STELLAR

INSIGHTS

Stellar Strategic Group's Strategies On Growing PFI Relationships.

FALL | 2021

HOW VULNERABLE IS YOUR AUTO LOAN PORTFOLIO?

How much of your portfolio is labeled "indirect"?

NEW The Stellar Market Analysis Portal

The all-in-one portal for you to learn more about The Stellar Auto Loan Recapture Program.

Overdrafts Fees

Is this an opportunity or a concern for financial institutions?

Student Loans

Often misunderstood, these loans should not be overlooked by credit unions.

Craig Simmers
Founder
Stellar Strategic Group

From Our Founder

Welcome to the Fall Edition of *Stellar Insights*

As we enter the final quarter of 2021, our focus shifts to what we have accomplished this year, how the market has changed, and what we should focus on in the upcoming year. I am sure all of you are going through that same thought process as you begin planning and preparing budgets for 2022. To help our readers plan for the new year, we have written articles for this edition of *Stellar Insights* that touch on relevant issues and opportunities.

The feature article in this edition focuses on the auto loan recapture business and the fundamental differences between *indirect* loans generated by dealerships and our *direct* auto loan recapture program. We hone in on the sustainability of each auto loan source and how they support the overall growth of membership for a credit union. As we've stated numerous times, the absolute best source for a credit union's member growth is through refinanced auto loans. These members are more likely to become lifers, not just loaners.

We also explore the value of the checking account. More specifically, relating to debit card interchange fees as an effective offset to the declining overdraft fee income that many institutions are experiencing. There have been massive changes in consumer behavior related to spending habits and payment processing. Not to mention, the pending increased government oversight related to overdraft practices and the actions some banks and credit unions have recently taken. This year has been a year of change that has affected the banking industry in multiple ways. Speaking of *changes*, or *opportunities* (as we call them), take a look at my brief article titled "A Missed-Understood Opportunity". We'll be talking about that opportunity quite a bit going forward.

Finally, we certainly hope this year has been a bounce-back year for most of you. For our company, the growth this past year has been unprecedented in our 21-year history. As a result, we have several exciting things planned for this fall. First on the agenda is the launch of *The Stellar Market Analysis Portal*. It will allow our potential clients to "window shop" our solutions at their leisure, and even pull relevant data for their specific market. We expect this to launch in early November. The other very exciting news will be announced later in the fall. Let's just say our clients will experience expanded options moving forward.

Stay tuned, and here's to a strong finish to 2021!

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STAY UP TO DATE

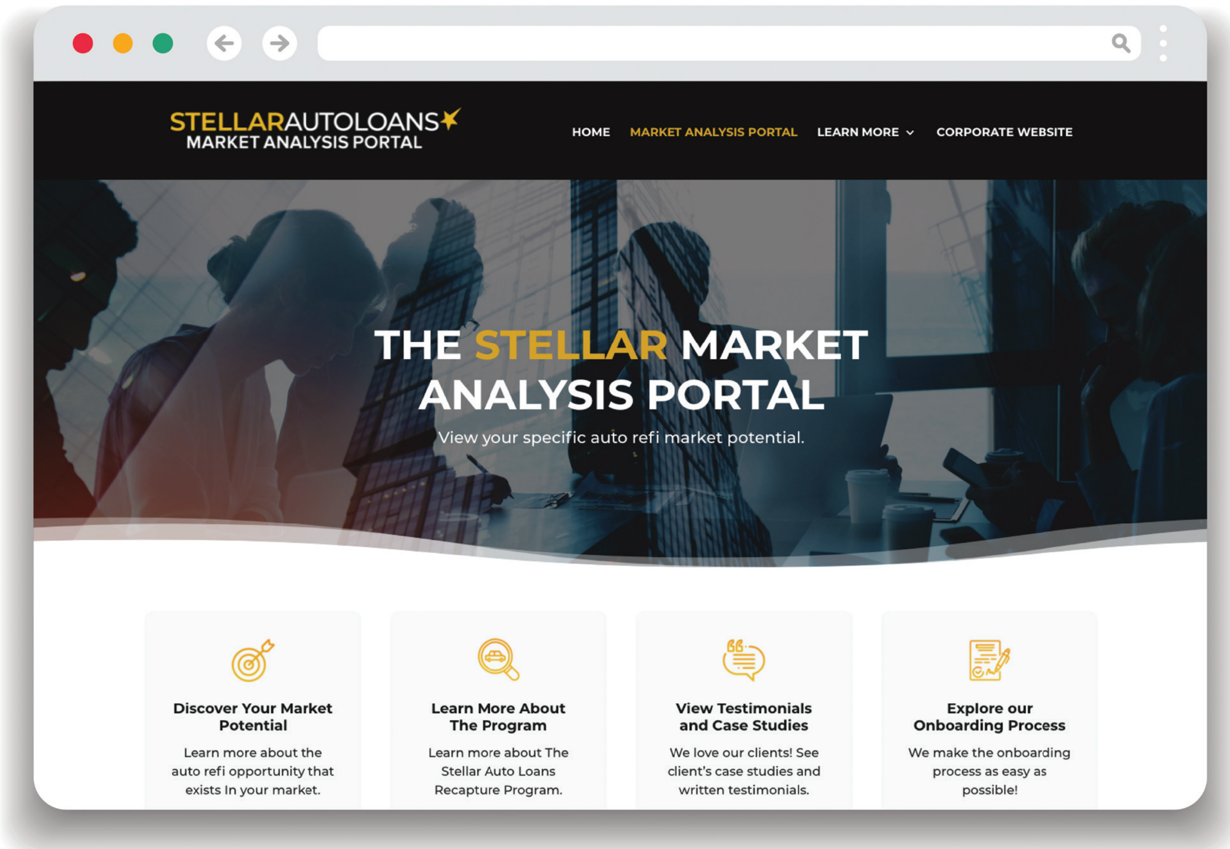
Sign up for our free quarterly newsletter: stellarstrategic.com/newsletter

