Share the Wealth
CONCEPT DOCUMENT

filene
IDEAS • INNOVATION • IMPLEMENTATION

INTRODUCTION/EXECUTIVE SUMMARY

Share the Wealth is a program for credit unions that are looking to grow their loan portfolio through high-quality home equity loans with the option of building additional fee income. The Share the Wealth program leverages the cooperative nature of credit unions through a Home Equity referral program. A Coordinating Credit Union develops relationships with First Mortgage Originators to obtain home equity referrals and match these loan opportunities with other credit unions interested in funding home equity loans. All credit unions receive a fair distribution of loan opportunities, unlike some indirect lending programs, and have the opportunity to develop a relationship with a new member, unlike some loan participation agreements. The program provides enhanced revenue opportunities for credit unions, building fee revenue for the Coordinating Credit Union and additional loan interest income for all participating credit unions. It also differentiates credit unions from other financial institutions through this highly collaborative arrangement, “sharing the wealth” rather than holding on to it.

West Community Credit Union in St. Louis is piloting this concept as the Coordinating Credit Union.*. There are at least two additional credit unions that have expressed interest in participating as Partner Lenders.** West Community Credit Union will distribute the loans in a round-robin-like format based on conditions set by the participating credit unions (how much liquidity is available, etc.). West Community Credit Union earns a fee for each loan it sends to one of the participating credit unions. The credit unions use standardized documentation that meets everyone’s compliance requirements. They have agreed to general underwriting guidelines as participating lenders but a credit union can deny a loan referral at any time. A standardized home equity product is offered, and the rate on the loan product is tied to an external index that cannot be controlled by the credit unions, such as the Wall Street Journal Prime Rate. Each credit union will hold its own loans and directly manage the payments with the member. Therefore, each participating credit union can offer additional products and services to deepen their relationship with each member.

OPPORTUNITY

There is no secondary market for home equity loans. Financial institutions must use their own funds to originate these loans. In many cases, a second mortgage (or home equity loan) is originated simultaneously when a first mortgage loan is funded. The purpose of this loan structure could be to help the homeowner avoid a higher loan rate on the first mortgage or to avoid Private Mortgage Insurance (PMI). Some First Mortgage Originators do not hold home equity loans on their books and must find a partner to originate those loans. Due to the large banks’ unwillingness to lend, it is a prime time for credit unions to reach out and partner with First Mortgage Originators in their market.

Share the Wealth offers two types of opportunities for involvement: Coordinating Credit Union and Partner Lenders.

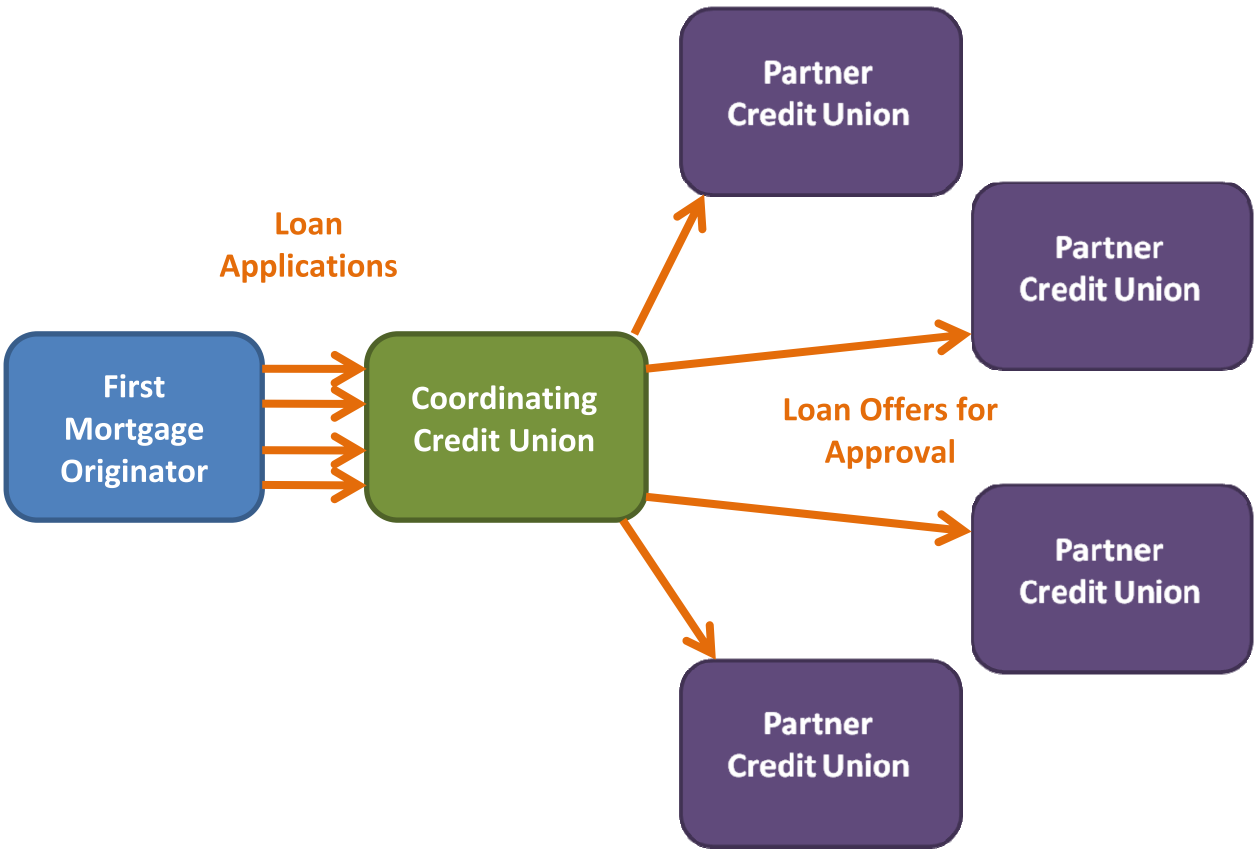
*Coordinating Credit Unions:

