STELLAR
INSIGHTS
Quarterly Newsletter about Banking and Finance by Stellar Strategic Group

SUMMER | 2020

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About Stellar Strategic Group

Achieving strong, long-lasting relationships with our clients is our top priority. 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 each of our clients and it shows in how we partner with you to achieve your goals every step of the way.

STELLARSTRATEGIC

Welcome to Our Summer Edition of *Stellar Insights*

Welcome to our summer edition of *"Stellar Insights"*. As I sat down to write this introduction I was struck with the thought, where to begin. This year started off with such great promise and quickly turned into something no one could've predicted. Hopefully, we can return to a sense of normalcy soon, although the new "normal" will certainly be different in many regards. We hope that you and your family have weathered the storm in good health.

As we approach the remainder of the year, we're all starting the process of developing strategies and budgets for the upcoming new year. This year more than ever, we'll all be challenged to update our business models to account for an ever-changing business world. This will require all of us to closely examine the changing needs of our customers to compete in the digital business environment. We can no longer overlook the ever-changing needs our customers expect and require. Companies that adapt will have a huge strategic advantage over those who don't.

On a much brighter note, we have a huge announcement to make regarding our Stellar Auto Loan solution. This month we're announcing "The Stellar Indirect Tool Kit[sm]". Over the past several years, clients and prospects have lamented about the lack of interest income and retention of indirect auto loans. Once we began looking at data from several clients, we came to the conclusion that neither of these deficiencies needs to just be accepted. This is one of the biggest opportunities we see for PFI growth in the banking industry. In fact, we have already been executing several of the steps in our solution for clients over the years. We simply had not put the component parts together in a solution to address the overall problem. The good news is we now have the solution finalized in a multi-step process that addresses the deficiencies our clients and prospects have been complaining about for years.

We have dedicated almost this entire edition of *"Stellar Insights"* to detailing the solution and its effect on revenue and PFI growth for your reading convenience. We're confident you'll see its value and we can't wait to hear what you think!

THIS EDITION WE'RE INTRODUCING...

The Stellar Indirect Tool Kit[SM]

The Indirect Dilemma

BY CRAIG SIMMERS *Managing Partner | Stellar Auto Loans*

Indirect Auto Loans have Created a *Direct* Dilemma

The indirect auto loan source has historically been a dilemma for bankers of financial institutions. The good news is that it provides a relatively steady source of loans. They increase the assets of an institution and require far less work for internal staff compared to a direct loan. The bad news is that it generates some of the lowest net-interest margins, must be closely monitored at the dealership level, and results in extremely low retention rates once the loan is paid off. To date, most institutions have accepted these negative aspects in order to continue to grow their asset base. For some institutions, this has created a huge churn problem. Unfortunately, during the recent COVID-19 pandemic, dealer sales have almost come to a halt. This has caused many institutions to feel the truly negative effects of customer churn when the funnel of new customers has been cut off.

While institutions work to grow their asset base through indirect auto loans, they also spend significant marketing dollars attempting to grow their customer base and core deposits. Often, FI's make the mistake of ignoring the auto loan customers they already have, assuming they aren't retainable and marginally profitable. We strongly believe that replacing what has become a wholesale product play with indirect auto loans into a key driver of PFI relationships is a sustainable guarantee of retail and asset growth. In short, using auto loans as profitable relationship starters to create eventual long term PFI relationships. Build on the relationship you've already invested in.

The *Direct* Solution to Your *Indirect* Problem

Over the past three years, we have been asked by our auto loan clients to solve this problem for them. So-called experts say, "in selling your value, the goal should be to find something that gives your clients pain and solve the problem". Fortunately for our company, most of the pieces to solve this problem had been used over many years to help our clients grow core checking deposits and direct auto loans. Our strong use of multi-level analytics across many communication channels has provided a turn-key solution to this opportunity. With the urging of our clients, we have combined the individual aspects and functions of past successful programs into one comprehensive program: **The Stellar Indirect Tool Kit℠.**

Throughout the rest of the newsletter, we lay out the individual steps necessary to take new indirect auto loan customers and focus on producing sustainable PFI relationships. We are confident the conversion of these new relationships into long-term relationships will be far more cost-effective than cold prospect marketing efforts. In closing, there are few groundbreaking marketing ideas that haven't been executed before. Our research has shown that this type of solution has virtually been non-existent in the banking industry, particularly in the credit union space. Don't look at indirect auto loans as a problem, embrace the opportunity that's sitting there waiting to be seized. At the end of the day, a well-balanced auto portfolio that includes a mix of direct and indirect loans is the most profitable path forward to ensure sustainable long-term asset growth.

