Borrow and Save

Borrow and Save™ Feasibility Study Report

Federation
Credit Unions United to Serve the Underserved

Filene

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EXECUTIVE SUMMARY

The National Federation for Community Development Credit Unions (the Federation) has worked with credit unions serving low- and moderate-income consumers around the country to test and refine an innovative, responsible, small dollar loan product known as Borrow and Save. This product provides borrowers with access to small dollar credit opportunities that are affordable and cost less than alternative loan options and help borrowers strengthen their financial condition with a required savings component.

The Federation launched the initial Borrow and Save pilot with four credit unions in 2011, funded in part by the Ford Foundation and Morgan Stanley. The project's goal was to develop an alternative loan product that increased the economic security of credit union members and had the potential for industry-wide adoption. In 2014, the Federation, Filene Research Institute, and the Ford Foundation partnered to test the Borrow and Save loan within Filene's Accessible Financial Services Incubator. The Incubator provided a way to further test, package, and deliver viable financial products designed to address the needs of the underbanked consumers. Fourteen credit unions initially entered the Incubator. At the 18-month mark, 12 remained in the program with 10 reporting for a full 12-month period. Over 3,100 loans were closed during the Incubator period representing $3M in lending and close to $1M in savings for borrowers.

This study highlights the key components and lessons learned from the Incubator. It demonstrates that the Borrow and Save loan is a foundational product that helps low- and moderate-income members build financial security, while helping credit unions build profitable member relationships.

Summary from the Pilots

1. **There is a strong market for responsible, affordable short-term loans**

   Studies show a majority of Americans could not afford an unexpected $400 expense unless they borrowed money or sold assets. Further, over 12 million Americans have become trapped in a cycle of debt as a result of predatory payday loans. These facts suggest that lack of access to responsible, affordable credit continues to be a serious problem in low- to moderate-income communities. The small dollar loan industry is dominated by payday lenders, auto title lenders, pawnshops, employers offering salary advances, financial institutions, and Internet lending. Many existing credit union products share some basic underwriting with Borrow and Save, including eligibility based on the borrower's ability to repay, limits on repeat loans, terms that are not "too" short-term, and rates below the regulatory interest rate cap. The difference is that Borrow and Save offers more than just a standard short-term small dollar loan; Borrow and Save also offers new credit-building opportunities for borrowers while encouraging savings for the future.

2. **Pilot credit unions have paved the way for success**

   During the Incubator's reporting period, 12 credit unions closed 3,100 loans representing $3M in lending and close to $1M in savings for borrowers. Additionally, borrower surveys provide strong testimonials about their experience with the credit union when getting a Borrow and Save loan and the impact this experience has had on their lives. These results demonstrate positive consumer demand and positive consumer impact.

3. **Implementing Borrow and Save is easy with minimal technical requirements**

   The program requires minimal, if any, changes to required operating systems. Furthermore, the reporting and policy guidelines have already been created by other experienced credit unions for easy replication, making implementation seamless. This information can be accessed through the Borrow and Save Implementation Guide.

4. **These loans are financially viable for credit unions and beneficial to the borrower**

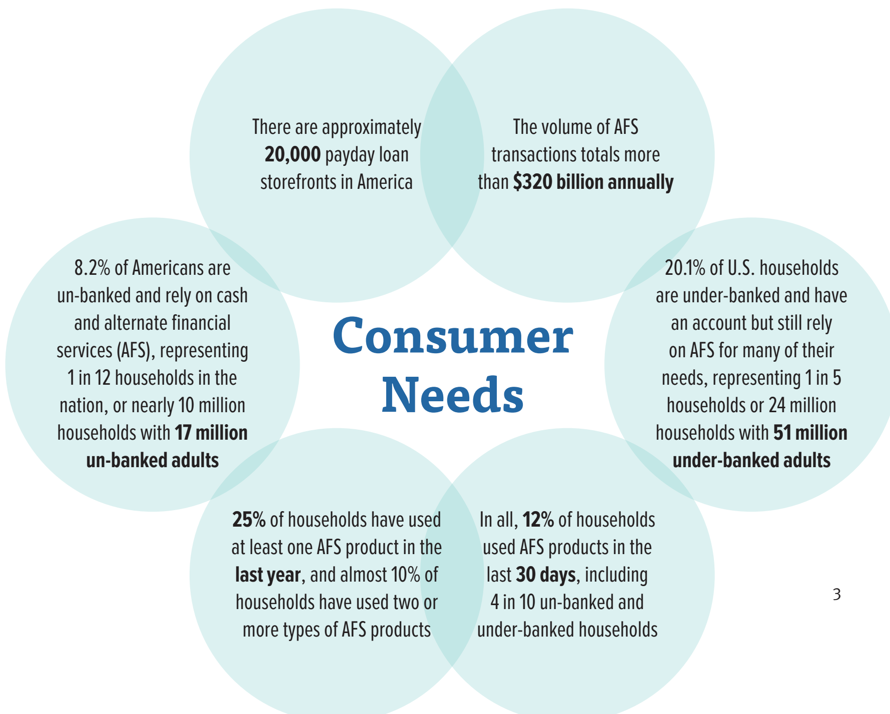
   During the Incubator's testing period, the average Borrow and Save loan rate was 18.2% APR. While necessarily higher than credit unions' prime rates, this is significantly lower than what borrowers are charged by other lenders. Seven credit unions completed a profit and loss assessment of their portfolio with five of them reporting back with a positive return on their net income. Members reported that these small dollar loans were easy to pay back and helped them to improve their credit score. Members were able to graduate to other services offered by the credit union including car loans, debt consolidation loans and other consumer loan products, thereby deepening their relationship with the credit union.

5. **Risk is mitigated through product policies**

   Small dollar lending is an activity that, if properly implemented and controlled, plays an important role in meeting members' needs. Credit unions can fill the void in ways that are financially viable by using appropriate pricing, underwriting, and risk management. Information on successful risk mitigation techniques can be found in the Borrow and Save Implementation Guide.

BACKGROUND

Over 12 million Americans have become trapped in a cycle of debt as a result of predatory payday loans.[1] A look at the state of financial services nationwide suggests that access to responsible, affordable credit continues to be a serious problem in low- to moderate-income communities. Payday lenders, whether storefront or online, bleed wealth from people of modest means. The typical predatory payday loans have interest rates that can exceed 400%.[2] Additionally, in July 2014, a Federal Reserve study concluded that the majority of Americans could not afford an unexpected $400 expense unless they borrowed money or sold assets.



