Upstart

2023 Credit Union
Auto Lending Outlook

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Introduction

Welcome to Upstart's 2023 Credit Union Auto Lending Outlook. Given the tumultuous state of the economy along with credit unions' growing market share in the auto lending space, Upstart conducted a survey to assess credit union leaders' perspectives on their pain points and growth strategy for auto lending. The following report features 55 unique responses from credit union executives.

The report will provide some insights into whether credit unions plan to continue their growth trajectory into 2023 and the areas we can anticipate credit unions making the biggest process improvements when it comes to indirect automotive lending and automotive refinance.

Jeff Keltner
SVP of Business Development

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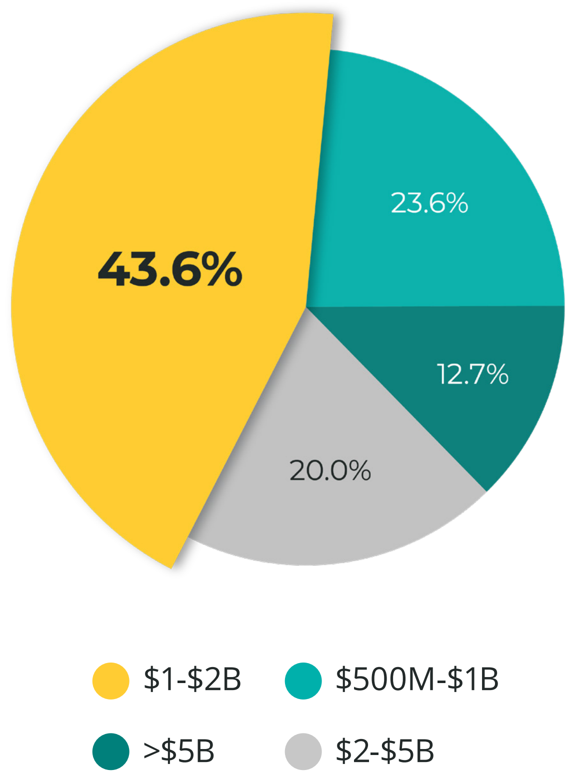
Methodology

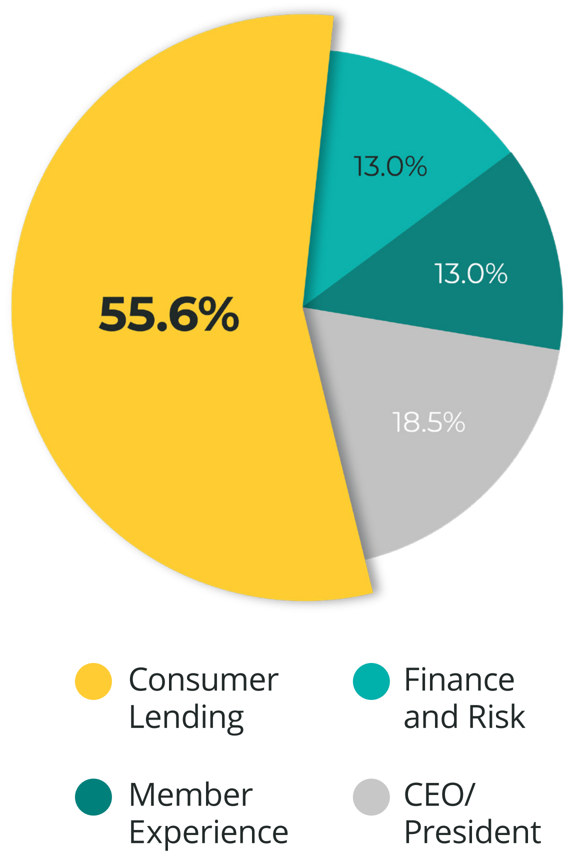
The survey was conducted between November 3 through November 18th, 2022 and assessed credit union leaders' perspectives on auto lending – including direct, indirect and refinance. The questions focused on current pain points, the difficulty of existing processes in the various types of auto lending and areas of strategic focus in 2023. Credit union leaders responded to between eight and fifteen questions, depending on their auto lending product offerings, to assess the difficulty of certain aspects of the auto lending process today, as well as credit unions' perspectives on what process improvements would make the largest impact to their business.

