TRENDS, PERSPECTIVES, & ADVICE ON OPERATIONS FROM CU360

CREDIT UNION

executive

NEWSLETTER

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An Award-Winning Approach to Lending

San Antonio Federal has been a pioneer in indirect lending

San Antonio Federal Credit Union is a point-of-sale (POS) lender, according to Chuck Smith, senior vice president and director of lending for the $2.2 billion credit union with more than 237,000 members. "When members want credit, they're making a purchase and the loan merely facilitates the transaction," he says.

"People usually don't say, 'I want a loan.' They say 'I want a new car or braces for my daughter,'" Smith continues. "We recognized we can provide credit for the small-ticket items people need more affordably and with better service than the national lenders do."

The credit union built its business model around being in places where transactions are conducted, and the approach led to an Excellence in Lending Award last year from the CUNA Mutual Group. "We need to be where members are when making purchases," Smith explains. "Credit cards do that, as do indirect auto loans at dealerships and manufactured-housing loans at retailer and broker locations."

Indirect Lending

The credit union began making indirect auto loans in 1987. "We were the first credit union in the U.S. to do it," says Smith. Now the credit union has developed a fully automated program that's unique in the industry.

An APPRO loan-processing platform automates loan decisioning, which enables the credit union to approve or deny loans quickly and handle high volumes. The DealerTrack and CUDL online application systems allow dealers to connect directly with the loan-decisioning system.

"Dealers can enter routine applications online and have a decision in about 20 seconds," Smith says, noting that the system automates decisions for about 55% of loans. "There are still some more complicated applications—the grey area—that loan officers review."

San Antonio Federal was also a pioneer in the area of e-contracting, whereby a dealer enters an application via DealerTrack, it's sent electronically to APPRO for an automated decision, and then back to the dealer. To execute the contract, the borrower uses a signature pad to create an electronic signature.

"The member gets a copy, but there's only one original, which is electronic," says Smith. "The change-in-custody process shows it hasn't been tampered with and it goes into an e-vault. If you print a paper original, the electronic one is eliminated." Dealers still fax ancillary paper documents such as invoices, membership cards, insurance cards, and proof of income, and the credit union is working to automate this process.

With this automation, the credit union's loan volume more than doubled in two years, from $435 million in 2003 to $950 million in 2005. It has also seen productivity gains. "We're basically doing twice the volume with three-fourths of the people we used to have," says Smith. "On the e-contracting side, we're seeing high member and partner satisfaction with the process."

From the dealers' perspective, the process is more

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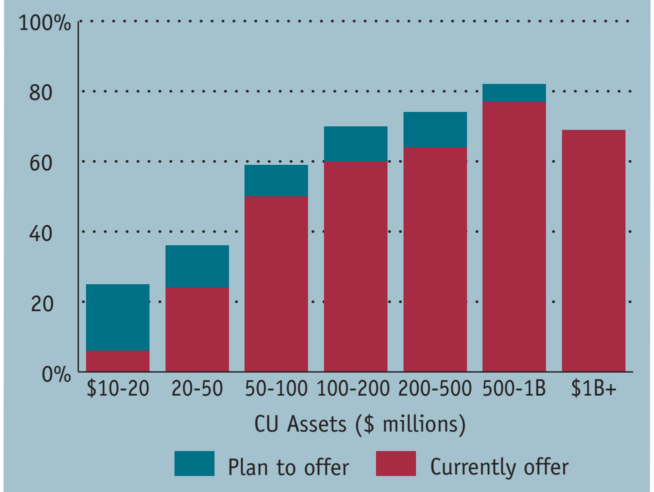
efficient and they end up getting paid more quickly. It's a more convenient process for members, so the interaction with dealers during the loan closing is improved. And because of its increased capacity, the credit union has begun providing indirect lending services for 18 other credit unions through a credit union service organization named Credit Acquisition Resource Systems (CARS). "They don't have to develop their own systems; they can leverage our platform, expertise, and excess capacity," Smith notes. "We process the loan and hand it over to them to book and service."

Figure I

CU Indirect Lending Programs



Source: CUNA's 2006 Consumer Lending Survey

135% Loan-to-Share Ratio

A couple of years ago, the credit union rolled out a loan program for manufactured homes. "We have a separate division called CU Factory Built Lending with loan-processing offices in San Antonio, Seattle, and Greensboro, N.C. We're doing business in 35 states and have about $450 million in loans outstanding," says Smith.