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*Craig Simmers, Managing Partner of Stellar Auto Loans. Craig can be contacted via email at **craig.simmers@stellarstrategic.com or call 410-990-0172.***

The Indirect Auto Loan Opportunity

BY CRAIG SIMMERS *Managing Partner | Stellar Auto Loans*

Credit Unions have been helping members finance vehicles since they were first established. Over many decades CUs have grown their indirect auto loan portfolio with aggressive rates and technological upgrades through dealership financing relationships.

Unfortunately, when all is said and done, profit margins have begun to shrink. When all costs are accounted for, some dealership relationships actually generate negative margins. We know of a well-run $1.6 billion-dollar credit union who only reported a .7% profit margin. This has been an acceptable piece of business for far too long. Many credit unions regardless of extremely low-interest margins and high member churn continue to rely on indirect loans. This simply doesn't need to be the case!

Over the past several years of meeting with clients and prospects we've consistently heard the negative aspects of indirect loans. Some of them have significantly reduced their reliance on indirect loans or completely eliminated them from their portfolio. We believe the best approach is a well-balanced auto loan portfolio with a new approach to indirect loans. Consider this: if you were going to start a new business would you focus on a low margin, high customer churn business? Of course not! So why do so many CUs accept that premise from their indirect auto loan portfolio?

Consider taking what has become a wholesale product play (Indirect Auto Loans) and use it as a relationship starter to create eventual PFI relationships. That's exactly what we have accomplished by developing The Stellar Indirect Tool Kit℠.

Over the next four pages you will find an overview of the program with details on the two specific segments of the program. This program is heavily dependent on data analysis as well as easy to use turn-key marketing templates that makes execution on your end a breeze. As with all of the Stellar products, price is a key driver in the development of our products and solutions. In many cases we will rebate the entire cost of the first and most important component of the program, the front-end data analytics.

So, take into consideration the significant change in attitude and approach regarding indirect auto loans. I'm sure you agree that low margins combined with high customer churn is not sustainable. That's the state of most indirect auto loan portfolios today. It doesn't need to stay that way. **The Stellar Indirect Tool Kit℠ is the *direct* solution to your *indirect* problem.**

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*Craig Simmers, Managing Partner of Stellar Auto Loans. Craig can be contacted via email at **craig.simmers@stellarstrategic.com or call 410-990-0172.***

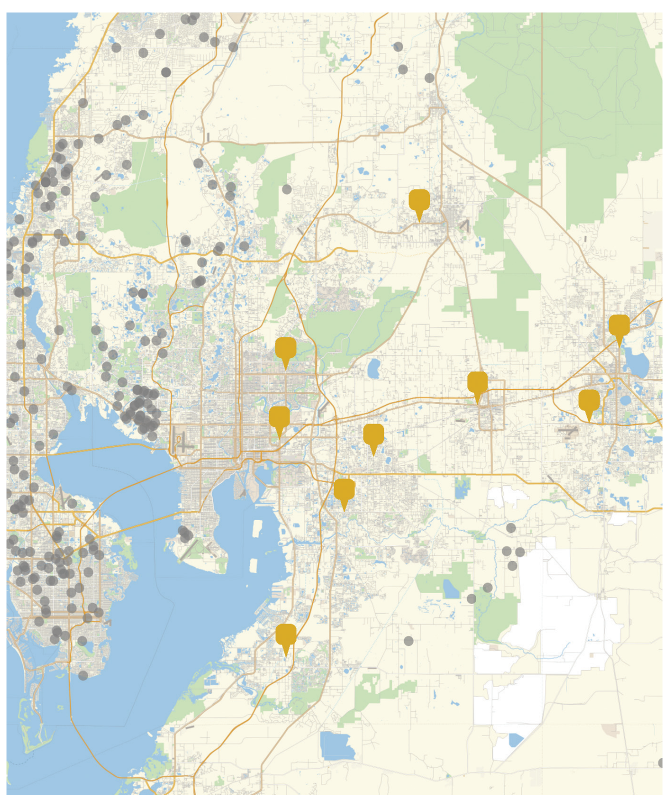
Analysis Component:
The Stellar Indirect Tool Kit[sm]

