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# WEBINAR 32

**Indirect Lending:** *Drive Home Profits*

*Presented by Ed Swanson*



# Webinar Outline

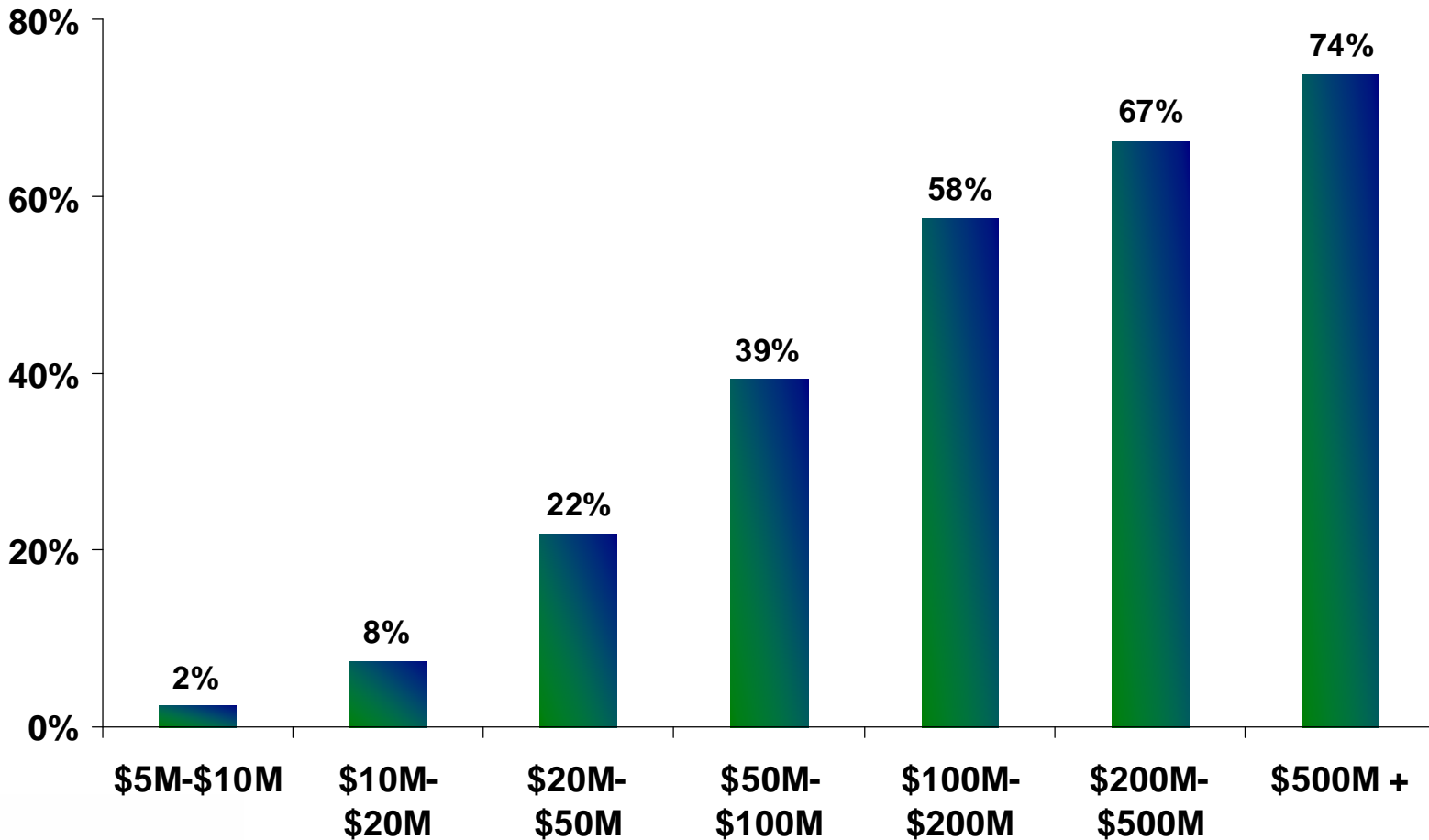
- Why would Credit Unions get into Indirect Lending
  - Why Indirect lending can benefit your credit union
  - Developing a Successful Indirect Program
  - Increasing your auto loan portfolio
- The Inherent Risks of Indirect Lending
- Turning Indirect Members into Full Service Members
- Best Practices for Your Indirect Program



# What is Indirect Lending?

- **Indirect Lending** is the process by which a vehicle purchaser may complete the entire loan transaction from start to finish at the dealership without ever having to communicate or visit the lender who will ultimately finance their purchase. The dealership personnel completes all of the necessary documentation with the purchaser after they assign or “sell” the completed loan package to the financial institution.