The loans work like any mortgage, but retailers and brokers can take the applications directly. "We've built relationships with the mortgage brokers and retail outlets," he adds. The credit union also provides financing to home manufacturers' retail outlets.

The credit union has an affinity credit card with the Alamo and recently introduced a new affinity card with the San Antonio Spurs professional basketball team. "We're a major sponsor for them and thought it would be a good fit. People associate us with the Spurs," notes Smith. In the five months since introducing the new card, the credit union's outstanding balances have increased 10%.

Smith attributes the credit union's lending success to its employees. "We have people who are professionals in the products they're financing—whether its homes or cars—it's not just a hobby," he says. "They provide great service to our members and business partners."

The credit union focuses on making each product as member-friendly and partner-friendly as possible. "For members, it's the ease of doing business with us, of getting applications approved, processed, and closed promptly," Smith remarks. "If it isn't easy, they'll go elsewhere, and our partners will send them elsewhere. Partners appreciate the ease of getting loans funded and closed, and the fact that credit union employees are experts in their fields."

Lending is central to the credit union's business model. "We believe in the 'credit' in credit union—our loan-to-share ratio is 135%," says Smith. He acknowledges that some credit unions are uncomfortable having such a high ratio but he says it's just a matter of understanding your business. The credit union has been selling mortgages in the secondary market for years and borrows long-term to offset its interest rate risk.

"Deposits aren't the only way to grow liquidity," Smith says. "We borrow from corporate credit unions and the Federal Home Loan Bank. They allow longer loan terms than members want to give us with their deposits, such as share certificates."

As for the future, "We're always looking at the latest technology to make sure we have what's needed to compete and be efficient," says Smith. "We're open to anything that adds value to our members or partners." ■

Top Tips for Lending Success

Chuck Smith, senior vice president and director of lending at San Antonio Federal Credit Union shares his top tips for lending success.

- First, know what your members need. Figure out what products they need to meet the purchasing needs of their life stages.
- Be flexible. If you're just doing everything "inside the box" like everyone else, you're competing only on price.
- Be innovative with technology and products.
- Have consistent underwriting practices. If you're doing point-of-sale lending with partners, you must be consistent and fair.
- Be priced right, efficient, and dedicated to the business. If you're not willing to do that, you'll struggle.
- Be able to respond as quickly to your members and business partners. Indirect lending used to be a matter of responding within hours—now it's a matter of minutes.

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Make Inroads to Gateway Communities

Serving immigrant communities requires a realistic risk assessment

As vital as it is, credit unions need to look beyond their social mission and acknowledge the economic power of underserved communities, according to Warren Morrow, CEO of Coopera Consulting, a subsidiary of the Iowa Credit Union League based in Des Moines.

Coopera (*www.cooperaconsulting.com*) specializes in helping credit unions reach and develop emerging markets, particularly those made up of recent immigrants (also known as "gateway" communities).

Morrow believes an over-inflated perception of risk in serving members of modest means, combined with a lack of knowledge of how to target gateway communities, has made many credit unions reluctant to meet these communities' needs.

"We see a balance between a sustainable model and offering services relevant to these communities," says Morrow. He asserts that alternative financial-service providers such as payday lenders have figured out their own business model and have flourished in many gateway communities—largely at the expense of vulnerable consumers.

Coopera's approach focuses on product innovation, process innovation, personnel best practices, and promotion/marketing strategies. Coopera's first step is to determine a credit union's position in relation to an emerging immigrant market and to assess the credit union's capacity to serve that market, says Max Cardenas, Coopera's president and co-founder.

This process includes interviewing relevant staff and board members, examining demographics, pinpointing partnerships with trusted community organizations, and discovering competitors. Coopera then develops a service baseline that provides a framework for goal-setting. Cardenas and Morrow advise credit unions to put infrastructure and commitment ahead of promotion and translating materials.

"Credit unions typically focus on cross-selling products and services and shy away from transaction-based relationships," Morrow says. "But in this case, the priority is to get these members in the door by promoting low check-cashing fees. Once they become your members, you can show how your member-focused cooperative structure also offers the security and trust needed for more sophisticated transactions."

In addition to check cashing, another valuable service to offer is international remittances. Coopera is working with the World Council of Credit Unions and the Iowa League to help more credit unions launch remittance services.