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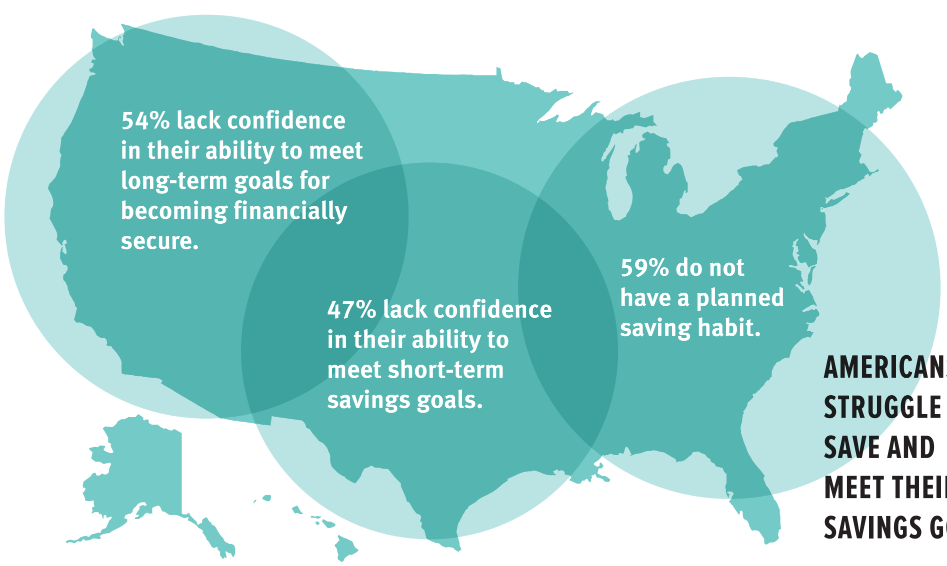

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AMERICANS STRUGGLE TO SAVE AND MEET THEIR SAVINGS GOALS.

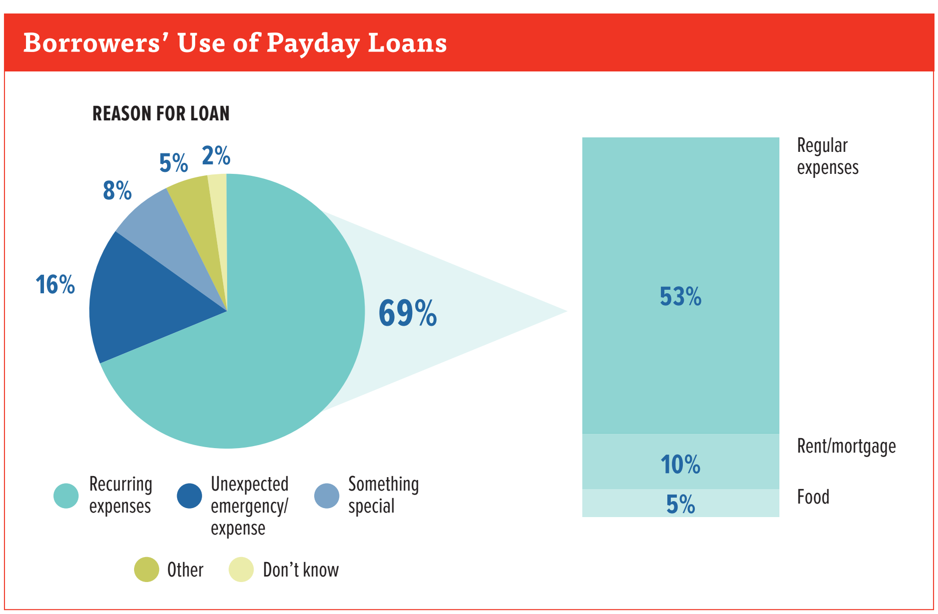
A survey conducted by the Pew Research Center found 5.5% of adults nationwide have used a payday loan in the past five years, with three-quarters of borrowers using storefront lenders and almost one-quarter borrowing online. On average, a borrower takes out eight loans of $375 each per year and spends $520 on interest.

The Pew study also found that most payday loan borrowers are white, female, and 25–44 years old. Five groups have higher odds of using a payday loan:

- Individuals who do not have a four-year college degree
- Home renters
- While most are white females between 25-44 other population segments may be disproportionally targeted including African Americans
- Individuals who earn less than $40,000 annually
- Separated or divorced individuals in states with the most stringent financial regulations
- 5.5% of adults report payday loan usage in the past five years (including storefronts, online, or other sources)

In states with the most stringent financial regulations, 2.9% of adults report payday loan usage in the past five years (including storefronts, online, or other sources). By comparison, overall payday loan usage is 6.3% in more moderately regulated states and 6.6% in states with the least regulation. Further, payday borrowing from online lenders and other sources varies only slightly between states that have payday lending stores and those that do not.[5]

When asked, borrowers said they used the loans for “emergency” purposes. When asked to define emergency many said rent/mortgage, utilities, food, expenses for children’s school and car repairs. Researchers found these expenses were not “emergency” but rather recurring.



The data above illustrates the demand for small dollar loans that can fill an emergency need or bridge a gap between paychecks. In an effort to help low-income borrowers avoid high-cost loan options and meet small dollar credit needs, the Federation created and tested an alternative small dollar loan product known as Borrow and Save.

Borrow and Save not only provides consumers with an alternative to high cost payday loans, but also includes a required savings component to help borrowers prepare them for future credit needs while accessing the credit they need now.

PAYDAY LANDSCAPE

When looking at the small dollar lending market, there are a variety of competitors that exist: payday lenders, auto title lenders, pawnshops, salary advances from employers, financial institutions, and Internet lending.

Payday Lenders

Payday loans are small, short-term unsecured loans. They are usually priced at a fixed dollar fee, which represents the finance charge to the borrower. Because the loans have such short terms, the cost of borrowing is very high. In return for the loan, the borrower usually provides the lender with a pre-dated check or debit authorization.

Auto Title Lenders

The auto title loan process involves the borrower driving the vehicle to the title broker for the purpose of pawning the title. Often, the borrower must present the vehicle's key to the lender to facilitate repossession, if necessary. Some states require the borrower to sign a power of attorney form so the lender has the right to transfer the vehicle title to the lender if the borrower defaults on the loan. In other states, the borrower sells the vehicle to the title lender in a sale or leaseback arrangement.

Pawnshops

Pawnshops offer collateral-based loans, meaning the loan is secured by something of value. The consumer brings in something they own (usually jewelry or electronics), and if the pawnbroker is interested, he will offer the consumer a loan. The pawnbroker keeps the consumer's item until the loan is repaid. The loan amount will likely be a small fraction of the item's actual value. The consumer receives a pawn ticket that summarizes the terms of the loan: fees, expiration date, description of the item, etc. The consumer can return to pay the balance, including the loan amount plus all added fees, before the deadline, which is usually one to four months after the initial transaction. If they do not return, the pawnshop keeps their item. On average, 80% of all consumers reclaim their items, according to the National Pawnbrokers Association.[6]

Salary Advances from Employers

Some employers offer services within their Human Resources or Payroll department that allow employees to borrow against their unearned wages. With a salary advance, the employee repays it either out of their next paycheck or over an agreed time span. Depending on the employer, terms can vary widely. Some employers may charge fees and others may not. If the employee parts ways with their employer, they could be expected to repay the balance in full when they leave.

Financial Institutions

Many banks and credit unions are now offering small dollar loans for their customers or members. Some also have savings accounts to help people save for special events such as the holidays or taxes. Very few financial institutions combine both of these products together to create a small dollar loan with an attached savings program.

