

INVESTIGATIVE REPORT

Lifestyle Lending

Offers Innovation and Growth
for Credit Unions

by

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Filene Research Institute

Introduction

In 2004, twenty-six “next generation” creative credit union leaders joined Filene i³ to:

Identify innovations that:

- Better meet the needs and wants of members
- Enhance operational efficiencies
- Build member loyalty
- Respond to the special needs of market segments
- Enhance organizational effectiveness
- Develop ideas to address issues and opportunities facing credit unions
- Identify innovations in other organizations
- Provide a forum for cooperation, collaboration, professional development and succession planning

One idea that emerged from the group and was implemented by a credit union in 2004 illustrates the power of innovation and the importance of responding to the needs of the market. This idea – first reported in the 2004 Filene i³ Progress Report, *Innovation: Novel Ideas from Next Generation Credit Union Leaders* – is worth further exploration, and is the purpose of this Filene i³ Investigative Report: *Lifestyle Lending Offers Innovation and Growth for Credit Unions*.

The American dream is changing. Although the home and automobile remain important, Americans are seeking other avenues of gratification. The needs of the market, including the needs of credit union members, are evolving.

Boomers are poised to enjoy a tremendous wealth transfer from the Great Generation in the coming years. Further, they are aging, but will likely live longer than any previous generation. Elective medical and cosmetic surgeries are on the rise. Many boomers are willing to make themselves look young because they still feel young. Meanwhile, medical technology continues to advance and enable the quality of life, or even create life, under circumstances that were not possible just ten years ago.

Today, credit unions are managing tighter spreads and looking for new lending solutions that meet the needs of their members. Here we explore a thought-provoking opportunity for credit unions, an emerging idea called “lifestyle lending.”

The Filene Research Institute would like to acknowledge Jim Jerving and Diane Gurtner for their contributions to this Filene i³ investigative report.

Lifestyle Lending Offers Innovation and Growth

Lifestyle lending is gaining credit union converts seeking innovation and growth in their loan portfolios. This type of lending – typically unsecured – has evolved to cover a variety of non-traditional loans that can enhance a member's lifestyle. These loans are financing adoptions, cosmetic surgeries, infertility treatments, and uninsured medical expenses. Lifestyle loans are consistent with the origins and philosophy of credit unions – they meet the needs of members at different stages of their lives.

Credit unions are getting involved in lifestyle lending to strengthen their relationships with members and to offer creative financing, according to Barry Shaner, President of Toledo Area Community Credit Union, which began offering lifestyle loans in 2004.

"We are looking for new ways to do lending," he said. "Our biggest segment of members is in the middle market – baby boomers in their mid-40s. As they age, they are not going to borrow as much for cars and homes. This program came as a response to a member who had a cosmetic procedure done."

Growth of Cosmetic Surgery

Other credit unions are following Toledo Area CU's path and finding that financing cosmetic surgery is a means both to serve members and to grow their loan portfolios. The growth of surgical and non-surgical cosmetic procedures in the United States has been dramatic – some 8.3 million cosmetic procedures were performed in 2003 – an increase of 293% since 1997, according to the American Society of Aesthetic Plastic Surgery.

Women accounted for most of the cosmetic procedures completed in 2003, nearly 7.2 million or 87% of the total. But men are also getting more comfortable with the surgeon's knife: they had nearly 1.1 million cosmetic procedures during the same time period.

The top five cosmetic surgical procedures for women in 2003, national averages for physician fees, and total U.S. expenditures are given in Table A. The same statistics for men are given in Table B. In some of the categories, the statistics for men and women are combined.

