Oracle Financial Services

Credit Unions in the Lending and Leasing Market

A VIEW INTO THE MODERN CREDIT UNION MARKET

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INTRODUCTION

With more than 6000 credit unions servicing the US, they are gaining ground in the country’s lending and leasing market at a fast pace. But as this happens, several other substantial changes are also reshaping the industry: a huge lot of the millennial generation is now entering workspace with a disposable income much higher than their parents’, regulatory norms are getting more flexible to let smaller players, especially credit unions, enter the marketplace more freely than ever, and digital technologies are now becoming intrinsic to people’s daily lives like never before.

TRENDS IN THE CREDIT UNION MARKET- THE RISE OF CREDIT UNIONS

The above mentioned changes are directly impacting the lending and leasing industry. For example, 97 percent of car shopping now begins online and this means a great selling opportunity for financial institutions that are ready to take the challenge head on. As credit unions are trying to get a bigger share of this market, here are the most peculiar observations:

- Leasing is gaining more traction than lending

  For the credit union members who do not want to undergo the long term loan cycles, credit unions are now fostering the idea of leasing for financing them. More auto consumers now prefer to lease their vehicles. In the first half of 2016, more than 2 Mn vehicles were leased which shows a surge in leases across the country. This is specifically good for consumers who lack a proper credit history as they can now opt for other options which are more flexible in terms of pricing and other terms. Leases are seen by credit unions as opportunities to increase customer base.

  Also, millennial customers, who are the largest consumer base now, do not prefer buying vehicles with high interest loans because they have sharing apps and smart public transport options at their disposal. In such a scenario, leasing automobiles acts as a win-win option both for consumers of loans and credit unions.

  These surging leasing entities are mostly concentrated around big cities. Leasing is outdoing traditional loans in the areas where population density is high so that mileage restrictions can attract customers. *

- Regulatory evolution

  Ever since the membership criteria for credit unions were relaxed in 1998 through the Credit Union Membership Access Act, it has been easier for credit unions to expand in the US market. In a recent regulatory update in 2017, credit unions were also given more autonomy in offering loans to their commercial customers.

  Apart from regular federal regulatory mandates, more than 100 credit unions and community banks in the US market have joined hands to form a coalition, known as the **Golden Contract Coalition** in order to put a stop to unfavorable contract terms and overpriced one sided deals.

  These regulations give credit unions the scope to operate freely in a fair marketplace and open more gates of opportunities for them with a larger audience base. Moreover, these developments provide them flexibility and give them the room to break free from the mandate to employ IT solutions from the big three.

LENDING AND LEASING THROUGH CREDIT UNIONS- HOW AND WHY IS IT BOOMING

Till very recently, credit unions were offering humble financial products to their members and though they have been present in the lending and leasing market, their lending solutions were all of the very basic nature. But with the advent of digital technologies and increased demand for sophisticated solutions by consumers, their profit margins are getting thinner and they need to look for ways to evolve. This need is further substantiated by the cut throat competition from other entities in the financial services industry, be it large banks who have advanced systems or new entrants who offer innovative products and services to customers.

Credit unions are looking to reformulate strategies and expand their product offerings to suit their members' pressing needs. They have also been introspecting their norms on member entry. This entire wave of change is also inspiring big mergers and acquisitions in the industry.

CHALLENGES THAT CREDIT UNIONS FACE IN THE LENDING AND LEASING INDUSTRY

- Size of operations

  Though credit unions have been growing at their own pace, they still lag behind the rest of the industry. They represent only 7.1 percent of all assets and loans of all depository institutions. Most of these credit unions are still extremely small even in contrast to the relatively smaller banks. While the top 10 credit unions own 15 percent of the market, the top 10 banks own approximately 57 percent of the banking market.

- Limited product portfolios

  One of the biggest challenges for credit unions has been the inability to provide products on demand. From overseas payments to specialized commercial banking needs, there are several areas where credit unions still lack well rounded products. Since most credit unions lag behind in latest technology, their ways of underwriting, processing and loan disbursal also remain old school.

- Inability to provide great servicing

  One of the biggest reasons for retail consumers and small businesses choosing banks over credit unions is their relatively low loan approval rates. Moreover, the speed at which they deliver solutions also usually takes a conservative approach as opposed to competitors who are disbursing loans in minutes. Also, during peak seasons, the website and mobile app traffic witness surges and conventional lending systems fail to address the demanding influx. A seamless flow of information across stages of lending and leasing and across channel is also a challenging phenomenon for most credit unions.

- New competition

  Since credit unions lack in the latest technology, they are often not the first choice for small businesses. They prefer opting for loans from full-fledged banks as their digitally advanced technologies give them a sense of confidence. With the new regulation that loosens rules for credit unions to lend to businesses, their market share in commercial lending is expected to grow.

  Fintechs that come up with innovative ways of offering products and services are also posing cut throat competition in this market and credit unions are the first ones to take a hit. Lending startups are employing platformification and data based underwriting to ensure relevant and seamless delivery of financial solutions to their millennial consumers. Shadow banking is now a huge chunk of lending business and is eating into credit unions' market share to a great extent. This makes staying relevant even more challenging for credit unions as they require to rethink their underlying technologies to claim the desired market share.

