Financial Liberation - Out of the Box Innovation

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Table of Contents

Background Summary

FILENE, i^3, AND OUR TEAM

The Filene Research Institute examines vital issues affecting the future of credit unions and consumer finance. Through this unique, non profit organization managerial problems, public policy questions, and consumer needs are examined. In 2003, Filene developed a new program entitled i^3—ideas, innovation, and implementation.

Today (September, 2005) 39 individuals representing credit unions throughout the United States have successfully completed the rigorous application and selection process. Importantly, i^3 members work in small groups to advance "quick hits" or "big rocks". Quick hits are developed over a six month timeframe while big rocks stretch over one year.

For the past year, five of us have been advancing our big rock—the single account concept—the flex•one account. This Business Plan represents our work from the past and lays the foundation for the future.

COMPETITIVE LANDSCAPE

<u>European Headlines:</u>

1997—The Virgin One Account Launches to Serve the Direct Consumer Market
2000—Intelligent Finance Boasts 10.4% Share of U.K. Net Mortgage Lending
2002—Royal Bank of Scotland (Formerly Virgin One) Attracts 92,000 Customers

<u>American Headlines:</u>

2005—Pacific Trust Bank Offers the Green Account After Two Years of Development

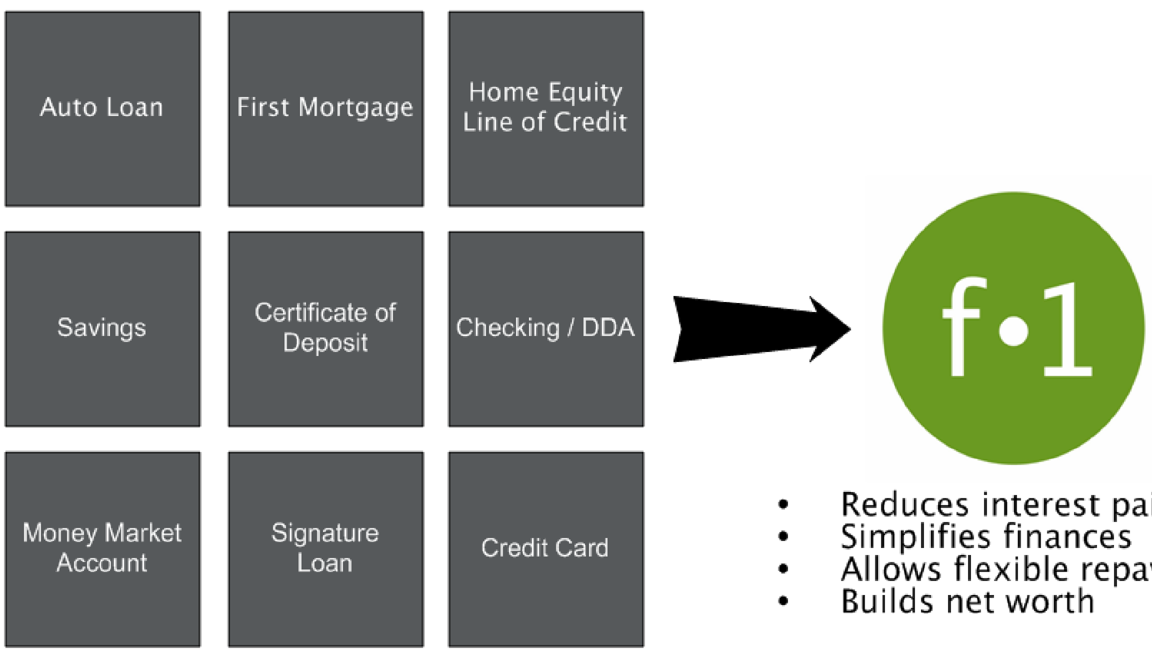
Clearly Europe has been the chief innovator in bringing the single account concept to the marketplace. Meanwhile, US financial institutions have been watching these trends and have been considering compliance and product development issues.

A year ago, when our team selected this idea as our big rock, we were confident that credit unions could use their size and determination as a strategic advantage in launching the single account concept in the U.S. Today, credit unions can no longer say they were *first* to market, but they can say they are *in* the market. Go big or go home—that's been our team motto.

RESOURCES

http://oneaccount.com
http://www.if.com/mortgage/mortgage_home.aspx
http://www.pacifictrustbank.com/Green/Green1.html

Traditional Accounts | **flex•one Account**



- Reduces interest paid
- Simplifies finances
- Allows flexible repayment
- Builds net worth

Executive Summary

PRODUCT DESIGN

The flex•one account is a first mortgage combined into a Home Equity Line of Credit (HELOC) with all the capabilities of a checking account. The member's entire loan is a line of credit, which allows the balance to be paid down when there is excess savings and withdrawn should those "savings" be needed. It also allows access via ATM, check writing, debit card/POS, ACH, and other features which make a separate checking account unnecessary.

STRATEGIC ADVANTAGE

With the revolutionary flex•one account, everyone's a winner. Members enjoy an improved financial picture. Credit unions enjoy a higher penetration of PFI members, a better loan-to-share ratio, lower risk, and an improved bottom line. Essentially, this product enables the credit union to make the strategic shift from selling products to building member relationships—supporting the primary mission for most credit unions. This product is not as profitable as a standard fixed-rate first mortgage, but it is more profitable than a HELOC, auto loan, checking, and savings combined. Clearly, deepening the member relationship by securing the first mortgage, along with the other traditional loan and savings products, drives household profitability. Most importantly, this product provides a substantial savings to our members by allowing them to "earn" more on their savings and reduce their mortgage debt faster. This savings could easily be over $100,000 during the member's lifetime.

IMPLEMENTATION

The two biggest operational obstacles raised are compliance and data processing. Almost any core system can allow a mortgage and home equity product to be rolled into one, and most systems can accommodate a vast majority of the checking features (check writing, debit card access, ACH, etc.). There may be a few features that cannot be accomplished immediately, but the product can still be rolled out and offered in conjunction with a checking account. If the overdraft feature of checking can be tied to a HELOC, and if a sweep feature can be added to move balances from checking to the HELOC, it can essentially function as a flex•one account. In the long run, there are more sophisticated money management tools that should be offered with this product, which can be done on the web or by moving the entire data processing function to a separate platform like a credit card processing operation. The compliance issues are more easily resolved.

REMAINING ISSUES AND CHALLENGES

Although the flex•one account is beneficial for both members and the industry, it's important to state some key issues and challenges remain. First, plastic and/or check access to a large line of credit does present potential risk issues. While these risks might be initially viewed as too significant, they can be minimized with technology and procedural solutions. Second, consumer fraud potential is an ever-increasing reality as more and more members fall victim to identity theft. Though consumer fraud will continue, careful procedural and policy planning can help mitigate flex•one account losses. Lastly, the resource/planning cycle for the credit union industry remains relatively fixed and we were not able to secure adequate resources or priority at any credit union during our project timeframe. Therefore, in order to successfully implement any phase of our proposed flex•one account, a credit union must proactively allocate the appropriate people, time and financial resources during their budgeting/project planning.

SEGMENTATION STRATEGY

Initially, this product should be targeted towards members who are very aware of and focused on their household finances. Through some primary research, we have identified two key market segments: the "Financial Hobbyist" and the "Convenience Driven". Based on our primary research, we validated that a clear niche-market demand does exist for a product like the flex•one account.

MORE INFORMATION

Visit www.f1account.com

Summary of Strategic Benefits

The flex•one account provides an attractive value proposition for the member, the credit union originating the mortgage, and the credit union industry as a whole.

MEMBER FOCUSED

For the member, the flex•one account is a means to drastically simplify his or her financial affairs, allowing for a single transactional account. This affords the member convenience in the form of fewer accounts to manage and fewer monthly payments. The flex•one account also offers financial appeal in the form of net interest savings.

The traditional account model calls for a depositor to keep short-term liquid assets in low interest savings and checking accounts. The flex•one account provides a means to net these deposits against the mortgage loan, saving far more in interest expense than would have been earned in interest income with the traditional model. Essentially, the flex•one account leverages the power of daily interest.

CREDIT UNION FOCUSED

The flex•one account is an exceptional vehicle for credit unions to deepen relationships and facilitate the much sought after role of becoming the primary financial institution for its members. Additionally, because of the adjustable rate nature of flex•one, the credit union can grow its balance sheet profitably while also reducing interest rate risk exposure.

In addition, the flex•one account allows credit unions to make the strategic shift from focusing on product sales to member relationships thereby offering "more for less". Fewer products result in streamlined operations, increased profitability, and a means to shift focus to more consultative member service.

INDUSTRY FOCUSED

The credit union industry stands to benefit on several fronts as well. Although similar products have been offered in Europe and Australia for some time, the concept is new to the United States. Indeed, being first to market as an industry allows credit unions across the country to improve their historically low mortgage penetration levels. The flex•one account also positions credit unions as an industry leader—perhaps altering contrary existing brand images that plague the credit union industry. Better yet, these goals can be accomplished by offering a product that improves the financial lives of members throughout the country, thereby fulfilling the industry mission.

Summary of Financial Benefits

MEMBER FOCUSED

The flex•one account creates an opportunity to significantly improve the financial condition of our members for obvious reasons. If existing savings accounts can be netted against existing debt, the savings on the debt will exceed the earnings on the savings accounts. In our model, the savings to the member is $58,000 during the 30 year period we are analyzing (see Appendix A). The financial benefit to the credit union is we become the PFI, if not the only FI, in the household. In addition, we increase our household profitability by capturing the member's mortgage along with the other products and services.

KEY ASSUMPTIONS

As previously stated, the flex•one account is designed to combine all the possible products a member can have into this one product (excluding retirement-type accounts like the IRA). In our models, we assumed that the flex•one has a 98% LTV, priced at a standard rate for a 3/1 adjustable rate mortgage (ARM) less .25%. If the flex•one balance goes negative (a deposit balance), we will pay 2%, which is better than most money market accounts (as of Q3 2005). Appendix A shows all of the assumptions that drive the financial model including balances, interest rates, terms, and margins on the various products the member has today and the features of the flex•one account. Additionally, Appendix A illustrates the impact of each product from the member's perspective.

We utilized current market rates (Q3 2005) for the existing products. Our approach looks at the interest expense and the interest income on a "typical" household over a 30 year period. We then compare the 30-year "total cost" to the household under that scenario versus the 30-year net expense of having the flex•one account. In both scenarios, when there was equity available in the mortgage debt we moved the auto debt and credit card debt to the real estate based debt to decrease the cost to the household. In both scenarios, as equity in the home increased more than $15,000, we increased the credit limits of the real estate based debt (HELOC or flex•one).

We believe that the assumptions are relatively conservative in that there are many other situations in which the flex•one account would have looked even more beneficial to the member. First, we may not have to price this at the standard ARM less .25%. Also, if we increase the beginning balance on the savings from $2,000 to $10,000, the household benefit in switching to the flex•one goes from $58,000 to $76,000. At $20,000, the savings increases to $95,000. There is also the possibility of someone receiving a one-time lump sum of money that might have been applied to a savings account. Instead, this can be applied to the flex•one permanently or just for a period of time until it is invested in the markets or spent. With a traditional mortgage, that is not an option.

Also in our model, this member household rarely had auto loans as they were able to use the equity line of credit almost the entire 30-year period. Obviously, for the member the flex•one account is cheaper than using a second mortgage, and it is significantly cheaper than using a non-deductible auto loan to finance those purchases.

The financial impact for the institution should be very favorable under most conditions. Appendix A illustrates the profitability of each product in our model. The shaded area in the institution impact shows the annual profitability (over 30 years) of the flex•one account, the traditional fixed rate mortgage loan in our current member scenario, and all the other traditional products in that scenario as well. If the member already has a fixed rate mortgage, which the credit union has not sold, the flex•one will cost the credit union some profits. However, if there is no mortgage or a sold mortgage in the member household, this product will increase the profitability of the household.

If the flex•one account does nothing but cannibalize the existing fixed rate real estate portfolio held on the books, there will be a negative financial impact. The exciting news is that the average credit union only has a fixed rate mortgage (not sold) in about 1% of its households, so the possibility of cannibalizing the existing portfolio remains substantially low. Additionally, even if we do cannibalize the mortgage portfolio, we will have attracted whatever additional products the member had with other institutions and secured their entire financial relationship. If the member did not have their mortgage with the credit union, we will have substantially increased the profitability and garnered the PFI status as well.

Summary of Marketing Strategy

IS THERE A MARKET FOR THE FLEX•ONE ACCOUNT?

During early 2004 we designed and implemented a comprehensive web-based survey which was taken by 1,000+ members at over a dozen credit unions nationwide (see Appendix D for a full report). The purpose of our survey was to measure member attitudes toward the flex•one account concept and assess the likelihood of members using our flex•one account. Key findings from our research include:

- 57% of ARM users said they were “extremely likely” or “somewhat likely” to use a product like the flex•one account.
- 41% of non-ARM users said they were “extremely likely” or “somewhat likely” to use a product like the flex•one account.
- “Credit-driven” and “upscale” segments showed the highest interest level.
- “Middle-market” and “middle-income depositors” showed the next highest level of interest.
- “Low-income depositors” (mostly retirees) and “low-income/fee-driven” people were the only groups notably unlikely to use the flex•one account.
- Low rate is the most appealing feature of the flex•one account.
- Convenience is the second most appealing feature of the flex•one account.

SEGMENTATION STRATEGY

Segmenting a market is the analytical process of identifying and separating the market into distinct member segments, each with shared needs and attributes. Our segmentation strategy is rooted in benefits segmentation with the focus on matching the flex•one account benefits to each member segment’s financial/lifecycle needs. One caveat: the segments identified below are “best guess” estimates based on our primary market research. We could not find secondary market research from the industry or elsewhere to support our market segment recommendations.

Segment 1

“Financial Hobbyist”: Members who are financially savvy and actively involved with managing their household finances on a routine basis. Credit-driven and upscale members, age 25–54, who are college educated, homeowners with a first mortgage elsewhere (or prospective homeowners with no existing first mortgage), and are receptive to variable-rate mortgage products represent the highest potential.

Segment 2

“Convenience Driven”: Members who understand the financial benefits the flex•one account provides but are less actively involved in managing daily finances. They may be time constrained or are simply motivated by the one-stop-shop convenience that the flex•one account provides. Middle market and middle-income depositor members, age 25–54, who are college educated, homeowners with a first mortgage elsewhere (or prospective homeowners with no existing first mortgage), and are receptive to variable-rate mortgage products represent the highest potential.

TARGETING/MESSAGING

Targeting is the decision to solicit a particular member segment with a marketing message. Our targeting strategy recommendation is to pursue both market segments identified above using a variety of mediums.

Segment 1 Messaging

The flex•one account saves you significant money in interest expense and allows you to pay off your loan balance faster.

Segment 2 Messaging

The flex•one account saves you time by consolidating your multiple banking and mortgage accounts to one convenient account at your credit union.

HOW TO REACH TARGETS?

A sample direct mail marketing piece is included with this business plan that could be used to reach either market segment identified above. The size and appearance of the marketing piece makes it stand out from competing mail that a member might find in their mailbox. The "financial liberation, out of the box innovation" headline on the cover should spark interest and tempt the recipient to open the direct mail piece. Once opened, the member finds a branded magnet inside, as well as a wealth of information to explain the benefits of the flex•one account.

Other marketing vehicles will likely need to be utilized to introduce this new product concept, generate awareness, and achieve results. In addition, focused training for experienced staff will be required to field member questions as well as cross-sell this product.