About Stellar Strategic Group

Strong, long-lasting relationships with clients is our top priority at Stellar Strategic. Simply stated, we continually evolve our product line to meet the ever-changing market demands our clients face. Plus, we work to deliver the projected ROI promised, and treat your budget as if it's our own. The bottom line is that we care about you and it shows in how we partner with you to achieve your goals every step of the way.

Introducing The Stellar Market Analysis Portal

Browse Our Product Solutions at Your Convenience



We are very excited to launch **The Stellar Market Analysis Portal.** This virtual marketing site will allow potential clients the ability to browse our product solutions, pull auto refi counts applicable to their market, and literally explore the entire onboarding process, at their leisure. The portal will essentially eliminate the need to sit and review a PowerPoint presentation to learn more about The Stellar Auto Loan Recapture Program. It's a form of window shopping that can be done at their convenience.

Explore Your Auto Refi Opportunity at YOUR Leisure

Stellar Auto Loans uses credit bureau information to identify households in specific charter footprints that meet a unique credit criteria profile and that are paying a higher interest rate for their auto loan than they would at another financial institution. With The Stellar Market Analysis Portal, you will be able to pull your refi counts based on your specific credit criteria. By uploading your rate sheet, you'll be able to view counts by county, paper grade, monthly savings, etc.

The Stellar Market Analysis Portal will be RELEASED THIS FALL!

Once the portal is live, just scan the QR code or go to MarketAnalysisPortal.com. There will be a simple sign-in process, as the portal is password protected.

Discover Your Market Potential.
Learn More About The Program.

View Testimonials & Case Studies.
Explore Our Onboarding Process.

Browse and Review Additional Program Related Information

In addition to being able to pull auto loan counts applicable to your market, here are some of the additional resources available:

- Case Studies
- Testimonials
- Collateral Material
- Learn More about Loan Participations
- Sample Offer Letters
- Stellar's Proprietary "7 Step Process"
- Onboarding Process Outline
- Online Application Flow
- Call Center Support
- Client Dashboards
- Ability to Schedule a Meeting on Your Time

HOW VULNERABLE IS YOUR AUTO LOAN PORTFOLIO?

How much of your portfolio is "indirect"?

According to the NCUA, credit unions have acquired a significant portion of their auto loan portfolio from indirect loans. There's over 1.3 trillion dollars worth of auto loans borrowed by consumers across the country, with close to 80% of these loans originating at auto dealerships. Credit union executive teams understand indirect lending can add loan volume, usually with compressed interest rate margins and very little, if any, non-interest income. Dealerships add additional basis points to the interest rate agreed to by the credit union, as well as charge almost double the rates most credit unions would charge for the same services, such as GAP, MBI, AD&D, etc.

