COMMON TRAITS OF SUCCESSFUL CREDIT UNIONS

WEBINAR 47

hosted by: Bob Schroeder

Welcome!

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National Credit Union Income and Expense Ratios (1)

	A	B		C		D		E		F		G		H		I
	Date	Interest Yield on Assets	-	Div/Int Cost of Assets	=	Gross Spread	+	Other Income	-	Operating Expense	=	Net Spread	-	Loss (2) Prov	=	Net Income (3)
1	Year-End 2016	3.40	-	0.52	=	287	+	139	-	310	=	116	-	40	=	76
	Mid-Year 2016	3.38		0.51		287		134		308		113		36		77
2	Year-End 2015	3.36		0.52		285		136		311		109		34		75

		A	B	C	D	E	F	G	H	I
		2015	3.36	0.52	285	136	311	109	34	75
		2014	3.36	0.54	283	134	310	107	28	80
		2013	3.36	0.59	278	139	314	103	26	83
		2012	3.62	0.72	290	145	316	120	35	84
		2011	4.05	0.92	312	131	326	117	50	68
		2010	4.46	1.21	325	133	319	139	78	50
		2009	4.91	1.73	318	161	315	165	111	18
		2008	5.56	2.41	314	136	335	116	85	31
		2007	5.89	2.78	310	136	338	107	43	64
	3	2006	5.52	2.35	317	129	333	113	31	82
		2005	4.97	1.73	324	125	324	125	39	85
		2004	4.72	1.41	331	116	320	126	35	92
		2003	5.03	1.65	338	114	319	132	34	98
		2002	5.89	2.28	361	105	325	141	35	107
	4	2001	6.93	3.35	358	105	335	128	33	95
		2000	7.34	3.56	377	95	339	133	31	102
Previous		1999	7.07	3.36	371	89	332	127	34	93
year-end		1998	7.38	3.57	381	86	331	136	42	95
totals		1997	7.54	3.61	393	81	329	145	43	102
		1996	7.47	3.56	391	77	323	145	32	113
		1995	7.39	3.54	385	70	317	139	26	113
		1994	6.84	2.98	386	64	305	145	24	121
		1993	7.04	3.07	397	71	301	167	28	139
		1992	7.95	3.87	408	71	306	173	36	136
		1991	9.16	5.27	389	65	314	139	45	94
		1990	9.88	5.94	394	61	319	137	42	95
		1989	10.00	6.02	398	58	319	137	43	94
		1988	9.56	5.63	392	52	307	138	39	99
		1987	9.43	5.56	387	45	300	131	37	94
		1986	10.26	6.32	394	54	311	136	36	100
		1985	11.43	7.10	433	48	336	145	29	116
		1984	11.96	7.36	460	40	347	153		
		1983	11.65	7.04	461	35	368	128		
	5	1982	12.82	7.53	529		418			
		1981	12.31	7.22	509		400			

FIRST TIME GROSS SPREAD < EXP

GREAT Recession!

FIRST TIME Other Inc > Net Income

Follow the TREND!

(1) Interest yield and dividend/interest cost expressed as percent of average total assets, all other figures expressed in basis points (100 bp=1%) of avg assets.

(2) For data through 1991, net loan chargeoffs are reported instead of loan loss provisions.

(3) Net income is after the corporate stabilizatation expense

Source - CUNA

What Successful Credit Unions Have in Common

"Top Earner" Checklist

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Top Earner Checklist

Loan-to-share ratio of 90% or greater

These credit unions put their money to work in loans. Each $100,000 you take out of 1% investments and put into a 6% loan generates $5,000 in additional revenue per year.

Top Earner Checklist

Minimum loan growth of 10% annually

Earnings will follow loans. Grow loans and you grow earnings. Declining loans will result in declining earnings.

Top Earner Checklist

Other income to assets of 2.5% or greater

You can't be a top performer without other income above your peers. Credit unions that focus on serving the underserved get a high return from members who like courtesy pay, gap insurances, credit life and disability, etc. This is the second largest revenue stream for credit unions. You cannot expect a high other income ratio if you are focused on serving only 'A+ and A' paper members.