MARKETING CONCLUSION

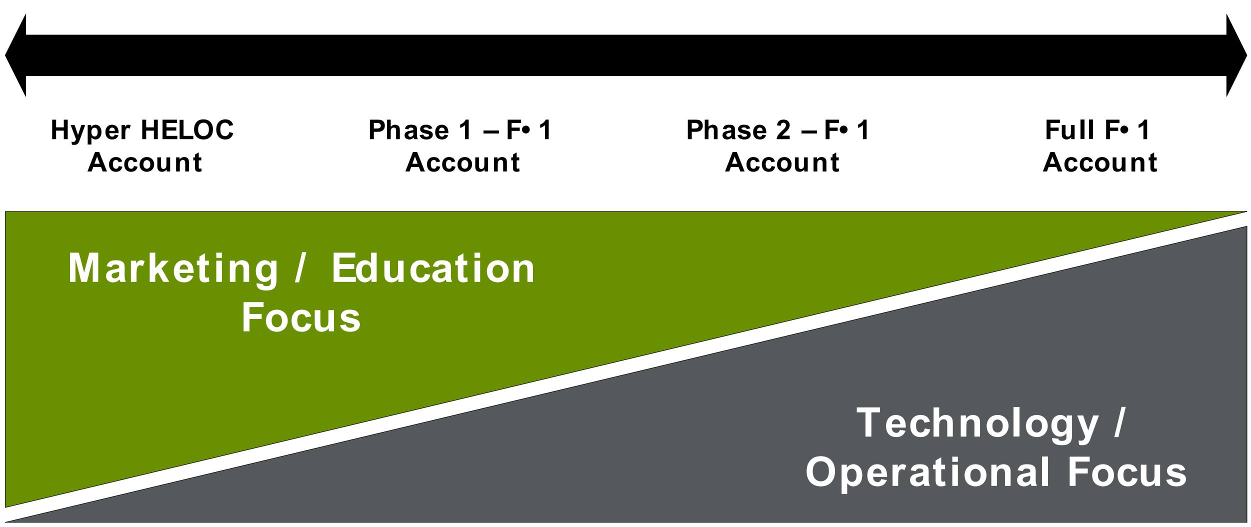
Based on our primary research, a clear niche-market demand does exist for a product like the flex•one account. But, it's important to note that the flex•one account will not provide the "mass market appeal" that other products in the credit union product mix provide. In other words, this product is not suited for every member. However, as the product is fully developed and deployed, the market potential for flex•one account is expected to expand. This expansion is a result of the tools becoming increasingly sophisticated to support the needs of a larger segment of the population.

Summary of Operations and Technology Issues

OVERVIEW
One of the challenging aspects of implementing the flex•one account is determining the operational considerations for the credit union. While the concept is complex, it can be implemented in phases to allow for both the operational and marketing/education considerations to be developed over a period of time. This section will detail the operational issues and possibilities for making the flex•one implementation easier.

IMPLEMENTING ALONG A CONTINUUM
The flex•one account can, and perhaps should, be implemented in multiple phases, each building on the phase before—like a continuum. It is our belief that very few credit unions will implement the flex•one fully in the initial launch. Our process is designed to enable a credit union to implement with the tools and systems which already exist in their credit union. Credit unions should implement individual features as their particular market demands. With a new innovation like the flex•one account, there will undoubtedly be modifications that are made throughout the implementation.

THE SHIFT FROM MARKETING/EDUCATION TO TECHNOLOGY
The graphic below illustrates how the resources needed and the focus will shift as the product moves from the initial launch phase to the full f1 phase. Notice the credit union's initial focus on member marketing and education, as the flex•one is a new account concept in the United States. As the product gains acceptance, new features can be added until the credit union arrives at full f1 implementation.



BUILDING BLOCK APPROACH

Each phase of the flex•one account builds on the phase before making the product ideal to roll out in a measured approach. While it is represented as a "stair step," it is possible that a credit union having core systems that would rank as a "Phase 2" might develop an integrated suite of web-facing tools that make the back office complexity invisible to the member. Likewise, a credit union may choose to focus on creating an integrated core system account structure with a single account for loans, transactions, and deposits, while not building the money management tools needed to create a full flex•one account.

There are clearly multiple variations of implementation and this graphic is intended to provide an overview of how a phased approach might work.

	Hyper HELOC Account	Phase 1 – F• 1 Account	Phase 2 – F• 1 Account	Full F• 1 Account
Money Management Tools				Integration suite of money management tools, including ability to "bucketize" savings for categorization, manage progress in loan repayment and set annual goals.
Single View of Account			Member has single view of accounts through web-based and IVR systems. Credit union tools may still show multiple accounts for call center support.	Single view of account because the native account structure is a single account. Both members and employees see a single, integrated view of all deposit and loan transactions.
Back Office Processes		Automated sweep process May use overdraft protection Direct deposit to either HELOC or DDA.	Automated sweep process May use overdraft protection Direct deposit to either HELOC or DDA.	Back office processes are all integrated into a single account structure.
Account Structure	Standard HELOC (combined with first mortgage) Standard DDA Member manually sweeps between accounts Direct deposit to DDA	Standard HELOC (first mortgage) Standard DDA	Standard HELOC (first mortgage) Standard DDA	Integration HELOC and DDA – true one account structure. All transactions post natively to a single account within data processing system

<u>Account Structure:</u> How can your data processing / core system set up the account? This ranges from using a standard HELOC and DDA structure available on every major system today to an integration of the HELOC and DDA account that is only available on a few systems and often requires modification to the standard set up.

Back Office Processes: This area represents the type of processes required to reconcile the accounts. In many implementations a nightly or batch process will sweep funds from the HELOC to the DDA and vice versa. In a full implementation of the account, these back office processes are minimized due to the integrated nature of the core system.

Single View of the Account: This section functions as the beginning of the member-facing tools. While most of Hyper HELOC and Phase 1 rely on existing web and phone-based tools, phase 2 begins to implement a consolidated view of the flex•one account. This eliminates the need to review transactions between the HELOC and DDA (although for regulatory reasons, the credit union may need to provide the member the ability to trace a transaction between these accounts). The credit union tools (call center, branch support) may still show multiple accounts and would require additional front-line training and support.

Money Management Tools: This represents the final block of the flex•one account. The money management tools are essential to full implementation. These tools include the ability for a member to track their repayment progress against a goal they define, interest savings calculators based on accelerated repayment, the ability to "bucketize" their savings into self-defined categories (college fund, boat fund, rainy day savings). These tools do not change the underlying operations of the account but allow the member to manage their money in new and different ways.

PRODUCT DESIGN CONSIDERATIONS

Appendix B calls out some additional depth and detail related to each building block. Flow diagrams have also been added as framework for visually designing the product and the access channels.

COMPLIANCE

As one might expect, there are compliance issues related to implementing a flex•one account. Essentially, combining the loan and the deposit products into a single account prompts compliance with numerous rules and regulations. It is our opinion that this challenge can be overcome by simply combining the disclosures into a single booklet-style guide for the member. An owner's manual concept would be appropriate. The European accounts we reviewed have examples—in concept, not content—on their web sites.

Summary of Next Steps

As you can see, there are a number of complexities with the flex•one concept, but they can be overcome by stepping through each phase as your membership demands new functionality and as you want to expand your own market penetration.

To assist credit unions with implementation we have developed the following:

- A financial model that can be customized
- Marketing materials that can be utilized as turnkey or customized
- Primary research to validate consumer interest
- Technology roadmaps that can be used to drive design and implementation
- A flex•one Product Design Worksheet (Appendix C) to walk you through critical implementation questions

If you need more information or want to interact with others thinking about the flex•one, please visit our website at www.f1account.com.

Financial Liberation - Out of the Box Innovation—it starts with you.

APPENDIX A – Financial Metrics
KEY ASSUMPTIONS

Impact on Consumer

Traditional Results		flex•one Results	
Interest Income	$16,779	Interest Income	$5,427
Interest Expense	$313,387	Interest Expense	$225,249
Net After Tax Cost	$224,318	Net After Tax Cost	$165,970
Net Member Savings	$58,348		

Mortgage	
Home Value	$250,000
Appreciation Rate	3.00%
Mortgage Balance	$225,000
Term (Years)	30
Mortgage Rate	5.75%
Interest Margin	1.91%
Contribution Margin	1.78%

Car Loans	
# at once	1
Amount	$25,000
Term (months)	36
Rate	5.75%
Interest Margin	2.98%
Contribution Margin	1.67%

Home Equity LOC	
LTV Limit	100%
Rate	7.00%
Standard Payment	3%
Amount	$25,000
What year?	4
Interest Margin	3.03%
Contribution Margin	2.06%

Credit Cards	
Balance	$5,000
Rate	10.00%
Standard Payment	2.00%
Minimum Payment	$50
Interest Margin	4.08%
Contribution Margin	-5.25%

Savings / MMA	
Initial Balance	$2,000
Monthly Increase	$150
Rate	1.60%
Interest Margin	1.00%
Contribution Margin	0.42%

Checking	
Initial Balance	$1,000
Monthly Growth	$10
Fees Incurred Yearly	$30
Interest Rate	0.40%
Interest Margin	3.30%
Contribution Margin	1.36%

flex•one Account	
LTV Limit	98%
Interest Rate Charged	5.25%
Interest Rate Paid	2.00%
Income Tax Rate	25%
Payment Reduction	0%
Minimum Payment	1%
Loan Balances	
Interest Margin	1.17%
Contribution margin	1.07%
Deposit Balances	
Interest Margin	0.92%
Contribution Margin	0.87%

The interest margins are based upon a Kohl Group study done for one credit union. In the study, there is also a 25 CU peer group and the numbers from the peer group were used where possible for the margins, rates (on deposits) and expenses.

DETAILED MEMBER RECAP

	Current	flex•one Account	Favorable Differences
Average Mortgage Balance	$143,193	$130,478	$12,715
Mortgage Interest	$247,694	$220,832	$26,862
Mortage Interest (after tax)	$185,771	$165,624	$20,146
Average Auto Loan Balance	$760	$694	$66
Auto Loan Interest	$1,315	$0	$1,315
Average Credit Card Balance	$842	$1,468	-$626
Credit Card Interest	$2,533	$4,416	-$1,883
Average Equity Loan Balance	$29,419	$69	$29,349
Equity Loan Interest	$61,845	$0	$61,845
Equity Loan Interest (after tax)	$46,384	$0	$46,384
Average Total Loan Balances	$174,214	$132,710	$41,504
Total Loan Interest	$313,387	$225,249	$88,138
Total Loan Interest (After Tax)	$236,002	$170,041	$65,962
Typical Monthly Loan Payments	$2,401	$2,413	$12
Average Savings Balance	$34,442	$9,371	-$25,071
Interest Earned on Savings	$16,481	$5,427	-$11,055
Interest Earned (after tax)	$12,361	$4,070	-$8,291
Average Checking Balance	$2,483	$0	-$2,483
Interest Earned	$297	$0	-$297
Interest Earned (after tax)	$223	$0	-$223
Total Interest Earned	$16,779	$5,427	-$11,352
Total Interest Earned (after tax)	$12,584	$4,070	-$8,514
Fees Paid	$900	$0	-$900
Net Financial Impact to Member	-$297,508	-$219,822	$77,686
Net Financial Impact (after tax)	-$224,318	-$165,970	$58,348

DETAILED INSTITUTION IMPACT

APPENDIX B – Product Design

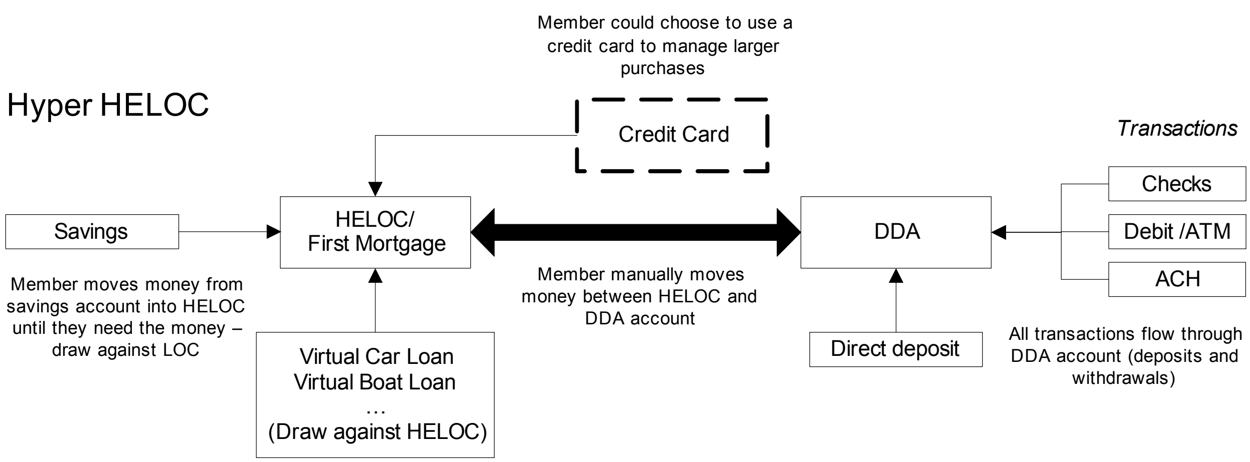
APPENDIX B – Product Design
PRODUCT DESIGN

Hyper HELOC: The first and most basic form of the flex•one account and the easiest to implement. There are no systems requirements beyond the ability to move money from an open-end home equity loan and a standard checking/share draft/demand account (DDA).

In this version of the f1, the member has two primary accounts: a HELOC and a DDA. The member manually moves money between the HELOC and DDA account based on their spending patterns. The direct deposit and all transactions post against the DDA and then the HELOC is used as a buffer to manage transactions. Usually a small balance would remain in the DDA account to cover normal monthly expenses, with transfers from the HELOC as needed.

The member could optionally use a credit card for certain purchases and then pay the balance off on a monthly basis via the HELOC. This maximizes float for the member (using a credit card with a grace period), but decreases the profitability for the credit union (decreased interest income).

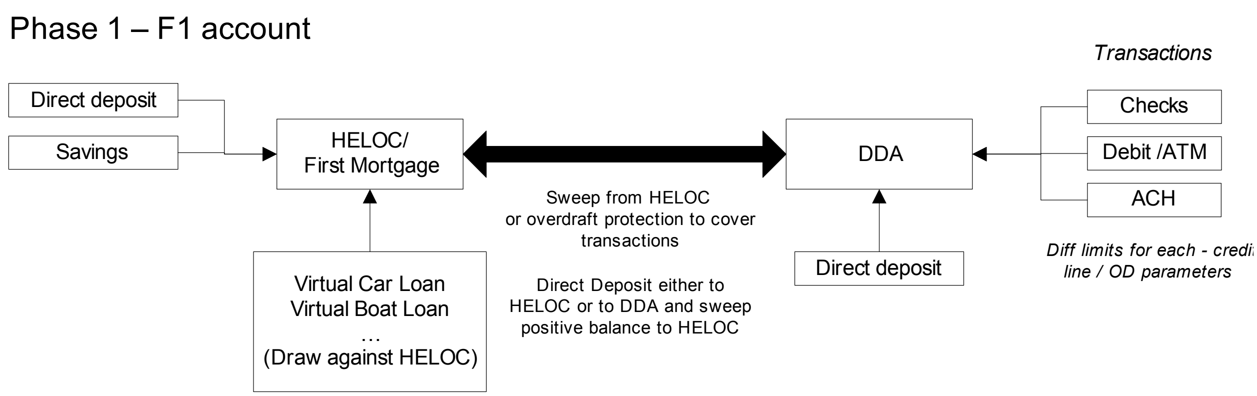
Clearly, this type of account is for a financially sophisticated user and actually requires no set up by the credit union (you may, in fact, have members using their HELOC and DDA this way today). It is an excellent place to start and begin to get your members and staff comfortable with the flex•one concept. Again, most of the effort in the Hyper HELOC stage is in marketing and education.



