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THE RACE IS ON

How to Drive Loan Growth in 2021

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INTRODUCTION

How to Drive Loan Growth in 2021

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The events of 2020 triggered major changes to the credit-risk environment and revealed new trends, challenges, and opportunities that will shape the industry for years to come. One of the biggest challenges to emerge for credit unions is loan growth: deposits have soared and lenders have been racing to catch up.

Deposits grew 10x as fast as the median growth of the three years prior. And the overall median growth for loans saw a 3.4% decline in 2020.

Due to the inability to keep pace with deposits, banks and credit unions have been racing to develop growth strategies and make the right investments to be successful. Based on conversations with industry experts and our work helping dozens of financial institutions meet their growth targets, we put together this guide to help your portfolios grow safely, too.

STRATEGY #1

Grow Down Spectrum

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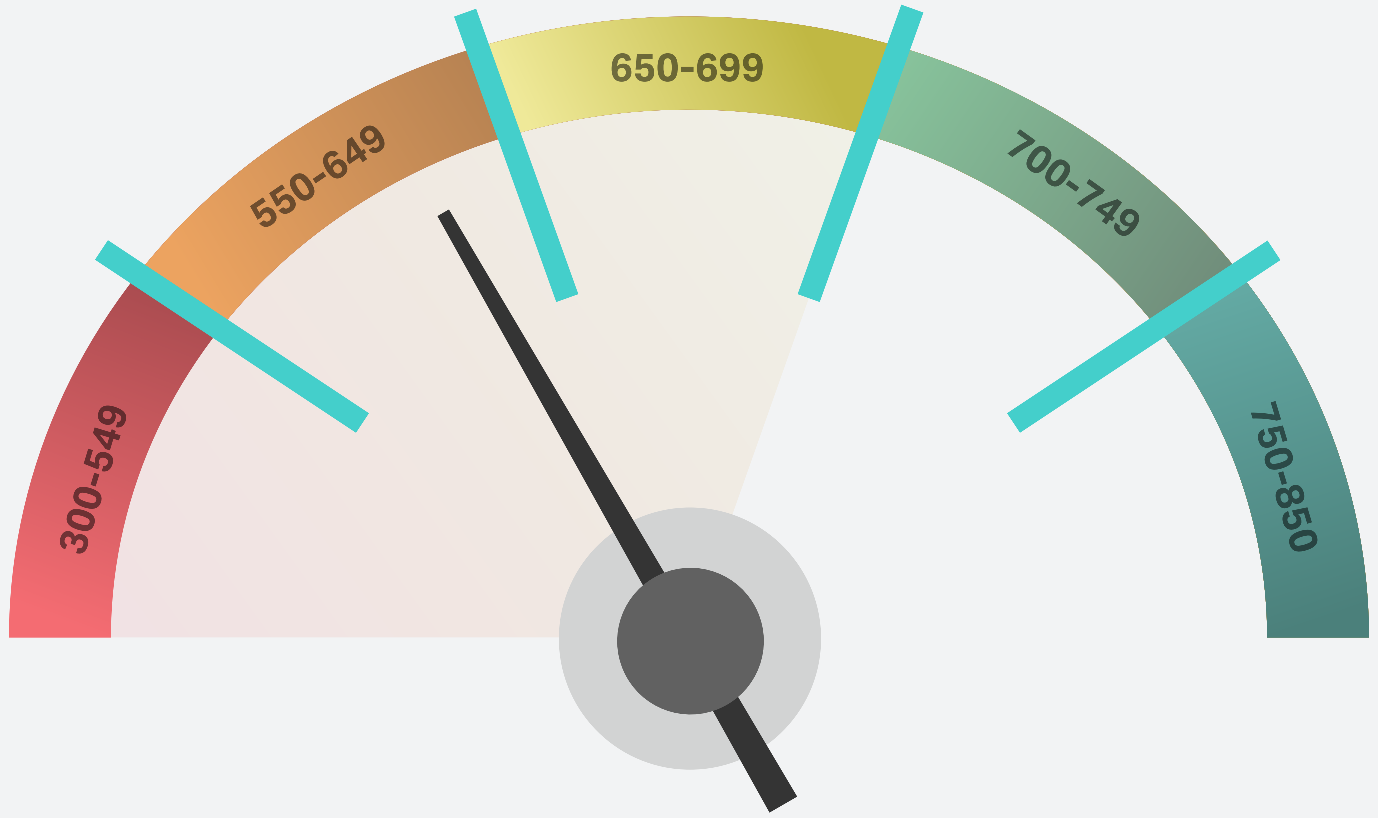
Credit unions have a trillion-dollar growth opportunity standing right in front of them: figuring out how to serve America's credit-invisibles and subprime borrowers. More than one-third (34.8%) of Americans fall into the subprime category, according to a 2019 Experian study. Also, research by the Consumer Financial Protection Bureau shows that 45 Million consumers are credit invisible.



