

A Credit Union Toolkit for Building a Better Virginia

realitycheck

affordable loans
for real life



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Executive Summary

275,000 Virginia Households Use Alternative Financial Service (AFS) Providers for Short-Term Loans

Since our inception, we credit unions have existed to provide affordable financial solutions for our members, *especially* to those of modest means. Owing to the recent economic downturn, the number of people who are now classified as those of “modest means” has grown exponentially. This is the **new reality** for households, including Virginia households. For example:

- Nearly one in four Virginia households earn less than the amount needed to meet basic monthly expenses without some form of outside assistance from government programs, family or friends, or local organizations;
- Further, 28% of Virginia households do not have sufficient cash assets to protect them in the event of a financial emergency;
- Another 56% of households report difficulty paying monthly bills.*

For households that are living paycheck to paycheck, having access to affordable credit is critical. Yet, for many Virginians, their primary and most convenient options may be alternative financial service (AFS) providers such as payday loan stores, pawn shops, and title loan outlets. About 275,000 Virginia households (10%) use these lenders to meet their short-term loan needs. Today, all too often, members turn to these usurious businesses before thinking of a credit union or after having been turned away by a bank.

Consumers’ needs have changed dramatically in the past few years. That means our response to meet these needs must change as well. Credit unions now have a tremendous opportunity to prove the Credit Union Difference—to demonstrate that we truly exist as trustworthy financial cooperatives of “people helping people.” Affordable credit, when people need it most, can result in stronger communities, and in turn, a stronger Commonwealth.

In response to this new reality, your Virginia League’s Community Resource Task Force and the Credit Union Marketing & Business Development Council created this **Reality Check initiative**. Reality Check gives Virginia credit unions the opportunity to demonstrate our uniqueness, to build visibility within our communities, and to enhance our status as not-for-profit financial cooperatives.

Two micro-loan products have been identified that would provide Virginians with access to more affordable credit. These loan products include: **Smart Size Loans** and **Credit Builder Loans** – each one designed to fulfill a critical need.

Need	Product	Description
Short-term cash	Smart Size Loan	A loan of \$3,000 or less
Establish/improve credit	Credit Builder Loan	A loan of \$3,000 or less with loan proceeds placed in a restrictive share account; funds available as loan is paid down

* Source: “Building Economic Security for Virginia Families,” University of Virginia’s Weldon Cooper Center for Public Service, February 2011

Your credit union may already offer members unsecured loans of \$3,000 or less. Most credit unions don't need to add new products to their loan portfolios to participate in Reality Check. However, the beauty of cooperatively participating in the project is the strength in numbers. The more members and potential members identify Reality Check as being helpful to their households and communities, the stronger we can demonstrate the Credit Union Difference.

Proving Our Worth

But this project is not just about making affordable small loans to people who need them. A complementary goal is to measure the impact credit unions are having on their members' lives and communities. To accomplish that goal, we need to collect manageable data and report results quarterly.

Here is where your League can help. This toolkit includes a template for aggregating your microlending data. It has been designed to make it simple for you to report as you prepare your Call Report each quarter. The League will combine the information received into quarterly Impact Reports, which will be used to demonstrate the Credit Union Difference to our members, communities, lawmakers and the media.

The data will include:

- Number of micro-loans (\$3,000 or less at origination) made to members by loan type;
- Dollar amount of these loans advanced to members by loan type;
- Loan purpose;
- Borrower income;
- Credit score (if obtained).

Note: No non-public personal information is to be collected and only aggregate data will be reported.

In addition, anecdotal stories will be collected to connect the data to the people living in our communities.

This toolkit includes everything your credit union needs to get involved: from turnkey marketing pieces to sample loan policies.

Why Should You Participate?

- Because all of us working together are stronger than each of us working alone. When your efforts and data are combined with other credit unions, the total picture can make a powerful impact.
- Because your credit union is already making small-dollar, unsecured loans.
- Because it is your mission, and the right thing to do.

- Because it helps the Virginia League capture the social value of the Credit Union Difference.
- Because it is great for public relations and grass-roots advocacy.

In short, why would you choose **not** to participate?

Participation is Simple

1. Sign the Memorandum of Understanding and Agreement;
2. Continue to make small loans as usual or enhance your micro loan program;
3. Collect your results and report quarterly to your League.

The success and effectiveness of this project hinges on your engagement!

Ready to Take a Stand on Behalf of Your Member-Owners?

Show us your intent! We have included a Memorandum of Understanding and Agreement at the back of this booklet to indicate your involvement.

SECTION I

Virginia Consumers Need Our Help

It's Time For a Reality Check!

Virginia Consumers Are In Need

On the surface, Virginia appears to be weathering the economic storm relatively well. For example, the November 2011 unemployment rate of 6.2% makes us the 41st lowest in the country and our 11.1% poverty rate (2010) makes us the 44th lowest, according to the U.S. Census Bureau. These ratios are much lower than overall U.S. averages, which are 8.6% and 15.3%, respectively.

However, this picture is deceiving as other statistics tell a different story. Unemployment in Virginia has increased 2.1% since 2008, when it was 4.1%. Bankruptcy filings have gone up from 2.5 filings out of every 1,000 people in 2007 to 5.4 in September 2011. Virginia ranks 33rd among states in home affordability ((householder paying over 30% of their income on housing costs). In fact, according to a study by the University of Virginia's Weldon Cooper Center for Public Service¹:

- Nearly one-in-four Virginia households earn less than the amount needed to meet basic monthly expenses without some form of outside assistance from government programs, family or friends, or local organizations;
- Further, 28% of Virginia households do not have sufficient cash assets to protect them in the event of a financial emergency;
- Another 56% of households report difficulty paying monthly bills.¹

The study concludes that the federal poverty rate is only one measure of household economic security, which it defines as a household's capacity to afford daily expenses and survive a financial emergency such as a job loss or illness. Its analysis of economic security includes two other measures: income adequacy to meet basic expenses and asset adequacy to meet short-term, unplanned events.

Another report² states that rising unemployment and bankruptcies mean higher credit card debt as households turn to more credit card usage to manage everyday expenses. The average FICO scores in Virginia remain relatively high at 700, according to the report, which is better than the national average of 693. As a result, credit card companies have been targeting households in the state in order to bolster their own bottom lines. Many of the households taking advantage of these offers are the households already struggling financially.

