

How to Grow Loans In a Difficult Economy

National Council of Postal Credit Unions
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Are You Having Fun Yet?

- An Economic Recession
- A Decrease in Consumer Spending
- An Anti-Financial Institution Bias in Washington DC
- Increased Regulatory Burden
- The Mortgage Industry Debacle
- An Aging Population
- A Large Number of Bankruptcy Filings
- Hyper-Competition
- Potential Loss of Courtesy Pay & Interchange Income
- The NCUA Assessment
- Record-Low Earnings



What Must You do to Earn More of Your Member's Business?

1. _____

2. _____

3. _____

4. _____

5. _____

The Common Thread...

Turning Around a Low ROA

1. Increase Income From Lending

- More Loans
- Higher-Yielding Loans
- Maintain Credit Quality

2. Increase Non-Interest Income

3. Cut Expenses



Your Issues/Challenges

1. Your expense ratio is probably too high.
2. Some of you are way too reliant on courtesy pay fee income that comes from debit/ATM cards.
3. Poor underwriting decisions (PUDS).
4. Your average loan yield is probably too low.
5. Branches are a totally inefficient delivery channel for selling your loans and services.
6. Supermen & Superwomen do not exist.
7. Low production numbers from your lenders.
8. Service is a corporate strength, sales is not.
9. Growing auto loans without indirect lending.
10. Who is responsible for loan growth?
11. You have too many employees involved in lending.
12. The IT function is a weakness at most credit unions.
13. A weak collections effort.

Two Options to Increase Fee Income

1. Relationship Pricing of Accounts

It is a sound basic business principle that states, "If you are scratching my back then I am scratching yours."

2. Courtesy Pay Fees Attached to a Debit Card

When the financial success of your credit union depends on the failure of your member, you may want to consider a new business model.



Relationship Pricing of Deposit Accts.

(A Better way to Increase Fee Income)

Providing world-class financial services is expensive. There are three ways that you can contribute to our cooperative:

1. Loans
2. Deposits
3. Fees

You choose how you would like to contribute.

Or, in the immortal words of Mike Moebis,

"Hey member, you can pay us with loans, or you can pay us with deposits; but if you choose not to pay us with either, then our hands are tied and we will need to charge you fees."



Branches: Love Them or Hate Them?

1. They establish your geographic presence.
2. Members want convenience.
3. Your expense ratio is most directly tied to the number of branches that you have.
4. Your number of employees is directly tied to the number of branches that you have.

The Bottom Line? Branches are not going away. But how many you build and how you staff them is a **BIG** part of your ROA.



Loan Growth

Food-for-Thought Questions

1. Do you think you are going to create a new loan product that will drive consistent loan growth?
2. Do you think you are going to come up with a new marketing or advertising campaign that will result in long-term loan growth?
3. Who is responsible for loan growth at your credit union?
4. Are you sure that indirect auto lending is the only way to grow your car loan portfolio?
5. How effective are your employees at selling your existing loans in order to achieve loan growth?
6. Do you think you can grow loans consistently just chasing A and B-paper members?



Ten Internal Factors That Determine Lending Success

1. The Ability of Staff
2. Leadership
3. Location of your Underwriting Pendulum
4. Sales Culture Development
5. Collections Effort
6. Policies, Procedures & Processes
7. Loan Product Design
8. Pricing
9. Marketing
10. Technology



Mistakes that will Lead to Unnecessary Loan Losses

1. Weak Loan Applications
2. Poor Underwriting Decisions (PUDs)
3. A Poorly Run Indirect Lending Operation
4. A Weak Collections Effort
5. Combining Variable Pay & Underwriting Authority



Good Loans will Make You & Bad Loans Will Break You

Exhibit A:

Jan 1, 2008 Delinquency: 1.45% Loss: 0.25%

Dec 31, 2009 Delinquency: 2.78% Loss: 1.93%

Increase in charge-offs of 672% in 24 months! ☹

_____ of 17 of the largest charge-offs reviewed were Poor Underwriting Decisions (PUDs).

Exhibit B:

Jan 1, 2008 Delinquency: 0.75% Loss: 0.57%

Dec 31, 2009 Delinquency: 5.54% Loss: 2.38%

Delinquency up 639% and losses up 318% in 24 months!

