

Inside NAFCU Services

Debt protection

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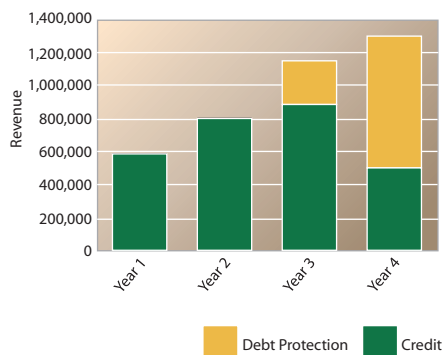
The subprime credit situation and its attendant effects cascading through various financial markets will raise credit issues for many credit union members, even those without such issues in the past. Credit unions will certainly want to continue addressing the needs of these members, but they will also not want to assume additional risk in the process.

One option is to significantly tighten requirements for loans and other forms of consumer debt—an effective way of minimizing risk, but not one that meets credit union or member needs. A better option is to focus on a member's need to borrow while minimizing risk. This can be accomplished through various products that offer protection against a variety of potential adversities.

Although credit insurance can be limited in its applicability and carries with it a set of growing regulatory burdens, debt protection is a tailor-made and more flexible alternative. Debt protection can significantly benefit both credit unions and their members by providing additional income and asset protection for the credit union and the coverage members want and need.

A recent case study illustrates the key success factors in moving from a credit-based program to a debt protection-based program. A successful credit insurance program was already in place and had total revenue of \$562,000 and \$777,000, respectively, in years one and two. In year three, the credit union began offering a debt protection program allowing more member flexibility and affording much broader coverage.

"Successful" client example



The credit union above employed a simple program, with only two packages. It sells more of the higher-rate program and effectively utilizes critical period benefits. The debt-protection products are less expensive than the former credit insurance offering.



This new debt protection program yielded added revenue of \$261,000 in year three and \$793,000 in year four to produce a combined (debt protection retail fees plus credit insurance run-off premium) revenue increase of 46 percent from year two to year three and 15 percent from year three to year four.

There are a number of lessons that can be learned from the case study. Two are that simpler plans helped members easily understand their alternatives and that credit insurance "look-alikes" continue to sell (selling within a comfort zone). Also, limiting benefits to a critical time period is a successful way to provide benefits while managing cost, and debt protection alternatives with lower rates and superior coverage than previous credit insurance programs are very attractive to members.

Credit unions were successful in using debt protection with home equity loans to minimize risk and increase overall revenue, since credit insurance is not always able to penetrate this loan type. Successful credit unions also offered a wide range of debt protection options, including consumer loans, home equity loans, mortgage loans, credit card accounts, and direct and indirect auto loans.

There are a number of issues that can impede success. They include:

1. offering too many debt protection packages as well as plans that are complicated;
2. debt protection packages that are more expensive than the previous credit insurance program;
3. no credit insurance look-alike plan to ensure a smooth transition (a complete shift is too drastic of a change);
4. low-priced packages that do not generate sufficient revenue;
5. conversely, packages priced too high; and
6. involuntary unemployment plans providing a critical period benefit greater than three months appear to increase price without increasing equitable value.

In a time when the economy is increasingly uncertain, helping members prepare for and endure difficult times when real-life events temporarily prevent them from fulfilling their financial commitments is the proverbial "win-win" solution.

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