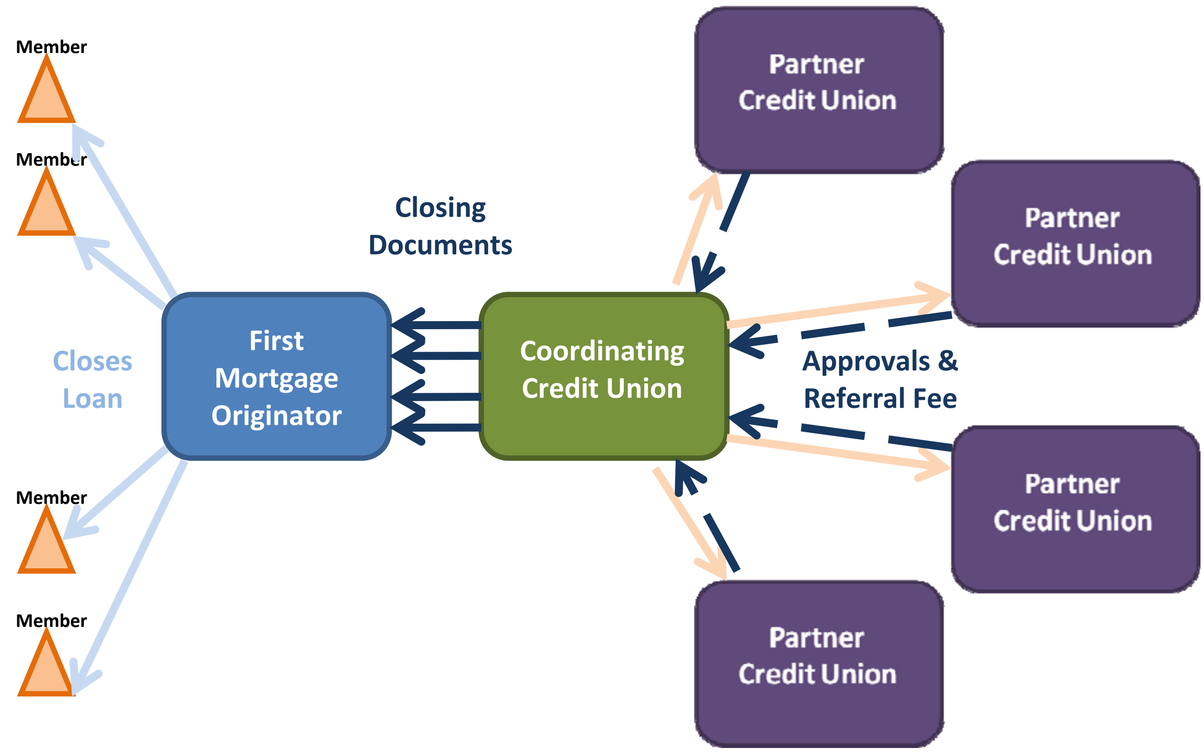
- Coordinate all aspects of the relationship with the First Mortgage Originator
- Manage the referral process and ensure smooth closing for Partner Lenders
- Earn non-interest income and generate a larger volume of second mortgage loans
- Create a cooperative program that offers a win-win-win opportunity for members, the First Mortgage Originator and Partner Lenders