Culturally Relevant

Credit unions need to tailor and repackage their traditional products so they're culturally relevant, says Cardenas. Immigrants are often turned off by credit unions advertising images of $300,000 homes to promote mortgages. Some regard these houses as unattainable.

Processes often need to be adjusted to be competitive with alternative financial service providers. Morrow admits lending can be challenging because of homeland security legislation and regulations. Immigrants might lack Social Security numbers and need other forms of identification. They may also have short or "bruised" credit histories and rely on cash-based income.

On the upside, however, they might also have a greater number of employed people in the household to help pay off a loan. Automatic underwriting procedures don't necessarily transfer well when evaluating these factors. Morrow points out that several credit unions are still rigorously examining risk while at the same time providing access to the unbanked by using alternative credit-scoring systems like Teletrac.

Building Relationships

Successfully interfacing with new gateway communities is essential and can include hiring bilingual and in-community employees. Credit unions that rely heavily on traditional hiring methods could miss out. Morrow recommends building partnerships with key groups who can endorse the credit union as an employer of choice.

Once your credit union establishes an environment that welcomes immigrants, you can promote to prospective members by identifying the preferences, needs, and desires of the segment you're targeting. Many cultural subsets exist within the Hispanic community, for example, and Coopera recommends mapping these out and developing advertising based on specific community research.

"Move toward these new markets, and don't wait for them to come to you," advises Cardenas. Develop trust by sending an ambassador to individuals, local churches, soccer leagues, and networking groups and win their endorsement. ■

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"Moments of Truth" Define Member Service

How does your frontline staff handle the most important member interactions?

Mature companies with extensive networks of front-line sales staff—banks, retailers, airlines, and others—have devoted a great deal of money and effort to retaining their existing customers. As many studies have shown, the cost of doing so is much lower than the cost of acquiring new ones.

Although companies are investing record amounts of money in traditional loyalty programs, CRM technology, and in general Service-quality improvements, most of these initiatives end in disappointment. Only 10% of business and IT executives strongly agree that business results from implementing CRM were met or exceeded, according to Forrester Research.

Great customer-service companies earn trust and loyalty during 'moments of truth'—those rare interactions when customers invest a high amount of emotional energy in the outcome.

What's regularly missing, according to *The McKinsey Quarterly*, is a spark between the customer and frontline staff members—a spark that helps transform wary or skeptical people into strong and committed brand followers. Great customer-service companies earn trust and loyalty during "moments of truth"—those few interactions when customers invest a high amount of emotional energy in the outcome.

McKinsey researchers have found a number of practical ways for companies to meet this challenge. In any industry that offers a service (or sells a product with an "embedded" service element), there are moments when the long-term relationship between a business and its customers can change significantly—for better or for worse. Supporting and developing employees' emotional intelligence (EQ) ensures that more of those moments have a positive outcome.

High Emotion, High Performance

In the retail-banking industry, McKinsey identified the critical moments for customers as well as the prize awaiting institutions that respond appropriately. These moments often occur when the customer has a problem (such as a hold on a check or a need for a quick answer on a loan) or receives good or bad financial advice.

The impact of frontline EQ on the bottom line is clear. After a positive experience, more than 85% of customers purchased more products or invested more of their assets. Just as telling, more than 70% reduced their commitment when things turned sour.

One bank found powerful evidence of the link between customer loyalty and value creation when it set out to explain striking differences in the performance of its branches—a more than 50% gap between the best and the worst as measured by share of wallet and customer retention. Surveys showed that the bank's better-performing branches turned moments of truth to their advantage by solving problems and emphasizing the financial needs of customers over the branch's own sales goals.

Given the clear link between moments of truth and share of wallet, every customer-facing business should identify the points of interaction relevant to its industry.

Behavior is the Key

Pure technological solutions can never stoke the emotional connection between employee and customer—the kind of connection that characterizes positive moments in complex frontline situations.

When technology falls short, frontline employees can succeed with the right skills and competencies. While most companies fully understand the importance of training to build capabilities, most ignore the mindsets of their front-line employees.

Consider, for example, the opportunity missed by many top financial institutions to meet the needs of people approaching retirement. These customers' financial advisers may have a mindset that makes them reluctant to help—a hesitancy that could stem from several sources: worry that they would be intruding on the customer's privacy, their lack of belief in the products and services they offer, or a fear of rejection.