# Credit Unions that Use Indirect Lending *(by asset size)*



Source: CUNA's Operating Ratios & Spreads, Year-End 2011





# **Why Would Credit Unions Get Into Indirect Lending?**

# Auto Buying and the Internet

- **87% of purchasers finance their auto loan directly at the dealership**
- 85% of purchasers do their research for their auto purchase online before visiting the dealership
- 60% research their financing of the vehicle online before visiting the dealership
- 14% who did auto finance research online ended up applying for financing online as well
- Kelley Blue Book and Edmunds are the most visited auto websites by consumers
- Purchasers spend an average of 4.9 hours online researching
- On average, consumers seek a new auto loan every 26 months
- The percent of new vehicles purchased by women is 37%
- The average age of a new vehicle buyer is 48 years old

*Per JD Powers & Associates Survey*

## From the Credit Unions' Perspective:

1. Huge potential for increased loan volume
2. Improves the relationship between the credit union and the dealership
3. Potential increase in new members
4. Sharing of the workload with the auto dealer to get the transaction done

## From the Members' Perspective:

1. Convenience at the point of sale
2. Can get their loan approved immediately without having to 'ping pong' back and forth between the dealer and the credit union
3. Might be able to get a better interest rate on their loan



## From The Dealers' Perspective:

1. To maintain control of the vehicle transaction
2. Serves as an additional profit center for the dealer
3. Speed of completing the sale of the auto and the financing
4. Ability to sell additional backend products to increase the profit margin

## Potentially...A Win, Win, Win

- **Member:** Wants a FAIR deal at a FAIR Interest Rate
- **Auto Dealer:** Wants to sell more cars at a FAIR price
- **Credit Union:** Wants to make more loans at a FAIR rate of return
- **Watch for:** The 3 Legged Table Analogy



## Indirect Lending: Pros

- Convenience for the member
- Most consumers get their auto loan through an indirect channel
- Loan volumes can be high
- New members generated for your credit union -  
Need to market to them to expand the relationship
- Can generate productive partnerships with the dealers that bring in business for years to come

# A Few Key Suggestions

1. **Learn the Business**: Understand what it takes for dealers to be successful. Understand that they only want to sell cars and dealer add-ons. They have to make money in order to stay in business.
2. **Know Your Partners**: Build relationships with dealers and treat them as you would like to be treated.
3. **Stay Consistent**: Do what you say you're going to do
4. **Monitor Dealer Performance**: Terminate any relationships that do not make sense with your business plan
5. **Understand the Long-Term Commitment**: It is difficult to jump in and out of the indirect marketplace



# **Developing a Successful Indirect Program**

# Developing a Successful Indirect Program

- **Plan Carefully**—Do your homework!!
- **Decide** whether to build internal expertise, hire experienced indirect lending personnel, or work with an established third party.
- **You must have strong dealer ties**—Consider hiring a Dealer Relations Representative
- **Set a competitive fee schedule to compensate dealers** - Shop your market of what is customary.
- Continually **refine processes** and your technology

## #1: Determine If You Need an Indirect Program

- What is happening with your auto loan market share at your credit union?
- Are there more competitors in your marketplace than there were 5 years ago?
- We have very narrow margins on our auto loans - especially on A+/A paper
- Do you need to establish a community charter or do you serve enough SEG groups in town to be successful?

## #2: Building Relationships with Dealers

- Your relationship with dealers is the most important factor in building a successful program
- Find out who the 'big players' are in your geographic region
- Pick a handful of reputable dealers that you want to do business with
- Credit union management needs to get together with the General Manager, Sales Manager and Finance Manager
- Be open-minded to what they share with you
- Be prepared to compensate the dealer for the service— They are in business to make money
- Hire a Dealer Relations Representative to be your 'eyes and ears' at the dealerships



## Have the Dealer Relations Representative:

- Bring food to the dealers
- Ask them what they like and dislike about your competition
- Ask them what you can do better
- Ask them what you need to do to get more of their business
- You ultimately will get more of their quality business—All of your competition is doing this

