RESEARCH BRIEF

Beyond Legacy Lending: Strategies for Loan Growth and Inclusion

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15 MINUTE READ

This brief explores how credit unions adapt to new paradigms for consumer lending while navigating a pandemic economy and advancing the credit union people-helping-people philosophy.

OVERVIEW

This research brief reviews findings from a qualitative study of credit union consumer lending strategies and operations. Summarizing key insights from ethnographic interviews with credit union chief lending officers, the brief highlights the barriers to adopting new technologies and the challenges presented by the COVID-19 pandemic and showcases the ways that credit unions are seeking to grow responsibly and advance inclusion through more calculated and innovative lending.

RESEARCH BRIEF

Credit unions have long served to expand access to financial services for the communities they serve. During times of uncertainty or economic downturn, credit unions tend to act counter-

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cyclically, increasing their lending to meet member needs. Today, many credit unions are seeking ways to grow responsibly by serving more diverse memberships more inclusively, including leveraging alternative and trended data in their underwriting and decisioning to build a more contextualized picture of members' financial lives and history. At the same time, the 2020 COVID-19 pandemic and recession have had powerful impacts on consumers' lives and livelihoods. Financial insecurity has heightened, particularly among people of color, affecting their ability to continue making payments on rent, utilities, home and auto loans, and credit card servicing. While access to credit during times of crisis can be a lifeline, many consumers today may also damage their credit scores as a result of missed payments due to income loss, or they may increase their debt burden to smooth consumption.

Are credit unions equipped to navigate this uncertain lending environment? Do their legacy underwriting and risk assessment policies and procedures allow them to meet the increasingly complex financial well-being needs of their increasingly diverse members? What solutions might credit unions employ to serve a broader consumer base more confidently and drive their growth simultaneously?

This research brief explores current and legacy risk assessment models used by credit unions and the strategic decision-making trends shaping how credit union leaders evaluate and evolve those models. It further explores the alternatives credit union leaders are implementing and identifies the barriers to incorporating trended and alternative data that may help credit unions better serve their membership's evolving needs.

DATA COLLECTION

We collected data from credit union leaders recruited from across the United States. This study includes ten participants from nine different credit unions located both in major metropolitan areas and rural towns in every region across the country.[1] Of the participants, six were male and four were female. One-on-one in-depth interviews (IDIs) between 30 minutes to 1 hour were conducted with participants, all of whom were credit union chief lending officers, or were similarly positioned within their credit union (e.g., Senior VP of Lending). Interviews were conducted

remotely using Zoom video conferencing software; participants gave informed consent to participate in this study. Participants are referred to by first-name pseudonyms throughout.

The interviews were semi-structured and followed an interview script covering four broad topics: the current state of lending operations, new paradigms for lending, the credit union ethos, and the impact of the COVID-19 pandemic. Participants were encouraged to share their personal experiences, stories, and perspectives related to interview topics in order to evoke a qualitative, ethnographic sense of the practices and belief systems that influence policy making and loan decisioning. After detailing the unique impact of the pandemic, we summarize five key themes that emerged from the interviews on the current state of lending before concluding with the broader implications for credit unions.

CONTEXTUALIZE THE PANDEMIC

The COVID-19 pandemic has touched every aspect of our lives; lending operations are no exception. When lockdowns began in 2020, and most branches faced either full or partial closures, credit union employees were forced to rapidly pivot to working remotely while improvising everything from printing documents to finding a way to get "wet signatures" for real estate transactions. In an environment of pervasive uncertainty, past data sets proved somewhat useless in projecting what would come next, and many credit unions pulled back on marketing credit cards and other forms of unsecured debt. Others stopped auto-decisioning processes to more intensively verify loan applicant information manually. "There were new questions we had to ask," one lending officer explained, "We've never had to ask, 'How has the pandemic impacted your business?' before." With many members receiving new forms of support payments, be they stimulus or unemployment checks, underwriters also had to take a more "holistic" approach to more thoroughly assess the sustainability of members' financial positions.