Table A		
Top Five Women's Cosmetic Surgical Procedures in 2003		
Procedure	National Average	Total U.S. Expenditures
1. Liposuction (men & women combined)	\$2,578	\$991,380,149
2. Breast augmentation	\$3,360	\$942,015,163
3. Eyelid surgery (men & women combined)	\$2,599	\$695,607,279
4. Breast reduction	\$5,351	\$787,439,833
5. Nose reshaping (men & women combined)	\$3,869	\$667,133,513

Table B		
Top Five Men's Cosmetic Surgical Procedures in 2003		
Procedure	National Average	Total U.S. Expenditures
1. Liposuction (men & women combined)	\$2,578	\$991,380,149
2. Nose reshaping (men & women combined)	\$3,869	\$667,133,513
3. Eyelid surgery (men & women combined)	\$2,599	\$695,607,279
4. Breast reduction	\$3,124	\$68,880,133
5. Hair transplantation	\$3,084	\$51,306,382

Source: The American Society of Aesthetic Plastic Surgery

Acceptance of Cosmetic Surgery

Cosmetic surgery used to be discussed in hushed tones; those who had such procedures were apt to either deny it or quietly confess to a few confidantes. There are signs, though, that this reticence is fading as cosmetic surgery is gaining acceptance at a rapid pace and signaling a cultural shift.

When the international media speculated on the youthful appearance of Italy's Prime Minister Silvio Berlusconi, the 68-year-old admitted to cosmetic surgery and a hair implant, saying that he feels "between 40 and 42 years old in all aspects of my life."

"I have taken one of the choices of modern life. It is a way of showing respect to those who share your life, your family. It is a way of showing respect to those who expect you to represent them on the international and national stage," said Berlusconi, according to the news agency Reuters.

A few years ago, it would have been difficult for a politician to make this admission. When former president Ronald Reagan was questioned about whether he dyed his hair, he denied it. One-time political adversary, former president Gerald Ford, even joked about Reagan's hair color during a primary campaign.

The growing awareness and acceptance of cosmetic surgery can be attributed in part to television shows: ABC's "Extreme Makeover," Fox's "The Swan," and FX's "Nip/Tuck." Each of these reality television programs features a "before" and "after" recipient of cosmetic surgery. These shows have even gained artistic acceptance: the Golden Globes awarded "Nip/Tuck" as the best dramatic series on television in 2005. The Golden Globes are awarded by the Hollywood Foreign Press Association.

Producers of these shows have no trouble finding applicants willing to experience their 15 minutes of fame. Some 1,200 applicants turned out in Oklahoma City to audition for "Extreme Makeover," where more than 7,500 descended on a mall for free plastic surgery and makeover consultations.

One of the first participants in "Extreme Makeover," Tammy Guthrie, had \$50,000 worth of plastic surgery to fix her crooked nose, bags under her eyes, and acne-scared cheeks. According to the *Tampa Times*, she was "thrilled about the outcome."

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"There were physical flaws about me that were occupying too much of my mind," she said. "What used to be an issue is now a non-issue. I don't have to worry. I'm not self-conscious."

Plastic surgery is gaining converts in America's heartland as well. Dr. Jeffrey Herold, a plastic surgeon in Sheboygan, Wisconsin, said in an interview in the *Sheboygan Press* that he noticed an increase in patients after "Extreme Makeover" made its debut. Diet fads such as Atkins and South Beach have left people with excess skin they want to shed, said Herold.

The disposable income of baby boomers is another factor. "They have more income," said Herold. "That's a huge population, and they're starting to age and they're concerned about it."



Spiraling Health Care Costs

One of the reasons that lifestyle lending is being considered by credit unions and other lenders is due to the increase in health care costs and insurance premiums. Trends also indicate that fewer medical procedures will be covered in the future; certain procedures once covered are now considered electives.

Bariatric surgery to lose weight is a case in point. Toledo Area Community Credit Union started its lifestyle lending program to finance this surgery for members. Bariatric surgery creates weight loss by reducing the size of the stomach in a gastric bypass, or by restricting the amount of food that goes into the stomach by "gastric banding." This causes a patient to feel full after eating a small amount of food. The typical cost is \$25,000.

Consumers approach cosmetic surgery as a retail decision, "as if they were buying a cruise, a vacation, a car."