Introduction

Analysis is a key component of The Stellar Indirect Tool Kit[sm] — it's what allows us to help you get the most from your marketing dollars to maximize the transformation of indirect loans into PFI relationships. To facilitate this, Stellar uses your current and historical institution-wide account data to segment your existing indirect relationships into three categories. The ultimate goal of this segmentation process is to identify what we refer to as your "franchise" carrier routes. Based on 20 years of growing retail market deposit share for our clients, we have developed a formula for identifying future growth potential by geography in any given market. Here's a high-level outline of our analytics process accompanied with maps of each segment in this particular market:

1. Outliers

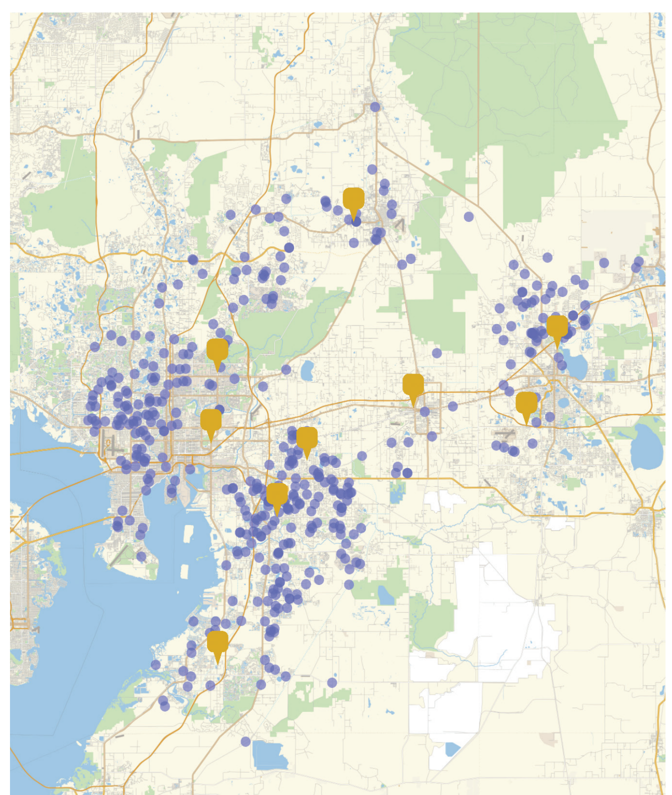
Depending on your specific market and branch footprint (both geographically and in terms of highway infrastructure), a number of indirect relationships will be designated as "Outliers". These loans are unlikely to transition into PFI relationships, and are earmarked for only a small number of cost-effective marketing touches over their lifetimes.