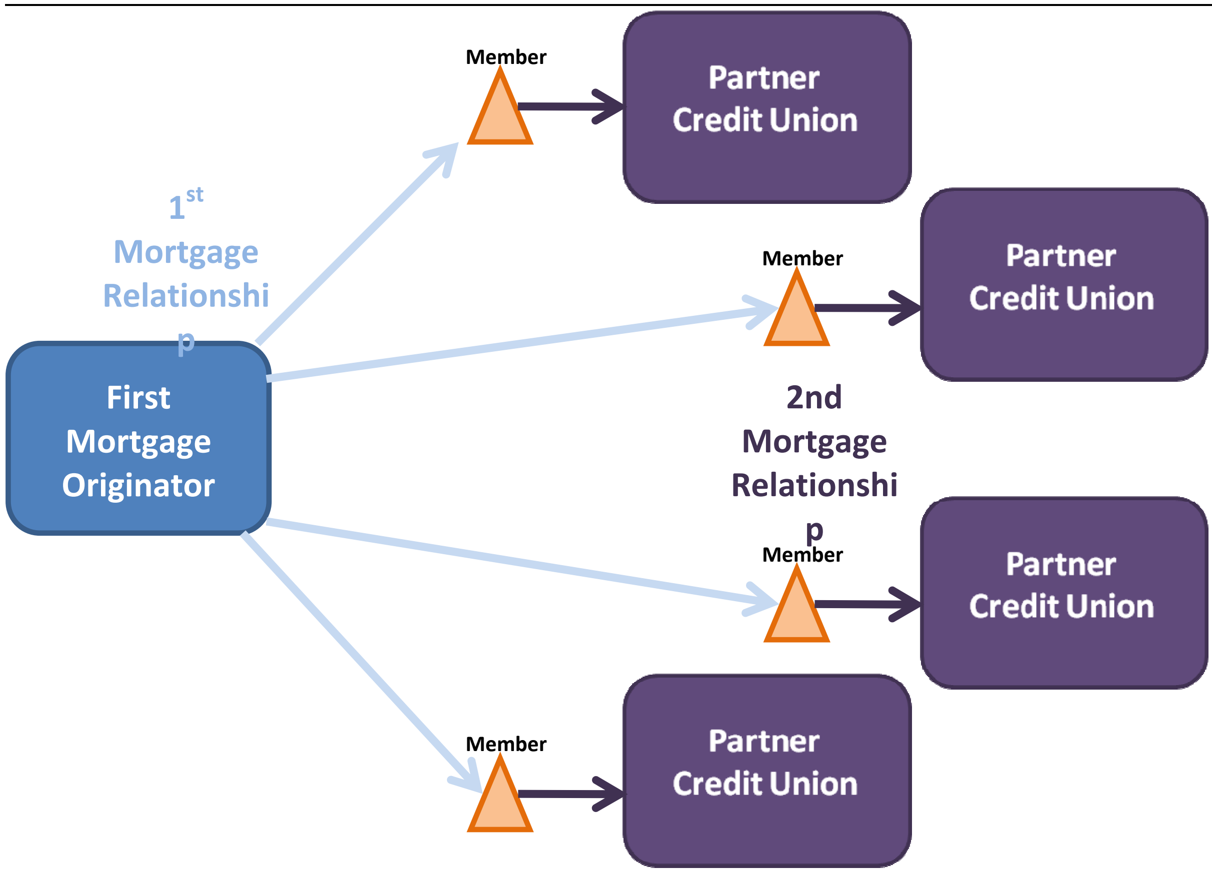
**Partner Lenders:

- Generate a larger volume of second mortgage loans with very little effort
- Participate in a cooperative program that will increase credit union market share in the second mortgage market.

The following charts illustrate the concept and relationships:




Member
Member
Closing Documents
Partner Credit Union
Partner Credit Union
Closes Loan
First Mortgage Originator
Coordinating Credit Union
Approvals & Referral Fee
Member
Member
Partner Credit Union
Partner Credit Union


Member
Partner Credit Union
1st Mortgage Relationship
Member
Partner Credit Union
First Mortgage Originator
2nd Mortgage Relationship
Member
Partner Credit Union
Member
Partner Credit Union

This opportunity also comes with some inherent challenges. In order to maintain a strong relationship with the First Mortgage Originator once banks are willing to ramp up loan volume again, it is crucial to establish a strong niche for credit unions in this marketplace. A distinguishing factor for credit unions is their emphasis on strong service and personal connections. Short turnaround times, attention to detail and simplified processes will be crucial in establishing and keeping this partnership.