Credit unions also had to grapple with novel, unexpected, forms of exclusion. In one credit union on the East Coast, for example, branches were closed for several months, but the drive-throughs remained open. Sometimes waiting in the drive-through line took upwards of 45 minutes. "There is a segment of our communities that we serve that really

> To respond to shifting realities, credit unions overwhelmingly took a compassionate and lenient approach. "You just say 'COVID', and we do something for you."

do much better in person. They really like to come in and sit with somebody," Lisa, CLO at this credit union, explained. A situation developed where a number of Spanish-speaking members, many of whom work multiple jobs and were unable to wait in line, but who were also unfamiliar with paying bills online, became delinquent on their credit cards simply because they had no way to pay. In response, Lisa spearheaded an effort to develop Spanish-language modules to teach members how to use online banking.

To respond to shifting realities, credit unions overwhelmingly took a compassionate and lenient approach. In the words of one lending officer, "You just say 'COVID', and we do something for you." Adjustments such as allowing members to skip multiple payments and deferring loans were commonplace. Some have found that these sensitivities, which eased members' financial lives during a difficult time rather than making things more challenging, are already "paying dividends" in terms of member loyalty. And this less stringent approach allowed many members who were behind to catch up on payments.

Contrary to gloomy predictions, credit unions have seen a massive influx of cash during the pandemic, both as a result of increased savings and multiple rounds of stimulus payments. With members unable to travel, eat out, and spend on entertainment, credit unions are seeing tremendous loan paydowns and increased deposits. "There's a lot of money," Michael said, "And people are changing their habits. Luckily, most people are paying their bills. It's really good behavior and people are being responsible. How ever they're getting their money, they're not just blowing it." It is not an exaggeration to say that the most common response in this study to the question "What are your delinquency rates?" was laughter. Delinquency rates were described as "extremely low", "scarily low", "historically low", and "like Phuket" (referencing the low tides before the 2004 tsunami hit). "We've never, in my 25 years seen it as low as it is right now," Josh told me.

Although the pandemic represents an extraordinary historical event, the exceptional circumstances have shed light on standard practices and prompted lending divisions to reimagine their credit union's relationship to risk, and to their members.

Inclusive Lending

Credit unions want to be more inclusive by taking more calculated risks. Participants expressed a desire to lend more deeply in the community as a means of reaching more marginalized and financially precarious members in need of support. This excerpt from our conversation with Daniel aptly illustrates the frustration many expressed with their credit union for being overly cautious around "risky" lending:

M: Do you have a sense of the profile of an average borrower at your credit union?

D: Yes. It's depressing. A+ and A basically.

M: Okay. Can you put that in context for me?

D: Yeah. Very, very clean credit. Not a lot of difficulty affording loans. We have a conscious effort to move down in the credit tiers, but we haven't been as successful as I would like there yet.

M: And is that why you said it's depressing?

D: Yeah. Because I think as a credit union, I like to be in tier 2 and 3, not 0 and tier 1.

M: So what's been the resistance to moving down those tiers?

D: History. When I came here, we were risk averse. And so if you're risk averse, obviously you're gonna have an A+ and A portfolio. It takes time. Now it's a rebuilding of the lending brand of this credit union. One that's accessible to all regardless of credit profile."

To Daniel, only lending to A+ borrowers is seen as "depressing" because it is at odds with the purpose of the credit union. A desire to move away from risk aversion isn't motivated by reckless profit-seeking, but an aspiration to responsibly balance potential risks against the ability to lend more deeply in the community. "It's really not a goal of ours to have low delinquency," Josh explained, "because we feel if we have really low delinquency, we're probably not helping enough people; we're not taking enough risks for the individuals who actually need our help."

Participants often expressed their concern over whether their credit union was sufficiently inclusive through the language of "identity" and comparisons to banks. Michael put it bluntly: "Credit unions say yes [to loans] more. And the credit union that doesn't isn't really a credit union. It's a bank hiding out as a credit union."[2] While Lisa

expressed that credit unions are member-owned, and should therefore be able to find a way to provide credit to all members, in her estimate some credit unions have "lost their identity," "You know, they look just like a bank. They act just like a bank." Others expressed the worry that they had become too "mechanical" in their interactions with members, a bit "too much like the banks." This differentiation from banks isn't simply a matter of branding, but rather is rooted in a recognition that the cooperative structure of the credit union should influence how lending unfolds, from the service that members receive to who is hearing that "yes."

