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Risk & Compliance Solutions | Office Hours

Lending risk landscape

Navigating the changing dynamics

Today’s session

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What’s on tap?

Lending challenges

- Account takeover fraud
- Auto loan fraud
- New variations of online loan fraud
- Alternative data
- Synthetic ID fraud
- Consumer protection

Shifting expectations

Increased automation & digitization

Hyper-personalized, proactive advice & pricing

Engaging & dynamic member experience

More choice to interact

More watchful eyes

Trends reshaping the process

- Increasing fraud trends - indirect and online lending
- Repossessions trending upward in 2024
- Alternative data and it's impact on credit underwriting
- Hyper-personalized advice and pricing - artificial intelligence and machine learning
- Lending compliance

Lending litigation trends

- Fair Credit Reporting Act
- GAP
- Defective post-repossession notices
- Fair lending

There has been a lot of news about the recent AT&T data breach and the potential impact on loan fraud.

What should we be on the lookout for?

Synthetic ID theft

- Fraudster combines real information (usually stolen), including a real SSN, and fake information to create a new identity/credit profile, which is used to open fraudulent accounts/obtain loans
  - Use SSNs belonging to children, the elderly, the incarcerated, and the homeless
  - Individuals are less likely to use credit or regularly check their credit
- Scheme to boost credit score for a synthetic identity which opens up more loan fraud opportunities
- Fraudster becomes an authorized user on a long-standing/good-paying revolving account (e.g., credit card)

Unfortunately, Synthetic ID theft is difficult to detect

Characteristics of synthetic identity fraud

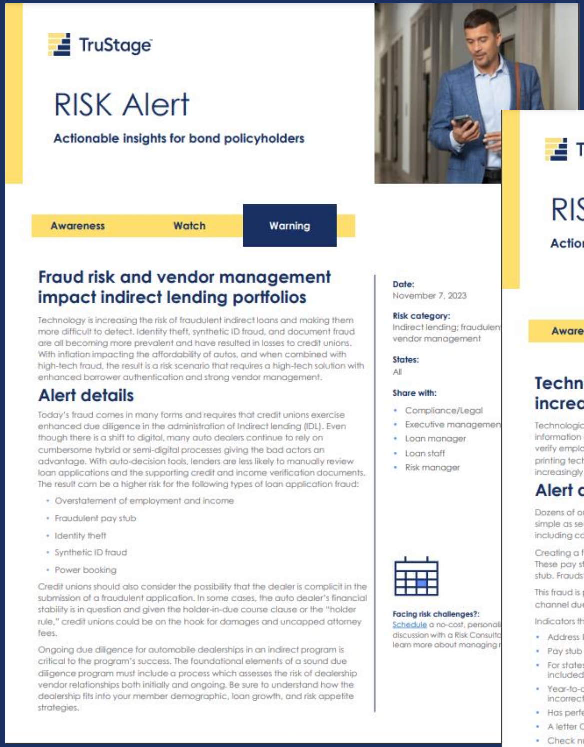
- Performing synthetics
- Staging synthetics
- Criminal synthetics

Intend to pay

Staged for legitimacy

Accumulation – bust-out

Online loan application fraud trends



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RISK Alert

Actionable insights for bond policyholders

Awareness | Watch | **Warning**

Fraud risk and vendor management impact indirect lending portfolios

Technology is increasing the risk of fraudulent indirect loans and making them more difficult to detect. Identity theft, synthetic ID fraud, and document fraud are all becoming more prevalent and have resulted in losses to credit unions. With inflation impacting the affordability of autos, and when combined with high-tech fraud, the result is a risk scenario that requires a high-tech solution with enhanced borrower authentication and strong vendor management.

Alert details

Today's fraud comes in many forms and requires that credit unions exercise enhanced due diligence in the administration of Indirect lending (IDL). Even though there is a shift to digital, many auto dealers continue to rely on cumbersome hybrid or semi-digital processes giving the bad actors an advantage. With auto-decision tools, lenders are less likely to manually review loan applications and the supporting credit and income verification documents. The result cam be a higher risk for the following types of loan application fraud:

- Overstatement of employment and income
- Fraudulent pay stub
- Identity theft
- Synthetic ID fraud
- Power booking

Credit unions should also consider the possibility that the dealer is complicit in the submission of a fraudulent application. In some cases, the auto dealer's financial stability is in question and given the holder-in-due course clause or the "holder rule," credit unions could be on the hook for damages and uncapped attorney fees.