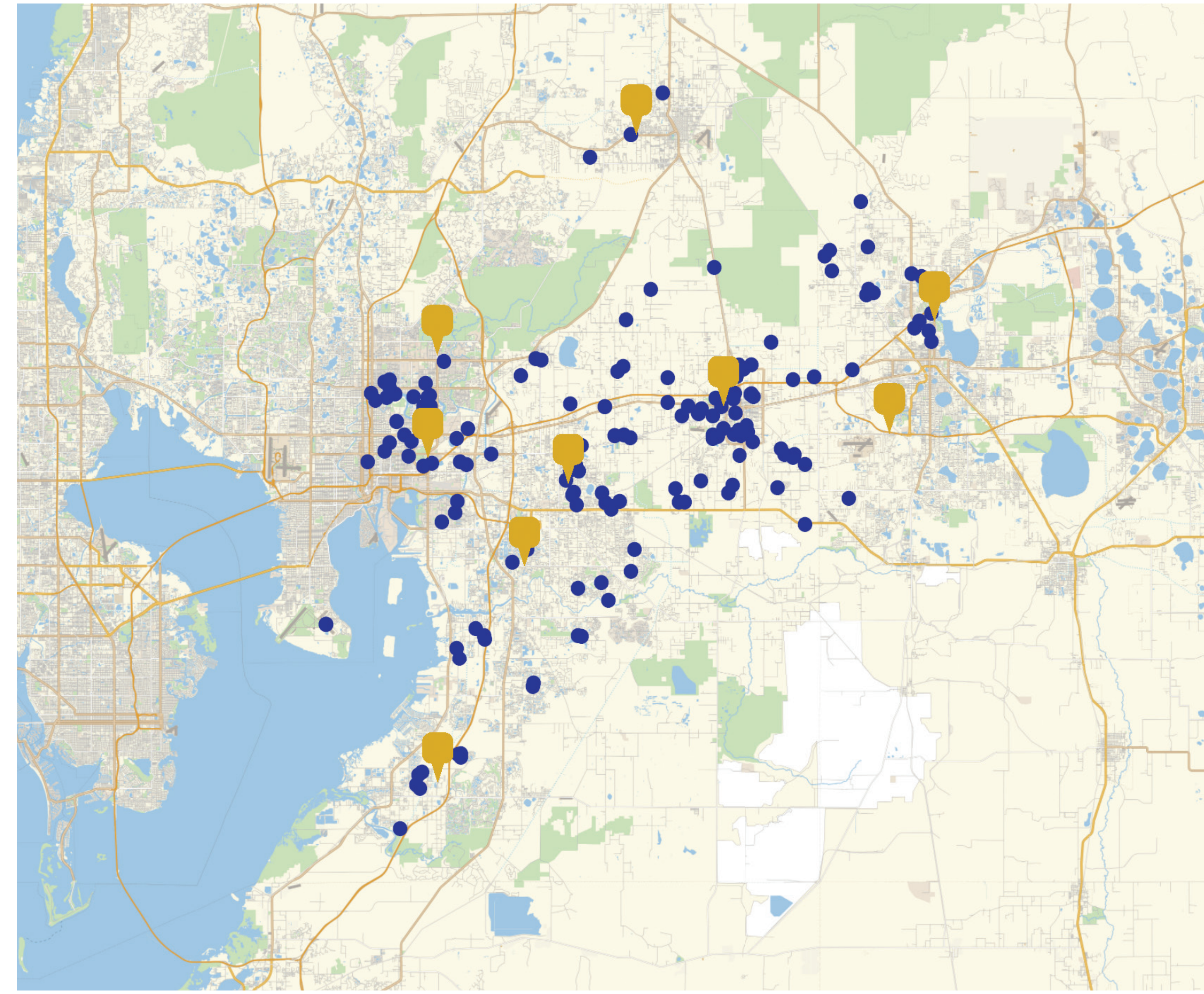
■ Outlier Indirect Loan ■ Branch Location

2. Proximity

The second category designated are the "Proximity" relationships, and are those that fall near enough your branches to have a meaningful in-branch experience if desired (and when required). Given the convenience of your branch locations to these customers/members, a more-frequent marketing plan is employed.



■ Proximity Indirect Loan ■ Branch Location



■ Franchise Indirect Loan ■ Branch Location

3. Franchise

The final — and key — category are those of the "Franchise". Indirect loan holders are elevated to this category based on a variety of historical trends seen across all account types. Not least of which is historical checking account activity — both incidence and duration. Stellar examines market penetration, historical account opening trends, and attrition-weighted account longevity to determine which subset of geographically-relevant indirect loan holders will tend to transition into full PFI relationships. An aggressive series of marketing campaigns is employed for this category.

Conclusion

While the volume and frequency of marketing touches to existing indirect relationships varies depending on the category to which they are assigned, *all* individual touches are timed based on the unique properties of the individual indirect account holder, and their level of additional account engagement (if any) with your institution. That's an important point to remember — all efforts are tailored to the individual account holder. We use the three categories — "Outliers", "Proximity", and "Franchise" simply to help better allocate finite marketing funds for a higher overall projected ROI.

The usefulness of these insights goes beyond indirect auto loans: The monthly analytics and targeting data that Stellar provides as part of the Indirect Tool Kit — particularly for the "Franchise" category — can be used for both external as well as existing internal marketing efforts, across all account types!

Marketing Component: The Stellar Indirect Tool Kit℠

Upon completion of the analysis phase of the Tool Kit you will now have the necessary knowledge to customize your marketing efforts. Keep in mind, the extensive data analysis was designed to answer the who, what, where, when, and why questions that create the templates for your marketing initiatives.