By contrast, the best advisers consider themselves guardians of the customer's well-being. They have full confidence in what they sell and in their ability to communicate. This mind-set makes it easy to have successful conversations with clients, to understand their emotional and financial needs, and to perform well during moments of truth. ■

Online Account Opening Saves Time & Money

Alliant CU's automated option facilitates member enrollment

In early 2006, Chicago's $4.4 billion Alliant Credit Union made the decision to broaden its member base by taking on the employees of a large company. This strategy highlighted a major issue: The manual processes used to open new accounts were in danger of becoming overloaded with the influx of new members. An automated account-opening solution was essential for Alliant to be able to execute its strategies.

Alliant started exploring account-opening solutions in the fall of 2005. The former United Airlines Employees Credit Union faced unique challenges. Approximately one-third of its 11 branches are located in secure areas within airports, meaning members are less likely to visit branches and spend face time with staff. Alliant's traditional account-opening process was inconvenient for many of its members.

In addition to making the process more convenient, Alliant explored automated account-opening solutions as a means of improving its operational efficiency. Management believed that an automated solution could help bring in new members with less cost and effort. Alliant wanted to reduce enrollment time by 50%, which was impossible using its current tools.

As it explored possible options, the credit union realized that several other business goals could be supported by an account-opening solution. Among them were:

- Improve overall compliance.
- Improve service consistency across channels.
- Leverage cross-selling.
- Enable membership drives.

In keeping with the firm's service-oriented culture, Alliant required any solution that could deliver on these goals to be user-friendly and in keeping with the company's brand and image. The results of the conversion process are detailed in a paper from the Boston consulting firm Aite Group.

Before implementing an automated solution, accounts were opened using a manual process. For telephone or walk-in applications, the entire process typically took 20 to 25 minutes. Any cross-selling was supposed to occur at the end of the process, but Alliant was missing these opportunities due to the length of the process.

A Brisk Timeline

In selecting a vendor, management recognized that the solution had to integrate with Alliant's core processor and third-party data providers. It had to dependably handle a full suite of products, and present a user-friendly workflow for staff. From the member's perspective, the solution had to deliver an improved service experience.

In early 2006, following a brief evaluation of available options, management selected a vendor who promised to focus on member service and complete implementation within Alliant's ambitious deadline.

After contracting with the vendor, the solution was implemented quickly. Only a month after the contract was signed, the screen flows and content were finalized. A month later, the system was ready for beta testing. Three months after the vendor was selected, the system went live. Alliant was able to move quickly because:

- Alliant chose a vendor with a packaged solution that included pre-built and configurable system interfaces and front-end applications. While some cosmetic changes were necessary, surprisingly little customization was needed.
- The vendor solution came with third-party integration already in place, including a long list of service providers and the credit bureaus.
- The vendor hosted the Alliant solution, which meant that Alliant could focus its attention on setting up the various workflows and configuring the solution to process applications.

Given its size, Alliant was able to dedicate a cross-disciplinary team of about seven people to the implementation. Departments represented on the team included compliance, account funding, audit, branch operation, and IT.

The implementation process included weekly status calls, with documents and deliverables coordinated through the vendor's client extranet. All work was reviewed by Alliant in the vendor's beta environment before going live.

Based on the capabilities of its new system, Alliant devised workflows to support in-branch account opening, plus true online account opening without staff participation. The workflows leverage the system's data-entry functions, real-time calls to third-party data providers, and real-time identification of cross-selling opportunities.

Alliant wanted to cut enrollment time 50%, which was impossible using its current tools.

Prospective members who walk into a branch to open a new account still might start the process with a paper application because Alliant's branches don't always have full-time employees available to open new accounts. Even so, having branch reps use the account-opening system cuts the time they spend on applications in half. And prospective members now spend less than 10 minutes on Alliant's Web site (*www.alliantcreditunion.org*) to open and fund new accounts.

The benefits of Alliant's online account opening solution include improved service levels, quicker capture of assets, improved strategic flexibility, and improved report-generating capabilities.

In the first six months following deployment of the account-opening solution, Alliant says about 13% to 17% of new accounts were opened online. Alliant is marketing the capability more aggressively to drive more traffic to its online channel.

Branch Costs

Aite Group estimates that it cost Alliant between $8 and $10 to open a new account manually. At original new-account volumes, the annual cost to the credit union was well into six figures. As Alliant's volume increased with changing business strategies, the cost was going to increase unless changes were made.