Ongoing due diligence for automobile dealerships in an indirect program is critical to the program's success. The foundational elements of a sound due diligence program must include a process which assesses the risk of dealership vendor relationships both initially and ongoing. Be sure to understand how the dealership fits into your member demographic, loan growth, and risk appetite strategies.

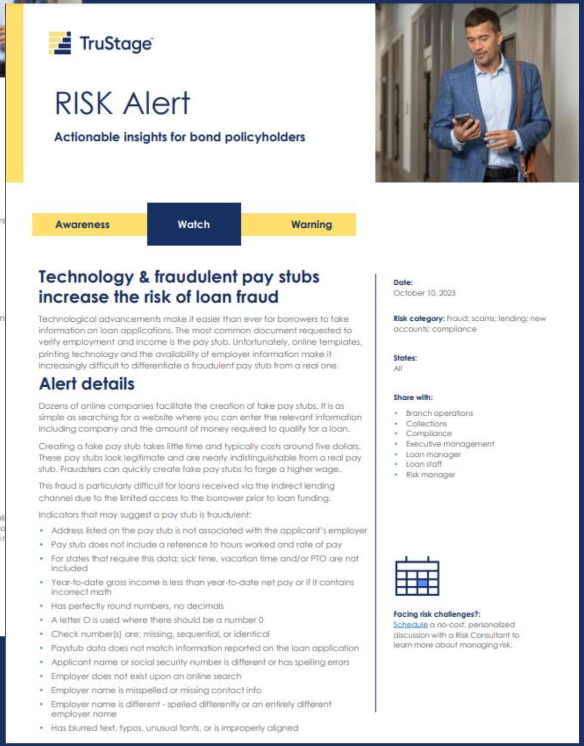
Date:
November 7, 2023

Risk category:
Indirect lending; fraudulen
vendor management

States:
All

Share with:
- Compliance/Legal
- Executive managemen
- Loan manager
- Loan staff
- Risk manager

Facing risk challenges?:
Schedule a no-cost, personali
discussion with a Risk Consulta
learn more about managing r



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RISK Alert

Actionable insights for bond policyholders

Awareness | **Watch** | Warning

Technology & fraudulent pay stubs increase the risk of loan fraud

Technological advancements make it easier than ever for borrowers to fake information on loan applications. The most common document requested to verify employment and income is the pay stub. Unfortunately, online templates, printing technology and the availability of employer information make it increasingly difficult to differentiate a fraudulent pay stub from a real one.

Alert details

Dozens of online companies facilitate the creation of fake pay stubs. It is as simple as searching for a website where you can enter the relevant information including company and the amount of money required to qualify for a loan.

Creating a fake pay stub takes little time and typically costs around five dollars. These pay stubs look legitimate and are nearly indistinguishable from a real pay stub. Fraudsters can quickly create fake pay stubs to forge a higher wage.

This fraud is particularly difficult for loans received via the indirect lending channel due to the limited access to the borrower prior to loan funding.

Indicators that may suggest a pay stub is fraudulent:

- Address listed on the pay stub is not associated with the applicant's employer
- Pay stub does not include a reference to hours worked and rate of pay
- For states that require this data; sick time, vacation time and/or PTO are not included
- Year-to-date gross income is less than year-to-date net pay or if it contains incorrect math
- Has perfectly round numbers, no decimals
- A letter O is used where there should be a number 0
- Check number(s) are; missing, sequential, or identical
- Paystub data does not match information reported on the loan application
- Applicant name or social security number is different or has spelling errors
- Employer does not exist upon an online search
- Employer name is misspelled or missing contact info
- Employer name is different - spelled differently or an entirely different employer name
- Has blurred text, typos, unusual fonts, or is improperly aligned

Date:
October 10, 2023

Risk category: Fraud; scams; lending; new accounts; compliance

States:
All

Share with:
- Branch operations
- Collections
- Compliance
- Executive management
- Loan manager
- Loan staff
- Risk manager

Facing risk challenges?:
Schedule a no-cost, personalized discussion with a Risk Consultant to learn more about managing risk.

