Responsible Lending in Subprime Automotive Finance

"Community development financial institutions seek to counter social, economic, and political patterns and behaviors that make and keep people poor."

—The Brookings Institution

Daniel Chu
Founder & Chief Executive Officer

tricolor
HOLDINGS

CERTIFIED
CDFI
U.S. Department of the Treasury

Introduction

CDFIs support the American dream: that everyone should have an equal opportunity to achieve prosperity and success through their own talent and hard work.

Since launching our business over twelve years ago, our mission has been to enhance the life of our customer with access to affordable financing, the opportunity to build credit, and ultimately, a path to a better future. Importantly for us, the CDFI certification validates our core beliefs and purpose-driven aspiration to *do well by doing good*.

In 2019, Tricolor was certified as a Community Development Financial Institution (CDFI) by the Department of Treasury.

Our approach places the customer at the center. Capitalizing on our direct-to-consumer model provides deep insights into our consumer's needs and catalyzes our solutions to those needs, allowing us to continually refine our offerings, which results in increased engagement, loyalty, and ultimately, revenue.

Innovation is our pathway. Utilizing an unprecedented amount of data, our proprietary risk model "scores the unscoreable", leveraging emerging technologies including artificial intelligence and deep learning.

Access to affordable financing is fundamental to financial health. Opportunities to secure and build credit on affordable terms should be inclusive of segments of the population which have historically been underserved and marginalized.

Tricolor Customer by the Numbers

96%	**66%**	**50%**	**86%**	**15**
Hispanic	foreign born	no FICO	rent	average years in the US

Background on CDFIs

Community Development Financial Institutions (CDFIs) are private financial institutions that are 100% dedicated to delivering responsible, affordable lending to promote financial inclusion and help low-income and other disadvantaged people join the economic mainstream.

In the 1960s and 1970s, while many Americans were prospering, low-income and minority communities were generally excluded from this economic growth because mainstream banks and institutions deemed these communities too risky for investment. There was a common practice among banks called "redlining" where the banks would draw red lines on physical maps around neighborhoods deemed too risky for investment. They refused to provide loans or financial services to those areas. Since so many parts of the country were prospering, there was a noticeable gap in opportunity, development, and wealth. In terms of access to financial resources, it was clear that these communities were left behind. In effort to fight this discrimination, the government passed the Community Reinvestment Act in 1977. This act, known as the CRA, encouraged financial institutions to meet the needs of every part of the community they served.

In the 1990s, after the U.S. Department of the Treasury's Community Development Financial Institutions Fund (CDFI Fund) was established an organization that provides federal support to individual CDFIs serving low-income communities. Its establishment was critical in the development, organization, and modernization of the community finance industry. Traditional lenders were encouraged to support these activities and communities through revised regulations, requiring qualified loans and investments in CDFIs in order to fulfill these CRA requirements.

By providing financing to CDFIs, investors provide critical opportunities to the underserved population deserving of opportunities for accessing capital, by providing access to credit. CDFIs also provide financial education and technical assistance, credit counseling. Studies have confirmed that financial literacy programs often increase the likelihood that the borrowers will be successful and able to pay back their loan.

CDFI certification provides Tricolor with greater opportunities to partner with banks to expand its affordable, credit building lending strategy. The designation enables banks to legally invest in Tricolor securities to promote public welfare and fulfill their Community Reinvestment Act (CRA) obligations.

Key Fundamentals of Our Purpose-Driven Responsible Lending Model

Since its founding in 2007, Tricolor has empowered customers by providing access to affordable financing on high quality, certified vehicles in order to enhance the quality of their lives and ultimately help them to build a better future. For more than a decade, Tricolor has successfully scored no file and thin file Hispanics, as evidenced by five well-received ABS securitizations.

The key building blocks to our approach:

Provide **affordable financing to low income borrowers** through lower interest rates and lower gross margins, increasing the probability of their success in repayment.

Help borrowers **to establish bureau credit** by reporting to major bureaus, through partnerships with Experian and Equifax, regardless of status, in order to ultimately mainstream credit invisible borrowers.

Leverage technology and deep learning to develop a proprietary model in order to segment borrowers with little or no credit history, driving more favorable and attractive lending terms.

Support customers with **financial literacy** programs with customized content to empower them in order to access mainstream financing and ultimately, build a better future.

Tricolor is the only lender among all auto asset-backed securities issuers to earn CDFI certification and one of a select group of for-profit enterprises which meet the rigorous standards for helping communities.

Establish

Credit

Leverage

Affordable

Technology-driven AI-optimized

Deep Learning

Payments

Financial

Literacy
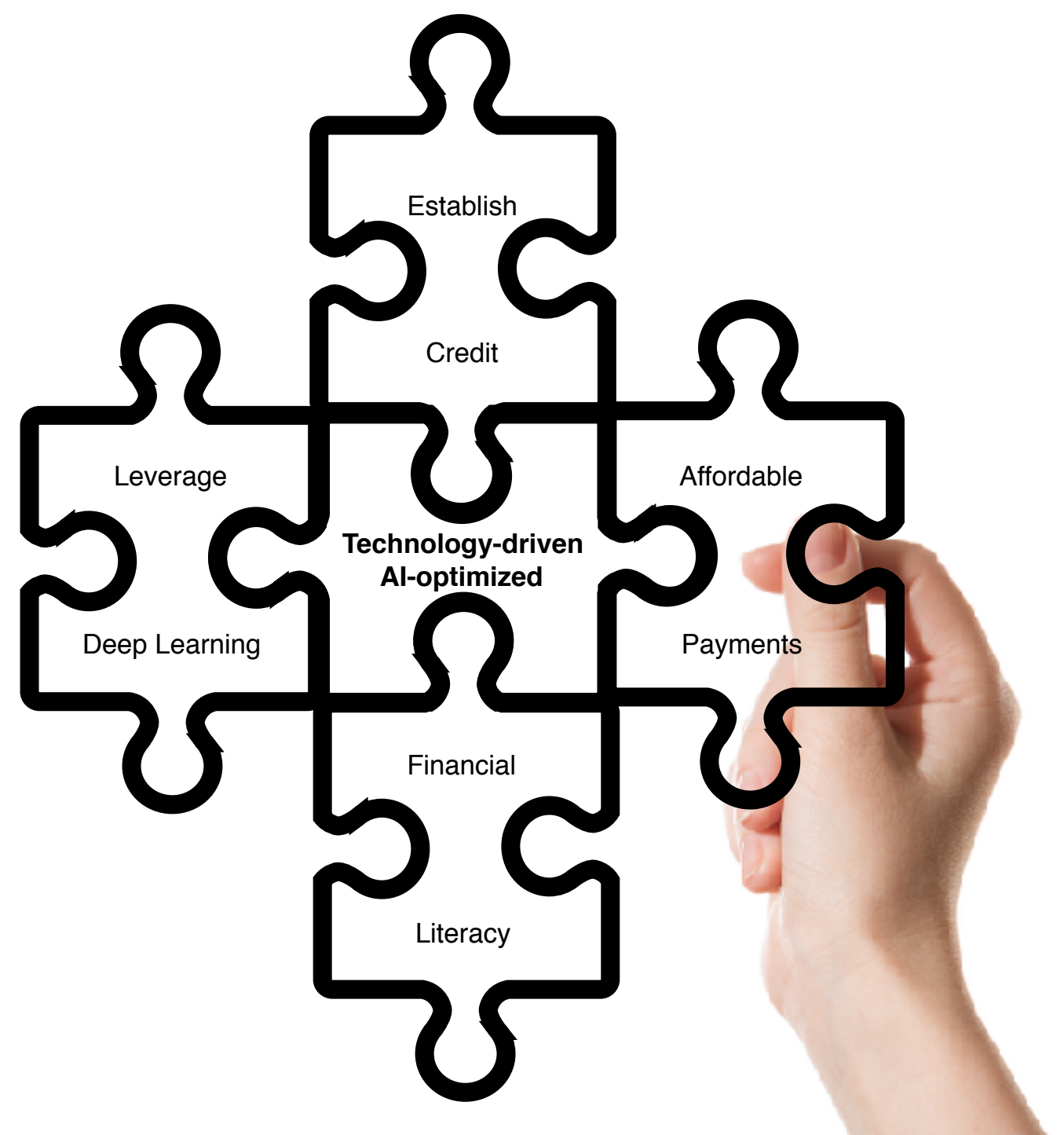
Offer Affordable Financing Terms