# Cultivating the Dealer Relationship

- Automate processing the loan as much as you can
- Eliminate the need for the dealer to fax you deals
- Give the dealers a quick decision on a loan application – they use the ‘shotgun approach’
- Give the dealer a counteroffer as opposed to just turning the deal down
- Try to automate the payment to the dealer as well

## #3: Setting Up Your Program

- Form a team made of lending staff and technical staff
- Try to automate some of the processing
- One of the biggest keys to success is quick response time with approvals
- Decide on type(s) of dealer compensation:
  - Flat fee per contract
  - Sliding fee based upon loan amount
  - Interest participation
- Meet with the dealers to discuss program — emphasize quality of paper and speed of response

# Dealer Compensation: Options

- **Flat Fee Per Contract**

Examples: 1% of the of the loan amount or \$150 flat amount per contract

- **Sliding Fee Based Upon the Loan Amount**

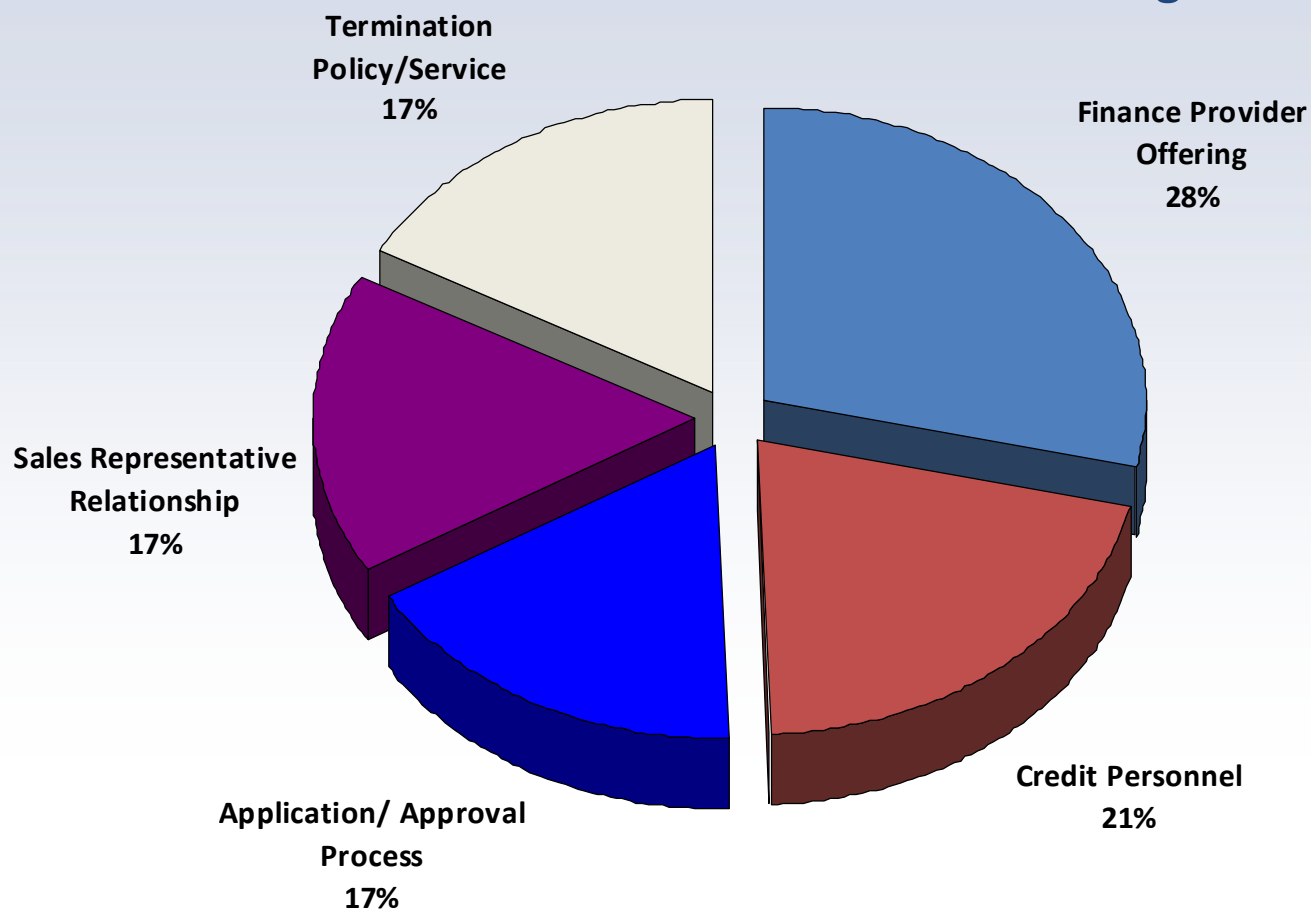
Examples:	<\$15,000	1.0%
	\$15,001-\$25,000	1.5%
	>\$25,000	2.0%