WAY OUT

- Build solutions specific to millennials

  Since leasing is gaining more traction in the market than lending, it is imperative to attract more millennials who lack credit history. They have seen their parents undergoing the pain of paying off their EMIs while they admire the alternative financing options. Building trust with millennial can go a long way for credit unions as they look to build broader inroads into financial services industry. Strictly marketing and selling on the basis of price might not be a big attractor and rather service will make a difference. Also, channels of delivery will definitely make a difference.

There are fintechs who are now introducing recent college pass-outs to the credit union communities. They are also reimbursing the tuition fee as a prepaid amount so they can reap the benefits by hiring these students at later stage. Some other startups are harnessing millennial friendly ideas such as gadgets and gaming to educate them about management of finances and improve their credit scores.

The quickest way to connect with millennial is through technology and this means credit unions need to up their game with the latest digital technologies. By making use of technologies such as big data analytics, artificial intelligence, and internet of things, they can stay ahead in the race to attract millennials, This may imply big initial investments but the returns might be worth since millennials, as mentioned earlier, now comprise the biggest demographic group on the planet.

- Cater to the requirement of commercial loans

Since the new NUCA rule makes it easier for credit unions to lend to businesses, lending to small businesses is definitely a bigger opportunity for them now. The rule replaces cumbersome prerequisites and constraints— such as collateral and security requirements, equity requirements, and loan limits — with more pragmatic and simpler principles. For credit unions, this means that they can now freely do business with businesses with looser mandates.

Since credit unions operate on a no-tax model, it will be easier for them than for banks to earn profits pout of this thin margin segment. Also, they will be able to foray into newer markets which are beyond their individual members. Credit unions have been gradually gaining ground in the commercial lending market and the opportunities for them seem to be immense.

- Build upon the auto market advantage

Automotive loans have been a large part of the increasing credit union market share. This clearly indicates they have immense opportunities in this market. With new vehicles sales expected to remain upward of 17 Mn in 2017, the auto lending market is an attractive area of investment.

In fact, a vast majority of credit union consumer loans are auto loans. While small banks make up only for 4% of the market, credit unions make up a whopping 25% share of the market*. A part of this is also due to increased interest rates that the US has been undergoing lately. Automobile financing is one of the biggest cash cows for credit unions and this implies a better product portfolio is require in this area.

- Make customer experience your key

Across retail and commercial lending and leasing market, customer experience is one of the biggest drivers to make costumers stay loyal. Right from originations to servicing through collections, there is a lot that credit unions can do in order to make the experience seamless and hassle free. Great customer experience not only delights end consumers but also makes routine tasks more convenient for the internal stakeholders.

End consumers applying for a loan product expect to access their application online across channels to fill out the required information, track their loan status, receive updates on their devices and receive instant decisions.

The loan underwriters, loan officers and loan closers also require to process various loan products (secured, unsecured, direct lending, indirect lending, home equity, HELOC’s and credit cards) on one central loan origination system to ensure great customer experience. Since self-servicing is preferred by most millennials, all users need to have the tools to process applications from submission, to decision, to remote or in-branch document execution, to finally fulfillment on their core processing system. Also, credit union administrators need to configure risk-based pricing rules, decision making rules and automatic routing/queuing rules to streamline the loan process with fewer touchpoints.

- Thrive on innovation

  As mentioned earlier in this whitepaper, several fintechs are disrupting the consumer lending and leasing market with simple and innovative ideas. There are lending startups offering new and relevant solutions right from residual value to hyper personalization of products and services to social media conversions swiftly converting in to lending transactions. In such a marketplace, innovation has become a hygiene factor which certainly has to be backed by robust and futuristic technology.

  As more and more competitors from across industries try to poach customers early on in their lives by monitoring their real time requirements and offering products specifically designed for them, credit unions also require to become innovative think tanks in order to stay ahead in the market.

CONCLUSION

As indicated in this whitepaper, constant re-imagination and evolution has now become a prerequisite in the lending and leasing industry. Credit unions, though with an advantage of tax-fee operations, have several limitations to them. The only way to swim the ocean of disruption is to keep introspecting as well as benchmarking across players not only inside the industry but also outside of it in the age of blurring industry boundaries and performance pressure built in by all the stakeholders. This might translate into flexibility for some credit unions and becoming more digitally savvy for the other, but definitely a competitive and forward looking approach for all.

***philadelphiafed.org**

ORACLE CORPORATION

Worldwide Headquarters
500 Oracle Parkway, Redwood Shores, CA 94065 USA

Worldwide Inquiries
TELE + 1.650.506.7000 + 1.800.ORACLE1
FAX + 1.650.506.7200
oracle.com

CONNECT WITH US

Call +1.800.ORACLE1 or visit oracle.com. Outside North America, find your local office at oracle.com/contact.

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