

Statement of Karen Harbin
President and CEO of Commonwealth Credit Union
on behalf of
America's Credit Unions
House Financial Services Committee
Subcommittee on Financial Institutions and Monetary Policy
"Financial Institution-Fintech Partnerships: Leveraging Third-Party Relationships
to Increase Access to Financial Services."

July 12, 2024

Opening/Introduction

Good morning, I am Karen Harbin, President and CEO of Commonwealth Credit Union, headquartered in Frankfort, Kentucky. Since opening our doors in 1951, we have expanded to meet the needs of our member-owners, now over 120,000 strong. We are a state-chartered credit union with over \$2 billion in assets and 18 branches in the Central Kentucky and Louisville Metro areas. Our credit union members elect a Board of Directors from their peers—the people they live and work with to provide oversight to the credit union. These Board members are unpaid volunteers.

We have stood by generations of families through both prosperous and challenging times, remaining abreast of technological advancements while always prioritizing the importance of personal connection and the difference we make in the lives of the members we serve. As a not-for-profit financial cooperative, we take great pride and effort to support the varying needs of the communities in which we serve as well. We offer extensive financial education programs facilitated by a team of professional educators who collaborate with local schools, colleges, and community organizations. Our aim is to educate and empower individuals with the necessary tools to enhance their financial well-being and health.

While credit unions nationwide have continued to grow over the past few years, now serving over 140 million consumers, the vast majority are small institutions with limited resources. As a matter of fact, the largest bank has 20 times the assets of the largest credit union. Furthermore, three banks earned more than the entire credit union industry did in 2023.

We prioritize supporting economically vulnerable individuals. As a credit union serving numerous low-income communities, more than half of our loan portfolio addresses these economically challenged areas in Kentucky. Moreover, during periods of economic hardship or personal challenges faced by our members, we provide support through various means such as low-interest loans, fee waivers, and flexible payment options.

CCU's Use of Fintech Technology

In 2019, Commonwealth Credit Union set out to make better lending decisions for our members. The lending team wanted to confidently lend down the credit spectrum through more accurate, unbiased decisioning that would not increase risk. They also knew they needed to innovate their lending processes to meet our members' increased demand for a fast, frictionless lending experience.

Just one year later, the COVID-19 pandemic changed the workforce: like many industries, Commonwealth Credit Union faced a high turnover rate, especially for our experienced underwriting staff. The ability to make accurate decisions and keep pace with application volume was critical to maintaining both relationships with members and business needs. We set out to find a fintech partner in the marketplace that could help us meet these challenges. We found one in Zest AI and their underwriting tool.

Zest AI was ready to fill in the gaps with increased automation, accuracy, and the ability to aid our new underwriting team in focusing on members who need more support. Zest AI's technology has allowed Commonwealth Credit Union to say yes to more members while not negatively impacting our charge-off and delinquency ratios. With 70-83 percent of all consumer loan decisions automated, Commonwealth's ability to compete with other lenders has skyrocketed. Since 2021, Zest AI has helped Commonwealth approve more than \$372 million in consumer loans, amounting to more than 21,500 loans. The performance of these loans is also stronger than ever before. Our Zest-decided loan delinquency is below industry standards at 45 bps and is trending 10 bps below our overall loan portfolio, even with 17 percent of those loans being unsecured.

With increased speed and accuracy, Commonwealth can reach more members in less time, allowing our lending team to focus on managing a stable pipeline of volume rather than looking for ways to attract more loans.

We can also assist our members and approve their loans using this automated technology outside of regular business hours, enhancing convenience and accessibility.

Before this partnership, we auto-decided about 28-30 percent of our loans. Since our partnership with Zest AI, our auto-decided loans have skyrocketed to above 70 percent. In 2023, we recorded over 3,000 more loans than in 2019. To fund over 3,000 more loans, we had to make a lot more decisions. With Zest AI, we managed to boost our decision-making productivity without expanding our staff, allowing us to help more members, approve more requests, and assist more individuals in achieving their financial goals. Zest AI has helped us make previously invisible credit files scorable, enabling us to say yes to a broader and more diverse range of applicants.