The credit unions that participated in the survey ranged in size from $500 million to over $10 billion in assets. Over 75 percent of respondents are individuals from credit unions that manage over $1B in assets. Additionally, over 90 percent are C-suite executives or VP-level individuals. This report provides an analysis of the survey results across all participating organizations and by these segments.

Asset Size Distribution



Role Distribution



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The State of Auto Lending

The fractious state of 2022, including Russia's invasion of Ukraine, high inflation, the rapidly rising Fed Funds rate and ongoing supply chain issues have been felt across the lending industry. While these periods of risk and uncertainty typically cause more conservative lenders like banks to pull back on lending, credit unions have continued to fulfill their mission to serve members and have gained market share as a result.

Despite a challenging 2022 economic environment, credit unions have had a record-breaking year of growth by offering affordable rates to their members. As of November 2022, over 6 million consumers became credit union members, and credit union loan growth reached its highest level ever in Q3 2022.[1]

In the auto industry in particular, higher car prices coupled with rising interest rates for new and used vehicle financing have posed a huge affordability barrier for consumers. The average annual percentage rate (APR) for a financed new vehicle reached 6.3 percent in October 2022 – the highest new vehicle APR since April 2019. Additionally, the average APR for a used vehicle purchase climbed to 9.6 percent in October 2022 – the highest since February 2010.[2]

By offering these rates, credit unions had a **record-breaking year of auto loan growth** and surpassed banks in percentage of loans and leases in auto lending for the first time ever.

However, credit unions have continued to support consumers by offering affordable rates, and according to the Credit Union National Association (CUNA), the average rates for new and used car loans were 3.9 and 4.6 percent in September 2022, respectively.[3]

In Q3 2022, Experian reported that credit unions had the highest share of auto financing, producing 28.4 percent of loans and leases while banks' share fell to 27.3 percent.[4] Melina Zebritski, senior director of automotive financial solutions at Experian, stated that, "The other lender types actually have had a much more significant rate increase and the credit unions haven't," Zabritski said. "The credit union rates are significantly lower than the other lenders. Even on the used vehicle side, we're talking over 200 basis points lower."[5]

However, this tremendous growth has also been met with liquidity challenges for credit unions. Many are loaned out with more low yield, longer-term assets on the balance sheet than they might want during a period in which interest rates have risen rapidly. At the same time, consumers are spending more on products and services during a time of high inflation, and are increasingly tapping into their personal savings. As a result, many credit unions are looking to diversify into higher yield, more profitable assets.

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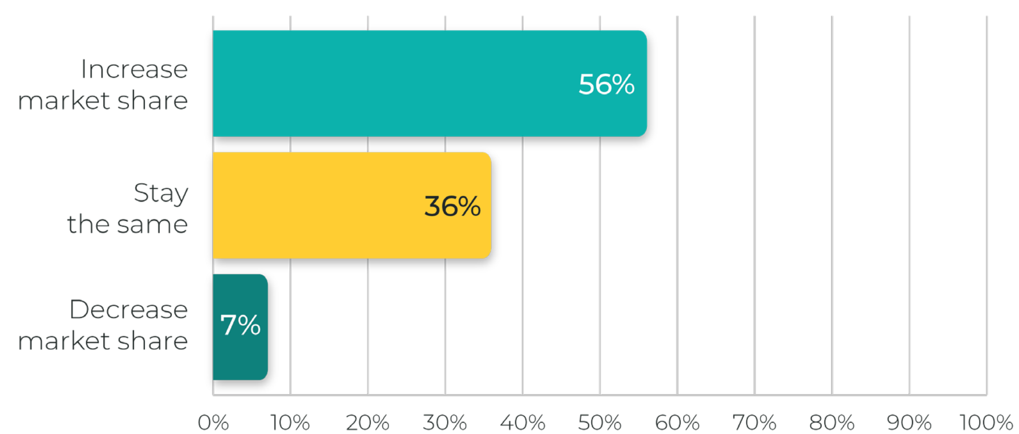
The Results

Credit Union Auto Lending Growth Plans

Off of the heels of a record-breaking year of auto growth for credit unions, 56 percent of respondents say they plan to increase their auto lending market share in 2023 while 36 percent plan to stay the same (Figure 1). Only 7 percent of respondents plan to decrease auto lending in 2023.