Loans provide access to credit for low income borrowers. 85% of Tricolor's portfolio would qualify for the Freddie Mac affordable lending program (Home Possible), with income at or below 80% of their county's median income.

Customer Income as % of County Median Income
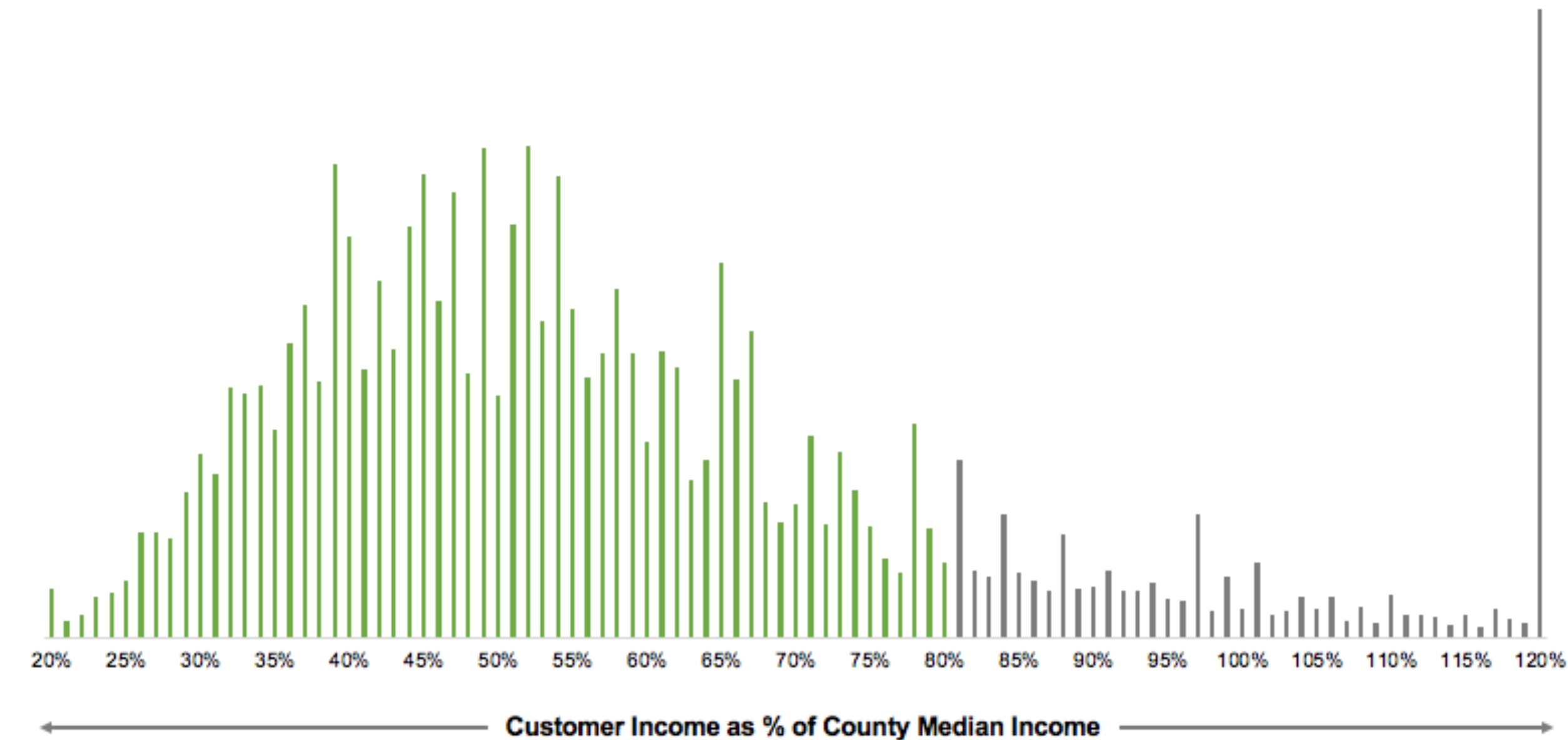
Source: Tricolor data, Freddie Mac Home Possible Income & Property Eligibility Tool