For these households and many others living paycheck to paycheck, access to affordable credit is critical. It can mean fixing the car in order to keep one's job. It can mean getting proper medical care for a child. It can mean paying the rent or utility bill to avoid eviction or service disconnection.

1) "Building Economic Security for Virginia Families," University of Virginia's Weldon Cooper Center for Public Service, February 2011.

2) "Fixing Credit Card Debt in Virginia," retrieved at: www.creditcarddebt.org/virginia.html.

workers have been unemployed for some period during the recession; a full 55% report some meaningful work-related hardship such as unemployment, a cut in pay, reduced hours or involuntary part-time work.³ Despite the fact that 62% of survey respondents indicated they have reduced spending and debt, the need for small-dollar loans has increased substantially as households struggle to make ends meet.

Almost 10 million U.S. households who are unbanked or underbanked borrow to pay for short-term, small-dollar loan needs; 40% of these borrowers do so to pay for basic living expenses.⁴ Other reasons for borrowing include making up for lost income, covering home repairs or a major purchase such as an appliance, or helping family and friends. In other words, these households require access to credit for real needs.

Reality Check

It is time for credit unions to take a Reality Check of their small-dollar, short-term loan products and ensure they are appropriate for the needs of their members and the marketplace today.

A study by the Center for Financial Services Innovation (CFSI)⁵ cites three reasons a financial institution should offer high-quality small-dollar loans.

1. Credit, when well-structured, can help a household save. This can be accomplished through a savings component included with a debt product or funding a savings account through debt for a future need.
2. Building a good credit history is a critical asset in and of itself. Credit scores are used by employers, insurance companies, landlords, mortgage lenders and others. Thus, a positive credit record can lead to long-term financial prosperity.
3. Credit can facilitate other wealth-building activities. For example, home mortgages have been a traditional method of building assets and wealth. Financing an education is another example. But even purchasing or repairing a car to ensure dependable transportation to work can result in a better-paying job.

As the financial realities of low- and middle-income households shift and deteriorate in today's economy, credit unions have the products and services in place to help families stabilize their short-term financial situations. This Reality Check project and toolkit have been designed to help Virginia's credit unions meet small dollar loan needs and to measure and report their successes. The two loan products that are included as part of Reality Check meet the CFSI goals listed above for adding value and purpose to credit.

3) "How the Great Recession Has Changed Life in America," by Paul Taylor, et al., for the Pew Research Center, June 2010.

4) "How Should We Serve the Short-Term Credit Needs of Low-Income Consumers?" by Rachel Schneider and Melissa Koide for the Center for Financial Services Innovation, 2010.

5) *Ibid.*

Virginia Communities

According to the Weldon Cooper report, economically secure households are less likely to put a strain on local and state services and more likely to have better physical and mental health, which translates into better school performance among children and higher workplace productivity. This results in stronger communities.

Access to affordable credit increases opportunities for consumers to manage financial emergencies, negotiate better jobs with a dependable car, upgrade their job skills at a local community college or technical school, and lead healthier lives with adequate medical care.

Access to affordable credit produces healthier and wealthier communities. First, more of the consumers' dollars are staying in their pockets rather than being paid out in exorbitant fees to predatory lenders. Secondly, the knowledge that unexpected financial emergencies can be endured through a small affordable loan, if necessary, gives families peace of mind and a greater involvement with their communities through schools, churches and community organizations.

Credit Unions Can (and Must) Help

U.S. credit unions were born in the early 1900s in response to a scarcity of credit and usurious interest rates for most laborers, farmers, and small businessmen. Fast-forward to the year 2011, and credit continues to remain elusive for modest-means households through the banking industry, or is very expensive through the alternative financial services (AFS) sector, such as payday lenders, rent-to-own stores, or finance companies.

As not-for-profit financial cooperatives, credit unions in Virginia have the opportunity to continue to demonstrate that credit unions are not just "tax-exempt banks." They meet a fundamental need within their communities – the small-credit needs of their members. For-profit banks don't see enough return on investment for small loans. Payday lenders get enough return on investment by adding excessive fees. Credit unions are the reasonable alternative and have the opportunity to strengthen their communities.

Demonstrating the Difference

Statistics demonstrate that credit unions are walking the talk. We **are** helping people. Through the collection of manageable data from credit unions, the Virginia Credit Union League can demonstrate the impact credit unions have in meeting the small-loan needs of Virginia consumers. Armed with data and anecdotal stories, the League and lobbyists can show Virginia lawmakers the "Credit Union Difference".

If not for credit unions, how many consumers and their families would not have access to affordable micro credit?

The effects of the recent recession have not only increased unemployment, but have caused other work-related hardships. A study by the Pew Charitable Trusts reports almost one-third of American



How Healthy Is Your Corner of the Commonwealth?

Statistics can be used to tell varying stories dependent on the writer's perspective and purpose. Virginia can look relatively healthy if one looks at the state's 2010 estimated poverty level of 11.1% when compared to the national level of 15.3% or its unemployment rate of 6.2% when compared to the U.S. average of 8.6% (November 2011). As such, Virginia ranks 44th lowest in the nation in poverty rates and 41st lowest in unemployment. Virginia also ranks 6th highest in median net worth for households.