Figure 1

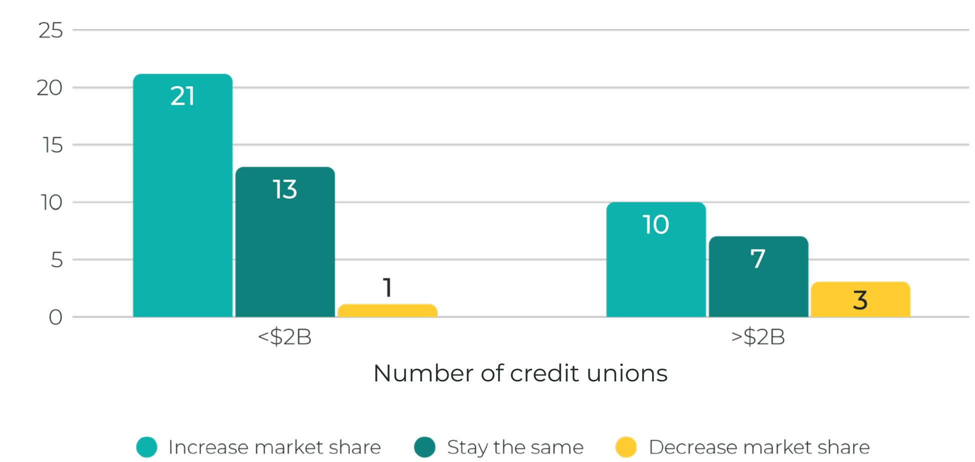
What is your credit union's growth plan for auto lending in the next 6-12 months?



Comparing credit unions with greater than $2B in assets against those with less than $2B in assets, smaller credit unions are more bullish on auto lending growth in 2023, with 60 percent of respondents planning to increase their auto lending market share in 2023 compared to 50 percent of respondents at credit unions greater than $2B (Figure 2). According to the National Credit Union Administration, larger credit unions have continued to lend in the current macro environment, averaging a loan-to-share ratio of ~80 percent. Conversely, smaller credit unions seem to have more liquidity with loan-to-share hovering between 50-72 percent.[6] This could explain why smaller credit unions are seeking to deploy this excess liquidity and continue to grow auto lending in 2023 while larger credit unions are being more conservative.

