

PREPARED auto financing

CONCEPT DOCUMENT

Prepared Auto Financing

TEAM MEMBERS

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PROBLEM DEFINITION

According to AAA, one in four Americans could not pay for a major car repair. This is not surprising, considering the personal savings rate in the United States is only 5.3%. A 2013 study from The Federal Reserve Board asked people how they would pay for a \$400 emergency. Forty-seven percent of respondents said they would need to borrow or sell something, or they would not be able to come up with that money at all. And, a 2014 survey from Bankrate found that only 38 percent of Americans would cover a \$500 car repair with money they had saved.

Whether it is needing savings for a down payment (Bankrate also found most American families can't afford a new car) or for emergency repairs, auto ownership is becoming more and more of a struggle for people across the country. Considering auto loans are the bread and butter of our industry, it is important to help our members save more money so they can get into the car they really want (with a reasonable down payment) and have money to cover emergency repairs if they come up.

We conducted a survey of more than 400 people using Google Consumer Surveys. When asked if they were satisfied with the amount of money they save each month, over 57% said "No." Another 14% said they were not sure, which can lead to the conclusion that if they don't know if they are saving enough...they probably aren't.

All of this research brought us to define the problem as:

How might we better empower our members for a lifetime of vehicle ownership?

A lifetime of vehicle ownership includes having money for repairs and being able to "buy up" to the car you want over time. Instead of rolling over negative equity with each car purchase, we want people to be able to have built up a savings so they can put down a sizeable down payment for the car they really want and need. That is a change that takes effort and commitment, and it can be daunting for people to do on their own.

INNOVATIVE SOLUTION

We believe if credit unions help members shape better savings habits, vehicle loan repayment will be more likely, and future vehicle purchases will be more affordable.

Our innovative solution is an auto loan with a built-in savings transfer to help members improve positive financial behaviors while ensuring peace of mind throughout vehicle ownership. The key features of our solution include:

- An initial deposit into a higher interest savings account in the amount of the new car payment, to start the savings process.
- A small automatic transfer, as part of a monthly car loan payment, to the deposit account.
- Members who use the product enjoy a higher interest rate on the savings account, and a reduced interest rate on their auto loan (allowing them to save even more).
- The funds in the savings account can only be accessed at the time of payoff (ideally to be used for a down payment on another car) or in the event of a vehicle-related emergency.
- If the member defaults on the loan, the money in the savings account is forfeited to the credit union to go toward the loan balance.