But other rankings tell a very different story. For example, Virginia is:

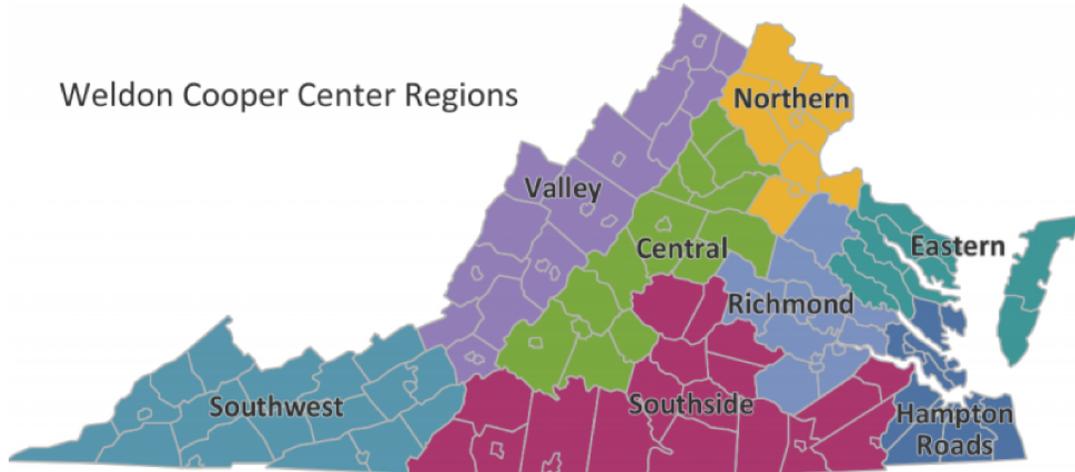
- 6th highest among states in median credit card debt;
- 19th highest in the rate of bankruptcies;
- 33rd in home affordability.

This information comes from a study by the University of Virginia's Weldon Cooper Center for Public Service titled: "Building Economic Security for Virginia Families: Income and Asset Adequacy," February 2011. The study reports that the federal poverty level does not begin to capture how many Virginia families face real economic challenges. The study uses a self-sufficiency measure to evaluate how much Virginia families must earn to pay basic expenses such as food, housing, transportation and child care. A family of four with an annual income of \$21,756 is above the federal poverty line. However, that same family actually needs income of about two times the federal poverty line (\$44,000) to cover expenses. And that doesn't provide any room for savings, emergencies such as car repairs or job losses, or special events such as birthdays or holidays.

Using data from the census and the Federal Reserve Board's Survey of Consumer Finances, the study calculated household income and available assets and reported that:

- Almost 25% of Virginia households earn less than the amount needed to meet basic monthly expenses on their own; and
- A little over 25% of Virginia households do not have enough cash assets (savings, retirement accounts) to protect them from financial ruin in the event of emergencies such as job losses, health problems or divorce.

The Weldon Cooper Center has defined eight regional profiles based on the 2010 Census Bureau's American Community Survey data. The information was gathered to provide a picture of how Virginia is changing. Those eight regions are used in this project to identify changing demographics in Virginia that can aid credit unions in meeting consumer financial needs.



Central Virginia

With a growth rate of 15.8% from 2000 to 2010, Central Virginia was one of the fastest growing regions in the state, second only to Northern Virginia. Four localities – Albemarle, Fluvanna, Louisa, and Orange – grew by nearly 30% during this period.

- Culpepper has the highest concentration of Hispanics in the region (9% of its population) and that population increased by 3,300 persons or 385%.
- Charlottesville has the highest concentration of Asians in the region (6%).
- Albemarle had a 2,300-person increase in Asians, the largest numerical increase in the region.
- Unemployment was 5.2% for the Charlottesville MSA and 6.8% for the Lynchburg MSA in November 2011.
- Nearly a quarter of Central Virginia's households earn less than \$25,000 per year.
- 12% of households fall below the poverty line.
- 7% of households receive food stamps.
- 25% do not have adequate income to meet regular expenditures.

CENTRAL	
Cities	Counties
Bedford	Albemarle
Charlottesville	Amherst
Lynchburg	Appomattox
	Bedford
	Campbell
	Culpeper
	Fluvanna
	Greene
	Louisa
	Madison
	Nelson
	Orange
	Rappahannock

Eastern Virginia

Eastern Virginia has the smallest population of any region, less than 2% of the state's total population. The region experienced negligible growth between 2000 and 2010, gaining only 500 persons, or 0.4% growth rate.

- Accomack has the highest concentration of Hispanics – 9% of its population.
- Asians represent less than 1% of the population.
- Unemployment was 7.3% in November 2011. More than a quarter of Eastern Virginia's households earn less than \$25,000 per year.
- 12% of households fall below the poverty line.
- 8% of households receive food stamps.
- 26% do not have adequate income to meet regular expenditures.

EASTERN	
Cities	Counties
	Accomack
	Essex
	King & Queen
	King William
	Lancaster
	Middlesex
	Northampton
	Northumberland
	Richmond
	Westmoreland

Hampton Roads

Hampton Roads has a high population density, second only to Northern Virginia. It covers only 5% of the state's land mass, but has more than 20% of Virginia's population. The region experienced moderate growth (5.7%) between 2000 and 2010.

- In Virginia Beach, the Asian population grew by nearly 6,000 and the Hispanic population grew by more than 11,000.
- Newport News has the largest concentration of Hispanics in the region (7%).
- Unemployment was 7.2% in November 2011.
- While Hampton Roads has been identified nationally as one of the best regions for high-paying jobs, median household income varies substantially across localities: Williamsburg and Norfolk have the lowest (\$42,000) and Poquoson City has the highest (\$85,000).
- 10% of households fall below the poverty line.
- 7% of households receive food stamps.
- 29% do not have adequate income to meet regular expenditures. This is driven by the high cost of living in the Hampton Roads region where housing costs are only higher in Northern Virginia.

HAMPTON ROADS	
Cities	Counties
Chesapeake	Gloucester
Hampton	Isle of Wight
Newport News	James City
Norfolk	Mathews
Poquoson	York
Portsmouth	
Suffolk	
Virginia Beach	
Williamsburg	

Northern Virginia

With less than 10% of Virginia’s land mass, but one third of the total population, Northern Virginia continued to experience tremendous growth between 2000 and 2010 at a rate of 24.2%. This growth accounted for more than half of the state’s total population growth since 2000. Fairfax was the slowest growing locality in the region with a 5% growth rate and Loudoun was the fastest growing locality, nearly doubling its population with an 84% growth rate.

