Merchant Lending

Indirect Loan Opportunities

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Executive Summary

The market opportunity for indirect merchant lending is plentiful. The economy is bouncing back (albeit slowly), credit unions have excess dollars available to lend, and dozens of industries exist with untapped lending potential. Looking at the competition brings the opportunity credit unions have into focus. Merchants and consumers alike are mainly relying on credit cards with terms credit unions can easily beat.

The advantages of indirect merchant lending seem clear: credit unions can provide their members with loans when and where they need them. What's more, they can expand their lending portfolios and acquire new members simultaneously.

The beauty of merchant lending programs is that their structure can be built and marketed around member needs, which vary from market to market. Credit unions are able to draw heavily on their experience with indirect auto lending programs, as well as extensive resources available from state leagues and CUSOs.

In this white paper, published by the CUNA Lending Council, we will explore:

- The market opportunity for merchant lending
- The competition for merchant lending
- The economic environment in which credit unions are operating and its effect on merchant lending programs
- Best practices from indirect auto lending
- Considerations for implementing a lifestyle/merchant lending program
- A one-to-one interview with Sandi Carangi

Introduction: The Market Opportunity

Merchant lending programs allow credit unions to respond to the need for unique, well-priced loans to both their members and the greater community. Consider the target consumer: they are someone who needs or wants to spend $1,000-$5,000. This might be for a home repair, medical emergency, or a funeral. Or they've chosen to make a lifestyle purchase such as cosmetic surgery or a home enhancement such as solar panels.

When this person goes to make the purchase, however, they'll either use their credit card or a financing program with risky conditions. An indirect loan from a credit union usually isn't the first option anymore, despite the potential to offer the most favorable terms.

In other words, credit unions have an opportunity to serve their members. At the same time, they can provide a great service for the community at large that will attract new members. Finally, the credit union can diversify its loans portfolio and increase revenue. Win-win-win.

To create these programs, credit unions should leverage existing structure and knowledge. The current review process for signature loans and any indirect auto lending programs will provide the basic architecture for any merchant lending program. In other words, merchant lending is a natural extension of the loan products credit unions already offer.

This isn't to argue that merchant lending programs don't have their particulars to which credit unions will need to adapt. Sandi Carangi, Director of Credit Union Marketing and Strategic Services for the Pennsylvania Credit Union Association, explains, "you're doing a lot of small dollar loans, so you have to do a large number of them to have any kind of impact on loan growth. It also takes quite a bit of time to build up the program. It's different than auto loans. You need someone to go out there and explain the program and then promote it, so businesses know that now they can offer financing through the credit union."

Fortunately, a vast amount of help exists to achieve this. These days, CUSOs can provide help with every aspect of a program. This includes finding partners, marketing the program, and analyzing risk. Of key importance for credit unions, CUSOs can help with technology solutions that minimize costs and maximize the chance to help your members and the community finance these loans. State leagues can also serve as fountains of information and contacts.

The potential downsides of indirect lending are the perceived risk and the extra time and effort spent setting up and running the program on an ongoing basis. Keith Troup, VP-Chief Lending Officer, Washington State Employees Credit Union Lending Division, Olympia, WA, indicates, "we feel that our Indirect lending program is a great way to provide members value and also makes sense financially for the credit union. We think it makes sense to be where our members are going to buy goods and services. It gives you the highest likelihood of acquiring loan business as a lender."

At their core, merchant lending programs are about going where members need the credit union and providing a valuable service to them.

The Competition

Before delving deeper into how to serve members with merchant and lifestyle loan products, there is a looming question: who is currently serving them?

The largest player in the merchant lending arena is GE Finance. They provide credit cards that businesses in turn offer to their customers. Fifty five million Americans use a GE store credit card. At a basic level, businesses use them because they work. The average first purchase on a GE Capital card is more than five times what customers spend on a traditional bankcard and more than eight times what they spend in cash.[1]

According to the Wall Street Journal, "GE has said the U.S. consumer-finance business earned $2.2 billion last year. The operation accounts for about $50 billion of the $274 billion in loans outstanding by GE Capital."