The three key questions that get answered in the analysis phase are the who, when, and where. However, in terms of the when, this is decided by using multiple triggers both indicated by information gleaned from your internal data as well as data purchased from credit reporting agencies. The what and why are determined collaboratively based on key initiatives your institution has identified as critical for particular product growth.

Once we have answered all of the key questions, a customized marketing plan can be developed to complete the process. This will set a plan in place to address to lack of profitability and retention of your indirect auto loans. After working with over 1,800 clients, we understand internal capabilities differ from institution to institution. That's why we offer the marketing component of the Tool Kit in multiple different formats.

Once we complete the analysis phase, you'll be able to decide how much of the execution you take on internally or allow us to execute the plan on a turn-key basis. Your decision is based on your internal capabilities and budget. Your assigned production representative and data analyst are with you every step of the way, regardless of how you elect to execute the marketing portion of the program.

Welcome Letter

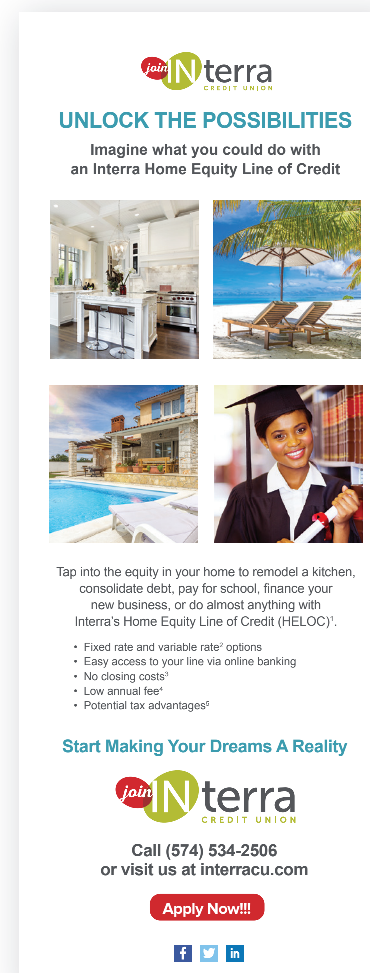
The welcome letter serves multiple purposes for new auto loan customers that may be doing business with your institution for the first time. This is where you sell yourself as a viable alternative to where the consumer may be currently banking. In addition, offers for services such as auto-pay, e-statement, and the all-important checking account can be sold. First impressions are critical, and a well-designed welcome letter positions you as a professional organization consumers would like to do business with.

Online Bill-Pay/Auto-Pay

We all know the value of both of these products. The key is to segment your customer base so only those who currently don't have these products are targeted. Improving collections and retention are invaluable in maintaining a profitable and growing auto loan portfolio.

Next Auto Loan Offer

Once the analysis phase of our program is completed, we will have identified the key trends that will allow us to estimate the timing for this type of offer. That data combined with trigger data purchased from credit bureaus will allow us to strategically target current auto loan customers for their next purchase. Inexpensive statement stuffers are a great tool to support the retention of your auto loan customers.



Email Targeting Offer

This is a very cost-effective way to communicate with your customers. As with all the offers detailed, the goal is to develop the least costly vehicle to deliver your message. Emails do just that. The ability to drive them to your website or a landing page to open an account electronically is critical these days. Consumers expect that given the huge move we've seen recently to acceptance of making purchases electronically.

Checking Account Offer

This is the key to customer longevity. The analysis portion of our program identifies the key areas within your charter footprint that will yield the highest response rate to a checking offer. These consumers are what we refer to as your "Franchise". Today, more than ever, the value of a checking account has never been greater based on the tremendous growth of electronic transactions. This product has been the foundation of our business for the past 20 years.

Home Equity Loan Offer

The increase in credit card debt and interest rates to historic levels have heightened the interest in Home Equity Loans. Conversely, HELOC rates are at historic lows. Utilizing credit bureau data to identify key prospects as well as new auto loan customers that fit this target segment, can be an instant feel-good second interaction with a new customer.

