PARTNERSHIPS & COLLABORATION

Fear of 'Fintechs'?

Engage with Market Disruptors to Better Serve Members and Protect Your Bottom Line

By Arch Mortgage Insurance Company

The digital revolution continues to disrupt industries that have grown complacent. In 2017, traditional mortgage lending is experiencing dynamic transformation as "fintechs" enter, innovate and occupy a growing share of the marketplace.

What is a fintech? Briefly, it's a company that uses innovative technology to compete aggressively in the financial services sector.

In the mortgage lending arena, fintechs aim to displace long-standing loan originators and the processes they have established. By ruthlessly streamlining processes, eliminating intermediaries and leveraging new technology and big data to the utmost, these firms are able to drastically reduce costs and accelerate efficiencies.

In many ways they appear to be the perfect mortgage lender for the millennial generation, whose lifestyle preferences and incomes align naturally with the fintech strategy.

How can credit unions meet the fintech challenge? The typical credit union lending model is built on a personal approach that has its roots in the 19th century. Can it still work in the 21st?

RISE OF THE FINTECHS

Fintech lenders emerged as the housing market gradually recovered from the Great Recession. They rapidly made their presence felt, introducing an online-only, consumer-direct approach that jolted traditional lenders and credit unions out of complacency.

The launch of Quicken's "Rocket Mortgage" in 2015 was a media sensation. It promised an "8-minute mortgage" at real-time rates by allowing borrowers to upload their own documents, on their own devices, for an exclusively online application and underwriting process.

A stunning symbol of fintech's effective disruption of the industry, it made the case that the old ways of doing business were now outmoded. The Rocket Mortgage addressed a new reality: Today's home buyers are looking for fast turnaround, low costs and an end to the proliferating paperwork and obstructive gatekeepers that stand between them and home ownership.

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Banks had already begun sounding the alarm on the fintech revolution and its implications for established lenders, but credit unions perceived a particularly acute threat.

Ironically, credit unions themselves started out as a disruptor of traditional banking practices back in the 19th century, winning members and share on the basis of their not-for-profit philosophy and community-oriented approach to lending.

Fintechs, however, seem to exemplify the complete overturn of this model, striving instead to remove human agents from their business model as much as possible and maximize profits.

Initially, the industry's incumbents trusted to mortgage lending's high barriers to entry and the complex regulatory regime backed by state and federal authorities to repel the fintech threat. However, as taxi drivers had already learned with the Uber invasion, fintechs proved adept at maneuvering around the thicket of regulation and winning the approval of governmental bodies that prioritized lower costs for consumers.

Free of the expenses associated with brick-and-mortar operations, including many compliance costs, and able to use cloud-based platforms to conduct business, fintechs enjoy enviable advantages over their competitors.

There has even been talk of fintechs being granted charters by the Office of the Comptroller of the Currency, similar to the charters that credit unions rely on to define the scope of their membership.

Credit unions traditionally pride themselves on the loyalty of their membership, regarding it as their most valuable defense against competition. However, the digital revolution has altered expectations.

Trained by Amazon, Google and their mobile phones, Americans now prefer—and demand—convenience above all, defined as easy, seamless online transactions, competitive prices, a wide array of choices tailored to their circumstances and round-the-clock accessibility. The fintech model is planned and scaled accordingly, an agile predator that can easily undercut its rivals on pricing as well as timing.

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Many credit unions have recognized that in fending off the fintech threat, it's not enough to merely hunker down and try to protect their existing business. The pressure on their market share and bottom line can only be delayed, not defeated, especially as millennials move into the marketplace.

The challenge is to adapt to this new industry breed and develop a mutually beneficial accommodation that respects the strengths of both models and the needs of their customers.

SWIMMING WITH THE FINTECHS

Credit unions can approach a partnership with some key advantages. In first quarter 2017, first-mortgage originations by Credit Unions were 8.6% of the market–the highest market share ever for their industry, according to the Credit Union Times (Jim DuPlessis, "Credit Unions on Fire in Hot Economy," May 25, 2017).

That market share was built on solid credit union strengths: superior customer service, dedicated attention to the individual and community focus. Currently, these attributes may appear old-fashioned against the fintechs' digital glitz and promise of instant gratification, but they are essential in establishing and maintaining long-term, profitable member relationships.