I always tell my underwriters the numbers are the first step, but the narrative around it and the story is almost equally important, and you don't get that in a scoring model.

There is a growing understanding in the industry that expanded lending can be a pathway to responsible growth. Many participants expressed that an overly conservative approach to lending is a disservice to members and the credit union itself. "We have been a less risky lender. We were very proud of our very low charge off rate," Mark shared, "That's something we shouldn't be proud of because we end up not doing a lot of transactions that would have made financial sense for both us and the member that we let go because we were so proud of that charge off rate." Credit unions take balancing the responsibility to serve the underserved with their fiduciary duty to their members seriously. But for Daniel, learning to trust members more is an essential step on the path to greater inclusivity. "Credit unions tend to think that they know what's better for their members; now I'm ok with that if it means giving them good advice," Daniel said, "but you can't keep your kid locked up in a cage until they're 73 years old because they may get in trouble! As soon as you stop being paternalistic and you become a partner with that member, that's a big transition. They thrive, and the credit union thrives."

Automation

The credit unions in this study ranged from fully manual underwriting operations to having upward of 75% automation. Credit union size often correlates to the degree of automation in underwriting, with smaller credit unions tending to manually assess loan applications more. Some participants expressed skepticism about the ability of automated processes to fully capture the dynamic, emotional, human elements of an applicant's story that may influence their motivation for the loan, and consequently the likelihood that they will repay. As Heather described her credit union, "It's manual inputs and manual analysis. And obviously we have the

thresholds we want to meet. But there's the story and the narrative around it is also equally important. I always tell my underwriters the numbers are the first step, but the narrative around it and the story is almost equally important, and you don't get that in a scoring model." For Heather, the small size of her credit union and its deep roots in the community means that working one-on-one with members is feasible and gives her underwriters a strong sense of how to assess the risk of a loan. Josh described his mostly manual underwriting as "more relationship lending," and similarly felt that "there's just certain things that an automated process can't do. It can't talk to a person and understand what's going on in their life that has caused certain things to happen that you're seeing on the credit."

Smaller credit unions tend not to permit automated declines, only allowing for automated approvals. "We just think that if someone is applying online and the first interaction they have with our credit union is a decline email, that is not who we want to be," Julie said. Daniel echoed this point, "No automated nos. Never ever ever let a machine tell a member that they're declined…" He paused and smiled, "Machines don't have any personality," he said, implying that an automated response may lack the finesse needed for this sensitive conversation. Many participants suggested their credit unions do not permit automated denials because they want the chance to work with members to put something together, even if it is not what the member initially requested. "The only ones we would auto-decision would be approvals," Chris clarified, "We don't' want to auto-deny somebody. We want to give every application as much thought to get it approved. We'd rather be able to say yes. And if we can't say yes, we'd rather be able to say, 'We can't do this, but we can do this.' So having ways to get as close to what the borrower requested as possible."[3]

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Despite these reservations, participants generally viewed automated underwriting as a positive advancement that could be incorporated selectively into existing processes in order to increase the volume of applications their officers are able to evaluate and free up time for manually assessing the less clear-cut cases.

Perceived benefits of automated underwriting:

- Reducing the volume of applications loan officers must assess
- Ensuring consistency in decisioning
- Removing unconscious bias
- Freeing up more time for loan officers to analyze difficult cases

"The tough ones you work, on the border," Michael explained, "That's where the underwriter comes into play." For larger credit unions, automated underwriting is seen as an essential tool for ensuring consistency across a large volume of applications (or "making sure that we're treating this 700 the same as this 700"). In fact, one credit union is partnering with a fintech in order to further automate their decisioning specifically to try to "take out that bias" of inconsistency from the process. Several participants mentioned "becoming more statistical" or "taking out the emotion" from underwriting a loan. Although one might perceive a tension between less "emotional" underwriting and an approach centered on the member's narrative, both aim at cutting through preconceived notions in order to understand a member's financial journey and the role a loan might play in it. In other words, depending on the credit union, both can be tools in becoming less paternalistic, as Daniel put it in the previous section, and more appropriately risk-taking for the benefit of the members.