- Northern Virginia has the greatest racial and ethnic diversity of all eight regions and the 2010 Census data show increasing diversity.
- The Hispanic population increased by 80% in the decade. In many localities such as Loudoun and Spotsylvania, the Hispanic population more than doubled.
- Northern Virginia’s Asian population increased by 7% over the last decade.
- Asians increased by more than 60,000 and Hispanics by more than 60,000 in Fairfax County over the decade.
- Nearly half of Northern Virginia’s households earn more than \$100,000 per year and 83% of workers are employed in high-paying occupations.
- Unemployment was 5.9% in November 2011.
- 5% of households fall below the poverty line.
- Less than 3% of households receive food stamps.
- 24% of households do not have adequate income to meet regular expenditures. This is due to the high costs of living in Northern Virginia, especially housing costs.

NORTHERN	
Cities	Counties
Alexandria	Arlington
Fairfax	Fairfax
Falls Church	Fauquier
Fredericksburg	King George
Manassas	Loudoun
Manassas Park	Prince William
	Spotsylvania
	Stafford

Richmond

The Richmond region has nearly 15% of the state’s total population and experienced a high growth rate at 14.6% between 2000 and 2010. All localities except Petersburg experienced population growth, with New Kent experiencing the most at 37%.

- The Hispanic population more than doubled in all but two localities.

- Chesterfield has the largest concentration of Hispanics (7%), but Caroline had the fastest growing Hispanic population (225%).
- Henrico has the largest concentration of Asians (7%), while Charles City County had the fastest growing Asian population (243%).
- Unemployment was 7.0% in November 2011.
- Median household income varies substantially across localities with Petersburg City having the lowest median income at \$36,000 and Hanover County having the highest at \$77,000.
- 11% of households fall below the poverty line.
- 7% of households receive food stamps.
- 28% of households do not have adequate income to meet regular expenditures. While not quite as expensive as Northern Virginia, Richmond has high living costs similar to Hampton Roads.

RICHMOND	
Cities	Counties
Colonial Heights	Caroline
Hopewell	Charles City
Petersburg	Chesterfield
Richmond	Dinwiddie
	Goochland
	Hanover
	Henrico
	New Kent
	Powhatan
	Prince George

Southside Virginia

Southside has only 6% of Virginia's population but more than one-fifth of its land mass. The region gained only 7,000 persons between 2000 and 2010, a growth rate of 1.4%. Eight localities experienced population loss, with Danville recording the largest losses.

- Hispanic populations grew in all localities, but numerical increases were small. Franklin County had the largest numerical increase with 850 people.
- Mecklenburg had the largest numerical increase in Asian population with 120 people.
- Unemployment was 9.3% in November 2011 for the Danville MSA. 31% of adults ages 25-64 are out of the labor force, meaning they are not working or looking for work. This is much higher than state (20%) and national (22%) levels.
- More than 36% of Southside's households earn less than \$25,000.
- 17% of households fall below the poverty line.
- 13% of households receive food stamps.
- 32% of households do not have adequate income to meet regular expenditures.

SOUTHSIDE	
Cities	Counties
Danville	Amelia
Emporia	Brunswick
Franklin	Buckingham
Martinsville	Charlotte
	Cumberland
	Franklin
	Greensville
	Halifax
	Henry
	Lunenburg
	Mecklenburg
	Nottoway
	Patrick
	Pittsylvania
	Prince Edward
	Southampton
	Surry
	Sussex

Southwest Virginia

Similar to Southside, Southwest Virginia has nearly one-fifth of the state’s land mass and 7% of its total population. The region grew by only 2.7% from 2000 to 2010, gaining 16,000 persons. Southwest has the least racial and ethnic diversity of all of Virginia’s eight regions, with 93% of the population reporting to be White.

- Galax City has one of the highest concentrations of Hispanics in the state with 14% of its population.
- Montgomery County’s Asian population grew by nearly 1,800 people over the decade.
- Unemployment was 7.0% in November 2011 for the Blacksburg-Christiansburg-Radford MSA. 32% of adults ages 25-64 are out of the labor force, meaning they are not working or looking for work. This is much higher than state (20%) and national (22%) levels.
- More than one-third of Southwest’s households earn less than \$25,000 per year.
- 19% of households fall below the poverty line.
- 14% of households receive food stamps.
- 32% of households do not have adequate income to meet regular expenditures.

SOUTHWEST	
Cities	Counties
Bristol	Bland
Galax	Buchanan
Norton	Carroll
Radford	Dickenson
	Floyd
	Giles
	Grayson
	Lee
	Montgomery
	Pulaski
	Russell
	Scott
	Smyth
	Tazwell
	Washington
	Wise
	Wythe

The Valley

The Valley grew by 10.6% from 2000 to 2010 and gained 75,000 persons. Of the region’s 23 localities, 18 had population increases. Frederick had the highest growth rate at 32% and the largest absolute growth, gaining 19,000 persons.

- Harrisonburg has one of the highest concentrations of Hispanics in the state at 16% of its population.
- Roanoke County had the largest increase in Asian population, gaining more than 1,000.
- Unemployment was 6.0% in the Harrisonburg MSA and 6.6% in the Roanoke MSA in November 2011.
- Nearly a quarter of the Valley’s households earn less than \$25,000 per year.
- 12% of households fall below the poverty line.
- 7% of households receive food stamps.
- 27% do not have adequate income to meet regular expenditures.

VALLEY	
Cities	Counties
Buena Vista	Alleghany
Covington	Augusta
Harrisonburg	Bath
Lexington	Botetourt
Roanoke	Clarke
Salem	Craig
Staunton	Frederick
Waynesboro	Highland
Winchester	Page
	Rockbridge
	Rockingham
	Shenandoah
	Warren

Comparison of Regions

	Central	Eastern	Hampton	Northern	Richmnd	Southsd	Southw	Valley	Virginia	U.S.
Population (000s)	588	141	1,641	2,595	1,167	505	580	784	8,001	308,746
% Growth	15.8	.4	5.7	24.2	14.6	1.4	2.7	10.6	13.0	9.7
% Unemployment	6.7	7.5	6.8	4.9	7.5	10.8	8.8	7.2	7.5	9.7
% Poverty	12	12	10	5	11	17	19	12	10	14
% Food Stamps	7	8	7	3	7	13	14	7	7	12
% Inadequate Income	25	26	29	24	28	32	32	27	25	Ukn
% White	77	65	57	58	59	64	93	84	65	64
% Black	15	27	31	12	30	32	3	8	19	13
% Hispanic	5	5	5	15	5	2	2	5	8	16
% Asian	2	<1	4	12	3	<1	<1	<1	6	5

Who are the Asset Poor?

