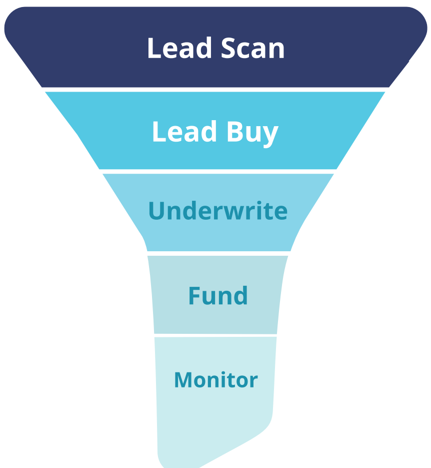
Driving Down Cost Per Funded & First Payment Defaults with Lokyata

Introduction

Cost-per-Funded and First Payment Defaults (FPDs) are key performance indicators tracked by most, if not all, lenders. Lokyata takes a holistic, managed services approach to measuring and improving these tightly connected KPIs and the processes that affect them. **Lokyata is your Risk Team in a Box.**



Lenders in many sectors depend on lead marketplaces to operate their businesses. The lead marketplaces generate millions of leads per day through a network of affiliates that attract borrowers through targeted messaging and internet search optimization. Borrowers complete one or more loan applications online that are routed through the affiliate networks, filtered, and segmented based on buyer (lender) preferences, then pushed to prospective buyers. The lenders evaluate each lead, then decide whether to buy the lead or pass. Once a lead is purchased, the lender engages with the borrower to complete the underwriting process and fund the loan. This process can be viewed as a funnel where the number of potential funded loans is reduced through conversion loss at each step. For this white paper, we will focus on consumer installment lenders and Lokyata's approach to addressing the two key business drivers - Cost-per-Funded and First Payment Defaults. We will also assume the reader is familiar with the lead marketplaces, lead scanning, ping trees, and third-party data sources used in the decision-making process.

Lead Scan and Lead Buy

A good lead is one where there is a reasonable expectation that the borrower will respond to the lender, pass underwriting, accept the loan, and repay it on time. Choosing which leads to purchase from the millions available each day is challenging given the business goals and constraints.

There are three primary costs associated with the Lead Scan/Buy process that make up the majority of the Cost-per-Funded. The cost per funded is calculated as the total spent in these three areas plus the underwriting costs divided by the number of funded loans. (Lead Cost + Underwriting Cost) / #Funded.

- Cost of the lead from lead marketplaces.
- Third-party data.
- API, Workflow, and Decisioning platform.

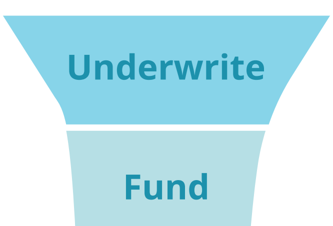
Decisions made at this point in the funnel can have a dramatic effect on portfolio performance and profitability as the purchased leads will eventually be underwritten and funded. Business goals and constraints help inform the strategy to balance lead purchase cost and funding volume with acceptable first payment default and write-off rates. Standalone business rules can filter out many unsuitable leads and are very inexpensive to execute. Business rules connected to third-party APIs and data sources can range in cost from a few cents to a few dollars per lead analyzed. A common methodology is the waterfall, where the leads are filtered through progressively more expensive analysis steps until a few fall out that are deemed purchasable. Through Lokyata's Managed Service, platform APIs, waterfalls, workflows, business rules, and decisioning algorithms are refined to continuously improve the lead scanning and purchase processes, to buy the right leads at the right price, then optimize spend and return on investment for third-party data providers.

Lead Purchase to Underwriting Conversion Loss

Once the leads are purchased, it is common for 15% -25% of the borrowers to not respond to the lender to start the underwriting process. This conversion loss immediately increases the cost per funded before any underwriting loss. Tracking the conversion rate from Lead Buy to Underwriting is important for evaluating the different lead providers and the quality of the leads they present for evaluation, and the decision-making time of the lead scanning process to respond to applicants in a timely fashion. Reducing conversion loss at this step by effective lead evaluation can materially affect cost-per-funded.

Underwriting and Funding

Underwriting effectiveness affects the performance of the business and portfolio in two areas, loan volume and loan default rates. Given an effective lead buying process, the maximum funding volume can be constrained by the human resources to underwrite and the capital to fund.