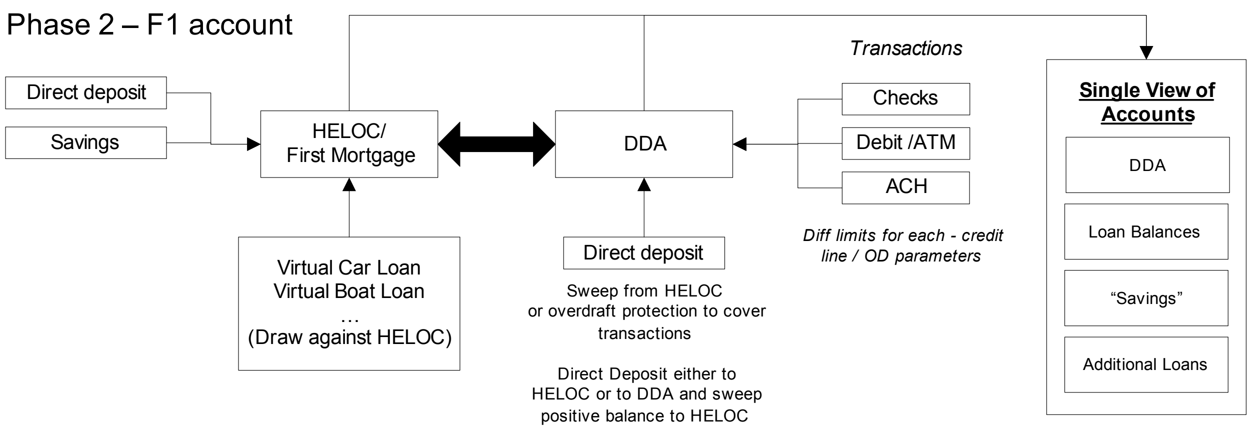
Phase 1: The next two phases have the most variants that could be implemented by a credit union. The flex•one Product Design Worksheet details many of the options that could be implemented between the Hyper HELOC and the full flex•one account. Phase 1 is distinguished from a Hyper HELOC primarily by the use of automation to manage the relationship between the DDA and the HELOC.

This can be accomplished multiple ways – using overdraft protection tools to sweep funds into the DDA on a nightly basis (which potentially requires a member move any deposits into a DDA to the HELOC), an automated back-office sweep (which resets the checking account to a zero nightly balance) or other ways to move the required money between accounts. In phase 1, direct deposit could be posted either directly to the HELOC or to the DDA (requiring a manual sweep or using automated tools to move from DDA to HELOC).

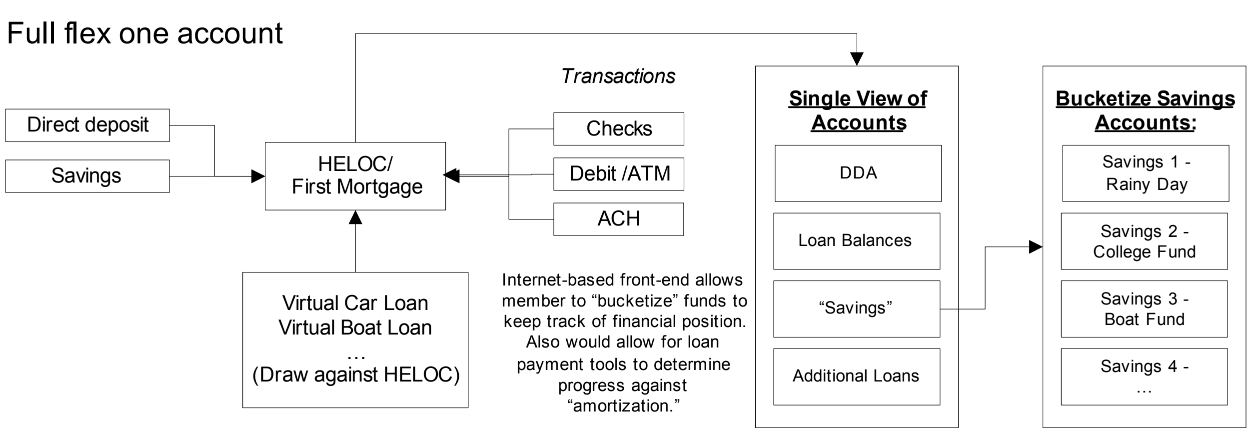
The key to phase 1 is to allow the member to maximize their yield by moving as little money as possible to the DDA on a daily basis. This can be accomplished many ways, but the importance is to make the account easy enough to allow a wider market to take advantage of the flexibility and convenience of a flex•one account.



Phase 2: This phase introduces new tools that the member uses to see a single view of their account through Internet-based banking tools and interactive voice response (IVR) systems. The back-office general ledger/data processing accounts are masked to the member through the use of technology. This will likely require custom programming to access systems (web-banking, IVR), but this will begin to allow more wide scale adoption as the member begins to have tools to manage the flex•one account, minimizing the need for a great deal of financial sophistication.



Full flex•one account: This account integrates all of the key pieces of the account—a single account to manage your financial life, a single view of your accounts, and the ability to use money management tools to better analyze and track where you are according to goals you define. Because there is no back-office sweeps between a HELOC and DDA, there is less complexity in the core system. This may be an advantage for credit unions looking to minimize technology and operational support for the product and may be implemented ahead of other tools.



APPENDIX C - flex•one Product Design Worksheet

Question	Subquestions	Issues	Decisions	Which flex•one?
Loan Setup				
1. Do you offer variable-rate HELOCs?	• Can you set up a first mortgage as a HELOC? • Can you offer HELOCs over 100% of available equity (120% or 150%) for those with the ability to repay? • Can you manage the appropriate reporting of tax-deductible interest payments? • Can you score first mortgage loans if they are set up as a HELOC? • Can you print the appropriate mortgage loan documentation?		• Amount of equity to allow for entire loan facility? (90 – 100% minimum; 100%+ recommended to allow for maximum flexibility)	If you offer variable-rate HELOCs and can set up your system to roll a first mortgage and HELOC into a single account, move on to question 2 to refine the servicing for your f1 account design.
2. How will you service the flex•one account (HELOC / first mortgage)? *Because the flex•one account is a non-conforming mortgage, you will need to keep this on your credit union's books (rather than sell to secondary market).*	• Servicing loans – how will the mortgage be serviced? • Escrow / Property Taxes – will you offer escrow, tax payment and insurance payment services? • City/County/State Filings – can you print the appropriate filing information from your HELOC "module"? • Can you support HMDA filings on borrowers, potential borrowers that submitted applications and denied applicants?	• Does your state have any compliance issues regarding escrow holdings, tax payments or servicing issues that could alter your flex•one account design?	• Will you offer escrow, tax and insurance payment services or require the member to manage this on their own through their flex•one account? • Does your flex•one design incorporate your members' mortgage servicing needs?	After determining loan servicing requirements, and if there are no regulatory issues that would prevent you from moving forward, move to question 3.

Question	Subquestions	Issues	Decisions	Which flex•one?
Loan Setup				
3. How will you handle "payments?"	• Loan "types" - Mortgage - Other loans • Multiple "payments" in a month (really multiple deposits to the account)	Interest calculations on payments (principal only, P&I, mixture) are likely determined by credit union policy and system capabilities. Applying interest once per month is the easiest method and most "member-friendly," although it does reduce the overall interest income to the credit union. There may be additional questions from members if they deposit $1,000 and only have a $987 posted due to interest calculated on that "payment."	• Interest calculation on first payment - Principal only - Principal and interest mixture • Will you handle "multiple payments" differently? Does your system even allow you to handle these differently?	Determine how you will handle payments and move to the System Capabilities section.

Question	Subquestions	Issues	Decisions	Which flex•one?
System Capabilities				
4a. Can your member access the HELOC through checks or debit card? 4b. Are these transactions posted via a file or real-time authorization (vs. manually posted)?	• What access vehicles do they have? - Checks - ATM / Debit • Can you limit the amount of "credit" they have access to?		• Will you set any limits on daily check clearing or debit/ATM card limits? • Will you let the member decide on limits or set a consistent policy?	4a. No – No – Hyper HELOC. Move to member tools section. 4a/b. Yes / No – Likely Hyper HELOC or Phase 1. Move to question 5. Yes / Yes – Likely Phase 1 or 2, move to question 5.
5. Can you support direct deposit / periodic ACH transfers to and from HELOCs?	Can you handle both ACH receipt (payroll) and ACH origination (bill payment, automated withdrawals)?		• Will you set any limits on ACH withdrawals?	No – Hyper HELOC. Move to member tools section. Yes – Move to question 6.
6. Can your data processing system automatically sweep between the HELOC and your checking / DDA accounts?	How will you accomplish the sweep for the member? - Overdraft protection - Automated sweep (usually batch or night process) - Other			No – Hyper HELOC with member manually moving funds between DDA and HELOC. Move to member tools section. Yes – Move to question 7.
7. Can your HELOC account handle both negative balances (loan) to positive balances (savings)?		When a member pays off all of their loans, they will move to a positive balance, which some systems cannot manage in a "loan" account. A credit union could move these to a money market-type account, especially if a member wants the first	• Will you allow members to stay in the flex•one after they move to a positive balance or will you move their positive balances to a money market-type account?	No – Phase 1 or 2 and decide how to handle positive balances. Move to question 8. Yes – Likely full f1 implementation (depending on member tools). Move to question 8.

		mortgage loan closed after repayment.		
8. Can your IVR provide information from the HELOC?	• Balances • Transactions • “Payments”	IVR functionality is a critical function for phase 1, 2 and full f1.		No – Hyper HELOC. Move to member tools section. Yes – Move to question 9
9. Can you generate custom statements to reflect this complex transaction activity between buckets?	• Can you provide a monthly status on the member’s position against their entire “facility” (line of credit)? • Can you provide progress against a member-defined payment goal?	The compliance issues surrounding statements are important to consider. While also a member tool for reconciling the account, the statement likely needs to provide all of the activity (even if there is a back-office sweep) to allow members to keep their accounts balanced.	• How will you handle statements to the member – integrated (single view) or by each separate account (HELOC, DDA)?	No – Phase 1 or Phase 2. Move to member tools section. Yes – The system capabilities are in place for a full f1 account. Move to member tools section.

Question	Subquestions	Issues	Decisions	Which flex•one?
Member Tools				
10. Does your web banking system allow for transfers from DDA to HELOC?		This is only needed for the Hyper HELOC design.		No – Limited Hyper HELOC. Members will need to call your IVR / branch / call center to move money. Yes – Preferred for Hyper HELOC to allow member to manually move money between accounts. **Hyper HELOC design complete.** If your flex•one design allows for posting of transactions to the HELOC system account, move to question 11.
11. Can your web banking system show daily transaction on HELOC activity (DDA-type activity)?		This is only relevant for phase 1 and phase 2 flex•one account designs.		No – Phase 1. You will likely still need to have both a DDA and a HELOC account for a member. Yes – Phase 2 or full f1. Move to question 12.
12. Can you “mask” multiple back-end accounts to create a single account view?	- Consolidated statement - Lending facility position” - Transactional info - Progress against repayment goal			No – Phase 1. You will likely still need to have both a DDA and a HELOC account for a member.

				Phase 1 design complete. Yes – Phase 2 or full f1. Move to question 13.
13. Will your members have access to services from the HELOC system account? - Bill payment - Could you wrap an A2A ACH payment product to replace checks?		Optional services will enhance a phase 2 or full flex•one account design.		Yes / No – Move to question 14.
14. Do you have money management tools to organize or "bucketize" transactions into different sub-accounts (i.e. Quicken / Quickbooks)?	• Can a member organize their information into different phantom accounts (savings for college, boat fund, etc)? • Do you offer reconciliation tools for the member? • Can you track the repayment progress against a member-defined goal?			No – Phase 2 **Phase 2 design complete.** Yes – Full f1 **Full flex•one account design complete.**
Additional Considerations				
Do you need or want to have additional collateral protection (i.e. car on car loan)?			• How will you handle the potential need for additional collateral on various types of loans?	
Does your branch / call center have access to same information as your member?	• Does your core system show a single view of the account? • Can your employees access a view similar to the web banking view your members will see?			

Appendix D – Survey Findings

Findings from the i3 survey of Member Opinions on Aggregated “OneAccount”-Type Programs

An online survey of credit union members was conducted between January and February, 2005 to assess general interest in the notion of a new “combined account” that would aggregate the owner’s loans and deposits, aiming at debt reduction and finance charge avoidance.

There were 1,243 respondents from nine credit unions, geographically dispersed across the U.S.

Below is an executive summary of the findings:

1. Overall interest in this type of account is moderate. While just 12.1% of respondents said that they would be “extremely likely” to use this kind of combined account, another 31.3% said that they were “somewhat likely”—bringing overall interest to 43.4%.

2. Low interest rates and convenience drive the market’s interest. Respondents gave low rates an overall score of 2.24 (lower is better, 1.00 is best possible, 6.00 is worst). Convenience was a close second, scoring 2.64. Other benefits were less enticing: accelerated repayment scored 2.98, tax advantages scored 3.36, flexibility rated 4.28, and improved cash flow management rated 4.67.

3. Geographic differences are fairly trivial. Respondents at all credit unions said that they were extremely or somewhat interested in a combined account between 40 and 50 percent of the time. The sole outlier: Spokane Teachers Credit Union, where combined interest was a humble 34.7%.

4. Attitude toward adjustable-rate mortgages strongly correlates with combined accounts. 57.0% of respondents who said they’ve owned an adjustable-rate mortgage (ARM) expressed interest (extreme or somewhat) in a combined account. Just 40.7% of those with no ARM experience expressed a similar interest. An even more striking correlation emerges between respondent’s likelihood of using an ARM and their likelihood of using a combined account. Fully 33.9% of those extremely likely to use an ARM said they were also extremely interested in a combined account, well above the overall 12.1% interest level.

5. Respondents who own mortgages showed higher interest than those who don’t. This one is probably obvious. 49.7% of those who owned mortgages expressed interest in the notion of combined accounts, just 35.4% of renters and those who have paid off mortgages are interested.

6. Those with higher-than-market mortgage interest rates showed interest in combined accounts. Again, not much surprise—teased by the prospect of a lower rate, 61.7% of those who perceived their current mortgage interest rate to be significantly higher than the market rate took an interest in combined accounts. Just 43.3% and 47.6% of those with somewhat or significantly lower-than-market rates expressed an interest.

7. Those with MORE variability in their income and bills had a somewhat higher interest in combined accounts. While the differences are fairly modest, the result seems counterintuitive. One might suspect that those with more variability would prefer more latitude in the disposition of their interest earnings than the combined account offers. The survey results suggest otherwise.

8. Aside from very low income suppressing interest in combined accounts, demographic differences are quite slight. Differences in net worth position (debtor vs. saver) and age, as well as differences

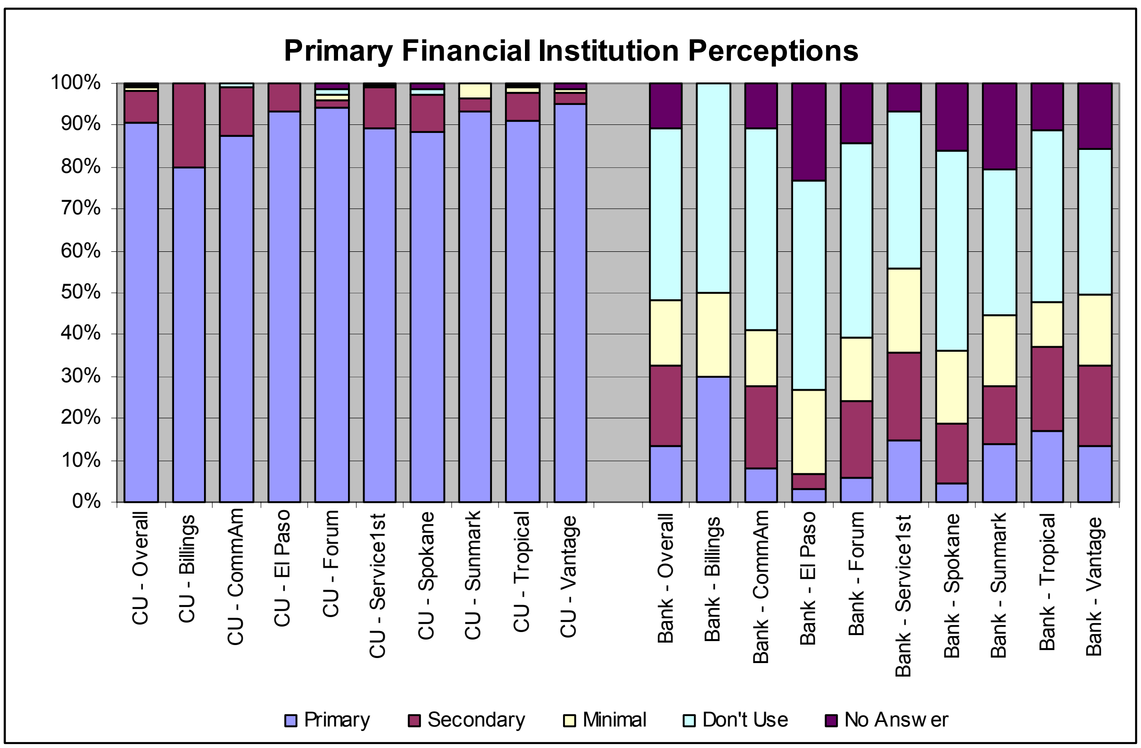
in income above $30,000 are hardly striking. Indeed, alongside other factors like ARM usage and mortgage ownership, they seem almost insignificant.

