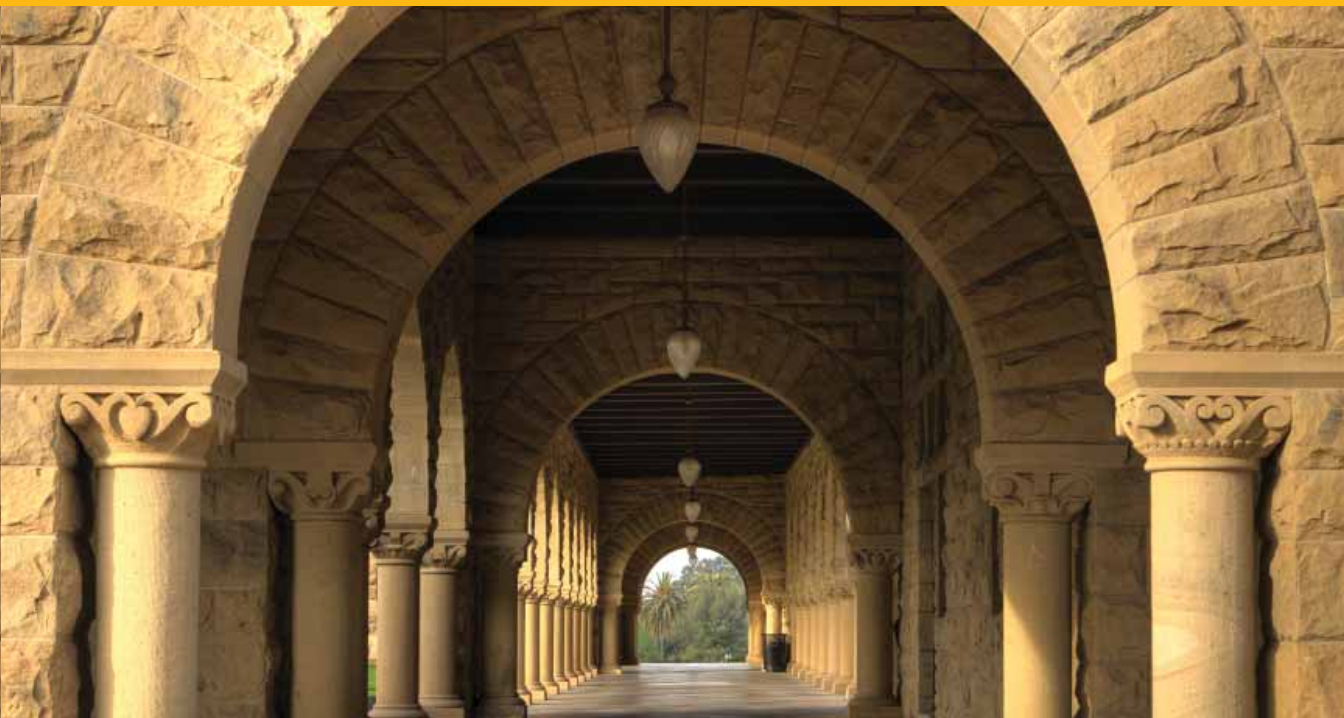


Student Loans: Credit Union Opportunity during the Credit Crunch

Ben Rogers

*Driver, CU Tomorrow
Filene Research Institute*



About Us

Deeply embedded in the credit union tradition is an ongoing search for better ways to understand and serve credit union members. Open inquiry, the free flow of ideas, and debate are essential parts of the true democratic process.

The Filene Research Institute is a 501(c)(3) not-for-profit research organization dedicated to scientific and thoughtful analysis about issues affecting the future of consumer finance. Through independent research and innovation programs, the Institute examines issues vital to the future of credit unions.

Ideas grow through thoughtful and scientific analysis of top-priority consumer, public policy, and credit union competitive issues. Researchers are given considerable latitude in their exploration and studies of these high-priority issues.