Figure 2

Auto lending growth plan by asset size



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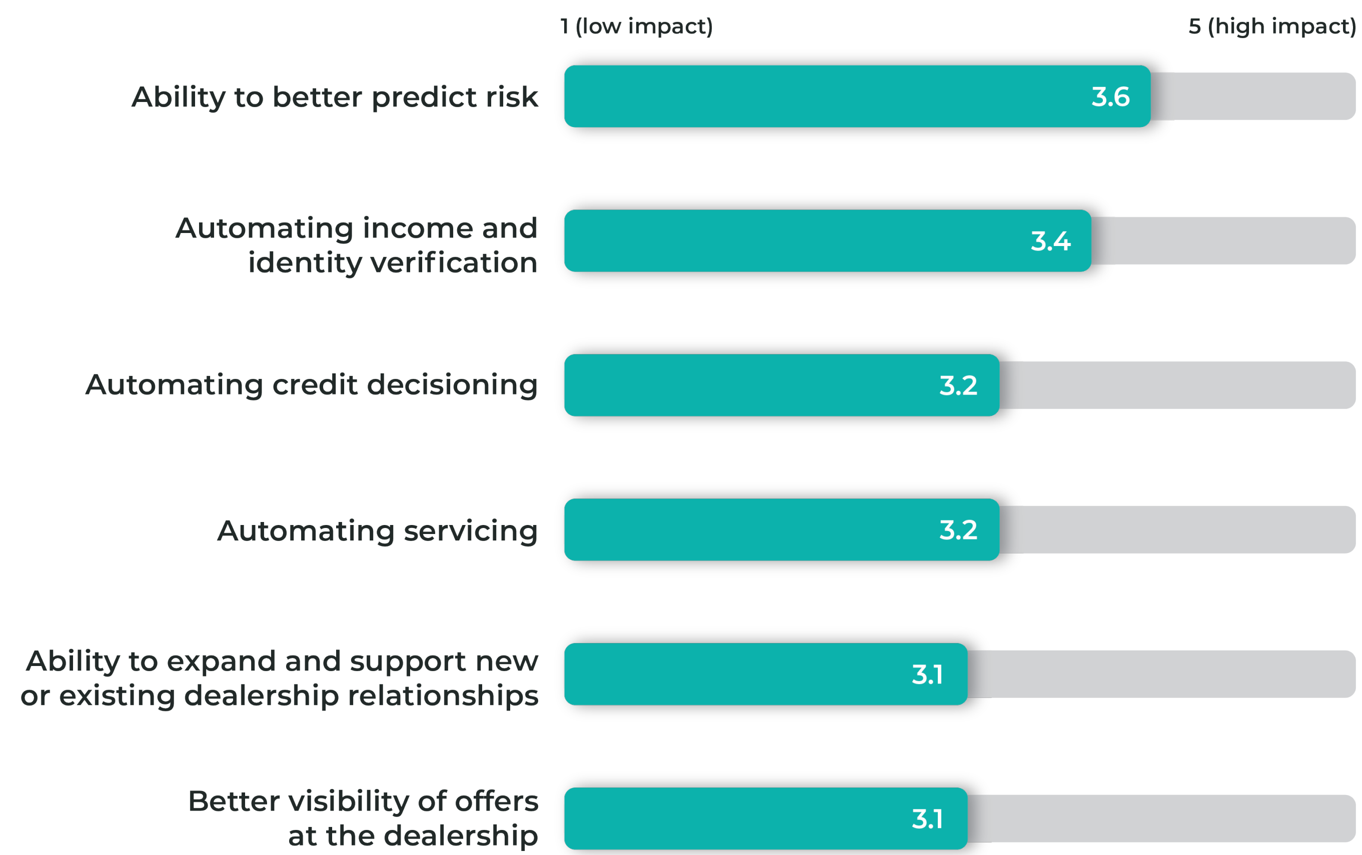
Auto Lending Process Improvements

In addition to their growth plans, credit union leaders also answered the question, “From a scale of 1-5, rank which process improvements would most improve your auto lending business.” Out of six process improvements, the ability to better predict risk averaged the highest or ‘most impactful’ to improving the auto lending business, receiving a 3.6 out of 5 average rating (Figure 3). With their mission to best serve their communities, many credit unions lend beyond the prime segment of borrowers that large banks traditionally serve. In fact, 79 percent of respondents share that their credit union lends to members with a credit score as low as 630 (Figure 4). However, with a growing concern of rising delinquencies and defaults, credit unions naturally want to more accurately assess default risk and the likelihood of repayment across the entire credit spectrum they serve. This growing concern of rising defaults may also explain why automating income and identity ranks as the next most impactful improvement, receiving an average 3.4 out of 5 rating.

Additionally, the third most impactful process improvement is automating credit decisioning, as 53 percent of respondents said that automating credit decisioning would be ‘highly impactful’ to their auto lending business (rated 5 on a 5 point scale).