Alternative Data

Similar to automation, the degree to which alternative or trended data has been adopted in underwriting tends to correlate to the size of the credit union. However, the use of nontraditional credit data was universally seen as an important means of accurately and fairly evaluating loan applicants and working toward more inclusive lending practices for thin- or no-file members. "Alternatives are especially important with our new Americans that are coming in, if they don't have a US credit history," Lisa noted, "They may not have had a banking relationship, but it doesn't mean that they're a bad credit risk and we need to be able to think about ways to do that differently." Many participants expressed that they felt a move toward custom risk scores was inevitable. In the words of one CLO, it was "just a matter of time," which was quite literally true for some who have imminent plans to integrate new products that use alternative data sources in the coming

months and quarters.[4] Mark felt that his credit union was "immature" in their scoring models because of their conventional approach to underwriting, and he suggested that they would be venturing toward "nontraditional credit characteristics" soon.

Types of alternative data mentioned by participants:

- Payday lending and other alternative financial services information
- Pay-as-you-drive (PAYD) insurance
- Rent payments
- Cell phone bills
- Utilities[5]

Heather's credit union has not yet formally incorporated alternative or trended data into their underwriting, but she echoed others in saying, "That's probably going to be something we'll need to do sooner rather than later." Yet, she continued, "I think when you're really small and you're only doing business in that one little community, it's not as important." Her colleague, Julie, similarly felt that the "relationship piece" took precedence, and she shared that she would weigh the member's history with the credit union more heavily than other sources of data. Though working at a credit union in a radically different context, Laura also expressed the significance of the member loyalty: "It's important to me to have the member relationship built into it, because we know our members and typically

As the drive toward greater automation and the further incorporation of alternative data continues, it is worth remembering that many credit unions, which tend to know their members more intimately, already informally incorporate "alternative" data through taking into account their relationship with members and more actively considering elements of the members' personal narrative.

they are gonna pay us if they can, even if they aren't paying anybody else." Unfortunately, some participants found that incorporating questions around member relationship made an application too cumbersome and lengthy. As the drive toward greater automation and the further incorporation of alternative data continues, it is worth remembering that many credit unions, which tend to know their members more intimately, already informally incorporate "alternative" data through taking into account their relationship with members and more actively considering elements of the members' personal narrative.

Barriers to Adoption

New paradigms for assessing thin- or no-file members are widely seen as desirable. What, then, are the barriers preventing credit unions from moving beyond legacy lending models?

Barriers to adoption can be summarized in three categories:

- Parsimony bias
- Doubting the return on investment (ROI)
- Other technological priorities

What is Parsimony Bias?

A desire for a streamlined, simple system. In philosophy, the "law of parsimony" (lex parsimoniae) warns against making things unnecessarily complex. Here, the term "parsimony bias" refers to the preference both for an uncomplicated, straightforward system and for one that is functional without being needlessly resource intensive.

On the back end, credit unions have often cobbled together various products, scores, and procedures to assess credit applications. Participants expressed a reluctance to introduce yet another element into this mix, either because of the technical complexity it would create, or because of the cost. Daniel's credit union is preparing to incorporate alternative data into underwriting, which he sees as a way to "digitize" how his underwriters already think; however, at the moment there is a "system limitation" preventing them from moving forward. Likewise, Lisa explained, "We rely very heavily on our vendors. As we got bigger, and there's more pressure, then we're always relying on this vendor for this and this vendor for that. I haven't found a good vendor that has really made me feel comfortable with what they're able to provide us that integrates with our existing systems as well."

The time necessary to research new tools and conceptualize how they would integrate into existing systems constitutes a resource that many are reluctant to expend, particularly when the ROI is uncertain. “It’s just the time,” Lisa admitted, “The time to launch something new, meaning the time that it would take me and my consumer manager to think about it, to write a new policy, to maybe vet a new vendor. All of those things are resources.” Although James’ credit union is using alternative data, he speculated that for smaller credit unions the price structure of new technology would be a “difficult point”. Indeed, Chris expressed, “It’s something that’s a significant investment. And it’s still somewhat new, so being able to take their quote unquote ‘ROI’ estimate and apply it is… I have concern for that because it hasn’t really been out long enough to really give you a solid ROI.”