Furthermore, dealerships add additional fees to the loan, such as “documentation fees”, “fuel charges”, etc., which quickly increase overall origination costs, and put most loans well over a 100% loan-to-value.

New auto sales have slowed due to the chip shortage needed to complete the manufacturing of many vehicle models. The used auto market volume has increased during the pandemic and appears it will continue for some time.

Indirect Loans = More $$$ for Dealerships

Financial institutions are looking for ways to make up some of the short falls, looking at different types of auto loan recapture programs. Many of these programs use the dealership model of packaging the loan, charging additional “process fees”, and keep the lion’s share of the non-interest income for themselves.

THE DEALERSHIP DOES NOT CARE IF THE LOAN IS REFINANCED, AS LONG AS IT IS NOT REFINANCED DURING THE TYPICAL 90 OR 120 DAY “CHARGE BACK” PERIOD AGREED UPON BETWEEN THE CREDIT UNION AND THE DEALERSHIP.

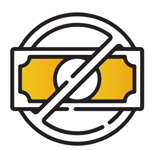
These types of recapture programs are now being identified by the NCUA as an ***“indirect loan”*** because the credit union doesn’t have a direct relationship with the consumer during the loan application, vetting, stipulation, and processing. They simply fund the loan with no real direct relationship to the “new member”.

Over the years ***Stellar Auto Loans*** has helped generate hundreds of millions of dollars in auto loans for our credit union partners. We’re sharing what we see from a cost and profitability standpoint of both indirect dealership loans, as well as indirect auto recapture loans vs. direct loans generated through their lending teams. Before I go into the numbers, let’s look at the BIG Picture. The credit bureaus are very happy to share their consumer auto loan information (at a cost).

THE STELLAR DIFFERENCE

A Unique Example of Each Recipient's Savings.

Every two to four weeks we will target another group of qualified prospects to generate new qualified applicants, building assets for your institution throughout the year. Our team has helped over 50 financial institutions generate millions of dollars in new auto loans.



No Out of Pocket Costs.

All incentives, credit bureau lists, mail, postage, telemarketing expenditures, microsite, digital marketing, etc., are paid by Stellar Auto Loans – thus taking all costly risks from your financial institution. You pay nothing out of pocket until the applicants respond.

So many consumers purchase their vehicles at dealerships that add hundreds of basis points to the loan that the credit union will service. Therefore, too many consumers are paying far above usual and customary market rates on their auto loans. Our credit bureau data pulls find that 70% of the population with an auto loan with a FICO score of 720 or better, are paying more than a 5% interest rate. Understandably so, since dealerships know consumers purchase a vehicle based on the monthly payment that they can budget.

Loans from Dealerships are Vulnerable

The F&I managers at the dealerships will structure the loans to maximize their profitability. With multiple institutions ready to shop the loan, dealerships add to the flat rates for even greater profits, extend the loan repayment periods, etc. It's pretty clear why consumers get hooked at the higher interest rate.

With more and more “recapture” programs having access to this information, these indirect members are extremely vulnerable of being targeted by other institutions. The dealership does not care if the loan is refinanced, as long as it is not refinanced during the typical 90 or 120 day “charge back” period agreed upon between the credit union and the dealership. I’ve had auto salespeople specifically mention not to pay off the loan within 90 days, so that they can get their commission.

Looking at our credit union partners’ auto loans, we typically see the average life of an auto loan is between 24-30 months for their entire portfolio. When we drill down to look at indirect loans, the average payoff period is typically 18-20 months. Obviously, many of these types of loans are being targeted by other institutions!

“Indirect” recapture programs have less vulnerable recaptured loans, but since there is a success fee associated with them, margins are being even further compressed vs. most dealership indirect margins. Like auto dealerships, these programs keep the lion’s share of the non-interest income. Lastly, and maybe most important, the member relationship is NOT with the credit union, but with the indirect recapture company. When that loan is paid off, that member RARELY finances their next loan with the servicing credit union.

My point isn't to say that indirect loans are bad, but to say there needs to be a balance of organic and direct loans to maintain dependable loan growth, as well as build more complete cross-sell member relationships.

