



“Transforming informal payments and lending relationships into real known credit.”

Concept Document - Informal Lending Formalized, June 2015

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PROBLEM DEFINITION

Informal lending relationships (loans between friends and family members) are part of the United States culture. It is common for the same individuals to participate in traditional banking systems. Recent research completed as part of the *US Financial Diaries* project indicates that over 89% of individuals with informal borrowing relationships hold a checking account and over 54% have access to credit cards. Still, many choose to borrow from friends and family given the ease of access and the implied flexibility of payment.

These informal lending relationships allow borrowers the opportunity to meet their immediate financial needs; however they carry a tremendous amount of risk of re-payment for the lender. Additionally, the borrower receives no credit for their payment history, eliminating the ability to leverage these relationships in building a positive credit history.

How might we provide a solution to our members to formalize informal borrowing/lending arrangements that educates and holds young borrowers accountable for financial agreements?

How might we apply this concept to housing lease relationships that carry similar challenges e.g. young adults moving back home and paying parents rent?

INNOVATIVE SOLUTION

To form a CUSO to take ownership of a customized website that tracks informal financial relationships and formalizes payments, ensuring accountability for payments while simultaneously building a credit history.

The solution process:

The borrower and the lender would each set-up a relationship with the website. This account would include a contract where both parties would document the terms of the agreement and the purpose for the loan. This could be a traditional loan or a lease agreement.

The website would have the ability to collect payments from the borrower and disperse these payments to the lender as received. Transactions would be documented and reported to the credit bureau as in any formal borrowing relationship. No direct manipulation of the history would be allowed by the borrower or the lender.

Included in the site would be educational features for the borrower including access to a monthly credit score and additional financial education materials.

The website would support the lender by providing payment reminders to the borrower via e-mail/text holding the borrower accountable for their payment.

Benefits

Lender- greater accountability and potential for re-payment given the increased consequences of missed payments.

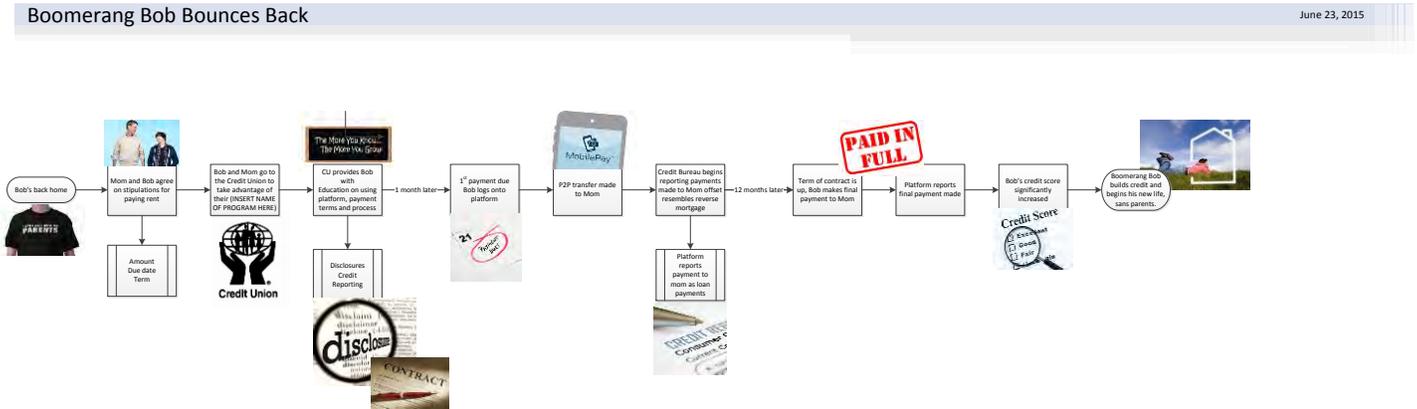
Borrower- builds credit from payments they were already making.