Internet Lenders

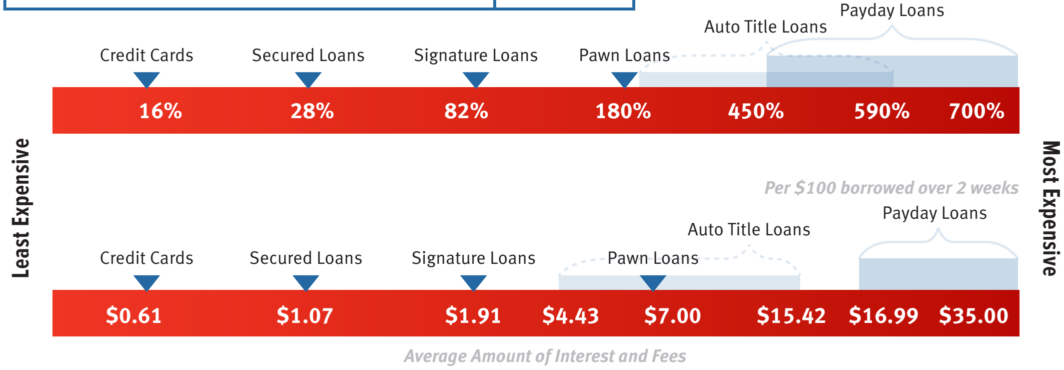
A number of new non-bank lenders are rolling out personal loans and other types of financing geared toward sub-prime borrowers. Such lenders face far less regulatory scrutiny than do financial institutions. Many of these firms are backed by Silicon Valley venture capitalists or funded by private investors or hedge funds seeking higher returns in the low-rate environment.[7] MoneyKey is one example of this type of lender. MoneyKey and its third-party lenders offer and facilitate payday loans, installment loans, and lines of credit to consumers via an online platform.

How Sub-Prime Loans Compare

How Does a Payday Loan Compare to Other Options?

CASH ADVANCE / BORROWED AMOUNT	$100
INTEREST PAYMENT The amount you will pay in interest for the loan.	$3.04
TOTAL OF FEES The amount you will pay in fees for this loan.	$233.74
TOTAL OF PAYMENTS The amount you will pay if you repay the loan on time.	$336.78
ANNUAL PERCENTAGE RATE (APR) The yearly rate of the interest and fees for this loan.	766.87%

Loan Calculation and Cost Comparison



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Overall, when looking at the lending options a borrower with subprime credit has, a majority of these are not in the best interest of the borrower and can even be described as predatory. To showcase a comparison of some of the options available for a borrower, the diagram above shows a breakdown of interest and fees for borrowing $100 over a 22-week period with 11 installments.

What Makes Borrow and Save Different from Other Responsible Small Dollar Loan Products?

- **Keeps members out of high-cost alternative products**
- **Fosters savings**
- **Borrowers have immediate access to needed funds**
- **Loans are not tied to a next paycheck**
- **Provides a solution for borrowers not eligible for other credit union products**
- **Puts borrowers on a continuum toward accessing a greater variety of credit union's products**
- **Does not require major investment on the part of the credit union**
- **Generates revenue for the credit union**
- **Improves the economic well-being of the community**

PILOT RESULTS

In 2011 the Federation, with the support of the Ford Foundation and Morgan Stanley, launched the Borrow and Save pilot. This provided grants to four community development credit unions (CDCUs) of different asset sizes and geographical distribution to provide a product that coupled a small loan with required savings. Over 18 months, the participating credit unions successfully developed and deployed their Borrow and Save product.

BORROW AND SAVE INITIAL PILOT PARTICIPANTS

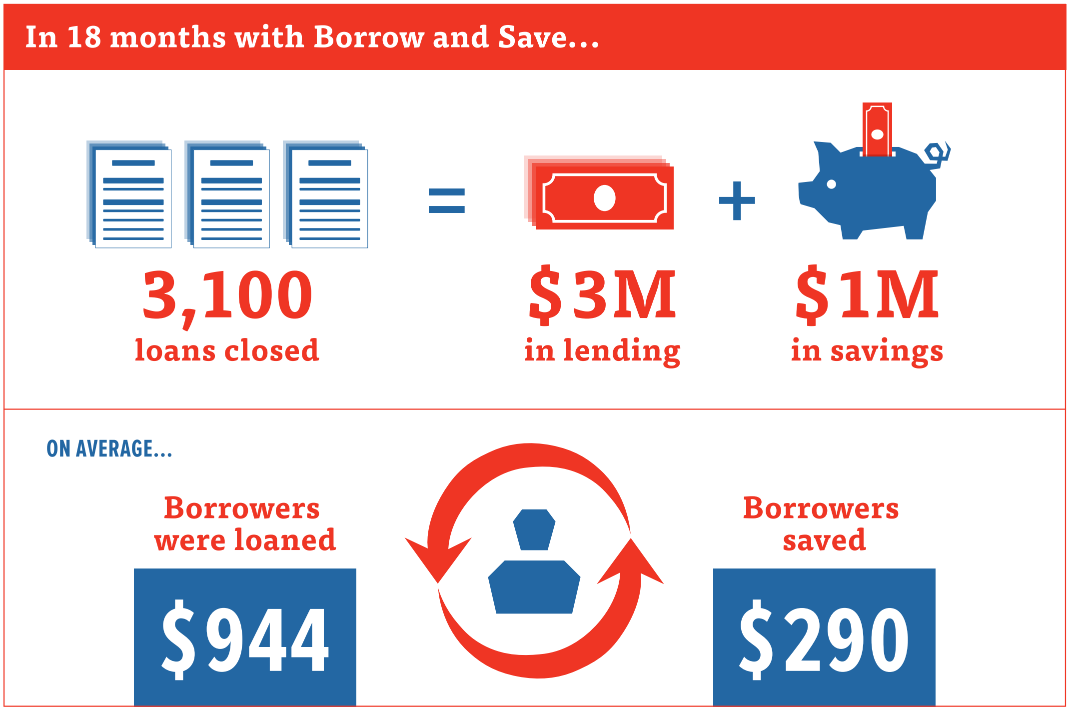
	Location	Asset Size	Membership
Union Settlement FCU	New York, NY	$6,928,160	3,644
North Side Community FCU	Chicago, IL	$10,762,869	3,347
Santa Cruz Community FCU	Santa Cruz, CA	$103,119,009	11,496
Freedom First CU	Roanoke, VA	$292,114,693	44,932

**As of 12/2012*

The initial pilot provided the opportunity to test a unique alternative small dollar loan that other credit unions could model to meet their borrower needs. In April 2014, 14 credit unions had agreed to participate in Filene's Accessible Financial Services Incubator program for an eighteen-month period. Twelve credit unions have remained consistently active in the program. These credit unions had the buy-in from both the board and staff and it was fairly easy and quick to implement the program. One credit union CEO remarked that Borrow and Save was much more user-friendly than their existing small dollar loan program and they have now adopted this model as their only small dollar loan program. Most of the credit unions in the Incubator pilot remarked that the program far exceeded their initial goals and delinquencies were similar or less than other short term loan programs.

While the majority of credit unions in the Incubator had a very positive experience with the program, two credit unions have decided not to continue offering the loan. One of the credit unions made this decision after a staffing change. They no longer had their "champion" for the program. Another credit union acknowledged that they started late and did not do a good job of marketing the program. They will revisit Borrow and Save at another time but will focus on other loan products at this time. Additional remarks from the credit unions participating in the pilot are listed in the following sections.