Credit losses are considerably lower than industry. Even with lower income, our cumulative net losses are below 20% comparing to BHPH industry peers at 30-35%.
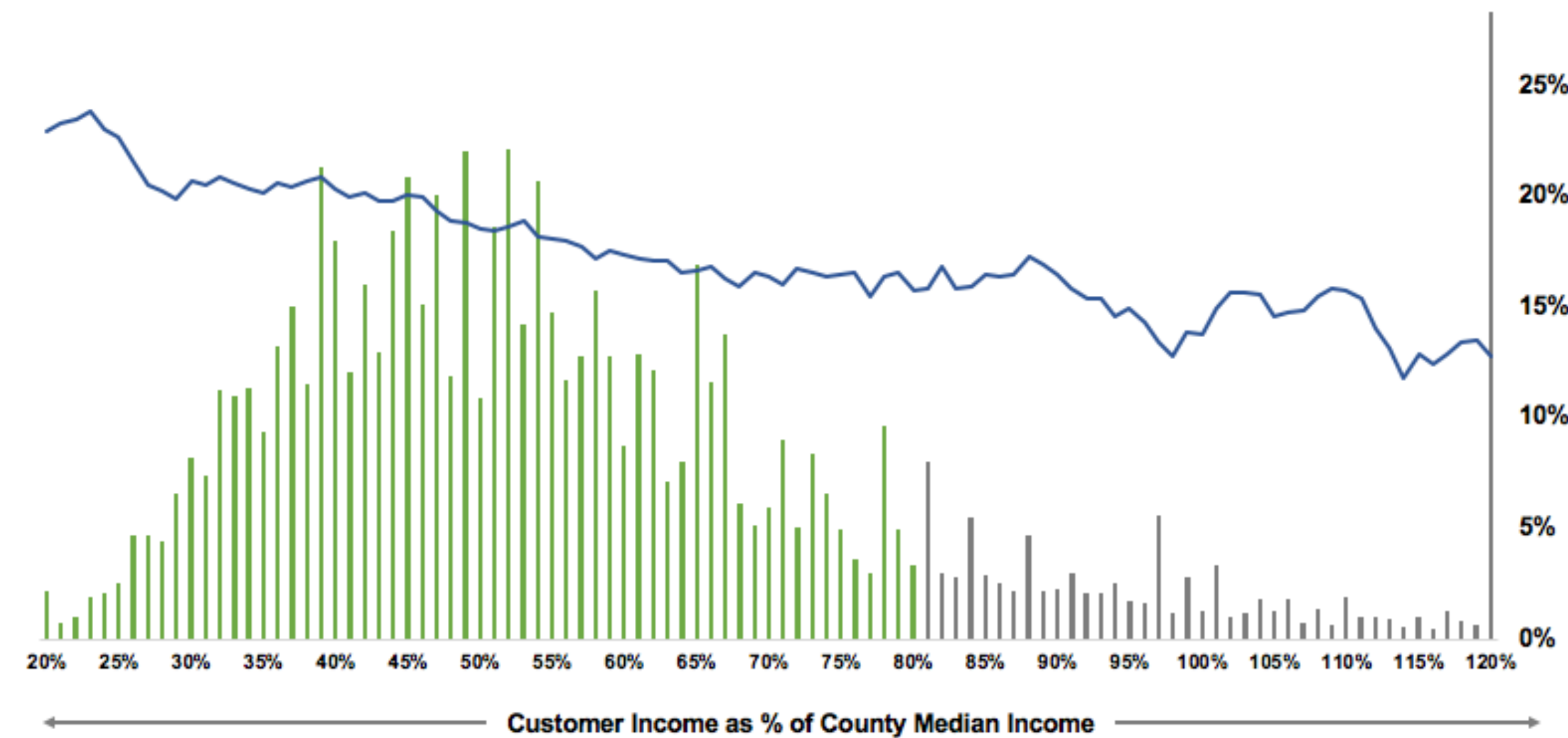
Customer Income as % of County Median Income

Source: Tricolor data, Freddie Mac Home Possible Income & Property Eligibility Tool

Offer Affordable Financing Terms

Interest rates are more attractive. Interest rate distribution between Tricolor and Santander Consumer's most recent subprime ABS transaction reflects Tricolor's focus on more attractive lending terms, which is even more pronounced given difference in cost of capital.
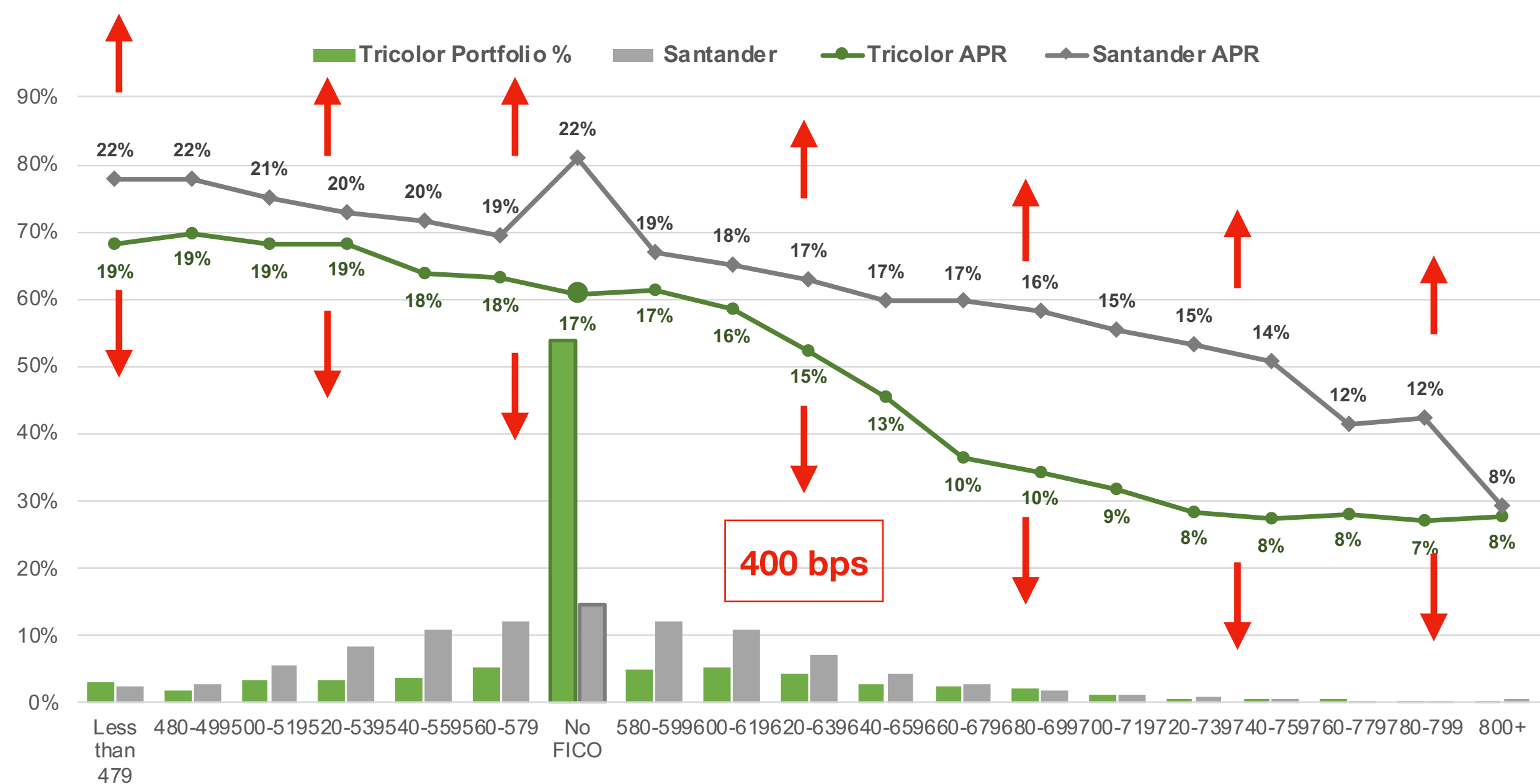
Source: Tricolor Internal Data; Drive Auto Receivables Trust 2020-2 Data Tape