Further, even if there are no cultural or technical points of resistance to incorporating new paradigms, credit unions may have other technological priorities that are seen as more fundamental. It is worth exploring Laura’s experience at length. Several years ago, the leadership at Laura’s credit union decided their core processor was out of date and needed to be updated. They rapidly made changes at the time, and now employees are still working to streamline and fix things more comprehensively.

> *"We have a lot of plugins to our core instead of using the core for things. So all these different… like we have four different reporting tools that we bought, each one for a different thing. Well, now we’re to the point we have to decide which one do we want? And that's the one we need to use because it's just confusing and you're uploading information to each of them… it's causing way more work than it's worth. It’s efficiencies. Our operating expenses are pretty high because all of these technologies we bought that we're not necessarily using as we should." –Laura*

In addition to getting a new core processor, the credit union had to make decisions about these somewhat redundant plug-ins, while also updating their lending system and their online banking. Without using their current technology to the best of its capabilities, Laura shared that their credit union was reluctant to add another piece: “We need to get that foundation really strong before we try to make other changes.”

Beyond Fair Lending

Credit unions are grappling with the historical and material legacies of discrimination in financial services. Some participants expressed fairly conventional stances regarding fair lending, stating their policies comply with regulations, that they regularly review guidelines for elements that

may be considered discriminatory, or that they participate in annual trainings on fair lending. "The thing is, you are a number," Michael said, "So we try to take any emotion out of credit decisioning. It's a FICO score. It's a debt ratio. It's an income. It has nothing to do with... somebody said years ago, 'it's all green.'"

However, there are early indicators that formulaic approaches to underwriting, even when they abide by the letter of the law, may not be enough to combat longstanding inequities. Rather than turn to technical fixes, many participants recognized the danger of implicit and algorithmic biases, and instead sought to fight them through person-to-person solutions. Daniel, an experienced CLO, spoke to the importance of regular underwriting meetings where a team could reflect on and challenge potential biases: "Overt biases are easier to manage. The trouble with disparate outcomes is... you can't digitize those. You can't come up with a technology solution." He continued, "Usually I let [underwriters] uncover it themselves with a series of questions. I think that's always the best learning tool for them. 'Tell me how you approach this particular loan.' And then, 'tell me how you approach this one. Well, why the difference between those two things?' It's always an 'aha moment'." Josh's team also participated in regular meetings to discuss loan decisions, in which underwriters have the opportunity to see things from a different perspective (something Heather called "checks and balances"). Speaking to the possibility of algorithmic bias, Julie shared that her credit union never auto-declines applications. "We want to put eyes on that. The systems are only as good as the data that goes in there. Junk in, junk out."[6] And, Lisa's credit union is even seeking an outside "pair of eyes," consulting with a local law professor with expertise in algorithmic bias to evaluate their credit scoring and check availability models.

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Even if their underwriting practices are fair, credit unions are also recognizing that technically "fair" decisions may not be contributing to undoing particular structural inequalities that afflict their communities. Some CLOs described comparing their lending outcomes to the demographics in their community as a way of benchmarking how well they were serving particular segments. Others noted that diversity in the workforce is essential, not only in bringing different experiences

and forms of expertise to the table when self-assessing for discriminatory outcomes, but also in building relationships of trust with different communities. Going the extra mile to build "consultative" relationships with members has also been essential for credit unions. In reflecting on his credit union's successes, Chris shared:

> *"Our underwriters and our loan sales reps have done a really good job with various members, helping them do what I would call a systematic debt consolidation. So taking little baby steps to, 'Hey, let's pay this small credit card off and then come back and we'll see what we can do. Then we'll pay this one off...' and walking them through a plan over 9 to 12 or 18 months. That they had $13 in their checking account and didn't know where their rent check was going to come from and then all of a sudden they've got $1,000 sitting in their savings account. Everything's paid current."*

For Daniel, consultative relationship-building involves working deliberately with members who have been turned down to implement a "road map" toward building their credit. This work can prove transformative, and as Lisa points out, "People become very loyal members of the credit union. They also become very profitable members of the credit union. They spread the word to others, so it's like marketing. There's so many reasons to participate in helping the people that need it the most. Even if somebody doesn't have the heart for it," she noted, "there's also a business case."

