Crisis Management - Part Two:

Managing the Unintended Consequences of Loan Forbearance and Payment Deferments.

Extend and Pretend: What To Do When the Can Stops Rolling

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"When you 'kick the can down the road,' you're not just solving the immediate problem, you are guaranteeing the arrival of a new problem. You kick the can down the road, you will get to the can again. There's no question about that."[1]

Early in the second quarter of 2020, lenders sprang to the aid of millions of borrowers who found themselves unemployed or otherwise unable to meet their financial obligations. In its April 2020 Letter to Credit Unions[2] the NCUA, in support of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, discussed Temporary Loan Modifications such as "CARES Act Forbearance", "Payment Forbearance", "Waiving Late Payment or Modification Fees", "Interest-only Payments" and "Reducing the Interest Rate."

The NCUA letter included the following caveat: "*When providing temporary loan modifications, credit unions should consider the borrower's ability to repay the debt at the end of the temporary modification period, especially if the modification will result in higher payments or a balloon payment. Prior to providing the relief, credit unions should ensure borrowers are aware of the terms of any temporary modification and potential impact on the loan balance and future payment…"*

The other shoe is about to drop.

An Unintended Consequence.
When the can was originally - or subsequently - kicked, there was the assumption that the distance the can traveled would outlast the reason for kicking it. Even though the

[1] "Kicking The Can Down The Road: A Habit That's Hard To Kick"- James Thorndike , NPR July 20, 2014

[2] NCUA Letter No. 20-CU-13

deferments are scheduled to go away, the virus isn't. If the COVID-19 related economic crisis continues past the expiration of current deferments, should we kick the can again?

The "*potential impact on the loan balance and future payment*" arises when the can ultimately rolls to a stop and the decision is made to not kick it further down the road. This is the guaranteed arrival of a new problem, one that can be described as a "Catch-22."

In other words, which is better? Forcing a resumption of payments while borrowers continue to suffer from financial stress, or further deferring payment obligations which will potentially result in higher payments, increased accrued interest or balloon payments? This dilemma strikes at the heart of two key Credit Union deliverables: auto loans and mortgages.

Kicking the Auto Loan Can:

The Catch-22 "is the miraculous result of stimulus money, the $600 a week in extra unemployment compensation, and forbearance, none of which are permanent features of our economic landscape. Stimulus money eventually runs out, and the extra $600 a week expired at the end of July, only to be temporarily replaced by Congress with a smaller amount. Future extensions or different versions might get concocted in Congress. But even those, if they happen at all, will end.

"And 'extend and pretend' can get stretched for a while, like a rubber band, but at some point, there is a reckoning. And with auto loans, it gets dicey in a hurry. Forbearance is just a delay, and during the delay, the auto loan balances grow as interest is added to the principal. With subprime auto loans, the interest rates are high, usually into the double digits, and the interest that is added to the principal adds up quickly. But the vehicle – the collateral for the loan – just loses value. With auto loans, lenders cannot play this game for long before they're even more deeply in the hole."

"Over the next few months, during the worst unemployment crisis in a lifetime, we might well see a further miraculous decline in the subprime auto loan delinquency rates, as auto loans in forbearance are marked "current." But then, when stimulus runs out and forbearance ends, it will come unglued with a vengeance."[3]

Mortgage Delinquencies Spike Due to COVID-19.

The mortgage delinquency rate jumped nearly four percentage points to 8.22% during the second quarter of 2020, when the economic fallout from the coronavirus pandemic really began taking hold, a new report from the Mortgage Bankers Association shows.

[3] https://wolfstreet.com/2020/07/13/subprime-auto-loan-delinquencies-after-april-fiasco-miraculously-cured-by-forbearance-stimulus-money/

FHA loans—popular among first-time homebuyers who might not have the savings to make a big down payment—led the pack in delinquencies, rocketing to 15.6% past due, according to the National Delinquency Survey. That's almost double the rate for all loans and the highest delinquency rate since MBA began its record in 1979. The delinquency rate includes loans that are at least one payment past due, as well as loans in forbearance, but does not include mortgages in foreclosure.

"The COVID-19 pandemic's effects on some homeowners' ability to make their mortgage payments could not be more apparent," says Marina Walsh, vice president of industry analysis in MBA's research and economics department. "The nearly 4 percentage point jump in the delinquency rate was the biggest quarterly rise in the history of MBA's survey." [4]

What to do When the Can Stops Rolling.
Steve Rick, Chief Economist with CUNA Mutual Group offered his thoughts in a recent *CUToday* article titled "Could Loss Numbers Double or Triple?"[5] According to Rick, "What will happen is somewhat unpredictable…Credit Unions are saying they expect to easily double their charge-offs next year, compared to 2019 levels." He continued, "It's the time for credit unions to prepare now – don't wait for the delinquencies to begin to rise…the fourth quarter is when all these loan payment deferrals will start ending, and I know some credit unions are doing a second round of three-month deferrals for members who are asking for that. But by the fourth quarter credit unions will say 'no more.' That's when it will start to get really bad in terms of charge-offs."

