Capacity

Capital

Collateral

Credit history

Character

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The 5 Cs of Credit

B2B BANK

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Understanding credit qualification

At B2B Bank, we know that you strive to provide your clients with the right financial solutions, at the right time — including the potential offered by credit products. But only you know whether a credit product, such as a loan, is suitable for your client. And once you've decided that it is, the next step is to determine whether they'll qualify.

B2B Bank uses the 5 Cs of credit (capacity, capital, collateral, credit history and character) as part of our underwriting process. By understanding these components of credit, you'll have the ability to assess the likelihood of your client qualifying for a loan — which can be a real time-saver down the road.

Think of the 5 Cs as a tool to help you understand your client's credit viability. Because at the end of the day, you want to ensure you're able to recommend credit products with confidence.

Determine your client's capacity

Can they handle the debt?

Capacity is the estimated amount of debt a borrower can carry, and is determined by a mathematical calculation known as their Total Debt Service Ratio (TDSR). TDSR shows the amount of one's gross income dedicated to the repayment of debt, and indicates the amount of additional debt one could reasonably afford to carry. Here is a quick way to calculate TDSR:

Total monthly debt payments	÷	Gross monthly income	x 100% =	Capacity (TDSR)
Typical monthly debt payments include: Housing [mortgage Principal & Interest plus property tax (PI&T) or rent payments] Loan payments Credit cards (minimum of 3% of the borrowed amount on bank credit cards and 5% of the borrowed amount on store cards) Lines of credit (minimum 3% of the borrowed amount on unsecured lines and interest only on secured lines) Car lease payments, car loan payments		**Typical monthly income includes:** Salary Commissions Self-employed net earnings Net rental income		**As a rule, TDSR (including the new loan payment) should be less than or equal to 40%.**

Here's how to put the calculation into practice if your client is applying for a $100,000 investment loan:

Total monthly debt payments	÷	Gross monthly income	x 100% =	Capacity (TDSR)
Mortgage (PI&T) = $2,000 **New Investment loan = $417** **Line of credit = $400** **Credit card = $100** **Car lease = $600** **$3,517**		**Salary = $9,500** **Rental Income = $500** **$10,000**		**35.17%** Note: This is normally an acceptable TDSR as the applicant's monthly debt payments are less than or equal to 40% of their gross monthly income.

Monthly living expenses such as utilities, cable, phone bills, etc. don't need to be included in the TDSR calculation.

Assess your client's capital

Do they have sufficient financial resources?

Capital is the measure of a borrower's net worth and demonstrates their ability to manage their finances and accumulate assets while repaying debt obligations. It is calculated by subtracting an individual's liabilities from their assets. Capital reassures lenders by providing alternative ways for the borrower to repay debt other than their monthly income.

Generally, minimum net worth requirements depend on the amount of the loan. Using our example of an individual applying for a $100,000 investment loan[1], the applicant's net worth is greater than the minimum net worth requirement (1x the loan amount) and therefore, is more likely to qualify. Here's an illustration:

Assets		Liabilities	Creditor(s)	Monthly payments	Total amount
Residence (est. market value)	$ 450,000.00	Mortgage	ABC Bank	$ 2,500.00	$ 300,000.00
Other real estate	$	Other mortgages		$	$
Registered savings	$ 75,000.00	Condo fees (if applicable)		$	
Cash/Liquid assets	$ 10,000.00	Line(s) of credit	AAA Credit Union	$ 150.00	$ 5,000.00
Other investments	$ 25,000.00	Personal loan(s)		$	$
Other	$	Credit card(s)	ABC Bank	$ 100.00	$ 2,000.00
Other	$	Other		$	$
Total Assets	$ 560,000		Total Liabilities	$ 2,750	$ 307,000
			Net Worth (Assets minus Liabilities)		$ 253,000

Net worth minimums for fully-funded loans (e.g., 100% loans):

≤ $100K - 1 x the loan amount
> $100K - 1.5 x the loan amount
> $250K - 2 x the loan amount

Items that qualify as assets	Items that do not qualify as assets	Typical liabilities
A home (registered in the name of the applicant)	Home furnishings	Mortgages
Registered plans (RRSPs, RRIFs, etc.)	Works of art	Personal loans
Tax-free savings accounts (TFSA)	Jewelry	Credit card debt
Mutual funds (non-registered)	Leased vehicles	Line of credit balances
Stocks (that trade on major stock exchanges)		Leases
Savings accounts		Amounts owing to the Canada Revenue Agency
GICs and bonds		Child support/alimony

Your client can check their credit report to ensure that inaccurate or out-of date information is corrected.

Look at your client's collateral and review their credit history

Can their assets back their debt?

Collateral is a pledge of property or other assets that an individual uses as security against borrowed monies. The relationship between the value of these assets and the amount of the loan is called the loan-to-value ratio (LTV) and is expressed as a percentage:

Loan amount	÷	Collateral value	x 100% =	LTV (%)
(outstanding principal + accrued interest)		(total dollar amount of collateral)		

In general, products such as mortgages and home equity lines of credit are secured by a person's home, and investment loans are secured by the mutual or segregated funds that are purchased with the loan proceeds.

How have they managed credit in the past?

Credit history is a collection of information about a client's past behaviour in meeting debt obligations. To gather this information, lenders use scoring systems such as credit score and other statistical assessment tools to help determine the credit risk and creditworthiness of a potential borrower.

Factors that contribute to the development of a credit score	Items that do not qualify as assets	Typical liabilities
Time in the file (usually, the longer the better)	Making loan payments on time	Opening multiple credit products in a short period
Number and type of accounts (e.g., loans, lines of credit, credit cards, etc.)	Paying down revolving credit card debt	Borrowing from a finance company
References to accounts paid as agreed	Maintaining moderate utilization rate on credit cards	Regularly reaching or exceeding credit card limits
Residence status	Refraining from credit card consolidations	Closing seasoned, well-paid accounts
Derogatory information (e.g., late payments)	No bankruptcies, collections or judgments	
Bankruptcies, wage garnishments, liens, collection items		
Requests for new credit		
Level of utilization of available credit		

A Credit Score typically falls between 300 and 900. The higher the number, the better.

Know your client's character

Do they have good habits?

Underwriters also assess the **character** of an applicant which is based on a number of factors. This includes the stability of their career and residence, and their willingness to provide complete and accurate information.

Questions you should ask	Why your client's answers are important
Has your client used credit before?	Past behaviours often predict future tendencies. If an individual has successfully used credit in the past, it is a positive indication that borrowed funds will be repaid.
Do they pay their bills on time?	This shows their responsibility toward debt obligations. If an individual regularly pays their bills on time, chances are they'll make their loan payments on time too.
Does your client have a good credit report?	Credit reports show a consolidated financial picture from various lenders. Solid payment history and prudent credit utilization are good behaviour indicators.
How long have they lived at their present address?	This provides an indication of a person's overall stability. In general, we prefer to lend to individuals who have lived at their present address for at least two years.
How long have they been at their present job?	This provides a further sign of a person's stability and also indicates their ability to continue earning a steady, reliable source of income.

A client's character is strengthened, and the application process simplified, when all financial information is **fully disclosed and reported accurately**.

All obligations should be up-to-date and paid as agreed.
B2B Bank does not lend to individuals with a history of bankruptcies, collections or judgments.

1.800.263.8349 or visit **b2bbank.com**

To contact one of our Business Development Managers, please visit **b2bbank.com/contactus** to locate the manager nearest you.

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