Top Earner Checklist

World-class service

The best credit unions staff themselves with more employees, not less, that are well trained and give incredible service. Plus, the fact we came up with a solution the members feel loved. These members also tell their friends, fellow employees and family.

Top Earner Checklist

<u>Higher ranking in loan yield versus their charge-off ranking</u>

This indicates you are getting compensated for your risk above the peer group. For example, a credit union with a loan yield in the 19th percentile would expect a lower charge off percentile due to attracting higher quality members who receive lower rates. If the charge-off percentile is higher than the loan yield percentile, it indicates the credit union is not being compensated for the risk.

	CU 1	Peer	CU 2
Loan Yield Percentile vs. peers	13	X	81
Charge Off Percentile vs. peers	70	X	44
LY-CO Percentile	-57	X	37

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LY-CO Percentile	-57	X	37
Loan Yield	4.05%	4.90%	5.55%
Charge Off	0.54%	0.46%	0.31%
Net Loan Yield	3.51%	4.44%	5.24%
NLY Difference	-0.93%	X	0.80%

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Net Loan Yield	3.51%	4.44%	5.24%
NLY Difference	-0.93%	X	0.80%
Loans	$336,899,476	X	$97,315,728
Cost / Benefit	-$3,133,165	X	$778,526

What's wrong with Credit Union #1?

1. Underwriting problem, and/or
2. Collection problem, and/or
3. Pricing, and/or
4. Local economy

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Top Earner Checklist

Net loan yield goal of 6.5% or higher

(Loan yields less charge offs), some as high as 8.0%. They do this by having well trained employees that serve the underserved that other are denying. They build relationships and the underserved will pay them before paying anyone else.

Top Earner Checklist

Delinquencies and charge offs are usually higher than their peers because they are taking more risk.

Top Earner Checklist

Primary financial institution (PFI)

Credit unions can take more risk if they have a relationship with the member and the member has all their business with the credit union (especially direct deposit).

Top Earner Checklist

Smaller than average loan balances

Mr. and Mrs. "A+" want a $40,000 loan for their Lexus. You offer 2.9% and they ask you to do the "limbo". How low will you go? You settle at 1.99% for 60 months and your total Finance Charges are $2,056, assuming the loan is not paid off early. Take the same $40,000 and lend it for 48 months at 12% to 4 members who live on "D" street and earn $10,560 in Finance Charges assuming no loan loss or prepayments. That is over 5 times the earnings with one less year. How are smaller loan balances accomplished?

- Less dependence on real estate.
- More dependence on unsecured (we recommend up to 20% of the portfolio).
- More emphasis on serving underserved (smaller car loans with higher yields).

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Top Earner Checklist

<u>Favorable FICO mix with a goal of 20% of portfolio C, D & E</u>

However, the C, D & E should have a greater percentage in auto loans versus unsecured loans.

Top Earner Checklist

Incentive plans for all staff

You need a strong sales culture to be a top performing credit union. It will be difficult to establish a sales culture without generous incentive plans for all staff members. We have specific plans that can be implemented at your credit union.

LSCI strategies for Credit Unions to improve earnings:

1. Be aggressive at A & B unsecured lending. (It is OK to offer <u>small</u> signature loans to C, D & E members with Payroll Deduction.)
2. Provide basic transportation (aka auto loans) to C, D & E members who have a good source of income. By definition, C, D & E members don’t pay all their bills, but most of them will pay for their car loans to get back and forth to work.
3. Focus on the trend. Many of your C & D members have FICO scores trending up and are far less risk than your high B and low A members with FICO scores trending down.
4. Focus on fee and other income opportunities.

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A TALE OF TWO CREDIT UNIONS

Missed Opportunities vs Doing it the LSCI Way

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Example #1: $110M Credit Union
"Missed Opportunities Galore"

	CU	Target
Assets $	$110,828,794	
Loans $	$49,476,938	
Shares $	$100,477,000	
Charge Off %	0.59%	
Gross Loan Yield %	4.73%	
Inv Yield %	1.73%	
Fee & Other Inc %	1.36%	2.50%
Loan to Share (LTS)	49.24%	90.00%
Net Loan Yield	4.14%	6.50%
ROA	0.21%	1.5%+

Example 1…continued

Income Opportunities:	
Additional Loan Income at Target LTS & Yield (90%, 6.5%)	$4,027,271
Additional Other Income at Target (2.5%)	$1,263,448
Total Additional Earnings if all 3 Targets Achieved	$5,290,719
Forecasted Additional Expenses (Operations & Salary)*	$2,900,000
Net Additional Earnings	$2,390,719
Post ROA if all 3 Targets Achieved (Current net earnings plus potential earnings)	2.16%

*Forecasted additional expenses were derived from a similar asset-sized peer credit union that is at or near target in all 3 categories.

