Bank Lending 101

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1pm

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General Overview

- Bank financing available for many asset classes (e.g., credit card receivables, auto loans, unsecured consumer loans, small business loans, merchant cash advances)

- Types of Financing
  - Warehouse credit facility (revolving credit – can draw, repay and draw again)
  - Term loan agreement (draws, once repaid, cannot be redrawn)
  - Mortgage repo financing
  - Notes issuance

Transaction Parties and Functions

- Borrower
  - A newly created special-purpose entity
  - Usually either a Delaware statutory trust or limited liability company
  - Special-purpose covenants and bankruptcy protections baked into organizational document
  - Exception for mortgage repo deals where originator is the repo seller (functionally the borrower)

- Lender
  - A banking entity or its affiliate
  - In mortgage financing, the "repo buyer"
  - Committed to lend if conditions precedent are satisfied (sometimes uncommitted)

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Transaction Parties and Functions (cont'd)

- Administrative Agent/Collateral Agent
  - Usually lead bank or its affiliate
  - Represents the Lenders in dealing with the Borrower on an ongoing basis
  - Will be the primary point of contact for the Borrower in delivering and receiving notices, reviewing servicing reports, approving borrowing base certificates and monthly settlement statements
  - Certain of its decisions or acts may be subject to majority Lender consent

- Paying Agent
  - In some deals, a separate function for receiving and holding collections, and making monthly payments to the Lenders

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Transaction Parties and Functions (cont’d)

- Seller/Transferor
  - Entity that originates (or acquires from another originator) the receivables and sells or transfers them to the Borrower
  - Transfer usually structured to qualify as a true sale
  - Seller is usually (but not always) the 100% direct owner of the Borrower

- Servicer
  - Entity that will service and administer the receivables on behalf of the Borrower
  - Will often provide monthly servicing reports to the Administrative Agent and the Lenders
  - Often the same entity as the Seller, or an affiliate

- Backup Servicer
  - Entity that is retained to step in as successor servicer if the initial Servicer is terminated following a default

Transaction Parties and Functions (cont'd)

- Custodian/Verification Agent
  - In connection with a borrowing, receives and reviews copies of receivables documents (e.g., consumer loan agreement, auto loan retail installment contract)
  - Custodian will hold physical or electronic receivables files for the benefit of Lenders
  - Custodian (or sometimes a separate Verification Agent) will verify the completeness of the files and will check certain data points (e.g., receivables balance, interest rate, tenor) by comparing a data tape to the actual consumer documents

- Account Bank
  - Bank where collection and collateral accounts are established
  - Enters into deposit account control agreement with Administrative Agent

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Credit Scoring

About VantageScore Solutions

- VantageScore was founded in 2006 by the three national credit reporting companies (Equifax, Experian and TransUnion) to provide competition in the market, to develop highly accurate credit scoring models, and to reliably score more consumers so that they can gain access to mainstream credit.
- Since then, we've launched 4 models. Thousands of lenders use billions of credit scores annually to make lending decisions.
- Tens of millions of consumers use our scores to understand their own credit worthiness and to monitor their credit health.