- **Interest Participation**

‘Buy Rate’ = 4.0% (i.e.) Dealer can ‘up-charge’ rate up to a capped amount. Dealer may or may not split additional finance charge income with the credit union

# While the offering is most important, other aspects of the relationship with the dealer drive a large portion of satisfaction

## 2011 Prime Retail Credit Index Model Weights



## #4: Tracking Results

*(Number of Loans and Dollar Amount)*

- Loans by grade of paper
- Measure volume of business by dealer
- Measure delinquency by dealer
- Measure charge-offs by dealer
- Measure volume, delinquency, and charge-offs by your loan officers compared to specific dealers
- This is extremely important - No shortcuts here!

## #5: Monitoring Your Program

### ✓ Check for Loans With the Following:

1. Inflated trade-in or purchase values
2. Rebates reflected as down payments
3. Compliance with lending regulations
4. Accuracy of member information
5. Excessive prices for dealer 'add-ons'

# Structure of the Deal on New Vehicle Contracts

**2011**

New Vehicles	Banks	Captives	Credit Unions	Independents
Amount Financed	\$24,736	\$25,952	\$27,010	\$22,950
APR	5.68%	3.94%	5.84%	9.74%
Buy Rate	4.61%	3.49%	5.27%	9.12%
Credit Score	740	734	726	658
Days to Turn	63	53	70	62
Loan to Value %	94%	95%	103%	105%
Percent Negative Equity	26%	30%	47%	50%
Spread	1.07%	0.45%	0.57%	0.62%
Term	65	61	69	66

**2010**

New Vehicles	Banks	Captives	Credit Unions	Independents
Amount Financed	\$22,859	\$25,179	\$24,190	\$21,753
APR	7.08%	4.86%	6.50%	12.06%
Buy Rate	6.12%	4.47%	6.02%	11.48%
Credit Score	739	734	736	663
Days to Turn	105	97	114	105
Loan to Value %	96%	96%	102%	105%
Percent Negative Equity	29%	30%	43%	50%
Spread	0.95%	0.39%	0.48%	0.59%
Term	64	59	67	67

Source: Power Information Network – PIN, a business division of J.D. Power and Associates

FICO is a registered trademark of Fair Isaac Corporation



# Structure of the Deal on Used Vehicle Contracts

**2011**

Used Vehicle	Banks	Captives	Credit Unions	Independents
Amount Financed	\$17,525	\$20,659	\$16,756	\$13,453
APR	8.62%	7.35%	7.26%	19.42%
Buy Rate	7.37%	6.38%	6.77%	18.91%
Credit Score	712	709	710	565
Days to Turn	49	52	49	42
Loan to Value %	98%	98%	105%	100%
Percent Negative Equity	24%	29%	37%	30%
Spread	1.25%	0.97%	0.49%	0.51%
Term	62	60	61	57

**2010**

Used Vehicles	Banks	Captives	Credit Unions	Independents
Amount Financed	\$16,163	\$19,160	\$16,007	\$12,511
APR	9.88%	8.39%	7.60%	19.86%
Buy Rate	8.76%	7.63%	7.17%	19.51%
Credit Score	710	705	718	564
Days to Turn	60	61	60	47
Loan to Value %	99%	100%	105%	99%
Percent Negative Equity	24%	28%	33%	26%
Spread	1.12%	0.76%	0.43%	0.36%
Term	61	59	61	55

Source: Power Information Network – PIN, a business division of J.D. Power and Associates

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## #6: Controls to Put In Place

- Get a second credit report on every new member
- Co-borrowers are subject to the same approval standards as the primary borrower
- Fraud check software available from credit bureaus used on every new member
- Employment verification form on new members that have never done business with you
- Verify auto values on Kelly Blue Book software
- Verify source of funds for down payments
- Verify housing expense (or lack thereof!)

