

Nonprime Auto Lending Is Something Credit Unions Should Be Doing

6 Best Practices of a Successful Nonprime Auto Loan Program

When a member is declined for an auto loan from their credit union, they often go on to get the loan somewhere else.

So, the National Credit Union Foundation and Filene Research Institute collaborated on a pilot that identified the best practices for credit unions offering different types of nonprime loan products. Here, we want to focus on data-mined auto lending, which is the use of various types of data to target good-risk members with poor credit scores.



Mark Lynch, co-founder of CU Difference and, until January 2018, senior program manager at the NCUF, emphasized, “This is something credit unions should be doing. It’s good for the members, and it’s good for the bottom line.” When borrowers are unaware their credit union can help them even if their credit is not stellar or are turned down by credit unions, they’re often taken advantage of at the dealership or elsewhere. Lynch emphasized that credit unions aren’t entirely at fault for not offering nonprime loans. In recent years, the US is coming off a recession during which the NCUA and other regulators became very strict in its oversight. He agreed that some lenders definitely have been burnt by lending to those with a low credit score, but the risk can be mitigated by doing it the right way.

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What is the right way for credit unions to offer nonprime auto loans? According to Lynch: Establish a risk-based pricing loan platform if you haven’t already. He said many credit unions have it, but they don’t do it well. Many just call a colleague at other credit union that offers nonprime loans, ask what their pricing is and how they handle collections. That can be useful, but running a successful program depends on many more factors:

1. Adapt underwriting practices to the nonprime loan. Debt-to-income and loan-to-value ratios are great to show the regulators but look beyond that. Is the vehicle used primarily to drive back and forth to work or is it a toy? Look at the member’s full story: Do they have poor credit due to a job loss, but they’re back on their feet now? Additionally, the trajectory of the credit score is more important than the score itself, Lynch stated.

2. Ensure the vehicle is in decent working order. Finally, if the loan is an origination, negotiate with the member on their vehicle they're buying, which can also help cross-sell and help set the member up for success at application time.
3. Protect the member and the credit union with insurance and a vehicle warranty or repair policy. Life, disability, and GAP all help the member and the credit union in this situation, especially if you're unsure the vehicle is reliable. Build it into the repayment costs.
4. Hone your credit union's closing discussion, which Lynch said may be the most important piece of nonprime loans. Lynch noted a trend toward automation or the hard close, but for these loans they need "the credit union close." During your appointment with the borrower, remind the member of how the credit union helped set the borrower up for success and that the credit union is lending other members' money, so the borrower feels a greater obligation to pay the loan back. Acknowledge that bad things happen to good people and they should be proactive if something comes up, Lynch advised. These loans should have no grace period and the credit union should call the first day it's late. If they can't pay, then repossess the vehicle.
5. Perfect your collections process. Follow up and do what you say you will within the law. But credit unions should also offer incentives to hopefully avoid this scenario, improve members' credit and build lifelong members who are promoters. For example, repayment incentives can include a lower rate after a period of time on the vehicle loan or even all of the borrowers' loans.



Once credit unions commit to nonprime auto lending, by very intentionally targeting the lower credit score brackets, mitigating risks through specialized underwriting, putting the member in a decent working car, and protecting them and the credit union with insurance and warranties, Lynch said these programs can be very successful for the credit union and the members. Credit unions earn new revenue and goodwill, which means an increasingly loyal membership. Serving all of their members are what credit unions were founded to do, especially when no one else will help.

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