Other Recapture Programs vs The Stellar Auto Loan Recapture Program

Profitability is not the only perk. The Stellar Auto Loan Recapture Program has many additional benefits that other "indirect" recapture programs do not offer or partake in. For instance:

- There are less charge offs with the Stellar program. These new members have great track records of being current on their loan repayments. Only those prospects that are current are targeted.
- All marketing material is branded with the credit union's standards, and look like they are generated directly from the credit union. There is nothing about Stellar Auto Loans on the marketing messages. The credit union enjoys the benefit of increased brand awareness at NO ADDITIONAL COSTS!
- Stellar's outbound call center that follows up on the direct mail offers to pre-qualified consumers doubles the overall application response rates.
- 95% of the targeted consumers are non-members, that can become a member. Our program generates new member growth, and these members are instantly profitable to the credit union.
- Stellar mirrors our credit union partners credit criteria and stipulations, to insure high loan approvals. Typically, we are averaging close to 50% look to book with our credit unions.

George Monnier is a founding partner of Stellar Auto Loans, a division of Stellar Strategic Group, which offers pay-for-performance auto refinance programs to the banking industry. Contact him at george.monnier@stellarautoloans.com or 402-708-2425.

	STELLAR AUTO LOANS	INDIRECT MARKETERS
Direct mail has a unique example of savings for each recipient	✓	✗
Letters customized to your FI's branding	✓	✗
Only target individuals that WILL save money each month after refinancing	✓	✗
Outbound calling to prospects	✓	✗
Extended-hours inbound call center	✓	✗
Application microsite customized to your brand	✓	✗
Microsite monitored to assist incomplete applications	✓	✗
Reminder mailings sent to qualified prospects	✓	✗
Tiered success-fee pricing (rates starting at 1.25%)	✓	✗
More qualified applicants = more funded loans	✓	✗

Refinanced loans typically have a minimum remaining balance of $15,000. Loan amounts tend to be higher with the higher minimums.

This revenue is based on the 30-month time period. Since these recaptured loan members have a direct relationship, they cross-buy more services and products than indirect recapture programs. The revenue generated is far greater than this number, since many members will continue their relationship with the credit union.

Success fees are charged by the indirect recapture programs as well as the lost non-interest income NOT being shared with the credit union.

Overdraft and Debit Card Interchange Fees:

One Big Concern, One Giant Opportunity

Overdraft Under Fire, Now What?

We are all well aware of the issues related to overdraft fees. While there are clear consumer advantages to have access to overdraft their account, the service has been under heavy fire from government officials and consumer groups. Online banks have seized this opportunity to promote no overdraft fees as another way to differentiate themselves from traditional banks. We are starting to see community institutions such as Alliant Credit Union, a $14 billion credit union in Chicago, eliminate their overdraft fees. There is very little doubt that this will be the last community banking institution to eliminate or drastically reduce the use of overdraft fees.

Many banks and credit unions have depended on overdraft fees as a substantial source of fee income. Now, combined with the end of government fee income from pandemic-related programs, such as PPP, ***what can banking institutions do to make up for their lost revenue?***

An Overlooked Opportunity

Fortunately, there is a solution created by changing consumer buying habits (related to the pandemic) and more electronic payment options. Recurring payment transactions associated with services like Netflix and Spotify have skyrocketed throughout the pandemic. Furthermore, account funding transactions for services like PayPal, Zelle, Venmo, and Apple Pay have driven debit card interchange fees up to historic levels. A recent 2*020 PULSE Debit Issuer Study* featured in

The Financial Brand found a 6.5% increase in debit card interchange fees from 2018 to 2019. *Callahan* reported that roughly 66% of interchange income during the first six months of 2020 came from debit cards and approximately 25% from credit cards. Debit card interchange income rose 1.7% annually, whereas credit card interchange income fell 11.9%. These statistics are indicative of the change in consumer spending patterns and attitudes toward debt.

WHILE WE HAVE SEEN CHECKING ACCOUNT MARKETING DECREASE DUE TO AN OVER-ABUNDANCE OF DEPOSITS, THE REVENUE ASSOCIATED WITH THAT NEW CHECKING CUSTOMER AND THEIR DEBIT CARD USAGE IS TOO BIG AN OPPORTUNITY TO OVERLOOK.