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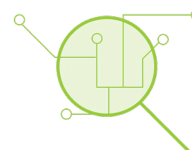
CREDIT UNION IMPLICATIONS

More than a Loan

"A loan has to be more than a loan," Daniel argued, "It has to be an experience that wows members and relates to them at the heart level." This is already a tall order, made more difficult by new entrants in the lending industry. One unexpected result of the pandemic has been an influx of what one CLO termed "non-native lending institutions" from out of state. Given that consumers are flush with cash, banks and even other credit unions are looking for ways to effectively deploy deposits, creating greater competition for local credit unions. This is perhaps only intensifying the pressure credit unions face to keep up with emergent fintech lenders.

Although some participants touted the "personal touch" they offer as an advantage over impersonal fintech lenders, others worried about the shame that sometimes accompanies a more intimate financial relationship. "Nobody talks about money. Nobody says they're having a hard time," Lisa pondered, "Everybody pretends that everything is great. And then people stop going to the bank because they don't want their banker to know that they might not be this picture-perfect person that they were. They don't want to see any of us. They want to go to an anonymous lender and take care of their problem."

Fintechs were positively cited by participants for their convenience, efficiency, and slick user interfaces. Tech giants such as Apple, for instance, were identified as particular threats to credit unions for their ubiquitous market presence. "They've already got a captive audience. How many people have an iPhone across the country?" Chris opined, "They essentially can have somebody approved with a card downloaded on their phone within 30 seconds. It is really hard to compete with that." In fact, several CLOs suggested trying to "compete with that" would be foolish. How then should credit unions think about their relationship to these competitors moving forward?



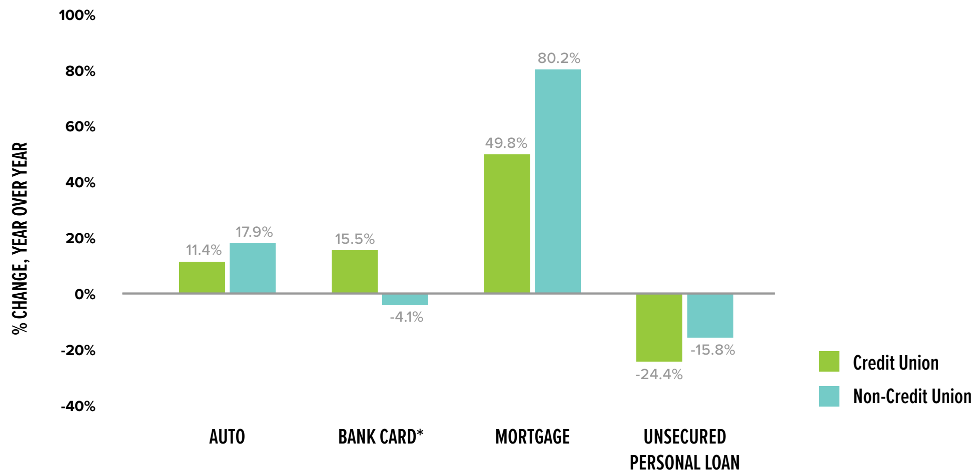
1. **Learn from the fintechs.** Several participants described studying fintechs and borrowing from particular facets of their business models to augment offerings for members. Whether slashing unnecessary fees or structuring loan payments differently, these small changes are easy to implement and can massively reframe members' experience as borrowers.[7] Though operating in a different regulatory landscape, credit unions can and should find ways to be more nimble, eliminate inconveniences, and appeal to new generations of borrowers.

2. **Shine on service.** Credit unions excel in service, and their commitment to the communities they are rooted in often translates into a greater willingness to find "creative ways of saying yes" to loan applicants. James explained, "We don't have the corporate set up where somebody eight states away makes a decision and that's it. We look for ways to put deals together to approve more people. There's a lot of back and forth." Supported by new forms of credit data and risk assessment models, credit unions can leverage this experience in order to take more calculated risks as a pathway to responsible growth.