VantageScore®
a higher level of confidence

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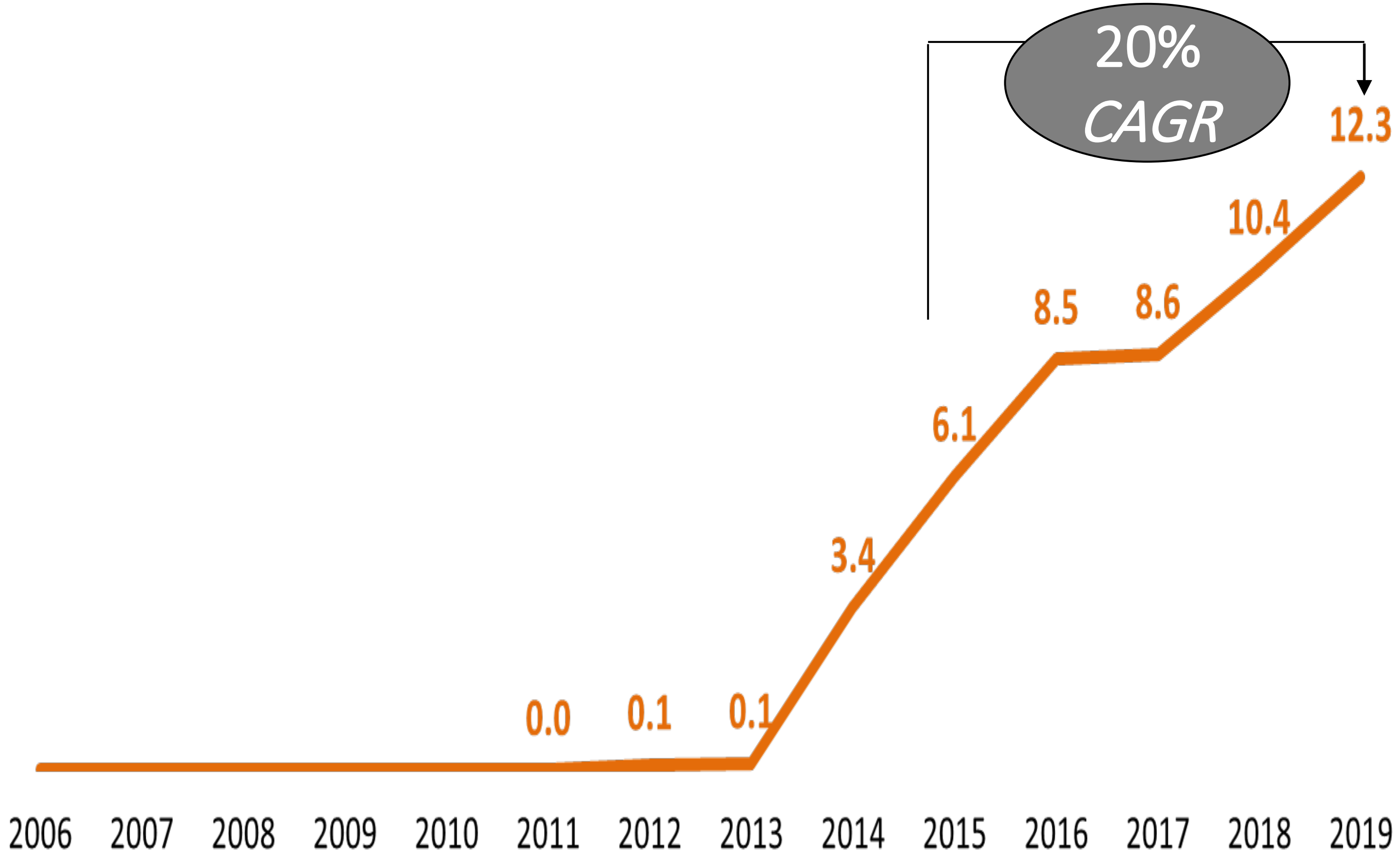
VantageScore models are widely used in the market

12.3 BILLION VantageScore credit scores were used between July 2018 and June 2019

- **2.5K users**, including **2.2K FIs** and **9 of the top 10 largest banks**
- **4+ BILLION** VantageScore credit scores were used by credit card issuers
- **20% CAGR since 2015**



Number of VantageScores used (billions)

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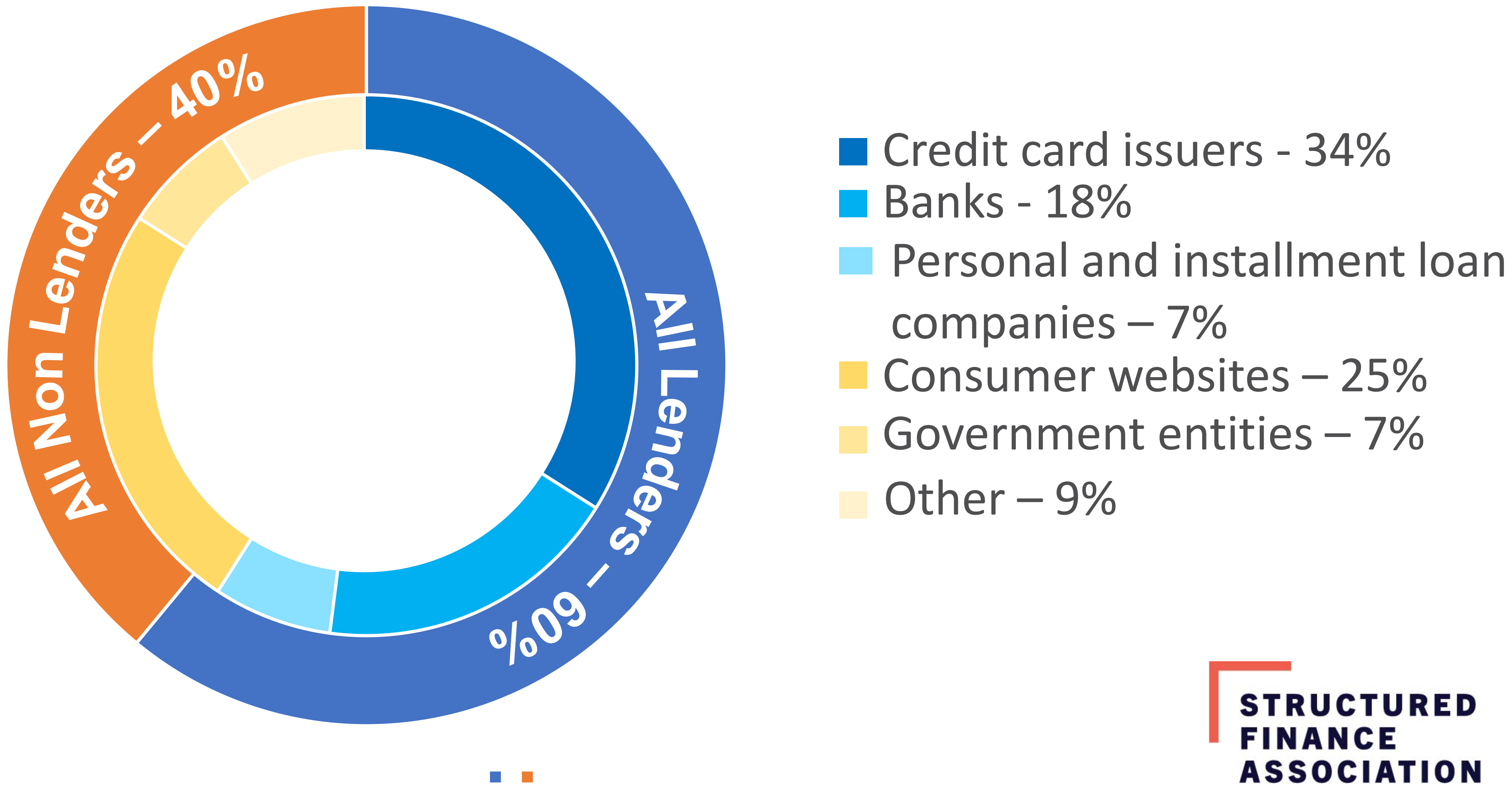
A closer look at VantageScore's user base



