Keys to Fighting Low Captial and Increasing Your Camel Rating

---

It is always a challenge to run a credit union successfully. The board has to set and maintain effective and profitable policies. Members needs have to be met. Juggling all of these duties to the credit union and members is certainly no easy task.

The supervisory agencies want the credit union to increase capital. This is a combination of watching the credit union's expenses and increasing the net income of the credit union. It does us no good to have income coming in that just covers the expenses.

Here are some suggestions that credit unions can carry out to raise low capital ratios. You do not have to follow any of these suggestions--some of the suggestions may need modifications. You have to start somewhere on a program.

1. Make better loans. In the last decade, credit unions have been unable to place out on loan to the members about 30% of the savings in the credit union movement. If the credit union is going to raise their capital, the credit union has to make more good loans to their members. Here are some suggestions:

a. *The best group to lend to are the old borrowers of the credit union*. Anyone that has borrowed from the credit union in the last five years and does not presently have a loan is a good market for credit union loans. The credit union should have a special mailing list for the old borrowers. Of course, be careful to eliminate from this list any member that does not meet the credit union's standards. This "old borrowers list" should get special mailings and a special telemarketing campaign.

b. *The credit union should contact* every member that has a car or truck or RV loan coming due in the next six to twelve months. If these loans were for 48 to 60 months, these vehicles may be in need of replacement. A special campaign should be made to these members.

c. *Use more telemarketing!* A recent Gallup survey found that one in four adults throw away unopened promotional material. However, credit unions have not picked up the telemarketing techniques being used by more and more firms. If you want to reach your members, use a telephone.

d. *Make an offer to your members* to take over any other car, truck, or RV loan the member may have with another institution.

e. *Try leasing programs for cars and trucks*. More credit unions are finding that by running a leasing program, the credit union may obtain more income.

2. It is easy to say that you should not make bad loans. The trick is to look at the loan

policies that you presently have.

* Has your credit union worked out debt-asset ratios for borrowers?
* Does your credit union give out loans above a certain debt-asset ratio?
* Does your credit union make sure that it obtains a new listing of all of the debts of the potential borrower?
* Does your credit union compare the member's loan application with the local credit bureau reports?
* Has your credit union a definite policy on collections? Does your credit union have a definite policy to follow up every single loan that is not being paid up on time? When does your credit union contact a member that is not paying according to contract? Do you do it at the end of thirty days? Sixty days? Ninety days?

3. If you do not have enough borrowers in your own bond of association, then see if you can bring small employee groups into the credit union. If the small employee groups have not had credit union services available to them, many of them may be interested in borrowing from the credit union.

4. Re-work your loan policies. Are your loan policies in line with the realities of the 1980s? What are the maturities on loans for autos, trucks, or RV vehicles? Are all of these maturities on loans the same, or does your credit union have different types of maturities for RV vehicles as opposed to trucks, or new and used cars?

Many credit unions have 120 months maturity for RV vehicles, but only 60 months or at the most 72 months for new automobile loans. Since many of the automobile loans are now for amounts greater than the RV vehicle loans, should the credit union make an investigation of their own delinquency history on these automobile loans and RV vehicle loans.

If your delinquency history shows that automobile loans go delinquent on an average of about 18 months to two years into the loan, does it really make that much sense to have maturities of only 60 months on new cars? Would there be any large additional losses if the credit union lengthened the maturity of new car loans? If the credit union lengthened the maturity on these new car loans, the monthly payments would decline. Would this bring in more new car loans?

5. Bringing in car loans by matching the competitor's rates. The automobile companies are offering very low interest auto loan rates. Credit unions can tell their members that the credit union auto loan is better than the competitor's. This does not do the credit union any good if the member is sitting in the auto dealer's show room discussing an automobile to be purchased.

The financing of the automobile is the last thing that is discussed in the purchase of a new automobile. The credit union must either give the member a line of credit before the member

goes to the dealer, or must somehow get the member to come into the credit union before the member signs purchase papers.

Some credit unions have advertised that they will match every single legitimate rate offered in their area. If the dealer is offering 4.6% APR, the credit union will give the member the same rate. If a credit union gives a member a 4.6% APR rate on an automobile, the member will get a good deal, and the credit union will lose income.