It stands to reason that the asset poor are similar to those with inadequate incomes to meet monthly expenses. After all, if a household doesn't earn enough money to meet basic needs, it will not be able to set aside a rainy-day fund. However, whereas 24% of Virginian households had inadequate incomes, 28% are estimated to be asset poor.⁶ Thus, having sufficient income to meet basic needs does not necessarily mean a household is able to set aside savings to manage short-term financial challenges. In comparison, among the U.S. population, 30% are estimated to be asset poor.

The Weldon Cooper study provides a good look at the demographic differences between those households that are asset poor and those that are asset adequate, as shown below. The asset poor and the asset adequate are demographically and economically distinct groups. For example, black and Hispanic households are more apt to be asset poor at over twice the rate of white households. Median income for asset-poor households is about one-third that of asset-adequate households.

Compared to the asset poor, asset-adequate households:

- Are older;
- Have higher educational attainment;
- Earn more income in professional occupations.

6) "Building Economic Security for Virginia Families," University of Virginia's Weldon Cooper Center for Public Service, February 2011.

Asset Adequacy by Demographic and Economic Characteristics, U.S. (2007)

	Asset Poor	Asset Adequate
Median Age	42	51
Race/Ethnicity		
White, Non-Hispanic	24%	76%
Black, Non-Hispanic	50%	50%
Hispanic	57%	43%
Education		
Less than High School	63%	37%
High School	36%	64%
Some College	29%	71%
Bachelors or More	12%	88%
Household Composition		
Proportion Married	47%	64%
Median Employment Income	\$23,400	\$67,000
Employment Status		
Employed	29%	71%
Self-Employed	18%	82%
Unemployed	58%	42%
Occupation		
Professional	14%	86%
Technical	33%	67%
Other	38%	62%
Median Net Worth	\$5,900	\$240,060

The median net worth between these two groups highlights the economic fragility of the asset poor. The median net worth of asset-poor households is \$5,900, which means that half of these households have a net worth less than \$5,900.

Source: 2007 Survey of Consumer Finances analysis of household head. Dollars represent 2007 dollars adjusted for inflations to 2009 values (rounded nearest \$100).

Use of Alternative Financial Services in Virginia

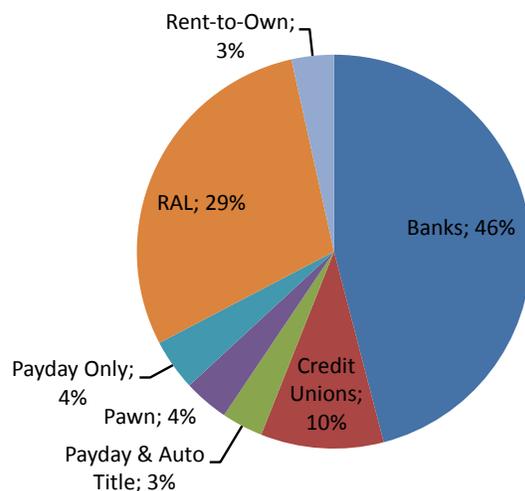
Virginia households have access to five types of alternative financial services (AFS) for short-term, small-dollar loans⁷:

1. **Auto Title Loans** – are for four months to one year and are secured by the borrower's car title. In the case of default, the lender can repossess the car. Nearly 150,000 Virginians (5%) have reported using auto title loans between 2005 and 2009.
2. **Pawn Shop Loans** – are typically for a 30-day period and are secured by a personal good of the borrower. If the borrower fails to repay at that time, the pawnbroker can sell the good. More than 95,000 Virginia households (3%) have borrowed money from a pawnbroker.
3. **Payday Loans** – are typically for a two to four week period. The borrower writes the lender a post-dated check for the loan amount plus fees. On the due date, the borrower either repays the lender or the lender cashes the check. Nearly 120,000 households (4%) used a payday loan in 2008.
4. **Refund Anticipation Loans (RALs)** – are typically for one to two weeks, until the tax preparer/lender receives the borrower's expected tax refund. Fees can vary between preparers and the loan amount is based on the expected refund, less any fees and interest. About 70,000 households (2.5%) in Virginia have used RALs at least once between 2004 and 2008.
5. **Rent-To-Own (RTO) Stores** – provide borrowers the option to lease big-ticket consumer items such as electronics, appliances, and furniture. The borrower owns the item at the end of the lease. A missed payment can result in repossession and the loss of all prior payments. More than 100,000 (3.6%) of Virginians have reported using RTOs.

Financial Lenders in Virginia, 2011 (by number of locations)

This chart shows the distribution of financial lenders in Virginia by number of locations. Traditional lenders (banks and credit unions) make up 56% of the lending institutions. Excluding RALs, which are available only during tax season, the remaining AFS providers account for 14% of financial lenders, more than the number of credit union locations.

The most frequent reasons cited for using AFS providers are convenience and fear of being turned down by a bank. This distribution chart would indicate there are many alternatives to using a bank or credit union.



7) "Undermining Economic Security," Univ. of Virginia's Weldon Cooper Center, June 2011.

Who uses alternative financial services in Virginia?

Nearly 10% of Virginia households (275,000) use some type of AFS product. This compares with 12% for the U.S. overall. Patterns of use, however, are similar between U.S. consumers and Virginians.

For example, among AFS users:

- The majority of households (71%) use only one type of alternative short-term loan;
- Three or more types of AFS are used by 8% of households;
- Payday and pawn loans are the most popular form of AFS.

This chart illustrates that there are distinct differences between households that use AFS loans and those that do not. For example, AFS-user households are:

- Younger, with lower incomes and higher unemployment;
- More likely to have children;
- Less likely to own a home or hold a bachelor's degree.

Among the households who reported using AFS providers, 49% were White and 44% were Black, even though Blacks make up only 19% of the population in Virginia. In fact, the report states, Black households are significantly more likely than White households to use AFS providers, even after controlling for characteristics such as age, income and education. Part of the explanation may be that Black households are more likely than either Whites or Hispanics to live in areas where there are only AFS providers, leaving them with fewer options.