Credit Union - access to data and financial relationships in critical demographics that otherwise may not be acquired.

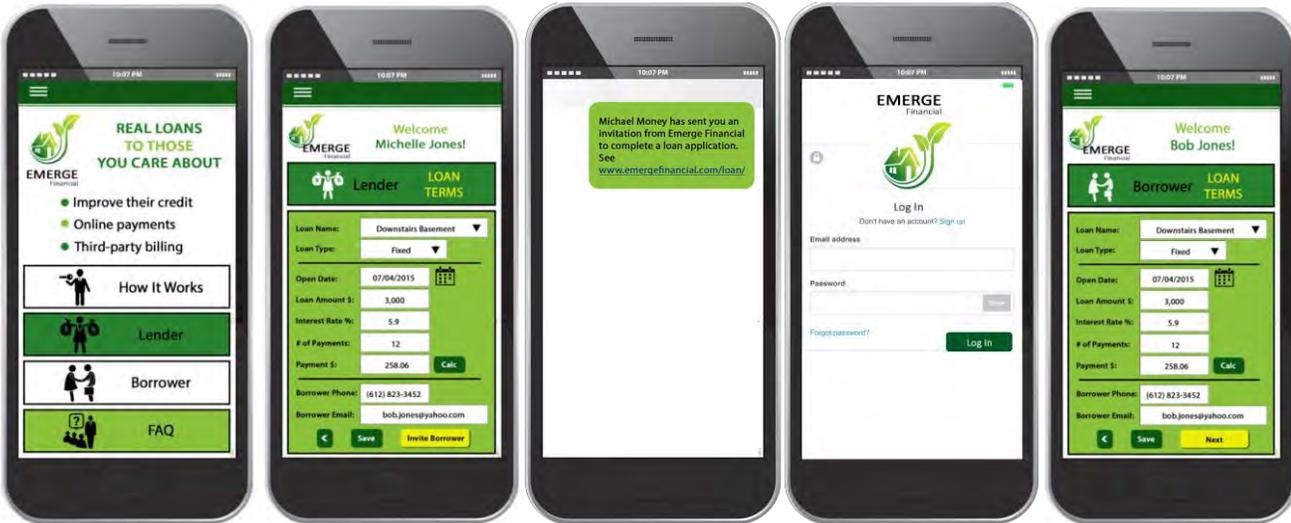
PROTOTYPE

A two phase approach was used for prototyping. As the platform could be used for multiple purposes, the initial focus was on a one use case, with the end-goal of the deliverable to have something visual to share with potential development resources.

The end product shown below:



Using this visual representation, we then sought development resources to help bring our vision to virtual reality. The end result of a very collaborative partnership with Ser Technology Corporation produced these mobile renderings that served as our platform for testing and presentation purposes:





TESTING AND RESULTS

A survey was conducted in June, 2015 soliciting feedback for the prototype from approximately 150 individuals within the Credit Union industry. 13% responded. Although not a scientific sample, the survey provided valuable feedback for consideration.

Survey Summary Results

84% of respondents indicated they have pockets of members who borrow/make informal payments to friends or family.

47% of respondents would promote this offering as an acquisition tool.

79% of respondents would promote this platform to “thin credit file” members as a means to grow their credit score and qualify for traditional lending products.

Average responses on a scale of 1-10

Prototype Value = **6.42** Likeability = **7.16** Likelihood CU would charge for the offering = **4.74**

Summary Comments

“The most value/need for our credit union members is in how to pay each other back for simple monetary transactions: easily and without fees!”

“Good Concept. Stick with it.” “This idea is sharp!”

“More people are moving home with mom and/or dad...this platform is a good way to set expectations and payments.”

“Mom/Dad do not think in loan terms, they think in dollars/cents.”

“The prototype is well structured. The interaction between the lender and borrower makes complete sense, however, how do you make sense of how the Credit Union intermediates since that is the value proposition?”

“What if Bob doesn’t pay on time? Will this negatively impact his credit rating?”