GE Finance is popular with businesses because it is fast and easy to use. Merchants benefit from fast credit approval decisions and money transfers within 48 hours. In addition, GE Finance provides training to help businesses maximize the effectiveness of the programs. They also have marketing collateral tailored to different industries. These include health care, home improvement, and many more. On the other hand, they demand small fees for their service and a percentage of each sale.

The typical GE card has an introductory period with no interest followed by an interest rate of 29.99%. In the medical and dentistry fields, most offices offer patients a credit card through CareCredit. GE Finance is the company behind CareCredit and the interest rate is 26.99%.

From the consumer's perspective, a credit card with 12 or even 24 months of interest-free financing can be a godsend. But they're often unprepared for the hit they'll take if they miss a payment or can't pay off the card during the introductory period. The APR for most cards will jump to 29.99% and the interest will be retroactive after the introductory period has expired.

Other financial service companies offer a product similar to what a credit union might present. These companies often specialize in financing for one industry such as medical treatment, home repairs, or funerals, and often offer both revolving and installment credit.

By way of example, Aquafinance is a specialty finance company, working with dealers across the nation to provide financing for their customers. Aquafinance began in water treatment financing and expanded into home improvement, medical financing, and more. They finance amounts up to $30,000 and have installment loans with terms up to 72 months. Their revolving credit APR is 17-17.99% and they offer introductory APRs as low as 0%. They seek to be flexible enough with the terms to allow dealers to close tough sales. In addition, they have small late payment/returned payment fees, provide daily funding, and give 100% payouts for qualifying "A" credit.[2]

Beyond credit card companies, payday loan companies are a last resort solution for many people. Payday loans companies aren't usually considered competition for credit unions as the loans are

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[1] Source: www.gogecapital.com
[2] Source: www.aquafinance.com

used to pay small, everyday expenses. What's more, the customers' credit ratings are generally poor and 10-20% of payday loans are not repaid.[3] Still, in emergency situations some consumers use payday loan companies for larger purchases. The attractive opportunity here is to support the communities the credit union serves and provide an alternative service for members who are otherwise left with no choice but to take out a payday loan.

The final competitor is no competition at all. Many businesses simply don't offer financing options, which is a lost sales opportunity for that business but a great business development opportunity for the credit union to swoop in with a proposal.

The Economic Environment

Macroeconomic indicators for potential loan growth in late-2013 are almost universally good but not great. Reduced government spending and weak exports have kept GDP growth around 1%, but consumer spending has been making up the difference with 3.2% growth in Q1 2013 and .5% in Q2 2013. The unemployment rate has hovered around 7.5% for much of the year. This is well off its peak of 10% in October 2009, but with the economy creating just 200,000 jobs per month, there are still 2 million fewer jobs than in 2007.

New auto purchases have been a strong part of consumer spending. Seasonally adjusted, annualized selling rate (SAAR) has been over 15 million since November 2012.

At credit unions, deposits surpassed the $1 trillion milestone and membership grew by 2 million people. Current members are more likely to choose a loan with their credit union, so there's a nice opportunity to offer further services to new members.

Credit unions have now had well over two years of growth. By May 2013, total loans were up 6.4% from May 2012. Vehicle loans were up 7.4% over the same period. Credit unions had 10.2% higher growth in consumer installment credit than May 2012 and were outperforming the market by 4.7 pp. (If you take government student loans out of the equation, this rises to 8.6 pp.)

Positive economic news and healthy credit unions have led to intense competition for A+ auto loans. This is due to bank and credit union liquidity, but also institutional investors desperate for anything better than treasuries.

This is, in turn, is increasing competition for B and C loans. Consumers have been more likely to make their auto loan payments, and resale value on repossessed vehicles has risen. As a result, these loans aren't as risky as in the past.

The other side to that coin, though, is that the more attractive these loans become, the narrower the rate margin. Bill Vogeney, Chair of the CUNA Lending Council Executive Committee and EVP/CLO at Ent Credit Union in Colorado Springs, CO, writes, "auto loans, the bread and butter for most credit unions, are subject to the greatest level of rate competition I have seen in 24 years at the credit union senior management level." Moreover, while enticing loss ratios currently exist, should they return to historic levels, many credit unions could find themselves in a bad place.