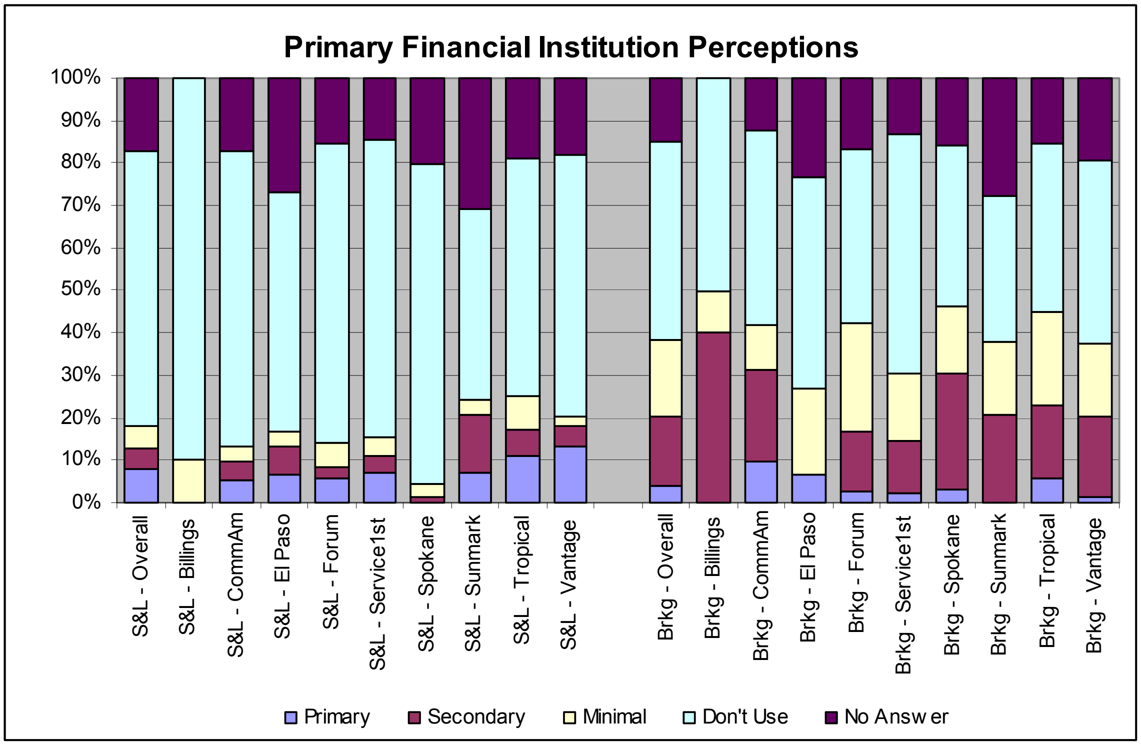
Regional Similarities

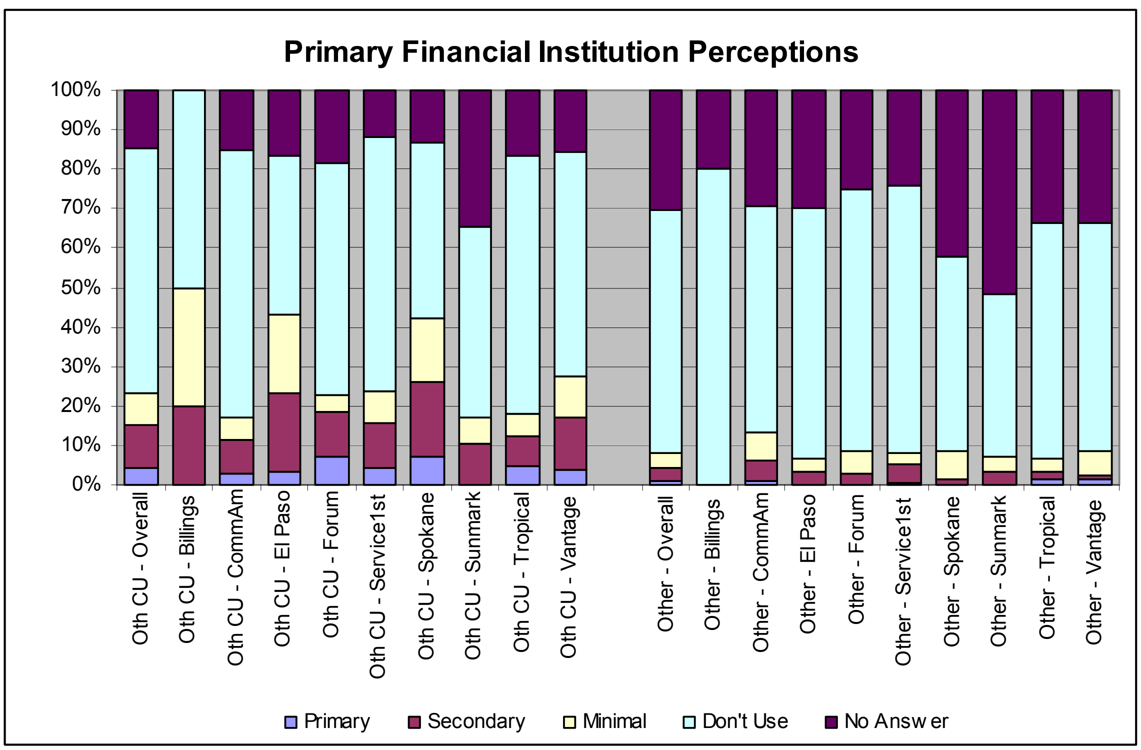
With few minor exceptions, differences among credit are easiest explained by a few with rather small sample sizes, and far less by any variations in geography or membership base. As you view the summary information that follows, please keep in mind that the credit unions that tend to deviate most from the overall average—Billings, Sunmark, and GE El Paso—are those whose survey sample was smallest (10, 29, and 30 survey responses, respectively).

Primary Financial Institution Perceptions

The results clearly indicate that respondents view the credit unions hosting the survey as their primary financial institution—90% of the time they were marked as primary. But the loyalty is also as clearly less than perfect—when a bank relationship was present, it was primary or secondary nearly 30% of the time. Brokerage relationships also run deep when present, but relationships with other credit unions and savings and loans seem to be less a threat.

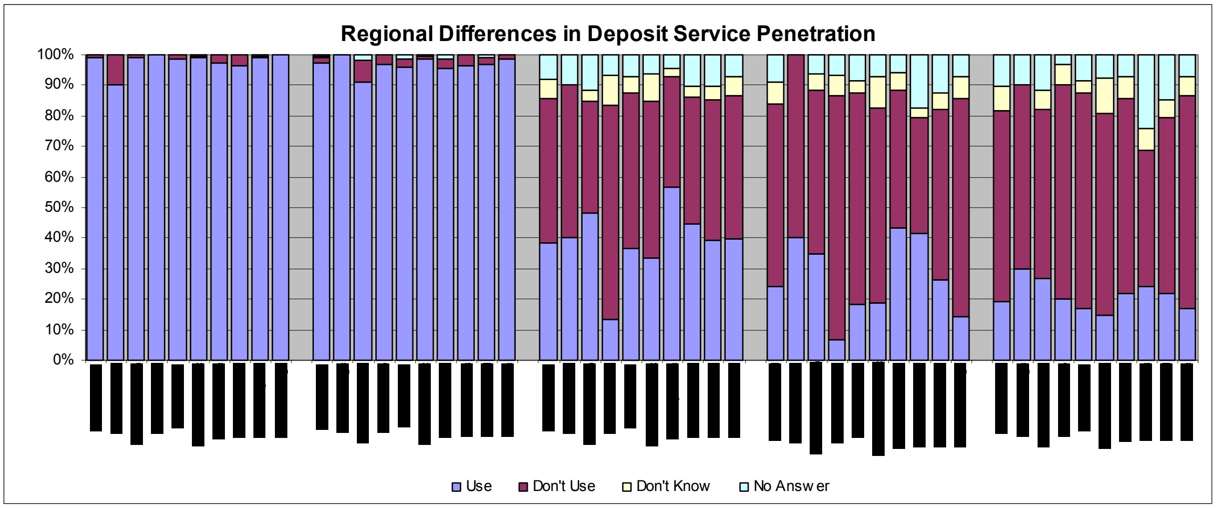



Primary Financial Institution Perceptions
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
S&L - Overall
S&L - Billings
S&L - CommAm
S&L - El Paso
S&L - Forum
S&L - Service1st
S&L - Spokane
S&L - Sunmark
S&L - Tropical
S&L - Vantage
Brkg - Overall
Brkg - Billings
Brkg - CommAm
Brkg - El Paso
Brkg - Forum
Brkg - Service1st
Brkg - Spokane
Brkg - Sunmark
Brkg - Tropical
Brkg - Vantage
Primary
Secondary
Minimal
Don't Use
No Answer

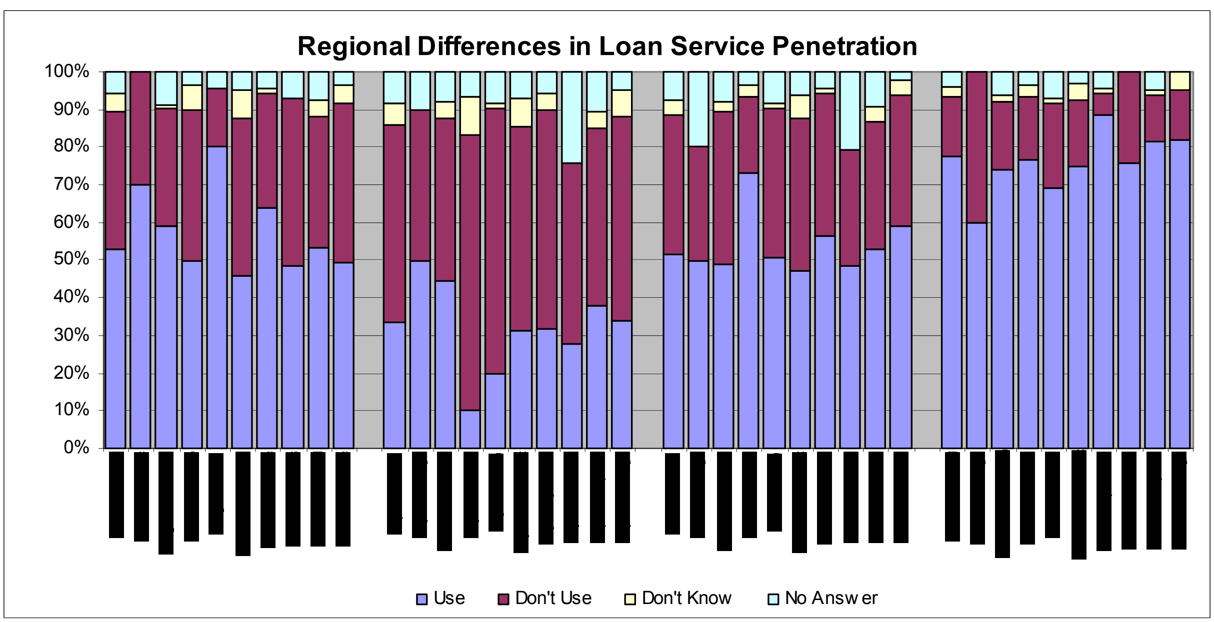

Primary Financial Institution Perceptions
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Oth CU - Overall
Oth CU - Billings
Oth CU - CommAm
Oth CU - El Paso
Oth CU - Forum
Oth CU - Service1st
Oth CU - Spokane
Oth CU - Sunmark
Oth CU - Tropical
Oth CU - Vantage
Other - Overall
Other - Billings
Other - CommAm
Other - El Paso
Other - Forum
Other - Service1st
Other - Spokane
Other - Sunmark
Other - Tropical
Other - Vantage
Primary
Secondary
Minimal
Don't Use
No Answer

Service Penetration

However difficult to read, the graphs below show nearly all survey respondents own and use savings and checking accounts (usage is shown in blue in the first two sets of columns)—99.0% and 97.1% respectively. Rounding out the top graph, overall usage of IRAs, money market accounts, and certificates of deposit are less, but still respectable: 38.4%, 24.1%, and 19.1% overall, respectively.

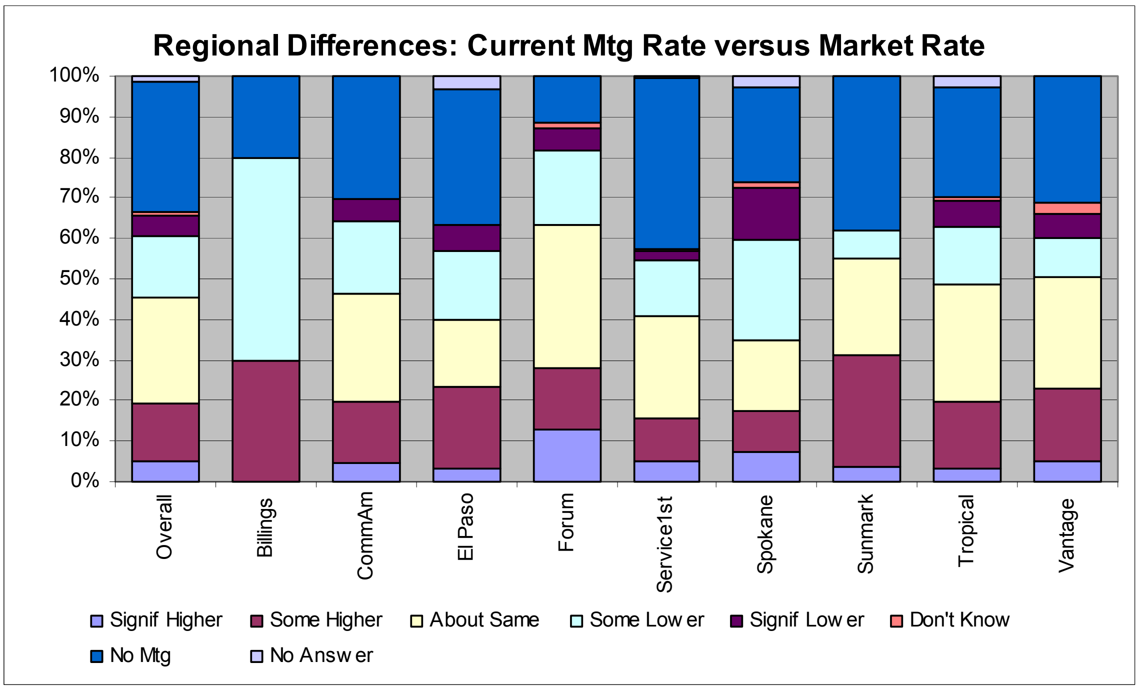


The graph below illustrates that borrowers made up their share of the survey. Overall, mortgage loans, equity loans, vehicle loans, and credit cards are owned by 52.9%, 33.6%, 51.4%, and 77.7% of survey respondents, respectively.



