CUNA LENDING COUNCIL

AUGUST 2000

SPECTRUM

AN ELECTRONIC REPORT FROM THE CUNA LENDING COUNCIL

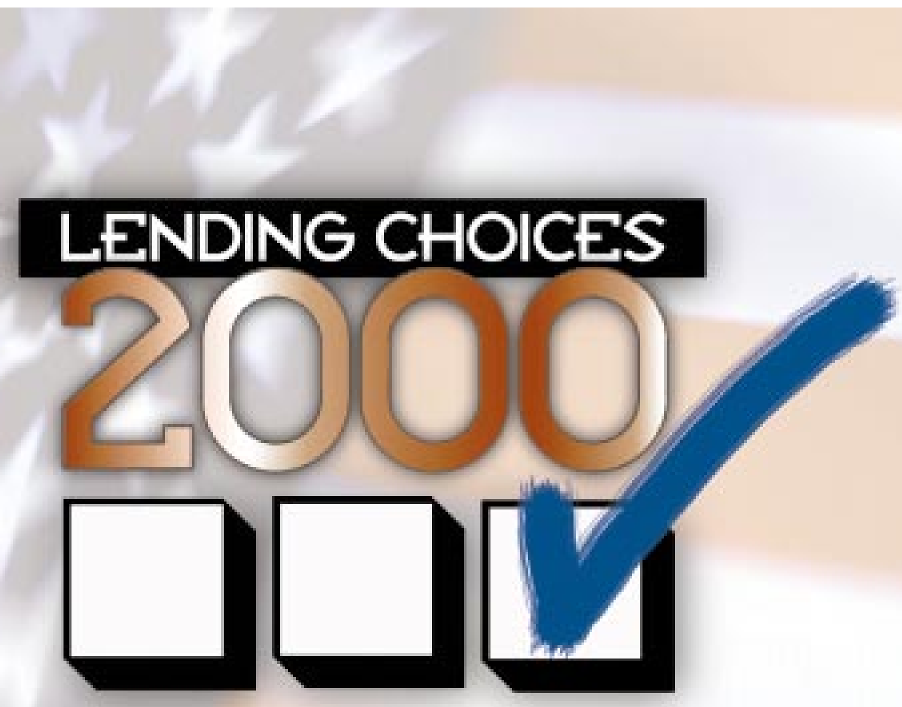
Develop Your Own Winning Lending Strategy

Where will you be on the night of November 7?

If you're concerned about casting the right vote for the future of credit union lending, you will be attending the sixth annual CUNA Lending Council Credit Union Lending Conference. This year's main lending event will convene at the beautiful Renaissance Esmeralda Resort in Indian Wells (Palm Springs), CA.

"Lending Choices 2000" is this year's conference theme. The focus of the conference's content will be to develop the right market strategy to set the wheels in motion for continued lending growth. Session topics will focus on the future of mortgage and consumer loan delivery in an increasing technological world.

We'll also have some of the leading experts in the field to talk about skills and strategies to give your lending program the boost it needs to compete. Keynote speakers include:



- ☑ **Patrick Adams**, a former credit union lender and current vice president/COO of Liberty Outsource Marketing Solutions, St. Louis, MO, will talk about development of master strategies for successful lending and better ways to serve current and potential members;

- ☑ **Dr. Jack Llewellyn**, the sports psychologist credited with helping "coach" the Atlanta Braves to World Series championship and pitcher John Smoltz to the National League Cy Young Award, will talk about ways to develop your own personal championship game;

- ☑ and, a pair of separate fee workshops will address specific topics and issues. **Kimberly Phillips**, EVP for Community CU, Plano, TX, will take e-commerce beyond the realm of Internet lending; and **Mark Spenny**, VP for CEFCU, Peoria, IL, will go beyond the basics in terms of business services.