During the eighteen-month reporting period, credit unions closed over 3,100 loans representing $3M in lending and close to $1M in savings for borrowers. The average loan per borrower was $944 and the average savings was $290 per borrower. The average age of the borrowers was 41 years old with an average income of $33,268 and an average credit score of 523.



The credit unions that participated in the Incubator program had varying asset levels and member numbers and were located across the country. Credit unions ranged from $8.6M to $435M in assets and had membership between 3,000 and 46,000.

CREDIT UNION	ASSET SIZE	# LOANS	LENDING	SAVINGS
Carter FCU	$256.4M	412	$162,505	$7,880
Communicating Arts CU	$30.4M	23	$19,500	$9,750
Freedom First CU	$391.2M	263	$632,111	$319,737
Guadalupe CU	$138.3M	683	$452,300	$79,275
Hope CU	$176.0M	805	$682,750	$171,457
Lake Trust CU	$1.6B	5	$8,000	$3,100
North Side Community FCU	$8.6M	223	$219,250	$15,225
Peninsula Community FCU	$162.5M	88	$70,496	$17,624
Seasons FCU	$153.9M	209	$208,500	$82,500
Southwest 66 CU	$83.7M	56	$49,100	$12,275
SkyOne FCU	$437.5M	171	$118,500	$59,000

Ratings and Testimonials from Credit Union Testers

The majority (75%) of the credit unions that participated for the entire Incubator period indicated they would continue offering Borrow and Save to their members. These credit unions found the program to be a true benefit for their membership. One credit union remarked that Borrow and Save answered a need for their members who needed access to a small loan at a responsible price.

During the Incubator, Filene collected additional data through a credit union survey to better assess the ease of implementation and management of the Borrow and Save loan program; the final ratings are highlighted below.

1 = STRONGLY DISAGREE, 2 = DISAGREE, 3 = NEUTRAL, 4 = AGREE, 5 = STRONGLY AGREE	
Implementation Prior to Launching	
Systems adjustments were easy to incorporate.	3.75
Staff training was easy to deliver.	4.00
Marketing was easy to implement.	4.00
The templates and marketing materials provided saved me time.	3.58
Implementation After Launching	
Employee acceptance came easily and with minimal effort.	3.92
Our members like the product.	4.00
The members reacted well to the mandatory upfront savings component of the Borrow and Save product.	4.00
Overall Program	
We would refer this program to another financial institution.	4.33

Many credit unions said Borrow and Save helped them to better serve their existing members. They were able to establish a connection to members that did not regularly use the credit union services. Credit unions in the pilot will continue to look at the number of new members as the short length of the pilot did not give them an opportunity to gauge retention.

Credit unions also provided qualitative information about the success of the program through testimonials; a few of those stories are highlighted below.

SKYONE FCU - FROM A MEMBER OF MANAGEMENT

"Everything is going better than expected. We had some member push back at the beginning from members who didn't 'need help.' That turned around quickly."

PENINSULA CU - FROM THE CEO

"Peninsula CU was able to grant new member, James, a Borrow and Save loan in June 2014. He had good employment, but was in the beginning stages of divorce, and found himself short on cash days before payday. James was also scheduled to head out of town for work and needed to pay the mortgage (for his soon to be ex-wife) and provide food for his children before leaving. He came to Peninsula CU to find an alternative to a payday lender. James paid off his Borrow and Save loan today and thanked Peninsula CU for the help. In the time since taking out the Borrow and Save loan he has been able to save $3,000 for a down payment on a new car and add $2,000 to a savings account. And great news...he financed his new vehicle with Peninsula CU. James expressed his gratitude and expressed that he is in a much better place in his life in part due to the assistance provided by PCU. What a great story!! Truly people helping people."

SOUTHWEST 66 CU - FROM THE CEO

"The program is going absolutely wonderfully. I believe we are up to 67 members taking advantage of this product and they can't say enough about the benefits of the program. We will be capping our first round at 100 loans to season the portfolio a bit and watch for charge-offs and delinquencies, which to date there have been none. Once we feel comfortable we will be opening it to 500 more loans. Our Board could not be more excited. This product is changing people's behaviors and in turn, their lives. We could not be more happy with your partnership."

HOPE CU - FROM THE LENDING TEAM

"Members use these loans for a variety of purposes, such as to pay taxes on one's car tags, tires, Christmas gifts, and to catch up on bills.

- Team members also mentioned enthusiasm for the length of the repayment period. The longer repayment period allowed some members to take on credit and build their credit score where they may not have had the opportunity in the past.
- Team members use the credit score snapshot to engage in member education/financial coaching that enhances members' ability to build credit scores.
- Team members have also specifically mentioned its use as an alternative to a payday loan when short-term expenses or emergencies occur."

SEASONS FCU - FROM THE LENDING TEAM

"We took our Summer Fun and Holiday loans and modified them to offer Borrow and Save. We had a soft roll-out Memorial Day week 2014, a big blitz for June, took summer fun loans, targeted direct deposits for members with D or E grade credit, offered a marketing blitz to promote for D & E members with lower credit."

Ratings and Testimonials from Consumers

During the Incubator, Filene collected additional data through borrower surveys to better assess the impact of the Borrow and Save loan in their lives. Although most members surveyed were supportive of the product, a few continued to take out payday loans. For some the amount of their debt will take a larger time than the 18 months of the Incubator to stabilize. The final ratings to survey questions followed by member comments are highlighted below.

1 = STRONGLY DISAGREE, 2 = DISAGREE, 3 = NEUTRAL, 4 = AGREE, 5 = STRONGLY AGREE	
This program helped me meet my emergency need.	4.62
This program is the reason I have started a savings account.	3.32
This product was fairly priced.	4.30
My financial position improved because of this program.	4.03
I have had to take out a payday loan since using this program.	2.08
I would take out another loan if the need arises in the future.	4.47
I am more loyal to my credit union after participating in this program.	4.20
I would recommend this program to my friends and family.	4.49

“It made a great impact due to the interest rate, which is GREAT, best I’ve seen yet. To summarize, this program is outstanding!”

“It has helped me stay out of a big hole that could have hurt my family.”

“It was what I needed without getting into deeper debt.”

“It made a great impact because it helped my family in our time of need.”

“Really and truly it helped me out and now that I’m about to finish paying it off, I really forgot about the saved amount I had coming to me. I’m glad it worked out that way. Now I have something to look forward to once the loan is paid.”

“Improved my money borrowing habits.”

“Helped me with the understanding of saving money for unforeseen occurrences.”

“Raised my credit score, allowing me to obtain credit from other companies, this is the only place to work with me on my budget.”

"There was an emergency need with my gas bill to be paid and other personal needs. I am a substitute teacher in the school system and I only receive social security each month. School is out for the summer. This made a tremendous impact so I can get a second chance to build good credit and strengthen my chance at solid credit."

"It improved my credit score tremendously and has allowed me to get a good loan price to purchase a house."

"I was very encouraged by the amount of funds deposited in my savings account. Thank you very much!!!"

"It helped me when no one else would."

"It put me at ease knowing I have savings to fall back on and improve my credit with automatic payments on the loan."

"It is a product I'm able to access easily. I have been able to increase my credit score from 410 to 570, and I have been able to pay off at least one debt each time I utilize the loan."