2021 Q1 & Q2 Lending Data: Originations, Balance Growth, and Delinquency

FIGURE 1: Credit Unions Lagged in Originations Except in Bank Cards Relative to the Rest of the Industry

YOY Origination Growth by Product, Q1 2021

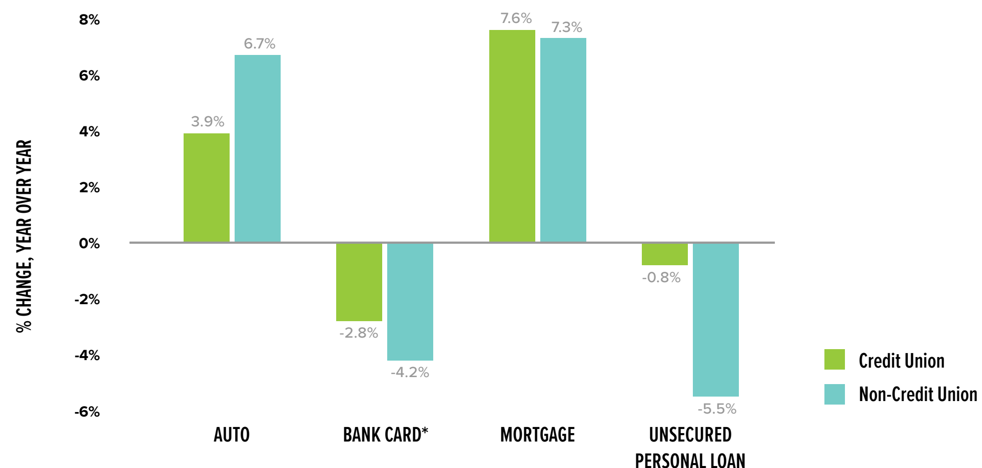


Source: TransUnion US Consumer Credit Database

**Bank card is a financial institution issued credit card*

FIGURE 2: Balance Growth on a Y-o-Y Basis was Mixed by Products When Comparing Credit Unions and Non-Credit Unions

YOY Origination Growth by Product, Q2 2021

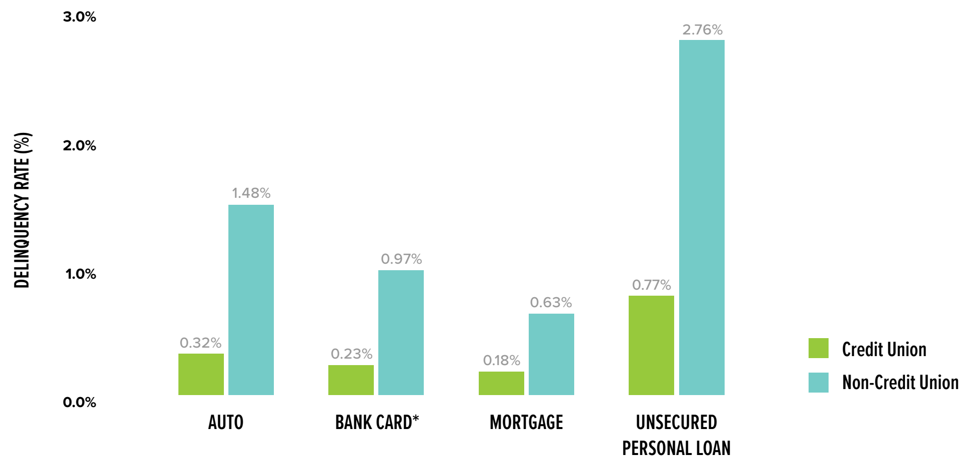


Source: TransUnion US Consumer Credit Database

**Bank card is a financial institution issued credit card*

FIGURE 3: Delinquency Levels are Significantly Lower for Credit Unions, Signaling Some Opportunity for Growth

*Serious** Consumer-Level Delinquency, Q2 2021*



Source: TransUnion US Consumer Credit Database

**Bank card is a financial institution issued credit card*

***Serious delinquency considered as 90+DPD for card, mortgage, HELOAN and HELOC, 60+DPD for all other products.*

SUMMARY OF FINDINGS

Inclusive Lending

Credit unions want to be more inclusive by taking more calculated risks. There is a growing understanding in the industry that expanded lending can be a pathway to responsible growth.