In addition, breakouts and roundtable sessions will focus on a host of lending topics, including construction loans, creating niches in the mortgage market, Internet applications for mortgages and cards, mortgage market penetration strategies, home equity loans, risk-based lending and more. You'll also hear from the winners of the first Excellence in Lending awards, cosponsored by CUNA Mutual Group and CLC.

And, to help celebrate the transition to a new national administration, we'll even have a real election night bash, with balloons, banners and a few of your favorite "presidents" from history to talk about their administrations.

Cast your vote now for the sixth annual CLC CU Lending Conference Nov. 5 -8 in Indian Wells (Palm Springs), CA. Visit the CLC web page (www.cunalendingcouncil.org) for more information and on-line registration.

And don't forget your absentee ballot. ◆

LENDING ISSUES

by Bill Vogeney, Fairwinds Credit Union, Orlando, FL

BUREAU SCORES IN THE NEWS

E-loan, one of the most aggressive Internet lenders, has stirred up controversy following their announcement to release consumer's credit bureau risk scores. The Experian score, known as FICO, and the Equifax score, known as Beacon, will be provided to all consumers who log into E-loan's "my E-loan" page. The process does not require the consumer to actually apply for a loan; however, they enter their personal information to expedite their future borrowing needs.

E-loan's decision to provide this information comes at a time when consumer knowledge and awareness of their "score" is at an all-time high. Even though the use of bureau scores is over a decade old, consumers are now just realizing the impact the score has on their ability to obtain credit, insurance, and even a new job. E-loan contends that consumers have a right to know their score so they can better understand how they can improve their chances for obtaining a loan. As of press time, all of the major bureaus have cut off E-loan's access to credit files for the disclosure of these scores.

The applicable question for credit unions is "how can we use the scores to approve and price loans, while answering questions from our members regarding their score?" Many of us have a hard time explaining to members why their score is "only" 705, and why they don't have the highest possible score. The member pays all their accounts on time, and doesn't abuse credit. Many credit unions are discussing the 4 reason codes provided with the score on the bureau file. Some fully disclose the score to their members. Others never discuss the score at all.

Here are some other suggestions for coping with this dilemma:

1. Make sure your staff is well trained and understands the score. The more they understand how the score is derived, the better they can handle member questions.

2. Stress the positives. Many members are more concerned about their loan being approved. Payments are much more important than interest rates. If your loan officer tells Mary Smith that "your loan is approved, however, you'll have to pay our higher rates" you will generate a lot of questions. If the decision is "your loan is approved, your payments will be $250 a month at 9.9% APR" the member may be less likely to ask extensive questions.

3. Know your competitor's rates. There are several services that will provide a rate survey, including rates based on Beacon scores. If your rate for a new car loan with a 615 score is 10.5%, it helps to know your competition is charging 14%.

4. Offer solutions if the member's credit improves. If the member's score is low because of some recent past due payments, offer to re-evaluate the loan in six months or a year and refinance it if their credit improves enough to offer a lower rate. The issue with this practice is that it's difficult to automate the review, and will be time consuming. However, for the credit union that struggles with the philosophical issues of risk based lending, it's a way of improving acceptance of this program. ◆

USING BUREAU SCORES FOR LIMIT INCREASES

Credit Unions wishing to remain competitive with the major card issuers are forced to fight fire with fire, meaning they must constantly increase credit limits to ensure their members won't turn to another credit card with a substantially higher limit. However, this strategic path is full of potholes.

Many credit unions follow the advice of their card processor and use cardholder information only to increase credit limits. They may evaluate the delinquency history on the card and the length the card has been open to determine whether they will increase the limit and by how much. However, over the last few years the accounts that become bankrupt and cause card issuers a loss are much more likely to be current with their payments. At Fairwinds Credit Union, more and more of our card losses are to members who have had their card more than 7 years.