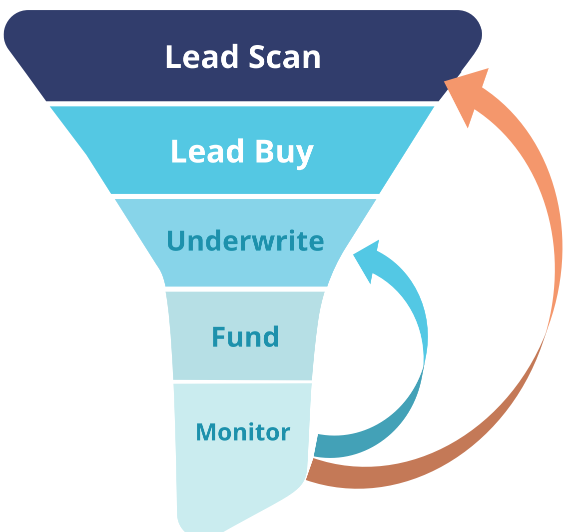


Lokyata reduces the human resource constraint through automated Instant Bank Account Verification (IBV) account transaction processing, analysis, scoring, and the final funding decision. Through a continuous improvement process, first payment default rates and write-offs are reduced.

Underwriting to Funding Conversion Loss

Conversion loss of those borrowers who have been underwritten and approved, but do not accept the loans, can significantly reduce the number of funded loans, driving up the Cost-per-Funded and lowering effectiveness of the underwriting process. Improving the lead buy and underwriting speed can reduce this conversion loss.

Monitoring and the Feedback Loop



A crucial aspect of the lead buy and underwriting approach is the ongoing monitoring and feedback loop used to continuously improve the key decisioning workflows, business rules, and algorithms during times of consistent customer behavior, drifting customer behavior, and during external shocks that immediately affect customer behavior, like COVID19. Outcome information in the form of customer payment behavior and funnel conversion rates are fed back to the Lokyata platform through APIs or batch processes. Advanced Analytics used in this process aggregates individual customer profile performance data into actionable feedback to improve the lead buy and underwriting processes, driving down Cost-per-Funded and First Payment Defaults.

Lead Scanning and Buying Strategies

Based on our experience, lead scanning strategies can be broadly categorized into three types; Low quantity of leads scanned with a high purchase rate of up to 100%; medium quantity of leads scanned (1000 to 10,000) with a medium purchase rate of 5% to 15%; and a high quantity (25,000+) of leads with a low purchase rate of 1-3% or less. Each of these strategies can produce good results that meet the business goals of the lender. Analyzing the costs and funnel conversion rates to optimize for lower cost per funded and first payment defaults may include adjusting the strategy.

How to Optimize the Funnel & Improve ROI

There is tremendous scope to improve efficiencies at each stage of the funnel - reduce cost per funded, first payment defaults, and increase the overall ROI. The best approach to solve this problem is to use an integrated solution that leverages data, enabling lenders to automate the decision process with data-driven decision models at each stage of the funnel. An ideal integrated solution would allow lenders to:

- Automate complex rules and manual/semi-manual processes at different stages of the funnel.
- Use data-driven decision models specifically designed to meet the lender's goals at each stage of the funnel and
- Implement performance monitoring and feedback models to learn and improve continuously.

Automation and data-driven models allow institutions to make focused improvements at specific stages of the funnel and have a significant impact on cost. Below is an example of an installment lender where we apply data-driven decision models at different stages of the funnel.

- Develop & manage lead scanning waterfalls through data-driven models optimizing spend on third party data.
- Scan more and purchase higher quality leads.
- Higher quality leads result in a higher borrower contact rate.
- Higher quality leads also increase the number of approved borrowers and funded loans.
- AI-driven automated bank account underwriting reduces human resource constraints.
- Continuous monitoring and feedback improve the lead-buy and underwriting performance.

The corresponding effect would be that the cost-per-funded loan would reduce to $293 from $149, a 49% reduction!

Further, improvement in FPDs facilitated by data-driven modeling at the underwriting stage and continuous monitoring of outcomes brings additional cost savings.

