Q&A Session for Webinar #12:
Take Off the Handcuffs –
A Policy Manual That Really Works

Q: If the member agrees to pay under Option 1 do you collect the 0% bankrupt loan offline or as an online loan to allow credit history to build?

A: I would create a new loan online at 0% to allow the member an opportunity to rebuild their credit. I would advise the member that you would be reporting it to the credit bureau so they can get credit for what they are doing and maybe this would encourage the member to pay voluntarily.

Q: Credit Mix - How much in C paper?

A: The national average for C paper is probably only 10 to 15% of total loans outstanding. That will vary according your field of membership and the quality of loan business that you are getting. To give yourself plenty of cushion if you feel you need to have a set percentage I would recommend 30%.

Q: I have a member that receives $600 a month from Social Security that is direct deposited here. This member has no assets, poor past credit, does not want any life insurance - would you grant this member a $500 credit card?

A: I would absolutely give them a $500 credit card provided you close the deal so that the member understands that the minimum payment will have to be deducted directly from their Social Security check each month and that they cannot withdraw this money under any circumstances. They also need to know that due to their limited income you probably will not be able to increase the $500.

Q: Do you have certain rules for 84 month loans (i.e. a model year requirement and/or a dollar amount restriction)? I'm also having a difficult time getting my board to do more than 90% LTV on new or used, based on high charge offs. Any advice?

A: In our matrix we recommend 84 month financing (the Decision Making Matrix is located within the Loan Policy Manual or for a copy of our Decision Matrix please send an email to David Johnson at djohnson@rexcuadvice.com requesting a copy) on loans of $36,000 and above. That is only a guideline.

Boards often react unfavorably when you have high charge-offs and they tighten up on the polices. You really need to look at getting a portfolio analysis done (for more info please contact David Johnson) so that we can see why the charge-offs are so high. Once we understand this we can help you sell the Board of Directors on why we can do greater than 90% financing especially if the evidence suggests that is not why we are having the charge-off problem. When you will not go over 90% you create a barrier to making loans and credit unions absolutely need loans and loan yield. With our new pricing you will be compensated for taking additional risk. You just have to make sure the decision making is sound.

Q: Does 20% pertain to a small CU. What about 25%?

A: The 20% you are referring to relates to the percentage of unsecured loans outstanding compared to total loans outstanding. With smaller credit unions, it is not uncommon to see up to 50% of their loans unsecured. With larger credit unions, you often see less than 10%. If you have over 20% and you are not having big delinquency or charge-off problems, don't worry about it.

Q: How do you use credit re-builder with new members?

A: The key to the Credit Rebuilder loan is knowing your member and making sure you get the loan on payroll deduction from direct deposit. With new members, make sure direct deposit is in place before you release the funds and make sure you find out something about the member such as the employment and so forth. The loan has to be closed so that the member understands they are not to cancel the direct deposit and that they can pick up an additional $500 on their next loan.

Q: In the LTV do you include back ends or is this LTV and back ends a separate ratio? If we do example 115% LTV we also allow back ends of 20% of Sales price, what do you think?

A: Anytime you allow the dealer to pack on all of the back-ends (including insurance), you are going to have a very happy dealer but you are probably taking a lot more risk. Understanding that, I recommend you be very careful and I would not be 115%+++ unless the member had exceptional qualifications such as a good long term job, not heavily indebted, some evidence that for the most part they make their payments on time and they are not having a lot of debt or trading cars every six months.

Q: What is your view on teaser rates for HELOC's?

A: It has been tried many, many times, sometimes with success and sometimes not. I am not a big fan of it as many of the astute members will take the teaser rate and when it switches they will pay their loan off by going somewhere else. You end up losing a lot of money with members like this. The rates we recommend on equity loans should get you all the business you could ever desire if your employees are looking for opportunities.

Q: Rex - your opinion of branch level lending vs. centralized?

A: My opinion has always been that branches should be decentralized and make their own decisions since they have the member sitting right in front of them. The employees obviously have to be trained and branch managers should have level 3 authority. You are always going to turn down more members when the decision maker is not talking to the member.

Q: How do the regulators look at giving employees a 2% discount on loans?

