

of interest!

A timely digest of regulatory changes, specialized reports and important information for the consumer finance industry.

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Industry Changes Mean New Carleton Solutions



Like many industries, the financial services industry has undergone major changes over the past 30-plus years.

Businesses that have been able to respond and keep up with the constantly changing technology have survived and grown. Carleton has had the privilege and enjoyment of having 30-plus-years relationships with many of their clients by staying ahead of the technology curve.

American United Life Clients Win with SmartNet Solutions

Many of the financial service and credit insurance companies that began working with Carleton as a rate chart supplier continue to retain a strong relationship with Carleton even today. One of these is American United Life (AUL), an individual, group and credit insurance company headquartered in Indianapolis, Ind.

Recently, AUL and Carleton formed a partnership to work together on an Internet-based "paperless credit insurance product" called Platform Partner for AUL's customers. AUL was looking for a provider that would offer them a state-of-the art solution that could be tailored to their specific needs. "After talking with AUL and accessing their objectives, we customized an Internet product to not only fit AUL's needs, but the needs of their customers as well," said Pat Ruskowski, president of Carleton.

With Carleton's help, AUL provides an Internet-based credit solution to its clients that includes loan quoting, credit certificate printing that interfaces with Laser Pro or

Banker Systems, on-line insurance penetration reporting and monthly electronic transmittal of sold credit insurance certificate data.

Carleton participates as a partner of AUL in presenting the capabilities of Platform Partner and then implementing the system after the sale. "Carleton's participation has played a critical role in helping AUL gain a competitive advantage and grow our credit insurance business," says Jerry Crabtree, director of financial institution sales at AUL.

Relationship building and listening to what clients need for their individual businesses is what Carleton believes has helped its own business grow to include most of the major financial and credit insurance institutions in the United States. AUL is one client that believes that philosophy has been Carleton's strength.

"It sounds like a cliché but we do business with Carleton because of their reputation, and more importantly, because of their people," notes Crabtree. "They truly work with AUL and our clients with a 'partnership philosophy.' Their people know and understand our business and have the technical expertise to deliver what they commit to."

SmartCalcs Keeps 1st Source Bank in Compliance

1st Source Bank is another long-time Carleton customer. In fact, Jim Seitz, senior vice president of retail banking for 1st Source, who has been with the bank



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PUBLISHER'S NOTEBOOK Happy 2004 to Everyone

We're off to a great start at Carleton and looking forward to an exciting year. We've got a number of new products to tell you about in this issue — products we think will help make your job easier and more profitable.

Our "quotes & calcs" column highlights two financial services companies that we are proud to work with — American United Life and 1st Source Bank. Carleton's SmartNet and SmartCalcs software has helped both of these companies meet their customers' continually changing loan and credit insurance needs and improve their bottom lines along the way.

As many of you know, the Regulation Z HOEPA amendments have caused a great deal of confusion and misunderstanding, switching many lenders from single premium to MOB insurance products. Our research staff has been following what is happening in the industry and provides a follow up to last month's discussion.

Our "compliance update" provides you with recent changes for the states of Illinois and New Mexico, as well as new rates for credit life and credit A&H.

For those of you who would prefer to receive *ofinterest!* via e-mail, just send us your e-mail address and we'll put you on the list to receive the digital version. Just send your request to ofinterest@carletoninc.com and we'll take it from there.

Thanks for your interest.

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Evaluating the “MOB Rush” Part II

from our research dept. ...

The overwhelming trend since October 2002 is a switch to MOB-type coverage from single-premium products for real estate and real estate secured transactions.

October 2003 represented the one-year anniversary of the effective date of the amendments to Regulation Z — almost universally referred to as the “HOEPA Amendments.” The second part of this series discusses what we have seen in the industry since the implementation of the amendments and the direction that we see things going, at least for the near future.

The overwhelming trend since October 2002 is a switch to MOB-type coverage from single-premium products for real estate and real estate-secured transactions. While HOEPA does not cover all real estate transactions, it is an administrative challenge, to say the least, to split coverage between single premium and MOB on the different real estate-related product lines. Many carriers and lenders are finding it significantly easier to make an across-the-board switch to MOB on all real estate-related transactions.

We have implemented a wider variety of MOB calculations than in the past due to HOEPA concerns. The urgency to quickly comply with the HOEPA provisions has spawned some new approaches tailored to fit existing back-end processing systems with a minimum of IT retrofitting. The most popular approach, so far is the “Level MOB” premium approach where the amount of the monthly insurance premium remains constant as compared to the traditional MOB approach, where the monthly insurance rate is multiplied by the actual outstanding balance each month to arrive at the premium amount due and changes every month as a function of the monthly outstanding balance.

The Effects of Cancellation and Delinquency

Another concern lenders have to take into account is the canceling of insurance and notice to the consumer in the event the consumer is 60 days delinquent in making a scheduled insurance payment. If a consumer’s insurance is cancelled, a new P&I payment must be computed and

communicated to the consumer. Many lenders have switched from coupon books to monthly statements to accommodate MOB insurance coverage. Additionally, the monthly premium reporting requirements on active loans with insurance is a new task for lenders who have always sold single premiums for closed-end loans.