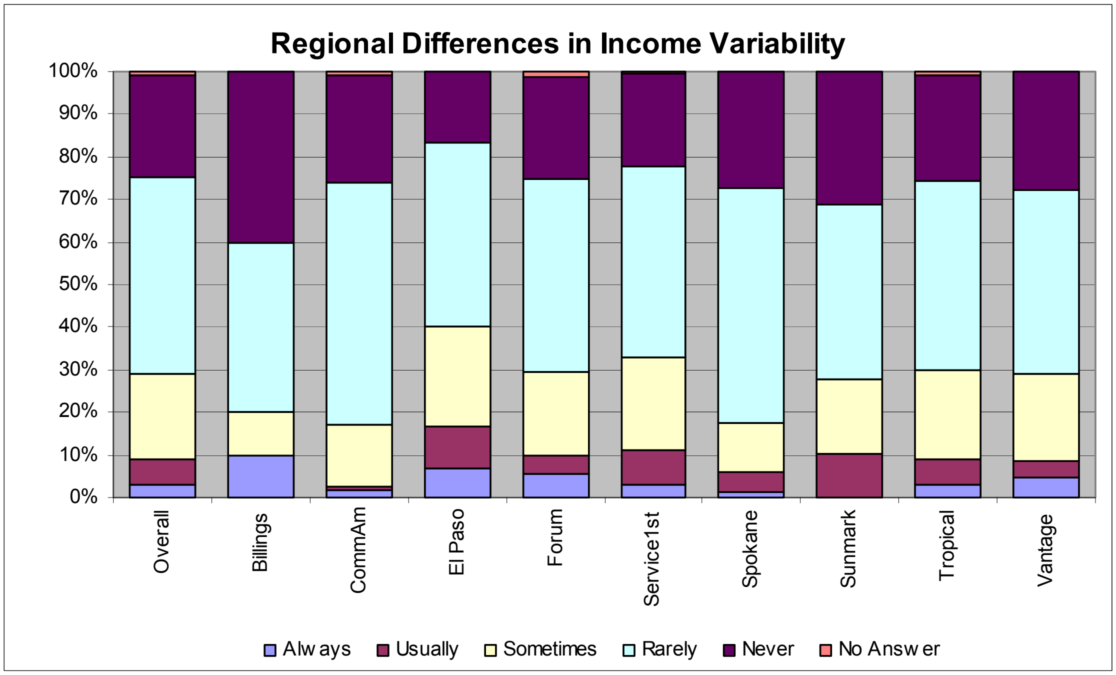
Mortgage Interest Rates

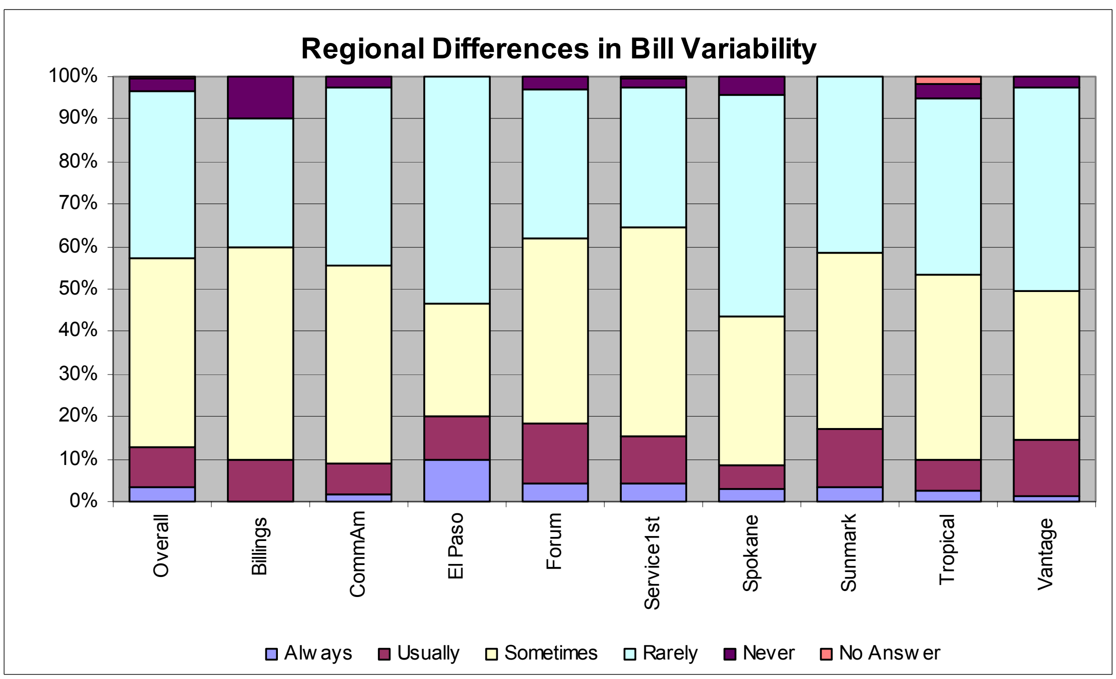
Despite our emergence from the recent mortgage refinancing boom and a slow increase in rates, respondents have a balanced view of their current rate relative to the market. In nearly all credit unions with large numbers of survey respondents, perceptions form a bell-shaped curve—with about the same percentage saying their rates are significantly higher as significantly lower, about the same percentage saying their rates are somewhat higher as somewhat lower, and a hefty percentage reporting their rate is about the same as the market. If there is an outlier, it's again Spokane. There those who report lower than market rates outnumber those reporting higher by about two-to-one.



Income and Bill Variability

Incomes of respondents enjoy a healthy stability—overall, slightly more than 70% said their income fluctuates rarely or never. Monthly bills aren't quite as predictable: between 40 and 50% said costs fluctuate rarely or never, with "sometimes" accounting for the difference.

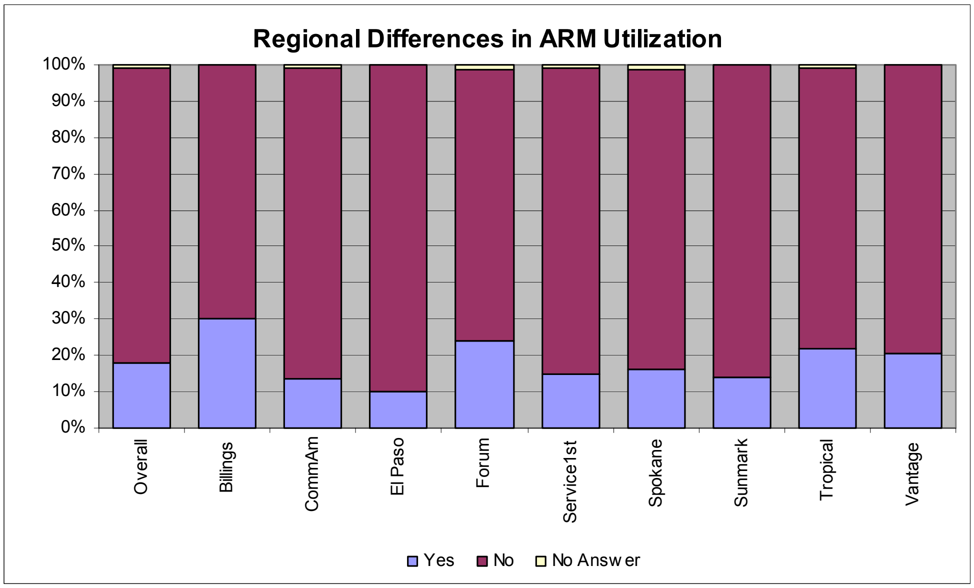




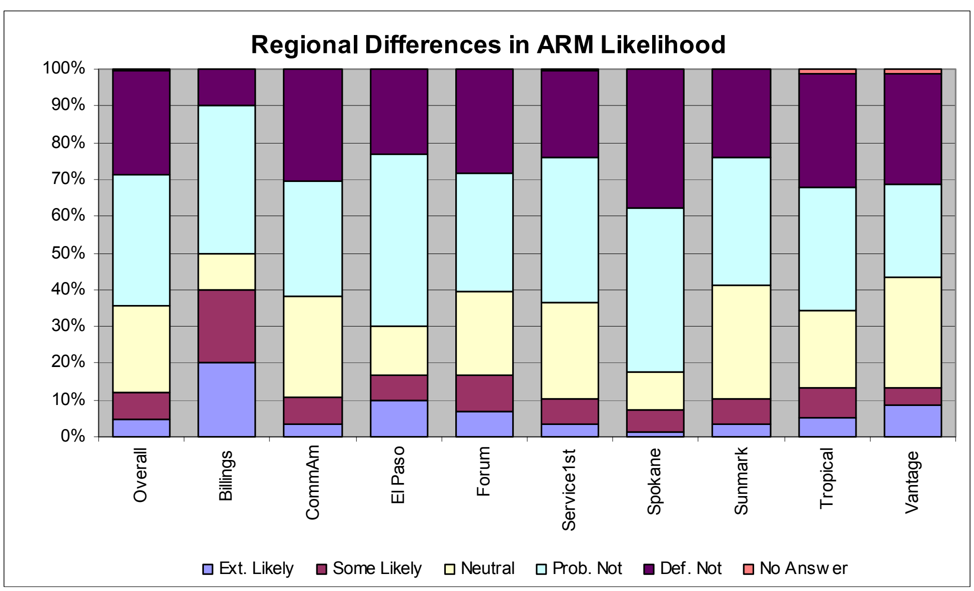
As noted in the introductory summary, one might normally have figured this general stability to reflect well on a combined account where steady, dependable debt reduction was a motivation. Strangely, as we'll see later, those with most variability showed greatest interest in the combined account.

Adjustable-Rate Mortgages

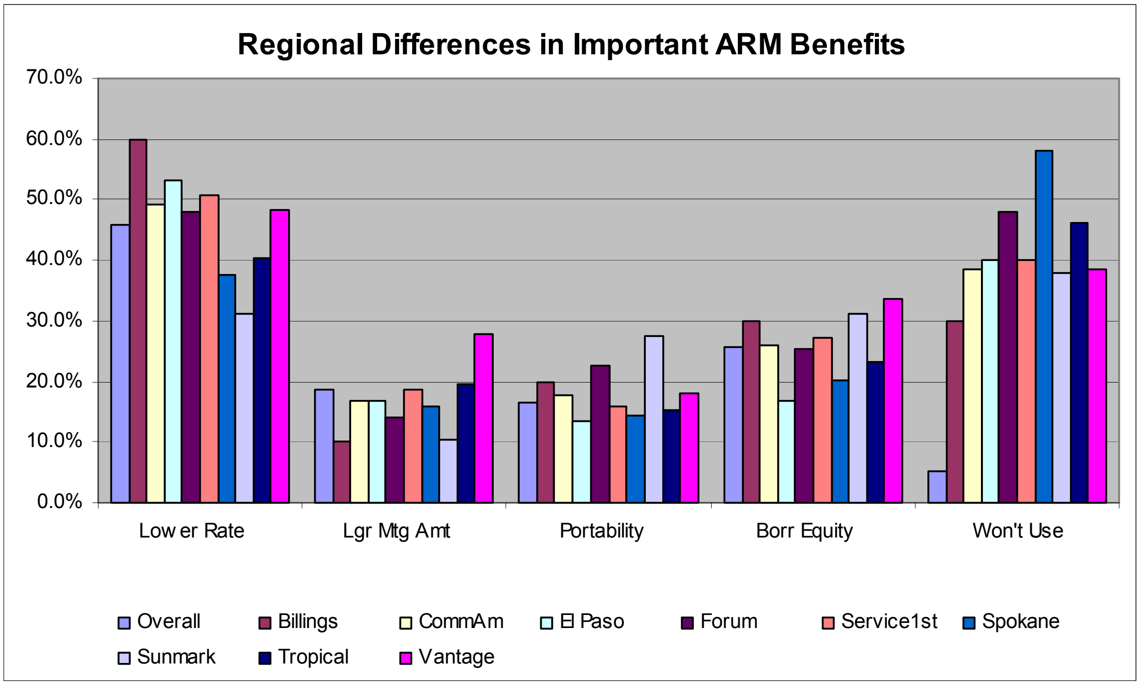
Between 10 and 20 percent of survey respondents report having experiences with ARMs, a product with some important attributes similar to the combined account being considered.



Curiously, while we'll see later that interest in combined accounts clocks in at somewhat over 40%, only 10 or 15% of survey-takers said they were extremely or somewhat likely to use an adjustable-rate mortgage.



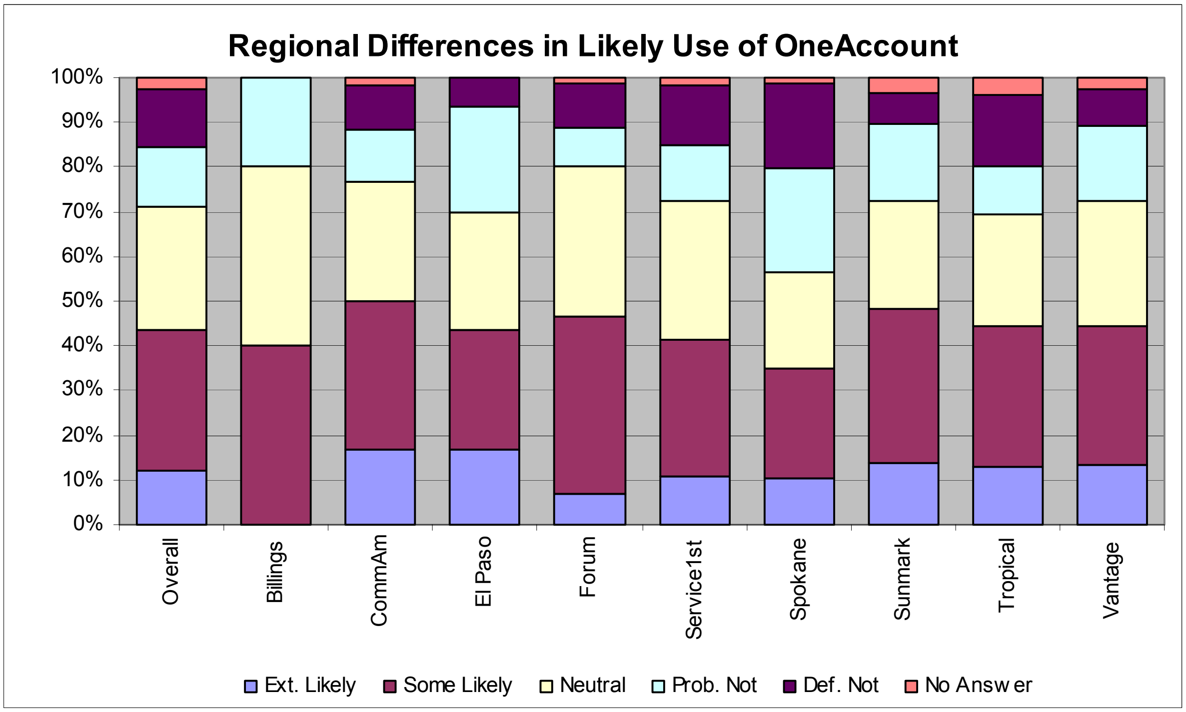
Parallel to the preferences noted for combined accounts, those who would consider ARMs are most interested in the rate advantages they offer—that cited as a reason for interest nearly twice as frequently as other benefits.

