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# KEY FINDINGS: 2.0

Transformational ideas from i<sup>3</sup>



**Market Need** There are 86.9 million credit union members in the United States, but credit unions held only 18.7% of the auto lending market in June 2005. The auto lending market is intensely competitive with little differentiation among lenders. Consumers are attracted to the best rate, speed, access and convenience. Credit unions need a new product to make the auto loan part of a lifetime membership relationship.

**Mission** Provide an auto loan product that is low-cost and convenient for members and differentiates credit unions from competitors.

Auto lending—with the exception of indirect lending and the ability to underwrite loans quickly via technological advances—has remained unchanged for the past 20 years. Auto loans, though, remain the cornerstone of the credit union lending portfolio. Competition is fierce as major auto companies are facing financial setbacks and need to move inventory.

In the first nine months of 2005, GM lost \$6 billion in the U.S., Canada and Mexico. If they didn't have the ability to finance auto purchases, GM would be out of business. Zero percent financing and employee discount pricing are part of their strategy to continue to stay in business. The numbers look bleak for Ford as well. For the second quarter of 2005, Ford reported nearly \$1 billion in pretax losses in its North American automotive operations. Credit unions can expect competition for auto lending to continue to be cutthroat as the auto manufacturers struggle to survive and depend on their auto financing subsidiaries to generate income.

Indirect lending is a mixed blessing for credit unions. More auto loans have resulted, of course, but relationships with dealers can prove to be troublesome when the dealer and credit union have dissimilar values. Anecdotal evidence, backed up by interviews with lending professionals, indicates that members who join through indirect car loans tend to balk at using additional credit union services.



# LIFETIME

**How it Works** Imagine the “Lifetime Auto Loan,” which is an open-end credit agreement for multiple loan advances designed for members with changing auto needs as they pass through life stages.

The major differences between the Lifetime Auto Loan and standard open-end lending plans are the added convenience and empowerment that are provided to members through continual pre-approval, the pre-approved check and the knowledge of their equity position with their current auto on an ongoing basis.

The Lifetime Auto Loan can be originated at a new account opening, or at any other time during the member's relationship with the credit union. The member makes one application, “one and done,” including a power of attorney agreement for current and future lien filing purposes. Once the agreement is completed, the credit union may provide the member with a pre-approved loan in the form of a check—valid for a limited time—capped at the approved amount. Restrictions on the loan-to-value ratio of the new vehicle, rate and terms may also be adapted to the credit union's needs and strategies.

The Lifetime Auto Loan leverages the advantages of open-end lending.

*“If you have an open-end platform, you can do this for many loans, all disclosures are up front. When the member applies for a loan in the future, the process can be done over the phone—all of the paperwork is completed. You still do the credit check and make a decision whether to grant the loan,”* said Danielle Chatfield, vice-president of lending for Kemba Financial Credit Union.

# AUTO LOAN

## Member's Equity in Auto

One of the creative elements of this product is the communications sent to the member every six months. This includes "servicing" information, which reinforces the benefits of the plan and lists the retail and wholesale value of their existing auto loan. If they qualify through a pre-screen, they'll receive a loan approval check valid for a limited period.

Here's the inventive part of the program—the member also receives a statement indicating their equity position in the vehicle. This is a significant benefit; members are frequently unaware of their equity position—negative or positive. If the member qualifies, he'll be sent a pre-approval along with the check that is valid until the next six month pre-screen.

The communication to the member contains concise information explaining "equity in your car" and the goal of achieving a positive equity position. The statement is both educational and informational as shown in the model equity statement.

## Model Equity Statement

### Lifetime Auto Loan Summary Statement

John Doe  
123 Main Street  
Chicago, Illinois 60606

Date: June 30, 2005  
Account# xxxxxxx1078

Vehicle:	2005 Honda Accord	Retail Value :	\$24,000
Payment Amount:	\$350.00	Trade-in Value:	\$22,000
Your current rate:	4.4% APR	Loan Balance:	\$19,000

### Trade Equity in Your Car: \$3,000

*"If you sell your vehicle to a private party today, not a dealer, you can expect to receive between \$22,000 and \$24,000, based on information published in the N.A.D.A. Official Used Car Guide, assuming the vehicle is in average condition with average mileage. This information is used by automotive dealers to determine the selling price of the vehicle and by lenders to determine the loan value. The Retail Value is the value that a dealer would expect to receive if he sold a vehicle on his lot. The Trade-in Value is the wholesale value of your vehicle, which is the amount that a dealer would pay you for your car."*

*"Trade Equity in Your Car refers to the difference between the Trade-in Value of your vehicle and the Loan Balance. When the loan is paid off, the equity is the actual value of the car. You may be able to sell your car for more than the Trade-in Value, which would increase your equity. The equity in your car is \$3,000.00. When this amount is positive, you will have money available when you sell your car. When this amount is negative, you will still owe money to the credit union after you sell your car. It is best to make sure that you have equity in your car before purchasing a new one."*



"THE CHIEF ENEMY OF CREATIVITY IS 'GOOD' SENSE."