_____ of 25 of the largest charge-offs reviewed were PUDs for a total loss of \$564,000! ☹



Costly Underwriting Mistakes

1. Not recognizing bankruptcy risk.
2. Incorrect loan-to-value (LTV) decisions.
3. Too much car = too much payment.
4. Too aggressive with unsecured loans.
5. Too aggressive with youngsters.
6. Denying good loans.



Four Undeniable Facts

1. There are very thin margins on A-paper loans.
2. You can make serious money on D and E-paper loans.
3. Members with bad credit need a car to get to work.
4. Members with bad credit can choose to pay their credit union on time.



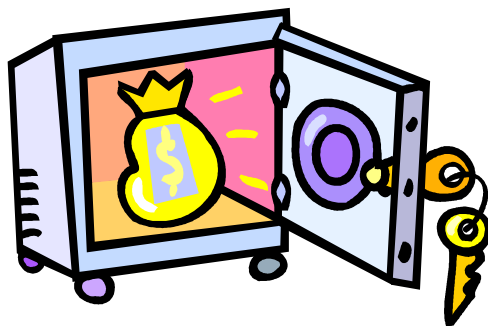
Reasons to Make More Higher-Risk Loans

1. These are the members with the greatest need.
2. These are the members that have the fewest options.
3. Credit unions were formed to serve these members (i.e. the under-served).
4. If you help D and E-paper members they will be very loyal. Can the same be said of A-paper members?
5. An aging population will force you to "buy deeper in to the pie" in order to maintain loan growth.
6. Aggressive dealer financing will cause you to lose many of your A+ and A-paper member auto loans.
7. You can actually make money on D and E-paper loans.



Keys to Successful Higher-Risk Lending

1. Start with secured loans.
2. Employees must use the loan interview to build a performing loan.
3. The loans must be priced correctly.
4. Underwriters must be able to distinguish between high risk and low risk members in every credit tier.
5. Collect the higher-risk loans more aggressively. This starts in the interview with a firm close.
6. Management and the Board of Directors promises not to FREAK OUT when the first few D and E-paper loans go bad.



Indirect Auto Lending

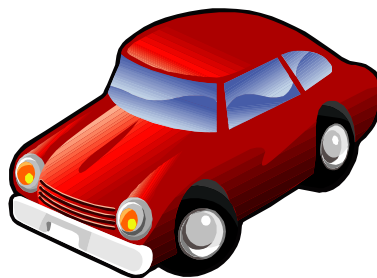
Four Reasons to Partner with Dealers

1. _____

2. _____

3. _____

4. _____



Indirect Lending

"The Rest of the Story"

1. Buy too deep and just wait for the blood bath to occur.
2. How much are you paying for the privilege?
3. Low loan rates are required to gain volume.
4. The dealer's motivation is different than your motivation.
5. Maybe I am from Missouri...
6. Do you think more volume will be the answer?
7. Best of luck creating long-term, meaningful relationships with these new members.
8. The program is not in the best interest of your members or potential members.



Do the Pros Outweigh the Cons?

How Productive are Your Employees?

1. Disbursed Consumer Loan Dollars per Month
2. Applications Taken or Processed per Day
3. Members Seen or Spoken to per Day
4. % of Loans Closed vs. Apps Taken
5. % of Loans Funded with Insurance Products Sold
6. Time Spent on Lending vs. Account Maintenance



Loan Pricing Considerations

- Risk-Based Pricing on all Loan Types
- Variable vs. Fixed Rates
- Do Members make Payments or Does Collateral make Payments?
- Relationship Discounts
- Unsecured Loan Pricing
- Matching Rates Provision
- Pricing of Loans for Old Collateral



Loan Product Design Considerations

- Alternative Payday Lending Product
- Credit Builder
- Risk-Priced Credit Cards
- In-House First Mortgage Capability
- C, D and E-Paper First Mortgages