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What is a credit report?

A credit report is a record of an individual's current and past financial liability experience. The report includes:

- Information about a consumer's personal identity,
- their employment,
- collection agency accounts (if any),
- public records (liens, judgments, and bankruptcies only),
- as well as their account history (also called "trade").

There are three "major" commonly recognized credit reporting agencies in the United States: Equifax, Experian, and TransUnion.

Each of the three companies maintains over 200 million credit files and they compete to have to most comprehensive, accurate and useful database.

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Who provides the data?

Information that is sent to the credit reporting agencies comes from companies generally referred to as "data furnishers."

These companies are almost always going to be some sort of financial institution:

- a bank
- credit union
- finance company
- loan servicer
- credit card issuer
- debt collector.

These furnishers will generally send their customer or debtor's account information to the credit reporting agencies once every statement cycle period, which is normally once per month.

- *More 200mm consumers have files*
- *Approx. 10,000 data furnishers*
- *Approx. 1.3 billion consumer credit accounts and other trade lines reported monthly*
- *Roughly 60% coming from retail- and network-branded revolving credit cards*

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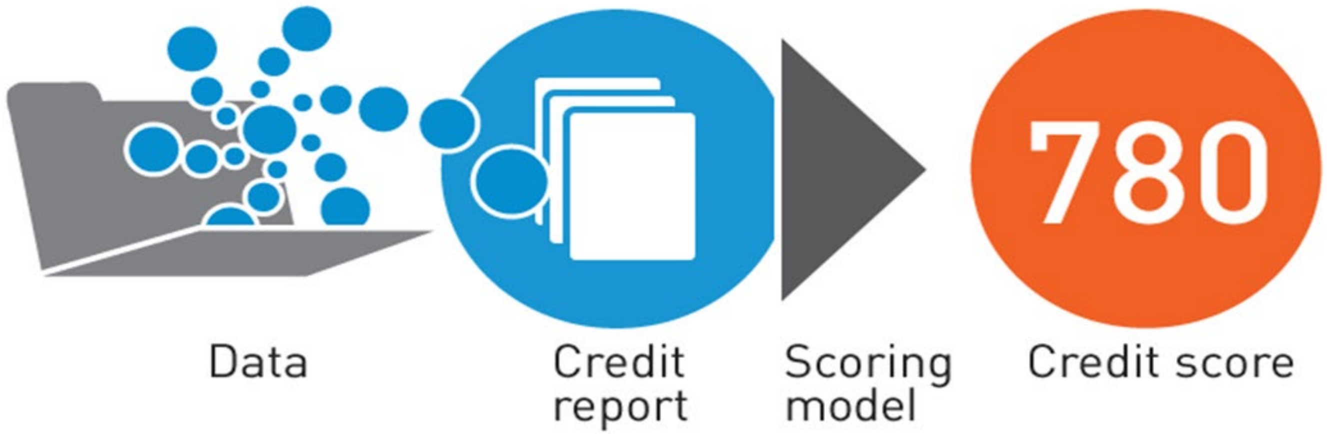
What is a credit score?

A credit score is a measurement, often a three-digit number between 300 to 850, that is derived from a mathematical algorithm based typically on the information available in a consumer's credit report.



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Data that is NOT used in a VantageScore credit score

- Discriminatory factors such as race, color, gender, religion, national origin or marital status
  - Prohibited by law
- Address
- Age
- Anything related to your job, such as income, employment status and history
- Interest rates you are currently being charged
- Inquiries that you make to see your own credit report
  - Additionally, inquiries that your current creditors make to help them manage your account
- Any information that is not contained in your credit report at one of the three CRCs

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Understanding the score: “rank ordering”

	Consumers who are:	
Score	**Likely to default**	**Likely to pay on time**
850	1	300
750	1	50
650	1	10
500	1	5
300	1	1

- A credit score of 850 means that for every **ONE** consumer who is likely to default, there are **300** consumers that are likely to pay on time.
- A score of 300 means that for every **ONE** consumer who is likely to default, there is likely just **ONE** who will pay on time.