According to Accenture, financial instiutions could generate up to $380 billion in annual revenue by closing the small business credit gap and bringing unbanked and underbanked adults into the formal financial system.

Financial institutions could generate

$380 Billion

in annual revenue serving the underbanked

Globally, wider access to credit could boost GDP by $3.7 trillion, and engender $4.2 trillion in new deposits and $2.1 trillion in additional loans, according to a report from McKinsey. Citibank's recent report echoed the business imperative and revealed that closing the racial inequality gaps could add $5 trillion of GDP to the U.S economy.

Subprime Too Risky? ML says “No.”

Credit unions that want to reach these members are understandably wary of the risk of making loans to subprime members and people with little to no history of using credit. But a lack of credit history doesn’t necessarily make someone riskier than someone with a robust file. It just makes it harder to score them using traditional approaches, which are typically limited to a couple of dozen factors such as credit score, income and current debt outstanding. Limiting the factors ignores a good deal of information that can greatly impact a loan approval.

So, rather than abandoning opportunity, lenders can tap the power of machine learning (ML) algorithms and substantially more data to generate a more holistic picture of members. Yes, technology has caught up to meet the moment.

Machine Learning Breaks the Cycle

Machine learning is better at assessing near-prime and subprime risk than status quo models, credit scores and scorecards. Why? ML models can ingest 10 to 100 times more data than the logistic regression models traditionally used in lending. With ML, underwriters can use trended data and credit-adjacent data from checking accounts, rental history, and utility bills to supplement borrower profiles.

Lenders Need a Holistic View of Members

More data helps build a more holistic picture of a member by having millions of correlations to explore among the variables. More data also makes models more resilient. If one variable goes haywire the model will fill in with other signals, something traditional models cannot do as well. The result: An automated way to swap in borrowers for approval who may have been overlooked by traditional underwriting techniques.

The increased predictive power yields real economic gains. Lenders we've worked with that switched to ML underwriting typically generate 15% to 20% higher approvals including far more thin-file, no-file, and protected-status applicants --- all with little to no impact on total portfolio risk.

15% - 20%

Increased Approvals with ML Underwriting

ML enables lenders to unlock the revenue potential of this segment and grow portfolios safely.

STRATEGY #2

Maximize Digital with Auto-Decisioning

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Credit unions know that digital is a crucial channel for growth and customer loyalty but often they struggle to succeed, according to a recent report from Forrester. Chris Skinner, publisher of the popular Finanser blog says, "What I see is banks maintaining systems and approaches, but not innovating. They need to be re-designing products and services around customer needs."

Easier said than done. With increasing consumer expectations and the entrants of new fintech startups that are quickly delivering digital experiences that meet consumers' needs, credit unions haven't faced so much competition or pressure to execute.

Give customers the digital experience they want

One area where credit unions and consumers are too far apart in their expectations is around loan decisioning speed. A 2020 Harris Poll Consumer Credit Survey revealed that 72% of Americans think that credit decisions should be instantaneous, taking no longer than a few seconds, given today's advances in automation.

But only 30% of consumers expect to be approved or denied immediately. In fact, more than 1 in 4 Americans (27%) expect to wait a day or more to get approved or denied, with close to half of Gen Z (45%) saying this.

This gap in expectations is the reason why half of Americans (51%) say the current credit approval process is painfully too long. Auto-decisioning closes this gap by giving lenders speed and scale in their lending business. Will your underwriting team fear being replaced by robots? Not necessarily. Reducing the number of applications for manual review enables more efficient underwriting, better customer service, and allows you to grow faster with the same operational resources.

> "Let's say that over a six-month period we go from 30% to 60% automated decision-making. That means my folks can spend a lot more time helping more people building performing loans but even excluding that, we're going to be growing 10% to 15% a year. Within a year or two, we'll be so much larger and decisioning so much more. A thriving organization always has opportunities for smart people."

David Bleazard
CEO of First Service Credit Union in Houston, Tex.

So, what's the best way to build a real-time auto-decisioning engine with accuracy? Many credit unions are turning to ML. By using more data and better math than traditional scorecards and linear models, ML models can more precisely rank applicants across the risk spectrum. Greater fidelity in your model allows for the ability to set lower auto-decisioning thresholds with confidence. One auto lender we worked with doubled its auto-decisioning rate to 60% and cut charge-offs by 40%.

Every lender wants something different from their automation play. The main benefits of auto-decisioning are speed, scalability and consistency. Credit unions tend to focus on the impact that automation can have on member experience, with goals to reduce friction and free team members to provide higher-touch service to the edge cases requiring attention.

Credit unions can also drive speed to decision as a competitive advantage for their auto lending portfolios. They know if they can return an approval quickly and with confidence dealerships will send them more volume due to their consistently fast response.

Bottom line: To keep up with consumer expectations and fend off fintech competitors, it's critical to boost auto-decisioning capabilities using new technology and approaches.

STRATEGY #3

Proactive Marketing & Pre-qualified Competitive Offers

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The pace of technological change in banking has not just transformed the customer experience and credit unions' back-end operations. It has also shifted the marketing function in credit unions. Not only will credit unions need to use multiple digital channels, but they will need proactive pre-qualified offers.

