VII. UNDERWRITING AND LOAN APPROVAL PROCESS

Underwriting is the process by which the lender decides whether an applicant is creditworthy and should receive a loan. An effective underwriting and loan approval process is a key predecessor to favorable portfolio quality, and a main task of the function is to avoid as many undue risks as possible. When credit card loans are underwritten with sensible, well-defined credit principals, sound credit quality is much more likely to prevail.

GENERAL UNDERWRITING CONSIDERATIONS

To be effective, the underwriting and loan approval process should establish minimum requirements for information and analysis upon which the credit is to be based. It is through those minimum requirements that management steers lending decisions toward planned strategic objectives and maintains desired levels of risk within the card portfolio. Underwriting standards should not only result in individual credit card loans with acceptable risks but should also result in an acceptable risk level on a collective basis. Examiners should evaluate whether the bank's credit card underwriting standards are appropriate for the risk-bearing capacity of the bank, including any board-established tolerances.

Management essentially launches the underwriting process when it identifies its strategic plan and subsequently establishes the credit criteria and the general exclusion criteria for consumer solicitations. Procedures for eliminating prospects from solicitation lists and certain screening processes could also be considered initial stages of the underwriting and loan approval process in that they assist in weeding out consumers that may be non-creditworthy in relation to the bank's risk tolerance level, identified target market, or product type(s) offered.

Compared to other types of lending, the underwriting and loan approval process for credit card lending is generally more streamlined. Increasingly, much of the analytical tasks of underwriting are performed by technology, such as databases and scoring systems. Whether the underwriting and loan approval process for credit cards is automated, judgmental, or a combination thereof, consistent inclusion of sufficient information to support the credit granting decision is necessary. Underwriting standards for credit cards generally include:

- Identification and assessment of the applicant's repayment willingness and capacity, including consideration of credit history and performance on past and existing obligations. While underwriting is based on payment history in most instances, there are cases, such as some application strategies, in which guidelines also consider income verification procedures. For example, assessments of income like self employment income, investment income, and bonuses might be used.
- Scorecard data.
- Collateral identification and valuation, in the case of secured credit cards.
- Consideration of the borrower's aggregate credit relationship with the bank.
- Card structure and pricing information.
- Verification procedures.

The compatibility of underwriting guidelines with the loan policy, the strategic plan, and the desired customer profile should be assessed. Examiners also determine whether such guidelines are documented, clear, and measurable, such that management can track compliance with and adherence to the guidelines. Moreover, examiners should assess management's periodic review process for ensuring that card underwriting standards appropriately preserve and strengthen the soundness and stability of the bank's financial condition and performance and are attuned with the lending environment.

In addition to the decision factors, management should also set forth guidelines for the level and type of documentation to be maintained in support of the decision factors. Records typically include, but are not limited to, the signed application, the verified identity of the borrower, and the borrower's financial capacity (which may include the credit bureau report or score). In the case of secured cards, records to look for include a collateral evaluation and lien perfection documents. Another item of interest to review includes a method of preventing application fraud such as name and address verification, duplicate application detection, social security number verification, or verification of other application information. The verification level supported by management normally depends upon the loan's risk profile as well as the board's risk appetite.

The process for altering underwriting terms and standards can involve prominent decisions by management to amend policies and procedures. However, more subtle or gradual modifications to the application of the card underwriting policies and procedures can also produce changes in bank's risk profile. For instance, the bank might increase credit limits or target a higher proportion of solicitations to individuals in lower score bands without reducing the minimum credit score. Albeit less apparent, the resultant change can create significant loan problems if not properly controlled. Examiners should assess management's records that outline underwriting changes, such as chronology logs, to determine whether the records are well-prepared and complete and to identify underwriting changes that, individually or in aggregate, may substantially impact the quality of accounts booked.