## Be Careful of the Following:

- **Policies:** Dealers often encourage credit unions to relax their policies for certain scores on items such as: Employment verification, income verification, etc,
- **Credit Union Stipulations:** If the credit union is requiring that negative items, such as collections, are paid, the dealer will often pay the negative item.
- **Automated Approvals:** Credit unions using automated approval process are quickly learning the car dealers know and understand it well and they know how to get someone approved without the credit union looking at the deal by:
  - *Inflating the income that the buyer earns*
  - *Changing the length of employment on the application*
  - *Inflating the value of the trade-in to make the numbers look better than they are*

# Spelling It Out

## *Your Indirect Lending Policy*

- **Portfolio Limits**: Decide if you will have one based as a percent of total loans, a percent of capital, or both
- **Establish Dealer Fee**: Decide how much and how you will pay the dealer...flat fee, percent, rate up-charge. Determine what is typical in your marketplace
- **Rates**: Determine whether your indirect rates will be the same as your direct rates. Determine financial goals and what the local market will bear
- **Credit Reports**: Pull your own. Don't ever put blind faith into what the dealer provides you
  - Auto Enhanced FICO score are prevalent with dealers

# Spelling It Out

## *Your Indirect Lending Policy*

- **Underwriting Criteria:** Establish clear criteria and communicate it to the dealers of what grades of paper you will buy
- **Verification Requirements:** Since the application is coming directly from the dealer, significant verification should be performed. The dealer is only concerned with getting the deal funded and selling their backend products.
- **Rotation of Underwriters:** Review underwriters loan decisions and rotate them so that they do not become 'overly influenced' by the dealers on making decisions.
- **Good Reporting:** Loans by Dealer, Loans by Paper Grade, Paper Grade by Dealer, Loan Officer's Volume by Dealer, Delinquency by Dealer, Delinquency by Loan Officer

# Are Employees Getting too Close to Dealers?

Make sure that the dealers are not getting so close to the employees that they forget who they work for. Watch out for employees, especially if only one employee is running the program, when they:

- Become very defensive about loan decisions
- Continually override decisions on turndowns
- Want everything to go through them
- Spend a lot of time with one or two dealers
- Waive the stipulations
- Intimidate other employees

## #7: Audit Every Transaction

- Review every dealer document and every member document.
- Verify membership application and signature card.
- Send out a new loan 'Welcome Letter' or kit to each new indirect deal.
- Call each member to discuss the quality of the service received at the dealership.
- Call each member to review the details of the transaction to insure that the member was not 'coached' by the dealer of what to write on the loan application or, worse yet, the dealer filled it out for the member.

## #8: Monitoring Dealer Performance

### Delinquency/Charge-off Levels

*(Example - You can go higher or lower)*

- ✓ **.05%-1%** Credit Union should have a meeting with the Owner, the General Manager and the F/I Department Manager to discuss credit quality
- ✓ **1%-2%** Put the dealer “on probation” until the credit quality improves—make it clear the type of paper you will purchase from them
- ✓ **Over 2%** Consider the option of terminating the entire relationship with the dealer



## #9: Monitoring Loan Officer Performance

- **Division of Tasks** - Separate the approval process and the loan funding process
- **Working with the Internal Audit area** - Guide them on the monitoring of these loans
- **Audit** a sampling of approved and funded loans on a monthly basis
- **Perform “Autopsies” on Charge-offs** — Use as training tools for the lending team

## #10: Create a Written Dealer Agreement

- Spell out what the dealer is responsible for and what the credit union is responsible for
- Indicate that the dealer will receive their funds from you within \_\_\_\_\_ # of business days of delivering a valid, signed contract by all parties
- Address the issue of fraud - If a deal is fraudulent, the dealer is fully responsible—pays off your loan and takes the car back from you
- Address what happens if your loan is paid off within the first 90 days of the contract....the dealer needs to return some (and possibly all) of the income that they earned from you when you bought the deal