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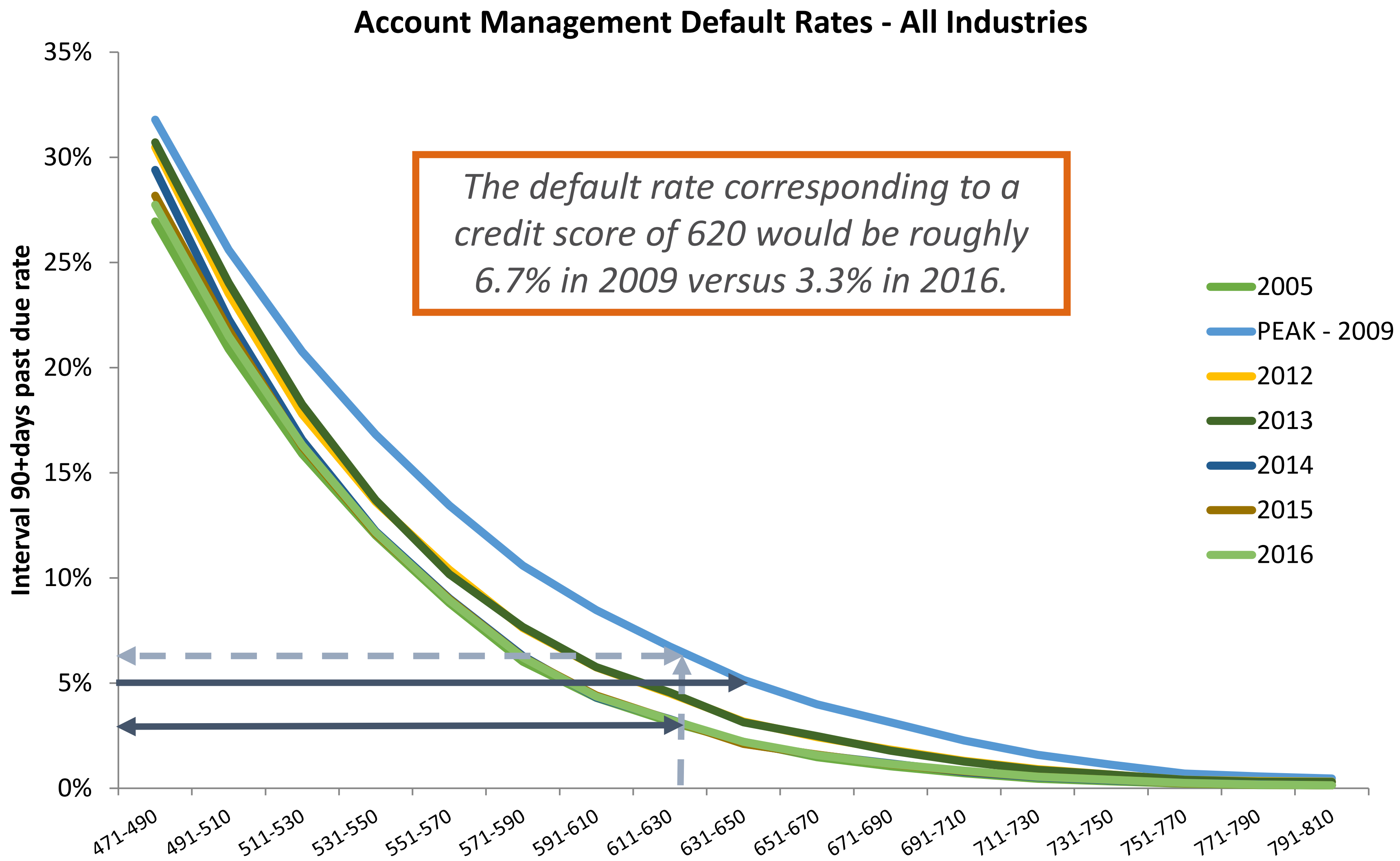
Risk shifts over time: Same credit score implies 2 to 3 times higher risk in 2009 than in 2016



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Many scores are available in the marketplace

VantageScore
- Newest model introduced Fall 2017
  - Range is 300-850
  - 4 models total in marketplace

FICO (Fair Isaac)
- Launched generic score model in 1989
- FICO®
  - Range is 300-850
  - Over 50 models in marketplace

Credit Reporting Companies (CRC)
- Each CRC has multiple products
  - Designed for each unique database
  - Score ranges vary

Other Third-party Developers
- CoreLogic, LexisNexis, L2C, Clarity, others
  - Score ranges vary