PABLO PICASSO, ARTIST AND PAINTER

## AN ALL-INCLUSIVE ACCOUNT THAT PROVIDES FLEXIBILITY, ACCESS AND CONVENIENCE

# FLEX.ONE



*"It's possible that a credit union might develop an integrated suite of web-integrated tools that make the back office complexity invisible to the member. A credit union may choose to create 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,"* said Eric Acree, chief operating officer, Vantage Credit Union.

**Market Need** Consumers increasingly prefer access, convenience and flexibility from their financial service providers. An account that provides consumers a product similar to a large home equity loan that offers savings, loans, checking and credit cards is the Flex.One.

**Mission** Develop a flexible account that pools all of a member's accounts—savings, loans, mortgage, checking, credit cards—into one account offering convenience and significant savings to the member.

**Target Market** Based on their survey and research, the i<sup>3</sup> group developed two primary member segments likely to use the Flex.One product. The group concluded that a clear niche market exists for this product, but it fails to have the mass market appeal that other credit union products have. But as the product is fully developed and used, the market potential is expected to expand.

**Segment one.** This group has the highest potential and includes the "financial hobbyist" or members who are financially savvy and actively involved in managing their finances. These are credit-driven and high-income, 25- to 54-year-old members. They are college educated, homeowners, or prospective homeowners, receptive to variable rate mortgage products.

**Segment two.** This group includes the "convenience driven" members who understand the financial benefits, but are less actively involved in managing daily finances. Products that save time and provide convenience are valuable to this group. They include middle-market and middle-income depositors, 25- to 54-year-olds. They are also college educated homeowners, or prospective homeowners, receptive to variable rate mortgage products.



# ACCOUNT

**How it Works** The Flex.One Account combines a member's mortgage, income, savings, loan and credit card balances into one account similar to a large adjustable home equity loan. By offsetting the member's savings and income against his mortgage balance and other loans, the Flex.One Account charges a lower interest rate to a lower level of total borrowing. By using one account, the interest that would have been paid into a savings account is deposited in the Flex.One Account. This savings reduces the principal and allows the member to repay his mortgage sooner.

The traditional account model calls for the depositor to keep short-term liquid assets in low interest savings and checking accounts. The Flex.One Account provides an approach to net these savings deposits against loans, saving more in interest expense. The Flex.One leverages the member's daily interest.

The member can choose from several payment options; he can change options during the life of the mortgage, according to lifestyle needs. The principal and interest option allows the member to reduce the overall balance of the Flex.One Account and pay off the mortgage quicker. This is accomplished by leaving sufficient money in the account to cover the principal and interest payments.

The interest-only option is similar to a traditional interest-only mortgage, where interest is paid over the life of the loan and the principal is paid in one lump sum at the end of the term. The member can also choose a combination of the two options, by repaying part of the mortgage over time and funding an investment to repay the remaining amount at a future date.

Data processing core systems that have been developed in Europe to handle Flex. One type accounts are technologically sophisticated. The Flex.One Account can be introduced in the United States on an incremental basis that is seamless to the member.



## Target Market

### A Niche Demand

During early 2005, the i<sup>3</sup> Flex.One group surveyed more than 1,243 members at 12 credit unions to measure attitudes toward the Flex.One Account and assess the likelihood of members using the account. Overall interest in this type of account is moderate.

### The findings:

- 12.1% of respondents said they would be "extremely likely" to use this kind of combined account, another 31.3% said that they were "somewhat likely," bringing the total to 43.4%.
- 57% of adjustable rate mortgage users said they were "extremely likely" or "somewhat likely" to use a product like the Flex.One.
- 41% of non-adjustable rate mortgage users said they were "extremely likely" or "somewhat likely" to use a product like the Flex.One.
- "Credit driven" and high-income segments showed the highest interest level.
- "Middle-market" and "middle-income depositors" showed the next level of interest.
- "Low-income depositors," mostly retirees, and "low-income and fee-driven" people were the only groups unlikely to use the Flex.One Account.
- Low interest rate was the most appealing feature of the Flex.One Account.
- Convenience is the second most appealing feature of the Flex.One Account.

"THE MORE ORIGINAL A DISCOVERY, THE MORE OBVIOUS IT SEEMS AFTERWARDS."

ARTHUR KOESTLER, AUTHOR