Lending Delivery Channels

1. Face-to-Face Direct Loan Applications at Your Branches
2. Direct Phone Loans
3. Direct Internet Loan Applications
4. Paper and Faxed in Applications
5. 24x7 Phone & Internet Vendors
6. Indirect Lending Relationships with Third Parties



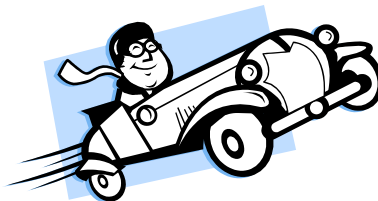
Great Reasons to do More (or All) Loans by Telephone

1. It is a proven technology that all members use and accept.
2. It has a much lower per-transaction cost than doing business in branches.
3. It is more personal than doing business online.
4. It is very convenient for your members.
5. Higher employee productivity.
6. Your employees only need to perfect one form of communication (not two).



Growing Loans 5% to 10% a Year In a Difficult Economy

1. Find Sales People to work up Loans
2. Train Them and Motivate Them
3. Remove Non-Sales Duties and Give them All of Your Applications
4. Set them up Organizationally to Succeed
5. Give them an Underwriter that can Approve Loans in All Credit Tiers
6. Matching Rates Provision
7. Flexible Terms & Loan-to-Value Policy
8. A Strong Marketing Effort
9. A Strong Collections Effort



Three Types of Delinquency

- 1. _____
- 2. _____
- 3. _____

The Three Keys to Successful Collections

- 1. _____
- 2. _____
- 3. _____



Lending Department Leadership

Who is responsible for waving the WE LOVE TO MAKE LOANS banner at your credit union? Who demonstrates to the front line employees a PASSION FOR LENDING? Who is willing to challenge the lending department status quo that has been built up over the last 20 years? Who in your organization questions, updates and validates your UNDERWRITING GUIDELINES? Who is writing a loan policy that helps you make MORE LOANS, not less?

Who is willing to stand up and THROW OUT the lending policies and procedures that have been put in place for auditors and examiners and not your MEMBERS? Who is responsible for creating and improving the ever-elusive TOTAL SALES CULTURE? Who is researching and bringing to the table NEW LENDING TECHNOLOGIES? Who is doing the work to maximize lending VENDOR RELATIONSHIPS? Who is generating and LEARNING from the many lending MANAGEMENT REPORTS that should be run each month?

Who in your organization creates, analyzes and validates lending staff EFFICIENCY and PRODUCTIVITY measures? Who is the champion of pay-for-performance INCENTIVE PROGRAMS? Who goes out on the floor or gets on the phone with your members and teaches your employees how to SELL by their own EXAMPLE? Who is taking the valuable feedback from the collections department and using it to IMPROVE UNDERWRITING?

Who is keeping your PRODUCT DESIGN & PRICING current and attractive to your membership? Who is setting and monitoring the PRODUCTION GOALS of the loan department? Who shares with the entire staff and Board of Directors LENDING SUCCESS STORIES every month so that they remember the credit union's reason for being? Who provides ONGOING TRAINING SESSIONS to your front-line lenders on a regular basis?

Are Your Policies Written for the Examiners Or For the Members?

1. Will you match rates?
2. Will you lower the rates on your own loans?
3. Do you document negative credit in your loan files?
4. How do you verify income and employment?
5. How do you handle self-employed borrowers?
6. Do you love your co-signers?
7. Total Debt Ratio
8. Loan-to-Value



Your Baby (Debt Ratio) Has Issues...

Three flaws to Total Debt Ratio (TDR):

1. _____
2. _____
3. _____

A study was done by the Filene Research Institute a few years ago that found that 65% of all bankrupts had debt ratios less than 40%.

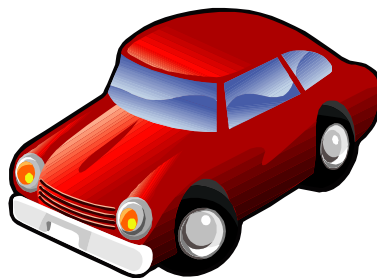
The Bottom Line?

Members need to be able to afford the new loan payment, but a total debt ratio calculation is not a full-proof method of determining this capability.