A: I have not heard from any credit unions where they had any problem with the regulators as long as the credit union documents it in its policy manual that the board has approved it. The discount has been going on for sometime so it is not new.

Q: When you give a discounted rate to the employees, are there any tax implications, and if so, what are they?

A: Your question is a good question and I would highly recommend that you would check with a tax expert. There was a time when you could not include this as taxable income when the value was less than $600. I am not sure what the amount is anymore or if there even is an amount.

Q: What are Chattel loans and straw purchases?

A: Chattel loans usually loans where you take collateral that has no title so therefore you record what is called a UCC1 to protect your interest. An example would be if you financed new furniture or a computer and you wanted to make sure your loan was considered to be a secured loan. A straw purchase is where the car dealer knowingly submits an application on someone who is not really buying the car or is taking delivery of the car. This individual usually will have good credit and the credit union thinks that the person getting the car when in fact they are doing a friend or relative a favor who may have major credit issues but you don't know about it since the dealer kept you in the dark.

Q: When you state actively employed, how long should they be employed?

A: You would like to see somebody employed at least 90 days on a job that will likely continue which would eliminate a lot of temp agency type jobs.

Q: We have a promotion that will "beat your rate" with another lender, up to 2%. What are your thoughts on this?

A: I am not really in favor of it if you are going to end up losing money because the other lender is out trying to buy the marketplace and they are losing money also. We believe you can match rates by discounting A+ and A paper up to 1%, B and C paper up to 2%, and D and E paper up to 3%. You will not lose money doing this assuming you are using our recommended rates.

Q: In the State of Wisconsin we need to comply with the Wisconsin Consumer Act which many times requires us to be more restrictive than we would like. How do you recommend we work that within this policy?

A: I am not that familiar with the Wisconsin Consumer Act. I would strongly suggest that if the Act creates barriers to you making loans and they are not willing to change it then you may want to consider changing charters to a Federal charter which might give you more flexibility. If enough Wisconsin credit unions convert to a Federal charter I will assure you they will make changes in their act.

Q: Why did you relax your Unsecured Debt guidelines such as 35% of annual income and 60% capacity?

A: We relaxed it for two reasons. The first reason is that the number of bankruptcies are down substantially although we believe they will start rising again. The second reason is that under the new bankruptcy law it is going to be far more difficult to always go Chapter 7 than it was before. Creditors can expect to recover more money under the new law than the old law.

Q: Do you reduce the 35% signature total for lower credit scores?

A: The answer is no. We also believe that the higher the risk the more cautious one has to be. When you see someone with a low score with a high level of unsecured debt, this suggests they are struggling to make their payments and in all likelihood could end up in bankruptcy so I wouldn't expect many of those loans to be approved unless they were bankruptcy proof but I would caution you on having a policy that states you could never approve them.

Q: Which credit score should we use for a co-signer that does not live with the borrower? Should these be qualified individually - should each individual's DTI be taken separately in relation to the loan?

A: We recommend that in the event there are two scores, whether it is maker and co-maker or joint borrowers that you use the average of the two scores. You would never want to increase the amount you are loaning somebody based on the co-maker's income since the maker will be making the payments. Their DTI should definitely be taken separately.

Q: The Wisconsin OCU has been very insistent that we obtain tax returns on self employed borrowers. How can we appease them and still make it easy for our members to borrow from us?

A: First of all you need to understand what the Wisconsin Credit Union Act requires and is it in writing. If the Act states that you must have proof of income and two years tax returns on self employed members, then you have no choice. On the other hand if it is just their best opinion thank them for their input and just make sure your policy allows you to not have to verify employment on every self employed member. This policy needs to be approved by your board of directors. Self employed members who have excellent credit, good scores, and assets plus a good relationship with your credit union should not have to bring their tax returns in every time.

Q: When you talked about the members that have caused the credit union a loss and we should give them their next loan you only talked about the BK losses, what about the members that did not file BK?