Tricolor's platform drives inclusion. Compared to its finch peers, Tricolor provides more affordable and realistic terms to a more underserved cross section of consumers.
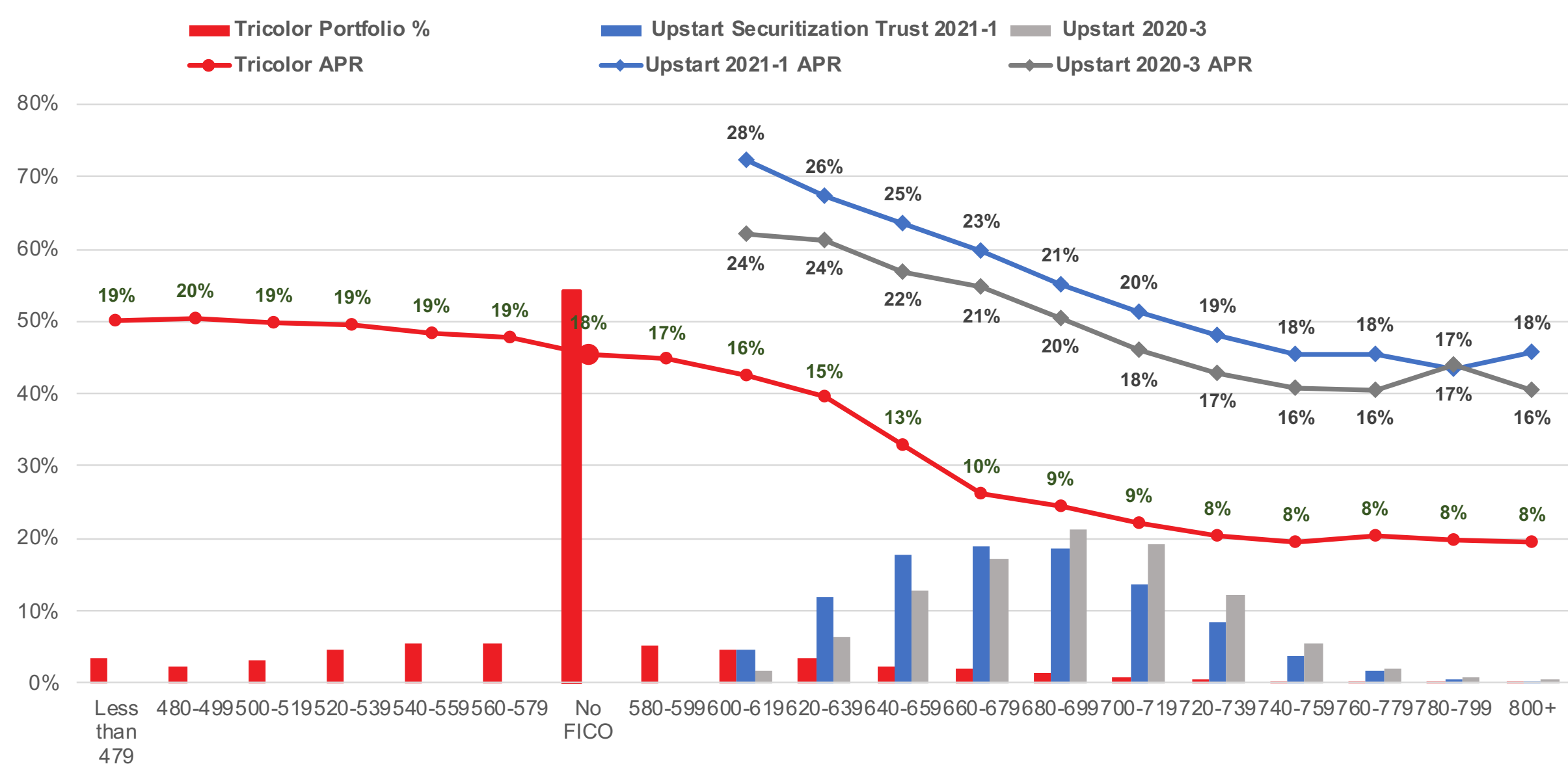
Source: Tricolor data, Upstart 2020-1, Upstart 2020-3

Offer Affordable Financing Terms

Tricolor delivers 50% more value than BHPH industry peers. Based on national industry averages, a borrower at Tricolor purchasing and financing vehicle with a wholesale value of $12,000 would contractually pay the same total amount in payments as a borrower at the average BHPH operator would pay for a vehicle with a wholesale value of $6,300.
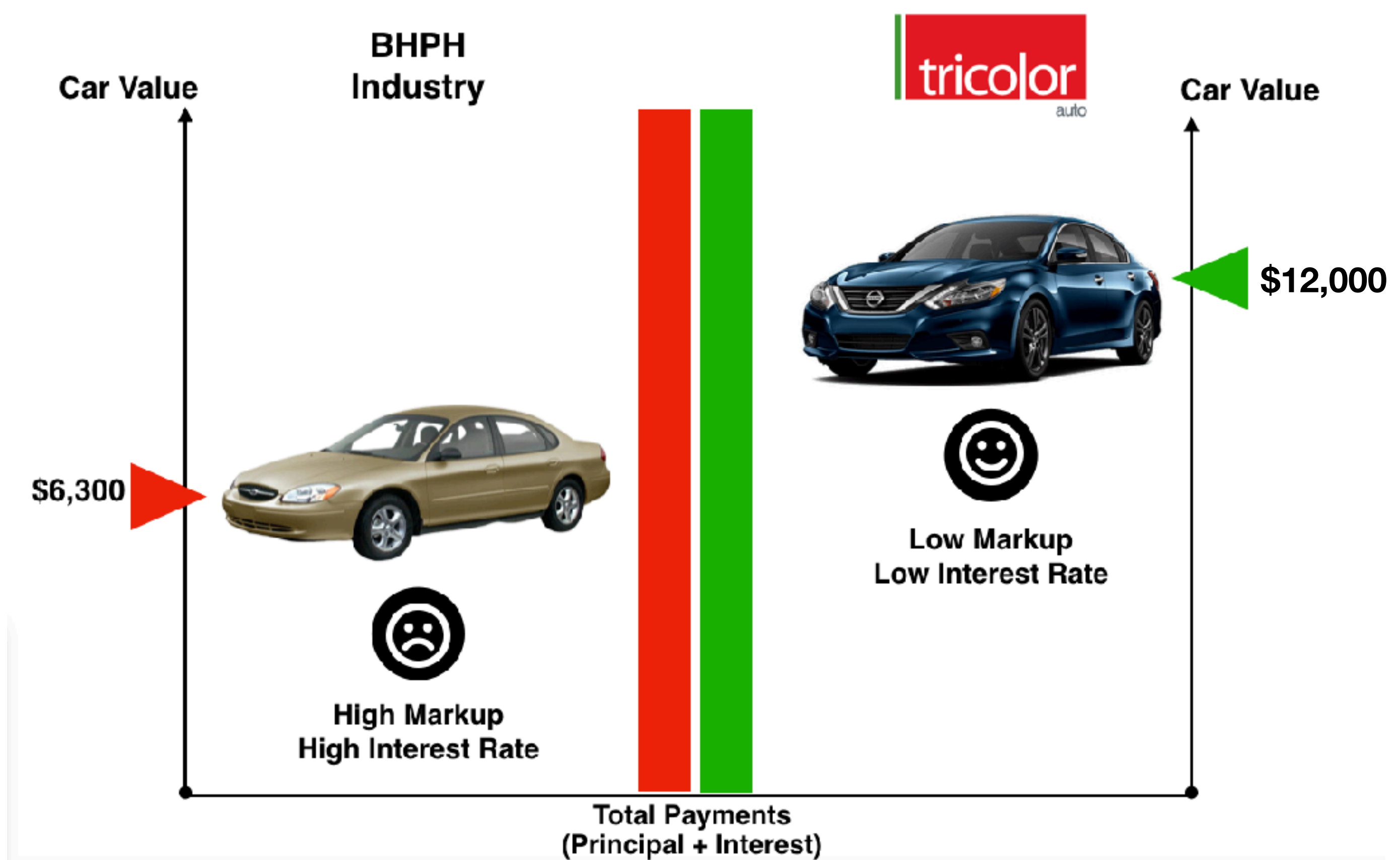
*"There are two kinds of companies——
those that work to raise their prices
and those that work to lower them"*