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[3] Source: Megan McArdle, http://www.theatlantic.com

Troup agrees on the difficult environment, "we are operating in a hyper-competitive marketplace for automobile loans. We have been challenged in producing new loans at the same pace new deposit dollars keep coming in."

The merchant lending environment, on the other hand, faces less competition. Troup continues, "for lifestyle loans, there's still very little competition. I think that's another reason it's appealing." By way of example, WSECU has developed a program for RVs in order to diversify its portfolio. Troup says, "we were the second credit union within the markets we serve to get into this arena back in 2010. Now, there are eight or ten of them."

Regulatory and compliance pressures are the final part of the environment to consider. The newest concern is Fair Lending. Credit unions are working carefully with lawyers to review all agreements. In addition, credit unions should now monitor any lending partners in order to be certain their rates are not influenced by race, gender, age, and so on.

Best Practices from Indirect Auto Lending

Before moving on to implementation ideas for new merchant lending products, it is prudent to review best practices from a well-developed sector of indirect lending: auto loans. Many of these practices will directly apply to the creation and success of merchant and lifestyle lending programs.[4]

Big Picture Thinking

Indirect auto loan program structures begin with goals and limits. The goals are for the net worth of the program, the number of loans, and the number of partners. Limits are set for the total size of the portfolio and its size in relation to other lending products. These standards are consistent with the direct loans at the credit union.

The size of the program directly affects staffing for lending and collection departments.

To pass muster with regulators, programs need regular cost-benefit analysis concerning net return and the associated risk. It should be clear how the indirect lending program will impact asset liability management at the credit union as well as liquidity risk management. An exit strategy will need to be in place if the risk becomes too high or the returns become too low.

Regarding vendors/merchants (the businesses the credit union is partnering with to offer these loans), specific underwriting standards present clear requirements for when the credit union will accept loans from vendors and when to cut ties. As the health and reputation of vendors are keys to ultimate success, a process should be in place for reviewing those vendors to ensure operations are strong and what the action steps will be should the situation with the vendor change.

Caleb Cook, vice president of lending at Seattle Metropolitan Credit Union, Seattle, WA, suggests, "monitoring volume fluctuations, credit quality distribution, lifecycle yields, early payoffs, first payment defaults, finance director portfolio performance, and underwriter and dealer loan pools."[5]

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[4] Key resource for this section: Matz, Debbie. "Indirect Lending and Appropriate Due Diligence." *National Credit Union* Administration. NCUA Letter To Credit Unions. August 2010 Web. 2 October 2013

[5] Source: Samaad, Michelle A. "Indirect Looks to Lead Again in Lending Dance." *Credit Union Times*, 27 February 2013. Web. 2 October 2013

The process for making exceptions, though they should be rare, specifies who will make the final decision and who will review the decisions after they are made. Strong partnerships insulate the credit union from too much rate competition. This means being ready to help the merchants out, being clear about processes, and making sure concerns are addressed. Cash flow is a particularly important element of this. Great programs are able to do things for their vendors that other fly-by-the-night competitors can't or won't.

If the program is new, it will generally take two years to mature and fast growth can hide performance issues early on, so it's important to be able to segment risk categories by origination period in order to isolate emerging negative indicators.

Designing the Product

Finding merchant-partners begins with creating a competitive product. Interest rate matters a great deal, as does the credit policy.

First, dealer reserves are key. A flat rate policy is common in the industry and prevents scrutiny into fair lending compliance.

Second, do the terms make doing business with the credit union easy? Specifically, this is the dollar amount you'll allow for a longer-term loan and how the size of the loan compares with the vehicle value. "If you'll only do a maximum loan to value of 50%, you're going to get very few loans even if you offer 1%," offers Troup.

Third is flexibility. Finding creative ways to reduce the monthly installment can be a great selling point.

Finally, dealers appreciate credit unions that are reliable, fast, and caring. Troup continues, "you can't win on rate all the time. We try to be competitive. The truth is, we are rarely the best rate. Where we are the strongest is providing excellent service and flexible terms and getting dealers their money fast."