A: Members who did not file for bankruptcy that caused you a loss are legally collectible unless the statue of limitations has run out. It is entirely possible that some members who have gone several years without paying have really forgotten they owe you the money. You certainly want to be upbeat and friendly with them but show them that the debt was never paid. You still may be willing to loan them new money if they are qualified but you should include your old balance in the new loan. If the member legally has to pay you then you should inform the member that not paying you is not an option. With bankruptcy they legally don't have to pay you if they are discharged.

Q: Scoring- if there is a guarantor do we average and why?

A: A guarantor is usually taken after the loan is made when there has been issues with the maker and because you are putting pressure on the maker to pay you they will bring you a guarantor that will stand good for the loan. I believe you have to honor the original rate of the contract unless you rewrite the loan but then the proposed guarantor would actually become a co-maker and I would then take the average of the two scores.

Q: Do you offer training on reading credit reports your way?

A: We absolutely offer the training. We do On-Site training, University of Lending training, Post Graduate training, and we will soon be introducing Lending 101 training which will focus a great deal on how to read and understand a credit report the way I teach it. Our first Lending 101 class will either be the later part of this year or the first quarter of 2008. Please check our website at www.rexcuadvice.com for more info or contact David Johnson.

Q: Does Rex offer any type of lending school for Member Business Lending?

A: At this time the answer is no. It is high on our priority list and we are going to give it strong consideration for 2008.

Q: Concerning annual reviews of revolving unsecured LOC's - should we adjust the rate on these LOC's to reflect the current % rate? If we should, how can this be done without a) making the member angry, and b) changing the terms of the loans as required by NCUA

A: Most LOC's have no terms. They are open ended and have a draw period such as a credit card. We recommend on credit cards as well as LOC's that if it is C, D, or E paper you do an annual review by looking at their new credit report and score and that you adjust the rate accordingly. If it is A+, A, or B paper your review should take place very two years and not every year. In this case you would still adjust the rate accordingly either up or down. You need to have someone look at your current master contract they probably signed when you gave them the LOC to see how much flexibility you have in adjusting the rate. I would definitely adjust the rates and I would explain to the member that the LOC is good for whatever time frame you choose, has to be reviewed, and their rate will be adjusted according to their score either up or down at that time. Most LOC's require a 30 day advance notice to the member before you make the adjustment.

Q: Can Federal credit unions offer discounted loan rates to employees?

A: I know there are a number of Federal credit unions that do. I believe if your board approves that policy they probably will not have any problem with it. You might want to check with your league attorney and get their opinion.

Q: I'm confused about the conflict between "terms" and the "pick your own payment plan" How do you set the term based on age of collateral?

A: There is no real conflict between term and age of collateral. What we are trying to eliminate is always financing cars for 36, 48, 60, 72, 84 months and so forth. We want to get the employees more focused on payment and selling to the payment. Our policy is that we will give the member the payment they are asking for as long as it is in the best interest of the member and the credit union. We also said the great the risk the shorter the term. When the credit union extends the terms to give the member the payment they are asking for they should get compensated for extending the term since we don't know what interest rates are going to do (i.e. go up or down). It is a common practice to price loans according to the age of a vehicle; therefore credit unions should charge a higher rate for older vehicles which again is consistent with the competition. Credit unions need income and this will help you produce more income while still giving the member a better deal than they can get elsewhere.

Q: What about deferrals? Do you use the same conditions you listed in the policy as Release of Collateral for a Deferral request? Even if the member is not delinquent?

A: Rex is having trouble understanding your question regarding deferrals. Could you please contact David Johnson with some further details and we will be happy to answer your question.

Q: I am interested in starting an indirect lending program. Where can I obtain necessary on line forms.

A: What you are going to need is a dealer agreement and a good understanding of indirect lending if you have never done it before. I would highly recommend you attend our school on indirect lending. Many credit unions that started a program without the right training ended up losing a lot of money. Our next indirect school is scheduled for late October and you can get more information on this school from out website www.rexcuadvice.com or by contacting David Johnson. In the meantime if you would like further information on this please email David Johnson for a copy of our sample dealer agreement.

Q: We just had a very positive exam with our OCU. Would you recommend that we phase in the new loan products (credit re-builder, etc) in order to prove that we are moving in a safe and sound manner?

