

SPECTRUM

AN ELECTRONIC REPORT FROM THE CUNA LENDING COUNCIL

CUNA LENDING COUNCIL SCHOLARSHIPS

Education is a cornerstone of the CUNA Lending Council mission, and providing access to the tools necessary to help the credit union community conduct safe and effective lending programs is a goal. In 2000, the Council approved \$5,000 in scholarship grants, and so far in 2001 we have approved \$3,695. These funds have helped 13 credit unions, most of them small in asset size but very big in passion about the credit union movement.

Michele Sosa, the CEO of San Francisco Recreation and Parks FCU (\$1.8 million) in San Francisco, attended the Collections and Financial Counseling seminar. She relayed to us that the scholarship meant a lot to their credit union because it allowed Michele the opportunity to increase her knowledge about the topic and bring it back to her credit union. This will directly affect their ability to manage a growing loan portfolio, and protect the assets of their membership.

Diane T. Dyer, Senior Loan Officer at the Sabattus Regional Credit Union (\$18 million) in Maine, attended the Consumer Lending School, Part 1. She commented that the

process was quick and easy, with a prompt decision, and reimbursement was handled without a lot of bureaucracy. The learning experience will help this credit union as it looks for more creative lending programs and services to better serve its members.

We will continue to communicate the availability of these scholarships through the CPD school mailings, and the associations that support Community Development Credit Unions. If you know of a small credit union that would benefit from access to CPD coursework, let them know about the site. And if you want to contribute to the fund, make sure to renew your CUNA Lending Council membership, tell other credit unions about the benefits of CUNA Lending Council membership and encourage them to join, or simply make a donation directly to the CUNA Lending Scholarship program. For more information about the scholarship program, select Recognition/Awards from the main page of this web site, or contact Joe Brancucci, Vice President and Chief Lending Officer at BECU at jbrancucci@becu.org. ♦



Mark Your Calendars

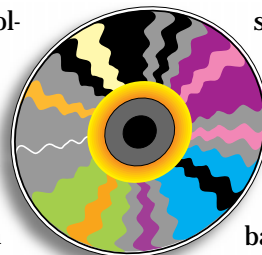
The Seventh Annual CUNA Lending Council Conference will be held on November 4 - 7 at Le Meridien Hotel, New Orleans, Louisiana. Look for more details in future issues of this newsletter.

BANKRUPTCY BEST PRACTICES TRAINING CD-ROM

Visa is pleased to announce the availability of the Bankruptcy Best Practices Training CD-ROM (Best Practices). Visa developed Best Practices as a training tool for collections and bankruptcy managers and their staff. It provides basic information on the bankruptcy process with emphasis on creditor concerns. Currently available free of charge, Best Practices addresses the nuts and bolts of bankruptcy through

an entertaining television format lecture that includes network news broadcasts, an interview with a television judge, a talk show segment and an infomercial.

As the hour-long program unfolds, Best Practices covers important aspects of bankruptcy under Chapters 7, 11, 12 and 13. Topics presented include the legal framework and process for the various bankruptcy chapters, eligibility



requirements, exemptions, nondischargeable debts and creditors' rights.

The lecture is followed by an interactive quiz that tests the trainee's mastery of the material. Upon selecting an incorrect answer, the trainee is presented with clues that lead to the correct answer. If he trainee still chooses an incorrect answer, Best Practices returns the trainee to the portion of the lecture that emphasizes information relevant to the question.

Melyssa Barrett, Director of Visa's Bankruptcy Recovery Program, demonstrated the CD's functions at Visa's Annual Bankruptcy Conference in Boston on September 21, 2000. The enthusiastic response to her demonstration confirms that Best Practices will help fulfill the need for quality training materials that address bankruptcy related concerns from an issuer's perspective. One issuer plans on integrating Best Practices into career development plans for

customer service, collections and bankruptcy associates.

A second part of the program will be released in CD-ROM format within the next few months. It will consist of six modules which cover the following bankruptcy topics: forms, mail procedures, notification procedures, recovery efforts for filings involving no assets, recovery procedures for filings involving assets and loss prevention.

In keeping with the entertaining format of the initial CD-ROM, each lecture will be presented through a motif drawn from popular culture including detective, western wrestling federation, and outer-space movie themes. Each module will be followed by a related quiz.

To order the initial Best Practices CD-ROM, contact Melyssa Barrett by email at Melyssa@visa.com or by phone at (650) 432-2980. ♦



NEW AND IMPROVED CREDIT BUREAU SCORES ARE INTRODUCED BY FAIR, ISAAC

by Allan Stevens, Franklin Mint FCU, Media, PA

Fair, Isaac, the vendor who produced and popularized consumer credit bureau scores, has just rolled out their new suite of scores. They are called NextGen scores and are the result of a major re-write of the "classic" FICO scores that were introduced in 1989. They represent an improved risk management tool to predict future credit performance of prospects, applicants or borrowers. NextGen scores are available now at Equifax (called Pinnacle), Trans Union (called Precision) and should be available at Experian in the second quarter of the year.