"Helped me through a difficult time, improved my credit score, and increased my savings."

OPERATIONAL CONSIDERATIONS

Before implementing the Borrow and Save loan program, there are a few operational items to consider applying in order to make the launch as effective as possible.

Personnel Resources/Training

Based on our survey of credit unions that participated in the pilot, those with an existing payday advance loan had a much easier time with training and rolling out the new Borrow and Save product. Staff already understood the targeted audience and were able to easily market the program to the right client. This also meant the staff were more equipped to underwrite the loan and understand the potential pitfalls; in many cases staff were able to offer this loan to Tier 5, the weakest borrowers. With an existing payday advance loan program, credit unions transitioned most members into the Borrow and Save loan. Some credit unions also transitioned a Salary Advance Loan and a Holiday Loan and now only offer Borrow and Save because it turned out to be a better product for their members. Frontline staff were trained on the new product and educated on identifying payday loan users and then recommended Borrow and Save as an alternative. Once members experienced the product, they frequently referred other members.

Credit unions that developed a new product for Borrow and Save indicated hands-on staff training was helpful. Peninsula FCU and SkyOne FCU created their Borrow and Save loan using the Implementation Guide and had a great response from members. Very little training was required since the product was very simple and easy to explain to members. Once credit union staff were able to define the right market for Borrow and Save, the loan process was easy. In many cases staff indicated a slow rollout is preferred and to focus the rollout at one branch and then expand as both the staff and the members become more familiar and comfortable with the loan. In some cases only one staff member was underwriting Borrow and Save. Cross-sale training will be important to scale the product.

Freedom First CU offers monthly workshops for its employees. It uses these workshops to educate staff on how the product works and who may be eligible or a good candidate. Understanding the target market appears to be key for all participating credit unions. Educating staff on an ongoing basis was also beneficial in keeping the product top of mind and reminding staff of how the product can help the credit union serve more of their membership.

Frontline Talking Points/Marketing

Very little marketing and training were required for the Borrow and Save product. Prior to rollout, all participating credit unions provided frontline employees with details about the product and the underwriting guidelines. In many cases, credit unions only rolled out the product in one branch as part of the testing phase. In other cases only one or two staff members focused on rolling out the product. Most members learned about the product through word of mouth. Several of the credit unions did use the Borrow and Save marketing materials and the logo created by the Federation to promote the program. Marketing included press releases about the new product, interviews with local radio, website/e-news marketing, and brochures at branches and community partner locations. While the credit unions were not required to use the materials, they were offered to all the Incubator participants. Those that did use the materials found them very useful and liked the idea of having materials ready to go for signage and use in mailings.

In many cases, credit unions that already had an alternative payday loan had an easier time transitioning to the Borrow and Save product targeting those members that already had payday loans outside of the credit union. Members were also encouraged to consider Borrow and Save if they were denied another credit product due to poor or no credit. Borrow and Save became a stepping-stone for members to access future credit opportunities. This graduated approach was used by all credit unions in the Incubator.

Technology

Each credit union had different technology experiences. Some indicated their core system could not easily manage Borrow and Save and track necessary data points, while others indicated that Borrow and Save was easier than the other existing payday alternative loans that they had in place. In some cases credit unions have to pay for a payday alternative loan platform. Those using the EPL core system stated Borrow and Save was easy to implement within their regular system. Being able to use the credit unions existing system makes it easier for frontline staff as well collections when accounts are slipping into default. One example of this is Guadalupe Federal Credit Union's use of an additional class code: the credit union taught tellers how to issue the loan and loan officers how to fund them. Borrow and Save loans were audited like any other loan, which streamlined the process.

In many cases some programming was necessary to identify the product within the credit unions core system to identify Borrow and Save loans. Freedom First had to create a code for the savings portion of the secured loan so that Borrow and Save savings were not released as the loan balance went down.

Reporting

It is important to track the effectiveness of the Borrow and Save loan portfolio with the rest of the credit union's lending portfolios. During testing, the following items were tracked on a monthly basis:

- Number of loans
- Dollar amount of loans
- Average loan amount
- Interest rate
- Loan term
- Age of borrower
- Credit score of borrower
- Charge-offs & delinquencies
- Percentage of loan portfolio that are Borrow and Save loans
- Amount saved

All credit unions were able to set up Borrow and Save into their regular reporting systems; reporting on the loan details was not hard. Credit unions indicated that although Borrow and Save tracking was different than for some of their other loans, it was not difficult.

Overall, all of the credit unions that participated in the program liked the product and saw it as an opportunity to provide an alternative to payday lending products that supports members' credit needs, while also building credit and setting members up for a safety net through the savings component. The product was also an opportunity to help some of their riskier borrowers. Credit unions that were most successful with the product already had a community development focus and credit building approach. In many cases credit unions that already had an alternative payday loan had an easier time transitioning into Borrow and Save and offered it to those members or targeted members they thought might use payday loans outside of the credit union. These credit unions were more familiar with doing small dollar loans, had a trained staff and were committed to helping members transition out of high-cost predatory loans.

Consistent staffing also made a difference. In instances where staff who were championing leading the product moved to different positions or left the credit union, the product was not as widely offered. Adequate staff training and support will be important for product sustainability. Training for frontline staff was simple once they understood the goals of the program and the target market it served best. In all cases very limited marketing was required to inform borrowers about the product; once members started accessing Borrow and Save, others followed. For "mainstream" credit unions, there was a higher learning curve. Traditionally, they would not lend to members with lower credit scores or no credit history at all. They usually do much larger loans for longer periods of time. As more mainstream credit unions expand their membership into lower income communities, it becomes more important for these credit unions to look at small dollar loans. The mainstream credit unions that participated in the Incubator were able to quickly adapt the Borrow and Save model into their product offerings. The Federation provided technical assistance to those who needed additional support.

REGULATORY & POLICY CONSIDERATIONS

Regulatory Considerations

Borrow and Save policies must be in accord with COMPASS Compliance Assistance for Credit Unions. The following is a list of regulations to be mindful of:

- Truth in Lending (Reg Z)
- Truth in Savings (NCUA part 707)
- Equal Credit Opportunity (Reg B)
- NCUA Part 701.21, Loans to Members
- NCUA Part 740, Advertising and Notice of Insured Status – does not apply if there is no required minimum share balance
- Electronic Funds Transfer Act (Reg E) – applies if there is a direct deposit component
- Unfair, Deceptive and Abusive Acts or Practices (UDAAP)
- Telephone Consumer Protection Act (TCPA) – limits use of auto dialers, texting, etc.
- Military Lending Act (MLA)

Product Structure

Based on the initial pilot and the results at participating credit unions, the Federation has developed parameters for Borrow and Save to maximize impact and minimize risk. Below are details for the loan and savings parameters for the Borrow and Save product.