Example #2: $100M Credit Union
"Doing It the LSCI Way"

	CU	Target
Assets $	$99,686,650	
Loans $	$70,785,932	
Shares $	$81,974,981	
Charge Off %	2.00%	
Loan Yield %*	9.49%	
Inv Yield %	.78%	
Fee & Other Inc %	4.34%	2.50%
Loan to Share (LTS)**	86.35%	90.00%
Net Loan Yield	7.49%	6.50%
ROA	2.00%	1.5%+

*This CU has 51% of its loan portfolio in C, D & E paper.

**The only target this CU is missing is Loan-to-Share. If Loan-to-Share was met, they would generate additional income of approximately $360,000.

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LENDING LESSON

A Quick Minute on Score Codes, Trends, and Things to Look For

‘A’ paper loans that fooled us and the dealer was happy

Indirect ‘A’ Paper Repossession Trends

Name	Age	Sec. D/R	LTV	Score	HYLS	Drop
	20	82%	120%	724 Invalid score	530	27%
	25	64%	114%	701 Invalid	485	31%
	27	52%	93%	729 Invalid	615	16%
	58	186%	121%	729	649	11%
	71 24	148% 72%	121% 121%	723 551	558 461	23% 16%
	24	59%	123%	689	584	18%
Average	25	95%	115%	715	555	20%

The important take a ways:

- Having secured debt ratio guidelines
- Validating scores
- Co-signers

Secured Debt Ratio Recommendations

A+/A/B = up to 75%
C/D/E = up to 50%

Validating a Score:

1. 4 Trade lines
2. Cumulative of $5,000
3. 2 years of credit history

Age	Job time	FICO	Valid Score (Y/N)	# of New Accounts in 24 mos.	$ of New Payments	Residence Status	Secured Debt Ratio	Debt Ratio	Unsecured Debt Ratio	LTV% after Add-ons	First Time Auto Buyer (Y/N)
32	1yr	489	Y	5	$479	Rent	94%	48%	0%	133.10%	N
34	4yrs	442	N	0	$182	Other	82%	26%	0%	100%	Y
23	4 mos	493	N	3	$810	Other	58%	33%	12%	70.00%	N
42	3 mos	594	N	4	$469	Own	11%	3.30%	0%	96.00%	Y
26	2 yrs	N/A	N	0	$240	Other	76%	26.70%	0%	101.00%	Y
48	1 year	677	Y	6	$1,328	Own	183%	71.00%	1%	138.00%	N
38	16 yrs	481	Y	6	$2,051	Own	77%	23.20%	23%	75.30%	N
35	7yrs	450	Y	12	$2,238	Other	115%	46.90%	31%	118.00%	N
21	5 mos	No score	N	1	$91	Other	18%	7.00%	0%	80.00%	Y
27	2 mos.	No Score	N	0	$318	Lives At Home	57%	14.00%	0%	92.00%	Y
24	3	No score	N	0	$260	Rent	60%	39.80%	0%	113.00%	Y
26	2	487	Y	5	$732	Lives At Home	111%	36.00%	29%	89.00%	N
33	6	559	N	22	$1,624	Own	117%	48.60%	32%	85.00%	N
26	1	636	Y	2	$624	Lives At Home	81%	47.00%	9%	96.00%	Y
53	4 mos.	588	N	4	$515	Other	60%	31.00%	25%	95.00%	Y
59	4	627	Y	4	$1,157	Own	127%	40.00%	17%	88.00%	N
30	5	618	Y	6	$3,331	Lives At Home	95%	36.00%	7%	83.00%	N
20	3 mos	587	N	1	$570	Lives At Home	102%	49.00%	71%	102.00%	N
61	20	513	Y	2	$330	Other	29%	13.00%	2%	134.00%	-
51	3 mos	515	Y	6	$912	Own	45%	20.00%	0%	75.00%	N
27	5	644	N	1	$437	Other	148%	40.00%	1%	115.00%	N
31	1	604	Y	0	$622	Own	97%	47.00%	0%	103.00%	Y
20	1	465	N	2	$236	Rent	40%	16.00%	0%	81.00%	Y
24	4	No Score	N	2	$377	Rent	39%	11.00%	0%	133.00%	Y
20	3	No score	N	2	$220	Rent	60%	17.00%	0%	111.00%	Y
33.24	**4.58**	**551**		**3.84**	**$806.13**		**79%**	**32%**	**10%**	**100%**	