# HYLS Indirect

1. *Number of Years as an Active Member*
2. *Length of Time the Member has Lived at their Current and Previous Addresses*
3. *Length of Time the Member has been Employed at their Current and Previous Jobs*
4. *Valid Credit Score*
5. *Credit Score with No Credit Flaws (living off of inflated income)*
6. *Number of Inquiries in the Past 24 Months*
7. *Number of Open or Closed Trade Lines as a Percentage of the Member's Age*
8. *Number of New Trade Lines Opened in the Past 24 Months*
9. *Total Dollar Amount Past Due With All Creditors*
10. *Payment History on the Most Recent Open Vehicle Loan*
11. *Payment History on the Last Prior Vehicle Loan*
12. *Number of Vehicle Loans Opened in the Past 5 Years*
13. *Total Dollar Amount of Add-Ons*
14. *Negative Equity Added-On From Trade-In*
15. *Cash Down Payment*
16. *Loan to Value on Vehicle Loan Request*
17. *Loan Amount versus Term*
18. *New Vehicle Loan Being Purchased vs Annual Gross Income*
19. *Total Secured Loan Balances Outstanding vs Annual Gross Income*
20. *Debt to Income Ratio*
21. *Total Outstanding Unsecured Debt versus AGI*
22. *Total Mortgage Debt vs. Annual Gross Income*



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## HYLS Underwriting Guide

**Scorecard for:** Hot Rod

**AppType:** Indirect    **Date:** 5/31/2012 3:55:52 PM    **Member Name:** Rod    **Loan Officer Name:** Lola Lender

### Top Positive Factors

- 3. Length of Time the Member has been Employed at their Current and Previous Jobs
- 2. Length of Time the Member has Lived at their Current and Previous Addresses
- 21. Total Outstanding Unsecured Debt versus AGI
- 9. Total Dollar Amount Past Due with all Creditors
- 11. Payment History on Last Prior Vehicle Loan

**Total Positive Point** 165

**Total Negative Point** -60

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**Total Factor Points** 105

**Credit Score** 642

### Top Negative Factors

- 7. Number of Open or Closed Trade Lines as a Percentage of the Members Age
- 10. Payment History on the Most Recent Open Vehicle Loan

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**Adjusted Credit Score** 747

### Bankruptcy or Inflated Income Indicators

Codes #20, 21, 22, 5, 6, 7, 8, 9

If combinations of these indicators show up under negative factors and the negative factors total over 100 points, you should be concerned, especially when the indicators total over 200 points.



# **The Inherent Risks of Indirect Lending**

## Indirect Lending: Cons

- Loan volumes can be high – Do you have the staff to support the increased volume?
- Might be challenging to convert these new members to do other business with the credit union
- It costs money to generate loans through the indirect lending channel
- Can you service the dealer on the evenings and weekends to ensure that you can get deals during off hours?

## Risks of Indirect Lending

- Growing your Indirect Program too quickly
- Insufficient staffing to handle the growth
- Relying solely on the dealer's credit report to make a loan decision
- Ensuring you have a well-staffed and highly-trained collection department
- Not recognizing high risk applicants vs. low risk applicants— Getting too caught up in the volume levels
- Lacking an understanding of scoring models

## Risks of Indirect Lending

- Important to do your homework upfront
- Can be very lucrative, but dangerous to be ignorant to the inherent risks
- You will have to learn to partner with the auto dealers—there has to be a level of trust
- 3 Key Elements: Trust, Relationship, Tracking



# Risks of Indirect Lending

- You will have to pay the dealers commissions to get the business
- Similar members may in fact, get different rates. It's a matter of convenience... 'Vending Machine Analogy.'
- Many dealers perceive credit unions as devious, untrustworthy, and unpredictable.
- Use common sense...Do not get caught up in the numbers game and become oblivious to everything else.



## Things to Watch For

**Car Quality for Used Cars:** CARFAX is a computer database that records the maintenance history of a car by its VIN number. A reputable dealer will tell you if a car is a fleet (program) car and will give you access to a CARFAX report.

**Excessive Trade-In Allowances:** Probably the most common way that dealers pad the numbers. You should book-out the trade-in value as well as the value of the car being purchased.

## Things to Watch For

**Financing the Down Payment:** It is illegal, but there is a lot of gray area. For example, a dealer can send out a coupon for a \$1000 to a potential buyer. When the buyer presents the coupon, it is often submitted as a down payment even though there is no cash involved

**False Hope:** Dealers that will only try to send you deals that they are having trouble getting approved everywhere else with a false promise of more good quality business if you can “buy this one deal for us.”