The Value of a Direct Auto Loan

BY GEORGE MONNIER *Founder | Stellar Auto Loans*

Most institutions understand the need to grow organically and provide a stable membership base. Members that use a credit union as their Primary Financial Institution (PFI) generate dependable assets and deposits for planned future growth. Typically, the more relationships and services each member establishes with the credit union will increase the profitability of that household.

New memberships are typically established by a new deposit relationship or a new loan relationship.

Auto loans are a large percentage of most credit unions' loan portfolios. There is often a mix of both indirect auto loans as well as direct auto loans. Indirect auto loan members usually do not have other products and services with the credit union since the credit union was never directly part of the members' auto loan financing at the dealership. Their relationship is with the auto dealership. Interest rates and non-interest income services are shared with the dealership, resulting in substantially reduced profits for the credit union, and usually very tight margins for the institution.

The industry average for cross-sells to new products and services is typically 5% or less. The indirect loan is viewed as a necessary evil, to put more assets on the balance sheet despite the extremely reduced margins. We recently spoke with a $1.8 billion asset credit union that was only realizing a .7% net margin on their indirect loan portfolio. Most credit unions view indirect loans as a wholesale commodity product, and not much more.

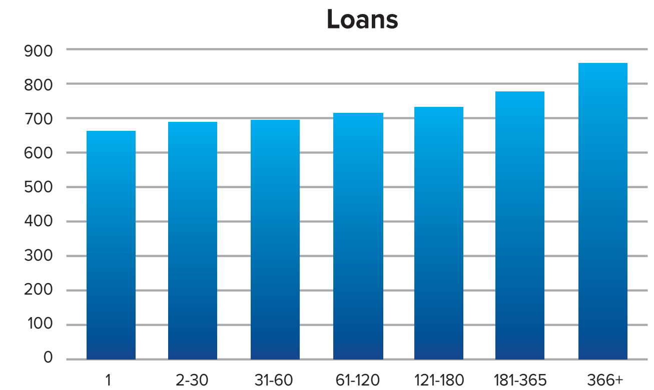
In contrast, a key driver of PFI relationships is direct auto loans. Stellar Auto Loans has helped generate hundreds of millions in new auto loans for our partnering credit unions.

The following are results from clients that have benefited with our unique contingency fee-based auto loan recapture program over the last few years.

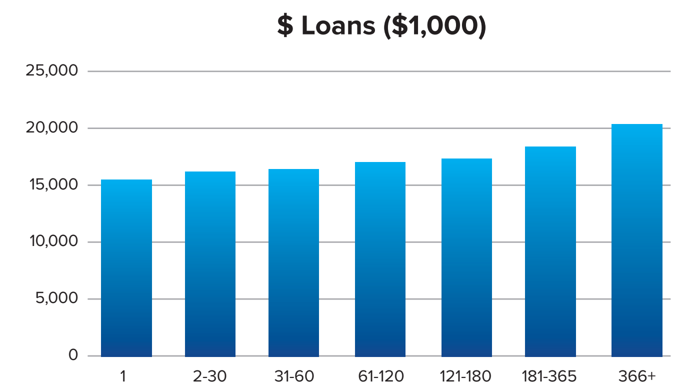
One Midwest $200 million asset credit union has used our services over many years and continues to benefit from the value of these direct auto loans. With a gross yield of over 7%, and net interest margins exceeding 5%, they are well ahead of their peers in the region.

The prospects that funded auto loans through the Stellar program and became new members continue to show increased growth and good results. Year to date, the original 601 new member direct auto loans in the last few years have grown from $15.2M to 793 loans, totaling over $20M in loans. That's a 32% growth in loans!

These profitable new members are generating more than just auto refinance loans. Their frequent contact allows loan officers to share the benefits of other loan types. A breakdown of the 601 new members shows an additional loan distribution of almost $3M in other loan categories.



The graph above shows the growth of total loans by day for the original 601 new direct loan members.



This graph shows the additional dollar volume of these loans over time.

Breakout of Total Loans Generated In Two Years	
New Member	$20,077,449
1st Mortgage Fixed	$438,778
Direct New Auto	$975,657
Direct New Recreational	$135,409
Direct Used Auto	$17,420,389
Direct Used Recreational	$461,642
Indirect New Auto	$265,226
Indirect Used Auto	$275,172
Misc. Items & Equipment	$23,539
Share Secured	$2,689
Signature Loan	$78,948

Our credit union partners continue to perform well during this pandemic, whereas the indirect loan volume has dropped dramatically. Many of our clients have had record months in direct loans. One multi-billion asset client stated last month was the first-time their direct loans exceeded their indirect loans.