The new scores have many more complex predictive variables, an expanded segmentation scheme and a more refined performance outcome than classic scores. What does this

mean to you? Depending on your business or member service needs you should be able to maintain current application approval percentages while reducing bad loan rates or increase your approval percentages while maintaining the number of bad loans. According to Fair, Isaac "...credit grantors can lower bad rates between 10% and 25% or increase approval rates up to 5% or more..."

NextGen and classic scores have much in common and quite a few differences too. Both are three digit numbers that are calibrated so that the higher the score, the better the credit

risk. They both are designed to predict future credit performance over a 24-month period. Further, the scores are scaled so that the odds-to-score relationship between classic and NextGen scores are approximately the same for each score range. For example, you may have found that for every 50 loans booked in the 700 - 719 score range, 49 perform well and one goes seriously delinquent. If so, you should see similar loan performance with NextGen.

The differences you ask? First of all the score range is much broader, starting at 150 and going to 950. Because of this broader range you will see a broader distribution of scores for applicants and borrowers. Since there are more predictive characteristics within the new scores they should more accurately predict loan performance than classic scores. Another difference is that these more precise scores will be accompanied by more precise score reason codes. They will still be listed in order of importance.

How do you implement the new scores?

Here is a brief list of possible to-do items:

- Determine which credit bureau reports should have NextGen scores appended to them and contact those credit bureaus to turn on the scores. Do not turn off classic or other scores being used until all the other steps are completed and you have fully transitioned to the new scores.
- Once scores are being returned, post them to loan origination and core systems for track-

ing and reporting purposes.

- Compare and contrast score distribution reports for NextGen and classic scores. Consider revisions to underwriting cutoff scores, establishing score ranges for risk based pricing and other strategies.

- Identify when and how you use credit bureau scores now - pre-approvals and underwriting, for example - and develop a plan to implement the use of the scores for each task. This should be done in order of importance.

- Consider obtaining a retrospective validation report from Experian, Equifax or Trans Union for all bureau scores used including NextGen. While “retros” are not cheap, expect to pay from \$3,000 to \$6,000, they provide very meaningful data for validating score performance. They can specifically identify which bureau score most accurately predicts good and bad loan performance for your members and portfolios. In addition you may be able to use the data to adjust cutoffs scores and risk based pricing tiers. Retros can be reviewed and evaluated with credit bureau scoring analysts and/or Fair, Isaac analysts.

- Develop and conduct training programs to educate associates about the nuances of the new scores and how operational activities will be modified.

In summary a new tool for the toolbox is available. The transition will require some work and commitment but the results should more than offset that. ♦

LENDING ISSUES

by Bill Vogeney, Fairwinds Credit Union,
Orlando, FL

Indirect Lending Programs face Additional Scrutiny

Based on investigations by the U.S. Justice Department, along with two class-action lawsuits, indirect lending programs that allow dealers to “mark up” rates to consumers may face future legal problems.

The concern is how the dealers decide who will pay the higher rates, above those set by the financial institution. In the class-action lawsuits, African-American borrowers claim the dealers singled them out. However, automobile dealers were not the target of the suits. GMAC and Nissan Motors Acceptance Corp are the defendants of the suits that claim they should have been responsible for verifying that rates were not determined by factors pro-

hibited under ECOA.

The impact is obvious to credit unions with a similar dealer participation program. If successful, these two suits might spawn additional suits against other, non-captive lenders. Credit unions can be proactive by building a non-discrimination clause into their dealer agreements, and sampling a group of loans to determine dealer pricing practices. Of course, credit unions with a flat fee arrangement should be protected against similar claims. ♦

Lease Programs Regroup

After several years of heavy residual value losses in leasing portfolios, ranging from many of the large banks (Bank One)

to the captives (Chrysler Credit), a wide variety of strategies are being implemented throughout the industry.

One such idea is called Maximum Residualized MSRP (MRM). Developed by Automotive Lease Guide (ALG—the industry “bible” for residual values), MRM sets a maximum residual value, regardless of options added to the vehicle. In some cases, factory options have been a concern, but the greatest impact is with dealer added options. Fancy wheels and tires along with upgraded stereo systems add several thousand dollars to the original cost, but matter little at lease termination. Previously, the residual values were determined by a flat percentage of the original MSRP or adjusted price including these expensive dealer options.