In the hyper-competitive credit card market, some banks may be inclined to relax lending terms and conditions beyond prudent bounds in attempts to obtain new customers or retain existing customers. Examiners should be sensitive to all levels of credit easing and the potential impact of the ease on the bank's risk profile. Rapid growth can, but does not necessarily, indicate a decline in underwriting standards. In addition, rising loss rates may indicate a weakening of underwriting criteria. Examiners should also consider that the bank's appetite for risk often involves balancing underwriting and the pricing structure to achieve desired results. Thus, management may have priced the products to sufficiently compensate for the increased risk involved in easing credit standards. Take, for example, subprime loans which typically exhibit higher loss rates. They can be profitable, provided the price charged is sufficient to cover higher loss rates and overhead costs related to underwriting, servicing, and collecting the loans. Examiners should sample management's documentation that supports credit decisions made. Management's documentation might include the contribution to the net interest margin and noninterest income in relation to historical delinquencies and charge-offs compared to other types of card programs. When relaxed credit underwriting is identified, examiners should assess the adequacy of the total strategy.

Results of credit underwriting weaknesses are not limited to elevated credit risk. For example, the weaknesses may cause difficulties in securitization or sales of the underwritten assets, thereby elevating liquidity risk. Further, future credit enhancements and pricing for securitizations may be more costly or less readily available when poorly underwritten receivables adversely affect the bank's reputation. In some cases, access to securitization-based funding may vanish. Impairment of a bank's reputation as an underwriter can limit accessibility to financial markets or can raise the costs of such accessibility.

PROGRAM-SPECIFIC UNDERWRITING CONSIDERATIONS

Affinity and Co-Branding Programs

Examiners normally expect banks to refrain from materially modifying underwriting standards for affinity and co-branded card customers. Rather, credit card underwriting guidelines for partnered programs should generally be compatible with the bank's loan policy, strategic plan, and desired customer profile. If underwriting practices diverge from the bank's normal standards, examiners need to determine the appropriateness of program differences and the overall impact on portfolio quality. They should look for evidence that management has ensured that the eased standards still result in an acceptable level of risk and that any elevated risks are appropriately addressed.

Private Label Programs

Examiners should expect management to pay careful attention to the financial condition of the retail partner when it determines whether to offer private label cards. They also normally expect management to refrain from materially modifying underwriting standards to accommodate its retail partners. A retailer that aims to maximize the number of cards in circulation may expect the bank to lower its credit standards. If the bank lowers its credit standards, management should ensure that the standards still result in an acceptable level of risk and that any elevated risks are appropriately addressed.

Loss-sharing agreements can be an effective means to mitigate risk and give merchants reason to accept more conservative underwriting standards. With a loss-sharing agreement, either the bank's loss rate is capped at a certain percentage or the merchant covers a certain percentage of the dollar volume of losses. The retail partner's share of losses can be quite high, and the bank's role may be more similar to that of a servicer than a lender. Examiners should analyze management's practices for ensuring that the retailer has the financial capacity to cover its portion of the losses. They should also gauge management's procedures for analyzing and responding to contingencies, such as if the retailer was to file bankruptcy and the cardholders were not compelled to repay their balances.

Corporate Credit Card Programs

Corporate credit card programs may pose more commercial credit risk than consumer credit risk because the company may be primarily liable for the debt. In cases where the corporation is primarily liable for the debt, examiners should expect that management's decision to grant the line of credit is consistent with the institution's commercial loan underwriting standards. The credit granting process should also consider relationships that the company has with the bank's commercial banking department. Examiners should review the contract terms of corporate credit card programs in a manner similar to how they would review any other commercial loan file. Documentation should include management's assessment of the financial condition of the company along with its willingness to pay in a timely manner. Examiners should also ascertain whether the bank or the corporate borrower decides which company employees receive corporate cards. It the borrower decides, examiners should determine what controls the bank uses to reduce risk.

Subprime Credit Card Programs

Subprime lending is generally defined as providing credit to consumers who exhibit characteristics that suggest a much higher risk of default as compared to the risk of default with traditional bank loan customers. Examiners should evaluate whether management has carefully attended to underwriting standards for subprime credit card programs. Underwriting for subprime credit cards is usually based upon credit scores generated by sophisticated scoring models, which use a substantial number of **attributes** to determine the probability of loss for a potential borrower. Those attributes often include the frequency, severity, and recency of delinquencies and major derogatory items, such as bankruptcy. When underwriting subprime credit cards, banks generally use risk-based pricing as well as tightly controlled credit limits to mitigate the increased credit risk evident in the consumer's profile. Banks may also require full or partial collateral coverage, typically in the form of a deposit account at the bank. Credit availability and card utility concerns are other important considerations.