Industry-based Models
- Auto, credit card, mortgage

Custom Models
- Many large lenders create their own custom credit score models

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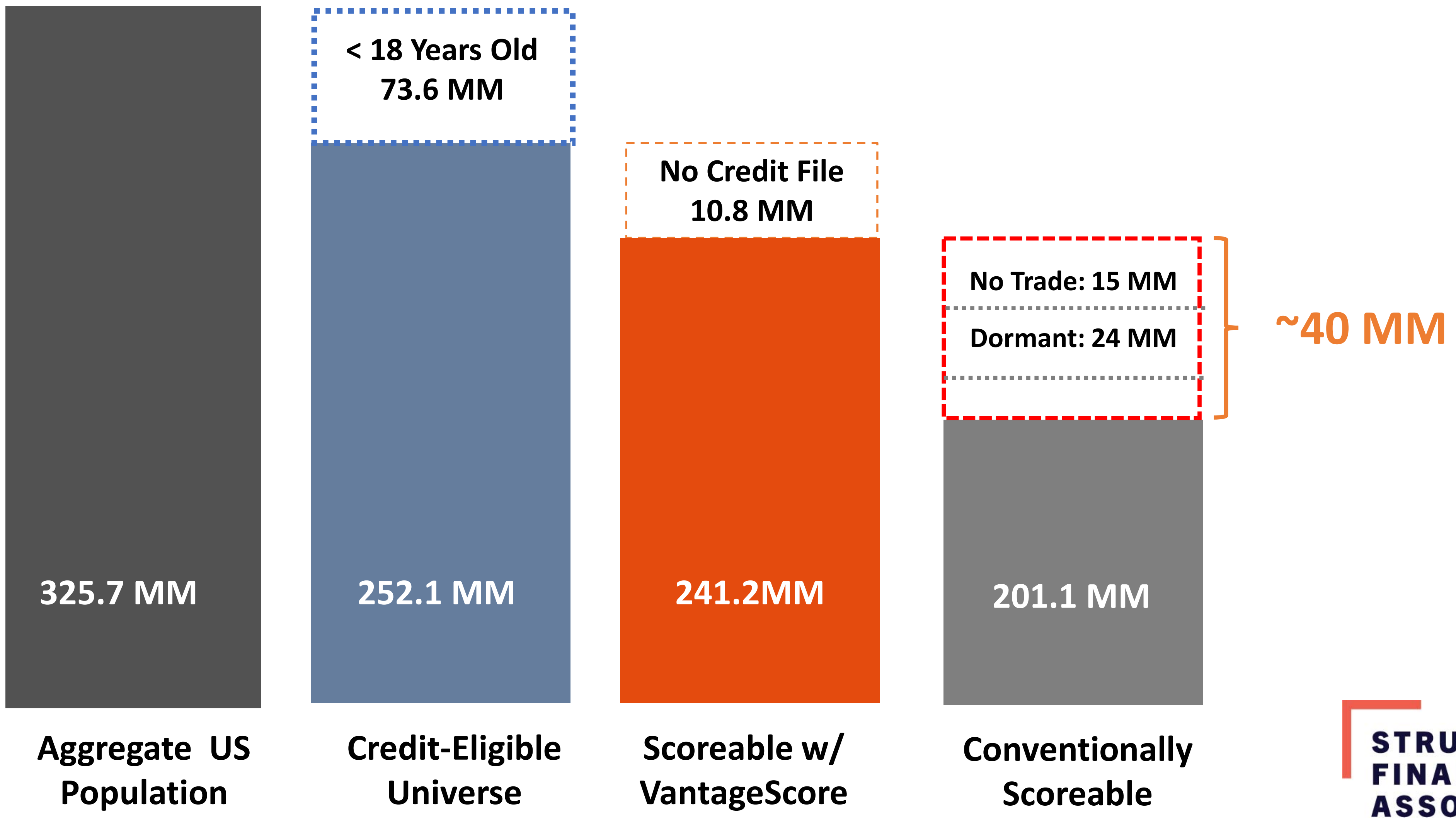
Accessing Credit: Sizing the Universe