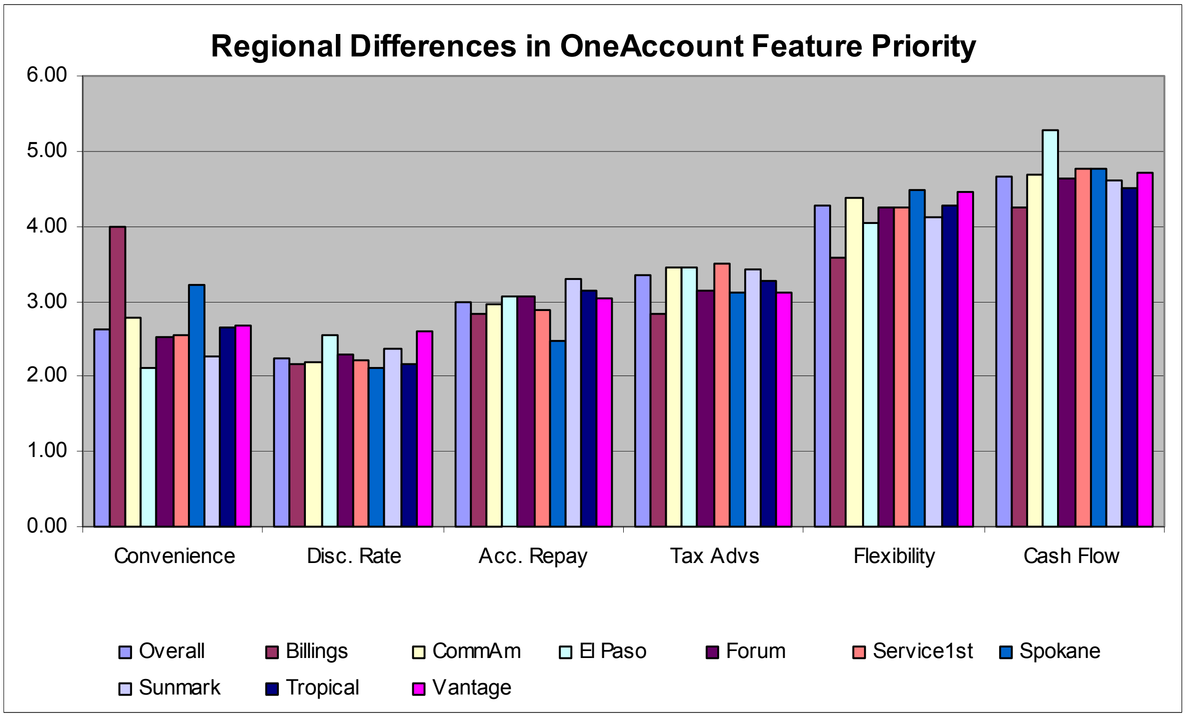


Interest in the OneAccount Concept

Whether it's because of innate difference between combined accounts and ARMs, or whether it was an unfairly rosy image painted in the survey, respondents show very respectable interest in the notion of an account that combines deposits and loans to aid in simplifying finances and securing low rates.

Between 40 and 50 percent of credit union members surveys are generally favorable to the idea of a combined account. Interest by STCU members is notably lower, however, perhaps correlating to the strong, unique perception in that marketplace that members' current mortgage rates are already very low.

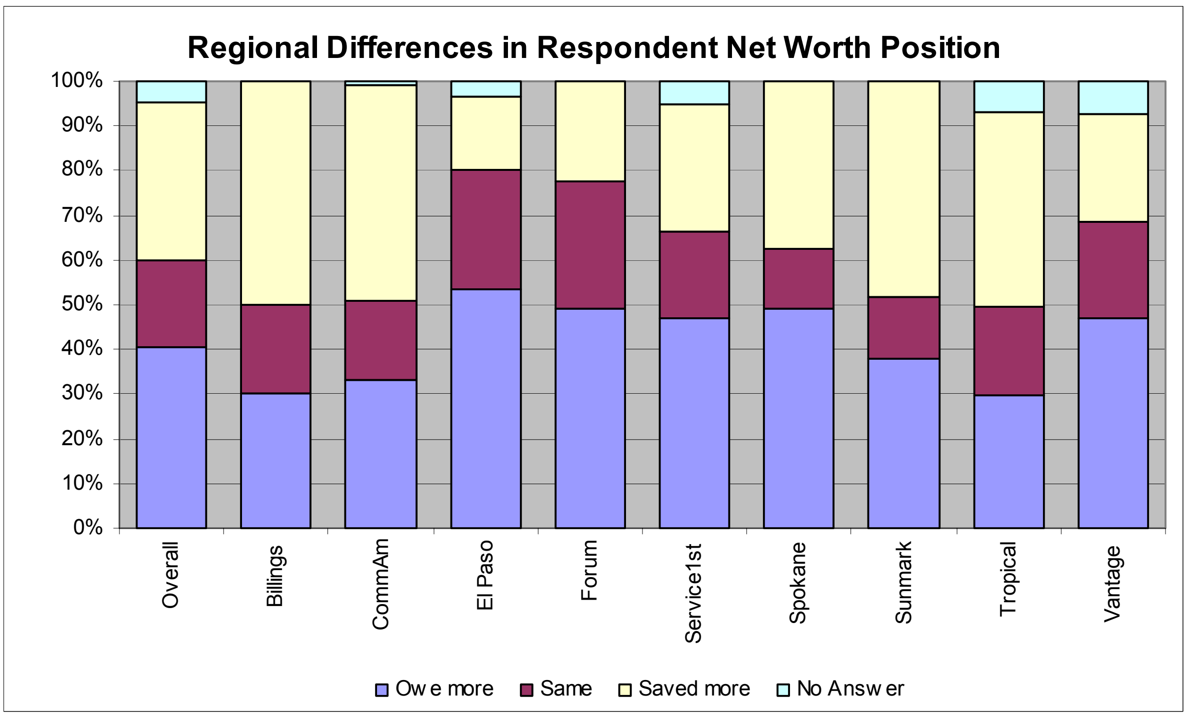




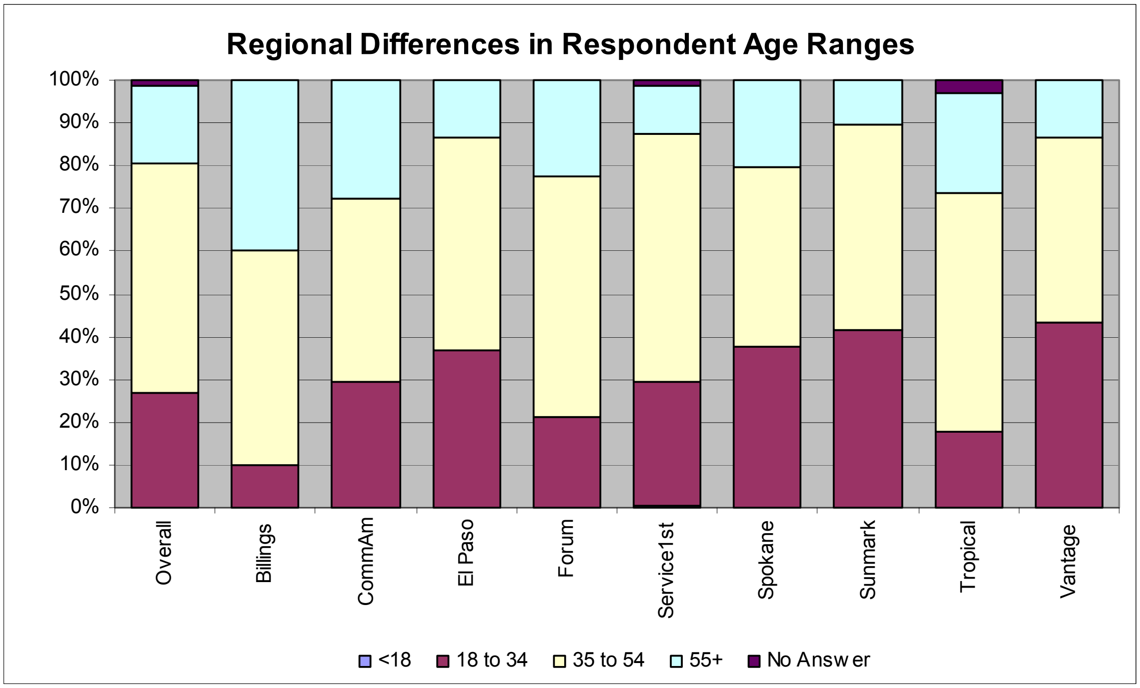
In cross-tabulating respondents' opinions about OneAccount features against all other survey questions, virtually no differences emerged. In all cases, rate and convenience led accelerated repayment, tax advantages, flexibility and cash flow in near-perfect mirrors of the chart above. So while different groups were more or less interested in combined accounts as a concept, everyone was in agreement as to what benefits of combined accounts took priority.

Demographic Profile of Respondents

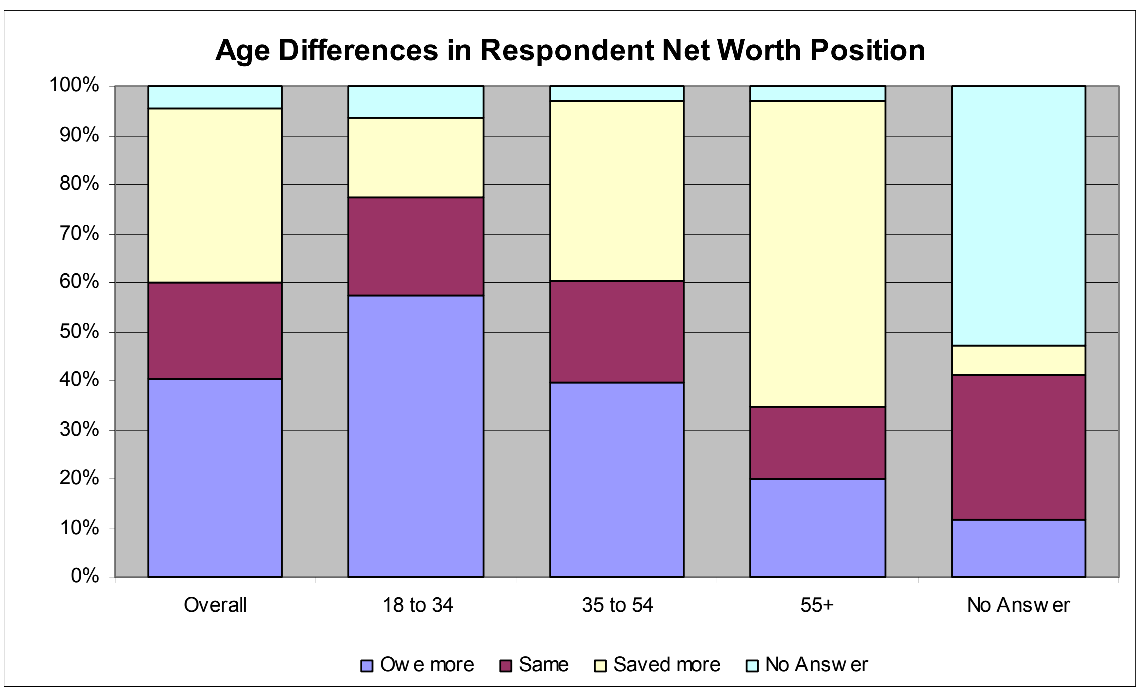
Interestingly, it's in their net worth position that respondents tend to show some geographic variability. Overall, the split between net borrowers and net savers is very close (40.4% vs. 35.3%) with 19.6% of survey-takers reporting savings and loans balancing out. But members of Billings, Community America, Sunmark, and Tropical report a decided bias toward savings; members of GE (El Paso), Forum, Service 1st, and Vantage have greater indebtedness.



One would be correct to assume these net worth differences are related to the age distribution of respondents from each credit union—those with younger respondents get a borrower bias, those with older respondents have a weighting toward savers. If the correlation is somewhat foggy in the chart of geographic differents, it's patently obvious when graphing net worth position directly against age.

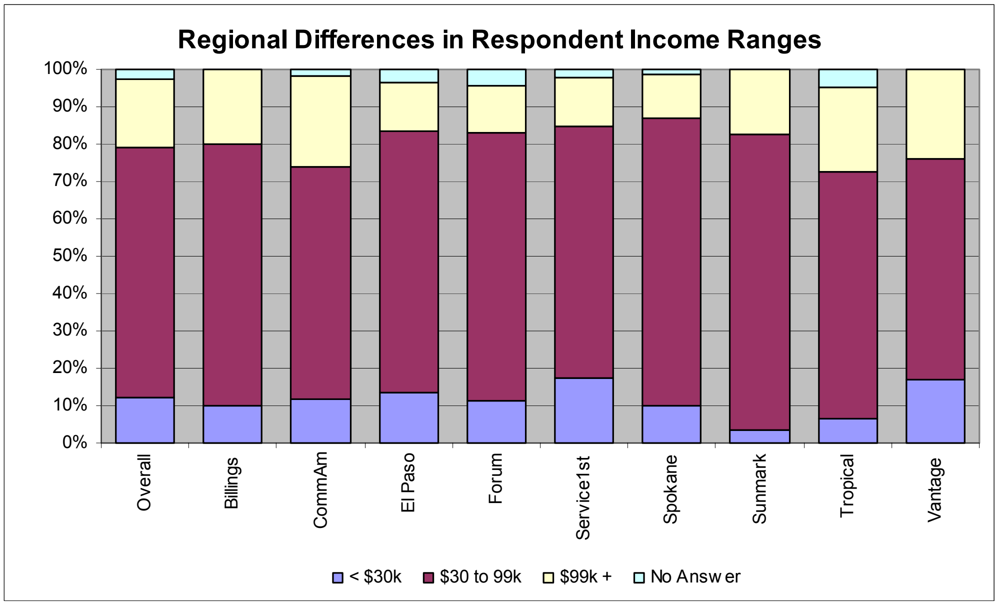


Regional Differences in Respondent Age Ranges
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Overall
Billings
CommAm
El Paso
Forum
Service1st
Spokane
Sunmark
Tropical
Vantage
<18
18 to 34
35 to 54
55+
No Answer



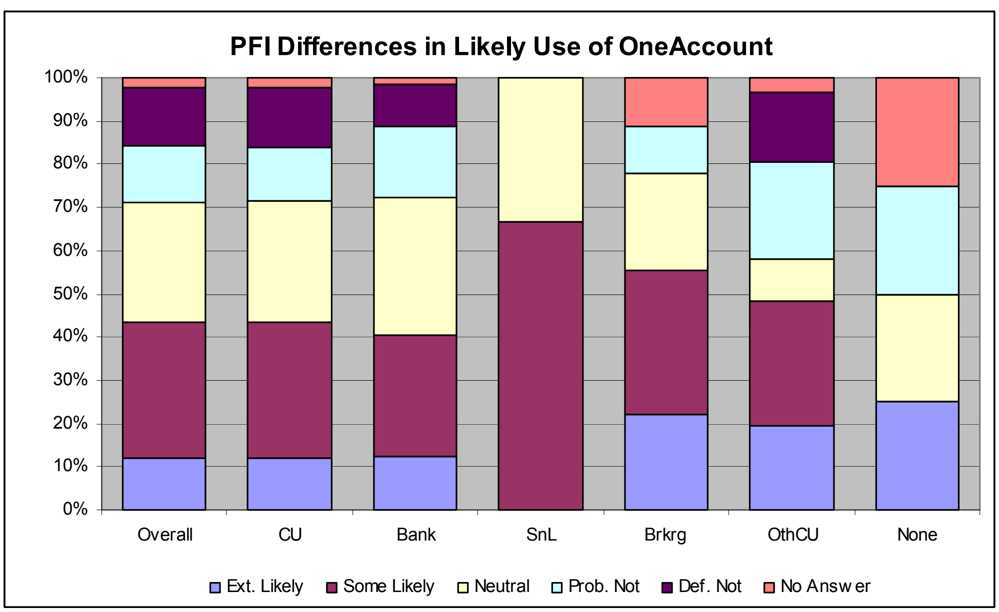
Age Differences in Respondent Net Worth Position
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Overall
18 to 34
35 to 54
55+
No Answer
Owe more
Same
Saved more
No Answer

Finally, income distributes fairly evenly among survey respondents, with a great majority falling into the middle $30,000 to $99,000 income range. With respect to income, there seems to be less variability geographically.