Another strategy is emphasizing longer-term leases. The captives and some of the banks suffered because of short-term leases. It has been estimated that as many as 90% of these short-term leases ended with the lessee returning the car. Combined with a weaker than anticipated used car market, lenders were left with huge losses on virtually every car in the portfolio. Many of the banks chose to self-insure the residual values, in an attempt to be competitive with the captives by setting artificially high residuals. Even lenders with residual value insure were left out in the cold, since the insurance does not protect the lender if the vehicle fails to sell at the Black Book “clean” value. The theory behind the longer leases is that the residuals will tend to be much more reliable after four or five years. In addition, with a long-term lease it is anticipated that fewer leases will go to term. The lessee is more likely to trade out of the vehicle.

Efforts to market the car aggressively to the lessee have paid some dividends to a certain degree. With lessors tightening terms, many lessees find that the down payment requirements for their next car, along with the monthly payments, have increased dramatically. In some cases, reduced rate loans and extended financing terms have reduced the number of cars coming back after lease termination.

For credit unions entering the lease

market, how can you avoid many of these problems?

- First of all, don't expect residual value insurance to totally prevent your lease termination losses. The policies are typically very restrictive, so consult your attorney about your potential liability.

- In addition, don't neglect the use of security deposits and origination fees to bolster yields and minimize losses. Many of the credit unions I have seen that offer leases provide for zero security deposits and zero origination fees. A \$495 origination fee on a \$25,000 lease with 48 month term and \$10,000 residual will increase your yield by .80% if carried to full term. If the lease pays off early, the impact on yield will be greater. The security deposit is absolutely essential since even minor damage not considered wear and tear will impact your net recovery.

- Closely related to the last strategy is having disposition procedures in place for lease termination. You should notify all lessees six months prior to lease end, offer the purchase option, and schedule an appointment for an initial inspection of the car. You don't want borrowers surprised when the excess wear and tear bill comes to several hundred dollars.

- Finally, be careful when analyzing the actual yields of lease programs offered through third parties. Much of the financial analysis I've seen centers on total finance income on a \$25,000 lease compared to a \$25,000 loan of similar duration. However, net yield is almost always conspicuously absent in the presentation. After paying residual value insurance and other servicing costs, the net yield is actually less. The total interest income will be higher because the lease balance will always exceed the loan balance. ♦

Mortgage Market Strategies

After a period of lower loan volumes, 2001 promises to be an excellent year in the first mortgage market. For credit unions who tend to be adverse to operating by the typical first mortgage lending employment strategy (hire like mad when volume is good, slash to the bone when

the market tanks), any dramatic change in volume can be traumatic to staff, management and the members.

The toughest part of handling the volume is the high level of what we refer to as “serial refinancers.” These are the consumers who will refinance even if their interest savings are less than 1%, especially when they need some additional cash. While attending the CUNA Lending Council annual meeting last fall, the new eMortgage program from CUNA Mutual Mortgage and Freddie Mac piqued by curiosity. They have collaborated to provide an Internet mortgage application that can provide almost instantaneous answers. The processing and closing are handled by a third party provider, with the mortgage serviced by CUNA Mutual Mortgage. Suddenly, I felt like a cartoon character that has their “light bulb” go off. “What a great way to deal with the serial refinancer.” For the borrowers who have no interest in who processes or services their loan and simply wants to lower their interest rate, it’s a great way to manage your mortgage pipeline.

Credit unions who aren’t using the

Fannie Mae Desktop Underwriter need to seriously consider the benefits of having this tool during a refinance boom. For members with good FICO scores, the DU system has significantly reduced documentation necessary on straight refinanced loans. If properly used on the front end of the application process, not only will you reduce your processing time, you will be providing a much easier application process for your member by reducing the paperwork they need to present at application time.

Some credit unions have chosen to offer a streamlined refinance program. Instances where the member simply wants to refinance with no cash out have allowed credit unions to simply perform a mortgage modification, with reduced fees. No appraisal or title search and minimal processing (in some cases just a credit report to ensure the member’s credit has not materially changed) along with keeping the mortgage on the same amortization schedule (leaving at 27 years left instead of refinancing back to 30 years) has eliminated the need for a new mortgage filing. ♦



CUNA Lending Council SPECTRUM is a web-based newsletter published bi-monthly by the CUNA Lending Council at www.cuna.org, selecting COUNCILS, then the CUNA Lending Council. Send news and Lending Council information to: Sharon Gaugler, Boeing Wichita Credit Union, phone: 316-651-5105, fax: 316-651-5197, e-mail: sgaugler@bwcu.org. For Council information, contact Pam Frey, manager council administration, phone: 800-356-9655, ext. 4141 or fax: 608-231-4061, e-mail: pfrey@cuna.com.

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