CU Tomorrow is a Filene Research Institute clearinghouse for credit union young adult strategies. The project publishes research and open-source business plans to help credit unions attract younger members, promising young professionals, and younger volunteers. Initiatives include:

- **Business briefs**—open-source, young adult business plans for credit unions.
- **30 Under 30**—entrepreneurial SWAT team of young credit union professionals.
- **Community**—CU Tomorrow and Filene Web sites for publication and idea sharing.
- **Leagues**—statewide collaboration to implement CU Tomorrow programs.
- **Recruiting**—talented interns and new hires from high-profile universities.
- **Research**—academic research, focus groups, online surveys, and interviews.

Visit www.cutomorrow.org for more details.



About the Author



Ben Rogers

The author, Ben Rogers, is driver of the Filene Research Institute's CU Tomorrow project and director of the Institute's 30 Under 30 group. Ben is a former editor of *The CEO Report* and chairman of the National Directors' Convention. Ben holds a master's degree in journalism from Northwestern University and graduated cum laude from Brigham Young University with degrees in English and philosophy.

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For many students, financing an education is much less interesting than getting an education. Jessica Vogel, a graduate student at The George Washington University in Washington, DC, has endured two rounds of student loan funding in the past six years. She hardly remembers the first, where she and her mother completed a Free Application for Federal Student Aid (FAFSA) and—after calculating for family contributions and work-study income—simply signed up with the student lending company that appeared on the top of her college’s preferred list.

When she applied for graduate school loans, she again went with one of her school’s suggested lenders and has largely ignored marketing from financial institutions aimed at getting her to move her loans. “I wouldn’t have changed financial institutions, even if I saw a good offer,” she says.

But as many large lenders make headlines by exiting the student loan marketplace or cutting their relationships with financial aid offices, credit unions that effectively market to parents and students during transition periods stand to win a share of the growing student loan market.

A Market in Turmoil

Credit unions need young adults, and young adults need credit unions. Nowhere is this more clear than from the financial headlines that have documented many lenders’ speedy withdrawal from the student loan business:

- “Survey Finds Majority of College Students Needing Loans for Fall Semester Are Still Awaiting Money”—*MarketWatch* (July 22, 2008)¹
- “Student Loans Start to Bypass 2-Year Colleges”—*New York Times* (June 2, 2008)
- “Credit Crisis May Limit Options for Student Loans”—*Wall Street Journal* (June 3, 2008)²
- “Credit Crisis Hits Student Borrowers”—*Boston Globe* (April 17, 2008)

Many student lenders, including some of the largest, have begun to pull back from lending to community college students. More than 40%—6.2 million out of 14.8 million—of American undergraduates attend community colleges.³ A *New York Times* article points

1 www.marketwatch.com/news/story/update-survey-finds-majority-college/story.aspx?guid={83FDDEC4-5213-4FED-AE58-47AFF1D18C7A}&dist=hppr.

2 online.wsj.com/article/SB121245068223239659.html.

3 “Student Loans Start to Bypass 2-Year Colleges,” *New York Times*, June 2, 2008.

out lenders—including Citibank, Chase, and HSBC—that are segmenting the student loan marketplace, keeping lending lines open at more competitive universities while cutting off new funding to students at schools that require smaller loans or schools whose students have poorer chances of repayment, such as technical colleges.

Even students at larger institutions are feeling the squeeze as once-solid lenders and guarantors face troubles of their own during the credit crunch, according to the *Boston Globe*. Lenders, who have long required a cosigner on student loans, are also scrutinizing parents' credit histories more deeply as they look at new student loan applications.⁴ But with college costs continuing to rise, the need for funding remains.

“It’s a new market and a growing market,” says Jeff Meyer, vice president of product incubation and market intelligence at CUNA Mutual. Even though secondary market funding has dried up during the credit crunch, the consumer need remains. “Ten years ago, in-state [tuition] was \$7,000; \$4,000 in loans and \$3,000 for yourself. Ten years later it’s \$17,000 and the gap is suddenly \$11,000. Credit unions need an infusion of youth. This is one way they can start that relationship,” Meyer adds.