Also, by design, the First Mortgage Originator only interacts with the Coordinating Credit Union. If service is slow or poor, this credit union must resolve the issue with the Partner Lenders.

However the payoffs, as suggested in the Financial Pro-Forma, far outweigh the challenges.

ENVIRONMENTAL SCAN

When researching credit unions or banks with similar programs in place, the team investigated its local markets and regional areas. Interviews were conducted with our own senior teams and staff. Additionally, Internet searches and conversations with representatives from Raddon Financial Group, C. Myers and Callahan and Associates resulted in no similar programs currently identified in credit unions. We also contacted a recent i3 member, Lisa Renner of CU Holding Company, LLC, who did some research using her legal contacts and the COO at her Mortgage CUSO. We received good questions, comments and feedback from all sources, yet these did not result in surfacing a program similar to Share the Wealth.

MEMBER BENEFITS

Members benefit from Share the Wealth by securing a second mortgage with a quick turnaround and a lower rate than perhaps they would have otherwise received. By getting a loan from the Coordinating Credit Union or one of the Partner Lenders they also have an opportunity to receive personal service and one-on-one attention to their needs. Moreover, members will not pay more to receive a loan through the Share the Wealth Program or incur extra fees for doing so.

CREDIT UNION BENEFITS

Share the Wealth offers a way to increase second mortgage lending while not lending to "riskier" borrowers. Each credit union remains in control of its own lending decisions and may deny a loan at any time. Each credit union may also establish deeper relationships with members joining via this channel, unlike some participation agreements.

Share the Wealth is a unique, cooperative opportunity that also offers several revenue opportunities for both Coordinating and Partner Lenders.

The benefits for the Coordinating Credit Union are:

- Increase non-interest income by coordinating the process by which Partner Lenders receive, approve and close referral loans. It is recommended that the Coordinating Credit Union receive a fee for every referred loan that funds.
- Generate a higher volume of second mortgage loans, remaining true to their current underwriting guidelines
- Reduce marketing expenses related to the promotion of second mortgage loans

The benefits to the Partner Lenders are:

- Generate a higher volume of second mortgage loans, remaining true to their current underwriting guidelines. A Partner Lender can refuse a loan at any time if it does not meet their current guidelines.
- Reduce marketing expenses related to the promotion of second mortgage loans and have the opportunity to establish relationships with new members joining through the referral process.

Perhaps a more intangible benefit to credit unions in general is the collaborative nature of this concept. It truly reflects the spirit of "spreading the wealth."

TARGET MARKET

There are two target markets:

1) First Mortgage Originators who need a funding source for home equity loans (second mortgages) .
2) Credit unions that need additional, more efficient avenues for loan growth.

OPERATIONAL AND OTHER CONSIDERATIONS

Coordinating Credit Union

The Coordinating Credit Union will manage the bulk of the work (and earn fee income as a result) to ensure the success of the program. Operational considerations include:

- Business development activities – build and maintain strong relationships with First Mortgage Originators and Partner Credit Unions
- Coordinating activities – process referrals and disseminate to Partner Credit Unions, conduct follow-up as necessary, ensure all parties comply with program service level agreements, generate monthly reports, manage billing of Participating Credit Unions
- Underwriting –manage turn around times of underwriting decisions for loans that are held by Coordinating Credit Union
- Management – manage agreements with First Mortgage Originators and Partner Credit Unions to ensure that service levels are achieved and risks are appropriately mitigated; internally, establish incentive plans and sales goals to ensure long-term sustainability of referral pipelines

The Partner Lenders will have the following operational considerations:

1) Underwriting – must be able to manage turn around times of underwriting decisions for loan referrals
2) Management – must be able to mitigate concentration and credit risks, as well as communicate to the Coordinating Credit Union regarding their funding capacity over time

PROOF OF CONCEPT

West Community Credit Union currently has relationships with several First Mortgage Originators operating in the local St. Louis market. In June and July, the credit union received and funded approximately 40 referred loans from these sources. In managing this volume, the credit union was able to understand the staffing requirements and operating processes required to manage a referral pipeline in context of the Share the Wealth concept.

In August, West Community Credit Union is set to begin testing the "Share the Wealth" concept. Processes and expectations have been formalized with all parties involved. On August 12th, West Community conducted orientation and training with its Partner Lender. Some loan documentation issues were discovered for the Partner Credit Union, and they are in the process of resolving them. The first referral should be sent over to the partner credit union by the end of August.

West Community has created a business plan to implement the Share the Wealth concept, and it has initiated the hiring processes for a program coordinator, business development loan officer and a home equity underwriter specialist. The pro-forma forecast included in this document is based on the West Community business plan for 2010.