Figure 3

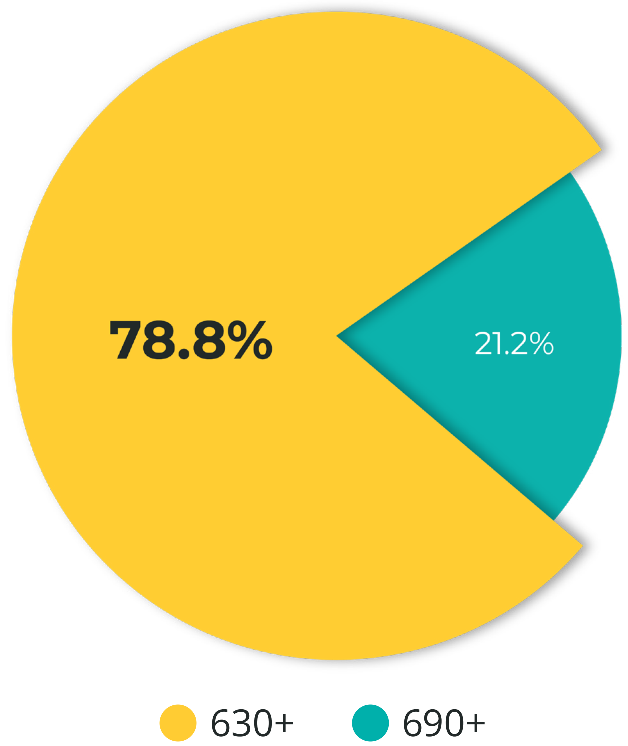
From a scale of 1-5, rank which process improvements would most improve your auto lending business.



Finally, the fourth most impactful process improvement is automating servicing, as 49 percent of respondents answer that automating servicing operations would be 'highly impactful' to their business.

Figure 4

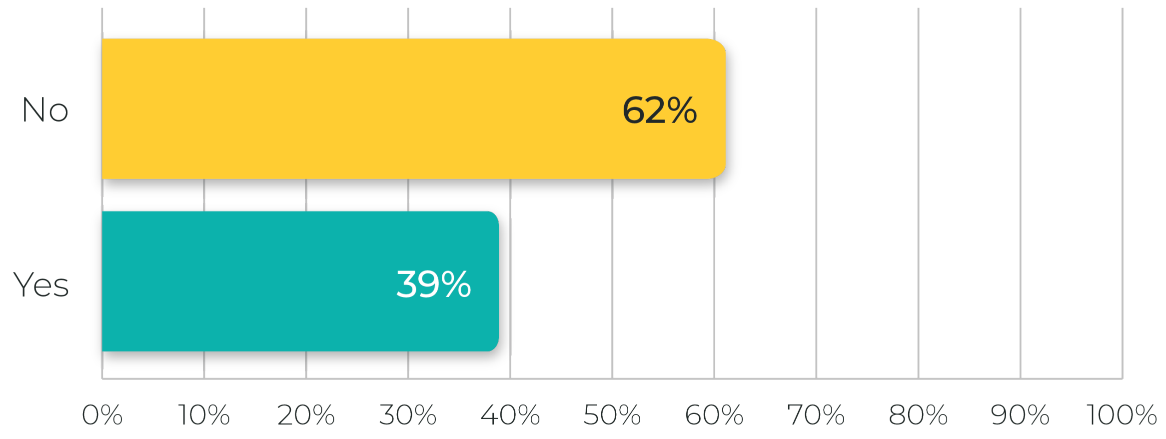
What range of credit scores do you lend in today for auto lending?



62 percent of survey respondents are not currently partnered with a fintech for auto lending (Figure 5). As credit unions look to improve borrower risk assessment and automate processes such as income and identity verification, credit decisioning and servicing, fintech partnerships serve as a potential avenue for improvement – especially for those who are both resource and budget constrained.

Figure 5

Do you partner with fintechs for any of your auto lending products?



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Auto Lending Outlook

With regards to specific types of auto loans, results show that direct, indirect and automotive refinance are all core to credit unions' long-term strategy. Direct auto lending received an average 7.7/10 rating, ranked as the top priority for credit union's long-term strategy. This is followed by auto refinance, which ranks 7.3/10 and lastly indirect lending, which receives a 6.9/10. The results show that while credit unions have gained significant auto lending market share in 2022 by offering affordable rates, these rates have also hurt profitability with low returns. With limited liquidity and the need for more profitable loans, credit unions are looking to pivot their focus from indirect to direct lending.

In an open-ended response, one chief lending officer at a $2B credit union explains, "We have liquidity issues, like many, and are trying to slow down indirect [auto lending]. We pay far too much for those loans in dealer reserve, making it a challenge to sell loans in a participation for a gain." Another member experience lead says, "We are moving toward direct lending so we can offer better incentives for the member. Indirect means we have to make more off the member so the dealer can get its cut. If we take out the cut to the dealer, we can pass that along to the member." By shifting from traditional indirect lending to direct lending and auto refinance, credit unions will be able to continue to provide affordable rates to their members while retaining profitability.