- Newest twist on identity theft – fake employers and fake employment/ income verification
- Credit washing
- Credit repair companies
- Identity theft – everything correct, except email and phone, fake IDs with fraudster's photo

What recommendations do you have on how to mitigate fraud risks on indirect loans?

Indirect lending risks

- Leverage technology for fraud scoring and alerts
- Postmortem analysis on first and early payment defaults
- Dealer monitoring
- IDL – revisit dealer agreements to ensure to include recourse for fraud identified within the first 30-60 days

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Dealer Due Diligence

Risk overview

Working with auto dealerships as part of your indirect lending program can be an important and complex issue to manage. If handled poorly, your dealership relationships can have detrimental outcome on your bottom-line results.

Indirect lending can be one of the fastest ways to generate membership growth and grow your loan portfolio. Programs come in all shapes and sizes – working with few to many dealerships to contracting with a CUSO or a for-profit organization and many variations in between.

Ongoing due diligence for automobile dealerships in an indirect program is critical to the program's success. In fact, in situations where relationships were loosely managed and monitored, credit unions have seen some of the largest indirect lending-related losses caused by unscrupulous dealerships and their employees.

Examples of key red flags stemming from poor dealer management can include inadequate analysis of portfolio performance, high instances of default, reliance on the dealer to obtain credit reports; dealers accepting loan payments; dealer-created down payments through incentives, fraudulent purchases with inflated or fraudulent trade-in/purchase prices; and fraudulent activity involving applications.

The foundational elements of a sound due diligence program must include a process which assesses the risk of dealer vendor relationships both initially and ongoing. Be sure to understand how the dealership fits into your member demographic, loan growth, and risk appetite strategies.

It is important to have a clear understanding of the operational structure of the dealership and monitor the vendor's program administration, underwriting, and contract expectations. You should have a sound procedure in place to manage the relationship.

Critical factors to consider

These are some critical factor to consider when evaluating dealerships to become part of your indirect lending partnerships.

- Strategic alignment and credit union centricity
- Financial strength and commitment
- Ownership structure
- Fair marketing and lending processes
- Regulatory compliance
- Dealership complaints, compliance matters, and litigation issues
- Levels of customer service, loan performance, and follow-through
- Loan volume quality and efficiency

