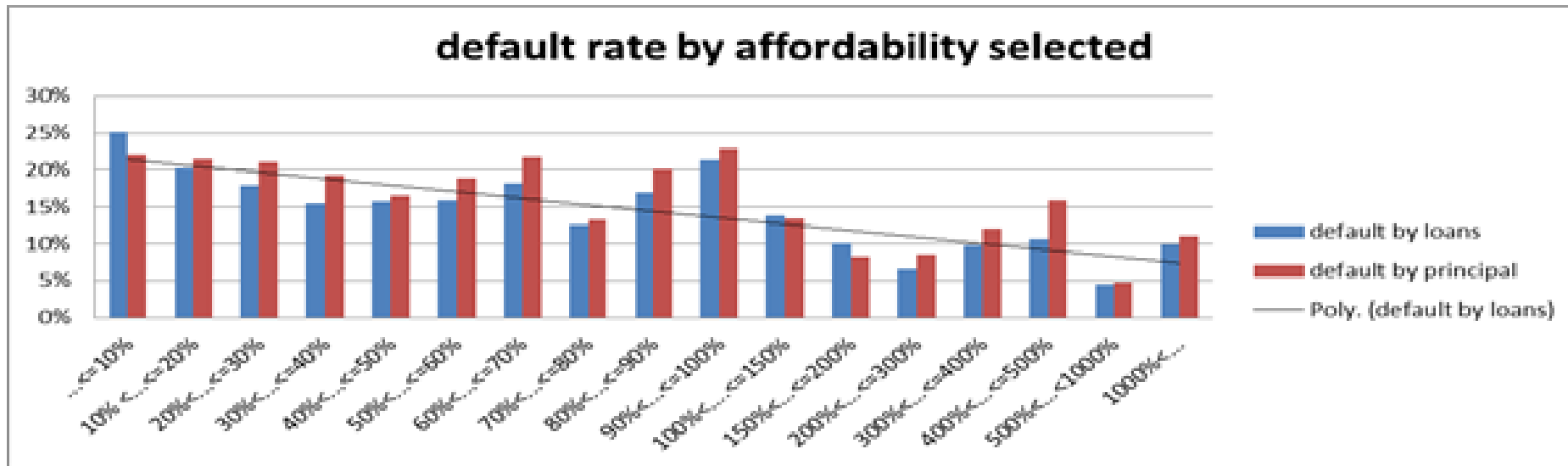
Latvia – Submitted Evidence

**This evidence for using scoring over DTI was submitted by a lender in Latvia
Default rate trends down where *financially more educated* customers (defined by score)
have decided to select more aggressive repayment**

Lenders offers loans that follow the “Credit Liabilities against Income Ratio” suggested by the CRPC,

Customers are in some cases also interested in choosing more aggressive repayment schedule
(main reasons being: to save in interest costs, short term need of funds, other extraordinary sources of income)

Evidence on consumer behavior prove that customers who proactively choose a more aggressive repayment schedule are of less risk



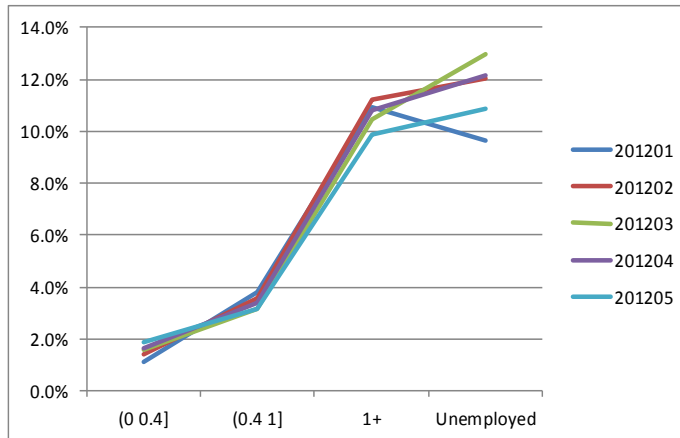
Lithuania – Submitted Evidence

The evidence generated from the credit bureau using the actual Taxable Income demonstrates that for Short Term Loans DTI has little significance less than 100%.

Even for Consumer Loans only at Very High levels does it demonstrate significant risk