Fintech offerings like Rocket Mortgage are easy to use and low-cost because they're tailored to a borrower with minimal issues: good credit, conventional loan, adequate down payment. However, there are quite a few borrowers out there in more challenging circumstances. They're good risks, but the "one-size-fits-all" approach won't put them in a house because they're self-employed, or have high student debt, or limited documentation or some other issue.

This is where credit unions shine. They have lengthy experience working with members who fall outside the conventional loan box. Because most credit unions hold loans in portfolio, they have the flexibility and freedom to develop specialty loan programs and guideline exceptions that accommodate a wider range of home buyer.

Credit unions can also do this because they know their members. Their commitment to community and personalized business relationships gives them a more three-dimensional perspective on mortgage applicants.

This is especially valuable when homeowners get into trouble.

What will the Rocket Mortgage borrower do when they lose their job? They might not have wanted to deal with a human loan officer when they obtained their mortgage, but it's likely that an impending default will spur a keen desire to speak with an actual person.

By contrast, credit unions can offer experienced, sympathetic staff in their loss mitigation departments who can talk the member through the situation and come up with possible workouts.

According to the National Center for Policy Analysis (cited in Alix Patterson's "Community Reinvestment in the Coming Year" in Callahan's Credit Union Strategy & Performance, 4Q2016), 10 million Americans lost their homes to foreclosure during the Great Recession and "more so than banks, credit unions modified mortgage terms for troubled homeowners."

With the economy stable, housing robust and business confidence buoyant , fintechs are enjoying a honeymoon period with the American home buyer. However, the very attributes that make them the go-to originators right now may become serious deficiencies in another phase of the housing cycle.

Both fintechs and credit unions should be clear-eyed in assessing the realities of the housing industry and work toward establishing a relationship of mutual accommodation—or something even closer.

FORGING A FINTECH ALLIANCES

Partnership with a fintech can be a win-win. Many credit unions have already done so with regard to payment systems, for example.

In originating mortgages, both parties can bring their separate strengths to the table and develop a fruitful collaboration based on respect and a willingness to learn. By leveraging the partner's advantages, each can revitalize and expand its own business model:

Credit Union

- Long-term relationships with members
- Reputation as trusted financial adviser
- Valuable data on membership
- Experience with regulations and security

Fintech

- Expertise with technology and innovation
- Speed and efficiency
- Ability to leverage big data
- Abundant capitalization

By allying with fintechs, either singly or as a group, credit unions can market more efficiently and effectively to the huge millennial generation, who are expected to constitute 80% of the workforce by the end of 2017, according to Arch MI research.

Both fintechs and credit unions should be clear-eyed in assessing the realities of the housing industry and work toward establishing a relationship of mutual accommodation—or something even closer.

Fintechs lead the way with their focus on frictionless convenience, speed and mobility, but credit unions bring a commitment to community, social responsibility and authenticity that millennials value—as well as a greater ability to recognize and support the members of this generation as individuals.

A fintech alliance can help with:

Communication to members. Fintech expertise with online and mobile platforms can be a boon to credit unions seeking to engage new millennial members, who are tethered to their devices and prefer to receive text messages or emails.

Enhanced business opportunities. Fintech algorithms and modeling based on big data can be adapted for credit union use with their member data, allowing them to better identify needs, develop a better picture of their membership and recognize corresponding opportunities.

Transparency and efficiency. Credit unions allied to fintechs can leverage their direct-lending approach to expedite their own in-house processes and reduce costs, passing on further savings to members.

Product development. Fintech access to capital opens up new possibilities for credit unions constrained by their charters. By emulating the fintech approach, they can develop loan products that meet a clear market need even if initially unprofitable, building in the "stickiness" that grows loyalty over time.

Technology innovation. Fintech expertise can help Credit Unions upgrade their technology infrastructure, including improvements to online security and the overall user experience.

Overall, credit unions should be open to change. The digital revolution continues and fintechs will not be the end of it.

By recognizing that fintechs offer real value and learning from their successes, credit unions can retool their movement to meet the needs of 21st-century members and prepare for the next phase of technological advance.

Arch Mortgage Insurance Company provides mortgage credit default protection using proven systems supported by experienced professionals dedicated to making customers the top priority and providing outstanding service with a personal touch. Arch MI believes in the value of mortgage lending, and of providing credit union customers with products and services to help their members achieve home ownership For more information, visit micu.archcapgroup.com.