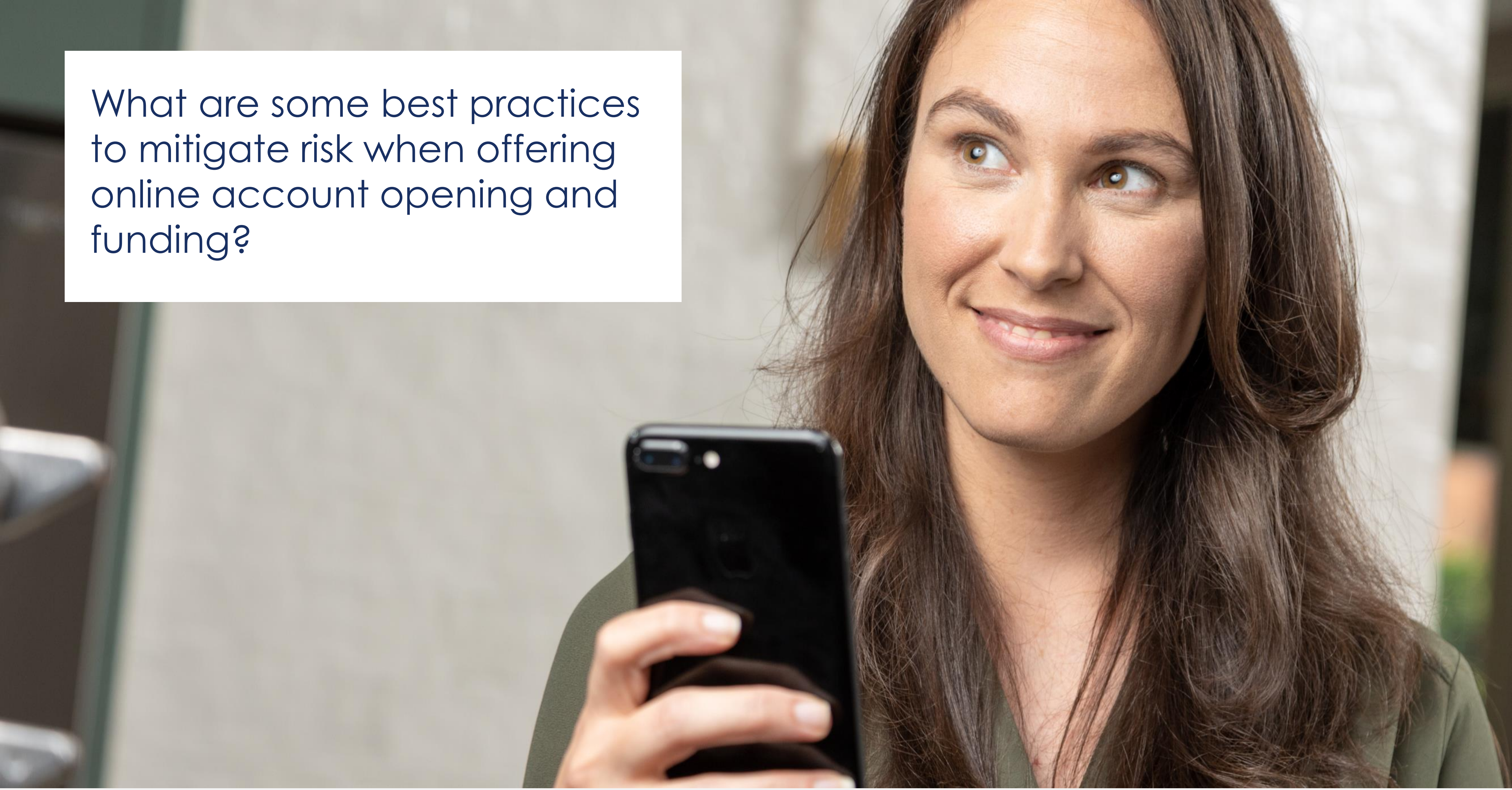
Portfolio monitoring

- Establish well-defined lending criteria and quality-control programs for each dealer
- Establish appropriate growth goals and concentration limits, along with minimum standards for creditworthiness, such as credit score & debt-to-income requirements
- Monitor the portfolio, such as performing a multidimensional portfolio analysis and static-pool analysis, to ensure they are meeting risk-tolerance levels
- Conduct dealership reviews regularly including on-site visits
- Take early action to revise the program when adverse performance trends occur