The monthly change in the P&I payment and the insurance payments makes coupon books ineffective when consumers cancel their insurance, miss payments and/or make advance payments. Monthly statements may not be as economical as coupon books in the short term, but in the long run they offer much needed flexibility, especially in dealing with the workings of insurance coverage cancellation, since the calculations can be adjusted in the system for subsequent billing periods. The inability of existing processing systems to handle the MOB calculation, monthly accounting and reporting requirements caused a great deal of consternation and concern prior to the enactment of the amendments.

Using the “Level Premium” Approach

The “Level” approach has three characteristics that makes it easier to implement on existing processing systems — the monthly P&I payment will not be a variable amount each period, the P&I payment is the same with or without insurance coverage and the monthly insurance premium is the same every month. The “Level” approach enables the loan processing systems to treat the level monthly insurance premium as if it was an escrow payment amount — a capability most loan processing systems already have in place for monthly accounting and reporting. If the insurance is cancelled, the escrow payment is eliminated and has no effect on the established P&I payment. Even with “Level”

MOB, lenders still have to concern themselves with coverage cancellation if the account is over 60 days delinquent in making an insurance payment.



Of course, like any decision made about policy, there are pros and cons to the “Level Premium” approach. The relative ease of implementation and compatibility with the existing system requirements is the biggest plus. However, on the other side of the ledger, the full expected rate of return on the premium is not realized until maturity in most cases. Cancellation of the insurance by the consumer, early loan payoff in full or any other event — including the death of the insured — that causes the loan to terminate before the scheduled maturity date will reduce the return on the premium due to the prorated nature of the monthly premium charges. The earlier the termination in the contract, the less return is realized.

Implications on Loan Originations

Now let’s revisit the implications of MOB on the loan origination side of lending.

In the last issue we posed the question of proper Truth-in-Lending Act (TILA) APR disclosure calculations for real estate transactions containing a prepaid finance charge and MOB credit life coverage. In this issue we take a look at the four values we listed as possible APR disclosures.

The common data for the transaction was a \$5,000 amount requested, traditional MOB credit life computed at \$1.00 per month per \$1,000 of coverage, 12 monthly payments, an 8% simple interest rate and a \$50 prepaid finance charge.

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New Software Module Introduced:

Supports Payment Processing with MOB Insurance

Many Carleton customers have followed the industry trend towards increased use of MOB insurance as a result of HOEPA regulations. However, one problem that many customers have experienced is that their loan processing software cannot keep up with the capabilities of Carleton's loan origination software. Simply put, they needed Carleton's help in providing software that would allow their loan processing system to determine how much of the loan payment should be attributed to the insurance premium and how much to interest, fees and principal.

Carleton has responded to the needs of the market by adding another product to its list of SmartCalcs integrated modules. This newly created module will handle the calculation of Monthly Outstanding Balance insurance for back-end payment processing. The module can be easily integrated within any processing system to determine the amount of payment that should be applied to the insurance premium before allocating interest, fees and principal.

This module supports the following insurance calculations in either a decreasing or level monthly premium.

Life: Principal Balance

A&H: Principal Balance
Payment Balance

Present Value of Remaining Payments

IUI Principal Balance
Payment Balance
Payment

The new module is written in C and can be compiled to work in PC, UNIX, AS400 and main-frame environments. Please contact Carleton's sales department at 1-800-433-0090 to learn about this exciting new product.

Effective State Changes

In each issue of our newsletter, we're **compliance** update pleased to bring you "compliance update" and "from our research department," the latest information on federal and state regulation changes.

Carleton maintains comprehensive familiarity with over 300 state consumer finance and real estate lending laws in the U.S., as well as the consumer credit insurance regulations in all 50 states, plus the Provincial laws and acts of Canada.

Our "compliance smart" support includes regulatory change notification and compliance white papers designed to keep you aware of regulatory changes that would affect your software.

Our research staff can also provide professional consulting support to make sure your origination and processing systems are in compliance.

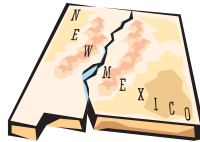
If you have any questions regarding the information provided in this issue, you can e-mail Jeff Buysse, director of research, at jbuysse@carletoninc.com.

Illinois

The maximum loan amount under the Consumer Installment Loan Act will increase to \$40,000 from the current amount of \$25,000. The change was included in HB 2543 and was effective January 1, 2004.



New Mexico



The Insurance Division of the New Mexico Public Regulation Commission issued Bulletin 2003-009 which effectively lowered prima facie credit life and A&H rates 10% on January 1, 2004.