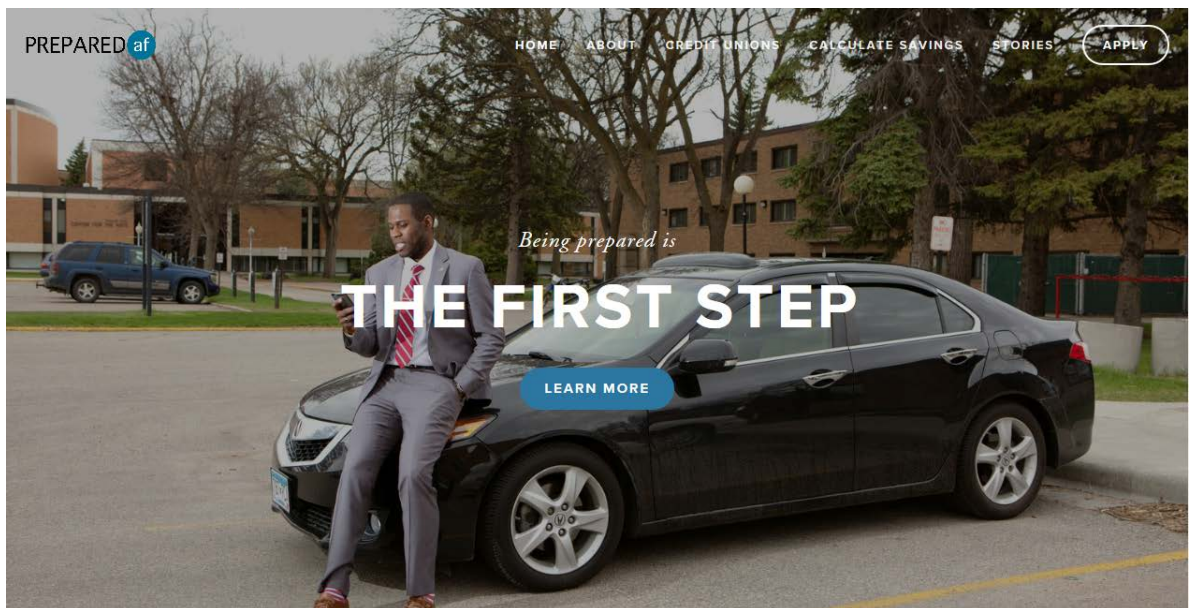
PROTOTYPE

Early in the ideation phase, we came to the conclusion that our solution could be implemented within any credit union's core systems, but that we could provide packaged resources, tools, marketing materials and key insights for a successful campaign that reaches the desired audience.

Based on the tool built and launched within Affinity Plus Federal Credit Union, "Savings Accelerator", we were able to utilize established best practices and identify modifications for our solution. These insights were integral to creating our "Credit Union Implementation Checklist" along with potential resource kits that would accompany this solution.

Below are mockups and screen shots of the prototype of Prepared Auto Financing.


Website built through SquareSpace: <http://preparedautofinancing.squarespace.com/>



Be ready.

Our team is focused on how to best support your car ownership needs by making access to a car loan easier and more affordable, while increasing your savings balance.

Prototype savings calculator for use in external marketing campaign:

Loan amount	<input type="text" value="\$ 15,000.00"/>	PREPARED 
Term	<input type="text" value="72"/>	
"Before" interest rate	<input type="text" value="4.99%"/>	
"After" interest rate	<input type="text" value="4.49%"/>	
Estimated monthly payment (using Reg Z calculator)	<input type="text" value="\$ 238.03"/>	
A) Calculation of interest saved from reduction of interest rate		<input type="text" value="\$ 249.33"/>
B) Calculation of interest earned from increase in S3 savings rate		<input type="text" value="\$ 47.29"/>
C) Extra \$ in your pocket (A+B)		<input type="text" value="\$ 296.62"/>
Total Savings Accumulated		<input type="text" value="\$1,365.32"/>
<small>*Assuming no prepayments</small>		

Example credit union integration instructions:

Credit Union Implementation Checklist

General

Work with internal teams (ALCO, IT, Lending, Compliance, Risk Management, QC) for approval of auto loan rate reduction, savings account interest rate and minimum required deposit.

Core Processor

- Set up separate savings account type for funds transfer
- Determine types of flags or freezes for account to ensure controlled/limited access
- Create workflow for employee setup process

LOS

- Determine to which loan type(s) Prepared Auto Financing may be added
- Determine how new loan payment and rate reduction is calculated into application
- Create ability for option to be added to auto loan package
- Set up process by which Prepare Auto Financing is added to loan documents

Loan Documentation

- Create additional component to closed-end note document explaining discounted rate
- Incorporate Prepared Auto Financing addendum into loan documentation (template provided as a part of the Resource Kit)

Reporting

- Determine method by which loans and savings accounts will be tracked and recorded
- Determine appropriate benchmarks to conduct analysis on loans and savings account balances

Employees

- Determine departmental needs within credit union – IT, QC, Risk Management, Lending, Branch Network, Operations, Compliance.
- Train frontline staff on set up and talking points associate with the program (marketing materials provided as a part of the Resource Kit)

Adding Credit Union to Prepared Auto Financing Website and Promotional Materials

- Create and/or provide pertinent webpage link to specific product or application page
- Provide high resolution logo (.jpg or .png file)

TESTING AND RESULTS

From our consumer survey sample we learned that 25-35% of the population is interested in an auto loan with the features we are proposing. Another 30% is uncertain, with only 30-40% *not* interested. The group that is not interested correlates with those who are already comfortable with their own savings behaviors and results. There appears to be enough need for, and acceptance of, the concept to build a reasonable level of market demand to continue our pursuit.

We also solicited feedback from industry leaders. They agree the majority of their members are insecure in their savings habits, and that most credit unions are not doing enough to support savings practices. Twenty percent of auto loan applications are denied due to lack of down payment or poor loan-to-value ratios, and there is consensus low savings rates contribute to delinquency and default.

When it comes to declaring interest in the concept, credit unions were a bit hesitant. Less than 10% indicated they were very interested, and another 35-40% are “somewhat” interested. We understand that proof of success will ultimately drive the actions of our industry, and fortunately we are working with one credit union that is involved in testing our solution right now.