This all culminates in the contract. According the NCUA, at a minimum, a contract with a dealer should include:

- Dealer compensation
- Credit Criteria
- Documentation standards
- Dealer reserves for charging back non-performing loans under certain circumstances
- Dispute resolution
- Exit clauses

The best programs have a multitude of benefits. Michael Cochrum, product director of analytic products for CU Direct Corp, writes, "more important than rate is consistent underwriting, timely funding and the ability to share in the profits of closing the loan."[6] Dealers prefer low interest rates

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[6] Source: Samaad, Michelle A. "Indirect Looks to Lead Again in Lending Dance." *Credit Union Times*, 27 February 2013. Web. 2 October 2013

because they help them sell more cars. But they prefer profits above all, so your program should contribute to their bottom line in a multitude of ways.

Open communication is an important, if less tangible, element of a program. "We have processors that do nothing but work with dealers to solve problems. The dealers love this," says Mark Wild, SVP-lending for Mountain Regions with the $7.3-billion Security Service FCU in San Antonio, TX.[7] Dealers also appreciate high-level contacts and, when possible, someone to call after business hours.

A great way to market the program is simply for branches to send foot traffic to a dealer. Dealers will take notice. The relationship and the product will be strong.

Due Diligence on Vendors

Due diligence begins with references and learning about a vendor's history with indirect lending. Vendors with a bad history are to be avoided. Vendors employing managers with bad histories—usually at another location—are just as bad.

In that same vein, due diligence requires knowing how long management has been there and who've they've worked with. The vendor's operational structure is important, as are the key people for various issues such as underwriting, contracts, and cash flow.

Other common questions include:

- ➢ How does cash flow between parties?
- ➢ Do they depend on volume or big sales?
- ➢ What is their marketing strategy and why?

It's no less important to pay attention to the dealer's business as time passes and a relationship develops. Deviations from standard business can be a sign that the vendor is struggling, but it also might mean a problem is being addressed or a new opportunity seized.

Financial statements and credit reports are used to review the financial condition of partners as well as the vendor's partners and affiliates.

Beyond one's network and available reports, credit union members are a final source of information on vendors. They can share their experiences and provide valuable information.

In the end, all of this is about building a strong relationship where both sides understand each other well and have honest and clear expectations for the relationship.

<u>Do's and Don'ts for Seizing Opportunity and Reducing Risk</u>

- ✓ Do value quality of loans and partnerships above quantity
- ✓ Do watch out for a high volume of missed first payments, payment deferment, and account re-aging.
- ✓ Do properly analyze the total indirect loan portfolio performance

[7] Source: Bartlett, Michael. "Security Service Shares Advice On Building Good Indirect Portfolio." *Credit Union Journal* 17.24 (2013) 6

- ✓ Do look out for dealer inflated trade-in and/or purchase price
- ✓ Do be vigilant against continuous overdrafts in dealer reserve accounts
- ✓ Do continuously assess vendor relationships and risk
- ✓ Do have written policies on all aspects of the program
- ✓ Do monitor vendors' financial and operational risks
- ✓ Do periodically reassess the legal agreements and needs of the program
- ✓ Do create a risk management process to control the risk associated with vendors
- ✓ Do review exceptions made
- ✓ Do train staff well and update them on policy changes
- ✓ Do use static loan pool data from the vendor and report on delinquency rates, default rates, current and cumulative losses, prepayments, and rates of return
- ✓ Do monitor volume fluctuations, credit quality distribution, lifecycle yields, early payoffs, first payment defaults, finance director portfolio performance, and underwriter and dealer loan pools
- ✓ Don't let the opportunity for greater returns distract from the risks.
- ✓ Don't link bonuses with indirect loan volume.
- ✓ Don't become dependent on indirect loans without adequate controls
- ✓ Don't rely on the dealer to obtain credit reports
- ✓ Don't accept loan payments from dealers
- ✓ Don't work with dealers who pay the down payment
- ✓ Don't make many exceptions
- ✓ Don't make one person responsible for many steps
- ✓ Don't make data available unless needed
- ✓ Don't just look at the whole program. Have information on each vendor.

