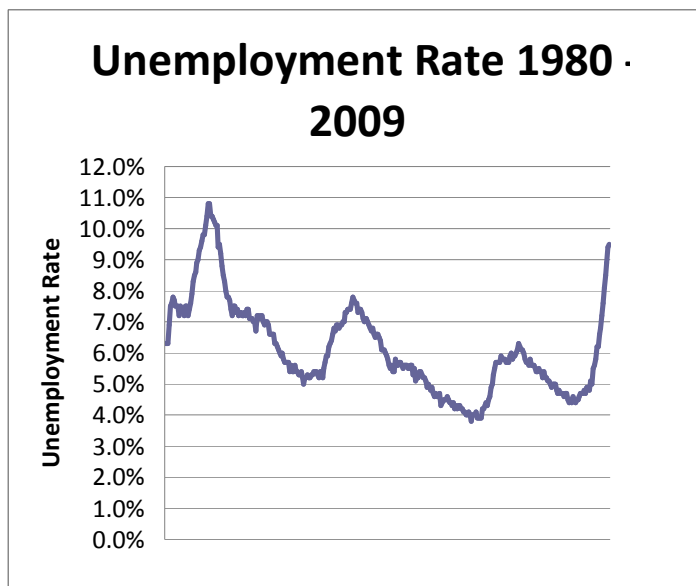


Collaboration Key in Developing New Product to Manage Unemployment Risk

Over a year ago, credit unions were sharing concerns with Gateway Services Group, the insurance, investment and trust solutions CUSO, about the rising level of member unemployment. Credit union executives feared that they were seeing a different level and kind of unemployment than had been experienced in the past. They were seeing not only a rising number of members unemployed, but also the companies impacted were covering a broader spectrum of industries and sectors. They were also seeing their highest credit score members impacted alongside other borrowers. Credit unions were concerned how these trends would impact delinquencies, loan losses and ultimately profitability.

Unfortunately, as we know today, these leaders were right to be worried. We are seeing record levels of unemployment, delinquencies, and charge-offs. See the chart below.



The growing unemployment rolls are affecting growing numbers of credit unions. The good news, however, is that when the GSG team started hearing the rising level of concern from its credit union clients, it started to explore ways to provide solutions to manage this increasing level of portfolio risk. The Gateway Services Group team reached out to Lending and Collections experts within key credit unions and to the top insurance carriers in the industry. The goal was to develop a new solution to help the credit union industry manage this new risk.

As GSG worked with its credit unions, they communicated several requirements for any new product/solution:

- Provide an additional period of time where the loan was kept “current” to allow the member to find a new job
- Any solution must be cost effective for the credit union
- The solution needed to be oriented to protect the credit union, but must also benefit the member
- Lending and collection departments needed to have better data on which members were being impacted by unemployment
- Credit unions wanted to stay in contact with unemployed members to offer other forms of support
- Any solution needed to be able to apply to a variety of loan types
- Credit unions wanted to be able to absorb the cost of the solution

- The product must be able to be marketed to differentiate the credit union in the marketplace
- The product claim procedure needed to be simple and easy to use for the credit union and the member
- The product needed to integrate with any current member-pay unemployment product already being offered
- The product needed to work in concert with any credit union re-work programs that had been instituted

“This product is an example of the true spirit of innovation and collaboration. GSG leveraged the Member Gateways Credit Unions and its insurance carrier partners to develop a very timely solution to a growing concern “ said Victor Pantea, President of the product incubation CUSO Member Gateways. This product became available in second quarter 2009.

A Risk Management Tool with an Involuntary Unemployment Focus

As credit unions started amassing greater risk in their portfolios from unemployment, it was critical that any product solution include an insurance component to move risk from the credit union balance sheet to the insurance carrier. The new product was built using a Debt Cancellation “chassis” including a monthly stop-loss protection feature in case credit union losses exceeded expectations. This meets the best practice test recommended by NCUA for debt cancellation products.