Deposits

Additionally, these new members also open deposit and transactional relationships. Another credit union located in the upper Midwest of a similar size is seeing similar results for increased loans above and beyond the original beginning refinanced loan. By examining the deposits associated with these new auto refi members, we see additional relationships develop.

Members that have opened savings accounts and checking accounts account for 40% of the loans. These members averaged 1.9 relationships, excluding loan relationships. Almost half were transactional checking accounts. With debit card interchange fees, etc. industry average values exceed $200 per checking account per year.

Conclusion

Just as most institutions have systems in place to attract and build dealership relationships for the indirect business, it would be wise to establish a program to build your direct auto loan portfolio. Better margins, greater cross-sells, and longer relationships are all great benefits for an institution. There needs to be a balanced approach to both indirect and direct auto loan production, to continue to grow the credit union in an organic and profitable manner.

George Monnier has spent over 18 years helping financial institutions generate new deposits and loans. He 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.
To learn more about Stellar Auto Loans[sm], please contact ***george.monnier@stellarstrategic.com or 402-708-2425.***

Auto Loan Recapture Best Practices

BY GEORGE MONNIER
Founder | Stellar Auto Loans

We have all seen the studies. Most consumers are living from paycheck to paycheck. Since the Great Recession, the median income has fallen by 13% from 2004 levels, while expenditures have increased by nearly 14%.[1]

In another recent study, it was determined that nearly half of the consumers in the U.S. have less than $400 in disposable income above their monthly budget. They would need to find alternative financing if an emergency occurred with a cost greater than this amount.[2] One unexpected expense, like a broken pipe or unexpected car repair, would disrupt a household's entire budget. Consequently, consumers have become VERY expenditure conscious, trying to find new ways to save money each month. Since auto loans are typically one of the top three monthly payments for many household budgets, most consumers would be interested in saving money by refinancing their loans.

Those of us working in the financial industry understand that the interest rate is important to the repayment of a loan. Consumers know this too, but at the time they are purchasing a new vehicle, they are far more concerned about how the total monthly payment amount may affect the balance of their checkbook. Proof of this is the volume of consumers paying a higher interest rate than what many local, community-based financial institutions typically charge. Consider the data in the chart below:

Credit Score Ranking	Consumers Paying Above Market Rates
A Paper - 720+	70% paying more that 5% interest rate
B Paper - 680 - 719	71% paying more that 6% interest rate
C Paper - 640 - 679	53% paying more that 8% interest rate

Most loan recapture program offers focus mainly on interest rates. Unfortunately, overall response rates tend to be low, and marketing costs often outweigh any profits generated. The exception to this rule is offering extremely low-interest rates, which then cuts interest margins to a less than desirable outcome.

Here's a good test of this theory...ask five of your friends, neighbors, or relatives (except those that work in the financial industry) if they know their auto loan interest rate to the nearest tenth of a point. Usually 4 out of 5 will tell you that they don't know it. Ask those same people if they know what their monthly payment is and usually, 5 out of 5 people will respond yes. In many cases, down to the penny!

So, what are some of the best practices to recapture profitable auto loans?

Focus on monthly payments, not rates. Speak your prospect's language. Focus the offer on what is most meaningful to their bank accounts (monthly payment) over what is most meaningful to a bank or credit union (interest rate).

Use credit bureau data. This data is very critical in determining which households could save monthly and yearly on their auto loans. You can create a very compelling and personalized offer for that consumer, thus generating more interest and response. This data also allows you to pre-qualify prospects based on your institution's credit approval criteria. Though this may involve additional front-end time and expense, using a pre-qualified consumer list will create higher conversion rates of applications to funded loans. Plus, it will save your loan officer's time as well.

Use multiple channels and provide several easy response options. It shouldn't need to be said, but please make your response options easy for the consumer. Give clear direction and offer alternative ways for them to respond. That includes online response forms as well as the more traditional phone number, email, or branch visit. Also, we highly recommend following up with a phone call as well. Just remember that most families now have two wage earners. The best time for them to communicate may be in the evening, after work. Calling during normal business hours may leave you with a lot of unanswered phone calls.