On January 12, 2005, Blue Cross & Blue Shield of Wisconsin dropped its coverage of bariatric surgery. "Most of our competitors do not cover these services...the fact that we did cover it hampered our ability to keep rates competitive. The decision was not based on the merits of the procedure, but on remaining competitive in the Madison market," said spokeswoman Jill Becher.

This is not an isolated event, but a growing trend. Premiums for job-based health insurance increased 11.2% on average in 2004 compared to 13.9% in 2003. This was the fourth year of double-digit increases, according to the annual health-care benefits survey conducted by the Henry J. Kaiser Family Foundation and the Health Research and Education Trust.

Premiums for family coverage increased 59% since 2000. Many employers, who cover the majority of Americans with health insurance, have responded by requiring employees to pay more for premiums, co-payments, and other fees, according to the Kaiser study.

While increases in health insurance costs are troubling, there are indications that the cost of cosmetic procedures will become less expensive. Cosmetic surgery that previously would have taken place in the hospital operating room and required overnight stays can now be done in a doctor's office. Like other products that gain popularity, the price usually drops, according to Dr. Lloyd M. Krieger, a plastic surgeon with an M.B.A. from the University of Chicago.

"Usually that does not apply to health care, which is bound up with insurance issues," he said. "But in the case of cosmetic surgery, people are using their own money, so the typical health insurance restrictions don't apply," Krieger told the *New York Times*. Consumers approach cosmetic surgery as a retail decision, "as if they were buying a cruise, a vacation, a car."



Financing Cosmetic Surgery

The financing of cosmetic procedures came into its own about 10 years ago. There are many providers, ranging from credit card giant Citibank to the Dental Fee Plan, which finances cosmetic dentistry as well as regular dental procedures. Cosmetic dentistry can be expensive, with some procedures costing up to \$50,000.

With these price tags, it's no surprise that financing these procedures is highly competitive. "It's not a bad risk," said Barry Shaner. "A lot of doctors are using national firms. The national firms have automated systems and can offer economies of scale. And the pricing is not that different – 8% to 9%."

The Dental Fee Plan (DFP) requires the patient to complete a simple application in the dentist's office, and DFP processes that application within 30 minutes or sooner, according to Dr. Chris Kammer of the Center for Cosmetic Dentistry in Madison, Wisconsin. If the application is accepted, DFP will provide the funds directly to the dentist. DFP charges the doctor 6% to 10% of the total procedure, but doesn't charge an annual fee.

The most popular cosmetic dental procedures performed in Kammer's office are invisible braces, teeth whitening, porcelain veneers and jackets, and general dentistry rehabilitation.

The Dental Fee Plan offers interest-free loans to patients if the loans are paid within one year. In January 2005, DFP's rate for qualified borrowers was 5.9%, with no prepayment penalties. DFP also pays the doctor's office a rebate check if it reaches a certain level of business. In 2004, the Center for Cosmetic Dentistry received a rebate of \$1,500.

Cosmetic dentistry is a "huge opportunity for credit unions. It's what people want and it's more acceptable in the mainstream culture," said Kammer. "If credit unions offer a competitive package, they would get a lot of business. We tell our patients to check out their banks. It would be nice to have information from a credit union to give our patients," he said.

Members of the Filene i³ work group on lifestyle lending, who were interviewed and contributed to this report, developed a comparison of four lenders, which is given in Table C.



Table C

Lender Rates for Cosmetic Procedures

Lender	Web site	Terms	Rates
Capital One/AmeriFee	www.feeplan.com	18-60 months	5.9%-12.9% fixed rate
Healthready	www.healthready.com	12-48 months	As low as 9.9%
CareCredit (GE Card Services)	www.carecredit.com	3-48 months	12.96%
Citibank (Citi Health Card)	www.healthcard.citicards.com	Revolving or 48-month repayment	21.98% (revolving) or 12.96% (fixed)

The Gift of a Child

Credit unions can serve other areas of lifestyle lending need, as well. To many couples, creating a family comes at a high price, both emotionally and financially. Adoptions in Russia, the Far East and South America require a substantial financial commitment, ranging from \$20,000 to \$30,000.