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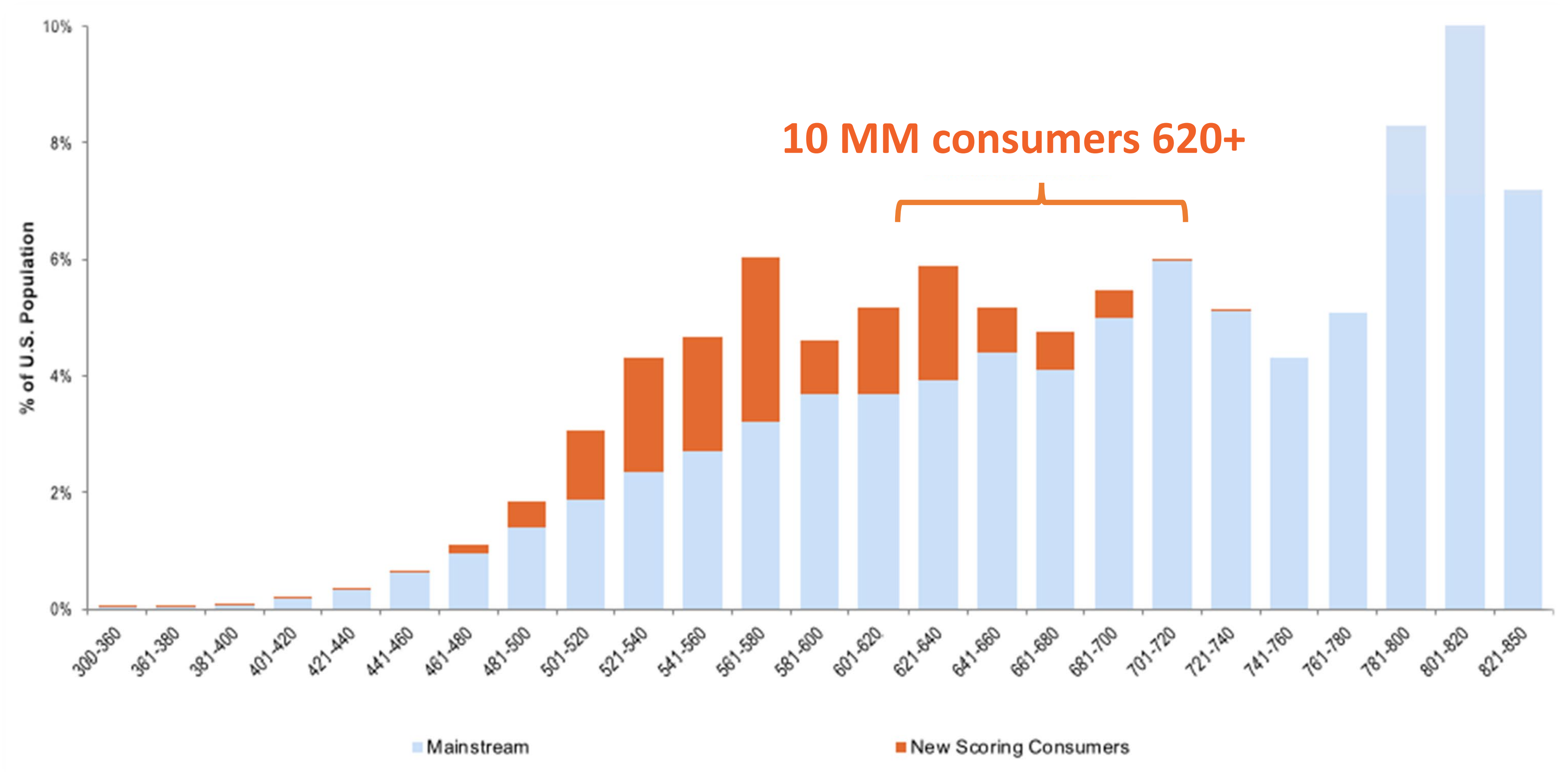
A quarter of the Newly Scored have scores 620+



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A Look at Key Ethnic Demographics

	Newly Scoreable	Above 620
African-American + Hispanic-American	12.2 million	2.4 million
Asian	1.6 million	< 1 million
Native-American	< 1 million	<1 million

- Only **71.9%** of African-Americans and Hispanic-Americans are conventionally scoreable.
- **2.4 million** of the newly scoreable 12.2 million African-American + Hispanic-American consumers have scores greater than 620.
- VantageScore 4.0 provides access to mainstream credit for these consumers while creating an opportunity for lenders to **identify new potential borrowers** with relatively low levels of credit risk.

Scores in strategies… applications

Prospecting
- List Design
- Pre-screen/ Pre-approved

Acquisition
- Application processing
- Underwriting
- Line Assignment
- Pricing

Portfolio Management
- Early MOB/ activation
- Authorizations
- Balance control
- Retention
- Cross-selling
- Fraud

Collections & Recoveries
- Contact-ability
- Collectability
- Recovery

Finance & Treasury
- Securitization
- Reporting
- Capital adequacy/Basel

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Other uses of credit scores

Who's checking scores?	What those scores may help them decide
Institutional Investors	1. Use in loan level data solutions used to analyze securitizations for buy/hold/sell decisions
Institutions lending money	1. Loan applications & underwriting 2. Managing existing customer relationships 3. Marketing new offers
Landlords	How much of a deposit they may require
Cell phone companies	Which payment plan for which a consumer may be eligible and whether any security deposit is required
Utility companies	Whether or not to require a security deposit and, if so, how much of a deposit is required

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Credit Scores are NOT designed for…

Predicting "repayment"	Credit scoring models do not provide an absolute prediction of whether a consumer will default but instead rank orders a population in terms of probability of default. Credit scoring models also cannot predict repayment as models do not consider collateral, collections efficacy, and other underwriting criteria.
Employment Screening	Credit scores are not used for employment screening. The three national credit bureaus never sell credit *scores* for that purpose Pre-employment credit *REPORTS* are sold by the bureaus to employers after an applicant has granted written permission
Insurance Purposes	<u>Generic</u> credit score models are not designed for insurance purposes. Some model developers design specific models for the insurance industry, which are known as "insurance credit scoring models"

Regulation

The **Fair Credit Reporting Act ("FCRA")** is the federal statute that defines, among other things, when credit reports can be accessed, consumer's rights, obligations of the credit bureaus and their data furnishers to perform reasonable investigations, and various notice requirements including score disclosure notices and adverse action notices.

