A Brave New World For Credit Unions

To not only survive, but thrive, First Citizens' Federal Credit Union has begun outsourcing its own expertise to other financial institutions across New England

In the last decade, forces buffeting credit unions are convincing many to consider collaborating and partnering with each other. More recently, some institutions are deciding to outsource some of their most expensive and complex services – from compliance and risk management to loan servicing and technology.

"Outsourcing lets credit unions focus on what they do best – serving their members," emphasizes a white paper by Symitar, which provides technology services to the industry.

Today's economic forces are placing unprecedented pressures on the bottom line. In the wake of the Great Recession, government regulations are growing in number, complexity and cost, compliance requirements are getting much more expensive and risky; profit margins are compressed by perpetually low interest rates; technology costs are expanding; and loan defaults are rising.

At the same time, previous income streams such as overdraft fees and interchange income have been constrained by government regulations.

Meanwhile, competition is coming from every angle.

"Financial institutions had a near monopoly on consumer and business lending for centuries. That is no longer the case," explains Guy Messick, General Counsel to the National Association of Credit Union Service Organizations. "Companies like Lending Tree, Prosper, Lending Club and many others make loans over the Internet much quicker and more easily than those made in the traditional financial institution model."

Payment systems like PayPal, Apple Pay and Chase QuickPay, as well as cell phone carriers and other disrupters "have positioned themselves to reduce the industry's share of the payment market each year," notes Messick.

The once steady and lucrative auto loan market has been upended. Two decades ago, credit unions could depend on loan rates ranging from 10 percent to 16 percent. Today, those rates are far less, while car dealers themselves are making many of those loans directly at the point of sale.

Two years ago, First Citizens' Federal Credit Union, whose roots go back 80 years, made a generational, strategic decision to treat all these challenges as new opportunities.

With total assets trending toward $700 million - growing about 10 percent a year – and net loans approaching $600 million while at a 9 percent annual rate – its board decided to establish a wholly-owned subsidiary, Coastal Outsourced Solutions.

It tasked Chris Howard, Senior Vice President and Chief Retail Operations Officer at First Citizens' to serve as Managing Director at Coastal to build out the subsidiary and guide its strategic development. When Howard was hired a couple of years prior, he was tasked with building out the Loan Servicing area in a best in class fashion. First Citizens' used the same line of thinking in other business units at well. Additionally Howard quickly recruited Jack Sullivan as Director of Sales and Business Development for Coastal.

At the same time, First Citizens' identified and began leveraging key personnel among its 180-person staff to provide the same expertise for new Coastal clients that they have mastered for their own credit union customers.

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"We've perfected processes with back-office and support functions, and now we can leverage these – along with technology and our people – to improve the way our Coastal clients do business," says Howard. "We can tell them that what impacts you, impacts us. That's not a slogan, that's a reality."

Coastal developed a carefully crafted series of concepts to share with prospective clients:

- We add tangible value to our solutions – improving your processes, performance metrics, customer experience and cost savings
- We form long-term partnerships and build sustainable solutions.
- We empower you to do more of what you do best.
- We take the time to understand your unique business environment and then tailor our approach accordingly.
- We don't settle for "out of the box" or "off the shelf" solutions.

Howard and his team studiously evaluated First Citizens' core competencies that had been built out and invested in over the past several years that could be leveraged by other primarily smaller credit unions as Coastal clients. The list is impressive:

- Loan Servicing
- Indirect Auto Lending
- Human Resources
- Facilities Management
- Marketing
- Retail Sales & Operations
- Default Loan Servicing
- Compliance and Risk Management
- Commercial Lending
- Deposit Operations Improvement, Consulting & Analysis
- Residential Lending
- Technology

"First Citizens' had developed strong core competencies in these areas. As we looked across the horizon, we asked ourselves, 'Why not leverage what we have built to help other credit unions. It is a win-win proposition," said Howard, a veteran in mortgage lending with a stint at Fannie Mae.

Results have been very positive, according to Sullivan.

One client, with assets of $170 million, outsourced delinquency management and default loan services to Coastal. Within one year, it saw total delinquencies drop from 3.75 percent of all loans to 2.21 percent and net charge offs decrease by 23 basis points. The client's delinquent loan to assets ratio dropped from 2.49 to 1.3.