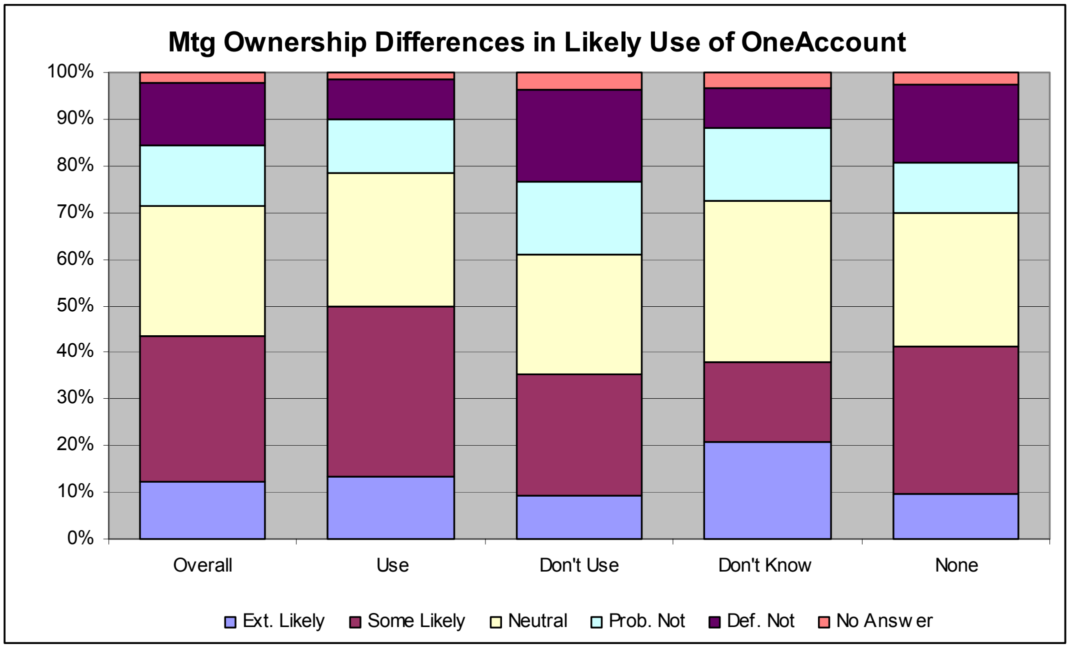
Primary Financial Institution Perceptions and OneAccount Appreciation

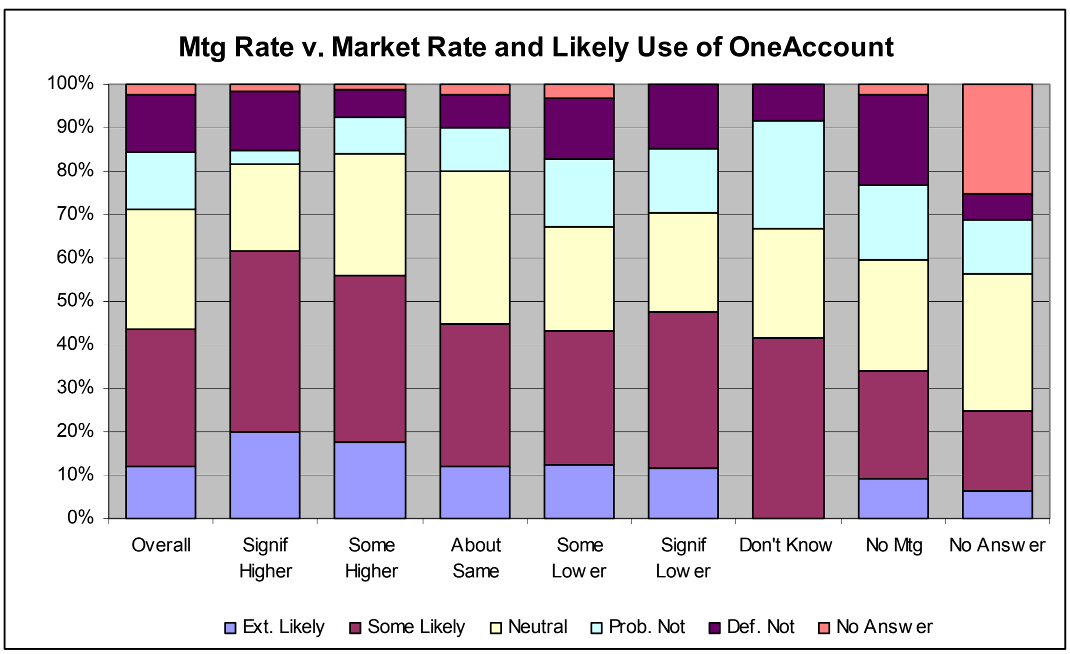
Disregarding those categories with unreliably small samples (savings and loans and other credit unions), there appears no material relationship between the kind of institution that respondents consider to be primary, and their interest in OneAccount type programs.



Mortgage Loan Users

As noted in the introductory summary, there is a clear indication that folks who have a current mortgage loan are significantly more interested in combined accounts than those who don't. Those without mortgages were more than twice as likely to say they're "definitely not" interested (19.8% to 8.8%). Those with mortgages were 40% more likely to be somewhat or extremely interested in combined accounts (49.8% to 35.4%).

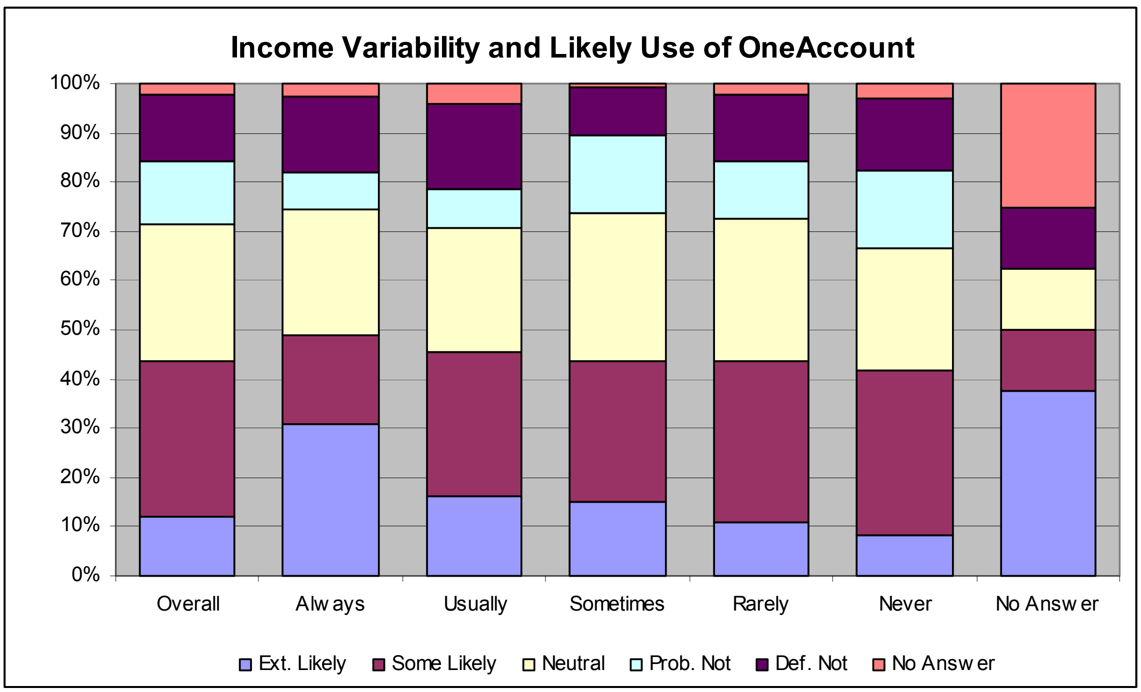


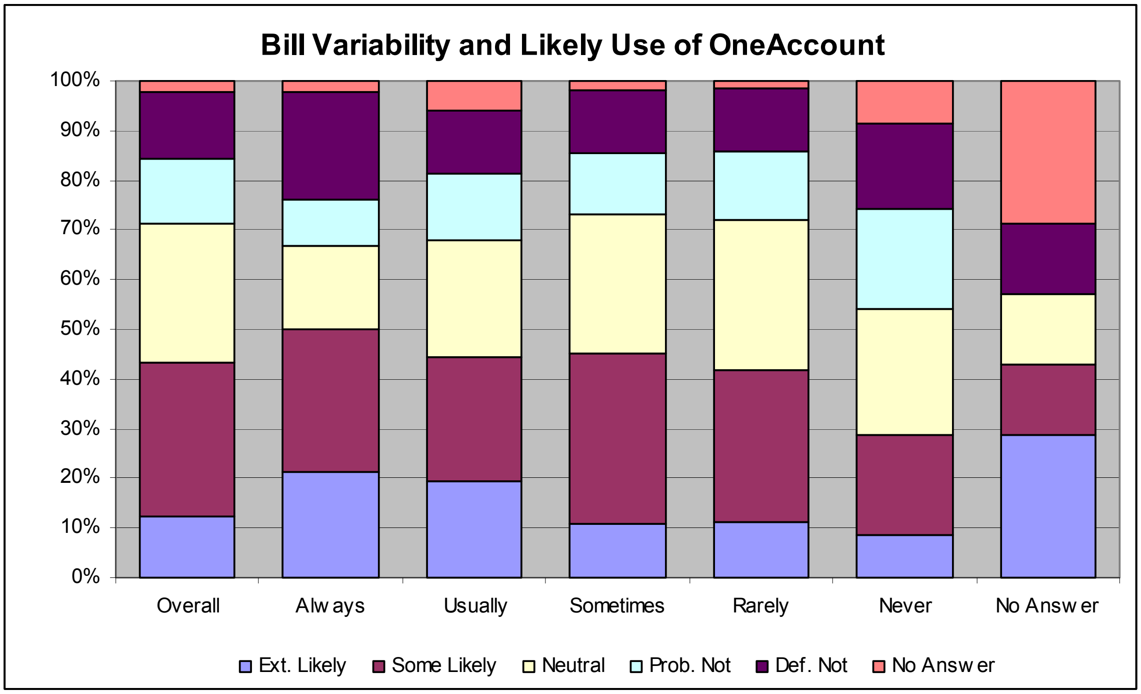


For those with mortgages, greatest OneAccount interest seems to be harbored by those who perceive their rate to be high, relative to the marketplace. Both "extremely likely" and "somewhat likely" responses are elevated for those groups. Strangely, those who believe their rate to be "significantly lower" than the market register a stronger "somewhat likely" interest than those with rates that are about the same or somewhat lower than the market—the only aberration in an otherwise clear correlation.

Income and Bill Variability

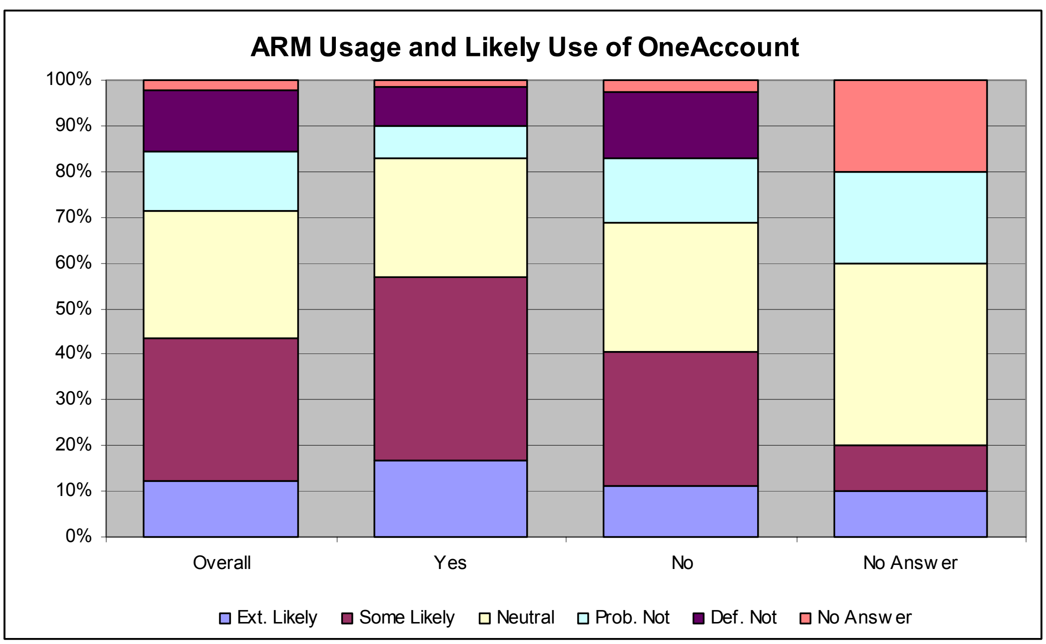
Why are those who report constant variability in their income and bills measurably more interested (in the extreme instance, anyways) than those with predictable incomes and bills?

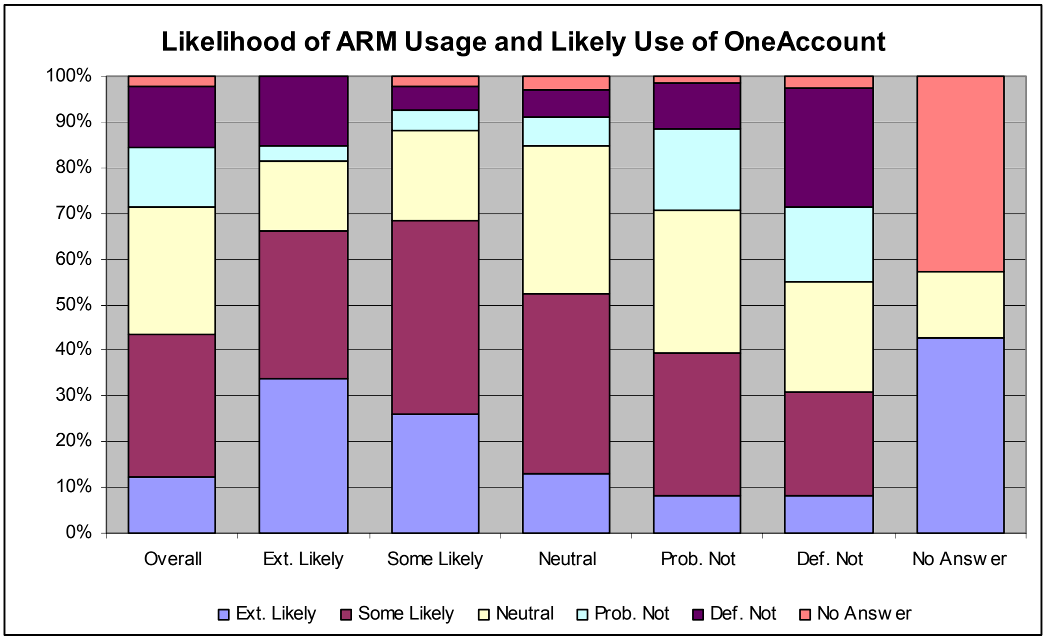




Attitudes toward ARMs

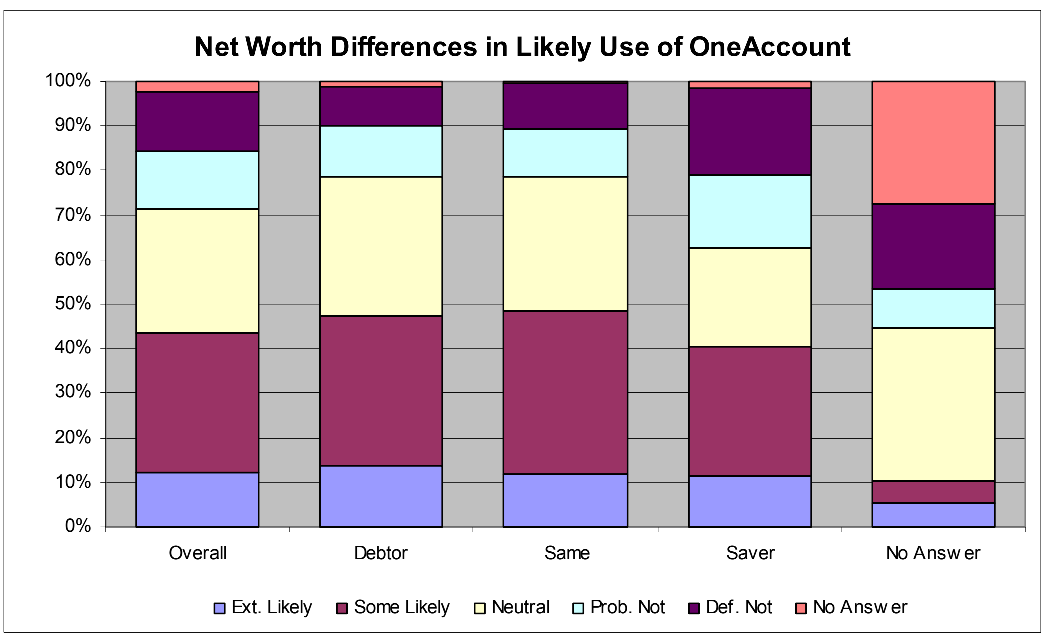
As strong as any other cross-tab relationship, respondents experience with and favorable attitude toward ARMs is a predictor of their likelihood of using a OneAccount-type product. This finding helps us properly position the combined account—it's far more likely to be perceived as a niche service similar to ARMs, and far less likely to carry broad appeal.