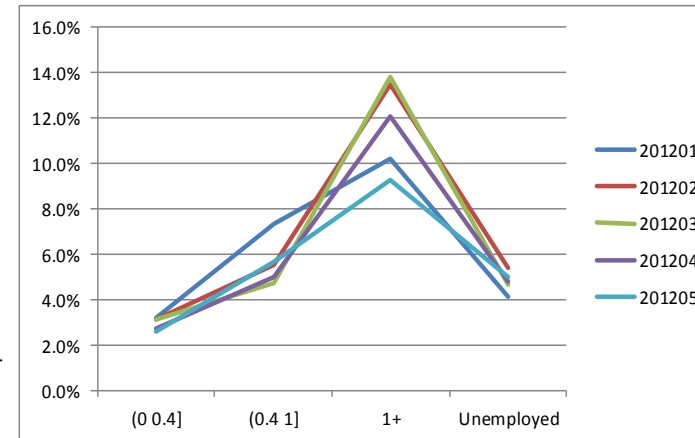
RISK (90d+ per 12 mėn) BY DTI

Quick Loans



Mėnesis	(0.0-0.4)	(0.4-1)	1+	Unemployed
201201	1.1%	3.8%	10.9%	9.6%
201202	1.4%	3.6%	11.2%	12.0%
201203	1.6%	3.2%	10.5%	13.0%
201204	1.6%	3.4%	10.8%	12.1%
201205	1.9%	3.2%	9.9%	10.9%
201206	1.5%	4.3%	10.9%	12.3%
201207	2.1%	4.0%	11.9%	12.8%
201208	1.9%	4.2%	11.2%	12.5%
201209	1.0%	3.5%	10.4%	10.5%
201210	1.0%	3.2%	9.7%	9.3%
201211	1.1%	2.8%	10.1%	11.6%
201212	0.7%	2.5%	9.7%	12.3%
201301	1.0%	2.6%	9.7%	12.0%
201302	0.8%	2.2%	7.8%	9.9%

Consumer Loans



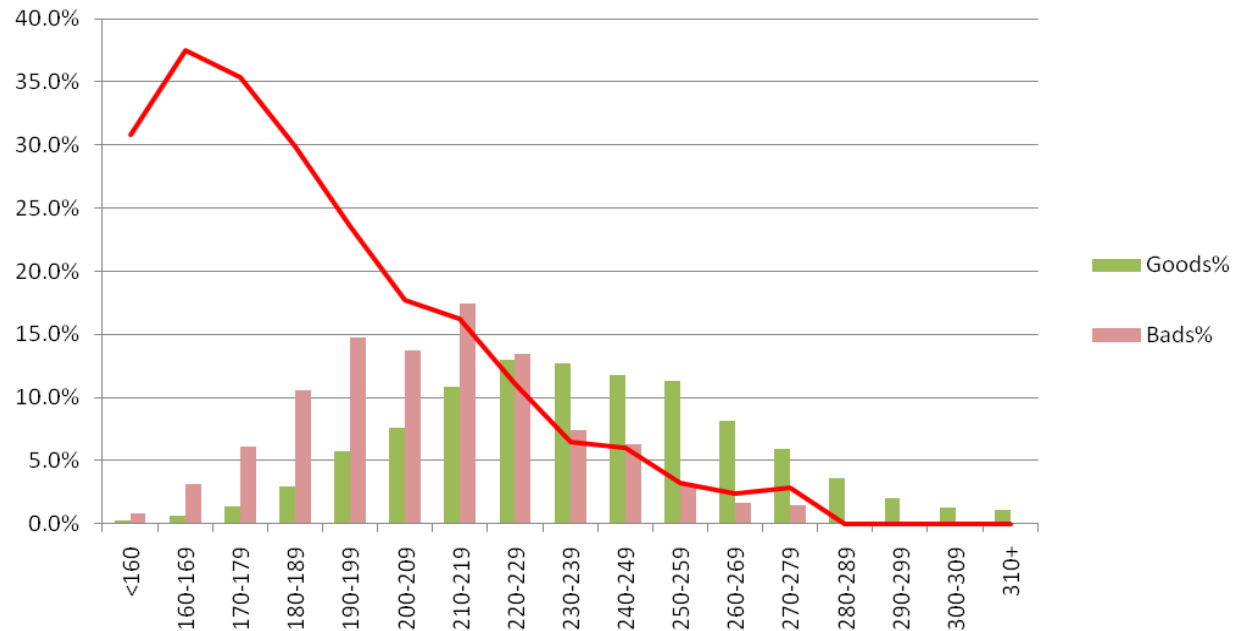
Mėnesis	(0.0-0.4)	(0.4-1)	1+	Unemployed
201201	3.2%	7.4%	10.2%	4.2%
201202	3.2%	5.5%	13.5%	5.4%
201203	3.1%	4.7%	13.8%	4.7%
201204	2.7%	5.0%	12.1%	4.8%
201205	2.6%	5.6%	9.3%	5.0%
201206	2.3%	4.5%	7.9%	4.3%
201207	2.6%	3.8%	10.0%	4.8%
201208	2.1%	5.0%	6.6%	4.0%
201209	2.4%	4.2%	10.0%	3.7%
201210	2.1%	4.1%	10.0%	5.0%
201211	2.2%	4.2%	6.6%	5.1%
201212	1.3%	3.0%	7.1%	2.8%
201301	1.5%	2.2%	4.6%	3.9%
201302	1.3%	2.0%	6.0%	2.8%

Ukrainian Bank – Consumer Loan Portfolio

The Ukrainian Bank gathered PTI and identified that there was increasing risk with higher PTI, however, opportunities for lending at all levels

Name:	PTI		
Gini:	19.05		
Group		Bad Rate	
<10		8.9	
10-14.9		6.1	
15-19.9		7.0	
20-24.9		11.6	
25-29.9		11.0	
30-39.9		15.6	
50+		10.7	
Total		11.0	

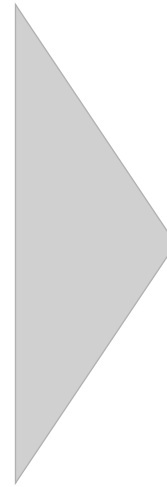
For the same Bank, the scorecard has significant higher predictive power at Gini 55 than the PTI



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THE END

