Data-Mined Auto Loans: Not Your Grandfather's Subprime Lending

The Filene Research Institute recently issued a report, Reaching Minority Households Incubator, of which Ser Tech was a proud participant. We partnered with the National Credit Union Foundation to build a platform of advanced data mining to bring to the surface low-credit score households with a vehicle loan that could benefit from refinancing high-priced auto loans at a credit union.

Each credit union set its parameters regarding credit score ranges, recent bankruptcies and other various attributes, and Ser Tech used its robust credit database to identify members who had car loans at other institutions. We then reached out, on behalf of a handful of credit unions, to potential program recipients via direct mail and e-mail announcing they were prequalified for the refinance opportunity. If approved, recipients could refinance their car loans to lower their payments. Ser Tech then provided detailed reports to the credit unions to allow them to follow up on the touchpoints.

> ***Want to learn more about growing and diversifying your loan portfolio? Click here to register for our Oct. 11 webcast!***

Once the potential borrower was approved and ready to sign, the credit union was asked to use a hard close for nonprime loans. Mark Lynch, former senior program director at the Foundation, explained this in our earlier blog, Nonprime Auto Lending Is Something Credit Unions Should Be Doing.

1. Remind the member of how the credit union helped set the borrower up for success.
2. Also remind them the credit union is lending other members' money, so the borrower feels a greater obligation to pay the loan back.
3. Acknowledge that bad things happen to good people, and the borrower should be proactive if something comes up.
4. Do not offer a grace period.
5. The credit union should call the first day it's late.
6. If they can't pay, then repossess the vehicle.

STANDARDIZED INCOME STATEMENT FOR DMALs, 2016–2017

	Dollar amount (1)	As a percentage of loan volume (2)
1. Loan volume	3,547,671	
2. Interest income	255,787	7.21
3. Interest expense (cost of funds)	30,155	0.85
4. Loan losses (actual and/or expected)	51,796	1.46
5. Noninterest income	4,967	0.14
6. Noninterest expense	153,259	4.32
7. Net interest income (row 2 – row 3)	225,632	6.36
8. Net interest income after loan losses (row 2 – row 3 – row 4)	173,836	4.90
9. Net income (ROA)	25,543	0.72

Source: Filene RMH Surveys (2018).

For the Foundation program, we asked the participating credit unions to clearly walk through terms and conditions of the loan, options if they expected to miss a payment, and to send reminders of upcoming payments.

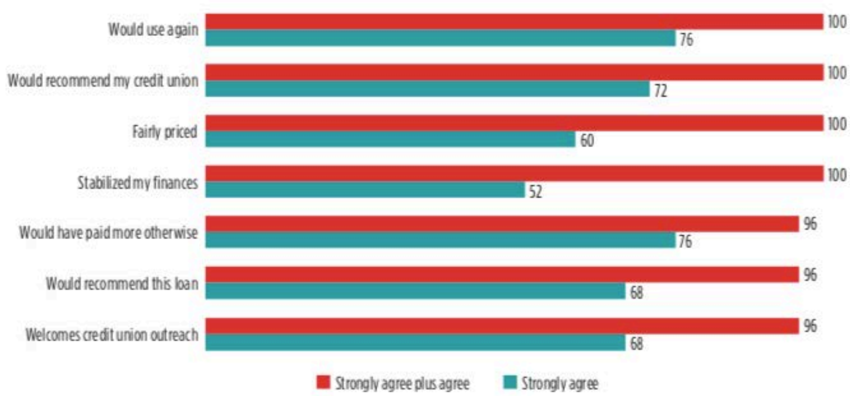
The performance of the data-mined auto loans was highly inconsistent among the test credit unions. We believe the variance was due to level of experience with nonprime loans, commitment to the program, willingness to loan below a 640 credit score and other factors. Still, the top performing credit unions earned ROAs of 4.79% and 7.26% on their DMALs.

Pricing is a key issue with making nonprime auto loans. Two credit unions actually experienced losses because the interest rates were priced far too low for the risk and expense. Those that were successful had average interest rates of 11.20% and 16.95%, versus the credit unions that experienced losses at rates of 5.73% and 5.92%.

> ***Ser Tech can help your financial institution diversify and grow. Click here to attend our webcast and learn more!***

Lenders must also look beyond the credit score to character-based lending and other tools to arrive at an approval. Consider factors such as the borrower's history with the credit union, payment history on car loans, stability of employment, residence history and the ability to employ payroll deductions for repayment. Credit disability/life protection, GAP programs, breakdown insurance and other coverages to keep the vehicle, and its payments, up and running. Incentives can also help ensure timely repayment, such as interest rate reductions after a certain period of on-time payments.

PERCENTAGE OF CONSUMERS AGREEING WITH (POSITIVE) STATEMENTS ABOUT DMALs



Source: Filene RMH Surveys (2018).

Consumers approved of the program, and it helped credit unions reach more minority households (62% of borrowers self-identified as minority). Most said they'd recommend the credit union to a friend and would use the product again themselves. Minority households reported more favorable experiences than nonminority households, the biggest difference being the program's ability to improve a consumer's credit score (64% of minority households felt DMALs helped compared to 38% of nonminority households). In data-mined auto loan borrower's own words, "The auto loan had a significant impact on my life. At the time of my loan I was going through a difficult financial situation and the loan relieved a lot of stress."

Ruby Alvarez, CEO of GECU, which was successful in the program, said, "This program aligns well with GECU's core values and our 'people helping people' philosophy. These families rely on their own transportation to get themselves to work and children to school and this loan program helps make transportation a reality for many. This program truly benefits our membership by significantly enhancing their confidence and quality of life."