beneficial state impact

Special Purpose Credit Programs

URJ Discussion

September 28, 2022

The Basics:
What is a Special Purpose Credit Program?

ECOA/Reg B prohibits discrimination against protected classes—and in most instances prohibits the collection of data that could be used to discriminate . However, the regulation also contains a carveout (Section 1002.8) establishing SPCPs as an exception

- "A creditor may obtain information that is otherwise restricted to determine eligibility for a special purpose credit program, as provided in § § 1002.8(b), (c), and (d)."
- The program must be established and administered to extend credit to a class of persons who, under the organization's customary standards of creditworthiness, probably would not receive such credit or would receive it on less favorable terms than are ordinarily available to other applicants applying to the organization for a similar type and amount of credit.
- If participants in a special purpose credit program described in paragraph (a) of this section are required to possess one or more common characteristics (for example, race, national origin, or sex) and if the program otherwise satisfies the requirements of paragraph (a) of this section, a creditor may request and consider information regarding the common characteristic(s) in determining the applicant's eligibility for the program.

The Basics:

What is a Special Purpose Credit Program?

TL;DR

With an SPCP, lenders can design and deliver loan products for a specific disadvantaged group of people (not offered to others who do not share characteristics with the priority audience)—that addresses the credit needs of that specific priority audience.

More Basics

- This carve-out was included in the amendment of the statute in 1977, making it nearly 50 years old.
- There is a recent surge in interest in the wake of racial justice movements gaining more visibility in the last few years, plus the release of new guidance by agencies including CFPB, Fed, FDIC, NCUA, OCC, HUD, DOJ, and FHFA.
- Any creditor can develop an SPCP (e.g. banks, credit unions, CDFIs, non-bank lenders).
- Most existing SPCPs are mortgage products or small business loans.

Relevance for URJ

- SPCPs allow institutions to design financial products and programs that address the barriers and needs of specific groups of people—for example, BIPOC consumers and BIPOC business owners—*and limit access to that product/program to the people it is designed to serve*.

- SPCP can be a tool to launch an URJ pilot within regulatory requirements.

- SPCPs are relevant to everyone who must comply with ECOA.

SPCP Requirements

- Demonstrate the need for SPCP by collecting data on historical or present barriers to accessing capital by your priority audience.
- Design the credit intervention and underwriting criteria to address the need above. SPCPs must be designed to provide credit where credit would otherwise be denied under conventional products or provide the credit with more favorable terms than would otherwise be offered.
- Write a Written Plan.
- Share Written Plan with regulators (not formally required).
- Track performance over time.

Research Questions

- Are SPCPs an effective tool for advancing racial equity?
- Why do so few banks have SPCPs?
- Among those that do, what are the challenges in establishing SPCPs?
- What are the common elements among successful SPCPs?
- What is needed to encourage banks in particular (and lenders in general) to develop SPCPs?
    - To test our ideas, some useful tools could include a public list of existing SPCPs, public encyclopedia of supportive data sources, template of a written plan, suggested workflow in designing the program, policy advocacy and/or banker education, published legal analysis

Findings to Date

- Interviewed 7 institutions (5 banks, 2 loan funds), representing different products and a variety of approaches in underwriting, data collection, and workflow.
- All have seen successful portfolio performance AND equity outcomes.
- None received formal regulatory 'approval,' but most received informal blessing from regulators.
- Several institutions expressed a desire to eventually design *all* their lending products to operate like their SPCP does.
- SPCP's can also provide additional motivation for banks to examine diversity/representation, including at leadership levels, because this helps drive further SPCP success.

Organization #1

Type	Small business lending
Priority audience	Minority-owned (Black or African American, Asian, American Indian or Alaska Native, Native Hawaiian or other Pacific Islander, Hispanic or Latino), Woman-owned , Veteran-owned, LGBTQ owned businesses
When established	May 2021
Pricing/Product description	All pricing is same, there are no preferred terms. Program is designed to increase approval rates, not to provide more favorable pricing.
Underwriting	Lower credit score minimum. Higher DTI allowed. No specific industry type treatment for industries such as restaurants, convenience stores, schools.
Results from justice/equity perspective	They hypothesized an approval gap, and the SPCP is demonstrating that there is.
Other insights	SPCP is not a standalone program (like SBA); rather, it is overlaid on top of their existing business loan products. This makes analysis of the program's success very easy—approval rates clearly increase.
Demographic qualifications approach	Self-reported: Applicant checks one or more boxes indicating they are Minority-owned, women-owned, etc.
Partnerships	N/A

Organization #2

Type	Small Business loans for various purposes (working capital, CRE, equipment or vehicle purchase)
Priority audience	In 1993: People in LMI census tracts. In 1996: Minority- and woman-owned businesses. In 2006: Added service-disabled veteran-owned businesses, then disabled veterans, then all veterans.
When established	1993
Pricing/Product description	Fixed rate, unsecured, or secured y-year term loan or up to 25year term loan for owner-occupied CRE. Or variable rate, unsecured or secured LOC subject to annual renewal.
Underwriting	Many elements of expanded/relaxed UW criteria: lower credit score; elimination of high supplier concentration disqualifier; higher leverage is alloed and global cash flow minimum lowered; guarantor net worth requirement lowered/more flexible; owner liquidity requirements flexed; property related lowns require only 20% down payment compared to 30% for non-SPCP loans; option for longer term for property loans in order to reduce monthly payments
Results from justice/equity perspective	15% of SPCP borrowers would not have otherwise qualified for loan without the SPCP's flexible underwriting. Org regularly examines whether they are serving the racial/ethnic groups/women/veterans they want to serve.
Other insights	Portfolio has performed as well or better than the rest of commercial loan portfolio.
Demographic qualifications approach	Self-reported for race and gender; veterans must provide DD214 form demonstrating honorable discharge. Data is not separated from loan application.
Partnerships	No formal partnerships, but many business relationships for outreach/marketing efforts including cultural/ethnic chambers of commerce, professional and trade associations, etc.