Metric & Cost at Funnel Stage	Sample Scenario (Before)				Sample Scenario (After)			
	Qty	Conv Rate	Unit Cost	Total Cost	Qty	Conv Rate	Unit Cost	Total Cost
Lead Scan	5,000		$0.02	$100	10,000		$0.20	$2,000
Lead Buy	500	10%	$23	$11,600	500	5%	$22	$11,000
Borrower Contacted	375	75%	$31		400	80%	$28	
Underwrite	90	18%	$130	$11,735	100	20%	$112	$11,150
Funded	40	8%	**$293**		75	15%	**$149**	

Table 1 – Sample Scenario Improvement

A solution that allows the institution to simultaneously target improvements at multiple stages of the funnel will help reduce not only the cost-per-funded but also the cost-per-repaid loan, substantially. Institutions based on their specific short to mid-term business goals can choose to enhance automation and decision making at specific stages or a combination of stages to reduce costs and improve ROI. An illustration of what such a solution would look like is shown in Figure 1 below.

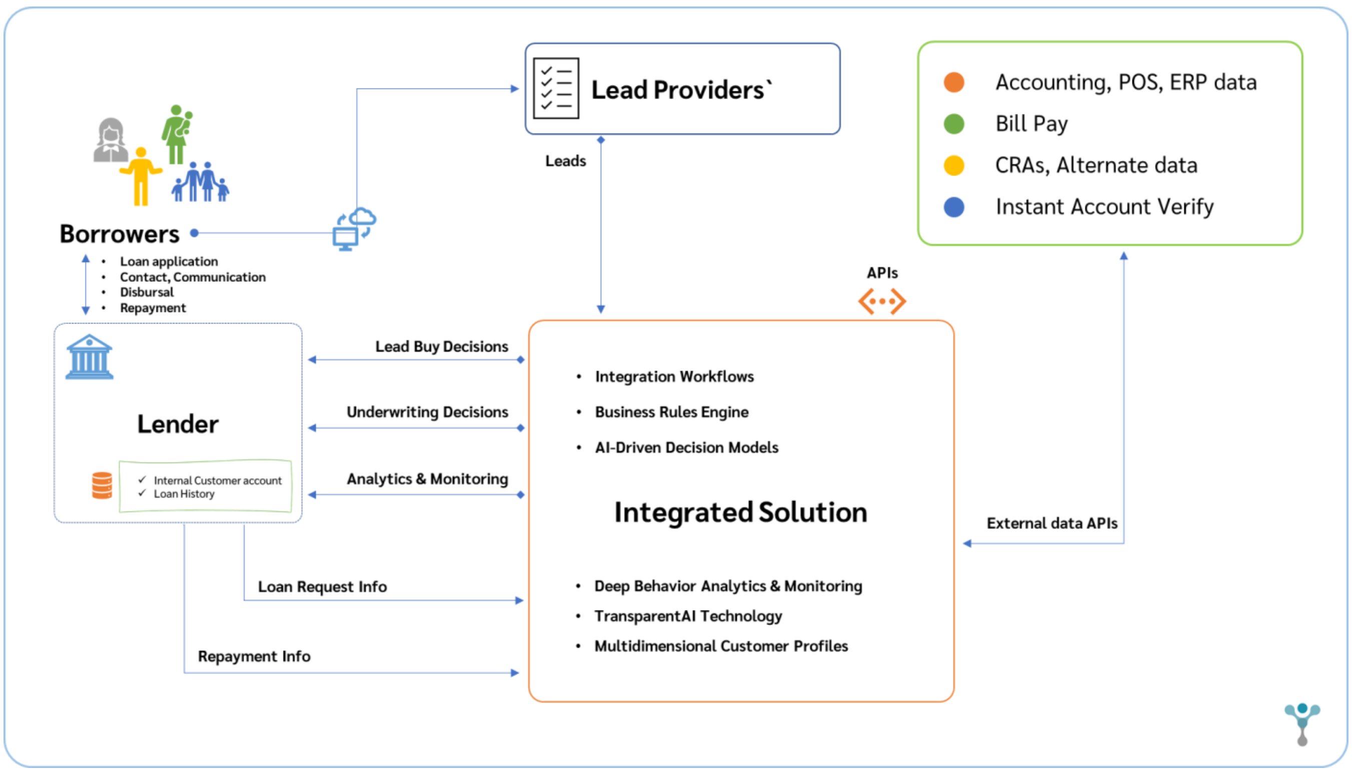


Figure 1

Summary

Integrated solutions that automate complex workflows, leverage multiple data sources, and implement data-driven decision models are critical for consumer installment lenders to improve efficiencies, quality, and reduce cost. Such solutions benefit not just the lenders, but also the end borrower through increased access to credit and lower interest rates.

About the author:

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