On June 13, 2016, Affinity Plus Federal Credit Union launched a new savings tool to be added to any auto loan, called Savings Accelerator. This solution operates similar to how Prepared Auto Financing would work. The Savings Accelerator can be added to any approved auto loan as an automatic savings transfer to a new Savings Accelerator savings account. Upon addition of the Savings Accelerator to a member’s new auto loan, the new savings account requires a deposit equivalent to one month’s payment on the auto loan. An automatic transfer to the new savings account is set up for \$15 each month for the term of the loan, or until the loan is paid in full.

Since any member has the option to add the Savings Accelerator to their new auto loan, Affinity Plus created incentives to joining this program. Members receive a premium interest rate on their new savings account (1.0% APY up to \$2,000) and a reduction in rate on their new auto loan, depending on their credit score as follows:

- Credit score 620 or below = rate reduction of .50%
- Credit score 620-699 or no score = rate reduction of .25%
- Credit score 670 or greater = rate reduction of .05%

As of August 31, Affinity Plus originated 114 loans for \$1,551,847 and an ending balance of 113 loans for \$1,520,934. One loan was prepaid and refinanced into another auto loan, with the Savings Accelerator added as well. These members saved a total of **\$31,909.36** during this short time period, with the largest balance being \$1,016.41.

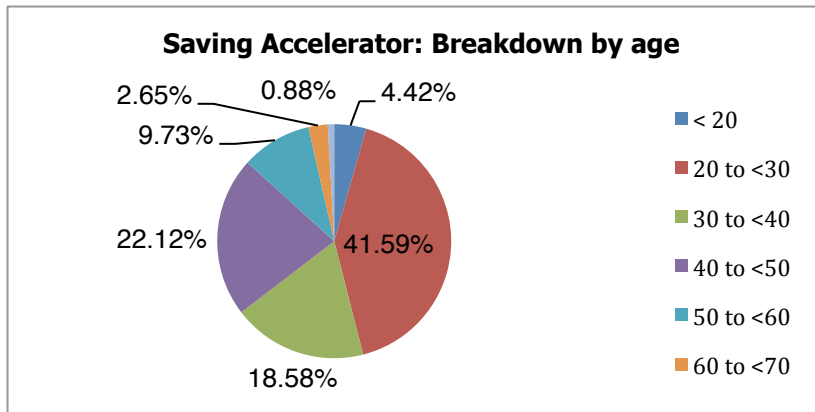
<i>Loan Type</i>	Count	Original Funded	% of \$ Overall
New Auto 2015-2016	4	\$ 116,180.32	7.49%
Used Auto 2010-2015	61	\$1,029,560.51	66.34%
Used Auto 2009 & Older	49	\$ 406,106.21	26.17%
Grand Total	114	\$1,551,847.04	

Originations by month:

- June: 27 loans for \$344,177
- July: 45 loans for \$627,658
- August: 42 loans for \$580,012

<i>Reductions</i>	Count	Original Funded	% of \$ Overall
FICO <620 = 0.50%	37	\$435,013.89	28.03%
FICO 620-669/No score = 0.25%	51	\$702,161.41	45.25%
FICO 670+ = 0.05%	26	\$414,671.74	26.72%
Grand Total*	114	\$1,551,847.04	

*The weighted average reduction in rate was 27 basis points.



Based on preliminary surveys and current application of this solution within Affinity Plus, the concept of Prepared Auto Financing has shown tremendous potential for both credit unions and credit union members. Specifically, for credit unions wishing to reach younger members, these results display not only desire from this demographic, but also immediate success in product penetration.

BUSINESS MODEL AND 3-YEAR FINANCIAL PROFORMA

Using this model, a credit union can estimate how the Prepared Auto Financing feature might impact their bottom line. The boxes in red below are variables unique to each credit union's case, and the yellow highlighted boxes allow for varying estimates on member penetration.