Infertility treatments – not covered by most insurance plans – are another potential need for members. The growing number of people turning to assisted reproductive technology is staggering. Spending on in vitro fertilization increased 50% during the past five years, reaching a total of over \$1 billion in 2003. It's estimated that 85% of insured Americans have policies that don't cover in vitro fertilization, according to *U.S. News & World Report* in 2004.

Credit unions are well-positioned to provide financial assistance and education to couples who are looking for a financial solution to the expenses associated with creating a family through medical procedures or adoption.

Business Opportunity for a Trusted Adviser

Members in the prime borrowing ages of 25 to 44 have been steadily declining over the past decade. Just 41% of this age group were members of credit unions in 2004, compared to 49% in 1994, according to CUNA Research.

“The slice of the lending pie is not as big,” said Nathan Saller, vice president of marketing for Telephone Credit Union of Manchester, New Hampshire (\$250 million in assets). “We want to maintain and increase the slice of pie and get bigger. As credit unions, we have to look for creative ways to lend money.”

As baby boomers age and retire, they will shift away from borrowing and focus on investing. The next generations – Gen X and Gen Y – have different attitudes about borrowing, and are smaller in number than the baby boomers. Cosmetic surgery is one area where baby boomers will want financing.

Lifestyle lending is a good business opportunity, credit union lenders interviewed for this report said. But this financial need is currently being met by other financial providers. Credit unions have advantages that other lenders lack – a direct relationship with members, being located within the community they serve, and their not-for-profit status. The latter gives credit unions the opportunity to offer competitive prices and terms for loans.

The nature of lifestyle lending requires that the lender be trusted. The borrower must feel that he or she will be treated with dignity during a vulnerable time. Members will be discussing intimate details of their personal lives and will expect discretion and sensitivity. Credit unions have the reputation for being trusted advisers in their communities, which provides an advantage over other lenders.



Nathan Saller
Vice President, Marketing
Telephone CU of New Hampshire

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What Doctors Want

Most medical offices spend time dealing with endless paperwork – insurance, patient records, billing, and correspondence. Doctors and lenders interviewed for this report agreed – medical practitioners don’t want to be in the finance business. And when patients want a cosmetic procedure but lack the funds, they want financing immediately. Doctors and patients alike are looking for financing that is quick and easy. Medical practitioners want to focus on their specialty and want to partner with a third party that has a high approval rate for loan applicants.

“We want to focus on the dentistry, so we ask for payment at the time of the procedure. I’d prefer finance partners with an approval rate of at least 75% or more and a flexible repayment plan,” Kammer said. “We want someone who can offer what our current partner offers – high acceptance, low rates for patients, cash-back rebates and no annual fees.”

Being a local lender is not necessarily an advantage, said Kammer. His staff faxes the application to his provider and gets a quick answer, so it doesn’t matter where the office is located.

Lifestyle Lending: An Indirect Model

Lifestyle loans usually involve an elective medical procedure that most individuals consider confidential. A credit union member may feel more comfortable discussing financing the procedure in a doctor's office instead of a credit union lobby. The indirect model of financing through the doctor's office, similar to the automobile indirect model, merits consideration.

Market research performed by the i³ work group suggests some doctors find this model appealing. Of course, the traditional direct model of credit union financing will also work and, in some cases, may be preferred. Innovation includes borrowing from an existing model and applying it in a new way. The doctor's office may be the next great delivery channel for lifestyle loans.

Toledo Area Community Credit Union

Being a local provider, however, can be an advantage for some lenders and medical practitioners. "We found that doctors wanted someone who has local knowledge of the marketplace, someone members could talk to. Credit unions are closer to members than other financial institutions, such as a national firm," said Toledo CU's President Barry Shaner.

Toledo CU has \$185 million in assets and began as a parish credit union for a Catholic church; it has since expanded to a community charter and can serve anybody in metropolitan Toledo. The credit union launched its lifestyle lending program in the summer of 2004 by offering unsecured loans to patients of Northwest Surgical Specialists.