BORROW AND SAVE SNAPSHOT

THE LOAN PARAMETERS
Installment Loan (no balloon)
Loans between $300 and $2,000
Underwritten on the basis of the borrower's ability to pay – Payments equal to 5% of paycheck
Application Requirements
I.D.
Proof of Income
Rent and utility payments with current address
Loan term between 3 and 12 months
No more than 3 loans per year
No more than one loan out at a time
Adherence to NCUA guidelines on maximum interest rates and fees
Not more than 28% and maximum $20 fee; not including savings portion
18% has been the sweet spot that works for CUs-sustainability and still aligned with mission

THE "BORROW" IN BORROW AND SAVE

Underwriting

The loan underwriting criteria must balance between providing greater flexibility than conventional personal or consumer loans and ensuring that a borrower can repay the loan. Underwriting a borrower's ability to repay based upon the debt to total income is critical. Proof of income protects the institution and the borrower and is consistent with the mandate to underwrite on the basis of the borrower's ability to make timely payments. Borrow and Save is designed for borrowers with challenged credit. The program can help members build credit with an acceptable level of risk for the institution.

Many payday loan borrowers report being unable to tap conventional credit due to prior credit challenges: Borrow and Save addresses this barrier to financing by not basing loan approval on credit scores. Not all credit unions participating in the Incubator pulled credit scores. Those that did pull credit reports and scores used them for informational purposes only to determine whether these loans pose a risk to the institution. Credit reports can also be used for the credit union to educate the borrower on ways to improve his/her credit rating. Despite this more open underwriting approach, in the Incubator the Borrow and Save write-offs were no greater than and in most cases less than other credit union consumer loan products.

Borrow and Save does not require a minimum membership tenure. In the initial pilot, duration of membership did not correlate with lower rates of delinquencies or write-offs. Also, competing in the small dollar marketplace means ease of access. Credit unions participating in the Incubator pilot were able to use the Borrow and Save product to grow their members, accessing an emerging market within their field of membership.

THE "SAVE" IN BORROW AND SAVE

Optimum Savings

The required savings is one of Borrow and Save's distinguishing features and a critical component of this product. From the credit union's perspective, a fixed amount in a frozen savings account can cushion against losses for the credit union as it fosters member savings. Saving amounts ranged from 25-50% of the loan. These funds were frozen in an account and only available, with accumulated interest, when the loan is paid in full. Additionally, these funds provide a nice transition for members to encourage further savings, such as a low-entry certificate of deposit.

THE SAVINGS
Mandatory savings requirement with percentage of savings not less than 25% and up to 50%
Frozen in an account and only available, with accumulated interest, when the loan is paid in full
Promote the transition to a "next step" product to encourage further savings (such as a low-entry CD, first-time home buyers, IDA)
The savings impact is compounded by keeping members out of high-cost alternatives

Pricing

There is no one size fits all interest rate for the product – each credit union needs to establish pricing based on its local market, taking into account the cost of delivering the product and projected losses. There are, however, two givens for the product:

1. 28% is the allowed regulatory interest rate cap and
2. 12% is an estimated minimum rate to cover costs and risk.

The goal is for a credit union to offer a product that is both financially sustainable for the institution and substantially more affordable to consumers than predatory alternatives. It is important that the product is transparent; the credit union must explain the interest rate if fees are included. Fees range from $0 to $20 per loan for a closed-end loan. While some credit unions have refunded this fee at pay-off, there is no evidence in the initial pilot to suggest that this has incentivized payments.

Though the Borrow and Save product may, in many cases, be higher cost than a credit union's other collateralized loan offerings, the product is well aligned with a mission of furthering members' financial independence. It is affordable compared to alternative financial service providers, establishes savings, builds credit, and enables a pathway out of payday debt cycles.

Loan Size

By NCUA definition, small dollar loans are less than $1,000. Loans of this size with the proposed interest rates allow for manageable payments. The minimum Borrow and Save loan size is $300, as it's been shown that loans below $300 increase the likelihood of repeat borrowing for the member and as well as additional underwriting costs for the credit union.

Term

Unlike payday loans with lump sum repayments that trap borrowers into repeat loans, the goal with Borrow and Save is to set terms that facilitate repayment. That is why "short-term" is excluded from the definition of the loan and the minimum term is 90 days with a recommendation for up to one year.

Number of Loans in a 12-Month Period

The Borrow and Save paradigm is based on meeting immediate credit needs and supporting the accumulation of adequate savings to minimize repeat borrowing. The survey results of credit unions participating in the Incubator show that given the opportunity to access multiple small dollar loans within a year, consumers will continue to borrow even when they have adequate savings to cover expenditures. If a member is failing to build a savings habit through this program, the credit union should look for other options for the borrower, including financial counseling. Given this information, credit unions should issue a maximum of three loans per year and the loan must be paid in full in order to access the next loan.

Collections

Because loan terms do not extend more than one year and can be as short as 90 days, it is important to get a jump on delinquencies almost immediately with a courtesy reminder. At the time of closing, encourage borrowers to let you know as soon as possible if there is a problem with repayment. Be sure that borrowers understand that the savings in their account will not be available until the loan is paid in full.

Institutionally, reexamine underwriting quarterly relative to delinquencies and charge-offs; use this review to determine if the product's pricing needs to be adjusted.

Regulatory Environment

As illustrated in the chart below, Borrow and Save falls well within NCUA's Small Dollar Loan guidelines and goes even further to ensure affordability, ability to repay, and improved financial position for borrowers.

COMPARING REGULATORY REQUIREMENTS FOR SMALL DOLLAR LOANS WITH THE BORROW AND SAVE PRODUCT		
	NCUA	**Borrow and Save**
Interest Rate	Up to 28%	Between 12% and 18%
Fees*	Up to $20	Up to $20
Terms	1–6 months	3–12 months
Amounts	$200–$2,000	$300–$2,000
Rollovers	None	None
Max Loans (12 month period)	3	3
Credit Reports	Not Required	Not Required; Informational Purposes Only
Required Savings	N/A	25% to 50%
Financial Literacy or Coaching	Not Required	Available and Recommended

**According to NCUA regulations, fees charged are excluded from the finance charge calculation. These are not included in the APR. Fees can be charged on a per loan or annual basis. If, however, fees are charged and then refunded based on a member's usage of the product, these fees would have to be included as a finance charge.*

Credit unions will want to stay informed of the Consumer Financial Protection Bureau's (CFPB) rulings for small dollar loans to ensure they are in compliance. In March 2015 the CFPB announced it is considering proposing rules that would end payday debt traps by requiring lenders to take steps to make sure consumers can repay their loans. The proposals under consideration provide two different approaches to ending debt traps – prevention and protection. Under the prevention requirements, lenders would have to determine at the outset that the consumer is taking on affordable debt. Under the protection requirements, lenders would have to comply with various restrictions designed to ensure that consumers can affordably repay their debt. These proposals would cover short-term credit products that require consumers to pay back the loan in full within 45 days. The regulations would also apply to longer term loans that have an all-in APR of over 36%.