In 2009, Virginia payday loans were capped at an annual interest rate of 36%. Lenders have to give borrowers up to two pay periods to repay the loan. Borrowers may make a request once in a 12-month period to be given at least 60 days and four equal installments to repay a loan, if they are experiencing repayment difficulties. Payday lenders cannot make a loan to a person with an existing payday loan and cannot make back-to-back loans – that is, cannot reloan money to a person on the same day an existing loan is paid off.

**Characteristics of Virginians
By AFS Use, 2009 CPS**

	Any AFS Use	Never Use AFS
Median Age	38	50
Race*		
White	49%	75%
Black	44%	15%
Income		
Less than \$25,000	38%	16%
\$25,000 - \$74,999	42%	44%
More than \$75,000	29%	71%
Unemployed	10%	3%
Education		
Less than High School	23%	9%
High School/GED	34%	28%
Some College	24%	22%
Bachelors or More	19%	41%
Household Characteristics		
Married	44%	57%
Have Child(ren)	41%	18%
Own Home	40%	78%

** Sample size of Hispanic and other race Virginians is too small to provide meaningful estimates.*

Typically these kinds of restrictions chase payday lenders out of the state. In theory, that may sound like good news for consumers. But sending payday lenders out of town doesn't eliminate the need for short-term credit among consumers.

In 2009, the average PDL borrower got 2.7 loans over the year, with an average loan amount of \$371.⁸ The total value of loans made in 2009 was over \$170 million. This compares to \$1.3 billion for 2008! Similarly, the number of loans made declined from 3.4 million in 2008 to 460,000 in 2009! The enormous change is likely a result of fewer payday lending options, not a sudden and radical shift in consumer credit needs.

The Role for Credit Unions in Virginia

The main reason Virginians use alternative financial services (AFS) for short-term, small-dollar loans is to meet basic living expenses. In fact, 42% of Virginians using AFS providers stated living expenses were their primary credit needs. That usage compares to 37% of U.S. responses, a possible indication that more Virginians are struggling to meet everyday needs than consumers in other states.

How can credit unions respond to the needs of struggling Virginia households? Credit unions have been making small loans to consumers for over 100 years. Credit unions responded to the scarcity and high cost of credit to people of modest means in the early 1900s and have continued to do ever since. Affordable micro-loan products can help bring economic security and peace of mind to more Virginia households living paycheck to paycheck. Credit unions can offer their members two products not generally offered through the banking industry:

- Smart Size Loans to help with short-term credit needs;
- Credit Builder Loans to help improve credit scores.

Not only do credit unions have the opportunity to respond to these credit needs, but they have the opportunity to measure the impact they are having within their communities. The collected data will bring greater visibility to credit unions as a vital community partner. With greater visibility more consumers will see credit unions as a better alternative to AFS providers and banks. That translates into healthy growth for credit unions and healthier, more secure Virginia households. Everyone wins!

If all Virginia credit unions choose to be part of this project to strengthen Virginia communities, the impact could be stunning!

8) Bureau of Financial Institutions, "Report on Virginia Payday Lending Activity for the Year Ending December 31, 2009," retrieved from: http://www.scc.virginia.gov/bfi/reg_inst/pay.aspx.

SECTION 2

Making Micro-Loans Successful

Marketing

Here's how you can grow your loan portfolios through micro-lending programs (unsecured loans of \$3,000 or less at origination) while meeting your low- and moderate-income members' credit needs. Two such "pre-branded" loan types have been developed that credit unions may use for the project:

- **Smart Size Loans** – unsecured personal loans for \$3,000 or less;
- **Credit Builder Loans** – loans to help members build or rebuild credit histories.

Most credit unions provide some form of unsecured micro-loan (also known as a signature loan). To participate in this project, you do not need to add a new loan product, unless you so choose. However, there are some advantages to naming and marketing these products as proposed. For example, marketing a loan product as a 'Credit Builder Loan' lets your members know you are willing to help them build or rebuild their credit.

Smart Size Loans

Smart Size Loans are unsecured loans of \$3,000 or less. All the loan proceeds are released at the time of closing. The loans could be used for many purposes, such as starting one's own business or purchasing equipment for a business, to make a large household purchase, for debt consolidation, to pay for a medical procedure, or to help a household through a financial emergency. Most credit unions already make such loans.



Given today's high unemployment rate and the struggles many individuals, particularly young adults, are having with finding suitable employment even with college degrees, marketing your micro-loans as career-building opportunities may have a strong impact on loan response. It could be marketed to meet new or additional training needs, new business attire, trade tools, etc.

How you market such loans will indicate to your members how willing your credit union is to help them with their small financial needs. Acknowledging that people have emergencies or unexpected expenses and your credit union is prepared to help can be a positive message of hope. Whereas it is strongly recommended that credit unions price their unsecured loans based on risk or a member's credit score, the message to members should acknowledge that life can throw curve balls occasionally and your credit union is prepared to help your members with less-than-perfect credit.

Some ways to mitigate risks to the credit union for higher risk borrowers include:

- Co-signer such as a parent or spouse;
- Membership requirement such as 3 or 6 months;
- Direct deposit requirement;
- A checking account with the credit union;
- Some form of financial education or counseling program;
- A Credit Builder loan;
- A firm close that emphasizes the importance of timely payments, notifying the credit union if there are any changes in employment or contact information, building a good credit history, etc.

The Operational Tools section (page 27) includes additional ideas for reducing risk. Making an unsecured loan to a member who is credit-challenged should be done with care and with prudent underwriting. Depending on your credit union's risk tolerance, there is nothing wrong with asking the member to demonstrate his/her commitment to the credit union and towards improving his/her credit score through some form of financial counseling or simply through a credit rebuilder loan. At the end of the loan term, the member has the necessary funds to make a purchase, pay off debts, etc. A firm closing tells the member the credit union is willing to make this loan despite past credit history, but any change in contact information or problems with making the payments on time must be communicated to the credit union immediately. Otherwise, no further loans will be made.