The doctor's office makes educational presentations to prospective surgery patients. Part of the presentation includes providing materials from Toledo CU on how to finance the surgical procedures. At the initial screening, the doctor's office gives the patient an application form, and the credit union contacts the patient.

"The value offered is that the member can discuss this with someone at the doctor's office, and we discuss the loan with the member," said Shaner. "The member is not embarrassed or intimidated and doesn't have to explain the reason for the loan. We can do most of the loan over the phone. The member comes into the credit union to sign the papers."

Shaner likens the program to indirect lending with auto dealers. The key difference is that auto dealers are more willing to get involved in the financing, while most doctors prefer less involvement. Toledo CU uses a risk-based pricing approach with terms of up to 60 months. The product pricing for unsecured and secured loans is:

- "A" tier, 680+ credit score for a 9% rate
- "B" tier, 640-679 score for a 9.99% rate
- "C" tier, 600-639 score for an 11% rate, collateral required

As with any new program, there can be a mix of both expected and unexpected benefits. There were, for instance, three lifestyle loan applications that Toledo CU was able to finance as home equity loans at a better rate. And the most notable benefit, according to Shaner, is that the lifestyle program offers "an entrée to other types of lending." Overall, it is a win-win for members and the credit union.

"The loans are good loans. We are gaining new members. We are doing a better job of helping members. It gives us a chance to build a relationship with a new member," said Shaner. In the future, Toledo CU would like to develop a network of physicians and promote health savings accounts that can be deducted directly from a member's payroll, he said.



Barry Shaner
Executive Vice President
Toledo Area Community CU

Arrowhead Credit Union

Members seeking financing for lasik surgery gave Arrowhead Credit Union in San Bernardino, California, the opportunity to begin lifestyle lending six years ago. The \$846 million-asset credit union partnered with Ontario Laser Center, then branched out to cosmetic and dental surgeons. Today Arrowhead CU has a network of 11 eye surgeons, 15 cosmetic surgeons and 15 dentists.

A seemingly small – yet critical – component of the program is the application. “We didn’t just want paper lying around in a doctor’s office. So we developed a generic application that was combined with a membership application. It’s a four-fold, very professionally done and colorful,” said Brenda Heusterberg, retail direct manager.

The doctor faxes the completed application to Arrowhead CU, which processes the application within 15 minutes. Arrowhead had 173 medical loans on the books in 2004 and had an approval rate of 60%. Arrowhead CU doesn’t charge the doctor a fee, which is different from some providers, such as Dental Fee Plan, which does. Arrowhead’s rates are competitive – 9.99% to 15.99% – with repayment terms of up to 42 months. The loan is structured so that a minimum of 2% of the loan is paid monthly.

Arrowhead CU also offers a medical line of credit so that the member can pay as the treatment is done. For example, a dentist may estimate that the procedure will cost \$10,000, but will require five or more treatments of \$2,000 each. Once the treatment is completed and the dentist certifies it, Arrowhead CU pays the dentist directly. With a medical line of credit, the member has the flexibility to pay as the treatment is needed.

Arrowhead CU’s lifestyle lending program has resulted in new members; the staff also has an opportunity to cross-sell other services. And the processing time is quicker, since the initial application for the loan and membership is done at the doctor’s office. Current members also became aware of the loans via Arrowhead’s Web site.

Marketing Strategy:

Remember to tell your members you provide loans to meet their needs and achieve their dreams. Financing automobiles and homes are not the only loans your credit union offers. Remind members in your marketing materials and newsletters that the credit union offers financing for lifestyle events: adoption expenses, fertility treatments, cosmetic surgeries, or other elective medical or dental procedures typically not covered by health insurance plans.



Getting Started

As with any new service, getting started is a methodical process. Arrowhead CU's Heusterberg says that doing your homework is essential – find out what the competition is offering for medical loans. Determine if your credit union can offer a package that is competitive, and evaluate how comfortable your credit union is with this type of lending.