-Jeff Bezos

Establish Credit

According to the Consumer Financial Protection Bureau (CFPB), more than 45 million people in the United States lack a credit score or are unable to be scored effectively by traditional credit bureaus. These customers are often locked out of mainstream financial services and live in an alternative financial services world. Without access to traditional credit, these consumers are forced to secure credit from predatory or expensive alternatives, such as payday, pawn shop or auto title loans. Approximately 12 million Americans use payday loans at an average APR in excess of 300%. This perpetuates a downward cycle of debt and fees.

Establishing credit provides a path to ultimately accumulating wealth and a better future.

- Through partnerships with Equifax and Experian, Tricolor has helped 28% of its borrowers with no credit score establish a credit history.

- Additionally, by offering affordable lending terms, an additional 30% of Tricolor customers have improved their FICO score after securing credit from Tricolor.

Unable to Establish Credit History 25%

Credit History Established 28%

FICO Decreased 17%

FICO Improved 30%
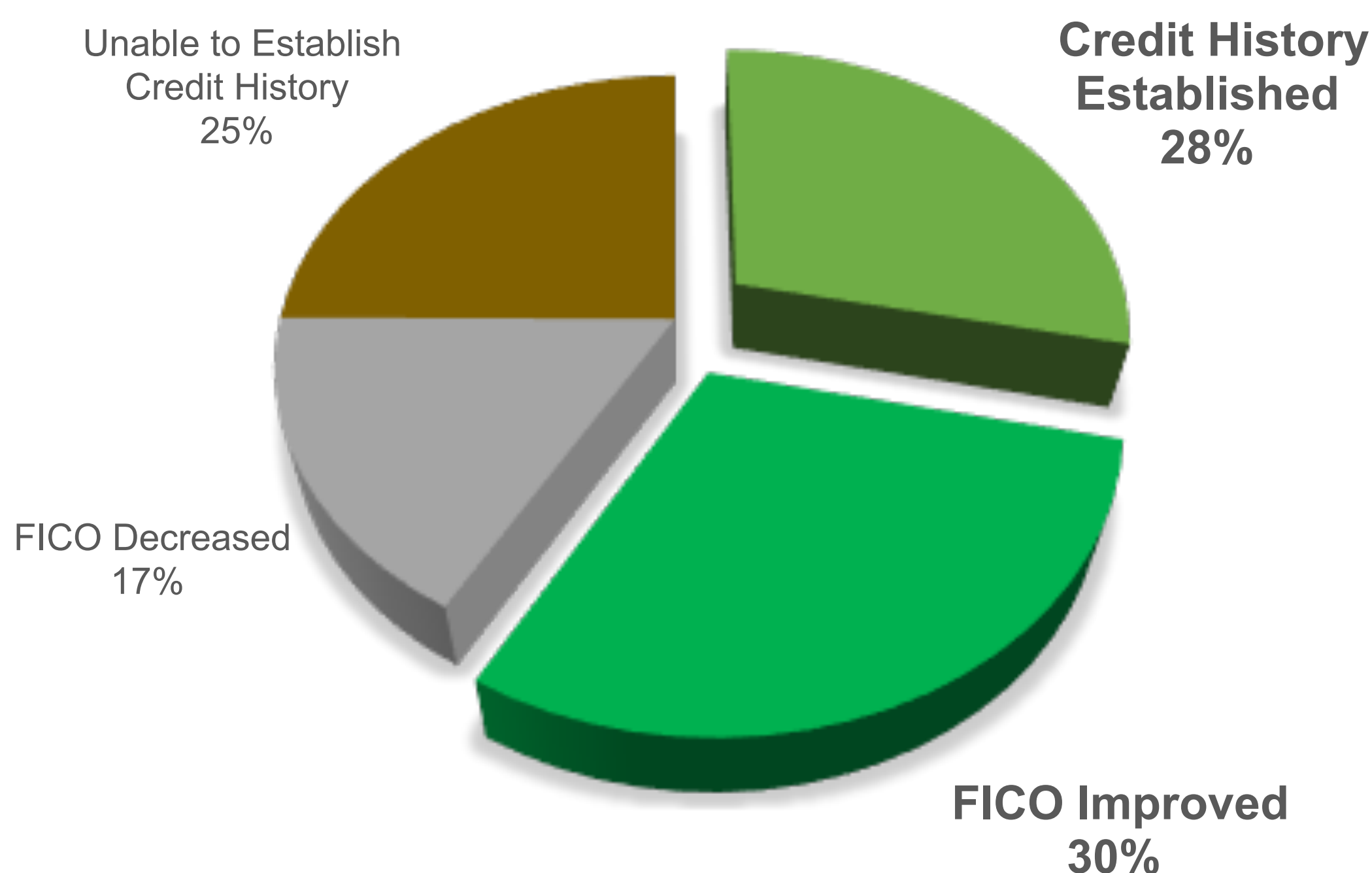
Source: Experian, Tricolor data.

Improve Financial Literacy

Through its partnership with EverFi, Tricolor provides an online financial education curriculum for free to any consumer.