"To further prepare for the losses, many CEOs are turning their attention to even tighter expense management. They're instituting a hiring freeze…" Credit unions are also ramping up their collections departments which Rick agrees is a prudent move. "It's important to hire those people now and train those people so they know how to be a good collection agent when the losses come," said Rick. "You don't want to wait until the trouble hits to hire new collectors."

The Catch-22:
We are engaged in perhaps the most delicate delinquency management challenge in history. Due to no fault of their own, millions of credit union borrowers will soon be faced with the need to resume mortgage, auto loan, credit card or other monthly obligations that they do not have the financial means to manage. The potential "solution" of hiring new, inexperienced collectors to work with member-owners who are still in financial crisis will likely exacerbate the problem for both the borrower and the Credit Union. Working with member-borrowers during what may well become a long-term

[4] Mortgage Delinquencies Spike Due To COVID-19: What To Do If You Can't Pay Your Loan. Forbes August 18, 2020

[5] http://www.cutoday.info/THE-feature/Could-Loss-Numbers-Double-orTriple?utm_source=Fresh+Today+081920&utm_medium=email&utm_campaign=Fresh+Today+081920

economic crisis requires experience, expertise and a unique ability to preserve human dignity while protecting the best interests of the lender. Here is an alternative strategy:

Profile of a Unique Solution.
Credit Solutions Corp. is a premiere delinquency management and first-party calling resource for Credit Unions and their member-borrowers. Headquartered in San Diego, California since 1997, Credit Solutions Corp. has helped tens of thousands of borrowers manage their mortgage, auto loan, personal loan, HELOC, credit card and other credit obligations by enhancing communication options and repayment strategies with their Credit Union. Hundreds of Credit Unions have benefited from outsourcing all or part of their delinquency management activities to Credit Solutions Corp. by availing themselves of CSC's highly experienced staff while minimizing internal employee expenses.

Credit Solutions Corp was established by an industry veteran - CEO Raechelle Joplin who has more than 30 years' experience in financial services. Prior to founding Credit Solutions Corp, she was Executive Vice President, Chief Financial Officer and, later, Chief Operating Officer of West Capital Financial Services Corp, a national debt resolution firm that she co-founded in 1989 which was sold to SunAmerica in 1999. West Capital was one of the first successful issuers of BBB-rated asset-back notes collateralized by collections from $3 billion of charged-off credit card accounts. For both West Capital and Credit Solutions Corp., Raechelle created the audit and internal control policies and procedures, operating systems, customer service policies and procedures, reporting systems, procedures for securitizations and bond investor reporting, performance tracking and trend identification systems for distressed portfolios, and cost-saving control measures for improving efficiency and profitability. Following the sale to SunAmerica, West Capital's operations and systems formed the backbone of its successor entity, Encore Capital Group, a publicly traded company with market capitalization over $1.7 billion.

Raechelle explains, "Credit Solutions Corp. was created to promote and improve constructive communication between lenders and borrowers during challenging economic times. Our primary goal is to help reduce delinquency by removing the element of embarrassment so that member-borrowers immediately realize that their Credit Union is there to help them in good times and in bad. We become ambassadors for the Credit Union while constructively helping member-borrowers manage their financial obligations."

Credit Solutions Corp has helped Credit Unions and their borrowers through the challenges of multiple economic down cycles by relentlessly adhering to the following tenets, each followed by actual testimonials from member-borrowers:

1. **Compassion.** *"Thank you for providing me this avenue to share some of my thoughts, regarding my recent experiences with you, by way of your associate Judy. I can only imagine the number of voices, stories, anger, distress, etc., that must be experienced by Judy and her colleagues during the course of*

their workday. I can't imagine the toll it takes on a person's emotional fortitude...not to exclude the necessity of keeping cynicism at bay. I was (am) one of those people that Judy had to reach out to and (again) begin that process....I was annoyed, embarrassed even angry with these (persistent) phone calls - not with Judy or your firm - with life and the circumstances from the downturn of '09 that contributed to my dilemma. Immediately, at the outset of our conversation (once I swallowed hard and made the return call), Judy put me at ease; even thanking me for returning her call.

While deliberate in her approach with me, she never denied me any respect. She had no idea that the man she was talking to was the same man who had to be brave for his daughter (who was in college during the '09 event) that he had no money...no money to help her. I later found out she had been selling her blood for money. That little girl has since graduated and is a chemist at a pharmaceutical company.

I have never really recovered from that bleak period. It took me almost a year to find a job, making $75,000 a year...yet, to me - that was a FORTUNE! Just not enough to repay those who had to tolerate my tale of woe during those years. Judy had no idea of the story within the person she was speaking to. Yet, her own personal style, her refined / levelheaded approach...maybe a better word would be controlled. Regardless, I feel as though she provided me the options (and the space) to reach a solution. My belief in God is unshakable; each day I ask for His guidance. Once again He has fulfilled my prayer (every inference is intended)." – Richard M.