FDIC-regulated institutions are subject to two Federal statutes that prohibit discrimination in lending. The **Equal Credit Opportunity Act (ECOA)** covers all credit transactions. It prohibits discrimination on nine bases—race, color, religion, sex, national origin, age, marital status, receipt of public assistance, and the exercise of a right under the Consumer Credit Protection Act.

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How credit scores are disclosed in securitization pools:

- References to VantageScore* in rated deals:
  - Oportun 2015-1 (Kroll) – securitization of personal loans, VantageScore explicitly referenced
  - SoFi 2015-B (S&P) – securitization of student loans, VantageScore explicitly referenced*
  - SoFi 2015-B (Moody's) - securitization of student loans, VantageScore and FICO described as 'credit scores'
  - SoFi 2019-1 (S&P) – securitization of student, both VantageScore and FICO explicitly reference*

- Other securitizations and documents of relevance:
  - Comenity 2019-A – References "Probability of an Account of Becoming 91 or More Days Past Due or Becoming Charged-off (within the next 12 months)" in lieu of a credit score*
  - Toyota Financial 2016-D -- the largest auto lender in the United States does not disclose which specific versions of FICO Score or VantageScore it uses. For approved loans, the borrower is assigned into a pricing tier based on "…customer risk as defined by credit bureau scores and other factors for a range of price and risk combinations."

- Ratings agencies are able to rate securitizations using different scoring models

**Use of VantageScore not reported as a negative ratings factor and no discount nor credit enhancement was applied*

Use in securitizations: Pool characteristics from Fintech lender

Initial Pool Characteristics

	Total	36 months	48 months	60 months	72 months
Principal amount ($)	525,096,826	9[illegible],214,475	68,408,356	230,352,431	[illegible],671,842
Initial term (% of the total pool)		17.75	13.03	43.8[illegible]	4.8[illegible]
Avg. loan amount per borrower ($)	31,634	24,275	29,925	31,5[illegible]	37,864
Weighted avg. annual gross income at origination ($)	151,144	183,135	154,432	133,9[illegible]	
Weighted avg. monthly free cash flow at origination ($)	5,696	7,045	5,687	4,916	
% of the aggregate loan amount using ACH (automatic account debit)	87.85	90.97	88.69	85.56	
Weighted avg. FICO score	753	757	753	742	
Weighted avg. Vantage score	713	722	712	701	

VantageScore usage in pool characteristics

300-599	0.00	0.00	0.00	0.00	0.0[illegible]
Total	100.00	100.00	100.00	100.00	100.0[illegible]
Vantage score (% of the pool)					
740 and above	32.46	38.72	31.15	23.59	45.1[illegible]
700-739	26.25	26.48	26.70	25.01	24.7[illegible]
670–699	18.19	17.28	19.60	20.30	15.8[illegible]
640–669	15.71	12.94	15.58	20.43	10.0[illegible]
600-639	6.86	4.28	6.66	9.85	3.9[illegible]
300-599	0.53	0.30	0.31	0.83	0.3[illegible]
Total	100.00	100.00	100.00	100.00	100.0[illegible]
Gross income (% of the pool)					
Greater than or equal to	5.85	10.28	6.20	3.42	6.0[illegible]

Loan Underwriting Process + Negotiated Credit Terms

- Due diligence of Seller/Servicer
  - Originator’s credit policy
  - Servicing policies and procedures; operations
  - Collateral performance history/static pool information
  - Regulatory diligence

- Economic terms
  - Interest rate (fixed or floating)
  - Upfront commitment fee; ongoing unused line fee
  - Step-up margin (e.g., after revolving period terminates)
  - Mortgage repo warehouse: margin requirements, mark-to-market provisions

- Borrowing base
  - The value of the collateral that is being advanced against
  - Generally, a function of aggregate receivables balance and advance rate

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Loan Underwriting Process + Negotiated Credit Terms

- Eligibility criteria
  - The minimum, mandatory characteristics of the receivables collateral
  - A combination of legal and economic characteristics
  - Requires a review and understanding of the Seller's credit criteria
  - Provides a mechanic for excluding certain kinds of receivables (e.g., Madden receivables)
- Concentration limits
  - Protects the Lender from exposure to excessive concentrations of certain receivables
  - Will reduce the borrowing base in an amount equal to excess concentrations
  - Examples:
    - "Eligible Receivables with respect to which the original term to maturity was 60 months shall not in the aggregate at any time represent more than 25% of the Aggregate Principal Balance of Eligible Receivables"
    - "The weighted average Credit Score of the Obligors of the Eligible Receivables (calculated on the basis of Aggregate Principal Balance) shall be at least 665"