Participation in the program increased 37% in 2019 and as a result of increasing communication with its existing customer base and increased awareness and promotion, participation has grown exponentially to nearly 300 users per month, corresponding to a growth rate year-over-year of 800%.
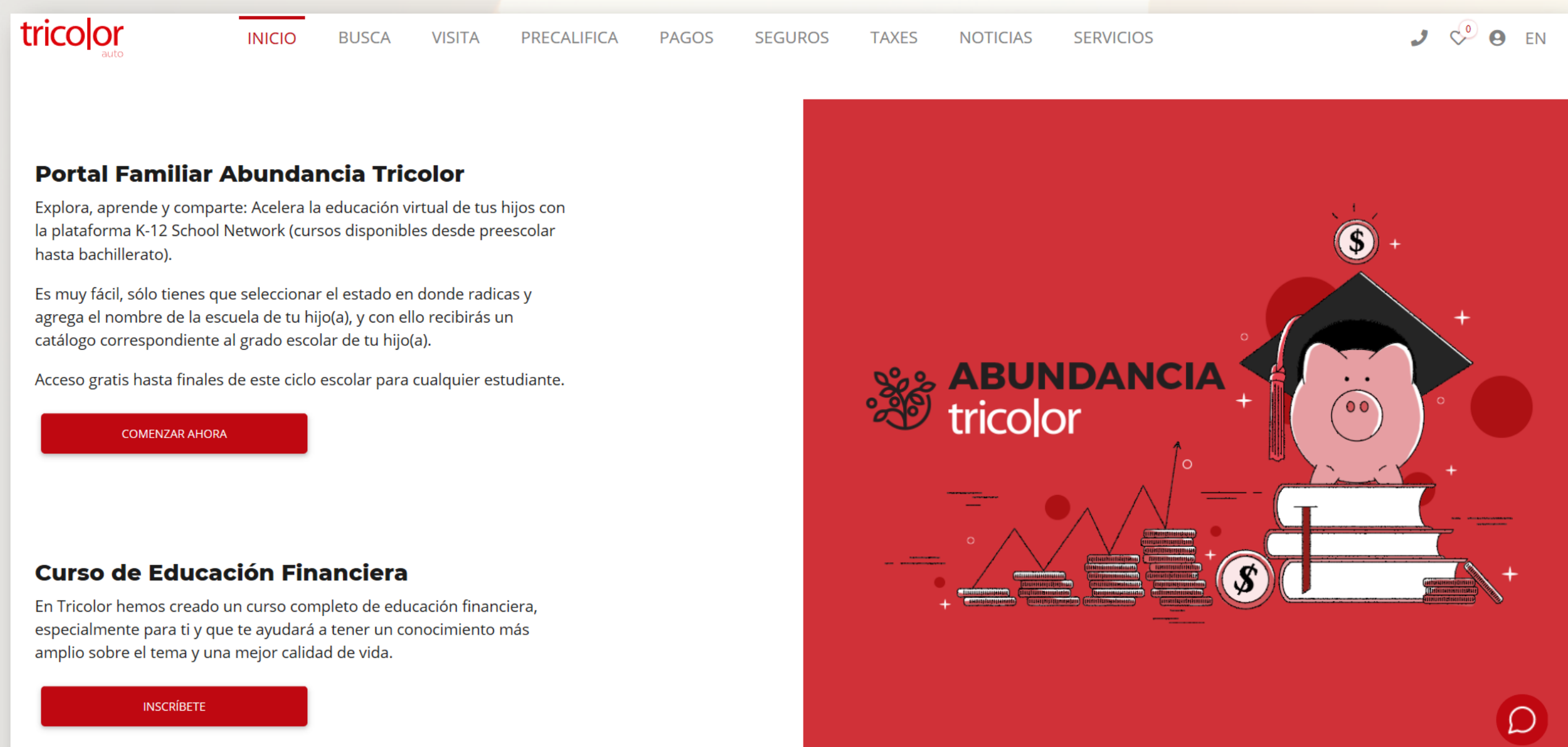
The Abundancia program has developed partnerships with the Mexican consulate in Dallas, Houston, Austin and San Antonio, and Los Angeles to offer its program more broadly.

In addition, Abundancia has developed partnerships with banks, both regional and national, to provide checking accounts for customers with no banking relationships.

"The secret of change is to focus all your energy not on fighting the old but on building the new."

-Socrates

The Abundancia portal can be accessed though Tricolor's website.

Leverage Technology

Over the past twelve years, Tricolor has gathered data from hundreds of thousands of applicants. In its early versions, Tricolor utilized traditional regression analysis to understand how these application attributes correlated with default enabling it to grade, or segment, applicants in six distinct grades.

For the past two years, Tricolor has dramatically advanced its risk precision using artificial intelligence to identify "patterns" among over 100 non-traditional attributes and their relationship to default. Given the absence of a FICO score among the credit invisible population, this competency is powerful.
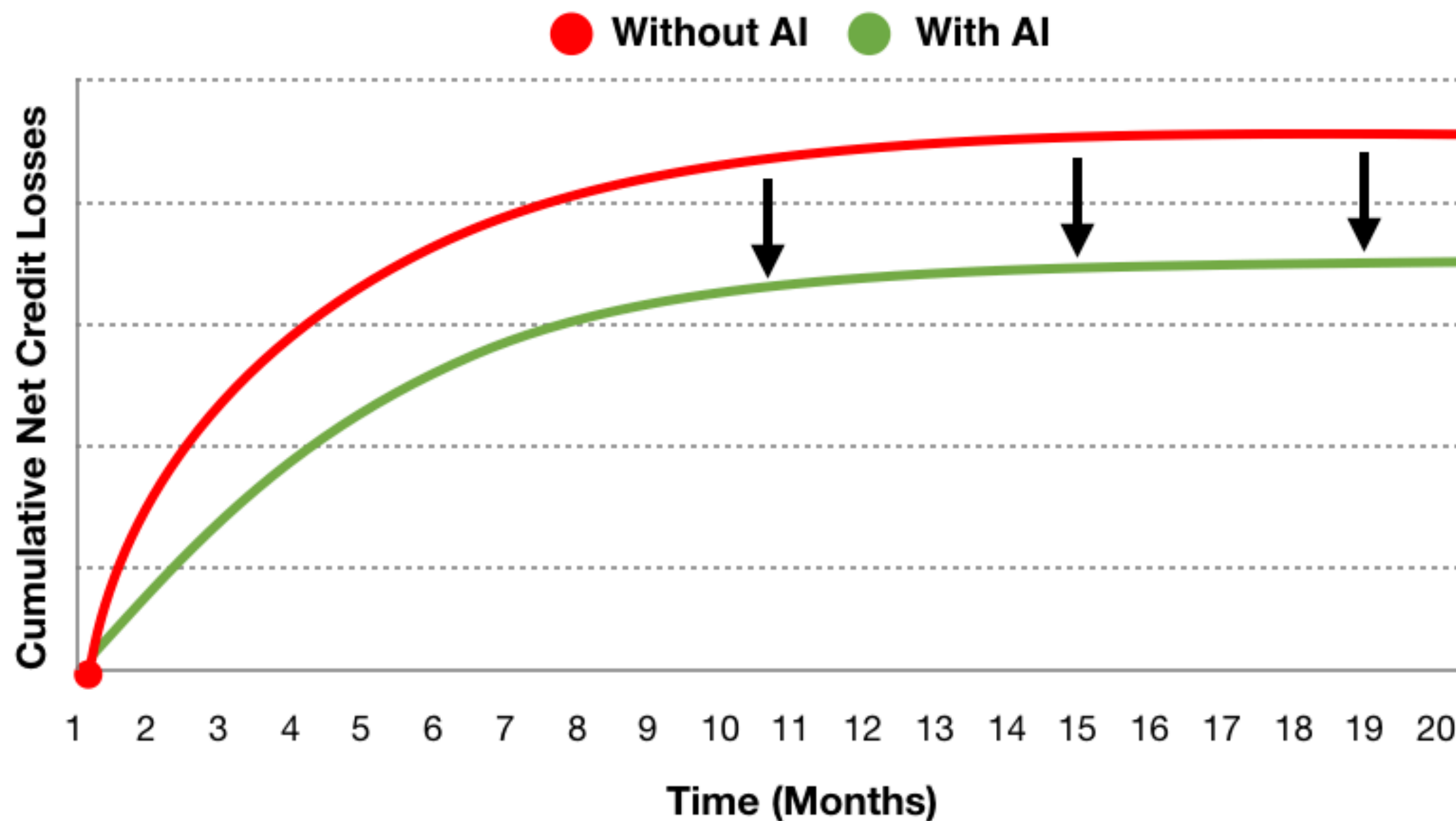

"In business strategy, the new game begins before the old game is over."