Prepared Auto Financing Pro Formas						
Auto Lending Assumptions		TODAY				
Apps submitted/yr	10,000					
Avg New Loan Balance	\$15,000					
Paymt Approval Rate	80%					
Paymt Denials/Year	2,000					
Impacts of Prepared Auto Financing Feature						
60-Month Auto Loan	TODAY	Recaptured Denials	25%	500	Adopted Approvals	10% 800
Avg Interest Rate	4.33%	Reduced Loan Rate	4.08%	-0.25%	Reduced Loan Rate	4.08% -0.25%
Replacement Rate	-0.83%	Replacement Rate	-0.83%		Replacement Rate	-0.83%
Interest Spread	3.50%	Interest Spread	3.25%		Interest Spread	3.25%
Loan Loss	0.52%	Loan Loss	0.52%		Loan Loss	0.52%
Monthly P&I Payments	\$278.49	Monthly P&I Payments	\$276.79		Monthly P&I Payments	\$276.79
Annual Impacts		Annual Impacts			Annual Impacts	
Net Interest Income (Loan)	\$447	Net Interest Income (Loan)	\$447		Net Interest Income (Loan)	\$410
Non-Interest Income	\$71	Non-Interest Income	\$71		Non-Interest Income	\$71
Op Expense	-\$318	Op Expense	-\$318		Op Expense	-\$318
Net Loan Profit	\$200	Net Loan Profit	\$200		Net Loan Profit	\$163 <i>-\$37.50</i>
		Savings Account			Savings Account	
		Initial Savings Deposit	\$276.79		Initial Savings Deposit	\$276.79
		59 Monthly Deposits	\$15.00		59 Monthly Deposits	\$15.00
		Ending Savings	\$1,161.79		Ending Savings	\$1,161.79
		APY	1.00%		APY	1.00%
		Deposit Interest Expense	-\$11.62		Deposit Interest Expense	-\$11.62 <i>-\$11.62</i>
					<i>PAF Cost per Loan</i>	<i>-\$49.12</i>
Annual Net Revenue	\$1,600,000	Additional Net Revenue	\$105,809		Reduced Net Revenue	-\$39,294
		Fee per loan (one-time)	\$20.00		Fee per loan (one-time)	\$20.00
		Addition After Fees	\$95,809		Reduction After Fees	-\$55,294
TOTAL ANNUAL IMPACT						\$40,515

If usage is high among otherwise previously denied members, there will likely be a positive financial impact to the credit union. However, if many members who would have already been approved without the product decide to take advantage of it, there will be less direct and immediate revenue increase, and instead should be an expense that is considered *added-value* to your membership. The resulting long-term positive financial behaviors and good-will pay off over time.

COMMENTS, NEXT STEPS, AND CALL TO ACTION

We believe strongly in the long-term benefits of this concept for both credit unions and car-buying consumers. If your credit union and others are interested in pursuing it further, Filene should take the lead in fully developing the Resource Kit and website tools, and determining the minimum fee structure necessary to maintain them indefinitely. Once that is established, each interested credit union can leverage these resources to work with their internal systems and people and roll out the feature for their members at their own pace. ***Let Filene know you want to empower your members for a lifetime of vehicle ownership today.***

ABOUT FILENE

Filene Research Institute is an independent, consumer finance think and do tank. We are dedicated to scientific and thoughtful analysis about issues affecting the future of credit unions, retail banking, and cooperative finance.

Deeply embedded in the credit union tradition is an ongoing search for better ways to understand and serve credit union members. Open inquiry, the free flow of ideas, and debate are essential parts of the true democratic process. Since 1989, through Filene, leading scholars and thinkers have analyzed managerial problems, public policy questions, and consumer needs for the benefit of the credit union system. We support research, innovation, and impact that enhance the well-being of consumers and assist credit unions and other financial cooperatives in adapting to rapidly changing economic, legal, and social environments.

We're governed by an administrative board made up of credit union CEOs, the CEOs of CUNA & Affiliates and CUNA Mutual Group, and the chairman of the American Association of Credit Union Leagues (AACUL). Our research priorities are determined by a national Research Council comprised of credit union CEOs and the president/CEO of the Credit Union Executives Society.

We live by the famous words of our namesake, credit union and retail pioneer Edward A. Filene: "Progress is the constant replacing of the best there is with something still better." Together, Filene and our thousands of supporters seek progress for credit unions by challenging the status quo, thinking differently, looking outside, asking and answering tough questions, and collaborating with like-minded organizations.

Filene is a 501(c)(3) nonprofit organization. Nearly 1,000 members make our research, innovation, and impact programs possible. Learn more at filene.org.

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