Create incentives to encourage actual applications. After all, you have pre-determined which prospects are pre-qualified with your institution's credit criteria and you have already determined you can reduce the prospect's monthly payment. Any application received should produce a high closing rate. The extra upfront analysis and credit data will drive responses that are well worth the extra time and cost. In addition, a personalized message tells the consumer that your institution must be confident that you can reduce that household's monthly payments. That is a powerful underlying message!

Create additional loan funding incentives. Okay, you have a well-qualified application on your desk, now offer an additional incentive to help close the deal. For instance, two delayed payments have great results, considering the fact many consumers are living "paycheck to paycheck". Plus, it is easy for that applicant to understand the benefit, and your institution will still accrue interest during that time frame.

Find a marketing partner with the experience to minimize your out-of-pocket expense. It is easy to send out a postcard or mailer featuring interest rates. However, to generate the best response and the most funded loans it takes some coordination, data analysis, creative knowledge, and insight to get there. Pay-for-performance marketing programs are few and far between. At Stellar Auto Loans, we offer a pay-for-performance program minimizing your risk related to upfront marketing costs.

From utilizing these best practices, many financial institutions are finding success!

Take this one example: A $750M asset credit union wanted to focus on households across all credit tiers. The pre-qualified offers were evenly distributed across all paper grades. We utilized the current credit rates the institution could offer with the rates of the consumer's current loan, as well as any credit criteria restrictions. In this instance, we targeted consumers with $10,000 or more in remaining balances.

After the campaign, closed loan data was used to match back to households receiving the personalized offer. Our client's data showed over $1.8M in newly booked loans came from our program. The refinanced members saved an average of over $95 per month on their new loans or over $5,000 over the life of the loan.

The extra upfront analysis and credit data will drive responses that are well worth the extra time and cost. In addition, a personalized message tells the consumer that your institution must be confident that you can reduce that household's monthly payments. That is a powerful underlying message!

The average blended interest rate for all funded loans was 7.78% (which was not a discounted rate) and was expected to bring over $293,000 in interest income alone. This does NOT include the additional non-interest income from cross-selling, AD&D, GAP, MBI, or other relationships generated from establishing the auto loan, such as checking.

With interest income alone, this institution had an ROI of 473%! Also, this credit union had no up-front costs. Their success was based on the program's performance. Many other financial institutions that have implemented our program have achieved similar results.

It just goes to show...a well-defined strategy can generate great results in the auto loan recapture market.

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[1] The Pew Charitable Trusts: Household Expenditure and Income: March 30, 2016
[2] The Atlantic: The Secret Shame of Middle-Class Americans: May 2016

Success Stories

Interra Credit Union — Goshen, IN

"Interra Credit Union is proud to partner with Stellar Strategic Group since 2011. The team's professionalism and data capabilities help to support the validity of using Stellar to reach new membership goals."

— Meegan Siegwarth, *Vice President of Marketing*

Oklahoma Educators Credit Union — Oklahoma City, OK

"Stellar's unique strategy provides an opportunity to capture current performing loans. Since the program allows direct communication with the potential members, stronger underwriting capabilities are more easily maintained and the ability to cultivate deeper relationships with borrowers is accelerated...our Stellar Auto Loans relationship helps us to obtain LIFERS instead of just LOANERS."

— Trent Vaughn, *Senior Vice President*

Bragg Mutual Federal Credit Union — Fayetteville, NC

"I wanted to create a competition among our lenders for increased loan production. We are a small credit union and our lenders were not used to making sales calls or quick loan decisions, therefore our loan prospecting was lethargic at best. Stellar Strategic was an easy choice. We and the folks at Stellar planned the marketing message. Stellar put it together, spent the marketing money, and then the loan requests landed in the in-box of our lenders. We have had a very nice increase in auto loan refi's even during the COVID-19 pandemic. In fact, our last four months have been our best auto loan production months in the past 18 months. Stellar did a great job of helping us market our name, and increase loan productivity, which of course increased asset size and profitability. Is there an expense? Yes, but we believe we would have paid more for a less effective marketing plan without the results. The plan from Stellar Strategic brought us exactly what we needed."

— Steve Foley, *President & CEO*

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