Target Audience

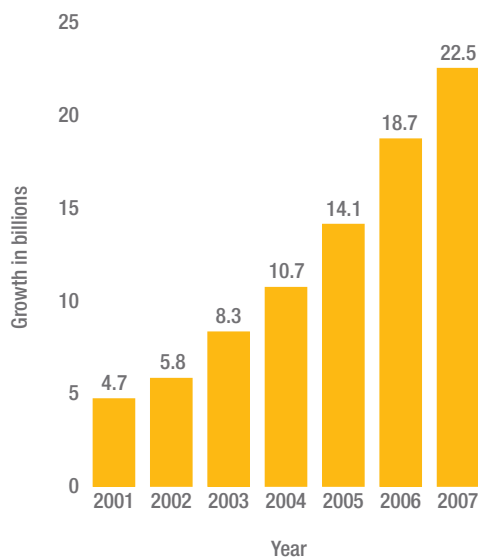
Credit unions should target parents of high schoolers and undergraduates with direct mail and Web promotions as they begin to plan for college, says Jon Jeffreys, president of Credit Union Student Choice, a CUSO led by Callahan & Associates along with several large credit unions. Target older students or transfer students directly, he adds.

The vast majority of student loan queries come from parents first, says Johanna Gomera, consumer loan manager at Affinity FCU (\$1.7B) in Basking Ridge, New Jersey. Rather than focus your efforts on blogging and “cool” promotions, market first to member parents, who usually take more interest in the financial side of college than do their children.

Regulatory Turmoil

Michael Kim, vice president of student services at USC Credit Union (\$348 million [M]) notes that proposed legislation would force students to obtain loans through lenders at their schools' financial aid offices.

Figure 1: Private Education Loan Market Growth—Non-Federal Student Loan Originations (in billions [B])



Source: Estimates by the College Board and Sallie Mae.

4 “Credit Crisis Hits Student Borrowers,” *Boston Globe*, April 17, 2008, www.boston.com/business/personalfinance/articles/2008/04/17/credit_crisis_hits_student_borrowers?mode=PF.

One of the reasons large lenders have pared back student lending is that it's not as profitable as it once was. Before this year, the federal government used to guarantee a 6.8% floor to any lender writing federal loans. Recent legislation cut that floor to 6% on federal products. The fees the government charges lenders for the guaranteed loans have also risen from 50 to 100 basis points.

Because of these changes, many lenders are pulling out of the federal programs and focusing on private loans, where students come once they've exhausted their federal loan limits, Kim says. Lenders set their own underwriting criteria, rates, and fees for private loans, he adds.

Potential Student Loan Partners

Few credit unions have the scale or the inclination to go it alone in the student lending arena. Here are three potential partners that credit unions can use to kick-start a student loan program.

Credit Union Student Choice

Callahan & Associates launched Credit Union Student Choice as a private student lending platform in the summer of 2008. At the end of July 2008, 21 credit unions were participating. Credit Union Student Choice is designed for credit unions that want help originating and underwriting loans, but that also want to set their own terms and keep the loans on their own books, says Jon Jeffreys, who leads the CUSO.

The CUSO provides participants with a Web page template for explaining the product. Members pay no origination fees on the loans, and the credit union can set its rates between LIBOR +0.85% and LIBOR +4.0%. For a fee, participating credit unions may also insure their portfolios through Callahan's partnership with insurance company AIG.

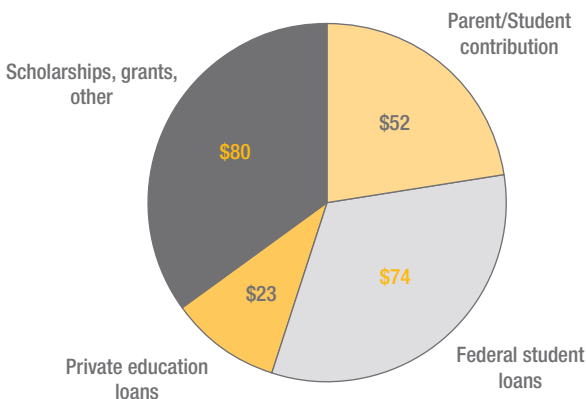
To date, participating credit unions have written individual loans averaging \$16,000 apiece, which is more than expected, Jeffreys says. Partner credit unions use a co-branded Web site that explains

the program and is hosted by the CUSO. Each loan requires a cosigner, and most credit unions in the Student Choice program set a lifetime cap of \$75,000.