-Clayton Christensen

Pricing Strategy

Tricolor has developed a disruptive strategy to <u>score the unscoreable</u>. The underlying fundamental which powers this distinct approach and unlocks its unique opportunity to serve the vast Hispanic market <u>is the ability to bifurcate lower risk from higher-risk applicants</u>.. Tricolor's pricing strategy leverages its technology-driven risk model which segments credit invisible borrowers into six distinct grades.
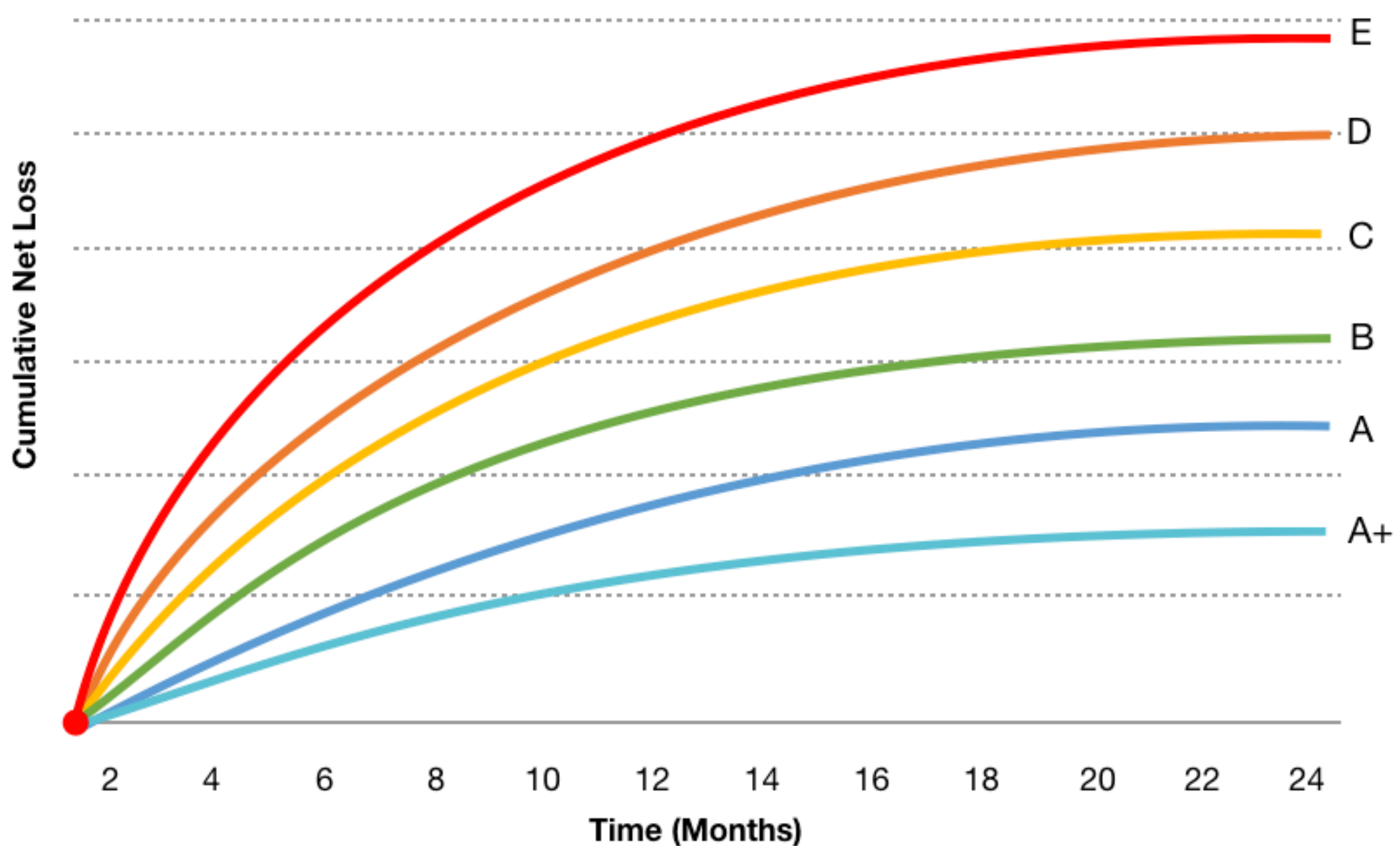

First, Tricolor lowers its margin across all grades.
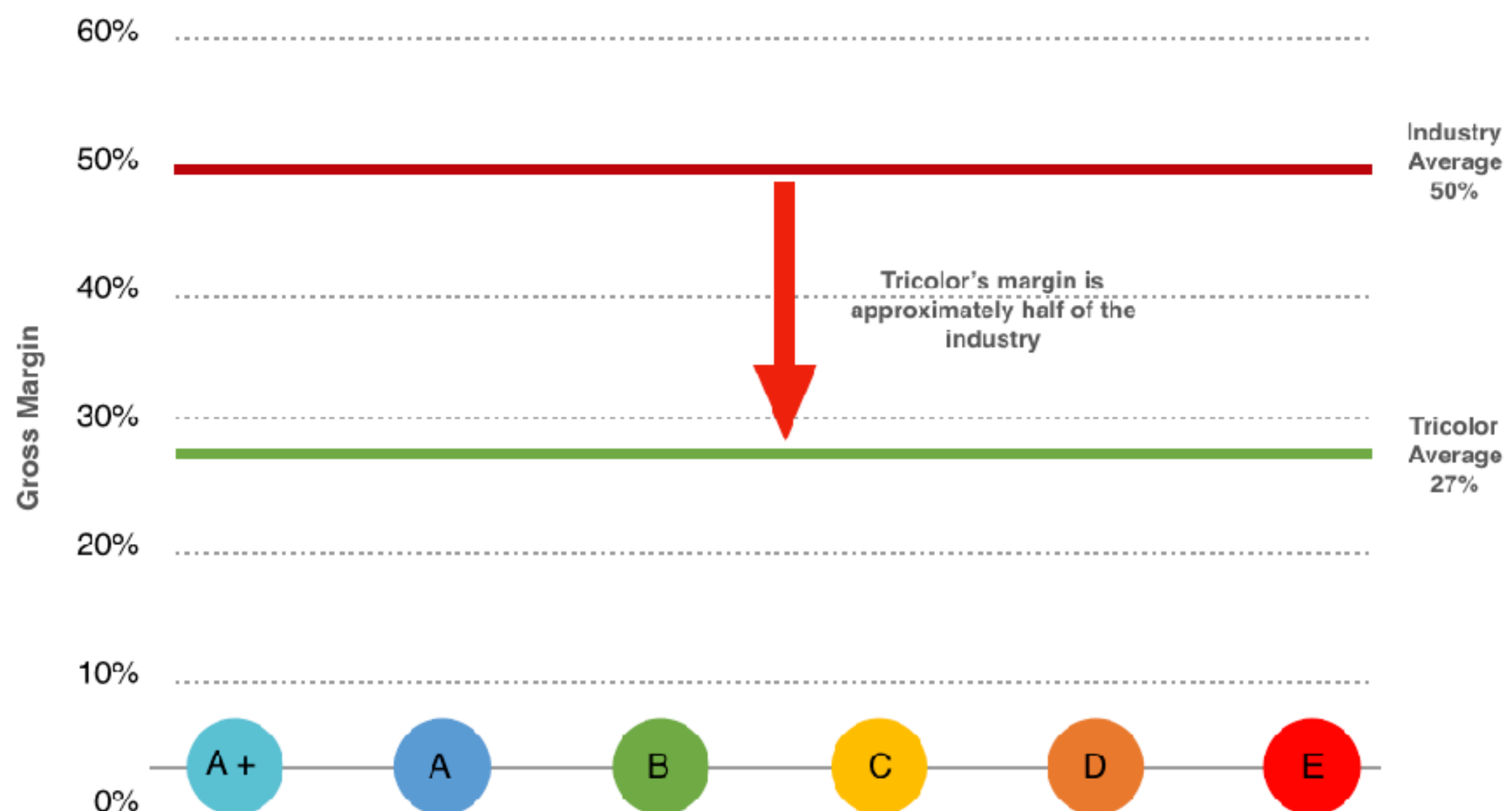
Pricing Strategy (continued)