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Similarly, there is moderate confidence in the market outlook for auto lending in 2023 given market uncertainty and the rising rate environment. When asked about automotive refinance, credit unions feel least optimistic about growth in this asset when compared to direct and indirect lending. When asked how optimistic they felt about auto refinance, credit union leaders average 5.8/10 compared with 6.8/10 for direct lending and 6.1/10 for indirect lending.

In this rising rate environment, it is not surprising that credit unions are feeling less optimistic about auto refinance and are perhaps waiting for rates to stabilize. However, given that members have overpaid for auto loans from other lenders in the past year, there may be a strong opportunity in the future for credit unions to refinance these loans for a lower monthly payment for their members. If interest rates stabilize in the near term, this will provide a compelling opportunity for credit unions to expand into the untapped auto refinance opportunity.

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Automotive Refinance Process Improvements

Credit union leaders say that improving the digital experience is the most difficult aspect of the auto refinance process today (figure 6), with 73 percent of credit union leaders ranking this as a 4 or greater on a difficulty scale of 1-5, 5 being the 'most difficult.' Additionally, over 50 percent of credit union leaders rank 'automating decisioning' as a 4 or greater on a difficulty scale of 1-5. Given the intricacies involved from application through quoting, verification, loan closing and lien perfection, it is not surprising that digitization of the entire refinance process has proven difficult.

73% **of credit union leaders rank 'improving the digital experience' as a 4 or greater on a difficulty scale of 1-5**