Home Equity Credit Card Programs

Home equity lending in general has recently seen rapid growth and eased underwriting standards. The quality of real estate secured credit card portfolios is usually subject to increased risk if interest rates rise and/or home values decline. As such, sound underwriting practices are indispensable in mitigating this risk. Examiners should look for evidence that management considers all relevant risk factors when establishing product offerings and underwriting guidelines. Generally, these factors include borrowers' income and debt levels, credit score (if obtained), and credit history, as well as loan size, collateral value (including valuation methodology), and lien position. Examiners should determine whether effective procedures and controls for support functions, such as perfecting liens, collecting outstanding loan documents, and obtaining insurance coverage, are in place.

For real estate secured programs, compliance with the following guidance is considered:

- Part 365 of the FDIC Rules and Regulations – *Real Estate Lending Standards*, including Appendix A which contains the *Interagency Guidelines for Real Estate Lending Policies*.
- *Interagency Appraisal and Evaluation Guidelines*.
- *Interagency Guidance on High Loan-to-Value Residential Real Estate Lending*.
- *Home Equity Lending Credit Risk Management Guidance* issued May 24, 2005.

Other laws, several of which are reviewed during the compliance examination, also apply.

Part 365 requires banks to maintain written real estate lending policies that are consistent with sound lending principles and appropriate for the size of the institution as well as the nature and scope of its operations. It specifically requires policies that include, but are not limited to:

- Prudent underwriting standards, including LTV limits.
- Loan administration procedures.
- Documentation, approval and reporting requirements.

Consistent with the agencies regulations on real estate lending standards, prudently underwritten home equity credit card loans should include an evaluation of a borrower's capacity to adequately service the debt. Considering the real estate product's sizable credit line typically extended, an evaluation of repayment capacity should most often consider a borrower's income and debt levels and not just the borrower's credit score. A prominent concern is that borrowers will become overextended, and the bank may have to consider foreclosure proceedings. As such, underwriting standards should emphasize the borrower's ability to service the card line from cash flow rather than the sale of the collateral. If the bank has offered a low **introductory rate**, repayment capacity should consider the rate that could be in effect at the conclusion of the introductory term.

A potentially dangerous misstep in underwriting home equity credit cards is placing undue reliance upon a property's value in lieu of an adequate initial assessment of an applicant's repayment ability. However, establishing adequate real estate collateral support in conjunction with appropriately considering the applicant's repayment ability is a sensible and necessary practice for home equity credit card lending.

Examiners should expect that management has established criteria for determining an appropriate real estate valuation methodology (for example, higher-risk accounts should be supported by more thorough valuations) and requires sufficient documentation to support the collateral valuation. Banks have streamlined real estate appraisal and evaluation processes in response to competition, cost pressures, and technological advancements. These changes, coupled with elevated LTV risk tolerances, have heightened the importance of strong collateral valuation policies and practices. The *Interagency Appraisal and Evaluation Guidelines* sets forth expectations for collateral valuation policies and procedures. Use of automated valuation models (AVMs) and other collateral valuation tools for the development of appraisals and evaluations is increasingly popular. AVMs are discussed in the Scoring and Modeling chapter.

Management is expected to establish limitations on the amount advanced in relation to the value of the collateral (LTV limits) and to take appropriate measures to safeguard its lien position. Examiners should determine whether management verifies the amount and priority of any senior liens prior to the loan closing when it calculates the LTV ratio and assesses the collateral's credit support. The *Interagency Guidelines for Real Estate Lending Policies (Appendix A to Part 365)* and the *Interagency Guidance on High LTV Residential Real Estate Lending* address LTV considerations, including supervisory LTV limitations. There are several factors besides LTV limits that influence credit quality. Therefore, credit card loans that meet the supervisory LTV limits should not automatically be considered sound, and credit card loans that exceed the supervisory LTV limits should not automatically be considered high risk. Examiners should refer to the mentioned guidance and to the Risk Management Manual of Examination Policies for LTV details, such as reporting requirements and aggregate limits in relation to capital levels.