Credit Builder Loan

A credit rebuilder loan enables members with damaged credit to rebuild their credit histories. A Credit Builder loan helps members with little or no credit to build a history. The concept behind a Credit Builder loan is that none of the loan proceeds are released at closing. Instead, funds are placed in a restricted share/savings account and available for release as the loan balance is paid down. The goal is to help members build or rebuild their credit by providing a positive credit reference.



Why should a credit union help members rebuild or build good credit histories? Because credit scores can have a significant impact on their members' financial lives. For example, a credit score can affect a person's ability to:

- Get a loan and the cost of that loan;
- Get insurance and the cost of the insurance;
- Qualify for utility payments without a substantial security deposit;
- Rent or lease an apartment;
- Get a job.

In fact, the Annie E. Casey Foundation reports that a good credit rating can save the average borrower \$250,000 in interest over a lifetime. Some 70 million Americans have either poor credit or no credit history.

Through the Reality Check loan program, credit unions have the opportunity to:

- Help their members review and understand their credit and credit scores;
- Teach members about how they can improve their scores;
- Communicate the importance of maintaining a good credit score;
- Provide members with a loan to build or rebuild their credit;
- Use the closing of the loan as a “teachable” moment;
- Build member loyalty and increase the member’s capacity to use other credit union services.

The beauty of the product is that risk is minimal because loan proceeds are placed into a restrictive savings account or share certificate. Loan payment history is reported to the credit bureau, enabling the borrowers to improve their credit history. Members earn a rate of return on the savings deposit and at the end of the term, have a savings fund that they might never have been able to accomplish in any other way.

A Credit Builder loan can also help borrowers with credit blemishes save for a particular goal, such as a down payment for a car.

The payments for the loan can be set to mirror the payments for an auto loan. At the end of the term, the borrower has the needed down payment and has demonstrated his/her ability to manage the auto loan payments.

Marketing Tools

For your convenience, the Virginia Credit Union League created predesigned marketing materials that your credit union may use for marketing the Credit Builder Loan and Smart Size Loan.

The following marketing items are available to download at www.realitycheckvirginia.org:

- Product Logos (PDF, EPS, JPG formats)
- Overview Brochure (PDF format)
- Posters/Flyers in (PDF format)
- Statement Insert (PDF format)
- Website Banners
- Newsletter Articles
- Social Media Tips
- On-hold Messaging



Operational Tools

While most credit unions probably won't need to make any changes to their operations to participate in this project, some may want to consider evaluating whether some changes could enhance their program and enable the credit union to reach more members and potential members through their micro-loan products. For example, many Virginians who are living at the margin and struggling to make ends meet may not be familiar with what a credit union is, or may think it's just a bank. Somehow your credit union needs to convey why it is different from a bank and that the person will be treated with respect and care. This section is intended to provide guidance and tools to help with operational issues.

Staff Training

If potential members who have had past credit problems enter your lobby, how will they be treated? Your front-line employees can make or break the relationship. Respect is paramount, particularly to people who often feel unwanted or second class. Messages of respect or lack thereof can often be communicated unintentionally. These messages can be conveyed through tone of language, qualification criteria, advertising aspects, etc.

If the credit union is reaching out to a potentially new and under-served market through these micro-loan products, staff should be briefed as to what the credit union is trying to achieve and why. Employees should be provided some sensitivity training to enhance their ability to understand and appreciate differences within people from different economic groups and to communicate with compassion.

The National Credit Union Foundation and its REAL Solutions program provides a wealth of information about serving emerging markets, including immigrants and low-wealth households at www.realsolutions.coop. Included under the "Resource" tab is a "Serving Diverse Members" sensitivity guide or it can be accessed through this link:

http://www.realsolutions.coop/assets/2010/1/25/Serving_Diverse_Members_Sensitivity_Guide_Jan2010.pdf.

Reduce anxiety for potential members by clearly spelling out prevailing practices, their underlying logic, charges and fees and how to avoid such fees or charges. Hiring locally is one way to integrate the community into your credit union operations. A greeter at the door is another way to make potential members feel welcomed and to help them navigate their way through your operations.

Sample Policy & Loan Closing Guide

A sample policy for Credit Builder loans is included here or can be accessed as a separate part of the toolkit. It is presumed that most credit unions already offer some form of micro or unsecured loan and have a policy in place. If not, or if you would like to make some changes to it or add a different category of micro loan for lower score borrowers, you may want to use the sample policy model offered here to incorporate some of the member eligibility elements into it.

Also included here is a sample Loan Policy that may be helpful to include as part of a “firm close” for borrowers that represent greater risk to the credit union. The firm close is a suggested technique to inform the borrower the credit union is giving him/her this opportunity to demonstrate he/she is credit worthy. If the rules aren't followed, it may be the borrower's last opportunity.

Mitigating Risk

Making unsecured loans to members who are credit-challenged is risky business. But if properly implemented and controlled, these loans can be an acceptable complement to your credit union's lending portfolio and help meet your members' needs. Depending on your credit union's risk tolerance, there is nothing wrong with asking members to demonstrate their commitment to the credit union and their desire to improve their credit histories through some form of financial counseling or simply through a Credit Builder loan. The following are some suggestions for how your credit union can limit its risks when making loans to non-prime borrowers.

- Request a co-signer such as a parent or spouse who has acceptable credit. If using risk-based pricing, price the loan based on the borrower's credit score, not that of the co-signer.
- Encourage or require automated payments from checking or savings or direct deposit. Loans perform better through automated payments than those made via a statement or coupon book. Set the loan payments to coincide with the member's payday.
- Require some form of demonstrated relationship with the credit union. This could include a membership requirement such as 90 days or an active share draft/checking account or another loan product.
- Encourage or require financial education or counseling with the credit union or an outside partner such as Consumer Credit Counseling Services. Depending on the borrower's credit history, this could simply be a meeting with a credit union representative; participation in a module through BALANCE, Accel, FoolProof, Debt in Focus or other credit union financial counseling program; or a structured program with a certified financial counselor.
- Provide incentives for timely payments. Incentives could include a lower interest rate after six or twelve on-time payments or an interest rebate at the end of the loan term.
- Require the member to use a Credit Builder loan until the member achieves a satisfactory credit score or demonstrates his/her ability to manage the loan payments. With a credit rebuilder loan all the loan proceeds are put into a restrictive share/savings account until the loan is paid in full. Loan payments are reported to the credit bureau enabling the borrower to repair a credit history.
- Employ a “firm close.” Members are more apt to listen to a lender when they know they are about to receive their requested loan funds. Use the opportunity to connect with your non-prime borrowers and impress upon them the “leap of faith” the credit union is making in them. A sample guide is included here to help your lender emphasize the importance of timely payments, notifying the credit union if there are any changes in employment or contact information, building a good

credit history, etc.