Determining the Correct Loan-to-Value (LTV) on a Consumer Secured Loan

- You wish making the correct LTV decision was as easy as management drawing some lines in the sand.
- There are A+ and A-paper members that should be financed at 70% or 80% LTV and there are D and E-paper members that can be financed at 110% LTV.
- Do you agree that when it comes to underwriting loans, that every member is unique?
- Your job as an underwriter is risk evaluation.
- Then how about this for a LTV policy statement?



Creating a Sales Culture (i.e. How to Grow Loans in a Difficult Environment)

1. Remove Internal Barriers to Sales
2. Get Employees Working New Accounts & Loans that Like It and are Good at It
3. Set these Employees up to Succeed
 - Leadership
 - Organizational Design
 - Training
 - Compensation



Brett's List of Internal Lending Barriers

- Not available to members (i.e. closed, inconvenient locations, no phone center, no Internet access, etc.)
- Long waiting times to receive service in lobbies and on phones.
- Long, repetitive applications.
- Application fees.
- Slow turn around time on loan decisions.
- Vehicle inspections.
- An industry-wide love affair with receipts.
- Unnecessary requirements for VOE and VOI.
- Traditionally conservative underwriting practices.
- Credit Committees.
- Denial rate/letter.
- Excessive emphasis on regulatory requirements.
- Policies designed for the 1% of loans that will go bad.
- Fear of change.
- Bullet-proof glass!
- Detailed policies and procedures.
- Narrow minded view of the world by Boards and senior management.
- One-size-fits-all rates, terms, and products.
- Organizations designed to produce expenses instead of revenues.
- Loan interviewers that work for the credit union and not the member.
- Pay and recognition systems that promote breathing over performance.
- Employees not motivated to sell, process, close, or even work for that matter!



I Feel Your Pain!

Characteristics of the Ideal One-Stop-Shopping MSR

- Friendly
- Accurate
- Detail Oriented
- Knowledgeable
- Hardworking
- Honest
- Dependable
- Quick Worker
- Judgment Skills
- Technical Skills
- Sales Ability
- Oral & Written Communication Skills



Qualities of a Highly Motivated, Truly Dedicated, Rompin', Stompin', Loan Sales Troop

- Gregarious Personality
- Loves Incentives (i.e. is a money-grubbin' scoundrel)
- Loves Members
- Fearless
- Competitive
- Confident (i.e. cocky or obnoxious)
- Energetic, Persuasive & Persistent
- Non-Conformist



Qualities of a Great Underwriter

- Looks to Make Loans, not Deny Loans
- An "Out-of-the-Box" Creative Thinker
- Analytical Mind
- Decision Maker
- Tolerance for Risk
- Math Skills



Qualities of Great Service Employees

- Friendly
- Patience
- Detail Oriented & Accurate
- Likes Policies & Procedures

Three Ways to Organize Lenders

Dedicated Loan & Member Service Departments

Pros:

- Loan Officers get good at lending because they are specialists.
- Employees end up gravitating to the department and the responsibility that they like more - loans or member service.
- Quality work gets done in both departments because employees are experts, which leads to greater member satisfaction.
- Training time is reduced because employees do not need to learn everything.

Cons:

- Just because a Loan Officer has strong product knowledge and underwriting experience does not necessarily mean that they are any good at selling.
- Very few loans and very little selling is done by the Member Service employees during the new account process.
- Very little selling gets done on the deposit side of your business.
- Member Service employees will get annoyed that the Loan Department employees have the incentive pay program.
- It is very easy for the, "That-is-not-my-job-attitude" to exist in this organizational structure.

One-Stop Shopping MSRs

Pros:

- More products and services can be delivered to the member by a single employee.
- Speed of service delivery.
- A sale can be made at the first point of member contact.

Cons:

- You are asking one individual to be very knowledgeable on a lot of different subjects.
- Therefore, employee training is extensive and never-ending.
- It is extremely rare for an employee to do a great job of selling, servicing, underwriting and processing.
- Great service-minded employees might be asked to leave if they cannot learn to sell.
- Managers are often frustrated because employees never get quite good enough in all areas of responsibility.
- You get "Jacks-of-all-Trades and Masters-of-None."