Cash Secured Credit Card Lending

While cash secured credit card lending may be less susceptible to credit risk than other types of credit card lending, credit risk is not eliminated. The outstanding balance on an account could exceed the collateral amount either due to the account being only partially collateralized at account set-up or due to allowing the cardholder to go over-limit. Partially secured cards represent unsecured credit to higher-risk consumers to the extent that the line or balance exceeds the deposit amount. Underwriting for these types of accounts (as well as for those fully secured) should clearly substantiate the consumer's willingness and ability to service the debt.

Examiners should verify whether management has established clear underwriting policies and practices for cash secured lending. These polices should include, among other items, guidelines for credit limit assignments in relation to the amount of collateral required. Examiners should also determine management's practices for performing credit analysis on the applicant, which may include verifying the applicant's income, and for ensuring that a perfected security interest in the deposit is established and maintained. If the bank retains possession of the deposit, its security interest in the deposit is generally perfected.

Purchased Portfolios

Similar to expectations for partnership agreements (that is, co-branded and similar programs), examiners should expect that the bank refrain from materially modifying underwriting standards when it purchases portfolios of credit card receivables. If underwriting criteria are eased in comparison to the banks' internally-established underwriting criteria it could result in elevated credit risk that management would need to take appropriate action for, which may include holding higher levels of loss allowances, hiring additional collectors, and so forth. And, if the cardholder base is significantly different than that normally held by the bank, management could be at risk of not fully understanding the expectations of those cardholders, thereby raising reputation risk. Examiners should confirm whether management considers underwriting criteria used by originators in its due diligence processes for portfolio purchases. If underwriting criteria for purchased portfolios diverge from the bank's typical underwriting standards, examiners need to determine the appropriateness of the differences in relation to management's capabilities and to the overall impact on portfolio quality and the bank's risk profile. Purchased credit card portfolios are discussed in the Purchased Portfolios and Relationships chapter.

COMPARISON OF AUTOMATED AND JUDGMENTAL PROCESSES

Once a consumer completes an application, the application either is processed through an automated processing system or is processed manually, or judgmentally. Regardless of the type of process used, the audit department should examine it with any deviations communicated promptly to management.

Automated underwriting and loan approval processes are increasingly popular and vary greatly in complexity. In an automated system, credit is generally granted based on the cut-off score and the desired loss rate. These systems are often based on statistical models and apply automated decision-making where possible. Banks sometimes establish auto-decline or auto-approve ranges where the system either automatically approves or declines the applicant based on established criteria, such as scores. The automated systems may also incorporate criteria other than scores (such as rules or overlays) into the credit decision. For example, the presence of certain credit bureau attributes (such as bankruptcy) outside of the credit score itself could be a contributing factor in the decision-making process. Examiners should gauge management's practices for validating the scoring system and other set parameters within automated systems as well as for verifying the accurateness of data entry for those systems.

Judgmental underwriting processes also vary in complexity but are not as popular as they have been in the past, mainly due to advances made in automated underwriting processes. While not as popular, judgmental processes are preferred and/or necessary in some cases, such as if the bank cannot (or does not want to) pay the amount necessary to establish and maintain such systems or if the portfolio is very small and perhaps consists of the bank's traditional customers. In a judgmental process, credit is granted based on a manual review using the bank's underwriting guidelines which guide the quality of new accounts. The bank's control systems for ensuring that analysts consistently follow policy should undergo review during the examination.

When an applicant is approved or denied contrary to a system's recommendations or guidelines, it is usually called an **override**. For example, if the applicant falls outside of the auto-approval range, the applicant may be referred for manual review in certain cases. As such, the applicant may be approved despite not meeting the system's criteria, which is called a **low-side override**. And, in other cases, applicants that would be auto-approved might be referred for manual review and declined based on rules or other guidelines that management has established or authorized, which is referred to as a **high-side override**. High-side overrides generally occur when derogatory information becomes known to management.