Credit unions that have tried out this program find that most members do not understand that these rates offered by automobile dealers are for extremely short maturities. Most members would like to have longer maturities that will allow a low monthly payment. If the credit union advertises that it will match all rates, the member has nothing to lose by coming into the credit union to discuss what the rates really are. Some members will take the 4.6% APR rate for 24 months or 36 months.

Most of them will want a 60 months or longer maturity period. As long as the members are sitting in the auto dealer's showroom, the auto dealer will offer them the longer maturity. If the members are in the credit union office, the credit union can offer them the longer maturity at a rate higher than 4.6%. The key is to get the member into the credit union office to get a pre-approved line-of-credit before the member goes to the dealer, or after the member has picked the car -- but before any financing papers are signed.

The approach of matching every rate can increase the auto, truck, and RV loans that are made producing net income to the credit union.

6. Deal with the dealers. The dealer needs to sell many vehicles so that his franchise is protected. In some cases, credit unions have worked out arrangements with local automobile dealers so that the credit union will do the financing of the member's automobile purchase.

The auto dealer is not expected to make this arrangement out of the goodness of his or her heart. However, if the credit union is willing to pay the auto dealer the same amount as the captive sales finance company is willing to pay the dealer, then the automobile dealer has an incentive to deal locally with the credit union. The dealer is paid immediately, and since the credit union has approved the loan, there are no dealer reserves.

If there are outlets in your market area for any of the large auto rental firms, this is a good way to obtain automobile loans that will produce net income for the credit union. This same arrangement of financing the sale of automobiles by the auto rental firms can produce net income for the credit union. Remember the credit union still must approve every loan to their members.

7. Bring in fees. The types of fees you bring in depend on what problems may be facing your credit union. For example, what type of fees do you have for checks that bounce? Members are paying off loans to the credit union, and some members may give the credit union checks with insufficient funds to back them up. If the credit union makes a study of

these members, it will find that most of these "insufficient funds" checks come from a small, select group of members within the credit union. The fees on these types of checks may be increased.

Do some members make excessive use of the credit union? Do some members make excessive withdrawals? There are fees that may be put in to make sure that the credit union does not lose money on certain services.

8. Bring in services that will cost the credit union little in expenses, and produce net income. Most services that are brought in by credit unions have a high initial cost. There are some services that are useful to the members that do not need a good deal of investment by the credit union.

The most popular service meets this criteria in the late 1980s - mechanical breakdown insurance. If the member wants this type of insurance, the credit union can provide this insurance to the member at a much lower cost than that provided by the automobile dealer. The member is helped; the credit union receives income at very little cost to the credit union. Member services such as this should be looked at by the credit union to increase the net income for the credit union.

9. Does your credit union have a minimum number of shares? True, anybody can join the credit union by buying one share for five dollars. But a five dollar share with no borrowing or other activity in the credit union only serves to drain the income of the credit union.

How much income do you get from a five dollar share, and what does it cost you to mail the member notices or even audit the account? If you raise the minimum number of shares to a balance of $50 or $100 over a period of six months or a year, at least these share accounts would be carrying their own weight and the credit union would not be losing money.

10. Should every member be receiving the same dividend rate? If the member puts in only $5.00, should the member receive the same dividend rate as a member who has built up their own share account to $1,000.00? With a split dividend rate, there may be a tendency for some members to save systematically and leave the savings in the credit union.

Most credit unions use the *arithmetic mean* as an average. What the credit union does is to add up all of the savings by all of the members and divide by the number of members. Most credit unions have average savings of $2,000 to $3,000. At the same time, half of all the members may have less than $200 in the credit union. If the credit union has a split dividend rate, the member may save more in the credit union, and some of the accounts will produce net income for the credit union.

The purpose of a split rate is to make sure that the members will support the credit union and the credit union will not be forced to subsidize too many low balance share accounts.

11. Use the secondary market. Credit unions should look at the secondary market for mortgages and student loans. If the credit union goes into the secondary market, the credit union does not have any risk and does have continuing income from servicing these mortgage and student loans.

The history of the mortgage lending industry has been that the originator of the mortgages has sold the mortgage in the secondary market. The largest holder of mortgages in the United states is the mortgage pool--Federal National Mortgage Association (Fannie Mae). With 20/20 hindsight, had the liquidated savings and loans in Texas, California, Oklahoma, Louisiana, and Colorado sold their mortgages in the secondary market, many of these savings and loans might still be operating.