A: Congratulations on a positive exam. Examiners tend to be very focused on strong capital, reasonable earnings, and very low delinquencies and charge-offs. They are not usually focused on growing which is where credit unions are hurting. The only way you can grow is to have strong earnings and pay above average dividends which means you are going to have to take some risk and adopt some of the strategies we talked about. Again congratulations on a good exam.

Q: How frequently should a new credit bureau be pulled when a new loan is requested? For example, a member has a loan based on a credit score that was pulled 2 months ago and now wants an additional loan - do we pull another credit bureau or use the last one

A: Always pull a new credit report every time the member makes a new loan request as scores can and will change quickly.

Q: In a credit re-builder loan if a member does not have the ability for direct deposit (perhaps works for a mom & pop shop) how would you recommend we handle that?

A: You are going to need a forced payment plan if the mom and pop shop thinks the member is a good employee and agrees to help the member by deducting the required payment and sending you a check for that payment every month you can still make the loan. I have seen many mom and pop shops willing to do this if they value the employee.

Q: Regarding the Bankruptcy letters, have you had anyone challenge this?? Lawyer, trustee, etc.?

A: To my knowledge we have never been challenged. I would recommend you send it to your attorney but make sure you call your attorney and let your attorney know this is something you would like to do. Let the attorney know the member has two options, not one. Make sure the attorney knows if the member is accepting option 1 that the credit union will not try to enforce payment as this is not a reaffirmation but only an agreement that the member wants to voluntarily pay. If the attorney says you cannot accept voluntary payments ask him to show it to you in writing. We are anxious to hear what you find out.

Q: What is the best way to market the credit re-builder loan?

A: Market it to members with scores below 620 and to members who have never had credit. You should simply let them know that we realize bad things happen to good people and we would like to see them get a fresh start. If you would like more information please contact David Johnson for an example of an offer of credit to a recent bankrupt. We call this our welcome back letter and David will be happy to email this over to you. As you will see from this letter the tone of the letter is very upbeat and positive and that is what you need to be offering. We have listed the requirements to qualify in the policy manual.

Q: Is offering a $500 credit card to anyone who gives you direct deposit, the same as making direct deposit a condition of approval?

A: It certainly is a kissing cousin if it is not the same. We understand that the Fair Credit Reporting Act does not allow you to make direct deposit a condition to get a loan. We also understand any member can be turned down for not making their payments on time. All we are suggesting is that when a member gives you direct deposit or has direct deposit that you reward them with a credit card.

Q: We have been giving up to a 1% discount for our rates in all categories for 20% down payment, automatic payment, and direct deposit in one of our accounts and it has worked well for us. Thanks for the great idea in U of L.

A: I really appreciate your feedback and I am excited it is working well for you. Keep up the good work!

Q: Are you stating that you require comp & collision only on auto loans over $10,000?

A: That is what I recommend but your insurance company will not like it. We used to only waive insurance when the balance was $2,000 or less, most credit unions have now increased that to $5,000 and we are suggesting $10,000. A lot of members just don’t want to carry insurance on cars worth less than $10,000 and if we keep adding this forced placed insurance some of these loans will never be paid.

Q: We are part of CUNA Mutual's lender development program and have been building loans on payment for quite some time. This along with your philosophies have helped to build our loan yields over time. We are proof it works.

A: I am delighted to hear that. It is refreshing when credit unions are growing their earnings and giving more back to their members. Keep up the good work!

Q: Do have the materials available for the auto sales seminar that we could use in giving the presentation?

A: Yes, it is located within the policy manual but if you cannot find it please contact David Johnson and he will be happy to email you a copy.

Q: Regarding Income Verification- how does Rex consider overtime pay? Does he count overtime?

A: What you want to pay attention to is that when a member has additional income, whether it is overtime or they work a part time job, what are they doing with it? If you look at their credit report and there is strong evidence they are making minimum payments, stretching out terms on car loans, maxing out credit cards and have lots of inquires then they are not making it in spite of the additional income. The decision to make or deny the loan is far more important than the debt ratio and I am sure that is why you asked the question. Should we include the income in computing the debt ratio? Most credit unions will include it if there is evidence it will likely continue and the member has been getting it for some time. Again be far more concerned on the decision then getting the math right.