Sales & Service Specialists

Pros:

- Employees get very good at their jobs and will therefore generally have higher production numbers.
- Employees are generally happier because they are not trying to become someone they are not.
- The training curve is significantly reduced.
- Less employee turnover, saving the credit union time and money.
- Service-minded employees are kept to perform valuable service work.
- Most of the difficult variable pay issues are solved.

Cons:

- Members are transferred to a different department when their question is outside of an employee's area of expertise.
- Jobs become more routine; so managers will have to deal with employee burnout.

Reasons for Centralized Loan Decision Making

1. More consistent loan decisions.
2. Better fits an aggressive incentive program.
3. Not all MSRMs have the skills and attributes needed to be good underwriters.
4. It allows for a more effective sales model to exist.
5. Less chance of loan losses resulting from Poor Underwriting Decisions (PUDs).
6. It is more efficient and more productive.



Organizational Design Question

How many lending challenges go away if you can find a way to significantly reduce the number of employees involved in the process?

Ways to Reduce Lending Staff

1. _____
2. _____
3. _____
4. _____
5. _____



Two Basic Approaches To Employee Compensation at Credit Unions

Philosophy #1: **“It is hard to find good, cheap help!”**

- I've seen great employees leave a credit union for 25¢ to \$1.00 more per-hour down the street.
- If wages are below competitor averages, turnover will be higher than the industry average.
- Average or below average salaries will result in the most talented employees at the credit union looking for jobs elsewhere.
- An undeniable truth of HR management - “You get what you pay for.”

Philosophy #2: **“We want fewer, more competent, more highly paid employees.”**

- I have seen one outstanding employee easily do the work of two average employees.
- Higher employee morale.
- Reduced turnover.
- Above-market wages allow the credit union to hire and retain talent instead of losing talent.

How to End the Whining About Incentive Pay

In the Sales Department:

- Lower & Equal Base Pay
- No Increases at the Annual Review
- A No-Cap Variable Pay Incentive Program

Or as my good friend Michelle recently told me,

“ _____!”



In All Other Departments:

- Higher Base Pays According to the Position's Market Range
- Annual Increases at Annual Review Time Based on Job Performance
- Minimal Variable Pay

What Business Are You In? Sales or Service?

Sales - Defined as the day one activities of:

1. New Accounts
2. New Loans
3. New Deposits



Service - Defined as all member needs from days two through infinity.

So why not organize the credit union according to these two vital functions?

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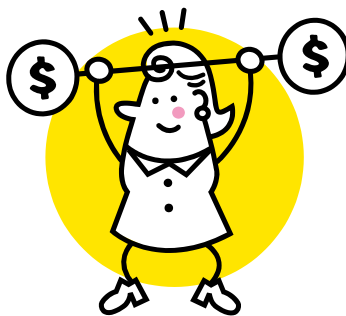
Your Expense Ratio is the Only Thing that You Will Always Control

1. # of Branches
2. # of Employees
3. Quality & Productivity of Employees
4. Use of Technology
5. "Thrifty" becomes a Core Value



Your Strategic To-Do List

1. Quit Building Branches Yesterday
2. Implement Relationship Pricing of Deposit Accounts
3. Reduce the Number of Employees Involved in Lending
4. Hire a few SALES People and Motivate Them (\$)
5. Make the Phone your Only Loan Delivery Channel
6. Make D and E-Paper Lending a Core Competency
7. Improve Underwriting Decisions
8. Separate Sales and Service Functions
9. Improve Your Collections Effort
10. "Fewer, More Competent, More Highly Paid" Employees
11. Charge Down the Technology Road



When it All Comes Together!

Southern FCU - Houston, TX

(\$54 Million in Assets - December 31, 2010)

Fee Income to Avg. Assets Ratio:	0.30%
Average Loan Yield:	8.75%
Delinquency Ratio:	1.52%
Loss Ratio:	0.24%
Loan-to-Share Ratio:	83.17%
Operational Exp. to Avg./Assets:	1.59%
Avg. ROA of Last Five Quarters:	<u>3.05%!!!</u>
Capital Ratio:	22.40%