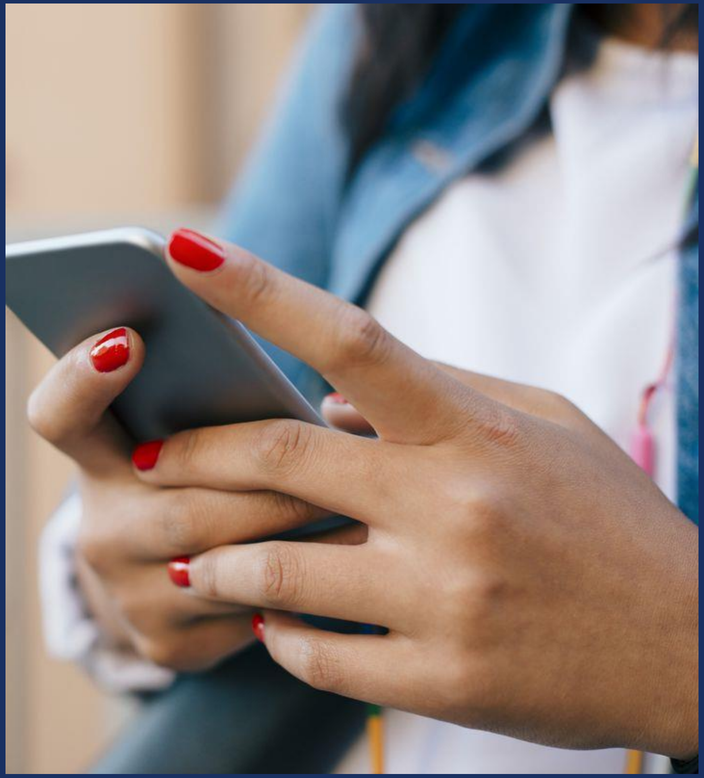
Questions to consider

- Does the dealer understand your expectations related to the loan portfolio and member eligibility?
- Franchise vs. non-franchise?
- Are facilities professionally maintained?
- How do they respond to complaints?
- Are financial reports stable, and free of red flags?
- What is the current licensure status?
- Has the ownership structure remained unchanged?
- Is business insurance up to date?
- Is finance staff trained on Fair lending compliance?

What are some best practices to mitigate risk when offering online account opening and funding?



Online account opening & funding



Risk mitigation strategies

- Deploy identity verification solution capable of detecting synthetic identities
- Enroll in the Social Security Administration's Electronic Consent Based Social Security Number Verification Service
- A subscription-based service that allows FIs to verify name, date of birth, and SSN combination against SSA's records
- Credit report review
- Send a welcome letter to new members
- Online account opening and funding
  - Avoid using the automatic approval feature
  - Establish reasonable ACH funding limit
  - Be alert for multiple accounts opened using the same IP address
- Extended check holds
- Waiting period for RDC and A2A/external transfer service, or
  - Lower limits for new members
  - Check holds
  - Holds on ACH deposits

What are the top-of-mind compliance issues for 2024?

- Climate risk as a component of loan pricing/ ESG
- Artificial intelligence (AI)
  - Credit union operations (back-office)
  - Member-facing services
  - Fraud risk
  - Fraud detection
  - Credit underwriting
- Consumer protection – regulating consumer outcomes (think UDAAP)
  - Misleading statements
  - Product promotions
  - Contract terms
  - Service charges/Fees
  - Pricing practices

Compliance risks & issues

Is collection letter and post-repossession notification no longer an issue?

Post-repossession notice mitigation

- Conduct legal counsel review
- Ensure the Notice of Disposition contains the 8 required items
- Use your state's version of safe harbor notice
- Confirm the Notice of Deficiency contains the
  6 required items in the required order
- Check & comply for variations of the model UCC for repossession activity in other states
- Train collections staff
- Audit notices periodically

We pull a credit report on all new members…what red flags should we look for?

Credit report red flags

- Mismatched address (indicative of accounts opened using stolen identities)
- Mismatched birth dates
- High number of credit inquiries
- High number of authorized user accounts (indicative of synthetic identity)
- High-risk credit bureau alerts linked to SSN
  - SSN issued before applicant's date of birth
  - Appears on the SSA's master death file
  - Has other names associated with it
- Mismatch of anticipated and actual credit history (indicative of synthetic identity)

  Example: Someone born 35 years ago would have ~15 years of credit history. A mismatch of expected and actual credit history would exist if the consumer only has 6 months' worth of history
- Follow-up on Fraud and Active Duty Alerts when a phone number is listed

Are there differences we should consider when lending on EVs vs. gas powered vehicles?

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Can a fee be charged to members who use pay-by-phone service to make loan payments?

- Credit unions may offer a fee-based pay-by-phone and/or online loan payment service
- Assessing a pay-to-pay fee has come under fire by the CFPB
- CFPB's June 2022 advisory opinion on the Fair Debt Collection Practices Act (FDCPA)
  - Prohibits debt collectors from assessing pay-to-pay convenience fees for making loan payments online or by phone that are not expressly authorized by the loan agreement creating the debt
  - Also applies when debt collectors collect pay-to-pay fees through a third-party payment processor

What is alternative credit data and how can it be used in loan underwriting?