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Loan Underwriting Process + Negotiated Credit Terms

- Collateral performance triggers
  - Measures ongoing performance of the collateral portfolio or the Seller/Servicer’s overall managed portfolio
  - Triggers can result in reduction of advance rate, termination of revolving period, accelerated amortization, or default
  - Types of performance triggers depend on asset type, but generally will measure ongoing levels of delinquency, default and charge-off, excess spread, or other collateral performance metrics
  - Can be measured either cumulatively or on a rolling basis
  - Net loss and delinquency curves may need to be developed and agreed upon
- Financial covenants
  - Used to measure overall financial health of Seller/Servicer
  - May include maximum leverage ratio, minimum tangible net worth, minimum liquidity
  - Violation of financial covenants may trigger early amortization or default

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Key Issues in Documenting and Closing a Bank Financing Transaction

- Transaction documents
  - Credit Agreement/Loan and Security Agreement
  - Mortgage repo warehouse: Master Repurchase Agreement
  - Fee Letter
  - Receivables Purchase Agreement
  - Receivables Servicing Agreement
  - Backup Servicing Agreement
  - Custodial Agreement/Verification Agent Agreement
  - LLC Operating Agreement/Trust Agreement
  - Guaranty (Credit Guaranty vs Bad Boy Guaranty)
  - Deposit Account Control Agreement
  - Mortgage repo warehouse: Assignment of Mortgage
  - Secretary’s certificates and closing certificates
  - Legal opinions

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Key Issues in Documenting and Closing a Bank Financing Transaction (cont'd)

- True sale and non-consolidation
  - Use of bankruptcy remote entity (special purpose covenants, restrictions on bankruptcy filings, independent director)
  - Receivables transferred to Borrower at fair value (paid in the form of net cash proceeds from related draw, with the difference being a deemed equity capital contribution from the Seller to the Borrower)
  - No credit recourse to Seller or any other affiliate for failure of receivable obligors to repay loans
  - Arms' length servicing fee (no hidden credit support)
  - Seller may have a repurchase obligation for ineligible receivables (tested only at addition date)
  - Mortgage repo warehouse: Mortgage repurchase agreements have the benefit of a specific safe harbor under Section 559 of the Bankruptcy Code (11 U.S.C. § 559). This section allows a "repo participant" or "financial participant" to terminate a repurchase agreement and liquidate the collateral after a bankruptcy of the repo seller without being subject to the automatic stay.

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Key Issues in Documenting and Closing a Bank Financing Transaction (cont’d)

- Cash management and control
  - How are collections being made and where are customer payments deposited?
  - How are lenders protected from cash collections being diverted or commingled with other funds?
  - Servicing concentration account, transaction collection account, payment account
  - Potential intercreditor issues

- Regulatory issues
  - What is origination model?
  - State licensing vs bank model
  - Madden loans
  - Licenses for servicing vs origination
  - Potential state licensing of Borrower merely for owning receivables

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Key Issues in Documenting and Closing a Bank Financing Transaction (cont’d)

- Creating and perfecting the Lender’s security interest in the collateral
  - Attachment of security interest (value given by lender, grantor has rights in collateral, grantor signs security agreement that provides a description of the collateral)
  - Perfection by filing a UCC-1 financing statement (accounts receivable, general intangibles, payment intangibles)
  - Perfection by possession (chattel paper, certificated securities, negotiable instruments)
  - Perfection by control (deposit accounts, security entitlements, electronic chattel paper)
  - Precautionary UCC-1 filing against Seller (Article 9 of UCC covers sales of payment intangibles and promissory notes; perfection is automatic upon attachment, but market practice is to file)
  - Need to understand the rules of priority among competing security interests (e.g., first to file)

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Key Issues in Documenting and Closing a Bank Financing Transaction (cont'd)

- Affirmative and negative covenants
  - Negative covenants more limited than in traditional asset-based financing to an operating company
  - Some covenants (e.g., no additional indebtedness) may extend to Seller/Transferor
  - Some covenants are more subject to negotiation
    - Delivery of monthly, quarterly and annual financial statements
    - Notice requirements for material events
    - Restrictions on changes to Seller's credit policy and Servicer's servicing policy and procedures
    - Release of collateral for securitization takeouts, portfolio sales
    - Prohibition on prepayments

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Key Issues in Documenting and Closing a Bank Financing Transaction (cont'd)

- Events of default
  - Failure to pay principal or interest when due
  - Failure to cure borrowing base shortfall or reserve account shortfall
  - Insolvency events
  - Breach of covenants, representation or warranties (potential cure periods)
  - Failure maintain perfected security interest
  - Unpaid judgments
  - Change of control
  - Cross-defaults to Seller or affiliate debt
  - Material adverse change
  - Servicer default

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Key Issues in Documenting and Closing a Bank Financing Transaction (cont'd)

- Post-closing loan administration
  - Monthly settlement statements—review and verification
  - On-site audits and inspections
  - Periodic securitization take-outs
  - Potential amendments, maturity extensions, increases in commitment

Questions....

APPENDIX

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