MARKETING STRATEGY

The Federation worked with participating credit unions to develop a Borrow and Save logo and key collateral materials to support the marketing of the product. The materials included two brochures, a postcard, and sample web banners along with design guidelines. It was not mandatory for credit unions to use the marketing materials, but all were required to use the Borrow and Save and Federation logos on marketing materials. Materials may also be personalized with credit union logo and contact information. The Federation has trademarked the Borrow and Save logo and has a licensing agreement in place for credit unions interested in offering the product. Based on the survey of the credit unions that participated in the Incubator we found the following results:

Target Audience

- Low- and moderate-income credit union members and/or non-members looking to build financial security
- Financial decision-makers (mostly women)
- Tend to live in urban settings
- Average age is 41 years old

How to Communicate the Information to Members

- Must connect with their (target audience's) lifestyle, location, etc.
- Outline benefits, "What's in it for me?"
    - Fast. Easy. Simple. Personable.
    - Positive way to build credit and savings
    - Allows members to save, while getting immediate access to funds they need
    - Financial wellness and education
    - Money is safe and insured through credit union
    - Member stories and testimonials are key and especially effective on social media
        - For example, "It helped my family in a time of need." or "It helped me when no one else would."
        - Showcase these stories in marketing pieces and conversations

How to Connect the Audiences with the Information

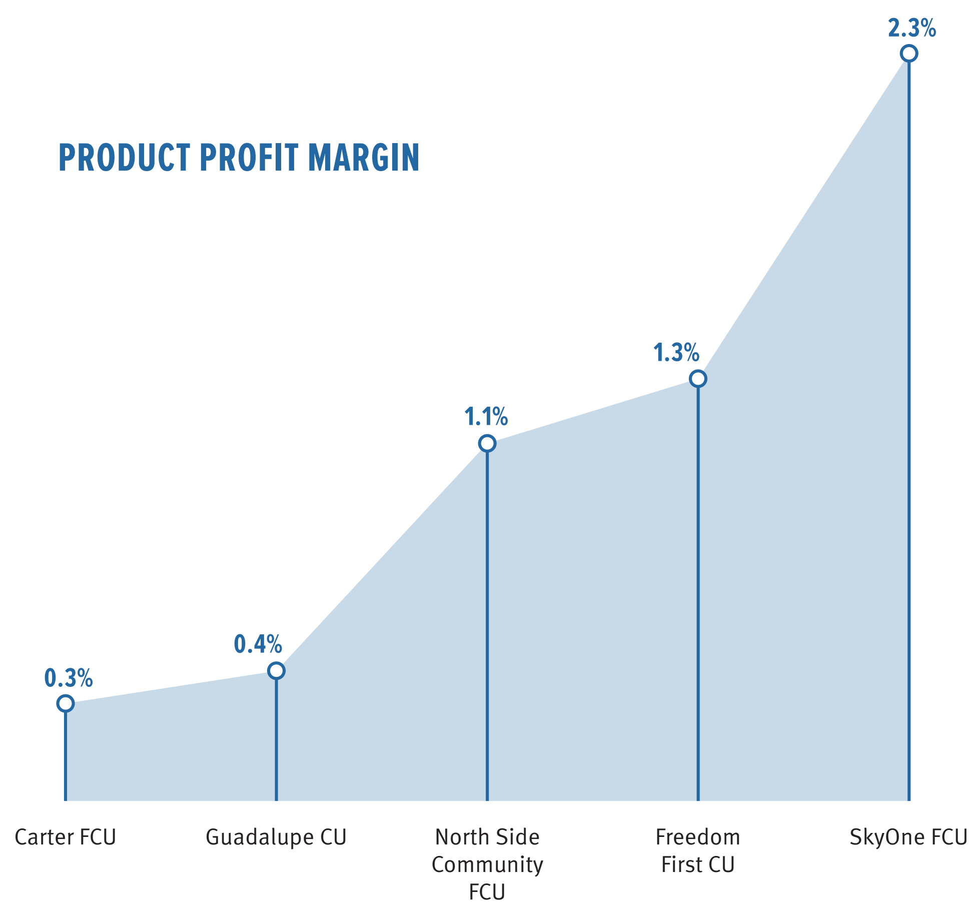
UTILIZE THE IMPLEMENTATION GUIDE AND MARKETING MATERIALS TO EDUCATE AND PROMOTE THE PRODUCT

- Promotional flyers
- Brochures in branches
- Brochures in Community Partner offices
- Staff training and engagement
- In-branch print and digital media (brochures, take-ones, posters, screens)

- Online – web banners
- Social media with testimonials
- Website with testimonials
- Direct Marketing
- Email marketing
- Outside media sources if applicable, such as billboards and TV advertising

FINANCIAL CONSIDERATIONS

Each of the credit unions that participated in the Incubator's testing period were asked to complete a basic profit and loss sheet to assess the financial viability of the Borrow and Save loan. Seven of the credit unions completed this task and five of them show that they were profitable. Specific results are shown below.



**Product Profit Margin includes cost of funds, loan losses, and operational expenses.*

CREDIT UNION	ASSET SIZE	# LOANS	LENDING	AVERAGE LOAN RATES	PROFITABILITY RESULTS
Freedom First CU	$391.2M	263	$632,111	16.62%	$7,913
SkyOne FCU	$437.5M	171	$118,500	18%	$2,778
North Side Community FCU	$8.6M	223	$219,250	18%	$2,459
Guadalupe CU	$138.3M	683	$452,300	21.99%	$2,092
Carter FCU	$256.4M	412	$162,505	15%	$629

In addition to the easily quantifiable results, there are other factors that help showcase that offering members Borrow and Save loans can yield positive income. One factor is that once you help C, D, and E paper members, they will be very loyal. In fact, as shown from the testimonials earlier in this report, members stated that they are more loyal to their credit union after receiving their Borrow and Save loan. Additionally, when members can improve their credit rating and establish savings accounts, this can lead to them opening more sophisticated and profitable products within the credit union.

Delinquencies and Charge-Offs

Credit unions monitored loans closely and had very few delinquencies. In some cases Borrow and Save had lower delinquencies than other payday advance loan products. For example, Guadalupe FCU reported over 683 loans with a 0.5% delinquency rate. Additionally, Guadalupe FCU added a reward tier to help people access higher dollar amounts with the hope that this would encourage them to get into traditional loans.

Balance Sheet Planning/Liability Management

Some credit unions that had a payday loan alternative product already had this type of analysis in place. Freedom First CU created a profitability analysis on Borrow and Save loans to make sure the product was sustainable and also tracks delinquencies on these loans.

RISK ANALYSIS

Risk Mitigation

Borrow and Save was developed with risk mitigation top of mind. Direct deposit, proof of income, financial counseling, and underwriting based on ability to repay are all critical product features that help credit unions mitigate risk.

Before a credit union engages in an aggressive sub-prime lending effort, it should review NCUA's Risk Alert letter of June 2005 (Risk Alert No.: 05-RISK-01). The letter states: "Sub-prime lending is an activity that, if properly implemented and controlled, can be an acceptable segment of your lending portfolio in meeting your members' needs." But it goes on to say that "adequate due diligence and control measures are required." [9]

Whereas this study is aimed at helping credit unions explore the benefits of offering more small dollar loans to low-income consumers who may be higher-risk borrowers, how the credit union chooses to implement and manage the process can make the difference between a sound loan portfolio and a speculative and risky one. NCUA states that "sound underwriting practices, effective control and monitoring systems, and sufficient capital levels are key components to a well-managed program." [10]

During the Incubator's testing period, many of the credit unions experienced a formal NCUA audit and were very pleased with their results for their subprime lending portfolio, generating no findings. Pilot results indicate that risk can be effectively managed by following NCUA guidelines and the Federation guidelines established for Borrow and Save.