- Stay in touch with your non-prime borrowers. Monitor these loans closely and be prepared to contact delinquent borrowers early to determine signs of problems. Periodic calls just to check up on your riskier borrowers and to provide encouragement can demonstrate your interest in the borrower's well-being.
- Hold monthly loan/collection meetings, especially if you are inexperienced at making loans to sub-prime borrowers. Review trends and losses and fine tune underwriting techniques and pricing for these loans.
- Establish thresholds (delinquency and losses) that trigger review of underwriting guidelines and more conservative practices.

Regulatory Issues

Risk-Based Pricing Rule

If your credit union is already using risk-based pricing, it is probably aware and conforming with the new rule that went into effect January 1, 2011. If your credit union is new to risk-based pricing and plans to use such pricing for these or other loans, you should be aware of the new rules issued by the Federal Trade Commission (FTC) and Federal Reserve Board (FRB).

NCUA's Regulatory Alert Letter No: 10-RA-15 dated December 2010 addresses the new rule as it applies to credit unions. As stated in the letter, if "your credit union uses a consumer report in connection with an application, extension, or other provision of credit and, based on the consumer report, grants, extends, or provides credit on terms that are materially less favorable than terms your credit union has extended to other consumers," then you must comply with the rule and provide the member with a risk-based pricing notice.

Disclosure to Borrower of Savings as Collateral

Your credit union's Loan and Security Agreement includes a section where the collateral security for the loan is listed. This section can be used to describe the borrower's shares and the account number that are being held as collateral for Credit (Re) builder loans.

Loans to Employees, Officials & Family Members: Employees, officials, and their family members are eligible for this loan and such loans will be processed using the same procedures in place for traditional loans..

Sample Loan Policy

Credit Builder Loan

Loan Type: A share-secured signature loan to build positive credit; 100% of the loan proceeds are placed into a restrictive share/savings account until the loan is paid in full.

Loan Purpose: This loan is intended to help members who have no or poor credit to build a positive credit record. The product meets the credit union's mission of helping member-owners with their personal financial needs. Productive credit is a necessary component to wealth-building. Credit blemishes can cause individuals to pay more for credit and may prevent them from obtaining insurance and even certain jobs.

Eligibility:

- Must be at least 18 years of age;
- Members with credit scores below ____ or with no credit score and who are unable to produce an acceptable co-signer;
- Minimum gross monthly income of \$____.

Loan Parameters:

- Maximum loan amount of \$3,000;
- Loan proceeds will be placed into a restrictive share/savings account until loan is paid in full;
- Repayment term up to 36 months;
- Periodic payments to coincide with member's paydays;
- No pre-payment penalty for early payoff;
- APR - ____%;
- Interest rate can be reduced to ____% with direct deposit;
- Loan will be reported to credit reporting agencies to help member build or repair credit history;
- The credit union's normal late fee of ____% of the payment or \$____, whichever is less, will be charged when the loan is ____ days delinquent;
- (Optional: Not Advised). If borrower must access available savings in restricted account (savings that exceeds loan amount), borrower will be charged a penalty fee of \$____ for early withdrawal;
- Once the loan has been paid in full and borrower has demonstrated credit-worthiness, borrower may be granted access to the credit union's other loan products, if the borrower meets the loan criteria.

Lending Authority

Loan approvals for this loan will be made by the same personnel authorized to approve traditional loans.

Collection and Charge-Off Procedures

Because these loans are made to individuals who have no or poor credit history, a more aggressive collection process will be used, such as:

- A courtesy phone call will be made when the member is 3-5 days past due reminding borrower of payment and how to avoid a late fee;
- If a late fee is incurred, it will be charged to the borrower's restrictive share/savings account at the time the next payment is due;
- Once the late fee has been assessed, another phone contact will be made with the member;
- When the loan is ___ days delinquent, payment will be transferred from the restricted savings account;
- If this is a first payment default, aggressive follow-up will be made using contact information;
- Late notices and cure letters will be sent following the credit union's normal procedures;
- After two consecutive payments have to be made from the borrower's restrictive savings account and the member is unable or unwilling to make the loan payments, the remaining funds from the restrictive share/savings account will be used to pay off the loan;
- Any deficiency balance not paid by the borrower will be reported as a charged-off loan.

Loans to Employees, Officials & Family Members: Employees, officials, and their family members are eligible for this loan and such loans will be processed using the same procedures in place for traditional loans.

Loan Officer Documentation

Loan officers will follow the same documentation guidelines for this loan as for other loans.

Board Policy Review

The board will review this policy on an annual basis.

SECTION 3

Cooperative Reporting for Continued Success

Tracking & Data Collection

Live data collected from credit unions will allow us to demonstrate the difference credit unions are making in meeting the small-loan needs of Virginia consumers. These statistics can show Virginia lawmakers the Credit Union Difference through compelling data and anecdotal stories.

Memorandum of Understanding

A Memorandum of Understanding and Agreement is included at the end of this document. To be a part of this project, simply complete it and fax it to us at (434) 239-8148.

Data Collection

Data to be collected and reported quarterly to the Virginia Credit Union League for these loans include:

- Number of micro-loans (\$3,000 or less) made to members by loan type;
- Dollar amount of these loans advanced to members by loan type;
- Loan purpose;
- Borrower income;
- Credit score (if obtained).

Survey Template

A survey template is provided to conveniently submit your credit union's data.

Impact Report

Data from all participating credit unions will be included in the League's Impact Report, an annual overview of the positive impact that Virginia credit unions have on Virginia's residents and communities. The report is used as an advocacy/public relations tool for lawmakers, local community leaders and the media. A recent report is available to download at www.realitycheckvirginia.org.

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