Q: Do you have any statistics relating to delinquency, charge-offs, and net charge-offs for mortgage and home equity loans that are in excess of 100% LTV?

A: If you read the newspapers over the last week many of the lenders are in serious trouble making these loans. The second largest lender just went bankrupt last week. Foreclosures are at an all-time high. In today’s market I would not recommend going over 100% and you have to be careful going up to 100% as homes are sitting on the market longer. The only time you should ever consider going over 100% is on collection workout loans or if your marketplace is so hot that real estate values are going up 20 to 25% a year.

Q: You may have covered this, but on your credit re-builder--can all levels of lending staff approve these?

A: If you will look at our lending matrix (it is within the loan policy manual) Level I decision makers can approve scores of 640 or higher and Level II 550 or higher. Therefore a good portion of these loans will be approved by Level III. Level I and II should make the recommendation.

Q: We have a couple of HELOCs that have a draw period of 8 years. At the end of that time it converts to a 15 year amortized loan where the interest rate remains variable but payments are fixed. Any suggestions on a better alternative to this payment structure?

A: I would recommend that during the first eight year period that the member's credit be reviewed every two years and their score would determine their new variable rate. At the end of the eight years you could continue to do what you are doing by offering a fixed payment, however if the rate continues to go up the member may end up with negative amortization. I think I would stretch the eight years to a ten year draw and then determine at the end of ten years if you want to discontinue the line of credit and just make it a fixed rate second mortgage loan based on their score with a fifteen year amortization. I can only see you doing this if the member was struggling to make their payments and you didn't trust them with the line of credit.

Q: For the Credit re-builder loan what would you recommend for initial funding to the ALL?

A: I wouldn't make a great deal of changes in the ALL. Credit unions that have been offering this product have charge-offs in the first two years of about 1.6%. Compute out what that would mean for your overall charge-off and make some slight adjustments but because we are not talking about a big dollar amount I don't see where big changes would have to be made.

Q: We had a question in relation to the Bankruptcy Score Predictor. How do you use it in relation to the level of approval?

A: The Bankruptcy Score Predictor should suggest to you whether the member is a potential bankrupt or not. The Bankruptcy Score Predictor does not know the assets a member would have or the member's income. For a copy of our Bankruptcy Predictor please contact David Johnson. If it is determined either through using their predictor or ours that a member is a potential bankrupt you can still make the loan but the loan has to be bankruptcy proof which simply means the value of the collateral exceeds the amount of the loan. If the member is a potential bankrupt and your loan is not bankruptcy proof nor can you make it bankruptcy proof, then you will most likely have to deny the loan. We recommend you do a "preview of coming attractions" and discuss the possibility of bankruptcy with the member. If the member elects to go bankrupt they need to know that you will be there for them after the bankruptcy.

Q: Since employees can get a 2% discount, can volunteers be afforded this same perk since they are volunteers?? I think this Loan Policy could be approved without a problem if that is available. Also, is the 2% off our lowest rates we offer??

A: 2% is off your lowest rates. Check with your examiner or league attorney to see if the volunteers' discount is allowed in your state. If so by all means offer it to them.

Q: Won't lending 84 month car loans result in up-side-down vehicle loans.

A: Absolutely. Approximately 80 to 85% of all indirect loans and all car loans in general are now upside down, that is why deficiency balances keep growing. At some point, when the losses are high enough, credit unions will say we have had enough. There are other loans than these types of loans. If you are going to continue to make these upside down loans, you cannot keep taking all the risk and allowing the dealer to make all the money. That is not a good formula.

Q: Do you have any suggestions for incentives to loan officers to really get everybody excited about looking for every opportunity to make loans? Thank you for any ideas. We enjoyed the presentation very much!

A: Please contact David Johnson for a copy of our incentive tracking sheet. The changes I would make and will soon make when I get an opportunity are 1) raising the cost of GAP insurance by $100 and paying the employees a $100 to sell a GAP policy and 2) paying $25 for direct deposit and 3) paying $25 for every credit card the employee can give out that the member accepts and uses. You are on the right track and you will see your loans go way up once you introduce this incentive program plus you will make more money.