2. **Understanding.** *"I just worked with John… He was extremely helpful and understanding. He helped us with various options for payment and was willing to work with us. I appreciate his efforts and am glad that we got this resolved. Thank you again." --Jenn B.*

3. **Helpfulness.** *"The gentleman I spoke with was very helpful. Allowed me some extra time to check a few things and advised me a one-time payment would save me approximately $160. Great customer service and attitude! If there's some sort of positive attribution for our contact, he deserves it!" – Marcos*

4. **Creativity.** *"The assistance I received was second to none. They helped come up with a payment plan to get me out of debt. Very courteous. Thank you, Mr. Moreno,!" –Brock C.*

5. **Empathy.** *"I would like for you to know how I truly appreciate the service and respect I have received thus far. From the start he was so polite and understood my situation as far as paying this loan off. When I couldn't pay it*

and call him, he understood my problems and we continue the next month. Never have I ever had such an understanding person that didn't harass me like other collectors. Thanks so much for the service that I have received from your company it's a pleasure to deal with such peace. Thanks again and God bless." –Charmaine

6. **Professionalism.** *"I would like to take the time to let you know that Patty was very helpful, professional and understanding regarding my concerns and situation. She made it pleasurable to do business with (you) and I am glad that she helped me get a start on fulfilling my debt obligation." – Bernice F.*

7. **Efficiency.** *"In regard to John's customer service, he has been nothing but friendly and professional. He made getting the process of paying off my current debt very quick and simple. Most companies will call incessantly but he has kept calls to a minimum and waited for me to get back to him. Honestly the nicest debt collector I've ever spoken to." –Matthew G.*

8. **Consideration.** *"I just want to mention how Tim was super helpful, very informative, and punctual. I was unable to go over these terms yesterday, and I asked him to call me today at 9am, and he did. I appreciate not feeling overwhelmed about this situation, and Tim was good about that. – Nasario V.*

9. **Support.** *"Carol has been wonderful in assisting me through this process. She has helped me and explained in detail what I needed to do once I do receive the paid in full letter. I appreciate her time and patience and wish that more customer service agents could be as personable and helpful as Carol is." – Jennifer F.*

10. **Respect.** *"I was initially contacted by Ms. Boen back in April 2016 and me was very impressed by her customer service abilities. In July, I was contacted again by Ms. Boen in regard to my delinquent account. Once again, she was very professional and gave me guidance pertaining to my case. For the last couple of months Ms. Boen has been in contact with me and I was able to acquire the required documents needed to bring my account to a 'paid in full' status. Additionally, Ms. Boen assisted me with an older account that I was still paying on (for at least 8 years) and this account has also been placed in a 'paid in full' status.*

    I normally do not like dealing with 'debt collectors' because in the past my experiences with them has not been good. I found that your staff is courteous, and they know how to treat people with respect. Ms. Judy Boen truly went beyond the call of duty when dealing with me. I called her a lot and asked many questions, but not once did she indicate that I was a nuisance (even tho I was). Most people out here in the real world who have gone

> *through (or are going through) some tough times are far more likely to make payment arrangements with someone like Ms. Boen. She was always straight forward, honest, helpful and most of all professional in her words and actions. I actually enjoyed dealing with her to get my accounts cleared up and appreciate her and your organization for helping me with my credit issues. –Lisa W.*

When researching potential third party delinquency management solutions, Credit Unions should look for the following attributes:

- Companies that reward their employees not just on collection results but also on positive feedback from member-borrowers;
- Highly experienced companies that have served lenders through several significant economic cycles and major downturns;
- Member-centric companies that understand and protect the Credit Union-Member relationship while focused on protecting the Credit Union's capital;
- Companies that are licensed, and registered with the NCUA and CFPB;
- Responsive A+ rated companies with zero unresolved consumer complaints;
- Companies that serve only Credit Unions.

SUMMARY

Never before in the history of the Credit Union movement has there been such uncertainty about the future. When you 'kick the can down the road,' you're not just solving the immediate problem, you are guaranteeing the arrival of a new problem. When the deferment and forbearance can stops rolling, a new challenge will emerge: how to balance the needs of financially challenged member-borrowers with the requirements of safe and sound Credit Union management.

How long will the COVID-19 pandemic last? When will the economy recover? What effect will all this have on members? What effect will all this have on Credit Unions? One thing is certain: kicking the can further down the road is not the right solution. Hiring new, inexperienced collectors is not the right solution. "Going it alone" is not the right solution. "Extend and pretend" is not the right solution. The right solution is identifying and engaging the right resources to benefit Credit Unions and members alike.

"We're All In This Together," the reassuring message that has been consistently repeated by school children, octogenarians, first responders, healthcare workers and families across America applies to Credit Unions, CUSOs, regulators and highly respected industry vendors. There are resources available that simultaneously provide strength and direction to member-borrowers as well as expanded capacity for Credit Unions. It is time to pick up the can.

For additional information please contact:

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