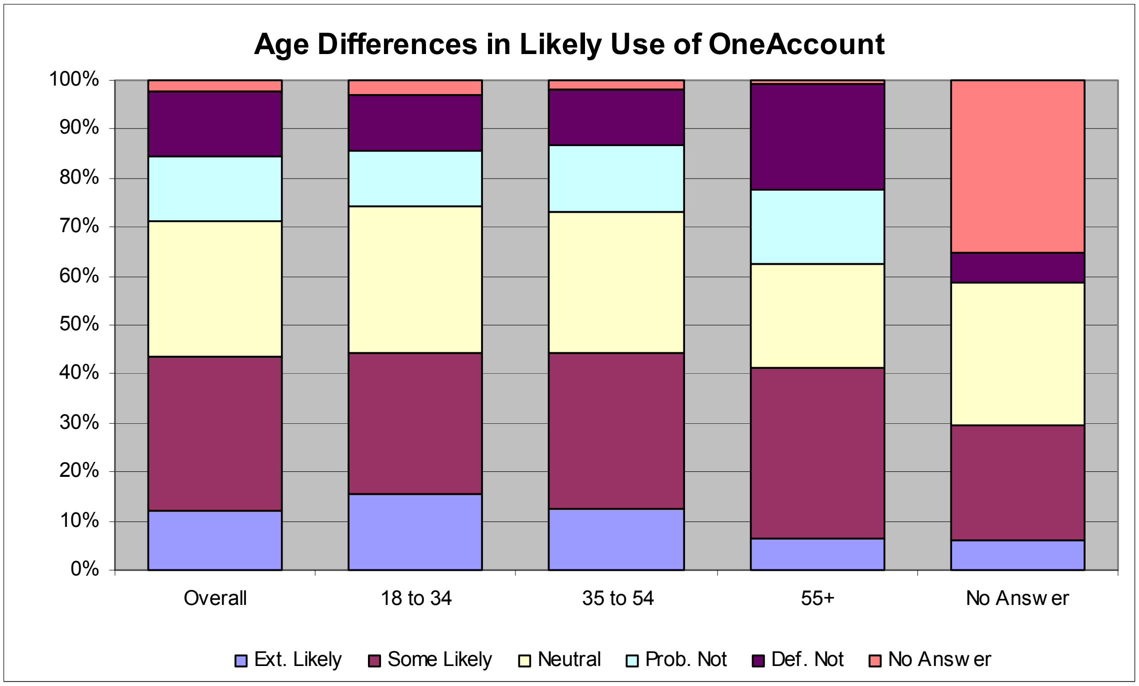


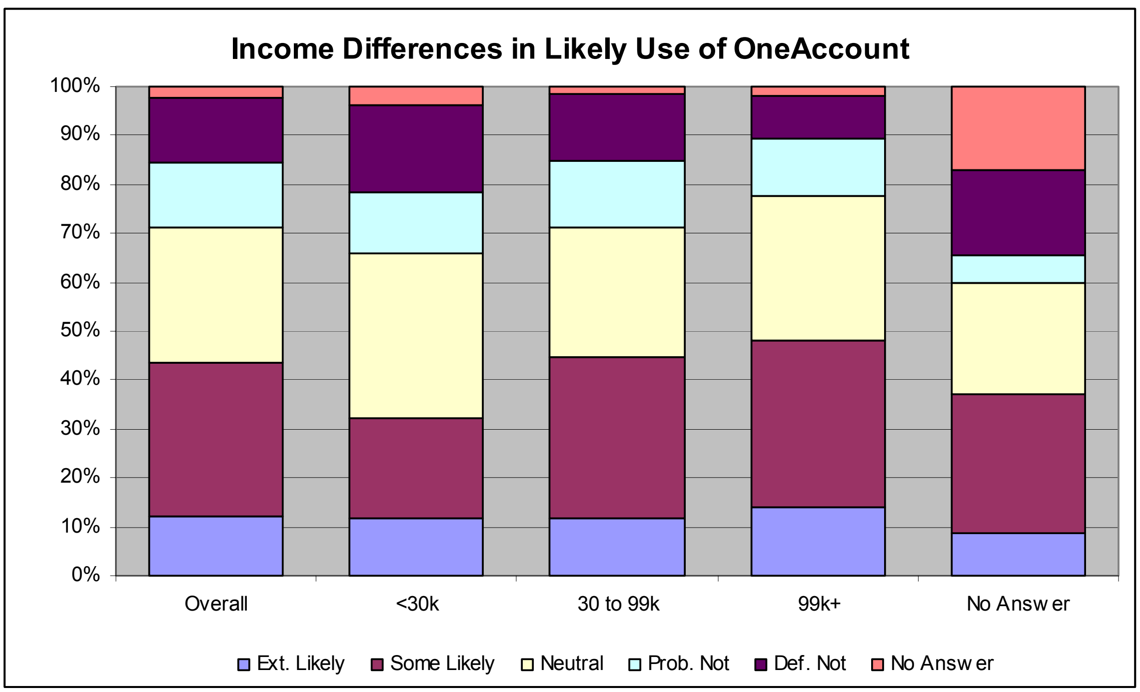


Demographics

Aside from older (55+) savers reporting in with a larger-than-typical "definitely not" disinterest in combined accounts, there are very few insights to be drawn when we look at net worth position, age, and income. Those with under $30,000 in household income show somewhat less enthusiasm for combined accounts as well, but that may be a simple reflection of their weak qualification for mortgages of any kind.

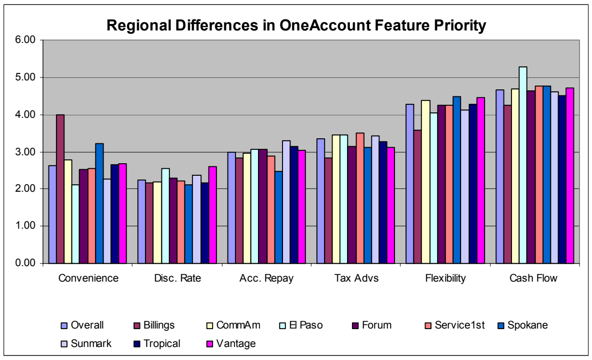


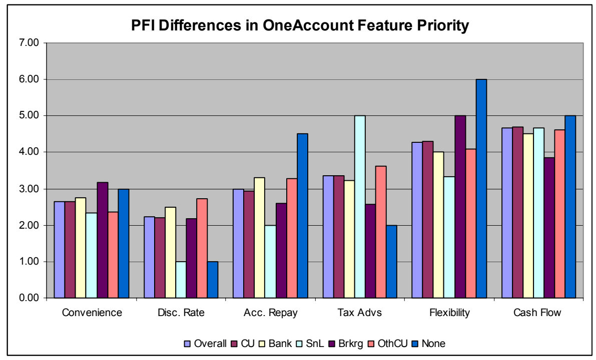

Age Differences in Likely Use of OneAccount
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Overall
18 to 34
35 to 54
55+
No Answ er
Ext. Likely
Some Likely
Neutral
Prob. Not
Def. Not
No Answ er

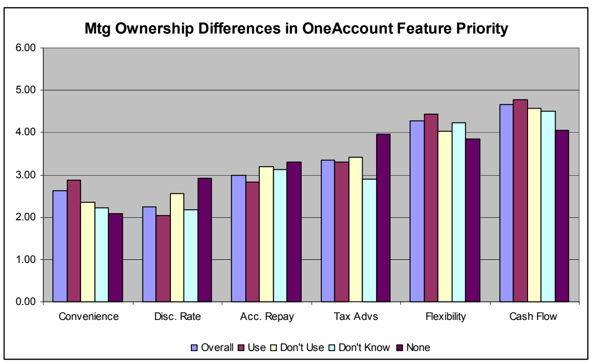

Income Differences in Likely Use of OneAccount
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Overall
<30k
30 to 99k
99k+
No Answ er
Ext. Likely
Some Likely
Neutral
Prob. Not
Def. Not
No Answ er

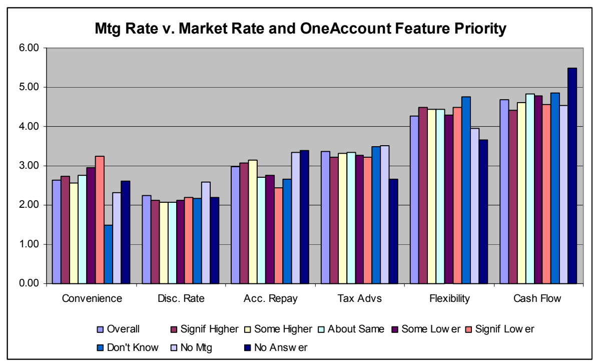
OneAccount Features: A Universal Consistency of Opinion

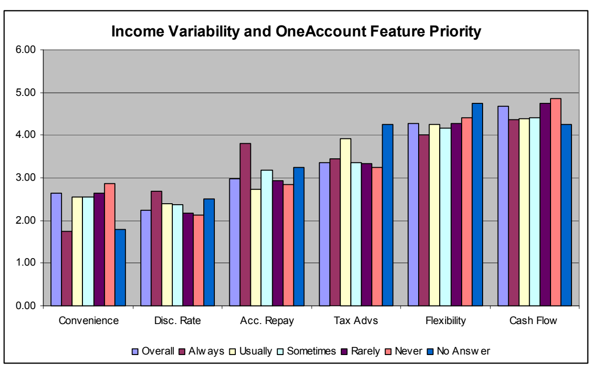
What OneAccount features are most enticing to survey respondents? Slice and dice them any way you want, the answer is exactly the same: low rate and convenience. More sophisticated features seem to be lost to the marketplace—saving money and time apparently trumps all else.

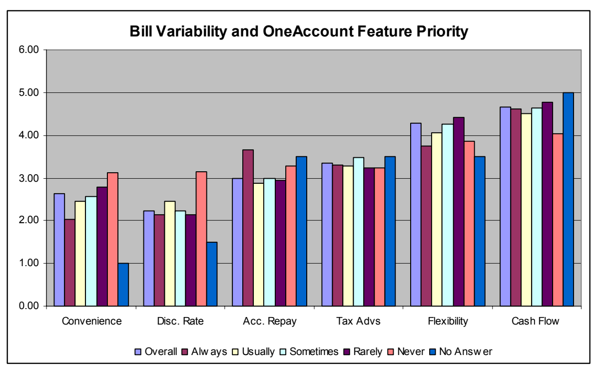


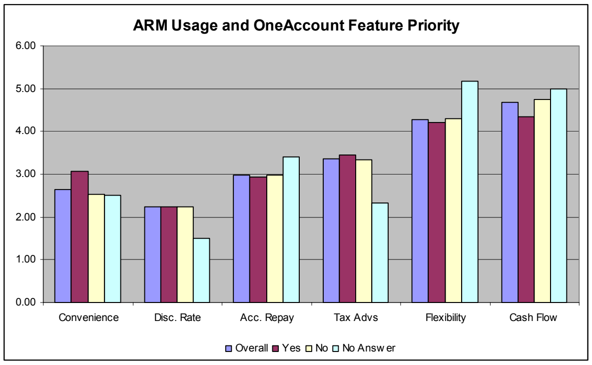


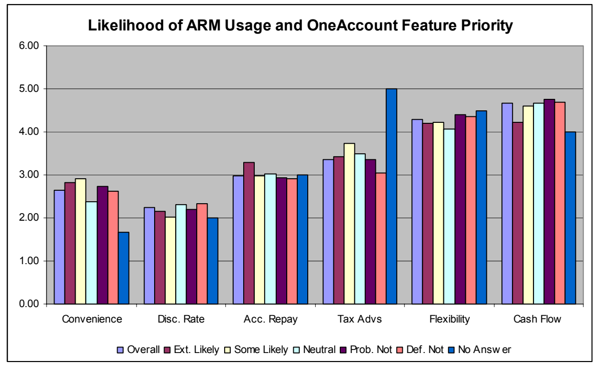


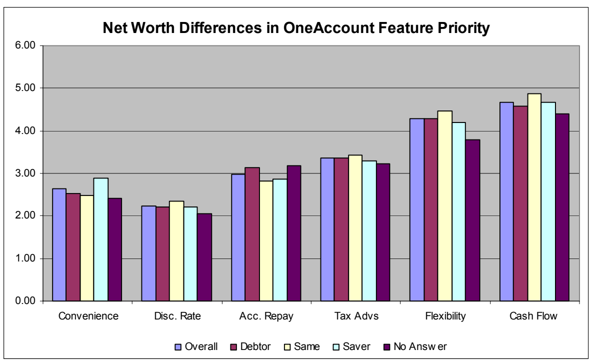


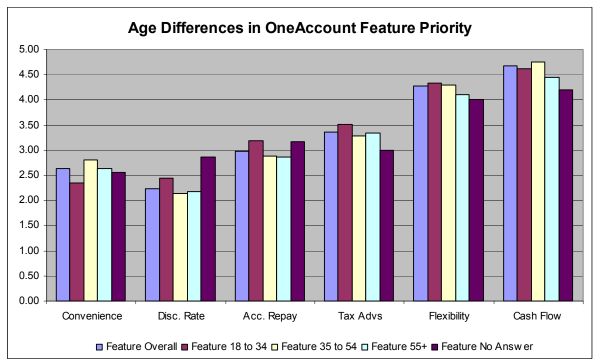


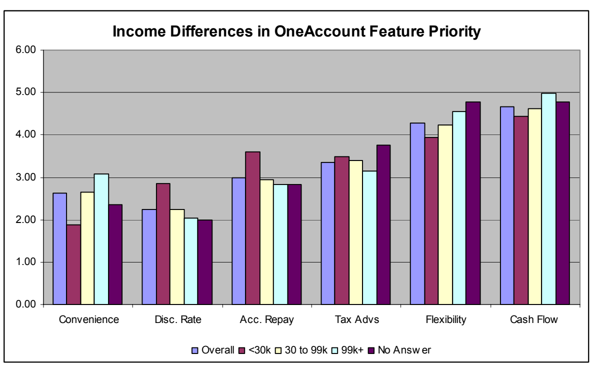



ARM Usage and OneAccount Feature Priority
6.00
5.00
4.00
3.00
2.00
1.00
0.00
Convenience
Disc. Rate
Acc. Repay
Tax Advs
Flexibility
Cash Flow
Overall
Yes
No
No Answer


Likelihood of ARM Usage and OneAccount Feature Priority
6.00
5.00
4.00
3.00
2.00
1.00
0.00
Convenience
Disc. Rate
Acc. Repay
Tax Advs
Flexibility
Cash Flow
Overall
Ext. Likely
Some Likely
Neutral
Prob. Not
Def. Not
No Answer


Net Worth Differences in OneAccount Feature Priority
6.00
5.00
4.00
3.00
2.00
1.00
0.00
Convenience
Disc. Rate
Acc. Repay
Tax Advs
Flexibility
Cash Flow
Overall
Debtor
Same
Saver
No Answer


Age Differences in OneAccount Feature Priority
5.00
4.50
4.00
3.50
3.00
2.50
2.00
1.50
1.00
0.50
0.00
Convenience
Disc. Rate
Acc. Repay
Tax Advs
Flexibility
Cash Flow
Feature Overall
Feature 18 to 34
Feature 35 to 54
Feature 55+
Feature No Answer


Income Differences in OneAccount Feature Priority
6.00
5.00
4.00
3.00
2.00
1.00
0.00
Convenience
Disc. Rate
Acc. Repay
Tax Advs
Flexibility
Cash Flow
Overall
<30k
30 to 99k
99k+
No Answer