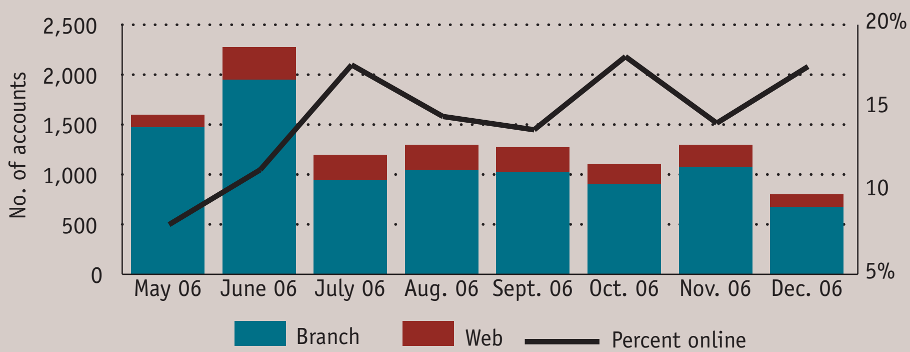
At Alliant's current adoption rate, where 13% of new accounts are opened online, the annual savings in branch staff time is now over $97,000. This is based on a unit cost of $9.79 using traditional in-branch methods, versus a unit cost of $5 for in-branch account opening facilitated by the automated solution, and a unit cost of only $0.25 for purely online account opening.

An additional benefit of automating workflow and account-opening processes is that it gives Alliant greater visibility into its daily operations. Staff can track activity over different time periods, monitor work volumes at various stages, and drill down to specific application details. This type of information was difficult to create when accounts were opened via a paper process. ■

The conversion process is described in Automating Account Opening In-Branch and Online: A Case Study of Alliant Credit Union, *available for purchase from the Aite Group, Boston, Mass. Contact them at* www.aitegroup.com, *or 617-338-6050.*

Figure II

Accounts Opened by Channel at Alliant CU



Sources: Alliant Credit Union, Aite Group

Are Data Breaches and ID Theft Linked?

A new GAO study fails to turn up a direct link

Data breaches involving consumers' personal and account information have become an inescapable fact of life for financial institutions. While the amount of information lost or stolen is clearly unacceptable, it's difficult to prove these breaches have led directly to identity theft and tangible financial losses for those affected, according to a July 2007 report from the U.S. Government Accountability Office (GAO).

The GAO examined the 24 largest (in terms of number of records compromised) data breaches from January 2000 through June 2005. Of the breaches studied, three included evidence of resulting fraud on existing accounts, while only one included evidence of unauthorized creation of new accounts. The agency could not find clear evidence of any link to identity theft for 18 of the breaches, and information about the remaining two breaches was inconclusive.

The low ratio of identity theft per stolen data is difficult to explain given the lack of information.

Ease Members' ID Theft Concerns

CUNA Strategic Services has entered into a strategic alliance with LifeLock to help credit unions ease their members' identity-theft concerns.

Unlike other credit monitoring services that only notify customers after a breach has occurred, LifeLock prevents identity theft from happening at all by rendering personal information useless to thieves. The company achieves this by maintaining active fraud alerts with the major credit bureaus, which gives its customers control of their own information, providing them the ability to authorize transactions such as address changes and the opening of credit lines.

The company also backs its service with a $1 million guarantee to completely fix any problems if a client is ever compromised.

Credit unions have the option to offer this service to members free of charge or at a discounted rate. Protection is also available for children, who are frequently the targets of identity thieves. For employees, the service can be added to benefit offerings on an existing plan.

For more information, visit *www.cuna.org* and type "LifeLock" in the search box or contact Brenda Halverson, product manager for CUNA Strategic Services, at 800-356-9655, ext. 4110, or by e-mail at *bhalverson@cuna.coop*.

Identity theft victims often don't know how their personal information was obtained, according to the GAO. Law enforcement officials told the agency that in some cases, stolen data might be held for a year or more before being used to commit identity theft. And issues of privacy and confidentiality make it difficult for organizations to conduct comprehensive studies of data breaches and identity theft.