Common Traits of Delinquencies

- Stability: 50% had job times of a year or less and 28% had under 6 months or less
- Mystery borrowers: 50% of the sampling was first time buyers. 6 of the first time borrowers were over 25 years old (3 were over 30). Are they really all first time borrowers?
- Buying too much: Close to 70% had secured debt ratio over our recommendations
- Ratios fit: Debt ratio and unsecured debt ratio “fit into the box” (i.e. very low)
- Living for free: 52% were not paying rent or a mortgage
- Rapid spending: 32% had opened more than our recommend 2 trades per year
- New payment: Average totals in 24 months was $800 and approximately 30% had over $1000 in new payments

THE CODES CAN TELL THE STORY

Where is the real risk at?

Turndowns								
Paper Grade	FICO Score	Score Codes (First two)	Monthly Income	Annual Income	Debt Ratio	Unsecured Debt Ratio	Number of new accounts in the last 24 months	New Balances being accrued monthly (inflated income calculation)
C	614	40,14	$2,276	$27,000	20%	1%	1	$299
C	625	38,13	$1,137	$13,644	68%	2%	2	$14
D	578	39,10	$5,000	$60,000	49%	12%	0	0
A	690	38,14	$4,333	$52,000	38%	8%	0	0
B	671	38,13	$4,333	$51,996	25%	34%	0	0

Non-Performing/At Risk								
Paper Grade	FICO Score	Score Codes (First two)	Monthly Income	Annual Income	Debt Ratio	Unsecured Debt Ratio	Number of new uns. accounts in the last 24 months	New Balances being accrued monthly (inflated income calculation)
A+	740*	10,30	$3,210	$38,520	30%	45%	2	$944
A+	736	10,08	$6,666	$80,000	23%	34%	3	$344
B	649	10,40	$4,698	$56,400	28%	39%	10	$1,460
A	695**	10,11	$14,000	$168,000	26%	52%	3	$1,297
B	677	10,30	$11,167	$134,000	30%	44%	3	$1,535
	*CU lost $16,307 on a $17,744 debt consolidation loan & **CU lost $35,000 on a $55,000 auto loan						Lethal combination: #10 & 11 or #10 & 30	

Note the trend

Note the differences in how busy the bottom group has been

8 – Too many inquiries in last 12 months
10 – Proportion of balance to limits, too high on revolving
11 – Amount owed on revolving account is too high
13 – Time since delinquency is too recent or unknown
14 – Length of time accounts established

30 – Time since most recent account opening
38 – Serious delinquency, derogatory public record or collection filed
39 – Serious delinquency
40 – Derogatory or public record or collection filed

LETHAL SCORE COMBINATIONS

- Lethal score combinations for predicting bankruptcy are when these two codes are first and second in the pecking order.
  - Code 10 followed by either codes 30 or 14 (accelerated spending/length of time opened)
- Determining the rate of acceleration and deceleration
  - The higher the score with the first two codes of 38, 39, 40 (relating to late payments) the quicker the score is rebounding
  - The lower the score with the first two codes of 10, 14, 30 the quicker the score is plummeting.

Common Codes
10 – Proportion of balance to limits, too high on revolving
14 – Length of time accounts established
30 – Time since most recent account opening
38 – Serious delinquency, derogatory public record or collection filed
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Questions? Submit using the WebEx toolbar.

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