CUNA Mutual Group—Private Student Loans

CUNA Mutual Group plans a two-pronged approach: selling private student loans directly to students, and teaming up with individual credit unions that refer students to its loans. The company will

Figure 2: Sources of Funding for College Attendance—Academic Year 2006–2007 (in billions)



Source: CUNA Mutual Group research.

advertise with targeted direct mail, Internet search ads, and Internet banner ads. CUNA Mutual will send direct mail to members of partner credit unions at no cost to the credit union.

Originations of private student loans have quadrupled since 2002, according to the College Board and Sallie Mae. “I expect that to continue for the next few years and then level off to near GDP growth,” says Jeff Meyer. “It is a viable market.”

Meyer thinks the CUNA Mutual program is ideal for credit unions that want to offer student loans but don’t have the scale to fully invest in the effort. “If you use national averages, for every 10,000 members a credit union has, there are 100 student loans. For larger credit unions [an in-house program] might work.” For others, outsourcing is a good solution, he says.

CUNA Mutual will set the pricing on its loans and will hold those loans on its books. The company will be beta testing its private student loans with several credit unions in the fall of 2008 and plans to open its program to all credit unions within a year.

USC Credit Union

Despite its asset size, USC Credit Union (\$348M) in Los Angeles has leveraged its ties with USC to become one of the largest credit union student lenders in the nation. It has been originating student loans for its members since 1998 and plans to open up its system to other credit unions through its Education Loan Resources CUSO this year.

The CUSO’s lending system was launched in June 2008 and originated \$1.5M for USC Credit Union in the first month. Partner credit unions will run underwriting and originations through the CUSO but keep the loans on their own books, says Michael Kim. Credit unions can purchase default insurance on those loans through AIG.

USC plans to beta test its program with five credit unions in the fall and open up to more partners near the beginning of 2009.

What to Measure

Tracking the adoption and results of CU Tomorrow business briefs is essential. If you choose to offer student loans in any form, please do these three things:

1. Monthly: Track the number of members who successfully open a student loan.
2. Monthly: Track the monthly loan volume in student loans.
3. Send monthly tracking results to Ben Rogers at benrogers@filene.org.

Cold Hard Facts

Figure 3: Elements of Student Lending Programs

	Federal Stafford loan	Federal Plus loan	Private loan
Eligibility	Undergraduate and graduate	Parents of undergraduate; graduate and professional	Varies by product
Award amounts	Annual limits apply	Up to price of attendance	Some available for expenses beyond price of attendance
Interest rate	Fixed at 6.0% (undergrad) Fixed at 6.8% (graduate)	FFEL—8.5%; Direct—7.9%	Variable based on credit risk
Interest rate subsidy	For subsidized Stafford loan only	No	No
Eligibility based on credit history	No	Yes	Yes
Require cosigner	No	Adverse credit history may require a cosigner	Nearly all loans require a cosigner
Default guarantee	Yes	Yes	No
Loan discharge available	For some, bankruptcy; borrower's permanent disability or death; other	Death of student for whom the parents borrowed	No
Deferred	Yes	No	Yes

Source: CUNA Mutual Group.

Figure 4: Different Colleges, Different Costs

Average college costs 2007–2008	However . . .
<p>Private four-year: \$23,712 (up 6.3% from last year) Public four-year: \$6,185 (up 6.6% from last year)</p>	<ul style="list-style-type: none"> • About 56% of students enrolled at four-year colleges or universities attend institutions that charge tuition and fees of less than \$9,000 per year. • 43% of full-time students enrolled in public four-year colleges and universities attend institutions that charge tuition and fees between \$3,000 and \$6,000. • While private four-year institutions have a much wider range of tuition and fee charges, only about 6% of all students attend colleges with tuition and fees totaling \$33,000 or higher per year.
<p>Public two-year: \$2,361 (up 4.2% from last year)</p>	<ul style="list-style-type: none"> • 22% of all full-time students attend public two-year colleges. • For full-time dependent students at public two-year colleges, net tuition and fees are no more than 2% of the family income.
<p>Students will pay, on average, from \$371 to \$406 more than last year for this year's room and board, depending on the type of college. The average surcharge for full-time out-of-state students at public four-year institutions is \$10,455.</p>	<ul style="list-style-type: none"> • About two-thirds of all full-time undergraduate students receive grant aid. In 2007–2008, estimated aid in the form of grants and tax benefits averaged about \$2,040 per student at public two-year colleges, about \$3,600 at public four-year colleges, and about \$9,300 per student at private four-year colleges.