Lifestyle and Other Merchant Lending

There are many best practices from indirect auto lending programs which can be adopted by lifestyle and other merchant lending programs. Some additional considerations, along with qualities that make lifestyle/merchant programs different, choosing partners, marketing the program, and getting help from other sources are explored below.

Benefits of Lifestyle and Other Merchant Lending
There is every reason for merchant lending to be a triple-win. The merchant wins with increased sales. The consumer wins with a great loan. And, of course, the credit union wins in several ways:

First is simply serving your members well. Members needlessly use credit cards and take out loans with unfavorable terms. The main reason they're not choosing the credit union is because you're not offering your loans at the point of sale. On a similar note, credit unions can also serve their business partners better. If merchants can offer their customers a fairer deal through the credit union, they will happily do so. They can increase their transactions and feel better about what they're doing.

Second, Troup argues credit unions have a chance to both, "serve more member needs and bring value to the credit union as a whole" Reduced competition creates the opportunity to originate more loans and serve more members effectively. What's more, new sources for loans allow a credit union to diversify their portfolio. In Troup's case, the volume of indirect RV loans at WSECU has surpassed auto loans in recent months and fits with the credit union's strategy of diversified loan growth.

Finally, there's an opportunity to acquire new members. At WSECU, more than half of the loans are given to new members. This new relationship opens up even greater opportunities for other credit union services.

Credit unions have had difficulty developing new members who begin with indirect auto loans, but a 2008 study commissioned by CUNA demonstrated that efforts with new members acquired through indirect auto loan channels can lead to new product sales. The three keys are a carful pre-screening process, putting enough effort into calling the new members, and being able to save them money. People generally respond well to these phone calls. They appreciate the relationship-building even if they don't take on a loan or credit card.[8]

How Merchant Lending Is Different

From an operations perspective, the components of merchant lending will be familiar to many lenders. The back-end parts are the same as with unsecured personal loans. Members, or potential members, will still be price and payment sensitive to varying degrees. A different kind of risk does enter the playing field when acquiring loans from a merchant; thus, credit unions replicate much of the risk protection practices from the auto channel.

Merchant lending is unique in several ways:

- First, **the loans are often small**. While big-ticket items aren't out of the norm, more partners deal in smaller dollar products. As a result, programs plan for a higher volume of smaller loans or for merchant lending to be a smaller part of their lending portfolio.

- Second, **the merchants also tend to be smaller and potentially less stable**. This increases the need for good due diligence, but don't overdo it. The risk is ultimately with the person making the payments.

- Third, **the competition isn't another lender offering similar terms**. It's usually some kind of credit card. This significantly reduces the competitive rate environment.

- Finally, **credit unions have an opportunity to educate**—and even wow—potential partners. Retail stores and service providers are often unaware of how much a credit union can help their business and their customers. They might not offer financing. They might dislike the financing they do offer and wish they had an alternative.

Choosing Partners

Paul Kirkbride, Vice President of CU Solutions at CU Direct, suggests, "find a market that's not being served well now and fill that niche." In other words, look for opportunities to help your members and your community.

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[8] Source: Jerving, Jim "Developing Members from Indirect Borrowers. Lessons Learned." *CUNA Lending Council, August 2008.* Web. 2 October 2013

Industries to consider include:

Cosmetic Surgery	Funerals	Musical Instruments
Dentistry/Orthodontics	Veterinarians	Seminars
Hearing Aids	Jewelry	Travel/Vacation Clubs
Vision	Weddings	Computers
Home Improvements	Education	Health and Fitness, and
Recreational Vehicles	Furniture/Appliances	Hair Transplant

Different industries will have different advantages and disadvantages. For example, Thomas M. Becker, Senior Vice President Lending, Hanscom Federal Credit Union, Hanscom AFB in Massachusetts, a $1.1 billion dollar institution, notes that some big ticket items will have huge and fast depreciation. A second example is that most dentists in the country offer credit cards through Care Credit, so you would be getting into a competitive area.

But Kirkbride, Vice President of CU Solutions at CU Direct, suggests that these big picture thoughts on an industry aren't as important as what your members are doing and what business partners you already have. He says, "go where there's a need. Even if there are current options, it doesn't mean you should shy away as long as you bring something unique. In many cases, credit union financing will be the best option."