The following types of overrides are commonly encountered:

- Informational overrides occur when information not included in the scoring process becomes known to management.
- Policy overrides occur when management establishes special rules for certain types of applications.
- Intuitional overrides occur when management makes decisions based on judgment rather than the scoring model.

Scoring is a predominant feature of most automated underwriting and loan approval processes. When scoring is used to grant credit, quality is controlled by setting the cut-off score at the desired loss rate. Credit scoring is discussed in the Scoring and Modeling chapter.

CREDIT BUREAU PREFERENCES

Information in a consumer's credit file is not necessarily identical across all credit bureaus. Banks often maintain a table reflecting preferences for certain credit bureaus to be used in the underwriting (and account management) process. The table is usually based on the geographic locations targeted. Management's periodic analysis of bureau preference to determine optimal credit bureaus for different states or localities should be subject to examination review. Optimal credit bureaus are generally described as giving the most comprehensive, accurate, relevant, and timely information on the consumer such that the bank can make the most informed credit and pricing decisions possible based on available information.

POST-SCREENING

Post screening is a supplementary risk management tool. Sound pre-screening criteria is a first-line of defense against taking on undesirable accounts, and post-screening will not correct poor selection criteria. Nevertheless, it can effectively reduce the exposure from undesirable accounts. Post-screening is a process used in conjunction with pre-screened solicitations to identify potentially bad, versus good, accounts. New credit reports are obtained for respondents after the consumer accepts the pre-screened offer and are reviewed for negative information established after the pre-screened list was created or missed in the initial screening.

The FCRA significantly limits an institution's ability to deny credit once an offer has been accepted. Nevertheless, in some situations, management may be able to take action to reduce risk to the bank. A pre-screened credit offer may be withdrawn in certain situations. Bankruptcy, foreclosures, judgments, attachments, and similar items may be grounds for withdrawing an offer if such items occurred between the prescreen and the consumer's acceptance ONLY if these criteria were part of the original prescreening. Identifying and rejecting these potentially bad accounts reduces the bank's exposure to loss. In addition, an institution is not required to grant credit if the consumer is not creditworthy or cannot furnish required collateral, provided that the underwriting criteria are determined in advance and applied consistently. If the consumer no longer meets the lender's predetermined criteria, the lender is not required to issue the credit card. For example, if the cut-off score in the predetermined criteria is 700 and the consumer's credit score has deteriorated to 695 at the time of post-screen, the institution would most likely not be required to issue the credit card. However, if the consumer's score fell from 780 to 704, the institution would still have to grant credit because the consumer met the pre-determined standard. Depending on the specifics of the offer, the bank might be able to reduce the size of the line extended, provided that any relationship between the credit score and the amount of credit line given is also pre-determined by the institution before the offer was made.

FACT ACT

In addition to marketing considerations, certain FACT Act provisions are applicable to the underwriting and origination process. Section 112 of the FACT Act addresses fraud alerts and active duty status alerts. According to the provisions, prospective users of a consumer credit report that reflects fraud alerts or active duty alerts generally may not establish certain new credit plans or extensions of credit in the name of the consumer unless certain criteria are met, including specified verification or contact procedures. Credit cannot be denied based on the existence of a fraud alert or active duty alert. Rather, the bank must use the specified methods to verify the identity of consumers with such alerts on their records. In addition, FACT Act provisions provide that certain entities that make or arrange certain mortgage loans secured by 1-4 family properties for consumer purposes using credit scores must provide the score and a standardized disclosure to the applicants. Examiners should familiarize themselves with FACT Act provisions and consult with their compliance counterparts if they run across concerns.

MULTIPLE ACCOUNTS

Without proper controls, multiple account strategies can rapidly and significantly increase the bank's risk profile. The elevated risk profile may come in many forms, such as excessive credit risk or elevated reputation risk. Ill-managed multiple account strategies can exacerbate portfolio deterioration trends.