GETTING STARTED

There must be one proactive credit union in each market to form relationships with First Mortgage Originators. The Coordinating Credit Union is key to starting the Share the Wealth Program. Partner Credit Unions provide the valuable funding support to meet the needs of a diversified mortgage referral pipeline through all parts of the economic cycle.

Here are some key steps to get started:

1. Create a legal agreement for the First Mortgage Originators that:

- Provides a single point of contact with the Coordinating Credit Union and prevent the creation of similar agreements with other local credit unions. This prevents a break down of the collaborative environment.
- Provides warranties to all credit unions involved regarding the First Mortgage Originators' responsibility in closing the loans on behalf of the credit unions and for those cases of institutional fraud
- Allows the Coordinating and Partner Credit Unions to solicit those members that receive funding from them through the HELOC product. However, credit unions may have to provide a guarantee to the First Mortgage Originator that they will not solicit their first mortgage product to referred members

2. Create legal agreement for Partner Lenders that:

- Details the responsibilities of each party, including communication and service levels
- Limits Partner Credit Unions from creating outside referral agreements with First Mortgage Originators already in the program.
- Explains the reporting and billing processes

3. Determine product pricing and terms to be sold by First Mortgage Originators. We suggest that the pricing of the product be tied to an external index that cannot be controlled by the credit union to avoid any accusations of price collusion.

4. Create workflow process that:

   a. Allows secure transfer of information from First Mortgage Originators to Coordinating Credit Union and Partner Credit Unions
   b. Facilitate timely underwriting and coordination for loan closing with First Mortgage Originator
   c. Provide reporting to Partner Credit Unions and billing of referral fee each month
   d. Manage and respond to service levels throughout entire process
   e. Develop new business opportunities to maintain and grow HELOC volume available to all participants

Sample legal agreements, documents/forms, and process descriptions may be purchased from West Community Credit Union by contacting Jason Peach.

MARKETING TACTICS

The Coordinating Credit Union will develop relationships with First Mortgage Originators through business development activities. Partner Credit Unions will also be solicited through "one-on-one" conversations with credit union management. Solicitation of the program may also occur through resources available through each State Credit Union League.

FINANCIAL PRO-FORMA

Coordinating Credit Union

<u>Figures are annualized</u>

Overhead (program coordinator, business development, underwriter) = $150,000
Other Startup Costs = $15,000
<u>Total Annual Costs = $165,000</u>

Total referrals from First Mortgage Originators = 360
Loan referrals funded by Coordinating Credit Union = 120
Average Loan referral Funded Balance = $40,000
Average net interest margin = 3.50%
Total net interest income on loans funded by Coordinating Credit Union = $168,000
Loan referrals to partner credit unions (assumes two partner credit unions) = 240
Average Referral Fee per loan = $300
Referral Fee Income = $72,000
<u>Gross Revenue = $240,000</u>

Net Income = $75,000
Return on Investment = 45%

Intangible Benefits: The Coordinating Credit Union also is able to leverage additional overhead, such as the underwriter and business development representative for other activities. For instance, the business development representative could also use his or her time to build more first mortgage origination opportunities for the credit union. The underwriter might provide more efficiencies in loan decision times if they can be utilized for loan decisions outside the referral program. Also, the Coordinating Credit Union builds the relationship with the First Mortgage Originators, and there might be other ways this relationship may be leveraged.

Partner/Lender Credit Union

Overhead (underwriter, loan processor) = $80,000
Other Startup Costs = $15,000
Total Annual Costs = $95,000

Loan referrals funded by Partner Credit Union = 120
Average Loan referral Funded Balance = $40,000
Average net interest margin = 3.50%
Total net interest income on loans funded by Coordinating Credit Union = $168,000

Net Income = $73,000
Return on Investment = 57%

RESOURCES

Each credit union would determine the resources they would dedicate to this effort. The effort might be easily absorbed into an existing Lending department.

PROJECT TEAM

Filene i^3 is a creative group of insightful and energetic credit unions professional who develop new ideas, innovate, and implement for the benefit of the credit union system. Please visit filene.org/home/innovation or email innovation@filene.org to learn more. The team members who developed this idea are:

Rebecca Secor
Member Loyalty Group
Chicago, IL
rsecor@memberloyaltygroup.com

Charlie Roberts
State Department FCU
Alexandria, VA
croberts@sdfcu.org

Mary Dolan
Maine State Credit Union
Augusta, Maine
mdolan@mainestatecu.org

Jason Peach
West Community Credit Union
St Louis, MO
jpeach@westcommunitycu.org