The new rates will be:

Credit Life	
Single Decreasing Life	\$.43/\$100/yr
Single Level Life	\$.81/\$100/yr
Joint Decreasing Life	\$.64/\$100/yr
Joint Level Life	\$1.22/\$100/yr
MOB Single Life	\$.69/\$1000/mo
MOB Joint Life	\$1.03/\$1000/mo
Credit A&H	
14 Day Retro	\$1.38 per \$100 @ 12 months
14 Day Elim	\$1.15 per \$100 @ 12 months
30 Day Retro	\$1.09 per \$100 @ 12 months
30 Day Elim	\$.88 per \$100 @ 12 months

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Industry Changes Means New Carleton Solutions (cont. from page 1)

for over 23 years, says the bank was using Carleton when he first arrived. He is one of Carleton's customers who have experienced the company's adaptability first hand.

Carleton has worked with 1st Source for 30 years by supplying them with products that have paralleled the bank's evolving needs, starting with rate charts and moving to desk-top calculators and portable hand-held loan calculators. Now, 1st Source utilizes Carleton's SmartCalcs in both its "home-grown" loan origination and loan processing systems.

In 1986, after 1st Source looked at many platform automations systems, the bank decided to build its own in-house system. "We called on Carleton to provide us with the loan calculations and credit protection tables," said Seitz. "As rules, regulations and rates change, Carleton makes those changes to our systems, which takes away a big headache for us."

1st Source uses Carleton's SmartCalcs, which allows the bank's system to accurately quote loans so they are in compliance with state and federal regulations. The customized software also enables 1st Source to sell credit insurance products, providing necessary protection for the consumer as well as producing revenue for the bank. The back-end processing software, also provided by Carleton, allows for accurate accounting of the bank's loans.

Carleton's goal for all of its customers and partners is to improve business for them. According to Ruzkowski, "The only way to achieve that goal is for us to listen to what the client wants to accomplish and be able to respond and change as their business and industry regulations change."

For Seitz, that's exactly why, after 30 years, 1st Source Bank continues to do business with Carleton. "When we began our development it only took one phone call and the people from Carleton were on board," Seitz explained. "Our programming staff deals with a variety of providers and rates Carleton at the top of the list."

Evaluating the "MOB Rush" Part II (cont. from page 2)

The four potential APR values listed in our last issue were: 8.000%, 9.891%, 9.869% and 10.025%.

In ascending order, our analysis of the four values is:

**8.000% APR –
Monthly Payment \$442.09**

This is not the correct APR for this set of data. It is merely a restating of the nominal computational interest rate. However, because of the complexity of computing an APR for a transaction with MOB insurance, many systems historically displayed the interest rate as the APR. The inclusion of a prepaid charge means an 8% disclosure would be out of compliance.

**9.891% APR –
Monthly Payment \$437.72**

This value would represent the proper disclosure if the prepaid fee was truly "prepaid" and paid in cash at the consummation of the transaction. If that were the case

and the fee amount came out of the debtor's pocket directly, the APR would represent an amount financed of \$4,950, a finance charge of \$269.09 and a payment schedule where 12 distinct P&I payments were recognized.

**9.869% APR –
Monthly Payment \$442.09**

This value would represent the proper disclosure if the prepaid fee were financed as part of the transaction and not paid in cash at consummation. The APR would represent an amount financed of \$5,000, a finance charge of \$271.79 and 12 distinct P&I payments recognized.

**10.025% APR –
Monthly Payment NA**

We just can't help throwing in a "red herring" when we create these challenges for our readers. This value has no bearing on the data of the transaction other than it is higher than any of the other values and we figured a certain percentage of readers would pick it as correct for that reason. Sorry.

In the first three scenarios it is important to understand that the MOB premium amount due each month represents neither the amount financed nor the finance charge. For that reason the insurance portion of the payment must be subtracted from the total level payment the consumer pays each month. Only the P&I piece of the payment is used in the TILA APR calculation.

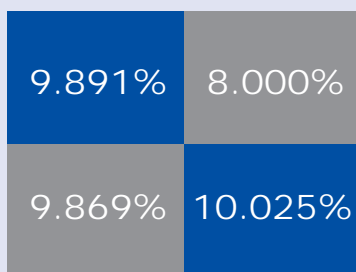
As we stated earlier, for many years APR "calculations" simply restated the interest rate. The inclusion of a prepaid finance charge renders that process inaccurate. Since real estate transactions routinely contain a prepaid charge, the actual P&I payments need to be used in any APR calculation routine. With the longer lengths of real estate transactions, this becomes a much more cumbersome process.

The "Level Premium" approach illustrated earlier does lend itself to simpler TILA APR calculations. Since the P&I payment remains constant, the calculation of the APR does not require the input of a

number of distinct payment streams. For validation, the lender can merely use the constant P&I payment in an existing APR verification program.

More Data Needed

The full effects of the HOEPA amendments will not be seen until we get more actual-experience data from the industry. To date we have seen some changes in types of coverage but not the drastic ones that many predicted. The introduction of new approaches to MOB coverage has provided challenges and opportunities in providing software solutions to a wide variety of clients in the credit industry. We look forward to continuing to change with the industry in order to meet the needs of both lenders and insurers.



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