# Top 10 Car Dealer Scams<sup>©</sup>

1. The “Financing Fell Through” Scam (Spot Delivery Scam)
2. The Lie to the Member about their Credit Score Scam
3. The “Forgot to Pay off Your Trade in” Scam
4. The Straw Purchase Scam
5. The “Your Lender Bounces Checks” Scam
6. The Forced Warranty Scam
7. The Dealer Prep Fee Scam
8. The “We’ll Pay off your Loan no Matter How Much you Still Owe” Scam
9. The Previously Wrecked Used Car Sold “As Is” Scam
10. The Fake Vehicle Escrow Service Scam

***Per [CarBuyingTips.Com](http://CarBuyingTips.Com)***

# Get Your Collection Department Involved

- **All collectors** need to be trained on indirect loans
- **Collection Approach**—Must be more aggressive for indirect loans
- **Follow up immediately** on first payment defaults
- **Protect the collateral** and get your lien recorded
- **Cancellation and reimbursement** of all added-on back end products such as extended warranties, maintenance agreements, credit insurance, and GAP insurance
- **Disposition of Collateral**—Explore all options such as auctions, retailing, or third-party administrators, in your parking lot, Craigslist, eBay, etc.

# A word or two about Collateral



## Some Credit Unions Have Considered to Get Out of Indirect Lending

- Dealers are often looking for a 'one and done' transaction
- Some play a 'catch me if you can' approach to the business
- Not honoring the contract with the credit union... 'sue me'
- Pay members 1% or a flat fee to bring their auto loans over to you instead of paying the dealer

# Keys to Maintaining A Successful Program

- Trust in the dealerships that you partner with
- Relationship with the management at the dealership
- Tracking of your results
- Ease of dealers to be able to get the loan applications to you
- Timeliness of approvals and funding of the contract
- Swiftiness of handling any negative issues with the dealer





# **Turning Indirect Members into Full-Service Members**

# Turning Indirect Members into Full-Service Members

- Key: timely, professional follow-up
- Need a proactive personal approach
- Outbound calling is most effective
- Introduce the credit union and welcome them to it
- Educate the member about the credit union and your other products and services
- The key is to get the new member into your branch
- Cross-sell your products---checking accounts, credit cards, home equity loans, mortgages, direct deposit
- Thank them for their business—ask for more business

# First, You've got to Grab Their Attention: What one credit union is doing

1. **Send something unexpected**---a plastic toy car in a box
2. **Set the hook with an enticing offer:** A gift tag thanking them and an offer for a \$50 gas card if they would stop by a branch to hear about other products and services
3. **Make the pitch:** Hand out the gas card, chat about other products, thank them for their business, hand out business card to “plant the seed” for future business
4. **Measure the results:** On average, those who stopped in for the gas card added 1.8 additional services....typically increased savings and added another loan account



# **Best Practices**

# Best Practices in Indirect Lending

1. Always be in control
2. Set rates without being influenced by the dealer
3. Develop partnerships with select dealers that you want to work with
4. Do not try to be 'all things' to every dealer in town. So what if you are getting 1-2 deals per month from 100 dealers?
5. Hire experience or get your employees trained

## Best Practices: Continued

6. Consider hiring a Dealer Relations Representative - 'Eyes and ears' of the credit union, visibility
7. Monitor activity — By dealer and loan officer
8. Deal with dishonest dealers quickly and firmly
9. Perform verification of down payments, income, length of job, housing expense, etc. (especially brand new members)
10. Give the dealers a quick response time for loan decisions - They are using a 'shotgun approach'

## Best Practices: Continued

11. Pay the dealer quickly after the loan contract has been presented and your necessary audits have been completed
12. Buy quality paper — Do not be a “bottom feeder”
13. Use a “Recapture” report as a tool for deals that you have lost to competitors
14. Manage the flow of the business so that you are not dependent upon borrowed funds to support loan demand
15. Reward your good dealers: Preferred Partner of ABC Credit Union; Dealer of the Month Award; Dealer Appreciation Event held annually

## Best Practices: Continued

16. Segregate and separately track brand new members initiated from your program
17. Develop ways to market other products and services to these members — outbound calls are key
18. Reach full Board and Management consensus if you expect to have a successful indirect lending program. No second guessing after the fact
19. Think of indirect lending as a strong, viable book of business that provides your credit union with a solid revenue stream and potential members to cultivate
20. Always be in control



# Now we know how to finance the car, but how about the gas?