Management's practices for considering the bank's entire relationship with an applicant, including, but not limited to, any other existing card accounts, should be incorporated into the examination review. The bank's system to aggregate related credit exposures should also undergo review. In extreme cases, some banks have granted additional accounts to borrowers who were already experiencing payment problems on their existing accounts. Examiners should expect management to carefully consider and document its decision to offer multiple accounts, especially when the products offered are accompanied by substantial fees that limit credit availability and card utility. A best practice for management is to identify why use of a multiple account strategy was selected as compared to use of a line increase program. For banks that offer multiple credit lines, examiners should see evidence that management has established sufficient reporting to show items such as count, balance, and performance of cardholders that hold more than one account. They should also determine whether management compares the performance of multiple account portfolios against the performance of portfolios where each cardholder maintains only one account. Regulators can and have required banks to discontinue multiple account strategies when management has not provided for these necessary and appropriate management tools and reporting. If multiple account strategies are not offered, examiners should evaluate how management prevents multiple accounts from being issued.

INITIAL CREDIT LINE ASSIGNMENTS

With the profitability potential that credit cards typically exude, issuers usually try to assign the highest credit lines possible. But, the potential rewards must be balanced with the risks for the programs to be effective. Thus, it is critical that initial credit line assignments are based on sound credit information. Inadequate analysis of repayment capacity usually results in consumers receiving higher credit lines than they may be able to service and the risk of default heightening.

Criteria for line assignments varies but is often based on a combination of credit bureau score, income level, and/or other criteria. In any case, the credit lines assigned should be commensurate with the consumer's creditworthiness and ability to repay in accordance with soundly-established terms, including emphasis on a reasonable amortization period. As discussed in the Marketing and Acquisition chapter, some banks assign the credit line up front and disclose the line to the consumer as part of the pre-approved offer while other banks assign the credit line on the back end, such as by offering the consumer a credit limit up to a maximum amount in the solicitation. For back-end credit line assignment, the amount of the credit line is not assigned until the consumer responds to the solicitation.

As discussed in that chapter, compliance, credit, reputation, and other risks may arise depending on credit availability and card utility at account opening. Banks that offer products with limited credit availability or card utility at account opening are expected to maintain careful and thorough analysis demonstrating that the product will be and is marketed and underwritten in such a way to fully address the various accompanying safety and soundness and consumer protection concerns raised by such products.

POLICY AND UNDERWRITING EXCEPTIONS

Policy and underwriting **exceptions** are conditions in approved loans that contravene the bank's lending policies or underwriting guidelines. In an automated approval environment, policy exceptions should be rare. However, if the underwriting process includes a judgmental element, overrides are more likely to occur. Examiners should look for evidence that management has provided guidelines and limitations for granting loans that do not conform to the lending policy and underwriting guidelines and that it has established procedures for tracking and monitoring loans approved as exceptions.

Tracking exceptions is a valuable tool for several reasons. In addition to aiding the assessment of portfolio risk profiles and the adequacy of loss allowances, it helps hold staff accountable for policy compliance and reassess the appropriateness of existing policies and practices.

Exceptions are tracked both on an individual and aggregate basis. Tracking the aggregate level of exceptions is common and helps detect shifts in the risk characteristics of the credit card portfolio. It facilitates risk evaluation and helps management identify new business and training opportunities. Analysis of aggregate exceptions eventually enables management to correlate particular types of exceptions with a higher probability of default. Policy and underwriting exceptions that are viewed individually might not appear to substantially increase risk. But, when aggregated, those same exceptions can considerably increase portfolio risk. As such, early detection and analysis of adverse trends in exceptions is a necessary element for ensuring timely and appropriate corrective action.

An excessive or increasing volume or a pattern of exceptions could signal unintended or unwarranted relaxation in underwriting practices. If the volume of exceptions is high, management may be prompted to reconsider its risk tolerance, revise policies to be better aligned with the credit culture or current market conditions, establish new limits on the volume of exceptions, or change the type of exceptions permitted. When management has revised policies in response to high volumes of exceptions, examiners should assess the implications of the revisions, including impacts on the bank's risk profile.

While high volumes of exceptions may indicate increased risk, so can a lack of exceptions. A lack of exceptions may indicate that the policy is too general to set clear limits on underwriting risk. If examiners identify an absence of exceptions, they should carefully review the bank's policies to ascertain whether such policies provide adequate and clear guidance and limits.