For those of you who use credit bureau scoring to make your limit increase decisions, the score may not tell the entire story. The large issuers use advanced profitability scoring models to determine which cardholders get a limit increase. If you set your bureau cut-off score

too high, you'll increase the limits of cardholders that are unlikely to increase their balance. The most profitable cardholders are also very close in score to the borrowers who will cause you a lot of losses.

We saw this first hand several years ago after a pre-screening for new credit cards. There were many members who had satisfactory Beacon scores in the 670-710 range who owed $30,000 to $90,000 in credit card balances. One potential solution is to use credit bureau screening along with custom criteria designed to exclude overextended cardholders. For instance, you might build a matrix for this purpose:

MAXIMUM REVOLVING CREDIT BALANCES (SAMPLE)

Current Limits	Credit Score			
	<680	680-719	720-780	780+
<$1500	$3,000	$5,000	$10,000	$20,000
$1501-$3500	$5,000	$7,500	$15,000	$25,000
$3501-$7500	$7,500	$10,000	$20,000	$25,000
$7500+	$10,000	$15,000	$25,000	$30,000

If this is a concern, discuss it with your credit bureau representative. After the pre-screen is run, they typically will audit the results and provide you with the number of accounts excluded because of custom attributes like revolving balances owed. You may decide to set your limits higher or lower, based on your results. ◆

TRACKING BANKRUPTCY SUCCESS

341 MEETING

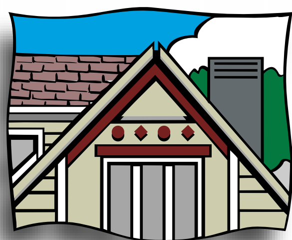
Many credit unions over the last few years have been more pro-active in their bankruptcy collection efforts. Attending the first meeting of creditors (known as the 341 meeting) and active "pursuit" of the bankruptcy attorney has paid impressive dividends for these credit unions.

The CUNA Lending Council is interested in your bankruptcy collection efforts. We would like to hear from credit unions that have implemented various techniques to increase reaffirmations and voluntary repayment agreements. Specifically, we would like as much data as you have on:

1. Total dollar amount of loans to members who declared bankruptcy in a calendar year.
2. A breakdown of Chapter 7 and Chapter 13 filings.
3. The dollar amount of loans charged off for the same period from bankruptcy filings.
4. Your percentage of total loan portfolio in unsecured loans (credit card and signature loans).

The purpose of gathering this information is to provide CLC members a method of evaluating their bankruptcy collection efforts against other credit unions. Please submit your information to Communications Sub-committee Chair, Bill Vogeney of Fairwinds Credit Union, Orlando, FL at bvogeney@fairwinds.org. The results of your submissions will be featured in a future issue of the Spectrum. ◆

SELF-INSURANCE VERSUS PMI FOR SECOND MORTGAGES



2000 should be proclaimed "the year of the second mortgage!" Over the last several years, with first mortgage rates steadily declining, there was limited demand for second mortgages and home equity lines of credit. The economics behind this was simple. Members who wanted to consolidate or borrow to improve their home refinanced their first mortgage. If they could lower their rate from 7.75% to 7.25% and borrow the cash they needed, they did it. Given the current rate structure, it makes sense for

borrowers to take a second mortgage and leave their 7.25% first mortgage alone. Now is the time to improve your market share!

In most markets, if you aren't active in granting 100% LTV second mortgages, you will still struggle to make loans. Many of my peers have discussed self-insuring these loans instead of finding second mortgage insurance. What's right for your credit union? Here are some issues to consider before you make this critical decision.

1. The size of your credit union. With a smaller credit union, a few 100% LTV loans that default could have a dramatic impact to your bottom line. The larger the credit union (along with considering your capital position) the more likely you might be to self-insure.

2. Real Estate market values. If prices in your market have been stable, you might be a good candidate to self-insure. However, if you operate in a market where values have increased at a high rate, seriously consider insuring these loans. Many newer lenders have never experienced any adversity, as our economy has been riding an 8-year long "bubble." Any economic downturn could cause values to decline just as dramatically, forcing many borrowers to "walk away" because of negative equity.