The way the secondary market works is that another institution buys the mortgage from the originating institution. The originating institution receives back the funds it granted to the person desiring a mortgage. The person with the mortgage still has to pay interest and principal; the originating institution gets a service fee for handling the payments. The originating institution can lend out the funds again, and sell the second mortgage in the secondary market. The member that gets a mortgage from the credit union has the home, the credit union has the income and the mortgage pool has the risk.

The secondary market for student loans is generally considered to be "Sallie Mae". Again, the credit union member has the student loan. The credit union has the service income. "Sallie Mae" has the risk. The use of the secondary market brings income to the credit union at a very little cost to the credit union.

12. Minimums for share drafts. If you have share drafts, put in the minimum amount that you have to have on your share draft accounts before there are fees. While it is nice to pick up individual share draft accounts, this is the same problem you have with no minimums on shares. The share draft account has to be audited, and the individual should keep a minimum amount in the share draft account so the credit union does not lose money on the account.

The banking system generally has a minimum balance of $300 on a checking account, or else fees are applied. Just getting members to open share draft accounts does not necessarily mean that the share draft account will produce net income to the credit union. The fastest way to see if the share draft accounts are producing net income is to look at the number of accounts of less than $300. If your credit union cannot make net income on a $300 loan, how will they make net income on a $300 or less share draft account?

Buying into a market may be a good service idea for the members, but is it good for the credit union? The credit union must raise its capital ratios. Having a losing service does not help the credit union, even though it may help the member.

13. Credit Cards. The member generally is carrying a credit card. The credit union may wish to provide the member with a credit card handled through the credit union. The credit

union knows that some of the members will take out loans via the credit card. Traditionally, the interest rate charged on the credit card loan is higher than the interest rate charged on an unsecured loan at the same credit union.

The member knows that the rate for an unsecured loan is lower, but the convenience of a credit card "loan" keeps the member in the higher credit card loan. If the member wants to pay the higher rate for the convenience of the credit card, there is not much the credit union can do except provide this service to the member.

The credit union has some additional income from the merchant's discount. The credit card issued by the credit union produces income every time the card is used. In addition, the credit union may wish to have an annual fee on the credit card.

14. Take money out of the credit union. There are credit unions that have worked out arrangements with either insurance companies or brokerage firms. The credit union suggests to the member that the member buy a single premium insurance policy or invest in selected tax-free annuities or mutual funds. If the member does take funds for investment, either from the credit union or from other sources, the credit union receives a commission from the insurance company or the brokerage firm.

If the member takes the funds from the credit union, the amount of shares fall, thereby statistically raising the capital ratio, since the amount in reserves and undivided earnings remains the same.

15. Keep cash at minimum. The credit union should keep as small an amount of cash as is possible in non-earning assets. The credit union should place as much of the funds of the credit union in earning assets. All corporates and many other financial institutions will pay the credit union for overnight funds. The credit union should keep a very accurate record of the cash that is needed to run the credit union on a daily basis. The rest of the funds should either be kept overnight to earn some income, or invested based on the needs of the credit union.

16. Do you know the credit union break-even point? This is a relationship between the income that the credit union receives from the members and the cost of running the credit union. There has to be some type of a break-even point for every type of loan.

Most credit unions cannot make any net income by making a $100 loan. Most credit unions probably can make net income if they make a $1000 loan. But the thing is for your credit union to find out what the size of the loan should be for the credit union in order to make net income. Without net income, you cannot have an increase in capital. If you have not worked out your break-even point, do so. You may find that it is the larger loans which produce net income--and that you are making too many small ones. You cannot cut off the small ones, but you can emphasize larger ones in marketing programs.

17. Work out an incentive program for your employees in the credit union. If your credit

union is going to raise up the capital ratios in your credit union, your credit union will have to watch costs, and also make sure that the services that produce more net income are being made by the credit union. If your credit union wants to raise the capital ratio, then the credit union has to make more net income. The credit union should share this net income with the employees of the credit union so that the employees have a greater incentive to raise the capital ratios.

Although many credit union managers state that the way to raise the capital ratio is to form a credit union service organization (CUSO), the history of many CUSOs would suggest that it may take a good deal of time before the CUSO produces a good return on the investments made by the credit union.

Look over these ideas to raise the capital ratio. This is a starting point. If you have any suggestions based on your experience to raise the capital ratios, send it in to the editor. Other credit unions may be helped by your experience.

▲ Top