Examiners should gauge the sufficiency of portfolio managers' procedures for comparing the performance of exception loans with that of loans made within established guidelines. To facilitate comparison, management often uses exception coding and retains it even if the condition triggering the coding no longer exists. Examiners should review management's practices for dropping exception codes or re-coding and should identify whether the practices skew or spoil the effectiveness of exception tracking.

INDICES AND REPORTING

A variety of indices are available regarding the underwriting function and its relationship with the marketing function. Items of interest include, but are not limited to:

- Origination cost per account, which is the total origination cost over a measurement period in relation to the number of accounts that were originated during that same period. It measures the cost of establishing a new account relationship.
- Approval rate, which is the number of accounts approved over a measurement period in relation to the number of applications (or responses) received.
- Booking rate, which is the number of accounts actually booked over a measurement period in relation to either the number of approved accounts or the number of applications (or responses) received. In some instances the customer applies for credit but then declines the offer after approved.
- Override rate, which is the number of overrides over a measurement period in relation to the number of applicants in the population.
- High-side override rate, which is the number of applicants over the cut-off score who were denied credit in relation to the number of applicants over the cut-off score.
- Low-side override rate, which is the number of applicants below the cut-off score who were given credit in relation to the number of applicants below the cut-off score.
- Application processing time, which is the amount of time it takes the institution to

process the application from the time of receipt to the point the credit decision is made and communicated to the consumer.

Portfolio problems can frequently be traced back to the bank's business generation and underwriting practices. Management is expected to devote sufficient resources to analyze changes in underwriting and credit scores, use appropriate systems and analytical tools to examine the results, and monitor warning signs of market deterioration. Common reports found in the underwriting department include, but are not limited to, those detailing policy changes, average credit score for new accounts, average initial credit lines assigned, approval rates, booking rates, and costs associated with the marketing and underwriting functions. Examiners should also determine whether management is monitoring reports as detailed in the Multiple Account Strategies and Policy and Underwriting Exceptions sections of this chapter. They should also look for evidence that management is using appropriate and sufficient segmentation techniques (program type, vintage, marketing channel, score distribution, etc.) within its reporting and is frequently monitoring marketing reports, usually no less than monthly.

SUMMARY OF EXAMINATION GOALS – UNDERWRITING AND LOAN APPROVAL PROCESS

Review of the underwriting and loan approval process is important because the goal of the examination is not only to identify current portfolio problems, but to identify potential problems that may arise from ineffective policies, unfavorable trends, lending concentrations, or non-adherence to policies. Examiners normally review items such as:

- The structure of the underwriting department and the expertise of its staff.
- Applicable board and/or committee minutes (in coordination with the examiner-in-charge).
- Underwriting policies and procedures.
- Underwriting chronology logs or similar documents summarizing changes in the underwriting and loan approval process.
- Planned underwriting and loan approval changes.
- Management reporting, tracking, and monitoring, including department statistics, portfolio statistics, and other segmentation statistics.
- Automated underwriting systems.
- Controls over judgmental underwriting processes.
- Management's identification of and response to adverse trends in the underwriting and loan approval area.
- Audits or other reviews of the underwriting and loan approval function.

The following items might signal current or future elevated risk and, thus, might warrant follow-up:

- Excessive or rapidly rising approval rates.
- Frequent or substantial changes in underwriting criteria.
- High employee turnover in the department.
- High or increasing exception volumes.
- Extremely low or non-existent exception volumes.
- High or increasing volume of accounts closed shortly after booking.
- Adverse performance of multiple account holders compared to cardholders with only one account.
- Few or ineffective management reports.
- Trends in the credit score distribution toward higher-risk accounts.
- High or increasing volume of consumer complaints.
- Credit lines inconsistent with products offered or with the target market's risk profile.
- Trends showing marked changes in average assigned lines.

These lists are not exhaustive, and examiners must exercise discretion in determining the expanse and depth of examination procedures to apply. If examiners identify significant concerns, they should expand procedures accordingly.