Organization #3

Type	Home mortgage lending
Priority audience	Borrowers with ITINs (almost entirely Latinx borrowers)
When established	Q1 2022
Pricing/Product description	30-year fixed rate mortgages
Underwriting	Up to 90% LTV. No mortgage insurance requirement. Minimum credit score is an eligibility criteria, but pricing is not connected to credit score. UW is focused largely on LTV.
Results from justice/equity perspective	Of the top 8 most popular mortgage insurance providers, only 1 accepts ITINs. This means ITIN-holding home-buyers would need at least 80% LTV since they would have a much harder time finding a mortgage insurance provider compared to people with SS numbers.
Other insights	"Stellar" performance, with losses equal to or better than secondary market performance. SPCP actually helps protect against Fair Lending concerns that the org would have otherwise had.
Demographic qualifications approach	Borrowers apply under their ITIN number. HMDA data is collected as usual but kept separate from credit decisioning.
Partnerships	N/A

Organization #4

Type	Small business loans
Priority audience	BIPOC- or Woman- owned small businesses in operation 18 months+ and located in a LMI community in the org's region.
When established	Q1 2021
Pricing/Product description	Loan limit of $1MM. Can be used for business acquisition, refi, equipment financing, owner-occupied CRE, LOC's
Underwriting	Does not use credit score at all; instead, uses utility bills, phone bills, etc. and looks at prior 3 years of business income instead of 2. Screen for negative indicators like delinquencies but will override them in most circumstances (e.g., C/Os for medical events are exempted). Flexible amortization periods.
Results from justice/equity perspective	With help of smarter marketing, the org has been able to support more BIPOC- and Women- owned businesses than they believe they did before the SPCP. Certainly, they increased approval rates for qualified businesses compared to approval rates without the SPCP.
Other insights	Initially designed with a rate buy-down benefit. However, this created too much subjectivity in terms/pricing and the rate discount didn't materially improve borrower's ability to repay. Instead, they changed program design to a pooled fund model and the supportive capital is treated as top-loss reserve.
Demographic qualifications approach	Self-reported. Borrower attests they are a qualifying business type (BIPOC- or Woman-owned) but does not specify which.
Partnerships	Program is paired with philanthropic capital. A funder approached org and wanted to support BIPOC businesses. This funder remains a partner in the org's SPCP.

Organization #5

Type	Small dollar loans for home emergency repairs
Priority audience	Black or African American borrowers who earn less than $140k/year.
When established	March 2022
Pricing/Product description	$40k loan limit. Flat 4% rate for all borrowers, with 7-year term for $10-$20k loans and 10-year term for $20-$40k loans. No flood fee, no appraisal fee, no financing charges, NO FEES.
Underwriting	660 credit score minimum—soon to be lowered to 620. No LTV requirement. Minimum 50% DTI but will accept rental income for borrowers with 2-4 family home. Org requests W2s, income tax statements, proof that applicant has paid the last several months of primary mortgage.
Results from justice/equity perspective	Borrowers report not being able to get comparable credit anywhere else. Also, nonprofit partner maintains a database of Black/African American contractors and other home repair service providers, which borrowers are encouraged to use. This enables further community investment.
Other insights	Nonprofit partner was instrumental in establishing trust between prospective applicants and the org. Other programs exist in their region, but with extremely low-income thresholds ($25k/year) or only for elderly 65+. Strong loan performance.
Demographic qualifications approach	Borrower must self-identify as Black or African American. Data is collected on the loan application and is not treated separate from UW, as it is a prerequisite to the program.
Partnerships	Local nonprofit housing agency serving Black/African American communities in the org's region.

Organization #6

Type	Various residential mortgage-related products (mortgages for home purchase, home improvement, HELOC, etc.)
Priority audience	LMI borrowers in LMI census tracts
When established	Early 2018
Pricing/Product description	Product is not available to general public; only to people living in LMI census tracts. Reduced financing fees.
Underwriting	Lower down payment minimum. More forgiving DTI ration. Reduced credit score minimums. Pricing enhancements. Some other policy exceptions.
Results from justice/equity perspective	This is not shared publicly.
Other insights	This org's initial motivation in developing their SPCP was a "Needs to Improve" result on CRA exam. SPCP, in addition to other CRA enhancements, helped them improve their CRA rating. The costs of developing/administering the program paid off in this way.
Demographic qualifications approach	Geographic qualifier.
Partnerships	Nonprofits were key in helping design the SPCP, but also important in collecting feedback about how to change SPCP over time. Nonprofit partners help solicit borrower applications, offer TA and education e.g. free homebuyer workshops, classes on how credit works and how to improve credit, etc.

More Findings to Date

- Confirmed some of our assumptions about what is needed in the field.
- Policy priorities: Sandbox?
- Interest in SPCPs continues to grow; new public tools are being released by various interested orgs (e.g. www.spcptoolkit.com).

Source: spcptoolkit.com

Thanks!

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