3. Closing costs. In many markets, lenders are forced to pay closing costs on home equity loans in order to compete. If you have to order an appraisal and obtain a title search or title insurance, these costs will negatively impact your net yield on the loan. If you self-insure, you pay these costs. If you self-insure, you may not have the loan on the books long enough to make paying the costs worthwhile. If you choose to insure the loan, you may not have to obtain a title search and appraisal. The member pays the insurance via a higher rate. In order to make loans and earn a decent yield, mortgage insurance might make sense for you.

4. Speed to close. In our market, one large regional bank has been very aggressive, approving home equity loans up to $50,000 with no appraisal and no search, and closing the loan in 48 hours. **(NCUA will allow credit unions to substitute a written estimate of value in lieu of an appraisal on loans under $100,000.)** Many borrowers are driven by speed and convenience. How will you compete? If insurance allows you to skip these steps and drive down your processing time, you won't gain an advantage, but you'll remain fairly competitive.

5. Experience with large unsecured loans ($10,000 to $25,000). A 100% LTV loan is for all intents and purposes an unsecured loan. Based on bureau scores and your track record of losses on these large unsecured loans, you might be able to estimate your future losses. **If you have excellent experience with underwriting 80% LTV second mortgages, using the same criteria may not necessarily work for your higher LTV loans. Consider merging your 80% LTV guidelines with your large unsecured lending guidelines.** However, if you're operating in an area that is experiencing a larger than average "boom," beware of the "bust." ◆

ASPs: WHAT TECHNOLOGICALLY SAVVY LENDERS NEED TO KNOW

by Allan Stevens, Franklin Mint FCU, Broomall, PA

You may have noticed, there is a new acronym out there. The old LOS (loan origination system) may or may not be passe. The "new guy" on the block is called an ASP. That's short for Application Service Provider. An ASP is software that is provided and supported by a third party vendor and is located offsite.

In this case it specifically refers to the increasingly popular loan decision engines that are on the World Wide Web. The most common arrangement allows for members to apply for loans on your web site. When they hit "submit," the credit application gets transmitted to the ASP and automatically makes a decision in a minute or less using your credit policy and scoring parameters. The member is notified via email of the loan approval, or that the application needs additional review

by the credit union. Early on you may be able to approve a third of your credit applications online. As you gain experience you may be able to approve a half or more of your credit applications in this manner.

A hybrid service is the combination of an ASP and a call center staffed by real, live humans. Call center loan officers may approve "B" or "C" loans, which do not meet policy parameters, in a judgmental fashion. They do so quickly in order to take the member out of the loan shopping market. Some would say it is the best of both worlds but that's for you to decide. At least two national call centers that have credit union clients provide this service. More will surely follow.

Some of the advantages of ASPs are the limited capital needed at the outset. They are "pay as you go" services. They offer the ability to decision applications rapidly, accurately and 24 /365. Once a contract is signed, you can be up and running in 30 to 90 days. Furthermore, you will not need internal IT staff to support these applications. The provider does that. Those are just a few of their advantages.

On the down side we are talking about software that is not in your shop and is somewhat out of your control. Revisions and maintenance are on someone else's schedule, not yours. And the "I" question appears again. Namely, interfaces. Downloads and uploads to your core processing systems may not be feasible. Other interfaces to credit insurance, mechanical breakdown and "lease like" lending applications may be an obstacle. Duplicate data entry and other processes may result. Moreover, many credit unions do not decision loans in an entirely objective manner. We consider such things as "history with us" that a matrix or other questionnaire cannot easily accommodate.

At any rate, ASP's are here to stay. They offer real value and will help us serve members. We need to take steps to approve as many credit applications as we can and book those deals before our competition does. ASP's and their forefathers, the old LOS's will take us to that end. ◆

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