Credit unions naturally gravitate towards industries they already know something know about. If you go where your members are spending money, you'll be able to help them regardless of the particulars of the different industries. Knowing the industry will make due diligence concerns easier and being able to speak the partner industry's language helps with marketing.

Troup adds, "there are geographic limitations. We're about serving who we are. I think it needs to complement and support who you already are as a credit union."

If you are looking for a way to begin, businesses that are currently using your credit union for business services are a great place to start learning more. There's established trust and they know everything about the competition's price schedules and other product elements. In addition, you can learn about the potential volume of loans and get a sense of the close rates.

Finally, note that industry size and close rates should make a program's goals possible.

All of this information will be vital as you design your program and structure your product. You'll need the figures to help you calculate cost and build your price.

Marketing

Marketing begins with education. Here are some important points to take into consideration to effectively promote the availability of merchant and lifestyle loans with your credit union.

Merchant lending is a fantastic opportunity for a win-win-win relationship. The credit union wins with a new package of loans that boosts income and diversifies risk. The merchant now has fair financing that lets their customers spend more, and more often. And, best of all, the customer wins because they get a great interest rate and a comfortable payment.

For current credit union members, deepening the relationship is a win all around. Everything will be easy because you're already serving them. New members will win in all traditional ways as the credit union leaves other financial institutions in the dust on service and terms.

Carangi, now the Director of Credit Union Marketing and Strategic Services for the Pennsylvania Credit Union Association, says that while she was Vice President of Business Development at a Pennsylvania credit union, one of the great points for merchants was that many of their customers were already members of the credit union. To find more merchant lending partners, she says, "we went through all the data in our system and pulled a report on all the small businesses that were members of the credit union and did a direct mail piece."

Kirkbride agrees that being a local lending provider is a great plus and emphasizes the trend for community banking. He asks a great question, "how can a local business find a better lending partner than their credit union down the street? If they ever have a question or concern, they know where to go."

Beyond basic education, your partner merchant will determine the nuts and bolts of how the actual product looks and is marketed. If you deal with a doctor's office, processing speed is vital. For home improvement, flexible terms are more likely to be important.

Kirkbride says, "once you understand how someone does business you can give them what they need to support their product, something that is both beneficial to the provider and to the credit union. You can also hire someone from that industry who really knows how to talk to those providers. Someone who can walk in and say 'here are your pain points and here's how I can help.'"

Informational brochures should be at branches and other touch points for your members. Troup says, "you can't have channel conflict in a strong program. Branches need to support it, including sending people to a dealer. Branch staff should feel comfortable. Sending foot traffic is huge to dealers and a pre-approved buyer is heaven sent." To that end, Troup added that WSECU employs many means to reach out to members and make them aware of their Indirect Lending Program. WSECU also sponsors industry-related events such as local RV shows to help increase both member and dealer visibility of WSECU's Indirect Lending program.

Other joint marketing efforts—such as working together on merchant advertising campaigns—can deepen the relationship and increase the volume of loans. For instance, "Dr. XYZ is now offering XYZ procedure for only $$$$, with 36 month financing from YOUR CREDIT UNION."

At the merchant location, the collateral should be easy for the consumer to spot and right there with any competing materials.

Regardless of the industry, the loan terms won't be the only thing that makes working with the credit union a good idea. As with auto loans, it's also important to be flexible, reliable, fast, and caring. The stronger the credit union exemplifies these traits, the more merchants will choose to work with the credit union.

Getting Help
Credit unions have justifiable concerns about whether a program will be cost effective, how to acquire the necessary technology, and how to market to a target industry. New programs will need at least 60-120 days for research that will lead to internal justification meetings and possibly hiring.

Your state league can be a great resource for merchant lending. Carangi says, “we (the league) can do so much to make it so much easier for you. Try your state league.” They can put you in touch with other credit unions and CUSOs. Then look for other credit unions who are lending in your area of interest or who are working with an industry you’re considering. They’ll be great help.