The goal for the product was to protect credit unions from the risk of an increasing number of members becoming *involuntarily* unemployed. It is not intended for members who retire, quit or are fired. If a member becomes unemployed, the qualification process is simple. The member simply needs to provide evidence that they qualify for their state’s unemployment benefits. This can be as simple as providing a copy of their unemployment benefit check. When a member becomes unemployed, the credit union can simply refer the member directly to the insurance carrier to handle the claim qualification process. This can help the credit union manage staffing levels.

Customizable Product Solution

A key distinction of this new product is its customizability. The credit union can choose which portfolios to cover, what benefit type to provide and the length of the benefit term. The product can also integrate benefits if the credit union has offered member-pay unemployment coverage. Credit union portfolios available to be covered have included new and used auto loans, direct and indirect auto loans, home equity loans, HELOCs, first mortgages in portfolio, second mortgages in portfolio, credit cards, unsecured loans, etc.

The credit union can also elect what type of coverage they would like to provide. The most common and most cost effective is interest-only coverage. However, full payment coverage is also available. The credit union can also elect the length of time the benefit is provided. The most commonly requested coverage period has been three months. However, in some areas harder hit by unemployment six months of coverage has been of more interest. The three-month coverage period was determined based on national unemployment data. During product development, the average period of unemployment across the U.S. was 5 months. Most credit unions stated that their workout process about 90 days. Therefore, providing three months of added protection plus the three months of their workout process, provided the needed member support for the bulk of members.

Competitive Differentiation Tool

One of the most attractive features available when covering an entire portfolio is that the coverage is effective immediately, with no waiting period. This allows the credit union and its members to immediately reap the benefits from the coverage. Chuck Smith, Senior Vice President/Director of Lending for the \$2.9 Billion San Antonio Credit Union had a different view on

the potential value from this product, “We operate in a very competitive lending market where consumers are anxious about unemployment. We saw this product as a unique value we could offer to help us differentiate our loans and increase our market share in a very competitive local market.”. Since this product is so new, it is unlikely that other local financial institutions will have a similar product giving credit unions that competitive edge. It also truly promotes the credit union difference of providing ways to help members when they are in hardship situations.

Quantifying the Unemployment Risk

As GSG began talking with credit unions, it was clear that the lending and collections staff believed that unemployment was impacting levels of delinquencies and charge-offs. However, they had no way of quantifying the exact impact or how many of their members were unemployed or how many of those loans were impacted. They also knew that many loans showing as current may be held by unemployed borrowers, raising future risk. Credit unions wanted a way to develop reliable data on the impact of unemployment on current and future delinquencies.

With this new Unemployment Coverage, credit unions could offer members a financial incentive to “raise their hand” and let them know they were unemployed. Once the credit union knew members were unemployed they could not only offer the benefits of this product but many also had other programs and services that could support the unemployed member. The credit unions also felt that by supporting the member during this difficult time they would deepen their relationship with their members and that if repossession or charge-off was ultimately required, the situation may be able to be resolved in a more positive manner. Finally, since the product requires the member to “re-qualify” each month to receive the benefit, the credit union could stay in touch with them member throughout the unemployment event and have a better idea of the location and condition of their collateral.

Cost Effective Permanent Solution

While the current economic challenges and unemployment woes served as the catalyst to create this product, this product can become a permanent solution for credit unions in risk management best practices and market differentiation. Therefore, it was critical the product be priced to be the most advantageous for credit unions. Scott Jentz, GSG’s President and Founder, was able to draw on his 30+ years of credit union industry experience to recommend product structures and pricing alternatives for the carriers. He wanted to leverage many of the features of another product aimed at providing member benefits- -the old loan protection life savings product. Therefore, despite the fact that this is a brand new product he was able work with the carriers to structure the product on a cost-plus basis. What this means is that the credit union only pays actual claims plus an administrative fee based on claims. This dramatically minimizes the cash outlay to the credit union.

It is simple to obtain a pricing quote. The only information needed is basic information about the credit union, its field of membership and geographic area and then data on the portfolios that they may want to cover. For most credit unions, if this program allows them to save only one or two loans from charge-off by providing the member additional time to find a job the product more than pays for the cost of covering the entire portfolio.

If you would like to learn more about this new product, please contact Gateway Services Group, LLC at 1-800-915-1004 and ask for Bill Bushlack, Scott Jentz or Judy Sandberg.