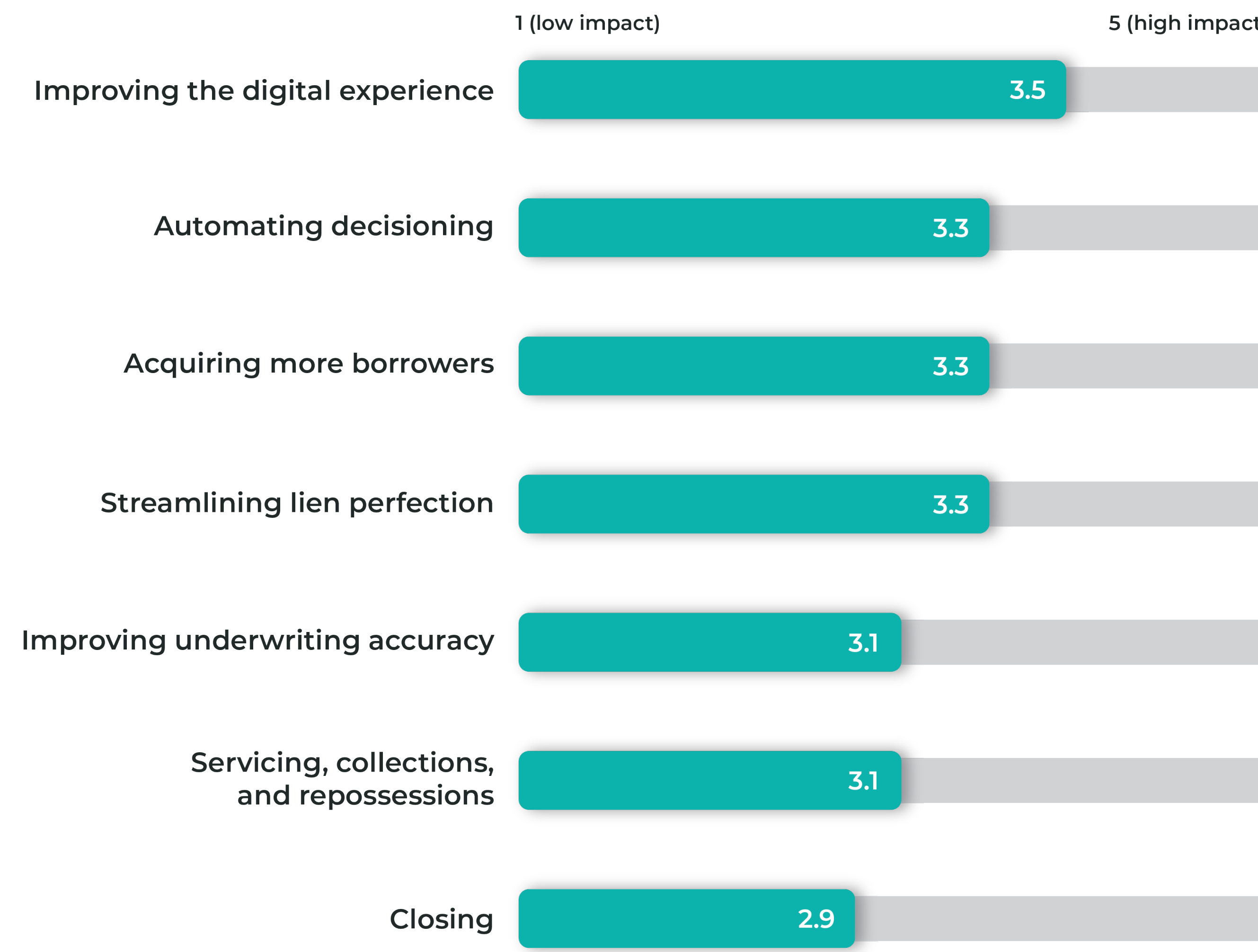
5 being the most difficult

50% **of credit union leaders rank 'automating decisioning' as a 4 or greater on a difficulty scale of 1-5**

5 being the most difficult

Figure 6

When it comes to auto refinance, rank the difficulty of the following processes on a scale of 1-5



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Indirect Lending Process Improvements

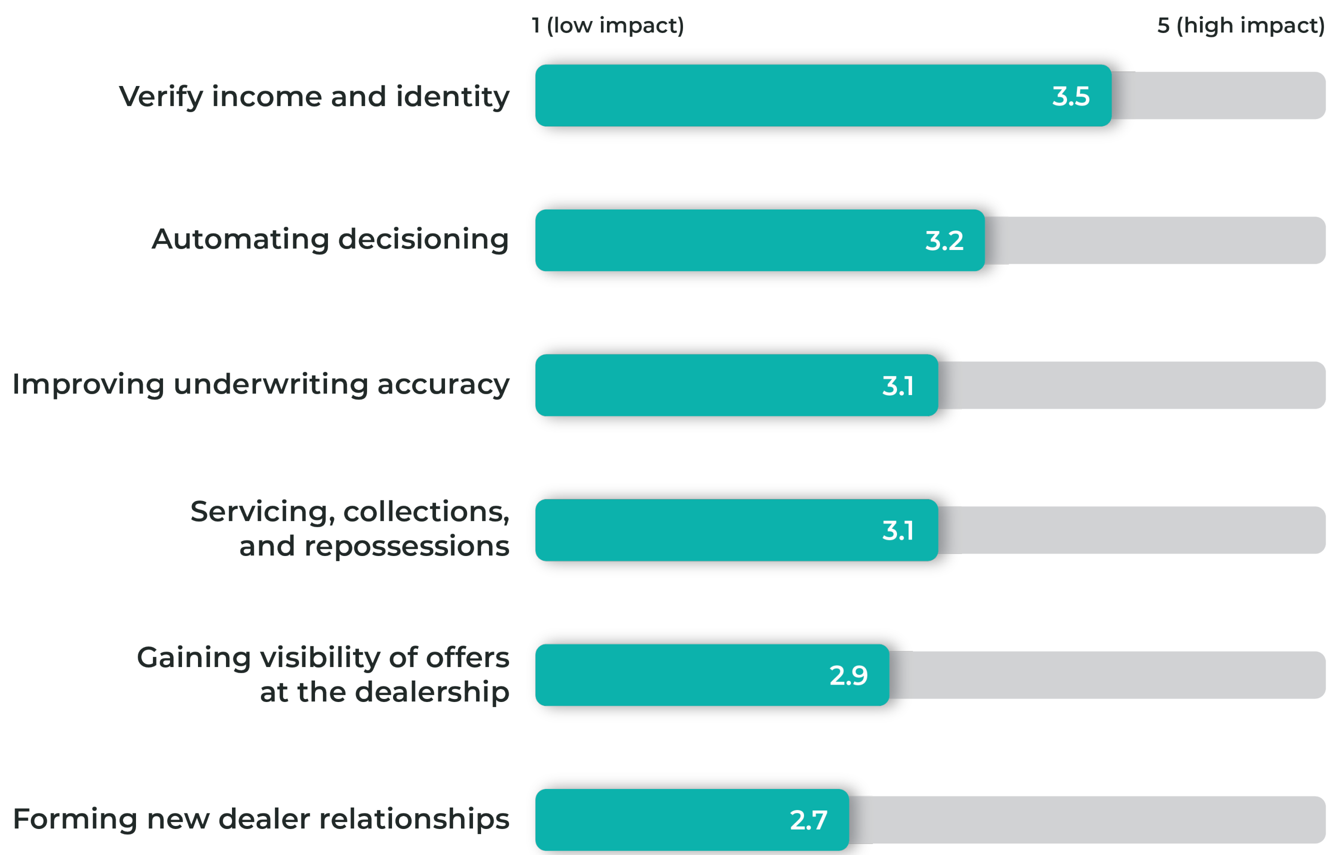
For indirect auto lending, verifying income and identity was ranked as the most difficult aspect of the indirect auto lending experience (figure 9). Given the necessary third-party integrations necessary to perform verification, 48 percent of respondents rank this as a 4 or greater on a difficulty scale of 1-5, 5 being the 'most difficult'. Understanding who the buyer is and validating all of the necessary information to ensure the dealerships are in compliance is crucial. Additionally, 51 percent of credit union leaders rated automated decisioning as a 4 or greater on a difficulty scale of 1-5, and 44 percent rank accurate underwriting a 4 or greater. As credit unions look to remain competitive and cost-effective, fintech partnerships are an avenue to address these top three challenges and could be a key focus area in 2023.