Next, Tricolor "slopes" its financing terms sharply across all six grades. It offers highly attractive terms---low interest rates, low down payments, and longer terms---to the high-grade applicants, resulting in high conversion. Conversely, sloping results in poor conversion of low grade applicants, ultimately creating adverse selection for the competition.
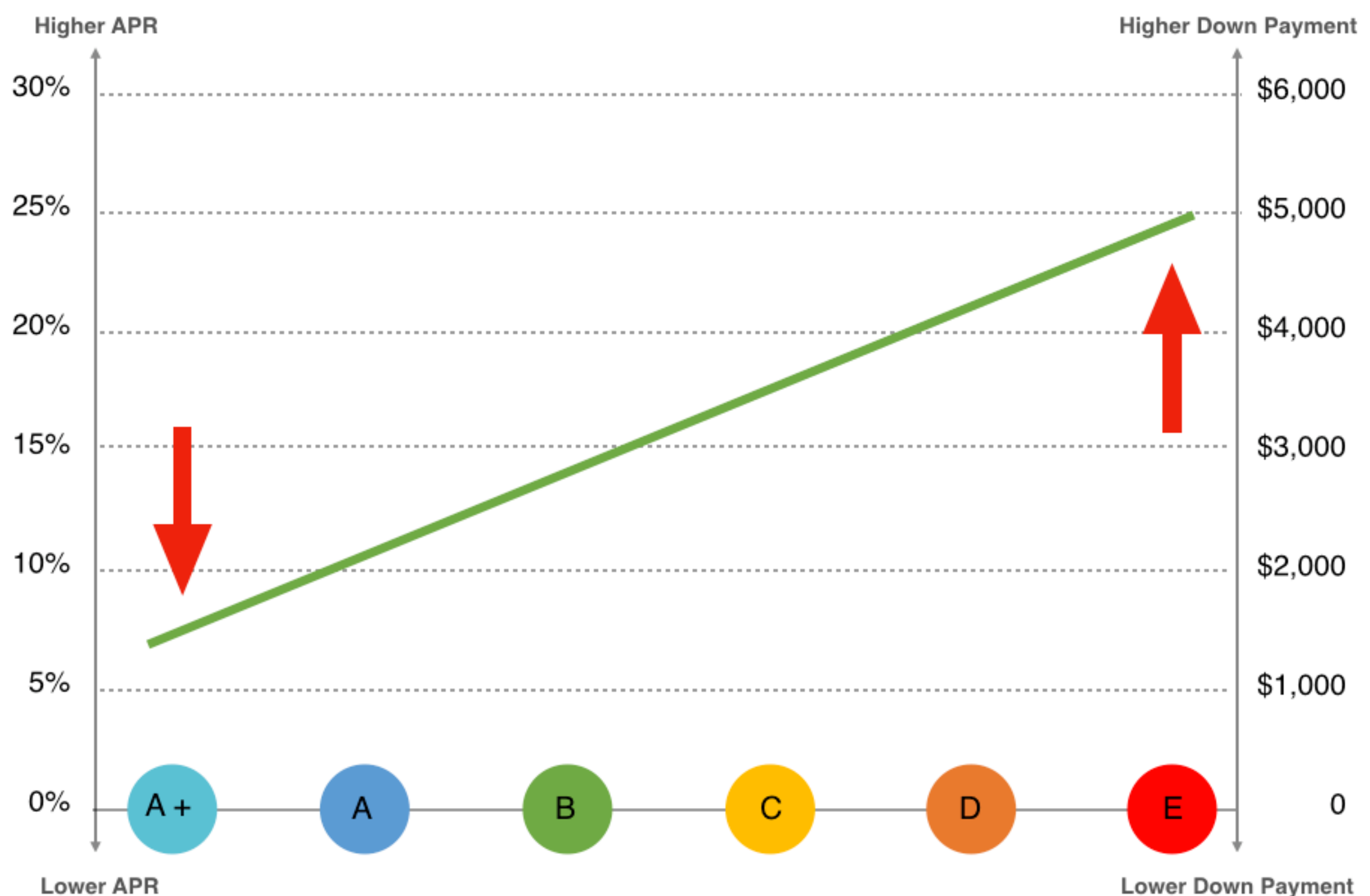
A brief video and white paper on Tricolor's Pricing Strategy can be found on our corporate website at tricolorholdings.com.

About Tricolor Holdings

Daniel Chu is the founder and CEO of Tricolor Holdings, which operates Tricolor Auto Group and Ganas Auto Group.

Tricolor is a Community Development Financial Institution (CDFI) and mission-driven company which sells and finances high quality, certified used motor vehicles through its premium brands, Tricolor Auto Group in Texas and Ganas Auto Group in California, utilizing advanced data analytics and technology to advance financial inclusion to a highly underserved market and offer responsible, affordable, credit-building auto loans to individuals with no or limited credit history.

Headquartered in Dallas, Tricolor and its affiliate Ganas Auto Group operate 45 retail dealerships across 16 markets in Texas, California, Nevada, Arizona, and New Mexico, as well as a shared services center in Guadalajara, Mexico. On a combined basis, Tricolor and Ganas have served over 75,000 customers and disbursed over $1 billion in affordable auto loans by using its proprietary model to segment risk.

For more information contact Daniel Chu at dchu@tricolor.com or visit tricolorholdings.com