> *"The way we look at it is the higher that [loan to share ratio] is, the more we're helping our members." –Laura (SVP)*

> *"We feel if we have really low delinquency, we're probably not helping enough people. We're not taking enough risks for the individuals who actually need our help." –Josh (EVP)*

Automation

Credit union size often correlates to the degree of automation in underwriting. Smaller credit unions tend not to permit automatic declines (only automatic approvals). While it would seemingly be better resourced, larger institutions with the capacity to revisit auto-declined applications, more often this is done by smaller credit unions with a commitment to working with their members to get to "yes."

"The only ones we would auto-decision would be approvals. We don't want to auto-deny somebody. We want to give every application as much thought to get it approved. We'd rather be able to say yes. And if we can't say yes, we'd rather be able to say, "We can't do this, but we can do this." So having ways to get as close to what the borrower requested as possible." –Chris (COO)

Alternative Data

Similar to automation, the degree to which alternative or trended data has been adopted in underwriting tends to correlate to the size of the credit union. However, smaller credit unions, which tend to know their members more intimately, informally incorporate "alternative" data through taking into account their relationship with members and more actively considering elements of the members' personal narrative.

"That's probably going to be something we'll need to do sooner rather than later. But I think when you're really small and you're only doing business in that one little community it's not as important." –Heather (VP)

Barriers to Adoption

New paradigms for assessing thin or no-file members are widely seen as desirable. Barrier to adoption include: "parsimony bias" (i.e., a desire for a streamlined, simple system), doubting the ROI, and other technological priorities.

"I haven't found a good vendor that has really made me feel comfortable with what they're able to provide to us that integrates with our existing systems as well." –Lisa (SVP, CLO)

"We need to really get the foundation really well before we try to make changes like that." –Laura (SVP)

Beyond Fair Lending

Credit unions are grappling with the historical and material legacies of discrimination in financial services. There are early indicators that formulaic approaches to underwriting, even when they abide by the letter of the law, may not be enough to combat longstanding inequities.

"Overt biases are easier to manage. The trouble with disparate outcomes is... you can't digitize those. You can't come up with a technology solution. Usually I let [underwriters] uncover it

themselves with a series of questions. I think that's always the best learning tool for them. 'Tell me how you approach this particular loan.' And then, 'tell me how you approach this one. Well, why the difference between those two things?' It's always an 'aha moment'." *–Daniel (CLO)*

"We are working with a consultant, a law professor, involved in some bias in AI research projects. We engaged with him to help us with looking for bias in our credit scoring model and then looking for bias in our check availability model." –Lisa (SVP, CLO)

THANK YOU

Filene thanks TransUnion for making this research possible.

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END NOTES

[1] Participants live and work among nine different states in the West, Southwest, Northwest, Mid-West, Southeast, Mid-Atlantic, and Northeast regions.

[2] This so-called "loss of identity" may be more pervasive than some CLOs realize. According to data from TransUnion's Q1 2021 Credit Union Market Perspectives report, only 9% of credit union originations were in subprime, compared to 31% for non-traditional lenders.

[3] While in keeping with credit unions' orientation of service toward the community, this approach also accords with broader trends toward more individualized, less "one-size-fits-all" approaches in credit scoring, as unpacked in Filene's ***"The New Wave of Credit Scoring"*** report.

[4] Data in TransUnion's Q4 2020 Credit Union Market Perspectives report shows community banks and credit unions lagging behind fintechs and large banks in the adoption of trended data; however, preliminary data suggests that adoption has rapidly increased in 2021, specifically as a result of small and mid-size credit unions.

[5] Participants only cited non-traditional financial data as possible sources of alternative credit data; social data and nonfinancial transactional data (such as mobile phone activity) was only mentioned in passing by one participant in speculatively describing the use of AI.

[6] For an in-depth exploration of algorithmic bias in alternative credit scoring, see Filene's recently published study: ***"Fairness and Accountability for Algorithms in Financial Services."***

[7] In his ***"Beyond Personal Lending"*** report, Bruce Cahan similarly suggests that credit unions can borrow from fintech advances in pricing and managing loan portfolios.

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