51% of credit union leaders rate 'automated decisioning' as a 4 or greater on a difficulty scale of 1-5

5 being the most difficult

Figure 7

From a scale of 1-5, rank the difficulty and resources required for the following processes in indirect auto lending.



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Conclusion

As evidenced by their growth plans for auto, many credit unions, especially those under $2B in assets, are bullish on growth in 2023. Concern for rising delinquencies and defaults have many prioritizing accurate risk assessment as well as automated income and identity and credit decisioning.

For credit unions that continue to invest in auto lending growth, there will be greater focus on direct lending and automotive refinance in 2023 especially once rates stabilize. In fact, Transunion projects that the auto industry will see 4.6 percent growth in 2023.[7]

Given the challenges within both auto refinance and indirect auto lending, fintech partnerships pose the biggest avenue for opportunity. At the time of the survey, 62 percent of respondents were not currently partnered with a fintech for auto lending.

Economic downturn can prove to be a beneficial time to partner with fintechs so credit unions are prepared to lend when times improve. The process of evaluating the right partner, performing due diligence and aligning the necessary internal teams can take months, followed by implementation. Fintech partners can deliver a turnkey solution for credit unions to improve the car buying and auto financing and refinancing experience while growing members. Especially as banks continue to pull back on consumer lending, credit unions have a unique opportunity to compete and gain market share while adding new members in their time of need.

By leading with lending and serving consumers in their time of need, members are likely to be more loyal and receptive to future offers from the credit union. At the same time, these fintech partners enable credit unions to get started with minimal resources while maintaining full control over the program's return, volume and losses.

If credit unions wish to grow auto lending in 2023, they can use this economic cycle as a strong opportunity to vet and implement new fintech partnerships. This will enable them to increase lending once rates stabilize, serve members' needs and drive future growth.

Upstart partners with credit unions to increase access to affordable credit through our AI lending platform. Upstart-powered credit unions can offer higher approval rates and experience lower loss rates, while simultaneously delivering the exceptional digital-first lending experience members demand in both the auto refinance and indirect lending experience. To learn more about how Upstart can help your credit union, check out upstart.com/creditunions.

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