“What is the ROI for the Credit Union?”

“How does Mom report the income to the IRS?”

“Does the lender report payments? Is the Credit Score indicator an approximation?”

The comments above confirm the prototype is off to a solid start with many layers yet to be explored. There is general interest in the platform and a clear target consumer in the boomerang generation. Of utmost concern is the viability reporting to the Credit Bureaus. In addition, ROI for credit unions based on member acquisition is an opportunity for further research.

BUSINESS MODEL AND 3-YEAR FINANCIAL PROFORMA

Emerge financial is best suited to operate as an independent entity in an appropriate for-profit business format. This will allow for the greatest ease of integration with all interested credit unions. A capital investment will be required to fully develop the app and market the product to financial institutions and end users.

The financial viability of EmERGE Financial is dependent upon paid partnerships with credit unions that are focused on gaining data that will assist in attracting and cultivating profitable relationships with younger members. Based on survey data, no fee would be charged to the participating members who choose to use the service.

Partnerships will be critical to the efficiency and effectiveness of the entity. Key technological execution, such as app development, will be outsourced. Additionally, credit reporting partners have yet to be solidified, but they will be necessary to deliver on the value proposition.

Finally, the scope of the services provided will be restricted as to limit the staffing needed to operate the business. As an example, EmERGE will defer collection efforts beyond payment reminders to the designated Lender.

The business model considerations, along with the delineated assumptions, have been used to develop the Pro Forma below:

Revenue	Year 1	Year 2	Year 3	Total
Annual Credit Union Fee	\$52,500	\$87,500	\$140,000	\$280,000
Total Revenue	\$52,500	\$87,500	\$140,000	\$280,000
Expenses				
App Development	\$15,000	\$5,000	\$5,000	\$25,000
Server Costs	\$1,000	\$1,500	\$2,000	\$4,500
Marketing	\$5,000	\$5,000	\$5,000	\$15,000
Legal Expenses	\$5,000	\$2,500	\$2,500	\$10,000
Staffing	\$60,000	\$62,000	\$64,000	\$186,000
Transaction Costs	\$450	\$1,500	\$3,600	\$5,550
Total Expenses	\$86,000	\$76,000	\$78,500	\$240,500
Net Revenue	-\$33,500	\$11,500	\$61,500	\$39,500
Assumptions				
Credit Union Adopters	15	25	40	
Annual CU Licensing Fee	\$3,500	\$3,500	\$3,500	
Users	150	500	1,200	
Transactions	1,800	6,000	14,400	

COMMENTS, NEXT STEPS, AND CALL TO ACTION

The challenges of attracting young members to credit unions and/or working with thin-file members have been well documented. We foresee this platform as a step in the right direction towards solving for both of these problem use cases. Emerge Financial will be available for credit unions to use as a strategy for building preliminary relationships with the millennial generations and/or thin-file members to build lifelong partnerships. This solution will provide credit unions an opportunity to formally orchestrate these informal financial relationships, and leverage the power of positive payment history to assist their members as they successfully “emerge” into the next phase of their financial lives.

We recommend moving this idea forward with Ser Technologies to continue to scale the proto-type and garner feedback from a more robust end-user base. *Is this a product that members would find beneficial to use, if so, do they find all the necessary tools they need are being included in the framework that has been presented?* In parallel, the business model via a CUSO should be vetted in more detail in order to determine if this in fact the best way to structure such an offering. Lastly, we encountered a roadblock related to the credit bureaus willingness to partner with financial institutions on reporting these types of transactions. Experian was the only bureau we contacted during the research phase. They quickly came to a point where they were unwilling to move the idea in partnership toward a working proto-type. This is a constraint that will need to be explored in its entirety with all the credit bureau reporting providers.

That being said, please vote with your feedback and let Filene know that this is an i3 concept that you find valuable, will use at your credit union and that it should be funded accordingly!

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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.

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