So, here's where we are today. Overdraft fees are under assault from many fronts. We will most likely see reduced fee income for many banks and credit unions going forward. On a more positive note, debit card interchange income is on the rise and a real opportunity for banks and credit unions. This brings us to the real driver of taking advantage of this change in consumer spending: **CHECKING ACCOUNTS.**

Checking accounts are more valuable than ever. While we have seen checking account marketing decrease due to an over-abundance of deposits, the revenue associated with that new checking customer and their debit card usage is too big an opportunity to overlook. The disruption that now exists in most markets nationwide further support the need to be aggressive in marketing for new checking accounts and continued marketing to support increased usage of your customers debit card. Bottom-line, as consumer buying habits have changed significantly, so has the need for every bank and credit union to get back to growing their consumer base. That old saying "if you're not growing, you're dying" is very applicable today.

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A Missed-Understood Opportunity

Throughout our 20+ years in business we consistently hear the question, "What's New?" from our clients and potential prospects. For many years there really wasn't much that I would categorize as "New". The growth of neobanks and the Covid-19 pandemic have in our estimation created quite a bit of new opportunities.

As much as we view neobanks as competitors, it's important we pay close attention to what they are doing. Keep in mind, they have built their businesses from scratch with no legacy restrictions that tend to limit creativity in the traditional banking world.

One such opportunity that neobanks have had great success with is refinancing student loan debt. Not originating, but refinancing. This is a much misunderstood product that has tremendous potential for those willing to take a serious look at the numbers. Most people confuse private student loan debt with government debt. These are two vastly different products.

Private student loan debt exists today at every community bank and credit union but is masked as a HELOC or consumer loan. In addition, these loans are not exposed to anything the government might do in terms of forgiveness. The final point to consider is these loans can be targeted with the exact same efficiency we currently target auto loan refinances. Here's the good news. Those loans with advanced degrees and most undergraduate degrees are very high performing loans.

Having stated the above, where's the apprehension to considering these loans an opportunity for community banking institutions? The apprehension exists due to a lack of knowledge and the legacy thought process that we all tend to have when it comes to change. So, the next time you ask the question "What's New?", keep an open mind when the answer is student loan debt refinancing.

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I have included links to the *Callahan* (www.creditunions.com/blogs/industry-insights/a-dive-into-interchange-income/) and *The Financial Brand* articles (https://thefinancialbrand.com/100527/debit-cards-retail-payments-p2p-ecommerce-mobile-wallet-pulse/) referenced in this article. I encourage you to take a few minutes to review both of these very important articles.

Craig Simmers is the Founder of Stellar Strategic Group. Contact him at craig.simmers@stellarstrategic.com or 410-990-0172.

Works Cited: Streeter, Bill "Debit Cards Dominating Retail Payments, Fueled by P2P and eCommerce" The Financial Brand, 10 August, 2020, www.thefinancialbrand.com/100527/debit-cards-retail-payments-p2p-ecommerce-mobile-wallet-pulse/

Hunt, William "A Dive Into Interchange Income" CreditUnions.com, 26 Oct. 2020, www.creditunions.com/blogs/industry-insights/a-dive-into-interchange-income/

SUCCESS STORY

Belco Community Credit Union

Harrisburg, PA

We began our partnership with Stellar Strategic January 2020; since then the Stellar Strategic team has exceeded all of our expectations! Their marketing to potential members within our footprint has been extremely effective. Their insight has resulted in solid loan growth and high member satisfaction. Their representatives are able to contact applicants after hours if we are unable to make contact during the day, which adds another level of convenience and ease of service for our applicants. Everyone I have worked with at Stellar Strategic has been responsive and eager to help us grow. Partnering with Stellar Strategic has been a positive experience and I would highly recommend their services to anyone who wants to see loan growth.

– Melissa Pender
Lending Sales Manager
Belco Community Credit Union

STELLAR'S BIG ANNOUNCEMENT

We have a lot of exciting news to tell you about in the coming weeks, including our BIG announcement.

STUDENT LOAN DEBT
The Missed-Understood Opportunity

DIRECT AUTO LOAN REFINANCING
at 1.25% Success Fee

DEBIT CARD INTERCHANGE REVENUE HISTORIC GROWTH
The checking account is back in vogue!

OVERDRAFT
How do you maintain regulator integrity and the income you've come to rely on?

Plus, don't forget to listen to our podcast, Stellar Conversations!

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