Determine Risk Tolerance and Expertise

The first thing a credit union should do is determine its tolerance for risk and its level of underwriting expertise. As part of its lending strategies, the Board of Directors should establish parameters for credit and concentration risk. For example, if the credit union has limited expertise and exposure to subprime lending, the board may want to restrict such loans to only C or D paper, and limit the dollar or percentage amount of such loans. The limits may be based on the credit union's net worth. However, if managing risk to net worth, make sure the credit union is monitoring aggregate exposure of risks to net worth. This is covered in NCUA's March 2010 Letter to Credit Unions (Letter No.: 10- CU-03) on concentration risk. If the credit union has other at-risk loan products tied to net worth, these should be monitored both individually and aggregately.[11]

Manage Yield by Risk Tier

The cost to make and service subprime loans and associated loan losses will invariably be greater with riskier loans. It is strongly recommended that credit unions calculate these extra expenses. This enables management to demonstrate to boards and examiners what each risk tier adds to the bottom line – or in the case of negative net yield, what it subtracts from the bottom line. Higher losses from riskier loans can cause boards and examiners to become concerned, unless it can be shown these loans are producing positive ROI based on higher average yields.

Static Pool Analysis

In its Risk Alert Letter of June 2005, NCUA recommends credit unions use static pool analysis to monitor performance of loans over time. This is further discussed in the following white paper: https://www.ncua.gov/Resources/Documents/Risk/RSK2005-StaticPoolAnalysis.pdf.

A static pool is made up of those loans originated with similar underwriting criteria during the same month or quarter. It is a longitudinal study of the loan pool over its life. For example, a credit union could use FICO tiers as its underwriting criteria and track all loans made monthly or quarterly by tier. It then tracks the performance of each pool over 18 to 24 months, until the pools become seasoned.

New loans entering a portfolio can mask the performance of older loans, since new loans will generally perform better than seasoned loans. A static pool analysis eliminates any distortion from new loans because each pool is kept distinct based on its origination date.

Capture Exceptions

In order to monitor loan performance by FICO tier or by any other underwriting criteria, credit unions must have the data processing means to segregate loans in this manner. NCUA also recommends that credit unions capture within some data processing field any loan exceptions made to policy or other at-risk loans that management would want to monitor for performance. The ability to collect and monitor loans in this manner provides management with the tools to identify problems early and make any changes to policy or underwriting guidelines.

Moving Forward

The Borrow and Save loan has shown tremendous potential to help members save during the Incubator Pilot. Credit Unions members that took out the loan during the pilot were able to save almost one million dollars. The loans had a default rate of less than 2% during the pilot. During the pilot phase, participating credit unions mitigated the risk of the loan with a combination of slightly higher interest rate (12%–18%) than would typically be placed on a partially secured loan and an allowable application fee of up to $20. This succeeded in being able to reach credit-challenged borrowers and others that would not have been able to access existing CU loan products. Based on the results from the pilot and the very low default rate, the application fee can be reduced and even eliminated and maintaining an APR that does not exceed 18%. These options will ensure that the loan will be compliant as a small dollar loan with both the credit union and consumer protection regulators.

ACKNOWLEDGEMENTS

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The Federation and Filene would also like to acknowledge the following: the staff at the credit unions that initially tested Borrow and Save and those that participated in the second testing program with Filene's Accessible Financial Services Incubator over the 14- month period. Special thanks to Freedom First FCU and Together Consulting for their ongoing efforts to provide technical assistance to credit unions participating in the Incubator.

CREDIT UNION	LOCATION	ASSET SIZE	WEBSITE
Initial Pilot Participating Borrow and Save CDCUs from 2011-2013			
Freedom First CU	Roanoke, VA	$391.2M	freedomfirstcu.com
North Side Community FCU	Chicago, IL	$8.6M	northsidecu.org
Santa Cruz Community CU	Santa Cruz, CA	$105.5M	scccu.org
Union Settlement Federal CU*	New York, NY	$42.6M	lespeoples.org
Borrow and Save Incubator Participants from 2014-2015			
Carter FCU	Springhill, LA	$256.4M	carterfcu.org
Communicating Arts CU	Detroit, MI	$30.4M	cacuonline.org
Freedom First CU	Roanoke, VA	$391.2M	freedomfirstcu.com
Guadalupe CU	Santa Fe, NM	$138.3M	guadalupecu.org
Hope CU	Jackson, MS	$176.0M	hopecu.org
Lake Trust CU	Lansing, MI	$1.6B	laketrust.org
North Side Community FCU	Chicago, IL	$8.6M	northsidecu.org
Peninsula Community FCU	Shelton, WA	$162.5M	pcfcu.org
Seasons FCU	Middleton, CT	$153.9M	seasonsfcu.org
Southwest 66 CU	Odessa, TX	$83.7M	southwest66.com
SkyOne FCU	Hawthorne, CA	$437.5M	skyone.org

**Union Settlement (now Lower East Side People's Union Settlement branch)*

About the Federation

The National Federation of Community Development Credit Unions is a certified CDFI Intermediary representing community development credit unions (CDCUs). The Federation's member CDCUs provide credit, savings, transaction services, and financial education to more than five million residents of low-income urban, rural, and reservation-based communities across the US, and hold over $45 billion in community-controlled assets. Founded in 1974, the Federation is headquartered in Lower Manhattan with offices in Madison, Wis. We offer a wide range of advocacy, educational, training, investment, marketing, and outreach programs to support and assist CDCUs. For more information about the Federation and its programs, please visit www.cdcu.coop.

About Filene

Filene Research Institute is an independent consumer finance think and do tank. We are dedicated to scientific and thoughtful analysis about issues vital to the future of credit unions and consumer finance. We live by the famous words of our namesake, credit union and retail pioneer Edward A. Filene: "Progress is the constant replacing of the best there is with something still better." Together, Filene and our thousands of supporters seek progress for credit unions by challenging the status quo, thinking differently, looking outside, asking and answering tough questions, and collaborating with like-minded organizations. Filene is a 501(c)(3) not-for-profit organization. Nearly 1,000 members make our research, innovation, and impact programs possible. Learn more at www.filene.org.

39 Broadway, Suite 2140 | New York, NY 10006 –3063 | T 212.809.1850 | F 212.809.3274

ENDNOTES

1 http://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf

2 http://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf

3 http://www.fdic.gov/householdsurvey/

4 CFSI webinar on 11/17/15: Saving Habits and the Financially Struggling Majority

5 Pew Research Center, Payday Lending in America: Who Borrows, Where They Borrow and Why, 2012

6 http://www.bankrate.com/finance/personal-finance/pawnshop-101-what-you-need-to-know-1.aspx#ixzz3ryTAOFyJ

7 http://www.wsj.com/articles/lenders-step-up-financing-to-subprime-borrowers-1424296649

8 https://www.moneykey.com/licenses/consumer-disclosures-Texas/TXF-P100$29Fee.pdf

9 http://www.ncua.gov/Resources/RiskAlert/2005/05-RISK-01.pdf

10 http://www.ncua.gov/Resources/RiskAlert/2005/05-RISK-01.pdf

11 http://www.ncua.gov/letters/2010/CU/10-CU-03.pdf