Recently Jenny Vipperman, Chief Lending Officer, Vystar Credit Union shared her thoughts on how this new experience should look:

"I have the data. I know who you are. Shouldn't I be coming to you and telling you what you qualify for, offering it, and then earning your business, asking you to come and do business with me? Imagine what that feels like, and how that's different."

Translating data into personalized and pre-approved offers delivered in real-time will separate the winners from the losers in the coming years. Using better models to predict loan eligibility and automate processes to provide the right experience will be crucial to success.

David Bleazard of First Service Credit Union talks passionately about using tech to make seamless hand-offs between marketing channels. "If I have ML-powered auto-decisioning," he says, "it has to be embedded everywhere. It has to work with our marketing efforts, with our geo-fencing, with our pre-qualified offers, with auto recapture. I want it being used by employees in our lobbies."

STRATEGY #4

Loan Participation Programs/Pool Buying

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Loan participation programs aren’t yet in widespread use, but they are on the rise as a growth strategy. Participation programs allow financial institutions to pool resources and collectively make larger loans than they would be able to on their own. From student loan participation programs to home improvement/lending to leveraging a fintech platform to drive creditworthy consumers to personal loan options, loan participation is on the rise.

Lori Bettinger, co-president of Alliance Partners LLC and president of BancAlliance commented on the growing trend: "We have definitely seen a pickup in the last six months. Banks are looking for loan growth [as they are] awash in liquidity, and participations could be an efficient way to address that."

By implementing loan participations into your growth strategy, financial institutions can diversify portfolios with reduced risk exposure, invest in pools of loans without taking on servicing burdens and origination overhead, and expand offerings to consumers who are looking outside their traditional institutions for credit and loans. It’s also a great way to test unfamiliar loan and borrower types to evaluate performance before offering directly.

As you develop your strategy, it’s essential to understand the makeup, performance, and forecast for the loans and borrowers in your portfolio so you select the right loan participation program to complement your current portfolio and you’ll need more predictive capabilities to assess risk for these new programs. Leveraging ML to optimize your portfolio and gain better predictions will help you make more informed decisions to ensure success.

STRATEGY #5

Launch New Product Lines (Safely)

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As banks and credit unions look for growth, diversifying portfolios and expanding into new product lines is a viable strategy. The central challenge becomes mitigating risk to successfully launch new loan offerings and grow a new portfolio safely.

Traditionally, expanding new loan offerings without the proper lending experience is taxing and takes time to ensure a strong infrastructure in underwriting, loan origination, and loss mitigation is in place.

Fast forward to today, and ML modeling has removed these traditional barriers. With ML and automation, you can jumpstart your entry into a new segment because you can get a more accurate and product-specific model into production faster. ML modeling consumes enough core bureau data that you can reuse much of the modeling and data analysis work between product categories.

While every model is unique, ML-powered product-specific models typically can be built, validated, and deployed in 3 months compared to the 16-month timeline for traditional models.

	SOLUTION	TYPE	TIME TO MARKET
1	Zest AI	ML-powered	3 months
2	Traditional Models	Traditional	16 months
3	DIY ML Model	ML-powered	16+ months

Overall, ML models enable your organization to get new loan product launches right from the beginning, increasing confidence with predictive credit assessment, accelerating your time-to-market, and scaling quickly to launch other new loan products.

Conclusion

From increasing consumer expectations and competition to pressure for growth, banks and credit unions face challenges like never before. The good news is executing some of the growth tactics in this guide can generate real competitive advantage over those that opt for the status quo. Building a successful growth strategy around your customers and members involves more than simply choosing new tactics - new technology adoption and approaches may be required.

To adapt and thrive, lenders are considering machine learning-based underwriting to boost approvals with no added risk, provide a superior digital experience with auto-decisioning, and respond more quickly to market volatility. Zest customers have seen approvals jump 15% with no added risk, or charge-offs drop by 30% while holding approvals constant when switching to ML underwriting.

While ML underwriting has multiple benefits across lending objectives, it also provides the capabilities needed to unlock new revenue streams and make your growth strategy a success. To learn a step-by-step approach from lenders who have moved to AI-powered underwriting, check out our recent roadmap guide. You can also schedule a demo to learn how AI can help your organization make better and faster lending decisions.

Ebook: A Lenders Roadmap to AI Adoption →

Thank You

Schedule a demo to learn how AI can help your organization make better and faster lending decisions.

hello@zest.ai

About Zest AI

Zest AI makes the power of machine learning safe to use in credit underwriting. Lenders using Zest AI software make better decisions and better loans—increasing revenue, reducing risk, and automating compliance. Zest AI was founded in 2009 with the mission of making fair and transparent credit available to everyone and is now one of the fastest-growing fintech software companies. The company is headquartered in Los Angeles, California. Learn more at www.zest.ai and connect with us on Twitter and LinkedIn.