Source: The College Board (www.collegeboard.com/student/pay/add-it-up/4494.html).

Adapting to a Member Need Affinity Federal Credit Union (\$1.7B) Basking Ridge, New Jersey

Until recently, Affinity FCU members who wanted to finance educational expenses got an unsecured term loan or were pointed to a home equity specialist. But most students want and need a deferred payment option, so Affinity partnered with American Education Services (AES) to offer federal Stafford loans and private student loans beginning in March 2007.

Even as a larger credit union, Affinity wanted a partner that would manage paperwork and communication with schools' financial aid offices, which AES does, while it could originate and hold the loans itself.

Affinity realized quickly that it didn't need to market student loans on blogs to be successful. Instead, consumer loan manager Johanna Gomera estimates that 85% of the inquiries for student loans come from parents eager to solidify the financial side of their child's education. The credit union earns member gratitude not just by giving the loans but by guiding parents through the process.

Families must fill out the Free Application for Federal Student Aid (FAFSA) by the June prior to August enrollment. Affinity encourages families to start even earlier because the application usually takes several weeks to process, and it must be approved by a student's school before the credit union can issue any funds. Thus, July and August are Affinity's busiest student loan times, with eager parents and students making their final arrangements. In

one week in July, Affinity had a queue of 60 applications.

Affinity offers any 18-year-old student enrolled full time a \$10,000 line of credit, even if he or she doesn't have an established credit history. The line is popular during financial "crunch times," but most students and parents still prefer the government loans, Gomera says.

The credit union has softly marketed its student lending program through statement stuffers, newsletter articles, and a banner ad on the home page.⁵ But now that the program is a year old, Gomera thinks heavier marketing will attract even more applications.

In January 2007, the credit union's education loan portfolio was \$2.6M. In January 2008 it was \$6M. As of June 30, 2008, it held 965 accounts at \$7,147,492. Since the new deferred loan was introduced in March 2007, Affinity FCU has booked more than 500 new lines of credit and more than doubled its portfolio.

"We have to focus on the people who are up and coming not just our older members," Gomera says.

Successful Cross Selling UW Credit Union (\$1.1B) Madison, Wisconsin

The University of Wisconsin Credit Union (UWCU) has offered federally backed student loans since the early 1970s. It introduced private student loans in 2006. "It's a very important product, one of our most profitable lines," says Chad LaFlash, director of research and development at UWCU.

The credit union's experience is perhaps most instructive, though, for the ways it encourages new members to move beyond student loans into sticky products like checking.

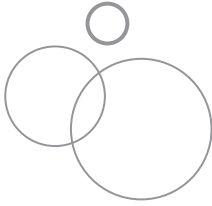
"Five or six years ago we saw much increased competition [for student loans] from banks. Initially, we were criticized by financial aid offices for not matching their terms," LaFlash says. "Now there's a dramatic change in the other direction. We're seeing a lot of lenders drop out of the business. When banks can't make a certain profit on this business they don't want to play there anymore." Federally insured Stafford loans carry just a 1% margin for UWCU. Private loans are generally more lucrative and carry a blended margin around 3%.

More than 60% of UWCU's student loan borrowers have a checking account with the credit union; 10% have only a student loan. The advantage of student lending is that many of the borrowers are already

moving and looking for a new financial relationship, LaFlash says. The credit union calls out to new members how a student loan helps them qualify for more benefits, like a rewards checking account or a "Campus Package" that includes a debit card, a credit-builder credit card, and the popular University of Wisconsin logo checks.

To access incoming students, UWCU makes sure it stays on preferred lender lists for student loans. Credit union employees maintain personal contact with student aid offices, attend financial aid meetings at the schools, and offer the same perks to students that other lenders offer: low rates, fee waivers, and rate cuts for payment performance.

For student loan members, the next most popular product is a checking account, followed closely by a credit card, LaFlash says. Auto loans come in a distant third, and student members usually open them to take advantage of UWCU's graduation rate discount.



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