- Bank account information, such as deposits, withdrawals or transfers
- Rental payments
- Small-dollar loans
- Mobile phone payments • Internet and utility payments • Cable TV payments
- PayPal and other online payment activities & systems

Alternative credit data & loan underwriting

- To adhere to the regulatory requirements of the FCRA, alternative credit data must be readily accessible by the consumer to facilitate disputes and corrections challenges due to misinformation.
- The added inclusion, collection, and evaluation of these types of alternative credit provide lenders with previously untapped insights into both thin-file and full file consumers. By enhancing the visibility and transparency of the consumers' individual behaviors, borrowers also benefit by gaining improved access to conventional lending services while gradually building their credit histories over time.
- Current research clearly indicates the existence of a substantial information shortage in relation to traditional credit scoring models. Regrettably, this shortage prevents a large percentage of U.S. consumers from achieving financial inclusion. However, research also shows that alternative credit data reporting is a vital component of the much-needed improvements for the current credit ecosystem.
- Millennials are not the only ones underestimated and unfairly penalized from a credit data perspective. When one-third of the country's largest consumer generation cannot be rated accurately or are significantly undervalued according to convention credit bureau data, there's a tremendous opportunity for improved financial inclusion.

ACH booster payments

- Similar to check kiting
- Fraudulent ACH payments made (ACH debits) on line-of-credit loans (e.g., credit cards) to free up credit limit
- Member uses up the credit limit before ACH debits are returned unpaid
  - Cash advances – frequently requested at CU branches
  - Purchase gift cards
- Payments are frequent – several ACH payments are made in a single billing cycle
- Frequency and amounts grow over time to make up for ACH debit entries that are returned
- Most are returned as NSF or account not found; others are returned as unauthorized
- Credit unions are not spotting the problem until it is too late – by that time the balance is well in excess of the credit limit

Transaction Summary

Transaction Date	Posting Date	Reference Number	Transaction Description	Plan Number	$ Amount
			TRANSACTIONS		
Account Level					
03/04	03/09		PAYMENT REVERSED	00000	$12,000.00+
03/06	03/11		PAYMENT REVERSED	00000	$88,447.05+
03/09	03/09		BRANCH CASH ADVANCE	10001	$2,400.00+
03/11	03/17		PAYMENT REVERSED	00000	$34,479.68+
03/11	03/11		ACH PAYMENT - THANK YOU	00000	$34,479.68-
03/12	03/12		ACH PAYMENT - THANK YOU	00000	$88,456.12-
03/12	03/18		PAYMENT REVERSED	00000	$88,456.12+
03/13	03/13		BRANCH CASH ADVANCE	10001	$6,000.00+
03/14	03/15		BRANCH CASH ADVANCE	10001	$6,000.00+
03/18	03/26		PAYMENT REVERSED	00000	$56,479.68+
03/18	03/18		ACH PAYMENT - THANK YOU	00000	$56,479.68-
03/19	03/19		ACH PAYMENT - THANK YOU	00000	$88,456.12-
03/19	03/27		PAYMENT REVERSED	00000	$88,456.12+
03/20	03/20		BRANCH CASH ADVANCE	10001	$2,000.00+
03/20	03/20		BRANCH CASH ADVANCE	10001	$2,000.00+
03/20	03/20		BRANCH CASH ADVANCE	10001	$2,000.00+
03/20	03/20		BRANCH CASH ADVANCE	10001	$2,000.00+
03/24	03/24		ACH PAYMENT - THANK YOU	00000	$22,000.00-
03/24	03/31		PAYMENT REVERSED	00000	$22,000.00+
03/27	03/27		ACH PAYMENT - THANK YOU	00000	$56,479.68-
03/27	04/02		PAYMENT REVERSED	00000	$56,479.68+
03/30	03/30		ACH PAYMENT - THANK YOU	00000	$91,456.12-
03/30	04/06		PAYMENT REVERSED	00000	$91,456.12+
04/01	04/01		ACH PAYMENT - THANK YOU	00000	$22,000.00-
04/03	04/03		ACH PAYMENT - THANK YOU	00000	$56,711.14-

What is the impact of student loan debt on portfolio credit quality?