Finally, credit union service organizations can be your best friend. CUSOs shouldn’t replace your own due diligence or risk management, but they can make those tasks much easier, especially for technology solutions. Carangi continues, “there are providers now that can help set it all up. It’s much, much easier now. They offer all the marketing materials, technology, and training. Troup adds, “technology is a major contributor towards allowing this to happen. Automation delivers efficiency throughout the entire process. It’s paperless. 90% of our contracts come into us electronically. We can review them within five to ten minutes.”

At Hanscom Federal Credit Union, Becker explains how they expanded their indirect program to supplement their direct lending (to do so, they had a great partnership with a CUSO):

> We formed a partnership with Northeast Credit Union in New Hampshire. They formed a CUSO called Indirect Auto Solutions to do indirect lending for other credit unions. They have a representative that presents our products and handles all the dealings with the dealers. We fund the deal through CUDL. It’s really worked out well for us because we have minimal staff here. We do have an underwriter on our staff to approve our own loans. And then we have a person who funds it. About 40% of the business we do is in vehicles. The other 60% is in motorcycles. In August 2013, we did 186 loans totaling $2.2 million. For motorcycles the average loan amount is in the $10,000 range.

While this example is for auto and motorcycle loans, a similar arrangement could be made to support merchant and lifestyle lending programs.

CU Direct is a CUSO owned by more than 100 credit unions. They offer the popular CUDL program and serve over 1000 credit unions around the nation. Kirkbride explains, “our goal is to give credit unions the tools and support to be successful lenders in their markets. We want to help credit unions increase loans, efficiencies and membership.”

CU Direct’s exclusive credit union-building brands include:

- Automotive Products:
    - **CUDL AutoSMART**: an online auto buying platform that enables credit union members and consumers to sell, research and find vehicles.
    - **AutoPREMIER**: a full-service auto buying program that provides credit union members with special vehicle prices and personal car buying assistance.
    - **CUDL**: an automotive lending network of 10,000+ dealers and 1,000+ credit unions that enables car buyers to receive credit union financing at the dealership.

- Lending Products:
  - **Lending 360**: a complete loan origination platform that includes features such as pre-approved financing and new account origination.
  - **Lending Insights**: a lending performance management system that enables credit unions to identify the most profitable loan opportunities while managing risk and meeting regulatory requirements.
  - **OnSpot Financing**: convenient retail and lifestyle point-of-purchase lending solutions that build member and business relationships.

Final Points

When it comes to starting a merchant and lifestyle lending program, it's smart to start small and create proof of a concept. It is key to understand the components, especially logistics such as how referrals are going to work from the provider to the credit union. Many of the existing tenets of indirect lending can serve a new merchant/lifestyle lending program well.

As merchant/lifestyle programs mature, look at maintaining efficiency, keeping relationships strong, and where there may be chances to scale up (or out) a successful program.

Large or small, with merchant/lifestyle lending programs, credit unions can make fair yet profitable loans, and better serve their members and the community.

Real World Example, Real Great Success: An Interview with Sandi Carangi

As Vice President of Business Development at a credit union in Pennsylvania, Sandi Carangi began and grew a merchant lending program. She's now the Director of Credit Union Marketing and Strategic Services at the Pennsylvania Credit Union Association.

How did your program at the credit union get started?

In 2008, we had a business come to us and say, "it's great that you're offering small business loans, but is there any chance that you can offer loans to our customers?" I did some research and found out that most local companies were going through lending providers that offer these loans with an average interest rate of 18% or even higher.

So we used our local attorney to draft up an agreement modeled after our indirect auto lending program. We also used the company we used for our indirect auto lending and they helped us do an online component. We got the application electronically and it was basically a signature loan. The only difference was we did need to have a special form to send the funds directly to the company. Checks were made payable both to the business and the person taking out the loan.

How did you promote the program?

I was attending home shows. We found out that many home improvement companies were all using similar programs [with high interest rates.] That's where a lot of business came from.

We went through all the data in our system and pulled a report on all the small businesses that were members of the credit union and did a direct mail piece.

Also, companies that were coming in for business loans were offered to start making merchant loans and all the merchants were listed on the credit union website.