After you've done your research, the next step is to make sure that all of the paperwork is completed. Heusterberg suggests you have the following documents completed before you start making loans:

- a merchant agreement with the doctor's office
- a membership and loan application for the patients
- a copy of the doctor's license, and
- three months of the doctor's financial statements

"Medical people are not finance people," she said. "You need to communicate with them about why you need the paperwork you require. You need to explain that when you turn a patient down for a loan, you can't tell the doctor why – it's confidential."

Lifestyle lenders interviewed for this report concur that credit unions should start with one medical provider and develop the relationship, then branch out later if the program is successful. Another inexpensive means of getting started is by developing a lifestyle lending program and offering it to your members to gauge interest.

"By establishing a relationship with one doctor, you can create a model within a smaller environment and expand," said Phil Smith, vice-president of lending strategies at Affinity Plus Federal Credit Union, with \$950 million in assets, located in St. Paul, Minnesota. "The key is the relationship with the member – the one with the provider comes later. Start with the member first. Understand what is best for the member."

Relationship building, a natural advantage for credit unions, is the foundation for success with lifestyle lending.

"I personally knock on doors and let medical offices know what we are doing," said Heusterberg, "or send out letters and follow up a week later. When we started, I spent a lot of evenings going to educational seminars for patients, and I supported doctors in any way I could. My laptop goes with me so I can do on-the-spot financing."

"By establishing a relationship with one doctor, you can create a model within a smaller environment and expand," said Phil Smith, vice-president of lending strategies at Affinity Plus Federal Credit Union, St. Paul, Minnesota.



Phil Smith
Vice President Lending Strategy
Affinity Plus FCU

Lessons Learned

Lending has historically been the lifeblood as well as the purpose of the credit union portfolio. As the membership ages and fewer members are entering the prime borrowing years, creative and alternative ways to offer loans are needed for credit unions to grow and survive. Lifestyle loans are a means of growing lending portfolios while deepening relationships with current and potential members.

There are benefits for credit unions offering lifestyle loans: new members, cross-selling opportunities, as well as an entrée to other types of lending. These loans are consistent with the traditional roots of the movement – providing loans to members for worthwhile uses at their time of need.

Lifestyle lending is a good business opportunity; credit unions have a unique advantage in offering lifestyle loans due to their close relationship to members, excellent service and location within the community. As trusted advisers, credit unions are well-positioned to offer loans for medical procedures that require discretion and confidentiality.

As the cost of health care continues to spiral while employer benefits decrease, members will need to finance more of their health care. They will look to their credit unions for financing. Trends indicate that cosmetic surgery and in vitro fertilization procedures will continue to grow rapidly. Members will continue to have these procedures; if your credit union doesn't offer financing, they will go elsewhere.

Consumers tend to view cosmetic surgery as a retail decision, like buying a car, not necessarily as a health care decision with insurance considerations. Medical practitioners favor cosmetic surgery – it's a cash business without the insurance restrictions. Even though it is a competitive field, credit unions can compete on price and terms. Lifestyle lending may foster opportunities to develop CUSOs or partnerships with other credit unions to achieve economies of scale.

Medical procedures are just one of the many opportunities for lifestyle lending. It is an area of business that allows the credit union to be innovative and offer loans for a variety of needs in different stages of their members' lives. Lifestyle lending is a way to serve members, grow the lending portfolio and remain true to the mission of credit unions.



How to Learn More

Your credit union may want to learn more about the projects being undertaken by i³, and the Filene Research Institute encourages you to call Mark Meyer at 608-231-8554; or visit www.filene.org to access work group reports.

Members of i³ serve staggered three-year terms. An additional 10 individuals will join the group in 2005.

The i³ initiative is being partially underwritten by a grant from the Corporate Network. "The Corporate Network has made a strong statement of belief in the intellectual power of our human resources and in the contributions they are capable of making to the future of our industry," says Bob Hoel, executive director of the Filene Research Institute.

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