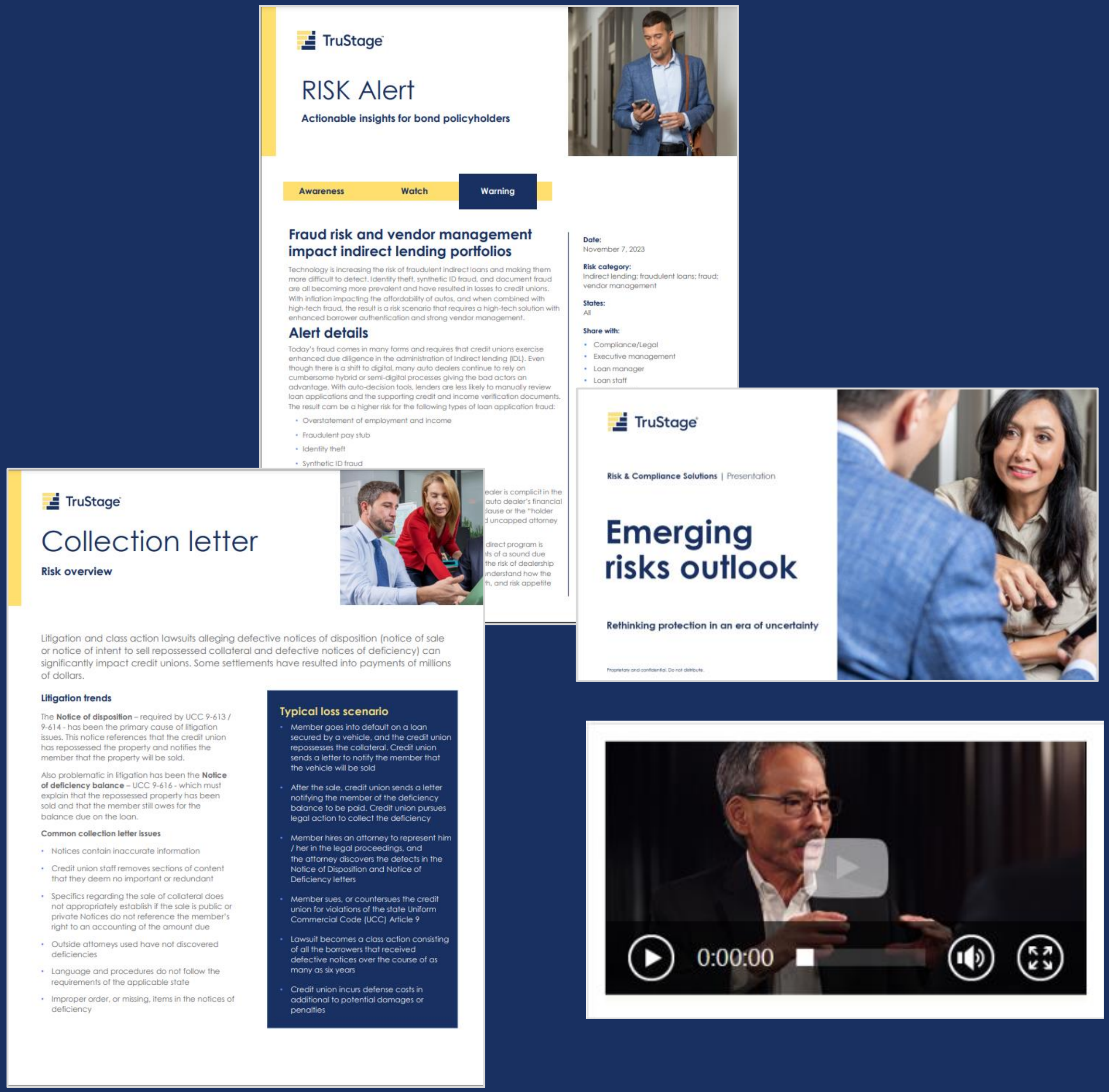
Risk resources

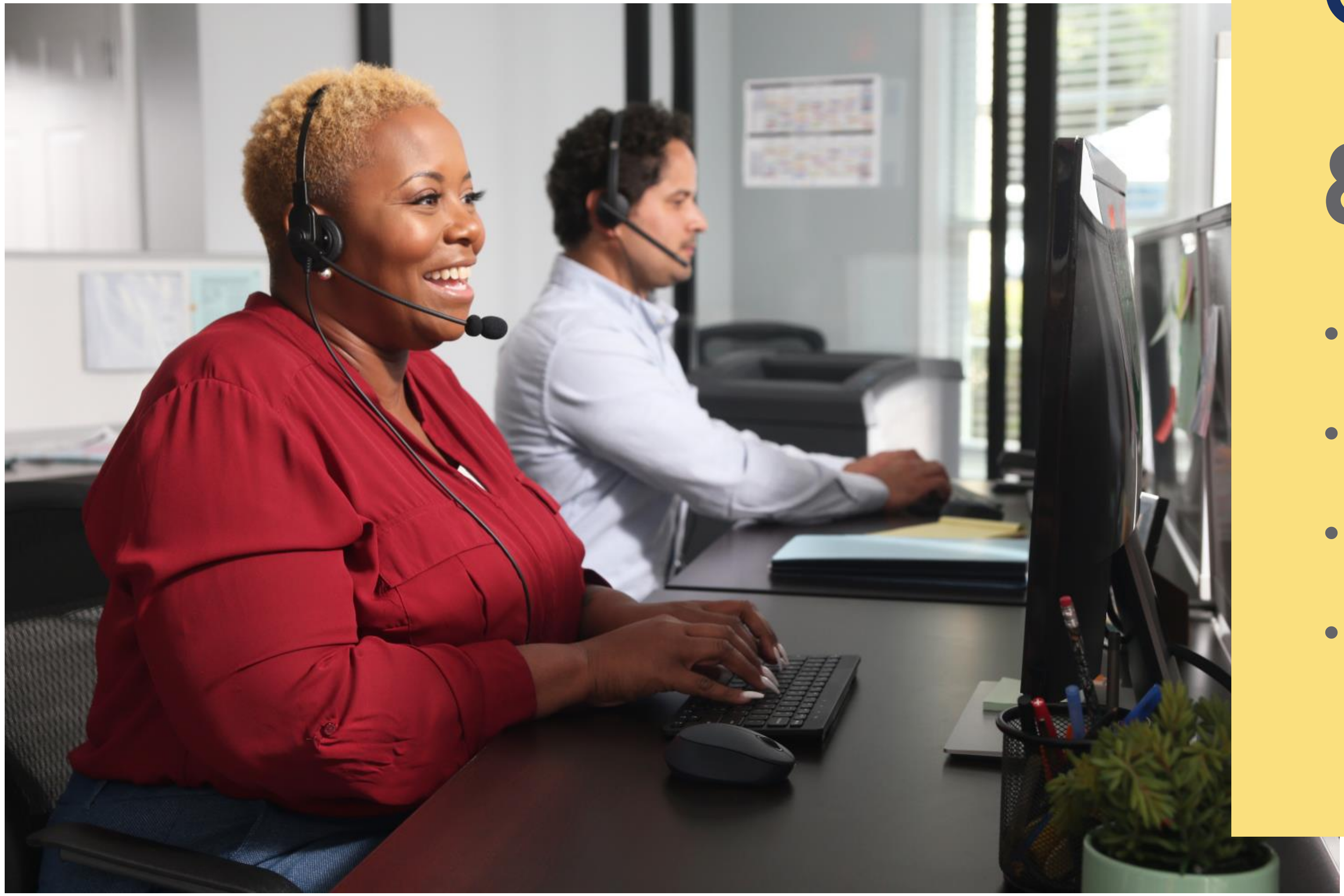
Business Protection Resource Center
www.trustage.com/bprc

- RISK Alerts – warning | watch | awareness
- Loss prevention library
  - risk overviews, checklists & whitepapers
- Emerging risks outlook
- Live webinars, risk forums & office hours
- On-demand learning & interactive training modules

"Great webinars - serious, important information delivered in a relaxed, 'we're among friends' way."

$9B credit union





Contact us

800.637.2676

- riskconsultant@trustage.com
- Ask a risk manager interactive form
- Schedule a 1:1 risk consultation
- Report a risk or scam

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Thank you.

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