Why would merchants and their customers choose you over another lender?
If people were already a member of the credit union that was a huge bonus for us. They were more likely to want to apply for a loan through their credit union. It was a local company financing with the local credit union and the person was already a member of the credit union. That made us attractive to businesses in the area.

Another huge selling point was that when companies did the financing through other lenders, they paid a fee. With us, they did not have to pay a fee.

And, if someone went to a merchant, we offered a 1% discount on whatever the credit union was offering for a direct signature loan.

How did the program fit into the greater credit union?
For higher dollar amounts, a lot of those did turn into home equity loans. We did let people taking out the loan know they could apply and tried to help them with that process.

What advice would you give to other credit unions?
The number one thing I would tell anybody starting a program is make sure that you have your legal counsel look at your documents and make sure that you're covering all your risks.

Credit unions should go to their state leagues to get help setting up a program. They have the information and the partners they've worked with. We can do so much to make it so much easier for you.

And it does take a lot of time. The first year was kind of slow because people weren't familiar with it, but after the development stages, businesses wanted to sign up for it. Twenty different businesses signed up within the first year or year and a half. It's a lot different than auto loans. It takes a while to build it up. You need someone to go out there and promote it to these small companies.

Conclusion

With merchant and lifestyle lending, credit unions have a chance to open up their market, expand and diversify their portfolio, serve their members in new areas, and attract new members. They can do so while leaning on existing knowledge and leveraging the large amount of available resources. In a competitive lending environment, it may make sense to move into a less competitive area where members need greater support. Kirkbride says,

> We firmly believe that credit unions do good work. They provide balanced lending programs that are affordable with great local service. How do we expose those benefits to more people? If we can get a merchant or provider to look at a credit union, it's very likely that they'll realize the credit union's program is better than any other financing option they have today. The provider is also going to feel better about what they're offering to their customers, which can help them be more competitive and increase sales. It's a win, win, win.

Resources

The following websites were particularly helpful in the preparation of this white paper.

General Credit Union Resources
www.creditunions.com
www.cunamutual.com
www.nacuso.org
www.ncua.gov

CUSOs
www.cudirect.com
www.nationalcreditors.com

Sampling of Merchant Lending Competitors
www.aquafinance.com
www.carecredit.com
www.eastbridgefunding.com
www.gogecapital.com
www.springleaffinancial.com

Compliance
www.consumerfinance.gov

The following articles include discussion of strategic thinking at credit unions, portfolio management, developing partners, pricing, collections, developing new members, the rate environment, compliance, and lifestyle lending.

Bartlett, Michael. “Security Service Shares Advice On Building Good Indirect Portfolio.” *Credit Union Journal* 17.24 (2013) 6

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Fry, Richard. “Young Adults After the Recession: Fewer Homes, Fewer Cars, Less Debt.” *PewResearch Social & Demographic Trends* 21 February 2013. Web. 2 October 2013

Hess, Gary. “Lifestyle Lending. Credit Union Services and Products Forum 2012.” *Slideshare* 20 September 2012. Web. 2 Ocotober 2013. www.slideshare.net/RTEFinancialServices/lifestyle-lending

Jerving, Jim “Developing Members from Indirect Borrowers. Lessons Learned.” *CUNA Lending Council, August 2008.* Web. 2 October 2013

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Northwest Credit Union Association. “CFPB Issues Guidance on Indirect Lending and ECOA Compliance.” *CUNA Lending Council*, 8 April 2013. Web. 2 October 2013

Samaad, Michelle A. “Indirect Looks to Lead Again in Lending Dance.” *Credit Union Times*, 27 February 2013. Web. 2 October 2013

Vogeney, Bill. “Don’t allow your Indirect auto lending program to become ‘commoditized.’” *CUNA Lending Council*, 18 July 2013. Web. 2 October 2013

Vogeney, Bill. “Loan Portfolio Management: Level 101 to Graduate Work.” *CUNA Lending Council*, 23 May 2012. Web. 2 October 2013

Vogeney, Bill. “Want more B and C loans? Expect ‘stupid competition.’” *CUNA Lending Council*, 24 October 2012. Web. 2 October 2013

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Keith Troup, CCE, VP-Chief Lending Officer, Washington State Employees Credit Union Lending Division, Olympia, WA

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