Yet another client has developed a $20,000 monthly fee income stream for its 37,000 loan portfolio by leveraging Coastal's electronic payments solution.

In both these cases, clients also have reported improved customer experience, reported Sullivan. They also noted reduced compliance risks; improved cash flow; and cost savings in employee salaries, legal fees and facilities, said Sullivan.

"When you look at small and mid-size institutions, they are under tremendous pressures to remain profitable," added Howard. "Revenues are not growing at the same rate as the expense curve. Regulations, including Dodd-Frank, are adding expense. As net margins continue to shrink and become more compressed, outsourcing becomes a very attractive option."

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In its first year, Coastal has focused primarily on servicing loans, collecting default loans and indirect auto loans.

"We understood that we could not, nor should not, jump into a dozen lines of service overnight. Each one requires careful planning. It is not a matter of build it and they will come," said Howard.

"We did a lot of work focusing on the New England region, talking to many financial institutions – not only credit unions but also small banks – to determine what they needed in this challenging environment," he said. "If a potential client wants the service, that's the trigger point for us to mobilize."

There are many competitors in the outsource space, many much larger. But Coastal – backed by First Citizens'– possesses distinct competitive advantages, noted Howard.

For one, not many credit unions are entering the outsource industry.

"What differentiates us is that we come from a credit union ourselves, and we completely understand every aspect of the industry," said Howard. "We are not transaction oriented. Our model is to develop long-term sustainable relationships."

In contrast, the largest outsource companies tend to offer one or two specialized services in a silo, mostly off the shelf. They are primarily publicly traded, and their goal is to sell at the highest margins, Howard said.

"Coastal is not outsourcing commodities. Our model is a comprehensive one," he noted.

"From a client perspective, that is a huge advantage. No matter how good the service, there always will be times when a problem or hiccup occurs. That's when communication, understanding, and trust are critical. We won't provide a service to a client's customer that we are not precisely providing to our own customer."

In one year, Coastal Outsourced Solutions counts 5 clients, primarily smaller credit unions elsewhere in New England, but not currently sharing First Citizens' market. "In every instance, we create a Chinese Wall between them and First Citizens', even as we leverage First Citizens' experts and processes. What happens within Coastal stays there."

Howard noted that all Coastal's initial clients are looking to shift their focus from the back office to the customer. "They are feeling the constraints, cost pressures and risks associated with compliance. They also find themselves dedicating all too much of limited personnel to collecting delinquent loans."

At some smaller credit unions, staff must wear multiple hats – being responsible for everything from collecting bad loans to answering customer phone calls to human resources. That's becoming ever-more burdensome given the pace and complexity of the financial landscape, he added.

With Coastal's early success, it is tempting to ramp up faster, but Howard urges caution. "Yes, we are growing exponentially, but it is critical that we seek out only the right partners for us. We are not looking to be the Walmart of CUSO's (Credit Union Service Organization).

"Our model is to drive quality and value for a client. It's not necessarily bringing on more new clients all the time, but enriching the relationships we have with current ones," he emphasized. "At the end of the day, we can provide a one-stop relationship with our customer. As they become happy with one service, they may be inclined to contract others."

In addition, a satisfied client will be more prepared to recommend Coastal to another institution, added Howard.

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One of Coastal's strengths – technology that supports services from payments to compliance – actually is an outgrowth of First Citizen's decision several years ago to outsource to another company – Connecticut Online Computer Center (COCC).

As Coastal brings on clients needing the same technology, its overall economies of scale grow – and that provides it with more leverage regarding COCC. That, in turn, results in lower overall costs and growing capacity that benefit all the institutions, explained Howard.

Looking ahead, Howard identifies prospects as credit unions and small community banks with assets between $200 million and $500 million, although clients can be smaller or larger based on their needs and Coastal's expertise.

Howard recognizes that Coastal's success may encourage new competition in the market. That makes customer satisfaction now so critical.

Despite all that confronts the credit union industry, Howard is confident that there's still time to adapt – but the horizon is shrinking fast.

"Those willing to adapt will succeed. Those that don't won't," he said. There will come a time when pressures will be too great for some institutions to deliver the value customers expect."

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