Using automated underwriting as part of our partnership with Zest AI, Commonwealth Credit Union has more than doubled our approval rate for auto loans to minority borrowers. Our credit card approvals for minority borrowers have also seen a 40 percent increase using Zest AI when compared to the standard underwriting previously used. Even personal loan approvals for minority borrowers have grown 9 percent under Zest AI. Loan approvals for female borrowers have also seen similar increases since using Zest AI. This partnership has been very successful for us. While our approvals are increasing, our delinquencies are remaining stable. We believe this is a great example of how working with the right AI partner can benefit financial institutions like ours.

It is not just the credit union that has benefitted from this partnership; our members do too. We have heard from numerous members thanking us for approving their loans. Many are now turning to us, their credit union, when other lenders are turning them down. Zest AI has made it easier for us to now serve them.

The Regulatory Environment for Fintech Partnerships

Regulators frequently recognize the advantages of technological collaborations, yet they have also voiced apprehension that certain technologies, like AI, may be functioning in ways that neither they nor consumers fully understand.

In examining the broader financial sector, the Treasury Department has highlighted the favorable impacts of AI in credit underwriting and risk management. They suggest that leveraging machine learning and big data analysis effectively will increasingly serve as a crucial competitive edge, especially for smaller firms. Simultaneously, however, Treasury has cautioned that while AI advancements offer advantages, they could also limit consumers' ability to make informed choices if the market for AI solutions becomes dominated by a small number of technology providers. Regulatory skepticism towards AI could result in decreased competition if the economies of scale required to meet excessive compliance expectations are possessed only by the largest financial institutions or the largest vendors.

A stringent stance on AI usage in the financial sector could disproportionately harm credit unions and smaller institutions while benefiting the largest incumbents. It is reasonable to expect explanations about the outputs and decisions an AI system can generate. However, demanding a detailed inspection of source code, algorithmic weights, or other technical aspects underlying AI models would impose significant and impractical burdens on credit unions that rely on proprietary models from fintech partners. Such requirements could divert scarce in-house developer resources towards compliance activities, which larger institutions can more readily afford.

Statements from the CFPB suggesting that AI algorithms function as opaque "black boxes" introduce uncertainty about the level of regulatory scrutiny required for algorithmic processes, especially in the absence of evidence of harm to consumers. This skepticism puts credit unions and other community institutions at a significant disadvantage. Instead of being able to innovate and explore new technologies like AI freely, credit unions may find themselves compelled to demonstrate that these innovations pose no risk—a daunting task. When regulatory discussions approach technology in this manner, it reinforces the idea that smaller entities could face obstacles to success, as only the largest institutions may possess the resources necessary to meet such rigorous risk management standards.

Regulatory assessments of new technologies must embrace balanced and flexible approaches to risk management that can accommodate innovation while protecting consumers. Often this balance is expressed as "responsible innovation," which regulators have sometimes supported through official statements and relevant guidance. For example, in 2019, an interagency statement issued by the National Credit Union Administration (NCUA) and other banking regulators recognized that the "use of alternative data may improve the speed and accuracy of credit decisions and may help firms evaluate the

creditworthiness of consumers who currently may not obtain credit in the mainstream credit system.” This statement has helped legitimize the use of new data for credit underwriting purposes while simultaneously acknowledging that “the use of certain alternative data may present no greater risks than data traditionally used in the credit evaluation process.” While alternative data is an input rather than a new technology unto itself, the interagency statement demonstrates how consensus within the regulatory community can help reduce uncertainty and drive innovation forward in a way that is beneficial for consumers.

Conclusion

In conclusion, credit unions, including Commonwealth Credit Union, do not boast the massive earnings of big banks, but our impact lies in our genuine commitment to serving communities. Every step we take is in line with our primary mission to better the lives of those we serve. As we adapt to the ever-changing economic landscape, our focus remains consistent—prioritize our members and their needs in order to help move communities forward. Commonwealth Credit Union, like other credit unions, is a testament to the resilience and dedication of community-oriented institutions. Our partnerships with fintechs like Zest AI allow us to better serve our members. While clear rules of the road may be necessary, it is important that regulators not create expansive requirements or new hurdles that threaten the ability of credit unions to take advantage of successful partnerships like we have with Zest AI.

Our goal is to empower, educate and uplift our members, ensuring their financial well-being. Our partnerships with vendors like Zest AI help us improve the financial wellbeing of our members and meet their needs.

Thank you for allowing me to be here today. I look forward to answering any questions you may have.