Causes of Breaches

In studying the data breaches, GAO compiled lists of causes categorized as "intentional" or "accidental." Breaches involving intentional actions include:

- Hacking—accessing computer systems without authorization.
- Employee theft—could include hacking, but more often involves physical removal of data and records.
- Theft of physical equipment—including laptops, servers, discs, flash drives, and other types of data storage/processing equipment.
- Deception or misrepresentation to obtain unauthorized data—including imposters posing as legitimate data users to gain access to data.

Breaches involving negligence or accidental losses of data include:

- Loss of IT equipment—in this study, the lost equipment was exclusively laptops.
- Loss of data tapes/drives—often involving archived records and data, and is associated with relations between data managers and storage facilities.
- Unintentional exposure on the Internet—often involving exposure of internal organization Web processes to the Internet through neglected security procedures.
- Improper disposal of data—often involving sensitive documents improperly disposed of.

A Growing Problem

While the correlation between data breaches and identity theft is unclear, there's no mistaking that data breaches are a growing problem. More than 570 data breaches were reported in the media from January 2005 through December 2006, the GAO found.

And law enforcement is feeling the strain. The FBI's Cyber Division told the GAO that it's currently working on more than 1,300 pending cases of computer or network intrusions in which data breaches resulted from unauthorized electronic access to computer systems, such as hackings. The Secret Service in 2006 opened 327 cases involving network intrusions or data breaches, specifically in which financial information was lost or stolen. ■

Automation Is Changing the ATM Landscape

Acceptance of Check 21 provisions leads to ATM advances

While its market acceptance has been slow, most ATM industry analysts agree that the next 18 months will be marked by a noticeable increase in the adoption of deposit-automation technology, according to *ATMmarketplace.com*.

Research suggests that consumers prefer envelope-free deposits, and financial institutions are responding, according to Tony Hayes, vice president of financial services for Boston-based Dove Consulting. Twenty-one percent of banks and 24% of credit unions deployed deposit-imaging ATMs in 2006, according to Dove. Another 58% of banks and 65% of credit unions planned to deploy the ATM technology within the next year.

By 2011, about one-third of all ATMs in the U.S. will accept automated deposits for cash and checks, according to Peg Bost, a Check 21 expert at Diebold.

Check 21

The rise of widespread check imaging had been predicted since the early 1990s. Finally, it seems the check-processing industry reached a tipping point.

Volume growth in check imaging in 2006 was remarkable, even to most industry insiders. A 2007 Federal Reserve/ECCHO study found:

- Check-21 enabled volume (substitute checks and image exchange) grew 726% in 2006. Image-exchange increased 3,160%.
- The percentage of routing and transit numbers receiving image files more than doubled to nearly 6,000, representing 34% of U.S. financial institutions.
- Image-exchange volume exceeded substitute check volume for the first time in September 2006.

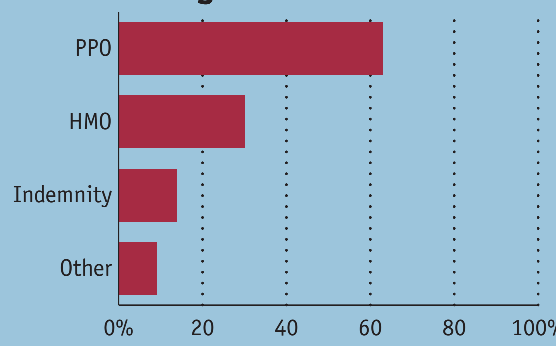
CUs and Imaging ATMs

Credit unions and other smaller financial institutions are likely to use automated-deposit features for checks as a way to compete with larger financial institutions. This potential will force ATM manufacturers to provide imaging features at reasonable cost.

"At some of the trade shows we've gone to recently, credit unions specifically say they're looking for check-scanning capabilities when they make their ATM upgrades," one ATM manufacturer tells *ATMmarketplace*. ■

A CLOSER LOOK

CUs Offering Health Insurance



Source: CUNA's 2007 Credit Union Staff Benefits Report

Controlling health care costs is top of mind for employers. In fact, rising health care costs was number one in the Society of Human Resource Management's Top Ten Trends for 2007. Credit unions in 2007 are more likely to offer group health insurance to employees than in years past, according to CUNA's *2007 Credit Union Staff Benefits Report*. Overall, two-thirds of credit unions provide group health insurance to their employees—up from 58% in 2003, a figure that had not significantly increased since 1995. PPOs continue to be the most common health insurance plan offered, followed by HMOs, conventional indemnity coverage, and other types of health care plans.

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